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Islamic Banking: A Mechanism for Financing Local Development in Algeria

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Abstract:

This paper aims to examine the interest and commitment of the Algerian legislator to Islamic banking through the adoption of Bank of Algeria Regulation 20-02 and Directive 03-2020, which regulate banking operations associated with Islamic banking and establish the rules for its practice. It assesses the potential of Islamic banking to contribute to the financing of local development in Algeria by supporting economic investments. Islamic banks, like their conventional counterparts, create substantial investment pools by channeling funds from savers, whether individuals or institutions with financial surpluses, to finance production and various development plans. In recent years, Algeria has increasingly turned towards economic development by leveraging Islamic banking to attract financial surpluses held by economic agents who prefer Islamic financing tools. This approach positions Islamic banking as an effective alternative financing method. This paper demonstrates that Islamic banking can play a crucial role in comprehensive local development by reviewing and elucidating the various Islamic financing instruments that are compatible with different types of investments.

Keywords: Islamic banking, Islamic financial instruments, Islamic financing methods, banks and financial institutions, local economic development.

Introduction:

Since the 1980s, the capitalist system has periodically experienced complex financial crises that impact the core foundations of the financial system, which is fundamentally based on interest rate mechanisms. Additionally, various modern financial engineering innovations have led to global financial crises, the most recent being the significant 2008 American subprime mortgage crisis, whose effects lingered for many years. A precise diagnosis of the crisis revealed that its root cause was the banking (financial) system, which relies on usury as the basis for all banking operations. These operations are fundamentally based on interest-driven debt relationships, causing cash flows and financial movements to diverge from real economic development. Consequently, these practices fail to create real wealth, impeding the ability to foster national or local economic development.

Research Importance:

The significance of this research lies in the fact that Islamic finance is considered a suitable solution to bridge this gap. Islamic banking tools are closely linked to the real economy, and as an interest-free alternative, they can aggregate savings and circulate them as cash flows that generate real wealth for the national economy. The impacts of this approach are evident in both national and local economic development.

Research Objective:

The objective of this paper is to clarify the role of the Islamic financial system, through Islamic banking tools, in its ability to finance various national and local development projects and create tangible real wealth. This is due to its diverse and flexible tools that are compatible with various investment projects.

The state has delayed adopting Islamic banking for several decades since independence for multiple reasons (which are not the focus of this paper). This delay has led to a significant shortfall in aggregating large savings that operate outside the formal banking system (official financial system), resulting in a substantial lack of capacity to finance local development projects. Consequently, the Bank of Algeria intervened to regulate it (following state adoption) through Bank of Algeria Regulation 20-02 and the Implementing Directive 03-2020 concerning Islamic banking. The expected outcome is that Islamic banking will play a role in attracting savings and financing development projects.

Research Problem:

Based on the aforementioned points, the research problem can be formulated as follows:

- To what extent can Islamic banking tools finance local development projects?

Research Methodology:

To address the research problem, we followed the descriptive-analytical methodology. The first method involves collecting information related to general concepts of Islamic banking and local economic development. The second method involves analyzing the texts of Bank of Algeria Regulation 20-02 and Directive 03-2020, which clarify and regulate Islamic banking tools in Algeria, and examining the impact of Islamic financing through these tools on local economic development.

Research Structure:

The research is divided as follows:

- **Chapter One:** Islamic Banking in Algeria.
    - **Section One:** Islamic banking in Algeria, reasons for its delay, and the rationale for its adoption.
    - **Section Two:** Adoption of legal texts regulating Islamic banking in Algeria.
- **Chapter Two:** The Role of Islamic Banking in Achieving Local Development.
    - **Section One:** The impact of Islamic banking financing on local development.
    - **Section Two:** The impact of Islamic banking products in creating opportunities for local development in Algeria.

Chapter One: Islamic Banking in Algeria

Algeria was among the latecomers in introducing Islamic banking into its banking system, prompting several questions about the reasons for this delay and the rationale for its adoption as a significant funding source for the national banking organization (Section One), and about the legal texts regulating it and its products (Section Two).

Section One: Islamic Banking in Algeria, Reasons for its Delay and Rationale for its Adoption

Subsection One: The Real Reasons for Algeria's Delay in Adopting Islamic Banking:

Several reasons contributed to Algeria's delay in adopting Islamic banking, including (1):

- The persistence of traditional usurious banking thought derived from the colonial banking system in its organizational structure and its human resources.
- The preoccupation after independence with a radical shift from the inherited capitalist system to a socialist system, preventing the authorities from considering Islamic banking.
- Educational, cultural, and ideological convictions of the ruling system, which were not conducive to accepting the idea of integrating Islamic banking into the Algerian banking system and consistently downplaying its ability to keep pace with modern banking industry advancements.
- The establishment of branches of foreign Islamic banks (e.g., Al Baraka Bank of Saudi Arabia) to mitigate the demands for the adoption of Islamic banking.
- The significant financial abundance in the previous two decades and the lack of a need for additional financial resources contributed significantly to this delay.

Subsection Two: Reasons for Algeria's Adoption of Islamic Banking:

There are several reasons contributing to Algeria's adoption of Islamic banking, which can be categorized into general and specific reasons:

1. **General Reasons:**

   - The growth and development of Islamic thought, accompanied by the increasing writings of thinkers and advocates calling for the establishment of an Islamic economic and social system based on the principles and foundations of Islamic Sharia, aligning with the modern requirements of the Muslim community.
   - The avoidance of interest-based dealings with conventional banks and the reluctance to subject Muslims to mandatory transactions with them due to the lack of alternative Islamic financial options.
   - Efforts to develop the economic and financial system and make it practically applicable, thereby integrating it into the daily interactions of individuals and groups in a way that significantly impacts their lives.
   - Joint awareness to gather various scientific and jurisprudential efforts of those working in the financial and economic fields, advancing society to a developed reality that keeps pace with modernity on one hand and adheres to Sharia regulations on the other, involving everyone according to the principle of participation for the sake of progress and development.
   - The desire of the Islamic society to adhere to its Islamic principles and apply them to various areas of financial and economic transactions.

