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How does the economy matter for terrorism

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*„Ökonomie ist nicht alles, aber ohne Ökonomie ist auch militärisch Alles nichts“
(Economics is not everything, but without economics also militarily everything is nothing)
Bruno Staffelbach, Universität Zürich*

Terrorist movements and suicide terrorists can be found in different societies and among many religions. History is full with examples. Martyrdom is a phenomenon known from early Christhood as a survival strategy against the oppressive Roman state power as well as today's holy warriors with Islam faith. There were always people, who preferred to die instead of giving up their religion and/or political preferences for a particular way of living. This section develops a new and original look on the troubling phenomenon of terrorism with the eyes of economics.ⁱ

In the wake of the 11/09 attacks terrorism studies became a rapidly expanding branch of literature in social sciences and in particular political economyⁱⁱ. Many valuable insights have been found by applying strategic, econometric and economic models to settings in which terrorism prevails. However, most of these attempts focus on individual aspects of terrorist behavior. Cost-benefit analysis, utility maximization and game theory are then applied to find out under what assumptions it is rational to become a terroristⁱⁱⁱ.

Only few authors emphasize the role of institutions, political structures and social stratification. Kitschelt (2004) finds that the Middle East accumulates a unique combination of factors, which favours a confrontation between a predatory and oppressive regime and a violent insurgency. However, most terrorist movements are not directed against internal structures within an otherwise homogenous society, but reflect a conflict between different distinct groups, or target an external supporter of a specific group.

The relation between the economy and terrorism does not reveal itself very easily. Krueger and Laitin (2003) find that this relationship is indirect at best. They also quote a statement from George Bush, the American president^{iv} that "Poverty does not transform poor people into terrorists and murderers. Yet poverty, corruption and repression are a toxic combination in many societies, leading to weak governments that are unable to enforce order or patrol their borders and are vulnerable to terrorist networks and drug cartels." This approach also seems to be supported by Abadie (2005), who finds that there is no correlation between terrorism and economic development, but there is a strong hump-shaped correlation with political suppression.

What is missing in the current economic literature on terrorism is an explanation why terrorist groups exist at all and why they find enough material support to function actively. Scheckenecker (2002) analyzed successful and failed cases of ethnic conflicts in Europe and finds that a peaceful exit from the conflict is possible if there is power sharing possible between the ethnic majority and minority and if it is underpinned by strong rules. Power sharing makes

sense economically if it allows for more distribution for all partners compared with what would be possible in case of conflict.

Just to recapitulate: terrorism is a violent attempt to overthrow a legitimate government or at least to force it to refrain from exercising its legitimate power in certain areas, against a specific group in the population or concerning a specific type of contracts by spreading fear among the civilian population.^v In technical terms terrorism implies negative sum games for the society as a whole^{vi}. Even if terrorist organizations are successful they will find less to be distributed than there was available before. Terrorism is therefore always about a struggle over the current distribution of property rights and the resources used for this struggle are considerable^{vii}. This will also include the distribution of status rights, meaning the identification of specific members of the society, who can exercise certain privileges. Often control over raw materials, but also access to foreign humanitarian aid is playing a decisive role in violent conflicts.^{viii}

Economics as science is a very young discipline which developed after societies reached a level of development above subsistence and introduced democratic political systems^{ix}. Economics therefore is about making choices in order to reach a goal. Firms decide about what, how and how much they produce. Consumers decide about what and how much they consume. They also decide how they use their property, including their human capital or labor force, in order to balance income with consumption and savings plans. Politicians – defined as representative rule-setters for the society - set the framework for these choices, by defining what is allowed and what not, as well as setting a mechanism in place, which regulates sanctions in case of contract violations. In such societies the power monopoly of the state is generally accepted. Part of these framework conditions is the definition of property rights as well as rules, which determine how property can be acquired, transferred and confiscated.

Modern economics aims at understanding how the economy is working under different framework conditions and how different policies impact on the choices of consumers and producers. A crucial precondition for this type of analysis is to assume that individual actors know what is good and better for them and that they make choices in order to improve their situation. Once choices are made they become contracts, which have to be honored. Such an economy is called a “market economy”. It reflects a system in which choices are possible, made freely. It also requires that contracts, which are in line with the framework conditions, can be enforced and that legitimate property rights can be exercised.

