Delivering migrant workers' remittances

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Abstract

As globalization has led to ever higher levels of labor mobility, so the volume of funds remitted to their families by workers employed in countries far distant from their homes has increased by leaps and bounds. The total volume of such transfers currently amounts to over U.S.$100 billion per annum, the greater part of which flows from economically advanced regions in the West and North to developing countries in the East and South. Delivering those funds swiftly, reliably, and cheaply to relatively remote destinations opens up new opportunities for the financial services industry, but also represents a major logistical challenge.

Although many banks and money transfer agencies have recently begun to consider how they can make the most of these opportunities, those that seek to enter this field soon find that they are up against very effective competition: the Informal Value Transfer Systems which many migrant groups have themselves developed to meet this challenge. In a post 9/11 context, there has been much fevered discussion about the threat which such 'underground banking' networks allegedly present to the stability of the global order. In an effort to replace ill-informed speculation with empirically grounded detail, this paper demonstrates the extent to which such informal networks have developed in such a way that they now provide a highly efficient response to the logistical challenge of delivering migrant remittances. In doing so it also sets the scene for a more informed debate about how IVTS networks might best be regulated.

Delivering migrant workers' remittances

The growth of migration and remittances in the contemporary world

In the context of an ever more globalized labor market, many millions of people are now living and working in locations far distant from their countries of origin, and to which they regularly remit a substantial proportion of their earnings. The financial flows generated by migrant remittances in this sense are by now very substantial. Although accurate figures are extremely hard to come by, it is not unreasonable to suggest that the current flow of transnational value-transfers currently generated by migrant workers amounts to at least U.S.$100 billion per annum, and perhaps a good deal more.

Nevertheless migrant workers are far from being a homogeneous socio-economic category. Although the professionally qualified employees of multinational companies now tend to display high levels of spatial mobility during the course of their careers, such high-fliers only make up a very small proportion of the global stock of migrant workers. Instead the vast majority work at far lower levels in the occupational hierarchy. But although their wages are only a small fraction of those enjoyed by the high fliers, most display a much higher propensity to save, so much so that they frequently send a substantial proportion of their relatively meager incomes back to their kinsfolk in Asia, Africa, and Latin America. The size of the resultant transactions, examined one by one, is very small. The vast majority of migrants rarely remit much more than a few hundred dollars a month, mere penny packets in banking terms. However it is the volume of such transactions which gives them their current significance, no less locally than globally. In many countries of the developing world migrant remittances now form the largest single source of foreign exchange, comfortably exceeding the sum of all forms of development assistance and FDI.[1]

Not only has the scale of these remittance flows grown very rapidly in recent years, but so, too, has the logistical challenge of delivering them, not least because so many of their recipients live in remote rural areas, far beyond the reach of the formal banking system. However a growing number of stakeholders — stretching from migrants themselves to their families and countries of origin to the International Development Community — have an interest in ensuring that migrant remittances are as swift, reliable, and above all cheap as possible.[2] It follows, therefore, that the recent rapid growth in South-North labor migration, and the concomitant growth of remittance transfers in the reverse directions, presents both a major new challenge and an equally substantial set of novel commercial opportunities to the financial services industry. This paper explores the ways in which those opportunities have so far been met, identifies the kinds of institutional initiatives which have emerged to meet them, and on that basis seeks to look forward to the likely course of future developments.

Although migrants have always played a major part in providing the labor power needed to fuel urban and industrial growth, and despite the fact that they continue to be a vital source of menial workers in most post-industrial societies, and most especially those with plummeting birth-rates, their arrival has rarely been planned or centrally coordinated. Moreover all efforts to achieve such coordination invariably fail, for one very obvious reason. Migrant workers are not only invariably self-selecting, they also behave as self-motivated entrepreneurs whose principal concern is to advance the interests of themselves and their kinsfolk.[3] Migrants have always acted thus. No less than the millions of European migrants who crossed the Atlantic during the 19th and the 20th century, their ever more numerous successors from Asia, North Africa, and Latin America seeking their fortunes in the affluent cities of other continents are pursuing their own agendas on their own terms. In doing so they not only aimed to make the most of the income-earning opportunities available at their destination, but were equally committed to increasing the wealth, and hence the status, of their families and their communities back home.[4]

Yet although a reverse flow of remittances follows the arrival of migrant remittances almost as surely as night follows day, until very recently the formally constituted financial sector made no ordered efforts to respond to this rapidly expanding

1 Ratha, D. "Workers' Remittances: An Important and Stable Source of External Development Finance". Global Development Finance Report. World Bank, Washington D.C. (2003)

2 House of Commons International Development Committee. "Migration and Development: How to make migration work for poverty reduction" HC79-1. The Stationary Office, London (2004)

3 An overview of the growth and qualitative characteristics of Britain's South Asian population can be found in Ballard, R (Ed). "Desh Pardesh: The South Asian Presence in Britain." C. Hurst and Co., London (1994).

