Chapter 6

THE NEXUS OF DRUG TRAFFICKING AND HAWALA IN AFGHANISTAN

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I. INTRODUCTION

During recent years, informal money service providers, or *hawaladars*, have gained an enhanced role as an important informal institution and key economic agents in Afghanistan. The *hawala* system, handling both financial transfers and currency exchange, was important in Afghanistan even before the war. But during the long period of conflict, and especially under the Taliban regime, the *hawala* markets fully replaced the formal banking system, providing people with the only facility to transfer money into and out of the country. These markets became host to a complex interplay of actors from the benign through to the ethically questionable and patently criminal.

There are currently two documents in the public domain that should be read in conjunction with this chapter. The first examines total opium production and trade figures for Afghanistan (UNODC, 2005a) and the second is a World Bank report that investigates the current mechanisms of the *hawala* system in Afghanistan (Maimbo 2003). This chapter is based on survey research that represents the first attempt to focus primarily on obtaining feedback from the *hawaladars* themselves. the research is based on an investigative sample of 54 dealers across the major financial centers of Afghanistan during a five-month period from March-July 2005. This sample comprises 6% of an estimated 900 significant *hawala* shops in the country. Reading this chapter in conjunction with the above documents provides an opportunity to verify or challenge existing data and add new insights on the issue of drug money laundering in Afghanistan.

For obvious reasons, the *hawala* markets comprise an extremely difficult target from which to glean accurate information. As a result, the quantitative estimates are presented in wide ranges and need to be viewed with considerable caution. This chapter does, however, build an understanding of drug money laundering methods from the ground up. The results also help to corroborate figures already in the public domain that were developed on a more macro, top-down basis.

Background, Objectives, and Structure of the Chapter

Media and law enforcement investigations into the 9/11 terrorist attacks prompted criticism of the *hawala* system as one of the sources of criminal money laundering and terrorist financing in Central Asia and the Middle East (Passas, 2003). But in a country where an estimated 80-90% of economic activity is in the informal sector (World Bank, 2005), it would be mistaken to presume that Afghanistan's *hawala* system, which is currently the most effective, reliable, and sometimes sole method for moving funds across the country, deals only with dirty money. In practice, there are no clear boundaries between the illicit and licit economies, where networks have developed over time with complex overlapping connections.

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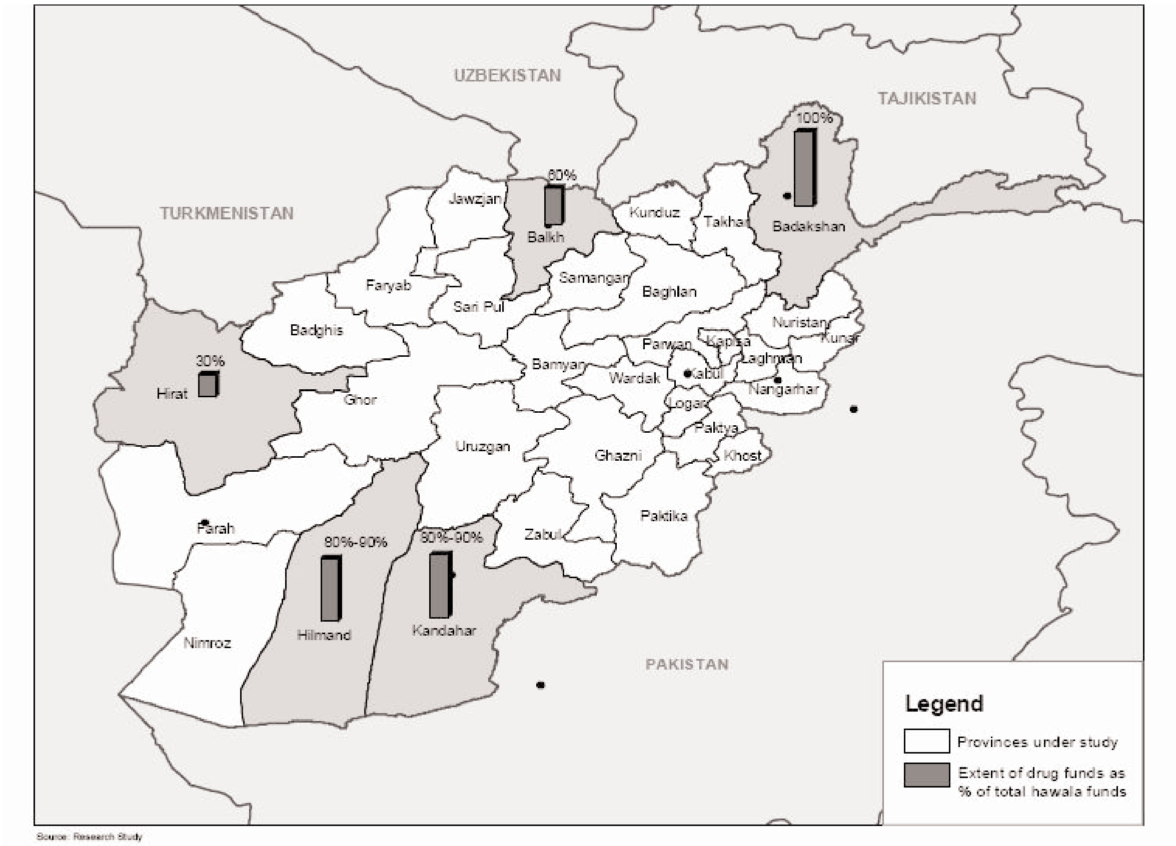
A detailed analysis of the placement and integration of drug earnings in Afghanistan's economy beyond the farm-gate level is long overdue. On account of the Afghan government's and international community's commitment to combat Afghanistan's illicit narcotics production and trade, the pressure to launder drug money in the world's largest opium-producing country should not be underestimated. Drug traffickers are faced with the additional task of disguising profits that remain among the highest in recorded history (see Figure 6.1 below).

Figure 6.1: Estimated Percentages of Drug-related Funds in Provincial *Hawala* Markets



It is no secret that the system remains to a large extent statistically unknown. Available information on it is limited, often vague, and contradictory, which results in counter-narcotics policies being based on a limited understanding of the processes at work. There is an urgent need to redress this gap through proper research and analysis.

The objective of this chapter is to enhance our knowledge of the *hawala* system and the methods used to launder the proceeds of drug trafficking in Afghanistan. It is a first attempt to build a qualitative story of the nexus between drugs and the *hawala* system together with an analysis of fresh quantitative data. It demonstrates how– reliable research into the mechanics by which drug money enters the system can help guide decision-makers in designing appropriate policies affecting both the illicit opiate industry and national economic reconstruction.

The chapter is structured in the following manner. The introductory section briefly maps out some key features of Afghanistan's contemporary political economy. This is followed by a discussion on the dynamics of the "informal" or parallel economy in Afghanistan and a review of the related drug money laundering problem. The next major section provides background material on the mechanics of the *hawala* system, including an explanation of regional networks, trading risks and trust. The fourth section explores key provincial *hawala* markets as they relate to the drug economy. Monthly revenue calculations for medium-sized and top-end drug *hawaladars* are used to derive estimates of drug money entering the *hawala* system. The concluding section of the chapter summarizes the main findings and offers some preliminary observations on policy implications.

Broader Perspective

Contemporary political economy of Afghanistan. With a per-capita legal domestic product of less than US$ 300, and some of the lowest indicators of human development from a global perspective, Afghanistan is one of the poorest countries in the world. Annual domestic revenue of the Afghan state is only around 5% of licit GDP. Together with the lack of security and governance capacity, the level of poverty in the country makes reconstruction a daunting task (Rubin, 2005).

During the decades of conflict, trust in the government was progressively eroded and transposed to kinship, ethnic, and other social connections. As a result, traditional tribal loyalties that existed before the war were strengthened, leading to the collaboration of groups in forging or strengthening informal institutions. A group of alternative power holders, including predatory warlords, commanders and organized criminals, emerged to control important political and economic networks that governed drugs and trade. Aside from their potential graduation to politics, there are few incentives for these groups to engage meaningfully with the national government. There are arguably even fewer incentives for those on the margins, particularly the *hawala* operators, who have benefited materially in remaining hidden from view.

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. This is partly due to restricted public access to modern banking services. As of October 2005, 13 licensed banks were operating in Kabul,[2] but their high fees, stringent policies and minimum balance requirements alienate the local population, of which only 36% are literate.

There are four major sources of externally generated income in the country: opium production and trafficking, unregulated trade in legitimate goods, remittances from abroad, and donor assistance. The narcotics sector has been by far the most important, adding value of US$ 2.7 billion to an economy otherwise producing about US$ 5.4 billion of goods and services in 2005 (UNODC 2005). A World Bank study found that the gains appear to accrue mainly to traffickers and commanders and only secondarily to farmers, many of whom are heavily indebted (Byrd and Ward, 2004). However, while some groups experience discrimination in accessing certain markets, the narcotics trade has fostered cooperation among all groups and regions. Even during the war between the Taliban and the Northern Alliance, opium produced in Taliban areas was trafficked through Northern Alliance-controlled areas (UNODC, 2000).

[2] These included the following international banks: the National Bank of Pakistan, Standard Chartered Bank, the Habib Bank of Pakistan, Afghanistan International Bank (managed by Dutch ING Bank), Kabul Bank, and Punjab National Bank.

In an attempt to capture some of the income generated by narcotics and tax-free international organizations, the government of Afghanistan has levied a new tax on high housing rents in Kabul. Although potentially effective, strategies such as this are not sufficient to mitigate the deleterious effects of an economy to a large extent based on illegal production, trade, and aid.

A government report estimated that a growth rate of 9% per year in the non-opium economy was the minimum needed for longer-term economic development while phasing out the drug industry over time. In 2002/03 and 2003/04 the legal Afghan economy was estimated to have grown by 29% and 16% per year respectively, but this was the result of a rebound in agricultural production due to good rains following severe drought, and an influx of foreign aid (World Bank, 2005, cited in Rubin 2005). In January 2005, the IMF reduced its growth projection for 2004/05 to only 8% (IMF, 2005). In 2005/06, economic growth rebounded to 14%, primarily as a result of a weather-related recovery of agricultural outputs (IMF, 2006).

