THE GOLD DINAR WIPE OUT; THE IMPACTS TO THE FLEXIBLE MODEL[1]

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Abstract

Malaysia is promoting the usage of Gold Dinar as a payment settlement in international trade as a platform of unity between OIC countries. This paper is an extension to an article written by Nuradli Ridzwan Shah Mohd Dali & Abdul Ghafar Ismail (2004) entitled "The Flexible Model, Gold Dinar and Exchange Rate Determination. An Exploratory Study" presented at the COBM Academic Discourse organized by College of Business Management, Universiti Tenaga Nasional. However in this paper, we would investigate the *consequences* of using the Gold Dinar as a medium of exchange **entirely** and its impact to the flexible model as an exchange rate determination. Our simulation shows that the implementation of Gold Dinar would increase domestic income if a domestic monetary expansion occurs.

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A. Introduction

Malaysia is promoting the usage of Gold Dinar as a payment settlement in international trade as a platform of unity between OIC countries. In respond, this paper would investigate the *consequences* of using the Gold Dinar as a medium of exchange entirely using the flexible model assumptions and investigate its impact to the flexible model as an exchange rate determination.

Gold Dinar

Questions arise, whether it is practical for pieces of paper of US currency that cost on average 4 cents have different values as printed on the paper. If we compare the paper money to gold, gold has intrinsic value. The paper money has value because we believe that it has value but will be only papers if there is no trust from the public.

The needs to revisit the gold dinar as a monetary stability has been voiced out by many scholars and ulama's since 1970s. The resistance towards the interest economy could be the major motivation for the comeback of gold dinar. The prohibition of interest is not only mentioned in the Quran but the Bible and Torah. However, the Jewish has manipulated the books and prohibited interest being charged to jews but could be charged to gentiles.

In order to avoid riba and to provide alternative for the Muslim, the Islamic financial system and banking was developed starting in the 70s and started to operate in the 80s.Even though the Islamic banking is said to be maintaining the same framework as the counterpart except concepts of financing and depositing are improvised according to shariah, the Islamic banking is growing tremendously.

Zuhaimy Ismali, commented that the concept of islamization without taking consideration the overall impacts to values, will fail to be different from the conventional from the macro perspectives. For example, the rate of interest charge by the conventional banks and the rate of profit charged by the Islamic banking in debt financing instruments are the same or higher than the conventional rate. This is due that the calculation of the selling price of the properties being sold by the banks to the customers is based on the time value of money. A Ringgit today will have higher value than a Ringgit tomorrow. Therefore the implementation of Islamic banking is more the less as the current problem solver and not as the changes of attitudes towards Islamic values.

The fiat money would not guarantee the Islamic nation from being oppressed by the developed countries. Fiat money which does not have intrinsic value burdens the ummah especially during the crisis. Even though the supply is abundance, but with the effect of depreciation and inflation, the real purchasing power is actually small.

Malaysia initiatives to revive the comeback of gold Dinar do has some historical perspectives because gold Dinar has been used for international trade during the Malacca empire in the 16th century[3] (Berita Harian, 2004). Even though the Gold Dinar could provide a just and stable monetary system, the implementation is not as easy being said. The developing and less developing countries could not easily transformed their system to the gold standard because the developed countries would definitely opposed to the system which will make their paper money worthless.

In order to avoid disruption in the economic order, the implementation of gold Dinar must be done part by part to ensure success especially in overcoming obstacles which are listed below.

i) The amount of gold holding among Islamic countries is small. About 907 tone metrics from 32,291 tone metric worlds gold is hold by Islamic countries. For instance, the Malaysian only have 30.6 tone metric (approximately 1.2% from international reserve).

ii) The awareness level regarding the usage of gold dinar for trading transactions is still at the minimum level. This is because we are used with the existing fiat money and its system especially when dealing with the time value of money imposed by the fiat money i.e interest. The creation of awareness must be done from the root levels to ensure the survivor of Dinar Even Tun Mahathir Mohamad (former of Malaysian Prime Minister), encourage academicians and researchers to do research and seminars on Gold Dinar.

Fiat money does not only burden to undeveloped country in debts repayment but also troubled their economics and social welfare. For an example, the Ringgit Malaysia values have been dropped more than 20%. Simultaneously, it also decreases society purchasing power more than 50%. We are forced to pay or exchange more money to get the same quantity of goods as before the crisis because of currency depreciation.

Implementation of Gold Dinar.

Currently, the American Dollar and Euro are some of the major international currencies used for trade settlement. Many countries demand for these currencies in order to facilitate their international trade; therefore these currencies will be kept in their international reserves. However if these currencies decrease in value, wealth of a nation will be at stake. Therefore alternative stable and just monetary system should be adapted i.e. Gold Dinar.

However, super power country such as America would not be easy with the comeback of gold Dinar because this will a threat to the usage of US dollar as world currency. After US dollar taking the thrown of world currency from the British pound, any attempts to the comeback to the gold standard or Bretton Wood System will be drained.

But the gold Dinar is not the same as the gold standard or Bretton wood system because it is not only a medium of exchange but also the symbol of unity of the OIC countries.

[3] This is written in Malacca Rules (Chapter 33)

With more than 1.5 billion Muslim population in the world, Dinar is not a dream but a reality as compare to EURO money today with 300 million European people only.

Money

There are three basic roles of money, which are widely accepted. The roles of money are as a medium of exchange, as a store of value and as a unit of accounts. Money acts as a medium of exchange because it is accepted for exchange of goods and can be used to buy other goods. It must also act as a store of value for it could be used to trade current goods for future goods and it could also be measured as a unit of account. Money that could fulfill all the three roles is categorized as good money. The problem with the existing money in our monetary system is its failure as a store of value and as unit of account (Hifzur 2002).