4 Piore, M. J. "Birds of Passage: Migrant Labour and Industrial Societies." Cambridge University Press, Cambridge (1979).

population of migrant workers' consequent need to find a safe, speedy, and reliable means of transferring their savings back to their kinsfolk, especially when, as was very often the case, they lived in relatively remote rural areas. Hence just as the migrants organized their own means of entry into destination labor markets, which in many cases involve risking their lives, they also devised their own means of sending savings back home. Whilst the physical transfer of currency notes was the most obvious way of doing so, long-distance migrants, and especially those whose residence rights were uncertain, were unable to make home visits with any frequency. But as they soon discovered, the formally constituted financial sector was ill-equipped to meet their needs. Over and above delivery problems, the commissions charged by banks, let alone by specialist money-transmission agencies, such as Western Union, consumed an alarmingly significant portion of their hard-earned savings. Hence wherever groups of labor-migrants established ethnic colonies of any size they invariably went on to develop their own self-constructed strategies of informal value transmission.

As the years have passed, most of these informal alternatives have become steadily more sophisticated, aided by advancements in communication technology, particularly in terms of the development of fax and then the Internet, which have made it possible to organize larger-scale value transfers with speed, accuracy, and with high levels of reliability. Hence whilst these informal transfer systems went largely unnoticed during their initial years of development, with the turn of the century they suddenly became the focus of much higher levels of institutional attention. There were two reasons for this sea change. In the first place once millions and then tens of millions of dollars began to be transmitted through these Informal Value Transfer Systems (IVTS), they began to be sufficiently large as to make blips on institutional radar screens. Hence a number of major banks, led by those based in the U.S. with an outreach into Latin American markets, began to explore whether it made commercial sense to make a more active response to the potentially-profitable business of facilitating remittance transfers. Secondly, and ultimately even more importantly, questions began to be asked about the extent to which these IVTS networks were being used to provide a cover for laundering the profits of drug smuggling. And although initial reports[5] were rather skeptical about the extent to which IVTS was actually being used as a vehicle for criminal malfeasance, rather than a convenient means of facilitating wholly legitimate remittance transfer, the whole debate was transformed in the aftermath of the events of 9/11. Even though the greater part of the 9/11 operation was financed by wire transfers into personal accounts opened at the Suntrust Bank in Venice, Florida[6], a mass of luridly-written articles soon appeared in the press suggesting that Hawala/IVTS networks were in fact a wholly unregulated form of 'underground banking' which provided drugs smugglers and terrorists a vehicle for financing their evil deeds. Hence, despite the absence of any substantial body of evidence supporting such accusations, governments throughout the world have found themselves under ever increasing pressure, for the most part articulated by the U.S. Treasury, to introduce regulatory measures which could in effect put all such informal operations out of business.

However, as everyone within the financial services industry is now very well aware, draconian initiatives whose central objectives were to counter both money laundering and terrorist financing were by no means limited to the informal sector. Suddenly virtually every agency engaged in any kind of financial transactions on behalf of personal customers found themselves required to introduce elaborate Know Your Customer procedures, and also under a duty, backed up by severe criminal sanctions, to submit 'suspicious transaction reports', especially in the case of cash transactions in excess of U.S.$10,000. Whether this new regulatory environment is having any effect on the problems it is designed to confront remains to be seen. What is undoubtedly the case, however, is that as a consequence of these initiatives it is not just IVTS networks which have found themselves under pressure. Financial institutions of all kinds now find themselves faced with the necessarily expensive task of gathering and recording a great deal more personal data about their clients and their transactions than they had hitherto collected, and even then can often find

5 Passas, N., "Informal Value Transfer Systems and Criminal Organizations; a study into so-called underground banking networks." http://www.minjust.nl:8080/b_organ/wodc/publications/ivts.pdf (1999).

6 "The 9/11 Commission Report." Government Printing Office, Washington D.C.

themselves in an uneasy position for fear that they might find themselves charged with colluding in criminal activity.

A new opportunity for the financial services industry?

Yet despite the costly downside of these new, albeit still much disputed, regulatory regimes, these post-9/11 developments may, at least on the face of it, have opened up a major new opportunity for the financial services industry. A stable, and indeed a steadily expanding flow of value transfer to the tune of U.S.$100 billion per annum is certainly not an opportunity to be sniffed at, most especially when regulatory authorities around the globe are actively encouraging the formal banking sector to become much more heavily involved in providing services in this sphere, thereby providing migrant workers with an alternative to what the burgeoning AML/CFT industry regards as deeply suspect IVTS and Hawala networks.

Yet despite the obvious opportunities that these developments have thrown up, those players who have sought to enter this sector of the global foreign exchange market appear to be finding the going extremely tough. Devising a commercially viable response to the specific character of customer demands in this sphere is proving to be far from easy, not least because their competitors in the 'informal' sector still appear to occupy a position of clear competitive advantage, despite the high levels of official harassment to which they have recently found themselves subjected.

So just what are the financial and logistical requirements of a successful remittance transfer operation? Overall volume is not a problem. What does cause severe problems is the logistics of such operations. Given that individual transfers are mostly in penny packets, most transfers require funds to be converted into relatively obscure currencies, most senders prefer to make their deposits in cash, and recipients frequently live in rural areas, and hence well beyond the banking frontier.

