THE ISLAMIC GOLD DINĀR – MYTHS AND REALITY*

Murat Cizakca*

Abstract

Recently, there have been an increasing number of publications and conferences on the re-introduction of the Islamic gold dinār, a coin with pure gold content. The phenomenon could even be construed as a campaign. The proponents of this idea, who are known as denarists and are particularly active in Malaysia, advocate that this country, as well as the whole Islamic world, “urgently” return to the Islamic gold dinār. Their call has gained considerable urgency in view of the latest crisis in the West. But what the denarists are doing is proposing an essentially historical system (coinage was the norm throughout history) without having studied how the system they are proposing actually functioned in history. The main purpose of this article is to fill this vacuum.

Keywords: Islamic Gold Dinar, intrinsic value of money, zero rate of interest, debasement, barter, inflation, Gresham’s Law.

I. INTRODUCTION

Recently, there have been an increasing number of publications and conferences on the re-introduction of the Islamic Gold Dinar, a coin with pure gold content. The phenomenon could even be construed as a campaign. The proponents of this idea, who are known as

---

* Murat Cizakca is a Professor of Comparative Economic History and Joint Head of Research at INCEIF. He can be contacted at mcizakca@gmail.com.

# The author would like to thank Assoc. Prof. Mohammad Akram Laldin, Drs. Mohd Pisal and Shaikh Hamzah Abdul Razak as well as Mohd Zamree Ishak of INCEIF for their comments and insights. Special thanks are due to Prof. Dr. Obiyathulla Ismath Bacha, Prof. Dr. Zubair Hasan as well as to the two anonymous referees whose contributions were particularly significant.
The Islamic Gold Dinár – Myths and Reality

denarists and are particularly active in Malaysia, advocate that this country, as well as the whole Islamic world, “urgently” return to the Islamic Gold Dinar. (Meera, 2002, pp.88-89). They argue that if this return is achieved nearly all the ills of modern economies, such as rampant inflation, credit crunches, stagnation, unemployment, etc., which they associate with the present paper money system, would be significantly reduced. Some scholars also argue that since the Prophet (SAW) used coins, it would only be appropriate for Islamic countries to transform their currencies into gold dínârs. In short, what the denarists are doing is proposing an essentially historical system – coinage was the predominant form of currency throughout history – for the future. Since, a historical system is being proposed for today, it is essential that we understand how this system actually functioned in history. The main purpose of this article is to explain this.

II. FROM BARTER TO MONETISED TRADE

Let us start with the last argument. First of all, we need to understand what the overall purpose of the Prophet was when he condoned the use of coinage. Verses from the Qur’an as well as a number of aḥādīth make it perfectly clear that there was a divine plan to make Makkah the global hub of world commerce.¹ For this, the first task was to catapult the Islamic community from the age of barter to the age of monetised trade. The Prophet did this with two aḥādīth. While barter was thus declared as a form of ribā, trade with money was approved and encouraged.² To facilitate this, the Prophet condoned Byzantine and Persian coins issued by non-Muslim empires and did

---

¹ Consider for instance: Qur’an: 2: 198, as well as Sunan Abū Dāwūd, Book 10, Kitāb al-Manasik wa’l-Hajj, hadith 1730.
² See Malik, Book 31 (Business Transactions), hadith 31.12.21; Muslim, Book 10 (Book of Transactions), Hadith 3861. These aḥādīth pertain to the exchange of the poorer quality of a commodity with a better quality of the same commodity. Since barter is defined as as the “direct exchange of goods and services for other goods and services without any medium of exchange for settling payment”, these aḥādīth actually prohibit barter. Thus, barter is not limited merely to exchanging apples for oranges. It also covers exchanging lower quality of dates for better quality ones as explained in the hadith. On the definition of barter see: Siklos (2003) “Barter”, p. 242.
not hesitate to use them. Indigenous Islamic coins were introduced later (Ali, 2004).3

Since paper money had not yet been invented during the Prophet’s time, he couldn’t have used such currency even if he had wanted to. Therefore we need to ask, would he have wanted to use paper money if he had had the choice? Let us imagine for one minute that the Prophet had the choice between coinage containing gold or silver and paper currency. Which one would he have chosen and on what basis would he have made his decision? It is my contention that he would have thought of the Qur’an and would have based his decision upon the inspiration he obtained from the Word of God. The Qur’an does not ordain Muslims to use this or that currency but does provide a powerful clue: the prohibition of the rate of interest. Obviously, it is based upon this clue that he would have tried to reach a decision. We now know, with hindsight, that while paper money fulfils the ultimate Islamic goal of zero percent rate of interest, coinage does not.

