

GOLD STANDARD

THE FUTURE FOR A STABLE
GLOBAL CURRENCY



Hizb ut-Tahrir
Britain

November 2011 / Dhu al-Hijjah 1432

EXECUTIVE SUMMARY

In early August 2011 gold hit an all-time high, rising to over \$1,900 per ounce – and it would surprise few people if it rose still further. Not for the first time, fears over inflation and political instability have led investors to seek shelter in gold. Silver, similarly, reached a 30-year high at almost \$50 an ounce.

With Fiat currency (especially the US-dollar) expected to lose value, gold and silver have proved their worth once again. In times of crisis gold is, in effect, the world's reserve currency, as it can be trusted to hold its value.

This paper argues that gold is not just for times of crisis but should be the monetary base of choice to ensure financial integrity, economic stability and sustainable growth.

While it is not surprising that Islam's viewpoint on money is the use of gold and silver with 100% reserve backing, this paper sets out, then refutes, the ten main arguments cited against the Gold Standard in light of recent and historic precedence.

Some of the key points addressed in this document are as follows:

1. The charge that only the Fiat monetary approach, with its cheap credit and endless currency creation, can mitigate the business cycle is a disingenuous argument given that it is its cause.
2. At the heart of the criticism of the Gold Standard is the aversion and irrational fear of deflation. Flexible labour markets are a necessary condition to counter the negative effects of falling prices in product markets enabling businesses to remain competitive/profitable under deflationary conditions.
3. The evidence on inflation, for the UK at least, is clearly at odds with the argument that the Gold Standard causes deflation. Between 1800-1914, UK prices were almost as likely to fall as to rise, when average annual inflation was close to zero.
4. The real problem is not that there is too little Gold, but the fact there are too many dollars.
5. Whilst the production costs of paper may be regarded as negligible compared to the costs of extracting, mining and transporting gold, it's the total costs to society of Fiat money that are considerable.

6. The Gold Standard is not compatible with the Fiat system, and to be effective it requires a non-interest based economy.

7. Islam makes a 100% reserve currency obligatory, not optional. This is based on various Quranic textual evidences.

8. Islam obliges a full gold/silver system, whose discipline allows for balance of payments adjustment without the intervention of central banks.

9. The benefits of the Gold Standard are manifestly profound: a system of stability without major cyclical effects; independent of government manipulation; devoid of inflationary fiduciary issue, currency debasement, international crisis and long-term balance of payments deficits.

10. Converse to Gresham's law, strong currencies will soon become the preferred media of exchange, enabling the gold standard to quickly resume its position in the world.

The only system of governance that unequivocally insists upon the Gold Standard as a benchmark is the Islamic economy, as applied by the Islamic State (Caliphate). In Islam a dual metallic standard with gold and silver is applied. No fiat money would be issued by the state, and any paper currency must be 100% backed.

Gold and silver are both ideal as mediums of exchange: they have intrinsic value (including jewellery and industrial use), are widely available, cannot be dominated (monopolised), and there is a regular, yet growing supply of them to meet the needs of growing economies.

The financial crisis has exposed just how much fiat currency systems are at the mercy of the banking system, making phenomenal profits while exploiting wider society.

By contrast, Islam provides a non-interest environment in which there is less incentive to take money out of circulation.

"In order that it does not merely make a circuit amongst the wealthy" [Translated Meaning Quran Al-Hashr 59: 7]

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INTRODUCTION

“Gold is the money of kings, silver is the money of gentlemen, barter is the money of peasants – but debt is the money of slaves.”

Norm Franz, Money and Wealth in the New Millennium

On the 31st of December 2010, Gold ended the year at \$1,420 an ounce: up over 30% on the year, and the 10th year in succession in which it grew in dollar terms. Since 1971, when Richard Nixon unilaterally took the world off the Bretton Woods gold standard, gold has appreciated from its then price of \$35 per ounce to its current level, signalling a 3,950 percent appreciation in gold – or to be more accurate – depreciation in the US Dollar.

Gold was the leading investment class in 2010, and the only one to appreciate in every year since 2000. But this paper is not about relative investment asset performance; it is about gold as currency. It is about the perpetual wasting, debasement of the world's fiat paper based currencies and whether there is a viable alternative. With economic growth anaemic at best in the developed world and facing new bouts of currency wars, as countries try successive rounds of currency devaluation via money printing, many are now questioning whether gold can again be a cornerstone of the world's monetary system.

The head of the World Bank, Robert Zoellick in November 2010 in a Financial Times article reignited the debate by urging world leaders to consider reintroducing a gold standard to control currency movements. He argued that the world's largest economies needed to build a more co-operative monetary system, which he claimed would increase investor confidence and stimulate future economic growth:

“The G20 should complement this growth recovery programme with a plan to build a co-operative monetary system that reflects emerging economic conditions. This new system is likely to need to involve the dollar, the euro, the yen, the pound and a Renminbi that moves towards internationalisation and then an open capital account. The system should also consider employing gold as an international reference point of market expectations about inflation, deflation and future currency values. Although textbooks may view gold as the old money, markets are using gold as an alternative monetary asset today.” ^[1]

Zoellick's comments predictably elicited a storm of protest from financial and banking interests. However, the current system remains and continues to fail.

The US government's use of Quantitative Easing (which dramatically increases money supply) has also been widely criticized. Chinese Premier Hu Jintao on the eve of his visit to the US in mid January quite aggressively asserted:

“The liquidity of the US\$ should be kept at a reasonable and stable level”.

Hu Jintao also hinted at the need for a radical overhaul in the fiat monetary system when he said on the same trip:

“the current international currency system is the product of the past”.

Mr Hu was merely reiterating the fact that the world's de facto currency (the US\$) continues to depreciate rapidly and that major creditor nations such as China will not continue to bankroll US deficits. The paper based fiat system enables the US to wantonly print dollars as and when it feels fit. As the key global currency, this has dramatic effects on the world economy, with gnawing inflation and a persistent devaluation in the dollar (and indeed the other key world paper currencies).

As the immediate impacts of the financial crisis are digested, and currency devaluation emerges as perhaps the final tool to engender recovery, it is time to consider again alternatives to this unstable fiat paper regime. With the thorough discrediting of much of the world's banking system throughout the recent crisis, there is an opportunity to re-examine the monetary pillars of western banking – including credit creation through fiat currencies that are wholly devoid of any asset backing. Can and should the world return to the Gold Standard?

This paper reignites this debate by setting out then refuting the 10 main arguments cited against the Gold Standard. These arguments are distilled from the economics literature and media analysis. The arguments represent the lifecycle and scope of a contemporary gold-based monetary system.

We explain these arguments and counter arguments to explore whether they are still valid in light of recent and historic precedence, and whether they are insurmountable in the quest for a more stable currency in an unstable world.

Lastly, we set out the Islamic position with respect to currency: its adherence to a gold/silver standard and how this will be applied with respect to the ten arguments against its success.

ARGUMENT I: MANOEUVRABILITY PROBLEMS WITH THE GOLD STANDARD



Argument 1: A gold standard does not provide the levers for monetary policy control. Therefore governments would be unable to alleviate downturn in business cycles, stimulate growth and generate cash to spend for emergency projects.

Rebuttal: The ability of the fiat system to mitigate business cycle is disingenuous given that it is the primary cause. Islam categorically forbids interest and increasing money without the full backing of Gold and Silver. Emergency spending in the fiat system benefits the rich and results in hidden tax for the majority, while in Islam it is sourced from the rich.

Inability to influence the Business Cycle

The business cycle is considered by most mainstream capitalist schools of thought to be integral to the functioning of a free market. It is asserted that with the Gold Standard, various policy tools, such as the use of Fiscal and Monetary Policy, cannot be used to mitigate the negative phase of such cycles. The business cycle is characterised by periods of accelerated growth in output, followed by a period of slowdown and then contraction in output often called a recession.

It is argued that the central banks, some of which are independent of direct government control, can help to lessen the impact of such cycles and by so doing extend the period of the boom and minimize the bust phase of the cycle. This goal, it is claimed, can be achieved through various monetary policy tools such as the raising of interest rates and increasing the money supply. Such actions would not be possible under a fully backed Gold Standard where Gold would act as a limiting factor to the supply of money within the economy.

The business cycle is a product of external and internal factors. There can be cases where a downward trend or recession can be caused by external factors such as the 1970s oil price shocks; however such external or exogenous factors are beyond the scope of this paper.

Internal factors that cause recession tend to be related to monetary tightening (usually rising interest rates) policies to restrain an over-heating economy and accelerating inflation.

Usury and Fiat Money

Central banks perform various actions to encourage borrowing and investment especially when markets are in recession. These include increasing the money supply in circulation and also by setting a very low interest rate which is then a basis for banks to conduct inter-bank lending and lending to eager consumers of such easily accessible credit.

These are amongst the host of internal factors that are responsible for causing the business cycle and they clearly emanate from the monetary system of the current order. The culture of consumerism fuelled by unrestrained credit creation at low interest rate leads to a false and unsustainable boom that leads to an inevitable bust or recessionary phase of the cycle.

