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The Impact of Economic Sanctions on Financial Services: A Case of Commercial Banks in Zimbabwe

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Abstract: The study sought to assess the impact of economic sanctions on financial services offered by commercial banks in Zimbabwe for the purpose of establishing strategies that could be adopted by the affected banks. The study sought to address the following objectives; assess the impact of economic sanctions that affected the financial services offered by commercial banks in Zimbabwe; outline the nature and forms of economic sanctions which affected financial services offered by Zimbabwean commercial banks; and finally craft strategies that could be adopted by commercial banks to lessen the impact of economic sanctions. The study found that trade and financial restrictions were the major forms of economic sanctions which affected financial service provision of commercial banks in Zimbabwe during the period under study. These restrictions resulted in closure of some nostro (foreign) accounts, failure to access offshore lines of credit, difficulties in international money transfers as well as incapacitating financial intermediation. The study recommended that Zimbabwean commercial banks enter into strategic partnerships with some renowned international banks to enable them to survive the challenges posed by economic sanctions. Entering into strategic alliances with other banks (local and international) was also suggested as an option that could lessen the impact of economic sanctions. Diversification of operations in line with the Banking Act to limit the negative effects of economic sanctions was also recommended to commercial banks.

JEL Classifications: F18, F34 G21, H12

Keywords: Sanctions, Economic Sanctions, Commercial Bank, Financial Services, Nostro Account

1. Introduction

The issue of sanctions in Zimbabwe has received so much attention both inside and outside the country. Since the year 2000, Zimbabwe has been receiving sets of sanctions mainly from the United States of America (USA), United Kingdom (UK), European Union (EU), Australia and Canada. According to Chingono (2010), these western states cite human rights abuse, political intolerance, violation of property ownership rights, and disrespect for the rule of law as their major reasons for imposing the sanctions. On the contrary, the Zimbabwean government generally perceives the use of sanctions as an illegal tool meant to destabilize the internal political affairs particularly the land reform exercise and *in addition*, to cripple the economy as a whole.

There has been an ongoing battle on the exact nature of the sanctions in Zimbabwe. According to the majority of the western policy documents, such as CFSP (2010), sanctions in Zimbabwe were either \`smart\`, \`targeted\` or \`restrictive\` in nature. They were said to be directly targeted on those responsible for Zimbabwe's political crisis and not *meant to affect* ordinary citizens. On the other hand, the government of Zimbabwe strongly argued that the sanctions were economic in nature since they *had* adverse economic costs. It emerged that the terminology used to describe the Zimbabwe sanctions *varied* in respect of the sanctioners perception as well as the sanctionee\`s *points* of view. Empirical evidence showed that Zimbabwe was under economic sanctions especially from the USA. Legal statutes such as the Zimbabwe Democracy and Economic Recovery Act, 2001 (ZIDERA) enacted by the US government were used as vehicles to impose sanctions on Zimbabwe (Hondora, 2008). ZIDERA empowered the US to use its voting rights and influence (as the main donor) in multilateral lending agencies such as IMF, World Bank, and Africa Development Bank (AFDB) to veto any application by Zimbabwe for finance, credit facilities, loan rescheduling and international debt cancellation among other things. The US cited human rights abuse, political intolerance and absence of the rule of law as the main reasons for the imposition of sanctions (Hondora, 2008). Sanctions whether declared or undeclared, financial or trade, all undermine the economic activities of a country (Cortright and Lopez, 2002). They are said to create a bad country image hence *precipitating financial institutions\` failure* to access offshore lines of credit due to country's perceived credit risk. Zimbabwe *is perceived* a bank based economy. This then follows that the economy will be greatly affected by ills affecting the banking sector. According to Khan (2004), commercial banks are one of the most important contributors of economic growth. They are viewed as the lifeline of international commerce and without *them, it would be difficult* to conduct commercial transactions.

Research Questions

This *study sought to answer* the following research questions:

1) What are the forms of economic sanctions that affected the financial services offered by commercial banks in Zimbabwe?
2) What are the effects of economic sanctions on financial services offered by Zimbabwean commercial banks?
3) Which strategies can be adopted by the commercial banks affected by economic sanctions?

