

The Central Bank and its proposed monetary policy tools after Algeria's opening up to Islamic banking

البنك المركزي وأدوات سياسته النقدية المقترحة بعد انفتاح الجزائر على الصيرفة الإسلامية

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Abstract:

This research aims to shed light on the work of the Central Bank and monetary policy tools proposed by the researcher after the the openness that Algeria witnessed to Islamic banking, which is due to the issuance of Regulation 20-02 dated 15 March 2020 for banking operations related to Islamic banking, and this is for the purpose of avoiding Islamic banks and Islamic banking windows to avoid dealing with the interest method in their relationship with the Central Bank

(Bank of Algeria) and in their application of quantitative and qualitative tools of conventional monetary policy. This research relied on a descriptive and analytical approach, through which we were able to present a conceptualisation of the mechanisms of a comprehensive central bank with scientific alternatives to quantitative monetary policy tools. Scientific alternatives to quantitative and qualitative monetary policy tools that prohibit usury preventing the creation of money and achieving sustainable development .

Keywords: Central Bank; monetary policy; quantitative and qualitative tools; Islamic banking; Algeria.

ملخص:

يهدف هذا البحث إلى تسليط الضوء على عمل البنك المركزي وأدوات سياسته النقدية المقترحة من قبل الباحث بعد انفتاح الذي شهدته الجزائر على الصيرفة الإسلامية؛ والذي يرجع بعد صدور النظام 02-20 بتاريخ 15 مارس 2020م المحدد للعمليات البنكية المتعلقة بالصيرفة الإسلامية وهذا لغرض تجنيب البنوك الإسلامية والشبابيك الصيرفة الإسلامية التعامل بأسلوب الفائدة في علاقتها مع البنك المركزي (بنك الجزائر) وفي تطبيقها لأدوات الكمية والكيفية للسياسة النقدية التقليدية. وتم الاعتماد في هذا البحث على المنهج الوصفي والتحليلي والذي تمكنا من خلاله من تقديم تصور لآليات عمل بنك مركزي شامل رفقة البدائل علمية لأدوات سياسة نقدية كمية وكيفية كفيلة التي تحرم الربا وتمنع خلق نقود وتحقق تنمية المستدامة.

الكلمات المفتاحية: بنك مركزي، سياسة نقدية، أدوات كمية (كيفية، صيرفة إسلامية، الجزائر).

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1 .INTRODUCTION

The central bank is a governmental financial institution tasked with overseeing the banking system of any given country. Its primary goal is to maintain monetary and financial stability while fostering economic growth. As the principal authority for currency issuance, monetary supply regulation, and credit organization, the central bank serves as the cornerstone for implementing the desired monetary policy. In Algeria, the expansion of Islamic banking began with licensing Islamic banks, such as Al Baraka Bank Algeria in 1991 and Al Salam Bank Algeria in 2008. This was followed by the establishment of Islamic windows within foreign banks, including Gulf Bank Algeria (AGB), Housing Bank for Trade and Finance Algeria, Trust Bank Algeria, and ABC Bank's Al-Buraq window. Furthermore, public Algerian banks inaugurated Islamic banking windows, starting with the National Bank of Algeria on August 4, 2020, after the issuance of Regulation 20-02 on March 15, 2020, which governs Islamic banking operations. This was later reinforced by Monetary and Banking Law No. 23-09 issued on June 21, 2023, which regulates the operations of the Bank of Algeria.

Consequently, Islamic banks and windows operating within conventional banks are compelled to interact with the central bank, which applies traditional monetary policy tools based on interest. This practice contradicts Islamic principles, impeding the functionality of Islamic banking.

Problem Statement:

- Based on the aforementioned context, the research problem can be outlined as follows:

"What is the ideal model of a central bank, and what are the new tools of its monetary policy in light of Algeria's openness to Islamic banking?"

Sub-questions:

- What is the envisioned central bank, and how would it operate?
- What is the relationship between the central bank and Islamic banks or windows?
- What are the alternative monetary policy tools that comply with Islamic law?

Hypotheses:

In light of the previous questions, the research hypotheses are summarized as follows:

- Algeria's recent openness to Islamic banking is expected to lead to a reevaluation of the central bank's operations.
- Current monetary policy tools are incompatible with the nature of Islamic banks and windows.
- The Islamic financial system has successfully proposed alternative monetary policy tools that align with the operations of Islamic banks and windows.