Once the inevitable excessive demand from the manufactured credit causes general price increases and in some cases inflated prices, a phenomena often referred to as a bubble, such as the 2008 housing bubble in the US, then banks tend to respond by raising interest rates to control inflation.

Usually at around this peak point, credit becomes too expensive for many and defaults start to occur coupled with a realization by the market agents that prices have peaked and the time to sell such assets has materialised. This leads to the inevitable contraction in prices and in many cases price crashes thus terminating the false boom phase.

Once the market clears from such excessive behaviour through a recession, the whole process starts again and

this phenomenon repeats itself in a perpetual cycle. The key point here is that such false booms would be replaced with sustainable growth through a monetary standard that is anchored to gold and silver, which are not subject to such manipulation. Any deviation from a general growth trajectory would be driven by external market factors such as oil crisis that could slow output growth.

Therefore to level the charge that only the Fiat monetary approach, with its cheap credit and endless currency creation, can mitigate the business cycle is a disingenuous argument given that it is one of its primary causes.

Price Stability

Inflation would not occur to the same scale as it does if a nation adopted the Gold Standard. One need not look further than the price of gold as a commodity over the last few years. This is a symptom of people losing confidence in Fiat currencies and also the weakening in the purchasing power of such currencies. The real evil of the system behind the endless manufacturing of money becomes evident in the next section where the real motives of increasing money in all its forms are explored. The net effect of the endless creation of money is a transfer of wealth to the elite factions in society and this is done under the false pretext of price stability.

The risk of hyperinflation is significantly increased under a system of unrestrained money supply as evident in the recent hyperinflation in Zimbabwe where the annual inflation rate in 2008 reached over 200 million per cent. A similar fate could befall the US dollar if the world loses confidence in the ability of the US government to pay back its debts. China has already started to move away from buying US debt in the form of long-term government bonds and Treasury bills, which could act as a catalyst to create a run on US debt and a similar fate for the dollar under this regime of Fiat money creation backed by nothing of value unlike the Gold Standard

Emergency Spending

Critics of a Gold based currency often cite that emergency spending cannot be undertaken the way it can with the Fiat standard. This relates to matters such as the funding necessary during times of war which was a key factor behind President Nixon ending the last Gold Standard, albeit a diluted form of it in 1971. This was due to the cost of the Vietnam War necessitating spending beyond the means available to the US Treasury department.

In response to this charge, the following observations and alternative approaches can be discussed. There may be some initial benefit to being able to flex the amount of money and spend it for emergency projects, however the medium to long term effects of this

are inflation and a transfer of wealth from the masses to the elites. The additional money that is injected into the system does not initially effect the general level of prices and the early acquirers of this 'new money' can reap the benefits of this money before the negative effects by way of reducing the purchasing power of money (inflation) reaches the wider society. The initial acquirers are usually large corporate interest groups that can sell goods such as arms to governments and then convert the proceeds into assets other than cash ahead of the inflation that will reach the society. The people that deal in cash and loans are usually the masses and they are the ones that are hit by the decline in the purchasing power of money once inflation sets in. As a result, it is a hidden tax levied upon the majority of people that deal more with cash and bank deposits. It is no surprise why governments like the Fiat model along with the special interest groups they represent - not to mention the banks that charge interest on money that was not earned and was created out of nothing.

Secondly, the need for such funding is often as a result of the capitalist states instigating wars as an economic strategy to increase growth and economic prosperity for their economies. Hence the slogan: "war is good for the economy". Can it then be said that emergency spending such as this would be a significant factor if this utilitarian view were abolished?

In contrast, in the Islamic system based on its different view and values, when a genuine need for funding for emergency projects appears in the Khilafah State (Caliphate), the values of the population, with its orientation towards sacrifice, patience and the collective mentality based on the spiritual tendency of its adherents, can be relied upon to raise capital for such key projects. This would include use of Shari'ah rules for taxing the rich (extraordinary measures can lead to a percentage levy raised on the wealth of citizens, similar to zakat).

ARGUMENT 2: SUPPLY OF GOLD PROBLEM - FEAR OF DEFLATION



Argument 2: There is inadequate supply of gold, which can result in deflation if the gold standard is adopted. There are also major imbalances in supply of gold across regions of the world, and maintaining sufficient reserves of gold/silver is a challenging task. Injection of gold into the economy would result in inflation similar to quantitative easing in the fiat system.

Rebuttal: At the heart of this criticism of the Gold Standard is the aversion and irrational fear of deflation. Flexible labour markets are a necessary condition to counter the negative effects of falling prices in product markets enabling businesses to remain competitive/profitable under deflationary condition.

It is often stated that there is insufficient gold in circulation to account for all the trade around the world. Estimates of the value of gold are in the region of 6.5 trillion dollars and the world's GDP, as far as the real economy is concerned, is around 50-70 trillion dollars. How then could Gold currency be used in place of the Fiat currency that has replaced it?

In light of the above, it is argued that countries which transition to a Gold Standard would clearly not be able to maintain current prices and the realignment of prices would occur leading to significant levels of price deflation across all sectors of the economy. After this initial drop, then relative stabilisation would occur.

At the heart of this criticism of the Gold Standard is the aversion and irrational fear of deflation. To refute this dogma, an analysis of the supposed harms of deflation will be discussed along with an alternative view of how deflation can be a positive force in the economy, not being a trigger for recession and also a positive force behind the distribution of wealth in an economy. Deflation is argued as a bigger evil than inflation for numerous reasons including the following:

- It increases the burden of debt as debts increase in real terms as money is worth more when prices are falling.

- It is suggested that people will delay purchasing goods and services in anticipation of prices falling further with an attendant fall in demand thereby leading to a vicious spiral towards recession and ultimately depression.

- It renders monetary policy ineffective as there is no incentive to borrow and therefore no way that central banks can instigate a self-sustaining recovery. Some theorists such as John Maynard Keynes called this phenomenon a liquidity trap.

In response to this charge it is clear that many products have experienced rapid sales growth during prolonged phases of deflating prices due both to technological advancements such as the growth of ecommerce, or periods where growth in output has outstripped the supply of currency. The former would cause prices to deflate in specific sectors of the economy whereas the latter would cause a general decrease in the prices of all commodities as the ratio of money to goods and services would fall and a smaller quantity of money would need to cater for a larger volume of trade and hence each unit of money would be worth more in real terms (manifested in a drop in prices).

Trade and investment is not inhibited by prices that fall as a result of increasing efficiency. The growth as a result of the industrial revolution is ample evidence of the case

where entrepreneurs can effectively anticipate and predict price and cost trends and make informed decisions in the present time to ensure maximum benefit. Had this not been true, then the declining cost of communications technology would have seen many technology companies go out of business instead of an increase in growth and market presence as new market participants can now afford such products thereby increasing sales even further.

One of the reasons cited by the Keynesian school for deflation being a precursor to a recession is that while the selling price of goods and services are falling, cost prices, especially wage costs, are resistant to a corresponding fall and as such business start to increase redundancies which has an effect of lowering the overall level of demand in the economy which further exacerbates the fall in prices into a perpetual downward spiral until the government steps in to break the process and starts to exert its own demand through starting projects to compensate for the private sectors shortfall in demand.

The challenge here is to demonstrate how the costs of production can fall to enable businesses to remain competitive in such a deflationary climate and thus not suffer the ill effects described above. If businesses were able to drop their input costs and by so doing preserve their profitability, they would be relatively immune from the effects of declining prices.

Price inflexibility especially downward cost price movement can occur in areas such as labour costs where it is referred to as 'wage stickiness', or in other factors of production such as rent on land, due to long term leasing contracts which are hard to renegotiate. Wage stickiness can occur due to psychological factors as individuals look to the nominal rather than the real value of money. This concept is known as 'money illusion' as the phenomena where workers will be less inclined to accept lower pay despite the fall in prices than they will argue for their wages to rise when prices rise. If workers realized the contradiction they would be less likely to resist wage cuts especially if they saw the wider implications on their job prospects and on the wider economy.

Flexible labour markets are therefore a necessary condition to counter the negative effects of falling prices in product markets. In Islam there are various concepts such as the notion that Allah provides the sustenance and also a clearer concept towards value, in this case the value of money as defined by its purchasing power, to ensure the market does not suffer from such inflexibilities.

In contrast to this notion of measuring utility as a stand alone feature of a commodity, the early Capitalist theorists (the Marginal School) adopted a concept of value called the theory of diminishing marginal utility which defined

the value of a commodity as its utility at the point of consumption when satisfying the weakest point of need; this level of utility enabled the comparison of commodities for the purposes of exchange.

Money naturally became the universal good which acted as this scale for the measurement of the value of all things. The problem however was that with this ratio (called 'price') people started to measure the value of objects through the prism of price instead of the inherent utility of the object. Hence if the price, or absolute amount of their pay is reduced, the implication being that this must be a bad thing.

The implication of this confusion of looking at value through price is clearly demonstrated in the example of the phenomena of money illusion where workers cannot see the real value of their wages. Instead workers think about their wages in nominal terms measuring their pay through a nominal construct in the form of an absolute monetary amount devoid of real value, in this case real value would be through the purchasing power of money.

