

# Management in Monetary Authority (Case of Jordan)

Mohammad Abdulmajeed Alrgaibat

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## Abstract

This research aims at demonstrating how to manage the relationship between central banks and Islamic banks, a sample has been taken and the Central Bank of Jordan and Islamic banks operating in Jordan, through addressing the tools of the Central Bank of Jordan control of Islamic banks operating in Jordan and the use of a comparative approach between Islamic banks and conventional banks and the fundamental differences between them to clarify more some things in general and the legislation governing the work Islamic banks in Jordan, and finally the most important problems facing Islamic banks with central banks. In this research, we have concluded that Islamic banks are supervised and controlled in the framework of the unified approach, despite this, it is achieving remarkable success and it will continue to progress and consolidate its steps despite the difficulties and internal and external obstacles, the research was concluded with a number of recommendations for Islamic banks to invest their money in more investments and expand in other Shariah formulas and qualify employees and develop their skills, and recommendations of the Central Bank of Jordan may contribute to the Central Bank of Jordan to amend some of the control tools and the introduction of new elements in favor of Islamic banks and the creation of new investments in line with them, which may lead to the investment of Islamic banks excess liquidity, which is reflected in increasing profitability and increase the proportion of returns distributed On the accounts of its customers and work to separate the data and information in the reports and bulletins related to Islamic banks.

**Index terms**— management, monetary, authority, Jordan.

## 1 Introduction

he banking system is considered one of the most important organs in the economy because it provides financing for the various investment and consumer needs resulting from its role as a financial intermediary that transfers the surplus achieved by the savers category to investors and individuals who suffer from the shortage of financial resources.

The banking sector in any economic system consists of two main parties, the Central Bank as the highest in the monetary system of the State, which is responsible for the supervision and control of the total commercial banks, which intermediates financially between the public savers and investors, at the beginning of the seventies of the last century, the banking sector in a number of Arab and Islamic countries faced appearance of a new type of commercial banks called the participating banks, and in a period not exceeding thirty years, Islamic banking has achieved many economic and social achievements as a result of the great development in Islamic banking by the increasing number of Islamic financial institutions .

The banking sector has become an independent entity and a distinct personality, which qualified it to occupy an advanced position in the world economy, that has achieved a continuous growth in the volume of business despite its modernity and even prestigious Western banks began to apply Islamic banking, which shows the ability of Islamic banking systems to work efficiently in all developed societies, Which seeks progress regardless of religious difference. This unique financing system works very effectively alongside traditional banks in many developed countries and progressive countries in both the market economy and other economies.

## 2 II.

### 3 Research Problem

There is a central Bank in each country, also called the State Bank at the top of the banking system and some are called the Bank of Banks, which authorizes him to use the means of control over all banks operating in the traditional and Islamic state such as mandatory cash reserve, legal liquidity, credit ceilings, re-discount and other monetary policies which negatively affect the rest of Islamic banks. Islamic banks agree with traditional banks in mobilizing their financial resources and then re-investing them more effectively in the general economic life, but they differ with them as dealing with interest in taking and giving that aiming to achieve a public benefit for the Islamic society based on ethical and humanitarian foundations, so it is a nonprofit organization as much as it aims to achieve educational and social values, hence, the problem with the procedures, laws and regulations of financial supervision on Islamic banks by the Central Bank.

### 4 a) Research Importance

This paper discusses the relationship between the Central Bank of Jordan and the Islamic banks in Jordan and the role it plays in the Islamic economy, that the central banks regulate the banking sector in terms of the control means over the operation of commercial banks and Islamic banks in addition to other means such as inspection, field supervision, guidance and consultations, which are called literary means, hence, we address the problem of supervision of the Central bank on Islamic banks.