In view of these challenges it is hardly surprising that specialist cash delivery operations based in the formal sector, of which Western Union is currently the most salient example, regularly charge a commission of around 15% for their services, and even then their delivery-coverage is largely restricted to major urban centers, especially in the developing world. From the perspective of ill-paid migrant workers a cut of 15% on their hard-earned wages appears to be quite outrageous, especially since the margin charged by operators in the informal sector is dramatically smaller, often 2% or less. Why, then, does Western Union find it necessary to charge so much? And how, by contrast, do operators in the informal sector manage to offer a service which is just as reliable and with a much greater spatial reach whilst charging so much less?

The answer to the first question is obvious enough. Serving the financial needs of millions of migrant remitters drawn from developing countries is an accountant's nightmare. Given that the packet-size of each transaction is small and the delivery address is so often as remote as it is obscure, not only must elaborate and expensive arrangements to consolidate and then to deconsolidate these small packages at each end of the transmission chain be developed, but a process of currency exchange, on a wholesale basis of course, must also be implemented somewhere along the way. Because of the large number of the administrative staff required to implement these processes when conventional bureaucratic procedures are employed, costs are necessarily high. No matter how hard they try to cut down on administrative costs, Western Union and its many emerging rivals within the formal sector see little prospect of reducing their commission charges by much from their present levels. No wonder their competitors in the informal sector are currently having a field day. How, though, are they managing to pull it off?

The roots of Hawala

In the U.K. the Pakistani community, which is currently around three quarters of a million strong, is the most active sources of migrant remittances, and its members are collectively responsible for sending anywhere between £500 million (approximately U.S.$ 900 million) and £1 billion (approximately U.S.$ 1.8 billion) per year back to Pakistan.[7] Apart from a brief

7 The empirical data around which this section of the paper is constructed derives from more than thirty years' experience of ethnographic research on the growth of the South Asian presence in Britain and its transnational connections, which has in recent years provided a platform for a much more detailed examination of the activities of Hawaladars operating in the U.K. and Dubai, as well as in India and Pakistan. Between 2000 and 2002 I received a grant from the E.S.R.C. to conduct research on Kinship, Entrepreneurship, and the Transnational Circulation of Assets. A wealth of more detailed material on these issues can be found at http://www.art.man.ac.uk/CASAS/pages/papers.htm

blip when Customs and Excise arrested a series of major Hawaladars and charged them with money-laundering, the greater part of these funds were transferred back to Pakistan through the informally grounded Hawala system, often through deals facilitated in Dubai. However Pakistanis are not alone in using this system. To my knowledge similar Dubai-centered transfer networks have also been established by immigrants from Bangladesh, Pakistan, Afghanistan, Iran, and Somalia. Such networks also facilitate transfers from immigrants who have established themselves across the length and breadth of the E.U.

These networks did not spring into existence out of the blue. Whilst the growth of migrant remittances may have dramatically boosted the scale and scope of contemporary Hawala networks, the roots of these operations can be traced back to the ancient system of commercial banking, which grew up to serve the needs of long-distance traders in the Indian Ocean region. In their original format Hawala networks emerged to oil the wheels of commercial activity, meeting the needs of long-distance traders who wanted to transport the bullion they needed to finance their activities. A deposit made with a Hawaladar in one market place (the Gujarati port of Surat, for example) could be picked up as a credit from that Hawaladar's corresponding partner in Basra, Mogadishu, or Malacca.

As a result of completing such transactions on their customers' behalf, corresponding Hawaladars were constantly shifting debits and credits between one another. Just as in any other banking system, Hawaladars were prepared to take these positions because those within any given network trusted their partners to honor each other's instructions, and above all to make up any net deficiencies as and when a settlement was eventually implemented. Although system security was as crucial a feature of these operations as it is in any other banking system, its foundations were grounded in the cultural and religious context of the times. Medieval Hawaladars largely eschewed the elaborate clerical and bureaucratic procedures, such as regular inspection of participants' records by accountants and regulators, around which contemporary Western-style banking systems are routinely constructed. Indeed the only external authority to whom Hawaladars (the vast majority of whom were Muslims) were responsible was Allah himself.

But, although most Hawaladars took, and still take, the treat of Divine sanctions seriously, none are so idealistic as to rely on that as the principal source of system security. Instead they relied on relationships of absolute trust. Not only did the system rely on customers having absolute confidence in their Hawaladars' reliability, the Hawaladars themselves needed to have a similarly comprehensive level of trust in each other's honesty. This was necessary since due to the distances covered there were imbalances between the participants for long periods at a time.

Because of the need for absolute trust, it is hardly surprising to find that each network of corresponding Hawaladars, together with their customer-base, was normally language, religion, and hence community-specific. From this perspective Hawala networks are best understood as an Islamic version of a much wider range of pre-modern forms of long-distance value transmission and settlement, to which parallel Hindu and Chinese forms of IVTS also emerged during the mediaeval period, and likewise remain in operation to this day. Moreover it is quite clear that whilst each such system has its own specific set of cultural and religious roots, all are constructed around translocal networks of absolute interpersonal trust. These not only provide a secure channel of communication between spatially separated financial operators, but are also the foundations of a web of binding reciprocities which provides, in each case, a bedrock of system security.