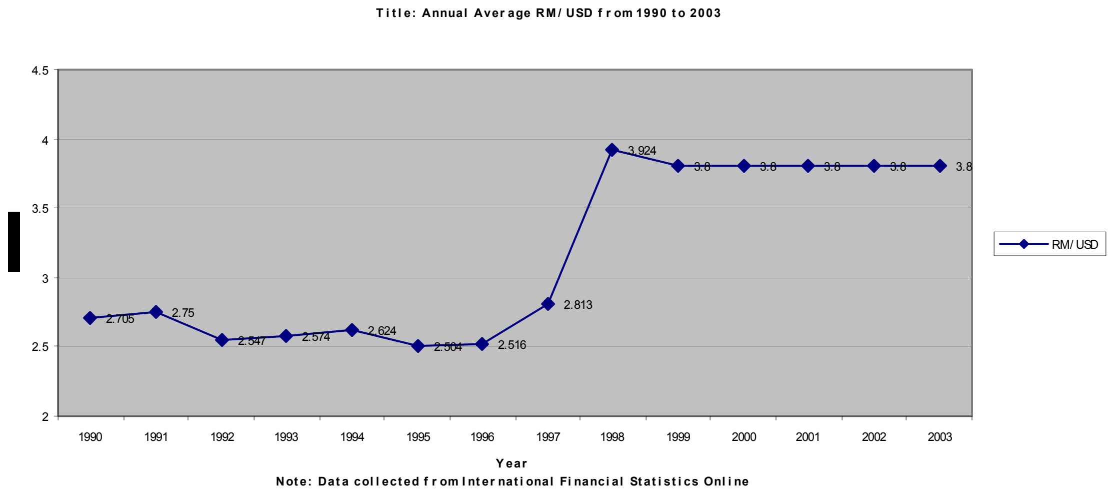
This in fact is true if we look at how purchasing power, decreases in currency value due to inflation and currency depreciation resulting from money creation. In addressing the problem of storage of value it is important for us to see the types of money that is in existence. The followings are some of commonly used types of money:

1. Commodity money is money that has value of own. Examples of the commodity money are gold, silver, barley, wheat, salt and dates.
2. Private bank notes (pbn) are notes that Banks issued with promise to redeem for gold. This *pbn* was widely used in the 1800s in the US. The major problem with *pbn* was bank insolvency due the to issuance of notes more than their underlying gold reserve[4].
3. The Gold Standard (*gs*) is a government issue of paper currency backed by gold. Each note could be redeemed for a specified quantity of gold. The Gold Standard reduces the cost of carrying physical gold[5].
4. Fiat money is the government issue of paper currency backed only by the reputation and trust of the value. This system depends heavily on the trust of the people to believe that it has value and accepted by others. We have been using the fiat money since the abandonment of the Gold Standard in the Bretton Wood System.
5. Other forms are silver coins, community money, hours, and flying kilometers (Hirzur, 2002)[6].

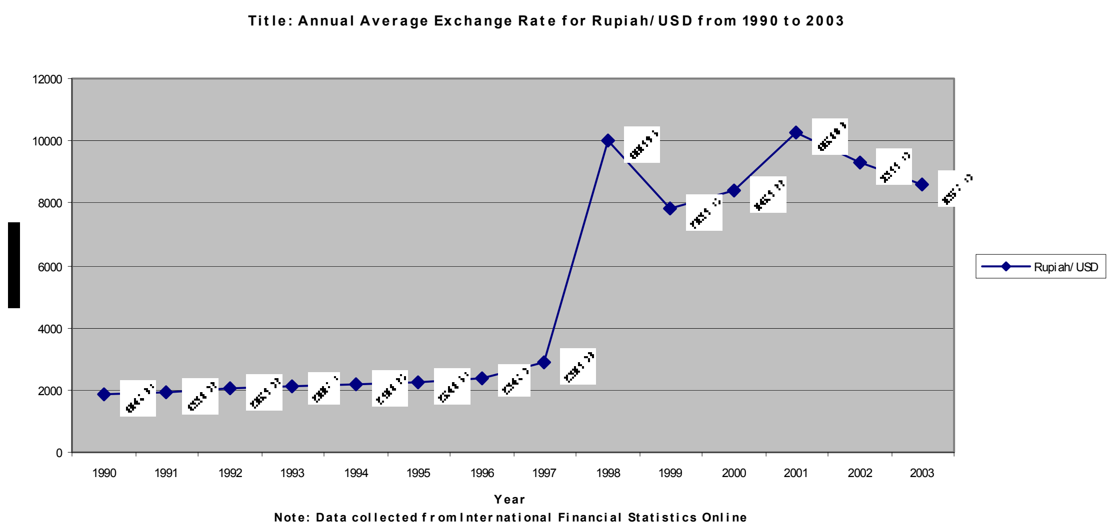
The fiat money could not fulfill its role as a store of money and as unit of account. The Asian financial crisis of 1997 is an example of this disadvantage. This disadvantage comes into play when speculators could manipulate the fiat money and the monetary system through serial speculative attacks on a regional group of countries, provoking massive capital outflows, simultaneous crisis and recession for a whole region (Konac, 2000). Since these regional currencies were being used as unit of account massive fall in the quantity of wealth represented by them badly corrupted the accounting process, introduced massive uncertainty in expected rate of return that forms basis of investment that pulverized the economy (Hifzur, 2002)

[4] Private Bank Notes which will be denoted as *pbn*
[5] Gold Standard which will be denoted as *gs*
[6] Fiat money, which will be denoted as *M*

For example, the annual average exchange rate for Malaysian Ringgit has depreciated from 2.514 in 1996 to 3.924 in 1998 against the USD before being pegged at 3.80 per USD in September 1998. Table 1, shows that the RM/USD was stable from 1990 until 1997 prior to Asian currency crisis.



Another example was the case of Malaysia's neighboring country, Indonesia (see Table 2). The Rupiah depreciated drastically against the USD at about *244.18 percent* in 1998 from Indonesian Rupiah 2909.38 per USD to Indonesian Rupiah 10,013.60 per USD.



Note: Longer Historical exchange rate series are shown in appendix 1.

Supply of fiat money can be increased freely without limit. Increase in money supply beyond the increase in economy's output leads to corresponding reduction in the quantity of wealth represented by money. Since money is used as unit of account, changes in the quantity of goods represented by currency corrupts accounting process and all economic transactions that are spread over time. It is therefore a clear case of fraud exactly similar to the fraud that results due to manipulation of weights and measures. Clearly it is not permissible under the divine law (Shariah). While it does provide some relief to the interest based capitalist system it acts as a poison for the Islamic system. It is a massive fraud that stands to demolish all that stands for equity and justice (Hifzur 2002).

