<u>Talking Points for YAB Perdana Menteri</u>

<u>Gold Dinar</u>
<u>(Seminar on 29 – 04 – 2002)</u>

Why the term"Gold Dinar" instead of "Islamic Dinar"?

In recent literature on this subject, The term *Islamic Dinar* and the term *Gold Dinar* have been used interchangeably. The term *Islamic Dinar,* is, however, a unit of account of the Islamic Development Bank (IDB), where the value of one Islamic Dinar is equivalent to one SDR (Special Drawing Ringgit). It is, therefore, preferable, for the purpose of our discussion, to use the term *Gold Dinar* to distinguish it from the *Islamic Dinar* of the IDB. More importantly, the term *Gold Dinar* is a neutral term and, therefore, will facilitate the implementation of our proposal with non-OIC countries as well.

What is the role of the Gold Dinar?

The proposed Gold Dinar will not replace the domestic currencies. The domestic currencies (e.g. Ringgit) will continue to be used for domestic transactions in the respective countries. The Gold Dinar will be used only for **external trade** among the participating countries.

The Gold Dinar will not exist in physical form. It will merely be defined in terms of gold. For example, if one Islamic Dinar is equivalent to one ounce of gold, and the price of one ounce of gold is today at US $290, then the value of one Islamic Dinar will be US$290 or equivalent in other currencies, on the basis of the prevailing exchange rates.

The actual settlement for trade can be by way of the transfer of equivalent amount of gold or the payment of an equivalent amount in US dollar, Euro, Yen or any other currency. Where the transfer of gold is used, it will not be a physical transfer of gold from one country to another, but a transfer of beneficial ownership in the gold custodian's account.

How will the Gold Dinar be used?

The Gold Dinar will be used initially, for settlement of trade with countries with whom Malaysia has already signed bilateral payment arrangements (BPAs). Eventually the BPAs will be converted to a multilateral payments arrangement (MPA), with the participation of as many countries as possible. The following is an illustration of how these arrangements work:-

Bilateral Payment Arrangement (BPA)

- Two countries, say Malaysia and Saudi Arabia, sign a bilateral payments arrangement, under which trade balances will be settled every 3 months.
- The trade will be denominated in Gold Dinar.
- The value of one Gold Dinar is defined, say, as one ounce of gold.
- The Malaysian exporters will be paid in Ringgit by Bank Negara Malaysia on the due dates of exports, based at the Ringgit/Gold Dinar exchange rate prevailing at the time of the export. Bank Negara will then debit the Saudi Central Bank's account. Similarly, the importers will pay Bank Negara the Ringgit equivalent of their imports.

- The Saudi Central Bank will do the same for its exports and imports.

- Say, at the end of the 3 month's cycle i.e. on March 31, the total exports from Malaysia to Saudi Arabia is 2 million Gold Dinar and the total exports of Saudi Arabia to Malaysia is 1.8 million Gold Dinar.

- Therefore, for that particular 3 months cycle ending on March 31, the Saudi Central Bank will pay Bank Negara 0.2 million Gold Dinar. The actual payment can be by way of the Saudi Central Bank transferring 0.2 million ounce of gold in its custodian's account, say, in the Bank of England in London, to Bank Negara's account with the same custodian or can be in US dollar, Euro, Yen or any other currency based on the exchange rate against Gold Dinar on March 31. The important point to note here is that, under this mechanism, a relatively small amount of 0.2 million Gold Dinar is able to support a total trade value of 3.8 million Gold Dinar. In other words, we optimise on the use of foreign exchange. Even countries that do not have a large amount of foreign exchange reserves can participate significantly in international trade under this mechanism.

Multilateral Payment Arrangement (MPA)

- The MPA functions in a similar fashion as the BPA, but it involves many countries and is, therefore, more efficient than BPAs.

- To illustrate the efficiency of the MPA, lets assume that there are 3 countries involved, namely **Malaysia, Saudi Arabia and Egypt**.

