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Informal Money Transfer Systems:

Opportunities and Challenges for Development Finance

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Abstract

This paper reviews the main types of informal money transfer systems (IMTS). Developed centuries ago as a way to settle financial obligations, IMTS remain today the preferred remittance vehicle among migrant communities. Characteristics, such as low transactions costs, speed, and little paperwork, render them more attractive than banking institutions. After September 11, IMTS were suspected of being used for terrorist purposes, leading some to call for their prohibition. The authors think such a response is too drastic and instead propose measures to make IMTS less prone to possible abuse by criminal elements and encourage the development of formal sector alternatives.

Key words:
Asia, Chit, Chop, Colombian black market peso exchange system, exchange controls, fei ch'ien, financial regulation and supervision, hawala, hawaladar, hundi, Informal money transfer systems, Latin America, macroeconomic and structural adjustments, migrant workers, money laundering, money transfer infrastructure, parallel foreign exchange markets, remittances, terrorist financing.

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Contents

Page

I. Introduction . . . 1

II. Main types and characteristics of informal money transfer systems . . . 1
How the hawala system works. . . . 2
How the fei ch'ien system works . . . 3
Other remittance systems . . . 3

III. Reasons for the continued existence and use of informal money transfer systems. . . 4

IV. Policy measures to promote legitimate remittances . . . 7
Migrant-specific policies . . . 7
Creating macroeconomic incentives to remit through institutional channels . . . 8
Improving conventional financial infrastructure . . . 9
Formalising informal systems . . . 12

V. Concluding remarks. . . 13

Notes . . . 17

Figures

1. Flow of activity in a typical hawala transaction . . . 15
2. Sample of hawala bookkeeping . . . 16

I. Introduction

In the aftermath of the September 11 attacks, informal money transfer systems (IMTS) have become the subject of heightened attention around the world. Strong concerns have been voiced about the actual and potential use of these unregulated systems by terrorist organizations as these systems have historically proven themselves to be one of the safest methods to transfer money without a trace. Accordingly, IMTS have come under intense scrutiny by domestic and international law enforcement authorities.

Much less consideration has been given to very important economic functions these systems perform. In fact, IMTS provide a fast and cost-effective method for worldwide remittance of money, particularly for low-income people who may be outside the reach of the formal financial sector or who transfer relatively small sums that are often subject to prohibitively high minimum charges at conventional institutions. Because of these features IMTS are sometimes called “the poor man’s banking system”.

The available information on IMTS is limited, vague and contradictory, while misconceptions about their operations are many. This paper is an attempt to summarise what is known about informal money transfer systems. Also, possible strategies to maximize the flow of remittances and their economic impact are discussed.

II. Main types and characteristics of informal money transfer systems

Scholars have given different names to the remittance systems that are being studied in this paper. For instance, these systems have been called “underground banking systems”.[1] This term, however, is a misnomer, because they are not “underground” in many areas of the world. Many IMTS operate openly, as they do 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 jewellery shops, textile or apparel shops and many other business establishments. Some operators based in the United States, particularly those who do not get involved in the transfer of illegal funds, also operate openly. Many operators advertise their services in ethnic newspapers.

It is also misleading to refer to them as “banking systems” since their operations do not involve traditional banking transactions such as deposit taking or lending. It is also not correct to describe them as “alternatives” to banking systems because these systems have been around long before the first bank came into existence.

It is also widely believed that IMTS arise when political instability impedes the efficient workings of conventional institutions or when people seek ways to evade trade and foreign exchange controls. These factors may be parts of the reasons why IMTS continue to exist today but they certainly are not the reasons why they developed in the first place. IMTS also are not generally associated with violence and do not fit the Western description of gangs and crime syndicates. It has been argued that IMTS operations run relatively smoothly because they are free of bribery and corruption.[2] Their beginnings were, in fact, benign, and were the result of people of similar ethnic background seeking a workable, efficient, cheap and secure means of transferring money and settling accounts with one another.

The term, “informal money transfer systems” (IMTS) is used here because it describes more or less accurately the nature and function of the process, that is, to expedite the transfer of money from one location to another. In fact, IMTS are remittance systems that exist and operate outside of (or parallel to) conventional regulated banking and financial channels.

Although IMTS have operated in various communities over time, the largest ones operating today evolved from two original types, namely the *hawala* (*hundi* in Pakistan), which developed in South Asia (Bangladesh, India, and Pakistan) and the *fei ch’ien,* which started in China.[3] In addition to these two systems, several money transfer systems have developed through the years, most notably, the Colombian system, which has arisen in the context of the black market for pesos.

When the two initial money remittance systems actually originated is not clear. Some researchers say that the *hawala/hundi* system was developed more than a century ago within the immigrant Indian population in Africa and South East Asia as a means of settling accounts. Other scholars place its origin many centuries ago when traders sought a secure system to transfer money and people looked for a way to travel without having to carry large sums, thereby making them less vulnerable to robbery by highwaymen.[4] Still, other experts claim that the *hawala* system has been around for thousands of years, having been part of the ancient Egyptian system based on credits called *giro*.[5] Regardless of its true age, the system remains widely used in the world today, especially in

Africa, Asia and the Middle East.[6] From the immigrant Indian communities in South East Asia and Africa, the use of the *hawala* system followed immigration patterns and spread to other regions of Asia, Middle East, Europe and North and South America.

There is no reliable estimate available to measure the growth and extent of the volume of money flowing through IMTS. It is difficult to obtain hard evidence to make an informed assessment possible. Data coming from governments and journalistic sources are usually a product of guesswork, or anecdotal in nature and so their reliability is questionable. In any event, it is estimated that as much as $100 to $300 billion flow through IMTS every year. In India, in 1991, it was estimated that *hawalas* were processing between $10 billion to $20 billion a year. In Pakistan, more than $5 billion flow annually through its *hundi* networks.[7] It would be helpful if more accurate estimates of the volume of business were available to guide decision makers in the design of appropriate policies affecting these systems.

How the hawala system works

The operation of *hawala* essentially involves a *hawaladar* (or "broker") delivering money from his cash reserve or account at the request of a counterpart *hawaladar* in another country who is serving a client.[8] In country A, a client hands over a sum of money to the *hawaladar* and requests that the equivalent amount (usually in the currency of the receiving country) be sent to a designated recipient in country B. The sending *hawaladar* relays all the necessary information concerning the transaction to a counterpart *hawaladar* in country B either through telephone, facsimile or email. At this stage of the process, a "collection code" is agreed between the two *hawaladars*. The *hawaladar* in country A will then communicate this code to the client, who, in turn, will relay it to the designated recipient in country B. The *hawaladar* in country B will give the money to the recipient upon presentation of the collection code. If the sending client is also the recipient, he would have to present the code to the counterpart *hawaladar,* upon arriving in country B before the money could be released to him. (See Figure 1 for a flowchart of activity in a typical remittance process). In many cases, the payment will be made by the counterpart *hawaladar* to the designated recipient within hours after the request to remit money was placed by the client in Country A. The income of the *hawaladar* from the transaction comes from charging a commission ranging from 0.25 per cent to 1.25 per cent of the amount involved and is paid either in local currency or foreign exchange.

The lower operating costs of *hawalas* enable them to entice clients to use their services by offering exchange rates that are more attractive than the official rate available through conventional banking institutions. For instance, *hawalas* in New York, which are engaged in the service of remitting money to the Philippines may offer customers an exchange rate of 52 pesos per US dollar compared to 50 pesos per US dollar that banking institutions are offering that day.

In the process of remitting the amount of money from Country A to Country B, the sending *hawaladar* will owe his counterpart the equivalent of the amount given to the designated recipient since the Country B *hawaladar* gave the money to the recipient out of his own cash reserves. The debt of the sending *hawaladar* is eventually cleared and the book on the transaction is balanced, either by a remittance requested in the opposite direction or a variety of methods of moving money. These methods include money transfers through conventional bank routes and postal money orders as well as goods swaps. The Rothschild family banks operated much the same way in the nineteenth century and settled their accounts at the end of the year.[9] Balancing the books could also be done through the movement of money by illegal means such as smuggling of currency, commodities or invoice manipulation.[10] Nowadays, netting operations of transnational corporations follow much the same principles. The purpose of these operations is to minimize, if not entirely eliminate, bank fees on their international remittances and foreign exchange fees on accounts payable and receivable. (See Figure 2 for a sample of a *hawala* bookkeeping record).

