

The Enduring Phenomenon of Hawala – Past, Present and the Future



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Summary

- Definition of Hawala
- Origins of the practice
- How the transaction works
- Size of the market
- Effects on the general economy
- Global regulatory response
- Future directions



Definition of Hawala

- Hawala are Informal Value Transfer Systems (IVTS) which are sometimes called alternative remittance systems or Informal Money Transfer Systems (Wilson, 2002).
- FATF (2005) defines IVTS as *“Any system used for transferring money from one location to another and generally operating outside the banking channels.”*
- Hawala is an ancient system originating in Asia and the Middle East, and used around the world today for remittances (Jost and Sandhu, 2000).
- The word Hawala comes from an Arabic root, which means to *‘change’* or *‘transform’* (Jost and Sandhu, 2000).
- Hawala is defined as a bill of exchange or a promissory note and is also used in the expression *“Hawala Safar”* which means traveler's check.



Definition of Hawala

- When the word Hawala came into Hindi (the national language of India) and Urdu (the national language of Pakistan) it retained these meanings, but it also gained the additional meaning of *'trust'* and *'reference'* which reflects the manner in which the system operates.
- The word *"Hundi"* comes from the Sanskrit root meaning to collect (Jost and Sandhu, 2000). In India, it generally means the collection box found in a Hindu temple.
- Hundi also has the same meanings as Hawala - that is a bill of exchange, promissory note, trust or reference.
- A Hawala transaction usually entails principals and intermediaries called *"Hawaladar"* or *"Hundiwala"*.



Other types of IVTS

Various systems derive their names from geographical locations and ethnicity of the groups. Following are some of the more common names and groups that once used or still use IVTS:

Hawala (trust, reference, exchange; The Arabic root h-w-l means “to change” or “to transform”) — India

Hundi (commonly translated as trust; it means bill of exchange or promissory note; it comes from a Sanskrit root meaning “to collect”) — Pakistan

Fei ch'ien (flying money) — Chinese

Phoe kuan — Thailand

Hui k'uan (to remit sums of money) — Mandarin Chinese

Ch'iao hui (overseas remittance) — Mandarin Chinese

Nging sing kek (money letter shop) — Tae Chew and Cantonese speaking groups

Chop shop — non-Chinese use this term for one of the Chinese methods

Chiti banking — refers to the “chit” used as receipt or proof of claim in transactions introduced by the British in China (short for “chitty”, a word borrowed from the Hindi “chitthi”, signifying a letter, document or mark).

Hui or hui kuan (association) — Vietnamese living in Australia

Stash house (for casa de cambio) — South American systems

(Passas 1999)



Origins of the practice

- Historians state that conditions governing trade in medieval times compelled merchants to carry hard cash with them (Holt, Lanbton and Lewis 1970).
- However, when they traveled beyond known merchant colonies, they took measures to restrict the carrying of cash by making agreements with known correspondents.
- Merchants began to carry “*Suftaja*” - Persian for ‘letter of credit’ (Holt, Lanbton and Lewis 1970). These letters of credit allowed someone to have money advanced to an associate or partner by a third party, usually at some distant place, and on a reciprocal basis.
- This procedure implied the maintenance of regular accounts and correspondence.
- In fact, the clearinghouse procedure in existence among banks is known to have been practiced in Basra in the fifth/eleventh century (Holt, Lanbton and Lewis 1970).
- Oldest recorded Hawala transaction in Christendom was in 1156 AD when two Genoese brothers who owed 115 Genoese Pounds repaid their debt in Constantinople with 460 Bezants (Parandeh, 2009)



Misconceptions about Hawala

- Hawala has been under intense scrutiny since the events of 9/11 as it is believed that Al-Qaida terrorists used this form of IVTS to finance their activities.
- Fact: 9/11 terrorists opened accounts in their own legal names at regular banks.
- This thesis stems from misconceptions about the system's origins.
 - For example, O'Hara (1997) states that Hundi and Hawala was *"born out of political turmoil and distrust of banks"*.
 - Similarly, Bosworth-Davis and Saltmarsh (1995) note that Hundi and Hawala *"developed in order to bypass rules, laws, or currency restrictions"*.
- Hawala transactions do not trace their beginnings to criminal enterprise or financial malpractice.

