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Countering ISIL's Financing

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RAND Office of External Affairs

CT-419

November 2014

Testimony presented before the House Financial Services Committee on November 13, 2014

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Published 2014 by the RAND Corporation
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The RAND Corporation

Countering ISIL's Financing²

Before the Committee on Financial Services
United States House of Representatives

November 13, 2014

Chairman Hensarling, Ranking Member Waters, and distinguished committee members: Thank you for allowing me to testify before you today on this critical topic.

Today I will discuss how the Islamic State of Iraq and the Levant (ISIL) accumulated the wealth that has made it the richest terrorist group in the world, what it spends that money on, how its money amplifies the threat it poses, and opportunities and challenges for the United States to counter its funding.

The success or failure of disrupting ISIL funding lies less in sanctioning foreign entities with whom ISIL or its intermediaries do business and more in developing the capacity of Iraqi and other local and regional partners to target ISIL financial facilitators and the group's local revenue sources. This can be achieved by supporting partner forces in rolling back ISIL's territorial gains; working with the local, regional, and U.S. government interagency partners to develop better financial intelligence on ISIL; and working with those same partners to block the various mechanisms by which ISIL raises money.

However, it is important to note that stopping ISIL financing is an extraordinarily difficult challenge. Even great success may not end the group's activities. We know from history that even when its predecessor organization, al-Qaeda in Iraq (AQI), was at the nadir of its power, it was able to maintain a core membership and conduct operations.

The Sources of ISIL's Riches

The first question is where ISIL gets its money. As part of my research at the RAND Corporation, since 2011 I have been studying the finances, management, and organization of the precursors to ISIL—AQI and the Islamic State of Iraq (ISI)—using their own financial documents. These declassified ledgers,

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payrolls, and memos were captured by U.S., Coalition, and Iraqi forces between 2005 and 2010, and show in great detail what has been publicly reported about ISIL in recent months.

The documents show that ISIL and its predecessors have long generated the vast majority of the group's funding internally. ISIL reportedly raises the majority of its money now through smuggling oil and products originating in the Iraqi and Syrian oil sectors or through extorting entities in those sectors; through extortion and taxation of the local economy in the areas it controls; through looting war spoils, including the region's rare and valuable antiquities; and through black-market sales of stolen and looted goods. Our analysis of the group's documents found that by 2008—well before Abu Bakr al-Baghdadi became the ISI's leader—ISI funded itself in Mosul by exploiting the same local revenue sources ISIL currently exploits there. The documents also revealed that the group was wary of strings attached to revenue from external sponsors and was unlikely to seek external support as a major component of its overall financing.³

This might have changed under Abu Bakr al-Baghdadi's leadership. Senior U.S. government officials have recently claimed that some of ISIL's funding now comes from external donors, and some believe external funding could become increasingly key to ISIL's financing if its finances in Iraq and Syria are squeezed and the group must look outward for financial support. Moreover, if ISIL mends its relationship with Jabhat al-Nusra (JaN), which splintered from ISI to become an independent affiliate in Syria of the central al-Qaeda organization (based in Pakistan), it is possible that ISIL could integrate JaN's external funding network into its broader financial scheme. Guarding against these possibilities will require the Treasury Department's continued vigilance in targeting external supporters for sanctions with the necessary authorities.

However, because only a modest share of ISIL's funding comes from external donors, sanctioning donors and external facilitators should be a secondary effort. Countering ISIL's internal financial operations must be the main effort.

The Growth of ISIL's Riches

The key difference between the financial activities of ISIL's predecessors and the financial activities of ISIL now is not in kind but rather in scale. Most recent estimates suggest that ISIL makes between \$1–3 million per day. In contrast, ISI's master financial ledgers in Mosul show that the group made an average of slightly less than \$1 million per month between August 2008 and January 2009. Although it is unclear

³ One captured ISI document—a lengthy internal review of the organization's "lessons learned"—explicitly warned against relying on external funding. The author cited the vulnerabilities such financial arrangements had caused in the past for Islamic militant groups. See Combating Terrorism Center at West Point, "Analysis of the State of ISI (English translation)," p. 23. As of August 24, 2014: <https://www.ctc.usma.edu/posts/analysis-of-the-state-of-isi-english-translation-2>

how much of present-day ISIL's revenues are made in and around Mosul, the key fact is that it used to take the group a month to make what it now makes each day. These resources have been critical enablers of ISIL's success in seizing broad swaths of territory in Syria and Iraq and in waging a two-front war against multiple governments and other non-state armed groups.

