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Systems and  
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A study into so-called  
underground banking networks

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# Informal Value Transfer Systems and Criminal Organizations; a study into so-called underground banking networks

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## Preface

This study was commissioned by the Research and Documentation Centre of the Ministry of Justice on the advice of the Advisory Committee for Research on Organized Crime.

With increasing regulation of the conventional banking sector in the Netherlands and elsewhere, a strong concern has been voiced about the actual or potential use of so-called "underground banking systems" by criminal organizations. Calls have been made for new measures to deal with this problem, some of them drastic. So, the chief objectives of this preliminary study were to find out whether 1) publicly available evidence supports this concern and 2) how are governments around the world responding to the issue. This would lead to policy recommendations to be considered by the Dutch government.

Before investing in a longer research project designed to collect original empirical data, it was decided to proceed first with a careful review of the existing literature, in order to establish what is known and what is not. This cautious first step was deemed necessary given the dearth of previous research on this relatively misunderstood topic. The sources we explored included press reports, government agency documents, public hearings, academic articles, and legal cases, court documents, and articles posted on the internet. The critical review of this material was complemented numerous unstructured interviews with law enforcement and other experts from all continents. All research and analysis took place within a period of three and a half months. In the light of the time and budget constraints, this study must be considered as preliminary, particularly because it was found that additional data can be made available for further and more in-depth research on the subject. These materials (cases, court documents, internal memoranda, intelligence reports, etc.) are held primarily by law enforcement and regulatory organizations around the world, especially in the USA, France (collected by Interpol), Great Britain, Australia, Hong Kong, India, and elsewhere. What was found from this study was, nevertheless, sufficient to establish the basic facts and to dispel a number of myths surrounding these informal banking networks.

The ultimate aim of producing policy-relevant information has been pursued in three steps. Firstly, we sought to develop a good understanding of "underground banking" operations, their origins, contemporary forms, and the factors contributing to their continued popularity. Secondly, we attempted to synthesize the available evidence on the interface between such operations and criminal actors. Thirdly, because the problem is for the most

part transnational, we tried to find out how several countries are currently dealing with this problem. The concluding part of the report summarizes the research and policy implications of our findings.

All of the interviewees, who are listed in the appendix, have been extremely helpful. Some of them, however, were particularly obliging. Ezra C. Levine, a lawyer with the Howrey and Simon firm in the USA, provided us a written

detailed response of the industry to proposed regulations for non-bank money businesses in the USA. Peter Djinis (FinCEN) was kind enough to send us transcripts of public hearings on the same issue. Bonnie Klapper (Assistant US Attorney, N. District of NY) spent a morning with us and supplied court documents on black market peso cases. The Hong Kong Police Force sent in a report answering a set of questions on the situation there. Lisa Carroll (Interpol and Sam Houston University) shared some of her materials and spent time on telephone interviews. Willard Myers, the director of the Center of Asian Studies, made himself available a whole evening for a discussion of Chinese "underground banking" in the USA and provided a report summarizing his database and knowledge on the issue at hand. Matt Miller (writer for the *Institutional Investor*) made time for interviews and shared his findings from a trip to Pakistan, as he prepared an article on "underground banking" for his magazine.

Most grateful I am to three exceptionally helpful persons. Patrick Jost (FinCEN) devoted many hours to this project, including several interviews in person and on the telephone, a day-long seminar based on material he has been collecting for years on the subject, and countless e-mail communications. Rick McDonell (FATF Asia, Australia) responded graciously to a very long telephone interview, suggested contacts persons in Hong Kong, participated in several e-mail exchanges and faxed a lengthy report furnishing the Australian experience and response. Detective Superintendent Nick Jackson (West Yorkshire Police, England), with whom I spoke extensively and repeatedly on the telephone. He not only sent in a paper of his outlining the problem from the British perspective, but also wrote another paper answering specific questions related to this project.

Finally, I am most grateful to my research assistants, Rob Dovidio, Kelly Lawlor and Hildrun Passas, for their wonderful collaboration and hard work.

# Contents

<b>Preface</b>	<b>1</b>
<b>Contents</b>	<b>2</b>
<b>Abbreviations</b>	<b>2</b>
<b>Executive summary</b>	<b>1</b>
<b>1 Introduction</b>	<b>7</b>
1.1 Definitions: "underground" banking or Informal Value Transfer Systems?	9
<b>2 The origins of IVTS</b>	<b>13</b>
2.1 Hawala/hundi	13
2.2 Chinese IVTS – fei ch'ien	16
2.3 Chits and chops	17
2.4 "Facts by repetition" and other inaccuracies regarding IVTS moduli operandi	20
2.5 The Colombian black market for pesos	23
<b>3 Causes for continued use of IVTS</b>	<b>27</b>
<b>4 Where IVTS can be found</b>	<b>31</b>
4.1 Paraguay	31
4.2 Surinam	31
4.3 Jamaica	31
4.4 Trinidad and Tobago	32
4.5 Turkey	32
4.6 Nepal	32
4.7 Hong Kong	32
4.8 Japan	33
4.9 Thailand	34
4.10 Sri Lanka	34
4.11 Canada	34
4.12 USA	35
<b>5 Use of IVTS by criminals</b>	<b>37</b>
5.1 Intellectual property/piracy	37
5.2 Arms	38
5.3 Drugs	38
5.4 Smuggling of illegal immigrants	39
5.5 Kidnapping	40
5.6 Tax evasion/currency control law violations	40
5.7 Illegal trade in body parts	40
5.8 Money laundering	40
5.9 Intelligence operations	41
5.10 "Trading with the enemy"	41
5.11 Corruption	42
5.12 Corruption/terrorism	42
5.13 Fraud	43
5.14 Effects of IVTS	43
5.15 Criminals' alternatives	44

<b>6</b>	<b>Extent, growth and concern</b>	<b>47</b>
6.1	Extent and growth	47
6.2	Concern	51
<b>7</b>	<b>Measures taken</b>	<b>53</b>
7.1	The Netherlands	53
7.2	United Kingdom	54
7.3	Germany	55
7.4	USA	55
7.5	Canada	57
7.6	Jamaica	58
7.7	Colombia	58
7.8	Australia	58
7.9	Singapore	59
7.10	Taiwan	59
7.11	South Africa	59
7.12	Hong Kong	60
7.13	China	61
7.14	Japan	61
7.15	Philippines	62
7.16	Vietnam	62
7.17	India	62
7.18	Pakistan	63
<b>8</b>	<b>Research implications</b>	<b>65</b>
<b>9</b>	<b>Conclusions and policy recommendations</b>	<b>67</b>
9.1	Regulatory measures	68
9.2	Criminal law	69
9.3	Public policy measures	70
9.4	Training issues	71
9.5	Organizational measures	71
9.6	Evaluation methods	71
	<b>References</b>	<b>73</b>
	<b>Appendix 1 List of interviewees</b>	<b>81</b>
	<b>Appendix 2 Search items</b>	<b>83</b>
	<b>Appendix 3 Additional sources consulted (not included in the references)</b>	<b>85</b>

## Abbreviations

AUSTRAC	Australian Transaction Reports and Analysis Centre
BCCI	Bank of Credit and Commerce International
BSA	Bank Secrecy Act (USA; official title: Currency and Foreign Transactions Reporting Act 1970, Public Law No. 91-508, Title II).
CMIR	Currency or Monetary Instruments Report (in USA)
CTR	Currency Transaction Report
CSDB	Closed Source Database
FATF	Financial Action Task Force
FBAR	Foreign Bank and Financial Account Report (USA)
FBSO	Federal Banking Supervisory Office (Germany)
FCBC	Foreign Currency Bearer Certificates (Pakistan)
FEBC	Foreign Exchange Bearer Certificates (Pakistan)
FinCEN	Financial Crimes Enforcement Network (USA)
GTO	Geographic Targeting Order
IMF	International Monetary Fund
IRS	Internal Revenue Service (USA)
IVTS	Informal Value Transfer Systems
OGD	Observatoire Géopolitique des Drogues (Paris)
PRC	Peoples' Republic of China
SAR	Suspicious Activity Report
USC	United States Code
URC	Unregulated (or Unlicensed) Remittance Centres (operating in Hong Kong)





# Executive summary

This report presents the findings of a preliminary study into what is commonly called “underground banking systems”. The study was funded by the Research and Documentation Centre of the Dutch Ministry of Justice, which acted on the advice of the Advisory Committee for Research on Organized Crime. As the conventional banking industry is increasingly being regulated, many fear that criminal organizations may turn to alternatives, such as “underground banking systems”, in order to avoid detection. The main goals of the study were to provide a policy-useful analysis of the way in which such systems operate, the extent to which criminals may resort to their services, and the policies adopted by different governments.

This relatively short study did not start with many ambitions of generating new and original data. Rather, the objective was to take stock of what is known about the issue, to separate myths from reality about the problem, and to offer a first assessment of the risks posed by “underground banking systems”. This should give a good indication as to whether urgent measures need to be taken or more research is necessary before considering any policy or legislative adjustments.

The methods for this project consisted in a combination of archival, legal and historical analysis with unstructured interviews with regulators, law enforcement agents and academic or other experts from the USA, Canada, Britain, France, Australia, Hong Kong, Germany, South Africa, India and Russia.

First of all, an attempt is made at conceptual clarification. There are many terms to describe the practices in question – e.g., hawala, hundi, fei ch’ien, – depending on the ethnic group involved. These practices do not involve traditional banking transactions or services, like deposit taking or lending. Instead, these are essentially mechanisms serving the transfer of value from place to place. Moreover, they are not at all “underground” in many parts of the world. In many cases, it is, therefore, suggested that the term “informal value transfer systems” (IVTS) is more appropriate for our purposes than “underground banking”. IVTS is defined as any system or network of people facilitating, on a full-time or part-time basis, the transfer of value domestically or internationally outside the conventional, regulated financial institutional systems.

Most contemporary forms of IVTS have evolved out of two main variations, the South Asian and Chinese methods of value transfer, both of which originated centuries ago. Following a presentation of the historical roots and evolution of these two prototypes, a more contemporary Colombian modus operandi is outlined, which emerged in the context of the black market for pesos. The mechanics of each of these IVTS are briefly sketched, while six contemporary variations are both described and graphically represented. The most basic method is when a client wishes to send money to a relative in another country. He gives it to a local IVTS agent, who calls or faxes instructions for payment to his counterpart in the relative’s city. His

counterpart makes the payment in a matter of hours and balances his account with a transfer in the opposite direction. When the transfers are of unequal value, from time to time the IVTS agents may wire transfer the difference. More complicated ways of balancing the books involve invoice manipulation and trade in consumer items, gold or other commodities. Unfortunately, a lot of the conventional wisdom was found to be misleading or false. Contrary to widespread beliefs that IVTS sprung from political turmoil or that they began as ways of violating currency controls and other laws, their origin was found to be rather benign. They served people well before the development of modern banking institutions, they facilitated legitimate trade or other transactions, while protecting against robbery and theft in highways. They were so widely accepted that they became integral elements of the culture in Asian countries and communities of immigrants. Other errors in conventional wisdom include the assumption that IVTS are usually surrounded by violence and corruption, and that high technology may be used in the near future for more secrecy and confidentiality. The evidence suggests that typical IVTS operations are smooth, consensual and require only low technology, such as a telephone or fax machine. Such inaccuracies in conventional wisdom come about by a process described as "facts by repetition". That is, erroneous statements were included in widely circulated articles, which were later reproduced in other media articles, government reports, academic publications, and even United Nations documents. This problem, which is regrettably common in analyses of transnational and other serious forms of crime, points to the need for critical reading of internet and other publications, as well as the importance of triangulation.

As Asian ethnic groups immigrated to the four corners of the earth, the necessary infrastructure for IVTS expanded. Many factors contribute to their popularity as remittance methods among certain ethnic groups to this day. They range from the absence of conventional banking facilities in many parts of the world to the distrust in ordinary banks or government policies, discrimination, currency controls, and the confidentiality of IVTS. Many people resort to IVTS because they simply follow cultural traditions or simply because their services are faster, cheaper, less bureaucratic and more convenient than any other alternative.

Although IVTS originated in Asia, they are now found to operate in every continent. The extent of IVTS operations is highlighted in the report by reference to media and government publications regarding several countries. Given the wide availability and convenience of IVTS together with the anonymity they offer, it is no wonder that intelligence agents and criminals also enjoy their services. Indeed, evidence is cited in this report of use of IVTS for the facilitation of capital flight, tax evasion, covert operations, corruption, intellectual property violations, ransom collection, financial fraud, terrorism, smuggling of illegal immigrants, money laundering, as well as illegal trade in drugs, body parts, arms or commodities. Case examples for each type of such illegal transactions are given from various countries – with a word of caution about the reliability of many journalistic or other sources that were not triangulated in the short period of this study.

It is by no means suggested that IVTS are infested or controlled by criminals. All that can be proven is that IVTS is no more than one of numerous alternatives available to individual offenders and criminal organizations. As a matter of fact, it appears that other options money laundering or transfers are preferred by criminal organizations, as IVTS cannot handle easily or at all the substantial amounts of money generated by illegal enterprises. These alternatives include conventional banks, insurance companies, non-bank financial institutions (e.g., bureaux de change and money remitters), real estate and gold transactions, and currency smuggling.

An area of substantial controversy is the extent and growth of IVTS business. There are no reliable estimates and no hard evidence for proper assessment. Consequently, many of the figures that have been put into circulation by reporters or government agencies either come out of thin air or are based on anecdotal evidence. The best we can do is probably clearly establish all the conditions contributing to the use/growth of IVTS and then conduct studies inquiring into the existence and strength of such factors. Interviewees of equal standing and integrity have argued in opposite directions. There is wide agreement that what is known constitutes only the tip of an iceberg. For some observers, though, this iceberg is much bigger than for others.

Nevertheless, it has been persuasively argued that IVTS are unable in most cases to transfer very high amounts of money, while many criminals find that money laundering is not necessary, as it can be easily integrated in local economies. These facts, together with the availability to criminals of many other alternatives, suggest that the IVTS-related crime and other risks may have been exaggerated.

Authorities in Third World countries have been concerned about negative effects of IVTS to their economy and government policies. Capital flight and tax evasion, in particular, have worried officials in the South for a long time – although it must be added that IVTS also perform useful functions in times of crises, as they provide safety valves and added liquidity. The more recent official concerns in Western countries stem from the perception that IVTS are increasingly becoming a vehicle for money laundering and other offenses. So, as IVTS generally do not break any laws in the West, they had been left more or less alone in the past. The war on drugs and the anti-money laundering movement have changed this. Yet, the newly found agreement that IVTS is an issue is neither founded on solid evidence nor has it led to harmonized policy approaches.

Many IVTS practices are misunderstood and treated with suspicion even when nothing illegal or unethical is involved. The lack of unified approach is due to the diverse interests of the West and the South. The best illustration of the problem is when South Asian countries tried to discourage the use of IVTS by advertizing bearer bond certificates with no questions asked about the origin of the money. This de facto facilitated the laundering of dirty money, exactly the problem for which IVTS are now targeted in the West. Such misunderstandings and lack of policy co-ordination may be remedied through careful studies into IVTS and their effects on society and wide dissemination of the results. Better awareness of the respective concerns, national interests and policy priorities can pave the way for improved collaboration among national and international control bodies.

In order to further this aim, the report also provides a brief overview of laws and practical measures taken by a number of countries. In general terms, Western governments have attempted to render IVTS more transparent and required them to get a license and report or record unusual transactions of certain magnitude. In the West, IVTS-related policies are closely linked to the issue of money laundering, and governments have not taken any specific action against IVTS. Some of these measures may actually affect certain formal and regulated business, which would be faced with additional operating costs. For this reason, proposals for further regulation of non-bank financial institutions in the USA have been met with strong opposition by money remitters, such as Western Union and American Express (the dialogue between the authorities and money remitters on the proposed rules continues). In the South, on the other hand, governments have tried to take money out of the informal economy and bring business to their (often inefficient) conventional financial sector by encouraging non-resident citizens to invest in bearer bonds with tax and other privileges. They have also liberalized (at least partly) the gold trade, which is intimately linked with many Indian and Pakistani IVTS operations. Yet other countries, such as China, have attacked the whole unofficial banking sector, but not specifically the IVTS businesses (which essentially bring value into the country).

The extent and consequences of IVTS seem to vary significantly from country to country. Therefore, it makes sense for each country to review carefully the facts, risk and interests involved before making policy decisions and implementing measures that might backfire or prove to be overkill. Country studies could employ archival/historical analysis along with participant observation methods and in-depth interviews with knowledgeable controllers and citizens. In addition, import and exports statistics can be analysed for the detection of invoice manipulation indicative of IVTS activity. Finally, where available, remittance patterns can be analysed in order to ferret out any transfer of value out of a given country that corresponds to amounts larger than the legitimate income of the senders.

There is no doubt that IVTS are used by criminals. However, an important, albeit preliminary, conclusion is that IVTS do not seem to represent a cause for grave concern in the Netherlands and most countries. Spectacular and publicized cases involving criminal abuses of IVTS appear to be atypical and, thus, should not lead to hasty decisions and draconian measures. Some measures may be counterproductive or involve unnecessary invasion of innocent people's privacy. They may also give the impression that the cultural traditions underpinning IVTS are unfairly attacked. So, before implementing drastic measures, more solid evidence of negative consequences is required. The legislative arsenal in the West can adequately deal with those who have committed crimes. After all, criminals are the main problem, not the way they move their money.

Criminal laws appear to be the least effective way of dealing with IVTS. Some have recommended the extension of money laundering legislation (e.g., know your customer rules) to cover IVTS. Critics point out that the operation of IVTS will be unaffected, while more people (clients) would be needlessly criminalized. It is also essential to bear in mind that IVTS are often the only

channel through which immigrants can send funds to assist their families in the homeland.

The report concludes with a host of regulatory, public policy and training issues that may be considered. The most effective policies would be those going to the heart of the problem: government over-regulation, discrimination, political and economic crises, inflexible bureaucracies, high taxes, unfriendly, inefficient, expensive or lacking banking services, lack of confidence in a given country's economic system and banks. In the South, the most effective measures seem to be improvements of the formal banking sector, consistency in economic and other public policies, a higher degree of economic liberalization (especially with respect to precious metals, interest and currency exchange rates) and fewer currency and other regulation. To be sure, these are long-term objectives. In the meantime, regulations may be extended to cover IVTS activity, but care ought to be taken to avoid the application of ethnocentric rules that may alienate ethnic groups. Licensing or record-keeping requirements can be contemplated and discussed openly with representatives of the communities concerned. Banking institutions may also be approached to assist with the detection of IVTS suspicious or unusual transactions (many IVTS hold bank accounts).

Police need also to be trained to be more sensitive to other cultures as well as to be able to identify IVTS patterns and irregular (possibly criminal) transactions.

Finally, given that the issues are mostly international in nature, better collaboration and exchange of information among control agencies is needed. This can be achieved by paying attention and respecting in practice the interests, priorities and policies of all countries concerned.

The report ends with the recommendation that, regardless of what measures and policies a government opts for, evaluation tools should be provided, in order to monitor the progress, successes and failures as objectively as possible.



