NOREF
NORWEGIAN PEACEBUILDING RESOURCE CENTRE

Expert Analysis
October 2013

Conflict trade: regulating illicit flows to and from war

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Executive summary

This expert analysis note describes an emerging approach to regulating illicit flows of goods to and from conflict zones. The approach, based on norms of national and international law defining business due diligence, is well suited for dilemmas posed by war economies. Due diligence offers the possibility of excluding goods from global flows if they are produced through human rights abuse or used for conflict financing, while at the same time it can limit harm to livelihoods and avoid the wholesale criminalisation of informal economies. To that end, further inter-governmental policy coordination is needed to define conflict financing under international law and to elaborate an effective regulatory strategy.

Introduction

In April, Member States of the United Nations agreed overwhelmingly to regulate the arms trade. The Arms Trade Treaty (ATT) was passed by the UN General Assembly and will enter force after 50 ratifications, most likely in 2014. Although campaigners rightly warned of significant weaknesses in the treaty, the passage of the ATT marks the first comprehensive step towards the regulation of the global trade in conventional weapons.

Until now, international responses had relied on arms embargoes and several treaty instruments that focused on illicit flows of small arms and light weapons, but without much success. In part, this was because the unregulated global space of the legal arms trade enabled a whole range of questionable commercial practices to take place. In fact, until very recently, the global economy has been largely unfettered in its circulation of all kinds of commodities to and from war zones or parties to a conflict. After all, there is no law against profiting in or from war (indeed, if there were such a law, what would be legal about defence industries?). The traffic in small arms flows easily into war zones and conflict minerals flows untouched in the opposite direction.

These global flows have their origins in local or national production for war. National war economies are often formal and industrialized. But sub-national war economies often consist of informal and rent-seeking activities. As described in NOREF policy briefs (Taylor, 2012a; 2013), these war economies sustain the fighting capacity of both state and non-state armed groups through the phenomenon of conflict financing. In irregular armed conflicts – the dominant form of warfare today – the coincidence of armed violence and informal economies offers coercion specialists – the state and non-state users of force – access to economic opportunity. The activities and relationships that result from the intersections of armed violence and informal markets generate revenues and increase the likelihood of predatory crimes and human rights abuse. The global flows that service these conflict financing activities have helped sustain some of the most brutal wars in recent memory and have linked global commerce with international crimes.

Conflict financing and illicit flows

Conflict financing is serviced by global flows of money, goods and services. The transboundary movements and transactions that make up the global flows constitute conflict trade.[1] For the purposes of policy and law, I define

1 For a detailed exploration of the social realities of conflict trade, see Bøås (2013) and Le Billon (2012); for a discussion of some of the international regulatory dynamics, see Cooper (2002).

conflict trade as the purchase, sale, transfer, harbouring or receipt of a good or service connected to armed conflict or international crimes.[2]

Table 1: Criminal Markets, Illicit Trade

Market	Estimated Value of Illicit International Trade
Drugs	$320 billion
Humans	$36.1 billion
Wildlife	$7.8 to $10 billion
Counterfeiting Total	$320 billion
Counterfeit Pharamaceuticals	$35 to $40 billion
Counterfeit Electronics	$50 billion
Counterfeit Cigarettes	$2.6 billion
Human Organs	$614 million to $1.2 billion
Small Arms & Light Weapons	$300 million to $1 billion
Diamonds & Coloured Gemstones	$860 million
Oil	$10.8 billion
Timber	$7 billion
Fish	$4.2 to $9.5 billion
Art and Cultural Property	$3.4 to $6.3 billion
Gold	$2.3 billion

In practice, conflict trade integrates conflict financing activities with the global economy, often by creating or taking advantage of what have been termed illicit flows (Van Schendel and Abraham, 2005; Kar and Freitas, 2012). Although by definition difficult to estimate, illicit financial flows account for anywhere between $1 trillion and $1.7 trillion (U.S.) per year, and consist of proceeds of crime and drug trafficking, looted or embezzled state funds, bribery and other forms of corruption, and tax avoidance (Reed and Fontana, 2009). Illicit flows may also consist of goods or commodities, such as the weapons and minerals mentioned above, as well as counterfeit goods, art and human organs (see Table 1).[3]

At the centre of the illicit flows concept is the ability to move goods and services from informal or illicit markets into legal and formal markets. The specific mechanisms for this "laundering" of money, goods or services differs according to sector, but in every case the tension between legal and illegal, formal and informal is crucial to the profitability of illicit flows.

In recent decades, the kinds of illicit flows identified here have prompted various forms of regulatory action, but often only sporadically.[4] The full range of legal responses have their sources in different international regimes, including international peace and security, international humanitarian and criminal law, transnational criminal law and human rights law.

