



# E-NOTES

*“A nation must think before it acts.” - Robert Strausz-Hupé*

JUNE 2015

## ISIL REVENUES: GROW OR DIE

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The Islamic State of Iraq and the Levant (ISIL) is the ultimate predatory state. It has been able to obtain vast amounts of financial and other resources in a relatively short period of time by theft or extortion. However, its revenues are mostly unsustainable. As a result, like other extreme predatory states, it must either rapidly expand or slowly die. Coordinated activities by the anti-ISIL coalition can accelerate this loss of revenues and substantially weaken the ISIL proto-state.<sup>1</sup>

As has been reported by the Financial Action Task Force (February 2015), the Combating Terrorism Center (December 2014), and a wide range of news outlets including the Economist (June 4, 2015), and the Wall Street Journal (March 23, 2015), ISIL has obtained large financial and other resources from a variety of sources. A rough summary of ISIL financial revenues in 2014 is given below although it should be noted that this list is not exhaustive. There are other sources of ISIL revenues including funds brought in by foreign fighters, financial support raised through social media such as twitter, donations by some non-profits, etc.

Source of Revenue	Amount (\$)
Seizing the assets of state-owned banks	\$500 - \$800 million
Agriculture theft	\$10 - \$50 million
Business taxation	\$20 - \$70 million
Skimming government employee paychecks	\$100 - \$300 million
Oil trafficking	\$100 million
Kidnapping for ransom	\$25 - \$45 million
Human trafficking	Unknown
Border tariffs	\$10 - \$50 million
Artifact smuggling	Unknown
Capture of weapons/equipment/supplies from ISF <sup>2</sup>	\$20 - \$50 billion

<sup>1</sup> This study is based on discussions with Glenn Goddard, Commanding General 353<sup>rd</sup> Civil Affairs Command, U.S. Army; Anthony O’Brien, Professor Emeritus at Lehigh University; James Savage, Professor at University of Virginia and author of Reconstructing Iraq’s Budgetary Institutions; and Mohaned al-Hamdi, Assistant Professor at Kansas State University. However, the opinions expressed are entirely those of the author.

<sup>2</sup> ISF is the acronym for Iraqi Security Forces.

While ISIL has obtained resources from an impressive variety of sources, they tend to share characteristics that make them unsustainable. A strategy to defeat ISIL will require the coordination of substantial political, economic, military, and maybe cultural lines of operation. Part of this strategy must be an attempt to sharply reduce this predatory state's revenues. The U.S. Department of the Treasury led a successful international effort to block foreign financial flows to ISIL's predecessor, al Qaeda in Iraq. However, the same tactic will be of limited usefulness in defeating ISIL since only a small proportion of its revenues are obtained from international sources. What is required is a coordinated attack on each source of ISIL revenue. After discussing the strengths and weaknesses of each possible source of revenue, there will be a discussion of methods to reduce or block each source.

### **Banks, Farms, and Businesses: One and Done**

The theft or heavy taxation of the assets of state-owned banks, farms, and businesses in ISIL-occupied Iraq and Syria has changed incentives. The implications of the changed incentives are clearest in the case of the looted state-owned banks, Rafidain and Rasheed. Neither the Government of Iraq, nor its agencies, nor private residents are going to deposit more money in a bank that was looted by ISIL. Therefore, the opportunity to steal more assets from the previously looted banks is gone. And despite the well-known inefficiencies of Rafidain and Rasheed banks, individuals and businesses in ISIL-occupied territory are now forced to operate in a more inefficient manner – reducing incomes that could be taxed.

The effect on agriculture is almost as extreme. Over half of the population of ISIL-occupied Anbar Province lives in rural areas and is dependent on agriculture. Following the ISIL confiscation of crops in 2014, planting has dropped dramatically since farmers have little confidence that they will be able to keep and sell any crops that they grow. The situation is exacerbated by ISIL mismanagement and corruption in the operation of the complex irrigation system. This has not only reduced the volume of water available for irrigation but also – more critically - reduced the predictability of water flows. The collapse of agricultural production will have several adverse effects on ISIL. Rising food prices will work hardships on urban dwellers throughout ISIL-controlled territory as well as increasing the expense of maintaining ISIL soldiers. And the fall of agricultural incomes has led to increased rural poverty. The rural regions have changed from a source of revenue in 2014 to a drain on ISIL resources.