An economic approach to understand the phenomenon of terrorism therefore implicitly assumes that terrorists and their supporters are choosing their way, because their perception of benefits exceeds the associated costs.^x By definition, terrorists and the organizations backing them, do not respect the power monopoly of the state. Such organizations also do not accept the conclusions of existing institutions, which are concerned with the generation, confiscation or redistribution of property rights. As a first step one therefore has to understand, why terrorism is the exception and not the rule in the struggle over the distribution of property rights. The significance of this approach lies in its conclusions. If it turns out that terrorism has also economic roots it means that a military approach alone will not necessarily solve the problem. It may also mean that a military solution will be successful only with the complete elimination of the enemy. It does mean that a peaceful solution will not always exist, quite on the contrary. If the struggle is over property rights it must be assumed that any participant in the conflict will not give in voluntarily. In such cases the economic analysis would reveal what is at stake. Skaperdas

(1992) has shown that in the absence of clearly defined and generally accepted property rights conflict can become a rational outcome.

Having said so answers the question at the beginning, about how much economics can contribute to the explanation about the phenomenon of terrorism, already to some extent: economies, in which actors are self determined and accept the framework conditions, cannot generate terrorism as a rational choice in order to improve personal or collective wellbeing. If a country is open to redistribution of income and wealth via the market while applying a rule of law and observing the power monopoly of the state, it is not rational to undermine the positive outcome of such activities.^{xi} Even if an individual would find to be disadvantaged by a specific transaction and would prefer not to honor the respective contract, this would not be supported by others. The main reason for a general preference for lawful behavior is that it is not predetermined in advance who will gain or loose and therefore everyone can be considered a potential winner in advance. Success and failure in such societies and economies are considered to be individual and not collective outcomes of external constraints and circumstances.

Bruno Frey (2004) rightly concludes that terrorism in a functioning market economy is less likely to be successful. The basic reason for this is that participation in the regular economy will deliver a positive return, while terrorism always generates a negative return. Freely and self-determined agents would therefore rule out terrorist activities from their feasible choices.

Attempts of terrorism in well developed economies of this type were undertaken in Germany ("Baader-Meinhof-RAF") and Italy ("brigate rossi" – "red brigades"), but neither achieved their goals nor could last longer than a short period. In successful economies terrorism is identified as a negative sum game, which reduces the amount of wealth to be distributed to the members of its society and it will therefore not find the necessary support. If people see that they can improve their situation better by accumulating human capital by learning and financial capital by saving they will neither engage nor support terrorism.

A particularly illuminating example for such an abated terrorist movement can be found in South Tyrol after the Second World War. This region with a predominantly German speaking population was allocated to Italy after the First World War. Industrialization and resettlement during the fascist rule of Mussolini threatened the cultural and economic foundation of the indigenous population. After the Second World War a separatist movement emerged, which carried out a number of spectacular attacks, mainly against energy transport infrastructure. Finally the German speaking population was granted some autonomy and the region is now among the richest in the European Union. Terrorism would certainly have reduced the attractiveness of the region, as well as the incomes of the local population, while obviously a peaceful conflict settlement also furthered the economic development of the German speaking minority. Terrorism would not have served a purpose in such an environment, although the initial conditions seem to have favored violent conflicts.^{xii}

Another case, in which it could be argued that the emergence of "normal" economic activities put an end to a terrorist movement, is Northern Ireland and the IRA. For many decades the two religiously separated fractions of the Northern Irish population were confronted with many acts of bloody terrorism as well as the full and sometimes overshooting application of law enforcement. It could be argued that the spectacular economic development of Ireland, which converted from a reservoir of emigrants to the most attractive target region for immigrants, provided an offer for potential Northern Irish terrorists, which could hardly be rejected. Now Northern Ireland is ruled by a "grand coalition" of Protestants and Catholics.^{xiii}

Contrary to these two cases many more examples of continuing terrorist activity prevail. Cravin and Chalk (2003) mention the separatist movements in South Philippines (Mindanao) and the Palestinian territories as examples of unsuccessful development efforts with respect to reducing support for terrorist activities. As reasons for failure the authors mention endemic Palestinian corruption and oppressive Israeli tactics, together with a lack and unreliability of funding. In other words, putting efforts and wealth into work and entrepreneurship is less promising than claiming a larger share from the existing cake by force. Sharansky (2006) argues that Israel's and its supporters inability to support the establishment of a free and prosperous Palestinian society contributes to the perpetuation of terrorism.

