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Hawala Bank System Economic Bridge or Criminal Loophole?

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The hawala system has been around since the 8th century in India and developed as a trust-based remittance method without going through formal banking. The system allows for fast, inexpensive, and hassle-free cross-border fund transfers, making it popular in communities that are less accessible to banking services. However, due to its undocumented nature, hawala is also often misused for money laundering, terrorism financing, and other transnational crimes. The mechanism involves a hawaladar network that completes transactions verbally or through the calculation of intermediary balances. As technology develops, hawala begins to adapt to digital platforms and cryptocurrencies, increasing efficiency while adding challenges in its supervision. Different countries implement different regulations to control these systems, but these efforts still face obstacles in transaction tracking and law enforcement. Despite the high risk, hawala remains the primary method for many global communities in making remittances.

8th Century India

The Hawala system has existed since the 8th century in India. Initially, traders used it to send money across borders without having to physically carry cash, which was at high risk of theft. The word "hawala" itself comes from the Arabic language which means "transfer" or "trust".

Over time, this system spread to South Asia and along the Silk Road. Although the modern banking system has replaced it, hawala is still used in many countries, especially in areas that are difficult for banks to reach or where people do not trust the formal banking system.



Figure 1. A Non-Resident Indian (NRI) gives dirhams to hawala agents. In return, the NRI received 1.5 lakh rupees in India, but in the form of defunct Rs 500 and Rs 1,000 notes. Source : https://www.iinvesting.in/wp-content/uploads/2019/09/the-hawala-system_2.jpg

Currently, hawala is more often used for legitimate purposes, such as business transactions, remittances by migrant workers, and personal purposes. The advantage is that the process is fast and does not require complicated documents. However, because it does not have official records, this system can also be misused for illegal activities such as money laundering and terrorism financing. [1] ; [2]

