

The Promotion of Islamic Finance in Algeria: The Role of the Banking Sector

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Abstract :

The Islamic finance sector has experienced remarkable growth worldwide, with significant development marking the evolution of Islamic banks since the 1990s. The foundation of Al Baraka Bank in the early 90s enabled the launch of a range of Islamic products in Algeria. On the regulatory front, the Islamic finance sector has been shaped by the publication of several decrees aimed at aligning it more closely with conventional finance. This paper aims to examine the reality of Islamic finance in Algeria by focusing on the evolution of regulations and the current state of Islamic banking activities in the country.

Keywords : Islamic finance; Islamic banking sector; Algeria

Jel Classification Codes : G21; G25

1. INTRODUCTION

Islamic finance recorded its first experiences in the 1950s in Pakistan, followed by Egypt in the 1960s with the establishment of the Mit Ghamr Local Savings Bank. Significant development marked the evolution of Islamic banks starting in the 1990s (Bitar & Madiès, 2013, p. 293).

The growth of the Islamic banking system was stimulated by the creation of the Islamic Development Bank in 1975, giving recognition and an institutional framework for the development of Islamic finance.

(Guermas-Sayegh, 2011, p. 2). Today, this financial services industry continues to expand, with Islamic banks located not only in Muslim countries but also in Western nations.

The sharp increase in energy prices acted as a catalyst for the development of Islamic finance globally, as it enriched certain countries and directed excess liquidity to global financial markets. Many countries established Islamic banks to enable the use of these funds in accordance with Islamic principles.

Islamic finance offers financial solutions while adopting an ethical conduct (Islamic Finance Advisory & Assurance Services, 2020, p. 7). All banking transactions are primarily based on sharing results, as well as the prohibition of interest collection and payment.

Islamic banking institutions place greater emphasis on moral and social dimensions and exhibit certain distinctive features, particularly in terms of balance sheet configuration, compliance considerations, and social objectives (Guéranger, 2009, p. 203). This contrasts with the conventional system, where the primary goal of transactions is economic and financial in nature.

The foundation of Al Baraka Bank in the early 90s enabled the launch of a range of Islamic products in Algeria. . Other than Al Salam Bank, several other traditional banks are involved through counters that offer products compliant with Sharia principles.

From a regulatory perspective, the Islamic finance sector in Algeria has been shaped by the publication of several decrees aimed at aligning it

with conventional finance while establishing an institutional, legal, and regulatory framework for this financial industry in the country.

We aim to examine the overall state of Islamic finance and, more specifically, the activities of Islamic banks in Algeria. However, we question the actual status of the Islamic banking sector in Algeria:

To what extent has the promulgation of a regulatory framework tailored to the unique characteristics of Islamic banking created an environment conducive to the development of Islamic finance in Algeria?

To address this issue, we base our analysis on the following hypotheses:

- The presence of Islamic finance as a whole is limited and still in a maturation phase.
- The establishment of a specific regulatory framework for the Islamic finance sector and the activities of Islamic banks, in particular, should facilitate the launch and development of this segment.

We will first look at Islamic bank financing, then at the development of the legal framework and the State of Islamic Banking Activity in Algeria

2. Islamic Banks and Financing

An Islamic bank is defined as one whose activities are entirely compliant with Sharia law. The compliance of these activities and the banking products offered is assessed by an independent body, represented by a Sharia committee established within the bank (Bitar & Madiès, 2013, p. 294).

Implementing banking activities in line with Islamic principles requires adherence to specific principles, which are verified by the compliance council. These principles include (Amjid, 2010, p. 3) :

- The prohibition of interest, known as Riba or illicit gains, is formally prohibited by Islamic law.(prohibiting any enrichment without a corresponding obligation).
- The prohibition of Gharar, which refers to uncertainty and ambiguities in contract terms.
- The prohibition of speculation or gambling in all commercial transactions (prohibiting any enrichment without effort).

- The promotion of participation and the sharing of losses, and profits.
- The prohibition of generating profits from transactions not backed by tangible assets or services. Islamic financiers must derive earnings from projects where returns are tied to risk-taking (unrelated to credit risk), with losses and profits shared.
- The prohibition of unethical investments, as Islam forbids investing or trading in certain sectors deemed illicit, such as alcohol.

For Islamic banking institutions, the intermediation system is approached in a different way. Here, the depositor faces an investor's risk. Unlike depositors in conventional banks, who are compensated with interest and protected by a deposit guarantee system in case of bank failure, depositors in Islamic contribute to the gains or losses linked to the project financed by their bank (Bitar & Madiès, 2013, p. 296).

