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Research Paper

Taming the Untamable: Rethinking, Regulating, and Revamping *Hawala*

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Abstract: This paper examines the Hawala system, an ancient remittance mechanism enabling money transfers without physical fund movement. Originating from medieval commerce in the Near and Middle East and China's Tang Dynasty, Hawala now handles an estimated \$100-\$300 billion annually, operating in parallel with formal financial systems. Despite its vital role for unbanked communities, especially in South Asia and among migrant populations globally, Hawala is often associated with corruption and illicit activities, with post-9/11 links to terrorism and money laundering intensifying calls for its eradication. This study delineates Hawala's historical roots, unique characteristics, and structure through illustrative examples. It dissects its widespread popularity, exploring geographical prevalence and competitive advantages. Focusing on India, the paper provides a comprehensive overview of Hawala's socio-economic impact and regulatory complexities, advocating for a balanced dual-pronged approach to integrate Hawala into the formal economy without driving it underground.

Keywords:
1. Political economy
2. Global justice
3. Banking
4. Hawala
5. Illicit financial flows
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1. Introduction

In an era dominated by digital banking and instantaneous money transfers, the ancient Hawala system stands as an enigma. An alternative remittance system, Hawala performs the curious act of transferring money without any actual movement of funds. Remarkably, Hawala predates the modern banking era, tracing its roots back to premodern medieval commerce in the Near and Middle East and China's Tang Dynasty (Nakhasi, 2009). Today, the vast scale of Hawala transactions, estimated between \$100 billion to \$300 billion annually, unfolds discreetly, in parallel to the formal financial structures that dominate our modern world (Henry, 2017). A migration-driven surge in remittances further fuels the system's allure, defying any presumptions of Hawala's obsolescence in today's world (El Qorchi, 2004). Notably, countries like India, Pakistan, and the U.S. emerged as key nodes in this intricate network, with India showcasing the system's resilience and its controversial intertwining with 'bad politics' and corruption (Daudi, 2005; Kapoor, 1996).

Yet, it's essential to underscore that Hawala isn't merely an instrument of vice. It operates in a realm of duality: on one side, facilitating terror and illicit activities, and on the other, a lifeline for innocents seeking affordable, speedy transfers. Post the 9/11 paradigm shift, the narrative around Hawala has been marred with vilification, often tying it inextricably to terrorism and money laundering (Teichmann & Wittmann, 2023; Wilson, 2005; Daudi, 2005). While these interpretations emphasize the need to eliminate Hawala entirely as a means to combat illicit financial flows (Malit Jr et al., 2017), they oversimplify the complex reality. This reductionist view fails to capture the nuance of Hawala's everyday functioning, its humanitarian value, and its contributions to global development. It is thus essential to discern between its illegitimate and legitimate uses, a distinction that hinges less on legality and more on the purpose behind the transaction. With this backdrop, our essay aims to transcend the monolithic narrative that paints Hawala solely as a malevolent system. Rather, recognizing its existence as both an unregistered entity and an entrenched financial network, we aim to address its multi-layered impact on global economic health. An unregulated Hawala is a double-edged sword — while it facilitates legitimate remittances, its very nature masks illicit financial flows and fosters tax evasion. Addressing this, we investigate the formidable challenge of taming the untamable i.e., formalizing an entity that, at its core, thrives on informality.

The structure of our essay will unfold as follows: firstly, we will delineate Hawala, navigating its historical roots, unique characteristics, and structure through an illustrative example. Then, we seek to dissect its widespread popularity, shedding light on its expansive geographical prevalence and delving into the driving factors behind its enduring appeal, particularly illuminating its competitive advantages. Furthermore, we take a multifaceted look at the contemporary manifestations of Hawala flows, accentuating its role as an indispensable tool for humanitarian aid, an everyday remittance network for the unbanked, as well as its darker side as a conduit for criminal undertakings. Next, we grapple with the complexities of regulating Hawala, laying out the imperatives for such oversight, and evaluating current global efforts. Acknowledging the challenge of regulating such an inherently informal system, we survey the merits and shortcomings of various approaches, using India as a focal point. In doing so, we argue for a dual-pronged approach, balancing both investigative and public-policy efforts. This essay posits that rather than merely seeing Hawala through a criminal lens, a comprehensive understanding that positions it within the broader socio-economic landscape is crucial for effective oversight and integration into the modern financial realm.

2. Origins and Characteristics of Hawala

2.1. Definition and Historic Origins

At its core, Hawala is an alternative remittance system, offering "financial services, traditionally operating outside the conventional financial sector, where value or funds are moved from one geographic location to another" (Passas, 1999). This description also includes other similar Informal Value Transfer Systems (IVTS) scattered across the globe, each marked by their regional nuances. These systems are efficient, discreet, and often operate around the clock, presenting a unique blend of secrecy and reliability. Their very nature makes them "fast, inexpensive, reliable, convenient, and, most notably, discreet," fostering a sense of mystery for those outside the ethnic communities that rely on them (Wheatley, 2005).

While the West witnessed the rise of its formal banking systems, the historical origins of Hawala predates these by several centuries, finding its genesis in the early medieval commerce of the Near and Middle East (FATF, 2003). Its historic inception can be traced back to the need for Arab traders to safely move their wealth without the physical burdens and perils of robbery on the Silk Road (Schramm and Taube, 2003). The etymology of the term 'Hawala' further underscores its significance. In Arabic, Hawala translates to 'payment' or 'debt transfer', paralleling the Roman 'delegation debiti'. Interestingly, when integrated into the Hindi lexicon, it further acquired the connotation of "trust" – an invaluable attribute that remains a bedrock of the Hawala system (Wheatley, 2005; Jost and Sandhu, 2000). Simultaneously, religious tenets furthered Hawala's acceptance, with Muslims leveraging it to fulfill their religious obligation of almsgiving (Wheatley, 2005)[1].

Entering the modern era, we witness the reshaping of Hawala under various sociopolitical and economic influences. The 1970s, marked by the oil boom in the Middle East, saw a surge in Islamic banks. Additionally, the gold smuggling endeavors between the Middle East and South Asia in the 1960s led Indian and Pakistani expatriates working in the Middle East to rely on Hawala for transferring funds to their families (Wheatley, 2005; Nissman, 2002) describes the South Asians who profited from gold sales utilized the Hawala system to distribute the proceeds. Today, Hawala remains a pivotal instrument within Islamic commercial law, serving both as a mechanism for transferring claims and enabling payments through intermediaries (Redin et al, 2014). Its international ubiquity has even garnered it a quasi-legitimate status in regions like South Asia and the Middle East (Passas, 1999). Thus, as Jost and Sandhur (2000) caution, terms like 'underground banking' may misrepresent these systems; many, like Hawala, function in plain sight, enjoying overt cultural recognition and socio-legal legitimacy.