2. Literature Review

According to Cortright and Lopez (2002), a sanction is a coercive measure adopted usually by several nations acting together against a nation violating international law. Smith (2004) *asserted* that sanctions involved one party attempting to change another party's behaviour without the use of weapons or military force. These *attempts* may range from travel bans, arms and financial embargoes to complete trade bans. On the other hand, Hawke (2004) defines sanctions as a form of non-military coercion whereby a state applies leverage to try to change the conduct of another state. For the purpose of this study, sanctions are operationally defined as restrictive measures imposed on a nation in an effort to curtail its activities and to exert pressure and influence on it to abandon objectionable policies. Perken and Drury (2007) state that sanctions can be classified as declared or undeclared. Declared sanctions are those which are pronounced and normally legislated by the imposing country or organization. ZIDERA of 2001 issued by the US government on Zimbabwe is an example of a set of declared sanctions. Hondora, (2008), argued that in Zimbabwe, smart or targeted sanctions have taken the form of travel bans for selected individuals and trade embargoes on certain companies. Viewing it on the other hand, comprehensive sanctions cover several (if not all) sectors of the economy thus paralyzing the economy as a whole (Cortright and Lopez, 2002).

2.1 Nature of Economic Sanctions

Kern (2009) *defined* economic sanctions as restrictions upon international trade and financial dealings one country or a group of countries impose on another, usually as punishment for following policies of which the sanctioning county/countries disapproves. Trade restrictions are trade penalties imposed by one or more countries on one or more other countries and they take the form of import duties, licensing schemes or other administrative hurdles (Hufbuer *et al*, 2007). According to Bennett (2004), trade sanctions limit the country's exports and restrict imports and can be in the form of embargoes and quotas. In Cuba, the US enacted statutes such as the Foreign Assistance Act of 1961, the Cuban Democracy Act of 1992, and the Cuban Liberty and Democratic Solidarity Act of 1996 (Bennett, 2004). Trade sanctions lead to a shortage of foreign currency reserves of a nation as a whole if the sanctions involved a limit on exports of a country under the sanctions (Bennett, 2004).

2.2 Impact of Economic Sanctions on Financial Service Delivery

Reynolds *et al* (2007) noted that economic sanctions affected the banks` money transfers and nostril accounts. Nostril accounts are foreign currency deposits of a local bank held with the corresponding bank in another country usually in the currency of that country (Reynolds *et al* 2007). Economic sanctions affected banks` money transfers in Iran as evidenced by seven banks namely; Bank Separ, Meli, Sederat, Mellat, Kargshaee Arian Bank and Persian International Bank PLC being prohibited from transferring money to and from United States banks (Torbit, 2005). The study concluded that the effects of the US led sanctions on Iran were significant. The economic cost of trade sanctions was measured by applying the concept of welfare loss. The financial sanctions impact was evaluated by assessing the extra charges Iran had to pay on its foreign debt obligations and for financing its oil development projects. The economic sanctions on Iran curtailed the banks` ability to borrow funds abroad. The banks were forced to obtain loans with less favourable terms and at higher interest rates due to the county's perceived credit risk. In contrast to this assertion, Bruno (2007) argued that Iran's economy was affected by poor governmental policies and not economic sanctions. The financial difficulties that faced Iran could be eliminated through a change in the country's financial policies (Bruno, 2007). In conclusion, Iran's financial woes emanated from a combination of bad policies and sanctions (Bruno, 2007). Economic sanctions had an impact on Burmese international money transfers. Money transfers between Burma and Singapore through the United Overseas Bank and nonblank money transfers via agents from Thailand to Burma were cancelled as a result of US sanctions blocking financial transactions related to Burma (Moe, 2007). Foreign banks in other countries refused letters of credit from Burmese financial institutions (Moe, 2007). According to Hawke (2004), US sanctions on Burma represented the toughest measures that any state could take against the country. American financial institutions were prohibited from providing any services to Burma under The Burma Freedom and Democracy Act. The most damaging of the sanctions was the ban on clearance of payments to and from Burma through the American banks. The sanctions on Burma had adverse impact on Foreign Direct Investment (FDI) and in particular western FDI needed to develop the keystone of its economy (the oil and gas industry).

