

FINANCING FOR DEVELOPMENT

Alternative Perspectives on
Challenges and Opportunities of
Financing Development



ORGANISATION OF ISLAMIC COOPERATION
STATISTICAL, ECONOMIC AND SOCIAL RESEARCH
AND TRAINING CENTRE FOR ISLAMIC COUNTRIES



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of Financing Development

Editors:

Kenan Baęcı and Erhan Türbedar



ORGANIZATION OF ISLAMIC COOPERATION
THE STATISTICAL, ECONOMIC AND SOCIAL RESEARCH AND
TRAINING CENTRE FOR ISLAMIC COUNTRIES (SESRIC)



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Please cite the work as follows: SESRIC (2019). *Financing for Development: Alternative Perspectives on Challenges and Opportunities of Financing Development*. Editors: Kenan Bağcı & Erhan Türbedar. Economic Development Studies. The Statistical, Economic and Social Research and Training Centre for Islamic Countries. Ankara.

ISBN: 978-975-6427-83-5

Cover design by Savas Pehlivan, Publication Department, SESRIC.

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Foreword

The Member States of Organization of Islamic Cooperation (OIC) are highly diversified in terms of their level of economic development and their ability to finance public investment needs. Many OIC member countries, like low and lower middle income countries elsewhere, require additional resources and support to finance their development agendas effectively. The longstanding challenges of inadequacy of domestic resources, high incidence of tax evasion and ineffective use of existing resources remained at the heart of this matter. On the other hand, a growing number of OIC member countries are active in supporting and financing development in other economies, but their role in development assistance is not properly recognized and recorded at the global level.

In order to address the development finance challenges, alternative mechanisms are being voiced across the globe. A particularly strong mechanism that became increasingly popular is the Islamic finance instruments in financing for development, which can be crucial for OIC countries in fostering development when effectively utilized.

In this regard, the Statistical, Economic, Social Research and Training Centre for Islamic Countries (SESRIC) and Islamic Development Bank (IDB) organised the International Symposium on Financing for Development, under the theme "Thinking Innovative Solutions to Persistent Development Challenges" on 22-23 November 2018, in Istanbul – Turkey to provide a platform for dialogue and discussions among policymakers, policy-advisors, practitioners and academicians to address the problems related to financing for development.

The Symposium aimed to identify the opportunities for innovative financing mechanisms, including Islamic finance instruments, as well as effective utilization modalities of existing resources for financing development in developing countries, with a particular focus on the OIC Member States. It also highlighted and discussed the growing role of some OIC member countries as development financiers and emerging donors in achieving global development goals.

As an outcome of the Symposium, the SESRIC prepared this edited book with short essays provided by the speakers of the symposium. It presents alternative perspectives on challenges and opportunities of financing development in OIC Member States.

I hope that you will enjoy reading the book.

Nebil Dabur
Director General
SESRIC

From the Editors

Financing for development is an integral part of the 2030 Agenda for Sustainable Development. The Addis Ababa Action Agenda outlines a comprehensive framework to secure necessary financial means to implement Sustainable Development Goals (SDGs) while exploiting all sources of finance. Though trillions of dollars are required at global level to achieve SDGs, financing needs substantially differ across the world. While needs are relatively smaller for the developed countries, there are serious challenges especially for the low and lower middle-income countries, including OIC Member States, to mobilize the necessary financial resources for the implementation of SDGs.

Temporary solutions and classical ways of financing are not fully able to help the developing world to achieve sustainable development. For instance, domestic public finance is the most important and critical source for financing SDGs. Achieving development outcomes and the SDGs depends largely on the ability of a country to mobilize sufficient public revenues. However, progress in increasing tax revenues remains slow in many developing countries. This requires reforms to widen the tax base, including development of new solutions and creation of more effective public finance mechanisms.

On another front, the realization of SDGs requires scaling up of international development financing by streamlining the Official Development Assistance (ODA) and resources from multilateral development banks. According to some estimates, spending needs for achieving SDGs in low and lower-middle-income countries may amount to at least 1.4 trillion US dollars per year. Around half of this funding shortfall could be financed by the private sector, whereas domestic public finance could cover 805 to 836 billion US Dollars. The remaining 152 to 163 billion US Dollars per year must be met through international public finance. However, ODA and international finance mechanisms have certain flaws and weaknesses and they are far from financing the investment gap in developing countries, including some OIC Member States. This requires all stakeholders and development partners to re-think on their approach towards ODA and re-work on alternative and innovative ways with a view to better addressing needs of the developing world.

This book aims to provide alternative views and perspectives on different dimensions of financing for development, particularly in developing countries including OIC Member States. It involves 17 essays authored by high level policy-makers, finance experts and academicians from different national, regional and international institutions. The book is structured around three main parts.

The first part focuses on development challenges and alternative perspectives on financing for development. There are major issues and challenges on how to effectively mobilize and utilize available domestic and international resources in order to achieve socio-economic development. In this regard, authors dwell on major development challenges, various ways, means and instruments for effectively mobilizing available domestic and international resources; challenges that limit the contribution of these resources to socio-economic development; issues on measuring and diverting available domestic resources towards financing development; and improving the domestic ecosystem for maximizing the contribution of domestic resources.