In the transaction described above, money is transferred between two parties living in two different countries but cash does not cross borders. Also, the money never enters the conventional banking system. The transaction is based upon a single communication between the two *hawaladars* and is usually not recorded or guaranteed by written contract between them. A bond of trust that exists between the two "brokers" secures the debt. Country B *hawaladar* has no legal means to seek redress in the event of a default by the Country A *hawaladar* on payment of the debt. In some cases, that trust between client and Country A *hawaladar* enables money to be delivered to the recipient party in Country B even before the sending *hawaladar* has received the money from the client.

How the fei ch'ien system works

The *fei ch'ien* (means "flying money or coin") system of money remittance evolved during the latter half of the T'ang Dynasty (618-907 AD) as a result of the growing commodity trade within China. One account claims that it was developed as a consequence of the increased rice trade between the northern and southern part of China, while another theory states that the *fei ch'ien* developed out of growing tea commerce between the Imperial Capital and southern China.[11] Scholars argue that the *fei ch'ien* system evolved from the ancient Babylonian debit system that employed cuneiform tablets as debit instruments (cheques as we known them today).[12]

During that period, merchants from the southern part of China sold their tea and other goods at the Capital and transferred their revenues from the sales to "memorial offering courts" (liaison offices or agencies of provincial governments located at the Imperial Capital) where these revenues were used to pay taxes due from these provinces to the central government. These "courts" issued certificates indicating amount paid by the merchants who, upon their return, would present them to the provincial governments for payment of an equivalent sum of money. The *fei ch'ien* system was thus a convenient means of exchange, sparing the merchants and couriers of the provincial governments the inconvenience and risk involved in transporting money physically over long distances. Without any money in their possession, the merchants would be less attractive targets for highway robbers. This system enabled money to "move" instantaneously from the capital to the provinces.

In addition, as the Chinese began to migrate to many parts of the world, a split

family system developed, featuring one part that stayed back home and another that took up residency abroad. This split family system was held together by a strong bond, which was characterized by the continued flow of remittances from the expatriate unit in support of the family that stayed in China. The expatriate families with stores (like gold shops) soon dominated the business of transferring money from abroad to China. The remittance system that developed as a result of the demand to send money back home was the precursor to the early banking services in China. For instance, in the Shansi Province during the Ch'ing Dynasty (1644-1911), banks were originally a system to transfer money safely between locations. These operations, initially run by families, soon expanded outside provincial borders to cover the whole country. Branches were opened in cities where the families had business interests and issued drafts, similar to present-day travellers checks. Later, other forerunners of the modern bank, such as silver shops, clearinghouses, and money exchangers sprouted and competed with the Shansi "banks".

With the advent of Chinese emigration in the nineteenth century, the *fei ch'ien* system became "internationalised". The "within-the-family" structure of the remittance process offered the added advantage of privacy in the transactions and many clients would use the system to shield their income from the heavy tax burdens imposed by some governments on the ethnic Chinese.

Other remittance systems

A variant of the *hawala* and the *fei ch'ien* systems is the *chit* system, which, contrary to the popular belief that it was developed by the Chinese, was, in fact, introduced by the British colonialists in China during the nineteenth century. *Chit* is a diminutive of the Hindi word, *chitti,* and means a note, pass or certificate given to a servant.[13]

In the *chit* system, the salaries of British workers were deposited to an escrow account managed by a Chinese *comprador*. These foreign workers would write *chits* to pay for food and other essentials that they purchased from local merchants. In turn, the merchants would present these *chits* for collection (payment) to the comprador, who would then deduct the corresponding amounts from the accounts of the foreign workers.[14] The *chit* system offered not only safety from robbery as people needed to hold less cash than otherwise, but it was also convenient since foreign workers did not have to carry around with them cash, silver ingots or even bulky commodities, such as silk, to use as payment for their purchases.

The *chop* system works the same way as the *hawala* system and is still in use today.[15] A client in Country A wishing to remit money to a recipient in Country B would come to a "broker" at a store or outlet who will take the cash, make an entry into a ledger book for the amount received and communicate the relevant information about the transaction (amount to be remitted, name and location of recipient, etc). The "broker" will also create a *chop* (in this situation, possibly a train ticket or play card), tear it into two pieces, give one piece to the client and send the other piece to his counterpart broker in Country B. The client sends his half of the *chop* to the recipient. A match of the two halves will be made before the broker releases the money to the recipient. Transactions involving the transfer of goods usually entail the use of seals (which would be broken in two pieces) and generally follow the procedures described above in the remittance of money. A commission fee is charged the client for the service.

Despite many similarities between *hawala* and *chit* and *chop*, there are notable differences between the two systems. The *hawala* system makes comparatively less use of negotiable instruments since the components that drive its operations are the element of trust and extensive use of ethnic or familial connections. Some remittance systems, like those operating in Hongkong, and the Chinese and Vietnamese systems in Australia, require that the entire sum to be remitted be given before the transaction takes place.[16] Furthermore, one group of researchers argues that the remittance function of the *hawala* system today is intertwined with gold smuggling and money laundering and therefore involves the extensive use of such schemes as the manipulation of export and import invoices more often than is the case with its Chinese counterpart system.[17] Also, the Chinese IMTS are mostly one directional (to China), while the South Asian systems are bi-directional. To restore balance in the books of the Chinese remittance systems, evidence suggests that conventional banks and wire transfers are used to send money back to China.[18]

The *Colombian black market peso exchange system* has been developed more recently as a vehicle for the movement of money across borders. Contrary to reports that it was established to facilitate laundering of drug-related money, the Colombian black market peso exchange system was developed in the 1970s to serve the needs of Colombian importers. The currency controls instituted by the Colombian Government during the period to ensure that taxes and duties were paid sharply reduced the profitability of importers. Exchange controls handicapped their ability to obtain the hard currencies needed overseas to settle their accounts as the Government placed limits on the amount of foreign currency that could be purchased. Importers were thus willing to purchase them at a premium over the official rate. Buying hard currencies through this system enabled the importers to obtain hard currency without limit, thereby removing a constraint on how much they could import.

With the rise in the drug trade in the early 1980s, the demand of drug dealers for local Colombian currency (to repatriate some of their drug revenues abroad to Colombia) complemented the robust demand for hard currency by importers. Matching the drug dealers' demand for Colombian currency and the importers' demand for hard currency was done by money changers in Colombia and their United States associates and a profit was made from the spread between the official and the black market rates. As a result, the use of the Colombian black market peso exchange system became widespread and took on a more sinister turn. It began to be used as a vehicle to launder drug money and other illegally acquired wealth.

The Colombian model of the black market is not unique. It is but one of many black markets found operating around the world. Some black markets operate in the open, even publishing their exchange rate through the mass media. Some are tolerated by national governments, which have occasionally used their services.

Many unlicensed remittance centres (URCs) operate in Hong Kong and their services mainly involve the transfer of money from Hong Kong to other parts of the People's Republic of China, where currency controls are enforced. URCs exist in various forms. Many are located in shop or office premises offering remittance service exclusively or along with some other services such as money exchange or international facsimile services. They are also situated in residential premises, operated by a member of the occupying family as a part-time job. If a client wishes to send money from Hong Kong to other part of China, say Shanghai, he must find a URC that is able to remit money there. The client deposits money into the bank account of the Hong Kong URC and relays to the Hon Kong URC all pertinent information regarding the intended recipient. The Hong Kong URC contacts its counterpart URC with instructions to remit money to the designated recipient.

There are other types of IMTS, including the Thai (*poey kuan*) and Vietnamese systems. Their operations, however, are similar to either the South Asian *hawala/hundi* or Chinese *chop* system.[19]

III. Reasons for the continued existence and use of IMTS

Despite the increased pace of globalisation, ease of travel, introduction of new technologies and the growth of transnational banking, IMTS have not been replaced by conventional or Western-style banking and continue to be used in the present day. The reasons for their popularity are manifold. One of them lies in the hosting country's macroeconomic environment and government policies and regulations, such as currency controls and overvalued currencies, high tariffs and taxes, and slow and expensive licensing process for financial institutions. In Jamaica, for instance, the vibrant underground economy, together with stringent government restrictions, slow licensing process, high tariffs and other prohibitions provide fertile ground for the growth of informal money transfer systems.[20]

IMTS also experienced strong growth in times of political change and instability. For instance, *hawala* significantly increased its operations after the partition of India in 1947 and subsequent introduction of foreign exchange controls that made illegal all transport of currency between India and Pakistan. It happened again in Southeast Asia during the Vietnam War, in tandem with the rise in a huge black market for foreign exchange.

There is strong incentive to use IMTS if the official exchange rate is overvalued (thereby acting as an implicit tax on those who remit money through official channels). In fact, many experts view the difference between the official exchange rate and the black market rate as one of the most important factors determining the choice of transfer channel.[21] According to a study of six major labour-exporting countries of North Africa and Europe, a rise in the black market premium of 10 per cent results in a decline in remittances through formal channels by 3 per cent.[22] It is worth noting that foreign exchange restrictions not only provide incentives to remit through informal channels. They also create strong demand for these types of transactions because of capital flight from the sender's home country. In sum, the more regulations are in force to restrict trade and currency exchange and flows or the movement of people and money, the wider the use of IMTS.

