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CONCEPTUAL PAPER

The Substitution Dilemma In Islamic Finance: Contemporary Muslim Legal Thought on the use of Paper Money

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Abstract - Gold and silver became the most widely accepted and circulated form of money in the medieval world. Even though paper money was introduced, state banks continued to store their equivalent in gold. In 1971 the US government abolished the Bretton Woods system and exchanged with the floating or fiat economy system which soon became the standard currency system worldwide. Many economies felt compelled to adopt the new US currency system because of the strength of the all-dominating American dollar and criticism was sparse. Disappointingly, no Muslim government produced legal rulings (*fatwas*) which rejected the legality of the fiat system and demanded the return to gold and silver backed currency. The single fatwa issued in Saudi Arabia in 1985 concluded that paper currency had completely replaced gold and silver and that all previous Islamic legal rulings issued on gold and silver were now applicable to paper currency. This paper study critically and evaluates the consequences of the Muslim intellectuals and *Fiqh* Academies' approval of substitution of gold and silver by banknotes on the Muslims and their nations.

Keywords : Substitution; Dilemma; Islamic finance; Contemporary Muslim; Legal thought; Paper money

Introduction

Money (*'Umlah*) is defined as anything that has value and serves as a means of exchange which is durable and accepted as currency by the public. Historically, gold and silver monetary system had been plausible system of exchange in human history. However, it has suffered numerous degradations from generation-to-generation (Hossein, 2007; Bernstein, 2008). Despite its unpleasant existence it survived until early 1970s when it was finally crucified by the US government. The world's currency exchange system deviated from Bretton Woods' system of exchange in the early 70s when the US President Nixon unilaterally abolished the 1944 established gold back exchange system (Bretton Woods' system of exchange) followed by declaration of floating exchange system. This was done without knowledge of any other government around the world. The US allied such as Britain, Japan etc. were only promised better future by the US government (Hossein, 2007). The world was silent on it, not even the EU strived to question the sudden change. The only response was from the Middle-east (subsequently Muslim countries) which could be considered as scrawny action.

The action only recognized the reality of change of exchange system form Bretton Woods to floating exchange regime. Thus, Muslim intellectuals have to find a way to blend the floating system together with Islamic values, principles, and culture. They realized there is inverse relationship between floating exchange system and Islamic monetary system. However, the Islamic intellectuals found no way out of this problem except turning over the Islamic legal rulings to justify the replace of banknotes (fiat money) of gold and silver money or gold backed money.

For around five-year there was no action from the Muslims until 1976 when they held the first Islamic economic conference at Jeddah. For the sake of brevity, most of the conference papers pointed out the incompatibility of the fiat monetary system (Zarqa (1976; Uzair, 1976; Abu Saud 1976; Al-Jurhi 1976; Chapra 1976; Kahf 1976), however, some such as Faridi (1976) and Gilani (1976) contended on the comingling of *halal* and *haram* transactions. Above all, the resolution recognized that the fiat monetary system come to stay forever and serve as replacement for the gold and silver monetary system. Thus, banknotes and its types replaced gold and silver. Furthermore, Islamic legal rulings that are divined rulings on gold and silver are transferred without adjustment to the new fiat monetary system i.e. the banknotes. Their argument was on the ground that banknotes and gold and silver were same in all forms (Ahmad, 1976)

Subsequently, the *Fiqh* Academy of Makkah was founded in early 1980s (Usmani, 1997) evaluates the 1976 Muslim intellectuals' decision from Islamic jurisprudent perspectives and found that banknotes have replaced gold and silver money in all attributes and form, specifically intrinsic nature of gold monetary system (*Fiqh* Academy Resolution 1985-1988). Similarly, the *Fiqh* Academy affiliated to Organization of Islamic Conference (OIC) established after that of Makkah, re-evaluated the scenario and concluded that banknotes have replaced in all shapes and manner (*Fiqh* Academy OIC Resolution 1987-1988). Likewise, *Fiqh* Academy of India founded in 1989 concluded that fiat money i.e. banknotes have substitute gold and silver in all manner. These three juristic institutions concluded that all Islamic legal rulings on gold and silver are automatically transferred and applied to banknotes (*Fiqh* Academy India Resolution, 1989-2004).

Based on these discussions this study tries to unfold the genesis of the problems facing the Islamic financial system in today's contemporary business world. It also states the consequences that institutional fatwa errors can descended on the Muslims and their nations. This study is arranged as follows: the next section discusses the contemporary intellectuals and jurists' reasons for replacement, followed by the consequences of the Jurists' legal rulings of replacement on eco-political, intellectual corruption, finally conclusion and recommendations.

Justification of Contemporary Muslim Intellectuals and Jurists on Substitution

The Muslim intellectuals' conclusions indicated that they were aware of the danger ahead while some were based on western/capitalist economic view. For those who understood the dare consequence provided no solution other than stating the problem. For no reason one should accept their incompetent or disappointing views based on their level of exposure to historical background of both gold and fiat monetary systems. They are aware of the antecedents that made-up the fiat money and were fore told in the *Qur'an* and *Sunnah* of consequences associated with this system. Nevertheless, the Muslim governments have shown some sort of skepticism about their resolution and founded experts' body in Islamic jurisprudents i.e., *Fiqh* Academies to justify the intellectuals' resolution.