# 1 Introduction

Since the late 1980s, officials in many countries have been expressing a concern that, with the increasing regulation of banks and financial institutions, criminal entrepreneurs are turning to alternative means of money transfers and the laundering of criminal proceeds, especially in Western countries where anti-money laundering measures came into force (Blackhurst, 1988; Bosworth-Davis and Saltmarsh, 1995; Carroll, 1995; Elliott, 1991; Evans, 1997; Nove, 1991; Savona and Defeo, 1994). Among the non-bank alternatives, the so-called underground banks or alternative banks are repeatedly cited as a most likely candidate (alongside money exchange houses, check cashing services, insurance brokers, mortgage brokers, importers, exporters, precious metal dealers, casinos and express delivery services; Bureau for International Narcotics and Law Enforcement Affairs, 1996). By the term "underground banks" reference is most frequently made to unregulated and opaque methods of transferring money or value from place to place. Such methods have been used for a very long time by various ethnic groups, primarily for quite legitimate purposes and transactions. The confidentiality and anonymity of underground banking appears to be a significant incentive for drug traffickers and other serious offenders to use these channels, as the conventional banking avenues become more supervised and monitored. Therefore, the fear is that, to the extent that criminals turn to such alternatives, the effectiveness of anti-crime and anti-money laundering measures may be undermined.

## *Structure of the report*

This report aims at summarizing and analyzing the available information about "underground banking systems" and their use by criminal entrepreneurs. After briefly discussing the methods employed for this research, an attempt is made at conceptual clarification. It is suggested that the term "informal value transfer systems" (IVTS) may be more appropriate for our purposes than "underground banking". The next section outlines the historical origin of such systems, concentrating on the South Asian, Chinese and Colombian networks. The mechanics of each of these IVTS are briefly sketched before turning to the main reasons these *modi operandi* are popular among certain ethnic groups to this day. The report then highlights the extent of IVTS use by citing evidence from several countries. The next section examines the evidence of the use of IVTS by criminal entrepreneurs and provides case examples for each type of illegal transactions. The report then proceeds to a presentation of the alternative methods employed by criminals and a discussion of the extent and growth of IVTS business, as well as the public concern it causes around the world. The following section outlines legislative and policy responses to IVTS by a number of governments. Finally, the report concludes with research and policy implications.

### *Methods*

This study has combined historical and archival research with in-depth and short interviews with practitioners and researchers from around the world. Most of the data on which the present report is based come from a review of the literature in social sciences, legal periodicals and journals, documented cases, media articles and government reports. In the light of many exaggerations and contradictions found even within single documents, a critical analysis became necessary, in order to establish the internal consistency and credibility of various sources. In the course of this analysis, it emerged that inaccurate or de-contextualized information found its way into academic and policy writings, contributing thus to the creation of false conventional wisdom.

In the task of separating “information” from facts and knowledge, the interviews as well as the review of some legal cases in the USA and Britain were of vital importance. A number of in depth interviews have been conducted with officials from the USA, Canada, Great Britain, Australia, Hong Kong, South Africa, and France. Short interviews have also taken place with practitioners and academics in other countries (e.g., China, Germany, Russia).

Nevertheless, in the short period of this preliminary study (three months), it has not been possible to triangulate every single detail or description of particular cases and events. This is especially the case with reports on the incidence and prevalence of “underground banking” in different countries. The reader is thus invited to treat the corresponding parts of this report with caution.

From the evidence we collected, it became quickly apparent that some criminal organizations do use “underground” or alternative banking channels. However, a lot of material and valid data are scattered in agencies around the world. In most cases, it is found in police files considered sensitive and not shared with the academic community<sup>1</sup>.

The main issue, thus, is whether the available empirical evidence and experience justify the official concerns. If so, what are the most effective measures to be adopted? If the concerns are out of proportion, one would have to assess the risks posed by the introduction of additional rules and regulations aimed at curbing or controlling these traditional methods of value transfer.

<sup>1</sup> FinCEN and Interpol, for example, have very substantial material, which can be made available for the purpose of review and analysis on behalf of the Ministry of Justice. However, before this takes place, both agencies have requested contacts with concrete individuals working for the MoJ, with whom they have a working relationship. Within the limited period of time available for the present study, despite our best efforts, this bureaucratic procedure was not completed successfully.



## 1.1 Definitions: “underground” banking or Informal Value Transfer Systems?

“Underground banking” is also described as informal banking, unregulated banking, quasi-banking, alternative banking, alternative remittance systems, and parallel banking. In many instances, the literature refers to the terms employed by different ethnic groups, such as hawala, hundi, fei ch’ien, chi[t]i banking, etc. Sometimes, the jargon includes terms used by Westerners to describe Asian practices, such as “chop shop banking”. All these terms are used most of the time interchangeably. Although the expression “underground banking system” is by far the most prevalent, it appears to obscure more than it illuminates. Essentially, all three words are inaccurate. It is not always underground; banking is rarely involved, if ever; and it is not a single system.

Firstly, it is important to recognize that certain alternative banking systems operate quite openly. In countries where there are restrictions or the practice is banned, this is certainly not the case. Yet, in many countries and regions, there is little or nothing “underground” about them. For instance, in India or Pakistan, it is very easy to find hawala bankers in the street market. The same applies to some US-based operators, particularly those who do not get involved in illegal money. In many instances, hawala operators advertise their services in the ethnic press. As one interviewee put it, “give me a couple of days and I will tell you exactly where you can find them” in Europe or in the USA.

Secondly, the practices law enforcement agents have in mind when they talk about “underground banking” do not involve any proper banking activity. A review of common definitions reveals that the focus of attention is on the transfer of value, which is far from the defining characteristic of the conventional banking industry. According to the Australian National Crime Authority, for instance, “underground banking is an unofficial (or parallel) banking system..., which enables funds to move from one country to another without production of a paper trail” (NCA, 1991: 35). These informal “bankers” do not take deposits nor do they extend loans and credit to their customers<sup>2</sup>.

Carrolls’ definition of “alternative banking” is a “system which is subject to no external auditing, control or supervision, whereby money or value can be transferred from one country to another” (1995: 3). Schaap and Mul (1995)

<sup>2</sup> There are “proper” underground banks in many parts of the world, which engage in exactly this type of informal banking and finance. These banks range from the traditional neighborhood loan shark to sophisticated, albeit unregulated, financial institutions. In Taiwan, for example, where even the government admits that the underground economy is about 40% of its official GNP, such underground/unregulated banks are numerous, well established, and offer lending facilities at very competitive terms (Economist, 1993; Asiamoney, 1993). Despite government efforts, underground finance is still thriving in South Korea, where consumer credit is in short supply or expensive (Yu, 1995). This, however, is different from the money transfer business that has officials around the world concerned (this does not mean, of course, that underground banks are not connected to criminal enterprises, corruption or other problems; see Asiamoney, 1993 about Taiwan; see also Kaplan and Dubro, 1986 about Japan).

define the term as “a commercial activity involving the transfer of money across national borders through a non-bank institution or organization”. This definition has been largely adopted by the Akse (1996) report, with the important addition that underground banking did not emerge in order to transfer criminal money. Yet, even this definition is not without limitations.

- There may be no commercial activity underlying the transaction (i.e. money sent to a relative who is studying or touring abroad).
- Sometimes it is not money, but commodities or other items that are transferred, such as gold, electric appliances or computer equipment. Some interviewees in the USA suspect that diamonds may play an important part in the Netherlands.
- The transactions are not always international; they can also be domestic.
- Sometimes, the transfer takes place through no organization or institution. It can be as simple as two individuals, a family or a small network of people.

Thirdly, we can hardly speak of a single underground “system”. Each geographic area and ethnic group engages in different non-bank transactions and value transfers. Most accounts of unconventional (legal and illegal) value transfers focus on India, Pakistan, Dubai, Southeast Asia and China. Yet, there are remittance systems connecting various Western countries with Colombia, Surinam, the Dominican Republic, Belize, Jamaica, several African countries, etc.

The “informal bankers” range from corner shop owners to operators of giro houses, bureaux de change, brokers, wire services, other conventional money transmitters, and money changers to the more stereotyped hawala banker. Occasionally, the existence of multiple systems and networks is acknowledged, but then the authors of reports go on to use one term, hawala, as a generic descriptive term (Commonwealth Secretariat, 1998). This usage may be convenient, especially in the light of many similarities in methods. However, it is important not to lose sight of substantial differences in the various practices (see below; also, Carroll, 1999).

Moreover, each of these systems operates for the most part independently and relies on its own trust-bonded networks. Although it is conceivable that various networks could potentially interface, there is neither evidence nor speculation about it<sup>3</sup>. Some networks interface a great deal with conventional business, organizations and people, while others are capable of operating entirely on their own.

So, the central issue here is essentially with methods of money movements outside the institutional channels, which are supervised and monitored by government authorities. In a general sense, this report could focus on non-bank and non-financial institution methods of transferring money or value from place to place. Some of these channels are regulated, while others are not (some people argue that the main feature of “underground banks” is that

<sup>3</sup> In Hong Kong, however, there are cases where a transaction in a country in which a given remittance provider does not have a network can be completed through another remittance center; “The second business will offer their service at a discount to the trader, who absorbs all of the additional costs” (Carroll, 1995: 41).

they are unregulated; yet, some of them are). Some of them are completely legitimate and legal, while others are not. A good deal of the confusion and inconsistent use of various terms originates from the objective of those writing about alternative banks. Overwhelmingly, this objective is to find out how criminals launder dirty money. Once some vehicles for money laundering are identified, they are all placed in the same basket of “underground banks” (for example, see some contributions in Savona, 1997). I think this is a path full of pitfalls and does not lead to conceptual clarity and good understanding of the problems. Not every informal financial system is conducive to criminal activity or exploited for illicit purposes (e.g., there are many instances of perfectly legitimate informal banking systems in Africa; see Nwanna, 1998).

The reasons why I am reluctant to use even the word “alternative” are that some of these systems predate the conventional banking systems and because in many parts of the world these “alternatives” are actually the rule – the formal banking system is the exception, the “alternative” system (Choucri, 1986). FATF has provided a description quite faithful to the practices of interest here, when it stated that: “Several members reported significant use of hawala, hundi or so called “underground banking”, as well as other systems. This system is almost always associated with ethnic groups from Africa or Asia, and commonly involves the transfer of value between countries, but outside the legitimate banking system.” (FATF, 1997: par. 28). Consequently, the term “informal value transfer systems” (IVTS) has been adopted for this report. This will refer to any system or network of people facilitating, on a full-time or part-time basis, the transfer of value domestically or internationally outside the conventional, regulated financial institutional systems. IVTS originated and are still found most prominently among Asian ethnic groups. They have spread to the other continents as a result of immigration and social mobility. They are characterized by trust, a relative absence of written records, and a reliance on contacts around the world. In most instances, value/money is transferred without the movement of money.

The names of IVTS vary, depending on geographic location and ethnic group. Following is a sample of the most common terms:

- Hawala (trust, reference, exchange; The Arabic root h-w-l means “to change” or “to transform”) – India
- Hundi (commonly translated as trust; it means bill of exchange or promissory note; it comes from a Sanskrit root meaning “to collect”) – Pakistan
- Fei ch’ien (flying money) – Chinese
- Phoe kuan – Thailand
- Hui k’uan (to remit sums of money) – Mandarin Chinese
- Ch’iao hui (overseas remittance) – Mandarin Chinese
- Nging sing kek (money letter shop) – Tae Chew and Cantonese speaking groups
- Chop shop – foreigners use this term for one of the Chinese methods
- Chiti banking – refers to the “chit” used as receipt or proof of claim in transactions introduced by the British in China (short for “chitty”, a word borrowed from the Hindi “chitthi”, signifying a mark).

- Hui or hui kuan (association) – Vietnamese living in Australia
- Stash house (for casa de cambio) – South American systems

(interview with Jost; Carroll, 1999; Cassidy, 1994; US DEA, 1994; Jain, 1929).

## 2 The origins of IVTS

Although many groups practice IVTS during the last two decades, two are the main original sources and models. According to one interviewee, “true underground banking is practiced in only two cultures, the Indian (including Pakistan and Bangladesh) and the Chinese. It is only within these two cultures that social rules have evolved sufficiently to insure the trust essential to completion of a banking transaction” (personal communication with W. Myers). These two ethnic groups have a long history of transferring money from place to place. They also have long immigration traditions, as workers from these countries met needs of European economies. From the new countries of residence, they sent back home money to support their families. After immigrant workers became more established and wealthier in the foreign lands, they also had substantial income (earnings and investment returns) to repatriate or invest in their homeland. IVTS was a low-tech, quick, reliable, and cheap method of transferring money or other value. As noted earlier, it is not correct to call such systems “alternative” banking, because there was no other banking at the time some of them were developed. So, IVTS are variations of the South Asian model (hawala/hundi) and the Chinese model. We shall examine the historical roots and evolution of these two prototypes, while attempting to point out some of the myths, inaccuracies and errors that have become part of the conventional wisdom about “underground banking”. Then, we will take a brief look at the black market for pesos in the Americas.

### 2.1 Hawala/hundi

Contrary to several reports, what is widely referred to as “underground banking” has not developed in order to bypass rules, laws, or currency restrictions (Bosworth-Davis and Saltmarsh, 1995). It is incorrect to assume that it was “...designed originally to circumvent currency controls...” (NCA, 1991: 35). Another erroneous statement is that hawala was “[b]orn out of political turmoil and a distrust of banks...” (O’Hara and The Wild Palms Foundation, 1997: 1)<sup>4</sup>.

According to some observers, hawala or hundi developed more than a century ago when Indian immigrant communities in Africa and South East Asia devised it as a means of settling accounts (Miller, 1999). Others place the origins of it to centuries ago, when people sought a secure system through which traders could transfer money (Alert Global Media, 1996) and travellers could protect themselves from thieves (Brown, 1991).

<sup>4</sup> Note the self-contradiction of this author who goes on to state that: “The system dates to Arabic traders who established hawala as a means of avoiding the endemic robbery of caravans. *It predates the establishment of western banking by several centuries.*” (O’Hara and The Wild Palms Foundation, 1997: 1; emphasis added). How can something be caused by mistrust of something that does not yet exist?

The most authoritative and original study on the beginnings and mechanics of indigenous banking in India appears to be a doctoral dissertation published early this century (Jain, 1929). Jain devotes a chapter to the description of the hundi methods. He argues that, while one function of "hundis" was "to enable one to get advances" (72), they "may be either pure finance bills or trade bills, the latter being against some produce or goods" (176). The hundi was payable either on sight (in which case it was a "darshani hundi") or at a later date (called a deferred or usance or "muddati hundi"). In modern times, the partition of India in 1947, the huge movement of people and the prohibition of money transfers between India and Pakistan have fuelled hawala. Memoni traders<sup>5</sup> have managed to dominate hawala in both countries. More recently, Indian and Pakistani immigrants have found in hawala the most reliable and convenient way of sending money back home for their own use or for their families.

The basic modus operandi is as follows. The client approaches a hawaladar (hawala operator or broker) to request the transfer of a certain value to country X. The banker will call or fax the details to his counterpart in that country and payment will be made within hours to the requested party (see Figure 1). In some cases, the client may wish to pick up the money herself in the other country. If that is so, a code will be given to the client for reference to the "banker" in the country where the pick-up is to take place. This code will be communicated in the meantime by fax or telephone to the hawaladar responsible for the payment. In this basic example, no money will actually cross borders. The client will hand over to the local broker the amount she wishes to transfer either in advance or, in some cases, when assurance is given that the money has been received on the other end.

The hawaladar's profit usually comes from currency exchange rates manipulation (Jost interviews; Miller, 1999). In other cases, a commission is charged ranging from 0.25-1.25% of the amount involved. When the hawaladar understands that the transaction involves criminal proceeds or transactions by the client, the charged commission may go up to 15-20 percent (Carroll, 1999). The hawaladar at the pick-up point will make the payment out of his cash reserves or account. The balance will be settled with transfers in the opposite direction. When more value is transferred from or to a given country or operator, the accounts are balanced from time to time through transfers via conventional bank routes, postal money orders, the smuggling of currency or other commodities, or through invoice manipulation (interviews with Jost).

Mis-invoicing, which entails the occasional or systematic participation of traders in legal goods, appears to be very common. The legitimate trades may be conducted either by hawaladars or associates, who may or may not be part of an extended family. To illustrate the system, let us assume that more money has been transferred out of India than came into the country, causing an imbalance of USD 80,000 between the hawaladars concerned. In such eventuality, the hawaladar based in the West (or an associate) purchases USD 150,000 worth of goods, such as computer equipment, and sends them

<sup>5</sup> Memoni come from what is now India's Gujarat state (Miller, 1999).

through ordinary channels to India with an official invoice for only USD 70,000. The Indian operator can then sell the merchandise and make a legitimate profit, retrieving at the same time the USD 80,000 owed to him from overseas. The same method is employed when the funds must move in the opposite direction. Instead of under-invoicing by \$80,000, the overseas operator will over-invoice by that amount. Hawala and mis-invoicing have been used extensively for the purpose of tax evasion and/or capital flight (on Turkey see Bhagwati, 1964; on India, see Zdanovicz et al., 1995).

If hawaladars make their profit out of the exchange rate, how can they be so attractive compared to conventional value transfer methods? The answer is that they take advantage of the difference between the street (black market) rate and the official rate of the currencies involved. Quite often, such differences are very substantial<sup>6</sup>. So, while they give their clients in the West a competitive rate, they can get an even better rate by selling the hard currency in the black market. In addition, when hawala transfers are combined with gold deals and smuggling operations, the main profit is made from the sale of the smuggled commodities rather than from the money transfer service. For example, hawala dealers commonly transfer the local currency to the United Arab Emirates (especially Dubai), where they use it to buy gold. The gold is then smuggled into India and sold for a profit (see Figure 2). Part of the proceeds from this sale can be used to pay the recipients of the hawala transaction. Sometimes, the clients may wish to be paid in gold rather than rupees<sup>7</sup>. For this reason, the profit margins for hawaladars depend greatly upon the price of gold in India (Cassandra, 1998; Vadayar, 1997). Finally, the other advantages of hawala (speed, convenience, no tracing, discretion etc.) keep it very attractive anyway.

Although it is said that "Money never enters the formal banking system..." (UN General Assembly, Special Session on the World Drug Problem, 8-10 June 1998), hawala operators often do have their own conventional bank accounts, in which they deposit their clients' money and which they use to set off balances with their counterparts in other parts of the world (Jackson interview and personal communications). They also hold other accounts, since they occasionally deal with securities, currency and other conventional business. Finally, they may mix their clients' money with money they have from their other (legitimate) business. It is then that investigators may be able to find some traces of illicit or irregular transactions and evidence of wrongdoing. Carroll points out that Chinese and hawala systems "use the conventional banking sector at some point in the transaction, to receive customer payment or to settle debts with other brokers" (Carroll, 1999).

As some interviewees have noted, it is when IVTS interface with the conventional banking sector that they are at their most vulnerable.

<sup>6</sup> Particularly when government interventions impose artificial exchange rates, when there are currency controls, in cases of high inflation, during periods of political instability, etc.

<sup>7</sup> The importance and value of gold cannot be overstated when it comes to South Asia. Gold is used in traditional rituals, it is a most valued gift or dowry, and a hedge against inflation. The price of gold in India and Pakistan has been much higher than world prices, sometimes at a premium of 40 percent or higher (interviews with Jost and Cassandra; FATF, 1999).

## 2.2 Chinese IVTS – fei ch'ien

Once again, inaccurate rumors have it that the Chinese IVTS emerged as a result of distrust of banks, political turmoil, communist takeovers, and discrimination against the Chinese (South, no date). Nevertheless, it has existed for centuries, well before the development of the postal and banking services. In fact, some contemporary reputable banks have emerged from such informal systems (Akse, 1996). According to Akse (1996), the origins of the system are located in the North-South rice trade, when traders sought to avoid the physical transportation of money. Fei ch'ien was an ingenious and convenient system of settling accounts, while providing protection against the common highway robberies at the time (interview with W.Myers). To the extent that transactions and payments were going in both directions in similar amounts, the accounts could be settled without any movement of money at all.

