

Challenges of money laundering for sovereign states that uses the US dollar

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Abstract

Purpose – There has been almost no scholarly work on the challenges of money laundering in sovereign states that use the US dollar as their currency of choice. This study aims to break the silence by highlighting how money laundering thrives in these situations mainly due to lack of or weak regulation of the US dollar by both the adopting states and the USA.

Design/methodology/approach – The research depended on various secondary data sources. It is an adapted academic version of a shorter piece for a professional magazine for professionals in the Anti-Money Laundering (AML) Field.

Findings – Preliminary findings show that due to the lack of regulation of the US dollar in dollarized economies, unscrupulous politicians, organized criminal gangs and multinational corporations among others can use a variation of the Black Market Peso Exchange (BMPE) to counteract money laundering controls and launder ill-gotten gains from crimes such as corruption, transnational crimes and tax evasion. Furthermore, ordinary citizens, migrant workers and small businesses avoiding stringent exchange rates are also using the black market, posing a further challenge to the law enforcement authorities.

Practical implications – The practical implications of this paper relate to how the mutations of money laundering techniques, as they are adopted by criminals, to operate in different conditions are making it difficult not only to dictate but also to address using traditional AML techniques.

Social implications – BMPE has far reaching social consequences. Hence, this study is significant to instigate a search for solutions and for further detailed studies into the money laundering techniques in countries that do not have a sovereign currency.

Originality/value – To the best of the authors' knowledge, this is the first paper to discuss the unique challenges faced by countries that have adopted the US dollar for domestic use. The paper also shows how dollarization is a modest reminder that money laundering technique such as the BMPE can evolve to counter the legislative and regulatory environment of the various jurisdictions in which they are laundered.

Keywords Zimbabwe, Black-Makes Peso Exchange

Paper type Viewpoint

Introduction

Some countries have abandoned their sovereign currency in times of economic crisis for other stable currencies. According to the World Bank, seven sovereign countries use the US dollar as their official currency of exchange. This paper uses the case of Zimbabwe as a



special reference to highlight peculiar challenges faced by these countries without the control of their sovereign currencies with regard to money laundering.

Narcotics traffickers in Colombia and Mexico invented and improved the Black Market Peso Exchange (BMPE), making it arguably the largest money laundering scheme in the world. In a variant of the BMPE, the Zimbabwean cartel is finding innovative ways of circumventing anti-money laundering (AML) controls, sanctions, perennial cash shortages and strict correspondent banking restrictions imposed on Zimbabwean financial institutions, to exchange money on the black market to externalize the proceeds of corruption outside Zimbabwe into offshore accounts.

The article argues that stronger responses are needed from the USA to limit the effects of BMPE-like techniques in states that use the US dollar as an official currency. This paper will bring to the fore the AML challenges faced by sovereign states that use the greenback as the official legal tender – a practice that is known as dollarization in the financial parlance.

Dollarization

It is necessary at this stage to first clarify what is meant by dollarization. An International Economist at the U.S. Department of the Treasury, Kurt Schuler, writes that the term “dollarization is used in varying senses that mean everything from widespread illegal use of foreign currency alongside domestic currency to official approval for use of foreign currency as the main or sole means of payment and unit of account (Schuler, 2005).” The term dollarization is *lato sensu* shorthand for the use of any foreign currency by another country [1]. Thus the issues raised in this article apply to countries that use the US dollar as it would apply to countries in the Southern Africa region using the South African rand, for example, and as it would be for any country of, say, Eastern Europe, which has adopted the euro without a formal agreement with the European Union.

What is important about the above-cited definition is that it encompasses all the stages of dollarization in Zimbabwe. At first covertly and then with increasing openness. In 2003, the Zimbabwe dollar that had deteriorated to the point where the cost of issuing it in the form of regular notes and coins was greater than the face value, resulting in the government issuing the Zimbabwe dollar by way of time-limited “bearer checks” on lower- quality paper, with very high denominations. Zimbabweans started using the US dollar as a preferred currency.

Zimbabwe experienced the first hyperinflation of the 21st century and the second highest inflation in world history (Hanke and Kwok, 2021). Although, the government terminated the reporting of official inflation statistics, to overcome the apparent insurmountable data problem two renowned economists Hanke and Kwok were able to produce reliable record of Zimbabwean inflation. According to Hanke and Kwok and at its peak in 2008, inflation spiralled out of control, reaching an annualized rate of 89.7 sextillion (or 89,700,000,000,000,000,000,000,000%) (Hanke and Kwok, 2021).

In February 2009 under the Short-Term Economic Recovery Program, Zimbabwe consented to transactions in foreign currency and to the full dollarization, albeit without any formal agreement with the U.S. The bearer checks were to circulation since 2003 were taken out of circulation (Noko, 2021). Foreign currencies – the rand, euro, pound, US dollar, metical and kwacha – replaced the Zimbabwe dollar (Noko, 2021). Zimbabwe became the world’s only multi-currency economy in the world [2]. Other currencies, however, remain far behind the US dollar in daily usage.

