Spring 2024

A Study of Informal Financial Market of Afghanistan

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A Study of the Traditional Financial Market of Afghanistan
The “Sarafi and/or Hawala” System

Senior Project Submitted to

The Division of Social Studies

of Bard College

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Annandale-on-Hudson, New York

May 2024

ACKNOWLEDGMENTS

I want to take this opportunity to express my sincere gratitude to the people who have been instrumental in my life. These individuals have shown me the path, motivated me, inspired me, and encouraged me to do better in life and to pursue my dreams.

First and foremost, I would like to thank my parents who have always been my pillars of strength. Despite facing numerous difficulties, they never gave up on me and my siblings. They worked tirelessly to ensure that we could pursue education and have a good life. I owe everything to them, and without their sacrifices, I would not be where I am today.

I would also like to pay tribute to my dear friend, Fatima "*Natasha*" Khalil, who inspired me to pursue an Economics degree. Although she is no longer with us, her memory continues to motivate me to strive for excellence. May her Soul rest in peace!

Lastly, I want to thank Bard College’s staff who helped us transition from AUAF to Bard, and my professors, Aniruddha Mitra, Pavlina Tcherneva, Sanjay DeSilva, Dimitri Papadimitriou, Dominique Townsend, and others who have guided, educated, and instructed me during my time at Bard with their wisdom and kindness. Their mentorship has been invaluable in helping me complete my bachelor's degree.

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Abstract

This paper examines the hawala system, an informal money transfer mechanism that is deeply rooted in Afghan society and used globally. Although *hawala* has been criticized for potentially facilitating illegal transactions due to its anonymity, our research aims to provide a deeper insight into its historical significance, operational methods based on trust, and the challenges in its regulation by authorities such as the Da Afghanistan Bank (DAB). We differentiate between 'Hawala' and 'Sarafi' in the Afghanistan context and highlight *hawala's* critical role for those without formal banking services. The paper also looks into current regulatory strategies and underscores the importance of financial literacy programs for *hawala* operators to facilitate their transition into the formal financial system. Our conclusion advocates for policies that balance regulation with recognition of *hawala's* essential role in the Afghan economy, and we identify a gap in the literature, suggesting the need for more comprehensive research on the integration of informal financial practices into the broader economic framework.

Introduction

It has been extensively documented that Informal Money Transfers (IFTs) exist in developing countries (Razavey, 2006). Informal Money Institutions or systems such as the *hawala* have rarely been studied to understand its nature, interconnectedness, and distance from formal financial systems in countries like Afghanistan (Maimbo 2003). Despite existing for hundreds of years, the *hawala* system has hardly received the attention it deserves from empirical or academic research to understand its function, history, and importance (Razavey, 2006). The *hawala* system, as empirical evidence documents, has been used by merchants and traders in various parts of the world, such as the Middle East, Southeast Asia, and Africa (Sharma, 2006). This system strongly relies on trust and social relationships to enable financial transactions without the establishment of a formal financial institution. It serves as a conduit for both legal and illegal transactions, with the former being of economic concern and the latter being a major concern for law enforcement (Robson, 2007). The *hawala* system is characterized by its lack of detailed record-keeping, limited connections to mainstream banking, and the ability to avoid financial auditors and law enforcement officials (Nakhasi, 2007). However, perceptions about this system have changed since the terrorist attacks in New York City in 2001 under the constant criticism of the media. A better understanding of this system's impact is necessary for developing countries like Afghanistan. This paper aims to a) provide an overview of the *hawala* system's origin, b) differentiate between the *hawala* and *Sarafi* terminologies in Afghanistan and how DAB (Afghanistan's Central Bank) provides definitions for each, c) describe the system's operational characteristics, d) illustrate the activities facilitated by this system in Afghanistan, and e) provide recommendations for filling the gap in the literature and further reconsideration for policy reevaluation. The paper aims to encourage policy makers, academic institutions, and law enforcement agencies for reevaluating their approach to integrating *hawala* into formal banking system instead of completely ignoring its importance in countries with no or little formal banking system in places like Afghanistan. The paper is structured as follows:

Chapter 1, presents, first, the literature review which lays out the linguistic, historical, and cultural aspect of *hawala*. Second, the chapter distinguishes between a "Saraf" and a "Hawaladar" who act as *hawala* system operators. Third, the chapter also focuses on why *hawala* received the media spotlight and how it shifted the focus from its historical and cultural importance to a shady-underground money laundering system. It also provides data and estimation of informal financial market size in terms of the number of *hawala* system operators (Sarafs and/or hawaladars). Lastly, the chapter focuses on why hawala is a preferred method of funds transfer over formal banking in countries like Afghanistan. The chapter concludes with providing literature on policies and regulatory frameworks that have been attempted by Afghanistan's Central Bank to regulate the hawala system operators (Sarafs and/or Hawaladars). Chapter 2 provides a brief history of formal and informal financial markets in Afghanistan and how public and private partnerships in Afghanistan shaped the financial landscape of Afghanistan. Chapter 3 provides information on the unbanked population of Afghanistan with a focus on challenges of regulating cash movement within Afghanistan and its borders. Furthermore, the chapter talks about the utilization of hawala in Afghanistan by the unbanked its preference over formal banking. Chapter 4 presents information on the estimated number of *hawala* operators (Sarafs and/or hawaladars) documented through research papers, journal articles, and academic papers. The focus of this chapter is on differentiating between the operational characteristics of the hawala operators (Saraf and/or hawaladar) from a definition and regulatory framework so that a more accurate estimation in terms of numbers of these operators can be found in future research. We present an estimation, based on literature, on the scale of *hawala* operation at a given period. The following chapter (5) presents arguments and claims based on the operational characteristics and nature of hawala on the activities these operators (Sarafs and/or hawaladars) enable in local contexts such as Afghanistan. We present these arguments and claims by looking at the literature and on-ground realities of hawala in the Afghanistan context. We merely present an idea here for further research on the type of activities the hawala performs which literature might have overlooked previously or have not found out about yet. Chapter 6 focuses on the regulation concerning hawala in the Afghan and international context. It focuses on the attempts of Da Afghanistan Bank (Afghanistan's Central Bank) for regulating individual operators of the hawala and the system as a whole. Furthermore, it presents a dilemma in the linguistic, from our point of view, aspect of building policies and regulations in the Afghanistan context and how such loopholes in definitions could have drawbacks instead of creating a foundational oversight for a government to regulate the *hawala* system.

Chapter 7 presents the limitations and challenges in terms of regulating, researching, and estimating the overall operational scale of *hawala* in Afghanistan. The chapter focuses not only on the challenges posed by academia and policymakers in researching and finding the true scale of hawala and its impact, but also encourages consideration of new methodology or approach into learning more about hawala's impact at local, national, and international scale. The paper concludes by recommending that new approaches be found for integrating the hawala users and operators into the formal banking system.

1. Literature Review

The *hawala* system has been widely criticized by global Western financial institutions and the media for enabling anonymous financial transactions. The enablement of terrorist financial activities has regularly been pointed out when *hawala* has been mentioned in literature and media contexts. While its nature of operation has been unique in terms of financial transactions, it is important to also look at its cultural and social context rather than only observing it from a financial institutional perspective. Furthermore, empirical evidence suggests that this system has often questioned formal banking institutions around the world for its swift transaction enablement, cost-effectiveness, and reliability. Lastly, it has helped the senders and/or receivers of money to stay anonymous. A major success point for its operators. Therefore, it has created challenges for governments around the world to regulate it or completely shift it into a formal banking system and/or encourage the operators of the system to integrate with formal banking system.

1.1. Brief History of the Hawala System

Hawala is a traditional method of transferring money and value from one place to another, commonly used in Afghanistan, the Middle East, and the African continent. Furthermore, Afghans involved in the Hawala system are described as "sarafi" or "Saraf," which means "money changer." They are referred to as hawaladars, service providers responsible for transferring money and value from one place to another (Thompson 2008, 1). The process involves the use of service providers called "*Hawaladars*". For clarity, "Sarafs" solely means (money exchangers) in Afghanistan, but they do operate as “*Hawaladars*” under the *hawala* system. Complicating the regulations enacted by the government for “Sarafs” (money exchangers).

3.2. Clarification & Definitions

“The Arabic root s-r-f (ص ر ف) has, among other meanings, “pay and disburse”. The Arabic word for bank, masrif (مصرف), comes from this root. It is also the basis for the Farsi words “Saraf” (صراف), which means a money changer or money remitter (hawala dealer) and “Sarafi” (صرافی), which is the name for the business.” (Jost, 2000. 1). In Afghanistan, "Saraf" solely refers to a 'money exchanger', while "Sarafi" denotes the establishment or business providing 'money-exchanging-services', also known as Foreign Exchange Services (FSP) as per Da Afghanistan Bank (DAB), which is Afghanistan’s Central Bank. To operate a "Sarafi", a "Saraf" must obtain a permit or a license from DAB. Although DAB has established rules and regulations for permitting foreign currency exchange services, these laws are predominantly designed for "Sarafs" as "money changers" and not for "money remitters" or "Hawaladars" — those who operate using the *Hawala* system. The terminologies used in English and local languages seem a direct copy of some of the wording used in ‘the United States’ federal Bank Secrecy Act (BSA) [that] requires any person or group acting as a money-services business (MSB) to adhere to numerous reporting and record-keeping requirements.’ “Money Service Business (MSB)” copied to “Money Service Providers (MSP).”. Furthermore. “these businesses, by law, must register with the Department of the Treasury’s Financial Crimes Enforcement Network (FinCEN), which, again, they usually disregard.” “FinCEN” have become “Financial Transaction and Reports Analysis Center for Afghanistan (“FinTRACA”]).

