Can gold dinar replace fiat money as currency?

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ABSTRACT

Currency instability often leads to economic crisis. This can be seen in period of worldwide economic recession in 1933, Mexican Peso crisis in 1995, currency depreciation in Southeast Asia in 1997 and 1998, and the Russian Ruble crisis in 1998. These crises have led to a discourse on fiat money as a possible culprit to the crises due to its inherent promotion of speculation, debt and interest related economy. The currency crises have also resurfaced the discourse on using gold as a currency. This paper discusses the advantages of using gold dinar that enables it to be a superior currency than the existing fiat money. The paper further examines the possibility of replacing fiat money with the gold dinar and recognises that the implementation of gold dinar proves to be problematic under current realities. One of the major problems related to fiat money is that of credit creation. The paper argues that if the Islamic banking industry under the control of central bank could limit credit creation to prevent excessive growth of money, then the use of fiat money could be defended. In addition, current developments in crypto and digital currency could make the discourse of going back to gold in the future rather obsolete.

1. Introduction

Currency instability can lead to economic turmoil. This was reflected during the global economic recession in year 1933, Mexican Peso crisis in 1995, followed by currency depreciation in Asian nations in 1997 and 1998, the Russian Ruble crisis in 1998 and the recent global economic crisis in 2008 (SalmyEdawati, 2012). This crisis urges discussions on money and monetary system. Throughout this crisis, arguments arise on Islamic currency permissible by Shari’ah, highlighting on the significance of gold and silver. However, since 1970s, the contemporary Islamic economic scholars implicitly approved existing monetary system that were based on fiat money. Therefore, this paper attempts to
examine Shari’ah position on the use of gold dinar as a currency, and whether money is only limited to gold.

Monetary systems concern on the functions of money. Anything that functions as money should be considered as money. In other words, money refers to anything that is an acceptable mode of payment for goods, services or debts. Nowadays, people only look at paper notes and coins as currency but in reality, money includes anything that can be used as medium of exchange. Money has its own function such as medium of exchange, unit of account and store of value. Money as medium of exchange brings high degree of economic efficiency. Money needs to be standardised, widely accepted, stable, durable, and mobile. Money also functions as unit of account that removes the quote in barter exchanges prices. Next, money as a store of value related to consumer’s purchasing power. It means that if money has good store of value, the purchasing power will be preserved from the money received until it is being spent on commodity. The problem that arises from current monetary system is the inability to fulfil the functions of money as a unit of account and store value. Thus, in the economy, the currency must achieve the functions of money in order to stimulate stability and good monetary system.

The existence of dirham and dinar blessings of Allah and it is the necessities of human being. Besides, it has always been a mediator between all commodities. Gold Dinar is one of the Shari’ah currencies or Islamic currencies. Dinar was used as a medium of exchange and had been adopted by Prophet from the era of Rashidun Caliphate until the end of Ottoman Caliphate. The word ‘dinar’ derived from Roman gold currency which is denarius and in Arabs, it was called as dinar. Meanwhile, the term ‘dirham’ derived from silver currency that was used by Sasan people in Persia which is drahms. The gold coins weigh 4.25 grams while silver coins weigh 2.975 grams (Lee, 2011). Gold dinar as a currency was encouraged by Islam due to its perfect role as store value. It means that the value of gold dinar is secure and more stable than fiat money. It can also be kept for the future without decrement in value.

Other than that, the idea about using gold dinar was addressed by Tun Dr. Mahathir Mohamad, former Malaysian Prime Minister during his speech in Gold Dinar Convention in year 2003. Tun Dr. Mahathir Mohamad had mentioned that gold dinar should be consumed in order to unite Muslim countries because the value of gold dinar can stand the test of time (Siti Zaiton and Nurshuhaida, 2013). The idea of using gold dinar in economic system is reasonable and had been acknowledged as a stable currency. This idea has also been realised during the Malaysia economic crisis. At that period, the usage of fiat money span worldwide and it affected the economy when it lost its value.

Thus, the purpose of this paper is to understand the concept of gold dinar and fiat money and to examine the views of proponent and opponent on the use of gold dinar as a currency. The following sections will discuss literature review on superiority of gold dinar as a currency, some arguments on gold dinar as currency and will provide the conclusion for this paper.

2. Superiority of gold dinar as currency

Gold dinar is a minted currency which has been used since the early period of Islam. It has advantages as currency over other forms of money. Gold is widely used across the earth and it can be minted by anyone, unlike fiat money which relies on the authorities for production and issuance such as central banks and commercial banks. Gold dinar signifies the strength of Muslims on which its commendable strength is to be able to overcome foreign currencies. It preserves the value of gold dinar and mitigates inflation.