Had market participants been operating in an Islamic economic environment with clarity over these concepts (in the case of value became confused by early classical economic theorists) and thus been able to see value in real terms, then the correct view of the worth of ones wage in a deflationary phase would have resulted in workers more likely to accept lower wages knowing that the purchasing power and hence value of their pay would not be affected as a result. Furthermore the constant fear of inflation associated with the Fiat system exacerbates this fear and further discourages workers to accept pay cuts.

Furthermore, a 1999 study in North America entitled "Why Wages don't Fall During a Recession" by Truman Bewley [published by Harvard University Press], which was based on interviews with over 300 businessmen union-leaders and recruiters, found a huge disparity between the theoretical modelling of wage stickiness and actual causes.

The study cited reasons such as employers fear or lowering worker morale out of fear that lower nominal wages would lead to a lower standard of living. The study found that employers would fear an increase in staff turnover and this is very costly. The implication being that employers would rather lay off a percentage of workers as a means of reducing labour costs to counteract this effect instead of dropping wages. Clearly if the reality of money illusion was clarified, and the view towards value was understood, then the reluctance to lower wages would be minimized and so would the negative effect on morale which acts as an impediment to lowering wages.

In conclusion to this point, it can be said that wages and other input prices would need to fall to help the market



which is gradually polarizing the divide between rich and poor at an ever increasing rate. It is no surprise that people are often forced to take loans to try to get onto the wealth ladder.

Finally as far as people delaying making purchases, this is an argument which is blown out of proportion to justify the Quantitative Easing (QE) programs that target the creation of inflation to counteract the deflation described above. If wages are more flexible as shown in the preceding analysis, then the incentive to delay a purchase when wages will fall, potentially before the drop in the price of the good or service in question negates this false dogma.

It must be noted that we advocate a bimetallic standard that's gold and silver providing the monetary based. The bimetallic standard will augment the money supply, as it would not rely upon gold alone.

readjust to new equilibriums necessary to avoid the downward spiral towards contraction of the market towards recession, high unemployment and ultimately depression. However if the underlying investment were not robust enough to withstand such shocks then it would be better for the business entity to fail instead of being bailed out by the taxpayer.

Secondly as far as increasing the burden of debt, the Islamic model is built on the premise of encouraging the market participant of the virtue of living within ones means and funding investment through savings and not unsustainable debt. Therefore being in a situation were debt servicing with interest is not the reality. There general ethos of the distributive approach in the Islamic system ensures there is much more parity in wealth amongst market agents and hence saving is the norm rather than the exception as is the case in the highly polarized distribution system in the capitalist system

ARGUMENT 3: PRICE INSTABILITY PROBLEM



Argument 3:The Gold standard leads to greater price instability in the short term, inhibiting business decisions. Gold is a commodity whose price is too volatile, being constantly shifted by supply and demand.

Rebuttal:The argument of short-term price instability solely hinges on relatively high coefficient of variation ratios over the period of the Gold Standard. However the coefficient of variation is a highly unstable statistic when the average (mean) of a dataset is close to zero as was the case with relatively low and stable long term inflation over the period of the Gold Standard. Far from destabilising markets, short-term price variability around a low average in actual fact suggests markets were providing effective signals for producers and consumers to actively engage in economic activity during the period of the Gold Standard.

Where open markets operate, the prices of goods and services are determined by changes in their respective demand and supply. Money or currency is used to denominate the prices of goods and services where the value of a currency is determined by the quantity of goods and services that can be bought with a given sum of money.

Increases or decreases in the supply of money itself may cause a general increase or decrease in the prices of goods and services irrespective of supply and demand conditions within individual markets.

Michael David Bordo [2] argued that the adoption of the Gold Standard leads to price instability in the short term and that this inhibits economic activity. At the same time and perhaps paradoxically the Gold Standard is said by others to cause deflation.

However, when investigated empirically both assertions are contestable.

Despite the predominance of Fiat currencies in the world today, the first point to make is that over the last 250 years or so, implementation of the Gold Standard has been the norm rather than the exception.

Since the beginning of the Industrial Revolution to the start of World War I - in excess of 150 years - the classic Gold Standard was implemented in the major economies of the world.

Looking at the Britain, where the Industrial Revolution began and being the dominant world power in the

UK Consumer Prices, Average annual Change %

| | Inflation | |
|-----------|-----------|---------------------------------|
| 1750-1800 | 2.0% | Gold Standard |
| 1801-1851 | -1.2% | Gold Standard |
| 1852-1902 | 0.3% | Gold Standard |
| 1903-1914 | 0.5% | Gold Standard |
| 1915-1925 | 5.4% | Gold Abandoned during WW1 |
| 1926-1931 | -2.1% | Gold Standard |
| 1932-1945 | 3.8% | Gold Abandoned during WW2 |
| 1946-1971 | 4.4% | Gold Abandoned by Bretton Woods |
| 1972-1993 | 8.9% | Fiat Currency |
| 1994-2003 | 2.6% | Fiat Currency |

Table 1: UK Consumer Prices, Average Annual Change in Inflation since 1750 (%)
Source: UK Office of National Statistics

eighteen and nineteenth centuries, Table 1 above presents inflation in the UK since 1750 as recently published by the Office of National Statistics [3]. In these first 50 years, inflation averaged a steady 2% per annum. Following a deflationary period between 1801 and 1851 when

inflation averaged -1.2% per year, in the next 50 years prices rose by 0.3% per year followed by growth of 0.5% per annum to 1914 when the Gold Standard was abandoned in order to finance the war effort. Average annual price inflation of about 1% over the period 1750-1914 suggests the classic Gold Standard produced unprecedented long run low price stability.

The evidence on inflation for the UK at least is clearly at odds with the argument that the Gold Standard causes deflation. Between 1800-1914, UK prices were almost as likely to fall as to rise, when average annual inflation was close to zero. Since this was often caused by an increased supply of goods and services and not by a shortfall of demand, the resulting deflation was benign. Prices tended to rise when many countries abandoned the Gold Standard, during the First World War. As countries aimed to restore the Gold Standard at the pre-war parity in 1925, prices were required to fall back - resulting in policy-induced deflation. This expectation of prices to fall helped contribute to an environment with relatively flexible prices and nominal wages. From 1925-1929, the falling prices and increasing output make this deflation to be the likely consequence of beneficial developments reflecting the increased ability of the economies to provide goods and services. Since WWII, there have been few episodes of deflation worldwide, with UK

the coefficient of variation is a highly unstable statistic when the average (mean) of a dataset is close to zero as was the case with relatively low and stable long term inflation over the period of the Gold Standard. Thus the high coefficient of variation shows spurious short-term variability over the period of the Gold standard and is an unsuitable and improper measure of statistical variation.

Far from destabilising markets, short-term price variability around a low average in actual fact suggests markets were providing effective signals for producers and consumers to actively engage in economic activity during the period of the Gold Standard.

Indeed the unprecedented increase in industrial and agricultural output and international trade during the Industrial Revolution suggests the implementation of the Gold Standard had no apparent adverse or lasting impact on the economy. This is shown by the 0.5% per annum growth in the UK's GDP per capital between 1750 and 1850 [4] - during implementation of the Gold Standard - allowing for the increase in population and inflation.

Steady though unspectacular growth implies the Gold Standard had no underlying adverse impact on economic activity. Economic activity rose ahead with inflation and population increasing 'average' livelihoods, in spite of the



Figure 1: UK Consumer Prices, Average Annual Change in Inflation since 1750 (%)
Source: UK Office of National Statistics

experiencing an average inflation of 7% since then. Between 1999-2005 an unwinding of inflated asset prices associated with a crisis in the Japanese banking system prompted deflation in Japan, where consumer prices fell by an average of 0.5% per year.

The argument of short-term price instability solely hinges on relatively high coefficient of variation ratios over the period of the Gold Standard (as cited by Bordo). However

inherent disparities in income and wealth created by capitalism.

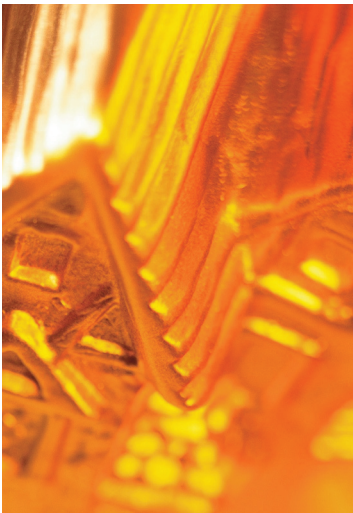
Looking at the experience of Britain, this period between 1750 and 1914 of the implementation of the Gold Standard can be contrasted with the following decades when the Gold Standard was intermittently or partially implemented.

The Gold Standard was abandoned between 1915-1925 and 1932-1945 with inflation in Britain rising by 5.4% and 3.8% respectively. 1946 to 1971 saw the partial implementation of the Gold Standard through the Bretton Woods system and inflation rose slightly above 4% per year. Since the demise of Bretton Woods the UK's inflation has been very variable exceeding 8% per annum between 1972 and 1993 with Fiat currencies in operation.

The Gold Standard anchors a currency to a relatively

fixed monetary base guaranteeing low inflation, with possible periods of low deflation. In contrast Fiat currencies have a tendency to generate inflation – often at high growth rates - even allowing for the mitigating effects of restrictive monetary and fiscal policy.