The DAB Law does not clearly differentiate between "Saraf" and "*Hawaladar*". On the ground, however, a "Saraf" often acts as a "*Hawaladar*". This presents a regulatory challenge for DAB and other institutions in overseeing "*Hawaladars*" who are acting as "Sarafs" or running "Sarafi" businesses. Therefore, the first step in effectively regulating this sector is to clarify the terminology used in DAB laws.

To note this distinction further, while DAB policies refer to these service providers as FSPs, the practice and terminology on the ground differentiate the two terms. "Saraf" is used for Foreign Exchange Services providers or "money exchangers", and "*Hawaladar*" refers to someone operating the *Hawala* system or the "*Hawala* operator". The distinction between these terms is essential for regulatory purposes, and further discussion on the regulation of "Sarafs" and "Sarafi" is elaborated in a later chapter of this paper. In the Afghan context, individuals involved in the *Hawala* business are often referred to as Saraf (or Sarafi in plural), but there is a lack of clear differentiation in DAB's language usage. ((Thompson 2008, 1).

Here, what we emphasize on is not only clarification of definition and localizing the language within the policies but also helping shed light on the context where foreign policies, which mostly are copied from English and then translated into local languages, will create regulatory challenges and loopholes in legal settings like in terminologies of “Saraf” and “hawaladar”. This could be manipulated. A legal loophole operators of the *hawala* would look for anyway. Policies originating from local context and emphasize on local terminologies is essential.

3.3. What is Hawala?

In terms of definition and what Hawala is, the literature provides several different meanings and definitions based on its history and referencing language. The term "*hawala*" is derived from the Arabic word "*Hawala* [حواله]" which means "transfer" or "exchange of debt." (Thompson 2008, 1). “…it is an alternative or parallel remittance system. Furthermore, on its history and definitions, Ferrero, Calderon, and Redin (2014) state that “*Hawala* is an ancient banking practice, deeply rooted in Islamic moral traditions and based on trust that enables the transfer or remittance of money between two parties in a fast and inexpensive manner, without the direct involvement of a financial institution—such as a bank or a money transfer. Thus, in this sense, the transactions are "informal”. (Ferrero, Calderon, & Redin 2014, 2). It exists and operates outside of, or parallel to “traditional” banking or financial channels.” (Jost, 2000. 1). Literature states that “*Hawala* originated in South Asia possibly many centuries ago and means ‘reference’ in Hindu (i.e. you provide a reference and receive funds or credit in exchange).” (Passas 2006, 4). On its history, the literature states that *Hawala’s* roots could go back to ‘premodern societies of Near and Middle East’. (Taube 2003, 407). Although *hawala* has strong connections with Islamic legal tradition, it was also prevalent among non-Muslim merchant communities in ancient and medieval times. On the other hand, while the Islamic jurists codified the concept of *hawala* in Islamic law, it is mentioned that the practice likely existed before its formalization (Thompson 2008, 5). Despite efforts to regulate or disrupt the system, *hawala* has persisted since its inception, as it existed well before its codification in Islamic law (Thompson 2008, 5). The roots of the *hawala* can be traced back to the past seven or eight centuries, and it is also considered an offshoot of the Indian credit instrument known as "*hundi*." (Thompson 2008, 12). "In India, the most commonly used informal value transfer system (IVTS) is *Hawala*. It is a variation of the centuries-old Hundi system, which is arguably the oldest term used for credit or bill of exchange." and "…the Indian indigenous banking system evolved centuries before the European and Western banking systems." (Sharma, 2006, 5). Furthermore, Smriti S. Nakhasi writes for the Northwestern Journal of International Law and Business that *Hawala* ‘pre-dates the current modern banking system’ and that the system originated in China during the Teng Dynasty (618-907 AD) (Nakhasi 2007, 3). It was developed to facilitate the transfer of money from the south of China to the Imperial Capital without the need to physically transport large sums of money due to security reasons. (Nakhasi 2007, 3).

3.4 Hawala System and the Media Spotlight

The *Hawala* system has been widely criticized in Western media outlets for enabling anonymous transactions. The *Hawala* came under constant attention and criticism, especially after the terrorist attack on the Twin Towers of New York City in 2001. One investigative reporter even went so far as to broadcast the headline that *Hawala* is "A Banking System Built for Terrorism." (Thompson 2008, 7). Calls for regulation and dismantling of the system have echoed from various media outlets in the West after the attacks. However, almost no attention was given to its historical roots in the media spotlight. Several statements about informal value transfer systems (IVTS) such as the *Hawala* system have been noted to look loosely at the system in articles, government reports, and academic publications. This has contributed to the portrayal of *hawaladars*, or "money dealers," located in Islamic regions as belonging to underground or criminal finance. The media has associated *hawala* with hidden caves, dark alleys, and non-Western banking practices, creating a sense of mystery and portraying Western banking as the standard and legitimate space of international finance (Thompson 2008, 7). Dina Habjouga and Joanna Clendinning, writing for Dow Jones, have reported that terrorist funders may use small businesses, such as ice cream shops in New York or other parts of the United States and Europe, to transfer money from one location to another. Instead of resorting to complex financial instruments, they may use the traditional method of *Hawala* (Habjouga & Clendinning. n.d.). Despite being in use for centuries, IVTS (Informal Value Transfer System) is still considered a risky financial instrument in the eyes of policymakers, media, and intelligence agencies due to its potential use by groups like Al Qaeda and the Taliban. According to a report by The Telegraph, even two decades after the 9/11 attack, British authorities are still allowing the Taliban to launder money in and out of the UK, as stated by a former White House intelligence chief (Bodkin, 2021). As a result, the *hawala* system, a type of IVTs, is often portrayed as a shady and underground financial tool primarily used for terrorist activities or illegal money laundering. After the attacks on the Twin Towers in New York City in 2001, the media spotlight was as much on the financial activities of the groups like Al-Qaeda as it was on the attacks itself. The U.S Treasury under the Bush Administration came under immense pressure to regulate and close down some of the financial networks these groups used within the United States and other European countries. Maryam Razavy writes for the University of Alberta that the Bush administration closed two major financial institutions, Al-Barakaat and Al-Taqwa in Northern Virginia and New York City after the Twin Tower attacks. Bush stated, "Today we are taking another step in our fight against evil…By shutting down these networks, we interrupt the murderers' work" (Razavy 2006, 1). As a result, the immense pressure from the media and government entities on the *hawala* and tying it solely with terrorist activities had put it under scrutiny to be named an underground shady financial network. Therefore, making arguments to look at the *hawala's* historical and cultural context to the public a challenging task. This paper, however, does not promote or calls for further use of *hawala*, but rather encourages the literature and readers to understand its historical context and why it is beneficial in smaller communities in countries like Afghanistan.

3.5 The Preference of Hawala Instead of Commercial Banking system.

It is no secret now that the *hawala* is widely questioned by economists, financial regulators, academia, law enforcement agencies, and others because of its unique operational characteristics.

While looking at it through a ‘systems-lense’ (as a whole), the *hawala* seems complex and interwoven with traditional and cultural roots, and we cannot simply ignore the fact that the majority of the, if not all, its users and operators use the system for its convenience compared to the transitional banking system. When looking at it from a user’s perspective, there are several reasons one would resort to using *hawala* instead of resorting to a commercial banking system. Some of the reasons for the usage of the Hawala system over the commercial banking system have been noted in the literature as following.

1. Trust: *hawala* is based on trust and personal relationships. These relationships are usually built on business or family ties. The success of hawala transactions depends on the trust between the operator and their contact in the client's home country. Users of *hawala* resort to using the system because they have established trust with the operators who facilitate the transactions. “No cash is actually transferred through the *Hawala* remittance system. It is based on a relationship of trust between a trader and his contact in a client's home country who pays out the cash. The contact is repaid by recalling the debt or favour, which is determined by the nature of their relationship. Its use is not limited to low-income workers, but they dominate the hawala client base because it is a quick and inexpensive way to send cash” (Robson 2007, 3). This trust allows for quick and reliable money transfers without the need for formal documentation. *Hawaladars* gain customers’ trust through personal connections, word of mouth, and/or their reputation in the market, highlighting the crucial role of trust in the operation of the *hawala* system. “…the reputation of an individual is considered to be a sufficient guarantee of his honesty and so requirements such as Know Your Customer (KYC) are sometimes perceived as a pointless imposition by a foreign power (Razavy and Haggerty 20.). "Our customers trust

us," says a Deira-based *hawaladar*. "We have exchanges in Iran and Afghanistan, where we have been running businesses for 10 years, and we have a name in the market." (Robson 2007, 2). “The components of *hawala* that distinguish it from other remittance systems are trust and the extensive use of connections such as family relationships or regional affiliations. Unlike traditional banking or even the chop system, *hawala* makes minimal (often no) use of any sort of negotiable instrument. Transfers of money take place based on communications between members of a network of *hawaladars*, or hawala dealers.” (Jost, 2000. 1).

2. Speed and Efficiency: *Hawala* offers a fast and efficient way to transfer money, especially in regions where formal banking systems may be limited or inaccessible. The funds can be transferred within a short period, sometimes even within minutes. "It is faster, cheaper and often people can get credit through it [*hawala*]." (Robson 2007, “A *hawala* remittance takes place in, at most, one or two days. This can be contrasted with the week or so required for an international wire transfer involving at least one correspondent bank (as well as delays due to holidays, weekends and time differences) or about the same amount of time required to send a bank draft from North America to South Asia via a courier service (surface mail is not a reliable option where the contents are valuable, and it can also take several weeks to arrive).” (Jost, 2000. 1).
3. Privacy and Confidentiality: *Hawala* transactions are typically conducted with a high level of privacy and confidentiality. People may choose to use *hawala* to keep their financial transactions discreet and avoid scrutiny from authorities or other parties. "The system is paperless and depends on the reliability of the trader and his contact." (Robson 2007, 2). On the other hand, in the literature, *hawala* is also reported to be used to evade

taxes. “In South Asia, the “black” or parallel economy is 30%-50% of the “white” or documented economy. Money remitted through official channels might invite scrutiny from tax authorities. “…*hawala* provides a scrutiny-free remittance channel.” (Jost, 2000, 9).