With respect to Chinese early banking facilities, Cassidy (1994) has furnished the most reliable account. In the second half of the T'ang dynasty, a growing tea commerce between the south and the imperial capital created the need for a convenient means of exchange. As a result, "flying money" (fei-ch'ien) evolved. As Cassidy (1994: 2-3) notes, "Provincial governors maintained "memorial offering courts" at the capital. Southern merchants paid the money they made from the sale of goods at the capital to these courts, which then used it to pay the tax quotas due from the Southern provinces to the central government. In return, the courts issued the merchants with a certificate. When the merchant returned home, he presented this certificate to the provincial government and was paid an equivalent sum of money. Thus ... both the merchant and the local government avoid[ed] the risk and inconvenience of carrying quantities of copper or silk".

In the Shansi province, "old style" banks and first remittance services began a courier system as a secure money transfer method during the Ch'ing dynasty. They were family based and soon grew beyond Shansi province to the whole country. They opened branches in cities where they had business interests and issued drafts, much like the contemporary travellers' checks. Other "old-style banks", such as local retail banks, money exchangers, clearinghouses, customs banks and silver shops, emerged to compete with Shansi banks (Cassidy, 1994). Modern banks were colonial institutions, which thrived thanks to the monopoly of the opium trade.

As Chinese started to emigrate around the world, a dual family system emerged. The immigrants had one family back home and one wherever they resided. Consequently, the Chinese laborers overseas sent regularly remittances to support the homeland family as well. The continuing strong bond with the family in China served as a safety net, for one could always return home in the event of unemployment in the foreign land (Purcell, 1951). Dual families with stores (gold shops, etc.) overseas soon dominated the remittance business. In this way, transactions were shielded from the inquisitive eyes of the authorities in host countries, some of which imposed excessive taxes on the ethnic Chinese (Cassidy, 1994).



### 2.3 Chits and chops

Contrary to many reports, the chit system is anything but Chinese indigenous banking. In fact, it was introduced by British colonialists, who borrowed the term (diminutive of "chitty") from Hindi (chitthi). Chit came to mean a "note, a pass or a certificate given to a servant". In order to make transactions with foreign residents in China more convenient, a system was invented whereby "The salary of foreign employees was paid by check drawn on the Chinese compradore, who then held the funds against which the employee wrote 'chits'...memoranda acknowledging debts for retail transactions. These were accepted by the shopkeeper and passed for collection to the firm's compradore" (King, 1965; cited in Cassidy, 1994).

As Cassidy (1994) notes, "certainly, representative paper, i.e. chits, are being employed to move money in Asia", but this reality is at odds with Western law enforcement and intelligence reports suggesting that "chit banking" is a Chinese indigenous money movement method beyond the easy comprehension of Westerners, and which is currently used for money laundering.

Finally, banks and counting houses often use "chops" (to cheung) to this day. A chop is a seal of stone (also found in wood, ivory and various other materials) "dipped into vermilion ink-paste and impressed by way of a verification stamp. Types of chops include the general purpose chop (shu kan to cheung) for acknowledging letters or indicating ownership; the goods delivery chop (fat for to cheung), usually a square seal sent on invoices accompanying goods; the cash delivery chop (kau ngan to cheung), used on a blank receipt delivered with cash; the goods acknowledgement chop (ying him fo to cheung), stamped by the receiver on the invoice when goods are delivered; the acknowledgement chop (shau ngan to cheung), stamped on the cash receipt when cash is taken in, and the indebtedness chop (kit hong to cheung), stamped in acknowledgement of a loan" (Cassidy, 1994: 5-6). Chops can also be used on currency to prove ownership or "to identify 'off the books' currency destined for certain accounts (ibid.).

The system, at its simplest, works like this: A client who wants to send funds overseas contacts someone at a store or other business who will take the cash, make an entry in a ledger book, and then telephone another business in the city of the recipient. The client will at the same time contact the recipients to let them know where to go and collect the money in local currency. The recipients may have to show a chit or token to claim the money. The chit may be anything from a playing card to a train ticket torn in two – one sent to the paying broker, the other to the recipient of the money (DeStefano, 1995; South, no date).

The Chinese system generally functions on the basis of "guanxi", which is "an overarching social system of rules that govern all social behavior. It is guanxi, which is the guarantor of both secrecy and the integrity of the parties to the

transaction. Violate its prescriptions and find yourself a social outcast, essentially shunned in all circles" (personal communication from W. Myers)<sup>8</sup>. An exception to trust-based transactions is offered by Hong Kong operators, who are reported to be more cautious and get involved only with "cleared funds", even though they deal with known clients or referrals from their customers. That is, they will immediately remit cash, but otherwise "the customer must provide evidence that they have deposited funds into the bank account of the trader. Once the funds have been cleared, the trader will proceed with the transaction" (Carroll, 1995: 41).

According to the Hong Kong Police, the main features of IVTS operating there are as follows. "Underground banks are commonly known as Unregulated (or Unlicensed) Remittance Centres (URCs) in Hong Kong. They are businesses, which provide customers with a service for sending money to, or receiving money from, other countries. They do not provide other forms of financial services normally provided by banks.

URCs take various forms. In many instances the URC will be situated in a shop or office type premises offering remittance services either alone, or more commonly, along with a variety of other services, such as money exchange, and international fax facilities. Numerous URCs are also operated in trading companies and guest houses in addition to the main business being carried on. As the operation of an URC requires little more than a fax machine, URCs are often located in residential premises, operated by a member of the occupant family as a part-time job.

If a customer wishes to send money overseas from Hong Kong, he must first find an URC with the ability to remit money to the overseas country in question. Normally, an URC will operate in parallel with a sister company, or companies, overseas and will specialize in providing remittance services to the country or countries in which their sister companies are located. To remit money from HK, the customer must deposit money into the HK bank account of the URC and provide the details of the overseas person or bank account to which the money is to be sent. The URC then contacts its sister company in the overseas country concerned and instructs it to pay the money to the nominated person or account. If money is remitted to HK, the same process is used in reverse" (written communication from the Hong Kong Police).

According to W. Myers, the Chinese IVTS "has two components and serves two purposes. The first component is the "customer" who desires to transfer and convert an amount of foreign currency to a recipient in the Peoples' Republic of China (PRC). The second component is the local "banker", or agent of a PRC resident banker, who desires to acquire foreign exchange without compliance with the controls on foreign exchange acquisition imposed by the PRC. In a completed transaction, the customer has efficiently transferred and converted his funds to the recipient free of delay, fees and controls on the exchange of foreign currency and the banker has acquired foreign currency outside the PRC free of exchange and acquisition controls.

<sup>8</sup> On the significance of "guanxi", which also refers to a social strategy by which ethnic Chinese gain access to resources, see Myers (1995).

Inherent in the functioning of this system is the fact that currency never moves through any international financial system, it remains in the country where the transaction originated. In order for the system to function, it requires that the "banker" have access to large amounts of liquid capital to pay out the amount of the remittance in the PRC. It would of course be self-defeating for the banker to transfer the currency to the PRC, since the objective of the transaction on his part is to acquire and export foreign exchange. (It should be noted however, that this capital, in many instances, does find its way back to China in the form of investment capital and receives extremely favorable tax and exchange treatment)" (written communication from W. Myers).

According to a brief report issued for the purposes of the present project by the Center of Asian Studies, the evidence from a closed source database (CSDB) on the situation in the USA shows that:

- 2,105 of 4,113 records reflect the use of a Chinese underground banker for the remittance of funds to a relative or friend in the PRC.
- The average remittance was \$2,000 and the low remittance was \$400 and the high was \$23,000.
- The transactions occurred between 1989 and 1996.
- Three "bankers" were used with the most transactions in occurring with a single banker located in New York's Chinatown (99%) and the remaining one percent were with bankers in Los Angeles and Washington, DC.
- In no instance do the records reflect that the funds were acquired as a result of unlawful activity.
- In some instances ( $\pm 18\%$ ) the records reflect the funds were transmitted in furtherance of a crime, i.e. as a partial payment to a human smuggler for the recipient to be smuggled to the United States.
- Other entries in the CSDB reflect that for the period between 1993-1995, one particular banker was estimated to be transacting \$1-2 million per month in business.
- An analysis of this information supports the following conclusions.
- The funds transacted by customers were acquired in a lawful manner and were not the proceeds of crime being laundered.
- The laws broken by these transactions were primarily those of the PRC. Even these in many instances were vague and only recently amended (regulations issued on 8 Sept. 98) to cover these types of transactions. A case could and would be made on violation of regulations of the Treasury Department concerning reporting violations of cash transactions and possible state laws on illegal banking transactions.
- Some funds were transmitted in furtherance of a crime in the PRC and the United States – human smuggling. (It should be noted that this method of transferring funds did frustrate an analysis [of] currency exchange transactions conducted by the Treasury Department to attempt to pinpoint the locus of smuggling activity). Other funds were used in various illegal activities within the PRC, principally commodity smuggling.

- The acquisition of foreign exchange by one particular banker permitted her to acquire large amounts of real estate and engage in business activities of a nature which have illegal and legal components.
- The economic, social and legal impact of this activity can not accurately be assessed based on the available evidence at this time.
- The activity is not regarded by the Chinese community as unlawful. It is rather seen as an efficient and safe manner to remit funds to the recipients in the PRC.
- Evidence strongly suggests that Chinese underground banking activity is global in scope (written communication with W. Myers).

#### **2.4 “Facts by repetition” and other inaccuracies regarding IVTS modi operandi**

IVTS may operate either entirely openly (e.g., in the street markets of Asian cities) or out of legitimate businesses, such as travel agencies, import/export or shipping companies, grocery stores, gold and jewelry shops, textile or apparel shops etc. In many cases, the transfer of money is a tangential activity and is done to provide fuller services to the customers who need it, as a way or attracting clients, or as a service to the ethnic community. In other cases, the legitimate business may be a sheer front. In England, for example, there are travel agencies that provide no travel services and are equipped only with a telephone and fax machine. Yet, they have security devices at the door for protection against robbers (interview with Jackson). The informal value remitters range from quite simple, small, one-time operators to sophisticated, long-term businessmen with family tradition and extensive networks (Miller, 1999). They may also be members of well-known banking families with an established reputation (Carroll, 1999).

People who wish to remit money overseas mostly know about IVTS by word of mouth. However, the money transfer services are very often advertised in the ethnic press in many countries. The advertisements may be sometimes cryptic, simply referring to “great” or “beautiful” rupee deals (or the “best rate for guilders”) among other things they offer. There are also very straightforward advertisements for “same day delivery. Rupees, New York to Bombay”.

One important difference between the two chief IVTS is that the import-export and invoice manipulation practices are most prevalent in the hawala networks than the Chinese (interviews with L. Carroll and W. Myers).

Also, contrary to many press reports, the evidence and interviews suggest that the “proof of claim” (such as the chit) is used primarily in Chinese rather than in hawala/hundi transactions (esp. interview with Jost, who has never seen this practice in India or Pakistan)<sup>9</sup>. Some South Asian cases involving proof of claim are reported by law enforcers in Britain, but all such cases are related to drug proceeds (Jackson interviews and communications). It might

<sup>9</sup> This point is made here also because Akse (1996) cites an article by Lambert on the use of “proof of claim”. See the following footnote raising doubts on the credibility of Lambert as “expert” on the matter of IVTS.

be, then, hypothesized that such proofs are used and perhaps are necessary, when the element of trust is either weak or lacking, and when it comes to dirty money, transactions among people who do not know each other well or at all and large amounts. With the limited empirical evidence publicly available at the moment, however, these are mere hypotheses.

Another difference is that the Chinese IVTS is mostly a one-way traffic. Money goes essentially to China, whereas hawala/hundi is bi-directional. The question one may raise is: how is the money transferred to China, and how are the balances set off? This, to my interviewees, is a mystery. Every time they pose that question to their informants, the response is that transfers are handled by people with access to large amounts of money. No specifics are provided. Anecdotal evidence suggests that corporations and state agencies may be involved in this. In one case, cheap goods were purchased in the US and then dumped in China. Despite the loss, it was worth it, given that the money was laundered and became "usable". In other cases, Chinese use front companies to move money to China. In yet other cases, they use conventional banks and wire transfers. However, the evidence is thin and inconclusive. So, this remains an important gap in our knowledge. Several features or *modi operandi* of IVTS are remarkably similar to the early banking practices in Europe, when Italian institutions issued drafts to facilitate business transactions in different countries. The services they offer today are no different from Thomas Cook, American Express, Western Union, etc. (Akse, 1996).

Violence is generally not associated with these alternative/informal systems. As one interviewee has suggested, there is evidence of violence used for example in connection with drug money moved around through hawala. Yet it is unclear whether such violence has to do with hawala (the transfer method and the related network) or with the drug traffickers. Even in those rare cases, it is impossible to say with certainty that the hawala brokers were involved in violent acts (interview with Jackson). There is evidence that IVTS operators may become victims of violent crime, given that they handle a good deal of cash on a daily basis. For instance, two Bangladeshi hawaladars who catered to the needs of London's Bangladeshi community were stabbed to death by robbers in their London home (Elliott, 1991).

Most importantly, all interviewees who have had direct experience with hawala networks emphasized in no uncertain terms the paramount importance of trust. It is trust, rather than fear and violence, that makes this system work efficiently and reliably. Violation of this trust brings about shame, ostracism and dishonor within the family and the wider community (it also brings about economic ruin as a secondary effect). This does not mean that fraud never occurs. For example, many Filipino immigrant workers in Dubai lost their money in 1993, when they trusted door-to-door minor money remitters, who later disappeared (Khaleej Times, 1993). This example of dysfunction in IVTS highlights the importance of ties and tradition, which is lacking with the Filipino ethnic group (the best and most reliable IVTS in South East Asia are operated by ethnic Chinese [interview with W. Myers]). Finally, the hawala/hundi or *fei ch'ien* networks hardly fit the Western description of "gangs". In many instances, IVTS operators are providing a desperately needed service to immigrant groups who wish to send funds back

home, but the absence of adequate infrastructure and banking facilities makes that impossible. An African resident of Australia has been furnishing this service to his community for no profit. He received in an Australian account the funds his "clients" wished to remit, regularly moved these funds to a dollar-denominated account (in order to reduce currency fluctuations) and then on to accounts of African businessmen in the Middle East or different parts of Africa. The businessmen then provided the funds in local currency to the designated recipients (Carroll, 1995; see Figure 3).

Nevertheless, sensational accounts, which appeared in the literature were subsequently picked up by press reporters, academics, government officials and people working in international organizations. Given a few repetitions (sometimes simple cut-and-paste "reporting"), erroneous or out-of-context statements became "facts" worthy of inclusion in United Nations documents. The following is an illustration of how false conventional wisdom is generated with everyone referring to the same misleading statement (often without even referring to the original source).

- "...these parallel banking systems are based on family or gang alliances and reinforced with an unspoken covenant of retributive violence." (Malhotra, 1995: 1).
- "...these parallel banking systems are based on family or gang alliances and reinforced with an unspoken covenant of retributive violence." (O'Hara and The Wild Palms Foundation 1997: 1) [no quotation marks].
- "parallel banking systems are based on family or gang alliances and reinforced with an unspoken covenant of retributive violence." (Williams, 1997: 6; in quotation marks, but without reference to source in the web version of the publication).
- "Money never enters the formal banking system but is instead transmitted through alternative banking systems such as the "hawala" in India and Pakistan. These parallel banking systems are based on family or gang alliances and reinforced with an unspoken covenant of retributive violence." (UN General Assembly, Special Session on the World Drug Problem 8-10 June 1998; no quotation marks and no reference to original source).

Similar "facts by repetition" were created through the above publications with respect to the Chinese system, the role of bribery and corruption, or the mechanics of hawala. Williams (1997), for example writes: "One of the reasons that these schemes work so effectively is that they are protected through bribery and corruption". These are hardly necessary elements of efficient hawala operations. When they combine with smuggling or other activities, of course official blind eyes are purchased. Bribery and corruption are not vital at all, however, for the day-to-day activities, which typify informal value transfer systems.

Malhotra (1995), whose article contains several factual errors, has been cited as authority for other modi operandi too: "For such services the dealer can charge up to 15 percent of the sum exchanged" (Williams, 1997: 6). Yet, hawala dealers make their profit out of exchange rate manipulation, not on the basis of commission. Indeed, 15% is extremely high and might only apply in cases where the dealer knows that the money he transfers is criminal. But, as noted earlier, this is not the typical way hawala operates.

Another statement I have found to be unsupported by the available empirical evidence regards the use of new technologies by IVTS. Some have speculated that the arrival of the internet and cyber-payments will usher in a new era of high-tech "underground banking", even more difficult to investigate because of the technology involved (cryptography, etc). As has been noted, the anticipated sophisticated methods "have not yet been adopted by the Indian or Pakistani Underground bankers for the most part, but they are expected to make the transition to newer technology early in the 21st Century as a result of available technology and a rising generation which is more "tech friendly." As a practical matter, investigation of underground cyber banking is extremely difficult and requires expertise not only in the culture creating the system, but sophisticated techniques in computer investigation and cryptography. In order to secure its borders, all nations need to be aware of underground banking practices, not only as they existed in the past, and as they exist today, but where things are headed" (Lambert, 1996). This statement is sheer speculation and based on no known cases of such a transition. The lack of the necessary infrastructure in rural regions of developing countries, basic cultural understanding, and most interviewees suggest that there is no need for IVTS to evolve in this particular way. The systems are so efficient, in part, precisely because they are so low-tech and cheap to operate<sup>10</sup>.

It is often thought that IVTS are used primarily in transactions taking place in the underground economy, which economists divide into the informal economy, the gray economy, the black economy and the criminal economy (Feige, 1989; Tanzi, 1982; Thomas, 1998). However, interviews and other material strongly indicate that ordinary transactions, family business and even legitimate corporate deals also go through IVTS. There are so many advantages compared to the conventional banking channels and so much cultural baggage (a preference for cash, following the tradition, the tendency to contract with those ones knows well, etc.) that the assumption linking IVTS only or principally with the underground economy is not faithful to the facts in many countries.

## 2.5 The Colombian black market for pesos<sup>11</sup>

The Colombian black market for pesos is much more recent than the previously examined IVTS. This market employs methods similar to hawala, in order to bypass currency restrictions in Colombia and to launder drug money in the USA. As with the other IVTS, the rumors are that it was

<sup>10</sup> Lambert's article is a good illustration of cut-and-paste "authoring". In this case, parts of a Bureau for International Narcotics and Law Enforcement Affairs (1993) report and Cassidy's (1994) article were taken in their entirety and reproduced with no quotation marks or acknowledgement of the original source. In fact, this article also distorts what Cassidy was trying to show. That is, he cautions that some government reports on IVTS are erroneous. Lambert misses this point and reproduces statements that Cassidy criticizes as inaccurate.

<sup>11</sup> The section on the Black Market for Colombian Pesos is based on interviews with US officials, several documented cases in New York, sworn statements by US Customs and IRS agents as well as Congressional testimony (James et al., 1997).

originally established in order to facilitate drug money laundering. US federal agents with direct knowledge of this market have emphasized before Congress that, "Contrary to some reports, the Colombian Black Market Peso Exchange is not an outgrowth of the narcotics industry. The system developed to serve the needs of Colombian importers" (James et al., 1997). The Colombian Black Market Peso Exchange emerged because the currency controls, which were introduced by the Colombian government to ensure that taxes and duties are paid, reduced the profitability of importers. The latter needed US dollars and other hard currency overseas for the settlement of accounts and were prepared to pay a premium over the official rate. Given the taxes and duties they could evade, their margin of profit was wider, even if they bought foreign currency in the black market – the brokers bought the dollars in the US at official or reasonable rates, but charged the importers for their service.