Whilst religious and sectarian loyalties provided the basic foundations of such networks, these were, and still are, routinely reinforced by ties of kinship and marriage between the participants, so generating an even tighter web of mutual reciprocities. Hence it is through the operation of such informally constituted networks, rather than through the implementation of formal bureaucratic procedures of paper trails and

audit inspections, that IVTS networks have characteristically achieved a condition of self-regulation. Whilst reliance on self-regulation in this sense may seem as old-fashioned as it is insecure, it is worth remembering that so long as the networks within which these transactions are implemented have an all encompassing impact on their members' lives, sanctions against malfeasance, no matter how informal their foundations, can be as far-reaching as they are severe. Breach of trust characteristically leads to swift and comprehensive social ex-communication not just of the offender, but also of his entire family; and because these networks are now becoming ever more transnational in character, flight offers fewer and fewer opportunities for escape.

The gradual eclipse and subsequent revival of Hawala

Financial operations only survive if they can sustain a position of competitive advantage, and IVTS systems are no exception. When European adventurers initially broke into Indian Ocean trading systems in the 16th century they soon found that they had little alternative but to make extensive use of locally constituted financial services, and for straightforward commercial reasons they continued to do so until the beginning of the 19th Century. But as Imperial domination became steadily more comprehensive, European banks gained a dominant position in major trading centers all around the Indian Ocean. As a result more indigenous providers of financial services were driven steadily outwards towards the social, geographical, and economic periphery of the system.

However, in the post-colonial world four key developments have facilitated the resurgence of IVTS operations in general, and of Hawala in particular. Firstly, the imposition of over-tight exchange controls in many parts of the Indian Ocean region has resulted in the emergence of a vibrant black market in foreign exchange. Secondly, as the number of labor-migrants from all over the region to the Gulf and Euro-America grew so did the amount of migrant remittances. Thirdly, the rapid growth of manufacturing activity in East and South East Asia has lead to an upsurge in intra-regional trade in manufactured goods. Finally, radical improvements in communications technology — including fax, internet, cell- and satellite phones — have made such transfers more efficient. Taken together, these developments rapidly gave Hawala operations a new lease of life.

How do contemporary IVTS systems actually work?

Although Hawala networks and other similarly structured IVTS operations are often described as providing underground banking services to their clients, it is worth remembering that Hawaladars do not provide retail banking facilities, such as current accounts, taking deposits, or making loans. Instead IVTS networks are best understood as specialist forex agencies whose sole purpose is to facilitate value transfers over long distances and between different currency regimes, and in so doing specialize in the delivery of relatively small sums to recipients based in remote destinations in the developing world.

Fulfilling that specialist role is far from straightforward. Even though the gross annual flow of credits into any given labor exporting country may well amount to several billions of dollars per annum, closer inspection soon reveals that organizing the swift, reliable, and efficient delivery of innumerable small packets of value on a global scale is a major logistical challenge. With that in mind it is worth running through just what kind of activities the task necessarily entails.

It goes without saying that in meeting this challenge Hawaladars rarely become involved in the physical transfer of currency notes across international borders. Instead they use familiar banking processes of consolidation, deconsolidation, and settlement whenever and wherever they possibly can. Hence Hawaladars' collection, transmission, and delivery operations have three core elements, all of which are closely interconnected.

The first is information processing, which deals with provision of current exchange rates to prospective senders, collection of

data from senders about how much is to be delivered where and to whom, and the transmission of delivery data to the remote destination.

The second is value transmission and settlement, which means that they need to organize availability provision of credit at the point of delivery against accumulated debits at the point of deposit, so enabling the organization of subsequent processes of settlement.

The third element is collection and delivery of currency notes, which involves collection and consolidation of senders' deposits and the onward transmission of these funds to settlement partners, and the deconsolidation of credits received from settlement partners and their distribution to assigned recipients at a variety of overseas destinations.

Since all remittance agencies, be they formally constituted banks or Hawaladars operating in the informal sector, face the same set of technical and logistical challenges, it is worth exploring which of the two is in a position to implement this complex set of tasks with the highest level of effectiveness, efficiency, and reliability.

A concrete example: the transfer of remittances from the U.K. to Pakistan's Mirpur District

More than a third of a million people whose ancestral origins lie in Mirpur District are resident in the in the U.K., most of whom keep in close touch with their kinsfolk back home. Not only are visits back and forth extremely frequent (PIA operates no less than ten flights into Manchester every week), but many of the pioneer settlers who arrived in the U.K. forty years ago have now retired, and are now taking the opportunity to use their accumulated savings to build splendid new houses for themselves back in Mirpur.[8] As a result, remittances from U.K. to Mirpur are currently running at somewhere in the region of £250 million (approximately U.S.$ 450 million) per annum, the greater part of which passes through Hawala networks. Delivery is routinely achieved within 48 hours, with no significant organizational fuss and 100% reliability. From the customer's perspective sending money back to Mirpur could hardly be more straightforward. All they have to do is approach their local Pakistani travel agent (the vast majority of whom offer such services, either in their own right, or as the agent of a larger Hawala operator based in a city which supports a large local Pakistani population), enquire about and agree upon a rate of exchange, prove their identity (a requirement of the recently introduced anti-money laundering regulations), make the agreed payment, and provide the recipient's name and address in Mirpur. Within 48 hours the sum agreed upon will be ready for collection in Mirpur.

