2010

SALE OF GOODS AND SALE OF DEBT: A COMPARATIVE ANALYSIS

MUGHEES SHAUKAT

ISLAMIC LAW OF CONTRACT S

PAPER

INCEIF

12/6/2010

TABLE OF CONTENTS

ABSTARCT

Law is concerned, primarily, with fairness whereas social good, including economic good, is conceived in terms of provisions that depend, ultimately, on production. Fairness is necessary for ensuring dignity whereas wealth is needed to guaranty security. It goes without saying that Islamic economics as a discipline cares about efficiency as well as justice and fairness. It is well aware of the fact that in a balanced realization the two reinforce each other. This paper will propose to demonstrate the ever so prevalent and dynamically wisdomful nature of Islam even enshrined through Islamic finance by venturing into a detailed debate rooted from and to the very foundational paradigm of TRADE, the concept of exchange of property, selling and buying. Incept- ionizing from the submerged argumentation over the permissible stacked up with the non-permissible stretching to the dimensions of understanding the basic concepts and then gliding to the depths of despair by permitting the non-permissible pinnacled by modern financial instruments and concluding in more a self explanatory parlance.

1.0. INTRODUCTION:

Most of the contracts entered into in Islamic banking and finance are in the category of exchange contracts *(al-muawadat),* which are essentially trading-based. This is quite to the contrary with the activities in conventional banking and finance, which are mainly lending-based activities. When the contracts are exchange contracts, they necessarily entail the exchange of goods, services, or usufruct, for a consideration or price. The most common forms of the contracts of exchange are either buying and selling *(ai-bay')* which involves the sale of goods, or leasing *(al-ijarah)* which involves the sale of the usufruct *(manfa'ah).* In both, the subject matter (*Mahall al- 'aqd)* is the central focus of the legal effects accruing from the valid conclusion of the contracts. In Islamic jurisprudence, exchange contracts require more stringent fulfillment of the conditions of the subject matter *(shurut mahall al- 'aqd),* particularly on the conditions of certainty, ascertainability and proprietary value. This is because, exchange contracts involve the exchange of counter values, as opposed to the uni-lateral contracts of gratuity *(al-tabarru'at),* which give one-sided benefit to the recipient.

In an Islamic contract of exchange, the counter values - goods/usufruct and price/consideration - are the subject matters of the contract. To be valid subject matters of a contract, these counter values need to be properties *(amwal)* which are certain, valued and beneficial *(mutaqawwam).* This is to ensure that their exchange would give a fair and legal commercial benefit for both sides of the contracting parties. The fairness of the transaction can be ensured by the ability of both parties to appreciate and benefit from the proprietary worth of both counter values in the subject matter and give their consent to the exchange accordingly.

Of late, the range of possible counter values and subject matters has expanded so as to include certain rights, which proprietary value and capacity to be valid subject matters of contracts may still be very much debatable. These possible counter values include mostly abstract rights such as, the rights to receivables, the rights to future benefits from a concluded contract, and the rights to license and concession.

The main issue is, can these rights be traded or sold for a consideration? Can these rights be valid subject matters for an Islamic project-financing contract, which consists mainly of a series of exchange contracts? For example, if a person or company obtains a license to develop a piece of landed property into an industrial area consisting of factories and other paraphernalia, can the person or company sell the right to others? Alternatively, can the person or company securitize the right in order to get the financing for the project?

Thus, it becomes ever so pivotal for one to know what qualifies to be exchanged and the opposite and even more so when one wants to analyze and that to in a comparative tone. this article will therefore make an effort by starting from the very scratch seeking to first scrutinize and hence establish an understanding of what Islam means when it talks about property and property right with special reference to these rights and their validity to be proper subject matters in Islamic contracts of exchange.

In doing so, the article analyses the classical and contemporary *fiqh* writings on the issue. Then, the study examines the application and relevance of the *fiqh* interpretations and develop from the parlance in a self explanatory approach the comparison between which exchange is permitted and which is not by focusing on sale of dayn to sale of

other forms, evidenced and supported by to some of the concepts in modern banking and finance contracts as will be unfolded by the discussion.

2.0 AL-BAY IN ISLAM; THE FOUNDATIONAL ROBES

THE STARTING POINT

2.1. PIVOTAL UNDERSTANDING OF *MAL* AND *MAL MUTAQAWWAM:*

As a general rule, the subject matter in a contract of exchange should be property *(mal)* that is of value *(mutaqawwam)* and is capable of ownership *(milkiyyah).* Thus, it is important for us to analyze the concept of *mal* and *mal mutaqawwam.*

In the dictionary, definition of *mal* (its plural - *amwal)* is simple and straight forward, i.e., "whatever you own from all matters". However, the legal defmitions given by the jurists to *mal* are various. This is mainly due to their differences in describing the focus of the proprietary aspects of things *(manat maliyyah al-ashya').* Some of them say that properties are limited to corporeal matters only *(a 'yan),* whilst others say that they also include usufructs *(manafi')* and rights (huquq). Majority of the classical Hanafi jurists were in favour of the first approach towards defining *mal,* i.e., limiting it to corporeal matters only. For example, Ibn Abidin defined *mal* as "that which human nature inclines, and can be stored for future needs.

In other occasions, he described *mal* as "corporeal matter *('ayan)* that is capable of being controlled and acquired", and " ... is limited to corporeal matters *(a'yan),* to the exclusion of usufructs *(manafi'}".*He further said, "the proprietary aspect of *mal* is also established by its worth or value *(taqawwum)* that allows the lawful enjoyment of the property. Interestingly, Ibn 'Abidin recognized that usufructs can be subjects of

ownership *(milk),* yet, they are not *amwal* because they cannot be made specific subjects to dealings and transactions (tasarruf).