There is a risk that growth will stagnate without major new investments and improved security. Effective government monetary and fiscal policy, combined with the influx of aid, has abated hyper-inflation, although there has been significant albeit moderate inflation. After decades of hyper-inflation, the new currency that was introduced by the reformed central bank (Da Afghanistan Bank, DAB) at the end of 2002 has remained stable, largely thanks to foreign exchange reserves earned through narcotics exports, remittances and the expenditures of foreign organizations (Rubin,2005). The real appreciation of the currency (i.e. stable nominal exchange rate while domestic inflation has been higher than global inflation) may reflect a "Dutch disease" problem resulting from a single-crop (opium) economy, pricing other exports out of the market (see Chapter 2).

<u>The informal economy</u>. This constitutes the bulk of economic activity in Afghanistan (World Bank, 2005). It is supported by the *hawala* system, which carries out the majority of the country's cash payments and transfers. *Hawala* dealers choose to label their money "black", but they do not readily associate this with a negative subtext. While many acknowledge that their clients predominantly consist of Afghan business traders (who regularly trade "legal" goods "illegally"), they are quick to defend themselves against accusations of dealing in "illegal business", such as drug money laundering. These examples illustrate how difficult it is to separate legitimate and illegal financial trading in a country such as Afghanistan where the economy has existed in a legal vacuum over a prolonged period of time.

<u>Trade and *hawala*</u>. Official trade with countries in the region, such as Turkmenistan, Uzbekistan, Tajikistan and China, is gradually growing while attempts have been made to secure trade agreements between Afghanistan and several of its neighbours. In 2003, Afghanistan certified two trilateral transit and trade agreements (Afghanistan-Iran-India and Afghanistan-Iran-Tajikistan) and four bilateral transit and trade agreements (with Iran, Turkmenistan, Uzbekistan, and India). But the Afghan Transit Trade Agreement (ATT) that was signed in 1965 by Pakistan and Afghanistan governs the most well-known and well-trodden trading routes in and out of the country. The Agreement grants freedom of transit between the territories via two land routes (Peshawar-Torkham and Chaman-Spin Boldak). It also guarantees that "no customs duties, taxes, dues, or charges of any kind whether national, provincial or municipal regardless of their name and purposes, shall be levied on traffic in transit".

It is not surprising that smugglers seeking to avoid Pakistan's stringent taxes and duties on foreign goods have exploited this facility. Many of the items imported via the ATT, which range from fast-selling to high-end consumer goods, were never meant for sale in Afghanistan. During the transit process these items make a U-turn to be sold in the local bazaars, such as Peshawar's sprawling Karkhano market. This route provides an important conduit of smuggled goods in the region. Another important channel is the import of goods directly from Dubai or through Iran for subsequent unofficial re-export, mainly to Pakistan but also elsewhere.

Millions of dollars related to trade circulate outside of formal legal reckoning in the extra-state banking system. The latest published estimate of annual "unofficial" imports and exports from Afghanistan to other countries, principally Pakistan and Iran, is an estimated US$ 1.1 billion (World Bank, 2001). While this figure offers some insight into the extent of the shadow economy, what remains unexplored is the link between this unofficial trade and the trafficking of opiates.

Anecdotal evidence suggests that there is a strong relationship between *hawala* and smuggling. Trade in goods was often identified by *hawaladars* as a strategy to settle remaining balances from *hawala* transactions. Complex linkages between the trafficking of drugs and import of legitimate goods, whether by licit or illicit means, also emerged in the border areas where legal and illegal flows–of arms, cars, drugs, edible oil, fuel, and other consumer goods–are highly complex and interrelated.

<u>Drug money laundering</u>. The pressure to launder drug money in the world's largest opium producing country is arguably greater than ever before. The international community's commitment to combat Afghanistan's drug trafficking networks is complemented by an increased sense of domestic responsibility to tackle the problem. A government ministry has been established to deal exclusively with counter-narcotics, along with a dedicated counter-narcotics police force. Various efforts to curb illicit drug flows at the border have also been stepped up, with the recently established Afghanistan Border Security Force manning key points along the border with Iran, one of the primary routes for export of opiates. Within this environment, traffickers are faced with the difficult task of disguising their profits, which remain among the highest in recorded history (see Figures 6.2 and 6.3 below).

A more detailed analysis of the placement and integration of drug money in Afghanistan's economy beyond the farm-gate level is long overdue. But before any analysis, it is important to obtain a sense of the volume of profits generated by the production and export of illegal opiates. First, domestic profits should not be confused with those amassed internationally. While the aggregate estimated value of the international trade in Afghan opiates is in the neighbourhood of US$ 40 billion, the total export value of opium to neighbouring countries is estimated to be US$ 2.7 billion in 2005. Gross revenues accruing to Afghan farmers are calculated to be on the order of US$ 560 million, while Afghan traffickers are estimated to receive roughly US$ 2.14 billion (UNODC, 2005a). Needless to say this is a very significant amount of money for a very poor post-conflict developing economy like that of Afghanistan to manage, especially in the absence of a fully operational banking system. The question remains as to in what amounts, which forms, and by what means drug money arrives in the country.

Figure 6.2: Value of Opiate Exports (US$ billion) 2000-2005

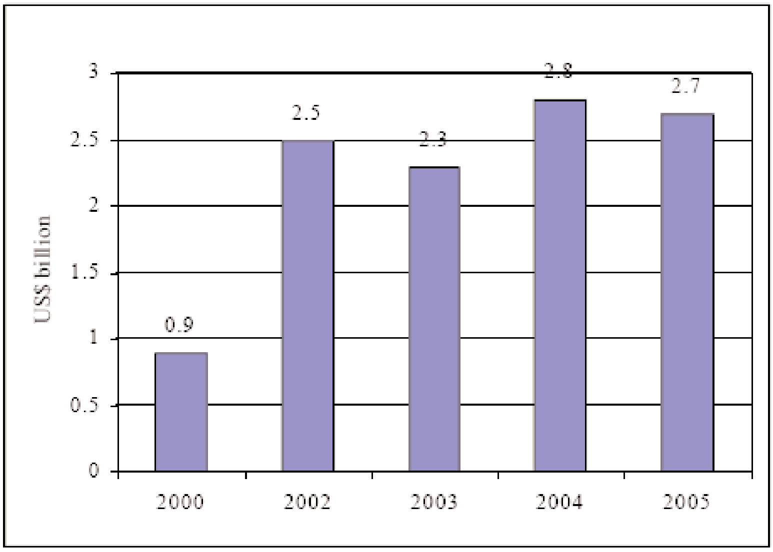
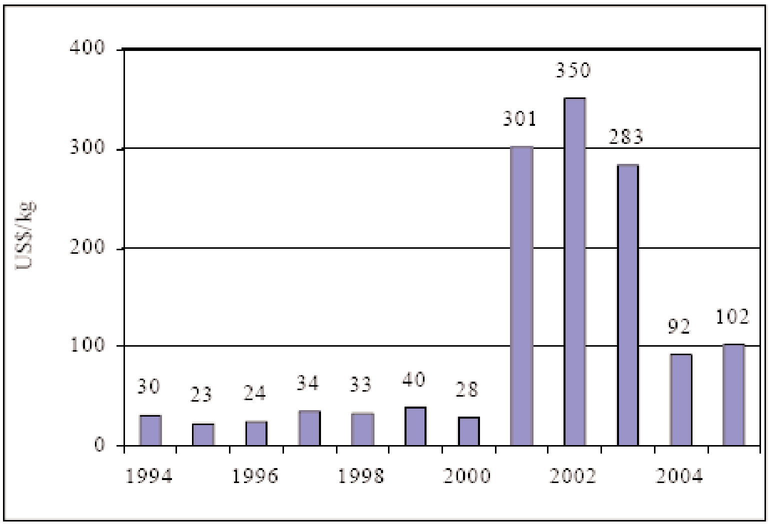


Figure 6.3: Opium Farm-gate Prices (US$/kg), 1994-2005



Overall size of the *hawala* market. Based on the information available to the author, Table 6.1 was compiled with rough estimates of aggregate *hawala* flows into and out of Afghanistan for 2004/05(See Table 6.1). Any estimate of the overall size of the *hawala* market in Afghanistan should however be viewed with extreme caution.

Most of the figures provided in this chapter relate to inflows of funds into Afghanistan through the *hawala* system. It is important to be aware, however, that the system relies on a two-way flow of funds. At the end of each accounting period most of the flows are balanced and any net residual is relatively small and/or settled among the *hawaladars* concerned. Hence, as per the table below, there should be almost equal outflows. An estimation of outflows was beyond the scope of this chapter, so it supplies no empirical data on their composition. Nevertheless, Table 6.1 provides us with some idea of what the counterflows are likely to be. Included in the list of items, for example, is the import of goods, which is often used to balance an inflow of money.

Because the *hawala* system experiences an incredibly high turnover rate of funds, *hawaladars* can manage a very high flow of funds while keeping only small balances of funds in their hands.

Table 6.1: Rough Estimates of Aggregate *Hawala* Flows in Afghanistan (2004-2005)

Item	Inflow (US$ million)	Outflow (US$ million)
Opium trade~	1,700	?
Unofficial re-exports^	1,100	1,000
UN agencies*	500	?
NGOs**	1,300	?
Inward remittances and informal investments***	1,000 - 1,500	?
Imports of goods	---	?
Expatriation of opium profits	---	?
Other outward capital movements	---	?
Total:	5,600 - 6,100	5,600 - 6,100

~ The figure used here includes all farm-gate proceeds of the opium economy (because it is reasonable to assume that these do flow into Afghanistan), but only half of the aggregate profits accruing to Afghan traffickers (because it is not reasonable to assume that all of the "value added" at the processing and trading state enters Afghanistan).

^ These figures are based on World Bank 2001 estimates. It is possible to offer an estimate on the out flow here because the import bill cannot be too much less than the export bill on unofficial trade (a 10% margin on the unofficial re-exports is assumed).

* This figure accounts for the amount of funds transferred by two major UN agencies through the *hawala* system, as verified by the author.

** This figure emerged from interviews with major NGOs operating in Afghanistan.

*** This figure includes regular remittances from migrants and refugees in Pakistan and Iran, and irregular foreign direct investment from the diaspora.

II. METHODOLOGY

Data Base

Primary data forms the basis of the research on which this chapter is based. Intensive investigative fieldwork was conducted through formal and informal discussions with a wide variety of informants in Afghanistan, Pakistan, and the United Arab Emirates. These included formal and informal money service providers, NGO workers, opium producers and traffickers, business traders, accountants, and Afghan politicians. Collection of this primary data focused on two subsets aimed at (i) quantifying the nexus between drugs and the *hawala* system, and (ii) assessing the importance of *hawala* networks for the movement of drug-related profits.

