

## The Evolution of Islamic Banking in the Algerian Banking System: An Analytical Study for the Period 2018-2023

Samiha Nouri

University of Chedli Ben Djedid - El Tarf, [nouri-samiha@univ-eltarf.dz](mailto:nouri-samiha@univ-eltarf.dz)

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### Abstract

The study aims at introducing Islamic banking as a solution to the issue of cash circulation outside the banking system in Algeria. It found that Islamic banking deposits knew slight growth during the study period while cash circulation outside the banking system did not decrease due to the limited spread and restricted range of products and offered services. The contributions of Islamic banking remain dependent on the privileges granted to public banks.

**Keywords:** Islamic finance, Islamic banking products, cash circulation outside the banking system, Algerian banking system.

### تطور الصيرفة الإسلامية في الجهاز المصرفي الجزائري دراسة تحليلية للفترة 2018-2023

#### ملخص

تهدف الدراسة إلى التعريف بالصيرفة الإسلامية وتقديمها كحل لمشكل التداول النقدي خارج الجهاز المصرفي الجزائري، وتوصلت الدراسة إلى جملة من النتائج أهمها أن ودائع الصيرفة الإسلامية شهدت نموا طفيفا خلال فترة الدراسة وبالمقابل لم ينخفض التداول النقدي خارج الجهاز المصرفي، بسبب ضعف انتشارها وكذا محدودية المنتجات والخدمات المقدمة، وتبقى إسهاماتها مرتبطة بمدى تمتعها بالامتيازات الممنوحة للمصارف العمومية.

**الكلمات المفتاحية:** تمويل إسلامي، منتجات الصيرفة الإسلامية، التداول النقدي خارج الجهاز المصرفي، نظام مصرفي جزائري.

### L'évolution de la banque islamique dans le système bancaire algérien: une étude analytique pour la période 2018-2023

#### Résumé

L'étude propose à introduire la banque islamique comme solution à la circulation monétaire en dehors du système bancaire en Algérie. Elle a révélé que les dépôts des banques islamiques ont légèrement augmenté pendant la période d'étude, tandis que la circulation monétaire hors du système bancaire n'a pas diminué en raison de leur faible diffusion et de la limitation des produits et services offerts. Les contributions des banques islamiques restent conditionnées aux privilèges accordés aux banques publiques.

**Mots-clés:** Finance islamique, produits de banque islamique, circulation monétaire hors du système bancaire, système bancaire algérien.

Auteur correspondant: Samiha Nouri, [nouri-samiha@univ-eltarf.dz](mailto:nouri-samiha@univ-eltarf.dz)

## **Introduction:**

Islamic banking is the suitable model for Islamic economies which faces challenges in providing alternatives to cash for transactions, whether for households or economic agents. These alternatives need to be diverse and cater to their preferences, especially religious ones, to attract deposits and employ them according to Islamic law (Sharia).

Developing economies, including Algeria, suffer from the phenomenon of cash circulation outside the banking system, driven by behaviors such as hoarding, tax evasion, and the parallel economy. This phenomenon leads to various issues, such as the ineffectiveness of monetary policy tools and the inadequacy of oversight mechanisms for economic agents.

This phenomenon indicates a preference for using central bank currency over alternative payment tools, negatively impacting deposit volumes and, consequently, reducing loans directed towards investment financing.

In Algeria, the 1990 Monetary and Credit Law, followed by the 2023 Monetary and Banking Law, opened the door for local and foreign private banks to offer promising banking products that cater to under-served segments of consumers. Public banks have not provided products that gain religious trust while Islamic banking offers highly satisfactory solutions to the Algerian banking system despite its challenges. Islamic banking continues to evolve in terms of products and the number of service windows, supported by a legal framework.

## **Study Problem:**

Islamic banking operates according to Islamic Sharia which prohibits interest-based transactions. This has led its institutions to be recognized as major financing entities in Islamic countries, quickly establishing themselves as a legitimate alternative to conventional banks. Islamic banking has achieved global spread and attracted significant capital. In Algeria, Islamic banking began post-independence with the entry of Al Baraka Bank in 1991, followed by Al Salam Bank in 2008. Public banks in Algeria started offering Islamic banking products in 2018. Consequently, Islamic banking has expanded and developed within both public and private sectors of the banking system.

The problem of the study can be formulated in the following questions:

### **To what extent does Islamic banking contribute to reducing cash circulation outside the Algerian banking system?**

The following sub-questions fall under this problem:

- What are the motivations behind the Bank of Algeria's shift towards Islamic banking?
- What are the causes of cash circulation outside the Algerian banking system?
- What are the contributions of Islamic banking in reducing cash circulation outside the Algerian banking system?

## **Study Hypotheses:**

This study proceeds from the following hypotheses:

- Cash circulation outside the Algerian banking system is a strong incentive for the shift towards Islamic banking.
- The Bank of Algeria supports Islamic banking with a legal framework that allows its expansion to include public banks, benefiting from their high density.
- Islamic banking has contributed to reducing cash circulation outside the banking system.

## **Study Importance:**

The study is highly significant as Islamic banking is a crucial financing tool globally. For the Algerian banking system, it is even more important as it provides a solution to the problem of cash circulation outside the banking system, especially if it is implemented within the robust and widespread public banks. Moreover, Islamic banking enhances financial depth by increasing the number of marketed banking products.

