Volume: 5 Issues: 30 [June, 2020] pp. 13 - 22]
Journal of Islamic, Social, Economics and Development (JISED)
eISSN: 0128-1755
Journal website: www.jised.com

INTEREST (RIBA) AND ITS CONSEQUENCE ON THE ECONOMY

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Article history

Received date	**:**	7-5-2020
Revised date	**:**	8-5-2020
Accepted date	**:**	18-6-2020
Published date	**:**	15-7-2020

To cite this document:
Gani, I. M. (2020). Interest (Riba) and Its Consequence on the Economy. *Journal of Islamic, Social, Economics and Development (JISED),* 5(30), 13 - 22.

Abstract*: Interest or Riba is regarded as the reward of the factor of production or return from the loaned fund. However, it causes more harm than good, and Islamic religion categorically prohibited any form of activity involving interest or Riba. Therefore, the objective of this study is to assess the consequence of interest on economy and differentiate profit from interest. The study adopted library research, and conceptual approach as the method of analysis. The analysis revealed that the consequence of Riba within an economy includes low investments, distortions in distribution of wealth, and encouragement in the exploitation of the needy as well as the economic instability. It can be said that interest rate is only baited by creditors to transfer the wealth of the debtor which serves as a tool for exploitations. The study concluded that the conventional financial activities appeared to be an agent of exploitations and to some extent brings economic destabilisations. Therefore, for the economy to be free from the negative influence of interest, countries are encouraged to adopt Islamic finance which is based on profit and loss sharing as an alternative financial intermediary. Islamic finance must be adopted in Muslim countries to abide by Islamic ruling.*

Keywords: *(Interest (Riba), Consequence, Economy, Profit and loss, Islamic finance.)*

Introduction

Finance and economics in traditional or conventional point of view, considered interest or Riba as the reward of one of the factors of production, which is capital, or returns from the loaned fund. But Islam prohibits giving or accepting Interest or Riba. Riba is an Arabic word which linguistically means growth or addition and increases to anything; in this regard, it refers to an increase in capital or principal of the loan and this is referred to as Interest. Interest or Riba or usury is strictly and categorically prohibited in Islam. The primary and significant sources of Islamic *Shariah* such as Quran, Hadith, *Ijma* (jurist), *Qiyas* (analogy) have all regarded and considered Riba as Haram (unlawful). The evil of Riba includes selfishness, cruelty, and killing the spirit of fellow feeling and cooperation, and it also encourages hard-heartedness, money worshipping and ruins the societal norms, morals, spiritual beliefs and economy (Gusau & Aliyu, 1995).

Riba or interest was prohibited in Islam in order to encourage and direct Muslims to make investments on the rightful and lawful manner, give Muslims protection on their wealth not to be taken unjustly so that hatred, evils, and envy among them can be avoided. Thus, when Riba is prohibited among people within society, it will make them lend to each other willingly without any expectation of getting more than what was loaned out, this can make the spirit of mercy and charity among Muslims prominent and firm (Rufai, 2014).

This study is aimed to achieve its main objective of exploring the consequence and implications of Riba on the economy. In view of this, the specific objectives of this study include the expatiating of the differences between Riba and profit as well as direct and indirect effects of Riba on micro and macro economy of any society. Nevertheless, in order to achieve the aforementioned objectives, this study adopted the library research method, narrative analysis as well as conceptual approach of analysis.

This study is divided into five parts, the first part is this introduction, followed by an overview of interest and it's prohibition from Quran and Sunnah in the second part. The third part of this study is the discussion of the difference between interest (Riba) and profit. The discussions of the consequence of Riba on economy is in the fourth part of this study. The fifth part which is the last part is the conclusion of this study.

Literature Review

There are two major points that will be discussed in Literature Review which are very vital in relation to Riba and the economy of any nation. These points are the Riba and its prohibition in Islam and other religions, secondly the difference between Riba and Profit.

