



# Central Banking in Iran



Central Bank of the  
Islamic Republic of Iran



**In the Name of Allah  
the Beneficent  
the Merciful**

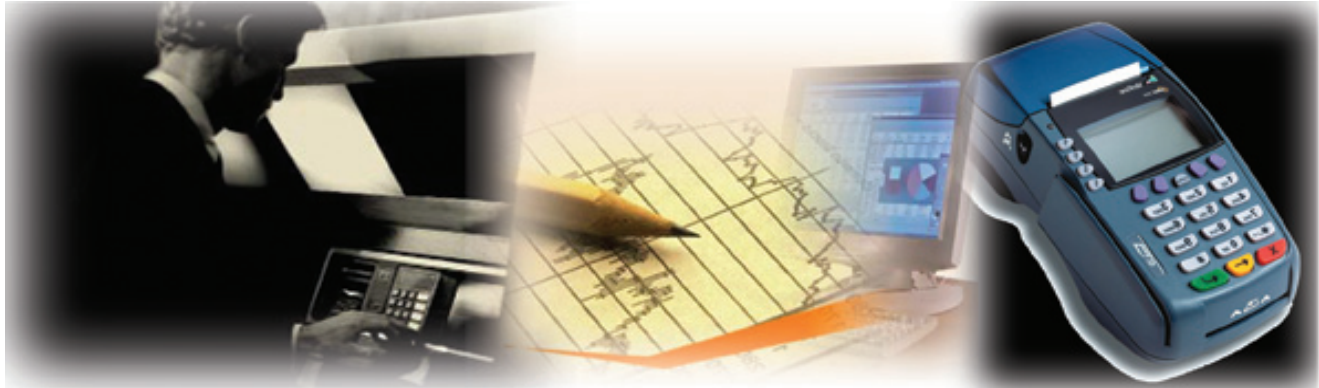




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## Role and Functions of Central Bank in the Economy

Scrutiny of history reveals that the initiation of the first banks to be operated as central banking dates back to the 16<sup>th</sup> century A.D. Although many believe that the Swedish “Riks Bank” was the first central bank ever, the implications of what a central bank’s functions should have always been subject to great changes in time. In the 20<sup>th</sup> century and even in the recent years, the functions of and expectations from the central bank have undergone dramatic changes; for this reason reaching to a unified and comprehensive definition of central banks in a fashion that it could be possible to determine the foundation date of this institution is very unlikely. Although the unique specifications of this foundation and the functions that have remained intact during years, have made it possible to assign particulars to it; but as mentioned earlier, it is almost impossible to determine a universal and comprehensive definition that covers the entire dimensions of this foundation.

For instance, one of the primary functions of a central bank is the right to issue bank notes. Almost all central banks of the 16<sup>th</sup> up to 18<sup>th</sup> century were distinguished from other banks only by this unique right. From the beginning of the





20<sup>th</sup> century, the need to develop a central bank with functions other than other banks was felt. In a conference in Brussels on international monetary issues, formation of a central bank separate from the other banks was recommended to all countries. Thus central banking was initially introduced based on monetary issues and for performing tasks like issuance of banknotes and financing government liabilities.

At the initial stage of formation, central banks were trying to establish solid relations with the public, and through attraction of public confidence, proved their superiority to other banks. In addition to that, being in the position of financial manager of government and also taking charge of the treasury, the early central banks could attract other banks' confidence too; so that by accepting deposits and gold reserves of other banks, they could assume the role of lender of the last resort. Based on the literature and findings of the economic texts, the role and functions of the Central Banks before 1950s is figured out as follows:

1- Exclusive privilege to issue banknotes and coins

- 2- Discounting of commercial banks documents
- 3- Safeguarding gold reserves of other banks
- 4- Regulate and control of the domestic money market
- 5- Financial management of government
- 6- Directing the credit allocation, control of monetary crises and domestic prices, and overseeing currency par value.

