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The state and the 'legalization' of illicit financial flows

Trading gold in Bolivia

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Abstract: Most research on illicit financial flows (IFFs) has focused on illicit outflows from developing countries and the role of non-state actors in generating IFFs. Less attention has been paid to processes and interfaces through which IFFs enter formal value chains—in effect being 'legalized' before leaving the country—or the crucial role of state institutions as gatekeepers. We develop a novel explanatory approach to account for the enabling role of state institutions in the 'legalization' of IFFs. Building on political settlement theory, we explain the performance of institutions in the regulation of IFFs as a function of political settlements. Taking the case of the Bolivian gold-trading sector, we examine how the process of 'legalizing' illicit value flows works in practice and analyse the motives and underlying conditions that lead state institutions to permit the formal export of gold shipments that have been illicitly sourced or transferred. Evidence from Bolivia indicates that the 'legalization' of illicit flows cannot be sufficiently explained by reference to corruption, illicit rent-seeking, or a general lack of administrative capacity. Rather, the process accommodates the interests of the cooperatives dominating the gold-mining sector, which are critical to maintaining the political settlement on which the incumbent government's power is based. By maintaining a status quo of non-enforcement, legal ambiguity, and pervasive informality, gold-mining cooperatives are permitted to reap higher benefits from resource extraction at the expense of domestic revenue mobilization.

Key words: illicit financial flows, political settlement theory, gold mining, gold trading, value chains, state institutions, domestic revenue mobilization

JEL classification: K42, Q32, Q37, O17

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1 Introduction

Illicit financial flows (IFFs) emanating from tax evasion, capital flight, smuggling, and fraudulent trade practices severely undermine domestic revenue mobilization (DRM) in many low- and middle-income countries, depriving them of much-needed capital for development. Research on IFFs has focused on identifying and measuring illicit outflows from developing countries and commodity trading has been identified as an important source of IFFs (Ahene-Codjoe et al. 2022). Less attention has been directed to how IFFs, as well as domestic illicit financial flows (D-IFFs), become 'legalized' before entering formal international value chains and the financial system as legitimate financial flows.

So far, analyses and policy debates on IFFs have centred on private companies engaged in illicit business practices (e.g. profit shifting, trade mispricing, tax evasion) or criminal groups and networks supplying illicit markets (Collin 2020; OECD 2014, 2016). Although state actors and institutions are generally identified as playing an important role among the 'enablers' or 'facilitators' of IFFs (UNCTAD and UNODC 2020; UNECA 2021), explanations frequently limit themselves to highlighting (systemic) corruption, weak governance, a general lack of capacity and political will, or 'rent-seeking' by local elites. These accounts typically emphasize the agency of individual politicians and bureaucrats. However, the underlying rationale may go well beyond narrow motives of personal enrichment and involve a more political logic. The proactive and instrumental role of state institutions in permitting or legalizing (D-)IFFs is not sufficiently investigated in the literature and has important implications. Understanding how, and the mechanisms through which, (D-)IFFs are legalized and identifying respective interfaces in the global trade and financial system is crucial to the development of adequate policy responses.

Our first research question (RQ1) is therefore descriptive: how does the process of 'legalizing' illicit value flows of both domestic and external origin work in practice? What are the processes, interfaces, and mechanisms that permit the large-scale 'legalization' of (D-)IFFs and the respective roles of state and private-sector actors, including those operating informally? The second question (RQ2) is analytical: what are the causal factors that can explain the enabling role of state institutions? What leads state institutions to routinely sanction the export of gold shipments that have been illicitly sourced or transferred, in effect legalizing illicit value flows?

To answer these questions, we move beyond mainstream institutionalist accounts in order to render our analysis sensitive to political dynamics. Political settlement theory (Khan 2010) is particularly well suited because it theorizes de facto institutional performance as a function of a bargain between contending political elites. Using this lens suggests that the state-tolerated legalization of (D-)IFFs can be a means to mobilize both political and economic rents to satisfy groups with sufficient holding power. Deliberately forgoing tax revenues serves to consolidate the power of the incumbent government by maintaining a particular political settlement.

Bolivia is a prime case for examining the mechanisms and motivations behind the legalization of (D-)IFFs and how they contribute to stabilizing political settlement dynamics. Gold production has increased from an estimated 6.4 tons in 2010 to some 45 tons in 2021 (INE 2022). More than 90 per cent of the gold is produced by about 1,600 cooperatives across the northern Bolivian Cordillera in the department of La Paz as well as in the Amazon basin (MMM 2021). With an export value of more than US$2.5 billion, gold exceeded the value of natural gas exports in 2021 (SIIP 2022), performing a crucial function in stabilizing Bolivia's foreign trade balance (interview partner [IP] 1). The sector has also become a steady, albeit limited, source of income for the central state and gold-producing departments and municipalities. Procedures for internal trade and export

are formalized, but the implementation is flawed by widespread informality. In addition, Bolivia's gold exports have often been suspected of exceeding domestic production due to the large-scale export of gold smuggled into the country, calling official production figures into further question (ANF 2021; Miranda 2020).

We find that the active role of state authorities in Bolivia in the legalization of (D-)IFFs has become standard practice and is associated with political interest mediation and stakeholder accommodation involving national politicians and state authorities on the one Hand and the influential cooperative mining sector on the other. Although public sector corruption and a lack of administrative capacity are not absent, our findings indicate that the 'legalization' of (D-)IFFs in the Bolivian gold sector is primarily the outcome of complex political settlement dynamics. By presiding over the 'legalization' of (D-)IFFs, the Bolivian state abandons higher tax revenues in favour of perpetuating a long-running political settlement.

Our research expands the scholarly literature on IFFs to include D-IFFs more explicitly, as they can be as harmful to tax income as cross-border illicit financial outflows. It also adds to the political settlement literature by undertaking an in-depth study of institutional performance as a political function. At the policy level, our findings are relevant for domestic resource mobilization reforms and initiatives to curb IFFs by demonstrating the need for politically sensitive analysis and for more effective regulation of financial flows and cross-border due diligence.

In the remainder of the paper, we first develop the conceptual framework based on a brief review of the literature (Section 2). Next, we introduce the methodology and data (Section 3) before moving to the presentation and discussion of the findings (Sections 4 and 5). We conclude (Section 6) that the state-sponsored legalization of illicit gold flows does not exempt downstream actors from due diligence or from the responsibility to work towards socially and ecologically sound production and trading.

2 Theory and conceptual framework

2.1 Domestic IFFs: definitions and conceptual ambiguities

Although international consensus has emerged on the need to counter IFFs, the term remains a contested umbrella concept that lacks a universally accepted definition. The subject literature generally distinguishes three basic categories off IFF: (1) flows that have been *generated* through illegal practices such as the trafficking of goods and people, theft, or other criminal profit-seeking activities; (2) flows that are illegally *transferred* involving corruption, tax evasion, or other illegal practices; and (3) flows that are *used* for purposes that are illegal such as the financing of organized crime or terrorism (IMF 2020; OECD 2014; World Bank 2017). Similarly, according to the World Bank (2017), the most used definition of IFFs is 'money illegally earned, transferred, or used that crosses borders'.