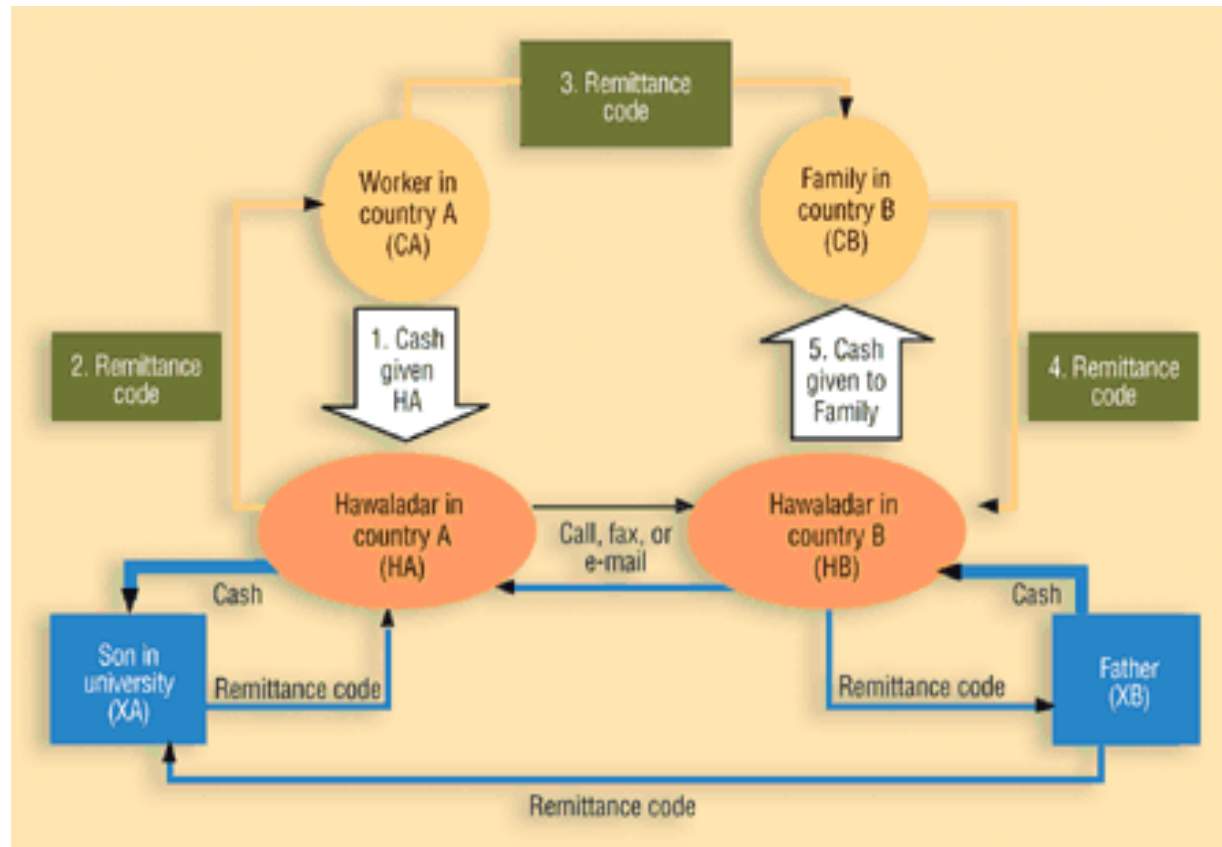


Use of Hawala transactions

- Today, Hawala continues to be used primarily for legitimate purposes all over the world (Passas, 1999).
- Hawala transactions are used as:
 - Remittance instruments (to transfer funds from one place to another).
 - Credit instruments to borrow money (i.e. IOUs)
 - Instruments for trade transactions (as bills of exchange).



How the Hawala transaction works



El-Qorchi (2002) <http://www.imf.org/external/pubs/ft/fandd/2002/12/elqorchi.htm>



Fundamental differences between HNets and the formal money transfer services

- The HNets do not rely on third party monitoring.
- All transactions are monitored by individual Hawaladars and other members of the network. This is enabled by the customary trust that exists between the Hawaladars.
- This trust stems from a homogeneous set of beliefs that govern code of conduct within ethnic groups and communities. Any individual engaging in acts contrary to the code of the network is punished accordingly (Schramm and Taube, 2002).
- Detailed and standardized documentation required to monitor the formal system is missing from the Hawala mechanism.
- Traditionally record keeping existed but was neither standardized nor available in the form that was accessible to monitoring agents in the formal system.



