Economic Counterinsurgency: Implications for Political Violence and Foreign Investment

by

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Dedication

For my parents, Michele Stone and Glenn Simonelli.

Acknowledgments

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Abstract

Government efforts to insulate financial systems from criminal and terrorist exploitation are a centerpiece of 21st century counterinsurgency and counterterrorism. This dissertation describes this relatively new global economic counterinsurgency regime and analyzes its impact on political security and economy. Despite the growth and expansive scope of these policies, the academic and policy evaluations of these institutions have been limited, far less than the scholarship devoted to the military and law enforcement prongs of counterinsurgency. I seek to bring these diverse policies under one research agenda. I argue that these institutions have wide-ranging consequences across a broad spectrum of political phenomena including security and international political economy. This dissertation will demonstrate the importance of both targeted and systemic economic counterinsurgency in explaining patterns of political violence and foreign investment. I address the following questions: How does targeted economic counterinsurgency impact rebel groups use of violence against opponents and civilians? How do we measure country-level systemic economic counterinsurgency? How does systemic economic counterinsurgency impact the levels of political violence within a country and the desirability of a country's economic market?

Economic Sanctions and Insurgent Violence: How do targeted sanctions affect the battlefield behaviors of insurgent groups? Policies that seek to restrict rebel group's access to resources, such as freezing assets, imposing embargoes, and limiting travel, are increasingly common forms of third-party intervention aimed at reducing a rebel group's ability to perpetrate violence. However, extant literature on battlefield dynamics show that economic sanctions are rarely effective and that rebels may be most prone to victimize and exploit

civilian populations during periods of relative weakness. I present a theory that explains heterogeneity in rebel responses to economic sanctions based on the rebel group's economic portfolio and founding connections with local communities. I expect groups with diversified funding streams and sources of income that are difficult to interdict to be relatively resilient to economic sanctions. However, groups with few sources of income or funding that is vulnerability to external interdiction will reduce their overall levels of violence when targeted by sanctions. I expect rebel groups lacking organizational ties to local populations, such as those that mobilized around external resources, to increase their violence against civilians when targeted by sanctions in order to recoup losses and extract resources. In contrast, groups that have preexisting social connections to non-combatants will reduce civilian victimization when sanctions make them further reliant on maintaining support from civilians. My theory is tested using data on insurgent groups from 1998-2012 and implementation of United Nations sanctions. The results show that sanctions reduce violence from economically vulnerable groups, but groups that lack social ties to civilians will respond to resource deficiencies by *increasing* their violence against civilians. This work demonstrates when policymakers can best expect economic sanctions to succeed and when these policies might produce a backlash of violence against civilians.

Measuring State Counter-Illicit Financing Systems: Government efforts to insulate financial systems from criminal and terrorist exploitation are a centerpiece of 21st century counterinsurgency and counterterrorism. The goal of anti-money laundering and countering the financing of terrorism (AML/CFT) policies is to reduce political violence by cutting off funding to violent non-state actors. Despite the proliferation of these policies, their prevalence, design, and efficacy have largely been neglected in the conflict literature. To fill this gap, this article introduces a two new concepts, counter-illicit financing structures and effectiveness. AML/CFT structures comprise the institutions and regulatory tools designed to detect, monitor, and counter illicit financing. AML/CFT effectiveness encompasses a state's

willingness and capacity to use their toolbox to effectively secure their financial system. I create state-level estimates of structural and the effectiveness of these institutions using expert reports from the Financial Action Task Force (FATF) and a Dynamic Item Response Theory model. I demonstrate the validity of these measures by exploring the model parameters and correlation with other measures of government institutional quality. The results show that an aversion to regulating private businesses hinders the strength of structural provisions to countering illicit financing. I conclude by evaluating the impact of these policies on political violence. The results show that effective AML/CFT systems are associated with fewer civil war battle deaths.

Counter-Illicit Financing Measures and Foreign Investment: How do AML/CFT policies affect foreign direct investment (FDI)? Domestic and international AML/CFT provisions aimed to disrupt the flow of money fueling violence were developed in the 1980s and became widespread after the September 11, 2001 attacks in the United States. These policies are costly for businesses and require increased transparency over business dealings, customer due diligence and documentation requirements, and coordination between host markets and firms. This presents a puzzle for understanding firm investment behavior. Firms prefer host markets with fewer costs and regulations but are attracted to capable host governments that can rebuff violent instability. To understand these tensions, I consider two measures of state counter-illicit financing systems, the laws and regulations that make up a country's AML/CFT institutions and the government capacity to use these tools to produce AML/CFT effectiveness. My theory of firm preferences shows that firms should invest in markets with fewer AML/CFT institutions but high AML/CFT effectiveness. However, firm preferences for an effective AML/CFT environment decreases as the regulations they are subject to increase. Using original data on state robustness to illicit financing and FDI inflows, I find support for these expectations. Evaluating other measures of the business environment further support my core expectations. This study contributes a new theory

explaining variation in FDI and highlights a tension between firm preferences and efforts to protect financial systems from illicit exploitation.

CHAPTER I

Introduction

1.1 Economic Counterinsurgency

International efforts to disrupt the financing of violent non-state actors first developed in the late 1980s in response to an era of violence from warring drug cartels. These narco-cartels amassed substantial fortunes and weapons stockpiles by exploiting trade routes and the legitimate financial system for drug trafficking and money laundering. The Group of Seven (G-7) created the Financial Action Task Force (FATF) in 1989 to coordinate efforts to disrupt illicit financing and develop international standards on combating money laundering. After the September 11, 2001, attacks on the World Trade Center these existing structures were integrated into the United States' War on Terror. In a Rose Garden address, on September 24, 2001, President George W. Bush implored of world leaders, "Money is the lifeblood of terrorist organizations. Today we are asking the world to stop payment" (Bush, 2001). This dissertation evaluates the tools and policies designed to accomplish this ambitious goal, presents new country-year measures of counter-illicit financing structures and effectiveness, and analyzes how well the world has met this challenge.

Under the coordination of FATF, individual governments and intergovernmental organizations have created a massive interconnected system of regulations, surveillance, and

enforcement with purview over every part of the global financial system (Biersteker and Eckert, 2007). I refer to these individual laws and policies as economic counterinsurgency and use the term economic counterinsurgency regime to described this broad international effort.[1] Economic counterinsurgency encompasses actions that range from narrowly targeting a single group to broad structural policies that affect the global financial system. Selective policies include terrorist designation lists and unilateral or multilateral sanctions such as the United Nations ISIL and Al-Qa'ida Sanctions Committee. Categorical efforts target entire countries or specific sectors, for example the Kimberley Process,[2] legislation regulating charitable donations or conflict minerals (Section 1503 of the U.S. Dodd-Frank Act), the United Nations Office on Drugs and Crime (UNODC)'s efforts to disrupt the narcotics trade, and country-level sanctions. Policies can also center on structural changes that impact the ability of all illicit groups to use or manipulate financial systems to fund violence. These systemic efforts include intelligence sharing across national financial intelligence units (FIUs) within the Egmont Group[3] and strengthening of anti-money laundering and countering the financing of terrorism (AML/CFT) provisions under FATF.

This dissertation describes this relatively new global economic counterinsurgency regime and analyzes its impact on political security and economy. Despite the growth and expansive scope of these policies, the academic and policy evaluations of these institutions have been limited, far less than the scholarship devoted to the military and law enforcement prongs of counterinsurgency. I seek to bring these diverse policies under one research agenda. I argue that these institutions have wide-ranging consequences across a broad spectrum of political

[1]Within the policy community, these efforts are commonly labeled some variation of Countering (or Combating) the Financing of Terrorism (CFT). This terminology is used by the United Nations, the International Monetary Fund, the World Bank, Financial Action Task Force, and many individual governments. The policies discussed here are used to target terrorists, insurgent groups, and criminals. For simplicity I use the term counterinsurgency but this refers to actions against all violent non-state actors.

[2]The Kimberley Process creates certification standards to ensure rough diamonds are not used to finance insurgent groups.

[3]The Egmont Group was founded in 1995 to provide a platform for cooperation between FIUs in sharing technical expertise and intelligence.

phenomena including security and international political economy. This dissertation will demonstrate the importance of both targeted and systemic economic counterinsurgency in explaining patterns of political violence and foreign investment. I address the following questions: How does targeted economic counterinsurgency impact rebel groups' use of violence against opponents and civilians? How do we measure country-level systemic economic counterinsurgency? How does systemic economic counterinsurgency impact the levels of political violence within a country and the desirability of a country's economic market?

This dissertation takes an intersectional approach to evaluate these questions across three papers. I expect the impact of economic counterinsurgency to ripple through the global financial system, just as military operations have wide-ranging impacts on the broader security environment. I begin by discussing the ways illicit actors exploit the financial system to fund their violent operations and analyzing one of the most popular economic counterinsurgency tools: targeted sanctions. Building on theories of rebel mobilization, tactics, and origins, I theorize that economic sanctions should have heterogeneous effects across rebel groups based on characteristics of the rebel groups' economic portfolios and origins. This study examines enforcement challenges based on the economic portfolios of individual groups but highlights state-level compliance and enforcement as unexplored sources of variation that should also influence the efficacy of targeted policies. To investigate this variation further, I create state-level yearly measures of counter-illicit financing structures and effectiveness. Then, I evaluate how systemic economic counterinsurgency affects political violence and the economic market within a country. In the third paper I move from exploring illicit exploitation of financing markets to evaluate how these counter-illicit financing policies will impact legal business using financial markets for trade and routine transactions. Together this dissertation evaluates the impacts of government economic counterinsurgency on three sets of actors: violent non-state actors, civilians in proximity to insurgencies, and multinational firms navigating the counters of financial markets redefined by systemic economic counterinsurgency.

My approach differs from the existing body of work on economic counterinsurgency in four primary ways. First, this diverse set of economic counterinsurgency tactics affects a range of actors through unique mechanisms. In Chapter 2, I evaluate how the same economic counterinsurgency tools might have different impacts on violent non-state actors depending on the unique characteristics of the rebel group. My theory describes heterogeneity across insurgent groups in their responses to economic coercion based on the vulnerability and diversity of their economic portfolios and organizational origins. The results show that economic sanctions can reduce net levels of violence by rebel groups with diversified economic portfolios. My approach proves that not only do the tools of economic counterinsurgency vary, but within a single tool the impact varies based on attributes of the target.

Second, I move beyond prior studies of economic sanctions that only evaluate rebel groups' battlefield violence (Radtke and Jo, 2018; Escribà-Folch, 2010; Hultman and Peksen, 2017) and consider how economic coercion might have unintended consequences on civilian populations. Building on my approach of evaluating rebel heterogeneity, I show that groups' foundational connections to pre-existing institutions such as political parties, local governments, or religious movements can have enduring impacts on their responses to economic coercion and relationship to civilian populations. Economic sanctions increase these groups' reliance on civilian populations and incentivize rebel groups to reduce any coercive behaviors toward noncombatants. Alternatively, rebel groups that originated around external resource endowments or from splintering off prior violent non-state actors do not have these shared social connections or tools to persuade civilians to supplement their losses under economic sanctions. They will instead use increased violence and predation against civilian populations to shore up resource deficiencies.

Third, this dissertation is the first research to cross-nationally measure and evaluate systemic economic counterinsurgency. As the following sections will show, academic work on economic counterinsurgency has mainly focused on economic sanctions or case-specific

evaluations of categorical economic counterinsurgency. However, these actions take place under the broader AML/CFT structures that I elucidate. I create two new concepts to evaluate counter-illicit financing. AML/CFT structures measure a country's AML/CFT laws and regulatory tools and AML/CFT effectiveness encompasses the government's latent capabilities and willingness to use these tools to produce improved security of financial markets. Using these original measures, I uncover a correlation between effective systemic economic counterinsurgency and lower levels of intrastate violence. These measures will enable other researchers to study these phenomena further, incorporate systemic variation into analyses of categorical and targeted measures. They can also provide guidance for policymakers seeking to compare and improve state security against illicit manipulation of financial markets.

Finally, I look beyond political violence and evaluate how economic counterinsurgency policies affect the broader political economy of a country. Policymakers and scholars must consider these downstream effects when evaluating the costs and benefits of economic counterinsurgency. I argue that systemic changes in the financial system meant to rebuff illicit financing will also impact legitimate actors in the international political economy. Focusing on primary actors of the international political economy, multinational firms, I show that firms consider systemic economic counterinsurgency in their investment location choices. Foreign firms offer employment opportunities, technology spillover, and services that can bolster social and economic conditions within a country, particularly for developing countries, and may be associated with less violent conflict (Schneider, 2017; De Soysa and Fjelde, 2010). As such, exploring factors which entice or repel foreign investment is a prominent research vein in international political economy (Pandya, 2016). My results show that foreign firms avoid markets with costly AML/CFT structures but are attracted to countries that effectively insulate their financial markets from illicit exploitation. These findings point to a source of tension between governments seeking to attract foreign investment and im-

prove their compliance with international counter-illicit financing policies. This dissertation demonstrates the interconnected nature of the actors involved in the international financial system, both licit and illicit.

This chapter reviews the tools of economic counterinsurgency and our existing knowledge on them. I classify forms of economic counterinsurgency based on the scope and discrimination of their targets. At the most narrow, targeted economic counterinsurgency focuses on a single violent non-state group or individual within a violent group. Categorical economic counterinsurgency encompasses a collection of targets based on a shared feature, for example all the groups within a given country or commodity-specific measures such as diamond certification standards. Systemic economic counterinsurgency involves fundamental shifts to the financial system and the functioning of the economy to avoid illicit exploitation. These forms of economic counterinsurgency are not mutually exclusive and a given group may operate under systemic, categorical, and targeted economic counterinsurgency. I highlight the gaps that remain within our understanding of each of these areas and where I make my contribution. Then, I briefly review the organization of the dissertation. I conclude this chapter by discussing implications for public policy and my dissertation's contribution toward the literatures on economic counterinsurgency, political violence, and foreign investment.

1.1.1 Targeted Economic Counterinsurgency

Targeted economic counterinsurgency is the oldest form of economic counterinsurgency and encompasses many different tactics.[4] I define targeted economic counterinsurgency as efforts to block, disrupt, or destroy tangible support to a *specific* insurgent group, individual group member, or supporter of the group. The goal of targeted economic counterinsurgency is to reduce political violence by cutting off violent groups' access to financing, munitions,

[4]The first known use of targeted economic counterinsurgency occurred in 432 BC between city-states when Athens embargoed merchants from Megara to create economic costs on Sparta (Zarate, 2013).

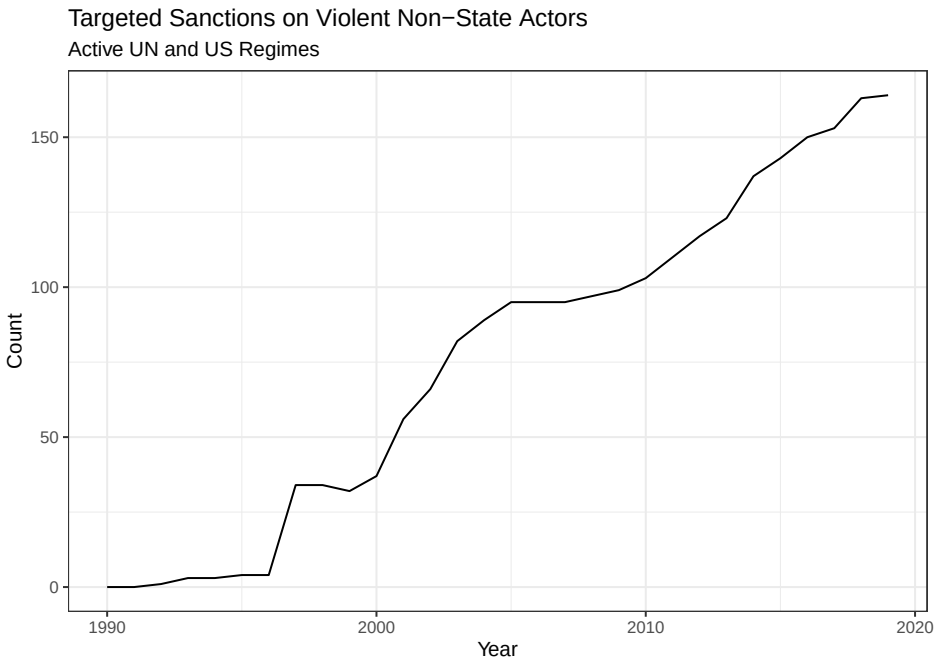


Figure 1.1: Active UN and US Targeted Sanctions Regimes

logistical support, transnational travel, and other supplies. These actions take many forms including but not limited to military strikes against money reserves, arresting financiers, raiding and confiscating caches of supplies, terrorist exclusion lists, and freezing assets of specific leaders on the United Nations ISIL and Al-Qa'ida Sanctions Committee. Since the end of the Cold War, these tactics have increasingly taken the form of targeted economic sanction regimes. Figure 1.1 shows the increase in rebel groups targeted by United Nations and United States economic sanctions from 1990-2020.

The limited literature evaluating specific targeted economic counterinsurgency tools has found that these can be effective tools for curtailing violent groups. Paul, Clarke and Grill (2010) reviews 30 resolved insurgency cases from 1978-2008 and finds that reducing tangible support to insurgents is a highly effective strategy. In the eight successful cases of counterinsurgency in the sample, counterinsurgents disrupted at least three forms of tangible support, and in the 22 cases where counterinsurgency was deemed a failure, counterinsur-

gent forces disrupted no more than two sources of support (Paul, Clarke and Grill, 2010). Sanctions are most successful at curtailing violence and reducing the duration of civil wars when combined with military or peacekeeping operations (Lektzian and Regan, 2016; Le Billon, 2012). Escribà-Folch (2010) evaluates 87 civil wars from 1959-1999 and determines that economic sanctions and arms embargoes can hasten the decline of civil wars. However, the record on intensity is mixed. Hultman and Peksen (2017) distinguishes the components that form targeted sanctions, demonstrating that economic sanctions are associated with increased intensity of violence, but arms embargoes reduce battlefield violence.[5] For rebels lacking diversified funding streams, sanctions can contribute to territorial losses and reduced levels of violence (Radtke and Jo, 2018). Radtke and Jo (2018) is one of the first studies to specifically consider sanctions targeting non-state actors, but is limited by only considering variation in groups' economic endowments. Phillips (2019) evaluates the United States' Foreign Terrorist Designations and shows these measures are associated with reduced terrorist violence, but only from groups based in countries aligned with the United States. These results show economic counterinsurgency may effectively reduce rebel capacity for violence in some cases. Research into targeted economic counterinsurgency is the most developed, yet our understanding of why targeted economic counterinsurgency works against some groups but not others is still limited. This literature has only begun to explore the direct impacts of economic sanctions and not yet examined the broader effects on insurgent group structures and tactics, rebel groups' willingness to negotiate, violence against civilians, and impacts on states and non-state entities that enforce sanctions.

[5]Most sanctions targeted at rebel groups include arms embargoes. All the sanctions analyzed in this dissertation are comprised of freezing assets, travel restrictions, and arms embargoes.

1.1.2 Categorical Economic Counterinsurgency

I use the term categorical economic counterinsurgency to refer to the policies that impact many different groups based on their locations and economic profiles. These efforts mostly arose in the 1990s out of academic and policy research that identified the prevalence of natural resources as associated with conflict, deemed the resource curse. Research and policies built around this topic sought to break the various mechanisms linking resource-rich countries to cycles of violence and instability. Prominent examples of these institutions include the Kimberley Process, Extractive Industries Transparency Initiative (EITI), international and domestic legislation regulating the use of conflict minerals in technology products, and United Nations' resource sanctions targeting entire countries. The Security Council implemented commodity-specific sanctions in approximately one third of resource-based conflicts from 1989-2006 (Le Billon and Nicholls, 2007) and, in 2009, the United Nations Environment Programme issued a report that argued "international sanctions should be the primary instrument dedicated to stopping the trade in conflict resources" (United Nations Environment Programme (UNEP), 2009). These policies do not target a specific violent non-state actor but will impact any group in a targeted region that uses the designated resource including access to armaments. Figure 1.1 traces the development of key categorical economic counterinsurgency policies.

Table 1.1: Timeline of Categorical Economic Counterinsurgency

1990	UNSC imposes sanctions on all goods and arms in Iraq and Kuwait (resolution 661).
2000	Kimberley Process Established.
2002	Extractive Industries Transparency Initiative established.
2002	Kimberley Process enters into force.
2010	United States passes Dodd-Frank Act.
2021	EU Conflict Minerals Regulations enters into force.

The academic and policy research into categorical economic counterinsurgency shows mixed results. Beevers (2015) analyzes the efficacy of natural resource management strategies in Liberia and Sierra Leone and argues that the Kimberley Process has improved monitoring and reduced smuggling, resultantly strengthening government control over mining areas. In a systematic review of the process, Grant (2012) argues that the Kimberley Process is effective at reducing the trade in diamonds and this has contributed to successful peacebuilding efforts in Angola and Sierra Leone. Evidence from several recent studies also suggests EITI improves regulatory behavior. Rustad, Le Billon and Lujala (2017) provide a comprehensive evaluation of EITI goals, organizing them into three categories: institutional, operational, and developmental. Institutional goals include building the EITI organization, increasing membership, and promoting EITI norms. Operational goals focus on implementation of EITI standards and improving state compliance with guidelines. Developmental goals are long-term outcomes such as reducing corruption, increasing investments, and improving living conditions. In Rustad, Le Billon and Lujala (2017)'s review of 45 studies, 72% find evidence

of institutional success, 44% for operational success and 23% for development success.[6]

However, research into policies to disrupt the conflict-mineral link offer a less hopeful outlook (Bloem, 2018; Stoop, Verpoorten and Van der Windt, 2018). Section 1503 of the Dodd-Frank Act was created to break the link between natural minerals and conflict in Eastern Democratic Republic of Congo, but has been associated with increased violence and looting in affected areas (Bloem, 2018; Stoop, Verpoorten and Van der Windt, 2018). Bloem (2018) shows that the Dodd-Frank Act doubled the probability that administrative areas within DRC would experience a range of violent unrest including violence against civilians, battles between rebel groups, riots, and protests. The results suggest there is more work to be done to link the mechanisms undergirding policies to case-specific and broader knowledge on how rebel groups extract, manage, and use resources. Understanding the components of these resource-generating tactics, their supply chain features, and rebel groups' organizational structures can help policymakers anticipate and safeguard against side effects.

1.1.3 Systemic Economic Counterinsurgency

In the late 1980s and 1990s, states began developing domestic legislation and forming international agreements to disrupt the booming illicit trade in narcotics and money laundering systems that allowed criminals to obscure the origins of their fortunes. In 1999, the United Nations General Assembly adopted the International Convention on the Suppression of the Financing of Terrorism, which only four states had ratified prior to September 2001 (Biersteker and Eckert, 2007). The September 11, 2001, attacks on the World Trade Center produced a sea change in domestic and international efforts to counter the financing of terrorism and, led by the U.S. Treasury Department, galvanized states, intergovernmental

[6]Several studies were unable to fully evaluate EITI's developmental success because it was too early in the process.

organizations, and civil society actors to identify and disrupt sources of funding to violent non-state actors (Biersteker and Eckert, 2007; Zarate, 2013). These efforts were paired with targeted and categorical tools of economic coercion that have been frequently applied against states to construct an international regime of economic counterinsurgency. Figure 1.2 provides a timeline of the development of key systemic economic counterinsurgency policies. Despite its omnipresence, systemic economic counterinsurgency has been the most neglected in the literature, in part due to measurement challenges, and is the focus of two chapters of this dissertation.

Table 1.2: Timeline of Systemic Economic Counterinsurgency

1989	Financial Action Task Force (FATF) established by the G7.
1995	Egmont Group convened.
1996	FATF updated.
1999	October: UNSC first introduces Resolution 1267.
	December: UNGA adopts International Convention on the Suppression of the Financing of Terrorism.
2000	Wolfsberg Group formed.
2001	UNSC Resolutions 1368, 1373.
2001	FATF issues eight special recommendations on terrorist financing.
	G8 Counter-Terrorism Action Group (CTAG) established.
2004	UNSC creates Counter-Terrorism Committee Executive Directorate (CTED) (Resolution 1535).
2006	UN Global Counter-Terrorism Strategy adopted by UNGA.
2012	FATF rules updated to current standards.
2017	United Nations Office of Counter-Terrorism (UNOCT) established.

In surveying the literature on targeted, categorical, and systemic economic counterinsurgency, I identify two areas where new research could be most impactful. First, the literature on targeted and categorical sanctions is relatively disconnected from broad theories in the conflict literature on rebel origins, mobilization strategies, and treatment of civilian popu-

lations. Access to resources and relative abundance of endowments feature prominently in these theories, but far less attention has been paid to economic deprivation and changes in rebel behavior as they lose resources. Prior work on economic counterinsurgency has produced qualitative case-studies that contribute important knowledge of the mechanisms of economic counterinsurgency and their application in specific environments, and broad analyses of civil wars that do not measure group-level effects and behavioral changes. This dissertation connects theories of rebel organization and tactics from the conflict literature to the mechanisms of targeted economic sanctions to elucidate rebel behavior under resource constraints.

Second, this literature provides no unified measure or analysis of cross-national systemic economic counterinsurgency. Chapters 3 and 4 of the dissertation center on filling this gap. The lack of a measure of systemic economic counterinsurgency or state counter-illicit financing policies poses a challenge for understanding the entire economic counterinsurgency regime. Economic counterinsurgency policies overlap and the enforcement and success of one measure is inextricably linked to the quality of other economic counterinsurgency institutions. For example, Al-Qa'ida in the Islamic Maghreb (AQIM) operates in Mali and across the African Sahel region. AQIM has been subject to sanctions under the ISIL (Da'esh) and Al-Qa'ida Sanctions Committee since 2001[7] and subject to numerous targeted economic counterinsurgency operations to confiscate, destroy, and block their supply chains and resource stockpiles. The group also is subject to the country-wide sanctions and arms embargo imposed on Mali (pursuant to UNSC resolution 2374). To evaluate the impact of these policies, scholars must also consider the wider tools and capabilities that national governments have available to monitor and enforce economic counterinsurgency provisions. My measures show that Mali has relatively strong AML/CFT effectiveness compared to Mauritania

[7]The group was initial listed under its original alias, the Salafist Group for Call and Combat, on the original UNSC Al-Qa'ida sanctions list.

and this variation may shine light on differences in the efficacy of categorical and targeted economic counterinsurgency measures in the region. I create measures of counter-illicit financing structures and effectiveness to evaluate systemic economic counterinsurgency, but expect these measures to also be integrated into the evaluation of targeted and categorical economic counterinsurgency.

1.2 Organization of the Dissertation

In Chapter 2, *Economic Sanctions and Insurgent Violence*, I begin my study of the global economic counterinsurgency regime by evaluating economic sanctions that target insurgent groups. This paper fills the gap I have identified in the literature by connecting our knowledge of the mechanisms of economic counterinsurgency with theories of rebel mobilization and origins. This expands the literature by evaluating not just violence between warring parties, but also a targeted insurgent groups' propensity to attack civilians. I expect the impacts of sanctions to vary across rebel characteristics. My theory centers on the vulnerability and diversity of a rebel group's economic portfolio and how its founding origins shapes its relationship with civilian populations. Economic sanctions are designed to create economic costs for the target by restricting its access to foreign markets for imports and exports. I expect rebel groups with economic portfolios that are comprised of resource-generating tactics with long supply chains and cross-boarder transactions to be especially vulnerable to economic sanctions as these revenue streams rely on access to the wider world economy. Alternatively some rebel groups' resource-generating tactics are relatively difficult to interdict and I expect these groups to be more resilient in the face of economic coercion.

Next I move beyond extant research that only evaluates battlefield violence (Radtke and Jo, 2018; Escribà-Folch, 2010; Hultman and Peksen, 2017) and analyze how economic coercion might affect violence against civilians. I consider two primary tactics groups use to

elicit civilian support: persuasion and coercion. I build my theory of rebel violence against civilians based on theories of rebel origins and the impact of origins on rebel institutions. The pre-existing institutions from which rebels drew their initial membership have enduring impacts on rebel groups' organizational structures and subsequent treatment of civilian populations. I show that groups founded in pre-existing institutions with connections to local communities will maintain their ties to civilians and use persuasion to acquire more resources from civilians. The implementation of economic sanctions are accompanied by international condemnation meant to name and shame the deleterious behaviors of the target. Attacks on the reputation of a rebel group can be particularly harmful to groups with social origins, as they rely on civilians favorable perceptions to maintain their support. These rebels groups will face economic constraints produced by and in order to extract additional resources from civilians they will need to counter the UN's narrative. This incentivizes groups that occasionally were coercive to civilians to improve their behavior and cease any violence that could provide evidence in support of a harmful narrative. Groups with social origins are more likely to extract additional resources from civilian populations without reliance on coercion. Economic counterinsurgency efforts that are viewed as unfair or repressive may actually galvanize civilian networks to provide additional support.

Facing economic sanctions, groups lacking institutional ties to civilians will have few strategies available to recoup their potential losses. Relationships with local communities require trust and shared interests which develop over time through iterated reciprocal interactions. Predatory groups facing economic constraints cannot use persuasion or shared social networks to seek resources from civilian populations. These groups may attempt to strategically offload their economic losses onto civilian populations, violently extracting more resources to supplement losses in other income steams. In periods of economic decline, rebels are particularly vulnerable to other forms of counterinsurgency and may increase coercive measures to dissuade or punish civilian cooperation with government forces.

I evaluate my theory using data on insurgent groups from 1998-2012 and implementation of United Nations sanctions. The results show that sanctions reduce violence from economically vulnerable groups, but groups lacking institutional connections to civilians will respond to resource deficiencies by increasing violence against civilians. Sanctions are most effective at reducing violence from groups with few sources of income. Economically diversified insurgents can avoid the costs of sanctions or rely on alternative sources of funding to continue their violent operations. These findings highlight the risk of implementing sanctions without careful consideration of rebel characteristics. Policymakers targeting rebels without ties to local communities may need to pair economic counterinsurgency with programs to protect civilians from potential backlash.

This chapter does not find support for my expectations on the vulnerability of rebel resource-generating tactics. If there is not variation in enforcement of sanctions based on funding streams, where else might we be able to observe differences in the enforcement of economic sanctions? An important and missing source of variation in Chapter 2 is differences across governments in their ability to implement sanctions, secure borders from the smuggling of goods, and the resilience of their financial systems from illicit exploitation. These systemic forms of economic counterinsurgency are an important layer of the broader counterinsurgency efforts that rebel groups face. However, there exists no cross-national measure of systemic economic counterinsurgency, so I create these measures in Chapter 3.

In Chapter 3, *Measuring State Counter-Illicit Financing Systems*, I evaluate the broadest level of economic counterinsurgency, system-wide laws, policies, and tools that governments use to insulate their financial systems from exploitation from illicit actors. This chapter introduces two new concepts to measure a state's counter-illicit financing systems. AML/CFT structures comprises the legal framework and regulatory tools established to oversee, investigate, and block illicit financing. AML/CFT effectiveness is derived from a government's

capacity and willingness to use its toolbox to disrupt illicit activities.[8] AML/CFT effectiveness captures how well a government is able to achieve the goals of AML/CFT and ability to identify, disrupt, and prevent efforts to use financial systems for illicit purposes. I create county-level estimates of AML/CFT structures and AML/CFT effectiveness using expert country assessments from FATF and dynamic ordinal item response theory models.

I demonstrate the validity of these measures by exploring the model parameters and correlation with other measures of government institutional quality. I conclude by evaluating the impact of these policies on political violence. The results show that financial robustness has no clear impact on levels of terrorism but is associated with fewer civil war battle deaths. Exploring the latent variable model parameters highlights the challenges governments face in regulating private entities which serve as the day-to-day regulators over transactions. Governments are adverse to regulating private businesses and this hinders the strength of structural provisions to AML/CFT. I explore this tension further in Chapter 4 by evaluating firm preferences over host markets with different counter-illicit financing systems.

Chapter 4, *Foreign Investment and State Robustness to Illicit Financing*, delves deeper into the behaviors of legitimate firms operating in financial markets that have been reconfigured by systemic economic counterinsurgency. Chapter 3 showed that an aversion to regulating private businesses hinders the strength of structural provisions to countering illicit financing. I investigate this further with a firm-centric approach by considering a firm's preferences over host markets with varying levels of AML/CFT structures and AML/CFT effectiveness. The policies of systemic economic counterinsurgency are costly for businesses and require increased transparency over business dealings, customer due diligence and documentation requirements, and coordination between host markets and firms. This presents

[8] I use the terms structural AML/CFT and AML/CFT technical compliance interchangeably. Both terms refer to the first measure of counter-illicit financing systems which captures the underlying laws and tools in a country. I use the terms AML/CFT capacity and willingness interchangeably with AML/CFT effectiveness. This second dimension captures a government's ability to identify, enforce, and disrupt money laundering and terrorist financing.

a puzzle for understanding firm investment behavior. Firms prefer host markets with fewer costs and regulations but are attracted to capable host governments that can rebuff violent instability.

I argue that firms seek out host markets where they can minimize the costs of invasive AML/CFT regulations but reap the benefits of a government with a strong capacity to counter illicit financing and environment free of well-financed violent actors. Firms most prefer host markets characterized by weak AML/CFT structures but high AML/CFT effectiveness. However, as AML/CFT regulations and restrictions on business dealings become more onerous, firms prefer governments less adept at implementing them. To evaluate my theory, I use the original measures of state AML/CFT structures and AML/CFT effectiveness developed in Chapter 3 and data on FDI inflows. The results support my theoretical expectations. Firms prefer host markets characterized by weak AML/CFT structures but high AML/CFT effectiveness and investment into strong host markets decreases with increasing AML/CFT structures. This chapter contributes a new theory explaining variation in FDI and highlights a tension between firm preferences and efforts to protect financial systems from illicit exploitation. These findings provide additional context for the trade off identified in Chapter 3 between a government's goal to insulate financial markets from exploitation by violent non-state actors and their desire to attract foreign investment to stimulate economic growth.

In Chapter 5 I conclude with a summary of the dissertation, policy and academic contributions, and future research that follows from this work.

1.3 Contribution and Policy Implications

This dissertation makes several contributions to the study of economic counterinsurgency as a unified area of research. First, I contribute new knowledge on the scope and

occurrence of economic counterinsurgency. The policies of economic counterinsurgency have been largely studied in isolation, but I connect these policies under the framework of the global economic counterinsurgency regime. Although my contributions center on targeted and systemic economic counterinsurgency, I believe the wider context of the global economic counterinsurgency regime is helpful to understanding its individual components.

Second, I create the first cross-national measure of systemic economic counterinsurgency. Systemic economic counterinsurgency is important to several areas of study in political science and public policy, including political violence, international political economy, and international interactions. Future work can use these measures to evaluate variation in robustness across state features, variation in economic markets, state behavior in international bargaining, and political violence. These estimates are also useful to policymakers to evaluate counterparts' robustness to illicit financing and separate false signals of compliance from strong AML/CFT systems. The results show that several countries that have the highest structural robustness fail to effectively block the illicit exploitation of their financial systems. Information is a key aspect of international cooperation and bargaining. The information provided by these measures can help regulators understand compliance and reduce enforcement noise for efforts to enhance international institutions.

My focus on the downstream effects of economic counterinsurgency is a significant departure from prior approaches and a key contribution of this dissertation. I pursue this line of inquiry down two paths. In Chapter 2, I evaluate how targeted economic counterinsurgency will impact the civilians living in proximity to insurgency groups. The results show that rebel groups lacking social ties to local communities may attempt to recoup their economic losses by attacking civilians and extracting resources via coercion. Policymakers should carefully consider when to implement economic counterinsurgency and when to pair these interventions with policies to protect civilian populations from a potential backlash.

Chapter 4 evaluates the impact of systemic economic counterinsurgency on the legitimate

firms that form the backbone of the international financial system. Changes to the financial system meant to repel illicit actors flow through international markets and can impact a broad range of actors. This work shows that foreign investors are repelled by AML/CFT structures that impose onerous regulations on them but are attracted to markets that have demonstrated an ability to keep illicit actors from exploiting the financial system. This finding has direct relevance for policymakers as foreign direct investment represents a significant share of many countries economies and firm preferences for less regulated markets may be an impediment to international efforts on AML/CFT. AML/CFT efforts are costly for domestic governments, and this study has identified additional opportunity costs of repulsing foreign investors that seek out less regulated environments.

CHAPTER II

Economic Sanctions and Insurgent Violence

2.1 Introduction

Targeted sanctions and other forms of economic counterinsurgency are increasingly common policy tools for disrupting violent non-state actors' access to financing, munition, and transnational travel.[1] Yet, our understanding of the processes and efficacy of economic coercion are based on policies targeting states and theories of state behavior in the international system. There lacks scholarship linking the mechanisms of economic sanctions to theories of insurgent behavior. The logic undergirding economic counterinsurgency is straightforward; rebels require resources to mobilize and sustain insurgencies, so limiting the availability of resources should reduce rebel capacity to perpetrate violence. However, there has been limited evaluation of the assumptions underlying these policies or their potential side effects. Drawing on theories of rebel origins and mobilization, I evaluate these assumptions and analyze the impact of targeted United Nations (UN) sanctions on rebel violence against combatants and civilians.

Access to resources and relative abundance of endowments feature prominently in theories

[1] I use the terms rebel, insurgent, terrorist, and violent non-state actors interchangeably throughout this dissertation. This chapter's scope encompasses all violent groups contesting governments and is operationalized as a group that has engaged in conflict with a government producing more than 25 battle deaths in a given year.

of rebel mobilization (Olson, 1965; Lichbach, 1998; Weinstein, 2006) and strategic behavior (Lei and Michaels, 2014; Buhaug, Gates and Lujala, 2009; Lujala, Gleditsch and Gilmore, 2005; Fearon, 2004; Lujala, 2009; Maystadt et al., 2013) but are understudied sources of heterogeneity in explanations of rebel evolution, including their demise (Jones and Libicki, 2008; Toft, Duero and Bieliauskas, 2010; Cronin, 2009; Gaibulloev and Sandler, 2014). If resources are vital to the onset and sustainment of violent insurrection, how are groups affected when resources become more costly to procure or run out entirely? Inherent to the termination of any insurgent group is a period of decline, characterized by a combination of battlefield losses, resource deprivation, and erosion of local or external support. Recent work in this vein has found that rebels facing battlefield or resource losses may be more abusive toward civilian populations (Hultman, 2007; Wood, 2014) and this increase in civilian victimization can further undermine opportunities for peace (Pearlman, 2009; Fortna, 2015; Findley and Young, 2015). Given that the goal of economic counterinsurgency is to downgrade the capabilities of insurgents, scholars and policymakers must explicitly study rebel behavior in periods of relative weakness.

To fill this gap, I present a theory of rebel behavior which explains when sanctions are likely to succeed in curtailing the violence of rebel groups and when sanctions may result in rebel groups increasing violence against civilians. My theory centers on heterogeneity across insurgent groups based on their economic portfolio's diversity and vulnerability and their foundational connections to local populations. An economic portfolio comprises all of a rebel groups' resource-generating tactics. Resource-generating tactics refer to the methods rebel groups use to acquire the money, personnel, weapons, shelter, logistical supplies, food, and other goods necessary for their violent and non-violent activities.[2] Economic sanctions

[2]I use the term resource-generating tactics instead of financing to denote the full range of resources that insurgents procure which goes beyond financial resources. Common tactics include soliciting donations, extortion, trafficking in commodities, kidnapping for ransom, legal business activities, exploitation of natural resources, smuggling, state sponsorship, and non-state sponsorship.

are designed to isolate targets from the global economy, and this impacts some resource-generating tactics more than others. I expect rebel groups with resource-generating tactics that require long transnational supply chains and groups with few sources of income to be especially vulnerable to economic sanctions, resulting in a reduction of net violence when targeted.

I move beyond prior studies of economic sanctions that only evaluate battlefield violence (Radtke and Jo, 2018; Escribà-Folch, 2010; Hultman and Peksen, 2017) and consider how economic coercion might affect violence against civilians. My theory builds on a growing literature that traces rebel group origins to variation in rebel groups' organizational structures and tactics (Staniland, 2012, 2014; Larson and Lewis, 2018; Braithwaite and Cunningham, 2020; Parkinson, 2013). This approach has two advantages. First, the pre-existing institutions that rebels emerge from have an enduring impact on a rebel group's organizational structures and connections to civilian populations (Staniland, 2012; Braithwaite and Cunningham, 2020). Understanding the origins of groups can elucidate their connections with local civilians that stem from shared experience in pre-existing institutions and flow along cultural, religious, political, or ethnic lines. Second, rebel group origins are relatively easy to observe and are not dynamic like other measures of organizational characteristics such as structure, leadership, and tactics (Braithwaite and Cunningham, 2020). Once a group's origins have been ascertained this information can help predict subsequent behavior. This should be particularly useful to policymakers, as other rebel features vary over time and require additional resources to continually track.

Civilians can provide valuable resources to insurgent groups including personnel, armaments, intelligence on government forces, abstaining from providing intelligence on the rebels to opposition forces, money, and access the supply networks beyond the rebels' territory. Groups formed from societal institutions have pre-existing connections with civilian populations that they can use to foster collaboration and persuade civilians to provide re-

sources to sustain the insurgency. Alternatively, rebel groups that were founded from prior violent non-state actors or from external economic endowments lack these ties and it will be difficult to build bridges with civilian populations. Instead, these groups tend to rely on coercion to maintain control over and extract resources from civilians (Weinstein, 2006; Wood, 2010; Salehyan, Siroky and Wood, 2014). When targeted by economic sanctions, I expect groups that formed from pre-existing societal institutions to maintain resource support by improving their behavior toward civilians and persuading civilians to supplement their resource losses. For groups lacking these connections, I expect they will seek to redress their losses by violently extracting resources from civilians.

I evaluate my theories using a dataset of insurgent group net violence and civilian victimization from 1998-2012 and the imposition of United Nations Security Council (UNSC) sanctions. This fine-grained data allows me to precisely test how sanction regimes impact specific rebel groups and measure the distinct violent behaviors of groups. Using a Bayesian multi-level model, I find support for several components of my theory. The results show that sanctions often work. Groups with few revenue streams reduce their levels of violence when targeted by economic sanctions, but groups with diverse funding sources are unaffected by sanctions. The empirical evaluation supports my hypotheses on group origins and violence against civilians. This finding should caution policymakers to carefully consider rebel group features when enacting sanctions as these policies are associated with increased violence against civilians from rebel groups whose foundations were not derived from pre-existing institutions in local communities.

This chapter makes several contributions to the study of targeted sanctions and rebel behavior. The existing body of knowledge on sanctions is dominated by state-centric theories and datasets (Peksen, 2019) and most studies conclude that sanctions are usually ineffective despite their popularity as a policy tool. I argue that these existing theories do not adequately explain the sanctioning process against insurgents and instead I offer a theory centered

around rebel groups. This theory highlights heterogeneity across rebel responses to financial constraints based on the diversity of their resource generating strategies and relationship with civilian populations. This approach is complimented with an appropriate measurement strategy. Existing studies of sanctions in the context of violent conflicts tend to focus on conflict-level sanctions and aggregated measures of violence at the country-level (Escribà-Folch, 2010; Hultman and Peksen, 2017).[3] This chapter focuses on sanctions targeting rebel groups and disaggregates rebel violence to understand how economic constraints force choices between violent tactics.

