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There and Back Again, a Smuggler's Tale: Hawala and Money Laundering in the Greater Philadelphia Area

David Marshall Block
University of Pennsylvania

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Abstract:

This paper seeks to explain the extralegal contractual relations governing Hawala and other related informal financial transfer systems (IFTS). Hawala, and other IFTF's, have faced a regulatory onslaught in the aftermath of the terrorist attacks of September 11, as well as competitive pressures from traditional money transfer systems. Despite these competitive pressures, IFTS's still occupy a major market position in the money transfer market place, in particular amongst Asian and African immigrant communities in the Western world. Two recent academic papers have theorized what governs the extralegal contractual relations of Hawala, but no literature has been developed based on a case study to confirm these theories. This paper seeks to outline what governs the contractual relations of cross-border Hawaladars by interviewing IFTS brokers in the greater Philadelphia area. This Paper will be broken into four parts: Part I will analyze what Hawala is and how it works, Part II will analyze how Hawala works in practice based on a case study of Hawaladars in the Greater Philadelphia area, Part III will analyze why Hawala still exists & Part IV will be a conclusion analyzing the future of Hawala.

"Illegal is Always Faster"
- Eoin Colfer

Introduction

A middle-aged man, let's assume from Bangladesh, enters his local community grocery store in West Philadelphia, takes out $600 in cash and hands it to the cashier. The cashier, also the owner of the small store, puts the cash in his register and records the deposit by pencil in his private books. The depositor receives a small slip as a receipt and leaves. The broker places a call to his cousin, another grocer in Dhaka, and takes out a $20 fee from the $600. The depositor's mother picks up 45,000 Taka the next day in downtown Dhaka. There is no government record of the transfer in either the United States or Bangladesh[1]. The system that allows this movement of money rapidly, discreetly and cheaply is called *Hawala*. This paper will explore who operates *Hawala*, how it operates and why such a simple and ancient form of money transfer continues to exist in the 21st century.

Part I: What is *Hawala?*

What is Hawala and where did it come from?

The word *Hawala* comes from Arabic, and has various translations including: "assignment, change, transform or promissory note". [2] *Hawala* is defined by the

[1] I watched the first part of this transaction occur during one of my visits to a *Hawala* broker's store.
[2] Rachana Pathak, *The Obstacles to Regulating Hawala: A Cultural Norm or a Terrorist Hotbed*, 27 Fordham Int'l L.J. 2007, 2010 (2007)

Financial Crimes Enforcement Network (FinCen) as a "parallel remittance system," that exists outside of " 'traditional' banking or financial channels."[3]

There is substantial debate over the origin of *Hawala.* Some scholars have argued that similar money transfer systems have independently appeared across the pre-modern world in societies as diverse as China (the fei ch'ien), Latin America and Southeast Asia.[4] Others, most prominently Schramm & Taube, have argued that a predecessor of *Hawala* emerged out of economic necessity during the 10th century in the Islamic world.[5] Currency shortages coupled with widely dispersed trade routes unsafe for travel with gold or silver necessitated the development of a system of finance. The "evolution of an institutional solution to the problem of coordinating economic interaction was decisively influenced and strongly guided by the Koran's moral directives as to how business was to be conducted." [6] *Hawala*, which complies with Islam's restrictions on usury and lending, filled the economic void.[7]

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3 Patrick M. Jost & Harjit Singh Sandhu, *The Hawala Alternative Remittance System and its Role in Money Laundering,* Report prepared by the Financial Crimes Enforcement Network in cooperation with INTERPOL/FOPAC, https://www.treasury.gov/resource-center/terrorist-illicit-finance/Documents/FinCEN-Hawala-rpt.pdf

4 *See Pathak* at 10, citing Manuel Orozco, *Worker Remittances: An International Comparison, (*Inter-American Dev. Bank, Working Paper Feb. 2003, at 2)(arguing that similar money transfer systems have developed independently throughout human history in widely differing civilizations).

5 Matthias Schramm & Markus Taube, *Evolution and institutional foundation of the Hawala financial system,* Int'l R. Fin. Analysis (2003)

6 *Id.*

7 *But see* Edwina A. Thompson, *Misplaced Blame: Islam, Terrorism and the Origins of Hawala*, 11 Max Planck Y.B. U.N.L. 279 (2007) (suggesting that the origins of *Hawala* may date back to the pre-Islamic period in the Arab world, as the practice of "al-hawala" was already recognized during the time of the Prophet Mohammed in the 7th century); *see also* Divya Sharma, *Historical Traces of Hundi, Sociocultural Understanding, and Criminal Abuses of Hawala,* 16.2 Int'l Crim. J. 99-121 (2006) (proposing that *Hawala* in its contemporary form is a more recent phenomenon dating back only "seven or eight decades" and is better seen as an offshoot of its' close relative *Hundi,* a related financial transfer system dating back to at least the 12th century on Indian subcontinent. Operationally, the two systems are similar, but there is less evidence that *Hundi* is rooted in either Islamic law or culture)

How does Hawala work?

