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Hundi/Hawala: *The Problem of Definition*[1]

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Abstract

In contemporary times, *Hundi* has collected countless labels; the international press has spurned innumerable villainous descriptions, the bulk of which have helped to perpetuate a dense fog of notoriety. The critical problem lies in definition. As there is an incomplete understanding of hundi's form and remit, there is also a rather limited understanding of why the system persists, set against the backdrop of modern banking. In many ways the problem of definition presented legal and financial authorities of the early and late twentieth century with core issues which remain unresolved and problematic for authorities in the twenty-first century. By drawing on archival and other historical material pertaining to the system's usage amongst Indian merchants, this paper attempts to tackle much of the confusion and many misconceptions surrounding hundi. The discussion explores the idea that hundi is more accurately described as an indigenous banking system endowed with a complex range of functions, but whose central purpose is trade.

Introduction

It is perhaps ironic that an ancient South Asian banking system which had earned a reputation for trust should today be widely regarded as an opprobrious marker of the black market economy. Also known as *hawala*, *havala*, or *havale*, *hundi*'s disrepute is reflected in the many villainous descriptions awash in the international press: 'illegal financial transactions market',[2] 'black money' and 'drug money',[3]

[1] I would particularly like to thank John Harriss, Gareth Austin, Tirthankar Roy and last, but not least, Alexander Evans for excellent guidance, comments and unfailing encouragement. Any errors are purely my own.

[2] M. Rama Rao, *Finance Minister Interviewed on Inflation, IMF, Subsidies, 1545 GMT, 22 June*, 26 June 1993. LexisNexis, accessed 2004.

[3] Erhard Haubold, "Spekulationen ueber die Rolle der indischen Mafia (Speculation over the role of the Indian Mafia)," *Frankfurter Allgemeine Zeitung GmbH* 1993.

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'system of tax evasion',[4] 'illegal transfers of foreign exchange',[5] 'illegal money laundering network'[6] and Hindi word meaning 'providing a code'.[7] In a similar vein, the descriptions of hawala and hundi as *informal* or *alternative*[8] have developed because they are perceived as both unofficial and lacking in legal accountability. The confusion does not cease there; there is no universal agreement over whether hundi and hawala are in fact the same, and, just as press descriptions have been wildly different, this uncertainty has much to do with diverging opinions of what hundi and hawala respectively are.

In many ways, the notoriety collected by hundi and hawala is connected to what Austin and Sugihara correctly describe as the broader 'disparaging' connotations of the words informal or 'unorganised'.[9] The authors argue such negative connotations arise from the persisting dominant view that indigenous or traditional banking and its instruments were primitive and inefficient. Yet, whilst developments in modern banking appear to render hundi obsolete, emerging contemporary studies that demonstrate the continued use of hundi/hawala indicate otherwise.

The critical problem lies in definition. As there is an incomplete understanding of hundi/hawala's form and remit, there is also a rather limited understanding of why the system persists, set against the backdrop of modern banking. In turn, this presents enormous difficulties for law enforcement and financial regulatory authorities. This paper draws on archival and other historical material pertaining to the system's usage amongst Indian merchants, in order to tackle confusion and misconceptions surrounding what hundi/hawala actually is. Trade, it will be argued, is the primary function of the system. This discussion will demonstrate that problems of definition presented legal and financial authorities of the early and late twentieth

[4] Philip Coggan, "The Chronology of Corruption," *The Financial Times* 1991. LexisNexis, accessed April 2004.

[5] Shirish Nadkarni, "Confidence in Tatters Over Hawala Fallout," *South China Morning Post* 1996. LexisNexis, accessed June 2004.

[6] Chhaya Mayank, "Diaries Tell a Sordid Story of Corruption," *India Abroad* 1996. Lexis Nexis, accessed June 2004.

[7] "India Cash Market Tied to Burgeoning Scandal; Funds from Abroad Key Hawala Deals," *Chicago Tribune* (sourced from the Associated Press) 1996. LexisNexis, accessed June 2004.

[8] Widely used by Interpol, the Financial Action Task Force (FATF) and the Asia-Pacific Economic Cooperation (APEC) for instance.

[9] Gareth Austin and Kaoru Sugihara, eds., *Local Suppliers of Credit in the Third World 1750–1969*; Austin *et al.*, *Introduction* (1993), p. 2.

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century with core issues which remain unresolved for authorities in the twenty-first century. It concludes that legal and financial policies will remain problematic unless a proper understanding of hundi/hawala is achieved.

The considerable historical literature on hundi is also partly to blame for confusion over whether hundi and hawala are one and the same. Contemporaries effectively disagree over whether hawala possesses all the functions of hundi, or if it simply serves as a remittance vehicle. El Qorchi *et al.* portray hawala and hundi as interchangeable entities,[10] yet Ballard distinguishes between the two, describing hundi as a letter of credit or promissory note that was once used by hawaladars (hawala operators) to document debt.[11] Passas too asserts that hundi and hawala should be distinguished, describing hundi as an ancient credit instrument, which 'functioned as a remittance vehicle, as an IOU, and as a bill of exchange.'[12]

Hawala, Passas claims, 'is simply the practice of transferring money from place to place', which in modern times largely does not involve the use of hundi.[13] He contends that hundi is often confused with hawala because, like the latter, it too serves as a remittance vehicle. Yet Jost and Sandhu conclude that hundi and hawala are the same, since hundi also means *trust* in Hindi, deriving from the Sanskrit root *Hund* meaning 'to collect'. They point out that in common with hundi, hawala also carries the same senses of bill of exchange, promissory note, and reference. Rather strangely however, in the same paper, they define hawala as an 'alternative or parallel remittance system', and also state that the system 'makes minimal (often no) use of any sort of negotiable instrument'.[14] So is hawala/hundi simply a remittance vehicle? Or does it too serve as a credit instrument? And how accurate are the above definitions of hundi and hawala?

[10] Mohammed El Qorchi, Samuel M. Maimbo and John F. Wilson, *Informal Funds Transfer Systems: An Analysis of the Informal Hawala System*, *IMF/WorldBank* (Washington, D.C.: 2003).

[11] Roger Ballard, "Coalitions of Reciprocity and the Maintenance of Financial Integrity within Informal Value Transmission Systems: The Operational Dynamics of Contemporary Hawala Networks," *Journal of Banking Regulation* 6(4) (2005); Roger Ballard, *The Principles and Practice of Hawala Banking* (2002 [cited April 2003]), p. 7.

[12] Nikos Passas, "Informal Value Transfer Systems, Terrorism and Money Laundering," National Institute of Justice, 2003, p. 37.

[13] Ibid., p. 39.

[14] Patrick M. Jost and Harjit Singh Sandhu, "The Hawala Alternative Remittance System and Its Role in Money Laundering," Lyon: Interpol General Secretariat, 2000, p. 5.

