

# The Paymasters: Financial Systems Supporting Terrorism

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## Introduction

From September 11, 2001 onwards, in the wake of the terrorist attacks in New York, Washington, Madrid, and London, the need to develop mechanisms to identify (members of) terrorist organizations and networks has strongly increased. One of the ways in which this may be done is to follow the money trail that leads from those secretly financing acts of terrorism to the actual perpetrators of terrorist deeds.

Literature suggests that one of the strategies to eliminate terrorism is to understand the ways in which the terrorist organizations and networks obtain their financial resources (Adams 1986; Napoleoni 2004; Pieth 2002; Raphaeli 2003). In doing so, it would be possible to stem the flow of money on which they ride at the source (Raphaeli 2003: 59). Lacking the possibilities to collect funds makes terrorists unable to operate. Or as Napoleoni (2004: xi) puts it, terrorism ‘cannot thrive without a constant supply of ready cash’. Against this background, a flood of research on the financing of terrorism has evolved. However, the authors involved offer contradicting perspectives on the costs of terrorism.

For instance, Rathbone and Rowley (2002: 8) state that ‘because of the nature of an asymmetric war, terrorists are able to impose very high costs on their enemies at seemingly trivial costs for themselves. September 11, 2001 is the most extreme example to date of this asymmetry. It has been estimated that the successful attacks launched that day against the United States may have cost the terrorists no more than \$200,000. (The terrorist lives lost were at most costless since the perpetrators were expediting their journey to Paradise)’. Raphaeli (2003: 60), on the other hand, claims that the ‘September 11 attack, with its complex planning, preparation and execution, would not have been possible without abundant resources’.

Whatever the perspectives on the costs, the primary question remains: Where do the organizations that terrorize the world get the money to do it? To date, two authors in particular have examined this question exhaustively. First, dating from 1986, Adams examines the funding of international terrorism in the 1970s and 1980s. His purpose is ‘to encourage a re-examination of the way society views terrorism’ (Adams 1986: 5). He argues that a refocusing of the counter-terrorist effort is necessary. He believes it makes sense for democratic governments to take initiative to go for the money feeding the terrorists, instead of repressing ‘the civil liberties which democratic societies tend to revere’.

Second, originally dating from 2003, Napoleoni adapted her work with a new chap-

ter on account of the Madrid attacks in 2004. She introduces the concept of the *New Economy of Terror*. The New Economy of Terror is 'an international network linking the support and logistical systems of armed groups ... with a turnover of about \$1.5 trillion' (Napoleoni 2004: xix).

Based on a literature survey, this paper aims to provide an overview of the mechanisms terrorist networks may use to finance their operations. We gladly borrow Simons' concept of 'levers of control' (Simons 2000) to explain ways to financially control terrorism.

The present paper is structured as follows. First, a clear understanding of the concept of terrorism is called for. Therefore, the following section considers the definitions of terrorism Adams and Napoleoni use to paint their pictures of financial networks enabling terrorist attacks. Subsequently, the sources of terrorist groups' funds are examined, after which the question whether stemming the flow of money at the source would provide an adequate lever to control terrorists networks is discussed. Finally, section five summarizes the findings of this paper.

### **Who is a terrorist and what constitutes terrorism?**

One man's terrorist is another man's freedom fighter. In ancient Egypt, the Pharaoh may well have regarded Moses as a terrorist, while his own people beheld him as their hero. Similarly, Samson may be regarded as the world's first suicide bomber.

The concept of terrorism appears to be elusive. Definitions are either highly impressionistic, reflecting personal opinions, or else, they are of an all-embracing nature to cover a broad variety of acts and actors (see Mockaitis 2005: 22; Sorel 2003: 366-371). Perhaps it would be possible to acknowledge an act of terrorism, based on the assumption that certain acts of violence will not be condoned in certain societies. According to Nassar (2005: viii), terrorism is an inaccurate concept that lacks an acceptable definition. In 1794, during the Reign of Terror in the aftermath of the French Revolution, the term was coined, referring to the use of terror by governments against their own people (Napoleoni 2004: xviii; Nassar 2005: 27; Rathbone & Rowley 2002: 1).

