

The Hawala System

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Abstract

This paper describes the hawala system. The system is a way for people to transfer money with relative ease. Unfortunately, there are terrorists both in the United States and abroad that have used the hawala system to transfer funds in order to carry out terrorist attacks. Al Qaeda and other terrorist groups have used the system. Because of its underground and secretive nature, the system is very difficult to track and regulate. It is the author's argument that one of the best ways in which to combat this problem is to continue to allow the hawala system to flourish, but for the United States to encourage countries to tax the system. Taxation of the system would enable counterterrorism officials to regulate terrorist funding patterns. Taxation would also provide revenue to many poor states where the system is used extensively. Additionally, the United States should require all hawaladars within its borders to register with the government. Imposing sanctions and fines on hawaladars that do not register with the government would be way to get hawaladars to register. All of these recommendations would greatly help regulate and monitor the hawala system. And, more importantly, the recommendations may potentially reduce terrorist attacks.

Key words: International Terrorism, Terrorism Financing, Counterterrorism, Security

Introduction

This research paper focuses on the hawala system. The general outline of this paper is as follows: (1) a description of the hawala system; (2) why certain terrorist groups use the system; (3) which terrorist organizations use the system (4) how it can be advantageous for terrorist groups to use; (5) the relevance of the system; (6) what the counterterrorism (CT) implications are for the United States; and (7) what the policy implications and recommendations are in regards to the hawala system.

What is the hawala system? Put simply, the hawala system is a way for individuals to channel money. Unfortunately, terrorists will often use this system to move money around. Terrorist organizations that are financially destitute are unlikely to perform well. They are unlikely to thrive. They are unlikely to be able to coordinate and conduct attacks on various targets. Therefore, they need money. By the channeling of money underground, the hawala system helps provide many terrorist groups the much needed funds that assist in keeping their operations alive. N.S. Jamwal states "terrorist groups need money to motivate people to join their activities, to procure materials like arms and ammunition and to keep their network going" (Jamwal, 2002). The hawala is system is an informal way for people to transfer money.

Mohammed El-Qorchi (2002) states:

the hawala system refers to an informal channel for transferring funds from one location to another through service providers^o known as hawaladars^o regardless of the nature of the transaction and the countries involved. While hawala transactions are mostly initiated by emigrant workers living in a developed country, the hawala system can also be used to send funds from a developing country, even though the purpose of the funds transfer is usually different.

Jamwal states "hawala is a system through which money is transferred from one part of the world to another without following the normal banking channels" (Jamwal, 2002). Further, the author states the hawala system is, "in fact, an unauthorized underground banking system used by people from different walks of life, for a variety of reasons" (Jamwal, 2002).

How exactly does the hawala system work? As mentioned above, the system provides a way for people to transfer money. El-Qorchi gives a good example of how the system works. The author (2002) states:

an initial transaction can be a remittance from a customer (CA) from country A, or a payment arising from some prior obligation, to another customer (CB) in country B. A hawaladar from country A (HA) receives funds in one currency from CA and, in return, gives CA a code for authentication purposes. He then instructs his country B correspondent (HB) to deliver an equivalent amount in the local currency to a designated beneficiary (CB), who needs to disclose the code to receive the funds. HA can be remunerated by charging a fee or through an exchange rate spread. After the remittance, HA has a liability to HB, and the settlement of their positions is made by various means, either financial or goods and services. Their positions can also be transferred to other intermediaries, who can assume and consolidate the initial positions and settle at wholesale or multilateral levels.

In other words, the hawala system is not terribly complex or convoluted. It is a fairly straight-forward avenue for people to transfer funds. The reason I explain, in detail how the hawala system works is because I think it is important to have at least a basic intellectual grasp of the system. It is important to be able to understand how people transfer money via the hawala system.