The study involved a sample of 54 *hawala* dealers across the major financial centers of Afghanistan during a five-month period, from March to July 2005. Comprising 6% of the estimated 900 significant *hawala* shops in the country, this provided a reasonable sample with which to work. The dealers were selected on the basis of the following criteria:

1. recommendation by trusted informants or colleagues;
2. geographical spread;
3. category, i.e. small, medium, large;
4. type, i.e. those who dealt in money, goods, and/or opium;
5. variation in ethnic group;
6. length of time spent in the business (most had 10-25 years' experience); and
7. those with partners in the world's major trading centers.

In order to verify the claims made by the *hawaladars*, the following groups were also interviewed on the basis of their expertise or knowledge of the system:

1. the *users:* drug dealers, businessmen, traders, international aid workers;
2. the *regulators:* government officials, DAB personnel; and
3. the formal *service providers:* private bankers, accountants.

The task of quantifying monetary transfers– particularly those relating to drugs– is exceedingly difficult, but it is nevertheless worthwhile to make use of figures gathered during fieldwork in an effort to reach more reliable estimates on the extent of drug money in the *hawala* system. To manage the enormous range in figures gathered, the dealers are separated into small, medium, and large categories. This categorisation was complicated by some *hawaladars* who claimed to be a lot smaller or bigger than their monetary transfers would indicate. All currency conversions were made according to the exchange rate on the day of interview.[3]

The topic under investigation could not be properly understood by studying a single site. Therefore fieldwork was conducted in the country's main financial centers where the *hawala* system is most active. The author travelled to five regions of Afghanistan, which included visits to Faizabad (Badakhshan), Gardez (Paktya), Herat (Herat), Jalalabad (Nangarhar), Kabul (Kabul), Mazar-e-Sharif and Charsang village (Balkh), and the North West Frontier Province (Pakistan).

In 2004, the top three poppy cultivating provinces–Helmand, Nangarhar and Badakhshan–accounted for 56% of the total area under poppy cultivation. These provinces not only have been major production sites, but are concomitantly important transit points on drug smuggling routes and major centers for drug money laundering. For these reasons, it was important to explore these sites in some depth.

Security

Due to security considerations, it was not possible to travel to Kandahar and Helmand. Instead, interviews were conducted indirectly with certain key drug dealers and *hawaladars* through trusted informants. The author is therefore particularly grateful to a number of people who helped in this process, but who unfortunately cannot be named due to the nature of the topic. The author's planned research in Jalalabad was interrupted by an unexpected local riot causing her to be evacuated immediately to Kabul. Any future research should explore this site more fully.

[3] During the five-month interview period, there were only minor fluctuations in the rate of the Afghani and Iranian Toman against the US Dollar.

Seasonal Aspects

Both the illicit drug industry and financial markets share one crucial characteristic–large fluctuations over short periods of time. Together with lack of openly available statistical data, this makes quantitative study of either extremely difficult. In all surveys, therefore, the informal money service providers were asked to take into account the fluctuations in the market. This proved particularly important when measuring the median volume of drug-related transfers.

Kandahari *hawaladars* explained that there are some months when shops receive very little money from the drug business. This is the case, for example, during the months of February, March, and April when opium poppy is at the growing stage. On the other hand, during the poppy cultivation months (from October to December) the *hawala* market experiences a huge influx of funds reflecting advance payments to farmers for crop cultivation. The market also experiences large fluctuations from the end of April, to June because the opium is ready for purchase. The *hawaladars* therefore reported figures of the highest order during the two phases of opium poppy cultivation and harvesting.

The inflow of advance payments for opium at the time of planting suggests that there is a chain of credit not just from farmer to first-level trader but also beyond, including internationally. Reports suggest that, on receipt of a drug order, a buyer transfers another payment, although in a smaller amount, to the trafficker, either in Afghanistan or to an account held outside the country.

In contrast to drug inflows, outflows of funds do not appear to be seasonal. While *hawaladars* have to allow for fluctuations in the drug market, they do not have the same problem with the steadier outflows that mostly finance trade in goods.

Data Limitations

In view of the clandestine and illicit nature of the subject, and the many grey areas surrounding it, the figures and results in this chapter must be treated with caution. This study is the first of its kind and should be understood in the context of the shortage of data available on the subject and the difficulty in redressing this deficit. Representative data samples are provided wherever possible, covering a specific time period from February to July 2005, and tentative conclusions are drawn out of the data collected.

In spite of the data limitations, the study has achieved an overview of the nexus between drug trafficking and the *hawala* system in Afghanistan, and offers useful insights for the design of drug control strategies and the shaping of economic policies relating to the financial services industry.

III. THE MECHANICS OF THE HAWALA SYSTEM

Background

In Arabic, the term "*hawala*" (حوالة) means "transfer", and in simple terms denotes the practice of transferring money and value from one place to another through service providers, known as *hawaladars*. The practice is understood in Arabic legal commentaries as the "exchange of debt", particularly in its historical context of long-distance trade. When the word was adopted into Hindi and Urdu (हवाला / حوالہ) , it retained this sense but gained the additional meanings "trust" and "reference", which reflect the code by which the system functions. Afghans involved in the trade tend to call themselves *sarafi*, or the singular, *saraf* (صراف),which means "money changer".

The *hawala* process consists of three main functions: money exchange, the sending and receiving of money ("outbound" and "inbound" transmissions), and the settlement of transactions. In the transfer of money, various intermediaries tend to be engaged, but this does not generally delay the payment or affect its reliability, cost, or convenience to the customer. These features make it the remittance system of choice for many labour migrants wanting to remit money back home.

When a *hawaladar* sends payment instructions to his counterpart, an informal debt is created which must at some stage be settled. Kinship and family ties usually ensure a smooth settlement process (Passas, 2003). In Afghanistan, intermarriages between the families of *hawaladars* are commonplace because they are seen as a way of cementing the trust between parties. It is common for a number of brothers to operate in the same *hawala* business, covering some of the world's major financial centers such as Karachi, Dubai, London, Mumbai, New York, and Shanghai.

Despite the emphasis on familial connections, it should be noted that the business is like any other, driven first and foremost by profit. In this sense, *hawaladars* should be perceived in their true form as financial entrepreneurs operating as part of the informal economy; instead, they are portrayed in some accounts as motivated primarily by ethnic ties to distant relations abroad, or tarnished with the brush of terrorist and insurgent financing in others. In reality, if it maximizes profit to deal with a Tajik when the dealer is Pashtun, he will not hesitate to do so after verifying that the other party is trustworthy. This is particularly the case in the trafficking of drugs; in Kaldor district of Balkh, the author encountered an Uzbek, Turkman and Pashtun that cooperate with 10-15 others at the border to transport opium for 4-5 commanders in the North. Ethnicity is thus a poor explanatory factor in the cooperation among *hawala* dealers.

Table 6.2 below provides a simplified outline of the stages involved in a typical *hawala* transaction.

Hawaladars utilise the services of formally constituted banks– especially TT and SWIFT facilities–to effect transfers. Deposits are occasionally fragmented and wired to various banks throughout the world before being brought back together in an aggregate (the "starburst" effect), or they can be sent on a circuitous trip and returned back to the account of origin (the "boomerang" effect) (Boaden and Kenney, 2004). The movement and layering of funds from informal to formal institutions blurs the boundary between the two, making it impossible to separate one from the other. The formal and informal banking systems become interlocked, just like the official and unofficial markets serviced by the *hawala* system itself.

Table 6.2: Stages in a Typical *Hawala* Transaction

Client contacts hawaladar and requests remittance to a designated recipient in country B of US$ 20,000 in foreign currency equivalent. Client hands over the money in cash and receives a numerical code.
Hawaladar profits from a commission or favorable rate of exchange to the foreign country.
Amount of remittance and destination is communicated to hawaladar in country B and the numerical code is relayed.

Recipient (or sender) gives code to hawaladar. Local currency equivalent of USD20,000 is given to recipient from counterpart hawaladar's cash reserve.

(3) Settlement

Hawaladar in Country A owes US$ 20,000 to hawaladar in Country B. It will be settled in the future by offsetting transactions in the other direction, by remittance through formal bank accounts, or by delivery of commodities of equal value.

Source: Adapted from an earlier version presented by Carroll (2002).

The fieldwork conducted indicates that the widespread perception of the *hawala* system as being paperless is incorrect. Access to financial records reveals that each transaction is carefully logged, and follows its own accounting procedures. Not surprisingly, transfers made on behalf of drug traffickers tend to be kept more discreet, either by maintaining very simple notes locked in the safe, or by not keeping a record at all. However, one *hawaladar* confided that he documents all of the shop's drug-related financial transfers on his son's computer at home.

It should now be clear that, while anonymity and potential for nominal documentation make the *hawala* system an attractive means to transfer money, these qualities also make it vulnerable to abuse. But it is notoriously difficult to draw a simplistic distinction between the illicit and licit forms of Afghanistan's informal economy, especially when evaluating the extent of drug money passing through the *hawala* system. A glance at the various users of the system reveals that it is critical to the movement of both illicit and licit finance.

Structure of Hawala Markets

Regional and transnational networks. The *hawala* system relies on the extensive networks of mainly Pashtun diaspora and refugee communities in Iran, Pakistan, Saudi Arabia, Europe, and the United Arab Emirates (UAE). The groups link to the political, religious, and socio-economic networks within the core countries of Central Asia, three of which share a border with Afghanistan, and well beyond the region to the Middle East, the UK, and the US.

Anecdotal evidence points to close relations between different regional centers. Typically, each province connects to its closest neighbour; for example, the provincial markets in the north, at Mazar-i-Sharif and Faizabad, are articulated toward Tajikistan and Pakistan, while the markets in the west are articulated toward Iran. The presence of the respective foreign currencies provides confirmation of these close regional ties. In the case of southern Afghanistan, the markets depend on trading centers in Pakistan's North West Frontier Province (NWFP).

Both within Afghanistan and more broadly across the region, triangular flows of various kinds can be found between *hawala* dealers. An illustrative example includes the following movements of funds:

1. A drug payment arrives in Peshawar, Pakistan, by TT from the UK.
2. The payment is fragmented, and part of it is transferred to a *hawala* operator in Helmand province.
3. The profits are then used to finance imports from Dubai through Herat.
4. The settlement process could take several weeks to complete.