Subsequently, as the illegal drug trade intensified, the importers' currency needs were symmetrical with those of their drug exporting compatriots. The traffickers needed to repatriate at least some of the drug proceeds as pesos, while the traders needed dollars in the USA. The match-making is done by money exchangers in Colombia and their US associates, who make a profit out of the spread between the official and the black market exchange rates. The money changers assume the risk of money laundering in the US, which they carry out in four main ways.

The simplest modus operandi is that the proceeds of drug sales are collected into "stash houses" and then "smurfed"<sup>12</sup> into accounts controlled by the Colombian money-changer or an associate in the USA. From there, the money is wired to the trading partners of Colombians, who buy the legitimate goods they wish to bring to Colombia. Alternatively, the drug money is mixed with the legal money of money remitters in the US (who receive a commission from the Colombian money exchanger) and then transferred to the USA (or other Western) exporters to Colombia. Thirdly, the money can be given in cash to exporters directly from the stash house. A fourth way is to purchase small denomination money orders, which are then passed on to the exporters. Finally, another alternative is to smuggle the cash into Mexico, deposit it into conventional banks there and get bank drafts with which to pay the exporters for their goods (all five methods are depicted in Figure 4: "La Vuelta"). All this "vuelta" (cycle) is arranged by the money changers, who assume the risk of money laundering for a commission up to 20 percent of the amounts involved (a number of low-level employees carry out the dirty work). So, in the end, the drug proceeds enter the conventional and legitimate US economy as payment for exported goods, while the drug traffickers receive their profits in pesos back home. On the basis of informants and law enforcement intelligence, officials have estimated that up to 30-40 percent of the drug proceeds in the US are laundered through this system.

<sup>12</sup> That is, structured into deposits of less than USD 10,000 or even less than USD 3,000, in order to avoid currency transaction reports to the authorities.



In other instances, money brokers bid for the drug proceeds in the USA, smuggle them to Panama and then sell them to Colombian importers. This market is also exploited by exporters of legal goods, who purchase drug dollars in the USA, declare inflated sales in the West, and claim export subsidies from the Colombian government.

The Colombian peso black market is far from unique or terribly recent. It is merely one of numerous parallel or black markets for currency that can be found around the globe, from Brazil and China to Israel and from Turkey to India, Iran or Jamaica. In many cases, they are tolerated by national governments, which have occasionally used their services. The black market exchange rates are widely known and publicized through the mass media on a daily basis (Naylor, 1995/96).



### 3 Causes for continued use of IVTS

The available evidence confirms a statement made in a recent report on money laundering that "...like so much "informal finance", techniques of underground banking really have benign origins. They were evolved for perfectly legitimate purposes, reflect institutional underdevelopment and/or unfamiliarity with or lack of confidence in the formal banking systems, and have been, in some cases, unfairly targeted by law enforcement officials for criticism. It is impossible to avoid the conclusion that ethnic and cultural misunderstandings, even on occasion prejudice, have played a role in some of the adverse attention focused on these so-called underground banking systems" (Blum et al, 1998).

Hawala and Chinese IVTS have not been replaced by conventional (or Western-style) banking. They are continuing to be used as remittance systems throughout the world. This raises the question of why they are so popular at a time of globalization, unprecedented ease of travel, the introduction of new technologies, economic liberalization and the growth of a multinational banking industry. So, regardless of the origins of IVTS, an important question is why people still use them today.

Diasporas from Asia have facilitated the formation of word-wide networks, which are essential for the operation of IVTS. Close ties with the family left behind and a culturally promoted practice of sending money back home to help out enhance the business of alternative bankers. As many countries introduced currency controls and restrictions, for a variety of reasons, the infrastructure of IVTS came in quite handy. The higher cost, inefficiency and slowness of the formal banking sector have also contributed (Akse, 1996). An added advantage is the lack of records and confidentiality. Further growth was due to a general distrust of banks, political turmoil, and the desire to evade high taxes (Cassidy, 1994).

As noted by the Hong Kong police, "Legitimate customers normally use URC because of their quick and cheap international remittance service. Persons wishing to deliberately conceal the source, or destination, of international remittances, or break the audit trail, use URC because of their generally inferior customer background checks, customer identification records, transaction records and lack of adherence to suspicious transaction reporting requirements, compared to banks. Persons using URC for these reasons include international criminals, notably narcotics traffickers, and those wishing to avoid overseas tax and currency regulations" (written communication from the Hong Kong Police).

Real or perceived discrimination against the Chinese, South Indians and Arabs has fuelled the continuing popularity of IVTS in the West (Fielding, 1993; South, no date). For example, in the aftermath of the Bank of Credit and Commerce International (BCCI) affair, British regulators closed down another two Asian-owned banks. With only one Asian bank left in the United

Kingdom, it was expected that many would turn to hawala for their needs. It was believed that “we will probably see the growth of the informal hawala banking system, which many people used before the Asian banks were well established” (Fielding, 1993). Indeed, it was real discrimination against minorities in Britain and elsewhere that helped immigrant-friendly BCCI gain a meaningful share of business in the 1970s (Passas, 1995).

In many parts of the world, especially in rural areas of the Third World, conventional banking facilities are simply non-existent or terribly inefficient, slow and expensive. The absence of banking channels between Kuwait and Pakistan, for instance, have forced non-resident Pakistanis to rely on the Hundi to remit money back into their homeland (Asia Pulse Staff Writer, 1998; see also Carroll, 1995 on Vietnam and some African countries). A similar lack of conventional facilities between Australia and several African countries was the reason for establishing the non-profit IVTS mentioned earlier for African expatriates and their families (see Figure 3).

Where it does exist, the formal banking system often fails to deliver, particularly during financial and other crises. In Russia, barter trading has increased, although IVTS transactions are also taking place (interview with Maksimof). In Pakistan, in recent times, “the formal banking system fails to grease the wheels of commerce”. In such cases, legitimate traders are left with no other option. Even when they go to conventional banks, officers there refer them to hawala operators. For a letter of credit, banks require a 30% of the amount in cash. At best, the transaction will be concluded with substantial delays. In some cases, amounts over \$50,000 are rejected anyway” (Miller, 1999). In China, the IVTS are used because the “official currency exchange market does not have the capacity to meet the needs of the economy” (Jianping, 1998: 28)

The more regulations restrict trade, currency exchange, or the movement of money and people, the wider the use of informal value transfer systems. It is important to note that, notwithstanding several adverse consequences, the economy of many countries relies extensively on alternative value transfer systems and the networks which operate them.

The reasons why people turn to non-banking institutions are very similar to the factors contributing to the emergence and growth of the underground or unrecorded economy, in general (Naylor, 1995/96; Thomas, 1998). A resurgence of hawala, for example, was noted in Southeast Asia during the Vietnam War, when a huge black market developed in South Vietnam (O’Hara and The Wild Palms Foundation 1997). More recently, in Jamaica, the underground economy, tourism and IVTS go hand in hand in a context of government restrictions, a slow licensing process, prohibitions, high tariffs, and lack of access to currency (Grosse, 1994).

It is worth underlining also the economic functions of trust, the most critical element of IVTS. IVTS are not merely more convenient than other methods. The presence of trust makes them cheaper and more pleasant to participate in because, in economic terms, it reduces transaction costs. As has been pointed out, transactions are “made easier if the parties believe in each other’s basic honesty: there is less need to spell things out in lengthy contracts; less need to hedge against unexpected contingencies; fewer disputes and less need to litigate if disputes arise. Indeed, in some high-trust

relationships, parties do not even have to worry about maximizing profits in the short run, because they know that a deficit in one period will be made good by the other party later" (Fukuyama, 1995: 151). This is precisely what happens between hawaladars, who may take a year or longer sometimes to balance their accounts. Another factor contributing to trust is the fact that many IVTS are managed by members of the same ethnic group or even family (this applies to both hundi/hawala and Chinese operations).

In some cases, the use of IVTS becomes so ingrained and part of a tradition or culture, that even when the reasons for their emergence and development eclipse or totally disappear, people still shun conventional financial institutions. This is highlighted by the example of baseball players from the Dominican Republic, who remit part of their legitimate income back home through alternative channels (US Embassy at the Dominican Republic, 1996).

In short, the main reasons for using IVTS today are the following:

- Lack of confidence in the conventional banks
- Lack of access to the conventional banking system
- Local bank does not have the means to send the money overseas
- Inefficient, costly, bureaucratic, unfriendly banking system
- Lack of legitimacy of the tax system
- Real or perceived need to bypass government regulations (perception of over-regulation or costly compliance)
- Cultural reasons – following tradition.
- Lower costs
- Faster service
- In order to avoid reporting and ensure secrecy
- In order to protect assets from nationalization
- In order to make payments to intelligence operatives overseas (as in the case of Vietnam; Cassidy, 1994).
- In order to by pass currency controls
- Criminal purposes



## 4 Where IVTS can be found<sup>13</sup>

IVTS operate in many parts of the world, especially (but not only) in those countries rich in ethnic groups from Asia and Africa. The brief reference to particular countries in this section is by no means exhaustive, but aims at highlighting the existence and functioning of IVTS well beyond the countries in which they originated.

### 4.1 Paraguay

The US State Department has reported that ethnic Chinese groups and members of the 14K group, in particular, have sought to pave the ground for illegal drug and money laundering operations in this country, years before the return of Hong Kong to China. It has been suggested that the aim was to infiltrate Latin American banking systems. At the same time, the report speculates that, since these groups run IVTS elsewhere, such methods may be used in Paraguay too (Bureau for International Narcotics and Law Enforcement Affairs, 1993).

### 4.2 Surinam

According to a confidential report entitled "Financial Flows Below Amsterdam Ordnance Datum – Underground Banking in the Netherlands" authored by the CRI [Central Detective Information Service] in the Netherlands, a growing number of Surinamese residents send money back home to assist their families, because of the economic problems in Surinam. They often use currency exchange offices in food shops, jewelry stores, and other small businesses, which efficiently deliver local currency to their relatives. The CRI report suggests that "crime organizations make "grateful use" of this banking system" and also that some of the businesses are controlled by criminal organizations (Boom, 1996).

### 4.3 Jamaica

Jamaica's tourism-based economy helps both a black market and a parallel market for foreign exchange<sup>14</sup>. IVTS are used by tourists, expatriates remitting funds, exporters and importers of legal goods, marijuana exporters and cocaine re-exporters, and "higglers" (i.e., those who use the underground

<sup>13</sup> It must be stressed that this section of the report is based primarily on government and media reports, which I have not been able to corroborate independently. Given the large number of errors detected by Cassidy (1994) and the present project, this part of the report should be read in a critical spirit.

<sup>14</sup> According to Grosse (1994), the black market for foreign exchange operates outside the law, whereas the parallel market is any other than the country's commercial banking system. The latter include casas de cambio or cambistas.

economy to deal in otherwise legal products). Capital flight and tax evasion are also facilitated by IVTS. The clients of IVTS are able to buy local currency at a mark-up over official rates, while the government turns a blind eye (Grosse, 1994).

#### **4.4 Trinidad and Tobago**

The “whe whe” informal banking system in Trinidad and Tobago operates under the protection of the local police. A report to the Ministry of National Security indicates that underground banking brokers bribe Trinidad and Tobago police officials with money in return for protection against police interference. This protection includes refusals to: 1) execute warrants, 2) charge underground banking employees with criminal offenses, and 3) testify at court. According to the report, the bribe money is a regular source of income for police officials (Seabry Report, 1993; cited in Griffith, 1997).

#### **4.5 Turkey**

According to the US State Department, Turkey has become a major money laundering concern. Turkish heroin trafficking organizations, which have dominated the European market, are using inter alia IVTS to bring their proceeds to Turkey. It appears that a large part of this money is channeled into legitimate investments. Another sort of legal-illegal enterprise interface observed here is the use of legitimate business transactions for money laundering. The type of businesses involved include travel and tourism agencies, real estate deals, and currency exchanges (Bureau for International Narcotics and Law Enforcement Affairs, 1993).

#### **4.6 Nepal**

Smuggling networks operating in India and Nepal have been using hundi as a clearing system for gold, silver and illicit drugs transactions. A number of cases show that Nepalese, Indian, Pakistani, Danish, German, Dutch and Polish traffickers operate out of Nepal. Gold and silver, purchased in Dubai, Hong Kong and Singapore, are smuggled into India to satisfy the high demand for the metals. When hundi is used by the traffickers, US dollars are wired to Hong Kong bank accounts against deposits of Nepalese rupees in Nepal. In these cases, a commission of five percent is charged for the service (OGD Correspondent, 1999: 8).

#### **4.7 Hong Kong**

Remittance services have been a thriving industry, and many traders have been offering such services as a way of gaining a competitive advantage. Business associates would use such facilities because of convenience, their preference to deal with people they know and their preference to do business with those to whom they are related through “guanxi” (social connections). A strong link, which has been observed between Australian remittance services and gold bullion, is absent in cases involving Hong Kong, which is explained



by the lack of currency controls (the conversion into gold is the mechanism through which reporting regulations are bypassed in other countries; see Carroll, 1995: 45).

Hong Kong is particularly attractive to money laundering because of its physical proximity to the Golden Triangle, the secrecy legislation, the culture of cash deals and the presence of IVTS (Carroll, 1995: 44). This explains how the flow of funds through IVTS is considered to be “phenomenal” (FinCEN, 1994), despite the existence of a well-developed conventional financial services industry in Hong Kong. It is roughly estimated that there are about 300 remittance agents and more than 150 money changers (Oldfield, 1998). The Hong Kong police, however, stressed that there are no reliable data on the total number of “Unregulated Remittance Centers” or the amount of money they handle. An indication of how substantial their turnover may be was provided by a survey of seventy-eight URCs conducted by the authorities recently. The 78 URCs they visited had an estimated annual turnover of over \$23,000 HK million (1 USD = 7.76 HK Dollar)<sup>15</sup>. They went on to note that, “Although, this is not an accurate estimate of the total turnover of all HK’s URCs, the enormity of the figures allows for the conclusion to be drawn that URCs are involved in a significant proportion of financial transactions conducted in HK” (written communication from the HK police).

#### 4.8 Japan

IVTS have been active linking Japanese clients with others in many Asian countries, such as China, South Korea, Myanmar, Thailand, and the Philippines. In 1998, criminal organizations allegedly used IVTS to send at least 32 billion yen (USD 265.5 million) to countries in Asia and the Middle East. The Tokyo police uncovered 14 illegal money transfer systems. Of the 14 IVTS, four involved the transfer of about 16 billion yen (USD 132.8 million) to China and two had sent 10.4 billion yen (USD 86.3 million) to South Korea (Agence France Press, 1999).

In another instance, Japanese criminal justice officials uncovered an IVTS in Tokyo that served Myanmar immigrants living in the Kanto region. The broker, Suleman Soe Min, was arrested for violating the Banking Law. The IVTS had handled 2.5 billion yen (USD 20.7 million). Min used the money to purchase used cars in Japan, then exported them to Yangon, where they were sold by his brother for double the purchase price (see Figure 5). Min offered an exchange rate about 50 times higher than the official rate, while his IVTS operated since June 1993 (The Daily Yomiuri, 1998).

The Japanese press has published reports that more than forty IVTS operate in Tokyo, Kanagawa, Chiba, Saitama, Ibaraki, Gunma, Nagano, Shizuoka, Aichi, Mie and Niigata prefectures, remitting approximately 10 billion yen (USD 83 million) per annum to the Philippines. One article has alleged that a single operator is handling 100 million yen (USD 830,000) every month drawing clients from the estimated 40,000 illegal Filipino residents there.

<sup>15</sup> All US dollar exchange rates quoted in this report are as of June 15, 1999. These rates may have been substantially different at the time the transactions mentioned here took place.

Some IVTS are so well organized that they offer convenient door-to-door delivery service in the Philippines (Kyodo News International, 1997a). Two Chinese men, He Jie and Wu Tikeng, were convicted in January 1997 for breaking the banking law by operating without license an IVTS that remitted 5.2 million yen (USD 43,000) to China from Japan. The money was deposited by nine Chinese (who resided in Japan) under false names into bank accounts set up by the IVTS operators at major financial institutions. The details were then faxed to brokers in the Fujian province for payment in cash to local recipients (Kyodo News International, 1997b).

#### **4.9 Thailand**

The US State Department has reported that a whole underground financial system has been set up there, in order to cater for the needs of criminal organizations. The main service IVTS are said to provide is money laundering of proceeds from drug trafficking, oil and arms smuggling, gambling, prostitution and counterfeiting (Bureau for International Narcotics and Law Enforcement Affairs, 1996: 78-79).

#### **4.10 Sri Lanka**

The same report suggests that proceeds from the illegal heroin trade are channeled out of Sri Lanka through hawala networks to India and, to a lesser extent, to other countries. It adds that these IVTS may be used solely for unlawful transactions and purposes: "The hawala network is primarily used by criminals in Sri Lanka that are looking to launder illicit earnings. The government's liberal foreign exchange and investment policies would give no incentive to legitimate business to use these underground channels" (Bureau for International Narcotics and Law Enforcement Affairs, 1996: 141).

#### **4.11 Canada**

In Canada IVTS have always been active, but they used to be confined to ethnic groups. According to one interviewee, new regulations on conventional banks and the capability to freeze assets, has turned IVTS into a problem. The practice has spread well beyond the traditional ethnic groups. Prominent in this business have now become groups from South America. The Caruana-Cuntrera investigation of drug trafficking, which culminated in the arrest of the head of the clan (Pron, 1998) shed light on the operation of IVTS in Canada too. The Caruana network evolved since the 1980s and became involved in the investment business. The network covered Vancouver, Toronto, Montreal. In Canada, there are both new groups/networks and increasing use by existing ones by other ethnic groups. Illicit informal bankers disguise themselves as currency exchange or investment businesses (interview with Stammmler). A difference from the US situation is that Canadian dollars are not in high demand in international markets. Therefore, bulk movements of cash do not take place. Instead, the cash is converted into US dollars. So, there is a high

demand for US dollars in Canada and, not surprisingly, there are close links between Canadian and US groups.

#### **4.12 USA**

The IVTS that have come to the attention of the US authorities in connection with networks involved in drug trafficking, the smuggling of illegal immigrants and money laundering. Given the current US law enforcement priorities, this should not be surprising. The black market for Colombian pesos, for instance, has been in existence for some time, for the benefit of Colombian traders who wanted to do business with North Americans and Europeans but were constrained by currency exchange controls. These operations were illegal from the Colombian perspective, but constituted no serious problem to the US. This market came under fire by US law enforcement only when drug traffickers and money launderers started matching their needs with legitimate traders. This suggests that a much wider range of IVTS may be operating in the US, a country rich in ethnic groups from all over the world. We have not studied or know much about them, probably because they have not made any headline news for breaking US laws.



## 5 Use of IVTS by criminals

In both theory and practice, there is nothing to restrict the use of IVTS for any purpose, legal or illegal. It is a method that lends itself to anything, just like the conventional banking or other industries. The anonymity, efficiency and convenience of IVTS are also appreciated by criminal offenders of all sorts. Smuggling networks dealing in heroin, humans, gems, commodities (cars – Mercedes in particular, electric equipment, etc.) are deemed to be among the most prominent criminal customers of IVTS. The other main type of criminal activity is intellectual property violations. Otherwise, as far as several interviewees are concerned, the only illegality involved in the alternative remittance system is about tax evasion (interviews with Carroll and W. Myers). On the basis of documented cases, illegal purposes served by IVTS include the following:

- Evasion of currency controls (capital flight, etc.)
- Tax evasion
- The purchase of illegal arms, drugs, or other illegal/controlled commodities
- To make corrupt payments
- Intellectual property violations
- To receive ransom
- To make payments for the smuggling of illegal aliens
- To make payments for illegal trade in body parts
- To further the commission of financial fraud
- To finance illegal activities, such as terrorist attacks
- To launder the proceeds of criminal activities

According to Carroll, three are the main reasons why Asian criminals are using IVTS. Firstly, the Asian/Pacific criminal entrepreneurial activity generates substantial amounts of money and IVTS are simply a convenient vehicle. Secondly, given that crime proceeds are in cash and that many countries increasingly regulate cash transactions, criminals turn to unregulated IVTS, which do not record or report such transactions. Thirdly, IVTS are cheaper, faster and more secure than banking channels or smuggling operations (Carroll, 1999).