In which situations could therefore rational agents decide to support or become terrorists^{xiv} and when can groups secure enough resources in order to carry out their deadly activities although an open, market economy driven system would be available as an alternative? Why are liberal democracies and their representatives becoming a target?^{xv} We have to assume that the group choosing to use a terrorist strategy is unified by certain characteristics, a religion^{xvi}, a minority^{xvii}, maybe also an ideology^{xviii}, typically also concentrated in a certain region. Two conditions then have to work together:

First, the society is an "end game" over the distribution of valuable property rights: Choosing to participate in the alternatively available open system – in other words to integrate into the majority society - must have a negative impact on the property rights of the group in question. This could be because this group is living on income, which is protected by entry barriers. Economically speaking this income must have the character of a rent, which is a transfer of income, for which no equivalent transfer of goods and services exists. Examples for this are the control over the exploitation of raw materials, the control of transit routes, or also a privileged access to foreign aid. The situation could be considerably complicated in case of the parallel presence of organized criminals, who use the emerging chaos for their own, money-making purposes. However, the rewards from organized crime can also be subsumed under the same category of rents gained from the absence of law enforcement.^{xix}

Second, the limited mobility condition: There must be a mechanism, which prevents that individuals in this group choose to integrate with into the majority society or just leave and look for a better life somewhere else. This mechanism could be an economic interest, for instance if each member of the terrorist group will share the available income, which is generated in the way described in the previous paragraph. Other mechanisms could be the loyalty with a religion or minority.^{xx} Finally, there is always an element of force, which makes it difficult for members of the terrorist group to defect. Such a mechanism is greatly enhanced, if mobility is restricted. The basic characteristics of such a mechanism (frequent use of force, secrecy, limited mobility) make it all the more likely that organized crime is also playing a role.^{xxi} Strict entry barriers in attractive host societies (Europe, Northern America, Australia) could play a role on the surface, although it seems as if entry barriers are less effective to enforce than exit barriers.

How does this approach fit the most widespread and spectacular examples of terrorism? Can this economic approach explain terrorism in Palestine, Chechnya, Cashmere or Turkey? Can we find the two elements, which prevent the integration of the minority group and favour the conduct and support of terrorist acts? Without pretending the deep and necessary analysis, the economic background of Palestinian terrorism is checked as to whether the two above mentioned conditions for an "economic rationality" behind can be found.

The Palestine population is mainly living on external contributions. The domestic economy is crippled and a large part of the adult male population is unemployed. Living

conditions for the majority are miserable while a few leaders can afford a luxurious life style, partly abroad. Foreign aid is channeled through controlled networks and corruption is endemic. The inflow of foreign aid is tied to the refugee status of the population, which is kept in camps since three generations. The rent character of Palestinian income was underlined by the violent internal fights between the incumbent Al-Fatah, the forces of the president and Hamas over control of ministries and flows of funds.

The mobility of the population is severely restricted. Palestinians cannot move freely on their own territory and also international mobility is restricted through visa requirements. This is also true for Palestinians living abroad, like in Lebanon. In Jordan the refugee population was driven out of the country and only a small minority of privileged Palestinians manages to settle permanently abroad. This is a stark contrast to other violent and forced dislocations. The several million German refugees, who fled to Western Germany were quickly integrated into a booming economy and relatively easily overcame the material shock of being a refugee and deprived of all savings^{xxii}. It seems to be very difficult for Palestinian refugees to settle in other Arab countries. This could hint to the dominance of rents as incomes in these countries. While economies where income is dominated by the remuneration of active labor benefit from the availability of more labor in rent dominated economies more heads mean more among whom to share. Such economies therefore tend to be closed, which reduces the mobility of a refugee population considerably.