The results demonstrate that economic sanctions can be effective policy tools for reducing rebel violence, but the impact varies importantly across rebel features. Sanctions are most effective at reducing violence from groups with few sources of income. Economically robust insurgents can avoid the costs of sanctions or rely on alternative sources of funding to continue their violent operations. Sanctions curtail the battlefield violence of rebel groups, but predatory rebels will respond to economic constraints by violently extracting resources from civilian populations. Policymakers targeting rebels without ties to local communities may need to pair economic counterinsurgency with programs to protect civilians from potential backlash.

The next section describes the efficacy of sanctions broadly and their application to conflict reduction. Then I discuss where the process of sanctioning non-state actors diverges from the mechanisms of sanctions against states. The following section describes mobilization strategies of insurgent groups and their tactics for garnering resources and support from civilian populations. Building on this literature, I present my theory of insurgent tactics under targeted sanctions and heterogeneity across insurgent groups. The empirical section uses data on economic sanctions implemented by the United Nations and insurgent violence,

[3]A prominent exception is Radtke and Jo (2018) which analyzes rebel-specific economic sanctions and will be discussed more thoroughly in a later section.

finding support for my expectations. I conclude with a discussion of this study's limitations, avenues for further research, and the policy implications of the results.

2.2 Economic Sanctions and Civil Conflict

The United Nations Security Council (UNSC), regional economic bodies, and individual countries implement sanctions as a coercive tool to alter the target's behavior and restrict weaponry, economic activity, specific commodities, and travel by targeted entities and associated individuals. Most research into sanctions focuses on sanctions targeting states, and this research concludes that sanctions are often ineffective or counterproductive in changing states' behaviors (Mack and Khan, 2000; Peksen, 2009*a*; Hufbauer, Schott and Elliott, 1990; Peksen, 2019). Part of this poor track record can be attributed to a selection effect; states most likely to acquiesce to the demands do so before sanctions are implemented (Nooruddin, 2002). The sanctioning process can also be disrupted by incomplete implementation due to sanctions-busting (Early, 2015) and faces a targeting challenge, as those most impacted by the sanctions are not empowered to create political change (Mack and Khan, 2000). Sanctions targeting governments have produced negative side effects for civilian populations, including repression and physical integrity violations (Wood, 2008*b*; Peksen, 2009*b*; Peksen and Drury, 2009), worsening outcomes of public health, economic conditions and educational opportunities (Cortright et al., 1997; Weiss, 1999; Lopez and Cortright, 1995), and increased political violence and instability (Marinov, 2005; Choi and Luo, 2013). While individual states impose sanctions to further a range strategic goals, sanctions implemented by the UNSC have been largely focused on conflict reduction.

The United Nations Charter Chapter VII vests the Security Council with the authority to impose sanctions for the specific purpose to "maintain or restore international peace and security"(UN, 1945). The formal announcement of sanctions are complemented with strategies

for monitoring, identification of violations, and enforcement mechanisms. These monitoring and enforcement strategies are a primary reason why the United Nations and international institutions generally tend to produce more effective sanctions regimes than other multilateral actions or bilateral sanctions (Hufbauer, Schott and Elliott, 1990; Drezner, 2000; Miers and Morgan, 2002; Drury, 1998). Sanctions work by isolating targets from economic markets vital to their economy, so monitoring and punishing sanctions-busters is key element of enforcement. The Security Council implemented sanctions in approximately one third of resource-based conflicts from 1989-2006 (Le Billon and Nicholls, 2007) and, in 2009, the United Nations Environment Programme issued a report that argued "international sanctions should be the primary instrument dedicated to stopping the trade in conflict resources" (United Nations Environment Programme (UNEP), 2009). In the wake of the Cold War, the United Nations increasingly enacted sanctions regimes to quell violence in civil wars. The September 11, 2001 attacks on the World Trade Center ushered in a new era of sanctions and financial controls to counter the threat of transnational terrorist attacks. The United Nations, regional economic unions, and most individual states maintain some form of a terrorist exclusion list which includes provisions to freeze assets, block weaponry, and restrict travel for included entities and individuals.[4] The current UNSC consolidated sanctions list contains 305 entities and 708 individuals that are associated with ongoing sanctions regimes.[5]

UNSC sanctions regimes target rebel groups and individuals with diverse ideologies, organizational structures, sizes, and goals. Most sanctions regimes are associated with specific countries or conflicts. For example, the sanctions regime in the Democratic Republic of Congo[6] initially applied an arms embargo to all "foreign and Congolese armed groups and militias operating in North and South Kivu and Ituri, and to groups not party to the Global

[4]The UN maintains a sanctions regime concerning the Islamic State in Iraq and the Levant (ISIL or Da'esh), Al-Qa'ida and associated individuals, groups, undertakings and entities. Violent non-state actors may be added to this sanctions regime or regimes covering specific conflicts.

[5]The full list is available at https://scsanctions.un.org/consolidated/

[6]Pursuant to UNSC resolutions 1493, 1533, 1596, 1649, 1698, 1807, 1857, 2078, 2136

and All-inclusive agreement" (UNSC, 2003). This affected relatively large, well-financed ethnic rebel groups such as the Democratic Forces for the Liberation of Rwanda (FDLR) and lesser known small religious groups such as the Allied Democratic Forces (ADF) which only conducted occasional violent attacks. The mandate behind the ISIL (Da'esh) & Al-Qa'ida Sanctions Committee[7] is far broader, applying to any individual or entities associated with Al-Qa'ida or ISIL (Da'esh). Member states can petition to add any individual or entity to this list if they provide evidence of an association with these groups.[8] Within a sample of all 135 insurgent groups from the Big Allied and Dangerous (BAAD) II dataset, I found that 45 groups were subject to UNSC sanctions from 1998-2012. Table 2.6 in the appendix provides a comparison of the groups that have been sanctioned to those that have not. Rebel groups that were sanctioned in the sample tended to be far more violent overall, on average resulting in three times more battle fatalities and six times the civilian deaths compared to groups that were not sanctioned. This suggests that the UNSC might face pressure to act when violence flares and particularly if it targets civilians. These groups also tend to be younger, slightly larger in size, and exist in countries with lower GDP per capita and less democratic governments.

Although economic sanctions are often unsuccessful at changing state behavior, recent work on the UN's central goal of reducing violence and promoting peaceful resolutions to civil wars has found areas of limited success. The multilateral nature of UN sanctions and the monitoring and enforcement capabilities that an international institution provides may also enhance their likelihood of success as UN member states are expected to comply with sanctions regime and contribute to enforcement.[9] Sanctions are most successful at curtailing

[7]Pursuant to UNSC resolutions 1267, 1989, and 2253

[8]UNSC Resolution 2368 specifies acts and activities that quality as associations. These include: "Participating in the financing, planning, facilitating, preparing, or perpetrating of acts or activities by, in conjunction with, under the name of, on behalf of, or in support of; Supplying, selling or transferring arms and related materiel to; Recruiting for; or otherwise supporting acts or activities of, ISIL (Da'esh), Al-Qa'ida or any cell, affiliate, splinter group or derivative thereof." (UNSC, 2017)

[9]The empirical support for the relative efficacy of multilateral sanctions compared to unilateral sanctions

violence and reducing the duration of civil wars when combined with military or peacekeeping operations (Lektzian and Regan, 2016; Le Billon, 2012). Escribà-Folch (2010) evaluates 87 civil wars from 1959-1999 and determines that economic sanctions and arms embargoes can hasten the decline of civil wars. Sanctions regimes implemented by international organizations such at the UNSC or EU are also positively associated with negotiated settlements (Escribà-Folch, 2010). Sanctions bundled with other policy interventions, such as arms embargoes and military intervention, are the most likely to reduce battlefield violence (Hultman and Peksen, 2017). However, the record on intensity is mixed, Hultman and Peksen (2017) distinguishes the components that form targeted sanctions, demonstrating that economic sanctions are associated with increased intensity of violence, but arms embargoes reduce battlefield violence.[10]

Radtke and Jo (2018) analyzes UN economic sanctions that specifically target rebel groups, and finds evidence that sanctions can indirectly reduce rebel violence conditional on the rebel group's resource adaptability. Radtke and Jo (2018) defines resource adaptability as a rebel group's robustness to the severing of one of their financial strategies.[11] For example, in response to a 2012 UN embargo on charcoal exports, Al-Shabaab shifted their financial revenues to criminal activities such as extortion and piracy (Radtke and Jo, 2018; Levy and Yusuf, 2019). Adaptability is operationalized based on whether or not a group has external state-sponsorship, non-state sponsors (donations from diaspora communities),

is mixed. Despite the expectation that more compliance should ease enforcement challenges, most comparisons of regimes find that unilateral sanctions are more likely to be successful than ad hoc multilateral sanctions (Hufbauer, Schott and Elliott, 1990; Drezner, 2000; Miers and Morgan, 2002; Drury, 1998). However, international institutions, such as the United Nations, can enhance compliance and create monitoring mechanisms to oversee implementation of sanctions, leading to more successful regimes (Drezner, 2000; Bapat and Morgan, 2009).

[10]Most sanctions targeted at rebel groups include arms embargoes. All the sanctions analyzed in this paper are comprised of freezing assets, travel restrictions, and arms embargoes.

[11]This is operationalized as an additive scale indicating the number of income opportunities a group uses from external state sponsorship, non-state sponsors, territorial control, and access to natural resources. This concept is further measured through micro-analyses of National Union for the Total Independence of Angola (UNITA) and Al-Shabaab.

territorial control, and access to natural resources (Radtke and Jo, 2018). For rebels without diversified funding portfolios, the implementation of sanctions can contribute to territorial losses and reduced levels of violence. However, sanctions do not reduce the violence of highly adaptable rebel groups that can divert financing to other strategies (Radtke and Jo, 2018). Together, these studies present mixed expectations over the impact of sanctions on violent conflict.

2.3 Sanctioning Non-State Actors

Economic sanctions and other forms of economic counterinsurgency against rebels are fundamentally different from economic coercion targeting states. A sanctions episode against a state actor generally begins with a negotiation phase in which the initiating actor threatens to sanction the target if a specific policy concession is not granted. Some literature suggests this phase is where potential sanctions are most likely to succeed in extracting policy concessions (Nooruddin, 2002). If the sanction is successful in this phase, the threat is sufficient and the sanction is never implemented. Alternatively, states can impose sanctions and create reputation and material costs for the target. Financial controls or embargoes are intended to raise economic costs for the target by isolating the target from important export and import markets and straining political and economic systems. Sanctions are also a form of "naming and shaming," tarnishing the target's reputation on the international stage and making the business of international relations more difficult. Imposed sanctions succeed when they create high enough costs that targets will agree to policy concessions in exchange for lifting the sanction.

The steps involved in sanctions against non-state actors follow a distinct process from sanctions against state actors. While some sanctions regimes against non-state actors are tied to specific policy-goals, the goal of economic counterinsurgency is generally to downgrade

and eliminate the group rather than a coercive tool to alter the behavior of an actor that will remain in the international system. For example, most entities and individuals targeted by the UNSC are added through the Al-Qa'ida or ISIL (Da'esh) sanctions list which includes groups based on their associated with Al-Qa'ida or ISIL. These sanctions are rarely tied to specific policy concessions that insurgent groups can grant in order to regain access to legitimate financial markets. Some sanctioning actors, for example the United States, publicly refuse to even engage with a group that has been listed under their terrorist designation list. This difference in objective changes the stages in the sanctioning process. Sanctions against violent non-state actors contain no threat stage, as this would undermine their efficacy in freezing the assets of insurgents and their financiers. Designating groups and individuals to the UNSC ISIL (Da'esh) and Al-Qa'ida Sanction regime is a confidential process, and once a listing request has been approved, member states are expected to implement sanctioning measures without delay, although this is not always achieved.[12]

Sanctions specifically targeting violent non-state groups are rarely lifted, thus eliminating the potential rewards for compliance.[13] Once listed, some states explicitly refuse to negotiate with designated groups, further diminishing a rebel group's incentives to change its behavior. As with state sanctions, the financial controls can be costly for insurgent groups, forcing them to seek out alternative sources of income or armaments as supply chains are targeted and assets frozen. However, the naming and shaming associated with publicly listing groups could have the opposite effect for terrorist and rebel groups. Adding groups to terrorist exclusion lists and sanctions regimes creates additional publicity for the group and opportunities for it to extend their propaganda to a wider audience, which is a key goal of many terrorist groups. The infamy associated with these lists might signal the prowess of listed groups,

[12]According to a recent report from the Counter-Terrorism Committee Executive Directorate and the Analytical Support and Sanctions Monitoring Team, most governments interpret "without delay" as within 24 hours or less. The full report is available at http://undocs.org/S/2020/493

[13]There are important exceptions, for example Mujaheddin-e Khalq (MEK) campaigned for decades to be removed from the United States Foreign Terrorist Organizations and the request was finally granted in 2012.

leading to increased donations or drawing support away from rival groups and undermining the original intention of financial blockades.

The literature on state sanctions does guide this evaluation in two areas. First, theories of state sanctions evaluate how regime characteristics shape responses to economic coercion (Brooks, 2002; Peksen, 2019). Expectations of sanctions against non-state actors must also be grounded in understandings of rebel organization and governance. A key component of my theory of rebel behavior centers on differences how rebel groups exert control over civilian populations. Second, the literature on state sanctions has identified important unintended consequences of state sanctions such as deterioration of human rights (Wood, 2008*b*; Peksen, 2009*b*; Peksen and Drury, 2009) and worse social outcomes (Cortright et al., 1997; Weiss, 1999; Lopez and Cortright, 1995). This chapter also considers the side effects of sanctions and how they might impact insurgent groups incentives for targeting civilians. Specifically, I evaluate whether rebels attempt to supplement resource losses by violently targeting civilian populations and coercively extracting resources.

Measuring the impact of sanctions on rebels poses a unique challenge compared to states. Unlike policy concessions which can be observable, sanctions targeting rebels are only successful if they are able to effectively block the material resources of the group. Insurgent groups are covert organizations, carefully guarding their funding sources and holding private knowledge of their relative economic, political, and military strength. It is difficult to analyze whether a specific sanction can effectively block an insurgent leader's access to financial resources or weapons. Many rebel behaviors, for example their violent acts, are observable, but their underlying capabilities and strategies are latent. An observable change in rebel production of violence may reflect a resource deficiency, a shift in underlying strategies and associated tactics, a change in the government's counterinsurgency and intelligence capabilities or some interaction of all the above.

Due to these challenges, the goal of this research is to measure changes in rebel production

of violence associated with the implementation of a sanction rather than attempt to measure the amount of resources that have been blocked by a given sanction. I evaluate rebel groups net violence as the best representation of their ability to produce violence. Then I consider potential side effects produced by rebels operating under economic deprivation, such as victimizing civilian populations to acquire resources. I argue that an insurgent group's economic portfolio and origins, will affect its violent tactics against governments and civilians in response to economic counterinsurgency.

2.4 Rebel Groups Resources and Tactics

This section reviews rebel groups' resource-generating tactics and the literature on civilian victimization in contexts of civil conflict. Asymmetric power is a central theme in intrastate conflict, with governments controlling a relative abundance of the country's wealth, security sector, infrastructure, and legitimacy. To overcome the imbalance in raw capabilities, rebel entrepreneurs innovate. They mobilize their labor force from untrained civilians and employ unconventional tactics that require cheaper inputs–improvised explosive devises (IEDs) and explosive-laden vehicles substitute for tanks and aircraft. Financing a sustained insurgency is expensive; according to the Global Terrorism Index. the annual revenues for the four most prolific insurgent groups range from $2 billion to $25 million (The Institute for Economics & Peace, 2017).[14] Funding is absorbed into recruiting, training, feeding, housing, and paying an often novice army of fighters; acquiring arms, ammunition, vehicles, and technology; financing individual attacks, and supporting any parallel non-violent activities such as political participation or social service provision.

Insurgents engage in a range of legal and illicit activities to procure funding for their

[14]In 2017, the Islamic State topped the list with $2 billion, the Taliban earned $400 million, Al-Qa'ida's revenues were $250 million and Boko Haram had an income of $25 million (The Institute for Economics & Peace, 2017).

violent endeavors. Rebel entrepreneurs capitalize on religious principles of tithes and zakat to illicit donations from supporters close and abroad. For decades, the Provisional Irish Republican Army relied on donations from Catholic Americans to fund their violent campaign in Northern Ireland (Horgan and Taylor, 1999) and Al-Qa'ida's funding prior to 9/11 was derived in large part from donations (Kean, Hamilton et al., 2004). Civilians can also be forced into footing the bill of their oppressors through extortion–under threat of violence or promise of protection–robbery, and seizure of property or goods. Extortion encompasses a range of coercive or bureaucratic taxation activities. For example, extortion is the Taliban's second most lucrative source of income and consists of a 2.5% tax on wealth (zakat), taxes on goods, and fees for services such as electricity and water–this final fee regardless of the Taliban's role in actually providing the service (The Institute for Economics & Peace, 2017). Other funding strategies include the exploitation of natural resources, trafficking in commodities, abduction and ransom, extortion of businesses and state sponsorship (Freeman, 2011; Raphaeli, 2003).

Rebel groups rely on local civilian populations for many resources including personnel, intelligence, and financing and their strategies for extracting resources from civilian populations has been the focus of much scholarship (Weinstein, 2006). Rebel entrepreneurs contesting a government must overcome a classic collective action problem to mobilize a labor force for rebellion. Civilians supportive of the rebel cause can gain the benefits of successful rebellion–ousting the government–without shouldering the costs of insurgency. Successful rebel entrepreneurs overcome this problem by using their underlying economic and social endowments to provide a bundle of selective incentives to recruits (Olson, 1965; Lichbach, 1998; Weinstein, 2006). The opportunity cost model suggests that rebels with an abundance of economic goods, for example from exploiting natural resources or foreign patronage, more easily resolve their collective action problems by offering wages and opportunities for looting and predation that exceed expected earnings through economic activity in society (Collier

and Hoeffler, 2004; Humphreys and Weinstein, 2006). Under this logic, a potential recruit weighs the risks, benefits, and wages in society versus those available through rebellion and will choose rebellion if it maximizes the economic return to their labor. Leaders lacking these endowments face a daunting mobilization process, but those who overcome it do so by leveraging their social capital, pulling on religious or ethnic ties that imbue trust and interdependence between leaders, recruits, and their communities.

Resource-rich rebels tend to attract opportunistic soldiers seeking consistent economic payoffs, while rebels defined by non-monetary commonalities share a disciplined commitment to victory and the bounty of political and economic power that would accompany it (Weinstein, 2006). Access to natural resources, particularly those that are easily lootable–such as diamonds, minerals, and drugs–are an opportunity to provide wages, purchase weaponry, and sustain insurgency that might not otherwise be possible for groups lacking in social capital. To sustain a supply of labor, rebel leaders must maintain payments to combatants while continually recruiting new members to replace those soldiers who perish in violent operations. Groups with recruitment and retainment packages skewed toward social capital will more successfully maintain their labor supply in the face of economic downturn because their payoffs are not purely wage-based. These movements tend to attract and select a higher caliber of soldier who is more devoted to long term victory than short term wages (Weinstein, 2006).

In contrast to theories of resource endowments driving organizational structure, Staniland (2012, 2014) argues that social bases form the organizational structures of rebel groups which create discipline and cohesion. Rebel groups can draw membership, organizing strategies, and leadership from pre-existing organizations such as political parties, student movements, religious organizations, government military and non-military structures and ethnic organizations. The vertical and horizontal organizational structures of these institutions are reflected in the rebel groups that come after them (Staniland, 2012, 2014). These underly-

ing organizational structures influence the cohesion and discipline of insurgent groups, and connections with civilians determine how resource wealth impacts a rebel group (Staniland, 2012; Larson and Lewis, 2018; Braithwaite and Cunningham, 2020; Parkinson, 2013). Institutions such as kinship networks can help emerging rebel groups bolster their reputation with civilian populations and persuade civilians to support the insurgent group by forgoing intelligence sharing with government or other opposition forces (Larson and Lewis, 2018).

These two theoretical views converge in agreement that insurgent groups' organizational characteristics affect the tactics they employ to maintain their relationships with and exert control over civilian populations. Civilian populations provide resources vital to sustaining rebellion. Civilians make up the labor and financial supply for groups and provide information such as local knowledge of terrain or intelligence on government activities. Maintaining the support of civilian populations and reducing civilian coordination with the government can sustain an insurgency and reduce the success of government counterinsurgency operations. Economically-endowed rebel groups are more prone to coercive measures of maintaining civilian compliance (Weinstein, 2006; Humphreys and Weinstein, 2006). These groups lack the hard-earned social ties with local communities, so they are unable to persuade civilians to support them without the fear-evoking threat of violence. Rebel groups funded by foreign sponsors and through the exploitation of natural resources often fail to develop mutually beneficial ties with local civilians and are more likely use violence against civilian populations (Weinstein, 2006; Wood, 2010; Salehyan, Siroky and Wood, 2014).

Alternatively, some explanations of rebel violence against civilians are not derived from inherent organizational characteristics, but instead focus on the dynamics of war and resources available in the current environment (Azam and Hoeffler, 2002; Bueno de Mesquita, 2013; Hultman, 2007; Faulkner, 2016). Conventional violence against a military force is far more capital and labor intensive than irregular tactics, such as terrorism, that can be launched against a range of targets–military, police, civilians, foreign dignitaries, businesses–

with influence over government policies (Bueno de Mesquita, 2013). The use of terrorism and civilian predation in particular are thought to signal a group's inability to engage traditional military targets, a sign of weakness and earning terrorism the moniker "weapon of the weak" (Crenshaw, 1981).[15] Hultman (2007) argues that insurgents attack civilians not to extract compliance or punish coordination with the government, but as a way of inflicting costs on the government when their battlefield operations are unsuccessful. These battlefield or material losses from engagement with government forces has been shown to increase subsequent civilian targeting by the weakened challenger (Hultman, 2007; Wood, 2014) [16] The logic of substitution in periods of weakness can extend to other proxies for government forces, such as peacekeeping forces (Fjelde, Hultman and Lindberg Bromley, 2016).

External actors can also affect the balance of capabilities between a challenger and government, leading to shifts in each belligerents' strategy. Military, diplomatic, and economic interventions in favor of one belligerent tend to increase that actor's likelihood of winning albeit at the risk of prolonging the duration of conflict or reducing the chances for negotiated settlements (Balch-Lindsay, Enterline and Joyce, 2008; Regan and Aydin, 2006; Lektzian and Regan, 2016; Sawyer, Cunningham and Reed, 2017). Asymmetric military interventions decrease civilian targeted by the bolstered side, but increase the use of civilian victimization by their opponent, demonstrating both government and rebel propensity to rely on these tactics as the balance of power shift unfavorably (Wood, Kathman and Gent, 2012).

My research question sits at the nexus of these theoretical arguments. I evaluate a third-

[15]Although elements of the weapon of the weak argument are well disputed, there is evidence for the central notion of this label: terrorism is a relatively cheap and easy form of violence. According to a report from the Wilson Center, it costs $6,000-$12,000 USD annually to supply, feed, and house a single combatant in the Revolutionary Armed Forces of Colombia (FARC) (Otis, 2014). A North Atlantic Treat Organization (NATO) report estimates the average cost of a suicide attack, a particularly lethal form of terrorism, is approximately $150 USD. Report available at https://www.nato.int/docu/review/2008/04/EN/index.htm. Note: this estimate excludes the cost of replacing the combatant and any martyrdom benefit that the group pays to the attackers beneficiaries.

[16]The definition of material losses in Wood (2014) includes solider fatalities and capture, loss of territory, and destruction of camps or supply stores.

party intervention that I expect will alter the conflict environment in which rebel groups operate. However, unlike dynamic arguments that predict uniform responses to changes in conflict dynamics, I expect a rebel groups' behaviors in response to shifting resources to be derived from its inherent organizational characteristics which I argue can be predicted based on the conditions of its founding. As such, I draw on both organizational and dynamic theories of rebel violence to evaluate rebel heterogeneity in response to economic sanctions.

2.5 Theory of Rebel Violence under Economic Sanctions

My theory integrates dynamic perspectives of rebel violence into Staniland (2012)'s social-institutional theory of rebel organizations. In line with Staniland (2012) and in contrast to Weinstein (2006), I seek to separate a group's economic portfolio from its organizational structure. First, I evaluate how the impact of economic sanctions on a rebel group's availability of resources may be intensified or attenuated by the diversity and vulnerability of its economic portfolios. A group's economic portfolio comprises all the strategies it uses to obtain the resources necessary for insurgency. Economic portfolios vary based on the characteristics of individual funding streams and the diversity of the overall portfolio. Then I evaluate how the group's foundational origins will shape its response to economic sanctions, focusing on its ability to violently or non-violently extract resources from civilian populations. I create three indicators of a group's origins. One builds on prior work on resource endowments (Weinstein, 2006; Wood, 2010; Salehyan, Siroky and Wood, 2014) using natural resources and state sponsorship as a sign of groups that are unlikely to have strong institutional ties with civilian populations. A benefit of this measure is its wide use in the conflict literature, but a limitation is the reintegration of economic measures as a proxy for organizational characteristics. To complement this measurement strategy, I use the FORGE data source for my other two variables. This data directly measures the pre-existing social

organizations that rebel groups were built upon (Braithwaite and Cunningham, 2020).

Economic sanctions against violent non-state actors work by isolating the target from the legitimate economy. This isolation is achieved through the cooperation of states, inter-government organizations, financial entities (such as banks and informal money transfer systems), and other private businesses dealing in resources relevant to the sanctions. I call this collection of actors *enforcers*. Economic sanctions generally comprise asset freezes of all economic resources owned by the target, travel bans that prohibit entry or transit through all enforcer states, and arms embargoes that require states prevent the direct or indirect sale, shipment, or transfer of armament and related materials (for example spare parts that could be used for military purposes) within their state or by their nationals transportation vehicles. Some sanctions regimes include additional provisions tailored to the funding strategies known to be employed by the target. For example, the Somalia Sanctions Committee (pursuant to UNSC resolution 751) added a provision banning the import of charcoal originating from Somalia due to Al-Shabaab's exploitation of the charcoal exports as a revenue source (UNSC, 2012).

Every country and non-state enforcer involved in the relevant sector of the economy must agree to implement these provisions for the regime to succeed. Adhering to sanctions provisions can be costly, as enforcers must forgo the benefits of transacting with the target and establish robust monitoring and enforcement capabilities to conduct the oversight required. The refusal of one government to uphold sanctions on a violent non-state actor can pose a significant challenge for enforcement, as this provides access to resources in the non-compliant market and an opportunity to traffic embargoed goods through the non-sanctioned economy and reach global markets (Early, 2015). However, enforcers exist within the larger network of the global economy, and refusal to enforce sanctions could result in cascading economic isolation or other punitive measures. For example, the European Union maintains a "black-list" of high-risk countries that are deemed insufficient in their efforts to counter the financing

of terrorism and implement international sanctions.[17] Companies and countries within the EU must conduct enhanced vigilance requirements when transacting with designated countries. Sanctions work best when intermediary actors along a rebel group's supply chain are vulnerable to financial exclusion, reputation costs, or punitive measures and decide to sever economic ties with the rebel group as the least costly option.

These features of economic sanctions make them more tailored to disrupt some types of resource-generating tactics than others. The global anti-money laundering and countering the financing of terrorism regime was constructed specifically to target terrorist and criminal exploitation of global supply chains and resource-generating tactics that involve transactions across borders. Economic sanctions are a component of these wider efforts and should be most effective at targeted resource-generating tactics that rely on global supply chains and the cross boarder transfer of goods or funds. This includes the common financing methods of drug trafficking, smuggling, state sponsorship, and donations. Each of these funding mechanisms has some unique characteristics that requires further elaboration.

Drug Trafficking: Drug trafficking involves the cultivation, manufacturing, transportation, and sale of drugs and plants from which drugs are derived including opiates, cocaine, amphetamine-type stimulants, and cannabis. Insurgent organizations may be involved at any level of the supply chain, including taxation and protection services for farmers, maintaining farms themselves, smuggling drugs, and selling to customers. Drug trafficking involves sprawling global networks for the transit of goods, traversing both the black market and legitimate trade routes. According to the United Nations Office on Drugs and Crime, opiates cultivated in Afghanistan which have long been a revenue stream of the Taliban, flow through established routes by land, sea, and plane to Russia, Europe, China, Africa, Australia, Canada and the United States. These

[17] A current list is available at https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/anti-money-laundering-and-counter-terrorist-financing/eu-policy-high-risk-third-countries_en

lengthy routes provide multiple opportunities for customs and border enforcement to intercept the drugs. From cultivation to end users there are many opportunities for law enforcement to disrupt these revenue streams and disrupting the drug trade has been a top priority of governments. For example, in 2009 law enforcement bodies were able to confiscate 76 tons of heroin representing 2-16% of global heroin flows (UNOCD, 2010).

Smuggling: Smuggling refers to the illegal transportation and sale of any good (excluding drugs). Rebel groups have funded their operations by smuggling diamonds (ex: Hezbollah, Al-Qa'ida), artifacts (ex: Islamic State), lumber (ex: Revolutionary United Front, Rally for Congolese Democracy;), human trafficking (ex: Boko Haram, Islamic State, Haqqani Network, Revolutionary Armed Forces of Columbia),[18] cigarettes (ex: Al-Qa'ida in the Islamic Maghreb), matériel, and other goods. Smuggling involves the transfer of legal or illicit goods or persons across international borders by land, sea, and air, in violation of customs and trade regulations. This funding strategy requires confronting or circumventing the front-line enforcers of sanctions, border police and customs inspectors. Smugglers may try to disguise goods and transport them through authorized border crossings or attempt to cross borders at unmonitored points of entry. Either strategy provides opportunities for interdiction. For example, in December 2020 Interpol and UNOCD conducted a seven-day joint operation covering airports, seaports, and land borders in West Africa (UNODC, 2020). Law enforcement officials arrested smugglers and confiscated 50 firearms, 40,593 sticks of dynamite, 28 detonator cords, 6,162 rounds of ammunition, 1,473 kilos of drugs, 2,263 boxes of contraband drugs, and 60,000 liters of contraband fuel (UNODC, 2020).

State-Sponsorship: The state-sponsorship of rebel groups has received ample attention

[18]For further information on human trafficking, see Avdan and Omelicheva (2021)

in the terrorism literature and was a particularly common financial strategy during the Cold War (Carter and Pant, 2019; Salehyan, Siroky and Wood, 2014; Salehyan, Gleditsch and Cunningham, 2011; Carter, 2012; Byman, 2005). In these cases, states provide funding, sanctuary, armaments, intelligence, and logistics to support an insurgent group that can further the geo-political goals of the sponsor-state. These relationships tend to be relatively weak and undependable (Carter and Pant, 2019) allowing governments to deny the relationship exits or sever it if the rebel groups are difficult to control or their interests diverge (Byman, 2005; Carter, 2012). Economic sanctions increase the costs of sponsoring a rebel group. Sponsor states will have to violate international sanctions to continue providing support for the rebel group and risk financial exclusion or punitive measures for their non-compliance. For example, the Libyan government under Muammar Gaddafi began sponsoring terrorist groups in the 1980s including financing prominent attacks on flights UTA 772 and Pan Am 103 (also known as the Lockerbie bombing) (Collins, 2004). In response, the UNSC applied economic sanctions on Libya in 1992 (pursuant to resolutions 731, 748, and 883) and this sanctions regime was sufficiently costly that Gaddafi offered concessions and abandoned his policy of supporting terrorism (Collins, 2004). State-sponsorship is vulnerable as the sponsors interests do not perfectly align with the rebels and states can succumb to international pressure.

Donations: Donations from domestic and international supporters and adherents is a common financing strategy. Donations often travel through diaspora communities, charities, and religious networks. After 9/11, donations and charity networks became a significant target of law enforcement efforts and this focus has integrated into the subsequent infrastructure for economic sanctions and other forms of economic counterinsurgency. For example, the UNSC sanctions regime in the Democratic Republic

of Congo (pursuant to resolution 1533) requires all states to "ensure that no funds, financial assets or economic resources are made available by their nationals or by any persons within their territories, to or for the benefit of such persons or entities" (UNSC, 2008). The United States overzealous enforcement of provisions aimed to disrupt donation networks led to the Treasury Department using sanctions, office raids, asset freezes, and judicial procedures to dismantle Al-Barakaat, an informal value transfer system based in the United Arab Emirates (Passas and Maimbo, 2007). Al-Barakaat was the primary avenue facilitating remittance flows and United Nations relief funds to embattled Somalia, and the broad overreach of the United States authorities in dismantling the network further imperiled Somalians already dealing with a humanitarian crisis and had wide ranging negative consequences for diaspora communities around the globe (Passas and Maimbo, 2007).

The ability of sanctions enforcers to disrupt these resource-generating tactics are imperfect and suffer from many enforcement challenges including sanctions-busting and difficulties maintaining compliance, lack of resources, and inability to monitor transactions. However, these resource-generating tactics have supply chain features that make them vulnerable to potential disruption, and there are numerous cases of enforcement authorities successfully attenuating or blocking these revenue streams.

Alternatively, there are some funding streams that should be particularly difficult for international economic counterinsurgency bodies and enforcers to monitor and interdict. These funding streams can flourish completely within regions under the control of the insurgent group or within the broader domestic context. The first is petty crime and robbery, which is difficult to systemically block and relies more on local law enforcement. The second strategy is abduction for ransom. Although some groups specialize in abducting foreign nations, most abductions are local. For international abductions, there exits a whole in-

dustry around paying ransoms and recovering abducted nationals. Some countries such as the United States and United Kingdom abstain from these transactions and threaten to prosecute ransom payments under terrorism provision. However, most have continued to pay ransoms despite involvement in the international economic counterinsurgency regime. Private companies that operate in dangerous areas purchase kidnap and ransom insurance (K&R) to cover ransoms because these incidents have become so routine. Finally, I expect extortion strategies to be relativity difficult to disrupt even if extortion sometimes includes taxation on goods with longer supply chains. Extortion involves taxation under threat of punishment or in exchange for protection services generally over certain areas of economic activity. These funding schemes are most prevalent in areas under control by the insurgent group where extortion operations often parallel the taxation policies of a government.

In many cases these revenue streams flow directly from the victim to the insurgent group. With petty-crime, robbery, and extortion, the payoff is immediate and there is no reliance on the financial system or need to traverse regional or national borders. Kidnap and ransom efforts often target locals and in those cases has the same characteristics. International kidnap and ransom efforts do require more intricate transfers of funds and intermediary actors (for example K&R insurance companies or governments), but for most target nationalities these schemes have successfully continued unabated by government participation in economic sanctions regimes.

I expect economic portfolios that are comprised of resource-generating tactics with long supply chains and cross-boarder transactions to be especially vulnerable to economic sanctions as these revenue streams rely on access to the wider world economy. These connections are exactly what economic sanctions were created to sever. Alternatively, economic portfolios with a higher ratio of domestic-based funding tactics will be relatively more resilient to economic sanctions

The depth of a group's overall economic portfolio should also impact its resilience to eco-

nomic sanctions. Diversification of revenue is a common risk management strategy employed by individuals, businesses, and investors to minimize the risk of any set of assets. I expect this principle to apply to insurgent groups as well. Trinkunas (2019) argues that diversification has always been a strategy of insurgent groups because "overreliance on any one source made them vulnerable to external pressure" (Trinkunas, 2019). There is some trade-off in the cost of maintaining multiple financing streams, but these efforts will be rewarded when economic counterinsurgency successfully disrupts one or more of the group's funding streams. Groups with multiple funding streams will have alternative sources of income should they loss access to one of their sources of revenue. Radtke and Jo (2018) describes these groups as more adaptable, as they are able to secure alternative sources of funding if sanctions do effectively cut off access to one financial strategy.

For example, Al-Shabaab has multiple funding streams including the trafficking of commodities, petty crime, extortion, and state sponsorship and operates in areas with poor government capacity and financial controls. Al-Shabaab was financially diversified enough to withstand sanctions implemented in 2010 and strengthened in 2012, resulting in no observable changes to their violent activities (Radtke and Jo, 2018). Ceteris paribus, a group with diversified sources of income will be more robust to sanctions compared to one without multiple funding streams.

Hypothesis 1: Targeted sanctions will reduce violence from groups that are not economically diversified.

Hypothesis 2: Targeted sanctions will have no effect on the violence of economically diversified rebel groups.

Hypothesis 3: Targeted sanctions will reduce violence for groups with a high proportion of cross-national funding streams.

Hypothesis 4: Targeted sanctions will have no effect on the violence of groups

with a high proportion of domestic funding streams.

Insurgent groups have a toolbox of violent and non-violent tactics to choose from in furtherance of their goals. My theory moves beyond prior studies of economic sanctions which only evaluate battlefield violence (Radtke and Jo, 2018; Escribà-Folch, 2010; Hultman and Peksen, 2017), to consider how sanctions might also impact rebel groups use of violence against civilians. The literature on civil wars and civilian victimization provides many explanations for violence against civilians.[19] Insurgent groups may strategically target civilians to exert control and extract resources (Weinstein, 2006; Wood, 2010; Salehyan, Siroky and Wood, 2014), raise costs and create leverage over their government opponents (Kydd and Walter, 2006), spoil peace processes (Pearlman, 2009; Fortna, 2015; Findley and Young, 2015), or demonstrate their dedication to a cause compared to rival groups (Bloom, 2005; Chenoweth, 2010; Nemeth, 2014; Kydd and Walter, 2006). My theory builds upon the strategic framework in which violence is one strategy that insurgents can employ to control and extract resources from local populations.

Local civilians can provide a range of resources for insurgent groups, including personnel, funding and smuggling routes, food, shelter, intelligence on local terrain, allegiances of community members, and knowledge of the government or other opponents. Civilians also collect intelligence on the insurgent group's actions and whereabouts, which can be valuable to opposition forces, so their secrecy is another important resource (Berman and Matanock, 2015; Larson and Lewis, 2018). Rebel leaders have two broad strategies for gaining the compliance of local civilian populations: coercion and persuasion. Coercion involves the use or threat of violence, retaliation, or punitive measure to create control by fear. Persuasion requires rebel groups build or maintain ties with local communities in order to align objectives and provide protection, services, or other benefits in exchange for civilian resources.

[19]For a recent review articles see Balcells and Stanton (2021); Nordås and Cohen (2021)

Recent work has highlighted the importance of rebel groups' origins in determining their organizational structures and tactics they use to acquire resources from local populations (Staniland, 2012, 2014; Larson and Lewis, 2018; Braithwaite and Cunningham, 2020; Parkinson, 2013). Most rebel organizations are created out of some formal or informal pre-existing organizations that provide structures and intragroup connections that can help leaders overcoming mobilization challenges (Braithwaite and Cunningham, 2020). While these social networks may be transformed over the course of the conflict Wood (2008*a*) they provide a foundation of shared values, interests, or simply acquaintance that rebel entrepreneurs can use to build trust and exercise persuasion (Parkinson, 2013). Common founding organizations include political parties or movements, religious groups, trade unions, student organizations, military, and regional governments. These pre-existing institutions provide a foundation of shared interests, avenues of communication, and interpersonal relationships between insurgent group leaders and members of civil society. Groups that have connections to broader civilian networks tend to rely more on persuasion to elicit support and resources from civilians rather than violence.

Alternatively, rebel groups may have formed outside of local institutions. Groups that were not founded from pre-existing organizations that have connections to local civilians may have splintered from a prior violent non-state actor (Braithwaite and Cunningham, 2020) or formed around the exploitation of a unique resource opportunity such as natural resources or at the behest of a foreign government (Weinstein, 2006). These rebel groups tend to be disconnected from local communities, viewing them antagonistically rather than creating a shared vision of success against the government. When these rebel groups require resources from civilian populations the only strategy available to them is coercion, using violence to create fear and demand compliance with rebel group demands (Weinstein, 2006; Wood, 2010; Salehyan, Siroky and Wood, 2014).

Economic sanctions pose a challenge for organizations that rely on persuasion to elicit

support and resources from civilian populations. A secondary goal of economic sanctions is to damage the reputation of the target, and the United Nations announces economic sanctions regimes while naming and shaming the negative behavior of the target. Although these effects are strongest against states, groups that rely on persuasion to attract support from local civilians are particularly vulnerable to fluctuations in civilian attitudes. Civilians who turn against rebels can provide valuable information to government forces (Larson and Lewis, 2018) and this information will be particularly costly when the rebel is facing economic constraints brought on by sanctions. Thus, economic sanctions impact a groups' resource-generating tactics and may undermine the positive image they have cultivated with civilian populations. To maintain support and convincingly dispel the negative narrative that accompanies the United Nations' international condemnation, rebel groups must improve any behaviors that civilians could view as supporting the United Nations narrative. If successful, the reputational costs of economic sanctions may even backfire on counterinsurgents. These naming and shaming aspects of terrorist designations or targeted sanctions may raise the profile of the organization, signaling their ideological integrity or physical prowess, and encouraging supporters to "rally around the flag." This can galvanize civilian networks to provide additional support and enhance the rebel group's available resources.

Facing economic sanctions, groups lacking institutional ties to civilians will have few strategies available to recoup their potential losses. Relationships with local communities require trust and shared interests which develop over time through iterated reciprocal interactions. Predatory groups facing economic constraints cannot use persuasion or shared social networks to seek resources from civilian populations. These groups may attempt to strategically offload their economic losses onto civilian populations, violently extracting more resources to supplement losses in other income steams. In periods of economic decline rebels are particularly vulnerable to other forms of counterinsurgency and may increase coercive measures to dissuade or punish civilian cooperation with government forces. The imposition

of sanctions may also be viewed as a signal of civilian populations coordination with government forces. I expect economic sanctions against groups originating from local institutions to further in-debts rebels to their peaceful compatriots, whereas economic losses will reinforce a disconnected rebel groups coercive strategy.

Hypothesis 5: Targeted sanctions imposed on rebels originating from local societal institutions will decrease rebel attacks on civilians.

Hypothesis 6: Targeted sanctions imposed on rebels without foundational ties to local communities will increase violence against civilians.

