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Article

Debt-Sale Securities as a Monetary Policy Instrument in the Islamic Banking System of Iran

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ABSTRACT - This paper discusses the legitimacy of securitizing the central bank receivables from the government and banking system in the Iranian financial market and making use of this instrument to conduct monetary policy. Ijtihad or independent jurisprudential reasoning based on Imamiah Fiqh (prevailing in the Iranian Islamic banking system), is used as paper methodology. The results show that considering the jurisprudential 'ownership unity' between the central bank, the government, and governmental banks in the Iranian banking system, securitizing the central bank receivables from the government or the governmental banks is not legitimate and not Shariah-compliant. Nevertheless, it is possible to issue debt-sale securities based on the debts of private banks to the central bank. Therefore, issuing debt-sale securities based on central bank receivables from the private banks can be considered a suitable instrument for conducting Shariah-compliant monetary policy in the Islamic banking system of Iran. This paper discusses for the first time the idea of issuing debt-sale securities as a monetary policy instrument in the Iranian financial system. Besides, the analysis is based on the Imamiah School of Fiqh, which is also new.

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INTRODUCTION

By issuing debt-sale securities (sale of debt securities), governments and economic agents can securitize their receivables from others and, by selling these securities in the market, raise needed liquidity (Adznan, 2018; Shaikh, 2018).

The characteristics of debt-sale securities are such that it is possible to use them as monetary policy instruments for the central bank (Saker, 2015). In other words, the central bank can sell the debts that are receivable from the government (in the future) in the interbank market. By doing this, the receivables will transfer from the government to the buyers of the debts. They can also sell these debts to others in the secondary market.

Reviewing the bases of Imamiah Fiqh (jurisprudence based on the Shi'a School of thought) on the issue of debt-selling, this paper tries to discuss the possibility of securitizing debts that the Iranian government and banks owe the central bank. In addition, it tries to find out the principles that should be paid attention to in the design and usage of debt-sale securities to conduct monetary policy.

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In what follows, after literature review and research method, the issue of fake (non-real) debts is evaluated ant then the effect of "united ownership" on debt-selling for conducting monetary policy is discussed. After that, the Shariah rules of debt-sale securities are assessed and the final part comes up with a conclusion and policy recommendations. It should be noted that the jurisprudential analysis of this paper is based on Imamiah Fiqh, which prevails in the Iranian Islamic banking system.

LITERATURE REVIEW

Evaluating the previous research on the use of debt-sale securities as a monetary policy instrument shows that only a little work has been done on this topic by Iranian scholars. In what follows, some of these researches are evaluated.

Sadr (2016) attempts to highlight the profound transformations that occur in usury-based financial systems when the Islamic concept of property rights is adopted. The results show that the nature of financial transactions changes, financial markets undergo a structural transformation, and money, capital, and financial assets acquire new jurisprudential status. Banks' relationships with their clients and with the central bank will be different, resulting in different macroeconomic policies and a more effective transmission mechanism. Further, the financial and real sectors of the economy will be integrated and sustainable.

Toutounchian (2009) examines how money in the absence of Riba (interest) can become an endogenous variable of an economic system. The author further tries to integrate money into capital theory and make the monetary sector part of the real sector, aiming at removing the problems that arise from the separation of the two.

Musavian and Qaramaleki (2012) evaluate the possibility of designing Islamic treasury securities in the Islamic financial markets. The results show that it is possible to use this instrument for government debts to those contractors, banks, and insurance companies that are non-governmental institutions (based on laws and regulations). However, it is not possible to use this instrument for government debts to the central bank, governmental firms, and insurance companies because these debts are not considered real debts in Imamiah Fiqh.

Qazavi and Bazmohhamadi (2011) evaluate the possibility of using Islamic treasury securities as monetary policy instruments. The results, based on Imamiah Fiqh, show that it is jurisprudentially and economically possible to issue Islamic treasury securities based on government debts. These government debts may have different sources including government debts to the banking system, contractors, insurance companies, and non-governmental public entities, among others.

As can be seen, most of the current literature on Islamic debt-sale securities (especially treasury kinds) has focused on using them for the conduct of fiscal policy by governments. By contrast, little attention has been paid to the potential of debt-sale securities for conducting monetary policy. This research focuses on monetary policymaking and hence contributes to the literature.

