

Effect of pyramid schemes to the Economy of the Country - Case of Tanzania

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Abstract— Pyramid scheme, in their various forms, are not a new thing in the world, however, they have reared their ugly menacing heads' in the Tanzanians society only recently. Before the Development entrepreneurship Community Initiative (DECI) debacle other schemes such as Women Empowering, woman had already racked havoc in the society. This study intended to evaluate the extent to which Tanzanians knew about the pyramid schemes operating in the world, their participation in these schemes and their general feelings towards the scammers, our judicial system and the course action they are likely to take in the event they are scammed. Results show that most Tanzanians are very naïve when it comes to pyramid schemes, with very scant knowledge about these schemes. Many do not know if they have participated in these schemes but in those instances that they had, they suffered huge financial losses. As to the reasons as to why they participated in these schemes in the first place range from pure naivety, personal greedy, and peer pressure. Many respondents do not have confidence in our judiciary and show great apathy towards the politicians. They think that rioting and anarchy are the best recourse they have in case they are scammed. This study makes the following recommendations that; Providing Adequate Knowledge on the Pyramid Schemes to the international community, since many members do not have adequate knowledge of these schemes. Scammers may use this opportunity to snare as many victims as possible daggling the 'get rich quick' carrot in front of the unsuspecting victims. Strengthening the Legal Systems of our countries, the institutions and our people must be in a position of make insisting that the law is improved in order to deal with the upheavals in the society more adequately. Prudence should be exercised before touting any scheme. The extent of financial loss suffered by individuals and institutions who participated in such schemes in Tanzania.

The possible legal precedents and resources that can be used to bring the culprits to be booked and asset recovery processes that can be employed so as to reimburse the victims.

Key terms— Pyramid scheme, Legal systems, Economy.

I. INTRODUCTION

The major aim of this project was to determine the financial and economic impact of get rich quick schemes to world community at large. It is hoped that the results of this project would enable the various stakeholders around the world to gain a better understanding of the operations of 'get rich quick' schemes and avoid the traps they offer. In particular, it is envisaged that the results would help not only individual Tanzanians but the international community to understand the market and economic evolutions and be able to identify pyramid schemes in their different forms, help legislative institutions-the parliaments, the police forces, the courts, etc.,

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come up with appropriate laws and mechanisms that will stop those unscrupulous people praying on unsuspecting individuals. Help supervisory institutions formulate appropriate policies that will require all investment plans to be documented, filed and thoroughly scrutinized and come up with the ways to recover assets of the culprits and use them to compensate the victims of get rich quick schemes.

II. BASIC VIEW OF PYRAMID SCHEME

Pyramid scheme is a fraudulent moneymaking scheme in which people are recruited to make payments to others above them in a hierocracy while expecting to receive payments from people recruited below them. It is an investigating plan that has unfortunately cost many people worldwide their hard-earned savings. The concept behind the pyramid scheme is simple and should be easy to identify; however, it is often presented to potential investors in a disguised or slightly altered form. For this reason, it is important to not only understand how pyramid schemes work, but also to be familiar with the many different shapes and sizes they can take – from pyramid schemes to envelope stuffing, there are a lot of scams masquerading as legitimate part time work. Many investors do not understand how to determine the level of risk their individual portfolios should bear.

III. THE "EIGHT-BALL" MODEL.

Many pyramids are more sophisticated that the simple model. These recognized that recruiting a large number of others into a scheme can be difficult so a seemingly simpler model is used. In this model each person must recruit two others, but the ease of achieving this is offset because the depth required recouping any money also increases. The scheme requires a person to recruit two others, who must each recruit two others, who must each recruit two others. The "eight-ball" model contains a total of fifteen members. Note that unlike the pictures, the triangular setup in the cue game of eight-ball corresponds to an arithmetic progression $1+2+3+4+5=15$. The pyramid scheme in the picture in contrast is a geometric progression $1+2+4+8=15$.

