

# Informal Value Transfer System – Hawala

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***Abstract.** Hawala plays a key role in facilitating remittances, especially those of migrant workers and is an integral part of the international finance system. There was, however little understanding of the concept, mechanism and its impact on the global financial channels. This research effort aims at providing a historical background to its origin, and discusses why it has lasted over the last several hundred years. The paper also presents the operational features that make the system attractive for both legitimate and illegitimate uses and its advantages over formal sector.*

**Key words:** hawala; informal value transfer systems; conventional banking sector; migrant workers.

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Hawala is one of several informal funds transfer systems, facilitating the transfer of funds or value outside the regulated financial institutions, without physical or electronic money movement. Scholars place its origin many centuries ago, in China and Indian Subcontinent, when traders looked for a way to travel, without having to carry large sums, thereby making them less vulnerable to robbery on the Silk Road (Buencamino, Gorbunov, 2002, p. 1).

In a traditional hawala transaction, four participants are required: a sender of the funds, a recipient of the funds, and two hawaladars. For instance, an expatriate worker wishes to send money back home. To do this he goes to an intermediary, the hawaladar, to arrange the transfer. He makes payment in dollars or other convertible currency. The hawala dealer contacts a counterpart in the receiving

country, who makes payment in local currency to the beneficiary (Wilson, 2002, p. 3).

Today, hawala services are found in all continents and most countries. Originally established on the Indian Subcontinent in Asia, the hawala networks have achieved international organization and status, especially with the intensification of transnational migration, in SUA and Europe, in the latter part of the twentieth century (Passas, 2002, p. 37).

When compared to a traditional means of remitting money, hawala seems cumbersome and risky, but there are some reasons for preferring the system today, including (Passas, 1999, p. 29):

- high costs of banking or official channels;
- a lack of easily accessible formal financial institutions in remote areas of some countries (Afghanistan, Yemen, Somalia);

- lack of confidence in the conventional banks;
- delays, in official sector, due to holidays, weekends and time differences;
- lack of efficient banking infrastructure so that the local bank has not the means to send the money overseas;
- rigid/strict foreign exchange regulations;
- to avoid currency reporting controls;
- wide divergence between official and black market exchange rates;
- cultural, political, social reasons;
- illiteracy;
- criminal purposes such as money laundering, terrorism financing, tax evasion, accepted by hawala networks.

Even they consider that economic and cultural factors explain the attractiveness of the hawala system (El Qorchi, 2002, p. 31), we think that the quality of its services is more important in this matter, providing more convenient, faster, efficient and reliable transactions than the formal financial sector. In addition, Harjit Sandhu claims that the informal value transfer systems such as hawala are used by ordinary people for socio-economic and political reasons, anonymity, lack of licensed banking channels, illiteracy and avoidance of local taxes (Sandhu, 2004, p. 13).

Harish Pawani observed, in 2002, on the occasion of the International Conference on hawala, that the system is a real alternative to corrupt official financial sector and a quick, cheaper, efficient, trustworthy and confidential way of transferring funds or other values who operates 24 hours a day, advantages that also make it vulnerable to illegal activities, such as money laundering, terrorist financing, organized crime or drug trafficking (Pawani, 2002, p. 14).

The lunchtime seminar on the alternative transfer systems, January 2003, was an opportunity for John Wilson to argue that the technicalities of the hawala system have been widely misunderstood and misrepresented since the events of September 11. He thinks that most of the people use the system because it is cheaper, faster, reach more destinations and it is more reliable than the formal banking system (Wilson, 2003, p. 1). The author also claims that the motivations for preferring informal transactions are due to convenient black or grey market exchange rates and reliability, based on cultural factors such as family

or tribal connections (Wilson, 2005, p. 3). Professor Roger Ballard, University of Manchester, also enumerates similar advantages of hawala services such as lack of forms, trust, speed of transfer and ethnic solidarity. The hawala networks are entirely based on trust and they are highly efficient, reliable and potentially safer than the formal banking institutions (Wilson, 2003, p. 4).

The hawala system is actually quite simple. The hawaladars work in a range of settings, from curbside stalls and modest offices in South Asia to back rooms and secret locations in Europe and North America (Loony, 2002, p. 2). Some dealers operate with even less, using a table in a tea shop as an office and having little more than a cellular phone and notebook as overhead expenses (Jost, Sandhu, 2000, p. 6).