After this decade and upon formation of the new international monetary system, the central banks functions also gradually transformed from the primarily quantitative functions to a more critical qualitative functions. The functions can be summarized into the following three categories:

- 1- To create monetary equilibrium. The equilibrium must result into a balance between supply and demand of money in the related market, and also into monetary stabilization that guarantees local currency value.
- 2- To strengthen and promote balance of payments. i.e. to provide such circumstances for balance of payments, so that purchasing power value or the par value of national currency in international transactions enjoys stability and is strengthened.





3- To function as the lender of last resort. Indeed, the task of creation of money which must be carried out by central banks.

What is noteworthy here is that in spite of similarity between the first and second functions, these two shall never coincide with each other. The first function focuses on local stability and purchasing power of money, while the second one concerns about balance of payments and preserving the international status of currency value and its foreign purchasing power. Any change in one shall undoubtedly affect the other, but the interrelation between these two functions must not mislead one to assume the both as the same. Another important point is preserving the currency value (both inside the country and abroad). It can be said that the primary function of issuance of banknote was the most prominent distinctive task of central banks (before 1950s); but under the later circumstances it is the third and the last among the tasks of a central bank. Issuance of banknotes is still a function that distinguishes between a central bank and other banks,

but the responsibility of stabilization and promotion of its value is the most important task that is expected from central banks. In other words, the new line of thought and the recent thoughts recognize this institution in charge of preserving value of currency of a country than simply responsible for issuing it. This implies that before issuing banknote, the central bank must guaranty its purchasing power.

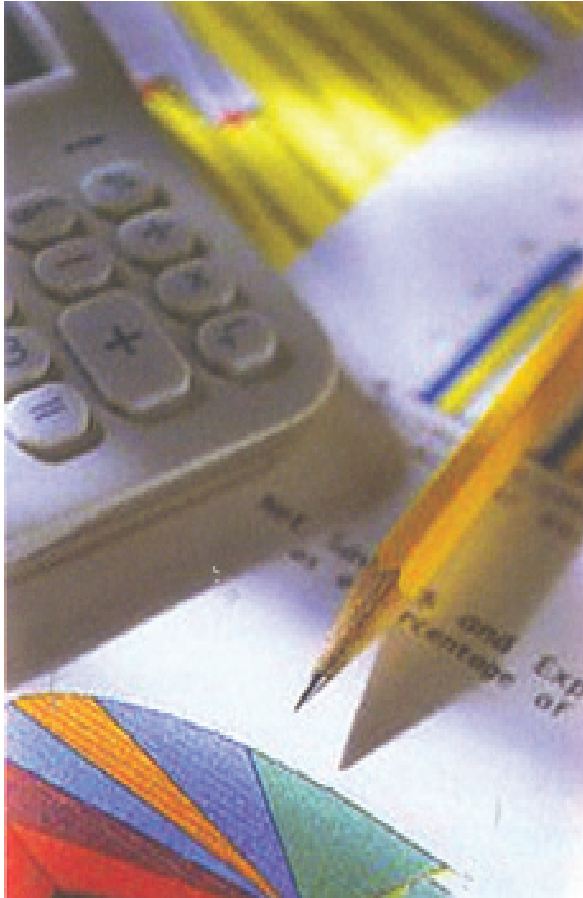
There is also a different set of tasks assigned to a central bank:

- 1- Banknote issuing institute in charge of management of foreign reserves
- 2- Banking for the government
- 3- Banking for banks
- 4- In charge of regulating and supervising domestic financial institutions

The above set of functions is consistent with former definitions of a central bank's tasks, except in paragraph 4. This is a newly assigned function which is in the scope of tasks of modern central banks. It is consistent with realization of economic development goals and in line with modification and financial liberalization policies.







## **An Overview to History of Central Banking in Iran**

Before 1266 S. exchange offices in different sizes constituted the face of financial institutions of Iran. The London based “The New Oriental Bank” was the first bank that opened a branch in 1266 S. In Tehran, rapidly expanding its activities by opening branches in the cities of Iran. It was the first real and modern banking institute established in Iran. This bank, with the knowledge of the modern banking methods of that time shaped as the result of decades of perfection in the European countries, started its activities in Iran. Two years later, “The Imperial Bank of Iran” was established upon obtaining a special authorization from the government, purchasing entire facilities of The New Oriental Bank in 1269 S. and terminating its operation in Iran. The concession for establishment of this bank had been granted to the Reuters from Britain, based on which the bank could monopolize issuance of banknotes and take charge of the governments’ trust fund, and could perform banking and commercial operations.