Lacking an acceptable definition, it is possible to ask oneself whether the Second World War bombings of Dresden and Hiroshima constituted acts of terrorism. And if so, whether the United States of America and its allies could be considered terrorists. The problems in defining terrorism, according to Van Leeuwen (2001: 8), are caused by two controversies, i.e.: (1) how to distinguish between terrorists and freedom fighters, and (2) whether states can be defined as terrorist agents. Van Leeuwen (2001: 9) tries to solve these controversies by declaring that states should not be called terrorists, and that terrorists are not soldiers wearing uniforms. She (2001: 8-10) defines terrorists as: non-

state actors, trying to change the political, societal, or religious order by actually using violence or threatening the use thereof. Terrorists may look for inspiration and moral guidance to a charismatic leader. However, at the same time, terrorists traditionally operate in small units with a great deal of autonomy. Finally, according to Van Leeuwen, terrorists seek to demoralize their enemy and win public support for their cause.

In order to understand and describe the ways in which terrorist organizations obtain their financial resources, a definition of terrorism and terrorist organizations is necessary. The remainder of this section looks at the ways in which Adams (1986) and Napoleoni (2004) approach their concepts of terrorists and terrorism.

At the outset of his study, Adams (1986: 10) defines a terrorist as ‘an individual or member of a group that wishes to achieve political ends using violent means, often at the cost of casualties to innocent civilians and with the support of only a minority of the people they claim to represent’. Based on this definition, Adams studies terrorism in the context of the Cold War era, in which the USSR and the USA support terrorist groups to encourage destabilization. To this effect, in the early 1980s, both super powers devoted hundreds of millions of dollars to train and supply secret armies all over the world. Adams illustrates how terrorism has evolved from the idealistic poverty-stricken beginnings in the early 1970s, to the ‘sophisticated multinational corporations’ in the mid-1980s. In describing the financing of terrorist activities, Adams refers to the lucrative means of kidnap, ransom and the narcotics trade.

Adams offers an insight into the development and inner workings of the PLO and the IRA. Instead of producing balance sheets, he aims to have some of the hitherto accepted beliefs about the funding of international terrorism re-examined. According to Adams, all terrorist groups have begun with ‘a few dedicated idealists, no money, no training and few concrete ideas. In the progression from fringe radicals to recognized terrorists, all groups have to acquire some income ... they have to buy some arms; and ... they have to achieve the international recognition that will help gather donations from supporters outside the organization’ (1986: 53). To remain viable, ‘a friendly border or safe haven must be adjacent to the area of operations. Without such a bolthole, terrorists have nowhere to run and no direct conduit for arms and cash’ (1986: 53).

In order to avoid falling into the trap of political definitions of terrorism, Napoleoni (2004: xviii) uses the word ‘terror’ to describe ‘the recourse to violence by armed groups to achieve political goals’. Napoleoni (2004: xix) introduces the concept of the ‘New Economy of Terror’: an international network linking the support and logistical systems of armed groups. Napoleoni (2004: 267) claims that, together ‘with the illegal economy, the New Economy of Terror claims amounts to nearly \$1.5 trillion’.

According to Napoleoni (2004: xix-xx), today’s problems with terrorism are caused by a global clash between two economic systems, one being the dominant Western

capitalism and the other being the insurgent New Economy of Terror. By now, the New Economy of Terror is an integral part of the global illegal economy, generating vast amounts of money that flow into traditional economies.

In trying to assess the magnitude, Napoleoni (2004: 262-267) distinguishes between the *illegal economy* and the *New Economy of Terror*. The illegal economy consists of criminal money and illegal capital flight. Criminal money is characterized as organized drugs trafficking, weapons, goods, and people. Narcotics generate a turnover of about \$400 billion a year; another \$100 billion is produced by the smuggling of people, weapons and other goods, such as oil and diamonds. Another component of the international illegal economy is illegal capital flight that makes up for \$500 billion a year. The New Economy of Terror has an additional financial source: 'assets and profits acquired by legitimate means and even declared to tax authorities' (2004: 267). This additional source, Napoleoni estimates at about \$500 billion a year. In sum, the illegal and New Economy of Terror amount to approximately \$1.5 trillion a year.

Both Adams and Napoleoni describe the concept of terrorism and the development of viable terrorist organizations by emphasizing the importance of having access to international funding<sup>2</sup>. Also, both trace the evolution of Cold War state-sponsored terror towards privately funded multi-billion corporations. On top of this, Napoleoni estimates the total amount of money involved.