## **Study Objectives:**

The study aims at introducing Islamic banking and its products as a solution to the problem of cash circulation outside the Algerian banking system which has been evident since the mid-1990s. During this period, public institutions began to address disguised unemployment by

laying off workers due to economic problems, transferring them to the National Unemployment Insurance Fund, closing bankrupt institutions, and ceding some to other entities. This situation allowed the growth of the parallel economy and, consequently, a monetary mass circulating within this market. Additionally, households' preference for central bank currency and their lag in adopting alternative transaction tools exacerbated the issue.

## **1- Islamic Banking: Theoretical Framework:**

### **1-1 Concept of Islamic Banking:**

The history of Islamic financial institutions dates back to 1940, when saving funds operating without interest were established in Malaysia. In 1950, systematic thinking began to emerge in Pakistan with the development of financing methods that adhere to Islamic law. Serious efforts to eliminate usurious banking transactions and establish banks that perform banking services in compliance with Islamic law in the Arab world began in 1963, with the establishment of local saving banks in Egypt. These banks acted as savings or thrift funds for small farmers<sup>(1)</sup>.

### **1-2- Definition of Islamic Banks:**

"An Islamic bank is one that adheres to the application of Islamic law in all its banking and investment transactions by implementing the concept of financial intermediation based on the principle of profit and loss sharing, through general and specific agency<sup>(2)</sup>."

"A financial and monetary institution that performs financial and banking services, attracting and effectively employing monetary resources to ensure their growth and achieve maximum returns while meeting economic and social development goals within the framework of Islamic law<sup>(3)</sup>."

From the above definitions, we conclude that Islamic banks are financial and monetary institutions that conduct their business in accordance with Islamic law. They aim to mobilize financial resources and invest them in projects while avoiding interest dealings, both in receiving and giving, and avoiding any work contrary to Islamic law. This enables them to link economic development with social development.

### **1-3- Characteristics of Islamic Banking:**

- Ideological nature of Islamic banks.
- Linking economic development with social development.
- Collecting idle funds and directing them towards legitimate investment.
- Focusing on productivity rather than the financial solvency of the borrower.

### **1-4- Definition of Islamic Finance:**

"Providing tangible and/or monetary funds from those who own them (Islamic bank) to a natural or legal person (the client) to manage within the provisions and controls of Islamic law, with the aim of achieving a lawful return through contracts that comply with Islamic law<sup>(4)</sup>."

"Providing tangible or monetary wealth for profit from its owner to another person who manages and disposes of it for a return permitted by Islamic law<sup>(5)</sup>."

From the previous definitions, we conclude that Islamic finance is the provision of cash or tangible funds to natural or legal persons through various financial products that comply with Islamic law.

### **1-5- Characteristics of Islamic Finance:**

- Exclusion of interest dealings in both giving and receiving.
- Directing money towards real investment.
- Directing money towards legitimate spending.

### **1-6- Importance of Islamic Finance:**

- Meeting the needs of Muslims in a manner that ensures real development for the individual and society.
- Balancing material and moral needs.
- Guiding the behavior and objectives of natural and legal persons towards achieving benefits for society as an integral part of it.

### **1-7- Islamic Banking Financing Methods:**

The main Islamic financing methods include:

- **Partnership** A partnership between two or more parties in capital and labor, with profit sharing according to agreement while losses are borne according to the proportion of capital contribution. It is a form of joint-stock company where the bank intervenes with its funds and management as a partner with the other party or parties<sup>(6)</sup>.
- **Profit Sharing** The bank provides the necessary capital for a transaction while the entrepreneur provides their effort. Both parties share profits according to agreed ratios while losses are borne by the bank in terms of capital and by the entrepreneur in terms of effort<sup>(7)</sup>.
- **Sharecropping** A contract between two or more parties for the investment and exploitation of agricultural land, where one party provides the land and seeds, and the other provides labor and production. The resulting product is divided according to agreed ratios with landowners losing the benefit of their land and farmers losing their effort in case of loss.
- **Cost-Plus Financing** The bank purchases goods, equipment, or commodities requested by the client, then sells them back to the client at a profit margin agreed upon. It is a short-term financing method<sup>(8)</sup>.
- **Advance Purchase** A short-term investment financing method involving a forward sale where the current payment is for future delivery of goods or services.
- **Manufacturing Finance** An agreement with a client to sell or purchase an asset yet to be constructed or manufactured according to the buyer's specifications to be delivered at a future date for a pre-agreed price.
- **Leasing** The sale of a known benefit for a known return, meaning that an individual rents a specific asset that they cannot afford to purchase for a known fee paid to the owner of the asset.

## **1-8- Challenges Facing Islamic Banking and Proposed Solutions:**

### **1-8-1- Challenges Facing Islamic Banking:**

- The multiplicity of Sharia supervisory boards and the lack of a unified body to standardize fatwa sources, leading to inconsistencies in fatwas on the same issue.
- Taxation on banking products like Cost-Plus Financing and Leasing increases the costs of Islamic products<sup>(9)</sup>.
- The limited market due to the insufficient number of Islamic banks in each country where these banks operate, depriving them from forming an active market for Islamic banking. Their presence would increase competition and diversify the Islamic services and products offered to customers.
- High risks for Islamic banks due to adherence to Sharia principles, coupled with common financial risks such as credit and liquidity risks<sup>(10)</sup>.
- The enthusiasm for Islamic banks by individuals is not matched by equivalent activity from these banks in offering products capable of absorbing the influx of deposits.
- Challenges from Basel Committee regulations which pose difficulties<sup>(11)</sup> because they do not consider the unique nature of these banks when setting the minimum capital adequacy requirements, increasing the burden of risk weights.

