Global Value Chain: Islamic Economics and Finance Position

Laila Masruro Pimada
Faculty of Economics and Business, Universitas Brawijaya, Indonesia
Corresponding email: lailapimada@ub.ac.id
http://dx.doi.org/10.22515/shirkah.v6i3.353

ARTICLE INFO

Keywords:
Global Islamic Economy; Halal Industry; Value Chain; Islamic Economics; Islamic Finance

ABSTRACT

The growing number of Muslim populations promotes significant development on Islamic economic and finance activities called halal industry. While the halal industry is experiencing positive growth in the last four years, the Global Value Chain (GVC) – the chain of system that drives international trades and global economic activities – remains stagnant. The present study aims to explain the position of the Islamic economics and finance in the GVC. This study employs a qualitative-descriptive method with systematic literature review approach. By collecting secondary data using strict-processing stages and content analysis techniques, the author manages to meet the study’s purpose. The findings suggest that the Islamic economics and finance have opportunities to boost countries’ participation in the GVC activities by harmonizing halal standardization, enhancing financial infrastructures, and providing various financial products. This study contributes to generate government policies and enterprises’ decisions in developing the Islamic economics and finance within the GVC framework. It further provides initial insights and potential topics for future studies.

Introduction

Global Value Chain (henceforth GVC), formerly Global Commodity Chain (GCC), has created complex cooperation between countries worldwide until its development is considered as the characteristic of 21st-century trade (Baldwin, 2011; Gereffi, 2014; Jaklic et al., 2020). International collaboration in terms of production, trade, and investment has been implemented since centuries ago. Along with the technological advancement, GVC grows massively from 1990-2007 (World Bank, 2020). However, after the global
financial crisis in 2008, GVS’s growth experienced a decline, and further performed stable improvement in the years of 2010 and 2011 (Li et al., 2019). Currently, based on the global Foreign Direct Investment (FDI) and the UE and US multinational enterprises' economic activities data, Dachs and Pahl (2019) stated that GVC growth is in a state of stagnation.

The stagnation of GVC is unfortunate, considering the GVC has proven to be an effective instrument in gaining an integrated view of the global structure of economic activities (Marchi et al., 2020). Furthermore, GVC plays crucial roles, such as stimulating economic growth and reducing unemployment and poverty rate, for its stakeholders especially for the developing countries (Fernandez-Stark & Gereffi, 2019). The GVC’s importance also attracts the attention of various international organizations such as the World Trade Organization (WTO), The Organization for Economic Co-operation and Development (OECD), and the World Bank Group (WBG). Since the primary purpose of WTO is to open a trade for the benefit of all countries worldwide, and the financial impact of transactions is magnified in GVC’s activities (Diakantoni et al., 2017), it is a highly necessary attention for WTO to focus on how to govern the development of GVC.

Meanwhile, The Organization for Economic Co-operation and Development (OECD), which works on building better policies, has been actively involved in the GVC initiative since 2012. The OECD believes that GVC is able to foster economic activities to be more interconnected and become a powerful booster for sustainable growth and productivity of economy. Moreover, World Bank Group published World Development Report in 2020 with a significant focus on explaining how important the GVC is. This report stated that funds, geography, market share, institutions, and policies/regulations regarding GVC sustainability could improve a country's participation in the GVC growth.

Research on the global value chain issues has indicated that GVC is essential in improving investment and productivity (Ignatenko et al., 2019; Pahl & Timmer, 2020) and fostering economic growth, job creation, unemployment, and poverty reduction (Fernandez-Stark & Gereffi, 2019). Several countries from parts of the world have contributed to GVC growth within the last 30 years. Nevertheless, the global financial crisis in 2008 impacted a stagnation towards GVC expansion due to insufficient human capital and infrastructure and regulatory and institutional barriers (Todo et al., 2019).