Adil Anwar Daudi outlines a typical *Hawala* transaction to explain how the system works. According to Daudi,

> "A remittance [comes] from a customer (CA) from Country A, or a payment arising from some prior obligation, to another customer (CB) in Country B. [There] a *Hawaladar* from Country A (HA) receives funds in one currency from CA and, in return, gives CA a code for authentication purposes. He then instructs his country B correspondent (HB) to deliver an equivalent amount in the local currency to a designated beneficiary (CB), who needs to disclose the code to receive the funds. HA can be remunerated by charging a fee or through an exchange rate spread. After the remittance, HA has a liability to HB, and the settlement of their position is made by various means, either financial or goods or services. Their positions can also be transferred to other intermediaries, who can assume and consolidate the initial positions and settle at wholesale or multilateral levels." [8]

Daudi proceeds to explain the importance of trust between the two *Hawaladars* in the example as well as the trust between *Hawaladar* and customer. There is no exchange of receipts between the *Hawaladars*, or between the *Hawaladars* and the customer. Daudi claims that a breach of either relationship is punished by ex-communication and a "loss of honor."[9]

Nikos Passas outlines a similar *Hawala* transaction but highlights *Hawala* as having two main distinguishable aspects: (1) the sending and receiving of money and (2) the settlement process.[10] The first aspect, according to Passas, is "simple and straightforward" while the second is "complex."[11] In the settlement process, each time a Hawaladar sends payment, he creates a debt. Closer relationships, according to Passas,

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[8] Adil Anwar Daudi, *Invisible Bank: Regulating the HAWALA System in India, Pakistan and the United Arab Emirates, The*, 15 Ind. Int'l & Comp. L. Rev. 619, 654 (2004-2005)
[9] This idea of social and economic excommunication is common in the literature, but there are very few citations to any instances of this excommunication.
[10] Nikos Passas, *Demystifying Hawala: A look into its social organization and mechanics*, 7.1 J. Scandinavian Studies in Criminology and Crime Prevention. 46,52 (2006)
[11] *Id.*

make the settlement easier. For *Hawala* to operate optimally, "there must be pools of cash or funds on both ends of the transactions."[12] This can be difficult when one country, such as the US, is labor importing, while another country, such as Pakistan, may be cash importing. These asymmetrical flows require a balancing through either a third party or multiple *Hawaladars* in multiple locations, weaving an intricate web of debt and interdependence.[13]

What problems does *Hawala* solve?

During an era of financial revolution and upheaval, *Hawala* seems like a dusty relic of a bygone era, best left as a footnote in the history of progressively integrating and digitized global markets. *Hawala*, however, continues to evolve, adapt and grow to meet consumer demand for alternative financial transaction services largely because the formal financial sector has failed to meet consumer needs for money transfer services. [14]

There are five major problems with money transfer services of formal financial institutions such as Western Union and Moneygram: (1) they are not anonymous, (2) they are expensive, (3) they do not cover a wide enough geographic range, (4) they take too long and (5) they are not tailored to meet religious or cultural demands.[15] *Hawala* solves each one of these dilemmas.

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[12] *Id.*

[13] Although unaddressed in the literature, these third parties would seem to be the natural enforcement mechanism of any dishonest breaches in the money transfer process.

[14] The Economist Explains, *How Hawala money-transfer schemes are changing*, The Economist (Oct. 15, 2015) (explaining how *Hawala* operators are adapting to Western financial regulation to continue to help money flow to poor countries were "formal banking is too expensive, heavily regulated, or simply absent")

[15] *See* Smriti S. Nakhasi, *Western Unionizing the Hawala: Privatization of Hawala and Lender Liability*, Northwester J.I.L & B. 27.2 (2007) (outlining the six reasons that *Hawala* has not been replaced as: (1) Anonymity, (2) Efficiency, (3) Reliability, (4) Expense, (5) Expansiveness and (6) Religious concerns); Rachana Pathak, *The Obstacles to Regulating the Hawala: A Cultural Norm or A Terrorist Hotbed?* 27 Ford. Int'l. L. J, 2007 (2003) (citing efficiency, cost-effectiveness, trust & lack of a paper trail as reasons why *Hawala* continues to operate); John F. Wilson, Senior Economist Middle Eastern Department, IMF,

First, illegal *Hawala* is anonymous.[16] Consumers on both ends of the transaction may prefer anonymity; the laborer depositing the funds could be in the sending country illegally or the funds may be used for illegal means such as terrorist financing or money laundering. Formal financial institutions would not allow these transactions to take place.

