

## Islamic banks in Algeria in light of current and future challenges

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**Abstract**---Islamic financial institutions in Algeria are a current development that has established itself on the economic and financial scene, both as a global economic and financial phenomenon and as a tool of Islamic finance through which the state seeks to strengthen its economic policies by achieving economic growth and development. Islamic banks have received significant and growing attention from researchers and economic writers, particularly in Arab and Islamic countries, which have found solutions to their economic and social problems. Islamic banks have come to rely on interest-free credit activities and offer a new credit activity that transcends the traditional roles of Islamic banks (murabaha, musharakah, mudaraba). This has created new economic and financial challenges for achieving economic growth and development, one way or another, by exploiting savings to directly finance investments. This has created an economic environment that is compatible with the nature of the economies of Arab and Islamic countries, even developing ones, and in line with the nature of Islamic customs, traditions, and values.

**Keywords**---Islamic banks, Islamic finance, Islamic formulas, Algeria.

**Jel Classification Codes:** G21, Z12

### Introduction

The economic reality based on the economies of Arab, Islamic, and even developing countries, including the search for new banking tools to find solutions to their economic, financial, and even social

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### How to Cite:

Hamidi, K., Imane, H., & Kheira, D. (2026). Islamic banks in Algeria in light of current and future challenges. *The International Tax Journal*, 53(3), 1078–1087. Retrieved from <https://internationaltaxjournal.online/index.php/itj/article/view/629>

The International tax journal ISSN: 0097-7314 E-ISSN: 3066-2370 © 2026

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Submitted: 22 March 2025 | Revised: 12 May 2025 | Accepted: 19 December 2025

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problems, including Islamic banks, which are considered a global economic and credit phenomenon, which increased the interest of researchers and economic writers to study their services that differed completely from what is provided by usurious banks, as the activity of Islamic banks has enjoyed rapid and significant growth during the past two decades by increasing the number of dealers and the abundance of liquidity in them, which raised the idea of the possibility of Islamic banks replacing usurious banks as an alternative to the capitalist economic system, which is faced by many financial and economic crises, which necessitated decision-makers and researchers numerous and major challenges to establish a legal and legal framework compatible with this type of activities in order to achieve the conformity and compatibility of the economic objectives of modern systems with the principles and rules of Islamic law.

Through the above, the following problem can be raised:

**How can Islamic banks in Algeria meet current and future challenges and support the national economy?**

- **Hypothesis of the Study**

This study adopts a basic assumption that:

There are many concepts of Islamic banks and their impact on the economies of countries, whether developed countries or underdeveloped countries, resulting from credit and financial activities derived from economic transactions that comply with the rules of Islamic law that affect the national economy with all its indicators. They contribute directly to raising the gross national income and thus enhance public revenues and the economy as a whole.

- **The Objective of the study:**

This study aims to know the different concepts of Islamic banks in terms of identifying their concept and the nature of their activity, and to shed light on the reality of these banks in the Algerian economy and the level of achievements achieved on the ground.

- **Study Approach :**

This study relies on the descriptive analytical approach in describing and analyzing the phenomenon of Islamic banks and its effects on the national economy, and clarifying the concepts and reasons explained as well as the effects resulting from analyzing the relationship between Islamic banks and the national economy by identifying the level of achievements achieved.

In order to address the problem of the study, we decided to divide this study into the following elements:

## **I. Conceptual Framework for Islamic Banks:**

### **1. Islamic banks**

The bank is a financial institution that collects deposits, accepts them and then lends them in order to invest money and supply projects with sources of funds. From an Islamic perspective, the bank is a financial, banking, developmental and social institution that derives its doctrinal logic from Islamic law, which distinguishes it from other banks (Amara, 1996, p. 48).

Islamic banks are defined as financial institutions that aim to raise and invest funds in accordance with the provisions of Islamic Sharia, away from dealing with usurious interest, while seeking to achieve economic and social development. The Islamic Bank is not just a financial intermediary, but rather a tool to achieve justice and economic balance by mobilizing savings and directing them to productive investment channels (Tantawi, 1989, p. 44). The essence of Islamic banking is based on excluding interest and compensating it with participatory contracts such as Murabaha, Mudaraba and Musharaka (EL-Gamal, 2006, p. 25).