The following are concrete cases, which illustrate the wide range of criminal activities, which have been supported knowingly or unwittingly by IVTS.

### 5.1 Intellectual property/piracy

In 1997, Japanese authorities arrested three Thai businessmen in Tokyo on charges of pirating US-made videos and using an IVTS to send the proceeds (which amounted to billions of yen) to Thailand. One of the three men arrested, Apisit Chalisarapong, was in fact the operator of the IVTS. Apisit remitted money into Thailand from Japan by contacting a broker in Thailand who made the payments out of a local cash pool. The IVTS was set up in

Japan primarily to serve illegal Thai residents in Japan. The system transferred several billion yen (1 USD = 120.5 yen) in 1996 alone – this takes into account both crime proceeds and remittances from legal wages earned by illegal Thai immigrants). Police witnesses indicated that, between August 12, 1997 and October 2, 1997, Apisit's IVTS was also given 4.13 million yen (USD 32,000) by 3 persons to transfer into Japan (Kyodo News International, 1997c).

## 5.2 Arms

The Jammu and Kashmir police discovered an international network, which financed militancy in Kashmir. They told the press that a group had employed philanthropic organizations and NGOs as fronts from 1995 to the end of 1997 to collect “zakat”, the 2.5% of annual profits given by Muslims to charity, and other contributions that found their way into the hands of Herb-ul-Mujahedin. Allegedly involved were the Kashmir Medicare Trust, the Muslim Welfare Society, the Kashmir American Council, among other organizations and many individuals. A series of transactions took place before the funds reached their final destination, including the smuggling of gold, the purchase and sale of legal goods sold to wholesale dealers in Srinagar, who would then turn over the proceeds to a carpet dealer. The money was then going into the hands of several other middle-men before eventually reaching Gulam Muhammad Khan, divisional commander of the Herb-ul-Mujahedin (The Asian Age, 1997). Other cases involving paramilitary or guerilla groups have been outlined by Sebastian (1995) and Miller (1999; on the funding of Afghani mujahedin).

## 5.3 Drugs

In the USA, two Indian citizens have been convicted for structuring transactions amounting to about US\$5 million between 1991 and 1996 through corporate accounts and hawala deals. One of them admitted that \$100,000 of this money was illegal drug proceeds. The investigation was initiated by a bank report of suspicious deposits made into two corporate accounts. The brokers received money from their clients and deposited it into their accounts in amounts smaller than \$10,000. After the bank questioned these transactions, they switched to corporate accounts. The money was transferred from the USA to India. They faxed the names and addresses of recipients in India to their counterparts there, who arranged for the delivery of the money in rupees. From time to time, the US-based brokers wire-transferred money to bank accounts they held in Hong Kong and Singapore. Associates from India would travel there to withdraw the funds, use them to buy gold and smuggle it to India, where it was sold for a substantial profit. So, their profit would come from both the money transfer and the gold smuggling business (, 1995); Bureau for International Narcotics and Law Enforcement Affairs, 1997; Alert Global Media, 1996). The interface between hawala and the conventional banking sector was critical in detecting and prosecuting this case.

US government reports have also drawn attention to drug trafficking enterprises' use of IVTS in India and Pakistan – along with tax evaders, smugglers, terrorists and corrupt politicians (Bureau for International Narcotics and Law Enforcement Affairs, 1996: 94-95). Pakistani IVTS are said to be particularly accommodating to heroin traders in Britain, the USA and Germany (Bureau for International Narcotics and Law Enforcement Affairs, 1996: 100-101).

On the other hand, it is noteworthy that ethnic Chinese (and Chinese IVTS) are apparently less involved in the drug trade in the West than many suspect. Chinese certainly play a role in the heroin trade; however, they can gain much more by engaging in the smuggling of humans or commodities (gold, gems, agricultural goods in the US, manufactured goods, such as cars and electronics) and in intellectual property violations. In this light, it is surmised that they would not wish to take more risks for less return (interview with W. Myers).

#### **5.4 Smuggling of illegal immigrants**

Three overlapping smuggling networks have been illegally bringing into the USA immigrants mostly from India, but also from Pakistan, Syria, and Afghanistan. A one-year long undercover investigation (Operation Seek and Keep) revealed that about 12,000 people were brought to the USA through these networks in the course of three years. According to US federal prosecutors, requests were solicited from families or prospective employers looking for cheap labor in the USA. The immigrants were then taken through Moscow to Cuba, then onto the Bahamas, Ecuador or Mexico and into the USA. The smuggling fees, USD 20,000 or more per person, were paid in the USA and then sent to India via Canada and the United Arab Emirates (Dubai, in particular) through standard hawala channels. The estimated total over three years, thus is about \$220 million. The alien smuggling/hawala broker in the US contacted his counterpart in India who made the smuggling arrangements. In the end, the US person eventually used a variety of hawala techniques to balance the books with the Indian (Rosenbaum, 1998; interview with Jost). Noteworthy is that this is the first time this sort of criminal organizations are successfully dismantled with the help of money laundering statutes.

In another case, two members of a Chinese immigrant-smuggling ring were arrested for running an IVTS. The suspects, Chen Xinrong and Jiang Huamei, were charged with sending over 2 billion yen (USD 16.5 million) to the Fujian Province of China from Japan for 5000 illegal Chinese immigrants in Japan during a three-and-a-half year period. Chen and Jiang allegedly charged commissions of up to one percent of the money they remitted. The IVTS clients deposited the money to be transferred in Chen's bank accounts. Chen withdrew the money using an ATM card and arranged for a broker in China to dispense the money to the local recipients. Similar IVTS have been used by Chinese gangs to receive payments for immigrant smuggling activities and to launder money related to theft rings (Yomiuri Staff Writer, 1997).

### 5.5 Kidnapping

US federal investigators have uncovered an IVTS in New York, which they believe is responsible for remitting millions of dollars a year to China. The system was discovered during an investigation of a Fujianese kidnapping gang. This gang kidnapped Chinese immigrants in Washington, DC and used the fei ch'ien system to transfer ransom from the victim's families residing in China – in one particular kidnapping case the ransom was set at \$10,000. The ransom would be picked up at a clothing store, which served as a front for this IVTS in New York's Chinatown (De Stefano, 1995).

### 5.6 Tax evasion/currency control law violations

Indian citizens are often paid through secret dollar accounts held abroad for the rental of premises hired out by diplomats and representatives of multinational companies there. While nominal figures are shown on paper, landlords ask that rents be paid into overseas accounts for residences and business premises in cities like Bombay and Delhi. As more Indians travel abroad and more foreign companies open offices in India, this practice has been increasing in frequency and volume. In this way, domestic taxes are evaded, while the money is in more stable currency offshore. "Sometimes assets acquired in India through black money are swapped for property or cash abroad in deals involving non-resident Indians wishing to return home or invest in India..." (Rediff on the Net, 1997).

### 5.7 Illegal trade in body parts

According to law enforcement authorities and the Indian Society of Organ Transplantation, patients from Turkey, Canada, Germany, Japan, and Southeast Asia in need of kidney transplants were purchasing kidneys by transferring money to Indian doctors through the hawala network. The transplants were conducted in India and were usually performed in a nursing home. In 1995 law enforcement authorities in Bombay apprehended a plane-load of Turkish transplant recipients at the airport. The patients had apparently paid Istanbul-based hawaladars *2 million rupees* for each kidney. In general, prospective body part recipients paid the money into dollar accounts held abroad by Indian doctors and nursing home owners and then flew to India for the operation, which took place in nursing homes throughout the country (Rediff on the Net, 1996).

### 5.8 Money laundering

The Lebanese community also employs IVTS for transactions from Africa to the Lebanon, the Arab peninsula, Cyprus, Europe as well as Latin America, esp. Argentina and Brazil (Koutouzis, 1999: 11). Koutouzis notes that even unsophisticated criminals use the same methods. He cites the example of a small African trafficker, who purchases about ½ kgr. of heroine and ½ kgr. of cocaine per month in Amsterdam, sells it in Paris and uses the proceeds to finance legitimate trade in raw materials and other investments in a number



of cities and several countries (see Figure 6). In this example, the IVTS is nothing more than a family network involved in both legal and illegal transactions, which has dealings with African or Lebanese IVTS and legitimate traders in commodities. This case illustrates the frequent interface between conventional banks and alternative value remitters. Koutouzis argues that this system would not be so effective, if African countries did not need so much foreign investment and if licensing procedures were less opaque. The method outlined above is only possible in a context of relative disorder and a certain level of corruption. Adequate customs controls would be sufficient to prevent such operations.

## 5.9 Intelligence operations

It does not take radical observers or conspiracy theorists to notice that “governments ignore the fact that people in their own organizations use the same techniques as criminals to move money around the world” (Bassiouni and Gualtieri, 1997: 156).

The British not only turned a blind eye to hawala/hundi agents and smugglers, but also encouraged them and offered institutional support (in Madagascar) during the second World War. In return, they used their services to send money to their agents in German and Japanese occupied areas. In addition, they used them as informants on “both Axis spies and Indian pro-independence militants. When the British left India, they took the records with them, bequeathing to the struggling new administration a sophisticated apparatus for smuggling money and goods just at a time when India was attempting to create a new, more autarchic economic structure with tight exchange controls” (Naylor, 1995/96: 149, fn. 155).

In another instance, a former CIA agent who participated in the covert operation funding the Afghani guerillas has explained how he relied on the hawala system for funds to be transferred to various mujahedeen commanders. He was based in Pakistan and sent “large sums” deep into Afghani territory. Within two days, he had radio confirmations that the exact amounts of money had been received (Miller, 1999).

Moreover, in order to finance their war efforts, Afghans have been laundering drug money from Pakistan, Europe, and the United States through the hawala network. Cash intensive business, such as restaurants and grocery stores, have been used in Afghanistan as the connection point for hawala networks (Bureau for International Narcotics and Law Enforcement Affairs, 1996: 130).

## 5.10 “Trading with the enemy”

The USA government has been criminalizing for many years transactions of Americans (or, indeed, others) with countries it considers as “enemies”, such as Cuba or Vietnam. One way of getting around such regulation is the use of IVTS. For example, Joseph Tran, a Long Beach California businessman, was found guilty on seven felony accounts related to an informal banking system he operated. According to the evidence presented in court, Tran illegally acted as a financial agent and used his IVTS (using cash, money orders, and

cashiers checks) to transfer over US\$ 60 million dollars to Hong Kong, Singapore, Bangkok, and Vietnam. By operating through this system, he effectively evaded taxes and circumvented the US Trading with the Enemy Act, which prohibited monetary transfers to Vietnam (Business Wire Staff, 1997). This is another example of how regulation perceived as excessive or unwarranted bring business to IVTS.

### 5.11 Corruption

In one celebrated case in Hong Kong, a government official received bribes amounting to 3 million HK Dollars (USD 386,600). This money was laundered through IVTS. The official received one half of a \$10 note; the other half was sent to Singapore. He went to Singapore carrying his half of the note, had it matched to the other half, and the money was paid out (Carroll, 1995: 44). In Pakistan, serious allegations of corruption and hawala involvement have been made against the Prime Minister Nawaz Sharif and his family. According to a report, the 140 million rupees (USD 2.7 million) were taken out with the assistance of a Peshawar hawala group by using the Bank of Oman. The money was brought back in the form of foreign exchange bond certificates in the names of forty-three family members. Substantial amounts of money remained overseas (in offshore companies owned by the family); the family also purchased luxury suits in London (Karachi Dawn, 1998).

### 5.12 Corruption/terrorism

"Hawala Bribery" case is the name of an affair involving 650 million Indian Rupees (USD 15 million) allegedly paid through hawala by Surindra Kumar Jain to top Indian politicians and bureaucrats for fixing government contracts, between February 1988, and April 1991 (Chopri, 1996; Haque, 1996). Forty-two leading politicians cutting across party lines and a large number of senior officials occupying sensitive posts figure in the Jain diaries as recipients of criminal foreign money through the same conduits that served Kashmiri secessionists. Surendra Kumar Jain, an ambitious man, and his brothers used to bribe ministers and top bureaucrats in exchange for bringing in large amounts of foreign exchange illegally through hawala. The prime minister has been accused of having accepted three million rupees (USD 69,000) in brief cases home-delivered at night by the Jains themselves or by trusted employees. Occasionally, the money was delivered overseas. In all cases, a cousin of the Jain brothers listed such payments with the initials of the recipients in two diaries and two note books. It has also been alleged that an Indian named Amir Bhai, who illegally ran his currency exchange business from Dubai, London and Hong Kong, and was not very discriminate about his customers used to accept money for Indian politicians and bureaucrats. He is said to have served Kashmiri activists and those who had planted bombs in Bombay in 1991. The Vohra Committee report has highlighted a variety of ways in which hawala was used for unlawful purposes and pointed to a nexus between politicians, and elements of the Indian underworld dealing in narcotics, weapon-smuggling and political violence (see also Kapoor, 1998; Rediff on the Net, 1996).

### 5.13 Fraud

Invoice manipulations, which involve defrauding the tax or customs authorities in one or more countries are often an integral part of hawala transactions. IVTS operators or their partners employ this method as they regularly balance their books or as another profit-making activity. Not surprisingly, in India and Pakistan, invoice manipulation is anything but rare (interviews with Jost; Zdanovicz et al. 1995). In China, over-invoicing and under-invoicing take place when traders wish to park large amounts of currency abroad until the rates become more favorable (Jianping, 1998: 29). Jamaican traders have also been reported to resort to invoice manipulations and IVTS (Grosse, 1994).

### 5.14 Effects of IVTS

The informal transfer of substantial amounts of money has several consequences for the economies involved. The country from which the money flows is deprived of revenue. To the extent that commodities are exchanged, the smuggling practices violate customs laws and result into additional loss of revenue. Tax evasion depletes the resources of governments, especially those in the South.

When money leaves developing countries with currency controls, it is not only that the corresponding regulations and laws are broken. The economic effect of capital flight can be devastating to countries in political and economic transition or where the political and economic systems are comparatively unstable, leaving them unable to stabilize the economy, improve services and infrastructure, and bring about the conditions for growth and prosperity.

If money enters through IVTS into a developing country, the country misses the opportunity to acquire valuable foreign currency. At the same time, inflation goes up when substantial inflows of money enhance consumer spending.

Trade gets distorted and policies fail or are seriously undermined as a result of invoice manipulation and customs-related misconduct, which are a means towards the balancing of books when the value inflows-outflows are not perfectly balanced.

The conventional banking system is also affected negatively, because significant amounts of money never enter into it. Finally, the official normative order is weakened by the, frequently blatant, disregard of laws and government regulations.

On the other hand, the impact of IVTS should not be overstated. IVTS are neither necessary for, nor always linked to, invoice manipulation, capital flight, or other legal and illegal value transfers. The next section demonstrates that IVTS are merely one of numerous other options open to both legitimate and criminal actors. Moreover, it should not be forgotten that IVTS may occasionally have stabilizing effects on certain economies, given that they operate as a safety valve and provide liquidity in times of crisis (Grosse, 1994; Miller, 1999).

### 5.15 Criminals' alternatives

While many officials are concerned about the use of non-bank institutions and IVTS for money laundering, it must be emphasized that the banking sector continues to serve well the sophisticated criminal enterprises. Sometimes bank personnel, particularly at representative offices of foreign banks, may accept funds and deposit them with their own accounts at local banks without disclosing the identity of beneficiaries. Accounts under false names, nominee accounts (e.g., "benami" accounts in India), accounts held by lawyers and accountants are among the preferred vehicles for money laundering<sup>16</sup>. The layering is also facilitated by the use of shell or front companies. A neglected source of concern is the private banking departments of regulated banks, which are used to transfer criminal proceeds. Getting access to these secret bank accounts constitutes a problem for US law enforcement (interview with Klapper). Finally, "smurfing" – the structuring of transactions, making deposits under the reporting thresholds and then wire transferring the funds overseas – remains a popular method.

A new challenge for controllers may be the move towards "cyber-payments", "smart cards", and "electronic banking", although there is little evidence so far to suggest that criminals are using such technologies for money laundering (Grabosky and Smith, 1998; FATF, 1999).

At the same time, many observers have noted a shift in laundering activity towards the non-bank sector, such as bureaux de change, especially in those areas that are lightly supervised or completely unregulated. Substantial amounts of illegal proceeds are invested in real estate. This is increasingly linked to interests in the former Soviet Union and Eastern Europe. The gold and jewelry business, as well as the international trade in other goods, remain popular money laundering vehicles. Simple mis-invoicing of all kinds of trade is deemed to be increasing (Wankel, 1996).

A method not often mentioned in law enforcement reports is the abuse of derivatives trading (FATF, 1999). This economic sector, which is completely unregulated, lends itself for fraud, manipulation and money laundering (e.g., mirror trades between real or shell companies controlled by the same organization or network will produce apparently legal gains and tax-reducing losses). Officials are also concerned about money laundering through the insurance (including re-insurance and life insurance) sector, while the worst fears about the casino industry and the securities sector have not materialized so far.

According to US prosecutors, the non-bank institutions used to support the transfer of criminal proceeds are:

- Money remitters (smurfing)
- Money order dealers – money orders are purchased by amounts below the reporting levels and used to make payments to companies for legitimate goods and services or deposited directly into bank accounts.

<sup>16</sup> Unless otherwise noted, the information for this section comes from FinCEN (1996) and FATF (1997, 1998).

- Check cashing stores – may accept criminal proceeds and issue a business check. The business checks are then deposited into a bank account of the criminal without raising suspicions, since it is a legitimate business check (interview with Klapper).

Finally, common smuggling of currency, appears to be on the rise. In Colombia, for example, “Bulk shipments of cash, whether in cargo planes or commercial shipments, continue to be the primary method of smuggling cash” (Wankel, 1996). Criminals have shown growing sophistication, often purchasing businesses engaged in the shipment of goods and hiding dirty money inside the product. Indeed, the main alternative to the use of IVTS is the smuggling of currency in containers. This is made very easy by the dominance of the global transport system – both container shipping lines and air freight – by ethnic Chinese (W. Myers interview; see also Carroll, 1995; US DEA, 1994).



# 6 Extent, growth and concern

## 6.1 Extent and growth

Few areas in this project have been more controversial than the question of the extent of IVTS business. Various estimates appearing in the press and other reports are derived from anecdotal evidence, informants, or confessions and testimony of arrested alternative “bankers”. Other estimates are based on calculations of the overall volume of hot and criminal money laundered around the world (which are themselves notoriously elusive and unreliable). Some estimates appear to come out of thin air: “Estimates on the amount of money coursing through the hawala system of the 1990’s vary from US\$100 billion to US\$ 300 billion in illegal transfers each year.” (O’Hara and The Wild Palms Foundation 1997: 1)<sup>17</sup>. Some argue that IVTS are becoming the vehicle of choice for many criminal organizations (Bureau for International Narcotics and Law Enforcement Affairs, 1993; US DEA, 1994). The IMF has estimated that the whole criminal economy is about US\$ 500 billion per annum, but there is no estimate of the proportion of such an amount going through IVTS (Carroll, 1999). Another recent estimate on the total money laundered annually puts it at about USD 300 billion (Bassiouni and Gualtieri, 1997). If these [gu-]estimates are anywhere close to the target, it would be clearly absurd to suggest that half or all these proceeds are funneled through IVTS (see earlier section on alternative methods).

