

## **Hawala and Hundi: vehicles for the long-distance transmission of value**

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All those whose activities give rise to long-distance travel – whether as traders, pilgrims, migrant workers, investors or holiday makers – find themselves in need of a vital financial service: a means of transmitting consignments of stored value (or to put it more bluntly, money) safely, swiftly and securely to distant destinations, either to finance their activities overseas, or as a means of remitting the profits they have made there back home. Not that access to such a service is absolutely essential: after all travellers can always do this on a do-it-yourself basis by carrying their assets along with them – either in the form of bundles of currency notes or as bullion. However, this has several serious downsides. Before the advent of steam and then jet engines, travelling, was tough enough task without being loaded down with gold or silver bars; moreover transporting one's accumulated assets in this way courted the danger of losing the lot to storms at sea or to pirates and other assorted brigands. To be sure paper currency is much easier to transport in physical terms, but besides being equally vulnerable to theft, currency notes issued in one's financial jurisdiction of origin are unlikely to be of immediate at one's destination: they have to be changed into the format used in the new destination – a transaction which can often turn out to be as complex as it is costly. No less in the present than the past, outsourcing the task of value transfer to a specialist agent not only provides a convenient means of by-passing those risks, but enables the task to be completed far more safely, swiftly and reliably – and often a good deal more cheaply – than if one had tried to do it oneself.

In virtually all contemporary vernaculars, activities of this kind are described as processes of *money* – as opposed to value – transfers. It is easy to see why: virtually every society in the globe has now been monetised, such that every transaction involving the sale and purchase of goods and services is now settled by a monetary payment – denominated in whichever currency is used for such purposes in the jurisdiction in which the transaction takes place. The invention of money as a stored, easily transferable and endlessly divisible unit of value was a vital step in financial evolution: it eliminated the clumsy practice of barter, and thereby facilitated the scale and velocity of economic activities of all kinds within the jurisdiction in which it was issued, and which the value of the otherwise worthless paper on which currency notes was guaranteed by the state. It also follows that in the absence of such a guarantee – or

more specifically of a powerful sponsor to underwrite their value – such currency notes would lose their value. Their printed 'promise to pay' would be reduced to an empty fiction.

It is for precisely this reason that currencies remain firmly parochial in character, even in the midst of an increasingly globalised world. By definition currency notes require a guarantor if they are to sustain their value, and in the contemporary world it is the state – and more specifically the State Bank – which routinely fulfil this roles. But although Washington DC has played host to a World Bank, neither Bank, nor its counterpart the International Monetary Fund, issue currency notes, and for very good reason: the global order contains close to two hundred autonomous financial jurisdictions. There is no world state.

But whilst at one level each of these financial arenas nominally forms an enclosed pool within which all transactions are settled through the use of its own local currency, none are nearly so financially autonomous as this proposition might seem to suggest. In the contemporary world virtually all such jurisdictions are also heavily involved in huge web of transjurisdictional value transfers, precipitated by the import and export of goods, of services, of migrant remittances, of tourists, savings and investments and much else besides. All these transactions give rise to transjurisdictional value transfers, currently amounting to many billions of dollars per day. Hence the business of facilitating these transfers – of money changing in plain English – at a global level is now quite mind-boggling scale, especially since it is also accompanied by a great deal of speculative activity. But although all readers of this Chapter will have made significant personal utilisation of this marketplace in financial mediation whenever they travelled abroad, and will implicitly have done so when they filled their cars with petrol or purchased a computer, and all members of diasporic communities will regularly have done so on an even more extensive scale, their knowledge of its operation – or of its various more localised formats – will in all probability be close to zero. However it is precisely the structure of these mysterious but vital processes of transjurisdictional financial intermediation – in the past, in the present, and on into the future – which are the subject of this chapter.

Given all this, it also follows that money changing is in no sense a modern phenomenon. On the contrary, it is one which is almost as old as the invention of money itself, and most certainly since the emergence of long-distance travel and trade. But whilst those engaged in moving value as differing financial jurisdictions have consequently utilised the services of specialist financial intermediaries ever since, such 'traders in money' were often popularly regarded as cheats and swindlers, on the grounds that they produced nothing of value, and

that exploiting their customers was their sole source of profit. Hence it should come as no great surprise that money-changers who set up shop in the precinct of the Temple in Jerusalem two millennia ago – where one can only presume that they were serving the needs of pilgrims who has flocked in from far and wide to pay their respects to the Holy of Holies – attracted just the same kind of ill-informed criticism as do the Hawaladars and Hundiwalas in more contemporary contexts.

### **Hawala and Hundi: their historical origins**

Long-distance trade is in no way a modern phenomenon, nor a product of European colonial expansion. Overland trade across the length and breadth of the Asiatic landmass – of which Europe is best regarded as a western promontory – has been active for millennia; moreover there is plentiful archaeological of direct seaborne trade between the ancient cities of Mesopotamia and the Harappan civilisation of the Indus valley from 2000 BCE onwards. Given its strategic location midway between the region stretching from East Africa through the Red Sea to the Persian Gulf to the West and from South East Asia and the South China Sea to Japan in the East, the Indian subcontinent has been a significant player in the oceanic trade routes which have crisscrossed this region ever since. Hence it should come as no surprise that the Indians, in conjunction with their trading partners to the east and west, should have develop a sophisticated range of financial instruments to facilitate value-transfers, and hence activities, as between the multiplicity of jurisdictions which have come and gone around this vast arena during the course of the past four millennia.