4. Accessibility & Reliability: *Hawala* networks are widespread and operate in various countries, making them accessible to individuals who may not have access to formal banking services. This accessibility allows for money transfers across borders and facilitates international trade and remittances. "Paid in cash and excluded from the official banking system, large numbers of workers are using this informal, yet legal, money transfer system to send money back to their families." (Robson 2007, 2). Furthermore, “Complex international transactions, which might involve the clients local bank, its correspondent bank, the main office of a foreign bank and a branch office of the recipient’s foreign bank, have the potential to be problematic. In at least once instance reported to the authors, money for a large commercial transaction (money being sent from the United States to South Asia) was lost in transit for several weeks while trying to conduct such a transaction. When the bank located the money, it was returned to the customer. He enlisted the services of a local hawaladar, who was able to complete the transaction in less than a day.” (Jost, 2000, 9).
5. Lower Costs: The primary reason is cost effectiveness. (Jost, 2000, 9). *Hawala* provides a quick and inexpensive way to send cash, which is particularly appealing to individuals who are not educated or have limited access to formal banking services. *Hawala* transactions often involve lower fees compared to traditional banking systems. This makes it an attractive option for individuals who want to minimize transaction costs. "A common use

> of hawala is in real estate transactions in India as it allows both vendors and sellers to circumvent currency controls and taxes." (Robson 2007, 2).

An illustration of the cost-effectiveness of hawala is well pointed out in the Passas (2005) paper on the use of hawala by migrant workers in the UAE. See tables 1 and 2 for further understanding.

The underlying challenge here for the traditional banks is the competitiveness of *Hawala* in exchange rate of currencies involved in the transaction. The example in Tables 1 and 2 clearly shows that the *Hawala* will not charge a fee on the 100$ USD transferred to maintain its operation for a) the people involved know each other well and have an extreme level of trust, b) the charged fee, which would be, which in most cases happen in practice, less than what traditional banks charge, and c) the fee is gained through exchange of currency between the two operators of the Hawala. The latter point meaning that the operators of *Hawala* will not charge fee for the user because they use a better exchange rate than traditional banks amongst themselves (*Hawala* Operators) to charge the fee. As a result, the user of the *Hawala* does not have to pay fee in some instances. However, in practice, a *Hawala* operator will ask for the fee upfront from the user when they want to send money which is still cost effective to the user.

See Tables 1 and 2.

Table 1 Comparative cost of Sending US$100 to South Asia from Dubai, UAE

Institution	Charges (US$)		
	Draft	Telegraphic transfer	Rate of Dh/US$
Exchange house	1.36–2.722	9.52–16.33	3.6735–3.68
Bank	2.722–6.80	12.25–27.22	3.678–3.693
Western Union	9.52	–	3.7
Hawaii	0	–	3.673–3.6736

Source: Passas (2005)

Table 2 Comparative amounts received in Pakistan for remittance of US$100 from Dubai, UAE

Method remittance	Charges	Total paid	PK rupees received
Draft (exchange house)	1.36–2.722	101.36–102.722	5,901–5,910
Draft (bank)	2.722–6.80	102.722–106.30	5,890
Telegraphic transfer (exchange house)	9.52–16.33	109.52–116.33	5,901–5,910
Telegraphic transfer (bank)	12.25–27.22	112.25–127.22	5,890
Wertern Union	9.52	109.52	5,858
Hawala	0	100	5,920

Source: Passas (2005)

3.6 Regulation of the hawala system

The regulation of informal financial systems like *hawala* presents several challenges, as highlighted by Samuel Munzele Maimbo for the IMF *"The Challenges of Regulating and Supervising Hawaladars of Kabul."* One of the primary challenges is determining the extent to which these systems pose systemic risks that necessitate formal regulatory and supervisory policies within the context of Afghanistan and in broader scope. Maimbo notes, "The fundamental question facing the central bank [Da Afghanistan Bank] was whether *hawaladars* posed systemic risks serious enough to require formal regulatory and supervisory regimes similar to those being developed for the banking sector" (Maimbo, n.d., 52-53). This underscores the difficulty in assessing the risk profile of *hawala* systems and the appropriateness of applying banking sector regulatory models to them.

Another challenge lies in balancing the need for regulation against the inherent benefits and resilience of the *hawala* system. Maimbo points out, "Despite improvements in policies and in conventional financial institutions, *hawaladars* will continue to represent an important and often necessary element of Afghanistan's financial architecture. The market's simplicity, cost-effectiveness, and convenience will ensure its survival for many years to come. It is therefore advisable that oversight policies focus primarily on regulation rather than on eradication" (Maimbo, n.d., 62). This emphasizes the need for regulatory frameworks that do not aim to eliminate *Hawala* but rather regulate it in a way that preserves its beneficial aspects.

Moreover, the international context, especially the efforts to combat money laundering and terrorist financing, influences how *Hawala* is regulated. Maimbo observes that "In view of intense international efforts to combat money laundering and terrorist financing, the first option had to be ruled out—it was not feasible to forgo regulatory standards altogether. Therefore, regulators began considering how *hawala* practices could be brought into closer compliance with international regulatory and supervisory standards" (Maimbo, n.d., 53). This reflects the global pressure to align informal financial systems with international standards, even though this alignment may pose its own set of challenges. Lastly, the process of regulation itself is complex and requires careful planning and consultation. Maimbo states, "To its credit, the central bank [Da Afghanistan Bank] has not implemented regulations for the informal financial sector in haste. Rather, its new money exchange regulations are the product of months of consultation and discussion" (Maimbo, n.d., 55). This highlights the importance of a thoughtful, consultative approach to developing regulations that are suitable for the unique dynamics of informal financial systems like *Hawala*. However, the laws of the DAB should further provide clarification in terms of whether there is a difference between “money-changers” (Sarafs) or “money-remitters” (*Hawaladars*) in order to create comprehensive regulatory structure for both financial systems.

Authored by Haroun Rahimi, a recent, 2021, study titled *"How to Create Better Hawala Regulations: A Case Study of Hawala Regulations in Afghanistan,"* looks at the various aspects of *Hawala* regulation in Afghanistan. He argues for the necessity of regulations due to the established connection of *Hawala* with illegal activities. "This article does not disagree with the diagnoses and prescriptions of the literature concerning *Hawala* and the necessity of regulations. The nexus of *Hawala* with illegal activities is well-established" (Rahimi 2021, 133). However, he criticizes the prevailing regulatory approaches for not considering the context of *Hawala* usage. Rahimi suggests that regulations often fail to implement effectively and can harm local economies. "However, this article contends that the prevailing diagnoses are incomplete, and the dominant regulatory prescriptions often do not take the context of *Hawala* usage into account.

As a result, the regulations designed based on international best practices often cannot be effectively implemented, and if implemented, can harm the local economy" (Rahimi 2021, 133). Rahimi advocates for a bottom-up regulatory approach, which includes formalizing informal credit practices of *Hawaladars* to improve local merchants' access to credit while imposing necessary transparency and accountability measures. "*Hawaladars* help Afghan merchants sell on credit despite the uncertainty of Afghanistan's business climate. *Hawaladar's* short-term working capital loans, which are executed as credit-hawala, help sellers/creditors meet their financial obligations to their foreign suppliers despite unpredictable cash flow from their receivables inside Afghanistan." (Rahimi 2021, 135).

Globally, the *hawala* system's adaptability has led to its use for legitimate and illicit activities. The challenge lies in balancing the need for regulation to prevent abuse while acknowledging the system's vital role in regions lacking robust financial services. Samuel Maimbo's "*The Money Exchange Dealers of Kabul*" working paper for the World Bank states that a number of countries in 2002 at a conference on hawala in the UAE in May 2002, a number of governments agreed to adopt the recommendations of the Financial Action Task Force (FATF) on Money Laundering and the Special Recommendations on Terrorist Financing in relation to remitters, including Hawalas and other alternative remittance providers. The Abu Dhabi Declaration on Hawala set forth several principles, including the adoption of FATF recommendations, the designation of competent supervisory authorities, the implementation of effective but not overly restrictive regulations, and the close support and commitment of the international community in regulating the Hawala System for legitimate commerce and preventing its exploitation or misuse by criminals and others (Maimbo 2003, 15).

