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To Stem the Flow of Illicit Drugs from Afghanistan, Follow the Money

By Mary Beth Goodman and Trevor Sutton March 17, 2015

Corruption poses an existential challenge to Afghanistan's stability, as well as its political and economic development. Under the leadership of President Ashraf Ghani and Chief Executive Abdullah Abdullah, there is an opportunity for the United States to capitalize on the newly expressed political will of Afghanistan's elected leaders to curb corruption. Afghanistan's national unity government has prioritized the fight against the epidemic of graft plaguing the country, and this fight is intricately tied to the production and flow of drugs.

Although the United States has invested $8 billion—as of December 30, 2014—in counternarcotics efforts, Afghanistan still leads the world in opium production, and its farmers are growing more opium than ever before.[1] The sale of opium and cannabis—another drug of which Afghanistan is a leading cultivator—on the international market produces huge sums of cash that must be laundered, or made clean, so it can appear legitimate. This parallel market and the illicit financial transactions that sustain it have a debilitating impact on the rule of law in Afghanistan; undermine the legitimacy of government institutions; and ultimately impede the ability of the Afghan government to provide basic services to its citizens. Because no bank outside of Afghanistan denominates in the Afghani—the country's national currency—the state's drug trade runs on the flow of international currencies such as U.S. dollars, euros, and British pounds. Moreover, the weak oversight of anti-money laundering controls coupled with the systemic corruption plaguing Afghan institutions serves to compound the narcotics conundrum.

The Afghan drug trade poses an immediate and urgent threat to U.S. interests in Afghanistan and to the integrity of the Afghan state itself. Greater efforts must be made to stem the flow of money derived from the narcotics trade in order to significantly reduce Afghanistan's narcotics production and curb corruption.

The scope of Afghanistan's drug problem

In February 2015, Special Inspector General for Afghanistan Reconstruction, or SIGAR, John F. Sopko submitted a written testimony to a U.S. Senate Committee on Appropriations subcommittee highlighting the perils of the Afghan drug trade:

> *The expanding cultivation and trafficking of drugs puts the entire U.S. and international investment in the reconstruction of Afghanistan at risk. The narcotics trade, which not only supports the insurgency but also feeds organized crime and corruption, puts the gains the U.S. agencies and their international partners have achieved over the past 13 years in women's issues, health, education, rule of law, and governance in jeopardy.*[2]

In war economies such as Afghanistan, drug traffickers benefiting from instability have vested interests in perpetuating and instigating further instability for their own gain. This stands in opposition to the development goals of the United States and other donors working to expand the rule of law, empower citizens, and build institutional effectiveness for the central government. The large profits generated from the drug trade make these criminals powerful and influential actors in the business, social, and political arenas, and as a result, they are closely positioned to the legitimate circles of power while facilitating the development of corrupt networks.

Under former President Hamid Karzai, the Afghan government often put warlords and drug traffickers in positions of power in order to buy their allegiance to the central government. In practice, these drug lords combined administrative and military powers in their provinces and took control of economic resources. In doing so, they established independent patronage networks, abused their public office, and promoted their own self-interests over the development of services for Afghan citizens.

The prominence of the drug trade in Afghanistan's economy and the role of Afghan narcotics in the global drug market are hard to overstate. The World Bank has assessed that narcotics constitute the largest source of externally generated income for Afghans by a wide margin.[3] Afghanistan now produces between 80 percent to 90 percent of the world's opium and accounts for the bulk of global heroin manufacturing.[4] In recent years, the country has also become one of the world's two largest producers of cannabis.[5]