2.2. An Illustrative Example

The brilliance of Hawala lies in its striking simplicity and the fact that money doesn't cross borders physically, but trust and faith certainly do. Drawing inspiration from Teichmann and Wittmann (2022), Wheatley (2005), and U.S. Hearing on Hawala (2002), we can break down this phenomenon with a real-world example:

> Rajesh, an Indian expatriate working in Dubai, decides to send some of his savings to his family residing in Delhi. His first thought is to use a bank. However, he soon realizes that to make a transaction, he'd need to have a dedicated account. This, paired with charges at the official exchange rate, and potentially extra costs if he opts for courier services, could mean his family wouldn't receive the funds for up to a week. Disheartened by this complicated and costly process, Rajesh remembers a conversation he had with a colleague about a local merchant in Dubai. This merchant, named Ali, not only runs a textiles business but also operates as a Hawaladar (a Hawala-broker). Unlike the bank, Ali only charges a minimal two percent commission and offers a more lucrative exchange rate. To add to the appeal, delivery charges are non-existent. Choosing the path of

[1] The practice of Hawala is not confined to the Middle East or South Asia, and other analogous informal value transfer systems manifested across various civilizations and epochs, such as the hundi in South Asia, defined by L.C. Jain as "a written order... for the payment, on demand or after a specified time, of a certain sum of money to a person named therein" (Jain, 1929). Moreover, in Tang Dynasty China, merchants developed fei-ch'ien, translating to 'flying money', echoing the foundational principles of Hawala (Ballard, 2005; Thompson, 2008). Other analogs include padala and chit in the Philippines and Thailand respectively (Wheatley, 2005; FATF, 2003). Given structural similarities across analogs, our proposals are applicable across these global systems.

efficiency and cost-effectiveness, Rajesh approaches Ali with his $1,000. Ali, with the aid of modern technology, promptly sends a WhatsApp Message to his business associate in Delhi, a fellow textile merchant and Hawaladar named Vivek. In this email, he instructs Vivek about the transaction. Rajesh, in the meantime, sends a previously agreed-upon password to his family. The following day, Rajeshs family visits Vivek, presents him with the password, and in exchange, they receive the converted amount in rupees, after deducting the commission. Astonishingly, the entire transaction is finalized within just 24 hours.

To further shed light on the intricacies of this system, one could look at the real-world account of Rahim Bariek, who testified before the U.S. Senate's Subcommittee on International Trade and Finance in 2001. As per Wheatley (2005), Bariek's Hawala venture catered to 200 and 300 customers in Northern Virginia with remittances ranging from $20 and $400 dispatched monthly to Pakistan, aiding in housing and basic sustenance. Bariek's services also accommodated larger transactions between $1,000 and $5,000, for occasions such as weddings and funerals. His operations were characterized by a five percent commission, twenty-four-hour delivery, and the mandatory password or identification protocol.

2.3. The Features of Hawala

In a Platonic sense, the 'being' at the heart of Hawala's 'form' are fundamental elements that both define and differentiate it from traditional banking structures. Namely, Hawala systems tend to be intricate, international networks, decentralized in nature, and typified by its operations—transfers of money that don't involve the actual movement of money. Such traits not only distinguish Hawala from conventional banking but also set the stage for the competitive advantages it offers, a question we will discuss in a subsequent section (3.3).

2.3.1. Money as a Social Relation

The very essence of Hawala seems to echo the Marxian sentiment: "money is not a thing, but a social relation" (Marx, 1847). Rather than being a mere transactional tool, money, in the Hawala system, is intrinsically tied to trust, community, and social networks. In our example, money is transferred without being moved: the Hawaladar Vivek assumes a debt for another, Ali, leveraging funds that were already positioned in India. Vivek's act weaves him into the expansive fabric of Hawaladars worldwide, a network held together by trust and social ties (Lascaux, 2015).

Interestingly, as the FATF (2003) observes, though theoretically there should be a balance of funds transferred in both directions, one side often dominates. Wheatley (2005) sheds light on this, stating that Hawala usually involves an unequal transfer, gradually offsetting one Hawaladar's debt to another. But this isn't always the case. Hawala can also be woven into broader commercial undertakings. Hawaladars might be entrenched in trade, with the Hawala transaction merely a segment of a grander scheme. Over time, these debts oscillate, and as Looney (2003) describes, Hawala often mirrors conventional banking, where transactions are cleared between units to level the books.

Addressing the eventual clearing of these debts, there are multiple avenues Hawaladars might explore. According to reports of the FATF (2003), they might resort to regular bank transfers, trade transactions, or even the physical transfer of cash. Teichmann and Wittmann (2022) emphasize the prominence of import-export transactions used by Hawaladars. This approach is so prevalent and lucrative that, in some instances, customers aren't even charged for a Hawala's services. Instead, the Hawaladar profits from the foreign exchange rate disparity between the black market and the standard rate. Settling debts can involve strategies like gold smuggling, manipulating invoices, or dealing in precious gems (Wheatley, 2005). Such strategies don't just clear debts; they can also mask the very existence of Hawala transfers. As Lascaux (2015) summarizes: "Hawaladars form cross-border networks and alliances with other informal bankers. They arrange capital flows and counterflows in multiple directions, while simultaneously entering into the multilateral relationships of debt."

2.3.2. A Matter of Trust

Central to the efficiency and reliability of the Hawala system is the incontestable element of trust. As Wheatley (2005) aptly notes, "In the absence of trust, the system would collapse and financial systems based on other principles would fill the void." In this universe of parallel transactions, theft is virtually an alien concept and the transaction points out, rests on a single line of communication and seldom the comfort of written documentation (Johnson, 2007; Looney, 2003). The power of trust within the system is so strong that, as Passas (1996) puts it, asking for formal identification would be considered an affront.

Another lens to scrutinize this trust phenomenon through is one of social control and reputation mechanisms. Each Hawaladar operates in a realm where their business thrives or withers based on their reputation of trustworthiness and competence (Schramm and Taube, 2003; Ballard, 2005; Redin et al, 2014). Looney (2003) points to the dire consequences of broken trust, where community ostracism becomes the Hawaladar's proverbial guillotine. Lascaux (2015) further suggests that Hawala's foundational trust is a manifestation of social control intertwined with community norms, religious beliefs, cultural affinities, and the weight of one's reputation. Hawala's underlying architecture ensures all parties have strong incentives to honor their commitments (Schramm and Taube, 2003). The value proposition is clear: honor your obligations and reap the benefits of an efficient value transfer system; deviate, and face economic exile (Lascaux, 2015). Razavy and Haggerty (2009) argue, though, that while trust and informal sanctions underpin the Hawala's operations, one must be wary of overly romanticizing such arrangements "to suggest that they are unambiguously preferable to the frustratingly alienating encounters based almost exclusively on bureaucratic credentials."