Prior instances of this scheme have been called the "Airplane game" and the four tiers labeled as "captain", "co-pilot", "crew", and "passenger" to denote a person's level. Another instance was called the "Original Dinner Party" which labeled the tiers as "desert", "main course", "side salad", and "appetizer". A person on the "desert" course is the one at the top of the tree. Another variant, "Treasure Traders", variously used gemology terms such as "polishers", "stone cutters" etc. or gems like "rubies", "sapphires", "diamonds", etc. Such schemes may try to downplay their pyramid nature by referring to themselves as "gifting circles" with money being

“gifted”. Popular schemes such as the “Women Empowering Women” do exactly this.

Whichever euphemism is used, there are 15 total people in four tiers (1+2+4+8) in the scheme with the Airplane game as the example, the person at the top of this tree is the “captain”, the two below are “co-pilots”, the four below are “crew”, and the bottom eight joiners are the “passengers”. The eight passengers must each pay (or “gift” a sum (e.g. Shs 100,000) to join the scheme. This sum (e.g. Shs 800,000) goes to the captain who leaves, with everyone remaining moving up one tier. There are now two new captains so the group splits in two with each group requiring eight new passengers. A person who joins the scheme as a passenger will not see a return until they advance through the crew and co-pilot tiers and exit the scheme as a captain. Therefore, the participants in the bottom 3 tiers of the pyramid lose their money if the scheme collapses. If a person is using this model as a scam, the confidence trickster would make the lion’s share of the money. they would do this by filling in the first 3 tiers (with 1,2 and 4 people) with phony names, ensuring they get the first 7 payouts, at 8 times the buy-in-sum, without paying a single penny themselves. So if the buy-in were Shs 1,000,000, they would receive Shs 8,000,000, paid for by the first 8 investors. They would continue to buy in underneath the real investors, and promote and prolong the scheme for as long as possible to allow them to skim even more from it before it collapses.

Although the ‘captain’ is the person at the top of the tree, having received the payment from the 8 paying passengers, once he or she leaves the scheme is able to re-enter the pyramid as a ‘passenger’.

IV. MATRIX SCHEME

Matrix schemes use the same fraudulent non-sustainable system as a pyramid; here, the participants pay to join a waiting list for a desirable product which only a fraction of them can ever receive. Since matrix schemes follow the same laws of geometric progression as pyramids, they are subsequently as doomed to collapse. Such schemes operate as a queue, where the person at head of the queue receives an item such as a television, games console, digital camcorder, etc. When a certain number of new people join the end of the queue. For example ten joiners may be required for the person at the front to worthless item, such as an e-book, for their position in the queue. The scheme organizer profits because the income from joiners far exceeds the cost of sending out the item to the person at the front. Organizers can further profit by starting a scheme with a queue with shill names that must be cleared out before genuine people get to the front. the scheme collapses when no more people are willing to join the queue. Schemes may not reveal, or may attempt to exaggerate, a prospective joiner’s queue position which essentially means the scheme is a lottery. Some countries have ruled that matrix schemes are illegal on that basis.

V. MULTI-LEVEL MARKETING (MLM).

Legal multi-level marketing (MLM) involves being recruited in order to sell a product or service that actually has some inherent value. As a recruit, you can make a profit from the

sales of the product or service, so you don’t necessarily have to recruit more salespeople below you. And while you may be encouraged to recruit other sales people whose sales would give you more profit, you can stick to just selling to product directly to the consumer if you choose.