The clear impression one gets by talking to line investigators and law enforcers with practical experience in the matter is that the problem is generally under-estimated. They all suggest that we have only seen a tiny tip of a huge iceberg. Their opinion is based on more than a gut feeling. They have indeed encountered cases of individual IVTS dealing in tens of millions of dollars within a year or even a week. Some have witnessed single transactions involving USD 10 million. Given the existence of additional and numerous operators (sometimes across the street from the one agents observed or arrested), they argue that the volume of money moving through non-bank networks is a multiple of what has so far been established. In an interesting British case, the hawaladar was remitting millions of British pounds (1 USD = 0.628 Pounds) daily – he was not charged with anything, because his business and transactions were legitimate (Belle, 1992). Stammler’s estimate on the volume is 10-15 billion Canadian dollars annually (USD 6.8-10.3 billion). He has no doubt about the capacity of informal bankers to move very substantial amounts of money. According to Indian officials’ estimates, the Indian Hawala was processing between USD 10 billion to USD 20 billion annually in 1991 (Elliott, 1991). A crackdown on the foreign exchange black market and unregistered banks in China has

<sup>17</sup> This article is echoing Malhotra (1995); the process of converting unsubstantiated rumors to conventional wisdom continues.

demonstrated that their activities are extensive, although it is unclear whether this crackdown targeted IVTS too or only illegal banks (see Liang, 1998). Estimates that took into account black market dealers' responses in Jamaica suggested amounts of more than \$1 billion per year (Grosse, 1994)<sup>18</sup>. The DEA has suggested that IVTS have become the preferred method of drug money movement in certain regions. They specifically note that Chinese IVTS handle most of heroin proceeds within Asia (US DEA, 1994). However, interviewees familiar with classified versions of the DEA report and with their authors are critical. One of them has stressed that there is little credible and reliable evidence to back up these estimates. The most knowledgeable US experts on Chinese criminal organizations suggest that a great deal of dirty money does not get laundered at all, most does not go to China and the overwhelming majority of transactions handled by IVTS are legitimate (interview with W. Myers). Elsewhere, media reports have reflected official estimates that drug "money-launderers in New York have been sending up to \$1.3 billion a year back to Colombia through storefront shops... that immigrants use to wire cash home" (McFadden, 1997).

On the other hand, a number of equally knowledgeable observers and practitioners suggest that there is a limit beyond which IVTS cannot go. In other words, there are certain constraints keeping IVTS from handling the substantial amounts of cash generated by the illegal drug trade or other illegal enterprises. Even though there may be specific cases of operators who facilitate the transfer of millions of legal and illegal proceeds on a regular basis, the bulk of the hundreds of billions of USD in criminal proceeds every year move through other channels (see above). For example, ethnic Chinese do not need to launder dirty money – it can be integrated in the country of residence in other informal ways. When they do have a need to transfer big amounts of money, they simply smuggle it. The anecdotal evidence from Pakistan and India regarding 160 million dollars per annum is "small fries" compared to what criminal enterprises are supposed to generate. So, some interviewees underlined that IVTS do not have the capacity to handle the gigantic amounts drugs and other criminal trades presumably generate (interviews with W. Myers and Jost).

Other interviewees point out that IVTS have grown in recent years, but that the problem is neither terribly significant nor out of control (interview with Koutouzis). Koutouzis (1999) argues that the practice of hundi has become exceptionally sophisticated. Especially in the East Coast of Africa, where there are significant Asian diasporas, hundi is a method channeling funds from Africa to India, Pakistan, Malaysia and the Arab peninsula. Once the funds are laundered through this system, they offer drug traffickers tax advantages and investment opportunities, particularly in the context of privatization programs in Mauritius, Mozambique, South Africa, Tanzania and elsewhere. At the same time, he notes that a substantial part of drug proceeds does not go through the money laundering phase, because it is immediately integrated

<sup>18</sup> Grosse (1994) also warns, however, that there may be a double-entry problem with remittances; firstly as part of retail transactions and secondly when they go through black market



into the informal or formal economy. He adds that probably more than two thirds of the proceeds from the drug trade get integrated into the economy without going through the money laundering processes targeted by the international community (Koutouzis, 1999: 6). Moreover, most of the money remains in countries of the South – for many of these countries, such substantial amounts are vital for their survival.

No one has found a good way of measuring or estimating the volume of IVTS transactions. Attempts to calculate it by taking into account trade figures and statistics from the conventional sector assume (erroneously) that the latter figures are reliable and accurate. Making matters worse, it appears that the private banking departments of many banks allow certain activities or transactions to take place rather discreetly.

Not knowing what the volumes are makes it impossible to estimate with any precision whether the use of IVTS is actually increasing or declining. What we can do is find out the reasons and circumstances leading people to make use of IVTS, and then try to establish whether these factors are multiplying or their effect is intensifying.

Hints as to the magnitude can be provided by sudden and otherwise unexplainable growth of activity through formal and conventional channels, once factors and laws or policies creating business for alternative bankers cease to exist or are minimized. According to Miller, for example, “official remittances to the Philippines in 1989 totaled \$600 million. This year, they're supposed to eclipse \$6 billion. In 1995, the government eliminated exchange controls; that year, remittances almost quadrupled. Even allowing for a more generous and economically secure overseas populace, it's doubtful total remittances more than tripled in the past 10 years. The difference must be attributed to the underground” (written communication)<sup>19</sup>.

To gauge whether the transferred money is related to criminal proceeds, law enforcers have examined whether the money sent to a specific country is above the financial means of members of a particular ethnic group. If the money transferred is more than what is deemed possible by the average income levels of those employed in legitimate posts, then they assume that dirty money is sent by the remitter (interview with Klapper).

A cautionary note is in order here, however, because Western standards and understandings are often used to make such calculations. My interviews and the academic literature suggest that many people who generate legal income actually remit much more than commonly assumed. The needs and consumption patterns of immigrants in North America and Europe are much lower than one might guess. Many of them work hard and spend extremely

<sup>19</sup> One might think that the bulk of the new remittances are due to the openness of the system and the ability to take the money out as well. That is, there is more confidence in the economic conditions of the country. So, those who used to be reluctant to send back home most of their savings, feel freer to do so in the new regulatory and economic climate. The response to this argument is that “...overseas Filipinos (mostly laborers, Hong Kong maids, but also a fair number of professionals) almost always are supporting family members back home. So, it was never a case of whether that group would keep its money offshore until there was greater confidence in the government” (personal communication from Miller, who added that even the rich - mostly ethnic Chinese - have probably been using IVTS).

little. Their culturally enforced duty to aid financially their extended family back home makes them remit the bulk of their income. This certainly applies to ethnic Chinese. It often escapes analysts' attention that many foreign workers may send up to 90-95% of their income back home to support their families. This is feasible especially when they work at a place, which provides food and board (interview with W. Myers). Indonesians have been estimated to remit 21-44% of their income (Hugo, 1979: 207). In Pakistan, it is estimated that around 57% of workers' earnings are remitted from abroad and that approximately 25% of remittances come through the hundi informal channels (Rashid, 1986: 770). In the North West Frontier Province, 48% of migrants reported using informal channels to move money. In Pakistan and Samoa, it is estimated that 27% of remittances are hand-carried by migrants. It has been the principal mechanism for transfer of funds in the Yemen Arab Republic, although one study showed that Yemenis began using official channels more when ordinary banks improved the quality of their services (Russell, 1986: 680, 682, 684). So, migrants use hundi extensively for remittances, as it is more efficient than formal banking channels and offers a premium exchange rate, but it is difficult to gauge the amount of money that flows through it (Omar, 1991: 77).

One way of assessing the trends in IVTS is to monitor the conditions that favor them (i.e., the contributing factors examined above). For example, the price of gold, central to the hundi and hawala systems, has been influencing the volume of remittances sent through these networks. When the price of gold plummeted in 1997, the profit margin for this business narrowed to the point that it lost a good deal of its popularity among non-resident Indians. Hawala brokers could not make more than 10% when they bought gold in Dubai, smuggled it into India and sold it for rupees there (Vadayar, 1997). Hawala business and gold smuggling clearly declined also due to the gold liberalization policy in India in October 1997<sup>20</sup>. This, however, also led to a huge outflow of foreign exchange, which weakened the rupee. Gold imports through the non-resident Indian window decreased, while official gold imports under the newly introduced restricted open general license surged (Business Line, 1999).

Indian authorities track the prevalence of IVTS by watching the black-market dollar price. They believe that, the lower the dollar price, the more prevalent must be hawala. Other factors may also play a role. For example, "The reduction in the black-market dollar value around election-time is an indication of Indian political corruption and the politician's involvement with Hawala. Around election-time, political parties usually close their foreign accounts and funnel the money back into India to pay for campaign expenses" (Elliott, 1991).

<sup>20</sup> The 1992-93 Budget freed bullion imports, by allowing Indians residing abroad to bring in up to 5 kg of gold every six months, for which a nominal duty of roughly 6 per cent had to be paid (the limit was raised to 10 kg from January 1, 1997). In addition, "The 1993-94 Budget ended the dichotomy between official and unofficial exchange rates, by making the value of the rupee vis-a-vis other currencies completely market-determined. In short, both the 'cause' and 'source' of gold smuggling were eliminated at one go" (Business Line, 1998).

## 6.2 Concern

Although hawala is an age-old practice, which has facilitated not only legitimate trade transactions but also capital flight out of South Asia, it has recently become a more serious concern primarily because of its connection with drug money. Blackhurst (1988) echoes the concern over hawala practices in the West, particularly in Britain and the USA:

“In India, the black market is no longer a domestic problem. Both the US Drug Enforcement Agency and UK Customs and Excise recently have stationed liaisons in Bombay between Indian, US, and UK authorities concerning drug movements. Gold – India's obsession – may not be legally imported, but gold smuggling is a growth industry, with prices 60% above the world market. The thread between gold and drugs produces money laundering, or hawala, on an international scale. Increasingly, police worldwide are finding Pakistani or Indian elements in major fraud or robbery cases. ...Criminal use of the system is widespread, and its ramifications affect the growth of crime and the stability of national governments and economics. Hawala is so old that it probably predates orthodox banking and so secret that anonymity is assured. Surveillance and control by authorities is nearly impossible. Only one Western police officer has been known to penetrate a hawala network.”

In Canada, there is a lot of concern in the law enforcement community dealing with organized crime. There has been a great deal of publicity in this regard and with respect to money laundering (interview with Stammier). Yet, fiscal considerations notwithstanding, the operation of IVTS per se breaks no laws and brings little or no harm to Western societies. The main problem has been the massive revenue losses and capital flight from developing economies. This has always been a problem, but not many officials in the West saw this as an urgent issue in the past. At a two-day Interpol conference on “underground banking” in 1991, Indian officials criticized the lax approach taken by law enforcement efforts against IVTS in Western nations (Elliott, 1991). The official concern has recently grown not necessarily because of some newly-found sympathy for the plight of struggling economies and unstable political regimes in the Third World, but because of the speculation that it is becoming an important vehicle for drug money laundering.

So, the concern is quite different in the Western countries than it is in the South. “Western nations see underground banking as complicating law enforcement investigations against criminal organizations. ... Since the money moves outside the regulated industry, government officials are unable to trace where the money is being sent and are unable to assess the amount of criminal money earned in connection to the criminal activity. Third World nations are less concerned with the law enforcement challenges presented by underground banking and more concerned with the tax revenue that is lost on money transferred underground” (Elliott, 1991).

In any event, all interviewees (see list in Appendix) have stressed how important they think is the problem. They are all concerned about the lack of reliable information about the problem (many line agents do not even have a name for hawala practices they encounter in their investigations). On the

basis of anecdotal evidence and material not reviewed given the limited scope of this study, those most knowledgeable about alternative banking are virtually convinced that the problem is much bigger than we think. They all welcomed this project and were happy to collaborate. They invariably regard this research of utmost importance and look forward to seeing some results in the near future.

Most concerned were interviewees in Australia, England, USA and South Africa. They all stressed their need to see their information complemented by the experience and knowledge from other countries, see the international aspects of the problem and how exactly it operates, and systematic analysis of existing reports, articles etc. It was found that law enforcement officials around the world do have experience with alternative banking and crime cases, but their writing, memoranda and reports remain sensitive or confidential. As a result, most of this knowledge remains fragmented and essentially hidden. Many interviewees would like to see their governments assist by funding or conducting more research into the nature and extent of the problem, introduce specific measures dealing with it, and train people who can recognize IVTS, decipher communications or ledgers and act effectively against criminal uses of the various networks. For this purpose, they also recommend that, at least part of the findings of this research, become widely available to government agencies and distributed or shared for educational functions as well as a way of raising the profile of the problem.

## 7 Measures taken

It must be noted at the outset that using informal value transfer methods has been legal in many parts of the world for long periods of time, even to this day (Choucri, 1986). When IVTS have been targeted, the reasons and objectives have varied from country to country. In broad terms, IVTS per se have been directly attacked only by countries concerned about currency controls, capital flight and the loss of business to their underdeveloped or inefficient banking system. The general trend among Third World countries affected by capital flight and IVTS has been to liberalize their economies, allow the import of gold, reduce taxes on gold, float their currencies, and eliminate or reduce currency controls. Many countries have also sought to bring gray and black money into the mainstream banking sector by inviting non-resident citizens to purchase bearer bonds with tax privileges and no questions asked about the origin of the money<sup>21</sup>. Other countries, such as China, have taken measures against "underground banks", which handle loans, stock deals, etc., but not specifically against IVTS.

Western countries, on the other hand, have not attempted to take IVTS out of business, but only to make them more transparent for the purposes of anti-money laundering controls. As part of anti-money laundering measures, many countries have introduced recording and reporting obligations applying to non-bank institutions. For instance, reporting cash transactions above a certain threshold is required not only by banks and financial institutions but also by "casinos, securities dealers, automobile dealerships, currency exchange houses and other cash intensive businesses" (Bassiouni and Gualtieri, 1997: 140).

Ironically, the responses to IVTS have been somewhat inconsistent and function at cross-purposes. Third World countries have taken measures that might have facilitated money laundering, whereas industrialized countries took or contemplate measures only to counter money laundering. The fact that the laws and practices of different countries are at odds and occasionally bring about the opposite effects with respect to crime control suggests that there is a lot of room for improvement in the policy area.

### 7.1 The Netherlands

The most relevant legislation is the Law on Reporting Unusual Transactions (MOT 1994), the Law on the Identification of Financial Services (WIF, 1993), the Exchange Rate Act (WWK, 1995), the Credit System Supervision Act (WTK), and the Foreign Financial Relations Act (WfBB, 1994). According to Akse

<sup>21</sup> Although this may sound like a radical or irresponsible way of luring even dirty money and cleansing it into the conventional economy, we need to remember that it is an oft-employed method introduced in the past by Western nations like the USA and France (Naylor, 1995/96).

(1996), the current provisions do not apply to IVTS, which may be breaking no Dutch law when they operate as money transfer services.

The MOT (1994, Article 9, para 1) introduced an unusual transaction reporting duty for all financial services. However, under the current interpretation, the term “financial institutions” does not include IVTS (Akse, 1996). A more recent report, however, states that “The Netherlands has introduced legislation which requires money transfer businesses to report unusual transactions” (FATF, 1999: par. 56), in a way similar to measures adopted recently in Belgium.

Under the WIF, financial institutions must know their customers (require ID), but the definition of “financial institutions” does not cover IVTS (ibid.). WWK refers to currency exchange services, which must be registered. Again under the current law IVTS are not deemed to perform such services. Akse (1966) argues that IVTS must comply with article 82 of WTK, which regards deposit taking activities, and deposit a bank guarantee with the Nederlandse Bank, in order to cover their clients’ deposits<sup>22</sup>. Finally, the WfBB deals with cross-border money transfers between residents and non-residents and establishes a duty to inform the Nederlandse Bank on the identities of the transacting parties, the reason for the transfer for amounts over NLG 25,000 (USD 11,850), etc. Yet, this information is collected only for statistical purposes and the law does not carry the weight of criminal law. Non-reporting such transactions carries a fine (Articles 7, 11). The liability disappears, however, if the party concerned reports the transaction ex post facto.

## 7.2 United Kingdom

Shortly after the Drug Trafficking Offences Act was introduced in 1986, British police expressed the concern that hawala methods would hinder the effective application of anti-money laundering measures (Carroll, 1995: 2). This was primarily because of the power to access bank records by investigators. A successful joint investigation by British and Dutch investigators leading to the exposure of a hawala network further fuelled that fear (Darbyshire, 1988).

In the early 1990’s, law enforcement agencies determined that the best way of controlling informal value transfer systems was through the Internal Revenue Service. That is, transfer agents were classified as “commission agents transmitting money” and were therefore subject to taxation on their commission. In addition, if the source of the money was unaccountable, the transfer agents were taxed on the full amount involved (Interpol, 1991: 24).

Under the money laundering regulation (Criminal Justice Act 1993), which came into force in 1994, the law requires financial institutions to maintain records of their customers and their transactions. Because of the experience with hawala networks in the past, money transmitters are clearly included in the definition of financial institutions. Hawaladars must comply under a penalty of up to two years imprisonment. As Jackson has noted, however,

<sup>22</sup> However, one might wonder whether difficulties seen in the past in the UK may arise, in that IVTS were not considered as deposit-taking institutions. Rather they are merely money transmitters.

there are many difficulties that remain. The law is neither strictly enforced nor does it provide the power of arrest or the power to inspect the premises of a store. Police will have to get a search warrant under a different statute dealing with an arrestable offense (as an incidental offense). At the same time, there is no concrete body responsible for enforcing the law (interviews and written communications with Jackson).

### **7.3 Germany**

Germany requires money transfer businesses to obtain a license from the Federal Banking Supervisory Office. Moreover, the FBSO mandates customer identification for transactions in foreign currency valued at DEM 5,000 (USD 9,390) (FATF, 1999). Other than anecdotal evidence and scant mention in press reports, the issue of IVTS has not been studied in depth in Germany. There is no legislation in force or contemplated to deal specifically with IVTS (interview with Sieber).

### **7.4 USA**

The Currency and Foreign Transactions Reporting Act 1970, Public Law No. 91-508, Title II (known as the Bank Secrecy Act), in conjunction with financial institution record-keeping requirements, mandated the reporting of currency transactions conducted with financial institutions, foreign bank accounts, and the transportation of currency across US borders. These reports were deemed to be useful for criminal, tax, and regulatory investigations and proceedings. Further, under Treasury Department regulations, a Currency Transaction Report (CTR) must be filed by financial institutions that engage in a currency transaction above \$10,000 with a customer (e.g., a deposit, withdrawal, or check cashed or purchased).

A Report of International Transportation of Currency or Monetary Instruments (CMIR) is required for anyone transporting currency of \$10,000 or over into or out of the USA. Individuals or businesses that hold foreign bank accounts of \$10,000 or over must file a Report of Foreign Bank and Financial Account (FBAR).

In 1984, Section 6050(I) of the Internal Revenue Code was enacted to require businesses not subject to the BSA to report to the IRS the receipt of currency worth any amount over \$10,000.

The Money Laundering Control Act 1986 created criminal offenses for money laundering and for knowingly engaging in monetary transactions involving property derived from certain unlawful activities (18 USC 1956 and 1957).