Interest (Riba) And It's Prohibition

Sustainable Riba or interest is a severe and sensitive issue in Islam. Allah (SWT) mentioned the prohibition of *Riba* vividly in the holy Quran. There are twelve verses of holy Quran that mentioned and deals with Riba in the holy Quran. It started in the chapter (*Surah*) *Al-Baqra* (2) (the Cow), Allah (SWT) said:

> "*As for those who devour interest, they behave like the one whom Satan has confounded with his touch. Seized in this state, they say: "Buying and selling are but a kind of interest, even though Allah has made buying and selling lawful, and*

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interest unlawful. Hence, he who receives this admonition from his Lord, and then gives up (dealing in interest), may keep his previous gains, and it will be for Allah to judge him. As for those who revert to it, they are the people of the Fire, and in it shall they abide. Allah deprives interest of all blessing, whereas He blesses charity with growth. Allah loves none who is ungrateful and persists in sin. Truly the reward of those who believe and do righteous deeds and establish Prayer and pay Zakah is with their Lord; they have no reason to entertain any fear or grief. Believers! Have a fear of Allah and give up all outstanding interest if you do truly believe. But if you fail to do so, then be warned of war from Allah and His Messenger. If you repent even now, you have the right of the return of your capital; neither will you do wrong nor will you be wronged. And if the debtor is having a hard time, then grant him time till it is easy for him to repay; but if you remit it by way of charity, that is better for you if you did but know." (Q. Al-Baqra 2:275-280).

Siddiqi (2004) provided the number of crucial points that these verses established. One Riba vehemently prohibited, number two, it is mentioned that Riba is what is more than the Principal. Three, it is excessive and unfair (zulm), number four Riba is ordained to destruction (mahq). Lastly, the worst effect, which is the personality of a human being, it humiliates and lessens the person who engaged in giving or taking it. Significantly, the assertion of Riba is the same as trade also rejected, because in trade all the parties involved mutually benefited whereas in Riba is to the advantage of one party. The next verse of the Quran about Riba is in Ahli Imran (3:130). It was followed by a verse in fourth Surah of the Holy Quran Al Nisa, (4:160-161). Lastly, the verse on Riba is in Surah Al-Rum (30:39).
"

Allah the Almighty vividly described Riba as an evil and something detrimental to societal wellbeing and to all mankind. It was described as an injustice among people, an evil to an economy and obstruction to the spiritual growth. In the holy Quran, Riba has not been dealt with in isolation, but most of the revelation is concerned with reform of mankind and their immediate environment. Quranic revelations described how Almighty Allah (SWT) brings down the rich low for their ego and disregard to the have-nots. The principle it teaches here is that Allah (SWT) richness is something from Allah (SWT) as a trust, and that is a test for those who are opportune to have it. It was categorically said in the Holy Quran that the haves to help the have-nots or those that economically disadvantaged like orphans, travellers, beggars, debtors, divorced migrants etc. in many verses of holy Quran the sound of justice such as economic justice echoed (Abdulkader 2006).

Like in the Holy Quran, Prophet Muhammad peace be upon him (PBUH) reaffirmed the prohibition of Riba among the Muslim *Ummah*. Many authentic hadith was reported in which prophet condemns and discouraged giving or receiving Riba. Prophet Muhammad (SAW) specifically in his farewell pilgrimage speech admonished interest in its all forms and also in several Hadiths Prohibit even participating in facilitating Interest (Ahmad & Hassan, 2007).
Islamic scholars opined that Riba is divided Riba into two categories, viz; Riba *An-Nasiyah* and Riba *Al-Fadl*. Riba An- *Nasiyah* is defined as an increase or excess, resulting from a predetermined amount, which a creditor receives over and more than the principal in any lending transaction. This is the actual and primary form of Riba. Allah (SWT) in the Holy Quran has straight away affirmed this type of Riba as haram, and this is also referred to as ''Riba Al Quran.'' Likewise, this type of Riba was one considered as Riba in the dark ages, so