Some forms of *Hawala* are far cheaper than their formal transaction alternatives.[17] On average, *Hawaladars* charge fees somewhere in the neighborhood of 2%, while financial institutions may charge closer to 10%.[18] This cost advantage is being undercut by new FinTech startups, but these startups lack the infrastructure to reach those on the receiving end of remittance transfers in many developing countries.[19]

Western Union, MoneyGram and other traditional international money transfer services do not have the infrastructure to reach populations in the developing world that *Hawala* can. In my conversation with a Philadelphia broker, the broker described how many of the remittance payments were not being sent to major cities in Africa or South

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Remarks for the Seminar on Current Developments in Monetary and Financial Law (May 16, 2002) (stating "*Hawala*-type informal transfers are often faster, more reliable, reach more destinations, sometimes benefit from a better exchange rate, and can be much cheaper than transfers through established, licensed financial institutions."); Interview with Mamadou, store owner, Touro (Two separate interviews in February 2016 and May 2016) (describing why his customers use a service other than Western Union or Moneygram).

[16] Legal *Hawala*, such as Dahabshil, Inc., is not anonymous and requires identification. It still, however, responds to the other problems raised by formal money transfer systems.

[17] An important caveat to this is areas were formal financial institutions do not compete. For example, my interview with Mamadou revealed that substantial rural populations throughout West Africa do not have access to international money transfer agents like Western Union. Transfers to these locations may be more expensive than the fees listed above.

[18] *Nakhasi* at 486 (citing Western Union as charging around 10% on a transaction); Interview with Mamadou (claiming there was around a 2% transaction fee for many transfers); Interview with store clerk at Makkah Market (March 2016)(claiming that Western Union would charge around 10% for a small transaction to Bangladesh);

[19] *See* LTP, *This Fintech Start-up is poised to Disrupt the Remittance Space with its $1 Money Transfer Service*, (2014), available at: www.letstalkpayments.com/fintech-start-poised-disrupt-remmitance-space-1/ (describing a start-up which cuts the 5% to 10% cost on remittance transactions to 1%, which is directly competitive and sometimes cheaper than traditional *Hawala* pricing). Note that another problem with FinTech money transfer services is that they leave a permanent financial record of the transaction.

Asia, but were sent to smaller villages and towns that did not have branches for these traditional financial companies.[20] The expansive network of brokers, however, could provide money transfer services to these rural areas were major financial institutions would not go.

Hawala takes less time than other money transfer systems because the money is not being physically transferred. *Hawala* may take less than 24 hours while other transfer systems like Western Union take closer to 72 hours[21]. Even though money may be wired quickly, the regulatory restrictions in the sending and receiving countries may delay these transfer payments.

Hawala is compliant with Islamic law and is bound by community ties. Islamic law has a specific set of rules governing commercial behavior generally, and lending and financing in particular.[22] *Hawala* operates not only as a way to send remittance payments, but also as a form of international financing between communities that complies with Islamic law.[23] *Hawala* is an easy and cost-efficient way of brokering this cross-border financing, whether it is for legal or illicit activities. Equally as importantly, brokers and their customers often know each other very well and trust one another. Many are members of the same ethnic communities, share the same religion (Islam) and do business together on a daily bases. These personal ties play an important role in repeat business.

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[20] Interview with Mamadou

[21] Interviews with Mamadou and Makkah Market

[22] *See* Edwina A. Thompson, *Misplaced Blame: Islam, Terrorism and the Origins of Hawala*, 11 Max Planck Y.B. U.N.L. 279 (2007) (pointing to Kitab al-Kasab ("On Earning") and Ar-Riba ("Usury and Interest") as regulations that are not broken by *Hawala*)

[23] Matthias Schramm & Markus Taube, *Evolution and institutional foundation of the Hawala financial system*, Int'l R. Fin. Analysis (2003); Edwina A. Thompson, *Misplaced Blame: Islam, Terrorism and the Origins of Hawala*, 11 Max Planck Y.B. U.N.L. 279 (2007).

Controversies within *Hawala*: Money Laundering and Terrorism

Hawala rose to prominence in the public's parlance in the aftermath of the terrorist attacks of September 11, 2001[24]. Many commentators and government officials have highlighted the role that *Hawala* has played in funding terrorist networks such as Al-Qaeda.[25] *Hawala* has been a largely undetectable and untraceable way for terrorist organizations to launder money and fund their activities. The Treasury Department has also highlighted the role that *Hawala* plays in money laundering for non-terrorist activities. [26]

There have been restrictions, driven by the fear of terrorist financing, placed on *Hawala* brokers in the United States as well as in foreign countries such as India and Pakistan. *Hawala* is legal in Pennsylvania[27], but anyone operating in the money transfer business in the United States is required to be registered with FinCen[28]. Many money transfer operators in Philadelphia are noticeably absent from this list.[29] *Hawala* is also

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24 *See Generally* Thompson; Pathak; Priceonomics, *Hawala: The Working Man's Bitcoin* (Feb 7,2014): available at: http://priceonomics.com/hawala-the-working-mans-bitcoin/.

