TAWARRUQ AND ITS ROLE IN ISLAMIC BANKING

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ABSTRACT

Tawarruq Finance is built on the principles of trade. You purchase a commodity, such as base metal, from the bank. You then authorize the bank to sell the commodity on your behalf; and have the sales proceeds deposited into your account. Tawarruq is a sharia compliant finance method, with which you can raise loan finance through buying installments in a commodity, owned by the Bank.

Key words: Tawarruq, Islamic banking, Islamic financial market.
INTRODUCTION

Tawarruq is one of the distinguished Shari’ah transactions that are predominant in Islamic finance nowadays. This is because many Islamic banks and foundations introduce financial product related to tawarruq, based on the fatwa that were issued by their Shari’ah boards. This financial product that is based on the sale of tawarruq (papering or paper money) aims to provide liquidity to banking customers, in which they will immediately receive an amount of money vis-à-vis their commitment to pay a deferred amount that is more than the cash that they have received. This deferred payment will be established via an agreement to buy a commodity on deferred basis, and then sell it to a third party who is not the first seller, at a price less than the initial selling price. With this mechanism, many financial institutions have begun to engage in this type of transaction, as other Islamic financial institutions decide to engage in this financial transaction (Fadhil Dabu, 2010).

Tawarruq began to take effect under the Islamic umbrella by several banks since 1421 H, i.e. in the Kingdom of Saudi Arabia. It was operationalized under various names, such as easy tawarruq, blessed tawarruq, charitable tawarruq and so on and so forth. This was followed by other banks in Bahrain, Kuwait, Qatar and United Arab Emirates. Banking tawarruq can be defined as, “a customer’s requirement of cash, by appointing the bank to sell a commodity on his behalf in a present market, i.e. after he had bought it from it on credit (deferred basis)”. On the other hand, it also takes the same meaning, which means that banking tawarruq is, “The bank sells a commodity by the proxy in the market instantly, which has been sold to the customer on credit, so that the customer obtains cash.” (Yusri Ahmad, 2010).
THE DIFFERENCE BETWEEN TAWARRUQ AND TAWRIIQ

Many researchers have mixed up the term tawarruq and tawriiq. Tawriiq means documentation (taskiik). This means transferring existing commodities into sukuk, which are subject to circulation. This type of arrangement needs to be guarded by certain restrictions and procedures, in order to attain the Shari’ah criteria that are based on investor’s ownership on the assets that yield income. The acceptable deeds (sukuk) are the likes of sukuk of ijarah (leasing), sukuk of salam (advance payment) and sukuk of mudharabah (profit sharing). The rulings for all these sukuk are based on certain Shari’ah criteria. The process of issuing sukuk can be divided into different parts, with the view of protecting the sukuk bearers and the integrity of their circulation, with the reference to that sukuk ijarah can be of long-term application, via the different amounts that is in agreement with the Shari’ah criteria, which can create different returns for the sukuk bearer (Fadhil Dabu, 2010).

DIFFERENT TYPES OF TAWARRUQ

There are two types of tawarruq which can be discussed as (Msatfa, 2011)

1. Real Tawarruq: Most jurists allow real tawarruq provided that it complies with the shariah requirements on valid sale. For example, in the case that the customer appoints the bank as an agent to sell the commodity on his or her behalf, the agency contract should be independent of the sale contract and it should be made after the agreement with the bank has been signed. Among the scholars who allow real tawarruq are those of the Islamic Fiqh Academy set up by the Organization of the Islamic Conference (OIC) and the Permanent Committee for Islamic Research and
Fatawa in Saudi Arabia. The scholars of these institutions consider tawarruq to be permissible as the technique is based on two sale contracts, with the ultimate buyer not being the same as the initial seller. The permission is also justified by the fact that this process allows rotation of part of the liquid assets to replace conventional credits. In addition, in an industry that remains in the embryonic stage, tawarruq helped institutions starting from inception, under severe regulatory constraints, to subsist and later to initiate a shift from debt to equity.

