

Mark Taylor and Anne Huser

**Security, Development and Economies of  
Conflict: Problems and Responses**

Fafo AIS Policy Brief



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# 1. Introduction

Markets don't kill people. Yet, the record indicates that illicit arms and commodity markets have helped sustain wars that have killed almost three million people in one African country alone. Commodities don't kill people. Yet, like unregulated markets, commodities can be a curse that undermines development and threatens human security.

The evidence is clear. In Cambodia, conflict timber helped sustain the Khmer Rouge and other factions during the civil war well into the 1990's. Illicit drugs and consumer goods have sustained factions in Afghanistan, and in the Balkans criminal gangs connected to belligerent factions traffic in narcotics, arms and humans. In the Democratic Republic of Congo (DRC) – rich in diamonds, other minerals and timber – over 2.6 million people have died since 1998 as a result of the war, most from the effects of the war on food security and health. For much of the past decade, diamonds and oil revenues fuelled the two sides at war in Angola. Timber and diamonds helped sustain the war in Sierra Leone, reducing the country to the rank of “least developed nation” in the UN index, with a population whose average life expectancy is 25.9 years.

Illicit markets and conflict commodities do not cause conflict, but very often they are the mechanisms through which conflict and underdevelopment reinforce each other. In a number of developing countries, the economic opportunity provided by natural resource and other commodities intersects with conflicts over power and identity, resulting in a downward spiral of state failure, underdevelopment and human insecurity. Commodities that would otherwise provide some impetus to economic and social development instead become the life-blood of informal markets and shadow networks. In the context of largely unregulated global markets, these economies can become a focus of conflict, or its fuel.<sup>1</sup>

Beyond the immediate impact on lives and livelihoods, these economies of conflict pose a daunting challenge, both to the promotion of economic and social development and to the management of conflict. Companies, governments, multilateral institutions and non-governmental organisations find themselves addressing overlapping problems: companies operating in resource rich, developing countries face increasing demands for corporate responsibility for human rights, regardless of the effectiveness or legitimacy of the government.

<sup>1</sup> Ballentine, Karen and Jake Sherman, eds., *The Political Economy of Armed Conflict, Beyond Greed and Grievance*, International Peace Academy / Lynne Rienner, (2003).

<sup>2</sup> Collier, Paul *et al* *Breaking the Conflict Trap: Civil War and Development Policy* (World Bank 2003).

<sup>3</sup> Recent campaigns in a number of countries are ample evidence that consumer advocates have shifted from a concern about price and quality of products, to a focus which interrogates the ethical values of production.

Development institutions must balance the need to address what has been described as the “conflict trap”,<sup>2</sup> with the danger that the commodities upon which some developing countries depend could become tainted in consumer markets, undermining their revenue potential.<sup>3</sup> For those working on security policy, the challenge is to get to grips with a range of diverse problems, from the financing of terrorism to the implications of economic incentives for conflict prevention or peace-building, what we refer to as the economic dimensions of international peace and security.<sup>4</sup>

The problem of economies of conflict does not present straightforward solutions or even a common approach to defining the challenges. Below we offer a summary of issues encountered in the principal policy areas concerned with economies of conflict, with an outline of recent policy responses and suggestions about future directions.

<sup>4</sup> Leiv Lunde and Mark Taylor, with Anne Huser, *Commerce or Crime? Regulating Economies of Conflict*, Fafo report 434 (2003).

## 2. Trade in conflict zones

*“It is also important that businesses should not contribute to economies that support conflict.”*

*Kofi Annan, United Nations Secretary-General*<sup>5</sup>

The presence of global companies in conflict zones has drawn attention to the fact that conflict zones are areas of economic activity, or trade. The ease with which conflict commodities such as diamonds and timber are brought to consumer markets has established that this conflict trade is well integrated to global markets. It seems that a conflict zone can be a profitable place. How is this possible?

In the terms of social and economic development policy, conflict trade is only one part of a larger process of governance failure in “marginalized countries”, those most prone to conflict.<sup>6</sup> These countries are poor, with declining economies and low average income, and dependent upon primary commodities. In this, they exist on the margins of growth-led development associated with economic globalisation, particularly global trade integration, and are vulnerable to the potential problems of natural resource governance. Typically, a combination of resource wealth, weak institutions, and more or less massive corruption, results in poor economic governance and economic stagnation. As institutional effectiveness wanes, development or poverty alleviation strategies become almost irrelevant, giving way to household coping strategies and the expansion of informal markets as the most relevant economic reality for most people. Power accrues to the representatives of the shadow states that wield real influence, often through the control of militias and diverted state revenues. It is not long before the bulk of commodity exports, or revenues from these exports, are captured by informal or criminal networks.

Those concerned about security policy are focused less on the pathologies of resource management and more on the role of conflict trade in the decision-making of rebels, some state armies, and terrorists. Here the line between armed factions and business entities can become blurred, particularly when armed force has become central to the activities of business entities, and economic activities have in turn become central to the tactical or strategic

<sup>5</sup> *Prevention of Armed Conflict*, Report of the Secretary-General, 7 June 2001; A/55/985–S/2001/574. In his report on Protection of Civilians, The Secretary-General recommended that “Member States and regional organizations...take appropriate measures against corporate actors, individuals and entities involved in illicit trafficking in natural resources and small arms that may further fuel conflicts.” Report of the Secretary-General to the Security Council on the protection of civilians in armed conflict (S/2001/331), 30 March 2001.