As a consequence of Asian financial crisis, researchers and economists are evaluating a return to the gold standard, which could protect countries from speculative attacks (Mohd Dali et al, 2002). One of the systems suggested is the Gold Dinar currency, which has been widely used by our historic ancestors. One of the questions that arose was if the gold Dinar currency would be similar to the classical gold standard of the 19th century.

The Classical Gold Standard

Griffin et al states that the first country to adopt the Gold Standard is England in the year 1821 and ended in 1931. (Griffin et al, 1995, p.119). Bordo states that it was established in 1880 and it ceased to exist in 1914 (Bordo, 1999). Eiteman et al states that the Gold Standard gained acceptance in the Europe[7] in the 1870s and ended in 1913 (Eiteman et al, 1995). The period from 1914 until 1944 was the Interwar Years and World War II was different from the Gold Standard because currencies were allowed to fluctuate over fairly wide ranges in terms of gold and each other (Eiteman et al, 1995). However, Temim (1989) contrarily views this as only superficially correct. The gold standard was suspended by the major European powers during the war, but the idea of the gold standard was not so easily vanquished. The regime was unchanged. No policymaker in 1914 saw the events of that August as the end of an era. Everyone saw it instead as a temporary interruption in a stable, ongoing international framework (Temim, 1989, p. 10).

The Gold Standard has been the focus of great interest by many policy makers and scholars ever since. There are four desirable features of the classical gold standard that explained its perennial appeal as presented by Bordo (1999). They are listed as follows:

a) Low inflation, stable exchange rates, relatively rapid economic growth and less real instability than in the interwar period (Bordo 1981, 1993). It also was an era of rapidly expanding international trade in commodities, services and factors production (Bordo, 1999). This favorable economic performance was because the system placed an effective limit on monetary expansion, since currency was based on gold, a durable commodity as compared to a monetary standard that is based on government fiat where currency can be printed without limit.
b) The second admired feature of the gold standard was its operation as an automatic system with limited government involvement. The world currency price depends on the supply and demand of gold[8]. Gold supply of the gold depends on gold production and the non-monetary demand such as jewelry.

[7] Including Russia, Austria-Hungary, France, Germany, and the United States (Griffin et al, 1995)

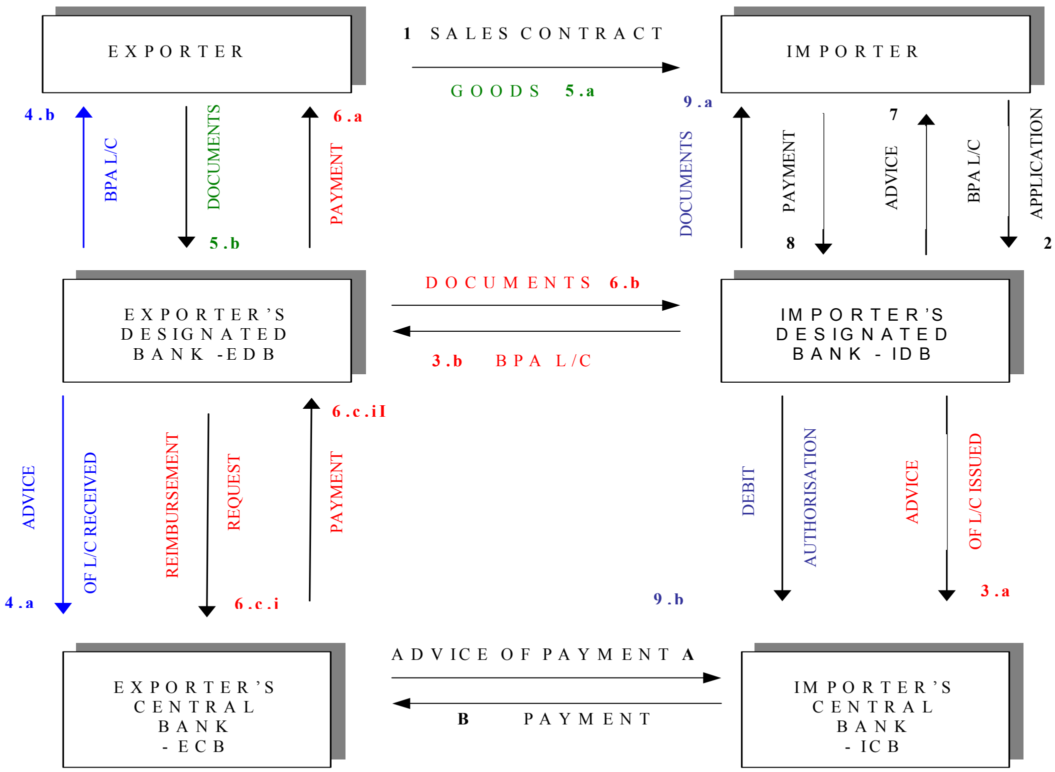
[8] Demand for gold could be divided into monetary and non monetary

c) A third feature of the classical gold standard era was that it was fostered and maintained by cooperation between monetary authorities of different nations.
d) A fourth admired feature was that it represented a *credible* commitment. This was due to the fact that many nations that adhered to the gold standard forgo opportunities to use expansion and fiscal policies that may jeopardize currency convertibility.

In contrast Temim has different views for item c and d as compared to Bordo.
The contrary are as follows: c) the absence of an international coordinating organization. Together these arrangements implied (d) there was an asymmetry between countries experiencing balance-of-payments deficits and surpluses. There was a penalty for running out of gold or foreign reserves (the inability to maintain the fixed value of the currency), but no penalty-aside from foregone interest and, possibly, inflation-for accumulating gold. In addition (5) the adjustment mechanism for a deficit country was deflation rather than devaluation…" (Temim, 1989, p. 8-9).

In response to that Malaysia has taken initiatives to ensure that the Gold Dinar is coordinated among the Central Banks of the participating countries to avoid problems during the Gold standard as laid out by Temim. This is done through the Bilateral Payment Arrangement and later on extended to Multi Lateral Payment Arrangement (Mohd Dali at el, 2003). The mechanism is illustrated as follows:

Flow Chart of BPALC Transactions[1]



[1] Source Bank Negara Malaysia, 2003.

