

# Causality and Critical Thinking: Illicit Economy and Fragile State

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**Abstract.** This paper seeks to address a two-sided question of the state illicit economy: can the illicit economy, which is undoubtedly harmful to the state, also be a beneficial enabler. The prevailing view is affirmative. The answer in this paper is negative. Focusing on the regions and countries around the world where the illicit economy has proliferated over the past three decades, this paper examines how it has been destroying state authority over time. Meanwhile, this paper critically thinks the dominant view that “the illicit economy can help national policy development, and that marginalised groups in the global South can use it to access markets”, and suggests that states that abuse the illicit economy are simply quenching thirst with poison. This paper also fills a research gap on the causality between the illicit economy and “fragile” states, which until then had not been associated with the illicit economy. The causes of what constitutes a “fragile” state were generally associated with violent conflict, services, regulation and human security.

**Keywords:** Illicit Economy; Fragile State; State Authority.

## 1. Introduction

The illicit economy is the clandestine and unauthorised cross-border movement of people, technology, money and information, which is prohibited and often associated with violence and lawlessness (e.g., drugs, antiques and endangered species, counterfeit currency) (Andreas, 2015). Such lawlessness is essentially a form of state construction, where the state is involved in almost every link of the illicit market chain, and this acquiescence weakens the legitimacy of state law and rights (Heyman and Smart, 1999). According to this logic, the illicit economy is the main culprit in hindering the national development, weakening the power of the state and breeding violence and instability.

However, at this point, some scholars have taken a positive view of the association between the illicit economy and the state. This has led to controversy and fragmentation in this field of research. For example, Gutierrez (2020) argues that the illicit economy can be a positive element of national development policy, which can help the state to formulate policies, improve institutions and environment. This view is clearly reflected into his 2015 publication *Drugs and Illicit Practices: Assessing their impact on development and governance* and his 2020 publication *The paradox of illicit economies: survival, resilience, and the limits of development and drug policy orthodoxy*.

In addition, Meehan (2021) argues that participation in the illicit economy provides a socio-economic solution for the integration of some marginalised groups (opium farmers in Myanmar) in the Global South into global markets. Illicit economy can help them address the renewed poverty and instability brought about by “economic liberalisation, market integration and agricultural modernisation”, as they are “left behind” in this process. Mansfield (2019) argues that the illicit economy can bring innovation in technology and industrial progress to the state, such as the increase in opium production in Afghanistan, which has boosted demand for solar energy equipment in Afghanistan.

It has to be acknowledged that many scholars admit that the illicit economy can make contribution to the state, albeit at a significant cost (e.g., state stability), and the state can use the illicit economy to develop national economy and improve state infrastructure.

However, this paper argues that the illicit economy is one of the essential causes of “fragile” state, defined by Stewart et al (2009) as a state that lack authority (authority failure), service entitlement failure, or lack legitimacy (legitimacy failure). Illegal economies gradually undermine the

construction of a state by eroding state authority, threatening state security and, ultimately, slowly forcing the state to become its protector, making the state “fragile”. This argument counters the view of above scholars that the illicit economy is conducive to sustainable state development, and fills the lack of causality research on the illicit economy and the “fragile” state.

This paper focuses on the last three decades, with a regional focus on countries in the global South and countries in the North (e.g., USA, Mexico) where illicit economies are rampant.

## 2. Literature Review

### 2.1 Main Theory Underlying this Paper

The main objective of this paper is to identify the causality of the illicit economy and fragile states, meanwhile, to critical think the dominant view that the illicit economy facilitates state policy development. Therefore, the grounded theory applied in this paper is the “fragile” state theory of Stewart et al (2009) and Grimm et al (2014), with Grimm et al's (2014) theory being more politically oriented; and Gutierrez's (2020) Illicit Economy-State nexus theory, which argues that the illicit economy facilitates state policy and infrastructure development; and Snyder and Duran-Martinez's (2009) theory of the drug trade and state-sponsored protection rackets; and Reuter and Trautmann's (2009) theory of “state enforcement distortions”.

Stewart et al (2009) include a wide range of views in their definition of “fragile” states, resulting in a new, all-encompassing definition. Fragility is manifested in three main ways: 1) Authority failures. The state fails to protect its citizens from violence/crime. 2) Service failures. The state fails to provide basic services such as healthcare, education and infrastructure. 3) legitimacy failures. The state lacks public support or is only supported by a small number of people or interest groups within the country. Stewart et al (2009) argue that the fragility of the state is a direct result of government activities and that the state suffers from weaknesses in governance. Grimm et al (2014) focus on international aid and how countries defined as “fragile” use the concept for strategic purposes. Grimm et al (2014) understand “fragile” states more in political contexts.

