Conflict Economies in the Middle East and North Africa
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Executive Summary

The conflicts in Iraq, Libya, Syria and Yemen have killed hundreds of thousands of people and displaced millions. In seeking to explain the violence that has struck the Middle East and North Africa (MENA) over the past two decades, analysis to date has focused predominantly on ideological and identity-based factors.¹ This report expands this discourse by incorporating approaches adopted from the literature on the political economy of war to examine the conflict economies of Iraq, Libya, Syria and Yemen.

Economic motivations, at the individual and group level, are key to understanding the wars in these countries, yet have tended to be overlooked in the MENA context. (As the wars have progressed and evolved, the national and local economies in which conflict is embedded have also changed.) Such motivations can offer an alternative or complementary explanation for armed group membership and armed group behaviour. While some groups will fight to promote or defend a particular identity, others fight for economic survival or enrichment. For many more actors, these motivations are tied together, and separating out ‘greed’ and ‘grievance’ is a difficult, if not impossible, task. Even if economic motivations did not spark the wars in Iraq, Libya, Syria and Yemen initially, it is clear that such factors now play a critical role in the persistence of open fighting, localized violence and coercion.

The objectives of this report are twofold. First, it seeks to develop a framework for comparative analysis of conflict economies at the local level in the MENA region. Traditionally, the idea of a conflict economy has been tightly linked to the funding for arms, ammunition and fighters. Further, most analyses of conflict economies are conducted at the national level. Even where research is conducted on a regional basis, discussion of the impact of conflict is brought back to the national level. In contrast, we see a broader political economy of war at work in the region. Our analysis illustrates how a conflict economy is embedded within a complex local socio-political system, in which many variables and agendas interact. We deliberately avoid characterizing conflict economies in terms of ‘black’ and ‘grey’ markets that somehow need to be ‘cleaned up’, as this erroneously implies that they can eventually be converted into licit markets like their peacetime counterparts.² A more nuanced and multifaceted reading is essential. For the purposes of this report, we define a conflict economy as a system of producing, mobilizing and allocating resources to sustain competitive and embedded violence, both directly and indirectly.³

Second, we show that a ‘political economy of war’ framing offers new approaches for reducing competitive and embedded violence. ‘Competitive violence’ can be defined as violence ‘deployed by warring elites to contest or defend the existing distribution


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of power’.\(^4\) Fighting between rival armed groups for control over resources and rents, among other things, usually falls into this category. ‘Embedded violence’, in contrast, underpins ‘how a political settlement\(^5\) works, as the deals agreed between elites may revolve around who has the “right” to use violence’.\(^6\) In practice, this could mean that one group is ‘permitted’ to use violence against another group – and no punishment will be enforced. In the context of this study, the use of armed force to assert the status quo to limit the number of ruling elite members is one example of embedded violence.

Conflict sub-economies

Analysis of conflict economies has mostly focused on state-level dynamics.\(^7\) However, less attention has been paid to the development of conflict sub-economies that are specific to certain types of location. This study demonstrates three distinct types of conflict sub-economy: (1) capital cities; (2) transit areas and borderlands; and (3) oil-rich areas. Our analysis highlights how each sub-economy creates distinct location-based patterns of resource production, mobilization and allocation to sustain competitive and embedded violence. The rents available in these areas vary. In capital cities, rents focus on control of the distribution of revenues and assets from the state and private sector. In transit areas and borderlands, rents centre around taxation and arbitrage. In oil-rich areas, rents are related to control of the area itself (and therefore the ability to levy taxes upon the oil sector), bearing in mind that the level of achievable taxation depends on the extent to which a given actor controls the supply chain.

As this report will elaborate, factors specific to each sub-economy type play a role in conditioning the nature of economic activities in each locality, and in determining whether and by which means violence is dispensed. For this reason, national-level generalizations and in-country comparisons of conflict economies are inadequate: for example, the conflict sub-economy of Baghdad has more in common with that of Tripoli than that of al-Qaim, an Iraqi town on the border with Syria. In turn, the conflict economy observed in al-Qaim has more in common with that of al-Mahra in Yemen than al-Mahra does with Sanaa, the Yemeni capital.

Recommendations for Western policymakers

In developing policy responses, policymakers must first accept that any aspiration to ‘do no harm’ is illusory. In conflict sub-economies, taking calculated risks with the aim of doing ‘less harm’ is the best option open to policymakers. In Syria, for example, the conundrum for donors is that humanitarian aid is instrumentalized by the regime of President Bashar al-Assad as a means of countering its economic failure, but is also critical to the coping ability of local populations. Donors must here accept that any intervention is likely to have unforeseen and/or negative consequences. These risks are best managed through developing a deep understanding of the operating environment in order to honestly assess whether there are opportunities to change

\(^5\) Here, we define ‘political settlement’ as ‘the underlying distribution of power… on which a society is based’. Ibid., p. 10.
\(^6\) Ibid.
Policymakers should develop incentives for peaceful cooperation rather than relying solely on enforcement mechanisms.

Conflict sub-economy dynamics (through partnerships, incentives or leverage). Such an approach also requires pragmatic acceptance of those elements of the conflict economy that policymakers cannot change.

In designing interventions, policymakers should develop incentives for peaceful cooperation rather than relying solely on enforcement mechanisms, which have demonstrated little success to date. Cracking down on illicit economic practices without offering viable alternative livelihood opportunities, for example, may have a displacement effect that can lead to something worse or simply encourage armed actors (or their associates) to take up alternative forms of profiteering.

When considering how to target specific illicit activities through enforcement mechanisms, policymakers should acknowledge that ‘legality’ is a relative, not fixed, concept in conflict economies. Legal measures therefore often lack potency as a policy intervention tool. In the four countries covered in this report, it is notable that the legality of a given practice may be decided by a single conflict actor – as in Syria, with the Assad regime. Rather than focusing on compliance with the law per se, it is more pragmatic to assess how political and economic gains and losses from conflict economy activities are distributed horizontally across groups and vertically within groups.

In choosing which illicit activities to target, policymakers should focus on those with shorter supply chains, where financial gains are not redistributed within or across groups, and where local coping economies are less likely to be affected. Financial and property crimes are good examples of this. In contrast, certain forms of smuggling – such as of subsidized goods and fuel – involve longer supply chains and wider networks of direct and indirect beneficiaries. For the greatest impact at the lowest cost to those in need, Western policymakers should therefore target bottlenecks where rent-seeking is most concentrated. In doing so, they must adopt clear, transparent, consistent and enforceable criteria in order to be taken seriously.

Recommendations specific to conflict sub-economy types

In identifying specific sub-economy typologies and their dynamics, this report concludes that it is possible to develop distinct policy approaches that target the particular rent structures of capital cities, transit areas and borderlands, and oil-rich areas. We offer insights for Western policymakers to guide them in this process.

Capital cities

Capital cities have symbolic as well as practical significance. In each of the countries, the relative strength of the state, the degree of centralization of powers in the capital, and the history of state consolidation of power differ. Yet in each case, powerful dynamics are associated with the seizure of the state’s institutional and legislative power in the capital, which in turn determines control of assets and the distribution of resources. Capital cities are also major financial centres that interface with the legal and economic institutions of the international system. Despite the political, economic and social fragmentation in Iraq, Libya, Syria and Yemen, in each state physical control of the capital remains the most prized asset.

The nature of the violence employed in each capital differs. In Iraq’s capital, Baghdad, the city’s resources are divided among a limited elite, sustaining a system of embedded violence. Libya’s capital, Tripoli, is similar, serving as the principal access point...
for revenues generated from the state’s oil wealth. However, in Tripoli, a sustainable division of power among rival forces representing elements from across the country remains elusive. As a result, the city has been subject to bouts of competitive violence that are likely to continue. In Syria and Yemen, the authorities in the respective capitals, Damascus and Sanaa, do not have the same largesse to distribute. Nonetheless, the role of the capital city in the conflict economy remains significant: in Syria, the regime has used the presence of financial institutions and the powers of the state in Damascus to build its economic capacity; in Yemen, the Houthis and their loose network of affiliates have seized institutions and channelled funds generated through taxation towards support of their war effort. In both cities, the actions of the dominant forces are underwritten by coercion. In Sanaa, before the war, the city’s role as a central clearing house for various forms of revenue reflected its economic importance. These financial inflows included receipts from oil and gas exports from the governorates of Mareb, Shabwa and Hadramawt; customs receipts from ports such as Aden and Hodeida; and revenue from manufacturing in Taiz. However, the Houthi takeover of Sanaa in 2014 precipitated a breakaway of these regions from the jurisdiction of the capital, and the subsequent loss of revenues for the central state.

Western policymakers should consider three key factors in addressing these developments:

1. **Policies aimed at strengthening state institutions in national capitals should seek to prevent monopolies of power** by supporting incremental change over time, even where a monopoly appears to be in the interests of the Western state in question. One of the possible paths is to widen the networks of beneficiaries to include people from outside the immediate circle of each conflict actor. In the long run, such an approach would dilute the influence of current networks and broaden the patronage base. Western countries have supported a broad range of civil society organizations and local councils over the years, and should use this knowledge to identify appropriate partners.

2. **Policy interventions must be directed towards developing processes and institutions, not just supporting personal relationships with elite actors in capitals.** A case in point is the concerted support provided by the West to the losing election campaign of Iraq’s then-prime minister, Haider al-Abadi, in 2018. Maintaining solid political relationships with key actors is critical, but when their political counterparts change or power shifts occur, the terms of these relationships will need to be renegotiated. Measures that cement rules and norms (such as on the peaceful transfer of power) within the political and institutional system can provide greater predictability and stability in such relationships. In addition, the risk with seeking to resolve conflict on the basis of personalized politics is that it can inadvertently cement the power of conflict profiteers.

3. **Decentralization needs to be accompanied by accountability.** Centralized revenue distribution has been a key driver of conflict in Iraq, Libya, Syria and Yemen because funds are distributed with little transparency or accountability. This has led many to see political decentralization as a potential solution. But structural change is no panacea. Decentralization that is not wedded to clear mandates and transparency and accountability mechanisms will merely shift rent-seeking into the regions and serve the interests of a different set of actors. Western policymakers should only support decentralization that meets minimum
transparency and accountability thresholds, and that ensures that institutions with sufficient administrative capacity are available at the local level. If these conditions are met, decentralization can help mitigate profiteering and rent-seeking because diluting the power of the capital city will reduce incentives to violently take control of it as part of a winner-takes-all system.

**Transit areas and borderlands**

To varying extents, the conflicts in Iraq, Libya, Syria and Yemen have created internal territorial divisions. These in-country lines of territorial control have in turn distorted markets and created distinct sub-economies across the fault lines that divide areas controlled by different armed groups. "Transit areas\(^9\) have risen to prominence as sources of tax revenue (levied on the movement of goods) and arbitrage income (realized from cross-border differences in the prices and availability of goods). Outside of capital cities, trans-market taxation and arbitrage have turned transit areas into prized assets for armed groups and other conflict economy participants.

In most cases, the economic activity in transit areas falls outside the control of the state. In some cases, state actors cooperate with the armed groups to take a cut of the profits from these locations, rather than reporting such activity up through the command structure. Similar informal arbitrage and taxation opportunities are also visible in international border areas – which this report terms ‘borderlands’ – with the difference that neighbouring state actors and their economic systems become engaged.

Transit areas and borderlands are major sites of competitive violence. Although the conflicts in the region have typically been depicted as ethno-sectarian or tribal in nature, they can alternatively be understood in economic terms, as actors competing for rents along formal or informal trading routes. The consequent revenue-generation opportunities often perpetuate the existence of territorial divisions, which further reinforce ethno-sectarian or tribal divisions, with harmful welfare implications for local populations.

Western policymakers should consider the following issues when designing interventions in transit areas and borderlands:

1. **External interventions should support the development of local governance structures that have clear mandates and are accountable to local populations.** More equitable and inclusive distribution of state resources – even accepting problems of corruption and accountability – can reduce the pressure on armed groups to use violence. Yet historically, borderlands have had limited connection to centralized state structures. Rather than simply subsuming local authorities in borderlands into the state system, the goal should be to develop systems that are appropriate for the operating environment. Given that service provision often underpins government legitimacy in MENA states, this may mean devolving more authority to local governance structures if the central state is not realistically able to provide services.

2. **The development of sustainable local economies can be fostered through reconstruction and development programming.** However, in some cases, it will not be possible to participate in aid programming without legitimizing and strengthening conflict actors. Where regimes are hostile and there remains political pressure to ‘do something’, external actors must develop a solid

\(^9\) For the purposes of this study, a transit area is defined as a physical area in which fees (informal taxes) are levied. Such points may also provide a security function and connect two markets.
understanding of the local operating environment in order to mitigate the risk of funding being diverted to unintended beneficiaries. Efforts to address conflict economy dynamics in borderlands need to be broadened to target the many root causes of smuggling, which are often linked to socio-economic inequalities across identity groups. In borderlands, Western governments could encourage negotiations with neighbouring countries to enable the free flow of goods produced in these areas. This would also encourage local production activity.

3. **Negotiated zones of control need to be agreed by a wide array of actors.**

In eastern Yemen, a robust system of informal taxation emerged at the outset of the war, allowing for the flow of goods in and out of the area without causing unmanageable price increases. Since 2017, however, growing regional interest in the area has disrupted this arrangement, and at times has seen the eastern border cut off entirely. In southern Libya, the proliferation of checkpoints used by armed groups as sources of financing has contributed to goods shortages and high inflation. Brokering reciprocal taxation agreements between communities in these areas could help to mitigate the negative impacts of price inflation on local populations, which in turn could mitigate some security concerns (i.e., over the protection of populations, property and markets).

4. **Anti-smuggling measures should focus on disrupting flows of goods that are directly related to conflict, such as arms and ammunition, rather than on preventing trade in basic goods essential for economic survival.**

Smugglers operated in the borderlands of Iraq, Libya, Syria and Yemen prior to the outbreak of hostilities, but their activities have intensified and diversified as the conflicts have evolved. It should be noted that not all forms of smuggling are directly connected to violence, and consequently not all of these should be targeted.

**Oil-rich areas**

Iraq, Libya, Syria and Yemen each have regions where oil wealth is situated. However, control over the physical territory where oil infrastructure is located does not necessarily translate into taking over oil revenue streams. There are significant barriers to entry in the oil industry, with a complex supply chain that requires infrastructure, expertise and market access in order to effectively monetize geographical control. Selling crude oil internationally generally requires market access that is conditional on international legitimacy — though there are no such obstacles to selling refined fuels. The case of Islamic State of Iraq and Syria (ISIS), prior to its wide-scale loss of territory as a result of the international anti-ISIS military campaign, is instructive. Because ISIS controlled only part of the oil supply chain in Syria, it was forced to cooperate not only with the engineers responsible for operating oil rigs but also with other actors that had access (which ISIS lacked) to refining capacity and tanker fleets. This scenario provided opportunities for middlemen who were able to negotiate with armed actors on all sides. On the other hand, when actors control the entire supply chain, as in the Yemeni province of Mareb, they have much greater latitude to operate independently. In Libya, the international community has prevented sales of crude oil from unrecognized authorities in the east of the country. This has meant that their opponents in Tripoli have continued to receive the revenues from oil sales. Meanwhile, in Iraq, smuggling routes established to circumvent international sanctions under Saddam Hussein’s regime continue to operate. These routes provide a source of patronage for those in control of the
oil infrastructure in the south of the country, even as the inequities of the centralized system of distribution remain entrenched.

Western policymakers should consider the following issues when designing interventions in oil-rich areas:

1. **The West should leverage its power to grant access to international oil markets.** Insisting that only one recognized authority can market oil internationally is perhaps the most significant lever of control that Western actors possess over the conflict economies of the four states. As a policy tool, this has been particularly effective in preventing oil sales from the east of Libya, though less so in Iraq (where overland smuggling networks are extensive) or in Yemen and Syria (where oil exports are not a factor).

2. **Incentive mechanisms should support the redistribution of oil wealth to local communities.** In some oil-rich areas, such as Basra in Iraq, poverty creates a powerful incentive for local communities to divert oil supplies. This in turn supports a local market for protection. More equitable distribution of wealth would likely reduce calls for federalism and support for separatist agendas. Western governments could encourage the allocation by the central government of a specific share of oil revenues to investment projects in the areas of production, in a similar fashion to the rule established for the Kurdistan Regional Government in Iraq. This could be based on the size of the population or on socio-economic indicators.

3. **Interventions should support deeper engagement between local populations and oil industry players (both public- and private-sector operators).** In Libya’s south, the population has limited access to skilled employment within the sector and is reduced to competing for rents by operating protection rackets that target oil installations. Oil companies (both national and international) should be incentivized to invest in local communities (e.g. via training programmes for engineers). This should also include efforts to address the environmental impacts of production activities, such as the pollution of underground aquifers, which negatively impact water-scarce areas. Such approaches may render oil operators less susceptible to strikes and blockades by local populations.

4. **Policymakers must understand who profits from oil and fuel smuggling – and the supply chain mechanisms through which those profits are achieved – before attempting to disrupt such activity.** Every link in the supply chain contributes to the conversion of crude oil into money, so disrupting even one upstream link can have a substantial impact on downstream communities. Policymakers need to design comprehensive strategies that address the entire supply chain rather than just one link.

Through different forms of engagement and intervention – security, political and humanitarian – Western policies play a key role in shaping the dynamics in the conflict sub-economies of Iraq, Libya, Syria and Yemen. Such interventions present many pitfalls, but there are also opportunities to help reduce violence and insecurity – though a basic requirement is that local dynamics are taken into account appropriately. Intervention targeting specific conflict sub-economies can increase policy impact, but this requires that Western policymakers invest in developing their understanding of local networks and local economies. Without such an understanding, there is a substantial risk of unintended consequences causing unanticipated harms.
1. Introduction

The conflicts in Iraq, Libya, Syria and Yemen have killed hundreds of thousands of people and displaced millions. In Iraq, the defeat of Islamic State of Iraq and Syria (ISIS) is unlikely to lead to lasting stability because it does not address fundamental conditions on the ground which allow violent extremist groups to resurge every few years. In Libya’s fragmented political and security environment, a wide range of largely local actors continue to compete violently for influence, as evidenced by the latest major outbreak of fighting around Tripoli. In Syria, ISIS fighters have been forced out of their last enclave in Baghouz, while President Bashar al-Assad consolidates his control over territory in the rest of the country. In Yemen, a precarious ceasefire on the Red Sea coast has led to an intensification of battles between the Houthis and their rivals on other front lines.

Other states within the Middle East and North Africa (MENA) region, along with Western states, have often been active proxy participants in these conflicts, supporting certain groups over others in pursuit of national interests. The impacts have also been felt far beyond MENA borders, as refugees fleeing conflict areas have travelled to Europe and other Western countries, sparking outcry over a supposed ‘migration crisis’ which has in fact been instrumentalized by political actors.

Identity-based discourses

To explain the violence that has struck the region, many scholars, policymakers, journalists and pundits have focused their analysis on ideological and identity-based factors. Developments in Iraq, Syria and Yemen have been viewed predominantly through the lens of ethno-sectarian politics.10 In Libya, significant attention has been paid to the development of Islamist and Salafi-jihadi movements since 2011, particularly in policy circles.11 In Iraq, the conflict since 2003 has been explained as a sectarian battle between Shia and Sunni Arabs, with the assumption that these identities are easily carved out along ethno-sectarian lines.

Such exclusively identity-centric explanations of conflict at times miss important realities on the ground. As the knowledge base around MENA political dynamics has expanded, so too has our common understanding of how ethnic and religious divisions

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10 A number of studies have examined conflict in the MENA region through the lens of sectarianism, such as Daniel Byman’s ‘Sectarianism Afflicts the New Middle East’. In Iraq, conflict has been analysed through the lens of sectarianism by scholars such as Panar Haddad in his Sectarianism in Iraq and by former policymaker Emma Sky in The Unravelling. In Syria, works such as Charles Lister’s The Syrian Jihad have explored the role of Salafi-jihadist forces in the conflict. In Yemen, analysts have generally pushed back against the idea that the conflict is a sectarian one, but media outlets have come to present it in terms of a regional conflict linked to identity politics: ‘Iran-backed’ ‘Shia’ Houthis versus ‘Saudi-backed’ ‘Sunnis’. See Saul, Hafezi and Georgy (2017), ‘Exclusive – Iran steps up support for Houthis in Yemen’s war: sources’. See also Byman (2014), ‘Sectarianism Afflicts the New Middle East’; Haddad (2011), Sectarianism in Iraq; Sky (2015), The Unravelling; and Lister (2015), The Syrian Jihad.

in the region have intersected with other critical factors. This has enabled more accurate and layered analyses. Chatham House research has sought to broaden policy analysis through its focus on the political economy of the conflicts in question.