A similar story can be told about businesses in ISIL-occupied territories. The high and arbitrary “taxes” are forcing businesses to either conceal their economic activities or cease them entirely. Under Saddam, most private economic activity was illegal and small businesses became accomplished at either concealing their activities or bribing local officials to turn a blind eye. These skills have been revived under ISIL's new regime. It can be expected that the tax revenues will continue to fall over the next several years.

### **Skimming Government Paychecks: An ISIL-Government of Iraq Partnership of Corruption**

There has been much nonsense written about the motivations for the Government of Iraq (GoI) continuing to pay salaries and pensions to persons in ISIL-controlled territories, which has allowed ISIL to raise funds by skimming a portion of these payments. The usual reasons given are that continued payments reflect a humanitarian desire to reduce the hardships faced by these government employees and pensioners or that the Shi'a-dominated GoI hopes to gain future political support from the mostly Sunni residents of the ISIL-occupied territories. But the most important incentive is rarely discussed -- corruption.

The GoI pays a large numbers of “ghost” workers who receive a paycheck but rarely show up for work. Instead these ghost workers give a portion of their pay to their supervisors to ignore their absence while the workers stay home or work at another job. In many cases, the ghost workers may not exist at all, allowing supervisors to pocket their entire paycheck. While it has been estimated that more than 25% of all GoI employees are ghosts, no one knows for sure. A decade ago, the International Monetary Fund recommended that the GoI perform a rigorous census of government employees to allow the identification of ghosts. But even before the ISIL invasion, census takers were bribed, threatened, or beaten in government offices to prevent them from creating an accurate list of employees. There have been similar difficulties in getting an accurate count of pensioners.

So the payments made from the GoI to government employees and pensioners in ISIL-controlled territories are much less than reported. For ghost workers and pensioners that don't really exist who are supposedly located in ISIL-controlled territory, the monthly salary or pension payments probably don't leave Baghdad. Rather they are diverted into the accounts of corrupt GoI officials. This is an almost ideal situation for corrupt officials since there is no way the payments can be confirmed in ISIL-occupied territory. And even for the employees and pensioners that really exist, it can be expected that corrupt officials in Baghdad take their cut. Maybe there is an even split: one-third for corrupt GoI officials in Baghdad, one-third for ISIL, and one-third for the actual employee or pensioner. In either case, the amount of reported salary and pension payments made to persons in ISIL-controlled territory is greatly exaggerated.

Therefore, on the one hand, humanitarian and political arguments are made to justify the GoI continuing to pay salaries and pensions to persons in ISIL-controlled territories; on the other hand, such payments reflect massive corruption in Baghdad, further drain a GoI treasury already severely stressed by low oil prices and the cost of conflict, and are a substantial source of revenue to ISIL. It will be a difficult decision to execute but if the GoI is serious about defeating ISIL, then these payments should cease immediately.

### **Oil Trafficking: It is Truly an Ill Wind...**

ISIL has been referred to as the newest oil state. And it has obtained revenues both by smuggling oil to its neighbors and refining oil for sale within the territory they control. Its oil resources are primarily in its Syrian occupied territory; its territory in Iraq contains little oil. In fact, Iraq has achieved record levels of oil production and exports since the ISIL invasion. While oil smuggling may have raised \$1-\$3 million a day for ISIL in 2014, the collapse in world oil prices since November of that year has sharply reduced the black market price of oil. Instead of earning an estimated \$40-\$50 a barrel, ISIL is believed to have received only \$20-\$30 a barrel during the first half of 2015. However, due to the loss of traditional supplies, fuel prices are high and this provides an opportunity for substantial revenue if refiners in ISIL-controlled territory can increase both the quality and quantity of refined fuels.

