USE OF USUFRUCT BONDS IN FINANCING PUBLIC UTILITIES

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Revised Draft
Rabi' Awwal 1418H

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INTRODUCTION

Public utilities are produced by the Government in most Muslim countries and, generally speaking, they burden the Government budget with their financing. The paper aims at proposing an alternative method of financing by throwing the financing burden on the users of these utilities and on investors in the private sector.

The proposed study covers financing the production and distribution of such utilities as water, electricity, public transportation, education, communication, radio and TV, postal services, etc. As easily observed, some of the public utility enterprises produce commodities, such as piped water; others produce services of their machinery and equipment, such as the communication service. Furthermore, some service producing enterprises have their output in the form of services whose main component is labor or work, such as education and garbage collection enterprises, while others produce services whose main component is a result of the operation of machinery and equipment, such as electricity. The kind of securities that can be used for financing may, therefore, differ from one enterprise to another, depending on the nature of its output, because of the intrinsic differences between *Ijarah* and sale contracts attached to the exchange of their different kinds of output.

In 1981, the Government of Jordan promulgated a special Act for financing the construction of land owned by *Awqaf* and Municipalities under the name of the Act of *Sanadat al Muqaradah*. *Sanadat al Muqaradah* were later studied by the Islamic *Fiqh* Academy and a decision was taken approving the basic idea of *Sanadat al Muqaradah* and stipulating certain conditions for their issuance and negotiability.[1] The idea of *Sanadat al Muqaradah* was derived from the *Mudarabah* (*Muqaradah*) contract, which is known in *Shari'ah.* In *Mudarabah*, the owner of funds shares with the entrepreneur the net profit, while bearing the losses alone. Thus, *Sanadat al Muqaradah* carry a high degree of risk and depend heavily on the business ability, efficiency and trustworthiness of the entrepreneur. Until today no *Sanadat al Muqaradah* have ever been issued in Jordan on the basis of the above mentioned Act.

On the other hand, *Muqaradah* serves as the cornerstone in the mobilization of resources for investment in the Islamic Banks all over the world and there are several deep-rooted experiences in

[1] Decision No.5 of the 4th Annual Meeting of the *Fiqh* Academy, held in Jeddah, 18-23/6/1408H [6-11/2/19881].

establishing unit funds on the basis of *Muqaradah* by several Islamic financial companies and by Islamic and conventional banks as well.[2]

The basic idea in this paper is based on the *Ijarah* contract. It is known in *Shari'ah* that *Ijarah* contract applies to the usufruct of lasting assets as well as to physical human services.[3]

A special kind of bonds (*sanadat*) will be proposed that is based on the sale of human services and/or the usufruct of machinery and equipment. As *Ijarah* is, in a sense, a sale contract whose subject is services, not assets.

In this paper the nature of proposed usufruct bonds shall be discussed. Its *Shari'ah* foundation and the different forms they can take will also be studied as well as the salient features of these bonds and their negotiability and issuance for financing public utilities whether owned by the Government or by the private sector. Usufruct bonds will also be compared with other kinds of securities that can be used for financing public utilities.

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2 Such as the *Mudarabah* funds of the Gulf Investment Companies, the specialized investment funds of Al Rajhi Banking Company for Investment and of Al-Barakah Group and a couple of funds by the National Commercial Bank in Saudi Arabia.

3 "Lasting" is a relative term that should be understood in relation to the period of *Ijarah* contract.

In addition to this introduction, the paper has three sections as follows:

Section I : Public Utilities and their Financing. In this section we will discuss the general definition of public utilities, especially from the point of view of the present paper. The public utilities financing needs will also be discussed especially from the angle of their effects in burdening the government budget. This will be done with the help of examples from a few member countries.

Section II : Usufruct Bonds and their *Fiqh* Foundation.

This section will focus on defining the proposed usufruct bonds and the implications that can be derived from their definition. The main characteristics of the usufruct bonds will also be discussed along with possible examples of the usufruct/service bonds. In this section we will also discuss the *fiqhi* foundation on which these bonds can be based, and their characteristics are derived.

Section III : Economics of usufruct bonds. The crux of this section will center on comparing the usufruct bonds with common shares and public debt bonds. We will also propose an approach for their application including pre-requisites for successful issuance and negotiability in the financial markets in the Muslim countries.

Conclusion : summing up the main points.

SECTION I

PUBLIC UTILITIES AND THEIR FINANCING

A- PUBLIC UTILITIES

The definition of public utilities vary from one writer to another and from one economy to another. Generally speaking, they include energy (electricity and gas), collection of garbage, sewerage, water and postal service. Some writers include telephone, Radio and T.V., airlines and toll bridges. [4] Others may also include railroads and urban and intercity mass transportation. Some others may further include roads, seaports and metropolis street lighting. For the purpose of this study, we will take a broader and more loose meaning of public utilities. Hence, we will also add education at all its levels, and public health services for reasons which will be explained momentarily.

Public utilities are sometimes produced by public enterprises whose definition is equally loose, and they are sometimes produced by privately-owned firms. Many countries have even applied the concept of mixed enterprises to the production and distribution of many public utilities.

[4] Dieter Bös, p.19.

Although most of the above mentioned public utilities (and the like) touches on the welfare of many people in all societies, the standard definition of “public goods” can hardly apply to all of them. Public goods’ definition is intrinsically connected to the principle of exclusivity, whereby the market fails to allocate their consumption through prices, and gives rise to allocation through a process of political choice.[5] Public utilities are not public goods in the above mentioned meaning.

