Migrants' money lifeline

Roger Ballard explains why the thriving hawala network of money transfers is so popular with the poor and shows how its success is built on the promise of my word is my bond

Contemporary transactional networks are far more numerous, complex and widespread than those in the past. But as the globe has "shrunk", so has the number of face-to-face transactions. This has brought new dilemmas, especially in financial contexts. As developments in the summer of 2008 brutally confirmed, once mutual trust has evaporated, markets seize up. The global financial system survived, but largely thanks to vast injections of liquidity from central banks, which were the only major institutions still considered good for the money.

Neo-classical theorists have constructed ever more sophisticated mathematical models of transactional behaviour. They aim to track the, assumed-to-be, rational actions of individuals as they negotiate their way through the world.

Their assumption that the social order is composed of autonomous players, all of equivalent status, has meant that contractual agreements, monitored by law, were assumed sufficient to ensure financial stability. Within this framework, "my word is my bond" appeared to have been safely consigned to the dustbin of history.

Why, then, did the carefully constructed contractual edifices collapse with such speed? It was not just that the theoreticians had "failed to pay sufficient attention to 'tail risk'". The real killer lay elsewhere. Since virtually all the main financial institutions had jumped on the "efficient market" bandwagon, no one could really assess whether or not their counterparty was still creditworthy. As a result, the bottom fell out of the market.

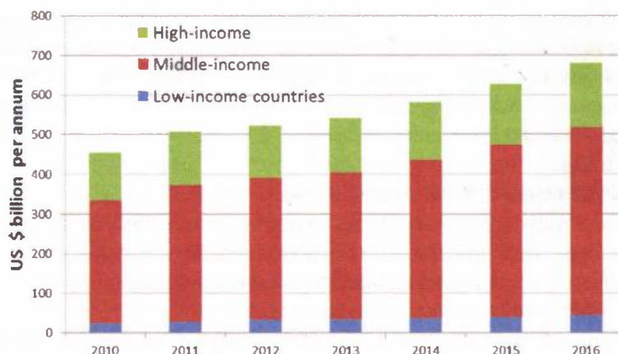
The remedy for all of this appears to be more regulation. However, as financial institutions are discovering, meeting regulators' requirements is an ever more expensive business. This means the institutions have every reason to work around regulatory restrictions whenever the costs of compliance are substantial, and most especially on behalf of high-net-worth customers. But since these work-arounds are fairly costly to implement, they are unsuitable for less wealthy individuals and for institutions making much smaller value transfers. Does this mean that the 99 per cent will have to pay through the nose while the 1 per cent escape relatively lightly?

Migrant remittances

The global payments system has exploded in size in recent years, partly because of the rapid growth of long-distance migration from relatively disadvantaged areas in the global south to the affluent global north. Many of these migrants have had to leave their families back home, which has led to a vast and increasing flow of remittances to those left behind.

The World Bank (2014) recently calculated that "remittances to developing countries are estimated at $404bn in 2013, up 3.5 per cent compared with 2012. This is expected to accelerate to an annual average of 8.4 per cent over the next three years. The average total cost of sending remittances fell in the first quarter of 2014, dipping below 8.4 per cent; however, the average cost of remittances to

Estimates and projections for remittance flows to developing countries



Source: World Bank Migration and Development Brief 22

sub-Saharan Africa has remained stubbornly high at around 12 per cent." It also notes that "south-south remittances are either not permitted or very costly due to outward capital controls. The closure of bank accounts of money transfer operators serving Somalia and other fragile countries is also a matter of concern. Remittances provide a lifeline to fragile and conflict-affected countries, where they are more than five times larger than foreign aid, FDI and other sources of international currency put together." The World Bank also warns that "anti-money laundering and countering the financing of anti-terror regulations have to be carefully balanced with the development objective of helping the poor".