In contrast, the Islamic economic sectors as represented by seven halal industry sectors, i.e. Islamic finance, halal food, Muslim-friendly travel, modest fashion, media and recreation, halal pharmaceuticals, and halal cosmetics, contribute to the global economy in the recent decade. DinarStandard (2019) reported that in 2018, the global Muslim population expensed 2.2 trillion USD to fulfill their consumption requirements.
Meanwhile, in the same year, the Islamic financial asset, consisting of Islamic funds such as hajj funds, takaful, sukuk, and sharia banking assets, reached 2.5 trillion USD. However, it is undeniable that due to a comprehensive Islamic economics and finance, the halal industry still encounters challenging situations, among them is the lack of cooperation between the involved sectors (Mubarok & Imam, 2020). The inconsistent international halal standards due to different perceptions has lessened the integrity of the halal supply chain (Latif, 2020). Moreover, the difference of halal standards between countries leads to negative perceptions among Muslim consumers (Al-Teinaz & Al-Mazeedi, 2020).

Despite some disadvantages, there is a favorable condition that needs to point out. The Islamic population's average growth domination projects a Muslim population number improvement of 2.2 billion in 2030 (PEW Research Center Forum on Religious & Public Life, 2011). Given the positive effect of demographic transitions (becoming more productive) on per-capita income growth (Sanchez-Romero et al., 2018), a demographic increase of productive age groups accompanied by the increasing number of Muslim populations may become a strength for the global Islamic economic and financial growth.

Based on the above discussion, there is a contradiction between GVC stagnation and global Islamic economic growth. While many researchers focus on the benefit of joining GVC and improving countries' participation, the present study aims to examine the Islamic economics and finance position within the GVC. Given the urgency of considerable funds and market share availability needed in the GVC's growth and development, there is a necessity to examine the current position of Islamic economics and finance sectors. Furthermore, to the best of the author's knowledge, studies investigating a relation between GVC and the Islamic economics and finance still remain unexplored. Therefore, this study aims to patch up the research gap to enrich literature and references for academicians and policymakers. In more detailed implication, this study provides input for government policies and enterprise decisions in developing the Islamic economics and finance sectors within the GVC framework. Moreover, this study also purposes initial insight and potential topics for future studies.

**Method**

**Research Design**

This study was conducted to discover the Islamic economics and finance position within the GVC from theoretical perspectives. Therefore, the qualitative-descriptive method with a systematic literature review approach was employed. While qualitative-descriptive method interprets and describes the research topic's concepts or phenomena (Basias & Pollalis, 2018), a systematic literature review based on content
analysis allows for the collection and analysis of a significant amount of evidence in a manner that is transparent, reliable and replicable (Koberg & Longoni, 2019). Furthermore, the method also provides both conceptual development and holistic interpretation (Koveshnikov et al., 2019; McWilliam et al., 2020).

**Data Sources and Data Collection**

Drawing on the secondary data, this study made use of scientific journals, websites, news, and annual reports as the data sources to address the identified issues. More specifically, by committing to providing the best analytical outcome using high-quality literature, the author carefully selected them by considering particular criteria: (1) the scientific journals must be indexed in reputable indices such as Scopus and Web of Science (WoS); (2) the journals are not listed as predatory publications; (3) the policy briefs, working papers, and reports are published by government officials or reputable international organizations; and (4) the literatures must be published in the last 10 years.

Furthermore, the author did a filtration process as modified from Sukmana (2020). First, the author searched articles through commonly used journal databases such as Science Direct, Emerald Insight, Springer, JSTOR and Proquest. The keywords for searching literatures were Global Value Chain, Halal Industry, Trade, and Islamic Economics and Finance. Second, the author identified reputable articles within the prior criteria and eliminated the predatory ones using a predatory identifier (https://beallslist.net).

**Data Analysis**

The content analysis focusing on interpreting and understanding was used to analyze the data. Since the study employed the latest data of GVC and halal industry, the author thoroughly looked up the related reputable articles, reports and policy briefs published by international organizations. Furthermore, the author transformed the data into tables and diagrams as the supporting evidence for the results and discussion. The literatures used in this study are shown in the Table 1.