### **Who are the paymasters: revenues and resources?**

Raphaeli (2003: 59) describes the financing of terrorism as a 'subterranean universe governed by secrecy, subterfuge, and criminal endeavours'. According to him it 'is best described as an octopus with tentacles spreading across vast territories as well as across a wide range of religious, social, economic and political realities'. In raising funds for terrorism, legitimate and illegitimate sources of funding are hard to distinguish from each other. Funds may derive from legitimate charitable organizations or they may come from credit card fraud, smuggling, car theft, kidnapping, and extortion. This section discusses the question: Where do terrorists get their money from?

Adams (1986: 238) does not attempt to provide an exhaustive overview of all sources of revenue and resources for terrorism. Rather, his book is an attempt to unravel 'a number of myths [that] have been created around the whole phenomenon'. These myths, according to Adams, 'have tended to confuse the issue and the judgements made considering what should be done about the threat'. After unraveling the myth that 'the Soviet Union and its allies have been largely responsible for the growth of international terrorism', and, for instance, suggesting that 'the Soviets have never provided funding for the PLO ... but make the Palestinians pay in hard-earned foreign exchange for all

arms delivered', Adams (1986: 251) concludes that bank accounts should be meticulously scrutinized. As much effort should be devoted to tracing the sources of money, the bank accounts and the investments of terrorist groups as is spent on countering the suicide bomber and the assassin.

Napoleoni (2004: 235) divides terror revenues into three main categories according to their origins: (1) legitimate business, including profits from companies or state-shells controlled by armed groups, donations from charities and individuals, asset transfer and legally approved aid from foreign countries, (2) illegal revenues circumventing legislation, originating from covert aid, from foreign governments and smuggling and (3) criminal activities, including: kidnapping, blackmail, theft, fraud, piracy, and money laundering<sup>3</sup>.

#### *Legitimate sources of funding*

Napoleoni (2004: 222-223) states that to a considerable extent, the terror balance of payments involves *remittances* from those countrymen who have sought refuge abroad. For instance, the PLO has exposed the so-called Palestinian Diaspora to 5% taxation. In a similar fashion, the Kosovar Diaspora living in Switzerland and Germany sent about 3% of their income to support UCK, the Kosovo Liberation Army. Such contributions may also involve appliances (e.g., radios, and night-vision equipment).

Another source of terror funding is *charities*. According to Napoleoni (2004: 223), the link between charities and armed organizations stems from the 1970s when Irish Americans started to support widows and orphans in their home country. Islamic charities came to bloom during the anti-Soviet jihad in Afghanistan. Napoleoni (2004: 223) estimates 'that a large portion of charity funds acts as an international pool of money, ready to be channeled to whichever group is in need in the Muslim world'. In this respect, Raphaeli (2003: 61) mentions *Zakat* (i.e., almsgiving). *Zakat* 'assumes a particularly significant role in countries, such as Saudi Arabia, which, for religious reasons, have no income tax ... individuals have to donate 2.5% of their income to the charity of their choice'. Raphaeli states there is no reliable figure on the size of the donations, nor on the ways in which they are used. However, he holds that some 'of these donations will find their way to nurture religious extremism or to finance terrorist activities' (2003: 62).

Another example of a legitimate source of funding is the *Hawala*. The *Hawala* 'is the transfer or remittance of money from one party to another without use of a formal financial institution, such as a bank or money exchange' (Raphaeli 2003: 70; see also: Napoleoni 2004: 167). Raphaeli (2003: 70) claims that 'international financial institutions estimate the annual *Hawala* transfers at about \$2 trillion a year'. *Hawala* leaves no

paper trail. 'A remitter gives money to an intermediary ... usually operating from a store or back office, who in turn instructs his correspondent in the receiving country to pay the beneficiary the transferred amount in local currency'. Furthermore, because 'so few elements of this informal transfer instrument are recorded, there is no way of obtaining the records of the transmitters and the beneficiaries or capturing the scale and magnitude of such transfers'. Because of its informal character, the *Hawala* is a money transfer instrument that is easily exploited by terrorists and other criminal elements.