Example of Intercontinental Bank Hawala Transaction Mechanism

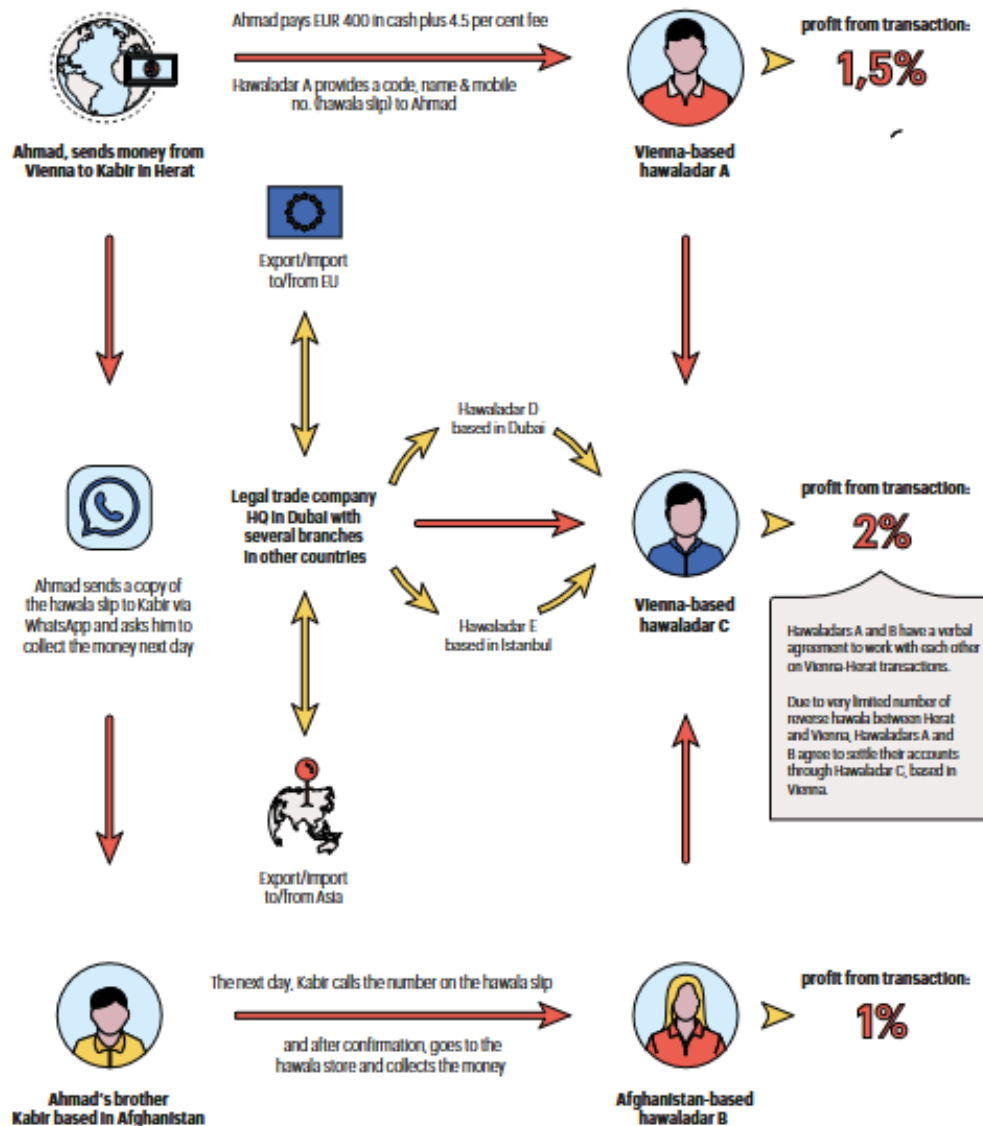


Figure 2. Hawala transactions from Afghanistan to Austria and account settlement arrangements between hawalada. Source: [1]

Mechanism Explain

Yanti (not her real name) is a newcomer to Vienna, Austria. He wanted to send money to his brother, Arafah, who lives in a province in Afghanistan. [1]

- Yanti asked the Afghan community in Vienna and was contacted by a hawaladar (hawaladar agent) named Hawaladar A.
- Hawaladar A is a local Austrian of Afghan descent and owns a grocery store in Vienna.
- Yanti wanted to send €400 to her sister and asked if it was better to receive it in euros (EUR) or Afghan

local currency (AFN).

- Hawaladar A told that:
- If Arafah receives money in euros, the commission fee is 5%.
- If receiving in afghani (AFN), a commission of 3%, at the rate of €1 = AFN 8.2.
- Yanti checks the exchange rate online (€1 = AFN 8.7) and negotiates the commission. Finally, they agreed on a 4.5% commission with payments in euros.

Anonymous Money Transfer

- Yanti pays €400 + 4.5% commission to Hawaladar A.
- Hawaladar A only asked for Yanti's name and the recipient's name (Arafah), without ID or other documents.
- Hawaladar A provided a 3-digit code, a phone number, and the name Hawaladar B in Afghanistan. Yanti sent these details to Arafah via WhatsApp.
- The next day, Arafah contacted Hawaladar B in the province where he lived and came to his shop.
- Arafah mentioned the secret code and the amount of money sent.
- Hawaladar B immediately gave €400 to Arafah without asking for any ID or documents.

How is the Hawaladar Account Resolved?

- In the hawala system, physical money does not actually move between countries. On the contrary, the hawaladar have a verbal agreement to settle the balance between them.
- Hawaladar A (in Vienna) and Hawaladar B (in Afghanistan) already have previous business agreements to handle transfers between the two regions.
- Since there are fewer return transactions from Afghanistan to Vienna, they use Hawaladar C in Vienna to help settle the balance.
- Hawaladar C is a major player that handles transactions in several countries, including Europe, Dubai, and Istanbul.
- Hawaladar C works with a Dubai-based legal trading company that has bank accounts in various countries.
- Of the 4.5% commission, the profit sharing is carried out as follows:
 - 1.5% for Hawaladar A in Vienna
 - 1% for Hawaladar B in Afghanistan
 - 2% for Hawaladar C who completes transactions between agents

Why is this system so popular?