The many-fold growth of ISIL's wealth in recent years has also enabled ISIL to generate a budget surplus. This is a new development that occurred sometime after spring 2010. The group's Mosul financial ledgers from 2008 and 2009 reveal that it maintained a meticulously balanced budget. They also reveal that the group spent nearly all of the money it made very rapidly on its operating expenses, such as members' salaries and legal costs incurred on behalf of its detained members, and to fund military operations and attacks.⁴ If reports published in June 2014 based on similar documents that were captured from a senior ISIL leader in Mosul are true, ISIL's surplus is now approximately \$2 billion. Unlike in the past, ISIL no longer struggles to maintain a balanced budget each month—it instead enjoys a significant amount of surplus capital.

How ISIL Spends Its Money

The question about this surplus is, how will ISIL use it? First, ISIL could use surplus funding to continue to expand its territorial base in Iraq and the Levant—the area of Syria, Lebanon, Jordan, Israel, the West Bank, and Gaza. Second, it could use it to expand its influence in other strategic parts of the Muslim world, including Pakistan and Afghanistan, as it attempts to usurp primacy in the jihadist world from al-Qaeda. Third, it could use this money to fund plots for attacks in North America, Western Europe, or elsewhere in the world. Fourth, it will need to spend some of its money to fund its members and to provide services and maintain its sharia-based order in the territory it currently controls.

Of the four options, the first and the last appear to be the most likely. ISIL's top priority appears to be building an Islamic caliphate emanating from Iraq and the Levant. For now, ISIL is focused primarily on controlling territory and establishing a viable caliphate in the region. It likely will spend a large share of its revenue on "state building"—that is, implementing its strict Salafi-jihadist governance structures in the territory it controls. The group's financial holdings do not allow for the same level of spending the Iraqi government had budgeted for the governorates ISIL controls. My assessment is that ISIL requires far fewer resources to implement its sharia-based governance structures within this territory because ISIL's

⁴ Analysis by my RAND colleagues in 2010 observed the same pattern of balanced revenues and expenditures in a study of captured AQI financial documents from Anbar province from mid-2005 through late-2006. See Benjamin Bahney, Howard J. Shatz, Carroll Ganier, Renny McPherson, and Barbara Sude, with Sara Beth Elson and Ghassan Schbley, *An Economic Analysis of the Financial Records of al-Qa'ida in Iraq*, Santa Monica, Calif.: RAND Corporation, MG-1026-OSD, 2010, pp. 42–43. As of November 11, 2014: <http://www.rand.org/pubs/monographs/MG1026.html>

operating expenses and provision of other services is limited in comparison to what the government of Iraq would spend on services.

ISIL's wealth no doubt could contribute to a capability to conduct external operations, the second option I mentioned earlier. Media reporting has suggested that ISIL operatives have traveled to Pakistan and Afghanistan, among other countries, to attempt to recruit jihadi militants to join ISIL. Several commanders of the Pakistani Taliban, the leaders of the Abu Sayyaf Group in the southern Philippines, the splinter group led by the former leader of Jemaah Islamiyah in Indonesia, and Ansar Beit al-Maqdis in Egypt's Sinai Peninsula have all sworn allegiance to ISIL. Although the extent of the links between ISIL and these groups is unclear, it is clear that ISIL's media operations and deployment of teams of agents to conduct operations in distant countries requires money. And some jihadists, such as the Philippines' Abu Sayyaf Group, which has stepped up kidnappings of Westerners in recent months, may shift their support to ISIL in exchange for financial support.

The third option is the least likely but has the highest stakes for U.S. national security. Although ISIL appears more intent on consolidating control in Iraq and the greater Levant and spreading its brand throughout the Muslim world, an ISIL terrorist attack in the West could boost the group's standing among jihadist elements worldwide and attract another wave of foreign jihadis to fight with ISIL in Iraq and Syria. Such an attack would be costly for ISIL to plan and execute, but probably not costly enough for it to be impossible, even if the U.S. and its allies do manage to significantly degrade the group's finances. However, a financially degraded ISIL would pose less of a threat of successfully conducting a major attack using expensive and deadly weapons than a financially strong ISIL, which would have the resources necessary for such an attack: research and development, long-term surveillance and reconnaissance operations, training, weapons, and other materiel.

Current U.S. Strategy to Disrupt ISIL Finances: Opportunities and Limitations

The U.S. strategy that Treasury Under Secretary Cohen outlined on October 23 in his speech at the Carnegie Endowment for International Peace has three core elements: cutting off ISIL's access to revenue, restricting ISIL's access to the international financial system, and targeted sanctions against ISIL's leadership and facilitators.

Cutting Off ISIL's Access to Oil and Extortion Revenue

The first element of Treasury's strategy is working to cut off ISIL's main sources of funding, in particular its revenue from oil sales, extortion and crime, ransom payments, and support from foreign donors. I will focus on revenues from oil and criminal extortion, as they appear to be ISIL's largest sources of funding.