This three-fold distinction of IFFs offers a useful framework for identifying what types of IFF are most prevalent in a particular context. Nevertheless, the definitional limitation of IFFs to monetary values, illegal activities, and cross-border flows is widely contested (Chowla and Falcao 2016; Eriksson 2017; Erskine and Eriksson 2018; Forstater 2018; Musselli and Bürgi Bonanomi 2020; UNCTAD and UNODC 2020).

The limitation to *monetary values* is argued to be too narrow since, in many low-income countries (LICs), illicit flows also occur in non-monetary form—for example, in valuable commodities such

as gold, diamonds, or timber (Eriksson 2017; Hunter et al. 2017). Such a widened conceptualization of IFFs is, for example, applied by UNCTAD and UNODC (2020: 12), which define IFFs as 'financial flows that are illicit in origin, transfer or use, that reflect an exchange of value and that cross country borders'.

The restriction to *illegal* activities is criticized for excluding activities that are not strictly illegal but widely considered as illegitimate (e.g. aggressive tax avoidance: Bustos et al. 2022; Cobham and Janský 2018; Seabrook and Wigan 2017). Several authors suggest accepting the limitation to unlawful activities in order to avoid even bigger normative challenges (e.g., IMF 2020; Musselli and Bürgi Bonanomi 2020; OECD 2014; World Bank 2017). Yet even 'legalistic' definitions do not distinguish between different types and degrees of illegality. Musselli and Bürgi Bonanomi (2020: 5) point out that 'the notion of "illegality" not only embraces actions contravening criminal law, but also [embraces] violations of civil or administrative law', meaning that 'some actions maybe unlawful even if they are not criminal.' A legalistic definition of IFFs further raises the problem of indiscriminately including activities that are generally considered 'informal', particularly where large sections of the economy are organized informally. Making a distinction between 'illegal' and 'informal' activities may be difficult, since the latter often involve illegal elements (e.g. tax evasion).

Finally, the limitation of IFFs to *cross-border transactions* excludes value flows that have been illicitly produced or transferred at the domestic level but are legally transferred across borders, i.e. their 'legalization' has been sanctioned by state authorities before or at export. This definition leaves it to the discretion of states to determine what constitutes an illicit inflow or outflow at any given point in a transnational value chain. The question whether D-IFFs should be classified as IFFs when their transfer across borders is legal, and their 'legalization' has been sanctioned by state authorities is not sufficiently addressed in the literature. Some definitions limit IFFs to illicit cross-border transactions (e.g., GFI 2017; OECD 2014; cf. Eriksson 2017); other definitions, however, remain unspecific in this regard. For example, UNCTAD and UNODC (2020: 13) merely state that 'IFFs can also originate from legal economic activities but become illicit when financial flows are managed or transferred illicitly' without qualifying whether this includes 'illicit management' or 'transfers' that occur at the domestic level, prior to legal cross-border transfer. Nor does this definition specify what constrains state-backed acts of legalization when it comes to receiving, managing, or transferring illicit financial and value flows of both domestic and foreign origin.

Against the backdrop of conceptual ambiguities and the adverse impact of forgone domestic revenues on development, we argue that the legalization of IFFs and the question whether D-IFFs are recognized as IFFs should not be left unreservedly at the discretion of individual states. The main reason lies in the intersectionality of taxation and the right to development. According to the UN, states have not only an internal obligation to fulfil the right to development but also a duty to do so 'internationally, through the adoption and implementation of policies extending beyond their jurisdictions; and […] collectively, through global and regional partnerships' (Muchhala 2018: 28). Extending what Muchhala (2018) demonstrates for the case of transfer pricing-based IFFs to domestic IFFs, the legalization of D-IFFs may undermine—at least in theory—the state's obligation to protect and fulfil the rights of its people, calling for cooperation between countries to ensure an enabling international environment for development. The same logic of the international dimension and collective responsibility for the right to development also underpins the approach to environmental and human rights violations in international finance and trade. For example, the UN Guiding Principles on Business and Human Rights rule out the option of legalizing environmental and human rights violations by state authorities through formalized cross-border transactions. Rather, such 'legalization' is seen as a violation of a state's duty to protect and fulfil human rights and activates the obligation of other actors, including businesses and their home countries (Ruggie 2008, 2011).

2.2 Political settlement theory

Mainstream institutionalist accounts explain adverse and unwanted outcomes of state bureaucracies through a rationalist conceptualization of institutions as constraining devices that have been ill-designed (e.g. Rodrik 2004). Such explanations fall short of making sense of the legitimization of (D-)IFFs.

To understand why state institutions choose to legalize (D-)IFFs and deliberately forgo tax revenues—called 'tax expenditure' in tax language[1]—we need to know the political function that these specific, albeit not formally sanctioned, tax expenditures play in a country's political settlement. Political settlement theory (Khan 2010) provides a conceptual framework for analysing the outcome of bargains between contending elites over the distribution of benefits. A political settlement is understood as an implicit arrangement between powerful groups that is more beneficial to those groups than engaging in a risky conflict with the aim of altering the power balance (Bebbington et al. 2018; Kelsall and Hickey 2020; Khan 2010). Institutions, broadly defined as decision-making rules, play a critical role in political settlement theory. Institutions embody distributive functions, i.e. they allocate entitlements and benefits to individual or group actors: first, by the way institutions are formally designed (de jure), and second, by the way they are interpreted and implemented in daily practice (de facto). The two can differ and the latter can change or even turn the original designation of entitlements and benefits into its opposite (Di John and Putzel 2009).

The theoretical concept rests on the notion that for a political settlement to be stable, the distributional effects of institutions must sufficiently benefit groups with 'holding power' within society in a way that is economically and politically sustainable over time. A reliable flow of benefits maintains the groups' interest in the status quo (i.e. the settlement) and is typically preferred over costly conflict. For Khan (2010: 6), the concept of 'holding power' denotes the capability of groups and organizations to contest the existing distribution of benefits by engaging in and surviving conflicts and is determined by the group's respective 'ability to impose cost on others' as well as their 'ability to absorb costs inflicted on them'.

When the distribution of benefits by formal 'Weberian' institutions is not in line with the distribution of power, resistance to formal institutions and their distributive implications is often inevitable (Khan 2010). Such resistance typically manifests itself through the establishment of various informal arrangements, including the organization of informal patron–client relations, that bring the distribution of benefits closer to the actual distribution of power.

Political settlement analysis is conducted at two levels (Behuria et al. 2017; Frederiksen 2019; Khan 2010). At the higher level, the analysis focuses on the emergence of a power distribution that leads to the establishment of a stable social order on which political settlements are formed. At the lower level, the distribution of power that sustains any given political settlement is treated as an 'exogenous variable' that can explain the performance of institutions as well as the constraints on institutional change. Hence, the lower-level analysis is concerned with how an existing political settlement affects the performance and governance of any specific (set of) institutions. While the two levels of analysis are conceptually independent of each other, an analysis of the lower level usually requires an understanding of the higher, i.e. of the processes, factors, and conditions that have led to the emergence of a power distribution that sustains any given political settlement. The

[1] The OECD Tax Glossary defines the term tax expenditure as 'special preferences provided in income tax laws which depart from the normal tax structure and which are designed to favour a particular industry, activity or class of taxpayer' (https://www.oecd.org/ctp/glossaryoftaxterms.htm).

higher-level analysis typically involves some form of historical political-economy analysis that traces how the distribution of power has evolved to form a specific political settlement. The lower-level analysis then focuses on the 'organization of the ruling coalition', which consists of the elite factions that 'control political authority and state power' and their ability to manage and absorb pressures emanating from both vertically and horizontally excluded groups or factions (Khan 2010: 8). Horizontally excluded groups oppose the prevalent political settlement and challenge the existing social and institutional order from the outside; vertically excluded groups support the ruling coalition but remain excluded from elite decision-making and need to be kept loyal to prevent them from challenging the political settlement from the inside (Bebbington et al. 2018). Kelsall and Hickey (2020) also refer to the latter as co-opted groups and to the former as either repressed or marginal groups. The stability of any given political settlement is a function of the relative power of the ruling coalition vis-à-vis excluded groups.