Debt-sale in Imamiah Fiqh

According to Imamiah Fiqh, debt (Dayn) is any general possession that one person owes another because of a contract. Thus, debt-selling is defined as: "The act of selling any general possession which a person owes" (Najafi, 1997).

Fiqh scholars (like Imam Khomeini) divide debt into Dayn that is due now and Dayn due in the future. Regarding the Dayn that is due immediately, the debtor and creditor do not consider any specific time for repayment. However, for a Dayn that is due at a certain time, there is a specific period for the contract and the creditor cannot request his claim before the end of the agreed period (Khomeini, 2000; Musavian et al., 2016).

In Imamiah Fiqh, debt-selling may have different forms and every form may have a different jurisprudential rule. In what follows, some of the most important forms are evaluated:

a. Discounting debts

The base of debt-sale securities that are discussed in this paper is centered on the discounting of debts. Scholars have argued this issue focusing on two different questions: firstly, is this contract permissible? Secondly, what is the responsibility of the debtor if the contract is permissible?

Regarding the first question, there is a consensus among Imami scholars that it is permissible (Heli, 1982). Regarding the second question, however, there are two views among scholars. The minority is of the view that the debtor should pay the customer (who has discounted the debt from the creditor) only the amount the customer has paid for buying the debt and nothing more. However, the majority of Imami scholars believe that the debtor should pay all of the debt (Musavian, 2007).

b. Sale of debt for debt

In this contract, both sides of the bayʿ contract are Dayn. There is a consensus among Islamic scholars that these kinds of debt-selling are not permissible (AAOIFI, 2017). In a famous saying, Imam Sadiq (peace be upon him) related that the Prophet said, "Do not do bayʿ al-Dayn bi al-Dayn".

This statement indicates that all forms of bayʿ al-Dayn bi al-Dayn are impermissible (Maghrebi & Mirakhor, 2015; Hasan, 2014). Based on this, the writer of the book, Javaher believes that there is a consensus among Imamiah scholars that bayʿ al-Dayn bi al-Dayn is not Shariah-compliant. Bayʿ al-Dayn bi al-Dayn includes debts that are available before the contract is formed and debts that are generated directly from the contract (Najafi, 1997).

Nevertheless, some scholars believe that if debts are generated directly from the contract (and do not exist before the contract) then the bayʿ contract would be valid (Musavian and Qaramaleki, 2012).

c. Sale of debt for non-debt

In this contract, one side of the bayʿ contract is Dayn but the other side is not. There are five different views on this issue in Imamiah Fiqh. They are:

1. Bayʿ al-Dayn is valid.
2. Bayʿ al-Dayn is invalid.
3. If the debt being sold is due, the sale would be valid; if not, it is invalid.
4. Bayʿ al-Dayn to the debtor is valid but to a third party is invalid.
5. Bayʿ al-Dayn is valid, but the customer can receive only the amount he has already paid and cannot claim anything over and above it.

As can be seen, there is no consensus among Fiqh scholars on the issue of bayʿ al-Dayn; however, the majority of Imamiah scholars[i] are of the view that bayʿ al-Dayn to the initial debtor or a third party is valid and Shariah-compliant (Musavian, 2007) [ii].

METHODOLOGY

Like some other research in the field of Islamic banking and finance (as an interdisciplinary area) in this paper the Ijtihad or independent jurisprudential reasoning based on Imamiah Fiqh (jurisprudence based on the Shi'a School of thought prevailing in the Iranian Islamic banking system), is used. Ijtihad method can be considered a research approach in which an endeavor is made to deduce the rules of Sharia from the sources of jurisprudence with the use of proper methods (Zuhri, 2019; Muneeza et al., 2019).

FAKE (NON-REAL) DEBTS AND THE ISSUE OF OWNERSHIP UNITY

Considering the fact that only real debts, originated from real economic activities, are permitted for debt-selling and trading of fake debts is not Shariah-compliant, the question arises: what are fake debts? It seems that debts would become fake in two different cases.