Moreover it is equally comprehensible that the skills, understandings and institutional structures generated over the millennia should have gained a resilience of their own, such that it has not been easy to press them into abeyance; hence despite intense efforts by Western-style banking systems suppress them during the colonial period, and further efforts by post-colonial states to regulate them out of existence, Hawala/Hundi networks continue to thrive to this day. However their current status is not a happy one. This contemporary system of so called ‘underground banking’ attract as just as much critical attention as did their colleagues in the outer courtyards of the Temple – although in this case they find themselves charged with being criminal ‘money-launderers’ rather than as allegedly exploitative money-changers. Hence one of my objectives in this Chapter is to explore whether that charge is justified – and if not, why not.

### **Origins**

Although Hawala and Hundi operations arose to serve precisely the same purpose, namely the transfer of value over long distances, and both have roots which are lost in the midst of time, their historical roots differ markedly: the concept of Hawala is of Arabic origin – it is derived Arabic root *h-w-l*, whose basic meaning includes ‘change’ and ‘transform’, whilst Hundi can be traced back to the Sanskrit term for a bond, both were designed to serve similar purposes, whilst also reflecting the priorities of their own religious and cultural traditions. In the case of Hawala, the demands of Islamic Law were twofold: firstly an insistence that unearned profits obtained without shouldering risk were intrinsically exploitative, and hence unlawful; and secondly the view that whilst debts were ‘real’, in that they were meaningfully grounded in patterns of interpersonal obligation, credit was merely an exploitative fiction.

Whilst Hawala procedures are consequently grounded in Islamic Law, they are also notably sensitive to the financial challenges of merchants operating in transjurisdictional market places, as is immediately apparent from masterly account of the premises by which the system is underpinned which Schacht sets out in his *Introduction to Islamic Law*. As he puts it, Hawala

... is in the first place, a mandate to pay, i.e. I owe something to *A* but charge *B* to pay my debt. It can also be an assumption of my debt by *B*. The practical prerequisite in both cases is that I have a claim against *B* which is equal to or higher than the claim of *A* against me. This is not necessarily a debt. It can also be for the return of an object, e.g. a deposit or something taken by usurpation. Normally, therefore, the *hawala* amounts to an assignment: I assign to *A* a claim of mine against *B*, in order to satisfy a claim of *A* against me.

But the existence of a claim against *A* against me is not a necessary prerequisite, and the *hawala* then amounts to a mandate to collect, i.e. I charge *A* to collect my claim against *B*. The element common to all cases is merely that an obligation of *B* towards *A* is created. The acceptance of the *hawala* by *A* extinguishes my obligation; it revives only if *B* dies bankrupt or denies the existence of the *hawala*. Performance of *B* towards *A* extinguishes my claim against him only if the *hawala* was conducted with specific reference to this obligation, not if it was unconditional.

Thus far Hawala simply amounts to a straightforward way in which merchants involved in a complex series of transactions in any given (local) marketplace can make a comprehensive settlement of all the debts which have accrued as between one another, as well as between themselves and their customers, within a given period: a process which can be anachronistically be described as ‘banking without banks’.

However that was much more to the system than this. At the core of the system lay a network of mutual commitments on the part of those involved to settle their debts in due course. Once

such a coalition of reciprocity had been constructed, there was no need for face-to-face contacts between those conducting business on this basis: they could as well be sitting in market places thousands of miles apart. Hence *hawala* was also an ideal means by which to implement long-distance value transfers. As Schacht goes on to explain:

One of the practical advantages of this institution is that it enables me to make payments in another place through *B*. Its effect is the same as that of the *suftaja* or bill of exchange. This defined as 'a loan of money in order to avoid the risk of transport'; I lend an amount to *B*, in order that he may pay it to *A* in another place. (Schacht 1964:148-149)

By contrast its Indic equivalent, the *hundi*, had quite different conceptual foundations. Etymologically rooted in the Sanskrit term for a bond, *hundika*, those utilising the instrument had never been affected by conceptual qualms about the legitimacy of credit, or with the prospect of debtors being required to pay interest on a loan. Hence whilst *hundis* were frequently issued on an interest-free basis, that was by no means necessarily the case. Those who utilised the system to generate financial liquidity by securing a loan against fixed assets (as did many rulers and landowners when they found themselves in financial difficulty) were regularly required to pay interest on the *hundis* issued to them by their bankers. It is also worth noting that development of these financial instruments substantially *preceded* their use in Western Europe. The etymological evidence is unchallengeable. When Bills of Exchange entered European banking systems, they were known as *avallo* in Italian and as *aval* in French. Similarly, the word cheque is derived from the Arabic term *saqq*, which entered European language as a result of the Knights Templar's use of what we would now describe as letters of credit to transfer funds into and out of *Outremer*.

