

# MARITIME PIRACY - ECONOMICS OF A FLOURISHING BUSINESS

Lieutenant Commander M Ravikant  
Lieutenant Commander P Ratheesh



## Introduction

When people talk about pirates today, the first thing that comes to one's mind is the stellar role of Johnny Depp in 'The Pirates of the Caribbean' and the legends from the dark past of ghost ships and one eyed pirates. The piracy which has been glamourised by numerous tales and Hollywood movies is not the real face of modern day piracy. The pirates have transformed from the old sea robbers into technologically empowered and privately funded groups, with links in mafia and drug cartels around the world.

There are two types of modern pirates in existence; 'small-time pirates' who operate singly and 'organised gangs of pirates'. Small time pirates are mostly interested in loot and the sale of the ship they attack. They are similar to the old pirates from the past. Their goals are not high and they work only for themselves. On the other hand, organised pirates are groups connected to other similar groups involved in



organised crime and work for certain influential and rich people and agencies. Their goals aren't just looting of small ships but they attack for fulfilling their part of the business. They just form a link in a long criminal chain.

The modus operandi of pirates has evolved from the use of simple boats, guns and pistols to speed boats with radars and several modern communication equipments like V/UHF portable sets and satellite phones. Modern pirates also have access to weapons like machine guns, rocket propelled grenades and they use all kinds of modern gadgets. They have AIS and tracking equipment to select, identify and locate their targets. With all these advantages it is but natural that they have a totally different style of attacking.

The availability of all these modern equipment with the pirates is only indicative of the economics involved in the business of piracy. It indicates the nexus between the mafia, drug cartels and weapon suppliers with pirates. The pirates end up being pawns in this much larger game being played out.

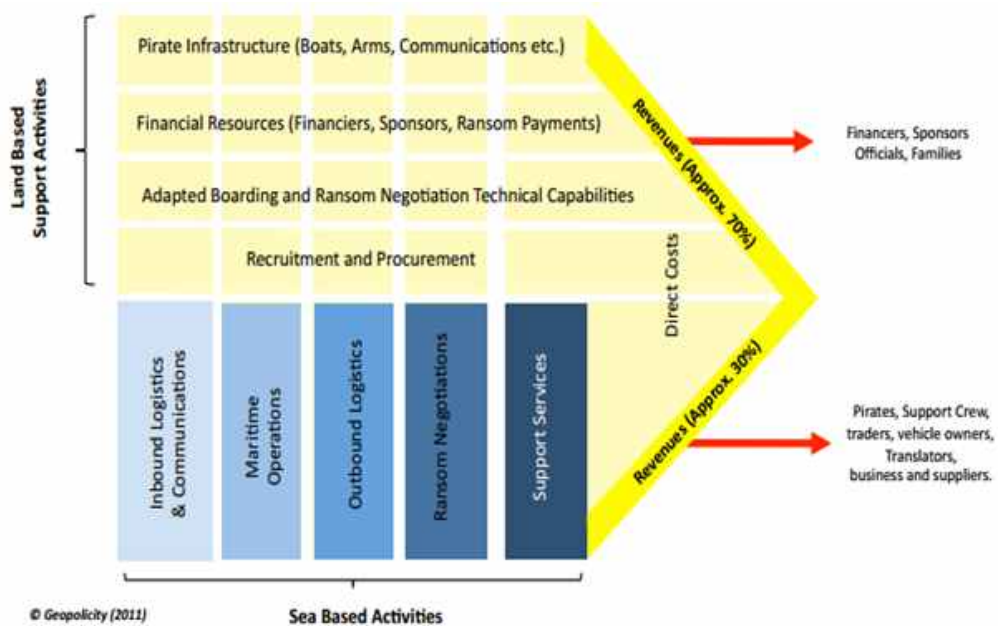
### Economics of Piracy

**Piracy - The Business Model.** Pirates who infest the sea these days are no longer mere robbers but are seasoned criminals with a different and new outlook towards piracy. These rough, seasoned, so called fishermen off the Somali coast are unrepentant criminals. In fact they're more than that. They're innovators who have invented their own unique business model. Whereas, earlier sea bandits were satisfied to make off with a dinghy full of booty, pirates who prowl the Gulf of Aden today hold captured ships for ransom. This strategy has been fabulously successful for them with the typical payoff today 100 times more than what it was in 2005.