Relating the concept of *mal* to the subject matter in a contract of exchange, article 363 of the *Majallah* provides that "a thing, which admits the consequences of a sale, is a thing sold, which exists, is capable of delivery, and is *mal mutaqawwim".* The *Majallah* also adopts the I:Ianafis' view in limiting the subject matter in a sale contract to corporeal matters *(a 'yan)* only. For example, article 150 provides that the subject matter of sale (mahall *al-bay')* is what is known as *al-mabi'. Al-mabi'* is defined in article 151 as" a thing fixed and individually perceptible('ayn) designated at the sale, and is the principal object of the sale, because the benefit is derived from the things *('ayn)* alone and the price is the means for the mutual exchange of property." *'Ayn* on the other hand is defined in article 159 as "a thing which is fixed and individually perceptible", giving the examples of a horse, a chair, a heap of com which exists and is present and a sum of money.

The *jumhur* comprising of the Maliki, Shafi'i and Hanbali schools took the second approach to the definition of *mal,* whereby they considered rights and usufructs as property as long as they are related to property and any assets of value: According to *the jumhur's* view, in order to be *mal mutaqawwam,* two essential elements should be present. First, the usufruct of the thing should be legally permissible; and second, it is customarily treated as property or of proprietary value. Almost all contemporary scholars prefer the view of the *jumhur* in the inclusion of rights and usufructs in the meaning of *mal.*

3.0. THE TALE OF THE TWO T's

3.1. TANGIBLE PROPERTY RIGHT VS INTANGIBLE PROPERTY RIGHT:

An issue that may arise in relation to a corporeal property right(Haqq *mali 'ayni* is whether its object should always be a material and tangible thing *('ayn maddi),* or, could it also be an abstract and intangible thing *('ayn ma'nawi)* as well?

According to al- 'Ibadi, an abstract right can still be considered as a kind of property right, because it is capable of being valued by property and is giving its owner a proprietary value *(qimah maliyyyah)* capable of being valued by pecuniary or monetary measures. 'Ali al-Khaifif also considered an abstract and intangible property right as a special form of ownership right, i.e., Haqq *mali 'ayni.* Al-Durayni further argues that the object of ownership (mahall *al-milkiyyah)* may also include abstract rights, and is not necessarily limited to material and tangible things only?

Thus, it can be concluded that corporeal property right also includes abstract and intangible rights. In fact, in the decision by the OIC Fiqh Academy, intellectual property rights have been said to be property rights that are capable of being bought and sold for a consideration, despite of their intangible nature.

The discussion on intangible rights opens the door to other analogous situations. For example, whether other abstract and intangible rights, such as the rights to license and concession enjoy the same position with intellectual property rights. An analysis of the decision according intellectual property right the status of Haqq *mali 'ayni,* that is capable of being a subject matter of exchange contracts, indicates a number of factors that qualify intellectual property right to its current status. The factors for its qualification as Haqq *mali 'ayni* can be summarized as:

- Its nature as a property with special characteristics;
- It has proprietary value according to custom;
- It can be owned exclusively by its owner, i.e., the owner is free to benefit from the property and prevent others from trespassing or interfering with the property.
- The property is deliverable and exsists
- It is not prohibited to own by Shariah

4.0. CALLING THE RIGHT *RIGHTS* HAS ALWAYS BEEN THE ORDER OF THE DAY

4.1. CORPOREAL PROPERTY RIGHT VS PROPERTY RIGHT IN THE OBLIGATION OF THE DEBTOR:

A more controversial issue pertaining is whether certain abstract property rights should be regarded as dependent on the corporeal matter *('ayn),* i.e., a kind of choses in possession; or should it be regarded as a kind of proprietary right established in the liability (al-Haqq *al-thabit fi al-dhimmah),* i.e., a kind of choses in action?

If the abstract proprietary right is dependent upon the corporeal matter, it is arguably an independent asset *('ayn)* and thus, the rule pertaining to the avoidance of *riba* in the exchange of debts and monies, i.e., that both counter values must be equivalent and the delivery be prompt, may not apply. On the other hand, if the abstract proprietary right is regarded as established in the liability *(fi al-dhimmah),* it is arguably a form of debt *(dayn),* hence, the rule of equivalence and promptness in the exchange of debts

and monies may apply. Similarly, if the right is considered as a debt, the rule against *bay' al-kali' bi al-kali'* should also be observed. It is thought that an abstract property right may still be attached to a corporeal matter, such as that of intellectual properties and products. Yet, some other abstract proprietary rights may not be clearly attached to a corporeal matter, and are arguably more in the nature of rights *fi al-dhimmah,* such as the rights to future receivables in a contract of sale with deferred payment *(bay' bithaman ajil).* The issue becomes pertinent in considering the legality of the sale of the right to receivables from sales contracts at a discounting, as it has been practiced, for example in Malaysia, for the creation of some of its Islamic bonds.

Being a debt or analogous to a debt, implies the treatment of this property right as similar to that of the treatment of money, the exchange of which, is subject to the rules pertaining to avoidance of *riba al-fadl* and *riba al-nasi'ah* in the exchange of *ribawi* items. According to the rule, the right in debt cannot in general be exchanged for another debt, deferred *(bay' al-kali' bi al-kali'* or alternatively termed as *bay' al-dayn bi al-dayn).* Thus, in a contract, say to sell a right to receivables from sales, the rules for the sale of debts with money will apply - i.e. the exchange has to be cash! spot, and if made in the same currency - the exchange should be at par. If the transaction is deferred, this may amount to *bay' al-kali bi al-kali'* which will also be tantamount to *riba al-nasi'ah.* The amount should also be the same if the purchase price is in the same currency with the original debts in order to avoid the occurrence *riba al-fadl.* The view that the right to receivables in sale contract is *dayn* makes the securitization of the right to receivables almost impossible.

The prevalence of this view also explains the objections that some of the Malaysian Islamic bonds receive from the other quarters of the Muslim world. Another example of an analogous situation where *haqq mali fi al-dhimmah* in sale contract becomes an issue is what the Hanbali"s describe as *bay'* al-mawsuf *fi aldhimmah* ,i.e., purchase of an 'abstractly defined good' in the obligation of the seller.