Hawala remains a popular method of remittance, especially in South Asia and the Middle East, for a variety of reasons. Cultural factors play a big role, where this system has been used for generations and is more trusted by many communities than formal banking. In addition, its convenience makes many people choose it, as transactions can be done quickly and without complicated documents. This is especially helpful for those who do not have access to banking services, especially in remote areas. In terms of cost, hawala offers lower rates than banks or other money transfer services, making it more profitable for the sender. The reach of this system is also very wide, covering areas that do not have banks, allowing people in rural areas to receive money easily. In addition, the trust factor is an important aspect of the hawala system. Agents or hawaladar are usually well known in their community and maintain their reputation, so that users feel safer. Another advantage that attracts many people is the anonymity offered by hawala. Unlike banks, which require official identification, this system allows transactions without the need for paperwork or in-depth checks. This makes it attractive to those who want to maintain their financial privacy, whether for legitimate or non-legitimate reasons. Its flexibility is also an attractive attraction, as users can send large or small amounts of money to various locations with ease. [1] ; [2]

Trend Adaptation

Along with technological developments, the hawala system has also undergone changes. Now, many hawaladar are starting to use digital platforms and cryptocurrencies to make transactions easier. The system remains an important tool for migrant and refugee workers who often do not have access to formal banking services, so they rely heavily on hawala to send money to families back home. Additionally, hawala allows for quick cross-border transactions, making it a top choice for many communities around the world. [3]

However, on the other hand, this system is also often abused for various criminal activities. Terrorist groups use hawala to send funds secretly, while drug traffickers and human smuggling perpetrators take advantage of it because it leaves no clear trace of transactions. Money laundering is also one of the main problems, as it allows a person to move money proceeds from crime without being detected by the formal financial system. [4] ; [5] ; [6]

Incorrect Usage

The hawala system has several main characteristics that make it attractive to criminals, namely anonymity, the absence of official records, and trust between hawaladar. Because transactions are carried out without going through formal banking, it is difficult to trace the origin and destination of the money transferred. This makes hawala often misused for various illegal activities.

- One of the biggest abuses is in drug trafficking and money laundering. Drug cartels and organised crime groups use hawala to move money from illegal transactions because hawaladar rarely question where the money comes from or who it will be sent to. In Afghanistan, for example, the hawala system is often used to transfer funds between opium farmers and drug buyers without being detected. [5]
- In addition, human trafficking also uses hawala as a payment method in human smuggling operations. Because the system leaves no clear trace of transactions, criminals can use it to pay for smuggling networks in the process of moving people across borders without the knowledge of the authorities. [1]
- What's even more dangerous, hawala is also often used to finance terrorism. Terrorist groups such as Al-

Qaeda and the Taliban take advantage of this system to transfer funds in a way that is difficult to trace. They often collect funds from other illegal activities, then use them to fund their operations without attracting the attention of financial authorities. [7] ; [8]

Halawa Countermeasures & Regulations

Many countries have implemented various rules to control the hawala system, but these regulations vary from country to country. In most countries, hawala is considered illegal because it is difficult to supervise and has the potential to be used for financial crimes. However, there are also countries that legalize hawala with certain conditions. For example, in the United Arab Emirates (UAE) and the United Kingdom, hawaladar is allowed as long as the hawaladar is registered with the central bank and complies with regulations such as anti-money laundering (AML) and know-your-customer (KYC). Meanwhile, in the United States, hawala was banned after 9/11, because the government suspected that this system was being used to fund terrorist organizations. [9] ; [10] ; [11] ; [12]

However, too strict rules can have a side effect, namely encouraging the haruffix to the Underground bank system. If people still need this system but cannot use it legally, they will continue to use it in secret, which makes it even more difficult for authorities to supervise illegal financial transactions. [8]