Under the Money Laundering Control Act 1995, money transmitters are not considered "depository institutions" and are defined as "any business that provides check cashing, currency exchanges, or money transmitting or remittance services or issues or redeems money orders, travelers checks and similar instruments". Money transmitters are required to file CTRs under the Banking Act. In addition, there is a requirement to register as a money transmitting business and to provide information on authorized agents and the estimated annual volume of transactions.

Charges against traditional Chinese IVTS that have been used by criminals can be brought under Title 31 cases and possibly 18 U.S.C. Sec. 1956 or Sec. 1957 cases. 31 U.S.C. Sec. 5312 is particularly onerous in that it specifically defines as a "financial institution," a private banker, a currency exchange, a dealer in precious metals, stones or jewels, and a pawnbroker, among others, all of which strike at the heart of traditional Chinese practice. "This, in concert with 31 U.S.C. Sec. 5324, the prohibition against structuring transactions to evade reporting requirements, certainly provides the tools to do the job" (Cassidy, 1994).

In 1997, a proposal was made to amend the Bank Secrecy Act rules, so that all money transmitters in the USA would be required to report certain currency transactions (FinCEN, 1997). This proposal followed the Geographic Targeting Order (GTO) in New York. Under Section 5326 Title 31 USC, the Secretary of the Treasury can order financial institutions operating in a designated area to keep more records and make additional reports to the authorities for the purpose of more effective money laundering controls. A great deal of credit for the creation of this GTO must go to Ms Bonnie Klapper, Assistant US Attorney in the Eastern District of New York – who was one of the interviewees for this report<sup>23</sup>.

The New York GTO selected twelve money-remitters and required reports of all wire transfers to New York above \$750. The number was later expanded to cover twenty-two licensed remitters. The volume of targeted money from the transmitters' business with Colombia dropped approximately 30 percent after the GTO went into effect. US Customs Service officials believe that most of this money has been physically removed from the New York metropolitan area, which produced a dramatic increase in US Customs seizures at the borders – over \$36 million since the GTO went into effect.

The El Dorado Task Force was established in 1992 to target financial services that facilitate money laundering and focuses on non-bank financial institutions, banks, brokerage houses, private banking, and bulk transportation and smuggling of cash. This Task Force brought together federal, state, and local agencies. It began to investigate cases relating to the use of money remitters by criminal organizations, when informants told agents about the willingness of certain money remitters to handle drug proceeds. Prosecutions focus primarily on money laundering cases in relation to drug proceeds, which were found to be typically transferred to Colombia, the Dominican Republic, Mexico, and Haiti. According to the Director of the White House Office of National Drug Control Policy, the record of this task force was remarkable. Since 1992, the Task Force seized more than \$170 million in currency, made 750 arrests, and interdicted over two tons of cocaine and 120 pounds of heroin. In fiscal year 1997, ONDCP invested \$1.8 million in the El Dorado Task Force (McCaffrey, forthcoming).

As mandated by the Money Laundering Suppression Act of 1994, the Department of the Treasury proposed in 1997 to register all money services businesses in one database. This registry would be available to law

<sup>23</sup> For more details on the GTO, see US House Committee on Banking and Financial Services (1997).



enforcement, federal and state regulatory agencies. The proposed regulation defines “money services business” in a way to include issuers, sellers, and redeemers of stored value – the so-called electronic money.

The Department of the Treasury has also proposed to extend the suspicious activity reporting (SAR) requirement, which applies to banks so far, to money transmitters and issuers and sellers of money orders and traveler’s checks. Because customers of these businesses do not maintain account relationships comparable to banks, it is often difficult for them to know their customers and identify suspicious transactions. For this reason, the proposed regulation offers some guidelines as to what are suspicious activities.

Finally, the Treasury proposed to lower from \$10,000 to \$750 the threshold for money transmitters to report remittances purchased in cash and going abroad. This change is based on the experience of the New York GTO, which has confirmed how vulnerable the money transmitting industry is to money launderers.

The industry’s response has been swift and rather negative. In a nutshell, the arguments opposing the rules under consideration are as follows. The industry has questioned the empirical basis on which FinCEN rests the rationale for new rules, it regards the reporting requirement as a counterproductive burden both on the businesses and the government, which may not make effective use of the additional information, and it argues that the threshold is far too low. Critics propose the limit to be increased from \$750 to \$1,000 (written communication from Howrey and Simon, the law firm representing the industry). Money remitters do not want a reporting requirement for all transactions over a specified amount. Instead they propose a record keeping requirement (interview with Klapper).

Prosecutors communicated additional problems with combating the transfer of drug proceeds using money remitters, money order sellers, and check cashing business:

- Some states do not have systems to regulate these non-banking institutions.
- States that do regulate non-banking institutions do not regulate them consistently.
- The federal agency charged with regulating non-bank institutions (FINCEN) has to play a law enforcement regulatory role and has to maintain a working relationship with these organizations. This results in a conflict of interest (interviews with US prosecutors).

## **7.5 Canada**

Canadian conspiracy laws are quite broad, as they cover cases of offenses committed anywhere in the world. For jurisdictional purposes, the conspiracy is often deemed to have been committed in Canada.

In 1989 Canada enacted the Canadian Proceeds of Crime Legislation, which made it an offense to possess the proceeds of crime directly or indirectly. The elements of this offense include the knowledge of the possessor and possession in Canada.

With respect to both of the above offenses, the crime (predicate offense) must also be qualified as crime in Canada. For example, someone sending

the proceeds of a crime from the UK to the Netherlands is also committing a crime in Canada, as long as the act is also a crime under Canadian law. If it is not, there is no remedy in Canada. This means that nothing could be done with respect to transactions violating currency control regulations (this is not an offense in Canada).

If crime proceeds are invested in Canada and a foreign authority is investigating the crime or making allegations, good co-operation from the Canadian authorities can be anticipated. However, this must be initiated by the overseas agency.

Things are not so easy when it comes to tax infractions. Unless there is a clear-cut case of tax fraud or false pretenses in Canada or elsewhere, Canadian law does not outlaw the transfer of money. Especially when technical violations of specific tax regulations are involved, no assistance can be afforded.

No license is required for money transfer businesses. There is not much regulation regarding the movement of money. For instance, there are currently no restrictions or permits required for the operation of a money remission business. Non-bank money remitters use securities as well as precious metals transactions.

The current regulations require certain record keeping practices (ID, forms to be filled out, maintain files). New regulations may introduce not only recording but also reporting duties on financial institutions. There is also reporting regulation of suspicious transactions (when a client refuses to provide a name). There is liability on the part of the financial institutions, if such reports are not made (interviews with Stammler).

## **7.6 Jamaica**

In September 1991, the Jamaican government introduced a policy to allow non-bank intermediaries to participate and to allow buy or sell transactions going both in and out of the country (Grosse, 1994: 19).

## **7.7 Colombia**

Two authors with hands-on experience have argued that "In recent years Colombia has relaxed its banking regulation. Source disclosure on large transactions is no longer necessary, and dollar denominated accounts are now legal. The relaxing of bank regulations was a result of the burgeoning underground banking systems that developed to serve both drug dealers and legitimate business interests" (Bosworth-Davis and Saltmarsh, 1995).

## **7.8 Australia**

The main regulatory instrument is the Banking Act 1959, which requires that banking business be conducted by properly authorized corporate bodies but does not define "banking business"; the courts have applied case law and this does not seem to cover the mere transfer of money, esp. when it is done as ancillary or incidental service. Remittance services are not considered by the Reserve Bank of Australia to be banking business. Consequently, they are not

subject to banking regulation nor do they need to register. There is the Financial Transaction Reports Act 1988, which created a “regime of reporting and identity verification requirements that ‘cash dealers’ must comply with” (Carroll, 1995: 2). Remittance service providers may have to report under the FTR Act to the Australian Transaction Reports and Analysis Centre (AUSTRAC), which decides on a case-by-case basis on whether they are defined as “cash dealers”.

So, there is uncertainty as to what is a remittance corporation, what is the business of their agents and whether they are subject to the Banking Act. If informal value remitters facilitate money laundering, they fall under the Proceeds of Crime Act 1987 (which introduced the offense of money laundering), if they “know, or ought reasonably to know, that the money or other property is derived or realised, directly or indirectly, from some form of unlawful activity” (Section 81[3]).

The import and export of gold is unrestricted in Australia. However, given that it is not only a commodity but also de facto currency in many parts of the world, it can be and is used as a way to convert the money one wishes to send overseas into a value measure that is easily convertible into the currency of the recipient (or remain as gold).

## **7.9 Singapore**

Because exchange houses are used to launder criminal proceeds, the government has amended the Money Changers and Remitters Act in 1996. Under the 1996 amendment, exchange houses must keep records on clients. At the same time, the criminal penalties for non-compliance and for assistance in laundering criminal proceeds were made more severe (Bureau for International Narcotics and Law Enforcement Affairs, 1996: 75).

## **7.10 Taiwan**

Taiwan has introduced money laundering legislation, which applies to both financial institutions and non-bank institutions, such as jewelry stores and insurance companies. The law requires the recording and reporting of suspicious activities by clients and establishes provisions for criminal negligence for institutions that do not comply with these provisions (Bureau for International Narcotics and Law Enforcement Affairs, 1996: 107). As the country attempts to regulate the alternative remittance systems, there are technical problems, for it is not a recognized country (interview with L. Carroll).

## **7.11 South Africa**

Apart from IVTS, which are used for remittances, there are also informal banks operating as saving schemes, mainly within the African community. These schemes – referred to as “stokvels” or “mashonisas” – are basically friendly societies. Members contribute a fixed sum on a monthly or weekly basis and the total will devolve to one of the members on a rotation basis. These schemes are actually small banks but are operating in terms of a

special exemption in the Banks Act. The exemption was given because they are difficult to regulate. There are probably a few hundred thousand of these schemes operating and they involve millions of rand (1 USD = 6.07 Rand). There do not seem to be IVTS in the South African culture; those known to operate are in the Indian and Taiwanese communities and will therefore fit that cultural pattern. The Indian community dominates the Mandrax trade in South Africa and there is anecdotal information about the use of IVTS to pay for imports of Mandrax to South Africa. Anecdotal information also points to the wide-spread use of these systems by members in those communities to evade the rigid exchange control regulations that South Africa had in place in the past. Although exchange control has been relaxed, it is still in effect (communication with Koker).

As professor Koker has argued, it is hard to assess the risks posed by IVTS in the country: "There is too little information available to quantify or define a threat. The threat is posed by the lack of information. We are developing extensive systems to deal with money laundering in the formal economy. Where countries have extensive informal economies and [underground banking systems], they may be forcing organised crime out of the formal economy into the informal economy, thereby making it nearly impossible to address it with the normal criminal justice methods. The shift of money from the formal to the informal economy could also affect the economy of the country, depending on the size of the pool of hot money in the economy" (communication with de Koker; see also de Koker, 1997).

## 7.12 Hong Kong

Hong Kong authorities have targeted IVTS through tax laws, because the commission the IVTS operators charge is often not declared as required by income tax laws. At present, IVTS are not regulated and do not require licence to operate in Hong Kong. As a consequence, there are no hard figures on the extent of any problem posed by IVTS or Unregulated Remittance Centers (URC), as they are called locally.

Money laundering was criminalized in 1989 (Section 25 of the Drug Trafficking Discovery of Proceeds) Ordinance 1989). The Police note that no URC has been charged so far for money laundering. Efforts are currently underway to clarify the rules applicable to them with respect to record keeping and reports of suspicious activities to the authorities. According to the Hong Kong Police, "In many investigations however it has been proved that URC have handled the international transfer of the proceeds of drug trafficking and other serious offences. The fact that no URC has ever been charged with money laundering is due to the need to prove that the agent "knew or believed" that the money concerned was the proceeds of drug trafficking or an indictable offence. In the vast majority of cases, no such evidence exists as the URC has merely carried out the remittance of the funds, without knowing of their source. It is generally true to say therefore that URC are not knowingly involved in money laundering, they are merely used by criminals for the purpose of money laundering.

...Police and the Customs and Excise Department have recently conducted a survey on 78 URCs previously identified during Police financial

investigations. The URCs were first issued with administrative guidelines to advise them to comply with anti-money laundering requirements, such as customer identification, record-keeping and reporting of suspicious transactions. In subsequent visits to these institutions, it was found that the majority of them did not comply with these administrative requirements. ...Only 3 of the URCs in the survey have criminal records, all for minor offences. It can be concluded therefore that URCs are not generally operated by criminal elements involved in organized or serious crime. This tends to support the general conclusion that URCs are used by money launderers, rather than being money launderers themselves.

Taking the survey into account, legislation amendments have been proposed to impose a duty on all persons carrying on remittance and money changing businesses to identify customers before engaging in transactions with them and to keep proper records about the transactions to minimize their risk of being used by money launders. Non-compliance will attract a fine. The law enforcement agencies will be empowered to carry out on-site inspections and examine the records kept by remittance agents and money changers" (Hong Kong police written communication; see also Oldfield, 1998).

It has also been reported that suggestions for amendments include lowering the standard of proof needed to convict people dealing with illegal funds. "It is understood the Department of Justice is considering amending the legislation's wording, possibly using terms other than "know" or "believe" (Lee, 1999).

### **7.13 China**

The black and gray markets for finance in China have been rather extensive (Xiaohu, 1996). Consequently, the authorities take the black market exchange rate into account when setting the official rate, because they fear that if rates differ drastically, then people will take money out of banks and send it through the black market (Jianping, 1998: 31).

In 1998, the Chinese authorities tightened their oversight of financial institutions and intensified their investigation and prosecution of violations of laws and regulations. When the People's Bank of China issued disciplinary sanction provisions for financial institution officers responsible for violating laws and regulations in early June, 1998, the State Council promulgated at the end of July the "Regulations Outlawing Illegal Financial Institutions and Illegal Financial Services" (Liang, 1998). So, steps have been taken to reduce the operation of "underground banks" in China, but not specifically against IVTS. One may speculate that this is so because IVTS bring value into China, rather than the other way round. It may also be that the authorities do not believe that the amounts of (criminal) money coming to China through IVTS are substantial enough to raise serious concerns.

### **7.14 Japan**

By contrast, Japan has been enforcing criminal laws against IVTS remitting money from Japan to China and other destinations in Asia. Two persons, for example, He Jie and Wu Tikeng, were recently found guilty for operating an

IVTS that remitted 5.2 million yen (USD 43,150) into China from Japan in January 1997. Jie was sentenced to 18 months in prison and the payment of a 700,000 yen (USD 5,800) fine, while Tikeng was sentenced to two years in prisons. The 5.2 million yen had been given to the brokers by nine Chinese men living in Japan. These men deposited the money in bank accounts set up by Jie and Tikeng under false names. The transaction details were faxed to brokers in China who distributed the money to the intended recipients (Kyodo News International, 1997b).

### **7.15 Philippines**

The Philippines government liberalized foreign exchange rules in 1992 in order to render conventional banks competitive with IVTS. A shift to conventional banking channels in the past has been effectively aided by the activities of small-time IVTS in the United Arab Emirates, who defrauded their client and never remitted the amounts they received from Filipino expatriates (Khaleej Times, 1993). In 1995, the government abolished currency exchange controls. Consequently, the official remittances quadrupled in the same year (interview with Miller).

### **7.16 Vietnam**

The Vietnamese government has encouraged its non-resident citizens to send funds home, either as remittances to their families or as a contribution "to the construction of the country". It has allowed overseas Vietnamese to open accounts in foreign currency, deal in and receive principal and interest in foreign currency as well. In addition, Vietnamese recipients of such funds are also entitled to open and hold accounts in foreign currency. When they make withdrawals, they have the option to take the money out either in foreign currency or convert it into Vietnamese Dong (Decision of the Governor of the State Bank of Vietnam on Foreign Currency Remittance to Vietnam by Overseas Vietnamese People, Hanoi, February 23rd, 1995). Unfortunately, the conventional banking system has been so inefficient and ineffective in this country that IVTS seemed the best way to do business.

### **7.17 India**

The government set up a special federal police unit under the direction of Prime Minister P.V. Narasimha Rao with the sole function to fight against economic crime in India. The unit will tackle serious economic crime such as bank fraud and the movement of money from foreign countries through IVTS. A major target of the unit is the big hawala brokers. It is hoped that strict enforcement of banking laws and more investigations of hawala operations will reduce the amount of money sent through the IVTS and divert the funds into the regulated banking industry. On the other hand, Indian officials believe that such measures may backfire. That is, stricter legislation may force money into the hawala system. Stricter regulation of the commercial banking system could also divert funds earned through legitimate means into hawala networks. In addition, the abolition of

bank secrecy could reduce the public's confidence in the banking system and cause a feeling of privacy invasion. In this context, the public would react by resorting to hawala, which provides more confidentiality (Natarajan, 1998). Some recent economic reforms by the Indian government appear to have reduced the amount of money flowing through the hawala. More specifically, lifting the ban on the importation of gold and silver has significantly reduced the smuggling of precious metals and the subsequent use of the proceeds from the sale of these metals to deliver money transferred through IVTS (Naqvi, 1994).

Official policy facilitates the legitimization of money brought into India through two schemes introduced by the government in 1991: the India development bond scheme and the foreign remittances (Immunity) scheme. The schemes were aimed at "whitening", the conversion of black income into white even though the money, including proceeds from tax evasion, bribes or other criminal activity, may have left India through hawala. The list of persons who took advantage of such programs is potentially more explosive than the Jain hawala diaries (see above in section on corruption and terrorism). "The list of those who brought in \$ 2,300 million in the first year alone reads like a who is who and includes not only politicians and businessmen but also professionals," said a Reserve Bank of India official (Rediff on the Net, 1997).

The 1992-93 Budget partially liberalized bullion imports by allowing Indians residing abroad to bring in up to five kilograms of gold every six months, for which a duty of about 6 per cent had to be paid. This limit was subsequently (since January 1, 1997) raised to ten kilograms. The 1993-94 Budget sought to put an end to the dichotomy between official and unofficial exchange rates, by allowing the value of the rupee vis-a-vis other currencies to be determined by market forces. In a sense, these measures aimed at both the "cause" and the "source" of gold smuggling (Business Line, 1998).

The slump in hawala business did not last for more than two years. Although the price of gold remained generally depressed, in early 1999 hawala benefited from another change in government policy. The customs duty payable by non-resident Indians for gold they imported to the country went up by 60%. Moreover, the price of gold within India rose well above the world market rates. "According to the World Gold Council's Regional Chief Executive, Mr. Rolf Schneebli, gold premium is expected to increase from the current 6.5 per cent to 9.5 per cent. This greater premium is likely to induce illegal arrival of gold into Indian shores and make hawala transactions more attractive" (cited in Kochi, 1999).

While the liberalization of the economy was supposed to help fight the prevalence of hawala, in India the problem continues almost unabated, as indicated by one successful investigation after another. Some interviewees went as far as to suggest that "hawala runs the country" in India, and agreed that hawala systems do facilitate substantial criminal activities in South Asia.

### **7.18 Pakistan**

The government has repeatedly tried to encourage capital to stay in Pakistan or flow back in through tax-exempt bearer bonds. It launched the Foreign

Exchange Bearer Certificates (FEBCs) scheme in 1985 and the Foreign Currency Bearer Certificates (FCBCs) in 1992. This second issue was timed rather badly, as it coincided with the close-down of BCCI, a bank managed by Pakistanis which was in the headlines everywhere in the world at the time amid accusations of unprecedented fraud, corruption and money laundering (see Passas, 1993, 1995, 1996). The FCBCs were supposed to attract capital by offering reasonable rates of return for funds from all sources, the origin of which was not to be questioned. The success of this scheme, advertised in a full page of the Wall Street Journal touting the “no questions asked” policy of the government, was therefore undermined by the BCCI scandal.