A pyramid scheme MLM, however, will most likely sell a product with no independent value. The product could take the form of reports of some kind, for example, or mailing lists. In this kind of pyramid scheme, you would be required to recruit new members into the MLM in order to make a profit and keep the MLM alive. Joining the MLM is the only reason anyone would buy the products sold by this pyramid scheme. The network marketing or multi-level marketing (abbreviated MLM) business has become associated with pyramid schemes as “some schemes may purport to sell a product, but they often simply use the product to hide their pyramid structure” and the fact while some people call MLMs in general “pyramid selling” others use the term to denote an illegal pyramid scheme masquerading as an MLM. For example, the United States Federal Trade Commission (FTC) warned “Not all multilevel marketing plans are legitimate. Some are pyramid schemes. It’s best not to get involved in plans where the money you make is based primary on the number of distributors you recruit and your sales to them, rather than on your sales to people outside the plan who intend to use the products and states that research is your best tool and gives eight steps to follow: Find – and study – the company’s track record,

Learn about the product, ask the questions, understand any restrictions, talk to other distributors. Consider using a friend or adviser as a neutral sounding board or for a gut check. Take your time think about whether this plan suits your talents and goals. Some believe MLMs in general are nothing more than legalized pyramid schemes.

i) Connection to Franchise fraud

Franchise fraud (or franchise churning) is defined by the U.S. Federal Bureau of Investigation as a pyramid scheme. The FBI website states:

“Pyramid schemes – also referred to as franchise fraud or chain referral schemes – are marketing and investment frauds in which an individual is offered a distributor ship or franchise to market a particular product. The real profit is earned, not by the sale of the product eventually leads to a point where the supply of potential investors is exhausted and the pyramid collapses”.

One of Pearlasia Gamboa’s 9President of the micro nation of Melchizedek) franchise fraud schemes was described by the Italian newspaper La Repubblica as “one of the most diabolical international scams ever devised in recent years”.

VI. CHARACTERISTICS OF PYRAMID SCHEMES

Because people are attracted to the idea of making a quick buck with very little effort, many different forms of disguised pyramid schemes have succeeded in fooling people. Despite the illusion of legality presented by these revamped schemes, they are still illegal. It is thus important to recognize the characteristics of such s-called investment plans:-

a) Growth Stock Pick (CTLE)

Many schemes will adopt the guise of gift-giving or loans that take place in investment clubs because none of these activities are technically illegal. However, the practice of donating a gift which is tax free up to a certain value to someone (the recruiter), then having to recruit people into the club in order to receive a return on your investment (or your gift, rather) is essentially a pyramid scheme in disguise.

b) Ponzi Schemes.

Named after Charles Ponzi, who ran such a plot from 1919-1920, the Ponzi scheme is a fraudulent investment plan. It is not necessarily a pyramid, which is hierarchical. In a Ponzi scheme, there is one person who takes people's money as an "investment" and does not necessarily tell them how their returns will be granted. As such, the people's return on investment could be generated by anything; it could come from money taken from new investors-which means new investors essentially pay off the old investors or even from money made by gambling in Las Vegas. The Kyiv Post reported on 26 November 2008 that American citizen Robert Fletcher 9Robert T. Fletcher III; aka "Rob") was arrested by the SBU (Ukraine State Police) after being accused by Ukrainian investors of running a Ponzi Scheme and associated pyramid scam netting US\$20 million. (The Kiev Post also reports that some estimates are as high as US\$150M). In 2011 Bernard Madoff was sentenced to sixty year prison sentence by the United States Federal government after being accused of running a Ponzi scheme.

c) Chain Letters

Chain letters can be received electronically or through snail mail and are not illegal on their own. However, they take on the form of a pyramid scheme when the letter asks you to donate a certain amount of money (even just 5 cents) to the people on a list, then delete the name of other people. The next people receiving the letter are then asked to do the same thing, so that you can receive your money as well. By forwarding the letter, you are asking people to give money with the promise of making money.

d) Internet

In 2003, the United States Federal Trade Commission (FTC) disclosed what it called an internet based "pyramid scam". Its complaint states that customers would pay a registration fee to join a program that called itself an "internet mall" and purchase a package of goods and services such as internet mail, and that the company offered "significant commissions" to consumers who purchased and resold the package. The FTC alleged that the company's program was instead and in reality a pyramid scheme that did not disclose that most consumers' money would be kept, and that it gave affiliates material that allowed them to scam others. Win Capita was a scheme run by Finnish criminals that involved about €100 million.

e) Others

In popular culture many face book games operate on a pyramid scheme system where you are greatly hindered in the game play unless you recruit your friends and family to play the game too.