In 1309 S., government repurchased the exclusive privilege of banknote issuance from the Imperial Bank, and the bank remained operative until the end of 1327; it continued its activities in Iran and the Middle East under the name of “English Bank” until 1331.

A little after establishment of the Imperial Bank, a concession was granted to a Russian citizen, ending up to establishment of “Iran-Russia Loan Bank” in 1270s. with its base in Tehran and a number of branches in the Northern provinces. After that The Tsar

government of Russia purchased the entire shares of the bank, and since then the bank's activities took a political turn. The bank's activities were not successful in Iran and it was finally taken over by the government in 1301 S.

### **Backgrounds of Creation and Establishment of Central Bank in Iran**

By establishment of new banks in the country, the banking network grew rapidly on quantity point of view. Bank Melli Iran, since its inception in 1307 S., performed the same functions and had the same powers that a central bank did, but the technical banking principles of the time required that central bank operations be performed within an independent organization. By 1339 S. there were 27 banks operating in the country, ten out of which were state-owned and the remaining 17 were private banks.

Along with rapid expansion of banking network, banking operations grew increasingly in volume, resulting to the strategic role that banking network assumed in economic developments, turning it to one of the fundamental foundations in the economy of Iran. Increasing number of banks and expansion of banking activities in the country, required to lay laws and regulations for supervision on activities of the banks and to direct banking operations. Therefore, a draft bill was prepared and passed by the then prime minister on 8<sup>th</sup> Tir, 1332. The bill was approved under the title "The Banking Law" by the joint commissions of the parliament and the senate upon some amendments on 5<sup>th</sup> Tir 1334, and was then put into effect.

In late 1330s, the governments' extra-curricular expenditure grew in an unprecedented fashion. The great part of the expenditure was covered by foreign short and medium-term loans and the rest by the oil revenue, one third of which was allocated to the current budget. Due to easy access to internal and international credit, monetary and financial controls were not strict in this period. Government asked for loan from the International Monetary Fund, and the Fund required implementation of economic stability program in return, dictating a strict contractionary policy to Iran with support of the World Bank.

Under such circumstances, the need for an organization that would not be affected by competition issues of the banks, that would perform functions of a central bank; such as issuance of banknote, provision of banking services for the government, fostering development of money market; an organization not involved in commercial activities that could



adapt appropriate monetary, credit and foreign currency policies with regard to the country's general economic framework and programs, mobilize financial resources, foster economic growth and address undesirable shocks, and efficiently supervise the banking activities, was felt. On this basis, the idea of establishing a central bank and drafting money and banking law according to the IMF instructions was put forward in the High Economic Council. Ultimately at 4<sup>th</sup> Khordad 1339, "The Money and Banking law" was forwarded to the government upon approval of the "Money and Banking Bill" by the joint commission of Ministry of Finance, Ministry of Justice, Parliament and the Senate, to be put into effect for a five-year period on an experimental basis.

Based on provisions of the Law, the aim of establishment of an independent organization of central bank is: to preserve currency value, regulate the credits, monopolize banknote issuance and the functions related to it, act as financial agent of government and municipalities inside the country and abroad, and to preserve country's balance of foreign exchange receipts and payments. Due to some deficiencies of the Banking and Money

law, rectified at 1339, another bill was provided and approved at 18<sup>th</sup> Tir 1351 S. As long as there is no contradiction in the area of Usury-Free Banking Law, this law is currently valid and still in effect. According to this law, the central bank is responsible to regulate and implement monetary and credit policy based on the country's general economic policy plan.