III. COINAGE AND ZERO PERCENT RATE OF INTEREST

Now, fast forward 14 centuries; as is well known, the Japanese interbank interest rate actually reached zero percent in 1999. Japan was followed by several other Western nations during the latest crisis. On July 30, 2010, the London interbank offered rate on three-month dollars was fixed at 0.46563 percent (Vollmer, Uwe & Bebenroth Ralf, 2010). Although this was obviously unintentional—indeed, none of these countries reduced their rate of interest to zero percent for religious or ideological reasons—they nevertheless inadvertently demonstrated that it is possible to bring into being an economy with zero rate of interest using paper money.

The question boils down now to whether this could have been achieved with coinage. I doubt it; because, every coin has two different values, face value and intrinsic value. Face value, which we may call “fiat value”, refers to what is written on it and is determined by the power of the state which declares it legal tender, while the intrinsic value refers to the cost of producing the coin plus, more importantly, the value of the metal contained in it. The intrinsic value of the coin

---

3 The first Islamic coins were introduced by the Umayyad Caliph Abd al Malik ibn Marwan in 691 or 692. For details see Ali, Wijdan (2004), p.1.
The Islamic Gold Dinár – Myths and Reality

is thus primarily determined by the global commodity market, where equilibrium prices of gold or silver come into being (Hassan, 2008). Under normal circumstances, face value should be greater than or at least equal to the intrinsic value. But this is not always so, as will be explained below.

Let us make two assumptions now. First, let us assume that a government with Islamic inclinations decides to reach a zero rate of interest. This follows directly from the interest prohibition in Islam. Since most economists agree that interest rate is actually the price of money, interest prohibition means that this price should be zero. Assume further that gold coinage constitutes the currency of the country and the Central Bank is ordered to take all necessary measures to reduce the prevailing interest rate to zero percent, regardless of any macro-economic consequences. My hypothesis is that, whereas the Japanese Central Bank reached this level without any such intention using paper money, the Central Bank of an Islamic country using coinage as its currency could not do so despite all its good intentions. Indeed, the Central Bank can adjust all the macro-economic variables under its control to reach its target of zero rate of interest but would find it extremely difficult, even impossible, to do so. This is because of the intrinsic value of the coinage, which is determined not by the Central Bank but by the global supply and demand for the metal contained in the coin.

The hypothesis that coins would always have a positive rate of interest is confirmed by monetary history. Genoa aside, where a one percent rate of interest was observed during the seventeenth century thanks to very special institutional factors, in general, historical rates of interest never fell below three percent in economies using coinage. Indeed, a zero percent rate of interest has never been recorded throughout history in monetary systems using coinage (Macdonald 2006, pp. 77 & 97; Martinez 2003, p. 37). Thus, we conclude that, while it is possible to reduce the rate of interest to zero percent with paper money, it is not possible to do so with coinage. Consequently, paper money appears to be a more appropriate medium of exchange than coinage for Muslim countries.

At this point we may ask if there is any fiqh objection to the use of paper money. Some of the most respected classical Muslim scholars, particularly Muĥammad ibn al-Ĥasan al-Shaybānī, Ibn al-Qayyim and Ibn Taymiyyah did not limit currency to gold and silver coinage only. Aĥmad ibn Ḥanbal ruled that there was no harm in adopting as currency anything that is generally accepted by the people. Thus, these
scholars, among themselves, opened the way for Muslims of future centuries to utilise paper money. Leading contemporary scholars like Yusuf al-Qaradawi and Muhammad Taqi Usmani are also of the same opinion (Haneef & Barakat, 2006; Chapra 1996, p.5).

There is a further complication: ceteris paribus, not only would coins always have a greater than zero price, i.e., a positive rate of interest, but their circulation in the economy would also be affected in the long run by price trends of precious metals in world markets. We will have more to say on this below.