AML/CFT and its consequences

Remittances are big business. Moreover, the data cited in the World Bank report are just part of the picture as they only track "legitimate" transfers, ie those that comply with the provisions of the US Patriot Act. Passed into law immediately after 9/11, the Patriot Act was intended to curb money laundering and the financing of terrorism (AML/CFT) – and most particularly the hawala-style informal value transfer networks (IVT) through which it was (erroneously) assumed that the attack on the Twin Towers was financed.

But while this meant that hawala networks found themselves being frozen out of New York's money markets, and hence out of the global banking system, it did not put them out of business. Rather, all such IVT networks cut their links with the formal financial sector, and disappeared "underground". It would appear that the World Bank is well aware of what is going on, especially in the sphere of migrant remittances. Its mild observation to the effect that AML/CFT regulations "have to be carefully balanced with the development objective of helping the poor" contains a clear message: namely the criminalisation of IVT networks enabled the regulated financial services industry to make substantial profits from providing trans-

jurisdictional value transfers for the poorest of the poor.

This was not, of course, the prime objective of the introduction of AML/CFT. It was intended to freeze criminals and terrorists out of global money markets and to catch them red-handed whenever they tried to use its facilities. As such, it has failed. Terrorists and drugs smugglers remain as active as ever, and trust-based IVT networks continue to thrive, albeit "underground". As this suggests, the IVT networks can be viewed with suspicion. Are their low-cost services another aspect of the "dark net", supporting a worldwide web of criminal activity, as the security services continue to insist? Or are they, on the contrary, trust-based transactional networks whose logistical arrangements are so efficiently organised that they are in a position to undercut the regulated sector by a wide margin?

Certainly, hawala networks continue to thrive, and when it comes to migrant remittances there are excellent reasons to suppose that the value transfers they implement are on a similar scale to those in formal channels. The main reason for their popularity is that transfers in the informal sector only attract a fraction of Western Union's charges, which substantially undercut those charged by banks, but, nevertheless, offer a next-day delivery service even to remote destinations, no matter how small the sum transferred may be.

Few members of the public have any idea how settlements are made in forex markets. In particular, they have little or no awareness that, enormous though the total value is, all such transactions are by definition zero-sum swaps. "The money", in whatever form it takes, stays put. Operators in the money market routinely aggregate many small transactions into a large tranche, whose value is disaggregated at the agreed destination. That makes migrant remittances difficult to deal with. Most transfers are little more than penny packets (the average is around $200), many of those sending and receiving do not have bank accounts and the delivery destinations are often both distant and remote. A logistical nightmare, at least as far as formally constituted institutions in the financial services sector are concerned. What, then, is the secret of the hawaladars' success?

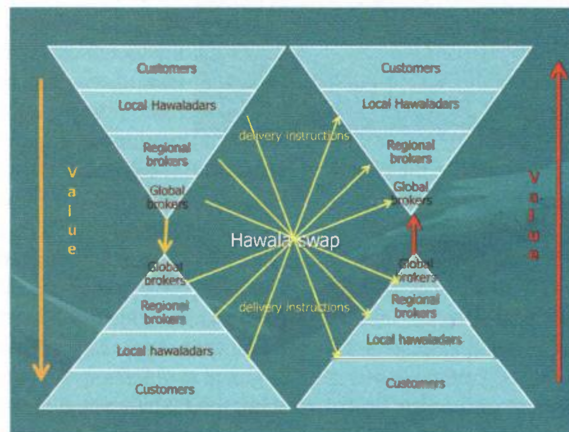
Hawala

The essence of hawala, Arabic for mutual exchange, is the implementation of back-to-back swaps, currently brokered in what amounts to a clearing house in Dubai. (The premises of hawala are spelt out in sharia law.) Routing the payments through Dubai means that remittances transfer a huge volume of liquidity into the Indian Ocean region. This, in turn, serves to facilitate reverse flows of value, enabling traders of all kinds to settle their trans-jurisdictional invoices in hard currency. The unit of account for settlements in Dubai is typically tranches of $100,000, a multiplicity of which will be stacked up in any given value-swap.

