DOES TREASURY BELIEVE SPREADING OUR FLAWED BANKING SYSTEM IS A SOLUTION TO TERRORISM?

Sheldon Whitehouse had a hearing on terrorist finance the other day. There was an interesting exchange that I think bears notice.

The hearing focused, in part, on hawalas, not least because DOJ recently prosecuted Mohammad Younis, the guy whose hawala Faisal Shahzad used to fund his terrorist attempt. Richard Blumenthal suggested (around 75:50 and following) that that funding may have come from Pakistani authorities (implicitly, the ISI). The FBI's acting head of counterterrorism wouldn't answer a question about that in public session.

A more interesting response came from Treasury's Assistant Secretary for Terrorist Financing, Daniel Glaser. Sheldon Whitehouse asked him (at 92:50 and following) whether we were making progress on solving the problem hawalas create for counterterrorism efforts. Here's my transcription of Glaser's response:

> Daniel Glaser: The reason hawala and other forms of informal remittances and informal money services exist is because there's large communities around the world that don't have access to formal financial services or affordable financial services. So the long-term quote-unquote solution to hawala is a generational one and it is about building an international financial system that everybody around the world has access to. Now, since that's a long-term solution, we need to address the problem in a shorter term way as well.
>
> [snip]

> The way we try to approach it beyond the long term effort to make financial services available to everybody is regulatory prong, enforcement, international standards, and general economic development.

While Glaser described a four-pronged approach in his written testimony (and described in more detail in the parts of his response that I've snipped), he said the ultimate solution would come when international financial services were available to everyone.

So the way to solve terrorism, then, is to make sure everyone banks at Jamie Dimon's bank?

That's an exaggeration, of course. And unless and until bankers get squeamish about the way the US government is accessing SWIFT, integrating everyone into the formal finance system would give counterterrror investigators transparency into terror financing. But given the state of the banking system—given how much more damage the international financial system has done to the world in the last decade than terrorism (leaving aside the effect of couter-terrorism and false counter-terrorism, like the Iraq War) it troubles me that a high ranking Treasury Department official believes one solution to terrorism is modern banking.

Now Glaser strikes me as an incredibly intelligent and sincere guy—coming from him this "generational solution" sounded like a completely sincere idea. So while this comment made my spidey sense tingle, it didn't in the way it would have if, say, TurboTax Timmeh Geithner had said it.

Nevertheless, here are some issues it raises.

Hawala still has some competitive advantages over modern banks

First, Treasury's own FinCEN provides a slightly more nuanced explanation why people might choose to use hawalas. It lists several reasons aside from the availability and cost issues Glaser notes. And some of these are legitimate reasons

to choose a hawala over a bank.

> In some countries, [informal value transfer system]-type networks operate in parallel with formal financial institutions or as a substitute or alternative for them. United States citizens, persons (legally or illegally) residing in this country from foreign countries, and individuals living in other nations may prefer or need to use IVTS in lieu of formal financial institutions for various reasons as described below:

- **the political instability**, inadequate payment systems, and/or an unstable financial sector that exist within a country;
- a lack of easily accessible formal financial institutions in remote areas of some countries;
- **transfers that are more efficient, reliable, and cheaper** than formal financial institutions. (For example, a wire transfer of funds using banks involves fees charged to the sender and receiver, may take from two to seven days to complete, and may be delayed or lost. Funds

moved through IVTS are available within 24 hours, with minimal or no fees charged to the participants.);

- **to avoid paying higher foreign exchange rates**. (Funds sent through traditional transfers are converted to the currency of the recipient's country; the fee charged for exchange rate conversion is set by the institution. IVTS operators, who speculate in currency exchange rates, charge lower fees.);
- to avoid currency reporting controls. (The United States, along with many foreign governments, has established currency reporting requirements for financial institutions. Some expatriates and citizens distrust governments and wish to circumvent any reporting of their financial

activities.);

- to avoid paying taxes; or
- to ensure anonymity since there may be minimal or no records maintained; in other words, no paper trail exists. [my emphasis]

As an example of how instability might counsel reliance on hawala, the UN and US are currently using the hawala system to bypass al-Shabaab in delivering aid to Somali famine victims.