However, what distinguishes Islamic banks is their commitment to clear Sharia controls in investment and financing, while moving away from prohibited activities such as gambling or financing harmful industries (EL-Gamal, 2006, p. 17), and thus some express that these banks adopt the principle of sharing risks and profits, which achieves greater justice compared to the traditional system (Usmani, 2002, p. 65).

## 2. Islamic banks

- **Interest (Riba) :** Traditional banks base their activities mainly on interest (lending/borrowing at a specific interest rate), while Islamic banks do not deal in interest at all, and rely on financing formulas such as Murabaha, Musharaka, and Mudaraba.
- **Funded activities:** Traditional banks have no legal restrictions in financing projects. They can finance any legal activity, while Islamic banks only finance permissible activities (avoiding alcohol, gambling, arms trade, laundering money...) (Usmani, 2002, pp. 15,23).
- **Gambling (facilitator) :** Traditional banks can invest in highly speculative activities or derivatives markets, while Islamic banks are prohibited from financing this type of activity, that is, they cannot finance any activity based on gambling or speculation.
- **Economic ownership:** Traditional banks are based on almost absolute individual ownership with legal restrictions, while Islamic royal banks are restricted in the interest of society as the individual owns but according to legal and legitimate controls (Chapra, 2000, pp. 45,112).
- **Risk Profit and Loss :** In traditional banks, the depositor gets a fixed interest regardless of the investment results, while transactions in Islamic banks are based on risk-sharing, where profit and loss are distributed among the parties according to legitimate contracts (Iqbal & Molyneux, 2005, p. 75).
- **Sharia Supervision:** In traditional banks, there is financial supervision only in the absence of Sharia Supervision, while Islamic banks are subject to a Sharia Board to ensure compliance with Sharia Supervision (Siddiqi, 2006, p. 14).
- **Development objectives:** Traditional banks mainly aim to achieve profit and maximize shareholder return, while Islamic banks seek to achieve social justice and development through several tools such as waqf and zakat (Khan & Bhatti, 2008, p. 710).

## 3. Islamic banks

Islamic banks, while performing their banking activity, seek to achieve a balance between individual interest and the interest of society by outlining a set of objectives derived from Islamic economic thought, and they can be classified into several main groups (Mashri, 2016-2017, pages 15,14):

### Economic Objectives

Unlike the traditional bank, which is a financial intermediary that trades in debts through interest, the Islamic Bank performs the role of financial intermediary without interest in light of the provisions of the Islamic Sharia. It practices all financial, banking, commercial, industrial, agricultural and real estate activities and seeks to achieve economic goals, the most important of which can be summarized in the following points:

- Profit-making is one of the most important goals for any economic establishment, and Islamic banks do not differ in this point with the rest of the economic establishments.
- Attracting and pooling funds and mobilizing the available resources in the Islamic world while supporting these resources through the development of saving awareness among individuals.
- Optimal utilization of the Bank's resources and employing them by legitimate methods.
- Contribute to the establishment of investment projects.
- Providing the necessary funding in its various terms and providing production requirements for the productive sectors.
- Carrying out all banking operations and services.

It is noted that these objectives are summarized in two basic elements, the first is to attract funds and mobilize resources and benefit from them in accordance with the legislative frameworks, while the second is to employ these resources in the establishment of investment projects, which leads to raising productivity and achieving profit, and the next is to contribute to the achievement of economic development.

### 2.3 Legitimate objectives: These are :

- ❖ Instilling and developing the values and rules of Islamic Sharia in all banking transactions, and proving them to customers and workers in or with Islamic banks, including the following:
  - Not to deal with usury by taking or giving in all its forms and forms.
  - Act in accordance with the priorities and purposes of Islamic law.
  - Investigating halal and renouncing haram in the practices and activities of Islamic banks.
- ❖ Introducing the Islamic alternative to traditional banking transactions to ease the embarrassment of Muslims.

