

HAWALA

Roger Ballard

The earliest historical reference to hawala is in Egyptian records over a millennium old, where it signified an 'exchange of debt' between those providing financial services to long distance traders. These financial service providers, or 'hawaladars', formed a coalition of reciprocity that routinely honoured each other's 'hundi' – bills of exchange, using conventional banking terminology. To long distance traders, hawala were useful because a hundi could be cashed by a coalition hawaladar in any other market. The encashment of hundis generated a complex network of debt that was ultimately settled in a series of 'debt swaps' – 'hawala'. After European powers established hegemony over the Indian Ocean, western banking houses dominated and hawala were marginalised. They were rejuvenated after colonial power collapsed, migrant populations increased and communication technology evolved. Hawaladars found themselves perfectly suited to the logistical challenge of delivering 'migrant remittances': money sent by migrants to family members in their home countries.¹

A modernised version of hawala was playing a significant role in financial transactions throughout the Islamic world well before 9/11. Used by migrant workers of Muslim origin as a cheap and convenient means of sending savings to their families back home, 'hawaladars' are found at the heart of virtually every community established by Asian migrant workers in Europe, North America and the oil-rich Middle East. Equipped with little more than a telephone, computer and fax machine – often in the corner of an inner-city store selling anything from cheap tickets to groceries to a largely migrant clientele – hawaladars guarantee delivery to recipients within 48 hours, no matter how remote the destination, at a fraction of the cost charged by formally constituted agencies such as Western Union, and to a far wider range of destinations. Cash deliveries to remote valleys in the Pir Panjal, to the mountains of the North West Frontier Province, to war-torn Afghanistan and Somalia are all routine. A similar system used by Chinese migrants is called *fei-chien*, 'flying money' – an apt description of hawala's wonders.

Terrorist finance?

Hawala is big business: millions of dollars a day flow through the system globally. Prior to 9/11 few outsiders were aware of the system; after 9/11 suspicion of all things Islamic suddenly labelled hawala a form of 'underground banking'. But this is clearly banking with a difference. For those accustomed to the clerical procedures of formally constituted banks and their mounds of documentation – cheques, deposit receipts, account statements, transaction summaries – hawala operations appear to

Within days of the 9/11 attacks, American authorities prepared to wage war on terror on both financial and military fronts. As the Taliban fled Kabul in the face of advancing American forces, US Treasury Secretary Paul O'Neill announced he was forging a global alliance through which 'we are going to pursue the financiers of terrorism like they've never been pursued before.' His target, however, was as shadowy as al-Qaida itself: the informal system of international money transfer known as hawala.

operate on an impossibly casual basis open to exploitation by terrorists and other malefactors.

Hawala is indeed an 'informal' system by contemporary Euro-American standards. Relying wherever possible on trust rather than written contracts to guarantee the security of their transactions, and transmitting only the data necessary to complete them, hawaladars deploy conventional banking procedures of consolidation, settlement and deconsolidation, but reduce record-keeping to a bare minimum. This 'lean and mean' approach dramatically reduces overheads and cost per transaction. It also alarms regulators: such operations appear to be un-auditable by conventional standards. During the post-9/11 panic, hawala was routinely described as 'a system without records'.

Much of that was hype. Careful inspection reveals that hawaladars do keep essential records – amounts delivered, recipient names and addresses – without which they could not run their operations. But these front-office practices were not what stumped outside observers; it was their back-office procedures culminating in cash deliveries to remote locations that remained shrouded in mystery. Sending funds overseas by conventional means is normally complex, which is why banks charge substantial commissions. How could 'backstreet' hawaladars achieve the same end so much more cheaply? Many sceptical observers smelled a rat.

