Informal Remittance Systems and Afghanistan

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One of the most crucial of financial services is the remittance of funds, particularly over long distances. Informal remittance systems ("informal value transfer systems" in jargon) have been in place for thousands of years and exist in almost every part of the world. Businesses use remittance services to pay their associates around the world, and the 200 million international migrants use them to send home $100 billion a year (Pew 2003). Business demands for such services are at least a thousand years old. In Asia, businessmen use century-old systems of remittance that handle small private remittances rapidly (such as the havala system discussed later in this paper). But migrants' demands are recent, made possible by advances in communication and transportation that enable migrants to maintain connections with their home countries. In Latin America and to some extent East Asia, major informal remittance systems developed only in response to recent migrations.

In a formal remittance system, a person goes to a bank and buys a telegraphic remittance or writes a check and sends it to the person to be paid. Carefully recorded and subject to audit, such transactions are governed by laws and regulations and are frequently expensive. For this reason much of the remittance business in many developing countries and between developing and developed countries is handled by informal organizations that avoid regulation and monitoring. Informal remittance services are popular among migrants and small businessmen who have no entrée to or confidence in commercial banks, or for whom commercial services are too expensive, seem unreliable, or are simply not available. Businessmen use informal remittance services because they are cheap, but also to make use of offsetting flows that businesses generate.

There are two bases for interest in informal money remittance systems: (1) their potential to assist in financial and economic development and (2) the threat they pose because of their unregulated nature. In this paper we will review how informal remittance works, look at efforts to reform or replace these systems, and assess the prospects of these reform and replacement efforts.

How Informal Remittance Works

In an informal remittance system, a dealer, often a store owner receives cash and instructs, directly or through a chain of intermediaries, a counterpart to pay someone in another place. Although the telephone and the Internet are used now, the basic mode is still the nexus between two contact points, each of which will pay or receive in combination with the other. Often the dealer and counterpart have a social, familial, or ethnic link, or there are such links somewhere along the chain between them. Along that chain various remittance orders can offset one another so that relatively small balances have to be settled at the end of the process.

Elaborate written transaction records and outside audits are rare. Depending on the complexity of the transaction, informal insurance may be available, and credit may be extended and secured against expected remittances. For example, an order to pay may require payment within 90 days or that the payee do something (e.g., produce a bill of lading for goods sent). With increased sophistication various uses of the float, interaction with formal sector financial institutions, and multilateral clearance of accounts increase.

Some idea of how informal remittance works can be gained from the recent high-profile Yehuda Abraham case, although it was by no means typical. Mr. Abraham is an elderly diamond dealer in New York who arranges for remittances, probably to offset some of his own business remittance needs. As reported in the newspapers, he handled a several-hundred-thousand-dollar remittance in connection with some terrorist arms sales that were discovered by the FBI. He gave a receipt for a remittance from New York to somewhere in the Middle East in the form of a ripped currency note and took a 5 percent commission. More typically, ethnic grocery stores serve as collection points in which emigrants can send money home.

Costs

The characteristics and costs of remittance systems vary considerably. Some recent studies give comparative costs for Latin America. The Latin American remittance agencies are not entirely informal; they typically are simply nonbank companies. Cuba, Nicaragua, and Haiti are among the most expensive countries for remittances. In these countries, there is a high level of informality, no regulatory environment supporting competition in providing low-cost transfers, and no innovative financial technologies. In other countries, such as Jamaica and the Dominican Republic, the presence of monopolies or oligopolies explains the high price of remittance. El Salvador, Ecuador, and Mexico have the lowest remittance costs. Mexican remittances cost 6 to 7 percent of the face value (Orozco 2003). Formal sector remittance costs (for small remittances cited by Western Union and Riggs Bank) are comparable to those for

other Latin American countries, even in other regions.[1] Rates for South Asian remittances are much lower, 1.5 percent to 3 percent for a $200 remittance, reflecting the age and sophistication of the South Asian system.[2] The World Bank reports rates of 1 percent to 2 percent into and out of Afghanistan (Maimbo 2003). A generalization is that formal sector costs are higher than informal sector costs, and Latin American remittance costs are considerably higher than in South Asia. Of course, lower costs are only one of the reasons clients use informal channels — in many cases they are the only channels that exist.