The hawala system has been around for a considerable amount of time. It is not something new and faddish. In fact, in India and other parts of Asia, the hawala system has been around for quite a long time (Jamwal, 2002). Patrick Jost and Harjit Singh Sandhu assert that the hawala system has been going on for at least three centuries. The authors state "hawala predates traditional or western banking (the first western bank in India was the Bank of Hindustan, established in Calcutta around 1770)" (Jost & Sandhu, 2000). The system is actually mentioned in very old texts of Islamic jurisprudence. The Economic Expert website (2010) states:

its origins are not entirely clear, but it is believed to have been used first in the financing of long-distance trade in the early medieval period on trading routes such as the Silk Road, the Eastern Mediterranean and the Indian ocean. Hawala is mentioned in texts of Islamic jurisprudence as early as the 8th century. In South Asia, it appears to have developed into a fully-fledged money market instrument, which was only gradually replaced by instruments of the formal banking system in the first half of the 20th century.

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Giving this brief historical background of the hawala system is to emphasize the fact the system has been around for quite a long time. The hawala system is certainly not something new and individuals have been taking advantage of this avenue of underground money transferring for a considerable amount of time. Additionally, although this will be further discussed and explained later in the paper, it is my belief that it is very difficult to stop something like the hawala system, which has plenty of historical roots and dates back to at least the 8th century.

In what regions of the world do terrorist organizations tend to use the hawala system? Kashmir is a prominent area for the system. That is, many terrorists use the underground banking system in Kashmir. For instance, Jamwal states "hawala is one of the most effective conduits of terrorist funding in Kashmir, also known as the underground or parallel-banking channel. Intelligence agencies estimate that about 90-95 percent of the funds come through this channel" (Jamwal, 2002). Furthermore, in another article, Jamwal (2002) asserts that the hawala system is used by several:

fundamentalist outfits in countries grouped under the Organization of Islamic Countries (OIC) to send money to terrorist groups in Jammu and Kashmir. Hawala funding is done through a network of dealers which extends all the way from the OIC countries to Delhi, Mumbai and other places in India. Many of these Hawala dealers have begun wholesale/retail businesses as fronts to divert money to the Jammu and Kashmir militant groups.

In other words, terrorists in Kashmir use the hawala system at an alarming and very significant rate. However, Kashmir is of course not the only area where the system is used by terrorists. It is used in Greater Asia. For instance, the system is used in places like India, Pakistan, and Dubai. Jamwal states "a U.S. Treasury Department study identified hawala as a means of money laundering for drug trafficking and other crimes in Pakistan. The report said Pakistan, India, and Dubai on the Persian Gulf form the "hawala triangle" to move money secretly worldwide" (Jamwal, 2002). Afghanistan is another area where the hawala system is used. Edwina Thompson states "the hawala system was central to the survival of Afghanistan's economy through the long period of conflict. Today, hawala continues to be the system of choice for most cash payments, transfers, currency exchange, and remittances in the country" (Thompson, 2007, p. 3).

What is even more concerning is that the hawala system is also used in the United States. In my view, it is not very concerning if average people, mainly immigrants, use the hawala system to send money back to their families. But it is concerning if terrorist organizations use this method to transfer money. Reyko Huang (2002) states:

according to experts, *hawalas* have existed in the United States since the 1980s. The number of outlets in the country is unknown, but six or seven *hawalas* are operating in the Washington-Baltimore area alone. Most clients are immigrants who use the system "which often transfers money faster than regular banks" for the legitimate purpose of sending money to relatives and friends abroad. Some users, however, exploit the system to launder money obtained or intended for illegal activity. Drug dealers have relied on *hawala* to send profits of drug sales from the United States, often to arms dealers abroad.

Therefore, the hawala system is used globally; and the United States is not isolated and unattached to the hawala system. Counter-terrorism experts in the United States and in other countries must learn to deal with the hawala system.