#### *Illegal sources of funding*

Typical of Islamic charities linked to terror groups is the combination of humanitarian aid and illegal activities. Raphaeli (2003: 67-69) describes several cases in which terrorist networks are disguised as legitimate charities until their cover is exposed. He refers to organizations such as the Afghan Support Committee, the Revival of Islamic Heritage Society and the Al-Haramain Islamic Foundation. Another source for the terror balance of payments, according to Napoleoni (2004: 225) 'is state sponsorship, such as the US-government's covert and legitimate aid for the Contras' in Nicaragua against the Sandinists.

However, a much more common means in today's financing of terror 'is asset transfer, defined as the redistribution of external assistance or existing assets in favour of armed groups'. Napoleoni (2003: 225) takes asset transfer as 'one of the most lucrative sources of revenue for armed groups and state-shells in Third World countries'.

#### *Criminal sources of funding*

The kidnapping of tourists or expats is another source of revenue for the terror balance of payments, as well as other criminal activities (e.g. car theft, credit card fraud and counterfeiting consumer products) carried out abroad. Smuggling makes up for the most important criminal source of income. Contraband ranges from cigarettes, to alcohol, to diamonds. 'The benefits of contraband for armed groups are manifold. Not only is it a healthy source of income, it also erodes the infrastructure of traditional economies'. In doing so, it facilitates the breeding of the economics of war (Napoleoni, 2004: 231). In smuggling oil, also, terror, criminal and legitimate economies interact. For instance, Recknagel describes how Iraqis offer oil to smugglers at a price of \$95 per metric ton. 'This ... enables a smuggler to purchase the oil for that price, pay the Iranians \$50 a metric ton ... and then sell the oil at their destination for around \$205 a metric ton' (Napoleoni, 2004: 233-234). Finally, armed groups may fund themselves by transfer of domestic assets in various forms: looting, robbery, extortion and pillage.

This method preys directly on the resources of the traditional economy (Napoleoni 2004: 235).

Raphaeli (2003: 72) suggests that the Islamic banking network appears to have been important in transferring and laundering money intended for terrorist organizations. These banks are theologically denied to pay interest to depositors. Any Zakat provided by them are off the books and may be used for any purpose whatsoever. Several banks have helped transferring money to al-Qaeda through the Zakat system, by direct donations or by knowingly providing means to raise and transfer funds to the terrorist organization<sup>4</sup>.

#### **Levers to control financing systems supporting terrorism<sup>5</sup>**

Tracing financial transactions by terrorist groups is difficult because they often transact money through third parties, numbered accounts, offshore accounts, charitable organizations and disguised fronts. Many transactions are cash transactions, often through agencies that keep incomplete records and often operate outside the supervision of central banking authorities. Transactions may be conducted through Islamic banks that, until recently, have escaped close scrutiny. There is a considerable number of banks operating offshore and they are not subject to scrutiny either. Some countries invoke banking secrecy, often to conceal illegal activities. Many organizations suspected of terrorist or terrorist related activities use multiple aliases. In this respect, Raphaeli (2003: 78) mentions that the largest Saudi charitable organization, Al-Haramain Islamic Foundation, 'appears under 26 different spellings and configurations'.

According to Raphaeli (2003: 79), the response of the US to the financing of terrorism can be distinguished into *tactical action* and *strategic initiatives*. Tactical action involves interrupting individual practices. Strategic initiatives apply to changing the context in which terrorists raise and move their funds. Strategic measures are hindered by ineffective bank supervisory and anti-money laundering regimes in many countries, particularly in the Middle East and South Asia. International measures against terrorism combine *repressive* with *preventive* measures. 'The repressive measures involve agreements amongst countries to make certain acts criminal offences in their legislation, and to cooperate among each other by exchanging information and providing mutual legal assistance' (Raphaeli 2003: 79). Preventive measures 'involve the establishment of a regulatory regime for financial institutions that is intended to reduce the scope for using the financing system to collect and transfer funds for terrorist purposes' (Raphaeli 2003: 80).

While Raphaeli focuses exclusively on measures to control the financing of terrorism, at the same time, he is rather pessimistic about the impact of such measures. According

to him the financing of terrorism, and terrorism itself, is there to stay.