Whilst the availability of promissory notes and bills of exchange are essential lubricants in the operation of every market economy of any complexity, it is worth noting that whilst the term *hundi* calls attention to the instrument itself, the term *hawala* focuses on the transactional processes to which their use can give rise. Nevertheless in purely financial terms, the purposes and consequences of their use is virtually identical. They serve to facilitate the transfer of value as between widely separated parties, and in doing so can readily continue to do so as between those separated by jurisdictional boundaries on behalf of their front-office customers, whilst *hawaladars* and *Hundiwalas*, no less the International Bankers, institute care settlement swaps through their back-offices. The reliability of their services that they offer their customers, as well as the cheapness of their product, is consequently absolutely dependent on the speed and efficiency with which they can implement those back-office settlement processes.

### **Trust and the containment of risk**

As the recent credit crunch has once again reminded us, trust plays a critical role in financial systems of all kinds. Unless retail customers are confident that those providing them with financial services can be trusted, and unless such financial intermediaries can be confident that they can be certain that the counterparties with whom they do business will likewise fulfil their obligations, the whole operation will swiftly grind to halt.

How, then, did *hawaladars* cope with this challenge, given that the counterparties on whom they relied to make disbursements to their customers in far-distant market places, and more often than not in wholly different jurisdictions? How was risk – and above all the risk that counterparties might fail to pay up – to be contained? To understand how this was achieved we must dig more deeply into the operation of *hawala* systems themselves, and above into the coalitions of reciprocity which sustained them.

The first point to make is that the principal objective of *hawala* networks, and indeed of international banking networks in general, is to *obviate the need to physically transfer money (as opposed to value) from one location to another*. In the long run, sum of all trans-jurisdictional value transfers must by definition be zero. If a financial crisis is to be avoided, the total value of goods and services flowing into any given jurisdiction must ultimately match that of those flowing out in the reverse direction: in the absence of such a balance, the value of the local currency will of necessity subside until such a balance is arrived at.

*Hawala*-style settlement networks build on precisely that insight. Hence whilst *hawaladars'* front offices present retail customers with what appears to be one-way value-delivery service, the secret of their success lay in brokering in a parallel transaction (or more usually a set of transactions) which have the effect of transferring a similar quantum of value in the reverse direction. The result is what can best be described as a back-to-back swap.

A (highly simplified) model of how such an exchange can be put into effect is set out below.

- i. Customer  $c^1$  indebts *hawaladar A* by handing over  $v^1$  in local currency for onward transfer;
- ii. *A* transfers the debt  $v^1$  to his distant *hawala* partner *B*;
- iii. *B* discharges the debt either to  $c^1$ 's agent, or to  $c^1$  himself on his arrival; the debt is discharged in an appropriate local currency;

- iv. However every *hawaladar* has a multiplicity of customers; before long A will have transferred debts to the tune of  $\Sigma v$  on behalf of  $\Sigma p$  customers to B, who will in due course have discharged the debts he had assumed to the assigned recipients;
- v. A is now indebted to B to the tune of  $\Sigma v$ ;
- vi. But B is in the *hawala* business as well, and has simultaneously transmitted debts to the tune of  $\Sigma w$  on behalf of  $\Sigma q$  customers to B, will in turn have discharged those debts to the assigned recipients;
- vii. And if  $\Sigma v = \Sigma w$ , the two hawaladars can readily extinguish their mutual debts.

Nevertheless the whole operation is in principle a risky business. How can customers be sure that either A or B will not run off with their hard-earned assets? And given that debts accumulated by any given Hawaladar over a relatively short period of time can be very substantial, what can be done to ensure that he fulfils the obligations he has assumed, given that the Hawaladar to whom he is indebted is resident in a different jurisdiction, as like as not located on the far side of an ocean?

As I have argued at considerable length elsewhere (Ballard 2005), Greif's influential analysis of the underlying logic of the strategies deployed by ways in which Jewish traders operating across the length of southern Mediterranean during the course of the 10<sup>th</sup> century contained risks of this kind. Taking his cue from games theory, he concludes that:

The Maghribi traders overcame the contractual problems associated with agency relationships ... through a non-anonymous organizational framework, the coalition. Within the coalition an internal information-transmission system served to balance asymmetric information, and a reputation mechanism was used to ensure proper conduct. This reputation mechanism explains the observed "trust" relations among the traders.

The "trust" did not reflect a social control system or the internalization of norms of behaviour (although these factors play a role in any economic system). Rather, the Maghribi traders established a relationship between past conduct and future economic reward. As a result, agents resisted the short-term gains attainable through deception, since the reduction in future utility resulting from dishonest behaviour outweighed the associated increase in present utility. Since this fact was known beforehand to all traders, agents could acquire a reputation as honest agents.... (Greif, 1989)

This analysis can be applied with equal force to the Hawala networks which were by then routinely being utilised to facilitate trade down the Red Sea and across the ocean to India – and on which a multiplicity of indigenous traders throughout the area continue to do to this day. Hence it follows that we can now add first-hand ethnography to Greif's textual analysis in the process of grasping their *modus operandi*, and thereby note that a vital prerequisite for the construction of the coalitions of reciprocity which underlay the Maghribi traders' highly successful strategies of risk and reputation management appears to be the prior presence of

tight-knit but spatially extended networks of kinship and quasi-kinship. Such networks remain a salient feature of the Indian Ocean region's multiplicity of caste-, sect- and *biraderi*-based communities to this day.