The functions of the central bank defined in the Law are as follows:

- Preserving value of the national currency inside the country and abroad
- Issuing banknote and coins as legal tender
- Formulating regulations that govern transactions in foreign exchange and Rial
- Supervising gold transactions and formulating the related regulations
- Formulating the monetary and credit system of the country

- Supervising banks and credit institutions
- Balancing the volume of bank credits, harmonizing it with the country's monetary needs
- Keeping the accounts of ministries, government agencies, and agencies affiliated to the government
- Taking custody of the country's foreign exchange and gold reserves
- Representing government in international and financial organizations
- Possessing the right to take full charge of issuance of government bonds
- Conclusion of payment agreements in the execution of monetary, financial, trade and transit agreements between the government and other countries.

Thus, the major mission of the Bank Markazi Jomhuri Islami is to firstly provide for a desired environment for economic growth of the country by implementing appropriate monetary and credit policy, and secondly to support government in executing stabilization and economic development programs. To this end, preserving stability of currency value and balance of payments in pace with the constant economic growth through implementation of monetary policies are the ultimate goals.

Upon outbreak of the Islamic Revolution, and due to the fact that all status of the country underwent fundamental changes, some revisions were made to the Law rectified at Tir 1351.

### **Organization**

According to the Monetary and Banking Law, rectified at 18<sup>th</sup> Tir 1351 and the amendments thereto, the organs of the Bank Markazi Jomhuri Islami Iran are as follows:

- General Assembly
- Money and Credit Council
- The Executive Board
- The Note Reserve Control Board
- The Supervisory Board



## General Assembly

The General Assembly of the Bank is composed of the President (chairman), Minister of Economic Affairs and Finance, Head of the Management and Planning Organization, the Minister of Commerce, and one of the Ministers as elected by the Board of Ministers.

The General Assembly performs the following functions:

- 1- Look into and approve the balance sheet of the BMJII
- 2- Look into and approve reports provided by the Supervisory Board
- 3- Look into and approve the recommended appropriation of the net profit
- 4- Elect the members of the Supervisory Board, upon recommendation of the Minister of Economic Affairs and Finance

## Money and Credit Council

The most important organ in policy decision-making capacity is the Money and Credit Council. Based on the initial monetary and banking law, rectified at 1339, the Council was in the position to co-operate with the governor of the central bank in general administration of the bank. Directing banking activities, providing consultative advice to government on financial affairs, providing comments on the monetary and economic issues, and co-operating with the High Council of Economy in decision-making process in relation to monetary and financial issues of the country were among other functions of the Money and Credit Council.

The Monetary and Banking Law of the country, rectified at 18<sup>th</sup> Tir 1351, requires that, in order to consider and decide on the general policy of BMJII, and to supervise the monetary and banking affairs of the country, the Money and Credit Council shall:

- 1- Examine and approve organization, budget, and regulations of recruitment and internal regulations and by-laws of BMJII
- 2- Examine and comment on the annual report of BMJII in preparation for discussion at the General Assembly
- 3- Review and approve regulations and by-laws drawn-up under the provisions of the Law (the Monetary and Banking Law)

4- Comment on the banking, monetary and credit issues

5- Provide consultative advice to the government on banking, monetary and credit issues of the country

The Money and Credit Council is composed of:

- The Governor of Bank Markazi Jomhouri Islami Iran
- The Minister of Economic Affairs and Finance or his deputy
- Head of Management and Planning Organization or his deputy
- Two ministers as designated by the Board of Ministers
- Minister of Commerce
- Two monetary and banking experts as proposed by the Governor of BMJII and approved by the President
- The Prosecutor General or his deputy
- Head of Chamber of Commerce, Industry and Mines
- Head of Chamber Cooperatives
- Representatives from “Economic Affairs” and “Planning and Budget and Accounting” Commissions of the parliament (one representative per commission) as the supervisor, designated by the Parliament


Comment: The Governor of Bank Makazi Jomhuri Islami Iran Shall be the Chairman of the Money and Credit Council.

### **The Governor, Members of the Executive Board and Scope of their Authority**

The Executive Board of the Bank consists of the Governor, Deputy Governor, Secretary General, and Three Vice Governors each with powers and responsibilities as specified by the Monetary and Banking Law.

The Governor of the Bank, as the Bank’s highest executive and administrative authority, shall be responsible for all the affairs of the Bank, excluding such responsibilities that have been entrusted to other organs of the Bank under the provisions of the Monetary and Banking Law. The Governor of the Bank is responsible for the proper conduct of the Bank’s affairs and implementation of the Monetary and Banking Law and the regulations relating thereto. He also stands responsible to represent the Bank before all local or foreign official bodies.

