

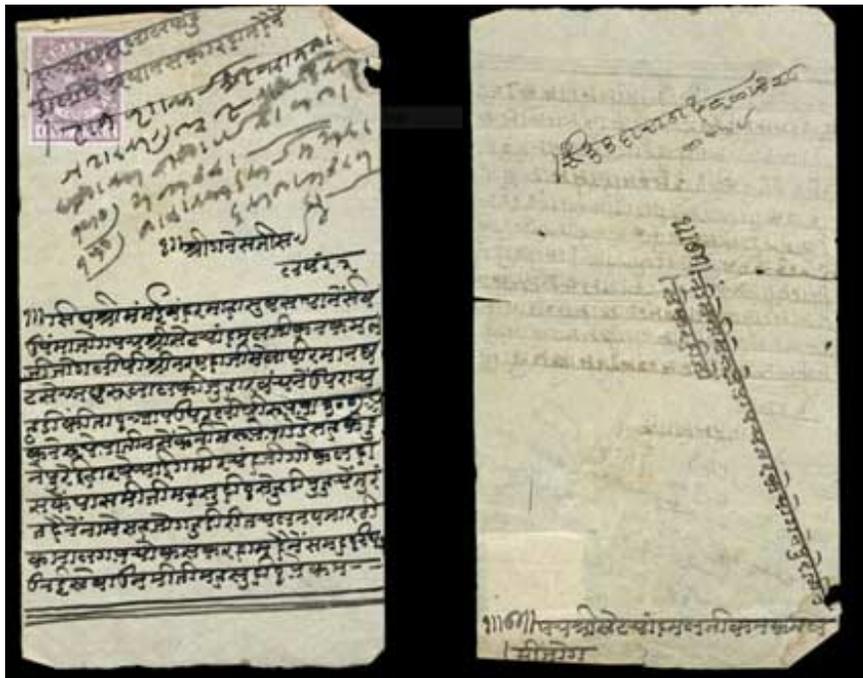
Between informality and formality: Hundi/Hawala in India

[LSE blogs.lse.ac.uk/southasia/2013/01/16/hundihawala-in-india/](https://blogs.lse.ac.uk/southasia/2013/01/16/hundihawala-in-india/)

2013-1-16

LSE's Marina Martin explains how the South Asian indigenous financial system, hundi/hawala, came to occupy the grey zone between formality and informality.

In modern parlance, remittance systems like the South Asian hawala or hundi system are largely referred to as part of the 'informal economy'. For the most part, they have garnered this kind of label because these remittance systems operate outside the modern banking domain, and are often deemed to have little or no paper trail. Why does the hundi/hawala system function outside, or at the fringes of, the modern banking system? The main reason is that it has been made illegal in a number of locations.



In India the word 'hawala' has become a notorious byword for the underbelly of the economy, or the black market. The term hundi is used synonymously with hawala in places like Bangladesh and Pakistan. However, in India, the term hundi has become detached from hawala and has been immortalised as denoting old bills of exchange, as seen by the specimens in the Reserve Bank of India Museum. And yet a quick glance at several primary sources as well as several historians' accounts shows that hundi was a remittance system operating (barring technological advances) in a similar way to hawala as we understand it today.

During the British Raj, hundis were classed as indigenous or traditional, but not informal. In fact, they were subject to a growing body of legislation revolving around key financial Acts such as the 'Negotiable Instruments Act' (NIA) of 1881 and the 'Indian Stamp Act' (ISA) of 1879. Through the inclusion of hundis within the purview of the ISA, for instance, hundis were perceived as traditional Indian forms of bills of exchange, and like English bills of exchange, were subject to stamp duty. The NIA was more problematic for the status of hundi as it only included hundis within its remit if Indian mercantile custom could not apply. In practice, a number of disputes between merchants arose which ended up within the British Indian courts. Many merchants actively applied to the conditions of the NIA to resolve their disputes in court. On the one hand then, hundi was effectively marginalised through its label of 'indigenous' by the NIA, but on the other hand, the growing body of legal precedent in the British Indian courts on the subject of hundi meant that the instrument was increasingly formalised and documented through court rulings.

One impetus for the way British Indian legislation unfolded around hundi at the time was the government's desire to

retain the integrity of traditional financial instruments and transactions, particularly where these could add to government coffers. The government also did not wish to upset the apple cart, and felt that it was inadvisable to interfere with the workings of hundi in the economy to any significant extent. Statutes and government proceedings around hundi reflected the legal and economic culture of the period along with the challenges of maintaining a status quo with the advent of modern banking. In the 1930s, with the setting up of the Reserve Bank of India, the British Indian government commissioned large-scale systematic studies into the workings of the Indian economy. These Central and Provincial Banking Enquiry Committee Reports attested to the continued use of hundis as a widespread medium of economic exchange amongst Indian merchants, despite the introduction of substitute instruments. Dismantling hundi, therefore, was not a viable option at this point.

Until 1978, various Indian Banking and Law Commissions had debated how they might incorporate hundi more fully into the modern banking architecture. In some quarters it was felt that hundi should no longer be seen as 'indigenous' instruments, but should attain the same status as modern banking instruments, which were influenced by international trends. Attempts were made to codify hundi, but the rift between the status of hundi and modern banking instruments had apparently grown so large that the attempt was abandoned. Stringent currency exchange laws in the 1980s appear to have further shifted the regular use of hundi by South Asian businessmen into the grey zone. At some stage the laws became so rigorous that currency exchange through hundi was firmly pushed into the prohibited zone. This most likely signalled the ultimate demise in the status of hundi in India.

Dr Marina Martin is a Visiting Fellow at the LSE Asia Research Centre.

Image: Copyright British Museum Trustees.

- Copyright © 2016 London School of Economics