

the Islamic Banking Industry is Instrumental in Promoting Financial Inclusion in Algeria

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Abstract

This research paper aims to examine the efforts and initiatives undertaken by Algerian monetary authorities to promote financial inclusion through the development of Islamic banking. The study explores the key concepts of financial inclusion and the Islamic banking industry, along with the challenges they face. The findings of the analytical study reveal that Algeria is making significant progress toward financial inclusion, especially in the wake of amendments to the Monetary and Credit Law. These amendments have legalized Islamic banking and facilitated the establishment of dedicated windows and branches offering Islamic financial services and products.

Keywords: Financial inclusion, Islamic banking industry, financial services, Islamic financial products.

Introduction:

Islamic finance has demonstrated its resilience and strength, particularly following the 2008 financial crisis, when Islamic banking emerged as an optimal tool for crisis mitigation and a means to promote financial inclusion. This is achieved by attracting the largest possible segments of society and institutions, especially those hesitant to engage with the conventional banking sector due to various considerations (religious, ethical, or financial). Through the use of diverse and innovative instruments that adhere to Islamic law (Sharia) and are offered at competitive and fair costs, Islamic banking aims to ensure equity in wealth redistribution and integrate risk-sharing mechanisms. This approach targets low-income groups, preventing their reliance on costly and unregulated informal channels.

As a result, the Islamic banking industry has become a viable alternative and a strong competitor to conventional banking, securing its position in the global economic and financial landscape. Its successes are evident in key indicators, including the increasing number of Islamic financial institutions, geographical expansion, growth in the volume of assets held by these institutions, and the rising growth rates of the Islamic banking industry.

In its pursuit of financial inclusion, Algeria has issued laws and regulations to govern Islamic banking operations, beginning with Monetary and Credit Law No. 90/10, which allowed the establishment of private national banks and branches of foreign banks. This was followed by

Regulation 18-02, which outlined the rules for conducting participatory banking operations by banks and financial institutions. Subsequently, Regulation 20-02 further clarified Islamic banking operations and repealed Regulation 18-02. However, the key question remains: What mechanisms were introduced in these monetary amendments to enhance the performance of Islamic banking and promote financial inclusion?

Through these monetary reforms, Algeria has emphasized that Islamic banking is an innovative and developmental approach to financing tools in financial and monetary markets. It offers opportunities to mitigate risks arising from interest rate fluctuations and provides services that are robust and flexible in addressing economic risks. Consequently, Islamic banking meets the needs of individuals and companies that refrain from engaging with conventional banks.

The objective of this study is to explain the concepts of financial inclusion and Islamic banking and to explore the relationship between them. It aims to demonstrate how Islamic banking windows contribute to financial inclusion by attracting individuals who prefer Islamic transactions and who have been financially excluded for religious reasons. Additionally, the study highlights the efforts and initiatives of the Algerian government to achieve financial inclusion by improving the performance of Islamic banking, particularly by adapting monetary policy tools to align with the specificities of Islamic banking windows.

Literature Review:

The Islamic banking industry is relatively new but has become a focus of attention in various countries, especially in light of the global economic changes and developments. Its proven ability to withstand financial crises and promote financial inclusion at minimal cost has bolstered its rapid and continuous growth. This growth is evidenced by the increasing demand for its innovative products, which serve as alternatives to conventional financial products, as highlighted in annual reports by the Islamic Financial Services Board (IFSB).

Economic studies in this field have significantly contributed to elucidating the objectives and instruments of Islamic financial industries and their role in establishing the foundations of financial inclusion. Among these studies are:

1. **Zamir Iqbal and Abbas Mirakhor (2012):**

Title: "Financial Inclusion, Islamic Finance Perspective," *Journal of Islamic Business and Management*, Vol. 2, No. 1.

This study demonstrated the potential of Islamic finance tools to enhance financial inclusion more effectively than conventional financing tools. The findings revealed that Islamic finance provides a comprehensive framework for promoting financial inclusion through principles such as risk-sharing and wealth redistribution, which remain underutilized in many Islamic countries.