Oil

Treasury has announced it will target for financial sanctions anyone who trades in ISIL's stolen oil. Under Secretary Cohen's commentary is worth quoting at length on the challenges associated with sanctioning ISIL's oil trade:

It is true, of course, that ISIL's oil moves in illicit networks that are largely outside the formal economy, where individuals are less vulnerable to financial pressure. But at some point, that oil is acquired by someone who operates in the legitimate economy and who makes use of the financial system. He has a bank account. His business may be financed, his trucks may be insured, his facilities may be licensed. All that makes ISIL oil facilitators vulnerable.

The middlemen, traders, refiners, transport companies, and anyone else that handles ISIL's oil should know that we are hard at work identifying them, and that we have tools at hand to stop them. We not only can cut them off from the U.S. financial system and freeze their assets, but we can also make it very difficult for them to find a bank anywhere that will touch their money or process their transactions. In combating ISIL's fundraising through oil sales, we will leverage the well-established reluctance of banks around the world to facilitate the financing of terrorism.

Beyond financial sanctions, we are working closely with others in the U.S. government to enhance the ability of our partners in the region to choke off cross-border oil smuggling routes and to identify those involved in the smuggling networks. The Turkish and Iraqi Kurdish authorities have both made commitments to combat whatever oil smuggling occurs in their territory.⁵

It remains unclear whether this can be done effectively enough to degrade ISIL's oil wealth. Although some information exists on ISIL's oil sales and the smuggling schemes that are used to move oil to market in Turkey, Kurdistan, and elsewhere, getting the high-fidelity comprehensive intelligence on how ISIL sells oil and smuggles it will be difficult. Sanctioning individuals associated with ISIL oil sales will be difficult and may only have second- or third-order effects on the group. Pinning down specific bank accounts in hard-target countries will be very challenging. Aside from the opacity of the informal economic processes ISIL uses to profit from oil, Turkish cooperation has been limited due to geopolitical concerns.

Enhancing liaison activities in key areas through the U.S. Consulate in Erbil and U.S. Embassy Ankara will be important for obtaining necessary intelligence on banking and oil trafficking in those areas, and for working effectively with our partners on the ground. These challenges are enormous, and in many cases, it may only be possible to identify the banks that are doing business with oil smugglers from Iraq and Eastern Syria—not the identities of the smugglers or of the downstream parties who do business with ISIL wittingly or unwittingly. After all, ISIL runs that part of the world and claims to have its own state. Thus, disrupting ISIL's oil revenues through sanctions may be possible, but in a less precise fashion than we

⁵ Remarks of Under Secretary for Terrorism and Financial Intelligence David S. Cohen at The Carnegie Endowment For International Peace, "Attacking ISIL's Financial Foundation," October 23, 2014.

would like. To address this challenge, banks in the region should be put on notice, and Treasury should be given the necessary authorities to sanction these financial institutions.

Extortion

As I have described, extortion has long constituted one of this organization's most lucrative revenue sources. As of early 2009, for example, ISI documents show that in Mosul, it was making roughly the same share of revenue from extortion as from oil. Treasury's tools are not currently well suited for disrupting this source of ISIL revenue. Under Secretary Cohen recognizes that cutting off ISIL extortion revenue will require rolling back its control over territory, local businesses, and the local population—that is, in the long-term, rolling back ISIL's financing will require a well-resourced and capable indigenous ground force. This is primarily a military and law enforcement challenge, and it shows the inextricable links between the financial and the military challenges presented by a group such as ISIL. Until ISIL's territorial control can be reduced, cutting off its revenue from extortion and other criminal activities will be extremely difficult.

However, in the near term, two steps should be taken as possible to *disrupt* ISIL extortion and criminal revenue: First, work with partners—especially Iraqi Arabs and Kurds—to monitor flow of goods into and out of ISIL territory in Iraq and along key border areas, and learn from truck drivers the amounts of money demanded for transit fees and other taxes. This will provide better visibility into ISIL's revenue stream. Second, monitor all contracts with entities in ISIL territories—or cut off contracting since it's going to be extorted. These measures should be expanded if and when ISIL's territorial control is degraded to ensure its black-market activities are also degraded.

Restricting ISIL's Access to the International Financial System

Treasury is actively working to limit ISIL's ability to transact through the Iraqi, Syrian, and international banking systems. Scores of bank branches are located in territories where ISIL operates. Through cooperation with Iraqi authorities, bank headquarters, and the international financial community, Treasury aims to prevent ISIL from using those bank branches. Bank Secrecy Act reports filed with the Treasury by U.S. banks could provide the U.S. government with valuable insight into ISIL financial activity in areas where ISIL operates to the degree it or those who do business with it use U.S. banks. Treasury can carefully review these reports for indications of ISIL financing and quickly disseminate information to the appropriate authorities. However, more cooperation from countries in Europe and the Middle East is needed to significantly undermine financial options available to ISIL.