Despite massive amounts of assistance from donors to diversify Afghanistan's economy toward agriculture, mining, manufacturing, or other areas, narcotics production remains a significant contributor to Afghanistan's overall gross domestic product, or GDP. According to a U.N. study, the annual export value of Afghan opiates and their derivatives reached $3 billion in 2013, or around 14 percent of Afghanistan's GDP.[6] While this is a marked decrease from 2006, when opium production constituted more than half of the country's GDP, it is still hugely significant.[7] In fact, much of that decrease can be attributed to the growth of Afghanistan's licit economy, which tripled between 2006 and 2014, rising from $7 billion to more than $20 billion.[8] Opium production, however, did not decrease notably during that period. To the contrary, despite efforts to curb the farming of the poppy plants from which opium is derived, cultivation has soared to record highs in recent years, especially in the strategically vital Helmand province, which remains the country's opium production center.[9] Some of the proceeds from drug agriculture go directly to farmers, but corrupt officials and traffickers capture a much greater portion of the profit.[10]

The narcotics trade is closely linked with corruption wherever it occurs in the world.[11] This is certainly the case in Afghanistan. The Afghan drug trade constitutes an entire parallel economy that runs on systemic and organized graft, from individual bribes paid to minor officials to massive self-enrichment by influential regional and national powerbrokers.[12] To put the matter in perspective, consider that 224,000 hectares, or roughly 824 square miles, of Afghan territory were used for poppy cultivation in 2014 despite the fact that growing poppies is illegal under Afghan law.[13] Even accounting for territory effectively controlled by the Taliban, this suggests a profound breakdown in the rule of law.

Besides contributing substantially to the broad range of destabilizing effects linked to corruption, the drug trade has the additional pernicious effect of channeling immense resources directly to the Taliban, essentially funding the insurgency. This is especially true with respect to opium production, which is concentrated in the Taliban heartland of Helmand province, as well as other southern provinces threatened by insurgency.[14] By one estimate, more than one-third of the Taliban's income comes from opium.[15] This income is derived from direct taxes that the Taliban levies on poppy farmers and small merchants; tariffs and protection fees collected from truckers and opium labs; and international narcotics cartels paying large sums directly to the Quetta Shura, the governing body of the Taliban.[16] In 2013, the U.S. Department of Defense concluded that counter-narcotics operations offered "the best line of effort available to the coalition, at this time, to directly affect the Taliban's tactical-level financing."[17]

Money flows in and out of Afghanistan

In Arabic, the term hawala means transfer and conveys the practice of transferring money and value from one place to another through service providers known as hawaladars. The ongoing conflict in Afghanistan prior to 9/11 resulted in a dependence on hawaladars, who as a result gained an enhanced role as an economic cornerstone providing money transfers, currency exchanges, financial transactions, and other services with the outside world. A 2005 study by the World Bank on the hawala system in Afghanistan found that an estimated 80 percent to 90 percent of the country's economic activity takes place in the informal sector.[18] In support of this informal economy, the study notes that:

> *… the hawala markets fully replaced the formal banking system, providing people with the only facility to transfer money into and out of the country. These markets became host to a complex interplay of actors from the benign through to the ethically questionable and patently criminal.*[19]

After 9/11, the international community helped reestablish a formal banking sector in Afghanistan, and this effort continues today. However, given the higher cost of transactions, the high level of illiteracy, and the remoteness of much of the Afghan population, the formal banking sector is still not the preferred method of financial transaction for most citizens, with scholars claiming:

> *… it would be mistaken to presume that Afghanistan's hawala system, which is currently the most effective, reliable, and sometimes sole method for moving funds across the country, deals only with dirty money. In practice, there are no clear boundaries between the illicit and licit economies, where networks have developed over time with complex overlapping connections.*[20]

Afghanistan's economy is at a nascent stage of development, and there are four major sources of externally generated income in the country: opium production and trafficking; unregulated trade in legitimate goods; remittances from abroad; and international donor assistance. The Afghan drug trade is supported by an elaborate financial infrastructure through which proceeds from wholesale and retail narcotics transactions are routed back into the country to small producers and merchants. Money is rarely transferred to these producers directly from retail markets and merchants but instead travels down the supply chain through a maze of hawalas.[21]