Significance of the Study:

This study is crucial for understanding the mechanisms of the central bank's operations, its relationship with Islamic banks and windows, and the proposed monetary policy tools aimed at reforming and strengthening the banking system to achieve its objectives.

Objectives of the Study:

The primary goal of this research is to prevent Islamic banks and windows from having to interact with a central bank that relies on interest-based tools in most of its conventional monetary policies, instead advocating for tools devoid of usury and gambling.

Research Methodology:

This research adopts descriptive, analytical, and exploratory methodologies to provide a comprehensive understanding of the central bank's expanded role and its new monetary policy tools that can support the banking system following the openness to Islamic banking.

Literature Review:

Given the novelty of this topic in the Algerian banking sector, no previous studies, research, or academic articles have been found addressing it in detail, despite extensive reviews of journals, conferences, and online platforms. Instead, some related references are cited:

- **Jamal Ben Daas (2007):** *Monetary Policy in Islamic and Conventional Systems: A Comparative Study*. First Edition. Algeria: Al-Khaldounia Publishing. This book discusses monetary economics in Islamic and conventional systems, with dedicated chapters on monetary policy in both frameworks and a comparative analysis.
- **Fouad Ben Hadou (2021):** *The Islamic Central Bank and Its Monetary Policy Tools*. *Global Islamic Economics Journal* (144): This paper presents a model of an Islamic central bank and its Sharia-compliant monetary policy tools, proposing them as alternatives to interest-based tools, which are religiously prohibited and inflationary.

Study Outline:

The study is divided into four main chapters:

- **Chapter One:** The concept of the Islamic central bank, its supervisory tools, and its relationship with Islamic banks.
- **Chapter Two:** The nature and objectives of monetary policy in the Islamic system.
- **Chapter Three:** Quantitative and qualitative tools of monetary policy in the Islamic system.
- **Chapter Four:** Complementary and direct tools of monetary policy.

2. Concept of the Islamic Central Bank

2.1 Definition and Supervisory Tools

2.1.1 Definition of the Islamic Central Bank

The Islamic Central Bank is defined as:

"An independent governmental institution responsible for achieving the economic and social objectives of the Islamic economy in the monetary and banking fields" (Omar, 1992, p. 196).

This institution can provide services and establish relationships with Islamic banks in a manner consistent with Sharia principles and objectives. This can be achieved

either by creating a standalone Islamic central bank or by introducing dedicated Islamic banking windows and services within existing central banks.

2.1.2 Tools of Supervision:

The tools of supervision employed by an Islamic central bank include the following (Hassan, 2000, p. 252):

- **Mandatory reserve ratio:** Allowing broader utilization of current deposits (checking accounts) for *Qard Hasan* (benevolent loans) purposes, not only for individuals but also for governments.
- **Participation in company capital:** Encouraging Islamic banks to invest in company shares.
- **Funds employment ratios and credit ceilings:** With a particular focus on credit ceilings as a qualitative tool.
- **Liquidity regulation ratios:** To maintain appropriate liquidity levels in Islamic banks.
- **Trading of commercial papers:** Subject to Sharia compliance.
- **Prudential regulations:** Ensuring the financial soundness of Islamic banks.
- **Inspection and oversight:** Regular audits and inspections to ensure compliance.
- **Clearing operations and other functions:** Provided these do not conflict with Islamic law.

As the lender of last resort, the Islamic central bank offers broader alternatives due to its reliance on non-interest-based mechanisms. Other proposed supervisory tools often involve utilizing profit-sharing ratios as substitutes for interest rates, influencing paid premiums. This approach is also employed, albeit differently, in conventional banking systems (Ismail, n.d., p. 251).

2.2 Nature of the Relationship Between the Central Bank and Islamic Banks, and Challenges Faced:

2.2.1 Forms of Relationship:

Three distinct forms of relationships between central banks and Islamic banks have emerged in practice (Ismail, n.d., p. 232; Fouad, 2021, pp. 37–38):

1. Integrated Original Relationship:

This type arises in countries that have converted their banking systems, including central banks, into Islamic systems. Examples include Pakistan, Iran, and Sudan.

