Ahamed Kameel Mydin Meera

The Islamic Gold Dinar

Pelanduk Publications, Kuala Lumpur, 2002

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The publication of this work by Dr Ahamed Kameel Mydin Meera comes at a time when the issue of gold-based currencies has found many ardent proponents. Proponents come from varied backgrounds – from among Islamic scholars who see a parallel between the proposed gold-based system and the early Islamic systems\(^1\); from political leaders of the Muslim world, such as Dr Mahathir Mohamed and others who may be motivated by a prospect of demise of the US Dollar\(^2\); and finally, from the ranks of senior bankers and economists, such as, Alan Greenspan who have their own reasons and ways of justifying policy prescriptions\(^3\). Dr Kameel’s work supports, conforms and contributes to the Islamic Dinar policy of the government of Malaysia. The release of the book was timed with organization of two major international conferences in Kuala Lumpur that discussed a proposal for creation of a Gold Dinar, intended as a replacement for the US Dollar as the currency of trade among nations. With the demonstrated hostility of US towards many Islamic countries, it is now increasingly probable that the Gold Dinar policy will be implemented in the near term, among certain Islamic countries at first, and potentially expanding to include non-Islamic countries. The first conference, “Stable and Just Global Monetary Systems,” held in Kuala Lumpur in August, 2002 announced that the Gold Dinar would be implemented as a bilateral arrangement between Malaysia and certain unspecified partners by the middle of 2003, and extended to multilateral agreements over time. The second conference “The Gold Dinar in Multilateral Trade” held in Kuala Lumpur in October 2002 witnessed some concrete steps involving representatives of members of the Organization of Islamic Conference (OIC), specifically Iran. Not surprisingly, the book by Dr Kameel devotes a chapter to discussion of the model proposed by Dr Mahathir Mohamed, the Prime Minister of Malaysia and finds it most ideal.

This book is organized as follows. It essentially has four chapters with the first three chapters seeking to highlight the evils and undesirable economic, social and political outcomes of the conventional system. In the last chapter, the author offers the gold dinar based system as the “perfect” solution and seeks to demonstrate how it may potentially get rid of all the ills highlighted in the first three chapters.
In Chapter One, the author seeks to set the stage for defending the gold dinar by highlighting the deficiencies of the conventional system. It uses the Malaysian financial and economic crisis as a model typical of all global economic crises. The root problem, according to the author, lies in the nature of money as defined in the existing monetary system. The “fundamental flaws” in the contemporary monetary system that need to be set right are: (i) fiat money, (ii) fractional reserve requirement, and (iii) interest rates. The stage is set because all the three features would be non-existent in a gold dinar based system.

Chapter Two continues discussing implications of the “fundamental flaws” with the Malaysian example. It explains with T-Accounts and other easy-to-understand examples, the process of money creation. It hypothesizes and purports to demonstrate that in an economy with the above features, i.e. fiat money, fractional reserve requirements and interest rates, monetary expansion is a certainty in the long-run. The author seems to be puzzled why “money creation is something well documented in conventional economics but seldom discussed about.” (footnote 7, p.16)

Interestingly, the author also questions the usefulness of the “100% Money” prescription of some scholars. As he asserts, “the fractional reserve requirement is a necessary condition for money creation, but not sufficient. The sufficient condition is provided by the fiat money. This means in a system like the gold standard, (which is not fiat in nature), there will be no money creation even with fractional reserves.” (footnote 8, p.16) One wishes if the author would have undertaken a more elaborate analysis of this important policy prescription.