Features of HNets

- By its nature, Hawala Networks (HNets) are a transnational economic activity conducted in a world of increasing interconnectedness.
- Unlike “formal” transnational economic activities conducted by banks and other multinational corporations which are regulated by national and international governmental institutions, the Hawala economy is constituted by networks of spatially dispersed heterogeneous actors with no specific center.
- Surprisingly for a network which exists in the “grey” area of legality and maybe illegal in some circumstances, the *default rate* and *default risk* is quite low; fraud and exploitation is not common.
- There is a surprising consensus among scholars that the HNets have a history of being reliable, speedy and convenient (Ballard, 2005, Schramm & Taube, 2003).
- HNets produce tangible economic outcomes without the traditional visible elements of management control normally associated with the formal sector.



Size of the formal and IVTS transactions

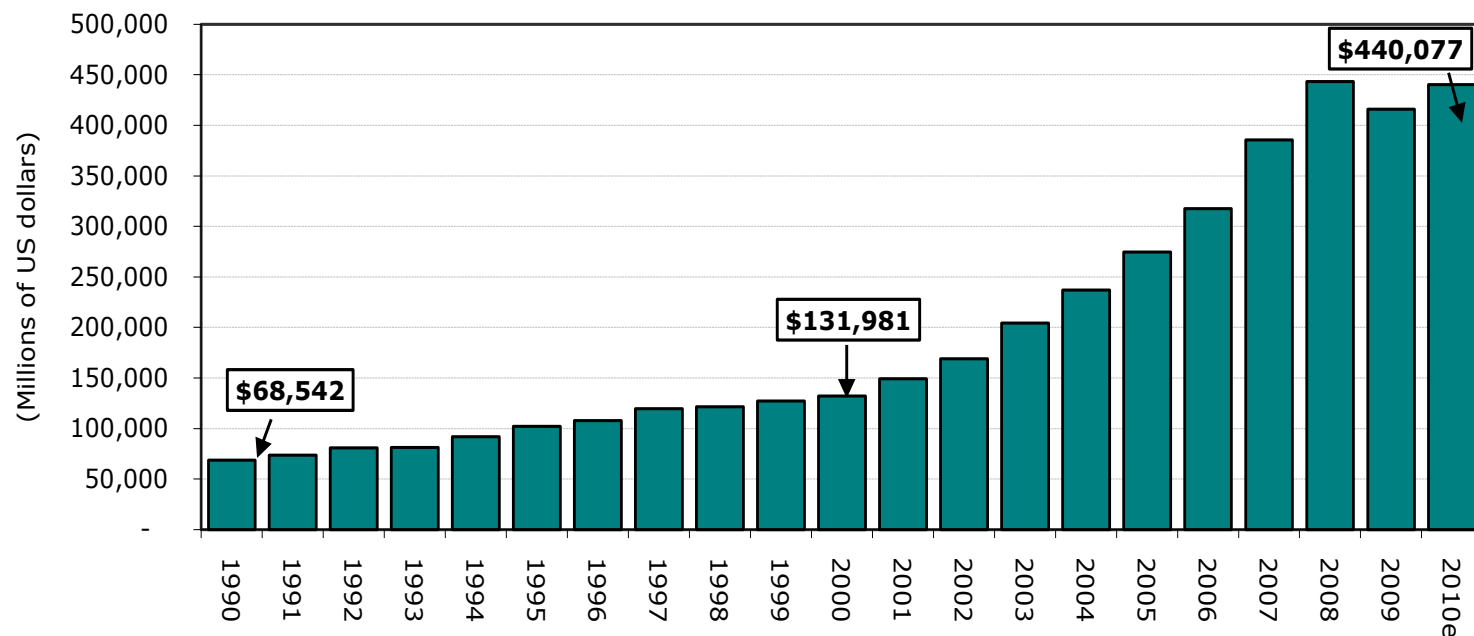
- It is estimated that every year US\$100 billion to US\$300 billion flow through the Informal Value Transfer Systems (Buencamino and Gorbunov, 2002).
- According to the World Bank *Recorded* remittances to developing countries exceeded **\$325 billion** in 2010. If all countries are included the amount increases to **\$440 billion**.
- Unrecorded flows through the IVTS such as Hawala are believed to be **50% higher than these recorded flows** (World Bank estimate).
- It is estimated that half of India and Pakistan's economies are based on Hawala transactions.
- Remittances are the largest source of external financing in developing countries.
- It is estimated there are 215 million migrant workers worldwide (3% of the world population) who sent home more than \$325 billion in 2010, far surpassing official aid flows to these countries (International Association of Money Transfer Networks and The World Bank).
- According to the World Bank, Canada has no official data on outward or inward remittance flows. In 2004, Denis Caron, an economist at Statistics Canada, estimated that the total value of Canadian foreign remittances ranged from \$750-\$850 million each year.