The second major reason relates to the weaknesses in conventional financial systems, such as high costs, poor or unavailable service and lack of access. For reasons described earlier, IMTS provide immigrants and small firms a much less expensive, faster and more secure way to remit funds than that provided by traditional banks and non-bank institutions, such as Western Union. This may be seen from a comparison between *hawalas* and Western Union of fees charged and the time it takes to remit $500 from Metropolitan New York City to selected cities around the world:

Also, in many parts of the world, especially in the rural areas of the developing countries, IMTS are the only possible means of receiving money from within the country or abroad. There are places where conventional banking facilities do not exist, are terribly inefficient, slow or expensive. For instance, the lack of banking linkages between Australia and several African countries was the reason behind the establishment of an IMTS in Australia to serve the needs of African expatriates there.[23] IMTS are also the only channel of sending money from the United States to some African countries including Somalia. And several aid groups funded by the European Commission use almost exclusively informal money transfer networks to transfer funds to some African and Asian countries.[24]

Even if conventional banking services are available in the area, they may not enjoy the trust and confidence of the people. This especially concerns those who have experience with bank runs and failures that have led to loss of their savings. Also, in many countries conventional banking facilities have failed to perform international remittance service efficiently. For instance, in the Russian Federation, the use of barter and IMTS systems substituted in part for functions usually performed by banks. In China, IMTS are used because the official currency exchange market cannot fully service the demand for foreign currency of the economy.[25]

The recognition that macroeconomic and institutional deficiencies are the primary reasons for leakages from formal to informal channels shifts the emphasis to political and economic crises, to extensive government intervention, including through repressive financial policies, excessive taxation, currency and trade restrictions and banking systems that are not trusted by the population and also global market dominance by large service providers as illustrated by Western Union. As long as these problems exist, IMTS will continue to thrive in many developing countries and fill important gaps left by the conventional financial system at the national, regional and international levels.

The operations of IMTS are free of bureaucracy and are reliable because they are streamlined, involving a minimum number of parties. The duration of a *hawala* transaction could be as short as a matter of hours.

Being a relatively document-free transaction, it also offers discretion, secrecy and anonymity to the sending and receiving parties of the remittance. The discretion that the *hawala* system provides to its clients makes the element of trust an essential feature of the system. With trust and the strong influence of social connections, such as family or regional relationships, *hawaladars* are almost universally honest in their dealings with clients and each other. It has been emphasised that, in some respects, the *hawala* system is self-regulating. It is rare for *hawaladars* to defraud one another or their clients. Cheating among *hawaladars* is punished by effective excommunication and "loss of honour", which is tantamount to an economic death sentence.[26]

The element of trust makes a typical IMTS transaction less formal and less adversarial in tone. Consequently, there is less need to prepare documents spelling out in detail the responsibilities of all parties. It has been argued that a business culture based on trust may prevent widespread use of formal financial systems. In the "modern" financial world, there is so much distrust that every letter has to be documented.[27]

It should be noted that informal money transfer systems have spread far beyond initial boundaries mostly as a result of the significant rise in immigration from developing to developed countries since the 1970s and the subsequent increase in migrant worker remittances back to the home countries. The flow of immigration to the West has spread the incidence of the split family with strong bonds between the two units. This bond is characterized by the provision of financial support by the expatriate family to the homeland unit in the form of a sustained flow of cash transfers. Indeed, the appearance of the *hawala* system in the United States is directly linked to the growth of immigrant communities, especially from South Asia.[28]

Millions of expatriate workers in the world remit incomes through informal money transfer services including the *hawala* system and the funds involved, while significant in total, are generally small per person and per transaction. This is a market response by economic agents who are constrained by the level of financial development and government policies. In effect, IMTS have become the poor man's private banking vehicle. In this regard, it has been argued that this private banking is on par with what conventional banks provide to the high net worth individuals in terms of personalised service, confidentiality, security and informality.[29]

According to many observers, efficient international consumer-oriented payment mechanisms capable of handling a very large number of small transactions simply do not exist in the "formal" economy.[30] Financial infrastructure in both developed and developing countries has failed to offer efficient services needed by migrant workers. This lack of outreach by the formal sector, coupled with traditions of not utilizing formal financial systems, has resulted in a growing population of unbanked individuals, especially immigrants, in developed countries and a money transfer process that is either costly and inefficient or is undertaken outside of the conventional financial system.

In many Asian, African and Latin American countries, informal foreign exchange markets are fuelled principally by migrants' remittances.[31] In these informal markets, money moves in both directions: into the labour-sending country from the migrant, and out of it on behalf of other economic agents who want the foreign exchange (mainly importers and wealthy individuals). As noted above, the foreign exchange may not even enter the labour-exporting country.

One indicator of the extent of the flow is that the total amount of recorded remittances increased from around \$2 billion in 1970 to more than \$100 billion in 1999, twice as much as official development assistance (ODA) in that year. Yet remittances through the formal channels represent only a part of this type of transfers. Research on remittance flows in Asian countries has shown that informal transfers may comprise from 15 to 80 per cent of the true amount of remittances. Also, one study of Mexican migrants has indicated that between 28 and 46 per cent of remittances may be sent through informal channels.[32] And, according to a recently published report of one consulting firm, in 2002 informal networks' share of remittance market in developing countries was around 45 per cent.[33] In several cases (Bangladesh, Pakistan), despite a growing migrant labour force, foreign remittances through official channels have declined significantly since the late 1980s.

The qualities of simplicity and anonymity of the operations of the *hawala* system have also attracted individuals and groups engaged in criminal activities such as money laundering, gambling, smuggling or the financing of terrorism. Similarly, while legitimate clients of unlicensed remittance centres (URCs) use that system because of its quick and cheap international remittance service, criminal elements also engage its services to hide the origin or destination or break the audit trail of money. Some characteristic features of URC operations, such as their generally inferior customer background checks, customer identification records, transaction records and lack of compliance with laws requiring that suspicious transactions be reported, lure criminal elements to use their services for illegal purposes.[34]

There is, however, no proof that IMTS are the criminals' preferred vehicle. It has been argued, for instance, that sums of money transferred through this channel by terrorists are so small as to be indistinguishable from those sent by its usual clients, migrant workers.[35] In fact, the conventional financial institutions may be a more efficient vehicle to send money to finance big operations since their capacity to process large sums without arousing suspicion is greater than that of the typical IMTS. It has been reported that the suspected hijackers of the airplanes involved in the September 11 attacks received and sent funds through Western Union and conventional banking facilities.[36]

It might not be easy for criminals to penetrate IMTS and control them. For instance, according to a spokesman for the European Commission, there had been nothing to suggest that the Taliban regime exercised control over the *hawala* system.[37]

Therefore, to argue that IMTS are heavily involved in criminal activity may be an exaggeration. IMTS seem to be no more of an impediment to laws aimed at eliminating money laundering activities or a risk of terrorist activity than the conventional financial institution. Determining the extent of involvement of the IMTS in illegal activity is an ongoing challenge to scholars and is critical to the design of appropriate policies to regulate their activities.

IV. Policy measures to promote legitimate remittances

As noted above, the bulk of money going through IMTS represent migrant worker remittances that increased manifold over the past several decades. Having realized the potential financial importance of remittances for development, governments and international organizations are searching for effective strategies to channel these funds to home countries.

Several studies have shown that the number of migrant workers abroad and their wages together explain over 90 per cent of the variation in inflow of remittances.[38] This implies that policy measures designed to encourage migrants to remit more would likely have insignificant impact on total remittances. However, these measures may have an effect on the migrants' choice between formal and informal remittance channels.

Migrant-specific policies

Over the years, governments have introduced a number of policy measures to encourage migrants to remit more through formal channels. Because remittances are essentially private transfers, these policy measures have been mainly in the form of incentives, but in some instances they have also been imposed as mandatory requirements.

There have been several attempts to introduce mandatory remittance limits in the form of a certain proportion of earnings transferred back to the labour exporting country through formal channels. Examples of countries where minimum remittance requirements were introduced include Bangladesh, Republic of Korea, Pakistan, and the Philippines.

This, however, proved effective only in Korea due to the unique features of the Korean labour exporting process. Almost all Korean migrant workers are employed directly by Korean companies involved in construction projects in the Middle East. The government plays an active role in the process by directly assisting companies to win contracts. In turn, the Korean corporations deposit their employees' salaries in foreign currency accounts in Korean banks.

