

The relationship between the central bank and Islamic banks, advantages and challenges

العلاقة بين البنك المركزي والبنوك الإسلامية المزايا والتحديات

Abdelaziz Salaheddine

PHD

University of Mohamed Boudiaf Msila

abdelaziz.salaheddine@univ-msila.dz

Received date: 12/12/2021

Accepted date: 06/06/2022

published date: 30/06/2022

Abstract:

Islamic banks constitute one of the most important parts of the banking system, especially in countries that have realized the necessity of having this type of banks within their financing system, given that they are a receptacle that absorbs and exploits the money of depositors who are trying to avoid dealing with traditional banks. This study aimed to describe the nature of the relationship that links the Central Bank with Islamic banks, by identifying the various advantages and challenges arising from this relationship. The results concluded that Islamic banks in Algeria face many obstacles, including the absence of legal texts regulating the work of Islamic banks in a usurious environment.

Keywords: Central Bank, Islamic banks, Islamic Sharia.

Jel Classification Codes : E58, G29.

الملخص:

تشكل البنوك الإسلامية إحدى أهم أجزاء النظام المصرفي لاسيما لدى الدول التي أدركت ضرورة وجود هذا النوع من البنوك ضمن جهازها التمويلي، وذلك بالنظر لكونها بمثابة وعاء يقوم باستيعاب واستغلال أموال المودعين الذين يحاولون تجنب التعامل مع البنوك التقليدية. هدفت هذه الدراسة الى وصف طبيعة العلاقة التي تربط البنك المركزي مع البنوك الإسلامية، عن طريق تحديد مختلف المزايا والتحديات الناشئة عن هذه العلاقة. توصلت النتائج الى ان البنوك الإسلامية في الجزائر تواجه العديد من المعوقات، من بينها غياب النصوص القانونية التي تنظم عمل البنوك الإسلامية في بيئة ربوية.

الكلمات المفتاحية: البنك المركزي، البنوك الإسلامية، الشريعة الإسلامية

تصنيفات jel: E58، G29 .

Corresponding author: Abdelaziz Salaheddin, abdelaziz.salaheddine@univ-msila.dz.

1. INTRODUCTION

With the emergence of banks and their global expansion, and the increase in the need for new financing practices that are compatible with modern economic reality. And given that the rules of Islamic Sharia lead to the necessity that all their financial and banking transactions be under the provisions approved by Islam. Hence, so-called Islamic banks appeared and expanded to include Islamic and non-Islamic countries.

Since central banks represent the cornerstone of the organization and the role of supervision over the components of every banking system, it has become obliged to deal with such banks and create the appropriate conditions that ensure that they carry out their activities in a way that meets their financing needs.

Here, the imperative of formulating a relationship that differs from the one that binds them with traditional banks is because of the peculiarities of these banks, especially their non-interest-bearing nature. Which is characterized by avoiding all transactions that contain an interest rate and replacing them with other formulas that comply with Islamic Sharia. and from here we can ask the following:

What Is The Nature Of The Relationship Between Central Banks And Islamic Banks?

To answer the main question of the study, the research was divided into three main points:

- A theoretical approach to central and Islamic banks
- The relationship between central banks and Islamic banks.
- Mechanisms of dealing between the Algerian Bank and Al Salam Bank.

The importance of the study:

The importance of the topic lies in the fact that studying the relationship between the central bank and Islamic banks is a necessity for improving the performance of the banking system. This is because determining the nature of the relationship and its effects is considered an evaluation process that facilitates the monetary authorities to take measures that would strengthen this relationship by what serves the monetary policy of the state. Detecting deficiencies, limiting their effects, especially in light of the expansion of the concept of banks and the emergence of new services, and financing formulas developed by Islamic banks. This requires directing efforts towards adopting policies to organize its work, taking into consideration the objectives of the various parties (banks, customers,)

Objectives of the study:

The study seeks to achieve the following objectives:

- Shedding light on Islamic bank finance and its peculiarities and outlining its advantages.
- Describe the type of relationship that exists between Islamic banks and central banks.
- Determining the impact of the relationship on the performance of the Islamic bank.
- Studying the reality of this relationship with the application on the Algerian banking system.

Study Approach:

The descriptive-analytical approach was adopted to describe and analyze the relationship between the central bank and Islamic banks and their effects in the theoretical aspect of the research, and a case study approach was used to test this relationship in practice by applying to the relationship of an Islamic bank operating in Algeria with the Central Bank of Algeria.