For example, the Hanbalis treat manufacture sale *(bay'* al-istisna') as a form of *bay'* al-mawsuf *fi al-dhimmah,* with a necessary condition that the buyer must pay in full at once, and is bound by the contract as long as the final product agrees with the contractual description. The condition of spot full payment is essentially to avoid the rule against *bay' al-kali' bi al-kali'.* However, due to the practical difficulty in imposing full payment at the time of a manufacture contract, the Hanbalis would alternatively allow for partial payments or even fully deferred payment using an alternative legal description of the contract. In this case, the contract is not treated as *bay'* al-mawsuf *fi al-dhimmah,* but rather, a contract of sale of the raw materials *('ayn),* actually delivered, with a condition *(shart)* that they be constructed into a building, the payment of which may be deferred and made subject to the final product satisfying the contractual description.The latter contract, thus, amounts to a sale of *'ayn* for *dayn* which is allowed, instead of a sale of *dayn* for *dayn* which is not allowed.

The second line of opinion on the issue of whether the right to receivables in sales contract should be treated as *Haq mali ayni or Haq mali fi-al-dhimmah* is that, the right is considered as an independent property right(Haq *mail).* The argument given is, since the right to receivable in sale contract is attached to real corporeal asset *('ayn),* i.e., the goods that form the subject matter of the sale contract, it is not a debt *(dayn).* The right

to receivables seen in this light is therefore an independent form of haq *mali* and can be traded like any other property rights?

An analysis of the view suggests that the exchange of these types of rights is considered as the exchange of *'ayn* for *'ayn* or *'ayn* for *dayn,* and thus, is not objectionable. In a similar line, the Hanafis have allowed *bay'* al-istisna:, defining it as a sale of an *'ayn* though one that does not exist yet. Here, the Hanafis treat the property which is yet to be constructed as an *'ayn,* not *dayn* nor *fi al-dhimmah.* Hence, a building to be constructed or partially under construction is already treated as an *'ayn* – a corporeal matter - though in reality it may only be an expectation of a corporeal property to exist in the future. This expectation may be described as a right to a future corporeal property, thus, a corporeal proprietary right (Haq *mali 'ayni).* Since this proprietary right is obviously attached to a corporeal property (*'ayn)* - though one that is to exist in the future - it is corporeal in nature *('ayni).* The combination of these characteristics justifies the entity to be that of ~aq *mali 'ayni* which is different from Haqq *mali fi al-dhimmah* because the former is categorically a corporeal matter *('ayn)* and can be exchanged deferred *(dayn)* without triggering the rule against the sale of debt for debt.

From the preceding arguments, it seems that the division between the concepts of *'ayn* and *dayn* have not been decisively drawn. Certain situations that may look like a liability *(fi dhimmah)* can still be argued to be an asset *('ayn).*hence it becomes imperative for us to venture on further even more deeply to understand what sale of debt it and the rules related to it and to decide on its permissibility or not and if so what effects it can have in the eternity of it.

5.0. THE WRITING HAS ALWAYS BEEN ON THE WALL

5.1. BAI AL-DAYN AS SALE OF DEBT:

"Dayn" means "debt" and "Bai' " means sale. "Bai'-al-dayn", therefore, connotes the sale of debt. According to Majalah al-ahkam al-adliyah, no 158 ; Dayn defines as the thing due i.e the amount of money owed by a certain debtor. Al-Dayn can be either monetary, or a commodity, i.e food or metal. Bay' Al-Dayn or debt trading or sale of debt can be defined as the sale of payable right or receivable debt either to the debtor himself, or to any third party. This type of sale is usually for immediate payment or for deferred payment.

The Shariah permits the selling of debt by its equivalent in quantity and time of maturity by way of hawalah. This form of debt trading is accepted by all schools of Islamic law provided it is paid in full and thus gives no benefit to the purchaser. The rationale for this ruling is that financial transactions involving debt should never allow deferred payment, as this would be regarded as Riba or Bay' al-Kali bi al-Kali which is prohibited by the Prohpet S.A.W. (International Journal Of Islamic Financial Services, vol 1, no 2, Saiful Azhar)

According to most Hanafis, Hanbalis and Shafie jurists, it is not allowed to sell Al-Dayn to non debtor or a third party at all. However Malikis, and some Hanafis and Shafie jurist allowed selling of debt to third party with some conditions which are :-

a- The ability of seller to deliver the debts;

b- The debt must be mustaqir or confirmed and the contract must be performed on the spot;

c- The debt cannot be created from the sale of currency (gold and silver) to be delivered in the future and the payment is not of the same type as debt, and if it is so, the rate should be the same to avoid Riba.

d- The debt should be goods that are saleable, even before they are received. This is to ensure that the debt is not of the food type which cannot be traded to the debtor. (Hasyiah Ad-Dusuqi, vol 3, p 63)

The main issue here is, whether it is permissible to sell a confirmed debt which is backed by a non ribawi goods at discounted price?

Mainstream Islamic scholars have put a plug on the possibility of earning profit by confirming that any sale of debt (Bay'-al-dayn) or transfer of debt (Hawalat-al-dayn) must be at face value. This means in the above question, when the bank buys the instrument of debt (shahada-al-dayn) from the original buyer, it is not entitled to any discount. Doors of riba are closed shut by disallowing any difference between what it pays (purchase price of the instrument) and what it receives on maturity (its maturity value). Notwithstanding the clear verdict against such transaction, some Islamic banks have been offering Islamic bill discounting products. They essentially treat debt as any other physical asset that can be traded at a negotiated price.

In fact, the prohibition of Bay'-al-dayn is a logical consequence of the prohibition of "riba" or interest. A "debt" receivable in monetary terms corresponds to money, and every transaction where money is exchanged from the same denomination of money, the price must be at par value. Any increase or decrease from one side is tantamount to "riba" and can never be allowed in Shariah.

