

# The Islamic Banking Industry in Algeria: Reality and Challenges: A Case Study of Al Baraka Bank

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**Abstract**---Banking is considered the backbone of the economy and the reference point for the movement of capital. Islamic banking is an integral part of banking in general because it is based on the same principles and considerations as global banking. This research aims to answer logical questions about the nature of Islamic banking and its historical development through the jurisprudence of financial transactions, which serves as a guide to trade and capital movement. As Islamic banking operates under the rules of Islamic law (Sharia), this study highlights the relevant Sharia rules and regulations that underpin these transactions and distinguish them from other financial transactions. The study also outlines the objectives of this mechanism in the Islamic financial market, particularly given its emergence as an alternative to traditional financial transactions, which often contradict the provisions of Islamic law. Religious motivations and fears surrounding Sharia prohibitions in Islamic banking have led investors to hesitate in providing significant capital for banking transactions in traditional banks. Consequently, Islamic banking has become a refuge for Muslims to invest their money, offering an alternative to ineffective hoarding and saving. The study applies its findings to Al-Baraka Bank in Algeria, which represents Islamic banking and serves as an alternative to the traditional banking institutions that dominate the Algerian financial markets. The research introduces the bank and its historical establishment, before applying Islamic banking principles to this real-world example in the Algerian financial market.

**Keywords**---Banking, Islamic, Al-Baraka Bank, Traditional Banks.

## Introduction

Traditional economic systems around the world have faced numerous crises, leading to calls for a response to current changes, especially in light of the repercussions of financial globalisation. Islamic

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banking has emerged as an alternative to traditional banking, particularly in Islamic countries. Islamic financial banking incorporates the principles of Islamic law into the systems and regulations of the banking and financial sector. These banks have become a tangible reality, operating within an economic framework that extends beyond the Islamic nation to the global stage, representing a valuable addition to the financial banking sector.

The idea behind this research project, titled 'Islamic Banking Industry in Algeria: Reality and Challenges... A Case Study of Al Baraka Bank', is to address the following questions: What does Islamic banking mean? When did it emerge? What are its characteristics and objectives? What is the reality of Islamic banking in Algeria through Al Baraka Bank? What are the main challenges it faces?

To answer these questions, I have outlined a plan that includes the following:

Chapter One: The Concept of the Islamic Banking Industry

Section One: Definition of Islamic Banks

- Emergence and development of Islamic banking
- Section Three: Characteristics
- Section Four: Objectives

Chapter Two: The reality and challenges of Islamic banking in Algeria: a case study of Al Baraka Bank

Section One: The reality of Islamic banking in Algeria.

- Section Two: Challenges of Banking in Algeria and Its Prospects

Through this paper, I aim to achieve the following objectives:

1) To understand the nature, methodology and characteristics of Islamic banking, and to familiarise myself with its fundamentals.

Uncover the role of Islamic banking in achieving economic and social development.

- Identify Sharia-compliant frameworks in banking transactions.
- Highlight the reality of Islamic banking operations at Al Baraka Bank in Algeria and the key challenges it faces.

To this end, I employed a descriptive methodology.

### **Chapter One: The Concept of the Islamic Banking Industry**

Islamic financial institutions are experiencing significant growth in global markets thanks to their success in applying the principles of Sharia law. In this chapter, we will clarify the meaning of Islamic banking and examine its most important foundations and characteristics, distinguishing it from other banks. We will also explore its significance and contributions to economic and social development.

#### **Section One: Definition of Islamic Banks**

An Islamic bank is defined as follows: 'A financial institution that attracts monetary resources from individuals in society and invests them effectively to ensure their growth and maximisation within a framework of rules compliant with Islamic law, serving the people of the nation and contributing to the development of their economies.'<sup>1</sup>

Sami Hamoud defines it as follows: 'Institutions that provide banking services on a non-interest basis. These institutions engage in opening current accounts and accepting investment deposits, which are then used within the prevailing liquidity systems alongside the bank's financial resources, to finance commercial projects in accordance with Islamic principles.'<sup>2</sup>

Wahba Al-Zuhaili defines it as follows: 'A modern financial institution that adheres to the principles of Islamic law and its regulations in civil transactions, particularly those concerning money.' It relies on gathering funds through lawful means, investing them, and growing the investment using legitimate methods and tools for the benefit of participants. Its goal is to rebuild the Muslim community and

<sup>1</sup>- Mohsen Ahmed Al-Khudairi, *Islamic Banks*, 3rd edition, Aitrak Publishing and Distribution, Egypt, 1999, p. 17.