25 Michael Freeman and Moyara Ruehsen, *Terrorism Financing Methods: An Overview*, Perspectives on Terrorism (2013); Thomas H. Kean & Lee Hamilton. *The 9/11 Commission Report*. Washington, DC: National Commission on Terrorist Attacks upon the United States (2004)(highlighting the role that *Hawala* plays in funding terrorist organizations such as Al-Qaeda)

26 *See* Jost at 12.

27 It is illegal in New Jersey, however, which has a large Muslim immigrant community. Although my studies did not confirm my suspicion, one would expect that Philadelphia *Hawaladars* would be natural beneficiaries of the differences in legality in the two states. In practice, however, I highly suspect that *Hawala* continues to operate in New Jersey.

28 *See* Jost at 11.

29 *See* 31 CFR 1022.380*; See Also* https://www.fincen.gov/financial_institutions/msb/msbstateselector.html (listing all of the registered MSB's in Philadelphia)

noticeably *Illegal* in India and Pakistan, despite its' widespread prominence in both nations economies. [30][31] The Tenuous legal status of *Hawala* both in the United States and abroad does not seemed to have threatened its operation, however, with estimates for the size of *Hawala* internationally as high as $415 Billion as late as 2013.[32] *Hawala* and other informal remittance systems are estimated to occupy roughly 40% of the global remittance marketplace. [33]

Part II: The "Interviews"

Part II of this paper seeks to explain how *Hawala* operates and self regulates through a series of interviews with brokers throughout the Philadelphia area. Much of the recent literature on *Hawala* says that it is self-regulating, and suggests that *Hawala* would not exist without self-regulation[34]. None of the literature, however, has explained beyond the generic explanations of "self enforcement" and "trust" the mechanisms of enforcement by the brokers. This article seeks to fill that void by taking an in-depth look at the brokers of the greater Philadelphia area and their operations.

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30 *See* Jost at 11.

31 Despite *Hawala's* illegality, some estimates suggest that as recently as 2008, after *Hawala* was outlawed, it still comprised roughly 40% of India's GDP and may have accounted for up to $7 billion dollars in money transfer to Pakistan. *See* Marie Chêne, *Hawala remittance system and money laundering*, u-4 Anti-Corruption Resource Center, available at: http://www.u4.no/publications/hawala-remittance-system-and-money-laundering/downloadasset/375.

32 Newsletter from the Anthemis Group, trends in remittances (June 2013) available at: http://www.anthemis.com/the-anthemis-newsletter-trends-in-remittances-june-2013/

33 *Id.*

34 *See* Schramm & Taube (arguing that *Hawala* is self-regulating and could not exist without self-regulation); Edwina A. Thompson (repeating the idea that *Hawala* is self regulating)

Methodology

I sought to identify potential *Hawala* brokers through five different methods: (1) I emailed or called 12 mosques in the greater Philadelphia area asking if any members of their congregations were involved in the international money transfer business, (2) I took five trips between February and May of 2016 to West and North Philadelphia to target small businessmen in Muslim areas potentially involved in money transfers (3) I called and visited stores throughout the greater Philadelphia area listed on FinCen's database of Money Services Businesses to ask if they were involved in any business similar to *Hawala* , (4) I emailed four of the nation's top scholars on *Hawala* to ask for introductions to *Hawala* brokers and (5) I spoke on the phone with a customer service representative for Dahabshil, Inc., a legally operating international *Hawala* broker.[35]

I chose Philadelphia because I am a law student at the University of Pennsylvania and I live in Philadelphia. Philadelphia is a good test case because there are currently over 200,000 Muslim residents, with perhaps 15% of them first generation immigrants[36]. There are also numerous small Muslim grocers, clothing stores and travel consultants heavily concentrated in two areas of the city that are easily accessible.

Once I had identified target locations, I sought to meet in person with potential brokers. I faced a series of major burdens in conducting my research: I was an outsider, the store owners did not trust me, the questionable legality of *Hawala* made shop owners hesitant to admit if they participated in it and it is unclear what exactly constitutes

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[35] Telephone interview with customer service at Dahabshil, Inc. (April 22, 2016)

[36] Jehron Muhammed, Philly's Growing Muslim Presence, www.philly.com, November 14, 2014, available at: http://www.philly.com/philly/blogs/jehron_muhammad/Jehron-Muhammad-Muslims-growing-presence-in-Philly.html

Hawala.[37] I also found that employees were generally unwilling to speak with me, perhaps out of fear for their job security.