### **1-8-2- Proposed Solutions to Overcome Challenges Facing Islamic Banking:**

- Unifying concepts and visions by forming a global Sharia fatwa board that all Islamic banks adhere to, standardizing banking terms used in practice.
- Training and qualifying human resources capable of developing and improving the performance of Islamic banks in the future by conducting research and studies that contribute to finding Sharia-compliant solutions that adapt to rapid changes and developments in banking transactions.
- Considering the specific nature of Islamic banking in terms of banking system laws and regulations, and central banks' oversight practices, especially regarding resource acquisition, usage, and relations with conventional banks.

–Since Islamic banks are relatively new compared to conventional banks, they use different financing methods. Therefore, it is essential to periodically evaluate these methods to ensure compliance with Sharia and adapt them to meet customer needs and preferences.

## **2- Cash Circulation outside the Banking System: Theoretical Framework:**

In advanced countries, the share of cash circulation outside the banking system does not exceed 4% or 5% of the global money supply which generally consists of book money, i.e., money transferred from account to account through checks.

Cash circulation outside the banking system refers to the portion of the money supply made up of coins and banknotes held by households and economic agents, rather than being deposited in banks, insurance companies, and other financial institutions. This external monetary mass is one of the major problems in the sector, significantly weakening deposit portfolios and limiting the possibility of expanding loan grants.

### **2-1- Definition of Cash Circulation outside the Banking System**

"Funds flowing from the banking system and retained as currency rather than being deposited in banks<sup>(12)</sup>"

"It is the withdrawal of money from the economy, leading to a reduction in national income. Wages, taxes, savings, and imports are its main sources<sup>(13)</sup>."

### **2-2- Causes of Cash Circulation outside the Banking System:**

- Excessive issuance of uncovered central cash not backed by real production.
- Limited reliance on an electronic payment system for transaction settlements, encouraging the preference for central cash dealings.
- Instability in the legislative texts governing the banking system.

### **2-3- Effects of Cash Circulation outside the Banking System:**

- Weak effectiveness of monetary policy tools in achieving their goals due to the inability to control the money supply.
- Growth of the parallel economy fueled by the circulating monetary mass.
- Reduced tax collection due to the inability to track transactions.
- Increased inflation due to a large uncontrolled money mass, which only allows for price increases.
- Lower growth and employment rates due to reduced liquidity in banks.

### **2-4- Cash Circulation outside the Algerian Banking System:**

The Algerian banking system consists of twenty banks and financial institutions, including seven public banks, among which is the Savings and Reserve Fund-Bank, and thirteen private banks with foreign capital, including one with mixed capital (Al Baraka). There are also two public financial institutions, five leasing companies (three public), and one agricultural insurance cooperative by the end of 2023. This system has made repeated attempts to absorb the cash mass outside the banking system.

### **2-5- Analysis of Monetary Mass Components and Their Equivalents in Algeria**

The monetary mass, or the amount of cash circulating in the economy includes the means of payment held by individuals and resident economic agents during a certain period. It encompasses all paper and coin money issued by the central bank, subsidiary money, and deposits which together form monetary aggregates. These reflect the spending capacity of resident financial agents, and are categorized according to liquidity levels.

**Table n°1: Evolution of Monetary Mass Components and Their Equivalents in Algeria for the Period 2018-2023**

Year	Scriptural Money	Monetary Mass	Quasi-Money	Net Foreign Assets	Loans to the State	Loans to the Economy
2018	5371.8	16636.7	5232,6	9485.6	6325.7	9976.3

2019	4351.2	16506.6	5531.4	7598.7	7019.9	10857.8
2020	4210	17659.6	5757.8	6418.2	9353.5	11182.3
2021	5278.2	20053.5	6463.2	6559.1	12908.7	9794.7
2022	6273.9	22964.5	7584.9	8650.4	13033.3	10115.2
2023	5965.8	24368.2	7924.3	9532.3	13189.7	10703.6

**Source:** Bank of Algeria. (2024, January 11). Statistical Bulletins 2018-2023. Bank of Algeria. Retrieved from <http://www.bank-of-algeria.dz> at 14:00.

The study period was marked by a health crisis in the form of the COVID-19 pandemic and a global economic crisis resulting from the Russian-Ukrainian war. However, the increase in fuel prices due to the crisis helped raise Algeria's net foreign assets, providing a good counterbalance to the monetary mass.

## **2-6- Components of the Monetary Mass:**

**2-6-1 Monetary Mass (Second Monetary Aggregate):** This includes the first monetary aggregate, which represents legal tender (central currency, i.e., banknotes and coins) plus demand deposits, in addition to quasi-money which represents time deposits. The monetary mass grew primarily due to the growth of the first monetary aggregate between 2021 and 2022, and the growth of quasi-money during the same period at a similar pace.

**2-6-2- Scriptural Money (Demand Deposits):** This includes current deposits at commercial banks, postal centers, and saving funds. It increased during the study period, as shown in the table above, due to the increased returns of the SONATRACH complex following the rise in fuel prices.

**2-6-3- Quasi-Money (Time Deposits):** This is the component that distinguishes between the first and second monetary aggregates. It has also known an increase during the study period.

## **2-6-4- Equivalents of the Monetary Mass:**

**A- Net Foreign Assets:** Representing the total international means of payment, such as currencies and bonds, resulting from exports. Since the nationalization of hydrocarbons in Algeria, their increase or decrease is almost exclusively tied to the volume and prices of hydrocarbon exports.

**B- Loans to the State:** These are loans provided by the Bank of Algeria to the public treasury. The year 2017 was decisive for financing the treasury's needs in Algeria with the amendment of the Monetary and Loan Law, allowing for non-conventional financing, thereby permitting the treasury to refinance and exceed the 10% limit to fund development projects and the investment fund.