### 5 b) Research Goals

The purpose of this study is to clarify the relationship between Islamic banks and the Central Bank of Jordan, so it can be summarized in:

### 6 Research Methodology

Based on the study of laws, regulations and policies issued by the Central Bank, which regulates the work of Islamic banks and conventional banks, and through interviews and reports on the Central Bank's website and supervision of Islamic banks through the supervision department of the banking system in the Central Bank, and follow the descriptive approach to reach to logical results supporting the theoretical hypotheses presented in this study. In practice, the Islamic banks in Jordan were applied to analyze the relationship between the Central Bank and Islamic banks, where the tools and laws of control and the use of a comparative approach between conventional banks and Islamic banks in order to clarify some things in general.

### 7 a) Information Gathering

The information was collected from books, periodicals and published researches, as well as from laws, legislations and reports on the website of the Central Bank of Jordan via Internet.

### 8 b) Previous studies

The study (Dr. Hussein Kamel Fahmy 2006) entitled: monetary policy tools used by central banks in the Islamic economy In this paper the researcher tried to evaluate the monetary policy tools currently applied in Islamic countries, whether in the traditional form now recognized by most monetary departments in the world as a whole or in forms of the new Islamic proposed by many researchers interested in issues of Islamic economics and Islamic banks, in the light of all the provisions and rules governing Islamic banking as well as the economical foundations and rules of monetary theory. One of the most important conclusions after the analysis is that due to the different nature of the rules and rules that govern the foundations of Islamic banking than the traditional banking rules are not suitable in their current form to apply to the Islamic, and that the proposed Islamic monetary instruments by some researchers interested in issues of the Islamic economy is also not suitable for application in light of the current Islamic banking and monetary structure. Study (Dr. Mahmoud Hussein Al-Wadi) entitled: Regulatory and economic effects that the Central Bank's control over deposits and credit in banks is one of the most important roles of the Central Bank to control the money supply and maintain the rights of depositors and the stability of the national currency. However, the practice of this control by the Central Bank has created problems between central banks and Islamic banks. Study (Dr. Mahmoud Hussein Al-Wadi) entitled: Regulatory and economic effects that the Central Bank's control over deposits and credit in banks is one of the most important roles of the Central Bank to control money supply, preserve the rights of depositors and stabilize the national currency, and Islamic banks are subject to such supervision. However, the practice of this control by the Central Bank has created problems between central banks and Islamic banks due to the negative impact of this control on Islamic banks because of the nature of their deposits and financing methods and privacy. The understanding of central banks of investment deposits and financing instruments in Islamic banks will enable them to apply more effective controls, and to achieve the interest and develop the economy, because it will help in pushing and stimulating Islamic banks to return to the most important goal that was established for it is the activation of financing tools based on participation and speculation, this leads to controlling money supply and finding a balance between

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money supply and commodity supply. And increase results and real national income. A study (Faleh Bader Al-Subaie for the year 2008) entitled Legal supervision of Islamic banks that the control exercised by central banks on conventional and Islamic banks are of the utmost importance, as a result, most countries in the world give central banks wide powers to control the business of commercial banks, as the primary responsibility for the implementation of monetary policy objectives. Islamic banks are currently supervised and controlled within the framework of the Standardized Approach based on the 1988 Basel Convention on capital adequacy and the attached Supervisory framework contained in the Basic Principles, we found in this study that Islamic banks have made a successful start, and it is hoped that they will continue to progress and consolidate their steps in the future despite the difficulties and obstacles faced by internal and external.

IV.

## 9 Central Banks

The history of central banks shows that the purpose of the establishment of the central bank was different according to different countries and their circumstances. But the role of these banks in the past was focused on issuing cash and securing the state's financial reserves and liquidity to banks a) Central Bank Functions

The most important functions of central banks are to control the amount of cash offered and also to prevent the collapse of banks, as they have other functions, they play the role of adviser for governments particularly with regard to international finance the main reason for the establishment of central banks is the intervention of governments in all economic activities and their desire to maintain monetary stability and manage issuance operations ensuring the convertibility of national currencies and advancing the process of economic growth in accordance with the general economic policy of these Governments. The most important functions of central banks are to control the amount of cash offered and also to prevent the collapse of banks, as they have other functions, they play the role of adviser for governments the main reason for the establishment of central banks is the intervention of governments in all economic activities and their desire to maintain monetary stability and manage issuance operations. Ensuring the convertibility of national currencies and advancing the process of economic growth in accordance with the general economic policy of these Governments. The functions of central banks are generally summarized as follows:

1. Regulating the size of money in proportion to the needs of business and individuals in general, and then granting the right of issuance on its own.
2. Performing governmental and agency banking operations.
3. Maintaining the cash needs of commercial banks.
4. Manage the country's foreign currency reserves.