We employ political settlement theory to analyse the role of the cooperative mining sector in shaping Bolivia's contemporary political economy and its impact on the performance of institutions that assume a crucial gatekeeper function for gold-related IFFs.

3 Methodology and data

3.1 Methodology

To answer our research questions, we proceed in three steps. First, we take stock of the literature analysing how the existing political settlement in Bolivia came about, focusing on how the role and political influence of mining cooperatives changed over time. This provides us with the higher-level analysis of the political settlement, i.e. the political dynamics with which the legalization of (D-)IFFs interacts. Second, we analyse the present institutional configuration in the production and trade of gold in Bolivia from extraction to trading and export. A particular focus is on the difference between the formal design of institutions and the way they are implemented. We build a simple heuristic matrix to assess a value chain actor's compliance with formal institutional requirements, which we call the institutional *modus operandi* (Figure 1). The y-axis maps the steps of the gold value chain from extraction to trading and export together with the institutional requirements and actors involved in each step. The x-axis depicts the levels of compliance with formal rules: formal operations (full compliance), semi-formal operations (partial compliance or formalization in progress), informal operations (non-compliance), and operations outside or in explicit contradiction to the law. In the cells, we provide a rough estimate of the distribution of actors, based on expert interviews and focus group discussions. Finally, we analyse which actors benefit from the institutional *modus operandi* identified and how this stabilizes the political settlement.

Figure 1: Matrix assessing the institutional *modus operandi* in the gold value chain

		Level of actors' compliance with formal rules			
		Fully formalized	Formalization in progress	Informal	Outside / violation of legal framework
Actors along domestic gold value chain	***Producers***				
	Institutional requirement 1	← Indicative distribution of all producers across levels of compliance → (Example next row)			
	Institutional requirement …	*	**	**	
	Traders				
	Institutional requirement 1				
	Institutional requirement …				
	Exporters				
	Institutional requirement 1				
	Institutional requirement …				

Note: asterisks indicate distribution, from 1 (few) to 5 (all).

Source: authors' construction.

3.2 Data collection

Our analysis is based on extensive field research. The bulk of the data was obtained through 17 semi-structured interviews. Interview partners (IPs) were selected based on their professional roles, positions, and/or expertise on the subject matter along the entire value chain from gold production, trading, and export. We interviewed senior representatives from mining cooperatives and federations, governmental and non-governmental organisations, private companies, and consultants. The two largest groups of IPs are senior representatives of private gold exporters and public officials from institutions with a relevant administrative, regulatory, and/or law enforcement function. The interviews are complemented by five focus group discussions (FGDs) between members of three gold-mining cooperatives and representatives of two regional mining federations.

In addition, a broad range of documents was reviewed, including legal documents, official reports, and statistics. Further, we consulted studies published by non-governmental organisations, international organisations, and media reports.

4 Results

4.1 Higher-level analysis: the longer-term historical structures

Political settlements in Bolivia

Natural resource governance has long played a central role in Bolivian politics, both influencing and being influenced by the distribution of power among contending groups. Analysing the emergence and demise of different political settlements in Bolivia over an extended historical period (1899–2018), Bebbington et al. (2018: 103) identify 'the use of natural resources, and above all the rents deriving from these in any strategy to build national settlements around the exchange of loyalties and patronage', as a recurrent theme. In the past two decades, this use of natural resource rents for the organization of political settlements in Bolivia has primarily related to the extraction of hydrocarbons and precious metals, especially gold. Within this period falls the latest political settlement identified by Bebbington et al. (2018), which emerged in 2003 after the collapse of the Sanchez de Lozada government and the rise to power of the Movimiento al Socialismo (MAS) party, then headed by Evo Morales. The period lasts until the formation of the present MAS government led by Luis Acre, being interrupted only during the interim presidency under Jeanine Áñez between 2019 and 2020. This political settlement has, *inter alia*, been marked by a greater inclusion of rural populations, including through the distribution of mining rights, and has seen the rise of mining cooperatives as a power factor in Bolivian politics.

Cooperatives as a political force

In Bolivia, mining cooperatives have a long history of social activism and political struggle, including their role in ousting the dictatorship in the early 1980s and forcing the resignation of the government during so-called Bolivian Gas War in 2003 (Francescone 2015; Marsten and Kennemore 2018; Marsten and Perrault 2017; Salman et al. 2015). Their political influence started to grow in the 1980s, when structural adjustment and economic reform polices led to, among other things, the dismemberment of the state-run Bolivian Mining Company COMIBOL (Corporación Minera de Bolivia), which led to the layoff of more than 20,000 mine workers.[2] In return, the state granted cooperatives mining rights on the abandoned concessions so that they could absorb the displaced miners (Bebbington et al. 2018). The restructuring of COMIBOL and the subsequent proliferation of mining cooperatives led to a shift in the relation between miners and the Bolivian state. Miners now found themselves outside state structures and reorganized under the roof of the National Federation of Mining Cooperatives (FENCOMIN). Drawing on the traditional political combativeness of the unions, a large constituent workforce and strong organizational capacities, FENCOMIN emerged as a powerful interest group (Marsten and Kennemore 2018; Radhuber and Andreucci 2014; Salman et al. 2015).

Mining cooperatives further gained in political influence when they joined the social protests initiated by MAS, becoming an important part of its political base and voting public. After Evo Morales was elected president in 2005, cooperative members ran for local elections on the MAS ticket, mining cooperatives were well represented in congress, and 'actors with close links to cooperatives – sometimes even former cooperative leaders – have served as vice-ministers of mining development and cooperatives' (Baraybar Hidalgo and Dargent 2020: 530).

[2] At present, COMIBOL runs only a few public mines and exists mainly as an administrative entity.

Yet, the relation between mining cooperatives and MAS-led administrations has often been ambivalent. The mining cooperatives use their political connections and ideological support for the government primarily to advance their interests, making FENCOMIN 'the most influential party, because of its supposed ideological affinity, its huge number of members and the current power relations' (Salman et al. 2015: 363f.). The cooperatives do not shy away from protests, blocking highways and engaging in (violent) conflicts with state security forces if they deem it necessary to achieve their goals: 'The professors will go on a hunger strike, the miners will go on a strike with dynamite in their hands' (IP 11).