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Linguistic Affinities Compared

A comparison of hundi and hawala in Hindi, Arabic and Sanskrit reveals strong linguistic affinities and functional similarities. In modern standard Hindi, the senses of trust, contract and promise are implicit in both hundi and hawala. McGregor's authoritative Oxford Hindi-English Dictionary[15] describes hundi as a bill of exchange, draft and a promissory note, whilst the entry *hunda* states, 'an inclusive agreement or contract', or *hunda-bhadha* as a contract for delivery of goods free of charge, or for insurance. Hawala, as represented by *havala* in Hindi, is defined as 'charge, keeping', or 'reference, allusion', and its etymology is attributed to Arabic. Modern standard Arabic translates hawala as *transfer*, which perhaps explains why more authoritative accounts have defined the system as *Informal Value Transfer System* (IVTS)[16] and *Informal Funds Transfer* system (IFT).[17] The word hawala is the verbal noun form of the verb haâla, which means the transformation of a situation in which a person or thing finds itself.[18] Scrutiny of Monier-Williams's Sanskrit-English Dictionary reveals no entry for hawala/havala, or hundi. However, *hundika*,[19] the entry most closely approximating hundi, is described as 'a bill of exchange, bond, Rajat, assignment or order', and its etymological roots are ascribed to Persian.

Historical Connections Between Hundi and Hawala

Although it is impossible to pin down the precise chronology and roots of either hawala or hundi, strong linguistic, political and economic historical connections between India, Persia and the Middle East suggest that similarities between the two systems are not merely coincidental. Arabic's influence on Persian is well documented, as

[15] McGregor, *Oxford Hindi-English Dictionary* (Oxford: Oxford University Press, 1993).

[16] Nikos Passas, *Informal Value Transfer Systems and Criminal Organisations: A Study into So-Called Underground Banking Networks* (Netherlands Ministry of Justice, 2000), p. 11.

[17] El Qorchi, Maimbo and Wilson, *Informal Funds Transfer Systems: An Analysis of the Informal Hawala System*.

[18] Richard Grasshof, *Das Wechselrecht der Araber: Eine rechtsvergleichende Studie ueber die Herkunft des Wechsels* (Berlin: Otto Liebmann, 1899), p. 37.

[19] Monier Monier-Williams, *A Sanskrit-English Dictionary (Etymologically and Philologically Arranged)* (Oxford: Oxford University Press, 1899), p. 1301.

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is the replacement of Sanskrit with Persian as the administrative language of North India during the Mughal period. Globalisation in the form of mercantile trade throughout these regions is also likely to have had a significant impact on the language of business. For instance, an intriguing *Financial Times* report[20] provides the sense that the Arabic term hawala was adopted because of increasing trade activities with the Persian Gulf or Middle East more generally. Reporting on Bahraini settlers at the turn of the nineteenth century, Field describes hawala as the name of Sunni Arabs originating from Arabia, who had settled on the Iranian coast before coming to Bahrain. Most of these settlers are said to have had strong trading connections in a variety of spheres.

Field also relates the arrival of an Indian merchant community in Bahrain. This merchant community had apparently 'dealt with the Bahraini pearl traders in Bombay and were drawn to the island by the prospect of buying pearls locally or importing food or other basic supplies to sell to the pearling dhows.'[21] The name hawala may well have been adopted within the Indian subcontinent through active trade with the Persian Gulf in the twentieth century. This does not mean that the system was not employed before this point. In fact, the rich literature surrounding merchant castes and their financial activities provides many strong indicators of the existence of such systems.

Functional Similarities Between Hundi and Hawala

Historical accounts detailing usage of hundi and hawala also strongly point to the two systems being the same. Both were at the heart of trade in India and the Middle East, and both were exercised as the chief banking instrument of merchants. Hawala was not merely a remittance vehicle; it had the same function as hundi, even if linguistic dictionary entries do not convey this sense adequately. Both the 1927 and 1961 entries in *The Encyclopaedia of Islam*, though authored by different individuals, are unanimous in defining hawala as a 'bill' or

[20] Michael Field, "An Island of Mixed Communities," *Financial Times* (retrieved from LexusNexis May 2004) 1983. Famous trading families of such origin are *Kanoo*, Almoayed and the Fakhroos.

[21] Ibid.

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'draft', 'cheque' or 'assignment', by which a transference or claim of debt is made possible[22]—all functions identical to those of hundi.

Boxing hawala into a single category does not adequately convey the sense of hawala. In the early twentieth century, within the context of growing developments in modern banking, technology and regulations, hawala/hundi undoubtedly had modified functions and connotations for Indian merchants and the Indian economy more generally. The nuanced nature of this indigenous banking system (IBS) is captured even in 1899 with Grasshof's analysis of Arab exchange laws; here he recommends caution in the treatment of hawala, emphasising the need to distinguish between hawala as an institution which has been integrated with specific Muslim laws, and hawala's specific meaning for Islamic culture and economic life.

Bei der Abhandlung der hawala haben wir also, um erschöpfend zu sein, folgenden Weg einzuschlegen: zunächst betrachten wir das Institut der hawala, wie es sich, systematisch gegliedert, in dem Kopfe eines bestimmten muslimischen Juristen malt, sehen dann in besonderen Exkursen, welche von der Auffassung dieses Juristen abweichende Ansichten über wichtigere Punkte sich bei anderen finden, und suchen endlich die Bedeutung der hawala für das islamische Kultur—und Wirtschaftsleben festzustellen. [23]

Thus, when examining the havala, in order to ensure thoroughness, we have to follow this procedure: first, we consider the institution of the havala, the way in which it is systematically structured in the mind of a Muslim legal professional. Then we pursue certain issues which will lead us to views on certain points which deviate from those of the Muslim legal professional. Finally, we will at last determine the significance of the havala for the Islamic culture and economy.

The link between hundi/hawala and trade has long been understated; contemporary voices appear to regard the system alternately as a remittance vehicle or conduit for crime. While both aspects of the system are correct, the missing piece is trade. Although there is little contemporary primary research to carry forward the assertion that hundi/hawala's primary function remains trade, there is a considerable body of historical literature which demonstrates that this was a core function right up until the late twentieth century. Again, the extent to which it was used for trade remained uncertain

[22] EI 1927, 1971.
[23] Grasshof, *Das Wechselrecht der Araber: Eine rechtsvergleichende Studie ueber die Herkunft des Wechsels*, p. 15.

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as exemplified by the Indian Banking Commission's 1971 report on Indigenous Bankers:

> Many regarded the hundi as representing a genuine trade bill and not merely an accommodation bill[24], but there is nothing in the face of the hundi to indicate that it arises out of a genuine trade transaction, nor is it supported in most cases by any documentary evidence indicating despatch of goods as is the case with bills of exchange. Hundis perform one or other of these three function, *viz*., they are instruments used to: i) raise money, ii) remit funds and iii) finance inland trade. Because the hundi performs one or other of the above essential functions, it has been used throughout the century for generations and its popularity has not significantly waned.[25]

In his analysis of Shikarpuri and Sindhi merchants, Markovits defines the merchant network as 'a structure through which goods, credit, capital and men circulate regularly across a given space which can vary enormously in terms of both size and accessibility.'[26] Hundi had a unique position within this network; it served first and foremost as credit, but its importance and successful implementation both within and outside the merchant network, lay in its close relationship with goods, capital and the merchants themselves. Hundi wove together credit, goods, capital and the merchants themselves in an extraordinarily cohesive fashion. Largely understated and dismissed in colonial discourses, hundi was not well understood outside Indian merchant communities, and hence its unique institutional character has been shrouded in obscurity.