<sup>2</sup>- Sami Hamoud, *International Union of Islamic Banks*, 1980, p. 16.

promote economic and social development while facilitating Islamic cooperation in accordance with Sharia principles.<sup>3</sup>

### **Section Two: Emergence and Development of Islamic Banking**

The first attempts to establish an Islamic bank date back to 1963 in Malaysia and Egypt. That year, Malaysia saw the creation of the first banking institution to collect savings from individuals for the purpose of providing interest-free funds for pilgrimage. Similarly, savings banks were established in Egypt. Interest in creating Islamic banks operating according to Sharia principles arose from recommendations made by the foreign ministers of Islamic countries at a meeting in Jeddah, Saudi Arabia. The ministers emphasised the necessity of establishing an international Islamic bank. Consequently, the first contemporary Islamic bank in the Arab world was established in the United Arab Emirates in 1973. This was followed by the proliferation of Islamic banking activities in several Arab and Islamic countries, which have significant systemic importance at local and international levels<sup>4</sup>.

### **Section Three: Characteristics of Islamic Banking**

Islamic banking is distinguished by a number of characteristics that set it apart from other banks. The most important of these are:

1. Adherence to Islamic law in financial transactions and activities: This characteristic gives Islamic banking a doctrinal aspect. Islamic law is designed to organise all aspects of human life. Since banking is part of the Islamic economic system, it must adhere to the values and principles of Islam. These are based on the belief that money belongs to God, and that humans are merely its trustees. Consequently, Islamic banks must seek religious guidance in all their operations<sup>5</sup>.
2. Prohibition of Riba (Usury) in Transactions: This is one of the key differences between Islamic and traditional banks. Rather than offering guaranteed interest, Islamic banks operate on the principle of profit and loss sharing, resulting in fair profit that reflects the active role of capital in economic development.
3. Linking economic and social development: Islamic banks aim to provide the necessary funding for activities and projects that are beneficial and important for individuals and society. This contributes to the economy as a whole. They promote economic and social development by using all their technical services to identify the best investment opportunities. This collaboration between capital and expertise safeguards wealth from misuse, ensuring the integrity of investment operations and the returns achieved by investors and banks alike<sup>6</sup>.
4. Mobilising Idle Funds for Investment in Development Projects: Islamic banks focus on gathering unproductive funds and channelling them into various development projects.
5. Partnership and trading relationship with clients: The relationship between Islamic banks and their clients is based on risk-sharing and participation in outcomes, whether profits or losses. This is different from the debtor-creditor relationship seen in traditional banks.
6. Revival of the Zakat System: In line with their noble mission to harmonise spiritual and material aspects, Islamic banks establish and manage special funds to collect zakat (almsgiving) and ensure these funds are distributed to their designated recipients in accordance with Sharia law.
7. Multi-functional role as 'universal banks': Islamic banks perform the roles of commercial, investment and development banks. They are not limited to short-term operations like commercial banks, nor solely to medium- and long-term operations like other banks<sup>7</sup>.

<sup>3</sup>- Wahba Al-Zuhaili, *Contemporary Financial Transactions*, Dar Al-Fikr, Damascus, Syria, 2003, p. 516.

<sup>4</sup>- Abdul Moneim Hiba, 'The Impact of the Growth of Islamic Banking on Monetary Policy Management in Arab Countries', *Economic Studies*, Arab Monetary Fund, Abu Dhabi, UAE, Issue 35, pp. 3–6.

<sup>5</sup>- Suleiman Naser and Abdul Hamid Bousherma, 'Requirements for Developing Islamic Banking in Algeria', *Al-Bahith Journal*, Issue 7, 2009–10, p. 304.

<sup>6</sup>- Mounira Bibas and Nabila Fali, 'Banking Industry in Light of the Growth of Non-Financial Intermediation Phenomenon: A Study of Islamic Banks' Experience in Khartoum', *Nama Journal for Economics and Commerce*, Issue 3, June 2018, pp. 90–91.