So how is it all achieved? As ever the back-office mechanisms which support these apparently straightforward front-office results are extremely complex, so much so that they are best considered in a series of stages, all of which have to be fitted smoothly together for the whole operation to produce the desired result.

The collection of sterling in U.K. and the delivery of rupees in Mirpur

In front-office terms, Hawaladars engaged in collecting and dispatching remittance transfers necessarily work in close collaboration with a corresponding partner operating at the destination(s) to which those remittances are dispatched. Moreover if we leave the issue of settlement to one side for the moment, implementing the component of the deal which matters to the customer, namely the delivery of rupees to the recipient, is simply dependent on the swift and accurate transmission of the appropriate delivery instructions. However to send separate messages for every single transaction would be highly inefficient, consolidation is the order of the day. Hence each consolidating Hawaladar (and for clarity's sake let us identify him as H^a operating in Birmingham[9]) will make up a list, setting out all daily transactions with over-the-counter customers and those passed on to him by a network of agents and sub-agents operating in smaller Pakistani communities elsewhere in the U.K. Then it is a simple enough task to fax the spreadsheet to his corresponding partner H^b, operating in Mirpur, who can promptly set about organizing the local deliv-

8 A detailed account of the history of mass migration from Mirpur District, as well as of the impact of the inflow of remittances on the local economy can be found in Ballard, R. "A case of capital-rich under-development: The paradoxical consequences of successful transnational entrepreneurship from Mirpur" in Gardner and Osella (eds.) Migration, modernity and social transformation in South Asia, New Delhi: Sage, 2004.

9 I have borrowed the notation for the identification of Hawaladars as H^a, H^b, etc. from the model set out in El Qorchi, Maimbo and Wilson "Informal Funds Transfer Systems: and analysis of the informal Hawala System" Washington DC: IMF/World Bank, 2003. However as my subsequent analysis shows, Hawala deals very rarely take the form of the simple bilateral exchanges which they set forth in their model.

ery of rupees to recipients as instructed, and where necessary using his own network of agents and sub-agents to make deliveries to recipients resident in villages in the more remote parts of the District. Please note that there has been no transfer of value from H^a to H^b. Corresponding Hawaladars are ready and willing to take on such a position of indebtedness given the relationship of trust between them, but at some stage that condition must of necessity be discharged.

Organizing settlement

Because the majority of migrant workers are drawn from relatively remote rural areas the most distributing Hawaladars operate in regions where there is no significant local demand for foreign exchange. That is certainly the case in Mirpur, so H^b rarely if ever has local customers interested in exchanging rupees for the sterling credits which he is constantly accumulating with H^a in Birmingham. However, in Pakistan's commercial capital, a thousand miles away in Karachi there is an almost insatiable demand for access to hard currency, for which members of the local business elite are frequently prepared to pay premium rate. Hence the informal money markets in Mirpur and Karachi are effectively mirror-images of one another. This provides an obvious opportunity to organize and implement complementary back-to-back settlements, with the added risk of having to move the cash between these two cities, which in most cases require hiring of armed guards.

Karachi's Hawala market

Like many other developing countries, Pakistan has long suffered from a severe deficit in its balance of trade, which is only partially remedied by remittances and other invisible exports. Since Karachi is Pakistan's commercial capital as well as the country's principal entrepôt, a major manufacturing sector, the city has long supported a pent-up demand for foreign exchange to settle invoices for manufactured goods imported from overseas, to purchase education, medical treatment, and property overseas, to aid the wealthy to export capital to hard-currency tax-havens beyond the purview of the Pakistani authorities, and to replenish the State Bank's foreign-currency reserves.

In these circumstances the outflow of migrant workers to the Gulf, the U.K, and the U.S, together with migrant workers' constant search for cheaper and more effective means of getting their remittances back home, has given a powerful boost to Karachi's informal money market.

As compared with Hawaladars serving the needs of migrant workers, their counterparts in Karachi operate in a very different kind of financial context. Not only are the majority of their customers drawn from the city's business and professional elite, but such orders for U.S.$ are invariably on a substantial scale. Hence a single order for U.S.$ in Karachi may well generate a sufficient quantum of rupees to meet a week's worth of daily out-payments in penny packages handles by H^b in Mirpur. Final settlement can only be achieved when the hard-currency credits held by H^a in Birmingham have been transferred to the destinations specified by the customers of H^c in Karachi.