2. Specific Reasons:

- Successful experiences (especially after the financial crisis of 2008) of some global conventional banks in benefiting from certain Islamic banking instruments, opening windows for them, and enabling them to attract large sums of money from Islamic-oriented savers.
- The conviction of decision-makers in Algeria regarding the necessity of adopting Islamic banking and integrating it into the financial system, introducing most Islamic banking instruments (such as Murabaha, Musharakah, Mudarabah, Istisna'a, etc.) for utilization.
- Conviction that a large amount of cash outside the national banking system is owned by individuals who do not want interest-based banking transactions, preferring instead to employ their funds in accordance with Islamic principles and regulations.
- Ensuring the ability of Islamic banks to attract a large number of savers with significant capital.
- The use of Islamic financial instruments in Islamic banks or through Islamic windows within conventional banks represents an important and profitable source that generates substantial financial returns through investments in real projects aimed at increasing local development levels.
- Islamic banks achieve low risk rates, working to avoid periodic financial crises at the national level or being affected by international financial fluctuations.

Second Section: Adoption of Legal Texts Regulating Islamic Banking in Algeria:

Regulatory texts governing Islamic banking in Algeria are divided into two branches:

First Subsection: Legislative Texts:

Public banks (state-owned) monopolized banking activities in Algeria until 1990. However, with the issuance of the Banking and Credit Law (Law 90-10) published in the Official Gazette No. 16 on April 14, 1990, the Algerian banking system witnessed a new development towards opening up to the private sector (2). It explicitly allowed the establishment of Algerian and foreign banks and financial institutions with private capital, resulting in the establishment of the first Islamic bank in Algeria (Islamic Bank of Baraka).

The Banking and Credit Law (90-10) remained in effect until the issuance of Order (03-11), which officially repealed it. It included banking regulation rules and designated authorities responsible for regulating the banking profession, fully vested in the Bank of Algeria (2), the Banking and Credit Council (3), and the Banking Commission (4).

Second Subsection: Regulatory Texts:

Laws and regulations governing Islamic banking in Algeria were delayed for a long time. The Bank of Algeria issued two successive systems: the first (18-02) and the second (20-02). (5)(6)

1. **System (18-02) on Participatory Finance:** System (18-02) establishes the legal and regulatory framework for banking operations related to participatory finance by banks and financial institutions. It is the first specific legal and regulatory framework for financial transactions according to Islamic Sharia principles. Article 1 defines this new system explicitly stating its purpose ("This system aims to define the rules applied to participatory products that do not involve the collection or payment of interest.").

Operations related to participatory finance include all banking operations conducted by banks and financial institutions mentioned in Articles 66 to 69 of Order (03-11), which include receiving funds (bank deposits), financing, and investment operations that do not involve the collection or payment of interest. These operations cover the following financial products: Murabaha, Musharakah, Ijarah, Salam, Istisna'a, and investment deposit accounts (7).

System (18-02) faced difficulties in implementation due to several reasons summarized as follows:

- Political instability in late 2019;
- The COVID-19 pandemic and its significant impact on the global economy;
- Declining oil prices and their effects on public treasury revenues and hence financial and banking activities;
- Associated shortcomings.

This led the relevant financial authorities to address many of these issues, followed by the issuance of System (20-02) specifically regulating banking operations related to Islamic banking.

2. **System (20-02) on Banking Operations Related to Islamic Banking:** System (20-02) specifically regulates banking operations related to Islamic banking and its practice by banks and financial institutions, effectively canceling all provisions of the previously mentioned System (18-02) (8). Article 2 of System (20-02) provides a precise definition of banking operations conducted by Islamic banks: ("In the context of this system, a banking operation related to Islamic banking is any banking operation that does not involve the collection or payment of interest. These operations must comply with the provisions referred to in Articles 66 to 69 of Order 03-11, as amended and supplemented.").

System (20-02) also specifies the types of Islamic banking products in Article 4: ("Banking operations related to Islamic banking cover the following products: Murabaha, Musharakah, Mudarabah, Ijarah, Salam, Istisna'a, deposit accounts, and investment deposit accounts.").

In addition, System (20-02) empowered the National Sharia Board for Islamic Financial Industries to legally qualify the process of certifying products' compliance with Islamic Sharia principles.

3. **Islamic Banking Products Regulated by System (20-02) and Directive (03-20):**

3-1- Murabaha (Cost-Plus Financing):

- Terminological Definition: Regarding Murabaha, jurists agree that:

It is selling with capital plus a known profit increase, meaning it is a contract that specifies the price as the original sale price plus an additional amount considered as profit (9).

It is selling at the same original price plus a known profit increase agreed upon between the contracting parties.

All these definitions define the concept of simple Murabaha according to ancient jurists. Compound Murabaha, however, is a modern concept extensively used in Islamic banks and is known as Murabaha to the Purchase Order (10).

Contemporary scholars have converged on the definition that Murabaha to the Purchase Order is a request to purchase a specific commodity with defined specifications presented by the client to the Islamic bank. This is in exchange for the complete commitment of the buyer to purchase what was requested at the agreed price and profit, with the possibility of paying the selling price in installments.