<sup>7</sup>- Mustafa Natiq Saleh Mahtoud, 'Obstacles to the Work of Islamic Banks and Ways to Address Them for Development', *Islamic Research and Studies Journal*, Issue 29, Iraq, 2012, pp. 295–297.

## Section Four: Objectives of Islamic Banking

As outlined below, the Islamic banking industry achieves numerous objectives and plays a crucial role in promoting economic development:

### 1. Reviving the Islamic approach to financial and banking transactions

This is achieved by:

Adhering to Islamic rules and principles in financial and banking transactions.

- Advocating the application of Islamic law in banking and financial transactions, first by committing to it and then by advising and guiding community members to behave in accordance with Islamic principles when investing and managing their funds.

Providing an Islamic alternative to traditional banking and financial transactions to alleviate difficulties for Muslims.

- Cultivating and reinforcing ideological and ethical values in transactions among employees and clients.

### 2. Achieving economic development: This is pursued through:

- Encouraging investment and combatting hoarding by creating various investment opportunities that cater for those who refuse to engage in usury<sup>8</sup>.

- Attracting and gathering surplus funds and mobilising idle resources within the Islamic world, while fostering a culture of saving and improving spending behaviour<sup>9</sup>.

The Islamic banking industry innovates financial solutions that emphasise innovation and renewal. These solutions meet existing needs, exploit opportunities and utilise idle resources, thereby defining the scope of innovation in economic activities, whether in exchange or financing<sup>10</sup>.

### 3. Achieving social development:

Islamic banks aim to balance the pursuit of economic profits with social benefits. They also ensure a fair distribution of income and wealth within the Islamic community. They revive the obligation of zakat and nurture a spirit of solidarity among members of the Muslim nation<sup>11</sup>.

It is clear, therefore, that the benefits of the Islamic banking industry are comprehensive and significant, making it a goal pursued by many banks around the world.

## Chapter Two: The Reality of Islamic Banking in Algeria and Its Challenges — A Case Study of Al Baraka Bank.

Following the emergence of Islamic banks and their engagement in global banking, this model began to spread and expand in Islamic countries. After being overshadowed by traditional banks and Western dealings for decades, it now represents the Islamic model in financial transactions. Al Baraka Bank is considered the first Islamic bank in Algeria. It was established following comprehensive banking reforms in Algeria in 1990 under the Currency and Credit Law (90/10), issued on 14 April 1990.

### Section One: The Reality of Islamic Banking in Algeria

#### 1. Establishment of Al Baraka Bank:

Al Baraka Bank is a Saudi-Algerian partnership, given that Islamic banking had made significant advancements in the Kingdom of Saudi Arabia. The bank was established just a few months after the law was issued, on 6 December 1990, and commenced operations in September 1991 with capital of 500 billion Algerian dinars<sup>12</sup>. It was the first Islamic bank in Algeria to operate according to Islamic principles.

<sup>8</sup>- Mustafa Ibrahim Mohammed Mustafa, 'Evaluation of the Phenomenon of Traditional Banks Transitioning to Islamic Banking', International Egypt University, 2006, p. 22.

<sup>9</sup>- Ben Issa, B. and Ben Aliyah, Q., 'Islamic Banking as a Form of Comprehensive Banking in Private Banks in Algeria', University of Laghouat, D.T., p. 264.

<sup>10</sup>- Suleiman Naser and Abdul Hamid Bousherma, 'Requirements for Developing Islamic Banking in Algeria', Al-Bahith Journal, Issue 7, 2009–10, p. 5.

<sup>11</sup>- Haidar Younis Al-Mousawi and Karam Kazem Jawad, 'Islamic Banks and the Challenges of Globalisation and Financial Liberalisation', Economic Axis, Vol. 11, Issue 4, 2009, pp. 103–104.

<sup>12</sup>- Al-TaHER Latresh, Banking Techniques, 2007, p. 203.

Despite its recent establishment, Al Baraka Bank achieved satisfactory results in its early years. Islamic banks in Algeria are generally the most dynamic and fastest-growing of all banks, with a growth rate of 15%, the highest in the country and surpassing that of traditional banks<sup>13</sup>.

Al Baraka Bank currently holds a 2% share of Algeria's total banking market and 15% of the country's total private banks. Its budget increased from 2,176 million DZD in 1993 to approximately 193,573 million DZD in 2015, representing an 89-fold increase during this period.

