

# Conflict financing: what's wrong with war economies?

By Mark B. Taylor

## ■ Executive summary

This report describes an approach to engaging in war economies in which informal economies meet irregular armed violence. International responses to the economic dimensions of conflict and peacebuilding have been hampered by a confusion of approaches and the complexity of the realities of armed conflict or widespread violence. The conflict-financing framework is proposed as a practical means of understanding what responsibilities arise in war economies and creating common approaches to how they might be regulated. Building on tentative progress in the relevant policy areas, the report makes several recommendations for policymakers grappling with conflict and peacebuilding.

The reality of war economies has long presented policymakers with a range of challenges. These include difficulties in establishing causal links between economic activity and the violence of conflict; difficulties in designing targeted regulations that do not also harm civilian livelihoods; difficulties in assessing contested legitimacy in conflict economies, not least with respect to rebellions against repressive regimes; a heterogeneous set of actors with strong incentives to resist regulation; and challenges in finding common ground among international organisations.<sup>1</sup>

Progress has recently been made on the last point with the tentative normative steps forward in regulating the trade in conflict commodities and the arms trade. As described in an earlier NOREF policy brief (Taylor, 2012), in 2011 policy developments at the United Nations (UN) Security Council and Human Rights Council, as well as at the Organisation for Economic Co-operation and Development, laid the foundations for a system to exclude the products associated with human rights abuse and conflict financing from global trade flows. In April 2013 the UN General Assembly approved a treaty governing the arms trade. Further progress towards regulating conflict economies depends on

the development of a regulatory strategy that responds to the challenges noted above. To this end, policymakers require a reliable description of the problems that arise in war economies in order to consider how these problems might be regulated. Such a description can be found through the conflict-financing framework.

## Conflict financing in war economies

There are two kinds of war economies. The first is the classic war economy that throughout history has been the mechanism through which economic resources were dedicated to the preparation for and conduct of war. These war economies are fundamental to national defence and as such have been variously described as the “arsenal of democracy” and, more menacingly, as a “military-industrial complex”.<sup>2</sup> Whether viewed as a threat to democracy or a necessary evil, the classic war economy is a central part of the political economy of industrialised economies and, as such, most governments consider such an economy to be essential to national security. As a result, states have ensured that international law and relations formally permit such economies.<sup>3</sup>

1 Elsewhere this has been described as a “malign problem structure” (Lunde & Taylor, 2005). See also Sogge (2011).

2 Both characterisations were made by U.S. presidents: the former by President Roosevelt during the Second World War and the latter by President Eisenhower during the 1950s expansion and beginning of the arms race with the Soviet Union.

3 The UN Charter prohibits the use of force in international relations (Article 2), but merely suggests a committee to consider plans “for the establishment of a system for the regulation of armaments” (Article 26). Although treaties have banned or regulated the use of certain weapons, such as land mines, cluster munitions and certain chemical or biological weapons, the arms trade as such has not yet been regulated (at the time of writing, negotiations over the Arms Trade Treaty had been completed, but entry into force was not expected until 2015). Article XXI of the General Agreement on Tariffs and Trade specifically allows states to make exceptions to the rules governing global trade on the basis of national security. See, generally, Gathii (2010).

The second kind of war economy is made up of the informal markets that co-exist with the armed violence of war. These are the economies that continue in conflict zones both despite and because of the violence. The dominant form of warfare today – irregular warfare<sup>4</sup> – is often sustained by the informal and illicit markets that form these economies. However, while economies of violence are sources of power for regime elites and non-state armed groups, they are also sources of jobs and livelihoods for households (e.g. see World Bank, 2011; Justino et al., 2013).

In short, these irregular war economies are vital to both life and power in conflict zones. The informal and sometimes illicit markets that operate in situations of armed conflict are populated by, among others, workers, farmers, households, communities, elites, rebels and businesses, whether local, regional or global.<sup>5</sup>

Distinguishing between legitimate and illegitimate market-based activity is not always easy, not least where weak state capacities and informal markets make information difficult to come by. To help, policy researchers from a variety of disciplines have turned to the concept of “conflict financing”.<sup>6</sup> For the purposes of policy and law, conflict financing is defined here as activities or relationships that generate revenues for armed groups or parties to a conflict. The conflict-financing concept assumes that in irregular war economies the coincidence of armed violence and informal economies offers state and non-state users of force unique access to economic opportunities. In situations of conflict the limits of economic opportunity are defined, firstly, by the relative strength of the warring factions (Naylor, 2002: 45-49). Options for outside sponsorship are always present, including through donations (e.g. from a diaspora), the diversion of aid flows or state sponsorship (especially arms supplies and military assistance).