The UN Security Council has sought to regulate commerce connected to conflict or widespread violence through such measures as sanctions, investigations and peacekeeping (Le Billon, 2012; see also Taylor and Davis, 2013). Despite a slow evolution of Council tools towards the disruption of certain commercial activities, there is a lack of a strategy: there is no global strategy with respect to conflict trade in general, nor are such strategies commonly developed with respect to the financing of specific conflicts. Even where UN sanctions are imposed, in practice there is an absence of enforcement action against business entities sourcing from conflict economies (Taylor and David, 2013). However, measures authorised by the Council are resulting in the evolution of a set of responsibilities for business actors that are increasingly coherent with criminal law and human rights law principles.

Globalising due diligence

In the area of transnational commercial crimes, anti-money laundering (AML) and anti-corruption laws are perhaps the most developed of the criminal provisions that attempt to control transnational illicit flows, at least when measured by numbers of statutes adopted by Member States and numbers of convictions against commercial actors. Legal responses to trafficking in persons have also evolved in recent years, as have efforts to recover stolen state assets, although the latter have had limited success (see box). AML and anti-bribery laws, as well as anti-trafficking laws in some jurisdictions, deploy the concept of due diligence as a means to clarify business responsibilities and standardise regulators' assessments of compliance.

The concept of due diligence has now been deployed in the field of human rights and business. In 2011, the UN Guiding Principles on Business and Human Rights defined a corporate responsibility to respect human rights based on a business's activities and relationships, and it placed due diligence at the operational centre of upholding that responsibility. The Guiding Principles, endorsed unanimously by the Human Rights Council, also reaffirmed a state's duty to protect human rights, in particular in conflict situations, including through regulation and adjudication.

A recent study commissioned by a coalition of civil society organisations, and supported in part by NOREF (De Schutter et al., 2012), found that such regulation can make effective use of due diligence. Due diligence is commonly used by the legal systems of states around the world, and across legal traditions, including both common law countries and civil law countries, to assess business compliance with standards set in law. The study found that

2 This adapts the definition of a "prohibition against trafficking in conflict goods" from Global Witness, "Simply criminal: targeting rogue business in violent conflict."
3 Table 1: Harald Tollen, MFA Norway (used with permission); data source Haken (2011).
4 For an excellent short summary of both the illicit flows and policy responses to them, see Sogge (2011).

The problem with asset recovery

Only $5 billion in stolen assets has been recovered and returned over the past 15 years (Brun, 2011).

Put simply, there are three categories of obstacles to asset recovery. The first lies in the legal regimes of host jurisdictions, which may not have the proper legal framework in place to permit or force banks to repatriate funds without the approval of the account holder. Global efforts at the G8, and via the Financial Action Task Force (FATF) of the Organisation for Economic Co-operation and Development (OECD), have sought to deal with this issue and there has been success in changing many laws and policies. However, progress measured in terms of repatriated funds has been slow.

In part, this is because of a second category of obstacle: identification. Tracking or finding looted assets is not easy. When a kleptocrat shifts his ill-gotten gains abroad, more often than not it means those funds have been moved via the global system of offshore jurisdictions. With the assistance of banks, accountants and lawyers who specialise in working the system, looted state assets are hidden away by means of banking secrecy, tax havens, shell companies or other third parties (e.g. trustees or corporate nominees).

Changes in the rules have recently had an impact in this regard. For example, in a matter of days after the fall of President Mubarak in Egypt, Switzerland was able to identify and freeze private accounts suspected of holding stolen state funds based on a new law enacted in 2011. The new law, dubbed "Lex Duvalier" after the deposed Haitian dictator, allows the Swiss government to return money to its legitimate owners in cases of proven embezzlement.

That phrase – "proven embezzlement" – points to a third category of obstacle to asset recovery, namely law enforcement. In principle, asset recovery is predicated on the idea that property rights can be overruled only if ownership was obtained through a criminal act, usually corruption or the payment of a bribe. In practice, this means that those seeking to repatriate stolen assets must show in a court of law that those assets were obtained through corruption and on that basis can be confiscated. This opens up any number of possible defences – including the standard of rule of law in the affected jurisdictions – and can cause delays lasting decades. In fact, the burden of proof justifying confiscation, and the complexities of repatriation, have led to the field of asset recovery being recognised as one of the most complex in the already complex field of transnational law enforcement.

compliance was enforced through a range of measures – legal sanctions, incentives and transparency requirements – and often through a mixture of such measures. It also found that national due diligence definitions are consistent with the due diligence process described in the UN Guiding Principles. The study concluded that it is possible to describe an emerging international standard of due diligence procedure that is familiar in many jurisdictions.