Regardless of the flaws in my research model, I attempted to build a connection with each particular storeowner through a systemic routine: I would enter a targeted store, purchase a small item, comment on any signs about cash money transfers and then inform the store owner that I was a law student at the University of Pennsylvania conducting research for a paper on money transfers. If I was able to engage the store owner in conversation, I would ask them a series of pre-prepared questions. [38]

I was unable to find success with three of my five methods used.[39] After purchasing twenty-two boxes of Gunpowder tea, three bags of Fonio and two bottles of shockingly cheap cardamom, I found two business owners and one employee that were involved in money exchanges outside of traditional financial institutions that were willing to speak with me, who I will refer to throughout the Part II as West Philadelphia

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[37] There are different names in different communities for *Hawala*, and there are numerous types of informal money transfer regimes. For this papers sake, I assumed that any money transfer system that operated like *Hawala* constituted *Hawala*, even if the storeowner did not call the money transfer system that they participated in *Hawala.*

[38] I asked each storeowner or employee nine basic questions and than followed up with individualized questions depending on the direction of the conversation. The nine questions I asked were: (1) What types of money transfer systems do you operate in your store?, (2) What locations do you serve?, (3) Do you have a relationship with your customers, (4) Are your customers repeat users of your services, (5) How frequent are customer transactions? , (6) How large is each transaction?, (7) What is the process behind each transaction?, (8) How familiar are you with brokers on the receiving end of the transaction? and (9) Is there any concern of breach or theft by the other brokers? Following these nine questions, I would follow up with a variation of: "Do you use an alternative forms of money transfer systems?" if their answer to question 1 was unclear.

[39] I received responses from two Mosques but no small business owner involved in money transfer was willing to be interviewed. I found the FinCen database unhelpful because every store registered on the Money Services Business Registration webpage that I visited was owned by "absentee" owners that were not present during the day-to- day operations of the business. Employees of these businesses were unwilling to speak with me, it seemed out of fear that their discussion with me would be a breach of protocol. Emails with *Hawala* scholars were equally unfruitful, with perhaps the most helpful advice coming from Professor Nikos Passas, who suggested that I "try to find some South Asian who could introduce me to a *Hawala* broker." Email from Nikos Passas, Professor of criminology and criminal justice, Northeastern University, Co-director of Institute for Security and Public Policy (April 11, 2016, 5:08 PM EST).

Hawaladar (WPH)[40], North Philadelphia *Hawaladar* (NPH)[41] and the Soap *Hawaladar* (SH)[42].[43]

WPH is the owner of a small Muslim oriented West African grocery store in West Philadelphia[44]. His primary business is his grocery store, but he also operates a money transfer business out of his grocery store. He proudly displays an "Anti-Money Laundering" certificate on the wall of his store and informed me that money transfers make up an "important" part of his business, but he was unwilling to reveal exactly how much. Despite his certificate, his store is noticeably absent from the FinCen Money Services Business database.[45] WPH was unique in offering all cash money transfer to locations throughout both Sub-Saharan Africa and certain parts of South Asia. No ID was required for any transfer under $1,000[46], and no trace other than a receipt of the money transfer would exist, but WPH assured me that the businessman on the other end receiving the transfer was trustworthy and reputable. WPH even told me that he used a broker in his native country to send $200 a month home to pay for his children's schooling.

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40 Interview with Mamadou, store owner, Touro (Two separate interviews in February 2016 and May 2016)

41 Interview with store owner, Multi Service, (March 2016)

42 Interview with store employee, Scensational Boutiqe (April 2016)

43 As I was driving home from my second interview through the winding and decrepit streets of Franklinville I could not help but become a disciple of the old adage "better lucky than good."

44 My interviews with WPH took place over the course of two encounters in February and May. During my initial interview, Mamadou, the owner with whom I conducted the interviews, was willing to admit to operating an "alternative" form of money transfer system but in my follow up interview in May when a customer was present he only mentioned the existence of three forms of money transfer services offered that were not Moneygram or Western Union and was far less willing to discuss the details of each transaction. I suspect that this was a result of a customer being present.

45 A common theme, as not a single business owner that actually spoke to me was registered with FinCen despite the requirement that anyone involved in *Hawala* or similar services register.

46 I am highly skeptical that an ID was required for any money transfer over this amount. I witnessed a man hand the cashier a large stack of bills wrapped in a rubber band that appeared to be above $1,000 and this man was never asked for his identification.

NPH was the owner of a small, Muslim oriented grocer and convenience store in North Philadelphia. NPH offered Western Union services out of his store, but upon further discussion admitted that he also offered a cash only alternative money transfer system to Pakistan for some of his customers. Although he did not explicitly call the money transfer system *Hawala*, the transfer system he described was almost an exact replica of the *Hawala* model I described in Part I.

SH was an employee at a tiny, Muslim oriented store that sold specialty soaps but that also offered money transfer and cash checking services. SH was willing to describe the normal users of the money transfer services, the locations that they serviced and how often the users would send money but did not have knowledge of the details of the service provided. SH did claim, however, that they used an independent money transfer service for transfers to West Africa.

Who Participates?