Today there are vast differences in standards of living across countries. Dr. Mustafa Mastoor presents the case of Afghanistan with its challenges and achievements over the last decade. Suffering protracted crises and conflicts for many years, Afghanistan experienced a rapid period of social, economic and political change since 2001 mainly due to international development assistance. He further emphasizes the importance of aid effectiveness and advocates for more targeted and more integrated cooperation among the OIC Member States.

While it is important to ask why nations fail, it is also important to discuss how nations succeed. Dr. Murat Yülek and Dr. Kenan Bağcı discusses the importance of industrialization and explains that designing and implementing successful industrialization policies are one of the most critical dimension in achieving development. Industrialization would allow developing countries to achieve higher growth rates, but it is a risky, complex and costly process. Financing these policies require well established institutions to channel the savings to most productive projects, where the success lies.

Development challenges are typically the same across the developing world, but we have always new options to tackle these challenges. Dr. Diana Barrowclough proposes six priorities for properly benefiting from national and international resources. Her suggestions are highly critical not only in increasing the capital flows to developing countries, but also in effectively utilizing them for profitable and productive activities.

The resources are scarce in economics and their effective allocation is a necessity for better economic performance. In this connection, Melikşah Utku stresses the importance of efficient use of scarce financial resources and generating high leverage with small financing. It is important to recognize the changing architecture of global financing system and instruments with the development of digital technologies, such as blockchain and crowdfunding. These may offer new opportunities for financing development not only in conventional finance but also in Islamic finance.

In fact, a lot of developing countries including some OIC Member States are rich in terms of natural resources where such resources offer great potential for fostering development. Many of these countries have already benefited extensively from their rich natural resources in their course of development and accumulated remarkable amount of capital in the form of sovereign development funds. Duncan Bonfield from IFSWF explains the nature and role of

sovereign wealth funds in national economies by discussing different types of funds and giving special cases across the world.

The second part of the book includes essays on bilateral and multilateral cooperation in financing for development. In recent years, we have witnessed some important changes in the understanding of financing for development across the globe. New actors and stakeholders have entered into the global landscape of financing, including global funds, civil society organizations, and philanthropic institutions. Many developing countries have started to collaborate with each other and provided additional resources to the implementation of development programmes. Several OIC Member States have been contributing to the global development efforts both in terms of financial resources, as well transfer of knowledge and expertise. For instance, Turkey's total amount of the ODA in 2017 was more than 8 billion US Dollars, while in same year the United Arab Emirates provided 4.6 billion US Dollars of foreign aid.

OIC Member States have varying levels of development and welfare, and some of them face major challenges in finding resources to achieve development goals. Dr. M. Kabir Hassan and Dr. S. Ahmad Shaikh deals with this topic and reviews the performance of Muslim countries in achieving the SDGs. Their findings reveal that the poorer countries require development assistance to fund their development projects, particularly in the areas of health and education. At individual country level, most countries set up special institutions to finance their development projects. Recai Biberoglu presents the case of Turkey on how development financing institutions fulfil their objectives and contribute to the economic development. Turkey has been also an emerging donor and an active partner in South-South cooperation.

Although, the South-South cooperation has emerged as a major factor of change, supportive to different models of development cooperation, there is still a long way to go in order to benefit from it as a reliable and sustainable source of financing development. This necessitates development of a more systematic understanding and improved dialogue among developing countries. Dato' Ku Jaafar Ku Shaari provides valuable information about the D-8 organization and its active role in promoting the South-South cooperation. Regional organizations not only enhance the cooperation and partnership among their members, but also between them and other major international organizations.

Millions of people are affected by various humanitarian challenges due to natural disasters and conflicts across the world. While partnership in financing development is important, assistance to affected people for their quick recovery is also equally important. Rashid Khalikov from UN-OCHA explains that investments in resilience building remain under-resourced. However, it is well known that investment in disaster prevention and preparedness is far more effective and cheaper than the rebuilding process and relief efforts.

European Union is accepted as one of the world's most successful organization in promoting regional cooperation and development. Dr. Maria-Francesca Spatolisano presents models and practices promoted and implemented by the European Union in financing development. She

highlights the importance of working together to shape policies and creating the right set of incentives for all actors.

Developing bilateral and multilateral cooperation modalities can be instrumental in facilitating capital flows across countries. Dr. H. Avni Bıçaklı gives details of the Economic Cooperation Organization (ECO) in promoting partnership among its member countries. Then he describes the initiatives of ECO in creating opportunities for collaboration in various sectors and with diverse partners. Similarly, Jeyhun Shahverdiyev explains the role of Turkic Council in facilitating partnership among its member countries and with other development partners.

The final part of the book contains essays that highlight the role and importance of Islamic finance services for financing development. The OIC Member States have specific challenges as well as unique solution mechanisms for securing financing for development that could help them avoid solely relying on a classical donor-recipient relation. Some of these potential avenues for bridging the financial gap include long-history of active intra-OIC cooperation in socio-economic development and availability of unique financing instruments like Sukuk, Zakat, and Waqf funds.

