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Towards Stabilization of the World Monetary System: A Sharīʿah Perspective

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In essence, the author proposes a supra-national complementary currency that seeks to provide monetary and financial stability. There are some technical issues relating to the demurrage charge which, rather than an interest rate, could be replaced by the *zakāh* rate in order to prevent hoarding and encourage circulation of the TRC. However, the author proposes a trade-reference currency (TRC) which as a money-of-account is defined in terms of a basket of commodities, and thus deemed inflation-free. This paper intends to analyze various monetary reform proposals since it is useful to understand the chronology of proposals that have anticipated this particular concept of a TRC. In fact, it is not without precedent from an Islamic perspective and was anticipated under the *Ayyubids* by none other than Saladin in 1171 (Abdullah, 2016). The army *dīnār* or *dīnār jayshī* (DJ), was an important money-of-account used to determine the present value of agricultural land for land concessions (*iqṭāʿ*) granted by the Sultan for military service, in lieu of a stipend.

The *dīnār jayshī* (DJ) was valued in cash and in kind, including gold, wheat and barley, which reflected the primary medium of exchange and agricultural output in Egypt. The DJ was also worth the equivalent of 2/3 of the Egyptian *dīnār* (ED) and its value was mainly influenced by the price of wheat and barley given the composition of the basket of commodities. The gold ED exchanged for 1:20 *dirhams* in circulation, which at that time were debased and contained only 2/3rd silver. Thus, the DJ exchanged for 13 1/3 Egyptian *dirhams*, given their purity (20 x 0.666 = 13.333). At the time of Saladin, the Egyptian *dīnār* weight was based on wheat grain (*qamḥah*) and weighed 4.30g. Similarly the Egyptian *dirham* weighed 3.01g – these differed from the legal *dīnār* (4.25g) and legal *dirham* (2.975g) weights by 1.25%, which were based on barley grain (*ḥabbah*). The prevailing *Ayyubid* gold:silver ratio was 9.3 (2.01 x 20 / 4.30), whilst at the time of the Prophet (peace be upon him) it was 7.0 (4.25 x 10 / 2.975) reflecting the market exchange rate of 10, which was also applicable in the determination of *zakāh*. To achieve the same gold:silver ratio of 7.0, it implies the same exchange rate of 10 and an Egyptian *dirham* that was not de-based (3.01 x 10 / 4.30 = 7.0). In that case, a pure *dīnār* would exchange for 10 pure *dirhams*, or exchange for 15 debased *dirhams* (10 / 0.666 = 15) containing only 2/3rd silver (Abdullah, 2016).

However, by monetizing the average agricultural revenue in the form of the *dīnār jayshī*, the Egyptian *dirham* exchange rate of 20 was reinforced through an implied money-of-account that consistently undervalued silver. The exchange rate for a coin of 2/3rd silver should have been 15 not 20 in relation to the legal exchange rate of 10 between a legal *dīnār* and *dirham* comprising pure gold and silver, when determining *zakāh* (10 / 0.666 = 15). This would have been so, had the market decided the intrinsic market exchange rate rather than the rate ascertained by government intervention. By valuing the *dirham* at 20 to the Egyptian *dīnār*, the same amount of silver was being valued at 25% less of what it should be as a coin of 2/3rd purity. Therefore, the rulers of Egypt under-valued silver in relation to gold. Silver became increasingly cheap and gold increasingly expensive. Through government intervention with money-of-accounts and exchange rate edicts, silver replaced gold as the main standard of value by the end of the *Ayyubids*. In other words, a monetary authority can misprice a basket of commodities that includes gold and silver, in relation to the prevailing market supply and demand for commodities and precious metals in the real economy, serving to undermine the objective of monetary and hence price stability. Thus, we have an empirical case study of a money-of-account, which was not successful and eventually by the time of the *Mamluks* became an unreliable measure of value. Furthermore, money is the common denominator for all economic transactions: even if the medium of exchange is constant in value (as the denominator), the fluctuation of prices of goods and services (as the numerator) are not determined by man, but by Almighty Allah.