Gold is the most reliable and most stable measure of wealth and therefore best unit of account as well as best store of value. This is due to its natural physical and chemical properties and because human nature is such that cherishes gold. Therefore gold-based currency if universally applied constitutes a perfect standard of wealth. Therefore, it supports efficiency and justice and inhibits/exposes fraud, corruption, manipulation, Riba[9] and speculation. Accordingly it assists welfare and sustained economic growth, free from deception, exploitation and oppression (Hifzur,2002).

In contrast to the classical gold standard, the gold Dinar would not replace the domestic currency and the currency would not be pegged to gold on a one to one basis. The system would operate using a combination of the gold Dinar and the fiat money. Specifically, the gold Dinar is intended for international trade whereas fiat money would be used for

[9] Riba is interest

the domestic currency. It roles would be as a medium of savings, payment of zakat and payment of dowry (Evans, 2003)

Thus, the circulation of fiat money, would not be the same as the gold reserve owned by the Central Bank. Eventually, the monetary system would transition to a full gold Dinar system, which means that the domestic currency will be 100 percent backed by gold, exactly like the classical gold standard.

Some people wrongly think that the Gold Dinar originated from the Islamic Caliphs. However, history shows that the gold Dinar had been used before Caliphs time. The word Dinar did not originate from Arabic but it has its origins in Greek and Latin or possibly the Persian word ***denarius***[10]. Meanwhile the word Dirham is derived from the name of silver currency ***drahms***, which was used by the Sasan people of Persia. ***Drahms*** was taken from the name of the silver currency ***drachma*** used by the historic Greek people (Anwar, 2002).

Originally the Muslims used gold and silver made by the Persians. Silver dirhams of the Sassanian, Yezdigird III was the first dated coins that can be attributed to the Muslims. A. Zahoor and. Haq (1998) mentioned that the Dinar and Dirham were used officially as the Islamic currency beginning with the second Caliphate. The first Muslim coins were used during the Khalifah of Uthman, (RA)[11] and there were not much different from the Persian coins except that Arabic inscription is found on the obverse margins of the coins (Zahoor & Haq, 1998), (E-Dinar Ltd[12]). Inscriptions in Arabic of the Name of Allah and parts of Qur'an on the coins became a custom in all mintings made by Muslims (E-Dinar Ltd).

The first *khalifah*[13] who ordered the dinars to be minted was Khalifah Abdul Malik Bin Marwan in the year 75 (695 CE). He ordered Al-Hajjaj to mint the dirhams, and officially established the *standard of Umar*[14] *Ibn al-Khattab (RA)*. In the year 76 he ordered the dinars to be minted in all the regions of the Dar al-Islam[15]. He ordered that the coins be stamped with the sentence: "Allah is Unique, Allah is Eternal". He ordered the removal of human figures and animals from the coins and that they be replaced with letters (E-Dinar Ltd).

Since then, the Dinar and the Dirham coins were stamped on one side with concentric circles with inscriptions in Arabic "la ilaha ill'Allah" and "alhamdulillah"; and on the other side was written the name of the Amir and the year. Later on it became common to

[10] Aramaic Language
[11] Radiy'allahu anhu (Blessings upon him)
[12] E-Dinar Ltd is an electronic gold payment system company based in Labuan, Malaysia.
[13] Khalifah is an Arabic word which stands for the leader of Muslims.
[14] Under what was known as the coin standard of the Khalif Umar Ibn al-Khattab, the weight of 10 dirhams was equivalent to 7 dinars (mithqals).
[15] The Islamic world

introduce the blessings on the Prophet, “salla'llahu alayhi wa sallam” and sometimes, ayats of the Qur'an (E-Dinar Ltd). Bahrain Monetary Agency stated that

"*the gold Dinars and the silver dirhams issued by the Caliph acted as missionaries of the Islamic faith wherever they circulated. In addition, the coinage inscription record the rise and fall of families and states, their victory and defeats, changing allegiances and shift in boundaries, as well as highlighting developments in Arabic calligraphy*" (Bahrain Monetary Agency).

Gold and silver coins remained official currency until the fall of the Caliphate. Since then, dozens of different paper currencies were made in each of the new postcolonial national states created from the dismemberment of Dar al-Islam (E-Dinar Ltd). Zahoor and Haq (1998) mentioned that paper money was introduced in the colonial era and continued into post-colonial era . As Malaysia is trying to implement the Dinar system to strengthen its financial sectors, it is vitally important to assess the impact of the implementation to one currency (Mohd Dali et al., 2002).

With the introduction of Gold Dinar this paper will aim of this paper is to study the impact of the Gold Dinar on the monetary model - flexi model. This paper will deal only on the theoretical framework since there is no country in the world using gold as currency and therefore there is no data available for analysis. This exploratory research will use the existing monetary model of exchange rate determination developed by Dornbusch (1976), Bilson (1978), Frankel (1978) and Hodrick (1978); to show its impact on the overall home country’s currency.

B. Assumptions Of The Model

1. Government, Consumers and firms will be using Gold Dinar as a medium of currency
2. Two countries, home and foreign.
3. All prices are flexible however in a full swing Gold Dinar environment prices in terms of gold Dinar tend to be very stable and general change in prices will tend to be minor and rare.
4. Absolute Purchasing Power Parity (PPP) holds continuously. The domestic and foreign price of the same commodities will always be equal[16].
5. Gold Dinar will become a portion of M1*.

[16] Due to transportation charges, limited transferability of factors of production due to cost of transferring these factors or otherwise, this assumption will hold only partially (Hifzur Rab, 2004).

6. Gold Dinar would be excluded in the money multiplier*. This is based from that gold only could be produced from real production and not from compounding interest as the fiat money system. Furthermore, the proposal of Gold Dinar will only be used for the purposes of savings, payment of Zakat and payment of dowry. If the Gold Dinar is lend out to the public even without interest, then it will have to be included in the money multiplier because the money supply will increase as the process of *Gold-Banking* occurs[17]. Hifzur commented "Gold Dinar will review Quardhe Hasan and practice of credit sale at market price that will reduce transaction demand of money. This in addition to near nil demand of money for speculative purposes will have a short of multiplier effect on the economy" (Hifzur, 2004).
7. A full swing Dinar economy would eliminate interest from the economy*[18]. This is based from the Shariah law, which prohibit from earning or giving interest. Hirzur also commented that Gold Dinar as such will not eliminate interest, however for the economy based on Dinar to perform efficiently, interest will have to be banned and Zakah will have to be enforced. The government will have to strictly ban Riba from all Dinar based transactions.