Murabaha is considered a form of entrusted sale because the sale process is conducted according to two methods (11):

- Negotiated sale, where the goods are sold at an agreed price without considering the initial purchase price by the seller.
- Trust sale, where the buyer trusts the seller, knowing the selling cost, enabling the buyer to base their offered price on that cost.

If the seller sells below their cost, it is termed a loss-making sale. If sold at cost, it is termed covering cost. If sold above cost, it is termed Murabaha (12).

The Accounting and Auditing Organization for Islamic Financial Institutions defines Murabaha as "documents of equal value issued to finance the purchase of Murabaha commodities, with the commodities becoming the property of the certificate holders." (13)

It is also known as certificates of equal value issued by a merchant or their agent to purchase a commodity that will be resold with a known profit, such as equipment required in manufacturing contracts. In this case, manufacturing equipment is purchased through Murabaha, and the certificate holders become the owners of the equipment and its selling price through Murabaha. (14)

Murabaha is defined as one form of sale where goods are sold at their capital value plus a known profit (15).

The initial form of Murabaha involved conducting the sale without the buyer requesting the purchase from the seller (the item for sale). The seller presents and explains the cost, and they agree on a specific profit. This is true Murabaha, while the established and accepted form nowadays is Murabaha to the Purchase Order (16).

Legitimacy of Murabaha: Islamic jurists unanimously agree on the legitimacy of Murabaha provided its conditions and regulations are met in the contract . They derive this from the Quranic verse: "But Allah has permitted trade and has forbidden interest" (Surah Al-Baqarah, 2:275), and from the Prophet's saying: "If the types differ, sell as you wish, so long as it is hand-to-hand." (17)

3-2- Musharakah (Profit Sharing): Definition: Musharakah is a trust contract where two or more parties agree to participate in the capital of an investment project or activity. The owner provides part of the capital for the required activity and seeks additional parties to complete the capital, with the condition of sharing profits or losses according to the agreed-upon percentage for each participant (partner) (18).

3-3- Mudarabah (Profit Sharing Investment): (Not translated in the current response)

3-4- Ijarah (Leasing):

- Defining Leasing: The Quran says, "She said: 'O my father! Employ him. Indeed, the best one you can employ is the strong and the trustworthy'" (Surah Al-Qasas, 28:26) (19). The Prophet (peace be upon him) said: "Do not outbid your brother, do not propose to a woman who is already engaged to another, do not make a false sale, and whoever hires a worker should inform him of his wages."(20)

- The concept of Ijarah involves compensation for work where one party benefits from another's services in exchange for payment. This arrangement typically does not involve direct buying or selling of goods but focuses on utilizing benefits over time in return for a fee (21).

- Legally, Ijarah is described as operations using capital without engaging in direct transactions of buying and selling goods. Instead, it centers around selling the use or benefit of something over time in exchange for compensation and profit (22).
- According to the International Islamic Fiqh Academy, Ijarah is a contractual agreement where parties exchange benefits that one owns and can trade. The lessor sells these benefits to a lessee for an agreed-upon price, which constitutes the rent. This type of contract shares fundamental principles with other reciprocal agreements, involving elements like the lessor, lessee, benefit, rent, terms, and mutual consent (23).
- In the Hanbali school of thought, Ijarah is defined more precisely as a contract where one party provides a known and permissible benefit for a specified duration, either from a known source or as described in the agreement, in exchange for a known compensation (24).
- These definitions emphasize that Ijarah requires specific conditions such as clarity on the benefit provided, its permissibility, and the agreed duration of the arrangement.

3-5- Al-Salam (Forward Sale): Al-Salam is ((taking immediate delivery with deferred payment)) (25), or it is ((a contract on a specified commodity deferred with a price paid in the contracting session)) (26).

- The jurisprudential definition of Al-Salam (terminological jurisprudence): ((It is a sale of a specified commodity deferred with an immediate payment)) (27). Jurists differ in defining its concept based on the conditions each adopts.

  Hanafis and Hanbalis require for the validity of the Al-Salam contract the receipt of the principal in the session and deferral of delivery by the seller.

  Shafi'is require the receipt of the principal in the session, defining it as a contract on a specified commodity deferred with an immediate payment.

  Malikis do not require the immediate delivery of the principal in the session and allow its deferral for two or three days for ease (28). They define it as a sale known in commitment, restricted to a specific attribute, aiding the present or what is akin to it until a specified term.

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) defines its concept as: the formulation of the Al-Salam contract ((Al-Salam is concluded by the word Al-Salam or Al-Salaf or sale or any word indicating the sale of a specified commodity deferred with an immediate price)) (29).

Therefore, Al-Salam is the delivery of the immediate price of goods which is considered the principal of Al-Salam by the buyer of goods upon agreement on the contract terms, with a subsequent process of deferred delivery from the seller according to specified specifications and terms.

2-3- Legitimacy of Al-Salam: Scholars have established the legitimacy of Al-Salam with evidence from the Quran, Sunnah, and consensus. Allah says: "O you who have believed, when you contract a debt for a specified term, write it down" (Surah Al-Baqarah, verse 282). In the Prophetic Sunnah, we find the saying of the Prophet (peace be upon him): "Whoever makes a forward transaction should do so for a specified weight of measure for a specified term." (30) This hadith indicates that the Prophet (peace be upon him) found them engaging in forward transactions for fruits in the year or two.

Ibn Al-Mundhir said: ((Everyone I've heard from scholars agrees that Al-Salam is permissible)) (31).