More recently, a number of modern scholars have suggested that a new mechanism can be developed which combines modern technological advances of e-channel payments with the stability of a gold standard. With the unprecedented amounts of paper money produced by the Bank of England from 1694, eventually a *de-facto* gold standard existed in England from 1717, *de jure* from 1816, and *de facto* in the U.S. with the limping gold standard and the demonetization of silver in 1873. Soon after, Berkley (1876) proposed that a clearing mechanism be adopted, but this would only later be explored further in the inter-war years. Fisher's *Stabilizing the Dollar: A Plan To Stabilize The General Price Level Without Fixing Individual Prices* (1920), involved a managed currency that implies centralized control and monopoly, by maintaining the gold standard and maintaining paper dollars but withdrawing the circulation of gold dollar coins. He wished to alter the value of the dollar and "make it conform in purchasing power to the composite or goods-dollar" (Fisher, 1920, p. 89), which was defined as a basket of commodities, whose value could be measured scientifically through an index number, in order to thereby alter the value by adjusting the weight of the nominal gold standard (Fisher, 1920, pp. 85-86, 104-105). Fisher then wrote *The Making of Index Numbers* (1922) in support of his thesis with a detailed exposition on the construction of a suitable price index. He reinforced the whole concept with *The Money Illusion* (1928), which differentiated the illusion of the nominal value and the real value of the dollar: "As I write, your dollar is worth about 70 cents of pre-war buying power. In order words 70 cents would buy as much of all commodities in 1913 as 100 cents will buy at present" (Fisher, 1928, p. 3).

Fisher again blamed the demise of the purchasing power of the dollar on the fixed weight dollar (i.e. the gold standard):

> Our fixed weight dollar is as poor a substitute for a really stable dollar as would be a fixed weight of copper, a fixed yardage of carpet, or a fixed number of eggs. If we were to define a dollar as a dozen eggs, thenceforth the price of eggs would necessarily and always be a dollar a dozen. Nevertheless, the supply and demand of eggs would keep on working. For instance, if hens failed to lay, the price of eggs would not rise but the price of almost everything else would fall. One egg would buy more than before. Yet, because of the Money Illusion, we would not even suspect the hens of causing low prices and hard times. In what sense, then, should a dollar be fixed, if not in weight? Evidently in buying power…[since the dollar] cannot at present be used with accuracy, for measuring value. This fact, is hidden from us by the Money Illusion. (Fisher, 1928, pp. 17-18)

Following WWI, although prices soared and then fell, technological improvements with improved radio and telephone communication, electrification, improvements in infrastructure with highway con-

struction and mass production in the automobile industry, saw improved earnings and demand for goods during the 'roaring 20s', which ensured that prices were still 30% above pre-war levels. However, Fisher blamed the gold standards' stable currency for the demise in purchasing power. Fisher would again blame the monetary system in *100% Money* (1935), by using his equation of exchange from *The Purchasing Power of Money* (1911) in an attempt to show that USD 8 billion reduction in the quantity of current account money was the cause of the Great Depression (Fisher, 1935, p. 6) and called for a 100% reserve system.

Milton Freidman and Anna Schwartz in *A Monetary History of the United States 1867-1960* (1963) in chapter seven entitled "The Great Contraction", would also blame the Federal Reserve and the monetary system, and by implication the gold standard. They suggested a reduction in the deposit-currency ratio, initially as a result of the payment of liabilities, following the Wall Street Crash of 1929 that saw by 1931 a contraction of deposits necessary to free a demand of currency (gold dollars), by a ratio of 14:1, as banks emptied their reserves. This led to a contraction in current account money (M2), and a spiral of bankruptcies and unemployment (Friedman & Schwartz**,** 1963, pp. 333-346). Abdullah (2013) established that the demand for increased government intervention and currency management was misplaced: whilst there was a problem with the fractional reserve banking system, there was in fact nothing wrong with the gold standard or the value of the dollar, which remained pegged to gold until 1933. Rather, it was trade policy in the form of the Smoot Hawley Trade Tariff Act, proposed in 1929, that caused the Wall Street Crash. When it was enacted in 1930, it caused a slump in agricultural prices which led to currency withdrawals, a multiple contraction of deposits, and a spiral of bankruptcies that led to widespread unemployment and the Great Depression.

Meanwhile, Keynes described the gold standard in *A Tract on Monetary Reform* (1923) as a "barbarous relic" (Keynes, 1923, p. 172), and in any case, "in the modern world of paper currency and bank credit there is no escape from a 'managed' currency, whether we wish it or not…the value of gold itself depends on the policy of the Central Banks" (Keynes, 1923, p. 170). As with Fisher, Keynes also proceeded to suggest monetary reform in the form of managing the purchasing power of a new commodity standard. He stated:

> By regulating the supply of currency and credit with a view to maintaining…the stability of the internal price level…I argue, therefore, that the same policy which is wise for Great Britain is wise for the United States, namely to aim at the stability of the commodity-value of the dollar rather than at stability of the gold-value of the dollar…We have reached a stage in the evolution of money when a 'managed' currency is inevitable. (Keynes, 1923, pp. 190, 203-204).