While the American military rounded up 'illegitimate combatants' the world over, the US Treasury Department took aim at illegitimate financial networks suspected of supporting terrorists. When the American embassies in Nairobi and Dar es Salaam were bombed three years earlier, the US alleged that al-Qaida operatives had received funds through local hawaladars. On the grounds that those responsible for the 9/11 atrocities must have done the same, American authorities soon found a target: the al-Barakaat network, the principal means through which members of the Somali diaspora supported their kinsfolk back home. The network was promptly shut down and all its assets confiscated, despite vociferous protests that al-Barakaat had a legitimate function and that the cash remitted by émigrés had kept the entire Somali economy afloat for the past decade. Suggestions that al-

Barakaat was the underground banking arm of al-Qaida turned out to be largely specious. The 9/11 Commission concluded most funds used to finance the Twin Towers operation were channelled through the Suntrust Bank in Venice, Florida, where two of the perpetrators had opened a conventional account.²

Know your customer

In the heated post-9/11 political climate, lack of evidence did not preclude taking action. Within six months Congress passed the Patriot Act, fully entitled: *Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism*. Among its draconian measures was requiring all US-based financial institutions to comply with the reinforced Anti-Money Laundering and Countering Terrorist Finance (AML/CFT) regulations promulgated by the US-sponsored Financial Crimes Enforcement Network. In addition to monitoring individual customer transactions, these regulations also required American financial institutions to ensure that the financial institutions with which the former did business – including those operating elsewhere in the world – complied with AML/CFT requirements.³ Thus American war-on-terror strategists aimed not only to detect and sweep up terrorists wherever they might be hiding, but to perform a similar operation with respect to suspect financial flows. Given the status of the dollar as the globally-preferred unit of exchange, no major financial institution in the world could afford to ignore the new provisions if they wanted to continue routing transactions through New York's markets – as they had to in order to stay in business.⁴ The American Treasury clearly felt it had the enemy cornered.

The Patriot Act also imposed 'Know Your Customer' (KYC) regulations, which required all financial institutions to perform criminal background checks of all customers and to ensure funds deposited were 'clean'. KYC non-compliance could lead to multi-million-dollar fines. The Financial Crimes Enforcement Network's main objective was to firewall the global financial system. If all institutions complied with its new requirements, of which KYC was the key, criminally acquired funds would be unable to penetrate the legitimate financial marketplace. 'Clean' money would circulate freely, while 'dirty' money generated by drug smugglers, crimi-

nals and terrorists would stagnate outside the firewall and, theoretically, get mopped up by authorities.⁵ In principle, the new regulations did not ban hawala networks. They simply demanded conformity to AML/CFT, KYC and other financial services industry regulations. Hence American authorities have had great success closing down 'terrorist' networks in breach of regulatory requirements. Many European governments took the same sceptical view of hawala networks.⁶

At first these initiatives appeared to have the desired effect. Faced with the possible seizure of informal sector transfers, many migrants switched to the more expensive services of formally constituted banks and Western Union to send money home. The results were spectacular: in Pakistan, for example, the formally recorded annual inflow of migrant remittances rose from US\$1.1 billion in 2001 to US\$4.2 billion in 2004.⁷ Since then, however, formal channel inflow has slackened and no evidence suggests the end of informal networks. The World Bank's 2005 estimates suggest the annual global flow of migrant remittances through formal channels exceeded \$233 billion worldwide, of which developing countries received \$167 billion. Unrecorded flows are conservatively estimated at 50% of worldwide recorded flows.⁸

Informal value transfer systems – of which hawala is one – are still very much in business. Wherever possible they adjust their practices (or how they represent them) to comply with AML/CFT regulations. They take advantage of local variations, given that countries interpret AML requirements differently. In Britain, for example, customs inspectors have confined their attention to front-office KYC compliance⁹ in keeping with the Financial Crimes Enforcement Network's 'firewall' policy; inspectors rarely, if ever, consider the back-office procedures of those engaged in trans-national and trans-currency transmission and as a result most hawaladars have registered themselves as licensed Money Service Businesses. Meanwhile, in France, Germany and the Netherlands, those seeking to operate such businesses are required to register as banks, with all the associated regulatory consequences. Nevertheless, hawaladars have managed to keep their heads well below the parapet. The Patriot Act has not killed off hawala; adjust-

ing to local circumstances, the operation is thriving.