WPH, NPH and SH described a remarkably similar set of users of their broker services. All three had regular, repeat and well-known customers that would consistently send a small amount of money, often bi-weekly or monthly, to family members in their home countries. The amounts would vary, but according to all three brokers were almost overwhelmingly under $1,000 (and according to WPH often closer to $100). WPH did concede in his second interview, however, that some of the transfers were in the thousands of dollars, but said that because of IRS regulations he did take down the ID and Social Security number of these transferees. Both parties would give "receipts" to senders, but in essence there was no record of the transactions, no ID required and no physical transfer of money. In the instances of WPH and NPH, the receivers of the transaction would be able to withdraw the foreign currency in the receiving country within one to three days.[47]

WPH and NPH used different types of brokers on the receiving end of the transaction; NPH was familiar with the receivers but was not a relative of any of them. According to NPH's account of where he could send money, the receivers were geographically dispersed in multiple regions of Pakistan. WPH slightly differed, in that he was a cousin of one receiver who he used consistently, but was not related to any other receiver brokers. All of the brokers involved were men, and the overwhelming majority of users of the system were men. Only WPH was willing to share how many transactions took place in his shop each month, which he estimated to be well over 100.[48]

WPH serviced customers sending money primarily to Sub-Saharan Africa and Bangladesh. He explicitly stated he did not send any money to either Egypt or Sudan. He told me "someone else" handled those transactions, and guessed that those senders would use either Western Union or a storeowner from one of those areas to send the money. NPH was unwilling to reveal his customer base beyond the fact that he did send money to Pakistan and other parts of South Asia, although he would not reveal were. SH had a very diverse customer base ranging from South Asia to West Africa to the Caribbean & Latin America. She did mention that the users from West Africa would use a different money transfer service than those from the Caribbean, but did not give any further information.

[47] SH did not know how long it would take for the receivers to be able to withdraw the money but estimated within a day.

[48] He would not give me an exact figure, so I asked him: "would you estimate that you had over 100 transactions each month" and he said yes. I then asked him if he had over 200 and he shrugged, indicating that 200 transactions a month was possible.

The Economics of Hawala in Greater Philadelphia

The Philadelphia marketplace for money transfer is a mixed system of a perfectly competitive marketplace and monopoly, with a wide variety of services and prices offered.

The prices of the MoneyGram and Western Union services offered ranged anywhere from 5.9% to 10%, depending upon the region of transfer.[49] Prices for the "alternative" services offered by NPH and WPH ranged from a $20 flat fee on transfers up to $1,000 (with a declining percentage fee on transfers above that amount) to a flat 2% on all transfers. [50] In both instances, the alternative transfer system was cheaper than Western Union or MoneyGram.

The estimated arrival times for the funds in the alternative transfer systems were both shorter than their respective traditional financial service counterparts. Western Union was far faster than the literature reported in the late 2000s, estimating delivery in 72 hours, but informal transfers remain swifter (perhaps because no money is actually being transferred). The price difference between the two products seems to be the most substantial current difference.

There are countless store in the Philadelphia area offering money transfer services. Virtually every ethnic grocery store that I visited offered some form of money transfer services. I highly suspect that many of the grocers who would not speak with me offered other, alternative, money transfer services that are only advertised to their well-known customers. The literature has consistently highlighted the prominence of non-

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[49] Interview with Makkah Market, Interview with YFR, April (2016)
[50] Interview with WPH, Interview with NPH

English advertisements of these services, and there is little reason that Philadelphia would be an exception to this rule.[51] The availability to transfer money to major urban areas is limitless.

WPH's service, however, highlighted how brokers can have a near monopoly on certain transfer locations. One shortfall of the traditional money transfer systems like Western Union is that they are not available in less populated or less financially connected regions of the world. WPH mentioned that his alternative service was available in some regions where Western Union was not located (he mentioned multiple locations in Senegal, Chad, Nigeria and Mali, for example). I was unable to find another store that offered widespread money transfer services to this particular area of West Africa, so I suspect that WPH had a virtual monopoly on this small subset of the population in Philadelphia seeking to transfer money to this region. The high fee (twenty dollars) charged on the alternative service suggests that while there are competitive pressures on money transfer services to major urban areas, more rural or geographically isolated regions have the potential to be profit centers for these brokers.

Enforcement

NPH and WPH both had different takes on the "enforcement" mechanism of *Hawala* due to the slight differences in the systems that they offered. WPH first was confident in the trustworthiness and honor of those brokers receiving the money transfer. He even used a broker to send money to his children. WPH seemed genuinely shocked at the question whether another broker would steal the transferred money. His comments explained why the systems' "honor code" seems to work. First, none of the brokers

[51] *See* Post.

involved in the transactions participate in *Hawala* as their primary business. Instead, money transfer is an ancillary service offered to their normal, repeat customers. Second, the money transfer amounts are small, so any potential theft would bring a limited gain. Third, if WPH did not know the broker on the other end, someone in the network almost certainly did. Maintaining a positive word of mouth reputation is incredibly important for all brokers, so that one will continue to use the others' service.

In the event there was some form of theft, WPH confirmed that economic and social isolation would occur. Any such theft would leave a broker entirely cut off from any future transactions, but equally as importantly the traditional business of the broker would suffer. The customers of the lying broker would simply leave and use another grocery store or convenience store, as well as another broker. The economic benefits for theft are miniscule, while the potential costs are substantial. WPH was unaware of any theft of transferred money taking place from the brokers.