One example of this ambivalence was the controversy surrounding the Law of Mining and Metallurgy of 2014 (Law 535),[3] which led to roadblocks across the country, hostage-taking of police officers, and fatalities (Radhuber and Andreucci 2014). Although the cooperatives' demands were not met, the final version of the new mining law has been highly favourable to mining cooperatives, including far-reaching tax exemptions (Bebbington et al. 2018; CEDIB 2015; Marston and Perrault 2017; Radhuber and Andreucci 2014; Salman et al. 2015). Nevertheless, in August 2016 there were renewed violent protests against the law, culminating in the assassination of the Deputy Interior Minister, Rudolfo Illanes (Ramos 2016; cf. Marston and Perrault 2017). Despite pledges by the government to rein in the cooperatives with stricter regulation, their influence has not been curtailed and disputes between the state and mining cooperatives have escalated into regular cycles of conflict. FENCOMIN has been confident enough in the past to threaten to bring down a president (Francescone 2015; Salman et al. 2015: 364), and some see it as having sufficient power to do so (IP 11).

The episodes above illustrate the cooperatives' 'holding power', i.e. their capacity to sustain conflicts with and to impose significant costs on political contenders and on society at large.

The role of gold mining cooperatives in the cooperative sector

The landscape of mining cooperatives and their internal power dynamics have changed as well. For most of the time, the large 'traditional' cooperatives involved in the mining of tin, zinc, and wolfram were dominant. With the rise in international gold prices, gold mining emerged as the most politically and economically influential subsector. Gold cooperatives are also the most numerous today. According to Bolivia's cooperative fiscal control authority AFCOOP, the number of registered mining cooperatives has increased from 911 in 2006 to 2,388 in 2021 (MMM 2021). Of those, some 70 per cent (1,600) are estimated to be gold-mining cooperatives (GMCs) (Flores et al. 2020; Salman et al. 2015), although earlier estimates suggest even higher figures (Baraybar Hidalgo and Dargent 2020). Of the 115,000–150,000 workers in mining cooperatives, the largest share belongs to GMCs (Baraybar Hidalgo and Dargent 2020; Graham 2019; Marston and Perrault 2017). Hence, the labour-intensive cooperative gold-mining sector sustains a sizable workforce and generates secondary employment opportunities for service providers and suppliers, providing both direct and indirect employment for large segments of the population, especially in rural areas.

The cooperative gold-mining sector has gained further political clout as GMCs have organized themselves into regional federations that are represented at the national level by FENCOMIN. Following the example of the 'traditional' mining cooperatives, GMCs rely on the influence of

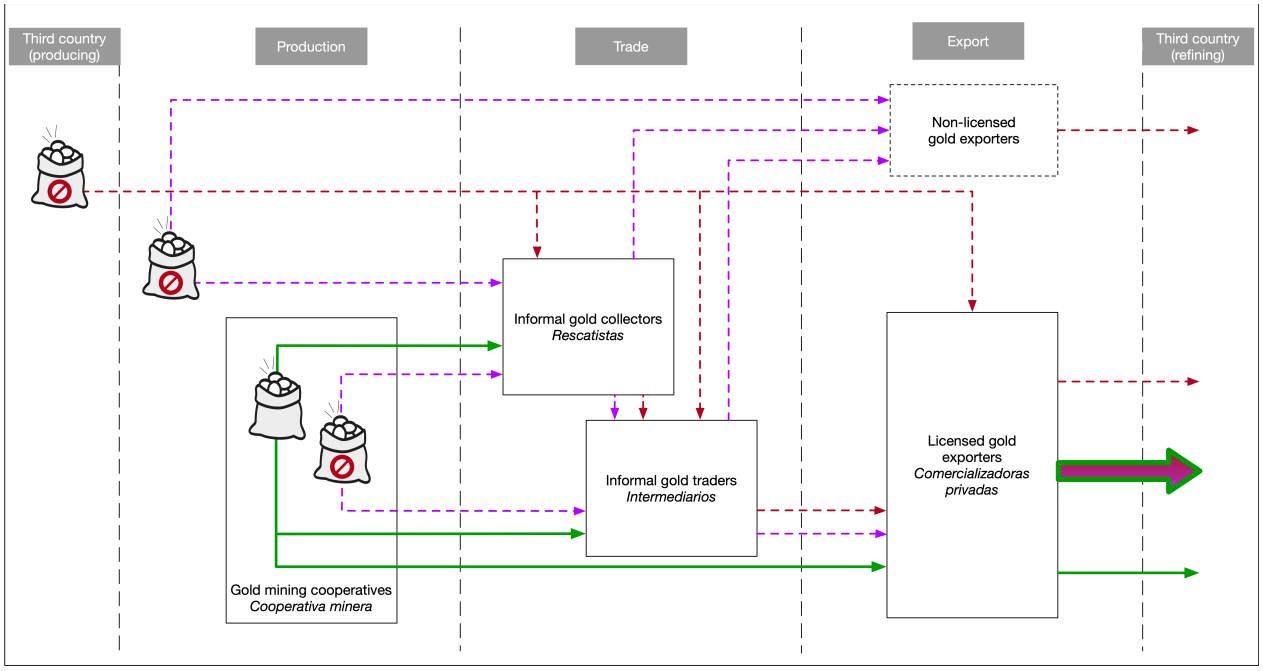
[3] Law 535 de Minería y Metalurgia of 28 May 2014, modified by Law 845 of October 2016 and Law 1140 of 21 December 2018 (SENARECOM 2020).

their federations and FENCOMIN to ensure that habitual violations of laws and regulations continue to be tolerated.

4.2 Lower-level analysis: (D-)IFFs along the gold value chain

Drawing on the conceptualization of IFFs, two predominant types of (D-)IFFs can be identified in the Bolivian gold trading sector (Figure 2): first, flows of illicit origin and, second, flows that have been illicitly transferred.

Figure 2: Overview over IFF flows in the Bolivian gold trade



Note: green = licit flows; purple = domestic IFFs; red = transboundary IFFs; ⌀ = illegal mining.

Source: authors' construction.

Illicit origin

Illicit gold production happens in various degrees of unlawfulness, with illegal practices that are explicitly banned by the law at one end of the spectrum and illicit practices that involve the routine violation of existing laws and regulations at the other (Table 1). We discuss the most relevant forms in turn.

The prevalence of illegal mining is officially acknowledged and estimated at 31–45 per cent of Bolivia's gold production (GI-TOC 2016). According to the assessment of an AML expert (IP 6), it has increased notably in recent years. Hence, a major share of D-IFFs in gold trading stems from illegal mining activities.

The key provision that distinguishes legal from illegal mining is the existence of a valid mining title. Mining without authorization or mining right (*derecho minero*)[4] is considered illegal and, in principle, those responsible are subject to prosecution. Actors involved in illegal gold mining

[4] Law 535 de Minería y Metalurgia of 28 May 2014, modified by Law 845 of October 2016 and Law 1140 of 21 December 2018 (SENARECOM 2020).

include enterprises that operate without a valid mining title, artisanal miners who work as individuals or small groups and are not organized under a legal entity, and GMCs that extend their operations beyond their concessions, including in protected areas.

Table 1: Assessment of the levels of formalization based on interviews, government data, and literature

Formalization requirements	Fully formalized	Formalization in progress	Informal	Outside or in violation of existing legal framework
Cooperative gold producers				
Registered legal entity	*	**	**	
Valid mining title	**	**		*
Operating licence	**	***		
Environmental licence	*	*	***	
Taxes and duties		*	****	
Gold sales		**	***	
Intermediary gold traders				
Registered legal entity				*****
Operating licence				*****
Access to finance				*****
Gold purchases				*****
Taxes and duties				*****
Gold sales				*****
Gold exporters				
Registered legal entity	*****			
Operating licence	*****			
Access to finance	*****			
Gold purchases		*	****	
Taxes and duties	****	*		
Gold sales	****			*

Note: asterisks indicate distribution, from 1 (few) to 5 (all).