Before moving on, one further feature of Greif's coalitions of reciprocity is that they are intrinsically self-regulating. Hence they had – and have – no need to look to outside agencies such as the state to guarantee their integrity; they remain have consequently remained untroubled when their networks stretch across a multitude of financial and legal jurisdictions, or reach into regions in which all traces of a coherent jurisdiction have collapsed – as in both Afghanistan and Somalia for example.

### **Hundi/Hawala networks and Imperial hegemony**

During the first three centuries of their presence in the Indian Ocean region, European traders – as well the institutions such as the East India Company through which control was exercised control over an ever-expanding swathes of territory – relied heavily on indigenous *shroffs* to handle their financial affairs, given that their access to *hundi* networks enabled them to facilitate value transfers across the length and breadth of the subcontinent, as well as into many neighbouring territories (Bayly 1983). Nevertheless the Company and its civilian and military agents eventually made ever more strenuous efforts to put their dependency on indigenous financial services to one side. Whilst the Bank of Calcutta, soon to be renamed the Bank of Bengal, was founded in 1806, but it took the two other Presidencies, Bombay and Madras, the best part of four decades to follow suit.

Thereafter change was rapid. As in all other spheres, the scale and the impact of British hegemony expanded rapidly in the aftermath of the 1857 uprising. Shortly thereafter all government business, as well as the bulk of that implemented by European-controlled business houses began to be directed through 'formal channels': European owned and run banks. Whilst indigenous service-providers consequently found themselves pushed to one side of the financial market place, there was still plenty left to play for, especially when it became clear that they still enjoyed a significant competitive advantage over their European counterparts. Besides being able to implement value transfers much more speedily than their newfound rivals, they were also in a position to do so on a basis that was largely inscrutable to the Imperial authorities.

This opened up a further set of contradictions whose implications have proved to be severe in the longer run. Hitherto *hundi* and *hawala* networks had operated as autonomous, self-

regulating coalitions of reciprocity, governed by their own internal customary conventions; as such they were subject to little or no administrative interference. Within the context of the British Raj they found themselves in the midst of a jurisdiction that was unprecedentedly intrusive in character: one which sought to regulate virtually all aspects of its newfound subjects' behaviour according to its own preferred premises, not least as a means of taxing those activities in order to defray the cost of their administration. Moreover this was all backed up by a novel legal jurisdiction in which disregard for regulatory prescriptions was rendered a criminal offence. Whilst *hundi* and *hawala* networks were by no means the only indigenous institutions whose activities began to be scrutinised as a result of these 'reformers', the scale of the value transfers passing through these systems was so large that they quickly attracted the attention of Revenue officials. Hence the principal practical objective of the 1879 Indian Stamp Act – which required details of all such transactions to be recorded in writing on expensively stamped officially printed paper – was not so much to render them legally enforceable (the basis on which their introduction was legitimated), but rather raise revenue, as well as to make a dent in the position of competitive advantage which such *desi* value-transfer networks enjoyed over their heavily bureaucratised rivals, the 'properly constituted' European Banks.

Whilst 'proper' Banks soon began to enjoy an ever-greater degree of prominence in the subcontinent's financial markets, the Stamp Act only made a minor contribution to their growing pre-eminence, whilst those who expected that the use of *hundis* would swiftly fall into abeyance were disappointed. Stamp duty could readily be evaded by failing to use stamped paper to record such agreements, and since the system had its own internal means of guaranteeing system security, recourse to the newly established British legal system – the 'advantage' which the use of stamped paper was held to bring – was simply an irrelevance. Moreover few Indians could see any reason to facilitate the efforts of the British Raj to tax them dry. Nor did matters change much when India gained its independence. Although no longer subject to an alien Raj, its 'steel frame' was largely retained by the indigenous administrators who inherited the structure. Indeed the 'license/permit Raj' which they went on to construct aimed to yet further reinforce state power, and in doing so to drive all economic activity of any significance into heavily bureaucratised state-run institutions.

### **Hundi/Hawala networks in post-Imperial contexts**

Despite initial hopes that at planned and socialistically oriented economy would lead to rapid progress towards prosperity, the Indian economy remained disappointingly stagnant in the immediate post-Imperial period: as state-run initiatives grew increasingly sclerotic, taxation regimes grew increasingly punitive, and access to foreign exchange became ever more tightly rationed. As a result India's so-called 'black economy' burgeoned, as did the *Hawala/Hundi* networks through which its 'invisible' dimensions – which many commentators concluded was as at least as large, if not larger than the 'visible' sector – were serviced. To be sure the processes of liberalisation which have stimulated unprecedented levels of economic growth which India has experienced during the past two decades have swept away the most egregious features of the licence/permit Raj. Nevertheless, as in many other post-colonial arenas – including those in the rest of South Asia – these regulatory excesses have by no means been wholly eliminated, most especially with respect to financial transactions. Hence in the midst of the cat and mouse game still being played out between revenue officials and both personal and corporate taxpayers *Hawala/Hundi* networks continue to thrive to this day.