NPH was far less willing to discuss the mechanics of the transfer system, but suggested that he would stop doing business with the thief and that a third party would cut off the lying broker. NPH's description strongly suggests that he participates in a far more densely populated money transfer network, with a third party operating to balance the transfer books between the multiple brokers participating. This third party operator is consistent with the description described in Part I by Nikos Passas' of outside, larger parties operating in the balancing of broker books.[52] It seems from NPH's comments that the smaller players free-ride off of the enforcement powers of a larger third party, but that the enforcement capabilities of these third parties to shut off lying brokers are substantial.

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[52] *Id.* at Passas

Both conversations confirmed the consensus in the literature that (1) trust is a highly valued commodity in the *Hawala* community, (2) reputation matters and (3) the network of brokers is self-enforcing by either individual members or powerful market actors[53]. In addition, the apparently limited economic upside of theft gives little actual incentive for theft. Cultures of honor and trust also seem to play an enormous role (both brokers seemed to take enormous pride in their honor, and where offended at the notion of theft existing). Religion was not brought up as a factor, but inevitably permeated the conversation (all three stores were Muslim oriented).

Dahabshiil, Inc

I have separated my conversation with the customer service representative at Dahabshiil, Inc. into a separate section because my interaction as a consumer was so radically different. Dahabshiil is a major international legal *Hawala* broker that operates through a series of "agents" or brokers in 126 countries. [54] They operate through a network of affiliated brokers throughout the United States and encompass all of the advantages of *Hawala* that the other brokers did. Their fees were higher than illegal *Hawala* (I was quoted 6% for a money transfer to Ethiopia)[55], but they are lower than the 10% Western Union fee. Dahabshiil also presumably did not maintain the same community ties as illegal *Hawala* and the money transfers are not anonymous. However, they still encompass the remaining advantages of *Hawala*: They are fast, they cover wide geographic areas and they are compliant with Islamic legal maxims on finance.

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53 *Infra* Part III for an in-depth discussion on these topics

54 Dahabshiil, https://www.dahabshiil.com/ (last visited May 1, 2016)

55 Interview with customer service representative at Dahabshiil

My conversation with the customer service representative was what could be expected of a conversation with any major multinational financial institution such as Western Union. They would not share any information on users of their services and were only willing to say that the broker in Ethiopia was a member of their wider network of affiliated agents. This corporate, multi-national *Hawala* is a substantially different player than WPH, NPH or SH. Cheating is unlikely to occur with their brokers because as affiliates they would be expelled from the formal Dahabshiil network if they stole.

Part III: The Literature

Why does *Hawala* work?

To some, it may seem puzzling why *Hawala* continues to operate. There is no formal enforcement mechanism for breaches, there is no access to a court system to enforce contractual claims and the interaction between individual *Hawaladars* is often limited to a phone call. Despite these shortcomings, a series of incentives have developed that have created a form of extra-legal self-regulation. This self-regulation has emerged because (1) *Hawala* networks share similarities with the economics of clubs and (2) trust & honor have created incentives which discourage breaches.

Extralegal Self Regulation

Extralegal self-regulation can naturally emerge amongst groups and industries when there are proper incentives. Linda Bernstein's pioneering work uncovering the extralegal enforcement mechanisms of the New York diamond industry offers some key insights into what type of factors need to be present.[56] The diamond industry, according to Bernstein, was built upon the twin pillars of reputation and trust. The prominence of repeat players and religious and ethnic similarities combined with these two pillars created the proper incentives for extra-legal self-regulation.

Avner Grief's article on contract enforceability amongst the ancient Maghribi offers another compelling example of what incentives are required for extralegal contractual enforcement.[57] Here, the traders operated a far-flung merchant coalition that allowed financing and trade in the 11th century Mediterranean world. This Maghribi trader's system was also built on reputation and trust, which was re-enforced by repeat players and religious ties. The system's dependence on distant brokers, word of mouth networks and trust in the money transfer business mimicked modern *Hawala*.

Hawala shares many of the characteristics described by Bernstein and Grief: Both the literature and the interviewed brokers highlighted the importance of trust & honor, the users of illegal *Hawala* are close nit and often share religious or ethnic ties and Islam permeates all of the transactions. Some markets, it seems, do not need government to effectively self-regulate.

The Economics of Clubs

[56] Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 11 JOURNAL OF LEGAL STUDIES 115 (1992); *See Also* Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation through Rules, Norms, and Institutions*, 99 Mich. L. Rev. 1724, 1790 (2001) (describing the extra-legal self regulation in the American cotton industry).

[57] Avner Grief, *Contract Enforceability and Economic Institutions in Early Trade: The Maghribi Traders Coaliton*, 83.3 The American Economic Review 525,548 (1993) (arguing that Maghrebi Traders made their disparate trading system function because "merchants conditioned future employment on past conduct, practiced community punishment, and ostracized agents who were considered cheaters.")