However, mandatory deposits of foreign labour earnings cannot be enforced where workers independently find employment in an open market, which is the more typical situation. In this regard, it has been argued that a legal remittance requirement policy can be effective only in the rare situations where the governments have direct control over the entire process of labour migration.[39]

Recently there was another case of successful official intervention. The crackdown on the *hundi* system of remittances to Pakistan has diverted significant foreign exchange flows to the banking system since September 11th. In seven months to January 2002, official remittances were 64 per cent higher than in the same period a year before.[40] It is estimated that between $5 and $11 billion per annum is remitted by overseas Pakistanis through the hundi system.[41] This is a large amount when compared to Pakistan's total exports of under $10 billion. Remittances through banking channels average just $1 billion a year. However, to make the shift to formal transfer channels, lasting improved bank performance and cost effectiveness are needed as well as a more conducive business environment in the country. Otherwise, this windfall could be short-lived.

Overly harsh government interference in the remittance process could lead migrants to send a higher share of remittances through informal channels, the opposite of the initial intent. There is a broad consensus that incentives rather than mandatory regulations should be used to increase remittance flows. However, it is still unclear which types of incentives would be best suited to accomplish the objective and how they should be implemented. Thus, many labour-exporting countries have attempted to divert remittances to official banking channels through various incentive schemes. To attract remittance money, many countries introduced migrant foreign currency accounts and bonds that are not subject to foreign exchange regulations. In Bangladesh, India, Pakistan, Sri Lanka and Viet Nam, foreign currency accounts pay above-market interest rates. Also in these countries, as well as in Egypt, Poland and Turkey, premium exchange rates are offered for the conversion of foreign-currency balances into local currency. Foreign currency bonds targeted to migrant workers also offer higher interest rates and premium exchange rates. Compared to foreign currency accounts, they are considered to be more effective in diverting unrecorded remittances in the formal banking system, because of anonymity provided.

In most cases, however, the introduction of migrant foreign currency accounts and bonds have brought mixed results. These instruments could be attractive only to professional and higher-skill categories of migrants who earn relatively high incomes and have funds for investment. These categories account for a minority of migrant workers.

More generally, special government programmes to capture remittances have been considered relatively ineffective.[42] None of the incentive schemes address major factors that lead to the leakage of remittances into informal channels. It would be difficult for "migrant specific" incentive schemes to be successful in significantly diverting remittances if macroeconomic fundamentals remain distorted and institutional deficiencies persist. These schemes cannot substitute for a stable macroeconomic and political environment as well as an efficient financial system.

Creating macroeconomic incentives to remit through institutional channels

Social and economic stability, a low rate of inflation, positive interest rates, a stable and realistic exchange rate and reliable financial institutions are the most important elements in deciding whether to remit through formal channels or use alternative systems. Hence, the core of the matter is that long-term structural policies are required to reduce the needs met by informal systems.

It has been argued that the best way to significantly reduce the volume of informal transactions is the orderly liberalisation of the economy. The more the government restricts imports and rations foreign exchange, the more important informal systems become.

There is a strong incentive to use informal systems in (quite typical) situations where the money is sent from the country that has a convertible currency and no capital controls to the country with inconvertible currency and/or "black market" exchange rate.[43] In this case the informal transactions can often be carried out at much better exchange rate than the official rate to the benefit of the remitter and recipient.

This incentive has appeared to be quite strong. For instance, a study of six major labour-exporting countries in North Africa and Europe has shown that a rise in black market premium by ten per cent results in a decline in official remittances by three per cent.[44] Conversely, the narrowing down of the difference between official and open market exchange rates tends to significantly increase the use of formal channels. Hence, the most effective strategy to divert remittances into formal channels is likely to do away with policies that result in dual and parallel exchange markets. Such markets are always an incentive to keep using informal systems.

Changes in foreign exchange regimes could exert very profound influence on the structure of remittance flows. For instance, in 1995, when the Philippines abolished exchange controls and unified the exchange rate, private remittances through formal channels from abroad quadrupled in the same year.[45] Since then, informal channels for that country are considered to be of low significance.[46] The changes in government policy in Pakistan in 1998 had just the opposite effect. After the nuclear test in May 1998, the government introduced strict currency controls including a freeze on foreign currency accounts. The withdrawals from these accounts could be made only in rupees at a government-set exchange rate of 46 rupees with *hawala* rate having been at around 58 rupees. As a result, foreign remittances through banks dropped to less than $50 million a month from about 150 million a month.[47] For Pakistani overseas workers the *hawala* system became almost the exclusive medium of transferring money back home.

Regarding black market premium, several countries have taken a half-way approach. For instance, while maintaining exchange controls, the Chinese financial authorities take into account the black market rate of exchange in setting the official exchange rate. The major aim of such a policy is to provide incentives for people to keep money in the banks.

Relaxation of trade restrictions could also play an important role. In most cases international remittance flows are very asymmetric; the inflow is not offset by a financial outflow from labour exporting countries. However, smuggling of foreign goods that are subject to import restrictions requires the outflow of funds to settle the accounts. Accordingly, trade liberalisation could significantly lower the volume of informal trade transactions. Indeed, in India, much of the steam from the *hawala* system was taken out in the mid-1990s, when bullion imports were partially liberalized while the value of the rupee vis-à-vis other currencies was allowed to be determined by market forces. These measures both reduced incentives to remit through informal systems and cut the amount of proceeds from the sale of smuggled gold that could be used to deliver money transferred through IMTS. As a result, *hawala* activity slowed while there was a 40 per cent increase in remittances by non-resident Indians through banking channels. However, the slump in *hawala* business did not last long. In early 1999 the government raised the gold import duty by 60 per cent. This change in government policy made *hawala* transactions more attractive once again.

There is also a strong case for the removal of taxes on remittances from overseas. For instance, in Viet Nam, the flow of remittances through official channels halved after the introduction of a 5-percent withholding tax on remittances in late 1996. After the government suspended the tax in February 1997, the inflow recovered.[48]

It must be noted that no single foreign exchange and trade regime will be optimal for all countries and at all times. Different external payment systems may be preferred solutions depending on the objectives of economic policy and the level of development. In many cases exchange controls may be necessary as a buffer against external economic shocks.

Nevertheless, controls cannot substitute for macroeconomic and structural adjustments that are needed. There is substantial experience to show that the effectiveness of controls diminishes over time, in particular when needed policy adjustments are not addressed. The less appropriate the overall policy package, the greater the leakage into the parallel foreign exchange regime. Sound fiscal, monetary and exchange-rate policies, appropriate tax policies, strong structures and institutions that support financial development are needed to minimize this leakage. However, the policy regimes in most labour exporting countries are thus far considered to fall short of providing adequate incentives to remit through formal channels.[49]

Improving conventional financial infrastructure

An effective strategy for attracting funds into the formal financial system should not be limited to macroeconomic policy issues. The effectiveness of the incentives to switch to official channels depends crucially on the ability of the formal financial infrastructures to compete with the informal market. There is evidence that the popularity of informal channels of remittances could not be attributed solely to the better exchange rates offered. Migrant workers turn to them because of efficient and speedy service, coverage of areas without banking facilities as well as innovative remittance methods designed to suit overseas workers' earnings patterns.[50] Hence, attempts should be made to take on more of the desirable features of the services offered by the informal networks in terms of costs, efficiency, reliability, speed, outreach, and products offered.

It is worth noting that the market for remittances is already providing some solutions to these problems. Increasing volume of remittances is attracting new companies and new services. Remittance companies are offering various alternative means to deliver money as well as services other than money transfer. There is a growing number of small and medium businesses seeking to tap the market of remittances. They are successfully competing with IMTS as well as with established money transfer companies like Western Union in speed, efficiency of execution, settlement and delivery of money and services. For instance, several exchange companies in Egypt, Jordan, Lebanon and the Persian Gulf countries have recently adopted the door-to-door delivery of money.[51] They followed an example of the Philippine banks that successfully introduced and implemented this approach to stave off the informal market operators. Also, many financial institutions in India are now using low – cost couriers to deliver door – to – door service. This compensates for the lack of the physical presence of banks in many parts of the hinterland of a large country.

Another important development has been the increasing involvement of commercial banks from developed countries as well as credit unions in offering transfer services. For instance, Wells Fargo has launched a pilot programme offering simple money transfer accounts even to undocumented Mexican migrants. Several large US banks are working with authorities of Latin American countries to develop low cost money transfer mechanisms. Also, many migrant workers residing in the United States can obtain additional bank cards for their relatives back home, allowing them to draw funds from U.S.-based accounts at any ATM connected to a major electronic banking network.