The mechanics of an inflow or outflow of gold into a country should also be considered. An inflow, ignoring the reasons for it, would lead to inflation while an outflow would lead to depression (Hasan, 2008, p.14). It is for this reason that in history most European nations were obsessed with ensuring that no gold would flow out of the country. Gold inflow, however, was encouraged as it expanded the economy. This Europe-wide doctrine was called mercantilism and was the cause of many wars between mercantilist nations. This is another very dangerous implication of introducing the gold dinar.

IV. COINAGE AND INFLATION

Ahamed Kameel Mydin Meera, who is the main proponent of the gold dinar, has argued that money creation would not be possible in a fully gold-backed system. With money creation thus prevented, inflation too would be avoided (Meera, 2002). The problem with this argument, like all the other arguments of the denarists, is that although they advocate a return to a system that existed in history, they have not done their homework and studied how the system they are proposing actually functioned in history. Let us now make up for this deficiency and observe if indeed historically, currency systems based upon coinage have been able to keep money supply stable and therefore avoid inflation.

To start with, much confusion has been caused by whether we are considering pure gold or coins containing pure gold (or silver) as a benchmark. If we consider prices of pure gold, we would indeed observe a relative stability over the long run (Jastram, 1977; Braudel & Spooner, 1967, p.460). But this must not be confused with prices expressed in gold or silver coins, which were by no means stable.
My arguments throughout this article are based on prices expressed in coinage, and why such prices were so volatile, will be explained below.

If we study historical data, the first thing we note is that inflation was well and alive in the past. Indeed, throughout Europe, there was massive inflation in the period 1440-1760, with the most rampant inflation being observed in the late sixteenth and early seventeenth centuries. Therefore, the claim made by another dinarist, Umar Vadillo, that “1400 years ago, a chicken cost one dirham. Today, it still costs one dirham” (Hookway, 2010, p.10) invites incredulity. I do not know the details of Vadillo’s calculations, but since all serious work done by economic historians indicates otherwise, I have grave doubts. Indeed, during the period 1440-1600, sheep, candles, wine, beer, beef and wheat prices expressed in gold or silver coins exhibited a massive inflation rate all over Europe (Braudel & Spooner, 1967). To give some examples: in Strasbourg, France, the average price index of rye went from 100 in the fifteenth century to 350 in the seventeenth. Meat went from 100 to 250. In Saxony, Germany, the two percentages were respectively 350 and 250.

Vadillo may, however, argue that the prices I have given above are European prices and therefore are not relevant to the Islamic world. In that case, we can look at prices in the Islamic world as well. Thanks to the more than four hundred million documents protected in the Turkish archives, we are well informed about the Ottoman prices. This data, collected from the waqf and palace kitchen books, indicate that prices expressed in grams of silver reached their peak in Istanbul during the first quarter of the seventeenth century at approximately 80 to 100 percent above their levels in the base year of 1489-90 (Pamuk, 2000, p.124). During this period two types of coins constituted the prevailing currency in the Ottoman economy: the gold sultani and the silver akçe.

Thus, in an economy using gold or silver coins, inflation cannot be prevented. Even pure gold does not protect against inflation. Consider the following statement by a well-known authority on the history of gold.

The evidence drawn from the English experience for 400 years is clear. Gold is no hedge against inflation of a prolonged character. Even worse, it lost operational wealth.

---

4 In the Ottoman silk sector, I have observed price increases in the range of 100 to 300 percent during the same period. See Çizakça (1980), pp. 533-551.
consistently and seriously in each inflationary episode. In the first inflation of modern time, and the only one to have gone its complete course (1897-1920), a person would have lost two-thirds of his operational wealth just by holding gold in bars from beginning to end. And this was in the golden age of the gold standard (Jastram, 1977, p. 125).

In any case, throughout this article I am primarily interested not in prices expressed in pure gold but in coins containing pure gold or silver. The problem with the mono-, as well as the bi-metallic system, where coins containing gold as well as silver circulated, was that money supply was never fixed, as Meera (2002) would like us to believe. On the contrary, money supply was subject to fluctuations both caused by chance discovery of gold or silver deposits somewhere in the world, as well as deliberate debasements. While money supply increased during the late sixteenth century due to the discovery of huge silver deposits in Potosi, South America, it continued to increase further during the next, seventeenth century, primarily due to debasements.