it has been popularly known as "Riba *Al Jahiliyyah*" as well. (Naqvis 2015). The second classification of Riba is Riba *Al Fadl*. Though the prohibition of this Riba basically was established on the Sunnah of Prophet Muhammad (PBUH), it is always being referred to as "Riba *Al-Hadith*." Riba *Al Fadl* actually means that excess or surplus is taken in exchange for a particular homogenous commodity and faced in their hand-to-hand buying and selling (Naqvis 2015). It means the increase is independent of postponement or maturity of the debt. It happens when two same things are exchanged unequally. For instance, let's say a kilo of rice to be exchanged with 1.5 kilos of rice. The basis for the prohibition of this type of Riba is on the Prophet (PBUH) hadith that says:

> "*Gold for gold, silver for silver, wheat for wheat, barley for barley, the date for date, salt for salt, must be equal on both sides and hand to hand. Whoever pays more or demands more (on either side) indulges in Riba."*

Furthermore, the Prophet (PBUH) implemented the prohibition of Riba. This was done firstly through focussing on any excess charged in all financial transactions for which no counter value existed. The then economy was sporadically monetised, and most of the business transactions were on direct exchange of goods for goods that are on the barter system, especially in rural areas. In that period of time Arabs used Roman dinars, Persians dirhams, and a gold coin as well as pure gold and silver as they don't have their own money (Siddiqi, 2004).

In another development, the exchange of gold for gold or silver for silver constraints, which was based on two conditions of simultaneity and equality, was clearly directed to prevent the exchange of now and money in the future, and this can prevent interest on loans. Prophet (PBUH) bans exchange of money now and money in the future, and also in case of a particularly specified four commodities what was banned in the form of gold and silver. No specified reason was given, but it was learnt that a violation of the ban would lead to indulging in Riba (Chapra, 2000).

However, Shahar and Shahar (2014) opined that it is not only Islam as a religion emphasized the forbiddance of Riba. It was also prohibited in other religions such as Christianity, Buddhism, Hinduism and Judaism. In Christianity, both old testaments and new testaments references on usury or Riba was resurrected and even more controversial. In the Bible, it was a reference that "*you shall not lend him your money for usury, nor lend him your food at a profit*" (Leviticus 25:36-37). It can also be found in Jeremiah 15:10. It is also the same thing in Buddhism and Hinduism. Usury or Riba was forbidden in an ancient Indian religious manuscript like Sutra texts. There was a time when a law was made among the highest castes in India (Priest and Warriors) which forbade them from being usurers or lenders. In Buddhist Jatakas, usury was regarded as a shameful act and practising it is a hypocritical attitude. Judaism is another religion that discourages and outlawed as well as scorned usury. It was classified as an act of "bite" it encourages lending more only to the poor and needy and prohibit money lending with interest.

In another development, Rania and Rana (2015) Highlights the disappearance of the discourses of Critical Muslim Intellectuals from classical Islamic accounting and banking literature and practices and argues that such disappearance hinders the emergence of real, creative and critical debate on the topic of *Riba* in particular and Islamic accounting and banking in general. They

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also expand on the need to integrate critical debates and thought into the fields of Islamic accounting and banking in Prominent Muslim Intellectuals if these fields are to contribute to improving socio-economic justice and seeking an alternative to their neoliberal traditional counterparts.

Furthermore, Daly and Frikha (2016) opined that the prohibition of interest payments by Islamic *Sharia* has instead made equity and profit sharing the cornerstones of its activities. However, according to them, the idealism of *Riba* free Islamic financial system goes beyond the simple interaction between the factor of production and the economic conduct. The guidelines on business ethics, wealth distribution, social and economic justice and honesty as well as the role of the government can only be fully respected in Islam. While the conventional vision focuses mainly on the economic and financial aspects of operations, the Islamic economic doctrine focuses on the moral, ethical, social and religious aspects of Islamic rule and its practical use through the development of Islamic economics, which improve equality and fairness.