ARGUMENT 4: GROWTH PROBLEM



Argument 4: The gold standard is inelastic and can introduce a mismatch in the quantity of money in relation to volume of economic activity. The insufficient gold-based currency can result in high or cyclical unemployment.

Rebuttal: The real problem is not that there is too little Gold but the fact there are too many dollars in the world. The Gold Standard ensures the amount of money in the economy is relative to economic growth, which therefore makes economic growth real and sustainable.

Point 1 – Fiat supporters have always argued there is not enough Gold in the world to fund the global economy and international transactions.

The total amount of gold that has ever been mined has been estimated at around 165,000 tonnes. Assuming a gold price of \$1,500 per ounce, the total value of all the gold ever mined would be around \$6.8 trillion. This is less than the value of circulating money in the US alone, where around \$1.4 trillion is in circulation and another \$11 trillion exists through banking deposits.

The real problem is not that there is too little Gold but the fact there are too many dollars in the world. The US, which has the dollar as its national currency, can continually print money to meet its economic needs because international financial markets and global commodities markets are all priced in dollars.

The money stock in the world far exceeds the value of the global economy. The banking industry creates money through loans and mortgages. It is here the advocates of Fiat argue that the more money existent in an economy the more growth. In reality more money has created more inflation. The need to create perpetual economic growth has driven western economies to print ever more money creating one economic crash after the other. The case in point is not the insufficiency of gold in the world but the

instability that unrestricted Fiat brings to national economies.

Point 2 - The proponents of Fiat money argue money plays a crucial role in the economy since sufficient amounts of money need to exist in the economy for transactions to take place. The more transactions that take place the more wealth is created.

Monetarists have long argued that giving up such an economic tool handcuffs a government. With the Gold Standard new gold would need to be mined in order to increase money supply and this would impact economic growth.

Capitalist economic growth requires the economy to continually grow, which in turn needs consumers to continually spend, the availability of debt allows this on a massive scale. Pro-Fiat economists believe the ability to print money freely drives economic growth. Whilst a certain amount of money is needed for transactions to take place, in almost all cases of Fiat economies the amount of money always exceeds economic activity that creates inflation and destabilizing the economy.

The last decade saw the financial sector, which was the driving engine of Western economies stimulate economic growth. Through the creation of nearly \$1,000 trillion this

artificially drove a housing bubble that stimulated the other aspects of the world economy. All of this took place with a real world economy of only \$50 trillion or so. The growth in the economy was false, artificial and unsustainable while the recession and its adverse impacts are all too real.

The Gold Standard would have restricted the amount of credit in the global economy and ensured a credit driven bubble never materialised. Since liquidity cannot be accessed either through printing or through interest-based credit, the productive activities leading to growth are risk sensitive and sustainable. Unsustainable growth is when the growth is not able to continue without causing

socio-economic problems, the potential of which is repeatedly witnessed in the interest based Fiat system. Economic growth, unemployment and money creation all need to be separated from each other. Economic growth has become synonymous with low unemployment and manageable inflation. Economic growth in any country is more than just these factors. Economic growth can also be driven by competitive labour and consumer markets, it can be driven and supported by innovation and strong public infrastructure. These supply side factors absorb any inflation created from the demand side of the economy. Thus without the supply side of the economy, money creation in the hope of manufacturing demand will just lead to higher prices.

ARGUMENT 5: THE HIGH COST OF PRODUCTION: SPECIE AS A WASTE OF PRODUCTION



Argument 5: The use of gold and silver requires costs of extraction, mining and transport, which is a significant portion of the GDP of a nation. This also leads to allocation of valuable effort towards, that which could be avoided.

Rebuttal: Whilst the production costs of paper may be regarded as negligible compared to the costs of extracting, mining and transporting gold, it's the total costs to society of Fiat money that are considerable.

Some influential economists produced estimates that the resource costs of gold (mining, refining, assaying, storing and guarding) could be up to 4% of GDP. As such it is a needless misallocation of resources if token coins or fiat money can do the job of being a medium of exchange at a negligible resource cost.

Before discussing the costs of the gold standard, it is important to keep in perspective the costs of the Fiat standard and more importantly the costs of the consequences of implementing the Fiat standard. One well-known consequence is the cost of bailing out the economy. A rather modest older example is given below.

| Country | % of GNP |
|-----------------------|----------|
| Sweden 1992-96 | 3.6 |
| USA 1988 | 3.7 |
| Spain 1977-85 | 16.8 |
| Venezuela 1994-5 | 18 |
| Mexico 1994 | 19.3 |
| Japan 1997 | 24 |
| Chile 1981-83 | 41.2 |
| Thailand 1997-2000 | 45 |
| Malaysia 1997-2000 | 45 |
| Argentina 1980-82 | 55.3 |
| South Korea 1997-2000 | 60 |

Table 2 Cost of Bank Bailouts as % of GDP
Source: Office for National Statistics [5]



Another line from the critics of the Gold Standard is that they assume that the activities of mining gold, refining it, casting it into bars or minting it into coins, storing it and guarding it are collectively wasteful activities – which are all under the implicit assumption that with the Fiat standard such activities would cease. But that case assumes that the imposition of the paper standard will cause gold to lose its monetary value. Whereas gold continues to be mined, refined, minted, stored and guarded – and still incurs a resource cost. In the case of irresponsible monetary management the resource costs of gold under the paper standard may indeed be driven higher than just the Gold Standard alone.

Finally, there are some false assumptions that lead to the high estimated costs for the resource costs of gold, namely assuming that gold supply is perfectly elastic. In truth gold supply is relatively inelastic. In an expanding economy, an increasing demand for money would lead to additional resources being devoted to gold mining. But given the inelasticity of supply, the dominant effect of the increase in the demand for gold would be a price effect rather than a quantity effect. There would be some increase in the quantity of gold supplied, but due to the price effect, this increase would be small in comparison with the increase in demand. The resource costs of extracting the additional gold would be correspondingly small.

It must be noted that advocating the Gold Standard does not necessarily mean having bars of gold to engage in everyday commercial transactions. A Gold Standard works perfectly well as long as any paper money in circulation is equivalent to the valued quantity of gold in the economy.

Studying the resource costs of gold production in isolation is a poor proxy of total costs. Comparing the resource costs of gold against the resource costs of paper does not settle the issue. We have to look at the opportunity costs from not having the Gold Standard, in essence this means realising the missed opportunities to the economy from the benefits that entail a stable and sound currency. So whilst the production costs of paper may be regarded as negligible compared to the costs of extracting, mining and transporting gold, it's the total costs to society of Fiat money that must be considered, which are:

- The costs of inflation-induced misallocation of resources from a Fiat standard. In essence paper money is the key facilitator of creating inequity between the rich and poor by being the engine for inflation growth.
- The costs of political factions vying for the power of the printing press.
- The costs imposed by special-interest groups in their attempt to persuade the authorities to misuse the printing press.

Thus the isolation in which the costs of gold are compared to the costs of Fiat, are in effect analogous to saying sand is cheaper than concrete, and therefore should be used to lay the foundation of a structure. The very edifice of Capitalist markets has been crumbling before our eyes – all based on Fiat currency, so who would argue against paying for a strong foundation!

ARGUMENT 6: COMPATIBILITY PROBLEM



Argument 6: The gold standard is not compatible with the Fiat system and to be effective it requires a non-interest based economy.

Rebuttal: Indeed the two systems are like chalk and cheese. If a country operating the Gold Standard began to print money the paper money would lose value and people will exchange the lower value paper for gold from the treasury or begin to hoard gold. The Islamic Gold based economy prohibits interest, which would not fuel credit creation, thereby guaranteeing the integrity of the Gold Standard

The Gold or Gold and Silver standards are not compatible with the Fiat monetary system. Indeed the two systems are like chalk and cheese. If a country operating the Gold Standard began to print money as in the Fiat system the paper money would begin to lose value in comparison to the gold and people will exchange the lower value paper for gold from the treasury or begin to hoard gold. This will undermine the economy and growth. Thus the Gold Standard has an internal automatic stabilisation mechanism that prevents the printing of paper money and consequent inflation.

Since the demise of the Gold Standard, Fiat monetary systems have expanded the supply of money enormously with the result that monetary policy is now primarily aimed at reducing inflation. Even so, inflation has been the scourge. This quote from the UK's national statistics authority compares consumer price inflation in Britain during mostly the period of the Gold Standard (1750 to 1938) with one since, when the Fiat system has been in operation.

"Taken as a whole, in the period between 1750 and 1938, before the start of the Second World War, prices rose by little more than three times. Since then prices have increased more than forty-fold".

Consumer Prices inflation since 1750. UK Office of National Statistics

The situation in Britain reflected that of the entire industrialised world. Notwithstanding periodic supply shocks the underlying inflationary pressure which caused the forty-fold increase in prices has come from an ever expanding money supply.