In the case of Palestinian terrorism the conditions for an economic rationale behind violence seem to be fulfilled. Large flows of rent income are tied to the perpetuated misery of the refugee population in form of aid from international organizations and transfers from other Arab countries. The distribution of these funds provides good opportunities for personal enrichment. The restricted mobility of the refugees restricts their choices tremendously. This in turn makes the recruitment of fighters and suicide attackers possible. Significant contributions for Palestine are coming from the oil-rich countries of the Arab peninsula and the Persian Gulf. These payments originate from rent income itself – the revenues from permissions to extract oil and gas by international companies. It seems that some of these payments are deliberately targeting the financing of terrorist organizations and activities.

All in all one could summarize that Palestinians are fulfilling a “demand for terrorism”, which generates income for those in power. Fighting will continue as long as these fractions are not properly compensated or shown an alternative with a dominating stream of revenues. This conclusion also seems to be confirmed by the inability of the superior Israeli occupation forces together with American logistic support to find a military answer. So long every retaliation measure, every targeted killing of Palestinians, the removal of Arafat and the severe reduction of mobility did not weaken the ability of the militant factions to carry out terrorist activities.

As long as Palestinian authorities have access to funds, which do not rely on the virtues of a law abiding society following market economy principles, but which may be redistributed by means of force, terrorism will be a central element in securing these sources for one or the other fraction.

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Steininger, R. (1998). Südtirol im 20. Jahrhundert. Vom Leben und Überleben einer Minderheit, Innsbruck-Wien, Studienverlag. 1998

ⁱThe relevance of the – lacking – economic development of the Islam world as an explanation for terrorism is stressed by Abdullah Badawi, the Malaysian Prime-minister. Badawi, Abdullah bin Haji Ahmad. (2007). The real challenge for Muslim nations is economic. FT, 28 May, 2007.

Noland and Pack (2007) argue that for countries with an Islam population good or bad economic development are possible, but in the latter case serious negative external effects for non-Islamic countries have to be expected. Noland, M. Pack, H. (2007). The Arab Economies in a Changing World. Peter G. Peterson Institute for International Economics. 2007.

ⁱⁱBenmelech and Berrebi (2007) for instance analyze the relation between human capital and the productivity of suicide terrorists. They find that more educated attackers are less likely to be caught and are more successful in terms of the number of killed and injured. The basis for their theoretical model is Becker's theory of rational crime. Benmelech, E. Berrebi, C. (2007). Attack Assignments in Terror Organizations and the Productivity of Suicide bombers. NBER Working Paper No 12910, February 2007.

ⁱⁱⁱ Becker, G. S. Posner, A. R. (2005). Suicide and Risk-Taking: An Economic Approach. Working Paper, University of Chicago, December 2005.

^{iv}*The New York Times* (September 11, 2002)

^vTerrorism therefore always has a political background, as is noted by Krueger and Maleckova (2003). They conclude that terrorism is only weakly related to economic development, poverty or educational background. Krueger, A. B. Maleckova, J. (2003). Education, Poverty and Terrorism: Is There a Causal Connection? *The Journal of Economic Perspectives*, Vol. 17, No. 4. (Autumn, 2003), pp. 119-144.

^{vi}For instance Abadie and Gardeazabal (2003) estimate that terrorism has reduced GDP in the Basque region by 10%. Abadie, A. Gardeazabal, J. (2003). The Economic Costs of Conflict: A Case Study of the Basque Country. *The American Economic Review*, Vol. 93, No. 1. pp. 113-132. 2003.

^{vii}Schneider (2002) estimates the assets of Al-Kaida to be worth 5 billion USD. Schneider, F. (2002). Money Supply for Terrorism - The hidden financial flows of Islamic terrorist organisations: Some preliminary results from an economic perspective. Paper prepared for the workshop "The Economic Consequences of Global Terrorism" organized by DIW Berlin, June 14-15, 2002.

^{viii}See Addison and Murshed (2001), who argue that violent internal conflicts are often related to the breakdown of a social contract and the provision of public goods. Addison, T. Murshed, S. M. (2001). From Conflict to Reconstruction: Reviving the Social Contract. Wider Discussion Paper No. 2001/48, August 2001.

^{ix}The founder of modern economics is Adam Smith (1723-1790) whose analysis about the virtues of free markets, private property and specialization became popularized with the parable of the "invisible hand", which steers interacting individual profit maximisers towards a social optimum.

^xSuch an approach is also taken by Sander and Endlers (2002). However, they focus only on individual rationality, without a broader context of the distribution of property rights. Sander, T. Endlers, W.