<sup>6</sup> Collier, *supra* note 2.

considerations of belligerents. In these situations, in which the threat or use of armed force becomes necessary to exploit the economic opportunity, it could be said that coercion has become a factor of production.

What the combination of the development and security perspectives makes clear is that the economic space of the conflict zone is not peopled only, or even mostly, by large corporations. Economies of conflict in almost every region of the globe have spawned hundreds of companies that would not exist in the absence of war and corruption. Some companies are fronts for corrupt officials or warlord networks. Others are simply willing to assume the higher risks of operating in war zones and find opportunities galore in the lack of effective regulation that accompanies war. Armed conflicts create the anarchic conditions and niche demands for these companies. Some are relatively small in size but usually operate regionally or internationally, using conflict as a cover for their operations, or profiting from supplying the combatants, or both. Some of these companies operate illegally, or in contravention of efforts to make peace, and in this sense can be described as rogue companies. If business in general prefers fewer regulations, the near anarchic conditions of conflict zones are the preferred operating environments for rogue companies.

Most companies seek to avoid association with rogue companies, or the appearance of benefiting from corruption or coercion. These associations present potential liabilities, or risks both to company operations and brand value. Similarly, national economies dependent upon a limited number of exports, as well as the coping strategies of communities that have come to rely on the informal economies of conflict zones, could face significant economic costs should their export goods start to be viewed as tainted in consumer markets. Yet, there is precious little in the way of policy or regulation to distinguish the rogues from the rest. When entering new markets or evaluating major changes in their operating environments, most international businesses look to governments for an elaboration of clear and predictable rules. However, there is no normative framework concerning private sector activity in conflict zones to which companies, affected communities or governments can refer.

The UN Commission on Human Rights has been developing a *Draft Commentary on the Norms of Responsibility of Transnational Corporations and Other Business Enterprises with Regard to Human Rights*, otherwise known after its main author, David Weissbrod, as the ‘Weissbrod Principles’.<sup>7</sup> The draft does not specifically address conflict or conflict trade, although the preamble notes that companies are “obligated to respect” a long list of human rights instruments, including those governing conduct during war, such as the Geneva Conventions and the statute of the International Criminal Court (ICC). This is a step forward in bringing companies under the rule of international law. In general, companies are legal persons and therefore do not qualify for prosecution under international criminal law, which only covers the acts of natural persons. Company officers may be liable for crimes against humanity and complicity in war crimes, as were Nazi and Japanese industrialists after World War II. Thus, while it would be possible to target company personnel for prosecu-

<sup>7</sup> E/CN.4/Sub.2/2003/WG.2/WP.1

tion for specific criminal acts in war, it is certainly not illegal under international law for companies to do business in war zones or based on war zone production.

In the absence of a normative framework, *ad hoc* efforts continue to emerge from the multilateral system in response to the problem of conflict trade. The UN Secretary-General's Global Compact produced a *Business Guide for Conflict Impact Assessment and Risk Management* (June 2002) that aims to "aid companies in developing strategies that minimize the negative effects and maximize the positive effects of investing in areas of conflict or potential conflict." The UN Security Council adopted an *aide memoire* concerning the protection of civilians in armed conflict during peacekeeping missions. A section of the *aide memoire* on Natural Resources and Armed Conflict reminds the Council to "urge Member States...to consider measures against corporate actors, individuals and entities involved in illicit trafficking..."<sup>8</sup>

The Organization for Economic Cooperation and Development (OECD) revised its Guidelines for Multinational Corporations in 2000. The efficacy of the Guidelines came under increased scrutiny in October 2002 when a UN Expert Panel on Illicit Exploitation of Natural Resources in the Democratic Republic of the Congo named over eighty-five companies operating in the DRC as being in violation of the Guidelines. The Panel's report caused significant confusion in capitals and boardrooms because it failed to explain what violations were alleged. This confusion was compounded by the fact that, while the Guidelines have a broad human rights clause, they have very little to say about conflict trade or even illicit exploitation. Despite, or perhaps because of these problems, the effect of the Panel's use of the Guidelines was to confirm the lack of clarity as to the nature of acceptable economic behaviour in a conflict zone and to expose the enforcement mechanisms of the multilateral system – both UN and OECD – as far from adequate.<sup>9</sup>

In addition to ad hoc multilateral responses, the courts are being called upon to elaborate new law. The Special Court for Sierra Leone issued its first indictments in March 2003, which included charges of participation in a "joint criminal enterprise" to exploit the diamond resource.<sup>10</sup> In addition, there have been a number of criminal and civil cases in several jurisdictions that implicate companies in violations of law relevant for conflict trade, both at home and abroad.<sup>11</sup> One example is the US Alien Tort Claims Act (ATCA), which permits civil action in US courts for violations of international law committed abroad. Under ATCA, the principles of private sector liability being applied are those established by the

<sup>8</sup> UN Security Council Presidential Statement (S/PRST/2002/6), 15 March 2002.

<sup>9</sup> Report of the Panel of Experts, DRC, Annex III; S/2002/1146, October 2002; see also, *OECD Watch Newsletter*, No 1 / April 2003.

<sup>10</sup> SCSL Case No. 3, "The Prosecutor against Sam Bokarie", 7 March 2003; similar charges were laid by the Special Court against Charles Taylor, former president of Liberia.