A survey on US sanctions against Cuba by Geis (2007) showed that the sanctions had adverse impact on the Cuban economy. Trade restrictions inhibited the flow of capital and technology and this had negative effects on Cuban companies. Reserve Bank of Zimbabwe (RBZ) report on the nature of sanctions in Zimbabwe (2007), reviewed that economic sanctions had adverse and downstream social and economic effects on the key sectors of the economy. Chigora and Dewa (2009) asserted that International Monetary Fund (IMF) and the World Bank joined the western countries and imposed sanctions on Zimbabwe. After reviewing Zimbabwe's overdue obligations on 25 September 2001, the IMF`s executive board declared Zimbabwe ineligible to access the general resources of the IMF.

2.3 Strategies to Mitigate the Impact of Economic Sanctions

Institutions shape and express the country's choices concerning the allocation of resources when faced with external shocks such as economic sanctions (Burlone, 2002). Country's that fell apart in the face of turbulent external factors such as economic sanctions did so because their administrative institutions were inadequate to bring about the adjustments required for macro-economic stability. According to Shaw (2007), when the US strengthened its sanctions against Burma, four Burmese banks joined the Belgium-based conglomerate SWIFT which offered banks membership in its comprehensive financial network. This enabled the Burmese banks to transfer funds abroad quickly and efficiently and thus this increased Burma's ability to trade internationally. On the other hand Iran made use of a centuries old financial transfer system known as `hawala` as a way of mitigating the impact of US sanctions (Fifield, 2008). `Hawala` is a cheap and remarkable reliable system for money transfer which date back to the eighteenth century. A `hawala` worked as follows; a sender gives money to a local broker who then instructs an agent based near where the intended recipient resides to pay out an equivalent sum, less commission. The system also works in reverse and overtime; the debts of the brokers always cancelled each other out.

3. Methodology

A descriptive survey design was used, which allowed the researcher to administer questionnaires and conduct interviews with the respondents. The survey used 14 registered commercial banks as both the population as well as the sample. Data was collected using both primary and secondary sources. Information and data gathering was done using questionnaires, interviews, internet, business journals as well as business magazines. A pilot study was done to improve on validity. The reliability was ensured with the aid of pre-testing the research instruments in the pilot study.

4. Results

All the 14 surveyed banks indicated that they had been negatively affected by the economic sanctions imposed on Zimbabwe. The impact of the sanctions on individual banks however varied with the services offered and the form of the economic sanctions involved. Eight of the surveyed banks indicated that they were affected mostly by the trade sanctions were as the remaining six said financial sanctions affected them the most.

4.1 Impact of Economic Sanctions on Financial Services

Of the 14 sampled banks, 10 banks reviewed that the economic sanctions affected their ability to lend. Four of the 14 commercial banks indicated that economic sanctions did not affect their lending operation much. According to Chigora and Dewa (2009), the IMF executive board declared that Zimbabwe was ineligible to borrow from the institution. This might have contributed to government's failure to assist commercial banks in liquidity problems through the central bank's accommodation rate system.

4.2 Impact on International Money Transfers

Economic sanctions affected International Money Transfers and this was supported by 11 of the *14 surveyed* banks. Three banks however reviewed that they were not affected. One bank pointed out that the economic sanctions made it impossible for them to transfer money internationally on behalf of its clients. The bank had to have an intermediary bank in another country to facilitate its Telegraphic Transfers (TTs). This was in line with the findings of Reynolds *et al* (2007), who postulated that in Iran, the US sanctions prohibited seven Iranian banks from transferring money to and from United States banks. As a result, these banks had to find a go-between bank to facilitate their transfers.

4.3 Impact of Economic Sanctions on Nostro-Accounts

Out of the 14 banks surveyed, 12 indicated that their nostro-accounts in foreign countries were affected by economic sanctions. Out of these 12, two banks indicated that their nostril accounts in USA were closed in June 2010 as a result of economic sanctions. One of these banks had to move its nostro-account from the USA to a bank in German which had a branch in America. Reynolds *et al* (2007) postulated that nostro-accounts of Iranian banks in Europe were frozen in early 2007 to put some pressure on the government of Iran.