Dubai as a settlement hub

Most such deals are currently brokered in Dubai. Why Dubai? Not only has Dubai taken advantage of the boom in the price of oil to establish itself as the Gulf's most important commercial entrepôt, but as a result of its close proximity to Bombay and Karachi, the stability of the Dihrams link to the dollar, and its consequent condition of unrestricted access to the global financial system, it has become South Asia's premier offshore banking center. So it is that Dubai's Exchange houses have come to play a key role as facilitators of remittance and commercially-driven Hawala settlements not just to serve the financial needs of the very substantial migrant-worker population in the oil-rich regions which surround it, but also on an ever more global scale. Hence with their newly established headquarters in Dubai, Hawala networks, which have their roots in mediaeval practices, have once again begun to oil the wheels of trade in the entire Indian Ocean region.[10]

A worked example

With all this in mind, a worked example, albeit much simplified, may provide a clearer and more concrete indication of

10 Ballard, R. 'Hawala Transformed: Remittance-driven Transnational Networks in the post-Imperial economic order' in Maimbo and Ratha eds. Remittances: Development Impact and Future Prospects. World Bank Publications, Washington D.C. (2004)

just how the whole settlement process operates. Let us suppose that H^a in Birmingham has taken orders for the delivery of Rs. 10 million in Mirpur, for which he has received £75,000 from his U.K.-based customers. Meanwhile H^c in Karachi has a customer who wished to purchase $100,000 in order to settle the invoice for a consignment of televisions which he has imported from China, whose manufacturer is expecting payment to be made into his U.S.$ account in Hong Kong. H^a and H^c separately approach a specialist settlement broker in Dubai, H^d, who calculates (for the sake of argument) that Rs. 10 million = U.S.$ 100,000 = £75,000, so generating an ideal opportunity to arrange a back-to-back swap. Hence H^d sets up a Hawala settlement in which H^a buys U.S.$ 100,000 on London money market through his bank which he promptly sends by TT to H^d's account with Bank of America in New York; meanwhile H^c takes delivery of Rs. 10 million in cash from his television-importing customer, which he promptly dispatches by road to H^b in Mirpur, thereby recompensing H^b for the disbursements made in response to H^a's previously faxed instructions; and last but not least H^d transfers U.S.$100,000 by TT from his account in New York to the television manufacturer's account in Hong Kong, thus fully closing the circle.

However it goes without saying that this is only a hugely simplified example, and that in the real deals such settlements are a great deal more complex. Hence in the instance cited, there is every prospect that H^c in Karachi would approach H^a in Birmingham directly, and having found a neat match between their immediate financial requirements would do a simple swap between themselves, such that there would be no need to look to H^d, who would inevitably take a small percentage cut on the deal to facilitate such a settlement.

In practice, opportunities to implement neatly managed swaps involving such large sums are relatively rare, given that Hawaladars operate in such a wide variety of national arenas, from which they seek to make deals in many different currencies in tranches which very rarely match up anything like so neatly as they do in the example cited. It follows that since mix'n'match settlements are extremely complex to set up, they regularly require the lubricating assistance of brokers in Dubai if such exercises are to be swiftly and smoothly implemented. Moreover all the evidence of the resultant settlement transactions which I have so far been able to obtain suggests that they are conducted on a very substantial scale, since the basic unit of account in making such deals appears to be U.S.$100,000.

How secure is IVTS/Hawala as far as its retail customers are concerned?

Whilst billions of dollars are processed through Dubai-based IVTS/Hawala networks every year, it is striking that despite the absence of any kind of central registry, let alone a central regulator, serious customer complaints are virtually unknown. How can this be? The basic answer is quite straightforward: like the pre-colonial structures from which they evolved, contemporary Hawala networks are best understood as distributed systems in which system security is rooted in the transnationally extended relationships of absolute trust which participating Hawaladars routinely maintain between themselves. Given that all members of the network are active participants in the whole enterprise, system security is not only a matter of collective concern, but is also articulated from the bottom up, in sharp contrast to the top-down patterns of external scrutiny and regulation which contemporary Western-style banking systems routinely deploy for that purpose.

It is also worth emphasizing that such informal methods of guaranteeing system security are far from being an outmoded hangover from by-gone age. Quite the contrary, such practices appear to be the prime source of the system's competitive advantage, above all because they allow large swathes of operationally redundant clerical and bureaucratic activity to be stripped out of the system. By doing so, Hawaladars are able cut down information transmission to the minimum level required to implement the task in hand, so enabling their core business of value transmission to be implemented with the maximum level of speed, reliability, and efficiency. Moreover having adopted such a lean and mean approach to the data

which they choose to transmit between themselves, Hawaladars have typically taken immediate advantage of developments in communications technology. Hence in addition to landlines and mobile phones, Hawaladars have moved rapidly onwards through fax, email, network portals and secure Virtual Private Networks as a means of information transmission amongst themselves, whilst all of the larger operators, and an increasing number of smaller ones, have now begun to plug directly into inter-bank electronic value transfer systems, such as BACS and SWIFT.

Given the manifest commercial efficiency with which contemporary Hawala systems cope with the logistical challenges thorn up by migrant workers' financial services requirements, as well as the ever-greater technical sophistication of the transfer and settlement processes which they have developed in order to meet those requirements, the use of the term 'informal' as means of characterizing the system as a whole needs to be approached with considerable care. In the first place, any suggestion that Hawala's informal character means that it is 'a system without records,' as those who suspect that the whole exercise is merely a convenient cover for criminal activity frequently argue, falls by the wayside. Despite their commitment to reducing clerical procedures to a minimum, there is no way in which Hawaladars could deal accurately and efficiently with transactions of the complexity to which remittance transfer processes give rise without extensive record-keeping. Secondly, and consequently, 'informality' is not to be confused with back of the envelope procedures. On the contrary Hawaladars have been much quicker to make use of the efficiency gains which can be extracted from recent developments in electronic communications than their rivals in the formal banking sector.