2. Literary review:

In the context of addressing the issue of the relationship between central banks and Islamic banks, we see the existence of some studies that indicated one or some of the components and aspects of this subject, we list them as follows:

- 1- Muhammad Ahmad Saqr, Buthaina Muhammad Ali Al-Mohtaseb, **Adapting the Supervisory Role of Central Banks to Deal with Islamic Banks** (2013) By applying

to Jordanian banks, the researchers concluded that the objectives of traditional banking supervision are not compatible with Islamic banks due to the inappropriateness of the objectives and means of traditional supervision with the nature of work. The Islamic banking, therefore, has focused on the necessity of creating a department in the Banking Supervision Department in the Central Bank that specializes in supervision, inspection, and follow-up on Islamic banks and economic institutions similar to them in employment and investment.

- 2- Mustafa PAKSOY, **The relationship between the Islamic Bank and the Central Bank** (2015) this study deals with the nature of Islamic banks and their features, and requirements of these features in terms of control tools and methods appropriate with the particularity of their business and their relation with the traditional central bank. At the same time aims to view the relationship between Islamic banks and central banks. To explain this relation the researcher started to explain what is the central bank, the objectives of a central bank, and its characteristics, what is Islamic bank and the objectives of the Islamic bank. Then the researcher will speak about the relationship between the Islamic bank and central bank from the side of how the central bank's politics will affect the Islamic bank's work.
- 3- Frieja Mohamed Hisham, **Central bank supervision of Islamic banks** (2017) this study deals with the nature of Islamic Banks and their features, and requirements of these features in terms of control tools and methods appropriate with the particularity of their business and their relation with the traditional central bank. The study aims also to be acquainted with the extent of the appropriateness of the traditional control tools and the particularity of the Islamic banking work. The study arrived at a set of requirements, which are necessary to adapt the control tools of the traditional central bank with the particularity of the Islamic banking work. The study set also a concept of a control framework supporting the Islamic banking work and regulating the relation of the Islamic banks with the traditional central bank in a manner securing for them an appropriate investment environment free from control and supervision hindrances.

2.1. The difference between our study and other studies: This study differs from previous studies in that it attempts to identify the positives, opportunities, and challenges arising from central banks' dealings with Islamic banks. To identify the defects that impede the growth of this type of financing, and ways to reduce them in light of the use of control mechanisms recognized in an underdeveloped country in the field of Islamic banking.

3. A theoretical approach to central and Islamic banks

3.1. Central banks

A bank is a financial institution that accepts deposits from the public and creates a demand deposit while simultaneously making loans (Glenn , Anne , & Lewis, 2012, p. 482). As for the central bank, it can be defined as the bank of banks because it takes over supervision and control over the rest of the banks. the issuing bank because it has the authority to issue state cash and the state bank where it has the authority to manage the state's reserves of gold and foreign currencies and direct monetary policies in the state (عبد الله , 2000, p. 18). The central bank represents a member or part of the government that takes it upon itself to manage the government's financial operations, and by managing these operations, it can influence the behavior of financial institutions, making them conform to the state's economic policy (De , 1983, p. 19). Central banks all over the world today perform similar functions aimed at achieving the common good, but the practice of these functions differs from one economic environment to another. Central banks in the modern era perform all or some of the following functions (صبحي و أحمد رمضان ، 1980 ، صفحة 155):

- Issuance of legal banknotes under certain restrictions following the need for transactions.
- Carrying out banking services for the government, which made the central bank called the government's bank.
- Performing banking services and assisting commercial banks (the Bank of Banks).
- Managing the country's foreign exchange reserves and monitoring the conditions of foreign trade contribute to the stability of foreign exchange rates.
- Monitoring credit quantitatively and qualitatively and directing it to serve the set monetary policy.

The central bank is a government institution that dominates the monetary and banking system of the country and is responsible for issuing cash and acting as a financial agent for the government, in addition to monitoring banking agencies and the credit process in support of economic growth and monetary stability for the country.

3.2. Central Bank Characteristics

Several characteristics, including the following, characterize the central bank (KIMBERLY , 2020):

- The Central Bank is a monetary institution of public ownership. The governments of countries are responsible for managing and supervising the Central Bank by establishing a set of laws that define its duties and objectives.
- The central bank is at the forefront of the banking system because it has supervisory authority over commercial banks.
- The Central Bank is not interested in making profits, but rather its existence depends on achieving the general interests of the state.
- The central bank is distinguished by its ability to convert assets of a real or fixed nature, such as real estate, into monetary assets.
- The central bank is the financial institution that monopolizes the moneymaking process, because the central bank is an independent institution in managing monetary policy, and the executive authority does not interfere with the nature of its work.
- The central bank has a strong relationship with commercial banks, and has different methods and authority to influence the activities of these banks this contributes to the realization of the state's economic policy.