In particular, Islamic Finance has emerged as an alternative financial source in addressing the major development challenges and financing the SDGs. It is promising to witness the uninterrupted growth of Islamic Finance over the last decades. According to the recent statistics, globally the size of Islamic financial assets rose from around 0.6 trillion US Dollars to more than 2.3 trillion US Dollars between 2007 and 2016. However, greater convergence as well as harmonisation of regulatory standards among OIC Member States is needed to improve long-term growth prospects of the industry.

In this connection, Dr. Bello L. Danbatta unveils the hidden potentials of the Islamic finance services industry for financing development. There is a wide range of development challenges ranging from poverty to climate change and health to education, and Islamic finance helps to stimulate economic activity and entrepreneurship towards achieving SDGs. Therefore, it can play a major role in closing the funding gap with regards to achieving the development goals.

Global and regional investment gap is also at the core of the contribution by Dr. Nosratollah Nafar, who argue that Islamic redistributive instruments can be additional sources of financing infrastructure needs in developing economies, especially when it comes to funding social infrastructure. Focusing particularly on the role of waqf funds, the author identifies a number of challenges that hinder their effectiveness.

There is a need for financing development through not only infrastructure investment, but also poverty alleviation and economic empowerment. An innovative approach proposed by Dr. Nabil Galleb involves economic inclusion and empowerment of poor people through generating business opportunities with a high added value. The approach is mainly based on Islamic microfinance and focuses also on value chain financing where job creation is at the core.

New innovative tools for raising funds in microfinance are highly needed to improve economic and financial inclusion especially in Muslim countries. Given the enormous potential of the industry, Dr. Salina Kassim and Dr. M. Tassine Khouildi present socially responsible investment sukuk as an innovative funding mechanism to promote the development of Islamic microfinance. The authors argue that the issuance of such sukuk will give more opportunity to micro projects to participate significantly to economic activities.

As a yet another alternative proposal for financing development, Dr. Mehmet Bulut and Dr. Cem Korkut promulgate the role of cash waqf funds in facilitating capital accumulation and allocating resources for financing development. The authors review the historical success of this instrument and argue that these funds can be instrumental in preventing moral problems and establishing proper linkages between financial and economic sectors today.

Presenting alternative perspectives and innovative approaches, we believe this book will contribute in pointing out to importance of mobilising additional and new financial resources, supportive to delivering the intended results and impact in developing world. We also hope that the book encourages the development partners and other stakeholders to refocus their attention on the challenges of financing development and diligently consider the alternative solutions presented in this book.

Dr. Kenan Bağcı, SESRIC
Dr. Erhan Türbedar, SESRIC

**PART I: DEVELOPMENT
CHALLENGES AND ALTERNATIVE
PERSPECTIVES ON FINANCING FOR
DEVELOPMENT**

Changing the Mindsets for Innovative Financing

Dr. Mustafa Mastoor¹

Minister of Economy, Islamic Republic of Afghanistan

The world today is different and the business as usual is not working anymore. In many of our countries, the population growth is much higher than the economic growth. Conflict zones are expanding with severe consequences on people and economies. Unavailability of up to date data and statistics is a chronic problem that prevents devising appropriate policies.

There are many actors in development business, but they are not acting in a coordinated manner. Huge gaps (USD 3.3 to 4.5 trillion/year) remain in financing development in developing countries. Uncoordinated interventions further increase aid addiction and dependency in least developed countries. There is also poor coordination and parallel agenda between UN agencies and financial institutions.

Inequality remains persistent not only across the world, but also among the Muslim countries. Islamic social finance (*zakat*) (USD 2 trillion in 2015) provides huge opportunities but lack of well-designed mechanism and instruments to align them with development agenda is still a challenge. All these issues retard the progress of already ambitious sustainable development goals (SDGs), particularly in countries affected by conflict and fragility.

Development Challenges of Afghanistan

Since late 2001, Afghanistan has gone through a rapid period of social, economic and regime change supported by the international community. The country has received more than USD 70 billion of official development assistance (ODA) for reconstruction and development. During the period between 2003 and 2012, Afghanistan's growth trajectory surged at an

¹ Dr. Mastoor was appointed as Minister of Economy of the Islamic Republic of Afghanistan in August 2017. His main work focuses on scaling up domestic production in selected economic sectors to create job opportunities, lower the poverty rate and maintain sustainable economic growth in Afghanistan. From 2004 to mid-2017, Dr. Mastoor served as General Director of Budget and subsequently as Deputy Minister for Finance at the Ministry of Finance (MoF) as well as Senior Advisor to the Chief Executive of the National Unity Government. For over a decade he has remained as a key counterpart to all donors and key financial institutions including the World Bank Group, Asian Development Bank, Islamic Development Bank and International Monetary Fund.

average annual rate of 9.4%, driven mainly by ODA flows financing the agriculture, construction and services sectors.

This impressive achievement was then challenged by the rapid withdrawal of international security forces starting in 2011. In the aftermath of the transition, economic growth plummeted to around only 1% marked by lower ODA flows, and low investors' confidence.

Afghanistan has one of the highest population growth rates estimated at 2.03%. In the face of a declining GDP growth, consecutive droughts and insecurity, the proportion of population living below the national poverty line increased from 34% in 2007/08 to 55% in 2016/17. Food insecurity has risen from 30.1% to 44.6% in five years. Almost one quarter or 24% of our labor force is unemployed; and the country has been running trade deficits for an extended period of time, with an export to total trade ratio of only 11% in 2016.