Exploring the political economy of war

Against this backdrop, this report seeks to expand the discourse by analysing economic drivers of conflict in Iraq, Libya, Syria and Yemen. Factors such as rent-seeking, economic coping strategies and local political expediency are key to understanding the civil wars in these countries, yet they tend to be under-emphasized. As the conflicts have progressed, the national and local economies in which they are embedded have likewise evolved.

Over the past several decades, research on the political economy of war has sought to explain the initiation, duration and character of war. Initially, as with the MENA wars of today, the dominant discourse in studies of the 1990s civil wars was identity-centred. Following ethnic cleansing in the former Yugoslavia, the Rwandan genocide, the end of apartheid in South Africa, and the violence of clan conflicts in Somalia, civil war was viewed largely as a product of group identity. In contrast, the quantitative study of war economies that subsequently developed in the late 1990s and early 2000s contended that economic motivations – especially in resource-rich areas – rather than group identities provided greater explanatory power for the onset of armed conflict. On the qualitative side, case study research focusing largely on sub-Saharan Africa (and, to a lesser extent, on Latin America and Asia) showed that profit-based incentives are co-mingled with narratives of grievance and embedded in a larger global political economy. The heart of that debate was about identifying economic self-interest as the main motivation for rebels joining and fighting civil wars.


20 See footnote 15.
More recent work on horizontal inequality has added nuance to these discussions. It has moved beyond a binary ‘greed versus grievance’ distinction to illustrating how group grievances are constructed. Such research seeks to demonstrate empirically how an unequal distribution of power and resources between groups generates conditions for violent mobilization. More generally, the incorporation of economic motives into analysis of civil war has revealed that members of rebel organizations, militias and paramilitaries have joined and stayed in such groups for a variety of reasons, and that the relative weighting of these imperatives can change over time. Individuals may join (or be forced to join) an armed group for one set of reasons, and stay for an entirely different set of reasons.

To date, the ‘political economy of war’ approach has had limited application in analysis of the MENA region. Yet we find that the insights of the literature associated with this approach resonate in each of our four case studies. We show how economic motivations at the individual and group level can offer an alternative or complementary explanation for armed group membership and armed group violence. While some people will fight to promote or defend a particular identity, others fight for economic survival or enrichment. For many more, these motivations are tied together, and separating out ‘greed’ and ‘grievance’ is a difficult, if not impossible, task. By focusing on conflict economies in a localized way, we aim to rebalance how the wars in Iraq, Libya, Syria and Yemen are portrayed and analysed. Even if economic motivations did not spark these wars initially, it is now clear that such motivations play a critical role in the persistence of open fighting, localized violence and coercion.

Approaching conflict economies

The objectives of this report are twofold. First, it seeks to develop a framework for comparative analysis of MENA conflict economies at the local level. We anticipate that this framework will also resonate beyond the MENA region. Second, it aims to map the logic of ‘competitive’ violence and ‘embedded’ violence (see Box 1 for definitions) within the region’s conflict economies in order to achieve a reduction in both. We should emphasize that we see conflict economies in the MENA context as the transactional space in which violent competition for rents is currently taking place. We do not define conflict economies in terms of ‘black’ and ‘grey’ markets that somehow need to be ‘cleaned up’ and converted into licit markets, like their peacetime counterparts.

25 There is a tendency to overemphasize the ‘criminal’ elements of the Syrian war economy in the literature, according to Bojicic-Dzelilovic and Turkmani. See Bojicic-Dzelilovic and Turkmani (2018), ‘War Economy, Governance and Security in Syria’s Opposition-Controlled Areas’. Like Bojicic-Dzelilovic and Turkmani, we seek to avoid this approach.
Traditionally, the conception of a conflict economy (also termed ‘war economy’\(^{26}\)) has been of one that is tightly linked to fundraising for arms, ammunition and fighters. In contrast, we see a broader political economy of war at work in the four countries under review, with conflict economies embedded in wider conflict systems.\(^{27}\) Framed differently, a conflict economy is not merely an economy that directly sustains and is fuelled by fighting. It also incorporates a ‘shadow economy’ (the unregulated and often illicit sector that thrives in situations of armed conflict) and what we might term the ‘coping economy’ (involving participation in commerce for survival purposes).\(^{28}\) This report uses the term ‘conflict economy’ to illustrate how economic activity is connected to violence, and ‘coping economy’ to illustrate how such violence affects the coping ability of local populations.

**Box 1: Definitions**

We have defined a series of terms and approaches as follows:

A **conflict economy** is ‘a system of producing, mobilizing and allocating resources to sustain competitive and embedded violence, both directly and indirectly’.\(^{29}\)

The **coping economy** comprises the numerous survival-based economic interactions that occur during armed conflict, primarily involving the poor and most vulnerable.\(^{30}\)

This report distinguishes between two forms of violence:\(^{31}\)

1. **Competitive violence**, which is ‘deployed by warring elites to contest or defend the existing distribution of power’. An example of this would be a battle for control of physical infrastructure, such as an oil refinery, or territory, as may be the case with an important checkpoint on a trade route.

2. **Embedded violence**, which can underpin how a political settlement works, as the deals agreed between elites may revolve around who has the ‘right’ to use violence. Examples of this form of violence are more indirect. In the context of this study, the use of armed force to maintain the existing status quo in favour of a limited subset of the ruling elite is one example of embedded violence.

Competitive and embedded violence can co-exist, but should not be conflated with one another. Indeed, the end of competitive violence in a given location does not mean that embedded violence has ended.

Conflict economies are themselves woven into a broader conflict system, which incorporates the social, political and economic institutions and agents that support competitive and embedded violence. We use the term ‘system’ to emphasize both its complexity and

\(^{26}\) The term ‘conflict economy’ is preferred to the term ‘war economy’ as it better reflects the wide array of actors, objectives and armed struggle within the four countries in question.


\(^{28}\) Pugh, Cooper and Goodhand (eds) (2004), *War Economies in a Regional Context*.


\(^{31}\) This distinction draws upon the UK Stabilisation Unit’s Elite Bargains project. Cheng, Goodhand and Meehan (2018), *Synthesis Paper: Securing and Sustaining Elite Bargains that Reduce Violent Conflict*. 
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Introduction

Conflicts economies are, more often than not, integral parts of a broader conflict system that simultaneously supports both violence and local livelihoods.

interconnectedness.32 The system analogy also underscores the difficulty of predicting with any confidence the full effects of change even of one element, because of the many cascading effects that will follow. In complex systems – such as those associated with armed conflict – elements of a system and sub-systems may have critical components that respond in non-linear ways: some components may move in tandem in specific circumstances; agents may have more or less influence depending on external conditions; in some cases, system components may interact unpredictably.

In using a conflict systems approach, this analysis acknowledges that the boundaries between formal and informal economies are blurred, and that the decision to enforce (or not enforce) a law often relies on personal relationships rather than a factual determination as to whether a ‘crime’ has been committed. These intermeshed imperatives exist not only at the domestic level in Iraq, Libya, Syria and Yemen, but also in relation to the various international actors (such as international organizations, donors, governments and multinational corporations) that actively broker (or deliberately turn a blind eye towards) relationships with armed groups. The conflict economies are, more often than not, integral parts of a broader conflict system that simultaneously supports both violence and local livelihoods. In other words, participants in conflict economies consist both of violent non-state actors and peaceful citizens attempting to eke out a living.

On the one hand, members of armed groups can be understood as rational economic agents who manage their use of violence (signalling how much violence is acceptable, when it can be used and who it can be directed towards) so as to maximize rents. On the other hand, they also need to be seen as actors who are embedded in social systems, and who will suffer social consequences if they do not address their constituencies’ welfare when deciding whether and how to redistribute their gains.

Even though this is a study of conflict ‘economies’, our primary goal is not to provide estimates of the size of these economies in dollar terms. Nor are we trying to measure the economic impact of war per se.33 Such approaches do not reflect how the structure of an economy adapts to the complexity of the situation on the ground, nor do they capture how localities might adopt very different economic strategies in response to a common threat. They do not account for the evolution of the contours and dynamics of a conflict economy over time, and shed little light on what drives competitive and embedded violence. As a consequence, this report does not treat conflict economies as a technical problem to be ‘fixed’.

Identifying conflict sub-economies

Analysis of MENA conflict economies has mostly focused on national-level systems, with more recent contributions highlighting how conflict economies within particular states are inextricably linked to transnational and/or regional conflict systems.34 However, little attention to date has been paid to analysing the region’s conflict economy at the level of sub-systems – labelled ‘conflict sub-economies’ in this report – or at subnational level, be it on a sectoral or location basis.

32 In contrast to studies that rely on regression analysis, there is no underlying assumption that changing the value of the independent variable still allows for all else within the model to be held constant. This approach assumes linear causality, which does not sufficiently reflect the complex interactions that take place. See Gillman, M. and Hails, R. (1997), An Introduction to Ecological Modelling: Putting Practice into Theory, Oxford and Malden, MA: Blackwell Science, p. 4.
34 Pugh, Cooper and Goodhand (2004), War Economies in a Regional Context.
Conflict Economies in the Middle East and North Africa

Introduction

Drawing on fieldwork in Iraq, Libya, Syria and Yemen, this study outlines three distinct types of conflict sub-economies in MENA wars:

1. Capital cities
2. Transit areas and borderlands
3. Oil-rich areas

Our analysis highlights how each particular type of conflict sub-economy creates distinct location-based patterns of resource production, mobilization and allocation in order to sustain competitive and embedded violence, both directly and indirectly. A more localized approach also reveals an intertwining of economic and political relationships that can involve cooperation, routine negotiation or informal non-aggression pacts, as well as violent competition between armed groups and their political patrons.

Drawing on the literature on the political economy of war, this study asks two questions:

1. How do conflict sub-economies drive violence in Iraq, Libya, Syria and Yemen?
2. How do local populations interact with conflict sub-economies?

Overview

This report seeks to make a contribution to analysis of conflict, both in the MENA region and more broadly, in two ways. First, via the implementation of a new comparative framework for examining conflict economies through the lens of sub-economies. And second, by exploring how the economic activities observed in the four states relate to patterns of competitive and embedded violence.

This report consists of three principal chapters, in addition to this introductory chapter. Chapter 2 provides an overview of the conflict economies of Iraq, Libya, Syria and Yemen at the national level, highlighting key players and dynamics. For those less familiar with the MENA region, the chapter provides useful background, but it can also be skipped by those with a strong working knowledge of the country contexts.

Chapter 3 lays out our analytical framework of conflict sub-economies consisting of capital cities, transit areas and borderlands, and oil-rich areas. It reviews the violent competition for rents in each sub-economy, with an analysis of what that contestation means for the types of violence dispensed and the behaviours they incentivize. The analysis is illustrated using case studies from Iraq, Libya, Syria and Yemen.

Finally, drawing upon the analyses of the sub-economies, Chapter 4 examines how Western policy has affected the development of the four conflict economies. The chapter concludes with recommendations for policymakers seeking to assess the implications of and trade-offs associated with their interventions, and to target interventions more effectively.

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35 An example of this may be the cooperation between Syrian rebel forces in the Euphrates Shield Area and the Turkish state over border management (particularly pertaining to the collection of checkpoint fees).
36 In Libya, many of the goods that stock the eastern market have continued to enter the country through the western port of Misrata, despite significant political differences between Misrata and the authorities in the east and the elements of the Libyan Arab Armed Forces (still commonly known as the Libyan National Army, or LNA) under the control of Khalifa Haftar.
37 In the Iraqi town of Tuz Khurmatu, rival armed groups accept each other’s presence in return for a share of the proceeds from taxing formal and informal trade through the area.
Introduction

Methodology

The core analysis for this report is based on fieldwork and analysis conducted over an 18-month period from July 2017 to February 2019. A variety of data-gathering methods were employed, including in-depth interviews with local actors, expert interviews, long-term tracking of local economic activity, and collation of available primary and secondary data. Given the extreme sensitivity of the topic and the challenging operating environment, interview material and data gathered as part of this process are referenced anonymously, in order to minimize public exposure to interviewees, Chatham House researchers and those who have worked closely with us. We have endeavoured to provide as much identifying information about sources as possible where this is critical for underscoring the legitimacy of a particular claim, and where sources have been comfortable with being identified in more specific terms.

To illustrate the dynamics of each sub-economy type, the report compares sub-economy case studies from each of the four states. In addition to the capital cities of Baghdad, Tripoli, Damascus and Sanaa, reference is made to Aden (as the government of Yemen has sought to move the capital there). Tuz Khurmatu (Iraq), Sebha (Libya), Morek (Syria) and Bayhan (Yemen) are examined as key transit areas. The Ras Jdir area on the Libyan–Tunisian border, al-Qaim on the Iraqi–Syrian border, the Euphrates Shield Area on the Syrian–Turkish border and al-Mahra on the Yemeni–Omani border are examined as borderlands. The oil-rich areas selected for comparison are Basra in Iraq; the ‘oil crescent’ in eastern Libya; northeastern Syria; and Mareb in Yemen.

Limitations and areas for further research

The nature of the subject matter means that this report cannot present a truly comprehensive or representative picture of conflict economy dynamics in the states in question. It is also not possible for us to determine with certainty how important the economic motivations of different actors are: we can only report on observable behaviours. We cannot fully untangle ethnic/economic/social status/social pressure incentives and motivations.

This report has sought to assess how local populations have been impacted by conflict economy dynamics. However, it should be noted that more targeted research is required to better understand these social dynamics, particularly in terms of how revenues are distributed. Similarly, the authors recognize that the sub-state and state-level focus of this paper does not address important regional and international conflict economy dynamics: this is something that future Chatham House research will seek to explore.

2. Conflict Economies – National Level

In order to examine the development of conflict sub-economies in Iraq, Libya, Syria and Yemen, one must first understand the national context: most notably the evolution and current status of each conflict, as well as the economic systems that pre-dated armed conflict and have evolved as a result of it. Here, it is worth noting that all four countries have legacies of long-term dictatorial rule going back to the 1960s. These legacies have played an important part in shaping current political and economic struggles.

Intensity and status of conflict

There are significant differences in population size between Iraq (38.27 million in 2017), Libya (6.38 million in 2017), Syria (18.27 million in 2017 – down from 21.96 million in 2011) and Yemen (28.25 million in 2017). The extent to which the local population in each country has been directly affected by violent conflict differs markedly. According to 2016 World Bank calculations, more than 90 per cent of Syrians had been directly affected by conflict. In Yemen and Iraq, that number falls to around 55 per cent, while in Libya it is 10 per cent.

Figure 1: Percentage of the population directly affected by conflict (2016)

As of April 2019, the development of conflict in each of the four countries was at different stages. This report does not seek to analyse the current status of each conflict, but it is necessary nonetheless to outline the salient aspects of the conflicts and describe the principal actors in order to provide a grounding for the discussion of conflict sub-economies that follows.

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40 This measure provides the share of the population in that country affected by all forms of violence.
Conflict Economies in the Middle East and North Africa
Conflict Economies – National Level

Iraq

Despite celebrating the end of ISIS’s territorial rule in their country in 2017, Iraqis continue to share concerns over how peace will be ensured. Iraq’s recent history reveals a poor track record of converting military victories into longer-term political solutions. A nationalist and populist protest movement has arisen throughout the country, reframing a conflict hitherto debated most often in terms of ethno-sectarianism into a class-based narrative of 'citizens versus elites'.

Multiple armed actors, loyal to political parties rather than to state institutions, fought together to achieve the victory against ISIS. They now compete to fill the vacuum left by ISIS’s territorial losses, their rivalry occurring along and around the main economic routes once used by ISIS. The competing actors in northern Iraq and the recently liberated areas include Kurdish Peshmerga armed groups, affiliated to either the Kurdistan Democratic Party (KDP) or the Patriotic Union of Kurdistan (PUK); the Popular Mobilization Units (PMU, or al-Hashd al-Shaabi); and armed groups linked to local tribes. At the same time, despite its territorial losses, ISIS continues to operate underground in several provinces, while the weak state conditions that had allowed ISIS to flourish remain unaddressed. Since 2003, neither the central government nor local representatives have been able to provide stability or basic services. This has allowed groups such as ISIS at times to exploit governance vacuums in the pursuit of legitimacy, resources and power.

Libya

Following the 2011 overthrow of the regime headed by Muammar Gaddafi, Libya’s slide back into conflict in 2014 resulted in the emergence of rival governance structures, a split that remains unresolved. The Libyan Political Agreement, brokered under the auspices of the UN in December 2015, led to the creation of the Government of National Accord (GNA) under the leadership of a nine-member Presidency Council. Yet the GNA has failed to become the unity government envisaged. Members representing the east of the country soon boycotted the Presidency Council, and the internationally recognized parliament failed to ratify the Libyan Political Agreement, meaning that the GNA has no grounding in Libyan law. Consequently, it nominally owes its continuing existence to support from Western actors – though in reality the GNA has little power to influence events on the ground. Armed groups remain active and beyond its control. The most powerful military actor, Khalifa Haftar, leads a coalition of tribal forces and regular army units under the banner of the Libyan Arab Armed Forces (but still commonly referred to as the Libyan National Army or LNA). Haftar was notably excluded from the Libyan Political Agreement, but has since been elevated

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42 It maintains an underground organization in the Hamrin and Makhul mountain region between the provinces of Salahaddin, Diyala and Kirkuk; in the Sharqat and Qiyara areas south of Mosul; and in the western desert along the Iraq-Syria border. 43 Note: the title of ‘Libyan National Army’ is contested. A number of officers and units based predominantly in the west of the country claim to represent the LNA but do not accept Haftar’s leadership, while Haftar’s forces also include a number of irregular and tribal militias. The actual name of the Haftar-led forces is the ‘Libyan Arab Armed Forces’. For the sake of simplicity, we use the abbreviation ‘LNA’.
to the rank of field marshal and appointed commander of the Libyan Armed Forces by the House of Representatives, the eastern-based parliament recognized by the international community.44

The blurred line between state and non-state armed groups further complicates the situation. Armed groups technically affiliated with state entities often operate autonomously, while competing with other quasi-state actors for control of territory, revenue-generating opportunities and influence. International efforts to chart a route out of Libya’s governance crisis continue to flounder. Within this context, a low-intensity conflict rumbles on, characterized by continued competitive violence as rival groups seek control of infrastructure, transit areas and state bodies. LNA forces have undertaken lengthy military operations in Benghazi and Derna, causing thousands of casualties and displacing thousands more. At the time of writing, the LNA was in the midst of an offensive on the capital, Tripoli, in what amounts to the third outbreak of civil war since 2010.

Syria

As of the spring of 2019, Syria remained divided into four distinct zones, three of which were controlled by combinations of local and international actors. In the most populated and urbanized western part of the country, the regime of President Assad is back in charge. This has been made possible through the active backing of Russia and Iran, which continue to play important security, political and economic roles. North of Aleppo, rebel opposition groups funded and armed by Turkey control a second area, which is being increasingly integrated into the Turkish economy. Meanwhile, the northeast is controlled by the Kurdish-dominated Syrian Democratic Forces, with the support of the US. A fourth region, in the northwest, broadly corresponding to the Idlib governorate, is under the control of Hayat Tahrir al-Sham (HTS), a Salafi-jihadi organization.45 This is the only part of Syria that is devoid of any significant foreign presence.

An internationally sponsored peace process led by the UN has sought to promote a political solution, but it has been gradually eclipsed by the Astana process, a tripartite forum grouping Turkey, Russia and Iran that has the more modest ambition of finding a short-term security arrangement. While the Assad regime’s successes in the past couple of years have ended calls for his departure, victory on the ground has not yet resulted in full acceptance of his rule by the West and the Arab world. Western sanctions also continue to isolate the Syrian regime. The scale of violence in the country has declined, although at the time of writing the regime was engaged in a new offensive in Idlib. A lasting political solution remains distant.

Yemen

Yemen’s civil war has divided the country into multiple, rival zones of control, each with its own system – and in some cases multiple systems – of governance, security and economic management. Northwest Yemen is controlled by Houthi rebels who entered Sanaa in September 2014 and then spread east, west and south in a quest to control the entire country, in alliance with loyalists of ex-president Ali Abdullah Saleh. The Houthis killed Saleh amidst rising internal tensions in December 2017, and have since moved to control

44 Fayez al-Serraj, who heads the Presidency Council (the executive of the GNA), is the internationally recognized prime minister of Libya.
45 Hayat Tahrir al-Sham was formerly known as the Nusra Front or Jabhat al-Nusra. The organization is the local arm of Al-Qaeda and was designated a terrorist organization by the UN Security Council in June 2018.