Black Money

Many informal remittance systems for small transactions violate currency conversion laws—they deal in "black money." Black money is associated with tax evasion, smuggling, drug trafficking, terrorism, and other organized criminal activity, yet comprehensive international sanctions against currency control or tax evasion are not yet available. In fact, many countries facilitate black money transactions for the purpose of tax evasion as a matter of commercial policy. International sanctions are generally available only for using remittance to handle the proceeds of or contributions to crimes other than violation of tax or currency control laws (except when special agreements are in force, such as in the European Union). However, day by day the extent of cooperation against even tax evasion increases and tax havens are under heavy pressure (Parker 2003). Increasingly strong efforts to suppress black money flows are repressing traditional remittance systems on the one hand while efforts are being launched to replace them by formal systems on the other hand.

Havala Systems in Afghanistan and South Asia

Havala, informal remittance systems in the Middle East and South Asia, have been the normal way to move money around those regions for many years. Roger Ballard describes the flow of remittances from the United Kingdom to Pakistan through Dubai in an interesting recent study. Havala to Afghanistan through Pakistan has come under special scrutiny because al Qaeda uses it, but for the entire period of the Afghan civil wars (1980–2001), a good deal of the financing of all parties moved through havala channels, and havala is still the preferred way to move money around the country.

Maxwell Fry ably described the system in Afghanistan in 1974. In Fry's day before 1967, most of the remitters in Kabul were Jewish, and in Kandahar, Sikh, and Hindu. Most of the Jews left Kabul in the 1960s (Fry 1974). In 1971, this author saw men at card tables piled with currency notes in Sarai Shahzada, a semi-covered structure, handling money change and

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[1] Western Union quotes a charge of 11 percent for a $200 remittance from Washington, D.C. to Russia or India. Bank remittances typically have minimum charges of $30–$50 for the sender and varying amounts for the receiver, which translates into a minimum of 15 percent for a $200 remittance.

[2] Indian banks give quotes on the Internet.

remittance while Da Bank Milli, the central and largest bank, had little retail presence. An early-1990s study by this author of the havala phenomenon in Peshawar and Karachi as it related to Afghanistan found that all the traders in Kabul and Peshawar were Pashtun. Their correspondents in Karachi were mostly Memons, a Gujerati-speaking trading community, and refugee from India (Timberg 1991). More recently, the January 9, 2002, *Financial Times* reported an interview with a moneychanger in front of the Afghan Central Bank, suggesting that informal remittance is alive and well in Afghanistan. The World Bank recently did a more comprehensive study of the system in Afghanistan (Maimbo 2003).

Of course, these systems also serve India, Pakistan, and Bangladesh. I first came across the Indian system in the 1970s in the Churchgate neighborhood of Mumbai, where Sindhi Hindu merchants, originally from Sind (now in Pakistan) handled a good deal of the remittances from migrants and for businessmen. Similar offices were located near New Market in Calcutta and in other major South Asian commercial centers. A description of the system in that period is contained in another study by the author and an associate (Timberg and Aiyar 1985).

Although some of the oldest and most heavily studied remittance systems are in India, the general impression there now is that informal remittance accounts for a small portion of the total of migrant remittances, partly because low-cost formal sector channels are available. Informal remittances are still used in India for commercial remittances, particularly to avoid income tax and to a lesser extent foreign exchange laws, but most remittances go through formal channels. One student of the informal remittance system in Pakistan judges that the proportion of informal remittances there is much higher than in India because of unwise government policies over the years (Ballard, n.d.). More than a decade ago when the present author was working in Bangladesh the system functioned there.

Remittance Systems Reform

Informal remittance systems have been the topic of study for many years. Earlier literature on informal remittance systems was motivated by a desire to understand the financial sectors in which they operate or to use the system more productively. Two streams of comment now differ. Concerns about the relationship between the unregulated flow of money and black money recently have generated interest in substituting a more institutionalized and regulated financial structure. At the same time, and on a different plane, some have written about the potential for using remittances as the basis for development of financial systems and whole economies.

Because of the lack of regulation informal remittances have been the focus of a wealth of recent research commissioned by those who are supposed to police and suppress criminal use of the remittance system. Unfortunately, law enforcement and financial development advocates rarely communicate with each other about remittance systems. The IMF, however,

recently produced analysis that attempts to bring the literatures together (El Qorchi *et al*. 2003).

REGULATORY APPROACHES FOR LAW ENFORCEMENT

The U. S. Treasury is trying to develop a regulatory system for informal remitters. Money services businesses (which include informal remitters) in the United States are now required to register with the U.S. Treasury, be licensed by the state where required (all states do not require registration, but there is pressure on the holdouts to do so), and report suspicious transactions. The Treasury has made considerable efforts to enlist informal remitters' cooperation. On one hand, informal remitters typically have to know their clients well in order to deal with them as they do, so the remitters are well-equipped to cooperate in stopping or reporting flows of noxious funds. On the other hand, collaboration with government regulators requires a profound social and psychological stretch for those who run the networks and for the regulators. The former have to overcome their ingrained suspicion of state authority; the latter must recognize the legitimacy of commercial actors who behave in a manner differently than regulators are used to and who often lack a common language with the regulators.