Of course, while migrant remittances are typically small amounts, business settlements can often involve several tranches of $100,000. Hawala networks consequently take the form of disaggregated information transfer systems, by means of which hawaladars at different levels in the system pass delivery instructions upwards through a hierarchy of nodes to Dubai, or any other convenient location in which to implement a global swap. Then, the value transferred is disaggregated down a parallel network of brokers who deliver the funds to the intended recipients – as I have indicated in this highly simplified diagram.

The key to this operation, which is normally cash-based, is two-fold. In the first place, the cash does not leave the jurisdiction in which it is issued. However, the original tranches of cash dispatched by customers are not tagged in any way, they are simply aggregated into larger and larger tranches until they are disposed of into the alternative local network after the hawala swap. But how do brokers deal with all this untagged cash? The answer is simple: as the cash is passed through the system, brokers at every level email their partners overseas, providing them with precise details of how the delivery of cash they are about to receive should be disaggregated and passed on down to the next layer of recipients. The rest is easy.

How a hawala swap works



Source: Author

However, as far as regulators are concerned, auditing the operation of highly efficient redistribution networks of this kind is a nightmare for the simple reason that it has no central registry. That structure saves a great deal of time and trouble for the users. As in the internet, instructions on information transfer only pass from node to node (routers do this work on the web), and only include instructions to implement node-specific transfers. Such networks are information rich but the data are scattered. Date redundancy is deliberately avoided, and so long as all instructions are promptly obeyed, value transfers can be implemented on a global scale at great speed, with a minimal degree of overhead costs. No wonder hawala networks can readily undercut their formally constituted rivals.

But is there a downside? With vast sums of money flying around the globe, surely the whole system is wide open to malfeasance, given that none of these transactions has contractual foundations, and none of the networks maintains a central registry through which to track activity. Everything is based on trust – in other words, the promise that "my word is my bond". Can this really provide a secure foundation for such a vast and complex system of value transfers?

Close inspection soon reveals the secrets of their success. In the first place, all transfers are completed within 24 hours. As a result, those involved have no opportunity to deposit the funds in the money market overnight, let alone longer, to take advantage of the interest generated. For the same reason, non-delivery is immediately apparent and generates warning signals throughout the network. This can lead to the malfeasant being frozen out of the system until reparations are made.

Secondly, and even more importantly, reputation is the counterpart to trust. In the absence of a reputation for honesty, no one can survive as a hawaladar. But even so, a hawaladar might be tempted to run off with the loot. This is where the key backstop kicks in. Hawaladars

are invariably drawn from extended biraderis (brotherhoods, descent groups). This means that a significant portion of their counter parties are kinsfolk and they are already bound together into what economics professor Avner Greif long ago identified as coalitions of reciprocity, the betrayal of which brings severe sanctions and, ultimately, excommunication. Moreover, the sanctions can extend to all of a hawaladar's immediate kinsfolk. He can also expect to discover that he is unable to find suitable brides for his sons, or husbands for his daughters. Given that these sanctions can be applied worldwide in diasporic contexts, they are highly efficient. Malfeasance among hawaladars is rare.

> Untrustworthy hawaladars face sanctions that can extend to their kinsfolk

Of course, there is always a prospect that hawaladars might engage in transfers that would upset the authorities in Washington, just as many of the big banks have done. Given the provisions of the Patriot Act, and the position of the US dollar as the global medium of exchange, the US has taken the opportunity to regulate and/or to rig, depending on your point of view, the global payments system to suit its political purposes. Those purposes now stretch way beyond AML/CFT. They include sanctions against those jurisdictions of whose policies they disapprove, in an effort to bring them to heel. This, however, has not been entirely achieved.

What has been achieved is that hawaladars are obliged to take steps to avoid money-laundering charges. Prior to 9/11, UK-based regional brokers routinely used Securicor to deliver consolidated tranches of cash collected from customers to their local bank, so enabling them to fulfil their transactions in the spot market in New York. However, that facility vanished following the appearance of AML/CFT and a work-around was required.