Stanton, a character of Charles Maturin's famous novel Melmoth the Wanderer, while put in Bedlam by his relative, finds a plan written by some of his predecessors in the room

he is placed. It is a plan of baptizing all the population of Ottoman Empire, beginning with the Turkish ambassadors, and his classical pyramid scheme.

The feature film Children of Invention tells the story of a mother gets entangled in a pyramid scheme.

The novel Welcome to the N.H.K. features a story wherein the main character is caught up in a cooked multi-level marketing scam called 'Mouse Road'.

On the NBC sitcom The office, it is revealed that Michael did not attend college because he lost all his tuition money in a pyramid scheme. At a later date, the same character unintentionally attempts to recruit members of his staff into selling calling cards, not realizing that he had been conned into a pyramid scheme until it is made clear by an employee.

Season one of the Channel 4 sitcom Peep Show, features an episode in which Jeremy becomes involved in a pyramid scheme after being ignorantly drawn into it by his neighbor Toni, whom he's trying to sleep with.

The 2010 film The fighter features Dicky Eklund (Christian Bale) attempting a pyramid scheme to help pay for his brother's training.

In an episode of the sitcom Two and a Half men entitled "That Darn Priests", Alan runs a Ponzi scheme in the name of his chiropractor business until Rose finds out and threatens to tell all his investors if he doesn't stop.

VII. VII. POSSIBLE EFFECTS OF PYRAMID SCHEMES.

There are many variants of pyramid schemes and you never know when you will be a victim of one. These schemes have many effects in the country and the economy. The possible effects of a pyramid schemes include:-

i. Financial loss and Economic Impairment

The most obvious effects of pyramid schemes are the financial loss and economic impairment of the victims. Victims lose hundred thousand and sometimes millions of shillings through such scams.

These lost millions have another dimension: they impact the economy in no small measure as people lose confidence after financial loss. There is also the issue that many schemes originate from outside the country thus a lot of funds are siphoned outside the country. For instance, throughout 2010 and 2011 a number of authorities around the world including the Australian Competition and Consumer Commission, the Bank of Namibia and the Central bank of Lesotho declared TV1 Express to be a pyramid scheme. TV1 Express, operated by Tarun Trikha from India, apparently recruited hundreds of thousands of "investors", very few of whom, it is reported, have recouped any of their investment. These financial problems arise because of the inherent fraud in the schemes.

ii. Forceful Government Changes

The 1997 rebellion in Albania was partially motivated by the collapse of pyramid schemes. The problem is that the scheme cannot go on forever because there is a finite number of people who can join the scheme (even if all the people in the world join). People are deceived into believing that by giving money they will make more money ("with an investment of just Shs 100, 000, you will receive Shs 900,000 in return"). But no wealth has been created; no product has

been sold; no investment has been made; and no service has been provided.

The fraud lies in the fact that it is impossible for the cycle to sustain itself, so people will lose their money somewhere down the line. Those who are most vulnerable are those towards the bottom of the pyramid, where it becomes impossible to recruit the number of people required to pay off the previous layer of recruiters. This kind of fraud is illegal in the United States and most countries throughout the world. It is estimated that 90% of people who get involved in a pyramid scheme will lose their money.

iii. Violence and Civil Unrest

In early 2006, Ireland was hit by a wave of schemes with major activity in Cork and Galway, participants were asked to contribute €20,000 each to a “library” scheme which followed the classic eight-ball model. Payments were made in Munich, Germany to skirt Irish tax laws concerning gifts. Spin-off schemes called “Speedball” and “People in Profit” prompted a number of violent incidents and calls were made by politicians to tighten existing legislation. Ireland has launched a website to better educate consumers to pyramid schemes and other scams.