- Conditions of Al-Salam: Al-Salam has a set of conditions that must be met for it to be valid, including (32):

1. Conditions of the principal (capital): A. It must be known in type and quantity; B. The principal must be delivered in the contracting session;
2. Conditions of the seller: A. The seller must be described in commitment, knowing the amount and its characteristics that distinguish it from others, eliminating ambiguity and common disputes. B. The term must be known (Malik said it is permissible when known like months and years).

3. Stipulation of the term: The majority of jurists consider stipulating the term in Al-Salam, saying that Al-Salam is not permissible immediately.

3-6- Al-Istisna (Manufacturing Contract):

- The terminological jurisprudential definition of Al-Istisna: ((It is requesting the making of a specific thing, with a specific rationale and face, its material from the manufacturer, so if another person from the skilled craftsmen says: "Make for me the specified thing with the following specifications for this amount," and the manufacturer accepts that, it constitutes Istisna)) (33).

The scholars differed in their legal classification of Istisna:

Some considered it merely a promise and not a sale, while others saw it as a non-binding commitment for the manufacturer. A group of scholars considered it a sale, with the condition of the buyer's option to inspect the product, while others accepted it as a binding contract for both parties in the manufacturing process (34).

We lean towards the opinion of the contract's binding nature agreed upon by both parties regarding what is specified in the Istisna contract, due to its regulation of the process and prevention of ambiguity on the part of the manufacturer. The Shari'ah Standard No. (11) defined Istisna as follows:

"2/1 Execution of the Istisna contract directly or after a promise: 2/1/1 It is permissible to execute an Istisna contract between the institution and the manufacturer, even if the institution does not already own the goods or the materials for it." (35)

"2/2 Nature of the Istisna contract and its conditions: 2/2/1 The Istisna contract is binding for both parties if its conditions are fulfilled, which include specifying the type, quantity, and characteristics of the manufactured item, clarity on the price, and setting a deadline if applicable. The manufacturer has the right to opt out if the delivered product does not meet the agreed specifications."

It is noted that the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has provided a precise definition of Istisna in its Standard No. (11), covering various aspects such as executing the Istisna contract directly or after a promise, defining the nature of the Istisna contract and its conditions, regulating the place of manufacturing and its guarantee, as well as determining the price of manufacturing and the associated guarantees. This standard also addresses modifications and additions to the manufactured product, how to handle unforeseen circumstances, and supervising the execution of the manufacturing process.

Additionally, Standard (11) concludes by defining Parallel Istisna and its conditions in accordance with Sharia guidelines.

3-7- Mudarabah (Partnership with Profit Sharing): The AAOIFI defined Mudarabah in its Sharia Standard No. (13) in terms of the standard's text, aiming to clarify the principles and legal rulings of Mudarabah in its two types: unrestricted and restricted, and the Sharia principles that Islamic financial institutions must adhere to, whether as a financial institution, mudarib (entrepreneur), or rab al-mal (capital provider).

- Definition of Mudarabah: "Mudarabah is a partnership for profit involving capital from one party (rab al-mal) and work from another (mudarib)." (36)

The concept of Mudarabah in Islamic jurisprudence is defined as a specific contract between two parties to establish a project or commercial activity, where one party owns the capital and the other is the investor or mudarib (worker). They share the profit according to an agreed percentage, with the capital provider entitled only to their invested capital if the project does not generate profit. The mudarib receives nothing in case of loss unless there is misconduct or negligence on their part (37).

- Definition of the Mudarabah Contract: Mudarabah is a contract where the participation agreement is made between two parties: the first is the owner of the capital (rab al-mal), and the second is experienced in investment. The capital provider contributes their capital, while the mudarib carries out the investment. They share profits according to the agreed terms from the outset, while losses are borne by the capital provider unless there is negligence or misconduct by the mudarib (38).

Additionally, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has specifically defined the contract of Mudarabah as follows (39):

1. Mudarabah is established using the terms Mudarabah, Qard, and Mu'amalah.
2. It is a requirement for both parties in Mudarabah to have legal capacity and authorization. Thus, it cannot be contracted except by two parties with full legal capacity or by those acting on their behalf in this capacity.
3. Originally, the Mudarabah contract is non-binding, and either party has the right to terminate it except in two cases where the right to terminate is not established: a. When the Mudarib (entrepreneur) starts working, the Mudarabah becomes binding until actual or judicial dissolution. b. When the parties agree on the timing of the Mudarabah, it cannot be terminated before that time except by mutual agreement.
4. Mudarabah is among the contracts of trust, and the Mudarib is entrusted with the funds of the Mudarabah. However, if the conditions of the trust contract are violated by exceeding the funds of the Mudarabah, mismanaging its funds, or breaching the terms of the Mudarabah contract, the Mudarib becomes liable for the capital.

Types of Mudarabah: Mudarabah is divided into two types, absolute and restricted (40):

1. Absolute Mudarabah: In this type, the Rab al-Mal (capital provider) delegates the Mudarib full discretion to manage the Mudarabah operations without specific restrictions. The Mudarib operates with broad discretionary powers based on trust and expertise. An example of absolute Mudarabah is when the Rab al-Mal tells the Mudarib, 'Work according to your judgment,' where the scope of discretion is wide but constrained by considering the mutual interest of both parties in achieving the intended purpose of Mudarabah, which is profit, and conducting transactions according to prevailing practices in the investment field subject to Mudarabah.

2. Restricted Mudarabah: In this type, the Rab al-Mal imposes restrictions on the place or scope of the Mudarib's work, allowing the Mudarib to act as he sees fit without restricting him from performing his duties.