**C- Loans to the Economy:** These represent loans provided by the Bank of Algeria to commercial banks to meet liquidity needs within the framework of loan or rediscount operations. There was a decrease in 2021 due to the negative impact of the COVID-19 lockdown, followed by an increase in response to support projects within the framework of the expansionary monetary policy to overcome the crisis.

## **2-7- Causes of Cash Circulation outside the Banking System in Algeria:**

–**Weak Domestic Savings:** The weak savings are mainly due to households' general wages. This has its roots in the early independence period when the state relied on treasury bonds, foreign loans, and oil revenues to finance its quadrennial and quinquennial plans during the planned economy period, neglecting domestic savings. The National Savings and Reserve Fund was tasked with housing-related savings.

–**Parallel Market:** The parallel economy emerged in Algeria in 1994 during the transition period towards a market economy. The government had to reconsider the public nature of Algerian companies which were experiencing hidden unemployment. That year, the

government massively laid off workers, directing them to the National Unemployment Insurance Fund. However, the allowance was insufficient, leading many to engage in informal work, which has grown since then.

–**Tax Evasion:** This is one of the factors contributing to the formation and increase of cash circulation outside the banking system due to the high flexibility of the tax system in Algeria and the negative perception of economic agents towards it, resulting in significant activities outside legal frameworks.

–**Weak Use of Cash Alternatives:** The use of checks and commercial papers by economic agents in Algeria is low due to the weak attraction mechanisms by the banking system and the lack of development and modern marketing techniques for these tools which could significantly absorb the circulating central cash in the economy.

–**Transactions Using Cards:** The use of cash alternatives such as cards remains low in Algeria, with a total of 23,867 million transactions worth 427,758 billion DZD in 2021, rising to 29,173 million transactions worth 834,834 billion DZD in 2022. This represents a growth rate of 22.23% in transaction volume and 2.58% in value.

### 3- The Evolution of Cash Circulation outside the Algerian Banking System:

**Table n°2: The Evolution of Cash Circulation outside the Banking System in Algeria for the Period 2018-2022**

	2018	2019	2020	2021	2022	2023
Liquidity Ratio	81.3	80.5	96.1	90.8	82.8	81.3
Cash Circulation Outside Banks	4926.8	5437.6	6138.3	6712.2	7392.8	7946.4
Percentage of Circulation Outside Banks	29.61%	32.93%	51.57%	49.38%	48.06%	49.75%
Cash Circulation Outside Banks / Monetary Mass	29.60%	32.90%	34.80%	33.50%	32.20%	32.94%

**Source:** Bank of Algeria. (2024, January 11). Statistical Bulletins 2018-2023. Bank of Algeria. Retrieved from <http://www.bank-of-algeria.dz> at 14:00.

–**Volume of Cash Circulation outside the Banking System:** Cash circulation outside the banking system represents more than one-third of the total money supply in Algeria, amounting to approximately 7,392 billion dinars at the end of September 2022, compared to 6,712 billion dinars at the end of December 2021. This represents a share of 33.35% of the total money supply at the end of September 2022, compared to 33.47% at the end of 2021. Cash circulation outside the banking system increased by 10.18% between these periods.

–**Reason for Cash Circulation outside the Banking System:** The proportion of cash circulating outside the banking system has been relatively stable over the past years but remains high. This reflects a clear lack of banking activity, a strong inclination to use cash over modern payment methods, and a significant share of the informal sector within the local economic and commercial sectors.

–**Groups Responsible for Cash Circulation outside the Banking System:** The large proportion of paper money circulating in Algeria indicates the informal nature of certain elements of the national economy, especially in the commercial sector. Economic agents, large traders, and other intermediaries generally prefer cash to reduce traceability and facilitate better tax evasion. The share of hoarding and the money retained by households in general, cash circulation is not a reason for this phenomenon as households use their assets to pay cash expenses due to the lack of widespread use of other payment methods, such as checks and bank cards.

–**Relationship of the Bank of Algeria with Available Cash:** The Bank of Algeria plays a role in better directing and controlling the money supply and its circulation. It issues money through loans directed to demand deposits and time deposits and monetizes foreign exchange flows (equivalents of the monetary mass) when the trade balance has a surplus. Economic agents and

households convert these deposits into banknotes, which is constitutionally guaranteed. Therefore, banks must adopt effective mechanisms to reintegrate cash into the system.

–**Banking Density in Algeria:** Banking density is the main factor that connects banks to customers. High banking density indicates the banking system's ability to cover all demands in areas where employment is desired.

**Table n°3: Distribution of Banking Density in Algeria for the Period 2018-2022**

	2018	2019	2020	2021	2022
Number of Public Bank Branches	1151	1567	1577	1604	626
Number of Private Bank Branches	381	390	389	402	400
Number of Financial Institution Branches	92	91	96	98	99
Total Number of Branches	1633	1658	1673	1702	1725
Number of People per Branch	8154	8234	7247	26675	26551

(Unit: Billion DZD)

**Source:** Bank of Algeria. (2024, August 1). Annual Reports 2018-2022. Bank of Algeria. Retrieved from <http://www.bank-of-algeria.dz> at 23:00.

#### –**Banking Density:**

The ratio of the working population to bank branch counters knew a slight decrease in 2022, with one bank counter serving every 8,228 working-age individuals, compared to 8,204 individuals in 2021.

#### –**Bank Accounts:**

By the end of 2022, the number of active bank accounts registered in dinars increased by 3.15%, with the total reaching 12,128,023 accounts in 2022, compared to 11,655,1567 in 2021. Accounts opened by legal entities represent 6.04% of the total accounts, amounting to 780,726 accounts in 2022. Meanwhile, accounts opened by natural persons account for a larger share, representing 93.96% of the total active bank accounts registered in dinars, amounting to 11,348,296 accounts in 2022.

