

2016 | OIC ECONOMIC OUTLOOK

*Transforming the
Potentials into Impact*

ORGANISATION OF ISLAMIC COOPERATION

STATISTICAL ECONOMIC AND SOCIAL RESEARCH
AND TRAINING CENTRE FOR ISLAMIC COUNTRIES





OIC ECONOMIC OUTLOOK 2016



TRANSFORMING THE POTENTIALS INTO IMPACT

Organisation of Islamic Cooperation
Statistical, Economic and Social Research and
Training Centre for Islamic Countries



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ACRONYMS

ADB	Asian Development Bank
BIT	Bilateral Investment Treaties
BNEF	Bloomberg New Energy Finance
EBRD	European Bank for Reconstruction and Development
EDBI	Ease of Doing Business Index
EFTA	European Free Trade Area
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GCC	Gulf Cooperation Council
GCF	Gross Capital Formation
GDP	Gross Domestic Product
GER	Gross Enrolment Rate
GFCF	Gross Fixed Capital Formation
GNI	Gross National Income
HDI	Human Development Index
HIPC	Heavily Indebted Poor Countries
ICT	Information and Communication Technology
IDB	Islamic Development Bank
IFS	International Financial Statistics
ILO	International Labour Organisation
IMF	International Monetary Fund
IPR	Intellectual Property Rights
LAC	Latin America and the Caribbean
LDC	Least Developed Countries
MDB	Multilateral Development Bank

MENA	Middle East and North Africa
MGI	McKinsey Global Institute
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
OIC	Organisation of Islamic Cooperation
PISA	Programme for International Student Assessment
PPP	Purchasing Power Parity
PPPs	Public Private Partnerships
PRETAS	Preferential Tariff Scheme for TPS-OIC
PTA	Preferential Trade Agreement
R&D	Research and Development
RTA	Regional Trade Agreement
SDG	Sustainable Development Goal
SSA	Sub-Saharan Africa
SWFI	Sovereign Wealth Fund Institute
TPS-OIC	Trade Preferential System among the Member Countries of the OIC
UAE	United Arab Emirates
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific
UNESCO	United Nations Educational Scientific and Cultural Organization
UNSD	United Nations Statistics Division
UNWTO	United Nations World Tourism Organization
USD	United States Dollar
WB	World Bank
WDI	World Development Indicators
WEF	World Economic Forum
WTO	World Trade Organization

FOREWORD

Growth in the global economy continues to remain weak in the aftermath of the global financial crises in 2008, which increased only by 3.1% in 2015. The repeated poor performance of the global economy is largely influenced by the sharp decline in commodity prices, economic slowdown in China, negative macroeconomic outlook in Brazil and Russia and increasing concerns about the global security. Furthermore, the uncertainty caused by the decision of UK to leave the EU membership and the tighter financial conditions and large debts in many countries of euro area has further weakened the prospects for the global economic growth. Accordingly, the growth rate of the world economy is predicted to reach 3.2% by the end of the year.

Economic development trajectory of OIC countries has been highly volatile over the last decades, while the resulting development landscape of OIC countries is multifarious. In general, OIC member countries could not sustain long-term growth as developed countries did over the last century. The fact that economic performances of OIC member countries have been relatively weaker than the western countries due to diverse reasons does not imply that OIC countries do not have enough capacity and resources to perform better. It is just a matter of identifying the productive resources and potentials and then developing correct mechanisms and instruments to effectively utilize them in welfare improving economic activities. Each and every country has different resources and potentials to catalyse for their economic development programs. This report followed a broader approach and tried to identify the most common potentials of OIC countries that can be utilized for better economic performance.

In this connection, this report identified three major factors that can potentially contribute to achieving better economic performance and living standards. These were dynamic population structure, rich energy resources and great market potential. In all these areas, the report provided some preliminary assessment on the significance of these resources and potential contributions that they can make to socio-economic development in OIC countries. It was also noted that reckless consideration of these resources and potentials may equally deteriorate already existing level of development, transforming the potentials into threat rather than strength.

Amb. Musa Kulaklıkaya
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EXECUTIVE SUMMARY

Recent Economic Developments in the World and OIC Countries

Production, Growth and Employment

Production

Global GDP – expressed in current USD and based on PPP – has witnessed an increasing trend over the period 2011-2015, reaching to US\$ 113.5 trillion in 2015 compared to US\$ 94.2 trillion in 2011. Developing countries witnessed more rapid increase in GDP from US\$ 51.5 trillion in 2011 to US\$ 65.3 trillion in 2015. Total GDP of developed countries was recorded at US\$ 48.2trillion in 2015 compared to US\$ 42.7 trillion in 2011. OIC countries also witnessed an increasing trend in economic activity and their GDP increased from US\$13.9 trillion in 2011 to US\$ 17.1 trillion in 2015. As a group, the OIC countries produced 15.0% of the world total output and 26.1% of that of the developing countries in 2015. In current prices, the share of OIC countries in world total GDP is measured as only 8.6%. The average GDP per capita in OIC countries also increased from US\$ 8,988 in 2011 to US\$ 10,224 in 2015.

Growth

The slowdown in the global economy continued in 2015 with growth rate plunging down to 3.1%. However, the outlook for 2016 and 2017 is positive with expected growth rates of 3.2% and 3.5%, respectively. While the recovery in the developed countries remained slow, the developing countries seem to be the driving force of the growth in the world economy. On the other hand, the global per capita GDP growth has also witnessed a declining trend with 2.2% growth rate in 2015 and it is forecasted to reach 2.3% in 2016 and 2.7% in 2017. In 2015, growth in GDP per capita was recorded at 2.9% in developing countries and expected to increase to 3.0% in 2016 and 3.6% in 2017. On the other hand, the developed countries witnessed a comparatively very low growth rate of 1.3% in their GDP per capita in 2015, which is estimated to increase to 1.4% in 2017. OIC countries also witnessed a slowdown in their economic activity and their average growth rate declined from 3.9% in 2014 to 3.4% in 2015. They are forecasted to grow at an accelerated rate in 2016 and 2017 with average

growth rates of 3.6% and 4.0%, respectively. The average growth rate of the real per capita GDP in OIC countries has decreased during the period 2011-2015, which was recorded at 1.5% in 2015 but forecasted to bounce back to 1.7% in 2016 and 2.1% in 2017.

Production by Sectors

In terms of the average shares of the value-added of the four major sectors in the global GDP in 2014, service sector recorded the largest share with 66.0%, followed by the industrial sector (both manufacturing and non-manufacturing) with 29.5%, while the share of agriculture, fishing and forestry was relatively small (4.5%). A similar structure has been also observed in the case of OIC countries as a group. The average share of agriculture in OIC economies has gradually declined from 11.8% in 2000 to 10.1% in 2014. Similarly, in non-OIC developing countries, the average share of agriculture in the economy has decreased from 10.7% in 2000 to 8.9% in 2014. Services sector accounted for 48.8% and industry sector (manufacturing and non-manufacturing together) accounted for 41.1% in OIC countries, which was respectively 53.9% and 37.3% in non-OIC developing countries.

GDP by Major Expenditure Items

When the shares of the major expenditure items in the total GDP are considered, final household and government consumption continued to be the highest in the total GDP over the years. In 2014, the global household consumption accounted for the lion share of 57.4% followed by gross capital formation (25.0%) and general government final consumption (16.8%). The relative shares of the major expenditure items in the total GDP of OIC countries registered significant variation from the world. In 2014, final household and general government spending accounted for 69.2% of the total GDP of OIC countries. These figures marked an increase in the shares of both consumption types compared to the previous two years.

Unemployment

Unemployment is one of the most serious problems facing the world today. Despite recovery in the economic activities lately, the global unemployment rate for adults has risen to 5.8% of the total labour force. The number of unemployed people around the world is estimated at 197.1 million in 2015, with less than 1 million additional unemployed compared with the previous year and about 27 million more compared with the pre-crisis level in 2007. Youth continued to suffer from lack of decent job opportunities across the globe. According to the latest estimates, some 73.4 million young people were unemployed in 2015. OIC countries recorded significantly higher average unemployment rates compared to the world and non-OIC developing countries during the period 2000-2015. During this period, total unemployment rates in OIC countries changed between 8.1% and 7.5%. After the global financial crisis, unemployment rates in developed countries increased from a level below 6% to over 8%. During the period 2009-2013, average unemployment rate in developed countries remained higher than the rate in OIC countries. In 2014, developed countries managed to lower the rate again below the rate observed in OIC countries. As of 2015, OIC countries recorded a rate of 7.5%, while it is estimated at 6.8% in developed countries. Average unemployment rate in non-OIC developing countries remained significantly lower than the OIC average during the whole period under consideration (between 2% to 3%). The

figures on youth unemployment in OIC countries are even less promising. As of 2015, youth unemployment in OIC countries estimated at 16.1%, compared to 16.0% in developed countries and 11.6% in non-OIC developing countries.

Labour Productivity

Globally, labour productivity has witnessed an increasing trend during the period 2010-2015. The average global output per worker has increased from US\$ 29,003 in 2011 to US\$33,237 in 2015. During this period, labour productivity in OIC countries, in terms of average output per worker, has increased from US\$ 22,815 in 2011 to US\$ 25,613 in 2015. The labour productivity gap between the developed and developing countries remained substantial throughout this period as output per worker in the developed countries was estimated at US\$ 91,294 in 2015 compared to just US\$ 21,731 in non-OIC developing countries.

Inflation

During the period under consideration, inflation was on the decline across the globe reflecting primarily the impact of decline in prices for oil and other commodities, and weakening demand in some advanced economies. The latest estimates show that global inflation rate has decreased from 5.1% in 2011 to 2.8% in 2015; and it is expected to remain at 2.8% in 2016. Price volatility remained a concern for but a more challenge for developing countries but not for developed countries. Inflation rate in 2016 is expected to be at 0.7% in developed countries and at 7.4% in non-OIC developing countries. In the OIC countries, average inflation rate for 2011 was higher than the average of the developed and developing economies. However, in line with the global trends, inflation in the OIC countries declined from 7.6% in 2011 to 5.9% in 2015.

Fiscal Balance

In the wake of tightening policies implemented especially in the developed countries and sharp decline in commodity prices especially for oil, fiscal balances are showing a mix trend across the world. World fiscal deficit as percentage of GDP witnessed an increase from -3.5% in 2011 to -4.0% in 2015. In the group of developed countries, the fiscal balance deficit as percentage of GDP has declined from -6.2% in 2011 to -2.9% in 2015. Developing countries have also recorded fiscal deficits but remained relatively in better position than the developed countries until 2015. In the OIC countries, fiscal surplus was recorded for the year 2011 and 2012; however this trend was reversed amid the sharp decline in oil prices. As a group OIC countries recorded fiscal deficit -6.0% of GDP in 2015 and it is expected to increase in 2016.

Trade and Finance

Merchandise Trade

Total merchandise exports from OIC countries fell for three consecutive years and contracted to US\$ 1.6 trillion in 2015, compared to their historically highest level of US\$ 2.3 trillion observed in 2012. Accordingly, the share of OIC countries in total exports of developing countries declined to 24.3% in the same year, compared to 30.5% in 2012. Similarly, after its peak of

12.7% in 2012, the share of OIC countries in the total world merchandise exports, which was recorded at US\$ 16.4 trillion, decreased to 9.9% in 2015, lowest share measured since 2005.

Total merchandise imports of OIC countries experienced a strong post-crisis bounce-back and increased from \$1.2 trillion in 2009 to \$2.0 trillion in 2014. However, OIC countries also witnessed a fall in imports in 2015, which decreased to US\$ 1.8 trillion. The share of OIC countries in global merchandise imports reached 11.1% in the same year. Their share in total developing country merchandise imports, on the other hand, sustained its expansion for three successive years since 2011 and reached 28.4% in 2015.

Services Trade

The OIC countries as a group continued to be net importer of services. They collectively exported US\$ 304 billion worth of services in 2015 and imported US\$ 517 billion in the same year. Between 2009 and 2014, services trade volume of OIC countries exhibited a constant increase, but the year 2015 witnessed a fall in both exports and imports of services. Accordingly, OIC shares in developing country services exports and imports dropped to 23.2% and 30.3% in 2014. While the collective share of OIC member countries in the total world services exports fell from 6.5% in 2009 to 6.3% in 2015 and their share in the total world imports increased from 10.5% to 10.9% during the same period.

Intra-OIC Merchandise Trade

OIC countries registered a total of US\$ 709 billion intra-OIC merchandise trade in 2015. In the post-crisis period, intra-OIC trade registered a relatively stronger upturn compared to the OIC countries' trade with the rest of the world. Accordingly, as of 2015, intra-OIC trade accounted for 20.6% of OIC countries' total merchandise trade. Intra-OIC exports were recorded at US\$ 339 billion in 2015, as compared to US\$ 375 billion in 2014. Intra-OIC imports, on the other hand, were recorded at US\$ 370 billion in 2015, registering a major decrease compared to its value of US\$ 400 billion observed in 2014.

FDI Flows and Stocks

World total FDI inflows stood at US\$ 1.76 trillion in 2015, of which 45.4% was attracted by developing countries. FDI flows to OIC countries, on the other hand, continue to remain below its potential. In 2015, OIC countries were able to attract only US\$ 116 billion in FDI, compared to US\$ 136 billion in 2013. The shares of OIC countries in both developing countries and global FDI inflows were recorded at 14.6% and 6.6% in 2015, respectively. Of US\$ 24.9 trillion global inward FDI stock in 2015, OIC countries hosted only 7.1%. Intra-OIC FDI instocks went down from US\$ 97.8 in 2013 to US\$ 84.1 billion in 2014. In a similar vein, intra-OIC FDI inflows slightly decreased from US\$ 8.8 billion in 2013 to US\$ 8.7 billion in 2014. As of 2014, both intra-OIC FDI inflows and instocks continued to stay lower than their peak values recorded in 2008 and 2010, respectively.

Financial Sector Development

The level of financial sector development in OIC countries remains shallow. As a sign of low financial deepening, the average volume of broad money relative to the GDP in OIC countries was 62.3% in 2015, compared to 139% in non-OIC developing countries and 116.2% in the world. In the same year, the domestic credit provided by the financial sector in OIC countries

was on average equivalent to 59.7% of the GDP whereas this figure was 137.6% in non-OIC developing countries and 205% in developed countries.

External Debt and Reserves

The total external debt stock of OIC countries continued to increase and it reached US\$ 1.5 trillion in 2014. Average debt-to-GDP for the indebted OIC countries increased to 22% in 2014 compared to 18.7% in 2011. During the same period, total external debt stock of OIC countries as percentage of total developing countries debt decreased slightly from 28.8% to 28.2%. Reserves are usually considered as an important instrument to safeguard the economy against abrupt external shocks. World total monetary reserves, including gold, reached US\$ 10.6 trillion in 2015, of which US\$ 1.5 trillion are owned by OIC countries. The share of OIC countries in total reserves of the developing countries declined from 23.6% in 2013 to 21.7% in 2015.

ODA and Remittances

In 2014, net ODA flows from all donors to developing countries reached US\$ 100.8 billion. In the same year, OIC countries, with US\$ 53.8 billion, accounted for 53.3% of the total ODA flows to developing countries. In 2014, the top 5 member countries received 36.5% of total ODA flows to OIC countries whereas the top 10 received 59.4% of them. The inflows of personal remittances to OIC member countries increased from US\$ 110 billion in 2011 to US\$ 133 billion in 2014, but sharply declined to US\$ 66.4 billion in 2015. Remittances flows to non-OIC developing countries followed a similar pattern during the same period, which increased from US\$ 238 billion in 2011 to US\$ 272 billion in 2014, but decreased to US\$ 209 billion in 2015.

Transforming the Potentials into Impact in OIC Countries

Exploring Potentials of OIC Countries with Economic Impact

A large variation has been observed in the growth experiences of different countries over time. While some countries experienced sustained growth for more than a century and became enormously wealthy, some others continue to live close to subsistence level. There are several factors identified in the literature in explaining the divergent growth experiences of countries over the years. It is important that whatever initial endowments countries possess should be utilized in a way they promote productive capacities of production factors.

This section identifies some potential areas where OIC countries have relatively stronger position vis-à-vis the rest of the world, effective utilization of which may result in higher economic growth rates. The potential strengths of OIC countries in terms of growth and development are explored under five categories: human capital, natural resources, knowledge capital, social capital and economic geography. Based on the assessment of potential strengths of OIC countries, the report identifies three major potentials for OIC countries that should be managed and coordinated for stronger and better economic performance. These are dynamic population structure, rich energy sources and great market potential. The rest of the report specifically concentrates on these topics in order to provide some deeper insight on how to utilize these important potentials. Social capital has been traditionally a strong asset of Muslim communities, but current indicators reveal serious

deterioration in this area. Once critical interventions are made, it can be also an important stimulus for socio-economic development in OIC countries in near future.

Dynamic Population Structure

Economic activities are highly influenced by demographic structure of a society. The proportion of population in each age group has implications on savings behaviour, participation to labour market, investment and expenditure decisions. These in turn affect the economy through its impact on real output growth, productivity, inflation and interest rates. Young people are more likely to engage in investment in their own skills as well as other productive assets in an effort to achieve a wealthier future. Well educated young population with good prospects in the labour market are likely to make significant contribution to overall economic development.

With a population of 1.28 billion people, OIC countries were accounting 21.1% of total world population in 2000. Until 2050, it is estimated that this share will increase to 29.5%, with a 2.9 billion population. By the end of the century, 4 out of 11.2 billion world populations will be residing in OIC member countries, further increasing their share to 36%. Increasing share of OIC countries in total world population and relatively faster ageing of population in non-OIC countries will also influence the world demographic structure in favour of OIC countries. The share of OIC countries will increase in all age groups, but the highest levels will be observed in younger age groups. By 2050, OIC countries will account for 36.9% of children aged 14 and below in the world. Similarly, 34.1% young people aged 15-29 in the world will be residing in OIC countries.

This creates opportunities as well as challenges and threats for the relevant OIC member countries. In this fashion, having a very dynamic population structure, OIC countries need to adopt effective policies and programmes to increase the capacities and skills of the young population and boost their contribution to national economies before the demographic structure becomes unsupportive of better economic performance.

A straightforward approach to utilizing this potential is to endow the youth with the skills and capabilities and give them opportunities to realize their true potential in their field. In generic terms, there is a need to provide good education and employment opportunities. It may be easier said than done. Governments face multiple challenges and resource constraints in creating appropriate conditions for quality education with good labour market perspective. Effective use of limited resources for better education opportunities and improved business climate cannot be granted due to various inefficiencies and limited capacities in the existing implementation mechanisms in some countries.

Young people graduates from education institutions with a set of skills, which has direct consequences on their level of employability. Primary responsibility of governments is to ensure that these skills sets are demanded by the labour market to the extent possible. When young people enter into labour market, it is important to ensure that there are jobs available that can benefit from the skills and capabilities of young graduates. In order to encourage young people to invest in their human capital, opportunities for entrepreneurship and shift in their economic status should be provided.

Rich Natural Resources

Several OIC countries in different geographic regions have utilized rich natural resources (especially gas and oil) during their course of development that enabled some of them to reach high-income country status. In 2014, 23.1% of all mineral fuels and 15.8 of all industrial minerals production in the world were originated from OIC countries. OIC countries altogether possessed 58.5% of the world's total proved crude oil reserves in 2015 and supplied 41.5% of the world's total oil production. The share of OIC countries in the worldwide proved gas reserves reached 58.8% in 2015 and 36% of the world's total natural gas production stemmed from OIC countries. On the other hand, 52.7% of all uranium, a raw mineral used in nuclear power plants, production in the world came from OIC countries in 2014.

With respect to use of natural resources in energy production, OIC countries provide a mix picture. 84.0% of all electricity production in OIC countries stemmed from fossil fuels (54.2% natural gas, 15.9% oil, 13.9% coal) in 2013 where the world average use of fossil fuels was amounted to 66.6%. The contribution of hydropower into electricity production was amounted to 11.0% in the OIC group where the world average was equal to 16.3%. All other types of renewable energy sources made a negligible contribution (1.1%) into the total electricity production of the OIC group. In non-OIC developing countries, the share of renewable energy sources (excluding hydro) in total electricity production was measured at 4.6% (more than 4 times higher than the OIC average) in 2013. If hydropower is added into calculation, developed countries generated almost 28.5% of their total electricity from renewable resources. This share was measured to be only 12.1% in the OIC group. Only 4 OIC countries have installed capacity to generate electricity from solar power in 2015. In total, 7 OIC countries were able to produce electricity from wind energy as of 2015. Pakistan and Iran were the only OIC countries that reported to have nuclear power plants to generate electricity.

Many OIC countries have benefited extensively from their natural resources in their course of development especially those endowed with rich fossil fuels and other minerals. Such natural resources offer great potential for fostering development. However, the figures revealed the underutilization of natural resources to a greater extent in OIC countries that slows down the pace of development. In particular, if OIC countries can activate the potential of renewable energy, it may be helpful for improving energy security, diversifying energy sources, mitigating environmental effects, scaling up access to electricity, and achieving energy efficiency.

Great Market Potential

A broad analysis on market potential reveals that OIC countries the total market potential of OIC countries reached to USD 1.13 trillion in 2014 from USD 0.6 trillion in 1991, with a total increase of 87%. On the other hand, the market potential of OIC countries accounted increasingly for greater share of world market potential, which increased to 25.6% in 2014 from its level of 24.3% in 1991. Moreover, intra-OIC market potential has almost tripled during the last 25 years, while it has increased only 70-75% between OIC and non-OIC

countries as well as among non-OIC countries. However, total intra-OIC market potential with a total value of USD 179 billion accounts only 5.5% of total world market potential as of 2014.

Despite the rapid growth in the market potential of OIC countries, their share in global market is still low compared to their share in world production. Effective utilization of existing market potential will help to expand it to even higher levels. In this connection, the report analyses the barriers and opportunities for how to utilize the existing market potential for more trade and investment.

Over the last 25 years, trade among OIC countries has grown at a faster rate compared to their trade with non-OIC countries. Total value of intra-OIC exports increased from USD 13 billion to USD 235 billion during this period, reflecting 17 times increase in value. Despite the increase in the share of intra-OIC exports, there are major barriers to trade among the OIC member countries. A major barrier is high level of trade costs. In 2012, trade costs in OIC countries (179% ad valorem) were on average two times higher than those in developed countries (86% ad valorem). Moreover, by applying an average of 7.4% tariff rate, OIC countries reveal a more protectionist picture when compared to the averages of developed countries (1.4%) and non-OIC developing countries (5.5%).

Given the existing levels of trade barriers, there is a need to increase partnership to ease trade among the OIC member countries. The constantly increasing number of regional trade agreements (RTAs) and preferential trade arrangements (PTAs) is a prominent feature of international trade. As of February 2016, some 625 RTAs had been recorded by the GATT/WTO, 419 of which are in force. OIC countries are also quite active in RTAs. There are 502 country pairs in the OIC region with a RTA. However, the number of trade agreements with non-OIC countries is increasing at a much higher rate. This implies that there is a need to adapt new mechanisms to strengthen partnership among OIC countries.

Export structure of OIC countries is highly concentrated on few product groups, mainly minerals and primary commodities. When the export structure is not diversified enough, it is practically difficult to find opportunities for more trade. In fact there are good opportunities for bilateral trade among OIC countries. If necessary policy measures are taken to reduce trade barriers and facilitate trade among the member countries, diverse structure of OIC economies may be driver of strong economic growth and development in the OIC region through higher economic integration.

Another important aspect of utilizing great market potential is increasing investment among the member countries. Higher market potential is associated with more investment inflows, because it allows for easy access to customers and suppliers for multinational enterprises and also allows for economies of scale that reduces the production and operation costs remarkably. Higher investment flows enhance economic cooperation among the countries. Similarly, a higher volume of intra-OIC FDI inflows implies the existence of stronger economic ties among OIC countries. Over a decade, intra-OIC investment flows have increased 9 times to reach USD 15.6 billion. The increase in investment stocks was more substantial. It surged to USD 95.3 billion from its level of USD 2.8 billion just a decade ago. This reflects an improved economic integration among OIC countries. Nonetheless, it is fair to claim that these figures are being far from their potential. The share of intra-OIC investment in total world investment flows is only 1.1%, which was merely 0.2% a decade ago.

Therefore, more policy-interventions are needed to reduce intra-OIC investment barriers. These interventions should not be only limited with the free movement of capital across the borders of OIC member countries but also need to address the restrictive visa regimes applied to citizens of OIC countries by other OIC countries since foreign investors usually look for easy labour mobility across borders. It is important for OIC countries to recognize that there is a great potential in terms of intra-OIC investment, which can boost economic growth and trigger development in OIC countries. However, existing barriers in OIC countries ahead of investors in terms of institutional quality, visa regimes, restrictions on profit and capital transfers etc., limits the level of economic cooperation among OIC member countries.

Policy Issues for Transforming the Potentials for Impact

In general, OIC member countries could not sustain long-term growth as developed countries did over the last century. The fact that economic performances of OIC member countries have been relatively weaker than the western countries due to diverse reasons does not imply that OIC countries have enough capacity and resources to perform better. It is just a matter of identifying the productive resources and potentials and then developing correct mechanisms and instruments to effectively utilize them in welfare improving economic activities. Each and every country has different resources and potentials to catalyse for their economic development programs. This report followed a broader approach and tried to identify the most common potentials of OIC countries that can be utilized for better economic performance.

In this context, the report focused on three major factors that can potentially contribute to achieving better economic performance and living standards. These were dynamic population structure, rich energy resources and great market potential. In all these areas, the report provided some preliminary assessment on the significance of these resources and potential contributions that they can make to socio-economic development in OIC countries. It was also noted that reckless consideration of these resources and potentials may equally deteriorate already existing level of development, transforming the potentials into threat rather than strength.

Most of the OIC countries have a young and dynamic demographic structure. Labour is traditionally one of the critical components of economic growth. In today's world, labour force is an asset but it becomes valuable for production process only if it is endowed with technical knowledge and capabilities to undertake complex tasks. Therefore, having bulk of youth population is not an advantage *per se*. In fact, the policy proposal for unleashing productive capacity of youth is very straightforward: provide quality education and create appropriate employment opportunities. The impact of human capital becomes strong when enough attention is paid to education quality instead of mere school attainment. Cognitive skills of young people will facilitate the economic development if they are utilized in productive production processes of goods and services. This will also improve their individual earnings and overall welfare distribution.

Rich natural resources are another potential contributor to economic development in OIC countries. Given the recent updates in the international development agenda, it is very timely for OIC countries to re-consider their energy policy and vision documents with a view to align

them with Sustainable Development Goals (SDGs) and OIC Ten-Year Programme of Action (TYPO), and enhance intra-OIC cooperation. As indicated by statistics, OIC countries are far from reaching their full potential in use of rich natural resources in a sustainable manner. Majority of natural resources and minerals are either stays unexploited or exported in raw form with a little value-added. Nevertheless, for diversification of energy sources and activating the full potential of renewable energy sources, OIC countries are in need of a paradigm shift from ‘development’ to ‘sustainable development’. OIC countries also need to focus on policies to increase the added value of extractive minerals rather than just investing into scaling up of existing production capacities. It is also highly critical for OIC countries to revisit the importance of nuclear technology where developed countries, on average, meet more than 19% of their total electricity production from nuclear power stations. In fact to achieve diversification of energy sources, exploit the full potential of (renewable) energy sources and reduce carbon foot-print, OIC countries have some window of opportunities such as existing large-scale sovereign wealth funds and major investor companies in the energy sector. Under a well-articulated framework coupled with wise political leadership, it is likely that many OIC countries can succeed the transformation in their energy sector where all stakeholders may be better-off.

The ability to access large markets is one of the most critical factors in shaping trade and investment decisions of private sector. Almost all OIC member countries have land or sea connection with another OIC member country. If artificial barriers that reduce the connectivity among the member countries are eliminated or significantly reduced, OIC region would provide an important opportunity for investors and traders. Market potential of OIC countries is rapidly increasing due to growth in economic activities as well as continuously increasing share of OIC countries in world total population. Supported with other policy reforms, 57 member countries, with an economically dynamic young population and high demand for almost everything from infrastructure development to consumer goods, will definitely attract more investors and increase their share in world trade.

Part I

RECENT ECONOMIC DEVELOPMENTS IN THE WORLD AND OIC COUNTRIES



This part includes:

1. Production, Growth and Employment
2. Trade and Finance

PART I

This part analyses the trends in major economic indicators in the OIC member countries, as a group, during the latest five-year period (2011-2015) for which the data are available. It investigates these trends in a comparative manner with their counterparts in the groups of the developed and other developing countries as well as with the world average and highlights a number of constraints and challenges confronting the OIC member countries in their efforts towards enhancing their economic development and progress.

The first chapter of this Part evaluates the developments in production, growth and employment. This includes GDP, GDP per capita, GDP growth, decomposition of GDP, inflation, fiscal balance, labour force participation and unemployment. The second chapter deals with trade and finance indicators, including exports and imports of goods and services, intra-OIC trade, current account balance, foreign direct investment flows, financial sector development, external debt and reserves, and official development assistance and remittances.





Section 1

Production, Growth and Employment

Figure 1.1a: Gross Domestic Product, PPP Current USD (2015)

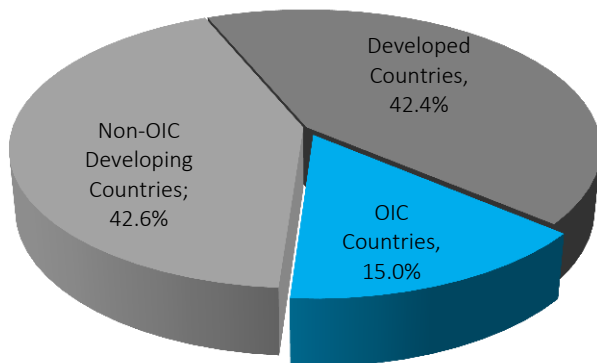
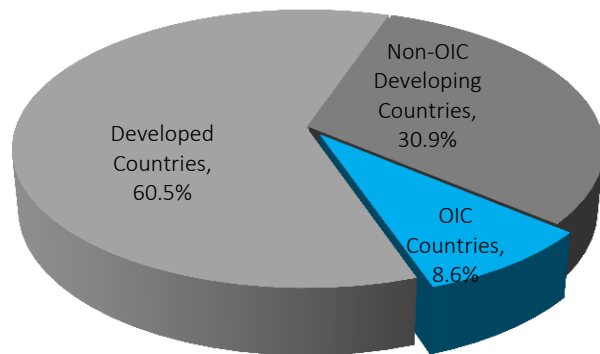


Figure 1.1b: Gross Domestic Product, Current USD (2015)



Source: IMF WEO Database April 2016.

PRODUCTION

Contribution of the OIC member countries to the global output remains below potential

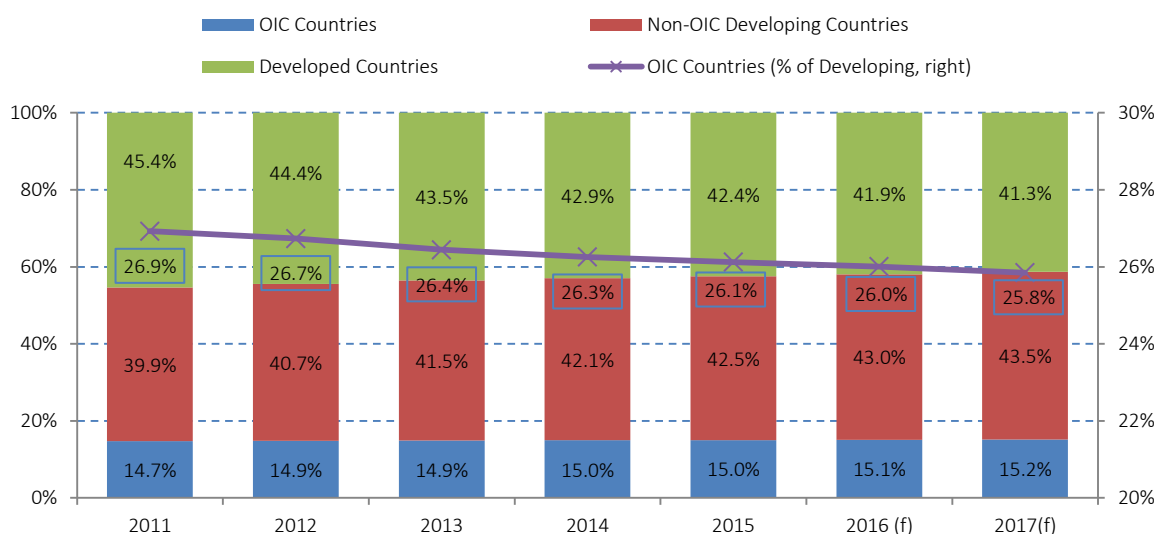
The group of OIC countries are well-endowed with potential economic resources in different fields and sectors such as agriculture, energy, mining and human resources, and they constitute a large strategic trade region. Yet, this inherent potential does not manifest itself in the form of reasonable levels of economic and human development in many individual OIC countries as well as in the OIC countries as a group. In 2015, having accounted for 23.6% of the world total population, OIC member countries produced as much as 15.0% of the world total GDP – expressed in current USD and based on PPP (Figure 1.1a). When measured in current prices, however, OIC member countries account only 8.6% of global production in 2015 (Figure 1.1b).

The global economic activity landscape has witnessed pivotal shift over the past several years and the dominance of developed countries group as the leading producer is on

decline. During the period under consideration, the share of developing countries in global output has witnessed an upward trend increasing from 54.6% in 2011 to 57.6% in 2015. The estimates show that the share of developing countries will climb up to 58.7% by the end of 2017. During the same period, the share of developed countries has declined from 45.4% in 2011 to 42.4% in 2015 and it is expected to decrease further to 41.3% by the end of 2017.

Over the last 5 years, the group of OIC countries has increased its share in the world output only by 0.3 percentage point to reach 15.0% in 2015 (Figure 1.2). Considering the fact that the individual countries such as United States and China had higher shares than that of the OIC countries as a group (15.8% and 17.1%, respectively in 2015), it can be stated that the contribution of the OIC countries to the world output is below their potential. On the other hand, the share of the OIC countries in the total GDP of developing countries has declined steadily and was recorded at 26.1% in 2015, a decrease by 0.8 percentage points over the 5-year period under consideration (Figure 1.2).

Figure 1.2: Gross Domestic Product, PPP Current USD



Source: IMF WEO Database April 2016, (f: forecast).

The decline in the share of the OIC countries in total GDP of the developing countries indicates that the OIC economies have performed poorer than non-OIC developing countries in expanding their output. Although the projections for 2016 and 2017 indicate that the GDP of the OIC countries as a whole will continue to grow, it is predicted that the share of the OIC countries in the world output will be stable around 15.1% in 2016 and 15.2% in 2017. However, the share of the OIC countries in the total output of the developing countries is estimated to shrink further to 26.0% in 2016 and 25.8% in 2017 (Figure 1.2).

PRODUCTION

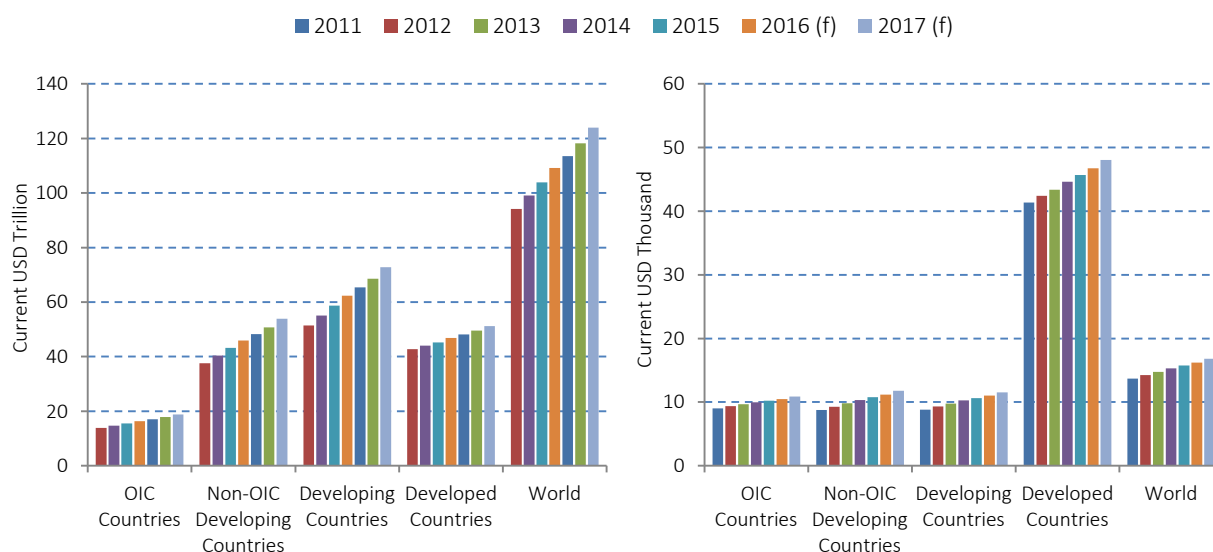
Share of OIC countries in total world GDP remained at 15% in 2015

Global GDP – expressed in current USD and based on PPP – has witnessed an increasing trend over the period 2011-2015, reaching US\$ 113.5 trillion in 2015 compared to US\$ 94.2 trillion in 2011 (Figure 1.3, left). During

the same period, developing countries witnessed more rapid increase in GDP as the total GDP in these countries climbed up from US\$ 51.5 trillion in 2011 to US\$ 65.3 trillion in 2015. On the other hand, developed countries witnessed comparatively a moderate increase as their GDP reached US\$ 48.2 trillion in 2015 compared to US\$ 42.7 trillion in 2011. During the same period, the average GDP per capita in the world – expressed in current USD and based on PPP – has increased continuously and reached US\$ 15,736 in 2015, compared to US\$ 13,711 in 2011 (Figure 1.3, right). Meanwhile, in 2015 GDP per capita was recorded at US\$ 45,693 in developed countries and US\$ 10,607 in developing countries. In other words, GDP per capita in developed countries is about 4.3 times higher than that in developing countries. This huge gap between developing and developed countries is expected to continue in coming years.

On the other hand, the global economic activity landscape has witnessed pivotal shift over the past several years and the dominance of developed countries group as the leading producer is on decline. During the

Figure 1.3: Total GDP (left) and GDP per capita (right), based on PPP



Source: SESRIC staff calculations based on IMF WEO Database April 2016, (f: forecast).

period under consideration, the share of developing countries in global output has witnessed an upward trend increasing from 54.6 % in 2011 to 57.6% in 2015. The estimates show that the share of developing countries will climb up to 58.7% by the end of 2017. During the same period, the share of developed countries has declined from 45.4% in 2011 to 42.4% in 2015 and it is expected to decrease further to 41.3% by the end of 2017.

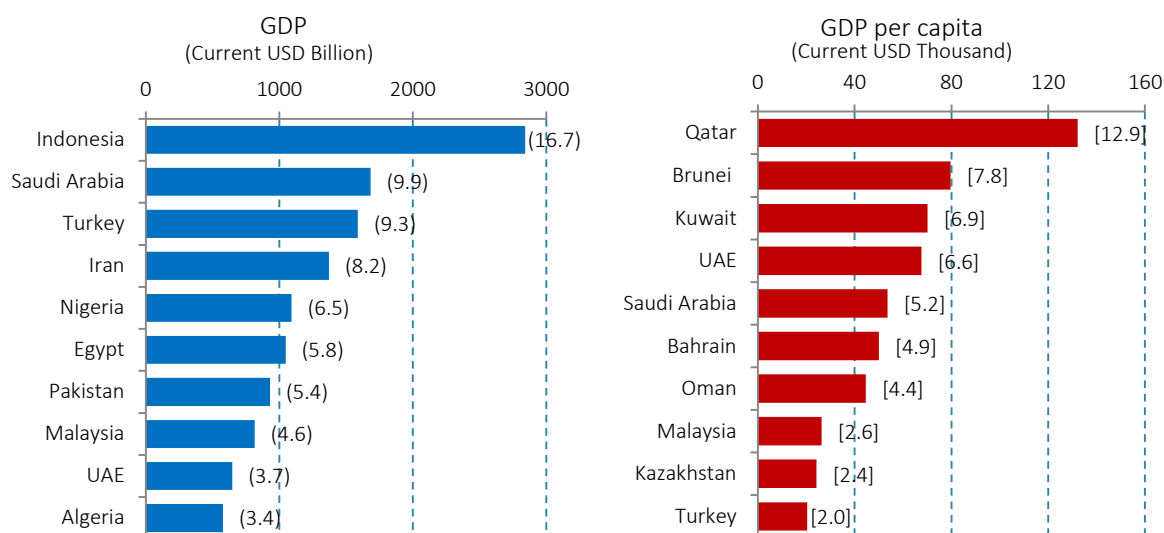
GDP PER CAPITA

The gap between average GDP per capita in OIC countries and the world continued to diverge

OIC countries also witnessed an increasing trend in economic activity and their GDP increased from US\$ 13.9 trillion in 2011 to US\$ 17.1 trillion in 2015. During the same period, non-OIC developing countries experienced a more rapid increase in their output as the total GDP in these countries reached US\$ 48.3 trillion in 2015, a level which is well above the US\$ 37.6 trillion they

recorded in 2011. Though the share of OIC countries in the world total GDP remained stable at around 15.0%, their share in the total GDP of developing countries group has declined steadily and was recorded at 26.1% in 2015, a decrease by about one percentage point over the 5-year period under consideration. During the same period, the average GDP per capita in the OIC countries has increased continuously and reached US\$ 10,224 in 2015, compared to US\$ 8,988 in 2011 (Figure 1.3, right). The gap between the average per capita GDP levels of the OIC member countries and those of non-OIC developing countries has widened over the years. During the 2011 and 2012, average GDP per capita in the OIC countries was higher than the non-OIC developing countries. However, the situation was reversed from 2013 onward and the average per capita GDP differential between OIC countries and non-OIC developing countries was recorded at US\$ 526 in 2015. The latest estimates show that this gap is expected to worsen in coming years. During the same period, the average GDP per capita in the OIC

Figure 1.4: Top 10 OIC Countries by GDP and GDP per capita (2015)



Source: IMF WEO Database April 2016 and SESRIC BASEIND Database. The numbers in round (square) brackets on left (right) hand side indicate the share (ratio) of the related country's GDP (GDP per capita) in the overall GDP (to the average GDP per capita) of the OIC countries as a group.

countries has also diverged from the world average as the gap increased from US\$ 4,723 in 2011 to US\$ 5,512 in 2015.

Furthermore, it is observed that the total GDP of the OIC countries is still produced by a few member countries. In 2015, the top 10 OIC countries in terms of the volume of GDP produced 73.8% of the total OIC countries output (Figure 1.4, left). Indonesia has the highest share in OIC GDP (16.7%) followed by Saudi Arabia (9.9%), Turkey (9.3%) and Iran (8.0%). The overall economic performance of the group of OIC member countries remained highly dependent on the developments in these ten countries. As a matter of fact, fuel is the main source of export earnings for 5 out of these 10 OIC countries; namely Saudi Arabia, Iran, Nigeria, United Arab Emirates and Algeria.

Among the OIC countries, Qatar registered the highest GDP per capita in 2015 followed by Brunei, Kuwait and United Arab Emirates (Figure 1.4, right). The per capita GDP of Qatar was 13 times higher than the average of the OIC countries as a group, a situation

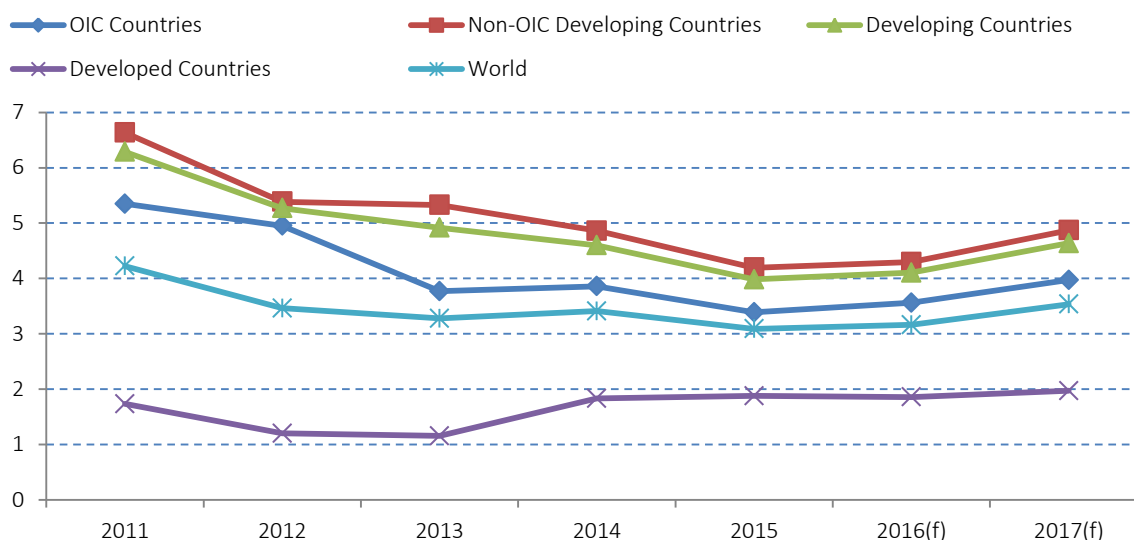
which reflects a high level of income disparity among the OIC countries. Among the top 10 OIC countries by GDP per capita 6 are from the Middle East region. Furthermore, in 2015, Qatar was ranked first, Brunei was ranked 5th, Kuwait was ranked 6th and United Arab Emirates was ranked 8th among the 186 countries in the world in terms of their per capita income levels.

GDP GROWTH

Global economy continued to slow down and grew only by 3.1 % in 2015

After bottoming out in 2009, global economy has since been experiencing positive growth rates. So far, recovery in global economy has mainly stemmed from positive economic growth rates occurred in developing countries. Though the global economic recovery continued since 2009, GDP growth rate has witnessed a declining trend in the recent years (Figure 1.5). In 2013, the world

Figure 1.5: GDP Growth in the World



Source: SESRIC staff calculations based on IMF, World Economic Outlook, April 2016.

economic growth rate was recorded at 3.3 % compared to 4.2% in 2011. Growth in the global economy slightly increased to 3.4% in 2014, which could not be sustained and declined to 3.1% in 2015. The consecutive poor performance of the global economy is largely influenced by the economic slowdown and rebalancing in China, historic sharp decline in commodity prices, especially for oil, severe macroeconomic conditions in Brazil and Russia and increasing concerns about the lack of macro policy space in emerging and developing economies. Furthermore, the uncertainty caused by the UK's referendum on EU membership and the risks of a deanchoring of inflation expectations coupled with the tighter financial conditions and large debts in many countries of euro area, has further hampered the prospects for the global economic growth (IMF, 2016). After demonstrating signs of recovery at the beginning of 2016, the growth rate of the world economy is predicted to reach 3.2% by the end of the year. The positive economic outlook for the USA and Euro area in 2016, supported by the decline in oil prices, seems to fuel the world economic growth. As a result, by following

the positive momentum in 2016, it is predicted that the global economy will grow by 3.5% in 2017 (Figure 1.5).

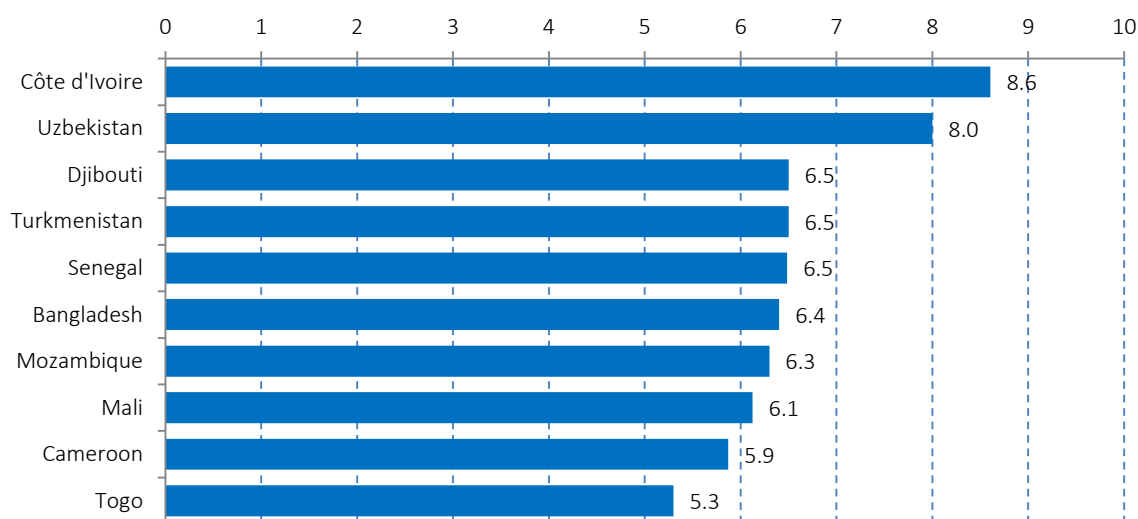
In general, developing countries have fuelled the world output growth rate since 2011, but the growth rates in these countries are steadily declining. While major developed economies remained sluggish, their overall growth performance started to improve. Nevertheless, developing countries are expected to grow by 4.0% in 2015, which is almost two percentage points higher than the developed countries, and will continue to be the engine of the growth in the world economy. Developing countries are expected to see an increase in the average growth rate that will climb up from 4.1% in 2016 to 4.6% in 2017.

GDP GROWTH

Growth rates in OIC countries continued to decelerate since 2011

The GDP growth of OIC countries has slowed down to 3.4% in real terms in 2015, as

Figure 1.6: Top 10 OIC Countries in terms of GDP Growth Rate (2015)



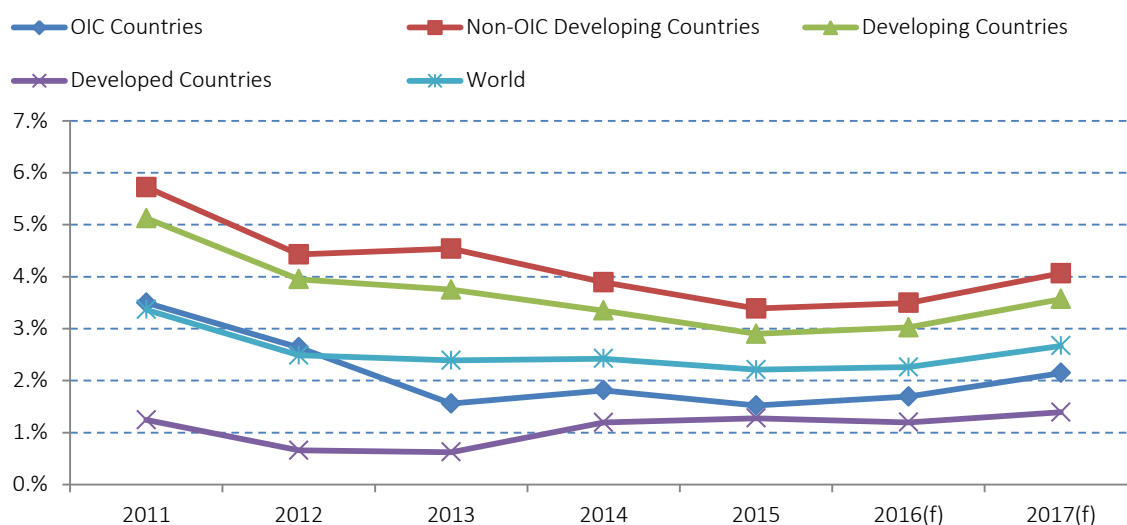
Source: IMF WEO Database April 2016 and SESRIC BASEIND Database.

compared to 3.9% in 2014 (Figure 1.5). Although this is in line with the persistent slowdown in across-the-board economic activity, which started to take hold in 2011, prospects for growth in OIC countries remained bleak amid the decline in oil prices and resulting macroeconomic distress and sharp downward revisions to growth forecasts for oil exporting countries like Saudi Arabia, Iraq, Iran, Nigeria and United Arab Emirates. According to the latest estimates of the IMF (2016), oil prices fell by roughly 50% in 2015 relative to 2014 (in annual average terms) and the markets suggest a further 10% average decline in 2016. Amid the expectations that oil prices may stay low for a protracted period of time, many oil exporting OIC countries have initiated measures like cutting subsidies and halting investment in infrastructure projects to adjust government spending. The economic performance of non-OIC developing countries, on the other hand, has so far been highly influenced by the pace of growth in the two leading Asian economies, namely China and India. However, the average real GDP growth rates in non-OIC developing countries were above

the OIC average during the period 2011-2015. Moving forward, the average rate of growth in the OIC countries will likely show a similar performance in 2016, with average growth rate forecasted to be around 3.6%. This recovery is expected to be consolidated further to 4.0% in 2017. Nevertheless, these figures are not better than the predicted average growth rates for the group of non-OIC developing economies (4.3% for 2016 and 4.9% for 2017), as well as the world as a whole (Figure 1.5).

At the individual country level, Côte d'Ivoire, with a growth rate of 8.6% in 2015, was the fastest growing economy in the group of OIC countries, followed by Uzbekistan (8.0%), Djibouti (6.5%) and Turkmenistan (6.5%). On the other hand, majority of the OIC top-10 fastest growing economies are from Sub-Saharan Africa (7), Central Asia regions (2) and South Asia (1). Whereas six of the OIC LDCs were among the top 10 fastest growing OIC countries in 2015: Djibouti, Senegal, Bangladesh, Mozambique, Mali and Togo with their real GDP growth rates ranging between 6.5 % and 5.3% (Figure 1.6).