It is noted from the types of absolute or restricted Mudarabah:

- The ethical aspect in Islam plays a fundamental role in Mudarabah, based on trust and confidence.
- Mudarabah is constrained by the conditions imposed by Rab al-Mal on the Mudarib to protect the Mudarabah's business and ensure greater diligence in achieving the expected profit.

Topic Two: The Role of Islamic Banking in Achieving Local Development. The financial developments in the global financial system based on usury and the unlimited financial engineering derivatives have led to a significant financial gap between the real economy and the financial economy, resulting in major financial crises that have devastated economies and affected the creation of real wealth and the development of local development.

The Islamic financial system, characterized by Shariah-compliant regulations that prohibit usury and gambling and keep financial circles separate from economic circles, has been one of the factors that has made the attention to Islamic finance significantly evolve day by day.

Despite Algeria's limited exposure to all this, our economy was experiencing a crisis in the parallel financial circle and its departure from the official channels of the banking system, and the inability of the Bank of Algeria to create financial and monetary policies that have a real impact on local development. Therefore, resorting to adopting Islamic banking as one of the transitional solutions to attract funds outside the banking operations circle on the one hand, and financing through various Islamic financial formats and instruments mentioned in the system (20-02) to stimulate local economic development on the other hand."

Algeria is still at the beginning of its journey in embracing Islamic finance by opening windows in traditional banks, as well as through the presence of foreign Islamic banks that have established branches in Algeria. The volume of their transactions and the types of financial products circulating in the market are noteworthy. However, these banks still face many obstacles, including legal, regulatory, and structural challenges, among others.

In the first section, we will attempt to clarify the impact of financing through Islamic banking on various aspects of local development. The second section will study the impact of Islamic banking products and formats on creating opportunities for local development in Algeria.

Section One: Impact of Islamic Financing on Local Development

Subsection One: Definition of Local Development Local development has several definitions depending on the perspective, dimensions, and objectives. Among them:

1. **Economic Aspect:** It involves a set of development plans and strategies with an economic dimension that harnesses all local capabilities, resources, and wealth to create goods and services for the society.
2. **Political Aspect:** It refers to the political will of the state to attempt to change and develop a specific region or a comprehensive national plan.
3. **Technical Aspect:** It starts with gathering data related to a specific region or comprehensive national data and identifying various needs based on the developmental priorities scale. This leads to providing and improving training and skills development, utilizing available local natural resources, and initiating implementation through the initiative of all local actors, both private and governmental, in achieving developmental projects to increase wealth and achieve local development.
4. **Development from an Islamic Perspective:** The philosophy of Islamic economics for development is based on achieving the general objectives of Islamic law, which prioritizes necessary general needs that Muslims require. Thus, Islamic finance is structured to fund urgent and necessary development projects (such as agriculture, health, education, housing, transportation, pharmaceuticals, etc.).

Moreover, Islamic economics adheres to several principles, including private property rights, profit and loss sharing, making investors collectively face investment risks, especially in distinguished local development projects with substantial financial allocations, long project durations, and stable returns for investors.

Subsection Two: Islamic Economics and Local Economic Development Local development under Islamic principles necessitates several conditions, summarized as follows (41):

- Gradual balance in economic, social, cultural, and scientific needs.
- Balance between various economic sectors and activities.
- Monitoring of project flaws suitable for the local population.

Subsection Three: Islamic Finance and its Role in Local Development Islamic finance enhances real ownership transfer between economic actors, thereby increasing the real value of wealth that adds to individual and corporate requirements (supply side). This elevates the importance of Islamic banking as a genuine financier for launching real developmental projects within the country. However, it is still in its early stages, aiming to benefit from the experiences of many Arab (especially Gulf) or Asian countries (such as Malaysia).

Section Two: Impact of Islamic Banking Products on Creating Local Development Opportunities in Algeria Case Study: Al Salam Bank Algeria

1. **Overview of the Bank** (42)**:** Al Salam Bank Algeria was established on June 8, 2006, under Algerian law with a capital of 7.2 billion Algerian dinars. It was approved by the Bank of Algeria in September 2008 and began its operations on October 20, 2008.

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The bank's capital was raised to 10 billion Algerian dinars in 2009, then to 15 billion Algerian dinars in 2020, and to 20 billion Algerian dinars in 2021, in compliance with Bank of Algeria Regulation No. (18-03) dated November 4, 2018, regarding the minimum capital of banks and financial institutions operating in Algeria.

Al Salam Bank Algeria is a multi-tasking bank that operates according to Algerian laws and Islamic Sharia principles in all its transactions, aiming to provide innovative banking services. The bank operates with a clear strategy that aligns with the requirements of economic development in all vital facilities in Algeria, by providing modern banking services to meet the needs of the market, operators, and investors, regulated by a Sharia board consisting of senior scholars in Sharia and economics.

Al Salam Bank Algeria currently operates a network of 25 branches spread across various regions of the country, in line with the bank's vision and strategy to provide and facilitate its banking services in various forms to its clients with the highest quality.