- Let us assume that the volume of trade between Malaysia and Saudi Arabia was the same as in the example with BPA, and we add the additional trade of these two countries with **Egypt,** as follows:-

(Gold Dinar – million)

Export to	**Malaysia**	**Saudi Arabia**	**Egypt**	**Total Export**
Malaysia	X	2.0	1.5	3.5
Saudi Arabia	1.8	X	2.0	3.8
Egypt	1.7	1.7	X	3.4
Total Import	3.5	3.7	3.5	**10.7**

- In the example above a total of 10.7 million Gold Dinar of trade takes place among the 3 countries, with a net payment of only 0.1 million Gold Dinar as follows:-

Islamic Dinar (million)

	Export	**Import**	**Net payment**
Malaysia	3.5	3.5	Nil
Saudi Arabia	3.8	3.7	+ 0.1
Egypt	3.4	3.5	- 0.1

- **In other words the only payment required is for Egypt to pay Saudi 0.1 million Gold Dinar, but the total value of trade among the 3 countries is 10.7 million Gold Dinar.**
- **It is also possible to refine the mechanism further, whereby the credit or debit outstanding at the end of each quarter can be forwarded to the subsequent quarters and final settlement is made only at the end of the year. The advantage of this refinement is that a net import position for a country during a particular quarter may be off-set by a net export position in the subsequent quarter, so that for the year as a whole, the payment flows are minimised. However, some countries could turn out to perpetual net importers, and the net import figure could balloon-**

up at the end of the year. To overcome this problem, a formula could be devised to cap the amount of debit position to be carried forward to the subsequent quarters. Any amount in excess of this limit will have to be settled at the end of the quarter itself.

The advantages of using the Gold Dinar in promoting trade among OIC countries, in the context of BPAs and MPAs, is very obvious from the illustrations above. Two issues remain to be answered:-

(i) **Can the Gold Dinar serve the same purpose outside the BPAs and MPAs?**

(ii) **Can the BPAs and MPAs serve to promote trade among developing countries without the creation of the Gold Dinar?**

It could be difficult, at least for the time being, for the Gold Dinar to be used effectively outside the BPA/MPA mechanism. Since the payment for trade denominated in Gold Dinar can be settled either by the transfer of gold or by payment of equivalent amount in US dollar, Euro, Yen or other currencies, it could be cumbersome, at least initially, to use the Gold Dinar on a **daily basis** to settle trade payments.

On the issue of whether there is a need for the Gold Dinar, if the BPAs and MPA themselves could achieve the same objective, it is true that the BPA/MPA arrangements, on their own, are useful in promoting trade and in optimising the use of US dollar reserves for trade. However, there would still be a demand for US dollar for the settlement of the net balances. Attempts to diversify the currency of settlement away from the US dollar to Euro or Yen has not been successful. More than 75% of the international trade is denominated and settled in US dollar. In the case of Malaysia, the figure is 85%.

Under the proposed Gold Dinar model, while some of the settlement of the trade denominated in the Gold Dinar may still be in US dollar, there is a better prospect that the bulk of the settlement will be by way of transfer of gold or payment in Euro or Yen, given that the **currency of denomination of trade is no longer the US$ but the Gold Dinar.** At present there is no difference between the currency of denomination and the currency of settlement. Both are mainly in US dollar. The question may be asked: **Why is there a need to dilute the currency of settlement function of the US dollar?** The natural and inherent demand for US$, in the context of its function as virtually the sole currency for the settlement of international trade, contributes to the instability of currency market during times of crises. It is also not wise for the entire international financial system to depend on the currency of one particular country.

Vulnerability of external reserves

It may sound strange, but it is true that a favourable balance of payments is not necessarily favourable. This is due to the fact that, by definition, a favourable balance means that the country has exported or given away more in real goods and services than it has imported or received. The so-called surplus is represented by payment in foreign exchange, i.e. money held in some foreign country. In other words, the external reserves representing our national savings also represent a form of lending money to the countries in which the savings are deposited, whether in the form of bank balances or some other financial instruments.

By so lending, the developing countries have not only allowed the rich, developed, reserve currency countries to enjoy the fruits of our labour, talent, intellectual capital, natural resources, and sacrificed consumption – we have also provided the depository countries with the resources to finance the expansion of their own companies and the growth of their own economies. We welcome investments from abroad, with sometimes undue and abject gratitude, when, ironically, some, at least, of the *foreign* funds would have been recycled from our own savings.

Let us not forget that the national savings of the developing countries provide a significant, even if not major portion, of the pool of funds which constitute the foundation of the international capital markets centered in the *reserve currency countries.* The more we retain our savings in those *reserve currency countries,* the more we *empower* them to wield their financial muscle, often with arrogance and disrespect and insensitivity. Unfortunately, too, by providing them with some of the resources to finance the growth of their armaments industries and develop military equipment, we have also enabled them to flex their military muscle and to take unilateral actions with impunity.

We need to be vigilantly aware that, when we accept payment from foreign buyers of our goods and services and then put the money back with their bankers, the foreigners as a whole would not have paid us anything. These indirect credits mean that they, as a group, could continue ad infinitum to take more real goods and services from us than we from them. We are effectively helping to maintain and even enhance their standard of living, while holding back on the standards of our developing countries.