This would soon arrive following the demise of the gold standard, first by Keynes (1942[1980]) and then by Hayek (1943[2009]) in advance of the Bretton Woods negotiations. Keynes suggested *Proposals for an International Clearing Union* in 1942 for a global clearing union involving the *bancor* or 'bank gold'(1), given that as a unit of account it was to be fixed in terms of gold, although "the purpose of the Credit Union is to supplant gold as a governing factor, but not to dispense with it" (Keynes, 1942[1980], pp. 72, 183).

In terms of governance, Keynes proposed that the Credit Union would set up a

> Super-national policing body charged with preserving peace and maintaining international order. If any country was to infringe its properly authorized orders, the policing body might be entitled to request the Governors of the Clearing Union to hold the Clearing Account of the delinquent country to its order and permit no further transactions on the account except by its authority. This would provide an excellent machinery for enforcing a financial blockade. (Keynes, 1942[1980], p. 190).

The Clearing Union would also provide for various mechanisms to maintain price stability through the finance of stocks of commodities, as well as commodity controls in staple products (Keynes, 1942[1980], pp. 190-191).

(1) *Banc* is the old French word for 'bank', and *or* in French means 'gold'.

Hayek also suggested *A Commodity Reserve Currency* (1943[2009])[(2)], and in doing betrays a pattern involving the leading economists of the day. Fisher and Friedman (quantity theorists), Keynes (mercantilist/purchasing power theorist) and now Hayek (Austrian school), despite their public differences in economic theory, suddenly all rallied around the demise of gold to suggest a more efficiently managed global monetary architecture based on the management of purchasing power to stabilize prices. As Hayek put it:

> The gold standard as we knew it undoubtedly had some grave defects. But there is some danger that the sweeping condemnation of it, which is now the fashion, may obscure the fact that it also had some important virtues which most of the alternatives lack. A wisely and impartially controlled system of managed currency for the whole world might, indeed, be superior to it in all respects…The basic idea is that currency should be issued solely in exchange against a fixed combination of warehouse warrants for a number of storable commodities and be redeemable in the same 'commodity unit'. For example, £100, instead of being defined as so-and-so many ounces of gold, would be defined as so much wheat, plus so much sugar, plus so much copper, plus so much rubber, etc. Since money would be issued only against the complete collection of all raw commodities in the proper physical quantities (twenty-three different commodities in Benjamin Graham's plan) [Graham, 1937, p. 57], and since money would be redeemable in the same manner, the aggregate price of this collection of commodities would be fixed, but only the aggregate price and not the price of any one of them…there are many ways in which gold could be linked with the new scheme if desired without thereby impairing the advantages of the scheme. (Hayek, 2008, Vol. 6, pp. 106, 109, 113).

In fact, the special drawing right (SDR) under the auspices of the International Monetary Fund (IMF) was adopted under the Bretton Woods gold exchange system in 1944 but it too collapsed in 1971, and the U.S. dollar emerged as the global international reserve currency backed no longer by gold, but by debt. Under the weight of debt and paper, the U.S., Europe and other economies have experienced numerous monetary and financial crises, reflected in the breakdown of monetary order, which has accelerated over the 20^{th}-21^{st} centuries. Accordingly, a number of monetary economists and theorists (table 1) have suggested monetary reform. However, the majority have a common denominator – that a new global monetary authority should be established to operate a global credit clearing union with a new *fiat* global reference currency (GRC), comprising a basket of commodities that includes gold, which would effectively de-monetize gold and eliminate national sovereignty. No doubt this would be coupled with a control of income from dominant global employers (multi-national companies), a control of expenditure through personal carbon taxes (under the auspices of climate change), and delivered through technological advances in e-channel payment and clearing mechanisms (through big data and block-chain technology). Thus, a new financial architecture might be marketed as a clever off-setting, inflation-free, interest-free commodity or even gold standard, but if a supranational global authority manages the commodities and retains the gold, whilst we are firmly left with the standard – what freedom do we have? In fact, such a system could easily threaten individual liberty altogether, as authorities extend their governance to even define knowledge (education) and religion. Liberty and monetary freedom, is derived from society owning and transacting of that which it owns, both in terms of goods and services and gold and silver.

(2) Based on Benjamin Graham's *Storage and Stability* (1937) and subsequently updated in *World Commodities and World Currencies* (1944).