Global formal remittance inflows

13

Formal Remittances Inflows



Source: [Remittances data, Development Prospects Group, World Bank, 2011](#)



Top sources of remittances (2009)

- United States: \$48.3 billion
- Saudi Arabia: \$26 billion
- Switzerland: \$19.6 billion
- Russian Federation: \$18.6 billion
- Germany: \$15.9 billion
- Italy: \$13 billion
- Spain: \$12.6 billion
- Luxemburg: \$10.6 billion
- Kuwait: \$9.9 billion
- Netherlands: \$8.1 billion



Top recipients of remittances (2010)

- India: \$55 billion
- China: \$51 billion
- Mexico: \$22.6 billion
- Philippines: \$21.3 billion
- France: \$15.9 billion
- Germany: \$11.6 billion
- Bangladesh: \$11.1 billion
- Belgium: \$10.4 billion
- Spain: \$10.2 billion
- Nigeria: \$10 billion



Top recipients of remittances

16

Top 15 Remittances-Receiving Countries

By amount of remittances, 2010e (US\$million)

	World	440,077
1	India	53,131
2	China	51,300
3	Mexico	21,997
4	Philippines	21,373
5	Bangladesh	10,804
6	Nigeria	10,045
7	Pakistan	9,683
8	Lebanon	8,409
9	Vietnam	8,000
10	Egypt, Arab Rep.	7,725
11	Indonesia	7,250
12	Morocco	6,452
13	Ukraine	5,595
14	Russian Federation	5,477
15	Serbia	4,896

By share of Gross Domestic Product, 2009

	World	0.7%
1	Tajikistan	35.1%
2	Tonga	30.3%
3	Samoa	26.5%
4	Lesotho	26.2%
5	Nepal	23.8%
6	Moldova	22.4%
7	Lebanon	21.9%
8	Kyrgyz Republic	21.7%
9	Haiti	21.2%
10	Honduras	17.6%
11	El Salvador	16.5%
12	Jamaica	15.8%
13	Jordan	14.3%
14	Guyana	13.7%
15	Serbia	12.6%

Notes: Developed (high-income) countries are not included.

Source: [Remittances data, Development Prospects Group, World Bank, 2011](#)



Top recipients of remittances - Developing countries

17

Remittances Received by Developing Countries by Region 2010e

	Amount (US\$million, 2010)	% of world's total		Remittances as Share of Gross Domestic Product, 2009
World	440,077	100.0	World	0.7%
All developing countries	324,700	73.8	All developing countries	2.0%
East Asia and Pacific	92,500	21.0	East Asia and Pacific	1.9%
Europe and Central Asia	34,900	7.9	Europe and Central Asia	1.3%
Latin America and Caribbean	57,600	13.1	Latin America and Caribbean	1.5%
Middle-East and North Africa	35,600	8.1	Middle-East and North Africa	3.1%
South Asia	81,200	18.5	South Asia	4.8%
Sub-Saharan Africa	21,900	5.0	Sub-Saharan Africa	2.2%