2. Special Relationship:

This exists in countries that have issued specific laws and regulations for Islamic banks to define their relationship with the central bank. Such regulations help Islamic banks achieve their objectives while avoiding involvement in prohibited *riba* (interest). Countries with such laws include the UAE and Turkey.

3. Exceptional Relationship:

Found in countries where Islamic banks operate alongside conventional banks under exceptional laws. The previous legal frameworks still govern the relationship between Islamic banks and central banks, which are rooted in the global banking system. Islamic banks in such contexts have worked hard to secure exceptions to interest-based transactions imposed by central banks. Examples include Islamic banks in Egypt, Kuwait, Jordan, and Bahrain.

2.2.2 Challenges Faced by Islamic Banks with Central Banks:

The relationship between the central bank and Islamic banks, including Islamic banking windows, is obligatory by banking law in any country, as they form an integral part of the banking system. However, this relationship faces numerous challenges due to the nature of conventional, interest-based central banking systems. These challenges can be summarized as follows (Al-Tarad, 2005, pp. 23–24; Al-Gharib, 1996, p. 101; Saleh, 1992, p. 27; Mustafa, 2002, p. 5; Al-Amaida, 1991, p. 116; Zaid, 1996, p. 30; Al-Sartaous, 2002, p. 20; Shahada, 1994, p. 19):

- Central banks apply the same liquidity ratio to Islamic banks despite differences in the components of the ratio denominator. Islamic banks do not deal with interest-based bonds, which are one of the denominator's components. Instead, shares can be considered as a substitute, as they do not involve interest-based transactions and fulfill the requirements of security and financial ease in managing funds within Islamic banks.
- Central banks impose the same statutory reserve requirements on Islamic banks as on conventional banks.
- Islamic banks face difficulty in obtaining financing from central banks when needed. To address this, central banks should allocate funds through *mudaraba* or *musharaka* contracts with Islamic banks, allowing the central bank to earn a profit margin distinct from that of other clients, thus preserving the margin for Islamic banks. Some central banks have resorted to placing investment deposits with Islamic banks to resolve this issue.
- Islamic banks do not benefit from rediscounting, as this tool conflicts with their operational nature and is prohibited under Sharia law due to its reliance on *riba* (interest). The rediscount rate, aimed at controlling money supply, should therefore be abolished.
- Open market operations conducted by central banks are incompatible with Islamic banking practices, as interest-based bonds are issued at a fixed rate. Central banks should instead issue Islamic *sukuk* as a substitute for conventional bonds.
- The capital-to-deposits ratio applied to Islamic banks mirrors that imposed on interest-based commercial banks. However, some argue that the ratio for Islamic banks should differ to reflect their distinct operational principles.
- Central banks typically apply penalties and financial fines, such as those for non-compliance with statutory reserve requirements, based on interest rates. This directly contradicts the prohibition of interest in Islamic banking. It is suggested that such penalties be fixed amounts instead.

3. The Nature of Monetary Policy in the Islamic Economic System

3.1 Definition of Monetary Policy in Islam and Its Objectives

3.1.1 Definition:

- Linguistically: The term "policy" (*siyasa*) derives from the Arabic phrase "*sust al-ra'yya siyasan*," meaning to govern, direct, and manage. It is said, "*soosa fulan amr al-nas*," implying someone became a ruler or king (Abadi, 2012, p.

551). Thus, *siyasa* denotes "a system or regulation established to govern ethics, interests, and financial stability" (Al-Barkati, 2003, p. 117).

- Terminologically: Monetary policy in Islam is defined as "a set of measures, actions, and decisions undertaken by the state through the central bank to regulate and control currency issuance, ensuring alignment with the investment, production, and consumption structures of the national economy" (Daghai, 2010, p. 448).

The primary objective of monetary policy is to achieve economic stability by controlling fluctuations, maintaining price stability, and ensuring the internal and external value stability of the currency in line with Sharia principles. This includes reducing unemployment, achieving full employment, and maintaining a balanced balance of payments (Irshid, 2012, pp. 160–161).

The term "monetary policy" is relatively recent, emerging in the 19th century with the rise of economic crises, wars, and the introduction of paper currency alongside its related issues, especially inflation (Ali, 1988, p. 372). However, the absence of the term historically does not imply the absence of practical implementation. In the early Islamic state, monetary policies were evident through the minting of coins, distinguishing pure from adulterated currencies, and regulating their circulation to preserve rights and stabilize prices—an essential function of monetary policy (Daas, 2007, p. 87).