In July 2000, the World Council of Credit Unions (WOCCU) launched the International Remittance Network (IRNet) to facilitate remittance transfers among credit unions. IRNet charges from \$6.50 to \$10 for up to \$1500 transferred – one of the lowest fees in the market.[52] Besides, senders are guaranteed the conversion of the currency at the official rate of exchange and informed of the amount of foreign currency to be picked up by the recipient prior to making the transfer. This project not only reduces transfer costs but also familiarizes immigrants with the services of a credit union. Immigrants who go through courier agencies have much less chance of interacting with mainstream financial institutions. Moreover, because the funds are distributed by local credit unions in the country of destination, low - income individuals in developing countries have an opportunity (maybe for the first time in their entire lives) to enter into the formal financial system. However, IRNet has an important limitation: the sender has to be a member of a credit union. In this regard there have been proposals that credit unions be permitted to provide check cashing and remittance services to non-members.[53] After September 11, several U.S. credit unions have put the project on hold to evaluate how the new rules introduced by the Patriot Act may affect their money transfer operations.[54]

There have also been proposals to increase the presence of national banks in the countries where their nationals are working – by expanding bank branches or at least money receivers to more areas, and by working to form partnerships with developed countries' banks, postal services and money transfer and exchange agencies.[55] In this regard experience of the Portuguese banks could be very instructive. In the early 1980s the largest Portuguese banks created special departments to monitor and develop foreign remittance business. Remittance offices in foreign countries with large concentrations of Portuguese people were established. The offices were equipped with proprietary transfer systems with daily file transfers to Portugal. The service was offered for free. To complement these structures, agreements were made with local travel agents to facilitate and expedite the transfers. As a result, by the late 1990s, deposits from emigrants represented about 20 per cent of total deposits in the Portuguese banking system.[56]

Aside from banking and other financial institutions, the postal system provides relatively low-fee services to transfer remittances across borders in many countries. In 1997, the U.S. Postal Service began a promotional programme "Dinero Seguro" (safe money) for electronic transfer of remittances to Mexico. The cost of the transaction itself and the conversion of dollars into pesos is still too high - around 10 per cent.[57] The money is available within fifteen minutes after it is wired.

Postal "giro" payment systems that are quick and inexpensive are widely used in Europe, Japan and certain developing and transition economies. There has been a proposal to link more of the postal giro systems in developed countries with those in developing countries. Currently, this is done through bilateral agreements. A more comprehensive approach would be to consider a global agreement for international postal giro transfers among participating countries, similar to the agreement for the exchange of mail among member countries of the Universal Postal Union.[58]

A fairly new development has been growing engagement of micro-finance institutions (MFIs) in the remittance transfer process. There is a general agreement that MFIs are well placed to handle transfer payments, due to their proximity to remittance-receiving families and their potential to reach out to poor communities. Moreover, they integrate the formal and informal sector practices and deal with small-scale transactions where personal relations are important. It has been also suggested that to succeed in the remittance business, MFIs should widen their portfolio of services, since most of them do not meet the full range of financial needs of migrants and their families.[59]

Competition is working to reduce the cost of remittances both in terms of fees and exchange rates. For instance, Western Union's charges have dropped by around 50 per cent during the past two years. For money transfer companies as a group, the average cost of sending money from the United States to Latin America dropped from 15.0 per cent of the amount transferred in

1999 to 7.54 per cent in 2001. During the same period costs associated with the difference between official and remittance companies' exchange rates declined from 11 per cent to 1-4 per cent.[60]

Although having fallen significantly, the costs continue to be high. Besides, the cost of sending money varies significantly across companies and countries, reflecting still limited competition in the sector. Also, commissions, fees and exchange rate are not always clearly communicated to remitters.

As more and more immigrants gain access to banking services and industrial countries financial institutions develop ties with their counterparts in the developing world, the cost of sending money back home will likely continue to drop. Along with couriers and other low cost means of delivering money, technology may push transaction costs further down. In this regard, many observers point to the prospects of more widespread use of ATMs in developing countries. According to one study, in 2006 ATMs will likely capture 11 percent market share in global remittances against 0.2 percent in 2002. The proliferation of ATMs in developing countries may lead to the emergence of new generation of remittance companies competing with card – based products at a global level in order to benefit from economy of scale. This could further reduce the attractiveness of IMTS whose market share in developing countries is expected to fall from 45 per cent in 2002 to 34 per cent in 2006. [61]

Along with the market forces, international organizations and governments could play an important role, especially in the countries that receive remittances, in the development of the money transfer infrastructure. For instance, Inter-American Development Bank (IDB) is establishing programs to help regulated banking institutions in the Dominican Republic, El Salvador, Jamaica and Mexico to put in place the electronic platform required to work more productively with their counterparts in industrialized nations and to acquire technologies needed to extend services to under- banked rural areas and towns.

Among the goals of the IDB projects on remittances is to promote agreements between financial institutions in countries where remittances originate and corresponding institutions with similar and complementary objectives in remittance – receiving countries. To that end, IDB is supporting the project intended to promote remittances and financial products for Ecuadorans working in Spain. In the project, Banco Solidario of Ecuador, a leading micro-finance institution, is teaming up with Caja Madrid of Spain to jointly build a system to directly channel migrants' remittances to Ecuador. Banco Solidario has also entered into a partnership agreement with the network of credit cooperatives in Ecuador to distribute these remittances throughout the country. The new system is aimed to reduce substantially the total cost of sending remittances and encourage the senders and recipients to make deposits in savings accounts.[62]

Governments in migrant-sending countries are also taking more active roles in monitoring the marketplace for remittances, informing consumers of available options, and promoting competition. For instance, the Mexican Federal Consumer Agency pursues information campaigns on the actual transfer costs incurred by different non-bank financial institutions and joined in investigating reported abuses by the major companies. Telecomunicaciones de Mexico, the government-run telegraph company that reaches remote rural areas, has ended its exclusive agreement with Western Union and will now open its 1800 offices to other money-transfer companies. Also in Mexico, a federal commission dedicated to helping Mexicans living abroad send money to family members back home has been formed. The commission will work with more than 200 banks and remittance companies to develop new technologies and strategies to lower transaction costs.[63]

Another important area for the governments is to establish appropriate regulations in the money transfer sector. The growing amount of international transfers has attracted a host of non-financial participants who, in many countries, are not subjected to a clear set of policies and regulations governing the transfer of remittances. Those institutions operate under their own rules and in many cases do not even need authorisation to start operations. The use of these unregulated firms by migrants has led to an increase in the number of claims of abuse by money transfer firms. These abuses include excessive transfer fees and the use of below market exchange rates.

It has also been argued that a government remittance policy should be part of a broader set of reforms aimed at modernizing the financial system to allow financial institutions to compete successfully with non-financial intermediaries in the money transfer sector. Such a policy would likely help not only lower transfer costs but also attract additional remittances currently being transferred through informal channels.[64]

At the same time, over-regulation should be avoided. For instance, in Brazil, all international transfers must go through Banco de Brazil, resulting in a time-consuming and expensive process.

Along with central governments, local administrations are also pursuing more active policy towards remittances. For instance, several Mexican states have started their own programmes to ensure the safe transfer of remittances to their communities. The state of Jalisco in association with Bank of America has created Raza Express, a money transfer mechanism. As a result, transaction costs have been lowered by 40 per cent. A similar mechanism, called Invermatico-Zacatecas was created in the state of Zacatecas in 1999 as a joint venture with the California Bank, Commerce One, and Wells Fargo.

Both central and local governments are developing closer relationships with migrants' organizations abroad. With their help "hometown associations", social clubs in US areas with large Latino populations, are beginning to expand from support networks for recent arrivals into economic links between immigrants and their native communities including money transfer issues.[65]

Formalising informal systems

Despite improvements in policies and conventional financial infrastructure, informal money transfer systems will likely continue to represent an important and often necessary element of third-world finance. They are simple, efficient and low-cost relative to other options. According to a study made by Interpol, the efficiency and cost effectiveness of *hawala* make it an attractive means of remitting money under almost any regulatory regime.[66] Moreover, informal systems may occasionally have stabilising macro effects, given that they operate as a safety valve and provide liquidity in times of crisis.[67] When a country's financial system is under stress, informal operations may become vital to the sustaining of an economy.

Given the importance of IMTS, actions in this area should not aim to ban these systems or limit their accessibility. Such an approach, attempted in several developing countries, did not achieve its intended goals and only harmed law-abiding people and served to drive informal money transfer operations further underground.[68] It is unlikely that efforts to shut down informal networks including *hawala* would succeed. Whatever happens, there will still be a huge demand for informal methods of money transfer and it is better that such services remain in the open. Otherwise, informal systems could become more prone to engaging in other illegal activities as part of or in parallel with their money transfer operations.

