

POLICY BRIEF

Curbing Illicit Financial Flows in Afghanistan

INTRODUCTION

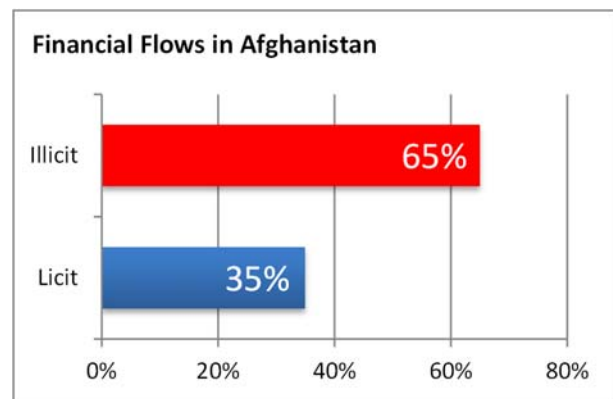
Illicit Financial Flows (IFFs) refers to the illegal movement of money. The movement, or laundering, of illicit funds is derived from such sources as corruption, tax evasion and the drug trade, and consists of many millions of dollars every year in Afghanistan. The government of Afghanistan has passed legislation to criminalize such IFFs but understanding of, and active support for, such laws by the agencies responsible for their enforcement is lacking. The challenge confronting the government of Afghanistan is to coordinate an effort to more actively address IFFs in the face of widespread corruption, tax evasion and a financial system which is dominated not by the formal banking sector, but by an informal financial system of money dealers (the *hawala* system) which remains largely unregulated.

This policy brief will highlight the current status of illicit financial flows in Afghanistan, actions which the government has taken thus far, further initiatives which are required and challenges to implementing such additional actions. This brief will conclude with a set of recommendations for policy makers including the SOM and SMAF whose meeting will be held in September 2015.

LICIT VS ILLICIT FLOWS

Accurate estimates on the volume of IFFs in Afghanistan were not provided by any relevant governmental authorities or other competent agencies. A key reason cited for the lack of such data is the very nature of IFFs: illicit financial flows are *unreported*, making it extremely difficult to measure. That said, according to the Ministry of Finance (MOF), of all the financial flows in Afghanistan, only about 35% are licit. As such, approximately 65% of the funds are illicitly earned, transferred, or utilized. According to MOF, this 65% includes IFFs linked to money

laundering, tax evasion, corruption/bribery, and lost customs revenues.



According to Global Financial Integrity's 2014 ranking of countries by the highest average annual IFFs over the decade, Afghanistan is ranked 102 out of 145 developing and emerging countries. As illustrated in the below table, Afghanistan's cumulative illicit outflows from 2003-2012 was USD 2.22 billion, with an average annual illicit outflow of USD 222 million per year. However, these figures are very conservative because GFI assigned a value of zero to Afghanistan's annual illicit outflows from 2007 to 2012 (GFI, Data by Country)¹. Moreover, the USD 222 million estimate does not pick up movements of bulk cash, the mispricing of services, or many types of money laundering. Afghanistan's rising IFFs linked to increased opium production and drug trafficking are also not captured in GFI's 2014 estimate. As such, the total amount of IFFs from Afghanistan is likely significantly higher than GFI's estimate of USD 222 million per year.

¹ It appears impossible that Afghanistan had zero IFFs during 2007-2012. Indeed, as explained in the subsequent paragraphs, approximately USD 4.5 billion in bulk cash left the Hamid Karzai International Airport (KIA) in 2011 alone.

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

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

In terms of bulk cash movement, it has been estimated that USD 4.5 billion was taken out of the Hamid Karzai International Airport (KIA) in 2011 alone. While large cash movements are typical in Afghanistan given the country’s cash-based economy, these bulk cash flows raise the risk of money laundering and bulk cash smuggling—tools often used to finance terrorist, narcotics, and other illicit operations (SIGAR, 2012). Indeed, despite the Afghan government’s pledge to implement regulations to govern the bulk transfers of cash outside the country, the existing measures to monitor the outflow of currency from the country are ineffective, as illustrated in the case of bulk currency counters² placed at KIA.

ACTION TO DATE

Afghanistan has taken a number of measures to combat IFFs. In particular, FinTRACA – the country’s financial intelligence unit – was established in 2004. In addition, the parliament recently approved the *Anti-Money Laundering Law* and the *Combating the*

² Bulk currency counters are important anti-money laundering tools because they can capture currency serial numbers and other important data useful for detecting and investigating financial crimes. These machines are also designed to transmit these data via an internet link to the Financial Transactions and Reports Analysis Center of Afghanistan (FinTRACA). FinTRACA—part of Afghanistan’s Central Bank (Da Afghanistan Bank)—uses data on financial activity to identify financial crimes and assist law enforcement agencies in the investigation and prosecution of criminal activity.

Financing of Terrorism Law (AML&CFT Laws). Da Afghanistan Bank has also promulgated relevant regulations.

Afghanistan’s AML&CFT laws and regulations have undergone amendments, which has enhanced the country’s compliance with the international standards set out in the Financial Action Task Force (FATF) recommendations. Despite the improvements in regulatory measures, much work still remains, particularly with respect to the enforcement of the AML&CFT rules and regulations.

