

# MINDANAO'S SHADOW ECONOMIES

## MINIMISING RISKS, MAXIMISING PEACE DIVIDENDS

### SUMMARY

The March 2014 signing of a comprehensive peace agreement between the Philippine government and the Moro Islamic Liberation Front provides a foundation for lasting peace and sustained development in Mindanao. The informal economy is one among many hidden drivers of continued violence and instability in Mindanao. Yet, this informal sector has not been discussed in the framework peace agreement and its component annexes. This policy brief argues that the informal economy needs to be seen as integral to all peacebuilding efforts because it will shape the prospects for a genuine and lasting peace. Stakeholders in the peace process should mitigate the conflict risks posed by the informal economy and, at the same time, harness it as a source of revenues and development that can bring peace to Mindanao.

### INTRODUCTION

The peace agreement between the Philippine government and the Moro Islamic Liberation Front (MILF) is expected to end nearly half a century of armed rebellion in Muslim Mindanao. At the heart of the agreement is the establishment of the *Bangsamoro* – an autonomously governed political entity for the majority Muslim provinces in Mindanao.

However, the failure of Mindanao's post-conflict transition after the 1996 peace agreement between the government and the Moro National Liberation Front exemplifies the fickle nature of peace processes. Making autonomous governance work, and thus avoiding a repeat of 1996, is what is at stake in the Bangsamoro peace and statebuilding process.

One of the challenges confronting the peacebuilding community concerns economic activities that take place in the shadow of Mindanao's political economy. These so-called 'shadow economies' include the illegal firearms trade, kidnapping-for-ransom, informal land markets, cross-border trade, informal credit provision, and illegal drug markets. Although these shadow economies are an important feature of the informal economy, they tend to be overlooked.

This policy brief argues that shadow economies need to be seen as integral to all peacebuilding efforts because they are likely to shape the prospects for a genuine and

lasting peace in the Bangsamoro. Stakeholders in the peace process need to minimise the conflict risks posed by shadow economies while, at the same time, maximize their development potential. So far, this crucial agenda has not received sufficient attention.

### THE INFORMAL ECONOMY IN THE BANGSAMORO

Although the informal economy is notoriously difficult to measure, economic data on employment and household income give a good indication of its relative size and importance. By any measure, the informal economy forms a major component of the 'real economy' in the Bangsamoro. Among the 17 regions of the Philippines, this region has by far the highest shares of informal income and employment. Moreover, the informal economy in the Bangsamoro has proven remarkably resilient during the last two decades, whereas the relative size of the informal economy has gradually declined in other parts of the Philippines.

The global discourse on fragile states tends to depict the informal economy as a threat to state capacity, economic development and human security in conflict-affected societies. This brief adopts a more nuanced perspective and recognises the ambiguous nature of informality. In the case of the Bangsamoro, relatively innocuous shadow economies, such as informal credit provision and cross-border trade, exist alongside shadow economies that are outright criminal in nature, such as illegal drug trafficking and kidnap-for-ransom.

Consequently, hard and fast distinctions between state-regulated economic activities and those that exist outside the framework of the state are difficult to make. Local state representatives engaging in informal or criminal economic activities exemplify the blurred boundaries between the formal and informal domains. The term 'shadow economy' focuses attention on these shadowy margins as well as the systematic connections between the formal and informal economy in the Bangsamoro.<sup>2</sup>

### WHY SHADOW ECONOMIES MATTER FOR PEACE

Shadow economies in the Bangsamoro are potential sources of wealth, power and conflict. They provide local elites with the economic power base to advance their political ambitions. Revenues from shadow economies can also be converted into political power. This occurs, for instance, when drug money is used to fund political campaigns. Subsequent control over political office by rent-seeking elites helps consolidate their access to the proceeds from lucrative ventures. Shadow economies can be a source of conflict precisely because they embody a significant amount of economic and political capital for local strongmen, armed insurgents and powerful clans. There are four reasons why the peacebuilding community must not ignore shadow economies.

#### Shadow authorities and peace spoilers

Local powerbrokers may regard the peace process as a threat to their political legitimacy and their economic and political authority. Chief among them are powerful clans, whose powers are rooted in their ability to deliver votes for politicians, their control of political office, their firepower in the form of private armies and their involvement in profitable shadow economies. As de facto shadow authorities, they are a force to be reckoned with. Shadow authorities in the Bangsamoro may become peace spoilers should the peace process abruptly disrupt the shadow economies that provide them with economic and political resources.

#### Capacity and legitimacy of Bangsamoro institutions

Building effective institutions of governance is crucial for the success of the peace process, yet shadow economies may complicate this task. The informal economy represents a large amount of untaxed wealth and therefore revenue foregone by the future Bangsamoro government. This could significantly limit its ability to carry out essential functions. Shadow economies can also inhibit the development of publicly accountable institutions. Having access to shadow economic rents means that locally elected representatives can avoid the need to generate tax revenues within their constituencies and subsequently account for them. These 'shadow profits' are therefore likely to strengthen patronage rather than governance institutions. The subsequent perception of patronage-based politics and corruption could undermine the legitimacy and authority of governance institutions in the Bangsamoro.