However, potentials also exist to resume economic transformation and achieve development. Today, 60% of population are below 20 years of age and mostly in education or/educated. Strategic location between Central Asia and South Asia, rich natural resources, and a reform and development oriented government are some of the other potentials that the country can utilize for its development.

Under the leadership of the National Unity Government (NUG), growth has started to pick up again to 2.7% in 2017. However, to realize self-reliance, our vision is to target a growth rate of over 8% by 2025. Without a doubt, this is an ambitious plan but not impossible, if we enable the environment for further private sector development in the country.

As far as reforms are concerned, Afghanistan has made significant efforts to create the right conditions for a more dynamic private sector that could become the main source of growth and development in the country. As a result, the country's overall ranking on the World Bank's Doing Business Indicators has gone up from 183 in 2018 to 167 in 2019, with major improvements in ease of starting a business, protecting minority investors, resolving insolvency and getting credit; and marked as one of top reformers this year.

To sustain progress and development, the Government is committed to utilize the remarkable potentials of Afghanistan as a hub for trade, transit and investment across the region and beyond.

Our accession to WTO, inauguration of regional projects such as CASA-1000, TAP, TAPI, TUTAP and others are some of the achievements that will advance our vision of transforming Afghanistan into a commercial land-bridge connecting Central Asia to the South and Southeast Asia.

Despite notable progress, the cost of doing business is still very high because a number of bottlenecks including insufficient infrastructure, lack of skilled labor and insecurity stand in the way of attracting private investment in Afghanistan.

These challenges are common in many least developed countries. However, their scale and importance vary from country to country. Therefore, the question is how can ODA be still

relevant and instrumental in addressing the challenges that are prevalent in landlocked and least developed countries affected by conflict and fragility?

The Role of Multilateral Development Banks in Financing Development

I strongly believe that the modality of ODA matters predominately more than its volume and the role of international financial institutions such as the World Bank (WB), the Asian Development Bank (ADB) and Islamic Development Bank (IsDB) as main sources of ODA will be essential to help countries like Afghanistan to embark on a sustainable development path.

Over the past few decades, the mandate and scope of multilateral development banks (MDBs) have transformed significantly. This shows evolution of MDBs and the need for constantly adapting to changes in the global development landscape as demands evolve for development financing especially with the ambitious SDGs. Also given the mandates and huge knowledge base of MDBs and regional cooperation institutions, they can play a critical role as a catalyst for other forms of financing such as private-sector resource mobilization to turn the SDGs into reality.

As stated earlier, the achievement of SDGs depends upon availability of huge amount of resources, in trillions of dollars speaking globally, that cannot be harnessed through conventional sources of funding such as ODA or MDB's own resources. Therefore, it is indispensable that MDB's role be transformed to mobilize funds through private sector financing and investments.

However, MDBs are still finding it challenging to create innovative solutions for the private sector. There are several avenues, which MDBs can utilize to avail the role of the private sector such as by helping member countries in creating favourable environment for private sector engagement.

In Afghanistan, the role of regional and Multilateral Development banks such as ADB, IsDB, WB, and IFAD have been prominent in advancing the development agenda of Afghanistan and in fact have been the key contributors to growth and development over the past 16 years. For instance, the World Bank has an annual commitment of more than USD 560 million.

ADB and IsDB have been instrumental in helping Afghanistan to gradually meet its infrastructure requirements. Cumulative lending and grants of ADB to Afghanistan totals almost USD 5.4 billion.

FDI has become the most important component of development finance for landlocked-developing countries occasionally overtaking ODA. However, there is a huge competition on attracting FDI and countries with less favourable political and security conditions remain underserved.

Changing the Mindsets

To bring my points to a closure, I would like to emphasize that achieving sustainable development will require, *inter alia*, moving away from the "business as usual" practices of

delivering ODA in the least developed, landlocked, and fragile countries towards a more targeted, integrated and programmatic approach. This is not only to ensure aid effectiveness but also to mobilize financing and technical assistance in support of building sustainable infrastructure and private sector development and bridge what is needed and what is available.

Additionally, bringing together public and private investors for the use and deployment of blended finance, and providing risk and insurance guarantee schemes to encourage FDI should remain on top of the development finance agenda of this century. In addition, there is a need for innovative approaches to engage the private sector, methodologies to effectively prioritize and sequence the development finance. Countries like Afghanistan has to ensure sustainability of gains and be realistic about resources and goals. Intra-OIC cooperation, particularly in the areas of finance and human development, is critical and we need to explore all potential areas of cooperation among the OIC countries. Finally, learning from the experience of successful OIC countries and beyond will be the key to success.

Development Challenges, Successful Industrialization and Financial Development

Dr. Murat Yülek¹ & Dr. Kenan Bağcı²

(1) Rector of Ostim Technical University, Ankara & (2) Acting Director of Research Dep., SESRIC

There are good and bad news about where the world economy stands right now. The good news is that the quality of life is at very satisfactory levels in developed economies. The bad news, on the other hand, is that billions of people are still living in poverty. A lot of countries are either in the low-or the middle-income-trap, reflecting the challenges in raising productivity, growth and income as well as distribution.