2.3.2. Behind Closed Doors

Hawala's clandestine operations with its minimal or non-existent paper trail poses significant challenges for law enforcement and regulators (Wheatley, 2005). While the Hawala system might not adhere to Western accounting norms, it's a fallacy to believe that it operates in complete anonymity and secrecy. While the system may heavily rely on memory, it is inconceivable that all its transactions remain unrecorded, given their complexity (Ballard, 2005). From the hundi—a promissory note—to encrypted ledgers, Hawaladars maintain records, albeit with their unique practical purposes (Maimbo et al., 2003; Passas, 1999; Keene, 2007)[2]. Martin (2009) rebukes the erroneous belief that Hawala transactions are undocumented, challenging the derogatory tags attached to it as 'informal' or 'unorganized', and suggesting that these arise from a skewed perception that indigenous banking systems are primitive. Importantly though, the intent of these records isn't for external auditors but to keep track of their finances (Redin et al., 2014). Furthermore, Redin et al. (2014) and Martin (2009) converge on the idea that while Hawaladars keep records, their confidentiality levels and unique record-keeping methods challenge conventional scrutiny. Therefore, while the absolute secrecy of Hawala accounting is

[2] An example of a Hawaladar's bookkeeping can be found in Appendix-D of Jost and Sandhu (2000).

a misconstruction, its inherent confidentiality emanates from the principles governing it, making its finances and books largely inaccessible to outsiders – namely, regulators.

3. The Size, Scale, and Survival of Hawala

3.1. Size and Scale

Any attempt to precisely quantify the scale of the Hawala system is fraught with uncertainty. Due to its covert operations and lack of oversight, few definitive statistics exist (FATF, 2019). To begin, the task of measuring remittances and other formal money flows is inherently convoluted. The dynamics of these transfers are so fluid that when external factors come into play there can be substantial discrepancies between reported flows and actual transfers (World Bank, 2023a). There's a substantial underreporting of remittances, given that "[n]ot all small transactions by migrants conducted via money transfer operators (such as Western Union), post offices, mobile transfer companies (like M-Pesa in Kenya) are included in all the countries, neither are informal transfers (such as via friends, relatives or transport companies returning to the origin community)." (World Bank, 2023a) Hence, estimates of remittances are likely to underreported — in particular in the context of South-South corridors — potentially by up to 50% (World Bank, 2011; Irving et al., 2011).

Estimating the total value funneled through the Hawala system annually is even more formidable. The entire Hawala network remains predominantly invisible within countries, resulting in its near-total exclusion from national financial compilations like balance of payments or monetary accounts (Wilson, 2005). The extent of a Hawala transaction's scale is confined solely by the sender's readiness to transport cash and the recipient agent's capability to facilitate the transaction. This flexibility in Hawala transaction's scale, ranging from modest amounts by blue-collar workers to substantial exchanges in the tens of thousands of dollars, further complicates estimations of Hawala flows (Looney, 2003).

While exact figures remain elusive, snapshots from history provide some scale. For instance, Interpol's staggering 1998 assessment posited that India's Hawala dealings, accounting for up to 50% of its GDP, reached a monumental $680 billion. (Looney, 2003; Baldauf, 2002). In 2002, approximately $10 billion of the $14 billion channeled to India was routed through unofficial systems like Hawala (Daudi, 2005). A year later, the General Counsel of the U.S. Department of Treasury acknowledged the global transfer of "tens of billions" through similar systems, underscoring their convenience, affordability, and speed (Kapur, 2003). By 2008, Roger Ballard, a Hawala expert at Manchester University, emphasized the globalization of the world economy, estimating Hawala remittances at a staggering $100 billion (Fifield, 2008). In Pakistan, despite its illegality, the system has been a significant source of hard currency, with estimates ranging from $2 billion to $5 billion annually (Wheatley, 2005). In Europe too, Hawala's dominance is evident among migrants, who rely on it for approximately 90% of their transactions - This system manages an estimated $2.5 billion annually in the human smuggling trade alone, with an additional $390 billion in remittances sent home (Legorano and Parkinson, 2015).

Recent trends in remittances further highlight the scale. By 2021, remittances to low- and middle-income countries soared to an impressive US$605 billion (World Bank, 2023b). Given earlier estimations, a substantial portion of these remittances could very well be funneled through informal channels, including Hawala. Thus, while the exact scale of the Hawala system remains shrouded in mystery, the fragments of data available paint a picture of a mammoth informal financial system. We address the appeal of Hawala in the subsequent section to explain its competitive advantages as a global financial behemoth.

3.2. The Persistence of Hawala

3.2.1. Cost-Effectiveness

In a world of rising transaction costs, Hawala stands out as a cost-effective solution. A report from the World Bank (2023b) highlighted the high costs of sending money internationally, averaging 6%, even with technological advancements. This becomes even more pronounced when considering the 8.8% average for Sub-Saharan Africa. In sharp contrast, Hawala's transaction costs hover between 2 to 5% (Redin et al., 2014), with some regions like Afghanistan reporting even lower fees of 1 to 2%. Wheatley (2005) illustrates this point with a stark comparison: "Western Union charges $22 to transfer $200 from Karachi, Pakistan to New York City. In comparison, a competing Hawaladar charges a mere ten dollars." In certain corridors like Australia-Africa, Hawaladars even offer free services, as noted by Passas (1999). This cost-effectiveness arises because Hawaladars operate on leaner profit motives, have alternative commercial activities, and lack the extensive overheads that banks incur (Teichmann and Wittmann, 2022).

3.2.2. Speed

Time, in many situations, is more valuable than money, and it is precisely here that Hawala shines. Armed with modern communication tools like phones, emails, and faxes, Hawaladars can execute transfers rapidly, often within hours. Wheatley (2005) notes, "Some Hawaladars advertise that they can complete a transfer in two hours, but most do so within two days." Building on our illustrative scenario highlights this efficiency. Rajeev, who chooses Hawala for his transactions, bypasses the usual hassles. There are no banks to engage with, no cumbersome forms to fill, and no waiting period for a bank's courier. A simple phone call to a Hawaladar often suffices. Remittances between major international cities can be accomplished in a mere 6 to 12 hours, with even the more time-consuming rural transactions taking a maximum of 48 hours (Passas, 2005; Maimbo et al., 2003).