V. DEBASEMENTS

Debasement occurs when a government obliged to increase the money supply mints new coins with lower metal content. Put differently, more coins would be cut from a given amount of precious metal. This is of course, tantamount to increasing the money supply. Thus, money supply in a mono- or a bi-metallic system was by no means fixed. It fluctuated in tandem with the world-wide discovery of precious metal deposits as well as the need of the state for additional money and the consequent debasements. With money supply not fixed and tending to increase, it was natural that inflation would occur. There is solid evidence that, indeed, this was the case (Braudel & Spooner, 1967, pp. 378-486). As explained above, data obtained from throughout Europe as well as the Ottoman Caliphate all tell the same story of rapid inflation. All these countries were using gold or silver coins. Thus we conclude that, having gold- or silver-based coins as the currency of a country does not in any way provide protection against inflation.
Numismatists who have examined the precious metal content of European coins have demonstrated that, in addition to the inflow of American silver from Potosi, debasements played a significant role in inflation. They have informed us that all the main coins of Europe lost their silver or gold content. In the period 1440-1760 the coins of England, Russia, Germany, France, the Netherlands, Austria, Genoa, Venice and Spain were all debased and their precious metal contents were reduced--some drastically, some to a lesser extent. To give some specific examples: during this period even the pound sterling, the most stable currency in the world, lost 43.42 percent of its equivalent weight in silver. The French *livre tournois* lost 82.68 percent, the Genoese *lira* 72.98 percent, and the Dutch *guilder* 68.74 percent (Braudel & Spooner, 1967, p.458).

In case the reader wonders about the Islamic world, it should suffice to note that the Ottoman *asper* (*akçe*) was one of the most frequently and drastically debased coins in Europe. During 1585-86 it lost 44 percent of its silver content. One *akçe* weighed 0.68 grams in 1584 and only 0.23 grams in 1689 (Pamuk, 2000, pp. 122 & 136).

Nor was debasement a special curse of the early modern period. It was observed throughout history. Consider, for instance, the original Roman denarius, which, by the way, gave its name to the Islamic *dînâr*, and was 95 to 98 percent pure silver, weighing 4.5 grams by the decree of Caesar Augustus in 15 B.C. By the reign of Nero, its weight was down to 3.8 grams. By the second half of the third century, some 270 years after its initiation, it was merely 2.0 percent silver (Pense, 1992, p. 213).

The most important universal reason for these debasements was warfare. When a government suddenly faces an external threat, it has to increase the number of men under arms and improve its armed forces--a very expensive affair. More soldiers, more and better arms—all need to be paid in cash. If cash is in the form of gold or silver currency then the solution is to cut new coins from a given amount of precious metal. In the year 1585, for example, during the long war with Iran, the Ottoman government wanted to nearly double the money supply by ordering the mints to strike 800 *akçes* from 100 *dirhams* of silver, whereas the earlier standard had been 450 akçes per 100 *dirhams* (Pamuk, 2000, p.124). Another important reason for debasement was the so-called seigniorage. This was the revenue received by the ruler during the debasement process.
VI. GRESHAM’S LAW

Governments desperate to increase the available money supply to cover their emergency expenses or pay their debts, however, faced a further difficulty with the coinage. This is the so-called Gresham’s Law, which should be explained properly.

We start with the following equation,

\[ FV = x + \frac{G}{TW} \cdot Pg \]

where,
FV is the face value of the coin.
x is the cost of producing the coin.
\( \frac{G}{TW} \) is the ratio of pure gold to the total weight of a coin.
Pg is the global price of gold.