From swapping debts to swapping data

Post-9/11 paranoia spawned conspiracy theories about how hawala enables criminals, drug smugglers and terrorists to run wild. Before jumping to such conclusions, it is worth examining the evidence. Do the excellent terms hawaladars offer migrant workers really result from large premiums criminals and terrorists pay to get their hands on 'clean' dollars? Or have hawaladars simply devised a highly efficient means of long-distance value transfers with which formal institutions cannot compete? From their customers' perspective, the most attractive dimension of hawala-style delivery systems is their capacity to provide financial services swiftly and at a fraction of the cost charged by Western Union or Travelex. Customers depositing cash in any one country and currency can expect a sum of similar value in local currency to reach its destination in another country within 48 hours.

How do hawaladars do it? The efficiency of their back-office procedures incur overhead costs dramatically lower than those of formal sector rivals. These costs have two major components. The first is the cost of moving raw cash from place to place, which all financial operators, including hawaladars, seek to reduce by turning cash into value: financial instruments that can be consolidated, traded and de-consolidated at will. While information is transmitted far more cheaply than cash, information processing also costs money: this is the second source of overheads. Hawaladars, like banks, still sometimes find it necessary to physically transfer currency notes among themselves. But just as in the formal banking sector, the greater part of hawala is conducted at a more abstract level, since it involves the transfer of value rather than of cash from one location to another. The more efficiently these transfers can be implemented, the lower the overheads.

The implementation of value transmission is not a matter of physical logistics, but rather of the transmission and processing of information – which is one reason why recent developments in communications technology have had such far-reaching impact on the global financial services industry. In a comprehensively wired world, data can

be instantly transmitted to anyone with access to a telephone, whether a land-line, mobile phone or satellite link. Hawaladars owe their competitiveness to marrying their ancient commercial art with modern communications technology.

Most migrants rarely remit sums of more than a few hundred dollars at a time. They demand recipients receive cash deliveries swiftly and reliably, even if they live in remote villages. For formal sector banks, meeting the demands of such customers is extremely challenging. Their procedures are cumbersome and overheads substantial: their migrant customers frequently find that between 15 and 20% of their hard-earned cash disappears in transfer and delivery costs. While hawaladars use conventional consolidation, settlement and deconsolidation, they substitute mainstream banks' expensive formal procedures with 'informal' reciprocities of trust and by using a distributed system of information-exchange (rather than storing masses of data in expensive central registries) to implement long-distance value transfers. Because hawaladars fulfil migrants' financial services requirements far more cheaply, migrants flock to them.

Trust

Whilst hawala and other similarly constituted value transfer networks are commonly identified as 'informal', they are anything but small-scale. In Dubai, the hub of contemporary global hawala networks, multi-million-dollar transfer-settlements are brokered every day using IT facilities and financial methods no different from those deployed by formal rivals. What is different is the virtually cost-free coalition of trust binding all participating hawaladars together within an alliance that maintains system security¹⁰ and allows bewilderingly complex transactions. Dubai mega-deals can involve multiple tranches of £100,000 assembled by a 'consolidating hawaladar' operating at a national level. This is where the physical

dimensions of hawala – including the physical transfer of currency notes – are more easily grasped by the uninitiated. Consider the sketch below, a simplified illustration of how two parallel sets of consolidation and deconsolidation in Britain and Pakistan and a back-to-back swap of value between consolidating hawaladars can facilitate the transfer of funds from Pakistani settlers in Britain to their kinsfolk in Pakistan.