Gutierrez (2020) argues that illicit crops (e.g. opium, coca) are a source of stability for countries and even a generator of economic growth, by studying local conditions in Afghanistan, Myanmar, Colombia and Bolivia. He argues that in “fragile” and conflict-affected households, unorthodox strategies are needed to cope with changing and insecure environments.

Snyder and Duran-Martinez's (2009) theory of the illicit economy and the state protection rackets is important. by examining the cases of drug trafficking in Mexico and Burma, they suggest that the illicit economy does not necessarily generate violence and that the relationship between the illicit economy and violence depends on the institution of protection. When the state sponsors the illicit economy, the illicit market may be peaceful; when the state umbrella breaks down, for example, with improved government enforcement or well-intentioned policy reforms, the illicit economy may lead to violence. Snyder and Duran-Martinez's (2009) theory is a cautionary warning for some countries that seek to use the illicit economy for nation-building, because the illicit economy cannot be successfully banned after it has benefited the country's development, and banning the illicit economy is associated with violent conflict.

Reuter and Trautmann (2009) found partial enforcement distortions in their investigation of illicit economic enforcement. Instead of having the desired results, enforcement has even had negative effects. For example, bans aimed at reducing drug syringes have instead led to an increase in needle sharing and accelerated the spread of blood diseases (e.g. HIV); in 2006, a crackdown on drug trafficking in Mexico resulted in horrific killings that weakened the legitimacy of the Mexican all level governments; many people were imprisoned for drug trafficking, resulting in children being left without their parents for long periods of time; in the US, arrests of cocaine traffickers tripled, resulting in cocaine prices have increased by 5-15% with no reduction in purchases (Kuziemko and Levitt, 2004). All of these law enforcement distortions demonstrate the complexity of the damage the illicit economy causes to the country.

In summary, the above-mentioned notion of Gutierrez (2020) is that, the illicit economy is conducive to national development and can be used to build the state; however, summarising Snyder and Duran-Martinez's (2009) and Reuter and Trautmann's (2009) perceptions, it can be concluded that the illicit economy is difficult for the state to properly control. Its prohibition can lead to violent conflict, and even the enforcement of the illicit economy can be distorted to various degrees. Any country that wants a stable and secure environment or aspires to long-term prosperity should not rely on the illicit economy to develop its economy. Further, illicit economy can lead to the failure of a state's authority, services and legitimacy, according to Stewart et al's (2009) definition of a "fragile" state, there is a causality between illicit economy and "fragile" state.

## 2.2 Overall Background

The struggle between the illicit economy and state power has continued unabated over the past three decades. The illicit economy is certainly not limited to drugs (Bainister, Boyce and Slack, 2015), and the World Wide Web is full of news reports of transnational illicit economy (Schendel and Abraham, 2005): endangered species smuggling from Jakarta and Moscow to overseas collectors; banned ozone-depleting chemicals in transit between India, Nepal and Bangladesh; the fall of the Taliban government linked to an astonishing increase in the flow of opium and heroin from Afghanistan to Russia and worldwide; the countless sex trade and slavery: Moldavian women to Germany, Nigerian children to Britain, Nepalese to India, Filipinos to Japan (Chantavanich, 2003). Terror is multiplied when illicit actions are merged, such as illicitly hunted animals whose skins are filled with cocaine, or illicit migrants who are "mined" for their organs (Frears, 2002).

The illicit economy is inextricably linked to the state, which may be clandestinely involved in it through authorisation, such as the clandestine trafficking of weapons to Mexico by the US Bureau of Alcohol, Tobacco and Firearms as part of intelligence-gathering operations (Conroy, 2012). Rampant illicit economies may involve lax or permissive regulatory processes, such as 2012, US judiciary decided not to criminally prosecute HSBC (which laundered billions of dollars in illicit drug profits) (Greenwald, 2012). The UN World Drug Report 2011 estimates that the global drug market is worth between \$20 billion and \$500 billion per year (Bainister, Boyce and Slack, 2015), Even though some psychotropic substances are sold locally or across the border as valuables under the legal control of the authorities (McAllister, 2000. Buxton, 2010. Pietschman, 2007), such a huge flow of illicit money for drugs reflects the failure of state authorities to protect state property. As Campbell (2009) describes: state actors "proactively provide aircraft, cargo trucks, and falsify official documents to allow the illicit economy to flow freely through airports, highways, checkpoints and border crossings".