Which terrorist organizations use the hawala system? This is an important question to ask, because there are many very dangerous terrorist groups that use the underground financial channeling system. For instance, Al Qaeda, the most notorious terrorist group to date, uses the hawala system. Maurice Greenberg et al. states "al Qaeda's financial network is characterized by layers and redundancies. It raises money from a variety of sources and moves money in a variety of manners" (Greenberg et al., 2002, p. 7). Furthermore, the authors state "al Qaeda moves its funds through the global financial system, the Islamic banking system, and the underground hawala system, among other money transfer mechanisms" and al Qaeda "makes good use of the ancient hawala (or hundi) underground banking system, which allows money transfer without actual money involvement, or any wire transfer" (Greenberg et al., 2002, p. 7/15). Moreover, it is thought that al Qaeda used the hawala system prior to the terrorist attacks against the United States. Joshua Kleymeyer (2003) asserts:

it is a well regarded fact that in the months leading up to September 11, 2000 al-Qaeda moved tremendous amounts of wealth to hidden corners of the world, confounding the ability of the world's most adept intelligence agencies to substantially freeze al-Qaeda's assets.

And even more recently, Faisal Shahzad, the Pakistani American arrested in May, 2010 for attempting to blow up his car in Time Square; and other men arrested that were connected to Shahzad, were thought to have used the hawala system. Bob Oakes, from the WBUR website states "the case has brought a lot of attention to hawala, an informal system of money transfer that doesn't involve a bank. The authorities say the men in custody might have used the system to transfer money to the bomb suspect" (WBUR, 2010). Furthermore, the 9-11 Commission website (2003) asserts:

the hawala system, long dominated by South Asians and serving customers throughout the Middle East, appears to be custom-made for al Qaeda. It is a cash business that leaves behind few, if any, written or electronic records for use by investigators in following money trails. It operates out of nondescript storefronts and countless bazaars and souks. It reaches both small villages throughout the region and large cities around the world. It is quick, efficient, reliable, and inexpensive. It draws from a long tradition of providing anonymous services.

The point here is to highlight the fact that al Qaeda is no stranger to the hawala system. That is, the hawala system has clearly aided the terrorist group in transferring funds to different members in different regions.

Unfortunately, al Qaeda is not the only terrorist group that uses the hawala system. There are other groups that take advantage of the underground transfer system as well. Certain terrorist groups that fight against Israel are known to use it. The authors assert "other Islamic terrorist organizations, Hamas and Hezbollah specifically, often use the very same methods-and even the same institutions-to raise and move their money" (Greenberg et al., 2002, p. 17). Additionally, in Kashmir, for instance, there are many terrorist groups that use the system. The Merinews website states that funds from the hawala system are "being sent to various commanders and ultras of Jaish-e-Mohammad, Lashkar-e-Toiba, Hizb-ul-Mujahedeen, Al-Jihad, Harkat-ul-Mujahedeen, JKLF, Al-Barq, Muslim Mujahedeen, Harkat-ul-Jihadi-al-Islami and others through couriers" (Merinews, 2009). In addition, David Johnson, from the United States State Department website

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asserts that Kurdistan Worker's Party (PKK) and the Liberation Tigers of Tamil Elam (LTTE) have used the hawala system (State, 2010).

What is the relevance of the hawala system? In other words, is it really very significant? Or is it something that can easily be ignored? Does it merit attention from the counter-terrorism community? Is it a vital part of terrorist groups' operations? I think the hawala system is quite relevant and significant. First, it is relevant and significant simply because it helps terrorist groups move funds. By itself, that makes the system relevant, because terrorist groups need money to operate. A terrorist organization that is destitute is most likely riding on its last legs. However, a terrorist organization that is financially robust and solvent has a much better chance of remaining active. Phil Williams gives good examples of how even seemingly small amounts of money helped fuel terrorist attacks. Williams (2005) states:

the Madrid bombings of March 11, 2004 for example, are generally believed to have cost no more than about \$10,000. Even though for this figure might be somewhat on the low side and a \$20,000 to \$30,000 estimate might be more accurate even this larger assessment is still a relatively modest amount of money. Other terrorist attacks such as the Bali nightclub bombing, the attack on the JW Marriott Hotel in Jakarta, the Cole bombing, and the thwarted strike against the U.S. Embassy in Paris in the summer of 2001, have been carried out for between 20,000 and \$75,000.

Even though the above examples of attacks did not require a significant amount of money, they still required some money. Even though the funds used for the attacks were not exorbitant, the results of the attacks were excessive. That is, there were many deaths as a result of the aforementioned attacks. Therefore, the simple fact that the hawala system helps to transfer funds to terrorist groups in order for them to conduct assaults, makes the system relevant.