The first is when the source of the debt is not real. For example, suppose one person wants to lend the other some money and receive interest. To prevent riba (interest) formally, the creditor wants the debtor to bring a special cheque, and by discounting the cheque, the debtor will get the needed money. Here, this cheque is not originated from real economic activities and hence is fake. Thus, the debt-selling contract is not Shariah-compliant.

The second case is in the case of 'ownership unity'. It means that the two parties of the debt-selling contract should not be legally united. If this happens, the debts between the two sides would become fake and not suitable for debt-selling. For example, suppose two branches of one Iranian bank want to trade something with each other. Here, although they are formally doing a kind of sale contract, it is not a real sale because of the ownership unity between these two branches (i.e. the two branches are of the same bank).

Paying attention to the fact that governmental institutions (like a central bank) are part of the government, the question is: are the debts available between the government and governmental institutions real debts? The hypothesis of this part of the paper is that these debts are fake and hence not suitable for debt-selling. To prove this, some issues are evaluated in what follows.

The possession of governmental entities according to Iranian laws

Reference to the Iranian judicial system clearly shows that the ownership of the governmental bodies belongs to the government and that these entities are only government representatives in using the governmental goods that are in their hands. Some articles from different laws are mentioned here to support this idea:

1. Article number 114 of the Iranian General Calculation Law states, "All of the immovable properties of the ministries and governmental firms belong to the government and the ministries, and governmental firms are responsible to keep and use these possessions. The ministries and governmental firms can transfer the right of using these possessions to each other after the approval of the cabinet.
2. Part three of Article number 3 of the Iranian constitutional general policies states, "The ownership and management in some activities is solely for the government including the central bank, the Iranian National Bank, Sepah Bank, Sanat and Madan Bank, Export Development Bank, Agriculture Bank, Maskan Bank, and Tosee Taavon Bank."
3. Article number 118 of the Iranian General Calculation Law states, "The immovable properties of the governmental firms can be transferred to ministries or other governmental firms provided the cabinet approves it." It shows that the properties of a governmental firm can be transferred to ministries or other governmental firms even if the managers of those firms do not like this transfer.
4. Part seven of Article number 19 of the Iranian Constitutional General Policies states, "The government is entitled to give the governmental firms to non-governmental public institutions provided it is not possible to supply these firms in the exchange market."
5. Part eight of Article number 10 of the Iranian Monetary and Banking Act states, "The capital of the Iranian central bank belongs to the government."

One may ask here: if the governmental firms are not the real owner of the goods in their possession and the ultimate ownership belongs to the government, why do governmental firms have the right to do contracts like sale, ijarah, and so on with the goods in their possession? The answer to this question is that the financial relationship that is prevailing between different governmental entities is not real. In fact, they are only transfers of goods from one part of the government to another part. The rules set by the government to manage the relationship of government firms are only for the sake of disclosure, accountability, supervision, and auditing.

Thus, although the laws, rules, and regulations that the government sets to manage the financial relation of governmental firms are mandatory (and are of high importance for the issue of transparency and supervision), it does not mean that the governmental firms are the owner of the properties they have. To put it in a nutshell, the ownership is exclusively belongs to the government and they are only agents of the government when using these properties.

The ownership unity in the financial relation of individuals

In Fiqh books, different conditions for the two sides of financial contracts are emphasized. The first and most important of them is that the two sides should be different from each other. Hence, they cannot be one legal entity. In addition, the two sides should be adults and wise and have authority and intention (Najafi, 1997). Thus, those who want to enter into a financial contract should be different from each other and satisfy the needed conditions for entering into a contract (Musavian, 2012).

The jurisprudential equality of individuals and legal entities

Fiqh scholars consider legal entities similar to individuals in the case of Shariah rules. Thus, all the Shariah rules that apply to the relation of individuals like bayʿ, *qard* (loan), *ijarah* (lease), and others will exactly apply to the relation of legal entities (Farahanifard, 2002).

Most Fiqh scholars point to the legal entities that existed in Islamic histories like bayt al-mal (treasury) and *waqf* (Islamic endowment) and conclude the aforementioned similarity. Imam Khomeini says, "All the financial contracts that are permitted to be done with Muslim individuals can be done likewise with banks (as legal entities) regardless of whether they are governmental or non-governmental banks" (Khomeini, 1970).