The developing countries must come together to help each other to grow and develop, by buying and selling more from each other and minimizing the use of the currencies of the developed countries for

settlement of the intra developing country trade. We should use our surpluses to finance each other. This is the ultimate objective of the Gold Dinar proposal.

It was an ominous portent of what could be, when the world saw how long queues were formed outside the banks in Argentina, because the authorities were compelled to restrict the withdrawal of funds from domestic banks by their customers. Those funds were the savings of their own citizens in their domestic currency!

With the unilateral decision of some countries to freeze the bank accounts of alleged terrorists, including long-established charities, it is not inconceivable, however unlikely it might appear, that the official reserves of countries, which are deemed by the "host" country to be threatening or otherwise sufficiently undesirable, could also be blocked by such unilateral action. It is also not difficult to imagine the harsh economic, political, and social repercussions of such denial of access to their hard-earned savings on the victimised countries. Victimised because there is no effective appeal to independent arbiters who can enforce remedies. The severity of the consequences would render the saver countries vulnerable to blackmail and probably suppress the expression by these countries of any opinions critical of the depository countries. The supplier of funds would be at the mercy of the keeper-and-user of the funds!

Recent history has shown that the unwritten rules of decorum, integrity, and honour are now subservient to the self-extended "right of self-defence" of the high and mighty. Even treaties in black and white are being abrogated.

Gold Dinar and Unity among OIC countries

While the *Gold Dinar* mechanism will apply to all developing countries, an important objective of the Gold Dinar proposal is also to bring about greater unity among the Islamic countries. The underlying basis of this greater sense of unity will be trade.

There is a famous Chinese saying that the journey of a thousand miles begins with a first single step. I do not want to exaggerate, but if we can succeed in increasing substantially the volume of trade among the OIC countries, the rest will follow. Trade could be the initial first step in the proverbial journey of a thousand miles.

The scope for increasing trade among the OIC countries is tremendous, and should pose no problem for us, since Islam is closely related with trade. Islam was born in Mecca, which, at that time, was the centre of trade in the Arabian Peninsular. When Islam took root in the Arabian Peninsular, trade was the main vehicle for dakwah activities for the spread of Islam from Andalusia in Spain to the Cape of Good Hope in Africa and to the Malay Peninsular. It is a fact that the volume of trade among Islamic countries, before the Western colonization began, was at a very healthy level.

However, when the Islamic countries began to be colonized by the West, trade among Islamic countries began to deteriote. The colonized Islamic countries were ruled with the objective of supplying raw material to satisfy the needs of the Industrial Revolution that was taking place in the West at that time. Not much has changed since then, although the Islamic countries have now achieved independence.

The continued dependence of the Islamic countries on the West can be illustrated by the following:-

(i) The intra OIC trade is only 12% of the total trade of the OIC countries. In other words, the trade of the OIC countries with the non-OIC countries is 8 times the size of the intra-OIC trade.

(ii) The total volume of the trade of OIC countries is only 7% of the total international trade, although 60% of the natural resources of the world are found in the OIC countries.

(iii) Lebanon and Turkey export butter to Belgium, the United Kingdom and some other European countries, while Iran, Pakistan and Syria import butter from Europe.

(iv) Egypt is a big export of textile, but Algeria, Indonesia and Iran purchase textile from Europe.

There are many other such examples. IF we can start to trade among ourselves, without using the Western countries as intermediaries, we can substantially increase the volume of such trade based and bring about greater prosperity among the OIC countries. This will create a virtuous cycle.

From trade to investment is only a short step. We can use the surplus of the richer OIC countries to assist by way of long-term loans in the building of infrastructure in the less developed OIC countries. Infrastructure, in term of roads, railways etc, as I see it, is a critical necessity for growth and development of a country.

Effect on the West

The growth and prosperity of developing countries, triggered by the greater volume of trade among themselves, need not be a disadvantage to the West. If the developing countries achieve prosperity and political stability, this will enable the West to sell more goods and invest more in these countries. The process I have described is not a zero sum game. The gain for the OIC is not a loss for the West. It can be a gain for both. But, the new scenario will be one of the mutual respect, tolerance and dignity for all countries, compared to present skewed relationship.

Moving Forward

We need to push this agenda of Gold Dinar forward. Perhaps one way is for Bank Negara Malaysia and Wisma Putra to discuss with the 29 countries with whom Malaysia has signed BPAs, with the objective of converting these conventional BPAs into Gold Dinar based BPAs.

The next step would be to convert the individual BPAs into a single multilateral payment agreement (MPA). Subsequently, we will have to get as many countries as possible to join this MPA.

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