## 2.3 Research Gap about Illicit Economy and Fragile State

There is some research gap between the illicit economy and fragile states, it means the illicit economy is not included within the definition of how a state is "fragile". Whereas, in fact, the illicit economy contributes to fragile states and it is important to include the illicit economy in the approach to defining fragile states. Because the fragility of the state is important in international development cooperation. The provision of financial assistance by states or international organisations to developing countries depends on two basic conditions: the state must exist and there must be a competent and authorised government (Engelhardt, 2018). The lack of a government with legal and practical capacity can make development cooperation very complicated, delayed, or even impossible to complete (OECD, 2013).

Thus, in international politics, some countries with a rampant illicit economy may need help from international aid organisations, but are excluded from being "fragile" states, because they have good economic indicators and a well-developed infrastructure.

The illicit economy may indeed develop a country's economy, but it gradually erodes a country's authority and legitimacy, which is particularly important in international politics. An illicit economy can lead to the fragility of a state's political rights, but because it cannot be defined as a "fragile" state,

it is difficult to access international assistance. Therefore, it is important to explore the causality between “fragile” states and the illicit economy.

There is no consensus definition of a “fragile” state, a typical example often cited is the OECD definition: “a fragile region or state with a weak capacity to carry out basic governance functions and a lack of capacity to build relationships with each other for social development”. In the 2015-2016 *Harmonized List of Fragile Situations*, the World Bank classified 34 countries and one region (West Bank and Gaza Strip) as fragile. The concept of state fragility is relatively new, but is fast becoming an integral part of international politics (Ghani and Lockhart, 2008. Kaplan, 2008). Stewart et al (2009) refine the concept of fragile states further. The concept of fragile states is relatively new in the 2010s, but by the 2020s, more research has been conducted on it.

In general, fragile states are associated with diplomatic development policies, state stability, per capita income, and human rights. War, violence and human rights oppression are all associated with “fragile” states. This paper focuses on demonstrating that the illicit economy makes states fragile, based on Stewart et al's (2009) definition of a “fragile” state. It fills the research gap between the illicit economy and fragile states.

### 3. The Causality between Illicit Economy and Fragile State

The concept of “fragile” states has been interpreted in a variety of ways, with the meaning reflecting the strategic vision and political goals of the main advocates (Grimm et al., 2014). Stewart et al (2009) emphasise the following three dimensions for defining fragile states. Although their study is not an exhaustive and all-encompassing approach, it is still a more comprehensive approach to the concept of fragile state. This paper will explore in detail how the illicit economy contributes to the fragility of a country, based on the definition of Stewart et al (2009).

#### 3.1 State Authority

Is the illicit economy a double-edged sword for state authority? For example, Gutierrez (2015) argues that the illicit economy has completed state building in Tajikistan, while also strengthening state authority in Colombia.

In reality, the massive drug trade permitted by Tajikistan's 1997 *Peace and Cooperation Agreement* has severely undermined the prestige of the government (Danieli, 2011); the Colombian government has allowed drug traffickers to use their status as “armed political actors involved in the suppression of the rebellion” to more effectively launder money, or to use this status to evade justice and avoid extradition requests from the US drug enforcement authorities (Grajales, 2011); in Mali, the “armed trade” has turned the encouraged interstate trade into a smuggling market for commodities. And in the 1990s, Caribbean pirates became the “supply major economic force supplying urban markets in North America” (Andreas, 2015).

The illicit economy undermines central government control, distorts the market economy and increases inequality. It is worth mentioning that the illicit economy is global, and in the age of globalisation, no one is immune to it. For example, the drug trade is, actually, a trade chain that spans the entire earth, damaging not only countries where drug cultivation is widespread (e.g. Colombia, Afghanistan), but also developed countries or regions that purchase drugs in large quantities (e.g. USA, Europe). In fact, the world drug trade developed a well-established supply system as early as the 1960s. The majority of cocaine in the global chain of cocaine commodities originates in the Andean regions or Latin American, and is sold largely to the United States, Europe, Canada and Mexico (Gillies, 2021). All of this means that the erosion of state authority by the illicit economy is globally oriented.