<table>
<thead>
<tr>
<th>Author(s)/Publication Title</th>
<th>Year</th>
<th>Type</th>
<th>Indexing/Publisher</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hidayat, S. E., Rafiki, A., &amp; Nasution, M. D. T. P.</td>
<td>2021</td>
<td>Article</td>
<td>Scopus</td>
</tr>
<tr>
<td>Hayakawa, K., &amp; Mukunoki, H.</td>
<td>2021</td>
<td>Article</td>
<td>Scopus</td>
</tr>
<tr>
<td>Verschuur, J., Koks, E. E., Hall, J. W.</td>
<td>2021</td>
<td>Article</td>
<td>Scopus</td>
</tr>
<tr>
<td>Chinazzi, M., Davis, J. T., Ajelli, M., Gioannini, C., Litvinova, M.</td>
<td>2020</td>
<td>Article</td>
<td>Scopus</td>
</tr>
</tbody>
</table>
Results
Global Value Chain (GVC) has been established years ago; since then, a number of studies have proven that it has an essential role in boosting macroeconomic
performances. Nevertheless, its prolonged stagnation growth attracts World Bank – the international institution that focuses on ending extreme poverty and promoting shared prosperity worldwide – to propose policy simulation (see Figure 1). Based on the simulation, Islamic economics and finance could positively contribute to the term of each fundamental.

![Figure 1. Policy Simulation](image)

The strength of global Islamic economic growth depends on various countries joining the Organization of Islamic Cooperation (OIC). From all members contributing to the halal economic activity growth, 15 countries with the highest Islamic indicator performance scores of economic activities came from OIC countries (Thomson Reuters, 2018; DinarStandard, 2019). In addition, 54 countries out of 57 active countries in the OIC membership are participating in GVC (World Bank, 2020). Table 2 provides the number of OIC countries within the GVC’s classifications.

<table>
<thead>
<tr>
<th>Category</th>
<th>Number of OIC Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low Participation</td>
<td>10</td>
</tr>
<tr>
<td>Limited Commodities</td>
<td>16</td>
</tr>
<tr>
<td>High Commodities</td>
<td>19</td>
</tr>
<tr>
<td>Limited manufacturing</td>
<td>7</td>
</tr>
<tr>
<td>Advance manufacturing and services</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total Number of OIC Countries</strong></td>
<td><strong>54</strong></td>
</tr>
</tbody>
</table>

Regarding halal industry as the manifestation of the Islamic economy, Table 2
states the increasing consumer expenditures in all halal sectors. It is clear that halal food took up most of the halal industry (banking and financial excluded) in the last four years and is still expected to be the most significant industry in upcoming future years. Meanwhile, fashion, media recreation, and travel recorded positive revenues from consumer spending at over 150 billion USD each year from 2015 to 2018. Nonetheless, the last two industries, pharmaceuticals and cosmetics, only managed to benefit under 100 billion USD in the four years.

Table 3. Global Islamic Economy Growth (Billion USD)

<table>
<thead>
<tr>
<th>Consumer Spending on Halal Industries</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2024*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Halal Food</td>
<td>1.173</td>
<td>1.245</td>
<td>1.303</td>
<td>1.369</td>
<td>1.972</td>
</tr>
<tr>
<td>Halal Fashion</td>
<td>243</td>
<td>254</td>
<td>270</td>
<td>283</td>
<td>402</td>
</tr>
<tr>
<td>Halal Media &amp; Recreation</td>
<td>189</td>
<td>198</td>
<td>209</td>
<td>220</td>
<td>309</td>
</tr>
<tr>
<td>Halal Travel</td>
<td>151</td>
<td>169</td>
<td>177</td>
<td>189</td>
<td>274</td>
</tr>
<tr>
<td>Halal Pharmaceuticals</td>
<td>78</td>
<td>83</td>
<td>87</td>
<td>92</td>
<td>134</td>
</tr>
<tr>
<td>Halal Cosmetics</td>
<td>56</td>
<td>57</td>
<td>61</td>
<td>64</td>
<td>95</td>
</tr>
<tr>
<td>Total Spending</td>
<td>1.890</td>
<td>2.006</td>
<td>2.107</td>
<td>2.217</td>
<td>3.186</td>
</tr>
</tbody>
</table>

*Cumulative Annual Growth Rate (CAGR) Estimation

Moreover, based on Table 4, as the largest sector of the halal industry, the financial and banking industry contributed more than 2.000 trillion USD from 2015 to 2018. Almost 75% of the total assets came from the banking industry only, while the rest is divided into takaful, sukuk, and other Islamic funds. This industry is projected to achieve 5.5% growth with total assets at more than 3.000 trillion USD (DinarStandard, 2019).