One step removed from this process there is likely to be an Afghan drug trafficker, based in southern Afghanistan, who determines the flow of funds and goods. In this scenario, he instructs a *hawala* dealer in Helmand to purchase the imports on his behalf. And after receiving the goods that enter Afghanistan via Herat, he is then provided with the option to sell them on for a further profit.

Dubai (UAE), China, Japan, and Germany are the main sources of imported goods for Afghan traders, while cities in Pakistan, UAE, and Saudi Arabia are the main transaction centers for the Afghan *hawala* markets. Dubai operates as the central "clearing house" for transactions. Major financial centers further afield, such as London and New York, host fewer *hawaladars* but are responsible for sending some of the largest amounts of money related to drugs. Although most drug *hawaladars* in Kandahar and Helmand identified London as their main source of drug orders, the payments are often routed to Afghan partners in UAE and Pakistan, where the money is reinvested or used to settle other transactions (as in the illustrative scenario above). Afghan *hawala* businesses make use of corresponding Pakistani networks, which often have greater reach in countries such as the UK.

In recent years, extensive networks have also developed throughout East Asia. Discussions with most *hawaladars* alluded to the importance of China to their business. Trading families, such as those belonging to the Afridi clan, also commented on the extension of their links to China and Japan, and often explained how they would establish their own *hawala* businesses as a "support center for their trade" (interviews conducted in 2005). This provides a further indication of the intermingling of the trade and money transfer businesses and marks an important shift in the expansion of the *hawala* networks beyond the immediate region.

Afghanistan's geographical location and transnational social networks underscore the impossibility of disentangling the contemporary political economy of the country from its wider regional and international context.

<u>Trading risks</u>. All *hawaladars* reported that the chief sources of risk are related to insecurity, both financial and personal. While they expect to encounter the normal trading risks of any conventional business, they talked of many additional risks. It is important to note the difficulty not just in identifying the major potential windfalls of *hawala* transactions but moreover to extract stories of market risks and downside outcomes.

Most examples that combine both financial and personal risk involve the transport of money. Intercepted couriers, either delivering funds to a client or to a banking institution for deposit, are major targets of organised criminal groups. Many *hawaladars* in Pakistan reported losses incurred in their Afghan partner shops by this method. Couriers travelling by taxi appear to be routinely targeted by criminal organisations, while there are also the obvious hijacking attempts on personal vehicles. There were several unconfirmed reports of victims being "drugged" by some kind of aerosol and waking up later to find that their money had been stolen. One *saraf* reported that his courier had been intercepted with a cash cheque for Afs1,100,000 (US$ 25,700). On leaving Sarai Shah Zadar, Kabul's money market, the man hailed a taxi to the National Bank of Pakistan branch. The taxi driver asked whether he could collect two relatives en route, and the courier obliged. When the two men entered the vehicle, the man was assaulted and the cheque stolen. Each informant had stories of a similar nature, all involving the theft of money and/or the violent deaths of people they knew, including family members.

There were also cases that appeared to be personal vendettas against *hawaladars* themselves–for example, in Kabul last year an organised crime group murdered five children of one shop owner. Neighbouring *sarafs* argue that this could only be in retaliation for a "bad deal", or too close an association with a controversial political figure. Various sources suggested that criminal groups target couriers delivering cash to politicians as a way of striking at their most vulnerable point, and depleting their power to influence through money.

The problem of personal security could be partially solved by opening bank branches closer to the money markets. At present the formal financial sector is based in another part of Kabul city, which makes it difficult for dealers to deposit and withdraw funds safely. After one company's recent loss of US$ 500,000 to a group of organised criminal hijackers, it employed a full-time armed escort for the transport of its money to the bank. The vehicles are subcontracted to other *hawala* shops also wishing to move their money overnight for safekeeping. This is perceived to be more secure than storing money in the shop's safe at the market.

Some dealers admitted to lacking the courage to report thefts to the authorities because of the association between some organised criminal groups and high-level political officials. In Pakistan *hawaladars* frequently complained of the confiscation and theft of their money by Pakistani government officials. Four years ago, one man officially reported the government's unlawful confiscation of Pakistan Rs 4 million from his shop. He spent several years submitting paperwork to retrieve the funds, and paid a total of Rs 500,000 worth of bribes in the process. The money was never returned to him–a familiar story among the *hawaladar* community, and one involving a lot less money than many other cases in similar circumstances.

The remarkable aspect of these financial and personal risks is that, although there are many stories of bankruptcies, they appear to be due more to "bad" currency speculations than to theft or injury. The assurance that "we can recover easily" was commonplace in almost every interview. Risks are viewed as a necessary gamble in the business, and any proposal for external interference (i.e. with regulation or state protection) is usually resisted. This was the case in interviews with medium and top-end dealers; the smaller dealers revealed a much greater sense of insecurity and perceived personal risk. In one interview, two *hawaladars* in Gardez, Paktika, were surprisingly open to the introduction of formal banking institutions in the province. They complained of serious and multiple security risks in transporting money from Kabul to Gardez by road, and expressed the need for a more structured, regulated banking system in the region. These complaints became more real when at the time of writing, on 7 July 2005, it was reported that unidentified gunmen on motorcycles killed a money changer in his car in Gardez, while only days earlier Rs 200,000 was stolen from his friend.

Many of the risks facing *hawala* dealers, such as theft, personal security, and price fluctuations, are similar to those in the drug trade, and also more generally in the informal economy (see Chapter 4 and Lister and Pain, 2004).

<u>Trust</u>. Although there are considerable risks involved, and customers do at times lose their money, the system generally works. It is widely recognised that a significant degree of trust must be in place for this to happen, but reports often conflate the issue without properly differentiating the various networks in play.

The following list outlines at least five networks of trust operating in the system:

1. *hawaladar* C1 + *hawaladar* C1
2. *hawaladar* C1 + *hawaladar* C2 (+ *hawaladar* C3 etc)
3. *hawaladar* + client (both remitting and receiving)
4. *hawaladar* + regulatory institution (i.e. Central Bank)
5. *hawaladar* + law enforcement agency (i.e. police)
6. business client 1 + business client 2 (business loans)

It is important to start with the first category because without this foundational level of trust the system could not function. As networks between *hawaladars* develop, they form a web of careful co-operation and competition, where each single strand might be weak, but the whole fabric is made strong through their interaction (Braithwaite and Drahos, 2000). While trust is essentially a transactional concept, its role in any given transaction depends entirely on the context. Generally speaking, most *hawaladars* operating in the same company (as outlined in item 1 above) have familial connections, which provide a firm basis on which to build trust between the company's various nodes spanning different parts of the globe.

The issue of trust becomes more complicated in networks that combine nodes from various companies, as demonstrated in item 2. In this instance, each transaction optimally increases the mutual trust between dealers, which serves to strengthen the system as a whole.

The third category, involving networks of trust between the *hawaladar* and client, seems fairly straightforward. The remitting client must trust that the *hawaladar's* counterpart will deliver the agreed amount of money to the recipient. There are cases where people pose as agents, while not officially being part of the system itself. These impostors are often guilty of abusing trust by failing to deliver the client's money. Although *hawaladars* rarely admit that dealers defect from the system, quite a number of examples were found where this has taken place, and at a great loss to clients. The instances that were cited were primarily from times of conflict, where the situation was particularly unstable, and one could not rule out the possibility of the dealer himself being killed or imprisoned, resulting in closure of the business.

An interesting aspect of the *hawaladar*-client relationship is the dealer's dependence on the client to honour the promise to provide funds punctually. For example, it is the policy of major INGOs and NGOs using the system to remit payment only on receipt of the money in the desired destination. These transactions can vary from US$ 20,000 to US$ 3 million. NGOs frequently reported instances where they were late with payments, which caused a souring of relations with the *hawaladar*. In these cases, the dealer is not provided with the necessary liquidity to meet his settlement demands. With barely any physical movement of money between *hawaladars*, it is crucial for each dealer to have sufficient cash pools to cover the other's debts. When the cash pools are inadequate, and the dealer has pledged to deliver his counterpart's money, the trust between *hawaladars* becomes strained.

Just as the use of trust increases the level of trust among groups (as with the *hawaladars*), its non-use diminishes trust. This particularly applies to the cases in items 4 and 5, where interactions between dealers and formal institutions have historically been weak. Contact with regulatory institutions and "lawful" law enforcement agents is especially limited during conflict and continues to be strained during the early stages of state-building. As per "the sum constancy principle", the more trust shown toward "outsiders" diminishes, the more identity and trust is strengthened between "insiders" (Offe, 1999).

Hawaladars view law enforcement agencies with suspicion and often contempt. Unlike other informal sector enterprises, such as the drug trade where there are close alliances with elements of the police for example (see Chapter 7), *hawaladars* have an adversarial relationship with law enforcement and view them as a major source of corruption and theft. Anecdotal evidence from central Afghanistan suggests that the police seek details of a theft to determine their share in the loot rather than to ensure that justice is done.

IV. PROVINCIAL AND REGIONAL CONTEXTS

This section explores key provincial sites where drug money transfers and laundering are occurring through the *hawala* system. These locations were selected on the basis of their varied importance to the drug economy. Four main aspects will be discussed:

- the distinctive characteristics of the province
- opium production and trade

- the structure of the *hawala* industry and markets
- provincial variation in the transaction volumes.

Due to the recent increase in opium production in the North and Northeastern regions of the country, Badakhshan is the first key province to be explored. The money market in its capital, Faizabad, is small and saturated with drug-related funds originating from the porous border with Tajikistan to the north and from Pakistan to the east.

Herat in the Western Region is the second key site under examination. It is a much more developed city than Faizabad, with good infrastructure and a number of excellent roads linking it to major cities in neighbouring countries. It derives much of its income from customs duties collected at the borders with both Iran and Turkmenistan. Its money market combines a mix of licit and illicit transfers related to trade, remittances, and opium trafficking.

Two major provinces in the South, Helmand and Kandahar, are the next focus of enquiry. Helmand not only accounts for more than aquarter of the total area under poppy cultivation and opium production in Afghanistan, it also dominates the country's opium trading networks. Located at the heart of the Pashtun belt, the province is therefore ideally placed to exploit the extensive Pashtun trading networks that reach many of the world's key financial sites (Schetter, 2004). When asked to describe the relationship between the Helmand and Kandahar *hawala* markets, one *saraf* commented, "you may as well see them as one and the same market" (see also Chapter 5). Helmand and Kandahar together were responsible for close to 40% of Afghanistan's opium production in 2005, and a considerably hight percentage in 2006.