The Governor of the Bank is appointed on recommendation of the President, the approval of the General Assembly of



BMJII. The letter of appointment is released by the president. The Deputy Governor of the Bank is appointed on the recommendation of the Governor, upon approval of the General Assembly of the Bank. His letter of appointment is also released by the President. The scope of authority of the Deputy Governor of the Bank is determined by the Governor, and in the case of the Governor's absence, resignation, hiatus or death, the Deputy Governor wields all the powers of the Governor.

The Secretary General is appointed to office on recommendation of the Governor of the Bank, and upon approval of the General assembly. He is responsible for the Secretariat of the Money and Credit Council.

The Vice Governors of the Bank are appointed by the Governor of the Bank, who also determines their duties.

### **The Law for Usury-Free Banking**

OH! You who believe! do not devour usury (Riba), making it double and redouble, and be careful of (your duty to) Allah, that you may be successful. AL-e-IMRAN 130

Since the outset of the revolution, compliance of the banking system with Islamic teachings and establishment of a usury-free banking system has been the major concern of the economic authorities of the country. The concern has its roots in the fact that in rules of Shariah 'usury' is considered confrontation with the God and his Messenger, and the Moslems are forbidden from payment or receipt of usury amounts. The first step taken with regard to this matter was ratification of the "Law on Usury-Free Banking Operations" at 8<sup>h</sup> Shahrivar 1362 by the Parliament and two days later by the Guardian Council. The Law was then forwarded to the banking system for implementation. The law has been drawn up in five chapters and consists of 27 Articles, and covers the general banking operations. Islamic Republic of Iran is among the pioneering countries whose banking operations fully complies with the shariah rules of the divine religion of Islam.


Note B, Article 3, in the second chapter of the Law states that banks act as representatives of the depositors and trustee of people. Banks invest the deposits in the form of Islamic contracts (Musharakah, Mudharabah, Ijarah and other contracts) on behalf of depositors. In fact banks act as representatives of their clients (depositors) and based on this relationship the funds are being utilized in generative and profit-making investments. The benefit is then paid to the depositors after deducting service fees of the banks.

## Relation between Governments and Central Banks

One of the most controversial issues after World War II has been the relation between governments and central banks. There are groups who under the influence of the Deutschmark and similar developments after World War I, believe that since government is a consumer of money, it should not be the authority to issue it. A dependent central bank with playing the role of treasury arm of the government, in fact allows the government to 'generate' the money that it needs. This affects monetary incomes and leads to high inflations. Moreover, access of government to readily available source of money, hinders realization of other more intricate but healthier sources such as income tax. However tax eventually incurs to consumers, disguised in inflated prices, with no explicit relation to their incomes, targeting those with fixed incomes. Thus it is believed that the consuming and the generating bodies of money must be separated and this can not be realized without an independent central bank.

The literature on central banks independence reveals that providing a comprehensive and all inclusive definition for central bank independence that clearly explains the relation between government and central bank is not an easy task. In fact the inherent interdependence of government and central bank as two decision-making bodies of financial and monetary issues, including some of the tasks of central bank such as banking to the government, adds to the sophistication. In any case, despite the prevailing disputes in the last two decades over independence of central banks, this fact is well-established now that it is necessary that certain obligations be in place to restrict the possibility of access of policy makers to monetary resources of banks, specifically that of central banks, and to foster independent utilization of monetary tools for the central banks. The subject of Central banks autonomy in respect of choosing tools towards achieving objectives has indeed been resolved, specifically in respect of the main objective of autonomous banks which is long-term stabilization of prices, which is one of the major concerns that has almost won international consensus. Central banks autonomy has gained support from two perspectives: firstly, the positive effects that independence from government (in the from of pursuing central banks main objectives, ultimately leading to a better achievement of overall economic goals) brings about; secondly, the detrimental outcomes of the banks' dependence to the financial policy makers wishes and desires on the economy.