As a result, as noted by Maimbo too, over-regulation may risk pushing Hawala further underground, making it more challenging to monitor and potentially exacerbating issues related to illegal fund movements. The case of Afghanistan illustrates the broader challenge of regulating informal financial systems in a manner that respects their historical and cultural significance while addressing global concerns about financial transparency and security. "The role of hawaladars in facilitating remittances is important. About 15 percent of the rural population receives remittances, which represents about 20 percent of the rural population's expenditure on average. During the past 25 years, more than 30 percent of the Afghan population has been externally or internally displaced (with over 3 million in Pakistan and 2.3 million in Iran). Remittances from Pakistan, Iran, North America, Europe, and parts of Australasia remain a central element of Afghan households." (Maimbo, 2003, 52)

2. Brief History of Formal and Informal Financial Markets in Afghanistan

The formal banking sector in Afghanistan dates back to 1933 when the BMA (Bank-e-Millie Afghani) was involved in managing state banking affairs before the establishment of Da Afghanistan Bank (DAB). "Bank-e-Millie Afghan (BMA) was the first financial institution established in Afghanistan in 1933. Similarly, it was the first financial institution established in a public-private partnership set up with a 72 percent share held by the private sector." (BMA, n.d.). Da Afghanistan Bank (DAB) was established in the capital Kabul in 1939 by the state by the back-king's order to carry out similar activities as commercial banks in the financial sector (BMA, n.d.). Until 2001, the DAB was carrying out similar financial activities as other commercial banks (BMA, n.d.). Following 2003, it transitioned into a separate establishment with distinct obligations and responsibilities and was given the status of the Central Bank of

Afghanistan (BMA, n.d.). The main goal of DAB was to "maintain price stability by formulating, carrying out, and adopting monetary policies, and foreign currency policies, producing banknotes and minting coins." (DAB, n.d.). Afghanistan's banking and financial industries have changed since 2003, with new legislation controlling bank lending (DAB, n.d.). The 2004 "Da Afghanistan Bank (DAB) Law", jointly developed by the World Bank and the IMF, improved bank supervision and monetary policy (DAB, n.d.). . The Banking Law legalized commercial banks in September 2003, and by 2005, eleven were licensed (DAB, n.d.). However, bad management, unethical behavior, and inadequate legal and regulatory frameworks affected most of them (Saeedi, 2023). Afghanistan's financial system has 15 commercial banks, 183 branches, 332 foreign currency dealers, and 100 regulated money service providers as of March 2008. (Saeedi 2024, 2). However, during this transformation of the formal banking sector, in parallel, the *hawala* system has remained relevant in various transactions due to the public's familiarity with its operations. This is due to the absence of documentation or bureaucratic procedures necessary for client authentication, risk evaluation, or transaction authorization which majority of the time offer challenges for the users (Maimbo, 2003). The *hawala* system is well regarded and dependable for both the general population and investors in Afghanistan (Maimbo, 2003). These operators are controlled through associations and formal-informal partnerships through trust. According to the DAB, there are 3,200 Sarafs and licensed money-service-providers (MSPs) in Afghanistan (Rahimi, 2021). However, it should be noted that due to the lack of formal oversight and proper regulatory framework, this number might not reflect the actual number of hawala operators in Afghanistan (Rahimi, 2021). The biggest financial market in terms of physical space, number of operators outside formal banking system, and transaction facilitation is the Sara-e-Shahzada, "Sari Shahzada", "Shahzada" market at the heart of Kabul city. The market has an eighty-year-old history [as of 2003] in Afghanistan (Maimbo, 2003). The market's location key because it is located close, in terms of proximity to other traders such as metal, food, textiles, and others within a walking distance which makes it a convenient system for funds transaction to such traders (Maimbo, 2003). In order for a *hawala* operator (Saraf and/or hawaladar) to be trusted by their clientele, a physical presence at the Shahzada market helps with customer retention and business growth. Furthermore, the physical presence in the Shahzada market means that operator "are likely to have a longer operational history than those that do not" (Maimbo, 2003).

Therefore, in such an environment, DAB could take certain measures to control this informal market. The two alternatives proposed by the IMF include extending banking regulations and supervision practices to money dealers, which would likely push the activity underground (Razavey, 2006). Firstly, the *hawala* dealers could subject themselves to self-regulation and supervision, utilizing an association that enforces unwritten rules. Secondly, recognizing the unique features of the hawala system, special regulations and supervision techniques could be developed to increase transparency while maintaining efficiency. Additionally, the DAB could educate money dealers about their responsibility to report suspicious activities through information campaigns.

To summarize, Afghanistan's banking and financial sectors have undergone significant changes since the establishment of DAB. While the *hawala* system remains relevant due to its convenience, DAB needs to take certain measures to control it. The IMF has proposed two alternatives: extending regulation and supervision practices to money dealers or recognizing the unique features of the *hawala* system and developing special regulations and supervision techniques.

3. Unbanked population and the Hawala system

The "unbanked population" refers to individuals who do not use formal banking services, a common scenario in countries like Afghanistan, where many rely on the informal money transfer systems instead (Integrity Watch, 2015). The traditional method of money transfer operation on trust and a vast network of brokers, such as the *hawala*, offers a reliable alternative to conventional banking, particularly in areas lacking financial infrastructure or political stability (Thompson, 2008). The *Hawala* system's popularity in Afghanistan is attributed to its accessibility, speed, and anonymity, making it an essential service for everyday financial transactions, especially for those unable to access or distrustful of traditional banks (Integrity Watch, 2015). This situation is not unique to Afghanistan, as similar informal financial systems are found in other countries facing challenges like limited banking infrastructure, conflict, or significant informal economies, demonstrating a global reliance on alternative financial services among unbanked populations (Integrity Watch, 2015).

As of 2017, only 15% of adults in Afghanistan had an account with a financial institution, which was much lower than the average in South Asia. By 2021, this number dropped even further to just 10% of adults. Before the Taliban government started in August 2021, the banking sector in Afghanistan was already facing problems. After that, it became even harder for banks in Afghanistan to connect with banks in other countries.[1] International banks did not want to take the risk of dealing with Afghan banks, which led to very few international transactions through banks (the Global Economy, n.d.) Because of this, Afghanistan has had to bring in more than $2 billion in cash since August 2021 (the Global Economy, n.d.). The people in Afghanistan don't

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[1] The Global Economy.com https://www.theglobaleconomy.com/Afghanistan/percent_people_bank_accounts/

trust the banks much because they can't always get their money when needed. The banks have rules on how much money people can take out, which makes people trust the banks even less (the Global Economy, n.d.). When the banks cannot serve their needs, Afghan people turn to Hawala (the Global Economy, n.d.). This system is not watched over as strictly as banks, so it has become an important way for people to manage their money. After August 2021, many skilled workers left the country, which meant that the Central Bank of Afghanistan (DAB) had even fewer experts to help it work properly. This makes it difficult for the DAB to watch over the banks and ensure they follow the rules (the Global Economy, n.d.).

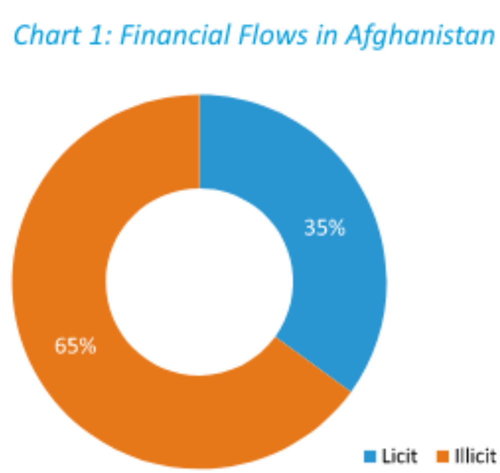
International banks see Afghanistan as a risky place. This view has not changed, even though there have been efforts to allow humanitarian aid to come into the country without getting stuck because of sanctions. (the Global Economy, n.d.). After two years, Afghanistan is still mostly cut off from the global system that moves money across borders. As a result, the use of informal services like *hawala* has grown, and the formal banking system is used even less than before. There needs to be a better system in place to help the flow of money in and out of the country. This system should help not only with aid from other countries but also with the everyday business of people in Afghanistan. “According to the International Monetary Fund data, 90% of financial transactions in Afghanistan are conducted through *Hawaladars*. Only 10% of the Afghanistan population uses banks. Another World Bank report suggested that 16% of Afghan families rely on the money sent by a family member working abroad which is almost exclusively transferred via *Hawaladars*.” (Rahimi 2021, 137). The prevalence of the *hawala* system, particularly its use in drug-producing regions by unlicensed operators, significantly contributes to the illicit flow of funds, supporting activities such as money laundering and the financing of terrorism. The Afghan government's efforts to implement and enforce financial regulations are severely impaired by systemic corruption, limited resources, and the challenge of technical know-how. The overlap of formal banking practices with informal *hawala* operations makes effective financial oversight challenging. Despite the presence of Afghanistan's financial intelligence unit, FINTRACA, there is a noticeable lack of adherence to Anti-Money Laundering (AML) and Countering the Financing of Terrorism (CFT) standards among operators in the financial sector. The nation also grapples with securing its borders, a situation that exacerbates issues of cash smuggling and allows for unchecked cross-border illicit activities. The DAB reported approximately $4.6 billion in cash left Afghanistan via Kabul International Airport in 2011. Tracking cash movements across borders or through airports has become increasingly difficult with implementing an executive order that makes it illegal to take more than $20,000 out of the country (DAB, n.d.). While there have been legislative attempts to bolster the financial regulatory framework, including measures for extradition and freezing terrorism-linked accounts, Afghanistan still faces significant gaps in its AML/CFT policies. Thus, it is needed to reinforce its legal and regulatory systems, tighten security at borders and airports, and enhance the operational capabilities of its regulatory bodies to tackle these deep-rooted challenges effectively.

4. The *Sarafs* and/or *Hawaladars* in Afghanistan

It is mentioned that there are between 500 and 2000 unregistered *hawaladars* in Afghanistan (Thompson 2008, 1). Furthermore, another literature by Samuel Maimbo for the World Bank states that "more than 300 hawaladars organized themselves [at one point in 2005] into an impressive open market offering foreign exchange services, funds transfers, microfinance, trade finance, and deposit-taking activities" (Maimbo, n.d.). Gathering accurate data in terms of the scale of operation from hawala in places like Afghanistan is a major challenge.