To fund government spending and help ease the liquidity crisis, the central bank began printing a surrogate currency called the bond notes in 2016 ostensibly “to guard against externalization of the US dollar” [3]. Bond notes were pegged, at least theoretically, to the dollar³. Unsurprisingly, Zimbabweans had no faith that they were equivalent and, on the black

market, bond notes lost value against the dollar. In 2019, the government declared that all commercial transactions be conducted electronically using the Real-Time Gross Settlement (RTGS) dollar understood locally to describe money that has been transferred into a bank account [4]. Despite all the efforts by the government to re-introduced a Zimbabwean currency, a virtual currency of sort and banning foreign currencies for local transactions, the local currency is quickly devalued and only the black market thrived, resulting in multiple exchange rates while the shortage of cash persisted (Jeff, 2021).

Significantly, the government has given up on the pretence that the bond note and the US dollar have the same value by introducing an auction (not to be mistaken with the Zimbabwean dollar auction where the rare ZW\$100 trillion-dollar notes can be purchased by money collectors, memorabilia enthusiasts (and money launderers [5]) system that operates on the Reuters Forex Trading platform, a real-time electronic trading system [6]. The auctions are designed to improve transparency and efficiency in trading of forex in Zimbabwe [7]. Sources of the government's US dollars are not published. This raises fears that the government is sourcing money from the black market. In a testimony to the court, it emerged parastatals are sourcing money on the black market through the use of shelf companies to hide their identities. The black market offers a much better rate than the official rate.

Black market forex dealers “fixing the economy”

Pic 1

(Photo AP/Tsvangirayi Mkwazhi)



Ordinary Zimbabweans are paying a heavy economic price for the political transgressions of their leaders. The once-prosperous Southern African country's economy is so weak from de-industrialization, low investment, low exports and high debt that it does not generate an adequate inflow of fresh US dollars needed for its dollarized economy. Once in the system the note will be in circulation until it disintegrates. A currency trader mends an old bill that is worn out or shredded by rats [8]. Ironically, the black market currency traders are not just fixing shredded bills, but they are fixing the economy in a country where the black market has become the normal⁸.

The black market is predominantly a roadside currency trade in which the US dollar is exchanged for local currency and other currencies in the multi-currency basket. Most of the trading happens in the streets of major cities and towns in broad day light as if it is legal. As one commentator noted “The trading of money had become one of the largest employers, as

tens of thousands of people throughout the country saw it as the only viable source of income” (Pilossof, 2009). The significance here is that when a government corrupts its official market, a black market arises in equal measure to recreate a “free” market. Ironically its very illegality assures that it remains free of regulations and functions effectively (Pilossof, 2009). In other words, the black market system, because of its appeal and acceptance, has become institutionally accepted [9].

In a variant of the BMPE, the Zimbabwean cartel is finding innovative ways of circumventing AML controls, perennial cash shortages, sanctions and correspondent banking restrictions imposed on Zimbabwean financial institutions, to launder and hide proceeds of corruption in foreign jurisdictions. This is unlike the drug cartels who used it in order to repatriate their wealth earned in another national jurisdiction. One study by a South African-based *Daily Maverick* classified the cartels into three categories, namely, first, the collusive relationship between private sector companies; second, those officials abusing public office; and third and main type, collusive relationships between public officials and the private sector [10]. A common denominator that underpins cartelism in Zimbabwe is they all “go against the public interest, and they are characterised by collusion between the private sector and influential politicians to attain monopolistic positions, fix prices and stifle competition” asserts the report¹⁰.

As with the BMPE, it is not only criminals using the methods. The BMPE is used by South American professionals to send dollars to their children studying in the USA. In Zimbabwe, it is used by ordinary citizens, migrant communities, as well as small businesses, to avoid the low official rate, to access money faster and for mundane activities such as buying groceries from the remittances they receive from relatives abroad. The BMPE in Zimbabwe is serving as a way to send money to friends and relatives living in Zimbabwe, as well as a way for affluent Zimbabweans to accumulate stable US dollars as a hedge against an unstable Zimbabwean dollar.

Whose responsibility is it to keep the US dollar clean?

Pic 2



The above image taken by Tsvangirayi Mukwazhi a Zimbabwean photographer and used in an article “Money Laundering in Zimbabwe Takes Soap: With many dollars too smelly to handle they are going through the spin cycle” is satirical [11]. There seems to

be no clear guidelines on dollarization. Malo argued that dollarization is deemed complete when a country's government declares US dollar to be official legal tender and "This can also be accompanied by a formal agreement between the country adopting the currency and the country that actually issues it, but not necessarily [12]." This lack of regulation, has kicked the door open for money laundering by the Zimbabwean cartels.