## **2. Functions and services offered by Al Baraka Bank:**

Al Baraka Bank provides a range of services to its clients, including:<sup>14</sup>

Current accounts: These are demand deposits from which the depositor can withdraw any amount at any time. Current accounts can be opened in Algerian dinars or foreign currencies.

Savings deposits: These are typically small deposits, and the account holder is usually issued a savings book, allowing them to withdraw some deposits at any time.

- Money transfers: This service enables the bank to transfer money from one location to another within the same country or between different countries.

- Letters of guarantee: Also known as bank guarantees, this service includes the issuance of bank guarantees and letters of credit.

- Providing loans: The bank offers loans to individuals and institutions in various forms for use in productive sectors.

- Investment of individuals' and institutions' funds: This is done through a system of conditional profit-sharing (mudarabah).

Purchase of assets: The bank buys movable and immovable properties for resale, investment or leasing.

- Establishment and management of funds: The bank creates and manages funds designated for various social purposes.

- Providing necessary financing: This can be total or partial financing for institutions and individuals (industrialists, artisans, traders, importers, exporters, etc.).

- Foreign currency transactions: The bank buys and sells foreign currencies based on the current exchange rate.

- Opening and advising documentary credits: The bank facilitates the opening and communication of documentary credits.

- Collection of commercial papers: The bank handles the collection of commercial papers and transfers funds both domestically and internationally.

## **3. Financial forms and transactions adopted by Al Baraka Bank:**

Islamic law permits a variety of financial transactions and financing forms. Al Baraka Bank has adopted several of these, including:

**1. Mudarabah (profit-sharing):** Mudarabah is a contract involving the provision of a specific amount of capital, defined by its type<sup>15</sup>, quantity and description, to a competent, discerning and responsible individual who will trade it in exchange for a predetermined share of the profits. In this arrangement, the capital provider is known as the 'owner of the capital' (Rab al-Mal), while the other party is called the 'worker' or 'mudarib'. One party provides the capital and the other offers their labour and expertise. Profits are shared according to their agreement, while losses are borne solely by the owner of the capital, as the worker's loss is limited to their time and effort. Mudarabah effectively creates a partnership between capital owners and capable workers, fostering social balance and solidarity. (Beltaji, 2007, p. 3). Mudarabah is one of the most prominent financial transactions used by Al Baraka Bank, serving both individuals and the bank itself.

**2. Musharakah (partnership):** Musharakah is an innovative financing method in which the Islamic bank provides the client with the requested financing without charging interest. Instead, the bank shares in the outcome, whether that be profit or loss, based on the distribution rules agreed by both parties

<sup>13</sup>. Ben Zakoura, Louina and Adouka, Lakhdar, 'The Position of Islamic Financial Instruments in the Algerian Banking System', Issue 14, 2022.

<sup>14</sup>. Qadri Muhammad Al-TaHER, 'Research Journal', Issue 1, 2021, p. 108.

<sup>15</sup>. Rashad Hasan Khalil, Companies in Islamic Jurisprudence, Al-Rashid Publishing and Distribution, 1981, pp. 152–153.

before the transaction begins. Musharakah is a contract in which two or more parties jointly invest capital in specific, defined activities and share the profits. However, losses are allocated according to each partner's share of the capital. Islamic banks participate in various projects and activities to address the shortcomings of traditional banks, particularly the disconnect between capital returns and risks<sup>16</sup>. Musharakah can be categorised as fixed-term, variable, or ownership partnerships.

This method is adopted by Islamic banks, but is one of the least frequently utilised approaches at Al Baraka Bank due to limited client familiarity.

3. Deferred Sales (Bay' al-Ajal): These are common forms of transaction in Islamic banking, primarily based on deferral, and include:

- Installment Sale (Bay' al-Taqsit): This sale involves providing the commodity while deferring the payment, which is repaid in known instalments at specified times. This type of sale is a widely used form of consumer financing among individuals dealing with Islamic banks.

- Forward sale (bay al-salam): This involves exchanging a debt for an asset or selling a deferred item for an immediate price. It enables Islamic banks to utilise their funds and generate profits.

- Leasing (Ijarah): This is the third type of deferred sale and serves as a tool for utilising funds in Islamic banks. It allows the lessee to use and benefit from the asset, and is also referred to as a leasing sale.