"The exact number of Sarafs and/or hawaladars is still unknown to the authorities because of several reasons. "…many licensed Sarafs operate from a permanent place of business (such as a store or an office), there are many more mobile Sarafs that hold neither a license nor have a permanent place of business." And that "mobile Sarafs stand on the street holding their money at hand. They do not execute Hawala—because they do not have a permanent address, and no one would trust them with a Hawala—but only buy and sell different currencies." (Rahimi 2021, 137).

We can assume that because of the absence of a legitimate government and restrictions on international banking in Afghanistan today, the number has increased after the collapse of the Afghan government in 2021 and the Taliban take over. With the restrictions and sanctions placed on official banking with the rest of the world, the Afghan population, even those who used to bank, might have returned to using the hawala system, and use hawaladars to transfer money from and to Afghanistan. "Only about 35% of the country's financial flows are legal" (Integrity Watch, 2015). "Afghanistan's illicit outflows from 2003-2012 totaled USD 2.22$ billion, which is an average of USD $222 million per year" (Integrity Watch, 2015). However, given the nature of operation and challenges in gathering data, the number could be even higher.



Furthermore, corruption and widescale lack of oversight in borders creates another challenge to track the movement of cash. "In 2011, an estimated USD 4.5 billion was reportedly taken out of the country through the Hamid Karzai International Airport (HKIA)" [2](Integrity Watch, 2015). Such estimations and analysis on data is conducted by looking at one location (HKIA). Therefore, we cannot ignore the fact that the number could be even higher if we look at other airports, land borders, and entry and exit points in Afghanistan.

Table 1: Corruption Perceptions Index 2014

Rank	Country
169	Turkmenistan
170	Iraq
171	South Sudan
172	Afghanistan
173	Sudan
174	Korea (North)
174	Somalia

Source: Transparency International (2015)

As Rahimi points out, Sarafs, now that it could be a bit clear from a definition and operation's perspective, solely are allowed to be engaged in the currency exchanges and not *hawala*. However, the exact number of the *hawala* system operators, whether a Saraf or a *hawaladar*, is still unknown due to the complication in first defining their role in the system and second lack of a comprehensive research on the ground to determine their exact number. Whether Thompson's 2008 paper refers to Sarafs and/or *hawaladars* in terms of statistic is unclear because literature looks at both a Saraf and a *hawaladar* from the same perspective. However, our emphasis is defining their roles first in order for us to get the statistics right later which will help us understand the dilemma of Sarafs and/or *hawaladars* clearer. Finally, as we see from literature and research papers, since 90% of the Afghan population rely on informal money transfer or

[2] *Curbing Illicit Financial Flows in Afghanistan*. Integrity Watch Afghanistan, 2015.

hawala system, we cannot find any data on how many users does the *hawala* have and what is the scale and size of a single transaction at a given period.

Country	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total	Avg
Afghanistan	892	667	505	159	0	0	0	0	0	0	2,223	222

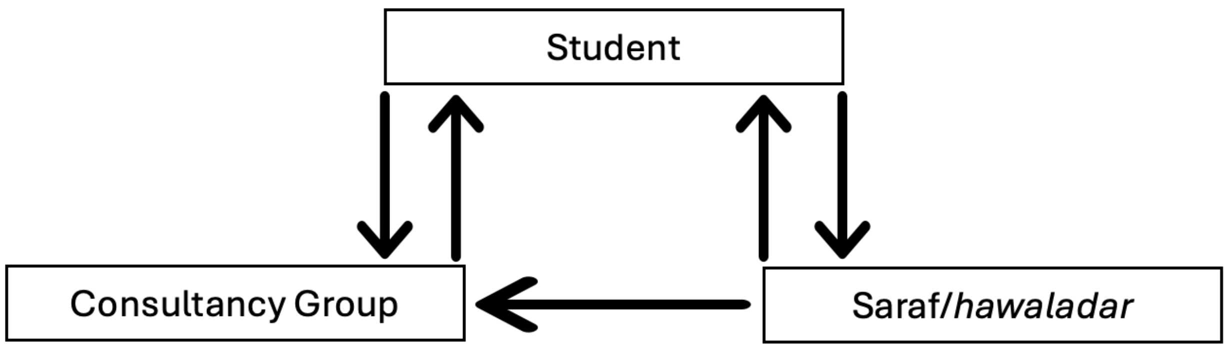
Source: GFI, Illicit Financial Flows from Afghanistan (in millions of U.S. dollars, nominal) (2014)

5. Activities of Sarafs and/or *hawaladars*

It is no secret that, while being an ancient system of remittance used by merchants, and also being the reason, as we see from its history, an enabler of trade for hundreds of years in Asia, the system has been abused by cartels, terrorists, money launderers, and many more who like to keep their identity a secret (Sharma, 2006). Extensive reports, literature, and media articles have constantly pointed out to *hawala* as a shady terrorist financing and money laundering system (Thompson, 2008). While this traditional system has been abused by some of its users, it should also be pointed out that the system has been used, at least in the local Afghan context, for enabling transactions and activities that have rarely or never have been reported about. Here, we are not presenting a research-based argument or data that could provide accurate statistics into these claims. However, looking at the operation of Sarafs and/or *hawaladars* closely in Afghanistan, we can clearly see a comfort the Afghan population feels when utilizing this system instead of the traditional banking systems where bureaucracy and paperwork, in a country with not a high-level literacy, creates space for the systems use. What we offer here is an insight based on the on-ground activities of these operators of the system. Extensive research and on-groundwork need to be done in order for this claim to be verified and looked at from an economics impact point of view. Therefore, here, we lay out a few examples of the activities the operators of the hawala system enable in the context of Afghanistan.

5.1 Education

Afghan students who are looking for undergraduate or graduate level studies outside Afghanistan refer to "Educational Consultancy" groups that exists in Afghanistan. The primary function of these consultancies is to look for educational opportunities for Afghan students in different parts of the world based on their eligibility; while in most cases the student would actually select a country they want to go to and the consultancy will look for universities and colleges within those countries for admission for the student. Once the country and college/university and the level of studies is determined with the student, the consultancy group will actively prepare all application materials, testimonials, and other required documents in consultation with the student for submission. An initial fee is discussed during this process which is paid upfront. Although, in most cases, the consultancies are so sure of their application admittance, that they will not charge a fee until the student gets into the college/university. Next, when the application is submitted, the student will reach out to a Saraf and/or *hawaladar,* in this case acting as the middleman, to deposit a certain amount of money with them, not in a bank, but give the authority of the cash to the Saraf and/or *hawaladar*. Once the application has been approved, the student will authorize a portion of the total cost of the money, which includes admission, tickets to intended country, accommodation, insurance, and other related expenses, to the consultancy group. The student will not authorize the total cost of this process to the consultancy until they reach their desired college/university in their intended country. After their arrival and admission process completion in their intended country, the student will reach out to the Saraf and/or *hawaladar* to release the remaining portion of the money to the consultancy group. This process is anonymous, less bureaucratic, fast, and cost effective, in comparison to if the student decided to do it themselves through official banking system. Although the consultancy groups do use official banking systems in terms of admission in other related costs, they will keep their actual cost hidden because of regulatory and tax purposes. In addition, in most cases, these consultancy groups will utilize offshore bank accounts to transfer money from their accounts to process the related costs of the admission. Making the whole process discreet and hidden from the government's sight. The diagram below illustrates how the process works between a student, the consultancy group, and the Saraf and/or *hawaladar.*



The student reaches out to the consultancy group for admission in an intended country and program, the consultancy group works with the student to prepare the application, the student then reaches out to the Saraf and/or *hawaladar* to make a deposit of the costs associated with the application and the whole process, after the application is approved the student releases a portion of the costs associated to the consultancy group by reaching out the Saraf and/or hawaladar, as the final step, once the student is in the intended country and has started his studies, he will reach out to the Saraf and/or hawaladar as a last step to release the remaining money to the consultancy group. Furthermore, it should be noted that the relationship between the consultancy group and the Saraf and/or *hawaladar* can also be a two-way relationship. Meaning, in some cases, the consultancy group will only work with a trustworthy Saraf and/or *hawaladar* that has a reputation in the market and who they can trust. In most cases, the Sarafs and/or *hawaladars* who enable this kind of transaction are well-known in the market and have a reputation. These consultancy groups exist in hundreds, if not in thousands, around Afghanistan who help students get admission in colleges and universities. The associated costs of admission into these universities, through official banking systems, in many cases costly, and students do not have foreign credit or debit cards through which they can process their payments to the college or universities accounts. Therefore, from an economic and education enablement point of view, these middlemen (Sarafs and/or *hawaladars*), working in conjunction with the consultancy group (s), as we see from one example, could create an opportunity for further exploration into considering the benefits of the *hawala* system at a community and local level. [3]

5.2 Local Trade

Hawala has been extensively employed by merchants and traders across Asia for enabling regional and local trade. In the context of local Afghan merchants and traders, *hawala* plays a key role. “Nonfinancial activities included telephone and fax services, regional and international trade, and, more recently, Internet services.” (Maimbo, 2003, 51). Due to the extreme security risks of carrying physical cash for trade in regions like Afghanistan, hawala has extensively played a pivotal role in securing trade. “During the Taliban period, the country’s formal banking system was not operational. The then six licensed state banks did not provide commercial banking services, nor did they have the capacity to offer international or domestic remittance services. Short of physically moving cash around the country, *hawala* transactions were the only reliable, efficient, and safe means of transferring funds into Afghanistan and within its provinces.

[3] Examples of consultancy groups and their advertisements on social media pages can be found in the appendices of this paper.