Adams (1986: 246) warned that by the mid-1980s the IRA had become so much a part of Northern Ireland's economy, its influence spreading throughout every aspect of working-class life, that it had become impossible to eliminate. As paradoxical as it may sound, it could be argued that a strong economic base might turn out to be the terrorist organization's pitfall in the end. After all, why should one destroy a societal system that allows for power, influence and wealth? Contemporary history shows Sinn Féin's metamorphosis as the former political wing of the IRA into a legal and respected political party.

Napoleoni (2004: 294-295) suggests 'that the first step in fighting [the New Economy of Terror] is to identify its channels of interaction with the economies of the West and progressively sever them - close its avenues into the free market and the world of capitalism'. According to her, this can only be accomplished 'if we ... take hold of the greatest privilege offered us by an open society - the opportunity to be informed about and to participate in the economic decisions that shape our lives'.

We believe that coping with the financing systems supporting terrorism needs a multi-actor approach. In this respect, counter-terrorism is as much a responsibility of the international police organizations and armed forces as it is a responsibility of international politics, business corporations and financial institutions. This would indicate worldwide inter-organizational cooperation, a phenomenon that is characterized, amongst others, by control, necessary to increase the predictability of –often unknown– partners. However, viable inter-organizational cooperation is also based on the awareness of interdependence to achieve the objectives and on trust.

Partners can reduce uncertainty about the other partners' behavior and develop confidence by two mechanisms. The first mechanism is based on control, or domain consensus. Examples are goal setting, rules and regulations regarding the participation in the alliance, monitoring the progress of activities and reporting the results of the alliance. Using such mutually agreed mechanisms, parties are able to reach consensus on the domains of cooperation and the division of responsibilities. The second mechanism is based on the development of trust, which is important for various reasons. Firstly, in inter-organizational alliances needed to cope with the financing systems supporting terrorism there will be no consented hierarchy. Partner-organizations participate in the alliance on a voluntary basis. Trust is one of the scarce means by which the alliance can be governed. Moreover, trust serves to foster positive expectations regarding the unknown partners' intentions. Only trust will enable the partners to depend on each other in situations entailing risk, which is necessary to cope with crises induced by terrorism (Bollen 2002: 47-63).



Concerning the amount of trust needed in inter-organizational alliances, Das and Teng (1998) refer to the concept of 'confidence in partner cooperation', which distinguishes three different kinds of dependencies that influence the necessary level of confidence. First, the amount of non-recoverable investments in the alliance has an impact on the level of confidence in partner cooperation that is needed. The more alliance-specific investments partners have to make, the more risk they will run and the more confidence in their partners' behavior they will deem necessary. Second, high levels of embeddedness and connectedness amongst partners require high levels of confidence, because partner-organizations will be hampered to leave the inter-organizational alliance voluntarily. Third, the amount of risk with regard to the partners' opportunistic behavior has an impact on the level of confidence. When chances are high for the partner-organizations to abuse the alliance's resources to further their own goals, high levels of confidence will be necessary.

Inter-organizational alliances, constituted to deal with the financial aspects of terrorism will be rather autonomous at a strategic level. Therefore, it can be expected, the amounts of non-recoverable investments in the alliance will not be very high. However, because of strong external and political pressure, which has been going on since September 11, 2001, the levels of embeddedness and connectedness will be quite intense. Partners may feel they are condemned to each other in order to solve the problems. Neither party is allowed to openly disclaim or refuse the need for cooperation. Finally, all parties involved in the inter-organizational alliance run some risk of the other partners abusing the mutual resources. Another sort of risk, however, may be that in cooperating within an alliance that is created to put a halt to terrorism, some partners may lose credibility in the eyes of their beneficiaries in the outside world. This may hold true, for instance, for members of the Islamic banking network and for some charitable organizations. To compound this effect, Lewicki, McAllister and Biest (1998) mention the mix of trust and distrust that manifests itself in most of today's transactional relationships. By this, the authors refer to the interdependence the alliance generates, while at the same time the parties involved in the partnership have to achieve their own goals in order to satisfy their grass root supporters. The occurrence of both trust and distrust at the same time is something participants in an alliance that aims to control financing systems supporting terrorist organizations will have to come to terms with.