As well as the Colombian cartels who invented the BMPE the cartels in Zimbabwe are taking advantage of the country's high mobile penetration that serves more than 90% of Zimbabweans' cash-in and cash-out functionality (Kwaramba, 2020). The cartels deposit dirty cash into a mobile account through a mobile money agent (unwittingly or working in cahoots with the black-market dealers) and withdraw physical cash at a convenient time and place [13]. There are various sources of dirty money that is used in the laundering the proceeds.

First remittances: Zimbabwe enjoys relatively large inflows of remittances, according to the World Bank in 2019 Zimbabwe received \$1.9bn (Cotterill, 2019) remittances made possible by political violence that resulted in widespread emigration (Zikhali, 2020) which in turn led to significant transnational transfers of funds through remittances [14]. Because of a shrinking formal economy and the cost of sending money to Zimbabwe that is significantly higher than elsewhere in the world remittances are often channelled through informal remittance transfer systems (IRTS) [15], such as transport companies, *hawala* operators owned or controlled by the cartels (World Bank, 2020). In other words, remittances have encouraged government corruption in a manner similar to the natural resources curse [16].

Second, corruption: corrupt officials give money to black market currency traders. As numerous reports have shown over the years, politically exposed persons (PEPs) with links to the central bank are getting money flowing straight from the central bank on to the streets through their Runners. Runners are proxies for PEPs who are in an asymmetrical relationship with the PEP and basically run a private sector entity on behalf of the PEP. They are typically loyal to one PEP or faction and oftentimes are a member of the PEP's extended family; a family friend; associated with the same social group the PEP is associated with, for example a church, or clubs and alumni groups; or have provided services to the PEP such as legal services or financial advice [17].

Third, organized crime: Criminals have taken advantage of the short supply of cash in Zimbabwe to legitimize illicit proceeds. Dirty dollars are obtained from illegal sources are sold on the black market to stranded Zimbabweans for their daily use. The major crimes providing foreign currency are mainly the illicit trade of Zimbabwe's minerals mainly gold and diamonds. In one region of Chiyadzwa artisan miners illegally operates with the blessing of the army loads of foreigners (mostly Israelis and Russians) roam freely with literally with suitcases of cash buying diamonds [18]. There is also trade happening just outside the border on the side of Mozambique a country currently struggling with an ISIS outfit the Cabo Delgado province attacking cities near the multi-million-dollar natural gas projects.

As is the way with the BMPE money laundering scheme cash comes out clean. The Zimbabwean cartel *cleans* proceeds from the main predicate offences including illicit minerals trading, tax fraud and proceeds from corruption and ironically externalisation of currency (which is a crime in Zimbabwe) [19]. Externalisation is defined as the "illegal transfer/export of foreign exchange and/or assets from Zimbabwe and/or offshore retention of foreign exchange and/or assets due to Zimbabwe, without relevant regulatory authorizations" [20]. While in a typical BMPE, no currency crosses borders, only title to a stash of cash or a highly negotiable instrument denominated in one of the currencies. It is not unusual to see the newly minted bond notes in neighbouring states even before they are

in circulation in Zimbabwe. The Financial Intelligence Unit estimates that over US\$3bn is externalised annually [21]. Roughly equivalent to country's aid from the US Government since 1980 (U.S Embassy in Zimbabwe, 2021).

Dirty money in the possession of the Zimbabwean cartels cannot be simply stashed under the mattress. Thus, the BMPE a system developed in Colombia has proved useful to the cartel as a one stop shop laundromat. It is used in all the three stages of money laundering with *placement* in the form of change of currency; *layering* wire transfers to those who want to earn higher (official RTGS/Bond notes) deposits into a single or mobile platform accounts; *integration* use of criminal proceeds in transactions with third parties – linked with the cartel. In combination with the informal remittances' money is deposited into accounts in neighbouring countries with weak AML such as Botswana. Waiting to be used in the event the PEPs are driven into exile to plan their return to power and/or blocking any attempts to make them account for their role in economic plunder and human rights violations. In so doing, the looting machine is robbing Zimbabweans of cash for hospitals, schools, roads and food security among others.

What is the way forward?

The USA has at least a moral obligation if not legal obligation to ensure the proper use of the US dollar, in those territories and sovereign states that have dollarized. By tearing a page out of the BMPE playbook, cartels in Zimbabwe are able to externalize the proceeds of crime overseas destabilizing economies and threatening security of the region and beyond. For instance, Zimbabwe could be used as a conduit country for financing terrorism in the neighbouring Mozambique where militants with links to ISIS are gaining a foothold into the region. If the USA has offered to assist the Mozambican Government in combating the insurgency. It should also curb money laundering in the region otherwise its efforts will be similar to clapping with one hand.

Notes

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