3.3. Islamic banks

Islamic banking or Islamic finance or sharia-compliant finance is a banking or financing activity that complies with sharia (Islamic law) and its practical application through the development of Islamic economics. Some of the modes of Islamic banking/finance include Mudarabah (profit sharing and loss bearing), Wadiah (safekeeping), Musharaka (joint venture), Murabahah (cost-plus), and Ijara (leasing) (Khan, 2014). So Islamic bank is a banking institution that does not deal in interest, i.e. usury by taking or giving. The Islamic bank receives from customers their deposits without any direct or indirect obligation or undertaking to give them interest. On the other hand, when it uses its cash resources in investment or commercial activities, it does not lend to anyone with the condition of interest but rather finances the activity based on profit and loss sharing (عبد الرحمن , 2001, p. 259). What is meant by calling the bank "Islamic" is to clarify the identity of the committee determined in the method of dealing that this bank follows in its relationship with its clients, whether they are depositors or financiers and investors. It provides sufficient alternatives that stem from the core of Islamic legislation (عبد الله , 1994, p. 88). To achieve a set of objectives that constitute the justification for the existence of this type of bank, which can be summarized as follows:

- Direct investment, partnerships, project promotion, aggregation of feasibility for others,

and improvement of the general investment climate, The Islamic Bank focuses on its financing investments on medium and long-term investment, from which the base of economic activity is expanded and the structure of its economic sectors is straightened (حسن, 1999, pp. 292-293).

- Serving and encouraging individuals who do not wish to deal with usury, and collecting their savings, and investing them in a way of participation in a way that serves the community based on Islamic Sharia (محسن, 1990, p. 32).
- Islamic banks contribute to achieving human happiness by securing legitimate material and moral demands and raising their standard of living. It provides him with his basic needs and contributes to his culture and education at reasonable competitive prices by relying on Islamic formulas for financing and investment (صالح, 2005, p. 29).
- Fighting monopoly and what may result from exploitation of people's needs, and then the Islamic bank works to break the oligopoly and spread the tools of production, which guarantees a fair distribution of wealth and abundant production that is sufficient for people and achieves their security and stability (محسن, 1990, p. 32).

3.4. Characteristics of Islamic Banks

Islamic banks are distinguished from other banks by a set of characteristics, the most important of which are:

- **Prohibition of usury:** It is a distinctive feature of Islamic banks to purify money, and from here Islamic banks do not deal with interest, whatever its forms, taking and giving, depositing or hiring, accepting or discounting, directly or indirectly, fixed or mobile (عبد الرزاق, 1998, p. 192). The Almighty said, “*O you who have believed, fear Allah and give up what remains [due to you] of interest if you should be believers.*” (L-baqarah, Verse 2:278). In addition, the Prophet, may God bless him and grant him peace, said, he said: “*Avoid the Seven Mubaqat,*” and he mentioned among them: “*And the consumption of usury.*” (Al-Bukhari & Muslim, pp. 2615 -145).
- **Sharia Supervision:** Islamic banks are unique from other traditional banks because they have additional control over their operations, which is Sharia control, in addition to financial, administrative, and banking controls, which is the main advantage of Islamic banks. It is worth noting that the Shariah observer or whoever is entrusted with the task of Shariah supervision should be legally and scientifically qualified to be able to express an opinion that is based on science (أحمد, 2006, p. 17). The Almighty said, “*And do not pursue that of which you have no knowledge. Indeed, the hearing, the sight, and the heart - about all those [one] will be questioned.*” (l-isrā, Verse 17:36).
- **Commitment to Halal Transactions:** The Islamic bank is committed to applying the rule of halal and haram in all its transactions and adherence to the morals and etiquette of Islam in these transactions, which extend to include all areas of human activity that the bank deals with (عبد الله بن محمد, 2000, pp. 1023 -1024). The Almighty said, “*Do they then seek after a judgment of (the days of) ignorance? But who, for a people whose faith is assured, can give better judgment than Allah?*” (L-māidah, Verse 5:50).
- **Attention to the social aspect:** Achieving social integration is the most important principle on which the economic system is based, for this reason; we find the Islamic Bank aims to develop the Muslim community, through its investment activities. If the goal of traditional banks is to accumulate funds and direct them to capital for making a profit, then the Islamic bank aims to advance society and establish the Islamic economy by directing wealth in a sound direction, taking into account the priorities as it is based on a social basis. Meaning that it aims to achieve Social solidarity, through the management for example the Zakat Fund, and through its consideration in setting its

development plans and policies in which the interest of the Islamic community is observed (السعيدى، 2000، الصفحات 1023-1024).