3.1.2 Objectives:

The objectives of monetary policy are as follows (Irshid, 2012, p. 161):

- To achieve an acceptable level of monetary and economic stability by avoiding changes that affect the national currency's value internally and externally, often due to fluctuations in the general price level.
- To contribute to achieving appropriate economic growth rates across various sectors, thereby enhancing national income, gross national product (GNP), and gross domestic product (GDP).
- To assist in developing financial institutions and markets (money and capital markets) that support national economic development.
- To accelerate economic development by creating an environment conducive to implementing economic and social development projects in developing countries.
- To achieve the required balance in the balance of payments.

While these goals are integral to conventional economic systems, the Islamic economic system fundamentally differs. Proper implementation of Islamic policies inherently prohibits practices that destabilize the economy (Al-Turkmani, 1988, pp. 42–43).

3.2 Principles and Types of Monetary Policy

3.2.1 Principles:

The principles of monetary policy in Islam are as follows (Afr, 1979, p. 346):

- Banking System Regulation: The monetary authority mints currency, distinguishes genuine from counterfeit, prevents forgery, determines the amount of currency in circulation, and monitors its usage to maintain price

stability. These functions are sovereign and must be exclusively managed by the state.

- **Savings Mobilization and Investment Allocation:** This involves directing savings toward investment by aligning with development plans and abolishing interest on capital. Instead, a profit-and-loss sharing system is implemented.
- **Regulating Money Supply:** Currency issuance is only permissible based on actual economic needs to prevent harm to value stability or unequal benefits for certain parties. It is known that fluctuations in purchasing power or money supply, as reflected in price changes, have significant societal effects, such as altering the value of assets and wealth distribution.

3.2.2 Types:

The types of monetary policy depend on the country's circumstances and economic conditions, as follows (Daghai, 2010, p. 505):

- **Expansionary Monetary Policy:** This policy is adopted during periods of stagnation or recession. The monetary authority increases the money supply by boosting incomes and stimulating demand for consumer goods and investments, thereby raising demand for goods and services.
- **Contractionary Monetary Policy:** This policy is implemented during inflationary periods. The monetary authority reduces the money supply, limits credit creation, and curbs spending at both individual and institutional levels.

4. Quantitative and Qualitative Tools of Monetary Policy in the Islamic System

4.1 Quantitative Tools

4.1.1 Definition:

Quantitative tools refer to instruments aimed at influencing the total volume of money in circulation within society, in accordance with prevailing economic conditions, to achieve the objectives of monetary policy.

4.1.2 Types:

The main quantitative tools include the following:

4.1.2.1 Adjusting the Allocation Ratios of Current Deposits (Demand Accounts):

Due to the prohibition of hoarding in Islam, the imposition of zakat as a penalty for idle wealth, and depositors' desire to earn profits rather than depositing without returns, the ratio of current deposits in Islamic banks is minimal compared to investment deposits. However, the accumulation of significant amounts from these deposits forms a substantial sum. Failing to invest these funds constitutes a hoarding of vital societal resources. Investment must be based on real deposits, not derivative money. In this case, the central bank may intervene with banks to adjust the allocation ratios of these deposits, distributing them to appropriate institutions and employing them in areas aligned with desired monetary policy goals (Daas, 2007, p. 241).

According to A. Jamal Bin Daas, the allocation ratio for current deposits is a concept introduced by Zahira Abdel Hamid. These deposits can be utilized to provide short-term financing for various economic projects, offer *qard hasan* (benevolent loans) to individuals in special circumstances (e.g., illness, death, marriage, pilgrimage),

and purchase non-interest-bearing government bonds to fund public spending (Afr, 1979, p. 364). The following allocation ratios are proposed for normal conditions:

- **20% as cash liquidity held by the bank:** Islamic banks must retain a portion of current deposits as cash liquidity to meet immediate withdrawal demands by depositors. This percentage can be determined based on the central bank's expertise and historical experiences of various banks.
- **20% as a reserve deposit with the central bank:** Islamic banks are required to deposit a portion of their current deposits as a reserve with the central bank, determined according to prevailing monetary policy. The purposes of this reserve include:
 - Ensuring depositors' rights and encouraging them to deposit funds in banks.
 - Utilizing the reserve as a quantitative tool in monetary policy to either inject or withdraw funds from circulation. Additionally, the reserve may be used as a qualitative tool to finance priority sectors or provide *qard hasan* loans to the government. The central bank may engage in either partnership-based or benevolent loan arrangements depending on the nature and significance of the activity.
 - Generating income for the central bank through the economic use of this reserve, aiding in maintaining its independence.
- **15% allocated for purchasing government bonds:** These bonds would take the form of *qard hasan* loans, representing indirect lending by depositors through the institutional intermediary of the bank, as individuals might be reluctant to deposit funds for extended periods to purchase such bonds (Aref, 1982, p. 36).
- **15% for loans to small investors:** These loans may be offered as *qard hasan*, provided adequate guarantees are secured, or as participatory investments in small and medium-sized enterprises (SMEs). SMEs are often more productive and contributive to the national economy than large projects, making them preferable for Islamic banks. In contrast, conventional banks favor large projects as they are perceived to offer greater security for recovering loaned capital and interest. Conventional banks are indifferent to project outcomes due to their lack of risk-sharing and reliance on predetermined interest rates (Omar, 1992, p. 147).
- **30% for the bank's investments:** The bank is permitted to invest this portion using various Sharia-compliant methods to cover administrative expenses. Additionally, the bank may offer rewards to major depositors to encourage continued deposits and attract new ones (Jaber, 1999, p. 57). This ratio is also known as the lending ratio (Siddiqi, 1999, p. 51).

The central bank may adjust these ratios to increase or decrease the money supply. For instance, during inflationary pressures, the central bank may reduce *qard hasan* loans to the government and small investors, as well as the bank's investments, thereby reducing the money supply. Conversely, during economic recessions, the central bank may increase allocations for investments and reduce reserves held by

itself and banks. It is important to note that this allocation applies only to current deposits, not investment deposits.

This policy serves as an alternative to the legal reserve ratio tool used in conventional systems, which is rejected in Islamic finance due to its reliance on allowing commercial entities to issue money for profit. Adjusting the allocation ratios of current deposits is a robust alternative, preventing the creation of unauthorized additional money while allowing the utilization of actual current deposits held by banks. By altering these allocation ratios, the central bank can effectively achieve its monetary policy objectives (Daas, 2007, p. 244).

4.1.2.2 Adjustment of Zakat Cash Ratios, Collection Timings, and Types:

If the ruler deems it appropriate, according to Sharia-based policy and for the purpose of ensuring public interest, they may decide to collect zakat from the wealthy in cash and distribute it to the poor in cash. Alternatively, they may distribute goods to the poor instead of cash, or opt for a combination of both cash and goods. This flexibility is based on the fundamental objective of zakat, which is to fulfill the needs of the impoverished. Any form of support—be it cash or goods—capable of meeting those needs is valid (Al-Turkamani, 1988, p. 261). Furthermore, the state may adjust the timing of zakat collection, either as a voluntary measure or upon the ruler's request, in alignment with public interest and prevailing economic conditions (Salhi, 2001, p. 104). By modifying the cash ratio or the timing of zakat collection and distribution in accordance with public interest, monetary policy can address economic conditions such as inflation or recession, even though such occurrences are rare or unlikely under an Islamic economic system (Al-Turkamani, 1988, p. 262).

In the case of inflation, the ruler may collect zakat in cash for all zakatable assets, effectively withdrawing large sums of money from circulation. Simultaneously, distributing zakat to beneficiaries in the form of goods will increase demand for those goods, naturally leading to their greater production. As production rises, prices decrease, thereby alleviating inflation. Conversely, during periods of economic stagnation or recession, the ruler can collect zakat in the form of goods and distribute it as cash to beneficiaries. This approach enhances liquidity within the economy, helping to mitigate the recessionary effects (Al-Turkamani, 1988, pp. 260–262). Zakat may also be distributed between consumable goods and productive goods (El-Din, 2020, pp. 393–394) based on the requirements of the state's economic activities, thereby achieving balanced growth and preventing monetary or commodity imbalances within society (Daas, 2007, p. 145).