2.6 Empirical Strategy

To evaluate my hypotheses, I use fine-grained data at the rebel-month unit of analysis. This provides a far more precise measure of my theory compared to studies that evaluate economic sanctions at the conflict or country level. To construct my sample, I use the Big Allied and Dangerous (BAAD)II Insurgency dataset from 1998-2012 (Asal, Rethemeyer and Schoon, 2019). BAAD Insurgency II is an actor-level dataset covering all insurgent groups active in Uppsala Conflict Data Program (UCDP) battles from 1998-2012.[20] This sample is advantageous because it is limited to insurgent groups (violent non-state actors contesting governments), but is not restricted to civil war periods so BAAD II contains group-level information in all years the group is active. Few insurgent groups fully demobilize after civil war termination and they continue to maintain capacity to conduct violent operations against civilians and government forces. The sample contains 135 groups across 49 countries resulting in 16,640 rebel-month observations. Groups are included in the sample beginning the year of their official founding, if known, or the first year they perpetrate violence and are

[20]The inclusion criteria is based on greater than 25 battle deaths in the UCDP battle-deaths dataset. For more information about the dataset see the hrefhttps://www.start.umd.edu/sites/default/files/files/BAADCodebook.pdfcodeook

removed from the sample once they formally disband, transition to a non-violent political entity, no longer perpetrate violence, or no information can be found to confirm the group's existence. Groups that persist before or beyond the time period are included for the full period.[21]

Rebel violence is disaggregated into two outcome variables to better understand how sanctions affect the full conflict theater. The UCDP Georeferenced Event Dataset (GED) provides fine-grained incident-level data on violence perpetrated by insurgent groups and governments. I aggregate individual incidents to the month-rebel level to create a monthly count of each outcome variable. *All Violence* measures the net fatalities associated with that group-month. This includes violence perpetrated against civilians, governments, and other rebel groups. This measure best captures the group's aggregate capacity to perpetrate violence in a given month. The primary limitation of this data is the lack of directionality in determining which actor initiated conflict.[22] A decrease in violence against governments or clashes with rebel groups could represent a shift in rebel tactics or capacity or might indicate a change in government counterinsurgency strategy. Despite these challenges, the UCDP data is the standard for measuring conflict intensity and the dyadic measure is an improvement over analyses that rely on country-level intensity measures.

The second outcome variable measures the fatalities from intentional attacks against civilians.[23] The GED dataset provides data on rebel-initiated one-sided violence against civilians. *Civilian Fatalities* measures the fatalities resulting from the specific rebel's attacks against civilians in a given month. Unlike the data on rebel clashes or battlefield violence, this

[21]Three groups only exist in the data for one year and 56 exist for the full time period. The average number of months a group is included is 120 (approximately 10 year) and the median is 138 months.

[22]To the author's knowledge there is no comprehensive dataset that disaggregates battles or clashes based on the initiating side. There are significant information challenges in creating such data as news sources in conflict settings are scarce and coverage may reflect the interests of governments or rebel groups that allow news organizations and journalists to safely operate. This commonly leads to conflicting reporting and completing claims over the perpetrator of a given attack

[23]This measure is distinct from civilian casualties that may be the result of collateral damage during battles between government and rebel forces.

data is directional. This measure allows me to isolate the intensity of violence perpetrated by the rebel group and highlights their strategy toward civilians. Not all groups engage in civilian victimization, and the sample contains 74 groups (54%) that have no documented one sided attacks resulting in civilian fatalities for the full time period. The Islamic State, formerly known as Al-Qa'ida in Iraq, has killed the most civilians in one-sided attacks from 1998-2012, resulting in 6,212 fatalities. Both outcome variables are highly over-dispersed count variables.

The primary independent variable is the imposition of UN targeted sanctions. I considered all UN sanctions regimes in creating this variable. First, I matched groups on the UN ISIL (Da'esh) & Al-Qa'ida Sanctions Committee entity list to groups in the dataset. There are 12 groups in the dataset that are sanctioned under this regime. Then I drew information on other sanctions regimes from the Targeted Sanctions Consortium (TSC) (Biersteker et al., 2018). This data contains information on 63 sanctions episodes from 1991 to 2013 across 23 countries and is a rich dataset comprised of quantitative and qualitative accounts of the underlying intention, targets, implementing actors, and effectiveness of each episode. Other datasets of sanctions, such as the commonly used Threat and Imposition of Economic Sanctions (TIES) (Morgan, Bapat and Kobayashi, 2014) focus on states and do not cover more recent time periods during which there has been a growth of sanctions against non-state actors.

Some groups are explicitly named in these sanctions regimes, such as the National Union for the Total Independence of Angola (UNITA), while others are war-parties that fall under the geographic scope and targeted definition of the sanctions regime. For each sanctions regime, I used the TSC qualitative dataset and independent research to determine if the sanctions would affect a given group operating in the targeted territory. These sanctions regimes targeted 38 insurgent groups, including some which were also added to the Al-Qa'ida sanctions list. In the full sample, 45 rebel groups faced UN sanctions during the time

period. Table 3 in the Appendix lists all the groups targeted by sanctions in the sample. The *Rebel Sanction* variable is an indicator for every month that a sanction is in place against the group. Table 2.6 provides a comparison of groups in the sample that have been subject to sanctions and those that have not. Within this sample, the United Nations has targeted rebel groups that are more violent toward government forces and civilians. Targeted groups tend to be younger, equally likely to be predatory and slightly less likely to have social origins. These groups are slightly larger, have more sources of funding, and are more likely to control territories. On average, they reside in countries with lower economic growth, smaller populations, and less democratic than the countries with insurgents that were not sanctioned.

I use the BAAD II data to construct the measures of a group's economic portfolio. This dataset contain yearly information on whether a group used one of six funding measures: drug trafficking, state sponsorship, smuggling, extortion, kidnapping for ransom, and robbery. I create two measures of economic portfolio based on this data. The first, *Economic Diversity*, is the number of funding strategies that a group uses in a given year. Figure 2.3 in the appendix shows the distribution of this variable across rebel-months. I create two measures of the vulnerability of a group's economic portfolio based on the supply chain features of each financing type. Drug trafficking and smuggling commonly rely on long supply chains linking cultivators of the good to the sale of the good to end users often located in other countries. These cross-national supply chains rely on many actors and crossing borders which introduces further oversight. *Cross-National Financing* represents the proportion of a group's overall economic portfolio that is drug trafficking or smuggling. For example, in 2008 the Myanmar National Democratic Alliance Army was financed by smuggling and drug trafficking. For this year their economic diversity would be 2, their cross-national financing ratio would be 1 and their domestic financing ratio would be 0. These variables are only available for groups with at least one known source of financing in the BAAD data, so the

scope is limited to 76 groups.

To construct the data on group origins I use Foundations of Rebel Group Emergence (FORGE) Dataset which provides information on the preexisting organizations from which rebel groups emerge (Braithwaite and Cunningham, 2020). This data includes a range of parent organizations which founded or provided membership for the rebel groups. I create a binary variable, *Social Origins*, to represent groups that were formed from the following pre-existing organizations: political parties, political movements, religious groups, trade unions, student organizations, military of a former regime, current military, nonmilitary government factions or nonmilitary factions from a former regime, religious communities or ethnic communities. Groups originating from pre-existing social organizations are more likely to have lasting social ties within the community and be reliant on support from civilian populations for their mobilization. These groups drew their initial membership from organizations that may still persist and members may share ideological, political, ethnic, religious, or other connections with civilians from these organizations. These pre-existing organizations often provide channels for rebel groups to communicate with civilian leaders that were involved in these parent organizations but never joined the rebel group. Groups built upon social networks maintain ties with local communities and are less like to predate on civilian populations for resources (Weinstein, 2006; Beardsley and McQuinn, 2009; Salehyan, Siroky and Wood, 2014). In the sample, 36% of groups originated from at least one of these pre-existing organizations.

I create two measures of groups without foundational ties to local communities. Based on the FORGE data, *Rebel Origins* is a binary variable representing a rebel group that created from splintering from another violent non-state actor. These variables provide the most direct measure of rebel origins that is separate from any aspects of the group's economic portfolio. I exclude any rebel groups that originated from a prior violent non-state actor and one of the social institutions mentioned above, so these variables are mutually exclusive. In

the sample, 61% of groups have origins based in other pre-existing rebel groups

Other scholars argue that group structures and subsequent strategies are derived from the resource endowments that rebel leaders can leverage to overcome their collective action challenges(Weinstein, 2006). Rebel groups that are rich in economic resources that are not derived from local communities often fail to develop constructive ties with local populations and instead rely on coercion when they need to extract resources from civilians. Building on these theories, I create a second measure to capture groups that are disconnected from local communities. I use the Rebel Contraband Dataset to identify groups that fund their operations through the exploitation of natural resources (Walsh et al., 2018).[24] This dataset contains information on the funding strategies–extortion, smuggling, theft or booty futures– and commodities exploited by rebels in each UCDP dyad-year from 1990-2012. The coding criteria includes a funding strategy when there is evidence that the groups earn "a significant fraction of funding in this manner" (Walsh et al., 2018). I do not distinguish between different commodities and include all the variables included in the model. Given the covert nature of rebel funding, it may be difficult to find annual evidence of the existence of a given funding steam. I consider a rebel group to be funded by natural resources for the full time period if the Rebel Contraband Dataset provides definitive evidence that the rebel group received a significant portion of their income from natural resources in any year in the time period. This reflects the central notion that funding strategies are an observable representation of a rebel's latent mobilization strategy. In line with the literature, I also include a measure from BAAD II on whether the group receives support from a foreign sponsor. *Economic Origins* is a binary indicator of whether a rebel group receives financing through exploitation of natural resources or foreign sponsorship. This variable reflects the evidence in the literature and is the most common way of distinguishing rebel groups that are disconnected from local populations and more prone to predatory behavior (Weinstein, 2006; Wood, 2010; Salehyan,

[24]Data available at https://dataverse.harvard.edu/dataset.xhtml?persistentId=doi:10.7910/DVN/COQ65B

Siroky and Wood, 2014). In the sample, 58% of groups have economic origins.

I expect other rebel characteristics to moderate the impact of economic sanctions and affect rebel responses to economic constraints. Using the BAAD II data, I include three group features that vary yearly for each insurgent group. This data contains five funding measures: drug trafficking, extortion, abduction, robbery, and smuggling. Following the adaptability technique used by Radtke and Jo (2018), I collapse these funding strategies into a rudimentary categorical variable, *Economic Diversity*, reflecting the number of known revenue streams available to the group. I expect rebels with multiple funding streams to have more robust financial strategies (including savings), and be less likely to shift their violent tactics in response sanctions. These measures may also reflect the group's capabilities broadly and be associated with more conventional targeting and less civilian victimization. *Size* is a ordinal measure of the group's number of members based on the following criteria: $1 = 0 - 99$, $2 = 100 - 999$, $3 = 1,000 - 9,999$ and $4 >= 10,000$. I also include a binary measure of whether the group controls territory in a given year.

The log of gross domestic product per capita and population from the World Bank are included to account for country-wide features and the government's counterinsurgency capabilities. [25] Strong democracies and autocracies are less likely to experience civil wars, but regimes that are transitioning and anocracies are beset by instability and violence. International actors may also be more likely to support democratic governments, targeted their sanctions instead at rebel challengers. Varieties of Democracy (VDEM v9) provides an electoral democracy index with a range of 0 to 1. Values close to 1 reflect highly democratic regimes that encompass widespread suffrage, clean elections, and freedoms of association and expression (Coppedge and Ziblatt., 2019). The mean and median values of this measure for the sample are 0.4, reflecting anocratic regime types. Sanctions are frequently enacted in concert with other economic, military and political counterinsurgency tactics. Kathman

[25]The World Bank Data can be accessed here: https://data.worldbank.org/

(2013) provides monthly data on the number of peacekeeping troops and military or police observers deployed in a country. Following Hultman and Peksen (2017), I include the total number of peacekeeping forces to the mission for each month. Table 2.5 in the appendix summarizes the descriptive statistic for each variable.

To evaluate my hypotheses, I estimate a Bayesian multi-level negative binomial model with random effects. This method is the best strategy based on several characteristics of the data. First, the outcome variables *All Violence* and *Civilian Fatalities* are over-dispersed count variables. Second, there are dependencies across several clusters in the data and I expect there to be significant heterogeneity in rebel use of tactics. This model also includes several specifications to mitigate concerns of reverse causality, i.e. that high levels of civilian victimization or battlefield violence influence the United Nations' decision to impose sanctions. All battlefield dynamics and intervention variables are lagged by one month, *(m-1)*, so that they precede the dependent variable by one period. Random effects are included to account for unobserved or omitted group and temporal variables that may influence the effect of sanctions on battlefield dynamics. This approach is also flexible to the unbalanced panel structure based on differences in group duration. The model is presented below:

$$Y_{gm} \sim \mathcal{NB}(e^{X_{gm}^T \beta + \alpha_g + \gamma_y}, \psi)$$

$$\alpha_g = Z_g^T \lambda + \epsilon_g$$

$$\gamma_y = \theta_y + \epsilon_y$$

$$\epsilon_g \sim \mathcal{N}(0, \sigma_g^2) \qquad \epsilon_y \sim \mathcal{N}(0, \sigma_y^2) \qquad \psi \sim Exp(1)$$

The model is set up to include random effects for clustered temporal and geographic components of the data. y_{gm} is the response variable, *All Violence* or *Civilian Fatalities*, for group g in month m. X_{gm} is a matrix of the interventions that vary at the group-month

level, α_g is the intercept for group g, and γ is the intercept for month m. α_g is a random variable that contains a matrix of group characteristics, Z_g^T. The error terms for group and year are drawn from a normal distribution with mean zero and variance σ^2 based on the cluster samples. The dispersion parameter, ψ, is drawn from the exponential distribution with rate 1.

2.7 Results

Table 2.1 presents the β coefficient for the first and second models evaluating the impact of economic sanctions on rebel groups, net violent output. The results show that UN sanctions are associated with decreased violence from targeted insurgent groups. This supports hypothesis 1: imposed sanctions decrease a rebel's ability to perpetrate violence. In contrast to the literature on the ineffectiveness of sanctions, this result shows that sanctions can succeed against violent non-state actors. The second model includes the interaction term between rebel economic diversity and sanctions. The results support hypothesis 2: sanctions only reduce the violent capabilities of groups that do not have robust financing strategies. This result supports findings in the literature that groups that are more financially adaptable can find new funding streams when sanctions target their resource generating strategies (Radtke and Jo, 2018). Economically diversified groups are resilient to the extra costs and severed funding streams brought on by sanctions. Their financial underpinnings suggest these groups are adapt at forming and maintaining sophisticated financial strategies. The results also support expectations that larger groups with control of territory are more violent.

Figure 2.1 shows the marginal effects of groups' economic diversity under sanctions and not under sanctions. For groups with few known sources of financing, sanctions effectively reduce their violent output. Economically robust rebels may have sufficient savings or weapons stockpiles to offset the costs of sanctions as they acquire alternative sources of income. These

Table 2.1: Summary of β Posterior Distributions for Models 1 and 2

Variable	Model 1	Model 2
	DV:*All Violence*$_m$	
Rebel Sanctions$_{m-1}$	−0.72*	−1.00*
	(−1.02, −0.42)	(−1.32, −0.67)
Economic Diversity	0.39*	0.31*
	(0.31, 0.48)	(0.23, 0.40)
Rebel Sanctions$_{m-1}\times$ Economic Diversity	-	0.27*
		(0.14, 0.40)
Rebel Size	0.13	0.15
	(−0.04, 0.29)	(−0.01, 0.31)
Territorial Control	1.36*	1.30*
	(1.16, 1.55)	(1.10, 1.49)
Peacekeeping Personnel$_{m-1}$	0.00	0.00
	(0.00, 0.00)	(0.00, 0.00)
Civil War$_{m-1}$	2.35*	2.37*
	(2.15, 2.54)	(2.16, 2.58)
GDP per capita (log)	−0.40*	−0.39*
	(−0.60, −0.18)	(−0.59, −0.17)
Population (log)	−0.18	−0.19*
	(−0.37, 0.01)	(−0.36, −0.02)
Democracy	−0.43	−0.63
	(−1.33, 0.44)	(−1.53, 0.23)
Constant	4.51*	4.77*
	(0.70, 8.16)	(1.26, 8.34)
Observations	14,495	14,495
Rebel-Month RE	Yes	Yes

Note: Parenthesis show 95% credible interval. GDP = Gross Domestic Product. RE = Random Effects.
* indicates 0 falls outside the 95% credible interval

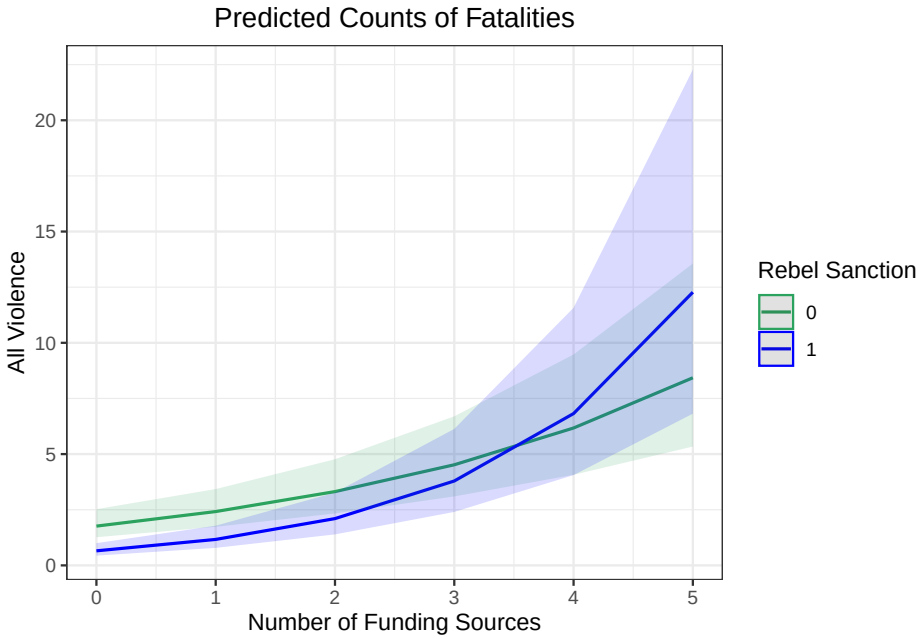


Figure 2.1: Marginal Effects of Economic Diversity and Sanctions

results also show that groups with more financial resources use that financing to engage in greater violence. Both rebel groups targeted with sanctions and those not currently under a sanctions regime are more violent as they obtain more sources of financing. This finding demonstrates the importance of economic sanctions and other efforts to curtain insurgent financing. Effectively blocking even one source of insurgent income can reduce their capacity to perpetrate violence.

Table 2.2 presents Models 3 and 4, evaluating hypotheses 3 and 4. These results offer mixed support for these hypotheses. I expected rebel groups with economic portfolios consisting of a high ratio of cross-national financing to be particularly vulnerable to economic sanctions. Groups most vulnerable to economic sanctions would have fewer resources to allocate toward violence and this would be observable in a decline in overall violent output. The interaction term in Model 3 is negative, as expected, but the posterior distribution is centered near zero suggesting there may be no effect of these mechanisms on violence. Within this sample, the β coefficient for Rebel Sanctions is positive with more than 90 per-

centage of the distribution greater than 0. This can be interpreted as the impact of sanctions when Cross-national financing takes its lowest value, indicating economic portfolios that do not rely on any vulnerable resource-generating strategies. Sanctions against these groups are associated with more violence. Cross-national financing without sanctions is negatively associated with net violence, suggesting that these supply-chain characteristics might result in more overall instability of financing.

Model 4 evaluated the opposite hypothesis, groups with a high ratio of domestic financing, which I theorize is relatively insulated from the reach of economic sanctions, should not be impacted by economic sanctions. The results show no effective of the interaction, as expected, but the coefficient for *Domestic Financing* is positive. This shows that groups with economic portfolios skewed toward domestic sources generally produce more violence when not under sanctions. Together, these results show that a rebel group's economic portfolio has important implications for its levels of violence.

These results suggest that economic sanctions can still raise the costs on groups with relatively difficult to interdict sources of income. Asset freezes, travel bans, and arms embargoes all make the day-to-day logistics of insurgency more costly. For a rebel group that relies entirely on relatively difficult to target financing, such as robbery and extortion, the business operations of insurgency under economic sanctions become more costly as they attempt to procure additional armaments or maintain their supply networks. Rebel groups must reallocate resources dedicated to fighting toward building new sources of revenue and re-configuring their armament supply chains to evade the reach of sanctions.

Table 2.3 presents the β coefficient estimates for models evaluating hypotheses 5 and 6. Model 5 evaluates hypothesis 5: groups originating from local institutions will reduce their violence against civilians when sanctions are imposed. The results offer support for this hypothesis. The posterior distribution for the interaction coefficient falls completely below zero. There is no relationship between groups that have social origins and do not face

Table 2.2: Summary of β Posterior Distributions for Models 3 and 4

Variable	Model 3	Model 4
	DV:*All Violence*$_m$	
Rebel Sanctions$_{m-1}$	0.41	0.21
	(−0.07, 0.89)	(−0.37, 0.79)
Cross-National Financing	−0.61*	-
	(−0.95, −0.26)	
Rebel Sanctions$_{m-1}\times$ Cross-National Financing	−0.19	-
	(−0.92, 0.52)	
Domestic Financing	-	0.60*
		(0.25, 0.95)
Rebel Sanctions$_{m-1}\times$ Domestic Financing	-	0.21
		(−0.51, 0.94)
Economic Diversity	−0.06	−0.07
	(−0.16, 0.04)	(−0.17, 0.03)
Rebel Size	0.44	0.43
	(0.24, 0.64)	(0.24, 0.62)
Territorial Control	0.75*	0.75*
	(0.53 0.98)	(0.53, 0.97)
Peacekeeping Personnel$_{m-1}$	0.00	0.00
	(0.00, 0.00)	(0.00,0.00)
Civil War$_{m-1}$	1.09*	1.09*
	(0.76, 1.41)	(0.74, 1.42)
GDP per capita (log)	0.07	0.07
	(−0.21, 0.36)	(−0.22, 0.37)
Population (log)	−0.40*	−0.40*
	(−0.65, −0.17)	(−0.65, −0.17)
Democracy	0.91	0.93
	(−0.33, 2.18)	(−0.32, 2.19)
Constant	6.09	5.48
	(1.10, 11.02)	(0.58, 10.54)
Observations	5,240	5,240
Rebel-Month RE	Yes	Yes

Note: Parenthesis show 95% credible interval. GDP = Gross Domestic Product. RE = Random Effects

* indicates 0 falls outside the 95% credible interval

sanctions and their use of civilian victimization. This suggests that these groups might use both coercive and predatory tactics. However, the unique challenges of economic sanctions cause rebel groups to increase their reliance on their civilian counterparts and their violent behaviors toward civilians decline as a reflection of this. Instead, these groups are able to use persuasion to extract additional resources.

Models 6 and 7 evaluate my expectations that groups lacking institutional ties to local communities and the relationships that these institutions facilitate will turn to coercion to recoup their economic losses from civilian losses. I create two different measures to evaluate this hypothesis. Model 6 presents the results for the analysis on groups that have access to resource wealth in the forms of natural resources and state sponsorship. Groups with access to these economic endowments can attract recruits by offering wages, rather than relying on social connections that can persuade adherents to take up arms based on shared political, religious, social, or ethnic ties. As a consequence of the lack of connections, it is difficult for rebel groups the persuade local civilians to support the rebels and provide resources in furtherance of their goals. The results show that when these groups face economic sanctions, they will attempt to make up for losses by violently extracting more resources from civilians. The β coefficient for $Rebel\ Sanctions_{m-1}$ is negative, supporting the findings in Model 5 that groups that have institutional ties reduce their violence against civilian populations when targeted by sanctions. However, the interaction term is positive demonstrating that groups with economic origins targeted by sanctions turn their violence toward civilian populations. Model 7 evaluates an alternative measure of this concept based on whether the group originated from a prior violent non-state actor. These results broadly support the findings in Model 6, however the 95% credible intervals for the key variables of interest include zero at the margins. Figure 2.4 in the appendix presents the distribution of these variables.

Figure 2 shows the posterior distributions of the key variables of interest from Model 3 and Model 6 with means plotted as circles and the thick line indicating the 95% credible

interval for each variable. This figure highlights the starkly divergent impact of economic sanctions against groups with social origins and those with economic origins. Economic sanctions targeting rebel groups with institutional connections from local communities are likely to reduce rebel use of violence against those communities. However, policymakers must be cautious that economic sanctions targeting groups lacking these community connections might predate on civilians to offset the costs of sanctions.

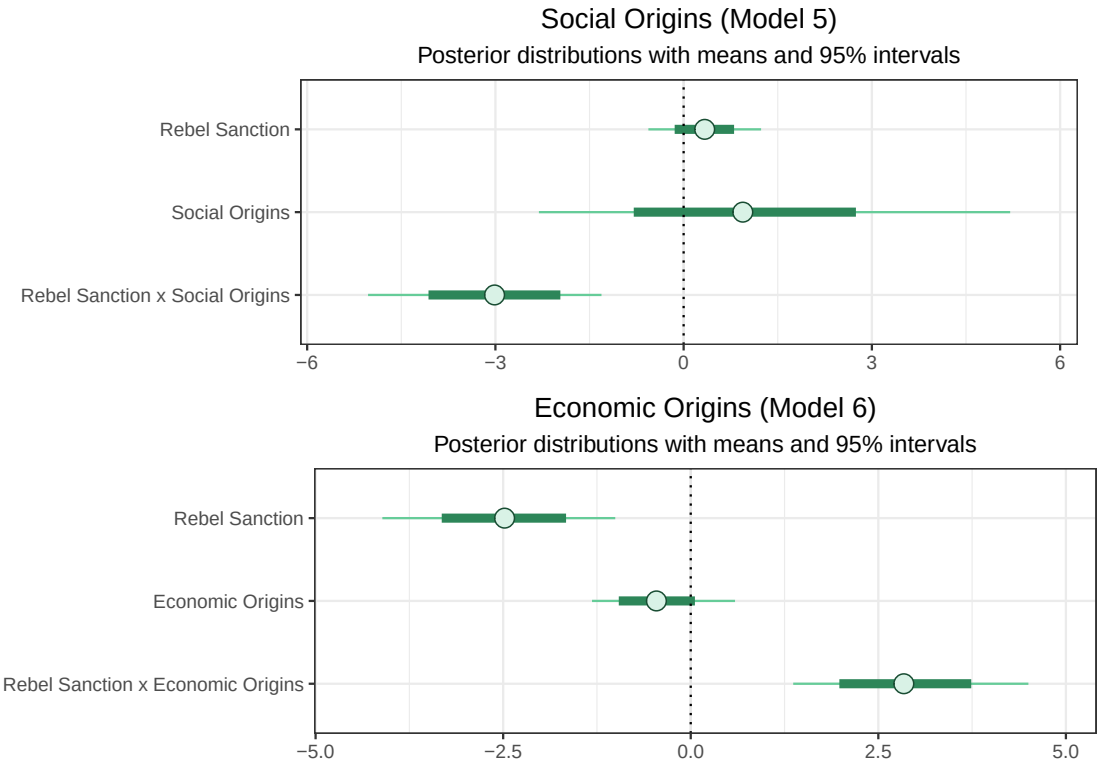


Figure 2.2: Interaction Terms and Violence Against Civilians

As the discussion and table 2.6 show, there are differences between the types of insurgencies that are sanctioned by the United Nations and those that are not. There is no evidence to suggest that the UNSC selects easy cases where success is likely. The opposite appears true, in the sample, groups that have been sanctioned perpetrate more than three times the amount of monthly violence as groups that avoid these forms of counterinsurgency. This is

Table 2.3: Summary of β Posterior Distributions

Variable	Model 5	Model 6	Model 7
	DV: *Civilian Fatalities*$_m$		
Rebel Sanctions$_{m-1}$	0.34	−2.28*	−0.96*
	(−0.14, 0.80)	(−3.32, −1.66)	(−1.92, -0.03)
Social Origins	0.94	-	-
	(−0.80, 2.75)		
Rebel Sanctions$_{m-1}\times$ Social Origins	−3.01*	-	-
	(−4.07, −1.96)		
Economic Origins	-	−0.46	-
		(−0.96, 0.06)	
Rebel Sanctions$_{m-1}\times$ Economic Origins	-	2.84*	-
		(1.98, 3.74)	
Rebel Origins	-	-	0.10
			(−1.99, 2.02)
Rebel Sanctions$_{m-1}\times$ Rebel Origins	-	-	0.80
			(−0.19, 1.85)
Economic Diversity	0.22*	0.17*	0.21*
	(0.11, 0.34)	(0.06, 0.28)	(0.11, 0.32)
Rebel Size	−0.05	0.20	−0.03
	(−0.29, 0.20)	(−0.05, 0.45)	(−0.27, 0.22)
Territorial Control	0.96*	1.04*	1.02*
	(0.65, 1.27)	(0.74, 1.32)	(0.71, 1.33)
Peacekeeping Personnel$_{m-1}$	0.00	0.00	0.00
	(0.00, 0.00)	(0, 0)	(0.00, 0.00)
Civil War$_{m-1}$	0.39*	0.35*	0.38*
	(0.35, 0.44)	(0.30, 0.39)	(0.33, 0.43)
GDP per capita (log)	−1.10*	−1.04*	−1.13*
	(−1.44, −0.74)	(−1.35, −0.70)	(−1.46, −0.77)
Population (log)	−0.41*	−0.39	−0.46*
	(−0.74, −0.06)	(−0.73, −0.08)	(−0.77, −0.15)
Democracy	0.09	0.33	−0.04
	(−1.38, 1.52)	(−1.73, 1.05)	(−1.50, 1.37)
Constant	7.72*	7.37*	9.23*
	(0.72, 14.76)	(1.14, 14.15)	(2.68, 15.49)
Observations	13,489	14,495	13,489
Rebel-Month RE	Yes	Yes	Yes

Note: Parenthesis show 95% credible interval. GDP = Gross Domestic Product. RE = Random Effects

* indicates 0 falls outside the 95% credible interval

particularly stark for their use of violence against civilians, sanctioned groups on average kill seven times more civilians than groups that are never sanctioned. This intensity and targeting of violence prompts actions from the international community. Despite taking on the most challenging insurgencies, these results show that sanctions can effectively curtail violence by these violent groups. Sanctions are particularly effective against rebel groups with few sources of income. However, policymakers must carefully consider rebel groups origins and enduring connections to civilian populations. Rebel groups lacking these ties may attempt to recoup the costs of sanctions by violently extracting resources from civilians.

2.8 Conclusion

In the past three decades, international organizations and states have increasingly imposed sanctions and developed financial counterinsurgency strategies to quell intrastate conflict and combat transnational terrorist groups. Sanctions are an attractive policy because implementation is generally low cost politically and low risk to the enacting party, but satisfies demands for action in international crises. By building a theory of economic sanctions centered on rebel groups and their violent activities, this chapter shows that sanctions can effectively reduce the violence of non-state actors. These results also suggest policymakers should reconsidered broad-based application of these tactics. Sanctions are particularly effective at reducing violence from economically vulnerable rebels and those with social ties to local communities. However, rebel groups that lack institutional connections to local civilians will increase their violence toward civilians when operating under a sanctions regime. Policymakers should carefully consider when to implement economic counterinsurgency and when to pair these interventions with policies to protect civilian populations from a potential backlash.

The approach taken in this paper overcomes some challenges associated with measuring

the impact of sanctions on rebel behaviors, but limitations persist. First, the results demonstrate changes in levels of violence associated with targeted sanctions, which I have argued is an observable implication of a change in the group's latent capabilities. However, this does not directly measure the effect of targeted sanctions on a group's access to financial and military resources. It is reasonable to assume that insurgent organizational characteristics and financial strategies will condition not only their behaviors under resource deprivation, but the magnitude with which sanctions create that deprivation. I have considered one source of resilience, economic diversity, but others may also affect rebel robustness to sanctions. This study does not account for rebel reserves of funding and armaments or country characteristics that might enhance or undermine the efficacy of sanctions such as sizable black markets and porous borders. Second, concerns of endogeneity and reverse causation caution the interpretation of these results. The Security Council may be most likely to find consensus among members and target sanctions against insurgents when these groups engage in particularly egregious forms of violence, such as civilian victimization. The empirical strategy undertaken should mitigate these concerns, but it may be fruitful to test these theories further by focusing on financial restrictions implemented through more routine bureaucratic and apolitical processes such as at banks and financial institutions.

My expectations regarding enforcement and the vulnerability of funding sources were not supported by the evidence. While this has been a micro-level approach, it is worth considering other layers of economic counterinsurgency or country-level variation that might impact the enforcement and efficacy of sanctions regimes. This study and other evaluations of economic sanctions in civil wars are missing country-level variation in financial resilience and enforcement capabilities. This chapter includes country GDP per capita as a rough proxy for government capacity broadly, but a more precise measure would be beneficial. Country-level counter-illicit financing systems should influence the enforcement of sanctions and may interact with rebels economic portfolios in interesting ways. Future work should incorporate

these systemic economic counterinsurgency measures into analyses of more targeted measures to isolate the variation of interest.

This chapter suggests several avenues for further research. Rebel production of violence is one observable implication of targeted sanctions, but these policies are likely to have broader impacts on the internal cohesion and strategic calculus of violent non-state actors and the governments opposing them. Given the interaction between rebel organizational structures and external interventions identified here, it is reasonable to evaluate the presence of this heterogeneity on other outcomes. Future work could consider the impact of sanctions on insurgent splintering, willingness to negotiate, and longevity. Economic sanctions targeting rebels best reflect the growing toolbox of financial counterinsurgency, but in the context of intrastate conflicts it is worth analyzing symmetric sanctions that impact the capabilities of all belligerents and sanctions that only target the government. This theory has focused on rebel groups, civilian populations, and domestic governments, but further analyses into the broader networks of violent non-state actors could identify if these policies cascade across rebel alliances or are disrupted by sanctions-busting foreign sponsors.

2.9 Appendix

Table 2.4: Economic Sanctions Targeting Insurgent Groups

Insurgent Group	Sanctions Regime	Enacted
Kosovo Liberation Army	FRY 2 EP1	Mar 1998
National Liberation Army of Macedonia	FRY 2 EP1	Mar 1998
Armed Forces Revolutionary Council	Sierra Leone EP2	Mar 1998
Revolutionary United Front	Sierra Leone EP2	Mar 1998
National Union for the Total Independence of Angola	Angola EP3	June 1998
West Side Boys	Sierra Leone EP3	Oct 1999

Continued on next page

Table 2.4 – *Continued from previous page*

Insurgent Group	Sanctions Regime	Enacted
Taliban	AQT EP1	Oct 1999
Liberians United for Reconciliation and Democracy	Liberia EP2	Mar 2001
Abu Sayyaf Group	ISIL & Al-Qa'ida	Oct 2001
Al-Ittihaad Al-Islami	Somalia EP1	Oct 2001
Al-Qa'ida	AQT EP1	Dec 2000
Armed Islamic Group	ISIL & Al-Qa'ida	Oct 2001
Islamic Movement of Uzbekistan	ISIL & Al-Qa'ida	Oct 2001
Islamic Courts Union	Somalia EP2	May 2002
Somali Reconciliation and Restoration Council	Somalia EP2	May 2002
Eastern Turkistan Islamic Movement	ISIL & Al-Qa'ida	Sep 2002
Ansar Al-Islam	Iraq EP1	Feb 2003
Mahdi Army	Iraq EP1	May 2003
Mujahedin-e Khalq	Iraq EP1	May 2003
Movement for Democracy in Liberia	Liberia EP3	May 2003
Islamic Army in Iraq	Iraq EP1	May 2003
Allied Democratic Forces	DRC EP1	July 2003
Bunda Dia Kongo	DRC EP1	July 2003
Congolese Rally for Democracy	DRC EP1	July 2003
Democratic Front for the Liberation of Rwanda	DRC EP1	July 2003
Movement for the Liberation of Congo	DRC EP1	July 2003
Ntsiloulous	DRC EP1	July 2003
Kurdistan Free Life Party	Iraq EP2	June 2004
Eritrean Islamic Jihad Movement	Sudan 2 EP1	July 2004
Justice and Equality Movement	Sudan 2 EP1	July 2004
Sudan Liberation Movement	Sudan 2 EP1	July 2004
Sudan People's Liberation Army	Sudan 2 EP1	July 2004
Islamic State[†]	Iraq EP2	Oct 2004
Forces Nouvelles	Côte d'Ivoire EP1	Nov 2004
Ivorian Movement for the Greater West	Côte d'Ivoire EP1	Nov 2004

Continued on next page

Table 2.4 – *Continued from previous page*

Insurgent Group	Sanctions Regime	Enacted
Sudan Liberation Movement/Amy -MM	Sudan 2 EP2	Mar 2005
Lord's Resistance Army	DRC EP2	April 2005
Islamic Jihad Group	ISIL & Al-Qa'ida	June 2005
National Congress for the Defense of the People	DRC EP3	Mar 2008
Al-Shabaab	Somalia EP3	Nov 2008
Hizbul Al Islam	Somalia EP4	Dec 2009
Al-Qa'ida in the Arabian Peninsula	ISIL & Al-Qa'ida	Jan 2010
Caucasus Emirate	ISIL & Al-Qa'ida	July 2011
Tehrik-i-Taliban Pakistan	ISIL & Al-Qa'ida	July 2011
M23	DRC EP4	Dec 2012

Notes: EP refers to the first sanctions episode the group was party to according to the Targeted Sanctions Consortium (TSC). Some rebels are listed under country regimes and the ISIL & Al-Qa'ida list, the table includes the first regime were they were listed.
† Originally listed as Al-Qa'ida in Iraq

Table 2.5: Descriptive Statistics

Variable	Data Source	Min.	Max.	Mean	Median
Interventions (group-month)					
Rebel Sanctions	UN, TSC	0	1	0.2	0
Peacekeeping Personnel	Kathman 2013	0	198,236	22,266	0
Battlefield Dynamics (group-month)					
All Violence	UCDP	0	3,043	22.65	0
Battle Deaths	UCDP	0	3,005	19.2	0
Civilian Attack	UCDP	0	2753	2.7	0
Rebel Characteristics (group-year)					
Social Origins	FORGE	0	1	0.4	0
Economic Origins	RCD, BAAD II	0	1	0.6	1
Rebel Origins	FORGE	0	1	0.6	1
Size	BAAD II	1	4	2.7	3
Diversified Funding	BAAD II	0	5	0.6	0
Territorial Control	BAAD II	0	1	0.2	0
Country Characteristics (country-year)					
GDP per capita (log)	World Bank	4.6	10.8	7.0	6.9
Population (log)	World Bank	13.4	20.9	17.7	17.7
Polyarchy	VDEM	0.1	0.9	0.4	0.4
Civil War	UCDP	0	1	0.8	1

Note: BAAD II = Big Allied and Dangerous iteration II. GDP = Gross Domestic Product. RCD = Rebel Contraband Dataset. FORGE=Foundations of Rebel Group Emergence TSC = Targeted Sanctions Consortium. VDEM = Varieties of Democracy

Table 2.6: Comparison Sanctions and Unsanctioned Groups in the Sample

Variable	Not Sanctioned (Mean)	Sanctioned (Mean)
Battlefield Dynamics (group-month)		
Peacekeeping Personnel	18,056.7	30,689.7
All Violence	13.3	41.3
Battle Deaths	11.9	33.7
Civilian Attack	0.9	6.3
Rebel Characteristics (group-year)		
Age (years)	20.7	11.2
Social Origins	0.5	0.3
Economic Origins	0.6	0.6
Rebel Origins	0.6	0.7
Size	2.6	2.9
Diversified Funding	0.6	0.7
Territorial Control	0.2	0.3
Country Characteristics (country-year)		
GDP per capita (log)	7.2	6.7
Population (log)	17.9	17.2
Polyarchy	0.5	0.3
Civil War Battle Deaths	90.9	182.9

Note: GDP = Gross Domestic Product.

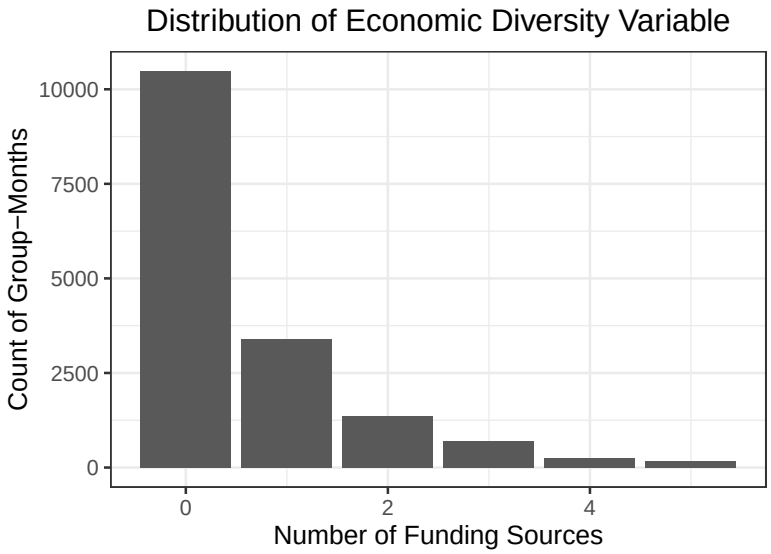


Figure 2.3: Distribution of Economic Diversity Variable

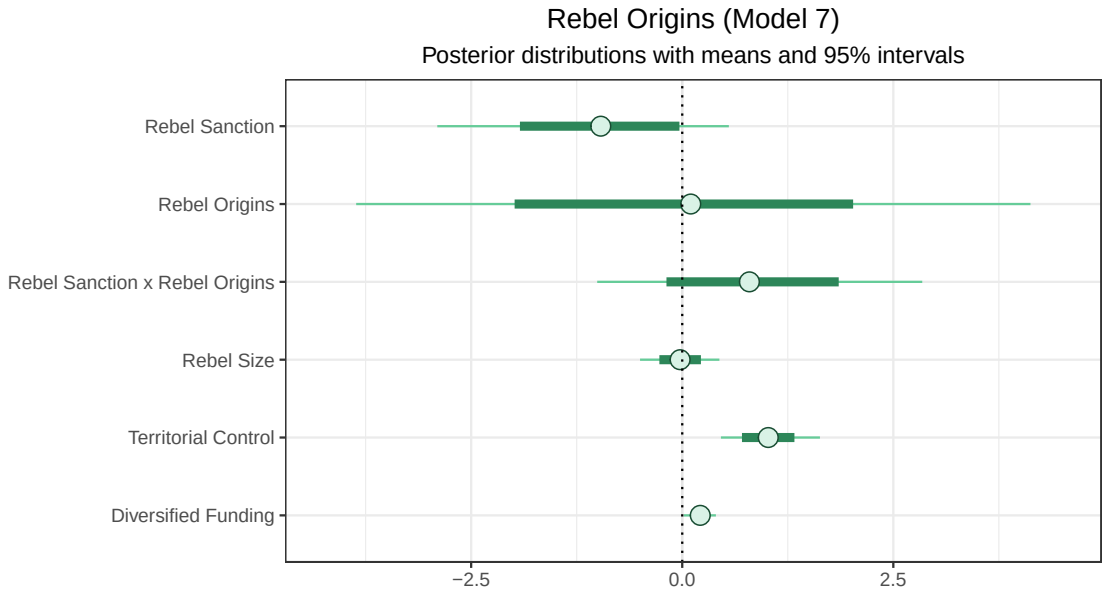


Figure 2.4: Posterior Distributions of Rebel Group Characteristics from Model 7

CHAPTER III

Measuring State Counter-Illicit Financing Systems

3.1 Introduction

The September 11, 2001 attacks on the World Trade Center produced a sea change in global counterterrorism efforts. In President George W. Bush's Rose Garden address on September 24, 2001, he laid out the contours of the United States' War on Terrorism, which centered on military engagements, expansive surveillance and law enforcement operations, and a new focus on countering the financing of terrorism. He concluded with a global appeal, "Money is the lifeblood of terrorist operations. Today, we're asking the world to stop payment" (Bush, 2001). There has been much journalistic, academic, and government evaluation of the military and law enforcement prongs of this strategy. However, the financial front of this war has been largely neglected in the literature, despite growing into an immense international system with purview over most transactions in the global financial system.