Accordingly, the purpose of any measure related to IMTS should be the regulation, rather than curtailment, of their activities.[69] Indeed, cost effectiveness and quickness of IMTS are virtues under any circumstances. However, a lack of transparency and accountability as well as absence of government supervision raises the possibility of abuse by criminals. At an extraordinary meeting held in Washington, D.C. on 29 and 30 October 2001, the Financial Action Task Force (FATF) agreed to a set of Special Recommendations on Terrorist Financing. One of these recommendations commits members to take measures to ensure that persons or legal entities that provide a service for the transmission of money, including transmission through an informal money transfer system or network, should be licensed or registered and subject to all the FATF anti-money laundering requirements that apply to banks and non-bank financial institutions. In June 2002, G-7 Finance Ministers in their statement welcomed the work underway to combat the abuse of charities and *hawalas*.[70]

The major purpose of anti-money laundering and anti-terrorist measures at the country level should be to increase the level of transparency of the money remittance business and to bring overall IMTS business activity within the scope of anti-money laundering legislation through, among other steps, tightening of the supervision of related activities, and lowering of client identification thresholds (imposing a stricter "know-your-client" policy). In Canada, the Netherlands, United Kingdom, and United States, the law requires financial institutions, including IMTS, to maintain records of their customers and their transactions. In Germany and the United States, a license is needed to engage in the business of money transfer. Licensing, record keeping and reporting requirements are applied to IMTS in Singapore, Taiwan Province of China and Hong Kong, China. Under newly proposed regulations, Pakistan would establish regulated currency-exchange companies. After these companies are formed, individual money changers would have to link themselves to one of these companies and accept all the regulatory requirements. And, according to the central bank, the United Arab Emirates will set up licensing and supervision system for informal money transfers by the end of July 2002.

Unlike outright prohibition, the introduction of regulatory measures strikes an important balance between protecting financial and security interests and allowing informal operations to serve legitimate purposes for which they have been designed. In this case the business owner acquires a legal standing that facilitates his operations while the customer is protected by law. As a result, there may be a growth in these money transfers, benefiting individuals and families in distant countries.[71] On the other hand, non-compliant businesses or those engaged in illegal activities would face sanctions for violating the new legal requirements, potentially limiting their customer use.

There is a belief that the majority of informal operators will want to comply with new legal requirements.[72] However, it will be some time before affected businesses will come under the regulatory umbrella. Given the importance of informality of alternative money transfer methods there could be resistance to change. It has been noted that in some countries the moment a law-enforcement officer is seen walking in the door to check on procedures, people simply switch to an as yet undetected dealer.[73] A concerted effort needs to be made at the grass roots level to explain the changes and clarify the obligations of those affected by new legislation. There should be a sincere dialogue with small businesses and community leaders in the affected populations and regions.

There have been suggestions to pay more attention to the role and functions of conventional financial institutions where informal operators' accounts may be held. These institutions need to investigate the legitimate business capacity of money remitters who want to establish bank accounts.[74] It could be important not only for alerting the authorities to the possibilities of criminals using the services of the specific money remitter. The investigation will serve as a seal of approval for legitimate businesses encouraging them to use more widely conventional financial networks.

V. Concluding remarks

Informal money transfer systems (IMTS) were developed centuries ago to facilitate the movement of money over long distances. Today, they remain in use and operate alongside the conventional financial sector. They attract customers because of their simplicity, efficiency, reliability and low cost relative to most other available options.

The bulk of money going through IMTS represents migrant worker remittances that increased manifold over the past several decades and became a very important source of development finance. The growth of international remittances has been the major reason for the spread of IMTS beyond initial boundaries to become a global phenomenon. This is a market response by economic agents to the failure of conventional financial infrastructure in both developed and developing countries to offer efficient services needed by migrant workers.

The major factors influencing the flow of formal and informal remittances are macroeconomic climate in a country and the innovativeness of the financial sector. Stable growth and orderly liberalisation of the economy encourage their flow and maximize their positive economic impact, including on development-oriented investments, such as housing. Where financial institutions remain underdeveloped and government policies are not conducive to the use of conventional financial facilities, the IMTS remain attractive vehicles for the transfer of money for a significant portion of the population. Indeed, the experience of many countries has shown that the migrant-specific incentives schemes aimed to encourage migrants to remit more would not be successful if macroeconomic fundamentals remain distorted and institutional deficiencies persist.

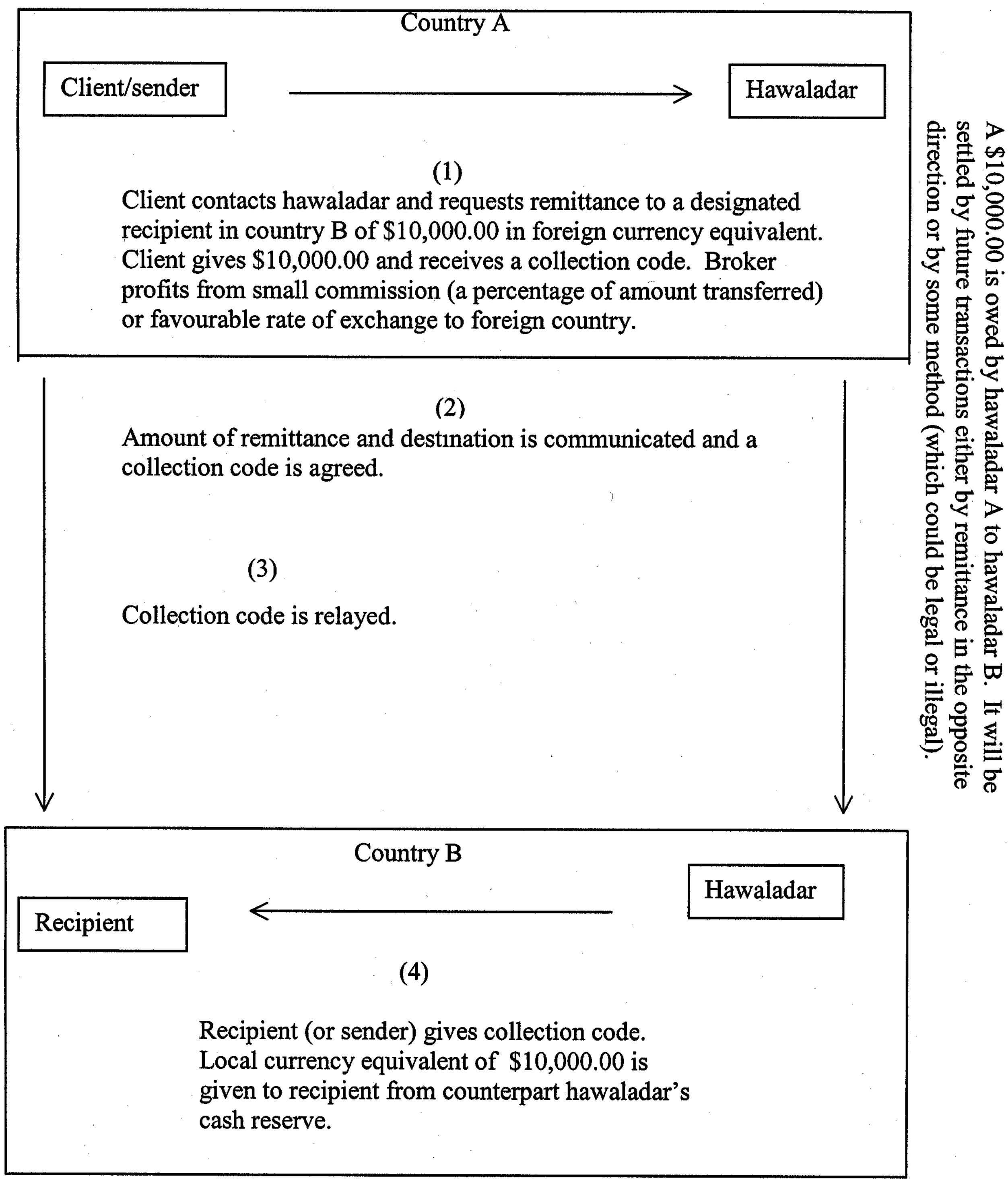
To promote the flow of remittances, governments and international organisations should set the ground rules for a competitive and secure marketplace for remittances and encourage the development of a consumer-oriented money transfer infrastructure. This can involve informal as well as formal systems, depending on the particular situations. Reduced transfer costs, innovative remittance methods, greater security and efficiency may attract people to remit more.