In fact, the hawaladars of Kabul were the only active financial operators." (Maimbo, 2003, 51). After the regime change in August of 2021 and the Taliban takeover of Afghanistan, hawala transactions have increased substantially. However, unlike the 1990s Taliban takeover of Afghanistan, this time, they have allowed commercial banks to operate under a strict supervision by Da Afghanistan Bank. Transactions from other countries using systems like MoneyGram, Western Union, and others have been allowed to enable transfer of funds but in smaller amounts or 'weekly allowances' if the transactions are larger than 250$ USD. The United Nations Cash transfer program that transfers USD cash into Afghanistan's commercial banks to stabilize the economy, it has helped raise the weekly or individual transactions someone receives in the country. It is evident that *hawala* is predominant and plays a key role in transfer of cash and stability of the market today in Afghanistan.[4] As a result, for the market to operate in a stable environment and without any sudden disruption, hawala has created an atmosphere of stability. While majorly relying on trust, the system's and the operators (Sarafs' and/or *hawaladars'*) roles cannot be ignored.

5.3 Political Campaigning

Election campaigns in Afghanistan over the past 20 years had transformed into meticulously organized endeavors. Success in these campaigns was no longer just about how much money or community support a candidate had. Instead, victory was increasingly linked to the strategic application of the resources available to run an election campaign. In Afghanistan, however, there's been a tendency to overlook this evolution. Despite considerable spending, election campaigns often lacked precision and sophistication. It was instrumental in actualizing the

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[4] According to an August 2023 World Bank report, the UN has purchased, transported, and transferred $2.9 billion in U.S. currency to Afghanistan since August 2021. This includes $1.8 billion provided in 2022 and $1.1 billion provided in 2023, as of August 2023. SIGAR (Special Inspector General for Afghanistan Reconstruction). https://www.sigar.mil/pdf/evaluations/SIGAR-24-12-IP.pdf

strategies and plans during the formal campaign period. Thus, the comprehensive organization and execution of campaign initiatives were pivotal for a candidate's success in the election even if it meant utilizing informal money transfer systems like *hawala* to enable money transfers from one location to another or raise funds using the system.

With the influx of the foreign forces after the 2001 NYC attacks into Afghanistan and the global fight against terrorism, Afghanistan underwent drastic political change compared to the 1990s. A new constitution was enacted by 2004 in Bonn in consultation and leadership of the United States along with a Loya Jirga "General Assembly" of Afghan elders who were crucial into shaping the political and government structure of Afghanistan. With the regime change and introduction of the new government, a parliament and presidential voting structure was introduced for the first time in Afghanistan's history to give the citizens an opportunity to vote for their desired candidate. To enable fundraising for campaigns, as we observe from on-ground activities, the hawala system and its operators (Sarafs and *hawaladars*) played a crucial role in transfer of money from one location to another. While the government did lay out policies and regulations on how much fundraising and cost should be associated with campaigning during the presidential and parliamentarian elections, it is evident that influential figures, in an unstable country like Afghanistan, have had their say in terms of fundraising and influence in these elections. Furthermore, in most cases, being very selective in who gets to win what province in terms of elections.[5]

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[5] "Audio tape causes controversy in Afghanistan's Election. Instructions for manipulating the election results are part of the content of this tape" https://www.bbc.com/persian/afghanistan/2010/11/101112_k02-afghanista-election-audio-clip

5.4 Humanitarian Assistance

It is evident that due to the lack of commercial banks and entities in places like Afghanistan, the general population will resort to informal transfer system in order to meet their needs. Cash plays a key role in these societies. This further develops the ground for challenges for international aid organizations to use formal banking systems to transfer funds and aid into these communities. While hawala has been pointed, in literature and in media mostly, as a shady financing system which used by terrorists, cartels, money launderers, and others who like to stay anonymous, it cannot be ignored that, at the same time, the literature calls, and by looking at its use, for some legitimate use of the system. For instance, "due to the lack of formal financial institutions and the unreliability of those in place, hawala was [playing a key role] during the war-torn Taliban years as it is today, the favorite method of delivery of funds for international aid organizations and non-governmental organizations (NGOs)." (Hancock 2008, 29). Furthermore, the operators of *hawala* have been able to transfer large sums of humanitarian aid to locations where formal institutions did not exist. "There was no limit to the volume of funds the *hawaladars* of Kabul could process, either individually or severally. Single transactions in excess of US$500,000, especially between Peshawar [neighboring city to Afghanistan in Pakistan] and Kabul, were not uncommon. Smaller organizations regularly remitted US$20,000-30,000 through the system to meet expenses." (Maimbo 2005, 52). Additionally, the system has been used by emergency aid workers not only in Afghanistan but in other conflict zones like Somalia to enable aid delivery into hard-to-reach locations. "In cases, such as Afghanistan and Somalia, where the formal financial system is not operating, the majority of aid organizations have used the [system] for international and domestic remittance services for humanitarian, emergency, and relief operations." (El Qorchi 2003, 12). As a result, due to the lack of formal financial institutions in places like Afghanistan and Somalia, *hawala* becomes the only liable option for transfer aid and assistance which is crucial in humanitarian aid programs. The swiftness, cost-effectiveness, reach, and operational characteristics of hawala cannot be ignored in such locations which serves these hard-to-reach communities while other formal institutions cannot.

To conclude, while we do consider the ethical and legal considerations of hawala compared to the traditional banking system, especially in developed countries, it cannot be ignored that it does play a pivotal role in smaller communities. By pointing out to some of the activities the *hawala* operators collectively (Sarafs and/or *hawaladars*) should be considered for further ground research and analysis. We do not recommend the replacement of formal financial institutions with the use of *hawala* but in locations such as Afghanistan, where literacy rate is low and basic infrastructure is still non-existent, the system should be acknowledged for enabling key resources for the population.

6. Dilemma of Regulation of the *Hawala* in Afghanistan

As we have seen from reviewing the literature and previous chapters, the *Hawala* is a challenging system to regulate because of its nature of operation. In this paper, our focus, while not only on its nature and characteristics, is also on the clarity of definitions and proper introduction of regulations of the policies by the government authorities. Rahimi's 2021 study *"How to Create Better Hawala Regulations: A Case Study of Hawala Regulations in Afghanistan,"* state that:

> "There are two types of non-bank actors in Afghanistan's financial system. The first are Sarafs, which literally means money exchanger. According to formal rules, they can only engage in the exchange of different currencies, art. 3.2.2). The second are Money Service Providers (MSP), which according to formal rules, in addition to currency exchange, can also engage in domestic

> and international money transfers, popularly known as *Hawala*: 3.2.1. MSPs can also buy, sell, and discount checks: 3.2.1. This article has called Sarafs and MSPs collectively by their popular name in the literature Hawaladar (singular), Hawaladars (plural), and *Hawaladari* (adjective). Hawaladars, according to formal rules, are barred from keeping deposits and issuing loans [11]: 3.2.1.c, they, nonetheless, de facto, perform these functions and other functions formally reserved for banks." (Rahimi 2021, 7).

However, the dilemma occurs, as we see from a linguistic and literature point of view, while also from an operation characteristic, from the conflation of the roles of "*Saraf*" and "*Hawaladar*". The prevailing literature often does not distinguish between the two, regularly pointing to the two as similar or using the words interchangeably, presenting a significant regulatory hurdle for the Da Afghanistan Bank (DAB). Moreover, DAB's legislation, articulated in the country's official languages of Dari and Pashto, and in English, conspicuously omits the term "*Hawala*". Instead, it employs the broader designation of 'Money Service Providers', pointing to a complication of the functions these agents perform. DAB Law, "*Article 5: 5.19 "money service provider" means any person who engages in the business of providing a money service."*

A "*Hawaladar*" is predominantly engaged in remitting funds across borders through a networked system that obviates the need for the physical movement of cash. This process is distinct from currency exchange, which is the "Saraf's" domain, who trades one form of currency for another. Thus, while "*Hawaladars*" do provide a form of money service, their core activity revolves around the translocation of monetary value, rather than currency exchange per se.

The absence of a clear legal demarcation between these two financial actors creates a vacuum that could have legal ramifications. In a hypothetical legal process, the lack of clarity in DAB's regulations and statutes could be exploited to the loss of the regulatory body itself. To preclude such results and to ensure both accountability within the *Hawala* system and the integrity of regulatory practices, it is imperative for DAB laws to provide careful explanation to this dichotomy. Without such legislative precision in laws and policies, the ambiguities could lead to judicial interpretations unfavorable to the DAB's regulatory objectives. Therefore, a delineation in DAB's regulations is not only a matter of linguistic and operational accuracy but also a back draw against potential legal challenges.

7. Limitations & Challenges

First, misconceptions and biases regarding *hawala* as a system for illegal activities, such as money laundering and terrorism financing, can bias research and public perception, overshadowing the system's role in legitimate finance (Razavy, 2005). The *hawala* system is deeply embedded in local traditions and community structures, which vary significantly across different regions, requiring insights into the cultural and social contexts of Afghanistan to better understand it (Razavy, 2005). Furthermore, the ongoing conflict and instability in Afghanistan pose significant security risks for researchers. These conditions can limit the ability to conduct fieldwork safely, especially in regions where the hawala system is most active (Besmel & Solop, 2016). Afghanistan's volatile political and economic environment means the context in which hawala operates is constantly evolving, which can quickly render findings outdated (Cramer & Goodhand, 2002). As a result, researching the *hawala* system in Afghanistan is challenging due to the system's informal nature, regulatory and security environment, and cultural and social dynamics. Despite these challenges, gaining insights into hawala is essential for a comprehensive understanding of Afghanistan's economy and society. Successfully navigating these challenges can contribute valuable knowledge to the field and enhance our understanding of informal financial systems in conflict-affected regions.