According to Ahamed, Mydin and Moussa (2006) in their paper on seigniorage of fiat money and the maqasid shari’ah, the compatibility of the gold dinar with maqasid, they discuss the characteristics that are present in gold dinar which makes it the ideal currency in the economy. Gold has major intrinsic value and it is not easy to create and destroy compared to fiat money. If the money is under the availability of
creation and elimination like the fiat money, then it will cause problem to the economy. For example, the problem of inflation occurs when the money is being created and soon, it leads to recession and unemployment when it is being destroyed. However, gold is metal that disables its own creation and elimination and on the other hand it always fulfill the role of money.

Besides that, gold is dominant than other forms of money in terms of its characteristics which are stability, durability, homogeneity, divisibility, rarity and globally accepted. Gold has homogenous features since it permits the pricing for all ranges of values. It means that if the gold bar is cut into two parts, then it is not necessary to choose between both parts since both are equal in terms of value. The value of gold dinar is also stable and it has store value that can be saved to be utilised in the future. There are no body of authorities required to force others to accept the gold as currency unlike the fiat money which needs legal tender. Therefore, characteristics aforementioned makes gold as a viable option to replace fiat money as currency since it fulfills the functions of money which are medium of exchange and store of value.

Mahmood (2001) states that Allah (S.W.T.) had made gold and silver to act as currency or money that human can use in their daily transactions. Allah (S.W.T.) has created gold and silver with criteria such as portable, homogeneous, durable, and desirable which are the requirements of money. This means that the gold and the functions of money are equivalent to each other and it is suitable to be a currency and can replace fiat money.

The characteristics of gold dinar are complete opposite with fiat money. It is easier to be created by banking sector and the growth of money supply will support the monetary system. However, there are many problems that exist. Fiat money has been created out of thin air that causes the inflation and assets price to bubble. This also widens the gap in distribution of income and it may lead to poverty. When the fiat money is destructed, then it reduces money supply and increases demand. This causes the economic problems such as recession, unemployment, financial crises and leaves the governments in debt. The existence of fiat national currency with large amount also encourages currency speculation, manipulation and arbitrage. The commodity money like gold dinar does not cause these problems since it cannot be created in similar ways on how fiat money is created (Ahamed, Mydin and Moussa, 2006). Thus, gold dinar has advantage against maqasidshari’ah.

Lee (2011) also mentions in his paper on the usage of gold dinar, viewing within the context of Islamic countries. In his paper, he argues that the usage of gold dinar is recommended in Islam due to its compatibility and fulfillment of maqasidshari’ah which is also the foundation of Islam. Maqasidshari’ah consists of protection and preservation of religious (deen), life (nasf), property (mal), intellect (aql) and family (nasb). In terms of property, gold dinar is a form of property and it promises fair and stable monetary system. Gold dinar does not charge any hidden tax on people especially for the poor. The gold dinar is aligned with maqasidshari’ah since it does not cause the inflation to occur and there are no loss on intrinsic value, unlike fiat money. It shows that commodity money like gold is able to replace fiat money since it is compatible with maqasidshari’ah.

Another study by Hazik (n.d) in his paper on gold dinar and fiat money; comparative views, gold dinar might eliminate the problem of inflation. Gold dinar overcomes the occurrence of inflation since it protects the value of currency and is not easy to produce, unlike fiat money which leads to inflation. Inflation occurs when the paper money used widely across other countries are not sufficiently backed up with the commodities or gold and the government has control over the value of money. Inflation also exists when the government can easily print the paper money as much as they want, beyond control. It is different to gold dinar which is difficult to be created since it is scarce natural resources. This statement was supported by SalmyEdawati and Sanep (2014) where they mentioned that empirical proof clearly indicates that there are no evidence of inflation that occurs under gold standard and Bretton Woods systems than any system that is not backed with gold. This shows that gold will be able to hold its value
against inflation. It shows that gold dinar has monetary stability than other currency, namely fiat money. Besides, the usage of gold dinar can regulate the problem of inflation and have the potential to replace fiat money as currency.

