

## A STUDY OF THE MECHANISM AND SHARI'AH PARADIGM OF CRYPTOCURRENCIES IN CURRENT ISLAMIC FINANCE DEBATES (AL-'AMLAH AL-MUSHFIRAH)

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### ABSTRACT

There is a lot of discussion in the Shari'ah-based financial system over whether cryptocurrency (al-'Amlah al-Mushfirah) is lawful. From an Islamic standpoint, the debate starts with the question of the money's worth and purpose (al-Qimah al-Jawhariyah) and develops from there. From an Islamic standpoint, money must have certain qualities, including inherent worth, stability, and asset-based longevity. Since cryptocurrency and digital tokens raise questions about their location, value, and assertion in Shari'ah, they might not meet this requirement. Peer-to-peer transactions that function independently of the central bank are made possible by the cryptocurrency. Cryptocurrency can be a "coin" that exists digitally; it is not tangible. Furthermore, it cannot be physically removed or withdrawn. Without actual possession, the owner can only give the money to other people. The financial sector benefits from the use of cryptocurrency, which is an intriguing aspect of money. The mechanism is based on a 'Block chain' that is out of the current modern financial system of fiat money. Meanwhile, fiat money is produced by the Central bank of each country; however, Crypto currency is based on a borderless system as it is not limited to any country, region or territory. No authority controls the money mechanism of Crypto currency. The value of Crypto currency is based on the block chain creation to store the data. The calculation is based on the algorithm, which is very much complicated. This is the mechanism of how the value of crypto currency is created. Then, the supply and demand of users can also lead to either the increase or decrease of the value of crypto currency. In the given context, Islamic finance debates the issue so far its legal position in Shari'ah is concerned. This paper evaluates the concept, mechanism, function and legality of the Crypto currencies and analyses its legal position in an Islamic perspective. The analysis envisions its 'speculative' nature together with a review of the reputed Islamic Finance Institutions and experts.

**KEYWORDS:** Gharar (Risk), Speculation, Mushfirah (Crypto) Intrinsic value, Token

### INTRODUCTION

Money's intrinsic value (al-Qimah al-Jawhariyah), which qualifies it for marketing or commercial purposes and makes it a token for exchange, is a fundamental aspect of Shari'ah. In certain situations and eras, the Islamic viewpoint on the role of money discourse can be organized in a flexible manner. The transaction motive and the cautious motive are the two reasons for keeping money on hand that are consistent with Islamic teachings.<sup>1</sup> However, trade or speculation is severely forbidden since it might be classified as hoarding or confusing, both of which are forbidden (Haram) in Islam.<sup>2</sup> Therefore, money ought to be viewed as a medium of exchange for transactions rather than as a means of making money through speculation.<sup>3</sup> From an Islamic standpoint, this idea would be the fundamental prerequisite for the money feature.<sup>4</sup> When the Prophet Muhammad (S.A.W.) presided over the Ummah (community) in Medina in 625 AD, the history of money began. Authority regulates the money mechanism of cryptocurrency. The Dinar, the unit of currency, was made up of 4.25 g of 22-carat gold (al-Dhahab) and Dirham. which was made of 3-grams of silver (al-Fizdah).<sup>5</sup> Consequently, money was prepared of the skin of a camel, but then it was prohibited, as it can significantly reduce the camel population. The Dinar was actually copied from the golden money of the Byzantine Empire while the silver was copied from the Persian Empire, but, Muslims had their own coinage struck by the Umayyad Caliph, 'Abd al-Malik bin Marwān (65-84 A.H / 646-705 A.D).<sup>6</sup> These two types of money had a stable ratio of 1:10 but then fluctuated to 1:15 in the long period of the Abbaside Empire (750-1258 A.D).<sup>7</sup> Such a fluctuation occurred because of the hoarding and non-productive issues at that time. In other words, they minted the Dinar to gold because the Dinar was made of gold, which turned into the intrinsic value of Dinar throughout the Muslim lands. This phenomenon was observed by Al- Maqrizi (945-998 A.D) and Imam Abu Yusuf (d.187 A.H) who mentioned all these issues and its remedy. Then, the terminology known as bad money drove out good money making Dinar and Dirham as the prime currencies of the Muslim empires. From the Islamic perspective, money/currency is exclusively used for the exchange not for creating any speculation (Gharar) or such trading that would result in gaining the fraudulent profit (al-Najsh)<sup>8</sup>. Taking profit

from money trading on purpose can be categorized as usury (al-Riba). On the other hand, referring to the phenomenon above, people would keep

## MECHANISM OF THE CRYPTOCURRENCY

Cryptocurrencies are not controlled by the government or Central Regulatory Authorities. As a concept, Cryptocurrency works outside of the banking system using different brands or types of coins with "Bitcoin" being the major player.<sup>13</sup>