The Houthis have become adept at coercing businesses, government institutions and other economic actors into cooperating with the de facto authorities in Sanaa
all aspects of life in Yemen's highlands and along its west coast. They have become adept at coercing businesses, government institutions and other economic actors into cooperating with the de facto authorities in Sanaa.

To the east of Sanaa, a network of military and tribal players from the al-Jawf, Mareb and northern Hadramawt governorates has emerged as the most important grouping in this region. Members of this network share common ties to Islah, Yemen's main Sunni Islamist party.

In the south of Yemen, rival factions vie for power and legitimacy. These include the technocrats and security forces affiliated with the internationally recognized government of Abd Rabbu Mansour Hadi. They also include a web of political and security forces linked to the Southern Transitional Council – a self-styled government-in-waiting that is closely linked to the United Arab Emirates (UAE) – as well as multiple UAE-backed armed Salafist-led groups. Members of the latter include secessionists, Salafists and indeed Salafist-secessionists, many of which defy classification. The UAE-backed southern networks and Islah harbour deep animosity towards one another: in Taiz, a front-line city in central Yemen, UAE-backed forces and allies of Islah clash regularly, making it all but impossible to govern the city. While a fragile UN-brokered agreement to freeze the fighting and demilitarize the key western port of Hodeida still holds, fighting continues in other areas of the country.

The development of the Iraqi, Libyan, Syrian and Yemeni conflict economies

In undertaking a comparative analysis of the conflict economies of Iraq, Libya, Syria and Yemen, we began by acknowledging the significant differences in their conflict histories. There are also major differences between the four countries in terms of development indicators and economic structure. On the UN’s Human Development Index, a summary measure of average achievement in key dimensions of human development (a long and healthy life, knowledge and education, and a decent standard of living), Libya ranked 108th out of 189 countries in 2017, while Iraq ranked 120th, Syria 155th and Yemen 178th.46

While official GDP statistics have limitations,47 they do offer a useful entry point for comparison of the economies in question and allow a relatively consistent basis for that comparison. GDP per capita in oil-rich Libya was $5,978 in 2017, while in Iraq it was $5,017. Syria and Yemen do not have natural resources on the same scale. GDP per capita was only $910 in Syria and $1,106 in Yemen in 2017 (see Figure 3).48 These differences have had a significant impact on the nature of the conflict economies to have developed. Oil revenues are the dominant source of rents in Iraq and Libya. In Syria and Yemen, shortfalls in funding have forced rival groups to adopt a range of coping strategies and seek alternative forms of revenue, most notably from external actors.

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47 They are likely to underestimate some measures and overestimate others. For example, the ability of these measures to calculate the informal economy is limited, despite the importance of informal economic activity to each of the countries in this study.
Figure 2: Human Development Index scores, 1990–2017


Figure 3: GDP per capita, 2000–17

Conflict Economies in the Middle East and North Africa
Conflict Economies – National Level

Figure 4: Overseas development aid (ODA) as a percentage of GDP, 2000–17


Iraq’s conflict economy

Iraq is the most oil-dependent state on earth. In 2015, the oil and gas sector accounted for 58 per cent of Iraqi GDP, 99 per cent of the country’s exports and over 90 per cent of central government revenue. At the same time, Iraq has not had an economy free from conflict in four decades. The Iran–Iraq war (1980–88), the first Gulf war (1990–91), international sanctions and intermittent airstrikes (1990s), the US-led invasion and subsequent occupation (2003–05), the first civil war (2006–08), and the emergence of ISIS (2013–18) have all conditioned the development of Iraq’s conflict economy. Despite the recapture of ISIS-held territory, the economic situation is deteriorating: gross national income (GNI) per capita has fallen from $6,900 in 2013 to $4,700 in 2017.

Control of the Iraqi state is key to accessing oil revenues, allowing leaders to sustain patronage networks and remove opponents. Since the ousting of Saddam Hussein in 2003, political and military elites have competed for control of the state and its institutions in order to access resources. The decision-making autonomy of political and security officials allows them to award contracts to preferred business partners and benefit from a culture of kickbacks. These networks of officials have captured parts of the informal economy. Political leaders also maintain relationships with state-sanctioned armed groups, which extract rents and taxes from smugglers and informal businesspeople. Mainstream political parties (divided along Shia, Sunni and Kurdish identity lines)

use their access to state-recognized (and therefore state-legitimized) armed groups – such as the Kurdish Peshmerga, the PMU and tribal forces – to maintain influence over the conflict economy.51

Iraqi officials often hold or control multiple political, economic and military roles, a status that provides lucrative economic opportunities in both the public and private sectors. After the Iran–Iraq war, the state was bankrupt. By 1990, many state-owned enterprises had been privatized. As a result, the regime had to cultivate new alliances with newly empowered economic actors. These mutually beneficial relationships strengthened the black market and the smuggling sector, seeding the informal economic networks that helped Iraq survive international sanctions. The networks incorporated a wide array of actors: government officials, Baathist regime-allied individuals, external business partners, local political and business entrepreneurs, tribal leaders and workers within the oil sector.

In the 1990s, international sanctions on oil exports pushed Saddam’s Baathist regime to establish alternative overland smuggling routes via Jordan, Syria and Turkey (a practice known as the ‘truckers’ trade’), as well as maritime smuggling routes via the Persian Gulf. Those involved in this trade became known as the ‘cats of the embargo’ (qitat al-hisar). The informal economy also provided income for many of the estimated 200,000 battle-trained soldiers who had returned from the Iran–Iraq war and the Gulf war but could not find employment. Today, war veterans (as well as lower-class labourers) remain closely associated with smuggling, often working as truck drivers, in a sector that has become increasingly dangerous. Traversing smuggling routes necessitates contact with an array of armed forces.

The rise of ISIS in 2013 and 2014 revealed the extent to which the conflict economy had become embedded. ISIS engaged in very similar economic practices to those that had begun during the Baathist era – it even employed many of the same Baathist loyalists, who had experience with the system as government economic advisers. By 2014, ISIS had become the richest terrorist organization ‘in history’ after conquering almost one-third of Iraq’s territory in a matter of months. Annual turnover equivalent to an estimated $2 billion provided the Salafi-jihadi organization with unprecedented finances that fuelled its fight against the Iraqi armed forces and their international allies.52

Many policymakers and writers identified the swift rise of ISIS with its command of a ‘new’ conflict economy, one based on the proceeds from oil and gas smuggling and taxation policies. Yet this is a misconception. The principal actors in, and overall structure of, the conflict economy pre-dated ISIS and even the 2003 US-led invasion. Instead, the present economic networks had their roots in the post-Iran–Iraq-war period. ISIS simply captured these networks by taking over the operating environment and employing Baathists and traders experienced in using the trafficking and trading routes. Since the collapse of ISIS, control of such networks has fragmented: now a mixture of the forces jointly responsible for defeating ISIS – the PMU, the Peshmerga, tribal forces, and individuals in the armed forces of the ministries of defence and the interior – profit from the same trade and smuggling routes.

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Libya’s conflict economy

Libya’s economy is heavily dependent on hydrocarbons: an estimated 96 per cent of state revenues were derived from the sale of oil and gas in 2013, leaving the economy highly vulnerable to fluctuations in international oil and gas prices. Since 2010, successive governments have replicated Gaddafi-era policies of free or state-subsidized social services but have circumvented legal restraints on public spending to do so. An estimated 25,000 fighters participated in the uprising against Gaddafi, but 10 times that figure were believed to have received payments as ‘thuwwar’ (revolutionary fighters) as of May 2012. In 2013, the government confirmed that it would continue making these payments. However, runaway expenditure on state-sector salaries proved increasingly unaffordable: international oil prices were falling and Libyan oil production was hampered by a major blockade of its eastern oil fields. In response, the state drew upon its foreign currency reserves to cover the deficit between government spending and state revenues. Libya’s reserves consequently fell from an estimated $115 billion in 2011 to around $75 billion in 2017, according to the World Bank.

Figure 5: Libyan budget, 2018

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Salaries: 6.6 Billion LYD
Operating costs: 6.7 Billion LYD
Project development: 4.7 Billion LYD
Subsidies: 6.6 Billion LYD
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Most of Libya's oil and gas wealth is distributed through state channels, making the control of the state itself the prime target for competing actors. The effects of the conflict economy are visible in Libya’s 2018 budget, with state-sector salaries accounting for 57 per cent of the agreed budget; this compares with an estimated 17 per cent in 2010, prior to the overthrow of the Gaddafi regime. However, the increase excludes spending

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by rival authorities in the east of the country, which official data do not account for.\(^5^7\)

Most armed groups remain on the state payroll, giving the Libyan government the peculiar distinction of funding its own civil war.

As detailed later, the fragmentation of the Libyan state has evolved into a competition for control of state institutions, assets and revenue streams. Amid the battle among political actors, the Central Bank of Libya (CBL) has put a brake on runaway expenditure of Libya's foreign currency reserves. However, the independence of the CBL has been constrained by a highly volatile security environment.

Import fraud has become a critical part of Libya's conflict economy. The growing disparity between the official rate for the dinar and the black-market rate created substantial opportunities for arbitrage, until September 2018 when a fee was imposed on access to foreign currency (over which the CBL has a monopoly) for the import of goods. As also detailed in Box 2, import fraud has become a significant revenue-generation opportunity for networks of profiteers – directly involving, among others, armed groups that have coercively and cooperatively exploited privileged access to foreign exchange. In addition to currency arbitrage, profiteers use fraudulent documentary letters of credit for the import of goods to transfer large amounts of money outside the country. Sometimes the value of goods imported is less than that documented in the letter of credit, and sometimes no goods are imported at all. In 2017, the CBL opened LYD11.2 billion ($8 billion) in documentary letters of credit for imports. The extent to which these funds were diverted remains unclear. The Libyan Audit Bureau claimed to have identified more than $570 million in fraudulent letters of credit in the 11 months from January to November 2016, based on the records it had reviewed, but it has since been denied access to the CBL database which keeps track of letters of credit.\(^5^8\)

Libya's generous fuel subsidy regime has been widely abused by corrupt actors and smugglers. Smuggling of refined fuel (not to be conflated with the smuggling of crude oil) has become lucrative in the country's conflict economy. Around one-third of refined oil products are diverted from the formal fuel distribution network, according to the Libyan Audit Bureau.\(^5^9\) In January 2017, the head of the investigations office of the Libyan attorney general told a press conference that fuel smuggling had cost the state LYD5 billion ($3.3 billion) over an unspecified period.\(^6^0\) In the past, state subsidies for basic commodities such as wheat and flour had also contributed to cross-border trade in the Maghreb and Sahel, laying the foundation for informal economic activity and the development of illicit trafficking pathways.

Human smuggling and trafficking, which generate the most attention outside Libya, are a key part of the country's illicit marketplace. On the northwest coast, armed groups have become directly involved in such activities as a result of their physical control of launching points and detention centres. In other areas of the country, it is very difficult for human smugglers to operate without paying armed groups for protection or submitting to demands for taxes on the movement of people. Taxing people flows is also a particularly

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\(^5^7\) The head of CBL East, Ali al-Hibri, said in March 2019 that CBL East has raised LYD32 billion ($23 billion) through the issuing of bonds to banks headquartered in Libya's east since 2014. These funds, in addition to the funds and liabilities of the eastern-based (and unrecognized) interim government, are not included in CBL Tripoli figures.


significant form of income for the armed groups in Libya’s south. At their peak in 2016, revenues from human smuggling were in the region of $1 billion, according to Chatham House estimates. Since mid-2017, however, Mediterranean crossings have fallen significantly, and revenues for human smugglers are likely to have fallen correspondingly.

**Syria’s conflict economy**

Prior to the conflict, Syria’s economy was among the most diversified in the Middle East. It relied on a mix of sectors including energy, agriculture, trade, transport and manufacturing. Years of intense conflict have transformed this picture, however. Government services and agriculture now contribute together up to 47 per cent of GDP, compared to 30 percent in 2010. Oil exports, which once represented a meaningful share of both government revenues (a third of the 2010 budget) and foreign currency receipts (around 25 per cent), now contribute much less to the economy than they used to. In 2017, approximately 64 per cent of Syrians in employment worked in the public sector, compared to around 25 per cent in 2010.

The conflict has drastically reduced export receipts, which fell from $13 billion in 2010 to less than $900 million in 2017. This has created a foreign currency crisis, with significant economic, political and social consequences. Despite the dire economic circumstances, the regime has managed to continue providing employment, as well as basic government services, to residents within its areas of control.

In 2016, the UN Economic and Social Commission for Western Asia (ESCWA) estimated Syria’s GDP at $25 billion, less than half its level ($60 billion) in 2010. GDP has fallen each year since 2011, with ESCWA putting total economic losses by the end of 2016 at an estimated $328 billion, split between approximately $100 billion in lost capital stock and $228 billion in accumulated GDP losses. While these macroeconomic figures tell us little about the violence on the ground, they provide a snapshot of how profoundly Syria has been affected.

The Syrian government budget has shrunk significantly in the past seven years, from around $18 billion in 2011 to $9 billion in 2018. Actual government expenditures have been even lower, since only half of the budget is estimated to have been spent in recent years.

To cope with funding shortfalls, the regime has provided loyalist figures with privileged access to government contracts, land, and import and export functions in return for financial and military support. In doing so, the regime has empowered individuals (including some based in neighbouring Lebanon) to bypass Western sanctions. In order to access resources from areas of the country no longer under its control, the regime has recruited new brokers to manage its relationships with ISIS and other groups, and to ensure a steady supply of energy and food products from the northeast (where these resources are located). It has also given a free hand to its militias to loot areas captured from the opposition.

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61 Eaton (2018), *Libya’s War Economy*.
63 Oil exports, however, represented a meaningful share of both government revenues (around a third of budget revenues in 2010) and foreign currency receipts (around 25 per cent). As the conflict expanded, this relative diversity acted as a cushion and bought the regime time during the first two years of the conflict.
The regime has benefited from uninterrupted support from Iran and Russia, its key foreign allies. Iran, for example, has provided $3.6 billion worth of oil supplies and $2 billion worth of other products (although the US imposition of sanctions in November 2018 on the shipping of oil to Syria reduced these supplies). The Syrian regime has further taken advantage of humanitarian aid to compensate for shortfalls in funding and supplies, and to finance state-owned businesses. Humanitarian aid flowing into Syria was estimated at $2.2 billion in 2018.67

The civil war has destroyed existing business and trade networks, while encouraging a major expansion of illegal and informal activities and networks. New activities such as kidnapping for ransom have become important sources of revenues for criminal actors. Unsurprisingly, war has diverted financial resources away from the formal economy into the informal one. This has included, for instance, the increased use of informal financial networks such as the hawala system, which residents of rebel-held areas have relied on following the withdrawal of the formal banking sector from those areas. The division of the country into different areas of control continues to provide opportunities for smuggling, as well as for arbitrage between the various fragmented markets. However, activities such as looting, kidnapping and trading in antiquities have become less prevalent in the past year as the intensity of the conflict has decreased. The reduction in the number of checkpoints, and in the number of men joining militias, has had a similar impact, particularly in regime-controlled areas.68

Yemen’s conflict economy

Yemen’s pre-conflict economy was dependent on sales of oil and gas, which accounted for almost 70 per cent of state revenues in 2014. The country’s GDP is estimated to have halved since then.69 Accurate data on the current composition of the economy are hard to come by, but publicly available estimates suggest that in 2017 agriculture accounted for 24 per cent of economic activity, industry 14 per cent and services 62 per cent. More than 80 per cent of people are believed to live in poverty.70

New hybrid systems and networks involving state institutions, the private sector and illicit trade actors increasingly underpin the Yemeni economy. These structures simultaneously ensure a continued supply of basic goods while exacerbating trade constraints caused by the conflict. Yet despite the often violent competition between actors, a bustling conflict economy has emerged since 2014, with ostensible rivals cooperating with one another to facilitate both licit and illicit trade. There is strong evidence that a robust arms trade still operates between different cantons of control, with weapons provided by the Saudi-led coalition available for sale in arms markets in Houthi-controlled territory. Qat, the semi-narcotic leaf that is chewed socially, is traded freely across internal borders, while milk and juices from Saudi Arabia

70 Ibid.
Conflict Economies in the Middle East and North Africa
Conflict Economies – National Level

The Houthis have taken an increasingly predatory approach to the private sector, seizing assets and forcing businesses to pay prohibitive taxes to the de facto authorities in Sanaa are widely available in supermarkets in Sanaa. Simultaneously, the Houthis and the government of Yemen have engaged in a battle for control of the institutions that manage Yemen’s economy, most importantly the Central Bank of Yemen (CBY).

The Houthis’ takeover of Sanaa in September 2014 allowed them to achieve control of key state institutions – notably, those with revenue streams that could be used to support the war effort. Latterly, the Houthis have sought control of the main levers of the economy, including the import and distribution of basic goods, particularly fuel, via merchants with privileged access to the Houthis’ leadership. The Houthis have exploited the war and their position of dominance – achieved through violence and other repressive measures – to integrate the state, the formal economy and the informal economy into a system that allows them to sustain the conflict, while simultaneously enriching their own leadership. They have taken an increasingly predatory approach to the private sector, seizing assets and forcing businesses to pay prohibitive taxes to the de facto authorities in Sanaa. No business – from high-revenue sectors such as telecommunications and pharmaceuticals to local market stands selling fruit, vegetables and qat – has been immune. In order to operate, businessmen inside and outside Yemen have learned that they need to develop commercial relationships with the political or military leadership.\(^71\)

The ports of Aden and Mukalla are conduits for various kinds of trade: particularly for shipping traffic between the Horn of Africa, the east of the Arabian peninsula and Asia; and, more recently, for containers entering Yemen. The south is also an important transit point for smuggled goods. Before the war, a variety of goods from drugs to arms to all-terrain vehicles entered the al-Mahra governorate by sea and overland (in the latter case via Oman, often after being trafficked from the UAE). Smugglers in al-Mahra also played an important role in the informal money-changing sector, transporting large volumes of physical currency from the UAE into northern Yemen.\(^72\) Smuggling networks in Shabwa and Hadramawt acted as a bridge between arms, drugs and human smugglers in the Horn, particularly Somalia and Djibouti.\(^73\)

Another source of revenue is the seizure of arms, fuel and other materiel provided by Saudi Arabia. The arms market has been highly liquid since the war began, with weapons that can only have been provided by the Saudis (Austrian Steyr rifles, for example) available for sale in Sanaa. Local merchants have entered into lucrative contracts with the military for the provision of fuel, food and transportation. Media reports suggest that these merchants, as well as local military commanders, are inflating the value of such contracts for personal gain; and that food and fuel are being sold into the local market at marked-up prices, often to the benefit of the Houthis. It is widely accepted that the individuals involved in these practices understand they are effectively undermining the overall war effort. As in the Houthi-held north, fuel imports are seen as a major revenue generator.

\(^71\) Houthi affiliates have also worked to consolidate control over the banking system and formal/informal money transfer networks that allow currency to pass in and out of the country. A key pillar of the Houthis’ revenues has been their control of Hodeida port on the Red Sea coast, as well as their affiliates’ growing stranglehold over inbound trade, particularly of fuel. Houthi supervisors at the port impose customs duties on incoming vessels and charge ships fees for discharging cargo. In total, the port provides them with as much as $400–500 million per year in revenues, and goods are also taxed when they are sold in the local market.

\(^72\) According to a confidential source, these networks were used to supply funding to both the Houthis and Al-Qaeda. Chatham House interview, location withheld, December 2018.

\(^73\) This assertion is based on multiple interviews conducted over the course of 2017 and 2018. Names and locations of interviews withheld to protect confidential sources.
3. Conflict Sub-economies

Analysis of conflict economies to date has mostly focused on state-level dynamics, while academic studies have also indicated that national conflict economies are inextricably linked to transnational or regional conflict economies. Less attention has been paid to the development of conflict economies at the subnational level. This chapter focuses on conflict sub-economies that are location-specific but similarly integrated into regional and transnational flows.