### **4- Islamic Banking to Mitigate Cash Circulation outside the Algerian Banking System:**

#### **4-1- Experience of Foreign Islamic Banks in Algeria:**

##### –**Al Baraka Bank Algeria:**

Al Baraka Bank Algeria is the first bank with mixed capital (public and private), established on May 20, 1991, with a capital of 500 million Algerian dinars as a joint-stock company under the Monetary and Loan Law 90/10 issued on April 14, 1990. It began its activities in September 1991. The shareholders are the Agricultural and Rural Development Bank (Algeria) and Al Baraka Banking Group (Bahrain). Under Law No. 03-11 dated September 26, 2003, the bank has the right to conduct all banking operations of financing and investments that comply with Islamic law<sup>(14)</sup>.

##### –**Al Salam Bank Algeria:**

Al Salam Bank is a universal bank operating according to Algerian laws and Islamic Sharia principles in all its transactions. It was established through Emirati-Gulf and Algerian cooperation and is a unit of Al Salam Bank Bahrain. It began its activities on October 20, 2008, with a paid-up capital of 72 billion dinars (100 million US dollars), headquartered in Algiers. The bank aims to provide the latest banking services that keep pace with development in Algeria and to manage the bank according to a clear strategy that meets the requirements of economic development in all vital sectors by offering modern services that comply with Islamic principles to meet the needs of the banking market and investor clients<sup>(15)</sup>.

#### **4-2- Islamic Banking within Public Banks in the Algerian Banking System:**

##### –**Participatory Finance according to Regulation 08-02:**

This is the first legal framework for transactions compliant with Islamic law. The regulation aims to set the rules applied to so-called participatory products that do not involve collecting or paying interest. It marks the first acknowledgment of the possibility for banks to conduct

banking operations without collecting interest, which contradicts Islamic principles. The counter is entirely independent with client accounts separated between conventional and participatory operations. Participatory banking operations are those conducted by banks and financial institutions as mentioned in Articles 66 to 69 of Ordinance No. 03-11 dated August 26, 2003, on Money and Credit, as amended, covering money reception, investment operations, and financing operations without interest collection or payment.

**–Islamic Banking according to Regulation 20-02:**

Regulation 20-02, which defines banking operations related to Islamic banking and the rules for their practice by banks and financial institutions repealed all provisions of Regulation 18-02. The conditions for practicing this type of banking remain the same, with a slight amendment regarding the entity legally authorized to issue a certificate of compliance with Islamic law. Regulation 20-02 in Article 14 requires banks or financial institutions to obtain a certificate of compliance from the National Fatwa Authority for Financial Industry<sup>(16)</sup>, established by the High Islamic Council on April 1, 2020.

**–Islamic Banking according to Law No. 23-09 on Monetary and Banking Law:**

Islamic banking includes all operations conducted by banks or Islamic counters that comply with Islamic law. These counters are financially, accounting-wise, and administratively independent from other structures of the bank or financial institution. Marketing these products requires prior certification of compliance with Islamic principles from a Sharia authority in the field of Islamic finance, with the approval of the Bank of Algeria, as stipulated in Articles 71-72-73<sup>(17)</sup>. The goal of the law is to strengthen the legal framework of the Islamic banking sector by establishing specialized banks for Islamic products.

**4-3- Listed Participatory Products and Conditions for Approval:**

The operations cover the following products<sup>(18)</sup>:

**–Islamic Banking Operations for Investment Financing:** (fixed and diminishing), (unrestricted and restricted), (ordinary and parallel).

**–Islamic Banking Operations for Asset Financing:** Cost-Plus Financing (absolute and Cost-Plus Financing to order), Leasing (operational leasing and leasing ending in ownership).

**–Islamic Banking Operations with the Depositing Client:** Deposit accounts (current accounts and savings accounts), investment accounts (deposits in unrestricted investment accounts, deposits in restricted investment accounts).

**4-4- Conditions for Approving Participatory Banking Products within the Traditional System (Public Banks):**

**–Establishing Participatory Finance Counters:**

This means the physical separation between the traditional banking activities and the new participatory activity, extending beyond just physical space to include the specialized staff managing this type of activity.

**–Independence of Participatory Activity from Traditional Activities, extending to Branches:**

This entails separating client accounts under the participatory finance counter from other client accounts.

**–Product Compliance Certification:**

Banks and financial institutions that wish to obtain a certificate of compliance for their products with Islamic law must obtain it from a Sharia authority represented by the High Islamic Council.

**5- Developing Islamic Banking to Mitigate Cash Circulation outside the Algerian Banking System:**

To clarify the development degree of Islamic banking in Algeria, the following relationships were analyzed:

### 5-1- Relationship between the Number of Islamic Bank Branches and the Volume of Cash Circulation outside the Algerian Banking System

**Table n°4: Evolution of the Number of Islamic Banking Branches in Algeria for the Period 2018-2023**

	2018	2019	2020	2021	2022	2023
Number of Branches in Public Banks	/	/	1	2	10	12
Number of Branches in Private Banks	44	49	52	56	59	63
Total Number of Branches	44	49	53	58	69	75

**Source:** Bank of Algeria. (2024, August 1). Annual Reports 2018-2022. Bank of Algeria. Retrieved from <http://www.bank-of-algeria.dz> at 23:00.