Moreover Al-Jarhi (2017) suggested that Islamic jurisprudence provides little beyond the principle of justice underlying prohibitions of interest with respect to the logic of Islamic finance. Higher contractual costs and transactions are involved in Islamic finance. It utilizes good and services based on various contracts, including the option of mixing and matching and securitisation rather than a structured contract, like the conventional lending contract.

Once more, Moussaoui (2018) explained that compliance with Islam's strict rules on the existence of financial transactions and its ban on interest significantly limits the freedom of Muslims in the Western world to make purchases, savings and other transactions. This has been a source of frustration and grounds for internal debate among both Muslims and Islamic scholars on the interpretation and implementation of Quranic texts as well as an external discussion between religious, secular, and ethical ideologies. It has sparked inspiration in the historical and modern-day sense of politics, economics, philosophy and religion to critically examine, re-evaluate and compare the values and financial systems of interest and usury. He further explained that the core issue is that some philosophies find any sort of interest to be forbidden, while others find financing to be necessary. Most of this discussion is focused on "interest" and "usury" concepts.

Difference Between Interest and Profit

Buying and selling of goods and services known as “trade” is an activity that was morally acceptable in all religions and societies. Islam approves a trade in the Holy Quran, and Prophet PBUH practised it himself. Therefore, trade is the facilitation of exchange and in the process to create value which traders try to capture (Siddiqi 2004). This value is the difference or the margin between the sale prices of goods or services and its purchase prices, which is the margin between cost and revenue involved in the trade, this is what is regarded as profit. But if the margin is negative, that is the cost is higher than the revenue, and then the trade incurs lost. It means in trade there is either profit or loss.

Trade in any giving society or religion involves cash and credit transactions; it also involves pre-payment transactions whereby payment is made, but the delivery of the goods or services will be in future. The margin in any kind of transactions in trade is a profit or loss which is a legitimate earning accepted by all religions and societies. Therefore, Riba or interest as explained earlier is also a margin between money giving as loan and what will be paid back. However, profit or loss can occur in trade, but in loans, with interest, it has to be paid whether profit or loss accrued. In a trade where profit generated, there is no guarantee of recovering the capital invested, unlike on Interest based contract where both capital and positive return of investment are assured.

In trade, profit earned is not pre-determined, the size of the profit is not known to the trader, and it all depends on the market forces, even some goods with fix price the profit depends on the cost and the revenue. On the other hand, interest is pre-determined since the initial agreement of the contract, where the size of the interest will be well known to the parties involved. Trade, where profit is the reward, involves different forms of risks, which may make the trade even to lose its initial capital. Though interest-based contract also faces default risk, this risk can easily be covered with insurance (Siddiqi 2004). It means when there is a credit default insurance agreement. Credit default insurance is a financial agreement which is common on a credit derivative such as a credit default swap, total return swap, or credit-linked note. This is to mitigate the risk of loss from default by a borrower or bond issuer (Kagan, 2018).

Interest increases over time, as time passes it will continuously be accrued till the end of the contract. But profit from any kind of trade accrued once without a further increase; its size depends on the difference between the cost and the selling price.

The analysis of the Consequences and Implications of Interest (Riba) on the Economy

Interest is prohibited before and during the time of Prophet Muhammad (SAW). Interest serves as the measure of the loan value (price) which is clearly a rent of money. Hence, according to Islamic rules, regulations, and principles (*Shariah*) any kind of a deal involving interest is vividly prohibited (Hasnuddeen, 2009). Other religions such as Judaism and Christianity also vividly prohibited collecting and giving of interest (Kareem, 2017). Criticising the interest rate system is much more controversial. Most people feel that possessing money has some inherent value that should be recognised in a zero (or almost zero) risk way. But with negative interest rates spreading around in the developed world, interest rates are so low in many countries that they simply do not fulfil their purpose of incentivising consumers to save any longer. In short, as Deutsche Bank's Jim Reid titled his research report as, we might be witnessing "The Start of the End of Fiat Money" (Yesilhark, 2019). In his report, Jim Reid vies that the fiat currency system "is inherently unstable and prone to high inflation. What could replace fiat currency is yet to be determined (Colson, 2017).