### Social goals

Islamic banks seek to achieve comprehensive development in societies, by balancing economic profit and maximizing social return by taking into account a set of objectives, which we summarize as follows:

- Achieving social development through social solidarity by collecting zakat.
- Contributing to the establishment of hospitals and necessary facilities, the dissemination of Islamic culture and the preservation of the Quran through its sponsorship of conferences and competitions.
- Emphasizing the role of work as a source of earning instead of considering money as the only source of earning.
- Encouraging community members to save and expand in it as long as the savings are invested for the benefit of the community and the owner is accustomed to halal profit.

### 4.3 Innovation Objectives:

Competition between banks in the banking market is intensifying to attract customers, whether owners of investment deposits, current ones, or investors. In order to achieve this, it provides them with many facilities, in addition to improving the level of performance of banking and investment service. In order for Islamic banks to maintain their presence efficiently and effectively in the banking market, they must keep pace with banking development in the following ways:

- **Innovating financing formulas:** so that the Islamic bank can face competition from traditional banks  
In attracting investors, it must provide them with the necessary financing for their various projects, so Islamic banks must develop new Islamic banking instruments through which investment projects are financed that are not subject to the provisions of Islamic Sharia.
- **Innovation and development of banking services:** Islamic banks must innovate banking services by developing current banking products provided by commercial banks that do not violate the provisions of Islamic Sharia.

## 4. Islamic banking products according to the system 20-02:

The system 20-02, which includes 24 articles, Article 4 of which specifies the products of Islamic banks: Murabaha, Musharaka, Mudaraba, Ijara, Salam, Istisna 'a, deposit accounts, and deposits in investment accounts (Articles 17 to 44 of the system 20-02, March 24, 2024). Each of these formulas has been explained in the following articles (from Article 05 to Article 12). This system is also supported by Instruction 20-03 issued by the Bank of Algeria to correct the deficiencies recorded by the system 20-02, where these formulas are as follows:

**4.1 Participation Formula:** Article (14) of Instruction (20-03) stipulates that participation is an investment contract linking a financial institution (bank) with other parties, for the purpose of contributing to the financing of an economic or commercial project or activity, on the basis of profit and loss sharing. Participation is distinguished from speculation by the fact that all parties contribute capital, unlike speculation in which financing is limited to one party while the other provides work (Shawky, 2005, p. 167).

**4.2 Mudaraba Formula:** It is stated in Article (19) of Instruction (20-03) that Mudaraba is a contract under which the bank (Rab al-Mal) provides financing to a contractor or investor (Mudarib) who operates the project in exchange for sharing profits according to pre-agreed ratios. The Bank's contribution may be in cash or in kind, and this formula is considered one of the oldest and most common Islamic financing tools (Al-Zuhaili, 2002, p. 119) .

**4.3 Murabaha Formula:** Article (03) of the Instruction from Instruction (20-03) clarified that simple Murabaha is based on the sale by the bank of a commodity owned by the customer at the purchase price plus an agreed profit margin. As for **Murabaha for the purchase** order (Article 09), it is a contract in which the bank buys a specific commodity at the request of the customer, and then sells it to him at a price that includes cost plus profit. This formula is most commonly used in contemporary Islamic banking (Al-Qaradawi, 1997, p. 250).

**4.4 Ijara Formula:** Article (24) defines it as a lease contract in which the bank places an asset owned by it at the disposal of the customer for a specific fee and for a certain period of time, with the asset remaining in the ownership of the bank, and this formula helps customers to obtain productive assets without bearing the cost of full purchase (Ali , 2001, p. 191).

**4.5 Salam Formula:** According to Article (36), the Bank enters into a salam contract as a buyer, and pays the price in advance in exchange for receiving the commodity at a later date. This contract allows the bank to conclude a second ladder contract (parallel ladder) to sell the same commodity to a third party. The ladder is particularly used in the agricultural sector (Almana , 2010, p. 83).