Figure 1.7: Real GDP per capita Growth, Annual Percentage Change



Source: SESRIC staff calculations based on IMF WEO Database April 2016.

GDP PER CAPITA GROWTH

Uzbekistan, with a per capita GDP growth rate of 6.7% in 2015, was the fastest growing economy among OIC countries

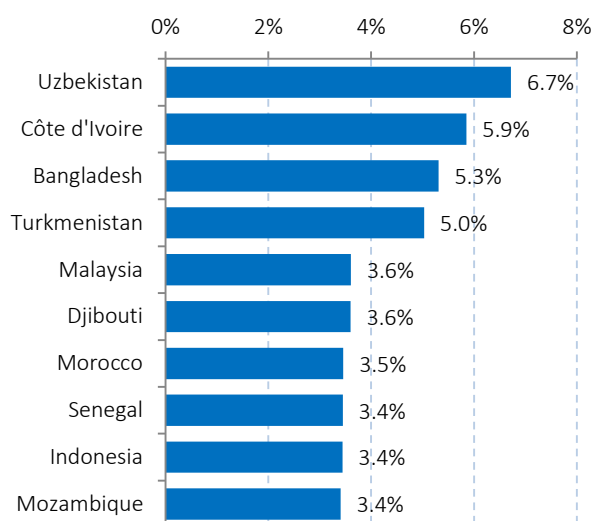
Globally, GDP per capita has witnessed significant recovery since 2010. This positive trend continued in 2011 with 3.4% growth rate. Nevertheless, this recovery was short lived and growth rate decelerated to 2.2% in 2015. The global real GDP per capita is forecasted to grow by 2.3% in 2016 and 2.7% in 2017. As it was in the case of real GDP growth, developing countries remained at the helm and drove the growth in per capita GDP. In 2015, growth in GDP per capita was recorded at 2.9% in developing countries, also expected to increase to 3.0% in 2016 and 3.6% in 2017. Developed countries, on the other hand, witnessed comparatively very low growth rate of 1.3% in 2015, which is estimated to decrease to 1.2% in 2016 before climbing up again to 1.3% in 2017.

The average growth rate of the real per capita GDP in the OIC countries has been

positive during the period 2011-2015 (Figure 1.7). This implies that the real GDP in the OIC member countries has grown on average faster than the population. This can be interpreted as a real increase in standards of living in the OIC community. However, a similar downward trend, as in the case of real GDP growth, is also observed for real GDP per capita growth rates. OIC countries seem to suffer from this trend as well. Following a short-lived recovery in the aftermath of the global financial crisis, the average real GDP per capita growth rate in OIC countries had started to decline again starting from 2012 and was recorded at 1.5% in 2015, as compared to 3.5% in 2011. The average real GDP per capita growth rate is forecasted to increase slightly to 1.7% in 2016 and 2.1% in 2017. During the recent years, the pace of the real GDP per capita growth in the OIC member countries remained below the averages of world, developing and non-OIC developing countries.

At the individual country level, Uzbekistan, with a per capita GDP growth rate of 6.7% in 2015, was the fastest growing economy in the group of OIC countries, followed by Côte

Figure 1.8: Top 10 OIC Countries in terms of GDP per capita Growth Rate, 2015



Source: IMF WEO Database April 2016.

d'Ivoire (5.9%) and Bangladesh (5.3%). Uzbekistan was the 4th fastest growing economy in the world. On the other hand, 4 of the OIC top-10 economies with the fastest growth of per capita GDP are from Sub-Saharan Africa and two from Central Asia region. Whereas 4 of the OIC LDCs were among the top 10 OIC countries in 2015, namely Bangladesh, Djibouti, Senegal, and Mozambique with their real per capita GDP growth rates ranging between 5.3% and 3.4% (Figure 1.8).

STRUCTURE OF GDP

Share of services in total GDP of OIC countries reached 48.8% in 2014

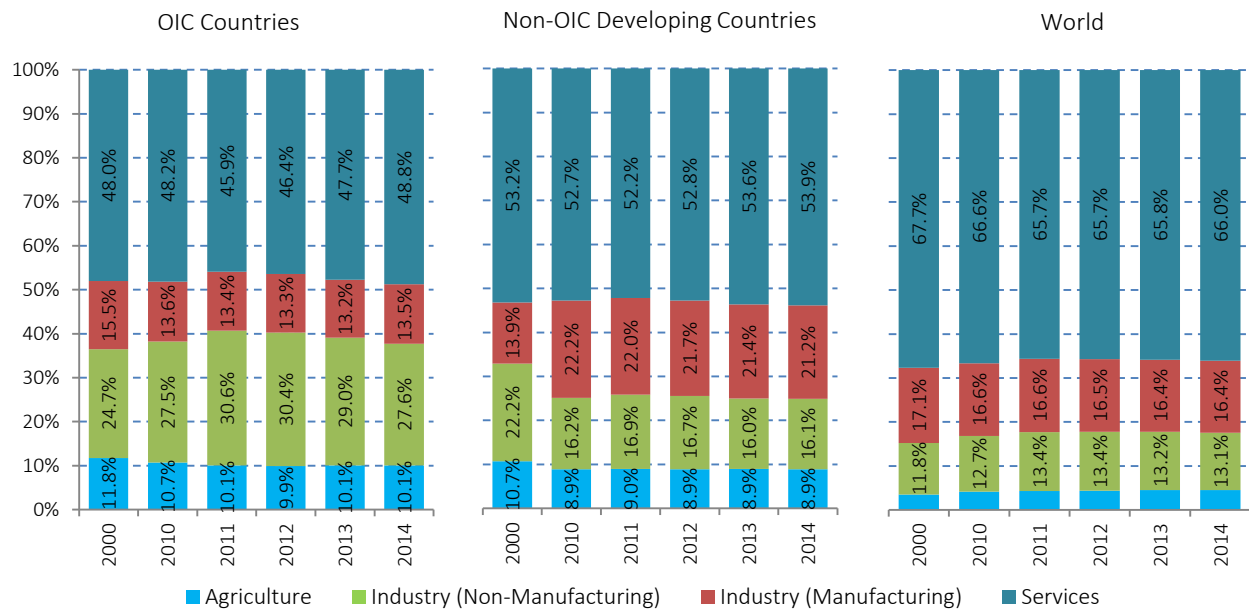
According to the latest estimates, as shown in Figure 1.9, service sector has the largest share of global total output in 2014 (66.0 %), followed by the industrial sector (both manufacturing and non-manufacturing) (29.5%), while the share of agriculture, fishing and forestry is relatively small (4.5%). Over the years, the share of services has

registered a decline of 1.7 percentage points from 2000 to 2014 whereas the shares of non-manufacturing industry and agriculture sectors increased by 1.3 and 1.0 percentage points respectively during the same period.

The analysis of value-added by major sectors in the total GDP of the OIC countries and non-OIC developing countries also shows a similar structure. Although agriculture is widely known to be the primary economic activity and assumed to play a major role in the economies of developing countries, this feature does not stand firm in the case of OIC and non-OIC developing countries as groups. Indeed, the share of agriculture in the total GDP of OIC countries has gradually declined from 11.8% in 2000 to 10.1% in 2014 (Figure 1.9). Coupled with the economic recovery and increase in the share of the non-manufacturing industry, the share of the agricultural sector witnessed a continuous downward trend. With industrial activity recovering, the average share of agriculture in OIC economies contracted to 10.1% in 2014. Between 2010 and 2014, a more stable trend was observed in non-OIC developing countries, where the average share of agriculture in the economy has for long remained about 8.9%.

At the individual country level, in 2014, the agricultural sector accounted for more than one third of the total value-added in 9 OIC member countries; namely in Somalia, Sierra Leone, Togo, Guinea-Bissau, Mali, Niger, Burkina Faso Comoros and Sudan— all of which were listed among the LDCs in the same year according to the UN classification. The share of agriculture in GDP varied substantially among the OIC countries, with the highest share of 60.2% in Somalia and the lowest shares below 1.0% in Qatar (0.1%), Bahrain (0.3%) and Kuwait (0.4%).

Figure 1.9: Value-added by Major Sectors of the Economy (% of GDP)



Source: SESRIC staff calculations based on UNSD National Accounts Main Aggregates Database, August 2016.

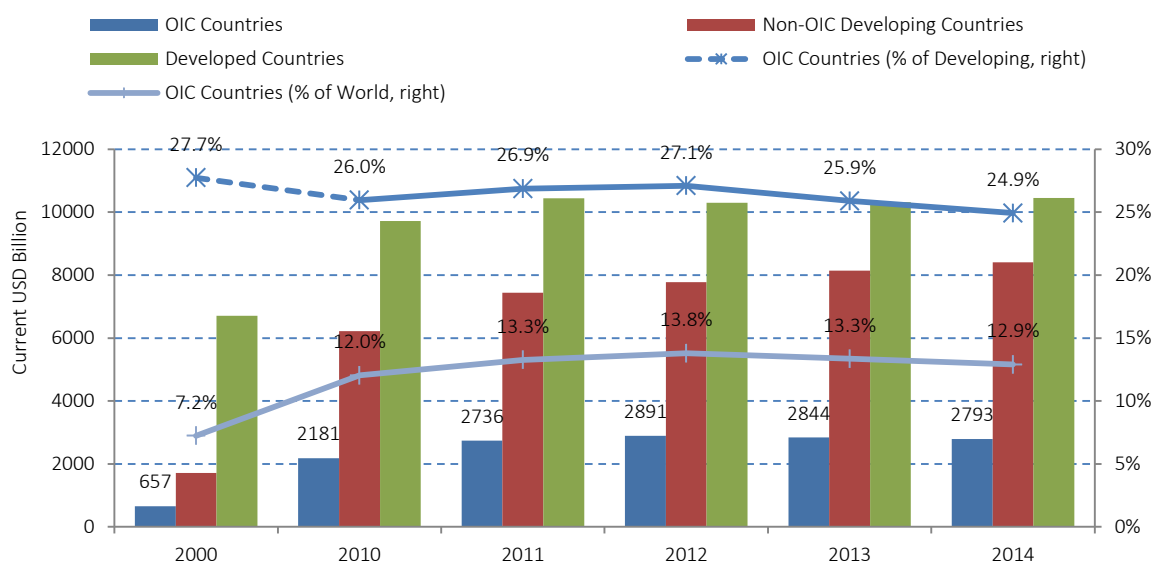
In contrast, the services sector continued to play a major role in the economies of many OIC countries as the most important source of income. After a rapid contraction in 2008 with the outbreak of the global financial crisis and the resulting decrease in its share, the average share of the service sector in total GDP of OIC countries increased in 2009. Yet, with the recovery in real economic activity from 2010 onwards, the average share of the services sector in OIC economies has returned back to its pre-crisis levels with shares of 45.9%, 46.4% and 47.7% in 2011, 2012 and 2013, respectively. Nonetheless, in 2014, the average share of the services sector in OIC economies was 48.8%. For non-OIC developing countries, the services sector continued to account for over half of the total GDP and its share was recorded at 53.9% in 2014 (Figure 1.9).

INDUSTRIAL PRODUCTION

Increasing trend in the share of OIC countries in total world industrial production ceased in 2013 and 2014

Industry sector – including manufacturing – accounted on average for 41.1% of the total GDP of the OIC member countries in 2014 (Figure 1.9). Its share in 2010 was significantly lower than that of the services sector, however the situation started to improve with the picking up of global industrial activity in 2011 and 2012 as the relative share of industry in economic activity was quickly catching up with the services sector before starting to diverge again in 2013. Compared to non-OIC developing countries where the industrial sector's contribution to the GDP averaged at 37.3% in 2014, the latter apparently constitutes a larger portion of the economic activity in the OIC member countries.

Figure 1.10: Industrial Production, Volume and Share



Source: SESRIC staff calculations based on UNSD National Accounts Main Aggregates Database, August 2016.

However, the share of industry in the GDP of a country, per se, does not reflect the actual industrialization level of its economy. Particularly in the case of OIC countries, the oil industry accounts for a significant portion of the total value-added of industry sector. Figure 1.9 reveals that, in year 2000, the share of manufacturing sector in total GDP of the OIC countries was 15.5%. In 2010, however, the share of the sector contracted significantly to 13.6% before decreasing slightly to 13.4% in 2011. Most recently, in 2014, the share of the manufacturing industry stands at 13.5% which is still below the 15.5% level observed in year 2000. As compared to the OIC countries, the manufacturing sector in non-OIC developing countries contributes significantly larger share to their total GDP where its share was recorded at around 21.2% in 2014.

According to Figure 1.10, the share of the OIC countries as a group in the world total industrial production has reached 12.9% in 2014. This marks 5.7 percentage points increase since year 2000. Despite this upward trend, the share of the OIC countries in the

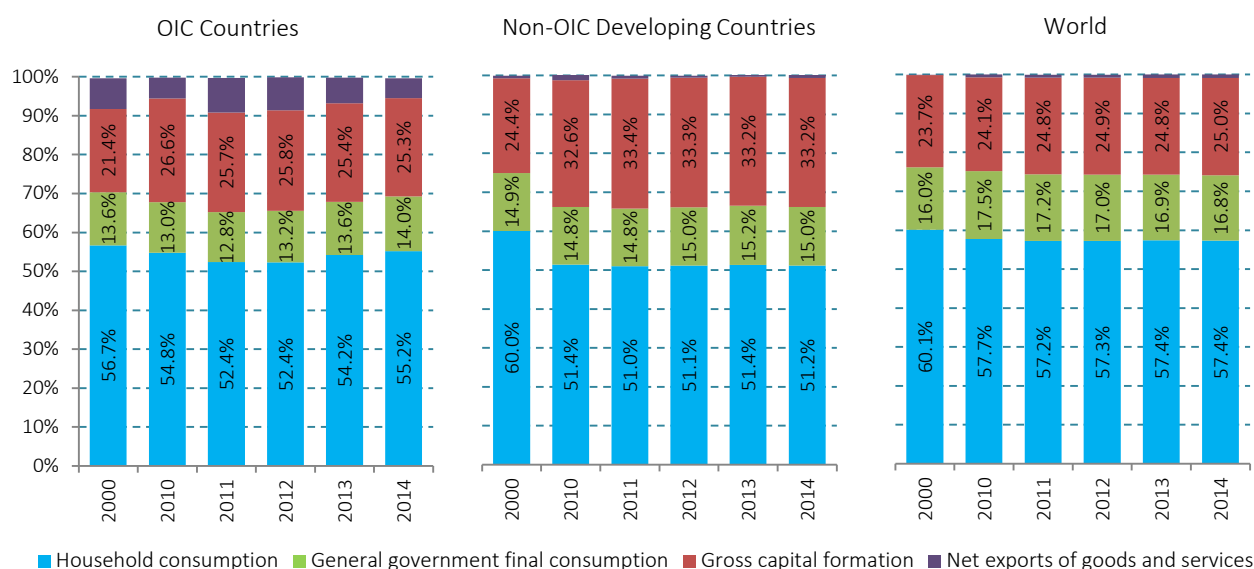
total gross fixed capital formation of the developing countries has been on decline and contracted from 27.7% to 24.9% over the same period. This indicates the relatively poor performance shown by the OIC countries in industrial production, as compared to non-OIC developing countries.

GDP BY EXPENDITURE ITEMS

The share of household consumption in the total GDP of OIC countries has been increasing since 2012

The analysis of global GDP by major expenditure items reveals that the share of final consumption (both by household and government) continued to be the highest in the total GDP over the years. As shown in Figure 1.11, in 2014 household consumption in OIC countries accounted for the lion share of 55.2% followed by gross capital formation (25.3%) and general government final consumption (14%). The share of net exports in total world GDP was negligible. During the period 2000-2014, the share of gross capital formation in total world GDP has increased

Figure 1.11: GDP by Major Expenditure Items (% of GDP)



Source: SESRIC staff calculations based on UNSD National Accounts Main Aggregates Database, August 2016.

by 1.3 percentage points whereas the share of household consumption declined by 2.8 percentage points.

The relative shares of the major expenditure items in the total GDP of OIC and non-OIC developing countries registered significant variation from the world. In 2014, final household and general government spending accounted for 66.2% of the total GDP of OIC countries. As constituents of the final consumption expenditure, expenditure by households and governments accounted for 55.2% and 14% of the GDP, respectively. These figures marked an increase in the shares of both consumption types compared to the previous year. However, the share of household consumption in the total GDP of the OIC member countries has decreased by 1.5 percentage points since 2000 whereas the share of government spending has increased by 0.4 percentage points over the same period. The decrease in the share of final consumption was mainly accommodated by an expansion in the share of gross capital formation from 21.4% in 2000 to 25.3% in 2014. On the other hand,

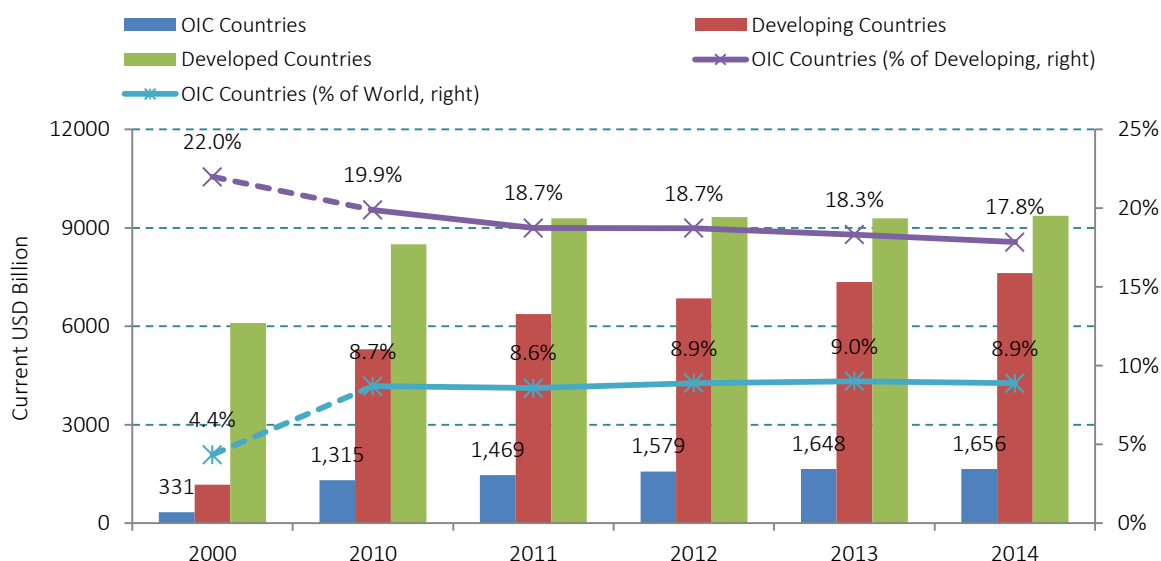
the share of final consumption in total GDP of non-OIC developing countries was recorded at 66.2% in 2014 and household consumption, with a 51.2% share in GDP, was again the main source of final consumption expenditure in these countries.

GROSS CAPITAL FORMATION

In 2014, 25.3% of the total GDP generated in OIC countries was invested in productive assets

Gross capital formation measures the amount of savings in an economy which are transformed into investments in production. As the analysis of GDP by major expenditure items revealed in Figure 1.11, 25.3% of the total GDP generated in the OIC member countries was invested in productive assets in year 2014. In comparison, non-OIC developing countries on average channelled 33.2% of their GDP into productive investments. The share of gross capital formation in the GDP of OIC countries as a group has increased by 3.9 percentage points over its year 2000 level of 21.4%, while it

Figure 1.12: Gross Fixed Capital Formation, Volume and Share



Source: SESRIC staff calculations based on UNSD National Accounts Main Aggregates Database, August 2016.

increased by as much as 8.8 percentage points in the group of non-OIC developing countries over the same period. Yet, one can argue that gross capital formation, as an indicator, is flawed primarily by the significant fluctuations in inventories and, most of the time, non-availability of the industry-level inventory information. Gross fixed capital formation, on the other hand, is promoted as being a better indicator on the net additions of productive assets created during a specific year.

In view of the above argument, Figure 1.12 offers a look at the gross fixed capital formation trends in the OIC countries in comparison to non-OIC developing as well as developed countries. According to Figure 1.12, the share of the OIC countries as a whole in world total fixed capital formation reached 8.9% in 2014. This marks 4.5 percentage points increase since year 2000. Despite this upward trend, the share of the OIC countries in the total gross fixed capital formation of the developing countries has been on decline and contracted from 22.0% to 17.8% over the same period. This indicates

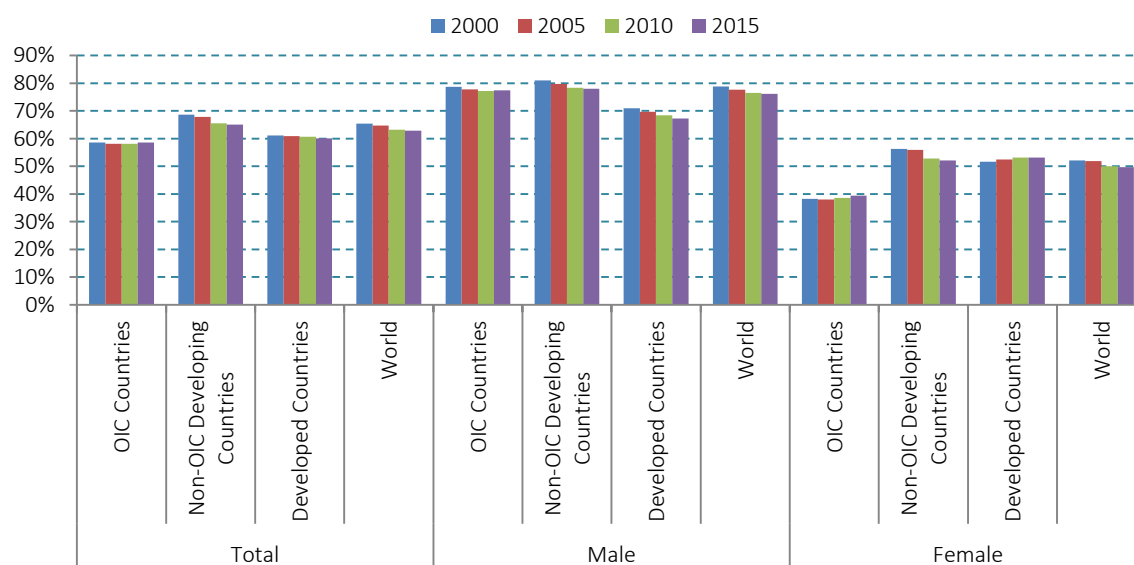
the relatively poor performance shown by the OIC countries in accumulating investment capital, as compared to developing countries.

LABOUR FORCE PARTICIPATION

LFPR in OIC countries remained lower than other country groups in 2015

Although unemployment rate is accepted as one of the leading macroeconomic variables which commonly used to examine the performance of the economy, it may not accurately reflect the health of labour market as the definition focuses on people seeking employment for pay but not the magnitude of people who are not working actually. Due to this, it might be ideal to first consider the labour force participation rate (LFPR), which measures the proportion of people aged 15 and above that engages actively in the labour market, either by working or actively searching for a job. It provides an indication of the relative size of the supply of labour

Figure 1.13: Labour Force Participation Rates, 2000-2015



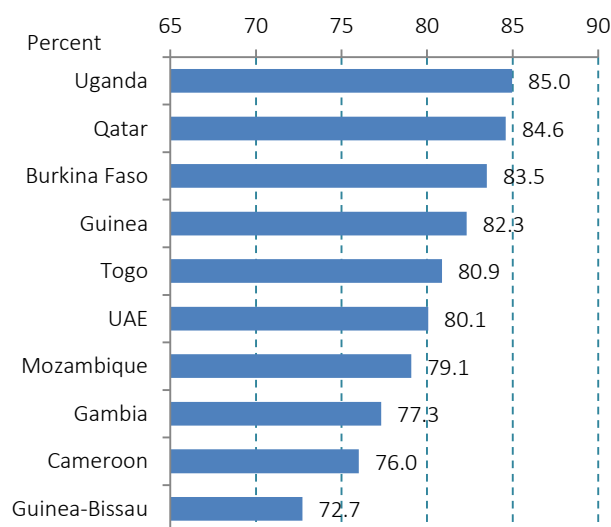
Source: SESRIC staff calculations based on ILO, WESO 2016 Dataset.

available to engage in the production of goods and services.

As shown in Figure 1.13, the average labour force participation rate in OIC member countries, contrary to other country groups, followed a slightly increasing trend, which stood at 58.6% in 2015 compared to 62.9% in the world, 65.0% in non-OIC developing countries and 60.0% in developed countries. In case of labour force participation rate for the male population, OIC member countries recorded a rate of 77.4% compared to 76.1% in the world, 77.9% in non-OIC developing countries and 67.2% in developed countries. Although, OIC member countries registered globally comparable performance in terms of total and male labour force participation rates, their performance in case of female labour force participation rate remained significantly lower. Female labour force participation rate in OIC member countries was recorded at 39.4% in 2015, which is significantly lower than the world average of 49.6%, the average of 52.1% in non-OIC developing countries and the average of 53.1% in developed countries.

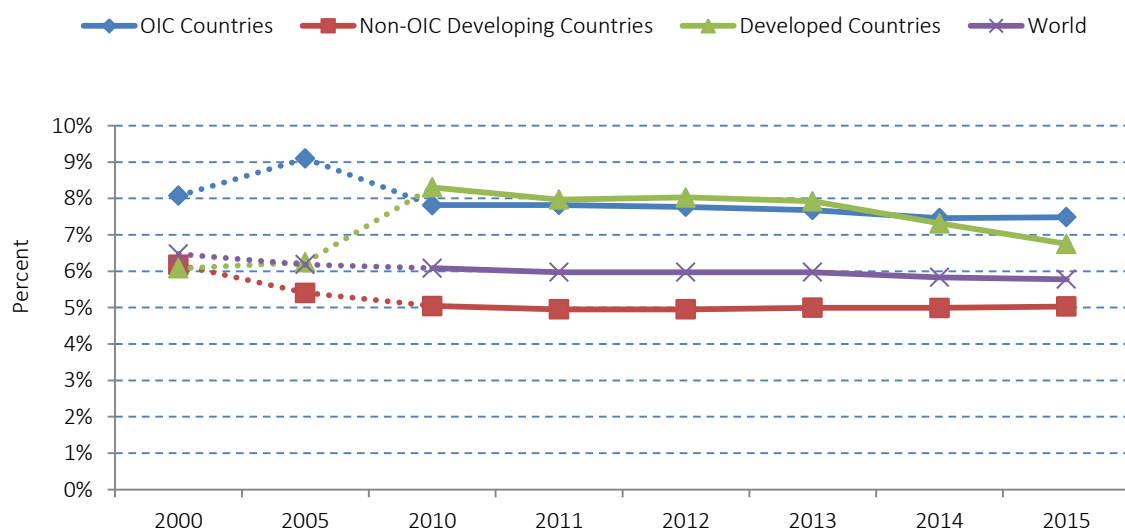
However, there is an increasing trend in labour force participation rates in OIC countries, particularly in female participation rates. Since 2000, female participation rate increased from 38.2% to 39.4% in 2015. An upward trend in this indicator is also observed in the case of developed countries from 51.6% in 2000 to 53.1% in 2015, while in non-OIC developing countries, female

Figure 1.14: Top 10 OIC Countries by Labour Force Participation Rate, 2015



Source: ILO, WESO 2016 Dataset.

Figure 1.15: Total Unemployment Rate (% of Total Labour Force)



Source: SESRIC staff calculations based on ILO, WESO 2016 Dataset

participation showed a declining trend and fell to 52.1% in 2015 from its level of 56.2% in 2000.

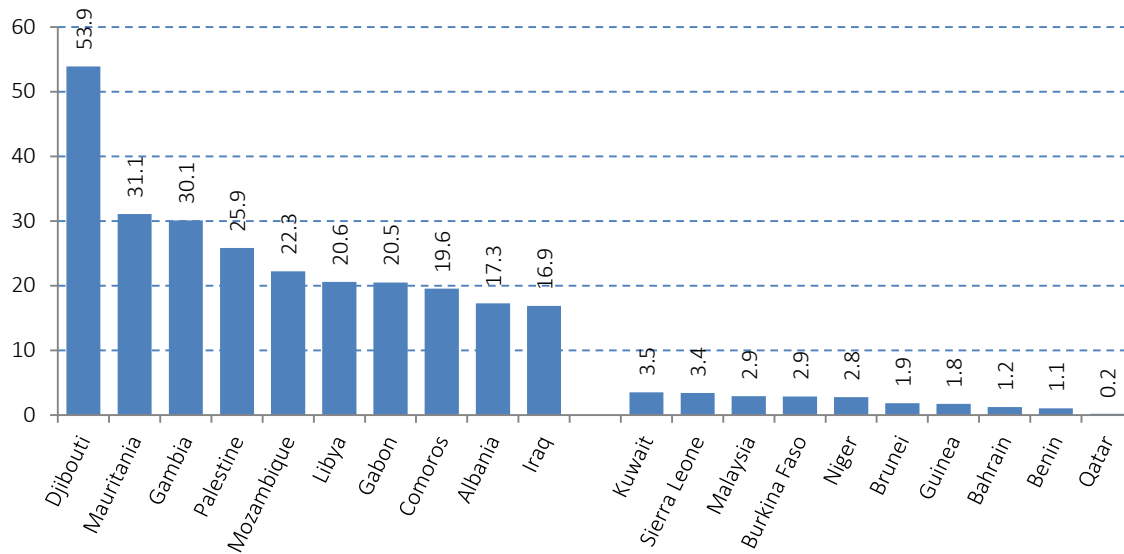
At the individual country level, Uganda registered the highest labour force participation rate in 2015 with a rate of 85%, followed by Qatar (84.6%), Burkina Faso (83.5%), Guinea (82.3%), and Togo (80.9%). It is worth mentioning that, with the exception of Qatar and United Arab Emirates, all top 10 performing member countries belong to the least developed countries according to UN classification (Figure 1.14). On the other hand, the lowest participation rate was recorded in Jordan with 40.0%. It is followed by Iraq (42.4%), Algeria (43.7%) and Palestine (43.7%). At the global level, with respect to labour force participation rate, Uganda is ranked 2nd, Qatar is ranked 4th, Burkina Faso at 7th and Guinea at 11th position. It is also worth mentioning that 13 out of the world 20 countries with the lowest participation rates in 2015 are OIC member countries.

UNEMPLOYMENT

After a five years interval, OIC countries have again the highest unemployment rate in the world with 7.5%

Unemployment remained one of the most challenging issues across the globe. According to the ILO World Employment and Social Outlook 2016 report, almost 197.1 million people were unemployed in 2014 around the world, an increase of almost one million compared with the year before and about 27 million more compared with pre-crisis level in 2007. This reflects the fact that employment is not expanding sufficiently fast to keep up with the growing labour force. Whereas, around 23 million people estimated to have dropped out of the labour market due to discouragement and rising long-term unemployment. According to the same report, the global unemployment rate remained at 5.8% of the global labour force, 0.1 percentage point lower than the year before. Due to mixed expectations about world economy for 2016, very little improvement is expected in the global labour

Figure 1.16: OIC Countries with Lowest and Highest Unemployment Rates, 2015



Source: ILO, WESO 2016 Dataset.

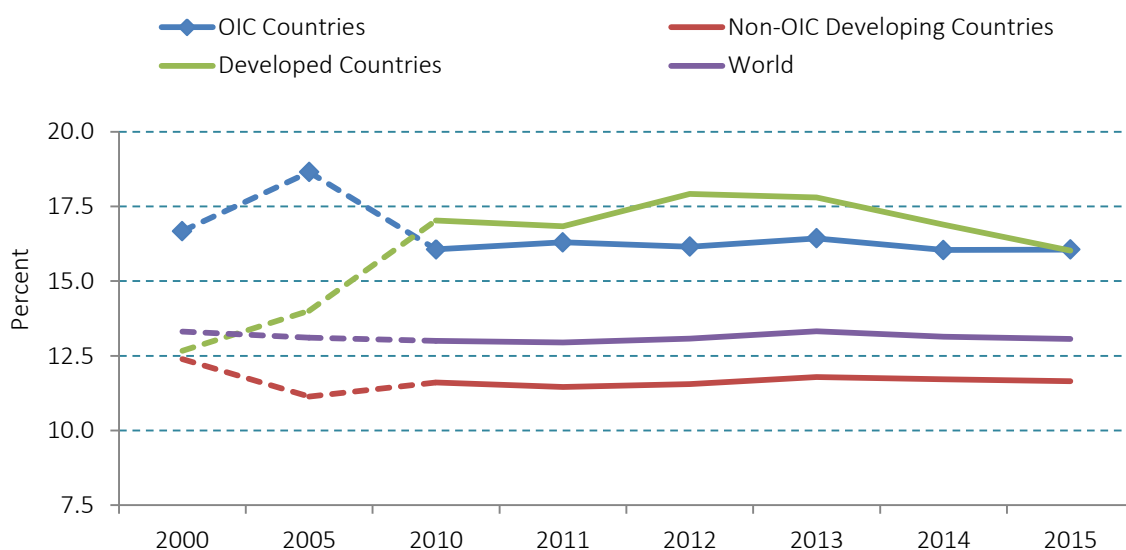
market and the global unemployment rate is expected to stabilize at 5.9% between 2015 and 2017.

According to the latest available data, OIC countries recorded significantly higher average unemployment rates compared to the world and non-OIC developing countries during the period 2000-2015 (Figure 1.15). During this period, total unemployment rates in OIC countries changed between 8.1% and 7.5%. After the global financial crisis, unemployment rates in developed countries increased from a level below 6% to over 8%. During the period 2009-2013, average unemployment rate in developed countries remained higher than the rate in OIC countries. In 2014, developed countries managed to lower the rate again below the rate observed in OIC countries. As of 2015, OIC countries recorded a rate of 7.5%, while it is estimated at 6.8% in developed countries. Average unemployment rate in non-OIC developing countries remained significantly lower (around 2-3%) than the OIC average during the whole period under consideration.

Unemployment rates for male are typically lower than the rates for female in all country groups. Despite significant improvement since 2005, female unemployment in OIC countries remains highest with 9.3% in 2015. It is estimated at 5.4% in non-OIC developing countries and 6.7% in developed countries for the same year. Male unemployment in OIC countries has decreased from 7.8% in 2005 to 6.6% in 2015 and from 5.2% to 4.8% in non-OIC developing countries during the same period. On the other hand, there is an upward trend in male unemployment rates in developed countries, which increased from 6.0% in 2005 to 6.8% in 2015.

At the individual country level, unemployment rates varied among OIC countries. The unemployed in 2015 constituted less than 1% of total labour force in Qatar (0.2%), which is also the lowest rate in the world. Benin (1.1%), Bahrain (1.2%) and Guinea (1.8%) are also among the ten countries in the world with the lowest unemployment rates (Figure 1.16). However, unemployment is a serious concern in Djibouti (53.9 %), Mauritania (31.1%) and Gambia (30.1%).

Figure 1.17: Youth Unemployment Rate



Source: SESRIC staff calculations based ILO, WESO 2016 Dataset.

YOUTH UNEMPLOYMENT

With a rate of 16.1% in 2015, OIC countries have the highest youth unemployment

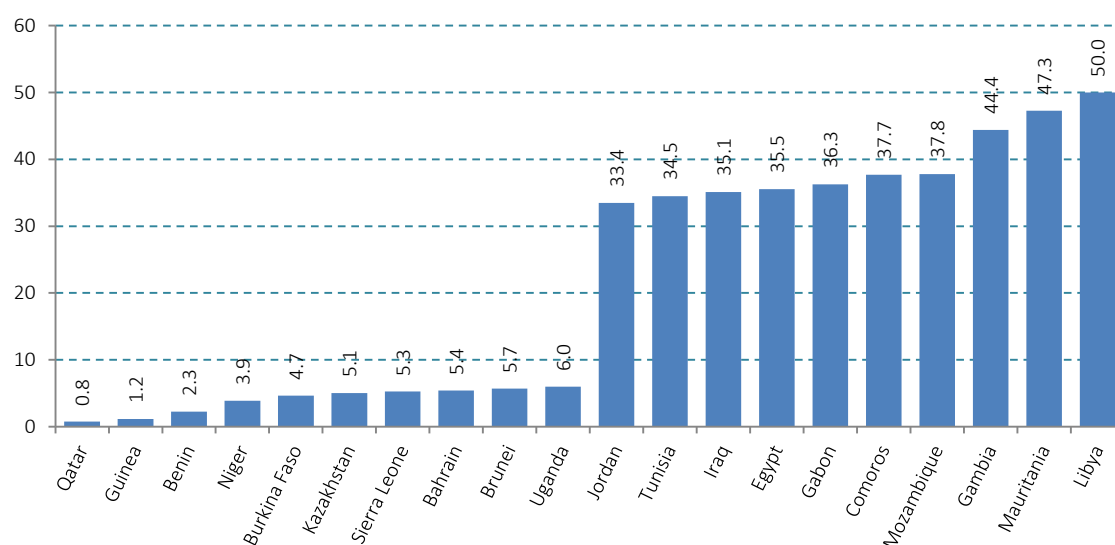
Youth (aged 15 to 24 years) continued to suffer from lack of decent job opportunities across the globe. According to the latest ILO estimates, some 73.4 million young people were unemployed in 2015. There were 31.5 million fewer young people in employment in 2015 than in 2007, while the global youth unemployment rate has reached 13.1% in 2015, which is almost three times as high as the adult unemployment rate (ILO, 2015). It is particularly high in the Middle East and North Africa (28.2%).

The figures on youth unemployment in OIC countries are even less promising. It remained constantly above 16% and also well above the averages of non-OIC developing and developed countries during the period between 2000 and 2015. During 2009-2014, the problem of youth unemployment in developed countries became even more

serious compared to that in OIC countries (Figure 1.17). As of 2015, however, youth unemployment in developed countries (16.0%) dropped to the levels below the OIC countries (16.1%), while it was as low as 11.6% in non-OIC developing countries.

As in other major labour market indicators, despite some improvement since 2005, female unemployment among young people is the highest in OIC countries. It fell to 18.0% in 2015 from its level of 22.2% in 2005. While female unemployment among youth has been decreasing in non-OIC developing countries during the period under consideration, it followed an upward trend in developed countries. As of 2014, it was estimated at 11.5% in non-OIC developing countries and 14.8% in developed countries. With respect to male unemployment among youth in 2014, it increased to 15.3% in OIC countries and 11.1% in non-OIC developing countries, but decreased to 16.8% in developed countries compared to the year before.

Figure 1.18: OIC Countries with Lowest and Highest Youth Unemployment Rates (2015)



Source: ILO, WESO 2016 Dataset.

There are again wide discrepancies in youth unemployment rates across OIC countries. Qatar (0.8%), Guinea (1.2%), Benin (2.3%) and Niger (3.9%) are the countries with lowest unemployment rates in 2015, which are also ranked among top five countries in the world (Figure 1.18). In contrast, the highest youth unemployment rate was estimated in Libya (50%), followed by Mauritania (47.3%), Gambia (44.4%), Mozambique (37.8%) and Comoros (37.7%). In 2015, youth unemployment rate was above 20% in 20 OIC countries and above the world average of 13% in 33 countries.

LABOUR PRODUCTIVITY

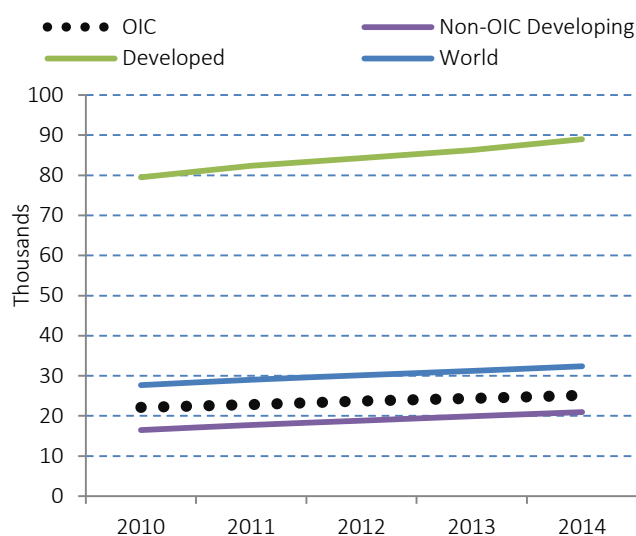
Only five OIC member countries recorded output per worker higher than the average of developed countries

Productivity plays a pivotal role in the development of an economy. It helps to increase real income and improve living standards by catalysing the economic growth. Labour productivity is usually defined

as the output per unit of labour input or output per hour worked. It helps to identify the contribution of labour to the GDP of a country and provides a base for cross country comparison and explanation of income disparities.

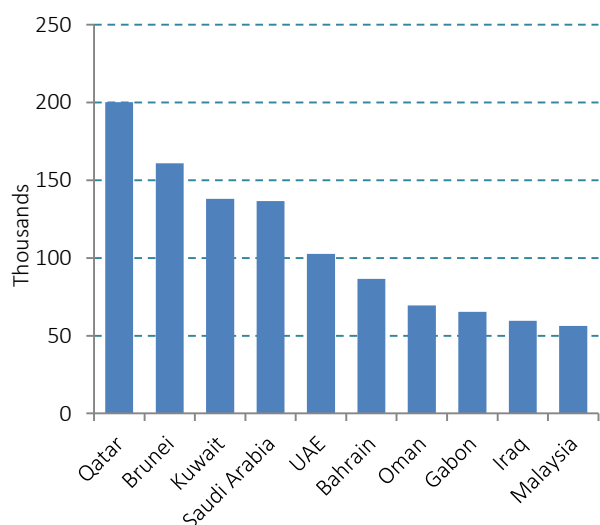
At the global level, labour productivity has

Figure 1.19: Labour Productivity (GDP per worker, US\$ PPP)



Source: SESRIC staff calculations based on ILO, WESO 2016 Dataset.

Figure 1.20: Top 10 Countries with Highest Labour Productivity, 2015



Source: ILO, WESO 2016 Dataset.

witnessed an increasing trend during the period 2010-2015. As shown in Figure 1.19, output per worker in OIC countries has increased from US\$ 22,124 in 2010 to US\$ 25,612 in 2015. The labour productivity gap between the developed and developing countries remained substantial throughout this period as output per worker in the developed countries was estimated at US\$ 91,214 in 2015 compared to just US\$ 21,730 in non-OIC developing countries and US\$ 25,612 in OIC countries, expressed in constant 2011 international dollar in PPP. This means that an average worker in the group of non-OIC developing countries produces only 23.8% of the output produced by an average worker in the developed countries and an average worker in OIC countries produces only 28.1% of the output produced by an average worker in the developed countries.

At the individual country level, Qatar registered the highest output per worker (US\$ 200,181) in 2015, followed by Kuwait (US\$ 158,300), Brunei (US\$ 160,716), Kuwait, (US\$ 137,931), Saudi Arabia (US\$ 136,436)

and United Arab Emirates (US\$ 102,672). Among the OIC member countries, the lowest labour productivity level was recorded in Guinea (US\$ 2,512) followed by Mozambique (US\$ 2,742) and Niger (US\$ 2,988.2). Only five member countries recorded output per worker higher than the average of developed countries (Figure 1.20).

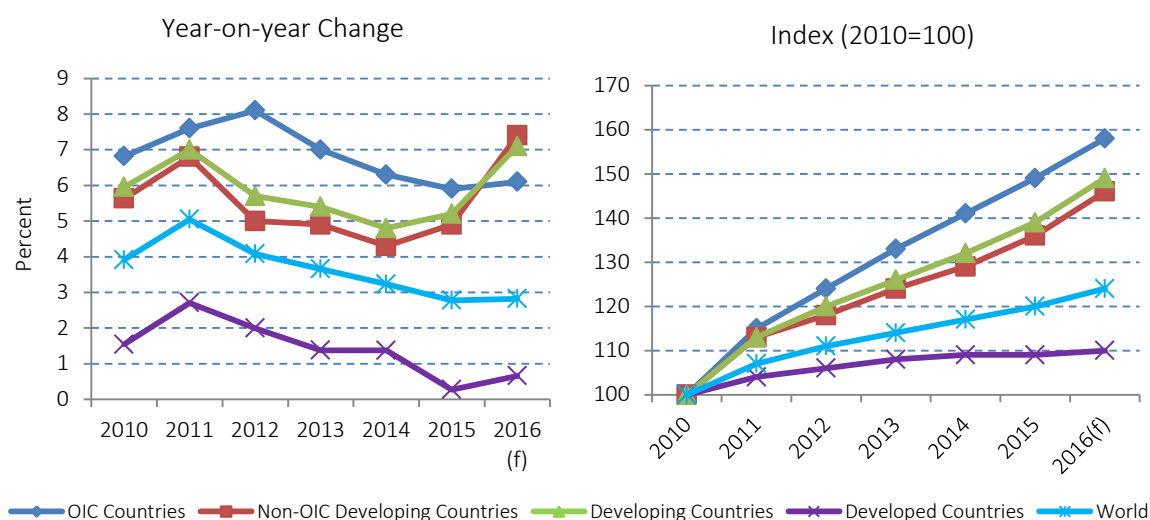
INFLATION

Global inflation rate decreased from 5.1% in 2011 to 2.8% in 2015 due to economic slowdown

Inflation is on decline across the globe reflecting primarily the impact of decline in prices for oil and other commodities, and weakening demand in some economies like euro area and Japan. The latest estimates show that global inflation rate has decreased from 5.1% in 2011 to 2.8% in 2015, and it is expected to remain at 2.8% in 2016.

As seen in Figure 1.21, price volatility remained a major concern especially for the developing countries. In the aftermath of the crisis, developed countries did not follow an uncontrolled monetary expansion, despite the existence of high pressure from public. As a result, the change in consumer prices remained below one in 2015 and despite an upward trend inflation rate is expected to remain less than 1% in 2016. In developing countries, the inflation rate decreased from 7.0% in 2011 to 5.2% in 2015. The expected inflation for 2016 is at 7.4% for these countries. This significant increase in inflation is largely driven by the exponential increase in prices in Venezuela, Yemen and Sudan.

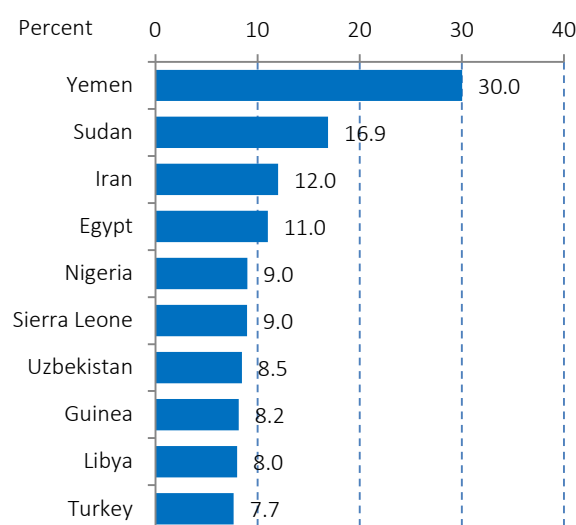
Figure 1.21: Annual Average Inflation (Consumer Prices)



Source: IMF WEO Database April 2016 and SESRIC BASEIND Database.

In the OIC countries, average inflation rate for 2015 was higher than the average of the developed and developing economies. However, in line with the global trends, inflation in the OIC countries declined to 5.9% in 2015. The average consumer price index marked an increase of 29.6% in the OIC countries during 2011-2015 (Figure 1.21, right). This is well above the average increase recorded in non-OIC developing countries (20.4%) as well as in the world (12.1%) during the same period.

Figure 1.22: Top 10 OIC Countries by Annual Average Inflation (2015)



Source: IMF WEO Database April 2016 and SESRIC BASEIND Database.

In the short-term outlook, inflationary pressures are projected to remain contained for the OIC countries, supported by the recent decrease in oil prices. The forecasts show that the growth in average consumer prices in the OIC countries will slightly increase to 6.1% in 2016 (Figure 1.21, left panel).

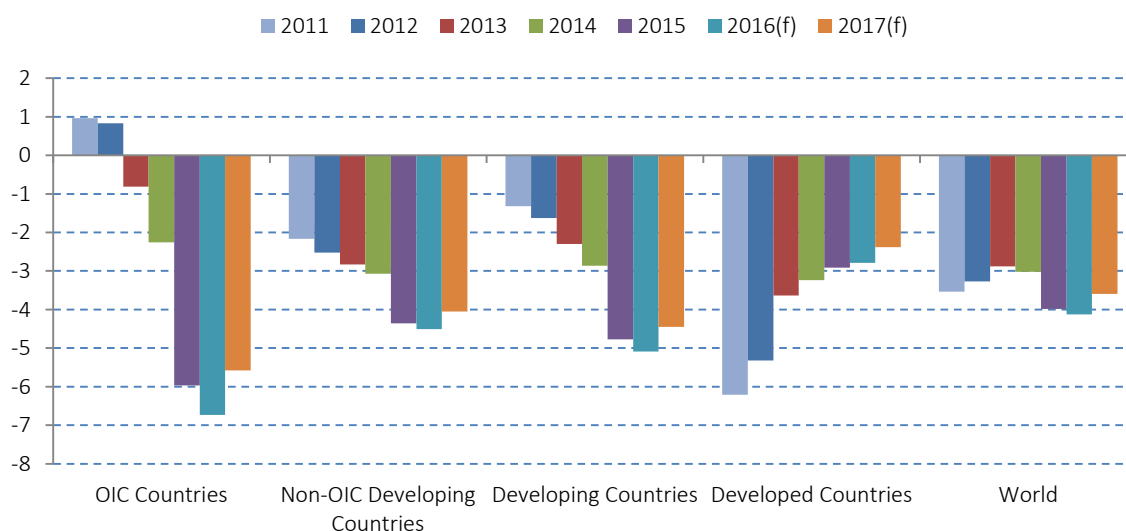
At the individual OIC country level, Yemen recorded the highest average consumer prices inflation rate of 30% in 2015, which was also the 4th highest in the world, followed by Sudan (ranked 7th in the world), Iran (12%) and Egypt (11%). Turkey, with an average inflation rate of 7.7%, was ranked 10th within the OIC group and 26th in the world (Figure 1.22).

FISCAL BALANCE

All country groups recorded fiscal deficits in 2014 and this is expected to continue

Latest statistics show that the fiscal tightening policies especially in developed countries have achieved the expected effect and their fiscal balances are improving.

Figure 1.23: Fiscal Balances (% of GDP)



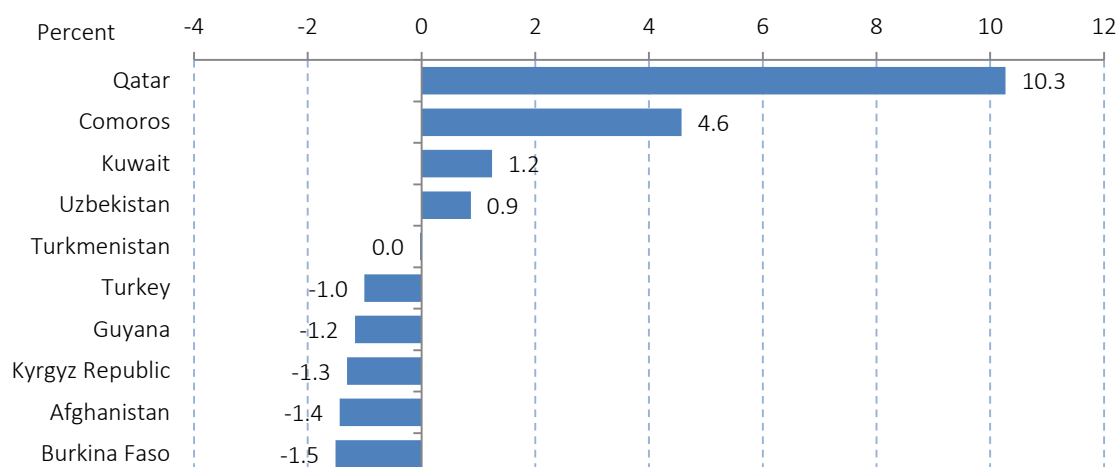
Source: IMF WEO Database April 2016 and SESRIC BASEIND Database.

Nevertheless, sharp decline in commodity prices especially for oil lead to significant increase in fiscal deficits in all major oil exporting countries in the developing world. As shown in Figure 1.23, world fiscal balance deficit as a percentage of GDP witnessed an increase from -3.5% in 2011 to -4.0% in 2015. An opposite trend is being observed in the developed countries group where fiscal balance deficit as percent of GDP has declined from -6.2% in 2011 to -2.9% in 2015. This ratio is expected to decrease to -2.8%

and -2.4% in 2016 and 2017 respectively for these countries. Developing countries also have registered negative fiscal balances but remained in relatively better position than the developed countries during the period under consideration. However, in 2015, the ratio was observed at -4.8% for developing countries group and it is expected to increase to -5.1% in 2016 before declining to -4.4% in 2017.

During the period under consideration, the OIC member countries as a group witnessed

Figure 1.24: Top 10 OIC Countries by Fiscal Balance, % of GDP (2015)



Source: IMF WEO Database April 2016 and SESRIC BASEIND Database.

a mix trend and their fiscal balance surplus during 2011 and 2012 was reversed quickly during the rest of the years under consideration. In 2015, OIC countries recorded fiscal balance of -6.0% of GDP. This sharp increase in fiscal deficit in OIC countries is largely triggered by the sharp decline in oil prices and consequently deteriorating fiscal position of oil exporting OIC countries. The fiscal deficit is expected to increase to -6.7% in 2016 before declining to -5.6% in 2017.