The core of the operation, executed on a daily basis, is an agreement between two hawaladars to swap tranches of cash of the same value, say, one in pounds sterling and the other in Pakistani rupees, as a means of implementing a multitude of smaller deals on behalf of their respective clients.¹¹ For example, assuming £1 equals 100 rupees, if a Britain-based hawaladar consolidates £100,000 from numerous Britain-based Pakistanis sending small sums back to family members in northern Pakistan, and his Karachi-based partner hawaladar accumulates 10 million rupees from local businessmen seeking to settle £100,000 of invoices from British suppliers, the two can do a straight-forward swap: the Britain-based hawaladar physically transfers £100,000 in cash to the Pakistan-based hawaladar's representative in Britain, while a parallel transfer of 10 million rupees takes place in Karachi and the bank notes are delivered to the northern villages where migrant workers' relatives live.

As the diagramme illustrates, many actors are involved in such a deal. The tranches of value that the two consolidating hawaladars swap are almost always a product of many independently brokered deals and sub-deals negotiated by each hawaladar's agents and sub-agents. Networks even more complex than the kind shown below 'pulse' on a daily basis. In essence, each deal is a transnational swap not so much of cash but of *information* between the two consolidating hawaladars – information that promptly generates two matched, simultaneous and *local* flows of hard

cash: one flows in pounds down the left side of the diagramme, the other in Pakistani rupees up the right. Both movements of cash take place within the system's back-office dimension and lead to a steady deconsolidation of the transnational value that culminates when cash reaches hawaladars whose front-office procedures hand cash over to the ultimate recipients. To the end recipient, value transmitted from elsewhere is transformed as if by magic into cash in hand or in their bank accounts.

Should we be alarmed?

Could such networks provide a financial haven for terrorists and drug smugglers? We know huge sums of dirty money regularly flow through the formal banking system, regardless of AML/CFT requirements.¹² Informal systems are open to similar forms of malfeasance, but does it actually happen? If so, on what scale? Conspiracy theorists, uninterested in exploring how hawala networks actually operate, bemused by suggestions that they constitute a highly effective entrepreneurial initiative in the increasingly competitive global marketplace for financial services, leap for easy answers. For example, the Financial Action Task Force website unequivocally asserts that cash delivery of the kind shown in the bottom left-hand quadrant of the diagramme is *prima facie* evidence of money laundering and a classic case of 'cuckoo smurfing' – the transfer of criminal funds through the accounts of unsuspecting persons.¹³ No other possibilities are considered.

This is not to suggest that money launderers do not or cannot exploit hawala networks. Some of those tranches of US\$100,000 could indeed come from a heroin sale. But no matter how great the profits of international drug-smuggling, they are dwarfed by the scale of migrant remittances. And is it likely that Britain-based drug smugglers shelter their profits in Pakistani rupees? All serious commentators agree smugglers prefer US dollars in formally

constituted banks located in well-sheltered Caribbean jurisdictions.

That said, one cannot exclude the possibility that criminals, terrorists and drug smugglers will take advantage of those jurisdictions where no formally constituted banks currently operate. In Somalia and Afghanistan, for example, financial transactions of all kinds, from the most innocent to the most criminal, can indeed pass through hawala networks. In more normal circumstances, however, hawaladars have a direct interest in avoiding criminal activity. Coalitions of absolute trust depend on the reliability of their members and everyone their members do business with. Violated trust imperils the stability of the whole coalition and invites severe sanctions. Precisely because hawaladars expect to maintain a *personal* relationship with their customers, especially those with whom they engage in large-scale transactions, they effectively maintain their own 'know your customer' scheme. They also have a personal interest in excluding dodgy dealers: failure to do so imperils their position within the coalition.

Nobody denies the need for authorities to do everything in their legal power to contain the activities of terrorism's financiers and drug traffickers, but so far the results have not been impressive. It's easy to impound cash passing through hawala networks and claim success in destroying the financial sinews of terrorist and drug-smuggling operations. But if neither terrorists nor drug-smugglers are apprehended, if heroin becomes so plentiful that its street price declines, shaking down hawaladars looks more like a public relations exercise.