<sup>11</sup> As part of the "Stenersen Process" of expert seminars, Fafo AIS and the International Peace Academy have carried out a survey of five OECD jurisdictions to assess the criminal liability of business entities for violations of international law; forthcoming at [www.faf.no/piccr/ecocon](http://www.faf.no/piccr/ecocon).

post-World War II trials of Nazi and Japanese industrialists. It is arguable that those precedents “could provide a similar foundation for establishing criminal (and perhaps even civil) jurisdiction in other countries.”<sup>12</sup>

While helping to clarify potential liabilities, the political fall-out in the US from the recent spurt of ATCA cases has been to profile the legislation in business circles as a tool for hunting multinational corporations. The result has been a political backlash against ATCA, seeking to de-legitimize and possibly repeal the act. This would be unfortunate. In the face of the disquieting proximity of some companies to human rights abuse and war, the repeal of ATCA would close down an important arena for redress for corporate wrong-doing. It would also deal a blow to legal developments that could clarify the normative basis for regulating conflict trade. The principles established by court actions in international courts or under domestic statutes in the US and elsewhere can provide the principled foundations for regulation – both co-operative and mandatory - that in turn can play a key role in solving the collective action problem for companies.

- Attempts to grapple with the problems of economies of conflict originate with an increasing concern over the economic dimensions of international peace and security on the one hand, and, on the other hand, from the evolving agenda for greater corporate accountability in development and human rights.
- The threat to human security posed by these economies of conflict originates when states fail and armed force becomes a factor of production. Rogue companies profit from coercion and corruption, helping to sustain the conflict.
- The risk of lumping legitimate private sector activity in with activities of rogue companies will remain, so long as the actions of the worst rogue companies are not checked and some clarity is not brought to the phenomenon of conflict trade.
- The *ad hoc* approach of the multilateral system to date, and the resort to the courts in domestic and international jurisdictions, is a result of the lack of clear and enforceable rules about what is and is not acceptable economic behaviour in a conflict zone.
- Given the lack of clarity to date, companies and countries are going to need international regulation to establish norms that level the playing field, thereby reducing risk to brands, commodity prices, coping strategies and investment.
- Legal development is required to end the situation of uncertainty most governments, companies and communities now face concerning the legality of conflict trade and the definition of acceptable economic practice in a zone of conflict. The absence of legal development will prevent the emergence of the definitions of liability for conflict trade abuses and cut short the movement towards ending the impunity of perpetrators.

<sup>12</sup> Anita Ramasastry, “Corporate Complicity: From Nuremburg to Rangoon, An examination of Forced labour cases and their impact on the liability of multinational corporations”: 20 Berkeley J. Int’l L. 91. See also, Ramasastry, A. ‘Secrets and Lies? Swiss Banks and International Human Rights’: 31 Vand. J. Transnat’l L. 325.

### 3. Corruption

*“Corruption, like everything else, is a question of supply and demand. The demand remains immense. The supply remains immense. And the ease with which money can move across borders undetected makes it easier than ever to get away with it.”*

*Eva Joly*

Corruption is not specific to economies of conflict. It appears in all societies, within every social class and across all sectors. However, corruption does play a key role by facilitating other illicit activities important for conflict trade, primarily by enabling access to economic opportunity. Access to and control over natural resources and other sources of wealth is often a rationale for the coercive and conflict behaviour that threatens human security.

Corruption’s most important function in economies of conflict is its facilitation of predatory behaviour by government officials, businesses and armed factions. In some cases, state oil revenues are kept off budget, or are used to obtain debt, in order to finance patronage networks and arms purchases. In others, timber concessions are granted in conflict zones in contravention of domestic and international law and at the expense of the local population. In many cases, the movement of commodities from conflict zones to consumer markets is lubricated by payments and bribes to armed factions, both in cash and in kind. As in the DRC, Sierra Leone, Angola, Cambodia, Afghanistan and elsewhere, the threats to people posed by these activities are extreme.

The effect of corrupt practices is to facilitate a failure of the state’s role to protect citizens, while at the same time promoting the informalisation of economic relations. Ultimately, corruption can result in a more or less lawless environment, which paves the way for other illicit economic activities like smuggling, plunder and money laundering. The result is to undermine effective or legitimate state regulation.<sup>13</sup>

In recent years, increased attention has been directed towards the role of corruption in resource rich developing countries. In what is commonly referred to as ‘Dutch disease’, the deterioration of macro-economic governance and the temptation for corruption tend to coincide with large influxes of income from oil or other natural resources. The oil and gas sector is of particular concern because multinational oil and gas companies make large payments of taxes, royalties, and signature bonuses to governments. The industry’s large and

<sup>13</sup> Leiv Lunde and Mark Taylor, with Anne Huser, ‘Commerce or Crime? Regulating Economies of Conflict’, Fafo report 434 (2003).

long-term investments make such companies close partners of governments, and NGOs have raised concerns over the lack of transparency in the payments of multinational companies to governments in developing countries.

Angola is a case in point. The IMF has estimated that more than four billion dollars disappeared from government coffers over a five year period. Global Witness, Open Society Institute, CAFOD, Oxfam, Save the Children, and Transparency International launched the “Publish what you pay” campaign aimed at promoting transparency as to company payments to host governments. When BP announced its intention to publish financial data on their operations in Angola, the reactions from Angola’s state owned Sonangol were immediate. The company threatened to terminate contracts with BP or any other oil company that considered making public their payments.<sup>14</sup>

At the World Summit on Sustainable Development in Johannesburg, September 2002, the British government followed up on the NGO campaign by raising concern over the lack of transparency in the relations between resource rich governments and multinational companies investing in them. The Extractive Industries Transparency Initiative (EITI) gathered broad support from other OECD governments. The EITI was discussed at the G8 summit in Evian in June 2003. Whether or not the EITI results in voluntary or mandatory measures for companies and affected governments, the policy objectives of the UK, other governments, and a range of NGOs, are to obtain tangible changes in the behaviour of corporations and some developing country governments.