Some or all of the public utilities have visible externalities that allow for a substantial social welfare element in them. For instance, garbage removal benefits thou neighbors in addition to improving health and environmental conditions. Most public utilities can sometimes be treated as merit goods where the social return from them exceeds what could be their market competitive price. Therefore, they are sometimes labeled as socialized goods,[6] or communal goods.[7]

However, from the point of view of the present study, what matters is the nature of the service produced by public utility

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[5] This definition itself is subject to the prevailing state of technology. For instance, the invention of broadcasting obscuring allows for the working of the principle of exclusivity in Radio and T.V.

[6] Ibid., p.23.

enterprises, regardless of whether they are in the private or public ownership. Since we are, strictly, interested in the securitization of usufructs/services, any form of service/usufruct that can be securitized may be included under the broad meaning of public utilities. An essential pre-requisite for this is that there must be some kind of “mass” demand of the usufruct/service and the service/usufruct is, or can be, standardized.

At any how, in most Muslim countries a great deal of public utilities is produced by governmental bodies and agencies or by independent entities owned by the state. Yet, even when such utilities are produced by the private sector, local or foreign, they are, usually, subjected to heavy governmental control, especially in the areas of labor compensations and pricing their products.

Furthermore, some of the public utilities are produced by what can be tagged as natural monopolies. Such cases like when the cost conditions, under the present state of technology, prevent the existence of more than one producer for the commodity or service.

Two kind of products are usually produced by public utility enterprises. Some of these enterprises offer for sale commodities that take the form of physical mobile assets, such as piped water,

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[7] Eytan Sheshinski, pp. 253-254.

liquefied gas or heating fuel. The ownership of these commodities is transferred to the consumer by means of a sale contract whereby the buyer can have possession of the purchased quantity in a stock form, such as piped water, or heating gas.[8] This kind of commodities can be stored if so desired by the purchaser in spite of the fact that some of them may require special storage facilities.

On the other hand, some public utility enterprises produce a pure service/usufruct that can only be consumed through time and does not provide the potentiality to store or to separate the moment of delivery from that of consumption. The obvious example of this kind of utilities is education, telephone services and TV viewing. The output of this kind of enterprises is only defined in term of a flow that can only be quantified at the moment of its consumption. This flow of services comes as a result of the operation of machines and other fixed assets, the expending of human energy and efforts, or a combination of both.

The distinction between these two kinds of public utilities is very important from the point of view of the present study. Commodities can be exchanged by means of a sale contract (including *Salam* and *Istisna*') while usufructs/services can be

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[8] Although, we usually consume these commodities at the same time of delivery, by turning on the water foset or pushing the gas heater button.

exchanged by means of *Ijarah* contracts. Each of these two contracts has its own characteristics that allow certain specific approach to financing.

Even for some of the first type of public utilities, i.e., the commodity producing enterprises, a closer analytical look may identify certain separable elements in the output that can be qualified as usufructs. For instance, a gas supply process requires delivery of a certain quantity of gas by use of piping network in a residential or industrial area in addition to the major pipeline system between the production facilities and the consumption quarters in the metropolitan centers. Thus, the final output of a gas supply company can be divided into two parts. The quantity of gas delivered and the transportation process of shipping that quantity from the production point to the consumer's place. The latter part of this public utility is the output that results from use of machines and the time of operators. Thus, it can be defined as a usufruct according to the above mentioned definition.

B) FINANCING NEEDS OF PUBLIC UTILITY ENTERPRISES

Most of public utility enterprises require huge financing for the production and transportation of their output. An electricity enterprise may produce electricity by means of a huge turbines installed under waterfalls from a dam or by use of fuel or atomic energy. The amount of investment required for the production of machinery is usually huge. Add to it the amount of investment required for a distribution network which is equally enormous.

Similarly, telephone communication, gas production and distribution, water refining, filtration and distribution and other public utilities, all require large investments to the extent that many Muslim countries were lead to utilize large portion of their public revenues for investment in the production and distribution of public utilities, especially, that the market size and the ability to pay of their consumers do not allow market pricing of the output of such huge invested installations and equipment.

Table 1

Expenditures on some Public Utilities and Services (U&S) in a Few IDB Member Countries*

1	2	3	4	5	6	7	8	9	10	11	12	13	14
Country	Currency	Year	Educa-tion	Health	Hou-sing	Ener-gy	Trans. & Comm	Total 5-8	% of U&S to total budget expenditure	Bud-get Deficit	Subsi-dies & curr. transfer	% U&S to Budget Deficit	% Subsi-dies to Deficit
Bahrain	M.Dinars	1994	77.7	55.9	10.4	49.0	62.7	255.7	39.5	58.3	82.7	440	143
Egypt	B.Pounds	1993	6.9	1.4	3.4	0.1	1.7	13.5	24.1	2.7	14.0	500	516
Jordan	M.Dinars	1993	201.2	87.1	16.2	17.7	71.3	394.5	31.9	69.7	118.8	566	170
Kuwait	M.Dinars	1994	451	235	200	229	61	1176	28.5	1302	1384	90.3	106.3
Malaysia	B.Ringets	1995	10.2	2.6	2.9	-	4.0	19.7	41.9	1.6	6.9	1231	431
Turkey	T.Liras	1994	122.5	26.9	11.3	25.3	5.0(1990)	191.0	21.2	150.9	277.1	126	183
Indonesia	T.Rupiah	1993	5.5	1.5	0.9	3.2	5.3	16.4	30	2.0	7.4	820	370

Source : IMF, Government Finance Statistics, 1995.