> The director of USAID, Raj Shah, told The Associated Press Thursday that aid agencies have had to resort to creative ways to prevent the militant group al-Shabab from seizing aid.
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> "In Somalia, we have had to really innovate how we do this work," he said. Shah was discussing the response with officials from other countries in New York during the meeting of the U.N. General Assembly.
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> Shah says the U.S. and U.N. officials are now using the hawala system to deliver food vouchers.

The point being, that hawala is a system that has evolved over hundreds of years. And in a number of circumstances, it still outperforms the western banking system, not least because the trust it is built on may be more resilient than the shaky confidence that keeps western banks afloat.

A multinational bank serving Middle East, South Asia, and Africa was the original global bank implosion

Then there's the notion that in one generation banking will be pervasive in the Middle East and South Asia. After all, it was a generation ago when the original great global bank implosion,

BCCI, the creation of a Pakistani working with Emirate and Saudi financing (originally in partnership with Bank of America and using the same secrecy jurisdictions like Luxemborg and Cayman Islands that mutinational banks still rely on). BCCI focused on many of the areas that Treasury would presumably like to see integrated into the banking system. It explicitly did so in a way that offered an alternative to the taint of western dominance, as described in The Outlaw Bank.

> [BCCI founder Agha Hasan] Abedi's vision was precise. He would build what no one had ever built before: a globe-straddling, multinational Third World bank that would break the hammerlock the giant European colonial banks held on the developing world. "Nothing had changed much since the colonial days, as far as banking was concerned," said Rahman. "Invariably the gunboats arrived, then the missionaries arrived, then came the banks." Western capital moved only very selectively into the developing world, and often with long strings attached. Abedi believed that by treating the Third World as a full partner, he could beat the big colonial banks at their own game. His would be a large corporate bank but would also bank the small-business people whom the Western banks would not touch. The capital and deposits to fuel the bank's growth would come from the one part of the developing world that had resources—the countries of the oil-producing consortium OPEC. (135)

And while the big scandals about BCCI include the same kind of elite looting that secrecy jurisdictions (and the recent bank collapse) still support, BCCI had a specific goal of extending banking to smaller accounts western banks shunned.

> Despite everything the bank did wrong in Africa and South Asia, it would not be accurate to say that BCCI did nothing more than bank the elites and buy its way into

> the centers of power. BCCI's relationship with the developing world was far more complex than that. Since he founded United Bank in Pakistan, Abedi had clung tenaciously to the idea of providing the small-business operators of the Third World with banking services, especially loans for the export or import of goods. BCCI officers were exhorted to bank the little people, and they did so enthusiastically, stepping in where the more traditional colonial banks and American multinationals refused to go. BCCI banked hundreds of thousands of such people and was a powerful engine of economic growth in dozens of poor countries. Its very success in banking the small or medium-sized trader or manufacturer made its demise excruciatingly painful for the small and struggling middle classes in much of the developing world. In addition to having lost their savings or their businesses, those same people also came to believe that they had been betrayed. (199)

BCCI had a lot more legal and structural problems than the even ones that crashed our financial system in 2008. And the fraud the western banks committed has been normalized in a way BCCI's terror and crime financing was not. But some of the same root causes—notably, lax regulation and oversight—are the same.

The international finance system doesn't want these customers

Perhaps the biggest problem with Treasury's plan to address terrorist financing by extending the international finance system to everybody is that the international banks aren't going to want to do this business. Even within this country, after all, Jamie DImon's response to limits on swipe fees was a threat to kick 5% of Chase's customers out of their banking system. And European reserve limits are going to require banks that do business there to get even stingier with customers.

Glaser was right in noting that international

finance has to be cheaper to become attractive to hawala customers, but there's absolutely no reason to believe that's going to happen.

I can certainly understand why Treasury would like the chaotic regions in which terrorism thrives to be integrated into the international finance system so they have to do no more than look at one messaging system to see where the money is flowing. But given the sorry (and, just as importantly, almost insolvent) state of the international finance system, it's unclear why anyone would think that might happen anytime soon.