Some scholars argue some forms of Bay' ad-Dayn is permissible, and they said that the permissibility of Bay ad-Dayn is: -

restricted to a case where the debt is created through a sale of a commodity. In this case, they say, the debt represents the sold commodity and its sale may be taken as a sale of the commodity. They said that on the conditions set by Maliki mazhab "payment is not of the same type as dayn, and if it is so, the rate should be the same to avoid Riba". In this context of the sale of securitized debt, the characteristics of securities differentiate it from currency, and hence, it is not bound by the conditions for exchanging of Ribawi goods, therefore, selling debt which is represented non-Ribawi asset is permissible to be discounted. (Securities Commission Shariah Advisory Council Resolution(p19)

The debt is created by the sale of goods and services through the sale-based modes of Islamic Finance, particularly Murabahah. The debt is created by the Murabahah mode of financing permitted by the Shariah and the price, according to the Shariah Scholars themselves, includes the profit on the transaction and not interest. Therefore, when the bank sells such debt instrument at a discount, what it is relinquishing, or what the buyer is getting, is not interest but rather a share in the profit.

The arguments, however, have been rejected by majority of the jurists. According to them, once the commodity is sold, its ownership is passed on to the purchaser and it is no longer commodity of the seller. What the seller owns is nothing other than money, therefore if he sells the debt, it is regarded as the sale of money and it cannot be termed by any stretch of imagination as the sale of the commodity. This is why the view has not been accepted by the overwhelming majority of the contemporary scholars. (Mufti Taqi Uthmani, An Introduction to Islamic Finance)

It is considered as the sale of rights on a debt and not the debt itself. In that sense, it is allowed to sell it to the third party and also either with discount or not. However, majority of Shariah scholar rejected this view as the right of the debt is still considered as the debt itself. Such sale would be nothing but a disguised way of receiving and paying interest.

This is the same as the principles of debt settlement. They say that there is a Hadith narrated by al-Bukhari that strongly support debt reduction, while parties opposing to the concept are unable to provide any strong arguments except to justify that debt reduction contains element of Riba al-nasiah and Riba al-Fadl. Such argument is not correct because the process of settling a debt does not constitute a trade. Furthermore, those opposed to debt reduction or discounting have overlooked the mechanism of Ibra' which involves the discharge of the whole or part of one's claim on a debtor. Ibra (rebate) which is similar to debt reduction is accepted by Shariah jurist. However, the opposing scholars do not agree with the analogy and considered ibra' and sale of debt with a discounted price is different in its objective and its

implementation. The prohibition is also based on the concept of Sadd az-Zariah or closing the potential Riba from occuring.

Some parties in Malaysia encourage the development for debt discounting as an Islamic Financial product on the basis that it represents an important field of short term and self liquidating investment, because the terms of negotiable instruments do not in most cases extend beyond six months especially in trade based debt discounting (Saiful Azhar , International Journal Of Islamic Financial Services, vol 1, no 2)

The Islamic Fiqh Academy of Jeddah which is the largest representative body of the Shariah scholars and is represented by all the Muslim countries, in its 16th convention at Mekka on 5-10th January 2002 has re-discussed the issue and stated that sale of debt is prohibited including the following:-

a) Sale of debts to debtors with a deferred payment plan exceeding debt amount as this can be considered as Riba al-Fadl and Riba an-Nasiah. (Jadwalah ad-Dayn)

b) Sale of debts to a third party with a deferred payment plan whether the debt is paid with the same type of kind or not; as this can be considered as sale of debt with debt (bai' al-kali bi al-Kali which is clearly prohibited by Prophet Muhammad)

According to the academy, commercial papers such as cheques, promissory notes and bill of exchange cannot be sold at a discount as there is element of Riba. It is not allowed to deal, issue, distribute or trade with Riba based Bonds because the element of Riba is present. It is not allowed to deal with debt notes in the secondary

market as it involves discounts and sale of debts to third parties which has Riba elements.

The Islamic Fiqh academy proposed that a Shariah approved alternative for discounted papers and and sale and purchase of bonds is sale in the form of goods; with a condition that the seller hands over the good during aqad (contract), it is allowed even though the price of the good is less than the value of the commercial paper.

It is crucial to recognize and appreciate the differences in opinion even though the opposite opinion is seems to be weak. Especially in the situation in which all parties involved are qualified and have their own evidences and interpretations which are guided by true ijtihad (intellectual effort) guidelines. We must also realize that there is still room for ijtihad, particularly in the Fiqh Muamalat issue which fall under the Islamic Legal Maxims “it is a fundamental principle that rulings in Islamic transaction must be taken into account it objectives”. Therefore, as long as there no ijma’ (consensus of jurist) that forbids Bay’ ad-Dayn, it is not healthy to condemn other ijtihad. However the best way suggested in this kind of issue is “Get out from the disputation is always recommended”. Thus, it’s better to avoid Bay’ Ad-dayn when there is alternative.

let us for the sake of argument support the view that the sale of debt is allowed and a system which involves selling of debt should be maintained and expand our understanding a little further for the stretch of imagination in the light of few following cases because the moment we support then due to the inated virulence of it, this is how it unfolds as we will judge it through certain pomp financial instruments which base on the allowance-the syndrome which is trying to sink its teeth in Islamic finance.

6.0 WISDOM PERSONAFIED

6.1. IT WAS ALWAYS MEANT TO BE LIKE THIS:

The sale of debt to third parties, especially through multiple securitizations, has been blamed for fueling the worst global financial crisis in generations. Although some banking experts still say the sale of debt is key to developing a liquid secondary Islamic bond market and a deeper, more sophisticated sharia banking system.

The global total of asset-backed securities issued and sold to investors fell by 79 percent to $441 billion in 2008, as overleveraged borrowers, banks and investors exited the market, according to think-tank International Financial Services London.