*(countries selected on the basis of availability of data)

A quick look at some financial data extracted from the budgets of a few IDB member countries and given in table 1 below indicates that the size of spending on these kinds of services and utilities was 21% and 42% of total budget expenditures in seven Muslim countries. It is true that some of the services and utilities mentioned in table 1 are income generating, but it is equally true that the revenues of these utilities are usually a small stream in relation to their huge expenditure burden. For instance, the Kuwaiti budget of 1991/93 showed a deficit of more than mKD 800 in some of these utilities and services.[9]

Consequently, table 1 shows that the ratio of five major items of utilities and services to the budget deficit in those countries was between 90% to 123%. This means that for the majority of the seven Muslim countries of table 1, an effort toward self reliance in those utilities and services can kick the budget deficit out for ever. To complete the picture information on government subsidies and current transfers is given in column No.12, and column 14 indicates that subsidies and current transfers exceed the deficit by 6% to 416% in the seven Muslim countries.[10]

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[9] Total of expenditure on education, health, information, postal and telephone services, electricity, water, public works and airlines were mKD 818.5, while their revenues were only mKD 68.5. See al Qabas Newspaper, No.6132, Monday, January 13, 1992.

[10] Unfortunately, direct data of the government subsidies to the utilities and services is not readily available.

Finally, this section can be concluded with the assertion of the enormity of the gap to help in its filling the proposed means of financing can be used, subject to willingness of applying *Shari'ah* compatible approaches and availability of resources that can be mobilized through the attractiveness of the means proposed in this paper.

SECTION II
USUFRUCT BONDS AND THEIR *SHARI'AH* FOUNDATION

DEFINITION

Utility usufruct bonds may be defined as:

certificates or securities representing a well defined quantity of services produced by a public utility and issued at given denomination or given number of units of the concerned services.

The elements in this definition are the following:

1. Usufruct bonds are securities based on the well known Shari'ah principle of securitization of owned rights. This principle implies that each right can be represented by a written document that provides the details and specifications of the right and the obligation implied. It also shows a full description of that right and indicates the legal or natural person who is obliged to make it available to the owner of the right.

2. Ownership of the security means the ownership of the right mentioned in it. This means that the security is only a veil and for any transaction on the security, the conditions required for the same transaction on the right itself must be satisfied.

3. The security also represents a well defined obligation on the signatory. An obligation that requires to be fulfilled at a certain point of time in the future or during a certain span or period of time.

4. A detailed description of the usufruct or service must be given in the security. Such usufructs/services may be derived from machines and equipment such as the telephone services, or from the efforts of experts such as educators and physicians or from a combination of both such as postal services and garbage collection.

   The description of usufructs and services should be accurate and undisputable, in terms of the kind of service and the number of units and the definition of each unit.

5. The amount of the value of the security, i.e., its sale price by the issuer should be announced and known to the public at the time of issuance. This price is the rent/wage of the

equipment/human time represented by the security. The issuance price of the security needs not be mentioned on it because the security does not represent the amount paid for it but the service/usufruct sold, which is at the same time pledged by the issuer.

6. The date of delivery of the service/usufruct must be stated on the security. The date of delivery may be an exact date such as on the first of Muharram 1419H (for an airline Hajj service) or may be left to the user, with or without a validity time span. A security may be issued without a validity time limit means that the renter (beneficiary or buyer of security) can take the service on demand at any time after the purchase of the security. It works like a phone card that can be used any time after purchase. On the other hand, a security with a validity date or period means that the owner of the service/usufruct can only receive it after certain date such as after 1/1/1421H, or during the period of 1/1 to 30/12/1425H.

EXAMPLES OF THE USUFRUCT BONDS

There can be many examples of usufruct bonds. Some of them are the following:

1) **Telephone Bonds,** a telephone bond may represent 1000 units of telephone services. A telephone service unit may be defined as, say 100 local calls or their equivalent of long distance and international calls. The bond may be sold with a condition that the usufruct may be received during a given period of time, such as "phone bonds 2000" which allow their owners to utilize the service of the telephone company, in the number of units mentioned on the bond, during the year 2000. There can be telephone bonds 2005 or 2006, etc..

   Telephone bonds may be issued by the telephone company to mobilize funds for financing its present needs of working capital. Such bonds may be issued for short period and may be for small denomination (number of usufruct units), or for financing its long term development and growth. In such a case, telephone bonds may be issued for longer maturity and larger denomination.

2) **Postal Service Bonds,** a bond representing certain quantity of postal service such as delivery of 1000 domestic letters of no more than 10 mg each, or their equivalent of international and/or heavier letters.[11] The postal service bonds may be issued by the Post Office Department or company to finance long term needs of expansion or short term working capital. Accordingly, the maturity of the bonds and their denominations would be determined to provide a high degree of convenience to bond holders.

3) **Electricity Bonds** may also be issued for different denomination of the electric services as defined in terms of number of kilowatts for different maturities and different quantities of electricity.

Electricity in this regard is treated as a service, not a commodity, from the point of view of contractual relationship between seller and buyer. Since electricity is consumable at the time of its receipt, it is the usufruct of turbines, generators and a cable network, and it is, therefore, subject to *Ijarah* contract.

[11] This requires that the schedule of equivalence of different postal services with the service unit be announced at the time of issuance of bonds (e.g., on the

4) **Fly Bonds** can also be issued for air transportation of a number of service units, each unit must be defined in terms of a given load of merchandise for certain given distance, or to air transport a person through certain mileage. Fly bonds can also be issued for long or short term maturity and they can be redeemed by owners (holders) receiving actually the service during the maturity period from the airlines.