That is why the relation between a central bank and government is of great importance. A true understanding of this relationship proves that while a great deal of interaction is needed between the two, because of the influential representation of the two foundations in a single environment with common objectives (that can be pursued in different directions), the failure to foster jurisdictions for independent functioning can also be very destructive to the economy. Therefore for steady improvement of the economy and reaching the end goals, it is necessary to be familiar with the discussions on relationship between central banks and governments which are always accompanied by delicate and intricate arguments regarding aims and necessities of independence in tools and methods.

### **An Overview to the Relations between BMJII and International Organizations**

BMJII is an economic-banking institution with distinct mission on leading, supervising and directing monetary activities. The increasing convergence of the global economy and the related international requirements has brought about a higher degree of participation and interaction of our country with outside world compared to the past. This includes more co-operations with the international organizations. Iran is now a member of three major international monetary and financial institutions, namely, the International Monetary Fund, the World Bank, and the Islamic Development Bank. BMJII participates and has an active representation in the meetings of the following organizations: IMF and World Bank Spring and Annual Meetings, BIS Annual and General Meetings, SEANZA, Interpol, Islamic Development Bank, Islamic Financial Services Board and Asian Clearing Union.

These meetings provide opportunities to present expert and scientific views, also to portray an appealing and safe picture from the economy of the country. It must also be mentioned that taking important decisions such as grant of big loans, delivering of speeches and articles by the banks' authorities, settlement of banking accounts, purchase of technologic equipment, etc. are all possible due to the representation in these international organizations.

### **International Monetary Fund**

Based on and in compliance with the law on Iran Government Participation in "Breton Woods Act" and Iran's Monetary and Banking law, Iran acquired the membership of the IMF in 1324 (1945), BMJII represents Iran's

membership at the IMF and by becoming the head group of the countries Algeria, Afghanistan, Pakistan, Morocco, Tunisia and Ghana in 1972, acquired the membership of the Fund's Board of Directors. One of the Fund's tasks is to look into and monitor the international monetary system and foreign exchange policies of the member countries on a regular, specific and complementary basis.

In recent years, IMF teams have provided the Islamic Republic of Iran with technical and consulting assistance on improving the central bank supervision, combating money laundering and financing terrorism, and data dissemination standards.

### **Islamic Financial Services Board**

The Board which is based in Kuala Lumpur, was founded on November 3, 2002 by a number of central banks of Muslim countries, and officially started operations in 2003. BMJII played an important role in founding the Board and was the head of the Board at 1384 (2005).

The Board, despite ample difficulties, has attained a high position at international level, comprising 65 active members. IFSB is a standard setting body that provides standards for Islamic Financial Institutions.

The main mission of IFSB is to strengthen and help increase soundness of the Islamic financial system. The Board introduces standards on banking and credit institutions supervision consistent with Islamic Shariah' Principles.

### **Asian Clearing Union**

Asian Clearing Union was founded by the initiative of the ESCAP Organization (Economic and Social Commission of the United Nations for Asia and Pacific Region) in 1974. In 1960s the organization embarked on extensive efforts for expansion of trade among countries of the region, ultimately leading to reaching a consensus on the following issues at the ESCAP ministers meeting in Kabul at 1970:

- 1- The expansion of co-operation and intra-ACU trade
- 2- The expansion of monetary co-operation
- 3- The establishment of the Asian Reserve Bank for grant of short-term facilities to the member countries

The agreement which gave birth to the ACU was signed by the central banks and monetary authorities of India, Islamic Republic of Iran, Nepal, Pakistan and Sri Lanka in December 1974. Bangladesh and Myanmar joined the Union in 1976 and 1977, respectively. By Bhutan joining the ACU on December 1999, the number of members amounted to eight.

The ACU functions under a Secretary General based at Tehran and The Central Bank of the Islamic Republic of Iran acts as the Agent Bank, responsible for supplying the necessary facilities for administration of the Secretary.

Asian Clearing Union, as the first experience of monetary co-operation in Asia, and still running more than 3 decades, is a unique institution in its own right at the Asia.