Comparative analysis of Iraq, Libya, Syria and Yemen reveals the existence of three distinctive types of conflict sub-economy: capital cities; transit areas and borderlands; and oil-rich areas. The value and types of rents extracted, and the types and intensity of violence associated with such rents, vary by sub-economy. In capital cities, rents are derived from controlling state institutions and treating the state as a resource – one that offers an assortment of assets, revenue streams and patronage postings. In transit areas and borderlands, rents centre around arbitrage opportunities and the taxation of goods and people. In oil-rich areas, rents are collected through oil sales (usually as taxes upon the sale of oil products, in the case of armed groups) and are contingent on physical control of the area (although the level of taxation achievable depends on the extent to which various actors control points along often-fragmented supply chains).

This chapter explores how the three types of conflict sub-economy condition local economic activity in different ways and determine whether violence is used. Through comparative analysis, we show that each type has a distinct set of characteristics and operating dynamics. Rather than conducting subnational comparisons of conflict economies within a single MENA country – as is common in both the scholarly and policy worlds – we argue that cross-national comparisons across sub-economy types are more likely to reveal generalizable patterns that can be applied to other MENA countries, and perhaps to other conflict-affected countries. For example, our analysis shows that the dynamics of Baghdad’s conflict sub-economy have more in common with that of Tripoli in Libya than with that of al-Qaim (a border town) in Iraq. The conflict sub-economy of al-Qaim, in turn, has more in common with al-Mahra in Yemen than al-Mahra does with the national capital, Sanaa.

Capital cities

Despite political, economic and social fragmentation in Iraq, Libya, Syria and Yemen, physical control of the capital city in each country remains the most prized asset. In Iraq and Libya, such control is equivalent to controlling the state, owing to the extent to which oil revenues run through Baghdad and Tripoli respectively. While Damascus and Sanaa do not provide the same opportunities for revenue capture, they are still the hubs of their respective conflict economies – with Damascus providing a means for the legal distribution of patronage, and both capitals enabling the capture of public and private institutions.

Capital cities have symbolic as well as practical significance. While the relative strength of the state, the degree of centralization and the history of state consolidation vary across the four capitals, what they clearly have in common is power. Baghdad, Tripoli,

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74 Pugh, Cooper, and Goodhand (2004), *War Economies in a Regional Context*.
75 Charles Tilly, writing on the intersection and interrelations between states, political systems and societies at large, popularized the idea of using social network analysis to explain political outcomes. He notes that major urban centres have been key to state formation in Europe, which he argues has been driven in part by the accumulation of capital – funds and assets – and coercive capacity, with cities acting as receptacles and administrative centres from which largesse and violence are then distributed. Tilly, C. (1993), *Coercion, Capital and European States, AD 990–1992*, Oxford: Blackwell. Revised edition: Tilly, C. (2005), *Trust and Rule*, Cambridge: Cambridge University Press.
Damascus and Sanaa each sit at the centre of control over state institutions, assets and legislative power. They are also the financial sector’s primary interface with international markets. Where forces in control of capital cities have international recognition, their access to external markets is typically enhanced (as is their influence in multilateral organizations such as the UN). Where such recognition is denied, warring actors in control of capital cities have nonetheless found ways to circumvent the constraints placed on their commercial and financial activity.

Map 1: Flows of goods, weapons and finances via Sanaa

Source: Chatham House.

The more the distribution of resources reflects both the power balance in the city itself and the broader national power balance, the more likely we are to see embedded rather than competitive violence. For example, Baghdad’s resources are divided among a limited elite, sustaining a system of embedded violence. While Tripoli, like Baghdad, is the principal access point for revenues generated from the state’s oil wealth, Libya’s rival forces have not agreed on how power should be divided. As a result, heavy competitive violence is currently under way in a bid for control over the city. Damascus and Sanaa do not have the same degree of largesse to distribute. Yet both the Syrian regime (which controls the government and formal powers of the state) and the Houthis (who have infiltrated Yemen’s state institutions) have used financial institutions and state resources to build their economic capacity in support of their war efforts. In both Damascus and Sanaa, the actions of the dominant forces are underwritten by coercion, sustaining embedded violence.

The ways in which control over capital cities has played out in these four countries suggest that when a sitting government loses physical control over the capital, competitive violence will continue until a clear winner emerges, after which ‘violence rights’ will be awarded and embedded violence will become institutionalized in the economic life of the city.
Conflict Economies in the Middle East and North Africa

Conflict Sub-economies

Patronage authority: control of state institutions, assets and jobs

Seizing physical control of buildings and territory guarantees access to state budgets and assets in capital cities, enabling control of patronage and revenue distribution. Once physical control is established, ‘violence rights’ are then linked to control over budgets and assets, as well as to access to state benefits and patronage posts. The conflict economy dynamics of capital cities are not unique to the MENA region, but will find easy comparisons with other countries that are mired in war. Undoubtedly, capital cities are central nodes in all government patronage systems, but they play an extra important role in the MENA region because power is comparatively more centralized than in other developing countries. This is particularly the case in Iraq and Libya, where almost all distribution occurs from the political centre. Still, for armed groups in any country, being able to reward loyalists with a stable salary or a regular welfare supplement, or to punish enemies by stripping them of their posts, is a powerful tool.

In Syria and Yemen, resources are more broadly distributed. Yet even in Syria, a major proportion of economic activity must pass through Damascus. The same applies to a more limited degree to Sanaa. The 2015 ouster of President Abd Rabbu Mansour Hadi’s internationally recognized government led him to announce that Aden would be the temporary capital of Yemen. Before the war, Sanaa functioned as a clearing house for revenues generated by oil and gas exports from Mareb, Shabwa and Hadramawt, for customs duties collected at ports like Aden and Hodeida, and for receipts from manufacturing in Taiz. The Houthi takeover of Sanaa precipitated a breakaway of these regions from the capital, and an accompanying loss of revenues. In other words, a degree of de facto decentralization occurred.

In Libya, the picture varies again: even though political forces in the east of the country have sought to establish rival state institutions to those in its west, oil revenues continue to be distributed solely from Tripoli. This has allowed Tripoli to retain its pre-eminence in the conflict economy (although at the time of writing the city was under threat from the LNA’s ongoing 2019 offensive, led by Field Marshal Haftar).

Control of Tripoli connotes dominance over the distribution of Libyan state revenues. The system of governance under Gaddafi was characterized by significant centralization: as a result, almost all key state institutions are found within 1 square kilometre in the capital. Since the overthrow of the Gaddafi regime, periods of calm have been short-lived. The GNA has survived only with the acquiescence of Tripolitanian militias, which coalesced from over 30 groups of varying military significance in 2012 to four dominant groups in 2016: the Tripoli Revolutionaries Brigade (TRB); the Nawasi Brigade; the Abu Slim Central Security Unit; and the Special Deterrence Forces.

Following this consolidation of power in Tripoli, two of these groups – the TRB and the Nawasi Brigade, along with their networks – used their territorial control to infiltrate state institutions, reducing the need for overt coercive violence. Their presence

76 Prior to Gaddafi’s accession to power in 1969, some key state entities such as the National Oil Corporation were based in Benghazi, in the east of the country. Under the monarchy (1951–69), the location of the parliament rotated. However, Gaddafi located all state institutions in Tripoli where decision-making and – critically – the management of budgets were to become hyper-centralized.

77 Security control of Tripoli has oscillated since 2011, when forces from the city of Zintan remained in the capital following the overthrow of the regime. Zintani forces were ousted from Tripoli principally by armed groups from the city of Misrata in 2014, in clashes between the so-called ‘Dignity’ operation led by General Khalifa Haftar and an amalgam of militias fighting under the banner of ‘Libya Dawn’. Following the governance split that ensued, it was not until the spring of 2016 that Misratan forces were displaced from the city and the GNA entered.

on or near the premises of state institutions has enabled them to extract rents, control access to buildings, and intimidate staff and visitors. Prior to 2016, armed groups in the capital were able to obtain salaried positions and access to the budgets of state institutions in return for protection services.79 In other cases, armed groups and their networks used their positions and coercive power to sign major commercial contracts from state institutions.80 As this dynamic has evolved, armed groups and their networks have increasingly learned to fill senior positions in order to guarantee their influence. For example, in 2018 the Nawasi Brigade, which controls the headquarters of the Libyan Investment Authority (LIA), sought to violently force the LIA’s management to recruit and employ candidates from the armed group itself. The LIA’s management refused, and was forced to move out of Tripoli for several months. However, a plan to relocate the LIA’s headquarters was blocked by the Nawasi Brigade.81 The group also has influence within the Ministry of Finance. While armed groups’ infiltration of state institutions has reduced the need for overt violence, their influence continues to undermine the institutions themselves and has contributed to the normalization of embedded violence.82

Powerful interests from outside Tripoli have felt excluded from rent-seeking opportunities as Tripoli-based armed groups have consolidated their physical and institutional control. This consolidation of control has provoked further episodes of competitive violence. In August and September 2018, the Tarhuna-based 7th Brigade sought, with a number of allied groups, to displace Tripoli’s militias within the city. The 7th Brigade, also known as the Kani Brigade, sought to characterize the Tripolitanian armed groups as ‘the Daesh of the public finances’. This political line of attack was an effort to curry favour with the local population. It reflected the well-known predatory revenue-generation methods of the incumbent militias in Tripoli. Following the successful defence of their positions in Tripoli, the Tripolitanian armed groups made public shows of taking a less rapacious approach to rent-seeking, perhaps also reflecting their prioritization of institutional infiltration over direct violence. Overall, events in Tripoli demonstrate how volatile the situation is when a limited number of groups are trying to maximize access to rents, while other groups and communities are locked out of revenue-generation opportunities.

In Yemen, Houthi-linked administrators and businessmen have adopted a similar strategy of institutional infiltration to dominate economic life in Sanaa through coercive means. Apart from a sudden outbreak of fighting in December 2017 – when the Houthis killed their erstwhile ally, former president Ali Abdullah Saleh, and consolidated their control over the capital – Sanaa has not witnessed significant levels of competitive violence. Yet the Houthis and their affiliates have continued to wage a campaign of institutional capture, underwritten by ‘violence rights’ and an implicit threat of force. Either directly or through their role as a so-called mushrif (supervisor), Houthi affiliates control

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79 This works as a quid pro quo between armed actors and political factions, as in the case of the Libyan African Investment Portfolio, where the Misratan ‘Desert Brigade’ controlled the headquarters of the organization in return for salaried positions in 2014.

80 The Libyan Post, Telecommunication and Information Technology Company (LPTIC) – which was reported to hold around $20 billion in assets, including the two dominant cellular networks and $7 billion in cash in Tripoli banks – is a prominent example of such practices. The National Mobile Force, an armed group aligned with the Government of National Salvation (GNS) – an unrecognized entity based in Tripoli following the governance split of 2014 – took over LPTIC’s headquarters. This control allowed the armed group to request payments to entities controlled by the GNS and resulted in $180 million in two payment requests alone. The UN Panel of Experts tracked requests for two payments: the first, for LYD160 million ($114 million), to be made from an LPTIC account into a Ministry of Telecommunications account (bypassing the Ministry of Finance); the second, for $70 million, to be transferred from the account of Al Madar to that of the Ministry of Telecommunications. Spittaels, S., Abou-Khalil, N., Bouhou, K., Kartas, M., McFarland, D. and Servia, P. (2017), Final report of the Panel of Experts on Libya established pursuant to resolution 1973 (2011) (S/2017/466), p. 58, https://www.securitycouncilreport.org/atf/cf/%7B65BFCF9B-6D27-4E9C-8CD3-CF6EAF96FF9%7D/s_2017_466.pdf.

81 Data taken from forthcoming Chatham House analysis.

82 Data taken from forthcoming Chatham House analysis.
the CBY, the Ministry of Finance, the Ministry of Oil and Minerals, Yemen Petroleum Corporation (YPC – the state fuel distributor), and tax and customs authorities. While customs revenues are largely collected from customs points at Hodeida, Dhamar and latterly in Amran governorate, the funds are routed to Sanaa for redistribution. Yemen's main telecommunications firms are all headquartered in Sanaa and mostly controlled by the Houthis. Such a consolidation of power in the capital has enabled the Houthis to integrate the state, the formal economy and the informal economy into a powerful military machine. These tactics have consequently allowed the Houthis and their associates to form a sustainable resource base to fund their military agenda, despite significant international opposition, although the Hadi government has since 2016 attempted to wrest control of the levers of the economy away from Sanaa.

In Iraq, political actors allocate government appointments and exercise control over ministries in order to gain access to state revenues and budgets, representing the prevailing power balance across ethno-sectarian lines. This is one reason why we see less competitive violence in Baghdad. As in Libya, Iraq's reliance on oil revenue reinforces the significance of the centralization of power in the capital. This process, in turn, makes the centre attractive to all armed groups operating throughout the country. The presence of oil serves as a centralizing force in Iraq's rentier economy. As a PMU commander told one of this report's authors, 'the money we make from checkpoints is minimal compared to money from Baghdad'.

Yet the connections between elites, political parties and their armed wings are much clearer in Baghdad than in Tripoli. These actors have divided the wealth among themselves. After 2003, Shia, Kurdish, Sunni and other elites all came together to 'split the national pie' under the so-called muhassasa (quota) system. Every subsequent government formation process in Iraq has involved a negotiation between these groups over government appointments and access to ministries. Ministers have reported to Chatham House that contracts and payment orders are processed by representatives of political blocs connected to political and armed factions, often without the ministers' consent or knowledge.

The balance of power in Baghdad differs from that in Tripoli or Sanaa, as the muhassasa system means that the proceeds from the city's conflict sub-economy are distributed among an array of actors (from different communities) across the country. Rent-seeking opportunities are more horizontally inclusive. Since 2003, Shia, Sunni, Kurd and minority leaders have become enriched, while their citizens remain poor. Less competitive violence is on display in Baghdad, yet this does not mean that violence is absent. In fact, to hold significant power in the capital, each network must have the capacity to employ coercive force. For example, armed groups control different areas in Baghdad, each exerting influence over the property and businesses in their area. Businesspeople are unable to work in the city without organized backing or protection. Armed factions use their presence in the city to control access to the state's institutions and assets. As the rise of the country's protest movement has indicated, privileged access to state resources is a driver of embedded violence. In turn, the failure to tackle this problem makes outbreaks of competitive violence more likely.

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83 Interview with PMU commander in Baghdad, February 2019.
84 Mansour (2017), Iraq After the Fall of ISIS.
85 Confidential interview with Iraqi minister in Baghdad, February 2019.
86 In east Baghdad, armed groups include Sarayat al-Salam, Asaib Ahl al-Haq, the Badr Organization and the federal police. In west Baghdad, the groups include Kataib Hezbollah, Asaib Ahl al-Haq, the Iraqi army and the federal police. In north Baghdad, the groups include Kataib Hezbollah, Badr and the army. In south Baghdad, the groups include Asaib Ahl al-Haq, Kataib Hezbollah, Harakat Hezbollah al-Nujaba and the federal police. Interviews in Baghdad, autumn 2018.
Provision of contracts in return for support for the war effort

Control over government ministries also confers the right to assign public procurement contracts. This is one of the most lucrative ways of rewarding loyalists and maintaining coalitions of armed groups. In Syria, the Assad regime operates a highly centralized system of governance through the capital, Damascus. This system is based on a combination of coercion and embedded violence, exercised through core institutions in the security and military services. Central Damascus has remained firmly in the grip of the regime. Since the outbreak of the conflict, the government has prioritized control of the capital and other major urban centres, while being more willing to cede other areas. As Syria lacks the scale of oil resources of Libya or Iraq, we also see differences in the dynamics of coercion and patronage. Without being able to rely on the revenues of the oil and gas sector, the regime has instead sought extensive foreign support (military support from Russia, and financial and military support from Iran), and cultivated loyalist elites to maintain its war effort, particularly during periods when vast areas of the country have come under the control of rebel forces.

Lacking the revenues required to keep fighting, the Syrian regime has at times subcontracted parts of its war effort to domestic and international allies. This quid pro quo has involved the exchange of privileged access to economic opportunity in return for financial and material support. Contracts and commercial licences have been granted to regime-affiliated figures and businessmen, some of whom fund militias that fight in support of the government. For example, oil supply deals, including import contracts, have been awarded to middlemen such as Baraa Qaterji and Hussam Qaterji, brothers who run a militia in Aleppo. Other examples include the extraction of steel and rubble from destroyed towns and cities. Mohammad Hamsho, a magnate who reportedly received the exclusive right to purchase scrap metal collected from destroyed neighbourhoods, was also blacklisted by the EU for his funding of regime militias. He is believed by many to serve as a proxy for Maher al-Assad, the president’s brother and commander of the Fourth Division of the Syrian Arab Army.

The regime has used similar tactics to requisition land. Perhaps the most emblematic development is the Marota City project, which is being built on land that once consisted of informal housing settlements but has been forcibly expropriated for development. The area had been a hub for the opposition in the early stages of the conflict. The scheme has attracted half a dozen businessmen as investors, each of whom has clear ties to the Assad regime and has contributed resources to its war effort.

In a variety of quid pro quo deals, natural resource contracts have been awarded to firms of foreign allies. Licences to extract minerals, including phosphate and salt, have been granted to Russian companies. In a move that perfectly encapsulates the dynamics of the Syrian conflict economy, the government has further committed to devolv-

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87 The regime’s core institutions are taken to include security agencies (Military Intelligence Directorate, General Security Directorate, Air Force Intelligence Directorate, Political Security Directorate) and military forces (mainly the 4th Armoured Brigade and Republican Guards) that are working independently but managed by Bashar al-Assad. This definition is taken from a forthcoming Chatham House analysis.

88 This modus operandi is similar to that described by Will Reno as ‘warlord politics’. See Reno, W. (1999), Warlord Politics and African States, Boulder: Lynne Rienner Publishers.


91 In January 2019, the European Union put under sanctions the main investors affiliated with the Marota project.
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...ing control and management of certain oil and gas fields to Russian entities. Yevgeny Prigozhin, a prominent Russian oligarch with close ties to President Vladimir Putin, has reportedly been granted the right to collect 25 per cent of revenues from any oil and gas fields 'liberated' by his mercenaries.\(^92\) That said, none or very few fields have so far been appropriated in this way.\(^93\) In April 2019, the port of Tartous was leased for 49 years to a Russian company.\(^94\)

Leveraging the legal authority of the state

Control of the capital city also comes with the ability to make laws and use the legal authorities of the state to legitimize, undermine, fast-track or block particular practices or behaviours. Particularly in Syria and Iraq, armed actors who control the capital can use the legislature to legitimize their actions and patronage decisions through the law. In contrast, in Libya and Yemen – where governance remains split – legal powers are contested.

In Syria, the regime has made full use of its legal authorities to create private militias to support the Syrian Arab Army. From the writing of a new constitution in 2012 to the enactment of laws on real estate and local administration, control of the state bureaucracy via Damascus has enabled the regime to continue to set the rules of the game. In addition to providing privileged access to state assets, legal powers have been used by the state in effect to ‘subcontract’ its war effort in official form. A 2013 law establishing the right of private enterprises to form their own security forces has allowed pro-regime business figures to fund loyalist militias, thus bolstering the forces of the Syrian Arab Army. Prominent examples of the militias formed include the National Defence Forces, supported by the Al-Bustan Charity that was founded by Rami Makhlouf, a cousin of Bashar al-Assad and the owner of a vast businesses empire.

In Iraq, the PMU’s armed groups leveraged their growing military capacity, public profile and political leverage in Baghdad to pressure the Haider al-Abadi government and Iraqi parliament into giving them legal recognition in 2016. This was achieved through allies in parliament. This recognition, in turn, has translated into direct payments to the PMU from the Iraqi state. The PMU emerged in 2014 as an umbrella organization of some 50 paramilitary groups across the country, in response to the rise of ISIS. A key priority for the group was to become financially self-sustaining; as such, its leaders sought to tap into the state’s resources. In October 2016, the Iraqi parliament passed Law Number 40 (2016), which legally recognized the Commission of the PMU. Funding for the PMU was consequently incorporated into the Iraqi state budget, and by the 2019 budget year the group was receiving an equal share of salaries per soldier to that allocated to the Iraqi Ministry of Defence. Despite its official recognition, the PMU remains something of a parallel structure, not fully under the command and control of the state. Like other armed groups and political parties in Iraq, it has access to other forms of revenue outside formal legal parameters, including informal taxation at checkpoints outside the capital. This is illustrative of the multi-pronged approach, discussed later in this report, of combining formal revenue streams from

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92 We have seen similar ‘payment in kind’ dynamics with the hiring of Executive Outcomes by the Sierra Leonean government. See Smillie, I., Gberie, L. and Hazleton, R. (2000), *The Heart of the Matter: Sierra Leone, Diamonds, and Human Security*, Ottawa: Partnership African Canada.


the state (via the capital) with informal revenue streams (via transit areas and borderlands). PMU forces are unlikely to cede their gains to the state despite the military defeat of ISIS. In this sense, PMU groups are both part of the state and in competition with it, perpetuating the presence of extra-state structures.