Abu Bakar, NuradliRidzwan and Norhayati (2002) who studied the implementation of gold dinar agreed that gold dinar plays a role in reducing speculation that widely happens in economic transactions. This is because speculation is prohibited in Islam since it has elements of maysir (gambling) which means that an individual does not have full rights to their property that had been traded. Thus, individuals should abstain from this since it is not permitted in Islam. However, in their paper, they also highlight that gold dinar would not be able to completely get rid of speculation due to the fluctuation in the price of gold. The price of gold is determined by demand and supply factors. The change in gold prices also lead to speculation. Speculators will try to speculate on gold prices in order to gain profit from the price differences. The speculators will try new method in fairly unconventional system if gold dinar is used as currency. In general, the use of gold dinar as currency can reduce the speculation but it should be noted that speculation cannot be rid totally.

To summarise this section in brief, we can see that the gold dinar is superior than fiat money because it has characteristics of good and fair monetary system which are durability, stability, homogeneous, mobility and divisibility. Gold dinar also conforms to maqasidsyari’ah, eliminating problems of inflation and reducing speculation. However, it is difficult to implement the gold dinar in current practices due to some problems that arose from certain factor. Hence, the following section will discuss more details on why the gold dinar cannot be implemented in today’s economic environment.

3. Some challenges of gold dinar as currency

Discussion on the intention of returning back the use gold dinar as currency creates some more critical questions. For example, should it be used as currency when it had failed a long time ago and why gold dinar is not relevant in current economy framework. Hazik (n.d) states in his paper about the hindrance of implementing gold dinar until now. In current practice, there is insufficient supply of the gold dinar. To adopt the gold dinar as currency, a lot of gold dinar is required to cover all the future and present economic transactions. If there is shortage in the supply of gold dinar, then it will be in deflation. It is a major challenge to supply the gold dinar across the world and to maintain enough reserves of gold dinar in the economy. In other words, if there are too much gold dinar channeled in the economy, it will cause inflation. It is different with fiat money, where in the case of inflation, the government can try to mitigate that problem by controlling the issuance of paper money. However, it is difficult to adopt this approach on gold dinar because government is incapable to control and monitor the supply of gold. This problem makes it harder to implement gold dinar compared to fiat money that is widely circulated in the economic practice nowadays.

Besides that, gold dinar is also difficult to implement due to higher cost of production. To utilise gold and silver as currency, it demands high cost of production in terms of extraction, mining and transport which consume a portion of nation’s GDP. It also called on the distribution efforts that are very costly and should be avoided. If paper money is able to function as medium for trade and exchange of goods, then the precious metals are better used for practical applications on which it utilises its intrinsic value of properties. Alas, gold is difficult to be used as currency in the economy (Hazik, n.d). In addition, in his paper, he mentions that there is short term price instability that occurs in the practice of gold dinar and this prevents efficient business decisions. It is true that the price of gold dinar is stable in long run because it offers the market driven mechanism. But in the short term, gold dinar is not suitable to be used by investors. Therefore, investors who involved in the short term investment will be affected if gold dinar is adopted in the economy. It makes it irrelevant to use gold dinar as a currency instead of fiat money.
Another study done by SalmyEdawati (2012) highlights that gold dinar is difficult to adopt in the economy due to lack of political support and motivation. In this issue, it is challenging to get consensus from all nations on the use of the gold dinar as currency in the economy. This is because the policy makers are aware that moving to a new currency needs a lot of efforts and radical changes in the economy. Therefore, if the approval from all nations is difficult to obtain, then the system of gold dinar will never be realized.

Gold dinar also faces obstacles to growth and the issues on compatibility. The gold is inelastic and there is a mismatch between the quantity of money and the volume of economic activities. Unemployment will happen due to inadequate gold currency. Besides, the gold dinar is not as compatible as the fiat currency system because it needs non-interest based economy in order to be effective and efficient. This shows that the implement of gold dinars will affect the growth of economy and changes of other aspects. Thus, the gold dinar as currency is not suitable to be implemented in the current economy.

Therefore, these are the reasons why we should continue to use fiat money as we practise today. The fiat monetary system that is still being used until now is approved by scholars and does not really contradict with Shari’ah compliance.

In addition to that, some point of view hadacceptfulus or fiat money as currency, using the approach of illah of riba. Currency is not limited to gold and silver but it can be anything that is accepted by society and considered to hold value. Fiat money is the currency that is established by government under legal framework. This currency is the monetary standard which is accepted and is used by all countries in this world. Santosos(2010) defines fiat money as most nation currencies including euro. He also stresses that fiat money has characteristics of intrinsic value, convertibility and backed by legal framework. It shows that fiat money is acceptable by all countries and is relevant until today.