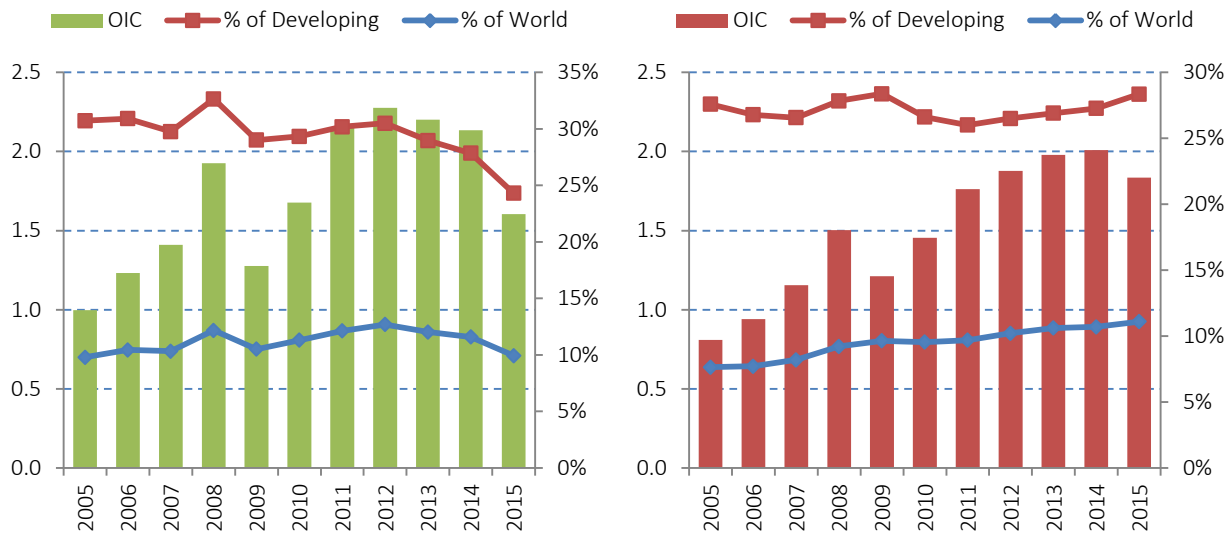
At the individual country level, only 4 out of 54 OIC countries with available data have recorded fiscal balance surplus in 2015. Among these countries, highest fiscal surplus was recorded by the Qatar (10.3%) followed by Comoros (4.6%), Kuwait (1.2%) and Uzbekistan (0.9%). The top two OIC countries were ranked among the world top 10 countries with respect to fiscal balance surplus. Kuwait was ranked 14th in the world whereas Uzbekistan was ranked 18th. During 2011-2015, almost all oil exporting OIC countries have witnessed significant decline in their fiscal balance surplus.



Section 2

Trade and Finance

Figure 2.1: Merchandise Exports and Imports (US\$ Trillion)



Source: IMF Directions of Trade Statistics (DOTS).

MERCHANDISE TRADE

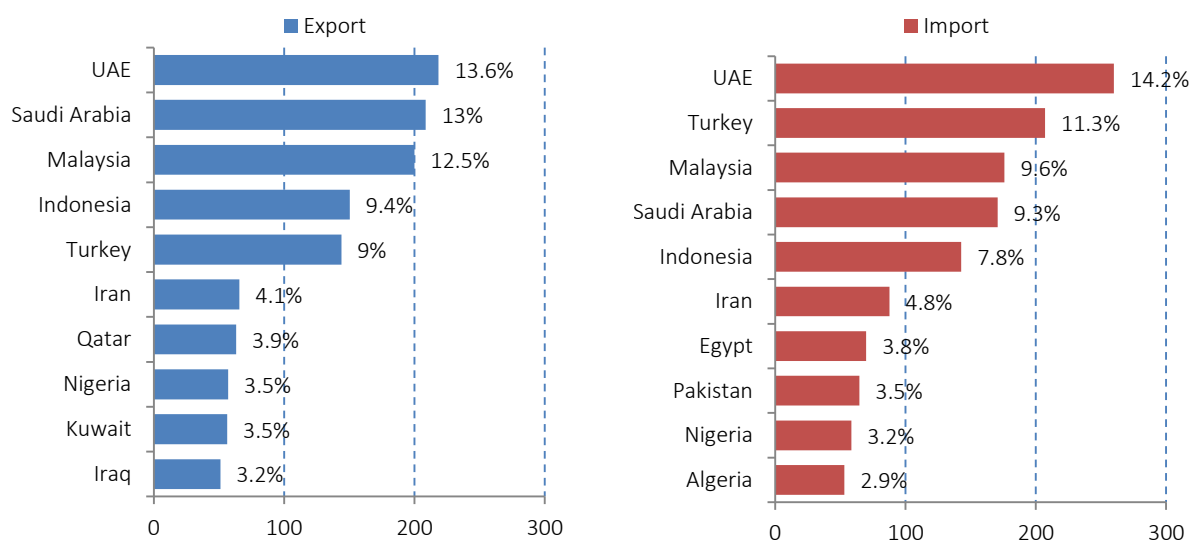
Share of OIC countries in world's total exports further decreased to 9.9% in 2015 compared to 12.7% in 2012.

The total value of world **merchandise exports**, according to the IMF Directions of Trade Statistics (DOTS), was recorded at US\$ 16.4 trillion in 2015, as compared to US\$ 18.7 trillion in 2014. This corresponds to 12% contraction in total world export volume and reflects the weakening of global economic activity. It is also the first time that world merchandise exports contracted after the global financial crises in 2009. However, global reports predict that global trade volume will increase around 2.7% in 2016.

After the sharp fall in total merchandise exports from OIC countries following the global financial crisis in 2009, it started to increase rapidly over the new few years and reached its historically highest level of US\$ 2.3 trillion in 2012 (Figure 2.1). This upward trend was stronger than those observed in non-OIC developing countries and the world

as a whole, resulting in an increase in the shares of OIC countries in total developing country and world exports. Since then, this upward trend has been reversed and total exports of OIC countries started to fall again. In 2015, total exports of OIC countries reached its lowest level since 2009 with US\$ 1.6 trillion. Accordingly, the share of OIC countries in total exports of developing countries plunged to 24.3% in the same year, compared to 30.5% in 2012, and continued to remain below its pre-crisis level of 32.6% observed in 2008. OIC countries' collective share in total world merchandise exports also followed a similar trend between 2012 and 2015, and decreased to 9.9% in 2015, which is the lowest ratio observed since 2005. The fall in exports can be partly explained by falling commodity prices, where OIC countries have significant concentration. Moving forward, to achieve long-term sustainable growth in merchandise trade and higher share in total world exports, OIC countries will apparently need more competitive economic sectors with significant diversification levels and higher technological intensity.

Figure 2.2: Top OIC Merchandise Exporters and Importers (2015, US\$ Billion)



Source: IMF Directions of Trade Statistics (DOTS).

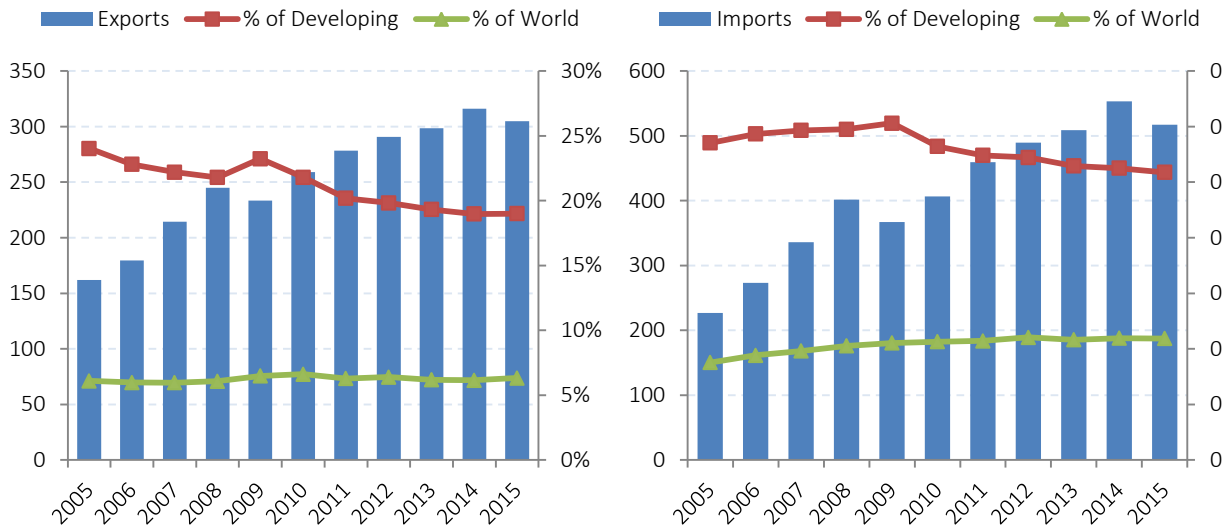
On the other hand, total **merchandise imports** of OIC countries experienced a stronger post-crisis bounce-back and increased from \$1.2 trillion in 2009 to \$2.0 trillion in 2014 (Figure 2.1, right), recording a double-digit (10.9%) compound annual increase during this period. However, OIC countries also witnessed a fall in imports in 2015, which decreased to US\$ 1.8 trillion. Despite the fall in import volumes, the share of OIC countries in global merchandise imports continued to expand throughout the period under consideration and reached 11.1% in 2015, compared to 9.2% in 2008. Similarly, their share in total developing country merchandise imports was recorded at 28.4% in 2015, sustaining its expansion since 2011.

In terms of the shares of the individual member countries in total merchandise exports from the OIC region, it has been observed that the bulk of total exports from the OIC countries continued to be concentrated in a few countries (Figure 2.2, left). In 2015, the top 5 largest OIC exporters accounted for 57.4% of total merchandise exports of all member countries whereas the

top 10 countries accounted for 75.7%. United Arab Emirates, with US\$ 218 billion of merchandise exports and 13.6% share in total OIC exports, became the largest exporter in 2015. It was followed by Saudi Arabia (US\$ 209 billion, 13%), Malaysia (US\$ 200 billion, 12.5%), Indonesia (US\$ 150 billion, 9.4%) and Turkey (US\$ 144 billion, 9%). In general, fall in commodity prices reduced the shares of commodity exporting countries and increased the shares of manufacturing goods exporters.

As in the case of exports, merchandise imports of OIC countries were also heavily concentrated in a few countries. As depicted in the right panel of Figure 2.2, with US\$ 260 billion and US\$ 207 billion of imports, United Arab Emirates and Turkey, respectively, took the lead in 2015 in terms of volume of merchandise imports and together accounted for 25.4% of total OIC merchandise imports. They were followed by Malaysia (US\$ 176 billion, 9.6%), Saudi Arabia (US\$ 171 billion, 9.3%) and Indonesia (US\$ 143 billion, 7.8%), which collectively accounted for a further 26.7% share in the OIC merchandise imports. Accordingly, the

Figure 2.3: Services Exports and Imports (US\$ Billion)



Source: UNCTAD STATS.

top 5 OIC importers accounted for 52.1% of total OIC merchandise imports, whereas the top 10 countries accounted for 70.3%.

To sustain long-term economic growth, OIC countries need to reduce the high reliance on exports of mineral fuels and non-fuel primary commodities, which involve the least technological intensity, and devise and implement specific policies for adopting more advanced manufacturing methods to increase the share of more technology intensive commodities in exports. This is also necessary for increasing competitiveness of tradable products in international export markets.

SERVICES TRADE

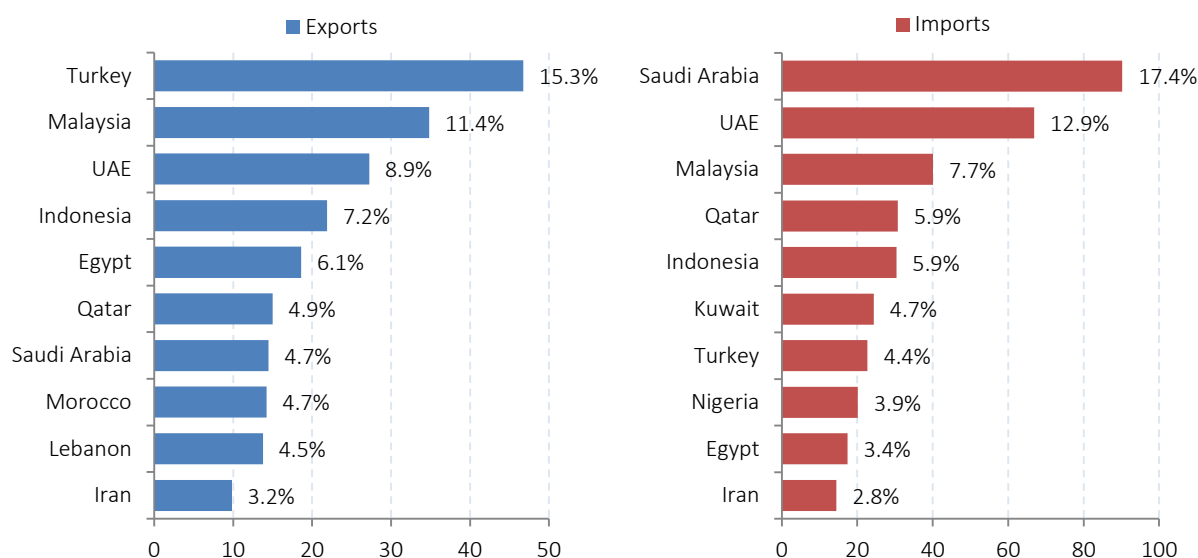
Share of OIC countries in total services exports of all developing countries has been constantly falling since 2009

The services sector plays an increasingly important role in the global economy and the growth and development of countries. It is also a crucial component in poverty reduction

and access to basic services, including education, water and health services. The services sector has emerged as the largest segment of the economy, contributing growing shares in gross domestic product (GDP), trade and employment. According to 2016 editions of the World Bank's World Development Indicators and United Nations' National Accounts Main Aggregates Databases the services sector accounted on average for 65%-66% of the global value-added during 2011-2014 and it is expanding more rapidly than the other two main sectors of the economy, namely, agriculture and the industry. The sector accounts for nearly 60% of employment worldwide (IMF, 2014). Trade in services constitutes around 20% of world trade of goods and services, with two thirds of global foreign direct investment (FDI) flowing into the sector (UNCTAD, 2013).

Yet these figures do not translate into a strong presence in world trade. In 2014, world **services exports** totalled only US\$ 4.8 trillion, compared to US\$ 16.4 trillion of merchandise exports in the same year. As a group, the OIC countries remained net importers of services. According to UNCTAD, OIC countries exported

Figure 2.4: Top 10 OIC Services Exporters and Importers (2015, US\$ Billion)



Source: WTO.

US\$ 304 billion worth of services in 2015, whereas the OIC services imports were recorded at US\$ 517 billion in the same year (Figure 2.3). Between 2009 and 2014, services trade volume of OIC countries exhibited a constant increase, but the year 2015 witnessed a fall in both exports and imports of services.

The share of OIC member countries in both services exports and imports of developing countries have followed a downward trend during the period under consideration (Figure 2.3). While OIC countries accounted for 23.2% and 30.3% shares in developing country services exports and imports in 2009, respectively, these shares dropped to 19% and 25.9% in 2015. While the collective share of OIC member countries in the total world services exports fell from 6.5% in 2009 to 6.3% in 2015 and their share in the total world imports increased from 10.5% to 10.9% during the same period.

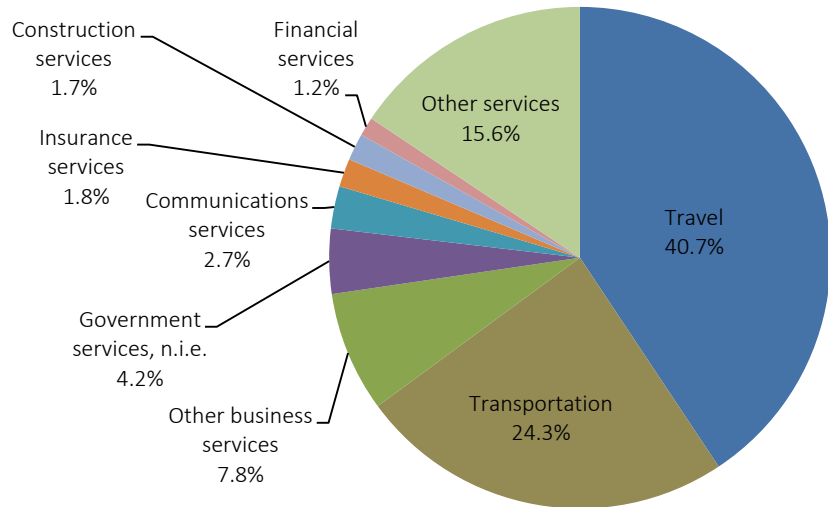
Figure 2.4 shows the top 10 OIC countries according to the sizes of their services exports and imports. Turkey, with US\$ 47 billion exports and 15.3% share in total OIC services

exports, was the top exporter in services in 2015 (Figure 2. 4, left). It was followed by Malaysia (US\$ 35 billion, 11.4%), United Arab Emirates (US\$ 27 billion, 8.9%), Indonesia (US\$ 22 billion, 7.2%) and Egypt (US\$ 19 billion, 6.1%). In 2015, top 10 OIC countries accounted for 71% of total OIC services exports. As far as the service imports are concerned, the Saudi Arabia registered the highest service imports with an amount of US\$ 90 billion and 17.4% share in OIC total services imports. It was followed by United Arab Emirates (US\$ 67 billion, 12.9%), Malaysia (US\$ 40 billion, 7.7%), Qatar (US\$ 31 billion, 5.9%) and Indonesia (US\$ 30 billion, 5.9%). The top 10 OIC services importers collectively accounted for 69.1% of total services imports of OIC countries.

In terms of sectoral allocation of services exports by OIC countries, travel and transportation services account for bulk of the services exports in OIC countries according to the latest statistics. As depicted in Figure 2.5, these two sectors collectively make up 65% of all OIC services exports. The share of travel-related services exports has generally been observed above 40% and the share of

transportation sector has been steady around 18-22%. The share of other business services category, including, but not limited to, research and development, and legal services, in total OIC services exports has also been significant as the subsector increased its share to around 8%. Communications, insurance, construction and financial services collectively represent 7.4% of all services exports.

Figure 2.5: Services Exports by Sector



Source: UN Service Trade Database.

INTRA-OIC TRADE

Share of intra-OIC trade in total trade of OIC countries reached 20.6% in 2015.

After witnessing a sharp fall in 2009, total **merchandise trade among the OIC countries** recovered quickly and, following a steep upward trend, reached US\$ 775 billion in 2014 (Figure 2.6, left). In 2015, however, this number decreased to US\$ 709 billion. As the fall in total exports of OIC countries was even bigger, the share of intra-OIC trade continued to rise even in 2015. Accordingly, the share of intra-OIC trade increased from 17.5% in 2011 to 18.6% in 2013 and further increased to 20.6% in 2015.¹ Over the last ten years, this

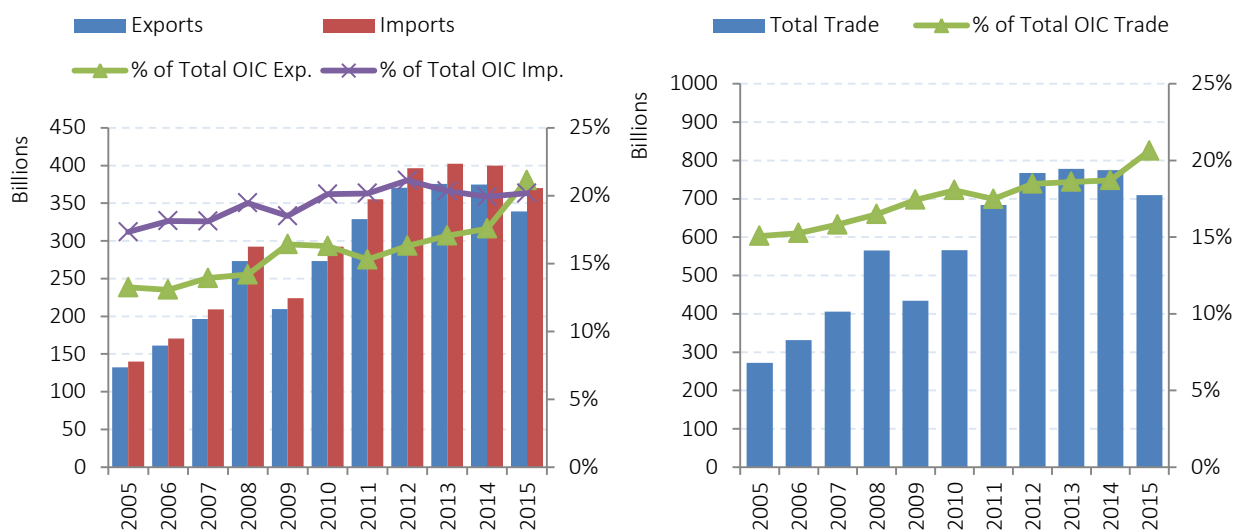
share has continuously increased, except in the year 2011. It should be well recognized that this is indeed a great achievement in realizing the 20% target stated in the OIC Ten-Year Programme of Action in 2005 and every efforts towards achieving this goal should be further supported.

However, one precautionary remark should be made. According to a SESRIC report (2014a), the structure of intra-OIC trade evolved over the years towards more non-fuel primary commodities and less mineral fuels. The share of mineral fuels in total intra-OIC trade decreased from 28% in 2005 to 21.9% in 2012. On the other hand, mineral fuels account around 50% of total OIC exports, but only 3% to 7% of total mineral fuels exported by OIC countries were made to other OIC countries. The falling oil prices since more than a year, therefore, reduced the monetary value of total exports of OIC

¹ **A note on international trade statistics:** Data on merchandise trade are collected from customs or from the balance of payments of individual countries. Because of differences in timing and definitions, trade flow estimates from these sources may differ. Several international agencies process trade data, each correcting unreported or misreported data with their own methodologies, leading to further differences in statistics. Therefore, it is common to observe significant differences in trade statistics provided by three major sources: UN Commodity Trade Statistics (Comtrade),

IMF Direction of Trade (DOT) and WTO databases. In reporting bilateral trade statistics, SESRIC uses IMF DOT database, as they provide most recent data with higher availability rate. It is also common for these agencies to update the figures on latest years as they collect more reliable data. Therefore, it is likely to see an update on the latest intra-OIC trade share of 20.6% in the next edition of OIC Economic Outlook.

Figure 2.6: Intra-OIC Merchandise Exports and Imports (US\$ Billion)



Source: IMF Directions of Trade Statistics (DOTS).

countries to the world, but narrowly affected the volume of intra-OIC trade. This, then, contributed to increase in the share of intra-OIC trade. Therefore, while evaluating the policy impacts on intra-OIC trade, the role of commodity prices should be taken well into consideration.

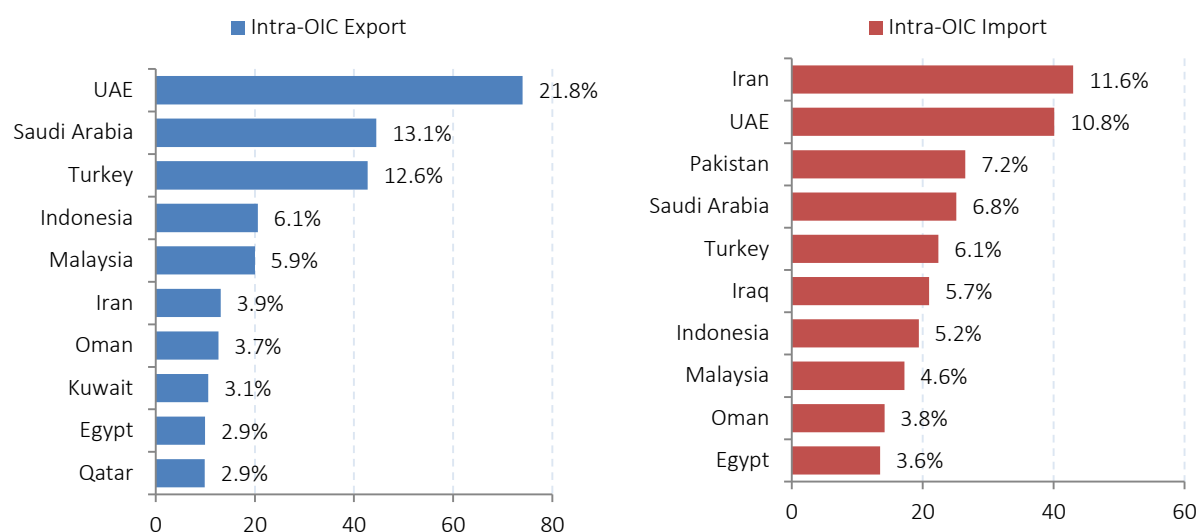
In 2014, **intra-OIC exports** were recorded at US\$ 375 billion, but it decreased to US\$ 339 billion in 2015. The amount is still substantial when compared to total intra-OIC exports of US\$ 210 billion in 2009, which had been preceded by a substantial decrease from its 2008 level of US\$ 273 billion, and only US\$ 132 billion in 2005 (Figure 2.6, right). The share of intra-OIC exports in total OIC exports continued to increase since 2011 and reached 21.1% in 2015. **Intra-OIC imports** reached US\$ 402 billion in 2013 and slightly decreased to US\$ 400 billion in 2014 and further decreased to US\$ 370 billion in 2015 (Figure 2.6, right). Again, these figures compared favourably to US\$ 224 billion bottom observed in 2009, when the global economic crisis were unfolding in its most severe form, and only US\$ 140 billion in 2005. The share of intra-OIC imports has

slightly increased from 19.9% in 2014 to 20.2% in 2015. Moreover, it should be noted that the share of intra-OIC exports in 2015 exceeded the share of intra-OIC imports for the first time during the period under consideration.

In order to increase the share of trade among them in their total merchandise trade even further, OIC countries should not only focus on operationalizing the OIC Trade Preferential System (TPS-OIC) with broader participation from the member countries, but also promote diversification and competitiveness of their tradable products taking into account their mutual needs and benefits from trade. As discussed in section 6 of this report, the progress made in operationalization of the system is rather sluggish.

Figure 2.7 (left) depicts the top 10 member countries in terms of the volume of their intra-OIC exports. In 2015, top 5 OIC intra-OIC exporters accounted for as much as 59.5% of total intra-OIC exports whereas the top 10 exporters for 76.1%. United Arab Emirates ranked first with US\$ 74 billion and 21.8% of total intra-OIC exports, followed by

Figure 2.7: Intra-OIC Merchandise Exports and Imports (2015, US\$ Billion)



Source: IMF Directions of Trade Statistics (DOTS).

Saudi Arabia (US\$ 45 billion, 13.1%), Turkey (US\$ 43 billion, 12.6%), Indonesia (US\$ 21 billion, 6.1%) and Malaysia (US\$ 20 billion, 5.9%).

The top OIC countries in terms of intra-OIC imports are also depicted in Figure 2.7 (right). In 2015, Iran, with US\$ 43 billion total volume and 11.6% share in total, was the largest importer from OIC countries. It was followed by United Arab Emirates with US\$ 40 billion and 10.8% share and Pakistan with US\$ 26.5 billion and 7.2% share. Top 5 OIC countries accounted for 42.4% of total intra-OIC imports and top 10 countries accounted for 65.5% in 2015.

FDI INFLOWS

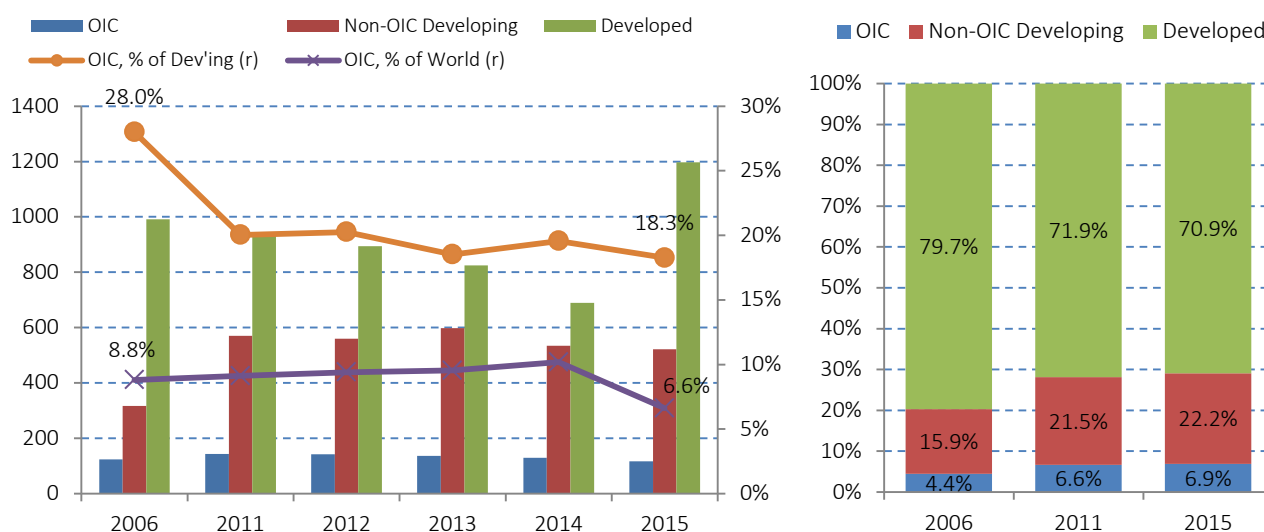
Share of OIC countries in total world FDI inflows fell to 6.6% in 2015, lowest level in recent years

World total **foreign direct investment** (FDI) inflows amounted to US\$ 1.76 trillion in 2015, marking a more than US\$ 486 billion increase over previous year's value of US\$ 1.27 billion. As of 2006, 70.7% of global FDI

inflows, which was then worth of US\$ 991 billion, were destined for developed countries, while the rest for developing economies. In 2013, developing countries reached 57.8% of the global FDI inflows and in 2015, the share of developing countries further decelerated to 67.9% thanks to the economic recovery in developed countries.

Figure 2.8 (left) depicts the total FDI flows to OIC countries in comparison to non-OIC developing and developed countries. It is observed from the figure that, during the period under consideration, FDI flows to OIC countries generally remained sub-potential. The total US\$ value of FDI inflows to OIC member countries was recorded at US\$ 123 billion in 2006. After global economic crisis, between 2011 and 2015 it remained in the US\$ 116-142 billion band. In 2015, the total value of FDI flows to OIC countries was recorded at US\$ 116 billion, registering a decrease for four consecutive years from its 2011 value of US\$ 142.8 billion. The share of OIC countries in total flows to developing countries, on the other hand, has generally been on decline since 2012. The share of the

Figure 2.8: Inward FDI Flow (left) and Stock (right) (US\$ Billion)



Source: UNCTAD STAT.

OIC group in developing countries amounted 18.3% in 2015. Depending on the trend in FDI flows to developed countries and non-OIC developing countries, its share in global FDI flows showed rather a fluctuating trend between 8% and 11% between 2001 and 2014. However, it decreased to 6.6% in 2015, the lowest level seen in the recent years.

Global inward FDI stock reached US\$ 25 trillion in 2015. OIC countries, on the other hand, collectively hosted 6.9% of the global FDI stock, which marked a 2.5 percentage point improvement given the value in 2006 (Figure 2.8, right). Furthermore, the bulk of the inward FDI stock in developing countries is hosted by non-OIC developing countries, which collectively recorded a 22.2% share in global inward FDI stock in 2015. Overall, developing countries increased their share in the world from 20.3% to 29.1% between 2006 and 2015, which was offset by a decrease in the share of developed countries.

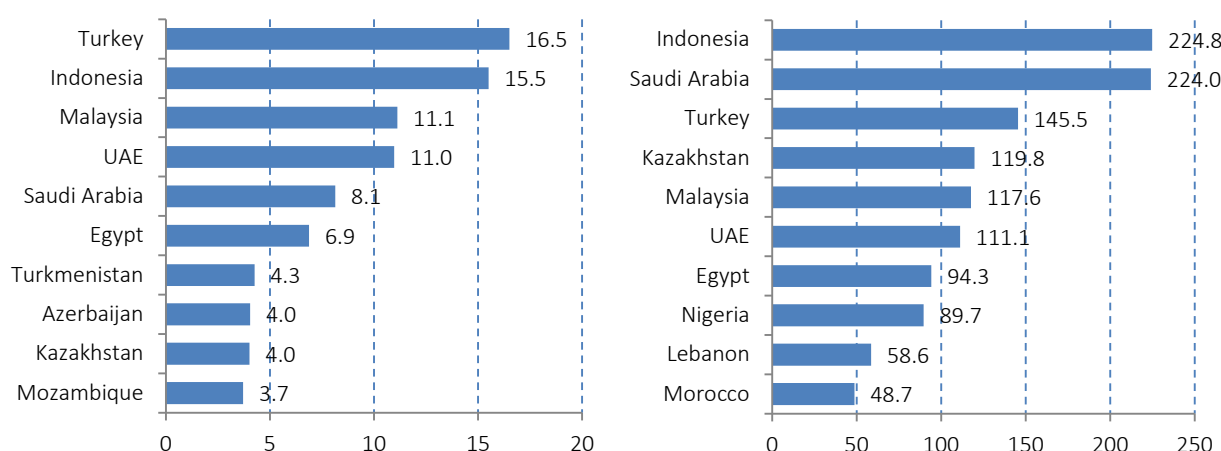
Like in the case of other major macroeconomic aggregates of the OIC group, FDI flows to OIC countries also exhibited a high level of concentration, with bulk of it persistently being directed to a few of them.

The top 5 OIC countries with largest inward FDI flows together accounted for 53.4% of total FDI flows to OIC countries, whereas the top 10 countries accounted for 73.2% (Figure 2.9, left). In 2015, Turkey took the lead in FDI inflows with US\$ 16.5 billion of inward FDI flow, and a 14.1% share in total FDI flows to OIC countries. Turkey was followed by Indonesia (US\$ 15.5 billion, 13.3%), Malaysia (US\$ 11.1 billion, 9.5%), United Arab Emirates (US\$ 11 billion, 9.4%) and Saudi Arabia (US\$ 8.1 billion, 6.9%).

A similar picture is observed in the case of inward FDI stock as well: top 5 countries hosted 46.8% of total OIC inward FDI stocks whereas the top 10 countries 69.4%. With US\$ 224.8 billion of inward FDI stocks (12.6% of the OIC total), Indonesia ranked first among the list of OIC countries with largest inward FDI stock in 2015. Indonesia was followed by Saudi Arabia (US\$ 224 billion, 12.5%), Turkey (US\$ 145 billion, 8.2%), Kazakhstan (US\$ 119 billion, 6.7%) and Malaysia (US\$ 117 billion, 6.6%).

Overall, this state of affairs suggests that a significant majority of the OIC countries are still not able to set up favourable economic

Figure 2.9: Top 10 Hosts of Inward FDI Flows (left) and Stock (right) (2015, US\$ Billion)

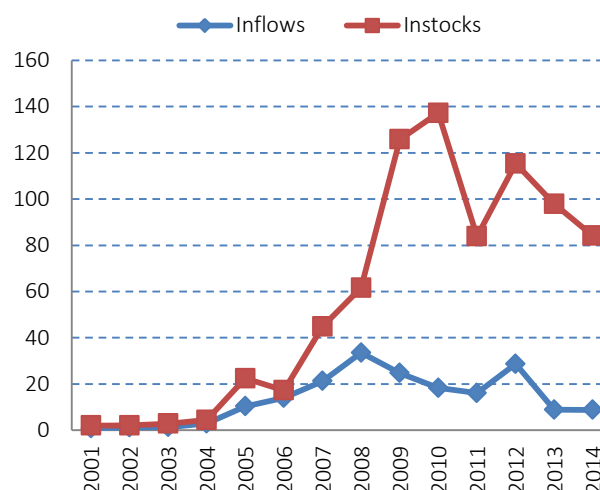


Source: UNCTAD STAT.

frameworks and to provide the foreign businesses with adequate regulatory as well as physical infrastructure to attract more FDI flows. Consequently, OIC countries, in general, need to take swift measures to foster an environment conducive to attracting more foreign investments. To achieve this goal, reforms are needed to improve the business climate and to introduce investment incentives tailored to the needs of both domestic and foreign investors. This, in turn, requires building adequate infrastructure as well as investing in modern technologies to enhance their productive capacities, which is still a significant challenge to majority of them.

the economic integration among OIC countries (e.g. intra-OIC trade and tourism), intra-OIC FDI trends can be a good indicator to assess the level of economic integration among OIC countries. A higher volume of intra-OIC FDI inflows implies the existence of stronger economic ties among OIC countries. In a similar fashion, an increased volume of intra-OIC FDI inward stocks indicates improvement among intra-OIC economic cooperation stemming from FDI originating from OIC countries.

Figure 2.10: Intra-OIC FDI Inflows and Instocks (US\$ Billion)

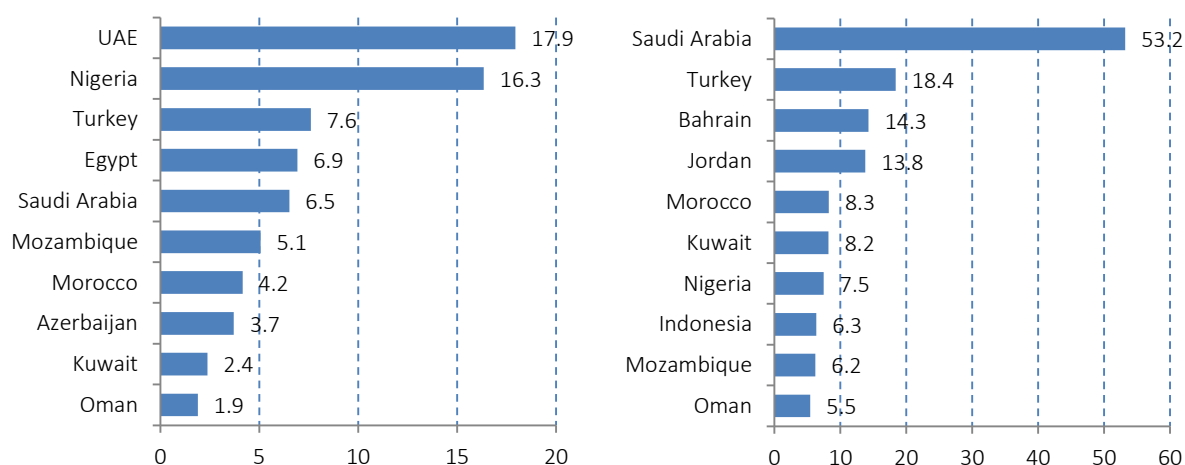


INTRA-OIC FDI INFLOWS

Intra-OIC investment flows have been falling since 2012

Intra-OIC FDI inflows and instocks (i.e. inward stocks) reflect the directed investment from one source OIC country to another host OIC member country. As in other dimensions of

Figure 2.11: Top OIC Countries in terms of Intra-OIC FDI Inflows (left) and Instocks (right) (US\$ Billion), 2010-2014



Source: UNCTAD STAT.

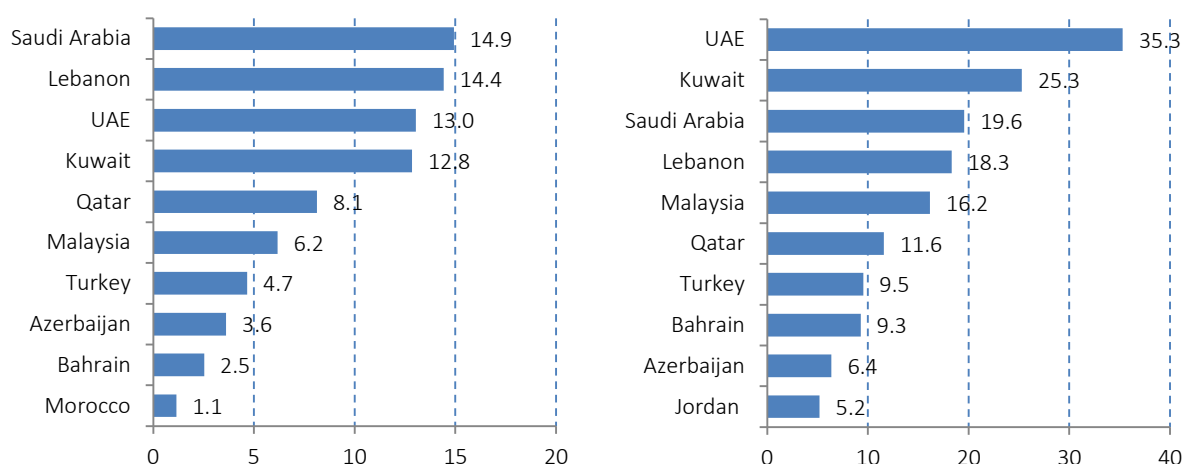
Figure 2.10 presents the trends on the intra-OIC FDI inflows and instocks between 2001 and 2014. According to Figure 2.10, between 2001 and 2004 both intra-OIC FDI inflows and instocks followed a stable pattern. Only after 2004 both inflows and instocks started to climb up until the global economic crisis. Intra-OIC FDI instocks reached its peak value in 2010 by hitting US\$ 137.2 billion. By 2014, it went down to US\$ 84.1 billion. Intra-OIC FDI inflows peaked up in 2008 with US\$ 33.4 billion. Intra-FDI inflows slightly decreased from US\$ 8.8 billion in 2013 to US\$ 8.7 billion in 2014. As of 2014, both intra-OIC FDI inflows and instocks were lower than their peak values in 2008 and 2010, respectively.

Between 2001 and 2012 intra-OIC FDI inflows and instocks figures improved, despite having booms and busts. This reflects an improved economic integration among OIC countries. Nonetheless, it is fair to claim that these figures are being far from their potential. Figures on intra-OIC FDI inflows and instocks were stagnating lower than their peak values. Therefore, more policy-interventions are needed to reduce intra-OIC investment barriers. These interventions should not be only limited with the free movement of

capital across the borders of OIC member countries but also need to address the restrictive visa regimes applied to citizens of OIC countries by other OIC countries since foreign investors usually look for eased movement of human capital across borders (i.e. limited or no restriction on transfer of labour). OIC countries need to get a common understanding that there is a great potential in terms of intra-OIC FDI flows, which can boost economic growth and trigger development in OIC countries. However, existing barriers in OIC countries ahead of investors in terms of institutional quality, visa regimes, restrictions on profit and capital transfers etc., limits the level of economic cooperation among OIC member countries.

At the individual country level, Figure 2.11 presents top-ten OIC member countries in terms of intra-OIC FDI inflows and instocks during the 2010 and 2014 period. United Arab Emirates and Nigeria were the two leading OIC countries in terms of the amount of cumulative intra-OIC FDI inflows. United Arab Emirates alone attracted US\$ 17.9 billion FDI between 2010 and 2014 from other OIC countries. In terms of intra-OIC FDI inward stocks, Saudi Arabia took the lead and

Figure 2.12: Top OIC Countries in terms of Intra-OIC FDI Outflows (left) and Outstocks (right) (US\$ Billion), 2010-2014



Source: UNCTAD STAT.

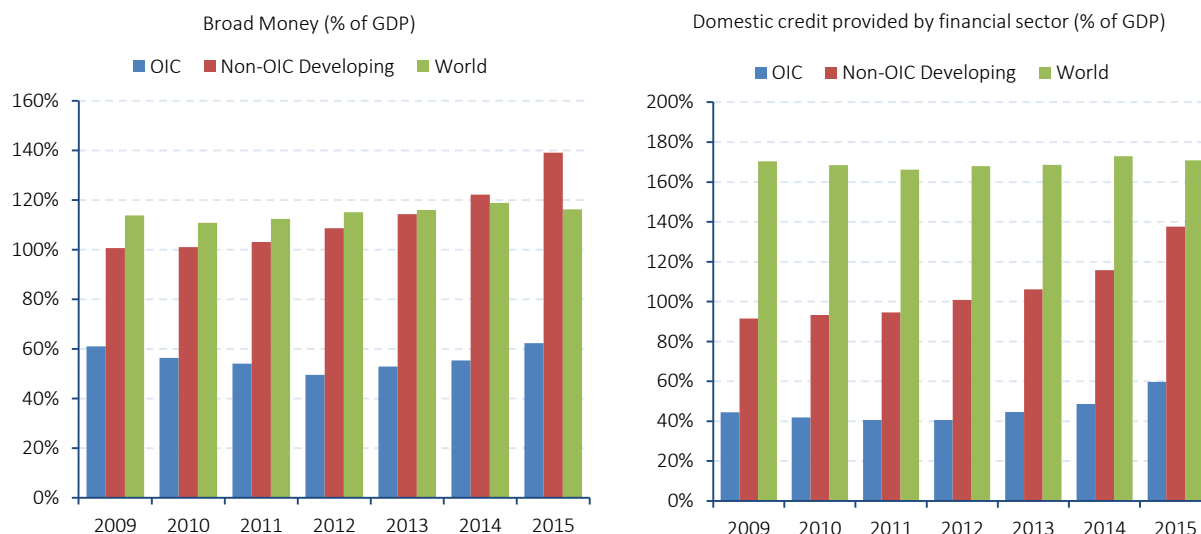
the inward FDI stocks reached US\$ 53.2 billion in the same period. Saudi Arabia was followed by Turkey with intra-OIC FDI inward stock amounting US\$ 18.4 billion. Intra-OIC outflows and outstocks figures can be used to track trends in major intra-OIC investor countries. According to Figure 2.13, Saudi Arabia and Lebanon were the two leading OIC countries who invested the most in other OIC countries between 2010 and 2014. Both OIC countries invested individually more than US\$ 14 billion into other OIC countries over the period 2010-2014. In the same period, United Arab Emirates, Kuwait and Saudi Arabia were listed as the top three OIC countries possessing the highest amount of FDI stock in other OIC countries. The existing total outward FDI stock of United Arab Emirates, Kuwait and Saudi Arabia in OIC countries exceeded US\$ 80 billion in this period.

The intra-OIC FDI figures provide some clues on the unequal distribution of intra-OIC FDI flows and stocks. A group of few OIC countries benefited relatively more than other member countries from intra-OIC FDI. For instance, the volume of intra-OIC FDI inflows recorded by the top four performer

OIC countries (United Arab Emirates, Nigeria, Turkey and Egypt) between 2010 and 2014 represented 60.6% of all intra-OIC FDI inflows seen in the same period. The share of the top ten performer OIC countries in total intra-OIC FDI inflows exceeded 90%. Therefore, the positive trends seen in intra-OIC FDI figures have not been stemming from an overall improvement in intra-OIC cooperation rather it is a result of increased economic integration among some OIC countries.

These figures indicate that the OIC countries have not yet achieve a desirable level of intra-OIC FDI flows. The existing levels seen in intra-OIC FDI figures are still far below its potential (SESRIC, 2014c; UNCTAD, 2013). The success on reaching the potential in intra-OIC FDI are closely linked to the determination of policy-makers of OIC countries to adopt some concrete policy measures for reducing trade and investment barriers, abolishing/easing visa regimes, and facilitating capital transfers among OIC member countries.

Figure 2.13: Financial Sector Development



Source: World Bank WDI.

FINANCIAL SECTOR

Degree of financial deepening in OIC countries remained unsatisfactory

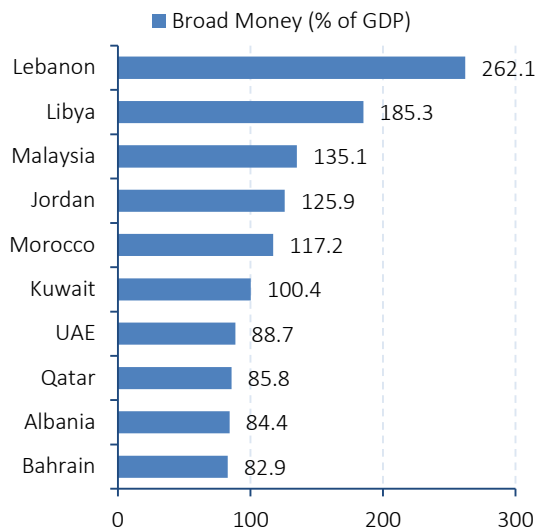
A well-functioning financial system can pave the way for rapid economic development through, inter alia, the efficient allocation of domestic savings into productive economic activities. The importance of this role has indeed gained much attention in the recent literature on economic growth, and a strong consensus has emerged in the last decade that well-functioning financial intermediaries have a significant impact on economic growth (Levine, 2004).

A commonly used indicator for determining the degree of **financial deepening** is the ratio of broad money to GDP. A higher ratio is generally associated with greater financial liquidity and depth. As shown in Figure 2.13 (left), the average volume of broad money relative to the GDP of OIC countries was recorded at 62.3% in 2015, compared to as much as 139% in non-OIC developing countries and 116.2% of world average.

Apparently, the financial sector in the member countries lag behind in the provision of sufficient liquidity and better investment opportunities to the economy at lower cost. This state of affairs partially manifests itself in low levels of credit provided by the financial sector as % of GDP. In 2015, the financial sector on average provided credit to the domestic economy as much as 59.7% of the GDP in OIC countries whereas, in non-OIC developing countries, this figure was 137.6% (Figure 2.13, right). Domestic credit by financial sector in developed countries, on the other hand, was on average in the excess of twice the size of GDP in 2015 (205%), which increased the world average 170.9%.

The degree of **financial development** varies substantially across the OIC countries. While some member countries have relatively more advanced financial systems including vibrant banking, insurance and other financial institutions, and effective financial regulatory and supervisory regimes; many others lag behind in terms of their stages of financial development. This, in turn, offers a

Figure 2.14: Financial Sector Development (2015)



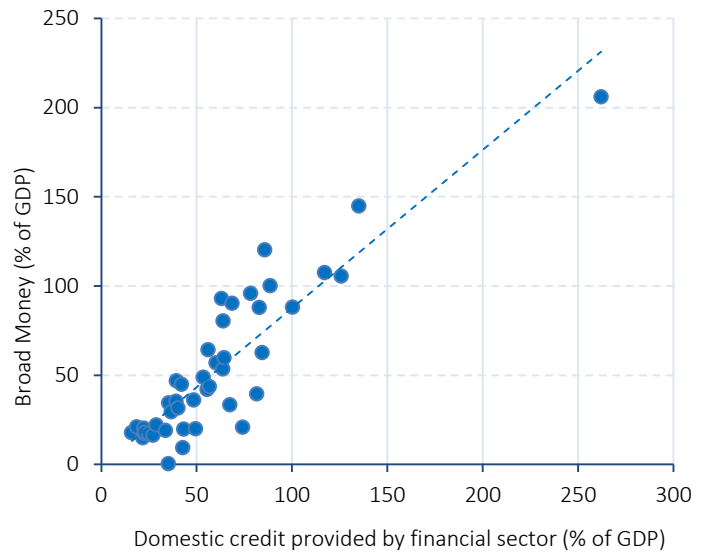
Source: World Bank WDI.

significant room for improvement of financial systems in OIC countries.

Taking into account the widely accepted view that the financial deepening confers important stability benefits to the economy, albeit with caveats, many OIC countries are apparently deprived of these stability benefits. Yet, there are some exceptions to this such as Lebanon, Libya, Malaysia and Jordan where financial depth, as measured by the volume of broad money relative to GDP, is above the average world level. In Lebanon, for instance, the total size of broad money which includes, inter alia, all narrow money and deposits, was more than twice the size of the GDP (262.1%), as shown in Figure 2.14. Similarly, in Libya, the size of liquidity in the economy corresponded to 185.3% of the GDP. In Malaysia, Jordan, Morocco and Kuwait, the relative size of broad money to GDP was more than 100%.

A report by IMF argues that financial deepening, through an increase in financial transaction volumes, can enhance the capacity of the financial system of a country to intermediate capital flows without large

Figure 2.15: Liquidity versus Domestic Credit

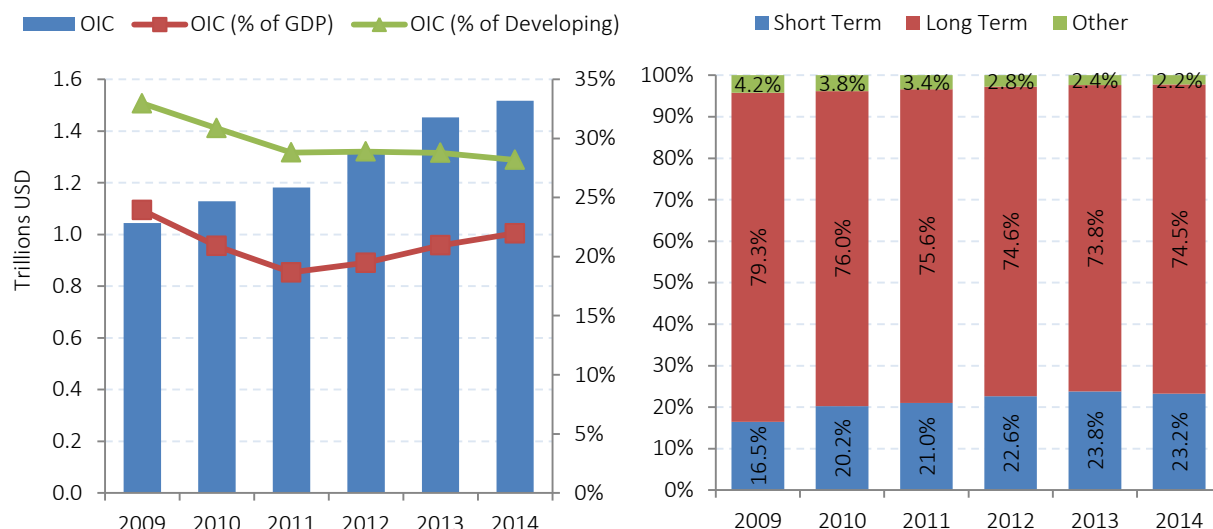


Source: World Bank WDI.

swings in asset prices and exchange rates (IMF, 2011). Deeper financial markets are argued to provide alternative sources of funding domestic financial market during times of international stress, limiting adverse spill-overs, as evidenced in the recent global financial crisis. Figure 2.15, in this regard, supports this argument for OIC countries by depicting the strength of relationship between broad money and availability of credit in 2015.