In the model, the gold Dinar will be a fraction in M1, which will be denoted as *gs*. Thus in a country with no gold Dinar, (1 - gs) = 1, and in a country with a full swing gold Dinar, gs = 1.

In this model it is better to assume that the foreign country is in long run equilibrium i.e its price level and income, and interest rate is not changing over time (for simplicity, set pt* =yt* = 0, it* = i*) which means that the price of foreign goods would be the same as the income in foreign and interest at time t will be the same as interest at time 0.

It should be also noted that in a full Dinar economy, no interest will be available anywhere in the system but since, the domestic fiat money is not fully displaced the interest rate would also be considered in the fractioned Dinar economic model.

In this paper, section D (The Monetary Model with a full swing Dinar economy) is a conceptual framework only because data for the **gs** is not available since it has not been implemented.

C. The Monetary Model - Flexible Price

The monetary models of exchange rate determination start with the assumption of perfect capital mobility. Purchasing Power Parity (PPP) and interest rate parity conditions are used in the models to define equilibrium conditions. Bonds (foreign and domestic) are assumed to be perfect substitutes.

PPP holds if s' = sP*/P = 1 where:

s : nominal exchange rate

[17] The author would like to use the name Gold Banking to explain the process of banking using gold instead of paper money.

[18] * Additional Assumptions added to the existing Flexi Model Assumptions

s'	:	real exchange rate
P*	:	foreign price level
P	:	domestic price level

So, $sP^*/P = 1$ which mean $s = P/P^*$
Or, in log form $s = p - p^*$ where:

s	:	natural log of nominal exchange rate
p*	:	natural log of foreign price level
p	:	natural log of domestic price level

$$s = p - p^* \tag{1}$$

The model assumes a stable money demand function in domestic and foreign countries. The money market equilibrium conditions for domestic and foreign countries are assumed to depend on the logarithm of real income, *y* and the logarithm of price level, *p* and the logarithm of interest rate, *i*. An identical relationship can also be assumed for the foreign country, where asterisks denote foreign variables. Monetary equilibria in the domestic and foreign country are then given by equation (2) and (3):

$$m = p + \alpha 2y - \alpha 3i \tag{2}$$

$$m^* = p^* + \alpha 2y^* - \alpha 3i^* \tag{3}$$

where m and m* are the domestic and foreign money supply, respectively. α2 is the income elasticity of demand for money and α3 is the interest rate semi-elasticity. Rearranging equation (2) and (3) for domestic and foreign price levels and substituting into equation (1) yields the following flexible price monetary model of exchange rate equation of Bilson (1978), Frankel (1978) and Hodrick (1978):

$s = m - \alpha 2y + \alpha 3i - (m^* - \alpha 2y^* + \alpha 3i^*)$

$s = (m - m^*) - \alpha 2(y - y^*) + \alpha 3(i - i^*)$

D. The Monetary Model With a Full Swing Dinar Economy.

The purchasing power parity will hold and if the two countries are using full swing Dinar economy then the PPP will have the form of p = sp* where s will be equal to 1. This assumption is based from the nature of measuring gold currency. If we are in a full swing gold Dinar economics, the measurement of the gold is based on weight, and quality of the gold. When this is true then the exchange rate of Malaysian Dinar and Indonesian Dinar would be one to one i.e. *s* equal 1.

Therefore the price of goods in home country will be the same as the price of goods in foreign country, which could be summarized as follows:

$$p = p^* \tag{1}$$

Where;
p = price of goods in home country
p* = price of goods in foreign country
From the definition of UIP, the equation will be:

$$Se - S = i - i^* \tag{2}$$

Where;
Se= Expected exchange Rate
S = Spot Exchange Rate
i = Interest rate in home country
i^*=Interest rate in Foreign Country
If the two countries are using full swing gold Dinar economy then UIP can be written as; $(Se- S)/S = 0$ since interest is not paid in the gold economy. This implies that the spot exchange rate would not be changed since there is no interest rate differential between the home and foreign country.

It is also useful to relate the money market equilibrium in the home country with the CPI. So let the CPI in the home country be Q. Therefore;

$Q=P(SP^*/P)^b$
In a full swing Dinar economy, $Q= P(1P^*/P)^b$ or $Q=P$
Therefore the money market equilibrium in the home country would have this form:
$M/P = Yt ^{\alpha} (1 + i)^{-\beta}$ where M/P is the real money balances, Y is the real domestic output and α is the income elasticity of money demand, and β is the semi-elasticity of money demand w.r.t to the domestic interest rate.
In money market equilibrium $Md = Ms = Mt$

However in a full swing Gold Dinar economy $(1 + I)^{-\beta} = 1$, therefore $M/P = Yt ^{\alpha}$
This is due to the nature of the gold economy, which does not recognize interest as in the conventional economy. In other words there is no money for speculation because when $i = 0$, $Ls = a(i^{-\eta}) = 0$
a= Arbitrary constant
i = interest rate
$-\eta$ = interest elasticity of the speculative demand for money.
Therefore in a full swing Dinar economy the money demand will be money for transaction only, Ls. Dinar being non-depreciating currency unless Zakah is enforced cost of holding it will be nil and that will reduce velocity of circulation. Thus unless Zakah is enforced transactions demand for money will be quite high.

In order to neutralize the power, we change the equation to log form and we get;
$m - p = \alpha y$
Or $p = m - \alpha y$ (3)
Substitute (1) in (3) we will get
$p^* = m - \alpha y$ (4)
Now consider the price levels in a foreign country has the same variables as the domestic.
$sP^*/P = 1$ PPP
Or, $sP^* = P$ $s = p - p^*$ (log form) (1)

$(Se - S)/S = i - i^*$ UIP (2)
$p = m - \alpha y$ domestic price level (3)
$p^* = m^* - \alpha y^*$ foreign price level (4)
Substitute (3) and (4) to (1):

$s = m - \alpha y - (m^* - \alpha y^*)$

Or, $s = m - m^* - \alpha(y - y^*)$ (5)

So the exchange rate s is determined by money supply and real income both in domestic and foreign countries.