This section ends with a brief analysis of Peshawar's *hawala* market in Pakistan, because it is impossible to examine the overall system without taking into account its regional partners. Afghanistan's political economy is so deeply constituted through regional and international associations that it would be a mistake to view it in a purely national context.

Northeastern Region – Badakhshan

<u>Background</u>. Badakhshan is a remote and mountainous province, bordering Tajikistan, China, and Pakistan. Major parts of the province are reachable only by foot, donkey, or helicopter. Badakhshan is particularly vulnerable to food insecurity and has always been one of the poorest areas in Afghanistan. Due to its location it depends on subsistence agriculture and trade, and was a main opium production center of the country during the 19th and 20th centuries, with a high-quality yield.

<u>Opium production and trade</u>. While wheat and barley have been the predominant crops in the region, strong increases in opium production have been reported, with cultivation in Badakhshan rising by 43% over the 1994-2000 period. In 2001, after the Taliban ban affected opium production in almost all of the rest of the country, Badakhshan accounted for 83% of total opium poppy cultivation in Afghanistan, although the situation changed again in 2002 with the resumption of opium production in the South and East (UNODC, 2004). By 2004, Badakhshan was the country's third major source of opium, accounting for 12% of the

national total. After it had experienced a considerable increase in the area under cultivation for the fourth consecutive year, in 2005 the province's reduced its area of opium poppy cultivation by 53%, making it the fifth largest contributor to national opium production (UNODC, 2005b).

Structure of *hawala* market. Badakhshan is host to a relatively modest number of money service providers in comparison with the other main money markets in Afghanistan. This should not, however, belie its significance to drug money laundering schemes in the informal banking structure. While the number of currency exchange dealers (predictably) decreased after the currency reform and consequent reduced opportunities for speculation over changes in the value of the national currency, the number of recognised *hawala* dealers increased to 5-6, compared with around 3-4 in previous years. This was attributed in large part, to the arrival of more international organisations and NGOs in the province.

Response to government action. One informant revealed that the threat of drug interdiction by the Afghan National Police (ANP) and special CN police had driven a large proportion of the *hawala* trade in the Northeast underground, in contrast to the open nature of the market during the previous few years. The *hawaladars* also indicated that their businesses had suffered from the decline in opium trade, which they suspected was a result of a decline in either provincial opium production or local storage of drugs. ANP and CNPA claim that their 2005 eradication campaigns were successful in reducing the area of Badakhshan's opium poppy cultivation by 144 ha. Far more important than eradication as such, however, was the perceived threat of eradication which discouraged farmers from planting opium poppy in the first place. Thus the area under poppy cultivation in Badakhshan declined from 15,600 ha in 2004 to 7,370 ha in 2005, a decline of 53%.

To counter the decline in business resulting from decreased drug funds, some *hawaladars* have opted to acquire new clients from the international aid community.

Aid money. The introduction of more development projects in the region was universally viewed as a positive influence on the provincial *hawala* markets. NGO personnel stressed the importance of the *hawala* networks for delivery of aid money to projects and staff. The *hawaladars* can deliver money efficiently and routinely to border districts of neighbouring provinces, such as Baghlan and Takhar, which are too difficult for NGOs to reach regularly. A UN World Food Program (WFP) representative in Badakhshan reported that their Wheat Distribution Program, which covers the months leading to winter (September to December), would not be possible without the payment facilities provided by the *hawaladars*. In serving the international aid community, the *hawala* networks thus offer an indirect means of development to people who would otherwise have few alternative means of survival.

Hawaladars were confident that trade would fill the gap left by the eventual departure of the international community, and that this would signal a time of better development and more opportunities to move into other sectors.

Transaction volumes. Variation in the demand for drugs causes both large fluctuations and huge injections of cash into the market. All reports confirm that an increase in demand for drugs causes a concomitant rise in the amount of money entering the *hawala* system; liquidity in the market naturally increases, therefore, when drug dealers provide advance payments to farmers, or when traffickers receive money from abroad for transfer of drugs. These fluctuations make the task of measuring monthly averages of financial transfers particularly difficult. A top-end *hawaladar* confided that, in a good day, he might receive a transfer of US$ 5 million from Peshawar, and US$ 200-300,000 from Jalalabad. But on an average day, he may transfer around US$ 500,000 in total.

Bearing these considerations in mind, the following table provides rough estimates on the inflow of funds of each *hawaladar* identified in Faizabad, as provided by the dealers themselves.

Table 6.3: Inflow of Funds of *Hawaladars* in Faizabad

Size of hawaladar	No of hawaladars	Monthly average (US$ million)	Annual total (US$ million)
Large	1	5.0	60
Medium	3	1.5	54
Small	2	1.0	24
Total:	6	1.9	138

Source: Author research interviews

Another way of measuring the liquidity of the main *hawala* shops in the province is by gathering data on the amounts of money routinely delivered to NGOs on the ground. On average, a number of international agencies collect US$ 150,000 per month for distribution to staff and to cover operational costs. One UN worker disclosed that, within 2 hours, his agency's *hawaladar* can deliver US$ 450,000, "always". Although it is important to note that there are only very few *hawaladars* in each province that have this amount of money available on site, the above example provides a good indicator of how liquid a top-end *hawaladar* can be at any one time, even in a remote province such as Badakhshan. Payment to *hawala* dealers is made via their formal bank accounts in cities such as Dubai (UAE) and Peshawar (Pakistan).[4] It is then the responsibility of the *hawaladar* to deliver the cash to a representative from the NGO in the respective province. Logic dictates that they must have the liquidity to meet these routine demands.

Another international aid worker provided a further insight into the question of liquidity. He explained that, when the agency receives salaries sent from its central office via the *hawaladar*, the money is counted, delivered to the national staff, and passed right back into the hands of the same *hawaladar* for further transfer to the worker's place of residence. This money, therefore, does not actually move physically from the *hawaladar's* shop in this example that involves several transactions. This might help explain how these *hawaladars* can so readily supply clients with cash. But at one point in time the money must have physically arrived in the province.

<u>Origin of payments</u>. All reports indicate that the majority of funds are transmitted from Pakistan. This was corroborated by NGO workers who observed that the fresh US dollar notes they receive bear Pakistani stamps. At times, money arrives in Badakhshan circuitously from Pakistan (i.e. via Kabul), and at other times via less conventional routes. During several interviews, the author was witness to *hawaladars* arranging for the transport

of large quantities of US dollars from Kabul to Badakhshan. On all occasions, this was done by road. The dealers commented that both the removal of roadblocks and the presence of ISAF troops had vastly improved conditions for this mode of transport. Previously, large sums of money had been stolen on the road, vehicles hijacked, and cars stopped at checkpoints controlled by commanders and other political elements.

Money is also transported by air, although this seems to be less common for everyday transactions. One (seemingly) exceptional incident occurred in July 2002, just after Hamid Karzai was elected as President of the transitional government. There was a hasty move to shift drugs out of the province, perhaps in anticipation of increased interdiction efforts. Two commanders reportedly arrived by helicopter to collect 3,700 kg of refined opium (heroin) plus some dry opium. They arrived with an estimated US$ 14.8 million. From Faizabad the drugs were transported to Tajikistan. Observers in the city speak of huge injections of cash into the market at this time–as much as US$ 1 million per day over a brief period. It is perfectly reasonable to deduce that INGOs, the PRT, inbound remitters, and/or legitimate traders then absorbed this money.

Conclusions. The estimated transaction volumes for Faizabad's *hawaladars* came to an annual total of US$ 138 million. The estimated aggregate value of opium produced in Badakhshan in 2003/04 (close to US$ 97 million at farm-gate prices as of January 2005) is of the same order of magnitude as the estimated annual total *hawala* transactions. This tends to substantiate the qualitative accounts that the essential liquidity in the province is derived from the drug trade. The international agencies and NGOs implementing projects in the province and surrounding areas are thus presented with a dilemma. Field research indicates that their liquidity is derived from *hawala* dealers whose capital base depends on illicit trade in goods and opium.

While there are clearly large inflows of money through the *hawala* markets in Badakhshan, associated with both drugs and UN/NGO expenditures, there are also corresponding outflows of funds. *Hawaladars* tend to balance their books mainly through the purchase of commodities and capital flight. Bordering Tajikistan, there is a lucrative trade in stolen luxury cars (imported from Russia), gemstones, flour, vodka, and weaponry.

Badakhshan is our first example where the legal and illegal sectors of the economy meet. Discussions with informants suggest that this might not be sustainable in the long term, but that this might be the beginning of a natural progression away from the illegal sector. If, for example, opium crop eradication efforts are taking effect, and the criminal economy is shrinking, then there could be a general movement toward legitimate business activities on the part of the *hawaladars*. As the INGOs and other traders bring more business to the area, the money traded is gradually being laundered from the illicit to licit.

Western Region–Herat

Background. Herat is the regional capital of western Afghanistan. During 2002 and subsequently, a series of public works projects brought electricity, irrigation, good roads, and parks to the city. Many of Herat's inhabitants boast that it acts as the country's real financial center. At the time of fieldwork, Herat reportedly collected an estimated US$ 5-10 million per month in customs revenue. Most of the business is derived from both official and

[4] This process of transferring funds to hawaladars via banks in Pakistan and the UAE was noted in Maimbo (2003).

"unofficial" trade. The substantial trade that passes through two major land ports bordering Turkmenistan (Torghundi) and Iran (Islam Qala) explains the large supply of foreign exchange in the informal financial markets.

Structure of the hawala market. In contrast to Badakhshan, a much larger and more vibrant informal market exists in Herat city, with an estimated 300-400 money exchange shops occupying two parts of the central business district. There is still a high turnover of exchange dealers due to the decreased opportunities for currency speculation after the currency reform. Those who stayed in the business continue to make significant profits from major *hawala* transactions, both domestic and international. Three large *hawaladars* in Herat were identified, who handle significant trade deals and drug profits, and there are also some 50 medium-sized dealers, as well as roughly 100 small dealers who use the *hawala* business as a supplementary source of income. The money market is articulated more toward Iran than Turkmenistan, as most of the trade from UAE transits through borders with Iran. Afghan *hawala* dealers in Iran, who have been forced underground due to discriminatory treatment by the state and local communities, broker trade deals between UAE and Afghanistan.

