



## ISLAMIC DEVELOPMENT BANK

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<https://doi.org/10.5281/zenodo.6585349>

### ARTICLE INFO

Received: 10<sup>th</sup> May 2022

Accepted: 14<sup>th</sup> May 2022

Online: 26<sup>th</sup> May 2022

### KEY WORDS

*Islamic banking, Islamic banks, Islamic financial system, principles of Islamic finance, Islamic Development Bank statistics*

### ABSTRACT

*Islamic Development Bank, Arabic Al-bank Al-islāmī Lil-istithmār, Muslim bank directed toward financing the economic and social development of members in accordance with the principles of the Shari'ah (Islāmic sacred law). Conceived by the Organization of the Islāmic Conference in 1973, the bank was headquartered in Jeddah, Saudi Arabia, and formally opened in October 1975. Its member nations are drawn from the ranks of those states belonging to the Organization of the Islāmic Conference.*

### INTRODUCTION

The Islamic Development Bank (Arabic: البنك للتنمية الإسلامي) is a multilateral development finance institution that is focused on Islamic finance for infrastructure development and located in Jeddah, Saudi Arabia. There are 57 shareholding member states with the largest single shareholder being Saudi Arabia.

The Islāmic Development Bank seeks to spur economic and financial growth by participating in equity capital, by investing in economic and social infrastructure projects, and by making loans to the public and private sectors. Special funds are available for technical assistance to Muslim communities in nonmember countries.

Bank, an institution that deals in money and its substitutes and provides other money-

related services. In its role as a financial intermediary, a bank accepts deposits and makes loans. It derives a profit from the difference between the costs (including interest payments) of attracting and servicing deposits and the income it receives through interest charged to borrowers or earned through securities. Many banks provide related services such as financial management and products such as mutual funds and credit cards. Some bank liabilities also serve as money—that is, as generally accepted means of payment and exchange.

### ANALYSIS OF THE LITERATURE ON THE SUBJECT

Organization of the Islamic Cooperation, Arabic Munazamat al-Ta'āwun al-Islāmī, an Islamic organization established in Jeddah,



Saudi Arabia, in May 1971, following summits by Muslim heads of state and government in 1969 and by Muslim foreign ministers in 1970. The membership includes Afghanistan, Algeria, Bahrain, Bangladesh, Benin, Brunei, Burkina Faso, Cameroon, Chad, Comoros, Djibouti, Egypt, Gabon, The Gambia, Guinea, Guinea-Bissau, Indonesia, Iran, Iraq, Jordan, Kuwait, Lebanon, Libya, Malaysia, Maldives, Mali, Mauritania, Morocco, Niger, Oman, Pakistan, the Palestinian Authority (PA), Qatar, Saudi Arabia, Senegal, Sierra Leone, Somalia, Sudan, Syria (suspended), Tunisia, Turkey, Uganda, United Arab Emirates, and Yemen.

The conference aims at promoting Islamic solidarity by coordinating social, economic, scientific, and cultural activities. Under the banner of strengthening the struggle of Muslims, the conference pledges to eliminate racial segregation and discrimination, especially in regard to the Palestinians. Projects include the International Islamic News Agency, the Islamic Development Bank, the Islamic Solidarity Fund, and the World Centre for Islamic Education. Egypt was suspended in 1979 after it signed the agreement known as the Camp David Accords with Israel; in 1984 it accepted an offer to rejoin the organization. Syria was suspended in 2012 as its crackdown on Arab Spring protesters evolved into civil war.

## ANALYSIS AND RESULTS

The Islamic Development Bank (IsDB) was established in 1975 and data on its concessional financing have been available in DAC statistics since 1977. In 2011, the IsDB expanded its reporting to cover non-concessional project financing to developing countries. This resulted in a

major increase in reporting coverage, as concessional financing represents only about 10 per cent of IsDB's total project financing in developing countries. In that same year, IsDB started to report details on individual projects (activity-level reporting). Activities of other entities of the IsDB Group and special funds will be incorporated in the reporting in the coming years. In collaboration with the Statistics and Development Finance Division of the Development Co-operation Directorate of the OECD, IsDB has mapped its financial instruments, all of which conform to Islamic financing principles, to the OECD-DAC's reporting system. This has enabled IsDB to report its concessional development finance and other resource flows to the OECD at the activity level in the standardised CRS++ format. Its data can now be incorporated in various analyses based on DAC statistics in a comparable manner with those of bilateral providers and, for example, the other International Financial Institutions (IFIs). The OECD-DAC warmly welcomes the efforts of the IsDB to report its flows and stands ready to collaborate with other Arab donors to improve the tracking of development co-operation flows at the global level.