### **Hawala in the Contemporary World**

Five major factors, all of which are closely interconnected with one another, have facilitated the resurgence of hawala-style value systems in the contemporary global order.

- The failure of the formal banking system as a whole to develop an effective, efficient and accessible global cross-jurisdictional payments system, such that retail customers and SMEs face substantial charges when they seek to settle invoices denominated in non-local currencies through the transjurisdictional value services offered by mainstream banks;
- The recent explosive growth in the volume of international travel and trade, which has precipitated an explosive global demand for such services;
- The emergence of the internet as a vehicle for instant (and secure) communication on a global scale
- The huge outflow of migrant workers, some highly skilled but mostly unskilled, especially (although by no means exclusively) from South and East Asia to Arabia and Northern America, who have in turn generated a reverse flow of remittances currently running at around \$US 100 billion per annum for the Indian subcontinent as a whole;
- The resultant capacity of Hawaladars to utilise a significant slice of this massive inflow of liquidity to facilitate outward counterparty transactions in hard currency to

every financial jurisdiction in the Indian Ocean region (many of which still remain heavily regulated), as well as to Dubai, New York, London and so forth.

South Asian migrants are by no means unique in having set up Informal Value Transfer Systems to facilitate the delivery of remittances back home: similar processes have been developed by members of all manner other diasporic communities, if only to take advantage of the novel opportunities which have precipitated in the midst of the current phase of globalisation ‘from below’ (Ballard 2010). Whilst all such networks deploy a similar form of financial logistics to implement such transfers, at an organisational level each has drawn upon – and yet further developed – the resources of their own specific social, cultural and conceptual traditions. Those resources of necessity differed considerably in quality and character as between different diasporic networks, in communities where those resources better developed than amongst the Chinese and the South Asians: hence just as members of Chinese diasporas have made extensive use of the ancient art of *fei qian* (‘flying money’) to create contemporary value transfer systems, so those of South Asian origin have relied on Hawala/Hundi networks to fulfil the same objectives. Hence whilst both systems are of ancient origin, they have enjoyed a huge resurgence during the course of the past few decades; but was only to be expected the novel circumstances within which they have been deployed has precipitated some significant changes in the fine detail of their *modus operandi*.

### **Contemporary developments**

Efficient Hawala swaps rest on hawaladars’ capacity to broker deals in which the incoming and outgoing flow of value across the border of any given jurisdiction are matched as closely as possible. Mixing and matching is a complex task. Even if the overall value of the two transactions is broadly matched, there are invariably other dimensions of the flows which are incommensurate with one another. Hence whilst most migrant remittances take the form of a multiplicity of relatively small tranches of value, most of which are destined for delivery in relatively remote rural locations, the rupees so delivered are for the most part of urban origin, and have been released by affluent businessmen in return for bulk purchases of hard currency (usually denominated in US\$) to settle their overseas suppliers’ invoices. However such commercial transactions – although very substantial – by no means exhaust the possible uses to which these counter-flows are put. To these must also be added well off families (in rupee terms) who need access to foreign exchange to meet the cost of educating their offspring in overseas universities, and/or the hospital bills of elders who have been sent overseas to

receive more sophisticated medical treatment overseas; and last but not least high net wealth individuals seeking to squirrel away their assets in overseas tax havens, well clear of the prying eyes of the Inland Revenue.

Meeting the discrepant needs of these widely varying and globally distributed sets of clients is a challenging task, especially since customer satisfaction rests on being able to implement deliveries in both directions on a swift and absolutely reliable basis. In meeting this complex logistical challenge contemporary hawaladars have relied on two complementary resources. On the one hand by constructing building globally extended self-regulating coalitions of reciprocity of a traditional kind, based on precisely the same principles as those outlined by Greif; and on the other hand by making the most of current electronic technologies to acquire and distribute the information needed to negotiate and execute individually negotiated trust-based transactions on an almost instantaneous basis. By bringing these two arms together they have devised a highly effective system of global financial logistics, implemented within the context of a series of acephalous, but nevertheless globally distributed, networks of reciprocal trust.

### **The essence of contemporary Hawala: back-to-back swaps**

A series of linked examples will serve to illuminate the logistical process by means of which value transfer are implemented. Since migrant remittances – and above all the liquidity to which such transfers give rise – are the driving force behind contemporary manifestations of Hawala, let us begin in Bradford, where there is a large concentration of migrants stemming from Pakistani controlled Azad Kashmir; as a result there is a substantial demand for a swift, reliable and low cost transfer system capable of making cash deliveries (in rupees) to recipients based in locations scattered across a mountainous and overwhelming rural terrain. The arm of what was subsequently to develop into a much more complex system was pioneered on a straightforward basis: a respected – and hence trusted – member of the settlement in Bradford began to take orders for the delivery of cash deposits made with him as rupees to recipients in Azad Kashmir, delivery of which would be organised by his brother back in Mirpur. Since everyone trusted each other, little paperwork was entailed, other than the fax (and subsequently the email) which the Bradford *hawaladar* regularly sent to his overseas partner setting out just how much should be paid out to whom in what village.