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#### The shifting patterns of conflict

The struggle of insurgents for stronger autonomy has gradually evolved into a complex conflict system. This has resulted in armed conflicts between various insurgent groups and the government, but also various manifestations of community-level conflict. These include clan feuds, crime-related violence, inter-communal conflict and violent competition between political elites. Violent contestations between and among clans, tribes and local elites, rather than insurgency-related conflict, have become the dominant form of violent conflict.<sup>3</sup> Shadow economies need to be factored into the analysis of changing patterns of violence because they shape inter-elite competition and can trigger or reinforce conflicts over scarce economic resources such as land.

#### Peace dividends

Shadow economies can sustain local powerbrokers, but they also provide marginalised communities with an economic lifeline. Cross-border trade in the Sulu Sea represents the quintessential example of a livelihood economy that sustains the precarious island economies of the Bangsamoro. This shadow economy generates a great deal of unrecorded and therefore unofficial wealth, which currently outstrips the official regional economy. Protecting shadow economies that support livelihoods and tapping the untaxed wealth can provide the future Bangsamoro government with the necessary peace dividends and revenue base to consolidate peace. It is therefore important to remain open to the idea that some shadow economies can actually contribute to peacebuilding efforts.

### WHAT THE EVIDENCE TELLS US

Despite the variegated nature of shadow economies in the Bangsamoro, it is possible to draw a number of general conclusions from the available evidence. These, in turn, have implications for interventions in areas pertaining to peacebuilding, development and governance.

#### The informal economy needs to be disaggregated

The informal economy in the Bangsamoro encompasses a broad spectrum of actors and motives – ranging from ruthless entrepreneurs in pursuit of wealth and power to individuals and communities that rely on the informal economy for their everyday survival. In spite of the ambiguous complexity that surrounds shadow economies, it is relatively easy to distinguish pernicious or criminalised shadow economies from shadow economies that support impoverished communities. Treating the informal economy as an aggregate phenomenon will merely complicate efforts to either accommodate or dismantle shadow economies. Indeed, the risk of lumping shadow economies together is that it leads to one-size-fits-all interventions that are likely to fail.

### Shadow economies are within reach of the state

Although shadow economies evade the state's regulatory regime, it is a fallacy to assume they are outside the reach of the state. Indeed, the evidence shows that shadow economies exist and thrive as a result of their proximity to state institutions at national and local levels. For instance, the trafficking of firearms relies on the connivance of state representatives who can produce the necessary legal paperwork. Notorious kidnapping syndicates remain a persistent feature of the Bangsamoro because local politicians provide them with protection. 'Special arrangements' with rent-seeking customs officials enable cross-border traders in the island provinces to avoid customs regulations. While shadow economies involve different degrees of circumvention, secrecy and rule breaking, they are nevertheless closely intertwined with state institutions. Hence, dismantling pernicious shadow economies requires closer scrutiny of formal institutions and state agencies that operate as a 'shadow state.'

### The informal economy is not necessarily violent, yet it is a significant driver of conflict

There is considerable variation in the level of violence across different shadow economies. Violence is central to kidnap-for-ransom and human trafficking, but other shadow economies such as cross-border trade are seldom accompanied by violent conflict. Policymakers therefore need to steer clear of the idea that violence is inherent in all shadow economies. Yet, shadow economies do shape conflict dynamics in the Bangsamoro by triggering or exacerbating violent conflict. For instance, the undocumented nature of the informal credit system renders it prone to disputes. While violence may not be intrinsic to informal credit provision, these disputes can become violent in a regime of ineffective rules and weak enforcement. In the case of violent disputes over land, these have less to do with informal land markets and more to do with state institutions impinging on the institutional arrangements and shadow authorities that govern informal land markets. Peacebuilders need to recognise the fact that the clash between state and non-state institutions, rather than informality itself, can be a major determinant of violence in shadow economies.

### Shadow economies thrive due to fragile state institutions

People choose to transact in the informal economy because formal markets are absent or poorly functioning – a point illustrated by the shadow economies in credit and land. The bureaucratic maze, complexity, fees and taxes associated with formal systems of land governance push people into informal land markets. Likewise, the informal credit system flourishes because borrowers have no access to formal credit providers. People turn towards the informal economy because the state has failed to create the conditions for formal markets to trump the economic benefits of informal markets. It is therefore the limited reach of the central state in the Bangsamoro that explains the thriving nature of shadow economies. Indeed, entrenched shadow economies in drugs and kidnap-for-ransom are a powerful reminder that these economies are

primarily the product of state fragility in the Bangsamoro, rather than market failure. Shadow economies thrive in conditions of state fragility, which implies that the informal economy needs to be incorporated into the subnational statebuilding project of the Bangsamoro.