E. Domestic Monetary Expansion.

Considering high stability of Dinar, there will be minor changes in price level. There will be increase in investment as well as consumption and therefore there will be increase in export as well as imports.

Over all growth will depend upon what part of this increased wealth is consumed for satisfying Tahsinaat (improvements) and what is consumed for satisfying necessities and needs and for investment.

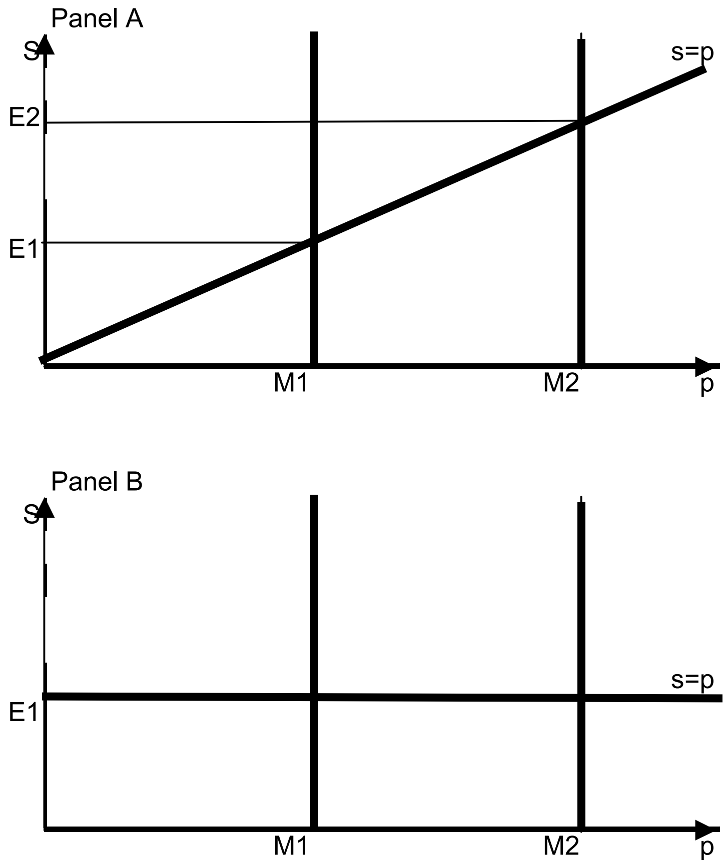
If there is a monetary expansion of the domestic money supply m, i.e. Since the government could not print gold as fiat money the monetary expansion would probably come from the discovery of gold mines, m will increase and in order for PPP to hold $p=sp^*$, and since s will always equal one, y the domestic output will increase if all other variables are held constant.

A simple simulation could illustrate the increase in y when m increases.

m	50	100	150	200
m *	50	50	50	50
alpha	0.5	0.5	0.5	0.5
y *	10	10	10	10
y	8	108	208	308

An increase of ***m*** from 50 to 100 will increase ***y*** from 8 to 108 assuming that everything else is constant.

The difference between the conventional and the full swing Dinar economy in exchange rate determination and the money supply could be shown by the following diagram:



Panel a shows that the increase in money supply from M1 to M2 will increase the equilibrium point which will depreciate the home currency against the foreign currency, whereas panel b shows that the increase in M will not increase the equilibrium point which make the home currency and foreign currency are constant the full swing Dinar economy.

F. Impacts Of The Implementation of Gold Dinar

The impacts of the implementation of gold Dinar could be seen through several dimensions such as consumerism, political, religion, social order, technology and globalization. In this paper we will highlight two dimensions of the impacts to consumerism and economic social order as written by (Mohd Dali, Mat Husin 2004) and another impact of Gold Dinar to political and globalization.

a) CONSUMERISM:

The impacts on the implementation of gold Dinar will affect how the consumers behave and protect their interest in the economic system (Mohd Dali, Mat Husin 2004). It is related to definition of consumerism :

" Consumerism is a movement advocating greater protection of the interests of consumers or the theory that an increasing consumption of goods is economically beneficial"

i) Real Economy

Gold Dinar will affect the way daily business is transacted. Purchasing of goods and services will be backed by real value or intrinsic value. The value of the goods and services would also be more stable because gold Dinar would reduce the inflationary problems associated with fiat money (Mohd Dali, Mat Husin 2004)

ii) Wealth Management

Dinar debit card could be introduced to reduce the consumers dependencies on credit card thus encouraging savings in the real value of wealth. Gold Dinar it could curb the unsustainable forward spending that is encountered by the developed countries such as USA nowadays.

Gold Dinar would measure wealth by its weight, quality and quantity. Therefore no reason if Indonesian Dinar must have higher value than Malaysian Dinar such as the existing fiat money. One Indonesian Dinar would be equal to one Malaysian Dinar. Therefore the unit of measurement will be free from any exploitation of interest rate, inflation rate and etc because it will depend on its intrinsic value rather that its token value. As the value of both Dinars would be the same then the price of goods and services in both countries also would be same.

iii) Wealth Creation

In addition to near nil demand of money for speculative purposes will have a short of multiplier effect on economy. Therefore the banking system would be savings and investment institutions which primarily based their business on the profit and loss sharing concept i.e. mudharabah and musyarakah with the aim to reduce the gaps between the have and have not. This concept would reduce poverty by the increase in participation in economic activities (Mohd Dali, Mat Husin 2004). The overall impact to the areas of consumerism is as follows:

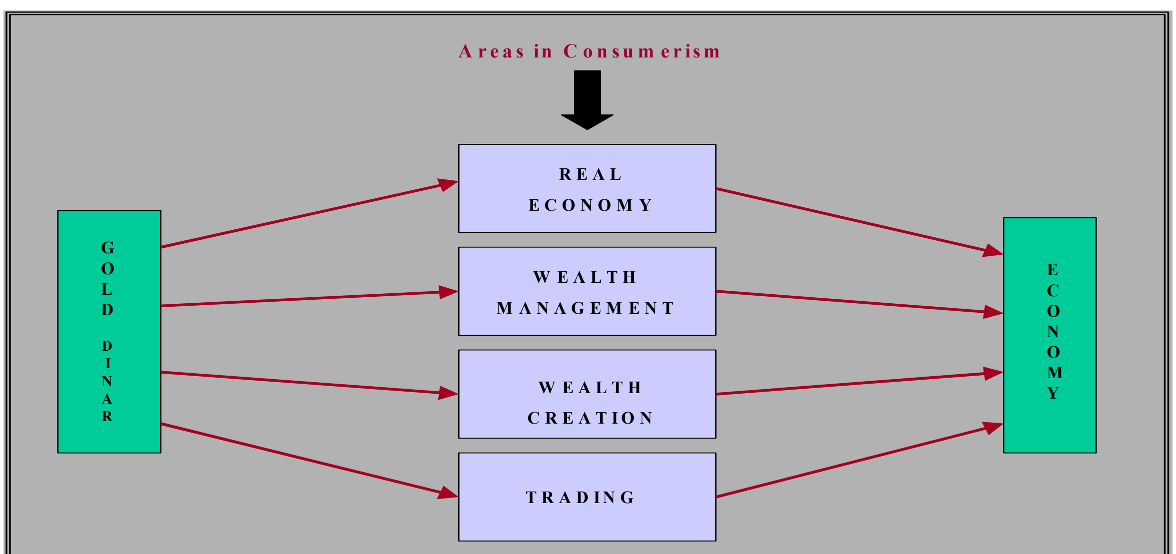


Diagram 1.: The impacts of Gold Dinar on economy through consumerism

c. SOCIAL ORDER

i) Curbing Greed and Other Negative Elements

In the gold Dinar economy, interest is strictly prohibited since the nature of gold Dinar prevents itself from being compounded. One gold Dinar could not be compounded because it will only be one gold. The reason is because gold could not be created at will as compared to fiat money. Therefore, gold dinar could only be increased from real gold production such as the exploration of new gold mining and production of gold.

Furthermore, free interest economy will decline injustice between the rich and poor. The rich would be able to assist the poor in the economic system by the payment of zakah.

In addition, Dinar economy promotes Mudharabah and Musyarakah concepts as the economic engines. Contradicts to the present fiat system which depend heavily on interest and inflation, this new engines will turn out to be less individualistic and be more helpful which in return reduce poverty problems. In the current systems, we could see a lot of problems arise due to poverty which led other social negative elements such as incest, rape, murder and many more.

ii) Creation of Focused Wealth Accumulation

In context of the current system, wealth accumulation could be divided into two categories, the artificial wealth and real wealth.

The percentage of real wealth to artificial wealth is not exactly known. For example, when a bank issues a credit card, how much wealth is created before the billing cycle? The fiat money is good because the government say it is so.

In long term, there will come a crisis of confidence, which will cause a run on the currency. The holders of the new "electronic wealth" will want full face value in paper but the paper won't be there which will cause migration from the paper to some commodity. The artificial wealth will be discovered and the economy will collapse.

iii) Creation of Discipline Corporate Society

Asian Crisis 1997 has seen the importance of a discipline corporate society, which is portrayed through corporate governance as one of the measure to prevent another financial crisis. Corporate governance as may be depicted from this definition is therefore not only about achieving business prosperity but also about ensuring accountability, a proposed theoretical framework for establishing corporate social reporting as a legitimate effort and it is said to enhance transparency of organizations and democracy in society (Gray et al 1996).

Implementation of gold Dinar could improve company's corporate governance by improving the transparency especially in the investment area. For instance, the use of Dinar as a single currency will eliminate the exchange rates and then would remove any attempt for speculation and arbitrage.

In addition, nowadays there are business transactions that involve something that is real (good and services) and virtual (binary bit of computers) (Ahamed & Hasanuddeen, 2002). This situation has widened the opportunity for corporate society to manipulate their operations that defeat the purpose of corporate governance. Dinar, on the other hand is real and therefore, each transaction is exchange only within the real sector. This will not only justify the point that the introduction of Dinar will create harmonization between money supply and real sector, but also enhance the creation of discipline corporate society.

iv) Reducing Dependency On Debts

Current monetary system has created lots of unnecessary debts. Paper money has encouraged society to spend more than what they are earning through creation of debt. The using of credit cards is one of the examples to illustrate the situation. Artificial transaction through credit cards has made it difficult for users to control their needs and hence causing them to keep on spending without realizing that their debt is increasing. Apart from this, when a card owner fails to settle monthly account, the bank will then impose an interest that consequently increase amount of debt. This will also distort the development in social order as most of the benefit will go to the banking system that gains through the interest charged.

This dependency of debt could have been reduced by the introduction of gold Dinar whereby all the transactions is gold backed. All transactions are instantaneous and take place with actual funds. There is no need for creation of intermediate credit like credit cards in the interest based monetary system (Ahamed & Hasanuddeen, 2002). The following diagram could illustrate the overall factors that lead to the improvement of social order:

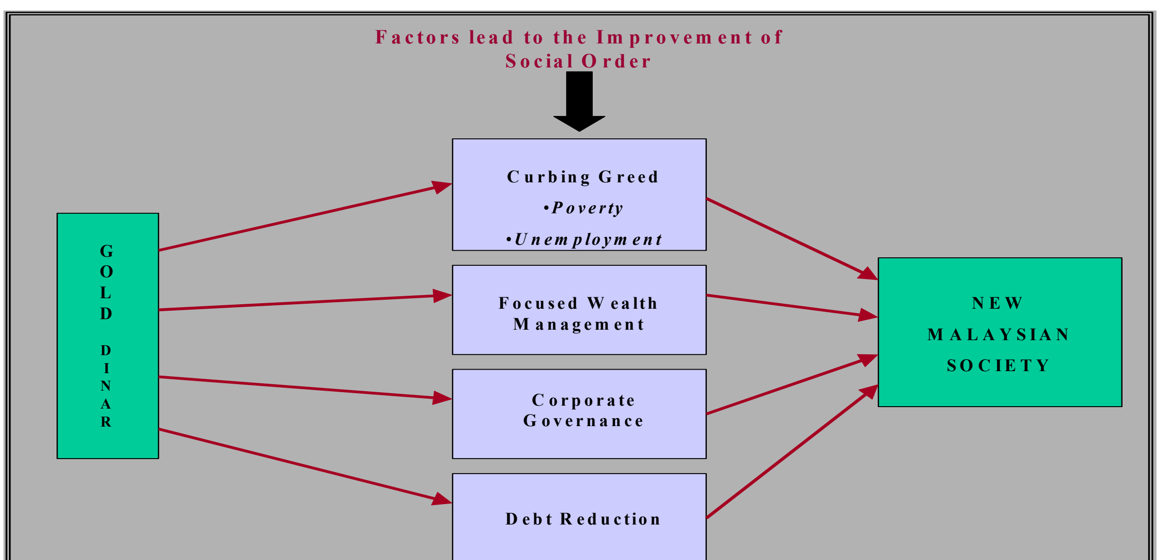


Figure 1.: The impacts of Gold Dinar on economy social order

c. POLITICAL & GLOBALIZATION

i) Trading

The Islamic economics promote trade as oppose for taking or giving interest as noted in Al Baqarah : 275. One of the major problem noted between the OIC countries is that they do not trade each other (Evans,2003). Examples of the OIC countries not cooperating with each other are as follows:

Lebanon and Turkey export butter to Belgium, UK and other European countries, while Iran, Pakistan and Syria import butter from Europe. Egypt is a big exporter of textiles but Algeria and Iran purchase textiles from Europe (Yakcop,2002). It is hope that the gold Dinar would become a platform to facilitate trade.

ii) Revived Islam

Besides being a means of payment for one of the biggest and most homogenous communities in the world the gold Dinar is also seen by many people as the only real challenge to the USD.

The last 100 years has seen the major western economies steadily dismantle the classic gold standard internationally and replace it with a “flexible” debt-based paper monetary system. We only have to look around to see that this system has had far-reaching and destructive implications globally on many levels.

In western world today we have had 2-3 generations of people that don’t know or understand gold or silver, have no experience with the precious metals from a monetary perspective and have absolutely no comprehension of their value.

In the east however the complete opposite is the case. The vast majority understand that gold is the only real money while paper is just a promise to pay. Islamic Nations have experienced and witnessed 1st hand currency crisis as result of the international USD policy. They have recognized that USD system has exported massive inflation, instability and unsustainable debt around the world. Islamic oil producing nations are well aware that they are exchanging a strategically important and diminishing asset for paper.

For decades, the west has been artificially lowering the gold price through selling and leasing in an effort to protect and manage a flawed and untenable paper monetary system. Meanwhile there is growing evidence that indicates eastern and Islamic nations have been quietly accumulating. The gold from the west has been transferring east, which is going to have huge geo-political ramifications in tomorrow’s world.

Islam is a vast trading block of over 1.5 billion people that transcends political and geographical boundaries. In a world of limited tangible supply of gold, consider the effects on the gold and broader financial markets as these nations start to unload their USD reserves to implement such a monetary system. Historically, it can be seen that military might does not save an empire that has debased its currency.

F. CONCLUSION

The idea of revisiting the currency of Gold Dinar is an interesting idea in the development of the Islamic countries and its trading bloc. Monetary expansion in the conventional economic could be done by increasing or decreasing the money supply, however in the full swing Dinar economy, the money supply could not be printed at will because money will be based on physical gold.

The implementation of Gold Dinar will have impact towards the level of income of one country and the level of the money supply or gold. Since the gold exchange rate would be constant as compared to the conventional economics, an increase in the money supply via the discoveries of new gold mines will increase the income of the local country whereas in the conventional system, an increase in money supply will depreciate the exchange rate.

Furthermore the impacts of the implementation of gold Dinar on several factors such as consumerism, political, religion, social order, technology and globalization would also increase the economic stability of Muslim countries.

In implementation of Gold Dinar, cooperation between the Islamic countries is vitally important. The creation of awareness should be done at all levels starting from the root. The society must be educated on the system, advantages and how could dinar could benefit in financial system as opposed to the interest rate system through profit loss sharing mechanism.

The government plays an important role to avoid *seignorage*s as in the 11 decades to happen again. It happen when the British government used one pound of silver to mint 700 silver penny from usual 240 silver penny in early 1666.This situation called "*seignorage*s", where monetary expansion done to induce an economics growth.

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Appendix 1

Figure 3: Annual Average Exchange Rate for RM/USD from 1948 to 2003

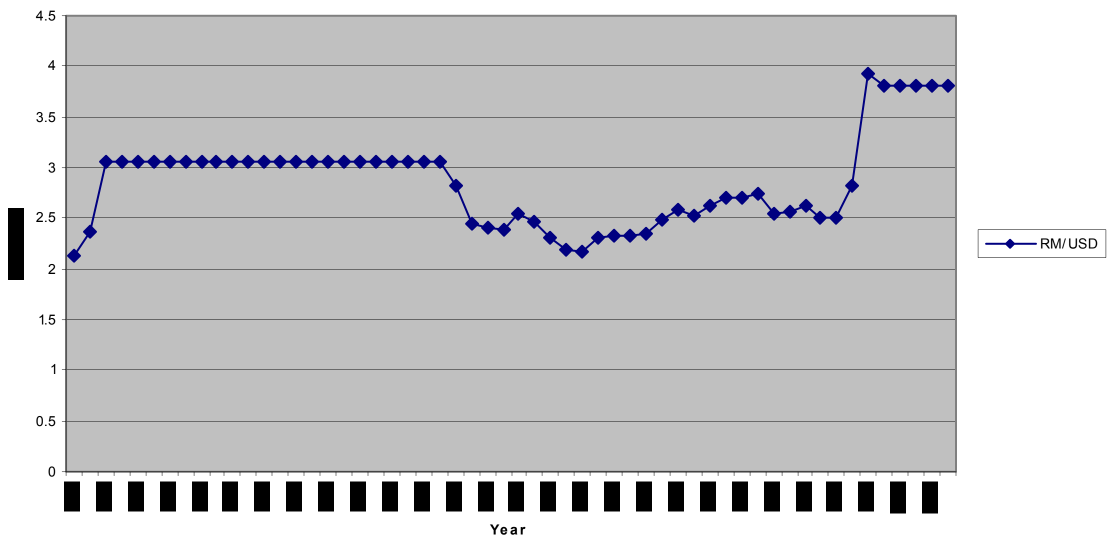

Figure 4: Annual Average Exchange Rate for Rupiah/USD from 1967 to 2003