On 12 November 2008, riots broke out in the municipalities of Pasto, Tumaco, Popayan and Santander de Quilichao, Colombia after the collapse of several pyramid schemes. Thousands of victims had invested their money in pyramids that promised them extraordinary interest rates. The lack of regulation laws allowed those pyramids to grow excessively during several years. Finally, after the riots, the Colombian government was forced to declare the country in a state of economic emergency to seize and stop those schemes. Several of the pyramid’s managers were arrested, and are being prosecuted for the crime of “illegal massive money reception”.

iv. Asset Recovery Process

One of the most important areas for consideration is if and how assets can be recovered from the culprits. There should be a mechanism in place to not just punish the wrong doers but also make them pay with ill-gotten assets. Their assets and property should be recovered and marshaled to reimburse the victims. A legal precedent can be obtained in the case of Bernard Madoff where the US Federal Government seized and auctioned his (and wife’s) assets so as to get money to reimburse the victims. Though Madoff was jailed for sixty years in prison the victims were more in favour of getting their money back.

The perpetrators and runners of pyramid schemes mostly use the cash to buy expensive assets for themselves and gifts for their family, spouses and friends. There should be means of tracing all the assets and property bought; investments and gifts made, and trusts created and bequests conferred. The recovered assets and property should then be sold and the cash received distributed among the victims. There should be a law place that will facilitate the asset recovery process.

v. The Case of Tanzania

There has been evidence of pyramid schemes operating in Tanzania, the only issue is that people do not know if many more schemes exist. Notable cases have been the early 1990s ‘Women Empowering Woman’ scam involving a wife of

Tanzania’s ambassador to a foreign country and the DECI scandal. However, there could be other forms of pyramid schemes unknown to people. Currently, there are forms of multi-level marketing schemes operating in the country such as GNLD, etc. There are other types of schemes, such as Q net, which depends on recruitment of new members for subsequent pay-offs to older members.

Most times, recruiters sing the benefits of joining the schemes and prophesized the getting rich quick doctrine without hinting at probable pitfalls. For example, new recruits are promised certain and expedited pay-offs once they are able to recruit new members into the scheme, but do not tell them that getting these members is difficult as many people already been scammed.

Other technique used by these schemes is getting influential people, on board thus providing credibility to the scheme.

But the question is: do all pyramid schemes have to be in the form of investment schemes or multi level marketing? What about the other forms of common pools that have not been legally registered by the Government authorities in the monetary issues?

VIII. CONCLUSION

It is revealed that to a great extent most of the world community especially Tanzanians have very little or no knowledge at all of the ‘pyramid schemes’ operating in the world and in the country and showed considerably lack of ‘what is on-going in the world’. Because most of them do not know any form of pyramid scheme or not. However, it is also revealed that there are people who unwillingly participate in these schemes while they know what they are doing.

It is highlighted that there are some abnormal observations. For example, there are people who believe that they have little or no knowledge of pyramid schemes and yet they are sure that they have not participated in any one of them. We find this to be somewhat out of normal. But in general it can be concluded that they answered honestly what they believe they know. Which parts of the world are likely to fall victim of the scammers? It has been found that people in the hinterland are more susceptible to fall victim of scammers compared to their counterparties in the coast. Since majority of the people living around the coastal areas are Muslims then it shows the cautious nature Muslims in participating in these kinds of schemes. It is also revealed that many people around the world have suffered losses by participating in the scams. Losses suffered are in excess in volumes of money and their standards of living of the people are still stagnant. Most people are driven to join these schemes out of pure greed but there are those who fall victim because of naivety and are somehow victims of circumstances. Some were convinced by relatives to join the schemes and some by their religious leaders. Can we surmise here that religious leaders have taken upon the dual role of being spiritual as well as financial experts? Are religious leaders qualified to offer sound financial advice? Generally there is a feeling among the global community that there is no adequate information has been given.

People would like to have information and education to pyramid schemes. They would like this education to be

provided through seminars, workshops, media, village meetings and societal groupings such as UPATU, VIKOBA, SACCOS, Local authorities, etc

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