Attempts to restrict ISIL's access to the international financial system face three significant challenges. First, a number of northern Iraqi banks in and around ISIL's Mosul stronghold are reportedly under the group's control. These banks obviously have no incentive to comply with any U.S. regulatory policies. Efforts to isolate these banks from other formal financial institutions are important, yet little can be done to prevent ISIL from using them to exert financial control over the *local* formal economy and as a means of generating revenue.

Second, to the extent that ISIL relies on the Iraqi, Syrian, and international banking systems—and the extent to which it does remains unclear—the group has an incentive to identify and use banks that are unlikely to comply with policies designed to target ISIL's financial operations. Iraq's weak governance and sectarian politics makes oversight of a segment of banks ISIL is likely to use extremely difficult. As long as ISIL violence remains a threat to those who refuse to cooperate with the group, the United States may struggle to garner cooperation from target banks in Iraq and Syria.

Third, to the extent that these policies are effective, ISIL still would not be cut off from informal banking systems, such as networks of *hawalas*—informal value-transfer institutions throughout the Middle East, South Asia, and parts of Africa. These institutions can move ISIL money in Iraq, Syria, and abroad and have been difficult for Western intelligence authorities to penetrate.

Targeted Sanctions Against ISIL's Leadership and Facilitators

The third element of Treasury's strategy aims to dismantle ISIL's financial foundation through targeting its leadership, supporters, and financial facilitators with official terrorist designations.

Running a terrorist organization—especially one as large as ISIL—is both costly and bureaucratically challenging.⁶ To keep track of all its revenues and costs, ISIL depends on complex management networks, with CFO-like figures and professional administrators who allocate and monitor the group's money top-to-bottom.

Citing success in identifying, exposing, and financially neutralizing individuals in similar positions in al-Qaeda, Treasury has made identifying and designating these members of ISIL a priority. Placing sanctions on ISIL's leadership and facilitation network would indeed make it harder for ISIL to conduct commercial or other formal financial activities. But ISIL's financing scheme is different from al-Qaeda's, and targeting ISIL's leaders and facilitators for sanctions may harm ISIL less than past sanctions harmed al-Qaeda. ISIL financial and administrative officials receive and transfer most of the group's money

⁶ Bahney et al., 2010; Patrick B. Johnston and Benjamin Bahney, "Hitting ISIS Where It Hurts: Disrupt ISIS's Cash Flow in Iraq," *The New York Times*, August 13, 2014; Howard J. Shatz, "To Defeat the Islamic State, Follow the Money," *Politico*, September 10, 2014.

internally, and in cash. Their limited reliance on the formal economy may reduce the strategic value of cutting off their access to formal economic channels. Alternative means of targeting these individuals, whether kinetic or non-kinetic, may be more valuable against ISIL.

Policy Recommendations

Recommendation #1: Continue conducting airstrikes against oil assets, refineries, and other financial targets. Airstrikes alone have been, and will continue to be, insufficient to stop ISIL funding flows. However, airstrikes do disrupt ISIL oil operations, reduce its profits, and most importantly, buy time to build more robust diplomatic, intelligence, and military capabilities for a coordinated effort to weaken ISIL financially. The tricky element will be avoiding destroying those assets that legitimate successor governments will need to maintain either revenue or legitimacy.

Recommendation #2: Develop more effective financial intelligence collection and analysis capabilities to gain the level of understanding of ISIL's financial networks needed to target them. This is necessary to target its local financial schemes, which generate the vast majority of ISIL's finances. Realizing these capabilities will require robust partnerships with local, regional, and U.S. government interagency partners. Several key steps should be taken, including (1) enhancing intelligence cooperation with Kurdish and Iraqi partners to identify oil facilitators; (2) prioritizing collection on, and monitoring of, the quantities and prices of oil that facilitators and intermediaries are smuggling; and (3) identifying and monitoring all external contracts for areas in and around territory ISIL controls, and taking action to stop them if they are not absolutely necessary for the population's well-being.

Recommendation #3: Continue supporting the deployment of U.S. advisers to Iraq to increase the capacity of Iraqi Security Forces and advise them in military operations. The financial fight is inextricably linked to the military campaign that is happening on the ground. ISIL accumulated its wealth by taking advantage of Iraq's weak central governance and exploiting political sectarian grievances—in addition to exploiting the ongoing instability in Syria—and its expanded territorial control also expanded its capacity to generate higher and higher levels of revenue. In short, cutting off ISIL's finances cannot be done without rolling back its territorial control, and the Iraqi, Kurdish, and other partner security forces will have to do this with U.S. advice and assistance in lieu of a U.S. ground combat role.

Thank you again for inviting me. I am happy to answer any questions you may have.