Much has been made of the ISIL attempt to capture the Baiji refinery with the implication that this would substantially increase the supply of refined fuels for sale. As I have argued elsewhere (Wall Street Journal, July 3, 2014), capturing this refinery may be a propaganda victory for ISIL but an economic defeat. As a result of decades of deferred maintenance and mismanagement, the refinery is extremely inefficient, producing excessive amounts of corrosive heavy fuel oil. In addition, ISIL lacks a reliable source of crude oil to feed this refinery and many of the skilled workers who are necessary to operate the refinery have fled. As a result, it will probably be less costly for ISIL to smuggle oil out and refined fuels in than to attempt to restart and operate the Baiji refinery.

ISIL earnings from oil trafficking are already down sharply from last year. And further reduction of oil smuggling revenue appears likely for several reasons. First, the recent decision of OPEC to continue high levels of oil production will contribute to at least another year of low oil prices reducing the gain to ISIL from smuggling. In fact, in view of the continued production of oil from fracking in the U.S., and the economic slowdown in the BRIC countries; it may be a decade or more before oil prices return to the levels that ISIL enjoyed in 2014. Second, neighboring states, especially Turkey, are clamping down on oil smuggling from ISIL-controlled territory. One motivation of this clampdown is to prevent an ISIL infection among its own people. Finally, the U.S. and other coalition air forces have targeted the transportation of both crude oil and refined fuels further reducing ISIL gains from both smuggling and sales to domestic consumers.

### **Kidnapping and Human Trafficking**

Among the more despicable sources of ISIL revenues are widespread kidnapping for ransom and the sale of human beings, many as sex slaves for ISIL fighters. Ransoms from kidnapping of foreign persons initially earned substantial amounts but it appears that these revenues have sharply declined as foreigners now avoid traveling or working in ISIL-controlled territory. Domestically, the threat and reality of kidnapping for ransom or sale has greatly contributed to residents fleeing ISIL-controlled territory. And to the extent that these refugees have valuable skills or assets, their departure further weakens the strength of the ISIL proto-state.

In addition to its direct effects, kidnapping and human trafficking can be expected to have severe reputational effects. As Somalia demonstrated, an organization or state that engages in or facilitates such activities loses its legitimacy. It is perceived more as a gang of thugs than a potential new state. While ISIL is much less dependent on international financial transfers than its predecessor, al Qaeda of Iraq, it does rely on a large inflow of foreign fighters. If it becomes increasingly perceived as an international pariah, then foreign states can be expected to act more aggressively to block the movement of fighters to ISIL-controlled territory.

Reducing ISIL revenues from kidnapping will require countries around the world to make a politically difficult tradeoff. In view of the well-known cruelty of ISIL towards its prisoners, there is a strong humanitarian argument to pay the ransom. But, of course, every time that a government allows the payment of a ransom for one of its citizens, this provides a stronger incentive for ISIL to kidnap and hold others for ransom. If the international community is serious about defeating ISIL, they must strictly enforce existing laws forbidding the payment of official or unofficial ransoms. The immediate cost will be high as ISIL has tortured and murdered persons who are unable to pay the ransom demanded. But if the payment of ransoms can be stopped, there will be not only a reduction in ISIL revenues but also – more importantly – a saving of lives in the future.

With respect to human trafficking, much of it for purposes of sexual slavery, there is little direct action that would be effective. However, the GoI and the emerging civil society in the region should ensure that those who escape from ISIL control have a safe place to go with a reasonable quality of life. Too often, women and girls who escape from human traffickers are treated as

damaged goods by Iraqi and Syrian society and even by their own families. This has led some ISIL apologists to argue that they treat these women or girls no worse than their own families. As difficult as it is to change a culture, if women or girls who are able to escape are then welcomed by their society, this will not only further undermine ISIL's international reputation but also further motivate other captives to make an escape attempt. These results seem inadequate compared to the harm done by human trafficking but, until the ISIL perpetrators can be punished, they might be the best that can be achieved.