According to Muhammad Aslam and Emaq Rafiq (2006), fiat money can be used because it receives approval through sunnah taqririyyah where it is not limited to gold and silver as currency even though it supports the usage of gold and dinar as money. Besides, in their study, they analyse the evidence that support the usage of fiat money as ibahah principle. Through this principle, everything is recognized as permissible unless there is evidence of prohibition state in al-Qur’an and Sunnah. Then, in al-Qur’an and Sunnah, there is no explicit prohibition found on utilization of other forms than gold and silver as currency, it means that fiat money is acceptable.

Furthermore, the usage of fiat money fulfill the concept of al-masalih al-mursalah in accordance with the purpose for welfare of society. This authority is given to scholars to decide the types of currency that can be used regarding to Shari’ah rule. For instance, Abd al-Malik ibn Marwan in period of 76 AH (d.86 AH) is the first Caliph that mints the standard Islamic currency. Even though gold and silver is utilized as currency, it is not minted or strictly stated by Islamic rulers that we cannot use other forms or substance as a currency. Therefore, it means that the currency of a country is decided by authorities regarding to the welfare and benefits of their society. It is in line with maslahah principle as expressed by Zubair (2008) in his research. This principle has been used by other scholars in depending on other materials that could also be used as currency other than gold and silver. It also means that as long as the society gets benefits from this principle, the fiat money is approved as a currency and does not contradict with Shari’ah principle.

In addition, Muhammad Aslam and Emaq Rafiq (2006) also view that fiat money can be consumed as a currency due to custom evaluation. This statement is based on the function of money as medium of exchange and store of value and these are not restricted for gold and silver only. In Islam, it concerns about society and any hardship that they face should be tackled. In this matter, if there is only gold and silver that can be traded as money, then they will face difficulties that might exist. Thus, we can accept currency other than gold and silver in order to remove hardship. This argument about hardship and
difficulties is also supported by Santoso (2010) where he states that whatever hurt society is against their welfare and the removal of hardship is encouraged and commendable. This shows that fiat money as a currency is relevant and more suitable.

Moreover, receiving other forms than gold and silver will assist Muslim in fulfilling their obligation. For instance, nowadays fiat money that has been practised by all the country will encourage the activity of preserving Shari’ah obligation which is paying zakah and avoiding interest (riba). In this case, if money is only limited to gold and silver, then it will make people neglect their obligation to pay zakah on their wealth. These people may involve with riba since the items are not being seen as form of money. Next, some views expressed that the concept of illah of thamaniyah which is not strictly constraint to gold and silver as currency but it is absolute and general. This argument on accepting the fiat money is backed by Ibn Taymiyyah. Thus, scholars and previous researches accept fiat money as a currency regarding to Shari’ah rule.

However, fiat money practices in the current economy have created many problems like inflation and interest rate. Previous studies have discussed more on fiat money, inflation and interest rate. For instance, Hazik (n.d) in his article of “Gold Dinar and Fiat Money: A Comparative View”, argues that Muslims deals with financial institutions as intermediaries between depositors and individuals. Then financial institutions will impose interest when they give loans to individuals or businesses as their profit and pay fixed interest or dividend to depositors. The financial institutions charge fixed interest against deposit and it will lend out to others, which cause inflation. For instance, the value of RM5,000 today is not similar to RM5,000 in the next five years. It means that the value of fiat money today is not the same with value of fiat money in the future and the value of paper currency is fluctuating. Additionally, if we borrow money from someone and returns the same amount in the future, there is no element of riba (interest) exists due to similar amount. But, in future, the value is not the same and it will cause instability in the currency market even though the element of riba does not exist.

Another study by NoradliRidzwan, Fidlizan and Muhammad Firdaus (2015) states that riba (interest) exists in fiat monetary system and it is related to debt. For example, the financial institutions give loans and they charge interest rates as their profit. This also occurs in the Islamic banking institutions which offer financing but charges profit rate. It is a similar concept of debt financing instruments. In their study, they mention that the interest in current economy gives motivation and ideas to return back to the use gold dinar as currency in economic transaction. This is because the prohibition of riba is not only being mentioned in Holy Qur’an, but also in the Bible and Torah. Islam truly prohibits the involvement in riba and people must avoid from taking riba or any interest. It also means that fiat money is close to the riba and gold dinar is protected from this element.

Needless to say, riba (interest) is being stressed as a prohibited element in Islam and it exists in monetary system which is based on interest. Creation of fiat money is also a form of riba. Ribahas a characteristic like creating additional purchasing power without any risks. For instance, A gives loans of RM 1,000 to B at 10 percent of interest per annum, and B need to pay extra RM100 as interest and provides extra purchasing power to A, which has been gained without any risk. This additional purchasing power is considered as riba. In this case, the riba occurs only after 1 year when B makes payment of RM 1,100 to A. Therefore, we cannot deny that the creation of fiat money leads to immediate purchasing power without looking on any risk (Ahamed, Mydin, and Moussa, 2006). Therefore, gold dinar shall be adopted in current economy to avoid riba from fiat monetary system. Ribat occurs in fiat monetary system leads to problem such as inflation. This is because, if money supply is high, it will promote higher credit creation, and then it will lead to inflation.