Two solutions emerged. On the one hand, the main exchange houses in Dubai set up wholly-owned subsidiaries in the UK and signed up the great majority of local hawaladars as their agents. This meant that consolidating hawladars in the UK ceased to deal directly in the New York money markets. They simply deposited the day's takings at their local bank in favour of the UK subsidiary of the Dubai exchange house that had signed them up and Dubai then implemented all the back-office transactions out of sight of the UK authorities.

The other option was to implement the wholesale cash swap within the UK. However, this is now an inherently risky option. The police or the National Crime Agency could confiscate the cash on the grounds that it is considered to be the proceeds of crime. If that happened, all the participants would be arrested and required to demonstrate that they were not engaged in money laundering. A tough task, since in this context the burden of proof is reversed.

Conclusion

Despite all the efforts made to suppress hawala networks since 9/11, the system has survived. Indeed, it has proved to be a reliable and exceedingly efficient global value transfer system based on trust, much to the benefit of the 99 per cent.

More importantly, it has demonstrated that efforts to manipulate the operation of payments systems to freeze criminals and money-launderers out of the global financial system are inherently mistaken. This is in no way to suggest that criminal activity should be overlooked. Rather, it is to insist that much greater progress towards achieving that goal could be achieved if skilled investigators worked in cooperation with all the agencies involved in facilitating trans-jurisdictional value transfers, of whatever form, rather than threatening them with criminal charges on the grounds of non-compliance with rules laid down in New York.

But while international banks are in a position to pay vast fines to avoid exclusion from New York money markets, if only because these can readily be recouped by raising the fees charged to their customers, hawaladars are in no position to do so. If this is so, could it be that AML/CFT is best understood as a sophisticated but low-cost PR exercise, and one that is proving extremely profitable to the authorities, given that there is no evidence to confirm that these measures have had any significant impact on terrorists and drugs smugglers' capacity to implement financial transactions?

A longer version of this article can be found at: www.casas.org.uk/papers/pdfpapers/trustvcontract.pdf.

References

Ballard Roger (2014), 'Hawala and hundi vehicles for the long-distance transmission of value'. Chatterji, J and Washbrook, D (eds) *Routledge Handbook of the South Asian Diaspora,* 53–64.

Ballard R (2013), 'Global Insider: Iran's informal financial sector has boomed under sanctions'. Q&A for *World Politics Review* http://www.worldpoliticsreview.com/trend-lines/12681/global-insider-iran-s-informal-financial-sector-has-boomed-under-sanctions.

Ballard R (2009), 'The dynamics of translocal and transjurisdictional networks: a diasporic perspective. *South Asian Diaspora* Vol 1, (2), 141–66.

Ballard R (2006), 'Hawala: criminal haven or vital financial network?' *Newsletter of the International Institute for Asian Studies,* September 2006 issue, University of Leiden, the Netherlands, 8–9.

Ballard R (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, 319–352.

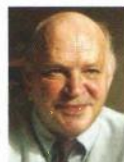
Graeber D (2010), *Debt: the first 5,000 Years* (Melville Publishing House).

Greif A (1989), 'Reputation and coalitions in medieval trade: evidence on the maghribi traders', *The Journal of Economic History,* 49, 857–82.

Greif A (1993), 'Contract enforceability and economic institutions in early trade: the Maghrebi traders' coalition, *The American Economic Review* Vol. 83, 525–48.

United Nations Regional Information Centre for Western Europe (2014), *From Worthington to Warsheikh.* Available at: www.unric.org/en/latest-un-buzz/29309-from-worthington-to-warsheikh.

World Bank (2014), *Migration and Remittances: recent developments and outlook.* Available at: http://siteresources.worldbank.org/Intprospects/Resources/334934-288990760745/MigrationandDevelopmentBrief22.pdf.



Roger Ballard*'s prime concern has been to track the dynamic trans-jurisdictional networks that immigrants from South Asia constructed as they established ethnic colonies around themselves in the UK. He currently heads the Centre for Applied South Asian Studies @ casas.org.uk.*