This is vividly exemplified by the fact that today the world money supply is nearly 5.5 times larger than the real economy, as illustrated in the table below.

| WORLD MONEY SUPPLY | \$TRILLION |
|----------------------------|------------|
| Narrow money | 22 |
| Broad money | 75 |
| Domestic credit | 105 |
| External debt | 60 |
| Foreign exchange reserves | 10 |
| Total Fiat money base | 272 |
| World GDP | 50 |
| Ratio of Fiat money to GDP | 5.4:1 |

Table 3: World Money Supply (\$trillion)
Source: CIA Fact Book

Interest, which is the opportunity cost of capital, has propelled the growth in creation of credit that is the fuel for expanding money supply.

Although borrowing and lending is allowed, an Islamic Gold based economy prohibits interest, which would not fuel credit creation, thereby guaranteeing the integrity of the Gold Standard.

ARGUMENT 7: MONITORING



Argument 7: How could governments be trusted to maintain the Gold Standard. The US for example was accused of printing more dollars than gold reserves in late 1960's before they dropped out of the Bretton Woods agreement.

Rebuttal: Islam makes a 100% reserve currency obligatory not optional. This is based on various Quranic textual evidences. For an Islamic state maintaining a 100% gold reserve ratio, is a matter of conviction related to belief and would warrant the removal of the ruler if he flagrantly abuses the supply of money in the economy.

Many have argued that maintaining 100% reserves for a Gold Standard regime is impossible and as a result have spoken against the Gold Standard. This chapter analyses the prospects of actually monitoring the application of the Gold Standard and possible checks and balances

A Gold Standard currency regime works on the basis that the amount of money – paper or coins, in an economy are 100% backed by Gold. Whatever the rate between the legal tender and a gram of gold, full reserves are the defining feature of such a currency regime.

Historically the world's powers have periodically broken the link between money and gold in the Gold Standard due to wars and debt repayments. This dishonesty has been one of the key arguments from protagonists against Fiat money.

A monitoring mechanism in the Gold Standard is essential to ensuring the Gold Standard is implemented correctly. Many anti gold protagonists believe a 100% reserve ratio is impossible due to the insufficiency of gold in the world and as governments have a virtual monopoly on money supply there is no mechanism to check the credibility of the gold reserves to money ratio in the economy. A monitoring mechanism is important as confidence in the gold standard is based on the ability to monitor the reserves of gold and currency in circulation.

Islam makes a 100% reserve currency obligatory not optional. For an Islamic state, maintaining a 100% gold reserve ratio is a matter of conviction related to belief and would warrant the rulers removal if he flagrantly abuses the supply of money situation in the economy.

The fixing of certain rules by the Dinar, the Dirham and the Mithqal, would make the dinar with its weight in gold, and the dirham with its weight in silver, a monetary unit by which the values of goods and services are measured.

Islam linked the Shari'ah rules to gold and silver by text, when these rules are related to money, this serves as evidence that gold and silver are emphasised as money. From this, Islam requires gold to definitely be part of any legal tender for the Khilafah state.

When Islam prohibited the hoarding of wealth, it specifically prohibited the hoarding of gold and silver despite the fact that wealth includes many other properties that can be owned by the individual. However, hoarding is reflected in money, not in the goods and services. Islam has linked gold and silver to a number of rules. Hence Islam makes the Gold Standard an obligation in principal and practice and thus aside from this being a matter of belief, the rulers removal can be initiated if the standard is not correctly implemented.

Another way in which the Gold Standard can be monitored is through an automatic mechanism, which is the level of prices in the country. If the general level of prices across the economy are rising or declining with no explanation related to changes in the product markets (i.e. market forces) then it must be because the level of money supply in the economy has changed. If this is the case, the ruler can be asked to explain such a (phenomenon). The ability to monitor this mechanism and formalise this through a committee or regulatory body breeds confidence in the state and the Gold Standard.

Without a monitoring system bad money would drive out good money leading to hoarding as observed by Gresham's law. A monitoring system will ensure the amount of money in circulation remains relative to the amount of gold in reserves, which will maintain confidence of the system.

Alongside this, an annual review can be taken in the form of the total stock of gold billion in the central treasury with an assessment of money supply in the wider

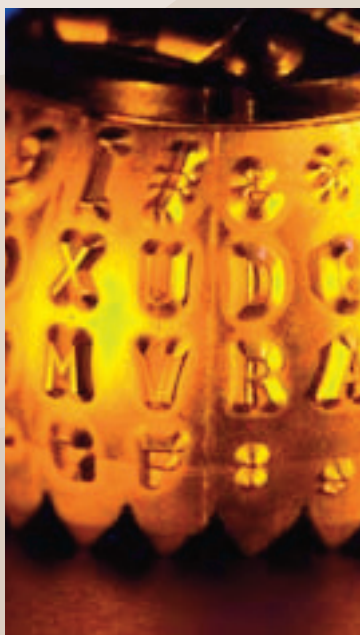
economy. This will allow on an annual basis the verification of the Gold Standard stock. This should be undertaken by experts in the area and would be by a team that is independent to the government.

Indeed any monitoring mechanism that is required to ensure the integrity of the gold and silver supply will be implemented on the basis that adoption of the Gold Standard in an Islamic obligation so anything that leads to its establishment and permanency will be sought. As the ruler's (Caliph's) continuation in office is dependent upon implementation of all Shari'ah rules, and because his removal can be sanctioned by the highest court in the

land (The Court of the Acts of Injustice), there will be a close monitoring of all economic functions including maintenance of the Gold/Silver standard fully. This is in stark contrast to the US administration, for example, which refuses to allow a public audit of gold reserves in Fort Knox.

These are the checks and balances to ensure the integrity of the Gold Standard, and trust in the authorities that maintain it.

ARGUMENT 8: GLOBAL ASYMMETRY PROBLEM



Argument 8: The Gold Standard suffers from a structural flaw if implemented internationally. Policies implemented by nations can have a biased impact on economies of other nations. The abandonment of the gold exchange standard during the interwar period is evidence of this problem.

Rebuttal: From examination of the gold exchange standard, it becomes clear that it was neither entirely gold/silver based nor was it implemented with the right discipline and priorities. Islam obliges a full gold silver system, whose discipline allows for balance of payments adjustment without the intervention of central banks. The challenges of engaging in gold exchange regime for an emerging state can be addressed with some prudent policies described.

There are two causes underlying the claim of global asymmetry:

1. Asymmetry in monetary response to gold flows between surplus and deficit countries. Ideal operations would mean deficit countries need to reduce money supply and deflate, while surplus countries increase supply and inflate. The problem relates to the difficulty of placing sanctions to prevent surplus countries from sterilizing gold inflows and accumulating reserves, if domestic objectives made that desirable.

2. Differential reserve requirements of central banks, giving some more monetary control than others in dealing with crisis. With fractional reserves, the relationship between gold outflow and the reduction in the money supply was not one for one; with a 40% reserve requirement; for example, the impact on the money supply of a gold outflow was 2.5 times the external loss. These variations across countries can cause sharp effects in the system. ^{[8] [9]}

In order to address this problem, one needs to appreciate firstly, what is referred to as the gold exchange standard, and secondly, the reasons for establishing and later abandoning the gold exchange standard.

A Gold Standard regime is expected to have some basic features such as interconvertibility of domestic money and gold at a fixed price, freedom for private import/export of gold and rules relating ratio of money in circulation to the country's gold stock. An international Gold Standard is said to exist, when a number of countries adhere to these principles.

The modern western literature commonly cites that a Gold Standard regime prevailed on a global scale from 1880 to 1914, prior to which most currencies were based on a silver standard. For example, Britain maintained a Gold Standard, whereas the US and France were on a bi-metallic standard.

It is important to note the varied ways in which these countries adhered to the Gold Standard regime. Some countries such as Britain had automatic convertibility and in others like France convertibility was at the opinion of the authorities. The cover system (quantity of currency linked to gold reserves) was also adopted in a variety of ways: a fiduciary system allowing authorities to create a certain quantity of unbacked currency while requiring remaining currency to be fully backed by gold (example England); proportional system treated all currency alike but permitted central banks to maintain a ratio of less than 100% (example Holland); a combination of the fiduciary and proportional (example Germany); and flexibility in permitting reserves to fall below legal minimum upon payment of a tax or finance minister's authorization (example France).

These countries implemented the Gold Standard because it was believed widely that it provided price and exchange rate stability. Convertibility ensured a check on inflationary finance and price stability encouraging domestic specialization and long term planning. With a stable exchange rate, international trade can be conducted with minimal risk of capital losses; that the Gold Standard provided this is of little dispute.

Convertibility was suspended with the outbreak of World War 1, where deficit spending was financed by money creation, aided by patriotic refraining from redeeming gold and difficulty in international specie flows. The cessation of hostilities featured persistent inflation rendering maintenance of pre-war parities unfeasible, with the exception of the US. However there was widespread desire to return to the Gold Standard. The ensuing series of committees and conventions entertained no other alternative, making the Gold Standard not merely desirable but essential for stability and reconstruction. About 50 countries participated with different capacities in the international Gold Standard during the interwar years. Many countries opted for convertibility at a depreciated rate of exchange, others were forced off the Gold Standard, in particular half of these countries followed Britain in 1931 off the Gold Standard.

It is the explanations for this unsatisfactory performance that brings the asymmetry argument against the Gold Standard to the fore. The 1931 Macmillan reports includes most of them, notably contributed by Keynes who predicted a loss of output and employment that was supposedly traded off for external balance due to restoring the Gold Standard.