Members of these bodies were highly respected and erudite Islamic scholars selected from all around the world. Most of them have reached the level of Mufti who is regarded as capable of passing Islamic legal rulings on matters that have no direct injunctions from the Qur'an and *Sunnah* based on his professional insights. Disappointedly, these professional concluded that banknotes have replaced gold backed monetary system in all forms.

Nonetheless, there were differences in the reasons presented by the *Fiqh* Academies i.e. *Fiqh* Academy of Makkah argued that banknotes replaced gold monetary because it is "unit of price" like gold money and were "separate genes". However, the *Fiqh* Academy affiliate to OIC broadly defined it as applied to currency exchange, dormant partnership etc.

Based on the above, the gap is transparent. It shows that, there were some sort of divergent views concerning the replacement. For both side, there seems to be lack of understanding about the replacement. To the researcher's understanding the might have result as majority of the scholars might have not comprehend well the conventional financial system. Similarly the intellectuals might have little or not so verse in Islamic jurisprudent. Thus, this great gap between the two groups might serve as loophole for the unforeseen comprehensive problem facing the Islamic financial institutions today consequently on the Muslim communities around the world.

Based on the above insights the researcher identifies some consequences of these errors on the Muslims and their nations as discussed bellow.

The Consequences of Contemporary Legal Rulings on the Replacement of Gold Currency

The substitution of gold with banknotes has negative consequences for Muslim economies all around the world. Having their local currencies tied to a U.S. Dollar dominated global economy renders them vulnerable and dependent. The disadvantages of such an arrangement express themselves in many different ways, such as follows.

The Danger of Eco-Politics

The negative effects of the fiat economic system with a floating exchange rate can be observed in all developing countries to which most Muslim countries belong. Not one Muslim country can be considered as developed based on its currency strength and economic viability. Muslim countries continue to occupy the bottom list of world economies. Although they are all members of international organizations and thus partake in the global economic decision making process and trade through alliances in world trade organizations, multinational companies, etc., they continue to play very minor roles in sophisticated, worldwide machinery which maintains an entirely capitalistic and interest-based financial hegemony. Muslim economies are compelled to purchase foreign currencies through agencies if they want to have a share in global business.

Muslim economists, jurists, and governments failed to insist to re-instate the gold *dinar* in 1971. It is therefore high time that Muslim political leaders realize this mishap and begin to lay ground for the return of gold *dinar* system of exchange or transactions to gain independence from the U.S. Dollar. All present dealings of Islamic financial transaction are built on the wrong basis – namely foreign currency -- which renders in return all transactions and exchanges into interest-embedded transactions, an illegal practice according to Islamic law. Modern 'Islamic banking' also includes buying and selling of currencies which has been coined 'Islamic currency swaps'. Likewise, other transactions deemed "permissible" in Islamic finance are such practices as "double sales in one fold" which have been introduced on the false and wrongful assumption that banknotes have to be considered equal to gold and can therefore substitute it. According to Bianchi (2007), every conscience must weigh the likelihood of error and its consequences for worldly fortunes as well as immortal souls. This is a weighty task for today's Muslim jurists and financial experts. A task they may have taken too lightly and too prematurely.

The Danger of Intellectual Corruption

If the foundation of a system is defective, whatever is built on it will also be defective. If the entire modern Islamic financial system is based on an erroneous claim, namely the equality and identical nature of gold and banknotes, then all practices derived from it and developed in accordance with it, are also erroneous. Based on the resolutions of the *Fiqh* Academies which accepted the U.S. floating system uncritically together with other *Shari'ah* advisory boards of Muslim financial institutions, the entire Islamic financial system which is supposedly *Shari'ah* compliant, has been criticized and questioned by non-Muslim experts. Studies on the Islamic financial system done by Muslim "experts" with vested interests do not suffice to present the Muslim public with the true picture of its success. It is a most distressing sign of a lack of sincerity and self-criticism of Islamic finance that well-founded critique seems always to be voiced from non-Muslim scholars who are capable of seeing it as what it really is, and not as what it appears to. In his analysis of Islamic economics and finance Bianchi (2007) states:

> *"The founders of Islamic economics always insisted that they were creating a more just alternative to modern capitalism, not a mere imitation with religious window dressing. Their heirs are increasingly critical of would-be Islamic bankers who seem eager to play by Western rules and who claim to observe the Shari'ah's ban on lending money at interest while employing countless legal fictions and multiparty transactions that violate it in practice and spirit. The most powerful Muslim indictment of today's Islamic banking is that it has become addicted to legal formalism and contractual subterfuge while losing sight of the higher goals and intentions (maqasid) that law and economics should promote… Many commentators urge those in Islamic finance to add their voices to the chorus of Western reformers trying to build a new type of world capitalism that values social solidarity and egalitarianism… integrating Islamic banks into the global financial system can "Islamize" world capitalism at least as much as it Westernizes Muslim economic behavior …"*