3.2.3. Lean and Mean: The Adhocratic Appeal

Hawala has earned its stripes not just because of speed or affordability, but due to its accessibility in places where formal banking systems might be absent. This is in stark contrast to Western-style banking systems, which are often mired in redundant information transfers and storage facilities. As Ballard (2013) aptly puts it, "[hawalas] are distributed systems: just like the internet, Hawala networks can operate reliably on a global scale in the absence of a central registry." It's this lean-and-mean approach that offers these 'branchless bankers' a formidable competitive advantage (Shabib-ul-Hasan & Naz, 2012).

Private financial markets, as observed by the former U.S. treasury secretary, Lawrence Summers, often sideline the impoverished, predominantly because they aren't lucrative clientele (Friedman, 2012). In juxtaposition, Hawala's agility allows its agents to operate anywhere – from the curbsides of South Asia to boardrooms in Switzerland and the USA. For individuals like Rajeev's mother from our example, who might reside in an inaccessible village, a Hawala operator might be her only lifeline to the world of funds transfer, while a bank might still be a distant reality. Hawala's significance extends further when viewed through the lens of banking inclusivity. The Federal Deposit Insurance Corporation (FDIC) classifies those without basic banking facilities as 'unbanked' and those who complement their banking with alternative financial services (like Hawala) as 'underbanked.' Hawala serves these 'underbanked' populations, meeting their financial needs when conventional systems fall short. As the 2002-03 FATF Report (2003) notes, Hawala "may be the sole reliable method available for getting funds to recipients in remote locations or those regions that do not have other types of financial services available."

Hawala bypasses bureaucratic quagmires and red-tape that ensnares many financial institutions. Orthodox banking systems, with their requirement for formal identification or registration, inadvertently exclude those who lack these documents – including those who wish to stay under the radar due to their immigration status. Dean (2015) provides a gripping account of Syrian refugees' reliance on Hawala, driven by the confiscation of their identification in non-government-controlled areas, which leaves them essentially invisible to formal remittance providers. Razavy and Haggerty (2009) elaborate on the cultural contrast between Western and Hawala systems, observing, "... individuals who lack credentials, Hawala is a subtle, culturally specific and appealing local solution to a series of financial dilemmas that flow from this lack of personal identification documents." This potent ability of Hawala to operate devoid of conventional identity markers is rooted in its reliance on a different trust framework than Western financial systems.

3.2.4. Cultural Familiarity

There's an inherent trust that threads its way through the fabric of the Hawala system. This trust, rooted in cultural familiarity, often makes it more appealing and reliable than the impersonal facade of global corporate banking entities. The nuances of culture, language barriers, and even religious considerations underscore the choice of many to opt for Hawala. For workers navigating these challenges in foreign lands, Hawala emerges as the preferred, if not the only, option (Redin et al., 2014).

Ergo, as Wheatley (2005) emphasizes, "in the developing world, Hawala possesses qualities that wire transfers lack." Its operations mirror what the World Bank recognizes as the quintessential elements for a payment system's efficiency, like "payment certainty, lowest cost, credit risk control, reliability, record maintenance, confidentiality, and convenience." (Martin, 2009)

4. The Many Faces of Contemporary Hawala

4.1. Remittances

Migration patterns, especially those traversing the North-South axis, augment Hawala's role as the primary medium of remittance. As Malit Jr et al. (2017) note, the sustainability of Hawala is firmly anchored in the diligent efforts of low-income migrants. For these migrants, sending money back home is not just a financial transaction, but a means to ensure the socio-economic well-being of their families[3]. Hawala has also come to symbolize the preservation of social and cultural ties. The diaspora, living thousands of miles away from their homeland, finds solace in the continuous interactions that Hawala facilitates 2004.

4.2. Humanitarian Purposes

In areas struck by the ravages of war, instability, and natural calamity, formal banking infrastructure collapses, but the decentralized network of Hawala perseveres. Most aid

[3] Dubai is considered the world's de facto clearinghouse for Hawala transactions. The stark disparity in formal financial services between the UAE and the home countries of its vast expatriate labor force inadvertently channels remittances through the Hawala network, further fortifying its importance in the UAE (Wilson, 2005). In lieu of reliable empirical statistics, Wilson (2005) relies on a blend of literature, hearsay, and on-ground conversations to contend that "[t]here is remarkable consensus that the 'degree of Hawala' for inward remittances to Pakistan is very high, and likely is also high for several other South Asian countries."

organizations, as Daudi (2005) points out, lean on this informal financial sector for their international and domestic remittance requirements. The United Nations too hasn't shied away from leveraging Hawala, using it in In countries like Somalia for aid delivery (Houssein, 2005). Thompson (2011) describes Afghanistan's five-year dependence on Hawala for tasks from national elections to infrastructure development. So much so that the “[H]awala is the core of Afghanistan’s financial system.” With limited banking access, most remittances, contributing up to 18% of the GDP, pass through it (Economist, 2020).

4.3. Criminal Purposes

Hawala’s inherent attributes - its trust-based networks, speed, minimal checks, and low costs - are precisely the characteristics that endow it with the potential for misuse in the realms of illicit transactions, terrorist financing, and the evasion of taxes, exchange controls, and import/export duties (Wheatley, 2005). Notably, the FATF underscores the allure of Hawala for criminals. “Familiarity, culture, international reach, ease of use, and speed of transfers make Hawala attractive to money transmitters. Criminals and terrorist financiers are also attracted to the lax supervision, anonymity, and lack of political will enforcing regulations on transaction information” (FATF, 2013).

Money laundering, with its intricate choreography of moving illicitly gained funds through legal avenues, finds a natural partner in the Hawala system. As Wheatley (2005) observes, “money laundering and terrorist financing … regimes rely upon factors that Hawala usually lacks, namely detailed records, registration with the government, and connections to mainstream banking.” Interpol, in its attempt to dissect the money laundering mechanism, has defined it through three distinct phases: Placement – where illicit funds are first introduced into the financial arena, Layering – a process that distorts the source of funds through a myriad of financial transactions, and Integration – the point at which the once-illicit funds are fully absorbed into the legal economy, appearing legitimate (Jost & Sandhu, 2000). Strikingly, the Hawala system effortlessly aligns with these three stages. Funds discreetly introduced into its channels align with the “placement” phase; its natural course of operations, involving transfers, aligns with the “layering” phase; and ultimately, when Hawaladars, who often run parallel legitimate businesses, deposit these funds in banks, they effectively achieve “integration” (Daudi, 2005). The process concludes with the once illicit money appearing completely legitimate, bearing testimony to John Kenneth Galbraith’s notion of disguised truth (Galbraith 1995).

The Hawala system's inherent characteristic of leaving a minimal paper trail positions it as an attractive avenue for terrorism financing by obfuscating the origins and purposes of laundered funds (Wheatley, 2005). The system’s traditional insulation from government oversight and its sparse record-keeping makes it a strategic choice for these groups such as al Qaeda (Landman, 2009). An illuminating case from the Financial Action Task Force on Money Laundering (2003) recounts the use of the Hawala system by terrorist outfits. Funds from international smuggling meant for a terrorist organization were laundered through the bureau, and its significant cash reserves were tapped into by the terror group. Such incidents paint a concerning picture of how informal money transfer systems can be manipulated by terrorist groups.