Yet, the evidence suggests that deeper financial markets can also attract volatile capital inflows, complicating macroeconomic management of the country's economy. Moreover, financial deepening can occur too quickly, leading to credit booms and subsequent busts. At the systemic level, all these factors, if properly managed, can attenuate the need to accumulate foreign assets, and, at the global level, promote global adjustment (Maziad et al., 2011).

Figure 2.16: External Debt (left) and Term Structure of External Debt (right)



Source: World Bank WDI.

EXTERNAL DEBT

Following the steady increase, the share of short term debts decreased slightly in 2014.

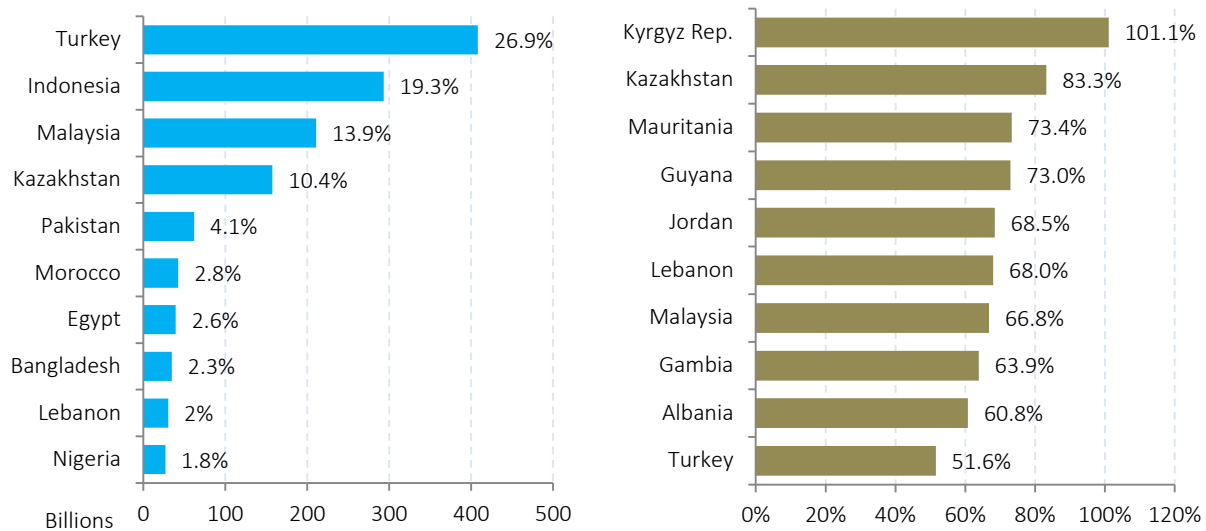
The total external debt stock of OIC countries showed an increasing trend during the period under consideration. In 2014, the total external debt of OIC countries increased by more than US\$ 100 billion over the previous year's value and reached US\$ 1.52 trillion. On the other hand, 20 OIC countries still continue to be classified as Heavily Indebted Poor Countries (HIPC) by the World Bank. In line with the increasing amount of debt in absolute terms, Figure 2.16 (left) illustrates that both the relative size of OIC debt to their GDP and their share in the total developing countries debt has been increasing since 2011. In this regard, average debt-to-GDP for the indebted OIC countries increased from 18.7% in 2011 to 22% in 2014. During the same period, total external debt stock of OIC countries as percentage of total developing countries

debt decreased slightly from 28.8% to 28.2%.

When the term structure of external debt of OIC countries is considered, it is observed that long-term debt continued to account for the largest portion of total OIC external debt, with 74.5% share in 2014. However, the share of short-term debt has been constantly rising during 2009-2013, which reached 23.2% in 2013 compared to only 16.5% in 2009 (Figure 2.16, right). In 2014, this share decreased slightly to 23.2%

In terms of debt stock in absolute terms, Turkey was the most indebted OIC member country in 2014 (Figure 2.17, left). The country held US\$ 408 billion in debt, which made up 26.9% of total OIC external debt. Turkey was followed by Indonesia, Malaysia, Kazakhstan and Pakistan, which had external debt levels varying from US\$ 293 to 62 billion. Only 3 OIC countries accounted for as much as 60% of total OIC external debt whereas the top 10 countries for 86.1%. However, given the size of a country's economic output, looking at the absolute size of debt stock might be misleading.

Figure 2.17: Top 10 Indebted OIC Countries (left) and Debt Stock as % of GNI (right)



Source: World Bank WDI.

Debt-to-GNI ratio, in that sense, is argued to give a more accurate view of a country's indebtedness, adjusting it for the size of gross national income. In terms of relative size of external debt to GNI, Kyrgyz Republic, with a 101.1% debt-to-GNI, was the most indebted OIC country in 2014 (Figure 2.17, right). It was followed by Kazakhstan, Mauritania, Guyana and Jordan, with debt-to-GNI ratios varying from 83.3% to 68.5%.

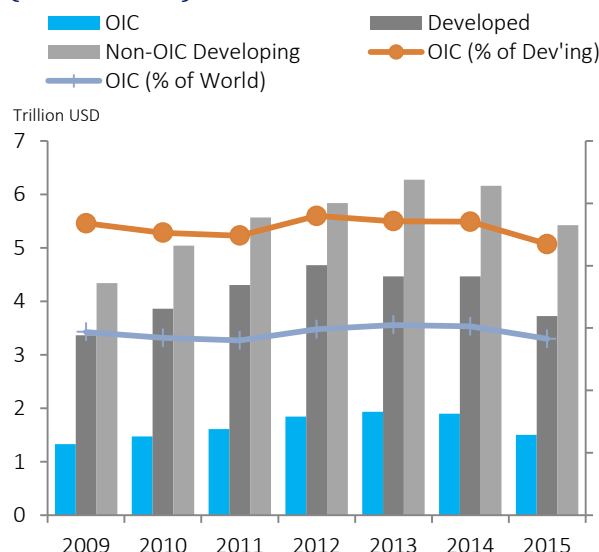
RESERVES

After many years of constant increase, total reserves of OIC countries started to fall in 2014.

Reserves are usually considered as an important instrument to safeguard the economy against abrupt external shocks. World total monetary reserves – including gold – increased from US\$ 9 trillion in 2009 to US\$ 12.5 trillion in 2014, but it decreased back to US\$ 10.6 trillion in 2015. Of this amount, US\$ 3.7 trillion are possessed by developed countries while the remaining US\$ 6.9 trillion are owned by developing

countries (Figure 2.18). Total reserves of OIC countries increased from US\$ 1.3 trillion in 2009 to US\$ 1.9 trillion in 2013. However, it started to decline over the last two years and reached US\$ 1.5 trillion in 2015. Accordingly, the share of OIC countries in total reserves of the developing countries declined from 23.6% in 2013 to 21.7% in 2015. As of 2015, share of all developing countries in world total reserves corresponded to around two thirds (65%). Although the bulk of this can be explained by the increasing trade flows from, and the resulting trade surpluses of, some emerging economies such as China, other newly industrialized countries in Asia, as well as oil exporting countries in the Middle East; the financial reform efforts in some developing countries (mainly, those with chronic current account deficits) to improve their reserves position also played a role. Capital account liberalization in some developing countries has apparently brought about the need for accumulating reserves as an insurance against financial volatilities including sudden stops/reversals of capital influx.

Figure 2.18: Reserves including Gold (US\$ Billion)



Source: World Bank WDI.

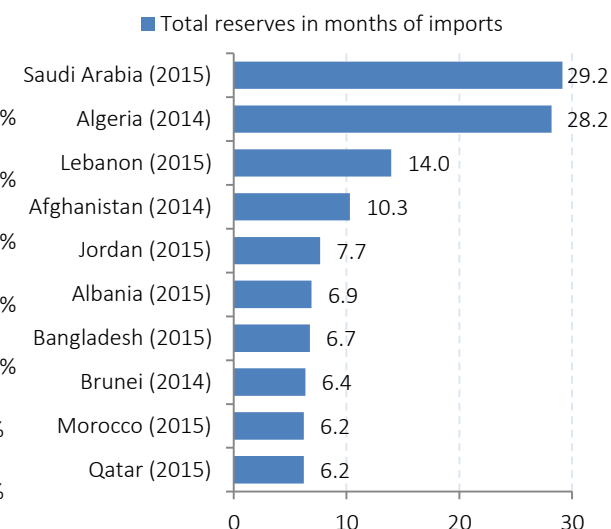
Figure 2.19 displays the top 10 OIC countries by volume of reserves in months of exports in 2014-2015. Saudi Arabia, with reserves equivalent to 29.2 months of exports, topped the list, whereas Algeria followed closely with reserves equivalent to 28.2 months of exports. Together with Lebanon and Afghanistan, only in four OIC member countries, the reserves were equivalent to more than 10 months of their exports.

ODA AND REMITTANCES

Ten OIC countries received 59.4% of total ODA flows to OIC countries in 2014.

Official development assistance (ODA) continues to be an important source of financing for many developing countries, including OIC countries. In 2014, net ODA flows from all donors to developing countries reached US\$ 100.8 billion compared to US\$ 88.9 billion in 2009 (Figure 2.18, left). Since 2010, ODA flows to OIC countries exhibited an upward trend. As of 2014, OIC countries, with US\$ 53.8 billion, accounted for 53.3% of

Figure 2.19: Top 10 OIC Countries by Total Reserves in Months of Exports



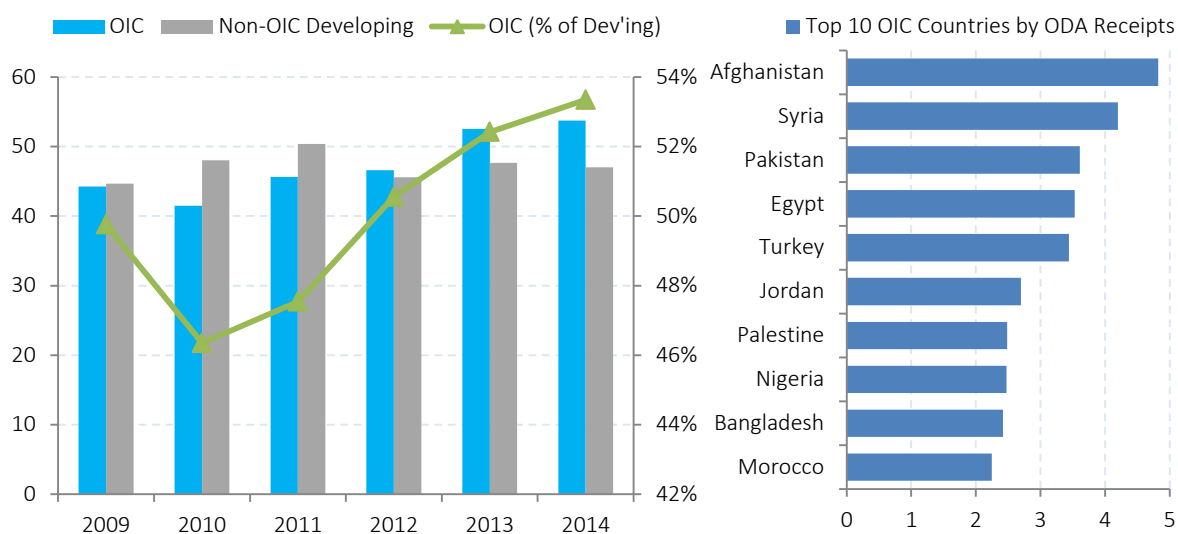
Source: World Bank WDI.

the total ODA flows to developing countries, the highest share observed during the period under consideration.

ODA inflows to OIC countries show similar characteristics, when their concentration level is concerned. In 2014, the top 5 member countries received 36.5% of total ODA flows to OIC countries whereas the top 10 received 59.4% of them (Figure 2.20, right). Afghanistan, with total inflows of US\$ 4.8 billion and 9% of OIC total, ranked first. It was followed by Syria (US\$ 4.2 billion, 7.8%), Pakistan (US\$ 3.6 billion, 6.7%), Egypt (US\$ 3.5 billion, 6.6%) and Turkey (US\$ 3.4 billion, 6.4%).

Figure 2.21, on the other hand, shows that the inflows of personal **remittances** to OIC member countries increased from US\$ 110 billion in 2011 to US\$ 133 billion in 2014, but sharply declined to US\$ 66.4 billion in 2015. As the financial and economic crisis of 2008-2009 affected the economies of the developed countries at first place, significant number of immigrant workers from developing countries experienced fall in their incomes as a major source of

Figure 2.20: Official Development Assistance, US\$ Billion



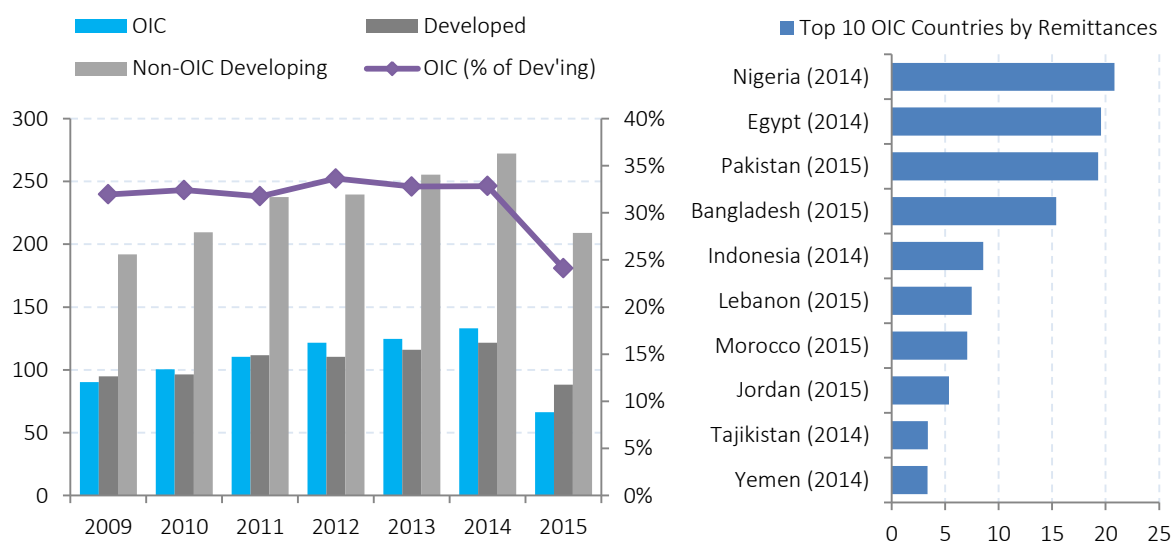
Source: World Bank WDI.

remittances to their home countries. This resulted in a decrease in remittance flows to OIC as well as non-OIC developing countries. Remittance flows to non-OIC developing countries, on the other hand, relatively improved during the examined period and increased from US\$ 260 billion in 2011 to US\$ 270 billion in 2013.

At the individual country level, it is observed that even a more significant portion of

inward remittance flows to OIC countries concentrate on a few members during 2014-2015. In the list of top remittance receivers in the OIC region, Nigeria took the first place with US\$ 20.8 billion of remittances inflows (Figure 2.21, right). It was followed by Egypt (US\$ 19.6 billion), Pakistan (US\$ 19.3 billion), Bangladesh (US\$ 15.4 billion) and Indonesia (US\$ 8.6 billion).

Figure 2.21: Personal Remittances, US\$ Billion



Source: World Bank WDI.

Part II

Transforming the **Potentials** into **Impact** in OIC Countries



This part includes:

3. Exploring Potentials of OIC Countries with Economic Impact
4. Dynamic Population Structure
5. Rich Energy Resources
6. Great Market Potential
7. Policy Issues for Transforming the Potentials into Impact

PART II

This special Part of the *OIC Economic Outlook 2016* provides a comprehensive overview of potentials of OIC member countries with economic impact under the theme of “*Transforming the Potentials into Impact*”. The report argues that economic development in OIC countries is just a matter of identifying the productive resources and potentials and then developing correct mechanisms and instruments to effectively utilize them in welfare improving economic activities.

In this context, section 3 identify some potential areas where OIC countries have relatively stronger position vis-à-vis the rest of the world, effective utilization of which may result in higher economic growth rates. The potential strengths of OIC countries in terms of growth and development are explored under five categories: human capital, natural resources, knowledge capital, social capital and economic geography. Section 4 focuses on the dynamic population structure of OC countries as a potential strength and discusses several issues related to enhancing productive capacity of youth. Section 5 discusses the role of rich natural resources as a potential factor in promoting growth and development. Section 6 stresses the importance of utilizing great market potential in OIC countries. Finally, section 7 provides some policy recommendations on how to unlock the potentials for better economic performance in OIC countries.



SECTION 3



Exploring Potentials of OIC Countries with Economic Impact

Today there are large differences in income and productivity levels across countries. As shown in Part I of this report, OIC countries are lagging behind the world average in many indicators and accordingly not productive enough to possess a proportional share of world prosperity. Despite the fact that OIC countries account for more than 23% of world population, they can account for only 8.6% of the total world production when measured in current prices. There are ample factors to explain the relatively poor economic performance of many OIC countries. However, they also possess critical resources that could promote growth and development if properly utilized.

Aim of this section is not to identify the problems associated with low economic performance and to explain the growth differences across countries. From a different perspective, it aims to identify the available resources that can potentially affect the development trajectory of the OIC countries. In this context, this section starts with a short overview of the potential factors identified in the literature to explain the growth in the long run. Then it explores key potential strengths of OIC countries in promoting growth and development under five categories. Based on the analysis in this section, the following sections will provide a detailed discussion of these potential resources for stronger growth and development in OIC countries.

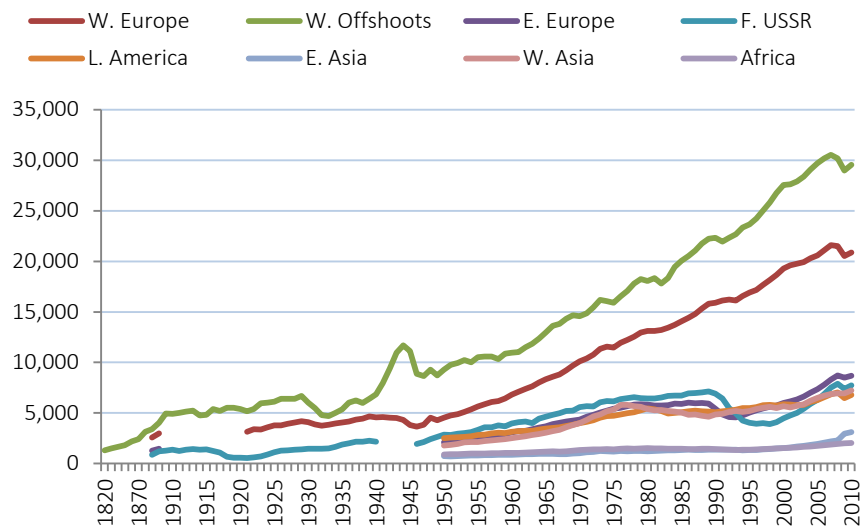
3.1 Factors Leading to Higher Economic Growth

A large variation has been observed in the growth experiences of different countries over time. While some countries experienced sustained growth for more than a century and became enormously wealthy, some others continue to live close to subsistence level, what is often referred to as the “great divergence”. Again, some poor countries could manage to achieve stronger growth

rates in catching up wealthier countries within several decades. Figure 3.1 shows the evolution of average income growths in different country groups over the last two centuries. The differences in growth experiences make it definitely challenging for economists to explain the drivers of higher growth rates across time and countries. Some models are able provide an explanation for the growth experience of developed countries but fail to do it for low income countries.

Figure 3.1

The Evolution of Average GDP per capita, 1820-2010



Source: The Maddison Project Database. Western Offshoots include USA, Canada, Australia and New Zealand.

Standard economic theory suggests a number of factors contributing to the economic growth. In terms of an aggregate production function, output of a country depends on its stocks of physical, human and natural capital. Physical capital broadly includes machines, buildings, and infrastructure such as roads and ports. A key characteristic of physical capital is that it is produced to be used in production of other goods and services. Human capital refers to the knowledge and capabilities embodied in people that can be utilized to advance the production techniques and contribute to the social and economic development. Natural capital is the stock of a country's lands, water, forests, and subsoil resources, which are not produced but used in the process of production of goods and services.

Historically, it is observed that countries with sustained growth rates attained high investment rates in physical and human capital. It is also observed that countries with similar stock of capitals may experience different growth rates. Accordingly, it is suggested that economic growth depends not only on the growth of capital accumulation but also on productivity, technology and efficiency. Productivity differences became the dominant factor in explaining the divergent growth paths and income differences. It includes both genuine differences in the techniques and instruments, but also differences in productive efficiency resulting from the way production and markets are organized. Technological development helps to boost intellectual capital and knowledge, through which production processes become more efficient. If resources are not productively used or misallocated through some bad policy choices, efficiency and productivity will not take place.

Consequently, countries with different capital endowments and productivity rates are explained to experience different growth rates. However, it would not be entirely satisfactory to explain the process of economic growth and cross-country income differences with level of technology, human capital and physical capital. In this connection, economic literature provides additional dimensions

in explaining divergent growth rates, such as institutional quality, geography, policy choices and culture. Institutions are about rules and regulations that affect economic incentives and thus the incentives to invest in technology, physical capital and human capital through protection of property rights, ensuring proper functioning of markets, and enforcing contracts. Accordingly, it is expected that societies with economic institutions that facilitate and encourage factor accumulation, innovation and the efficient allocation of resources to prosper and attain higher growth rates.

The “reversal of fortune” hypothesis of Acemoglu et al. (2002) highlights the particular role of institutions, where economic success 500 years ago is found to be negatively correlated with economic success today in the case of former European colonies. In 15th and 16th centuries, Europeans tended to set up *extractive* institutions in already economically successful places to transfer the economic gains back to Europe. On the other hand, Europeans themselves migrated to sparsely populated places and set up *inclusive* institutions that were conducive to long-run economic success.²

With respect to the role of geography, literature suggests different channels through which it may affect economic growth, including its effect on disease burden, agricultural productivity, transport costs and market access. In the same fashion, economic policies affect the return to investment and shape the incentives in a country. Policies that create inefficiencies and protect the unproductive processes or technologically backward firms make only a small group richer without promoting innovation and technological development. Social capital and culture also play an important role in economic development processes. While communities with strong social capital, trust, work ethics and respect for law and order become more productive, lack of social trust within communities only increases the potential risk of violence and conflict. It is hard to observe good economic performance in societies where conflict and deprivation have weakened co-operation and collective action.

All the factors explained briefly above are used in explaining the divergent growth experiences of countries over the years. There are some other less critical factors that are also used in the literature to explain the growth differences, such as macroeconomic stability, trade openness and financial deepness. However, the rate of accumulation of physical and human capital along with investment in knowledge creation considered to be the most critical factors. In the long term, impacts of these and other factors will be important only to the extent they lead to higher productivity levels.

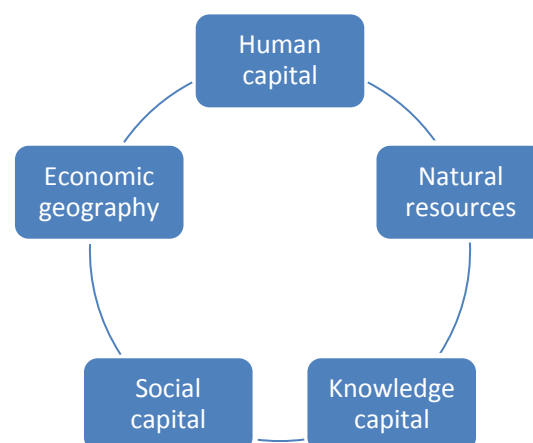
In this connection, whatever initial endowments countries possess should be utilized in a way they promote productive capacities of production factors. Next subsection will identify some potential areas where OIC countries have relatively stronger position vis-à-vis the rest of the world, effective utilization of which may result in higher economic growth rates.

3.2 Comparative Advantages of OIC Countries in Promoting Growth and Competitiveness

Based on the preceding discussion, the potential strengths of OIC countries in terms of growth and development will be explored under five categories: human capital, natural resources, knowledge capital, social capital and economic geography. Some of the factors discussed above are ignored as

² See also Jones (2015).

they do not fit into the purpose of this section in terms of exploring potential strengths. On the other hand, it should be noted that OIC countries have individually different resources in different categories. A collective analysis may not be a right approach in understanding the potentials of individual countries, but it offers a good prospect in exploring the collective strengths of OIC countries.

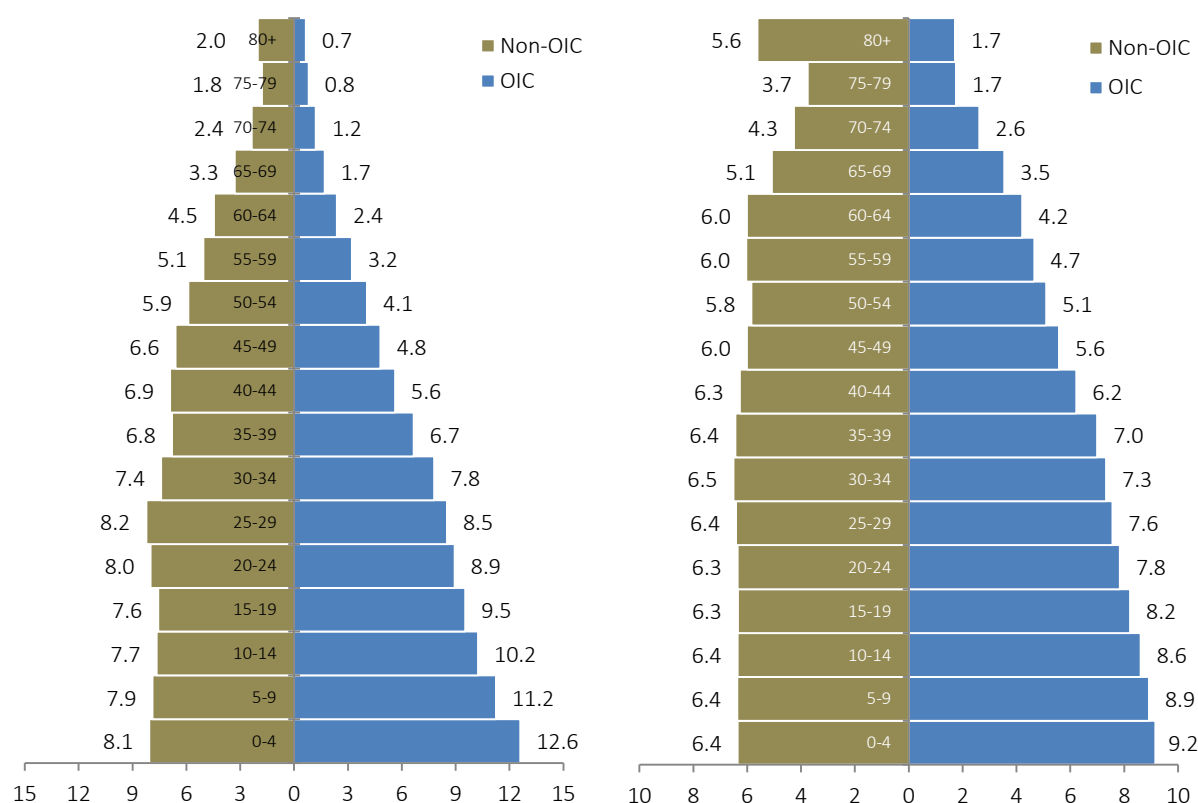


3.2.1 Human Capital

The stock of human capital plays an important role in determining the ability to absorb new knowledge and technologies, and thus increasing labour productivity. Measuring the stock of human capital is, however, challenging. In the literature, various proxies are used in analysing the human capital developments. School attainment has been the most common but also the easiest way of measuring human capital. Economic growth literature suggests alternative ways to construct such a dataset. According to the seminal work of Hall and Jones (1999), human capital is calculated by using two major indicators, the total number of labour force and average schooling. Thus, under given average schooling level, the countries with higher labour force will have higher human capital stock. Equivalently, under given size of labour force, countries with higher educational attainment

Figure 3.2

Population Pyramid in OIC and Non-OIC Countries, 2015 (left) - 2050 (right)



Source: SESRIC staff calculation based on UN World Population Prospects: The 2015 Revision.

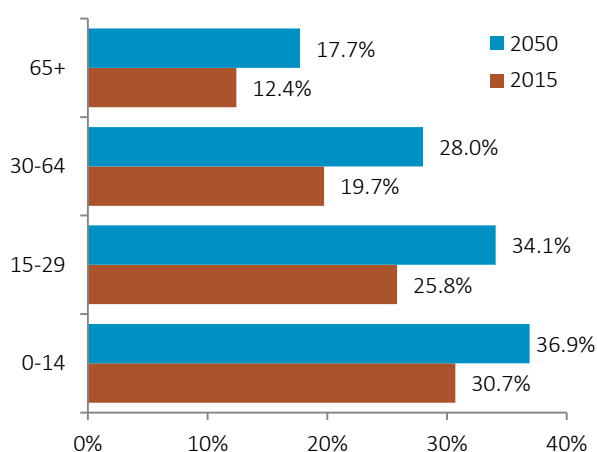
will have higher human capital stock.

Human capital accumulation primarily depends on two factors: working age population and education. A previous analysis on human capital accumulation in OIC countries reveal that, starting with low levels of human capital stocks, the OIC member countries have significantly increased their stocks of human capital over the last four decades, but this did not translate into higher economic growth in all countries (SESRIC, 2011). This fact led to questioning of the quality of education provided to their citizens by these countries. SESRIC (2014) also shows that quality of education in OIC countries is not sufficiently good. It appears that OIC countries do not have a specific strength in accumulating human capital through education and skills development. The analysis under knowledge capital will further shed light on the educational outcomes in OIC countries.

It remains only the population of OIC countries as a source of potential strength under human capital category. Figure 3.2 compares the population structure of OIC countries with the rest of the world. As of 2015, 34.1% of population in OIC countries is under age 15 compared to 23.6% in non-OIC countries. Young people at age 15-29 accounts for 27% of total OIC population, whereas it is only 23.8% in non-OIC countries. Similarly, it is projected that the population at age group 0-29 by 2050 will account for 50.3% of total OIC population compared to 38.2% in non-OIC countries.

It is evident that OIC countries have a more dynamic population structure and this trend will continue for a considerable period of time. Population growth rates are expected to decline all over the world over time, but this trend will be slower in OIC countries compared to the rest of the world. Accordingly, OIC countries are expected to account for a larger share of children and young people in the world. As shown in Figure 3.3, the share of OIC countries in total population of age group 0-14 is expected to reach 36.9% in 2050 compared to 30.7% in 2015 and that of age group 15-29 to reach 34.1% in 2050 compared to 25.8% in 2015. Therefore, it is fair to argue that current and prospective population structure offers a window of opportunity for OIC countries to grow faster with effective utilization of this dynamic force.

Figure 3.3
Share of OIC in Different Age Groups



Source: SESRIC staff calculation based on UN World Population Prospects: The 2015 Revision.

Although there have been also negative perceptions among some economists on the role of population, where it is argued that population growth reduces physical and human capital per worker and increases the rate of investment and school expenditure required to maintain output per worker based on a Malthusian approach. However, at a time when a significant part of the world becomes increasingly concerned about the ageing population, accounting for a larger share of young populations should undoubtedly be an important asset for OIC countries.

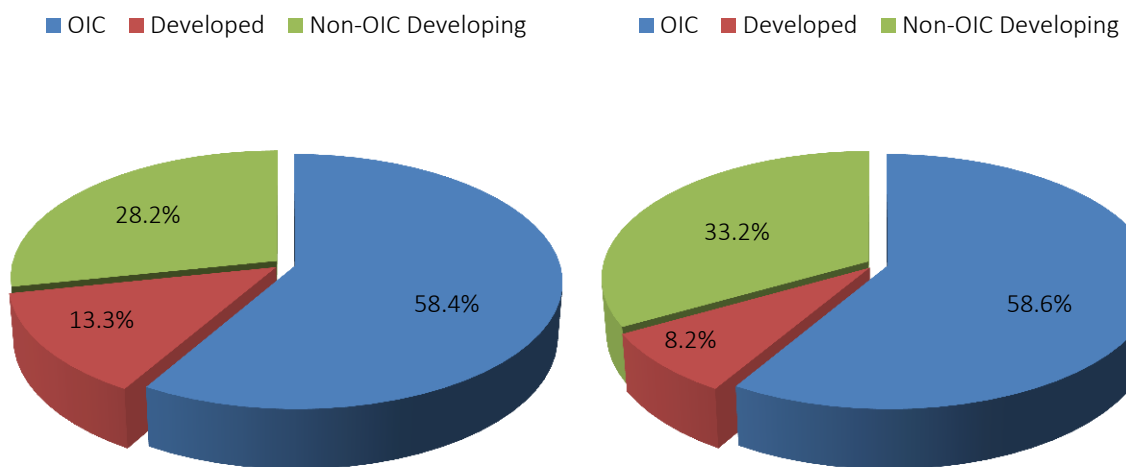
3.2.2 Natural Resources

Many developing countries are highly dependent on the exploitation of their *natural capital* to secure their needs and develop and meet the needs of future generations. However, increasing economic dependence on natural resources in today's developing countries is associated with poorer economic performance. Several theories have been proposed to explain why increasing economic dependence on natural resources in developing countries is associated with poorer economic performance. A popular explanation is inability to expand into other productive industries, commonly referred as the *Dutch disease* effects. Excessive specialization in primary product exports for too long creates additional fragilities. Another explanation is inequality in wealth and political power that generate legal and economic institutions inimical to growth and development (Barbier, 2007).

Despite the distortionary impacts of abundant natural resources, there are of course countries that benefited extensively from their natural resources in their development. Such resources offer great potential for fostering development if appropriate policies are developed and implemented for reinvestment of windfall gains in more productive and dynamic sectors. Before that, it is critical to understand whether OIC countries have a comparative advantage in different types of natural resources. In this context, evaluations will be made on mineral resources, water resources and agricultural land resources.

Figure 3.4

Share of OIC Countries in World Total Proven Oil (left) and Gas (right) Reserves



Source: SESRIC staff calculations based on international energy statistics of the U.S. Energy Information Administration.

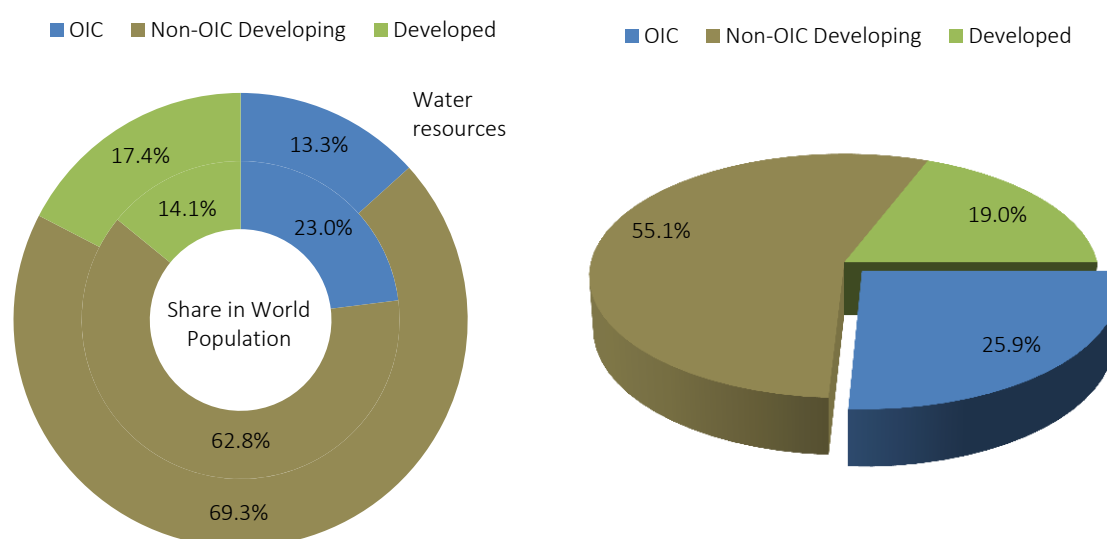
Oil and natural gas are two important mineral resources that are extensively used in meeting energy requirements. Figure 3.4 shows the shares of all OIC countries in proven oil and natural gas reserves. By having almost 60% of world total reserves in oil and gas, OIC countries possess a critical advantage in managing major fossil energy sources in the world, which can potentially support growth and development in the OIC region. As shown in SESRIC (2012), OIC countries do not have a similar strength in coal reserves. There may be some additional mineral resources where some OIC countries possess majority of reserves, but due to data constraints, investigation of such resources could not be made possible. On the other hand, it should be noted that, in

addition to fossil fuels, OIC countries have enormous potential in renewable energy sources, particularly in solar and wind energy.

In terms of water resources, the share of OIC countries in the world's total renewable water resources is 13.3%, which is less than their share in the world total population of 23.3%. In contrast non-OIC developed countries and developed countries share of the world's total renewable water resources are higher than their share of the world's population (Figure 3.5, left). Therefore, limited water availability is a challenge for OIC countries instead of an opportunity.³

Figure 3.5

Share of OIC Countries in World Total Water (left) and Agricultural Land (right) Resources



Source: SESRIC staff calculations based on FAO AQUASTAT online database.

Source: SESRIC staff calculations based on FAO online database.

OIC countries had a total agricultural land area of 1.4 billion hectares, corresponding to 25.9% of the total agricultural land area of the world (Figure 3.5, right). The arable land area in OIC countries amounted to only 306 million hectares in 2013, corresponding to 21.7% of their agricultural area, which is lower than the shares in the rest of the world (SESRIC, 2016). In general, the land resources are in proportion to their share in world total population and do not reflect any competitive advantage vis-à-vis other countries.

3.2.3 Knowledge Capital

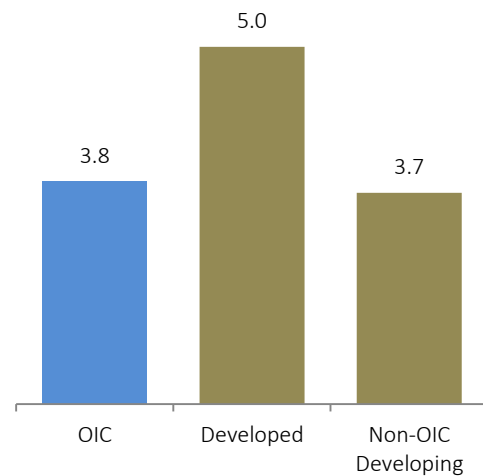
Knowledge is the foundation of economic prosperity. A recent publication by Hanushek and Woessmann (2015) makes a strong argument that the cognitive skills of the population (or knowledge capital), which incorporates the crucial quality dimension of human capital, could be at the root of much of the variation we observe around the globe. They demonstrate, for example, that the "Latin American growth puzzle" and the "East Asian miracle" can be explained by these regions' knowledge capital. Accordingly, they call for an education system that develops effective accountability, promotes choice and competition, and provides direct rewards for good performance.

³ See the SESRIC report titled "OIC Water Report 2015" for more discussion on water resources and associated challenges.

Different approaches can be used to assess the level of knowledge capital. In this report, capacity for innovation index of World Economic Forum⁴ and number of patent applications will be used. In order to anticipate the potential improvement in the knowledge capital, research and development (R&D) expenditures will also be analysed. As shown in Figure 3.6, average value of the capacity for innovation index in OIC countries is 3.8, which is significantly lower than the average of developed countries and almost equal to the level observed in non-OIC developing countries. This indicates that current level of capacity for innovation is not at a competitive level to promote long-term growth and development in OIC countries. As an outcome of this, the number of patent applications in OIC countries remains very limited. The total number of patent applications around the world in 2014 is estimated to have been 2.68 million. With 46,781 patents overall, OIC member countries accounted for nearly 1.7% of total patent applications (Figure 3.7).

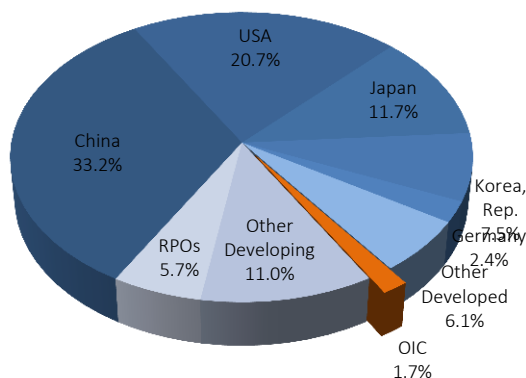
In their efforts to promote growth and development, the leading industrial nations of the world have been spending large amounts on R&D aimed at generating innovations. Today, nearly 86% of the global R&D expenditures is spent by developed countries, of which 27.4% by the USA, 20.7% by the EU member countries, and 9.7% by Japan (Figure 3.8). The OIC countries account for only 2.9% of the world total Gross Domestic Expenditures on R&D (GERD), whereas the GERD of China is more than 7 times the OIC total. This indicates that there is inadequate investment for promoting

Figure 3.6
Capacity for Innovation Index



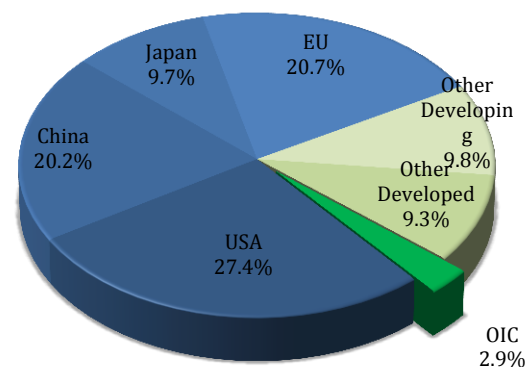
Source: Global Competitiveness Index 2015-16, World Economic Forum.

Figure 3.7
Distribution of Patent Applications



Source: World Intellectual Property Organization, Statistics on Patents, June 2016

Figure 3.8
Gross Domestic Expenditures on R&D



Source: UIS Database, UNESCO.

⁴ Index values range between 1 and 7, with higher values indicating higher capacity of companies to innovate.

innovative capacity in OIC countries, which reflects the weak base for knowledge capital in OIC countries.

3.2.4 Social Capital

Although not enough attention has been paid in the literature to the importance of social capital for economic development, it can contribute to economic growth by promoting cooperation and trust within the societies and improving efficiency of firms, markets and the state. In general, social capital can be understood as the stock of social relations based on norms and networks of cooperation and trust, which allows individuals, groups and communities to resolve collective problems more easily. According to the World Bank (2001), the social capital of a society includes the institutions, the relationships, the attitudes and values that govern interactions among people and contribute to economic and social development.

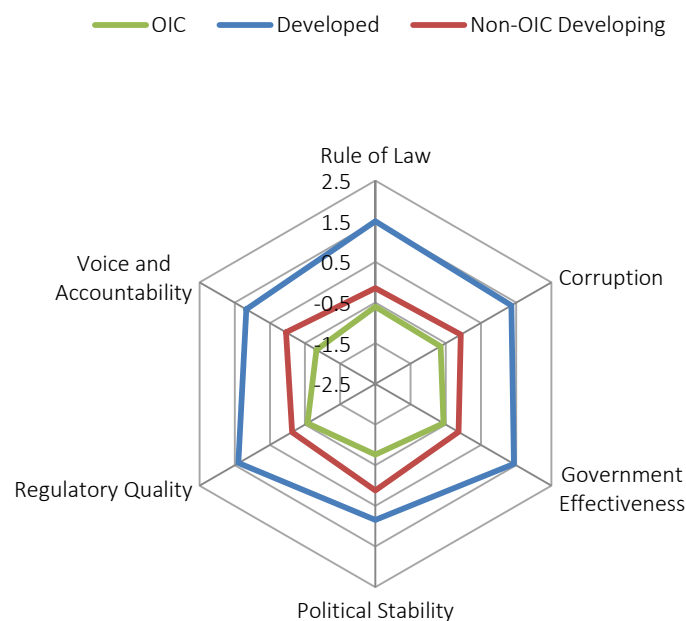
The existing literature suggests a positive relationship between social capital and economic development. Humphrey and Schmitz (1998) highlight how “trust-based relations between economic agents have been seen as part of the competitive advantage of manufacturing enterprises in Germany, Japan and parts of Italy”. Similarly, Putnam (2000) contrasts the impact of Silicon Valley and *Route 128* in the US. He comments that “The success [of Silicon Valley] is due largely to the horizontal networks of informal and formal co-operation that developed among fledgling companies in the area”. By contrast, in the *Route 128* corridor outside Boston, lack of inter-firm social capital led to a more traditional form of corporate hierarchy, secrecy, self-sufficiency, and territoriality (OECD, 2001).

The study by World Bank (2001) emphasises the role of social capital (or, more specifically the role of institutions, social arrangements, trust and networks) in reducing poverty and promoting sustainable development.

In this connection, lack of good quality institutions and weak state legitimacy can undermine social trust and lead to conflicts and economic collapse. Islamic societies have been traditionally strong in social capital. Different social protection and trust mechanisms have been instrumental in supporting community development throughout the history. However, recent developments show that there are serious issues that undermine the trust and social cohesion in OIC countries. Apparently,

Figure 3.9

Institutional Quality and Governance (2014)



Source: SESRIC staff calculation based on World Governance Indicators of the World Bank.

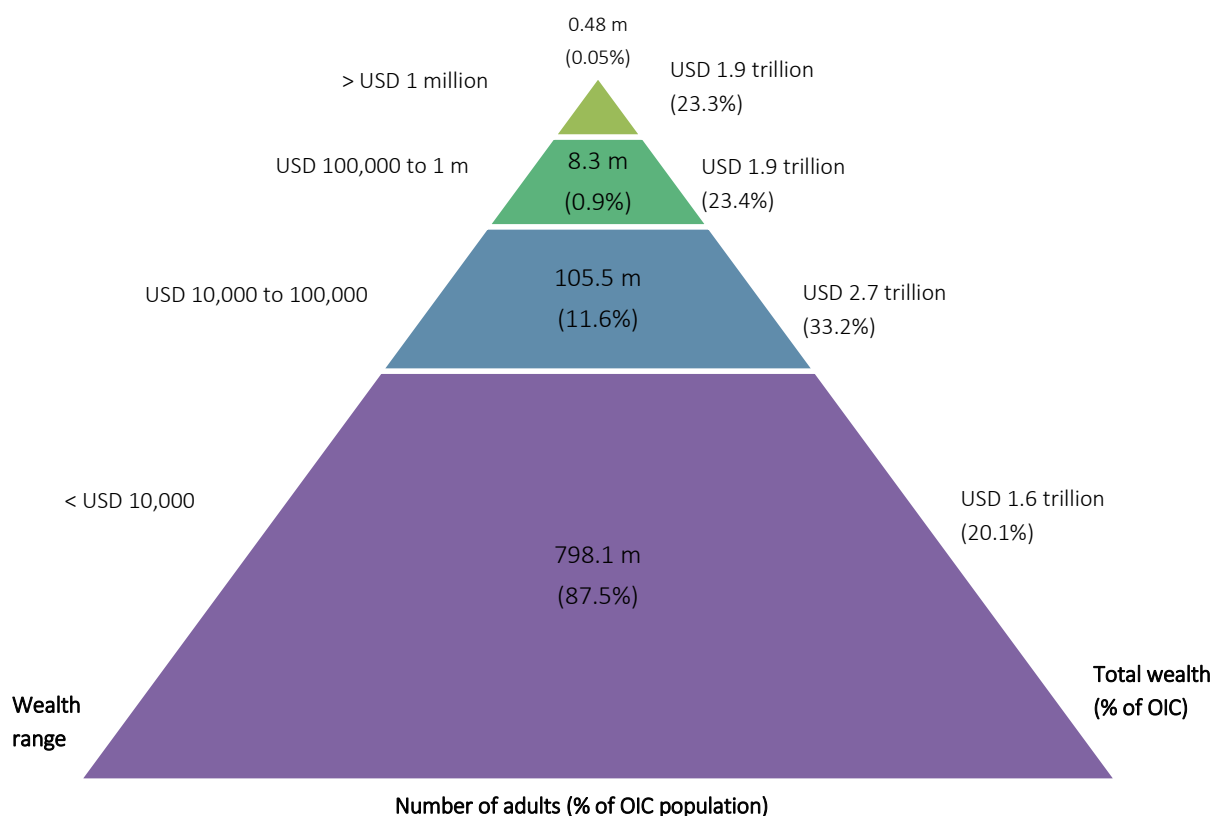
social inclusion, trust, voice and accountability are important elements of social capital. In this connection, in order to evaluate the potential of social capital, institutional quality, income distribution, political and social integration and conflicts trends will be analysed.

In practice, OIC countries face significant challenges in improving governance and ensuring inclusive development. Figure 3.9 compares the averages of the six governance indicators for OIC countries with other country groups in 2014, as estimated by the World Bank. While developed countries outperform developing countries in all categories, non-OIC developing countries also do comparably better than OIC countries. In none of the categories, OIC countries as a group attain a positive score. Non-OIC developing countries could attain a positive score only in political stability and voice and accountability categories. Voice and accountability and political stability categories are the weakest categories for OIC countries. On the other hand, regulatory quality, though negative, is the strongest category for OIC countries. All these reflect the lower level of institutional quality in OIC countries.

Another important dimension of inclusive development is wealth distribution. Figure 3.10 shows the distribution of wealth in OIC countries according to the estimations of Credit Suisse. It shows that there is a large base of low wealth holders, with upper tiers occupied by progressively fewer people. In 2014, it is estimated that 87.5% of adult population in OIC countries (corresponding to 798 million adult people) possesses less than USD 10,000 average per capita wealth. They together account for only 20.1% of total wealth in OIC countries, with USD 1.6 trillion total wealth. On the

Figure 3.10

Wealth Pyramid of OIC Countries (2014)



Source: SESRIC staff calculation based on data provided by Credit Suisse on Global Wealth for 2014.

other hand, just 0.05% of population owns 23.3% of total wealth and another 0.9% owns 23.4% of total wealth. Together, just less than 1% (namely 0.95%) of the population in OIC countries possesses 46.7% of total wealth in OIC countries. When compared to the world average and average of non-OIC developing countries, people with less than USD 10,000 wealth accounts for 69.8% of total population and 2.9% total wealth in the world and 77.6% of total population and 14.7% of total wealth in non-OIC developing countries. This reflects the fact that the share of people with low welfare levels is significantly higher than other country groups.

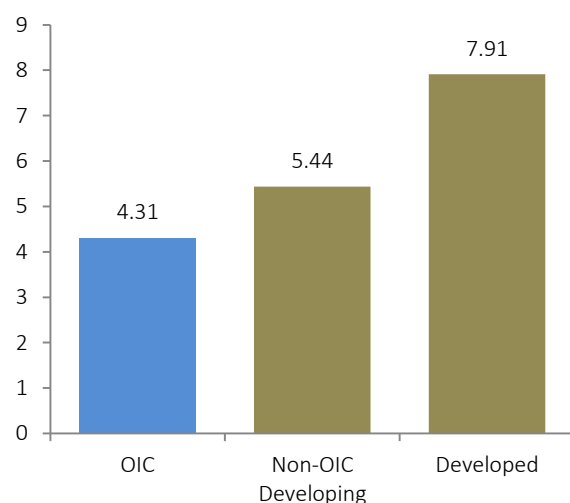
Political and social integration reflects the existence of a stable and solid party system to articulate social interests, associations to mediate between society and the political system and democratic norms and procedures strongly approved by citizens. The level of political and social integration in OIC countries is rather weak when compared with other country groups, as respectively shown in Figure 3.11. This fact has rendered OIC countries vulnerable to unrest as has been seen in a number of OIC countries since the beginning of the so-called Arab Spring in 2011.

The number of armed conflicts in OIC countries exhibits an upward trend which is in contrast to the downward trend observed in non-OIC countries (Figure 3.12). The intensity of conflicts in OIC countries has also been increasing since 2003, which corresponds to the year the USA and UK invaded Iraq. These

high intensity conflicts are resulting in tremendous human suffering and widespread devastation and will leave these countries crippled for many years to come.

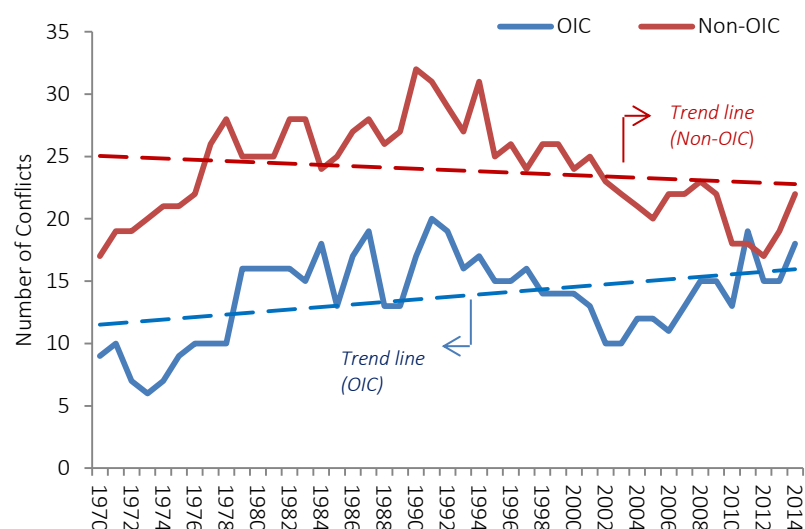
Based on the above investigation, current level of social capital seems to be rather weak. One of the traditionally most important strengths of OIC countries needs some attentions from policy makers and community leaders to restore its role in social and

Figure 3.11
Political and Social Integration



Source: SESRIC Staff Calculation based on BTI Transformation Index 2014. Data is available for a total of 128 countries, 47 of which are OIC member states.