In Libya and Yemen, the disputed status of the authorities dilutes the potency of legal tools for managing conflict sub-economy dynamics. The governance split between the Tripoli-based Government of National Accord (GNA), headed by the Presidency Council, and the eastern-based House of Representatives (the internationally recognized parliament) means that the route for new legislation, and therefore control over state authorities, is blocked. Legal battles over who has the authority to appoint the leadership of Libya’s institutions, and thus who has the right to control their assets, are ongoing. Particularly notable is the struggle through the international courts for control of the Libyan Investment Authority (LIA), which has assets worth an estimated $67 billion. Legal battles for control of assets have become a major feature of Libya's conflict economy, dovetailing with the trend of institutional capture and infiltration by armed groups. That said, negotiating an accord with whichever armed group physically controls the premises of a given institution can be more important than any legal ruling. During the 2016 legal battle between rival leaderships of the LIA, for example, it was the Nawasi Brigade, rather than the courts, that determined who had access to the building.

Monetary and financial authority

Despite war, and despite efforts to capture, control and destroy the states around them, financial hubs have been resilient, even where political actors have sought to relocate financial institutions. In each of the case studies, the capital city is the predominant node for monetary and financial policy, for transactions involving the private banking sector, and for interactions with the international financial system.

Financial sanctions and a lack of international recognition can significantly impede access to global markets, but even where this has been the case, the four capital cities have retained their financial authority. Centres of financial authority have been remarkably ‘sticky’. This is to say that it is difficult to dismantle or replicate the technical capacity, infrastructure, commercial support systems and human resource networks that are required to sustain a financial centre. It is also a sector that has historically been, by necessity, more rules-based and technocratic. These features have given the state’s financial institutions, and their supporting networks, more room to adapt to the conflict economy.

Iraq’s financial and economic institutions, headquartered in Baghdad, have served as financial conduits for armed actors who are not accountable to the state. For example, armed groups linked to various political elites rely on the state retail bank Rafidain and the Trade Bank of Iraq (TBI) to transfer money around the country and abroad.

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95 In February 2019, a remarkable court dispute between leadership rivals of the Libyan Investment Authority (LIA) was played out in a London courtroom, as the GNA-appointed chair of the LIA’s board of directors, Ali Mahmoud Hassan, continued to defend a case filed by the ousted chair, Abdulmajid Breish, who contends that the Presidency Council’s decision to appoint Mahmoud has no standing. The dispute between the two men has been ongoing since 2016. Both Breish and Mahmoud were then arrested shortly after the LIA’s decision to remove an asset management company suspected of corrupt practices was upheld by a court in the Cayman Islands. These arrests meant that neither Breish nor Mahmoud would be present for the case under way in London. Amid a bizarre scene, international legal firms representing the two men argued their cases while the two parties were allegedly imprisoned in Tripoli.


97 The TBI was established by JPMorgan to help facilitate exports and imports but has since become influenced by the major political parties. Interviews with analysts in Baghdad, autumn 2018.
Foreign states have also used these same vehicles to fund armed groups working against the interests of the state. Such arrangements incentivize armed actors to establish their own independent channels to receive money directly from external actors, which creates an accountability relationship between an armed group and a foreign power. From the funding of Sunni awakening (sahwat) groups by Turkey, the US and the Gulf states in 2008–10 to Iran's financial sponsorship of PMU groups, the transactions underwriting the operations of many of Iraq's key non-state armed actors have been conducted through Baghdad-based financial institutions.

At the same time, ‘leaks’ in the financial and monetary systems have provided opportunities for other armed actors competing with the state. Between 2014 and 2015, for example, ISIS infiltrated the central bank's currency auctions in order to launder money, relying on middlemen who worked inside the bank. According to an Iraqi banking source, in 2015 ISIS was earning a minimum of $25 million per month in these auctions.98

Control over a central bank is a powerful lever in any economy. But it is especially powerful in a conflict economy, where access even to sprinklings of financial or monetary information can be monetized without many of the normal restrictions that would be in place during peacetime. In Syria, the regime’s control over the Central Bank of Syria (CBS) is a powerful asset in the conflict economy. Many of the central bank’s operations generate significant profits for well-connected speculators, particularly in the foreign exchange market. A system of multiple exchange rates, including various official rates, enables individuals close to CBS or other regime officials to speculate, buying US dollars at the discounted official rate to resell them in the black market. Another tool of influence is the provision of asymmetric information to financial traders. One example was an unofficial CBS decision at the end of May 2016 to reduce the supply of Syrian pound liquidity in the market. This sudden decision led to a shortage of cash in the market and a temporary jump in the value of the pound.99 Days later, the CBS resumed cash supplies and the pound depreciated again. Between the end of April and the end of May, the black-market value of the US dollar fell by 25 per cent, before rising 20 per cent again in June.100 Analysts in Damascus believe the decision of the CBS was coordinated with several regime insiders, business partners and corrupt actors, helping these parties reap significant benefits.101

Economic sanctions have not decisively affected Damascus’s role as the hub for money transactions within the country and with the outside world. While Western sanctions do not formally ban financial transactions with all Syrian entities, in practice the country’s banking sector has become largely isolated from international markets as a result of sanctions. Sanctions have increased the cost of financial transactions and have made the processes involved more cumbersome. Even transactions with allies such as Russia and Iran have become more difficult. In early 2019, both countries were still struggling

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to get around the constraints on their financial transactions with Syria. Yet rules and regulations are still issued by the CBS, and the reduced flow of international bank transactions still needs to go through the Syrian capital. That said, Damascus has lost a substantial part of its financial role to Beirut, which a large number of traders now use to process payments via third parties.

In Libya and Yemen, rival actors have sought to relocate the state's resources to temporary capitals as a result of conflict. In Libya, this move has been opposed by the international community. As a result, the Central Bank of Libya (CBL), based in Tripoli, has largely retained its autonomy. International support for the CBL as an entity has, broadly speaking, prevented a rival leadership in the east from engaging with the international financial system, and has kept the east largely dependent on the redistribution of state revenues from the CBL. Eastern-based authorities have succeeded in purchasing banknotes and coinage from Russia to address liquidity issues, but they are unable to access SWIFT codes required to conduct international financial transfers. Their rivals in Tripoli have largely consolidated control over the assets of state institutions.

In Yemen, the Saudi-led coalition supported the Hadi government's relocation of the headquarters of the Central Bank of Yemen (CBY) from Sanaa to Aden while Western partners such as the US and UK opposed it. The move went ahead, resulting in the loss of SWIFT authorization for international financial transfers until early 2018. The Hadi government has since attempted to incentivize and pressure merchants and banks into working with the CBY branch in Aden, and has been bolstered in these attempts by the provision of a Saudi credit facility of $2 billion. In September 2018, the Hadi government introduced a new decree aimed at forcing importers to work with CBY Aden, while excluding Houthi-affiliated merchants who have emerged since the start of the war. While the Hadi government has achieved a degree of success in taking control of the economy, Sanaa has remained the de facto administrative, financial and commercial centre of gravity in the economy throughout the conflict. Most of Yemen's most important formal, semi-formal and informal financial institutions, fuel importers, food importers and revenue-gathering state institutions continue to be based in the city, although this could change.

Houthi networks in northern Yemen use a combination of formal banking channels and the hawala system to facilitate the continuation of financial and trade flows. Unlike in Syria, where the regime is able to circumvent international sanctions by operating via brokers who have not been subject to sanctions, the Houthis' system is centred around a state-run commercial bank (which has become popularly known as the 'Houthi central bank') and the hawala money exchange system, which critically does not require any actual transfer of funds (not even electronically). The Hadi government has attempted to revoke the bank's SWIFT access, but reportedly worked out a deal with the bank's management not to cut it off entirely. While international recognition and access to multilateral organizations remain important, the Houthis have also illustrated that control of the capital city in a conflict economy can offset the constraints in place.

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102 Western sanctions impact Russia and Iran in their financial transactions with Syria, both directly in the sense that there are Western sanctions on them and indirectly in the sense that sanctions on Syria also make it difficult for their banks to do business with Syria.

103 Syria's banking sector had been subject to sanctions as a result of fluctuating political tensions between Western countries and the Assad regime since the 1970s. Beirut has long been the intermediary for the Syrian banking sector and the international banking system.
Box 2: The dynamics of closed currencies – Libya and Yemen

The Libyan dinar and the Yemeni riyal cannot be traded outside their respective countries. Access to foreign currency therefore requires direct access to foreign markets. Where such access is limited, this creates opportunities for arbitrage reflecting differences between the formal price of foreign currency in local-currency terms and its value on the black market.

Import/export fraud in Libya
At the beginning of 2014, the black-market dinar/US dollar exchange rate in Libya was nearly equivalent to the official exchange rate. Yet a confluence of factors – including the impact of a major oil blockade in the east, a governance split between the east and west of the country, and a lull in global oil price movements – prompted the Central Bank of Libya (CBL) to implement a series of austerity measures. Policies to reduce corruption were also introduced.

Figure 6: Letter of credit fraud in Libya

1. Local company (often with close connections to armed groups) applies for letter of credit (LC) and places capital in LYD.
2. Local bank processes LC application. Armed groups may force through applications, or bank employees may be complicit.
3. Application passed and funds transferred in foreign currency to overseas company (which may simply be a front) for goods import.
4. Paperwork for goods shipment falsified. Some dollars re-routed to banks in other jurisdictions (see 8).
5. Due to fraud, fewer goods or sometimes no goods at all are actually imported.
6. Imported goods supplied to Libyan market. Retail price likely to reflect strength of dollar on black market.
7. Money effectively offshored in bank accounts and may be invested in overseas jurisdictions.
8. Dollars may be transferred back into Libya to sell in black market at significant profit, or be exchanged for LYD to repeat the process again.

Within Libya

Overseas
Put together, these measures had the effect of limiting access to foreign exchange, thereby creating a significant spread between the official and unofficial exchange rates. While the official rate held steady at around LYD1.4:US$1, at times the unofficial rate reached LYD10:US$1. This difference in exchange rates created a significant opportunity for anyone able to access foreign currency at the official rate and sell at the black-market rate. Given that Libya is heavily import-dependent, documentary letters of credit supplied for the import of goods became a major source of profit for actors ranging from businessmen to armed groups. The introduction of a fee upon access to foreign exchange in September 2018 has, however, lessened the arbitrage opportunity as the black-market rate for the dinar has fallen. Tripoli’s armed groups have developed significant business interests, setting up companies specifically to obtain letters of credit and divert the money from them. A number of armed groups also offer facilitation services: effectively a tax upon business in return for a guarantee that the letter of credit sought will be obtained.

Import fraud increased after 2013, in particular, when armed groups found it harder to access funding from the ministries of interior and defence. As of end-2016, militias from the Tripoli district of Tajoura were reported to have accessed $1 billion in misused letters of credit via 10 front companies. Haithem al-Tajouri, commander of the Presidency Council-affiliated First Central Security Division, has come under particular scrutiny over the affair. His division is in charge of providing security for diplomatic representations established in or visiting Tripoli. Tajouri also heads the Tripoli Revolutionaries Brigade (TRB), a non-state armed group formed during the civil war. After being cited by the UN Panel of Experts for allegedly extorting more than $20 million in letters of credit from CBL employees in 2015, Tajouri appeared to have refined his methods by using front companies. The UN Panel of Experts later reported that two banks had issued dozens of letters of credit to companies owned by an individual thought to have developed business links with Tajouri.

Tajouri’s control of security at the port of Tripoli provides a means of securing imports and navigating official customs checks. The scale of the profits from such activities has raised tensions not only with other armed groups that lack similar access to finance, but also with a local population that feels the effects of the inflation and goods shortages associated with this diversion of resources.

Contested access to foreign exchange in Yemen

Houthi merchants have been able to create a fuel oligopoly by coordinating with the de facto authorities to restrict rivals’ access to supplies of foreign currency required to import fuel. The income generated from these activities helps, at least in part, to fund the Houthi war effort. With access to much-needed foreign currency closely controlled by a Houthi-led council based in Sanaa, and merchants in the north actively discouraged from using credit facilities in Aden, some businesses have struggled to access foreign exchange. A number of merchants who have crossed the increasingly powerful Houthi traders have found their vessels held at the Hodeida port for days or even weeks, incurring costly fees. They have also had their cargoes inspected more rigorously and overtaxed, and have struggled to convert Yemeni riyals into US dollars – with funds often frozen for weeks or months before being released or converted. This has caused significant financial losses as a result of periods of (at times) rapid currency depreciation.

105 Ibid.
106 Data from forthcoming Chatham House analysis on Libyan armed groups. Interviews conducted in February 2019 with Tripoli residents.
Access to international organizations

The concentration of state and financial institutions in capital cities provides unrivalled access to the international financial system, as well as to aid received via multilateral organizations such as the UN. Closely linked to this is the fact that international recognition shapes the conflict economy of capital cities by determining different actors’ access to external forums. In particular, the ability to negotiate the conditions upon which multilateral organizations can and cannot access Syria has provided the regime significant control over aid distribution since 2014. In Yemen, control over the financial sector and local security has enabled Houthi networks to influence aid distribution.

In Syria, the conundrum for donors is that aid capture is instrumentalized by the Assad regime as a means of countering its economic failure, while for the local population it is an important contributor to the coping economy. This allows the government to subcontract some elements of public spending. Despite international opprobrium, the regime’s control of Damascus still provides it with de jure international recognition and a seat in global institutions, including most importantly at the UN. As a consequence, all UN agencies and many international NGOs are based in Damascus, and operate under the rules set by the central government. While cross-border aid provided to northern Syria continues to bypass Damascus, an increasing amount is distributed via the capital as government forces recover more territory. Funds routed through Damascus are likely to amount to more than $1 billion per annum, which is roughly equivalent to around 20 per cent of actual government expenditure.107 This makes foreign aid an important contributor to the Syrian economy.

The de jure status of the Syrian government in Damascus enables the Assad regime to determine which groups and communities receive aid. This allows the government to selectively reward loyalist networks and communities. To receive funds, aid recipients must be registered with the government. Registration is used as an instrument of patronage, and also as a means of generating funds for groups aligned with the regime. These groups, as well as various regime-aligned figures, often use NGOs registered in the names of relatives to win contracts. In other cases, the parties involved benefit indirectly from financial inflows by operating as subcontractors on aid-funded projects. Income from such projects will then partly be used to pay salaries to subordinates and/or affiliates, or to finance other expenses, including in support of the war effort.108

These practices place the UN and international donors in a difficult position. Funds earmarked for aid are clearly buttressing the positions of prominent government-allied actors in the conflict economy. Yet bypassing the government to distribute aid is extremely difficult, if not impossible. Thus far in Syria, international donors have not succeeded in applying conditionality to humanitarian aid to prevent the regime from using it as an income stream.

In Yemen, the use of formal financial networks for aid operations will benefit entrenched elites. The use of informal networks will benefit shadow elites. To pay local staff and procure goods in northern Yemen – where the headquarters of most humanitarian organizations in the country are located – Western donors must either use informal

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107 According to the Financial Tracking Service, $2.2 billion of aid was distributed in Syria in 2018. This calculation assumes that approximately half of those funds were routed through Damascus. The calculation for government expenditure is based upon a percentage of the official size of the government’s budget ($9 billion), because actual spending has been lower than the budgeted amount. In 2013 (the last year for which actual figures are available), the Syrian government’s expenditure amounted to 62 per cent of its official budget. If 62 per cent of the official budget was spent in 2018, this would be equivalent to $5.8 billion, making the $1.2 billion in aid equivalent to 21 per cent of the actual spend.

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financial systems closely connected to Houthi networks, or go through formal financial systems which are vulnerable to Houthi extortion. As donors cannot access Yemeni riyals outside the country, they are forced to do business with local financial operators. When informal transfers are required, donors must go through banks or money exchange businesses that are largely based in Sanaa and have purportedly strong Houthi links. Further, these businesses are overseen by several different economic councils controlled by the Houthis. It is likely that some of the proceeds from such informal transfers bleed into payment of Houthi fighters.

When using the banking system, aid agencies must work with banks that have branches or correspondent accounts outside the country. These banks have been able to command preferential exchange rates from international organizations, and charge sizeable fees. The Sanaa Center for Strategic Studies, a policy research institute, estimates that in 2017 this system netted a single bank $80 million in profit in an eight-month period.109 Such profits have made the banks a target for extortion by the Houthis, who have forced them to provide international financial services and cheap hard currency. In both Syria and Yemen, the developments outlined above illustrate that funds allocated – typically via capitals – for support to the coping economy cannot be protected entirely from entering the conflict economy.

Transit areas and borderlands

In all four countries, to differing extents, internal territorial divisions caused by conflict have given rise to market distortions and the emergence of distinct economic units (sub-economies). Transit areas110 sit on the fault lines of these divisions, and have become significant sources of both taxation (i.e. on the movement of goods) and arbitrage (i.e. where actors profit from differences in the prices and availability of goods). As a result, transit areas111 along key trade routes have become prized assets for armed groups and other conflict economy participants.

In most cases, economic activity within transit areas falls outside the control of the state. In some cases, state actors cooperate with armed groups in return for a cut of the profits from transit points, rather than reporting such activities up through their command structure. Similar arbitrage and taxation opportunities are perceptible in ‘borderlands’ – defined here as areas situated on international borders – with the principal difference being that the state actors and economic systems engaged are on the other side of that international border. The relative absence of the state in borderlands lowers the barriers to entry for armed actors.

In the four countries, transit areas and borderlands are major sites of competitive violence. Although these conflicts are at times interpreted as ethno-sectarian or tribal in nature, at their core they represent actors competing for rents. This can create undesirable incentives for the perpetuation of territorial divisions, with a detrimental impact both on local populations and on state-building more broadly.

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110 For the purposes of this study, a transit area is defined as a physical area where fees (informal taxes) are levied (i.e. at checkpoints). The checkpoints within transit areas may also provide a security function and connect two markets.

111 It is worth noting that airports and ports may also be considered transit areas by our definition. Indeed, ports and airports are important nodes within the conflict economies in question, but we have chosen to omit them to maintain a manageable scope of analysis.
‘Taxing’ the movement of goods within transit areas and borderlands

‘Taxation’ – in a broad sense of the term, often implying unofficial or illegal levies – is a major source of income for armed groups in the conflict sub-economies of Iraq, Libya, Syria and Yemen. It is particularly important for those groups with limited access to funding from the state and/or external patrons. Many of these transit areas are situated along historical trading routes that have always been sources of wealth, and are thus focal points for competition and violence. For national actors, subcontracting the control of transit areas and borderlands to local groups can be a useful strategy. It reduces labour costs, and gives local political or military partners a self-sustaining means of generating revenue. Competition for control of key transit areas, and the taxation opportunities associated with them, is a notable aspect of each of the conflict economies studied here. In addition, armed groups have established checkpoints within their own areas of control to further increase revenues.

One consequence of this pattern of activity is that acquisition of territory has assumed particular economic importance. Insurgent or underground groups, for instance, cannot reap the benefits available to groups that can expand their territorial reach into transit areas. Armed groups are thus incentivized to move away from the ‘underground’ model of resistance and to focus on territorial gains. Sometimes groups will justify income from transit areas as charges for the provision of security, or as a means of addressing funding shortfalls. In Iraq, for example, PMU armed groups have taken over or set up checkpoints in the north of the country ostensibly to raise funds and outsource labour costs (as fighters directly receive money at these checkpoints), despite the fact that PMU forces also receive salaries from the Iraqi state; this further builds PMU patronage networks.