ACTIONS REQUIRED

There needs to be new and improved legislation and regulations, as well as greater coordination and cooperation among relevant ministries, agencies, and authorities to curb IFFs. The roles of FinTRACA and other agencies must be clarified to eliminate redundancies and leverage synergies. Moreover, AML&CFT laws and regulations need to be further amended to increase compliance with FATF standards. Tougher legal sanctions, and commensurate penalties, are required for identified cases of money laundering and the associated instances of corruption and other illegal activities (tax evasion, drugs trade, etc.). Money laundering sanctions and measures relating to politically exposed persons (PEPs) must also apply to family members or close associates of PEPs. Corruption, as well as lack of investigative and enforcement resources and expertise, also present major obstacles in the implementation of rules designed to curb IFFs.

There is insufficient knowledge and understanding of AML&CFT laws and regulations by the courts, law enforcement, and other relevant authorities. Moreover, there is an alarming dearth of measures and sense of urgency in key governmental institutions involved in curbing IFFs. A number of important ministries and institutions either do not view IFFs as a significant challenge or are unaware of the extent of the problem in the country. Raising awareness and training governmental institutions, agencies, and relevant authorities on IFF issues and related measures must be a priority.

In addition, the declaration system and money laundering controls for cross-border transportation of currency and bearer negotiable instruments need to be rigorously enforced. According to SIGAR, approximately USD 4.5 billion in bulk cash left Afghanistan via the Hamid Karzai International Airport (KIA) in 2011. Despite the installation of bulk currency counters at KIA to counter the risk of money laundering and bulk cash smuggling, these machines

are not used for their intended purposes. Moreover, in the case of Very Important Persons (VIPs), the main customs screenings or use of bulk currency counters are completely ignored. Another needed change is the reduction in the limit on the amount of currency persons travelling outside of Afghanistan are required to declare from \$20,000 to \$10,000. Given the cash-based nature of Afghanistan's economy, strict enforcement of the declaration system and anti-money laundering measures along Afghanistan's porous crossings is critical to curbing IFFs.

Laws regarding establishing beneficial ownership have not been implemented and control of legal persons in Afghanistan is opaque. The Afghanistan Central Business Registry should be required to collect information on beneficial ownership of all registered business entities, trusts and foundations. Any organization not fulfilling such requirements of the Central Business Registry should be prohibited from conducting business, opening a bank account or to transfer funds within or outside of the country, by whatever means.

Tackling IFFs effectively requires genuine commitment by the government and relevant authorities to enforce the regulatory measures. Meaningfully addressing corruption and tax evasion, two important components of IFFs, is impossible without strong political will to implement the necessary reforms.

CHALLENGES

Tax-motivated IFFs are another major challenge facing Afghanistan. According to a confidential assessment of Afghan finances by the International Monetary Fund (IMF), the Afghan government's financial woes in 2013 was caused by widespread tax evasion and smuggling abetted by government officials and the increasing theft of customs revenues by provincial governors (Rosenberg, 2013).

Tax evasion takes myriad forms in Afghanistan. Some individuals and businesses underreport their income, or do not report their income altogether. Some organizations and businesses also conceal staff withholding³ tax. Large-scale misappropriation of revenues in various sectors such as telecommunications, construction, and

extractive industries present other related challenges.

Another major challenge to disrupting the movement of illicit financial flows is the lack of regulation or control of the informal financial sector (*hawala*) which controls the vast majority (estimated at 90%) of financial flows within Afghanistan and transfers to foreign countries. Da Afghanistan Bank (DAB) has issued regulations to govern the informal money service provider (MSP) – *hawala* – sector; however, the majority of *hawaladars* operate without licenses and do not comply with DAB regulations.

³ Withholding tax includes income tax withheld from employees' wages and paid directly to the government by the employer.

RECOMMENDATION

In order to address the challenges outlined above, we would recommend that the government implement the below specific recommendations.

- Amend the relevant laws and regulations to increase compliance with international standards in combating IFFs.
- Train the judiciary and law enforcement authorities on AML/CFT rules.
- Raise awareness within, and provide training to, governmental institutions, agencies, and relevant authorities in regard to IFF issues and related measures.
- Enhance transparency of beneficial ownership and the control structure of legal persons/organizations.
- Provide support and technical assistance to DAB by resuming collaboration with the international community.
- Support FinTRACA and other relevant institutions
- Assure strict enforcement of the declaration system and money-laundering controls for cross-border transport of currency and bearer negotiable instruments.
- Increase national coordination and cooperation among relevant ministries, agencies, and authorities to curb IFFs.
- Implement a more proactive tax examination regime; establish a high level task force between the Ministry of Finance and the Attorney General's Office to examine, audit and where appropriate take punitive measures against companies or organizations which are found to be evading taxes.
- Register/provide licenses for all MSPs (hawaladars), establish and apply appropriate regulations and ensure adequate supervision of this sector under DAB.

ABOUT INTEGRITY WATCH AFGHANISTAN

Integrity Watch is an Afghan civil society organization committed to increase transparency, accountability, and integrity in Afghanistan.

Integrity Watch Mission

The mission of Integrity Watch is to put corruption under the spotlight through community monitoring, research, and advocacy. We mobilize and train communities to monitor infrastructure projects, public services, courts, and extractives industries. We develop community monitoring tools, provide policy-oriented research, facilitate policy dialogue, and advocate for integrity, transparency, and accountability in Afghanistan.

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