Much of the international work on financial abuse and corruption has been concentrated within the OECD. The OECD Convention on Combating Bribery of Public Officials in International Business Transactions was agreed in 1997. The main objective is to criminalize bribery of foreign officials, but it also deals with accounting, auditing and corporate controls. NGOs have criticised weaknesses in the implementation of the convention and the lack of national political will to prosecute.<sup>15</sup> The work continues in the OECD Working Group on Bribery and the OECD/World Bank Corporate Governance Forum.

Other initiatives include The Wolfsberg Principles signed in October 2000 by eleven leading international banks. They represent a voluntary set of guidelines to discourage money laundering, terrorist financing and related abuses of private banking.<sup>16</sup> Although the principles do not target corruption specifically, they are important in this regard because corrupt elites use leading international banks to hide funds stolen from national budgets. Improved transparency and customer scrutiny implies an increased risk of disclosure of this type of activity.

<sup>14</sup> For information on the Publish What You Pay Campaign see [www.publishwhatyoupay.org](http://www.publishwhatyoupay.org) and [www.globalwitness.org](http://www.globalwitness.org)

<sup>15</sup> [www.globalcorruptionreport.org/](http://www.globalcorruptionreport.org/)

<sup>16</sup> [www.wolfsberg-principles.com/](http://www.wolfsberg-principles.com/). The principles were revised in May 2002.

The OECD Guidelines for Multinational Enterprises attempt to create a global framework for responsible business conduct. Observance of the Guidelines is voluntary for businesses. Adhering governments, however, are committed to promoting them and to making them influential among companies operating in or from their territories. 'National Contact points', located in assigned OECD country ministries, are charged with making the guidelines known by national companies, labour unions and NGOs. However, the level of commitment and the performance of the National Contact Points vary substantially.

Among recent initiatives is the Paris Declaration, lead by a former investigative magistrate in France, Eva Joly. In the process of writing a book about the investigation of fraud within the oil company Elf Aquitaine, she was prompted to put forward a plan of action for fighting international, large-scale corruption.<sup>17</sup> The Paris declaration was signed in June 2003 by leading anti-corruption NGOs and personalities.<sup>18</sup> The Declaration denounces "the devastating impact of high-level corruption and the levels of impunity that facilitate it" and calls for national and international action to combat it. The declaration includes recommendations to be incorporated into the new United Nations Convention Against Corruption and the FATF Recommendations.<sup>19</sup> The recommendations are organised around three principles: making investigations more effective, ensuring that offenders do not benefit from impunity, and deterring serious forms of corruption.

Taken together, these initiatives have had some impact in advancing the anti-corruption agenda. Transparency International's (TI) *Global Corruption Report 2001* highlights some positive trends related to the state of corruption worldwide. The Bribe Payers Index 2002 showed that companies from leading industrial countries are slightly less likely to bribe today than in 1999. Governments are responding to increased pressure from civil society and have taken steps to improve transparency. This is to a large extent due to efforts made by courageous journalists, lawyers, prosecutors and others in alerting the public, for which some of them have paid with their lives. There are also positive trends among donor agencies, which are increasingly insisting on commitments to anti-corruption policies by recipient governments. In addition, civil society organisations in the south are organising themselves more effectively, especially in many African countries, and business leaders seem increasingly concerned about the costs of corruption: a survey from the Philippines reveals that entrepreneurs there are willing to support anti-corruption programmes financially.<sup>20</sup>

Revenues from oil, gas and mining companies, in the form of taxes, royalties, signature bonuses and other payments should be an important engine for economic growth and social development, in stead of fuelling conflict and poverty. Increasing transparency of revenues and knowledge about corruption will empower citizens and other stakeholders to hold

<sup>17</sup> Eva Joly *Er det en slik verden vi vil ha?*, Oslo: Aschehoug (2003).

<sup>18</sup> [www.parisdeclaration.org/declaration.php](http://www.parisdeclaration.org/declaration.php)

<sup>19</sup> The Financial Action Task Force on Money Laundering (FATF), see [www1.oecd.org/fatf](http://www1.oecd.org/fatf)

<sup>20</sup> The entrepreneurs estimated that preventing corruption would give a five per cent increase in net income and a ten per cent saving on contracts; [www.globalcorruptionreport.org](http://www.globalcorruptionreport.org)

governments and companies accountable. It should also benefit developing and post-conflict economies by creating predictability in the business environment, helping investors and responsible companies benefit from a more level playing field.

- Corruption facilitates impunity. It permits economic and predatory abuses to go unchecked and promotes conflict.
- Access to information and transparency of payments are an important weapon against corruption.
- Financial services play a key role in facilitating corruption. To the extent that regulation can control illicit finance, it will have a positive impact on the opportunities for corruption.

## 5. Illicit finance

*“In recent years, with every substantial national, regional, or global failure of governance, a financial scandal has been found in close attendance. . . Repeatedly, political conflict and major political destabilizing activity, including grand corruption, narcotics trafficking, arms smuggling, and civil war have been facilitated and sustained by illicit finance networks embedded in the world’s licit financial services infrastructure.”*

*Jonathan M. Winer, in Illicit Finance and Global Conflict*

Illicit finance continues to undermine international policies concerning security and development generally, and the goals of the United Nations in particular. Illicit financial services are the arteries that transmit and deploy funds involved in a range of illegal or unethical activities including the trafficking in narcotics, arms or humans, the proceeds of corruption or conflict trade, and the financing of terrorism. As a result, financial institutions operating internationally have been subjected to increased scrutiny by governments and multilateral organisations in recent years.