Taxation within transit areas

Transit areas have been sites of significant armed clashes – not only because they determine the front lines of territorial control for each side, but also because they are major sites of taxation. In Syria, owing to the emergence of hard territorial divisions, taxation at transit areas has been a dominant form of revenue generation. The key transit areas are borders between territory under the control of the Assad regime and that controlled by rebel factions. Morek, a town northwest of Hama and south of Idlib, is illustrative of such dynamics. It lies on the Aleppo–Damascus motorway and serves as a crossing between regime-held areas and the rebel-held Idlib area. As a result of Morek’s strategic importance, armed groups controlling the town and the roads leading to it are able to generate substantial revenues, which in turn encourages regular competitive violence.112 For example, the expansion of the armed group Hayat Tahrir al-Sham (HTS) in the Idlib area in early 2019, while mainly motivated by a desire to pre-empt Turkish intervention, also had an economic imperative – one dimension of which was to secure control of the main road axis and intersections between rebel-held and regime-held checkpoints. Checkpoint fees are among the main sources of revenues for HTS. Open-source data indicate that HTS levied between $400 and $1,500 per truck transporting Turkish goods into regime-held areas, with the group’s revenues from taxa-
tion at the Morek crossing estimated by some at up to $1.5 million per month. On the regime side of the transit area, various security agencies, local militias and units of the Syrian army levy transport fees at checkpoints on the route from Hama to Morek. One such fee is called tarfiq, Arabic for ‘accompanying’, because regime militias are supposed to accompany trucks and provide protection until the next checkpoint is reached. The tarfiq, like other fees levied by militias, increases the cost of transport and the end price of the products sold.

In Iraq, despite the absence of formal conflict, the battle among armed factions for control of informal taxation continues. The Iraqi town of Tuz Khurmatu has suffered major violence in recent years. Often, this conflict has been described in ethno-sectarian terms – Shia fighting against Sunnis and Kurds. However, the strategic location of the town at the intersection of trading routes to Iran, Syria and Turkey, and its position as a waypoint for oil and gas flows from nearby Kirkuk, reveals an alternative explanation. When PMU groups, Peshmerga and Shia Turkmen affiliates captured the area from ISIS in 2017, they focused on implementing a checkpoint regime along the main highway from Tuz Khurmatu to Baghdad. The revenues from these checkpoints are critical for armed groups – from the PMU to the Peshmerga – that cannot always afford to pay their fighters but still want to maintain a base and legitimacy in the area. Forces linked directly to the federal government, including local and federal police (the 7th Emergency Force) and the army (the Tigris Operations Command), are either absent from the area or unable to mitigate the competitive violence between armed groups.

In Libya's southern region of Fezzan, a lack of access to state resources has meant that informal taxes levied at roadside checkpoints – along with protection fees – constitute the principal source of income for armed groups. Competitive violence is ongoing for control of trading routes and taxation opportunities. Under Gaddafi, certain groups were preferred over others as part of a system of divide and rule. The subsequent collapse of the regime’s monopoly on force resulted in the eruption of armed competition in the south of the country. In part, at least, this violence reflected local actors’ efforts to seek control of smuggling routes. The collapse of state services in the south has only

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113 People, fuel, agricultural commodities and other products transit through Morek both from Idlib to regime areas and vice versa. From Idlib, mostly agricultural products such as olive oil and pistachios are exported. Going the other way, from the regime areas to Idlib, the main commodities exported are fuel, wheat, sugar and manufactured products. Antiquities, which eventually find their way to international markets through Turkey, are also traded. Shifts on the ground in Morek have significant implications for market dynamics: the regular closure of the crossing leads to hikes in the prices of products imported into Idlib and more revenues for smugglers, and affects the Syrian pound/US dollar exchange rate. Meanwhile, prices for agricultural products that cannot be exported because of the closures – such as olive oil and pistachios – fall because the stocks available in the local (Idlib) market increase. In this way, the opening and closing of the Morek crossing also serves to regulate, and/or fuel speculation on, the prices of commodities. The values of the fees are taken from AFP (2018), ‘Making a killing: Syrian foes profit from trade across front lines’, *Daily Mail*, 31 July 2018, https://www.dailymail.co.uk/wires/afp/article-6009427/Making-killing-Syrian-foes-profit-trade-lines.html (accessed 6 Jun. 2019). The estimate for the monthly revenues for the crossing are taken from Khalifa, H. (2018), ‘The Morek Crossing: An Important Point of Commercial Exchange Between Tahrir al-Sham and Regime Forces’ (Arabic), *al-Hal*, 8 September 2019, https://bit.ly/2Wz8c0w (accessed 6 Jun. 2019).

114 In November 2015, clashes between the Kurdish Peshmerga and Shia PMU killed 11 and wounded over 20 residents. The town was also briefly taken over by ISIS in June 2014. By October 2014, a coalition of forces including PMU groups and the Peshmerga, aided by coalition and Iraqi air support, recaptured the town.


116 In this area, regions such as Khanaqin, Kifri and Tuz Khurmatu are important for the smuggling trade. More specifically, the districts of Tuz Khurmatu – Sulaiman Bee, Amerli, Matful, Injana, Hosseiniya – connect to Highway 2, which leads to Baghdad.

117 These include the Badr Organization, Sarayat al-Salam, Kataib Hezbollah, Kataib Khorasan and the Imam Ali Combat Division.

118 Unpublished Chatham House analysis based on interviews in southern Libya conducted in December 2018 and January 2019.
reinforced the importance of the informal economy. The problem has been com-
ounded by the fact that many ethnic and tribal groups have limited access to state
resources, and in particular to state salaries.\footnote{Ibid.}

Map 2: Human smuggling/trafficking, weapons and smuggled fuel flows via Sebha

The informal taxation practiced by groups in the Fezzan region appears to have
increased the prices and reduced the availability of goods in the local market.

Armed groups have monetized their control of transit areas in Yemen by taxing trade.
This trade takes place even where goods that pass through an area controlled by a par-
ticular armed group may strengthen the position of its enemies. Merchants who depend
on smuggling have ensured that transit routes remain open despite changes in military
control of these areas. A clear example is the town of Bayhan in northwestern Shabwa gov-

Sources: Chatham House and Global Initiative Against Transnational Organized Crime.
ernorate. Nominally controlled by military units loyal to the Hadi government, it sits at the intersection of territories respectively held by Islah-affiliated militias and military units, UAE-backed security forces and the Houthis. Despite Bayhan’s apparent insignificance as an urban centre, the area is known as a transit point for arms and other smuggled goods entering the country from the southern coast and elsewhere. Chatham House interviews indicate that the Shabwa smuggling networks play a crucial role in the continued flow of arms, people, drugs and fuel into the north. This is borne out by repeated attempts by the Yemeni government and UAE-backed forces to close down smuggling networks in Shabwa. By maintaining a presence in Bayhan, the erstwhile Houthi–Saleh alliance sustained access to the kondo mountain roads and southern coast. In 2017, the Hadi government initiated attempts to assert its authority in the governorate, including by sending forces from Mareb to Bayhan to fight the Houthis.

The 26 September Brigade, which controls Bayhan, is nominally aligned with the Hadi government. It has allegedly prioritized generating rents over curtailing a key Houthi trading route. The Houthis lost most of their territory in the Bayhan district following Saleh’s death in 2017. Logically, this should have impaired their trading links to Sanaa (which would have been a major setback). Yet within months of the 26 September Brigade’s capture of the territory, supply routes to the north appeared to have reopened. Indeed, the local arms market in Bayhan is now thriving. It is so well supplied that prices are lower there than in other areas of the country, according to two local sources. Thus Bayhan continues to operate as a transit area on a key Houthi trading route, despite the 26 September Brigade’s ostensible support of the government. Moreover, smugglers in southern Shabwa and along the mountain routes were well known to the de facto commander of Yemeni armed forces in Mareb, Ali Mohsen al-Ahmar, as well as to others, even before the change of control in Bayhan. They were thus well positioned to cut deals with all parties early on. In short, although the collectors of tax may change, it is likely that trade will continue regardless of who controls Bayhan.

**Taxation in borderlands**

The flow of goods through borderlands depends on the nature of each border and its infrastructure: it is more difficult to enforce border regimes on porous borders – and therefore collect taxes – than on non-porous ones. Borderlands are distinct from transit areas in that they involve direct interaction with the forces of external states. At tightly controlled crossings, this makes the barriers to entry much higher for armed actors in terms of controlling and taxing the movement of goods; the opportunities at more porous border crossings, which are difficult to police, are more readily exploited.

In Iraq, Libya, Syria and Yemen, the weakening of the central state has enabled local forces to control the flow of goods across international borders. For example, the Amazigh city of Zuwarah, situated close to Libya’s western border with Tunisia, was long marginalized by the Gaddafi regime. Yet in recent years the city’s forces have developed a high degree of control over the flow of goods through the principal formal border crossing at Ras Jdir. While state customs officials are present at this border post, interviews with smugglers have indicated that the forces of Zuwarah have the real leverage to determine what does and does not cross the border. In northern Syria, meanwhile, control of border crossings with Turkey has become a significant source of revenue for armed groups (see Box 3).

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121 Interviews with multiple sources in person in Yemen, Cairo and elsewhere and via messaging app over the course of 2018.
122 Interview with smugglers in Ben Guerdane, Tunisia, February 2019.
Box 3: External actors and the shaping of borderland conflict economies

The extent of the interaction between the occupants of borderlands and external state actors depends on the nature of the area. Some borders – as in western Iraq, Libya, eastern Syria and Yemen – are relatively porous. Others – such as in northern and southern Syria – are much more tightly controlled.

‘Turkish-ization’ of the Euphrates Shield Area

In Syria, Turkey exerts significant control over a territory known as the ‘Euphrates Shield Area’ (ESA). The ESA covers all the land north of Aleppo that was gained by Turkish-backed rebels in an offensive against ISIS and the forces of the Kurdish Democratic Union Party (PYD) between late 2016 and early 2017.

Economic and political developments on the Turkish side of the border have a meaningful impact in the ESA because of the overwhelming importance of Turkish influence, investment and expenditure there. For instance, the depreciation of the Turkish lira relative to the US dollar in the first half of 2018 effectively decreased the earnings of thousands of employees of local administrations and armed groups, as they received salaries in lira from Turkish state institutions. The war has also reoriented the ESA economy towards the Turkish market. The road network, for instance, is now being rebuilt to link towns in the region to Turkey. One example is a new motorway under construction between the al-Bab industrial zone and the al-Rai border crossing.

The financial sector of the ESA is also wholly integrated with the Turkish financial system. While there are no bank branches in the area, the Turkish Post Office has opened several branches. Turkish state-owned commercial banks have also opened ATMs and counters offering financial services. The hawala system is particularly developed in this border area, and is used for money transfers in all types of business transactions.

External intervention in Yemen to sever illicit trade routes

In Yemen, concentrated conflict around the western ports has increased the importance of the country’s eastern borderlands. Al-Mahra, Yemen’s easternmost governorate, has historically been the most politically and economically marginalized. Since 2015, however, the governorate has become a key transit point for goods being smuggled in and out of conflict-afflicted parts of Yemen, most importantly the Houthi-held northwest, as other routes in south and central Yemen have become less accessible.

As a result, since 2016 an increasingly fraught struggle for control of border posts and ports has emerged involving the governments of Yemen, Saudi Arabia, the UAE and Oman, as well as al-Mahra’s diverse tribes. In order to address the perceived threat posed by flows of money and goods from the governorate, the Saudi military has occupied the Nishtoun port and al-Ghayda airport – key strategic positions. This is despite resistance from a broad spectrum of tribal leaders.

Since 2016 the Saudis have closed off the southern coastal road between Oman and Yemen, and have prevented delivery of Omani fuel to depots in the al-Mahra governorate that were crucial to the movement of tribesmen. They have also prevented Omani aid from entering al-Mahra and other governorates. The power struggle has significantly reduced both licit and illicit trade in al-Mahra. This has further frustrated tribal groups, some of which have become increasingly vocal in their threats to rise up against the Saudi forces stationed in the governorate.123

123 Interviews with Mahri tribal figures, observers via telephone and messaging app, November–December 2018.
Arbitrage opportunities

Profits from arbitrage are generated at the point of sale by traders who are able to access markets on either side of transit areas and borderlands. Traders sometimes leverage their relationships with competing actors to negotiate market access, an activity which is not ostensibly violent in itself, but which supports the maintenance of the status quo. Physical control of transit points and borderlands by armed actors provides further opportunities for armed groups to tax the movement of goods. While taxation is a fee levied on the movement of the goods, arbitrage is a source of revenue generated from the sale of similar goods based on price differences. Market conditions typically vary on either side of transit areas (an internal border dividing two zones of territorial control) and borderlands (the area around an international border). With the exception of formal customs systems on international borders, the arbitrage opportunities available in a border area are often of the same nature as those in a transit area. A key dynamic to note (as also explored in the discussion of supply chains in oil-rich areas) is how conflict entrepreneurs profit from the trade of goods across front lines. This is particularly notable when warring armed groups on either side of a transit point cannot deal directly with the other side.

The increased trade friction at transit areas and external borders, while a significant source of revenue for armed actors, distorts markets. Goods available or produced in one area may not be available in another. They may become significantly more expensive as a result of fees on the movement of goods. As noted, entrenched front lines and the emergence of conflict-related governance structures can create new territorial divisions that strongly influence the development of conflict sub-economy dynamics.

Arbitrage across internal ‘borders’

Clear territorial and market divisions have thus far emerged only in Syria, although trade has been disrupted to differing degrees within and across Iraq, Libya and Yemen. In Iraq and Yemen, rivalry over local governance has created internal territorial divisions, although the fact that formal and informal trading routes have remained functional has diminished the impact of these divisions. Under its ‘caliphate’, ISIS increased the fees at certain checkpoints; in doing so, it affected the supply of goods on both sides of each checkpoint. In Yemen, shifts in the dynamics of the conflict on the Red Sea coast have impeded goods flows, in turn increasing taxation opportunities along sea and overland trading routes in the east of the country. In Libya, the intensity of the conflict has been considerably lower and territorial divisions are more blurred. Nonetheless, increasing informal taxation and insecurity in the south have detrimentally affected markets in that region. Current fighting around Tripoli has the potential to exacerbate these issues, particularly if goods entering Libya via Misrata are prevented from reaching the eastern and southern markets.

Territorial divisions in Syria have been more dynamic and openly violent than in the other three countries. Over the course of the civil war, entrenched but dynamic front lines have led to the effective ‘cantonization’ of the country, with areas controlled by the Syrian regime physically separated from those controlled by rebel groups. A range of rebel forces have established themselves as governance actors: they include opposition groups (some aligned with the Syrian National Coalition), the Syrian Kurdish-dominated administration of Rojava in the northeast, and proscribed Salafi-jihadi actors such as ISIS and HTS. Yet with the expansion of regime control to larger parts of the country, in particular...
the Damascus suburb of Eastern Ghouta, Daraa and a pocket north of Homs, territorial divisions have had a lesser impact on the conflict economy. As a result, in 2017 and 2018 countrywide inflation fell to single-digit levels as markets became more integrated again. While it has been possible throughout the war for goods to move through Syria, hard territorial divisions have transformed market dynamics – this has been manifest in the erection of trade barriers and shifts in supply and demand. The barriers between territories have created price differentials, shortages of certain foodstuffs and much suffering for local populations, as well as opportunities for profit. For example, the so-called ‘siege’ economy in Eastern Ghouta124 had dire consequences for the local civilian population. However, both for the regime and for the rebel Jaysh al-Islam forces that controlled access to Eastern Ghouta, the siege became a major taxation opportunity. Traders who leveraged contacts to buy goods in Damascus and sell them in Eastern Ghouta (after paying the armed groups to allow the goods through) were able to reap massive profits: at one point a kilogramme of sugar could be sold in Eastern Ghouta for 24 times its purchase price in Damascus.125

Arbitrage across international borders

Unlike transit areas, borderlands connect two formally distinct and separately regulated markets. Borderlands also offer the opportunity for different actors to profit from price differentials. As Box 3 indicates, external states have the power to control flows within more tightly regulated crossings.

The porous Syrian–Iraqi border, connecting two conflict economies, has been the location of a major trading post for Salafi-jihadi forces. One of these trading posts, al-Qaim, came to be known as the last bastion of ISIS forces in Iraq. The town has a history as a base for Salafi-jihadi groups. It was first held by Al-Qaeda in Iraq. Later, ISIS militarily controlled al-Qaim for several years, and in doing so was able to control historic smuggling routes. The al-Qaim border crossing served as a focal point for the smuggling of weapons, fighters and goods. Traders operating in the area benefited – and continue to benefit, post-ISIS – from the arbitrage opportunities between the Syrian and Iraqi markets. While there has been an understandable focus on weapons and fighters transiting the area, local traders have also smuggled licit goods such as sheep into Syria, where sellers could find better prices. Al-Qaim also remains an important point in the cross-border oil and gas trade. Smugglers often bring crude oil and sell it either to a refinery or to the al-Qaim oil market, one of the largest in the region. Buyers and sellers are taxed the equivalent of around US 30 cents per barrel of crude in this market. Given the flow of refugees across the border, the town has also become an important transit point for humanitarian aid in the form of food, water and medical supplies. At times, these supplies have been appropriated by militants and sold in local markets.

For a time, al-Qaim was an economic lifeline for ISIS. This helps explain its strategic importance to ISIS commanders. Following ISIS’s territorial defeat in 2017, armed groups loyal to political parties and paramilitary groups (but not to the state) were the first to fill the local security vacuum, establishing a presence ahead of the Iraqi security forces, which remain relatively weak. As a consequence, al-Qaim has become a contested area in which armed groups seek to profit from the departure of ISIS by estab-

lishing a foothold in cross-border trade – a trade which, incidentally, has never ceased to exist despite various armed groups coming and going. Sunni tribes, the PMU and criminal gangs are among the rival forces that have taken over different parts of the city's informal and black markets and smuggling routes.

Oil-rich areas

Contrary to what Western policymakers may assume, physical control of the oil-producing regions of Iraq, Libya, Syria and Yemen does not automatically confer a commensurate ability to capture revenues from oil sales. This is because there are significant barriers to entering the oil sector. Oil trade involves a complex supply chain that requires infrastructure, expertise and market access if it is to be monetized effectively.

The complexity of the oil supply chain means that armed actors seeking to wrest control of oil-producing areas must cooperate with local actors who have the expertise to operate the associated systems and facilities. As ISIS forces found in Syria, cooperation was required not only with engineers who operated the oil rigs, but also with entities that controlled those parts of the supply chain to which ISIS lacked access, namely refining capacity and tanker fleets. This broad situation – now minus the presence of ISIS forces – persists, providing continued opportunities for middlemen able to deal with armed actors on all sides.

In contrast, where an actor controls all aspects of the supply chain – as in the Yemeni governorate of Mareb – the dynamics of the oil market are determined by refining capacity. In Libya, the international community has prevented sales of crude oil from unrecognized authorities in the east of the country. This has obliged those in control of oil reserves in that region to accept the routing of crude sales via their opponents in Tripoli, in the west. Meanwhile, smuggling routes in Iraq that were originally established under Saddam Hussein to bypass international sanctions in the early 1990s still operate. These smuggling routes offer a means of patronage for those in control of the oil infrastructure in the south of the country, albeit without addressing the inequities of the centralized system of distribution, dealing with which remains a fundamental cost of doing business.

The complexity of monetizing oil: cooperation and complicity

Agency of local populations

Sustainably controlling oil-rich areas requires cooperation between local leaders and armed actors. For any armed group with a newly established foothold in a particular area, it makes little sense to expel the skilled workers and broader community that have the capacity to operate the oil supply chain. Rather, the incentive will be to cut a deal with the locals. Extracting, moving, refining and selling oil is a complex and labour-intensive process that requires expertise, and a quid pro quo is therefore required. A clear example of this can be seen in northeastern Syria, where ISIS effectively reached an accord over the division of profits with the local tribes that operated the oil infrastructure. In this case, it is believed that the local tribes negotiated terms that were more or less similar to those that existed under the Syrian government, indicating that ISIS operated as a rational economic actor and recognized the necessity of cooperation. Moreover, the battle to control oil resources has not prevented cooperation over sharing them. For example, Kurdish-dominated forces rely, as ISIS forces had done before them, on engineers paid by the Syrian government to operate oil and gas facilities – including the Conoco gas plant located near Deir ez-Zor.
Local populations have maintained a degree of agency in the contest for control of oil infrastructure. Cutting deals translates into lower levels of violence. Libya’s ‘oil crescent’ – which stretches along the coast from Sirte to Ras Lanuf, and extends southwards down to the Jufra district in central Libya – contains something like 70 per cent of the country’s oil reserves and has been subject to significant power struggles. A blockade of the area by the forces of Ibrahim Jadran, a militia leader, from 2013 to late 2016 cost Libya over $100 billion in lost revenues. At that point, the ‘oil crescent’ was captured by forces aligned with Field Marshal Haftar’s self-styled LNA in November 2016. In March 2017, Haftar briefly lost the area to the Benghazi Defence Brigades before recapturing it a week later. Then, in April 2018, as Haftar’s forces were concentrated in an offensive on Derna, Jadran was able to recapture the ‘oil crescent’. He held the area for two weeks, before again being ousted by Haftar. The key point, often overlooked, about all these changes in the short-term balance of power is that each was preceded by the conduct of bargains with local communities in the area, with little heavy fighting involved. This illustrates a degree of quid pro quo. While a limited amount of fighting initially caused some damage to oil and gas infrastructure, production itself was not dramatically affected except during Jadran’s blockade. The fact that the LNA’s takeovers of the ‘oil crescent’ have involved limited open fighting contrasts sharply with the intense bombardments unleashed by the LNA in Benghazi and Derna, and to a lesser extent currently in Tripoli, in much more violent attempts to defeat opponents.

