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Navigating the Halal Frontier: The Legality of Cryptocurrency in Islamic Finance

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Abstract*: The popularity of virtual currencies has expanded dramatically in recent years. Seminars and conferences have been held to discuss the nature and feasibility of cryptocurrencies. Some argue that having a replacement for the current fiat currency system is a good idea since it does not need a bank account, tax payments, or audits, as cryptocurrencies do. Others argue that any means of payment other than the commonly recognised ones, such as cash, checks, DD, and so on, would allow for tax and audit evasion, which would have a huge detrimental impact on the government budget and the economy. The convergence of cryptocurrencies and Islamic finance has caused much controversy among the Muslim community about whether cryptocurrency transactions are permissible (halal) or prohibited (haram). This study investigates Islamic finance concepts as well as the technological and economic elements of cryptocurrencies in order to assess their conformity with Sharia law. It was found that cryptocurrencies are not Halal in Islam because they lack inherent value and are susceptible to additional regulatory oversight.*

Keywords: Cryptocurrency, Bitcoin, Islamic Finance, Halal, Shariah Compliance

JEL: G2, K2, O3, Z1

I. INTRODUCTION

The introduction of bitcoin is often regarded as the greatest innovative financial innovation of the twenty-first century. These digital currencies make use of blockchain technology, which allows for decentralised transactions between individuals without the participation of banks, financial organisations, or governments. These transactions are recorded in the blockchain by "miners" who prevent double spending of bitcoin and validate the transactions. While over 2000 cryptocurrencies are in circulation, Bitcoin and Ethereum stand out as the most widely recognized ones (Coinmarketcap. com). Bitcoin, Bitcoin Cash , Ethereum, Litecoin, Ripple XRP and Dogecoin, are among the most widely used cryptocurrencies. It is critical to emphasise that cryptocurrencies, like contemporary digital fiat currencies, are accepted as a means of payment and a store of value within a community. They are, however, distinguished as tokens by digital identifiers rather than traditional paper cash or real coins. Technological advancements have raised acceptability of digital fiat money, and the incapacity of fiat currency to control inflation since the end of the gold standard has contributed to the growth and expansion of multiple cryptocurrencies. Worldwide, a multitude of companies provide cryptocurrency platforms, yet these platforms suffer from several limitations. These include the absence of regulatory backing, inadequate strategic planning, unpredictability, and a reliance on mere assumptions rather than tangible assets. Cryptocurrency may be purchased and sold using a trading platform or cryptocurrency brokers, who function similarly to foreign exchange dealers. (K, n.d.; K & Sumathy, 2022).

Key cryptocurrencies' Market cap and Volume

The table 1 shows the market capitalization and price details of major cryptocurrencies.

Table: 1 Key cryptocurrencies' Market cap and Volume

S No	Name	Symbol	Price (In USD)	Market Capitalisation (In USD)	Supply in Circulation
1	Bitcoin	BTC	22860.02	436.94 BN	19,111,950
2	Ethereum	ETH	1622.23	197.47 BN	121,823,914
3	BNB	BNB	300.06	48.42 BN	161,337,261
4	Ripple	XRP	0.3698	17.88 BN	48,343,101,197
5	Cardano	ADA	0.501	17.00 BN	33,934,048,406
6	Solana	SOL	38.86	13.48 BN	346,652,152
7	Polkadot	DOT	8.06	8.89 BN	1,103,105,142
8	Dogecoin	DOGE	0.066	8.83 BN	132,670,764,300
9	Dai	DAI	0.9995	7.41 BN	8,034,803,943
10	Polygon	MATIC	0.887	7.14 BN	8,034,803,943

Source: Coinmarketcap.com, Price as of 04-08-2022, Price in US$

Table: 2 Major Cryptocurrency Exchanges

S No	Name	Volume
1	Binance	13313989333
2	Coinbase	1860611320
3	FTX	1697324924
4	Kraken	525266150
5	KuCoin	946895104
6	Binance.US	417128377
7	Gate.io	898678850
8	Bitfinex	301224785
9	Huobi Global	816333491
10	Gemini	69125882

Source: Coinmarketcap.com, Volume as on 04-08-2022

Since the inception of cryptocurrencies in 2016, Bitcoin has emerged as the most valuable and costly digital currency. Boasting a market capitalization of 436 billion US dollars, it represents approximately 45 percent of the entire cryptocurrency market, holding the largest market cap among the top 10 cryptocurrencies. Among the primary crypto exchanges, Binance leads with the highest transaction volume.