Table 4. Global Islamic Finance and Banking (Trillion USD)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total of Global Islamic Financial Assets Value</th>
<th>Islamic Banking Distribution Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>2.004</td>
<td>1.451</td>
</tr>
<tr>
<td>2016</td>
<td>2.202</td>
<td>1.599</td>
</tr>
<tr>
<td>2017</td>
<td>2.438</td>
<td>1.721</td>
</tr>
<tr>
<td>2018</td>
<td>2.524</td>
<td>1.767</td>
</tr>
</tbody>
</table>

In short, by referring to these data and the World Bank policy simulation model, it is clear that the growing number of Islamic economics and finance sectors supports the GVC development through the World Bank policy model. The data demonstrate that almost all OIC countries committing to halal industry and lifestyle participate in the GVC. This fact leads to a bigger market size that requires a robust standardization policies and sufficient infrastructures. As for the discussion section, the following part
will discuss the opportunities in capturing the Islamic economics and finance position within the GVC.

Discussion

OIC Countries’ Position in the Global Value Chain

In line with this study, several previous studies have proved the positive effect of GVC participation on the economic growth of the developing countries. Fernandez-Stark and Gereffi (2019) suggested that GVC has a vital role in contributing to economic growth and reducing unemployment and poverty rate. Furthermore, Pahl and Timmer (2020) found a robust evidence for higher productivity effect from GVC integration, especially for those who are further away from technological frontier such as developing countries. These studies provide positive opportunities to OIC countries since its members are still developing countries.

Notwithstanding the fact, based on Table 2, OIC countries contribute 36% in GVC membership, i.e., 54 out of 146 countries. The contributions vary due to their capabilities in providing goods and services to the GVC. Most OIC countries participate in the commodities cluster that makes them essential in supplying inputs to other countries. This argument is supported by Kummritz and Quast (2016), which found striking evidence that the developing countries are the main reason behind the rise of GVC integration due to more fragmented productions and increasing involvement in the upstream stages of the GVC.

Figure 3. Manufactures Industry of OIC Countries

![Figure 3. Manufactures Industry of OIC Countries](source: SESRIC (2019))

In addition, World Bank (2020) stated that since 1995 manufacturing industry has been a dominant part of the GVC which means that the remaining OIC countries
categorized in manufacturing also hold a strong position in the GVC. This is also given to OIC countries’ increasing manufacturing production growth magnitude, as presented in Figure 3. Furthermore, the increase of OIC countries’ contribution to the global manufacturing industry signals that OIC countries participated in GVC positively impact the GVC continuity. Li et al. (2019) asserted that the high participation level in the manufacturing and service sectors often demonstrated the increasing production activities from GVC.

The Position of Islamic Economics in the Global Value Chain

Despite the multiple benefits of being a part of the GVC, there is a challenge that must be addressed. Todo et al. (2019) found two significant problems encountered by developing countries and underdeveloped regions in advanced countries, such as high initial cost for poor infrastructure and information and communication technology. In response to such problems, World Bank (2020) proposed a policy simulation as listed in Figure 1. The simulation is based on Kowalski et al.’s (2015) finding that at least five determination factors influence a country’s participation in GVC growth, i.e. funds, geography, market share, institutions, and policies/regulations.

In favor of these factors, the Islamic economy through halal industry offers substantial opportunities to tackle the significant issues and boost the GVC. The halal industry is a halal economy engaging in seven industrial sectors with the Muslim population as its primary customer. Nevertheless, the halal industry is not exclusive. It is open for anyone with the same value in economic activities, such as consuming halal food, saving money in sharia banks, buying Islamic financial instruments, and other things with specific considerations regarding gender interaction and religious practices.

By referring to Table 2, the global Islamic economics is predicted to reach 3.2 trillion USD in terms of consumption expenditure in 2024. The increasing consumption expenditure in the Islamic economy indicates a growing demand for halal goods. The Muslim population’s domination of up to 24% of the global population (PEW Research Center Forum on Religious & Public Life, 2011) and 60% of the total population are under age of 30 (Evan & Syed, 2015). The demography bonus and the increasing global trend of ethical consumerism in society (Irwin, 2015) expand the halal industry market share. Furthermore, the ability of halal industry sectors to accommodate consumerism ethics demands from the non-Muslim society also contributes to the rise of the halal market size (DinarStandard, 2019).