Depriving local populations of the proceeds of oil production drives political and social divisions. In Basra in Iraq, for instance, economic exclusion has entrenched armed networks of profiteers. The inequities of the Iraqi system for distributing oil revenues are stark. Basra is home to 90 per cent of Iraq’s oil production, which account for 95 per cent of the revenues of the central government in Baghdad. Yet this wealth has not trickled down to Basra’s residents. The province remains destitute, lacking basic services such as electricity and water. Reflecting economic malaise and political volatility, a vibrant protest movement has defined provincial politics, with citizens vocal in expressing grievances against the local and central governments. Protesters have on several occasions demonstrated against oil companies, blocking key roads and marching in front of their offices in a show of their anger and disillusionment.

The distribution system is sustained by an implicit understanding that local networks (which include armed groups) will be able to extract rents from the system in return for ensuring its continued functioning. A major factor in the looting of Basra’s oil resources has been the role of Iraqi state actors, many of which are either complicit in this activity or unwilling or unable to stop it. The local oil industry either lacks the equipment to measure its losses or deliberately chooses not to employ proper detection mechanisms, due to the tacit agreement with state employees and officials. Lack of capacity, incompetence and deliberate fraud are all potential explanations. For the central government, providing a source of revenue to armed tribes and groups in effect is merely another

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126 Ibrahim Jadran contended that his blockade was a means of demanding payment of workers’ outstanding wages. But his decision to abandon his role as central commander of the Petroleum Facilities Guard to found the Political Bureau of Cyrenaica (a grouping of federalists) is likely a better indication of his motivations. During the blockade, Jadran attempted to sell oil on to the international market, but was prevented from doing so through international intervention. The decision of the then UN Special Representative, Martin Kobler, to meet Jadran created a local backlash, further aggravated by the fact that the GNA authorized a payment to Jadran. A furious Mustafa Sanalla, the head of the National Oil Corporation (NOC), wrote to Kobler that the payment ‘sets a terrible precedent and will encourage anybody who can muster a militia to shut down a pipeline, an oilfield, or a port, to see what they can extort’. Ghaddar A., George, L. and Lewis, A. (2016), ‘Exclusive: Libya oil exports threatened as NOC warns against port deal’, Reuters, 24 July 2016, https://www.reuters.com/article/us-libya-oil-exports-exclusive/exclusive-libya-oil-exports-threatened-as-noc-warns-against-port-deal-idUSKCN1040DO (accessed 3 Jan. 2018).

Conflict Economies in the Middle East and North Africa
Conflict Sub-economies

form of subsidization, and far easier to implement than institutionalization and formal revenue-sharing between the centre and the periphery.128 Moreover, maritime police and border guards are unable to capture smugglers, and are often under orders not to arrest members of the cartels.

The complexity of the supply chain
The international community has mistakenly equated military control of oil fields with a monopoly over the revenues generated by them. Physical control over these areas is a necessary but insufficient condition for monetizing the oil trade. The complexities of Basra’s smuggling industry illustrate the breadth of actors involved. In Syria, the emphasis on oil as a source of revenue for ISIS prompted the US-led anti-ISIS coalition to conduct a widespread bombing campaign targeting oil and gas infrastructure in 2015. The objective was to reduce ISIS’s revenues, yet the policy also devastated the livelihoods of local populations and removed their principal source of heating oil just as winter was setting in. The incident offers an example of the perils of intervening in a conflict sub-economy where coping mechanisms are inextricably linked with revenue generation for armed actors.

In Syria, elements of the oil supply chain are controlled by actors in conflict with each other. Recognition of the need to monetize those elements under their control has led armed groups to tolerate a degree of cooperation with their rivals. Moreover, where this has not been possible through direct relations, profiteering opportunities for middlemen have arisen. Syria’s oil resources are overwhelmingly located in the country’s northeastern region, with around 85 per cent of extraction taking place between the Euphrates River and the Iraqi border.129 Between roughly 2013 and 2017, the northeast was divided into two areas of control: in the north, the so-called Jazira region was under the control of the Kurdish People’s Protection Units (Yekîneyên Parastina Gel – YPG), the military arm of the Kurdish Democratic Union Party (Partiya Yekîtiya Demokrat – PYD), which in turn is affiliated to the Kurdistan Workers’ Party (Partiya Karkerên Kurdistanê – PKK); meanwhile the southern part, including the city of Raqqa and half of the city of Deir ez-Zor, was under the rule of ISIS. Routes along the Euphrates River were also ISIS-controlled, meaning that most commodities traded with the northeast transited through areas under ISIS rule.130 Yet the country’s only two refineries are in Homs and Baniyas, territory that has remained under regime control. Hence, oil can be extracted from a field controlled by the PYD, transported by tankers operated by members of local tribes, then reach the regime, which will refine it and send some of it back to the eastern region. Other shipments will reach opposition areas, with some ending up in Turkey – thus generating revenues for each of the militias, checkpoints and border crossings (and the groups that control them) along the way.

In most cases, money earned from these activities in Syria has directly financed the warring armed groups. But it has also had an indirect impact on conflict economy actors, enabling intermediaries to earn hefty commissions and make financial contributions to the regime’s war effort. Among such intermediaries, two regime-affiliated figures have risen to prominence. Baraa Qaterji, a businessman originally from Raqqa who is now established in Aleppo, was identified by the US Office of Foreign Assets

Oil can be extracted from a field controlled by the PYD, transported by tankers operated by members of local tribes, then reach the regime, which will refine it and send some of it back to the eastern region

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128 Interview by one of the authors with analyst in Baghdad, autumn 2018.
129 In addition to domestic supply networks, imports of oil, including from Iran, contribute to Syria’s conflict economy. Because of US sanctions on the oil and banking sectors of both Iran and Syria, this has required bypassing traditional trade, transport and financial networks and using new intermediaries and modalities.
130 In the northern part of the northeastern region, mostly heavy oil is extracted from fields operated to this day by the Syrian Petroleum Company. Around Deir ez-Zor, lighter oil is extracted from fields previously developed by oil majors Shell and Total.
Control (OFAC) as a middleman between the regime and ISIS for the trade of oil products. Baraa operates in partnership with his brother, Hussam, who was put under sanctions by the EU in January 2019. The brothers have effectively become beneficiaries of Syria’s internal trade barriers. In recent years, both have employed intense competitive violence to control territory and access to resources. Besides doing business with the YPG and ISIS, they have worked with armed forces from opposition groups, the Assad regime and Iran.

Box 4: Smuggling in Basra, the development of protection markets, and the impact on the local population

Following the US-led invasion in 2003 and the breakdown of state order in Basra, armed groups vied for control of the area’s territory and resources. In Basra, by 2007, it was estimated that Muqtada al-Sadr’s Mahdi Army (Jaysh al-Mahdi) was stealing around $5 million worth of oil per day – most notably from the Abu Flus port – and selling it on the black market. By 2013, Shia Islamist armed groups and associated political parties were reported to be running 62 floating docks in the province of Basra, with nine armed groups controlling the port and collecting protection fees.131 Whereas in 2003 protection fees used to be around $100 per month, by 2014 the rise in the oil price had pushed them up to around $10,000 per month (to continue or to expand smuggling operations).132 The spike in oil prices from the mid-2000s to 2014 enriched the actors in this system, creating a nouveau riche and leading to market distortions: for instance, residential real estate rents in Basra skyrocketed to over $2,000 per month. As a result, a large proportion of Basrawis – excluded from employment or access to kickbacks in the oil sector – have become part of an underclass, suffering from a lack of electricity, water and jobs (which wasn’t a problem under Saddam). By the 2018 elections, the voter turnout in Basra was calculated at 14.4 per cent – underlining the high levels of political disillusionment in the city.133

In Iraq, Basra’s complex system of oil diversion requires a significant degree of cooperation from a network of actors in order to sustain the supply chain. Low-paid oil workers, engineers and transportation personnel seek to earn extra cash by stealing oil, which is then delivered to powerful tribal actors for storage. The tribes leverage their territorial control to store the stolen oil securely, working in conjunction with armed paramilitary groups and cartels in return for the payment of protection fees.134 Reports have indicated that up to 400,000 barrels a day (b/d)135 – or about 10 per cent of the oil from Basra province – are illegally intercepted and loaded on to trucks destined for Jordan and Syria. Such is the scale of these practices that local and federal politicians use their access to the state to accept bribes in exchange for looking the other way. Along the

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133 Ibid.
134 The first step in this process involves individuals stealing both refined fuel and crude oil from warehouses and loading it into makeshift pipelines or trucks near the various ports. Basra has several ports, including Abu Flus, Basra Oil terminal, Umm Qasr, Port of Basra, Abu al-Khasib and al-Faw. In addition, smugglers have developed underground pipelines that they use to connect to main lines to siphon oil without detection. At this point, tribes and local armed leaders who control territory store the stolen resources in underground tanks and eventually send it to tankers. Eventually, the resource is sold off and transporters take it north to be sold in the domestic market, as well as in Jordan and Syria. Surveyors, responsible for inspections, are paid not to report discrepancies.
smuggling route, PMU groups use their control of territories in the south to levy taxes at internal checkpoints but require cooperation with the Iraqi Security Forces at governorate and national borders. Here, the different sides cooperate and split profits. Many private security businesses also support this trade. International and local businesses view all this as ‘business as usual’, and pay off tribal and armed actors in order to operate without harassment.

The map of Iraq below shows this example as a way in which so-called state and non-state armed actors work together in smuggling oil from Basra towards the west and north.

Map 3: Reported PMU checkpoints on the oil smuggling route to Jordan

Completing the supply chain

Actors who control oil infrastructure and have a means of refining the extracted oil and converting it into fuel can more effectively monetize their assets than those who control only the means of extraction or the refining capacity. Amid Yemen’s conflict, the governorate of Mareb has developed its own self-sufficient supply chain. Before the war, Mareb was
Yemen’s conflict has afforded Mareb a high degree of economic independence. The governorate is able to complete the oil and gas supply chain without relying on rival groups or competitors, and is thus able to exert control over the revenues it generates. In this respect, Mareb has become a beneficiary of Yemen’s conflict. These attributes have had a broader economic impact, helping Mareb to become a trade centre: a large proportion of goods entering Yemen from Saudi Arabia via the al-Wadeah crossing in Hadramawt pass through Mareb before transiting into Houthi-controlled territory via al-Jawf. There has also been a real estate boom. Not least, the funds generated in Mareb are used to pay civil service salaries, finance infrastructure projects and cover the cost of electricity generation. Tribal militia salaries and military salaries are covered by Saudi Arabia, which also supplies weapons and other materiel to the formal military and tribal units operating in the governorate.

All of this has made Arada both powerful and influential – but his position relies on his allies maintaining their hold over the oil and gas production infrastructure. Arada has benefited both from a stable and manageable front line in the conflict with the Houthis; and from a rare balance of power under which the tribes have accepted his authority, as have military leaders including Ali Mohsen al-Ahmar, the de facto military chief of the government of Yemen. In the early years of the war, the Hadi administration, whose officials are based in both Aden and Riyadh, repeatedly demanded that the Mareb governorate hand over oil and gas revenues. However, the administration has since relented as it works to negotiate a deal for the transport of oil from Mareb to the south of the country for export. This deal, if agreed, would likely...
be a much bigger cash generator than local oil and gas sales, the proceeds from which are relatively modest. Hadi has reputedly considered replacing Arada, whom he sees as a threat to his authority. However, he has not been allowed to do so by his Saudi patrons, who have facilitated journalists’ trips to Mareb to demonstrate the coalition’s ‘stabilization’ activities. Arguably for Arada, maintaining the status quo in his governorate – having a single enemy in the form of the Houthis for the tribes, frozen front lines, a growing local economy and control over localized resources – is the preferable outcome. A peace deal is more likely to restore – nominally, at least – central control of oil and gas resources, potentially reversing Mareb’s gains.

**Access to the international oil market**

Selling crude oil on the formal international market requires international recognition. By controlling access to the international oil market, international actors have, to a large extent, been able to determine which domestic actors can directly benefit from oil. For groups in Syria, this has not been a significant impediment as wartime production has not even met domestic demand. That said, small volumes of oil have found their way via smuggling networks to Erbil (the capital of the Kurdistan Region of Iraq) and Turkey. In 2015, ISIS and the PYD were estimated by some sources to have exported up to 30,000 b/d to these two markets. In Yemen, a combination of domestic refining capacity and negotiations between armed groups and the internationally recognized government has created an informal local market and a formal international market. However, in Libya restricted access to the international market has had a critical impact on the development of the conflict economy. Although most oil resources are under the control of Field Marshal Haftar, who is dominant in the east of the country, eastern-based institutions have nonetheless been prevented from selling oil on the international market. Thus, while certain actors may control the resources, they sometimes have a limited ability to monetize them.

The international community has determined that only the National Oil Corporation (NOC), based in Tripoli, can market oil. Along with sole recognition of the Tripoli-based CBL, this has been the clearest policy of the international community towards Libya. During his lengthy blockade of the ‘oil crescent’, Ibrahim Jadran’s attempts to sell crude oil from that region were frustrated, most notably when US marines intercepted the tanker *Morning Glory* in 2014.\(^{138}\) When Field Marshal Haftar captured the ‘oil crescent’ in 2016, his decision to allow the NOC to operate there, and the CBL in Tripoli to receive the revenues from sales, was praised by the international community. This bolstered Haftar’s nationalist credentials. Yet upon his recapture of the ‘oil crescent’ in 2018, Haftar declared that a rival eastern-based NOC should market the oil internationally. After all, why should his forces secure the area only for the spoils to go largely to the capital, where an increasingly powerful oligopoly of militias antagonistic to Haftar was rapidly accumulating state wealth? But this was a miscalculation. Despite rumours about potential deals with foreign sales partners, the international community held firm, remaining insistent that only the Tripoli-based NOC and CBL could manage Libya’s oil wealth. Haftar eventually relented on 10 July 2018, ceding administration of the oil infrastructure to the Tripoli-based NOC.

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Competitive violence in the ‘oil crescent’, though partly alleviated by international support for the NOC, is likely to remain aggravated by the perception that the east’s resources are not fairly distributed by those in Tripoli. This will drive embedded violence. At the time of writing, in April 2019, Haftar’s forces had exerted control over two further major oil fields in Libya’s south. While this does not necessarily translate into an ability to monetize these resources directly, it increases his forces’ leverage over the GNA.

In Iraq, operators of oil smuggling networks established in the 1990s to circumvent international sanctions have combined with armed actors in the post-2003 landscape to supply a domestic black market for oil and to bypass the formal international market by exporting oil to Jordan and Syria. Such developments indicate that conflict economy dynamics can endure long after the supposed peace has been achieved, and can be hard to roll back. Indeed, the previously mentioned oil diversion system in Basra may indicate that those locked out of the international market are likely to find alternative means of accessing it. It should be noted in this context that attempts by eastern Libyan authorities to market oil have been ongoing. The current bout of competitive violence in Tripoli – involving the struggle for control of state institutions – may lead the eastern authorities to redouble their efforts to market oil independently.
4. Implications for Policy

This report has characterized the conflict economies of Iraq, Libya, Syria and Yemen as complex systems defined by violent competition for control of rents. Despite the differences between the four case studies, we find that the structure of rents and the patterns of behaviour and violence are comparable at the sub-economy level (see Table 1 below). We conclude that it is therefore possible to develop distinct policy approaches to target the specific rent structures of capital cities, transit areas and borderlands, and oil-rich areas respectively. In this chapter, we offer insights – but not a prescription – for Western policymakers to guide them in this process, with the end goal of reducing levels of violence.

Table 1: Rent structures, behaviours and patterns of violence in conflict sub-economies

<table>
<thead>
<tr>
<th>Rent structures</th>
<th>Armed group behaviour</th>
<th>Violence (competitive and embedded)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital cities</td>
<td>The state as a resource: seizing and allocating assets, revenue streams and patronage postings.</td>
<td>Institutional domination/control followed by institutional infiltration.</td>
</tr>
<tr>
<td>Oil-rich areas</td>
<td>Taxation contingent on control of the area, and proportion of supply chain.</td>
<td>Co-option more likely than coercion. Limited supply of civilian expertise. Significant opportunities for middlemen.</td>
</tr>
</tbody>
</table>

First, we begin by analysing how Western policies have affected sub-economy dynamics to date, before discussing how Western policymakers could help transform these dynamics to reduce violence and provide greater economic stability. This will require Western policymakers to undertake a frank appraisal of their own capacities and objectives; the extent and type of leverage that they possess; and the trade-offs associated with reducing competitive violence and embedded violence. Where leverage and capacity are limited or lacking, doing nothing should also be acknowledged as a policy option in its own right. Finally, we seek to apply these parameters to a series of recommendations for areas of intervention within the sub-economies of the four states.

How Western policies have affected sub-economy dynamics

Through different forms of engagement and intervention – security, political and humanitarian – Western policies play a key role in shaping the dynamics of MENA conflict sub-economies. However, in exploring the impact of these policies, it is necessary to note two important caveats. First, in the wars in Iraq, Libya, Syria and Yemen, external parties – Western states and international organizations – have not been the
disinterested, neutral or benevolent parties they sometimes imagine themselves to be. In many cases, Western states have supported one actor or set of actors over others – with the intention of helping one side win – rather than seeking to tackle the underlying causes of conflict. As a result, Western policy goals have often reflected a ‘victory’ or advantageous settlement for a preferred party on the ground. Second, Western policymakers have not considered conflict economy dynamics sufficiently in the development of their approaches towards the states in question. The pursuit of various political, economic and military approaches in isolation from one another too often misses the wider political economy connections, resulting in harmful implications on the ground.

**Capital cities**

In the MENA region's capital cities, security-based Western policy interventions have had a far-reaching impact on the distribution of rents. In some cases, this has had a direct role in determining who can access state resources and assets. Following the 2003 invasion of Iraq, for example, the US-led coalition sought to pacify rival groups via the *muhassasa* system of quotas – designing a power-sharing political system intended to ensure that people from different backgrounds were represented. However, this approach entrenched a set of elites into positions of power and economic privilege, further driving socio-economic inequality. This became a significant source of embedded violence. In Libya, Western actors' tacit acceptance of the revenue-generating activities of Tripolitanian militias, in return for their nominal alignment with the GNA, has supported neither functioning governance nor stability. Outbreaks of competitive violence have continued.

Western policymakers’ ability to restrict access to the international financial system through political recognition and economic sanctions remains a powerful tool for dealing with the conflict sub-economies of capital cities. As a result of sanctions, Western companies, international banks and insurance companies have been reluctant to deal with Syria. While restricting the capacity of some actors to access international financial resources, sanctions have also encouraged informal trade and financial networks across Syrian territory and areas of control. This has had unforeseen consequences: EU and US sanctions targeting individual Syrians have prompted the emergence of a new elite of conflict entrepreneurs who serve as the regime’s new intermediaries. This is exemplified by the most emblematic business project in Syria in recent years: the real estate development named Marota City (see Chapter 3), which is being built on land forcibly expropriated by the Syrian regime. The businessmen involved in this scheme were placed under EU sanctions for making large profits through their ties to the regime and its security apparatus, and for funding the regime in return.

Humanitarian aid for Yemen and Syria, while mostly not earmarked for expenditure in the countries' respective capitals, still flows via Sanaa and Damascus. This report has detailed how donors seeking to distribute cash in Yemen have little option but to operate via ‘Houthified’ banks based in Sanaa. Meanwhile, the *de jure* status of the Damascus-based government provides it with a seat at the UN and ensures oversight

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of the means of distributing aid. Both approaches present challenges to Western donors concerned that their support will be diverted to parties to the conflict – potentially sustaining competitive violence or the (re)development of authoritarian structures, or contributing to the development of embedded violence.