There is no limit on the volume of fund transfers that the money exchange dealers can move either as individuals or together. Given the nature of the hawala transactions, it is impossible to determine how much of the money is illicit as opposed to licit. The Financial Action Task Force, or FATF[22]—an intergovernmental anti-money laundering body—estimates that between 50 percent to 90 percent of all transactions in Afghanistan or across Afghan borders involve the use of hawala, and the drug trade is no exception to these sorts of dealings.[23] According to one World Bank report, between 80 percent to 90 percent of hawala brokers in the Kandahar and Helmand provinces—the most important poppy production region in Afghanistan—are involved in money transfers related to narcotics, and many brokers have reported that nearly all of the funds they received were from drug traffickers.[24]

The use of cash couriers and hawalas depend on financial institutions in regional trade centers, principally cities in Pakistan, Iran, Saudi Arabia, and the United Arab Emirates, which serve as the final destination for laundered narcotics money before its diffusion into informal networks.[25] In some cases, there may not be an actual cash transfer; instead, a consignment of goods may be sent to the hawala beneficiary in Afghanistan.[26] This form of exchange, operating without formal account-keeping processes but instead functioning on the basis of trust and oral communication, is extremely difficult to map and trace.

Large fluctuations occur in the volume of money flowing through hawalas based largely on the fluctuation of drugs and cash injections into Afghanistan's market. Scholarly insight on the volume of financial transactions through the hawala system provides a glimpse at the scope of the problem: One top-end hawaladar interviewed for a book on hawalas in Afghanistan confided that, "in a good day, he might receive a transfer of US$ 5 million from Peshawar, and US$ 200–300,000 from Jalalabad. But on an average day, he may transfer around US$ 500,000 in total."[27]

For high-level beneficiaries of the drug trade—such as senior provincial officials, corrupt middlemen, and drug kingpins—payoffs are more likely to take the form of a conventional transfer of funds to a bank account that need not even be within the Afghan banking system. These accounts can be cleaned by registering under the name of a shell or front company through which funds can be further laundered. These high-level beneficiaries are aided by extremely lax controls on the flow of money out of Afghanistan, which facilitates the recirculation of funds back to international financial centers or into investments in foreign property.

Recommendations

Reining in Afghanistan's drug economy will require substantial measures to curb both supply and demand. This means not only limiting opportunities for production inside Afghanistan but also disrupting the free flow of cash that has made trafficking Afghan opiates so lucrative for middlemen, corrupt Afghan officials, and cartels.

As noted above, the United States has spent more than $8 billion in poppy eradication efforts but cultivation levels continue to rise.[28] While the causes of the increase are complex, there is little question that eradication has not been a viable strategy for reducing opium production levels. Given the devastating effects of the drug trade on Afghanistan's economic growth and political stability, it is imperative that reducing opium production should continue to be a policy priority for the U.S. government. However, such efforts must be paired with a strategic review of the reasons why previous anti-drug initiatives have fallen short of their objectives. New efforts must make following the money associated with both the narcotics trade and corruption a priority of U.S. and Afghan officials. Action is needed in order to criminalize and seize the illicit funds tied to the narcotics trade through greater enhanced financial and law enforcement monitoring and to ensure that the lax oversight associated with complicit government acceptance of the drug trade under the Karzai administration is over. With these goals in mind, the authors offer the following recommendations for U.S. and Afghan policymakers.

Prioritize anti-money laundering surveillance, enforcement, and operational capacity

The Afghan government lacks many of the institutional mechanisms that more developed countries rely on in order to monitor and prevent illicit cash flows and to curb money laundering. Money laundering and drug trafficking flourish under weak controls. Only robust law-enforcement oversight and the use of powerful investigative tools can bring money laundering associated with the drug trade to heel. In the United States and other Western jurisdictions, anti-money laundering and anti-drug trafficking operations often entail the collection of thousands of financial records across multiple jurisdictions and the freezing and confiscation of millions of dollars in assets. Similar efforts are needed in Afghanistan in order to identify and prosecute high-net-worth individuals connected to the narcotics trade and disrupt the illicit trade networks that support them.