It was also thought that the return to the Gold Standard would lead to a scramble for gold, pushing up the commodity value of gold through competitive deflation. The financial commission of the conference was presided by Robert Horne, then British Chancellor of the Exchequer, which resulted in "currency resolutions",

which spells out the key outline and proposals of the gold exchange standard.

A serious weakness of the gold exchange system was the variability in which central banks relied on exchange reserves. This sheds light into the motives of countries during the early part of the last century to adopt the gold exchange standard and adhere to it. Instead of the realization of the common interest in preventing deflation, they tended to neglect external consequences of their actions. This led to the gold exchange standard to be used as a transitory expedient by countries such as France, Germany, Italy and Poland. It was also seen as a British sponsored device so that it could return to pre-war parity without necessary internal adjustments.

The unwarranted complexity owing to constant deviation from ideal operations presented a foggy picture for analysis. Countries that generally lacked discipline, the correct priorities and carried an inequitable global vision have primarily been those who have promoted the unfavourable opinions on the Gold Standard.

The Islamic Gold/Silver Standard

Islam advocates a genuine Gold and Silver Standard, whose discipline is guaranteed by state constitutional obligation instead of coming under the purview of financial discretion and amendments. Gold and silver are the sole measuring units. It becomes clear from the above historical explication that many of the disadvantages arise from not-adhering to a full Gold Standard, hence rendering much of its features to having only limited (nevertheless relatively better) impact on the economies.

Islam implements a Gold Standard where the gold and silver price ratio is determined by market demand and supply mechanisms. The ratio is left unrestricted to prevent differences in statutory and market prices, which can lead to hiding of currency whose price has risen and transfer to external markets (as happened to US (gold) and Britain (silver)). The cost of gold and silver depends on mining costs and demand for them against products and services. All discussions that apply to the uni-metallic standard also applies to the bi-metallic standard except that it enlarges the currency credit base.

The global economy is not exposed to sudden increases in circulation. The inability to issue unpegged currency eliminates (if not alleviates) long-term inflation, which is a constant feature of the Fiat monetary standard.

The full Gold Standard allows for adjustments for imbalance of payments without the need for intervention of the central banks. Import/export price adjustments and the fear that the state would incur loss of gold reserves if imbalances continued helps maintain discipline. This is contrary to how balances of payments

are realized via printing Fiat currency, thus disturbing the balance.

Importantly, due to the market driven prices and spontaneity in balance of payment adjustments, the full Gold Standard would protect the gold reserves of a country. This is because gold and silver would only move as prices for products and services, thus minimising supervision.

The implementation of a global Gold Standard does not come without its share of challenges, especially for countries that implement it in the presence of superpowers having larger reserves and capabilities. Notwithstanding, when implemented properly, these challenges are however more tractable than Fiat system or a partial Gold Standard. There are several policy options available to the state with respect to the asymmetry problem and its derivatives, which include:

- a. Program for self-sufficiency by reducing imports, to prevent further loss of gold and silver.
- b. Work to exchange goods imported with goods from the state, rather than gold and silver.
- c. Local transactions can be effected by several means of exchange, some of which may be a source of novel business models.
- d. Not fix the price ratio between gold and silver, to prevent flight of metal that is statutorily lower priced than by the market.
- e. The way in which gold is held, where strategic state property deposits could be partially decoupled from commercial or domestic accounts that form the credit base. This can insulate the internal money supply from balance of payments.

f. Neutralization of global currency fluctuations could be achieved by holding foreign reserves, which are to be used only or mainly for balance of payments and import/export.

g. Given the large raw resource base of the Islamic world, demanding gold repayment and possibility for sanctions are accessible options.

h. Given the geographical strategic positioning of the Muslim world, it is one of the most efficient locations for a gold centre.

i. The prospect of the Islamic world serving as a gold centre is aided by the fact that the state implements a strict Gold Standard, shows easy promise for it to become a popular reserve currency.

j. International conventions would only be signed where a genuine Gold Standard is respected.

k. Reciprocal transparency of gold reserves and cover ratios (to enable adjustments to balance of payments) can be encouraged by potentially imposing customs tax which could be estimated on level of potential exposure.

l. It would be a high priority strategic endeavour of the state to bring the world back to the full Gold Standard, and thereby prevent the exploitation of dominant states.

When the gold is left free from restrictions, an open market will be realized in a short period. All international currencies will assume steady exchange price in relation to gold, due to competitive pressures. The international dealings with gold will develop where-ever the payment of the prices is estimated by gold, which will be the preferred choice for valuation.



ARGUMENT 9: TRANSITION PROBLEM



Argument 9: Transitioning to a Gold Standard is seen as an insurmountable task. The use of the Gold Standard would it is argued disrupt the financial markets, causing chaos and havoc to the economy.

Rebuttal: When we consider that the Gold Standard is a system of stability without major cyclical effects, independent of government manipulation, devoid of inflationary fiduciary issue, currency debasement, international crisis and long-term balance of payments crisis – we are left thinking as to why indeed it would be such a difficult task to establish the Gold Standard, when the benefits are so manifestly profound.

Transitioning to a Gold Standard, in the eyes of many is seen as an insurmountable task – one that would involve convincing many stakeholders, the changing of public opinion as well as earning the conviction of the establishment. The use of the Gold Standard would it is argued disrupt the financial markets, causing chaos and havoc to the economy.

Popular Western economists are accustomed to denouncing the ‘terrible simplifiers’ who wreck everything by imposing simplistic and unworkable schemes. Our major problem, however, is precisely the opposite; mystification by Capitalists and the ruling elite of technocrats, who, whenever the call of the Gold Standard is raised, intone sarcastically about the dimwit masses who ‘seek simple solutions for complex problems’.

Well, in most cases, the solutions are indeed clear-cut and simple, but are deliberately obfuscated by people whom we might call ‘terrible complicators’. In truth, bringing back the Gold Standard is relatively straightforward and simple. It is the opposite of government controlled Fiat money, with its army of economists that cause invariable complications which wreck havoc on our economies, which should be seen with opprobrium and taken to task for leading us down such a blind path.

Plausible reasons for the difficulty of transitioning to a Gold Standard such as the availability of gold, managing supply, restrictions on growth, the cost of maintaining such a standard and so on, have been covered in the prior points in this paper. So when we consider that the Gold Standard is a system of stability without major cyclical effects, independent of government manipulation, devoid of inflationary fiduciary issue, currency debasement, international crisis and long-term balance of payments crisis – we are left thinking as to why indeed it would be

such a difficult task to establish the Gold Standard, when the benefits are so manifestly profound?

The only losers to the Gold Standard would be the corrupt governments and banking fraternity, who have long benefited from the manipulation of Fiat.

From the angle of government control, it had been the dream of past emperors and kings to increase their hoards of gold, which they often did through debasement only to precipitate their demise. Their modern day descendants though, could finally fulfil such wishes when gold was fully replaced by paper. Governments could spend recklessly and unsustainably, often in the form of empire building through the printing of money, with full knowledge that a stealth tax through higher inflation was being applied on the public. They would also be unaccountable; seeking comfort in the knowledge that only after their tenure in office would the effect of their excesses be felt.

In regards to the bankers and financiers who regard themselves as ‘Masters of the Universe’ (pumped up through multi-million pound bonuses), the fractional reserve banking system built on the foundation of Fiat money is what empowers them. When governments create money, the first recipients through the channel of central banks are the commercial banks. As these banks increase their ‘base’ money, so an inverse pyramid of credit forms, quickly dispersed to consumers seeking easy credit, and thus a boom period forms only to be popped into a devastatingly deflated bubble.

How to Achieve a Return to the Gold Standard

The return of the Gold Standard requires the removal of the reasons that led to its abandonment and the removal of the factors that led to its decline.

This would require the following:

- Stopping the printing of paper currency
- Restoring the dealings with gold currency
- Removing the custom duties on gold and all restrictions against its import and export
- Removing restrictions against owning, possessing, buying and selling of gold, and dealing with it in contracts.
- Removing restrictions against the possession of the major world currencies and making competition free between them such that they take a fixed price in relation to each other and in relation to gold, without state intervention by reducing or floating their currencies.

It was under Franklin D Roosevelt in the 1930s through emergency law that private gold ownership was prohibited for US citizens; this importantly was a crucial step in ensuring that the market for gold could not operate, since on a like-for-like basis Fiat cannot compete with the people's preference for gold. Whenever gold is left free, it will have an open market in a short period, and accordingly all international currencies will take a steady exchange price in relation to gold. The international dealings with gold will develop where the payment of the prices of goods contracts estimated by gold, takes place.

If these steps are carried out by one strong State, then its success would encourage other countries to follow-suit, which will lead towards returning the world to the Gold Standard once again.

ARGUMENT 10: IMPLEMENTATION PROBLEM



Argument 10: The gold and silver standard suffer from tendencies to devaluation by debasement to generate liquidity. This not only results in inflation but also takes the good money out of supply – an observation commonly known as Gresham's law.

Rebuttal: Islam disallows debasement securing monetary value of the currency. Modern technologies enable producing representative legal tender backed by gold/silver, which avoids this problem. Converse to Gresham's law, strong currencies will soon become preferred media of exchange, making the gold standard quickly resume its position in the world.