The IsDB Group is a multilateral development finance institution comprising five entities: Islamic Development Bank (IsDB); Islamic Research and Training Institute (IRTI); Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC); Islamic Corporation for the Development of the Private Sector (ICD); and International Islamic Trade Finance Corporation (ITFC). The mission of the IsDB Group is "to promote comprehensive human development with a focus on



alleviating poverty, improving health, promoting education, improving governance and prospering the people.” The IsDB Group is one of the specialised organs of the Organization of the Islamic Cooperation (OIC); all member countries of the OIC are eligible to become members of the IsDB Group. The present membership consists of 56 countries spanning Africa, Asia, Europe, Latin America and the Middle East, including one OECD member (Turkey). The main shareholders of IsDB are Saudi Arabia (24% of votes), followed by Libya, Iran, Nigeria, United Arab Emirates, Qatar, Egypt, Turkey and Kuwait. The authorised capital of the IsDB was USD 153 billion at the end of 2013.

The IsDB’s instruments for concessional financing include technical assistance and loans. Other project financing is extended through various non-concessional financing including leasing, equity participation, instalment sale, Istisna’a and profit sharing (see below). All eight modes of financing which will be explained in this brief are Shari’ah-compliant. In Islamic finance, any financial transaction must be accompanied by an underlying productive economic

activity that generates legitimate income, thereby creating a direct link between the financial transaction and the real economy. By contrast, interest is not Shari’ah compliant as it is considered as a payment for the use of money itself and therefore not directly linked with real economic activity. Another specificity of Islamic finance is that, if the buyer/debtor defaults on a deadline, it is impermissible for the seller/creditor to charge him any increment over the principal initially agreed upon.

1. Loans are used for financing development projects mainly in basic social infrastructure and rural development. The repayment period for loans is from 15 to 25 years, including a grace period of 3 to 7 years, depending on the beneficiary country. Even softer terms (30 years’ maturity with a grace period of 10 years, service fee of 0.75%) may be provided for projects in least developed countries. Loans are extended to governments or public institutions with a government guarantee.

2. Technical assistance is provided for institutional capacity building programmes, feasibility studies and project preparation and design, mainly in the form of grants.



**Table 1. IsDB financing (core resources) by instrument, in USD million**

Instrument	2011	2012	2011-2012 average % per instrument
<b>Concessional</b>			
Loan	347.8	391.0	10.8%
Grant (Technical Assistance)	31.0	11.5	0.6%
<b>Non-concessional</b>			
Istisna'a	1,591.3	1,559.9	46.3%
Leasing	1,024.2	520.0	22.7%
Instalment Sale	127.6	933.5	15.6%
Profit Sharing	100.0	50.0	2.2%
Equity	10.0	111.3	1.8%
<b>Total</b>	<b>3,231.9</b>	<b>3,577.1</b>	

The other modes of financing of the IsDB are non-concessional as the Bank makes a profit (mark-up) on the operations.

3. One of the main modes of financing extended by the IsDB is called Istisna'a. This is a form of sale agreement, applicable to assets that are not available or existing at the time of concluding the agreement. The asset can be, for example, a road, hospital or electricity transmission network, to be delivered on a specific future date. In practice, Istisna'a involves two parallel agreements – one between the Bank and the buyer and another between the Bank and the manufacturer, constructor or supplier – on the asset to be created, based on the specifications outlined by the buyer, at an agreed predetermined price. The direct link between the financial transaction and productive flows (the real economy) is established through agreement on project specifications and fixed date and place of delivery. In IsDB, Istisna'a sales are on credit, with semiannual instalments over a period extending up to 20 years.

4. The IsDB also provides financing in the form of leasing. The Bank purchases the asset (e.g. machinery or equipment) and leases it to the beneficiary for a specific

period of time, up to 20 years. The Bank remains the owner of the asset and lease instalments are not considered as debt. At the end of the rental period, the Bank transfers the ownership of the asset to the lessee as a gift. This latter feature, specific to the IsDB, warrants the inclusion of leasing operations in the Bank's reporting to DAC statistics, even if leasing is generally excluded. Leasing contracts often cover very large amounts (on average over USD 100 million in 2012). Agreements signed in 2012 were all targeted to the energy sector. 5. Another common mode of IsDB project financing is instalment sale. This consists of the Bank purchasing the asset (e.g. machinery or equipment) needed for a project and then re-selling the asset to the buyer at a higher price, which is mutually agreed between the Bank and the buyer. The ownership of the asset is transferred to the buyer upon delivery (which allows the buyer to use the asset to secure financing for operational purposes).