## 10 Granting banks credit facilities in many forms

whether through lending, re-discounting of their assets from commercial papers, or re-lending, that central bank performing its role as a bank of banks or as a last lender. 6. Settlement of payments between banks through clearing. 7. Control of credit to be in general conformity with the economic needs in a quantity and quality, and in the meantime, implement of monetary policy adopted by the government (2).

## 11 b) Characteristics of Central Banks

Central banks have a number of characteristics that distinguish them from other banks. The Central Bank does not deal with the public, does not accept deposits thereof, nor shall it grant credit facilities. deals only with commercial and specialized banks, the state and public institutions only (3). It solely responsible for the power to issue legal currency and maintain the stability of the currency. It acts as a financial agent of the State without any other banks. Supervises and directs the banking system in the interest of the national economy. The Central Bank is sole committee in the monetary and banking system and shall not be challenged by any other institution or body for the performance of its functions or roles. Central banks are mostly state-owned and may be in some countries as a joint stock company in which the state owns the bulk of its shares, to ensure control, the US Federal Reserve is owned by the 12 banks that make up the Federal Reserve System, and the Swiss National Bank is owned by 62% of sectors, While the central banks of Australia, Belgium, Chile, Mexico, Turkey and Japan are in the form of joint stock companies, in which the state owns at least 50% of the shares (1).

## 12 c) The establishment of the Central Bank of Jordan

The Central Bank of Jordan (CBJ) started its operations in 1964 in accordance with its 1959 law and its amendments to replace the monetary council, which was established in 1950, where the latter's functions were limited in keeping the dinar's cover from sterling pounds while the monetary council did not exercise any tasks related to directing monetary policy and controlling banks. Recognizing the importance of the need for a central bank to perform the traditional functions of central banks, the Hashemite leadership issued the Central Bank Law No. 23 of 1971, and Article 3 of the law granted the bank independence to enable it to perform its functions efficiently.

### 13 d) Objectives of the Central Bank

The objectives of the Bank are set forth in Article 4 of the Central Bank Law to maintain monetary stability, to ensure the convertibility of the dinar and thus promote sustainable economic growth in accordance with the general economic policy of the government and be as follows (1). 1. Maintaining the country's monetary stability, for example, in cases of inflation, it reduces the money supply by practicing monetary policy and vice versa in case of deflation. 2. Regulating the issuance of cash and coins (monopolizing the process of issuing cash).

### 14 Maintain reserves (commercial legal banks) to

stabilize the value of the currency in Jordan and the dinar prices abroad. 4. Act as a bank for the government and also for licensed banks and designated lending institutions. 5. Monitor licensed banks to ensure the soundness of their financial position and guarantee the rights of depositors and shareholders 6. Encouraging economic growth in accordance with the general economic policy of the State (2).

V.

### 15 The Islamic a) First: Definition of Islamic Banks

Many writers found it very difficult to come up with a specific definition of the bank, In many writings there are many definitions, if not very different in intent, but they came to known for business. There are those who knew it as:

(A social development investment banking financial institution based on adherence to the principles of Islam, its provisions and the realization of its goals; the Islamic Bank attracts and effectively mobilizes cash resources from the community to ensure its growth within the framework of Islamic Shari'a, and in the service of the nation's people and the development of its economy .Also defined by the Agreement Establishing the International Union of Islamic Banks as (those banks or institutions established by the law which is expressly committed not to deal with interest (usury) in giving and taking, according to the principles of Sharia. The definition of the Islamic Bank in the "economics of money, banking and international trade" as (a banking institution whose purpose is to collect money and savings from all who do not want to deal with usury "interest" and then work to employ them in various areas of economic activity as well as providing various banking services to customers consistent With Islamic law and achieves support for the goals of economic and social development in society. (2)

