



Islamic Development Bank (IDB) Group

Connecting to Global Value Chains and Aid for Trade



This report is a contribution of the IDB Group to the 4th Global Aid for Trade Review taking place from 8 to 10 July 2013 in Geneva prepared by the Group Trade Related Issues Committee (GTRC) of the IDB Group . * The Committee has developed into a platform where the various IDB Group entities share experiences and strengthen synergy on trade related issues. The report also benefited from inputs from other Departments of IDB Group entities and a sensitization workshop on “WTO Made in the World Initiative: Significance of Global Supply Chains for African Countries”, organized by IDB from 26 to 28 November 2012 in Dakar, Republic of Senegal.

This year, Global Value Chains (GVCs) are at the centre of discussions- This topic has moved up on the agenda because of the realization that participating in world markets provides better avenues for development than protectionism. In the 4th Global Aid for Trade Review, all those having a stake in promoting development are considering how countries can join and add value within networks of production and services chains. The development benefits of participating in value chains are another key topic for debate.

The IDB Group is convinced that the global expansion of value chains offers new opportunities such as increased GDP growth, job creation and diversification into new products and markets. At the same time, it can pose challenges for member countries specifically on the Least Developed Member Countries (LDMCs). Issues such as human dignity, sustainable development, regulation of multinational companies as well as the breadth and spread of value chains are to be considered.

This report sheds the light on:

- The IDB Group’s thinking on the role of GVCs in development. These considerations are feeding into trade-related operations and interventions by the IDB Group entities helping countries connect to value chains.
- Estimates on the overall IDB Group contribution in Aid for Trade.
- Details about IDB Group interventions in Aid for Trade including investments in trade-related economic infrastructure, support to private sector development, trade finance, investment and export credit insurance and several trade-related technical assistance programmes and initiatives.

The IDB Group has provided more than US\$3 billion for Aid for Trade (under the broad definition of Aid for Trade) and US\$4.5 billion in trade financing during 2012 (1433H), helping countries participate in trade and connect to value chains. These figures are set to increase in the near and medium terms given, among others, the recent tripling of authorized capital to US\$150 billion.

The IDB Group commends the WTO for choosing “Connecting to Value Chains” as a theme and hopes that this report provides stakeholders with useful information. The IDB Group welcomes further dialogue on this issue.

**This outreach is based on the main Report on Global Value Chains and Aid for Trade prepared by IDB Group which is forthcoming*

IDB Group's Approach to the role of GVCs in Development



The issue of Global Value Chains (GVCs) is a common development issue facing all member countries.

In our Vision 2020 (1440H), - 'A Vision for Human Dignity', the IDB Group has set itself to be 'an effective agent of change to prepare its member countries in facing numerous challenges brought about by the forces of globalisation and rapid technological change'. The IDB Group's aim is to foster socioeconomic development of its member countries and Muslim communities in non-member countries, in accordance with the principles of Shari'ah (Islamic Law). The 1440H Vision lays emphasis on the principles of human dignity, brotherhood and socio-economic justice for all. Participation in value chains should correspond with those values.

The IDB Group believes that the global expansion of value chains offers new opportunities for its member countries.

Global Value Chains (GVCs) have broadened the development options facing lower-income countries – now they can join supply chains rather than having to invest decades in building their own. For several developing countries, offshoring of labour-intensive manufacturing stages and the attendant international mobility of technology have led to an era of growth.

A study by the United Nations Conference on Trade and Development (UNCTAD) suggests that engaging in Global Value Chains is accompanied by higher gross domestic product (GDP) growth rates. Most sluggish growth is witnessed in countries with a low GVC participation growth rate and low growth of the domestic value added share of exports (0.7%). Higher domestic value addition without increased participation in GVCs correlates with higher GDP growth (1.2%). However, integration in GVCs without increase in domestic value added seems to offer higher GDP growth (2.2%). The highest GDP growths are recorded for those countries that have a high GVC participation growth rate and, at the same time, manage to increase their domestic value added in exports (a median GDP growth of 3.4%).