This immediately prompts a further question. Could it be that the competitive advantage currently enjoyed by contemporary IVTS networks is similar to the advantages Internet-based retail banks have over their branch-based competitors that are struggling with the crippling costs of maintaining a presence on the high street?

Regulation: Is Hawala broke? And does it need fixing?

Whilst there can be no doubt whatsoever that Hawala networks, as well as their Chinese and Latin American equivalents, provide an excellent deal from the perspective of the many millions of migrant workers who regularly utilize their facilities, the prospect that these informal, and currently almost completely unregulated, systems might also have significant operational down-sides also needs careful consideration. It is, therefore, important to determine how secure such value transmissions are, as far as its retail customers are concerned, and how vulnerable such networks are to criminal penetration?

Efforts to answer these questions have recently begun to precipitate a debate about how, on what basis, and to what ends this increasingly significant corner of the global foreign exchange market might best be regulated. Four equally pressing questions have now begun to be posed within that debate:

- To what extent do current Hawala networks have any in-built guarantees of system security?
- If these guarantees are either absent or inadequate, what measures might realistically be introduced to improve current levels of system security?
- Is there any way in which adequate and effective regulatory measures can be introduced whilst still retaining the strengths of such systems' informal procedures?
- Should all efforts be concentrated on driving all these dangerously informal financial transfers into the properly regulated forex channels maintained by the formal banking sector?

How vulnerable are contemporary Hawala systems to criminal penetration?

Yet, even if we accept that these informal systems have been providing an efficient, effective, and above all a reliable response to the logistical challenges thrown up by the exceptionally rapid growth in the North to South remittance delivery market in recent years, the priorities of the regulatory author-

ities have undergone a sea-change since 9/11. Hence whilst customer-protection still remains a significant component of the regulatory agenda, measures to curb money-laundering in general, and the financing of terrorist activities in particular, have suddenly leapt to the head of many agencies' concerns. Given that IVTS networks stand beyond the reach of any kind external regulation, alarmist accounts of their vulnerability to criminal penetration are now regularly articulated in all manner of official reports, most particularly those emanating from North America.

Yet despite these regularly articulated concerns, which have in turn led to the introduction of a swathe of anti-money laundering initiatives with which the entire financial services sector, formal as well as informal, is now required to conform, much less attention has yet been paid to determining just how far the informal sector has actually been used for such nefarious purposes. In a similar vein it is also worth noting that there have been even fewer efforts to explore whether the raft of anti-money laundering initiatives, with which all institutions in the formally constituted financial services sector have to comply, have had any significant impact on their nominal targets. If, as I strongly suspect, their impact so far has been more symbolic than real, it is high time to consider what alternative initiatives might be expected to produce the desired result.

Before proceeding further it is also worth reminding ourselves that money-laundering is a catch-all term covering a wide variety of different forms of financial malfeasance. Not only does the extent and character of their 'criminality' vary enormously, but there are excellent reasons for suggesting that only a small minority of the transactions so labeled are associated either with drug-smuggling or with terrorist finances. Instead the vast majority are the outcome of strategies which both individuals and corporations regularly devise as a means of confounding the efforts of national governments to tax their income, to impose excise duties on goods they wish to import or export, and/or to impose restrictions on their ability to export funds into alternative financial jurisdictions. The resultant contradictions are of long standing. Just as states have always needed to tax their subjects in order to finance their activities, their subjects have done their best to avoid them. Consequently, if Hawala networks also provide support for such evasive strategies, which they almost certainly do for people of the developing world, we should not be greatly surprised. However such strategies are in no sense unique to the informal sector. On the contrary, it seems quite clear that all the biggest players, as well as the vast bulk of the funds laundered in this sense, slip with ease between on- and offshore institutions which are firmly located within the formally constituted financial sector.[11]

AML/CFT

What, though, about transactions at the much more serious end of the money-laundering spectrum, drug smuggling and terrorist financing? Here we move into even shadier financial arenas. By contrast with the vast sums of money regularly transferred around the globe to facilitate tax evasion in all its various forms, the volume of cross-currency transfers generated by drug-smugglers seems to be relatively small. For example, although Afghanistan may currently be the source of around 80% of the world's heroin supplies, it is quite unreasonable to suppose that anything more than a tiny proportion of the profits accruing from its sale in Europe and North America ever come anywhere near the country in which the poppy crop is grown. Drug smugglers may indeed need to launder their ill-gotten gains, but it makes no sense for them to seek to do so by investing in the economies of failed and near-failing states. Meanwhile there is a growing awareness that the sums required to finance terrorist atrocities are so small that many commentators have likened the task of identifying such transfers to looking for a needle in a haystack. The FBI estimates that the cost of mounting the September 11 attacks was somewhere between U.S.$175,000 and U.S.$200,000, very small beer in the context of the global forex market. Moreover the bulk of these funds were dispatched to the U.S. by wire transfer into an account which two of the perpetrators opened at the SunTrust Bank in Venice, Florida.[12]