Second, in the process of designing and planning a survey to understand the size and operational characteristics of the *hawala* system within the United States, a key component was to understand the system from the perspective of its operators. The goal was to delve into the operational characteristics, the scale of transactions, compliance practices, and the broader economic implications of such an informal money transfer system. However, several significant challenges arose, preventing the effective execution of the survey among *hawala* operators in the United States. An initial assessment of approaching these operators in the United States, while not conducting the surveys at all, showed that a strong unwillingness to answer any survey questions. Although the surveys were designed for academic purposes, the initial assessment of these operators showed that they feared being exposed to law enforcement agencies. These challenges were primarily centered around issues of trust, animosity, secretive bookkeeping practices, and the inherent difficulty in accessing operators who are naturally inclined to maintain their anonymity. Therefore, we recommend re-thinking the approaches in the future for completing such surveys for data analysis purposes.

One of the primary obstacles encountered was the deep-seated mistrust *hawala* operators have towards any form of external inquiry, especially one that seeks to delve into the operational aspects of their business. The *hawala* system operates on the principles of trust and anonymity, not just for the customers but more critically for the operators themselves. This trust barrier is compounded by the operators' apprehension of potential legal scrutiny despite assurances of confidentiality and anonymity. The fear that any disclosed information, no matter how securely handled or anonymized, could somehow lead to legal consequences or unwanted attention from law enforcement, was a recurring concern. This fear is not entirely unfounded, given the legal ambiguities surrounding *hawala* operations in the U.S., where the system exists in a grey area of financial regulation. “After the “The U.S. approach of regulating informal value transfer activity is preferable to outlawing the activity altogether, a course chosen by some nations. Attempting to outlaw the IVTS ultimately deprives law enforcement of potentially valuable information and drives the informal remittance providers further ‘underground.’ Outlawing the activity also deprives the mostly law-abiding IVTS customers of the primary channel through which they transfer funds.” (Casey, 2007). Furthermore, another significant challenge was the obvious excuse for animosity and suspicion toward academic or institutional inquiries into their operations. The approached operators were wary of external investigations, fearing misrepresentation or misunderstanding of their services in a socio-political climate that is often unforgiving to informal financial practices. This animosity is coupled with cultural and linguistic barriers, making it even more challenging to establish the necessary inquiry with potential respondents. The cultural nuances of the *hawala* system, deeply rooted in trust and community relationships, can be difficult to navigate without an insider's perspective, further complicating efforts to engage with operators on a meaningful level.

The secretive nature of bookkeeping practices among *hawala* operators posed a substantial barrier to gathering accurate data on the operational scale and transactional flows. Many operators maintain minimal records, and those that do exist are often kept in formats that are not easily accessible or understandable to outsiders. This practice, while serving to protect the confidentiality of their clients and the security of their operations, significantly hinders the ability to collect detailed and reliable data. The lack of transparent operational records would, in case the surveys were even answered, make it nearly impossible to verify reported information or to gain a comprehensive understanding of the system's scale and economic impact.

Lastly, the sheer difficulty of accessing *hawala* operators due to their preference for operating within closed, often insular communities was a major impediment. The reliance on personal networks and community ties for conducting business means that outsiders, particularly those associated with academic or governmental institutions, are seldom welcomed. The operators' preference for maintaining a low profile and their cautious approach to new contacts made it challenging to identify and approach potential survey participants. As a result, the cumulative effect of these challenges – trust issues, animosity towards external inquiry, secretive bookkeeping practices, and the operators' elusiveness – effectively challenged the possibility of conducting a survey of *hawala* operators in the United States to understand their operational characteristics and size. The need to respect the privacy and security concerns of the operators, coupled with the ethical considerations of conducting such sensitive research, ultimately led to the decision to refrain from pursuing the survey among this group. This decision underscores the complexities involved in studying informal financial systems like *hawala* and highlights the need for innovative methodologies that can overcome these barriers while respecting the operational imperatives of the system's participants.

Lastly, the challenges faced in conducting research on *hawala* operators in the United States cast a spotlight on a broader issue that resonates globally: the need for financial literacy and certification for *hawaladars*, particularly in countries where *hawala* plays a pivotal role in the financial system, such as Afghanistan. Despite the critical function these operators serve in facilitating financial transactions, especially in regions underserved by formal banking institutions, Da Afghanistan Bank (Afghanistan's Central Bank) has yet to implement training or certification programs for operators of *hawala* or currency exchangers. This absence not only challenges the potential for their integration into the formal financial system but also overlooks the benefits that enhanced financial literacy could bring to the *hawaladars* and their clientele. Financial literacy for *hawaladars* is not merely about understanding the nuances of modern banking or the mechanics of international finance. It's about equipping these operators with the knowledge to manage risks, comply with international financial regulations, and enhance the efficiency and security of their transactions. Financial literacy programs can serve as bridges, connecting the informal and formal financial sectors and fostering a mutual understanding that can lead to the development of more inclusive financial services. Moreover, financial literacy is crucial for empowering *hawaladars* to make informed decisions that align with both local and global financial practices, thereby reducing their vulnerability to financial crimes and enhancing their contribution to economic development. Furthermore, certification programs for system operators could serve multiple purposes. Firstly, they would help standardize the practices within the *hawala* system, ensuring a baseline of knowledge and competency among operators. Secondly, certification could facilitate greater oversight and regulation, addressing concerns from international bodies regarding money laundering and terrorist financing. Finally, such programs could pave the way for a gradual integration of *hawaladars* into the formal banking system, offering them legitimacy and potentially expanding their business opportunities.

7.1 Potential for Future Threats or Growth

It is no secret, by now, that it should be clear that the operators of the system know how to handle money or physical cash. On the other hand, we find a gap in the literature, which is that it pushes for further regulation while no or little attention is given to how these operators should be integrated into the formal banking system. Regulation, in countries like Afghanistan, have had counter-intuitive effects instead of formalizing the informal system to attempting to integrate it with the formal banking system. "In 2016, DAB enacted a regulation concerning Hawaladars, Regulation of Organizing the Activities of Sarafs and Money Service Providers. The Regulation has been very controversial. DAB promulgated the Regulation with the aim of preventing money laundering and terrorism financing." (Rahimi, 2021). The regulation's counter-intuitive effects and its provisions for strictness instead of encouragement to integration resulted in a strike by the operators of *hawala* which further distances formal and informal systems. "The strike lasted four days (from 6–10 February 2018) and disrupted the business and personal lives of Afghans." (Rahimi, 2021).

While the literature argues for using regulation to push these operators into the formal banking systems, we, here, argue that the initial step in encouraging the operators of the *hawala* system to begin transitioning into a formal banking system is to facilitate their exposure into the operational characteristics and global interconnectedness of the formal banking system. By this, we mean not only exposing them to the formal banking system altogether but also providing them with the necessary training, certifications, and resources to understand why a formal system that is globally interconnected and is becoming more digitized is important. This certainly challenges the nature and existence of the *hawala* system altogether. However, what we find in the literature as a gap is that instead of blacklisting or completely outlawing the operators of such an important system, it is better to look for an alternative approach to how to work with these operators. This would mean the interconnectedness of all the operators, understanding the scale of the operations, and compliance with national and international regulations.

Several countries and international organizations have recognized the importance of financial literacy and have implemented programs that could serve as models for Afghanistan. For instance, the Global Money Week[6], an initiative led by the OECD International Network on Financial Education (INFE), aims to inspire children and young people to learn about money matters, livelihoods, and entrepreneurship. Although targeted at a younger audience, the initiative underscores the importance of broad-based financial education.

In countries like India, the Pradhan Mantri Jan-Dhan Yojana (PMJDY)[7] scheme not only aims to provide every household with access to financial services but also includes components designed to enhance financial literacy among its participants. This holistic approach recognizes the importance of educating users alongside providing them with financial services.

Similarly, in Rwanda, the Access to Finance Rwanda (AFR)[8] initiative works to increase financial literacy and inclusion by collaborating with the government, the private sector, and non-governmental organizations. Programs like these demonstrate how targeted financial education initiatives can significantly impact financial inclusion and literacy.

The absence of formal training and certification programs for *hawaladars* in Afghanistan is a missed opportunity for fostering a more inclusive and regulated financial environment. Implementing such programs, drawing inspiration from successful models around the world, could facilitate a more seamless integration of informal money transfer operators into the formal financial system. This would not only enhance the operational efficiency and legitimacy of the *hawala* system but also contribute to the broader goals of financial stability, inclusion, and development in Afghanistan and similar economies. By recognizing the importance of the financial literacy of *hawaladars*, Da Afghanistan Bank could take a pivotal step towards bridging

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[6] https://globalmoneyweek.org/ The OECD's site often hosts comprehensive reports and updates on initiatives like Global Money Week.

[7] https://pmjdy.gov.in/about This program is a flagship financial inclusion campaign, so detailed descriptions of its components, including financial literacy efforts, should be available there.

[8] https://afr.rw/who-we-are/about-us/ For specifics on the AFR initiative, visiting the official AFR website or looking for reports on financial sector development and financial literacy programs in Rwanda through development-focused organizations' sites could be fruitful.

the divide between informal and formal financial sectors, thereby fostering a more robust and inclusive financial ecosystem.

8 Conclusion

Researching the *hawala* system in Afghanistan is a complex task due to a range of challenges. The *hawala* system is an informal financial system that lacks formal documentation, making it challenging to track the flow of funds or understand its scale (Rahimi, 2020). Additionally, the system often operates outside of formal financial regulation and intersects with legal and regulatory frameworks in unpredictable ways (Rahimi, 2021). Researchers face difficulties in accessing hawaladars and their clients due to the private and sensitive nature of hawala transactions, which rely on trust and privacy (Rahimi, 2020). Therefore, considering the challenges and limitations listed, it is essential to come up with methodologies and strategies for research that would a) convince the *hawala* operators to participate in a study b) find out, through comprehensive data analysis, the actual size of the *hawala* market at a given time.