6. The other three IsDB instruments have been recorded in DAC statistics since 2010:



lines of financing, profit sharing and equity participation. Lines of financing are extended to national development finance institutions (to be used for leasing, instalment sale and Istisna'a), with the objective of enhancing the role of SMEs and promoting Islamic finance.

7. Projects with an expected high financial rate of return, are often financed by profit sharing. This instrument implies investing in a certain project together with another partner and both obtaining a percentage of the profit that corresponds to their respective investments.

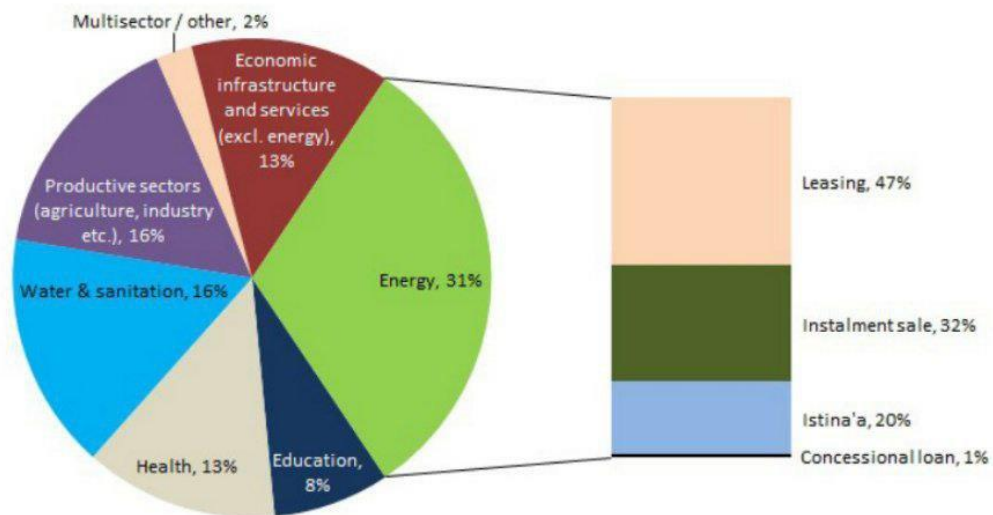
8. Finally, the Shari'ah rules also regulate the equity participation of the IsDB. Equity can only be extended to activities in the "real sector" that have economic value. Islamic financial institutions are not allowed to undertake businesses which involve speculation. In 2012, the IsDB approved two equity capital investments for a micro-finance institution in Sudan. Another possibility for investment is in public-private partnerships and equity capital of companies (public and private). One such operation was committed in 2012. Cumulative figures show that 9% of IsDB's project financing has been in the form of equity since 1975.

One project can benefit from several modes of financing. For example, IsDB can support a tertiary education quality improvement project through a combination of a loan, Istisna'a and instalment sale.

Chart 1 presents the sectoral breakdown of IsDB's net approvals in 2012 for concessional and non-concessional financing. Energy and other economic infrastructure and service accounted for almost half of its commitments in 2012, followed by the social sectors (water and sanitation, health and education) and the productive sectors such as agriculture and industry. 31% of financing was allocated to the energy sector, including all leasing and a significant part of the instalment sales and Istisna'a. The three main projects in this sector consisted of building power plants in Egypt, Morocco and Tunisia. With the Istisna'a instrument, USD 850 million was allocated to social sectors (like education, health and water), of which two projects (in total USD 345 million) were in Iran for water supply and sanitation. Instalment sales for over USD 200 million were approved for a rail transport project in Turkey and a polio eradication programme in Pakistan.