Indeed, participation in Global Value Chains can have positive impacts on productivity and hence average incomes and wages.

It can lead, for example, to transfer of technology through imitation or 'learning by doing' and to upgrading of the labour force. Employment opportunities for women are widening in certain sectors, among others in the textile industry and Business Process Outsourcing (BPO). For instance, female labour accounts for 90% of the work force in Bangladesh's ready-made garment industry.

Increased outsourcing of services provides opportunities for our member countries.

This has been made possible by technological revolutions in information and communications technology (ICT). Many IDB member countries have youthful, IT savvy populations with business and language skills. They are located close to major markets, and they can take advantage of this trend.

Nevertheless, not all IDB member countries equally take part in supply chains,

as most supply chains are concentrated in North America, Europe and certain parts of Asia. Based on a measure of 'GVC income', the EU27's share in world GVC income has remained stable between 1995 and 2009 at around 30%. East Asia's share has also been stable, at round 25%, with China taking a larger share within East Asia (showing the relative decline of Japan). The US's share dropped from 20% to around 15%.

The share of the BRIIMT which comprises Brazil, Russian Federation, India, Indonesia, Mexico and Turkey has been around 10% between 1995 and 2009. All other countries combined have a less than 20% share in Global Value Chain income.

In a similar vein, recent UNCTAD research shows that the share of OECD countries in total value-added created by GVCs is found to be 67%. The so-called Newly Industrialized Countries such as Korea and Singapore capture around 11%, BRICS countries comprises 14% of which China's share is 9%. The share of the Rest of the World which includes all LDCs and other developing countries is only 8%. Most IDB Group member countries belong to the latter category. IDB member countries with the highest shares include Malaysia (0.8% of total value added created by GVCs) and Indonesia (0.6%). However, the share of foreign value added is relatively high for Malaysia (around 40% compared with 15% for the United States). Indonesia has a higher domestic value added, driven by a high share of mining products which feed into other country's value chains.

The extent of internationalization of value chains is not equal across sectors and countries. While activities in many sectors are increasingly fragmented and taking place in different countries, some sectors are less internationalized than others. Take for instance agriculture, around 16% per cent of world food production by volume enters international trade. In other words, national and local markets are absorbing almost all the food that the farmers grow. In fact, most farmers do not sell in international markets, directly or indirectly. Focusing on global value chains only would miss out on those producers.

Multinational Companies drive global Value Chains and there remains a need for regulation to ensure sustainable development and human dignity. Multinational companies which have expanded their global network of production and sales through investment and trade have driven the increasing complexity and length of value chains. Determined by pursuit of profits, multinational companies outsource certain part of their production or services that were previously within their borders to those countries or regions that are most cost competitive.

Some have compared multinational companies and in particular manufacturing industries with 'shepherds' or 'nomads', moving all around the world going where there is profit. As a result, Global Value Chains are dynamically changing and are less accountable to national governments. Also, since GVCs are usually focusing on final demand in other countries, workers' ability to buy the goods they produce is considered less relevant. In order to ensure that multinational companies contribute to sustainable development and human dignity there is a need to regulate them in areas such as foreign direct investment, environmental regulations, Intellectual Property Rights and compliance with labour rights. With respect to environment, the OIC Ten Year Programme of Action (2005-2015) calls upon the member countries 'to coordinate their environmental policies and positions in international environmental forums so as to prevent any adverse effects of such policies on their economic development.'

Global Value Chains provide opportunities for employment and job upgrading but long-term impact on sustainable development and human dignity is indefinite. The long-term impact of joining GVCs on employment is an issue of interest to many policy makers. However, the OECD (2013) notes that there is very little direct empirical work on GVCs and labour markets.

The labour market effects of GVCs in developing countries are likely to be broadly positive, but highly case specific and depends on the role of complementary policies in particular human capital development. The available empirical evidence suggests that the type of activities undertaken by GVC participants influence labour market outcomes. The limited data available on firms engaged in processing trade (assembly), suggests that they do not systematically pay higher wages than domestic firms.