In 2014, the FATF threatened to blacklist Afghanistan for failing to implement many of the anti-money laundering reforms the organization had recommend three years earlier.[29] While Afghanistan ultimately avoided being blacklisted, the country has yet to meet international transparency standards.[30] The United States and other major international donors should prioritize efforts to support the Afghan government to ensure that its officials follow through on pledges to achieve compliance with the FATF standards. Entrenched interests and corruption stymied efforts to do so under the presidency of Hamid Karzai, but recent high-level commitments by the Afghan national unity government present a welcomed new momentum for this effort.

Create an independent and empowered financial intelligence unit

In 2011, the FATF found that the Financial Transactions and Reports Analysis Center of Afghanistan, or FinTRACA, lacked key powers that would allow it to "effectively perform the core functions of [a financial intelligence unit, or] FIU," such as operational independence; legal authority to disseminate information collected from nonfinancial businesses and professions where much money laundering occurs; and inadequate guidance on reporting.[31] Although FinTRACA officials have worked assiduously to execute their mandate, legal and budgetary constraints continue to impede their activities.[32] To support expanded authorities and the ongoing work FinTRACA is already doing, the United States or other donors should consider enhanced support for building the capacity of FinTRACA officials and embedding an anti-money laundering technical expert within the center as the unit scales up to meet international requirements.

Encourage effective enforcement of cross-border currency declaration requirements

Afghan law requires bearers of large sums of cash or negotiable instruments worth the equivalent of $20,000 entering or exiting Afghanistan to formally declare these cash or instruments.[33] Yet the FATF found that in practice enforcement was limited to individuals arriving at Kabul International Airport, or KIA, meaning that individuals with large sums of cash boarding a plane departing Afghanistan or leaving the country via all land border crossings were escaping the reporting requirement. Even with respect to inbound customs at KIA, enforcement was inconsistent and so-called VIP passengers were often excused from having to make a declaration.[34] Failure to collect information about cross-border cash flows critically deprives FinTRACA and other law enforcement agencies of vital information needed to combat illicit narcotic networks and allows vast sums of money to evade oversight.

Create more robust record-keeping, reporting, and due-diligence requirements for financial institutions

Afghanistan's Anti-Money Laundering and Proceeds of Crime Law, or AMLPCL, and anti-money laundering regulations issued by the Central Bank of Afghanistan require that financial institutions maintain adequate records, perform customer due diligence, and report suspicious financial transactions to FinTRACA.[35] In all three instances, government enforcement has been weak to nonexistent, and the level of compliance by financial institutions has been low.[36] For example, the International Monetary Fund, or IMF, found that there has not yet been an instance of an Afghan financial institution being sanctioned for due diligence breaches.[37] In addition, neither the AMLPCL nor the central bank's anti-money laundering regulations require monitoring of ongoing business relationships after an account has been opened or call for enhanced due diligence on higher-risk categories of customers.[38] In other words, Afghan law imposes no risk management requirement on banks.[39] The only exception to this generally lax regime is for individuals holding prominent or sensitive political positions, but this more stringent standard applies only with respect to direct ownership and is not implicated where a politician or bureaucrat wields beneficial ownership through an agent or intermediary, which is an enormous loophole.[40] To make matters worse, even the direct-ownership monitoring regime appears to have gone largely unenforced by Afghan authorities.[41]

Improve transparency standards for beneficial ownership

Individuals who wish to transfer funds or assets while concealing their involvement in bribery, embezzlement of public funds, or other forms of corruption often rely on shell companies to facilitate their actions.[42] Steps to combat fraud and embezzlement are time consuming and cumbersome but ultimately rely on unmasking the identity of beneficial owners—the natural person who owns or controls a corporate structure, organization, or trust. Afghanistan does not collect information on beneficial ownership of legal persons—that is to say, companies and nonprofit organizations—registered in the country, which creates great risk that such entities may be used to launder funds in furtherance of narcotics sales.[43] Afghanistan must take steps to establish a legal requirement that will help to identify and disrupt the flow of drug monies through shell companies. In the wake of Ukraine's recent revolution, the country developed a comprehensive law requiring the collection of beneficial ownership information. The Ukrainian law could provide a useful model for Afghanistan given both countries' experience with highly entrenched corruption.[44]