It is recognised that due to significant cultural, social and economic factors the informal money transfer systems will continue to be an important element of international finance and that attempts to eliminate these systems would be counterproductive, if not impossible. Formal markets could hardly meet the needs of all people, at least in the short run. Besides, cost effectiveness and quickness of IMTS operations will always make them attractive vehicles for people remitting money. Also, in many developing countries, IMTS are likely the most crisis-proof part of financial infrastructure. However, the lack of transparency and accountability as well as government supervision raises the possibility of abuse of these systems, although there is no conclusive evidence that IMTS are the preferred vehicle of criminals and terrorists. Accordingly, there is a need for appropriate regulation of informal systems to make their operations more transparent.

One should be realistic about the limits of what can or ought to be achieved in the short-term to bring informal money transfer businesses under regulatory control. Differences in financial development, taxation levels, laws pertaining to foreign exchange transactions, as well as in financial regulation and supervision standards across countries, will continue to create incentives for informal practices to function in traditional ways. Therefore, international cooperation in standards setting, information sharing and monitoring of international money transfers would be very important to keep IMTS operations within the bounds of the law.

Effective regulation of IMTS will likely reduce the gap between them and the formal sector. How to proceed further in this direction and establish closer linkages with formal systems, as well as with development process in general, could be major areas of further research and policy considerations.

***Figure* 1: Flow of activity in a typical hawala transaction**



Source: Lisa C, Carroll, "Alternative remittance systems: distinguishing sub-systems of ethnic money laundering in Interpol member countries on the Asian continent", INTERPOL, 27 February 2002.

***Figure* 2: Sample of Hawala bookkeeping**

(1) Transaction date	(2) Name of Hawaladar to whom debt is owed[a]	(3) Amount of transaction[b]	(4) Dollar/ rupee exchange rate	(5) Value of transaction (U $)	(6) Mode of payment[c]
16/6/98	Vinod	100,000	37.6	2,659.57	F-1202
16/6/98	Ashish	250,000	39.25	6,369.42	F-1203
16/6/98	Nitin Bhai	350,000	42.3	8,274.23	B-8146
17/6/98	DK	50,000	38.75	1,290.32	F-1204
17/6/98	Suresh Kumar	300,000	39.25	7,643.31	B-8147
17/6/98	Anil	200,000	40.1	4,987.53	S-5428
17/6/98	Vinod	150,000	39.75	3,773.58	F-1205
18/6/98	Manoj	300,000	41.25	7,272.72	B-8148
18/6/98	Vinod Bhai	350,000	42.2	8,293.83	L-2160
18/6/98	Ganesh	200,000	38	5,263.15	५२ती

Source: Patrick M. Jost (United States Department of the Treasury, Financial Times Enforcement Network (Fincen) and Haijit Singh Sandhu (Interpol, FOPAC), "The hawada alternative remittance system and its role in money laundering", INTERPOL General Secretariat, Lyon, January 2000, p. 13. http://www.interpol.int/Public/FinancialCrime/MoneyLaundering/hawala/default/asp)

[a] It is very common to use partial names (e.g. Vinod, Ashish, etc).
[b] The chart reflects a tendency to indicate amounts in multiples of 100,000.
[c] This column indicates the manner in which payment was made. The "F" reflects the name of a bank and the "1202" is the check number. The notation ५२ती for Ganesh Trading means 52 tolas of gold (*tola* = 10 gms), possibly paid to a local goldsmith or jeweller instead of remitting money through a bank.

Notes

1 See Nikos Passas, "Informal value transfer systems and criminal organisations: a study into the so-called underground banking systems", Ministry of Justice, Netherlands, 1999 (www.minjust.nl:8080/b_organ/wodc); see also Lisa C. Carroll, "Alternative remittance systems: distinguishing sub-systems of ethnic money laundering in Interpol member countries on the Asian continent", INTERPOL, 27 February 2002, page 10. The term "informal money transfer system" is a take –off from Passas's use of the term "informal value transfer systems". (www.interpol.int/Public/FinancialCrime/MoneyLaundering/EthnicMoney).

2 See Nikkos Passas, "Informal value transfer systems and criminal organizations: a study into the so-called underground banking systems", Ministry of Justice, Netherlands, 1999, p.22.

3 The terms *hawala* and *hundi* are both used, correctly and interchangeably, to refer to the informal money transfer system described in this report. The word *hawala* comes from the Arabic root *h-w-l*, which has the basic meanings "change" and "transform". *Hawala* is defined as a bill of exchange or a promissory note. When the word came into Hindi and Urdu, it retained these meanings but also gained the additional meanings "trust" and "reference", which reflect the manner in which the system operates. *Fei ch'ien* is a Chinese term meaning "flying money"; since the system enabled payments to be made between parties that are separated from one another by long distances, money was thought to have wings, and therefore, could fly.

4 See also Nikkos Passas, "Informal value transfer systems and criminal organizations: a study into the so-called underground banking systems and criminal organizations", Ministry of Justice, Netherlands, 1999, page 13 and Beate Reszat, "Hawala". (www.hwwa.de/Projects/IaD_Programmes/IDSPs/Asia_Gateway/Hawala.htm).

5 See Mark J. Scher, "Postal savings and the provision of financial services: policy issues and Asian experiences in the use of the postal infrastructure for savings mobilization", DESA Discussion Paper No. 22, United Nations, December 2001, page 2n.

6 See "*Hawala and underground terrorist financing mechanisms*", a prepared statement by Dr. Tarik M. Yousef before the United States Senate Committee on Banking, Housing and Urban Affairs, Subcommittee on International Trade and Finance, 14 November 2001.

7 See Beate Reszat, op. cit. p. 1; see also Daniel Pineu, "*Hawala* or the bank that never was", 18 October 2001. (www.csf.colorado.edu/forums/isafp/2001/msg00200.html); see also Nikos Passas, op.cit. p. 47.

8 *Hawaladars* could be corner storekeepers or owners of giro houses, bureaux de change, brokers, wire services and other conventional money transmitters.

9 See Lawrence Malkin and Yuval Elzur, "Terrorism's money trail", *World Policy Journal*, Vol. XIX, No.1 (Spring 2002), p.65.

10 Offsetting remittances are often used to settle debts among IMTS operators in the *hawala/hundi* systems of India, Nepal, Malaysia and the East Asian system of Hongkong, China. Gold smuggling is used also to settle debts in India and Pakistan. The *hawala/hundi* systems in India, Nepal, Pakistan and Sri Lanka also use invoice manipulation, as does the Vietnamese system. In the IMTS in Australia, Hongkong, China, Japan, the Republic of Korea, and Thailand, the conventional banking system is used to settle debts. The use of conventional banking systems to settle accounts between IMTS brokers is greater when there are no foreign exchange controls to limit the physical flow of money across borders. Accounts between *hawaladars* may also be settled by physically moving cash in the IMTS of Hongkong, China, Pakistan, the Philippines, and Vietnam. See Lisa Carroll, "Alternative remittance systems: distinguishing sub-systems of ethnic money laundering in Interpol member countries on the Asian continent", INTERPOL, 6 March 2002, p. 26-27. For a detailed discussion of how *hawaladars'* books are balanced, see John F. Wilson, "Hawala and other informal payments systems: an economic perspective". (www.imf.org/external/np/leg/sem/2002/cdmfl/eng/Wilson.pdf)

11 Passas considers as more reliable the theory that *fei ch'ien* arose out of the increased trade in tea between Southern China and the Imperial Capital. See the Passas report, p. 16.

12 See Mark J. Scher, op.cit., page 6.

13 Lisa C. Carroll, op.cit.; see also the Passas report, page 17.

14 See Jean-Francois Seznec, "Financing terrorism: the history and operations of maoney changers in the Middle East", edited transcript from his lecture entitled, "Terrorists using centuries-old system to finance operations", hosted by Columbia University on 23 October 2001.

15 A *chop* is a seal of stone dipped into Vermillion-ink paste and impressed on a document as proof of its authenticity. The types of *chops* (seal) include, among others, the general purpose *chop (shu kan to cheung)* for acknowledging ownership; goods delivery seal *(fat for to cheung)* usually a square seal on invoices accompanying goods , cash delivery seal *(kau ngan to cheung)* used on a blank receipt delivered with cash, and indebtedness seal *(kit hong to cheng)* stamped in acknowledgement of a loan.

16 See Lisa C. Carroll, op.cit. page 14

17 See Lisa C. Carroll, op.cit. page 11.

18 See Nikkos Passas, op. cit. page 21.

19 See Lisa C. Carroll, op.cit., p.10.

20 See R. Groose, "Jamaica's foreign exchange black market", *Journal of Development Studies,* Vol. 31, no.1, 1994, pp. 27.

21 See, Abdul Waheed and Mujahid Khalid, "What determines workers' remittances?" *Pakistan Economist*, February 5-11, 2001.