The left side of the equation shows the face value and the right side the intrinsic value of the coin. This is a precarious equality. As long as the face value of the coin is greater than or at least equal to the intrinsic value, there is no problem and the coin circulates in the economy without any problem. If, however, Pg increases in response to a worldwide increase in gold prices, then the dynamics of Gresham’s Law would be set in motion. This is best illustrated with the following numerical example. Assume that we are considering a gold coin with a face value of RM 1,000. Assume further that the cost of producing this coin is RM 50. This coin, moreover, is 90 percent pure gold. The global gold price is RM 1,000 per ounce. This would give us the following:

\[ RM \ 1,000 = 50 + 0.9 \times (1,000) \]
\[ RM \ 1,000 > 950 \]

Thus, the face value of the coin is greater than its intrinsic value. Coin circulates without any problem.
Now assume that the global gold price has increased to RM 1,200 per ounce. The equation now becomes:

RM 1,000 < 50 + 0.9 (1,200) or,
RM 1,000 < 1,130

Thus, the intrinsic value of the coin has now surpassed its face value. Now, it pays every speculator to melt the coin he possesses and extract the pure gold it contains, which he can sell in the market and obtain RM 1,080 (intrinsic value minus the cost of production). With the RM 1,080 he obtains, he buys another gold coin and makes RM 80 profit, *ad infinitum*.

There would be two consequences of all this. First, the demand for coins would increase, due to speculative purposes, shifting the aggregate demand curve for money to the right (Dm—Dm'). Second, the coins obtained by the speculators would simply disappear from circulation – they would be melted away! This shifts the aggregate supply curve for money leftward (Sm—Sm'). Combining the first and the second shifts gives us the new equilibrium rate of interest, \( r_1 \). Thus, the rate of interest would increase in an Islamic country because of global gold prices – not a very desirable situation. Equally important, a substantial increase in the rate of interest, through its negative impact on investment and unemployment, can be deflationary and curb our economic growth. These dynamics are depicted in the following graph:

*Diagram 1: Gresham’s Law Dynamics*

The government, wishing to avoid deflation, would have to respond to all this by increasing the money supply. In coinage systems, this
is done by debasement, i.e., by reducing the gold content of the coin, or the G/TW ratio. The government does this by striking more coins from a given amount of pure gold. In short, the government issues new coins with lower gold content. But this too would put in motion the dynamics of Gresham’s Law.

Indeed, when the public realize that new coins with lower intrinsic value are being issued, they immediately would take out their old and better coins from circulation and hoard them. Since the new coins issued would inevitably cause inflation and bring down the fiat value, the old coins would be either hoarded or melted. Consequently, “bad money” always drove “the good” out. This is the famous observation made by Thomas Gresham back in the sixteenth century. Known unfairly as Gresham’s Law, it is expressed as “bad money drives out the good”, and means that issuing new and lower quality coinage is actually a self-defeating process. Indeed, new coins issued in order to increase the money supply to combat deflation or to cover the emergency expenses of the state end up leading to the disappearance of the old coins altogether.

From the Islamic perspective, Gresham’s Law has the additional harm that it encourages hoarding—a situation strongly forbidden by the Qur’an (9:34). Furthermore, unless the amount of new coins issued is much higher than the old coins that disappear, the disappearance of the old coins means another leftward shift in the aggregate money supply, which would increase the rate of interest further—once again an undesirable situation for Muslims.

Another reason which would lead to an increase in the rate of interest with coinage is the cost of production of the coinage. Each coin costs a substantial amount to produce, which includes the actual cost of transforming the metal into coins. Moreover, seigniorage that the state always takes should also be added to this cost. In short, the price of coin (rate of interest) is formed by three elements: the global price of bullion, the actual cost of production of the coin and finally the seigniorage. By contrast, the cost of production of paper money, in comparison to coinage, is negligible. Once again, the denarists are invited to think about the consequences of their proposals. Do they really want a monetary system that encourages Muslims to hoard and, even worse, through the workings of Gresham’s Law, ends up raising the interest rate?

---

5 The phenomenon was known as long ago as the fifth century B.C.
VII. COINAGE AND GHARAR

Another huge disadvantage of the gold dīnār is that among all the Muslim countries only Indonesia is an important producer of gold – 6.6 percent of the global production. Other Islamic countries are insignificant producers. This would put the Islamic world at the mercy of the significant producers (South Africa 11.8 percent, the U.S.A 10.4 percent, China 8.9 percent and Russia 7.2 percent) (Hasan, 2008, p.18). The Islamic Gold Dinar would give these countries substantial leverage to play havoc with the monetary system of Islamic countries. If they so wished, the largest producers could collude and play with gold prices and therefore, indirectly, the rate of interest in the Muslim world using gold coins.6 If such speculation is possible, it would create huge uncertainty (gharar).