Opium production and trade. Herat has never been a significant drug producing area, although it does play an important role in drug trafficking and laundering of proceeds. Various sources estimate that only three or four *hawaladars* in Herat's money market specialize in the laundering of drug proceeds. However, interviews with non-specialists indicate that they too assist in the layering and integration of drug money, making it appear to have been obtained from legitimate sources. This may not be, and often is not, the primary aim of the *hawaladar*. He sees himself simply as a facilitator, transacting wherever the most profit will be generated.

While Herat is a conduit for opium trade from other provinces, it is also a major channel for imports of legitimate goods destined for other provinces. The extensive trading networks of the region connect imports of cars, building materials, edible oils, and glass to drug exports. It was consistently reported that key business figures offer their "legitimate" services, such as transport networks and contacts with customs officials, to those seeking to launder and transform their money into respectability. Most businessmen argued that they did not need to know the origin of the money–they would receive a commission in the process.

While it is widely recognised among Herat's financial community that legal commodities are traded for opium and other illicit goods, it is less well understood that there is a continuum of engagement between the trades. Some opium exports are directly linked to trade in legitimate goods, whereas others are removed to the point that it becomes impossible to link the commodity back to the illicit trade. The following are two simple hypothetical scenarios based on information provided in interviews, which fall at different places along the continuum.[5]

Scenario 1: Several *hawaladars* broker a deal between a trafficker in Afghanistan wishing to export opium and a businessman in UAE wishing to purchase the drugs. The trafficker prefers to receive commodities (e.g. vehicles) in return for the drugs, increasing the potential for profit. In this case, the *hawaladar* would facilitate the exchange of goods through his various trading partnerships in UAE, Iran, and Afghanistan. When the drugs are delivered to the buyer's representative in Iran or at the Turkish border, the payment is either (i) provided in cash to the *hawaladar's* partner shop in Iran or Dubai, or (ii) transferred electronically to the *hawaladar's* bank account. It is then the *hawaladar's* responsibility to broker the purchase and import of vehicles to complete the deal. In this instance, legitimate and illicit trade are directly connected with the knowledge of both clients, but the *hawaladar* may not be aware of the criminal origin of the investment.

Scenario 2: When a drug trafficker in Afghanistan wants to spend some of his profits from drugs (and his money is kept in Dubai, for example), he contacts a *hawaladar* to assist him in importing goods into Afghanistan. Alternatively, when he wants to transfer money into the country for investment, the *hawaladar* conducts the transaction for him. Again, it is possible that in facilitating the transfer the *hawaladar* is unaware of his role in laundering of drug proceeds. By the time the goods or money arrive in Afghanistan, it is impossible to link them to their illicit origin. Although most *hawala* dealers are aware that their monetary transfers combine legitimate and illegal activities, they insist that this is an inevitable practicality.

Due to the overlapping and interwoven connections between licit and illicit transfers in Herat's financial market, it was not possible to use direct methods to calculate the magnitude of drug proceeds in the local *hawala* system. Instead, qualitative reports from *hawaladars* and drug dealers had to be used in combination with indirect methods. Several *hawala* shops provided the author with access to their weekly record; however it was not possible to ascertain whether the transactions were routine or exceptional. No workable extrapolations could be made from the data.

<u>Transaction volumes</u>. A sample of one *hawaladar* from the large category, four from the medium, and six from the small group was interviewed to obtain a rough breakdown of transaction volumes, shown in the following table.

Table 6.4: Composition of Significant *Hawala* Business in Herat City's Main Market

Size of hawaladar	No of hawaladars	Monthly inflows (USS million)	Annual total (USS million)
Large	3	6.0	216
Medium	50	1.0 - 2.0	600 - 1,200
Small	100	0.2	240
Total:	~150	0.6 - 0.9	1,056 - 1,656

Source: Author research interviews.

The next table shows a breakdown of the average monthly inflows of several medium-sized *hawaladars* currently working in the market. Four dealers in this category were surveyed for the data.

[5] It should be emphasized that these are illustrative examples and are not intended to represent actual cases.

Table 6.5: Monthly Average Inflows of Medium *Hawaladars* in Herat

	US$ equivalent*(millions))
Total funds processed	2.3
Total funds processed related to drugs	0.7
Total funds processed related to legitimate trade	1.3

The average total funds processed came to over US$ 2 million per month, around US$ 0.7 millions directly linked to the drug trade and US$ 1.3 million attributed to trade in legitimate goods. This analysis is fully consistent with local reports that roughly 30% of the overall funds processed are related in some way to the drug trade.

An interesting correlation can be made between these figures and "legitimate" trade. There have been speculations in the literature that the movement of legitimate goods across the border facilitates the transfer of drug-related money (Maimbo, 2003). The field research, including interviews with Afghan importers based in Dubai and opium exporters in Afghanistan, produced evidence to support this hypothesis. While there is a wide range of imports brought into Herat, ranging from fuel to fast-moving consumer goods, car imports consistently arose in interviews as a major commodity often traded with drugs. It is interesting to note that estimated daily car imports at one border post are of the same order of magnitude as estimated drug exports at this point, although this is not meant to imply that all car transactions are facilitated with drug money.

Conclusions. In conclusion, contrary to widespread reports, this section reveals that *hawaladars* not only trade in money. They also act as brokers in facilitating the cross-border exchange of goods despite the Central Bank's licensing criteria expressly forbidding this function. In its recently enacted laws on money service providers, foreign exchange dealers and *hawaladars* are required to renounce their trading role and remove "trade" or "trading" from the title of their business.

In comparison with Badakhshan, where almost 100% of the liquidity is derived from drugs, Herat's *hawala* market, estimated at in excess of US$ 1 billion, also relies heavily on trade in goods. It seems fair to conclude that in facilitating legitimate trade the dealers also are directly or indirectly facilitating laundering of drug money.

Southern Region–Kandahar and Helmand

Background. Kandahar is home to some of the country's biggest traders. Located at the heart of the Pashtun tribal belt, it is ideally placed in the center of Pashtun trading networks that extend to many of the world's key financial sites. This makes it an important site to explore the links between informal *hawala* networks and the trafficking of drugs. Helmand is also one of Afghanistan's most important border economies and not only produces the country's largest share of opium but also provides some of the most effective opium trading networks both within and out of the country (see Chapter 4). In spite of the aggressive opium crop eradication efforts in both provinces during 2005, it was possible to glean enough data to develop an idea of the extent of drug money laundering in the region.

Structure of *hawala* market. When asked to describe the relationship between Helmand and Kandahar's *hawala* markets, one *saraf* commented, "you may as well see them as one and the same market". This should be borne in mind when comparing the data for each province. In order to gauge the extent of drug money laundering in these provincial sites, a selection of small, medium, and large *hawaladars* was interviewed in both Kandahar and Helmand.

In Helmand there are five relatively important centers for opium traders, some of which are also key sites for *hawala* business. These are:

- Sangin district center
- Lashkar Gah city
- Dishaw district border area (i.e. Baramcha)
- Musa Qala district center
- Grishk district center

Lashkar Gah city and Sangin district were selected for the sample of *hawaladars* in Helmand province because of their strategic and material importance to both the financial and opium markets.

According to the *hawaladars* sampled in both Kandahar city and at sites in Helmand, the median estimated number of significant financial traders "specialising" in the transfer of drug money in both provinces totals 54 (Table 6.6).

Table 6.6: Number of Specialist Drug Money Launderers

Province and city	No of sarafs specialising in drug monetary transfers
Helmand - Lashkar Gar	14
Helmand - Sangin district	15
Kandahar - Kandahar city	25
Total:	54

There was considerable unanimity among medium-large dealers when asked to estimate the percentage of *hawaladars* indirectly or involuntarily involved in drug money laundering. Helmand dealers estimated that 80-85% dealt in drug funds, while Kandahar dealers estimated that 90% handled drug money. These high percentages are not surprising given the level of opium production and trade in the South.

Opium production and trade. The Southern Region accounted for approximately 36% of Afghanistan's total opium production in 2003 and 2004, reflecting large-scale cultivation in Helmand province where the cultivated area fluctuated around 30,000 ha. Helmand consistently held the top position among opium cultivating provinces in most years (1994-2000 and 2005), while Nangarhar to the east was ahead of Helmand in 2003, and close behind in second position in earlier years. Reliable sources indicate that there are not more than 100 large to top-end opium traders in Helmand, and that there are around 300-350 opium traders in total (including small, medium, and large) that use the *hawala* system for monetary transfers.

The fieldwork revealed that "healthy" competition exists between drug traffickers operating in Nangarhar and the Southern Region, and that there is actually more cooperation than rivalry. This may be explained in part by the extensive tribal and family networks linking Nangarhar and Helmand. Drug transfers between these two provinces reflect particularly big deals, which is possibly why only top-end *hawaladars* in Helmand reported drug monetary transfers to Nangarhar.

<u>Destination of drug payments</u>. To begin with, it is helpful to follow one series of drug payments made in a *hawala* shop. Four brothers at the top-end of a *hawala* business in Kandahar revealed that they transfer or exchange approximately US$ 350,000 per day in the shop, and that most drug transfers are sent to Chaghcharan in Ghor province, Uruzgan, and Helmand. During the peak times, over US$ 10 million of drug-related funds and legitimate trade transfers are facilitated monthly. The informants reported that Turkish drug traffickers deposit the payment into their Dubai bank account, out of which they can then buy commodities to import into the country. However, the money is reported to originate in Western Europe, mainly the United Kingdom which has a sizable heroin addiction problem.

With the above exception, every medium-large, medium, and small *hawaladar* surveyed in both Kandahar and Helmand claimed that they remit the majority of drug-related funds to Mazar-i-Sharif (Balkh province) in the North. Opium comes to Mazar from other northern provinces after its purchase by big operators. Most drug traffickers from the Southern Region then either visit Mazar to buy the opium themselves, and pay for it there, or place advance orders and remit payment through the *hawala* system. This is done because of the disparity in opium prices between the two regions. For instance, 4.5kg of opium in Mazar was valued at Afs 16,000-18,000 in 2005, while the same amount was valued at Afs 40,000-50,000 in Kandahar and Helmand. It costs the dealer an additional Afs 7,000 to transport this amount of opium, but he will still make a profit of around Afs 17,000 in one shipment. Funds are thus dispatched to Mazar from the southern *hawala* markets for payment both to those who brought the opium from other northern provinces to sell in Mazar, and to the local dealers themselves.