Some debt financing has always been part of the financial markets. Even in heyday of Islamic civilization trade credit, a form of debt financing, thrived. Islam has no problem with that as it fits in with prohibition of exchanging money now with a larger amount of money after a period of time. The problem starts with sale of debt, whether created by a money loan or owed as a price of goods sold on credit. Sale of debt is allowed at par or face value. But there can hardly be a market for exchanging debts at par. You have a market for debt when bond [i.e., debt] prices are determined by supply and demand. Sale of debt implies selling risk [or shifting risk]. A thriving market for debts at prices determined by supply and demand [as in conventional bond markets] is vulnerable to gambling like speculation as there exists no objective basis for measuring risks of

default. The changing prices reflect changing subjective perceptions of the risks involved. As is well known these perceptions can sometimes be manipulated through planting stories in the media.

Remarkably, a ban on selling debts would drastically reduce the outstanding volume of debt. In effect it would scale down the volume of outstanding debts to the level of existing real assets. The inverted pyramid of debts, standing on a slender base of real wealth, would be replaced by a rectangular column of debts, owed against an equal amount of real goods and services acquired. The volatility in the bond market is directly related to the total volume of bonds. The larger the volume of debts, the weaker its connection with real wealth, and the more the scope for gambling-like speculation.

6.1.1. CASE OF DERIVATIVES:

Derivatives also involve excessive uncertainty. They facilitate managing certain market risks (related to prices, rates of exchange, etc.). Chance remains the basic element in the situation, however, expectations being based on pure speculation. Derivatives too are a zero sum game: you lose what I gain, unlike the win-win situations in trade or risk sharing. The claim that they increase liquidity and improve operational market efficiency in financial markets remains unsubstantiated. What can be empirically established is that, whatever the initial benefits for a certain class of investors, availability of derivatives invites speculative activity.

6.1.2. CASE OF FUTURES (which potentially can spill future)

Futures trading may be said to proceed over deferred and unpaid debts. A debt is normally created by a trader who enters the market either as buyer or seller without any physical exchange of values. The debt so originated may subsequently become the subject of an offset or a reverse transaction and a chain of sales and purchases may follow that amount essentially of the sale of debts. The offsetting transaction in futures also consist of sales involving a debt that one party owes to another and settles it through the modality of sale and purchase. Many types of sales have been included under *bay al duyūun* (lit., sale of debts, also known as *bay al kali bi al kali*), and it has been disputed as to whether some of them do in fact qualify as “sale of debts.” It will be noted that the *fiqh* concept of *bay al-dayn* referred to transactions over debts in the open market without any guarantees. *Bay al-dayn* basically envisaged sale over an unpaid debt involving either two, or in some cases, three parties. The basic rationale of the prohibition of *bay al-dayn* was over uncertainty in its repayment. *Bay al-dayn* could proceed over a bad debt or one in which the debtor simply wanted a further delay due to his inability to pay on time. Subsequent unfavorable price changes also added to that uncertainty. The situation is very different in the futures market now where all transactions are concluded over guaranteed debts. The critics have not hesitated, however, to pass judgments and say: since the buyer in futures does not pay the price to the seller nor does the latter take delivery, they transact over debts and indulge in *bay al-kali bil-kali*, which is prohibited Some instances of *bay al-dayn bil-dayn* are illustrated as follows:

1.A borrows two tons of wheat for his personal needs from B. This amount is returnable in six months. Prior to the expiration date, B sells the wheat, which is a debt on A, to C in exchange for a ploughing machine to be delivered in one month. This transaction proceeds over an exchange of debts and is considered unlawful due to uncertainty over delivery and the resulting likelihood of *gharar*.

2. A borrows $2,000 from B for a period of one year, but before repayment is made, B suggests to A that he will rent A's house in exchange for the sum owed to B. This too involves selling one debt for another without delivery on either side. If the proposed exchange is advantageous to one party, it will also involve unlawful gain amounting to *riba*.

3. A owes B RM1,000 payable in six months. Upon expiry of six months B asks A to give him a ton of wheat in exchange to be delivered in one year.

4. A sells a garment to B for RM1,000 payable on spot, and then buys from B the same or a similar garment for RM1,200 payable in one year. This transaction (*[inah*), although validated by the Shafi[is, is invalidated by other schools as it involves *riba* and, according to others, because it is a sale of debts. The following *Hadith* is quoted as evidence on the subject: Mūsa ibn [Ubayd reported from [Abd Allah ibn [Umar simply that "the Prophet prohibited *bay al kali bi al kali*.

6.1.3. CASE OF SALE AND SECURITIZATION OF DEBT:

The second issue we take up is the sale of debt, *bai 'al-dayn.* Prohibition of interest almost eliminates the direct lending of money for business. So there is no bond market in an Islamic economy whose liquidity should become an issue. Direct lending of money is replaced by murabaha and similar credit transactions, effectively tying the expansion of credit with the growth of the economy. In place of conventional treasury bonds Islamic financial markets have bonds based on Ijara (leasing), Salam (prepaid orders) or Istisna' (manufacturing orders on a pay as you get basis). But there also is a huge debt created by installment sales and murabaha. To some, making all these wait till maturity implies waste. This waste occurs at two levels. Firstly, those holding IOUs will need credit to command real resources in order to continue producing, having presumably exhausted their own resources in producing what they already sold on credit. This means the society will always carry lots of illiquid assets, the IOUs. Secondly, this may force sellers/producers to refuse selling on credit, demanding cash instead. A society in which all IOUs must await redemption by the original debtor cannot economize on the use of cash. This is rather inefficient (but not a big deal in a fiat currency regime!).

It may rightly be pointed out that somebody must await maturity of debts incurred in the process of acquiring command over real resources on credit. As Keynes pointed out commenting on the 'liquidity fetish', not everybody can be liquid all the time. It is, however, more efficient to provide opportunities for exchange between those who are willing to wait and share the risks involved (as the Islamic framework does not reward

pure waiting) and those who seek liquidity. One way to do so is to allow IOUs as collaterals for fresh credit---a practice already in vogue in the Islamic financial market. It is also permissible to exchange these IOUs for goods and services. But some want more, let us see if they can have it.