Besides, the previous study done by Zuriyati and Abdul Ghafar (2017) also discusses on credit creation via fractional reserve banking where it uses fiat money and manipulates existing money supply. In their studies, they stress that credit creation will reduce liquidity in the market. It means that increment in
money creation activity make way for more liquidity problem. Additionally, the ability of the banks to use the depositor’s money to create debt will give more profit to depositors in the form of interest rate. At the same time, money creation also causes instability in the economy and it can lead to inflation.

Santoso (2010), whose study “Fiat Money, Islamic Bank and The Real Economy” also stressed that fiat money can causes inflation. The reason given is that the value of currency keeps decreasing. In his paper, he mentions about inflation that happened in China currency in 9th Century, China is the first country that uses paper currency to replace the copper because of its shortage of supply problem. However, China does not back their paper money with gold or other commodities. Then in year 1051, China faced inflation because they produced a lot of paper money. Supplying and creating too much fiat money leads to currency instability.

Based on SalmyEdawati and Sanep (2014), inflation started to occur in the 1970s. In year 1973 and 1974, inflation occurs and the price is rising until 1979. From there, the problem was not fully solved yet. The rate is still high and will keep on increasing whilst various methods have been used to solve it. Inflation becomes a big problem and international phenomenon. A lot of countries that adopt free market constitution faced inflation, even though the severity might be different. Through evidence that has been found and discussed by prior research, fiat money can cause inflation and gold dinar should be adopted in the monetary system in order to solve this problem.

Briefly, this section describes why gold dinar cannot be implemented in the current economy. Then, the fiat money that was used in current economic practices is accepted by some scholars, admitting that it is in line with Shari’ah principle. However, the fiat monetary system remains associated with riba and inflation.

4. Conclusion

In conclusion, the idea about returning to gold dinar as currency is an interesting idea but there are too many hindrances and obstacles in its adoption in the current economy. This paper discusses the possibility of gold dinar to replace fiat money as a currency. This paper also elaborates on the superiority of gold dinar as currency and some challenges on gold. There are some arguments that support or reject the adoption of gold dinar as currency. Literature reviews stress that gold dinar has characteristics that are associated with functions of money and it is superior as a currency than fiat money. If gold dinar are to be implemented in the economy, the problems such as inflation and speculation can be reduced but realistically, it cannot be eliminated totally.

The creation of fiat money is deeply rooted from riba which exists in financial institutions. Thus, Muslims are at loss in adherence to fiat monetary system. In the current practice, the transaction revolves on riba-based currency. Fiat money can be secured and efficient as a currency as long as it does not involve in riba. The problem of riba is actually on the credit creation itself. For example, riba exists when interest is imposed on money lent to customer. The same case would be occurring if interest rate is imposed on gold dinar in the economy. Thus, the problem is actually on the credit creation side, rather than the monetary system itself.

Although there are some arguments on fiat money, we cannot deny that currently, fiat money is more preferable as currency than gold dinar. This is because fiat money in current practice is actually approved by some views, using the illah to riba approach, removes hardship and striving for maslahah of the society. Fiat money is also in line with Shari’ah. Besides that, society has been exposed to digital signatures that give benefits to them. The digital currency also known as bitcoin or cryptocurrency which it refers to as math-based, decentralised, convertible virtual currency and the process involved is protected by cryptography and exhibits an equivalent value in real currency (Financial Action Task Force, 2014). In
addition, the society must trust the third party to prevent double-spending. The fiat money and digital signatures can improve the efficiency of the economic system (Nakamoto, n.d). On the other hand, it is quite hard to implement gold dinar in the current economy, assuming that there are a lot of efforts that should be done in order to restructure the whole financial institutions such as central bank, Islamic banks and other institutions. The usage of fiat money is already accepted by some views, and it has been validated by Shari’ah sources. If the only acceptable form of currency is gold dinar, then all the financial institutions and scholars views on fiat money is not valid. Therefore, gold dinar as a currency could not fully replace existing fiat money. Additionally, some steps need to be taken to improve the fiat monetary system which includes reducing credit creation. Then, the financial institutions should ensure their transactions and operations are free from riba.

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