International efforts to counter the financing of violence from non-state actors have been sprawling and multifaceted (Biersteker and Eckert, 2007). I refer to these laws and policies as economic counterinsurgency and broadly refer these interconnected international efforts as the economic counterinsurgency regime.[1] Economic counterinsurgency encompasses actions

[1]Within the policy community, these efforts are commonly labeled some variation of Countering (or Combating) the Financing of Terrorism (CFT). This terminology is used by the United Nations, the International Monetary Fund, the World Bank, Financial Action Task Force, and many individual governments. The poli-

that range from narrowly targeting a single group to broad structural policies that affect the global financial system. Selective policies include terrorist designation lists and individual or multilateral sanctions such as the United Nations' ISIL and Al-Qa'ida Sanctions Committee. Other efforts target entire countries or specific sectors, for example the Kimberley Process,[2] legislation regulating charitable donations or conflict minerals (Section 1503 of the U.S. Dodd-Frank Act), the United Nations Office on Drugs and Crime's efforts to disrupt the narcotics trade, and country-level sanctions. Policies can also center on structural changes that impact the ability of all illicit groups to use or manipulate financial systems to fund violence. These efforts include intelligence sharing across national financial intelligence units (FIUs) within the Egmont Group[3] and strengthening of anti-money laundering and countering the financing of terrorism (AML/CFT) provisions under the Financial Action Task Force (FATF).

The international economic counterinsurgency regime is important to several areas of study in political science and public policy. The goal of these policies is to curtail the resources and activities of violent non-state actors. In a review of counterinsurgency from 1978-2008, Paul, Clarke and Grill (2010) finds that reducing tangible support to insurgents is one of the most effective counterinsurgency strategies. Yet, the few studies that evaluate economic counterinsurgency have produced mixed results. Targeted sanctions and terrorist designations can reduce violence from economically vulnerable groups (Radtke and Jo, 2018; Simonelli, 2021*a*) or those operating in countries allied with the United States (Phillips, 2019). However, policies to disrupt the conflict-mineral link have backfired, producing increased violence (Bloem, 2018; Stoop, Verpoorten and Van der Windt, 2018) and sanctions

cies discussed here are used to target terrorists, insurgent groups, and criminals. For simplicity I use the term counterinsurgency but this refers to actions against all violent non-state actors.

[2]The Kimberley Process creates certification standards to ensure rough diamonds are not used to finance insurgent groups.

[3]The Egmont Group was founded in 1995 to provide a platform for cooperation between FIUs in sharing technical expertise and intelligence.

against groups that are disconnected from local civil society can lead to civilian victimization (Simonelli, 2021*a*).

Economic counterinsurgency can also have unintended economic consequences on businesses and foreign investors. Foreign investors seek out host markets where they can maximize the returns on their investments while minimizing political risks. These duel concerns lead to interesting patterns of investment; foreign investors exploit environments with lax regulations but with strong protections from expropriation and political instability (Busse and Hefeker, 2007; Jensen, 2008; Johns and Wellhausen, 2016; Vernon, 1971). Onerous AML/CFT financial regulations and oversight can reduce the profitability of investments by adding burdensome documentation and reporting standards and increasing transparency over business practices. These provisions might dissuade foreign investors or alternatively could attract risk-adverse companies that are concerned with running afoul of home country regulations.

Finally, economic counterinsurgency is relevant to the study of international institutions and state behavior. Governments have a shared interest in reducing the capabilities of domestic or transnational groups that might target them. However, the rewards of increased financial regulations are, by and large, a public good and it is difficult to quantify or internally justify any one state's benefits from these institutions. States bear a heavy political and economic cost for compliance with the international institutions of economic counterinsurgency. Governments must spend precious resources and political capital on enhancing their intelligence gathering capacity, regulating formal and informal financial transactions, instituting anti-money laundering controls, and sacrificing sovereignty through pressure to share intelligence and by allowing intergovernmental monitoring agencies access to government records (Biersteker and Eckert, 2007). There is an additional opportunity cost of potentially repelling wealthy investors that seek a lax regulatory environment and angering civilians who face additional regulations and restrictions on donating to charities or send-

ing money through informal value transfer systems, such as hawalas (Clunan, 2006). This poses an intriguing coordination and bargaining problem that could be compared to the challenges states face in garnering support and compliance with regimes on human rights, labor standards, and the environment.

This chapter adds to the nascent literature on economic counterinsurgency by evaluating systemic efforts to improve robustness to illicit financing. I create two measures to evaluate the quality of a state's counter-illicit financing institutions and overall security from illicit financing. AML/CFT structures comprise the legal framework and regulatory tools established to oversee, investigate, and block illicit financing. However, the existence of laws and regulatory tools on the books does not necessarily imply a lower risk of illicit exploitation. I create a second measure to capture the efficacy of the overall system in rebuffing illicit exploitation. AML/CFT effectiveness is derived from a government's capacity and willingness to use their toolbox to disrupt illicit activities.[4] I create county-level estimates of AML/CFT structures and AML/CFT effectiveness using expert country assessments from FATF and dynamic ordinal item response theory models. Exploring the model parameters highlights the challenges governments face in regulating private entities which serve as the day-to-day monitors and enforcers over transactions. The results show that AML/CFT structures and effectiveness are highly correlated, but high quality AML/CFT institutions are not a necessary condition for an effective AML/CFT system. As I expected, strong AML/CFT structures do not always result in higher levels of AML/CFT effectiveness. The results demonstrate the importance of measuring both dimensions of counter-illicit financing systems. I validate these measures by demonstrating their positive correlation with five other common measures of government institutional quality.

[4]I use the terms AML/CFT structures and AML/CFT technical compliance interchangeably. Both terms refer to the first dimension of illicit financing robustness which captures the underlying laws and tools in a country. I use the terms AML/CFT capacity and willingness interchangeably with AML/CFT effectiveness. This second dimension captures a governments ability to identify, enforce, and disrupt money laundering and terrorist financing.

I explore the underlying goal of AML/CFT regimes by evaluating the relationship between these measures and political violence. I consider three measures of political violence, intensity of civil war violence, one-sided violence against civilians, and terrorism. The results show that AML/CFT structures and effectiveness have no conclusive relationship to violence against civilians and terrorism. However, AML/CFT effectiveness is associated with a lower intensity of civil wars.[5] This result suggests that governments that can effectively block insurgent groups from exploiting financial markets to transfer funds and launder money may curtail groups' violent capabilities. Due to temporal limitations and model features, these results cannot distinguish the direction of causality in this relationship. This work cannot yet conclude that AML/CFT efforts succeed in reducing violence or that they have been an ineffective policy tool that should be reconsidered. However, the results presented in this chapter highlight the importance of counter-illicit financing measures as a key aspect of economic counterinsurgency that is relevant for a broad array of political phenomena. This paper contributes the first measurement model of counter-illicit financing structures and effectiveness with the hope that others use these measures to explore these patterns further.

3.2 Counter-Illicit Financing Structures and Effectiveness

Counter-illicit financing systems constitute a state's ability to identify, disrupt, and prevent efforts to use financial systems for illicit purposes such as money laundering and financing terrorism. Money laundering is an illegal series of financial maneuvers meant obscure the origins of criminally obtained money so that it appears legitimate. The crime, for example drug trafficking, proceeds the exploitation of the financial system. In contrast, the financing of terrorism often originates with legal sources of income. For example, a supporter donates a portion of their salary or terrorists exploit a legitimate business. The financial

[5]AML/CFT structures is negatively associated with battle deaths and terror attacks, but the results cannot prove this relationship may not also be zero.

system is then used to transfer licit funds for illegal and terrorist purposes. The definition of counter-illicit financing systems reflects the interwoven nature of criminal and terrorism financing.[6] The primary tools available to regulators, for example tracking suspicious financial transactions and customer due diligence, can identify suspicious financial behaviors but do not distinguish between transactions meant for terrorist or criminal purposes. Improving counter-illicit financing systems should improve a government's ability to identify, track, disrupt, and prevent both money laundering and terrorist financing.

Counter-illicit financing systems comprise the institutions and resources used to safeguard financial systems from illicit exploitation and the security produced from these efforts. States can employ a range of strategies to improve the resilience of their financial systems. Rather than creating a unified measure of counter-illicit financing systems, I separate state institutions and de jure regulatory environment from the outcomes that reflect the latent effectiveness of the overall system. AML/CFT structures include the legal framework and regulatory tools that have been established to identify, understand, and target illicit financing. For example, governments can pass laws criminalizing the financing of terrorism and implement financial regulations requiring banks and other financial entities to conduct customer due diligence (CDD), record keeping, and submit suspicious activity reports (SARs). This overarching structure also includes the creation of a Financial Intelligence Unit (FIU) and other entities tasked with investigating malfeasance. The first FIUs were created in the 1990s, and since then 166 FIUs have collaborated and shared financial intelligence under the coordination of the Egmont Group. These institutions and enforcement agencies provide the toolbox that states can use to counter money laundering and terrorist financing.

AML/CFT effectiveness encompasses a state's capacity to use their toolbox to successful disrupt efforts to exploit their financial systems. The existence of regulations and law

[6]Terrorist financing regulations were built into extant institutions created to counter money laundering and the trade in illicit goods.

enforcement agencies must be complemented with government willingness and capacity to use the tools at their disposal to insulate their financial systems. Capacity encompasses the funding, personnel, and technical experience necessary to cull through SARs, investigate suspects, and pursue legal actions against those that violate their legal AML/CFT framework. Willingness captures the government's underlying preferences for disrupting illicit financing. There are many reasons governments might not prefer a financial system that is fully robust to illicit exploitation. International investors may seek out environments with less onerous regulations and reward these countries with increased capital inflows. Criminal enterprises may hold significant political power and corrupt politicians can enrich themselves by exploiting the same financial vulnerabilities that AML/CFT institutions were created to disrupt. Thus a state's AML/CFT capacity reflects their ability and desire to effectively use their legal framework to rebuff efforts for criminal financing. This measure best reflects a country's de facto levels of protection from illicit exploitation of their financial markets.

Measuring a state's counter illicit financing system poses a challenge. There are few observable indicators of counter-illicit financing institutions and effectiveness that are uniform across countries. Codified structural AML/CFT may be easier to observe, but it is difficult to compare technical components of different laws without a strong substantive understanding of each country's unique legal system and their money laundering and terrorist financing risks. Observing the effectiveness of a AML/CFT system is even more difficult, as this category is more subjective. In constructing a measure of effectiveness one must decide what metrics to use. Is an effective system one that produces the biggest paper trail, freezes the most assets, or deters exploitation attempts to begin with? I have defined effectiveness as the state's ability to identify, disrupt, and prevent illicit exploitation of financial systems. Once a metric has been chosen and validated, there are still challenges in accessing the correct observable data. Governments rarely report underlying data so it may be impossible to compare the number of SARs, investigations derived from financial intelligence, assets frozen, or

compliant industries. To overcome these challenges, I use expert assessments conducted by FATF.

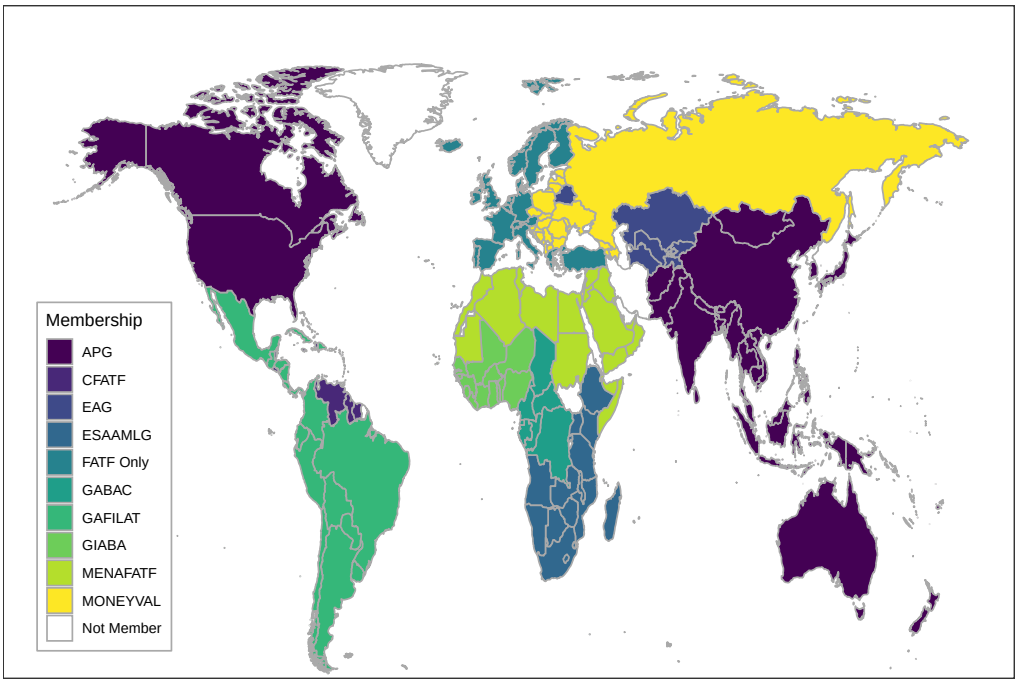
FATF experts are trained to evaluate the implementation of international AML/CFT standards within the context of each member's domestic legal system. These standards apply a risk-based approach, so while the money laundering and terrorist financing challenges in some countries might be greater, FATF ratings reflect a country's attempts to understand and evaluate their risks as well as the steps they've taken to counter them. The FATF's overarching definition of an effective AML/CFT system is "financial systems and the broader economy are protected from the threats of money laundering and the financing of terrorism and proliferation, thereby strengthening financial sector integrity and contributing to safety and security" (FATF, 2012-2020*a*). The FATF's definitions and measurement strategy align closely with my conceptions of counter-illicit financing structures and effectiveness.

3.3 FATF Reports

The Financial Action Task Force was founded by the Group of Seven (G-7) in 1989 to develop international standards for disrupting money laundering. In 1990 the FATF produced 40 anti-money laundering recommendations to combat the thriving illicit drug trade. The FATF expanded their scope to include terrorist financing in 2001, resulting in eight (and later nine) recommendations to counter the financing of terrorism. These recommendations were reviewed and revised in 2012 to produce a cohesive 40 international standards on AML/CFT. The goal of these standards is to facilitate international coordination, help states identify their risk landscape, and develop preventative, investigative, and punitive measures to counter threats.

FATF relies on nine FATF-Style Regional Bodies (FSRBs) to facilitate implementation of recommendations and monitor member progress. The FATF and FSRBs encompass 200

member countries and jurisdictions. Most countries are members of their regional bodies but not members of FATF separately. A key exception is the European Union, which does not have a regional FSRB and is a direct member of FATF. Figure 3.1 provides a map of FSRB and FATF membership.



Note: APG=Asia/Pacific Group on Money Laundering; CFATF=Caribbean Financial Action Task Force; EAG = Eurasian Group; ESAAMLG = Eastern & Southern Africa Anti-Money Laundering Group; GABAC =Central Africa Anti-Money Laundering Group; GAFILAT = Latin America Anti-Money Laundering Group; GIABA = West Africa Money Laundering Group; MENAFATF = Middle East and North Africa Financial Action Task Force; MONEYVAL = Council of Europe Anti-Money Laundering Group

Figure 3.1: Map of FATF Regional Body Membership

FSRBs and FATF monitor member progress on recommendations through Mutual Evaluation Reports and Follow-up Reports. The mutual evaluation process for a given jurisdiction takes 18 months to complete and involves information sharing between assessment teams and country officials, a two week on site visit, and review with input from the assessed country. Assessment teams comprise five to six legal, financial, and law enforcement experts from other member countries that have been confirmed by the FATF President. The process be-

gins six months prior to on-site evaluations with members answering a questionnaire on their technical compliance. Members must provide evidence documenting their progress on each recommendation and demonstrating the effectiveness of their policies which reduces subjectiveness in expert evaluations. These expert reports produce country ratings across 51 (40 recommendations and 11 immediate outcomes) aspects of their AML and CFT frameworks. The final report is considered and adopted by a Plenary session of the FATF.

The teams evaluate members' technical compliance and effectiveness. The technical component scores each member's compliance with the FATF 40 recommendations. These recommendations are listed in Table 4.8 in the appendix and are categorized within policies and coordination, money laundering and confiscation, terrorist financing and financing of proliferation, preventive measures, transparency and beneficial ownership of legal persons and arrangements, powers and responsibilities of competent authorities and other institutional measures, and international cooperation. Countries are evaluated on an ordinal scale with four ratings from non-compliant, indicating major shortcomings, to complaint. The effectiveness section contains 11 immediate outcomes that experts use to evaluate how well the country is meeting the objectives of AML/CFT and creating financial systems that are protected from exploitation. For example, the first effectiveness measure is "Money laundering and terrorist financing risks are understood and, where appropriate, actions coordinated domestically to combat money laundering and the financing of terrorism and proliferation"(FATF, 2012-2020*a*). Countries can receive a rating of low, moderate, substantial, or high levels of effectiveness.

The FATF ratings and accompanying reports provide incredibly detailed assessments of each country's countering illicit financing institutions. However they do not provide a clear strategy for evaluating or comparing the overall strength of AML/CFT institutions or effectiveness across countries. Which country has the best system for AML/CFT? What aspects of AML/CFT are the most important? How do counter-illicit financing systems

affect other important political phenomena such as mobilization of violence, international interactions among states, and foreign investment?

To address these questions and others, I construct two measures to capture states' counter-illicit financing systems. For the first measure, AML/CFT structure, I use information from the technical compliance section of the Mutual Evaluation Reports and Follow-up Reports which evaluate changes to technical compliance in subsequent years. To evaluate a country's AML/CFT effectiveness I use FATF's 11 immediate outcome measures in the Mutual Evaluation Reports. These are measures of the effectiveness of the overall AML/CFT system by evaluating whether a given country has achieved a goal that is indicative of an effective AML/CFT system. This measure is a strong reflection of latent capacity and willingness to counter illicit financing that I have described. The immediate outcomes reflect a government's ability to use the tools available to produce improvements in financial system robustness to illicit exploitation. To create these measures I use a dynamic ordinal item response theory model.

3.3.1 Geographic and Temporal Scope

Mutual Evaluation Reports (MERs) are not yet available for all FATF and FSRBs member jurisdictions. The FATF Plenary determines the schedule of evaluation reports and can only release reports that have been approved in semi-annual Plenary sessions. As of May 2021 FAFT has released MERs on 106 countries and jurisdictions. The geographic coverage of available reports is shown in Figure 4.3. There are reports on countries in every geographic region and across FSRB. The available reports include developed and developing countries and variation across economic markets, regime types, and population sizes. The FATF will continue releasing reports as they are completed and approved. As additional reports are released they will be incorporated into the measures I have constructed.

Figure 3.2: Countries with Complete Mutual Evaluation Reports 2014 - May 2021

The updated FATF standards came into force in 2012. The first evaluation reports based on the updated standards were finished in December of 2014 for Spain and Norway. Reports on nine additional countries were released in 2015 and the rate has increased since then except for disruptions due in the Covid-19 pandemic in 2020. Figure 3.3 shows the number of reports released from 2014 to May 2021. Given the high level of detail and coordination that is required for MERs, they are produced relatively infrequently. Initial MERs provide a baseline assessment that governments are expected to improve upon in subsequent years. To monitor progress, FATF conducts more frequent Follow-up Reports. Follow-up Reports evaluate a government's progress on technical compliance with FATF recommendations but do not reevaluate the immediate outcomes. These reports can results in a raising or lowering of a country's compliance with individual recommendations. Given the structure of Follow-up Reports there are multiple observations for a country's technical compliance in the time-period but only one observation of their effectiveness.

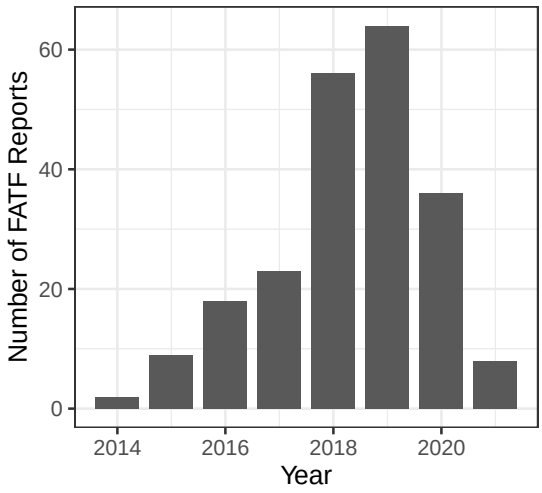


Figure 3.3: New FATF Reports Released by year from 2014 through May 2021

The average number of reports for a country in the sample from 2014-2021 is three and the maximum is six. For every country in the dataset there is a MER. This report provides the first evaluation of the country's AML/CFT systems and is the sole source of information on the system's effectiveness. Several countries have only had this report released, but others have multiple Follow-up Reports available as well. The expected schedule is for countries to follow up on their progress with FATF three years after their MER is released. FATF plans to produce a new MER covering effectiveness and technical compliance every five years, although no additional MERs are yet available. For countries that have substantial deficiencies, reports are more frequent, typically with three Follow-up Reports within a five-year period.

The irregular number and frequency of reports affects the empirical strategy but does not pose a substantial challenge for the use of these reports. First, subsequent Follow-up Reports do not necessarily signify improvements. The underlying goal of these intermediary reports is to encourage countries to improve their technical compliance with FATF recommendations. However, Follow-Up Reports can revise ratings upward or downward based on the experts' review. These are additional sources of information, but the standards and evaluation metrics

are the same. Second, this produces an unbalanced panel. The empirical strategy in this paper is able to handle this structure. Countries are included in the data beginning with the first year a MER is available. A country's counter-illicit financing systems are relatively slow moving. Once laws are codified they remain the law of the land unless specifically overturned. Changes to counter-illicit financing systems take time to codify and build technical expertise and capacity to effectively uphold new protocols. Given these features, I use a dynamic item response theory model which centers the prior distribution on the country's previous year. Countries with more frequent reports will have more certain estimates (smaller standard deviations), but the estimates themselves are not affected by the amount of data available for a given country.

3.4 Dynamic Ordinal Item Response Theory Model

I use a dynamic ordinal item response theory (IRT) to measure a country's AML/CFT structures and effectiveness. This modeling approach is becoming more popular in international relations literature to measure difficult to observe concepts such as democracy (Treier and Jackman, 2014), human rights (Fariss, 2014; Schnakenberg and Fariss, 2014), prevalence of sexual violence (Krüger and Nordås, 2020), peace agreement strength (Williams et al., 2019), nuclear proficiency (Smith and Spaniel, 2020) and state preferences over investor protection (Montal, Potz-Nielsen and Sumner, 2020). These models assume a unidimensional latent feature which maps onto observable variables, also called manifest indicators or items. In line with the theoretical argument and measurement strategy of the FATF, I estimate AML/CFT structures and effectiveness as two separate unidimensional latent variables.[7] These features represent distinct latent features that I expect may have different effects on

[7]It would be possible to estimate a multidimensional latent variable from the 40 FATF recommendations. As shown in table 4.8 these recommendations do have some structure and correspond to different overarching categories. While future work focused on one or more categories may explore this the latent concept of interest in this project is a country's comprehensive framework for countering illicit financing.

political phenomena. Scholars that are most interested state compliance with international AML/CFT institutions or legal strategies to protect financial systems should use the measure of AML/CFT structures. AML/CFT effectiveness is the correct measure for exploring variation across the actual levels of protection from illicit financing across financial systems.

There are several benefits of this strategy. First, an IRT model provides substantively interesting information about the underlying components and their contribution to the latent concept. This modeling strategy produces difficulty and discrimination parameters which can be interpreted to learn about individual FATF provisions. Second, this model effectively handles cases of missing data. Some provisions do not apply to certain countries based on their structural or legal features. For example, Recommendation 17 provides guidelines that financial institutions must follow when relying on third parties to perform customer due diligence. Israeli law requires financial entities conduct all customer due diligence without the use of third parties, so Recommendation 17 does not apply to this case. Less flexible approaches, such as factor analysis or an additive scale, would require either Israel and other countries be removed through list-wise deletion or would not be able to incorporate the information from Recommendation 17 at all. Finally, this is the best strategy to capture uncertainty in these measures. The results provide estimates for each country and include standard deviations so that users can evaluate the certainty of the estimates. Countries with fewer Follow-up Reports or with larger differences across scores will have greater uncertainty that users of the data can incorporate into their models.

In each model the latent feature of interest (either AML/CFT structure or AML/CFT effectiveness) is represented by θ. Individual countries are indexed by $i \in \{1...N\}$, items are indexed by $j \in \{1...J\}$, and years are indexed by t. The outcome y_{ijt} represents the score for country i on assessment item j in year t. Based on the FATF rating system, this score can take four values represented by $k \in \{1, 2, 3, 4\}$. I convert the FATF ordinal scale into this numeric ratings with 1 representing non-compliance or low effectiveness and 4 representing

full technical compliance or high effectiveness. I estimate the probability that observation y_{ijt} takes a given value k. The difficulty parameter for item j is represented by α_{j_K} subject to the ordering constraint $\alpha_{j_1} < \alpha_{j_2} < \alpha_{j_3} < \infty$. This parameter maps the cut-points at which a level of the latent trait would produce a score of k. The discrimination parameter, β_j, shows how much a given item contributes to the overall measure. This parameter is strictly positive and follows a half-normal prior.

I follow the priors for the standard dynamic model described in Reuning, Kenwick and Fariss (2019). Multiple observations for one country violate the assumption that observations are independent. Dynamic models allow the assumption to be relaxed and instead model the interdependence between multiple observations for the same unit over time. For the first observation of a given country the prior for θ is distributed $N(0, 1)$. For subsequent observations, $t \in 2...T$, the prior distribution of θ_{it} is centered on the previous year, θ_{it-1}, with a standard deviation of σ which is estimated from the data. I summarize the model priors below:

$$\theta_{i1} \sim N(0, 1)$$

$$\theta_{it} \sim N(\theta_{i(t-1)}, \sigma)$$

$$\beta_j \sim HN(0, 10)$$

$$\alpha_{j_k} \sim N(0, 10)$$

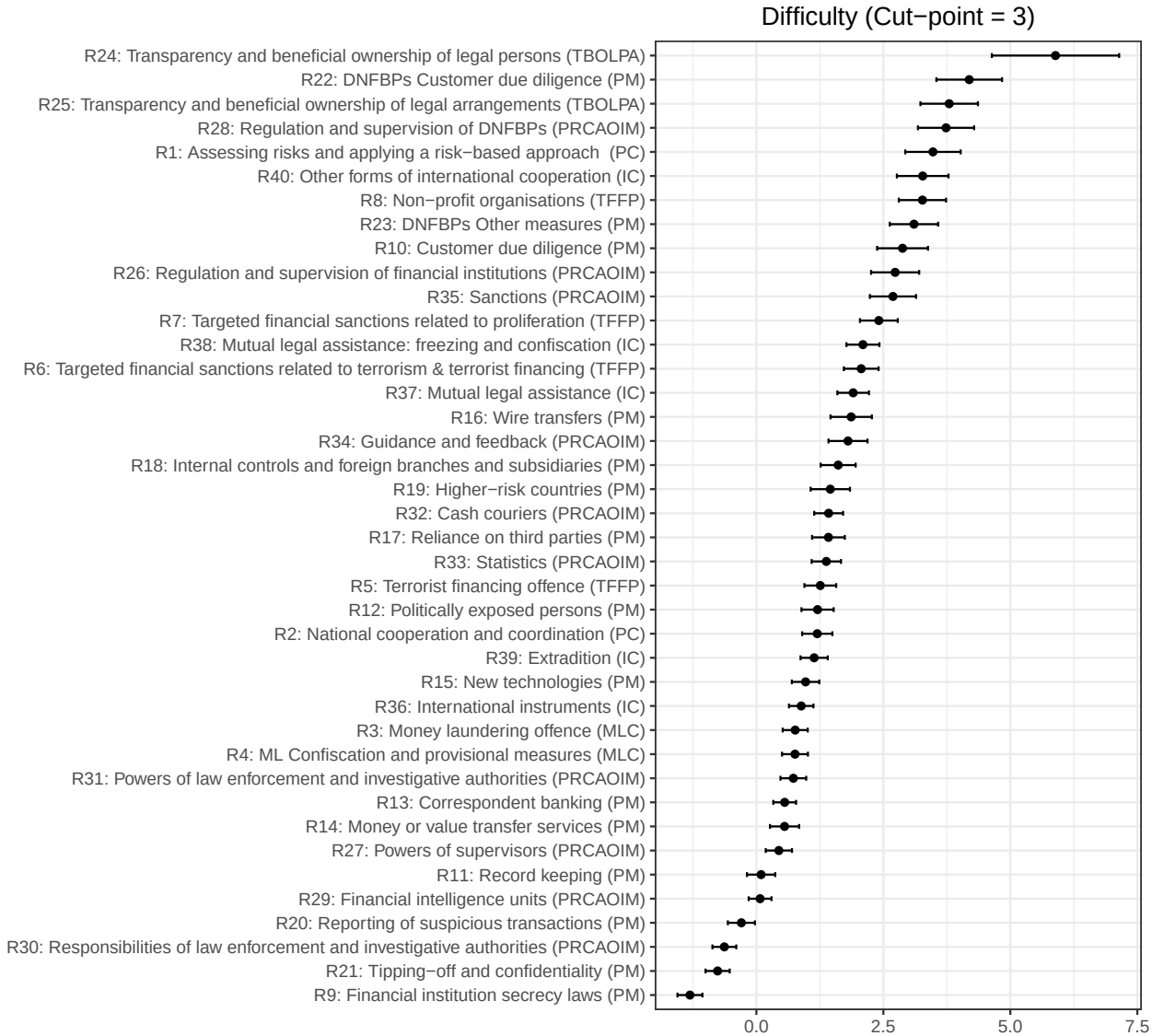
I estimate both models, structures and effectiveness, using Markov Chain Monte Carlo simulations with four chains. Each chain is run for 4,000 iterations, the first 2,000 are burn-in draws followed by 2,000 for sampling.

3.4.1 Technical Compliance

First, I consider technical compliance with FATF recommendations which make up the AML/CFT structures in a country. This measure encompasses 40 items for 106 countries. The recommendations are listed in Table 4.8 in the appendix. Figure 3.13 in the appendix shows the correlation table of these recommendations. Most recommendations are positively correlated below 0.5. Recommendations 22 and 23 are the most highly correlated.[8] These recommendations apply regulations such as customer due diligence and record keeping to designated non-financial businesses and professions (DNFBPs), such as casinos, rest estate agents, dealers in precious stones, and legal services. These recommendations are particularly high cost for states and will be discussed further.

To validate the technical compliance measurement model I first consider the parameters. Figure 3.4 shows the estimates of α, the difficulty parameter for the third cut-point. This cut-point distinguishes between "Largely compliant" and "Compliant" scores. The α values for the other two cut-points are available in the appendix Figure 3.15 and Figure 3.16. The difficulty parameter represents how hard a given item is to achieve based on the strength of a state's underlying AML/CFT structures. Higher values represent items that require higher levels of structural AML/CFT for the item to reach a satisfactory compliance. This parameter provides support for the theoretical validity of this measurement model. Several items, for example keeping records of financial transactions, creating offenses for AML and CFT, and clarifying the responsible law enforcement authorities are relatively low cost to codify and have few, if any, political costs. States with the lowest latent structural AML/CFT are still able to fulfill these provisions.

[8]Recommendation 22 requires customer due diligence and record-keeping provisions (described in Recommendations 10,11,12,15 and 17) apply in select scenarios to casinos, real estate agents, dealers in precious metals and stones, lawyers, notaries, and other independent legal professionals and accountants. Recommendation 23 requires additional measures (described in Recommendations 18-21) apply in certain scenarios to lawyers, notaries, other independent legal professionals and accountants, dealers in precious metals and stones, and trust and company service providers



Note: Recommendations are listed with their FATF categories. PC = Policies and Coordination. MLC= Money Laundering and Confiscation. TFFP= Terrorist Financing and Financing of Proliferation. PM=Preventive Measures. TBOLPA= Transparency and Beneficial Ownership of Legal Persons and Arrangements. PRCAOIM=Powers and Responsibilities of Competent Authorities and Other Institutional Measures. IC= International Cooperation

Figure 3.4: Difficulty (α) of items

The recommendation with the highest α parameter is Recommendation 24 regarding transparency and beneficial ownership of legal persons. This recommendation requires companies and entities to provide accurate basic identifying information about the person(s) who own or control a company, trust, or entity. False, opaque, or missing ownership information

is a key strategy to obscure the true ownership of shell corporations, which can be used for legal or illicit tax evasion and money laundering. The FATF has acknowledged the difficulty of achieving this recommendation and published additional guidance on beneficial ownership in 2014 and a best practices manual in 2019.[9]

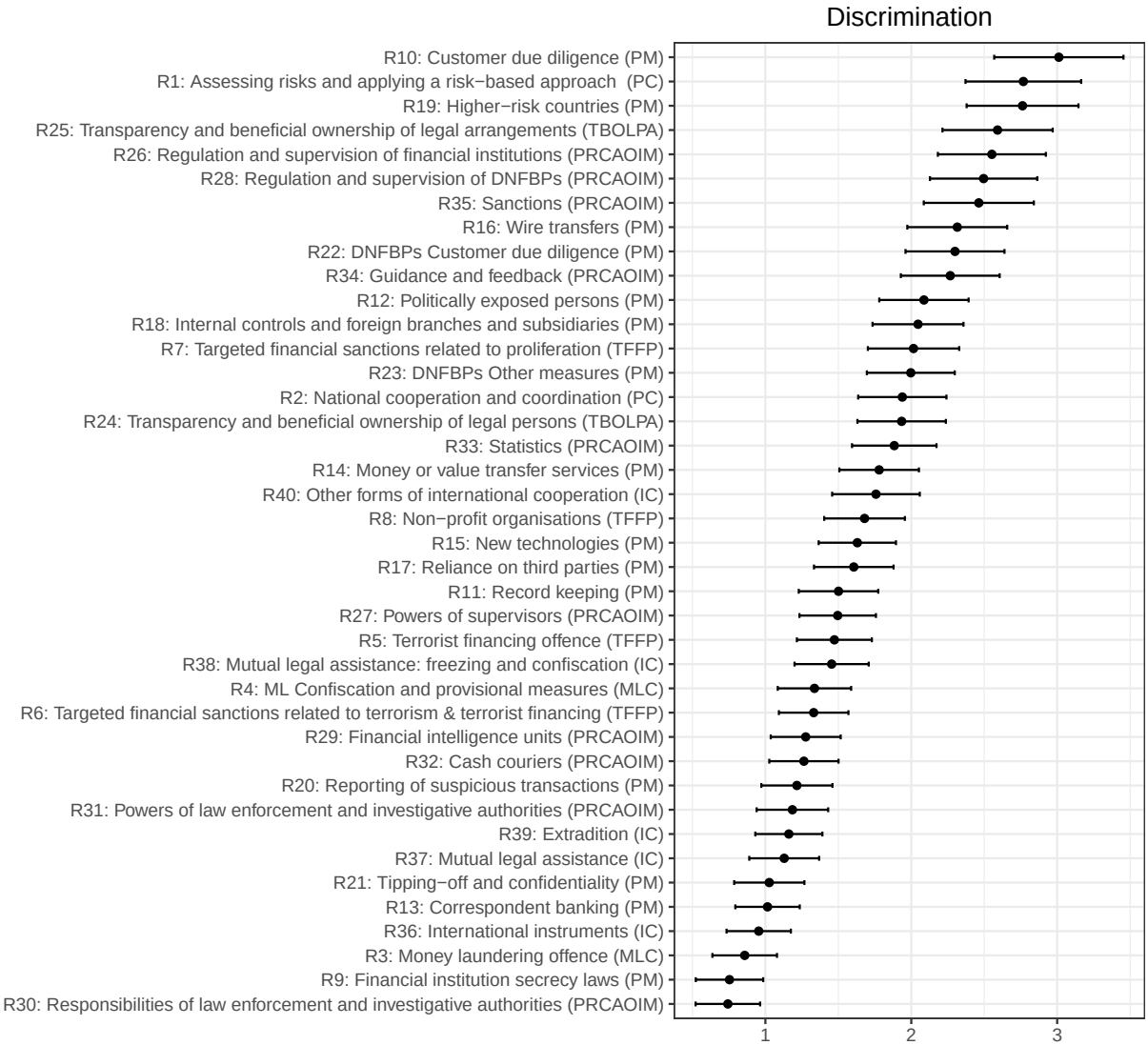
Several of the other highest difficulty parameters relate to government regulation and requirements on third parties, such as shell companies, non-profit organization, charities, and DNFBPs. This result points to the regulatory tension governments face. There is a trade-off between efforts to impose reasonable oversight and making onerous regulations that dissuade financial entities, NGOS, and DNFBPS from conducting business in a given country. Governments must balance enforcement of AML/CFT with the economic benefits of attracting businesses and allowing their businesses to conduct operations in less regulated markets.

One potential side effect of legislation that requires burdensome and well enforced regulations is de-risking. In these cases financial entities avoid entire markets due to concerns of violating domestic or international AML/CFT regulations. These actions are very costly for people living in affected areas who may lose their access to banking, informal value transfer systems, and remittances. For example, banks and financial entities based in countries with strong AML/CFT enforcement records such as the United Kingdom have pulled out of Somalia due to the weak regulatory environment and high risk of money laundering or financing terrorism. The Somali economy relies on remittances for 23% of its gross domestic product and the systematic withdraw of financial services can further humanitarian crises caused by the existence of terrorist organizations.[10] The FATF has recognized de-risking as

[9]The additional guidance (October 2014) is available here: http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-transparency-beneficial-ownership.pdf Best practices manual (October 2019) is available here: https://www.fatf-gafi.org/media/fatf/documents/Best-Practices-Beneficial-Ownership-Legal-Persons.pdf

[10]World Bank Press Release, "World Bank Makes Progress to Support Remittance Flows to Somalia", June 10, 2016.

a troubling side-effect of AML/CFT regulations and in February 2021 created a new group to study these unintended consequences.[11]



Note: Recommendations are listed with their FATF categories. PC = Policies and Coordination. MLC= Money Laundering and Confiscation. TFFP= Terrorist Financing and Financing of Proliferation. PM=Preventive Measures. TBOLPA= Transparency and Beneficial Ownership of Legal Persons and Arrangements. PRCAOIM=Powers and Responsibilities of Competent Authorities and Other Institutional Measures. IC= International Cooperation

Figure 3.5: Discrimination (β) parameters

Figure 3.5 shows the discrimination parameter, β. The discrimination parameter shows

[11]More information is available on their website here: https://www.fatf-gafi.org/publications/financialinclusionandnpoissues/documents/unintended-consequences-project.html

how well items distinguish between weak or strong structural AML/CFT. The least informative items involve designating a law enforcement agency with AML/CFT responsibilities and financial institution secrecy laws. Recommendation 9 on financial institution secrecy laws simply requires states "ensure that financial institution secrecy laws do not inhibit implementation of the FATF Recommendations" (FATF, 2012-2020*a*). Countries with both weak and strong structural AML/CFT generally comply with these provisions as it is a baseline requirement of any meaningful FATF engagement. The items that best distinguish structural AML/CFT systems relate to customer due diligence. Customer due diligence laws are aimed at tracing all accounts or entities to legal customers. This forbids the existence of anonymous or clearly fictitious account owners. Recommendation 10 requires financial entities conduct customer due diligence and Recommendation 22 applies the same standards to DNFBPs. The existence of these laws can best distinguish between countries with relatively weak AML/CFT structures and those with robust structures as they require governments engage in the difficult and politically costly task of regulating private businesses.

The first FATF recommendation is also pivotal in distinguishing weak and strong compliance with AML/CFT recommendations. This recommendation requires states understand their unique money laundering and terrorist financing risks and mobilize resources to mitigate those risks. The FATF argues that "This approach [Recommendation 1] should be an essential foundation to efficient allocation of resources across the anti-money laundering and countering the financing of terrorism (AML/CFT) regime and the implementation of risk-based measures throughout the FATF Recommendations" (FATF, 2012-2020*a*) and our results offer support for the importance of this recommendation in determining strong structural AML/CFT. This recommendation also requires governments ensure financial entities and DNFBPs monitor, investigate, and mitigate money laundering and terrorist financing risks. Recommendation 19 requires financial institutions conduct enhanced due diligence in business transactions with companies and individuals from FATF designated high-risk

countries. This further demonstrates the internal or external roadblocks governments face when forcing businesses to uphold AML/CFT regulations.

This result is indicative of the balance governments strike between international cooperation on AML/CFT and not overregulating businesses that may have significant domestic political power or the ability to relocate to less regulated environments. These regulations also reflect the well-known challenge of anonymous shell companies which serve as conduits for illicit financing and tax evasion (Findley, Nielson and Sharman, 2014). These companies are barriers to economic counterinsurgency and other efforts to increase transparency in global financing. Only countries that have the highest determination to insulate their financial systems from exploitation have full compliance with these recommendations. For many governments, regulating businesses is a bridge too far despite the insistence of regulatory bodies that these are essential steps in reducing money laundering and countering the financing of terrorism and crime.

Figure 3.6 presents the most recent estimates from the structural AMF/CFT measurement model. The top of the right panel shows the highest rated countries which continues in order to the bottom of the left panel. Points represent estimates and lines show the 95% credible interval of the distribution.