This paper attempted to understand and examine the *hawala* system, a cornerstone of the informal financial market in Afghanistan and beyond. The hawala system emerges as a deeply rooted financial instrument of societies like Afghanistan, serving as a testament to the resilience and adaptability of informal financial networks. Through a detailed exploration of its origins, operational dynamics, and regulatory environment, we sought to find the role of hawala within Afghan society's socio-economic dynamics and its implications for global financial practices.

By tracing the historical roots of the hawala system, establishing its ancient origins, and its evolution into a sophisticated network for financial transactions, we sought to understand the operational characteristics of this ancient system. Empirical evidence documents that merchants and traders in various parts of the world, such as the Middle East, Southeast Asia, and Africa, have used the hawala system. This system strongly relies on trust and social relationships to enable financial transactions without the establishment of a formal financial institution. Furthermore, by distinguishing between the terms "Hawala" and "Sarafi" within the Afghan context, we aimed to clarify the operational nuances of the system and its participants, highlighting the complexity of its integration into the formal financial landscape. “The Arabic root s-r-f (ص ر ف) has, among other meanings, “pay and disburse”. The Arabic word for bank, masrif (مصرف), comes from this root. It is also the basis for the Farsi words “Saraf” (صراف), which means a money changer or money remitter (hawala dealer) and “Sarafi” (صرافی), which is the name for the business.” (Jost, 2000. 1). In Afghanistan, "Saraf" solely refers to a 'money exchanger', while "Sarafi" denotes the establishment or business providing 'money-exchanging-services', also known as Foreign Exchange Services (FSP) as per Da Afghanistan Bank (DAB), which is Afghanistan’s Central Bank.

A significant portion of the paper was dedicated to dissecting the operational characteristics of hawala, emphasizing its reliance on trust and the vast network of hawaladars that facilitate money transfers across borders. The dilemma of regulating this system within Afghanistan, scrutinizing the efforts by Da Afghanistan Bank (DAB), and the challenges posed by ambiguous terminologies and overlapping roles of Sarafs and hawaladars notes that further clarification and policy reevaluation is necessary not only in terms of literature but regulation as well. The regulation of hawala, as we discussed, is fraught with difficulties, balancing the need for oversight against the system's inherent benefits and its critical role in providing financial services to the unbanked population. Additionally, the impact of hawala on the Afghan economy, particularly its significance for individuals and communities with limited access to formal banking services is another area the literature and future policy should pay attention to. The system's speed, reliability, and cost-effectiveness, jargoned with the regulatory and legal challenges it faces, underscore the complex connection between informal and formal financial sectors. A critical gap identified in the literature pertains to the nuanced understanding of hawala's dual role: as a facilitator of essential financial services and as a system vulnerable to misuse for illicit activities. This duality presents a conundrum for policymakers and regulators, who must navigate the fine line between stifling the system's economic benefits and mitigating its potential risks. Lastly, we argued for a reconsideration of the regulatory approach towards *hawala*, advocating for measures that recognize its indispensable economic role while addressing legitimate concerns over its misuse. We proposed the introduction of financial literacy and certification programs for *hawala* operators as a means to bridge the gap between informal and formal financial systems. Such initiatives could enhance the operational efficiency, transparency, and legitimacy of *hawala*, facilitating its integration into the global financial architecture without undermining its accessibility and utility for those it serves.

In conclusion, our study underscores the need for a balanced, informed, and nuanced approach to the regulation of *hawala*. By acknowledging the system's historical significance, operational dynamics, and socio-economic impact, policymakers can develop more effective strategies for its oversight. This involves not only tightening regulatory frameworks but also empowering *hawala* operators with the knowledge and tools to navigate the formal financial environment responsibly. Our recommendations aim to foster a more inclusive financial ecosystem that recognizes the value of informal systems like *hawala*, ensuring their sustainable integration into the broader financial landscape.

The way forward requires a collaborative effort among governments, regulatory bodies, financial institutions, and *hawala* operators themselves. One that does not threaten the livelihoods of ordinary citizens with vulnerable financial difficulties in places like Afghanistan. Only through a concerted and context-sensitive approach can we harness the full potential of *hawala* as a force for economic empowerment, while safeguarding against its exploitation for nefarious purposes. It is our hope that this paper contributes to the ongoing dialogue on this subject, laying the groundwork for future research and policy initiatives that embrace the complexities of informal financial systems in a rapidly evolving global economy.

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Appendices

Appendix 1

Articles of Regulation by Da Afghanistan Bank (Afghanistan's Central Bank)
Da Afghanistan Bank Law:

Article *5: 5.11 "foreign exchange dealer"* means any person who engages in the business of buying and selling foreign currencies, forward exchange contracts, options, payment in foreign currencies, swaps or other derivative contracts involving a foreign currency transaction.

Article *5: 5.18 "money service"* means any service conducted in relation to money including safekeeping, money transmission, check cashing, or currency exchange.

Article *5: 5.19 "money service provider"* means any person who engages in the business of providing a money service.

Article *5: 5.20 "money transmission"* means selling or issuing payment instruments, stored value, or receiving money or monetary value for transmission; the term does not include the provision solely of physical delivery, online or telecommunications services, or network access.

Article *5: 5.24 "payment system"* means any procedures, including communication. networks, agreed between three or more money service providers for the processing of payments, the clearing or settlement of payment transactions, and for the exchange of payments against other payments, financial obligations or securities, in any currency.

Appendix 2
These surveys were designed during our research to estimate the scale of operation of hawala at a given period. The primary location of research, on-ground research, were some locations in the United States. However, due to the challenges posed for researching hawala and short time frame to complete the project, we have left this to be conducted at another time with a focus solely on the hawala scale at a certain location and time.
The surveys were divided into two. One for the hawala operators and the second for hawala users.

Operator's Survey:
Age:
Gender:
State/Country of Residence (optional):
Occupation (other than Saraf/Hawala Operator) (optional):
Years of experience operating the Hawala/working as a Saraf (if any):

1. On average, how many transactions do you facilitate per week, and in which currencies? (USD, Afghani, Euro, or any other currency – Circle as many as they apply)
2. What would you say is the average size of a transaction you handle?
3. Can you estimate the total amount you facilitate in a month? Circle those applicable.
    - USD,
    - Afghani,
    - Euro,
    - Other
4. What is the geographical spread of the transactions you facilitate?
    - Local,
    - National,
    - International
5. Who are your typical clients?
    - Individuals,
    - Businesses,
6. Which currencies do you use to facilitate your transactions?
    - USD,
    - Afghani,
    - Euro,
    - Other__________________
7. How did you become involved in operating within the Hawala system?
8. What training or knowledge is necessary to operate effectively in the Hawala/Sarafi market?
9. What are the biggest challenges you face as a Hawala operator/Saraf?
10. Do you have unbanked customers?
    - Yes
    - No
11. What are some of the activities the Hawala/Sarafi system enables? (Examples can be acting as middle-men, guarantors, or any other transaction facilitators)
12. How do you ensure the security of the funds and transactions you handle?

13. What methods do you use to keep records of transactions, and how do you maintain confidentiality?
14. Are there any local or international regulations that you follow as a Hawala operator/Saraf?
15. How do you manage trust and resolve disputes when they arise in a transaction, either with a customer or a partner?
16. Do you think the Hawala system plays a role in facilitating illegal or unethical activities? Please explain.
17. What kind of support can the government provide to improve the Hawala system?
18. What changes would you like to see in the formal financial system that could affect your decision to continue operating within Hawala or as a Saraf?
19. Do you have any suggestions on how Hawala operations could be improved or made more transparent?

User's Survey

Age:
Gender:
Country of Residence:
City/Province of Residence (optional):
Educational level:
Marital Status:

1. Have you ever used or known someone who has used informal money transfer services like the Hawala/Sarafi system?
- Yes
- No

2. How often do you use this system to send/receive money?
- Weekly,
- Monthly,
- Yearly,
- or needs-based

3. On average, how much money do you or someone you know transfer using the Hawala/Sarafi system per transaction? In USD, Afghani, or other currencies.
4. For what purposes do you or someone you know use the Hawala/Sarafi system?
- To send money to family/loved ones.
- Business transactions,
- Exchange money from one currency to another
- Other reasons____

5. What is the largest transaction you have completed using the Hawala/Sarafi system?
6. What is the lowest transaction you have completed using the Hawala/Sarafi system?
7. In your opinion, what are the main advantages of using the Hawala/Sarafi system over formal financial institutions?
- Reliability
- Convenience,
- Trust,

- Cost-effectiveness,
- Anonymity,
- Or anything else___________________________

8. How did you or someone you know first learn about the Hawala/Sarafi system?
9. What kind of activities or transactions do you think are facilitated by the Hawala/Sarafi system that might not be possible or more difficult in the formal financial market?
10. On a scale of 1-10, how would you rate your satisfaction with the Hawala/Sarafi system?
11. What measures, if any, do you take to verify the transaction is completed as agreed?
12. What are your concerns, if any, regarding the security of your funds and the privacy of your transactions with the Hawala/Sarafi system?
13. Have you ever had a transaction fail or not go as planned using Hawala/Sarafi? What happened?
14. How important is the role of personal relationships and trust in your choice to use Hawala/Sarafi?
15. Is there anything you wish to improve or change about the Hawala/Sarafi system based on your experience?
16. Would you be willing to recommend Hawala/Sarafi to others for a money transfer? Why or why not?

Appendix 3

Screenshots of social media advertisements of the consultancy groups.

Click on images for social media page link.