Gharar is a complicated concept. But Ibn Taymiyyah has shown that in a transaction involving two or more partners, mutually agreed shared risks are permitted and constitute no gharar (Al-Suweilem, 2007, p.601); risks unshared and imposed solely on one of the partners are not permitted and constitute gharar. This can be considered as a corollary of the prohibition of ribā (Çizakça, 2010).

The reason why the Islamic Gold Dinar may be subject to gharar is that any speculation by the major producers of gold would not harm them but would harm the Islamic world. Risks would not be shared fairly by all transacting partners but only by the Islamic world. This is gharar of the worst sort–because we are not talking about an ordinary risk but a massive risk that would put the entire monetary system of the Islamic world in danger.

---

6 It can be argued that in countries where gold mines are owned by private enterprise such collusions would be difficult to apply. But this argument is irrelevant for China and Russia where these mines are primarily state owned. Moreover, even privately owned gold companies in these countries would ignore powerful government decrees at their own risk. Between the two of them, these countries control some 16 percent of the global gold supply and can thus affect prices significantly at will.
VIII. SUMMARY AND CONCLUSION

We are now in a position to summarise the arguments presented above.

1. Combining the interest prohibition in the Qur’an with the rulings of Aḥmad ibn Ḥanbal, Muhammad ibn al-Ḥasan al-Shaybānī and Ibn Taymiyyah, some of the greatest classical jurists, we deduce the following position of Islam regarding money: Anything that is generally accepted by the public can fulfil the role of money. Thus money is, primarily, a medium of exchange and not a commodity. The price of this money (interest) must be zero.

2. Economic histories of early modern Europe as well as the Ottoman Caliphate have vindicated the fact that money, indeed, is not a commodity but a medium of exchange. Economic historians have observed throughout history that the precious metal content of coins in the long run has always been reduced. Thus there is a natural tendency for money to lose its commodity character and metal content and to progress towards being a pure medium of exchange. With the advent of paper money, the intrinsic value of money approached zero. With e-money, which we use to transfer billions with the click of a mouse, it has become absolutely zero. Thus, the Islamic view that money is not a commodity but purely a medium of exchange is vindicated.

3. Japan as well as several other Western economies, though inadvertently, showed that with paper money it is possible to reach a state of zero-percent interest rate–hence a zero price for money, the Islamic position, is possible.

4. With coinage it would be impossible to reach this stage. This is because every coin has two different values. While the fiat value can be controlled by the Central Bank, the intrinsic value is beyond such control. Indeed, for the intrinsic value to be zero, the global supply of gold should increase at such a rate as to completely balance the demand for it–not a very likely scenario. Consequently, a return to coinage would force a country into a position where zero rate of interest cannot be achieved. This is an un-Islamic position and represents not progress but regress.

5. Throughout history governments have increased the supply of coinage through debasement. This supply was also subject to increase when new gold or silver deposits were discovered. In short, the supply of coinage was never fixed, as the denarists claim.
6. It follows then that with money supply constantly changing, coinage cannot avoid inflation—another dinarist claim that must be discarded. For those who are worried about inflation in the Islamic world, the solution does not lie in the type of currency in circulation but in granting central banks autonomy from the pressures of unscrupulous and short sighted governments.

7. Introducing the Islamic Gold Dinar, despite its pretentious name, is not only un-Islamic due to its worsening impact on the rate of interest, it is also of no practical value since it cannot control inflation.

8. Introducing the Islamic Gold Dinar would create global uncertainty, and therefore gharar, on a massive scale. Islamic law prohibits gharar.

9. Finally, an Islamic paper currency accepted world-wide, though a noble idea in itself, should not be imposed from above by some well meaning academicians and governments but should be demanded by Muslims. This can only come about by massively increased trade among the Muslim countries. Let us remember in this context that even the European Union was originally established as a coal and steel union, then progressed to the European Common Market and then, finally, to the European Union. The common European currency, the euro, was introduced much later. The priority for Muslim countries, therefore, should not be to introduce a common currency but rather, first, to increase trade among themselves and to learn to conduct this trade, as much as possible, with their own existing currencies.

References