We conclude that multi-actor alliances constituted to deal with the financial aspects of terrorism must be characterized by an average level of confidence in partner cooperation. Such levels of confidence require continuous communication and information sharing at strategic, operational and tactical levels amongst and within the partner-organizations involved. Intensive interaction is necessary to be able to solve problems

caused by fundamental differences among the parties involved in the alliance, by working in a nefarious context, by conflicts of interest, and by the performance of fluctuating and interdependent tasks for which new routines have still to be developed.

### Summary and conclusion

To sum up, first, an agreed generic definition of terrorism remains absent. To a certain extent, this means that certain groups will manifest themselves as terrorists in the eye of the beholder. In a cynical mood, one might wonder whether the war on terrorism would have been declared if, on September 11 2000, some people had decided to destroy the Eiffel Tower, thereby attacking the hearts and identity of the French. Napoleoni (2004) tries to circumvent this problem by referring to 'terror' instead of 'terrorism'.

Second, after examining the sources of terror groups' funds, it appears their paymasters are manifold. They range from legitimate business enterprises and governmental support to the world of charities and *Hawala*, and ultimately, to downright criminal activities, such as car theft, narcotics trade and kidnapping.

Third, we examined whether it would be possible to stem the flow of terrorist supporting money at the source. There are many answers to this question. To a certain extent, criminal financing systems are already investigated by international police organizations and forbidden by legislation. However, when it comes to getting at the paymasters that appear to be more or less legitimate or who are expedient at circumventing legislation, imposing measures of control seems not good enough to achieve the objectives.

Unilateral pressure on the implementation of measures to control worldwide systems for financing terrorism fails to achieve its goals. Partly, this failure can be ascribed to the fact that these systems are highly complex and impossible for a single agency - or nation - to deal with. This indicates that a multi-actor approach is needed. A multi-actor approach presumes that all parties involved possess complementary expertise and knowledge which makes them dependent on one another to solve the problems. Therefore, all parties will have to participate in decision-making processes, which by nature will have to be multilateral instead of unilateral.

Another motive that may cause control systems to fail, could be the fact that there is no consensus about the problem at hand. In this sense, the cliché of one man's terrorist is another man's freedom fighter may hold true on the ideological side, and on the opportunistic side. Financing terrorist organizations may account for huge profits.

If one holds that certain acts of terrorism cannot be condoned in certain societies, and that one of the ways to put an end to these acts is by cutting off the cash flow, besides measures of control a certain amount of trust will be needed among the actors

to bring this about. In this respect, it is important to notice, that most of today's transactional relationships are characterized by the manifestation of both trust and distrust at the same time, because partners in an alliance have to achieve joint goals, while they are also responsible for achieving organization-specific goals for which they are accountable to their own grass root supporters.

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### Notes

1. Both Winer (2002: 5) and Napoleoni (2004: 239) estimate the direct expenditure of the September 11 attack on \$500,000. Napoleoni adds, 'the cost for the US ... will be in excess of \$135 billion'.
2. We have adapted the word 'viable' from Beer (1995). He (1995: 113) assumes an organization viable if it is able to maintain a separate existence in its environment.
3. With 'state-shells' Napoleoni (2004: 36) refers to '*de facto* state entities created around a war economy generated by the violent activities of armed groups'.
4. For an overview of the "financial network" of al-Qaeda, see: Gunaratna (2002: 60-69).
5. With the phrase 'levers to control' we refer to - arguably - the most comprehensive control concept developed in the management control literature (i.e. levers of control for implementing strategy; Simons, 2000: 301-316). The relevant levers of control in his concept are: (1) belief systems (to empower and expand search activity), (2) boundary systems (to provide limits of freedom), (3) diagnostic control systems (to coordinate and monitor the implementation of intended strategies) and (4) interactive control systems (to stimulate and guide emergent strategies). We argue that pulling these levers will not be enough to stop the financing of terrorism. Inter-organizational alliances fighting terrorism should not only invest in control, but also in trust (e.g., by continuous interaction, personal contacts, open communication and information exchange in formal and informal settings). Partners in the alliance cooperate on a voluntary basis. Each of the organizations in the network must have confidence in the other organizations 'doing the right thing', while there exists no hierarchy and all are vulnerable to the actions of the other organizations in the alliance. In fact, for control mechanisms to work in such an alliance, an 'acceptable amount' of trust must be developed first.

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