Although rupee deliveries on behalf of customers in Bradford could consequently be implemented within a day or two, it goes without saying that the two hawaladars’ financial

position was unsustainable unless some means could be found of providing the disbursing hawaladar funds in rupees. This is where the second arm of the transaction came in: to settle up, the two parties needed to find a counterparty in Pakistan who urgently needed to turn a large quantity of rupees into a more internationally negotiable tranche of hard currency. Once such a counterparty had been identified, a deal was easily done. The counterparty – usually an affluent businessman – agreed to deliver a large sum in rupees to the Hawaladar in Mirpur, whereupon his Bradford based partner would transfer an equivalent amount in sterling into a bank account nominated by the counterparty. The matched pair of back-to-back transfers produced the desired result for all concerned, and in such a way that no currency notes were transferred across jurisdictional boundaries. Moreover the overhead costs were far lower than they would have been for all concerned if the transfer been implemented through the formally constituted banking system – always supposing that the system was capable of making deliveries to remote locations in Azad Kashmir.

#### **Advanced manifestations of Hawala: consolidation, settlement and deconsolidation**

As the scale of remittances grew steadily in size, finding suitable counterparties on an *ad hoc* basis became increasingly problematic, especially since the most urgent demand for foreign exchange in return for rupees was to be found in Karachi, the best part of a thousand miles south of Mirpur. As a result a further salient feature of contemporary Hawala networks soon came into play: the implementation processes of consolidation, settlement on a wholesale basis, and subsequent deconsolidation. All those involved in financial processing – whether they operate in the formal or the informal sector – are immediately familiar with exercises of this kind. Since the cost of making any given transaction bears little or no relationship to the size of the sum transferred, it follows that the larger the scale of the settlement, the smaller the proportion of its value eaten up in transfer costs will be. Hence the core secret in the Hawaladars' success in transferring migrant remittance arises from the fact whilst the remittances which they transmit on behalf of their migrant worker clients are rarely greater than a few hundred pounds, the consolidated back-to-back settlements at a transjurisdictional level are implemented in terms of tranches of value several orders magnitude larger, in multiples of \$US100, 000. So how is this achieved?

In the simple example set out above – which effectively represents the practices which emerged during the pioneering phase of UK-based initiatives – brokering Hawala swaps was a hit and miss business. Not only was it far from easy to set up equally-sized tranches of

value to swap, but the system was inherently inflexible: by no means all South Asian settlers seeking to make remittance transfer were of Mirpuri – or even of Pakistani – origin. It was in response to these challenges that strategies of consolidation and deconsolidation became ever more salient elements in the Hawaladars' operational toolbox. Once again coalitions of reciprocity played a major role in so doing, this time to underpin the construction of networks of agencies and sub-agencies by means of which to implement these processes of consolidation and deconsolidation.

As the operations of pioneering hawaladars major South Asian settlements grew steadily in scale, so leading figures occupying similar positions of trust in smaller communities elsewhere in the UK took the opportunity to tap into these more firmly established initiatives by acting as the initial pioneers' local agents. Hence a distinction began to emerge between retail Hawaladars and wholesale Hawaladars. The latter not only dealt with retail customers, but also maintained back offices in which they consolidated funds flowing in from networks of agents and sub-agents, such that they were in a position to broker even larger scale deals with what can best be described as global operators, based in initially in the Exchange Houses in Karachi, and eventually one step further up the chain with even larger-scale operators based in the Exchange Houses in Dubai.

Once relationships of this kind were in place, emergent UK-based Hawaladars no longer had look for locally based counterparties in northern Pakistan to implement Hawala swaps on an *ad hoc* basis. They could now begin to tap directly into the hawala swaps being brokered on a global basis in Dubai. In these circumstances the implementation of a straightforward hawala swap (for simplicity's sake for a single tranche of £100,000) as between the UK and Pakistan had become a complex and thoroughly professional business, as the much simplified model which I have set out in Figure 1 serves to demonstrate.

The core of each such operation – which is negotiated and executed on a daily basis – is an agreement between two consolidating hawaladars to swap similarly sized tranches of value, one in Pounds sterling and the other in Pakistani rupees, as a means of implementing a multitude of smaller deals on behalf of their respective clients. Having agreed on an exchange rate (e.g. GBP 1 = PKR 100), the UK-based consolidating Hawaladar agrees to swap his obligation to fulfil £100,000-worth of delivery orders in Rupees which he has accepted on behalf of his UK-based clients, in return for agreeing to implement £100,000 worth of payments (often to settle his partners' clients' invoices) into a series of nominated bank accounts in the UK. Mean while the Pakistani-based consolidator settles his debt to his UK-

based partner by arranging to deliver ten million rupees (often in cash) to his nominated agents in northern Pakistan, ready for further disaggregation and distribution to their ultimate recipients.