Second, the system is relevant because it has helped transfer an enormous amount of money to various terrorist groups. The sheer amount of money that is transferred through the hawala system is, to say the least, impressive. For example, Greenberg et al. state that in Pakistan, "government officials estimate that \$7 billion enters the country each year through the hawala system; the true number is likely to be significantly higher. But its nature also makes it particularly susceptible to abuse by terrorists" (Greenberg et al., 2002, p. 15). Also, Kashmir gets a substantial portion of its funding by way of the hawala system. For instance, Jamwal asserts that in Kashmir, roughly 90-95 percent of terrorist funds come via the hawala system (Jamwal, 2002). This is a very significant percentage of terrorist funds that come from the hawala system. Furthermore, Alexei Vassiliev, from the Jamestown website affirms that the hawala system has moved an enormous amount of money through South Asia. He states "the annual turnover of hawala in South Asia and the Gulf countries is estimated at United States \$20 billion" (Jamestown, 2003). Moreover, Vincent Schodolski, from the Dhushara website, states:

the power of the hawala dealers and smugglers to make money is immense; it is estimated that nearly a trillion US dollars per year is moved through these networks. The profits come not only from avoiding international exchange fees and scrutiny, but in taking advantage of steadily devaluing currencies. And since hawala is such a good deal for the customers (who can remain blissfully ignorant of how the hawala dealers can offer such low prices), the demand will always be very high.

Although the exact amount is unknown, the system has channeled a considerably high amount of funds to many individuals. And some of these funds have been used by terrorist organizations to fuel deadly attacks against innocent civilians.

Third, the hawala system is relevant because, as already mentioned, it has been used to help fund terrorist attacks. And some of these attacks have occurred on United States soil. For instance, Meenakshi Ganguly, a writer for the Time website, asserts that the hawala system helped to provide funds for the 9/11 terrorists. He states (2001) the system:

allows money to show up in the bank accounts or pockets of men like hijacker Mohammed Atta, without leaving any paper trail. There are no contracts, bank statements or transaction records, and yet those who use the hawala networks can move thousands of dollars around the world in a matter of hours.

Moreover, Charles Bowers states "only after the attacks on the Twin Towers and the Pentagon did knee-jerk speculation by various federal agencies bring the presumed relationship between hawala and terrorism finance to the forefront" (Bowers, 2009, p. 386). And the Allbusiness website states the secretive nature of the hawala system "began to attract attention after 9/11, especially after it became clear that some of the funds involved in the attacks on the WTC and the Pentagon were channeled to the parties involved through this system" and "the U.S. charged that the al Qaeda network had transferred funds through the hawala" (Allbusiness, 2003). In other words, the system is relevant because it has been used by terrorist groups to conduct attacks in the United States.

What are the counterterrorism implications for the United States? The system's underground nature makes it extremely difficult to combat. It has proven to be very difficult to regulate. For instance, Victor Comras states "most hawala operations are unregulated. Few records are kept and transfers are handled informally and, in most cases, with no real oversight. This offers al Qaeda, and those supplying it with money, an ideal channel for handling its money transfer requirements." (Comras, 2005, p. 9). To further emphasize the problem of regulation, Comras states "many hawaladars are also well connected with banks in Asia and the Middle East. Their transfer accounts raise few questions and are employed for settlement between hawaladars, hiding completely the transactions originator and ultimate receiver" (Comras, 2005, p. 9).

In addition to the problem of regulating the system, it has also been going on for a long time. As mentioned, it has been going on in the Middle East since at least the 8th century. It has a powerful cultural aspect to it in many areas of the world, and especially in Muslim dominated areas. That is, cultural ties are an important aspect of the hawala system. Bowers (2009) states: at the operator level, not much has changed since the twelfth century. For example, within many hawala networks, and other informal remittance systems, the core of trust among operators still consists of familial ties. Further, they continue to be ethnically exclusive in the services they provide (e.g. you must be Vietnamese to access the Vietnamese system) (p. 384).