Historically, hundi has been subsumed within the broader classification of *indigenous banking*. However, even this category has not escaped its share of problems. Within the context of South Asia, the term indigenous banking has always proved notoriously hard to delineate. Jain touched upon this in 1929, when he said that there was 'no legal definition of the term "indigenous banker" available.'[27] In 1931, the Indian Central Banking Enquiry Committee stated that use of the term *indigenous banker* had done a disservice to India. Its statement rested on information collected by the various Provincial

[24] Definition of an accommodation bill taken from Wikipedia: "An Accommodation Bill is as its name implies, is a bill of exchange accepted and sometimes endorsed without any receipt of value in order to afford temporary pecuniary aid to the person accommodated." Retrieved: 24 August 2006, http://en.wikipedia.org/wiki/Accommodation_Bill.

[25] "Report of the Study Group on Indigenous Bankers," Bombay: Banking Commission; Government of India, 1971, p. 47.

[26] Claude Markovits, *The Global World of Indian Merchants 1750–1947: Traders of Sind from Bukhara to Panama* (Cambridge, UK: Cambridge University Press, 2000), p. 25.

[27] L.C. Jain, *Indigenous Banking in India* (London: Macmillan, 1929), p. 1.

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Banking Enquiry Committees, which demonstrated the eclectic nature of agents falling within this broad category. It reasoned, did the name *indigenous* carry any real meaning if 'different types and varieties of bankers and moneylenders engaged in small functions and large functions, mixed up with land, the trade in precious metals, the trade in grain down to peddling' all fell under the single classification?[28]

However, the term indigenous banking, whilst undoubtedly encompassing a large arena, is useful in distinguishing *traditional* banking instruments such as hundi, from the modern or so-called *formal* banking sector. Most commonly described as a bill of exchange, promissory note, letter of credit and remittance vehicle, hundi more accurately is both an indigenous banking system and indigenous banking instrument, although in modern times it is only regarded as a remittance vehicle. Writing in 1960, ironically, Habib distinguished hundi from 'ordinary' bills of exchange on precisely opposite grounds, stating that hundi served as an 'instrument for raising short term credit repayable at another place', but that during the Mughal period 'it was also employed to transmit money from one place to another.'[29]

It seems reasonable to surmise that hundi's dominant function has varied over time, closely mirroring the needs of its agents and their political and economic contexts. In the course of the Mughal era, hundi performed as both the instrument and the system of deposit banking. A hundi drawn by a *sarraf* or *shroff* (money changer or banker) to expedite remittances might very well be considered a deposit accepted by the sarraf. In like fashion, the sarraf was actually lending money when he discounted a hundi.[30]

The chief function of hundi amongst Indian merchants is largely believed to have been its ability to alleviate the need for specie, particularly when travelling across arduous and often dangerous terrain. This was undoubtedly true of the caravan trade where hundi appears to have served primarily as a letter of credit, or bill of exchange. Examining the Shikarpuri merchants' caravan trade between 1750 and 1947, Markovits argues that hundi had particular importance because no other credit instrument was available at the time.[31]

[28] "Indian Central Banking Enquiry Committee, Vol. 1, Pt. 2 Minority Report," Nehru Memorial Museum and Library, 1931, p. 100.

[29] Irfan M. Habib, "Banking in Mughal India," in *Contributions to Indian Economic History I*, ed. Tapan Raychaudhuri (Calcutta: Firma K. L. Mukhopadhyay, 1960), p. 8.

[30] Ibid., p. 17.

[31] Markovits, *The Global World of Indian Merchants 1750–1947: Traders of Sind from Bukhara to Panama*, p. 186.

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However, there are a number of historical texts which illustrate that hundi's function amongst Indian merchants was more varied both within and outside the caravan trade. In the arresting seventeenth-century autobiographical poem the *Ardhakathānak*, the author, a Jain merchant from Jaunpur, describes the use of a hundi which operated rather like a promissory note: 'The hundi against which my father had borrowed money earlier in Jaunpur had now fallen due. I received it and paid out the required sum.'[32]

Hundi in the sense of a promissory note was remarkably ubiquitous, and certainly in the late eighteenth century, commercial agents of the East India Company regularly used to accept 'hoondian on bills granted by the Shroffs', for delivery of cash, which were later payable in silver from the Company treasury.[33] The use of hundis by the British also had the effect of socially elevating Indian trading families.[34] This suggests that the ubiquity of hundis was strongly connected to merchant reputation and vice versa.

Indian merchants frequently served as traders and moneylenders because they usually had access to extremely large pools of capital. In this way, hundis were used to remit funds in the case of the caravan trade, but also to finance other activities either within the host country or countries in which merchant networks had a presence. Hundis could have great reach if ratified by a merchant community of great repute; similarly, the circulation of hundis issued by specific merchant communities served to further the network's reputation.

During the late eighteenth century, there was a sanguine relationship between North Indian merchant capital in the form of hundi and the flourishing of the British East India Company. Hundi transactions were extraordinarily versatile, providing for military and administrative expansion into the rural heartland as well as important towns.[35] Bayly is among those who regard the British administration's later replacement of hundi with district treasury bills as a sign that links between Indian merchants and the British had attenuated. Yet, as we shall see later on, certain historical documents reveal that the British remained dependent on a number of merchant communities

[32] Banarasidas, *Ardhakathanak (1641)*, trans. Mukund Lath (Jaipur: Rajasthan Prakrit Bharati Sansthan, 1981), p. 315.

[33] Accountant Generals' Office correspondence to Earl Cornwallis K. G., Governor General in Council in the Public Department of Fort William, 11th June 1789.

[34] C. A. Bayly, *Rulers Townsmen and Bazaars: North Indian Society in the Age of British Expansion 1770–1870* (New Delhi, India: Oxford University Press, 1983), p. 241.

[35] Ibid., p. 211.

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for trade. District treasury bills never succeeded in replacing the use of hundi amongst Indian merchants.

An undeveloped transport and communication infrastructure across India massively impaired the reach and overall competence of modern banking,[36] perhaps explaining why hundi remained a dominant feature of the Indian economy more generally during the nineteenth century. In the nineteenth century, the hundi system employed its own couriers across the breadth of the country knitting India's domestic economy together through its reliable networks, in a hitherto unparalleled fashion. Some historians rather erroneously believe that the advent of the railway, cable and the telegraph subordinated the use of hundi by the late nineteenth century,[37] yet British colonial government records attest to the continued mainstream use of hundi by Indian merchants well into the twentieth century. In fact, as the accounts below demonstrate, the Government of India had attempted to find ways of replacing the use of hundi within trade on several occasions, with no success.