Overview of Islamic finance principles:

Islamic finance operates under the principles of Sharia law, the religious and moral code of Islam. Sharia law provides a comprehensive framework that outlines ethical standards and principles governing various aspects of life, including economic and financial activities. Within the realm of finance, Sharia law sets guidelines to ensure financial dealings are conducted ethically and in alignment with Islamic principles (Alshater et al., 2022; Bedoui & Robbana, 2019). This financial system prohibits specific activities that are deemed exploitative or unethical according to Islamic teachings (Usmani, 2021). It emphasizes several fundamental principles:

1. Prohibition of Riba (Interest)

In Islamic finance, the concept of Riba holds significant importance and is deeply rooted in the prohibition of interest-based transactions. Riba, often translated as "usury" or "interest," refers to the charging or receiving of any

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predetermined, excess, or exploitative return on a loan or debt. This principle is strictly forbidden in Islamic finance due to the ethical and moral beliefs outlined in Sharia law. The Islamic perspective on the nature of money serves as the foundation for this restriction. Money is regarded as a medium of exchange, a way of promoting commerce and transactions in Islamic teachings, rather than an asset capable of generating wealth on its own. (Suharto, 2018; Syed & Omar, 2017; Uddin, 2015). The idea is that money should not be allowed to increase in value over time simply due to the passage of time or the act of lending it to someone in need (Siddique, 2022). By prohibiting Riba, Islamic finance aims to foster a more equitable financial system that promotes fairness, encourages ethical economic activities, and focuses on wealth generation through legitimate trade and investment while discouraging exploitative financial practices (Harahap & Risfandy, 2022).

2. Emphasis on Fairness and Transparency:

The emphasis on fairness and transparency is a core principle in Islamic finance, aiming to ensure ethical and just financial transactions in accordance with Sharia law. This principle underlines the necessity for equitable and transparent dealings, promoting clarity and justice for all parties involved (Aravik et al., 2022). This principle seeks to prevent exploitation, promote equality, and establish a framework for economic activities that align with Islamic ethical and moral values.

3. Risk-sharing and Ethical Investment:

Islamic finance promotes the sharing of risks between parties involved in financial transactions. Instead of placing the burden of risk solely on one party, this principle encourages a fair distribution of risks and rewards. This practice aligns with the concept that gains or losses in investments should be shared proportionally between the involved parties (Danlami et al., 2022; Saleem et al., 2023). Islamic finance encourages investments in ventures that not only generate profits but also benefit society. This concept directs people and institutions to engage in socially responsible and morally sound economic activities, avoiding industries or practises deemed damaging or immoral by Islamic beliefs. (Aderemi & Ishak, 2023). Investments in industries associated to alcohol, gambling, or other illegal activities, for example, are discouraged, but investments in areas that benefit society, such as healthcare, education, and ethical commerce, are encouraged.

4. **Prohibition of Uncertainty and Speculation (Gharar):**

Gharar, which translates for avoiding ambiguity and speculation, is central to Islamic banking. It refers to transactions that have a high level of ambiguity, uncertainty, or conjecture, which might lead to unexpected or surprising consequences. This principle aims to minimize risk and ensure clarity and fairness in agreements within the financial system. Transactions that are purely speculative or resemble gambling, where outcomes depend solely on chance or luck, are discouraged (Farikhin & Mulyasari, 2022; Katterbauer et al., 2022; Kuznetsova & Tenberga, 2022). This is because such transactions are viewed as risky and can potentially lead to unjust gains or losses, which goes against the principles of fairness and ethical conduct in Islamic finance. The prohibition of Gharar aims to promote fairness and integrity in financial transactions. By avoiding excessive uncertainty and speculation, Islamic finance seeks to create a more stable and transparent financial system.

These principles are intended to create a financial system that operates in a manner consistent with the moral and ethical values of Islam. The focus is on fostering economic activities that promote social welfare and equity, while avoiding practices that may lead to exploitation, inequality, or unjust gain.

II. CRYPTOCURRENCY AND ISLAMIC FINANCE

Money, according to Islamic teachings, serves a societal function, promoting socioeconomic fairness for the benefit of the larger society rather than being a weapon for exploitation. Money, according to Shariah, has no intrinsic value and only serves as a measure of value or a vehicle for economic transactions. (Abu Bakar et al., 2017). Money and things are seen differently in Islam. Money, for example, can not meet human needs on its own and must be turned into a real item before it can be used. Only goods of inherent worth, such as gold (Dinar) and silver (Dirham), as well as commodities such as rice, dates, wheat, barley, and salt, are recognised as genuine currency in Islam, according to

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Islamic law. Paper and electronic money are both admissible as long as they are backed by one of these commodities at a predetermined exchange rate. (Hassan et al., 2022). During the early days of Islam, gold and silver were frequently employed as money and a means of exchange. Those were the days of the Dinar (gold) and the Dirham (silver). The Holy Prophet (PBUH) also permitted gold and silver as sources of payment. Throughout his reign, he also used Roman and Persian gold and silver money for commerce. Islam forbids the use of money as a commodity. Money can be used to promote trades, but it cannot be considered an item in and of itself, making trading impossible. The reasoning behind such a severe restriction is because dealing in money in the absence of any economic activity may result in interest.