This has led to the number of attacks skyrocketing to unimaginable proportions.

Like any business, 'Somali Piracy' can also be explained in purely economic terms. It flourishes by exploiting the incentives that drive the international maritime trade. The other parties involved - shippers, insurers and private security contractors stand to gain more (or at least lose less) by tolerating it than by putting up a serious fight. As for the pirates, their escalating demands are a method of price discovery, a way of gauging how much the market will bear. The risk and reward calculations for the various players arise at key points of tension; at the outset of a shipment, when a vessel comes under attack, during ransom negotiations, and when a deal is struck. As long as international Navies patrolling the area don't roll in with guns blazing and play spoil sport and foil the attempt, the region's peculiar economics ensure that almost everyone gets a cut.

**Pirate 'Value Chain'.** Value Chain analysis provides a systematic approach for examining the competitive advantage enjoyed by the pirates; in this case for the pirates off the coast of Somalia, their financiers, sponsors and counter piracy bodies. Piracy is a long and complex supply chain, involving literally hundreds of land based support staff and increasingly large and sophisticated maritime based operations.





Being a pirate is a very risky business, yet in a fragile state with an ineffective Government, financing piracy is relatively risk free over a long term. The worst case scenario for a financier is that he loses his boats and equipment. The worst case scenario for a pirate is death. There are no worst case scenarios for insurance companies because they pass on the risk as premiums.

**Participants and Profiteers.** In many aspects the organisation of piracy operations is guided more by the principles of private enterprise than military strategy and planning. Catalysed by the absence of effective Government or law enforcement in the region, piracy has transformed into a lucrative and highly organised illicit business. There are multiple actors associated with any given operation ranging from international actors, senior Government officials who provide political protection and money launderers who facilitate ransom transfer to

ground teams composed of locals.

Financiers and other prominent business and political figures, with assistance from the fishing industry, provide 'seed money' for the pirate groups to function, as well as resources and equipment. Financiers and sponsors are believed to retain approximately 50% of the ransom money, compared to the pirates themselves who take about 30% of the booty. The remaining 20% goes to the other elements of the chain.

An international network comprising mostly of Somali expatriates reaching as far as North America and Europe reportedly backs the spike in piracy in the African waters and beyond. With help from this network, Somali pirates brought in more than 30 million dollars in ransom in 2010. Financial backers and profiteers from countries across the world including Lebanon and the United Arab Emirates, as well as criminal gangs in Yemen, and global insurance companies in the West have been found to





be part of the beneficiaries in this racket.

**Estimated Cost of Piracy.** The important factors which contribute towards the cost of piracy are as follows:-

- Cost of ransoms.
- Piracy insurance premiums.
- Deterrent equipment.
- Re-routing vessels away from risk zones.
- Naval vessel deployments.
- Piracy prosecutions.
- Organisation budgets to reduce piracy.

Considering the costs involved in each of the factors above, the total global estimated cost of piracy is about US\$7 to US\$ 12 billion dollars per year. Getting to the mathematics for all the elements involved will essentially bring out the reason why it is luring in so many into its folds.

**Mathematics of Piracy**

**For Pirates.** Pirates who have not been press-ganged into becoming pirates would appear to be the very essence of rational profit maximising entrepreneurs described in neo-classical economics. Maritime piracy is turning into a lucrative business. GDP per capita in Somalia is estimated at US\$ 500 p.a. Over an average working lifetime of 29 years, a Somali man may earn US\$ 14,500. Compare this to that of a Somali pirate, who may earn upto US\$ 30,000 p.a. and US \$ 160, 000 in his lifetime. This however is based on success rates of attempted hijacks. What is alarming is the fact that over the years the success rate has increased manifold.