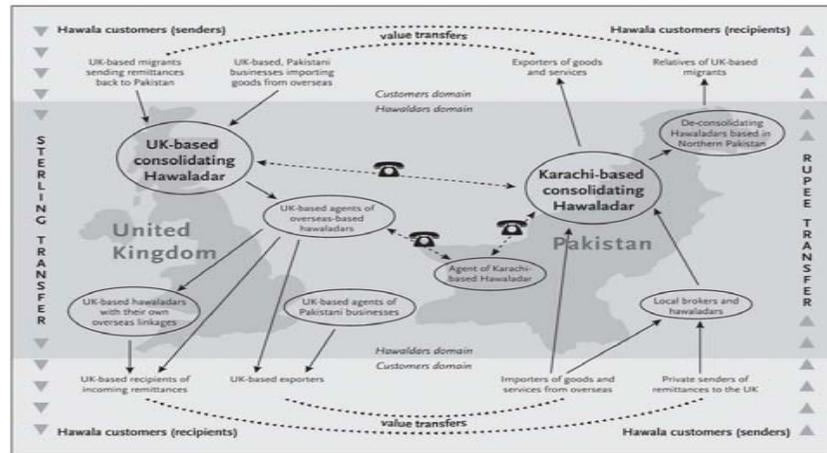


Figure 1: Transactions underlying a swap valued at £100,000 as between UK- and Pakistan-based Hawaladars

As the diagram demonstrates, a large number of actors in at least four separate networks are involved in the processes which lead up to the wholesale hawala swap, in which the unit of account is the product of a myriad independently brokered deals and sub-deals separately negotiated as between agents and sub-agents of the various networks. Against that background all the elements in the model effectively ‘pulse’ every 24 hours. Global settlements (of which the transaction shown is but a small component) are negotiated on a daily basis, thanks to series of *trans-jurisdictional information* flows passing back and forth along the horizontal axis between UK and Pakistan. Once everything is agreed, the ‘pulse’ takes the form of two matched, simultaneous and *intra-jurisdictional currency transfers*: in terms of my model pounds sterling flow down along the vertical axis to recipients elsewhere in the UK, for whom it represents value transmitted from Pakistan; meanwhile on the right hand side of the diagram a tranche of rupees of similar value moves upwards along the vertical axis to recipients in northern Pakistan who take the view that that the notes they have received were sent directly to them from the UK.

At this stage it is worth noting that few if any of the senders or the recipients have any knowledge of how this outcome has been achieved – anymore than customers extracting notes from ATMs scattered all over the world have any idea as to just where the cash doled out by the machine might have come from. In both cases value transfer and cash delivery are handled at a back-office level, using structurally identical techniques of consolidation, wholesale settlement and deconsolidation in both cases. The only substantial difference is that the hawaladars’ utilisation extensive use of ‘informal’ procedures – in which system-security is grounded in coalitions of reciprocity rather than in bureaucratically constituted contractual agreements – enables them to implement such exercises in financial engineering a great deal more speedily, efficiently and hence more cheaply than their ‘formal’ counterparts.

### A criminal conspiracy?

Despite all this Hawala networks have recently acquired an exceedingly bad name, so much so that Hawala deals are regularly reported in the press as vehicles for ‘money-laundering’, so much so that they are routinely identified as amounting to little more than criminal conspiracies, whose perpetrators deserve to be arrested and imprisoned. How far is this view justified? Viewed purely from a financial perspective, Hawaladars are best identified as financial intermediators: as such they perform exactly the same role – and ultimately deploy exactly the same methodologies – as those utilised by international banks. Why, then, have they acquired such a bad name? Why should this be so? Two main precipitants led to this outcome, one of which essentially internal to the subcontinent, whilst the other is more global in character.

When India gained its Independence immediately after the Second World War, the global economy was in chaos, and many countries – including the United Kingdom – were concerned about their financial stability. Many jurisdictions consequently introduced tight controls on access to foreign exchange in an effort to shore up the value of their currency. The subcontinents’ newly constituted jurisdictions were no exception, and in short order India introduced tight controls over both personal and corporate access to foreign exchange. These regulations were further reinforced by Foreign Exchange Regulation Act of 1973, and then significantly relaxed – but by no means eliminated – in Foreign Exchange Management Act of 1999, as India began to wind down its licence/permit Raj. However the imposition of draconian restrictions on financial transactions invariably leads to the construction of strategies to evade them. In the subcontinent there was a ready means of doing so, since

hundi/hawala transactions were effectively invisible to the authorities. Hence in addition to raw cash, transactions of this kind became an essential lubricant to the state of economic seizure to which the draconian provisions of the licence/permit Raj would otherwise have given rise.

Developments of this kind were by no means unique to South Asia. As Coyle reports

Currency swaps originally were developed by banks in the UK to help large clients circumvent UK exchange controls in the 1970s. UK companies, seeking to finance their US subsidiaries' operations, were required to pay a premium when obtaining dollar loans from their banks. The idea behind a swap was to avoid having to pay this premium for dollar borrowing. A bank would identify a UK-based organization that wanted to borrow in dollars and a US-based organization wanting a sterling loan. An agreement would then be negotiated whereby

- the UK organization borrowed sterling and lent it to the US company's UK subsidiary
- the US organization borrowed dollars and lent it to the UK company's US subsidiary.

The UK organization would take on the obligation to pay dollar interest and repay the dollar loan principal, and the US organization similarly would take on the liability to pay sterling interest and repay the sterling loan principal.