Given that the population of Algeria is 44.9 million according to 2022 statistics, approximately 45 million, the number of branches is very low to attract wider segments despite the adoption of many countries for expansion as an attraction factor. The table above shows:

–**Number of Public and Private Banks:** The number of banks licensed to practice Islamic banking in 2023 is 12 out of a total of 29 banks operating in Algeria, representing 41.37% of the total active banks in Algeria. This percentage is close to half, but the number is insufficient to create competition that could influence the prices of the products offered.

–**Number of Specialized Branches:** The number of specialized Islamic banking branches reached 75 in 2023, out of a total of 1,627 branches, representing 4.60%. This is a very small percentage compared to the total number of branches and does not serve the desired goal. The 75 branches are distributed across 58 provinces, mostly concentrated in the northern part of the country despite of the developmental programs and major projects implemented in the southern regions. Therefore, it is essential for the branches to increase their presence to accompany projects on-site.

–**Number of Islamic Banking Counters:** The number of Islamic banking counters reached 741 in 2023, compared to 655 in 2022, with the branches of private banks (two banks) remaining dominant.

### 5-2- Relationship between Islamic Banking Products and the Volume of Cash Circulation outside the Algerian Banking System:

The number of products, the volume of investments, in addition to the traditional and electronic services provided by banks contribute to attracting clients, whether they are households or economic agents. This, in turn, can introduce clients to the bank and encourage deposits later on.

**Table n°5: Evolution of the Share of Islamic Banking Products in Algeria for the Period 2020-2022**

Islamic Banking Products	2020	2021	2022
Financing Cost-Plus	132.3	128.4	125.7
Partnership	1.2	0.9	1.8
Sharing Profit	4.9	5.8	7.2
Leasing	82.7	82	83.6
Sale Forward	74.7	130.4	150.1
Finance Manufacturing	6.6	10.7	13.4
Products Total	302.4	358.2	381.8
Public Banks Share of	%0.10	%0.50	%1.30
Islamic Banks Share of	%99.90	%99.50	%98.70

(Unit: Billion DZD)

**Source:** Bank of Algeria. (2024, August 1). Annual Reports 2018-2022. Bank of Algeria. Retrieved from <http://www.bank-of-algeria.dz> at 23:00.

The number of banking products according to the Bank of Algeria has remained unchanged; however, their popularity determines their ranking.

### 5-3- Banking Services within Islamic Banking:

In addition to the products approved by the Monetary and Loan Law by the Bank of Algeria which are marketed by all banks practicing this activity, many traditional and modern services have been launched by these banks to attract customers. These services include savings and investment books, leveraging religious incentives as an attraction element, credit cards, and Takaful insurance according to Islamic law, which are expected to increase customer engagement with these banks.

### 5-4- Number of Islamic Banking Products:

Islamic banking products include real estate Cost-Plus Financing, car Cost-Plus Financing, equipment Cost-Plus Financing, and leasing ending in ownership. These transactions are provided by various Algerian public banks since the launch of Islamic banking services in Algeria.

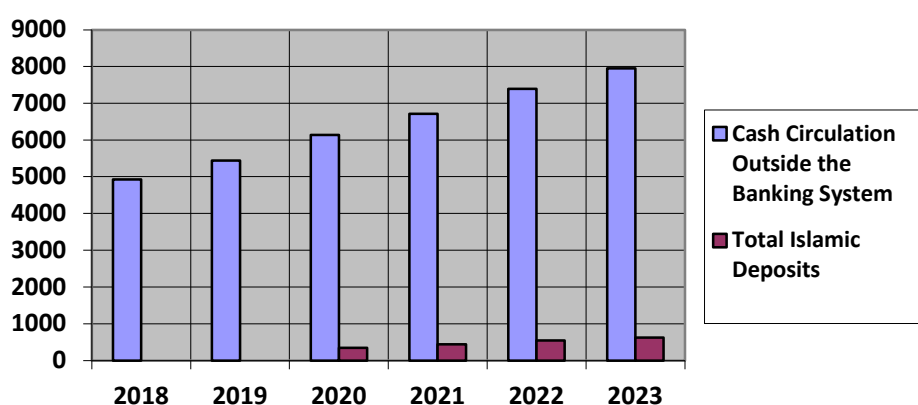
### 5-5- Volume of Financing for Islamic Banking Products:

By the end of 2022, the value of these products was 381.7 billion dinars compared to 358.3 billion dinars at the end of 2021. It is clearly noted that there is an increase of 6.5%. However, the financing ratio for public banks reflects the novelty of the activity, representing no more than 0.1% in the first year (2020), reaching 1.3% in 2022. This indicates a rising contribution of the public banking sector in financing Islamic products but at a slow pace, in contrast to Islamic banking in the private sector, which accounted for 99.9% in 2020, decreasing to 98.7% in 2022. However, this decline does not affect the volume of financing but shows the contribution in terms of percentage of Algerian public banks.

### 5-6- Relationship between Islamic Banking Deposits and Cash Circulation outside the Algerian Banking System:

The primary goal of moving towards Islamic banking in Algeria is to reduce cash circulation outside the banking system that significantly hinders the mobilization of bank resources to finance investments, raise growth levels, and achieve economic development. The figure below illustrates the development of both variables during the study period.

**Figure n°1: Evolution of Islamic Deposits and Cash Circulation outside the Algerian Banking System**



Source: Prepared by the researcher using EXCEL program.

Islamic deposits collected under Regulation No. 20-02, within the framework of the Monetary and Banking Law 23-09, authorized by the Bank of Algeria and the Sharia Board, consisting of deposit accounts and investment accounts in public banks and Al Baraka and Al Salam Banks, began to form in 2020 (excluding the deposit accounts held by the two banks before authorization).