Figure 3.12
Conflict Trends (1970-2014)



Source: SESRIC staff calculations based on the Uppsala Conflict Database

economic development. Until then, social capital will not be considered among the major strengths of OIC countries in promoting growth and development.

3.2.5 Economic Geography

With more than 1.7 billion population, OIC member countries account for more than 23% of world population. Although the member countries are geographically dispersed over four continents, they all have direct transportation corridor through land or sea with another member country. Only exception is Uganda, which remained disconnected after the secession of South Sudan in 2011. Higher connectivity over a large scale of geography itself creates an important opportunity for cooperation and development. However, while some countries are located in a relatively better position in terms of connectivity, such as Turkey, Iran and United Arab Emirates, some others are located in remote areas, such as Guyana, Suriname and Comoros.

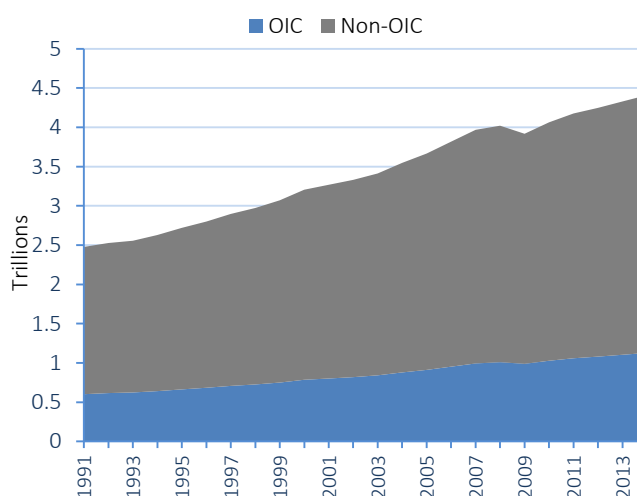
Importance of proximity to large markets has been depicted in the theoretical and empirical literature of economic geography. For instance, Mayer (2008) finds that market potential is a powerful driver of increases in income per capita and average wages. He also shows that the average growth of market potential due to neighbour countries between 1993 and 2003 in his sample is estimated to have raised income per capita by around 105%. Similarly, Boulhol et al. (2008) find for OECD countries that the lower access to markets relative to the OECD average could contribute negatively to GDP per capita by as much as 11% in Australia and New Zealand. Conversely, the benefit from a favourable location could account for as much as 6-7% of GDP in the case of Belgium and the Netherlands.

Market potential is a refined measure of proximity to markets, which is defined as the sum of all countries' GDP weighted by the inverse of the bilateral distance.⁵

⁵ More specifically, following Fujita et al. (1999) and Hanson and Xiang (2004), market potential is defined for country i as the distance-weighted sum of GDP in other n countries. Explicitly: $MP_i = \sum_{n=1}^J Y_n d_{ni}^{-\gamma}$. Following Hanson and Xiang, γ is set equal to 0.92. In calculating the market potential, population weighted distance measure provided by CEPII is used.

Figure 3.13

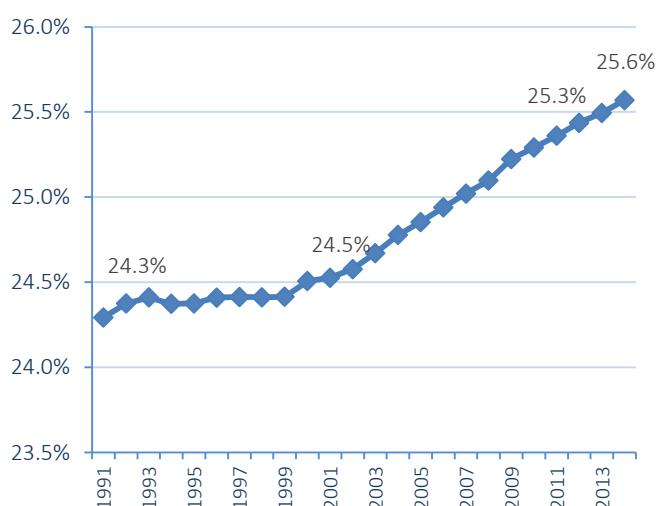
Market Potential of OIC and Non-OIC Countries



Source: SESRIC staff calculation.

Figure 3.14

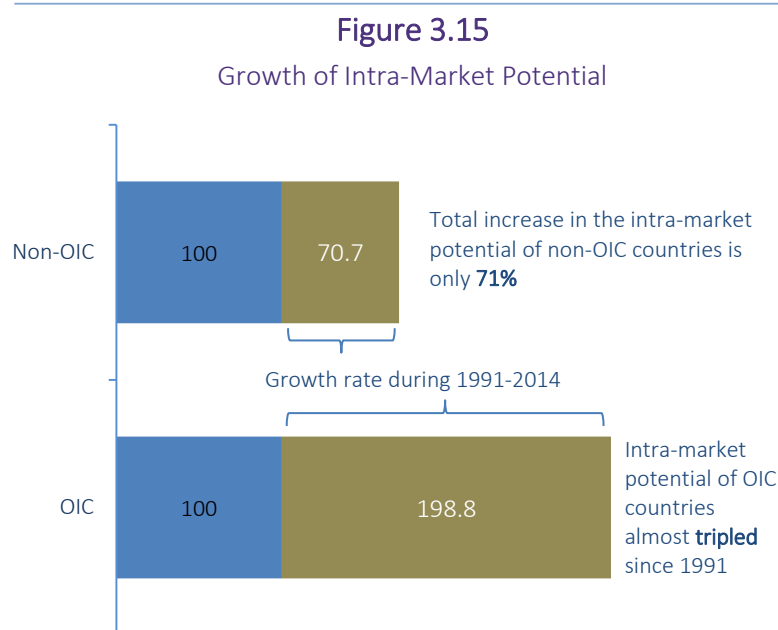
Share of OIC Market Potential in World



Source: SESRIC staff calculation.

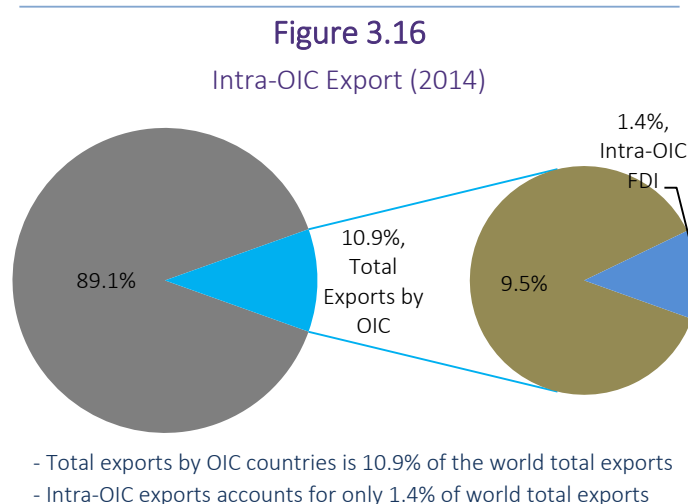
Relatively high market potential can be thought of being close to the main consumer markets. Changes in market potentials over time can be the result of the different performances of the countries in terms of economic growth or changes in transport costs.⁶ A broad analysis on market potential reveals that OIC countries the total market potential of OIC countries from 0.6 trillion in 1991 to 1.13 trillion in 2014, with a total increase of 87% (Figure 3.13). During the same period, market potential of non-OIC countries increased at a slower rate with 75%. On the other hand, the market potential of OIC countries accounted increasingly for greater share of world market potential (Figure 3.14), which increased to 25.6% in 2014.

More importantly, much of the increase in the market potential of OIC countries was due to the increase in intra-OIC market potential. As shown in Figure 3.15, total size of the intra-OIC market potential has almost tripled during this period. With growing economies of OIC countries, greater opportunities for trade and investment emerge in these countries. It is important to ensure that this potential is utilized more by other OIC countries instead of non-OIC countries.



Source: SESRIC staff calculation.

However, trade and investment figures among the OIC countries do not reflect the true potential of OIC countries. Despite the continuous growth of trade among the OIC countries, which reached almost 20% of their total trade, intra-OIC exports accounted only for 1.4% of world total exports as of 2014 (Figure 3.16). Nonetheless, it should be noted that total intra-OIC exports increased 17 times since 1991, where this share was only 0.4%. Despite the progress made, OIC countries are not utilizing their true market potential. Again, the share of intra-OIC investment in total foreign direct investment flows to OIC countries is only 6.6% in 2014,



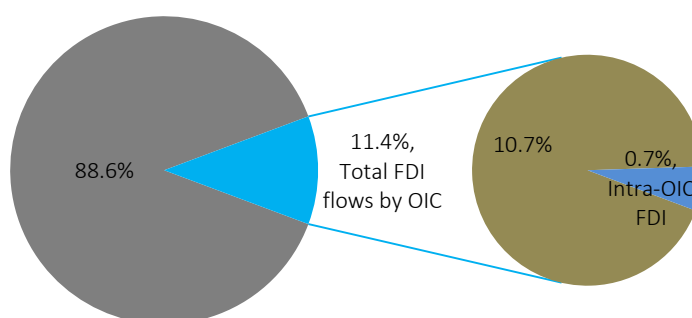
Source: SESRIC staff calculation based on IMF DOT database.

⁶ While calculating market potential in this report, transport costs assumed to be constant.

whereas the share in world total investment flows is only 0.7%, which is relatively low compared to its market potential (Figure 3.17). In this connection, it can be argued that OIC countries have great market potential, but it needs to be more effectively utilized by OIC countries.

Based on the above discussion, this report will focus on three major potentials for OIC countries that should be managed and coordinated for stronger and better economic performance. These are dynamic population structure, rich energy sources and great market potential. The following three sections will specifically concentrate on these topics in order to provide some deeper insight on how to utilize these important potentials. Social capital has been traditionally a strong asset of Muslim communities, but current indicators reveal serious deterioration in this area. Once critical interventions are made, it can be also an important stimulus for socio-economic development in OIC countries in near future.

Figure 3.17
Intra-OIC Investment (2014)



- Total FDI by OIC countries is 11.4% of the world total FDI flows
- Intra-OIC FDI flows accounts for only 0.7% of world total FDI flows

Source: SESRIC staff calculation based on UNCTAD Statistics.

SECTION 4



Dynamic Population Structure

Economic activities are highly influenced by demographic structure of a society. The proportion of population in each age group has implications on savings behaviour, participation to labour market, investment and expenditure decisions. These in turn affect the economy through its impact on real output growth, productivity, inflation and interest rates. Young people are more likely to engage in investment in their own skills as well as other productive assets in an effort to achieve a wealthier future. Well educated young population with good prospects in the labour market are likely to make significant contribution to overall economic development.

Population structure is important for economic policies and performance of countries, but almost all countries are now facing the challenge of ageing populations, albeit at different paces. It is a current problem in developed countries, but an approaching challenge for developing countries. Moreover, many developing countries face the additional challenge of getting “old” before they get “rich”. Developed and developing countries differ from each other not only in the pace and extent of their progress through the demographic transition, but also in the financial and institutional resources they have available in responding to ageing population. Therefore, it is extremely critical that they use the potential of young population to reach higher levels of living standards before it is too late.

While demographic structure with relatively younger population offers a window of opportunity to create dynamism in an economy, an ageing population is likely to depress economic growth. Empirical literature has paid great attention to the subject. In investigating the economic impact of changing population dynamics, Aksoy et al. (2012) find that average annual GDP growth in OECD countries will be slowed down by 0.9%, with the strongest negative impact in the US at 1.3%.

Studying a panel of 75 countries, Acemoglu and Johnson (2007) argue that increase in life expectancy due to advancements in medicine against infectious diseases led to a significant increase in population and a fall in income per capita. Bloom et al. (2010) finds modest effects of ageing population on labour force participation and economic growth. Feyrer (2007) also shows that changes in the age structure of the workforce is significantly correlated with changes in aggregate productivity and argues that different demographic structures may be related to almost one quarter of the persistent productivity gap between the OECD and low income nations.

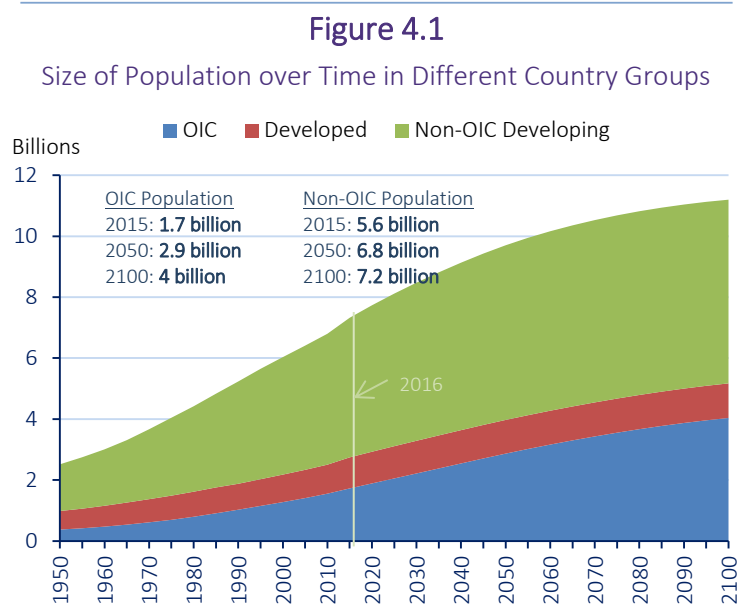
Needless to say, a country's economic characteristics will likely change as its population ages due to different needs and productive capacities of different age groups. Elderly people usually have different needs and economic behaviours than young people. Older people contribute to the economy with less labour and capital as they tend to work and save less. Moreover, they require more support from public finance for their health care and consumption. As their share in total population rises, cutting health financing, pension benefits or adoption some other policies will be difficult due to their politically stronger position.

In this fashion, having a very dynamic population structure, OIC countries need to adopt effective policies and programmes to increase the capacities and skills of the young population and boost their contribution to national economies before the demographic structure becomes unsupportive of better economic performance. Along these lines, next subsection provides some further information on the population structure in OIC countries. After discussing the role of human capital for economic growth, the section continues with the issues related to investing in human capital. Section ends with some policy issues related to enhancing productive capacity of youth.

4.1 Structure of Population in OIC Countries

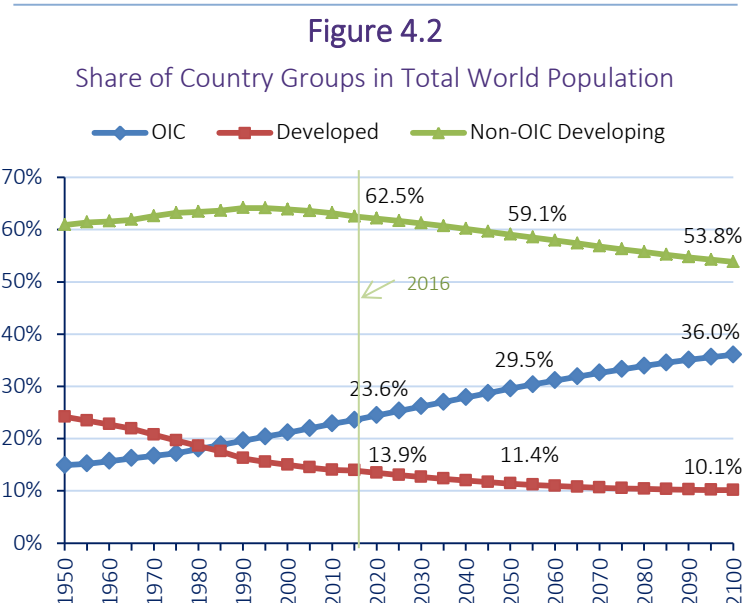
As a result of lower mortality rates and better living standards, world witnessed a rapid population growth over the last century. Today, an estimated 7.35 billion people live on earth and, with an estimated 1.73 billion people, OIC countries account for 23.6% of total world population. While total world population has been steadily rising, the total population in OIC member countries has been rising at a faster rate. According to the UN projections, population growth will decline all over the world until 2100, but its pace will be lowest in OIC countries. Consequently, as shown in Figure 4.1 and 4.2, OIC countries are expected to account for increasingly larger share of total world population.

With a population of 1.28 billion people, OIC countries were accounting 21.1% of total world population in 2000. Until 2050, it is



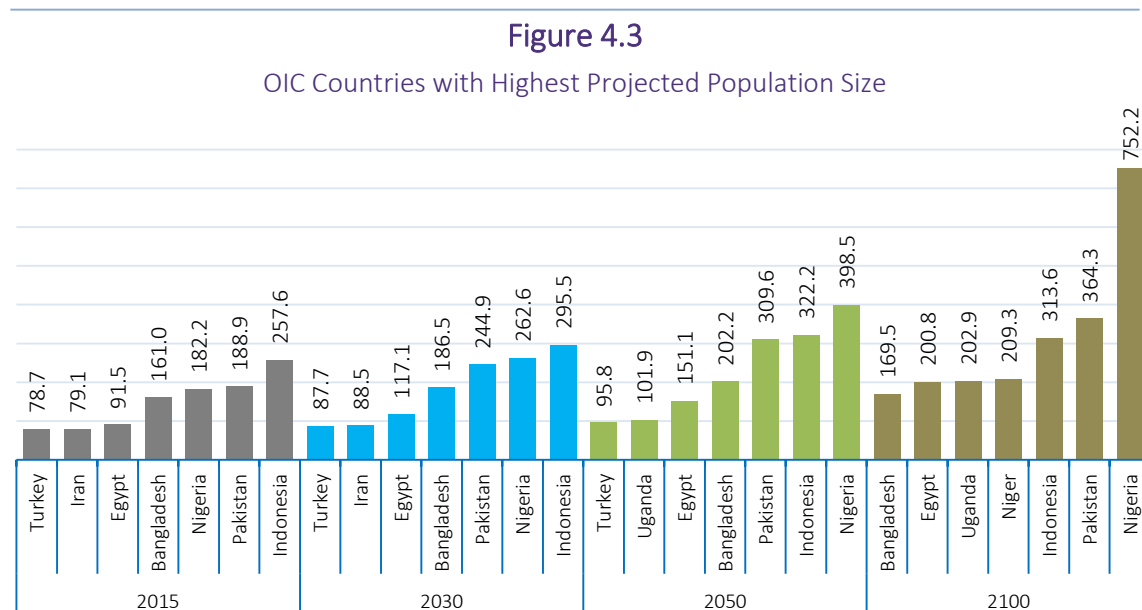
Source: SESRIC staff calculation based on UN World Population Prospects: The 2015 Revision.

estimated that this share will increase to 29.5%, with a 2.9 billion population. By the end of the century, 4 out of 11.2 billion world populations will be residing in OIC member countries, further increasing their share to 36%. At individual country level, countries in the sub-Saharan Africa are expected to experience fastest growth rates of population. By 2050, Nigeria is expected to be the OIC country with highest population size (Figure 4.3), but the largest increase is expected to be in Niger with 263% increase in population.



Source: SESRIC staff calculation based on UN World Population Prospects: The 2015 Revision.

Despite the increase in the share of OIC countries in the world population, OIC countries will also face a challenge of ageing population. As shown in Figure 4.4, share of population aged 0-14 was 34.1% in 2015, but it is projected that the share of this age group will shrink to 26.7% in 2050. Similarly, the share of population aged 15-29 will fall to 23.6% in 2050 compared to its share of 27% in 2015. While the share of the age group 30-44 will remain largely the same, the shares of elder population will increase significantly. Particularly the share of population aged above 60 will increase from 6.8% to 13.8% during this period.⁷

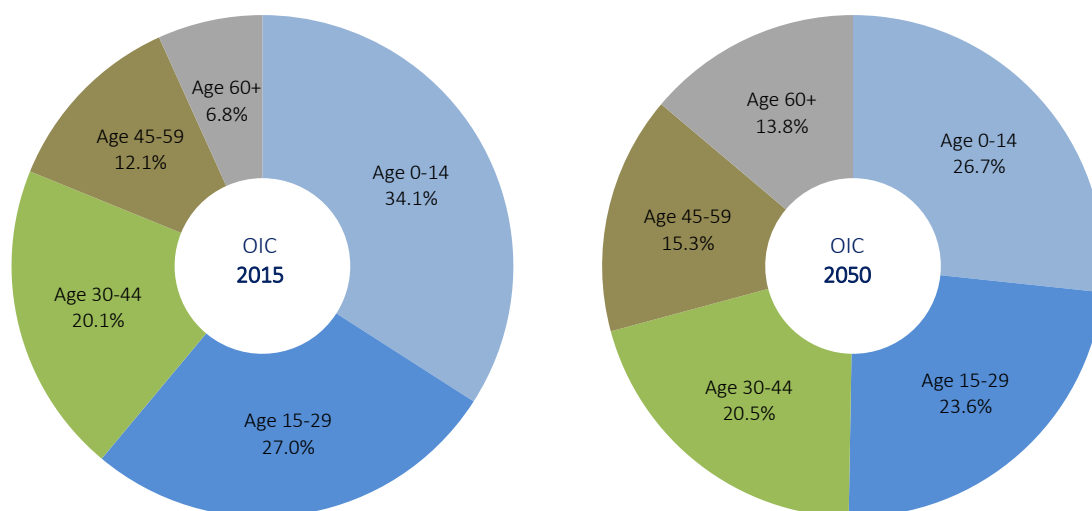


Source: UN World Population Prospects: The 2015 Revision.

⁷ It is important to note that above figures do not represent the trends in individual member countries, as population growth and change in demographic structure display different patterns in each country.

Figure 4.4

Distribution of Population in OIC Countries (2015 vs 2050)



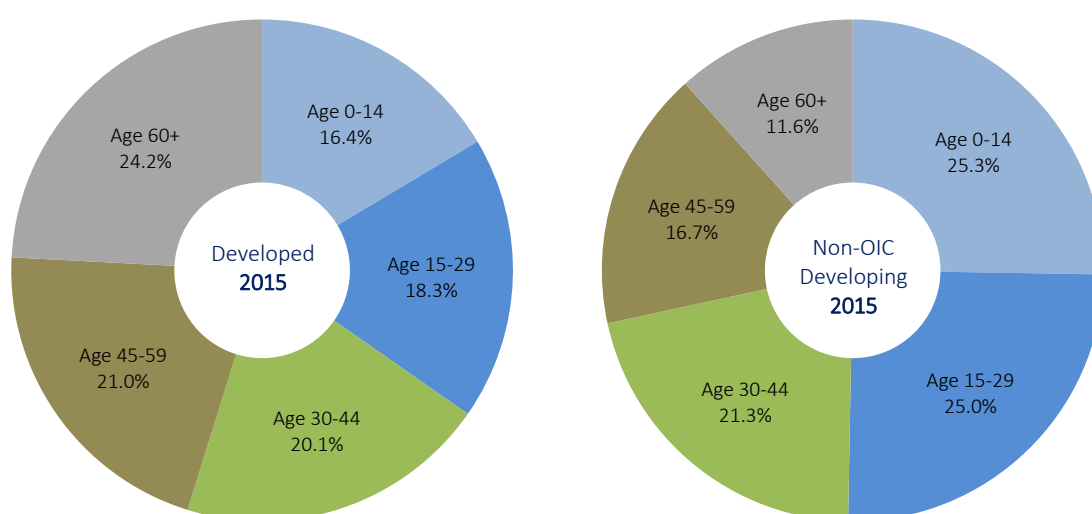
Source: SESRIC staff calculation based on UN World Population Prospects: The 2015 Revision.

In spite of this, the demographic structure of OIC countries will be younger than the rest of the world. Today, the share of population aged 0-29 is 61.1% in OIC countries and it will drop to 50.3% in 2050 (Figure 4.4). However, this share is only 34.7% in developed countries and 50.3% in non-OIC developing countries in 2015, which will decrease to 31.7% in developed countries and 39.5% in non-OIC developing countries in 2050.

Increasing share of OIC countries in total world population and relatively faster ageing of population in non-OIC countries will also influence the world demographic structure in favour of OIC countries. The share of OIC countries will increase in all age groups, but the highest levels will be observed in younger age groups (Figure 4.6). By 2050, OIC countries will account for 36.9% of

Figure 4.5

Distribution of Population in Non-OIC Countries (2015)



Source: SESRIC staff calculation based on UN World Population Prospects: The 2015 Revision.

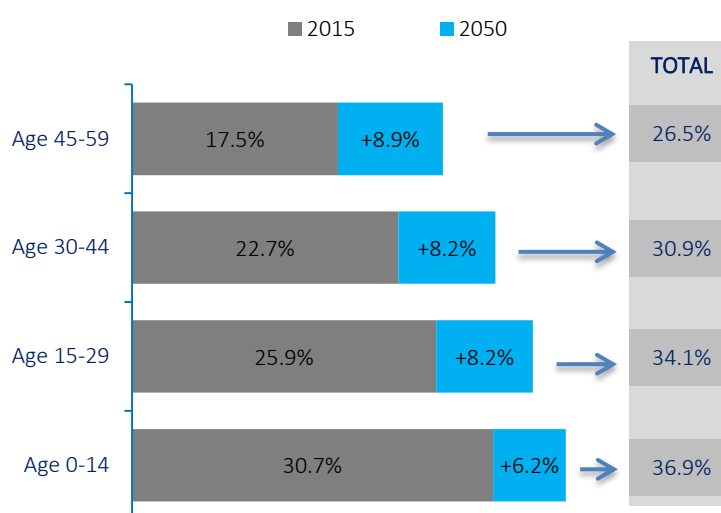
children aged 14 and below in the world. Similarly, 34.1% young people aged 15-29 in the world will be residing in OIC countries. In other words, more than one third of all young people aged 15-29 will be from OIC countries by 2050.

This creates opportunities as well as challenges and threats for the relevant OIC member countries. One implication is observed on dependency ratios. Youth bulge, a term coined by social scientists to describe societies with rapidly growing young populations, has been often associated with widespread unemployment and an increased risk of political violence. In a country with a youth bulge, as the young adults enter the working age, the country's dependency ratio, ratio of non-working age population (dependents or people younger than 15 or older than 64) to the working age population (those ages 15-64) will decline.⁸

Development patterns of countries are associated with the age composition of the population. From their education to health and employment, it requires special resource use and planning for the needs of the different age groups in many fields. A closer look at age dependency ratio in OIC countries shows that the ratio has been falling and it will continue to fall until 2050. In 2015, with 62.5% age dependency ratio, OIC countries show a higher dependency compared to other country groups (Figure 4.7). However, higher dependency ratio in OIC countries is due to larger share of children aged 0-14, rather than elderly population; as a result, OIC countries are expected to have the lowest average dependency rate compared to other country groups by 2050.

Figure 4.6

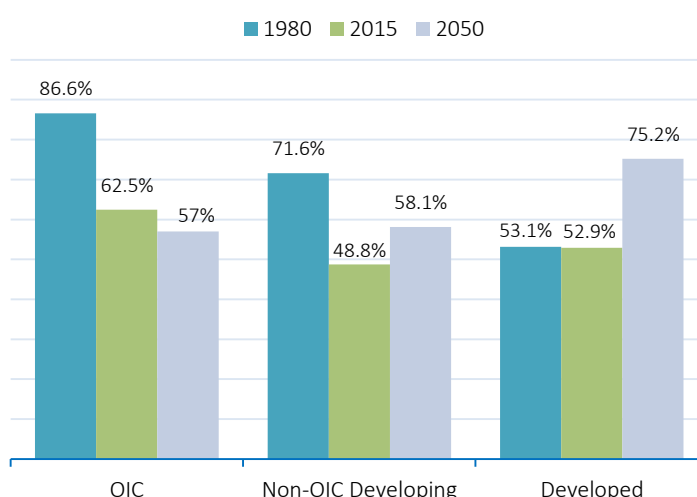
Share of Young Population (OIC in the world) (2015 vs 2050)



Source: SESRIC staff calculation based on UN World Population Prospects: The 2015 Revision.

Figure 4.7

Age Dependency Ratio (1980-2050)



Source: SESRIC staff calculation based on UN World Population Prospects: The 2015 Revision.

⁸ The ratio reflects only the age composition of a population, not economic dependency.

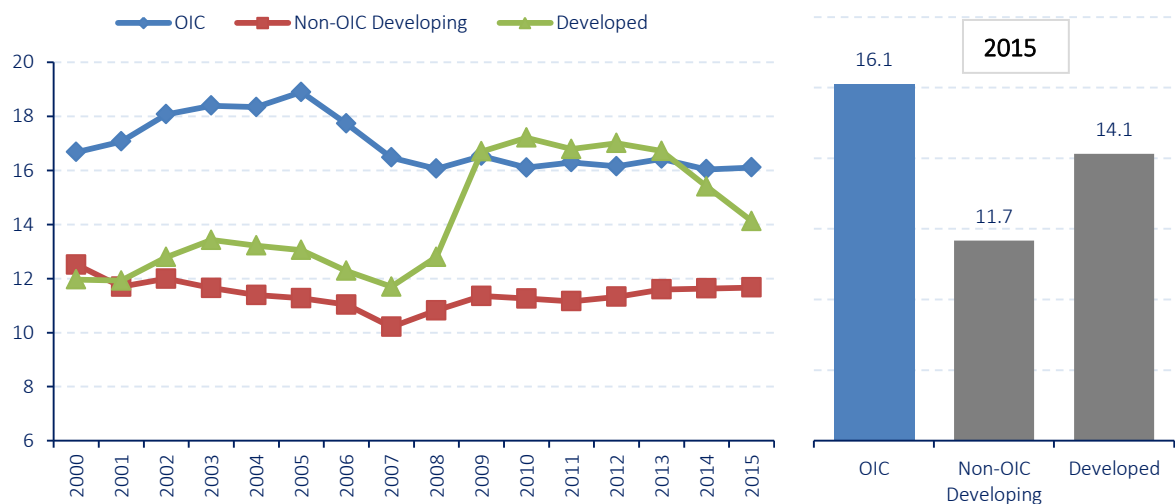
Increasing ratio of age dependency implies a demographic shift with significant impacts on societies and economies. The size of the workforce will shrink, putting pressure on governments to reform labour markets and retirement age thresholds. Increasing number of elderly will be depending for their welfare on falling numbers of active workers. This will require elderly to go on working well past current retirement ages. This will in turn require continuous updating of their skills to catch up with changing work environment and to remain employable and productive.

Economic development in a country with a youth bulge will be accelerated if the increase in the number of working age individuals can be fully employed in productive activities. If they remain idle and unproductive, it will turn to a great challenge for socio-economic development, because the frustrated youth with little prospects for better future is likely to become a potential source of social and political instability.⁹

Recent empirical studies also suggest that youth bulges are associated with an increased risk of political violence. One study finds that large young male bulges are more likely to increase the risk of conflict in societies where male secondary education is low (Barakat and Urdal, 2009). However, governments are to some extent able to reduce this risk through the provision of better opportunities for young people, primarily by providing education and jobs. For that reason, in order to avoid any potential instability and violence, the focus should be on improving economic opportunities for young people, particularly by providing educational or employment opportunities for youth. Moreover, if employment opportunities are not expanded while expanding opportunities for education, a large stock of highly educated youth may be source of other instabilities.

Figure 4.8

Youth Unemployment Rate



Source: SESRIC staff calculation based on ILO KILM Database.

⁹ In an interview, Samuel Huntington, the author of the controversial book on *Clash of Civilization*, stated that: "I don't think Islam is any more violent than any other religions, and I suspect if you added it all up, more people have been slaughtered by Christians over the centuries than by Muslims. But the key factor is the demographic factor. Generally speaking, the people who go out and kill other people are males between the ages of 16 and 30. During the 1960s, 1970s and 1980s there were high birth rates in the Muslim world, and this has given rise to a huge youth bulge. But the bulge will fade. Muslim birth rates are going down; in fact, they have dropped dramatically in some countries" (Huntington, 2001).

One basic measure of success in benefiting from the youth bulge is the youth unemployment rate. Unfortunately, the rates in OIC countries are largely unfavourable (Figure 4.8). The rate remained constantly above 16% and mostly above the averages of non-OIC developing and developed countries during the period between 2000 and 2015. Despite substantial disparities across individual member countries, a significant share of young population remains idle in OIC countries. High youth unemployment rates could have long-term consequences for their future careers and well-being at all ages.

On the other hand, increased longevity and declining sizes of younger generations generate additional complexity in the developing countries, where the aging process is occurring much faster and under less favourable conditions than in the more developed countries. The multiplicity of pressing needs and challenges, in a context of very limited resources, requires urgent actions to be taken to timely utilize the potential of youth for socio-economic development. Population ageing will put upward pressure on public expenditures while slowing down economic growth. For example, Europe is currently estimated to have a potential annual growth rate of 0.5% by 2050 due to changing demographic structure (OECD, 2007).

Currently, OIC countries have a very dynamic population structure. Despite the foreseen ageing of the population over the next few decades in many OIC countries, they will collectively retain more than one third of young population in the world. With appropriate policies and programmes, the potential of youth can be a catalyser of economic growth and prosperity in OIC countries and place them in a competitive position in the world economy.

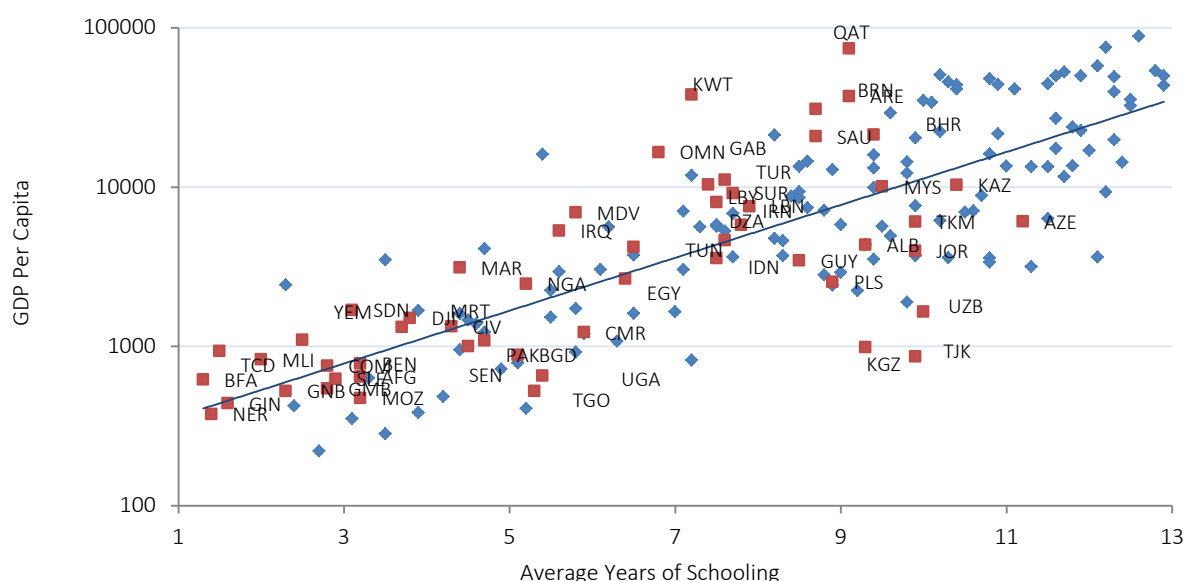
4.2 Role of Human Capital in Development

Human capital refers to the knowledge, skills and capabilities embodied in individuals that facilitate advancing the production techniques and contribute to the personal, social and economic well-being. The term “human capital” is used because people cannot be separated from their knowledge or skills in the way they can be separated from their financial and tangible assets. Along with physical capital stock, human capital stock is one of the factors of production in determining the economic prosperity and progression, with the stock of human capital playing an important role in determining the ability to absorb new knowledge and technologies, and thus increasing labour productivity. Productivity growth in turn is a key factor in promoting long-term economic growth. The role of education in increasing the productivity and efficiency of labour force by increasing the cognitive stock of economically productive human capability is well acknowledged.

Theoretical models of human capital and growth are built around the hypothesis that knowledge and skills embodied in humans directly raise productivity and increase an economy’s ability to develop and to adopt new technologies. Empirical literature also provides strong evidence on the impacts of higher educational inputs on productivity and growth. OECD (2007) notes that if the average time spent in education by a population rises by one year, then economic output per head of population should grow by between 4% and 6% in the long run. Figure 4.9 shows the relationship between average years of schooling and GDP per capita for 2013. Mean number of years that a representative worker has spent at school roughly determines the absorptive capacity that a worker can use in utilizing the knowledge developed elsewhere. Obviously, there is a strong relationship between income levels and educational attainment both in OIC countries (square) and non-OIC countries (diamond).

Figure 4.9

Average Years of Schooling vs Per Capita Income (2013)



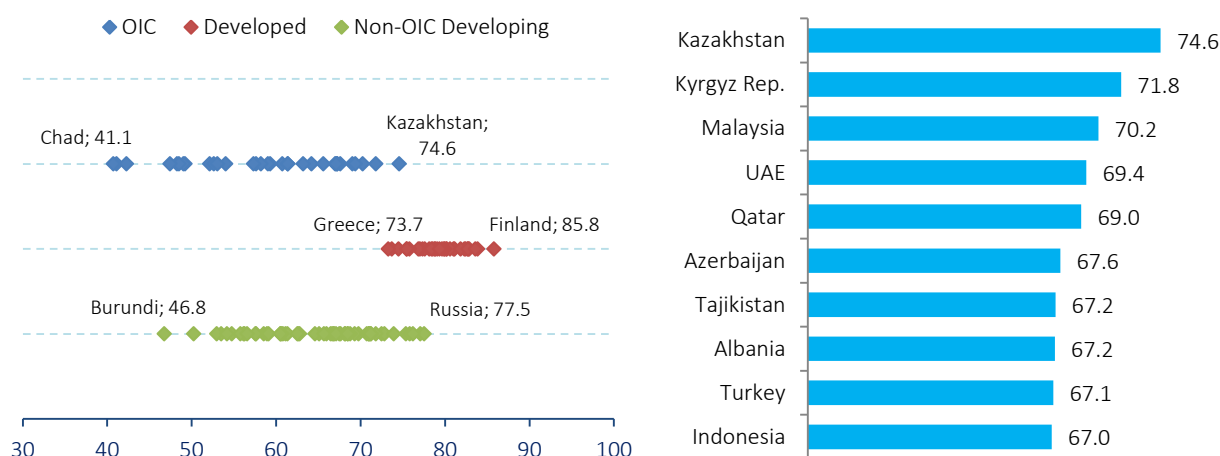
Source: SESRIC staff calculation based on World Bank WDI and UNDP HDI databases.

A skilled labour force contributes to social and economic development in many ways. It improves labour market outcomes in terms of employment rates and earnings. People with good education and skills base have also a higher likelihood of having good health and participating in social and political life. Empirical studies support the argument that skills have a profound relationship with economic and social outcomes across a wide range of contexts. Education and skills development are also critical in tackling inequality and promoting social mobility. Therefore, investment in human capital is one of the most effective ways of promoting growth and distributing the welfare.

In order to assess the current level of human capital development in OIC countries, an index developed by the World Economic Forum will be used. The “Human Capital Index” is designed to serve as a tool for capturing the complexity of education and workforce dynamics so that various stakeholders are able to take better-informed decisions. It provides country rankings that allow for

Figure 4.10

Human Capital Index, 2015 (All)



Source: World Economic Forum. Note: Data are available for 33 OIC countries, 34 developed countries and 57 non-OIC developing countries.

effective comparisons across regions and income groups. The human capital index contains two horizontal themes—learning and employment—running across five vertical age group pillars of the index (under 15; 15–24; 25–54; 55–64; and 65 and over). These two cross-cutting themes assess countries’ success in developing people’s skills and competences through learning and in deploying this acquired knowledge through productive employment. In total, the index covers 46 indicators.

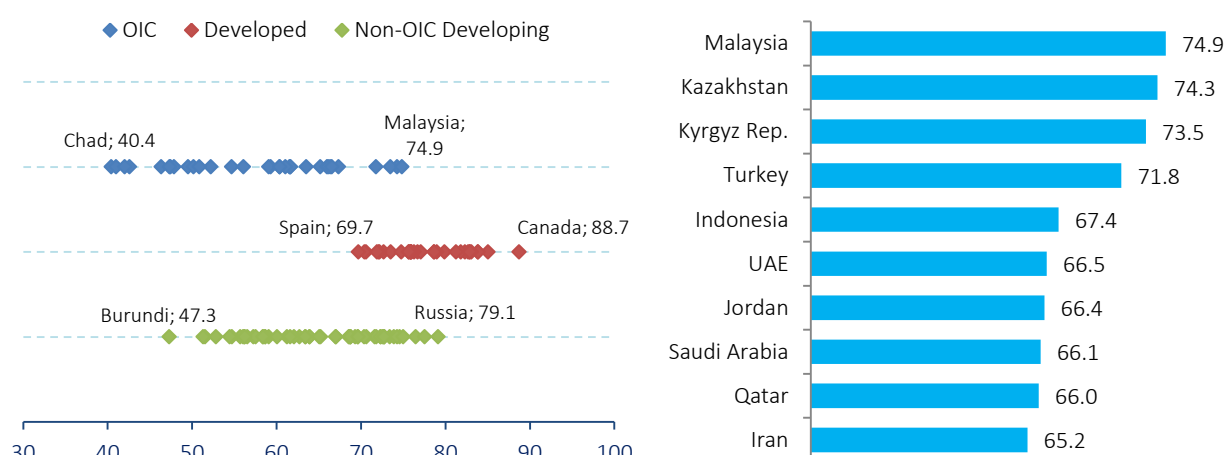
Figure 4.10 compares the index values for OIC member countries with developed and non-OIC developing countries. While some OIC member countries have the lowest values in the index (8 OIC countries are among the bottom 10), only Kazakhstan as the top performer OIC country gets an index value that is above at least one developed country. While the average human capital index value of OIC member countries is only 58.7, it is 79.4 in developed countries and 65.3 in non-OIC developing countries. This indicates that despite its dynamic population structure, OIC countries are not investing enough into their human capital. Top OIC countries are Kazakhstan (74.6), Kyrgyz Republic (71.8), Malaysia (70.2), United Arab Emirates (69.4) and Qatar (69). Top performer OIC country is only at 52nd position in the ranking of all countries.

A more informative indicator is the human capital index for the 15-24 age group. It shows the level of investment in young people’s human capital. While a similar picture is observed in the overall distribution of index values, but there are four OIC countries that are performing better than at least one developed country (Figure 4.11). These four countries (Malaysia, Kazakhstan, Kyrgyz Republic and Turkey) are among the OIC countries that are investing most for the development of human capital. These countries also occupy higher rankings compared to composite index. Malaysia has the 30th position in the world, Kazakhstan 34th, Kyrgyz Republic 37th and Turkey 50th position.

The stock of human capital is also closely associated with higher income levels. As depicted in Figure 4.12, countries with higher levels of human capital are also higher income countries. The relationship is particularly strong in the case of non-OIC countries. In OIC member countries, there are more countries that could not achieve high income levels despite moderate levels of human capital (Figure 4.12, bottom). Only resource-rich countries could attain high income levels, but the values of human capital index in these countries are significantly low compared to the countries with similar income levels in non-OIC countries.

Figure 4.11

Human Capital Index, 2015 (15-24 Age Group)



Source: World Economic Forum. Note: Data are available for 33 OIC countries, 34 developed countries and 57 non-OIC developing countries.

Having a huge population does not automatically mean that a country will have enough skilled people to fuel economic development. For example, despite a population of more than 1.3 billion people, India is suffering from a shortage of well-qualified graduates. It occupies only 100th position in the ranking with an index value of 57.6. As the size of population in OIC countries rises, governments should adopt well-designed policies to help people to develop their skills and competencies and to find a decent job in the market. Particularly the resource-rich countries have plenty of room to invest in their people to improve learning and employment outcomes.

Given the combination of high poverty rates, poor health and education outcomes, high population growth rates and low income growth in some OIC member countries, human

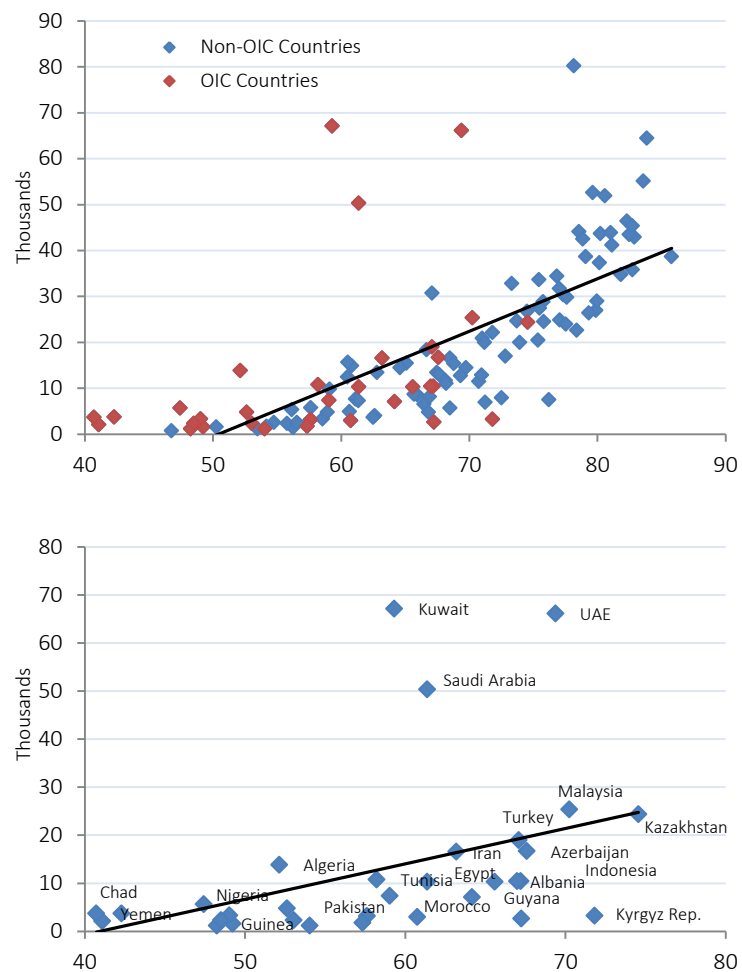
capital development remains a major challenge. It should be noted that population dynamics itself is not the major driver of poverty and inequality in these countries. For example, Klasen and Wolterman (2005) find in the case of Mozambique that demographic dynamics have helped support rising per capita incomes and falling poverty rather than hindering it. The even greater challenge is the lack of quality institutions, resources, capacities and political willingness to design and implement policies towards building up human capital.

4.3 Investing in Human Capital

Investment in human capital requires a multidimensional coordination, because positive impacts of such investments will depend on important pre-requisites in the economy – the presence of inclusive social, political and economic institutions that encourage the allocation of a nation's skills towards productive activities and entrepreneurship. It should start at very early ages and should continue until senior ages. Impact of limited resources spent on education should be regularly assessed to see if they are yielding the foreseen impacts in terms of improving skills base and

Figure 4.12

Human Capital vs Per Capita Income (2015)



Source: World Economic Forum and World Bank WDI.

employability. Coordination of public institutions with private sectors and education service providers, including academia, will be important in the evaluation process.

Human capital starts developing long before children go to school, as they constantly acquire skills and develop new ideas about themselves and outside world. Human capital formation can be regarded as a dynamic process that is on-going throughout a lifetime. A basic principle is that learning in one life stage precipitates learning in the next. Therefore, investment in the early stages of childhood increases the productivity of the next stages (see Box 4.1). In other words, access to quality early childhood care and education significantly proves learning outcomes in later years (Cunha *et al.*, 2006). What is more, the rate of return to a dollar of investment made while a person is young is higher than the rate of return to the same dollar invested at a later age.

In OIC countries, early childhood care and education appears to be widely neglected (Table 4.1). Out of 48 OIC countries for which data are available, 18 member countries have gross enrolment rate (GER) in pre-primary education above the world average of 44%. On the other hand, Malaysia, Guyana, Suriname, United Arab Emirates and Albania attained a schooling ratio at pre-primary level higher than the average of developed countries, 86.4%. While Malaysia ensures almost full participation into pre-primary education programmes, some other major economies within OIC, such as Turkey, Saudi Arabia and Egypt have also relatively low enrolment rates to support their efforts in building up human capital stock.

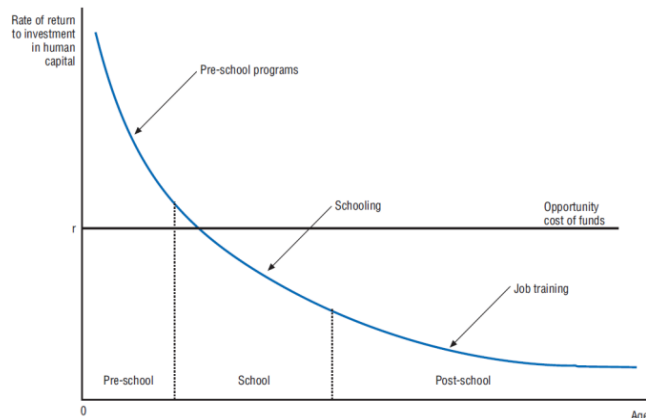
There are more children in primary school today than ever before, but there are various factors including poverty, gender or conflicts that complicate efforts to reach to children who do not go to school at all and there is much left to do to ensure the quality of the education they receive as well. In order to enhance the opportunities provided to new generations, their access to early education must be improved. This is also essential to improve the quality of education in the following stages of education. As noted by Cunha *et al.* (2005), interventions at very early ages have higher returns for the most disadvantaged. Due to higher share

Table 4.1: GER in pre-primary education (%), 2014*

Malaysia	98.9
Guyana	94.3
Suriname	93.7
United Arab Emirates	92.0
Albania	88.6
Lebanon	84.5
Kuwait	81.0
Algeria	79.2
Brunei Darussalam	73.5
Pakistan	70.2
Turkmenistan	62.9
Kazakhstan	60.4
Morocco	59.6
Qatar	58.5
Indonesia	58.2
Bahrain	55.2
Oman	54.4
Palestine	50.7
Tunisia	42.8
Iran	42.4
Gabon	37.1
Cameroon	34.4
Sudan	34.3
Gambia	33.8
Jordan	32.2
Bangladesh	31.8
Egypt	30.3
Turkey	27.6
Kyrgyzstan	25.3
Uzbekistan	25.3
Azerbaijan	23.1
Comoros	23.1
Benin	20.6
Saudi Arabia	16.3
Guinea	15.2
Togo	15.0
Senegal	14.7
Uganda	11.0
Tajikistan	10.6
Sierra Leone	9.5
Niger	7.1
Côte d'Ivoire	6.6
Djibouti	4.7
Burkina Faso	4.2
Mali	3.9
Mauritania	3.3
Yemen	1.3
World	44.0
Low income countries	17.2
Lower middle income countries	26.1
Upper middle income countries	72.9
High income countries	82.5

Source: UNESCO Institute for Statistics database (2016).
(*) Data for 2014 or latest year available after 2011.

Box 4.1: Rates of Return for Investment in Human Capital



Source: Cunha et al. (2005), *Interpreting the Evidence on Life Cycle Skill Formation*.

Nobel laureate James Heckman, with his co-authors, suggests that the early childhood period provides a unique opportunity for investment in human capital as investing in learning in early childhood brings higher returns than at any other time in life. Why? Learning at early ages makes it easier to go on learning throughout life, which increases human capital and, thus, earning.

of disadvantaged groups in OIC countries, especially in rural areas, this fact emphasizes the significant role of investment in education at early ages for the member countries' economic prospects.

Human capital theory rests on the assumption that formal education is highly instrumental to improve the production capacity of a society. Better education improves the production process in several ways. Educated, or skilled, workers are able to perform complex tasks and thereby contribute to producing more technologically sophisticated products. Especially in developing countries, skilled workers increase the absorptive capacity of the country by acquiring and implementing the foreign knowledge and technology, which is of crucial importance in successful economic diversification and development.

In this regard, the quality of education carries significant importance in building productive capacities. The impressive achievements in education in OIC member countries, however, have yielded only marginal contributions to the development process, which raises the concerns over the quality of education in the region.

Measuring and comparing the quality of education across the world is, however, not an easy task. A programme pursued by OECD, known as the Programme for International Student Assessment (PISA), is one of the major studies conducted to measure the quality of education.¹⁰ Though the number of OIC countries included in the programme is limited, it provides an opportunity to compare the quality of education in human capital development in OIC countries with other countries.

¹⁰ PISA is an internationally standardised assessment that was jointly developed by participating economies and administered to 15-year-olds in schools to test reading, mathematical and scientific literacy in terms of general competencies. See <http://www.oecd.org/pisa/home/> for more information about the programme.