## MINING

The technique of "mining" is used to create cryptocurrencies, which are entirely digital. This procedure is intricate. In essence, miners must use specialized computer systems to solve specific mathematical riddles in order to receive Bitcoins in return. In a perfect world, mining one Bitcoin would only take ten minutes, but in practice, it takes over thirty days.<sup>14</sup>

## Purchasing, vending, and keeping

Cryptocurrencies can now be purchased or sold by users from brokers, central exchanges, and private currency owners. The simplest ways to purchase or sell cryptocurrencies are through exchanges or websites like Coinbase. Cryptocurrencies can be kept in digital wallets after they are purchased. Both "hot" and "cold" digital wallets are possible. Hot indicates that the wallet has an internet connection, which facilitates transactions but leaves it open to fraud and theft. Conversely, cold storage makes transactions more difficult but is safer.<sup>15</sup>

## TRANSACTING OR INVESTING

Cryptocurrencies like Bitcoins can be easily transferred from one digital wallet to another, using only a smart phone. Once you own them, your choices are to:

- a) Use them to buy goods or services
- b) Trade in them
- c) Exchange them for cash

## TYPES OF CRYPTOCURRENCIES

There are tens of thousands of Cryptocurrencies available today with the figure pegged at 10,000 in 2022. Major Cryptocurrencies include the following:

### BITCOIN

Bitcoin is the world's first widely accepted form of Cryptocurrency. Bitcoin is so popular that there was a time when its name was synonymous with Cryptocurrency. But potential investors need to know Bitcoins have become very expensive. In 2021, the cost of one Bitcoin was \$68,000.<sup>17</sup>

### ALTCOIN

Altcoin is the term used for any alternative digital currency to Bitcoin. The most popular in this ecosystem is Ethereum, one of the fastest-growing Cryptocurrencies in the market. Luckyblock, Shiba Inu and Terra are also the Altcoins.<sup>18</sup>

## CRYPTO TOKENS

The concept of crypto coins vs tokens can be confusing. At first glance, coins and tokens appear the same. However, the two have many differences

Coins can be mined, but tokens cannot be mined.

Coins are linked to Blockchains, tokens are not.

In terms of utility, they vary in the type of product or service they allow users to purchase.<sup>19</sup>

## ISLAMIC CONTRACT RULES (FIQH AL-MUAMALAH AL-MUSHFIRAH)

From the perspective of Islamic contract rules, there must be an element of consideration that is Mal. The Mal refers to possession and effective storage, and Cryptocurrencies meet the criteria required as they can be possessed and stored and have commercial value (Mutaqawwam).<sup>32</sup> Crypto is a real and viable digital asset, its worth and value lies in what is paid for it, and it is capable of being owned and traded commercially so the Shari'ah

requirements on question of the Cryptocurrencies are fulfilled as well as satisfied.<sup>33</sup> The Shacklewell Lane Mosque in East London became one of the first mosques in the UK to accept Cryptocurrency donations and Zakat contributions in 2018 during the month of Ramadan, 1439A.H.<sup>34</sup>

## SHARI'AH PARADIGM OF THE DIGITAL CURRENCIES MEDIUM OF EXCHANGE

Cryptocurrency operates as a medium of exchange across the globe. This means that it can operate in legally diverse and unpredictable environments, often making it more accessible than mainstream finance options.<sup>39</sup> Although vulnerable to market changes and risks, Crypto coins such as Bitcoin and Ethereum are deemed to be a legitimate medium of exchange, available for use in transactions and trading in the Middle East.<sup>40</sup> The development of Shari'ah compliant Cryptocurrency guidelines provides Muslims with the opportunity for market investments. From a financial perspective, Islamic charities could benefit hugely from Zakat and other donations as a result of Crypto investment and trading. Many banks and financial establishments are recognising Crypto as a financially viable medium of exchange, and this makes it easier for investors to continue to trade, buy and sell cryptocurrency.<sup>41</sup> In terms of whether contracts ('Uqud) relating to Crypto are Shari'ah compliant, given that the contractual relationships in Crypto are based on smart contracts using Blockchain technology, this means that the process can be made increasingly secure and automated. This not only reduces administrative complexities, confusion and errors, but also ensures that banks are more likely to accept the contractual relationships created. In demonstrating Shari'ah compliance, Cryptocurrency is earning legitimacy across the Islamic finance world.<sup>42</sup> The Cryptocurrency agencies are springing up across the Muslim world such as OneGram in Dubai, and HelloGold in Malaysia. This adds further legitimacy to the rulings that Cryptocurrency is permissible (Halal) and can be utilised by Islamic financial institutions.<sup>43</sup>

## CONTEMPORARY FIQH (JURISTIC) DEBATES

The 'speculative' nature of the Cryptocurrencies has triggered debate among Islamic scholars over whether Cryptocurrencies are religiously permissible. Cryptocurrency companies are seeking to sway the debate by launching instruments based on physical assets and certified as valid by Islamic advisors.<sup>44</sup> Each One Gram Cryptocurrency unit is backed by at least a gram of physical gold stored in a vault. The idea is to limit speculation.<sup>45</sup> "Gold was among the first forms of money in Islamic societies, so this is appropriate," said Ibrahim Mohammed, the Briton who founded the firm with other investors.