Financial abuse is not a new phenomenon. However, the past decades have seen structural changes that have profoundly affected the nature of the financial markets and the ability of national governments to supervise and regulate them. By the turn of the century, the minimal regulation of financial services had dramatically reduced transaction costs and the liberalisation of the financial markets had turned money into a global commodity of incredible mobility. Economic actors could invest their capital where they found it opportune. Large cross-border transactions could be carried out with relative ease.

The simultaneous process of economic liberalisation and the revolution in technical communications, created new opportunities for small and remotely situated nations. Some small island states began attracting capital by establishing strict banking secrecy, guaranteeing the protection of customer information and ignoring calls for international law enforcement cooperation. To these offshore regimes, some countries added special rules, including tax advantages, available only to foreign customers. The result was an explosion of under-regulated financial centres during the 1990s.<sup>21</sup>

As the global financial system expanded, so too did financial abuses like money laundering, tax evasion and rogue banking. Today, networks of global financial services provide extensive opportunities for financial arbitrage, managing transactions to take advantage of differences in regulation from one jurisdiction to another to lower transaction costs and

<sup>21</sup> William F. Wechsler “Follow the Money”, *Foreign Affairs* (July/August 2001).

maximise profits. Those same networks also provide opportunities for illicit finance, in which regulatory arbitrage is used to hide or launder dirty money via offshore jurisdictions.<sup>22</sup>

Multilateral efforts have begun to combat these abuses and have already achieved some significant results. International standards for financial transparency were established through the Financial Action Task Force on Money Laundering (FATF), the Financial Stability Forum (FSF) and the Basel Committee on Banking Supervision. Initially, these efforts were not global: industrialised countries dominated the discussions from which less developed countries were largely absent. As long as the bulk of capital flows passed through the large financial centres in the industrialised countries, this absence did not cause major concern. But the upsurge in new financial centres created pressure for an expansion of the scope of policy responses. It became evident that any strategy had to be both global and multilateral.

The American government together with the rest of the G8 countries initiated a plan to address financial abuses through key multilateral institutions. The plan followed three tracks: the FSF would look into under-regulated offshore centres, the FATF would review nations commitments to combat money laundering, and the OECD was asked to investigate harmful tax practices.<sup>23</sup> The common objective was to identify systemic problems in national jurisdictions, to name and shame by publishing lists of uncooperative nations and to consider possible sanctions.<sup>24</sup> The reports and recommendations of all three initiatives were endorsed by the G8 finance ministers at the summit in Paris in 2000. Faced with political pressure from the G8, and the possibility of being blacklisted as uncooperative nations, a number of governments have taken steps to meet international standards. As a result some have been removed from the FATF list.

Activity to harmonize regulation in a manner that would combat abuses of the international financial services sector substantially intensified after the terrorist attacks of 11 September 2001. The United Nations Security Council adopted UN Resolution 1373 requiring all member states to freeze the funds of designated terrorist groups and persons and report back to the Counter Terrorism Committee (CTC).<sup>25</sup> The CTC also established a blacklist of embargoed organisations and persons. The Wolfsberg Group broadened its initial “Global Anti-Money Laundering Guidelines For Private Banking” to include guidelines to prohibit terrorist finance and to combat abuses of correspondent banking relationships.<sup>26</sup> The US and the EU enacted legislation that required banks to adopt stronger know-your-customer obligations. The mandate of the FATF was expanded to focus on terrorist financing, which issued new international standards to combat terrorist financing in addition to

<sup>22</sup> Jonathan M. Winer *Illicit Finance and Global Conflict*, Fafo AIS, (2002).

<sup>23</sup> Wechsler *id.* (2001).

<sup>24</sup> See the FATF and FSF homepages at, respectively, <http://www1.oecd.org/fatf/>, <http://www.fsforum.org/home/home.html>.

<sup>25</sup> <http://www.un.org/Docs/sc/committees/1373/>

<sup>26</sup> <http://www.wolfsberg-principles.com/>

its updated “Forty recommendations”. The IMF and the World Bank, in cooperation with the FATF, undertook new initiatives to include capacity building to combat money laundering in their technical assistance to member states.

As a result of the momentum behind addressing the financing of terrorist activities, new attention has been focused on financial services on the margins of the formal economy. In particular, the *hawala* system for the transfer of money through promises or chits, with minimal movement of cash, has been targeted for remedial action. The *hawala* and similar systems are used to transfer money mainly within and between developing countries, but also between developed and developing countries, (particularly for the transfer of remittances between families). There is no evidence that more illicit finance travels via these informal systems than the more formal banking systems, yet *hawala* type systems have become deeply suspect and, in some jurisdictions, illegal.

The experiences of the FATF and other multilateral initiatives illustrate that the naming and shaming of states has had some effect on the financial policies in those states. Similarly, efforts to combat illicit finance can generate significant political will, as exemplified by the banning of *hawala* networks in certain jurisdictions (e.g. India, Pakistan, USA).