Table 4.2 shows the mean performance of students on mathematics, reading and science for all 9 OIC countries taking part in the PISA 2012 study of OECD, along with some other comparison countries. The average score among OECD countries is approximately 500 points and the standard deviation is 100 points. About two-thirds of students across OECD countries score between 400 and 600 points. Among the OIC member countries, Turkey, United Arab Emirates, Kazakhstan and Malaysia have average performance over 400. Albania, Tunisia, Jordan, Qatar and Indonesia have average scores below 400 points. Turkey provides the highest quality education within the OIC countries but it is still below the OECD average. However, the annualized changes in the mean scores are among the highest in the OIC countries. Particularly, Kazakhstan, Malaysia and Qatar improved the quality of education at levels reaching up to 12% per year since last survey in 2009.

It is, however, worrying that among the 65 countries or economies surveyed in the study, 5 of the 10 worst performers on the overall reading scale are the OIC member countries. Turkey as the best performing OIC member country occupies only the 44th position. Several studies illustrate the seriousness of the learning challenge.

More than 30% of Malian youths aged 15–19 years who completed six years of schooling could not read a simple sentence. In Pakistan, tests of grade 3 children found that only half could answer very basic multiplication questions (World Bank, 2011). According to the Africa Learning Barometer of the Brookings Institute, which is the first region-wide survey of learning and education covering 28 sub-Saharan African countries, 61 million children of primary school age – 1 out of every 2 kids – will reach their adolescent years unable to read, write, or perform basic numeracy tasks.

Evidence also shows that learning levels rather than years spent in school are what drive social and economic returns on investment in

Table 4.2: Comparing Performances in Education for Selected Countries

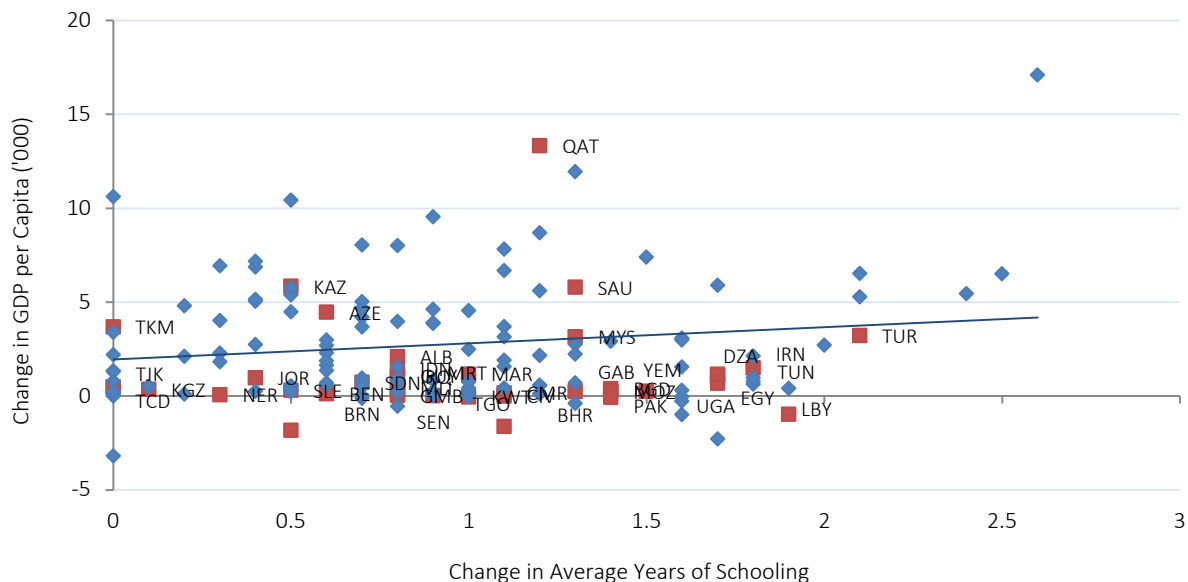
	Mathematics		Reading		Science	
	Mean score	Annualised change	Mean score	Annualised change	Mean score	Annualised change
OECD average	494	-0.3	496	0.3	501	0.5
Singapore	573	3.8	542	5.4	551	3.3
Korea	554	1.1	536	0.9	538	2.6
Japan	536	0.4	538	1.5	547	2.6
Switzerland	531	0.6	509	1	515	0.6
Germany	514	1.4	508	1.8	524	1.4
UK	494	-0.3	499	0.7	514	-0.1
USA	481	0.3	498	-0.3	497	1.4
Sweden	478	-3.3	483	-2.8	485	-3.1
Greece	453	1.1	477	0.5	467	-1.1
Turkey	448	3.2	475	4.1	463	6.4
Romania	445	4.9	438	1.1	439	3.4
Bulgaria	439	4.2	436	0.4	446	2
UAE	434	NA	442	NA	448	NA
Kazakhstan	432	9	393	0.8	425	8.1
Thailand	427	1	441	1.1	444	3.9
Chile	423	1.9	441	3.1	445	1.1
Malaysia	421	8.1	398	-7.8	420	-1.4
Mexico	413	3.1	424	1.1	415	0.9
Albania	394	5.6	394	4.1	397	2.2
Brazil	391	4.1	410	1.2	405	2.3
Argentina	388	1.2	396	-1.6	406	2.4
Tunisia	388	3.1	404	3.8	398	2.2
Jordan	386	0.2	399	-0.3	409	-2.1
Qatar	376	9.2	388	12	384	5.4
Indonesia	375	0.7	396	2.3	382	-1.9
Peru	368	1	384	5.2	373	1.3

Source: OECD. Countries and economies are ranked in descending order of the mean mathematics score in PISA 2012. Annualised changes are compared to the test scores in 2009.

education, including employability, productivity and growth (Brookings Institution, 2011). Hanushek (2013) also notes that cognitive skills of the population – rather than mere school attainment – are strongly associated with individual earnings, the distribution of income and economic growth. However, in many parts of the world, children leave school without acquiring

Figure 4.13

Change in Schooling vs Change in Per Capita Income (All Countries)



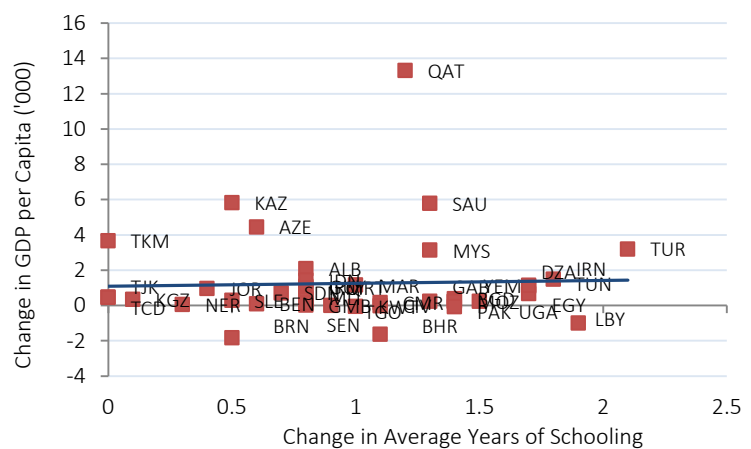
Source: SESRIC staff calculation based on World Bank WDI and UNDP HDI databases.

the basic knowledge and skills they need to lead productive, healthy lives and to attain sustainable livelihoods. Poor quality education is jeopardizing the future of millions of children and youth across the OIC region.

Differences in economic growth across countries are closely related to progress in educational achievements.¹¹ Figure 4.13 shows the relationship between change in per capita income levels and change in average years of schooling over the period between 2000 and 2013. Albeit weak, there is a positive correlation between changes in income and years of schooling. In the case of OIC countries, this correlation becomes even weaker (Figure 4.14). While some countries, such as Qatar, Saudi Arabia, Malaysia

Figure 4.14

Change in Schooling vs Change in Per Capita Income (OIC)



Source: SESRIC staff calculation based on World Bank WDI and UNDP HDI databases.

¹¹ An even stronger relationship exists between economic growth and cognitive skills, as presented by Hanushek (2013).

and Turkey experienced an increase in their per capita income levels with the increase in the years of schooling, many OIC countries experienced either a decrease or no significant increase in the average income levels. This shows once again the mere school attainment is not enough to support economic growth and development.

Improving the access and the quality of education at all levels has been a continuing national development objective throughout Malaysia's sequence of five-year development plans and this strategy played a central role in fostering economic growth and development of the country as well as an important factor in the reduction of poverty. Government policy has been to encourage education at all levels, backed up by higher share of budgetary allocations for education. In addition to expanding resources at the primary education level, sharply increasing expenditure for education reflected the importance paid by Malaysian governments to secondary and tertiary education as well. As accessibility to education improving, special efforts have been made to provide an environment that is conducive to learning. All these efforts in promoting education explain the economic and social achievements of Malaysia during the last decades.

4.4 Unleashing Productive Capacity of Youth

Demographic trends and untapped talent pools that we observe today in OIC countries require important measures to be taken in order to ensure that this dynamic population structure is an opportunity rather than a threat for them. Perhaps the very first thing to do is to attach enough importance to the current and projected demographic structure and be aware of the opportunities and threats it poses. As shown earlier, more than one third of young people will be living in OIC countries by 2050. This report presents only aggregate figures without analysing the dynamics at individual country level in order to promote the collective actions towards utilizing the dynamic population structure all around the region. Individual experiences will definitely differ across countries, but if OIC community recognizes that this is a collective strength of whole community, more effective mechanisms can be developed to better make use of this potential.

A straightforward approach to utilizing this potential is to endow the youth with the skills and capabilities and give them opportunities to realize their true potential in their field. In generic terms, there is a need to provide good education and employment opportunities. It may be easier said than done. Governments face multiple challenges and resource constraints in creating appropriate conditions for quality education with good labour market perspective. Effective use of limited resources for better education opportunities and improved business climate cannot be granted due to various inefficiencies and limited capacities in the existing implementation mechanisms in some countries.

In addressing the issues related to untapped potential of young population, this report will focus on three major issues: (i) skills development, (ii) entrepreneurship and job creation, and (iii) social mobility. In providing more opportunities for young people to realize their true potential, a smooth transition to labour market is required. Young people graduates from education institutions with a set of skills, which has direct consequences on their level of employability. Primary responsibility of governments is to ensure that these skills sets are demanded by the labour market to the extent possible. When young people enter into labour market, it is important to ensure that there are jobs available that can benefit from the skills and capabilities of young graduates. In order to encourage

young people to invest in their human capital, opportunities for entrepreneurship and shift in their economic status should be provided.

4.4.1 Skills development of youth

According to the latest statistics, 16.2% of young people in OIC countries are illiterate, lacking basic numerical and reading skills, and accordingly lacking the means to be able to sustain a living through full and decent employment (SESRIC, 2016 Education Report). With many young working poor missing even primary-level education, persistently high levels of youth unemployment and underemployment rates are likely to threaten social inclusion, cohesion and stability. Young people who drop out of school early are vulnerable to unemployment, poverty and involvement in risky behaviours.

The level of skills and qualifications of a person is a critical factor in enhancing the employability in the labour market. However, the benefits of skills development go beyond the employability. For an economy, skills development of workers with low qualifications in general increases productivity and strengthens long-term competitiveness. For enterprises, workers with better qualifications will be more productive and increase the profitability of the firms. Likewise, workers with better skills and training will receive higher earnings. Therefore, maintaining and upgrading the skills and competences of the labour force to meet and adapt the continuously changing working environments are all crucial for employees, employers as well as the whole economy.

Skills development can be achieved only with good-quality basic education. In order to ensure that young people obtain the skills that are required by labour markets and workplaces in different economic sectors, vocational education and training activities should be well connected to the world of work for effective skills development. This requires effective partnership between public authorities, business associations and training institutions.

Since the resources available for public education and training are not limitless, it is important to manage these resources effectively. If education system is not able to raise the cognitive abilities of the young population, countries may face even higher economic and social costs to reduce the gap between the needs and supply of relevant skills. It should also be noted that skills by themselves do not automatically lead to more and better jobs. Skills policies must be part of a broad set of policies that are conducive to high rates of growth and investment, including investment in basic education, health care and physical infrastructure, and strong growth in good-quality employment (ILO, 2011).

There are several aspects of developing a strategic framework for skills development of youth. Skills development is needed to improve employability, enhance productivity, enable matching of skills supply to the needs of labour markets, and facilitate the adjustment to changes in technology and markets. It is also important to develop capacities for anticipating and preparing for the skills needs of future. None of these issues has categorical priority against the others and they should be part of a comprehensive approach in skills development. However, according to the needs and priorities of each economy, special importance can be given to certain issues when devising programmes and policies for skills development. Chart 4.1 illustrates the key pillars of skills development for a productive employment

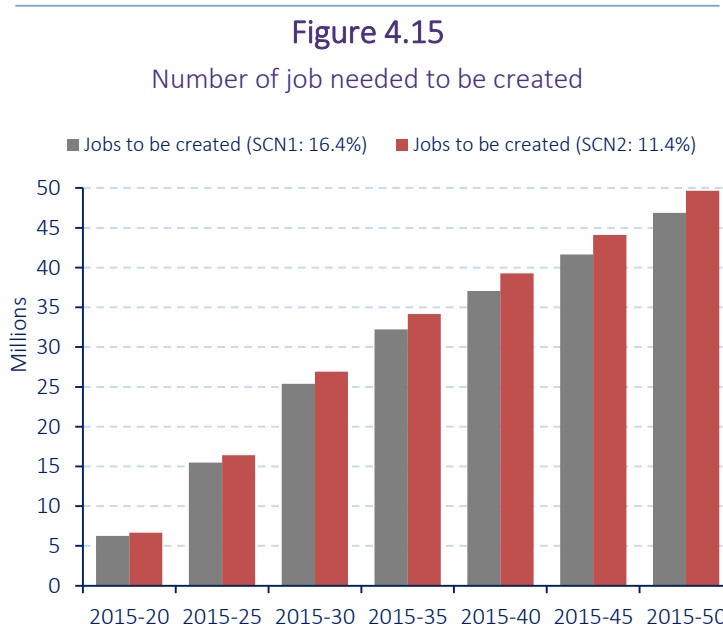
Chart 4.1: Key Pillars of Skills Development for Productive Employment



Managing skills development over the development trajectory can be a challenge. As countries adopt new technologies and diversify into new sectors, workers and managers must be well prepared to tackle new production and management practices in order to sustain growth in the economy and job market. If not properly coordinated, investment made in skills development can only increase the number of skilled workforce, without affecting the number or quality of jobs. Therefore, coordination and dialogue among the key stakeholders including public authorities and education and training institutions is critical in managing skills development process.

4.4.2 Entrepreneurship and job creation

Job creation lies at the core of policies required for resolving the high unemployment problem of youth. Without strong job creation, other policies and interventions will be rendered fruitless. Considering the latest population projections, the number of jobs needs to be created for the increasing youth population is estimated under two scenarios. In the baseline scenario (SCN1), the number of jobs to be created is estimated while keeping constant at the 2015 level of average youth unemployment in OIC countries (16.4%). In the second scenario (SCN2), the number of jobs to be created is estimated assuming that OIC countries would reduce the youth unemployment rates to the levels observed in non-OIC developing countries (11.4%) in 2015. In both scenarios, labour force participation rate is kept at its current level of 44.8% constant. The results are shown in Figure 4.15. From 2015 until 2020, OIC countries need to create an additional 6.3 million jobs for youth and approximately an additional 9 million jobs for every 5 year until 2035. OIC countries need to create almost 37 million jobs until 2040 just to keep the current level of unemployment rate constant.



Source: SESRIC Staff Calculations based on ILO Statistics.

Creating additional 9 million jobs for every five years is no simple task and in this context, entrepreneurship and small and medium enterprises (SMEs) come into play since entrepreneurial activity is at the heart of job creation. Entrepreneurship can play a role in supporting employment creation and attachment to the labour market. Entrepreneurial activity help to create jobs, promote innovation, and improves responsiveness to changing economic opportunities and trends. Therefore, unleashing productive capacity of youth has potential to stimulate economic development through job creation, innovation and improved competitiveness.

In designing a youth entrepreneurship policy, the overall strategy for youth entrepreneurship development should be based on the national socio-economic context and specific development challenges faced by a country. The effective adoption and implementation of entrepreneurship policies that are conducive to productive capacity-building of youth and linked with the long-term objective of improving the living standard for all will require targeted interventions at different policy areas. UNCTAD (2015a) identifies six policy areas that have a direct impact on entrepreneurial activity as follows:

1. Formulating national entrepreneurship strategy
2. Optimizing the regulatory environment
3. Enhancing entrepreneurship education and skills development
4. Facilitating technology exchange and innovation
5. Improving access to finance
6. Promoting awareness and networking

Young people are generally enthusiastic about starting businesses, but only few young people can actually realize their goals due to a number of barriers. Table 4.3 provides a summary of major barriers faced by young entrepreneurs in five policy areas identified by UNCTAD. UNCTAD (2015a) also offers potential solutions for policymakers. In principle, developing an enabling entrepreneurial ecosystem for young generations is the key to unleashing the potential of youth. Lack of job opportunities and barriers to entrepreneurial activity for young people, irrespective of their educational background, can have potentially serious impacts on a country's capacity and ambitions to achieve long-term sustainable development.

In view of that, it is important to ensure that youth entrepreneurship is integrated in national policies and that youth entrepreneurship strategies are aligned with national policy objectives. With a comprehensive framework on youth entrepreneurship, governments can resolve many of the challenges faced by young entrepreneurs and address the issues like the development of effective entrepreneurship education, vocational training and apprenticeship systems and issues related to access to finance, technical assistance and financial literacy. For example, Malaysia adopted an "Economic Transformation Programme" in 2010 to provide a framework for catalysing inclusive economic growth and reducing poverty and inequality, with the aim of elevating its status to a developed country by 2020. Overall objective of the Programme was to promote inclusive growth by raising income-earning opportunities through entrepreneurship, promote productive capacities by investing in human capital and provide social protection for the poor and vulnerable (UNCTAD, 2015b).

Table 4.3: Major Impediments Faced by Young Entrepreneurs in Five Policy Areas

Optimizing the regulatory environment	<ul style="list-style-type: none"> • High business registration costs • Complex regulatory procedures • Distrust in the regulatory environment • Limited knowledge of regulatory issues, in particular of copyright, patent or trademark regulations
Enhancing entrepreneurship education and skills development	<ul style="list-style-type: none"> • Inadequate integration of entrepreneurship in the education system • Limited practical or experiential opportunities • Lack of and/or limited orientation to enterprising attitudes, behaviours and skills among teachers • Limited and/or poor quality business development services
Facilitating technology exchange and innovation	<ul style="list-style-type: none"> • Lack of ICT skills • Inadequate infrastructure (physical workspace, digital infrastructure, access to reliable and cheap electricity) • Insufficient technological readiness • Limited linkages between youth-led start-ups and growth-oriented entrepreneurs and investors
Improving access to finance	<ul style="list-style-type: none"> • Inappropriate and/or lack of youth-friendly financial products • Excessive restrictions (age requirement to open a bank account) • Low financial literacy levels • High credit and collateral requirements
Promoting awareness and networking	<ul style="list-style-type: none"> • Negative societal attitudes towards entrepreneurship • Insufficient promotion of role models • Underdeveloped young entrepreneurs' networks • Insufficient promotion of entrepreneurship opportunities

Source: UNCTAD (2015a).

4.4.3 Social mobility

A large population of youth in many OIC countries experiences tremendous levels of stress due to limited opportunities for social mobility and restrictions on full participation in social, cultural, economic and political life. This state of affairs triggers in many cases to social turmoil and political unrest. Social mobility is the movement of people between social strata in a society. Social mobility can be evaluated using the indicators of education, occupational, wage and family income mobility, but these are based on highly specific datasets, which are not available for OIC countries.

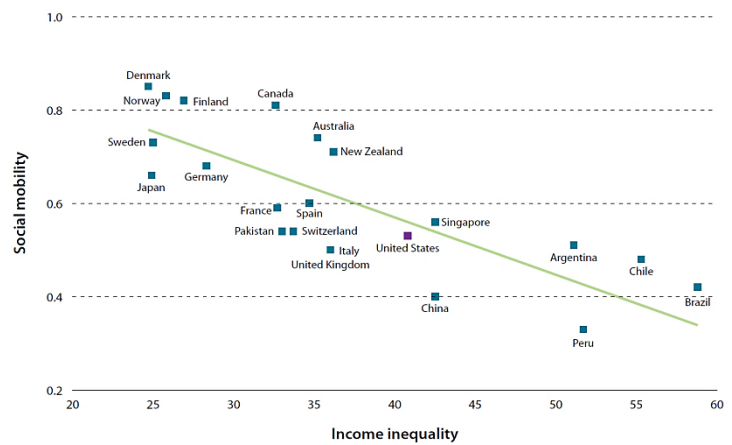
Governments should provide opportunities for young people to move up the social ladder through their own investments in their skills and capabilities with clear prospects in the labour market. Social mobility is essential for creating social harmony and building a more open and fairer society where every individual has opportunity to move up with their own efforts. If young people believe that they can improve their own prospects with their own efforts, they will be more willing to invest in their skills and take greater responsibility in contributing to socio-economic development in a society. On the other hand, reduced social mobility may negatively affect the perception of these people on equality of opportunities and the fairness of the society as a whole.

With economic development, and particularly with expansion of the educational system, a country's social mobility will increase. Evidence from the Middle East, however, suggests that this may not always be the case. Blinzel (2011) finds a decline in social mobility among the increasingly well-educated youth in the Middle East. High persistence of income levels across generations constrains low-income families from investing in the human capital of their children and makes them more vulnerable to risks from a variety of sources. Blinzel also finds that the dominance of the public sector and the high degree of regulation in the private sector have constrained the labour market's ability to absorb newly-skilled labour market entrants and to make use of their skills. The increased access to education raises the expectations for moving up socially among youth and their families, but wrong or ineffective policies resulted in reduced social mobility among the well-educated youth, particularly from a lower socio-economic background.

Social mobility is also correlated with income inequality. Countries suffering from higher income inequality tend to have lower social mobility as depicted in Figure 4.16. OECD (2011) states that rising income inequality “can stifle upward social mobility, making it harder for talented and hard-working people to get the rewards they deserve”. As shown in Figure 4.17, OIC countries, as a group, suffer from a serious inequality problem with people being denied access to equal opportunities. The Figure shows that OIC countries fair worse than all other country groups when it comes to equal opportunity. OIC countries score a mediocre 4.3 on the equal opportunity scale (ten being the highest score possible) whereas other developing countries score 5.2, developed countries score 8.4, and the world average is 5.0. Without tackling the inequality problem in OIC countries, it will be very difficult to increase social mobility.

Figure 4.16

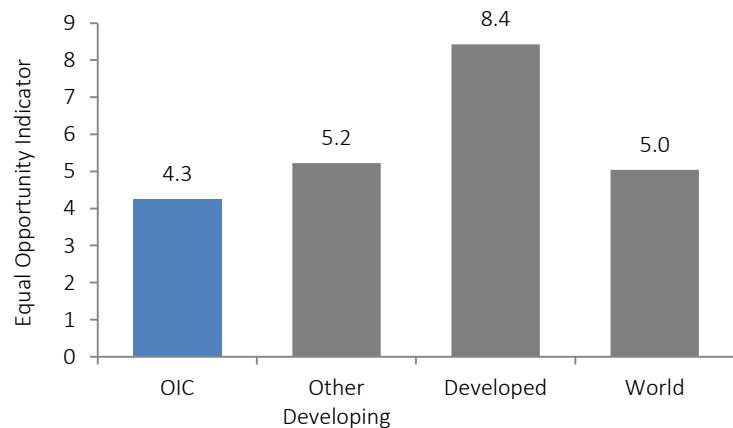
Income Inequality vs Social Mobility



Source: Greenstone et al. (2013).

Figure 4.17

Equal Opportunity Index (2014)



Source: SESRIC Staff Calculation based on BTI Transformation Index 2014. Data available for a total of 128 countries of which 47 are OIC member states

SECTION 5



Rich Natural Resources

OIC member countries are endowed with rich and diverse natural resources that have the potential to enable their people to enjoy a healthy and prosperous life. Despite having rich natural resources, 21 OIC countries out of 57 were listed by the UNDP in the group of least developed countries. Poverty, unemployment and income inequality not only constitute barriers for development in 21 least developed OIC countries but also stay as important socio-economic challenges for the rest of 36 OIC countries. One of the core reasons behind this sobering picture in OIC countries is the existence of capacity problems in exploitation and efficient use of existing natural resources for the benefit of people living in OIC countries. In this regard, this section of the report focuses on the topic of rich natural resources in OIC countries with a view to present a detailed picture of available natural resources, identify bottlenecks about their usage, and discuss about prospects. The section first looks at the existing stock of natural resources. Then it reveals to what extent OIC countries are exploiting the potential of available natural resources by using the recent available statistics. The section further lists and discusses some policy issues to provide a broad guidance for policy-makers on how to transform the natural resource potential of OIC countries into a growth and development enabling factor such as through green transformation, diversification of energy resources, and enhancing national capacities of OIC countries.

5.1 Stock of Natural Resources in OIC Countries

This section will review the current stocks of OIC countries in mineral resources including crude oil, natural gas, coal, precious metals and uranium as well as energy resources including renewable energy sources and nuclear energy.

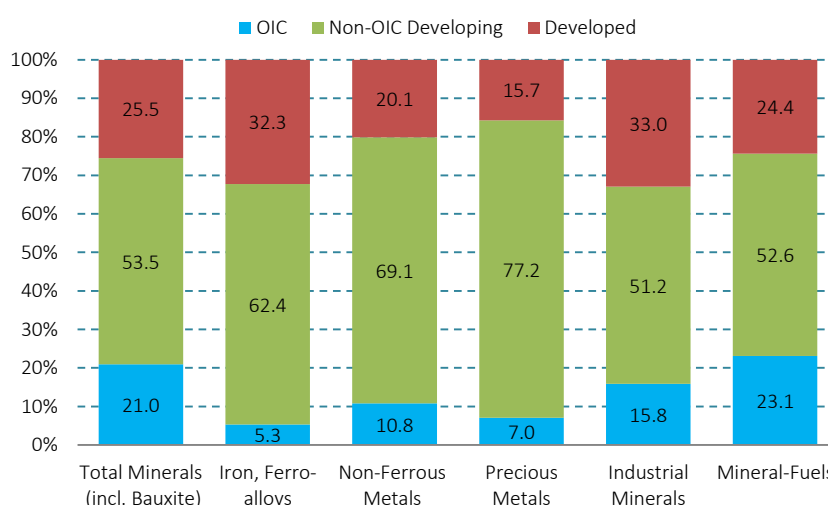
5.1.1 Mineral Resources

In their development process, many advanced countries have extensively benefited from the abundant natural resources, either by utilizing their own resources or by exploiting the resources of others. In particular, coal played an important role in the development process of the United Kingdom, Germany and France where the steam power was the leading technology for energy production in the 18th and 19th centuries. OIC countries are not also immune from this fact. Several OIC countries in different geographic regions have utilized rich mineral resources (especially gas and oil) during their course of development that enabled some of them to reach high-income country status.

Figure 5.1 illustrates that OIC countries altogether were able to meet 21% of the world's total minerals production where non-OIC developing countries supplied about 53.5% of the total mineral production worldwide in 2014. OIC countries, in aggregate terms, show a relatively high performance in production of two types of minerals: mineral-fuels and industrial minerals. In 2014, 23.1% of all mineral fuels and 15.8% of all industrial minerals production in the world were originated from OIC countries. A broad overview on minerals production without taking proved reserves into account may fail to reflect the real potential of OIC countries. As it will be presented in the next sub-section by sub-categories, OIC countries have some distinct advantages in several types of minerals both in

terms of their levels of production and availability of extensive reserves. Nevertheless, the existing production levels for OIC countries are far from their real potential given their extensive reserves of natural resources. To this end, OIC countries need to take some policy actions to benefit from these resources for enhancement of their development.

Figure 5.1
World Mineral Production in 2014, % Shares of Country Groups



Source: World Mining Data 2016, Minerals Production.

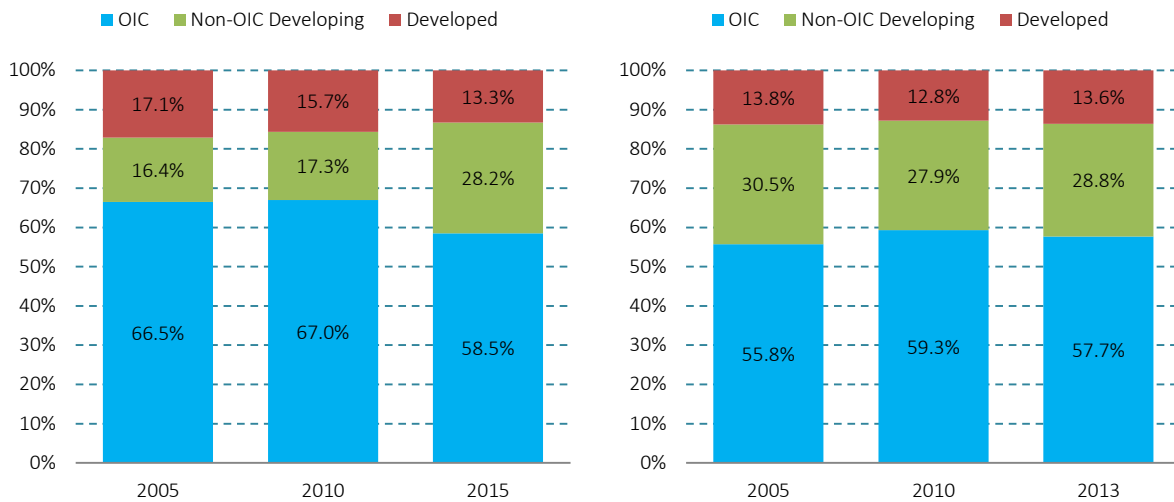
Crude Oil

Crude oil is one of the most important mineral fuels that has been used extensively in variety of sectors from transport to energy. Moreover, it serves as the raw material for many chemical products, including pharmaceuticals, solvents, fertilizers, pesticides, and plastics that makes a critical commodity for national economies. Due to its high energy density, easy transportability and relative abundance, oil has become the world's most important source of energy since the mid-1950s.

OIC countries, in aggregate terms, are abundant with crude oil both in terms of production and reserves. OIC countries possessed 58.5% of the world's total proved crude oil reserves in 2015

Figure 5.2

Proved Reserves of Crude Oil (left) and Exports of Crude Oil (right), (% Share in the World)



Source: U.S. Energy Information Administration. Note: Calculations are based on barrels per day production

(Figure 5.2, left). However, this share of the OIC group was measured at 66.5% in 2005. This implies that a gradual decrease was observed in the relative share of proved reserves of crude oil in OIC countries. Saudi Arabia and Iran were two leading OIC countries with the highest crude oil reserves. Saudi Arabia alone possessed 16.2% of the worldwide proved crude oil reserves (Figure 5.3, left). On the other hand, OIC countries recorded a gradual increase in their share of total exports of crude oil that climbed from 55.8% in 2005 to 57.7% in 2015 (Figure 5.2, right). Based on the available data, OIC oil producer countries supplied 41.5% of all produced crude oil in the world as of 2015 (Figure 5.3, right).

Natural Gas

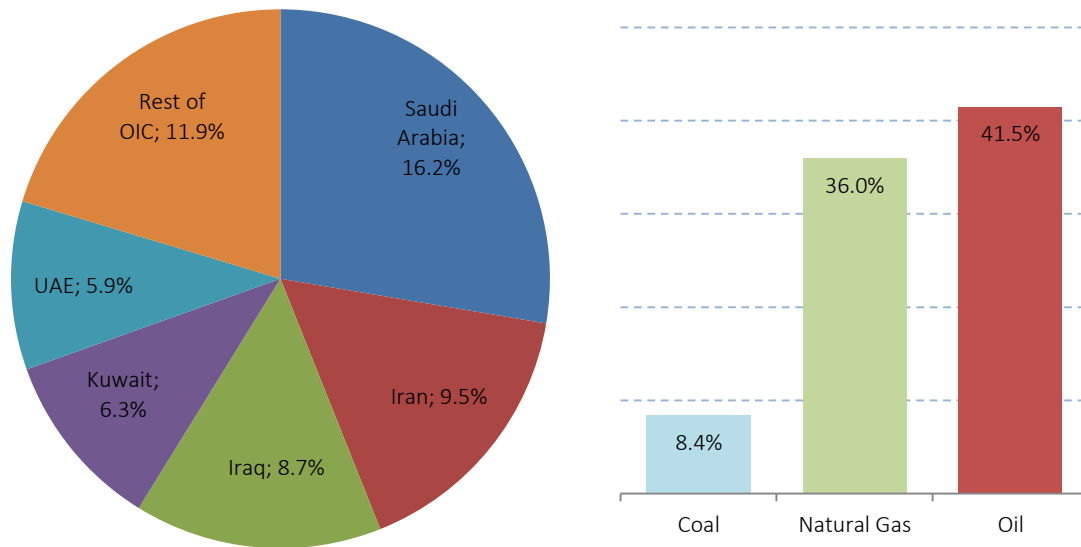
Natural gas is another major fossil fuel type used as a source of energy for heating, cooking, and electricity generation. It is also used as fuel for vehicles and as a chemical feedstock in the manufacture of plastics and other commercially important organic chemicals. Increasing number of countries globally has been replacing coal technology with natural gas technology to generate electricity thanks to improvements in the technology. Sea transport fleets for Liquefied Natural Gas (LNG) enabled many countries across the globe to access natural gas at affordable prices. All these developments have remarkably increased the importance of natural gas in the world commodity markets.

Box 6.1: Shale Gas

Shale gas is natural gas that is found trapped within shale formations. Energy Information Administration Agency of the United States Department of Energy listed 11 countries worldwide with proved shale gas reserves as of 2013. Among 11 countries, Algeria and Indonesia were two OIC countries possessing proved shale gas reserves. The estimated amount of "technically recoverable" shale gas resources were equal to 707 (trillion cubic feet) for Algeria and 580 (trillion cubic feet) for Indonesia in 2013.

Figure 5.3

OIC Countries with the Highest Crude Oil Reserves (% of World Total Crude Oil Reserves) (left)
and Share of OIC Countries in the World Production of Fossil Fuels in 2015 (right)

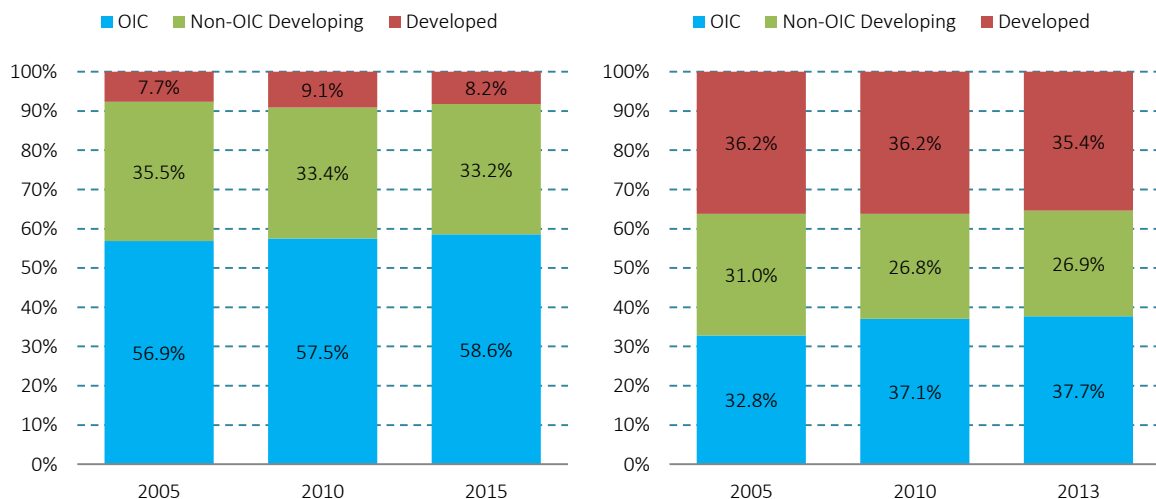


Source: U.S. Energy Information Administration.

OIC countries, in aggregate terms, are rich in terms of proved natural gas reserves. The share of OIC countries in worldwide proved gas reserves increased from 56.9% in 2005 to 58.6% in 2015 (Figure 5.4, left). The share of developed countries was measured merely at 8.2% in 2015. Iran and Qatar were two leading OIC countries with the highest natural gas reserves. Iran alone possessed 17.3% of the worldwide proved natural gas reserves in 2015 (Figure 5.5). OIC countries succeeded to record an increase in their share of natural gas exports worldwide as well. The worldwide share of OIC countries in exports of dry natural gas went up from 32.8% in 2005 to 37.7% in 2013 (Figure 5.4, right). Based on the available data, OIC natural gas producer countries supplied 36.0% of all

Figure 5.4

Proved Reserves of Gross Natural Gas (left) and Exports of Dry Natural Gas (right), (% of World)



Source: U.S. Energy Information Administration. Note: Calculations are based on barrels per day production.

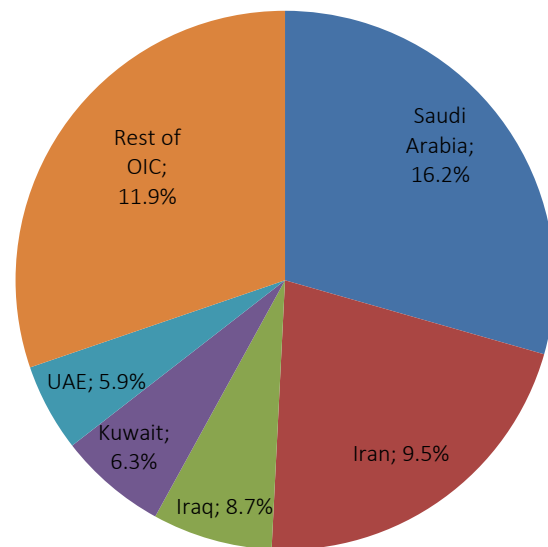
produced natural gas in the world as of 2015 (Figure 5.3, right).

Coal

Coal is a mineral fuel that has been used as an energy resource, primarily burned for the production of electricity and/or heat, and is also used for industrial purposes, such as refining metals. It is the largest source of energy for the generation of electricity worldwide, as well as one of the largest worldwide sources of carbon dioxide releases. The environmental impact of the coal industry includes issues such as land use, waste management, water and air pollution, caused by the coal mining, processing and the use of its products. Despite its severe side effects, it has been widely used both in developed and developing countries worldwide. OIC countries also go on producing coal and the level of production is on the rise. The share of OIC countries in the world coal production went up from 5.0% in 2005 to 8.4% in 2013 (Figure 5.6, left). In the same period, the share of OIC countries in the world exports of coal recorded a remarkable increase as well that jumped from 18.7% to 33.8% in the same period (Figure 5.6, right). In particular, improved production capacity of OIC countries and increasing demand for coal by non-OIC developing for energy production paved the way for the OIC group to record a 15.1 percentage-points increase in

Figure 5.5

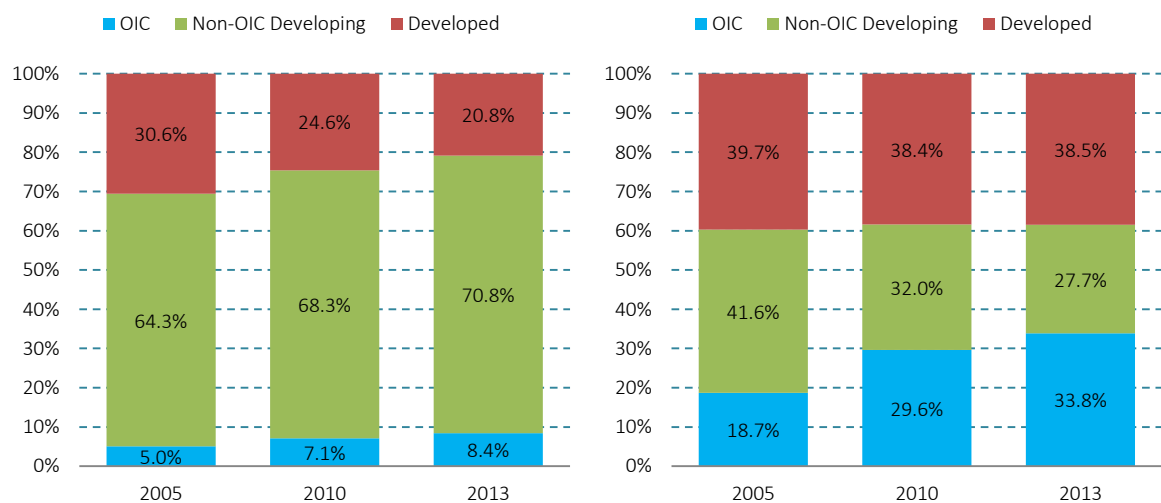
OIC Countries with the Highest Natural Gas Reserves (% of World), 2015



Source: U.S. Energy Information Administration.

Figure 5.6

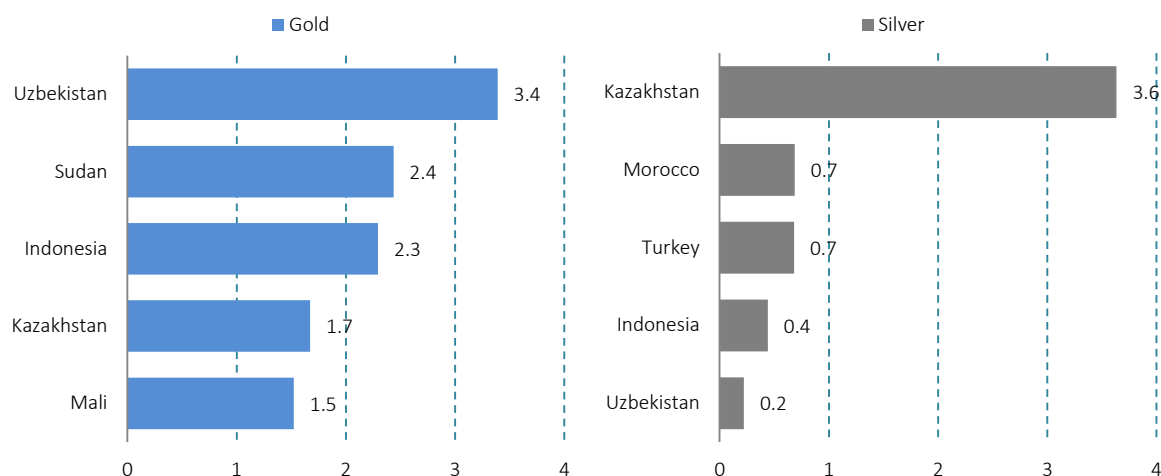
Production of Coal (left) and Exports of Coal (right), (% of World)



Source: U.S. Energy Information Administration. Note: Calculations are based on barrels per day production.

Figure 5.7

OIC Countries with the Highest Gold (left) and Silver Production (right) in 2014, (% of World)



Source: World Mining Data 2016, Minerals Production.

its share of the global coal exports market.

Precious Metals

The total production of precious metals in all OIC countries represented 7.0% of the total world production in 2014 (see Figure 5.1). In this regard, it is fair to say that OIC countries collectively do not constitute a strong presence in terms of precious production of precious metals. Nevertheless, as production figures of two important precious metals (gold and silver) indicate, some individual OIC countries have a relatively high abundance of production. In 2014, Uzbekistan and Sudan were two leading OIC countries in terms of gold production that supplied 3.4 and 2.4% of the world's total production, respectively (Figure 5.7, left). Altogether top five gold producer OIC countries (Uzbekistan, Sudan, Indonesia, Kazakhstan, and Mali) were able to supply 9.8% of the total gold production in the world in 2014. On the other hand, Kazakhstan alone met 3.6% of total silver production. Morocco and Turkey followed Kazakhstan with a production share about 0.7% in the world (Figure 5.7, right). The share of top five silver producer OIC countries (Kazakhstan, Morocco, Turkey, Indonesia, and Uzbekistan) in the world amounted to 5.4% in 2014.

Uranium

Uranium is the most important mineral that has been used in nuclear reactors to generate energy as a raw material. OIC countries in aggregate terms supplied 52.7% all uranium production in the world (Figure 5.8, left). The share of non-OIC developing countries amounted to 18.3% and developed countries supplied about 28.9% of the total world uranium production in 2014. Kazakhstan is the top producer of uranium in the world that alone met 41.1% of the total world uranium production. Niger and Uzbekistan are two other important OIC countries in terms of uranium production, with shares of 7.2 and 4.3%, respectively (Figure 5.8, right).

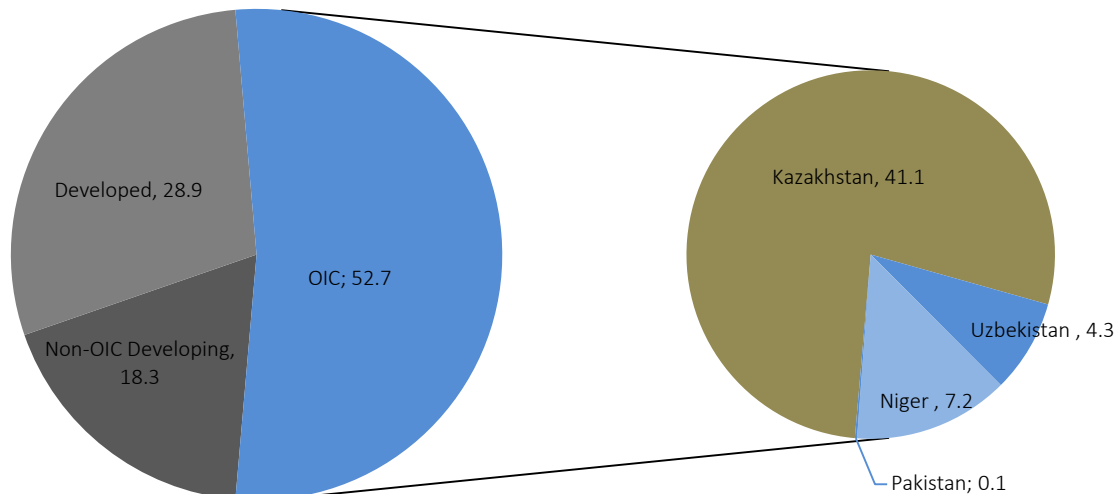
5.1.2 Energy Resources

Energy resources can be classified in two broad categories: renewable and non-renewable. Renewable energy is defined as an energy source (fuel type) that can regenerate and can replenish

itself indefinitely. The five renewable sources used most often are hydro, biomass, wind, solar, and geothermal. The use of renewable energy resources does not associate with severe environmental

Figure 5.8

Shares of Country Groups in the World Uranium Production in 2014 (left) and
Uranium Production Shares of OIC Countries in 2014 (right)



Source: World Nuclear Association.

effects. Non-renewable energy resources are the ones which are finite and do not have the ability to replenish. The use of non-renewable energy resources associates with severe environmental effects given the available global technology level. According to these definitions, all fossil mineral resources (i.e. oil, natural gas and coal) can be classified as non-renewable energy resources. On the other hand, it is still inconclusive in the literature whether nuclear energy is renewable or non-renewable which uses uranium as the raw input (Chowdhury, 2012).

Electricity is produced by using non-renewable energy resources, renewable energy resources and nuclear technology. A country's relative performance on the effective use of energy resources and its relative dependency on different energy resources can be tracked by looking at energy sources used in the production of electricity in a given period. In particular, such an approach is effective in cross-country analyses. The relative shares of different energy sources in the production of electricity are affected by the level of available national technology, natural resources, financial sources and national energy policies. In this context, Figure 5.9 presents relative shares of different energy sources in the production of electricity across country groups. Fossil fuels still keep the number one position as the major source for production of electricity worldwide. On average, 66.6% of electricity was produced by using fossil fuels where 41.2% of this production stemmed from coal power stations and 21.8% came from natural gas power stations in 2013. The share of oil power stations was only equal to 3.6%. OIC countries as a group had the highest share of fossil fuels in electricity production among others where 84.0% of all electricity production stemmed from fossil fuels (54.2% natural gas, 15.9% oil, 13.9% coal) in 2013. Developed countries only generated 50.6% of their electricity from fossil fuels in 2013. The average of non-OIC developing countries was close to the world average and measured at 69.6% in the same year. To this end, it is fair to conclude that OIC countries are heavily dependent on fossil fuels to meet their electricity demand when compared with other country groups.

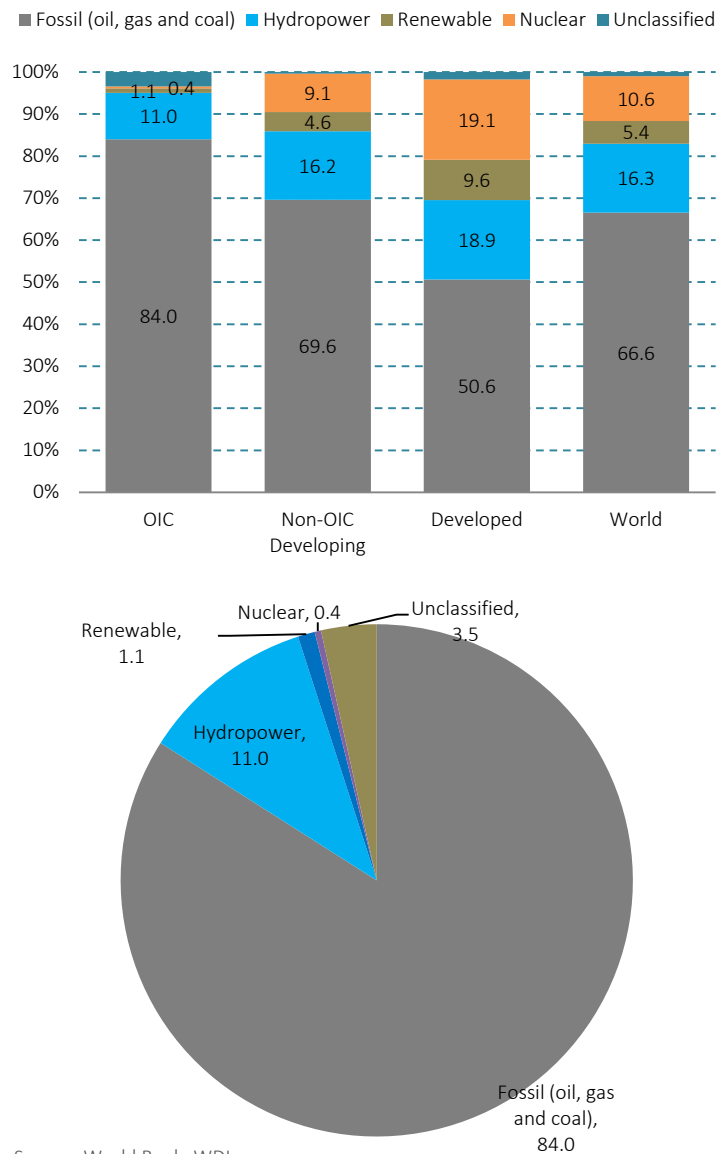
In terms of renewable energy resources, OIC countries performed relatively poorer especially when compared with other country groups. The contribution of hydropower into electricity production was amounted to 11.0% in the OIC group where the world average was equal to 16.3%. All other types of renewable energy sources made a negligible contribution (1.1%) into the total electricity production of the OIC group. However, in non-OIC developing countries, the share of renewable energy sources (excluding hydro) in total electricity production was measured at 4.6% (more than 4 times higher than the OIC average). On the other hand, developed countries went too far in benefiting from renewable energy resources when compared to other groups. They met 9.6% of their electricity production from variety of renewable energy resources. If hydropower is added into calculation, developed countries generated almost 28.5% of their total electricity from renewable resources. This share was measured to be only 12.1% in the OIC group (Figure 5.9). In this regard, it is

evident that OIC countries benefit remarkably less from renewable energy resources including hydropower when compared with other country groups as well as the world average.

Hydropower derives energy from turbines being spun by fresh flowing water. This can be from rivers or from man-made installations, where water flows from a high-level reservoir down through a tunnel and away from a dam. The contribution of hydropower to decarbonising the energy mix is thus twofold: the primary benefit is its clean, renewable electricity. The secondary benefit is as an enabler to greater contribution of other renewables on the grid. Furthermore, hydropower helps stabilise fluctuations between demand and supply. Hydropower development often contributes other benefits. The most important are water supply, flood and drought control, and irrigation; but navigation and recreational activities also have their place. These objectives can conflict at times, but are more often complementary.

Figure 5.9

Sources of Electricity Production in the World in 2013
(top) and in OIC Countries (bottom) (% of total)

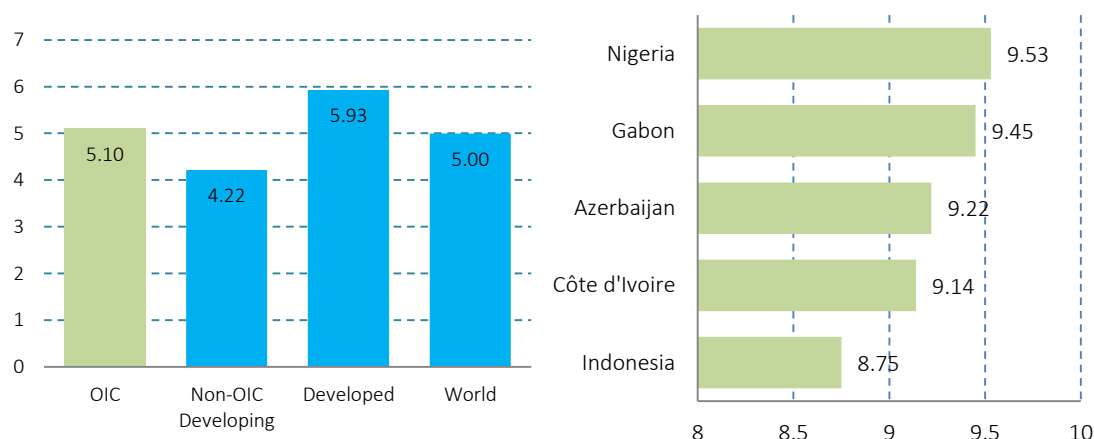


Box 6.2: Energy Security in OIC Countries

Briefly energy security can be defined as the uninterrupted availability of energy sources at an affordable price (Kocasan, 2014). Energy security is a complex issue with its multiple dimensions. The energy security index of the World Energy Council is one of three sub-indices of the energy trilemma index and ranks a total of 130 countries worldwide. The energy security index takes three dimensions into account: the effective management of primary energy supply from domestic and external sources, the reliability of energy infrastructure, and the ability of participating energy companies to meet current and future demand. Therefore the index score reflects how well countries manage the trade-offs between three dimensions to ensure energy security.