There are many Implications of *Riba* on the economy. Shahar and Shahar (2014) summarised some of the implications on investments, distribution of wealth, and encouragement in the exploitation of the needy, then lastly economic instability.

The first is the implication of *Riba* on Investments and savings. When there is a higher rate of interest, savings will increase, and classical economist believed that more saving more investments. It is true, but the higher interest increases the cost of investments, and this can affect the total investment in the economy as well as making the goods and services expensive.

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Keynes (1936) also opined that increase in the rate of interest decrease investment, with the higher interest few, might borrow for investment purposes. It can lead to low investment and hence affect the whole economic growth. In Nigeria for Example, interest paid by the economy as debt servicing since 2011, is more than the economy's investment. There is a tremendous increase in the amount of money to be used for the servicing Nigerian debt obligations between 1981 to 2015, which lead to low saving, and low investment hence causes unemployment and increase poverty among Nigerians which severely affected the growth and development of the economy (Kareem 2017). Instead of the loan with interest, money is to be saved for investments on a partnership basis and share the profit or loss. It is being practiced by Islamic financial institutions. This kind of investment will create more business activities and lead to economic growth. Even though, Islamic banks financing now a days are more on debt financing than what the model of Islamic finance provided, which is equity financing. But the profit or loss shared between the investors and borrowers is more significant, and it is not affecting the investment growth, rather expanding the investment opportunities through plough back profit. Secondly, Interest encourages inequitable redistribution of wealth, and it is a mechanism used by wealthy individuals to earn more money at the expense of the poor. The haves give their surplus of wealth to have-nots as loan and expects additional money in return. The have-nots are going to use the fund they collected in business or for personal use. If used for business, and it is successful, then they can be able to return the principal with the additional amount as interest which will increase the wealth of the rich from the little wealth of the poor. But if it failed, they will lose their collateral that they earned from different source, and it will add more wealth to the rich. In a situation when the money collected is for personal use, in returning it, there is an additional money to be paid as interest. It means the little that the poor saved from his earning for living will be transferred to the rich in the form of interest. It means there is an unjust distribution of wealth caused by interest. Instead of balancing the gap between the poor and rich, it makes rich richer and poor more unfortunate, and the gap between the rich and poor is getting wider.

Thirdly, interest exploited the poor and the needy. The wealthy individuals as creditors postponed their present earning in order to earn from the interest of the loan given to the needy debtors in the future. Therefore, it increases the future wealth of creditor and reduces the future earnings of the debtor. It demonstrates a total act of exploitation and will result in more poverty among the needy. When loan is collected with an interest to be paid, the borrowers must work harder in order to meet the loan obligations. The borrowers can be able to engage in any risky and hazardous occupation so that they can earn more in order to pay back the loan with interest. It signifies that interest make wealthy people greedy and inconsiderate; they earn soft money to the disadvantage of the poor. The high rate of percentage charged as interest on the principal means an act of exploitations. The fund owner contributes nothing but earn more than the fund borrower who struggle to make sure the fund is being utilised and yielded.