2. **Rafika Ben Aichouba (2018):**

Title: "The Islamic Finance Industry and Its Role in Enhancing Financial Inclusion – A

Case Study of Arab Countries," published in the Journal of Economics and Human Development, Vol. 9, Issue 2, June 2018.

This study examined the state of financial inclusion and Islamic finance sectors globally and within the Arab world, highlighting the role these sectors can play in providing financial resources to marginalized groups in Arab countries. The study concluded that the Gulf Cooperation Council (GCC) countries lead in achieving high rates of financial inclusion, with Islamic finance playing a significant role in this achievement.

3. Study by Rami Youssef Obeid

This study, published by the Arab Monetary Fund in 2019, investigates the impact of Islamic financial services on financial inclusion in Arab countries. The study emphasizes that Islamic financial services serve as a critical avenue for expanding access to finance by offering products and services that promote financial inclusion and reduce risks.

Our current study seeks to shed light on the role of the Islamic banking industry in accelerating financial inclusion in Algeria while identifying the main challenges this industry faces in advancing the sector and increasing financial inclusion.

Methodology

This research adopts a descriptive-analytical approach to review concepts related to Islamic banking and financial inclusion. It analyzes developments in Algeria's banking system aimed at activating the Islamic financial industry and establishing the foundations for financial inclusion. The study relies on published research papers, journal articles, annual reports from banks, and financial institutions as primary sources.

1. Financial Inclusion

The World Bank, in its 2014 *Global Financial Development Report*, defines financial inclusion as "the percentage of individuals or businesses utilizing financial services."

Additionally, a joint report by the Arab Monetary Fund and the Consultative Group to Assist the Poor, titled *Measuring Financial Inclusion in the Arab World* (January 2017), defines financial inclusion as:

"The access of individuals, including low-income earners, and businesses, particularly small enterprises, to effectively and affordably utilize a wide range of high-quality formal financial services (payments, transfers, savings, credit, insurance, etc.) responsibly and sustainably provided by diverse financial service providers operating in an appropriate legal and regulatory environment."

The OECD and the International Network on Financial Education (INFE) define financial inclusion as:

"The process of enhancing access to a wide range of regulated and formal financial products

and services at reasonable times and costs. It aims to broaden the use of these services across all segments of society through innovative approaches, including financial awareness and education, to promote financial well-being and social and economic integration."

Financial inclusion encompasses four main dimensions:

- I. Accessibility of financial services for all households and businesses.
- II. Sound financial institutions governed by regulatory and supervisory frameworks.
- III. Financial and institutional sustainability of financial institutions.
- IV. Competition in providing the best services and offering customers alternatives.

The positive impacts of financial inclusion are evident at both the economic level and within the banking sector, including:

- Strengthening financial stability and contributing to economic and social development.
- Enhancing efforts to combat money laundering and terrorism financing.
- Attracting informal enterprises to the formal sector, diversifying banking assets, and drawing new clients to banks.

2. Islamic Banking Industry: Concepts and Objectives

Islamic banking is one of the most dynamic and fastest-growing sectors in the global financial system. It possesses several attributes that enhance service quality, foster innovation, ensure security and risk reduction, and broaden its customer base. Additionally, Islamic banking plays a vital role in promoting social development, spurring economic growth, and operating under Islamic Sharia principles.

Definition of Islamic Banking

Islamic banking is defined as:

"A set of activities that include designing, developing, and implementing innovative financial tools and processes, alongside formulating creative solutions to financing problems, all within the framework of Sharia guidelines." (Fathur Rahman Ali Mohamed Saleh)

It is also described as:

"All activities and processes based on creating and developing financing tools compliant with Islamic Sharia principles. This includes either crafting new financing instruments or providing a Sharia-compliant framework for existing ones to solve financing challenges." (Fathur Rahman Ali Mohamed Saleh)

For financial products developed under Islamic financial engineering to be genuinely Islamic, they must adhere to the following principles:

- I. Commitment to profit-and-loss sharing, clearly and unequivocally outlined in compliance with Sharia principles, particularly in *mudarabah* and partnership contracts.
- II. Avoiding the reinvestment of funds raised through financial instruments designed to eliminate interest-based transactions into institutions or businesses that operate entirely under interest-based systems. Additionally, financial resources should not be invested in projects yielding predetermined returns without sharing the risks associated with those activities. Such returns, even if labeled profits, are indistinguishable from interest.
- III. Investing financial resources in projects with clear priorities aligned with the broader public interest of the Islamic community.