- **Bank relationship with depositors:** The relationship between Islamic banks and deposit holders is not based on a creditor and debtor (as is the case in conventional banks), but rather a partnership and trading relationship within the buying and selling operations (صوان، 2001، p. 91).

3.5. Islamic Banks Resources

There is no significant difference in the financial resources of Islamic and conventional banks, and the state or people can invest their money in them. These resources are divided into internal resources that include shareholders' equity (capital, reserves, and undistributed profits) and external resources consisting of various deposits similar to demand deposits. (Current accounts), savings deposits (savings accounts), investment deposits (investment accounts), Islamic savings books, investment Sukuk, Hashanah loans from other Islamic financial institutions (رکيبي، 2015، pp. 20-21).

3.6. Uses of Islamic Banks

Islamic banks employ their resources under the provisions of Islamic Sharia in several aspects, which are predominantly investment in nature, the most important of which are:

- **Mudaraba:** It is a contract that requires the payment of cash in cash - free of fraud - with a specified amount and description to the one who trades in it with a known part of his profit (النمر، 2000، p. 170). As for the Islamic bank, it means a partnership between the bank and almadarib, who may be an individual or a company for a period to be agreed upon in advance and the bank may invest in an existing company or a new company after it has been agreed upon on the profit rate attributable to the bank (bank, n.d.). The Almighty said, "Others traveling through the land, seeking of Allah's bounty" (l-muzamil, Verse 73:20).
- **Musharaka:** It is a contract between two or more persons to participate in the capital and profit, or the stability of something of financial value between two or more owners, each one of whom has the right to act as the owner (شيخون، 2002، p. 120). In "Musharaka finance", the customer requests financing for a specific project where the bank shares the customer in the expected results of the project (profits or losses), The Musharaka contract is carried out according to a set of rules and principles of distribution agreed upon in advance by the two parties, following the provisions of Islamic Sharia. In addition, unlike in the case of loans, Musharaka financing does not include interest rates (Bank A. D., n.d.). The Almighty said, "Truly many are the partners (in business) who wrong each other" (şād, Verse 38:24).
- **Murabaha:** Murabaha is a sale process at the purchase price plus a known and agreed on profit margin between the buyer and seller (sale with a known profit). Murabaha can take the form of a direct commercial transaction between a seller and a buyer or a tripartite transaction. This last formula has been adopted in Islamic banking operations, where the bank intervenes as the first buyer to the supplier and as a seller to the purchaser making the purchase order (the customer) (Al Baraka Islamic Bank, n.d.). The Almighty said, "But Allah hath permitted trade and forbidden usury." (L-baqarah, Verse 2:275).
- **Sharecropping (almuzaraea):** sharecropping is a financing formula created by Islamic jurisprudence within the framework of its regulation of the various sectors of economic activity by providing a jurisprudential treatment that matches the nature of each activity. Islamic banks have adopted this formula to finance agricultural activities, and it is a contract on planting with some outside obtained from the contracted land, which

indicates the existence of a contract between the owner of the land and the tenant according to a share of the growth (Bank A., n.d.). Almighty said, "See ye the seed that ye sow in the ground? Is it ye that cause it to grow, or are we the Cause?" (L-wāqī‘ah, Verse 56:63-64).

- **Silam sale:** It is a goods sale, in which the seller undertakes to supply the relevant goods to the buyer at a future date, in return for a specified amount paid fully in advance. The Islamic bank can finance the establishments in the form of Silam by purchasing production equipment, or to finance the production establishments that need to finance working capital (raw materials, salaries, operating expenses) (الأسرج, 2010, pp. 11-12).