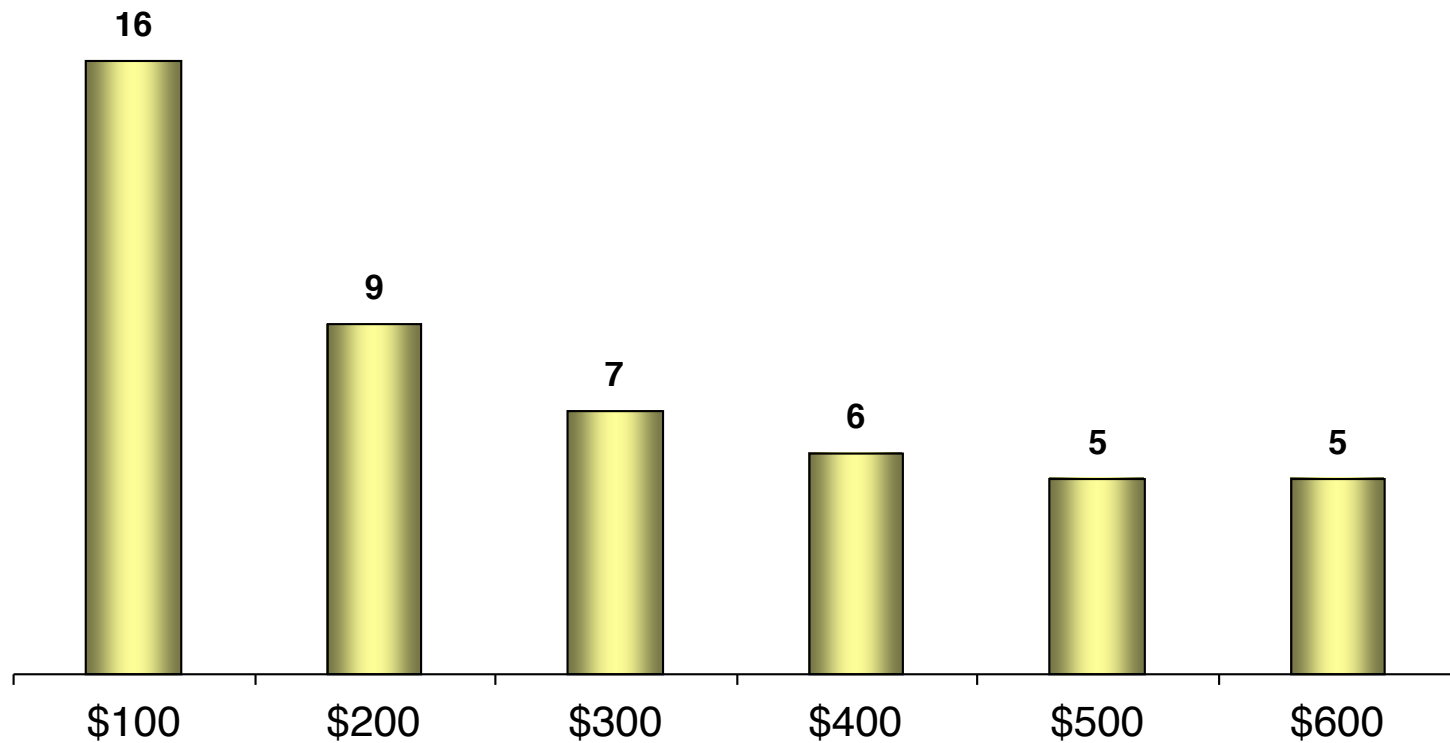
Source: [Outlook for Remittance Flows 2011-13, World Bank \(May 23, 2011\)](#)



Formal remittance fees are high and regressive

18

Fee and foreign exchange commission as % of principal



Weighted average of fees of four largest money transfer operators in the U.S.-Mexico corridor

Source: Economic Implications of Remittances and Migration, Global Money Transfer Conference. Dilip Ratha, 2006



How is Hundi and Hawala used today

- Modern Hawala networks emerged in the 1960's and 1970's to facilitate the transfer of wages of expatriates to their families, called home remittances and to circumvent official bans on gold imports in Southeast Asia (Vakin, 2001).
- Conversion rates were usually more favorable (often double) than the government rates, thereby providing a cheap, efficient, and smooth alternative to the often corrupt domestic financial institutions
- By far the largest proportion of people who use these informal remittance networks, are overseas workers who send money back home to their families (Economist, 2001).
- In many cases they distrust official institutions and/or they simply cannot afford them.
- In 2004 World Bank allowed the Government of Afghanistan to use the Hawala to send budgetary allocations to remote areas. The World Bank has provided up to \$25 million to Afghanistan to help bolster its banking system.



Impact on the economy

- IVTS such as Hawala damages a country's economy by undermining its exchange rate and reserves of foreign currency.
- Hawala transactions have macroeconomic impact on individual economies and state sovereignty (Reszat, 2001).
- Hawala has an impact on international financial markets, financial regulation and monetary policy (Reszat, 2001).
- Hawala may not directly drain a country of foreign exchange, but it does work in conjunction with oppressive government regulations to keep needed dollars and other currencies from coming into the country.



Impact on the economy

- In Pakistan, India and many South East Asian countries Hawala contributes to the weakening of the financial structure.
- In fall 2008, a leading Hawala operator was arrested in Pakistan on charges of illegally remitting \$10 Billion using the Hawala channel, depleting the country's foreign exchange reserves (The News, 2008)
- According to a KPMG report, over \$1 trillion are being laundered every year by drug dealers, arms traffickers and other criminals in India (2008).
- Under-invoicing exports and over-invoicing imports are chronic problems in countries which use Hawala transactions.
- As more businesses seek the Hawala alternative to traditional trade financing, local Hawala brokers raise the exchange rate and weaken the currency.