The National "Shari'ah authorities" have not ruled on whether Cryptocurrencies are permissible, and while several global bodies recommend standards for Islamic finance, none has the authority to impose them. Many governments seem ambivalent, worried about the potential for instability, but unwilling to lose the chance of benefiting from new technology.<sup>51</sup> The Saudi Arabian and UAE Central banks warned their citizens about the risks of trading Bitcoin but have not imposed outright bans. That leaves Islamic investors to choose between sometimes conflicting judgments by scholars at advisory firms, financial companies and academic institutions.<sup>52</sup> One of the earliest rulings came in 2015-2018 when California-based academician and Islamic scholar Dr. Monzer Kahf, an expert author of Islamic finance textbooks, deemed Bitcoin a legitimate medium of exchange, though vulnerable to manipulation.<sup>53</sup> Since then, Islamic jurists in South Africa have ruled in favour of Cryptocurrencies, arguing they have become socially acceptable and commonly used, said Z.Mahmood.<sup>54</sup>

, projects or businesses, so it's not appropriate to have a blanket Shari'ah ruling for all.<sup>56</sup>

Farrukh Habib, again, in consultation with Islamic Scholars since 2021 is involved in a project to categorize Cryptocurrencies based on Shari'ah-compliance criteria.

"Most of the existing Shari'ah rulings either deal with only Bitcoin or include all types of cryptocurrencies, disregarding their peculiarities."<sup>57</sup>

## COMPLEXITIES AND THE SHARI'AH UNDERSTANDING

With regard to the operational mechanism in the contemporary Islamic finance, the basic problem is that many Shari'ah scholars have trouble understanding of the complexities of digital currencies, said Dr. Harris Irfan, managing director at Cordoba Capital in London. He argues:

“I would caution against accepting any fatwa (Decree) from community scholars on the subject of Fiqh al-Mu’amalat, the jurisprudence of transactions, which is a highly complex area of Shari’ah.”<sup>58</sup>

Harris Irfan chairs the U.K Islamic Fintech Panel, a think-tank that is drafting guidelines for accreditation of Shari’ah-compliant Fintech Products, including Cryptocurrencies. Similarly, Z. Mahmood said some degree of consensus had emerged globally that cryptocurrencies were a form of wealth, or Maal, one step towards acceptance, But Shari’ah scholars have yet to rule conclusively on whether cryptocurrencies are in fact currencies or not. This is important for Zakat and for inheritances (Turath). Z.Mahmood proclaimed : “Overall, more evidence is needed to reach a consensus, at least until higher (Shari’ah) bodies pronounce themselves on the issue, such as the Islamic Fiqh Academy,” referring to an influential Jeddah-based institution.<sup>59</sup> ‘Abd al- Qahir Qamar, Director of the Fatwa Department at the Fiqh Academy, IIFA, S.audia Arabia told Reuters that the academy had not issued any resolutions on Cryptocurrencies but was planning to discuss the subject during one of its official sessions this year. While there is no firm timeframe, the academy will also seek to organize seminars with scholars on the matter.<sup>60</sup>

## CONCLUSION

The issue of the Cryptocurrency (al-‘Amlah al-Mushfirah) is a incessant debate in Islamic finance jurisprudence (Fiqh al-Ma’amalat) since 2017. However, during 2021-2022, the ongoing resolutions and views of the Shari’ah experts are somehow exhaustive which specify the concern for an advance research regarding its status and permissibility. Consequently, the discourse on Crypto as money or otherwise has become important, as will this be approved (Halāl) for Muslims or not. In some countries including China and Russia, Cryptocurrency is banned due to its so called uncertainty, insecurity and market risks. In Muslim countries such as Arabia, Turkey, Egypt, Iran, Indonesia and Pakistan which are bound to follow the Shari’ah verdict, the resolution on permissibility is a hot debate not only because of the uncertainty and risk, but also due to non availability of a uniform Islamic financial of digital currency rather than money which possess a prime factor of intrinsic value. Based on the thorough juristic analysis, resolves Indonesia’s National Religious Counsel, fiat Cryptocurrencies are not Shari’ah compliant due to character, uncertainty and configuration. However, some leading Muslim jurists in Malaysia, Iran, India and Pakistan stress for advance research and put the debate open and evolving.

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