The juristic objection to sale of debts resulting from murabaha, etc. is the same as in case of selling a debt created by a money loan. If I buy for 90 an IOU worth 100 after a year, I am doing so in order to earn 10 as interest. They see no reason to distinguish between IOUs created by murabaha and IOUs created by lending money. This seems to be underlying the latest Islamic Fiqh Academy resolution on the subject that states: 'It is not permissible to sell a deferred debt by the non-debtor for a prompt cash, from its type or otherwise, because this results in *Riba* (usury). Likewise it is not permissible to sell it for a deferred cash, from its type or otherwise, because it is similar to a sale of debt for debt which is prohibited in Islam. There is no difference whether the debt is the result of a loan or whether it is deferred sale' (Islamic Fiqh Academy, 2000, p.234). However, the view equating, in this context, money loans and debts resulting from credit has been challenged. There are reasons to treat the two differently, say Chapra and Khan : 'The debt is created by the *murabaha* mode of financing permitted by the Shariah and the price, according to the *fuqaha* themselves, includes the profit on the transaction and not interest. Therefore, when the bank sells such a debt instrument at a discount, what it is relinquishing, or what the buyer is getting, is not interest but rather a share in profit' (Chapra and Khan, 2000, p.78). In other words, a debt resulting from murabaha has an element absent from a debt arising from borrowing money-- the mark

up on spot price. Sale and purchase of murabaha-based debt would take place on this extra profit margin.

The problem with this proposition is that what was a profit margin for the seller of goods and services (on a murabaha basis) may not necessarily remain so when the same seller 'sells' the IOU arising from that transaction. Some of the factors involved in the determination of the mark up on spot price in murabaha may be different from those involved in the sale of the resulting IOU at a discount. Furthermore, the extra profits earned in murabaha sale, over and above those earnable on selling for cash, are still against sale of goods and services. But the part of it that goes to the buyer of the murabaha based IOU (according to the above mentioned rationalization) has no goods and services corresponding to it. It is money for money, with a difference of dates.

The authors go on to argue that there is hardly any *gharar* involved in the sale of debt-instruments under discussion, a point we may ignore because of the limited purpose of this paper. What interests me is their plea that the *fuqaha* reconsider the case of asset-based debt instruments and allow their sale as it would lead 'to the accelerated development of an Islamic money market' (ibid, p. 79) They proceed to emphasize the need for such a market by pointing out that Islamic banks may face a liquidity crunch in its absence, paralyzing the whole system. They also believe 'it is difficult for banks to play effectively their role of financial intermediation, without being able to securitize their receivables' (Chapra and Khan, 2000, p.79). After discussing alternative avenues of raising large funds required by client companies through banks, they conclude that 'it

would be preferable to allow banks to rely on the sale of their own assets to raise liquidity.'(ibid, p.80)

So it is efficiency that is at stake, in an environment where the inefficient may not long survive. Once again the same story: the jurists bent on ensuring justice by avoiding anything similar to riba/interest and the economists keen to maintain efficient markets. Do they understand each other's concerns? Is the rationale (*hikmah*) of prohibiting *riba* also applicable to sale of debts resulting from murabaha so that it must be blocked to ensure justice? What about a trade-off between the two objectives of Shariah, justice and wealth creation? Is such a trade off acceptable under certain circumstances? Does it become unavoidable sometimes? Can we agree on some formula that ensures a reasonable degree of fairness with a reasonable level of efficiency? These questions have yet to be thoroughly examined. Those arguing in favor of legitimizing sale of debt have to demonstrate that no alternative methods of ensuring liquidity are available. They have also to meet the objection that once sale of debt is allowed insofar as asset based IOUs are concerned, prohibiting the sale of IOUs based on money lending will be difficult, if not impossible, to sustain.

Bai' al-dayn is approved by Malaysian Shariah scholars (Securities Commission, 2002). It has a place in Islamic banking as practiced in Southeast Asia. Shariah scholars in that region which follows the Shafi 'i school of Islamic Law base their opinion on certain rulings which the scholars in the heartland of Islamic finance following other schools, generally speaking, do not agree with (Usmani, 2000). Bank Islam Malaysia is marketing Negotiable Islamic Deposit Certificates (NIDC) backed by murabaha based

assets (Archer and Karim, 2002, p.132). 'In Malaysia the Islamic benchmark bond was introduced in 1990 and is believed to be based on the *murabahah* concept. They are the most popular form of Islamic financing method used in Malaysia' (al-Amine, 2001, p.3). Al-Amine goes on to note, however, the controversy that still surrounds the Shari 'ah legitimacy of these bonds (ibid, p.4).

Many Islamic debt instruments on sale in the Malaysian market are criticized on the ground that they involve *bay' al-dayn* and *bay'al-'inah* (Rosley and Sanusi, 1999). But some scholars refer to certain Hanbali and Maliki jurists (.e.g., Ibn e Qayyim and Dasuqi, respectively) who 'are of the opinion that selling *dayn* to a third party is not against syarak (*shar')*' [Ishak.1997, p.6].It is noted that there is a difference between the debtor being asked by the creditor to pay more than the price agreed upon in a credit sale in lieu of delay in payment, and selling the IOU arising from that credit sale to a third party. In the latter case the seller on credit, who holds the IOU, is no longer dealing with the debtor. He is dealing with a third party to whom he sells the IOU. The deal between this third party, which now holds the IOU, and the debtor, is free of the constraints attending upon the deal between the seller on credit and the one who buys on credit. '*Bay al-dayn* to a third party, however, is different because a third party does not ask for increase in price from the debtor. The debtor will just pay according to the initial contract. As *dayn* has been sold to a third party, the initial creditor will no longer make a claim but the third party will.'(Ishak, 1997, p.7). Ishak proceeds to argue, ' Can *haq al-dayn* (be) sold at a lower price? The answer is yes, because it is not a currency and the attributes transferred when bought consist of *haq mall* not currency…….Based on the above, if the initial seller is willing to reduce his right and give the third party the

full right, it is not at all against syriah (Shari ‘ah) principles. The same with share certificates traded, it is an ownership right in a company and when sold in the secondary market the price is essentially different from the initial price’ (Ishak, 1997, p.7).