The competition between insurgents and the state results in zones of “contention”, “expansion” and “control” (Naylor, 2002: 45-49).<sup>7</sup> Although examples can be found of these types of zones, the point of this categorisation is not to demarcate the geographic space of conflict zones on the ground, but rather to make the point that a decisive factor in determining the conflict-financing strategy is the relative balance of power between state and non-state forces. The strength of a group both influences and is partly determined by its power and ability to control territory.

Ultimately, a group’s choice of financing activities is determined by both its “relationship to the broader society and its relative strength via-à-vis the enforcement arm of the state” (Naylor, 2002: 53).

In all of these situations, from contention through to control, the insurgents’ and incumbent’s objective is not just to control sources of financing, but also to undermine, deny or capture the financing of the opponent. This is why in zones of contention opponents will target each other’s economic infrastructure, seeking to deny revenue and increase costs (of rebuilding); disrupt economic activity; and force capital to flee, investment to shrink, production to fall, and unemployment and inflation to rise. For insurgents, the objective is to erode the formal economy, either by direct action or by provoking a government response, and in so doing increase the dependence of the population on the informal economy through the creation of a parallel economy, e.g. by abolishing or restructuring certain markets, introducing land reform, introducing co-operative principles to replace capitalist ones, etc. In addition, this has the knock-on effect of delegitimising the government, shrinking its fiscal resources and expanding the relative size of the black market from which the movement draws its material support.<sup>8</sup>

Within those zones, financing activities by insurgent or state armed groups may be more or less violent. Predatory acts “cover a wide range of crimes – from armed robbery to certain types of business fraud” (Naylor, 2002: 57). In zones of contention insurgents are vulnerable to law enforcement, so predatory acts focus on quick, one-time returns and it is this hit-and-run character of predation that lends itself to violence. Looting, armed robbery and kidnapping for ransom are prevalent forms of insurgent financing in contemporary armed conflicts. While some predatory acts are simple and violent, others are quite sophisticated and require more planning: attempts by the Irish Republican Army and the Tamil Tigers to mount counterfeiting operations, or forms of maritime fraud in Lebanon’s civil war<sup>9</sup> are both examples of more sophisticated predatory acts. For all of these acts of predation the defining feature is a short-term profit horizon with no certainty of being able to repeat the operation.<sup>10</sup>

When a guerrilla group switches from episodic activities such as robbery and kidnapping to more stable income sources such as protection payments, it crosses

4 “In 2011, 36 of the 37 active armed conflicts were fought within states. Of these, nine were internationalized, meaning that they saw international involvement with troop support to one or both sides of the warring parties.” In all 36 the warring parties included both government and rebels forces (Themnér & Wallensteen, 2012).

5 For an analysis of social conditions in irregular war economies, see Bøås (2013); see also Le Billon (2012).

6 The most developed framework specific to conflict financing is that of Naylor (2002). See also Cockayne (2010); Wennmann (2007); Humphreys (2005).

7 Naylor’s categorisation finds resonance in separate studies of armed violence in civil wars, such as Kalyvas (2006: 88), who describes zones of “incumbent control, zones of insurgent control and zones of contested control”. Writers on the overlap between conflict and crime have also used this characterisation, e.g. see Cockayne (2010).

8 But insurgents must be wary: as military demands rise because of attacks on them by incumbent forces, so too will social welfare demands rise, “because a true insurgent movement, as distinct from one engaged purely in adventurism, must displace at least partially the social services provided by the government” (Naylor, 2002: 47).

9 In which a ship would be captured, its goods sold locally or inserted into regional transit trade networks, and a deal with the ship owner struck in which the ship would be reported as lost at sea, the insurance collected and a kick-back provided. If the ship were old it would be scuttled, but if in working order it might be renamed and sold on for operations in another part of the world (Naylor, 2002: 58).