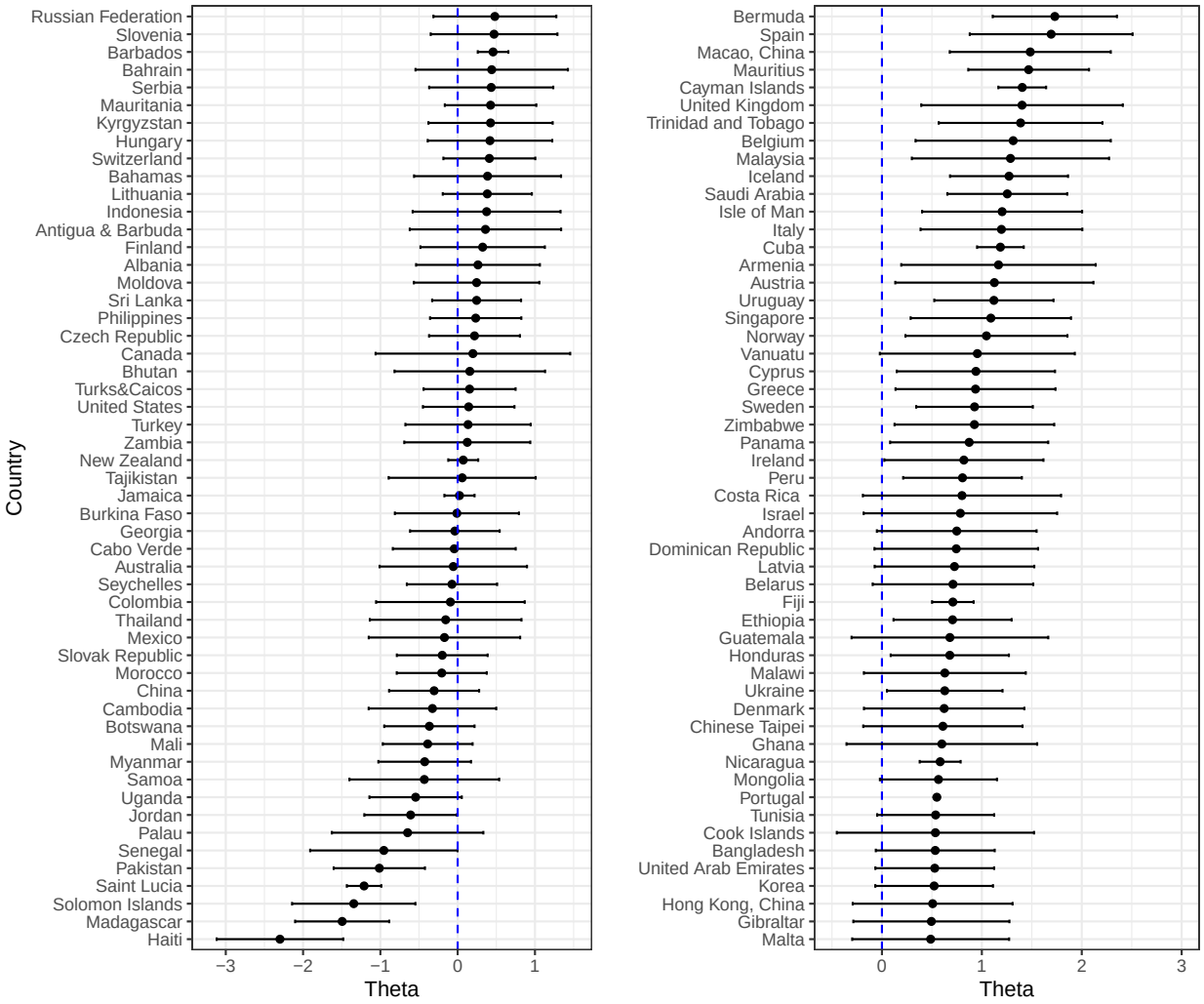


Figure 3.6: AML/CFT Technical Compliance in 2021

These results show each country's technical compliance for year 2021. Many countries had lower estimates in prior years but have improved their compliance over time. The top five countries with the strongest levels of structural AML/CFT includes Spain which has been a key architect of this system and three small island nations, Bermuda, Mauritius, and the Cayman Islands. These countries are all rated compliant for Recommendation 22 which requires DNFBPs conduct customer due diligence. These rankings may reflect a response to recent de-risking, particularly in the Caribbean. According to the World Bank, the loss

of correspondent banking relationships have been pervasive for small countries (WB, 2018). The Central Bank of Trinidad and Tobago, which currently has the 7th strongest structural AML/CFT rating, has specifically produced guidance on increasing compliance with FATF AML/CFT regulations as a tool to avoid the economic costs of de-risking.[12] Their technical AML/CFT score reflects this strategy.

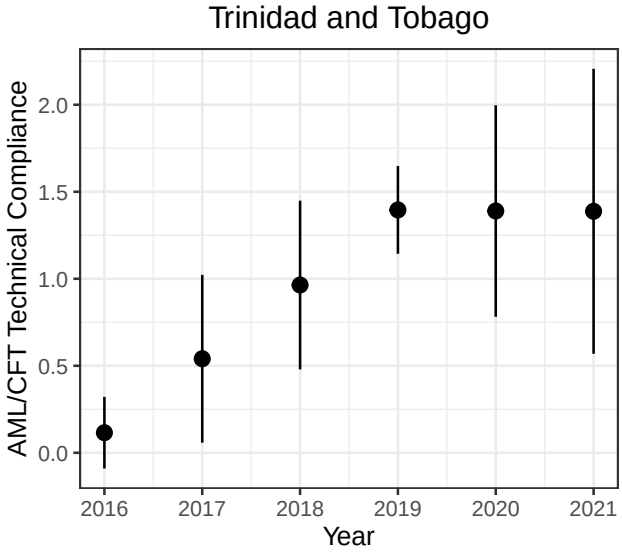


Figure 3.7: Trinidad and Tobago Technical Compliance Estimates 2016-2021

Figure 3.7 shows Trinidad and Tobago's estimated technical compliance from 2016-2021. In the plot, the dots represent Trinidad and Tobago's estimated score and the lines show the 95 % credible interval. Trinidad and Tobago received an average AML/CFT technical rating in their 2016 Mutual Evaluation Report. With this report as a template and fears about de-risking in the Caribbean, the government of Trinidad and Tobago sought to strengthen their AML/CFT framework. In 2019, the FATF released the three year follow up report for Trinidad and Tobago. This visualization also demonstrates key features of the dynamic IRT model used to estimate latent structural AML/CFT. The credible intervals for years

[12]https://www.central-bank.org.tt/index.php/news-centre/presentations/de-risking-or-withdrawal-correspondent-banking-relationships

with reports in 2016 and 2019 are smaller, demonstrating our higher certainty of those values given available data. The dynamic model smooths the estimates for 2017 and 2018 which aligns with Trinidad and Tobago making improvements to their compliance with FATF recommendations across these years. The 2019 report described significantly improved compliance with recommendations, increasing their ratings on 18 recommendations.[13] The estimates for 2020 and 2021 show the highest uncertainty as there are not yet reports available for these or subsequent years.

3.4.2 Effectiveness

Next I consider a country's latent capacity to counter the financing of terrorism and money laundering. To construct this variable, I include 11 manifest variables drawn from the FATF Mutual Evaluation Reports immediate outcomes. Collectively, these items rate whether a government understands and can identify AML/CFT threats, uses AML/CFT tools, engages in international cooperation in sharing financial intelligence, and has the ability to block exploitation of financial systems for AML/CFT.

Table 4.7 in the appendix lists the items and Figure 3.17 provides the difficulty α and discrimination β parameters for these variables which I only discuss briefly. I include the difficulty parameters for the third cut-point, representing the cut-point between the highest two levels of effectiveness. The immediate outcome with one of the lowest α values relates to international cooperation. This item states: "International cooperation delivers appropriate information, financial intelligence, and evidence, and facilitates action against criminals and their assets"(FATF, 2012-2020*a*). The literature on international relations would suggest this finding is surprising given the challenges of international cooperation, especially on issues that arguably impinge on sovereignty. However, this is within the context of countries that

[13]The report is available here: http://www.fatf-gafi.org/media/fatf/documents/reports/fur/cfatf-4mer-3fur-trinidad-and-tobago.pdf

have already joined FATF and assented to an invasive Mutual Evaluation Report. In many cases, this item reflects a country's willingness to receive financial intelligence rather than produce and disseminate that information. Of the items with highest α values, three relate to regulating financial institutions and DNFBPs. As we learned with structural AML/CFT, codifying regulations of financial entities and DNFBPs can be a difficult or unwelcome political task for governments. Only governments with the highest AML/CFT capacity and willingness are able to regulate and conduct oversight over these entities.

Figure 3.8 presents estimates for each country's latent AML/CFT capacity and willingness based on their Mutual Evaluation Reports which were conducted from 2014-2021.

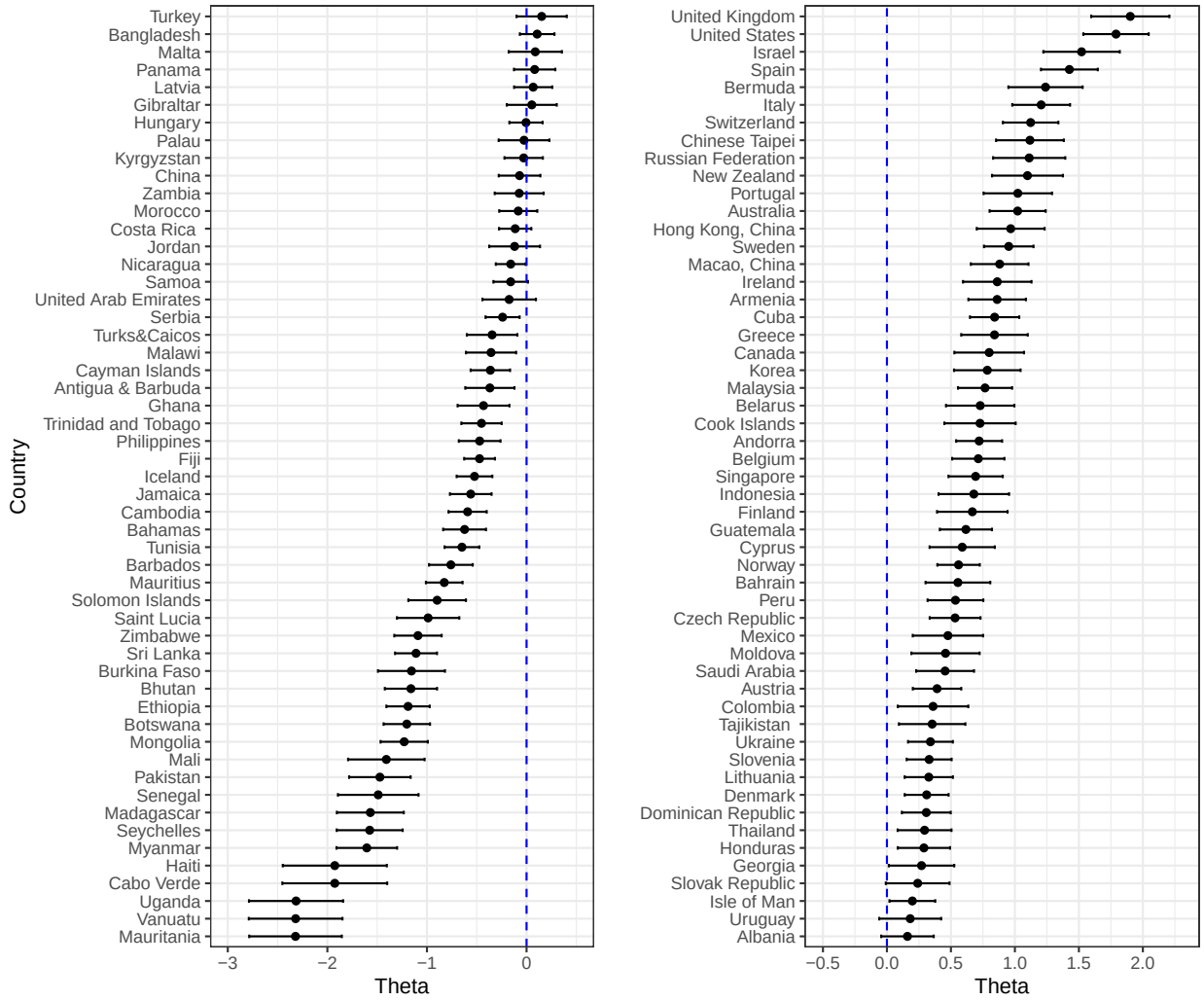


Figure 3.8: AML/CFT Effectiveness in 2021

3.5 Discussion of Dynamic IRT Measures

Together these results point to several interesting aspects of the global AML/CFT regime. Technical compliance and effectiveness are positively correlated, with a Pearson's Correlation Coefficient of 0.75 based on initial Mutual Evaluation Reports. Figure 3.9 shows this correlation with the regression line plotted. Countries above the regression line have relatively higher technical compliance compared to states of similar effectiveness. Countries below the

regression line have lower technical compliance than would be predicted based on their effectiveness. These scores will not match the most recent technical compliance scores in Figure 3.6 because those scores incorporate updated information from Follow-up Reports. Since AML/CFT effectiveness is not evaluated in Follow-up Reports, it is most straightforward to compare the correlation between measures from the first Mutual Evaluation Reports. The most recent technical compliance scores have a Pearson's Correlation Coefficient of 0.49 with effectiveness. Figure 3.19 in the appendix provides a scatterplot based on the most recent technical compliance scores.[14]

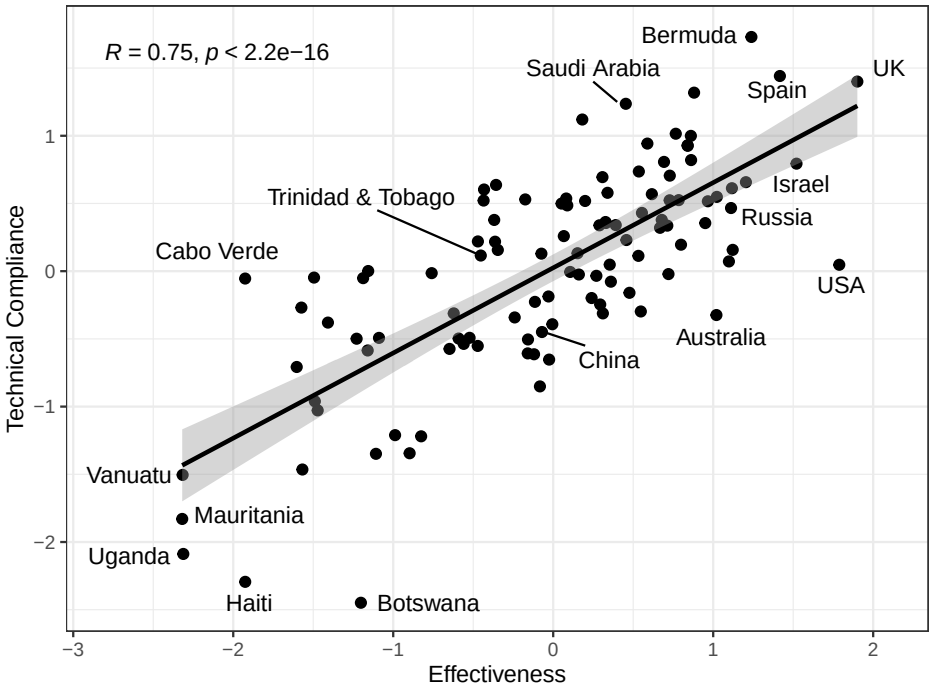


Figure 3.9: Scatterplot of effectiveness and technical compliance estimates based on initial Mutual Evaluation Reports

Although highly correlated, strong AML/CFT structures is not a necessary condition for effectiveness. For example, the United States has the second most effective AML/CFT system yet ranks in the bottom 30% for current technical compliance. This result is sur-

[14]Figure 3.18 and Figure 3.20 in the appendix provide these same plots with all countries labeled.

prising considering the United States' role in championing efforts to counter the financing of terrorism (Zarate, 2013). Although this is not out of character with the United State's behavior in international agreements broadly, often demonstrating involvement and leadership in the creation of international regimes, but then failing to ratify the legislation domestically.[15] The United States' low technical compliance is driven by their non-compliance with measures on DNFBPs and the transparency and beneficial ownership of legal persons and arrangements. The United States does not require casinos, accountants, dealers in precious metals and stones, lawyers, and other DNFBPs to conduct enhanced customer due diligences nor comply with AML requirements. The United States' lax regulatory environment toward company ownership has been critiqued for allowing shell companies to flourish.[16]

Despite ranking in the top five for AML/CFT structures, Mauritius, Trinidad and Tobago and the Cayman Islands all have below average AML/CFT effectiveness. Mauritius and the Cayman Islands have even been placed on the FATF's list of jurisdictions under increased monitoring as of February 2021 for low AML/CFT effectiveness. The FATF specifically describes a lack of law enforcement training and capacity as hindering the efficacy of Mauritius' strong AML/CFT structure. Similarly, the FATF critiques the Cayman Islands' lack of enforcement, particularly in overseeing the behaviors of private companies.

Bermuda also sticks out as an interesting case. Bermuda has the highest level of technical compliance and the fifth highest level of effectiveness. Bermuda is a well-known tax haven where shell companies are used to avoid corporate taxes. Google has been reported as using a Dutch shell company to shelter $23 billion on Bermuda which has a 0% corporate tax rate.[17] Given the importance of Bermuda as a hub for legal tax-avoidance schemes, it follows that they want to ensure all transactions are well documented to minimize the risk of nefarious financing that could invite investigations. Banks and other companies that have

[15]This includes the International Criminal Court, human rights treaties, and climate change initiatives.
[16]For examples see https://www.globalwitness.org/en/press-releases/shell-companies-secrecy-and-us/
[17]See https://www.theguardian.com/technology/2019/jan/03/google-tax-haven-bermuda-netherlands

violated AML/CFT provisions have faced hefty fines and may consider reinvesting in safer jurisdictions. Other tax havens such as Vanutu also have strong AML/CFT structures but are unable or unwilling to use them effectively.

These results show the different incentives that drive structural AML/CFT and effective AML/CFT systems. In some cases, structural AML/CFT reflects the efforts of small, financially vulnerable countries that seek to avoid the costs of de-risking. Compliance with FATF recommendations can be a strategy to regain or maintain access to financial services and correspondent banking. AML/CFT effectiveness reflects the capacity and willingness to secure financial systems from illicit exploitation. These countries tend to be larger in size, economically powerful, and more central to the international financial system. Countries like the United States and Australia are less vulnerable to de-risking given their economic position and have fewer incentives to comply with recommendations that may anger powerful business interests.

These models present the first attempt to measure and compare cross-national AML/CFT structures and effectiveness. There are several limitations of these measures that should be considered. First, I have discussed the geographic and temporal limitations of this study. While we have gleaned important knowledge from these models, they currently only cover 106 jurisdictions of the 200 FATF members. The remaining reports have either not been conducted and released yet or the member has not allowed a review process. This creates a non-random sample of countries. Researchers must carefully consider the implications of this sample on their analysis when using these measures. Second, Follow-up Reports provide updated information on technical compliance over time but do not evaluate effectiveness. These reports do not allow us to evaluate the impact of improved technical compliance scores on effectiveness. The examples of Mauritius and Cayman Islands suggest technical compliance may not result in higher levels of effectiveness. When follow up Mutual Evaluation Reports are published we will be able to evaluate the temporal trends of these two variables better.

Finally, the modeling approach has allowed me to create yearly measures for each country despite the limitations on reports. Yet, the effectiveness measure is not time-series and the technical compliance measure is slow-moving (due to infrequency of Follow-up Reports). These can be used to study cross-national variation, but researchers should be cautious of these temporal limitations in their own analyses.

3.5.1 Geographic Trends

I explore these measures and their validity further by evaluating variation in technical compliance and effectiveness across countries. Figure 3.10 presents the geographic spread of country counter-illicit financing systems.

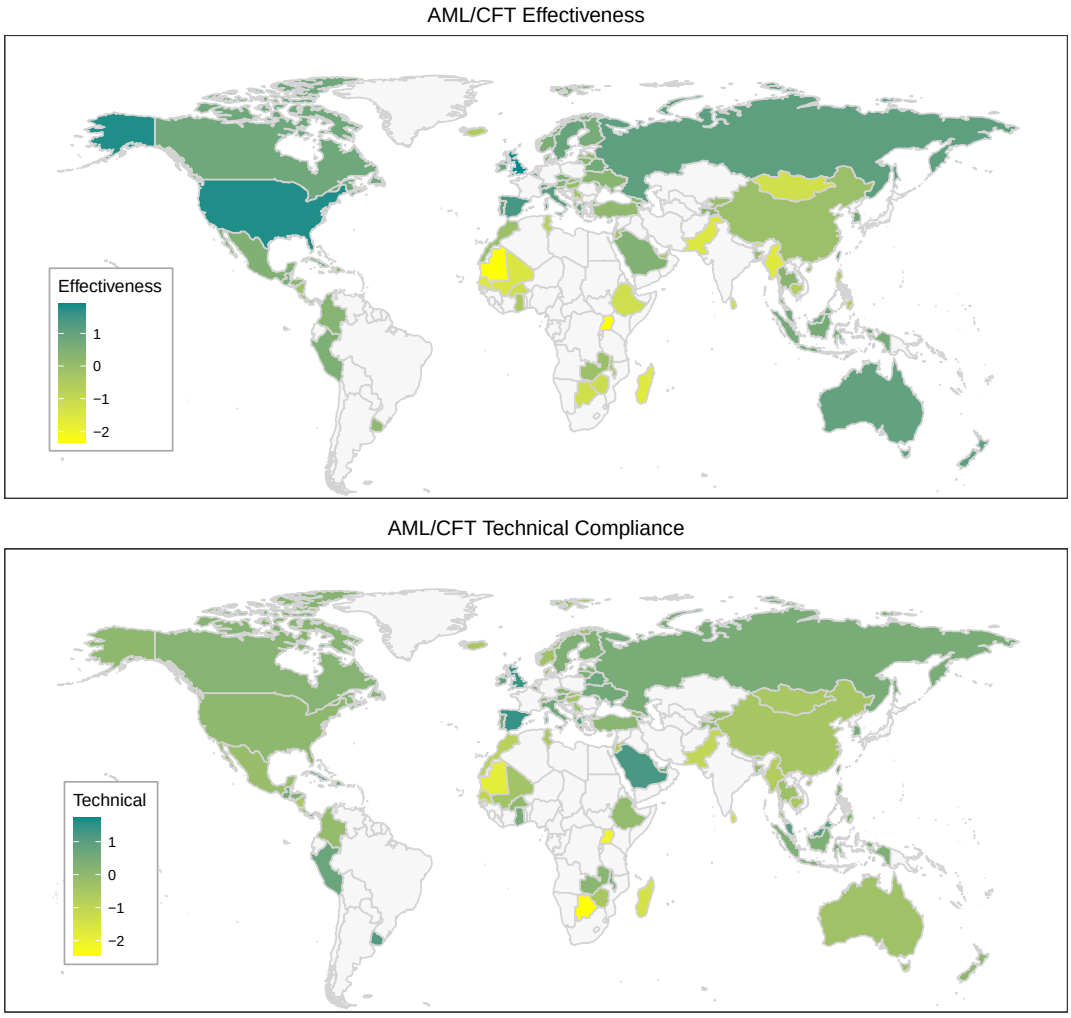


Figure 3.10: Estimates of AML/CFT Structures and Effectiveness from Mutual Evaluation Reports

The top map shows the level of effectiveness based on Mutual Evaluation Reports released from 2014- May 2021. Countries in light gray have no report available. Dark green represents higher levels of capacity and willingness to disrupt illicit financing and light yellow represents low AML/CFT effectiveness. Some clear geographic trends emerge from this visualization. More developed countries such as the United States, Canada, Spain, United Kingdom, Australia, and Russia have more effective AML/CFT systems. Countries located in North, Central, and South America all have strong scores as do most European countries

with reports available. Many African and East Asian states have relatively weaker scores. These results suggest regional integration and coordination may enhance AML/CFT capabilities. These regional trends are also present in the distribution of technical compliance and may be connected to regional economic integration that encourages similar financial regulations.

The second map shows trends in technical compliance. This map reflects the technical compliance scores that a country first received in their Mutual Evaluation Report. These values match the time-period available for the effectiveness scores. See Figure 3.21 in the appendix for a map with the update technical compliance scores based on Follow-up Reports. This map shows similar patterns to the geographic distribution of effectiveness. European countries are exceptionally strong across both dimensions of AML/CFT. The weakest areas for technical compliance are in Africa, although there is large variation across the continent. The updated map in Figure 3.21 shows fewer regional distinctions as countries with weak structural AML/CFT have worked to improve their technical compliance.

Saudi Arabia stands out for its strong technical compliance score. In the 1980s the Saudi monarchy established a financial system for connecting wealthy donors, charities, and mosques to facilitate the flow of money to non-violent and violent Islamic movements throughout the Middle East (Zarate, 2013). This financial system was exploited by Al-Qa'ida to finance the 9/11 attacks on the United States (Zarate, 2013; Kean, Hamilton et al., 2004). In 2002, the United States Treasury Security Paul O'Neill personally led a delegation to Saudi Arabia to begin negotiations with the Saudi monarchy over shutting down their network of terrorist financing charities and disrupting the flow of funds to Al-Qa'ida and other violent groups (Zarate, 2013). Since 2003, the Saudis have publicly embraced international efforts to counter the financing of terrorism and money launder (Blanchard and Prados, 2007). However, there remains a gulf between their technical compliance and the flow of money that continues to fund violent non-state actors from Saudi charities and donors (Zarate,

2013; Blanchard and Prados, 2007). In 2019, the European Union temporarily added Saudi Arabia to a list of "high-risk countries" for their failures in AML/CFT, however by 2020 the Kingdom of Saudi Arabia succeeded in leveraging political power for their removal (Turak, 2019; Guarascio, 2020).

The Saudi case highlights how some governments may use relatively cheap compliance with legal provisions as a public relations strategy to bolster their country's reputation or attract foreign investors. I expect these larger geopolitical concerns and international relations to undergird many states' efforts to improve their compliance with FATF recommendations. These political issues may elucidate states with high technical compliance but relatively weak capacity or willingness to effectively enforce AML/CFT. This also demonstrates the importance of measuring AML/CFT technical compliance alongside effectiveness, which can distinguish weak signals of compliance from meaningful efforts to insulate financial systems from exploitation.

3.5.2 Convergent Validity with Quality of Government Institutions

To demonstrate content validity of latent variable models, studies often replicate prior work that uses a single variable or additive scales to measure the same underlying concept (Treier and Jackman, 2014; Fariss, 2019; Solis and Waggoner, 2020). To the author's knowledge, this study represent the first attempt to cross-nationally measure counter-illicit financing systems, so no similar body of work exists. Instead, I evaluate the convergent validity of these measures by exploring their similarity to other measures of government quality and country features (Fariss and Lo, 2020; Trochim and Donnelly, 2008).

State counter-illicit financing systems encompass a strong legal and law enforcement toolbox as well as demonstrated capacity to effectively use those tools to produce financial controls on AML/CFT. These measures are likely to reflect the quality of a government's institutions broadly. Governments with more effective governing systems can leverage their

resources and technical expertise to enact and enforce these provisions. Strong underlying state institutions, such as law enforcement agencies and financing oversight bureaus, are characteristics of a state with strong capacity and are necessary to fulfill FATF recommendations and successful disrupt illicit financing. I consider several alternative measures of government capability and institutional quality. Figure 3.11 explores the correlation between these variables and country features.[18]

An imprecise but commonly used measure of state capacity is Gross Domestic Product per Capita (GDP). This measure is frequently used to proxy state strength or administrative capacity in the conflict literature (Hendrix, 2010; Fearon and Laitin, 2003). I use data on logged GDP per capita from the World Bank. As expected, GDP is strongly correlated with effectiveness and technical compliance. This measure has a particularly strong correlation with effectiveness which matches the concept of interest.

[18]To create these plots I use data from 2016-2020. Correlation plots require no missing values and I use list-wise deletion to create them. For this reason, the correlation between Effectiveness and Technical compliance varies across plots.

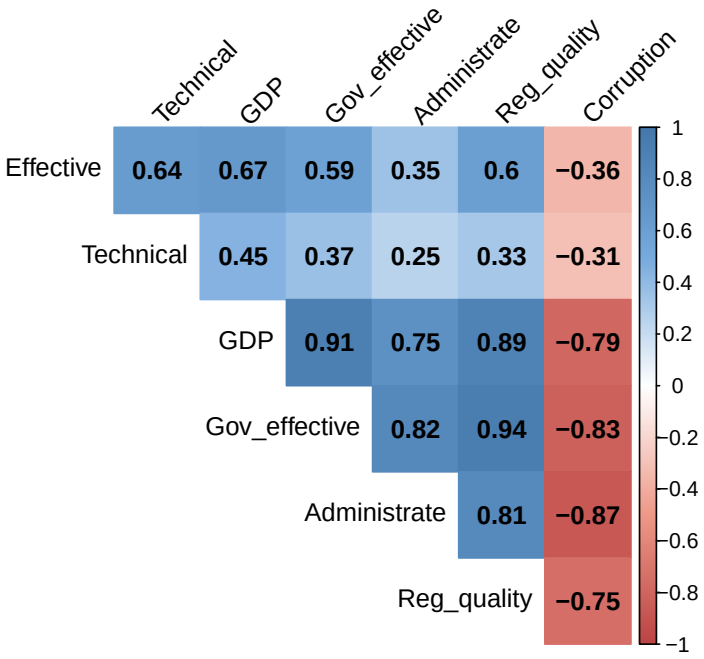


Figure 3.11: Correlation of AML/CFT Structures and Effectiveness and Quality of Government Institutions

Government effectiveness (*Gov_effective*) is the World Governance Indicator of the measure of "perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies" (Kaufmann, Kraay and Mastruzzi, 2011). Rigorous and impartial public administration (*Administrate*) is included from the Varieties of Democracy (VDEM) project. This variable measures whether "public officials are rigorous and impartial in the performance of their duties" (Coppedge et al., 2021). A well-functioning bureaucracy is vital for AML/CFT provisions which require coordination across agencies, monitoring of fine-grain financial transactions, and uncorrupted implementation of regulations. These measures are both positively

correlated with both AML/CFT structure and effectiveness.

Regulatory quality (*reg_quality*) is a measure of perceptions over the government's ability to formulate and implement regulations that promote private sector development from the World Governance Indicators (Kaufmann, Kraay and Mastruzzi, 2011). This is an interesting index, as it combines measures of government ability to regulate with a Western capitalist expectation that regulations should not be overly burdensome on businesses. This includes variables on tariffs, ease of starting a business, barriers to foreign investors, trade policy, regulator burden, and discriminatory taxations. Higher scores indicate regulatory environments that are fair, with clear and understandable provisions, uncorrupted in business dealings, and are business-friendly. The ability to implement these provisions shows a governments ability to effectively navigate complex financial matters, however, investors might also find AML/CFT provisions to be onerous regulations. Both measures of state counter-illicit financing systems are positively associated with regulatory quality. However, this measure is the largest gap between the two measures.

In the discussion of AML/CFT capacity and willingness, I expected government corruption to be antithetical to the success of these provisions. Corrupt politicians use many of the same legal loopholes, such as shell companies, as money launderers and terrorist groups to transfer and store bribes and embezzle funds. To evaluate this, I use the political corruption index *Corruption* from V-Dem. This index provides a broad measure of corruption across members of the executive to public bureaucrats including both petty and grand exchange of goods for favors or influence (Coppedge et al., 2021). As expected, corruption is negatively correlated with both measures of counter-illicit financing systems.

Collectively, measures of government institutional quality are more highly correlated with AML/CFT effectiveness which matches the conceptual distinction between these two dimensions. I briefly evaluated whether AML/CFT structures are more closely associated with international connectivity and the pressures that may come from reliance on the interna-

tional system for economic or political support. For example, if countries are highly reliant on international trade then concerns over de-risking might be particularly acute and drive compliance as it has in the Caribbean. Figure 3.22 provides the correlation of these measures with three measures of international connectivity: trade, resource rents as a percentage of GDP, and autonomy. AML/CFT structures have a weak (0.16) positive correlation with Trade, a weak (-0.16) negative correlation with the percentage of GDP as resource rents and no correlation with the level of autonomy from the international system. The relationship with trade fits my expectations about states reliant on international trade improving compliance to safeguard against financial exclusion, however, further work should evaluate how these state preferences interact with the preferences from firms involved in trade and foreign investment.

3.6 Resilience to Illicit Financing and Political Violence

I briefly evaluate the underlying objective of these provisions. The goal of economic counterinsurgency, including these specific policies, is to reduce political violence by cutting off violent groups' access to financing. However, recent work has evaluated specific economic counterinsurgency tools and found mixed results. Paul, Clarke and Grill (2010) reviews 30 resolved insurgency cases from 1978-2008 and finds that reducing tangible support to insurgents is a highly effective strategy. In the eight successful cases of counterinsurgency in the sample, counterinsurgents disrupted at least three forms of tangible support and in the 22 cases where counterinsurgency was deemed a failure, counterinsurgent forces disrupted no more than two sources of support (Paul, Clarke and Grill, 2010). Section 1503 of the Dodd-Frank Act was created to break the link between natural minerals and conflict in Eastern Democratic Republic of Congo, but has been associated with increased violence and looting in affected areas (Bloem, 2018; Stoop, Verpoorten and Van der Windt, 2018).

Targeted sanctions and foreign terrorist lists are associated with reduced violence conditional on group adaptability (Radtke and Jo, 2018) and location (Phillips, 2019), but can increase violence against civilians from predatory groups (Simonelli, 2021*a*). Sector-specific initiatives such as the Kimberley Process diamond certification and Extractive Industries Transparency Initiative have been successful at curtailing violence in some countries, but not others (Grant, 2012; Bone, 2012; Beevers, 2015; Rustad, Le Billon and Lujala, 2017).

Collectively, this work shows the potential benefits and risks of specific economic counterinsurgency policies. However, no work has cross-nationally evaluated the role of systemic economic counterinsurgency, such as the recommendations supported by FATF. This analysis provides an initial look at the relationship between AML/CFT systems and the prevalence of terrorism and insurgent violence. I expect that structural AML/CFT alone will have little impact on levels of political violence. The existence of laws may have some deterrent effects, forcing terrorists and criminals to expend some time and resources to reroute their financial transactions elsewhere to avoid oversight. However, until these tools are employed and funding streams are disrupted it is unlikely that laws alone would have a real impact on a violent non-state actor's ability to perpetrate violence. After all, these are actors that are well acquainted with operating outside the scope of the law.

Figure 3.12 shows the correlation of effectiveness and technical compliance with three different measures of political violence. Battle Deaths is the count of battle-related fatalities in a year from the Uppsala Conflict Data Program (UCDP). This measure captures the intensity of violence between government forces and insurgent groups. Simonelli (2021*a*) shows that economic counterinsurgency provisions, such as sanctions, might impact a group's battlefield violence differently from their violence against civilians. To evaluate this, I include two measures of violence against civilians. Civilian Deaths is a measure of the one-sided attacks on civilians by violent non-state actors from UCDP. Terror is the number of terrorist attacks in a given country-year from the Global Terrorism Database (GTD). This measure

includes a range of violence from small isolated incidents resulting in no fatalities to coordinated terrorist campaigns by large insurgent groups. Included attacks target a range of actors including governments and civilians.

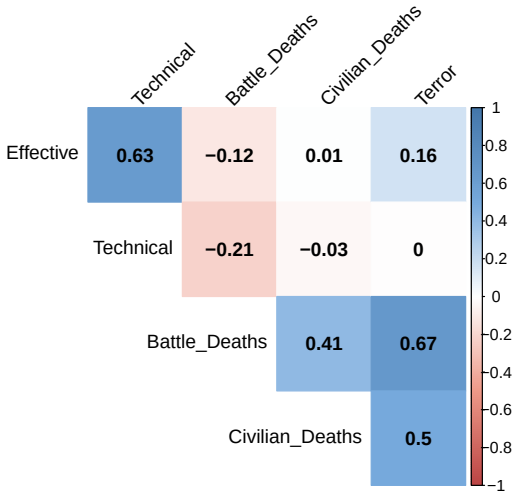


Figure 3.12: Correlation of AML/CFT Structures and Effectiveness and Political Violence

Both measures of financial AML/CFT robustness are negatively associated with battle deaths. This may provide support for these measures as tools to disrupt the funding to insurgent groups or could reflect that governments that are not involved in civil wars have a higher capacity to implement structural reforms. The first measure of violence against civilians, civilian deaths, is not associated counter-illicit financing systems. However, terrorist attacks have a weak positive association with effective AML/CFT policies. There are several possible explanations for this relationship. First, correlation tests cannot isolate the causality between two variables. It is plausible that terrorist attacks would prompt a government to devote more resources toward blocking the financing of terrorism. Terrorism from an Al-Qa'ida affiliate in Saudi Arabia from 2003-2007 was pivotal in the Saudi monarchy deciding to disrupt terrorist financing networks (Blanchard and Prados, 2007). Second, the increase

in terrorism could be associated with a decline in insurgency. If AML/CFT provisions are effective they should block an insurgent's ability to raise and transfer money, diminishing the resources available to procure matériel and support troops. Terrorism is a relatively cheap form of political violence (Crenshaw, 1981) and these correlations may indicate a shifting from the financial intensive tactic of battling governments to cheaper bombings and shootings that can be conducted with few resources and personnel. This conclusion would be a troubling side effect of these provisions and undermine one of the primary goals of these international standards.

I use linear regression to evaluate these relationships further. I include data from 2016-2019 which captures the majority of counter-illicit financing scores as well as availability of covariate data. The measure of AML/CFT effectiveness does not vary over time and the measure of technical compliance varies for some countries, but is relatively slow moving. For these reasons, I evaluate political violence cross-nationally. I include fixed effects for the year. To control for alternative explanations of political violence I include the log of GDP per capita, the log of population and the percentage of GDP that stems from resource rents from the World Bank. Democracy is the electoral democracy index from V-Dem. The dependent variable is the log of UCDP Battle deaths or GTD Terrorist attacks in a given country-year.

I use multiple imputation to estimate the missing data values. This technique uses predictive mean matching to estimate the missing values. Single imputation can underestimate the uncertainty of the dataset. Multiple imputation builds on this technique but incorporates greater uncertainty by creating multiple imputed values. I create five datasets with imputed estimates and then pool over these datasets when conducting my analysis. This strategy is preferable to other options, such as list-wise deletion. First, the scope of the data is already somewhat limited so it is best to retain as many values as possible. Second, the conditions when list-wise deletion are most appropriate, when values are missing at random, are not

met in the sample. Table 3.1 presents the results from the pooled analysis. Models run on the individual imputed datasets are available in the appendix for battle deaths in Table 3.5 and terrorism in Table 3.6.

Table 3.1: Pooled Results of Linear Models of Political Violence

	Dependent variable:	
	Battle Deaths	Terror Attacks
AML/CFT Effectiveness	−0.244* (0.139)	0.102 (0.114)
AML/CFT Technical Compliance	−0.202 (0.138)	−0.002 (0.113)
AML/CFT Effectiveness × Technical	0.054 (0.086)	−0.069 (0.070)
GDP per Capita (log)	−0.004 (0.093)	0.058 (0.076)
Population (log)	−0.055 (0.056)	0.366*** (0.038)
Democracy	−0.465 (0.376)	0.153 (0.314)
Terror Attacks (log)	0.740*** (0.065)	-
Battle Deaths (log)	-	0.489*** (0.043)
Resource Rents	−0.011 (0.014)	0.003 (0.011)
Intercept	1.081 (1.354)	−5.542*** (1.041)
Observations	240	240
Year FE	Yes	Yes

Note: AML/CFT = Anti-Money Laundering and Countering the Financing of Terrorism GDP = Gross Domestic Product

Note: *p<0.1; **p<0.05; ***p<0.01

The results show that AML/CFT effectiveness is associated with fewer battle deaths. AML/CFT technical compliance is also negative but the probability that the result would be observed due to chance is 14.5% which is above the traditional cutoff for statistical significance in these models. Surprisingly the interaction term is positive although the coefficient is very small and not statistically significant. If this result were stronger it would indicate countries with high levels of technical compliance and effectiveness experience more civil war violence which would warrant further investigation. However, the results indicate that the model cannot deduce the true relationship and this result is inconclusive. The results for the model evaluating terrorist attacks is similarly inconclusive for the primary measures of interest. AML/CFT effectiveness retains the positive relationship observed in the correlation matrix, but neither variable is significant. Other common covariates such as democracy and GDP per capita do not provide much explanatory power for the variation in these samples either.

Due to the temporal limitations and empirical approach, this study cannot isolate the causal link between the AML/CFT effectiveness and political violence. Countries with strong financial resilience may be better at countering the threats of insurgent groups. However, this result could also indicate that states which are not busy fighting active insurgencies are better able to devote resources toward preventative measures. Although the casual link cannot be isolated, these results demonstrate the importance of considering counter-illicit financing systems when evaluating the occurrence of political violence.

3.7 Conclusion

Economic counterinsurgency is a central strategy in government efforts to counter violent non-state actors. The effective implementation of these policies has been a feature of every successful counterinsurgent effort in recent decades (Paul, Clarke and Grill, 2010). To

better understand and explore economic counterinsurgency, this chapter has presented the first cross-national measures of counter-illicit financing systems. I use FATF mutual evaluation reports and dynamic item response theory models to construct measures of AML/CFT structures and government capacity and willingness to counter money laundering and terrorist financing. The results show that technical compliance with FATF recommendations does not necessarily lead to more effective AML/CFT systems.

This chapter demonstrates how AML/CFT structures and effectiveness can contribute to our understanding of political phenomena and be useful to policymakers. First, I have uncovered how business interests may be a significant roadblock to the development of AML/CFT structures. Only countries with the most rigorous AML/CFT structures extend these laws to regulate financial and non-financial businesses. These regulations can be costly, as foreign investors may prefer markets with less oversight and fewer reporting requirements. AML/CFT legislation is an important and overlooked consideration of the desirability of host markets and these estimates can help explain investor behavior.

Second, this chapter contributes to the nascent literature on economic counterinsurgency. The results show that effective AML/CFT systems are associated with lower intensity civil wars. This not only deepens our understanding of systematic economic counterinsurgency, but is a necessary feature when evaluating targeted measures as well. Ceteris paribus a targeted economic counterinsurgency measure is likely to be more effective in a country with robust AML/CFT systems. In countries with weaker AML/CFT structures or effectiveness, a domestic government might not cooperate with international efforts or lack the enforcement capacity to confiscate assets. The targeted group may more easily evade sanctions by storing monies under aliases or using unregulated informal value transfer systems. Without considering country-level financial robustness this variation would be attributed to the sanction itself. This parallels other policy evaluation areas; we would not expect to understand the efficacy of a specific anti-poverty policy without considering the extant economic and

social systems that it operates under. The inclusion of this important source of variation could help explain the mixed results in the broader economic counterinsurgency literature.

Finally, policymakers can use these estimates and framework to evaluate counterparts' counter-illicit financing systems and separate false signals of compliance from strong AML/CFT systems. The results show that several countries that have the strongest AML/CFT structures fail to effectively block the illicit exploitation of their financial systems. Information is a key aspect of international cooperation and bargaining. The information provided by these measures can help regulators understand compliance and reduce enforcement noise for efforts to enhance international institutions.