The study also found early evidence that due diligence is having an impact on regulation with respect to war economies: laws have been passed both in the U.S. and in the Democratic Republic of the Congo (DRC) that are coherent with supply chain guidance developed by the OECD and authorised by the UN Security Council, which in turn is consistent with the UN Guiding Principles. These laws in effect require all business actors in the supply chains of tin, tungsten, tantalum and gold to conduct due diligence against the risk of human rights violations or conflict financing. The laws remain only partially implemented, but in 2013 the EU began hearings about the possibility of similar legislation. There is little doubt that an important first step has been taken (Taylor, 2012a; see also Taylor, 2012b).

Next steps

In effect, due diligence regulation places the responsibility on companies to act as gatekeepers over the entry points of conflict commodities to global value chains. By contrast, the ATT requires states parties to set up monitoring and listing regimes to govern the import and export of weapons. Both approaches – government regulation and business due diligence – are necessary for an effective global response.

Due diligence offers the possibility of excluding goods from global flows if they are produced through human rights abuse, while at the same time it can limit harm to livelihoods and avoid the wholesale sanctioning of informal economies or the criminalisation of the financing of legitimate resistance to repressive regimes. However, businesses that are concerned to do the right thing require regulatory guidance. They also need assurance from governments that law enforcement will target those businesses which are the worst offenders or those which willfully ignore their responsibility to conduct due diligence.

In complex operating environments, a due diligence standard set down in law would offer clarity about minimum standards for business, while at the same time making clear to regulators and investigators the standards they should use for assessing commercial activity. In this way, due diligence enables the continuation of economic activity, not least those activities which sustain the most vulnerable, while at the same time excluding from global commercial flows any activities that violate universally accepted standards of behaviour.

What should those standards be? The UN Guiding Principles make it clear that business must respect all internationally proclaimed human rights. The problem is that states enforce this principle differently, especially when it comes to international crimes. In the final months of his mandate, the UN Special Representative of the Secretary-General (SRSG) for Business and Human Rights, Professor John Ruggie, stated that all stakeholder groups had reported a need for greater consistency in the legal protections afforded to victims of business-related human rights abuse in situations of "armed conflict or other situations of heightened risk". The SRSG found that "national jurisdictions have divergent interpretations of the applicability to business enterprises of international standards prohibiting gross human rights abuses, potentially amounting to the level of international crimes" (Ruggie, 2011, p.4).

There is substantive overlap between gross human rights abuse (which has no technical definition) and international crime (which does). International criminal law (ICL) does not have much in the way of norms governing economic crime (Schabas, 2005). There are a number of provisions about what can be described as "international crimes of an economic nature" (Cassese et al., 2011, p.122), such as prohibitions of pillage and forced labour, which are war crimes, and of enslavement, which is a crime against humanity. All of these include economic exchange as a necessary part of their elements of crimes.[5] However, in order to ensure that human rights are protected in those situations where national criminal laws may fail to function, the applicability of ICL to commercial activities and actors requires some clarification. Ruggie suggested that clarity was required with respect to the following:

- standards for appropriate investigation, punishment and redress;
- effective, appropriate and dissuasive sanctions;
- the appropriate extension of jurisdiction by states and the basis for such jurisdiction;
- resolution of jurisdictional disputes;
- international cooperation, technical assistance.

In practice, clarity on these issues requires answering a number of questions:

- What is the appropriate international space for policy coordination, i.e. an intergovernmental approach (Human Rights Council? Security Council? Other?)?
- What are the principal substantive prohibitions (crime definitions) associated with commercial activity in situations of armed conflict, severe state repression or widespread violence?
- What liabilities arise from these prohibitions? In what legal regimes? For whom? Through what remedies?
- What forms of jurisdiction are appropriate to such violations?
- What modes of liability for business entities are most commonly used by states?
- What kinds of punishment/redress should be expected for findings of guilt in such cases?
- What options are there for harmonisation with respect to the above (definition of crimes, nature of liability, territorial/national jurisdiction, modes of liability, redress)?
- How do the legal solutions envisaged interact with the other obstacles to justice for business-related human rights abuse (state–corporate nexus, lack of resources, etc.)?[6]

Answers to these questions are pivotal for the effectiveness of any regulation of today's war economies. Answers to these questions would provide the basis for a twin-track strategy for responding the economies which help sustain today's conflicts. That strategy consists, first, of the exclusion of predatory activities from global value chains through business due diligence. Second, it requires the disruption of abusive forms of conflict financing through trans-national law enforcement, including via UN sanctions, AML laws, asset recovery and judicial accountability for corporations.

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5 For a detailed discussion of pillage in this regard, see Stewart (2010).
6 For a summary of these and other obstacles to remedy, see Taylor, Thompson and Ramasastry (2010).

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