10 In this, Naylor agrees with Keen (1998: 2), who states that “Economic violence is violence from which short term profit is made”.

the line from predatory to parasitic modes of funding. If predatory fund-raising by guerrillas approximates blue-collar crime, parasitical fund-raising is more akin to white-collar offenses (Naylor, 2002: 63).

Parasitic financing requires better supporting infrastructure and a more consistent physical presence in order to implement protection rackets, “revolutionary taxation” (usually on business income or the wealthy), informal trade duties (often at checkpoints), employment rackets – controlling access to construction sites and forcing employers to hire only those designated by the group running the racket – and protection rackets. For these activities armed groups will normally have established their level of control of an area and are seeking to expand their activities. This is not to suggest predatory activities do not occur, but that there is now the possibility of a longer-term profit horizon that permits repeated rent-seeking behaviour, if not quite the prospect of being able to protect investments or property.

Finally, once physical control of a zone has been established the insurgent group seeks to set itself up as the de facto government, seeking to capture all tax revenues and establish itself as the enforcer of law and order. At this point the insurgent financing becomes symbiotic in that its central focus is the provision of goods and services to legitimate society, e.g. via smuggling and the provision of illegal consumer goods (drugs, illicit luxuries items) and services (prostitution, illegal gambling, union busting, illegal waste disposal). Insurgents who are able to control border areas can extract duties on cross-border traffic on anything from raw materials (timber, minerals, diamonds) to cut-rate consumer goods (cars, electronics, cigarettes).

Symbiotic financing mechanisms are typically those implemented by well-established, organised criminal groups, but may also be controlled by insurgents. The zones these groups control are economically useful for stabilising the funding base, politically providing more legitimacy to rebels and providing the basis for the eventual escalation of the conflict with a view to taking over the state. Forms of predation and parasitism may continue, in particular in economic sectors or physical locations that are not under the full control of the armed group or where challengers have weakened the control of the incumbent group.

## Conflict financing and the policy challenges of war economies

A central thesis of the conflict-financing framework is that social relations matter to the regulation of war economies at least as much as law does. In both forms of regulation,

armed violence or coercion plays a key role in determining compliance. In other words, the conflict-financing framework recognises that “coercion works; those who apply substantial force to their fellows get compliance” (Tilly, 1992, cited in Kalyvas, 2006: 24). At the same time the framework recognises that the ways in which coercion itself is used are influenced by the legal, social and economic reality in which it is deployed. This is an approach that is backed up by studies of the logic of armed violence in civil wars more generally, as well as those of the links between natural resources and armed conflict (Le Billon, 2012: 4; Kalyvas, 2006).

The conflict-financing framework identifies human agency in war economies, places this agency in a causal context, and provides a taxonomy of conflict-financing behaviour. This is a kind of criminology of war economies: it describes potentially criminal acts – such as looting, kidnapping or other predatory activities – and explains their causality in context.

In so doing, it is agnostic about the larger political affiliation of these groups – e.g. whether they are insurgents or state forces – and focuses instead on the acts themselves.<sup>11</sup> Regulation that remains agnostic as to affiliation avoids questions of contested legitimacy in a conflict situation because it does not target rebels simply because they are rebels, but only to the extent that they behave in a manner that is, for example, predatory. Similarly, it applies the same standards of behaviour to state security forces. While it is likely that any government will criminalise all the financing activities of rebel groups, the conflict-financing framework permits responses in international policy and law to make determinations about the legitimacy of conflict-financing activity based not on national law, but on international criminal and human rights norms.

A framework that identifies conflict-financing activities makes it possible to distinguish between perpetrators and victims and to assign responsibility for these activities according to legal norms. By considering the causality of specific acts in context, the conflict-financing framework permits a distinction to be made between those with criminal intent and those who merely seek to survive. This distinction could be made between civilians living in conflict zones and, for example, predatory armed groups, while avoiding the problems of politicisation that are inevitable in the polarised politics of violent conflict. Similarly, conflict financing permits a distinction to be made between repressive or predatory armed groups and those that seek to adhere to international humanitarian and criminal law. Rather than impose sanctions on entire communities simply because they are in the wrong place at the wrong time, or against rebel movements resisting

<sup>11</sup> Naylor (2002) draws a sharp distinction between the motives of criminal groups and those of rebel groups, at least when they reach the stage of geographic control and symbiotic financing: in Naylor’s view the former are simply criminal, while the latter have a political motive, e.g. state capture, secession, national liberation, etc. In law, drawing this distinction is complicated. The position advocated in this report is that a legal approach would involve both sets of actors being judged on the basis of their acts and their intent with respect to those acts, not on larger motivations of profit or political gain.

repressive regimes simply because they are doing so, the conflict-financing framework permits the identification of unacceptable behaviour based on international law or its analogues in national law.