4. The relationship between central banks and Islamic banks

4.1. Central bank controlling tools over the Islamic bank's activity

It is a set of tools, which control the relationship between the Central Bank and the Islamic banks. The following is a presentation of the most important tools:

- **Rediscount rate:** It is a tool used by the central bank to influence the amount of credit provided by commercial banks (Ondieki & Jagongo, 2013, pp. 1-9). The rediscount rate, according to the Bank of Algeria, is 4% (Bank of Algeria, 2016, p. 19), since one of the most important principles of Islamic banks is not to deal with interest; therefore, raising or lowering this rate is assumed by the Central Bank. It does not affect the amount of credit and financing provided by these banks.
- **Liquidity Ratios:** According to the Monetary and Loan Law 90-10, the elements of this ratio consist mostly of government bonds and discounted commercial papers. The Algerian legislation in Article No. 92 gave the power to determine the liquidity ratio and the criteria used in its calculation to the Central Bank of Algeria. and for information, the components of this ratio are not dealt with by Islamic banks at all.
- **Reserve ratio:** It is a tool used by the central bank in most countries to influence the ability of banks to create money deposits and thus their ability to expand the provision of credit. For Islamic banks, the impact of this tool poses the problem of restricting their activities since most of their financing operations are of an investment nature. The reserve ratio estimated by the Algerian legislation on Islamic banks is 12% (Central Bank of Algeria, 2013).
- **Censorship, inspection, and literary persuasion:** it is considered one of the tools of banking intervention and supervision. Given the lack of a Shariah authority to oversee Islamic transactions in banks, the inspections and monitoring carried out by the Banking Committee to monitor banks and financial institutions (according to Articles 142-153 of the Monetary and Loan Law 90-10) are based on a purely positional basis.
- **Credit Limits Policy:** It takes many forms, either by defining the loans that the bank can provide to customers as a total volume or by defining the amount of credit that the bank is allowed to provide as a percentage of its capital. This is considered an obstacle and is inconsistent with the provisions of Sharia, especially concerning the loss of profitable investment opportunities that will reflect positively on everyone.
- **Open market:** According to Ordinance 04-10 of October 26, 2010, related to Monetary and Loan Law, the Central Bank of Algeria (Bank of Algeria) can intervene in the money market by buying and selling particular public and private bonds. These bonds can be accepted for rediscounting or for granting advances, which constitutes an obstacle to the response of Islamic banks to such transactions (interest-bearing bonds).

4.2. The advantages and challenges arising from the Central Bank's dealings with Islamic banks

4.2.1. Advantages

It includes a set of privileges that Islamic banks benefit from compared to conventional banks, the most important of which are:

- The Central Bank does not interfere at all in determining the returns distributed to the owners of investment in Islamic banks. Because these returns are the outcome of the employment and investment, activity of those banks, in addition to the fact that the Central Bank does not interfere in determining the profit margin in Murabaha operations with these banks. The same is true regarding the profit distribution ratios in Speculations and shares.
- The Central Bank allows Islamic banks to acquire goods, equipment, and sometimes real estate, and own them for resale, and these operations are prohibited for conventional banks.
- Central banks require all banks operating within the country to deposit a certain percentage of their clients' deposits in foreign currencies with them, provided that these banks take interest on these deposits. Islamic banks do not deal according to interest rates, so the Central Bank replaced that banking process with a legitimate speculative process, as Islamic banks represent the owner of the money.
- Some central banks provide general facilities in the form of speculation to Islamic banks that operate within the scope of their supervision and are exposed to the problem of liquidity, provided that the banks pay the rate of profit on those deposits to the central banks equivalent to the profit announced for such deposits with them.
- Some central banks have taken the initiative to put a lower limit on the liquidity ratios established in Islamic banks in the areas of employment and investment.

In this context, Algeria has enacted many laws that Islamic banks can exploit as an entry point for Islamic banking in Algeria. after opening the way for foreign banks and private sector banks to operate after the Monetary and Loan Law (10-90) April 1990, similar to Article 68 of Ordinance 10 - 04 of August 26, 2010. which opened the way for the adoption of lease financing coupled with the purchase option, in addition to Article 73, which grants transactions involving receiving money from the public and employing them in the form of contributions that do not entail the benefits of an Islamic nature. as it encourages banking institutions to adopt this type of Financing clarifying and protecting the parties dealing with it.

4.2.2. Challenges:

They include a set of elements that represent restrictions on the work of Islamic banks to achieve their goals. The following is a presentation of the most important of these challenges:

- The application of the cash reserve ratio entails not investing the funds in full, i.e. disabling part of the depositors' funds from investing against their will, at a time when investment accounts represent a large proportion of the total deposits of Islamic banks, which results in a decrease in the return distributed to those accounts in the end.
- Central banks resort to setting credit conditions so that the financing provided by the bank to the various business sectors does not exceed the limits of a certain percentage of the total resources available for employment. Its activity has only a weak influence on the quantity supplied. In addition, this credit policy conflicts with the provisions of Sharia, due to the consequent loss of profitability opportunity for the deposit holders.
- Islamic banks like the rest of banks have no problem in being subject to the supervision of the Central Bank and, submitting data to it periodically. the problem is that they are obliged to send their data, accounts, and financial positions according to results and

investments specially prepared with data and items specific to traditional banks, and there is no doubt that this represents an obstacle in front of Islamic banks and leads to duplication of work within these banks.