Quality of jobs: Participation in Global Value Chains could lead to more pronounced distribution of the quality of jobs between countries. WTO-IDE-JETRO (2011) notes that developed economies tend to become vertically specialized in highly-skilled tasks. Looking at the labour composition in net trade of China, they conclude that China specializes in low-skill jobs, and this specialization has increased since 1995. Japan, in contrast, has specialized in export activities that are intensive in medium- and high-skilled labour. While GVCs offer opportunities for employment, developing countries could run the risk of locking in low-skill jobs.

Labour standards: Higher labour standards are difficult to promote because of the 'foot looseness' of many activities in the production chain. The practice of subcontracting within supply chains also makes it difficult to monitor and enforce compliance. Labour standards can raise operating costs of companies leading to a decline in cost competitiveness and diversion of foreign direct investment (FDI) to jurisdictions where cost-inducing labour standards do not exist or are not enforced.

Regional Value Chains remain important. Research shows that most value chains still tend to be regional, despite growing internationalization. Baldwin has called this Factory Asia, Factory North America, and Factory Europe. Some of the inter-regional FTAs currently under negotiation such as the Trans Pacific Partnership (TPP) or the EU-US FTA covers the areas where Global Value Chains are concentrated. Such agreements might lock out non-parties and prevent their participation into existing value chains located within those regions.

In the OIC region as well as in the respective regions of our member countries, a focus on regionalization has been a trend. Growing demand in Organization of Islamic Cooperation (OIC) member countries make these markets lucrative for other OIC member countries. These markets can also be friendlier for producers based in OIC member countries in particular for small and medium sized enterprises (SMEs), compared with developed country markets. They might impose fewer requirements and less stringent standards than developed countries. OIC member countries also share common relationship networks and cultural norms that can facilitate trade.

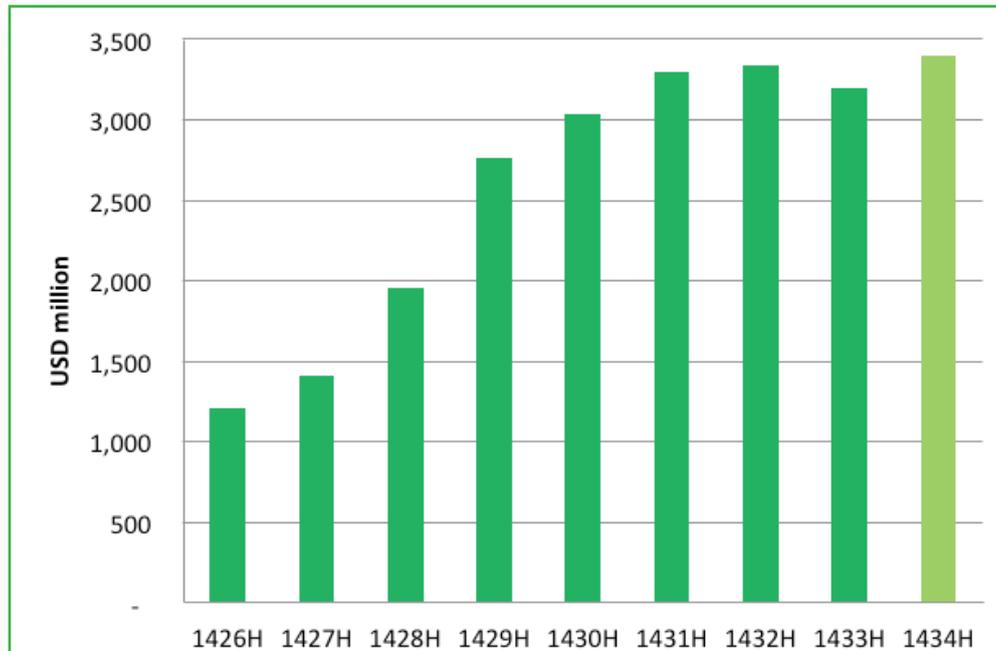
In this context, the OIC Ten Year Programme of Action 2005-2015 has set a target to increase the intra-OIC trade volumes from 15% in 2005 to 20% by 2015. In order to meet this challenge, the International Islamic Trade Finance Corporation (ITFC), member of the IDB Group and the OIC Institutions adopted a strategy with a Road Map for Enhancing Intra-OIC Trade in 2008.