In 1998, the government issued new “money whitener” FCBCs to replace the 1992 certificates, although the existing stock of bonds would continue. These FCBCs were to be traded in the country’s stock exchanges and enjoy freedom from tax, duties and zakat<sup>24</sup>. Certificates were issued also in the Middle and Far East. There was no limit on the amount invested, and the certificates could be encashed at any time with no deductions. Again, the Finance Minister announced that “both the princip[al] amount and profit is guaranteed by the government of Pakistan, and no question would be asked about source of income” (cited in Malik, 1998b). The aim was clearly to attract funds from Pakistanis abroad and to reduce the attraction of hundi and hawala networks in the country. Along the way, FCBCs would effectively turn some black money into “white”<sup>25</sup>.

Only a few months later, the credibility of the government and the public confidence in the bond programs suffered greatly. One of the most important incentives to invest in such bonds was the assurance that the FCBCs did not have to be encashed in rupees, given that many local and overseas investors would like to hold their accounts in foreign currency (Malik, 1998b). In the aftermath of Pakistan’s nuclear bomb test and the negative international response to it, foreign currency accounts were frozen and withdrawals could be made only in rupees at a government-set rate of exchange. The public showed its distrust to both conventional banks and the government by going back to the time-honored hawala and hundi networks. Overseas remittances through banks dropped from US\$ 150 million per month down to US\$ 50 million (Miller, 1999).

<sup>24</sup> As noted earlier, zakat is a percentage of the income of Muslims deducted for charity.

<sup>25</sup> Turkey has also been criticized for a similar “money whitening” policy recently. The objectives of that policy were also the repatriation of funds, replenishing the foreign currency reserves, undermining informal banking systems, etc.



## 8 Research implications

The most challenging part of this project was the fact that equally distinguished and good-faith people would offer diametrically opposite assessments of the IVTS issue. Judging the reliability of official sources was anything but easy, as some interviewees questioned directly the validity of government or agency reports. Intelligence reports and memoranda turned out to be of debatable quality. They are mostly based on arrests and particular cases. The authors usually extrapolate from such cases without any precision. The sample is very small and case studies are not done for analytical purposes. The DEA report (1994), in particular, about the Asian money movement systems is regarded in some respects unsubstantiated (interview with W. Myers). W. Myers' many years long investigations and research into the ethnic Chinese communities in the USA have never produced any corroborating evidence. So, the information we have about these money transfer systems is scant, unreliable and unsystematic<sup>26</sup>. It is in this context that "facts by repetition" are almost inevitable. Incidentally, this problem is not uncommon in the field of transnational crime. Lack of adequate funding sources has forced many observers to rely on journalistic and unchecked sources of information.

The patterns appear to vary from one country to another. So, it may make sense to throw away the conventional wisdom and look in depth into the Dutch reality to see what the nature of the problem is. The first task would be to establish whether it represents a problem for the Netherlands at all. The publicly available indicators lead to the conclusion that it probably is not a priority problem. However, given how topical the issue is and how various bodies actively contemplate measures and policies to deal with the perceived threat, a brief empirical study may be helpful in allaying the fears that IVTS may be THE money laundering instrument, once banks are properly supervised and monitored. Another reason for some limited empirical research in this area is to try and find out where the illegal money is going and about criminal activities in a very broad sense, including parts of the informal economy.

Investigating IVTS requires knowledge about both financial crimes and the cultures of ethnic groups who use their services (Cassidy, 1994). The method to follow for the field research would be based on participant observation

<sup>26</sup> In his own words, Myers has stated: "Underground banking is referred to in many reports and action statements, particularly those dealing with money laundering or narcotics control, but there is virtually no development of the topic other than unsupported conclusions that it is methodology for the laundering of funds for criminal activity. Other than scant mention of the topic in law enforcement seminars, underground banking is a topic that is essentially absent from written literature. Its methods of operation remain clouded in mystery as does the extent and volume of currency passing through underground banking operations. Equally undocumented are the economic effects in the affected economies - the country of origin of the transaction and the country of completion of the transaction" (written communication).

and unstructured interviews conducted by people well-integrated in the ethnic communities concerned. After they engage in one or two transactions and gain the confidence of alternative bankers, as they seek reassuring information regarding the transfer, they can gain insight into the volume, nature and modus operandi of the system. It is important not to convey any false impression that the aim of the research is to close down or damage the system. It is essentially a curiosity-inspired exercise to understand their experience and life-style. The categories of the various sources of information to be used for building a useful database for analysis and policy construction would include existing law enforcement documents (cases). These must include the case files in the hands of FinCEN, Interpol, British and Dutch authorities (e.g., CRI). These are the most valuable and reliable data. All agencies contacted so far have offered to make this evidence available for analysis, once proper requests are made through authorized personnel.

- English language press items.
- Minority language press items.
- Law enforcement reports and personnel.
- Human sources within each ethnic community.
- Sources in the social service sector (see Cassidy, 1990).

A parallel approach would be to attempt to compare imports and exports with the countries from which each ethnic group stems from. See what asymmetries exist and in which direction. (Illegal) money flows toward the countries of origin may be indicated by substantial under-invoicing of their exports and over-invoicing of imports (there are studies analyzing gross discrepancies in the import-export statistics of the US with the rest of the world, which offer a method of calculating the approximate value of irregular and illegal trade-related transactions; Zdanowicz et al., 1995).

At the same time, it may be useful to study the demographics of particular ethnic groups in the Netherlands and look into their numbers, occupation, average income and expenses. If money flows at levels well above the reasonable abilities of each ethnic group, the excess is likely to be illegal or criminal volume (bearing in mind the caution noted above about calculating the 'reasonable' living expenses for immigrants).

## 9 Conclusions and policy recommendations

The material reviewed for this study suggests that IVTS do not represent a money laundering or crime threat in ways different from conventional banking or other legitimate institutions. While criminal entrepreneurs do make use of IVTS, it appears that the amounts involved represent a rather small part of the dirty money in circulation. The growth of IVTS for hard core criminal purposes is limited by the wide availability of numerous other alternatives and by the incapacity of informal networks to handle very large sums of money on a regular basis. This does not mean that sophisticated criminals cannot adopt IVTS methods to transfers funds among legitimate or shell companies around the world<sup>27</sup>. However, the traditional IVTS seem to be used primarily by ethnic groups either for perfectly legitimate purposes or for the commission of relatively minor offenses, such as evasion of taxes and currency controls. Occasionally, criminal proceeds travel through IVTS without the knowledge of the operators/brokers. The particular cases that make the news and draw sensational headlines do not support the contention that increasing regulation of conventional banks means more criminal business for IVTS. There is little evidence that the most sophisticated and organized criminals make use of IVTS; quite the contrary. The press and law enforcement stories may reflect more attention paid by the police to IVTS or increased awareness of their existence and operation. Such offenses may be serious and consequential particularly to societies in transition or economic and political crisis, when the amounts involved become very substantial. As policies in several Asian countries have shown, measures other than criminal law can be much more effective and beneficial. So, unless credible evidence of abuse or control of IVTS by criminal enterprises can be produced, no drastic responses are necessary. This does not mean complete inaction, inattention or complacency about possible future risks. The main conclusion of this study is that harder evidence of this threat must be established before radical actions are contemplated. Given that the transfer of money or value is not criminal per se and that IVTS offer a good, speedy, cheap and reliable service to several communities, there is no clear a priori reason to ban them or limit their accessibility. So, the first step would have to be an in depth study into the current situation and problems in the Netherlands (see above research implications)

<sup>27</sup> It has been reported in the Netherlands that some enterprises functioning as IVTS are controlled by "mafia" type criminal organizations involved in the drug trade. However, I have not seen the confidential report referred to in the article. The other source cited in that article is a Surinamese money changer, who was sour about losing business to those allegedly controlled by drug traffickers (Boom, 1996). This is a matter requiring follow up.

and/or other countries<sup>28</sup> (see Carroll, 1995; Commonwealth Secretariat, 1998). Given the concern about IVTS in many official circles, it may be helpful to conduct such a study also in order to assure those worried about the problem that the situation is not as bad as it may appear. If it is, then a number of policies can be considered at different levels and in concert with the other countries concerned. The policy options can be regulatory, legislative, educational, organizational or long-term public policy measures.

### 9.1 Regulatory measures

Any regulatory or other reform ought to proceed with some caution in order to avoid the introduction of ethnocentric rules and approaches that may alienate ethnic groups or minorities, which are involved in no criminal or harmful activity. As noted earlier, IVTS is the only available means for sending funds to the family or relatives to the homeland. These methods may also be used by illegal immigrants who have perfectly legitimate jobs. They may prefer to use these channels to prevent their detection by immigration authorities. Aggressive actions against IVTS may be counter-productive, as it may drive a lot of generally law-abiding people to more radical solutions or criminal networks. Before enacting particular measures, it may be possible to “test the waters” and find out what is the response to attempts at regulating IVTS business by those concerned.

It may be desirable, in the first instance, to examine existing rules to see whether they may be amended to cover the activities of IVTS under the rubric of “unlicensed bankers” or “unregistered money transmission service” (see also Interpol, 1991). Record keeping duties and reports of suspicious transactions may be extended to apply to money remitters. Mere record keeping, while less onerous on the businesses involved, may facilitate the investigative work of the police, especially in cases of criminal abuses without the knowledge of the money remitters. Given the importance of informality of IVTS methods, the anticipated resistance and non-compliance can be addressed through a sincere dialogue with small businesses and community leaders in the affected populations and regions (much like the consultation process involving other legitimate businesses before the implementation of regulatory reforms).

An indirect approach to monitoring IVTS activities is to turn to financial institutions where hawala accounts may be held (as is the case very often in the UK). A most vulnerable point to money remitters who transfer criminal proceeds is where the money interfaces with the regulated banking industry (see US drugs-related case cited above). Therefore, we need to pay more attention to the role and functions played by conventional banks, so that appropriate steps may be taken (Jackson interview). Banking institutions need to investigate the legitimate business capacity of money remitters who

<sup>28</sup> De Koker urges a basic study into money laundering in S. Africa focusing on IVTS in particular. “Such a study should especially attempt to ascertain the extent of money laundering through the underground banking system and other systems in the small business sector” (de Koker, 1997: 39).

want to establish bank accounts. By doing a background investigation on these companies, banks can estimate the transaction volume generated through legitimate business. If the money remitters exceed these estimates, banks need to alert the authorities to the possibilities of criminals using the services of the specific money remitter (Klapper interview). Some British banks are able to detect “hawala” patterns in accounts held at their branches and are prepared to report this to the National Criminal Intelligence Service for closer monitoring. However, a “hawala pattern” does not automatically mean criminality, as shown by previous cases in England. Nevertheless, changes in patterns could be monitored for possible investigations in the case of prima facie criminal abuses.

## 9.2 Criminal law

The US government has urged the establishment of international standards with respect to reporting requirements and laws that criminalize non-compliance with reporting regulations (Bureau for International Narcotics and Law Enforcement Affairs, 1996). The Commonwealth Secretariat (1998) has also recommended the extension of money laundering laws to cover IVTS. For instance, they should have to adopt “know your customer” rules, keep records on the identity of their clients and the amounts transferred, report transactions above a certain threshold to the authorities as well as any suspicious deals, etc. This would provide the audit trail and leads necessary for investigations. On the other hand, a DEA report (1994) has warned that rules aimed at the regulation of ordinary financial institutions cannot be expected to be effective against the use of IVTS by criminals. Interviewees are also of the opinion that IVTS will not be affected by any such rules (interviews with L. Carroll and Jost)<sup>29</sup>.

The DEA went on to argue that the only way to contain such activity is to change “attitudes towards compartmentalizing criminal activity” (US DEA, 1994). This seems to imply that facilitating the laundering of proceeds from a serious criminal offense, such as illegal arms or drug trafficking, is just as serious as the original crime itself. Treating IVTS in the same and way and with the same tools available for arms and drug traffickers may prove to be overkill. If IVTS operators do act together with criminals, however, then conspiracy and similar laws may be adequate to deal with the problem. Of course, when IVTS obstruct investigations or knowingly participate in money laundering, the relevant criminal laws could also apply to them, as they do to other enterprises (see the European Money Laundering Directive).

<sup>29</sup> Because IVTS flourish in cash economies, it has been proposed to outlaw the use of cash for transactions above a certain threshold in order to encourage the wider use of the conventional banking sector and electronic payments – especially for transactions in capital and luxury goods or real estate (Commonwealth Secretariat, 1998: 19). This type of approach requires cultural changes and traditions, which have deep routes in many parts of the world.

### 9.3 Public policy measures

A Canadian interviewee (Stammler) observed that the general trend has been towards a US-like approach relying increasingly on criminal law measures and policies. Yet, international criminal groups have overwhelmed the police and strained their resources. Even if the cost of criminal business is thereby increased, he emphasized, the profits remain high: "As a result, not much changes in practice. The root cause lies with organized criminal activities involving consensual business. This is what needs to be dealt with. Often, it is governments that create the problems by introducing or maintaining high taxes, regulations and other constraints". This comment points to the core of the matter, the long-term, structural policies required to reduce or eliminate the needs met today by IVTS.

This shifts emphasis to government over-regulation and controls, discrimination, political and economic crises, burdensome bureaucracies, unfriendly, inefficient, expensive or lacking banking services, lack of confidence (by ordinary citizens and foreign investors) in a given country's economic system and banks, etc. As long as such serious problems persist, IVTS will continue to thrive and fill important gaps left by conventional society at the regional and international levels<sup>30</sup>.

Interestingly, both economic liberalization and state intervention in the market have also been proposed as ways of dealing with IVTS in developing countries. To the extent that invoice manipulation takes place for the purpose of obtaining foreign currency and exchanging it in the black market, an Indian economist has urged the government to add to the export subsidies and to increase tariffs on imports (Thiruvengkatchi, 1984). He noted that in the case of India in the past, invoice manipulation provided so much benefit through the currency black market that even heavy subsidies were ineffective: people made even more money in the black market.

On the other hand, many have argued more recently that the best way of taking the business out of IVTS is the liberalization of the economy. This would involve adjustments of the currency exchange rate to reflect demand and supply or floating the currency. Relaxing or abolishing currency restrictions and controls could also take much business out of the hands of IVTS. Further, one could envisage the liberalization of interest rates, the removal of income taxes of remittances from overseas and the lifting of restrictions and duties on the gold bullion trade (Commonwealth Secretariat, 1998; Interpol, 1991). It must be stressed, however, that such rules and non-market based interest rates are important tools of fiscal policy in the hands of various governments that seek to stabilize their economy, avoid adverse consequences by speculative transactions, and protect the national interests in more traditional ways. In other words, there are serious reasons for the

<sup>30</sup> The faith of Pakistanis, for instance, in banks and the government was undermined, when their foreign currency deposits were recently frozen and they were only allowed to withdraw local currency. In many parts of the world, both governments and financial institutions have a good deal of work to do to restore their citizens' confidence and trust (Miller, 1999).

existence of certain rules, which nonetheless have the effect of encouraging IVTS.

#### **9.4 Training issues**

The above policies can only be pursued and achieved in the long term. In the meantime, it is essential to sensitize controllers to the various ethnic communities; explain how they can identify IVTS patterns and how to spot irregular and potentially criminal abuses. In the short-term, investigators must be trained to understand the culture of ethnic groups they look into. Prosecutors, law enforcers and regulators stress the importance of culture and argue that researchers could assist by conducting studies into demographics, estimates of the volume of transactions, IVTS and the traditions around them.

#### **9.5 Organizational measures**

In the light of basic lack of knowledge about IVTS and the misleading nature of many public reports, it is vital to develop international agreements that allow for the exchange of information among law enforcement agencies. It is also critical to promote international cooperation in investigations of misconduct concerning more than one countries (Bureau for International Narcotics and Law Enforcement Affairs, 1996).

It is also important to be sensitive to the varying needs and priorities of different countries. More initiatives are proposed and implemented, for example, when drug money is involved than against capital flight. The optimum degree of cooperation and mutual assistance can be achieved when the needs, objectives and policies of all countries are respected in practice. With respect to developing countries, often victimized by capital flight through both conventional and unconventional bank channels, it has been recommended that they co-ordinate the action and policies they wish to implement among the various government departments. Specifically, an Indian agent seconded to Interpol has suggested that a coordinating body be introduced to ensure that the different agencies act in harmony (Harjit Sandhu, quoted in Commonwealth Secretariat, 1998: 18).

#### **9.6 Evaluation methods**

Finally, measures and policies are often implemented without specific targets or objectives, especially in the "war on drugs" in several countries. Policy makers, controllers and the public can only benefit from the introduction of evaluation tools, so that we can all have a sense of whether these responses to given problems are working or not. The use of evaluation instruments to measure success and failure will reduce the chance of having sterile arguments between supporters and critics of each policy (e.g., when they can use the same information to reach different conclusions).





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*Finance India*, vol. 9, no. 3, 1995





## Appendix 1

### List of interviewees

- Stephen R. Kroll, legal counsel, FinCEN
- Patrick Jost, Ph.D., FinCEN (two interviews, a one-day meeting, two telephone interviews, written exchanges and extensive email follow-ups).
- John A. Cassara, US Customs Service
- Patricia Milla-King, FinCEN
- Joseph M. Myers, FinCEN
- Peter G. Djinis, FinCEN (three interviews)
- Bonnie Klapper, Assistant US Attorney, N. District of NY (Long Island)
- Deborah G, Special Agent, US Internal Revenue Service.
- John Moscow, US Attorney's office, Southern District of New York State, Manhattan.
- Willard Myers, Director of Center of Asian Studies (one half-day interview, three telephone interviews and email exchanges)
- Lisa Carroll, Interpol and Sam Houston University (three telephone interviews and written exchanges).
- Tom Brown, Interpol (telephone interview)
- Michel Koutouzis, Observatoire Géopolitique des Drogues, France.
- Rick McDonnell FATF Asia, Australia (telephone interview and several written exchanges by faxes and email).
- Lam Kwai-bun, Hong Kong Police Force, Hong Kong
- Professor Mark Gaylord, City University of Hong Kong, Hong Kong (interview in Washington DC and email communications).
- Nick Jackson, Detective Superintendent, England (three telephone interviews and written exchanges).
- Professor Barry Rider, Cambridge University, UK
- Rowan Bosworth-Davis, investigator/consultant, UK
- Matt Miller, Institutional Investor, USA
- Jack Blum, attorney, former Congressional chief investigator, USA
- Professor Simon Pak, Florida International University, USA
- Rod Stammler, former Assistant Commissioner of the RCMP; at various times he headed the Drug Directorate and the Economic Crime Directorate, Canada (two telephone interviews)
- Professor Tom Naylor, McGill University, Canada
- Professor Ulrich Sieber, University of Würzburg, Germany
- Professor George Aditjondro, Newcastle University, Australia and Indonesia
- Professor Peter N. Grabosky, Australia
- Sergei Maksimof, Russian Prosecutor

- Professor Louis de Koker, Centre for Business Law at the University of the Free State, South Africa
- Lala Camerer, Institute for Security Studies, South Africa
- Amjad Awan, banker, Pakistan
- Dr Neera Burra, India and UN Drug Control Programme
- Professor Steven Sampson, Lund University, Sweden

## Appendix 2

### Search items

#### *Search words employed*

Alternative bank  
Alternative remittance system  
Black market peso exchange  
Cambios  
Casa de cambio  
Chiao hui  
Chit  
Chop shop  
Fei ch'ien  
Flying money  
Giro houses  
Hawala  
Hawalla  
Hui kuan  
Hundi  
Informal bank  
Money transmitters  
Nging sing kek  
Parallel banking system  
Parallel remittance system  
Phoe kuan  
Underground bank

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Hotbot  
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