However, it is essential to approach this subject with nuance and care. As Wheatley (2005) accentuates, while some Hawala transactions might cater to illicit activities, the overwhelming majority remain legitimate. In this same vein, Passas (1999) warns against the danger of sensationalizing the misuse of IVTS like Hawala. He suggests that it's imperative not to be led astray by atypical cases that gain media spotlight. Instead, Passas stresses the need for solid evidence before formulating stringent policies, which might inadvertently jeopardize innocent people's privacy and malign cultural traditions. He goes on to explicitly state: "IVTS do not represent a money laundering or crime threat in ways different from conventional banking or other legitimate institutions. While criminal entrepreneurs do make use of IVTS, it appears that the amounts involved represent a rather small part of the dirty money in circulation" (Passas, 1999).

Much of the post-9/11 literature on Hawala's supposed criminality may be superficial and fraught with inaccuracies (Passas, 2003; Viles, 2008). By 2005, several experts believed that concrete evidence linking IVTS to modern terrorist organizations was scarce (Cheran & Aiken, 2005; Viles, 2008). However, as highlighted by Wheatley (2005), a lack of extensive evidence doesn't completely rule out illicit activity. A sizable minority of Hawala transactions might still be employed for nefarious purposes.

5. Regulating Hawala

5.1. The Imperative to Regulate Hawala

The Hawala system poses a significant policy challenge in today's globalized economic landscape. The dilemma stems from the necessity to achieve two simultaneous objectives: harmonizing economic aspirations and implementing robust AML/CFT (anti-money laundering/countering the finance of terrorism) mechanisms. The urgency to harmonize and formalize the system emerges from two paramount concerns: the economic necessities and the imperative to curtail criminal behavior.

5.1.1. Economic Necessity

At the heart of the economic concern lies a structural issue: the lack of transparency inherent to Hawala. Nakhasi (2007) articulates this, pointing out that the efficient capital markets theory predicates market prices on the availability of comprehensive information. In essence, this theory suggests that for capital markets to function optimally, all pertinent information should be accessible to stakeholders. The Hawala system, with its characteristic absence of formal records and regulations, inherently creates information gaps. Such gaps not only skew the market's perception of global economic health but also place the entire system on precarious grounds, threatening to undermine global economic stability in the long run.

The challenges posed by Hawala aren't just theoretical; they have real-world implications. Wheatley (2005) underscores the enigma that Hawala represents for financial auditors and law enforcement. This invisibility poses fiscal challenges as governments find themselves handicapped, unable to tax transactions they cannot identify or regulate (Johnson, 2007). Moreover, the ramifications of this unregulated system extend to both sender and recipient countries. Maimbo et al., (2003) highlight the fiscal implications, emphasizing that informal funds transfers remain outside the purview of the formal banking sector, thus escaping conventional taxation structures. This not only deprives governments of potential income but also indirectly impacts the formal financial sector, which loses business to its underground counterpart.

Further complicating the economic landscape is the influence of Hawala on broader monetary policies, with these informal transactions significantly altering the composition of broad money (Maimbo et al., 2003). By influencing the supply and demand for foreign currency, Hawala transactions have the potential to sway exchange rate operations.

5.1.2. Deterring Illicit Activities

As argued above, Hawala, inherently, does not exclusively support illegal transactions. However, the absence of malevolent intent does not exempt it from scrutiny or from the critical need for oversight. It is imperative not to allow the Hawala system to function as an unchecked playground for potential malefactors. Nakhasi (2007) draws attention to a critical concern: the system's secretive essence has rendered the unregulated Hawala an attractive avenue for money launderers. The very attributes that make Hawala a lifeline for many, such as its rapidity and discretion, simultaneously transform it into a haven for those with nefarious intentions. Furthermore, a tepid regulatory stance can send a misleading message. As Waterson (2013) points out, inadequate regulation can be perceived as a tacit endorsement, leading criminals to believe that they have a free pass to indulge in illicit activities due to the lack of stringent enforcement and penalties.

Regulation, however, is not without its own set of challenges. Passas (2005) elucidates that an ill-conceived regulatory framework could cause the underground to further recede into obscurity, adopting even more clandestine informal value transfer methods. The repercussions of such a shift are manifold: diminished transparency and traceability; attenuation of the positive economic impacts of remittances; more costly remittance channels for expatriates; undue penalization of legitimate participants; augmented financial burdens on immigrant families; and, critically, the alienation of vast population segments whose cooperation is indispensable in the fight against terrorism. Johnston (2005) adds that for regulation to be effective, it must offer tangible benefits that outweigh the perceived cost i.e., the regulations must be "incentive-compatible." A salient example of the consequences of regulatory missteps is provided by the Afghan central bank's experience in 2018. Under international pressure to ensure transparency in the Hawala system, the bank introduced measures that restricted traders from holding deposits and making loans. The mandate to collect comprehensive customer documentation was also imposed. However, instead of ushering in a new era of transparency, these measures sparked a massive backlash. Hawala traders, seeing their business threatened, went on strike. Their collective action underscored the significance of the system; as one scholar remarked, "shutting down Hawala markets would paralyse the economy" (Economist, 2020).

5.2. Caveats

Before evaluating any regulatory measures, we must discuss some critical caveats. Beyond the sheer economic and crime control rationale, the regulation must respect equity, face practical enforcement challenges, and most critically, address the moral and cultural nuances of the Hawala system.

5.2.1. A Holistic Approach

For starters, the dialogue surrounding Hawala has often been dominated by a focus on AML/CFT. However, casting a blanket of suspicion over Hawala based solely on this narrow viewpoint can be problematic for two reasons.

At its core, Hawala is a deeply entrenched socio-political norm, and any attempts at regulation need to acknowledge its intricate web of social relevance. By disproportionately spotlighting Hawala's association with illicit activities, regulators risk sidelining its predominant use for legal, non-criminal endeavors. Such an approach, albeit well-intentioned, can inadvertently perpetuate a black market of sorts, allowing unregulated Hawala transactions to persist. Hawala is as susceptible to misuse as any other financial institution (Passas, 2006). Looney's (2003) perspective further contextualizes Hawala's essence, emphasizing that it primarily remains an economic entity, with or without the tangential issues of terrorism financing, drug trade, or money laundering. Thus, limiting the lens to AML/CFT can potentially cloud our perception of Hawala's broader societal significance.