Hundi Proved Difficult to Substitute

In 1908 the Government of Bombay 'strongly opposed' the suggested adoption of 'a system of exportation of opium in bond' as a substitute for the hundi system. The reason for this considerable resistance was that this alternative bond system was seen to entail 'the payment of a stamp duty at a higher rate than that leviable on a hundi.' It was also found that the exportation in bond would not circumvent the problem of interest lost through the hundi system.[38] There were other more compelling reasons for rejecting the introduction of the bond system: the strength of the hundi system amongst merchants in Bombay, and the system's ability to 'afford protection in transit' whilst

[36] S. M. Dhume, *The Evolution of Banking in India Part II* (Bombay, India: Examiner Press & Publishers, 1926), p. 98.

[37] Rajat Kanta Ray, "Indigenous Banking and Commission Agency in India's Colonial Economy," in *Money & Credit in Indian History*, ed. Amiya Kumar Bagchi (New Delhi, India: Tulika Books, 2002), p. 119; Dhume, *The Evolution of Banking in India Part II*, p. 98.

[38] Correspondence from Lieutenant-Colonel H. Daly, Agent to the Governor General in Central India and Opium Agent in Malwa, to The Secretary to the Government of India, Finance Department, 9th January 1908.

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demanding expenditure which was 'a mere trifle compared with the value of trade'.[39]

Trade between Afghanistan and India reached a virtual standstill when the Afghan government stopped the issue of *exchange hundis* on Peshawar in 1940. Hundi represented the primary form of Indian exchange, since Afghan law prohibited merchants from bringing Afghan or British currency to India from Afghanistan. The precise impact of this on Indian traders and the local economy is described as follows:

> These firms and others, who are dealing with Afghanistan say that money between 15 to 20 Lakhs has been lost in Afghanistan, and that the business has suffered badly because neither are they able to make purchases nor dispense with their servants, carters etc. They also state that if this state of affairs continues it will dislocate the market and lead to the commission of crime because of the unemployment of many people.[40]

In 1945, the Government of India revoked a customs notification which prohibited all legal currency tender, including cheques, hundis and all other bills of exchange, from being brought into British India across its customs frontiers in the east of India and north of Assam, without explicit permission.[41] Correspondence from the Governor of Assam's office to the Finance department sought to highlight the extreme difficulty this would impose on trade within the region between Tibetan and Chinese merchants:

> 3. Hundies and bills of exchange provide these traders with the greatest portion of their purchasing power and almost all larger traders bring such hundies mostly on firms at Kalimpong. It is impossible for these traders to obtain the necessary permission of the Central Government or of the Reserve Bank of India before entering India.
>
> 4. If this order is to be put into force hundies, bills of exchange, Indian coins and currency notes cannot be brought into India and this will stifle 80% of the trade now being carried on, and will create adverse feeling in South East

[39] Correspondence from the Chief Secretary to the Government of Bombay, to the Honourable Agent to the Governor General in Central India, 18th December 1907.

[40] Express letter from the Chief Secretary to Government of the North West Frontier Province, to the Foreign Office in Simla, 15th July 1940.

[41] Cancellation of the customs notification: "Rose, W.A.—Under Secretary to the Government of India to The Secretary to the Governor of Assam, Shillong, 24th April 1945, C. No. 114-Cus. II/45. Sadiya Frontier Tract—Hundies and Bills of Exchange Brought by Tibetan and Chinese Traders Coming via Lohit Valley Route—Prohibition against—Relaxation of," ed. National Archives of India (Simla, India: External Affairs, Central Asian, Progs. nos. 491-X, 1937).

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Tibet and in the long run throttle trade between Mishmis and the Zayuli Tibetans.[42]

Even still, despite its ubiquity and critical importance to trade, hundi's indigenous character and the particular rules governing its usage amongst Indian merchants seem to have marked it as different to other financial instruments. The Madras Income Tax Appellate Tribunal had already defined hundi as an instrument that was written in vernacular languages only.[43] The Indian Negotiable Instruments Act (NIA) passed in 1881 defined hundi as a negotiable instrument. However, it was not affected by the provisions of the act because local usage of instruments in an oriental language was exempted.[44] Yet, on the other hand, exhibits retained by the Reserve Bank of India, and specimens within the 1971 Report of the Study Group on Indigenous Bankers, reveal that hundis were written in English as well. So again, we are left with the unsatisfactory conclusion that hundis were not well understood.

In 1930, the Report of the Burma Provincial Banking Enquiry Committee maintained that hundi was not defined in law, and was moreover 'used loosely in commercial and banking circles to mean a credit document in any language emanating from or drawn upon persons carrying on business according to Indian methods.'[45] The 1971 report on Indigenous Bankers revealed that the Indian government and the modern banking sector continued to find hundis both perplexing and difficult to govern. It also sums up the historical problem of defining this indigenous financial instrument:

> Hundis are, by and large, instruments in vernacular languages and a number of bewildering local usages govern these instruments, though they are inconsistent with the provision of the Negotiable Instruments Act, 1881.

[42] "Letter no. L.30/45 G.S from P. F. Adams, Esqr., Secretary to the Governor of Assam, to The Joint Secretary to the Government of India, Finance Department (Central Revenues), Shillong, the 27th March, 1945," ed. National Archives of India (External Affairs, Central Asian, Progs. nos. 491-X, 1937).

[43] Madras ITAT cases: M. K. A. Chimiaswamy Nadar & Sons 14 TTJ 546; Grahalakshmi & Co. 2 ITD 420, as cited in Dilip Lakhani, *Amount Borrowed or Repaid on Hundi—Section 69D* (Laws4India.com, Lex Infotax (India) Pvt. Ltd. [cited 18 November 2005]); available from http://www.laws4india.com/corporatelaws/commentary/cc/cc5.asp.

[44] Ibid.

[45] "Report of the Bombay Provincial Banking Enquiry Committee 1929–30, Volume I" (Bombay, 1929–30), p. 149.

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Although a credit instrument dating from antiquity, it has never been defined by any authority on banking.[46]

The problem of defining hundi also stems from seeking comparison with European credit instruments and banking facilities. The hundi was rather different to the European bill of exchange because it was used to remit funds and to raise different forms of credit. There are, in fact, many types of hundis; the diverse function of each hundi makes it difficult to squarely apply the usual labels of promissory note, bill of exchange or system of advancing loans. This was compounded by the Indian government's struggle to document hundi usage and enforcement amongst multiple mercantile communities. This complexity is reflected in the Provincial Banking Enquiry Committee reports of the 1930s, which covered regions as far afield as Bombay, Bengal, Madras and Burma.

Despite some differences in name, and customs in banking, in essence North Indian merchant hundi systems appear to roughly correspond with that of South Indian merchants. All merchants had two broad categories of hundi: *demand* or *sight* hundis known as *Darshani*[47] or *Dharsan*,[48] which were payable either straightaway or within a few days of presentation, and *usance* or fixed-term hundis known as *Muddati* or *Thavanai*,[49] whose maturity period might be anywhere between 30 and 120 days. Within these two broad categories, individual merchant communities had a number of other classes of hundis, which differed in terms of the type of bearer or drawee, or goods despatched. Understandably, the rate of interest charged would vary according to the type of bearer. Some merchant communities additionally had broad hundi categories which served either a particular function, such as dowry, or were discharged purely for use within the specific merchant group.[50]

The full range of hundis within key merchant communities, such as the Marwari, Nattukottai Chettiar, Shikarpuri or Multani and the

[46] "Report of the Study Group on Indigenous Bankers" [NMML], Bombay: Banking Commission; Government of India (1971), p. 46.