Lastly, Interest or *Riba* brings economic instability. Interest to some extent destabilises the economy, as Friedman (1971) associates the ups and downs of an economy with an increase and decrease in an interest rate. Moreover, Shajari and Kamalzadeh (1995) contends that there are serious suspicions against interest rate and other economic objectives. For instance, the use of the interest rate as inflation control measure is not satisfactory. This is, because first of all, inflation often takes place together with stagnation. The inflation phenomenon in times of depression cannot be simply adjusted through interest rate variations. Secondly, in cases of low elasticity of demand, the excess burden of interest rate will simply fall on the final consumer. In such situations, the interest rate transforms itself into an inflationary variable. Finally, in the long run, via decline in investment and production, rise in interest rate turn out to be more inflationary (Shajari and Kamalzadeh (1995). However, the financial market is not stable when there is a regular fluctuation of an interest rate. It also causes inflation within the economy as when producers borrowed capital with higher interest, the goods or services they produced will bear higher prices. Furthermore, it allows outflow of currencies to the wealthy people when the poorly paid loans back with interest, more currency within the economy means inflation.

The prohibition of interest -based lending contributes tremendously to the stability of financial system and the economy in general accordingly. It is due to the reality thorough screening and supervision of *shariah* accepted financial derivatives in Islamic financial system which was not there in conventional financial system, and its severe impacts makes the economy to suffer (ISRA 2018).

To this end, Siddiqi (2004) opined that the consequence of interest on the societal wellbeing can be summarised as a) It brings corruption among the people in the society, b) It is unjust and unfair, c) It degrades and lessens personality of people, d) It brings an adverse effect on growth e) It implies indecorous seizure of other people properties (Siddiqi 2004).
Therefore, based on the discussed reasons, it can be said that interest rate is only baited by creditors to transfer the wealth of the debtor; it cannot be an agent for growth and development but rather a tool for exploitations (Kareem 2017).

Conclusion and Recommendation
Interest or Riba is prohibited in Islam based on Quranic provision and Prophet Muhammad (PBUH) Sunnah as well as other religious beliefs discussed earlier. The prohibition of Riba by Islamic *Shariah* can also be justified. The negative implications of interest on economy are part of the reasons for the prohibition. Based on the earlier discussions, it is concluded that interest rate is different from profit. It is no longer a tool for economic growth and development, but a tool for exploitation and economic instability. Therefore, this study recommended a moving away from abusive high-interest businesses, interest-based savings accounts and embrace what can bolster the global economy. It is a common-sense way for the global economy to enjoy a truly free market. The global economy can be bolstered when it adopted Islamic financial activities. This financial activity is a universal traditional Abrahamic ethic, it is not only Islamic economic concept. The assertion of Jim Reid on what will replace the fiat money after it ended (Colson, 2017) have already been identified in Islamic finance. The traditional or conventional economic and financial activities which are the agent of interest are to be substituted with that of Islamic economics and finance where both debt and equity financing is acknowledge. According to Al-Jarhi (2017), Shareholders' participation in management reduces the firm's incentives to substitute riskier for safer assets in equity finance. Meanwhile, the firm's incentives to hide profits would be reduced by debt finance. A combination of both debt and equity finance would therefore be ideal. Empirical studies confirm the advantages of using a combination of debt and equity finance to both banks and firms. Theoretically, banks are relatively more exposed to adverse selection during economic booms and to moral hazard during recessions. Empirical studies have confirmed that banks globally face lower risk than commercial banks during both booms and busts (Al-Jarhi, 2017).

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Though, Muslims are not allowed to participate in any form of conventional financial activity so that the economy will be free from the negative influence of interest. Furthermore, it can be said that, Islamic financial activities became an obligation to all Muslims who want to participate in modern time financial activities. Participating in Islamic financial activity is an act of worship. Furthermore, economies of non-Muslims countries are also encouraged to adopt Islamic banking and finance which is based on profit and loss sharing as an alternative financial intermediary. Islamic banking and finance are the banking other financial markets activities which is built around the teaching, the values, the spirit, and the ethics of Islamic religion, and guided by the Islamic *Shariah* principles. Islamic banking and finnace activities exclude any transaction which the subject matter is invalid (*haram)* in the Islamic *Shariah* context (ISRA 2012).

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