In addition to market share and halal industry availability, halal industry movement performed in the developing countries such as OIC countries strive to increase GDP growth, diversify the economy, increase foreign investment, and develop
the Consumer-Packaged Goods industry (Kamarulzaman & Muhamad, 2021; Park & Jamaludin, 2018). Unfortunately, this common goal between countries has not been accompanied by a reduction in trade tariffs. OIC countries’ high trade tariff is caused by the distance between the countries (SESRIC, 2019).

Despite the high trade tariff among OIC countries, the agreement of halal certification regulation intensification for all products and services in the halal industry has been conducted (Hasanah et al., 2021; Sari et al., 2021). This effort is carried out to ensure that the products and services quality is following Islamic ethical values. Another objective is to answer the problem regarding the halal industry growth owing to the lack of global halal standardization (El-Gohary, 2020; Halim & Salleh, 2012). By standardizing the halal certification, the countries would have significant opportunities to access more inputs and deepen the trade agreements.

Furthermore, trade continuity among OIC countries which is guaranteed by the halal status would continue to increase because of Information and Technology Communication (ICT) connectivity boost. OIC countries have implemented 18 priority agendas agreed together in the 13th Islamic Summit Conference. As depicted in Figure 4, one of the priority agendas is the digital and ICT structure development, which is advanced within the last three years.

Source: OIC Economic Outlook (2019)

Figure 4. The Development of Priority Program Implementation of OIC Countries

In today’s global activities, digitalization and ICT connectivity is an encouraging factor of the economic development. It is proven as a useful platform organize better economic activities (Wang et al., 2021) by reducing costs, communicating transparency between economy actors, and cutting goods shipment time (Cheng et al., 2021). The agreement upon halal certification, digital connectivity, and information and communication technology advances among the OIC countries put the Islamic
economics as the stimulus for the GVC growth.

The Position of Islamic Finance in the Global Value Chain

The financial and banking sector is a significant factor that positively influences economic growth (Guru & Yadav, 2019). Access simplicity upon finance is established as a crucial factor in trade activities (Kowalski, 2011). In more detail, World Bank (2020) simulated that one factor affecting the participation level in the GVC was the finance development in the member countries. One of the policy solutions elaborated in the simulation was by improving banking literacy in commodity-based countries. Then, countries in the manufacturing and service cluster as well as the innovative countries should be given access to the improvement for capital financing.

The importance of financial quality improvement by OIC countries has not been realized maximally. It can be seen from the finance sector growth in the country that remains below the average global finance sector. In the report of OIC countries in 2019, it was mentioned that the world's population percentage with banking literacy was 69%, while there was only 46.3% of the population of OIC countries that was inclusive to the banking sector. This value put the OIC countries under the global standard.

Furthermore, by using the broad money to GDP ratio variable to determine the financial depth rate, OIC countries are left behind than the global accumulation of such a ratio. Concerning this matter, SESRIC (2019) recorded in 2018 that the broad money percentage of OIC countries only reached 60%, while the global rate was 123.6%. OIC countries could only distribute 66.7% of the total GDP owned in the domestic credit distribution, while the worldwide percentage of domestic credit distribution was 172.8% from the total GDP.

However, in favor of the financial sector's crucial function in improving GVC performance, the Islamic financial and banking sector offers a positive signal that this sector dominates the halal industry improvement (see Table 4). Using the Cumulative Annual Growth Rate (CAGR) method approach, DinarStandard (2019) predicted that Islamic finance and banking assets would continue growing up to 3.472 trillion USD in 2024. This development is also supported by the wide spreading of Islamic banking in some western countries (Novikov et al., 2019). In addition, the aggressive prediction development is also based on the sector's ability to adapt to technological advances by adopting financial technology, cryptocurrency, and other digital banking products (Rabbani et al., 2020).