In addition to Fiqh, Iranian laws treat legal entities as eligible for conducting financial contracts (just like individuals). For example, Article number 588 of the Iranian Commercial Law states, "The legal entity can have all the rights and responsibilities that individuals can have except for those special for individuals like paternal rights. Hence, the legal entity may have a name, origin, and address and may also conduct financial contracts, etc." (Musavian & Qaramaleki, 2012).

Nevertheless, because of the fact that legal entities cannot physically do their jobs, there should be a representative of any legal entity. In this regard, Article number 589 of the Iranian Commercial Law states, "The decisions of the legal entity are taken by those who are eligible to do that according to regulations."

Ownership unity and Riba rules

From what is stated above, one may ask the question that if the government and governmental firms are equal in ownership, is there Riba between them? What about Riba between the government and the public? In answering this question, three different cases should be evaluated.

Case 1 is about the situation where the financial relation is shaped between the government and the public. Some scholars are of the view that Riba is not prohibited here (Marefat, 2000). They usually justify this by pointing to the Shariah rule that states, "Riba is not prohibited between father and son or slaves and their owners." However, this just seems to be wrong due to the difference between these relationships and that of the government and the public. The government is not the owner of the public nor is the public the owner of the government. Thus, the unity of ownership does not apply to the financial relationship of the government and the public.

Case 2 is about the relation of the government and governmental firms (like the Iranian central bank which is part of the government). In this case, the governmental firms are not independent of the government and hence they are united in ownership. So there is no Riba between them. Considering this, the government can borrow one billion from the central bank and after one year, pays back one billion and a half.

Case 3 is about the relation of governmental firms with each other. This case is just like the previous one. Hence, governmental firms can lend to each other and receive more than what is lent.

Discounting Governmental Debts Considering Ownership Unity

Some conclusions can be drawn from what is stated above. It was shown that ownership unity makes the debts unreal and not suitable for a discount. It was also shown that the same commercial rules apply in general to legal entities as to individuals. Considering these two factors, one may come to the conclusion that ownership unity in the financial relations of legal entities makes the debts fake.

Another important point discussed above is that in Iran's judicial system, the government is the ultimate owner of all governmental institutions. Considering all this, it can be concluded that the government is the owner of all governmental firms and institutions and hence the debts between them will be fake and not permissible for discounting.

This result is similar to the statement of the Shariah board of the Securities and Exchange Organization of Iran (SEO) in the year 2010. This statement says, "Issuing Islamic treasury bills based on discounting is permissible only for non-governmental institutions. [That is] because the debts existent between the government and governmental firms are not real ones and are not useful for discounting." The Shariah board of the Iranian central bank also proclaimed the same view on this issue.[iii]

UNITED OWNERSHIP, DEBT-SELLING AND MONETARY POLICY

Now we can use the above jurisprudential and theoretical analysis in practice. In fact, there are different kinds of debts (to the central bank) that should be paid attention to in issuing debt-sale securities as a monetary policy instrument. In what follows, these kinds are evaluated.

Private Banks Debts

In the Iranian banking system, private banks' debts to the central bank are either generated based on a specific contract or not. If it is based on a specific contract, it is called 'a credit line'; if not, it is called 'an overdraft'.

In fact, all money that the Iranian central bank pays to a private bank that involves a specific contract is called a credit line. For example, the Iranian government (through the central bank) may want a private bank to finance a special project. In this situation, the central bank pays the needed money to private banks to finance such projects. The rates of return of these facilities are determined based on the discretion of the government and the central bank.

It can be said that the legal forms of these contracts are *wakalah* (agency). In fact, the central bank gives money to a private bank that acts as an agent. The debts originated from these contracts are useful for discounting. Here, the challenge of ownership unity does not arise.

One should note here that discounting is permissible only for the contracts that have resulted in due debts. However, for the contracts that may produce debts in the future, discounting is not possible.

On the other hand, all money that the Iranian central bank pays to a private bank without any specific contract is called an overdraft. For example, a private bank may be in trouble settling the cheques of its customers at the very end of a day. In this situation, the central bank pays the needed money and considers this as debts of the private bank to the central bank. There is a penalty equal to 34 percent for these overdrafts.