### **Border Tariffs and Artifact Smuggling: Business as Usual**

ISIL now collects tariffs of several hundred dollars per truck of goods and persons moving across its borders. But as the GoI realized long ago, geography and cross-border tribal relationships severely limit tariff revenues. If ISIL attempts to raise tariffs from their current low levels, then smugglers bribe border guards instead of paying the tariff. And if guards at one station refuse to accept bribes, then smugglers will simply move fifty miles in either direction across the mountains or desert and try again. With respect to bribes, every border station is in competition with every other station; smugglers will eventually find guards that are willing to turn a blind eye to the movement of goods accompanied by forged documents. This smuggling is facilitated by cross-border tribal relationships. Members of the same tribe have been moving illicit goods and persons across the Syrian and Iraqi borders for centuries. Therefore, ISIL faces a conundrum. If it relies on local officials who know the territory, then they have probably already been co-opted by the smugglers. On the other hand, if it relies on outsiders, then they will probably be ignorant of the local smuggling routes and techniques.

Widespread smuggling is already reducing ISIL revenues from tariffs on border trade. But this puts ISIL's neighbors on the horns of a dilemma. If they turn a blind eye to smuggling across their borders, then this reduces ISIL tariff revenues but securing the borders reduces illicit oil and artifact sales. In view of the different scale of earnings from oil and artifacts versus border tariffs, the better choice is to secure the borders. And better security at the borders should also reduce the illegal import of military or dual use equipment and supplies.

After human trafficking, probably the most disturbing ISIL revenue source is the extensive trade in stolen or looted historical artifacts. This illicit trade is decades old in both Syria and Iraq and was facilitated by payments to government officials. Some of these objects of both artistic and historical interest were looted from Syrian or Iraqi museums or government storage. However, many of the items are obtained directly from the many archeological sites in ISIL-controlled territory. As a result, not only do artifacts that illustrate the incredible history of the region disappear into the international black market in art but also tomb raiders, in their eagerness to quickly find items of value, often damage the sites. This permanently reduces the knowledge that can be obtained by archeologists in the future.

Successful efforts by the U.S. and the European nations to reduce trade in looted artifacts will lead to a substantial increase in the black market prices of authentic artifacts. This price rise can be expected to both increase the incentives for artifact smuggling and increase the production of counterfeits. It is not clear whether ISIL revenues from such trade will increase as a result of higher prices or decrease as a result of decreased volume from trade restrictions and increased competition from counterfeits. However, one fear is that if the profits from artifact smuggling decrease, then this will result in increased destruction of such treasures motivated in part by an extremist view among many ISIL supporters that representations of persons are religiously prohibited. Some have argued that as long as ISIL is in control, these priceless artifacts may be safer in private collections in Europe and Asia than in museums or archeological sites in ISIL-controlled territory.

### **Captured Equipment: It's Maintenance, Stupid**

Government reports and news stories refer to billions of dollars of weapons, equipment, and supplies captured by ISIL from the Iraqi Security Forces (ISF). Unlike the revenue sources discussed above, captured equipment and supplies cannot be easily converted into dollar revenue for ISIL. However, the capture of this equipment does reduce the amount that would have to be spent to purchase them on the black market, freeing up ISIL funds for other purposes.

In other words, capturing such weapons, equipment, and supplies provides a tremendous short-term advantage to ISIL by providing resources to its fighters while, at the same time, denying them to the ISF. However, the advantage will probably be short-lived. Whether as simple as a machine gun based on a eighty-year-old design or as sophisticated as a state of the art tactical radio, military weapons and equipment require constant skilled maintenance. Increasingly, ISIL-controlled territory is littered with vehicles and other military equipment that were captured intact from the ISF but no longer operate.