Source: authors' construction.

The level of formalization also varies for GMCs that are legally constituted entities[5] and hold at least a transitory authorization.[6] Informal business practices predominate, as the vast majority do not comply with labour laws, environmental regulations, or tax laws (cf. CEDIB 2015). A common illicit practice among GMCs, which nominally consist only of registered members (*socios*), is the employment of informal (day-)labourers (*peones* or *segundas*) (Graham 2019; Marston and Perrault 2017; Salman et al. 2015). Such *segundas* often work under hazardous and exploitative conditions, without basic social and labour rights. Some local observers have branded these informal labour arrangements a modern form of slavery (IP 14; see also IBCE 2016). Other GMCs partner with private companies to receive investment and machinery for mining, a practice that is illegal under the 2014 Mining Law. In the most flagrant cases, mining cooperatives merely act as fronts, effectively subleasing their mining titles to (illegal) mining enterprises, some of which are run by foreign operators, e.g. from China or Colombia (Mercado 2018a, 2018b). Furthermore, only a

[5] Law 356, Ley General de Cooperativas, of 11 April 2013.

[6] To operate legally, GMCs must hold a mining title in form of an administrative mining contract (Contrato Administrativo Minero, CAM). GMCs established before the current mining law (Law 535, 2014) was enacted may continue operations while requesting a CAM from AJAM. These GMCs operate legally on the basis of special transitory authorizations (Autorizaciones Transitorias Especiales, ATEs).

fraction of all mining cooperatives hold the required environmental licence (IP 4, 9; cf. Marston and Perrault 2017; Tellería 2022).

While GMCs operate under a preferential tax regime that exempts them from paying a range of taxes, they are—in theory—liable to pay corporate income tax (*Impuesto a las Utilidades de las Empresas*, IUE). However, most GMCs do not pay taxes at all (ANF 2022; Tellería 2022). This large-scale tax evasion was confirmed by several interviewees and is also evident from the fact that most GMCs are not even registered in the national tax system (*Sistema de Impuestos Nacionales*, SIN) and therefore do not have a tax identification number (*Número de Identificación Tributaria*, NIT) (IP 4, 5, 11, 14). However, even properly registered GMCs circumvent the IUE by exploiting inconsistencies in regulations and the opportunity to trade gold anonymously. As we will discuss in the next chapter in detail, anonymous trading is possible because of insufficient due diligence by gold exporters and SENARECOM. The latter is mandated, among others, to control compliance with the laws regulating the commercialization of gold, impose administrative sanctions in case of infractions, and inform the Public Prosecutor's Office of alleged offenses detected.[7] Similarly, many GMCs fail to pay the annual mining patent fee (*patente minera*) to AJAM required by law for all concession holders (IP 5, 10; see also MMM 2019).

In a nutshell, most GMCs operate without proper state oversight and 'conduct their business as they like' (IP 7). GMCs resist the distribution of costs and benefits implied by the current set of formal institutions governing the production and commercialization of gold, thereby securing greater access to resource rents.

Illicit transfer

The second type of IFFs pertains to the illegal transfer of gold and related money flows, including smuggling and illicit domestic transfers. Bolivia has earned the reputation of being a hub for smuggled gold from Peru, Brazil, and Colombia due to its porous borders and weak regulation of the gold trade (GI-TOC 2016; OAS 2021). IFFs that are indirectly linked to gold mining and trading also exist, including the illicit cross-border trade in mercury (AJAM 2018; Flores et al. 2021; UN 2021). Furthermore, the gold-trading sector offers ample opportunities for laundering money from the drug trade and other criminal activities (Rettberg and Ortiz 2016; Zabyelina and Heins 2020). Since we focus on IFFs stemming directly from the illicit trade in gold, those aspects are beyond the scope of our study.

Gold is also regularly illicitly transferred out of Bolivia through cross-border smuggling and fraudulent export practices; amounts are assumed to be several tons per year (Aguirre 2021). In some cases, smuggling is directly linked to illegal production. In 2021, for example, Chilean law enforcement disrupted a major trafficking ring ('Operation King Midas') involved in smuggling gold from illegal mining in the Bolivian Amazon (Reyes 2021). In other instances, smuggling involves gold-exporting companies, as evidenced by the case of the Indian gold exporter GoldShine SLR, which falsified documents to illicitly export over 300 kg of gold (MMM 2022). Several people with insight into the sector reckon that the GoldShine case was likely only the tip of the iceberg (IP 7, 11, 12); a public official shared that there was 'complicity' between some GMCs and exporters to avoid paying the mining royalty (IP 2).

A very different—and unexpected—type of illicit trade happens between producing GMCs and exporters in La Paz. Informal local gold collectors (*rescatisas*) buy small amounts of gold from small-scale miners, and intermediary traders in regional gold-trading hubs function as local retail agents

[7] Law 535 de Minería y Metalurgia of 28 May 2014, Art 87, lit a, g, h

to transport, organize, and bundle gold flows along the value chain. By linking artisanal and small-scale gold producers with private export companies, *rescatisas* and intermediary traders fulfil a crucial role, as many cooperatives lack the capital to accumulate gold while also covering the costs of maintaining production. Large distances to La Paz or other trading hubs make regular trips to sell small amounts of gold unprofitable.

Despite their key role in the commercialization of gold, nearly all *rescatisas* and intermediary traders are informal, self-employed tradesmen who operate illegally. The applicable legal framework[8] stipulates that gold sales on the domestic market are permitted only by legally entitled producers or persons with a demonstrable relation to a mining right. This legal provision prohibits the internal commercialization of gold by intermediary traders, in effect rendering the entire midstream of Bolivia's gold value chain illegal. The representative of a gold-exporting company noted that midstream value chain actors simply 'do not exist' in the legal framework and that 'in a radical analysis' all midstream-level traders must be considered illegal (IP 11). Despite their de jure illegality, *rescatisas* and intermediary traders are generally considered 'informal' actors rather than criminals. Consequently, they do not face a serious risk of prosecution or state reprisals but are de facto tolerated (IP 11, 12, 15, 16). This is evinced not least by the numerous gold-buying shops operating openly in La Paz and other commercial towns as well as in mining areas and nearby villages.

The de jure non-recognition of intermediaries has implications for (D-)IFFs. As informal actors, intermediaries do not pay taxes or maintain documentation on the origin of gold, breaking the chain of due diligence. It is therefore often impossible to verify the origin of gold, especially since many traders melt down their gold before reselling it to the next trader or directly to an exporter. In addition, almost all financial transactions by gold collectors and intermediaries are conducted in cash, in violation of the 2015 decision by the National Tax Authority to prohibit cash transactions of more than Bs. 50,000 (about US$7,000).