This brings back the question posed at the beginning of this section: is the illicit economy a double-edged sword for state authority? The answer is negative. For the illicit economy is uncontrollable and there is always more to lose than to gain. This is despite the fact that some countries are blinded by the huge benefits that the illicit economy brings. The consequences of the state's indulgence in the

illicit economy have been described above, but is it feasible for a state to attempt to control the illicit economy within reasonable limits? The answer is also negative. It will only be followed by corruption, resistance and conflict.

For example, in 2001, in the Helmand province of southern Afghanistan, the Department of Development of International Development (DFID) began destroying opium crops and providing compensation to farmers in the form of aid. However, this enforcement had two consequences: 1) the local authorities pocketed large quantities of money; and 2) in 2006, angry farmers clashed with the government and demanded that the authorities return the destroyed crops (Gutierrez, 2020). In addition, the Andean Initiative (1989), Plan Colombia (1999) and the Mérida Initiative (2008) have all produced the same problems: the “balloon effect” (The “balloon effect”: in order to fill the supply gap created by the intervention, some households migrate to other areas to continue illicit cultivation, and others who are not cultivating illegally may start to do so.) (Gootenberg, 2014, cited in Gillies, 2021, p.9) and human rights violations (Youngers and Roisin, 2002, cited in Gillies, 2021, p.9).

### 3.2 State Service

According to the Canadian Indicators Foreign Policy (CIFP, 2004), fragile states include countries that “lack the functional authority to provide basic security within their borders”. Stewart et al (2009) provide a more concise definition of “failure of service”. In general, fragile states are unable to build a secure service system.

Apparently, the illicit economy is a significant threat to the basic security of the state. For example, Gutierrez (2020) argues that the scope and scale of the illicit economy profoundly affects the accessibility of land and markets, especially for marginalised farmers in the global market. In addition, illicit cross-border financial flows threaten national service systems and national security. For example, global cocaine sales reached US\$169.2 billion in 2018, based on a street price of US\$120,000 per kilo for cocaine in Chicago ((Reuter and Trautmann, 2009, p. 23). Meanwhile, sales of sugar and coffee only reached US\$69.7 billion and US\$107.8 billion (Shahbandeh, 2021). This means that large amounts of land are being deprived of illicit crops and the resulting illicit capital is flowing around the globe. People growing illicit crops do not have access to legal commodity markets and are often associated with violence and conflict. For example, according to the Centre National Memory of History, over 218,000 people died in Colombia as a result of the drug conflict and over 5.7 million were displaced (CNMH, 2012). Illicit crops consume large amounts of local water resources, leading to further water shortages in an already desertified environment. For example, opium cultivation contaminates soil and water sources.

In addition to this, the illicit economy may hinder the state's regulatory and law enforcement services and distort domestic enforcement. For example, many hardline countries (Russia, China, Saudi Arabia) have also stalled on reforming the illicit economy (Walsh and Jelsma, 2019); the Global Commission on Drugs has concluded that the “war on drugs” has failed; and the US has shifted its approach to drugs from prohibitionism to public health--such as the legalisation of marijuana in the US states, or the allowance of safe and legal drug injection centres in some US states in 2021. Illicit economies render state services ineffective because, according to Reuter and Trautmann (2009), they lead to “domestic enforcement distortions”. The specific idea of domestic enforcement services is to make contraband more expensive/harder to obtain. The basic model is to arrest, imprison and detain producers and distributors, raising the cost of trafficking in contraband (Reuter and Kleiman, 1986). The higher the risk of trafficking, the higher the service fee charged by the supplier and the lower the number of buyers. However, a published study in the US, which rigorously tested the effects of increased enforcement, disproved this view. The test found that: when the number of people arrested for selling cocaine triples, the price of cocaine increases by 5-15% (a huge increase) and, according to the enforcement model, the number of people buying the contraband should be deterred by the increased service fees. In reality, however, the number of purchases does not decrease (Kuziemko and Levitt, 2004). As a result, producers and sellers have instead received more illicit funds through domestic enforcement services.

The illicit economy distorts the pattern of enforcement and regulatory services of the state. Regulatory services for the illicit economy have instead led to increased revenues for suppliers and producers of the illicit economy. This “domestic enforcement distortion” is one of the features that distinguishes the illicit economy from other licit economies. It dismantles the state's regular system of regulatory services.