**For the Shipping Companies.** En route between Europe and Asia, it takes 12 hours and hundreds of thousands of dollars in fees to traverse the Suez Canal and skirt the Somali coast. The alternative is rounding the Cape of Good Hope at Africa's southern tip, which adds millions to the cost in terms of fuel costs as well as the time required for the voyage. Added to this is the exposure to the area's unpredictable weather phenomenon. The big question would be - Is it cheaper to brave the pirate waters or to bear the more expensive and time consuming circuitous

route?

**For the Insurance Company.** The insurance business to start with itself is a gamble. Insurers know that some ships will be hijacked, forcing the companies to dispense multimillion-dollar settlements. However, they know the chance of this happening is remote and unlikely in most cases, which by the calculations of their industry makes it worth issuing policies. For an insurance company, a successful piracy bid on any of their insured ship would probably end up in a costly ransom payout.

That may seem like a problem but rising premiums for anti-piracy insurance more than make up for any losses. Given the number of ships being insured vis a vis the number being hijacked for ransom, piracy ransoms would have to multiply by double digits to keep pace with the ballooning price for a US\$3 million piracy insurance policy.

**For the Negotiators/ Interlocutors.** A private negotiator's/interlocutor's job is not to prevent piracy but to free the ship and crew by negotiating and delivering the ransom. These firms, made up mostly of former military personnel, enter into a sort of partnership with the attackers. Dealing directly with pirates builds a reputation for fair play and decreases the chance of mishaps. Meanwhile, a successful negotiation funnels cash to criminal gangs, fueling further hijackings and further opportunities for these companies. Security personnel can take in as much as pirates when a hijack is resolved. Armed guards, expert planners, daily outlays, legal fees and other expenses are extra. With opportunities for private security waning in Iraq, the Somali coast is the new Promised Land.

**For the Security Agencies.** Following the exponential increase in piracy attempts, a lot of security agencies have been employed to provide armed sentries who guard the ships against attacks. Every ship has been proactively employing armed guards and sentries to safeguard their ships in transit through the piracy infested waters. The daily rate of the security guard is about US\$ 600/day. In the wake of piracy, maritime security agencies are blooming all over the world providing employment opportunities





for several individuals. How successful they are in foiling or deterring piracy bids remains a question unanswered.

**For the Financers and Arms Dealers.** These are the true handlers for the otherwise uneducated and poor pirates who carry out the attacks. Either way, they get to push more arms and equipment into the market for a cost and share of the booty picked up by the pirates. Each successful bid gives them enough to finance more and more such attempts. The ransom money is routed out of the country through various channels to accounts in well established tax havens and banks in certain countries.

**Conclusion**

Maritime piracy is developing into a huge profit making illegal business vested with private interests. With politicians, well placed expatriates and big

finance companies secretly funding acts of piracy with the help of mediators, it has become virtually impossible to terminate maritime piracy.

To put an end to piracy the world needs to adopt a twin-track policy which would mean first putting money and effort into training Coast Guards and constructing courts and prisons in the region. The authorities should also go after the dozen known kingpins who back the pirate gangs. At the same time, because it will take decades to rebuild the shattered Somali State, the outside world must itself engage directly with Puntland's clans and help rebuild villages, infrastructure and fisheries which have been ravaged by foreign trawlers and the dumping of toxic waste. Although the region is chaotic, its prospects are not hopeless. The mathematics therefore points to targeting the cause rather than the effect.

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**ABOUT THE AUTHORS**



Lt Cdr M Ravikant

This essay is coauthored by Lt Cdr M Ravikant (05097-H) and Lt Cdr P Ratheesh (05376-T). Both the Officers are alumni of Naval Academy and are presently posted at INAS 31 I/INS Dega as Sqdn QNI and QFI respectively.