IDB Group overall contribution to Aid for Trade



Since the launch of the Aid for Trade agenda in 2005, the contribution of the IDB Group to Aid for Trade has tripled from over US\$ 1 billion / year to over US\$ 3 billion/year. This increase was mainly caused by increased development finance from the Islamic Development Bank (IDB).

IDB Group Project Financing on Aid for Trade (2005-2013)



Sources: IDBG Annual reports 1426H to 1433H and staff estimate (for 1434H). 1426H corresponds with 10 February 2005 – 31 January 2006 in the Gregorian calendar. 1434H corresponds with 15 November 2012 – 4 November 2013. All development finance provided by IDBG is considered ‘aid’ for purposes of calculating ‘Aid for Trade’. Figures are based on approvals (not disbursements) and include operations by ICD. It excludes trade financing operations as well as investment/export insurance (by ICIEC). Support to the following sectors has been excluded: education, health, public administration, water, sanitation, real estate.

Future Aid for Trade flows are likely to increase further. In order to meet development needs of member countries, some key initiatives of IDB Group are as following:

- On 22nd of May 2013, IDB tripled its authorized capital to US\$150 billion
- Increased the Bank’s subscribed capital to about US\$75 billion

The capital increase will enable IDB to meet the growing development requirements of its 56 member countries and carry out its development mission in a more efficient manner. The IDB Group is also in the process of consolidating and expanding its trade-related technical assistance programmes operating within the different entities.

IDB Group Aid for Trade Interventions



Investment in Trade Related Economic Infrastructure

Development of trade-related infrastructure, particularly for transport, information and communication technology (ICT) and energy, is at the heart of IDB's Aid for Trade assistance to its member countries. Since its inception, the IDB financed more than US\$8.3 billion for energy infrastructure (of which over US\$1 billion in 2012 alone), US\$7.1 billion for transport and US\$343 million for ICT. For example, IDB financed road projects in Sub-Saharan Africa for developing East-West (Trans-Sahelian) and North-South (Trans-Saharan) corridors primarily to promote trade between member countries. Other examples are regional roads between Mauritania and Mali; and Djibouti and Somalia. Besides roads, the IDB supports investments in railways, airports, ports and multimodal facilities.



Islamic Corporation for the Development of the Private Sector (ICD)

Supporting Private Sector Development

The Islamic Corporation for the Development of the Private Sector (ICD) was established in 1999 to serve as the private sector arm of the IDB Group. The Corporation aims at promoting economic development of its member countries, in accordance with the principles of the Shari'ah, by encouraging the establishment, expansion and modernization of private enterprises producing goods and services in such a way as to supplement the activities of the IDB.

This support is important to help boost competitiveness and improve member countries' standing in value chains. ICD's aim is to act as a catalyst for private sector development (see the box below for two success stories). It finances projects in both real and financial sectors, provides advisory services and establishes (seed) funds in partnership with the private sector such as SME Funds, a Renewable Energy Fund, and a Food & Agribusiness Fund.

Examples of ICD projects enabling countries to become more competitive in value chains

The Al-Nouran Sugar project in Egypt

ICD has led an arrangement and structuring of the equity and mezzanine financing facility for a sugar production facility in Egypt. This will boost Egypt's sugar production, supply and trade. The project will also lead to creation of jobs, transfer of technology, promotion of sustainable practices and poverty alleviation. The Al-Nouran Sugar project is expected to generate up to 3,000 new jobs and numerous indirect opportunities associated with the delivery of sugar beet for which the factory will contract with up to 50,000 farmers annually with substantial developmental benefits. Production from Al-Nouran Sugar will reduce the country's reliance on imported sugar by 25 per cent from the current 1 million tons annually. Exports of by-products are expected to generate savings to the balance of payments of up to about \$ 250 million annually. The project is expected to be completed by Q4 2015

Expansion of Horizon fish factory in Maldives

The ICD finances the expansion of Horizon fish factory in Maldives, the single largest ICD's investment in the Maldives. It involves the development of a world-class fish processing facility at Maandhoo in Laamu Atoll, a cold storage facility and infrastructure development in Hoadedhdhoo Island of Maldives. The facilities will contribute to sustainable fisheries in the south central region of the Maldives while providing additional *employment to the local population*.