### Shadow economies form part of a (trans)national political economy

Shadow economies transcend geographical as well as political boundaries and form an integral part of the national and regional political economy. For example, the evidence debunks the facile assumption that shadow economies in guns and drugs are a homegrown problem of the Bangsamoro. The main sources of illegal firearms are leakages from legal imports and government procurement, while drug criminals in the Bangsamoro source high-grade narcotics from suppliers in Metro Manila or neighbouring countries. Shadow economies are also at the centre of political arrangements that tie local powerbrokers to national elites. Local strongmen play a strategic role in extending the state's writ in the Bangsamoro. In return, they are allowed to maintain their hold over shadow economies with little intrusion from the state. The informal economy of the Bangsamoro is not a geographically self-contained phenomenon. This means that efforts by the Bangsamoro to address the challenges posed by shadow economies need to be complemented with interventions that are national or even regional in scope.

## CONCLUSION

This policy brief argues that one cannot comprehend the Bangsamoro's political and economic challenges, let alone address them, unless shadow economies are brought to the fore. Its main message is that engaging with Mindanao's shadow economies is a strategic imperative for peacebuilding in the Bangsamoro.

Shadow economies straddle formal and informal domains. This ambiguity is reinforced by the shifting alliances between state representatives, rent-seeking elites and local powerbrokers. The informal economy generates vast amounts of wealth and underpins the political power of local powerbrokers. It would therefore be a mistake to see the informal economy as a sector of and for the poor.<sup>4</sup> Reducing the informal sector to the domain of marginalised and excluded communities risks overlooking the political and economic dynamics that shape violent conflict, development and subnational state formation in the Bangsamoro.

Left to its own devices, the informal economy could have a negative impact on Mindanao's trajectory towards peace. This brief proposes that an effective peacebuilding approach should seek to minimise the conflict risks and maximise the peace dividends of shadow economies. Failure to curb criminalised shadow economies – and, in a similar vein, failure to tap the economic potential of shadow economies – could have serious consequences for violent conflict, the subnational statebuilding process and, ultimately, the transition towards a lasting peace in Mindanao.

## RECOMMENDATIONS

- Harness the peacebuilding potential of shadow economies:** Accommodating those shadow economies that provide income-generating opportunities can produce the peace dividends to instil confidence in the peace process. In the long run, the onus should be on rendering shadow economies such as cross-border trade economically productive for local communities and the Bangsamoro government. The peace process presents a window of opportunity for getting this process underway.
- Neutralise shadow economies that threaten the peace process:** The primary focus should be on the pernicious shadow economies in guns, narcotics and kidnap-for-ransom. These shadow economies pose huge physical risks for people and could have a detrimental effect on the fledgling governance institutions of the Bangsamoro. Visible police actions, jointly undertaken by the MILF and national law enforcement agencies, against loose firearms, drug markets and kidnap syndicates can boost citizens' trust in the ability of the future Bangsamoro government to provide security and justice.
- Prevent entry of ex-combatants into criminal shadow economies:** Ex-combatants possess 'marketable skills' that are of potential interest to local powerbrokers and criminal entrepreneurs in the Bangsamoro. Without alternative livelihood opportunities, former MILF combatants may be tempted to engage in criminal shadow economies. The socioeconomic development component of the peace agreement needs to adequately address the needs and grievances of ex-combatants, their families and communities.
- Expand the formal economy in the Bangsamoro:** The sheer size of the informal economy confirms structural shortcomings in the formal economy. The solution is to strengthen the formal economy, instead of curtailing the informal economy. This requires, in the first place, substantial financial investment as well as reliable security provision in conflict-affected areas. Risk-reduction measures for local entrepreneurs – for instance, through targeted subsidies, protectionist measures or development aid – should form part of targeted interventions to strengthen and expand the formal sector in the Bangsamoro.
- Explore options to formalise the informal sector:** Bangsamoro agencies should consider how they could support sectors and communities involved in various shadow economies to move within a system of regulation. A mix of incentives and adequate support can sustain the creation of income-generating opportunities and gradually incorporate these shadow economies into the formal sector. One strategy to consider is voluntary formalisation by informal entrepreneurs. For instance, they can be incentivised to comply with regulations in exchange for legal status, access to finance and reduction of regulatory barriers.
- Adopt a conflict-sensitive approach to shadow economies:** Shadow economies can trigger or contribute to violent conflict, especially when formal institutions clash with informal institutions and shadow authorities. Adopting a conflict-sensitive approach to shadow economies can help stakeholders in the peace process to minimise the risk of violent conflict at a delicate time in the peace process. Care should be taken to not simply impose formal structures and processes on the informal economy, as this may provoke a violent response. Shadow authorities and local powerbrokers should not be excluded and instead be harnessed as effective instruments to mitigate conflict risks.

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## Endnotes

- Reprinted with minor changes in January 2017 and April 2018.
- J. MacGaffey (1991). *The Real Economy of Zaire: The Contribution of Smuggling and other Unofficial Activities to National Wealth*. London: James Currey. p.10.
- F. Lara and P. Champain (2009). *Inclusive Peace in Muslim Mindanao: Revisiting the Dynamics of Conflict and Exclusion*. London: International Alert. Available at <http://www.international-alert.org/resources/publications/inclusive-peace-muslim-mindanao>
- On this point, see also C. Nordstrom (2004). *Shadows of War: Violence, Power, and International Profiteering in the Twenty-First Century*. Berkeley and Los Angeles: University of California Press. p.107.

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