Yet, today, national governments continue to find it difficult to monitor the international activities of private financial institutions. Home country regulators rely on self-regulation and reporting in addition to private sector auditors engaged by the institution itself. Criminal actors profit from the fact that there is a global financial market but no global financial police. While regulators within a territory are constrained by national borders, financial services permit the movement of funds across jurisdictions. The uneven level of regulation between jurisdictions implies that there will continue to be substantial opportunity for regulatory arbitrage and, therefore, abuse.

The work of the Wolfsberg Group<sup>27</sup> indicates that there is room for initiatives that shift the focus from state regulation to a co-operative model of regulation involving business-government partnerships. The objective of such initiatives should be to address the collective action problems inherent to a sector in which the practice of arbitrage plays such an important part. The purpose should be to encourage the development of voluntary or mixed “carrot and stick” mechanisms for enhanced financial transparency.

One such idea is the white list model. Building on the FATF’s blacklist of non-cooperative states, Jonathan M. Winer has designed a white list for private international financial institutions. The white list mechanism would offer an incentive for global banks to implement existing transparency standards across their operations globally.<sup>28</sup> By way of an incentive, governments, development organisations and multilateral organisations would make

<sup>27</sup> In 2000, a group of global banks known as the Wolfsberg Group, in collaboration with Transparency International, agreed a set of global anti-money laundering guidelines.

<sup>28</sup> Jonathan M. Winer *Globalizing Transparency: Implementing a Financial Sector White List*. Fafo AIS (2003).

inclusion on the white list, determined by FATF-style peer review evaluations, a key criterion in the selection of financial institutions with which to do business.

- There is to date no effective global instrument to combat illicit finance. Even the work of the Counter Terrorism Committee at the UN, which established a mandatory reporting requirement for all member states, is showing signs of losing momentum.
- The bulk of efforts so far have avoided legal regulation and relied on voluntary mechanisms backed by political pressure deriving from naming and shaming of targeted trouble-makers. These efforts have also to a large extent been directed towards states, rather than the financial institutions themselves.
- The exception which proves this rule is the effort to shut down *hawala* and other informal financial networks. This poses serious challenges to effectiveness and fairness because informal systems are well placed to evade enforcement measures and their users are those least likely to be able to adjust to such efforts to control illicit finance. Because informal services are the least transparent, and therefore the most difficult to monitor, it is difficult to know whether a legal or prohibition approach will be effective concerning this part of the financial services sector.
- Attempts to counter illicit finance by establishing standards and strengthening control mechanisms have proven fruitful. These have laid the normative foundations upon which co-operative or incentive-based regulation should be based. The work of the FATF, the OECD and others deserves continued support and recognition.
- Voluntary and co-operative mechanisms to combat illicit finance are steps in the right direction. A global financial white list should be considered seriously by governments and financial institutions. Ideas that create substantial incentives for private sector transparency and implementation of agreed standards are one logical way forward.

## 5. International Organised Crime and Terrorism

*“[A]l Qaida has already shown its willingness and ability to take advantage of weak states, corrupt institutions, existing criminal networks as well as the lack of transparency and the insularity of the trade in precious commodities...to fund its terrorist operations.”*

*Global Witness* <sup>29</sup>

In situations of conflict and insecurity, existing informal economies are vulnerable to processes of criminalisation. The criminality involved in conflict trade is entirely recognizable, often as so-called ‘white-collar crime’<sup>30</sup> or other non-violent economic crimes. It is via such economic crimes as smuggling and sanctions busting, export fraud, and money laundering, that links are established between economies of conflict and international criminal and terrorist networks.

As criminal economies take hold, they tend to spread a climate of insecurity down the smuggling routes and across borders, creating a ‘spillover’ effect of instability in parts of the region not otherwise connected to the conflict. Rogue companies are set up to launder plundered resource wealth onto global markets, via the ports and airports of countries neighbouring the conflict zone. Revenues from captured trade routes are transformed into arms purchases, helping to sustain the conflict economically and militarily.

It is rarely the case that the marketing chains or revenue streams of a conflict commodity or its producer are entirely illegal from the point of production to point of sale in a consumer market. Nor are the supply lines of combatants necessarily run as criminal networks, or filled with illegal goods. But experience indicates that to operate effectively, the procurement, marketing and payments processes related to conflict and terrorism consist of a series of transactions that combine the perfectly legal and legitimate with the thoroughly illegal or illicit. More often than not, the borders between these categories are ill defined. In fact, there is little to obstruct what is a relatively seamless integration of conflict goods and profits to the markets and financial systems of global trade.

At the centre of these operations are the brokers, the middlemen at the helm of rogue companies who manage the transactions that make possible the integration of the conflict zone to the global economy. Today’s warlords, governments and non-state actors alike, need

<sup>29</sup> *For a Few Dollars More: How Al Qaida moved into the diamond trade*, Global Witness, April 2003.

<sup>30</sup> Usually defined as non-violent crime involving deceit, corruption, breach of trust. Matts Berdal and David Malone identify the need for an international regime to deal with white collar crime; see their introduction to *Greed and Greivence: Economic Agendas in Civil Wars*, p. 13 (2000).

brokers to make use of global financial and commodity markets in order to transform control over natural resources into war fighting capacity. Under the cover of secrecy and the inevitable 'fog of war', the brokers ensure that legally or illegally produced commodities are traded on the legitimate, but highly unregulated, global markets to obtain financial resources, weapons and other materiel needed to sustain the war.