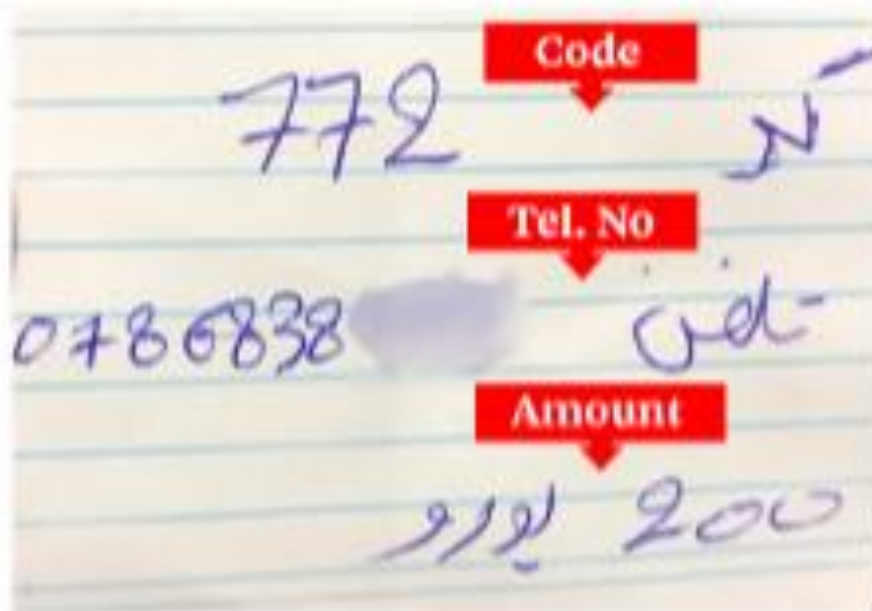
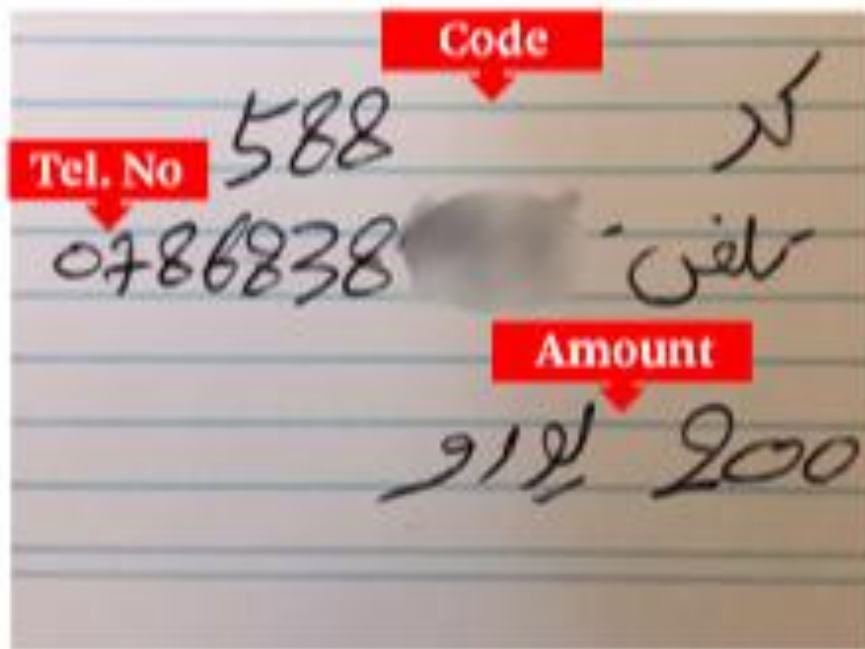


Figure 3. Hawala transaction slip for the transfer of funds from Austria to Afghanistan. Source:

Law enforcement officials also face great challenges in supervising hawala, especially because of its transnational nature. Money can move without going through official banking channels, making it difficult to trace its origin and destination. The anonymity of transactions, family relationships between hawaladars, and informal systems make investigations more difficult, especially in countries that do not have strict regulations or do not implement them properly. [5] ; [6]

Because the hawala system has become widespread globally, existing regulations have also become non-

uniform between countries. Despite differences in supervision, regulations are still needed to reduce the risk of financial crime and maintain economic stability, so that the financial system is not abused by criminals.

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