On another note, trade tensions continue to rise, leading to increasing risks for the global economy. It is epitomized by recent rhetoric of the US President repeatedly expressing his displeasure over trade patterns. These are partly the result of the so-called global imbalances, where some countries are recording high trade surpluses and while others excessive deficits.

This does not mean that international trade is harmful for countries. On the contrary, it can increase welfare and efficiency compared to no trade situation. By trading, nations can consume goods that they do not produce or cannot afford. However, if a country imports more than it exports (that is, if they are running trade deficits) for extended periods of time, than it gets more and more indebted. That is the case in many developing countries, and the debt crises in poor countries in 1980s and 1990s was a reflection of that.

However, this is not a problem of only developing countries. Since the beginning of 2000, the USA has been running growing trade deficits against China. In turn, China used the proceeds to buy USA treasury securities. Effectively, the USA owed more and more to China because it has been running massive trade deficits against China. Now the USA owes 3 trillion dollars to China. The argument of the Chinese authorities is that it is not their fault to export too much to the USA; they argue that the US consumers consume a lot and the Chinese firms offer them

¹ Prof. Dr. Murat Yülek is the Rector of Ostim Technical University based in Ankara, Turkey. He has taught at Georgetown University and is a former IMF economist and corporate and banking executive. He has had responsibilities in economic development, corporate finance and macroeconomic policy in various countries.

² Dr. Kenan Bağcı is the Acting Director of Economic and Social Research Department at the Statistical, Economic and Social Research and Training Centre for Islamic Countries based in Ankara, Turkey.

competitive or cheap products thus increasing the American consumers' purchasing power and welfare.

How Nations Succeed?

Recent history has shown that some countries could not achieve to increase their incomes from low levels. Others, which recorded high growth rates and graduated to middle income levels subsequently slowed down and have remained locked in middle-income levels for decades. Consequently, today, there are only a few countries in the world that enjoy high standards of living, while the rest of the countries are trapped in low or middle-income levels (Yülek, 2018).

We argue that getting out of low and middle-income traps and participating in international trade more fairly can be achieved through successful industrialization. Manufacturing is the engine of growth; thus, successful industrialization is what can take countries out of both traps. Though manufacturing, nations can succeed and participate in global trade in a more balanced way.

Manufactured goods consist of three quarters of world merchandise exports and most of them originate from a few developed (industrialized) countries. Poorer countries export –almost entirely– basic, unprocessed agricultural or mining products (the so-called primary products). In turn, they mostly import manufactured products from developed countries (in addition to energy and food), which carry much higher value added compared to primary products.

However, from the 1970s to the present, we can count the number of countries, which succeeded to escape from the middle-income trap on the fingers of one hand. South Korea or Taiwan are leading examples along those lines. Their experience has shown that to beat the middle-income trap, the governments should implement effective policies to support the development of the private sector in the industrial sector. Such examples are not limited to East Asia. In Europe, Airbus or Swedish Aircraft Industries (SAAB) are good particular examples where industrial policy paid off. From a small start-up, Saab became one of the high technology industrial engines of the Swedish economy. Airbus on the other hand is a multi-country effort to develop an aircraft industry supported by governments that has supported economic development and welfare in Europe.

Industrial policy constituted an important component of structural reform that countries need to escape the “middle-income trap.” Industry is the core of productivity and technological growth. As Nicholas Kaldor has pointed out, industrialization leads to the growth of productivity in the services and agricultural sector thus making it the “engine of growth.” A service sector without an effective industry is possible but it is only a major engine of employment at low levels of income and productivity.

On the other hand, manufacturing and industrialization are necessary to raise income levels but they do not happen by accident. No country has industrialized by mere coincidence but

through the appropriate industrial policies. Since the 19th century, some prominent examples to that are the USA, Germany, Japan, Sweden and South Korea.

Industrialization would allow the poorer countries to achieve much desired higher growth rates and reduce their trade deficits. That is what the Korean miracle is all about. South Korea demonstrates an example to a small country that has become a high-income country with trade surpluses through successful industrialization without any significant natural resources.

Designing Successful Industrialization Policies

Industrialization is a good thing economically, but it involves a costly, risky and complex process. Many confuse industrialization with the construction of factories. In fact, it is a capacity building process with a significant intangible aspect. It goes through certain stages and many countries of the world have not been able to proceed to advanced stages. The observation is that successful industrialization in the modern era has nowhere and never been an accident. It has always been based on some policy that aimed at supporting manufacturing.

Industrial policy is used to change the production structure of an economy in favour of the manufacturing industry by channelling public and private resources of capital, labour, and entrepreneurs towards the manufacturing sector. Industrial policy, as other 'structural policies,' is designed and implemented to improve the long-term growth performance of the economy. In particular, it helps countries surmount the so-called middle-income trap by sustaining growth over the long term.

Few fully realize that industrialization is a crucial necessity for economic development and requires design and implementation of appropriate policies; countries such as Japan, South Korea, Germany, Sweden, China and Finland stand out as rare relatively recent examples of successful economic development on the back of industrialization. Many other countries ignore industrial policy or fail to employ it effectively. The outcome is that they remain in the middle-income trap, or—if we may call it so—the low-income trap.