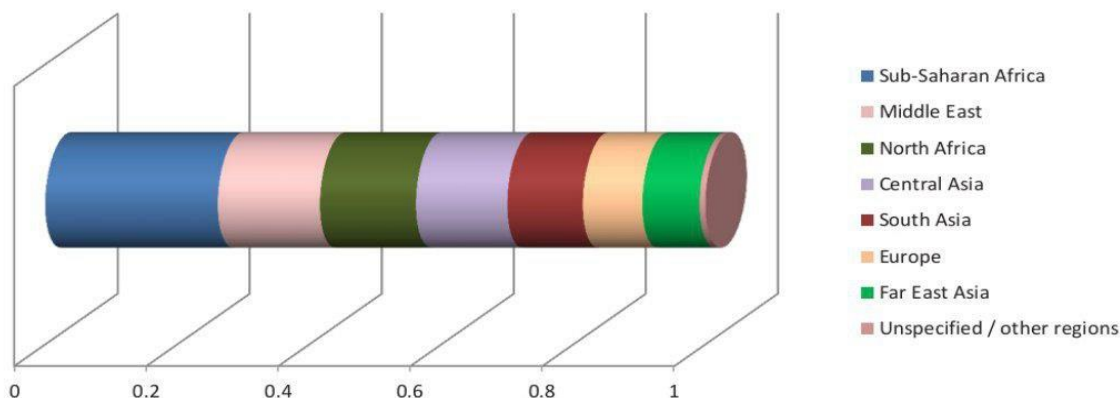
**Chart 1. IsDB financing (core resources) for development by sector (commitment data 2012) including both concessional (USD 403 million) and non-concessional resources (USD 3.2 billion)**



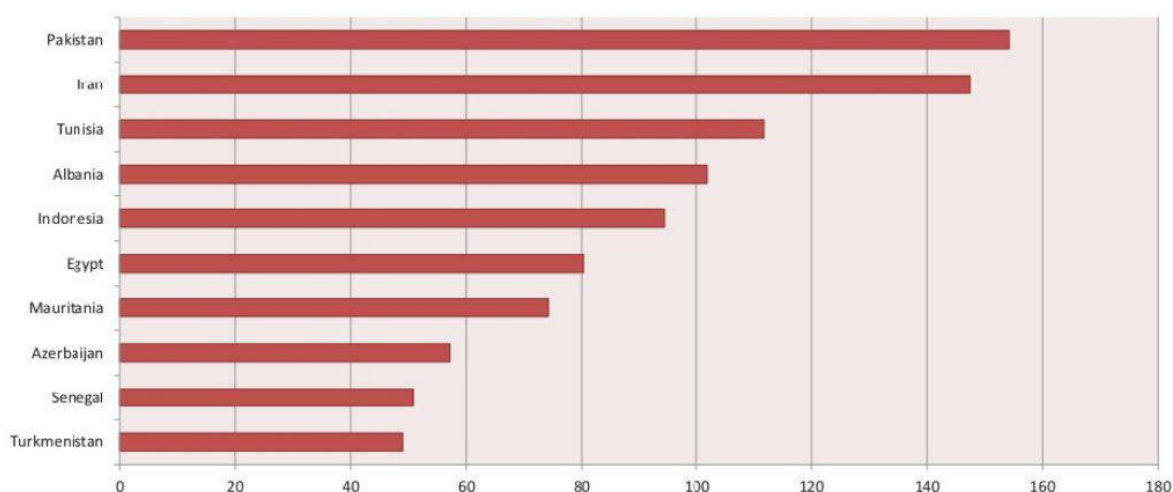
More than 50% of the concessional financing was allocated to social sectors, with main projects in Tajikistan (education) and Uganda (health). Technical assistance grants (USD 22 million) were extended to projects in many sectors in combination with loans and other modes of financing.

Chart 2 presents the regional distribution of IsDB finance in 2012 (gross disbursements) and Chart 3 the main recipients. IsDB works in countries with significant Muslim communities, mainly in the Middle East, South Asia and Indonesia.

**Chart 2. IsDB operations by region (concessional and non-concessional, core resources, 2012 gross disbursements)**



**Chart 3. Top 10 recipients of IsDB's operations (concessional and non-concessional, core resources, 2012 gross disbursements, USD million)**



## CONCLUSION

The Islamic Development Bank is an international financial institution whose purpose is to foster the economic development and social progress of member countries and Muslim communities individually as well as jointly in accordance with the principles of Shari'ah i.e., Islamic Law.

The Bank is established in pursuance of the Declaration of Intent issued by the

Conference of Finance Ministers of Muslim Countries held in Jeddah in Dhul Q'adah 1393H, corresponding to December 1973.

The Bank's vision is to be the leader in fostering socio-economic development in member countries and Muslim communities in non-member countries in conformity with Shariah.

The IDB Group is committed to alleviating poverty; promoting human development; science and technology; Islamic economics;



banking and finance; and enhancing cooperation amongst member countries, in

collaboration with its development partners.”

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