### 16 b) Significant differences between Islamic and conventional banks

The main task of commercial banks is to pool the available financial resources and provide the means to invest them, ie to act as a financial intermediary, the difference is in the means, but the goals are not different. Below we will discuss the most important differences between Islamic and conventional banks:c) Goals

The variation in goals comes at the forefront of the differences, while the conventional bank's goal is to maximize the wealth of owners, the Islamic Bank, in addition to its efforts to regulate the wealth of owners, also aims to maximize the wealth of depositors, as well as the goal of economic and social development of Muslim communities, by giving priority to investing depositors' money in projects that contribute to the desired development. The Islamic Bank also seeks to achieve several social goals, such as achieving justice in the distribution of wealth, and providing aid to the poor with donations and good loans in addition to fighting monopoly and speculation.

### 17 d) The relationship between the bank and its customers:

The classification of deposits is almost identical between Islamic and conventional banks, but the difference is in the obligation to return the deposit (1). The current deposit is a trust that the bank is obliged to refund on demand without paying interest. As for the investment deposit, the Islamic bank is not obligated to return it or to guarantee a certain return to the depositor, even the depositors alone bear the losses resulting from the investment of their funds without the participation of the bank in them, Except in cases where the loss is caused by mismanagement because the relationship between the applicant and the bank is not a creditordebtor relationship ,and branching from that relationship the depositor's knowledge of the amount of income generated by the deposit with the conventional bank; but the applicant in the Islamic Bank cannot know what ends up .The applicant in the Islamic Bank cannot know what ends up, as for the relationship with the users of the funds, the Islamic Bank has a relationship with the users of its funds speculative relationship, they have ????? and they have ?,???? where the exception is speculative operations, in which the bank is determined a certain profit margin on the funds invested regardless of whether the user made a profit from the commodity or not (2). The traditional bank's relationship with the users of funds is limited in lending against pre-determined interest, but the activity of unauthorized sale or purchase of trade is to protect the depositors' funds.

### 18 e) Diversification of Investment Activities

While the main activity of commercial banks is investment banking in lending, Islamic banking activities are characterized by diversity, such as contributing to the establishment of companies operating in activities that do

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not contradict with Islamic law, and directing part of its resources to invest directly in fixed and movable assets. While the conventional bank is not on the same footing as banking legislation obliges the conventional bank to direct the bulk of its financial resources to invest in loans and securities, in particular bonds need to maintain an adequate level of liquidity to meet customer withdrawals (2).

## **19 f) Relationship with the Central Bank**

Conventional banks can resort to the Central Bank to request a loan when they need liquidity and are unable to provide them from other sources, while Islamic banks can not resort to it for the same purpose as they refuse to deal on the basis of interest, as the Central Bank refuses to provide loans without interest, even if it accepts to offer good loans to Islamic banks on the basis of the principle of participation, the nature of loans provided by the central bank short-term may extend for a few days, which makes it difficult in practice to apply that principle.

## **20 g) Control of the Bank's Activity**

The activity of conventional banks is subject to the control of the owners representing the general assembly of shareholders. The Islamic Bank is not limited to the control of its activities on the owners and the government, but there is also the supervision of Shari'a and depositors control, which did not adopted by any of the Islamic banks. Shari'a Supervision is represented by Shari'a Board formed by the General Assembly or the Board of Directors, and is designed to ensure that the Bank's operations are in line with the requirements of Islamic Shari'a.

## **21 h) Central Bank Control Instruments on Licensed Banks**

in Jordan 1. Regulating the quantity, quality and cost of credit to respond to the requirements of economic growth and monetary stability. 2. Act as a bank for licensed banks. 3. Monitor banks to ensure the soundness of their financial position and guarantee the rights of depositors and shareholders.