Gresham's law is widely stated as "bad money drives out good money". This statement needs some clarification as it has been used beyond its intended import. The more common observation is actually the opposite, i.e. the strong currencies drive out the weaker ones. Historically, the stronger currency has always dominated the rest, for example the Persian Daric, the Greek Tetradrachma, the Macedonian Stater, the Roman Denarius, the Islamic Dinar, Italian Florins/Ducats, Pound Sterling and the US Dollar. The precious metals won over others because they were more "dear" and efficient than other instruments in fulfilling the required functions of money.

The correct implication of Gresham's law phenomenon is related to debasement, i.e. bad money drives out good money if they exchange for the same price. This is a

simple theory of rational economic behaviour, where given choice in an economic transaction, people would part with cheaper rather than dearer commodities. The tendency for good coins to disappear would become pronounced if the government introduced debased or lightweight coins.

The erstwhile Islamic state faced similar issues. Ibn Taymiyyah critiqued the debasement of currency by Mamluk sultans in Egypt, which resulted in flight of good money abroad. Mehmed II is also reported to have repeatedly debased the currency to raise additional revenue for the treasury. Such large-scale debasement also led to inflation. Others have noted similar phenomena of bad money driving good money, but mixed it with ineffective mint and market metal ratios.



However depreciation can occur due to general wear, clipping and counterfeiting of the coins. This could be presented as a criticism if money in use is the metal itself. However it is common to see money supply composed of new and worn coins (some separated by centuries), all of which are accepted at face value. The important issue is whether excess money is issued. In other words if bad money is insufficient to fulfil the total money demand, some of the “good” money will have to remain behind to help. This is similar to the observation of having machines of different ages, people of different abilities and paper currencies of different crispiness working side by side at the same price or value.

Taking this one step further, we could explore the replacement of gold by a representative instrument such as paper. The new paper money will drive out an equivalent value of coins. John Stuart Mill analysed such replacements and concluded the circumstances under which the system breaks – “The substitution of paper for metallic currency is a national gain: any further increase of paper beyond this is a form of robbery”. Therefore it is not necessarily true that good and bad money cannot circulate together or good money circulates with a premium.

From the above discussion, the following points become clear:

- When a Gold Standard is implemented, it would be quickly adopted - driving out bad money from circulation.
- When paper/coin currencies are issued beyond real metallic reserves, it leads to debasement. When they get exchanged for the same price Gresham’s law applies, and good money will be driven out of circulation.
- Representative legal tender (paper or electronic) can be used matching the amount of bi-metallic reserves, which can avoid the discussion of debasement entirely.
- During transition periods, such as when money supply is increased or replaced, careful attention should be paid to the implications of Gresham’s law.
- Historical incidents of debasement were either unintentional or in breach of Islamic law, and occurred as abnormal episodes during the period of the Khilafah.
- The critique of debasement flies in the face of quantitative easing which is a feature of the Fiat monetary system.
- Debasement is disallowed in Islam, and will set the standard for security of monetary value globally.

CONCLUSIONS

"We have at this particular stage a Fiat money which is essentially money printed by a government and it's usually a central bank which is authorized to do so. Some mechanism has got to be in place that restricts the amount of money which is produced, either a gold standard or a currency board, because unless you do that all of history suggests that inflation will take hold with a very deleterious effects on economic activity... There are numbers of us, myself included, who strongly believe that we did very well in the 1870 to 1914 period with an international gold standard."

Alan Greenspan - October 2007

The 10 arguments presented in this paper are presented as the main impediments to a successful return to the Gold Standard. While we believe that the arguments are not as strong as often presented and have argued accordingly, the main arguments for the Gold Standard must also be made, and in their own right provide a compelling argument for the required radical change.

When governments and major banks have the unfettered right to print money, the result has sadly always been the same - significant increases in money supply and ultimately high inflation. This fact is the strongest argument in favour of a solid asset backed currency. As George Bernard Shaw in 1928 wrote:

"The most important thing about money is to maintain its stability... You have to choose between trusting the natural stability of gold and the honesty and intelligence of members of the government. With due respect for these gentlemen, I advise you, as long as the capitalist system lasts, to vote for gold".

This paper is about money, particularly the stability of money. It is worth positing a reminder of what real money is. As a medium of exchange it functions to facilitate trade, provide stability in transactions and not act as a hindrance to the functioning of the economy - an accusation all too often levelled at Fiat paper money, particularly with the spectre of money supply driven inflation.

The following summary by Richard Russell sets out the key requirements any society should expect from its medium of exchange.

Good money must have a number of unique characteristics.

- (1) It must be durable, which is why we don't use wheat or corn.
- (2) It must be divisible, which is why we don't use a Picasso painting or jade statues.
- (3) It must be convenient, which is why we don't use lead or copper or real estate.
- (4) It must have value in itself, which is why we don't use paper.
- (5) It must be transportable, which means that large values must be contained in a small area (a gold coin weighing only one ounce can be worth far more than fifteen hundred dollars).
- (6) It must have a long history of being accepted as a store of value. Gold was considered valuable as long as 5,000 years ago in the age of the Egyptians.
- (7) It cannot "disappear" or be used up in manufacturing as is copper and even silver. Thus, the gold coin that you have in your hand may have been part of Cleopatra's earrings centuries ago. Almost all the gold that has ever been discovered is still available in one form or another.
- (8) It must not be the liability of any sovereign nation, nor should it require governmental law to make it money. For instance Gold requires capital, talent, risk, sweat and courage to recover or to accumulate.

Note — It's possible that gem-quality diamonds can fit all the above characteristics but diamonds are not divisible, nor do they have a long history of being stores of value. [8]

As a medium of exchange, gold is universally accepted for the above reasons, yet governments have for one reason or another (often in times of global mistrust like WWI) suspended the use of gold and retrenched to a national paper currency. Slowly over time nations have come to accept paper Fiat currency and have almost imperceptibly failed to notice that the previously required asset backing for their money has been removed, enabling the banking system to print dollars, pounds, yen and the rest as they see fit.

This chart (by shadowstats.com) indicates the steady but significant increase in the money base of the US, followed by the violent increases corresponding with the 2008 financial crisis - which has yet to be resolved. It is no surprise that the US dollar has depreciated by 3,000 % compared to gold over the timeframe from 1971 when Nixon unilaterally declared the end of the Bretton Woods Gold Standard.

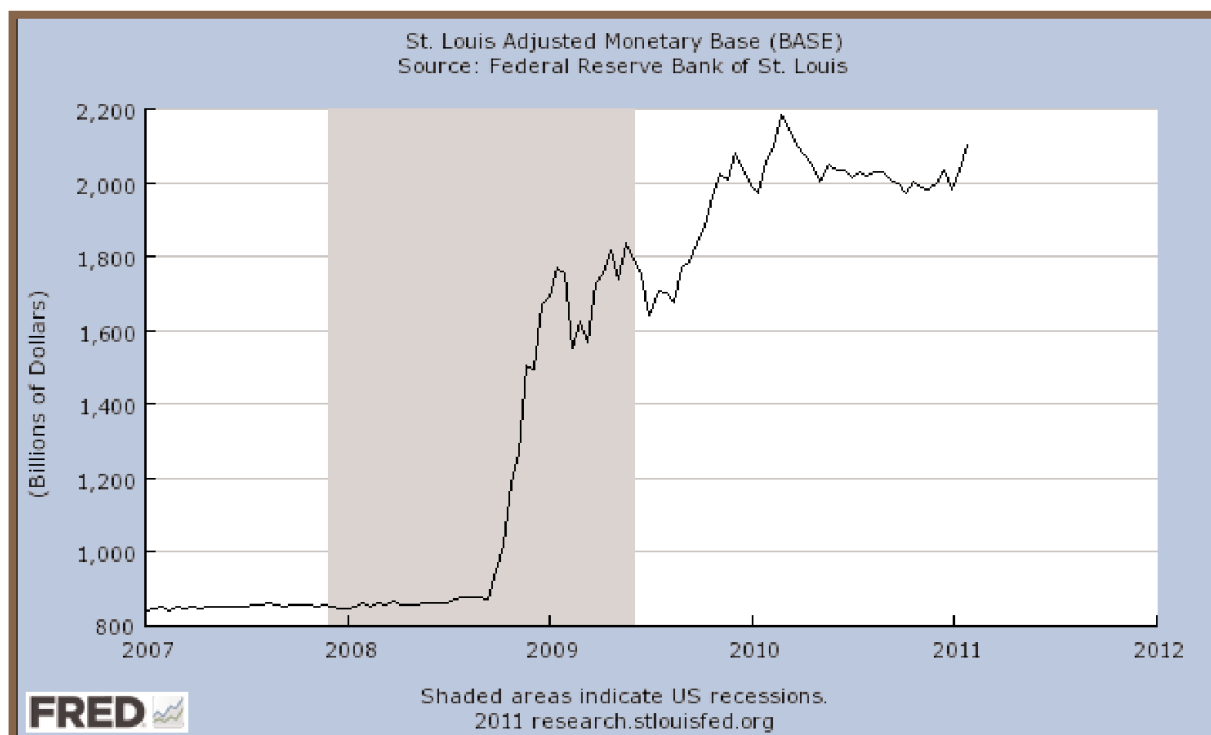


Figure 2 St Louis Adjusted Monetary Base (BASE). Source: [http://research.stlouisfed.org/fred2/graph/?s\[1\]\[id\]=BASE](http://research.stlouisfed.org/fred2/graph/?s[1][id]=BASE)