Here, the important question is: is it possible to discount the private bank debts to the central bank? It seems that the answer is affirmative. The rationale for this is that the challenge of ownership unity does not happen here for the fact that the central bank and private banks are not united in ownership.

Governmental Banks Debts

Governmental banks' debts to the central bank are the other part of the debts to the central bank which have effects on the monetary base. Just as with private banks, in the Iranian banking system, these debts are either generated based on a specific contract or otherwise. If it is based on a specific contract, it is called 'a credit line'; if not, it is called 'an overdraft'. These two are discussed below.

Here again, all the money that the Iranian central bank pays to a governmental bank based on a specific contract is called a credit line. For example, the Iranian government (through the central bank) may want a governmental bank to finance a special project for the housing of the poor. In this situation, the central bank pays the governmental bank the needed money to finance those projects.

As in the case of private banks, the legal form of these contracts is *wakalah*. In fact, the central bank gives money to the governmental bank as an agent. However, these debts are not useful for discounting. The reason for this is the ownership unity between the central bank and the governmental bank.

In the same way, all the money that the Iranian central bank pays to a governmental bank that is not based on a specific contract is called an overdraft. For example, a governmental bank may be in trouble settling the cheques of its customers at the end of the day. In this situation, the central bank pays the needed money and considers this as debts of the government bank to the central bank. There is a penalty equal to 34 percent on these overdrafts, similar to that applicable for private banks.

Now, are these kinds of debts suitable for discounting? It can be said that the answer is negative. The rationale for this is again the ownership unity between the central bank and the governmental bank.

Government Debts

Evaluating the Iranian central bank balance sheet shows that the governmental debts include the direct debts of the government and the debts of governmental firms. These debts are usually generated from the government borrowing from the central bank and central bank facilities to the government and governmental firms. The main characteristic of these assets is that the government ensures their repayment (Qazavi & Bazmohhamadi, 2011).

Now the question here is: what is the nature of government debts to the central bank? Are these debts suitable for discounting? It seems that all of the money that the government receives from the central bank is a kind of borrowing although, in practice, this borrowing is done based on different ways and modes. For example, at the beginning of the year or within the year, the government may have some expenditure for which there is no money left. In this situation, the government can borrow this amount from the central bank and pay it back at the end of the year.

However, this lending and borrowing are not real because the government and the central bank are united in ownership and hence cannot lend to each other from the jurisprudential point of view. Thus, these debts are not useful for discounting or securitization. Considering this, the Iranian central bank cannot issue debt-sale securities based on these debts to conduct monetary policy.

THE SHARIAH RULES OF DEBT-SALE SECURITIES

As was seen, only debts that originated from the financial relations of the central bank and private banks are discountable. However, in these cases, some important Shariah rules should be considered. Three of these are highlighted below:

The Legitimacy of the Secondary Market

It seems that the central bank and the government banks or firms can enter the secondary market for the central bank debt-sale securities. In fact, after these debt-sale securities are sold in the market, the central bank and the governmental banks can buy them back. For example, suppose

that the central bank has issued a ten-billion Iranian rial debt-sale securities to conduct a contractionary policy. It is quite possible that after some time the central bank may refer to the market and buy these debt-sale securities back to conduct an expansionary policy.

Selling Private Banks Debts to Governmental Banks

Here the question is: can the central bank discount its receivables from a private bank with the governmental bank? For example, can the central bank refer to a governmental bank, give it the cheques (that show the private bank owes the central bank some money), and get fresh money? The answer is yes. The reason for this is that the central bank and the governmental bank are united in ownership and in this contract (in fact) the governmental receivables are transferred from one part of the government to another.

Discounting Debts Originated from Late Payment Penalties

As was shown, the central bank requests 34 percent over and above the money banks received as overdrafts or credit lines from the central bank. These 34 percent is called a late payment penalty. Now the question is: can the central bank discount the debts which are related to the late payment penalty?