The first group of countries, today's industrialized nations, which experienced their industrial revolutions after the British, have all employed industrial policies at different times in their development cycles. This is confirmed by the stories of France, the USA, Japan, Germany, and Russia. In each of them, one or more dominant leaders pushed for economic (and social) reform and industrialization. Interestingly, in each case, the governments employed industrial policy also to become powerful both militarily and politically.

Windfall gains attained by colonizing other nations or extracting resources do not warrant a successful industrialization per se. It is illustrative to compare the UK with Spain and Portugal, which secured economic benefits from colonial practices. In the UK, the Industrial Revolution began in the eighteenth century. It was not an accident; what can be identified as industrial policies had started much earlier. In the UK, the process started at a time that was characterized as a mercantilist, colonizing, hegemonizing, and brutal empire built after the fifteenth century. Britain started to employ policies to achieve industrialization through

import–substitution-type industrial policies as early as the 14th century. After its global empire was built, its industrial policies aimed at keeping its colonies as suppliers of raw materials and the mainland as a manufacturing hub. The outcome for Britain was impressive; it indeed became the manufacturing and commercial hub of the world; it collected raw materials at low prices from around the world and disseminated its manufactured products to its colonies and other markets.

The Spanish and Portuguese empires preceded Britain with their versions of mercantile, brutal, and hegemonizing histories. However, they could not industrialize, as they ultimately failed to employ industrial policies. They started the twentieth century as poor countries, although they had reaped a significant amount of gold and silver from South America and other continents in the previous centuries, as their governance remained extractive and pillaging and not developmental in spirit.

This comparison reveals that successful industrialization requires effective policies. Industrialization is possible through the industrial layer consisting of industrial firms and entrepreneurs, industrial labour and managers, and industrial finance. Industrial policy should be designed and implemented by the state targeting the entire industrial layer. It is the capacities of the state and the industrial layer that are key to success in industrial policy.

Overall, industrialization is a capacity-building process that materializes through real manufacturing experience over time. It requires the development of human and institutional skills. Manufacturing always has positive side effects through linkages to other industries and through learning effects that generate larger impacts on society than on the individual manufacturing firm. However, a critical challenge for many developing countries is how to finance industrial policies when resources are already limited.

How to Finance Industrial Policies

In order to finance industrial development, many governments establish development banks or similar financial institutions and channel domestic as well as foreign savings towards medium-and long-term industrial projects. These are usually government-sponsored financial institutions to solve failures in credit markets inhibiting industrial growth. Existing historical accounts show that development banks exist at least since the 19th century with the creation of Société Général pour Favoriser l'Industrie National in the Netherlands (1822) and, later on, a group of institutions in France that had important influence on European infrastructure investments such as railways (Lazzarini et al. 2011). Today's industrialized economies such as Germany, Japan and the Republic of Korea have greatly benefited from the services provided by national development banks during their industrialization.

Today, many OIC countries have state-sponsored or privately owned financial institutions to support industrial development. Bahrain Development Bank, Bangladesh Development Bank, Development Bank of Kazakhstan, Industrial Bank of Kuwait, Industrial Development Bank of Pakistan, Development Bank of Turkey and Uganda Development Bank are some of the examples of national development banks in OIC member countries. There are also regional or

multilateral development finance institutions such as Asian Development Bank, African Development Bank and Islamic Development Bank as well as global institutions like International Bank for Reconstruction and Development (IBRD, World Bank), where OIC countries are among their members.

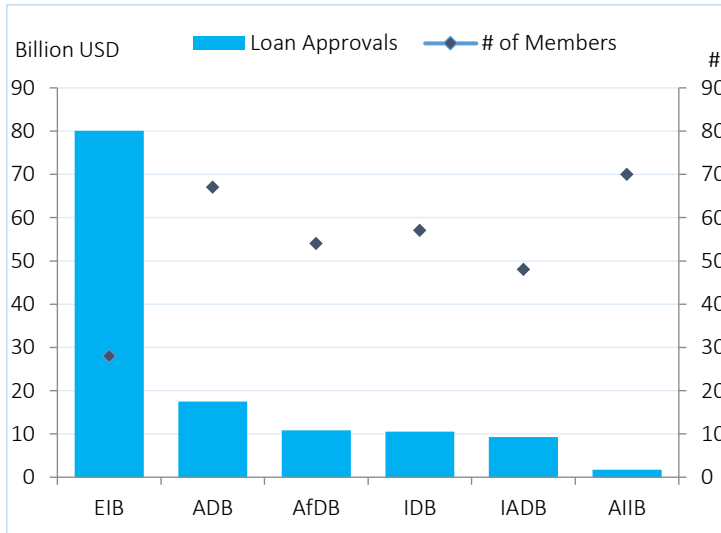
There are multiple roles that development banks perform. They typically finance infrastructure investments but also support structural changes in line with national development strategies, and to create an environment conducive to the improvement of the quality and competitiveness of goods and services in the domestic and world markets. They provide long-term capital to stimulate investments in strategic industries and contribute to industrial development. In addition to these, they support investments in periods of economic downturn, performing a counter-cyclical role. Moreover, development banks encourage innovation and new firm growth by supporting risky R&D intensive start-ups and innovative projects. Development banks can leverage resources by attracting other lenders that do not have the same technical capacity to assess a project's viability and potential. They can also provide resources to address societal challenges such as climate change or aging populations (Mazzucato and Penna, 2014; UNCTAD, 2016).