The most distinctive pillar of Islamic finance is the prohibition of interest. The borrower manages the project financed by the bank, and the project's outcomes—whether profits or losses—are shared between the two partners (the bank and the borrower) based on terms agreed upon in the contract. The goal is to ensure socially responsible financing and a fairer distribution of wealth.

Participatory banking intermediation, based on the principle of profit-sharing, is a unique feature of Islamic banks. It fosters the development of relationships between the bank and the depositor on one side and between the bank and the entrepreneur on the other (Ben Daoud, 2012, p. 37).

Islamic banks encourage the creation of profitable projects, where project financing is based on existing resources or their own equity. The resources of these banks primarily consist of clients' investment deposits. Demand deposits, which fund exchange and payment operations, and savings deposits constitute another source of financing. Donations and zakat fund the social services account.

Islamic banking institutions exhibit specific characteristics, particularly in relation to the following aspects (Guéranger, 2009, pp. 203-212) :

- The balance sheet configuration: This reflects the nature of the relationship between the bank and its clients. There is a significant difference between the balance sheet of an Islamic bank and that of a conventional bank due to the specific nature of certain Islamic products.
- The issue of compliance: For Islamic banks, compliance also includes adherence to Islamic prescriptions, which is ensured through the use of a Sharia committee.
- Social objectives: The moral dimension of the objectives of Islamic banks is evident in social programs that fulfill religious obligations.

The role of the central bank remains marginal, with Islamic banks financing their projects from funds raised or from their own capital. (Bitar & Madiès, 2013, p. 297). The absence of an interbank money market prevents the spread of failures between banks.

3. The Legal Framework for Islamic Banking Operations in Algeria

A framework legalising the existence of Islamic finance in Algeria was introduced by the regulation of 04 November 2018. Banking operations linked to participative finance have been specified, without however explicitly mentioning Islamic finance.

Taking an interest in the legal environment of a sector is one of the priorities that encourages its expansion and guarantees greater transparency. In this context, the 2020 regulation, followed by the instruction of 2 April 2020, provides a framework for the operations of Islamic banks.

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The 15 March regulation, allowed Islamic banks to operate legally. All operations do not have to be related to anything that is considered interest. The regulation also defines the various banking products related to Islamic finance, namely (Regulation of March 15, 2020, Articles 5 to 10):

- Murabaha: A sales contract for movable or immovable goods between the bank or a financial institution and a client, at a cost price increased by an

agreed-upon profit margin and according to the payment terms set by both parties.

- Musharaka: A partnership contract between a bank or financial institution and one or more parties, aimed at generating profits. The participation can involve the capital of a business, a project, or commercial operations.
- Mudaraba: A contract in which a capital provider, representing a bank or financial institution, supplies the capital for a project to an entrepreneur, who provides the labor with the aim of generating profits.
- Ijara: Under this contract, the bank rents a movable or immovable asset to a customer for a period and at a price set down in the contract.
- Salam: A forward sale contract, where the bank or financial institution acquires and delivers goods to a client at a future date, against immediate payment.
- Istisna'a: A contract in which one party (the buyer) agrees to acquire a specific good from another party (the manufacturer). The good must be produced according to predefined specifications, price, and terms agreed upon by both parties.

This regulation also requires Islamic banks to obtain authorization from the central bank to establish a Sharia compliance control committee and to operate through a dedicated window offering exclusively Islamic finance services and products, catering to the needs of individuals and businesses.

New fiscal provisions were introduced by the supplementary finance law for 2021 to promote and strengthen Islamic finance operations. These provisions include tax incentives and public treasury measures, such as tax exemptions and interest rate subsidies for investments in certain regions of the country related to Islamic finance products.

The monetary and banking law in 2023, introduced a set of measures modernizing the banks and strengthening its regulatory, supervisory and develop Islamic finance. Only authorised banks and financial establishments can carry out Islamic finance operations.

Starting from 2024, applicants for Islamic finance can benefit from a subsidy on the profit margin of mortgage loans granted by banks. The profit

margin is set at 5% when the beneficiary's income is more than one time the National Minimum Guaranteed Wage (SNMG) and less than or equal to six times the SNMG. When the income is greater than six times the SNMG and less than or equal to twelve times the SNMG, the margin will be 3% (Executive Decree No. 24-232 of July 13, 2024).