4.4 Issuance of Letters of Credit (LCs)

Of the 14 banks, 12 indicated that they stopped issuing LCs due to economic sanctions. This was due to the fact that their LCs was not being accepted by the western countries and this forced their clients involved in international trade to operate on cash basis. Moe (2007) revealed that in Burma, financial sanctions resulted in foreign banks refusing LCs from Burmese financial institutions. The remaining two banks indicated that economic sanctions did not affect their issuance of LCs. From these findings, it could thus be deduced that these banks were not offering the service even before the imposition of the sanctions.

4.5 Strategies to Mitigate Impact of Economic Sanctions

From the survey, all the 14 banks believed that the impact of economic sanctions could be mitigated by adopting a range of strategies. Six banks indicted that strategic alliances would help reduce the impact of economic sanctions on the bank's service delivery. Four banks pointed out that diversification of operations would help minimize the negative effects of economic sanctions on their financial services. The remaining six indicted that there was need to adopt strategies like liaising with other commercial banks to find a common ground to deal with the sanctions as they affected them more or less alike. Opening nostro-account in various countries as well as liaising with other commercial banks to find a common ground in dealing with the impact of economic sanctions was also highlighted as worthy options.

4.6 Discussion

From the results, it could be deduced that eight banks derived most of their deposits from firms that were involved in international trade. A ban or limit in exports business for these firms, would in turn reduce their deposits with the banks. Firms which relied on imported raw materials and spare parts for their machinery were affected by an embargo in that shortage of these *imports* affected the firms` productivity. This concurred with findings of Geis (2007) when highlighting the impact of US imposed sanctions on Cuba. The embargo resulted in frequent work stoppages in the production sectors because the trade restrictions inhibited the flow of capital, raw materials and special technology. As a result of this, production levels in Cuban firms decreased dramatically. The other six banks indicated to have been affected more by financial sanctions. These might have been affected by a cut on offshore lines of credit. Financial sanctions as indicated by Bennet (2004) impede financial flows such as short term and long term loans thus, reducing foreign exchange flows to a country. According to Nzaro and Njanike (2011), Zimbabwean companies operated at varying levels below capacity *during the recessionary period stretching from 2000 to 2010*. This was in *spite of* the fact that these companies indicated their desire to operate at higher levels. Financial sanctions *affected* access to credit lines. This then caused under utilization of both human and capital assets.

The extent to which economic sanctions affected banks also varied amongst the surveyed banks. Using the Likert scale, two banks indicated that the sanctions had a limited impact on their service delivery. The other banks however indicated that the impact ranged between moderate to extreme impacts. The findings also revealed that economic sanctions were not the only external shocks that had adversely affected the financial services sector. There were other factors such as the global recession, droughts as well as the central bank's regulatory policies which affected service provision. Bruno (2007) indicated that sanctions were not the only contributing factor to the problems faced by Iranian financial Institutions. The study postulated that whilst western restrictions on Iranian banks had an effect, Iran's financial institutions suffered mainly from a combination of bad policies as well as sanctions. Policies are important especially in relation to operation of commercial banks. Banks are fragile hence the need for carefully crafted policies.

5. Conclusion

From the study, it could be concluded that although trade and financial restrictions were the major forms of economic sanctions affecting financial services of commercial banks in Zimbabwe, trade restrictions tended to pose the greatest difficulties than financial restrictions. the fact that the majority of the commercial banks relied on deposits from firms that were involved in exports and imports can be cited as the major reason for this scenario. Economic sanctions caused the closure of nostro-accounts, failure by banks to access offshore credit lines, difficulties in effecting international money transfers as well as incapacitating financial intermediation by commercial banks. To mitigate the impact of economic sanctions, strategic alliances, diversification of operations, opening of branches outside Zimbabwe as well as liaising with other banks to find common ground to deal with economic sanctions were suggested as options at the disposal of commercial banks. Overally, the study found that economic sanctions had a negative impact on financial services offered by commercial banks in Zimbabwe.

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