Variations on this basic pattern have been described repeatedly by UN expert panels monitoring sanctions busting or illicit exploitation in Sierra Leone, Liberia, and the Democratic Republic of the Congo. The same patterns have cropped up in the monitoring of sanctions against non-state actors, such as UNITA in Angola or Al Qaida. Independent investigations by journalists, investigative NGOs and researchers have confirmed those patterns.<sup>31</sup>

Victor Bout and Leonid Minin are two examples of brokers. Both have been a focus of police and counter-terrorism agency monitoring since the late 1990s. Both have appeared in the UN expert panel reports on sanctions busting and illicit exploitation. News reports have linked them both to arms shipments and illicit commodities trade in Europe, Africa and Asia. Yet, for many years these brokers operated with impunity.

Even as law enforcement agencies caught up with them in recent years, the problems of pursuing international justice have prevented either of them getting their day in court. Belgium issued a warrant for Bout's arrest last year for diamond smuggling and money laundering, not arms trafficking, but he remains at large in Russia. Minin was declared persona non grata in the Schengen jurisdiction and in several other countries for reported ties to the East European mafia organisations. He was arrested in Italy in 2000 and charged with illegal arms trafficking, but was released in late 2002 after the Supreme Court decided they would not proceed on a case that, in their view, did not involve a threat to Italy. That decision effectively ignored evidence of Minin's role in UN sanctions busting.<sup>32</sup>

There are international legal instruments that cover these kinds of violations. These include:

- Targeted UN sanctions (e.g. against UNITA, RUF, AL Qaida) supported by UN Sanctions Expert Panels
- The UN Convention against Transnational Organised Crime (2000)

<sup>31</sup> See, "UN Action against Terrorism" at [www.un.org/terrorism](http://www.un.org/terrorism); see, also, "Security Council Sanctions Committees: An Overview", <http://www.un.org/Docs/sc/committees/INTRO.htm>. See, also, Doug Farah, Al Qaeda Cash Tied to Diamond Trade, *The Washington Post*, 2 November 2001; Global Witness *For a Few Dollars More*, id. (2003).

<sup>32</sup> See, variously, Peter Landesman, Arms and the Man, *New York Times Magazine*, 17 August, 2003. "Italian Court Releases Arms Dealer", *Terror Trade Times*, No. 4, Amnesty International, [http://web.amnesty.org/pages/ttt4-article\\_2-eng](http://web.amnesty.org/pages/ttt4-article_2-eng); Brian Wood & Johan Peleman, *The Arms Fixers: Controlling the Brokers and Shipping Agents*. Oslo, Nisat/Prio/Basic, 1999.

- The ECOWAS Moratorium on the Exportation, Importation and Manufacture of Light Weapons (1998)
- The UN Convention for the Suppression of the Financing of Terrorism (1999)
- The OECD Convention on Combating Bribery of Foreign Public Officials (1997)
- The UN Convention against the Illicit Traffic in Narcotic Drugs and Psychotropic Substances (1988)

As illustrated by the Minin and Bout examples, the problem is enforcement. First, it is not easy to capture what are, in effect, moving targets. Bout came to the attention of law enforcement as a result of his airline operations in Africa's war zones in the 1990s and for many years he was able to move his operations to avoid the law. Similarly, despite UN efforts to track them, Al Qaida affiliates remain active, not least because the list of targeted individuals is vague and incomplete.<sup>33</sup> The fact is that the high-end brokers associated with terrorists, criminals and their associates operate with multiple identities, several passports, significant logistical capacity and financial resources. In some cases, they enjoy the protection of dictators or intelligence agencies.

Second, enforcing international instruments in domestic jurisdictions has not been as smooth or automatic as a might have been expected. The fact is that, where states agree and ratify international instruments, they may often neglect to implement them with vigour. Even those obligations which carry the highest authority - Chapter VII Security Council authorisation - are neglected: no Member State has ever convicted a perpetrator for breaches of UN sanctions and only twice have prosecutions been pursued. One of those was against Leonid Minin.<sup>34</sup>

Until the attacks on the US on 11 September 2001, it was also difficult to get states to take seriously the need to pursue international operators in their own backyards. This has changed somewhat, not least because terrorist attacks forced the US to address the problem. But the initial momentum and political will mobilised behind inter-governmental efforts to tackle the economic aspects of terrorist groups has already begun to wane. In 2001, the UN Security Council's Counter Terrorism Committee obligated states to report on progress in implementing measures to counter terrorist financing. More recently, the work of the CTC has suffered due to the focus of US policy on Iraq.

<sup>33</sup> "Despite the travel ban, members of the al Qaeda network have retained a high degree of mobility, and have been able to carry out and contribute to terrorist attacks in several countries around the world"; "Report Says UN Embargo Does Little to Halt Al Qaeda", Colum Lynch, *Washington Post*, June 20, 2003.

<sup>34</sup> We would be happy to be disabused of this notion, but we have failed to find evidence of convictions. "[M]any member states have failed to criminalise sanction busting, and even fewer have acted upon such legislation. So far there has been no arrest on charges of commodity sanctions busting and only two individuals – one of them also a primary commodity trader – have faced charges for the violation of a UN arms embargo." Philippe Le Billon, *Getting It Done: Instruments of Enforcement*, in Paul Collier and Ian Bannon (eds), *Natural Resources and Violent Conflict: Options and Actions* (Washington DC: World Bank, 2003).