In this regard, the fees charged by hawaladars on the transfer of funds are lower than those charged by banks and other remitting companies, thanks mainly to minimal overhead expenses and the absence of regulatory costs to the hawala agents, who often operate other small businesses. To encourage foreign exchange transfers through their system, dealers sometimes exempt expatriates from paying fees. In contrast, they reportedly charge higher fees to those who use the system to avoid exchange, capital or administrative controls. These higher fees often cover all the expenses of the hawaladars. (El Qorchi, 2002, p. 32).

The hawaladar's profit usually comes, according to Nikos Passas, from currency exchange rates manipulation, the difference between the street (black market) rate and the official rate of the currencies involved. While they give their clients in the West a competitive rate, they can get an even better rate by selling the hard currency in the black market. The author also reports the case when hawala transfers are combined with gold deals and smuggling operations. He thinks that the main profit is made from the sale of the smuggled commodities rather than from the money transfer service. For instance, hawala dealers commonly transfer the local currency to the United Arab Emirates, where they use it to buy gold, which is then smuggled into India and sold for a profit. Part of the proceeds from this sale can be used to pay the recipients of the hawala transaction, but sometimes the clients may wish to be paid in gold rather than rupees. For this reason, the profit margins

for hawaladars depend greatly upon the price of gold in India (Passas, 1999, p. 15).

According to Buencamino and Passas, the income of the hawaladar comes from charging a commission ranging from 0.25% to 1.25% of the amount involved (from 0.25%-0.65%, according to Saltmarsh (Saltmarsh, 1999, p. 96) and from 1%-5%, according to World Bank (World Bank, 2006, p. 4). Samuel Munzele Maimbo argues that the cost of making funds transfers into and around Afghanistan averages 1% to 2% and the final quotation depends on the negotiating skills of both parties and their understanding of how the market operates. Discounts are offered depending on the volume of the transaction, the relationship between the client and the hawala dealer, the currency of exchange, the security environment in Afghanistan, and also on the destination of the funds (Maimbo, 2003, p. 5). The official financial institutions charge higher fees ranging from 15% to 25% of the amount transferred (World Bank, 2006, p. 135). For instance, in Western Union case, the fee depends on the transferred amount and ranges between \$13, for an amount not exceeding \$50. The maximum amount can be transmitted through Western Union service is \$ 10,000 or Euro equivalent (Banca Transilvania).

Hawala transfers remain fast, generally quicker than any official system, so funds can be collected by recipients in as little as two hours (Fugfugosh Ahmed, 2006, p. 4). This can be contrasted with the week or so (from two to seven days to complete) required for international wire transfer involving official sector, as delays due to holidays, weekends or time differences (US Department of the Treasury, 2003, p. 3). For instance, Western Union Money Transfer services depend on the working hours of the agent in the destination country, on any applicable restrictions, as well as on the service type requested (Banca Transilvania).

The system is more efficient than formal financial transfer channels, partly because of the lack of bureaucracy and the simplicity of the operating mechanism. Just using a phone, facsimile or an e-mail and large amounts of money are transferred around the world, without raising questions or identification from either the remitter or receiver and, above all, without leaving any paper trail. The sender is given a code/password, which is passed on to the

recipient and this is all he must know in order to pick up his money from dealer's counterpart (Vaknin, 2005). Funds are often delivered "door to door" within 24 hours by a correspondent who has quick access to villages even in remote areas (El Qorchi, 2002, p. 32).

The official financial institutions require the receiver to complete a "*To Receive Money*" form with the following information: name, address, phone number, amount expected, sender's full name, country from which money transfer was sent. Both sender and receiver also need to provide valid identification documents. The same steps are also followed by the sender who needs to complete a "*To Send Money*" form with the following information: name, address, phone number, receiver's full name, the country he is sending to, the amount transferee, and the expected city of payment (Banca Transilvania). According to Cheran and Aiken, Western Union and MoneyGram charge higher fees, ranging from 15% to 25% of the amount involved, and under these circumstances they can not represent yet a real alternative to the informal transfer services (Cheran, Aiken, 2005, p. 20).

The minimal documentation and accounting requirements help reduce the time needed for transfer operations. This informal way of transfer operates without leaving any paper trail; there are no contracts, bank statements or transaction records, and yet those who use the hawala networks can move thousands of dollars around the world in a matter of hours. In addition, confirmation and payment are instantaneous, and the entire transaction can be concluded in minutes (Maimbo, 2003, p. 28).