5) **Education Bonds** can also be issued for different levels of education and/or training with full description of the type and quantity of services the bond represents and the maturity period during which they can be redeemed. Issuance of education bonds can again be used for financing growth and development of educational institutions as well as for financing working capital. However, the maturity periods of the bonds may have to be different, so may be their denominations.

6) Land occupancy bonds can be created to represent land occupancy units. This can be done especially with *Waqf* land for long term *Ijarah*. The proceeds of the bonds can be used for land development and construction and their return can be determined as a share of the total rental income of the project,

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back of the bond).

or on the basis of renting it back, on consecutive contracts basis, to the same *Awqaf* organization.

7), 8), 9) ...etc. bonds may be issued for units of medical services, goods transportation by land or by sea, urban public transportation, pumping water to household units, sewerage services, garbage collection, etc..

<u>CHARACTERISTICS OF USUFRUCT BONDS:</u>

In this sub section we will discuss the basic characteristics of the usufruct bonds and we will compare them throughout with other kinds of securities.

Essentially, usufruct bonds are based on the principle of securitization of financial rights. Securitization in Islam is encouraged since day one. The earliest form of securitization is the documentation of debts that is encouraged and enhanced in the Qur'an (2:282). Although this verse deals with documentation (securitization) of debts, documentation of other financial rights is also encouraged by simple analogy.

Furthermore, by their very definition, usufruct bonds, depend on *Ijarah* contract in which an asset is leased or human services are hired, and the bonds come out of this kind of contract in a form of financial securities.

The implication of this introduction is that all the characteristics of usufruct bonds are derived from and based on these two principles of securitization and *Ijarah* contract, as we will momentarily notice.

1) Usufruct bonds represent ownership of well defined and clearly described usufruct/service

Since the bond comes as a result of documentation of an *Ijarah* contract between the asset owner/service provider and the purchaser of the bonds, these bonds, thus, represent the right that is sold to bond holders.

This is a financial right in the sense that it represents an ownership of the usufruct of assets or services of human beings or a combination of both, that is well defined and described in the contract.

Ijarah in *Shari'ah* is a form of sale whose object is not the asset itself but its utility. Therefore, the owner of the bond is an owner of the asset's utility or usufruct. By the same token, when the *Ijarah* contract applies to human services, the bond represents ownership of of the services.

The owner of the bond owns the utility itself. The immediate result is that the bond does not represent the amount of money for which it is bought. It rather represents a well defined quantity of utility of assets or service of human beings. Such utility or usufruct or service must be well defined even if it requires clearly defining the asset that produces the usufruct and the period for which this usufruct is owned by the purchaser of the bond.

Once the period, during which the usufruct is defined, lapses, the bond will vanish. In other word, in an *Ijarah* contract the lessor is required to enable the lessee to use the asset so that the latter can extract its usufruct for the leased period. It is the responsibility of the lessee to extract that usufruct. The lessor is only required to allow the bond holder to avail of the right she/he owns, but the actual use or benefit depends on the owner of the usufruct (the bond holder). All the above also applies to the case of human service *Ijarah*.

2) Pricing of usufruct bonds:

The issuance price is one that is subject to the market forces of supply and demand. The concern of *Shari'ah* centers only around the freedom of choice to enter into an exchange contract. The price the parties agree on is the price of the contract (bond) as long as they enter freely in the contract and the contract is not in violation of any of the *Shari'ah* rules.[12] The market determination of issuance price has many implications from the point of view of expected buyers. For instance, if a usufruct bond is issued for the use of transportation facility, that expires in a short period of time. The mass of expected customers of such an issue would come basically from potential users of the service and their appetite to buy the bond and pay for it in advance would depend on the prevailing price that they may obtain in the market discounted for the term of the bond.

However, if the period of the usufruct is defined to be after relatively a long span of time, such as an education bond that has a five year period for the beginning of the extraction of its usufruct, the buyers would not be restricted to the potential users of that kind of service alone. Savers and investors would have also an appetite to buy this kind of usufruct bonds and keep it until some time before its maturity, when they can sell and make profit on their investment. This process depends on present and expected prices of the service/usufruct, the discount rate and other conditions related to the conditions of supply of investible funds and the economy at large.

Once the bond is issued at a certain price, the sale of the usufruct it represents becomes a right of the bond holder so that any price for further transaction on the bond will be subject to the market conditions and the individual wills of the contractors. In other word, an owner is fully authorized of what an owner owns and can, therefore, suggest the price that she/he feels suitable to sell the owned usufruct for. This means that further transactions on the usufruct bonds are also subject to market pricing and they depend on the general economic conditions in addition to the specific circumstances of a given issue of usufructs, and the forces determining its supply and demand.

3) Issuers of the usufruct bonds:

Usufruct bonds can be issued by the producers of a given usufruct, i.e. air transport bonds can be issued by the airlines and postal service bonds can be issued by the postal service. Issuing

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[12] Keeping in mind that excessive deviation of the contractual price from prevailing market price is always challengeable under the premise of *Al Ghabn*

agencies may be public enterprises in the sense that they are owned by the government or may be private companies.

There are no restrictions, in *Shari'ah,* on the issuance of such bonds by any enterprises whether they produce the usufruct or not, i.e., bonds can be issued by bodies that do not, themselves, provide the subject service of the bond, as long as they are able to give the pledge to get the service from others and deliver it to the bond holders at the maturity period. For instance, the Ministry of Finance or the Central Bank may issue train goods/people transport bonds on the national train service as long as once the bonds become mature, the Ministry of Finance or the Central Bank would be able to take necessary action that will allow the bond holders to avail of the service/usufruct they paid for.