In 2015, the global average of the energy security index score was calculated at 5.0 where developed countries, on average, obtained the highest score of 5.9. The average of non-OIC developing countries was the lowest and measured at 4.2. The average of data available 37 OIC countries corresponded to 5.1 that exceeded the world average and the average of non-OIC developing countries. Among data available OIC countries, Nigeria obtained the highest score of energy security index as 9.5 and followed by Gabon with a score of 9.4. 18 out of 37 data available OIC countries ranked above the world average score of 5.0. To this end, it can be inferred that several OIC countries have relatively higher energy security scores when compared with the world average thanks to rich and diverse natural resources.

Worldwide Energy Security Scores (left) and Top Performer OIC Countries (right), 2015



Source: World Energy Council 2015

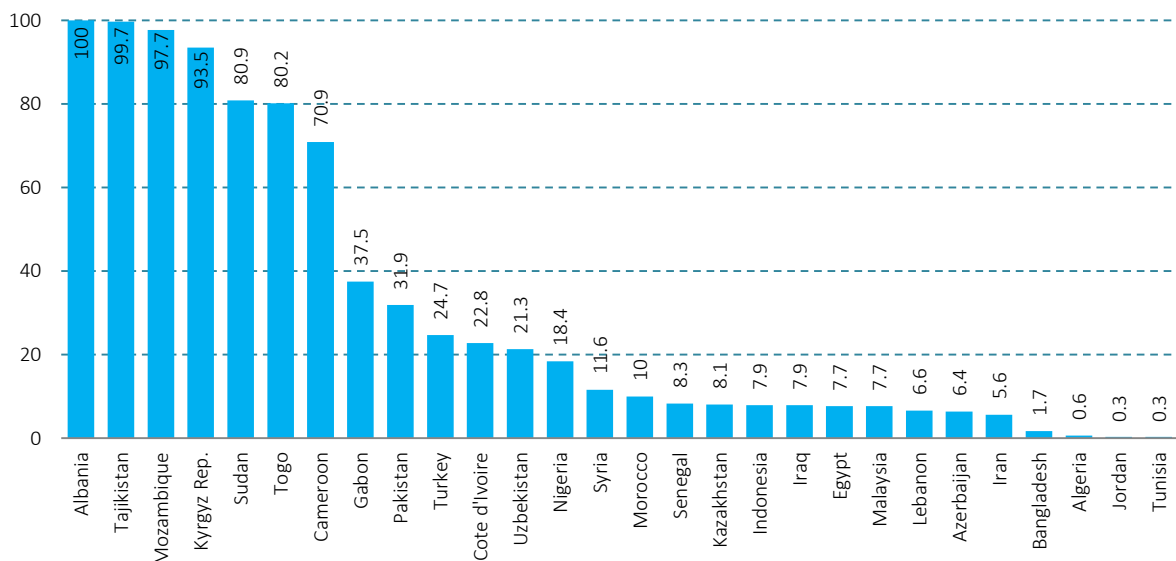
Note: The OIC average reflects the average of data available 37 OIC Countries. A higher index score represents a higher energy security.

Hydropower

Hydropower is a mature and cost-competitive renewable energy source. It plays an important role in today's electricity mix, contributing to more than 16.3% of electricity generation worldwide and about 85% of global renewable electricity. In OIC countries, on average, 11% of electricity was produced from hydropower. At the individual country level, 28 OIC countries were listed to have hydropower stations in 2013. Albania and Tajikistan were the two OIC countries with the highest share of hydropower in electricity generation (more than 99%). On the other hand, in Jordan and Tunisia only 0.3% of electricity was generated by hydropower stations (Figure 5.10). To this end, in terms of hydropower capacity, OIC countries present a mix picture where 7 member countries

Figure 5.10

Share of Hydro Energy in Electricity Generation in OIC Countries, 2013



Source: World Bank, WDI.

meet more than 70% of their electricity generation from hydropower. On the contrary, 29 OIC countries failed to report electricity generation from hydropower.

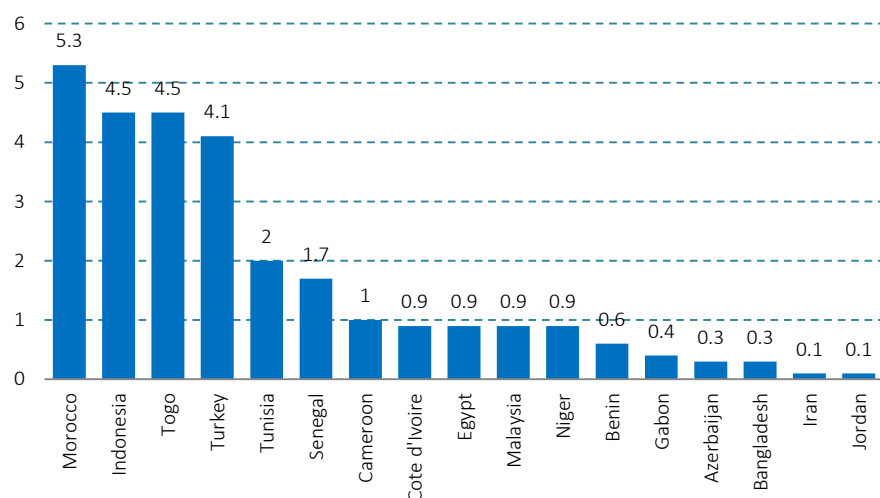
Other Renewable Energy Resources

When hydropower excluded, among 57 OIC countries only 17 OIC countries generated electricity from other renewable energy resources (e.g. biomass, solar, and wind). Among these OIC countries, Morocco was the top performer countries in terms of having the highest share of renewable energy in electricity generation in 2013 where 5.3% of all electricity stemmed from renewable energy sources (Figure 5.11). Indonesia and Togo followed Morocco with an average share of 4.5% in 2013.

Apart from hydropower, solar and wind are other two major types of renewable energy

Figure 5.11

Share of Renewable Energy (excl. Hydro) in Electricity Generation in OIC Countries, 2013



Source: World Bank, WDI

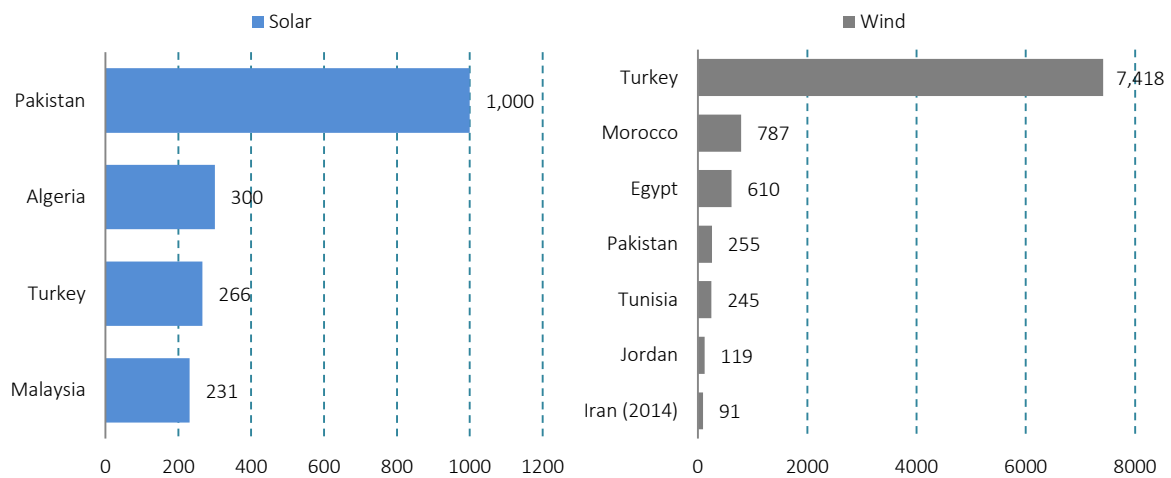
resources that are widely used across the globe at varying degrees to generate electricity. OIC countries have more recently embarked on benefiting from solar and wind energy when compared with developed countries. According to the available data obtained from the International Energy Agency, only 4 OIC countries have installed capacity to generate electricity from solar power in 2015. These OIC countries are listed as follows: Pakistan, Turkey, Algeria, and Malaysia.¹² The capacity of Pakistan reached 1000 MW by 2015 that makes it the leading country among 4 OIC countries in solar power. The cumulative share of 4 OIC countries in the total world solar capacity corresponds to only 0.7%. On the other hand, Turkey was the OIC country with the highest installed capacity in wind power in 2015 where its capacity exceeded 7000 MW. Morocco, Egypt, Pakistan, Tunisia, Jordan and Iran are other 6 OIC countries with readily available installed wind power capacity. Altogether the share of 7 OIC countries represented 2.2% of the world's total installed wind power capacity. In other words, both in solar and wind power, OIC countries are far from their potential and do not have a strong presence in the global solar and wind power markets in terms of installed capacities. To this end, several OIC countries need to re-work on their national energy strategies to find out ways to benefit from solar and wind power to a higher extent as increasing number of non-OIC developing countries do.

Nuclear Energy

Despite having enormous uranium reserves where 52.7% of the world's total uranium production was met by OIC countries in 2014, only two OIC countries (Pakistan and Iran) have the nuclear technology to generate electricity. According to the World Bank statistics, in 2013, 4.9 and 2.0% of all national electricity production was stemmed from nuclear power stations in Pakistan and Iran, respectively. In other words, electricity generated by using nuclear technology represented only 0.4% of all electricity production of the OIC group in 2013. However, developed countries, on average, generated 19.1% of their electricity from nuclear power stations where the world average amounted to 10.6%.

Figure 5.12

Installed Solar (left) and Wind Capacity (right) (MW) in OIC Countries in 2015



Source: International Energy Agency 2016 and Global Wind Energy Council.

¹² Morocco started generating electricity from solar energy in February 2016. However, this recent development has not been covered yet by international statistics.

These figures imply that although several OIC countries are endowed with nuclear raw materials, vast majority of them do not have the necessary technology as well strategy to utilize nuclear raw materials to produce energy (see Figure 5.8). Even in two OIC countries with the nuclear technology, the levels of electricity production through nuclear power stations remain too modest given their national total electricity production capacity. In this regard, it can be concluded that OIC countries have not really exploited the full potential of nuclear energy. This existence of stark difference between developed countries and OIC countries in terms of the usage of nuclear energy sources makes OIC countries heavily dependent on fossil fuels for generation of energy.

5.2 Adding Value to Natural Resources

Several OIC countries have benefited extensively from their natural resources in their course of development especially those endowed with rich fossil fuels and other minerals. Such natural resources offer great potential for fostering development. However, in order to maximize the potential contribution of natural resources, OIC countries need to upscale their capacity not only in terms of extracting these sources but also adding more value into them through appropriate policies and investments.

For instance, in the oil industry refineries play a great role to improve the value of crude oil and help to produce secondary hydrocarbon products from oil. As one of the developed countries and the number one oil producer country, the United States of America has 137 oil refineries with an operational capacity of 18.3 million barrels per day. On the other hand, Saudi Arabia, the second largest oil producer in the world, has the capacity of refining 3.3 million barrels per day in 10 refineries within the country. As listed in Table 5.1, despite having a 41.5% share in the world production of oil, only 4 refineries from OIC countries ranked in the world's top 15 refineries in terms of operational capacity size. It is therefore important for OIC countries to re-consider existing strategies and adopt new ones in line with the new developments across the globe to benefit more from production and exports of natural resources especially fossil fuels by processing them in order to add more value.

In terms of nuclear energy and the use of uranium as one of the most important minerals, OIC countries also struggle with similar under investment and under capacity problems to a greater extent. Only two OIC countries (Pakistan and Iran) have the installed capacity to generate electricity from nuclear energy through using uranium. It is therefore hard to claim that OIC countries really benefit from the nuclear technology given 52.7% the world's total uranium production uranium was met by OIC countries in 2014.

Another striking example can be given from Niger in this domain. According to the World Bank 2012 statistics, only 14.4% of the population in Niger had access to electricity, even though Niger alone meets more than 7% of the world's total uranium production. In other words, if Niger utilizes its rich uranium resources for electricity generation, the share of population with electricity can easily exceed 90%. However, this requires large-scale investments, human capital and technology transfer. At this point, intra-OIC cooperation may play a significant importance. For instance, OIC countries with the nuclear technology can assist Niger and other OIC countries for transfer of technology and development of technical personnel where investor companies from other OIC countries may invest into the construction of nuclear power stations. By following such an

approach many OIC countries may be better-off in terms of energy security, electricity generation and overall welfare.

Table 5.1: World's Largest Refineries

Rank	Name of Refinery	Location	Barrels per Day
1	Jamnagar Refinery (Reliance Industries Ltd.)	Gujarat, India	1,240,000
2	Paraguana Refinery Complex (PDVSA)	Paraguana, Falcon, Venezuela	940,000
3	SK Energy Co., Ltd. Ulsan Refinery (SK Energy)	Ulsan, South Korea	850,000
4	Ruwais Refinery (Abu Dhabi Oil Refining Company)	Ruwais, UAE	817,000
5	GS Caltex Yeosu Refinery (GS Caltex)	Yeosu, South Korea	730,000
6	S-Oil Onsan Refinery (S-Oil)	Ulsan, South Korea	670,000
7	ExxonMobil	Singapore	605,000
8	Port Arthur Refinery (Motiva Enterprises)	Port Arthur, Texas, USA	600,250
9	Baytown Refinery (ExxonMobil)	Baytown, TX, USA	560,500
10	Ras Tanura Refinery (Saudi Aramco)	Jubail, Saudi Arabia	550,000
11	Garyville Refinery (Marathon Petroleum)	Garyville, LA, USA	539,000
12	Baton Rouge Refinery (ExxonMobil)	Baton Rouge, LA, USA	502,500
13	Abadan Refinery (NIOC)	Abadan, Iran	450,000
14	SAMREF (Aramco Mobil Refinery)	Yanbu, Saudi Arabia	405,000
15	Shell Pernis (Royal Dutch Shell)	Rotterdam, The Netherlands	416,000

Source: US Energy Administration and PEMEX

5.3 Activating the Potentials of Renewable Energy

According to the International Energy Agency (2011), there are three classic policy drivers that are often cited as the rationale for renewable energy: energy security and reduced fossil fuel input, environmental benefits, and economic benefits. Underutilization of renewable energy therefore leads to increased energy security concerns and dependence, severe environmental impacts as well as sizeable economic losses. Underdeveloped technology, poor infrastructure, insufficient human capital and lack of financial sources are usually listed as the major reasons to explain why developing countries including many OIC countries could not start exploiting the real potential of renewable energy.

Although many OIC countries are endowed with rich renewable energy resources, majority of them do not have readily available installed capacity in the renewable energy sector. Nevertheless, recently several OIC countries initiated some projects in different renewable energy types, such as the Masdar City project of United Arab Emirates and Solar Power project of Morocco, in order to diversify their energy sources, reduce environmental emissions and scale-up energy generation capacities. However, the most important step towards activating the potentials of renewable energy is to review existing national energy strategy and vision documents, which usually see the fossil fuels as the major energy source with a view to increase the installed capacity for renewable energy sources.

First of all, this requires a paradigm shift in energy policy-making in OIC countries. Secondly, the new understanding in the energy sector of OIC countries that aims to improve the share of



renewables can only be achieved with new investments that imply additional funds for financing. 21 OIC countries have already built up their sovereign wealth funds (see Table 5.2). Some portion of these funds can be utilized to meet associated investment costs into renewable energy. On the other hand, Public-Private Partnership (PPP) modality provides a unique opportunity for energy investments and funds were already allocated from multilateral development banks (e.g. World Bank, Islamic Development Bank, African Development Bank) that wait for concrete project proposals from countries in the renewable energy sector. According to ADB (2016), \$81 billion was mobilized for climate finance including renewable energy projects by the world's six largest multilateral development banks (MDBs) in 2015. Also unique experiences of leading OIC countries in the renewable energy sector can make important contributions to other OIC countries through organizing experience-sharing, training and capacity building programmes. It is therefore OIC countries are likely to activate the real potential of renewable energy in a short period of time with their rich renewable energy resources and readily available national and international funds, if they can achieve to make a paradigm shift in the domain of energy policy-making.

SECTION 6



Great Market Potential

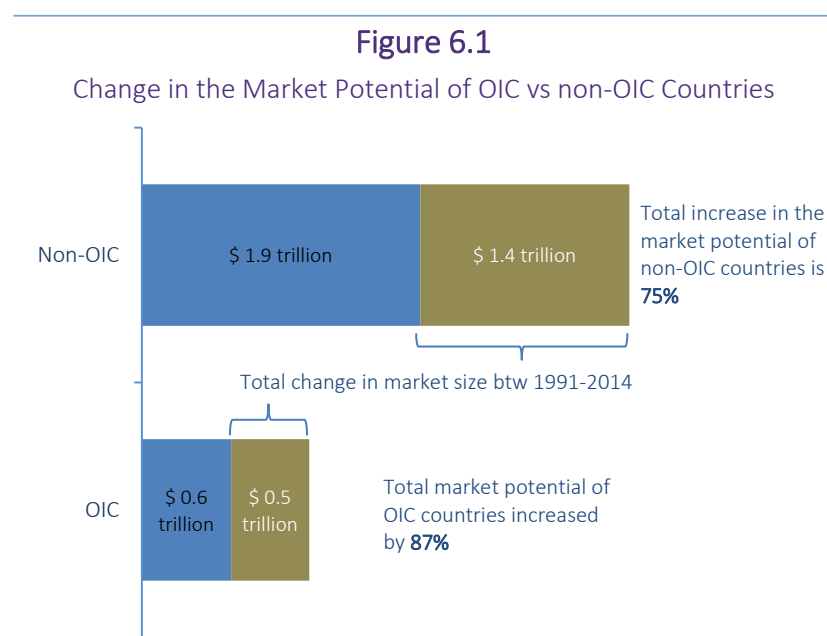
In economics, the concept of a market is understood as any structure that allows buyers and sellers to exchange any type of goods, services and information. It is the way in which an economic activity is organized between buyers and sellers through their interaction with one another. Markets can differ, among others, by products (goods, services), factors (labour, capital), size, concentration, place, target customers, duration, process, regulation, legitimacy, speculation intensity, information asymmetry, volatility and geographic coverage. The amount of something that is available for sell (the supply) and the amount of something that people want (the demand) make up a functioning market. Buyers and sellers determine the overall demand and supply of a product or service at different prices. The quantity demanded depends mainly on price of goods or services, income level of buyers, prices of related goods, tastes and expectations. Similarly, the quantity supplied depends on price of goods or services, prices of inputs used during the production process, level of technology and expectations.

While markets facilitate trade and investment, they also enable an efficient distribution of resources in a society. The openness of markets to competition can provide a powerful incentive for allocation of resources towards their most productive use. This will not only result in improved economic performance and productivity, but also better infrastructure and stronger institutions. Today, with the reduction in transport and trade costs, international markets are highly connected with each other. This creates global production networks, which increasingly account for a large share of international trade. Multinational enterprises are exploiting competitive advantage of different regions in their production processes, but small and medium size enterprises are also taking part in global value chains. While trade promotes exploitation of economies of scale and specialization, it promotes technology and knowledge spillover, and thereby contributes to development.

Trade and investment are essential to support long term economic development and employment growth, but open markets alone are not sufficient to realize that. They must be accompanied by complementary policies that enable individuals and firms to exploit the benefits of more open markets. OIC region itself offers a great opportunity in production as well as marketing of goods and services. This in turn creates opportunities for investment among the countries with high economic integration. In this context, this section will discuss some important elements in promoting trade and investment in OIC countries with a view to utilizing their great market potential.

6.1 Size of the Market in OIC Countries

As highlighted in section 3, market potential is a refined measure of proximity to markets, which is defined as the sum of all countries' GDP weighted by the inverse of the bilateral distance. A broad analysis on market potential reveals that the total market potential of OIC countries reached to



Source: SESRIC staff calculation.

USD 1.13 trillion in 2014 from USD 0.6 trillion in 1991, with a total increase of 87% (Figure 6.1). During the same period, market potential of non-OIC countries increased at a slower rate with 75% and reached USD 3.28 trillion. On the other hand, the market potential of OIC countries accounted increasingly for greater share of world market potential, which increased to 25.6% in 2014 from its level of 24.3% in 1991 (see

Figure 3.14).

Over the last 25 years, total market potential of OIC countries has grown faster than that of non-OIC countries (Figure 6.2). During 1991-2000, market potentials of both country groups were growing at similar pace, but OIC countries started to expand their market potential at a higher pace than non-OIC countries after 2000. Growth in total market potential of OIC countries can be explained by the growth in individual OIC economies as well as non-OIC economies.

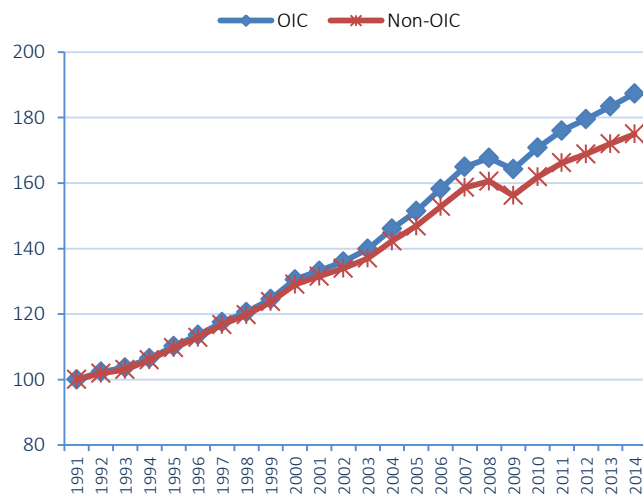
A closer look at the changes in intra-OIC market potential and market potential of OIC countries with non-OIC countries reveal that intra-OIC market potential has grown much faster than the market potential of OIC countries in non-OIC countries as well as intra-market potential of non-OIC countries (Figure 6.3). Intra-OIC market potential has almost tripled during the last 25 years, while it has increased only 70-75% between OIC and non-OIC countries as well as among non-OIC

countries. Therefore, it can be argued that the growth in the market potential of OIC countries is mainly driven by the growth in intra-OIC market potential and fast-growing individual OIC member countries.

Despite the rapid increase in the market potential of OIC countries, total intra-OIC market potential with a total value of USD 179 billion accounts only 5.5% of total world market potential as of 2014 (Figure 6.4). This share is even lower than their share in total world production (see Figure 1.1). Compared to its level in 1991 with a share of only 3.2%, the achievement is noteworthy. However, even if the current trend continues, the share of intra-OIC market potential will reach only 9.3% over the next 25 years, or until 2040. While it is critical to sustain the current growth, there is a need to identify new mechanisms to boost the growth in intra-OIC market potential even further. This is definitely connected to the growth in individual economies of the OIC member countries.

On the other hand, the relative importance of OIC markets is increasing, particularly for other OIC countries. For the individual OIC member countries, market potential of other OIC member countries has increased on average from 10% in 1991 to 15.9% in 2014 (Figure 6.5). This implies that there are more opportunities for individual OIC member countries to benefit from greater OIC market potential. Similarly for non-OIC countries, market potential of OIC member countries represent a higher share of their market potential, which increased from 4.3% to 6.6% during the

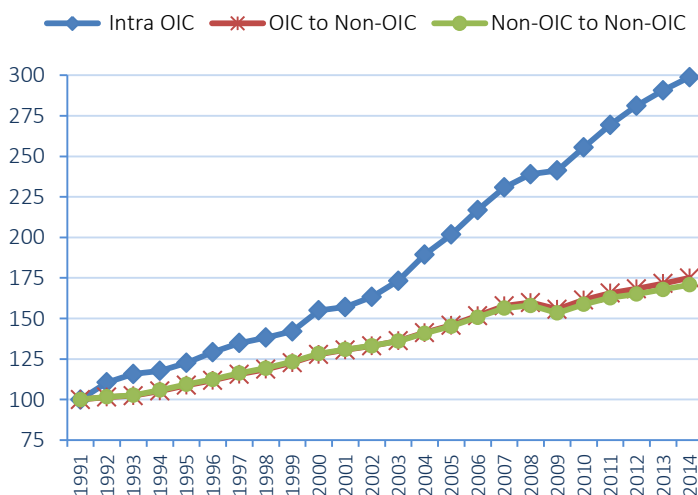
Figure 6.2
Growth of OIC Market Potential



Source: SESRIC staff calculation.

Figure 6.3

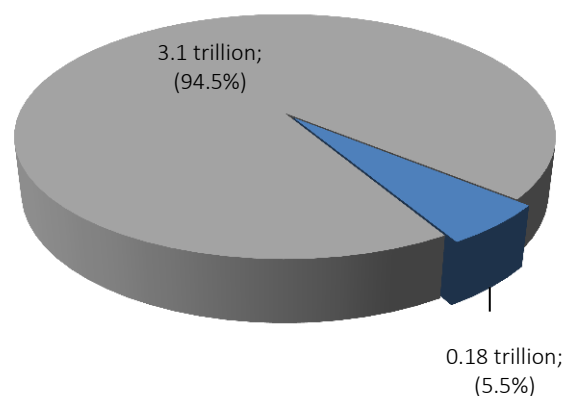
Growth of Intra-OIC Market Potential



Source: SESRIC staff calculation.

Figure 6.4

Share of Intra-OIC Market Potential in World



Source: SESRIC staff calculation.

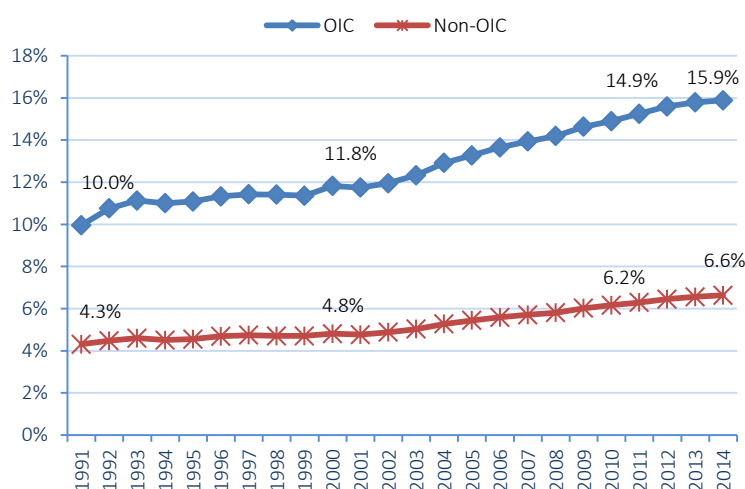
same period. While these numbers still inadequately represent the true potential of OIC countries, the trend reflects the growing importance of OIC member countries for global trade and investment.

Figure 6.6 depicts the intra-OIC market potential at individual country level in 2014. Qatar and Kuwait have the highest market potential with other OIC member countries, which is more than 3.5 times higher than the OIC average. They are followed by Bahrain, UAE, Lebanon, Jordan and Turkey. In general, OIC countries that are located in the central (mainly Middle East) have more favourable access to other OIC countries and therefore enjoy higher market potential. A company based in these countries will have greater opportunity to reach greater markets compared to a company based in other OIC countries. On the other hand, countries located in the periphery, such as Guyana, Suriname, Mozambique, Guinea-Bissau and Guinea have relatively lower market potential in accessing to other OIC countries.

The analysis in this subsection reveals that there is a growing potential of OIC countries for intra-OIC as well as global trade and investment. Despite the rapid growth in the market potential of OIC countries, their share in global market is still low compared to their share in world production. Effective utilization of existing market potential will help to expand it to even higher levels. In this

Figure 6.5

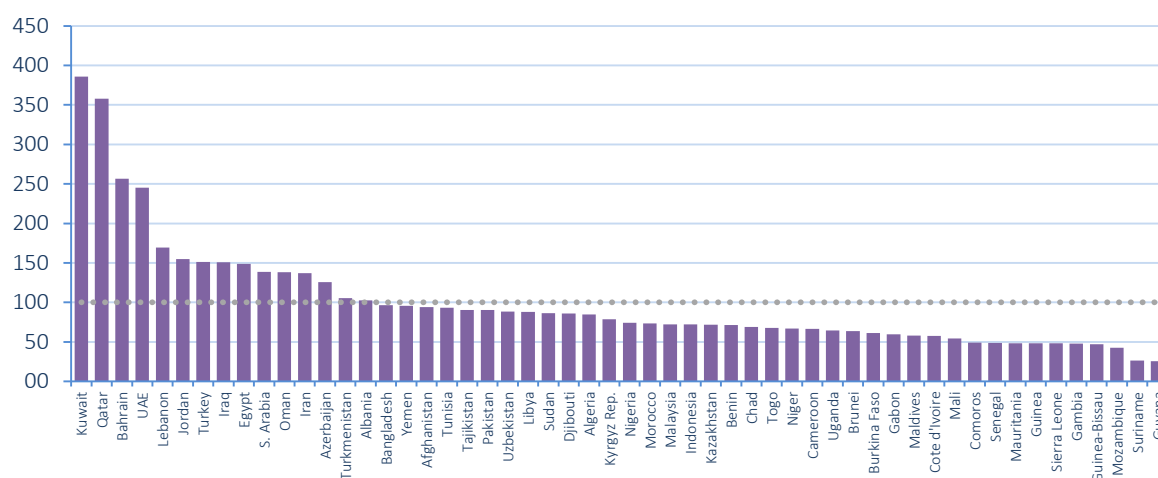
Importance of OIC Market Potential



Source: SESRIC staff calculation.

Figure 6.6

Intra-OIC Market Potential of Individual OIC MCs vis-à-vis OIC Average

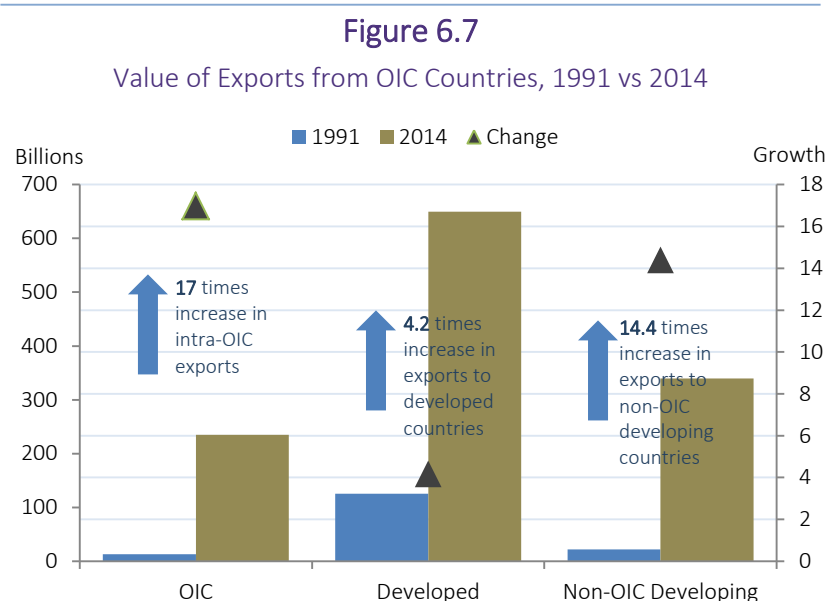


Source: SESRIC staff calculation.

connection, the following subsections will analyse the barriers and opportunities for how to utilize the existing market potential for more trade and investment.

6.2 Utilizing Market Size for More Trade Flows

Over the last 25 years, trade among OIC countries has grown at a faster rate compared to their trade with non-OIC countries (Figure 6.7). Total value of intra-OIC exports increased from USD 13 billion to USD 235 billion during this period, reflecting 17 times increase in value. While developed



Source: SESRIC staff calculation based on IMF DOT database.

countries are still main export partners of OIC countries with a total value of USD 650 billion exports, total value of exports from OIC countries to developed countries increased only 4.2 times during this period. A rapid increase (14.4 times) is also observed in exports to non-OIC developing countries, which reached USD 340 billion in 2014 compared to its level of USD 22 billion in 1991.

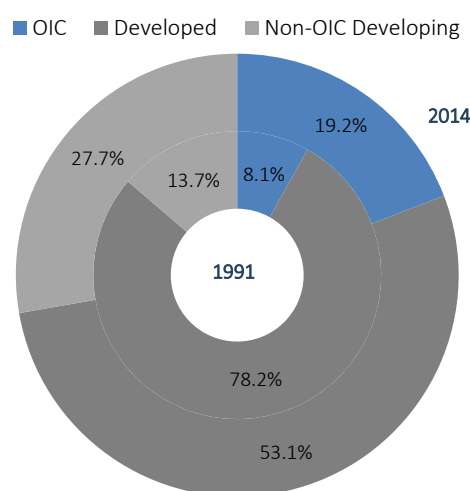
Accordingly, the share of intra-OIC exports increased

significantly from 8.1% in 1991 to 19.2% in 2014 (Figure 6.8). The share of developed countries in total exports of OIC countries decreased from 78.2% to 53.1%. During the same period, the share of non-OIC developing countries also significantly increased to reach 27.7% compared to its level of 13.7% in 1991. Overall, the share of intra-OIC exports increased 11.1 percentage points, share of exports to non-OIC developing countries increased 14 percentage points and share of exports to developed countries decreased 25.1 percentage points.

6.2.1 Overcoming Barriers to Trade

Despite the increase in the share of intra-OIC exports, there are major barriers to trade among the OIC member countries. A major barrier is high level of trade costs. Trade costs

Figure 6.8
Share of Exports from OIC Countries, 1991 vs 2014



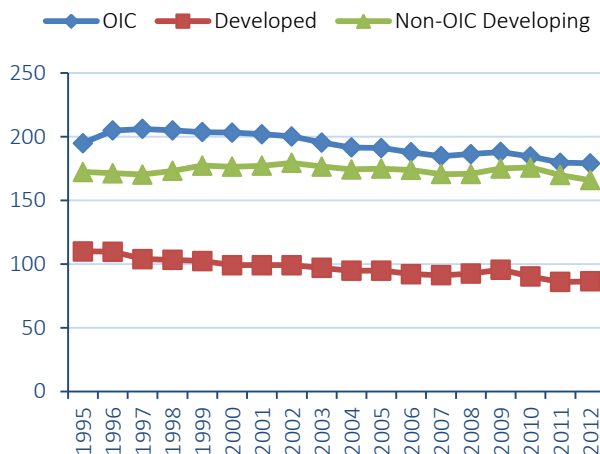
Source: SESRIC staff calculation based on IMF DOT database.

broadly include all costs incurred in getting a good to a final user other than the marginal cost of producing the good itself: transportation costs (both freight costs and time costs), policy barriers (tariffs and nontariff barriers), information costs, contract enforcement costs, costs associated with the use of different currencies, legal and regulatory costs, and local distribution costs (wholesale and retail) (Anderson and van Wincoop, 2004). Therefore, in an increasingly globalized and networked world, trade costs matter as a determinant of the pattern of bilateral trade and investment, as well as of the geographical distribution of production and they are an important determinant of a country's ability to take part in regional and global production networks (Arvis et al., 2013).

Based on the dataset prepared by the World Bank and the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP), Figure 6.9 shows the average trade costs for different country groups over the period 1995-2012.¹³ In order to avoid any potentially misleading aggregation, the averages are calculated by using the bilateral trade costs with 20 largest export partners for each country. As it is evident, although tariffs in many countries are now at historical

Figure 6.9

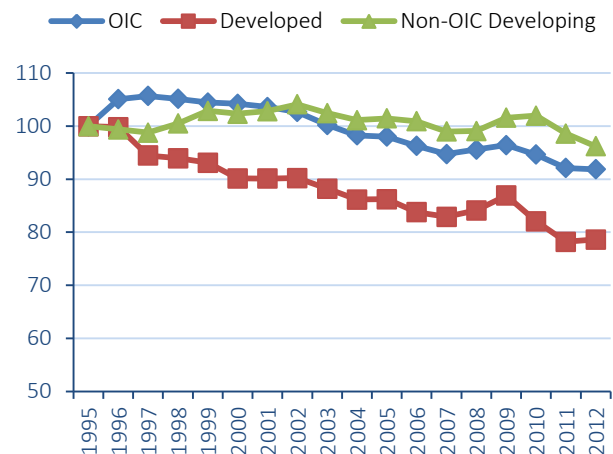
Average Trade Costs



Source: SESRIC staff calculation based on WB-UNESCAP Trade Costs Database.

Figure 6.10

Average Trade Costs (1995=100)



Source: SESRIC staff calculation based on WB-UNESCAP Trade Costs Database.

lows, overall trade costs remain high. Average trade costs tend to exhibit higher trade costs particularly in developing countries. OIC countries, on average, display even higher trade costs. In 2012, trade costs in OIC countries (179% ad valorem) were on average two times higher than those in developed countries (86% ad valorem).

Converting ad valorem equivalents to index numbers makes it possible to see the rate at which trade costs have evolved over time in different country groups. Figure 6.10 shows that, on average, trade costs have fallen most quickly in developed countries (around 21%). They have fallen considerably more slowly in OIC countries and decreased only around 8% to 91.9 in 2012, which is still better than the performance of other developing countries. The fall in average trade costs in non-OIC developing countries decreased by 4% to 96.2 in 2012.

¹³ Data for 2013 are available for fewer number of country pairs. Therefore the year 2013 has been omitted in calculating the averages for different country groups.

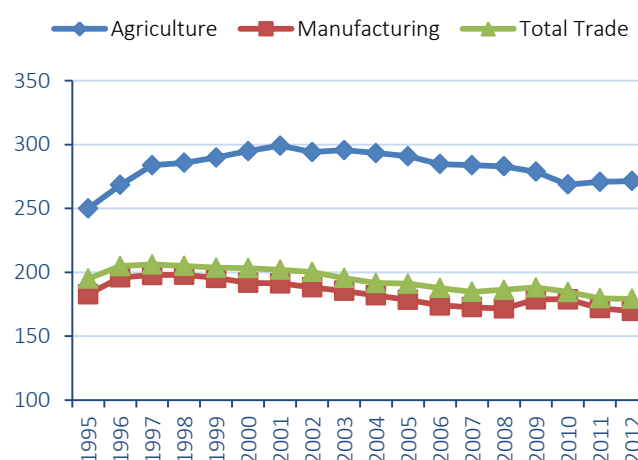
Finally, Figure 6.11 shows the average trade costs in OIC countries in agriculture and manufacturing sectors separately. On average, agricultural products tend to exhibit significantly higher trade costs and it did not decreased over the period under consideration, which is consistent with the continued existence of major policy barriers. There was only a modest decrease in manufacturing from 183% ad valorem in 1995 to 170% ad valorem in 2012. This dynamic needs to be addressed by policymakers in OIC countries if there is an aspiration to deepen their countries' integration into the global economy.

Figure 6.12 compares the development of bilateral trade costs between different country groups. During much of the period under consideration, trade costs between OIC countries are slightly lower than their trade costs with developed countries. In 2012, average bilateral trade costs between OIC countries were 263 ad valorem, whereas it was 241 between OIC and developed countries and 321 between OIC and non-OIC developing countries. On the other hand, average trade costs among developed countries were constantly below the costs between OIC and its partner groups and it fell to 109 in 2012.

Table 6.1 summarizes the bilateral trade costs between different country groups for the year 2010. For all group pairs, agricultural products are the most costly item in trade. Even among the developed countries, 1 unit worth of agricultural product incurs additional 2.1 unit costs until it gets to final consumer. This is only 1.1 in manufactured items for the same country group. For the OIC countries, average trade cost in agricultural products is 3.3 times more than the unit value of that product. This number is around 2.4 for manufacturing products. Trade among OIC countries are less costly compared to trade between OIC and non-OIC developing countries, but it is more costly when compared with the costs among OIC and developed countries. Trade between non-OIC developing countries and developed countries is on the other hand less costly than trade between OIC and developed countries.

Figure 6.11

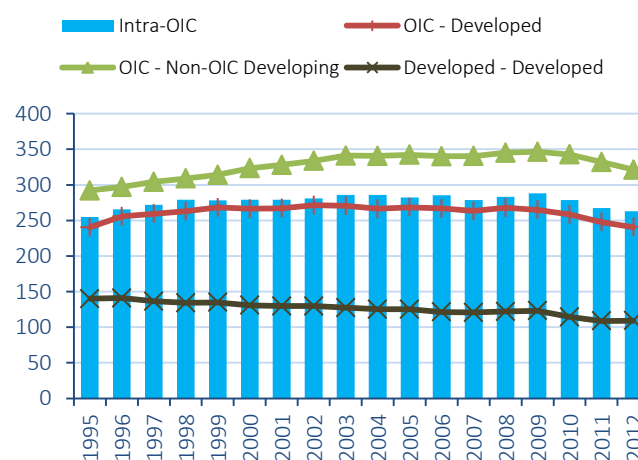
Average Trade Costs in OIC Countries by Sector



Source: SESRIC staff calculation based on WB-UNESCAP Trade Costs Database.

Figure 6.12

Average Bilateral Trade Costs



Source: SESRIC staff calculation based on WB-UNESCAP Trade Costs Database.

It is also worth to see the country pairs within OIC community with relatively low and high trade costs. As depicted in Figure 6.13 for 2010, trade between Senegal and Mali is the least costly one. It costs only 60 more to deliver 100 units product to a final consumer between these countries. They are followed by Guyana-Suriname (63), Indonesia-Malaysia (68), Algeria-Tunisia (70), Saudi Arabia-Jordan (70), Turkey-Algeria (74), Lebanon-Syria (74), Kazakhstan-Kyrgyz Republic (75), Kuwait-Saudi Arabia (75) and Jordan-Syria (78). With regard to the country pairs with highest trade costs within OIC community, trade between Nigeria and Uganda is estimated to be the costliest one within OIC. It will cost 1349 units more to deliver 100 units product to final consumer between these countries. They are followed by Jordan-Albania (931), Iran-Guyana (895), Tajikistan-Morocco (834), Sudan-Niger (827), Chad-Uganda (815), Lebanon-Suriname (741), Uganda-Tunisia (726), Benin-Uganda (724) and Mozambique-Sudan (722).

It is evident that countries with lowest trade costs usually share a common border as well as certain cultural resemblances. However, there are also countries at relatively smaller distance but with high trade costs, mostly in sub-Saharan Africa. This clearly highlights that although distance is a critical factor in affecting the trade costs, other barriers to trade can also have substantial impact on trade costs.

Various trade policy measures and trade costs are likely to have some implications on the export market diversification of OIC countries. In this context, as depicted in Figure 6.8, exports of OIC countries to other OIC countries has increased more than their exports to non-OIC countries, which increased the share of intra-OIC trade over the last two decades. Changing

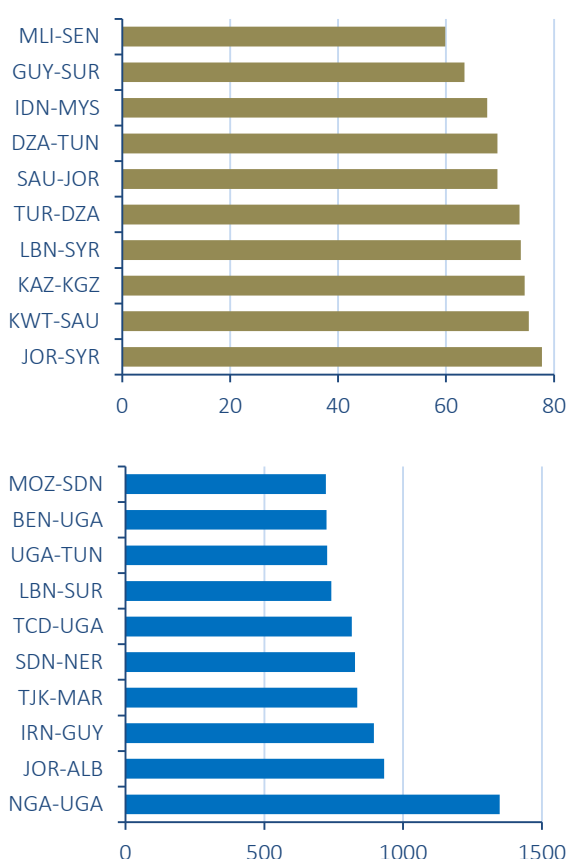
Table 6.1: Average Trade Costs between OIC, Developed and Non-OIC Developing Countries (2012)

Reporter: OIC Countries			
Partners	Agriculture	Manufacturing	Total
OIC	333.1	242.3	263.0
Non-OIC Developing	345.1	296.4	321.2
Developed	321.9	231.2	240.5
Reporter: Developed Countries			
Partners	Agriculture	Manufacturing	Total
OIC	321.9	231.2	240.5
Non-OIC Developing	304.6	226.2	235.2
Developed	208.6	105.9	109.2

Source: SESRIC staff calculation based on WB-UNESCAP Trade Costs Database.

Figure 6.13

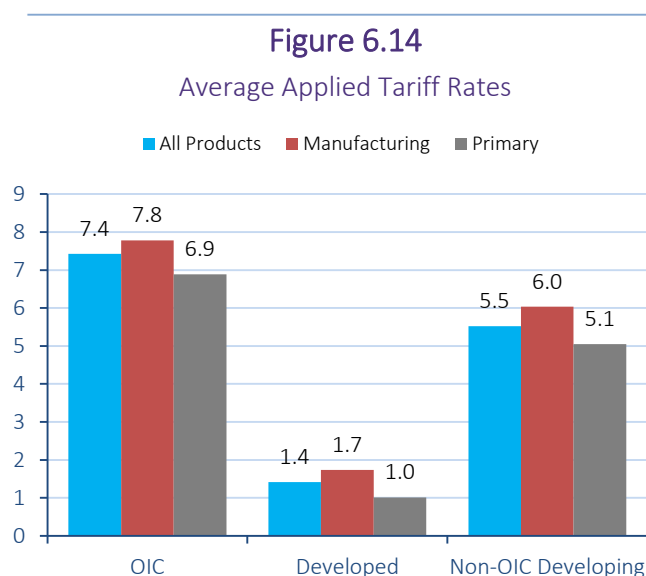
Lowest and Highest Bilateral Trade Costs between the OIC Member Countries, 2010



Source: WB-UNESCAP Trade Costs Database

pattern of trade costs may have played a major role in this transformation.

Investigating the linkages between trade costs and intra-OIC trade, Bagci (2014) argues that much of the changes in the direction of exports of OIC countries can be attributed to the changes in trade costs. In this framework, he analyses the role of trade costs (in aggregate as well as its various components) in determining the direction of exports from OIC countries. The estimation results show that 1% reduction in trade costs can increase world exports by 3.8%, but it can increase exports from OIC countries up to 4.3%. When trade partners of OIC countries are considered separately, 1% fall in trade costs increases exports from OIC countries to developed countries by 4.2% and increases intra-OIC exports by 3.9%. However, 1% rise in trade costs leads to 4.5% fall in exports to non-OIC developing countries. These findings support the view that the current trend in trade costs is one of the major factors shaping the direction of exports from OIC countries.



Source: SESRIC staff calculation based on World Bank WDI.

Figure 6.14 compares the average level of protectionism applied in OIC countries with the averages of other comparison groups by using the applied tariffs rates in 2014, or latest after 2010. It presents simple averages of weighted average tariff rates applied by each country for manufacturing, primary and all products. By applying an average of 7.4% tariff rate, OIC countries reveal a more protectionist picture when compared to the averages of developed countries (1.4%) and non-OIC developing countries (5.5%). In manufacturing products, countries tend to apply higher tariff

rates compared to primary products. OIC countries remain the most protectionist group in these two product categories with 7.8% and 6.9% tariff rates, respectively.

6.2.2 Increasing Partnerships

Given the existing levels of trade barriers, there is a need to increase partnership to ease trade among the OIC member countries. The constantly increasing number of regional trade agreements (RTAs) and preferential trade arrangements (PTAs) is a prominent feature of international trade. According to World Trade Organization (WTO), RTAs are reciprocal trade agreements between two or more partners, which include free trade agreements and customs unions. PTAs are unilateral trade preferences and include Generalized System of Preferences schemes (under which developed countries grant preferential tariffs to imports from developing countries), as well as other non-reciprocal preferential schemes.

As of February 2016, some 625 RTAs had been recorded by the GATT/WTO, 419 of which are in force. The overall number of RTAs in force has been increasingly steadily, a trend likely to be strengthened by the many RTAs currently under negotiations. Of these RTAs, free trade agreements (FTAs) and partial scope agreements account for 90%, while customs unions account

for 10%. A majority of the agreements that have been notified to the WTO are bilateral agreements, involving only two parties. In addition, a majority of them are between developed and developing countries or between developing countries only (WTO, 2015). At regional level, RTA activity is strongest in Europe (21% of RTAs in force), with agreements with countries in Eastern Europe and around the Mediterranean basin as well as RTAs notified by the European Free Trade Area (EFTA). This is followed by East Asia (15%), the Commonwealth of Independent States region (12%) and South America (11%).

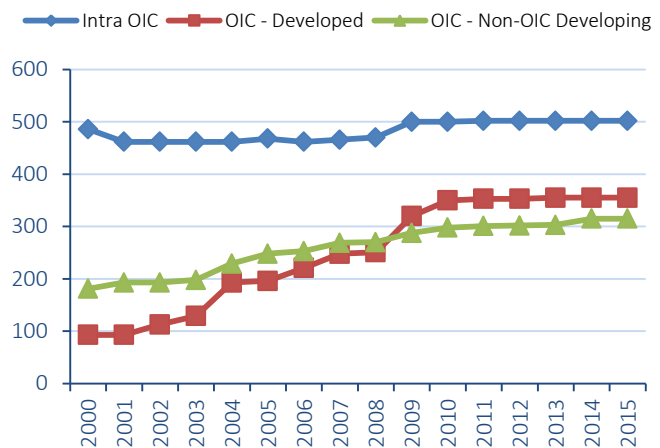
As tariff protection declines either due to unilateral decisions or multilateral negotiations, there is a growing trend for RTAs to not just liberalize goods trade, but also to liberalize services, investment and cover other issues such as intellectual property rights, government procurement, competition policy, and in some cases environment and labour standards. The scope of RTAs, therefore, seems to be growing to include not just barriers to trade at the border but also increasingly behind the border measures that could impact trade (WTO, 2015).

OIC countries are also quite active in RTAs. There are 502 country pairs in the OIC region with a RTA (Figure 6.15). On the other hand, RTA with developed countries reached 355 and with non-OIC developing countries 315. Despite the fact that the total number of RTAs among OIC member countries is higher than their RTAs with non-OIC member countries, the number of trade agreements with non-OIC countries is increasing at a much higher rate. This implies that there is a need to adapt new mechanisms to strengthen partnership among OIC countries.

A mechanism initiated by the Standing Committee for Economic and Commercial Cooperation (COMCEC) that is under way for many

Figure 6.15

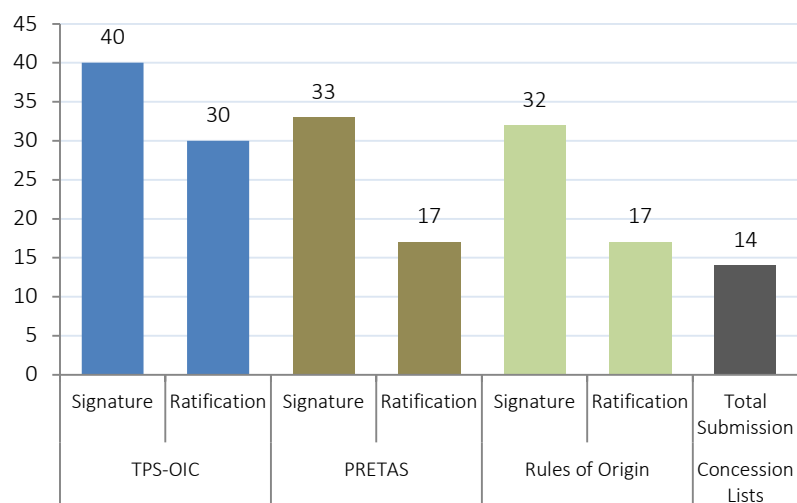
Regional Trade Agreements Signed by OIC Countries



Source: SESRIC staff calculation based on the updated dataset of De Sousa (2012).