–**Year 2020:** A total of 340 billion DZD was deposited while the volume of cash circulation outside the banking system was 6138.3 billion DZD, resulting in a deposit-to-circulation ratio of 5.53%.

–**Year 2021:** A total of 442.1 billion DZD was deposited while the volume of cash circulation was 6712.2 billion DZD, resulting in a deposit-to-circulation ratio of 6.85%.

–**Year 2022:** A total of 546.7 billion DZD was deposited while the volume of cash circulation outside the banking system was 7392.8 billion DZD, resulting in a deposit-to-circulation ratio of 7.39%.

–**Year 2023:** A total of 623.83 billion DZD was deposited while the volume of cash circulation outside the banking system was 7946.4 billion DZD, resulting in a deposit-to-circulation ratio of 7.85%.

#### 5-7- Relationship between the Growth Rate of Traditional and Islamic Deposits and Cash Circulation outside the Banking System:

To determine whether the deposits collected through Islamic banking are sourced from withdrawals from the traditional system in favor of Islamic banking, the deposit growth index was employed along with an analysis of the growth pace of these deposits.

**Table n°6: Growth Rate of Islamic Banking Deposits, Traditional Deposits, and Cash Circulation outside the Banking System for the Period 2018-2023**

	2018	2019	2020	2021	2022	2023
Growth Rate of Islamic Banking Deposits <sup>(i)</sup>	/	/	/	1.02%	1.04%	0.77%
Growth Rate of Deposits in the Banking System <sup>(ii)</sup>	14.52%	-6.47%	4.59%	18.54%	21.39%	4.89%
Growth Rate of Cash Circulation Outside the Banking System	2.10%	5.10%	7%	5.74%	6.80%	5.53%

**Source:** Prepared by the researcher using EXCEL program.

#### 5-7-1- Growth of the Monetary Mass outside the Banking System:

From the table above, it can be seen that the growth rate of the monetary mass outside the banking system in 2018 was estimated at 2.10%, which did not increase significantly despite the adoption of non-conventional financing in 2018. However, it rose to 5.10% in 2019, indicating that the injected monetary mass began to appear in circulation outside banks. The COVID-19 pandemic contributed to raising the growth rate of the monetary mass outside the banking system to 7% due to the preference for liquidity during the crisis, driven by fears of potential banking issues that could prevent individuals from recovering their deposits. The growth rates of cash circulation outside the banking system remained at this level and did not decrease during the study period due to various influencing factors.

#### 5-7-2- Growth of Islamic Banking Deposits:

Islamic banking deposits knew an increase although it did not exceed 1%. The reasons are mainly:

–**Individual Factors:** Banking customers generally include economic agents and households. For economic agents, the incentives provided by the state, such as support and exemptions, are more enticing, making interest-based transactions preferable. It is noteworthy that those who own means of production (capital) tend to hold more cash in all its forms. For households, there is an increased interest in Islamic banking.

–**Bank-Specific Factors:** The number of branches and counters acts as a barrier to attracting deposits. Thus, banks must enhance their presence nationwide and diversify their products and services.

–**Legal and Economic Framework Factors:** The development of Islamic banking in Algeria should be accompanied by a legal framework that offers the same advantages as the traditional banking system to attract economic agents.

### 5-7-3- Growth of Deposits in the Banking System:

The growth rate of traditional deposits shows that they were not withdrawn or transferred in favor of Islamic banking. However, it is noteworthy that the rate saw a significant decline, recording a negative figure in 2019 due to the onset of the COVID-19 crisis.

### 5-8- Evolution of Islamic Banking Deposits:

Islamic banking deposits are divided between deposit accounts and investment accounts, distributed among public banks that have received product approval and authorization from the High Islamic Council, and the two private banks, Al Baraka Bank and Al Salam Bank Algeria.

**Table n°7: Distribution of Islamic Deposits between Public and Private Banks for the Period 2018-2022**

	2020	2021	2022
Public Banks	1.8	19.3	57.5
Private Banks	161.3	193.4	198
Total Deposit Accounts	163	212.8	255.5
Public Banks	1	1	7
Private Banks	176	228.3	284.2
Total Investment Accounts	177	229.3	291.2
Total	340	442.1	546.7

**Source:** Bank of Algeria. (2024, August 1). Annual Reports 2018-2022. Bank of Algeria. Retrieved from <http://www.bank-of-algeria.dz> at 23:00.

### 5-8-1- Evolution of Deposits in Public and Private Banks:

#### A- Islamic Finance Deposits in Public Banks:

By the end of 2022, Islamic finance deposits in public banks more than tripled, increasing from 20.4 billion DZD in 2021 to 64.5 billion DZD in 2022. This contributed to approximately 42.2% of the increase in this category of deposits within the banking system. This development increased their share in total deposits by 6.97 percentage points by the end of 2022, reaching 11.8% compared to 4.8% the previous year. However, the collection of these deposits remains low.

#### B- Islamic Finance Deposits in Private Banks:

Islamic finance deposits in private banks knew an increase of 14.3%, reaching 482.2 billion DZD in 2022, contributing to approximately 57.8% of the increase in total Islamic finance deposits. The two specialized Islamic finance banks (Al Baraka Bank and Al Salam Bank Algeria) accounted for 73.3% of the total Islamic finance deposits by the end of 2022, amounting to approximately 400.8 billion DZD by the end of 2022 compared to 371.0 billion DZD by the end of 2021.