### 3.3 State Legitimacy

The legitimacy of the state is reflected in having an authorised and legitimate government. The illicit economy has, over the last thirty years, made the state a protection racket for the illicit economy (Snyder and Duran-Martinez, 2009). The illicit economy is eroding the legitimacy of government, and states that use the illicit economy to develop only eventually injure themselves. According to Snyder and Duran-Martinez (2009), if the state provides a protective net for the illicit economy and is supportive of it, then the market is peaceful. For example, the Burmese government's support for the illicit economy greatly reduced the civil war and violence after 1990. But if the state tries to control or discard the protective net after gaining benefits, then violent conflict ensues. For example, the Mexican government formed an umbrella to support the illegal economy in the 1940s, but its disintegration in the 1990s triggered the violence and continued collapse of the state. Snyder and Duran-Martinez's (2009) argument suggests that the legitimacy of states involved in the illicit economy confront only two outcomes: either the state forms a protection network for the illicit economy, engages in illicit trade and allows it to erode central authority, or it controls the illicit economy and accepts violent conflict. Either scenario reflects the trampling of state legitimacy by the illicit economy.

For example, according to a *US Senate report*, in 2012, the US Senate investigated HSBC, one of Europe's largest banks, which laundered billions of dollars for Mexican drug cartels. However, its actions received protection from the UK government, which argued that revoking the bank's licence to operate would significantly raise unemployment rate. Ultimately, the US government did not appeal. The state protects the illicit economy in order to maintain domestic stability, but at the same time, the power and legitimacy of the state is seriously violated. In addition, the state protects the illicit economy for the purpose of controlling “public danger”. For example, drug traffickers are obliged to submit trade information about their drug consumers (Gambetta, 1996), competitors and class enemies from abroad (Stanley, 1996). Drug traffickers are also expected to assist the police and political system by providing material for the judiciary (Lupsha, 1991). The protective network created by the collusion of the state with the illicit economy erodes the legitimacy of the state in a variety of ways.

## 4. The Critical Thinking about Illicit Economy and State Development

If one focuses on the illicit economy and state development, it is easy to find many examples of the contribution of the illicit economy to state development. For example, in Afghanistan, farmers have converted desert land into agricultural land by building deep wells using solar energy with generous loans from opium traders (Gutierrez, 2020); in Colombia and Putumayo, illicit coca cultivation has brought marginalised farmers into the mainstream economy market; and bank deposits per capita in Putumayo went from 179 in 1995 to 1049 in 2005. The illicit economy has changed the structure of the state and market in Putumayo (Torres, 2011).

Therefore, it is no wonder why the relevance between illicit economies and fragile states has been difficult to identify. “Differences in the size of economies suggest that illicit does not always breed fragility” (Gutierrez, 2020). Even part of the mainstream view is that the illicit economy can contribute to the development of the state.

However, this paper argues that the illicit economy brings only disadvantages to state development, and it selects the most representative illicit economy: the drug economy, to prove this view. This paper focuses on the countries around the world where the drug economy is most prevalent. As can

be seen in Figure 1 and Figure 2 below, the major opium producers and exporters in Asia are Afghanistan and Myanmar, and the major importers/regions are the Central Asian countries and Europe. The major cocaine producers and exporters in North and South America are the Andean region, and the major importers are the United States, Canada Mexico and Europe. Therefore, this paper investigates the drug trade in Afghanistan and Colombia, to critically research the drug economy (illicit economy) and state development.