Figure 6.16

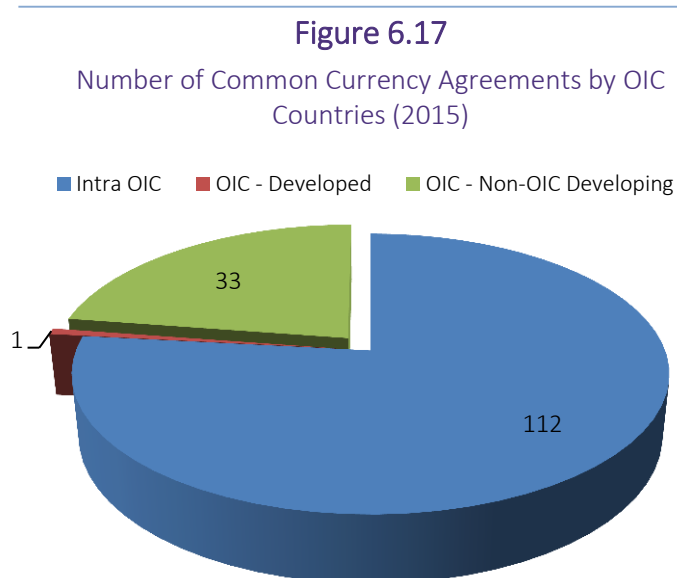
Progress in Trade Preferential System of OIC



Source: COMCEC website. Data as of May 2016.

years is the Framework Agreement on Trade Preferential System among the Member States of the OIC (TPS-OIC). The Framework Agreement sets out the general principles towards establishing a trade preferential system among the OIC countries. The Preferential Tariff Scheme for TPS-OIC (PRETAS) complements the Framework Agreement by laying out the concrete reduction rates in tariffs. Finally, the Rules of Origin will be applied for determining the origin of products eligible for preferential concessions under the Framework Agreement and PRETAS. As shown in Figure 6.16, since early 1980's only 14 member countries could fulfil all the requirement of the agreement in order for its entry into force. It reflects the difficulties in improving partnership in OIC countries in the important area of trade, which needs to be addressed in order to benefit from the great market potential of OIC.

Currency unions are an advance form of economic and monetary integration. Common currency can naturally reduce trade costs through elimination of transaction costs and exchange rate uncertainty as well as increase in price transparency. However, establishing common currency areas is a challenging task requiring a highly developed level of economic integration. While it appears to be a hard-to-achieve target for OIC countries, any progress towards this direction will definitely improve socio-economic integration among OIC countries. In fact, there are quite a number of OIC countries sharing the same currency. As depicted in Figure 6.17, there are 112 country pairs in the OIC region using the same currency in 2015. While only one OIC country uses the same currency with a developed country, there are 33 cases where an OIC country shares a currency with a non-OIC developing country.



Source: SESRIC staff calculation based on the updated dataset of De Sousa (2012).

6.2.3 Opportunities for More Trade

Export structure of OIC countries is highly concentrated on few product groups, mainly minerals and primary commodities. When the export structure is not diversified enough, it is practically difficult to find opportunities for more trade. In fact there are good opportunities for bilateral trade among OIC countries. If necessary policy measures are taken to reduce trade barriers and facilitate trade among the member countries, diverse structure of OIC economies may be driver of strong economic growth and development in the OIC region through higher economic integration.

Table 6.2 shows the top 10 export products (at 4 digit level) of OIC countries with highest values, together with their import from the world in the same products and their export to other OIC countries. Six products that are on the list are also among the top products that OIC countries import from the world. However, in some of these products, only limited shares are imported from

other OIC countries. For example, in non-crude oil although OIC countries are exporting more than they import, only 28% of the demand is met by other OIC countries. Similarly, only 1.6% of the demand in electronic components and 7.9% in cars could be satisfied by other OIC countries.

Table 6.2: Top Export Products of OIC Countries (Billion USD, 2014)

Product	Export to World		Import from World		Import from OIC		
	Value	Rank	Value	Rank	Value	Rank	Share
Crude petroleum oils	808.3	1	48.4	5	42.7	1	88.3%
Petroleum gases	211.5	2	15.9	13	11.5	4	72.3%
Petroleum oils, not crude	160.8	3	137.5	1	38.5	2	28.0%
Electronic integrated circuits and micro-assemblies	32.2	4	32.6	6	0.5	123	1.6%
Gold unwrought or in semi-manuf forms	32.2	5	49.2	4	18.6	3	37.7%
Palm oil & its fraction	29.9	6	7.7	43	7.3	6	95.8%
Electric app for line telephony, incl. curr line system	27.3	7	64.0	3	5.8	9	9.0%
Cars (incl. station wagon)	25.2	8	80.8	2	6.4	8	7.9%
Articles of jewellery & parts thereof	21.7	9	16.3	12	7.7	5	47.2%
Coal; fuels manufactured from coal	19.4	10	4.7	79	1.2	48	24.8%

Source: TradeMap, International Trade Centre.

Looking from another angle, medicaments, automatic data processing machines, wheat and parts of motor vehicles are among the major import products of OIC countries, for which there is a great demand from OIC countries (Table 6.3). Export capacity of OIC countries in medicaments and wheat is already low. If all products exported by OIC countries are shipped to other OIC countries, they could meet only 13% of total demand in medicaments and 4.5% in wheat. By respectively meeting 8.2% and 3.5% of these demands, OIC countries are doing in fact good job. In automatic data processing machines and parts of motor vehicles, OIC countries could meet the demand by 63% and 43%, but only 24% and 12% of these demands are satisfied by other OIC countries, respectively.

Table 6.3: Top Import Products of OIC Countries (Billion USD, 2014)

Product	Import from World		Export to World		Export to OIC		
	Value	Rank	Value	Rank	Value	Rank	Share
Petroleum oils, not crude	137.5	1	160.8	3	19.6	1	14.2%
Cars (incl. station wagon)	80.8	2	25.2	8	9.0	7	11.1%
Electric app for line telephony, incl. curr line system	64.0	3	27.3	7	16.3	4	25.4%
Gold unwrought or in semi-manuf forms	49.2	4	32.2	5	13.2	5	26.8%
Crude petroleum oils	48.4	5	808.3	1	17.2	2	35.5%
Electronic integrated circuits and micro-assemblies	32.6	6	32.2	4	0.4	162	1.2%
Medicament mixtures, put in dosage	26.7	7	3.5	61	2.2	21	8.2%
Automatic data processing machines; optical reader, etc.	24.8	8	15.6	12	5.9	10	23.7%
Wheat and meslin	24.4	9	1.1	199	0.9	76	3.5%
Parts & accessories of motor vehicles	23.1	10	9.9	17	2.7	17	11.8%

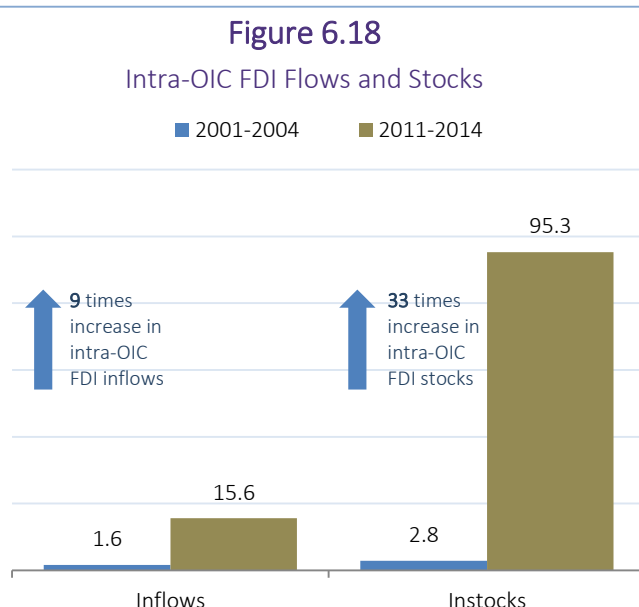
Source: TradeMap, International Trade Centre.

This preliminary assessment reveals that there are important opportunities for trade among OIC countries. Direction of trade is influenced by many factors, including costs, quality, standards and

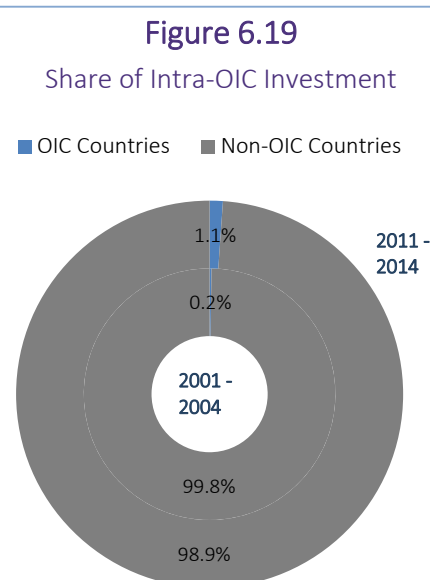
competition, but if business communities and policy makers work together in identifying the market opportunities and addressing trade barriers, it would be possible to create more opportunities for trade among OIC countries. International production and trade is increasingly organized within global value chains, where different stages of the production process are located across countries in order to benefit from skills and materials that are available at competitive prices and quality. This fragmentation of production process may also help to grow faster, import skills and technology, and boost employment.

6.3 Utilizing Market Size for More Investment Flows

Another important aspect of utilizing great market potential is increasing investment among the member countries. Higher market potential is associated with more investment inflows, because it



Source: SESRIC staff calculation based on UNCTAD statistics.



Source: SESRIC staff calculation based on UNCTAD statistics.

allows for easy access to customers and suppliers for multinational enterprises and also allows for economies of scale that reduces the production and operation costs remarkably. Higher investment flows enhance economic cooperation among the countries. Similarly, a higher volume of intra-OIC FDI inflows implies the existence of stronger economic ties among OIC countries. Figure 6.18 shows the intra-OIC inflows and stocks for the period averages of 2001-2004 and 2011-2014. Over a decade, intra-OIC investment flows have increased 9 times to reach USD 15.6 billion. The increase in investment stocks was more substantial. It surged to USD 95.3 billion from its level of USD 2.8 billion just a decade ago. This reflects an improved economic integration among OIC countries. Nonetheless, it is fair to claim that these figures are being far from their potential. As shown in Figure 6.19, share of intra-OIC investment in total world investment flows is only 1.1%, which was merely 0.2% a decade ago.

Therefore, more policy-interventions are needed to reduce intra-OIC investment barriers. These interventions should not be only limited with the free movement of capital across the borders of OIC member countries but also need to address the restrictive visa regimes applied to citizens of

OIC countries by other OIC countries since foreign investors usually look for easy labour mobility across borders. It is important for OIC countries to recognize that there is a great potential in terms of intra-OIC investment, which can boost economic growth and trigger development in OIC countries. However, existing barriers in OIC countries ahead of investors in terms of institutional quality, visa regimes, restrictions on profit and capital transfers etc., limits the level of economic cooperation among OIC member countries.

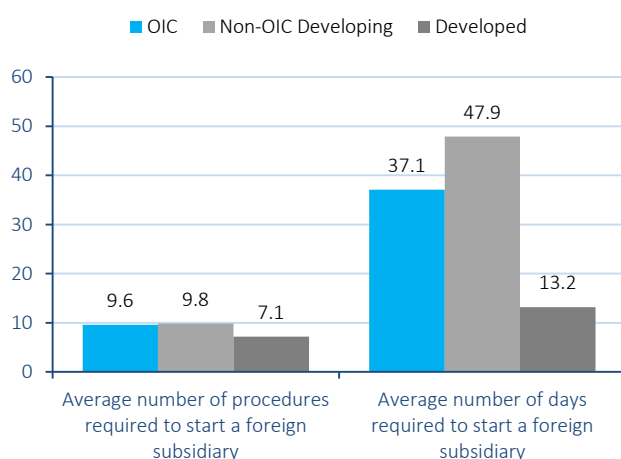
6.3.1 Overcoming Barriers to Investment

Firms consider a wide range of factors before making investment in foreign countries, including the market size, factor endowments, transport costs, institutional and regulatory barriers, financial market development, economic diversification, governance, infrastructure quality and macroeconomic stability. Every country and region faces different challenges and obstacles in attracting foreign investment. OECD (2004) reviews private sector investment in MENA region and identifies four significant barriers to private investment in the region: (1) lack of ownership diversity, (2) insufficient diversification of the economy, (3) inadequate transparency and regulation, and (4) underdeveloped capital markets. While some countries prohibit foreign companies from holding bank accounts in foreign currencies, some other lack clear, transparent laws and regulations allowing for efficient commercial transactions.

Since it is difficult to assess the barriers to investment at individual country level, a broad assessment will be made based on regulation and infrastructure indicators. A more detailed discussion on how to attract FDI can be found in the 2015 edition of the OIC Economic Outlook. The first indicator that we investigate is starting a foreign subsidiary in a host country. Average number of procedures required to start a foreign subsidiary in OIC countries is 9.6, which is higher than the average of developed countries (7.1), but slightly lower than the average of non-OIC developing countries (9.8). In terms of average number of days required to start a foreign subsidiary, OIC countries (37.1) perform much better than non-OIC developing countries (47.9), but well behind the average of developed countries (13.2). Overall, it appears that OIC countries are performing better in facilitating the entry of foreign enterprises through a subsidiary compared to

Figure 6.20

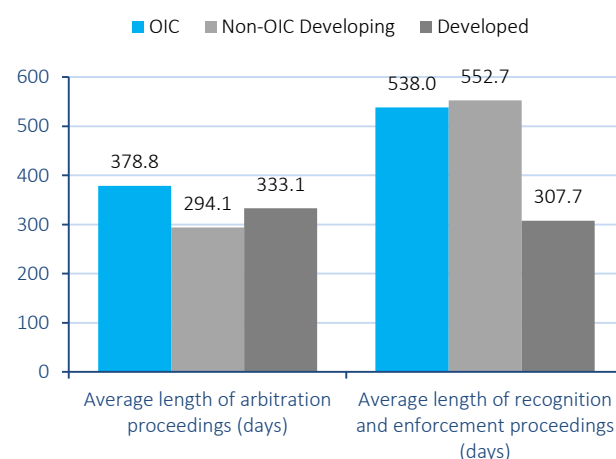
Starting a Foreign Subsidiary



Source: SESRIC staff calculation based on World Bank Investing Across Borders database.

Figure 6.21

Arbitration and Enforcement Proceedings

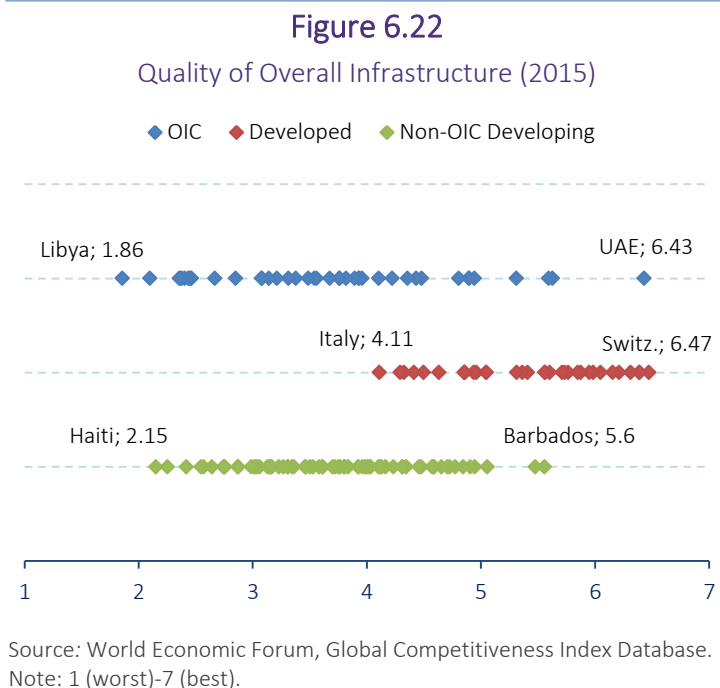


Source: SESRIC staff calculation based on World Bank Investing Across Borders database.

non-OIC developing countries, but they need improvements in terms of the number of procedures and days required to start a foreign subsidiary.

When it comes to resolving commercial disputes, all countries allow the use of arbitration. However, various barriers still impede foreign companies' ability and interest to use arbitration in many countries. A country's legal regime should provide investors sufficient security to make them feel comfortable in operating and expanding their businesses. As shown in Figure 6.21, average length of arbitration proceedings is highest in OIC countries with 379 days compared to non-OIC developing (294 days) and developed countries (333 days). Average length of recognition and enforcement proceedings in OIC countries (538 days) is also well above the average of developed countries (308 days), but slightly lower than the average of non-OIC developing countries (553 days). With the heightening regional and global risks, OIC countries should act to create effective, predictable and transparent conditions for attracting more investment.

A foreign investor tends to invest in a country where the quality of infrastructure is reliable and allows the foreign investor to run the business without any interruption during its operations. For instance, a flawed electricity infrastructure or a rail network system with unpredictable delays and extra costs in a host country affect the decision of a foreign investor negatively. Figure 6.22 compares the overall quality of infrastructure in different country groups. While few OIC countries are even performing better than some developed countries in terms of offering a quality infrastructure for investors, many others appear to have only moderate or poor quality of infrastructure.



6.3.2 Increasing Partnerships

Countries enter into investment agreements to facilitate investment between the countries. International investment agreements are typically divided into two types: (1) bilateral investment treaties (BIT) and (2) treaties with investment provisions. A BIT is an agreement to promote and protect investments made by investors from other country, including fair and equitable treatment, protection from expropriation and access to neutral dispute settlement. It eliminates or minimizes market access barriers and ensures greater protection for foreign investors. It is an essential tool for facilitating investment across borders. The great majority of international investment treaties are BITs.

OIC countries have been quite active in entering into BIT with other countries. They have been party to 1,606 agreements since 1970. However, only 370 of which were signed with another OIC

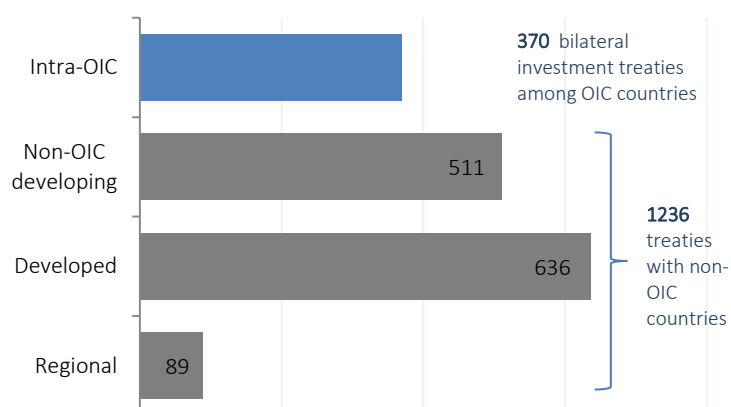
member country (Figure 6.23). Most of the treaties were signed with developed countries (636), followed by non-OIC developing countries (511). In 89 cases, OIC countries were part of a regional agreement.

Figure 6.24 shows the trend in bilateral investment treaties among the OIC member countries. While the annual number of BITs has been persistently below 3 until 1992, it remained constantly above 10 during the period between 1994 and 2004 and reached its peak level of 42 in 2001. Since then, the number of BITs has been falling and only one BIT is recorded by UNCTAD among OIC countries.

Figure 6.25 shows the number of BITs that are signed and ratified over the last four decades. In total, only 187 of the whole 370 BITs have been entered into force. Again, most of the BITs that entered into force have been recorded during the last two decades. Apparently, there is a need to revitalize the partnership among the OIC member countries to promote bilateral investment.

At individual country level, Turkey (51) signed the highest number of investment treaties with other OIC member countries since 1970 (Figure 6.26). It was followed by Egypt (44), Morocco (38), Iran (28), Malaysia (28) and Tunisia (28). 30 OIC member countries have signed more than 10 BITs with

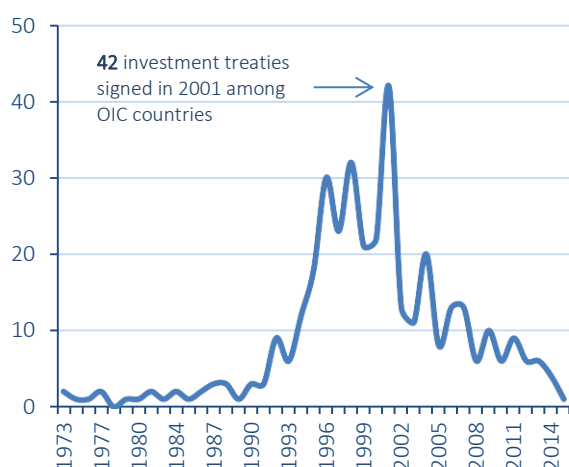
Figure 6.23
Investment Treaties since 1970



Source: SESRIC staff calculation based on UNCTAD International Investment Agreements Navigator.

Figure 6.24

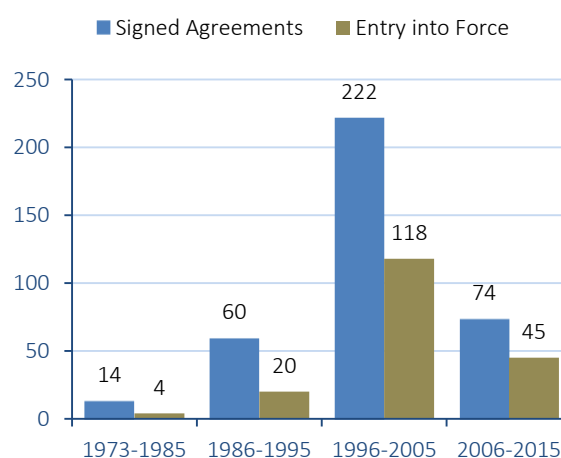
Investment Treaties among OIC Countries



Source: SESRIC staff calculation based on UNCTAD International Investment Agreements Navigator.

Figure 6.25

Investment Treaties among OIC Countries



Source: SESRIC staff calculation based on UNCTAD International Investment Agreements Navigator.

another member country.¹⁴

It is clear that there is a need to increase partnership among the OIC member countries to promote investment within the OIC region with a view to utilizing its great market potential.

Investment treaties are one way of increasing partnership, but countries should

strive for developing an environment conducive for foreign investment. Some of the elements have been discussed earlier in this section and in the previous edition of the Economic Outlook. International literature also provides ample guidance on how to attract international investment. Investment promotion agencies are doing great job in promoting investment in their countries, but an OIC Forum of Investment Promotion Agencies could do even greater job in enhancing intra-OIC investment and trade if such a mechanism is established. Moreover, new modalities and approaches can be adopted for increasing intra-OIC investment through, inter alia, developing joint investment projects at the OIC regional and sub-regional levels and harmonizing investment codes and other legislations between OIC member countries.

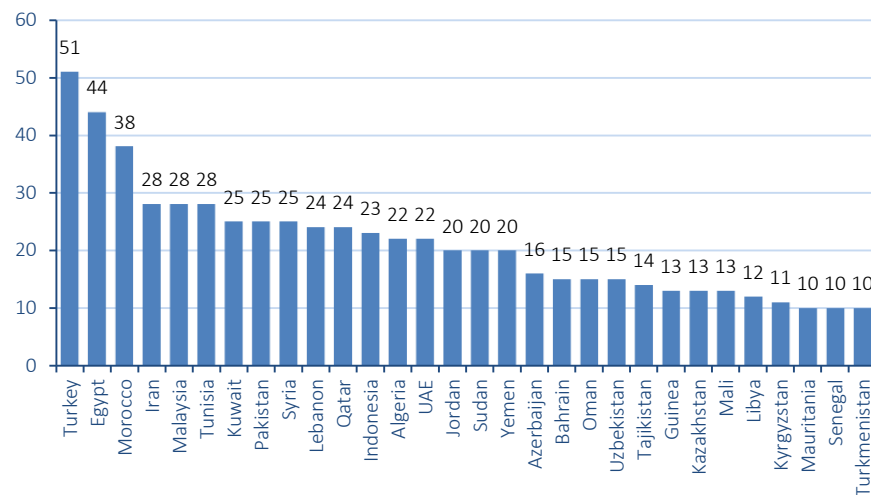
6.3.3 Opportunities for More Investment

Great market potential offers plenty of opportunities for investment. Several countries are undertaking serious economic transformation and diversification programmes with a view to improving their resilience to shocks, enhancing their competitiveness and sustaining long-term growth. Particularly, diversification process from traditional sectors to new productive and competitive sectors provides enormous opportunities for investors. In energy sector, for example, a lot of countries are investing in renewable energy to reduce their reliance on fossil energy sources. Many other countries are developing strategies for improving their transport, tourism and communication infrastructure.

Recent achievements of Turkey are noteworthy. Turkey is effectively using the potential of private sector in realizing large scale infrastructure investments. It enjoyed an exceptional year in 2015, with financial closings on seven projects totalling US\$44.7 billion, or 40% of global investment. Turkey is also investing a lot for transformation in health, education and energy sectors. Turkey's public-private-partnership (PPP) model healthcare projects, dubbed the "city hospitals," are to receive significant amounts of investment in the coming years. Many multilateral development

Figure 6.26

Top Countries in Bilateral Investment Treaties among OIC Countries



Source: UNCTAD International Investment Agreements Navigator.

¹⁴ It should be noted that some countries have signed more than one treaty with each other. So it does not mean that Turkey, for example, signed treaties with 51 OIC countries, but signed 51 agreements with other OIC member countries.

banks, including the Islamic Development Bank (IDB) and European Bank for Reconstruction and Development (EBRD) are co-financing the development of high-tech hospitals in Turkey. Such projects provide new opportunities for investment among OIC countries.

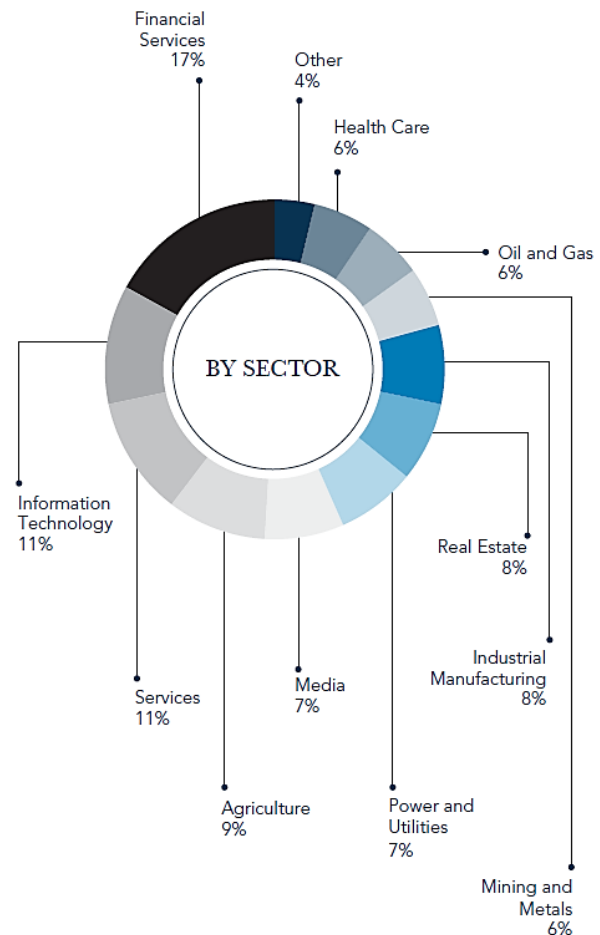
Similarly, Saudi Arabia's National Transformation Plan, named as "Saudi Vision 2030," outlines the key elements to shift the kingdom's economy away from its dependence on oil and sets its determination to become a global investment powerhouse. Such kind of transformation plans offer opportunities for bilateral investment among OIC countries.

It is difficult to identify investment opportunities across the OIC region in this report, but GIIG (2015) attempts to present some insights. The GIIG report makes use of a sector-based investment strategy to provide best opportunities for investment in a region that is economically and geographically dispersed. It prioritize 10 sectors, namely energy, food & agriculture, electronics, travel & transportation, metals, chemical, plastics/rubber, textiles, infrastructure & construction, and health products & services to present the unique investment opportunities. According to the report, with low oil prices, downstream sectors and renewable energy are key growing areas with many governments having aggressive plans to incorporate renewable energy as part of their domestic consumption mix. In

travel and transportation, it is noted that OIC travel destinations, including Dubai (UAE), Turkey, Indonesia and Malaysia, are some of the fastest growing travel markets in the world with enormous opportunities. Similar opportunities are presented in other sectors. Figure 6.27 shows the distribution of investment opportunities across sectors in OIC countries, as estimated by GIIG. Opportunities appear to exist in all sectors in the OIC region.

Figure 6.27

Investment Opportunities in OIC Countries



Source: GIIG (2015).

SECTION 7



Policy Options for Transforming the Potentials into Impact

Economic development trajectory of OIC countries has been highly rippled in shape, while the resulting development landscape of OIC countries is multiplex. In general, OIC member countries could not sustain long-term growth as developed countries did over the last century. Despite comprising few high income countries, there is no OIC member country that is classified today as a developed country by international agencies. High income OIC countries, mainly the Gulf countries, achieved their status mainly by benefiting large scale windfall gains from natural resources, not from increased productivity and competitiveness. On the other hand, some member countries with rich natural resources remained poor and experienced further political instabilities and economic deprivation due to lack of quality institutions that can equitably manage and distribute the gains for the benefit of their people.

There are few emerging economies that achieved relatively stronger economic performance, such as Turkey, Malaysia and Indonesia, but growth performance of these countries has been occasionally interrupted due to diverse structural problems. In a large number of OIC member countries where structural problems are more widespread and deep-rooted, people remained persistently poor and lacked access to even basic services. All these factors contributed to the different standards of living that are observed today across the OIC region, which is in any case below the levels attained by developed economies.

The fact that economic performances of OIC member countries have been relatively weaker than the western countries due to diverse reasons does not imply that OIC countries do not have enough capacity and resources to perform better. It is just a matter of identifying the productive resources and potentials and then developing correct mechanisms and instruments to effectively

utilize them in welfare improving economic activities. Each and every country has different resources and potentials to catalyse for their economic development programs. This report followed a broader approach and tried to identify the most common potentials of OIC countries that can be utilized for better economic performance.

In this context, the report focused on three major factors that can potentially contribute to achieving better economic performance and living standards. These were dynamic population structure, rich energy resources and great market potential. In all these areas, the report provided some preliminary assessment on the significance of these resources and potential contributions that they can make to socio-economic development in OIC countries. It was also noted that reckless consideration of these resources and potentials may equally deteriorate already existing level of development, transforming the potentials into threat rather than strength. Based on these and other assessments made in previous sections, several policy recommendations come forth.

Unleashing Productive Capacity of Youth

Most of the OIC countries have a young and dynamic demographic structure. Labour is traditionally one of the critical components of economic growth. In today's world, labour force is an asset but it becomes valuable for production process only if it is endowed with technical knowledge and capabilities to undertake complex tasks. Therefore, having bulk of youth population is not an advantage *per se*. If appropriate policies are not taken to build human capital in OIC countries, having one third of all young people by 2050 will only attract multinational enterprises to OIC region that wants to utilize cheap unskilled labour force. If OIC economies with large youth population do not become enough sophisticated to create employment opportunities for those who invest in their skills and capabilities, these people will simply seek opportunities in developed countries where they are desperately needed due to rapidly declining and aging population in these countries. This trend will only contribute to the widening of the welfare gap between south and north, where south becomes simply the factory and north becomes the knowledge and technology centre of the world.

In fact, the policy proposal for unleashing productive capacity of youth is very straightforward: provide quality education and create appropriate employment opportunities for income generation. The impact of human capital becomes strong when enough attention is paid to education quality instead of mere school attainment. Cognitive skills of young people will facilitate the economic development if they are utilized in productive production processes of goods and services. This will also improve their individual earnings and overall welfare distribution.

Investment in education does not require everyone to graduate from a university. It requires education policies that provide the right skills to right people based on national development strategies and labour market assessment. Designing an education system with a focus on quality is typically tough, because it is generally easier to plan how to expand access than to improve quality. Providing more funds to schools does not necessarily result in a better quality education. Experiences of advanced countries can be duly considered while preparing a strategy for education system.

Given the low participation to education and low quality of training in low-income countries, the priority should be clearly given to improving accessibility, relevance, quality and completion of education and training programmes in order to provide the right mix of skills and competencies to

the labour force. If education system is not able to raise the cognitive abilities of the population, countries may face even higher economic and social costs to reduce the gap between the needs and supply of relevant skills. It should also be noted that skills by themselves do not automatically lead to more and better jobs. Skills policies must be part of a broad set of policies that are conducive to high rates of growth and investment.

When it comes to realizing the best returns on investment in skills, it is important to have mechanisms to assess the available skills in the population, determine the skills required in the labour market and match those skills effectively with jobs that lead to higher productivity and better lives. In order to ensure that firms make the best use of the skills available, it is important to put in place framework policies that help to create better skilled jobs in the formal sector. Failure to do that will contribute to increasing the likelihood of brain drain and social unrest.

Managing skills development over the development trajectory can be a challenge. As countries adopt new technologies and diversify into new sectors, workers and managers must be well prepared to tackle new production and management practices in order to sustain growth in the economy and job market. If not properly coordinated, investment made in skills development can only increase the number of skilled workforce, without affecting the number or quality of jobs. Therefore, coordination and dialogue among the key stakeholders including public authorities and education and training institutions is critical in managing skills development process of youth. It is also important to note that training by itself does not create jobs, nor does it necessarily raise productivity in the informal economy. In order to achieve these objectives, economic and labour market environment should support the development and use of skills and the formalization of informal activities (ILO, 2008).

On the other hand, in cases where education and training systems do not provide young people with the basic skills needed to escape poverty and unemployment, even when they continue to receive formal education, non-formal education programmes could be a remedy. Provided often through youth and community based organizations, such programmes can fill the gap by providing learning and skills development opportunities, especially for disadvantaged and marginalized groups. By complementing the formal education, such facilities can improve opportunities for youth to meet the challenging demands of work and life. In this respect, activities of civil society organization should be supported in filling the gaps in skills development of young people. Moreover, skills that are obtained informally should be recognized with an effective skills recognition system in order to facilitate employment in the formal sector.

Technical and vocational training programmes are also critical in equipping young people with the skills required for decent employment. Without having the desired level of skills and qualifications, it will be difficult for young people to find a job, to keep the job and to promote in the job. Such programmes will improve problem solving capabilities and adaptability to changing environments as well as their awareness on new technologies and entrepreneurial activities. By supporting life-long learning, such programmes will enhance the employability of young people by enabling them to seize immediate employment opportunities and to adjust new career opportunities.

An important element in promoting youth employment and job creation is the entrepreneurship. It is important to invest in developing entrepreneurship skills and nurture the entrepreneurship spirit among youth. In this context, diverse services can be offered to youth by providing information,

advice, coaching and mentoring, developing infrastructure for entrepreneurship and providing financial support. Young people face major challenges in their efforts to create their own job. One of the major constraints on entrepreneurship in OIC countries are the issues of finance and the lack of financial inclusion. Many of youth who venture to become entrepreneurs have to rely on their own savings or borrow from family. The ones who do not have saving or family members who can provide them with initial capital are practically blocked from entrepreneurship.

For encouraging entrepreneurship, the best place to start off is schools. Students need to be introduced to business concepts and to the idea that starting up a business later in life is a viable and attractive option. In many middle income OIC countries with high education attainment levels there is pressure on youth from their parents to choose what they perceive as a safe and stable job in the public sector as a first choice and in the private sector as a second choice. In these countries public opinion about entrepreneurship needs to be modified, and this can be achieved by promotional campaigns around inspirational success stories of youth who have chosen the entrepreneurship route. Furthermore, it has been shown that using popular TV series to influence people attitudes has been successful, thus popular TV series can be used to positively influence people perceptions about entrepreneurship. Finally, many young people who decide to venture to become entrepreneurs lack the market and technical skill to do so and in this regard, incubators can provide an effective solution.

In addition to skills development and promoting entrepreneurship, a further dimension of unleashing youth potential was improving social mobility in OIC countries. In this perspective, in order to improve social mobility in OIC countries, a comprehensive approach should be developed that encompasses the critical stages of individual development from early childhood care to schooling and from higher education to transition to work and progress in the labour market. This requires attention and action from all relevant stakeholders. OIC Governments should ensure equal access to opportunities, civil society organizations should support disadvantaged people to succeed, education institutions should consider the diverse background of students in their efforts to get good quality education and labour market players should be flexible in giving a second chance to those who fail to adapt to working environment.

When increased educational achievement does not translate to corresponding economic outcomes, new generation will be bound by an environment determined by the parental background. It should not be a surprise for youth to show their dissatisfaction in one way or another when well-educated youth do not experience a considerable change in their social status despite their huge investment in education.

Stimulating the Growth and Diversification with Rich Energy Resources

OIC countries are rich in terms of natural resources. Several OIC countries have comparative advantage in variety of natural resources. Some of them are rich in terms of fossil fuels where others have a great potential for renewable resources from wind to solar.

In particular, fossil fuels first can be used domestically to meet domestic energy demand. Second, exports of fossil fuels enable fossil fuels producer countries to gain and accumulate foreign currency that may be used to finance national investment projects. Third, unconsumed income gained from fossil fuels may be saved in reserve accounts of national central banks that strengthen national capacity to cope with economic shocks. Finally, with appropriate policies, countries can

invest into future generations and better use extra income through establishing sovereign wealth funds. In this respect, 16 OIC countries have already built up sovereign wealth funds thanks to income generated by fossils trade. These sovereign wealth funds may help to secure the wealth level of future generations in OIC countries (Table 7.1). Moreover, OIC countries can utilize some portion of these wealth funds to transform their economies and energy sectors with a view to reduce the share of fossil fuels in energy production and diversify nationwide economic activities.

Table 7.1: Sovereign Wealth Funds in OIC Countries with Origin of Oil and Gas			
Country	Funds	Assets (Billion USD)	Origin
United Arab Emirates	Abu Dhabi Investment Authority	792	Oil
	Abu Dhabi Investment Council	110	Oil
	International Petroleum Investment Company	66.3	Oil
	Mubadala Development Company	66.3	Oil
	Emirates Investment Authority	15	Oil
	RAK Investment Authority	1.2	Oil
	Total	1,050.80	
Saudi Arabia	SAMA Foreign Holdings	598.4	Oil
	Public Investment Fund	160	Oil
	Total	758.4	
Kuwait	Kuwait Investment Authority	592	Oil
Qatar	Qatar Investment Authority	256	Oil and gas
Kazakhstan	Kazakhstan National Fund	77	Oil
	National Investment Corporation	2	Oil
	Total	79	
Libya	Libya Investment Authority	66	Oil
Iran	National Development Fund of Iran	62	Oil and gas
Algeria	Revenue Regulation Fund	50	Oil
Brunei	Brunei Investment Agency	40	Oil
Azerbaijan	State Oil Fund	37.3	Oil
Oman	State General Reserve Fund	34	Oil and gas
	Oman Investment Fund	6	Oil
	Total	40	
Iraq	Development Fund for Iraq	0.9	Oil
Nigeria	Nigerian Sovereign Investment Authority	1.4	Oil
Gabon	Gabon Sovereign Wealth Fund	0.4	Oil
Mauritania	National Fund for Hydrocarbon Reserves	0.3	Oil and gas
Turkmenistan	Turkmenistan Stabilization Fund	n/a	Oil and gas
GRAND TOTAL		3,034.5	

Source: Sovereign Wealth Fund Institute (SWFI), June 2016.

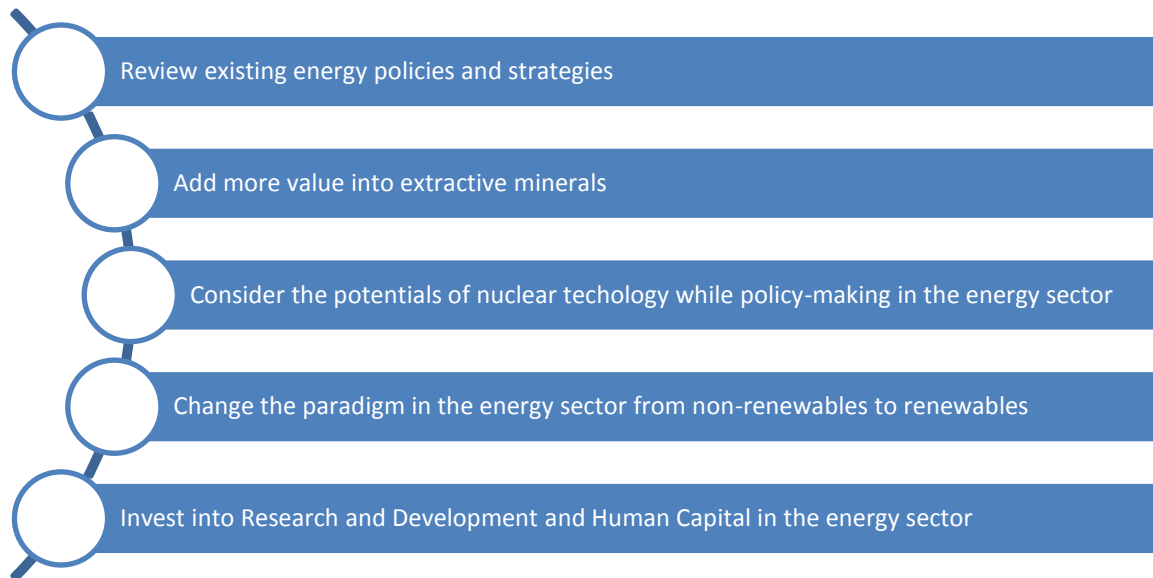
Despite having these potential positive effects on development, having rich fossil fuels may associate with several risks. First, foreign currency earned through exports of fossil fuels may appreciate the nominal value of national currencies, if not managed properly. A strong national currency may hamper competitiveness of national products in international markets (i.e. Dutch Disease). Having rich fossil fuels may discourage economic diversification that other economic sectors may stay underdeveloped. Rich fossil fuels may also trigger national consumption of fossil fuels in all sectors that usually associate with poor land, air and water quality due to environmental impacts. Natural resource wealth may turn out to be a 'curse' rather than a 'blessing', if not managed properly. To this end, reserves of rich fossil fuels in OIC countries may constitute a comparative advantage and foster development provided that these rich natural resources are wisely managed with appropriate and visionary national policies and strategies.

Rich natural resources in OIC countries are also not restricted with fossil minerals. OIC countries have a high potential in different types of renewable energy resources. A quick look to OIC countries in the world map can easily indicate that majority of OIC countries are positioned in a rich zone with direct solar light exposure both in terms of duration and density. On the other hand, OIC countries are also endowed with very long coastal areas that imply a high potential for wind and wave power to generate electricity. In summary, if OIC countries can activate the potential of renewable energy, it may be helpful for addressing several problems such as improving energy security, diversifying energy sources, mitigating environmental effects, scaling up access to electricity, and achieving energy efficiency.

In the light of above, OIC countries need to review their existing national energy policies and strategies with a view to improve their overall energy security, diversify energy sources and align them with the Sustainable Development Goals (SDGs) as well with the OIC Ten-Year Programme of Action (2016-2025). During this review process, OIC countries also need to focus on policies to increase the added value of extractive minerals rather than just investing into scaling up of existing production capacities. It is also highly critical for OIC countries to revisit the importance of nuclear technology where developed countries, on average, meet more than 19% of their total electricity production from nuclear power stations.

For diversification of energy sources and activating the full potential of renewable energy sources, OIC countries are in need of a paradigm shift from 'development' to 'sustainable development'. In fact, many developed countries already made this shift and set concrete targets to gradually reduce the share of energy production from fossil fuels and to enhance the energy production from renewables. Several developing countries are also on the way of changing their energy production mix with a more emphasis on renewables. For instance, China accounted much of the surge by developing economies over recent years, by increasing investments into renewables up from just US\$ 3 billion in 2004 to US\$ 83.3 billion in 2014 (BNEF, 2015).

The McKinsey Global Institute has estimated that rates of environmental degradation are unsustainable for the long-term functioning of the global economy (MGI, 2011). Existing and future investment, therefore, must be 'greened' to avoid risky levels of climate change and adverse environmental impacts. Special attention should be paid to fostering investment in renewable energy generation, energy efficiency, sustainable transport, agriculture, forestry and land-use, waste and waste water. Increasing investment in clean energy infrastructure facilitates cost-effective access to energy, reduces pollution and associated health costs, reduces reliance on



fossil-fuels, fosters innovation and creates new jobs. Moreover, the International Energy Agency estimates that every additional dollar invested today in clean energy can generate three dollars in future fuel savings by 2050 (OECD, 2015a).

A key challenge for governments in channeling investment to renewable energy projects is the lack of designing and implementing clear and predictable domestic policy frameworks (OECD, 2015b). It is therefore highly critical for OIC countries to develop domestic policy frameworks that may attract foreign and domestic investors into the renewable energy sector.

Inclusiveness in policy-making in the energy sector is important for the success of policies and transformation. Therefore all stakeholders including governments, investors, and international organizations must cooperate in identifying the challenges and promoting green investment. Academia and civil society organisations played a key role in developed countries and increasing numbers of developing countries to convince policy-makers on the importance of such a paradigm shift. To this end, more research is needed to be carried out in OIC countries to reveal the real potentials of renewable energy, and to measure environmental footprint and economic costs of increased use of fossil fuels. No doubt, civil society organisations would play a constructive role and be a mediator between the local community and public officials for the success of new energy policies.

OIC countries not only are in need of paradigm shift and physical investments to achieve sustainable development but also require boosting soft investments in the form of R&D expenditures and human capital development. In this respect, OIC countries need to invest more into R&D sector with a more emphasis on new technologies in the energy sector, allocate more sources to develop necessary technical and research personnel who can work in the energy sector from nuclear power plants to wind farms. Without such investments into human capital, energy policies and strategies are likely to fail even if they are very well-articulated by policy-makers with good intentions.

A High-Level Energy Council at the OIC level may be established with a view to serve as a platform for OIC countries to exchange their views and ideas about developments in national, regional and

international energy policy-making. Moreover such a platform may be used to explore the potential cooperation areas among OIC countries in the energy sector. There are some good examples of intra-OIC energy cooperation especially at the OIC sub-regional level. Among others, the GCC grid interconnection project is one the most important energy projects that interconnects OIC countries in the GCC region namely Kuwait, Saudi Arabia, Bahrain, Qatar, Oman and United Arab Emirates since 2011. In May 2016, Jordan also signed a MoU to join the Gulf countries' power grid through Saudi Arabia. As in the case of the GCC grid interconnection project, OIC countries should generate more concrete cooperation projects in the domain of energy to facilitate 'green' energy transformation, diversify energy sources and improve energy security.

Utilizing Great Market Potential for More Trade and Investment

The ability to access large markets is one of the most critical factors in shaping trade and investment decisions of private sector. Almost all OIC member countries have land or sea connection with another OIC member country. If artificial barriers that reduce the connectivity among the member countries are eliminated or significantly reduced, OIC region would provide an important opportunity for investors and traders. Market potential of OIC countries is rapidly increasing due to growth in economic activities as well as continuously increasing share of OIC countries in world total population. Supported with other policy reforms, 57 member countries, with an economically dynamic young population and high demand for almost everything from infrastructure development to consumer goods, will definitely attract more investors and increase their share in world trade.

Today, world trade takes place increasingly in parts and components, with each country specializing in particular stages of a good's production sequence. A key feature of this vertical specialization is that imported inputs are used to produce a country's export goods, which also reflects an international division of labour. An important driving force for growing vertical specialization has been trade barrier reduction. Despite several re-export and border crossings, reductions in trade barriers yield a multiplied reduction in the cost of producing a good sequentially in several countries. In order to be able to take larger share in this form of production and trade, it is required to have efficient and fast transport and trade mechanisms in place in addition to appropriate factors of production.

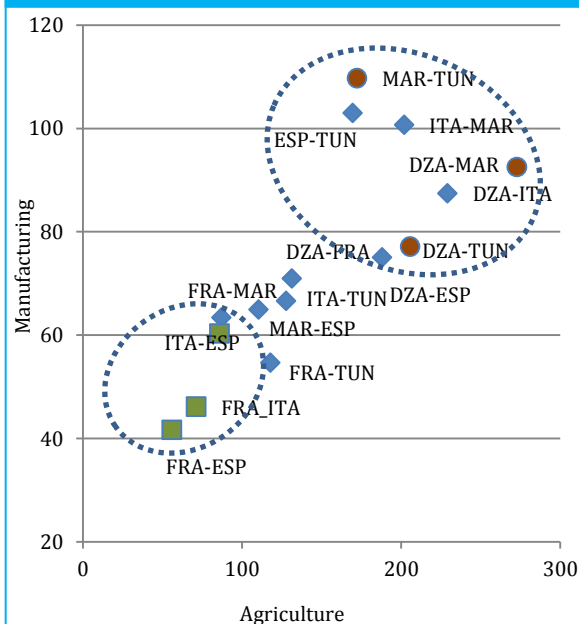
Assuming the process of vertical specialization will continue, understanding the source and nature of trade costs remain crucial. However, the analysis and policy implications for trade costs are more complex than for traditional trade barriers such as tariffs or quotas. Moreover, some behind-the-border trade costs may involve intangible factors such as concerns about security or they may be constant instruments of national political debates. Such concerns and debates should be underpinned with firm understanding of the nature and consequences of trade costs. Various measures of trade facilitation can naturally be recommended, such as simple rules and procedures, operational flexibility, fair and consistent contract enforcement, standardisation of documents and electronic data requirements, and Single Window System. This requires strong political willingness and commitment, with participation of private sector as well.

Trade costs can be reduced unilaterally, regionally or multilaterally, either by further reducing traditional trade barriers or by taking effective trade facilitation measures. Achieving global agreement has been difficult, despite the inclusion of trade facilitation in multilateral trade

negotiations. However, much progress has been achieved by national measures. On the other hand, there has been substantial progress in regional agreements, most obviously in Europe. By introducing Trade Preferential System (TPS-OIC) OIC countries are also targeting to reduce trade barriers among the OIC countries. However, they require stronger commitment and willingness to promote trade among them.

While trade policy measures are important elements of industrial policies in promoting the competitiveness of domestic industries, careful analyses should be made to measure the effectiveness of such restrictive policies for the welfare of the country in the long-term. If not properly regulated, such measures may harm the majority of the people, without significantly contributing to the overall well-being of the country.

Figure 7.1: Comparison of Bilateral Trade Costs for Maghreb Countries (2009)



Source: WB-UNESCAP Trade Costs Database

Legal and regulatory costs and local distribution costs are other components of total trade costs. Therefore, in contrary to common perception on the relevance of tariffs for trade costs, special efforts should be made to facilitate trade through reducing various barriers to trade that limit the flow of goods across borders. For example, as shown in Figure 7.1, three OIC countries in North Africa have significantly higher costs among themselves compared to the countries at the European side of the Mediterranean. Despite geographical proximity, common language, cultural similarities and other favorable factors, bilateral trade costs for Maghreb countries tend to be higher than the bilateral trade costs for EU countries as well as the bilateral trade costs between Maghreb and EU countries. Here comes the importance of trade facilitation. If policies are not designed in a way to facilitate trade between countries,

despite other supportive conditions, bilateral trade will not increase due to relatively high trade costs. This is clearly proven at the European side of the Mediterranean.

In terms of utilizing the great market potential for more investment, member countries need to be proactive about improving their attractiveness to FDI. Many drivers of foreign investment—such as a country's location, market size, and availability of natural resources—cannot be influenced by decisions and actions of policymakers, but OIC countries have already strong potential in terms of size, location and natural resource endowments. In order to activate these potentials, focus should be on policy-related drivers of FDI—such as macroeconomic performance, infrastructure quality, rule of law, good governance and human capital. Member countries should ensure a clear national commitment for creating the necessary enabling investment environment that would promote and encourage investment both national and foreign. This should be supported by appropriate national legislations, strategies and institutional mechanisms.

Increased investment provides important benefits for the economies. It provides access to new sources of capital and new markets, generates jobs, allows for the transfer of technology and for associated diversification of economic activities. It also provides access to competitively priced goods and services. Investment creates also opportunities for companies in accessing resources, expanding markets, enhancing strategies and increasing efficiency. Therefore, developing and improving appropriate investment framework and enhancing the business environment is essential.

Member countries should ensure a clear national commitment for creating export and investment promotion strategies, adequate linkage between production and export policies and the capabilities to deal with new global trade and investment rules. This necessitates the development of adequate institutional bases such as specialised export and investment promotion institutions.

Creating efficient legal and institutional investment frameworks and developing reliable infrastructures and financial systems in starting new businesses, registering properties, dealing with licenses, enforcing contracts and protecting investors is also fundamental in creating an enabling environment. The legal and institutional framework should pay particular attention to transparency, recognition of private property, securing industrial and intellectual property rights, freedom of contract and corporate control and liability, curbing private and public monopolies, tax reform and long-term environmental policies.

In addition to these factors of a well-functioning market economy, member countries should build and improve adequate key infrastructures, particularly transport and information and communication technologies (ICTs) in order to offer safe and profitable investment opportunities. Integrated infrastructure facilities conducive to industrial development should be established and investment on human capital should be made to enhance the skill levels of labour force for them to apply advanced technologies. Developing the adequate infrastructure facilities, particularly in transportation and telecommunication, human resources and well-developed institutional capacities are essential to create a proper enabling investment environment in and among the OIC countries.

International investment treaties are commonly signed to address such concerns. Such agreements typically include (i) not to discriminate against each other's investors on the grounds of nationality, (ii) not to take control of their assets, such as through nationalisation without paying them compensation, (iii) to allowing foreign investors to eventually transfer funds related to their investments to and from their home country – for example, by repatriating profits or using them to add to their capital base, and (iv) to protecting foreign investors against being unfairly treated in certain other ways, such as through denial of justice or targeted discrimination.

In order to facilitate capital flows and foreign investment and to prevent the negative impact of often-conflicting national investment policies, it is also crucial to conclude bilateral, multilateral and regional investment agreements of a mutually beneficial nature among the OIC member countries. New modalities and approaches can be adopted for increasing intra-OIC investment through, inter alia, developing joint investment projects at the OIC regional and sub-regional levels and harmonizing investment codes and other legislations between OIC member countries.

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