[47] Ibid., p. 47.

[48] "Burma Provincial Banking Enquiry Committee Vol. 1: Banking and Credit in Burma" (Rangoon, 1930); David Rudner, *Caste and Capitalism in Colonial India: The Nattukottai Chettiars* (University of California Press, 1994), Berkeley, p. 93.

[49] "Report of the Study Group on Indigenous Bankers," p. 47.

[50] Rudner, *Caste and Capitalism in Colonial India: The Nattukottai Chettiars*, pp. 93–94.

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Gujarati shroffs,[51] were so well articulated and implemented that the 1971 report on indigenous bankers observed, 'some of the usages of the hundis are said to give better facilities than corresponding provisions of the Negotiable Instruments Act.'[52] Customs ruling the use of hundis may have varied according to each merchant group, yet irrespective, according to literature on the subject, seldom did a situation arise where hundis were dishonoured.

In fact, hundi/hawala was an institution which served Indian merchants particularly well because it embodied economic and cultural sanctions. Seen from this light, it has explanatory power for understanding how mercantile networks have dominated the business world in India for centuries. In his work on one such successful mercantile community, the Marwaris, Timberg emphasises the need to 're-examine the functions of traditional commercial and social values and institutions as they are used by trading communities in the transition to *modern* forms of economic activity'. He suggests that perhaps these very values and institutions have been responsible for the success of commercial communities.[53]

The IBS was one such institution, more obviously facilitating the mercantile network's access to capital, credit and goods, but with a second equally important function of building on and even enhancing merchant reputations, in a kind of harmonious loop. Family reputation, as described earlier, directly influenced the extent to which a hundi was circulated; widespread circulation or usage of hundi by influential persons strengthened the merchant network's status and increased the merchants' access to capital, credit and goods.

Revising Conceptions of Hundi/Hawala and Informality

To understand exactly how this would have worked, hundi/hawala should be understood as a more formal institution than is commonly understood today. The contemporary labels *informal* or *alternative* applied to hundi/hawala underscore the system's unofficial status; this is a position reflected in India's prohibition of the system today, as well

[51] Key indigenous banking communities as defined in the "Report of the Study Group on Indigenous Bankers," pp. 24–43.

[52] Ibid., p. 52.

[53] Thomas A. Timberg, *The Marwaris: From Traders to Industrialists* (New Delhi, India: Vikas, 1979), p. 16.

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as approaches by regulatory bodies such as the Financial Action Task Force (FATF). These terms indicate the widespread contemporary understanding that hundi/hawala is somehow radically different from modern or so-called formal banking systems. Yet, as the following comparison with modern banking systems demonstrates, this IBS is remarkably similar on a number of important points.

Both hundi/hawala and formal payment transactions share an *obligation to discharge*,[54] but where modern payment systems operate by conforming to a series of regulations and legal instructions, this IBS is regarded as being bound by nothing more than a code of honour and reciprocal trust amongst hawaladars[55] (hawala dealers). This circumstance is quite alien to modern commercial transactions where formalised legal parameters are regarded as essential to safeguarding financial interests and accountability. The label *informal* is, however, premised on a rather narrow conception of trust—a kind of ethical altruism. It is important to distinguish between calculative trust and altruistic trust, where the latter is decidedly more risky than the former. It involves having faith in a largely unknown quantity, motivated by benevolence or idealism. Altruistic trust, we can reason, is much more likely to result in oral agreements which have weak or no penalty mechanisms built in. Calculative trust, on the other hand, is premised on weighing up the costs and benefits of a given quantity, and making a decision based on a number of penalties or fail-safes built into the agreement.

Hundi/hawala networks are typical of mercantile networks in which 'trust is related to expectations about behaviour and has to do ultimately with reputation'.[56] The point about such a reliance on reputation is that it is not premised on altruistic trust, but rather on concrete information flows within given mercantile networks. At their heart such networks would seem to be much more about calculative rationality rather than trust. Or as Greif puts it, 'the

[54] Official terminology obtained from Robert Listfield and Fernando Montes-Negret, "Modernising Payment Systems in Emerging Economies," in *The World Bank Policy Research Working Paper 1336* (Washington, D.C., 1994).

[55] See Ballard, *The Principles and Practice of Hawala Banking*; Roger Ballard, "A Background Report on the Operation of Informal Value Transfer Systems (Hawala)" (2003); El Qorchi, Maimbo and Wilson, *Informal Funds Transfer Systems: An Analysis of the Informal Hawala System*; Passas, *Informal Value Transfer Systems and Criminal Organisations: A Study into So-Called Underground Banking Networks*; Jost and Sandhu, "The Hawala Alternative Remittance System and Its Role in Money Laundering."

[56] Markovits, *The Global World of Indian Merchants 1750–1947: Traders of Sind from Bukhara to Panama*, p. 260.

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observed "trust" reflects a reputation mechanism among economic self-interested individuals.'[57] Of course there is an implicit trust in the mechanism, in other words, that the flow of information will always exist and be accurate. But such implicit trust exists with most modern banking services, where banks or credit card companies trust the information provided by credit reference agencies. These flows of information might also be formally documented transactions.

Another key reason for hundi/hawala being labelled informal is the belief that the system uses minimal[58] or, quite erroneously, no[59] *record maintenance*. At any rate, the high level of *confidentiality* preserved by hundi agents (*hundiwallahs*) or hawaladars makes detailed observations difficult. Scrutiny of some hundiwallah/hawaladar records has demonstrated that agents do maintain records; however, these do not necessarily correspond to western book-keeping methods.[60] Markovits describes how Sindhi merchants often kept written records of merchant behaviour in past transactions.[61] It does not require a great leap of imagination to see similarities between this type of documentation and modern credit reporting agencies.

The whole concept of institutional credibility is based on a form of trust. In modern times, if a company is considered credible, reputation often outweighs mere legality. The question arises, why should a formalised reputation-based mechanism be construed as more informal than businesses which are considered formal by virtue of their legal parameters? Histories of other mercantile systems provide an instructive reference point; Greif analyses the specific agency relations and contractual arrangements that make reputation mechanisms possible. Using documented evidence on eleventhcentury Maghribi traders, Greif concludes that 'private order' economic institutions such

[57] Avner Greif, "Reputation and Coalitions in Medieval Trade: Evidence on the Maghribi Traders," *The Journal of Economic History* 49(4) (1989), p. 858.

[58] Shah Cheema, *Fiducitation: Hawala—Traditional Asian Remittance System* (www.fiducite.com, 2001 [cited March 2005]); available from http://www.fiducite.com/Fiducitations/Fiducitation%20-%20Hawala%20Traditional%20Asian%20Banking%20System.htm; Ballard, *The Principles and Practice of Hawala Banking*.