2. Financing Methods Adopted by Al Salam Bank Algeria and their Contribution to Local Development

2.1. Indicators of Activity of Al Salam Bank Algeria: The table below presents the developments in various activity indicators of Al Salam Bank Algeria from 2015 to 2022, allowing for the following analysis:

Table No. (01): Activity Indicators of Al Salam Bank Algeria from 2015 to 2022 Unit: Million Algerian Dinars

Return on Equity	Operating Efficiency Ratio	Net Profit	Net Allowances	Operating Expenses	Net Income	Shareholders' Equity	Customer Deposits	Customer Financing	Total Assets	Label
%2	%50	301		1.737	2.214	14.301	23.685	21.268	40.575	2015
%7	%57	1080	/	1267	2769	15381	34512	29377	53104	2016
%7	%46	1181	/	2362	3990	16562	64642	45454	85775	2017
%14	%36	2418	/	3680	7016	17305	85432	75340	110109	2018
%21	%32	4007	/	3880	9331	19012	102405	93510	131019	2019
%15	%35	3069	/	3551	7705	18900	129320	99252	162626	2020
%14,6	%36	3389	3389	3320	9268	27263	195031	150267	237804	2021
%16 ,4	%34	4393	4393	3811	11136	27312	215076	170759	261693	2022

Figure 01: Activity Indicators for Al Salam Bank Algeria from 2015 to 2022

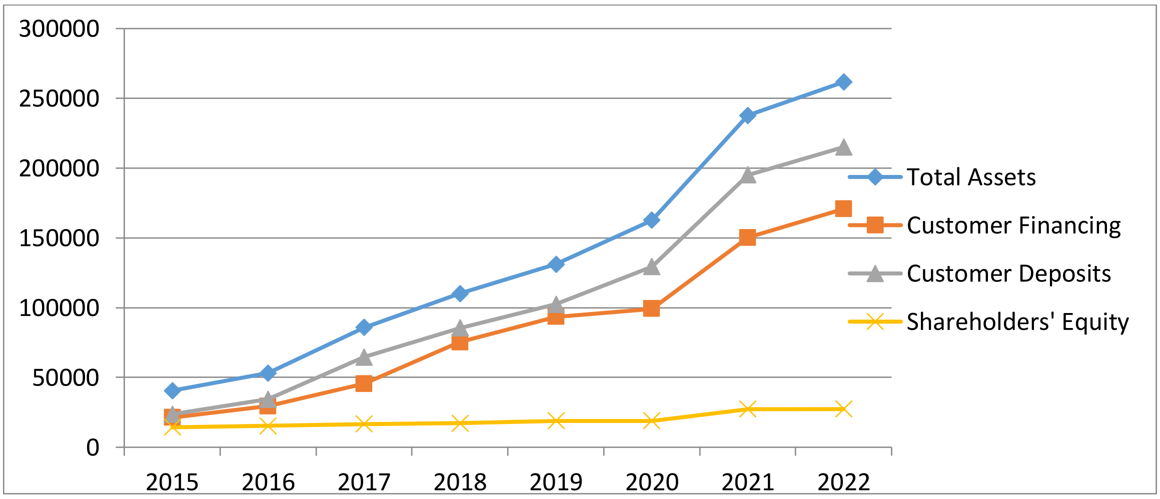
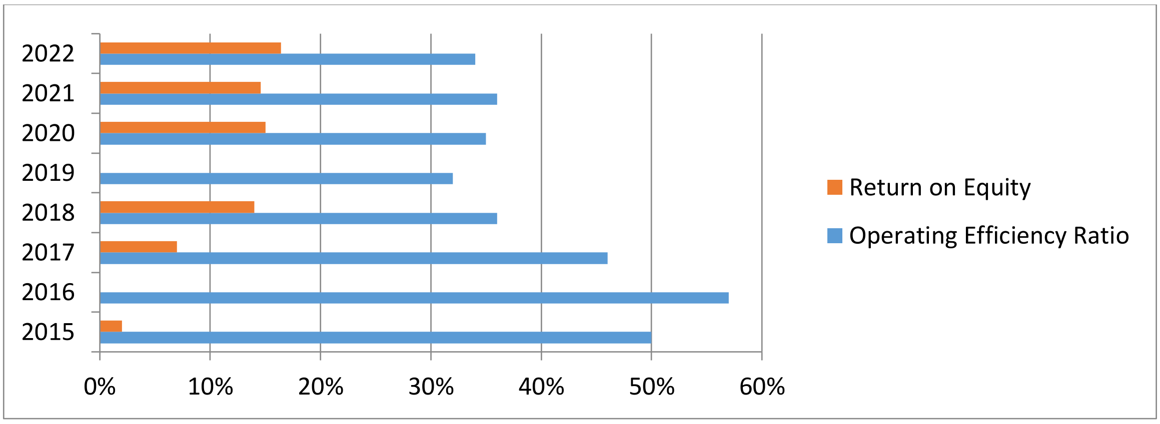


Figure 02: Activity Indicators for Al Salam Bank Algeria from 2015 to 2022



Analysis: Through Table 1 and Figures 1 and 2 above, and based on our study of the activity indicators for Al Salam Bank Algeria from 2015 to 2022, we observe the following:

- Customer Financing: Shows an upward trend from 21.268 million Algerian dinars in 2015 to 170.759 million dinars by the end of 2022, marking a significant increase over the 8-year period despite the economic downturn following the oil price decline in 2014, subsequent government spending cuts, resulting economic impacts, political events in the country, and the COVID-19 pandemic, which nearly halted economic and social activities.
- Customer Deposits: Financial deposits also exhibited a consistent upward trend during the study period, increasing from 23.685 million dinars in 2015 to 215.076 million dinars by the end of 2022, reflecting substantial continuous growth despite the challenging economic conditions experienced nationally and the bank's relative youth in experience.
- Total Assets: Total assets similarly showed an ascending trend following the continuous increase in financial deposits. This reinforces the bank's financial position and enhances its capacity to increase ongoing financing to its clients, thereby increasing its profits.