(2002). An Economic Perspective on transnational terrorism.
http://www.diw.de/deutsch/produkte/veranstaltungen/ws_consequences/docs/diw_ws_consequences2002_06_sandler.pdf

^{xi}Li and Schaub (2004) find that transnational terrorism is declining with increasing trade and FDI.
Li, Q. Schaub, D. (2004). Economic Globalization and Transnational Terrorism - A Pooled Time-Series Analysis, Journal of Conflict Resolution, Vol. 48, No. 2, 230-258. 2004.

^{xii}See Steininger (1998) for a thorough analysis of the emergence and resolution of violent conflicts in this case. Steininger, R. (1998). Südtirol im 20. Jahrhundert. Vom Leben und Überleben einer Minderheit, Innsbruck-Wien, Studienverlag. 1998.

^{xiii}Cragin and Chalk(2003) argue that the massive and purposeful allocation of development funds for providing a more equitable access to education, health and business opportunities for Northern Irish Protestants and Catholics has been decisive to largely contain terrorist activities since the conclusion of the 1998 “Good Friday” accord. Cragin, K. Chalk, P. (2003). Terrorism & Development. Using Social and Economic Development to Inhibit a Resurgence of Terrorism, Rand, Santa Monica, CA. 2003.

^{xiv}Frey (2004), Chapter 3, is applying the standard neoclassical utility optimisation model to explain choices of how “terrorist” a rational agent will become. Optimally a rational agent applies as much terrorism at which marginal benefits and costs are equalised. While this approach yields interesting insights it is also bound by accepting the usual complex of assumptions of utility maximisation. Furthermore it does leave out the important issues related to institutions, which is stressed here. Frey, B. F. (2004). Dealing with Terrorism – Stick or Carrot. Edward Elgar, Cheltenham, UK, 2004.

^{xv}Endler and Sander (2006) argue that liberal democracies are more vulnerable, because they are restrained by the pursuit of human rights. Endlers, W. Sander, T. (2006). The Political Economy of Terrorism. Cambridge University Press, Cambridge, UK, 2006.

^{xvi}The extent to which Islam is compatible with a market economy and democratic principles is not answered conclusively in the literature. However, there are certain characteristics in Islam, which could favour the development of framework conditions, which might make terrorist activities more likely. The most important among these is certainly the possibility to impose the dominance of Sharia law over any act of state power.

^{xvii}Many minorities have established traditions of common law, which exist either beside the official legal system or replace it altogether. Such arrangements can generate deep conflicts, because of the incompatibility of what is considered to be lawful behaviour under both sets of rules. An example for this is the institution of “blood revenge” in the Albanian population, which violates the power monopoly of any modern state.

^{xviii}Many groups, which pursue terrorist strategies, use one or the other variation of a Marxist ideology in their public statements. Examples are the PKK in Turkey, Maoist rebels in South Nepal, or the FARC in Columbia.

^{xix}For the close relations between terrorism and organised crime see Préfontaine D.C. Dandurand, Y. (2004). Terrorism and Organized Crime. Reflections on an Illusive Link and its Implication for Criminal Law Reform, International Society for Criminal Law Reform. Annual Meeting – Montreal, August 8 – 12, 2004-08-11

^{xx}The *hawala* system of transfers, which is frequently used by Islamic terrorist groups, relies on the absolute loyalty of every participant. This is accompanied by a strict and private enforcement mechanism. See Schramm and Taube (2002) for a description of *hawala*. Schramm, M. Taube, M. (2002). The Institutional Foundations of Al Qaida's Global Financial System. Mimeo. 2002.

^{xxi}Schneider (2002) is pointing to the rapidly growing share of the underground economy in western countries like Germany or Italy. Schneider, F. (2002). Money Supply for Terrorism - The hidden financial flows of Islamic terrorist organisations: Some preliminary results from an economic perspective. Paper prepared for the workshop "The Economic Consequences of Global Terrorism" organized by DIW Berlin, June 14-15, 2002.

^{xxii}This does not want to suggest that the German refugees after the war were not suffering from the loss of their homelands. Even now, many decades after the event they participate in annual meeting, dressed in local costumes, to remember their old homes and ancestors.