### Iran Treasury of National Jewels



The unique and peerless “National Jewelry Treasury” comprises a collection of the most priceless jewelry of the world. The treasury, collected through centuries and ages, depicts part of the ancient history of our land. The precious jewelry and the rare pieces have been used by the rulers as ornament items, often utilized to demonstrate glory and splendor of their courts. But these pieces have also been viewed as source of financial strength and treasury reserve of the country. It is impossible to estimate the true or even the approximate value of this artistic, historic and unique collection, even by the most experienced experts of the world.

The present National Jewels Vault was built in 1334, and since the establishment of the Central Bank of Iran in 1339 (1960), and function of safeguarding the Jewels is given to the Central Bank.

## Projects Implemented by BMJII

### A) Security Paper Manufacturing Complex (TAKAB)

Despite rapid growth of electronic trading and use of other methods of electronic payment like credit and debit cards, banknote is still considered the most reliable means of payment. The increasing growth of the use of ATMs is an indicator of this. There is a high demand for security and extra security documents in the country, and TAKAB complex, with its expert staff, advanced machinery and equipment is able to supply the whole demand of the country. Utilizing a wide range of threads and security parameters, the complex has the capacity to manufacture all types of water-marks paper with multi-tone quality.

Before the outbreak of the Islamic Revolution up to early 1362, the country's banknote demand was entirely supplied from the Europe. Since 1362, after putting the security paper manufacturing complex into operation by BMJII, the banknotes are published within the country.

TAKAB is the acronym for "security paper manufacturing complex" in Persian. The project was implemented in a 25 hectares land at Mazandaran province, city of Amol, situated at the 7<sup>th</sup> kilometer of Amol-Chamestan Road, with 37,950 square meter structure.

In Mordad 1381, the manufacturing line was fully put into operation by manufacturing security papers, and ultimately, printing of 10000 denomination banknotes was initiated at month of Day the same year.

The complex products are as follows since putting into operation at 1381:

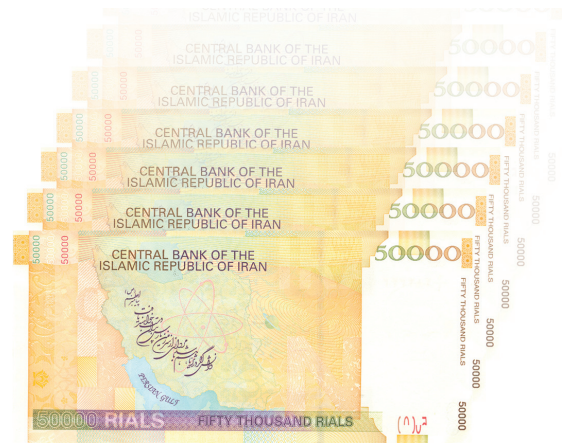
- Banknote papers, namely, one hundred, two hundred, five hundred, one thousand, five thousand, ten thousand , twenty thousand and fifty thousand in Rial denominations.
- Participation papers and all types of ordinary cheques.
- Iran-cheque old version, Iran-cheque new version printed by the Banknote Printing and Minting Organization quality of which is approved by TAKAB and which can compete with similar foreign-made types.

### B) Banknote Printing and Minting Organization



The Organization is responsible for the following tasks:

To perform acts regarding issuance of banknotes and minting of coins as legal tender of the country based on rules and standards set by BMJII, to accept orders from BMJII and from other countries for issuance of banknotes and minting of coins based on the contract approved by the Executive Board of the Bank, to mint all types of gold and silver coins and types of medallions as ordered by the private or government sectors based on rules and standards set by BMJII, to perform acts regarding design, engraving, photography, plating and making of cylinders required for banknote and securities printing and to carry out any other needed printing tasks, also to cut and pack the banknote papers, to count and pack the minted coins, to maintain and safeguard the banknote papers, whether original or experimental, and also to safeguard the stock of banknotes, gold, also the silver and gold bullions and coins, to safeguard the damaged banknotes and other scraps, including the act of annihilation based on the related rules and instructions, to place orders to supply necessary raw material, parts and the machineries needed for production of banknotes and minting of coins based on the rules and regulations of transactions set by the Bank.



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