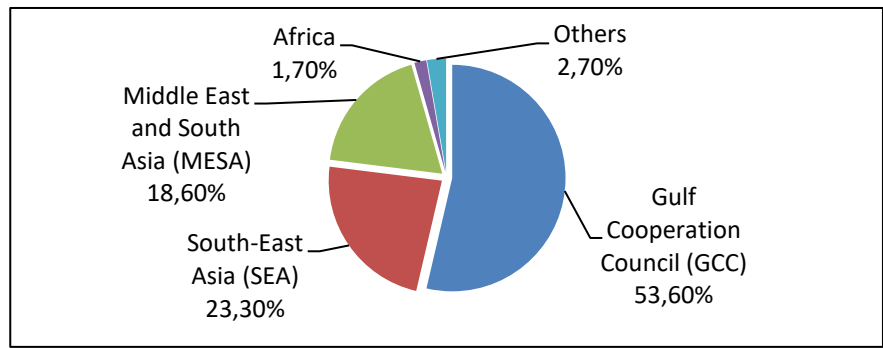
The insurance partnership with public and private banks involved in Islamic finance, in accordance with the executive decree of 23 February 2021 introducing Islamic insurance (Takaful) in Algeria, has strengthened the presence of these banks in the Islamic financial services market.

4. STATE OF ISLAMIC BANKING ACTIVITY IN ALGERIA

The financial crises experienced globally have enhanced the attractiveness of Islamic finance, particularly Islamic banks, with several Western countries showing interest in this type of financing due to its avoidance of speculation and risk-sharing features, as well as the significance of its characteristics, particularly in terms of banking regulation.

The global distribution of assets in the Islamic financial services sector in 2022 according to region shows that the Gulf Cooperation Council region holds the top position, accounting for more than half of the industry's assets. The total value of assets, amounting to \$3,245.5 billion, is primarily driven by the banking sector, with \$2,249.2 billion (IFSB, 2023, p. 11), or 69%.

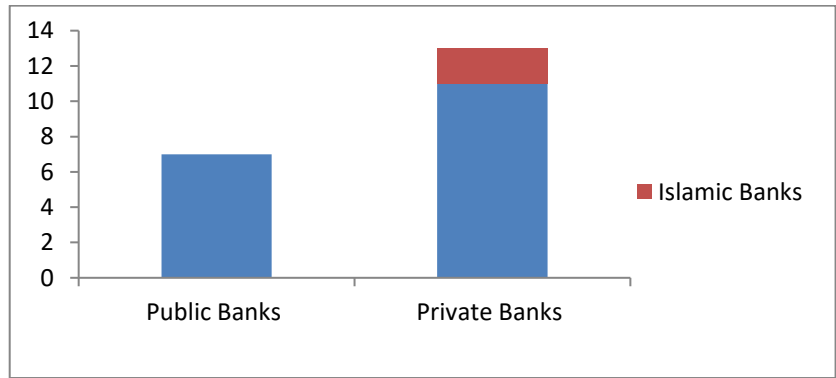
Fig.1. Distribution of the Islamic Financial Services Industry (IFSI) by Region (2022)



Source: created by us based on: (IFSB, 2023, p. 11)

Islamic funding in Africa lags behind its development worldwide, accounting for less than 2% of total global Islamic financial services (see Figure 1). Banks account for 90% of assets, estimated at 49.6 billion dollars.

Fig.2. Distribution of Banks in Algeria (2023)



Source: Created by us based on: (BA, 2024)

In Algeria we count in total 20 banks (7 public banks & 13 private banks with foreign capitals) as well as two public financial institutions (BA, 2024).

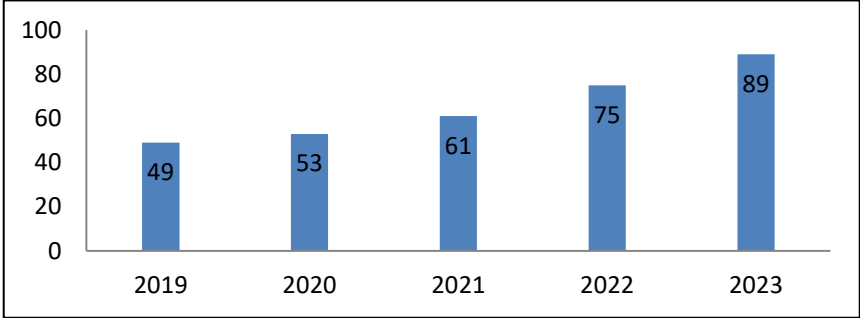
Islamic financial services are also offered by public commercial banks through branches dedicated to offering Islamic financial products.