### 5-8-2- Evolution of the Volume of Islamic Banking Deposits by Nature:

#### A- Deposit Accounts:

The total deposit accounts reached 255.5 billion DZD in 2022 compared to 212.8 billion DZD in 2021, registering a new growth of 20.1%, after a growth of 30.6% in the previous year. This increase was higher in public banks where deposits have more than tripled. Their contribution to the increase in total deposit accounts was 89.4% by the end of 2022, compared to the contribution of private banks that was 10.6%.

#### B- Investment Accounts:

Representing 53.3% of total deposits, investment accounts increased by about 27% by the end of December 2022, compared to an increase of 29.6% by the end of December 2021, growing from 229.3 billion DZD by the end of 2021 to 291.2 billion DZD by the end of 2022. This development is primarily due to the increase in deposits in private banks, growing from

228.3 billion DZD by the end of 2021 to 284.2 billion DZD by the end of 2022, contributing 90.4% to the increase in total investment account deposits. Almost all of these deposits, 97.6%, are collected by private banks.

**Conclusion:**

Shortly after the establishment of the counters, the volume of deposits of various types slightly increased along with the volume of financing provided by public banks. This transition moved from the counter stage to the stage of public banks specializing in Islamic banking which could make a significant difference, if these banks enjoyed the same advantages as their traditional activities. The shift to Islamic banking in Algeria aims at reducing cash circulation outside the banking system which currently seems difficult to achieve due to the cash-holding segment and the challenges faced by Islamic banking.

**Study Results:**

Cash circulation outside the banking system represents a major problem for the Algerian economy, in general, and the banking system, in particular. This is due to reasons such as the non-use of alternative payment methods like cards by households, and the economic agents' reluctance to use scriptural money like checks and commercial papers. Consequently, the turn towards Islamic banking aims to solve this problem with cash circulation outside the banking system amounting to half of the total money supply during the study years, reaching 7946.4 billion DZD in 2023.

The Bank of Algeria issued a strict legal framework separating the traditional interest-based activities of public banks from the Islamic banking counters. Ensuring account independence, and defining a set of products that banks can market after being approved by the Bank of Algeria and the Sharia authority represented by the National Fatwa Authority for Financial Industry at the High Islamic Council. While the number of traditional bank branches in Algeria reached 1725 in 2022, Islamic banking branches totaled 75 in 2023, which is insufficient for national coverage, limiting the marketing of Islamic banking products and services.

Despite the recent adoption of Islamic banking in Algeria, its activity is growing modestly with an annual growth rate of 1%. Private Banks (Al Baraka Bank and Al Salam Bank Algeria) dominate more than 89% of the deposit volume. The volume of Islamic banking products has seen significant development, reaching 302.4 billion DZD in 2020, distributed across Profit Sharing, Partnership, Manufacturing Finance, Leasing, Forward Purchase, and Cost-Plus Financing products, and increasing to 381.8 billion DZD in 2022. The Cost-Plus Financing and Forward Purchase products attract the most customers. Islamic deposits during the study years reached considerable figures, estimated at 381.8 billion DZD in 2020, increasing to 623.83 billion DZD in 2023, distributed evenly between deposit accounts and investment deposits. The study shows an increase in demand deposits and time deposits for households and economic agents in traditional banking, indicating that traditional deposits were not withdrawn to be transferred to Islamic banking counters.

The development of Islamic banking has contributed to absorbing a small part of the cash circulation outside the Algerian banking system. However, Islamic banking remains capable of absorbing a larger share if given more attention, better promotion, and accompanied by legal amendments and facilitation for Islamic banks or counters to develop their products and attract more customers. Establishing specialized public Islamic banks would help reduce cash circulation outside the banking system.

**Validation of Hypotheses:**

– **First Hypothesis is Valid:** Cash circulation outside the Algerian banking system is a strong driver for the turn towards Islamic banking. The study shows the legal flexibility and quick transition from Islamic counters in 2018 to Islamic banking, defining products by the Bank of Algeria, and establishing a Sharia authority to approve products. The aim is to move towards specialized public Islamic banks in 2023, furthering Islamic transactions with Takaful insurance, supported by the Ministry of Finance's clear objective of containing cash circulation outside the banking system through Islamic banking.

– **Second Hypothesis is Valid:** The support of the Bank of Algeria for Islamic banking with a legal framework allows for the expansion of its activities within independent counters separate from the traditional public banking activities, benefiting from high density. The 2023 Monetary and Banking Law demonstrates the sector seriousness in moving towards Islamic banking and the adoption of specialized public Islamic banks, transitioning from independent counters to specialized banks.

– **Third Hypothesis is Invalid:** Islamic banking did not significantly reduce cash circulation outside the banking system. The study shows serious challenges, such as the newness of Islamic banking in Algeria, the low number of branches and counters, and the limited number of marketed products and services alongside stable growth of the monetary mass outside the banking system and slight growth of Islamic banking deposits.

**Suggestions:**

– Addressing cash circulation outside the banking system requires several converging factors to mitigate and contain it, monitored by the Bank of Algeria.

– The effectiveness of Islamic banking is reflected in its contribution to financing development projects such as renewable energy and public works through long-term Partnership bonds, Manufacturing Finance, and operational leasing. It should also target the agricultural sector through adopting profit-sharing for tree planting and expanding its use for crops like wheat, barley, and corn.

– Deepening the range of Islamic banking products and services, balancing short and long-term transactions and local dealings, and enhancing their contribution to international trade while expanding branches locally and subsidiaries internationally.

– Enabling Islamic banking in Algeria to enjoy the same privileges as its traditional counterpart, such as state-supported loans.

**Notes:**

i. Islamic banking deposits include deposit accounts and investment accounts.

ii. Banking system deposits include demand deposits and time deposits.

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