Additionally, brokers or agent, such as travel agencies for air transport bonds, or shipping brokers for sea shipping bonds are, theoretically, capable of issuing usufruct bonds on the same basis, i.e. as long as at the time of maturity they will be able to take necessary action that allow the bond holders to derive the usufruct they own.

Al Fahesh.

The pledge by the bond issuer to provide the service is sufficient for issuing usufruct/service bonds. However, a necessary condition is that the bond issuers would be having the capabilities of standing behind their pledge. This can be done either on the basis of a line of authority as it may be between a national train service and the Ministry of Finance or on the basis of a contractual relationship between issuers of bonds and providers of services/usufructs.

4) Proceeds of bonds issuing

The proceeds of the issuance of usufruct bonds, the price of the usufruct or the rent/wage of the service is fully and completely owned by the issuers of the bonds who have full authority over it. This means that proceeds of bonds' issuing can be utilized for financing working capital or fixed capital, expansion project or current expenses, they can be utilized to spend on the usufruct producing agency or on other agencies.

If the government issues utility education bonds for a given number of credit hours in the governmental universities, the proceeds of such an issue can be utilized for construction of new laboratories in these universities or for cleaning the streets of the capital, for salaries in a government refinery, or any other use whether developmental or not, and whether or not related to the production of usufruct/service sold in bond issuance.

5) Negotiability of the usufruct bonds:

Since the bonds represent a well defined usufruct/service that is to be delivered during a given period of time in the future, owners of those usufruct/services can always sell them at will, at any time, before maturity, or even before they actually avail of the service/usufruct, as long as there remains sufficient time for the buyer to receive the usufruct/service she/he is paying for. The sale price will be determined by the two parties, and affected by the supply and demand forces, regardless of how much different it might be from either the issuance price or the price paid by the seller when she/he bought it. This means that usufruct bonds are fully negotiable. They can be sold and bought in the market at any time and by any buyer/seller. Other forms of disposition of one's property can also be performed on them such as making them part of a last will and testament (*wasiyah*), giving them as a gift, lending them to others free of any charge, using them as collateral in a lien, etc..

6) The end of a usufruct bond:

A usufruct bond will end by either of two ways: (1) actual use or consumption by the user/owner of the bond during the maturity period, when the bond holder submits it to be exchanged for the actual service pledged in it. This will be simple when the issuer of the bond is the provider of the service. However, if the bond was issued by other than the service provider, the issuer remains the contractually responsible party for fulfillment of the pledged (mentioned in the bond) usufruct. At the cost of the issuer, the bond holder would be transferred to a relevant service provider. An example of this may be a bond issued by a Ministry of Finance on a national, government-owned airlines. The Ministry must have suitable arrangement with the national airlines to provide the service upon presentation of the usufruct bonds.

A usufruct bond may also come to an end by revoking its contract (*iqalah*) via a new agreement between the issuer and the holder. *Iqalah* may be at the same issuance price or it may be at the prevailing sale price of the service/usufruct at the time of maturity. The *Shari'ah* position on *Iqalah* will be discussed later.

7) Amortization of usufruct bonds:

Usufruct bonds may also be amortized when the issuer buys them back from the market at prevailing prices. This allows usufruct bonds to be used in open market operations by the Central Bank, especially, when the Central Bank issues usufruct bonds.

FIQHI **BASIS OF USUFRUCT BONDS**

Usufruct bonds are based on the idea of transforming the ownership of usufructs (*Manafi'*) into financial assets. This transformation is essentially derived from the idea of documentation in writing of exchange and other contractual transactions, which is encouraged in the Qur'an (2:282).

The ownership of a usufruct/service, as independent from the ownership of the rented asset and hired human hours, is based on the *Ijarah* contract.

Ijarah (leasing) is a sale contract on a known usufruct (*Manfa'ah*) of a defined or a well described asset for a given period of time. The subject of an *Ijarah* contract may also be an amount of work of described human beings. An *Ijarah* contract is an exchange contract in which the usufruct/service is **sold** for a given and well-defined amount of money or any other valuable asset.

An *Ijarah* contract allows the lessee to become an owner of the usufruct/service for which she/he pays the price. The usufruct/ service sold in *Ijarah* shall obviously be received by the lessee during a period of time or on sequential basis after the conclusion of the contract because time itself is an ingredient in the measurement of a usufruct/service. Therefore, the nature of the possession in the sale of usufruct/service (*Ijarah*) is different from that in sale of objects (*bay'*), although the same principle of possession still apply.

The three Schools of *Fiqh* (Shafi'i, Maliki and Hanbali) consider usufructs similar to physical assets from the point of view of being an economically valuable asset (*Mal*). The Hanafis do not look at usufruct as a *Mal*. However, with regard to a usufruct/service owned by means of an *Ijarah* contract, they all agree that the lessee can dispose of the owned usufruct/service before it is actually possessed, simply because a possession of a usufruct/service can only be done by its consumption.[13]

The important implication of this is that a usufruct/service owned by means of an *Ijarah* contract can be sold, given as a gift,

[13] See: Al Zuhaily, Vol.4, p.763 and Abu Sulayman, p.34.

bequest through inheritance or last will and be subjected to any other contractual relationships before its consumption (possession).[14]

Consequently, an *Ijarah* document can be handed over, or endorsed, to a third party in a form that represents a transfer of ownership against a price that can be freely determined between the owner of the usufruct/service and the new buyer is a two party deal, to which the original price and its date of payment become irrelevant. This implies that a usufruct bond is fully negotiable with no limitation in *Shari'ah.*[15]

[14] Abu Sulayman, ibid.