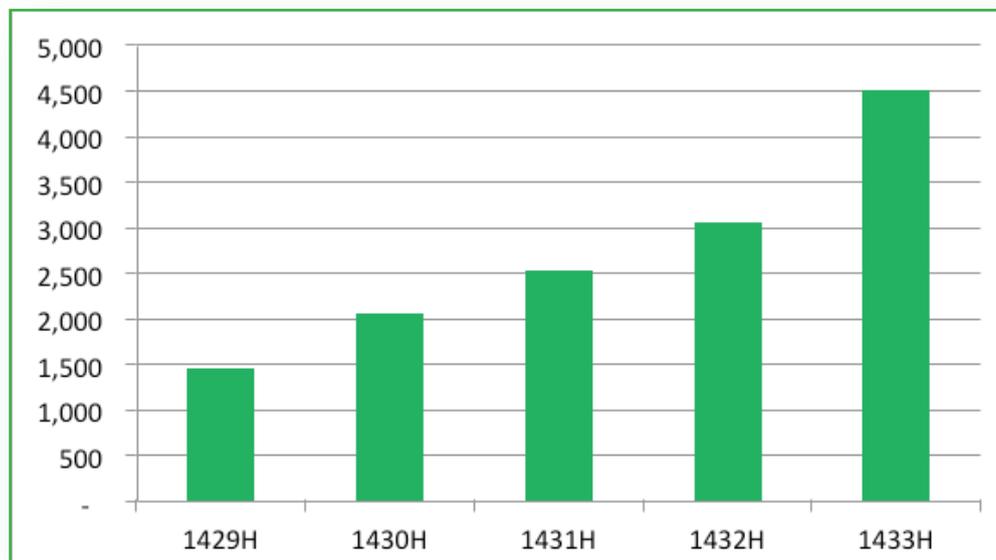
itfc

International Islamic Trade Finance Corporation (ITFC)

The Islamic Development Bank (IDB), since its inception over three decades ago, has been a pioneer among the multilateral development banks for providing trade finance. The Islamic Trade Finance Corporation (ITFC) was established in 2005 as a specialized entity for trade facilitation building upon previous programmes within the IDB, in particular the Import Trade Financing Operations Program (ITFO), operating since 1977, and the Export Financing Scheme (EFS), operating since 1987. ITFC started operations in 1429H (2008) providing trade finance to member countries mainly for intra-OIC trade. It has a mandate in promoting intra-OIC trade and enhancing trade cooperation among OIC member countries. The bulk of trade financing within the IDB Group are done through the ITFC.

ITFC was selected as the winner of the prestigious Euromoney Trade Finance Deal of the Year Award 2008 for financing operations in the cotton sector in Côte d'Ivoire. The ITFC deal was selected as it demonstrated a number of significant innovations compared to standard pre-export finance, as well as being Shari'ah-compliant and of great social and economic importance. Up to November 2012, the IDB Group's trade financing has amounted to US\$44 billion. Volumes have been increasing continuously since 2008 from around US\$1.5 billion to around US\$4.5 billion per year. Thus, the IDB Group has made an important contribution towards mitigating the adverse impacts of the financial crisis for its member countries.

Trade financing operations by the IDB Group (2008-2012) (US\$ million)



Sources: IDB Group Annual Report 1433H (for 1431-1433H), Annual Report 1432H (for 1430H) and Annual Report 1431H (for 1429H). 1429H corresponds with 10 January 2008 – 29 December 2008, 1433H corresponds with 26 November 2011 – 15 November 2012.



The Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC)

The IDB Group provides insurance of investment and export credit through the Islamic Corporation for the Insurance of Investments and Export Credits (ICIEC). ICIEC is a subsidiary corporation of the IDB, established in 1994 (1415H). It carries out, in accordance with Shari'ah, the insurance of export credit in order to protect trade against commercial and non-commercial risks, mainly for transactions between member countries.

Trade-related Technical Assistance Programmes and Initiatives

The Trade Cooperation and Promotion Program (TCPP) - ITFC

The TCPP is the trade promotion and facilitation arm of the International Islamic Trade Finance Corporation (ITFC). It is in charge of planning and implementation of effective trade-related technical assistance programs with the objective of contributing to ITFC's mandate in promoting intra-OIC trade and enhancing trade cooperation among OIC member countries. TCPP's activities fall into six categories, namely: 1) trade promotion, 2) trade facilitation, 3) capacity building and 4) development of strategic products 5) Trade Mainstreaming 6) Trade Finance Support. The aim for the first two categories, i.e., trade promotion and facilitation, is to increase trade cooperation among the member countries for achieving higher economic growth. On the other hand, capacity-building focuses on improving and enhancing human and institutional capacity, which will accelerate trade development in each country. Lastly, the development of strategic product aims at assisting member countries to enhance their production and expansion of products, which have strategic importance. ITFC has also been involved in the development of regional Aid for Trade strategies, through the SPECA Aid for Trade Road Map and Aid for Trade Initiative for Arab states.

The WTO-related Technical Assistance and Capacity Building Program (WTO-TAP) - IDB

WTO-TAP was launched by the IDB in 1997 with a view to helping the member countries upgrade their human and institutional capacities to cope with the challenges of the new multilateral trading system. The Program aims at providing awareness on WTO Agreements and facilitating their implementation by the member countries. It also serves as a forum where relevant officials from member countries can exchange views and discuss various multilateral trade matters. In recent years, the focus of the Program has been more on helping the member countries in their accession to WTO, strengthening their negotiation skills, regional integration and the impact of bilateral agreements on regional integration within the framework of the Doha Development Agenda.

The IDB Group's Investment Promotion Technical Assistance Program (ITAP) – ICIEC

ITAP is an initiative by the IDB Group, established in 2005, and managed by ICIEC. Its objective is to help unlock the developmental potential of the IDB member countries through a comprehensive and integrated program of foreign investment promotion technical assistance. Its focus areas include institutional development, sharing best practices, and information dissemination on investment opportunities in member countries. Interventions include needs assessment studies and specific sector studies, capacity building of Investment Promotion Agencies and relevant government institutions, country promotion events, including seminars and conferences as well as policy advice to improve the investment environment.



The Islamic Research and Training Institute (IRTI)

The Islamic Research and Training Institute (IRTI) was established in 1401H (1981). It is an independent affiliate of the IDB Group and leads the development and sustenance of a dynamic and comprehensive Islamic Financial Services Industry (IFSI) through research, publications and capacity building programs. IRTI has published a number of books and articles on Intra-trade among OIC countries. It has also organized a number of training courses and capacity building programs on topics such as Private and Public Partnerships (PPP), Financing Small and Medium Enterprises (SMEs) and Islamic modes of trade finance. IRTI handles the IDB Solidarity Prize for the promotion of intra-trade among OIC member countries.

The Reverse Linkage initiative

Since 2010, the IDB Group launched Member Country Partnership Strategy (MCPS) to strengthen dialogue with member countries. Through the MCPS, the IDB Group provides support to member countries in key strategic areas that directly contribute to their medium-to-long-term development plans. Through the MCPS process the IDB Group has introduced the “Reverse Linkages” initiative.

Reverse Linkages is a mechanism where a member country, based on its competitive advantage, can offer its expertise, knowledge and know-how to another member country with the IDB Group serving as an “enabler” in a mutually beneficial (win-win) process facilitating strategic alignments between the IDB Group and the member countries. Nigeria is one of the countries where Reverse Linkage activities were implemented. Indonesian experts and technicians transferred knowledge of best practices in agricultural land practices, water management and irrigation systems. For the same member country, Malaysia offered cooperation for the development of rice production.



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