[59] Cheema, *Fiducitation: Hawala—Traditional Asian Remittance System*; Praveen Swami, "Kashmir's Hawala Scandal," *Frontline* (23 August–5 September 1997).

[60] Roger Ballard, "Processes of Consolidation and Settlement in Remittance Driven Hawala Transactions Between the UK and South Asia" (paper presented at the Centre for Financial Studies and Innovation Roundtable on Hawala, London, March 2003), pp. 3–4; Samuel Munzele Maimbo, "The Money Exchange Dealers of Kabul: A Study of the Hawala System in Afghanistan" (The World Bank, 2003), p. 12.

[61] Markovits, *The Global World of Indian Merchants 1750–1947: Traders of Sind from Bukhara to Panama*.

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as the 'coalition' were established to capture efficiency gains which the market and legal system were unable to secure.[62] This tallies with the modern perception that this IBS exists because of weaknesses in the modern banking sector. However, it goes one step further and demonstrates the formalised nature of trust-based economic relations. Maghribi coalition members conducted business with other agents and merchants precisely because of economic, rather than just social, sanctions implicit within the system.

Hundi/hawala embodied contractual relations, which reduced transaction costs within mercantile networks. Distances breached by a given merchant community, and levels of difficulty involved in obtaining or exchanging either capital or goods, were reflected in hundi/hawala interest rates, which allowed merchants to control supply and demand. If a good or currency was in short supply, hundi/hawala interest rates were likely to have been correspondingly higher. For instance, in the case of the Nakarattars, Rudner writes, 'Nakarattar bankers made collective decisions about interest rates that standardised the cost of credit.'[63] This kind of calculative rationality pervaded all hundi/hawala transactions.

However, cultural sanctions were also strongly in evidence, for instance, more favourable interest rates were usually available for members of the mercantile community.[64] This was consistent with the calculative rationality that members of the network would necessarily be the most reliable borrowers or lenders. In such cases, lower hundi interest rates amongst merchant communities ensured overall liquidity and easy access to capital, as such, borrowing and lending within the network was common. Rudner[65] describes how British attempts to limit the access of small Chettiar firms to credit would have been ineffectual since borrowing amongst Chettiars was so common. In effect smaller Chettiar firms could always borrow from large Chettiar firms. British considerations of insolvency were quite meaningless within mercantile networks.

As an institution that largely has many core qualities in common with modern payment systems, hundi/hawala has been misunderstood because its sanctions and functionality have not been well documented.

[62] Greif, "Reputation and Coalitions in Medieval Trade: Evidence on the Maghribi Traders," pp. 866–868.

[63] Rudner, *Caste and Capitalism in Colonial India: The Nattukottai Chettiars*, p. 95.

[64] David Rudner, "Banker's Trust and the Culture of Banking among the Nattukottai Chettiars of Colonial South India," *Modern Asian Studies* 23(3) (1989).

[65] Ibid., pp. 429–430.

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In his work on the South Indian merchants known as the Nattukottai Chettiars, Rudner highlights that traditionally, legal approaches to hundi have been blindsided by court sanctions and judgements, neglecting the 'considerable negotiability' of this instrument. This, he argues, 'simply ignores customary sanctions on hundi transactions that are rigorously enforced by multilocale, multiregional and even multinational communities of businessmen.'[66]

In addition to possessing the formal parameters of private order economic institutions, this IBS is characterised by many of the elements which the World Bank has classed as qualities required for a payment system to operate efficiently, for example, *payment certainty*, *lowest cost*, *credit risk control*, *reliability*, *record maintenance*, *confidentiality*, and *convenience*.[67] *Payment certainty* is high amongst hundi/hawala users, despite lacking a legal framework. Studies conducted in the last decade reveal that this system of calculative trust seems to extend to relationships between hundi/hawala dealers and their customers. Higher levels of familiarity with customers are believed to positively influence the *cost* of transactions. Whilst the currency exchange conversion rate for payment transactions between South Asia and the United Kingdom is considered significantly more favourable than the rate formal institutions offer,[68] the exact commission charged by hundiwallahs/hawaladars varies from customer to customer. For hundi/hawala agents this acts as a measure of *credit risk control*, militating against the risks of dealing with unknown or little known parties.

In his study of hawaladars in Kabul, Maimbo points out that the cost of transactions is also dependent on the delivery location and the competitiveness of hawaladars within a given location. Differential modes of transaction may be offered, as in the case of NGOs and international aid organisations using hawala to receive funds in Kabul from foreign locations such as Washington, D.C. Such customers use a more rigid confirmation process, particularly given concerns about counterfeit cash.[69] In these instances, the absence of a competent

[66] Rudner, *Caste and Capitalism in Colonial India: The Nattukottai Chettiars*, p. 37.

[67] Official terminology obtained from Listfield and Montes-Negret, "Modernising Payment Systems in Emerging Economies."

[68] Roger Ballard, "Hawala Transformed: Remittance-Driven Transnational Networks in the Post-Imperial Economic Order," Centre for Applied South Asian Studies, University of Manchester, 2004.

[69] El Qorchi, Maimbo and Wilson, *Informal Funds Transfer Systems: An Analysis of the Informal Hawala System*.

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formal banking sector in Afghanistan has made the use of hawaladars virtually indispensable.

Hundi/hawala's processing type is also not alien to modern banking methodologies. It broadly falls under the category of *batch processing*[70]—a methodology which assembles a number of customer transactions for processing and delivery, rather than dealing individually with each transaction from the outset. Nevertheless, hawala is not only regarded as much faster than modern batch-processed transactions but, in many cases, also faster than more *immediate* modern payment processes. For instance, the transfer of funds through hawala from key cities such as Dubai and London to Kabul, can take no more than half a day, or little longer than one day for funds transferred to more remote locations.[71] In this way, like Greif's example of eleventh-century Maghribi traders, hawala/hundi as a 'private order' economic institution has succeeded in capturing efficiency gains wherever the modern legal system and market has been weak.

Approaches to Hundi/Hawala

The Development Angle

The 2005 third international hawala conference[72] underscored two core approaches to IBS: recognising the value of remittances and controlling the system's vulnerability to crime. Development agencies are cognisant of the system's efficiency gains, specifically with reference to the many migrant workers who use the system to remit funds back to the Indian subcontinent (and other locations) speedily and cost-efficiently. Perceived as a corollary to the subcontinent's weak modern banking infrastructure, hundi/hawala is defined as an *alternative remittance system*. Such agencies widely acknowledge the positive correlation between remittances and poverty reduction, and stress the need to view migrant worker remittances as an important vehicle to develop financial services. They have concluded that payment certainty, reliability, cultural convenience and lowest

[70] Listfield and Montes-Negret, "Modernising Payment Systems in Emerging Economies", p. 4.

[71] El Qorchi, Maimbo and Wilson, *Informal Funds Transfer Systems: An Analysis of the Informal Hawala System*.

[72] The Third International Conference on Hawala, Abu Dhabi, 2–3 April 2005.