The Islamic financial position strength is not only based on the positive asset growth but also on the availability of various financial products addressed by the economic actors. Global financial product diversification, including what Islamic financial offers – *murabahah, musyarakah, salam, istishna, ijarah wadi’ah, wakalah* – will
affect the global economy. Weller and Zulfiqar (2013) discovered that money market diversity affected economic stability. The more diverse the product is, the faster the improvement will be. It also expands the credit market, extends the deposit base, and reduces asset bubbles.

In improving the participation rate to the GVC continuity, Islamic finance and banking have provided diverse financial alternatives. One of the financial products favored by society is sukuk. Sukuk is a sharia bond issued by the government of private parties to obtain long-term financing. Some sukuk publishers are the Indonesian Government, Oman Government, Malaysian Government, Almarai Enterprise, and known organization IsDB cooperating with HSBC, JP Morgan, and Standard Chartered (DinarStandard, 2019).

Not only being maximized by sukuk publishers, but the global investor enthusiasm also shows a positive pattern, as seen from the total sukuk issuance that increases each year, as presented in Figure 5. Financing from sukuk is vast and long-term financing. Indonesian and Oman Governments issued sukuk with a total of 2.5 billion USD (DinarStandard, 2019) to finance infrastructure development. Considering the need for adequate infrastructure support and capital financing access development in Generation IV International Forum countries (World Bank, 2020), sukuk and Islamic finance can boost GVC development in the long term period.

Source: SESRIC (2019)

Figure 5. Global Sukuk Issuance (in Billion USD)
Effect of COVID-19 Pandemic on the Global Value Chain Development

The Novel Coronavirus Disease (COVID-19) outbreak has forced most countries to issue restrictions such as mandatory quarantine, international travel limitation, prohibition of public gathering, and business closure. These policies have proven effective in reducing the spread of COVID-19 (Hsiang et al., 2020; Chinazzi et al., 2020). However, such restrictions have also affected the economic and social activities worldwide due to diminishing production and decreased demand for several goods and services (Guan et al., 2020; Verschuur et al., 2021). Furthermore, the pandemic also turned some OIC countries into debts. For instance, Iran, Pakistan, and Nigeria received IMF loans to cope with the COVID-19’s side effects (Hossain, 2021).

The inevitable global economic downturn is aggravating GVC’s performance. In a more detailed explanation, most countries have experienced low productivity and workforce size resulting in the struggle of meeting global demand within the GVC framework (Hayakawa & Mukunoki, 2021). Nonetheless, the technological advancement creating consumptions’ disruption manages to hold the instability of consumer demands, especially in importing countries (Hayakawa & Mukunoki, 2020). This internet and digital technology provide society a way of demanding goods and services through online transactions. Therefore, the COVID-19 cases and death undermine the supply chain effect (Hidayat et al., 2021).

Conclusion

In regards to supplying on the literature scarcity of the concept of GVC from Islamic economy and financial perspectives, the author found that halal industry – the implementation of Islamic economic activities – offers a significant market share for GVC development. Even though there is a considerable challenge, i.e. the trade tariffs in OIC countries remain high because of the far distance between countries, OIC countries are committed to creating a harmonious policy particularly regarding halal standardization in the global halal industry enterprise sector of GVC. Meanwhile, the Islamic financial and banking sector's financial product diversification can help stabilize the global economy, including trade. This will encourage the GVC member countries' participation rate through infrastructure development and the availability of financing models via sukuk issuance and other Islamic financial products.

Furthermore, since theoretical concepts will perform better with some empirical justifications to make a robust concept, future research needs to be conducted using a quantitative method with statistical data analysis. Finally, the optimism of the Islamic economy and financial position in encouraging the participation rate of the GVC member countries is challenging if the GVC stakeholders do not see the importance of collaboration and cooperation between countries. The critical factor in improving GVC...
growth to help the global economy, create jobs, and reduce the unemployment and poverty rate is the significant participation of the 146 countries in GVC. Therefore, the reformation upon economy openness, harmonious policies, and supporting review implementation on GVC are vital to be conducted together.

**Author’s Declaration**

The author made substantial contributions to the conception and design of the study. The author took responsibility for data analysis, interpretation and discussion of results. The author read and approved the final manuscript.

**ORCID**

Laila Masruro Pimada [https://orcid.org/0000-0003-1980-0924](https://orcid.org/0000-0003-1980-0924)

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~312~