11 Robinson, J. The Sink: Terror, Crime and Dirty Money in the Offshore World Constable. London (2003)

12 Public Affairs (2004) The 9/11 Commission Report New York: Public Affairs.

The fact that those funds were transferred through the formal banking system also raises another important wider question: to what extent are transfers made through informal sectors, as is widely assumed, 'more anonymous' than those sent through more established banking channels? In fact there is good reason to suppose that the opposite is true. By definition, Hawaladars normally know their customers on a personal basis. When such customers transfer substantial sums of money, the Hawaladars will normally have a pretty shrewd idea of the sources of those funds, and the purposes for which they have been dispatched. Moreover, if he knows that there is a prospect that those funds have been acquired on a seriously illicit basis then the Hawaladar who takes those funds aboard will be well aware that by implementing that deal he is implicitly confirming the bona fides of the whole transaction as far as all his partners in that Hawala network are concerned, needlessly putting the integrity of the system as a whole at risk. In other words, not only are Hawaladars likely to be aware of which of their customers might be engaged in shady deals, but they are also under a significant degree of systematic pressure to keep clear of such transactions.

By contrast there are good reasons for supposing that serious criminals have a much better opportunity of preserving their anonymity by dealing with the formal banking sector. Post 9/11 Know-Your-Customer AML procedures with which all major institutions in the financial services industry are now required to conform are expensive to implement, and customers may often be annoyed by the requirement to produce a variety of documents to verify their personal identity. However there is no reason to suppose that those determined to slip beneath the net would have any difficulty whatsoever in doing so.

Money, it is worth remembering, is merely a medium of exchange. It is neither black nor white, and neither guilty nor innocent. If the authorities are really concerned about tracking down serious criminal activities it is becoming increasingly clear that to do so solely on the basis of seeking to identify 'suspicious transactions' is highly unlikely to provide positive results. Whilst smoke does not necessarily conceal a fire, most serious financial arsonists long since perfected the art of building smokeless fires. In these circumstances there are no short cuts. If the security services really want to track down terrorists, and if law-enforcement officers really want to track down drug smugglers, neither cracking down on Hawaladars nor ever more elaborate KYC requirements are likely to be of much use. If the authorities really want to catch terrorists and drug smugglers, rather than to generate headlines which suggest to the public at large that something is being done, there appears to be no alternative to the hard slog of detective work in which suspect transactions, no matter how complex and obscure, are tracked right through from one end to the other, and arrests are made. The current scatter-gun approach, which appears to be as much directed at the formal as the informal sector, may well be a vehicle for bringing successful prosecutions against those who have failed to conform to post 9/11 regulatory requirements. If the 'war on terror' goes no further than that, such surrogate successes appear to be little more than diversionary exercises in public relations. In such circumstances terrorists and drug smugglers will continue to wend their way through the global financial system with no greater difficulties than they have so far enjoyed.

Conclusion

In my experience the vast majority of Hawaladars have no great objection, at least in principle, to subjecting themselves and their operations to regulatory scrutiny, especially if the central aim of those regulations is to ensure that their facilities are not being surreptitiously utilized by terrorists and drug smugglers. After all, like all other operators in the financial services sector they have businesses to run, and client confidence to maintain. Blithely processing criminal transactions would in no way be worthwhile in straight commercial terms.

However, given that they have businesses to run, and that position of competitive advantage arises precisely from their capacity to implement long-distance value-transfers on a comprehensively lean-and-mean basis, no Hawaladar would ever wish to be saddled with a requirement to implement elaborate

bureaucratic procedures of questionable utility, most especially if those procedures stood comprehensively at odds with the way in which his business routinely operated. By the same token it also makes little sense to demand conformity to a regulatory regime which was designed for use in a business which is wholly different in character[13]. Nevertheless, it is to everyone's advantage, except for committed criminals, that Hawala and other similar IVTS networks should be brought in out of the cold. But that will only occur when much greater cognizance is taken of the way in which contemporary remittance-driven value-transfer systems actually operate, such that appropriately-grounded and genuinely reality-checked regulatory procedures can be introduced.

Meanwhile on quite another level altogether, there can be no doubt whatsoever that IVTS networks are highly effective service-providers in an increasingly significant corner of the global financial services sector. Moreover it should by now be quite clear that informal in this context should not be viewed as either casual or unsophisticated. IVTS networks are in essence a highly efficient technical response to some very substantial logistical challenges. As such they have emerged as very significant competitors to more mainline institutions which operate on a more formal basis. But as Gerry Adams said of Irish republicanism, 'it's not going to go away, you know.' Just as Japan, and more recently China, have reversed the terms of trade between East and West through their innovations in the manufacturing sector, we should also not be surprised if similar challenges from below also begin to emerge in the financial sector. This is not to suggest that there is any likelihood that Hawaladars will be turning the way in which the entire established financial services sector operates on its head. But, it is to suggest that in the specific field of long-distance cross currency value transfers, the formal sector has a great deal to learn from its more informal competitors.

13 In the Netherlands and Germany, for example, current regulations treat value transmission agencies as banks, and hence require them to maintain capital reserves and to use audit procedures of the kind which are entirely appropriate for institutions which offer a comprehensive banking services. In the face of such requirements hawaladars have no alternative but to conduct their operations 'underground'.