- Central banks play the role of the last lender to banks operating in the country when they need liquidity, or when the state follows an expansionary policy and wants to increase the financing provided by banks to customers. This method, which makes it in a sensitive position concerning liquidity.

In addition to these problems, and the absence of a legal framework for the working mechanism of Islamic banks in Algeria. Islamic banks suffer from the problem of adapting their activities and services according to the Algerian law of a traditional nature. which requires institutions to abide by it in their transactions based on the provisions of Order 10-04 related to Monetary and Loan Law (Article 128). Therefore, it is necessary to:

- Create an organization at the Central Bank of Algeria that monitors the work of Islamic banks and makes recommendations that would value and develop the various Islamic transactions.
- The need to change the restructuring of liquidity ratios with components that take into account the provisions of Islamic Sharia.
- The Algerian state must offer debt instruments and certificates (Islamic bonds) that are compatible with the provisions of Islamic Sharia so that Islamic banks can participate in the various operations related to the issuance of these certificates.
- Setting standards for Islamic bank account statements.

5. Practical indicators of the Central Bank's dealings with the Salam Bank

5.1. A brief definition of Al- Salam Bank

5.1.1. Bank Origin:

Al Salam Bank of Algeria was established in June 2006 and started its activities in October 2008, with a subscribed and paid-in capital of (7.2) billion Algerian dinars. That was within the framework of the process of establishing a group of Salam banks in Arab and Islamic countries, after the success achieved by Islamic banking. Algeria was chosen to host one of its headquarters due to its fertile investment environment, and this choice was helped by the economic openness that Algeria had to the Arab countries, and was reinforced by the Algerian-Emirati rapprochement. Since most of the capital of Salam bank is Emirati, The founders of the bank, due to their firm conviction in it, chose the Islamic banking method for the bank's work, since then it has been striving to represent Islamic banking in the best way, and it seeks to verify what it can in this capacity.

5.1.2. Estimated Al Salam Bank Budget:

Al Salam Bank started its activities with a capital estimated at 7.2 billion Algerian dinars, to reach 10 billion Algerian dinars in the year 2009, and the total assets of the bank are estimated at 207, 40.75 thousand Algerian dinars in 2015. To meet the requirements of customers by supporting their needs in the field of exploitation, investment and savings by providing international banking products that comply with the teachings of Islamic Sharia. Since practicing its activities, Al Salam Bank has recorded results in continuous development. Comparing the results of the years 2019 and 2020, we find that:

- The bank's total financial position amounted to 163 billion dinars (1,230 million dollars), compared to 131 billion dinars (1,096 million dollars) in 2019, with a growth of 24%.
- Total customer deposits amounted to 129 billion DA (978 million dollars) in 2020, compared to 102 billion dinars (857 million dollars) in 2019, a growth of 26%.
- Bank output for the year 2020 amounted to 7.7 billion dinars (\$58 million), compared

to 3.9 billion dinars (\$78 million) in 2019, a decline of 17%.

5.2. Practical indicators of the Central Bank's dealings with the Salam Bank

Within the framework of the Central Bank's exercise of some of its functions, especially the functions of banks and credit control, the most important features of the relationship between the Central Bank and Al Salam Bank and the rest of the banks that fall under its supervision are formed.

5.2.1. Legal Reserve Ratio

As we mentioned above, the mandatory reserve ratio applied by the Bank of Algeria is estimated at 12% according to the Central Bank of Algeria's instructions No. 01-201 3. The deposits subject to the legal reserve ratio are deposits in Algerian dinars of any nature. namely demand deposits, term deposits, savings deposits Represented by a savings book, deposits represented by bonds (fund bonds), other deposits, in addition to these items the daily average of cash in the fund represented by banknotes and coins, and all are declared during each month.