4.3 The mechanics of legalizing gold-related (D-)IFFs

Gold-mining cooperatives: strategic use of sales channels

GMCs have two options to market their gold: they can sell up to 40 kg of gold per month as an entity; or individual members of the cooperative (i.e. the *socios*) can sell up to 2 kg per person per month individually as 'natural persons' (*personas naturales*). A report produced in December 2017 by the head of SENARECOM's control unit for the internal commercialization of minerals noted that some 80 per cent of all internal gold sales were conducted by individuals, preventing the verification of the origin and legal provenance of traded gold (MMM, 2020).[9] According to several gold traders and informed public officials, this situation has remained unchanged (IP 4, 5, 11, 12, 13). Hence, although more than 90 per cent of Bolivian gold is produced by cooperatives, the largest part is marketed through individuals.

There is a strategic reason behind these market behaviours. Marketing gold through the *socios* allows GMCs to artificially lower their production volumes and, hence, to evade corporate income tax (IUE) (IP 2, 4, 5). That is why most GMCs choose to sell the gold produced in lots of max 2 kg (average around 1.5 kg) through *personas naturales* rather than on the cooperative's account. The legal requirements for individual sales are minimal. While the legal framework that entered

[8] Supreme Decree 29165, 2007.

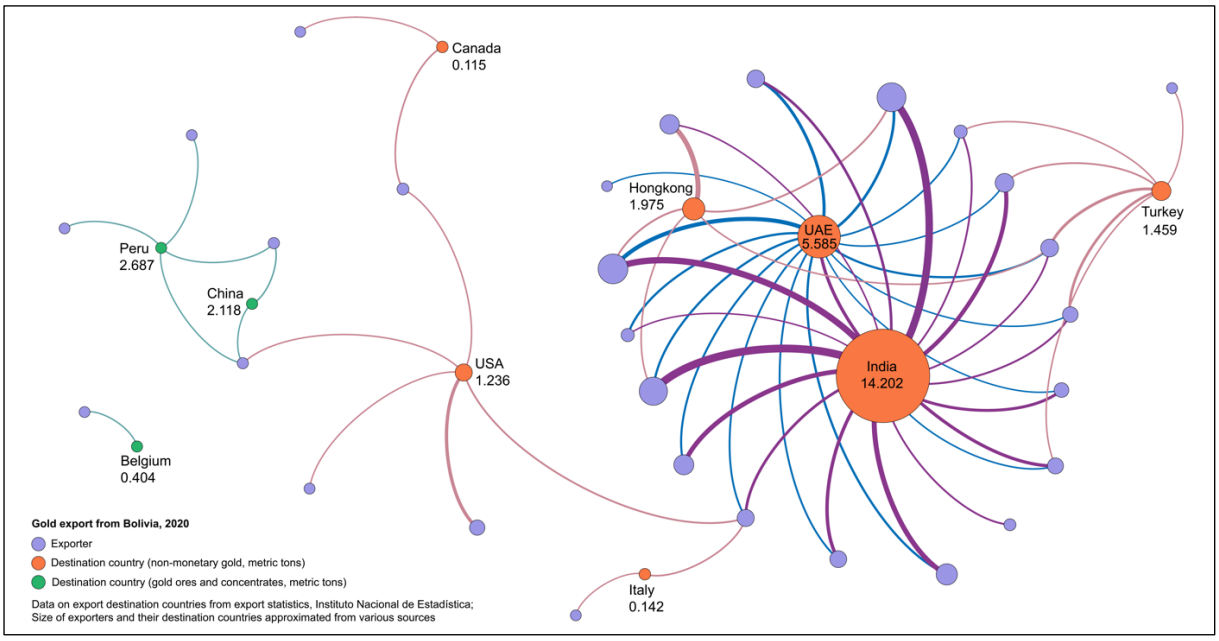
[9] Informe UCC/INF N°46/2017 de 4 de diciembre de 2017.

into force in 2007[10] stipulates that individual sellers must prove their affiliation with a legitimate producer, a 2009 ministerial resolution[11] allows the sale of up to 2 kg of gold by individuals identifiable by an identity card. Presented as a temporary measure to disincentivize gold smuggling from Bolivia, the 2009 resolution has since served as the regulatory basis for internal gold trading. Thus, in practice, any person presenting an identity card can sell up to 2 kg of gold per month without evidencing its legal provenance. The contradiction between the 2007 law and the regulatory practice is part of the mechanism that allows GMCs to engage in systematic tax evasion while promoting the 'legalization' of (D-)IFFs.

Private exporters: the legalization interface

Domestic trade ends up with licensed export companies (*comercializadoras*), which account for all official gold exports from Bolivia. Mostly located in La Paz, these companies purchase gold either directly from producers that come to the capital or from informal intermediaries before exporting it to international markets. The main export destinations are India and the United Arab Emirates (UAE). As of 2020, a total of 29 gold-exporting companies were registered, the five largest accounting for over half of all gold exports and the largest ten for about 80 per cent, indicating an oligopolistic structure of the gold export market (Figure 3). While there is no public information on beneficial ownership, according to the assessment of a sector expert, the ten largest exporting companies belong to only a few owners, suggesting an even more concentrated ownership structure (IP 4).

Figure 3: Export structure and trade patterns of the Bolivian gold sector in 2020



Source: authors' construction, based on data from *Instituto Nacional de Estadisticas*.

As the formalized link at the end of a mostly informal value chain, Bolivia's *comercializadoras* operate at the administrative bottleneck where all royalties and other official levies are collected and all due diligence on the internal marketing of the gold is to be conducted and controlled. Before gold can be officially exported, exporters must submit an affidavit to SENARECOM documenting the legal

[10] Supreme Decree 29165, 2007.

[11] Resolución Ministerial 0131 of 1 October 2009.

origin and provenance of gold shipments, and evidencing the payment of royalties and other duties. Given the widespread informality in production and trading, *comercializadoras* face significant challenges in documenting and verifying the legality and origin of gold shipments, forgoing meaningful sourcing due diligence (IP 2, 4, 11, 12). An AML expert noted that 'most *comercializadoras* don't care where the gold comes from, only very few. I don't know if even one does it in a legally correct fashion, certifying that everything is in order' (IP 7). This is generally acknowledged by *comercializadoras.* As a representative of a gold export company explained:

> So, what do you do? No one has the papers in order. Therefore, no one would be legally entitled to sell gold in Bolivia—all of them are illegals. SENARECOM knows this and says: 'Ok, we accept natural persons as a form of tolerance—this time only'. But it has been 'this time' for years! Since 2007, the law [Supreme Decree 29165, 2007] says it is prohibited to sell [gold] as an individual but still they accept it. Because they know that the cooperatives do not have their papers in order. (IP 11)

SENARECOM: the clearinghouse

Due diligence compliance is de facto suspended for gold sales of up to 2 kg by *personas naturales* to allow continuous gold exports (IP 2, 4, 5, 11). The legal ambiguity between the 2007 law and the 2009 regulatory provision undermines the ability of SENARECOM to conduct proper due diligence. The former requires that a gold shipment assigned for export has been sold by a legally entitled producer. The latter permits the sale of up to 2 kg of gold by *personas naturales* and has made compliance with the legal framework 'almost impossible', as the gold could 'pass through up to ten hands' before being exported (IP 2). This practice encourages both sellers and exporters to make false statements regarding the legal provenance and origin of gold, frequently attributing gold shipments to unrelated cooperatives or submitting false copies of mining patents (*patente minera*). Efforts to withdraw the 2009 provision and reinstate the 2007 law have consistently been opposed by mining federations (IP 2, 11).