Clarify and strengthen rules governing correspondent banking relationships

A correspondent banking relationship is an agreement between two banks that effectively allows one bank to act as a banking agent on behalf of the other bank in order to clear and conduct financial transactions in the physical location of the other bank. Correspondent accounts play an important role in the international banking system, but they are also vulnerable to money-laundering schemes when there is ineffective supervision. Afghan banks do not hold correspondent accounts for foreign financial institutions, however, they do hold correspondent accounts in foreign banks abroad, including in a number of jurisdictions that often serve as money laundering centers, such as the British Virgin Islands, Dubai, and Singapore.[45] The AMLPCL and associated regulations lack a clear requirement for conducting due diligence on correspondent banking institutions in order to ensure they have adequate anti-money laundering policies in place and to verify that they are not suspected of connections to transnational crime networks.[46] In addition, there is no requirement that senior management of financial institutions approve the creation of a new correspondent banking relationship.[47] More robust oversight of correspondent relationships will close a very vulnerable loophole in Afghanistan's anti-money laundering regime. It is essential for Afghanistan to enable the sharing of information between financial institutions in relation to cross-border correspondent relationships, intermediaries, and wire transfers.

Develop more robust licensing and oversight for informal remittance services

Although the government of Afghanistan requires hawala brokers and other providers of informal remittance services to register and subject themselves to government monitoring, that regime has not been implemented effectively in key regions, including the opium production center of the Helmand province.[48] In fact, as of 2011, no hawala brokers had been registered in the Kandahar and Helmand provinces, despite the presence of an active hawala market in those areas.[49] The insecurity of these regions has played a role in this failure but so to have inadequate resources and lack of political will. Afghanistan should coordinate with international donors to deploy the necessary resources in order to improve monitoring in and around key narcotics production centers.

Ramp up pressure on intermediary countries to monitor informal financial transactions

Both the formal and informal payment networks that funnel cash and goods to Afghanistan in exchange for narcotics receive inadequate oversight in the countries where they are based.[50] The United States and international anti-money laundering agencies should continue to apply pressure on regional banks and the regulatory agencies that oversee them in order to more effectively carryout their responsibilities. These institutions must more diligently monitor inbound and outbound transfers of funds from individuals and entities appearing on international anti-money laundering watch lists and improve information sharing with national and international FIUs, especially as concerns regarding the flow of funds into and out of Afghanistan. In addition, to the best extent possible, similar pressure should be applied to regional partners, such as the United Arab Emirates, Pakistan, and Saudi Arabia, to more effectively regulate and monitor hawala brokers operating inside their borders and to establish more robust cross-border currency declaration regimes.

Conclusion

The production and sale of narcotics, while part of a broader pattern of illicit activity undermining the legitimacy of the Afghan state, is distinct in its scale and negative impact on the country's stability and security. Drastic measures are required to curb the narcotics trade but reining in the Afghan drug economy will require more than reducing poppy production. Eradication efforts will only be effective when paired with policies that undercut the financial networks that encourage the production and sale of opium and facilitate the corruption that allows such illicit financial flows to flourish.

At present, Afghanistan's banking sector and the government authorities that regulate and oversee the country's financial institutions operate well short of established international standards and best practices. It is imperative that the newly constituted Afghan unity government seize the political momentum of the moment and implement meaningful reform to support the long-term viability of the Afghan state and to stem the corrosive flow and influence of drug money to all levels of social, economic, and political life. Failure to do so will further entrench Afghanistan's position at the center of a global narcotics network and imperil political stability in a country where the effects of internal destabilizing elements are felt across the world.

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