The development of an Islamic window within a bank must ensure (IFSC, 2015, p. 11) :

- Compliance with Sharia principles in transactions and operations of the windows.
- Appropriate risk management policies.
- Separation of Islamic activities from non-Islamic ones.

These branches contribute to the expansion of Islamic banking by developing partnerships with international financial institutions offering new financial products (Tahraoui, 2022, p. 654).

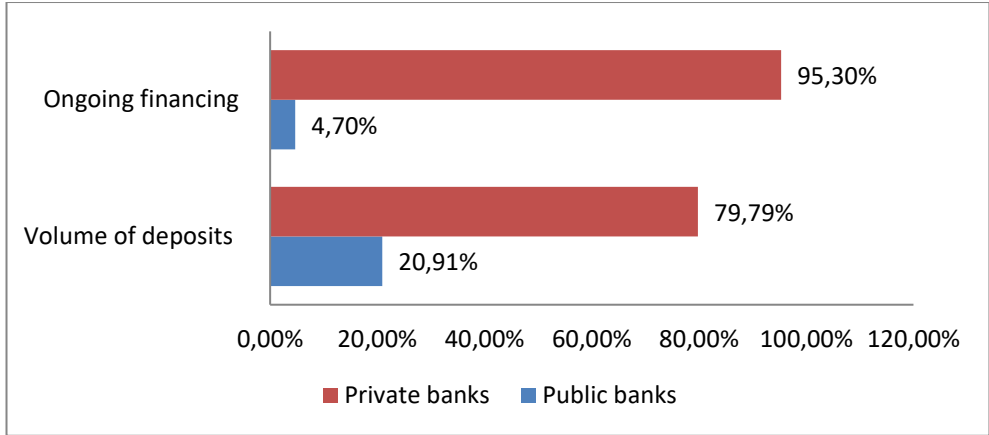
Fig.3. Evolution of the Number of Bank Branches Dedicated to Islamic Finance (2019-2020)



Source: Created by us based on: (BA, 2024)

Figure 3 shows the trend in the number of Islamic bank branches. Some banks have invested in extending their networks for Islamic financing, with the number of branches doubling between 2019 and 2023 from 49 to 89. This action is part of an objective to facilitate citizens' access to Islamic financial services, thus accelerating banking penetration and financial inclusion.

**Fig.4. Outstanding Deposits and Financing in Islamic Banking
(2023)**



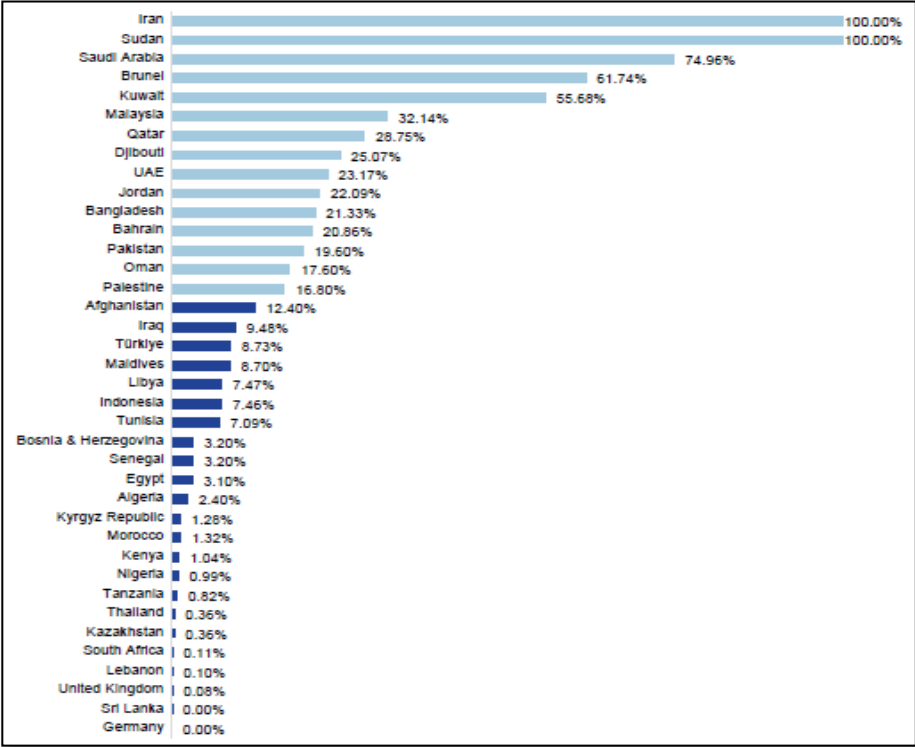
Source: Created by us based on: (BA, 2024)

The data on the balance of deposits and financing related to Islamic finance within the banking system in Algeria show that the largest share is held by private banks.