Against this background, illegally mined or smuggled gold can easily enter the formal value chain at any point before export. One AML expert concluded 'I could be a drug trafficker, a criminal, or even a gold thief from Colombia and sell in Bolivia' (IP 7). The fractured due diligence system makes Bolivia's gold value chain, and in particular the export interface, susceptible to (D-)IFFs, since channelling illicit gold or money flows into the Bolivian gold value chain is an almost risk-free activity.

SENARECOM establishes the 'origin' of gold shipments, i.e. it identifies the producing municipality by accepting a photocopy of the *patente minera* (IP2). Yet, since the chain of custody is often broken, this error-prone control of the 'origin' of gold regularly fails to verify provenance. Therefore, the most reliable step in approving gold exports is to verify the payment of royalties. Mining royalties are then redistributed to the respective departments and municipalities.

The consequence of the legal ambiguity and the above-mentioned procedural deficiencies is that, *nolens volens*, potentially illicit gold consignments, are transformed into officially approved exports, turning SENARECOM into a kind of 'clearinghouse'. Other institutions with regulatory or oversight obligations use export permissions issued by SENARECOM as a reference point for documenting the legality of transactions. For example, the national customs authority at La Paz airport only verifies that the physical cargo matches the documentation issued by SENARECOM; if the paperwork is in order, gold shipments are waved through (IP 8).

The private (and, in the case of the Banco Unión, state-controlled) banks handling the flow of funds between exporters and international buyers are another key player with a due diligence responsibility. Financial intermediaries are required to comply with national regulations on anti-money laundering and countering the financing of terrorism (AML/CFT), i.e. assess the risk of transactions, take measures to mitigate those risks, and report suspicious transactions to the UIF.

The UIF Instructions for Financial Intermediaries provide for the establishment of monitoring and evaluation procedures, the application of enhanced due diligence procedures, and explicit management approval for business relationships with precious metals traders (UIF 2019). Despite those instructions, however, banks rely on the approval by SENARECOM to verify the legality of transactions. Given the limited scope of SENARECOM's due diligence practice, it is unclear how financial institutions can meet their AML/CFT due diligence obligations. In the view of an AML expert, controls at banks dealing with gold export traders are generally 'very lax' and 'there is no enhanced due diligence'. Banks that take their due diligence seriously would refuse to accept gold exporters as clients (IP 7). After the GoldShine case, the attitude of the banks started to change somewhat, and they began to require the presentation of export licences issued by SENARECOM and to limit the daily and weekly remittance amounts that could be received from traders to enable better reconciliation of reported exports with revenues generated (IP 4, 7, 11). While this 'mass balance' approach may permit better detection of fraudulent exports, it remains toothless in detecting gold flows of illicit origin on account of the lack of due diligence by traders.

Bolivia is a member of the Grupo de Acción Financiera de Latinoamerica (GAFILAT), the Latin American associate member of the Financial Action Task Force (FATF). GAFILAT member countries base their AML/CFT laws on the 40 FATF recommendations and engage in regular peer reviews to strengthen regulation in their member countries; Bolivia was reviewed in 2013 and the next review is scheduled for 2023. However, these regulations are of limited effectiveness, as an AML export noted. The Bolivian AML agency would receive only a fraction of the anti-money laundering alerts from banks compared with its counterparts in neighbouring countries. And of these alerts, only about 5 per cent would lead to actual investigations. There was also no reporting of suspicious gold-related transactions from banks to the UIF unless an investigation into a certain client had already been initiated by law enforcement (IP 6).

The UIF has an explicit mandate to monitor and control the gold-trading sector. However, since the *rescatisas* and intermediary traders are not registered, and since almost all transactions are conducted in cash, the UIF cannot perform any meaningful monitoring or control function.

> The only way you can control any business is to force them to declare their transactions. Without that there is no way to control them. […] There should be a register of approved miners, as with other companies and their owners, a register of approved traders, and all the operating statistics, which are simply reports of their transactions. (IP 7)

Instead, the precious minerals sector is an area where the UIF has very little information and relies on estimates of illegal activities but no concrete data that could be used for official purposes (IP 6). In the view of an AML expert, UIF fails to monitor the gold-trading sector effectively, not because of a lack of capacity but because the tools and procedures lawmakers have approved restrain UIF from doing so. (IP 7).

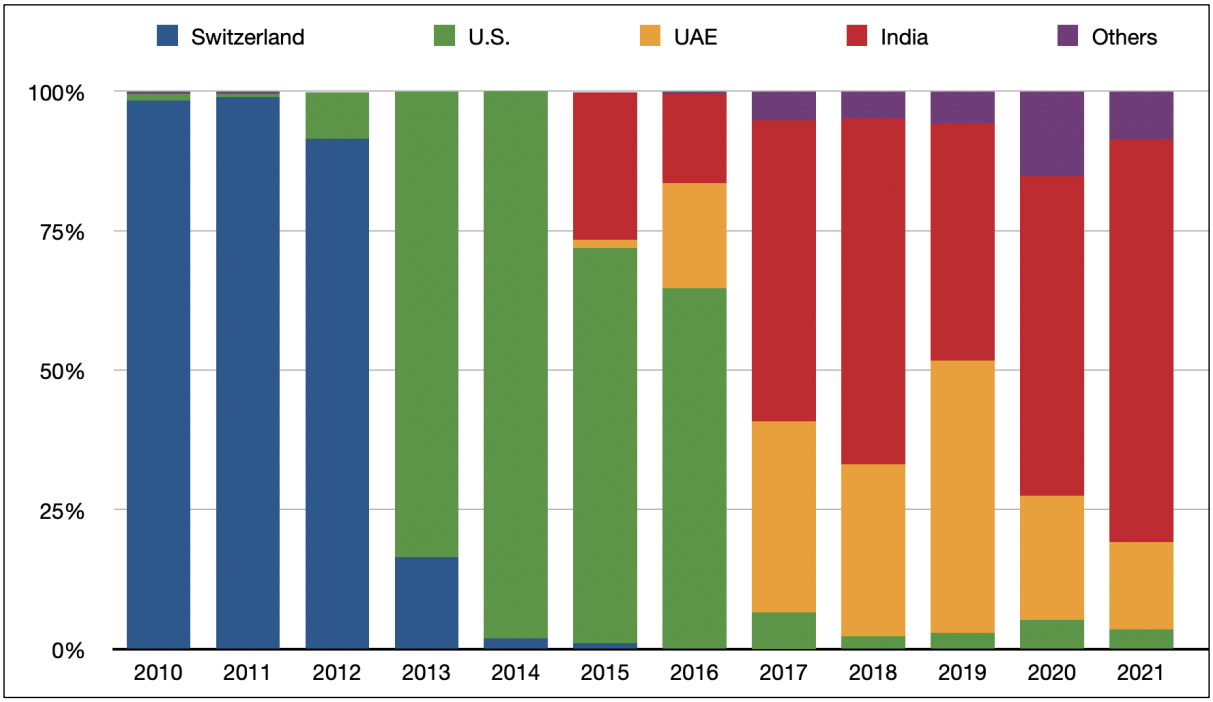
Finally, payments to Bolivian gold exporters by their international customers are always transferred in US dollars, which are largely processed by US correspondent banks (IP 7). The FATF AML/CTF recommendations also apply to correspondent banks when establishing business relationships with a respondent bank and for the ongoing monitoring of transactions, including

requests for information about specific transactions (FATF 2016). Thus, in theory, banking due diligence regulations, imposed by international correspondent banks on their Bolivian counterparts, have the potential to empower Bolivian banks to demand documentation from gold exporters and, where this is not available, stop their transactions. Currently, however, this seems not to happen—at least not systematically. Our data do not provide sufficient information for us to comprehend the rationale behind this seemingly lax approach. The literature observes that in high-profile gold-laundering cases in the USA involving South American countries, traders and refiners were targeted and fined for failing to comply with AML/CTF requirements, but banks were not accused of wrongdoing in handling wire transfers (Zabyelina and Heins 2020).