Table (01): An example of calculating the legal reserve ratio

Deposit type	Amount (DZD)
demand deposits	5,345,752,415.60
Term Deposits	2,008,084,084.37
Deposits represented by bonds	73,291,600.00
Savings Book Deposit	4,550,482,104.46
Other deposits	5,099,835,396.14
Total deposits	17,077,445,600.57

Source: Prepared by the researcher

Subtract from this total (total deposits) the monthly average amount of cash in the fund: **405,257,582.24 DA**. This is according to the instructions of the Bank of Algeria, so the total remains **16,672,188,018.33 DA**, when this total is multiplied by **6.25%**, we find the amount: **1,042,011,751.15 DA**. This means that the bank's current account with the Central Bank (Bank of Algeria) must not be less than this last amount, and based on it the interest rate granted to the bank is calculated according to the legal reserve. It is noted through these numbers and operations that the bank suffers in the application of the legal reserve ratio from two problems:

- The reserve rate is applied to the total deposits held by the bank, and except demand deposits guaranteed by the bank. Which represent about 20% of the total deposits, most of the other deposits received by the bank as a matter of speculation, i.e. in the profit and loss sharing system. Therefore, the bank does not guarantee them except in case of infringement or default.
- The bank receives interest on the money deposited as a legal reserve with the Central Bank (Bank of Algeria) like other banks, knowing that it is an Islamic bank, that is, it does not deal in interest by taking or giving.

To solve this last problem, the bank has opened a special account with the Bank of Algeria in which these interests are placed, pending their disbursement to projects and charitable aid.

5.2.2. Indicators of the rules, with a focus on capital adequacy:

Regulation No. 74-94 issued on November 29, 1999 AD specifies most of the rates related to the prudent rules, Les règles prudemment, the most important of which are:

- That the size of the risk (the amount of credit granted) for one customer does not exceed 25% of the bank's total capital, starting from 01/01/1995 AD. The size of the risk means that represented in the form of loans as well as off-budget pledges (such as the competencies and guarantees given), its risks are calculated with the equivalent elements of the budget. If the bank's net capital = 72 4,207,870.00 DA, then 25% of this

amount = 605,196,750 DA. Relying on the bank's documents authorized by the Central Bank it was found that Algeria's Al Salam Bank respected this ratio, as the size of the risks represented by any of the bank's clients did not reach this last amount.

- The total risks (undertakings) for clients whose risk size exceeds 15% of the bank's capital must not exceed ten times this capital, i.e., of the bank.
- The ratio of the bank's capital to the total risks of loans and commitments must be equal to at least 8%. Article 5 of Instruction No. 94-74 specified how to calculate the bank's capital in its basic part, while articles 6 and 7 specified the elements that are calculated within the bank's capital. The supplementary money of the bank and the sum of these two parts constitute the bank's capital, while Article 8 of the regulation indicated the sum of the elements in which the risk element is available, then Article 11 classified it according to its risk weights according to its equivalent loan.

5.2.3. Discount and Re-discount price:

The operations of discounting and rediscounting carry the usurious nature with it, so Al Salam Bank avoids using this method in its dealings and compensates for its failure to benefit from the function of the last resort of the Central Bank with the profits resulting from the Murabaha and Musharaka operations that it performs.

5.2.4. Monitoring and Inspection Operations:

The Bank of Algeria conducts routine monitoring and inspections, in addition to the requirement that it obtain information regarding the various accounts and the movement of funds belonging to Al Salam Bank under Algerian law. It is noted that the inspections and supervision are not subject to Sharia standards. Therefore, Al Salam Bank faces the problem of double standards in preparing various reports and statements. Financial (budget, off-budget, results in the calculation, cash flow schedule, private funds change schedule,) under the disclosure requirements issued by the Central Bank, which are required by the custodians (the Banking Supervision Authority) on the one hand, and the controls for compliance with Sharia standards on the other.

5.3. Problems of dealing between the Bank of Algeria and Al- Salam Bank

5.3.1. Al Salam Bank's contribution to the capital of companies

Law No. 10-90 related to monetary and loan law issued on 04/14/1990 stipulated that the total contribution of banks and financial institutions to the capital of companies should not exceed half of the private funds of any bank or financial institution.

5.3.2. The problem of dealing with the Bank of Algeria as a last lending resort based on interest rate

Al Salam Bank was able to employ a significant part of its surplus liquidity with the Bank of Algeria, for it to be able to borrow in return for no more than this amount when necessary. However, with the low interest rate prevailing in the local monetary market, the Bank of Algeria notified the Al Salam Bank that it was not possible to benefit from this liquidity by employing it in the monetary market. Therefore, it could not continue in this dealing and since this amount was placed at, the disposal of Al Salam Bank and it can withdraw it at any time.