4.1.2.3 Open Market Operations Policy:

This policy involves the central bank's intervention in financial or monetary markets as a buyer or seller of securities, gold, currencies, government bonds, or treasury bills, with the goal of either injecting or withdrawing liquidity (Qadi, 2003, p. 90). If the aim is to increase the money supply in the market to address a recession, the central bank engages in purchasing operations, injecting funds into the economy. Conversely, to combat inflation, the central bank conducts selling operations to withdraw cash from circulation (Others, 2005, p. 293).

In adherence to the prohibition of usury (riba) in the Islamic system, trading in stocks is permissible, as they represent ownership stakes in companies (Al-Kafrawi, 1997, p. 196). Transactions involving sukuk (Islamic bonds) based on partnership principles, such as sukuk al-mudarabah, sukuk al-murabahah, sukuk al-ijarah, and sukuk al-salam, are also permissible. These instruments, issued by the state, aim to involve the public in various developmental and productive projects, fund urgent expenses within reasonable capacity, or absorb excess liquidity in the market (Sabrina, 2007, pp. 190–199; Al-Omar, 1993, p. 381).

While this policy appears outwardly similar to conventional open market operations, it differs fundamentally. In conventional systems, as Maurice Allais noted, such operations resemble gambling due to their reliance on interest rates as the basis of exchange. They often involve the use of fictitious money created by commercial banks in secondary markets, causing fluctuations in prices, alternating waves of optimism and pessimism, and ultimately having a detrimental impact on the real economy (Allais, 1993, p. 35).

The Islamic system rejects such practices and operates exclusively with real, not nominal, assets. It permits only sukuk or investment certificates that are tied to profit and loss, representing stakes in existing economic institutions, and allows their trade in alignment with prevailing economic conditions (Daas, 2007, p. 247).

4.1.2.4 Adjustment of Profit Distribution Ratios and Profit-and-Loss Sharing Ratios:

This involves:

- **Profit Distribution Ratios:** The central bank may intervene to determine the profit distribution ratio to shareholders. If the monetary authorities aim to increase the money supply, they may raise the profit share allocated to savers and depositors to incentivize further investment deposits and attract new investors (Afir, 1979, p. 356). Conversely, reducing the profit share discourages investment deposits, leaving more funds dormant in banks, which can help reduce liquidity in the market.
- **Profit-and-Loss Sharing Ratios:** The central bank may alter the ratios of profit-and-loss sharing between banks and depositors or between banks and investors. To encourage investment, authorities may increase the depositor's share, attracting more deposits for investment purposes. Similarly, the investor's share may be raised to incentivize their involvement in specific sectors. Conversely, to restrict investments, both ratios can be adjusted to favor banks, reducing depositors' incentives and investors' participation (Daas, 2007, p. 248).

The central bank may also provide refinancing to banks by either participating in new projects or purchasing banks' participatory financing instruments like murabahah or mudarabah to facilitate funding (Salhi, 2001, p. 61). However, this approach may have limited effectiveness since banks are not allowed to create book money. Instead of acquiring participatory stakes from banks, the central bank could directly finance projects it deems necessary, in accordance with pre-set profit-sharing ratios, ensuring optimal resource allocation (Daas, 2007, p. 248).

This policy serves as an alternative to the rediscounting tool in conventional systems, which is rejected in Islamic finance due to its reliance on interest rates, unanimously regarded as equivalent to usury (riba) and prohibited under Islamic law.

5. Complementary and Direct Monetary Policy Tools in the Islamic System

5.1 Definition of Complementary Tools for Islamic Banks:

These tools complement the role of the previously mentioned instruments by directing monetary resources toward desired sectors.

5.2 Types of Complementary Tools:

- **Banks' Contribution Rates to Economic Activity:**

This refers to the percentage of loans provided by banks to finance small-scale investment activities and other investments, with project owners covering the remaining costs from their resources. Monetary authorities can determine and adjust these rates based on the priority and financial status of economic activities. Banks may increase their contributions to activities that the authorities wish to encourage and reduce or eliminate contributions to non-priority activities. This tool serves as an alternative to the margin of collateral required in conventional systems. The main difference is the avoidance of interest-based practices, as Islamic banks rely on profit-sharing mechanisms in investment projects (Daas, 2007, p. 252).