The legitimacy of cryptocurrencies in Islamic finance is a topic of continuing discussion among academics and Shariah experts. We must understand the monetary operations of all cryptocurrencies and how they comport with Shariah regulations on money in order to comprehend the legal situation. If we concentrate on the qualities of cryptocurrencies concerning money, we can see that the majority of cryptocurrencies match modern definitions of a currency, including being a unit of account that can be quantified and a means of exchange for buying and selling. Cryptocurrencies are also portable, resilient, and divisible, which makes them comparable to currencies.

Legality of Cryptocurrency in Islam

The various Islamic perspectives contribute to a range of opinions on the acceptance of cryptocurrencies within Shariah law. This diversity extends to the discussion on whether Bitcoin and other established cryptocurrencies qualify as financial assets, commodities, or currency. Nonetheless, there appears to be consensus regarding the acceptance of the blockchain technology as compliant with Shariah principles. The Islamic Monetary Theory of value (IMTV) states that the unit of account for money must have intrinsic worth or be supported by something tangible, such as precious metals. Bitcoin, as a fully digital currency, has no intrinsic value, no physical presence, and is not issued or managed by any one body (Bedoui & Robbana, 2019). In particular, anything must have an inherent worth from which one might profit in it to be considered a commodity, and Bitcoin does not meet this requirement (Khan, 2023; Rabbani et al., 2022, 2022; Shovkhalov & Idrisov, 2021).

Because cryptocurrencies like Bitcoin are speculative, both governments and academics warn against investing in them to avoid future financial losses. This is the fundamental basis for the argument against cryptocurrency usage and restriction. Understanding cryptocurrency mining and trading practises is critical in determining the permissibility of digital currencies in Islamic banking. This has resulted in the birth of Shariah-compliant crypto in some form, which will be discussed more in the next section.

Arguments against the cryptocurrency

Cryptocurrencies are considered contrary to halal law due to three main reasons. Firstly, their absence of intrinsic value is a critical factor. Unlike gold or silver, the value of any cryptocurrency is solely determined by global market activities, lacking inherent worth (El Islamy, 2021). Consequently, trading cryptocurrencies becomes highly suitable for speculative purposes. Secondly, the anonymity that cryptocurrencies offer their holders is another argument against their compliance. The secretive nature of cryptocurrency ownership, where holders' identities and the amount they possess remain undisclosed, provides an ideal environment for hiding unexplained funds (Mohd. Zain & Mohamad, 2021; Wiwoho et al., 2023). Finally, the third point is the notable price fluctuations. Cryptocurrencies exhibit significantly higher volatility compared to stocks or derivatives, further complicating their use (K & Sumathy, 2022).

The Way ahead

It's fascinating to see how the cryptocurrency industry is changing and how Shariah-compliant asset-backed or asset-based cryptocurrency is rising. Cryptocurrencies, which have recently emerged as an alternative to the long-established fiat currency paradigm, face various hurdles before becoming a generally accepted mode of payment, particularly in the context of Islamic banking.

The development and promotion of cryptocurrencies that are specifically structured to adhere to Shariah principles represent a promising way forward. Creating digital currencies backed by tangible assets or commodities, thus complying with Islamic finance requirements, could increase acceptance among the Islamic finance community. Clear regulatory frameworks and rules are required for the incorporation of cryptocurrencies into Islamic finance. Clear regulations would aid in addressing Riba, Gharar, and intrinsic value compliance difficulties while adhering to Shariah principles. It is critical to increase education and awareness among stakeholders, including academics, financial institutions, and the general public. Improving awareness of the workings, benefits, and possible issues of cryptocurrencies in Islamic finance will help them gain acceptability. It is critical to emphasise the ethical use of cryptocurrencies. It is critical for the adoption of these digital assets in Islamic finance that they are not involved in usurious operations, speculative trading, or other endeavours that are opposed to Islamic law.

III. CONCLUSION

As the area of cryptocurrencies evolves, the incorporation of digital assets into Islamic finance will most likely necessitate a healthy balance of technical innovation and adherence to Shariah principles. Overcoming compliance, ethical concerns, regulatory frameworks, and stability challenges will be crucial in determining the future trajectory of cryptocurrencies in Islamic banking. Before they can be recognised in the broader arena of Islamic finance, cryptocurrencies must overcome negative perceptions stemming from significant price volatility, involvement in fraudulent operations, and a lack of clear standards under both financial law and Shariah law. Certain Islamic thinking sects support the idea that trading in digital currencies is allowed as long as it does not entail speculative elements. Cryptocurrency regulation should strive to stimulate rather than inhibit their growth inside financial and economic institutions. The future integration of cryptocurrencies in Islamic finance might be an exciting development, potentially increasing financial inclusion.

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