3.8 Appendix

Item	Description
IO1	Money laundering and terrorist financing risks are understood and, where appropriate, actions coordinated domestically to combat money laundering and the financing of terrorism and proliferation
IO2	International co-operation delivers appropriate information, financial intelligence, and evidence, and facilitates action against criminals and their assets.
IO3	Supervisors appropriately supervise, monitor and regulate financial institutions and DNFBPs for compliance with AML/CFT requirements commensurate with their risks.
IO4	Financial institutions and DNFBPs adequately apply AML/CFT preventive measures commensurate with their risks, and report suspicious transactions.
IO5	Legal persons and arrangements are prevented from misuse for money laundering or terrorist financing, and information on their beneficial ownership is available to competent authorities without impediments.
IO6	Financial intelligence and all other relevant information are appropriately used by competent authorities for money laundering and terrorist financing investigations.

IO7	Money laundering offenses and activities are investigated and offenders are prosecuted and subject to effective, proportionate and dissuasive sanctions.
IO8	Proceeds and instrumentalities of crime are confiscated.
IO9	Terrorist financing offenses and activities are investigated and persons who finance terrorism are prosecuted and subject to effective, proportionate and dissuasive sanctions.
IO10	Terrorists, terrorist organizations and terrorist financiers are prevented from raising, moving and using funds, and from abusing the NPO sector.
IO11	Persons and entities involved in the proliferation of weapons of mass destruction are prevented from raising, moving and using funds, consistent with the relevant UNSCRs.

Table 3.2: FATF Effectiveness Immediate Outcomes

Item	Description
	AML/CFT Policies and Coordination
R1	Assessing Risks and Applying a Risk-Based Approach
R2	National cooperation and coordination
	Money Laundering and Confiscation
R3	Money laundering offence
R4	Confiscation and provisional measures
	Terrorist Financing and Financing of Proliferation
R5	Terrorist financing offence
R6	Targeted financial sanctions related to terrorism & terrorist financing
R7	Targeted financial sanctions related to proliferation
R8	Non-profit organisations
	Preventive Measures
R9	Financial institution secrecy laws
R10	Customer due diligence

R11 Record keeping
R12 Politically exposed persons
R13 Correspondent banking
R14 Money or value transfer services
R15 New technologies
R16 Wire transfers
R17 Reliance on third parties
R18 Internal controls and foreign branches and subsidiaries
R19 Higher-risk countries
R20 Reporting of suspicious transactions
R21 Tipping-off and confidentiality
R22 DNFBPs: Customer due diligence
R23 DNFBPs: Other measures

Transparency and Beneficial Ownership of Legal Persons and Arrangements

R24 Transparency and beneficial ownership of legal persons
R25 Transparency and beneficial ownership of legal arrangements

Powers and Responsibilities of Competent Authorities and Other Institutional Measures

R26 Regulation and supervision of financial institutions
R27 Powers of supervisors
R28 Regulation and supervision of DNFBPs
R29 Financial intelligence units
R30 Responsibilities of law enforcement and investigative authorities
R31 Powers of law enforcement and investigative authorities
R32 Cash couriers
R33 Statistics
R34 Guidance and feedback
R35 Sanctions

International Cooperation

R36 International instruments
R37 Mutual legal assistance
R38 Mutual legal assistance: freezing and confiscation

R39	Extradition
R40	Other forms of international cooperation

Table 3.3: FATF 40 Recommendations

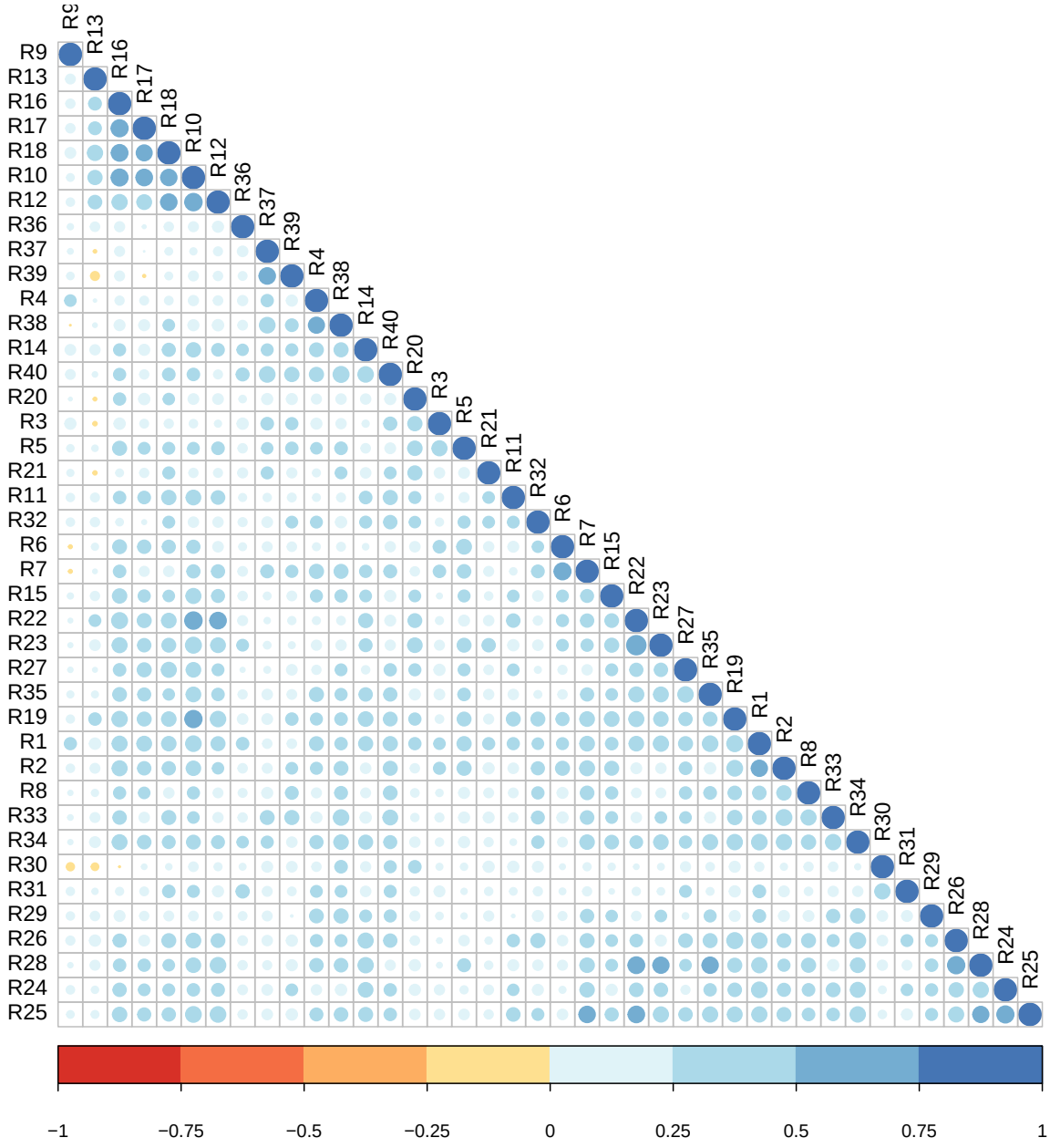


Figure 3.13: Technical Recommendations Correlation Plot

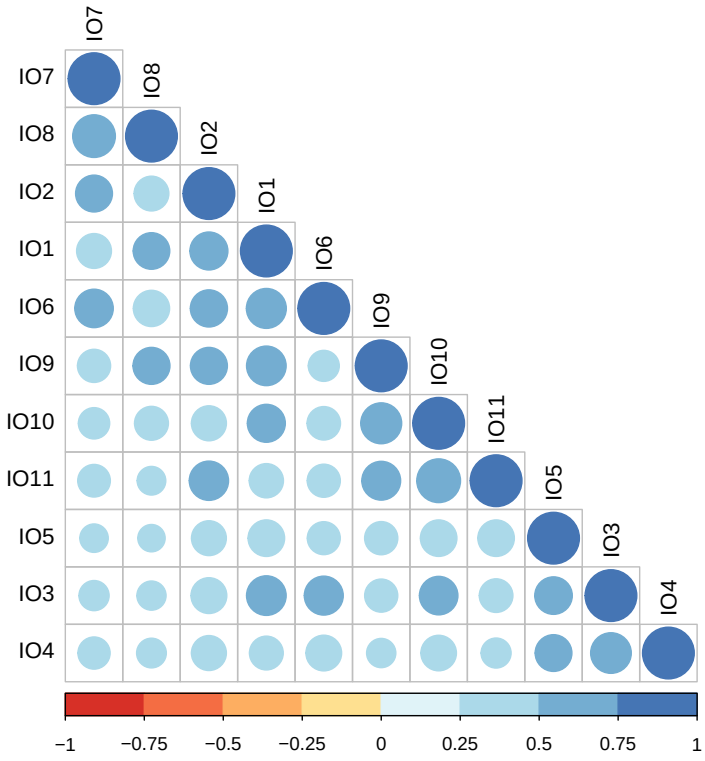
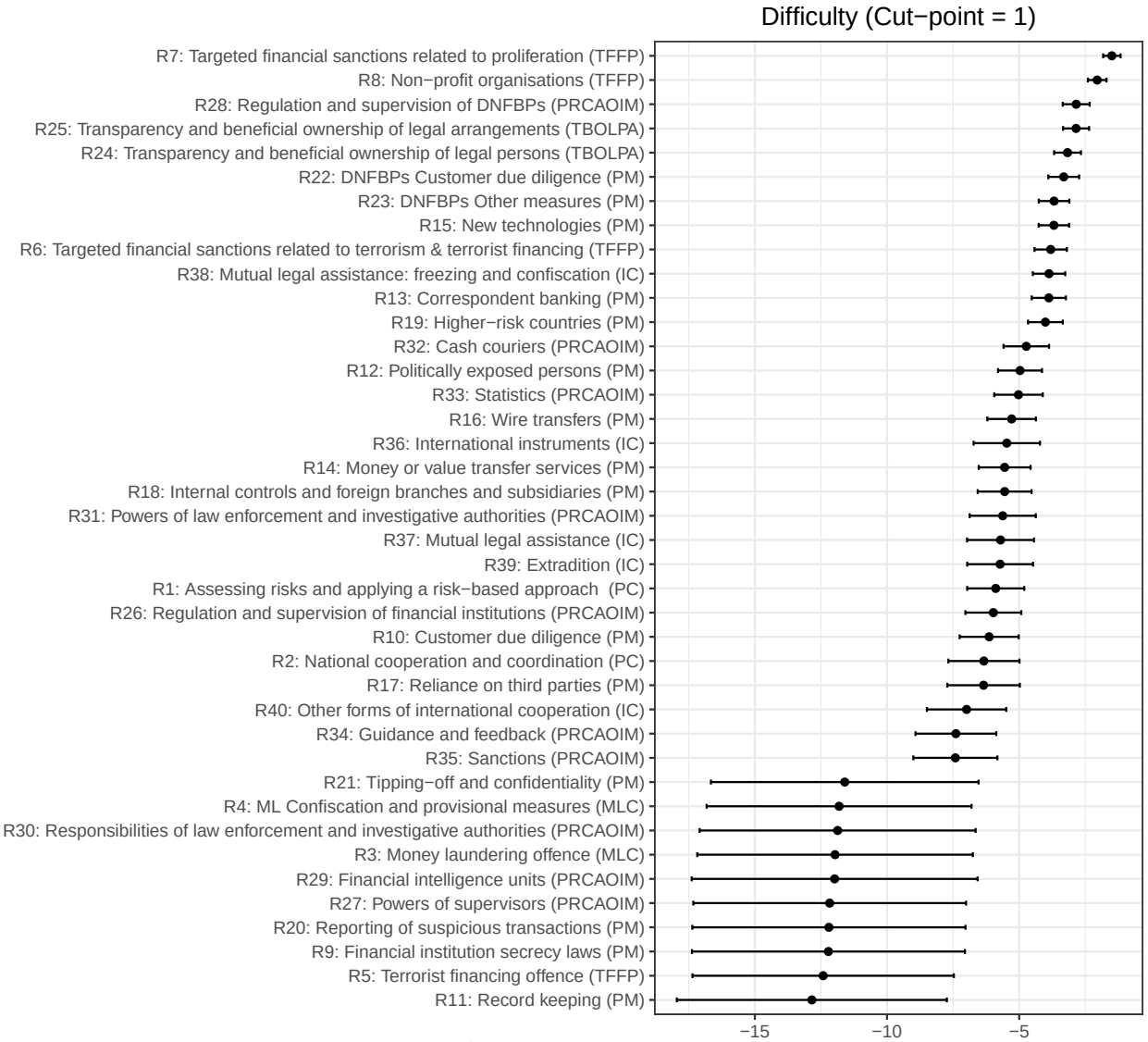


Figure 3.14: Effectiveness Immediate Outcomes Correlation Plot



Note: Recommendations are listed with their FATF categories. PC = Policies and Coordination. MLC= Money Laundering and Confiscation. TFFP= Terrorist Financing and Financing of Proliferation. PM=Preventive Measures. TBOLPA= Transparency and Beneficial Ownership of Legal Persons and Arrangements. PRCAOIM=Powers and Responsibilities of Competent Authorities and Other Institutional Measures. IC= International Cooperation

Figure 3.15: Discrimination (α) parameters of cut-point 1

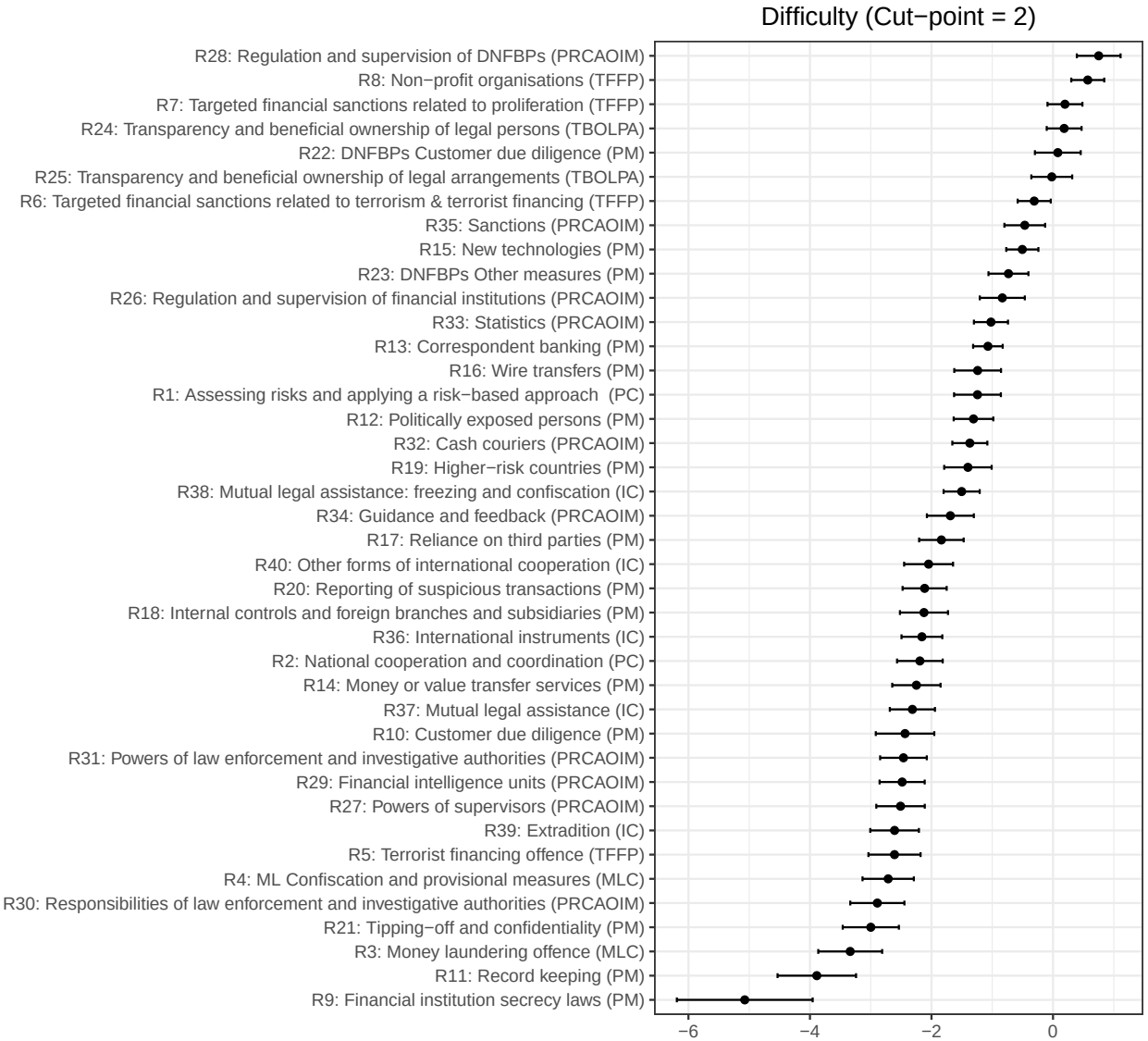


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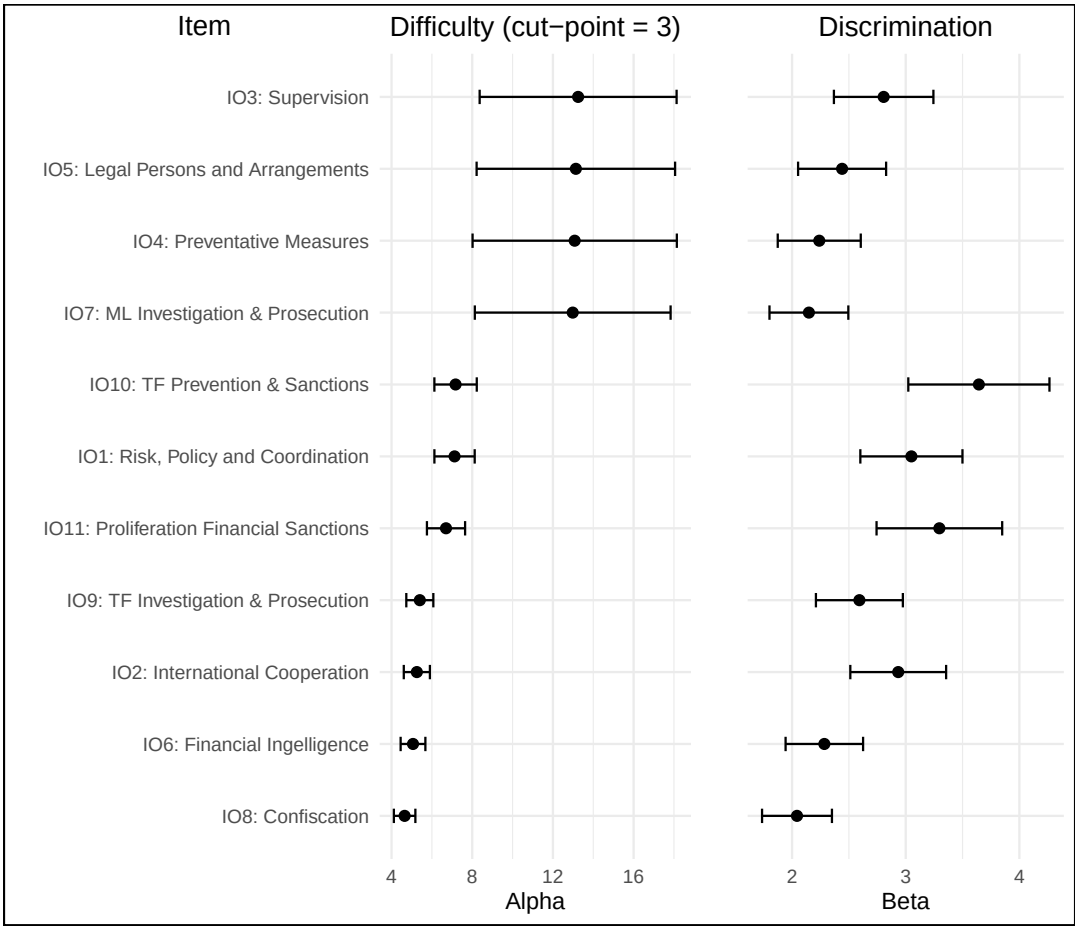
Figure 3.16: Discrimination (α) of cut-point 2

Figure 3.17: Discrimination and Difficulty parameters



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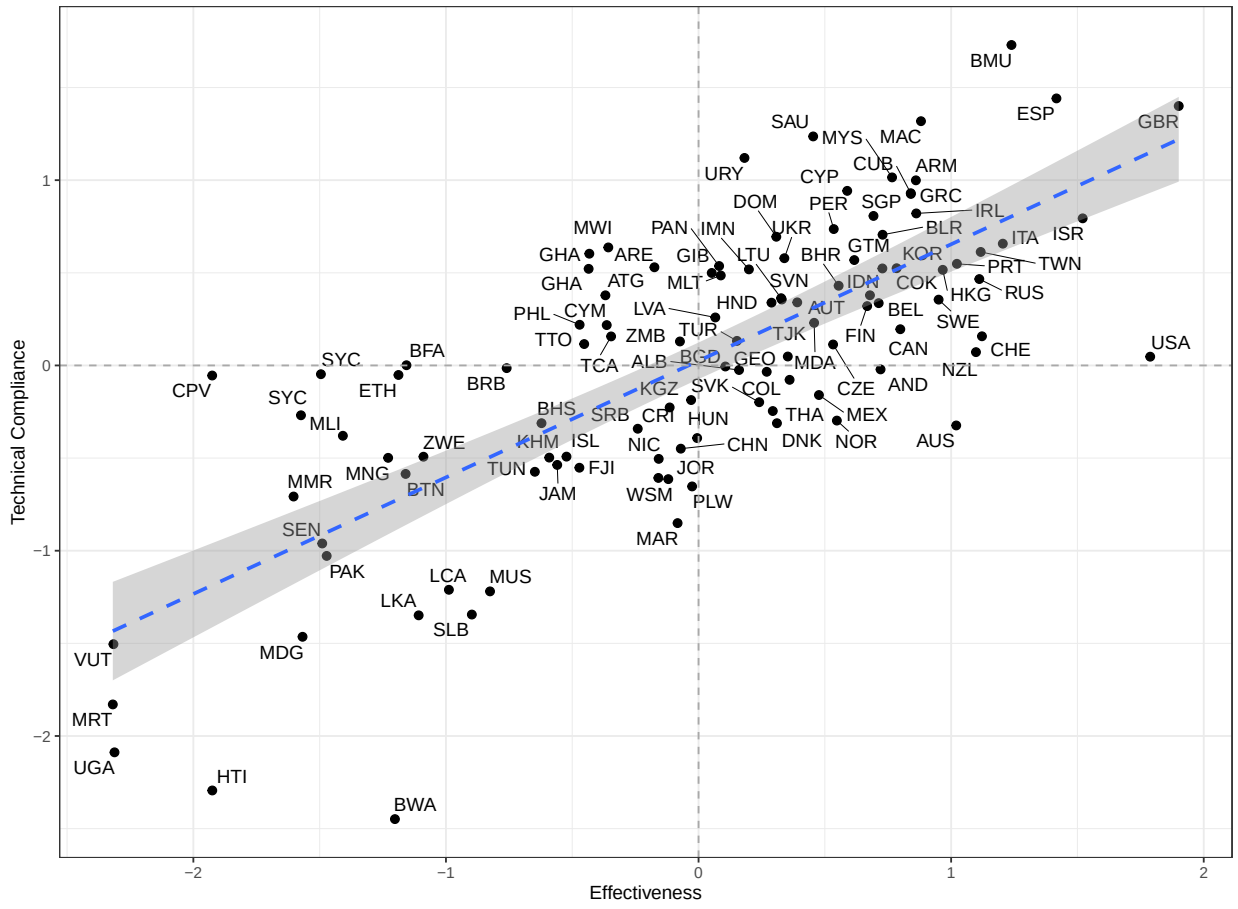

Figure 3.18: Scatterplot of Effectiveness and Technical Compliance with Country Labels (ISO 3c) based on first Mutual Evaluation Reports

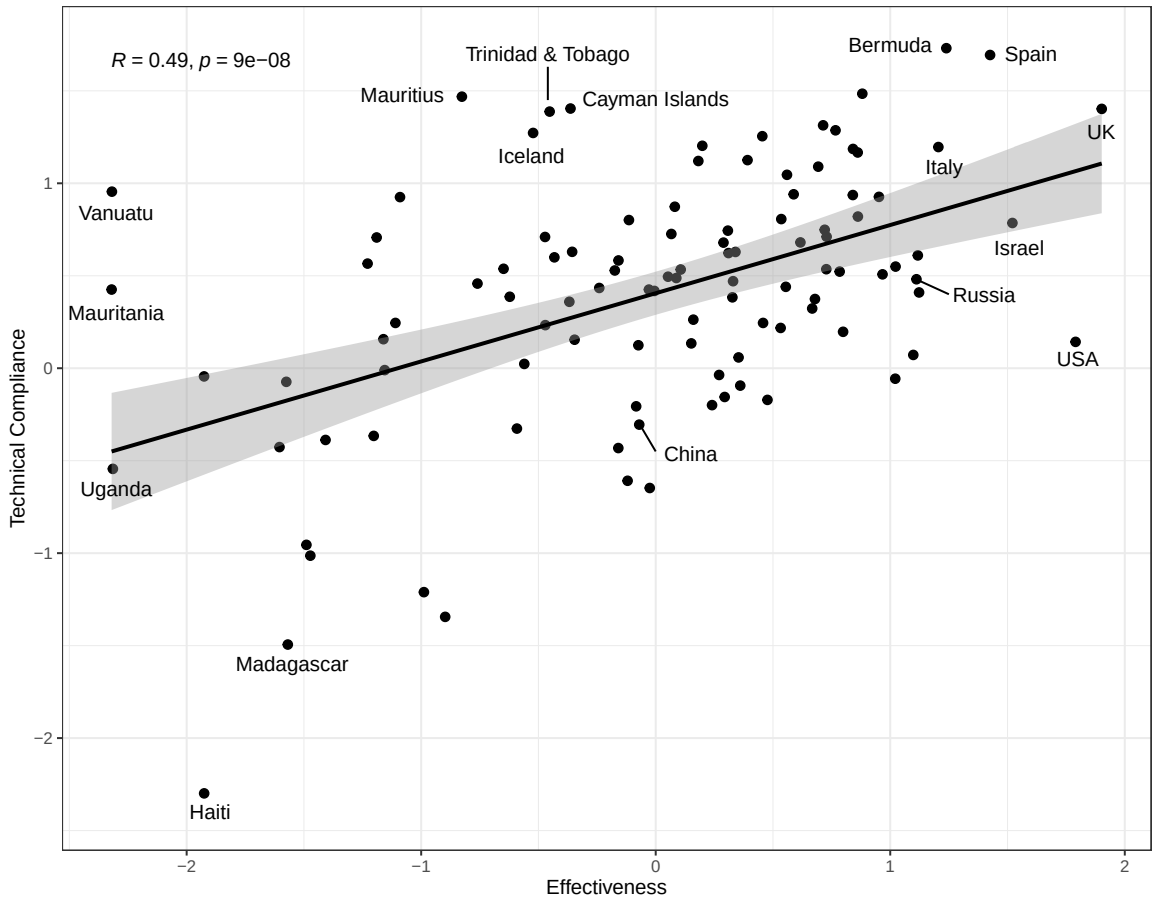

Figure 3.19: Scatterplot of effectiveness and technical compliance estimates in 2021

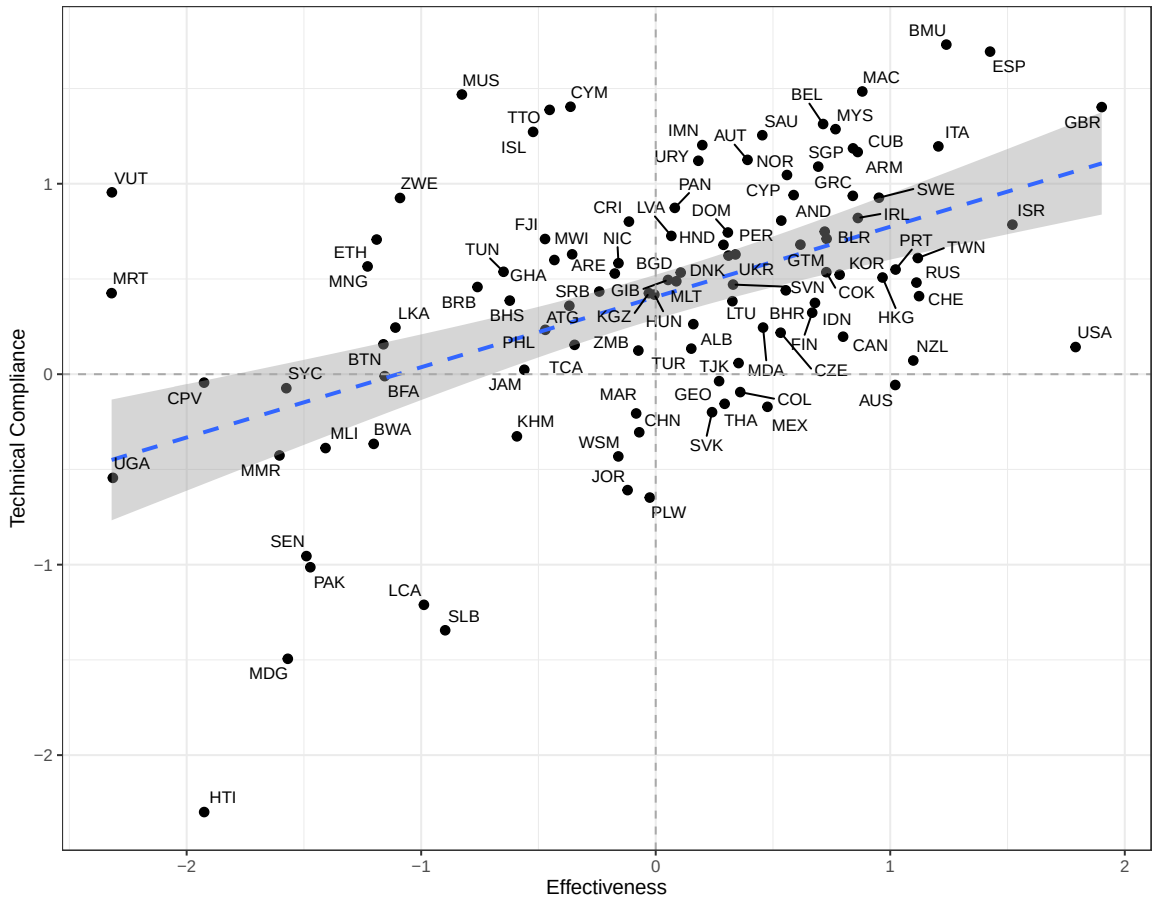

Figure 3.20: Scatterplot of Effectiveness and Technical Compliance with Country Labels (ISO 3c) based on 2021 values

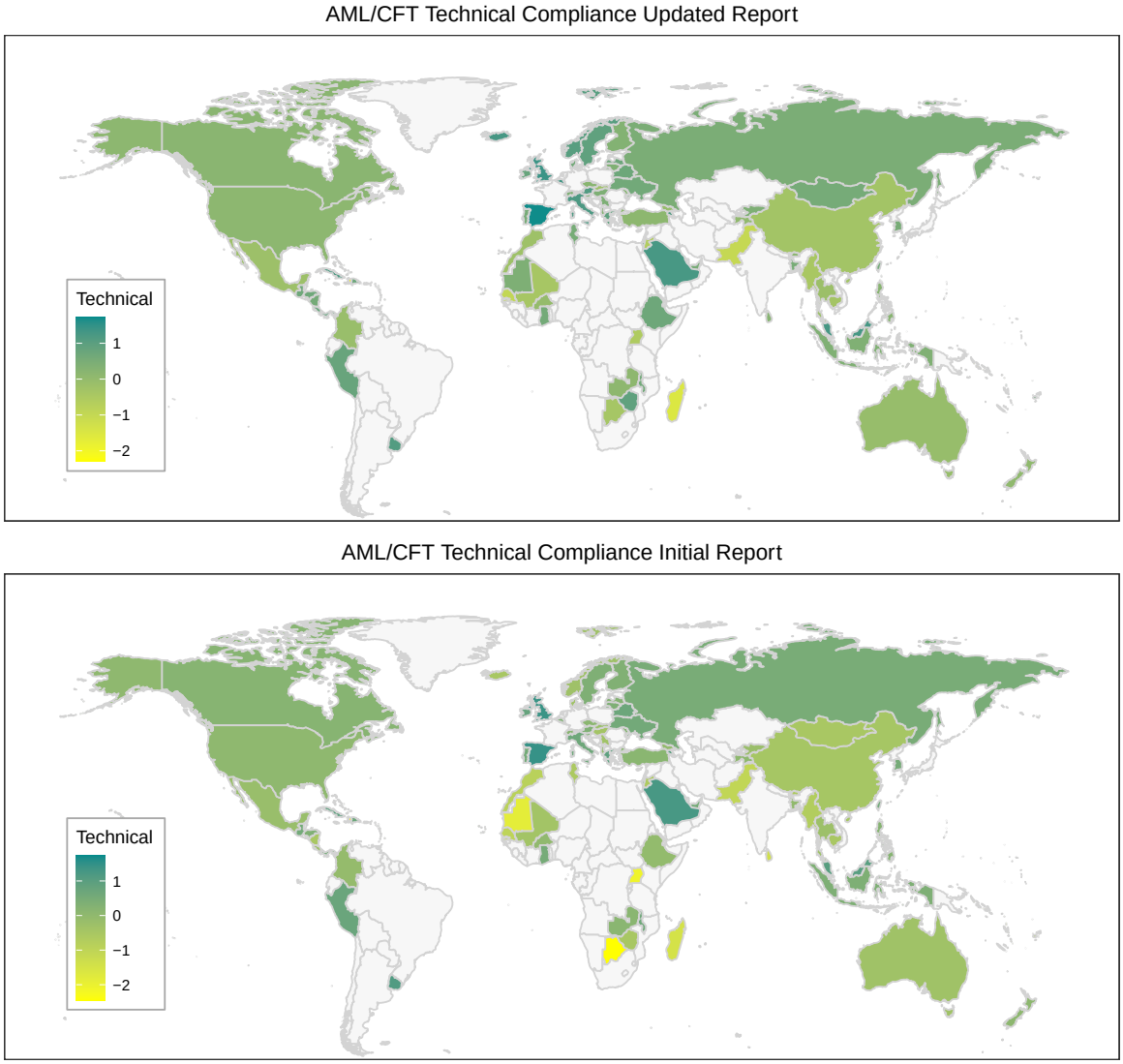

Figure 3.21: Estimates of AML/CFT Effectiveness and Technical Compliance from Reports updated through 2021

Table 3.5: Models of Insurgent Violence Across Five Imputed Datasets

	Dependent variable:				
	Battle Deaths				
	(1)	(2)	(3)	(4)	(5)
AML/CFT Effectiveness	−0.229	−0.251*	−0.263*	−0.243*	−0.236*
	(0.141)	(0.139)	(0.139)	(0.136)	(0.136)
AML/CFT Technical Compliance	−0.202	−0.199	−0.194	−0.208	−0.209
	(0.140)	(0.139)	(0.138)	(0.138)	(0.137)
AML/CFT Effectiveness × Technical	0.056	0.054	0.059	0.046	0.052
	(0.086)	(0.086)	(0.086)	(0.086)	(0.086)
GPD per Capita (log)	−0.007	0.001	0.001	−0.003	−0.014
	(0.093)	(0.092)	(0.093)	(0.093)	(0.094)
Population (log)	−0.059	−0.056	−0.051	−0.053	−0.054
	(0.055)	(0.056)	(0.056)	(0.055)	(0.056)
Democracy	−0.408	−0.493	−0.477	−0.490	−0.456
	(0.364)	(0.376)	(0.374)	(0.368)	(0.388)
Terror Attacks (log)	0.741***	0.739***	0.740***	0.740***	0.741***
	(0.065)	(0.065)	(0.065)	(0.065)	(0.065)
Resource Rents	−0.002	−0.012	−0.017	−0.010	−0.014
	(0.011)	(0.014)	(0.014)	(0.010)	(0.011)
Intercept	1.104	1.084	0.998	1.062	1.154
	(1.361)	(1.353)	(1.367)	(1.341)	(1.344)
Observations	240	240	240	240	240
Year FE	Yes	Yes	Yes	Yes	Yes
Adjusted R^2	0.492	0.494	0.495	0.495	0.495
Note:					*p<0.1; **p<0.05; ***p<0.01

Table 3.6: Models of Terrorist Attacks Across Five Imputed Datasets

	Dependent variable:				
	Terror Attacks				
	(1)	(2)	(3)	(4)	(5)
AML/CFT Effectiveness	0.118	0.090	0.097	0.108	0.098
	(0.115)	(0.114)	(0.114)	(0.112)	(0.111)
AML/CFT Structure	−0.013	0.007	−0.004	−0.001	0.001
	(0.114)	(0.113)	(0.113)	(0.113)	(0.112)
AML/CFT Effective × Structure	−0.070	−0.068	−0.071	−0.064	−0.069
	(0.070)	(0.070)	(0.070)	(0.070)	(0.070)
GDP per Capita (log)	0.061	0.048	0.063	0.064	0.053
	(0.075)	(0.075)	(0.075)	(0.075)	(0.076)
Population (log)	0.361***	0.371***	0.368***	0.361***	0.368***
	(0.038)	(0.038)	(0.039)	(0.038)	(0.039)
Democracy	0.083	0.212	0.166	0.078	0.224
	(0.296)	(0.306)	(0.305)	(0.301)	(0.316)
Battle Deaths (log)	0.487***	0.488***	0.489***	0.490***	0.490***
	(0.043)	(0.043)	(0.043)	(0.043)	(0.043)
Resource Rents	0.006	−0.004	0.004	0.006	0.003
	(0.009)	(0.011)	(0.012)	(0.008)	(0.009)
Intercept	−5.457***	−5.552***	−5.631***	−5.493***	−5.578***
	(1.044)	(1.037)	(1.048)	(1.030)	(1.030)
Observations	240	240	240	240	240
Year FE	Yes	Yes	Yes	Yes	Yes
Adjusted R^2	0.655	0.655	0.655	0.655	0.655

Note: *p<0.1; **p<0.05; ***p<0.01

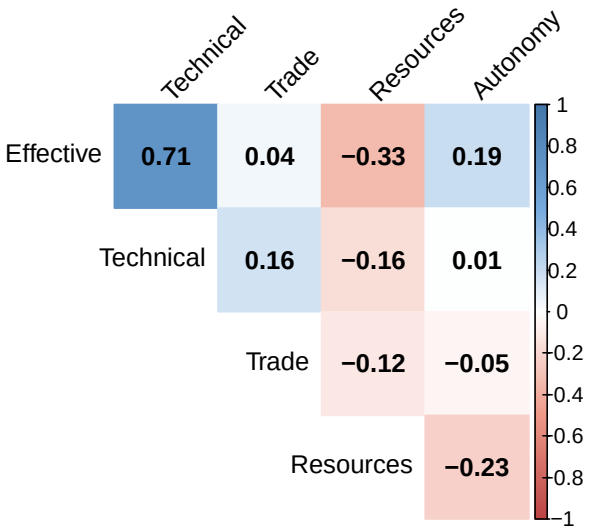

Figure 3.22: Correlation of Financial Resilience Measures and International Connections

CHAPTER IV

Counter-Illicit Financing Measures and Foreign Investment

4.1 Introduction

On the morning of December 6, 1989, a vehicle containing 1,100 pounds of dynamite detonated outside the Administrative Department of Security (DAS) building in the middle of a bustling commercial district in Bogotá, Colombia (Long, 1989). The explosion, claimed by the notorious Medellín Cartel to target a government intelligence unit, ripped through the prominent district, killing 57 people, injuring hundreds, and destroying or damaging commercial buildings within a two-square-mile area (AP, 1989). The deadly terrorist attack capped off a decade of violence across the globe fueled by powerful cartels enriched by drug trafficking and money laundering. This growing violence propelled world leaders to pour resources into disrupting intricate global networks for drug trafficking and money laundering. To coordinate these efforts, the Group of Seven (G-7) created the Financial Action Task Force (FATF) in 1989 to develop international standards on combating money laundering.[1]

[1]The Group of Seven is an intergovernmental organization comprising seven leading industrial countries and tasked with coordinating strategies to global challenges. Its members are Canada, France, Germany, Italy, Japan, the United Kingdom and the United States. Russia was a member from 1997 until 2014 during which time the organization was called the G-8.

FATF's scope and standards were expanded to include countering terrorist financing in the 2000s. The goal of these standards is to understand, monitor, and block illicit exploitation of legitimate financial markets and international trade. Under the coordination of FATF, individual governments and intergovernmental organizations have created a massive interconnected system of regulations, surveillance, and enforcement with purview over every part of the global financial system.

This chapter evaluates how this relatively new system of financial oversight impacts the investment choices of multinational firms, the key actors propelling global economic activity. Foreign direct investment (FDI) has been a major cause of development in the 20th century and some argue it has contributed to a decline in civil conflict (Schneider, 2017; De Soysa and Fjelde, 2010). Multinational corporations (MNCs) have globalized their supply chains to exploit the unique competitive advantages and input profiles of countries around the world.[2] Firms generally seek out stable host markets where business operations are predictable and political risks are low (Busse and Hefeker, 2007; Jensen, 2008; Johns and Wellhausen, 2016; Vernon, 1971). Firms are attracted to host markets with low taxation, laws that protect businesses from government overreach, and strong rule of law (Biglaiser and Staats, 2012; Staats and Biglaiser, 2012; Jensen, 2008; Li and Resnick, 2003). Investment flees from host markets where governments might intercede in business dealings or expropriate assets and where political violence, such as the bombing of the DAS building, can destroy assets and interrupt business (Abadie and Gardeazabal, 2008; Bandyopadhyay, Sandler and Younas, 2018; Braithwaite, Kucik and Maves, 2014; Witte et al., 2016; Powers and Choi, 2012).

Given these preferences, state counter-illicit financing systems present a challenge for firms evaluating the suitability of a host market. The international standards to counter

[2]Multinational corporations refers to firms that own assets, produce goods, or sell services in more than one country. I use the terms MNCs, firms, FDI, and foreign investors interchangeably in this manuscript to describe these actors. If I reference a firm that only engages in domestic economic activity I will specify this with the term "domestic firm".

money laundering and terrorist financing laid out by FATF encompass substantial government oversight into foreign firm's business dealings, require companies invest in or be subject to onerous customer due diligence procedures, and erode customer privacy expectations that are cultural tenets of financial institutions. However, these provisions also emphasize anti-corruption in government and, if effective, should reduce funding for political violence that can be antithetical to smooth business operations. State counter-illicit financing systems send conflicting signals on the desirability of a host market to investors.