Secondly, Hawala is a cog in the wheel but not the wheel itself. When it comes to criminal undertakings, Hawala is but a conduit, a consequence following a primary illicit act. While Hawala itself might be deemed criminal due to its opacity, it's crucial to understand that it's not necessarily the root cause of these unlawful endeavors. Consequently, regulating Hawala solely from a criminality perspective can be likened to addressing the symptom rather than the ailment. Redin et al. (2014) echo this sentiment, arguing that Hawala isn't the magic bullet against organized crime. Criminal funds might flow through Hawaladars, but they equally traverse other conventional financial mechanisms. Moreover, as Wilson (2005) discerns after an in-depth analysis of balance sheets and the Hawala model, economically, Hawala's modus operandi is reminiscent of many other payment methods, particularly international remittances. The perceived difference between Hawala and these other mechanisms lies predominantly in their institutional versus informal channels.

In essence, a more nuanced, informed approach to regulating Hawala recognizes its multifaceted existence and can mitigate the risks associated with money laundering, and tax-evasion due to absent accountability.

5.2.2. Equity

Hawala fills the void between rich and poor, developed and underdeveloped regions, and more importantly, caters to a segment often overlooked by conventional banking systems due to their perceived lack of economic appeal or system overloads (Redin et al., 2014). A blanket, heavy-handed approach to regulating Hawala might seem progressive but comes with its own perils. After all, it is primarily the economically vulnerable who flock to Hawala, attracted by its cost-effectiveness and speed (Looney, 2003). Over-regulation risks not only alienating this group but also impeding essential humanitarian services that prefer Hawala's pragmatism over traditional channels.

The IMF, emphasizing the importance of remittances, especially for migrant workers, warns against painting all informal funds transfer systems with the same brush (Johnston, 2005). Such a perspective becomes even more relevant when considering the World Bank's estimation, which places informal remittances at par with half the volume of the formal sector.

5.2.3. Moral and Cultural Imperatives

Regulating the Hawala system raises profound moral and cultural questions that deserve careful exploration. Delston (2014) ponders the moral question of consent when he questions the legitimacy and obligations of global actors to enact financial laws to prevent terrorism. Furthermore, the West's response to Hawala has been largely shaped by fear and mistrust, intensified by the “secrecy and opacity” enveloping Hawala and often overlooks the deeply-rooted moral and cultural context within which Hawala operates. The moral legitimacy of Hawala isn't a derivative of Western perspectives but arises from its intrinsic goals, operational methods, contextual circumstances, and the eventual outcomes of its transactions (Redin et al., 2014). By elevating Western banking to a pedestal of legitimacy, there's an inadvertent, yet palpable, sidelining of Hawala as a legitimate alternative (De Goede, 2003) touches on another layer of this discourse. This kind of Eurocentric myopia not only marginalizes Hawala but also disregards its historical significance and socio-cultural resonance. Additionally, Western regulatory models, shaped by and for Western financial systems, might be ill-suited for IVTs like

Hawala (Keene, 2007). A regulatory approach designed without an appreciation for Hawala's cultural nuances is doomed for misalignment.

5.2.4. Enforcement and Practical Challenges

Johnson (2007) aptly points out the glaring inadequacy of traditional anti-money laundering platforms: they do not tackle the foundational reasons that make Hawala so appealing and internationally accessible. The unique operational modality of Hawala inevitably stymies conventional monitoring efforts. Addressing illicit financial flows through such informal channels demands more than just a replication of existing anti-money laundering measures. We need to look beyond conventional tactics, like due diligence and suspicious activity reporting. Keene (2007) elucidates this by highlighting the importance of acquainting oneself with the intricate inner workings of Hawala and rallying the support of its key players. The intent behind any regulatory move should pivot towards enhancing transparency, thereby facilitating investigative endeavors. Yet, it's crucial to underline that the Western regulatory model, often flaunted as paragons of efficacy, might not resonate with the ethos of systems like Hawala.

In essence, if we are to usher Hawala into an era of transparency and minimize potential abuse, our efforts shouldn't be directed toward constricting the system itself. Instead, it should be directed at comprehending and, if necessary, regulating the methods through which Hawala operates.

5.3. The Case of India

The Hawala conundrum is especially profound in India. Despite being effectively outlawed, Hawala persists in India and remains part of the transnational financial pipeline and shapes the Indian economy and polity (Passas, 2005). The Interpol estimated that in 1998, the money involved in India's Hawala system amounted to a staggering $680 billion—equivalent to 40% of the country's GDP at the time (Wheatley, 2005; Baldauf, 2002). This demand for Hawala is driven by a mix of political-economic conditions, a general distrust of formal financial sectors, and the allure of gold markets (Johnson, 2007).

Since the early 1970s, the Indian government has sought to curtail this shadowy monetary system (Daudi, 2005). Yet, even with legislation banning Hawala transactions, it remains a “routine transaction” for many, indicating a palpable disconnect between law and practice. But despite the regulations and stringent laws against it, Hawala remains deeply entrenched in India's financial landscape. The network has been exploited for funding insurgency in regions like Kashmir and enabling groups like Al Qaeda to transfer funds to collaborators in Pakistan. “It's certainly not in the interest of my country to encourage Hawala. But for politicians and criminals, it's a handy tool,” notes Jyoti Trehan, Inspector General for the Punjab Armed Police and an expert on underground banking in India (Baldauf, 2002).

An analysis of India's regulatory efforts against Hawala reveals an intricate interplay of policies, politics, and public interest. In the 1990s, a paradigm shift occurred as the Indian government aimed to reduce Hawala's appeal. They introduced liberal economic reforms, including the establishment of floating exchange rates and a relaxation of gold restrictions (Passas, 2003). The lifting of the ban on importing gold and silver, for instance, resulted in a significant decrease in the smuggling of these precious metals, subsequently reducing the proceeds from their sales used in the Hawala system (Passas, 1999). However, economic liberalization wasn't the sole strategy employed. To foster transparency and oversight, the government introduced the India development bond scheme and the foreign remittances (immunity) scheme, aiming to legitimize money entering the country, even if its origin was dubious. These measures effectively converted illicit ‘black’ money into ‘white’, and unsurprisingly, some of the major contributors to these schemes were influential politicians, businessmen, and professionals (Passas, 1999). The sheer volume of transactions, compounded by the inability to differentiate between legitimate remittances and illicit funds, rendered record-keeping almost redundant. Adding to the complexity, many on the list included government officials, making the initiative a potential political minefield.

Further policy shifts throughout the 1990s included India's revised stance on foreign exchange regulations. In an epochal move, the government introduced a "no questions" policy related to residents' foreign exchange holdings. This policy reform potentially paved the way for the simple financial settlement of Hawala balances, which, as evidence suggests, did take place (Wilson, 2005).

