

ISLAMIC DEVELOPMENT BANK AND ITS ROLE IN FINANCING PROJECTS

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ABSTRACT

This paper provides an introduction to Islamic Development Bank (IDB) and discusses the challenges that face the IDB and its member countries. The paper also discusses the role of IDB in addressing these challenges and its role in financing infrastructure projects.

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HISTORY AND BACKGROUND

The Islamic Development Bank started during the Second Foreign Ministers Conference held in Karachi when the idea of establishing an International Bank for the Organization of Islamic Conference (OIC) member countries was promoted. This idea was further crystallized during the first conference of the Finance Ministers of OIC member countries that convened in Jeddah in 1973, decided to establish an international financial institution to foster the economic development and social progress of member countries and Muslim communities in non-member countries in accordance with the principles of Shariah. The Inaugural Meeting of the Board of Governors took place in Rajab 1395H, corresponding to July 1975, and the IDB was formally opened on 15 Shawwal 1395H corresponding to 20 October 1975. The Islamic Development Bank has therefore been at the service of the Islamic Ummah for the last 25 years.

In line with its overall objectives of fostering economic development and social progress, the IDB finances projects in both public and private sectors in member countries. It invests in economic and social infrastructure projects, provides technical assistance to member countries and assists in the promotion of trade among member countries, especially capital goods. The IDB also assists Muslim communities in non-member countries and undertakes Shariah-based research studies in Islamic economics and Islamic banking.

The membership of the IDB grew from the 22 founding members (Pakistan being one of them) at its inception in 1975 to 53 members now stretching from Senegal in the West to Indonesia in the Far East and with Suriname as a foothold in Latin America. The basic condition for membership is that the prospective member country should be a member of the Organization of the Islamic Conference, pays its contribution to the capital of the IDB and be willing to accept such terms and conditions as may be decided upon by the IDB Board of Governors.

With the expansion of the IDB's activities over the years, its authorized capital increased from 2 to 6 billion Islamic Dinars, roughly equivalent to 8.5 billion Dollars. The Islamic Dinar is the accounting unit in the IDB and is equivalent to one SDR (Special Drawing Right) of the International Monetary Fund. These 6 billion Islamic Dinars are divided into 600,000 shares having a par value of 10,000 Islamic Dinars each.

In November 2000, during the OIC summit held in Doha, the delegation of Saudi Arabia, the largest share holder of the IDB, led by HRH Crown Prince Abdulalh Ben Abdul Aziz, proposed to increase the authorized capital of the IDB from 6 to 10 billion Islamic Dinars (or 14 billion Dollars) to strengthen the IDB's financial position and help it contribute more towards the social and economic developments of its member states.

IDB GROUP ENTITIES

In order for the IDB to respond to the ever-increasing demand to finance projects and trade operations for both the public and private sector, it has established over the years five entities that together with the IDB form the IDB Group. These categories are described briefly as follows:

Islamic Banks Portfolio

In line with its strategic objectives, the IDB invited leading Islamic financial institutions to participate in establishing Islamic Banks Portfolio (IBP) for Investment and Development. The IBP instituted in 1987 brought together funds from the IDB and sister Islamic banks to promote investment and trade among member countries and to serve as the nucleus for developing an Islamic financial market.

The IBP is administered by the IDB as a 'Mudarib' (Manager). By the end of 1420H, participating shareholders membership comprised twenty Islamic commercial banks and financial institutions, including the IDB.

The IBP has a fixed paid-up capital of US\$ 100 million and a variable capital of US\$ 280 million. In addition, it has access to funds of US\$ 250 million placed by the IDB as a specific deposit. The IBP currency is the US dollars and its financing is oriented towards (but not exclusively to) the private sector in IDB member countries.

IDB Unit Investment Fund

The IDB Unit Investment Fund (UIF), a private sector window of IDB aims to raise additional resources for the IDB from the market to complement IDB efforts and to strengthen its operations in member countries. It also aims to provide institutional investors with a profitable Shariah-compatible channel of investments. The Fund started operation in 1990.

The Fund extends financing facilities through several Islamic modes of financing. The maturities of financing vary depending on the modes used: five to ten years for medium to long-term financing and six to twenty four months for short-term financing.

Although the initial thrust of the Fund's investment strategy was to acquire mature projects from the IDB Portfolio, the Fund has progressively reduced its dependence on the IDB as a source of investment opportunities and income generation. The current emphasis of the Fund's investment policies is direct investment in the private sector of IDB member countries.

IDB Infrastructure Fund

The economic development of a country, as all of you know, is very much dependant on the development of its infrastructure. Only in a few number of IDB member countries, there is an estimated need of more than \$ 740

billion to finance infrastructure projects in the coming decade. It is in this context that the IDB has established an Infrastructure Fund for an amount of US\$ 1.5 billion.

The Fund's strategic objectives are to seek long-term capital appreciation (by making equity and equity-related investments in infrastructure projects and infrastructure-related industries in IDB member countries) and to promote the use of Islamic finance in infrastructure projects. The Fund is under establishment in the State of Bahrain, where the government has agreed to grant it special status as a limited partnership. The sectoral focus of the Fund is in power, telecommunications, transportation, water, sanitation and natural resources development.

The commitments for the Infrastructure Fund have so far exceeded \$ 850 million and the first closing shall be announced shortly.