The above statement is enough to make us realize the grave extent of Muslim self-deception. It is a most disturbing and embarrassing truth that non-Muslim economists have to remind Muslims of the true nature and purpose of Islamic economy and finance. These non-Muslim economists have not been deceived. Quite plainly they voice their disapproval of an 'Islamic' finance system whose foundations are not Islamic yet. The 5% *haram* 'unlawful dealings' allowed in trading Islamic shears falls nothing short of hypocrisy. Other stock exchanges in the U.S. like Dow Jones have allowed up to 33%. All this has no basis in Islamic law and is simply unlawful (*haram*). Muslim economists and financial experts who are aware of this blatant deception in disguising something unlawful in the form of something lawful have to voice their criticism and stop silently condoning such practices. A truly Islamic system of finance is not only a possibility but also a necessity. The Muslim world has yet to prove that Islamic finance according to the *Shari'ah* is indeed superior to all other systems and does indeed help to create a more just economic world order, a viable alternative to the present capitalist system.

A system of truly genuine Islamic transactions which fully comply with the *Shari'ah* has yet to be developed and put to the test. Muslim finance cannot be directed by corporations and individuals who attach the label "Islamic" to un-Islamic and unlawful dealings in order to attract Muslim investors. Islam is not a 'marketing strategy' and those who consider it no more than that, have obviously ceased to believe in it. The Prophet {peace be upon him} was reported to have said "There is no faith (*Iman*) for he who has no shame".

Bianchi (2007) spares no one, especially not those Muslim *Shari'ah* 'experts' of today who lead the numerous financial advisory boards and committees of today's Islamic financial institutions when he writes:

> *"…Filling this power vacuum has created a bonanza for the "financial Ulama' - a narrow class of Islamic scholars with a credible claim to knowledge of both classical Shari'ah and modern business practices. Many ulama serve on multiple boards simultaneously. The same religious scholars frequently advise competing businesses,*

government regulators, private entrepreneurs, Muslim-run companies in their own regions, and non-Muslim-owned multinational corporations headquartered in Europe, North America, and the Far East. The financial Ulama often serve their clients not only as outside auditors, but also as permanent consultants or even as regular employees. These inherent conflicts of interest and temptations for self-dealing compromise advisors and clients alike….Islamic finance has always been a fluid blend of business, politics, and religion, adapting to cultural differences and changing tastes…"

The above criticism of Bianchi (2007), a Westerner and non-Muslim may offend Muslims who may already expect him to show an unjustified anti-Islamic bias and find fault in Islamic finance. On the other hand, his observations are correct and based on hard facts and evidence, not on preconceptions. Bianchi sees what he is offered to see and observe in Islamic financial institutions.

It is certainly justified at this point to question the ultimate purpose and the underlying political reasons which brought about the establishment of the first *Fiqh* Academy in Makkah which had initiated the error. Interesting to note also is that to other *Fiqh* academies were founded later – independent of the first, namely the *Fiqh* Academy Affiliated to OIC and the *Fiqh* Academy of India respectively. One would have expected for Saudi Arabia to accommodate the sister-organizations of other Muslim countries and welcome them as equal members into their *Fiqh* Academy but that was not the case. The *Fiqh* Academy Affiliated with OIC and that of India were subsequently recognized by political leaders of Muslim countries.

It is incumbent on modern Muslim scholarship to remind ourselves and all those involved in the practical realization of Islamic law and Islamic values that *Allah* and His Prophet (peace be upon him) will wave war against any consumer, administrator or provider of interest-based profit (*riba*). The present representation of *riba* dressed in colourful "Islamic" terminologies offered by Muslim banking and financial institutions must be put to a halt and the path reopened for a new beginning of Islamic finance can only be achieved by the creation of a sound and lawful basis.

Conclusion

The substitution of gold with banknotes is impermissible in Islamic law and should not be part of any Islamic discourse. As long as the exchange rates are fixed by an exclusive group of people to the exclusion of the rest of the world, rates will continue to be determined in their favour. If Islamic countries and their financial institutions can unite and also determine the exchange rate of their currency, then currencies could be exchanged more equitably. However, the ultimate solution to this problem could lie in the return of a gold-based system. It could serve as a reliable means of Islamic financial transactions such as asset-backed businesses whose assets are durable in value. The suggestion that strong currencies should be represented in gold, such as the U.S. Dollar, the British Pound Sterling and the Euro, while other weaker currencies should be represented in silver, such as the Saudi Riyal and Malaysian Ringgit is unacceptable because such a system would only consolidate present dominating powers. Muslim jurists and scholars of finance should decide upon a new *ijtihad* in order to return to the original spirit and purpose of Islamically sound transactions. The present inequalities in the global economy cannot be redressed under the governance of the fiat system because it is a financial system running on debts and interest. The financial powers which control these international debts control the economies of the debtors and ensure the dependence and slow growth of these countries. There is no room for window dressing and replication anymore. If the Muslim world is ever to propose to the world a new and more just and equitable world order, it is only an equally just and equitable financial and economic system which conforms to the tenets of Islamic law and values which can achieve this objective.

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