Nonetheless, the U.S. Treasury reported receiving reports of 15,000 suspicious transactions last year from nonbank remitters, the larger ones mostly concerning Nigerian financial fraud. The rest were mostly remittances of less than $10,000.

The Treasury has also responded positively to concerns about the high costs of remittance from the United States to Latin American countries as indicated, *inter alia,* by the testimony of Wayne Abernathy, the Assistant Secretary for Financial Institutions at a Congressional hearing in October 2003. As he indicated, the Treasury has supported an increasing level of competition in remittances to Latin America that has resulted in lowering remittance costs as well as positive development impacts. Comparable attention has not been devoted to remittances to South and East Asia.

Maimbo (2003), in his discussion of Afghanistan's system for the World Bank, suggests how the organized money remitters could be associated with a safe remittance system. His proposals have met strong resistance, however, especially from culture-bound U.S. Treasury officials working in Afghanistan who cannot conceive of money remittance conducted according to any but U.S. middle-class principles, although their stateside colleagues do not seem to share their views. The Treasury's and Maimbo's approach suggest the possibility of moving from repression to regulation.

One can only be doubtful about the success of regulatory efforts if regulated structures cannot compete with existing businesses. Previous efforts to suppress informal remittance systems have had mixed results. Naim (2003) recognizes the challenges of "bureaucracies fighting networks" and of "going against market forces" for all sorts of informal trading networks

(e.g., money, drugs, arms). He suggests that we "devise new mechanisms and institutions," or "move from repression to regulation."

The competition alternative to regulation is to develop parallel, formal but cheap institutions. USAID funds the World Congress of Credit Unions and the Caja Popular Mexicana to "bank the unbanked." Among the Overseas Private Investment Corporation's first projects in Afghanistan will be to establish new private banks. South African banks have developed successful and cheap remittance schemes, and the Department for International Development has supported efforts to develop similar schemes elsewhere in Africa. In India commercial banks have competed successfully for small remittance business.

DEVELOPMENT POTENTIAL OF REMITTANCE SYSTEMS

The development potential of remittance systems has been the focus of a fair amount of the literature on informal remittance systems in high-migration areas.[3] Migration Information Sources recently published a succinct review of the literature, considering the modes, motivations, and distribution of immigrants' remittances and the use to which they are put. It noted four research priorities: identify the welfare impact of remittances; understand how to improve the efficiency and transparency of remittances; understand remittances in the broader social relations between migrants and others, especially family and community; and understand the kind of changes needed in poor countries or countries with poor political climates to enable remittances to be put to effective use.

The Inter-American Development Bank and the Pew Hispanic Center have sponsored studies of the remittance system in Latin America to explore possibilities for development based on remittances. South African banks have experimented successfully with the use of debit card machines in isolated areas to help with South Africa's remittance needs, including for various sorts of social income.

From building good and cheap remittance systems the next step has often been building broader financial institutions to serve remitters. Already some rudimentary forms of credit are connected with remittances, but more could emerge, such as easily monitored trade credit.

Conclusion

Repression of some of the leading money remittance networks in Afghanistan may be successful for a time, but institutionalizing money remittance will require some imagination. Building remittance systems has been the traditional path to developing financial systems and

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[3] Post-2000 titles: as "Role of Remittances from Albanian Emigrants and Their Influence on the Country's Economy," "The Effect of Remittances on Household Borrowing Activities: The Case of Pakistan," "The Hidden Economy: A New View of Remittances in the Arab World," "Measuring Human Development in Countries with Invisible Economies: Challenges Posed by the Informal and Remittance Sector in Jamaica," and "The Optimal Shares of Exports, Tourism, and Workers' Remittances in Total Foreign Revenue Portfolio in Turkey."

there is no reason to think it will not recur in Afghanistan. The more easily sustainable forms of credit will not be the new enterprise facilities on which attention has been focused, but more easily monitored trade credit, credit against receivables and goods in transit, pawn broking, and when the land tenure situation clears up, perhaps lending secured by real estate. But even real estate finance should not be rushed.[4]

[4] Real estate gives the illusion of solidity. The U.S. kept commercial banks from lending against real estate for more than a century, and U.S. taxpayers might have been well served if that policy had been continued. For residential real estate secured against the income of U.S. American homeowners, solidity may be real, but in many other countries, the value of real estate and the ability to transfer and deal with it are limited.

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