The maintenance problem has several dimensions. First, much of the equipment operated by the ISF was poorly maintained in the first place. This is an endemic problem in Iraq. Just a few miles from the Haditha Dam, there was a field covered with hundreds of brand new government vehicles that had been abandoned because of the lack of basic maintenance such as the failure to change the oil. Second, the hot and dry Syrian and Iraqi climate is very hard on equipment. Filters must be constantly cleaned, seals tend to fail much earlier than expected, and friction damage from the very fine sand disrupts not only precision instruments but also any equipment with exposed moving parts. Much of the equipment requires fluids, disposables, or parts

that may be difficult to obtain or transport to where they are needed, when they are needed. This is one of the problems of military logistics.

Finally, ISIL lacks the skilled manpower to maintain all of this equipment even if they can obtain, manufacture, or cannibalize the necessary supplies and parts. In these days of widespread Internet access, it is usually not difficult to obtain the maintenance instructions even if they were not captured with the equipment. However, obtaining the maintenance manual is only the first challenge. Many of the ISIL fighters and equipment operators are only semi-literate in Arabic so even if the instructions were translated, they will have difficulty performing maintenance and repairs. And many maintenance and operating procedures are easy to demonstrate but difficult to explain – many instructors are needed. For example, correctly setting the headspace and timing of a M2 machine gun is required for its proper operation. These procedures appear complex in the manual but can be demonstrated in less than a minute even during a combat situation. Finally, leaders up the entire chain of command must focus on maintenance or it won't be performed and the equipment will fail when it's needed. The old cliché is true: “Amateurs talk tactics, professionals talk logistics.”

### **Grow or Die**

ISIL finds itself in a situation similar to that of the slave-owning plantations of the pre-Civil War American South. Raising tobacco initially led to very large and profitable harvests but within a few years the fertility of the soil was exhausted and production collapsed. Therefore, plantation owners had to constantly move their slaves to new land where the pattern of initial prosperity followed by collapse would be repeated again. Similarly, ISIL gains much of its revenue in ways that are not sustainable. Revenues from newly conquered cities and towns are initially quite large but then rapidly decline. And this financial unsustainability is a critical vulnerability of ISIL.

It can be expected that ISIL will respond to the expected loss of revenue. They may ratchet up the level of extortion in ISIL-occupied territory, accepting a rise in the hostility of the occupied population in order to obtain a short-term boost in revenues. If the financial situation continues to deteriorate, ISIL may “cut loose” those mercenary foreign fighters who are motivated more by pay than ideology. This response will be a mixed blessing for those states that oppose ISIL. The loss of foreign fighters will weaken ISIL but possibly spread the infection as these fighters move to other conflicts. Possibly, the ISIL leadership will attempt to get more than the current low levels of funds from foreign sources. Foreign funding sources have been preferred by other insurgencies since they allow the insurgency to avoid financially exploiting persons in occupied territories increasing the likelihood that such persons would support or at least tolerate the insurgency. However, substantial increases in foreign funding for ISIL are unlikely for two reasons. First, there are few states inside or outside of the Middle East that both favor the ISIL ideology and are able to supply substantial funds. Second, since 2001, an international coalition led by the U.S. Treasury has developed an increasingly sophisticated capability to identify and block funds destined for terrorist groups.

Another option is that ISIL may execute raids outside its current territory intended not to permanently seize cities or towns but rather to execute a “smash and grab” -- steal everything of value including foreigners that might be held for ransom and then return to ISIL-controlled territory. This possibility emphasizes the most important element of an anti-revenue strategy. The ISF, with the support of the international coalition, must deny ISIL any further geographic expansion in order not only to prevent humanitarian tragedy but also to thwart the looting of banks, farms, and businesses. It will not shorten the conflict if the ISF re-conquers an already devastated town in one part of Iraq while ISIL fighters subjugate another town elsewhere. The revenue gain from the latter town to ISIL will more than offset the loss of the former town, which has already been looted. The ISIL proto-state must either grow or die. Preventing that growth will strangle ISIL.