Islamic Corporation for Insurance of Investment and Export Credit

Islamic Corporation for Insurance of Investment & Export Credit (ICIEC) is an international institution with full juridical personality established in 1995 as an affiliate of IDB, with an authorized capital of about US\$ 150 million to which IDB contributed 50%. The remainder has been opened to participation by OIC member countries. Currently (on 10th June 2000) 27 countries are full members of ICIEC.

The objective of ICIEC is to enlarge the scope of trade transactions and flow of investments among member states. To serve its objectives, ICIEC provides for exporters, banks and investors from member countries, the following services:

- Export credit insurance service against commercial and non-commercial risks.
- Investment insurance service against non-commercial (country) risks.

In the Board of Governors meeting held in November 2000 in Beirut, Lebanon, a decision was taken to expand the scope of action of ICIEC to include services with goods and exports to non-member countries.

Islamic Corporation for the Development of Private Sector

The Islamic Corporation for the Development of Private Sector (ICD) is an affiliate of the Islamic Development Bank. It is an international multilateral financial institution created for the development of its member countries through the provision of financial services to the private

sector. It has authorized capital of US\$ 1.0 billion of which US\$ 500 million is subscribed.

The ICD focuses on the following objectives:

- Identifying opportunities in the private sector that could function as engines of growth.
- Providing a wide range of Shariah compatible financial products and services.
- Expanding access to Islamic capital markets by private companies in IDB member countries.

ICD's direct financing is through the subscription and purchase of shares or the provision of term financing in productive and profitable projects or companies operating in member countries.

The projects eligible for IDB financing are:

- Green field projects or expansion projects
- Existing projects under restructuring/ rehabilitation
- Privatization operations whereby ICD will finance state-owned enterprises which are being privatized as long as the remaining investment by the government in the company does not exceed 49%. Moreover, it will structure and finance projects implemented through concession agreements (BOT, BOOT, BOO, etc.) and also finance the modernization of privatized companies to enhance their productivity and competitiveness.

Having described a brief outlook of the IDB group, all the above facilities are translated into actual operations to the benefit of the member countries.

PROJECTS FINANCING

Over the 25 years of its existence, IDB group has financed 1221 projects worth 5.9 billion ID (or 7.7 billion US Dollars) of which 495 operations worth 2 billion ID have been completed, 563 operations under implementation for 3 billion ID and 163 operations worth 0.9 billion ID have been cancelled. To this should be added 1249 operations for trade financing worth more than 11 billion ID. Of these amounts Pakistan, being among the top 10 shareholders with 3.05% of the paid up capital, has benefited from IDB through the financing of 137 trade operations worth ID 1.8 billion (2.4 billion US Dollars) and 34 projects worth ID 194 million (250 million US Dollars).

The infrastructure financing had the lion's share of the approved operations. In fact 43% of the approved amount was allocated to infrastructures, followed by 20% for social sector, 15% for industry and mining, 14% for agriculture and agro-industry, and 8% for other sectors.

As far as project financing is concerned, the project cycle comprises three phases: Identification and preparation, appraisal and implementation. This is followed by a post evaluation of completed projects to enable the IDB to ensure that the project has achieved its development objective and if not to build up on lessons learnt and avoid pitfalls in future operations.

The identification phase is usually through a country assistance strategy developed jointly between the IDB and the beneficiary whereby the priority sectors are identified and a set of projects within these sectors are prioritized in a 3-year rolling program. On the basis of this list of projects, an operations plan is worked out for the first year.

Then comes the second phase, the appraisal phase, whereby a mission comprising the appropriate skill-mix visits the country to appraise the project technically, economically and financially. Once the project is approved by the Board of Executive Directors (which convenes

roughly every 6 weeks) the project starts the implementation phase by selecting the consultant, the contractor, the supplier, etc...

It is worth mentioning here that IDB encourages the procurement of goods and services from its member countries. In this respect, projects are classified into 2 types according to their complexity. The procurement of goods and services for the simpler projects are reserved to IDB member country firms. In fact, 50% of the projects approved in 1420H (1999 – 2000) were reserved to member country firms. A similar approach is adopted for consultants whereby a member country consultant benefits from a preferential treatment when he competes with a non-member country firm. The IDB went even a step further in promoting consultant services of member countries by helping the establishment of a Federation of Consultants in the OIC member countries.

The main purpose of this Federation is to urge on Consultants from the member countries to play a major role in the implementation of the IDB financed projects in member countries as well as to promote cooperation among consultants in member countries. As a result of this a number of joint ventures have been established among Consultants in member countries such as the Turkish/Pakistani consultant firm TURKPAK thus increasing their chances in accessing markets in the IDB member countries.

The IDB also promoted the establishment of a Federation of Contractors in OIC member countries. The main purpose of this Federation also is to urge on Contractors in member countries to play a major role in the implementation of IDB financed projects in member countries as well as to promote cooperation among them by establishing joint ventures and exchange of information and technical know-how and so on.

CONCLUSIONS

Development is not an easy task. Not only it requires large sums for financing the increasing needs of the population but also it requires dedication and perseverance, creativity in solving problems and last but not least full commitment from all those concerned. The IDB throughout the 25 years has faced various challenges that tend to impede a smooth

implementation of the projects. Weak executing agencies, change of government priority, unfamiliarity with IDB procedures are few of the challenges that the IDB faces in its member countries but Al Hamdolillah, the dedication and commitment of all parties concerned helped in dealing with these problems by solving some of those and learning how to live with the others.

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