Table (1) A Contemporary Chronology of *a priori* Views on Monetary Theory

Cent.	School	Scholar	Comments
20th-21st	Monetary Reformers	Berkley (1876), Fisher (1920), Graham (1937, 1944), Hayek (1943), Keynes (1923, 1942) Gesell (1958), Friedman (1963), Huber & Robertson (2000), Lietaer (2001), Davidson (2002), Stiglitz (2007), Bonpasse (2009), Greco (1990, 2001, 2009) influenced by E.C. Riegel, Meera (2004), Brown (2010, 2013), Abdullah (2016).	All these authors called for monetary reform that requires an alternative to the use of gold and silver as a primary medium of exchange. Instead, they suggest a new global clearing mechanism and *fiat* reference currency that would effectively de-monetize silver and gold: except Meera whose analysis called for a return to gold and Abdullah who called for a return to a *dīnār* and *dirham* commodity standard.

Source: Adapted from Abdullah (2016)

From an Islamic perspective, contemporary scholars have introduced a new asset class of debt certificates called *ṣukūk*, although it is worth recalling the classical opinion regarding promissory notes:

> It was reported that Abu Hurairah (may Allah be pleased with him) asked Marwan: "Have you legalized usury?" Marwan said: "No." Then Abu Hurairah said: "You have legalized selling promissory notes) whereas the Messenger of Allah (peace be upon him) forbade selling food-stuff unless received by the seller". Marwan then addressed the people and forbade selling such notes. (al-Naysaboori, Muslim, 1991, Vol. 3, p. 1162, *ḥadīth* no. 1528)

Ṣukūk also include non-interest bearing, non-redeemable, promissory notes issued as paper currency by a central bank, such as the Federal Reserve note (the USD) or Bank of England's pound note (the GBP). The GBP note still has the now broken "promise to pay the bearer the sum of five (10/20/50) pounds" of gold, since the Bank of England (BoE) paper notes were historically redeemable for sovereign gold coins. The BoE tries to justify a new meaning of the word 'promise', where "public trust in the pound is now maintained by the operation of monetary policy, the objective of which is price stability" (Bank of England, 2017). However, central banks have failed to deliver on this promise as well. *Fiat* money is debt organized into bank money (the medium of exchange is debt), where a customer promises to repay a debt, and the bank promises to repay a customer's deposit, thus bank credit involves exchanging two IOUs, but such a transaction would then come into the "forbidden category of a debt for debt" (al-Asbahi, Malik ibn Anas, *al-Muwatta'*, 1991, p. 254). Moreover, we have a specific *ḥadīth* that insists on the "prohibition of destroying *dirhams* and *dīnārs*";

> Alqama bin Abdullah reported on the authority of his father that Allah's Messenger (peace be upon him) forbade from destroying the coins in vogue among the Muslims without any necessity. (Ibn Majah, 2009, Vol. 3, p. 370, *ḥadīth* no. 2263; Abu Dawood, 2009, Vol. 5, p. 320, *ḥadīth* no. 3449).

Therefore, we have a clear injunction in the *ḥadīth* that clearly states that Muslims cannot destroy the *dirhams* and *dīnārs* that were being used by the Muslims – if we cannot destroy them, surely we cannot discard them, only to adopt promissory notes, which also have been specifically rejected by classical scholarship.

However, can netting between two parties whom simultaneously owe debts to each other, as understood in the Islamic concept of debt clearance (*muqāṣṣah*), be extended to a credit clearance system, where accounts receivable are netted against accounts payable, or does the credit-clearance framework reflect transactions in aggregate that are "disapproved of – delay for delay. Delay for delay is to sell debt against one man for a debt against another" (al-Asbahi, Malik ibn Anas, *al*-Muwatta', 1991, p. 268)? A proposal argued by Meera (2004) in *The Theft of Nations: Returning to Gold*, involves bilateral or multilateral payment arrangements, where gold