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cost are factors driving the use of IBS. The United Kingdom's Department for International Development (DFID) also emphasises the gap in efficiency between UK banks and money transmission service providers.[73]

Shifting remittances from so-called 'informal' to 'formal' channels is seen as a desirable objective by development organisations such as the World Bank, Asian Development Bank (ADB), International Monetary Fund (IMF) and DFID. These bodies adopt the line that hundi/hawala is core to countries such as India and Pakistan because they are cash-based economies. The IMF emphasises that systems such as hundi/hawala frequently fill a critical gap in cash-based economies which are usually characterised by limited financial capacity. Premised on this understanding of hundi/hawala, most development agencies have concluded that a broader range of financial services would benefit migrant workers and their families; on a macroeconomic basis, improved savings and investment possibilities are regarded as providing migrant workers with better economic prospects and means for managing financial risk.

However, if, as World Bank studies reveal, hundi/hawala channels are more resilient to financial shocks and function in the midst of crises when all else fails—as with Afghanistan and Somalia—these ideas are questionable. Moreover, part of the appeal of so-called informal systems is the fact that they have much greater access to poorer people than the formal sector has and is ever likely to have. For instance, an independent South African consulting firm[74] found that 50 percent of 27 million South Africans do not have bank accounts, whilst 38 per cent of existing accounts fall in to the low-income category. Meanwhile, a sizeable proportion of South African households—30 per cent - live in traditional dwellings or informal structures, whilst only 44 per cent of the population were found to have formal addresses including postcodes. What is more, since this IBS is cheaper for all point-to-point international payments, this is a market incentive that regulators and development agencies would be hard-pressed to outdo.

[73] "Sending Money Home? A Survey of Remittance Products and Services in the United Kingdom," (London: Report prepared for DFiD and Banking Code Standards Board by NOP World and Profile Business Intelligence Ltd., 2005)

[74] Hennie Bester, "AML/CFT in Developing Countries," in *The Third International Hawala Conference* (Abu Dhabi, 2005).

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The Evils of Hundi/Hawala

In contrast, since 11 September 2001, the ensuing 'war against terror' waged by the Bush administration has sharply focused attention on hawala as a possible funding channel for militant activities. Hundi/Hawala has for some years also been linked to a number of other criminal activities ranging from money laundering and political corruption to illegal trade in body parts. However, a more positive note was struck in relation to the system at the 2005 conference. The Financial Crimes Enforcement Network (FinCEN) sounded a note of caution against 'fixating' only on hawala and 'missing other vulnerable avenues'.[75] British HM Customs & Excise said it did not oppose IBS but highlighted the experience of dealing with criminal money laundering using 'hawala techniques'.[76]

HM Customs & Excise critiqued the FATF—the supranational institution which is responsible for issuing the main legislative and regulatory guidelines on money laundering and terrorist financing: it pointed out that one of the FATF's core problems lay in definition. What, it argued, were correct definitions for *underground*, *illegal*, *alternative*, and *formal*? Pakistan's National Accountability Bureau highlighted the many challenges it faced in regulating hawala, but also emphasised that the system itself was not considered criminal but rather those misusing the system. The FATF too distanced itself from vilifying hawala, indicating instead that the system was *exploited* for criminal use.

Regulators and Their Discontents

These approaches to IBS demonstrate a fundamental problem for regulators: *how does one identify systems such as hawala*? This is a critical question, and one that seriously impinges on the feasibility of applying the FATF's 40 Standard Recommendations and 9 Special Recommendations (SRs), irrespective of their interpretive notes. For instance, the Select Committee of Experts on the Evaluation of

[75] FINCEN, "Panel III," in *The Third International Hawala Conference* (Abu Dhabi: 2005).

[76] HM Customs & Excise, "Panel IV," in *The Third International Hawala Conference* (Abu Dhabi: 2005).

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Anti-Money Laundering Measures—MONEYVAL[77]—expressed a concern with the possible use of *hawala-type* systems for an increase in human smuggling and trafficking, and larger sales of counterfeited goods found in its member countries.

A fundamental problem for most regulators is the lack of familiarity with hawala. FATF-Style Regional Bodies (FSRBs) such as MONEYVAL expressed limited experience with hawala and the difficulty in applying FATF Special Recommendation Six (SRVI). Hundi/hawala falls under the FATF category *Alternative Remittance System* (ARS) and is subject to SRVI. SRVI and its interpretive note emphasises registration or licensing of hawaladars in a bid to increase the transparency of payment flows through remittance channels such as hundi/hawala.

Crucially, MONEYVAL found that distinguishing between so-called formal and informal systems proved arduous. The United States' Financial Crime Enforcement Network (FinCEN) highlighted the complexity involved in identifying which businesses are 'Money Services Businesses' (MSBs), yet another acronym which clouds definition. FinCEN includes money transmitters, cheque cashers, currency dealers or exchangers, issuers, sellers or redeemers of money orders, travellers' cheques and stored value, under the MSB banner. The IMF, on the other hand, includes courier services, bus companies, traders, microfinance institutions and money carried by hand through family and friends as instances of remittance providers.

There is also the difficulty in applying SRVI to different national and regional contexts. It could be said that hawala provides a classic chicken and egg scenario. Which should come first—regulation on the basis of national experiences or national compliance with international standards?

At the conference, HM Customs & Excise advocated risk-based regulation, a form of regulation that lies in evaluating the inherent risks of the problem before taking action. However, the trials in evaluating risks lie at the heart of law enforcement and financial regulators' problems. Since hundi/hawala is badly defined, it still seems to mean different things to different people. Interpol, for instance, drew attention to the differences in hawala usage; it perceived the Indian subcontinent to have a particular problem with invoice manipulation and gold smuggling. Pakistan's NAB acknowledged hundi/hawala's vulnerability to the transit trade in

[77] MONEYVAL is a sub-committee of the European Committee on Crime Problems of the Council of Europe.

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narcotics from Afghanistan. Citing a United Nations (UN) report describing an increase in the cultivation of opium in Afghanistan, the NAB representative indicated that economic incentives for farm opium represented a greater share of the problem than IBS itself. The NAB also emphasised the need for global policing; much of Pakistani criminal money ended up in the UK, which is regarded as a key hub for money laundering. HM Customs & Excise too expressed a concern with the abuse of hawala by criminal cash controllers, whom they had reason to believe were often drug traffickers.

In contrast, at the conference, Nikos Passas offered a trenchant critique of over-regulation. He asked, 'Are we exaggerating the risks of mosquitoes whilst elephant-sized risks are neglected?'[78] Describing many financial controls as 'growing regulatory tsunami', he stressed that whilst regulation of hawala was necessary, rash regulation would drive hawala networks and transactions underground and alienate a number of ethnic groups. He warned that erroneous counter-terrorism regulations would increase economic and other asymmetries, create grounds for more grievances and possibly nurture militant sentiment.