**4.6 Istisna Formula:** Article (44) defines Istisna as a contract in which the bank is obligated to deliver a commodity manufactured according to the customer's request and specifications, in return for a specified price and agreed payment terms. The bank can contract with another factory to carry out the production process (parallel istisna 'a). This formula is suitable for financing industrial and construction projects (The Blind Friend, 1996, p. 315).

## **5. Intellectual and jurisprudential obstacles:**

Islamic banks face a number of obstacles of an intellectual and jurisprudential nature, the most prominent of which can be summarized as follows:

**1.5 The multiplicity of jurisprudential opinions:** The issue of different jurisprudence is one of the most prominent challenges, as the opinions of scholars differ in contemporary banking issues due to the multiplicity of schools of jurisprudence and the different interpretation of texts, and this discrepancy reflects negatively on the unification of fatwas related to banking transactions, and sometimes leads to inconsistencies, which puzzles customers (Al-Qaradawi, 1997, p. 212).

**2.5 Scarcity of qualified Sharia and banking competencies:** Islamic banks suffer from a lack of frameworks capable of combining deep knowledge of Islamic jurisprudence with technical expertise in banking, as the jurist finds it difficult to issue an accurate judgment without the help of specialists in economics and finance to understand the nature of transactions ,especially since modern financial products are characterized by a high degree of complexity (Shawky, 2005, p. 145).

**3.5 Lack of legal legislation:** Positive laws (banking, commercial and tax laws) often hinder the development of Islamic banking, as the legal environment does not provide sufficient protection for Islamic financial activities, and the reliance of these banks to a large extent on the trust of investors increases their risks (Al-Zuhaili, 2002, p. 98).

**4.5 Inadequate tax structure:** Islamic banks face tax challenges, as high taxes on investment profits push some dealers to hide their profits, which reduces the demand for Islamic financing formulas based on participation and speculation (Siddiq Al-Dhir, 1996, p. 301).

**5.5 Weak control and supervision:** Subjecting Islamic banks to the traditional control of central banks, which are based on the interest system, may lead to a reduction in their privacy and make them forced to conform to systems contrary to their legitimate nature, which may affect their credibility (Ali, 2001, p. 187).

**6.5 Limited geographical spread:** The limited number of branches and the weak geographical expansion network are among the most prominent obstacles, in some cases due to the difficulty of obtaining official licenses to open new branches (Al-Manna, 2010, p. 77).

**7.5 Absence of a developed Islamic financial market:** Islamic banks lack alternative financial instruments to traditional instruments traded in financial markets, which reduces their ability to manage liquidity and achieve short-term returns, as their instruments remain limited to current and investment deposits and relatively long-term financing formulas such as participation and speculation (Shawky, 2005, p. 203).

**8.5 Delay by solvent debtors:** Delay by solvent customers in paying their obligations is one of the most prominent problems, as Islamic banks cannot impose delay interest in compliance with Sharia, which opens the way for some dealers to exploit the situation and harm the bank's investments (Al-Qaradawi, 1997, p. 219).

## II. The Reality of Islamic Banks in Algeria:

Considering that Islamic banks are new to the Algerian banking system, they are recording great progress at all levels, as this can be measured through the following elements:

### 1. Deposit Volumes

The volume of deposits in Islamic banks in Algeria reached 680.1 billion Algerian dinars at the end of 2023, while it reached 554.8 billion Algerian dinars at the end of 2022, and it reached 444.7 billion Algerian dinars at the end of 2021 distributed between public and private banks, and the following table determines this (Annual Report, 2023, page 55 in hand):

**Table (01) shows the size of Islamic finance deposits in Algeria (unit: one billion Algerian dinars).**

Statement	2021	2022	2023
<b>A/Deposit Accounts</b>	<b>212</b>	<b>254</b>	<b>421</b>
Public Banks	18,9	56,9	112,5
Private Banks	193/1	197	309.0
<b>B/Deposits in investment accounts</b>	<b>231</b>	<b>299</b>	<b>-.256</b>
Public Banks	4.1	15/8/2010	24,9
Private Banks	227	283	231
<b>Total</b>	<b>443</b>	<b>553.7</b>	<b>678</b>

Source: Annual Report 2023 Economic and Monetary Development, issued by the Bank of Algeria, p. 55 (acting).