The Central Bank uses these Instruments through the following tools:

First: Mandatory Cash Reserve: Article (42) of the Central Bank of Jordan Law No. 23 of 1971 and its amendments shall regulate the methods of how the Central Bank of Jordan dealing with the mandatory cash reserve which imposed on licensed banks. Paragraph (A) of this Article states that "The Central Bank of Jordan has to require licensed banks to deposit cash reserves "The Central Bank of Jordan shall require the licensed banks to deposit a mandatory cash reserve with a percentage or percentages of their various deposits, this percentage shall not be less than 5% and not more than 35% of it, the Central Bank may deposit the obligatory cash reserve in a current account or in the form of a notice or term deposit withdrawal from this account shall not be allowed to exceed the prescribed percentage with the approval of the Central Bank of Jordan. The Central Bank has to asked the licensed banks to maintain the mandatory cash reserve by 60% in the form of a deposit subject to two days notice and 40% in the form of a current account, also the Central Bank also set the rate applicable to banks at 8% as of 1/1/2002, In light of the Central Bank's implementation of the immediate gross adjustments system, the Central Bank of Jordan decided to integrate the requirements of the mandatory cash reserve in the current account so that the bank's balance will appear including the minimum amount not to be disposed of (80%) and not to allow the bank's actual balance to fall below, this limit shall be calculated by the Central Bank of Jordan as a monetary fine not exceeding 1% of the shortfall value for each day the shortage continues (2).

Second: Legal Liquidity: The application of this ratio to Islamic banks may achieve the desired purpose in part, but this could lead to the disruption of another part of the funds deposited in Islamic banks as a speculation (for the purpose of investment), because the Islamic Bank had to maintain the required liquidity ratio even if most of its deposits are investment.

The objective of this ratio is to ensure that the Bank is able to meet its obligations in sudden withdrawals and that the Central Bank does not take into account the nature of investment deposits, especially restricted investment deposits, which are added to the ratio, although they are usually invested for a relatively long period. In general, it can be said about the use of the cash reserve ratio and the general liquidity ratio, that this difference between the nature of investment accounts in Islamic banks and investment accounts in conventional banks is represented in the deposit of the first on the depositors themselves, as for, the second is an obligation on the conventional bank, which requires maintaining a certain degree of liquidity to meet this obligation, unlike Islamic banks (1). The Central Bank of Jordan has set the minimum legal liquidity ratio that banks must adhere to by 30%.

Third: Credit/Deposit Ratio: The Central Bank aims by impose this ratio to determine the percentage of credit granted by licensed banks to the size of their deposits so that the credit does not exceed a certain percentage has ranged between 70% -90% during the period from 1974 to 1995 depending on the prevailing economic conditions, and the Central Bank abolished this ratio in 1995 as part of its drive to adopt an indirect approach to the management of monetary policy (2).

Fourth: Upper limits and Credit Concentrations The policy or instrument of credit Upper limits took a prominent place among the monetary weapons adopted by the Central Bank in 1992, when the Central Bank had to adjust the size of credit facilities within the limits and lines decided by the economic correction program,

## 23 J) THE PROBLEMS FACED BY ISLAMIC BANKS WITH CENTRAL BANKS

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and he has limited the amount of credit facilities granted in dinars and foreign currencies by licensed banks to no more than ten times its capital and reserves.

The facilities here are loans, advances, current accounts receivable in various forms, discounted bills and any other direct facilities.

Lack of capital and reserves have facilities here means loans and advances and current accounts receivable in various forms and discounted bills of exchange and any other direct facilities Banks' investments in bonds and equities, while capital and reserves refer to paid-up capital, compulsory and voluntary reserves and retained earnings. The facilities here are loans, advances, current accounts receivable in various forms, discounted bills and any other direct facilities, and the facilities here are loans, advances, current accounts receivable in various forms, discounted bills and any other direct facilities, while banks' investments in bonds and equities, while capital and reserves refer to paid-up capital, compulsory and voluntary reserves and retained earnings (1).