This corroborates information gathered in Balkh where many *hawaladars* admitted to receiving almost 100% of their funds through the business of drug traffickers. Reports from Badakhshan also confirm Kandahar to be one of the three main sources of drug money for the Northeastern Region (Nangarhar and Peshawar in Pakistan were the other two).

<u>Origin of payments</u>. Each of the *sarafs* interviewed in the Southern Region agreed that drug payments are remitted from Pakistan (and Iran), but that they originate first in Europe and the United States. There is patchy evidence on the method of funds transfer at this stage; however, discussions with formal bankers in Peshawar confirmed reports that money arrives electronically into Pakistani banks. The foreign currency used for drug transfers in the region gives some insight into the origin of payments. *Hawaladars* from Kandahar and Helmand primarily operate with Pakistani Rupees.[6] This provides us with a strong indication that the large bulk of drug payments arrives in Afghanistan via Pakistan. The Southern Region has strong links to Quetta, where most of the payments are made.

UNODC concluded in 2005 that 61% of Afghanistan's opiates are destined for Iran, 20% for Pakistan, and 19% for Central Asia (based on information on the distribution of opium production across Afghanistan, intelligence information on trafficking flows, and seizures of opium in neighbouring countries). While most opiates were apparently destined for Iran, the majority of payments were sent to Afghanistan via Quetta in Pakistan.

Fluctuations. A number of opium traders reported that they hold a part of their annual purchase as reserve stock to enable them to respond to unexpected orders, mainly from international traffickers. The *hawaladars* explained that, because these sales are sporadic, they do not have a major impact on the financial market. Instead, the seasonal aspects of opium production and trade were consistently identified as the key determinants of fluctuations in monetary transfers.

During periods of low drug activity, small *hawaladars* in Kandahar and Helmand receive only Rs 15,000 (US$ 250) per month, while the biggest hawaladars obtain as little as Rs 50,000 (US$ 840). It is not uncommon for some of the smallest sarafs or *hawaladars* to receive no money relating to opium during this period because there is no sale or purchase. They tend to be engaged in the *hawala* business mainly on a seasonal basis, while maintaining a shop or other enterprise full-time.

Transaction volumes. Ten *hawaladars* were asked to estimate their individual turnover and the drug component, along with their estimate of the number of local *hawaladars* who are significant dealers in drug money(see table 6.7). There tends to be significant variation among groups in their reliance on the drug trade. Qualitative statements indicate an even higher reliance on drug funds on the order of 80-90%.

There is a certain degree of consistency in the estimated number of significant drug *hawaladars* operating in each of the districts. However, these figures do not include a considerable amount of business done by many additional dealers who also participate to some degree in the laundering of drug money. When the figures offered by medium-large dealers were shown to other hawaladars in both Peshawar and Herat, the response was that the monthly transaction volumes appeared to be accurate, but that the proportion of drug money was understated.

In Table 6.7 the figures in Table 6.6 are extrapolated to another level to show the total number of significant drug-related *hawaladars* and their aggregate annual drug turnover, which could amount to a total of US$ 1 billion in both Helmand and Kandahar. The figures being of a similar order of magnitude for each province adds weight to the notion that they should actually be treated more as one market to avoid the risk of double-counting. By converting these values to drug volume equivalents (assuming a trading price of US$ 400/kg -- the median between the farm-gate price of US$ 138/kg and the border price of US$ 665/kg, calculated using the assumptions below), the resulting tonnage corroborates UNODC statistics that this area is responsible for the largest share of Afghanistan's opium trade.

[6] This is also the case in Faizabad, Mazar, and Jalalabad; however, most of the foreign currency that enters Nimroz and Herat in the Western Region is in the form of the Iranian Toman.

Table 6. 7: Inflow of Funds and Drug Component in Helmand and Kandahar (2005)

Hawaladar interviewed	Annual turnover (USDm)	Drug component (%)	Drug turnover (USDm)	Estimated no. of significant drug hawaladars
Lashkar Gah City				
L1	126.0	73	92.0	5 - 9L + 20-30 >av
L2	24.2	63	15.1	15
L3	8.5	18	1.5	11
L4	3.0	15	0.5	15
Sangin District				
S1	12.0	60	7.3	5
S2	3.0	91	2.8	8
S3	2.5	73	1.8	12
Kandahar City				
K1	32.2	32	10.3	17
K2	9.7	14	1.3	30
K3	5.9	82	4.8	27

NB: The informants are listed below.

Note: Summary profiles of key informants in Southern Region

L1 Top-end drug *hawaladar* (Lashkar Gah city, Helmand province)
L2 Large drug *hawaladar* (Lashkar Gah city, Helmand province)
L3 Medium drug *hawaladar* (Lashkar Gah city, Helmand province)
L4 Small drug *hawaladar* (Lashkar Gah city, Helmand province)
S1 Large drug *hawaladar* (Sangin district, Helmand province)
S2 Medium drug *hawaladar* (Sangin district, Helmand province)
S3 Small drug *hawaladar* (Sangin district, Helmand province)
K1 Large drug *hawaladar* (Kandahar city, Kandahar province)
K2 Medium drug *hawaladar* (Kandahar city, Kandahar province)
K3 Small drug *hawaladar* (Kandahar city, Kandahar province)

An alternative approach indicates that Helmand could account for roughly US$ 0.8 billion of Afghanistan's drug-related *hawala* business (see Table 6.8), based on the following assumptions:

- the value of opium traded to Helmand is around US$ 100 million (see table);
- Helmand produces 1,000 tons of dry opium;
- the border price is US$ 665/kg;
- the total farm-gate sales are US$ 560 million, calculated by using UNODC's farm-gate price of US$ 138/kg for 2005; and
- the total export value of opium to neighbouring countries is US$ 2.7 billion.

Table 6. 8: Drug Inflows for Helmand and Kandahar Markets in Sample

	Significant drug hawaladars	Annual drug turnover (US$ thousand)	Equivalent drug traded @ US$ 400/kg (tons)
Lashkar Gah	25 - 39	75 - 1,053	188 - 2,633
Sangin	5 - 12	15 - 324	38 - 810
Helmand total*:	30 - 51	15 - 1,053	226 - 3,443
Kandahar total*:	17 - 30	51 - 810	128 - 2,025

*Assuming no double counting is involved.

Table 6.9: Estimates of Quantity (%) and Value (US$) of Opium Traded to Helmand Before Further Sale (2004/05 Harvest)

Province	2004/05 crop (ha)	Yield 2005 (kg/ha)	Total value at av farm-gate price US$ 138/kg (US$ million)	Opium traded to Helmand	
				Quantity (%)	Value (US$ million)
Badakhshan	7,370	41.8	43.7	20 - 40	8.7 - 17.4
Balkh	10,837	38.8	59.7	40 - 60	23.9 - 35.8
Bamiyan	126	38.8	6.9	80 - 100	5.5 - 6.9
Ghor	2,689	41.4	15.8	80 - 100	12.6 - 15.8
Nangarhar	1,093	44.0	6.8	20 - 40	1.4 - 2.8
Nimroz	1,690	41.4	9.9	80 - 100	7.9 - 9.9
Uruzgan	4,605	37.9	24.8	80 - 100	19.8 - 24.8
TOTAL:					79.8 - 113.4

Both approaches indicate the same order of magnitude for Helmand's *hawala* market as it relates to drugs. The large dealers in both Lashkar Gah city and Kandahar claimed that they deal directly with buyers in Pakistan, Turkey, the United Kingdom, and the United States.

Conclusions. Helmand and Kandahar provinces are key trading sites for moving drug-related funds in Afghanistan, both for outbound inter-province transactions and for inbound international transactions. They are not only the country's top producers of opium but also the leading traders. The Southern Region provides government regulators with a formidable challenge. The predominantly Pashtun *hawaladars* are able to sustain an impressive network of loyal and ready partners across the country and further out into the region.

Pakistan ---Peshawar

Background. With steady flows of refugees from Afghanistan to Pakistan during the long conflict, as well as large exports from Pakistan to Afghanistan in recent years, Afghan and Pakistani markets have become increasingly integrated, with linkages only occasionally and temporarily interrupted by political developments.

Structure of the hawala market. While it may not be immediately obvious to the casual observer, the money market at Chowk Yadgar in Peshawar is heavily populated by Afghan *sarafs* and *hawaladars*. As the majority of Afghans working in the markets are of Pashtun origin, to an outsider they are barely distinguishable among their fellow "Pashtoon" people from the North West Frontier Province (NWFP). Part of NWFP consists of autonomous federally or provincially administered tribal areas (FATA/PATA), where the administrative systems differ substantially from those in other parts of the country. This further enhances the freedom to transfer goods and money with impunity.

The usual response to enquiries about the number of money service providers in Chowk Yadgar is generally that "there are too many to count." Several estimates of currency exchange houses on the order of 200-300 have been reported in World Bank and other studies. But the total number is simply too difficult to calculate when one takes into account the many outlets hidden in butcher's shops, the gold market (which is attached to the money market), various bazaars, and so on. It is slightly less difficult to develop estimates, however, of the number of very large *hawaladars* in the city. One gold dealer confided that there are roughly 30 to 35 dealers trading in gold and performing *hawala* transactions, while a recently retired---but young---*hawaladar*, who entered and left the game before he could incur major losses, speculated that there are 10 to 15 significant *hawaladars* in Peshawar, and countless smaller ones. This same informant pointed out that not one of them is self-reliant ---all of the businesses are connected in some way.

<u>Origins and destinations of payments</u>. It is fair to deduce from discussions with *hawaladars* in Afghanistan that their links to Pakistan are crucial for their survival. As has already been demonstrated, a large part of the Afghan market relies heavily on Peshawar and Quetta as a conduit for delivery of money from places further afield. NGOs and other international agencies--- important customers of Afghanistan's *hawala* system---frequently send their funds to Pakistan, where the money is deposited and can be received in Afghanistan only hours later. Peshawar is also a recipient of significant inbound remittances from family members living overseas, in countries such as Germany, UAE, and the UK. These funds are routinely forwarded to other family members who stayed behind in Afghanistan, and provide an important contribution to their subsistence. Of course there are also the drug payments to Afghan traders, which depend to a large extent on in flows from Pakistan.