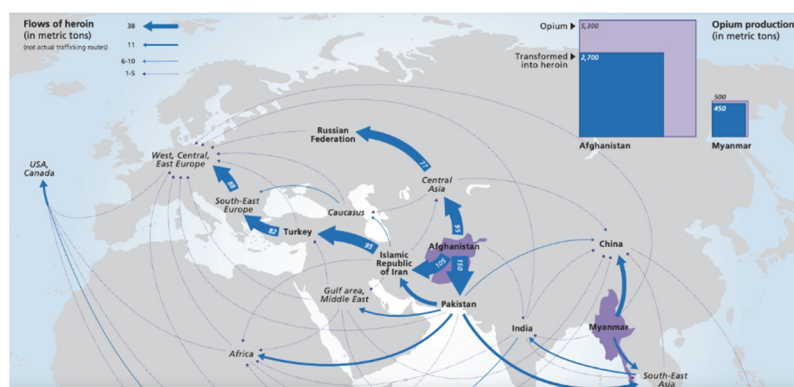


Figure 1. The drug (opium) chain in the Asian



Figure 2. The drug (cocaine) chain in the North and South America/Europe

#### 4.1 Afghanistan

Afghanistan is ranked first in the world in terms of opium extraction, which is accompanied by the smuggling of chemicals. For example, in 2008, approximately 2,700 metric tons of opium were refined into approximately 380 metric tons of heroin in Afghanistan (UNODC, 2010), with Myanmar and Laos in second place generating 40 tons of heroin. In this process, a key chemical for the extraction of opium, acetic anhydride, is also diverted from the licit trade and smuggled into Afghanistan (or other potential countries of processing). Production, refining and trafficking on such a large scale make it impossible for the Afghan authorities to effectively curb the drug industry. For example, while Afghan authorities reported destroying 69 opium manufacturing facilities in 2008, while UNODC investigators found 97 facilities in the same year (UNODC, 2009). Besides, almost every province in Afghanistan is involved in the drug processing trade chain. For example, processing and cultivation is concentrated in Hilmand (which accounts for 50% of opium seizures), Kandahar and Nimroz in the south (UNODC, 2009); in the country’s centre, Nad Ali also has a large seizure volume. Meanwhile, Afghan opium and heroin are trafficked and sold in almost every corner of the globe. 1.3% of the opium and purified heroin produced in Afghanistan remains locally for consumption within the country, or is seized by enforcement authorities (the seizure rate less than 1%). The remaining 98% or so of the drug flows through Central Asian countries for export to Europe, Russia and Asia. Illicit drug crops are considered to be a cause of violent conflict, or at least an essential attribute. The UN Commission on Narcotic Drugs (CND) described in its 2009 *Political Declaration* that “drugs infect societies through open wounds” (UNODC, 2009).

In general, drugs have made Afghanistan fragile by creating a chain of production that has increased violence and conflict in Afghanistan; weakening the government's authority to operate and weakening its regulatory services. The “open wound” created by drugs is spreading from Afghanistan to the rest of the world. Even if drugs may accelerate Afghanistan's economic and state development to some extent, the consequences of this development are miserable.

## 4.2 Colombia

How the violent conflict resulting from the illicit economy eroded the power of service in Colombia. From August to December 1889, drug traffickers engaged in war with the government in reaction to arrests; by October of the same year, Colombian police linked 142 deadly bomb attacks to the Medellin Cartel (a highly organised Colombian drug cartel), with nearly 100 car bombs exploding in banks and hotels in major Colombian cities. Ramirez (2011) explains that the central government described the Colombian province of Putumayo as “an uncivilised and disorderly place, beyond the hegemonic control of the state”. Vargas (2014) points out that Colombia's agreement on drug control is weak, limiting the vision to drug crop substitution and not considering the persistence of the criminal economy. The Table 1 below shows essential data on drug crops in Colombia in 2017.

**Table 1.** Illicit drug production in Colombia

	Colombia - cocaine and cannabis
Population	49.06 million
GDP 2017 (WBG figures)	\$314.46 billion
Land area	1.142 square Kilometres
Land area planted to illicit crop	146,000 hectares (68.5%) of world total of 213,000 hectares (UNODC, 2018b, p.29).
Illicit crop production level	9000 tons (85%) of 10,500 tons of cannabis produced globally in 2017 (UNODC, 2018b, p.12).
Processed drugs production levels	Estimated production is 866 tons (61%) of the total of 1410 tons of cocaine produced globally, of which 378 tons were seized in Colombia (UNODC, 2018b, p.29).
Estimate of the size of the illicit economy as a proportion of GDP	The farmgate value of coca leaf production in Colombia is about 0.2% of GDP, or 3% of the agricultural sector's GDP.

Source: UNODC, 2018.

## 5. Conclusion

In summary, firstly, this paper explores the causality between the illicit economy and the “fragile” state. It concludes that the illicit economy contributes to fragile states. Colombia, for example, continues to suffer from violence, war and service failures caused by the illicit economy. In reality, however, Colombia is not defined as a “fragile” state because of its high GDP and foreign investment, as well as the huge benefits derived from the drug trade. Thus, it seems unfair to exclude the illicit economy from the definition of a “fragile” state at this stage of international cooperation and assistance. In international political interaction, the illicit economy should be recognised as the one of dominant factors in “fragile” states.

Secondly, the paper refutes the prevailing view that “the illicit economics are conducive to state development”, and citing Afghanistan and Colombia as examples of countries that are important exporters of drugs in Asia and North/South America, respectively. Investigations have shown that the drug trade has ultimately only served to dismantle state power in both countries, exacerbating conflicts and finally, infecting the whole world.

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