2-2- Financing Activities for Al Salam Bank Algeria - 2018-2019 We will delve into the following elements to study the bank's activities for some available years as per its official annual reports issued on the official website of Al Salam Bank Algeria for the years 2018, 2019, 2020, 2021, to identify key financing activities and sectors of interest to the bank and economic stakeholders as required by the investment climate on one hand, and the level of financial funding requirements for vital sectors in the national economy on the other.

Year 2019: 2-1-1- Financing Economic Institutions There was intensive activity in 2019 through financing files for institutions and companies active in various economic sectors, reaching a total of 467 files, including investment and operational files, reflecting a growth rate of approximately 6% compared to 2018. The value of evaluated financing requests decreased by 3%, attributed to the bank's policy of portfolio distribution and diversification where the bank postponed some investment financing requests.

Table 02: Comparison between Evaluated Files in 2018-2019

	2019	**2018**	**Percentage Change**
Files number	files 467	files 440	%6
Finance value	million DZD 70319	million DZD 72559	%3-

Table 03: Total Granted Facilities

Type of Financing	Financial Amount	Number	Percentage Change
Total Granted Facilities	million DZD 61214	394	%87

Several financing files were rejected either due to weak profitability of the company's activities, inadequate financial data, non-compliance of the financing structure with Shariah principles, or the bank's public policy.

Table 04: Comparison between Evaluated Files in 2018-2019

	2019	2018	Percentage Change
Number of Files	files 467	files 440	6%
Financial Value	million 70319 DZD	million DZD 72559	-3%

2-1-2- Distribution of Granted Facilities by Decision Authority

Table No. (05): Total Granted Facilities

Decision Authority	Bank Board of Directors		Finance Committee		Facilities Committee	
Decision	**Amount**	**Number**	**Amount**	**Number**	**Amount**	**Number**
Accepted	18175 million DZD	20	11734 million DZD	34	31305 million DZD	340

2-1-3- Distribution of Granted Facilities by Branches of Bank Al Salam:

The distribution of granted financial facilities by branches of Bank Al Salam varies significantly. Major cities with significant economic activity dominate, starting with the Dali Ibrahim Agency in Algiers, followed by the Oran Agency in western Algeria, then the Blida Agency near the capital, and the Setif Agency, followed by the Constantine Agency. Returning to Algiers, there are two agencies (Bab El Oued and La Quba), followed by the Annaba Agency, then Batna, Ouargla, Biskra, and Adrar respectively.

2-1-4- Distribution of Studied Financing Portfolio Based on Business Number and Type of Institution:

The following table illustrates the criteria applied by Bank Al Salam:

Table No. (06): Distribution of Studied Financing Portfolio Based on Business Number and Type of Institution

Enterprise Size	Business Number
Very Small Enterprise (Standard)	Up to 50 million Algerian Dinars
Small Enterprise (Silver)	50 million < Business Number ≤ 250 million Algerian Dinars
Medium Enterprise (Gold)	250 million < Business Number ≤ 1 billion Algerian Dinars
Large Enterprise (Platinum)	Business Number > 1 billion

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2-1-5- Distribution of Institutional Financing by Sectors for the Year 2019:

Figure (03): Distribution of Financing by Sectors for the Year 2019

A- Sectors Receiving Financing in 2019:

In 2019, trade sectors accounted for 51%, industry 15%, real estate leasing and commercial services 13%, and construction 8% of the total financing distributed by Banque Salam Algeria. The remaining percentage was allocated to agriculture, fishing, extractive industries, health and labor, transportation and communications, restaurants, and hospitality sectors.

It is noticeable from these percentages that the prevailing investment climate influences the nature of financing, dominated by trade, industry, real estate leasing, and commercial services, with the construction sector receiving a relatively lower share.

B- Leasing Financing:

The bank achieved a growth of 25% from 2018 to 2019, a significant increase in its history, attributed to housing shortages and high prices, prompting both individuals and institutions to opt for leasing. The number of lease financing applications in 2019 reached 496, with requested financing amounting to $108 million (13 billion Algerian Dinars), and granted facilities totaling $37 million (4.4 billion Algerian Dinars), representing 34% (43).

C- Consumer Financing:

Consumer financing, especially in the automobile assembly sector, faced disruptions in the first half of 2019 due to regulatory measures limiting locally assembled car quotas. This scarcity made it difficult for various agencies to meet customer demands. Despite these challenges, consumer financing maintained substantial sales for the third consecutive year since its inception. In 2019, 7,357 utility vehicles were sold under the installment sale formula, a form of Islamic compound financing, compared to 7,425 in 2018, a minor decline of 0.96%. Consumer financing in 2019 amounted to 8.5 billion Dinars, down from 9 billion in 2018 (44).

D- Real Estate Financing:

Individual Real Estate Financing:

Individual real estate financing reached 1.3 billion Dinars in 2019, indicating a growth rate of 60.72% compared to 2018. Various financing schemes were approved by the bank for all applications received, studying 382 files and granting financing to over 294 files (45).

Real Estate Financing for Real Estate Developers:

Banque Salam adopted a selective policy in financing real estate developers, preferring traditional bank clients known for their seriousness and adherence to planned repayment deadlines. The bank's financing for these developers in 2019 amounted to 740 million Dinars.

3- Deposit Attraction and Liquidity Management:

3- Financial Activity of Banque Salam Algeria 2020:

3-1- Institutional Financing:

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The volume of financing granted to bank clients in 2020 witnessed a respectable increase of 26% compared to 2019 (46).

Investment financing witnessed a significant decline in 2020 across all banks and financial institutions due to the COVID-19 pandemic.