The essence of the discussion in this chapter is that, in an interest-based fiat money monetary system, money supply simply grows in the long run even though in the short-run, it may be altered through monetary policies. The author then goes on to offer his analysis of business cycles, which according to him are unavoidable and quite pronounced in such a system and would naturally have many undesirable outcomes. This is how it happens. “This growth (in money supply) continues even after the potential GDP has been achieved, causing interest rates to fall due to excess money supply in the economy. The lower borrowing cost may translate into higher debt-ratio in the capital structure of firms and the excess funds may find their way into unproductive sectors. Further, the increased level of money supply would show up in the form of asset price bubbles - particularly in the stock market and the properties market that enjoy easy access to credit. However, the absurd price levels may not continue due to portfolio adjustment by investors. Investors begin to sell thus starting a bear market. The stock market leads an economic downturn. The downward trend in the stock and property markets would cause financial distress among some individuals and businesses that would show up in the form of NPL’s and bankruptcy. Through the reverse process of money creation, NPL’s destroy the money supply through a multiplier effect; and thus further shrink the money base and loanable funds. Banks may respond by confiscating collaterals and calling for early repayment of loans. Businesses may start retrenching workers to save cash flow for debt service. This transfers what was originally a problem in the financial sector to the real sector of the economy. Retrenchments would contract aggregate demand and shrink the economy through a multiplier effect, causing further unemployment, business failures etc.” (pp. 44-45)
So powerful and fundamentally destructive the above features of contemporary monetary system are, that even Islamic banks and financial institutions would in essence, turn “unIslamic.” According to the author, in a system where the Islamic bank is linked to the conventional banking system through fiat money, fractional reserve requirements and interest rates, the bank cannot operate independently from the conventional banking system according to its own principles. This is because arbitrage opportunities would set in if there are any “price” differentials between the Islamic and conventional systems. Profiteering such arbitrage opportunities would move the pricing in these two systems to converge, a force in economics called the Law of One Price. In effect, there would be hardly any difference “in substance” between products of Islamic banks and those of their conventional counterparts.

The chapter also deals with the role of speculators. It seeks to dispel the widely held belief that speculation was the root cause of the Malaysian financial crisis. As the author asserts, “the speculators are not the root cause of a crisis. However, their aggressive collective actions do make things worse during a crisis. While one may argue that it is ethically not right for speculators to attack a currency, the current financial system that countries have adopted allow them to do so. It is this flaw that needs to be looked into. In fact, it is the fiat money interest rate system that provides a fertile ground for speculative, manipulative and arbitrage in the foreign exchange market.” (p. 57, para2)

In Chapter Three, the author puts on the additional hat of a sociologist and attempts to trace the socio-economic effects of the fiat money interest-based monetary system. The author seeks to demonstrate that such a system is inherently inflationary, leads to disparity in income distribution and creation of poverty, calling for policies of control prices of basic necessities. And if the price of housing is not controlled, the money-creating system would place a burden on the low-income group. Also, since most of the price controls are on agricultural products, in the money-creating economy, agriculture would become less attractive compared to sectors that do not face such controls, like manufacturing or construction. The author feels that over time there would be other undesirable effects on society. The fiat money interest based economy has numerous effects on the environment; both the physical environment and social environment. On the social front for example, the struggle to survive in the economy, and an increase in the incidence of crime. Last, but not the least, money creation would cause a gradual shift of power into the hands of those who control the financial system. With foreign financial institutions like banks operating, a gradual loss of sovereignty is likely to be seen in the land. Needless to say, this scenario has strong political implications.

In Chapter Four, the author introduces the Islamic gold dinar system. He briefly touches upon the role of dinar in the early Islamic empire and the globally accepted Gold Standard before it was abandoned. The entire chapter is devoted to how the evils highlighted above would be eradicated or minimized in an Islamic gold dinar-based system. This is not quite “unexpected” for the reader since, the three identified features of contemporary system that cause the evils namely, fiat money, fractional reserve requirement, and interest rates would be non-existent by definition.

This book is unexpectedly simple. It uses plain English to argue its case. Assuming little academic background in economics, the author often uses the Equation
of Exchange to put forward its arguments and even has a Primer to explain this High School economics. It also has a Primer to explain the role and functions of Money at the end of the text! While simplicity is often a virtue, one wonders if this is not at the cost of sacrificing analytical rigor.