Positive impact on the economy

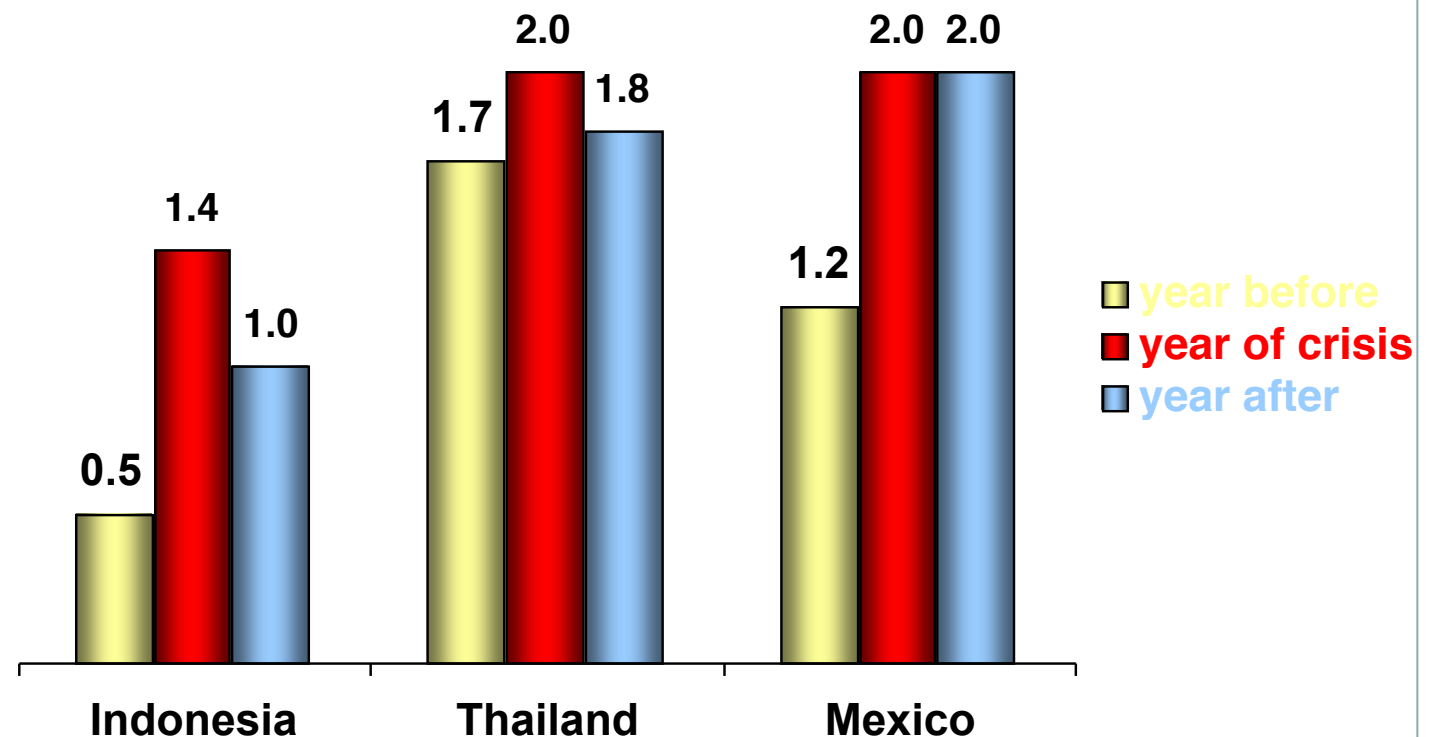
- Hawala transactions are typically transfers from a law-abiding, well-meaning individual who is sending money to his/her household in a developing country.
- Hawala often provides the only affordable means to transfer money for poor migrants - remittance fees can be as high as 10-15% of a remittance of under \$200.
- Hawala at times provides ability to transfer funds to rural, war torn or areas impacted by natural calamities and disasters where formal banking and financial systems have been destroyed or are nonexistent.
- At times expatriate workers have fled their home countries due to ethnic or religious strife as such secrecy, anonymity and security of financial transfers are of critical importance and more so for the survival of their families back home.
- World Bank studies have shown that remittances tend to reduce poverty levels in under-developed countries.
- According to a 2005 study by the IMF, remittances helped lower poverty in Uganda by 11%, Bangladesh by 6% and 5% in Ghana.
- Remittances also help pay for imports, external debt servicing etc.