3-2- Leasing Financing:

The total leasing financing for 2020 amounted to $133 million (equivalent to 17.6 billion Algerian dinars), with a growth rate of 36% compared to 2019.

Leasing facilities granted in 2020 amounted to $67 million (equivalent to 9 billion dinars) compared to $33 million (equivalent to 4.4 billion dinars) in 2019, representing a growth rate of 103%.

3-3- Consumer Financing:

Individual consumer financing experienced significant disruption in 2020 due to two main reasons: first, measures taken by authorities during the first half of 2019, which capped locally assembled cars, significantly impacting individual consumer financing; second, the COVID-19 pandemic, which affected the activities of all economic sectors and led to delays in repayments by clients.

These aforementioned conditions led to a decrease in individual consumer financing to 456.7 million Algerian dinars in 2020 compared to 8.5 billion dinars in 2019 (47).

3-4- Real Estate Financing:

Real estate financing continued its activities in 2020 but at a slower pace due to health conditions.

3-5- Real Estate Financing for Individuals:

Real estate financing for individuals remained at the same level as 2019 despite the exceptional health situation in the country, with financing amounting to 1.157 billion dinars in 2020 compared to 1.3 billion in 2019 (48).

3-6- Real Estate Financing for Real Estate Development Companies:

The volume of real estate financing for real estate development companies in 2020 amounted to 76 million dinars, with selectivity in studying applications from real estate developers (49).

3-7- Foreign Trade Activity:

Documentary credits for foreign trade operations in various financing operations amounted to 172.701 billion Algerian dinars in 2020 compared to 164.034 billion dinars in 2019, reflecting an increase of 5.28% (50).

2-2- Financing Activity of Banque Salam Algeria - 2021-2022:

Table No. (07): Types of Financing Activities for Banque Salam Algeria for the years 2021-2022.

Form of Financing	**2022**	**2021**	**Percentage Change**
Operating Loans	**136 020 576**	**115 967 825**	**%17**
Investment Financing	**16 760 405**	**13 950 009**	**%20**

Leasing of Movable Assets	**11 327 318**	**10 599 263**	**%7**
Real Estate Leasing	**3 344 835**	**2 796 509**	**%20**
Overdraft Accounts	**356 523**	**257 399**	**%39**
Real Estate Financing	**6 495 525**	**5 493 417**	**%8**
Consumer Financing	**5 887 396**	**9 028 744**	**%-35**
Total Advances and Right	**180 192 578**	**158 093 166**	**%14**
Allowance for Impairment	**5 657 981**	**4 477 256**	**%26**
Total Net Advances and Rights	**174 534 597**	**153 615 910**	**%14**
Prepared by the researcher based on: Annual Report of Al Salam Algeria Bank for the year 2022, p. 30.			

Table No. (08): Financing Activities by Economic Operator:

Unit: Thousands of Algerian Dinars

2022				
Total	**Individuals**	**Public Institutions**	**Private Institutions**	
180 192 578	18 630 369	-	161 562 209	**Total Liabilities and Equity**
5 657 981	157 597	-	5 500 384	**Provision for Impairment**
174 534 597	18 472 772	-	156 061 825	**Total Net Liabilities and Equity**
//				
2021				
Total	**Individuals**	**Public Institutions**	**Private Institutions**	
158 093 166	17 794 741	2 552	149 295 873	**Total Liabilities and Equity**
4 477 256	161 081	-	4 316 175	**Provision for Impairment**
153 615 910	17 633 660	2 552	135 979 698	**Total Net Liabilities and Equity**

Conclusion: This study provides a comprehensive view of the financing activities at Al Salam Bank Algeria with its clients, highlighting the bank's pivotal role in local economic development despite its relatively short operational history of less than fifteen years. The bank is distinguished by its modern and advanced administrative and technological practices, coupled with a diverse range of Islamic financial products adhering to Sharia principles. These products have garnered significant interest among Algerian economic entities and individuals who prioritize Islamic financial norms.

The increasing demand for various financing options and substantial deposits underscores the effectiveness of Al Salam Bank's approach. Medium and small enterprises, educational and cultural institutions, and craftsmen are increasingly turning to Islamic finance through Al Salam Bank, as evidenced during the study period.

Looking ahead, Islamic financial products are poised for further growth, promising to contribute significantly to Algeria's economic landscape by addressing gaps in Islamic financial diversification. This appeal is rooted in the preferences of a large segment of Algerian society, reflecting their adherence to Islamic principles and aversion to conventional banking practices.

Recommendations: Based on the findings, several strategic recommendations can be made:

- Islamic banks should intensify efforts to support and finance the agricultural sector and livestock industry through available Islamic financing mechanisms like farming and sharecropping, despite operational complexities, to bolster these critical sectors across provinces.
- There is a strategic imperative for Islamic banks to expand their support for local traditional industries and incentivize their participation in export markets, leveraging Algeria's inherent competitive advantages. Additionally, expanding activities in both domestic and international tourism sectors should be prioritized.
- Following the establishment of branches in numerous provinces, Al Salam Bank should focus on underserved regions with significant untapped potential, thereby enhancing its operational footprint and fostering regional development.
- Algerian legislators should consider enhancing regulatory frameworks to empower Islamic banks, including broadening the spectrum of Islamic financial instruments and ensuring competitive profitability vis-à-vis traditional banking counterparts.
- Efforts should be intensified to raise awareness and promote understanding of Islamic financial instruments among hesitant economic stakeholders, thereby fostering broader adoption and trust in Islamic finance principles.

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