My theory unravels these contradictory preferences by evaluating two components of a state's counter-illicit financing strategy. Anti-money laundering and countering the financing of terrorism (AML/CFT) structures are the legal frameworks and regulatory tools available to monitor, track, disrupt, and prevent money laundering and terrorist financing. These provisions include significant regulatory and monitoring requirements for financial institutions and businesses involved in trade. AML/CFT effectiveness encompasses the government's capacity and willingness to use their AML/CFT toolbox to disrupt money laundering and terrorist financing. This variable captures how well the government and AML/CFT institutions functions and achieves the goal of preventing criminal and terrorist actors from raising, transferring, and sending funds through the financial system.[3]

I argue that firms seek out host markets where they can minimize the costs of invasive AML/CFT regulations but reap the benefits of a government with a strong capacity to counter illicit financing and of an environment free of well-financed violent actors. This leads to divergent preferences between a state's counter-illicit financing systems. Firms most prefer host markets characterized by weak AML/CFT structures but strong AML/CFT effectiveness. However, as AML/CFT regulations and restrictions on business dealings become

[3]I use the terms structural AML/CFT and AML/CFT technical compliance interchangeably. Both terms refer to the first dimension of illicit financing robustness which captures the underlying laws and tools in a country. I use the terms AML/CFT capacity and willingness interchangeably with AML/CFT effectiveness. This second dimension captures a governments ability to identify, enforce, and disrupt money laundering and terrorist financing.

more onerous, firms prefer governments less adept at implementing them. Thus firms' preferences for governments that are effective at enforcing AML/CFT diminishes as the AML/CFT structures they are subject to increase. I test my theory using original data on state counter-illicit financing systems and FDI inflows. The results support my central contentions about firm preferences over state AML/CFT structures and AML/CFT effectiveness. Firms prefer host markets characterized by low AML/CFT structures but high AML/CFT effectiveness and investment into strong host markets decreases with increasing AML/CFT regulations. This finding has important implications for the success of these international efforts.

This chapter offers several contributions to the study of foreign investment and political violence. First, this work identifies an important new source of variation across host markets that drives investment decisions. My conceptualization of counter-illicit financing as falling along two dimensions and original data allows me to evaluate divergent firm preferences over these relatively new concepts. Second, this work highlights the interrelated nature of these traditionally separate areas of study in international relations. Incidents of political violence can directly or indirectly disrupt economic market activity. Policies designed to counter political violence are influenced by the interests of foreign investment and affect the location decisions of foreign firms. Foreign firms may be hampering these efforts and imperiling their own future investment by eschewing host markets where governments are attempting to strengthen their AML/CFT laws but are still developing their capacity. This finding has direct relevance for policymakers as foreign direct investment represents a significant share of many countries' economies and firms' preferences for less regulated markets may be an impediment to international efforts on AML/CFT. AML/CFT efforts are costly for domestic governments, and this study identifies an additional opportunity cost of repulsing foreign investors that seek out less regulated environments.

This chapter proceeds as follows. The next section presents my definitions of AML/CFT structures and AML/CFT effectiveness. I review FATF's international standards and the

responsibilities and costs associated with these standards for governments and private businesses. Next I review the literature on the desirability of host markets for foreign investment. I highlight the tension between a firm's preferences for low overhead costs and restrictions and their attraction to markets with well-functioning government bureaucracies that can protect firms from societal instability and violence. The following section presents my theory of firms' preferences over state robustness to illicit financing. The empirical strategy describes the data and linear regression model that I use to evaluate my hypotheses. I present my main results and conclude with a discussion of the study's implications and future research avenues.

4.2 Anti-Money Laundering and Countering the Financing of Terrorism Provisions

Anti-money laundering and countering the financing of terrorism provisions were constructed to monitor and disrupt three common channels illicit organizations use to raise, transfer, and launder money. The most common strategy illicit organizations use involves the legitimate international financial system using routine transfers between bank accounts and wire transfers. Money that is raised through illicit means, such as drug trafficking, will be transfered through a series of accounts, often with anonymous or fictitious ownership information, and across currencies or goods to obscure the original source of income. The money used to fund terrorism is often legally obtained and the financial system is used to transfer money to end users who will spend it for terrorist purposes. Alternatively, to avoid oversight and detection some criminal and terrorist organizations eschew the financial system and physically move funds through bulk cash smuggling. Cash couriers serve as intermediaries between sources of income and depositing and spending funds by physically moving cash across borders. Once the cash has arrived at its destination it is spent or deposited into

banks and rejoins the financial system with its origins obscured (FATF-MENAFATF, 2015).

The third most common method is trade-based money laundering (TBML) and trade diversion.[4] Trade-based techniques exploit existing supply chains, complicit or unwitting companies, and the daily transaction of legitimate goods in the global economy to exploit price differences across markets or launder money. Architects of these schemes falsify invoicing for goods and services, duplicate invoicing, or falsely describe the goods being transferred in order to launder illegally obtained funds. Trade diversion is a strategy to raise funds through illegal arbitrage, taking advantage of differences in prices across markets and diverting goods from their intended markets. Collectively, the financing of criminal and terrorist organizations has infiltrated every corner of the modern global economy, and efforts to disrupt them have similarly broad reach, impacting all firms in the international economic system.

International efforts to counter money laundering and illicit financing began in the late 1980s to disrupt the booming narcotics trade and violence that surrounded it (Biersteker and Eckert, 2007). The Financial Action Task Force (FATF) was founded in 1989 to develop international standards for disrupting money laundering. In 1990 the FATF produced 40 anti-money laundering recommendations to combat the thriving illicit drug trade. The FATF expanded their scope to include terrorist financing in 2001, resulting in eight (and later nine) recommendations to counter the financing of terrorism. These initial recommendations were focused on disrupting the first two channels of illicit financing, exploitation of the financial system and the smuggling of cash (FATF-Egmont, 2020). Increasing regulations and government surveillance of these systems pushed more organizations toward alternative funding strategies such as TBML and trade diversion schemes (FATF, 2006). The recommendations were revised in 2012 to reflect this illicit financing landscape and FATF produced a cohesive

[4]Trade based money laundering is defined by FATF as "the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimize their illicit origins"(FATF, 2006). Trade diversion involves diverting products from low-price to high-price markets often with the use of shell companies and falsified order documentation.

40 international standards on AML/CFT.

FATF recommendations are the international standard for AML/CFT and 200 countries and jurisdictions are members of the task force and FATF-style regional bodies. Member countries and jurisdictions are required to codify recommendations into domestic laws and build out their AML/CFT monitoring and enforcement infrastructure in line with recommendations. The recommendations are listed in Table 4.8 in the appendix. A central principle undergirding these standards is the risk-based approach. This approach involves the coordination of government authorities and private sector entities to identify the unique money laundering and terrorist financing challenges prevalent in their markets. Regulations and enforcement strategies are tailored to these vulnerabilities and are intended to evolve over time as the risks change. The overarching goal of the FATF is to facilitate international coordination, help states identify their risk landscapes, and develop preventative, investigative, and punitive measures to counter threats.

The FATF recommendations require the coordination and involvement of many actors in the international system. I briefly review the responsibilities that fall on the public sector, private sector, and the public-private partnership. This discussion reflects the environment should a country be completely in compliance with the FATF recommendations and have fully effective counter-illicit financing systems. In reality, countries have different levels of AML/CFT structures and AML/CFT effectiveness which is the key variation of interest in this study. The goal of the present section is to highlight the broad reach of these regulations and the various channels through which they impact firms involved in foreign investment and trade.

4.2.1 Public Sector Expectations

The domestic government is the centerpiece of AML/CFT provisions. A fully compliant government's responsibilities broadly fall under identifying risks and creating a risk-based

approach, creating policies and institutions to mitigate risks, facilitating cooperation domestically across government agencies and between public and private sector entities, monitoring and enforceing standards within the private sector, and coordinating with foreign governments and international bodies to share intelligence, implement sanctions, and strengthen AML/CFT capabilities. These recommendations include establishing specific authorities to monitor and enforce AML/CFT provisions, such as a Financial Intelligence Unit (FIU), and pursing actionable intelligence on illegal transactions through law enforcement and judicial agencies. Governments are further required to codify specific provisions, including criminalizing money laundering and terrorism financing, limiting financial secrecy laws, mandating customer due diligence for financial entities and designated-non financial entities, restricting value transfer systems and cash couriers.

The FATF standards arguably represent a significant encroachment on state sovereignty. To achieve a high level of compliance member states must implement specific AML/CFT laws, create new government authorities, and devote scare resources toward AML/CFT. Their sovereignty is further impinged by oversight from the FATF which conducts intensive on site evaluations of a country's technical compliance and effectiveness in countering money laundering and terrorist financing. These restrictions on privacy trickle down from the government's loss of sovereignty, through financial entities subject to increased government monitoring and enforcement, to individual firms and customers. The government is deemed responsible for creating, funding, and sustaining a robust AML/CFT system with purview into every wire-transfer, bank account, and new business customer establishing a relationship with a financial entity.

Accomplishing these responsibilities is costly for domestic governments. They must create and staff new agencies specifically tasked with monitoring financial intelligence. In 2019, the United Kingdom's Financial Intelligence Unit (UKFUI) received 570,000 suspicious activity reports from financial institutions that UKFUI officers had to cull through to identify threats

and leads (NCA, 2020). The information technology requirements and technical expertise required to track and evaluate suspicious transactions exceeds the capabilities of many governments. FATF tries to make up for these deficiencies through information sharing and technical trainings. Governments must also have the capacity to maintain statistics on their AML/CFT actions and guide and monitor financial institutions in their implementation of standards.

4.2.2 Private Sector Expectations

Financial institutions: Financial institutions are the frontlines in the battle against money laundering and terrorist financing.[5] Table 4.1 summarizes ten recommendations that specifically pertain to financial institutions within FATF's standards. Financial institutions are responsible for conducting customer due diligence (CDD), monitoring accounts for suspicious activities, implementing internal programs on AML/CFT, and reporting any suspicious transactions to government FIUs.[6] CDD provisions require financial entities obtain and verify information regarding the direct and beneficial owners of all accounts. This process is a time and resource intensive task that can delay transactions and repel customers with other financing options. There are additional CDD requirements for countries on FATF's "high-risk" list and foreign or domestic politically exposed persons (PEPs) and their families.[7] These requirements represent a significant shift from institutionalized policies of non-interferences and customer privacy.

[5]FATF defines a financial institutions "as any natural or legal person who conducts as a business one or more of the following activities or operations for or on behalf of a customer: 1. Acceptance of deposits and other repayable funds from the public; 2. lending; 3. financial leasing; 4. money or value transfer services; 5. Issuing and managing means of payment (e.g. credit and debit cards, cheques, traveller's cheques, money orders and bankers' drafts, electronic money); 6. Financial guarantees and commitments; 7. trading in (a) money market instruments (cheques, bills, certificates of deposit, derivatives etc.); (b) foreign exchange; (c) exchange, interest rate and index instruments; (d) transferable securities; (e) commodity futures trading; 8. Participation in securities issues and the provision of financial services related to such issues; 9. Individual and collective portfolio management; 10. Safekeeping and administration of cash or liquid securities on behalf of other persons; 11. Otherwise investing, administering or managing funds or money on behalf of other persons; 12. Underwriting and placement of life insurance and other investment related insurance; 13. Money and currency changing" (FATF, 2012-2020*b*)

[6]Customer due diligence policies are also called know your customer (KNC) regulations.

[7]FATF defines PEPS as: "Foreign PEPs are individuals who are or have been entrusted with prominent public functions by a foreign country, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials. Domestic PEPs are individuals who are or have been entrusted domestically with prominent public functions, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials." (FATF,

Table 4.1: FATF Recommendations Overseeing Financial Entities

Item	Description
R10	Prohibited from keeping anonymous or fictitious accounts and must conduct customer due diligence (CDD) to identify and verify the customer, beneficial owner, purpose of business relationship, and engage in ongoing due diligence monitoring to ensure transactions align with business expectations
R11	Must maintain records on domestic and international transactions, including documentation CDD, for five years and comply with any information requests from international or domestic authorities
R12	Additional precautions and enhanced monitoring for foreign and domestic politically exposed persons, their family members, and close associates.
R13	In conducting correspondent banking, financial entities must evaluate respondent institution's AML/CFT controls, obtain approval from higher managers, and require partners conduct CDD
R15	The AML/CFT risks of new technologies must be evaluated and mitigated before they are introduced.
R16	The identifying information of originators and beneficiaries of wire transfers must be documented and authenticated, including searches for the United States terrorist sanctions list.
R18	Financial institutions, their foreign branches, and subsidiaries must create internally programs against money laundering and terrorist financing.
R19	Enhanced customer due diligence is required on persons and institutions from countries on FATF's high-risk list
R20	Funds that are suspected to be related to money laundering or terrorist financing must be reported to the Financial Intelligence Unit.
R21	Employees and institutions are prohibited from informing customers about suspicious activity reports and are protected for any confidentiality breaches in filing reports

To ensure financial institutions do not skirt their AML/CFT responsibilities, governments hold financial entities liable for criminal activities that are associated with accounts held by a financial entity. In order to comply with these regulations, financial institutions have invested significant money in technical experts, often directly hiring former government regulators (Favarel-Garrigues, Godefroy and Lascoumes, 2011) and expensive technology that uses artificial intelligence and network analytics to monitor and flag transactions in

2012-2020*b*)

real time. Under FATF guidelines financial institutions must redesign their business operations and culture from one that prioritizes privacy to an emphasis on transparency, conduct internal AML/CFT risk assessments, oversee CDD, submit suspicious activity reports to FIUs, and develop a legal team and strategy to counter government fines or regulatory cases against the financial institution.

Designated non-financial businesses and professions (DNFBPs): Designated non-financial businesses and professions (DNFBPs) include casinos, real estate agents, dealers in precious metals and stones, lawyers, notaries, other independent legal professionals and accountants and trust and company service providers. These businesses are subject to some of the same customer due diligence and accounting provisions as financial institutions.[8] These provisions can be costly and malleable for these businesses. For example, in 2020 the German finance ministry lowered the CCD threshold for dealers in precious metals and stones from €10,000 to €2,000 causing dealers to scramble to build out their CDD capacity (Germany, 2019). Although the scope of cases the require oversight for DNFBPs is smaller, the costs of conducting CDD are just as high and these businesses may have a less developed infrastructure compared to financial entities.

Other Multinational Corporations: These regulations require high levels of involvement from financial institutions in particular, but all firms involved in international trade are subject to the costs associated with AML/CFT, particularly given the rise of trade-based money laundering and trade diversion (Dekieffer, 2008). Regulators have emphasized that professional money launderers and terrorist financiers "will exploit any sector, commodity, or service where they perceive an opportunity" (FATF-Egmont, 2020). Trade-based money laundering

[8]FATF recommendation 22 require due diligence for DNFBPS and 23 applies recommendations 18-21 to DNFBPs in certain circumstances

(TBML) has far reach across industries and these schemes have been discovered in companies dealing in cosmetic goods, second-hand textiles, golds, precious metals and minerals, automobile companies, and agricultural products (FATF-Egmont, 2020). Although these firms do not have additional responsibilities under the current terms of the FATF standards, they are subject to increased regulations and surveillance by governments and financial institutions. Firms are customers of financial institutions and must submit to their CDD provisions which requires documentation and processing time. Governments seeking to crack down on TBML are monitoring import and exports more closely, increasing oversight on all firms involved in international trade.

4.2.3 Public-Private Partnerships

The public-private partnership is the bridge that connects government resources and law enforcement to the avenues where criminals and money launderers profit off the financial system. Money laundering and terrorist financing schemes run through private companies so the partnership between these private entities and the government is crucial to the success of the overall AML/CFT system. However, this partnership can be collaborative or antagonistic. The government is both the supporter of financial institutions, sharing resources and technical expertise, and the enforcer of regulations, with a willingness to sue financial entities that they deem negligent on AML/CFT.

The responsibilities for financial institutions include sending FIUs suspicious activity reports when accounts show unusual or suspect patterns of deposits, transfers, or withdraws, monitoring accounts for known terrorist and criminal suspects, and providing law enforcement with relevant customer information to assist investigations. Government agencies are responsible for assisting private sector entities with their internal evaluations on illicit financing risks, sharing relevant intelligence, and providing technical expertise and guidance for financial entities. Favarel-Garrigues, Godefroy and Lascoumes (2011) argues that the

routinized formal and informal interactions between financial institution employees and government law enforcement and oversight agencies has been the most consequential impact of these policies. These professional networks can help build mutually beneficial public-private partnerships that are aligned in their preferences for identifying and disrupting illicit manipulation of the financial system.

4.2.4 Counter-Illicit Financing Structures and Effectiveness

FATF measures are not implemented uniformly across states and so the unique burdens and responsibilities of the government and private sector varies across member countries. I define counter-illicit financing structures as the legal framework, regulatory tools, and agencies that have been established to identify, monitor, and disrupt illicit exploitation of financial systems. The FATF recommendations represent the international gold standard for counter-illicit financing structures. States vary to the degree in which they have codified this legal framework into their domestically. Simonelli (2021*b*) uses a latent variable model to create an overarching measure of a state's counter-illicit financing structures and effectiveness. In evaluating the parameters of this model, it is apparent that regulations on private entities such as financial institutions and DNFBPs are particularly difficult for states to fully implement and are helpful provisions in discriminating between relatively weak or strong counter-illicit financing structures. Governments with lower counter-illicit financing structure scores often fail to extend their laws and monitoring over private entities or shy from mandating financial institutions implement costly customer due diligence provisions, which experts consider vital to disrupting illicit financing. The strongest counter-illicit financing structures encompass private entities and maintain a large degree of compliance with the costly provisions discussed in Table 4.1.

The second source of variation across states is their counter-illicit financing effectiveness. This reflects a state's capacity to use the toolbox of counter-illicit financing structures to

successful disrupt efforts to exploit their financial systems. This measure best represents a state's demonstrated overall ability to identify, disrupt, and prevent efforts to use financial systems for illicit purposes such as money laundering and financing terrorism. The existence of regulations and law enforcement agencies must be complemented with government willingness and capacity to use the tools at their disposal to insulate their financial systems. Capacity encompasses the funding, personnel, and technical experience necessary to cull through SARs, investigate suspects, coordinate with financial institutions, and pursue legal actions against those that violate their legal AML/CFT framework. Willingness captures the government's underlying preferences for disrupting illicit financing. Governments might be hesitant to build an effective AML/CFT system due to opposition from powerful business interests, political considerations, internal corruption, lack of concern about money laundering and terrorist financing, or privatization of other political priorities. A state's AML/CFT effectiveness reflects the overarching security of their financial systems from illicit exploitation.

The relative levels of structural AML/CFT and AML/CFT effectiveness impacts the relative burdens places on private firms operating in the market. Given the costs and benefits associated with AML/CFT and variation across states, how will robustness to illicit financing influence firm decisions across host markets?

4.3 Foreign Investment Preferences Over Host Markets

Modern multinational corporations have many options to choose from across potential host markets. Foreign investors benefit host markets through job creation, technology spillover (Alfaro, Kalemli-Ozcan and Sayek, 2009), and increased tax revenues.[9] As a re-

[9]There is debate over whether these potential benefits are commonly realized and provide tangible benefits to the host economy. However, these expected benefits and other political benefits have resulted in host government competition for foreign investment.

sult, rather than having to compete for access to markets as was more common in the era of protectionism, firms are often pursued by host governments who compete against other potential host markets to win investments through incentives (Pandya, 2016). Yet, firms face an obsolescing bargain (Vernon, 1971). They hold significant leverage during the negotiation phase, but once they have invested in a country their assets are sunk into the market and reliant on the host government maintaining their ex ante guarantees. Foreign firms are vulnerable to ex posts risks such as host violation of investment terms, changes in economic policy, societal unrest that disrupts factors of production or transportation, and in the most extreme cases loss of assets due to government expropriation or destructive political violence (Braithwaite, Kucik and Maves, 2014). Firms have several strategies to minimize these risks, such as arbitration and protections through bilateral investment treats (BITs) (Büthe and Milner, 2009; Allee and Peinhardt, 2011; Kerner, 2009) and preferential trade agreements (PTAs) (Büthe and Milner, 2008), but the most important is their ex ante decisions over locations.

Multinational corporations invest in foreign markets to circumvent trade barriers to foreign consumers or take advantage of cheaper inputs or other local resource endowments. These firms seek to minimize the costs of operations and other risks while maximizing their productivity and profits. These cost-benefit analyses have produced firm preferences over many features of home markets including regime type (Li and Resnick, 2003; Jensen, 2003, 2008), rule of law (Biglaiser and Staats, 2012; Staats and Biglaiser, 2012), regulatory environment (List and Co, 2000), and more. Foreign investors tend to prefer democracies because foreign leaders that are accountable to the public are expected to have more constraints on their exploitative behavior (Jensen, 2003, 2008). Additional constraints through strong rule of law and independent judiciaries contribute to investor confidence (Biglaiser and Staats, 2012; Staats and Biglaiser, 2012). Market characteristics associated with economic liberalism, such as protections over property rights, see heightened investment (Li and Resnick,

2003). Investors seek out capable governments with clearly-defined laws and independent branches of government that can ensure leaders do not overstep their powers.

While firms prefer constraints on the host government, particularly the executive, they eschew markets that overly regulate business or impinge on free market values. However, when it comes to investor preferences over specific regulations, the results are less clear. For examples, foreign investors do not seem to seek out host markets with fewer environmental regulations, so-called pollution havens (Erdogan, 2014). Firms that are extensive producers or downstream beneficiaries of carbon-intensive activities are not more likely to create subsidiaries in low regulation markets (Manderson and Kneller, 2012). Yet in the United States, multinational firms in both pollution-intensive and non-pollution intensive industries prefer states with less stringent environmental regulations (List and Co, 2000) and domestic firms that are carbon emitters or connected to carbon-related costs via their supply chains form strong lobbies to oppose regulations (Cory, Lerner and Osgood, 2021). Alternatively multinational firms that have few adjustment costs of implementing climate regulations have lobbied for increased regulations as a strategy to increase costs on domestic firms that lack their capacity (Kennard, 2020). Theories of FDI have established firm preferences for locations that minimize production costs, but more work is needed to understand how individual regulations or institutions impact these costs and firms choices of host markets.

Foreign firms are also sensitive to political and societal risks outside the control of domestic governments such as protests and strikes (Schneider and Frey, 1985), terrorism,[10] and civil war (Braithwaite, Kucik and Maves, 2014; Collier, 1999; Lee, 2016). Political violence raises costs for foreign firms by disrupting transportation and supply chains (Gaibulloev and Sandler, 2009; Johns and Wellhausen, 2016; Gaibulloev and Sandler, 2011; Meierrieks and Gries, 2013), stifling domestic market activity (Benmelech, Berrebi and Klor, 2010;

[10]See Abadie and Gardeazabal (2008); Bandyopadhyay, Sandler and Younas (2018); Braithwaite, Kucik and Maves (2014); Brandt and Sandler (2010); Witte et al. (2016); Powers and Choi (2012); Osgood and Simonelli (2020)

Blomberg, Hess and Orphanides, 2004), and directly targeted firms, their physical assets, and personnel (Brandt and Sandler, 2010; Enders, Sachsida and Sandler, 2006). As highlighted by the DAS bombing in Bogotá, violence aimed at the government or unrelated targets can massively disrupt business operations. To counter these risks firms pay for heightened security protocols (Busse and Hefeker, 2007) and insurers raise the premiums for firms (Jensen, 2008). Political violence also affects the strategic environment of the host government, raising incentives on governments to divert resources from the economy to military spending (Gaibulloev and Sandler, 2009). These constraints and uncertainty over leadership tenure can cause the government to violate contracts and expropriate assets to supplement resource supplies or counter domestic unrest.

As a result of heightened costs and uncertainty associated with political violence, scholars largely conclude that terrorism repels foreign investors. Foreign investors avoid markets characterized by violence and those that are already invested may abandon their sunk assets and exit the market. However, the negative impact of political violence on foreign firm location choices may be ameliorated by the host government's counter-terrorism capabilities (Bandyopadhyay, Sandler and Younas, 2014; Lee, 2017). Countries that receive counterterrorism aid from the United States do not see reduced FDI inflows in the wake of domestic terrorist attacks (Lee, 2017). Effective counter-terrorism provisions may bolster investor confidence that the host government is capable of containing the political risk while maintaining their contract obligations to foreign investors.

This literature on firm location preferences does not provide a straightforward framework for evaluating investor preferences over state robustness to illicit financing. Extant literature suggests that investors may on one hand be repelled by the regulatory costs and oversight associated with structural AML/CFT. However, firms are attracted to capable, well-resourced governments that can create internal stability and defend against political violence. State robustness to illicit financing represents a tension between a firm's desire for

low regulations and overhead costs and their attraction to stable investment environments. In the next section I build a theory that interweaves these dueling preferences to develop a cohesive understanding of firm preferences over state robustness to illicit financing.

4.4 Foreign Investors and State Robustness to Illicit Financing

My theory centers on two primary channels through which counter-illicit financing measures should affect multinational firms' investment choices. First, AML/CFT regulations and enforcement impacts MNCs directly through additional regulations, encroachment on privacy, and availability and cost of financial services. These regulations are especially acute for financial institutions and DNFBPs, but affect every firm involved in international trade. The second mechanism is through the domestic government. Domestic governments manage relationships with foreign investors and are also the biggest risk MNCs face when investing in a host market. Foreign firms are highly sensitive to the political structures and legal constraints on host governments (Jensen, 2003, 2008; Li, 2009). Counter-illicit financing measures that impact a government's availability of resources, oversight capacity, and legal purview into private business will inevitably influence firm decisions.

The counter-illicit financing measures in a state comprise legal framework and institutions that create AML/CFT structures and the government's capacity and willingness to use their toolbox to produce an effective AML/CFT system which can disrupt money laundering and the financing of violence. Varying levels of these two features create unique investment challenges and opportunities for foreign firms choosing investment locations. I first consider the impact of AML/CFT structures, then AML/CFT effectiveness, before evaluating my expectations for their interaction and where foreign direct investment should flow.

The AML/CFT regulatory environment laid out in the FATF recommendations raises the costs and uncertainty for firms operating in a host market. Financial institutions and

DNFBPS must hire and maintain a skilled staff for the labor intensive work of customer due diligence. These efforts often require advanced technology and the processing power to expediently evaluate new potential customers and monitor transactions for suspicious patterns in real time. This includes requesting, verifying, and maintaining records on the ownership of every account, business owner, and beneficiary with whom they transact. Financial institutions either build out their internal information technology capabilities or hire third-party vendors to provide regulatory services.[11] These policies are contrary to the culture of financial entities where customer confidentiality is an esteemed principle (Favarel-Garrigues, Godefroy and Lascoumes, 2011). There is an additional opportunity cost of diverting resources from other technology and business advancements that allow institutions to remain competitive.

The overhead costs to create and maintain this infrastructure are ample. In a survey of 772 financial institutions, Thomson Reuters found that customer due diligence requirements are a significant burden for financial entities and their customers (Reuters, 2016). Banks in the survey self-reported spending an average of $60 million annually just on customer due diligence. In 2015 the United States' financial intelligence unit, FinCen, conducted a regulatory impact assessment on CDD requirements and predicted that the regulations would cost banks and their customers $700 million and $1.5 billion over a ten year period.[12] These regulations can cause significant processing delays and result in the loss of customers due to lengthy on-boarding processes.

Firms that do not fall under the scope of financial institutions or DNFBPS are the customers of these entities and absorb many of the costs associated with AML/CFT structures. In order to acquire or build a new business in the host market the foreign firm must sign

[11]Some countries, for example Israel, prohibit financial entities from contracting out any customer due diligence processing to third-parties.

[12]FinCEN stands for the Financial Crimes and Enforcement Network and is housed within the United States Department of the Treasury.

ownership contracts and establish relationships with the domestic government, financial institutions, and intermediary businesses that will transport and facilitate the supply chain. In doing so, these firms will be subject to these due diligence requirements. Firms must disclose and provide documentation for the owners of accounts and the beneficial ownership for the subsidiary. This information is then processed and validated before the acquisition or greenfield investment can be finalized. These procedures have increased on-boarding delays, which averaged more than two months according to a Thomson Reuters survey of 822 corporate officers in 2016 (Reuters, 2016). Of these corporate customers, 89% reported an unsatisfactory experience with their customer due diligence processing at financial institutions (Reuters, 2016). Foreign investors may struggle to navigate strict AML/CFT environments or spend extra resources to hire local experts for these provisions.

The risk-based approach ingrained in the FATF standards mandates a cycle of risk analysis and policy revisions that can create uncertainty for business operations. For example, the German Federal Ministry of Finance conducted their first national review assessment in 2019 and concluded that trade in precious metals and stones posed a high risk of exploitation by money launderers (Germany, 2019). To combat a pattern of trades falling just below the CDD threshold of €10,000 the government lowered the threshold to €2,000 (Germany, 2019; FATF-Egmont, 2020). This drastic change in standard resulted in panic buying amongst German citizens who hold ample wealth in gold bars and jewelry. Dealers in precious metals were overrun with buyers exchanging gold prior to the law going into force. After the lower threshold was enacted these firms had to expend substantial resources and time to meet the more stringent requirements (Manly, 2020). This cyclical process is ingrained in the laws and structures of AML/CFT; compliant states must continually evaluate their illicit financing risks and then revise regulations and allocate resources to target vulnerabilities. This creates an environment where firms cannot be ex ante certain of the regulations they will operate under ex post.

State robustness to illicit financing also redefines aspects of the relationship between governments and firms. Government regulatory authorities monitor suspicious financial transactions and evaluate the compliance of financial institutions. When compliance is lacking, the government can fine financial institutions for their negligence and hold them accountable for the behaviors of their customers. The rise in trade-based money laundering and trade diversion has led to increased government oversight into exports and imports and customs processing. High technical compliance requires additional government oversight into the firm's transactions and could exacerbate investor fears about government meddling in private business or using AML/CFT as grounds for expropriation. Together, these create a costly and risky investment environment for multinational firms. Most firms have many host markets to choose from that provide a good match to their inputs. Given these choices, I expect firms to avoid markets where AML/CFT structures are strong.

Hypothesis 1: Firms will prefer host markets with lower levels of AML/CFT structures.

The second aspect of a state's robustness to illicit financing is the government's capacity and willingness to use their toolbox to disrupt criminal and terrorist financing networks within their country. The FAFT describes the high-level objective of an effective AML/CFT system as "financial systems and the broader economy are protected from the threats of money laundering and the financing of terrorism and proliferation, thereby strengthening financial sector integrity and contributing to safety and security" (FATF, 2012-2020*b*). This measure centers less on compliance from financial entities and more on the government's ability to effectively allocate resources to combat money laundering and terrorist financing risks.

Governments are tasked with overseeing the compliance of financial institutions and DNF-

PBs. In order to effectively accomplish this monitoring and enforcement task government must allocate resources away from other priorities and toward AML/CFT. For example, the United States' FIU, FinCEN, maintains a workforce of 300 and an annual budget of $125 million. This FIU is the forefront of monitoring suspicious transaction reports and tracing money laundering, but its just one of many agencies that devote resources and personnel to disrupt illicit financing. Law enforcement and judicial branches of the government are involved in arresting, processing, and prosecuting criminal and terrorist persons. In order to effectively carry out these tasks, the government must have a well-functioning bureaucracy, law enforcement apparatus and a judiciary that can process criminal and civil money laundering and terrorist financing cases. These institutions reflect government capabilities and rule of law that usually allays firm concerns over expropriation (Jensen, 2003, 2008; Li, 2009).

Countries with effective AML/CFT systems face less internal and external political pressure to change their regulations. For example, the Cayman Islands has the fifth strongest AML/CFT structures as of 2021 yet was placed on the FATF's list of jurisdictions under increased monitoring due to strategic deficiencies in the effective implementation of these procedures. The FATF and other regional economic bodies such as the European Union maintain black lists that spotlight countries that fail to effectively block money laundering and terrorist financing. These listings come with ramifications for firms operating within these countries. Financial institutions must conduct additional enhanced due diligence procedures when transacting with persons and business entities from countries on FATF's watch list.[13] However, once a country has demonstrated a record of effective AML/CFT their structural deficiencies are often overlooked. For example, the United States falls in the bottom 30% for their AML/CFT technical compliance yet has devoted tremendous resources and toward effectively monitoring, investigating, prosecuting, and disrupting money launder-

[13]FATF recommendation 19 describes the requirements for higher risk countries

ing and terrorist financing. Effectiveness decreases the uncertainty associated with FATF's risk-based approach, as there is less external and international political pressure to enact additional regulations on the private sector.

Finally, an effective AML/CFT system should create a secure environment with a financial system that can rebuff illicit financing streams and provide important financial intelligence to government counterinsurgent agencies. This reduces the risk that well-organized and funded violent non-state actors can perpetrate violence and disrupt the economy. The attack on the DAS building in Bogotá in 1989 exemplifies a state with an ineffective AML/CFT system that was unable to block a multi-billion dollar illicit financing operation by the Medellín Cartel. While firms are sensitive to the costs they might encounter under these structures, they should prefer host markets with the government capacity and willingness to effectively protect financial markets from illicit infiltration.

> **Hypothesis 2:** Firms prefer host markets with stronger AML/CFT effectiveness.

Firms prefer less regulated host markets where the government has the capacity to shoulder the burden of creating secure financial systems. However, firms do not observe these two dimensions in isolation as both covary across potential host markets. Firms must consider how the AML/CFT structures in a country interact with the government's willingness and capacity to use them to block illicit financing. Table 4.3 summarizes my expectations about how these features should interact across four types of counter-illicit financing regimes.

Table 4.3: Summary of Investment Environments Across State Counter-Illicit Financing Features

Structures	**Effectiveness** *High*	**Effectiveness** *Low*
High	**Benefits:** Low likelihood of political violence, highly certain and stable environment **Risks:** High costs of compliance; strong oversight and enforcement of private sector **Example:** Spain, Bermuda **Expectation:** Low risk, high AML/CFT costs	**Benefits:** Government lacks capacity to monitor and enforce provisions **Risks:** Uncertainty over enforcement; lack of strong public partner in implementing regulations; political violence risks **Example:** Iceland, Vanuatu **Expectation:** High risk, moderate AML/CFT costs. Least preferable investment environment
Low	**Benefits:** High functioning public sector counterpart; low risk of political violence; few regulations; stable environment **Risks:** Government enforcement increases oversight and costs of non-compliance **Example:** Australia, United States **Expectation:** Low risk and low AML/CFT cost. Most preferable investment environment	**Benefits:** Few regulations, Compliance is low cost and unlikely to be enforced **Risks:** High uncertainty; state could be subject to black-listing; political violence risks **Example:** Madagascar, Haiti **Expectation:** High risk, predictable low AML/CFT costs

The public-private partnership demonstrate the interdependence of responsibilities that governments and the private sectors face under these regulations. Higher government capacity can enhance a private entity's ability to comply with regulations by providing clear guidelines, offering expert support, and creating the infrastructure for reporting requirements. Alternatively, higher AML/CFT effectiveness might signal the government's willingness to strictly regulate private entities, monitoring their adherence to AML/CFT structures, carefully reviewing paperwork, fining firms for deficiencies, and pursuing lawsuits against their private sector counterparts. Government sector zeal for AML/CFT enforcement could also

heighten the resources firms must devote to responding to investigative requests and increase inspections and processing time through customs.

Effective AML/CFT systems present a trade-off for foreign firms. On one hand an effective government counterpart and secure investment environment are beneficial, and on the other these governments might make compliance with AML/CFT structures more costly. I expect firm preferences for strong AML/CFT effectiveness to diminish as a country's AML/CFT technical compliance creates additional regulatory requirements for private sector entities. The non-exclusionary benefits of a secure financial system become less appealing as firms are forced to absorb additional costs of compliance.

> **Hypothesis 3:** Firm preferences for effective government AML/CFT diminishes as the strength of AML/CFT structures increases.

4.4.1 Alternative mechanisms

It is worth briefly discussing three alternative mechanisms that could connect state counter-illicit financing measures and foreign direct investment. I have argued that multinational corporations have strong incentives to avoid markets with robust counterterrorism and anti-money laundering institutions. However, a different and possibly simultaneous mechanism may be through the government's decision to enact AML/CFT legislation given the importance of foreign investors in an economy. Foreign investment provides substantial benefits to host markets through job creation, technology spillover, providing services. Governments actively seek out firms and these potential benefits. The current study cannot distinguish causality given the temporal constraints of the data and research design. However, this alternative mechanism still supports the underlying logic of my theory and we would observe the same empirical pattern. The results here might not show foreign investors actively choosing host markets but instead represent governments that are dependent on

foreign investment *anticipating* FDI's adverse reaction to additional AML/CFT regulations and choosing lax regulations as a result. It is plausible that the empirical results reflect the interwoven nature of these two mechanism and both occur.

Second, money launderers and terrorist organizations exploit legitimate transactions through trade-based techniques and falsify their financial documentation to hide illegal funds. These schemes will appear as routine transactions in export and import filings and resultantly in the data governments and intergovernmental organizations use to measure trade flows and foreign direct investment (Perez, Brada and Drabek, 2012; De Boyrie, Pak and Zdanowicz, 2005). According to the United Nations Office on Drugs and Crime, 2-5% of global GDP is laundered each year (UNODC, 2021). Some portion of the companies that exist in the financial system and FDI data explicitly exist as front companies to launder money. If the decisions of these firms are driving my results, I would expect to see foreign investment which flees from countries with high robustness to illicit financing. These criminal and terrorist organizations should prefer host markets characterized by low AML/CFT technical compliance and low effectiveness.

Finally, large firms that produce an outsized proportion of global trade may have different preferences from medium or small firms involved in foreign investment. These firms have superior resources compared to smaller firms and can invest in the human capital, technology, and legal experts necessary to comply with AML/CFT structures. These firms also have the highest risk of violating these provisions as regulators tend to investigate and prosecute cases that will have the largest impact on markets and fetch the highest penalties. These competitive advantages may compel firms to advocate for greater regulations as a form to crowd out smaller firms that lack compliance capabilities (Gulotty, 2020; Kennard, 2020). This mechanism would be particularly likely if the costs of compliance with AML/CFT regulations were fixed. There are many startup costs that a firm has to absorb in order to build internal knowledge, processes, and capacity to comply with strict AML/CFT Structures.

However, the daily operating of these institutions is also costly and we might expect even large firms to prefer markets with fewer regulations so they can focus these resources on domestic compliance with AML/CFT regulations. If large firms have a competitive advantage in implementing AML/CFT regulations which they use to push out smaller firms, I would expect to observe a positive relationship between AML/CFT structures and FDI.

4.5 Empirical Strategy

My theory centers on multinational firms decisions to allocate long term capital-intensive investments across potential host markets. I measure this concept with country-year data on net FDI inflow data from the World Bank.[14] FDI inflow data captures investments and disinvestment across countries and time. This is a good measure of long term investments in a host market, such as greenfield investment or the acquisition of foreign firms. These investments are vulnerable to the political risks I have described.

The temporal and geographic scope and modeling strategy is defined by the key explanatory variables, robustness to illicit financing. I use a new measure of robustness to illicit financing from Simonelli (2021*b*). I create two dynamic latent variable models using FATF expert Mutual Evaluation Reports on member country's effectiveness and technical compliance to AML/CFT. These measures estimate a country's latent levels of structural AML/CFT and AML/CFT effectiveness based on compliance with 40 FATF recommendations and 11 measures of effectiveness. The validity of these measures are demonstrated through substantively informative exploration of their parameters and correlation with similar measures. However, Mutual Evaluation Reports are currently only available for 106 countries and their time-series is limited. Each country in the sample has one report available assessing their effectiveness, but most countries have multiple measures of technical

[14]The data is available here: https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD

compliances over time. I use a dynamic item response theory model to produce country-year estimates for AML/CFT structures and effectiveness from 2016-2021. Effectiveness does not vary over time, and, the AML/CFT structures variable does vary for most countries but is a slow moving indicator.[15] The countries in the sample are shown in Figure 4.3 in the appendix and contain variation across every continent, market size, and regime type.

I create a country-level dataset matched to the countries with FATF scores available. I include several additional covariates to account for variation across countries and other common explanations of foreign investment. To account for differences across economic development and size of the available labor markets I include GDP per Capita (log) and population (log) from the World Bank. To account for the role of natural resources in fueling investor decisions, I include the percentage of GDP resource rents from World Bank. The varieties of democracy (VDEM) project provides indexes based on expert surveys of several variables of interest. From VDEM I include measures of property rights, democracy, rule of law, and corruption. VDEM provides several measures of democracy and I include their electoral democracy index, polyarchy.

I include two measures of political violence to evaluate the impact of AML/CFT Robustness outside of this direct mechanisms. I include data on the number of terrorist attacks from the Global Terrorism Database. I measure violence between challengers and governments with data on battle deaths from the Uppsala Conflict Data Program. Both violence count data are zero inflated with a long right tail. I included the logged values of both these variables.

The sample includes 106 countries from 2016-2019. I only include data up to 2019 because most covariates are not yet available for 2020 and values in this year would reflect a significantly altered patterns of investment due to the global pandemic. However, there remains some missingness across covariates. I use multiple imputation to estimate the missing

[15]See Simonelli (2021*b*) for further discussion of these measures and their limitations

data values which I expect to be missing at random conditional on the observable covariates in my dataset. This technique uses predictive mean matching to estimate the missing values. Single imputation can underestimate the uncertainty of the dataset. Multiple imputation builds on this technique but incorporates greater uncertainty by creating multiple imputed values. I create five datasets with imputed estimates and then pool over these datasets when conducting my analysis. The variables from VDEM have the greatest missingness, missing values in 13 countries, so their values show greater uncertainty in the results. This strategy is preferable to other options, such as listwise deletion, because it allows us to retain the full sample of countries for which robustness to illicit financing scores are available and accounts for the uncertainty that accompanies the missing data.

I use a cross-national analysis to explore variation across countries and evaluate my hypotheses. I use linear regression on each of the five imputed datasets and pool over the results. I estimate the following model:

$$FDI_{it} = \beta_0 + \beta_1 \cdot \text{AML/CFT Structure}_{it} + \beta_2 \cdot \text{AML/CFT Effectiveness}_i + \beta_3 \cdot \text{AML/CFT Structure}_{it} \cdot \text{AML/CFT Effectiveness}_i + \beta_{4-13}\mathbf{Z}_{it} + \mu_t + \epsilon_{it}$$

The model term FDI_{it} represents the inflows of foreign direct investment in country i in year t. The coefficients for AML/CFT structure is β_1 and β_2 is the coefficient for AML/CFT capacity. The relationship between these two variables and foreign investment is captured in the interaction term with coefficient β_3. $\mathbf{Z}_{it}$ represents a matrix of covariates that vary at the country-year unit of analysis. A limitation of this data is the lack of temporal variance in country AML/CFT capacity. There are no updated reports yet available on changes in AML/CFT capacity. AML/CFT structure does vary across time for some countries but given the data generating process described above, these are slow moving indicators. Including country fixed effects is a common strategy in panel data to reduce bias in the error term

associated with multiple non-independent observations from a single country. This allows researchers to study changes within a given country over time. Given the theoretical question of interest, firm choices between different potential host markets, and data limitations, this study focuses on cross-national variation, and country-fixed effects would mask the key variation of interest. I include a fixed effect for the multiple years of data that is available in term μ_t. The remaining error of the model is represented in term ϵ_{it}.

Results

The main results from the pooled linear regression models are presented in Table 4.4. Individual model results on each of the five imputed datasets are available in Table 4.9 in the appendix. The results offer support for the central theory of firm preferences across country robustness to illicit financing.