Export destinations

The question emerges whether the legalization of (D-)IFFs affects the export markets available to *comercializadoras*. The export statistics for Bolivian gold reveal an interesting pattern. Bolivia's gold export destinations shifted away, first from Switzerland to the USA, and from the USA to the UAE and India after 2016 (Figure 4). The second shift coincides with a major US law enforcement effort, Operation Arch Stanton, against US refineries that import gold from Latin America (Bolivia, Chile, Ecuador, Peru) without performing the required due diligence.

Figure 4: Shifting export patterns away from the USA towards India and the UAE after Operation Arch Stanton



Source: authors' illustration based on data from *Instituto Nacional de Estadisticas.*

According to conversations with *comercializadoras*, speed of payment by the international buyer is as important as price when selecting a buyer. Buyers from India and Dubai are preferred by many traders since they pay quickly—sometimes the day the gold is bought and before it is shipped—allowing export traders to buy more gold on the internal market (IP 11). In contrast, European and US buyers certified by the LBMA do not pay until the shipment is received and inspected. This can take up to a week from the time of the transaction. Only exporters with sufficient liquidity can wait for these payments (IP 11). As due diligence procedures translate into payment delays, US and European law enforcement and LBMA standards appear to have at least an indirect impact on export market selection.

5 Discussion

Our research into (D-)IFFs in the case of Bolivia reveals the 'mechanics' of their legalization (RQ1). A largely informal production and trade arrangement is formalized by SENARECOM, the state agency responsible for administrating gold exports. SENARECOM is used by licensed exporters as a clearinghouse before selling to international markets. Illicit gold flows—i.e. those that have entered Bolivia from third countries as well as those illicitly produced or transferred within Bolivia—become 'legalized' at the point of their departure from Bolivia when gold shipments are exported by formal private export traders through official export channels. Thus, the 'legalization' of D-IFFs and IFFs goes hand in hand.

The state is emerging as the enabling force behind this legalization, facilitated by legal ambiguities through lowering formal requirements, reinterpreting laws through decrees, and deliberate non-enforcement of existing regulations. Together, these remove most incentives for GMCs to formalize and comply fully, and for exporters and the financial industry to take due diligence seriously. As a result, the Bolivian state forgoes tax revenues, tolerates trafficking, and accepts environmentally harmful production conditions.

Institutionalists argue that this underperformance is mainly a problem of inappropriate institutional design and lack of capacity. While capacity constraints in some units of the administration may play a role, the state's agency—particularly its authority to set priorities on investing in state capacity, such as whether to strengthen units of the administration charged with oversight of a strategically important sector—must not be disregarded. Other research confirms that the lack of enforcement in Bolivia's informal mining sector is not due to a general lack of government capacity, but rather to political incentives (Baraybar Hidalgo and Dargent 2020).

This brings us to the next question, i.e. what motivates the state to legalize (D-)IFFs at the expense of higher revenue mobilization (RQ2)? Our analysis reveals that mining cooperatives play a key role in the current political settlement of Bolivia and that gold-mining cooperatives have grown in number, size, and influence within the cooperative sector over the last decade. Their 'holding power' rests on the sheer number of members and their dependants, who build an important voting constituency, on their mobilization capability, and on the links with the MAS government. The government is aware that its fate also depends on support from cooperatives and that it may not survive a serious conflict with this internal power group.

We therefore conclude that politically motivated attempts to appease GMCs, represented through their powerful federations, play an important role in explaining the institutional underperformance not only of SENARECOM but also of the other agencies involved in regulating the gold mining and trading sector. In support of this argument, we have established that the benefits from the institutional performance accrue to the GMCs by the de facto lowering of entry barriers and operating costs, as well as transaction costs. This, in turn, reinforces the role and position of the gold sector in Bolivia's economy and politics. Private exporters benefit from lax controls that at least some exploit by engaging in illegal export practices, i.e. by creating illicit financial outflows.

The 'legalization' of (D-)IFFs allows the government to balance competing interests: it raises some revenue while maintaining a veneer of regulatory control; it avoids a struggle with the mining federations with an uncertain outcome; and it mitigates the risk of increased smuggling of gold out of the country. Thus, the continuous 'legalization' of (D-)IFFs may be seen as a pragmatic, albeit imperfect and legally and ethically problematic, stop-gap solution.

Building on political settlement theory has allowed us to move beyond institutional accounts and explain institutional performance 'from within', i.e. based on intrinsic rationales rooted in domestic elite bargains, and understand the forgone tax revenue as the purposeful creation of access to rents for groups with holding power. The availability of complementary data from official statistics and reports allows triangulation between sources, which makes our findings and conclusions robust.

6 Conclusion

While our investigation into the 'legalization' of (D-)IFFs focuses on the case of Bolivia, the findings are relevant for the wider discourse on understanding and curbing IFFs. In other contexts where state policy on IFFs affects rent distribution between ruling elites and social and political groups with holding power, various political settlements are likely to influence institutional responses towards IFFs. Our findings indicate that prevalent explanations for the role of state actors in permitting IFFs may fall short of identifying structural causes, as they focus too narrowly on problems of individual behaviour and formalistic institutional governance. Broadening the analysis of the role and function of state actors in the context of IFF generation and facilitation is therefore important for the development of adequate policy responses to counter IFFs.

At the conceptual level, the study has highlighted definitional ambiguities around IFFs and demonstrated the limitation of a restrictive definition of IFFs. More (and interdisciplinary) work is needed to advance the conceptual underpinning of IFFs.

At the research level, this paper contributes to the operationalization of political settlement theory by successfully deploying it for the analysis of institutional performance in the gold trade. The systemic link between the analysis of everyday institutional practices and longer-term elite bargain dynamics offers a richer understanding of politics to inform policy. Future research should advance the methodological toolbox to facilitate and improve cross-case comparison.

At the policy level, the findings expand the scope of IFFs by explicitly including the creation, transfer, and legalization of D-IFFs in the debate. Our findings suggest that state-sponsored legalization measures do not exempt recipients of financial or value flows from due diligence obligations or from the responsibility to confront socially and/or ecologically destructive production conditions. Our results further suggest that policy measures must go beyond technical fixes such as isolated capacity building towards more comprehensive initiatives that are mindful of the political and distributive functions of institutions.

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Appendix: List of interview partners and focus group discussions

IP: 1-8, 16: public officials
IP 9-10: civil society representatives
IP 11-15: trading companies and private sector actors
IP 17: cooperative representative
FDG 1-4: cooperatives and gold cooperative federations