The legal framework concerning Hawala in India has been continuously evolving. The Prevention of Money-Laundering Act of 2003 mandated Hawala brokers to keep detailed transaction records and introduced the suspicious transaction report (STR) system to enhance oversight (India Code, 2003). More comprehensively, India introduced the Financial Exchange Regulation Act (FERA) followed by its consolidated form, the Financial Exchange Management Act (FEMA), both of which explicitly prohibited "Hawala-type" transactions (Maimbo et al., 2003). Under these regulations, only specified institutions could deal with foreign exchanges, and specific transaction types were closely defined. The very wording of FEMA directly addressed Hawala by prohibiting certain types of financial transactions linked to foreign asset acquisitions. FERA went further, with sections outlining strict legalities around the Hawala market and imposing rigorous licensing requirements on money changers (Daudi 2005). While these laws are stringent on paper, the on-ground reality showcases the resilience and adaptability of the Hawala system. The assertion that even the most stringent regulatory frameworks might fail to curb Hawala transactions, especially given the evident corruption in Indian politics, underscores the scale of the challenge (Daudi 2005).

The Jain Hawala Scandal of 1991 is a stark example of the intertwingling of Hawala with political corruption and the pitfalls of the investigative process[4]. The very nature of Hawala, combined with political interference, makes regulation extremely tough. As Daudi (2005) aptly puts it, India's regulation of Hawala is an example where even the most stringent provisions might prove ineffective.

5.4. Two Models for Hawala Regulating

5.4.1. An Investigative Approach

An investigative approach towards regulation would target the criminal acts directly instead of merely controlling the hawala channels themselves. The US model for regulating informal financial systems such as hawala is instructive, particularly the USA PATRIOT Act of 2001. This legislation amended the Bank Secrecy Act to recognize “informal money transfer system[s]” like hawala as financial institutions (Wheatley, 2005). As per this act, such informal systems must now register as “money transmitting businesses.” Furthermore, the act also criminalizes the conscious transfer of funds derived from or intended for crimes, encompassing acts of terrorism (Office of the Federal Register, 2001). From December 2001 to 2003, there was a significant

[4] The Jain Hawala controversy surfaced when the Central Bureau of Investigation found account books while investigating a case tied to the funding of militants in Jammu and Kashmir. These books implicated India's elites, including the then Prime Minister, P.V. Narasimha Rao, for accepting illicit payments via Hawala (Kapoor, 1996; Baldauf, 2002). After the discovery of evidence in R.K. Jain's home, there were allegations of officials being pressured to overlook implicating evidence against politicians and instead focus solely on terrorists. Those who resisted these pressures faced consequences even losing their jobs. In the end, charges against the majority of implicated politicians were dropped (Baldauf, 2002).

surge in registrations. By 2008, the number of registered hawala dealers reached over 40,000, with these businesses now mandated to maintain records and adhere to "know your customer" rules equivalent to traditional banks (Fifield, 2008). Similarly, the FATF issued a Special Recommendation in 2001, aimed at increasing transparency in these systems and introducing oversight (FATF, 2003).

However, investigative approaches by imposing quasi-regulation on a system that inherently resists it presents its own set of challenges. The continued existence of many unregistered money remitters indicates loopholes in the system, and hawaladars circumvent registration requirements for IMVT services by rebranding themselves as non-profit organizations (FATF, 2003). Even those operating within the regulatory framework, like registered hawaladars, are mandated only to file Suspicious Activity Reports, leaving room for potential illicit activities (Wheatley, 2005).

Nakhasi (2007) posits that hawala transactions primarily gain value when converted to cash, suggesting a pivotal relationship between hawaladars and mainstream banks. This connection could be the hawala system's vulnerability, offering rich investigative opportunities. Echoing this, Patrick Jost's testimony emphasizes that money entering the U.S. via hawala is largely static until converted to a widely accepted form (Yousef, 2002). Nakhasi (2007) then advocates for bank investigators to diligently monitor unusual banking activities, such as heightened deposit activity or outgoing transfers to major financial hubs. Distinctive deposit patterns of hawaladars might also provide leads (Jost & Sandhu, 2000). The implementation of Anti-Money Laundering measures in the UK and USA resulted in several hawaladar convictions. Yet, as Passas (2007) points out, these rarely led to identifying terrorists or drug traffickers, undermining the intent of these regulations. Similarly, while FATF states that many jurisdictions have criminalized terrorist financing, few report actual convictions.

Additionally, such measures may deter illegal activities but do not diminish the economic attractiveness of hawala (Daudi, 2005). The hawala's inherent features, like vague paper trails and limited interaction with mainstream banking, can render some investigations fruitless – a challenge not just in India, but globally. Furthermore, investigative measures largely treat Hawala as a Western financial institution, which it decidedly is not (Razavy and Haggerty, 2009). While the operations of hawala in remitting countries might primarily face legal issues concerning registration or licensing, in receiving countries, the challenges compound. Here, potential clashes with exchange control regimes can further muddle the waters, dovetailing into broader concerns about the black market and underground economies (Wilson, 2005).

Despite external pressures, many argue that the hawala system possesses intrinsic self-regulation. Hawaladars often serve specific communities, forging personal ties that make identification easier without demanding formal documents (Ballard, 2005). These personal bonds mean hawaladars are better positioned to assist authorities in hunting major criminals, provided authorities respect the legitimacy of their operations. Keene (2007) reiterates this point, emphasizing the trust basis in hawala. Hawaladars, he contends, have a deeper familiarity with their clients than traditional bankers. This personalized approach enables them to better scrutinize suspicious transactions. As Martin (2009) suggests, the reputation mechanism intrinsic to the hawala system shields it from criminal infiltration. However, self-regulation isn't foolproof. Although Soudjin (2015) and Passas (2004) provide hawalas with indications to identify criminal transactions, these are not enforceable.

Other regulatory attempts go beyond individual scrutiny, focusing on disrupting hawala’s overall efficiency. Levitt (2007) and Viles (2008) emphasize “targeting key nodes” and pressurizing “chokepoints” for funds transfers. This pressure tactic aims to constrict criminals’ operating environment. However, Ballard (2005) asserts that overly zealous AML/CFT procedures detract from tracking substantive offenders, inadvertently leading to scapegoating while the real culprits escape. Aggressive crackdown ignores the humanitarian aspect and implementing standard AML/CTF rules in informal settings might hamper economic development and poverty reduction initiatives (Passas, 2006b).