Objectives of Islamic Banking

The Islamic banking industry seeks to achieve several objectives, including:

- Providing high-quality, Sharia-compliant financial products as legitimate alternatives to conventional products.
- Enhancing economic efficiency by expanding investment opportunities, promoting risk-sharing, and reducing transaction costs.
- Mobilizing idle capital that refrains from engaging in interest-based projects and utilizing it to stimulate economic growth.
- Innovating Islamic financial instruments that contribute to developing local and global financial markets.
- Creating a real economic cycle by providing stable and genuine financing, thereby mitigating inflationary effects.

Distinctive Features of Islamic Banking

- a) **Sharia Compliance:** Ensuring products meet Sharia requirements and avoid disputes among scholars by striving for consensus and providing model solutions for Islamic economics.
- b) **Social Solidarity:** Offering services such as interest-free loans, creating zakat funds from shareholder and individual contributions, and distributing them according to Sharia.
- c) **Economic Efficiency:** Delivering innovative financial products that outperform traditional ones while minimizing negative effects like inflation, unemployment, and wealth disparity.
- d) **Investment Climate Activation:** Conducting market research, forecasting, and regular disclosures to enhance transparency, understand investor needs, and supply necessary data to stakeholders.

3. The Role of Islamic Banking in Promoting Financial Inclusion in Algeria

Algeria has demonstrated a strong commitment to enhancing financial inclusion through the Islamic financial industry, particularly by establishing specialized banks in this field, such as Al Baraka Bank and Salam Bank. Reforms initiated by monetary authorities, including amendments to Ordinance 03/11, have focused on adapting to global challenges, improving financial institutions, and fostering competitiveness and innovation. These reforms have included opening Islamic financial windows and branches that offer Sharia-compliant financial services. The key amendments are as follows:

a) **Regulation 18-02 on Participatory Finance**

Issued on November 4, 2018, this regulation set out the rules for banking operations involving participatory finance by banks and financial institutions. It marked the first regulatory framework for Islamic financial transactions in Algeria, specifying permissible products such as Ijarah, Istisna'a, Salam, and deposits in accounts. It also allowed conventional banks to open participatory finance windows, provided these were financially and operationally independent and governed by a Sharia compliance committee.

b) **Regulation 20/02**

Enacted on March 15, 2020, this regulation defined Islamic banking operations as transactions that do not involve earning or paying interest. It permitted banks and financial institutions to establish Islamic finance windows with financial and accounting independence from other bank structures. The regulation introduced eight Islamic financial products, adding "deposit accounts" to the seven specified in Regulation 18-02, and repealed Regulation 18-02.

c) **Instruction 03-2020**

Issued on April 2, 2020, this document detailed the products and services outlined in Regulation 20/02, comprising 60 articles explaining Islamic financial services and their operationalization.

Growth of Islamic Banking in Algeria

Following these reforms, the number of Islamic finance windows within public banks increased significantly, reaching 469 windows by October 31, 2022. These windows served 66,217 Islamic banking accounts, with financing valued at 5 billion Algerian dinars and deposits totaling 50 billion Algerian dinars.

Several public and private banks, including the BNA, CPA, CNEP, BEA, and BDL, obtained licenses to market Sharia-compliant products. For instance, the CPA managed 26,000 Islamic accounts, while the BEA operated 9,200 accounts across 50 branches, with deposits totaling 17 billion dinars in 2022.