Roger Ballard, one of the academic analysts in this field, argues that the hawala operators frequently relied very heavily on memory, as there was no way in which they could hope accurately to remember all aspects of the increasingly complex transactions in which they were engaged. They also developed their own very elaborate and very private forms of record keeping, which non-specialists were wholly unable to decipher, in order to guarantee the security of their private records (Ballard, 2003, p. 19). A hawaladar in Delhi (Ganguli, 2001), who would not give his real name, claims that all he needs is a good network of trustworthy people and the transfer will be done anywhere in the world (Hong Kong, Johannesburg, New York, Paris), in maximum eight hours. He also

thinks that hawala dealers don't care about where the money comes from, if they are from legitimate or illegitimate sources.

One of the most important features of the system is trust. The international wire transfers through official financial institutions which might involve the client's local bank, its correspondent bank, the main office of the recipient's foreign bank, have the potential to be problematic. So, in at least one instance reported to the experts, Patrick Jost and Harjit Sandhu, money for a large commercial transaction (money being sent from the United States to South Asia) was lost "in transit" for several weeks while trying to conduct such a transaction, and when the bank located the money, was returned to the customer (Jost, Sandhu, 2000, p. 6).

The hawala system is based on credibility and trust between the dealers and their clients, in a relationship that develops over the years, so none of those *involved* can afford to make a mistake. Not only do all partners in the system need to trust each other, but they also need to ensure that no-one in the network will get the network into illegal activities, because that would bring the whole fragile edifice, from which they nevertheless manage to extract a reasonable living, down. Those who are betraying the network of absolute trust know that they and all the immediate members of their family have to face social and commercial ostracism (Ballard, 2003, p. 21). In such circumstances, dealers know that any failure to honor contracts will result in immediate blacklisting, and possible expulsion, from the market (Looney, 2002, p. 2). Hawala system is entirely based on ethnic and family solidarity and depends on absolute trust between the participants, so in order to encourage foreign exchange transfers through their system, hawala dealers may instruct their counterparts to deliver funds to beneficiaries before expatriate workers make payments (El Qorchi, 2002, p. 32).

According to Mohammed El Qorchi, there are cultural considerations encouraging expatriate workers to remit funds through the informal transfer systems. Usually, many expatriate communities are exclusively male, because wives and other family members remain in the home country, where family traditions prevail. These traditions may require family members, especially women, to maintain minimal contacts with the outside world. A trusted hawaladar, known in the

village and aware of the social codes, would be an acceptable intermediary, protecting women from having direct dealings with banks and other agent. In his testimony before a US Senate panel, Rahim Bariek, a hawala agent, said that in Afghan culture the hawaladar is an honest person, with a good reputation and credit and without him people would never be able to send money to their families abroad (Sharma, 2006, p. 112).

Because of language issues and lower social status, expatriate workers may experience difficulties with formal institutions. As barriers of using official channels, Rob McCusker mentioned limited education or even illiteracy (McCusker, 2005, p. 2).

In many parts of the world, especially in the rural areas of the developing countries, informal networks are the only possible means of receiving money from within the country or abroad. There are places where conventional banking facilities do not exist, are terribly inefficient, slow or expensive (for instance, the lack of banking linkages between Australia or SUA and several African countries; also several aid groups funded by the European Commission use almost exclusively informal money transfer networks to transfer funds to some African and Asian countries) (Buencamino, Gorbunov, 2002, p. 5).

The extent of the hawala networks is related to the weaknesses in conventional financial systems, foreign exchange restrictions, or even to political instability. For instance, according to Samuel Munzele Maimbo the hawala dealers in Afghanistan have traditionally provided clients with a range financial of and nonfinancial business services, including:

- currency conversions;
- funds transfers;
- micro-finance;
- deposit-taking services;
- communication facilities (telephone, fax, and e-mail).

Strict foreign exchange regulations, high tariffs and taxes, and currency reporting controls, are the main reasons for the current interest in using the informal money transfer channels. In this regard, hawala services are often preferred by migrants with questionable visa status, because it would be difficult, if not impossible for them to open a bank account as they don't have adequate identification (Jost, Sandhu, 2000, p. 6).

US Department of State claims that the qualities of efficiency, anonymity or lack of paper trail explain the attractiveness of the hawala system for its clients, but they have also attracted individuals and groups engaged in criminal activities such as money laundering, drug trafficking, smuggling or the financing of terrorism (US Department of the Treasury).

Despite all this, hawala remains the most popular informal transfer network because of its components

of trust and the extensive use of connections such as family relationships or ethnic solidarity. Although the great bulk of hawala transactions are harmless, the system has proved to be extremely useful for money laundering or other illicit activities. In this regard, the authorities should, work on ways to further develop the hawala system to meet international rules and regulations that safeguard against abuse.

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