22 See Alexander O'Neill, "Emigrant remittances: policies to increase inflows and maximise benefits", *Indian Journal of Global Studies*, Vol. 9, Issue 1, Fall 2001.

23 Ibid. p. 28.

24 EIU Views Wire, 12 November 2001.

25 Nikos Passas.op..cit. p.28.

26 See "How *Hawala* Works", Nihar, p. 2, 21 January 2002 (www.niharonline.com/news/hawala.php). In rare cases where a *hawaladar* has defrauded a counterpart or a client, other hawaladars have been known to make good on the debt of their colleague (See Patrick Jost, Prepared statement for hearing on "*Hawala* and underground terrorist financing mechanisms", U.S. Senate Committee on Banking, Housing and Urban affairs, November 14, 2001, p.3).

27 "Money pipeline hard to shut", *Deccan Herald*, September 27, 2001.

[28] See Dr. Tarik M. Yousef, op. cit., p.2.

[29] "Poor Man's Private Banking", Emirates Bank Group, Dubai, UAE, 19 May 2002 (http://www.emiratesbank.com).

[30] See for instance, "Status of the international remittance industry", Statement on behalf of the Credit Union National Association (CUNA) and World Council of Credit Unions (WOCCU) before the US Senate Committee on Banking, Housing, and Urban Affairs, February 28, 2002.

[31] Shivani Puri and Tineke Ritzema, "Migrant worker remittances, micro-finance and the informal economy: prospects and issues", Working paper No. 21, International labour Office, Geneva, 1999, p.9.

[32] Lindsay Lowell and Rodolfo de la Garza, "The developmental role of remittances in U.S. Latino communities and Latin American countries", a final project report, Inter-American Dialogue and the Tomas Rivera Policy Institute, June 2000, p. 10.

[33] Celent Communications, LLC, "Global Money Transfers: Exploring The Remittance Gold Mine", 8 August 2002 (http://www.celent.com).

[34] See Nikos Passas, op. cit., p. 27.

[35] See Lawrence Malkin and Yuval Elizur, "Terrorism's money trail", *World Policy Journal*, Vol. XIX, No.1, Spring 2002, p.65.

[36] Ibid. pp. 64, 66-67; *Business Week*, November 26, 2001, p.40; *New York Times*, January 4, 2002.

[37] EIU Views Wire, 12 November 2001.

[38] See, for instance, G. Swami, "International Migrant Workers' Remittances: Issues and prospects", World Bank Staff Working Paper 481, World Bank, Washington, D.C.,1981; Shivani Puri and Tineke Ritzema, "Migrant Worker Remittances, Micro-finance and the Informal Economy: Prospects and Issues", Working Paper No. 21, International Labour Office, Geneva, 1999.

[39] Diaz Briquets, Sergio and Jorge Perez-Lopez, "Refugee remittances: conceptual issues and the Cuban and Nicaraguan Experiences", *International Migration Review*, Vol. 31, No. 2, 1997, p. 415; Shivani Puri and Tineke Ritzema…, p.20.

[40] DAWN the Internet, 20 February 2002.

[41] BMA Capital Management, "Pakistan Equity Research", December 24, 2001; Business Week Online, January 31, 2002.

[42] Deborah Waller Meyers, "Migrant Remittances to Latin America: Reviewing the Literature", The Tomas Rivera Policy Institute, May 1998, p. 12.

[43] The term "black market" originally referred to illegal currency exchange but it is used here in a broader context to include non-institutional currency markets that might be formally illegal but openly tolerated or that are officially permitted.

[44] Alexander O'Neill, "Emigrant remittances: policies to increase inflows and maximize benefits", *Indiana Journal of Global* Legal *Studies*, Vol. 9, Issue 1, Fall 2001, p. 5.

[45] The Economist, November 24th 2001, p. 71.

[46] John Wilson, "*Hawala* and other Informal Payments Systems: An Economic Perspective", p. 11. Prepared for the IMF Seminar on Current Developments in Monetary and Financial Law, May 16, 2002.

[47] Matt Miller, "Underground banking", *Institutional Investor*, January 1999, p. 34.

[48] Jonathan Haughton, "Money transfer", *Vietnam Business Journal*, Vol. VII, No. 1, January 1999.

[49] See, for instance, Shivani Puri and Tineke Ritzema, "Migrant worker remittances, micro finance and informal economy: prospects and issues", Working Paper No. 21, International Labour Office, Geneva, 1999, p. 27.

[50] See, for instance, Daren Abella, "A note on the money courier industry on the Philippines", Philippine Labour Review, Vol. 13, No. 1, 1989, p.p.99-107.

[51] "*Hawala,* the poor man's banking vehicle, under attack", *Jordan Times*, 2 June 2002.

[52] Manuel Orozco, "Family remittances to Latin America: the marketplace and its changing dynamics", Paper delivered at the Inter-American Development Bank Conference on "Remittances as Development Tool", May 17-18, 2001, p. 6.

[53] "Status of the International Remittance Industry", Statement on behalf of Credit Union National Association (CUNA) and World Council of Credit Unions (WOCCU) before the Senate Committee on Banking, Housing, and Urban Affairs, February 28, 2002, p.4.

[54] Tina Carlson, "Government crackdown leads some to rethink transfers", *Credit Union Journal*, December 24, 2001.

[55] Deborah Waller Meyers, "Migrant remittances to Latin America: reviewing the literature", The Tomas Rivera Policy Institute, May 1998, p. 12.

[56] Pedro Belo, "Perspectives from formal financial institutions", Paper prepared for the Inter-American Development Bank Conference on "Remittances as a development tool", May 17-18, 2001.

[57] Manuel Orozco, "Remittances and markets: new players and practices", The Tomas Rivera Policy Institute, May 2000, p. 6.

[58] Mark J. Scher, "Postal Savings and the Provision of Financial Services: Policy Issues and Asian Experiences in the Use of the Postal Infrastructure for Savings Mobilization", DESA Discussion Paper No. 22, United Nations, December 2001, p. 32.

[59] For an extensive discussion of the role of MFIs in handling remittances, see, for instance, "Making the best of globalisation: migrant worker remittances and micro-finance", Workshop Report, International Labour Office, Geneva, November 2000.

[60] Manuel Orozco, "Family remittances to Latin America: the marketplace and its changing dynamics", Paper delivered at the Inter-American Development Bank Conference on "Remittances as Development Tool", May 17-18, 2001, pp. 6, 7.

[61] Celent Communications, LLC, "Global Money Transfers: Exploring The Remittance Gold Mine", 8 August 2002 (http://www.celent.com).

[62] Inter-American Development Bank, Press Release, September 27, 2001.

[63] Associated Press, November 13, 2001.

[64] See, for instance, German Zarate-Hoyos, "The case for a remittance policy in Mexico", presentation at the symposium on consumer international money transfer issues hosted by the Federal Reserve Bank of Chicago, November 9, 2001.

[65] Manuel Orozco, "Latino hometown associations as agents of development in Latin America," Tomas Rivera Policy Institute, June 2000.

[66] "The *hawala* alternative remittance system and its role in money laundering", Interpol General Secretariat, Lyon, January 2000, p. 8.

[67] See, for instance, Matt Miller, "Underground banking", *Institutional Investor*, January 1999.

[68] In India and Pakistan, IMTS are illegal. Nevertheless, in India up to

50 per cent of the economy uses *hawala* for routine transactions. And in Pakistan the amount of informal international transfers is much higher than that going through the country's banking system. (*American Banker*, October 12, 2001, p. 14.) The official position of the Pakistani Government regarding IMTS seems ambivalent: while it has banned the operations of *hundi* systems, the State Bank of Pakistan, the central bank was reported, in May and June 2001 to have sought their assistance in purchasing US dollars to bolster the country's low level of foreign exchange reserves.

69 This, for instance, was the prevailing view of the participants at the International Conference on *hawala* held in Abu Dhabi in May 2002 (See "Abu Dhabi Declaration on *hawala*", made at the conclusion of the International Conference on *hawala* on 16 May 2002, http://www.uae.gov.ae). The conference was attended by more than 300 regulators, law enforcement officers, bankers, money changers and scholars from developed and developing countries.

70 Statement of G-7 Finance Ministers, Halifax, Nova Scotia, June 15, 2002.

71 See, for instance, Prepared statement of Tarik Yousef, hearing on "*Hawala* and underground terrorist financing mechanisms", U.S. Senate Committee on Banking, Housing, and Urban Affairs, November 14, 2001, p. 2.

72 Ibid., p. 3.

73 *The Economist*, November 24th 2001, p. 71.

74 Nikos Passas, op. cit., p. 69.

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