Through the above table, we note that deposit accounts increased by 209.7 billion Algerian dinars from 2021 to 2023, which represents an estimated increase of 49.72 percent, and by 167.4 billion Algerian dinars from 2022 to 2023, which represents an increase of 39.70 percent, while deposits in investment accounts increased by 24.6 billion Algerian dinars from 2021 to 2023, which represents an estimated increase of 9.60 percent, but recorded a decrease of 43 billion Algerian dinars from 2022 to 2023, which represents an estimated decrease of 14.36 percent, as it is noted from the table that most deposit accounts and deposits in investment accounts are concentrated in private banks.

2. **List of financing products:** The financing products are represented in the amount of products of Islamic financing formulas in public and private banks, which can be summarized in the following table:

**Table No. (02) List of financing products in Islamic formats in public and private banks (one billion Algerian dinars)**

Financing products	2021	2022	2023
Murabahah	130	129	139
Engagement	1.1	2	4,2
speculation	6	7,6	8.3
LEAVE	624-83-9	75-86-5	100% (4)
Al-Salam	133,1	153	-0.187
MANUFACTURED GOODS SALE	11.1	14.3	18.5
<b>Total</b>	<b>365</b>	<b>393</b>	<b>458</b>
Share of public banks	50%	1 6.	4% 7%
Private Banks	99.5%	98-12-4	UNTRANS95,3%

Source: Annual Report 2023 Economic and Monetary Development, issued by the Bank of Algeria, p. 57.

From the above table, we note that the financing products in Islamic formulas, compared to 2023, witnessed an increase in the total amounts, reaching 458.5 billion Algerian dinars, an increase of 16.4% compared to 2022, when they reached 393.9 billion Algerian dinars. Despite this increase, we find that they are concentrated in private banks, where they reached 95.3% in 2023, while they reached 98.4% in 2022. The Murabaha, Leave and Peace formula dominated the rest of the formulas, as 2023 was estimated at 139.5, 100.4, and 187.7 billion Algerian dinars, respectively.

### 3. Banking Sector:

In 2023, the new Monetary Banking Law was issued (Law No. 23-09, 2023), which came to enhance the stability of the financial system in general and the monetary system in particular, by strengthening the role of the Bank of Algeria in financial and monetary stability in the absence of a truly active financial market.

#### 1.3 Solvency of the Banking Sector:

The total solvency ratio (ratio of regulatory capital value to risk-weighted assets) and the base solvency ratio (ratio of base capital value to risk-weighted assets) that we estimate can be summarized in the following table:

**Table (03) showing the solvency ratios in the banking sector in Algeria.**

Item	2021	2022	2023
<b>Total solvency ratio</b>	21-60	((21:53))	76%
<b>Base sheet ratio</b>	72 17	17,74%	19:17

Source: Annual Report 2023 Economic and Monetary Development, issued by the Bank of Algeria, p. 59 (acting).

From the above table, we note that the total solvency ratio and the base solvency ratio recorded a significant increase at the end of 2023, which exceeds the required regulatory minimum ratios. The total solvency ratio rose from 21.53% in 2022 to 22.76% in 2023, an increase of 1.23%, while the base solvency ratio rose from 17.74% in 2022 to 19.17% in 2023, an increase of 1.43%.

**2.3 Liquidity of the banking system:** In 2023, the banking sector recorded a clear improvement in the liquidity ratio, as it exceeded 200% in some banks and above 100% in the total banking sector (Annual Report, 2023, page 60). The following table shows this:

**Table (04) shows the liquidity of the banking system in Algeria.**

Detail	2021	2022	2023
Liquid Assets/Total Assets	98%	40 x 22	10:40:37
Liquid assets/short-term liabilities	102	108	117%

Source: Annual Report 2023 Economic and Monetary Development, issued by the Bank of Algeria, p. 61 (acting).