- **Conditions for Murabaha Sales:**

Murabaha is a sale contract where a commodity is sold at cost price plus a mutually agreed profit margin. It plays a vital role in various economic sectors, meeting domestic and foreign trade needs and stimulating overall economic activity. Murabaha transactions can be structured to promote specific sectors by easing terms for desired fields and tightening them for others. Easing could involve lowering upfront payments or extending installment periods, encouraging investment in those sectors. Conversely, stricter terms might limit access to non-priority goods, such as luxury items. Similar conditions can be applied to leasing, Salam sales, and Istisna contracts (Daas, 2007, p. 253). These tools also help diversify investments across varying risk levels, ensuring the protection of bank funds and depositor savings (Jaber, 1999, p. 187). They are comparable to conventional installment sales policies or mortgage credit tools, provided they follow Sharia-compliant principles with no reliance on interest-based practices.

5.3 Direct Tools:

5.3.1 Definition:

Direct tools are measures through which the central bank intervenes directly to ensure the implementation of monetary policy, especially during critical economic situations requiring significant and rapid changes in the money supply.

5.3.2 Types of Direct Tools (Salhi, 2001, pp. 57–58):

- **Faith-Based Persuasion:**

The central bank intervenes to persuade banks to adopt measures to address economic challenges based on a shared belief in prioritizing public interest over personal gain and adherence to the ruler's directives. This is rooted in the Quranic

command: *"And obey Allah and obey the Messenger and beware. And if you turn away, then know that upon Our Messenger is only [the responsibility for] clear notification"* (Surah Al-Ma'idah, Verse 92). Persuasion often involves direct meetings with bank managers.

- **Direct Instructions:**

When faith-based persuasion fails, the central bank issues binding directives to banks, mandating the implementation of necessary measures to execute monetary policy.

- **Direct Oversight:**

To ensure proper supervision and alignment of the banking system with the broader economic interests, the central bank conducts direct oversight of banks. This involves evaluating their compliance with prescribed measures and taking appropriate actions for or against these banks.

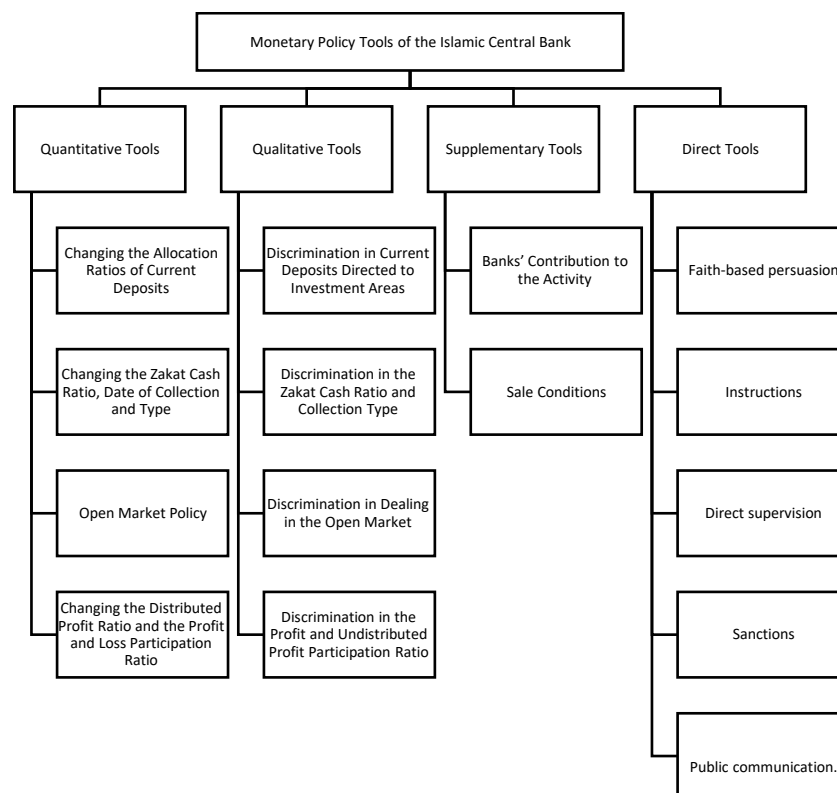
- **Sanctions:**

Sanctions are a last resort to ensure compliance. These may include penalties such as denial of borrowing or refinancing opportunities, financial fines for violations, or even suspension of banking activities. Positive incentives may also be offered to reward compliant banks, encouraging others to follow suit (Daas, 2007, pp. 253–254).