Clubs are described by James Buchanan as "consumption ownership-membership arrangement[s]".[58] Club members create rules of self-regulation so that club commodities are not depleted. In *Hawala*, trust is a commodity or club good[59][60]. The "trust" commodity shared by *Hawaladars* is neither a purely private nor a purely public good. The trust produced between the parties has the private good characteristic of being individually created and consumed but the public good characteristic of benefiting or hurting all members depending on how much trust is either re-enforced or breached. The members of the club, in this case the *Hawala* brokers, have an incentive to self-regulate their club so that other members do not deplete the "trust" commodity for all the other brokers.

The network of *Hawaladars* is also similar to clubs in other ways. The benefit of additional members can serve to reduce costs faced by a single person (for example, balancing of accounts will be easier with more operators as will the attraction of customers). There are also potential "crowding costs" if the club becomes too big, as enforcement of trust can become more difficult as *Hawaladar* operators become more dispersed and culturally heterogeneous.

Trust and Honor

The literature has universally highlighted the importance of "trust" and "honor" as being crucial to *Hawala's* operation.[61] If there is not trust between the brokers and the

[58] James M. Buchanan, *An economic theory of clubs.* Economica 32, no. 125, 1,14 (1965)
[59] Dasgupta, Partha. *Trust as a commodity* Trust: Making and breaking cooperative relations 49-72 (2000) (describing trust as a tradable commodity)
[60] Matthias Schramm & Markus Taube, *Evolution and institutional foundation of the Hawala financial system*, Int'l R. Fin. Analysis 406, 411(2003) (arguing that the economics of clubs are a good way of understanding how *Hawala* self-regulates)
[61] *See Generally* Divya Sharma, *Historical Traces of Hundi, Sociocultural Understanding, and Criminal Abuses of Hawala*, 16.2 Int'l Crim. J. 99-121 (2006); Adil Anwar Daudi, *Invisible Bank: Regulating the*

customers, no one would use *Hawala.* This trust commodity is crucial to the networks functioning. Partha Dasgupta's paper on "Trust" as a commodity argues that if there is an absence of "suitable punishment" for breaking agreements, individuals will not possess the appropriate incentives to fulfill their obligations.[62] The threat of punishment for breaches must be credible, and the enforcement agent must be trustworthy. When trust is a club good like in *Hawala*, strong incentives develop to create "suitable punishment" for those who breach.

Honor of the *Hawala* brokers also plays a crucial role in creating incentives to not breach agreements with customers or other brokers. WPH seemed genuinely offended at the idea of anyone stealing from a money transfer in his network.[63] Basic human decency, but also esteem seeking, may play a major role in encouraging enforcement of contracts for money transfers.[64]

Whether it is the incentives created by the economics of clubs, the importance of trust and honor, or a combination of the two, conditions clearly exist that allow *Hawala* to flourish even without a formal, legal enforcement mechanisms. It seems that informal enforcement is sufficient to allow the operation of *Hawala.*

HAWALA System in India, Pakistan and the United Arab Emirates, The, 15 Ind. Int'l & Comp. L. Rev. 619, 654 (2004-2005); Nikos Passas, *Demystifying Hawala: A look into its social organization and mechanics,* 7.1 J. Scandinavian Studies in Criminology and Crime Prevention. 46,52 (2006); Matthias Schramm & Markus Taube, *Evolution and institutional foundation of the Hawala financial system,* Int'l R. Fin. Analysis (2003)

[62] Dasgupta, Partha. *Trust as a commodity* Trust: Making and breaking cooperative relations 49-72 (2000)

[63] WPH spoke with passion how most of the money being transferred was for school, medicine or food. He saw himself as performing a vital function to local members of his community both in Philadelphia and to the family members of the senders back home. He clearly thought that theft from either group would be dishonorable.

[64] *See Generally* Richard H. McAdams, *Origin, Development, and Regulation of Norms, The*, 96 Mich. L. Rev. 338, 433 (1997-1998) (highlighting the importance of "esteem seeking" by actors in the enforcement of norms)(esteem seeking could also be at play with refusal to steal from one's own community)

Part IV: Conclusion and the Future of *Hawala*

A drive through the streets of Franklinville & Fairhill shows a Philadelphia far removed from the comforts of an Ivy League law campus. Here, beneath the dilapidated urban exoskeleton of North Philadelphia lies a rich and vibrant network of immigrant communities, globally connected to their home countries through friends, neighbors and merchants. *Hawala* is the financial artery of this network, delivering untraceable funds throughout the entire world in mere minutes. Regulatory crackdowns and rising competition have barely placed a dent in the multi-billion dollar informal financial transfer system industry that is so popular amongst this immigrant community. As long as there is demand for fast, discreet and cheap forms of money transfers, Illegal *Hawala* will continue to remain a major market player throughout the globally dispersed Muslim world for the foreseeable future.