Further, the cultural ties that the system encourages are crucial in rural areas. Bowers asserts that cultural ties are particularly vital "in rural areas where rarer dialects, lesser known traditions, and a general distrust of outsiders act as further barriers to entry (Bowers, 2009, p. 384). To say that counterterrorism officials across the world are going to simply do away with it, is, I believe, unrealistic and naïve.

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In addition, the hawala system is not illegal. And I would wager that the vast majority of the people that use the system are not doing it to channel money to terrorist groups. They are probably using it to send money back home, in order to help support their family. For instance, Bowers makes a good point about the system provides money to people in need. Bowers (2009) states:

hawala continues to be the best option for most immigrants and the only one for those coming from regions devastated by civil conflict and disasters. In Afghanistan, in the absence of traditional financial institutions, hawaladars provided the only viable commercial banking services while the Taliban held power (p. 383).

Also, Jamwal states ÷illions of Pakistanis, Indians, Filipinos and other people from Asia working in foreign countries use the system to send money home to relatives through the Hawala routeö (Jamwal, 2002). I think a complete severing of the system would be very detrimental to the bulk of the people that use it for legitimate purposes. It would have a deleterious effect on the people that send money and on their families, as well. Even if it were possible, I think it would be cruel and heartless to completely shut the system down. I believe it would be inhumane. Additionally, if the hawala system were ever entirely abated, this would most likely not win over any fans in the Middle East of the Global War on Terror. In other words, halting the hawala system would in essence cut off financial support for many people in the world, and especially for individuals in Asia and the Middle East. And losing a vital form of financial support would certainly not foster backing for the United States and its war against terrorism.

How do counterterrorism officials stop the hawala system? I have shown, without a doubt, the security-risk that the hawala system poses. In my opinion, it is going to be very difficult to stop the hawala system, mainly because of its underground nature and lack of regulation. Realistically speaking, it may be nearly impossible to completely ameliorate. That is, due to its underground nature, the hawala system will never go extinct. Instead of stopping the hawala system, I think it is much more of a realistic goal to try to decrease terroristø usage of the system. At the same time, honest people that are trying to send money back home should be allowed to continue using the system. In other words, I think a realistic goal is to decrease terrorist funding through the system; but continue to allow the system, whenever and wherever it is used for legitimate purposes, to flourish. There should be a distinction between people that use the system for legitimate versus illegitimate and illegal purposes. A distinction should be made because I think it would be counterproductive, inconsiderate and inhumane, to not allow honest people that are trying to lift themselves out of poverty, to send money back home to their impoverished families. Additionally, there is a strong cultural aspect associated with the hawala system. This aspect would make it difficult to completely halt the system.

I do have three policy recommendations regarding measures officials in the United States and worldwide should try, in order to reduce terrorist financing via the system. The first policy recommendation I have for decreasing the incidence of terrorists using the hawala system involves taxation. As previously discussed, the hawala system is unregulated. There is typically no paper trail. The figures provided for the amount of money channeled through the system are estimates; they are by no means exact figures. They are estimates because the system is unregulated and secretive. My proposal is to continue to allow the system, but regulate it with taxation. This could happen globally. The reason I think taxation may work is because it might actually be a good thing for the governments of most nations. The United States would of course not be able to tax people living in other countries, but it could have a positive influence on these

countries. For instance, if the United States diplomatically persuaded these countries that the taxation of the hawala system would be beneficial, then there may be some success at decreasing terrorist funding.

How exactly would the taxation of the hawala system be a good thing for countries? Most of the countries where individuals send money to through the hawala system are poor countries. Many people, as already discussed, are temporary workers that send money back home to poor families. I think the United States and other nations could persuade many countries that the taxation of the system would help bring in much needed revenue. Taxation would help regulate and provide some transparency to the system. And, importantly, it would be good for all the states involved. In my view, the key is to convince these countries that taxation would benefit them. States would tend to not implement a tax on the system if there were no benefits; but the fact that taxation would bring in more revenue to many poor nations may be a very attractive incentive. For instance, if Pakistan were to impose a small tax on the hawala system, depending on the tax rate, its government would receive a substantial amount of revenue from the estimated \$7 billion that is channeled through the system each year. This would certainly be beneficial for Pakistan. That revenue could be used for a host of projects, such as humanitarian aid for the recent flooding in the country. It would also be beneficial for the United States because, in essence, taxation puts the responsibility on each individual country. It is not the United States' responsibility to tax Pakistan. Each country would have to monitor and regulate hawaladars within their borders. Lastly, if the system is ever taxed, I highly doubt that most terrorist groups with even a small degree of intelligence would use the system. Terrorists using the system would be easier to be monitored and potentially hunted down. Therefore, taxation would mean less terrorist funding via the hawala system.