- **Public Announcements:**

The central bank communicates its future monetary policies, including qualitative and quantitative guidance for directing monetary resources, supported by data and statistics. Such transparency builds public trust in monetary policies, encouraging informed economic decisions by banks and individuals. This, in turn, aids in addressing economic issues like inflation or recession by either curtailing or expanding spending. Announcements may take the form of published reports or periodic statements through various media channels.

Figure (01): Monetary Policy Instruments in the Islamic System



Source: Prepared by the researcher

Table (01): Alternative Monetary Policy Instruments in the Islamic System and Their Comparison with the Capitalist (Conventional) System

Islamic System	Capitalist System
First - Quantitative Instruments:	First - Quantitative Instruments:
Adjusting the allocation ratios of current deposits	Adjusting the required legal reserve ratio
Open market operations (stocks, Sukuk)	Open market operations (stocks, bonds)
Adjusting the distribution ratio of profits and the ratio of participation in profits and losses	Discount rate policy (interest rate)
Adjusting the Zakat cash ratio, collection timing, and type	Monetary effects of fiscal policy
Second - Qualitative Instruments:	Second - Qualitative Instruments:
Differentiation in current deposits directed to investment fields	Differentiation in the required legal reserve ratio
Differentiation in open market transactions (stocks, Sukuk)	Differentiation in open market transactions (stocks, bonds)
Differentiation in profit-sharing ratios and undistributed profits	Differentiation in the discount rate (interest rate)
Differentiation in the Zakat cash ratio	Differentiation in the monetary effects of fiscal policy
Third - Complementary Instruments:	Third - Complementary Instruments:
The banks' contribution ratio to investment activities	Required margin of guarantee

Terms of Murabaha sales	Adjusting installment sale and mortgage credit conditions
Fourth - Direct Instruments:	Fourth - Direct Instruments:
Faith-based persuasion	Moral persuasion
Direct instructions and supervision	Directives and orders
Media dissemination	Media dissemination
Sanctions	Punitive measures

Source: Prepared by the researcher

6. Conclusion:

Through this research, we have addressed the hypotheses and reached a set of conclusions that led to several recommendations:

6.1 Testing of Hypotheses:

- **First Hypothesis:** The recent trend of the Algerian government and its openness to Islamic banking will inevitably contribute to a reconsideration of the central bank's operations. This hypothesis was proven true by presenting examples of countries that managed to adjust the relationship between their central banks and Islamic banks, benefiting both the banks and the economy as a whole.
- **Second Hypothesis:** The current monetary policy tools are incompatible with the operations of Islamic banks and Islamic banking windows. This hypothesis was confirmed, as traditional or classical monetary policy tools are based on interest (usury), which is inconsistent with the principles of Islamic banking.
- **Third Hypothesis:** The Islamic system has been able to offer alternative monetary policy tools that align with the operations of Islamic banks and banking windows. This hypothesis was confirmed by presenting both quantitative and qualitative tools, as well as complementary and direct tools, all operating in accordance with Islamic law (Sharia).

6.2 Findings:

- The proposed central bank functions similarly to a traditional central bank, with the addition of tools that align with Islamic banking operations.
- Some countries have managed to adapt their central banks' relationships with Islamic banks in accordance with their principles and objectives.
- The central bank has provided Sharia-compliant alternatives to traditional monetary policy tools that rely on interest, which is rejected in the Islamic system.
- Monetary imbalances are less likely to occur with Islamic monetary policy tools compared to traditional tools, which are known for their negative aspects, primarily interest and money creation from deposits (money supply creation).

6.3 Recommendations:

- The Algerian government should amend the laws regarding currency and credit to align with its actual openness to Islamic banking.

- The establishment of an Islamic central bank, a dual central bank system, or even a traditional central bank with flexibility is recommended. This would facilitate the ability of Islamic banks and Islamic banking windows within conventional commercial banks to achieve their objectives in line with the Islamic economic system.
- Islamic monetary policy tools, which prohibit interest (usury) and money creation, should be adopted to achieve sustainable development, instead of using conventional monetary tools that are Sharia non-compliant.
- A monetary policy based on Islamic principles should be implemented to stabilize the value of money, curb inflation, achieve high national income growth, support the development of banking and financial institutions, and contribute to the national economy by ensuring a balance in the balance of payments.

7. Footnotes and References:

Quran:

- Surah Al-Ma'idah, Ayah 92.

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