It is clear that industrial development is not the only objective of development banks. While the development banks in lower income countries tend to focus largely on industrial development, they target additional objectives at higher income levels such as creating employment, reducing regional and social inequalities and spurring technological change. The typical instruments that they use include loans, grants (to finance particularly risky innovative projects), equity investments (to promote long-term fixed investments), trade finance (to facilitate export), SME support and technical support (Guadagno, 2016).

If interventions are made in sectors that are not crucial for economic development or in an unsustainable, politicized or poorly managed fashion, expected benefits will not materialize. Moreover, it will create an additional burden on national economy. In order to increase efficiency in allocation of resources to productive sectors, private sector may also play an important role. As one of the few examples of privately owned development banks, Industrial Development Bank of Turkey (TSKB), established in 1950 with World Bank support, derives resources from the governmental and international financial institutions, and makes loans and investments. Interest rates on such loans were kept low, and the TSKB was not permitted to accept deposits and could not issue bonds in the market. This made the TSKB largely a vehicle to implement the State's policies of promoting manufacturing and influencing the allocation of investment, although there are already three state-owned development banks, namely İllbank, Eximbank and development bank (UNCTAD, 2016). However, in Turkey the importance of the development banks has declined over time partly because of the massive growth of commercial banking. The share of development and investment credits in total credits declined from around 25-30% during 1970s to around 10% in 1980s and then further declined to below 5% during the last decade (Öztürk et al., 2010).

The number of development banks worldwide is difficult to ascertain, due to definitional and data-related problems. According to latest estimations, the presence of development banks in the financial system remains significant, as they account for 25% of total banking assets around the world (Luna-Martinez and Vicente, 2012). At regional level, European Investment Bank

Figure 1: Total Loan Approvals by MDBs (2016)



Source: Author's calculations based on banks' annual reports.

(EIB) of European Union approved by far the largest amount of loans to its member countries, which are mainly industrialized economies. Other regional development banks' total lending remained around USD 10-20 billion (Figure 1).

Despite the presence of development finance institutions at national, regional and global level, many countries struggle to

find resources for their economic transformation. The lack of financing mechanisms for industrial and economic development is in fact not due to a shortfall in global savings. It is reported that annual global savings are at around USD 22 trillion and the stock of global financial assets is estimated to be about USD 218 trillion (UN, 2014). If these savings could be channelled to long-term investments, they would support industrial and economic development across the world and probably get higher returns. National, regional and international development banks can bridge the largely available finance to potentially strong projects that can transform the economies.

In this context, Islamic financial instruments would be another option to mobilize resources and finance industrial development in OIC countries. Islamic finance services have shown remarkable success in terms of growth, expansion, and institutional and product diversification. The asset-backed and risk-sharing nature of its products has strong potential to contribute to social and economic development through promoting entrepreneurship. Particularly in bridging the gap in infrastructure development, Islamic finance provides great complementarities. While Islamic finance seeks real assets to be financed, infrastructure investment provides those tangible assets for financing. Moreover, it offers a mechanism where investors can have ownership in assets and receives from the profits. The *Sukuk* market has been particularly instrumental for fund raising and investment activities.

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Benefitting more from National and International Resources for Financing the Sustainable Development Goals: Old Challenges and New Options

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The Sustainable Development Goals (SDGs) represent the single biggest investment push in history, and governments around the world are being encouraged to attract private sector investment to support them – with a particular emphasis on international private finance. This brief note takes a different track and aims to show that other priors are equally and maybe more important. These include (1) reversing the current outpouring of capital from developing countries, because at least some of these funds could be directed towards SDG investments at home; (2) stopping the general decline of private investment into profitable and productive activities, before taking on the difficult task of luring it into SDG-related activities; and (3) better supporting public investment, especially via the national and regional development banks that are the institutions best placed to serve the SDGs. Other priorities include (4) resisting calls to reduce Official Development Assistance and restoring its developmental composition; (5) building a coherent infrastructure plan that is designed to meet national development goals rather than a piece-meal, project by project non-plan that only meets the needs of finance; and (6) finally ensuring national macroeconomic policies support SDG and development goals rather than undermining them, as can often happen.

Each of these six issues can also be seen through the lens of Southern-led and Southern-oriented development finance that has been one of the most striking trends of the last decade. New South-South development banks and infrastructure funds are being established alongside the strengthening and expanding of long-standing ones, and south-south credit swaps and foreign exchange reserve pools are complementing, or in some cases even substituting, the historical Bretton Woods institutions. These trends are examples where the South is taking the lead and finding alternative routes to finance development, in the face of

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disappointments and limitations with the international financial system, which does not serve development well and especially not the long-term investment needs of the SDGs. While there is an increasing willingness to discuss it, especially in the context of finance to address climate change, actual reform in the near-term still seems beyond the scope of current political will.

These South-South mechanisms have significantly changed the centre of gravity in development finance but nonetheless their scale and reach remain uneven, with some regions, countries and activities still largely missing out. Much still remains to be done to support them to fulfil their potential, and to avoid falling into the same limitations or weaknesses of existing institutions. This brief note highlights some of the major challenges and opportunities facing developing countries in their effort to achieve the SDGs and suggests a few policy steps going forward so that Developing Countries can benefit more from national and international resources for finance². Some steps are more ambitious than others, especially those requiring cooperation within regions; all are needed for the task of directing and scaling up finance for the SDGs.