No sterling left the UK and no dollars left the US, so there was no requirement to pay the exchange equalization premium on dollars. The benefit of cheaper borrowing could be shared between both parties to the swap, and both the US and UK organizations therefore could pay less for currency debt liabilities than if they had borrowed directly in the foreign currency (sterling or dollars). These early arrangements were called back-to-back loans or parallel loans, from which more sophisticated currency swaps were gradually developed over time. (Coyle 2000: 24-5)

If Coyle is right in suggesting that this was a novel financial instrument in Euro-American Forex markets – albeit one which has been greatly elaborated since then – it would seem that that the Hawaladars had got there long beforehand, and were consequently able to deploy their already well-honed skills in precisely the same initial circumstances: the imposition of exchange controls. Why, though, did the Hawaladars get such a bad name, whilst the ever more elaborate versions of the currency swap which Coyle goes on to describe have become a routine component of contemporary Euro-American forms of financial engineering?

A range of factors have undoubtedly contributed to this outcome. That these initiatives were of Asian, as opposed to Euro-American origin, has undoubtedly been a source of widespread suspicion, which was further reinforced by the view that Hawaladars conducted their business by underhand means, in the sense that the system security of their networks was grounded in relationships of mutual trust, rather corporately grounded legal contracts. However the most powerful source of criticism which they have encountered, especially in the aftermath of 9/11, has been that their principal activity is nothing less than 'money-laundering'. As a result international efforts – led by the US Treasury – were set in train to drive all such IVTS networks out of business on the grounds that they facilitated criminal activity..

### **Money Laundering? Or a necessary form of Financial Intermediation?**

'Money Laundering' is a blunderbuss of a concept, since it covers a multitude of potential sins. However these sins are by no means uniform in either their malevolence or scale. Set out in order of financial magnitude, the activities which can legitimately be classed as 'money laundering' include

- i. The redistribution of corporate value on a global scale in such a manner as to minimise the impact of taxation.
- ii. The relocation of personal assets in hard currency locations, such that they are unlikely to be eroded by inflation, depreciation or inquisitive tax inspectors.
- iii. The facilitating trading and value transfer activities which regulatory restraints would otherwise render either impossible or much more expensive.
- iv. The distancing of criminally acquired assets (e.g. the profits of drugs smuggling) from their source, such that 'black' money can be rendered 'white'.
- v. The financing of terrorist activities.

But whilst the degree of turpitude precipitated by these activities increases exponentially towards the bottom of the list, the opposite is true with respect to the scale of the financial involved. Hence whilst terrorism and drugs smuggling are activities which are manifestly contrary to the public good, even if the transjurisdictional transfers of value to which such activities give rise amount to hundreds of millions of dollars on an annual basis, they pale into insignificance alongside the multi-billion if not trillion dollar scale of transfers generated by the first three items in the list (Baker 2005).

A further point worth noting that those who facilitate transfers of this kind in the course of their wider business operations – whether as Wall Street banks or as Exchange Houses in Dubai – are not themselves engaged in the underlying activities which attract the label 'money-laundering'. Their role is essentially that of providing a service of financial intermediation on behalf of both individual and corporate customers: without an installed capacity to implement such services, the world's increasingly globalised economy would seize up overnight. But if this is the case, what role – if any – should service providers (whether in the formal or the 'informal'/indigenous sectors) have in policing such transfers? Regulatory initiatives such as those enshrined in FEMA in a local Indian context, and yet further reinforced the rules set out by the Financial Action Task Force at a global level actively implicate Hawaladars in the whole process, so much so that they all too easily find themselves facing criminal charges which suggest that because they have failed to follow

regulatory requirements, they must *ipso facto* have been facilitating the activities of terrorists or drugs smugglers. If such charges can be made to stick – which most usually occurs at a regulatory level – the result makes for excellent headlines in the press.

However, when this occurs, who had been caught? The organ grinder, or merely his monkey? And the Hawaladar is merely a monkey in this sense, the terrorists, the drugs smugglers and the exporters of ill-gotten gains will undoubtedly be able to breathe more easily if this kind of strategy is routinely applied, since the persons who could most easily have led investigators to the perpetrators of these dangerously nefarious activities will have been safely locked up behind bars. As Passas (2006) has graphically suggested, it seems that have been ‘fighting a war on terror by shooting ourselves in the foot’.

Hawala style networks deserve our respect for the cheap and highly effective globally-extended financial value-transmission services which they offer to millions of clients, most especially in diasporic contexts. Their mindless criminalisation, no less by the regulatory authorities in London and New York than by those in Delhi and Islamabad may well have enabled them to produce a bunch of headline-generating scapegoats, and lay their hands on large sums in cash which their customers had entrusted to them. However the moment one deploys a more relevant yardstick – such as the identification and prosecution of those who have acquired huge quantities of value by criminal means – the results of efforts to criminalise ‘money-laundering’ appear much less impressive. Despite all the ballyhoo, there is no sign that that the criminal activities they were designed to suppress – and which in any event only ever made up much more than a small fraction of the Hawaladars’ activities – have encountered a significant setback. In other words the whole exercise has proved to be largely counterproductive, albeit at considerable public expense.

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