Remittances typically increase following crisis, natural disasters or conflicts

23

Remittances as % of private consumption



Source: Economic Implications of Remittances and Migration, Global Money Transfer Conference. Dilip Ratha, 2006



Risks of Hawala transactions

- Erosion of Profits: The profits of formal banking and money remittance channels are eroded by the use of Hundi and Hawala. (Passas, 1999)
- Loss in Tax Revenues: Money moved outside formal channels is not subject to taxation and results in a loss of government revenue. (El-Qorchi, 2002)
- Decreased Estimation Capability: Uncertainty regarding the composition of monetary aggregates may result in inefficient monetary and fiscal policies. (El-Qorchi, 2002)
- Limited Paper Trail: Because of limited and informal paperwork government supervision is difficult and it becomes hard to get to the root of a problem. (Schramm and Taube, 2002)
- No Legal Leverage: There are no governing bodies to enforce implicit contracts, thus there are no efficient legal safeguards. (Schramm and Taube, 2002)
- Potential Increase in Financial Crime: Hundi and Hawala not only facilitates legitimate but also illegal transfers. As a result, there is an ever-increasing need to monitor criminal activity. (Passas, 1999)



Preference for Hawala transactions

- **Low Cost**: This results from less monitoring as compared to the formal system, the ability to use unofficial exchange rates rather than official rates, less paper work, fewer channels of operation, no legal contracts. (Schramm and Taube, 2002)
- **Less Time**: The transactions are simple to execute and are not bound by any formal regulations. They follow basic and simple paper work (Schramm and Taube, 2002).
- **Increased Trust**: The network constitutes a homogeneous club, with shared social, religious, ethnic values. There is less defection among players (Schramm and Taube, 2002).
- **Increased Efficiency**: Hundi and Hawala by nature is efficient and cost effective, as opposed to many larger, formal systems. Thus the network puts pressure on the formal sector to become more efficient and cost effective too (Ballard, 2003).
- **Increased Disposable Income**: Both receivers of remittances and hawaladars realize additional income from the use of Hundi and Hawala (Ballard, 2003).
- **Culture Friendly**: Ethnic and cultural ties with Hawala brokers make the system user friendly and convenient.
- **Anonymous**: Transfers money without formal and standardized records or documentation.



Legislation and control

- In the months since September 11th, Hawala have been in the news with greater frequency and often in alleged connection with terrorist activities (Wilson, 2002).
- Impetus to regulations effecting IVTS was provided by anti-money laundering legislation.
- To foster international cooperation to combat money laundering the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances was signed at the Vienna Convention in 1988.
- This was followed by the establishment of the Financial Action Task Force on Money Laundering (FATF) at the 1989 G-7 Summit.
- Following the events of September 11, 2001, FATF expanded its mission to include the fight against terrorist financing as well
- The Canadian government in the recent past amended Bill C-25 as part of its ongoing fight against money laundering and terrorist financing.



Legislation and control

- Anti-terrorist legislation in the Canada, US, UK and other countries allows these governments to regulate businesses suspected of being a front for Hawala.
- In the US, FinCEN (Financial Crimes Enforcement Network) and FTAT (Foreign Terrorist Asset Tracking Center) have been setup to counter the misuse of informal funds transfer systems.
- Canada has setup FINTRAC (Financial Transactions and Reports Analysis Centre of Canada) and an Anti-Terrorism Act has been passed to deter, disable, identify, convict and punish terrorist groups.
- In Canada, all money services business were required to register with FINTRAC by June 23, 2008. Real estate agents are also required to report on suspicious property transactions.



Legislation and control – European experience

- All EU legislation is consistent with FATF recommendations.
- The Third Money Laundering Directive (2005/60/EC) was adopted in 2005 to align EU member's policies with FATF recommendations.
- EC Regulation 1781/2006 introduced stricter requirements for money transmitters and required verification of customer information for transactions above 1000 Euros.
- The EU Payment Services Directive (PSD 2007/64/EC) introduced a new legal framework for payments in the internal market and established comprehensive rules to make cross-border payments easy, efficient and secure.
- Article 26/1 of the PSD allowed a waiver for certain microbusinesses from the burdensome licensing requirements (for businesses having average monthly transactions of less than 3 million Euros per month).



Legislation and control

- Despite its prevalence, Hawala operations are illegal in a number of locations.
- By banning Hawala, it would likely only be pushed underground. Therefore a preferred approach would be to see how it could be regulated.
- In India for example, some estimates conclude that up to 50% of the economy uses the Hawala system for moving funds.
- Through licensing or registration it has been shown that it is possible to continue serving those who need the service, while at the time, preventing it from being abused by money launderers and criminals.
- Money is increasingly data. As a result, the de-materialization of money is a problem facing governments and others and causing widespread paranoia.
- There is a growing realization among regulatory organizations that Hawala operations should not be regulated using banking laws as they are simpler and straightforward transactions.