If my analysis is correct, most transactions routed through hawala networks are wholly legitimate and offer a financial lifeline to millions of migrant workers needing a cheap and reliable means of sending money back home. The authorities are correct in believing that some 'dirty money' lies concealed within the huge sums flowing through the hands of hawaladars, as is the case within the mainstream banking system. The challenge is to find an effective means of separating the sheep from the goats. But authorities appear to have issued those who guard the gates of financial rectitude with blunderbusses rather than stilettos – their efforts cause considerable collateral damage. Meanwhile, the goats continue to slip by undetected and are becoming more skilled at evading surveillance.

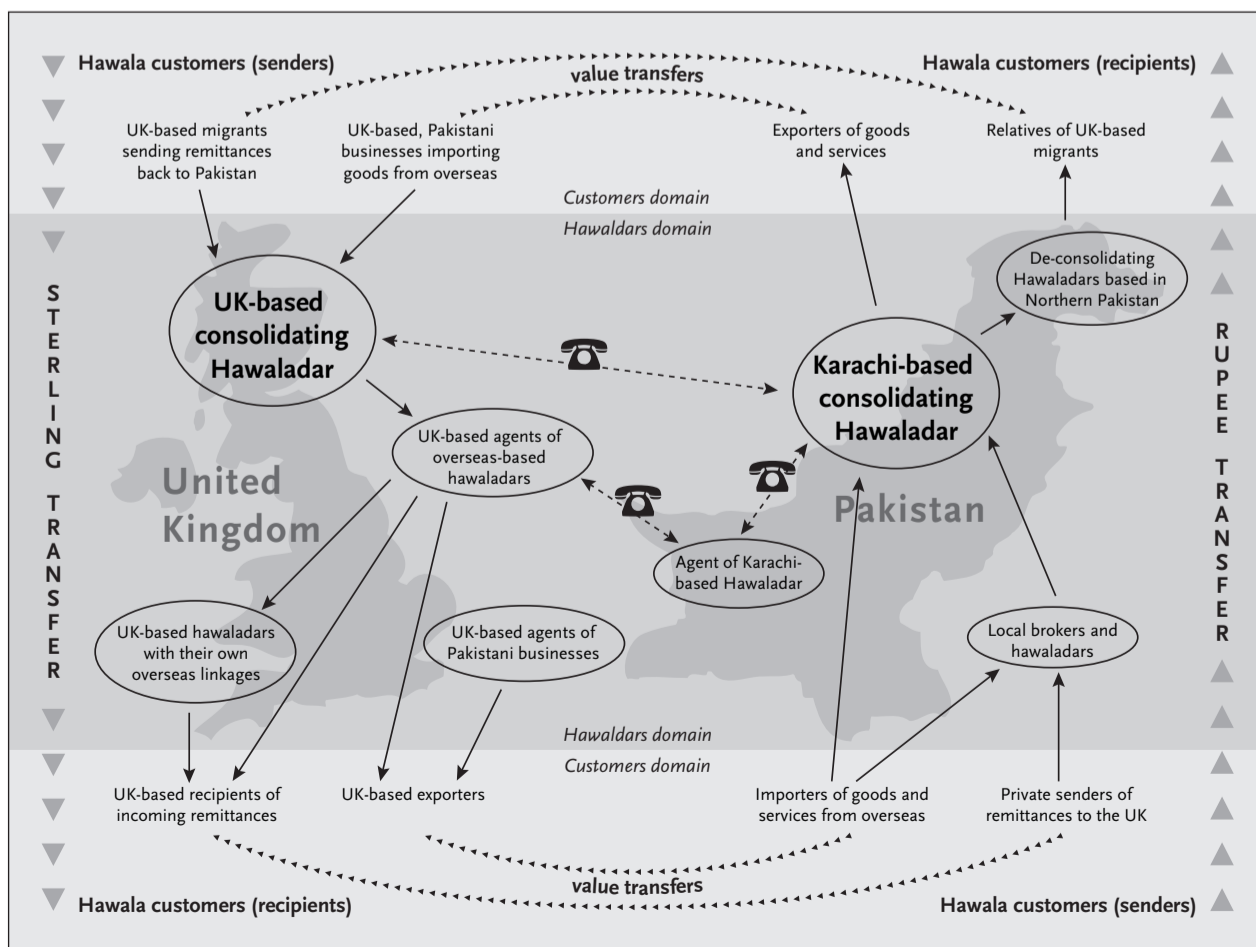
The authorities' chances of success would have been greater had they formulated their strategies with a better appreciation of the character, location and *modus operandi* of their targets. Merely driving the system underground – the currently preferred tactic – favours criminals much more than their pursuers, given that the ultimate targets are the terrorists and drug smugglers behind those alleged to be providing them with financial services. Rather than succumbing to panic, might not the authorities make greater progress if they sought the co-operation of hawaladars instead of subjecting them to random prosecution on specious grounds? If some 'dirty money' passes through the system, nobody is better placed than