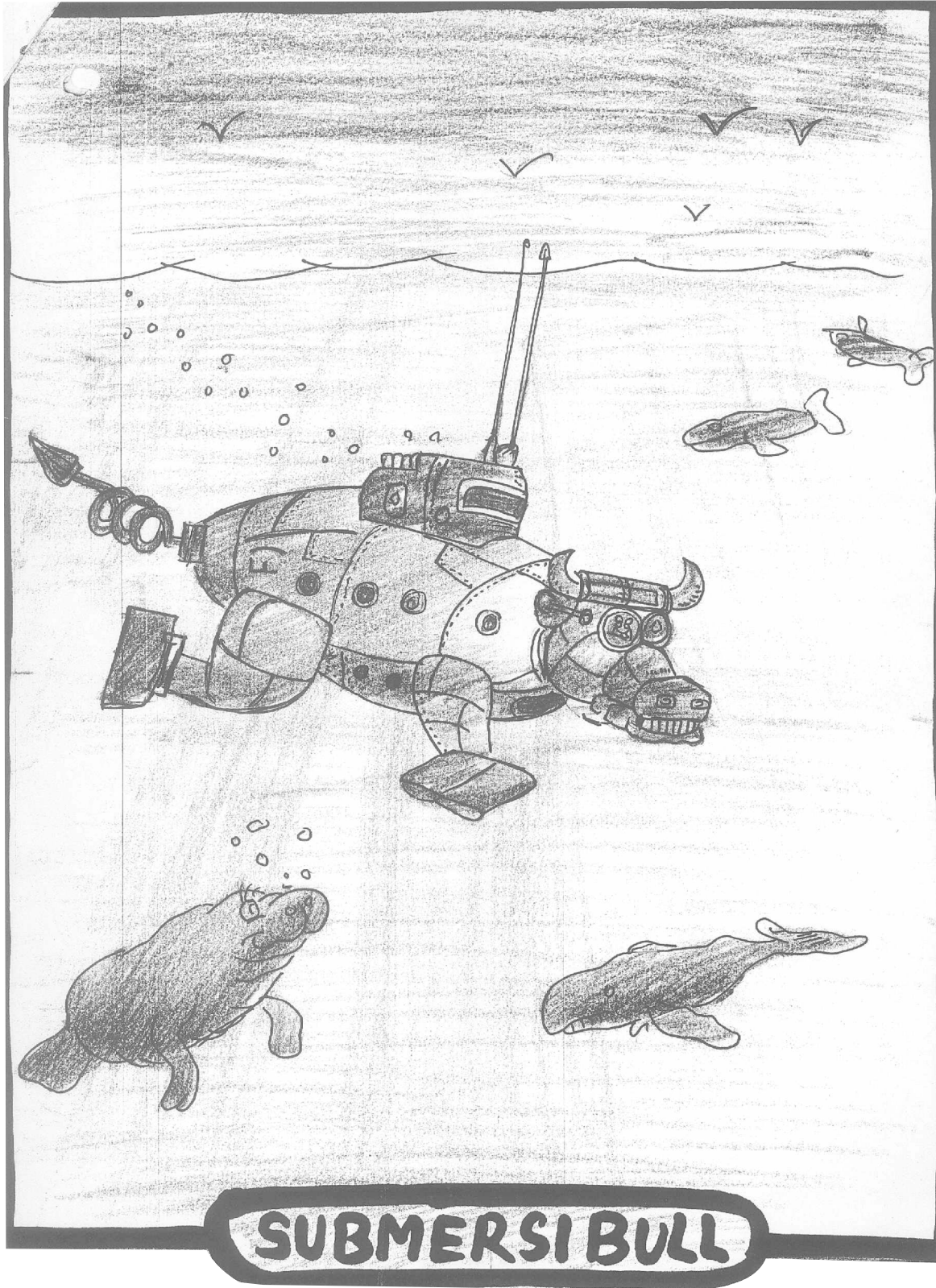
Lt Cdr P Ratheesh

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**TIDBITS**

- ★ A bicycle can't stand alone; . . . it is two tired.
- ★ A dentist and a manicurist married . . . . They fought tooth and nail.
- ★ A thief who stole a calendar . . . got twelve months.
- ★ A will is a . . . dead giveaway.
- ★ Acupuncture : . . . . a jab well done.
- ★ I am reading a book about anti-gravity. It's impossible to put down.
- ★ It's not that the man did not know how to juggle, he just didn't have the balls to do it.





By Sub Lt SS Rao