Yet, as with any investigative challenge, the success of these efforts depends on a global approach and the adaptability of strategies to regional and local nuances. Financial control will be effective only if trade transparency parallels it (Passas, 2005). Outcasting could be a method by which international bodies and governments exert economic pressure on jurisdictions to encourage them to adopt statutory and regulatory standards for AML/CFT regimes. However, the inevitable presence of outliers, accompanied by moral and socio-political barriers, weaken this mechanism Jurisdictions can superficially enact AML/CFT legislation and claim compliance with international standards (Bowers, 2009). Inconsistencies in regulations provide hawaladars with loopholes, enabling them to shift their transactions to jurisdictions with weaker regulations, thus circumventing more stringent regulatory environments.

5.4.2. A Public-Policy Approach

Rather than imposing broad-based investigative regulations, it's more effective to mold policies based on conditional incentives. These incentives are deeply rooted in regional realities such as inefficient infrastructure, lack of comparable alternatives to hawala, and a global lack of coordination in tackling the challenge (Passas, 1999). Viewing hawala as an “economic phenomenon” influenced by demand and supply necessitates altering the economic landscape to reduce its appeal (Wilson, 2005).

The inadequacies of the formal sector, especially in countries like India, are exacerbated by burdensome bureaucracies, over-regulation, and a lack of public confidence in banking systems (Passas 1999). Hawala thrives where formal banking is absent or weak, and a robust, competitive private banking system can reduce hawala's allure (Maimbo et al., 2003; Nakhasi 2007; Looney, 2003). Notably, India is experiencing a shift with platforms like UPI and e-banking, promoting financial inclusion and growing trust in banking since the 1980s. While the upsurge of formal banking mechanisms is commendable, it cannot overshadow the intrinsic importance of financial inclusion. Martin (2009) underscores this by explaining how a profound understanding of traditional systems like hawala leads experts to a common conclusion: diversifying financial services invariably benefits migrant workers and their families A revamped financial architecture can lower transaction costs and elevate transparency, offering swift, affordable, and reliable services in developing regions (Kapur, 2003). Microlending platforms also have the potential to counteract informal sector incentives due to their alternative availability to mainstream banking, cultural familiarity, affordability, and offered anonymity (Bowers, 2009). State strategies should offer regulated banking alternatives aligned with global standards to boost confidence in conventional banking, including adopting standardized Know-Your-Customer procedures (Johnson, 2007).

Furthermore, liberalizing economies and adopting policies like lower taxes on remittances, floating currency rates, and a more relaxed approach to currency regulations and interest rates can counter the very conditions that sustain hawala (Wheatley, 2005). Building on this, shifting more financial activity into the formal sector can significantly benefit countries like India (Johnson, 2007). The logic is simple: More assets and revenue within the formal sector can amplify a nation's lending capacity. While individual incentives might not catalyze radical changes, the broader socio-economic benefits can be substantial.

The enduring popularity of Hawala largely arises from its lack of significant competitors, suggesting it will remain dominant until such competitors emerge (Wheatley, 2005). A notable emerging rival is Western Union, which, through a strategic alliance with the Indian national postal service, has transformed money transfers in India. This collaboration led to a pioneering International Money Transfer Service via post offices, enabling money remittances from nearly 195 countries to India (India Post, 2019). By 2011, it recorded transfers of USD 6.5 billion across 7,000 postal locations (Economic Times, 2011).

Mobile Money platforms like Remitly, M-Pesa, UPA, and Orange Money are reshaping the landscape of financial transactions. Mali (2019) accentuates the need to invest in the technological aspects that bolster the digital services of the formal sector, making them equally efficient and decentralized, akin to Hawala. The exponential rise of mobile money, especially in regions like the Middle East and Central Asia, attests to its demand and efficacy. The affordability of mobile banking striking: sending $200 using mobile money costs an average of just 1.7% of the transaction amount compared to banks which have an average cost of 11.8% (World Bank, 2023b). Mobile money, owing to its speed, is more prevalent than physical cash in regions like Somalia (Economist, 2020). However, for this system to thrive, it requires synergy between service providers and the government. The World Bank (2023b) underscores that the potential growth of mobile digital money faces hurdles due to regulations aimed at thwarting money laundering and terrorist financing. For costs to remain low and services to be accessible, competition must flourish in both sending and receiving nations, and regulations must facilitate, not stifle, this growth. India’s example demonstrates an aggressive push towards digitization witnessed the birth of initiatives aiming to foster a transition from cash to digital payments. These efforts were bolstered by the bold, yet economically-dubious, move of demonetization in 2016, signaling India's determination to tackle corruption and promote digital transactions (Saraf, 2022).

Yet, even public-policy approaches for regulating hawala are fraught with challenges. Nakhasi (2007) illuminates how the inherent nature of hawala, combined with risks tied to privatization, creates daunting obstacles to the success of these formalization efforts. Complying with banking regulations might open banks to civil liabilities and introducing regulatory measures can escalate the costs associated with background checks in countries like India. Alternatives to hawala might not address the customers' need for anonymity or the efficiency and reliability that hawala offers. However, the digital age has made financial services like digital banking almost instantaneous and reliable. Although they might lack the trust associated with hawala, the global confidence in banking systems is growing. Initiatives like the National Mission for Financial Inclusion and platforms like UPI in India are bridging the accessibility gap. Alternatives also placate religious concerns, with the rise of Islamic banks ensure compliance with Sharia Law and regulatory norms.

5.4.5. What’s Next?

A two-pronged approach emerges as a robust strategy. On one hand, there's the push towards driving financial activities into regulated channels, and on the other, a focused investigation on those hawala operators who remain beyond oversight. The ultimate goal should be to foster a sense of supervision without pushing hawaladars so far that they feel compelled to retreat into the shadows (Passas, 1999; Watterson, 2013). Johnson (2007) notes, “The lower the amounts of money hawala operators handle, the more difficult it is for them to make multiple financial deliveries or to handle large financial deliveries.” The cyclical compounding effects of reduced money flow through hawala systems can change the very nature of Hawala. With less money flowing through Hawala, operators may find it challenging to keep the system operational as they would have to settle debts among themselves more frequently. This in itself could be a deterrent for using hawala for illegal financial transfers, gradually steering users toward formal banking systems that are more transparent and regulated.

However, while these strategies present a pathway to controlling the unchecked flow of money through hawala, an absolute resolution seems elusive. These systems will continue to exist and even expand as long as people find reasons to prefer them over formal financial systems (El Qorchi, 2004).

6. Conclusion

In addressing the intricacies of the Hawala system, it's clear that regulating it is not just a matter of legality or cultural understanding, but also a pressing issue for global security. The dual approach of enhancing state-backed remittance services while tightening oversight on hawala operators offers a pragmatic solution, considering the balance between supervision and not driving hawaladars underground. While technological advances and evolving financial practices, coupled with government incentives, could make formal systems more appealing, the tenacity of informal systems like hawala remains. As history has often shown, every financial solution will inevitably birth new challenges, emphasizing that in the realm of finance and governance, vigilance and adaptability are paramount.

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