Legislation and control

- Hawala systems exist for a variety of reasons having little to do with terrorism or money laundering (Teixera and Cheema, 2001).
- If terrorist money movements are to be blocked, Hawala and all of its related unregulated payment systems must be brought into the world of regulated and tracked financial transactions as well.
- The unfortunate effect of this would be the negative impacts it would have on the millions of people who legitimately use these systems worldwide.
- A better approach would be to reduce the economic incentives to use Hawala (Wilson, 2002).
- If a system to make cheap, fast, reliable remittances across international borders, could be developed by the institutional banks, this might do away with the duality in these parallel remittance systems.



Legislation and control – Evidence of misuse of Hawala

- Data from law enforcement case from around the world shows that formal and informal remittance systems are both susceptible to criminal and illegal use.
- The US Government's first ever threat assessment of the problem of money laundering found that only 1% of Suspicious Activity Reports filed by financial institutions involved potential terrorist financing.
- It is important that the regulatory response to governing these Informal Money Transfer Systems strike a balance between curbing their criminal use at the same time facilitating the free flow of funds through efficient formal channels.
- Emerging approaches to international standards need to sufficiently take into account specific domestic circumstances.
- Developing effective regulatory and supervisory standards for informal funds transfer systems is a complex process.



Legislation and control

- Differences in the stages of economic development in general, and the financial sector in particular, imply that national regulators need to give careful consideration to country-specific circumstances and national legal systems.
- Attempts to over-regulate or regulate without understanding their inner workings cannot be expected to work.
- Attempts to regulate without the consensus and input of operators, users and intermediaries will violate the element of trust that is one of the defining and time-abiding elements of the system.
- Attempts to regulate strictly will drive Hawala more underground; will provide incentives for secrecy and better organization and resistance to authority in general.



Future directions

- The IVTS sector should be dealt with as an independent, *unique* type of financial services industry which is different from the mainstream banking industry.
- According to Wilson (2002): *“Hawala is an economic phenomenon, and would remain so even if there were no drug trade or money laundering on the international scene”*
- He suggests that the best method to stamp out Hundi and Hawala (to lure it to the surface?) is to reduce its economic advantages. This entails facilitating cheap, fast remittances and doing away with the system of parallel exchange markets.
- Creative solutions are being developed to cater to the specific niche of IVTS - Example of remittance tools based on cell phones, smart cards or the internet are being developed.



Future directions

- As the use and penetration rates of cell phones in the developing countries are quite high, use of Short Message Service (SMS) to provide SMS-based payment systems could be deployed in rural areas (Example: CashtoChina in collaboration with China Postal Service).
- Increasing access to and decreasing the cost of remittances through the mainstream financial networks.
- Development of non-bank money transfer operations (Example: Western Union with its 312,000 worldwide centers, iRemit in Philippines and electronic money transfer services provided under the UN Universal Postal Union).
- Provide assistance and training to the central banks in developing countries to assist in developing regulations to fit their unique situation and to provide an effective interface with such regulations in other countries.
- High remittance costs faced by poor migrants can be reduced by increasing access to banking and strengthening competition in the remittance industry.



Future research directions

- One possible reason for lack of success is a *single-minded focus* of governments to use regulatory mechanisms to control and curb the use of Hawala Networks.
- Current research provides only limited information at best concerning the governance, control structures and mechanisms of Hawala Networks.
- This missing piece of the Hawala puzzle is critical in understanding the nature and endurance of Hawala Networks.
- This missing piece of the puzzle will also allow for a better understanding of the practice of Hawala Networks and identify alternate and additional mechanisms to curb its use.



Current research project

- The issue of research interest is how these networks of actors, who are scattered in physical space but highly proximate in relationships to outcome, govern and manage their operations and transactional relations.
- More specifically, the focus of my current research is to examine the following intertwined and inter related notions:
 - How do various actors enter into the network?
 - How do their relationships to each other develop both vertically and horizontally?
 - What are the forces that bind the actors to one another, including the role of trust?
 - What are the practicalities associated with managing these multinational relationships?



Conclusion

- The Hawala system should be studied and lauded for what it has accomplished and not penalized because criminals have abused it.
- Illegal activity will exist both in the formal and informal channels of the international financial system as long as there are incentives and lacunae in procedures and mechanisms.
- It needs to be reiterated that Hawala, in its essence, is a naturally efficient medium of transferring funds that has withstood the test of time.
- It has resolved information asymmetry problems without the need of an impartial third party.
- It is this that has shaped Hawala into a fascinating economic and sociological institution.
- Illegal activity around Hawala needs to be resolved with preventive care. It cannot be alleviated by quick-fix methods. Care, vigilance, and prudence are required to develop policies and regulations that would make it difficult and costly to use Hawala for illegal purposes.



THANK YOU!

It has been a pleasure to share some ideas with you.

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