The second policy recommendation I have is focused on the United States. I think the hawala system should be allowed to continue in the United States, but all hawaladars living in the country should be required to register with the government. How would this benefit the United States? Put simply, it would be a way in which the government, to some extent, could regulate the system within its borders. Allowing the hawala system to continue would mean that law abiding citizens and migrant workers seeking to remit money back to their home countries, in order to provide for their families, would be able to continue doing so. However, requiring all hawaladars to register with the United States government would, I believe, mitigate terrorist financing via the hawala system. To be sure, there may be some difficulty in finding all hawaladars in the United States. But the ones that are found should register or be forced to quit their involvement in the system. And terrorists would certainly not want to use the system in the United States if there was some type of hawala registration database. For terrorists, if hawala registration were required in the United States, using the system could prove to be disastrous to their operations. Counterterrorism officials would have the upper hand; they would be able to track these terrorist groups down that use the system. And another crucial point is that some terror plots in the United States could potentially be foiled.

The third policy recommendation is connected to recommendations provided by the Financial Action Task Force (FATF). The FATF consists of thirty-four states that work together in combating terrorist financing. The FATF website (2010) states:

the Financial Action Task Force (FATF) is an inter-governmental body whose purpose is the development and promotion of policies, both at national and international levels, to combat money laundering and terrorist financing. The Task Force is therefore a policy-making body which works to generate the necessary political will to bring about national

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legislative and regulatory reforms in these areas. Since its creation the FATF has spearheaded the effort to adopt and implement measures designed to counter the use of the financial system by criminals.

What does the FATF say about the hawala system? The FATF has special recommendations regarding combating alternative remittances, such as the hawala system. Similar to my second policy recommendation, the FATF recommends that the hawala system should be regulated by requiring hawaladars to obtain licenses. The website states "jurisdictions should require licensing or registration of persons (natural or legal) that provide money/value transfer services, including through informal systems" (FATF, 2010). Further, the FATF recommends that sanctions should be imposed on hawaladars that do not have a license. The website states "jurisdictions should be able to impose sanctions on money/value transfer services, including informal systems, that operate without a license or registration" (FATF, 2010).

FATF is correct in saying that sanctions should be imposed on hawaladars that choose not to register or obtain a license. The problem, however, is that the FATF's recommendation is just that, a recommendation. In other words, the FATF's recommendation needs to be put into action for it to work. I think that sanctions could potentially work to get more hawaladars registered or to obtain a license, because hawaladars would unlikely want to pay a fine. So sanctions would be a good way to encourage hawaladars to register with their governments. It would also help to prevent terrorist financing.

In conclusion, the hawala system is a system that people use to transfer funds. It is culturally important and has been used since at least the 8th century. The system is quite relevant. There are a number of terrorist organizations that have used the system. The system also channels a very significant amount of money to various regions, including the United States. The system is almost completely unregulated and clandestine in nature. It is my belief that not only would completely eliminating the hawala system be impossible, it would also be cruel to the largely poor people who use it for legitimate purposes. I think it is a much more realistic goal to mitigate terrorist financing within the system. This goal seems realistic and doable to me. The policy recommendations I have given would, I believe, help to accomplish the goal of decreasing terrorist funding. It should be mentioned, however, that I have intentionally not thoroughly discussed other avenues of terrorist funding, such as kidnapping, money laundering, drug trafficking, and charities. These are other ways in which terrorists raise money and they deserve no less attention than the hawala system.

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