Does not sound very convincing, as a shareholder does not hold a claim to a definite sum of money to be paid in future. But there is no need for me to evaluate these arguments in analogical terms. What I am interested in is their focus on distancing sale of debt from riba/interest and trying to show it is fair trade, free of injustice as symbolized by riba/interest. Hence the claim that asset based securities are like share certificates and necessary for the well being of people. This is evidenced by Ishak’s appeal to the ‘syari‘ah (Shari ‘ah) principles of *ra’fah* and *takhfif* in his conclusion (ibid, p.8).In other words, it is being asserted that allowing sale of debt arising from credit sales is neither unjust nor unfair as it does not involve riba/interest. Also it is emphasized that it should be allowed in order to make life easy and prosperous. I think it would have been better if instead of finding an analogy between a certificate of ownership in a company and an IOU, Ishak had pursued the *maslaha* based arguments on which he concludes.

It would be far better to conduct the debate openly in the framework of ease versus hardship, efficiency versus fairness, growth versus distribution. The trade-offs could then be openly examined, sometime even measured. At the macroeconomic level, we need to know why liquidity cannot be guaranteed without legitimizing the sale of debt. It has to be discussed how giving debt-financing a greater role is likely to change the nature of Islamic economy which emphasizes risk sharing and participatory finance.

Alas! That is not the way legal issues are handled, especially in an industry in a hurry, as the Islamic financial industry currently seems to be, under tremendous pressure from its more 'efficient' competitors. While the Shariah scholar sitting on an Islamic bank's advisory board may have barely the time to check the relevant texts and whether a particular analogical reasoning is acceptable, the task of the social scientists/moral philosophers is more contemplative, time taking. An appeal to *maqasid al-shariah* (objectives of Shari 'ah) is not that easy as it may seem to the un-initiated. It involves a far deeper understanding of Islam as a way of life, a process of social reconstruction and a mission with humanity that one would normally expect in a legal expert these days. Islamic Finance is about all these objectives, some of which are hard to realize through analogical reasoning, even financial engineering.

7.0. CONCLUSION:

The above literature is a self explanatory pragma which analyzes the whole dimension of trade in Islam which submerges in it the qualification of mal and hence its origination of becoming a permissible subject matter derived from which understanding, extricates the very realm of the non-permissibility of the controversial and enigmatic sarrogative subject matter, trade of which violates the very basics norms of shariah hence sabotaging harnessing of the society .this article has tried to showcase the Islamic wisdom of why permissible qualification of a subject matter is pivotal and why the debt as permissible subject matter is debarred ruling out the sale of it.

It proves that allowance of debt salability creates a black hole environment which sucks the blood out of real sector into virtualism by providing breeding ground to excessive

risk taking, speculation showcased by cases on derivatives and futures, securitization hence sale of debt, catapult of which is deterioration in from of the present crisis.

Islamic allowance of permissible property for trade and debt as the opposite substantiate the very fact that how Islam is always trying to provide justice and avoid disputes as to harness not only the individual but the society as a whole. An approach of do good and have good under the ambit of a just society.

Table 1. Types of the Contract of Sale that the Scholars Have Covered in Their Writings

Type of Sale	Subject Matter	Price	Mode of Exchange
Barter (*Muqāyaḍah*)	Corporeal	Corporeal	Simultaneous trading
Mua'jjal sale	Corporeal	Corporeal	Price is delayed
Mua'jjal sale	Corporeal	Corporeal	Object is delayed
Barter but falls under the category of *bayʿ al-kāli' bi al-kāli'*	Corporeal	Corporeal	Both are delayed
Sale	Corporeal	Money	Simultaneous trading
Mua'jjal sale	Corporeal	Money	Price is delayed
Salam sale	Corporeal	Money	Object is delayed
Bayʿ al-kāli' bi al-kāli'	Corporeal	Money	Both are delayed
Ṣarf	Money[9]	Money	Simultaneous trading
Ribā al-nasī'ah	Money	Money	Delay in one of the exchanged countervalues
Ribā al-nasī'ah	Money	Money	Both are delayed
Sale of debt for cash	Debt[10]	Money	Immediate payment
Bayʿ al-kāli' bi al-kāli'	Debt	Debt	Deferred

APPENDIX

OPINION OF THE PAST ISLAMIC JURISTS:

Hanafi Mazhab

The Hanafis are unanimous in not permitting bay al-dayn with reason that the debt is in the form of mal hukmi (intangible property) and the buyer takes great risk because he cannot own the item bought and the seller can not deliver the item sold.

Maliki Mazhab

The Malikis allow bay al-dayn subject to certain conditions as follows:

- Expediting the payment.
- Debtor present at the place of sale.
- Debtor confirms the debt.
- Debtor belongs to the group that is bound by law so that he is able to redeem his debt.
- Payment is not the same type as dayn, and it fit so, and the rate should be the same to avoid riba.
- The debt cannot be created from the sale of currency (gold and silver) to be delivered in future date.
- The dayn should be goods that are saleable even before they are received. This is to ensure that the dayn is not of the food type which cannot be traded before qabadh occur.

- There should be no enmity between the buyer and seller, which can create difficulties to the debtor.

Shafi'i Mazhab

The Shafi'i allows the selling of debt to a third party if the dayn was mustaqir (guaranteed) and was sold in exchange for goods that must be delivered immediately. The debt is sold; it must be paid in cash or tangible assets as agreed.

The Securities Commission Shariah Advisory Council held that in the context of the sales of securitized debt, the characteristic of securities differentiates it from currency. It is not a legal tender and therefore, it is not bound by the conditions for exchanging of goods. It is not a ribawi item as the fifth condition set by Maliki mazhab.