Progression of Specialized Islamic Banking Agencies (2018–2022)

Year	Public Banks (Total Agencies)	Islamic Finance Agencies in Public Banks	Private Banks (Total Agencies)	Islamic Finance Agencies in Private Banks
2018	1,160	-	381	44
2019	1,177	-	390	49
2020	1,188	1	389	52
2021	1,202	2	402	56
2022	1,226	10	400	59

Source: Bank of Algeria, www.bank-of-algeria.dz

Results

The monetary authority's initiatives to promote financial inclusion through Islamic finance have fostered a banking culture tailored to economic participants' needs, attracted funds from the informal market, and expanded the customer base for banks. By 2022, the CPA and BEA led the sector, with CPA offering 10 Islamic products across 50 branches and BEA managing deposits worth 17 billion dinars.

Algeria's Financial Inclusion Efforts

Algeria is classified as a medium financial inclusion country by the World Bank. To enhance inclusion, the country seeks to extend banking and financial services to various societal groups, improve financial infrastructure, and raise awareness about Islamic financial products. Efforts are also focused on educating citizens about the benefits of these products and how to access them to improve their socio-economic conditions.

Public banks have increased their Islamic financing branches from 2 in 2021 to 10 in 2022, while private banks, including Al Baraka and Salam, have contributed significantly with 59 specialized branches in Islamic finance.

Discussion

One of the primary drivers behind the establishment of specialized Islamic banking agencies in Algeria's public banks is the relatively small size of the Islamic banking market, which constitutes only about 3% of total conventional financial transactions. Additional factors include the aftermath of the 2014 oil crisis, which negatively impacted national revenue, and the economic downturn caused by the COVID-19 pandemic starting in 2020. Under these circumstances, the government sought to expand reliance on Islamic banking as a solution to mobilize savings and support local development by promoting comprehensive banking practices and attracting funds outside the formal monetary system.

Specialized Islamic banking agencies contribute to improving financial inclusion indicators through various mechanisms (Allawi, 2021):

- **Zakat, charity, waqf (endowments), and collective risk-sharing;**
- **Qard Hasan (benevolent loans), waqf, microfinance, and micro-takaful;**
- **Supporting small and medium-sized enterprises (SMEs);**
- **Encouraging profit-and-risk-sharing financing models as alternatives to debt financing.**

Challenges

Despite Algeria's significant efforts to achieve financial inclusion through Islamic finance, several challenges persist:

- I. **Delayed Regulatory Framework**

Islamic financial institutions in Algeria lacked formal regulation until 2018. This delay contributed to weak financial literacy, especially regarding Islamic financing instruments and their mechanisms. Consequently, misconceptions arose, with some perceiving Islamic banking as mere rebranding of conventional interest-based systems, leading to skepticism about its legitimacy (Ben Tayeb, 2011).
- II. **Compatibility Issues with the Central Bank**

Differences in principles and regulations between Islamic and conventional banks create challenges for Islamic banks in aligning with the central bank. For instance, Islamic banks face difficulties in accessing liquidity due to Sharia principles, which prevent them from engaging in traditional money market operations.
- III. **Human Resource Limitations**

Islamic banking suffers from a qualitative shortage of trained personnel. The educational and training systems do not adequately equip employees with specialized knowledge in Islamic finance. Additionally, training is limited to a single center affiliated with Al Baraka Bank, slowing the capacity-building process.
- IV. **Weak Collaboration Among Islamic Banks**

Despite sharing common goals and principles, Islamic banks in Algeria lack sufficient cooperation. This hinders their ability to create a unified Islamic banking system aligned with Sharia.
- V. **Weak Interbank Linkages**

Islamic banks lack strong connections with one another and fail to form banking alliances that could enhance their collective bargaining power internationally and facilitate the transformation of central banks into Islamic central banks.

VI. **Difficulty in Establishing an Islamic Financial Market**

The underperformance of Algeria's conventional financial market, coupled with limited public awareness of savings and investment opportunities, poses challenges for developing an Islamic financial securities market.

Conclusion

Despite being a relatively new experience, with Islamic banking activities limited to two banks (Al Baraka and Salam), Algeria is striving to expand its engagement in diversified Islamic banking transactions. This is being pursued through the opening of windows and branches offering Sharia-compliant financial services. These efforts aim to achieve financial inclusion by attracting funds currently outside the banking system and encouraging individuals who prefer to hoard money at home or invest in informal markets to engage with the formal Islamic banking sector.

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