SHARED RISK & REWARD

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Tawarruq and Murabaha

The concept of tawarruq (specifically organized tawarruq) is a controversial one among many commentators and Shari'ah scholars, although it is widely used in Islamic finance, particularly as a substitute for an inter-bank money market product. A paper presented at an OIC Fiqh Academy (see link to the left) puts the role of finance within Islam into a context. I think it is use - ful for explaining where the line is drawn between acceptable and not acceptable when the products look similar:

"Financing is essentially intended to facilitate exchanges and to serve real productive activity; the return on financing becomes deserved when it is a cause of wealth creation. [The relationship is inverted when] exchange becomes a means and financing becomes the goal, and the sale becomes ancillary instead of primary."

The OIC Fiqh Academy Shari'ah Board has ruled that organized tawarruq is not Shari'ah-compliant, a ruling that has been largely ignored in practice as the use of tawarruq continues. The main difference between organized and classical tawarruq (the board allowed the latter) is that in an organized tawarruq the sequence of transactions is organized by the buyers and sellers of the commodities, even if each transaction is legally independent of the others.

In the past I have supported the use of organized tawarruq out of the need for products that can be used inexpensively for inter-bank liquidity management (and I have deferred any judgment of the Shari'ah-compliance to the scholars who have approved it). However, the description above clarifies for me the distinction between many Islamic finance products and their conventional analogues.

It is always a difficult task to explain how products which have the economic outcome as conventional interest-based loans are different, but I think the description above for distinguishing between different forms of financing based on sales is useful. There remains a lot of formalism in the distinction (in a mortgage the bank lends money with the house as security, while in an murabaha mortgage the bank buys the property and resells it to the buyer).

But, for describing the difference between a murabaha sale and tawarruq financing, it provides a good way for me to understand the difference.

Until next week,
Blake Goud

My Reading List

- Tawarruq (Sharing Risk)
- IDB Scholar: Tawarruq is Usury (link)
- OIC Fiqh Academy Rules on Organized Tawarruq (Sharing Risk)
- ISRA Exec. Dir. Laldin: Tawarruq is Allowable (link)
- OIC Fiqh Academy Paper: Tawarruq Banking Products (link)

Blog Posts This Week

- India to consider allowing Islamic banking...maybe
- Open the takaful markets in Pakistan

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