Compellingly, Passas suggested that trade was more vulnerable to real abuse. For instance, closer scrutiny of diamond import/export invoices showed a massive 20–30 per cent extra profit. Similarly, the disparity between global cigarette imports and exports was shown to have averaged an astounding 30 per cent between 1995 and 2000 (according to U.S. duty rates). Passas invited regulators to concentrate the better part of their energies on increasing trade transparency.

This is an important point, and underscores the relevance of a strong irrefutable historical connection between IBS and trade. However, as development agencies and regulators focus on migrant remittances and money laundering, the trade function has been understated to the point of being forgotten. A proper historical understanding of IBS raises the following questions, all of which are critical to questions of policy and regulation: *to what extent is hundi/hawala still critical to trade from, to and within India? What is the relationship between trade using this IBS and crime?*

Not fully understanding, hundi/hawala presents major challenges for regulatory and law enforcement agencies. For instance, how do they accurately identify suspicious transactions? How do they understand IBS records and customer bases? How do they determine methods of operation? Law enforcement agencies such as FinCEN and HM

[78] Nikos Passas, "Fighting Terror With Error? Transcending Fact-Free Policy Making", in *The Third International Hawala Conference* (Abu Dhabi, 2005).

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Customs & Excise must frequently resort to a reliance on certain broad observed patterns of transaction. FinCEN, for example, recognises the existence and use of cash-intensive businesses within close-knit ethnic communities to transfer funds to and from different countries. The conversion of bulk cash to monetary instruments such as money orders, to transfer funds abroad, is also seen as indicative of MSBs, but not necessarily hundi/hawala.

In *Operation Sparkle*, HM Customs & Excise targeted an alleged criminal network,[79] which were believed to be laundering the proceeds of drug trafficking. The Crown attempted to prosecute three individuals for contravening the 2002 Proceeds of Crime Act[80] ; two of the defendants also faced charges of conspiring to launder money of an illicit origin.[81] These two defendants were involved in the rag trade, buying second-hand clothes from a number of suppliers in the United Kingdom; the clothes were then shipped abroad, usually to Pakistan. The defendants claimed that they were carrying out hawala in the course of their garment business, rather than laundering money. The Prosecution asserted that 'money of criminal provenance was introduced into the scheme to fund the purchase of clothing and was later realised when the goods were sold in Pakistan.'[82] The defence had claimed that hawala was carried out to cost-efficiently remit funds for settling invoices pertaining to the garment business. The expert witness for defence also maintained that relationships of trust inherent within hawala networks would make it much more difficult for criminally acquired funds to enter the hawala system. Thus crucially, the prosecution's case depended on demonstrating that the defendants were not in fact using hawala services.

On 1 February 2006, the case was officially dismissed; core pieces of evidence threading the prosecution's case were inadmissible in court. Nevertheless, the particulars of the trial raise a salient question: why would a business opt to use hawala rather than the modern banking system to settle invoices? The expert witness for the defence, Roger Ballard, attempted to clarify the defendants' use of the system; he stated that 'the central purpose of contemporary hawala systems is to

[79] Funds were confiscated from the defendants on 11 November 2003.

[80] *Proceeds of Crime Act*. 2002, accessed: http://www.opsi.gov.uk/acts/acts2002/20020029.htm, February 2006.

[81] *Regina v. Shahid Siddiq, Abid Iqbal, Christopher Hall* (2006).

[82] Prosecution Case Summary (2004).

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facilitate the transfer of value between one currency and another on a global scale.'[83]

Yet, no one has fully identified what the *central* purpose of hawala is today, and this remains a difficult assessment given that the system can operate anonymously and is so hard to identify. The problem in identifying hawala also has implications for development agencies wishing to calculate the size of remittance flows. The figures are large but hopelessly sketchy, and guesswork remains the order of the day. What is known is that inflows to developing countries such as India must necessarily be balanced by flows from developing countries to developed countries. Given that trade for centuries formed the backbone of hundi/hawala, it seems logical that goods or services of value might yet make up the belly of hawala transactions. For instance, according to Passas, hawala transactions might well entail: 'payments for imports; investment funds (in case of restrictions as, for example, in India); services provided overseas but paid for locally; over-invoicing of exports and bogus exports; tax evasion money; proceeds of criminal enterprises, such as cigarette or human smuggling, drug trafficking or any kind of fraud; contributions to militant and terrorist groups.'[84]

Ballard has also drawn on Greif's coalition network theories to claim that hawala is more difficult to penetrate (than the modern banking system) by criminals because of the reputation mechanism amongst hawaladars. He maintains that 'it is in every hawaladar's personal interest to sustain his reputation for probity *vis-à-vis* clients and colleagues'.[85] The old adage *honour among thieves* springs to mind here! There are essentially many levels of probity amongst networks, and many networks, and it is quite unlikely that all hundi/hawala networks are beyond turning a blind eye to a profitable situation or client. Furthermore, since the original hundi/hawala operators were in fact prominent merchant or business communities, is it not entirely

[83] Roger Ballard, "Methods of Account Settlement Utilised by Transnationally Oriented Pakistani Businesses: An Expert Report" (2006), p. 11.

[84] Nikos Passas, *Hawala and Other Informal Value Transfer Systems: How to Regulate Them?* (US Department of State International Information Programs, 2003 [cited February 2006]); available from http://usinfo.state.gov/eap/Archive_Index/Hawala_and_Other_Informal_Value_Transfer_Systems_How_to_Regulate_Them.html. See also Nikos Passas, *Informal Value Transfer Systems and Criminal Organisations: A Study into So-Called Underground Banking Networks* (Netherlands Ministry of Justice, 1999), p. 2.

[85] Ballard, "Coalitions of Reciprocity and the Maintenance of Financial Integrity Within Informal Value Transmission Systems: The Operational Dynamics of Contemporary Hawala Networks," p. 344.

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possible that many of the import and export businesses are conducted by the very same hundi/hawala networks?

The challenge of defining hundi/hawala is by no means straightforward. However, an accurate understanding of the system must yield important benefits to policymakers and regulatory authorities. In this discussion, I have sought to cut through much of the confusion surrounding the terms hundi and hawala to establish that they are essentially the same, and are similarly endowed with a complex range of functions. By weaving together some important historical and linguistic threads, it becomes clearer that both are more accurately described as an indigenous banking system. The term *informal* does not effectively articulate the self-regulating reputation mechanism that lies at the heart of the system. Instead, it links back to colonial administrators' inability to come to grips with a proper understanding of IBS.

This historical tapestry reveals that Indian merchants were the chief indigenous bankers whose trade formed the primary function of hundi/hawala. Contemporary voices are so painstakingly attentive to the system's remittance function, and vulnerability to organised crime, that this connection to trade has largely been overshadowed. There is an implicit assumption that such trade as existed, which formerly made up the life-blood of the hundi/hawala system, has since declined. This assumption has never been validated, and cases thrown up by Customs & Excise for instance are indicative that trade, to and from the Indian subcontinent via IBS, is alive and well. If so, this will have enormous macro- and microeconomic implications, and lays bare fertile terrain for additional important research into the history of Indian trade networks. Such future research will hopefully bridge the gap in understanding why and how private order institutions such as hundi/hawala have evolved, and continue to evolve over time.

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