A conflict-financing framework enables an analytical approach that is both normative and operational. It suggests a minimum standard based on criminal law as the basis for defining the relevant norms applicable in such situations. In addition, it offers a framework for use by analysts charged with identifying criminal activity in a war economy and distinguishing this from legitimate economic activity.<sup>12</sup>

The categories of criminal activity in a war economy might include:<sup>13</sup>

- the commission of predatory crimes by business actors, e.g. murder, torture, rape, kidnapping, theft, pillage, smuggling, forced labour or enslavement;
- knowingly providing substantial assistance to those who commit predatory crimes, e.g. aiding and abetting a crime through commercial transactions; or
- breaching laws governing the illicit global flows (e.g. anti-money-laundering laws) or the trafficking of conflict goods, e.g. rules governing the use of or trade in conflict minerals,<sup>14</sup> violations of export-licensing regimes, UN sanctions, etc.

From the conflict-financing approach, it is possible to glean several implications for policy responses:

- Firstly, in war economies, any regulatory strategy should rely on international criminal law as the basis for *minimum* standards of behaviour, while at the same time ensuring that such an approach does not criminalise indiscriminately.
- Secondly, where national law enforcement may be largely absent, international or transnational law enforcement will be necessary. To function properly, transnational law enforcement (e.g. Interpol, Europol) and multilateral investigative functions (e.g. during peace operations or sanctions monitoring) will require additional analytical and investigative capacity.
- Thirdly, because international and transnational law enforcement can be slow and complex, a distributed regulatory strategy will be necessary, one that draws on law, markets and social norms to require and encourage compliance.
- Finally, common standards for ethical economic behaviour in conflict situations, now available under the international human rights regime, should form the basis for communicating – and enforcing – expectations to those operating in transitions from conflict and peacebuilding contexts, be they peacekeepers or foreign investors.

## Conclusion

Irregular war economies generate a range of policy challenges. In situations of widespread violence, people are more vulnerable and livelihoods less certain. Where states are fragile, legal regulation is by definition less effective. Where economic activity is informal or illicit, domestic or international oversight is more difficult.

The conflict-financing framework enables policymakers to understand what legal responsibilities might arise from war economies, for whom, and how these might be regulated. It is a framework that can inform the work of national law enforcement agencies, transnational agencies such as Interpol and Europol, international prosecutors and criminal analysts at the International Criminal Court, and relevant UN bodies, such as peacekeeping operations and sanctions-monitoring bodies.

Yet it must be remembered that attempts to control illicit economies will reduce the resilience of households who rely on informal economies. Those deploying law enforcement measures that rely on the conflict-financing approach should understand these measures in light of a larger regulatory strategy. “Regulation” is the key word and must be distinguished from criminalisation. Informal economies should not be sanctioned as a whole or simply because they are unregulated. Similarly, armed groups should be targeted on the basis of their failure to respect the relevant laws. The financing of conflict per se may not be illegal, just as households’ reliance on informal markets is not a crime. But conflict financing may include violent and predatory acts that are. Criminal law standards are minimum standards and as such should be used with caution, but they do need to be used. A regulatory strategy that targets obviously criminal acts should be the minimum basis for a broader regulatory approach to the global dimensions of conflict trade and the peacebuilding strategies used to transform war economies.

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<sup>12</sup> Cockayne (2010) refers to the need for a “normative transformation” as one part of a larger strategy for grappling with war economies, as well as the need for increased analytical capacity.

<sup>13</sup> Adapted from Global Witness (2010).

<sup>14</sup> In 2010 the U.S. enacted provision 1502 of the (Dodd-Frank) Wall Street Reform Act concerning conflict minerals from the Democratic Republic of Congo; in 2013 the European Union began public hearings on similar legislation.

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