[15] Most of the *Fuqaha* consider that the original seller of the usufruct does not even have right to restrict such a secondary sale on the ground that first sale entitles the first lessee to full ownership rights including the right to sell what one owns, and any such restrictions would interfere with the general principle of ownership, thus, they are void and invalid. However, those *Fuqaha,* who do not accept such limitations require that the second lessee may not be a person who may put a heavier burden than usual or contracted, on the leased asset. The example they usually give is renting transport animals and they say that re-leasing by the first lessee should not be to a person heavier than her/him. See: the F*iqhi* Encyclopedia, Vol.1, *Ijarah*.

Guarantee of the lessee in the second *Ijarah* contract

A re-sale of a usufruct, owned as a result of an *Ijarah* contract, is obviously done by means of a new *Ijarah* contract (this can be performed by endorsement of the bond or by delivery if the bond is issued to bearer). This creates an issue related to the outcome of contractual relationships, as in each of these consecutive contracts the two parties are required to fulfill their mutual obligations. Thus, the lessor in a second *Ijarah* must guarantee the delivery of the usufruct/service to the second lessee. Exactly by the same way the issuer of the bond guarantees her/him the delivery of the sold usufruct/service as being the first lessee. By the same token, the new lessee guarantees delivery of the price to the lessor in the second contract as much as the latter guarantees the same to the issuer of the bond. This lessor's commitment of usufruct delivery is essential to any *Ijarah*, without which an *Ijarah* contact loses its basic characteristic of being a contract of exchange (*Mu'amadah*), and *Shari'ah* does not approve relaxing such a commitment.

As far as the payment is concerned, this may be done at the time of sale or at a future date if each contract includes any form of financing granted to the lessee.[16] In the latter case, the second lessor

[16] In this case payment of the price of the usufruct will be after the actual receipt of the service/usufruct. However, the whole idea of usufruct bonds is to mobilize

may obtain any and all kinds of collaterals for payments for fulfillment of the obligation of price payment.

This leaves the guarantee of usufruct delivery to be more important of a problem than payment of its price, as it hinders the negotiability of usufruct bonds.

To solve this *Shari'ah*-posed problem, we suggest either of two ways:

a) To treat usufruct bonds like commercial papers whose endorsement implies a guarantee by the endorser. In this case, the final user of the usufruct may have the right to sue any of the signatories on the back of the bond for delivery of the usufruct. Obviously, all intermediary lessees/lessors are not usually producers of the usufruct/service. Thus, such a guarantee would only take a monetary form by being responsible for compensating the final bond holder of the loss of usufruct in case of default of the bond issuer.

b) On the other hand, an administrative solution can be arranged by the bond issuer, under law enforcement authority of the government. It consists of providing

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funds for the issuer of the bonds. Thus, delay of full payment until after delivery of the usufruct does not make sense. However, second transaction on the bond sufficient collateral and guarantee by the bond issuer to maintain its ability to deliver the service in the maturity period of the bond, in such a way that leaves no room for any possible default. Such an arrangement may be controlled by the government and its law enforcement capabilities.[17] This kind of administrative arrangement turns the legal (*Shari'ah*-based) responsibility of the consecutive usufruct sellers redundant because it is easier for the last bond owner to follow the issuer of the bond than its respective sellers. Moreover, the bond may be issued to the bearer, which makes pursuing its previous holders difficult and costly. Finally, under this arrangement the issuer's guarantee may be stated on the bond itself and made transferable to any new holder, whether the bond is issued to the name of a buyer or to bearer.

Although the first suggestion is characteristic to the commercial papers and doesn't have much of a hampering to their negotiability, its application to usufruct bonds poses a serious constrain, especially when these bonds have long term maturity and when they are made to the order of the bearer which may imply many

may contain such financing.

[17] It must be noted that in a usufruct bond the usufruct/service is, itself, the subject matter of the *Ijarah* contract, being the sale of the usufruct. Therefore, the seller of the bond (even in a second lease) must guarantee the delivery of the usufruct since such guarantee is an essential element in legitimizing the

transactions on the bond before its redemption to the last owner. Consequently, the second solution should be considered superior.

The *Ijarah* with deferment of delivery of the usufruct

The *Ijarah* contract can be concluded with the condition of postponement of delivery of the usufruct/service to a future time or to make it during a future period of time. This is known in *Shari'ah* as "an *Ijarah* suspended on future time". This is approved by the three Schools of *Fiqh* (Hanafi, Maliki and Hanbali).[18] Moreover, an *Ijarah* can also be concluded in which the usufruct/service is well-described without the existence of the usufruct-producing asset or service-producing humans at the time of the contract. Both these *Shari'ah* clauses allow for the creation of usufruct/service bond in which the described usufruct/service can be benefited from in a future time on the basis of using the proceeds of the sale of the bonds for expanding the service/usufruct-producing facilities.

Reversal of an *Ijarah* Contract (*Iqalah*)

secondary *Ijarah* contract, itself, and legalizing the receipt of its value by any secondary lessor.

[18] Zuhaily, Vol.4, pp.762-763 and Abu Sulayman, p.53). See: also the *Fiqhi* Encyclopedia of Kuwait, Vol.1.

The meaning of the term *Iqalah* in *Fiqh* is derived from its Arabic language meaning, whereby *Iqalah* means removal or reversal. *Iqalah* is, thus, a means of ending an exchange contract like *bay'* or *Ijarah*.