4. Manufacturing Contract (Istisna'): Istisna' is a contractual agreement with craftsmen to produce a specific item. The worker is the manufacturer and the buyer is the requester. This form is used by Islamic banks, but not as commonly or extensively.

5. Cost-plus financing (murabaha): Murabaha is a type of trust sale, which is one of the sale contracts. It involves selling an item at its original price plus an agreed profit margin for the seller. This method provides traders, industrialists and capital owners with a legitimate financing option, while also offering consumers security in the form of transparency regarding the original price of the goods and the bank's profit margin.

## Section Two: The Challenges of Islamic Banking in Algeria and Its Prospects

### 1. Legal challenges

Like other banks, Islamic banks are subject to oversight by the Bank of Algeria and must adhere to statutory laws, as do traditional banks. This makes it difficult for Islamic banks to comply with the legal regulations governing banking operations in Algeria.

**2. Liquidity challenges:** Islamic banks differ from traditional banks in that they cannot rely on financing from the central bank or conventional individual financing, as these methods depend on bank interest, which is considered usury (riba) in Islamic law. Therefore, the only viable solution is to seek funding through legitimate Islamic methods.

**3. Sharia compliance challenges:** Sharia compliance involves ensuring that the operations of Islamic financial institutions align with Islamic law, as defined by issued fatwas and approved decisions. There are three supervisory bodies for Sharia compliance:

The Supreme Supervisory Body functions at the level of all Islamic banks.

The Fatwa Authority operates at the level of each individual bank, addressing theoretical aspects and providing Sharia-compliant alternatives and practical solutions to issues faced by Islamic banks.

The Sharia Auditing Body operates at the level of each bank, focusing on practical aspects and ensuring that the bank's management adheres to Sharia guidelines and complies with the Fatwa Authority's directives<sup>17</sup>.

A lack of a clear concept of oversight within the bank's management can lead to numerous issues for the authority, especially if the bank's management has not established a clear methodology for its work. The Fatwa Authority faces several challenges in Islamic banks, including:

- A shortage of scholars specialising in banking transactions and modern economic issues, resulting in an unclear understanding of these matters and difficulty in making correct Sharia rulings<sup>18</sup>.

<sup>16</sup>- Participation Transactions, Research Management, International Islamic Bank, Cairo, pp. 6–7.

<sup>17</sup>- Al-Shawbi, Studies and Research on Principles of Supervision over Public Administration in Jordan, p. 31.

<sup>18</sup>- Al-Kafrawi, 'Financial Supervision in Banks', Light of Sharia Journal, Issue 14, p. 365.

- Slow responses from the bank's management to the authority's decisions, which may result in ongoing violations of Sharia principles becoming habitual among employees, ultimately leading to superficial Sharia oversight<sup>19</sup>.

**4. Monetary policy challenges:** This relates to the interest rate applied to legal reserves according to Instruction 06-2002, which is set at 2.5%. Islamic banks cannot benefit from this type of deposit, nor can they approach the central bank for assistance in cases of liquidity shortages due to the prohibition of interest-based transactions. Additionally, the discount rate, or rediscount rate, poses another barrier<sup>20</sup>.

## Conclusion

At the end of this paper, we have reached the following conclusions:

Islamic banking has emerged and spread globally as an alternative to the economic crises faced by traditional economic systems.

- Islamic financial banking adheres to the principles and rulings of Islamic law, giving it a unique character that enables it to compete and granting it significance, making it the best option for overcoming and addressing crises.

- Islamic banking aims to promote economic and social development.

- Islamic banking in Algeria represents a promising development in financial banking.

Al Baraka Bank was the first to open the door for Islamic banks to enter the Algerian banking sector.

Despite the significant challenges facing Islamic banking in Algeria, the substantial progress achieved indicates the success of the Islamic financial experiment.

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<sup>19</sup>- Hassan Youssef Dawood, *Sharia Supervision in Islamic Banks*, International Institute of Islamic Thought, Egypt, 1996, p. 35.

<sup>20</sup>- Suleiman Naser and Abdul Hamid Bousherma, 'Requirements for Developing Islamic Banking in Algeria', *Al-Bahith Journal*, Issue 7, 2009–10, p. 16.

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