Table 4.4: Summary of Model Results

	Dependent variable:	
	Model 1: FDI	Model 2: FD1
AML/CFT Structure	−0.352*** (0.119)	−0.436*** (0.111)
AML/CFT Effectiveness	0.456*** (0.142)	0.414*** (0.122)
Structure × Effectiveness	-	−0.140** (0.067)
GDP per capita (log)	0.114 (0.097)	0.125 (0.087)
Population (log)	0.156*** (0.051)	0.156*** (0.044)
Property Rights	−1.815 (1.085)	−1.174* (0.669)
Democracy	−0.068 (0.608)	−0.283 (0.524)
Corruption	0.160 (0.811)	0.244 (0.568)
Rule of Law	0.663 (0.978)	1.189 (0.792)
Terror Attacks (log)	−0.083 (0.084)	−0.05 (0.066)
Battle Deaths (log)	0.107* (0.058)	0.1* (0.052)
Resource Rents	0.003 (0.013)	0.003 (0.011)
Intercept	−2.043 (1.676)	−3.013** (1.322)
Observations	240	240
Year FE	Yes	Yes

Note: GDP = Gross Domestic Product

Note: *p<0.1; **p<0.05; ***p<0.01

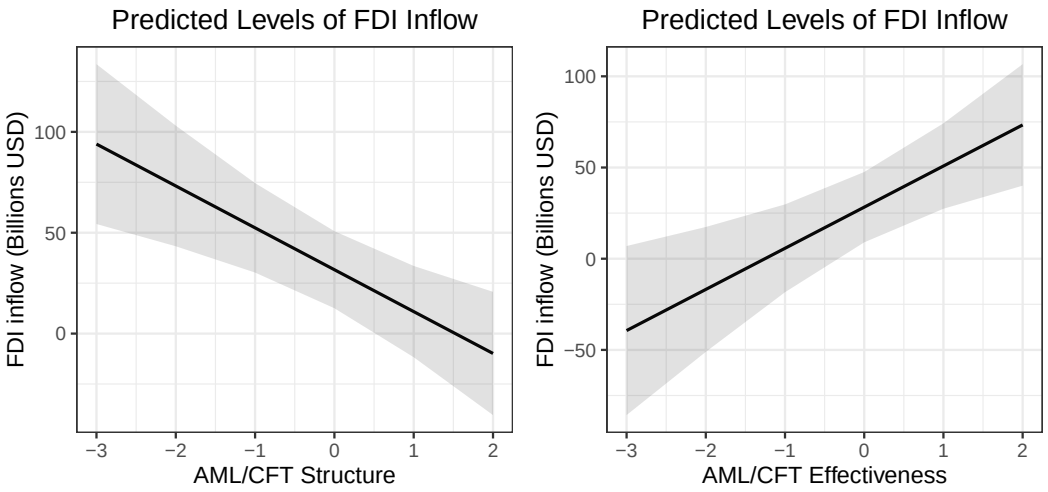

Figure 4.1: Marginal Effects of AML/CFT Effectiveness and Structures on FDI Inflows

Figure 4.1 shows the marginal effects of AML/CFT structure and AML/CFT effectiveness on FDI inflows. AML/CFT structure is negatively associated with FDI inflows. This supports hypothesis 1 that high levels of AML/CFT regulations will repel foreign investors. The coefficient for AML/CFT effectiveness is positive, offering support for hypothesis 2. Countries characterized by economic systems that are protected from money laundering and terrorist financing are rewarded with higher levels of foreign investment. GDP per capita is included in the models as a broad measure of government capabilities, so the observed effect is specific to government effectiveness over AML/CFT. Figure 4.2 shows the interaction effect between the two dimensions of state robustness to illicit financing. The blue line represents investment into countries with the most effective AML/CFT systems. The red flatter line shows the marginal effects of increases in technical compliance for countries with the least effective systems. Firms have a strong preference for low technical compliance regardless of a country's overall effectiveness, as shown by the negative β_1 coefficient in Table 4.4 and trend present in the plot. However, these preferences are strongest when governments have demonstrated capacity and willingness to enforce AML/CFT provisions. Operating in the undesirable environment of high technical compliance, firms have a slight preference for the

benefits associated with effective AML/CFT systems but these benefits are drastically offset by the costs associated with compliance and business oversight by government and financial entities.

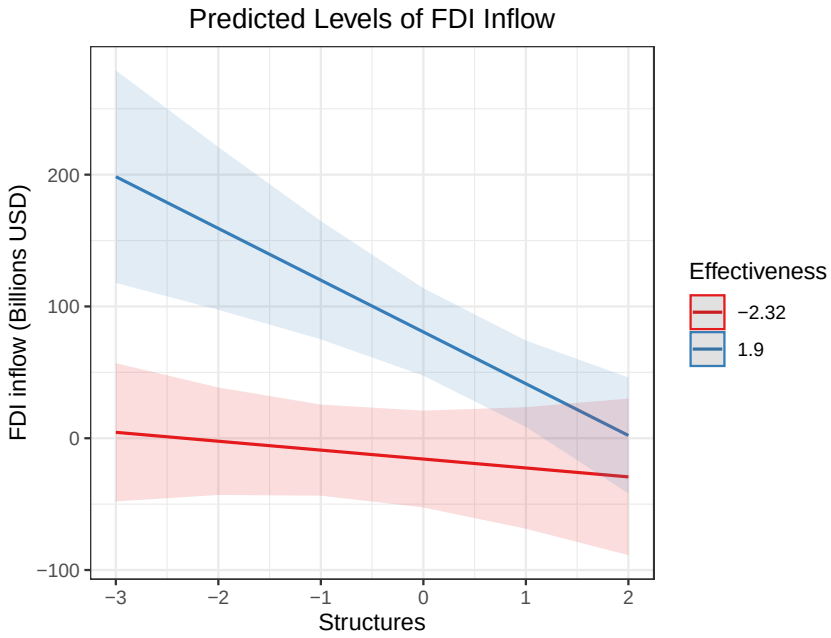

Figure 4.2: Interaction of AML/CFT Effectiveness and Structures on FDI Inflows

Foreign firms have a clear preference for host markets where the government has the resources and capacity to protect financial systems from infiltration but where onerous regulations do not raise the costs of doing business. This highlights two interesting characteristics of state robustness to illicit financing. Despite the central role the FATF has played in constructing standards, building state AML/CFT expertise and capacity, and monitoring state robustness to illicit financing, the highest adherence with FATF standards is not necessary for an effective AML/CFT system. These two dimensions are highly correlated, but governments can choose to neglect some recommendations, particularly those that regulate businesses, if they have enough capacity to take on more of the monitoring workload. Second, these dynamics may be an impediment to developing robust AML/CFT structures. We see no evidence that relatively under-resourced and low AML/CFT capacity states are

rewarded for their signaling of structural compliance. The opposite is true, investors choose their less regulated counterparts.

The current study cannot distinguish causality given the temporal constraints of the data and research design. I have argued that multinational corporations have strong incentives to avoid markets with robust counterterrorism and anti-money laundering institutions. However, a different and possibly simultaneous mechanism may be through the a government's decision to enact AML/CFT legislation given the importance of foreign investors in an economy. However, this alternative mechanism still supports the underlying logic of my theory and we would observe the same empirical pattern. The results here might not show foreign investors actively choosing host markets but instead represent governments that are dependent on foreign investment *anticipating* FDI's adverse reaction to additional AML/CFT regulations and choosing lower levels of structural AML/CFT.

4.5.1 Alternative Measures of Business Environment

To further evaluate my theory and the robustness of my results, I consider alternative outcomes that represent market-friendly policies within a country. I include three measures of the ease of doing business within a country from the World Bank Doing Business indicators and one measure of regulatory quality from the World Bank Governance Indicators (provided in the VDEM data). *Doing Business* is the World Bank's aggregate ease of doing business score that measures regulatory best practices across 41 indicators that evaluate the costs of starting and conducting a business in a country. *Starting Business* is a measure of how easy it is to start a new business in a country based on the number of regulatory procedures a company must go through, average number of days, costs, and minimum capital necessary. *Credit Ease* measures the strength of legal rights for borrowers and the availability of relevant credit information for lenders. This information is particularly relevant as the ability of financial entities to quickly assess intentional customers is vital to conducting

customer due diligence. All these Doing Business indicators range from zero representing the worst regulatory environment to 100, representing the best regulatory environment.[16] The variables are scaled and with a mean of zero for the analysis. Finally, I include *Reg. Quality* which is a measure of perceptions over the government's regulatory environment and private sector development from the World Governance Indicators (Kaufmann, Kraay and Mastruzzi, 2011). This measures how well the government can provide regulations that help business development such as access to capital and banking supervision while avoiding excessive regulations that deter foreign trade and investment.

I evaluate these dependent variables using the same modeling strategy and imputed datasets as my primary model on FDI. Table 4.5 and Table 4.6 provides the results of analysis with these alternative dependent variables. These results provide consistent support for my argument that systemic economic counterinsurgency impacts the broader business environment. Across all four models AML/CFT Effectiveness is positively associated with a more desirable business environment. This association is significant in the first three models, but there is greater uncertainty in the final model on regulatory quality. AMF/CFT structures is negatively associated with all four business environment indicators, even though this result is only statistically significant in the models evaluating regulatory quality and starting a business. The interaction between structures and effectiveness is less consistent across the models and with the main model. In the first two models the interaction is not significantly distinguishable from zero. However, the interaction for ease of credit access is negative with $p < 0.1$ and the interaction for regulatory quality is positive and significant. Reported levels of ease of access to credit follows similar patterns as the main models on foreign investment. Businesses generally find it easier to access credit in countries with more effective AML/CFT systems, perhaps representing the benefits of the public-private partnership, but

[16]Further information about the Doing Business methodology is available at https://openknowledge.worldbank.org/bitstream/handle/10986/32436/9781464814402_Ch06.pdf

as AML/CFT structures increase this preference diminishes. If customer due diligence and other regulations on financial entities are onerous than even efficient public counterparts cannot reduce the hoops business have to jump through to access lines of credit. Ratings of regulatory quality are negatively correlated with the regulations that comprise AML/CFT structures, providing further evidence that businesses are repelled by these host markets. As these AML/CFT regulations increase, the benefits of high AML/CFT effectiveness balance out the costs of regulations and regulatory quality remains fairly static. However, ratings of regulatory quality countries with low AML/CFT effectiveness are particularly sensitive to changes in AML/CFT structures and as these regulations increase, ratings of quality plummet.

Table 4.5: Summary of Model 3 and Model 4

	Dependent variable:	
	Model 3: Doing Business	Model 4: Starting Business
AML/CFT Structures	−0.099 (0.065)	−0.235** (0.101)
AML/CFT Effectiveness	0.378*** (0.077)	0.394*** (0.104)
Structures × Effectiveness	0.012 (0.040)	−0.046 (0.057)
GDP per Capita (log)	0.372*** (0.056)	0.021 (0.079)
Population (log)	0.056 (0.034)	−0.081 (0.060)
Property Rights	0.820** (0.364)	3.126*** (0.499)
Democracy	−1.716*** (0.324)	−1.215** (0.469)
Corruption	−2.022*** (0.441)	−0.980 (0.581)
Rule of Law	3.612*** (0.525)	2.242*** (0.720)
Terror Attacks (log)	−0.118*** (0.039)	0.044 (0.059)
Battle Deaths (log)	0.048 (0.031)	0.023 (0.043)
Resource Rents	0.015* (0.008)	0.017** (0.008)
Intercept	−7.127*** (1.322)	−2.841** (1.369)
Observations	240	240
Year FE	Yes	Yes

Note: GDP = Gross Domestic Product
Note: *p<0.1; **p<0.05; ***p<0.01

Table 4.6: Summary of Model 5 and Model 6

	Dependent variable:	
	Model 5: Credit Ease	Model 6: Reg. Quality
AML/CFT Structures	−0.159 (0.111)	−0.117** (0.056)
AML/CFT Effectiveness	0.479*** (0.126)	0.091 (0.058)
Structures × Effectiveness	−0.126* (0.068)	0.058* (0.032)
GDP per Capita (log)	0.147 0.094	0.495*** (0.043)
Population (log)	0.107* (0.055)	0.087*** (0.026)
Property Rights	−0.339 (0.738)	1.064*** (0.273)
Democracy	−0.385 (0.555)	−0.541** (0.238)
Corruption	−3.685*** (0.739)	−0.827** (0.339)
Rule of Law	3.811*** (0.909)	1.849*** (0.399)
Terror Attacks (log)	−0.209*** (0.072)	−0.059* (0.030)
Battle Deaths (log)	0.062 (0.052)	0.040 (0.024)
Resource Rents	0.015 (0.011)	0.004 (0.006)
Intercept	−6.289*** (1.510)	−8.023*** (0.677)
Observations	240	240
Year FE	Yes	Yes

Note: GDP = Gross Domestic Product
Note: *p<0.1; **p<0.05; ***p<0.01

Although my theory centers on the trade-offs for foreign investors, these results support my expectations that AML/CFT structures and effectiveness impact the desirability of a market. Governments that prioritize and allocate resources toward blocking illicit exploitation of their financing systems also provide clear guidelines for business that want to access the market legitimately. Governments that diligently implement every international standard

on AML/CFT are punished for creating additional costs and red tape for businesses.

4.5.2 Discussion of Results

The results have uncovered a clear trend of multinational firms and businesses broadly favoring markets with high levels AML/CFT effectiveness but weaker AML/CFT structures. One might have a prior expectation that AML/CFT structures and AML/CFT effectiveness would behave similarly considering they are both measures of state counter-illict financing systems. Why then do they have such different effects on investment environments? Three features of these variables are important to evaluating this question. First, AML/CFT structures are not a necessary condition for AML/CFT effectiveness. States that are able to create relatively secure financial markets do not always do so by codifying international standards into domestic law and requiring businesses engage in costly investigation and monitoring of customers. Further research should explore this discrepancy more and determine why states are able to achieve financial resilience without onerous regulations on private entities and other characteristics of strong AML/CFT structures.

Second, the features that distinguish high and low levels of AML/CFT structures center on the regulation of private entities. This finding motivated the investigation in this paper and may explain why business preferences are so closely tied to lower levels of AML/CFT structures. Countries with high scores for AML/CFT structures achieve this by employing costly regulations on private entities. Finally, this study is compelling because it specifically investigates an area where I expected preferences to diverge across these two features of a country's AML/CFT regime. There are other cases where my a prior expectation would be for these two counter-illicit financing measures to have similar or compounding effects. Both may be connected to a governments level of connectivity to international institutions, histories with high-profile exploitation of financial systems by terrorist groups, or levels of political violence.

It is also worth considering features of the sample that could influence these results. There is evidence that fears of de-risking and loss of correspondent banking can push small countries to adopt greater compliance with international AML/CFT standards to publicly demonstrate the security of their financial systems. Implementing FATF recommendations may be a relatively low cost way for these countries to signal their reliability even if they have little capacity or interest in enforcing provisions. However, large countries that are major players in the international economic system are not vulnerable to these risks, lowering their incentives to comply with onerous recommendations especially if they have already achieved a relatively high level of financial resilience. Countries with larger economies may have political systems prone to influence from business interests that can pressure governments to improve their capacity of public sector AML/CFT tools, but resist compliance with recommendations that shift responsibilities to the private sector. As more FATF reports are available future work can expand the sample of countries included in the analysis and further work can also seek to disentangle these casual pathways.

4.6 Conclusion

This paper highlights a significant barrier to international efforts to countering the financing of terrorism and disrupt money laundering. The incentive structure for foreign investors compels firms to seek out markets with fewer regulations. This creates two interrelated challenges for policymakers. First, this limits the transactions that fall under the scope of these regulations. In a highly globalized world, a few unregulated, outlier countries can shield lots of illicit financing from oversight. Second, fear of losing current or potential investment may discourage governments from enacting more stronger provisions. However, these results also point to a solution; firms prefer countries with more secure financial systems. By investigating why some systems are more effective than others, international regulators may

be able to find common ground with powerful business lobbies and focus on regulations or capacity-building that is more likely to create security from illicit financing.

This work suggests several avenues for further research. First, a firm's preferences may also be shaped by the regulations in their home market. The firm is subject to oversight in both their home and host market. If the home country is a strong adherer to AML/CFT then it may actually be less costly for firms to seek out host markets with similar regulations. This is the logic underlying de-risking. Financial entities operating under strong customer due diligence and documentation requirements from their home market may avoid unregulated host markets due to concerns of violating their home market's provisions and facing fines. The results presented in this paper provide support for an alternative "race to the bottom" mechanism. This logic which has been shown for labor standards would suggest that firms from highly regulated host markets may be the most likely to seek out weakly regulated host markets. The relative cost of host market regulations should be a function of the firm's home market. Firms that are already compliant with high standards face fewer costs than a firm that must create new capacity for customer documentation, verification, and investigation. For these reasons we might expect FDI to travel between country dyads with the most similar institutions on AML/CFT.

Second, I have argued that these provisions reach and create costs for multinational firms across sectors. However, the costs and risks associated with AML/CFT provisions vary across industries and there may be interesting heterogeneity across these dimensions. It is plausible that financial entities prefer host markets with stronger technical compliance to avoid fines and reputation costs associated with violating international AML/CFT standards. However, for firms with less risk of being targeted by domestic regulators a low technical compliance environment may be an appealing low cost choice. There also may be other host market features that interact with counter-illicit financing systems to shape investment preferences. For example, firms may generally prefer lower structural AML/CFT but prefer

strong AML/CFT structures in countries with a history of funding violent non-state actors or being targeted by unilateral or international black-lists. Similarly, firm preferences for high AML/CFT effectiveness might be strongest in countries with a history of instability or violence conflict.

4.7 Appendix

Item	Description
IO1	Money laundering and terrorist financing risks are understood and, where appropriate, actions coordinated domestically to combat money laundering and the financing of terrorism and proliferation
IO2	International co-operation delivers appropriate information, financial intelligence, and evidence, and facilitates action against criminals and their assets.
IO3	Supervisors appropriately supervise, monitor and regulate financial institutions and DNFBPs for compliance with AML/CFT requirements commensurate with their risks.
IO4	Financial institutions and DNFBPs adequately apply AML/CFT preventive measures commensurate with their risks, and report suspicious transactions.
IO5	Legal persons and arrangements are prevented from misuse for money laundering or terrorist financing, and information on their beneficial ownership is available to competent authorities without impediments.
IO6	Financial intelligence and all other relevant information are appropriately used by competent authorities for money laundering and terrorist financing investigations.
IO7	Money laundering offenses and activities are investigated and offenders are prosecuted and subject to effective, proportionate and dissuasive sanctions.
IO8	Proceeds and instrumentalities of crime are confiscated.
IO9	Terrorist financing offenses and activities are investigated and persons who finance terrorism are prosecuted and subject to effective, proportionate and dissuasive sanctions.

IO10	Terrorists, terrorist organizations and terrorist financiers are prevented from raising, moving and using funds, and from abusing the NPO sector.
IO11	Persons and entities involved in the proliferation of weapons of mass destruction are prevented from raising, moving and using funds, consistent with the relevant UNSCRs.

Table 4.7: FATF Effectiveness Immediate Outcomes

Item	Description
	AML/CFT Policies and Coordination
R1	Assessing Risks and Applying a Risk-Based Approach
R2	National cooperation and coordination
	Money Laundering and Confiscation
R3	Money laundering offence
R4	Confiscation and provisional measures
	Terrorist Financing and Financing of Proliferation
R5	Terrorist financing offence
R6	Targeted financial sanctions related to terrorism & terrorist financing
R7	Targeted financial sanctions related to proliferation
R8	Non-profit organisations
	Preventive Measures
R9	Financial institution secrecy laws
R10	Customer due diligence
R11	Record keeping
R12	Politically exposed persons
R13	Correspondent banking
R14	Money or value transfer services
R15	New technologies
R16	Wire transfers
R17	Reliance on third parties

R18	Internal controls and foreign branches and subsidiaries
R19	Higher-risk countries
R20	Reporting of suspicious transactions
R21	Tipping-off and confidentiality
R22	DNFBPs: Customer due diligence
R23	DNFBPs: Other measures
	Transparency and Beneficial Ownership of Legal Persons and Arrangements
R24	Transparency and beneficial ownership of legal persons
R25	Transparency and beneficial ownership of legal arrangements
	Powers and Responsibilities of Competent Authorities and Other Institutional Measures
R26	Regulation and supervision of financial institutions
R27	Powers of supervisors
R28	Regulation and supervision of DNFBPs
R29	Financial intelligence units
R30	Responsibilities of law enforcement and investigative authorities
R31	Powers of law enforcement and investigative authorities
R32	Cash couriers
R33	Statistics
R34	Guidance and feedback
R35	Sanctions
	International Cooperation
R36	International instruments
R37	Mutual legal assistance
R38	Mutual legal assistance: freezing and confiscation
R39	Extradition
R40	Other forms of international cooperation

Table 4.8: FATF 40 Recommendations

Figure 4.3: Countries included in the sample

Table 4.9: Models on Five Imputed Datasets

	Dependent variable:				
	Foreign Direct Investment				
	(1)	(2)	(3)	(4)	(5)
AML/CFT Structure	-0.434^{***}	-0.450^{***}	-0.423^{***}	-0.440^{***}	-0.435^{***}
	(0.111)	(0.109)	(0.110)	(0.109)	(0.111)
AML/CFT Effectiveness	0.424^{***}	0.401^{***}	0.402^{***}	0.384^{***}	0.458^{***}
	(0.121)	(0.115)	(0.121)	(0.118)	(0.118)
Structure × Effectiveness	-0.138^{**}	-0.148^{**}	-0.137^{**}	-0.143^{**}	-0.135^{**}
	(0.068)	(0.067)	(0.066)	(0.067)	(0.068)
GDP per Capita (log)	0.129	0.111	0.134	0.124	0.125
	(0.088)	(0.083)	(0.088)	(0.088)	(0.087)
Population (log)	0.160^{***}	0.158^{***}	0.161^{***}	0.156^{***}	0.146^{***}
	(0.043)	(0.044)	(0.043)	(0.043)	(0.044)
Property Rights	-1.305^{**}	-0.888	-1.289^{**}	-0.844	-1.546^{***}
	(0.585)	(0.575)	(0.584)	(0.573)	(0.594)
Democracy	-0.219	-0.368	-0.297	-0.384	-0.148
	(0.527)	(0.514)	(0.512)	(0.485)	(0.524)
Corruption	0.108	0.486	0.165	0.347	0.112
	(0.544)	(0.527)	(0.539)	(0.533)	(0.546)
Rule of Law	0.996	1.530^{**}	1.086	1.303^{*}	1.028
	(0.768)	(0.737)	(0.759)	(0.738)	(0.761)
Terror Attacks (log)	-0.062	-0.035	-0.055	-0.035	-0.066
	(0.064)	(0.063)	(0.063)	(0.064)	(0.064)
Battle Deaths (log)	0.103^{**}	0.096^{*}	0.102^{**}	0.096^{*}	0.110^{**}
	(0.052)	(0.051)	(0.051)	(0.051)	(0.052)
Resource Rents	0.005	0.006	-0.002	-0.001	0.007
	(0.012)	(0.011)	(0.009)	(0.007)	(0.010)
Intercept	-2.887^{**}	-3.481^{***}	-2.925^{**}	-3.335^{***}	-2.437^{*}
	(1.212)	(1.257)	(1.238)	(1.235)	(1.272)
Observations	240	240	240	240	240
Year FE	Yes	Yes	Yes	Yes	Yes
Adjusted R^2	0.270	0.271	0.279	0.272	0.271
Note:					*p<0.1; **p<0.05; ***p<0.01

CHAPTER V

Conclusion

5.1 Summary

This dissertation describes the relatively new global economic counterinsurgency regime which has grown into an expansive interconnected system of regulations, surveillance, and enforcement with purview over every part of the global financial system. This project demonstrates that targeted and systemic economic counterinsurgency have consequences for peace and security, civilian victimization, and foreign investment. Specifically, I have evaluated the the following questions: How does targeted economic counterinsurgency impact rebel groups use of violence against opponents and civilians? How do we measure country-level systemic economic counterinsurgency? How does systemic economic counterinsurgency impact the levels of political violence within a country and the desirability of a country's economic market?

I began my exploration of the global economic counterinsurgency regime at the most narrow level, evaluating targeted sanctions against violent non-state actors. In Chapter 2, *Economic Sanctions and Insurgent Violence*, I ask how economic sanctions affect rebel groups use of violence against combatants and civilians. In this chapter I move beyond prior studies of economic sanctions that only evaluate rebels battlefield violence (Radtke

and Jo, 2018; Escribà-Folch, 2010; Hultman and Peksen, 2017) and consider how economic coercion might affect violence against civilians. This chapter draws on theories of rebel mobilization, origins, and civilian victimization to develop a theory of rebel behavior under economic sanctions. I argue that the mechanisms of sanctions will work differently against non-state actors compared to state targets and should not be expected to have homogeneous impacts across rebel groups. Instead I theorize that the effects of economic sanctions will be based on the diversity and vulnerability of their economic portfolios and foundational origins. Economic portfolios comprise all the distinct methods rebel groups employ to raise and maintain the resources necessary to continue their violent campaigns. Sanctions work by isolating the target from their wider economic networks and severing supply chains. Given these characteristics, I expect sanctions to have larger impacts on rebel groups whose economic portfolios are more reliant on long transnational supply chains than those that acquire funding from difficult to interdict methods.

Next, I evaluate how economic sanctions will impact rebel groups reliance on and tactics toward civilian populations. I consider two primary tactics groups use to elicit civilian support, persuasion and coercion. I explore heterogeneity across rebel groups based on their origins. The pre-existing institutions from which rebels drew their initial membership have enduring implications on rebel groups organizational structures and subsequent treatment of civilian populations. I show that groups founded in pre-existing institutions with connections to local communities will maintain their ties to civilians and use persuasion to acquire more resources from civilians. The implementation of economic sanctions are accompanied by international condemnation meant to name and shame the deleterious behaviors of the target. These reputation attacks can be particularly harmful to groups with social origins as they rely on civilians favorable perceptions to maintain their support. These groups will need to counter the UN's narrative in order to extract additional resources from civilians. This incentivizes groups that occasionally were coercive to civilians to improve their behavior and

cease any violence that could provide evidence in support of a harmful narrative.

Groups that were founded around the exploitation of an external source of income such as state sponsorship or natural resources, generally lack these productive ties with civilians. These groups overcame their mobilization challenges through economic endowments, lack foundational connections to pre-existing civic institutions, and never had to expend resources to build connections with civilians where no prior ones existed because of their alternative sources of resources. When these groups do require resources from civilians they tend to rely on coercion, using violence or the threat of violence to evoke fear so civilians withhold providing intelligence to government forces and provide food, money, or other goods. Sanctions will also raises costs for these groups, but lacking a positive relationship with civilians the tactic of persuasion is unavailable and these groups will redouble their coercive tactics. The results support this theory and explain variation in patterns of violence against civilians in the wake of economic sanctions.

This work does not find a clear connection between supply chain features of insurgent groups' resource-generating tactics and sanction effectiveness. After this anlaysis at the micro-level, I consider whether macro-level features at the country-level could impact the enforcement of sanctions. In Chapter 3, *Measuring State Counter-Illicit Financing Systems*, I use a dyanmic oridinal item respose theory model and FATF reports to create two new measures that capture this variation cross-nationally and over time. AML/CFT structures measures a government's creation of laws and regulatory tools to counter illicit finacing. AML/CFT effectiveness encompasses a state's latent capacity and willingness to create a financial system that is secure from illicit exploitation. Exploring the model parameters highlights the challenges governments face in regulating private entities which serve as the day-to-day monitors and enforcers over transactions. The results show that AML/CFT structures and effectiveness are highly correlated, but high quality AML/CFT institutions are not a necessary condition for an effective AML/CFT system.

Using these measures I explore the impact of counter-illicit financing systems on political violence within a country. The results show that neither AML/CFT structures nor AML/CFT effectiveness are associated with terrorism. AML/CFT structures have no significant impact on any of the violent outcomes I explore. Although these systems are relatively new, this finding should cause policymakers to examine the international standards on AML/CFT and consider why these laws fail to produce observable shifts in the prevalence of terrorism. AML/CFT effectiveness is associated with a lower intensity of internal conflict. AML/CFT effectiveness measures the actual level of security from financial exploitation in a country so this result is encouraging for the utility of these efforts. While terrorism is relatively cheap, financing an insurgency is exorbitant. This chapter demonstrates the importance of severing large insurgencies exploitation of the legitimate economy to financing their operations.

An important observation from Chapter 3 is difficulty or hesitant governments face in enacting AML/CFT provisions that require financial entities and other private businesses engage in enhanced customer due diligence and monitoring of accounts for nefarious transactions. These provisions are costly for businesses who need to build the capabilities and technical expertise to comply with standards and allocate resources toward monitoring and enforcement. This chapter prompts the question: How do country counter-illicit financing systems effect foreign firms decisions to invest in a host market? Multinational firms tend to be repelled from markets where regulations are onerous and costs of day-to-day operations are high. However, foreign firms prefer stable host markets where the risks of political violence are low and governments have the capacity to maintain and enforce rule of law. In Chapter 5, *Foreign Investment and State Robustness to Illicit Financing*, I evaluate the puzzle of firm preferences over counter-illicit financing systems.

My theory unravels these contradictory preferences by evaluating two components of a state's counter-illicit financing strategy. Anti-money laundering and countering the financing

of terrorism (AML/CFT) structures are the legal frameworks and regulatory tools available to monitor, track, disrupt, and prevent money laundering and terrorist financing. These provisions include significant regulatory and monitoring requirements for financial institutions and businesses involved in trade. AML/CFT effectiveness encompasses the government's capacity and willingness to use its AML/CFT toolbox to disrupt money laundering and terrorist financing. This variable captures how well the government and AML/CFT institutions function and achieve the goal of preventing criminal and terrorist actors from raising, transferring, and sending funds through the financial system.[1]

I argue that firms seek out host markets where they can minimize the costs of invasive AML/CFT regulations but reap the benefits of a government with a strong capacity to counter illicit financing and environment free of well-financed violent actors. This leads to divergent preferences between a state's counter-illicit financing systems. Firms most prefer host markets characterized by weak AML/CFT structures but strong AML/CFT effectiveness. However, as AML/CFT regulations and restrictions on business dealings become more onerous, firms prefer governments less adept at implementing them. Thus firms' preferences for governments that are effective at enforcing AML/CFT diminishes as the AML/CFT structures they are subject to increase. I test my theory using original data on state counter-illicit financing systems and FDI inflows. The results support my central contentions about firm preferences over state AML/CFT structures and AML/CFT effectiveness. Firms prefer host markets characterized by low AML/CFT structures but high AML/CFT effectiveness and investment into strong host markets decreases with increasing AML/CFT regulations. This finding has important implications for the success of these international efforts.

[1]I use the terms structural AML/CFT and AML/CFT technical compliance interchangeably. Both terms refer to the first dimension of illicit financing robustness which captures the underlying laws and tools in a country. I use the terms AML/CFT capacity and willingness interchangeably with AML/CFT effectiveness. This second dimension captures a governments ability to identify, enforce, and disrupt money laundering and terrorist financing.

5.2 Contribution

This dissertation offers several contributions to the study of economic counterinsurgency, political violence, and foreign investment. I begin by contributing new knowledge on the scope and occurrence of economic counterinsurgency and proposing that economic counterinsurgency tactics are best understood under the framework of the broader global economic counterinsurgency regime. I argue that this diverse set of economic counterinsurgency tactics affect a range of actors through unique mechanisms. In Chapter 2, I show how the same economic counterinsurgency tool, economic sanctions, has different effects on insurgent groups based on the vulnerability and diversity of their economic portfolios and organizational origins. Groups with social origins, economic origins, and rebel origins all respond differently to this same policy intervention. This approach proves that not only do the tools of economic counterinsurgency vary, but within a single tool the impact varies based on attributes of the target.

Second, I move beyond prior studies of economic sanctions that only evaluate rebel groups' battlefield violence (Radtke and Jo, 2018; Escribà-Folch, 2010; Hultman and Peksen, 2017) and consider how economic coercion affects violence against civilians. Building on my approach of evaluating rebel heterogeneity, I show that groups with social origins have enduring connections to civilian populations that they use to persuade civilians to provide resources for their efforts. Economic sanctions increase these groups reliance on civilian populations and incentivize rebel groups to reduce any coercive behaviors toward noncombatants. Alternatively, rebel groups that originated around external resource endowments or from splintering off prior violent non-state actors do not have the shared social connections and tools to persuade civilians to supplement their losses under economic sanctions. My results show that these groups will increase violence against civilian populations to shore up resource deficiencies caused by economic sanctions. These findings should caution

policymakers to evaluate rebel group characteristics when applying targeted economic counterinsurgency. These features can help predict where economic counterinsurgency should be complimented with policies to safeguard civilians from negative side effects.

Third, this dissertation is the first research to cross-nationally measure and evaluate systemic economic counterinsurgency. I create two new concepts to evaluate counter-illicit financing systems. AML/CFT structures measures a country's AML/CFT laws and regulatory tools and AML/CFT effectiveness encompasses the governments capabilities and willingness to use these tools to produce improved security of financial markets. This dissertation has demonstrated how these concepts can elucidate variation in political violence and foreign investment. These measures will enable other researchers to study these phenomenon further, incorporate systemic variation into analyses of categorical and targeted measures.

Finally, I look beyond political violence and evaluate how economic counterinsurgency policies affect the broader political economy of a country. Policymakers and scholars must consider these downstream effects when evaluating the costs and benefits of economic counterinsurgency. My results show that foreign firms avoid markets with broad AML/CFT structures but are attracted to countries that effectively insulate their financial markets from illicit exploitation. These findings point to a source of tension between governments seeking to attract foreign investment and improve their compliance with international counter-illicit financing policies. This dissertation demonstrates the interconnected nature of the actors involved in the international financial system, both licit and illicit.

5.3 Future Research

This dissertation paves the way for several areas of future research and there are direct extensions of this work that I plan to pursue to further our understandings of the efficacy and drawbacks of economic counterinsurgency. This dissertation has only explored one form

of targeted economic counterinsurgency, economic sanctions. However, governments have a toolbox of targeted measures including arresting financiers, raids, confiscating goods and armaments from safe houses, enhancing security to disrupt intelligence networks, and conducting surveillance over supply chains. I have collected preliminary data on these targeted measures against insurgent groups from 1990-2018. Data collection is ongoing and there is not currently sufficient coverage to produce a random sample of groups for analysis. However, the patterns in the preliminary data in Figure 5.1 suggests economic sanctions are a far less common form of economic counterinsurgency than the law enforcement actions domestic governments routinely take to disrupt resource-generating tactics. Figure 5.2 shows the increase of targeted economic counterinsurgency in recent years and highlights the need for further data to evaluate the use of these tactics.

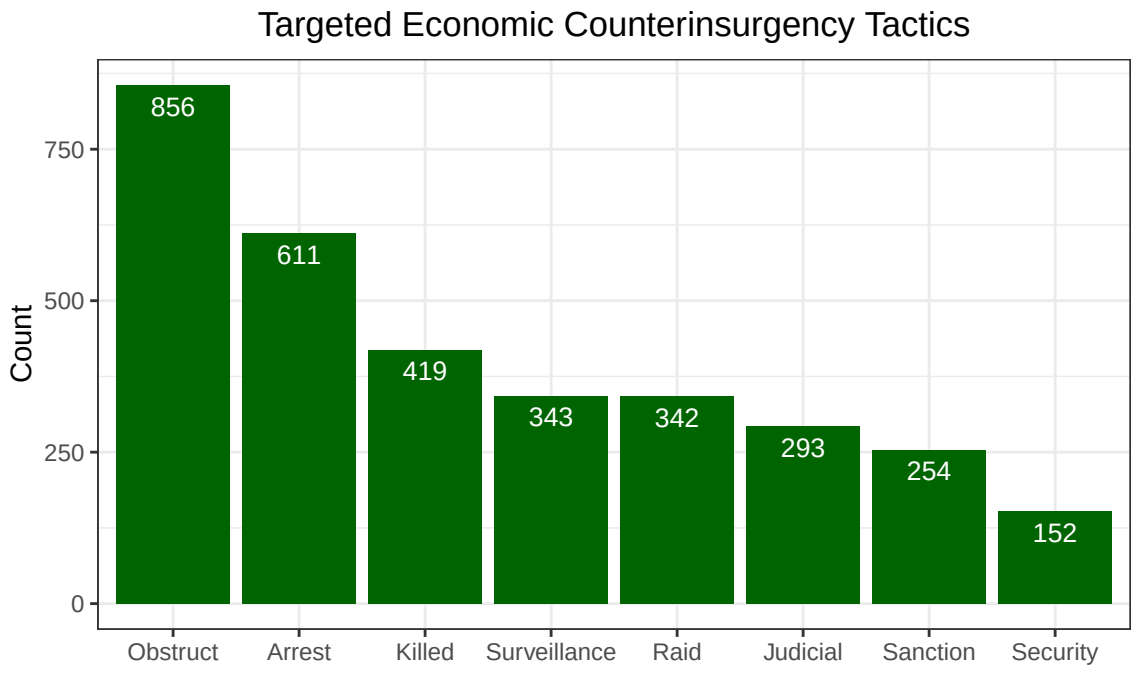

Figure 5.1: Frequency of Targeted Economic Counterinsurgency Tactics (Preliminary Data)

The dissertation project focused explicitly on economic counterinsurgency, but the reality

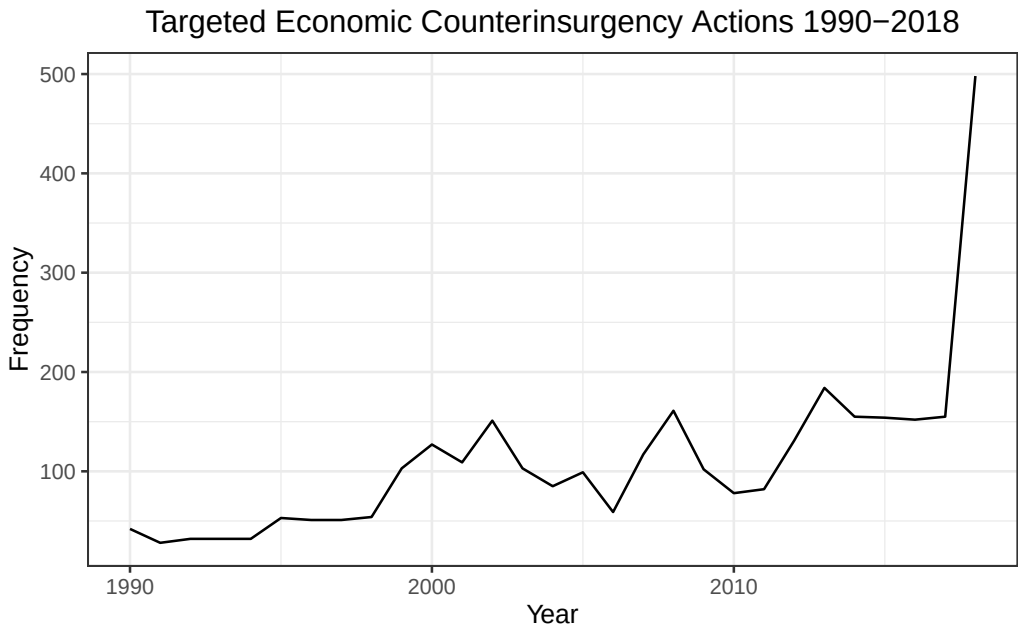

Figure 5.2: Occurence of Targeted Economic Counterinsurgency 1990-2018 (Preliminary Data)

is that these actions are often interconnected with military or law enforcement officers who can serve as front-line enforcers of strategies to disrupt insurgent supply chains. Military or police operations against physical strongholds or insurgents can also result in the confiscation of large quantities of resources and disrupt supply chains. I hope future work using this original data will help integrate the study of economic counterinsurgency with studies focusing on the military or law enforcement prongs of counterinsurgency.

Beyond this original data collection, this project suggests several additional avenues for future work. An immediate extension of this dissertation will be to include state counter-illicit financing measures in evaluations of targeted and categorical economic counterinsurgency. Due to the focus of rebel organizational attributes in Chapter 2, I was restricted in the time period by the data available with yearly information on insurgent groups. As such, I was unable to incorporate the measures of counter-illicit financing from 2016-2019 into my evaluation of economic sanctions which covered 1998-2012. However, I plan to explore this

further with new data in future papers. These measures may also be well-suited to regional analyses that exploits inter-regional differences across government AML/CFT structures and AML/CFT effectiveness. My results show that there could be useful variation across AML/CFT effectiveness in South Africa, West Africa, East Asia, and South East Asia. Governments in South and West Africa also vary substantially in their AML/CFT structures. For example, it may be fruitful to explore variation in the enforcement of targeted sanctions against Al-Qa'ida in the Islamic Maghreb across countries with varying counter-illicit financing systems in the African Sahel region in particular as several countries including Mauritania have worked to bolster their AML/CFT structures in recent years.

Rebel production of violence is one observable implication of targeted sanctions, but these policies are likely to have broader impacts on the internal cohesion and strategic calculus of violent non-state actors and the governments opposing them. Future work could consider the impact of sanctions on insurgent splintering, willingness to negotiate, and longevity. Economic sanctions targeting rebels best reflect the growing toolbox of financial counterinsurgency, but in the context of intrastate conflicts it is worth analyzing symmetric sanctions that impact the capabilities of all belligerents and sanctions that only target the government. This theory has focused on rebel groups, civilian populations, and domestic governments, but further analyses into the broader networks of violent non-state actors could identify if these policies cascade across rebel alliances or are disrupted by sanctions-busting foreign sponsors.

This work also suggests several avenues for future research in international political economy. A firm's preferences may also be shaped by the regulations in their home market. The firm is subject to oversight in both their home and host market. If the home country is a strong adherer to AML/CFT then it may actually be less costly for firms to seek out host markets with similar regulations. This is the logic underlying de-risking. Financial entities operating under strong customer due diligence and documentation requirements from their

home market may avoid unregulated host markets due to concerns of violating their home market's provisions and facing fines. The results presented in this paper provide support for an alternative "race to the bottom" mechanism. This logic which has been shown for labor standards would suggest that firms from highly regulated host markets may be the most likely to seek out weakly regulated host markets. The relative cost of host market regulations should be a function of the firm's home market. Firms that are already compliant with high standards face fewer costs than a firm that must create new capacity for customer documentation, verification, and investigation. For these reasons we might expect FDI to travel between country dyads with the most similar institutions on AML/CFT.

Finally, I have argued that these provisions reach and create costs for multinational firms across sectors. However, the costs and risks associated with AML/CFT provisions vary across industries and there may be interesting heterogeneity across these dimensions. It is plausible that financial entities prefer host markets with stronger technical compliance to avoid fines and reputation costs associated with violating international AML/CFT standards. However, for firms with less risk of being targeted by domestic regulators a low technical compliance environment may be an appealing low cost choice.

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