There are two views among *Fiqh* scholars on *Iqalah* (reversal of the contract): one view considers *Iqalah* as a removal of the contract and its elimination in such a way that brings all parties' situation to their pre-contract status as if the contract never took place at all, i.e., the contract is annulled along with all its effects. This is the view adopted by Shafi'is, Hanbalis and Muhammad of the Hanafis. Malik and Abu Yusuf looked at *Iqalah* as a new sale.[19]

Accordingly, while reversal of the *Ijarah* contract must be at the same price and other conditions of the original *Ijarah*, according to Shafi'i, Hanbali and Muhammad, Malik and Abu Yusuf allow for the *Iqalah* to be at a price different from the original contractual price.[20] This implies that should the issuer of the usufruct bonds decide to withdraw the bonds from the market, an option is open to offer the bond holders an amount of money different from the issuance price for surrendering their bonds.

[19] While Abu Hanifa considers its annulment with regard to relations between the two parties of the exchange and a new sale with regard to relations with others.

[20] *Fiqh* Encyclopedia of Kuwait, Vol.5, pp.324-331).

However, it must be noted, in this regard, that resemblance to *Riba* must be avoided by regulatory instructions, so that no benefit may generate to a party in an exchange contract without a substitute (*'Iwadh)*.[21] This means that an *Iqalah* if it ever happens must be based on real difficulties in fulfilling the promised delivery of usufruct/service, and the regulatory authorities must organize the usufruct bonds in such a way that prevents their issuance by any party that may not be capable of delivering the pledged usufruct/service.

[21] The *Fiqhi* Encyclopedia, Vol.5, p.329.

SECTION III

ECONOMICS OF USUFRUCT BONDS

RELEVANCE OF PUBLIC UTILITIES TO USUFRUCT BONDS

Usufruct bonds can be issued for the usufructs of any long-living asset or for human services. The bond may become like a simple commercial bill, just an IOU, stating that some one is in debt to some other by a given amount of usufruct/service.

The economic importance of usufruct bonds arises from applying them to public utilities, especially as a tool for resource mobilization of small savings from masses. Public utilities usually enjoy a relatively stable and steadily growing demand, especially in the developing countries. This demand is affected mainly by steadily stable factors such as population rate of growth, long term rate of growth of GDP, urbanization and rate of technological transfer to the developing countries.

Additionally, most public utility enterprises are major landmarks in the economies of many countries, especially developing ones. Many of them are either owned by the state or under its heavy control. Their prices are usually stable and determined with a long-run perspective. These prices are generally more sticky than the prices of other industrial products and their changes are usually slow and subject to lengthy procedural arrangements and public control.

Besides being compatible with the believes and values of the people in Muslim countries, usufruct bonds may be able to raise public interests because they touch on matters related to the daily life of all people. Every one spends a considerable part of one's income on public utilities and is directly affected by one public utility or the other.

USUFRUCT BONDS AND SHARES

Usufruct bonds are simply ownership documents. Yet at the same time what is owned is to be provided by some other party, so the bond represents a marketwise-valuable right on some other party: the issuer. This dual character of the bond: representing a real asset and an obligation on others is the source of its unique treatment in *Shari'ah* and the origin of its amenability to serve as a negotiable form of bonds within the limits of *Shari'ah*.

Therefore, usufruct bonds can be treated like special kind of shares from the point of view of their ability to be priced and sold in the market. But unlike common shares, they do not represent partial ownership of an asset or group of assets. The fulfillment of the pledged financial right represented in a usufruct bond to any specific bond holder is completing independent and not related at all, and by any means, to the pledge given by the issuer to other bond holders even of the same issuance, same service/usufruct and same denomination. Furthermore, unlike common shares, the relationship, and the pledged right is absolutely independent of the performance and profitability of either the bond issuer or the service provider.

Similar to shares whose return is not known in advance, the usufruct bonds' return is also not known in advance, especially, when we talk about long term usufruct bonds. What attracts buyers of usufruct bonds is, in fact, the difference between the expected price of the service/usufruct at the time of maturity and the issued price of the bonds. Undoubtedly, the expected price of the bond during the maturity period depends on many factors that include, in addition to the current service/usufruct price, expected changes in technology, especially, in the field of the concerned service/usufruct, the size of expected supply of and demand for the service/usufruct during the maturity period, present and expected rate of interest and other opportunity cost of investible funds, inflation rate and the general economic environment in the country.

Consequently, unless potential buyers are convinced that the expected price of the service/usufruct during the maturity period is higher than its current price by a differential that is substantial enough to reward investors on competitive grounds.

Furthermore, like shares in common stock companies usufruct bonds provide a protection against inflation whether anticipated or not. This is due to the fact that the bond represents the ownership of a real service/usufruct. Therefore, if the general level of prices is expected to increase, carrying with it the expected prices of concerned service/usufruct, the market price of the bond may witness an upward push.

USUFRUCT BONDS AND PUBLIC DEBT BONDS

Usufruct bonds issued by the government are similar to public debt bonds from the point of view that the proceeds of the bond can be used for any purpose at the discretion of the state. Therefore, usufruct bond can be a good Islamically accepted substitute of public debt bond from the point of view that proceeds of sale of bonds can fill in the deficit gap in the government general and/or special budgets.

Usufruct bonds are also similar to public debt bonds from another angle that both end up with burdening future tax payers in the amount of funds advanced to the government. In usufruct bonds the government will be required to pay in the form of services/usufructs or to buy the bonds back from the market at the prevailing price. In both cases future tax payers will carry the burden.