Transit areas and borderlands

In transit areas and borderlands, security-based policies have had a major impact on the market dynamics that determine trading patterns and opportunities for taxation. The Western-supported crackdown on irregular migration in northern Niger, for example, has indirectly affected the conflict sub-economy in southern Libya. The criminalization of human smuggling in Niger means that Nigerian army units that had previously facilitated human smuggling now fire at smuggler convoys, making overland travel more costly and dangerous for migrants seeking to enter southern Libya. The reduced flow of migrants into Libya, in turn, is reportedly prompting armed groups to resort to ever more violent means of generating revenues from migrants. Apart from their support to the Kurdish-led Syrian Democratic Forces (SDF) in northeastern Syria, Western actors have made limited interventions in transit areas and borderlands. Regional actors that share borders with Iraq, Libya, Syria or Yemen have been more active. In northern Syria, Turkey has allowed only the groups that it supports to control border crossings. Over the course of the Syrian conflict, these crossings have provided a key revenue stream both for armed groups (via checkpoint fees) and for businessmen (via arbitrage). Syrian–Turkish border areas controlled by the SDF, which Turkey opposes, remain closed.

In Yemen, Saudi forces have intervened militarily at key transit areas in al-Mahra governorate to halt the flow of weapons to their government’s enemies. This approach has angered local actors – who had been benefiting from the increase in trade via al-Mahra as a result of the fighting in western Yemen – and threatens to spark conflict. Yet in Bayhan, the Saudi-led coalition appears to have taken a political, pragmatic approach in accepting – in order to keep local actors on side – the continuation of smuggling routes that supply Houthi-aligned forces.

As in capital cities, humanitarian support directed into transit areas and borderlands may be diverted or used by armed actors to generate revenues to finance military agendas. Humanitarian support can also distort markets and create arbitrage opportunities. This presents dilemmas for Western donors. As noted in Chapter 3, a ‘siege’ economy operated between 2013 and 2016 in the Damascus suburb of Eastern Ghouta, for example. This involved both the armed rebels and government forces profiteering from the taxation opportunities associated with the movement of goods into the area. Donors sending aid into Eastern Ghouta were therefore not only providing much-needed support to the local population, but also sustaining the siege economy and the incomes of armed forces on both sides.

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141 Data from forthcoming Chatham House analysis.
142 Micallef (2019), The Human Conveyor Belt Broken.
143 Lund (2016), ‘Into the Tunnels’.
Oil-rich areas

In oil-rich areas, Western policies to target assets both militarily (through airstrikes) and economically (through limiting access to international financial markets) have had a major impact on the development of local conflict sub-economies. In Libya, the international community’s insistence that oil can only be marketed through the internationally recognized NOC in Tripoli has likely been a factor in reducing violence. If local actors had been directly able to sell the crude oil extracted from the areas under their control, more bouts of competitive violence would probably have been witnessed in these areas and beyond. On the other hand, curtailing access to international markets can lead to unintended consequences: in Iraq, UN sanctions in the 1990s led to the development of overland smuggling routes and the growth of business ties between the regime and trafficking groups. These networks still operate today, long after the removal of sanctions. Oil smuggling presents a source of revenues for a variety of armed groups – including, until recently, ISIS. Some groups have utilized such revenues to fund military challenges to the state.

In Syria and Iraq, Western governments have expressed concern that oil-rich areas could provide revenues for ISIS. However, these areas also support local livelihoods. In north-eastern Syria, the bombing of oil infrastructure by the US-led anti-ISIS coalition reduced ISIS’s revenue-generation capabilities. It also cut off the local population’s fuel supplies just as winter set in, damaging the local coping economy.

Designing interventions in conflict sub-economies

The above analysis makes it clear that many pitfalls are associated with interventions in Iraq, Libya, Syria and Yemen. It also suggests opportunities for policies to achieve positive outcomes. In developing plans for tackling conflict economy dynamics, policymakers must first accept that the aspiration to ‘do no harm’ is illusory. In conflict sub-economy systems, the best available option is to do ‘less harm’. This involves taking calculated risks. It means accepting that any intervention is likely to have unforeseen consequences. Mitigating this threat requires policymakers to deepen their understanding of the operating environment and honestly assess where leverage exists over conflict sub-economy dynamics. It also requires them to accept those elements of the conflict economy that cannot be changed.

Without critically interrogating data sources, the motives of participants, and the completeness or accuracy of information on conflict economies – and without understanding the context of those findings – policymakers may end up supporting policies that do significant harm. Consequently, doing nothing should also be evaluated as a potential policy choice in its own right. This may be particularly relevant to Syria, where it is difficult to design interventions when the Assad regime is seeking to reconsolidate authoritarian rule and Western diplomatic leverage is waning, yet where doing nothing further enables authoritarian reconsolidation. The question here is what kinds of interventions – for instance, support to local governance structures, livelihoods and civil society initiatives – can benefit populations in need in ways which are not susceptible to exploitation by regime networks, or at least where the risk of such exploitation can be managed. For example, while large-scale funding for post-conflict reconstruc-

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tion would likely risk capture by regime-aligned interests, might Western donors instead support local communities directly, for example through civil society projects in conflict-affected areas?

In considering the risks of intervention, Western policymakers should also accept that doing nothing carries its own consequences. Where violence – competitive, embedded or both – persists unchecked, external actors who turn a blind eye will be perceived as tacitly condoning violence and offering political approval to its beneficiaries. Yet cutting off aid to Syria for fear that such support will bolster the regime would also surely exacerbate the hardships of populations in need.

Acknowledging trade-offs: short-term stability vs long-term development

Addressing conflict economy dynamics through the pursuit of political settlements in the form of elite bargains involves significant trade-offs that must be openly discussed and acknowledged. Buying off warring parties may curtail violence in the short term, for instance, but is likely to entrench patronage and corruption that will drive future conflict through embedded violence. On the other hand, trying to disrupt patronage networks and challenge rent-seeking theoretically offers a more inclusive and sustainable peace – but comes with a higher risk of sparking competitive violence.

Elite bargains offer mixed benefits. On the one hand, power-sharing can mitigate the negative effects of a winner-takes-all dynamic. On the other, policymakers must consider the long-term implications and potential unintended consequences of such policies. As the muhassasa system in Iraq illustrated, it can be hard to roll back such arrangements: taking power away from actors who directly or indirectly rely on rents is difficult, even where stability and security are offered in exchange. In Libya, the transactional nature of the GNA’s allocation of ministries and political offices inhibits state-building, while the GNA’s reliance on Tripolitanian armed groups to ensure its security has enabled those groups, and their networks, to infiltrate state institutions. This threatens to shift power away from the state, entrenching a transactional approach to politics that will be difficult to alter in a post-settlement landscape.

It is a mistake to assume that a process of reform will be possible once an elite bargain is reached, i.e. once ‘stability’ has been ensured. While establishing elite bargains may reduce competitive violence, this approach will not reshape incentive structures. It will not compel political and military leaders to ensure more equitable distribution of resources, nor will it encourage decentralization of the political system. Under the centralized systems of governance in Iraq, Libya, Syria and Yemen, the victors will undoubtedly seek to retain the spoils from conflict economies. Equally, events in Yemen illustrate that if an elite bargain is to be successful, it must accommodate the interests of the most powerful parties and emerging centres of power. The relative exclusion of Houthi interests from an elite bargain in 2011 can be seen as a motivating factor in their violent contestation of the status quo in 2014.

Failure to address sources of embedded violence is likely to result in a return to competitive violence. Western states have often preferred quick wins to longer-term solutions. Events in Iraq amply illustrate that the muhassasa quota system has failed

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147 Heydemann (2018), ‘Civil War, Economic Governance & State Reconstruction in the Arab Middle East’. 
to address the violence embedded in the system, and that it has created conditions for a cyclical return to competitive violence.\textsuperscript{148} Such considerations raise difficult questions over whether ending a particular bout of competitive violence is a sufficient measure of success, when another sustained bout of competitive violence is expected to follow.

On the other hand, challenging vested interests and lucrative patronage-based networks within MENA conflict economies increases the probability (and likely scale) of competitive violence. This route is high-risk and uncertain. However, if successful, it is more likely to create space for genuine economic and institutional reforms. This report has illustrated that while competitive violence draws the most attention, embedded violence continues after war nominally ‘ends’. Stabilization actors and humanitarian aid donors should therefore seek to address forms of embedded violence, while development agencies need to consider how their approaches can tackle embedded violence at both national and local level.

To address embedded violence, elite bargains must offer more than agreements on power-sharing and political transition: they must also include measures to reform the system of governance, including enforceable measures to increase accountability. They must confront the underlying distributions of power. Economic components of political settlements are too often absent or contain minimal content, even though they have a powerful anchoring effect. The Libyan Political Agreement, for example, contained less than one page on interim financial arrangements, yet these arrangements are still in place over three years later. In such circumstances, political settlements may contribute to ending active combat, but they pose long-term challenges for equality and accountability by entrenching the conflict economy in the supposed peace economy.\textsuperscript{149}

**Policies tailored to conflict sub-economies**

Targeted intervention at the local (i.e. sub-economy) level at which conflict economies operate brings meaningful opportunities to increase impact. This is significant where progress at the national level has stalled, or is not deemed possible. However, it requires Western policymakers to invest in developing their understanding of local networks.

In seeking to address conflict sub-economy systems, policymakers should design interventions that develop incentives for peaceful cooperation rather than solely relying on enforcement mechanisms. Cracking down on illicit practices without offering viable livelihood alternatives, for example, may simply encourage a different form of illicit activity. One example from the Libyan case is that external pressure on people-traffickers has reportedly led some to switch to fuel smuggling.\textsuperscript{150}

In providing aid and livelihood support to populations within conflict sub-economies, Western policymakers must accept that the risk of funds being diverted to illicit activities cannot be entirely mitigated. While Western donors accept this reality behind closed doors, they feel unable to admit so in public for fear of the political ramifications. This places the onus on implementing partners to carry the risk, and inhibits

\textsuperscript{148} Mansour (2017), *Iraq After the Fall of ISIS*.


the development of transparent mitigation measures. Meanwhile, cutting off humanitarian aid on the grounds that armed groups will profit from its distribution will harm those who depend on that support. Consequently, the best that agencies and foreign companies can do is to establish clear guidelines for the distribution of aid and engagement with local partners.\textsuperscript{151} Imposing conditions upon aid – such as the right to select and conduct proper due diligence on local counterparties, and the insistence on transparency – may seem like a hopeless task, but these efforts should not be abandoned.

When considering how to target specific activities through enforcement mechanisms, policymakers should acknowledge that ‘legality’ is a relative, not fixed, concept in conflict economies. Policy intervention tools cannot therefore be limited to legal measures. In the four conflict economies reviewed in this report, it is notable that the legality of a given practice may be decided by a single conflict actor, as in Syria. As indicated above, a better measure for deciding policy interventions would be to assess how the political and economic benefits from conflict economy activities are distributed horizontally across groups, and vertically within groups.

In choosing which illicit activities to constrain, policymakers should focus upon those with shorter supply chains, where fewer vested interests are involved and critical economic coping mechanisms are less likely to be affected. Financial and property crimes are examples of this. In contrast, certain forms of smuggling – such as of subsidized basic goods and fuel – have longer supply chains and affect wider networks of participants. Such activities provide employment and benefits to many people. For the most impact at least cost to those in need, Western policymakers should target bottlenecks where rent-seeking is most concentrated. Where measures target specific individuals, Western actors must adopt clear, transparent, consistent and enforceable criteria in order to be taken seriously.

\textit{Capital cities}

The sub-economies of Baghdad, Tripoli, Damascus and Sanaa have an outsized influence over developments at the national level. These capitals are central nodes for public and private patronage, as well as the principal connection points to the international financial system and multilateral organizations.

In these centralized systems of governance, where power is wielded in the capital, physical control of territory translates directly into influence over the management of state resources and assets as well as those of the private sector. State capture and the infiltration of state institutions have been notable features of the conflicts in all four capitals in the case studies. Similarly, the redistribution of state resources as rents has driven local dynamics of embedded violence. This has also resulted in power being held by those who physically control institutions rather than by the institutions themselves.

Western policymakers should consider three key factors when seeking to addressing these issues:

1. \textbf{Policies aimed at strengthening state institutions in national capitals should seek to prevent monopolies of power} by supporting incremental change over time, even where a monopoly appears to be in the interests of the Western state in question. One of the possible paths is to widen the networks of beneficiaries to include people from outside the immediate circle of each conflict actor. In the long run, such an approach would dilute the influence of current networks and

\textsuperscript{151} For example, see the Voluntary Principles on Security and Human Rights, which are targeted at the extractives sector.
broaden the patronage base. Western countries have supported a broad range of civil society organizations and local councils over the years, and should use this knowledge to identify appropriate partners.

2. **Policy interventions must be directed towards developing processes and institutions, not just supporting personal relationships with elite actors in capitals.** A case in point is the concerted support provided by the West to the losing election campaign of Iraq’s then-prime minister, Haider al-Abadi, in 2018. Maintaining solid political relationships with key actors is critical, but when their political counterparts change or power shifts occur, the terms of these relationships will need to be renegotiated. Measures that cement rules and norms (such as on the peaceful transfer of power) within the political and institutional system can provide greater predictability and stability in such relationships. In addition, the risk with seeking to resolve conflict on the basis of personalized politics is that it can inadvertently cement the power of conflict profiteers among political elites, while ignoring the need for reforms in governance and state institutions.

3. **Decentralization needs to be accompanied by accountability.** Centralized revenue distribution has been a key driver of conflict in Iraq, Libya, Syria and Yemen because funds are distributed without transparency or accountability. This has led many to see political decentralization as a potential solution. But structural change *per se* is no panacea. Decentralization that is not wedded to clear mandates, and to transparency and accountability mechanisms, will merely shift rent-seeking into the regions and serve the interests of a different set of actors. Western policymakers should only support decentralization that meets minimum transparency and accountability thresholds, and that ensures that institutions with sufficient administrative capacity are available at the local level. If these conditions are met, decentralization can help to mitigate profiteering and rent-seeking, because diluting the power of the capital city will reduce incentives to violently take control of it as part of a winner-takes-all system.

*Transit areas and borderlands*

Internal transit areas within states and borderlands with neighbouring states are the main sites where goods and people are informally ‘taxed’. This taxation provides a major source of income for warring parties. Policymakers often see either the removal of transit areas or the establishment of monopoly control over transit areas as a tangible step towards stabilization. However, transit areas themselves are symptomatic of political instability. For armed groups, they provide money and security. Only when these needs are met through other means will informal taxation at transit areas disappear.

The best way to tackle rent-seeking at checkpoints is to address the root causes and the wider dynamics of the conflict economy. Looking at the issue through a state-building lens, one approach to transformative change in conflict economies is to consider how to convert an armed group’s ‘checkpoint’ into a state-sanctioned ‘toll booth’. Ostensibly, both checkpoints and toll booths perform similar functions: collecting a ‘tax’ on those using the road. Yet they operate under very different conditions and reflect very different assumptions about the state – the degree of state capacity, the level of trust in the state, the presence or absence of a government monopoly on physical violence, the need for checks on the abuse of power, the role of the rule of law, etc. That said, a wholesale shift
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from a ‘checkpoint’ economy to a ‘toll booth’ economy implies a number of significant institutional reforms and societal changes that cannot realistically be achieved in a five- or even 10-year period after the negotiation of a political settlement.

The West's prevailing approach towards borderlands as originators of threats complicates the goal of mitigating conflict economy dynamics. Attempting to seal borders through securitized approaches in order to prevent the flow of illicit goods inhibits the local economy, and is itself a driver of instability.

Western policymakers should consider the following types of interventions in transit areas and borderlands:

1. **External interventions should support the development of local governance structures that have clear mandates and are accountable to local populations.** More equitable and inclusive distribution of state resources – even accepting problems of corruption and accountability – can reduce the pressure on armed groups to use violence. Yet historically, borderlands have had limited connection to centralized state structures. Rather than simply subsuming local authorities in borderlands into the state system, the goal should be to develop systems that are appropriate for the operating environment. Given that service provision often underpins government legitimacy in MENA states, this may mean devolving more authority to local governance structures if the central state is not realistically able to provide services.

2. **The development of sustainable local economies can be fostered through reconstruction and development programming. However, in some cases, it will not be possible to participate in aid programming without legitimizing and strengthening conflict actors.** Where regimes are hostile and there remains political pressure to ‘do something’, external actors must develop a solid understanding of the local operating environment in order to mitigate the risk of funding being diverted to unintended beneficiaries. Efforts to address conflict economy dynamics in borderlands need to be broadened to target the many root causes of smuggling, which are often linked to socio-economic inequalities across identity groups. In borderlands, Western governments could encourage negotiations with neighbouring countries to enable the free flow of goods produced in these areas. This would also encourage local production activity.

3. **Negotiated zones of control need to be agreed by a wide array of actors.** In eastern Yemen, a robust system of informal taxation emerged at the outset of the war, allowing for the flow of goods in and out of the area without causing unmanageable price increases. Since 2017, however, growing regional interest in the area has disrupted this arrangement, and at times has seen the eastern border cut off entirely. In southern Libya, the proliferation of checkpoints used by armed groups as sources of financing has contributed to goods shortages and high inflation. Brokering reciprocal taxation agreements between communities in these areas could help to mitigate the negative impacts of price inflation on local populations, which in turn could mitigate some security concerns (i.e., over the protection of populations, property and markets).
4. Anti-smuggling measures should focus on disrupting flows of goods that are directly related to conflict, such as arms and ammunition, rather than on preventing trade in basic goods essential for economic survival. Smugglers operated in the borderlands of Iraq, Libya, Syria and Yemen prior to the outbreak of hostilities, but their activities have intensified and diversified as the conflicts have evolved. It should be noted that not all forms of smuggling are directly connected to violence, and consequently not all of these should be targeted.

Oil-rich areas
When attempting to constrain the finances of armed groups in oil-rich areas, policymakers should avoid directly damaging the livelihoods of local populations. Failure to observe this condition is likely to exacerbate the grievances harboured by those who receive few (or no) benefits from central state authorities. This was evidenced by the bombings of oil infrastructure in northeastern Syria conducted by the US-led anti-ISIS coalition. In this case, the distribution of revenues along the entire supply chain was key. Understanding the dynamics of the conflict sub-economy would have helped Western policymakers to target their intervention more effectively and mitigate the potential second-order effects of their policy. It would also have been clear to policymakers that ISIS was not generating funds on the scale initially estimated, and that the distribution of revenues from ISIS activity was broad – meaning that large segments of the local population were affected by the bombings.

Western policymakers should consider the following imperatives in developing interventions in oil-rich areas:

1. The West should leverage its power to grant access to international oil markets. Insisting that only one recognized authority can market oil internationally is perhaps the most significant lever of control that Western actors possess over the conflict economies of the four states. As a policy tool, this has been particularly effective in preventing oil sales from the east of Libya, though less so in Iraq (where overland smuggling networks are extensive) or in Yemen and Syria (where oil exports are not a factor).

2. Incentive mechanisms should support the redistribution of oil wealth to local communities. In some oil-rich areas, such as Basra in Iraq, poverty creates a powerful incentive for local communities to divert oil supplies. This in turn supports a local market for protection. More equitable distribution of wealth would likely reduce calls for federalism or support for separatist agendas. Western governments could encourage the allocation by the central government of a specific share of oil revenues to investment projects in the areas of production, in a similar fashion to the rule established for the Kurdistan Regional Government in Iraq. This could be based on the size of the population or on socio-economic indicators.

3. Interventions should support deeper engagement between local populations and oil industry players (both public- and private-sector operators). In Libya’s south, the population has limited access to skilled employment within the sector, and is reduced to competing for rents by operating protection rackets that target oil installations. Oil companies (both national and international) should be incentivized to invest in local communities (e.g. via training programmes for engineers). This should also include efforts to address the environmental impacts...
of production activities, such as the pollution of underground aquifers, which negatively impact water-scarce areas. Such approaches may render oil operators less susceptible to strikes and blockades by local populations.

4. **Policymakers must understand who profits from oil and fuel smuggling—and the supply chain mechanisms through which those profits are achieved—before attempting to disrupt such activity.** Every link in the supply chain contributes to the conversion of crude oil into money, so disrupting even one upstream link can have a substantial impact on downstream communities. Policymakers need to design comprehensive strategies that address the entire supply chain rather than just one link.

Interventions present many pitfalls, but there are also opportunities to help reduce violence and insecurity—though a basic requirement is that local dynamics are taken into account appropriately. Intervention targeting specific conflict sub-economies can increase policy impact, but this requires that Western policymakers invest in developing their understanding of local networks and local economies. Without such an understanding, there is a substantial risk of unintended consequences causing unanticipated harms.
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