hawaladars to guide investigators to its source. But there is little chance of their volunteering such information if their normal commercial business places them in constant danger of arrest. ◀

Roger Ballard is Director of the Centre for Applied South Asian Studies at the University of Manchester
r.ballard@man.ac.uk

Notes

- Ballard, Roger. 2004. 'Delivering Migrant Remittances: The Logistical Challenge'. *Journal of Financial Transformation* 12.
- Public Affairs Commission. 2004. *The 9/11 Commission Report*. New York: Public Affairs.
- Amongst other things this initiative led to the emergence of expensive AML/CFT compliance consultants. www.money-laundering.com gives constant updates on the additional spheres of financial activity into which the regulatory regime has spread, and offers ever more detailed training programmes which enable participants to become certified anti-money-laundering consultants.
- It is precisely these provisions which have facilitated the shut-down in the financial sinews of the Palestinian economy since the election of Hamas. Once labelled a terrorist regime, no international banks have dared to transfer funds into Palestine for fear of having their facilities in New York withdrawn.
- This strategy was based on a largely illusory premise. As Raymond Baker demonstrates in great and illuminating detail in *Capitalism's Achilles Heel: Dirty Money and How to Renew the Free-Market System* (Wiley 2005), trillions of shadily acquired dollars already circulate freely within the firewalls the Financial Crimes Enforcement Network is so desperately seeking to erect.
- The USA Patriot Act – A Proven Homeland Security Tool. www.dhs.gov/dhspublic/display?content=5077
- The State Bank of Pakistan's best estimate of the annual total inflow of remittance funds during this period was US\$8 billion. In other words, despite the massive post-9/11 switch into the formal sector, around 50% of the inflow was still being channelled through the informal sector. <www.sbp.org.pk/publications/wpapers/wp03.pdf>
- World Bank. 2006. *Global Development Finance 2006*, p.3.
- Anyone who has recently opened a bank account will be familiar with KYC regulations, which require two independent forms of personal and financial identification before the transaction can proceed.
- A full analysis of how such relationships of reciprocity are constructed and maintained can be found in: Ballard, Roger. 2005. 'Coalitions of Reciprocity and the Maintenance of Financial Integrity within Informal Value Transmission Systems: The Operational Dynamics of Contemporary Hawala Networks'. *Journal of Banking Regulation* 6-4.
- In this example I am assuming that the two hawaladars are acting independently. In practice these localised swaps are often part of much larger global swaps brokered elsewhere, usually in Dubai.
- See Baker in footnote 5.
- Money Laundering and Terrorist Financing Typologies 2004-2005, p.18 ff, www.fatf-gafi.org/dataoecd/16/8/35003256.pdf



Transactions precipitated by a Britain/Pakistan exchange of debt between two consolidating hawaladars