The book suffers from the lack of a Shariah perspective to the entire issue. References to Shariah and Islamic texts are rare, if not non-existent. Only in the first paragraph of the first chapter, the author begins with the following hadith:

> It is reported that the Prophet Muhammad (peace be upon him) had said that “A time is certainly coming over mankind in which there will be nothing left which will be of use save a dinar and a dirham” (Musnad of Imam Ahmad ibn Hanbal).

The author also generally observes, “Muslim scholar Ibn Khaldun (1332-1395 C.E.) claimed that God created the two precious metals, gold and silver to serve as a measure of all commodities (and) his contemporary, al-Makrizi (1364-1442 C.E.) asserted that only gold and silver can play the role of money.” No references are provided for this assertion. It is interesting to contrast this view with that of Chapra (1996).

Chapra feels that “there is no specific text in the Qur'an or the Sunnah that would make it incumbent upon the Muslim ummah to use continually the bimetallic standard prevailing during the Prophet's (pbuh) time and early Islamic history or even the full-bodied monometallic standard that came to prevail later on.” (p5, para2) Chapra finds managed money or fiat money quite acceptable and draws support for his position from the fact that Umar, the Second Caliph (d. 23/644), once thought of introducing camel-skin coins (fiat money) but abandoned the idea when he was advised that the virtual impossibility of controlling the issue might not only lead to an excessive creation of money but also to the disappearance of camels through their excessive slaughter.

Chapra also draws support from writings of some early jurists, such as, Ahmad ibn Hanbal (d. 241/855) who observed that there was no harm in adopting as currency anything that is generally accepted by the people and Ibn Hazm (d. 456/1064) who did not find any reason for the Muslims to confine their currency to gold or silver, and Ibn Taymiyyah (d. 505/1328) who felt that the dirhams and the dinars were not desired for their own sake but rather because of their ability to serve as media of exchange. Hence, there were no natural or juristic specifications for them. Their acceptance depends on custom and usage.” (p5, para3) Thus, one finds two contrary positions on the Shariah-basis of gold dinars and acceptability or otherwise of fiat money. Ironically perhaps, the author of the present book makes no serious attempt to build his case for Islamic gold dinar on the basis of Shariah-related arguments.

On gold-silver exchange rate, the author notes that dinar was equivalent to 4.3 grams of gold while the dirham was 3 grams of silver. Under this coin standard 10 dirhams were equal to 7 dinars or mithqals. Since the exchange between the dirham and dinar were fixed, the Islamic economies of those days basically operated on the gold standard. The above may be contrasted with the findings of Chapra (1996) who asserts that the ratio that prevailed between the two coins at that time was 1:10. (p. 1, para1) One wonders which of the two positions is the correct one.

In a work of this nature, one would naturally expect a discussion of views (contrary or otherwise) of contemporary Islamic economists and jurists. Unfortunately, such discussion is completely missing from the book. Similarly, one would normally
expect in this kind of a book some solid reference to the global experience of gold standard. It is natural for a reader to ask, “why did the world do away with the gold standard in the first place after experimenting with this over centuries, till as late as 1971?” It would have been extremely useful to examine the arguments offered against the use of gold standard and undertake a realistic assessment of the same before advocating the same for future, especially when there is no divine ruling in its favor.

As some readers would feel, a major weakness of the book may be in the unseemly haste the author demonstrates in defending, appreciating and recommending the recent Malaysian economic and financial policies. Examples abound. At times, one almost wonders if the book aims to initiate rigorous and scholarly research into the issue. Or does it simply offer a loose collection of arguments in favor of a “politically expedient” change over to an alternative system?

Notes

1. One may find a number of websites set up by proponents of gold-based system, e.g. Tarek ElDiwany at www.islamic-finance.com, Umar Ibrahim Vadillo at www.murabitun.org. These sites provide useful references on the Shariah-basis of the proposed system. Majority of Shariah scholars are however, comfortable with paper-based fiat money.