- Much of the criminality associated with economies of conflict could be classified as white-collar crime.
- Brokers and their rogue companies are central to the criminal aspects of conflict trade and to the ability of illicit activities to produce goods for licit markets.
- Most brokers continue to operate with relative impunity, in part because their market share depends upon them being hard to catch.
- Still, states have done far too little to implement already existing obligations that would go some way to dealing constraining the room with which brokers now manoeuvre.
- New international instruments should be considered to deal with white-collar crime, rogue companies and brokers

## 6. The Next Generation of Policy Responses<sup>35</sup>

There are significant obstacles in the way of continued momentum in addressing economies of conflict. The problem involves a multitude of sectors and players, including states and companies that may oppose efforts to regulate conflict trade.

The problem is by nature complex, cutting across a number of different policy areas such as peace and security, development, corporate responsibility and attempts to combat international organised crime. This suggests that policy makers from otherwise separate areas should be seeking to bring policy and practice from their respective arenas closer together in responding to economies of conflict. It also suggests that no single law, sanction, code of conduct or multi-stakeholder agreement is likely to have a decisive, global effect on the problem.

Nonetheless, national, juridical and multilateral responses have begun to converge around the principle that economic activity that sustains or profits from armed conflict is unacceptable. We believe there are many pitfalls – and dangers – implicit in such a definition, not least to national economies or local communities dependent upon commodity exports. It is, however, the most effective general description of the problem. It points to the need for global responses to the problem of impunity in conflict trade. Those responses will have to target the problems of corruption, coercion, rogue companies, brokers, and illicit finance.

The challenge is how to move forward.

- **Globalise the norms.** The diversity of regulatory responses suggests the urgent need to elaborate core principles, or norms, which governments, business and civil society organisations and affected communities can use to design responses to conflict trade. Ultimately, this will require some form of inter-governmental negotiation, and possibly an international instrument, to establish a global normative basis for the identification and control of abusive forms of conflict trade.
- **Take advantage of the enforcement continuum.** Discreet initiatives in a wide variety of sectors, countries and institutions are already building a patchwork regime of very different and largely unrelated pieces of regulation. While many may not be directly targeted at conflict trade as such, taken together they could have significant impact on the phenomenon. Measures to combat money laundering or illicit imports, organised crime, terrorism, sanctions-busting, corruption, corporate malfeasance, etc. all address conflict trade issues as increasingly important secondary aims. They can be mapped along a con-

<sup>35</sup> This section is based on conclusions reached in *Commerce of Crime? Regulating the Economies of Conflict*, Leiv Lunde and Mark Taylor, with Anne Huser, Fafo AIS report 434, (October 2003).

tinuum from purely voluntary approaches based on company self-regulation on one extreme, to the legally based governmental or intergovernmental mandatory regulation and enforcement on the other.

- Voluntary measures, in which companies and/or industry associations take initiatives which are implemented in the absence of any pressure or involvement from governmental bodies.
  - Voluntary multi-partner initiatives, convened by national or international public bodies, where governments see their role primarily as a convenor, facilitator and motivator rather than actively pursuing specific policy
  - Public-Private Partnerships (PPPs), where governmental bodies take on more active roles and have more specific policy objectives with regard to companies. The main incentives used are 'carrot-based', positive incentives such as direct financial benefits and/or tax exemptions for companies complying with intended policies.
  - Government-based regulation where compliance measures vary from voluntary to quasi-mandatory, including so-called 'naming-and shaming' and the monitoring mechanisms this requires.
  - Pre-emptive voluntary agreements between governments and industry sectors/associations, in which companies commit to specified actions in order to pre-empt proposals for governmental regulation.
  - Conditionality by public or private, domestic or international financial institutions.
  - Legally binding regulations at national and/ or international levels, including sanctions authorised by the UN Security Council targeted at natural resource commodities linked to conflict trade.
- **Nationalise implementation.** Business entities look to national laws to guide their activities. It is in the domestic jurisdiction where legislation will have the most immediate effect and where global norms can be confirmed and developed through practice. However, an international capacity to enforce compliance will also be necessary, not least because conflict trade (with its anarchic and criminal dimensions) is a global phenomenon. In the absence of a domestic will or capacity to enforce domestic law, international law will be needed to ensure there are legal remedies to abusive forms of conflict trade.
  - **Use co-operative regulation.** Given the general complexity and the lack of experience in, and consensus on, regulating private sector players in this area, much attention should be focussed on maximizing the value and effectiveness of different forms of corporate voluntary- and/or self-regulation. A range of precedents already exists, including in the form of codes of conduct. Particular emphasis should be put on multi-stakeholder initiatives of various forms that may be mainly voluntary in nature while at the same time involve government and international institutions. These may gradually develop regulatory elements such as third party monitoring and control, and binding self-assessment procedures. All of these can help lay the foundations for global norms.

- **Build consensus across constituencies.** Advocates should be careful about bringing regulatory proposals to the UN or other multilateral forums until these proposals are relatively mature, both in their causal analysis and their political base. This implies a need to stress the importance of informal, step-by-step policy-making and consensus-building initiatives in order to build momentum and support for global norms in the global North and South, in industry and affected communities.
- **Address the collective action problems.** Stimulate corporate self-interest in normative approaches, regulatory frameworks and law to address the collective action problem in specific industries, countries or regions. A global approach is likely to be useful to most industries.
- **Do no harm.** Regulation should design responses to unacceptable economic activity in a targeted manner, without causing unintended economic damage to national economies, local communities or conscientious companies.
- **Improve Conflict Trade Analysis.** Conflict trade is still a relatively immature political problem in terms of both knowledge and political processes. The analysis presented above indicates that more research and consensus building is critically important in terms of convincing key players of the needs for, and implications of, political action towards regulation.

## **About the Authors**

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