"In the absence of the gold standard, there is no way to protect savings from confiscation through inflation. ... This is the shabby secret of the welfare statist's tirades against gold. Deficit spending is simply a scheme for the confiscation of wealth. Gold stands in the way of this insidious process. It stands as a protector of property rights. If one grasps this, one has no difficulty in understanding the statist's antagonism toward the gold standard." Alan Greenspan, 1971

THE ISLAMIC ARGUMENT

The only system of governance that unequivocally insists upon the Gold Standard is the Islamic economy as applied by the Islamic State (Caliphate). In Islam a dual metallic standard with gold and silver is applied. No Fiat money will be issued by the state, and any paper currency must be 100% backed. The key features of the Islamic state's management of currency are the following:

1. The State maintains a dual metallic (gold and silver) standard (as stipulated in the Islamic texts – Quran and Hadith of the Prophet (peace be upon him)).
2. The State will not issue any currency that is not 100% backed by gold and silver. Fractional reserve banking is not practiced and not allowed.
3. Citizens may hold and use Fiat currencies from any country, but the official currency of the State is gold and silver.
4. All interest is forbidden; hence creation of credit beyond existent resources is curtailed.
5. Credit creation by banks including the State Treasury

(Bait al Mal) is forbidden.

Gold and silver are both ideal as mediums of exchange; they have intrinsic value (including jewellery and industrial use) are widely available, cannot be dominated (monopolised) and there is a regular, yet growing supply of them to meet the needs of growing economies. The annual increase in gold supply over many generations is approximately 2%.

Whilst the Shari'ah law does not forbid ownership of other (non gold or silver) currencies, the Islamic state will not operate any other currency standard, and the Fiat based systems where currencies are not backed by any assets at all is forbidden. Islam made all the rules linked to currency, linked to gold and silver in their capacity as a medium of exchange for all goods and services and as currency for exchange, both as coins and as ore. There is no restriction on the ownership of gold and silver and no fixed exchange rate between the two. A key element of the success of the Islamic currency system is Islamic rules forbidding the hoarding of wealth.

"And let those who board gold and silver and do not spend them in the way of Allah know that a severe and painful punishment is awaiting them"

[Translated Meaning Quran 9:34]



This injunction coupled with a taxation system focused upon wealth rather than income tax encourages the circulation of wealth and investment. When wealth is not hoarded or left within a restrictive banking system (that fluctuates in lending policies as the business cycle fluctuates), the impact is a tremendous velocity of investment across all sectors of the economy.

In a Hadith Qudsi (narrated by Nawawi) the Prophet (pbuh) said: **“Spend oh son of Adam, and I will spend on you”**.

The combination of prohibiting banks from trading with interest, and acting as the sole middle man in effectively controlling the money markets, together with the incentive for investment (zakat tax is raised on unused assets together with the prohibition of hoarding) has meant that the Islamic society benefited from high and consistent investment. These disincentives to take wealth out of circulation have consistently been applied over hundreds of years and massively softened the impact of business downturns, which usually resulted from natural shocks such as climactic disasters. The current liquidity crisis post the 2008 financial crisis is as much about those that are taking their cash and wealth out of circulation as the high levels of losses that banks have been experiencing and credit de-leveraging that have caused massive retrenchment.

Fiat currency systems are at the mercy of the banking system that will determine the flow of cash according to their estimation of demand and risk. In times of greatest need for investment and loans, we have often seen the

banks in a period of retrenchment and hence the available cash is restricted. Islam in contrast to this provides a consistent non-interest environment in which there is no incentive to take money out of circulation.

“In order that it does not merely make a circuit amongst the wealthy”

[Translated Meaning Quran Al-Hashr 59: 7]

The Islamic system provides a compelling investment model, and there is no basis to suggest that the Islamic economic system does not promote investment. The truth is that Islam encourages business and investment, but does not encourage interest-based investments, which ultimately restricts the flow of wealth around the economy. Allah (swt) distinguished between this when He said: *“... they say, “trade is like usury” but Allah has permitted trade and has forbidden usury”*

[Translated Meaning Quran Al Baqarah: 275]

Stability in the economy is built upon investments only being permitted in real products or business that makes wealth generation a result of work and profits, not debt. The currency system also reflects this with money (gold and silver) being also tangible and real.



BENEFITS OF THE GOLD STANDARD

If the benefits of the Gold Standard were to be compared with the Fiat standard, it would be inevitable that the Gold Standard would become a global standard. Throughout the history of money and up until the First World War, the whole world operated the gold and silver standards. No other standards were known to the world until then. However, when the colonialists mastered the various styles of economic and financial imperialism, and began using currency as a means of colonialism, they established different monetary standards. They considered bank deposits and non-exchangeable banknotes, which had no reserve of gold or silver, as money, along with gold and silver. Then in time the gold/silver standards were completely dropped.

Some of the key benefits of the gold/silver standard are:

1. The gold basis necessitates the free circulation, import and export of gold, which leads to monetary, financial and economic stability. In this case, transactions of exchange would only originate from foreign payments to meet the cost of commodities and the salaries of workers.
2. The Gold Standard ensures the stability of exchange rates between countries, and the stability of the exchange rates in turn leads to a boom in international trade, for

traders would no longer fear the uncertainty of exchange rate instability.

3. If the Gold Standard was employed, central banks and governments would not be able to expand the issuance of banknotes, for as long as the banknote remains non exchangeable with gold at a fixed rate, the authorities concerned would fear that if they exceeded limits in issuing banknotes, the demand for gold would increase and they would not be able to meet this demand. Therefore, they would always tend to maintain a reasonable ratio between what they issue in terms of banknotes and gold reserves.

4. Each of the currencies used, all over the world would be fixed by a specific amount of gold. As a result, the movements of commodities, money and people from one country to another would be easier, and the problems of hard currency would disappear.

5. The Gold Standard would help each country preserve her gold, for there would be no gold smuggling from one country to another, and countries would not need to exercise control in order to protect their reserves.

Today we have witnessed that people's ability to save has been diminished over time, despite the fact that we are earning more than ever. The purchasing power of money has declined in real terms as the value of assets generally remains the same, but the amount of money required to buy hard assets (land, property, goods) is increasing. In general terms people today save very little compared to people only two decades ago.

Islam put the emphasis on wealth and seeks to guard people's wealth by ensuring that its policies do not devalue money. The Islamic system does not allow the printing of money as it pleases since all its currency must be 100% backed by gold or silver reserves. This means that the currency itself has a value relative to all assets. So this means that the value to the consumer of land will always remain in proportion to the value of gold. This creates stability and confidence in the value of the State's currency.

Growth in the Islamic economy is not viewed in terms of mere increase in GDP compared to previous years, but is a more holistic and profound measure of how transactions in society have improved in terms of quantity, quality and equity. Hence quantitative GDP growth that is sought by nations today, which leads to a declining way of living, is not seen as growth, but rather as a decline. To grow is a natural instinct in people; and enhancing it is a problem of science, which is never in short supply. However enabling sustainable macro growth without booms and busts is a problem for the economic system, which can only be addressed by Islam. Although many economies are now facing price deflation for goods

and services, a massive wave of monetary inflation is being stored up for coming months and years. The strict application of the metallic money standard as practiced in the Islamic system is the only way to avoid this when there is such little control over the central bankers of the world.

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HIZB UT-TAHRIR

Hizb ut-Tahrir (the Liberation Party) is a global Islamic political party established in 1953 under the leadership of its founder - the scholar, thinker, politician, and judge in the Court of Appeals in Al-Quds (Jerusalem) - Taqiuddin an-Nabhani.

The current leader of the organisation is Ata ibn Khaleel Abu Rushta. In the Muslim world, Hizb ut-Tahrir works at all levels of society to restore to the Muslims a means of living an Islamic way of life under the shade of the Khilafah State (Caliphate) adopting an exclusively intellectual and political method.

Exclusive to the Muslim world, our political aim is the re-establishment of the Islamic Caliphate as an independent state - having an elected and accountable ruler, an independent judiciary, political parties, the rule of law and constitutional rights for minority groups. Citizens of the Caliphate have every right to be involved in politics and accounting the ruler - as the role of the ruler (Caliph) is that of a servant to the masses, governing them with justice.

In the West, Hizb ut-Tahrir works to cultivate a Muslim community that lives by Islam in thought and deed, whereby adhering to the rules of Islam and preserving a strong Islamic identity. The party does not work in the West to change the system of government, but engages in dialogue and debate with Western thinkers, policymakers and academics to show the strength of Islamic ideas, so projecting a positive image of Islam to Western society.

The party is active throughout the Middle East, Central Asia, Indonesia, Malaysia, Africa, Afghanistan, Pakistan and Bangladesh, and also has a presence in Europe, Australasia and the Americas.



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