V. NOTE ON THE FORMAL BANKING SYSTEM

An interesting disparity between the domestic Afghan *hawala* markets and the Pakistani markets is their different degrees of interaction with the formal banking system. While the extent of reliance on formal banks in Afghanistan appears to be rather limited, each *hawaladar* interviewed in Pakistan makes regular visits to at least five or six of the major banks in town. Interviews often had to be arranged around the bank opening and closing times, so that *hawaladars* could make their deposits and withdrawals before the day's end. One of the reasons for the frequent interaction with banks is the banks' strategic location in the main centers of town. Pakistani banks were aware that they would attract important custom if they opened branches in the main business areas, especially in and around Chowk Yadgar and Karkhano market. In Kabul, on the other hand, new banks are being established in an area disconnected from the main business districts, making it difficult for the *sarafs* operating in Sarai Shah Zadar to access them.

Despite the launch of the National Accountability Bureau Ordinance in 1999 that was mandated to increase regulation and awareness of corrupt financial practices in Pakistan, discussions with branch managers revealed that banks in Pakistan are not properly investigating suspicious transactions and client behavior. While it is explicitly forbidden to open and maintain accounts for *hawala* dealers (Jost and Sandhu, 2000, p. 11), bank managers admitted to regularly opening accounts for local *hawala* dealers at the direction of their superiors. On the day of an interview at a bank included in this survey, a customer deposited US$

16.6 million, only to withdraw it again the following day. "We know by their transactions that they're *hawala* dealers," admitted one branch manager; "2-3 million rupees per transaction is simply not routine".

As mentioned earlier, the movement of funds between informal and formal institutions blurs the boundary between the two, making it impossible to separate one from the other. The formal and informal banking systems have become interlocked, just like the licit and illicit markets serviced by the *hawala* system itself. Moreover, as indicated earlier, the linkages of the *hawala* system with the formal banking system do not stop with regional banks but lead indirectly (in terms of the ultimate origin or destination of transfers) to banks headquartered in Europe and the USA.[7]

VI. CONCLUSIONS

There is no doubt that the task of mapping the informal economy and associated money laundering is difficult. As a US Senate Report explained:

> Ultimately, the degree of sophistication and complexity in a laundering scheme is virtually infinite, and is limited only by the creative imagination and expertise of the criminal entrepreneurs who devise such schemes … [In recent years criminals] have mastered the details of modern technology, international finance, and foreign secrecy laws to create a select fraternity of money laundering professionals. As a result, organised crime today uses banks and other financial institutions as routinely, if not as frequently, as legitimate business (US Senate Report, 1986).

An important point is that we should not be looking only at the informal financial systems of developing countries in our search for money launderers, but also at the world's major financial centers. The informal systems of money transfers explored in this study are deeply international and cannot be viewed in isolation from the formal banking sector. Major drug trafficking networks must be seen in the same light. The fieldwork conducted in this study has shown that tracing drug money flows in a country such as Afghanistan is a complicated, time-consuming business.

This chapter has also illustrated how unclear the dividing line is between "licit" and "illicit" transactions. It concludes that most drug-related export revenues are remitted to Afghanistan through the *hawala* system, in the form of either hard currency or commodities, but that these funds do not comprise anywhere near the total amount of funds circulating in the system. On the one hand, the *hawaladar*--who sits comfortably as a lynchpin at the intersection of "licit" and "illicit" transactions--delivers much-needed funds to people with few alternative means of survival, while on the other he provides the cover of anonymity and an opportunity to launder money.

Hence this chapter must conclude that the *hawala* system in Afghanistan is central to processes of development as well as to the laundering of drug money. It would be virtually impossible for a country like Afghanistan to piece together its shattered economy without relying on this kind of informal financial system. Although only occupying small shop fronts, the *hawala* system is immense, transmitting millions of dollars outside of formal legal reckoning through familial ties, ethnic linkages, and important business partnerships. It remains, legally and morally, an indeterminate grey area where the money changing hands straddles numerous illicit/licit boundaries. Like any other financial market, it is a place where fortunes are won and lost, and those willing to take risks are rewarded accordingly.

As long as Afghanistan depends on the *hawala* system, the door for large-scale money laundering activities remains wide open. Policy makers should thus aspire to develop over time a fully functioning banking system consistent with the Financial Action Task Force on Money Laundering (FATF) guidelines. However, they must also recognize that there will be no quick transition, and that any new banking system has to be developed in a manner that is sensitive to the needs of an emerging licit economy in Afghanistan. The application of rigid rules in this context could turn out to be counter-productive. The business sector and the general public will still have to be convinced of the advantages of a modern banking system. In the meantime, it is also clear that Afghanistan will have to live with its traditional *hawala* system. While recognizing the likelihood of abuse of the *hawala* system for illegal business activities, such as drug-related money laundering, it is also clear that without the *hawala* system, the provision of even basic financial transfers could not be guaranteed in Afghanistan for the time being.

Main Findings

The main findings of this chapter are briefly outlined below, followed by a summary of policy implications. The field research found substantial evidence that the *hawala* system does facilitate the transfer of drug-related funds in Afghanistan. *Hawaladars* reported turnover of the highest order during the two phases of opium cultivation and harvesting. In an attempt to assess roughly the extent of drug money in the *hawala* system as a whole, the chapter offers a provincial breakdown by dealer size and proportion of total financial transactions related to drug money. It was confirmed that in the settlement process the dealers are heavily reliant on formal banking channels throughout the region.

Each of the four sites selected for fieldwork provided a different perspective on the laundering of drug funds, which demonstrates how difficult it is to gain a sense of the aggregate drug money laundering problem in the country. The field research in Faizabad, for example, indicated that during certain times of the year close to 100% of the liquidity in the province is derived from drugs, while in Herat it was estimated that only 30% of the *hawala* market's overall transaction volume was directly linked to drugs. The data gathered at sites such as this, where trade in legitimate goods is the province's primary source of revenue, was complicated by confirmed links between drug money and legitimate imports.

Helmand province has emerged as a key facilitator of the opium trade, both between provinces and exports, while overall estimates of the local *hawala* markets' drug-related component were of a similar order of magnitude to those in Kandahar. This finding adds weight to the notion that the major trading centers in these two neighbouring provinces should be treated as one market. Treating them separately may lead to a risk of double-counting. Bearing this in mind, the study calculated that Helmand could account for roughly US$ 800 million of Afghanistan's drug-related *hawala* business and that Herat is the second largest contributor, with in the range of US$ 300-500 million of drug money laundered annually.

[7] As Ballard (2003, p. 20) notes: "…the implementation of these verbally negotiated hawala swaps not only takes place within the formal sector, but most usually involves wholesale transfers into or out of individual or corporate accounts held at the New York headquarters of one or other of the United States' major international banks.

The southern region (Helmand and Kandahar) is a key center for money laundering in Afghanistan: about 60% of the funds are drug related and 80-90% of the *hawala* dealers in Kandahar and Helmand are involved in money transfers related to narcotics.

Furthermore, Dubai appears to be a central clearing house for international *hawala* activities (see FATF, 2005, p. 16, and Ballard, 2003, p. 14). In addition, various cities in Pakistan, notably Peshawar, Quetta, and Karachi, are major transaction centers.

Overall, the chapter confirmed that the *hawala* system has been key to the deepening and widening of the "informal economy" in Afghanistan (see World Bank, 2005), and has provided the cover of anonymity and opportunity to launder money to those wishing to abuse the system. However, the results of the survey should also be viewed in light of the positive contributions of the *hawala* networks. The system has been central to the survival of Afghanistan's financial system through war and, as demonstrated by Maimbo (2003), "integral to processes of early development and vital for the continued delivery of funds to the provinces". The *hawala* system also plays an important role in currency exchange. It participates in the Central Bank's regular foreign currency auctions, and was instrumental in the successful introduction of a new currency for Afghanistan in 2002-2003.

Policy Implications

In drawing up an appropriate policy response to the *hawala* system, it is crucial for policymakers to:

- **Recognise the positive impact of the *hawala* system on Afghanistan's economy and society.** Without its transfer mechanisms, basic assistance could not have been delivered to people in need, during either the civil conflict or the reconstruction process.

- **Involve *hawala* dealers in the policy process.** They are among the most knowledgeable stakeholders in the economy, and their knowledge should be drawn on in designing and planning the reconstruction of Afghanistan. Contrary to existing reports on there being a democratically elected group called the Money Exchange Dealer's Association, *hawala* dealers claim that those members were self-appointed and hence not legitimate. Any selection process must be designed to ensure proper representation.

- **Develop real incentives for compliance with current registration and taxation initiatives.** *Hawala* dealers have had an adversarial relationship with corrupt law enforcement and tax authorities. This needs to be reversed through progressive building of trust between *hawala* operators and government officials.

- **Enhance the effectiveness of the Central Bank's registration program.** Explore opportunities to use the information supplied by dealers in the registration process, and develop a way of measuring the benefits of registration.

- **Ensure that the assistance and business communities are diligent in their use of the *hawala* system.** Proper checks on dealers should be made in order to protect their transactions from becoming intermingled with illicit transfers. Currently, agencies select dealers on the basis of their speed, efficiency, and reliability rather than their accountability.

- **Encourage genuine anti-money laundering compliance in countries with banking links with Afghanistan including Pakistan and Dubai.** While they have publicly agreed to the FATF standards, evidence on the ground suggests that implementation still needs to be strengthened.

- On the other hand, **the FATF guidelines must be viewed within, and if necessary adapted to, the Afghan context.** There is a risk that international banks, applying FATF guidelines in an inflexible way, could alienate the local population. The reality is that 74% of the population is illiterate (including 91% of women), and that most Afghans lack formal identification papers. Under such conditions, demands for strict adherence to FATF guidelines could be counter-productive and would hinder large-scale transfer of financial business to the formal banking sector.

The chapter recognises that there is no immediate or single fool-proof solution to the problem of drug money laundering through Afghanistan's *hawala* networks. Because of its cross-sectoral nature and reliance on regional partners, a combination of interventions is required to deal with the problem satisfactorily, without causing too much collateral damage. These would include:

- **Sustained, effective measures against the opium economy:** the strategy for reducing its size must be gradual and based on proper sequencing of development and law enforcement.

- **Growth of the legal economy:** this will require the identification and development of international markets for Afghanistan, especially for agricultural products.

- **Tightening of the financial system domestically and in neighbouring countries:** a coordinated regional response is fundamental to the fight against money laundering.

Policymakers should aspire to develop a fully functioning formal banking system along the lines of the FATF, while at the same time recognising that this will not be a quick transition, and that it should be done in a manner that is sensitive to the needs of the local people.

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