2. **Organized Tawarruq**: There are different views concerning the ruling of organized tawarruq. According to scholars of the OIC Islamic Fiqh Academy, financing by this form of tawarruq is not permissible because simultaneous transactions that occur between the financial institution and the *mustawriq* are *haram* in Islamic law. They support their view with the fact that the Prophet said: “The condition of a loan combined with a sale is not lawful, nor [are] two conditions relating to one transaction, nor [is] the profit arising from something which is not in one’s charge, nor selling what is not in your possession.” However, some scholars interpret the two conditions relating to one transaction in the above *hadith* as referring to a seller who indicates two prices in the contract without a decision on one of them; while other scholars interpret the *hadith* as referring to a transaction between two people who deal with the same commodity by selling it the first time by deferred payment and the second time for immediate payment. The contract of organized tawarruq is clearly different from these two interpretations, as the transactions are separate, even though they are simultaneous for the same commodity.
ROLE OF TAWARRUQ IN MOBILIZATION AND ALLOCATION OF BANKING RESOURCES

1. Mobilizing of banking funds: For mobilizing of banking funds there are three stages which are:
   
   A. Depositor will make bank as his representatives and attorney for purchase of commodities. Based on this contract, depositor will give money to the bank as a represent of depositor to purchase a commodity in cash and transfer it to depositor.

   B. In second stage, bank will purchase that commodity on deferred basis with higher price (purchase price plus the amount of cash dividends).

   C. Bank will sell that commodity in cash to a new trader apart from the first merchant with the original purchase price. In this step, money will be deposited in banks’ account and commodity will be transferred to the ultimate purchaser.

   As a result of these three steps, bank instead of paying any interest to depositor for deposit will transfer deposits from depositor to bank based on tawarruq and because of difference between cash and credit transactions, depositor will be benefited.

2. Allocation of banking funds: for allocation of banking funds there are three stages too.

   A. Bank will purchase goods in cash by its own funds in market. Therefore, bank is owner of commodity at this stage.

   B. Bank will sell commodity in deferred to clients and this price will be higher than purchase in cash. In this stage customer will be owner of commodity and should pay price of this commodity on deferred base during time.
C. In third step client will make bank his attorney to sell the commodity to a trader other than the first merchant (first seller) in cash and deposit the price to customer’s account.

As a result of these three steps, customer will get his needed cash and bank without receiving any interest from customer will make profits from the difference between the sale and deferred price.

HARMFUL EFFECTS (MAFASID) OF TAWARRUQ

Harmful effects of tawarruq can be:

1. It leads to creation of debt whose volume is likely to go on increasing.
2. It results in exchange of money now with more money in future, which is unfair in view of the risk and uncertainty involved.
3. It leads, through debt proliferation, to gambling like speculation.
4. It leads, through debt finance, to greater instability in the economy.
5. In a debt-based economy, the money supply is linked to debt with a tendency towards inflationary expansion.
6. It results in inequity in the distribution of income and wealth.
7. It results, through debt finance, in inefficient allocation of resources.
8. It contributes, by consolidating debt financing, to raising anxiety levels and destruction of environment.

It is worth noting that giving priority to public interest over individual interests has been an accepted principle in Islamic jurisprudence. The benefits of tawarruq to individuals in certain circumstances must be overruled in view of the huge public benefits of not allowing
it. It will, however, be necessary to make some social arrangements for taking care of the individual problems sought to be solved through tawarruq (Siddiqi, 2007).

CONCLUSION

The global tawarruq market is estimated to exceed US$1.2 trillion per annum, and since there will always a need for lending products to meet short-term liquidity needs, reducing the utilization of tawarruq in Islamic banks in favor of more shariah-compliant financing modes would require a resolute political determination. Tawarruq is a financing method used by most Islamic financial institutions in the world. It consists of a sale contract whereby the client buys a commodity from the bank for deferred payment and then sells it to a third party for cash at a price that is lower than the deferred price. The result being that the bank’s client gets an immediate liquidity without having recourse to prohibited interest-based loans. This mode is very popular with bankers as a rapid and flexible way of acquiring liquidity. In fact, by using tawarruq bankers avoid constraints related to capital adequacy and allay the provision for managing doubtful debts. Tawarruq can also be used in more complex structures, such as Islamic foreign exchange swaps, where it helps to hedge against currency rate fluctuation risks. These kinds of contract combinations, replicating interest-based loans in the form of a deferred liability, have been practiced by many Islamic banks for more than three decades. However, there has never been a consensus on their permissibility, and there are even some shariah scholars who were initially open to such practices but later called for a reassessment of the product in order to avoid opening the door of riba (usury). Due to its nature and the environment that it operates, it presents a barrier for a wider application of tawarruq. The commodity requires huge storage and logistics cost and is subject to price and forex fluctuations as well as governed by its spot market regulations and there has been recent debate about the permissibility of some of its forms under the sharia.
REFERENCES