However, while the public debt bonds[22] require the government to periodically pay interest to the bond holders, usufruct bonds postpone the whole payment until the maturity period. Thus, usufruct bonds are closer to zero coupon bonds than to regular bonds. Lastly, both usufruct bonds and public debt bonds represent a public debt that the government is required to settle some time in the future.

On the other hand, during inflation public debt bonds, unless indexed to certain price index, are characterized by wearing out the wealth of the creditors, while usufruct bonds do not do that but instead they provide a shelter from inflation.

Also like public debt bonds, usufruct bonds may be issued for short term or long term, especially, that the providers of usufructs/services for which bonds may be issued have, usually, price increases slower than the general rate of inflation because most public utilities are usually subject to some form of price control or another. Furthermore, if such bonds are issued against public-sector

[22] Like treasury bonds, treasury notes or other public indebtedness bonds.

provided services/usufructs, the government, who issues the usufruct bonds, may have certain leverage in controlling the prices of such services/usufructs.

THE EFFECT OF GOVERNMENT POLICIES ON PRICING USUFRUCT BONDS

The market pricing of usufruct bonds depends on the forces of supply and demand which are, in turn, influenced by the general economic conditions, the special circumstances of the industry for which the bonds are issued and more important the design of the bond issuance and its focus points of attraction.

This means that the success of usufruct bonds as an instrument for mobilization of savings depends on the government action and the public confidence in the stability of government policies. The attraction to savers lies in the price difference between the time of buying and the time of selling or availing of the usufruct offered for sale in the bonds.

Consequently, the issuance price of the bond and the stability of the price of the usufruct for which it is issued are the two most important variables that affect savers' decisions toward usufruct bonds. Both these elements are determined by the government if the bonds are issued for publicly owned enterprises or publicly produced services which is the case in most IDB member countries.

On the other hand, one may argue that under the conditions of mixed economies in which the market institution is strong and predominant, prices of public services and public utilities are usually more sticky than prices of other commodities and services, because of reasons discussed earlier in this paper. This means that a prudent issuance of usufruct bonds under those conditions would be expected to reasonably mobilize financial resources for the implementation and expansion of public services/utilities if there ever exists such potential resources that can be mobilized. What should always be kept in mind is that in most IDB member countries the behavior of government toward usufruct bonds would be most essential for their success.

APPLICATION OF USUFRUCT BONDS

Usufruct/service bonds represent an idea put forward in the form of a proposed instrument for mobilization of funds to finance the production and expansion of public services. This idea has not yet been tested or applied in any Muslim country.

However, a very close example of the application of such an idea is the telephone card that has been used in abundance in most countries. A telephone card is sold by telephone companies (we can imagine its issuance by any other party that offers the calling services for which the card issuer contracts a producer of telephone services) for a price that is paid in cash at the time of issuing the card. Presently, this card can be used immediately and is, usually, issued in small denomination of 20, 50 and 100 units of the local currency. The card does not, usually, offer any concession on the prices of the concerned services (although it may give its users the benefit of selecting lower fare of direct calling as compared to the fare of using the help of an operator). It also gives the card holder an immediate access, at wish, to the telephone services. Although phone cards can be, and they actually are, sold by their holders to other people, presently there is no organized market for selling and buying these cards. Therefore, the phone cards are not presently used for funds mobilization and they do not have any built-in attraction for placement of savings.

Now let us imagine a telephone card that is issued with a condition of deferred access to the calling services and it is sold at a discounted price, so that savers are attracted to buy this card instead of holding their funds in cash form, or in any other less attractive form of investment. This amended form of the telephone card would make an exemplary usufruct bond, and would create its own market under a suitable legal framework.

For a useful application of the idea of usufruct bonds in any society, especially, in developing countries where the institutional and legal set up is not fully conducive toward the use of this kind of financial instruments, we believe that there is a need to provide a legal framework for the issuance and administration of the usufruct bonds. Such a legal framework must deal with the different aspects, conditions, guarantees, supervision, control, etc., related to a successful introduction of this idea in actual application.

The legal framework must also follow some kind of conservative prudence in order to avoid the emerging of fictitious usufruct bonds that do not rely on a real usufruct that has been, or can realistically be, produced or at least guaranteed by the issuer of the usufruct bonds. In other word, there ought to be certain legal conditions that restrict the access to issue usufruct bonds to only the real factual producers of the usufruct for which the bond is issued or to parties that can provide sufficient collaterals and guarantees that the given usufruct is going to be factually produced in the economy.

A second pre-requisite for the success of usufruct bonds in application is to introduce the idea to the masses of savers in the Muslim countries and inform them about its *Shari'ah* and economic characteristics and aspects.

The third pre-requisite for the success of this idea is to take it in a gradual manner so that the market would be tested by the issuance of one usufruct bond by a strong and reputed producer of a public service such as electricity or telephone services.

CONCLUSION

In this paper we discussed the idea of usufruct bonds as an instrument for funds mobilization to finance both fixed and working capital of public services' enterprises within the limits of *Shari'ah*.

We have noticed that the idea of usufruct bonds has many merits. The absolutely most important advantage of the bonds is their negotiability while they are still compatible with the Islamic norms, values and injunctions.

We have also showed that the usufruct bonds can be used to finance most, or practically all, of public utility production and distribution.

We also discussed the details of the *Fiqhi* aspects of the idea of usufruct bonds and showed how a combination of the principles of documentation and *Ijarah* can produce usufruct bonds as a security, or financial asset that is *Shari'ah* compatible.

Finally, we discussed the economies of the usufruct bonds and compared them with shares and public-debt bonds, and looked into the effects of governmental policies of their pricing and the pre-requisites for implementing this idea in the real life of the Muslim countries.

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