Through the above table, we note that the percentage of liquid assets in a gradual rise between the third years recorded 40.37% in 2023, which is an appropriate percentage, and that liquid assets cover short-term liabilities, which are on the rise from 108.53% in 2022 to 117.56% in 2023, recording an increase of 9.03%, which is an indication of improved conditions.

#### 4. Profitability of banks and the banking sector:

The profitability of the banking sector has improved from 2022 to 2023 as a result of the efforts made by the competent authorities to contain the previous crises. The following table shows the profitability of banks in the banking sector:

**Table (05) shows the profitability of banks in the Algerian banking sector.**

Item	2021	2022	2023
<b>Return on Capital</b>	14:35	13:47	15:59
<b>Return on capital (before provisions)</b>	19.16.)	16.83%	18/67
<b>Percentage of coverage of costs by results</b>	141	137	143%
<b>ROA</b>	1.72%	1.38	1.49:
<b>Bank Margin</b>	— 3,37	+2.67	( 2.72)

Source: Annual Report 2023 Economic and Monetary Development, issued by the Bank of Algeria, p. 65 (acting).

From the above table, we note an improvement in the rate of profitability, which is the return on capital (ROE) between 2022 and 2023, which reached 15.59% in the last year compared to 2022, in which the percentage was estimated at 13.47%, which is a remarkable improvement. The same observation was recorded for the rest of the elements, except the return on assets (ROA) and the net margin, where they recorded the best performance in 2021, and this is due to several reasons, which are the successive financial and economic crises.

#### 5. Automated Cash Activity:

The activity of the automated cash can be determined through several indicators of the cards offered for trading, the number of activated cards and the activity rate, as this can be summarized in the following table:

Table No. (06) shows the activity of automated cash in the year 2022.

Nature of the cards	The status of the cards in 2022			The status of the cards in 2022		
	Total Cards	GOLDEN	Interbank	Total Cards	GOLDEN	Interbank
<b>Cards in circulation</b>	3505583	10124456	13630039	1022203	12487304	16509507
<b>Number of active cards</b>	1063208	2977153	4040361	1257230	11028570	12285800
<b>and activity rate</b>	30-33	29.41%	29,64%	31-Dec-26	31-Dec-26	74%

Source: Annual Report 2023 Economic and Monetary Development, issued by the Bank of Algeria, p. 78 (adapted).

Through the above table, we note that the activity rate is constantly rising in all types of cards from 2022 to 2023, as the highest tangible increase in cards among banks was from 29.64% in 2022 to 74.42% in 2023, with an estimated increase of 60 percent. The state also sought through the mobile switch project to manage the flow of mobile payments through a platform that connects all mobile payment solutions of banks and ensures their interoperability (Annual Report, 2023, page 70).

#### Afterword:

Based on the above, it is clear that Islamic banks are one of the organizations through which countries seek to find solutions to economic and social problems, through the main role they play in achieving financial intermediation and mobilizing savings to make investment that achieves growth and economic development, as Islamic banks are the only way out for Arab and Islamic countries to bank in isolation from suspicious usurious transactions based on the interest rate, as Islamic banks are considered a banking financial institution whose task is to mobilize resources and employ them in investment projects in accordance with the rules of Islamic Sharia, which ensures that usury is not dealt with and that economic growth, development and social welfare are achieved.

Where Islamic banks base their work on several formulas, most notably Murabaha, participation and speculation, which are the main formulas in their work in addition to other formulas, which requires a special legal and economic environment that suits these formulas. Nevertheless, the activity of Islamic banks has witnessed a wide development in many countries through the enactment of laws and the development of special legislation. The emergence of Islamic financial institutions and the development of their financial instruments has contributed in one way or another to the achievement of growth and economic development, as this role has remained in some countries very limited and needs basic support from the state in line with the aspirations of individuals and society legally, economically and socially.

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