Al Salam Bank has recently suggested to the officials in the Bank of Algeria that it solve the problem of refinancing it by re-discounting the commercial papers it owns, and this if necessary, so that the bank borrows money from the Bank of Algeria with the guarantee of those papers, and what is deducted Of its value as interest, it can be taken directly from the creditor's bank account related to the interest as previously mentioned, provided that the amount of interest paid by Al Salam Bank does not exceed the balance of what it owns in that account. Al Salam Bank did not receive a response from the Bank of Algeria on this proposal so far, but the origin of Islamic banks is to avoid paying or receiving usurious interests, so this process even if it

takes an exceptional character (at a time of urgent need), is not without its usurious nature, so the researcher suggests:

- That the Bank of Algeria employs all or part of the deposits of Al Salam Bank in Islamic transactions with the sharing of profits and losses.
- That the Bank of Algeria lends Al Salam Bank according to participation mode.
- Involving specialized organizations to provide Sharia advice to adapt this process under the provisions of Islamic Sharia.

5.4. Other problems between the Bank of Algeria and Al- Salam Bank:

Here we mean by other problems those that are not often raised when talking about the relationship of Islamic banks with central banks, in contrast to the previous elements:

5.4.1. Interest on Conditional Deposit as Security in Imports:

The bank was able to convince the officials at the Bank of Algeria of the specificity of its work. Which does not allow for Regulation No.: 94-20 dated April 12, 1999 AD, where the customer has the option to place this deposit as a demand account, i.e. without interest, and subject to the conditions of the import process itself or as a frozen account. It is subject to the terms of the mudaraba contract, and if it is subject to the last option, it is entitled to a return starting from the lapse of 31 days from the date of the contract for each import transaction, and for 3 months. the deposit participates in the investment by 50%.

5.4.2. Mandatory participation of the bank in the deposit guarantee fund at the Bank of Algeria:

Ordinance No. 11-03 dated 08/26/2003, related to the Monetary and Loan Law stipulates that banks must participate in financing the bank deposit fund in the national currency at the Bank of Algeria by paying an annual guarantee premium of a maximum of 1% of the total deposits. Provided that the Monetary and Credit Board determine each year the amount of the bonus as well as the maximum compensation. A person's deposits with the bank are considered one deposit, even if they are in different currencies, and this guarantee is not valid unless the bank stops paying.

6. CONCLUSION

The systems and tools espoused by the central banks are largely inconsistent with the nature and work of the Islamic banks. Since the central bank has erected its methodology of control and dealing, based on the nature of the work of traditional banks. Hence, these tools are harmonious with their methodology despite the nature of the work of the Islamic banks. Thus, the system and base of dealing by the central bank with the Islamic bank shall be different in order to be applicable with their work nature.

6.1. Results

By addressing the issue of the relationship between Islamic banks and central banks in Algeria, and after reviewing the various aspects of the relationship between Islamic banks and central banks, the following results were presented:

- 1- Islamic banks differ radically from traditional banks, especially in the financing formulas, due to the different nature of this financing as well as the principles and foundations that govern it, which necessarily requires a special and distinct relationship between Islamic banks and central banks.
- 2- Islamic banks in Algeria in particular face many obstacles, the most important of which is the absence of clear legal texts explaining the rules of work of these banks, which in turn face competition from the usurious banks that have the advantage of dealing with the Bank of Algeria.

- 3- Islamic banks do not benefit from the central bank's function as a last resort lender, as well as do not benefit from re-discounting.
- 4- The lack of flexible and rapid communication channels between central and Islamic banks facilitates coordination and communication processes.
- 5- Al Salam Bank in its relationship with the Bank of Algeria embodies some of the problems faced by an Islamic bank operating under a traditional central bank. Such as the application of the legal reserve ratio or the latter's dealing with the former as a last resort for borrowing, or how to calculate some rates that fall within the prudent rules. However, at the same time, it does not suffer from the problems that other Islamic banks suffer in the same situation, such as determining the ratios of liquidity, or the bank owning real estate or movables more than what is permitted in the framework of its work, or a problem with public bonds.

6.2. Recommendations and suggestions

In light of the previous results, some recommendations can be made, which can contribute to the development of methods of dealing and financing by the Central Bank for the benefit of Islamic banks.

- 1- The central bank should motivate Islamic banks to expand the use of various Islamic banking transactions.
- 2- The Central Bank should adopt procedures and laws that are compatible with the nature of the work of Islamic banks, with an emphasis on the need to establish a Shariah organization that monitors the extent to which banks comply with these laws.
- 3- The necessity of legal adaptation in monetary policy tools and financing methods to suit the nature of the activity of Islamic banks.
- 4- The Central Bank shall make a legitimate investment of bank deposits with it to ensure that Islamic banks benefit from their deposits with it.
- 5- Monetary authorities should discuss the possibility of converting to an Islamic banking system and encourage efforts to achieve this goal.

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