Fifth: Interest Rate: The interest rate represents the amounts charged by banks for providing loans and facilities to their customers, so if the monetary policy aims to reduce the size of credit, the central bank raises the interest rate to becomes high borrowing costs and thus reduce customers' demand for loans and thus shrink credit operations and vice versa if the central bank wants to increase the volume of credit and works to reduce the interest rate becomes low cost Relatively encouraging customers to apply for loans, that banks are working to expand the granting of credit facilities. The Central Bank of Jordan does not intervene in determining the interest rate paid by licensed banks on customer deposits or those charged on credit facilities, but has left banks free to set interest rates as of 1990 (2).

Sixth: Rediscount price: The central bank can influence the size of the credit by changing the discount rate, that raising the discount rate means instructing banks to restrict credit and reducing the discount rate, means instructing banks to expand credit. The discount rate is the interest rate at which commercial banks deal with the central bank, so if a commercial bank wants to increase its cash balances, it will resort to the Central Bank for re-discounting some commercial papers and bonds in its possession in accordance with the conditions specified for the discount operations by the Central Bank of Jordan and the Central Bank shall deduct them on the basis of the interest rate set by it, and we call this discount price .If the central bank raises the discount rate, the commercial banks transfer this burden on their customers by raising the interest rate on loans, which reduces the desire of individuals to obtain credit and thus shrink the volume of credit and vice versa if the central bank cut the discount rate, and also the discount rate at the Central Bank of Jordan in September 2002 was 5% (1).

### 22 i) The legislation governing the work of Islamic banks in Jordan

The new law of the Banking Law No. 28 of 2000 sets out the objectives of the Islamic Bank, that provide banking services and non-interest-based financing and investment, as well as to provide services aimed at reviving forms of social solidarity organized on the basis of mutual benefit. The law has dealt with matters that should be taken into account in the practice of Islamic banking, taking into account that such activities are in accordance with the approved jurisprudential opinions and that these activities are not based on interest.

### 23 j) The problems faced by Islamic banks with central banks

The most prominent problems faced by most Islamic banks with central banks are the following: In the light of this tendency to the application of Shariah forms of dealing more closely to the applications of traditional banks such as current accounts and savings and for notice and for the time in the area of attracting funds, and similar forms of financing that do not require effort, follow-up and supervision, such as the sale of Murabaha, which does not differ in the procedures followed in lending with ribabased banks (1). <sup>1</sup>

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<sup>1</sup>Management in Monetary Authority (Case of Jordan)

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and conventional banks were paid interest from this reserve, and Islamic banks lost the opportunity to invest this percentage and consequently the profits of depositors and shareholders were affected.

2. Legal Liquidity that the Central Bank of Jordan imposes a liquid percentage of assets on each bank, which reaches from 20% to 30%, and by studying the components of this ratio we find that the numerator includes cash in the fund and balances with the Central Bank and others, as well as treasury bills and governmental bonds, all based on interest (1) and suggest that stocks be considered as components of the ratio rather than governmental bonds because it does not depend on educational dealings, also it fulfills the demand for security and financial ease in managing of funds in Islamic banks (2).

3. Credit and investment ratios that central banks set a ceiling for the total credit granted by the bank, and when applying such ceilings to Islamic banks, it is necessary to apply only to all debts to customers as a result of various financing operations, also central banks impose ceilings on Islamic banks in investments, like sharing, owning real estate and owning shares, it is sometimes necessary for the Islamic Bank to own a whole company to carry out its various investments, therefore, imposing ratios on these investments injustice to Islamic banks.

4. The problem of the administrative apparatus that the cadres of Islamic banks have been brought from conventional banks, and it was not easy for them to move to financial, commercial and investment operations of the kind required by the Islamic Deep Bank, with the implications of such operations Branches and details, And what it requires of the specialized agencies, authorities, and compliance with the instructions of the supervisory authorities.

Figure 1:

## VII. Recommendations

1.

Figure 2:





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