accounting is settled periodically via national monetary authorities involving the transfer of the beneficial ownership of an equivalent amount of gold, contained in a third-party gold custodian account. As such, a smaller amount of gold can support a larger amount of trade (Meera, 2004, pp. 89-91) through the democratization of credit creation. However, in terms of economic substance this is not dis-similar to how digital claims are netted in the current payment system albeit through the intermediation of commercial banks and also international monetary assets including gold through central banks. Currently, the Federal Bank of New York and the Bank of England, act as gold custodians under the auspices of the Bank of International Settlements (BIS) and the International Monetary Fund (IMF). The only difference is that it is interest-free. However, with regards to *muqāṣṣah* the suspicion of usury might remain in transactions involving deferred sales. If 'A' sold 'B' ten measures of food with a deferred price of ten coins and the food was consumed by 'B'. Subsequently, 'B' sold 'A' twenty measures of the same type of food for ten coins, it is not permissible to clear the two debts, even though the two prices are the same. In fact, 'A' sold ten measures of food that he consumed and was repaid with twenty measures of the same food, which is a loan that benefited the lender and is *ribā* (Al-Zuhayli, 2003, Vol. 2, p.306). In this case, modern modes of risk-free deferred sales extended by "Islamic" banks, which are currently being exposed as not Islamic (Abdul Manap, 2016), may still go un-noticed in a direct credit-clearance mechanism.

Abdullah (2015) observed that official reserves treat gold-in-vault and gold receivables from gold lending activity as a same-line-item (as required by the IMF), which serves to disguise the true amount of gold left physically owned and controlled by central banks. Indeed, there is not only a fractional reserve banking system, but also a fractional reserve gold market. For every 45 oz. of gold being sold by the gold market via unallocated gold, only 1 oz. is real, and 44 are paper oz., which implies that the fractional reserve ratio for gold (FRRG) is only 2.27% (or 1/44 x 100). Assuming an average nominal price of gold of USD 1,250/oz., the real price, absent of any paper oz., should be about USD 54,000 (or 1,250/ 0.023). The real price of gold is about USD 54,000/oz. absent of the unallocated gold, in the presence of which, the market price of gold has been reduced to about USD 1,250/oz. The value of the USD is therefore 45 times over-valued (= 54,000 / 1,200). In the U.S. in 1792, the official price of gold was USD 19.3939/FTO (Warren & Pearson, 1935, p. 154), whilst the current market price of gold is about USD 1,250/oz. Thus one dollar in 1792 is now only worth USD 0.016 (19.3939 / 1,250), or less than 2 cents in 2017. However, in reality it is arguably worth considerably less than even 2 cents, when we take into account the FRRG. A complementary currency cannot operate in parallel to the current system, which is itself clearly not sustainable. The silver market is as equally manipulated as the gold market, so that at the true price of gold, the market value of silver would also significantly increase. According to Abdullah (2016) the total value of above-ground gold and silver stocks could easily redeem global M3 money supply, without the assumption of a systemic economic crash. However, this would assume a different financial architecture absent of financial intermediation, such that commercial banks would be replaced by investment accounts and equity finance on the basis of profit-and-loss sharing. This will ensure the separation of the provision of public money and private partnership finance. It is interesting to note that the West is arriving at the same conclusion and supported by research undertaken on block-chain technology by the Bank of England (Wolf, 2014; Evans-Pritchard, 2016).

Indeed, Abdullah (2016) in *The Islamic Currency* empirically established that the current fractional reserve banking system is operating contrary to the objectives of the Sharīʿah (*maqāṣid al-Sharīʿah*) since it is a wealth transfer mechanism. Based on a qualitative analysis of Islamic texts and a quantitative investigation of gold, silver and commodity price data over 1,300 years, Abdullah developed an Islamic monetary theory of value, which involves a return to the *dīnār* and *dirham*, without monetary monopoly or management except to ensure that the value of money (VM) is high. The findings established that a high VM implies low and constant prices over the long term, such that gold and silver protects wealth. Conventional monetary policy involves the management of money supply through monetarism (Friedman), or via interest rates (Keynes) with the objective

of price stability, but under the *fiat* standard, prices have increased exponentially. A loss in the value of money involves a transfer of wealth to the issuers of money through an increase in the price level. Society has to lower its standard of living to pay for higher prices and interest, such that our wealth is being confiscated through inflation and transferred to the profit and loss statement of the banking system: *fiat* money transfers wealth. The only way to put a halt to this Ponzi scheme is to own allocated physical bullion. We might pass from digital debt-based money creation to digital interest-free money creation, but still be subject to a global authority that does not agree with all the values that Islam requires. Given Keynes remarks about supra-national governance in the form of a financial blockade (Keynes, 1942 [1980]), which one assumes could equally apply to nations, corporations and individuals, it would be better from an Islamic perspective and perhaps beginning with OIC countries, to ensure the orderly redemption of *fiat* money into gold and silver occurs first, as a bimetallic commodity standard, and then introduce a 100% bimetallic gold and silver standard for the settlement of international payments through a Muslim national monetary custodian such as the Islamic Treasury (*bayt al-māl*).

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