Evaluating the Fiqh scholars' views about this issue shows that there is no consensus regarding it. Most of the scholars are of the view that the late payment penalty is sheer *riba*. However, some others believe that it is a solution to prevent late payment. Nevertheless, the Guardian Council of the Constitution, which has the last word on Shariah issues in Iran, says the late payment penalty is not *riba* and is needed in the banking system to force customers to pay on time (Musavian, 2012).

However, based on the Guardian Council's view, the late payment penalty is legitimate only if it is stated in the contracts as a condition. However, in the case of overdrafts, because of the fact that there is no specific contract between the central bank and the commercial bank (that is in need of money), the late payment penalty is not legitimate and hence the debts which are related to it, cannot be discounted.

CONCLUSION

This paper has tried to review the Imamiah Fiqh bases on the issue of debt-selling and to discuss the possibility of securitizing the debts that the Iranian government and banks owe the central bank as a monetary policy instrument. The results show that there is united ownership between the government and the central bank and hence the debts that the government itself or the governmental banks owe the central bank cannot be securitized as debt-sale securities.

In addition, the debts of private banks to the central bank (either as overdrafts or as credit lines) are eligible for discounts. In other words, based on these debts, the central bank can issue debt-sale securities for the sake of monetary policy. However, because of the united ownership between the central bank and governmental banks, in case of overdrafts or credit lines, the debts that the governmental banks owe the central bank cannot be securitized as debt-sale securities.

Finally, yet importantly, with regard to the debts that the governmental banks owe the central bank, the issue of ownership unity arises only in the case of the government deposits of the governmental banks. However, in the case of public and non-governmental deposits in governmental banks, ownership unity does not exist.

Based on these conclusions, some policy recommendations can be stated. Firstly, the Iranian central bank can use debt-sale securities as a monetary policy instrument. In addition to the central bank, the commercial banks themselves can use debt-sale securities based on the receivables they have from their customers. Secondly, in the case of governmental bank debts to the central bank, it is not possible to issue debt-sale securities directly. However, it is possible for governmental banks to transfer their receivables from their customers to the central bank and for the central bank to then issue debt-sale securities based on these receivables from the public. However, after the issuance of the debt-sale securities, the governmental bank cannot issue another debt-sale

security based on the same debts. Thirdly, as was seen, the challenge of ownership unity arises because in the Iranian legal system the central bank is considered a governmental institution. Thus, it can be suggested that in the long run, the legal structure of the central bank should change. It should become a non-governmental public institution as is the case in some other countries. Finally, another long-run suggestion is that the Iranian central bank should try to use other kinds of *ṣukūk* that do not use the debt-selling concept for monetary policy. There is no need to limit the monetary policy instruments to one special type.

In this paper, the focus was only on a special instrument that is debt-sale securities for monetary policy. However, some important questions remaining could be topics for future research. For example What are the challenges of conducting monetary policy in an Islamic economy such as Iran?; What are the issues related to debt financing in an Islamic financial system?; What is the relation between the ideas of this paper and issues like common ownership, related party transactions, legal personality, and asset ownership (especially considering the Western law that shareholders own a company's shares, which are a claim on the company, and as such, they do not own the company or its assets)?; What is the volume of the possible market for debt-sale securities in the Iranian financial system? And finally, what are the issues that may arise when structuring debt-sale securities based on other Fiqhi schools of thought?

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[i] One should note that debt-selling to a third party is not permissible in the Ḫanafi and Ḫanbali schools of jurisprudence. Hence, it is not possible to make use of debt-sale securities based on these schools' views (Musavian, 2012, p. 12).

[ii] In the Iranian Islamic banking system, before 2010, there was no regulation about debt selling and hence debt-selling contracts were done based on a special circular issued by the Iranian central bank. In 2010, however, debt selling was accommodated in the laws. In fact, Article number 98 of the Fifth Iranian Development Law has added debt-selling to the Iranian Usury-Free Banking Act or UFBA (1983). It should be noted that in all laws and regulations about debt selling, it is emphasized that only real debts (which are originated from real economic activities) can be traded and fake debts (which are not originated from real economic activities) are not permissible for debt-selling.

[iii] For more details, one can refer to the website of the Securities and Exchange Organization of Iran (SEO) and Iranian central bank at: en.seo.ir and www.cbi.ir.