The balance of deposits collected by banks operating in Islamic finance, represented more than AD 680 billion in 2023, while the value of financing granted to businesses exceeded 493 billion DA (BA, 2024).

Nearly 21% of the volume of deposits and less than 5% of the financing balance of public banks are allocated to the marketing of Islamic finance products and services. For private banks, the share of deposits and financing remains significant.

Fig.5. Islamic Banking Share in Total Banking Assets by Jurisdiction (2023)

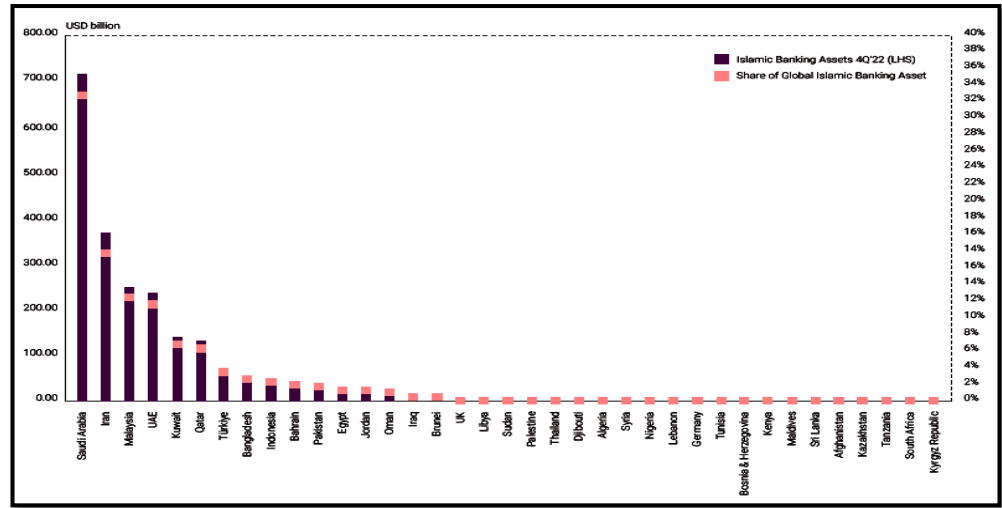


Source: (IFSB, 2024)

In Algeria, the presence of Islamic finance remains relatively weak, with Islamic banks holding only 2.4% of the total national banking assets in 2023 (see Fig.5).

Like many Arab countries, Islamic finance in the country has been marked by a delay in its formalization through a legal framework compatible with its specificities.

Fig.6. Domestic Islamic Banking Assets (USD billion) and the Share of Global Islamic Banking Market (2022)



Source: (IFSB, 2023, p. 24)

Figure 6 highlights the disparity between different countries in terms of the share of Islamic banking assets in the global Islamic banking market. Algeria remains at the bottom among countries to introduce Islamic finance, and the weight of its banking system is also marginal.

5. CONCLUSION

Despite the remarkable and growing rise of the Islamic finance industry globally, its weight remains relatively in Algeria compared with the financial sector as a whole.

The 2018 regulation legalized the existence of Islamic finance within the Algerian financial and economic environment, while the 2020 regulation addressed gaps left by the previous one.

The regulation of the Islamic finance sector in Algeria was one of the elements on which the authorities relied to promote the activity of banks in accordance with Islamic religious and moral principles.

The introduction of a policy by the public treasury in 2024, offering interest rate subsidies and margin reductions on real estate loans, was part of

the government's efforts to strengthen the role of Islamic banks in the national banking market, reducing the cost of real estate loans and facilitating access to homeownership.

Putting in place tax and accounting legislation that takes account of the specific features of Islamic banking, and controlling the risks specific to this activity, will enable Islamic finance to develop more effectively. Integrating Islamic finance into the realm of digital technologies, innovating its tools, and training professionals in this field are also of particular importance.

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