BIBLIOGRAPHY:

- S.E. Rayner, The *Theory of Contracts of Islamic La*w, Graham & Trotman, London, 1991
- Mawlana Taqi Usmani, *An Introduction to Islamic Finance*, Idaratul Maarif, Karachi, 1998
- Uduvitch, *Partnership and Profit in Medieval Islam*, Princeton University Press, 1970
- M. Tahir Mansuri, *Islamic Law of Contract and Business Transactions,* Adam Publishers & Distributors, New Delhi, 2006
- Razali Nawawi, *Islamic Law on Commercial Transactions*, CT Publications Malaysia, 2000.
- Alaeddin Kharufah, *Transaction in Islamic Law*, A.S. Nordeen, Kuala Lumpur 20048. Liaqat Ali Khan Niazi, *Islamic Law of Contract.*
- *The Majelle*, (the Ottoman Civil Law based on Hanafi school) Published by Open Press KL
- *The Hidayah*, English translation by Hamilton of the Arabic Hanafi Fiqh Manual: al-Hidayah .
- Nabil Salih, *Unlawful Gain and Legitimate Profit in Islamic Law*, Graham & Trotman, 1992 Abdul Barr, Muhammad Zaki (1990), Raiun Aakhar fi Matl al-Madin, hal yulzam bi'l-Ta'wid?, *Journal of King Abdulaziz University:Islamic Economics* (Jeddah),vol.2, pp.155-160.

- Abdul Barr, Muhammad Zaki (1991) Ta'liq, *Journal of King Abdulaziz University :Islamic Economics* (Jeddah), vol.3, pp.61-62 (Arabic/English Section)

- Al-Amine, Muhammad al-Bashir Muhammad (2001) The Islamic Bond Market: Possibilities and Challenges, *International Journal of Islamic Financial Services*, vol.3, no. 1, April-June , <http://Islamic-finance.net/journal.html>

- 'Attiyah, Jamal (1990) al-Jawanib al-Qanuniyah li Tatbiq 'aqd al-Murabaha, *Journal of King Abdulaziz University: Islamic Economics* (Jeddah),vol.2, pp.125-145.

- Chapra, M.U and Tariqullah Khan (2000), Regulation and Supervision of Islamic Banks, Jeddah, Islamic Research and Training Institute, Islamic Development Bank

- Al-Dareer, al-Siddiq Muhammad al-Amin (1985) al-Ittifaq 'ala Ilzam al-Madin al-Mu'sir bi Ta 'wid Darar al-Mumatalah, *Journal of Research in Islamic Economics* (Jeddah), vol.3, no.1, pp.111-112.

- al-Dareer, al-Siddiq Muhammad al- Amin (1993) Ta'liq, *Journal of King Abdulaziz University : Islamic Economics* (Jeddah),vol.5, pp.69-77.

- Al-Dareer, Muhammad Siddiq al-Amin (1993) Ta 'liq, *Journal of King Abdulaziz University : Islamic Economics (*Jeddah),vol5,pp.63-67.

- Elgari,Mohammad Ali,Mohammad Nejatullah Siddiqi and Mohammad Anas Zarqa (1993) Qanun al-Masarif-- Sighah Muqterahah li-Tanzeem Qita 'in Masrafi Islami, *Review of Islamic Economics* (Leicester),vol. 2, no. 2,1993, pp.67-97.

- Hammad, Nazeeh Kamal (1985) al-Muwayi'dat al-Shar'iyah li Haml al-Madin al-Mumatil 'ala'l-Wafa' wa Butlan al-Hukm bi'l Ta'wid al-Mali 'an Darar al-Mumatalah, *Journal of Research in Islamic Economics* (Jeddah),vol.3,no.1,pp. 101-108.

- Ishak, Dato Othman Hj. (1997), Developing Dha' wa Ta 'ajjal in Structuring Islamic Instruments, Paper presented at the International Capital Market Conference held at Kuala Lumpur on 15-16 July ,1997

- Islamic Fiqh Academy (2000) Resolutions and Recommendations of the Council of the Islamic Fiqh Academy 1985-2000, Jeddah, Islamic Research and Training Institute, Islamic Development Bank

- Al-Kaff, Habib Hamid Abdul Rahman (1993), Ta 'liq, *Journal of King Abdulaziz University: Islamic Economics* (Jeddah), vol3, pp.63-64.

- Al-Roobi, Rabi‘(1992), Ta ‘liq*, Journal of King Abdulaziz University* : *Islamic Economics* (Jeddah),vol4,pp.67-69.

- Saleh, Ibn al-Haj Mohammad (2002) al-Ta ‘wid ‘ind al-Takhir fi al-Sidad bain al-Mu ‘aradah wa’l Ta’id in *Majallat al-Masarif*, (Khartoum) No.1 June

- Securities Commission (2002) Resolutions of the Securities Commission Syariyah Advisory Council, Kuala Lumpur, March
- Usmani, Muhammad Taqi (2000) Bay ‘ al-Dayn wa’l Awraq al-Maliyah wa Badailuha al-Shar‘iyah, in *Dirasat Iqtisadiyah Islamiyah* (Jeddah), vol. 7, no. 1,pp.7-34

- State Bank of Pakistan (2004) Press Release: State Bank’s Shari ‘ah Board Approves Essentials and Model Agreements for Islamic Modes of Financing, April 16 (http://www.sbp.org.pk/press/2004/Islamic_modes.pdf)

- Al-Zarqa, Mohammad Anas and Mohammad Ali Elgari (1991), al-Ta ‘wid ‘an Darar al-Mumatalah fi’l Dayn Bain al-Fiqh wa’l Iqtisad, *Journal of King Abdulaziz University :Islamic Economics* (Jeddah),vol.3, pp.25-25-56

- Al-Zarqa, Mustafa Ahmed (1985) Hal Yuqbal Shar‘an al-Hukm ‘ala’l-Madin al-Mumatil bi’l Ta ‘wid ‘ala al-Da’ in?, *Journal of Research in Islamic Economics* (Jeddah), vol.2, no.2, pp 89-97.