Staunch the outpouring of capital from developing countries

Rather than flowing into developing countries, as envisaged in discussions about the SDGs, for several decades capital has actually been going in the other direction. As shown in Figure 1, in recent years the net outflows in 2012 were \$1,999 billion for developing countries in total and 1,352 billion when excluding China. Of this, almost 20% flowed out from MENA countries. Cumulating the flows over the years since 1980, developing countries were net providers of resources to developed ones to the tune of around USD 16.3 trillion³. This occurs for various reasons, including net outflows relating to debt servicing, transfers of profits to TNCs headquartered in advanced economies, payments for intellectual property rights and royalties and illicit flows into tax havens, as well as licit flows seeking external investments, but the point is that some proportion of these outflows, potentially a high one, could rather have been invested at home – both in regular productive activities and in the SDG-related investments so urgently needed.

Further crowding in effects could also be expected, if the leakage outwards was reduced – potentially even a net inflow from international sources. Making matters worse, the negative effects of the current leakage is compounded by the fact that most developing countries earn a lower rate of return on their foreign assets than they pay on their foreign liabilities, compared to developed countries for which it is the other way around (Akyuz, 2017). As a first step to increasing investment in the SDGs, reducing these outflows would help.

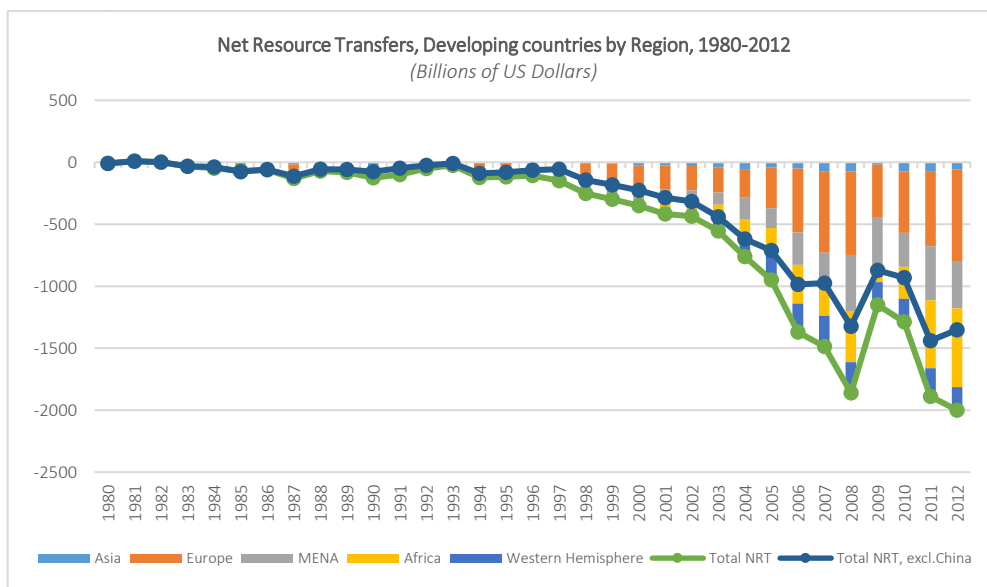
Restoring investment to profitable activities would help attract it to SDG activities

While corporate profitability has been on the increase almost everywhere in the world, the same cannot be said for investment trajectories. Attracting private investment in SDG-

² For a more detailed discussion see Barrowclough and Gottschalk (2018); UNCTAD (2018), UNCTAD (2017).

³ See Global Finance Integrity (2016) www.gfintegrity.org

Figure 1: A source of investment in the SDGs -- net capital flows of developing



Source: UNCTAD secretariat, based on *Global Financial Integrity, Financial Flows and Tax Havens*, 2015.

activities is a doubly uphill battle because private investment even in profitable activities has been falling for many decades. These trends are especially apparent in advanced economies and in the manufacturing sectors, but it is happening in developing countries, too. The investment to profit ratio for Indonesia fell from 110 for the years 1995-2002 to 81 by 2009-2014; for countries such as Brazil and Turkey the fall was even sharper, going from 178 to 80 and from 140 to 70, respectively (UNCTAD, 2016).

Rising profits are, in theory at least, supposed to be a spur to investment, the reward for successful operations and the source of new investment. However, it is not working like this in most places at present – even in activities that are profitable and during a period of history where the global economic environment has been mostly benign.

It is too soon to say that the traditional profit-investment nexus has completely broken down, and for some developing countries the investment-profit nexus has not even been established in the first place. But these unhealthy trends do not augur well for efforts to attract private investment into activities that are by their very nature, likely to be less profitable unless there is a very big dose of government support.

Furthermore, these efforts need also to be supported by a broader stance that reins in corporate financialization and encourages productive investment, by changing the corporate governance and incentive structures (Minsky 1993). In other countries that have yet to develop a positive nexus between profits and investment, this must be created and supported through the building of effective financial and banking system. Industrial policies are also needed as part of this, to help firms overcome early hurdles so they can play their role in

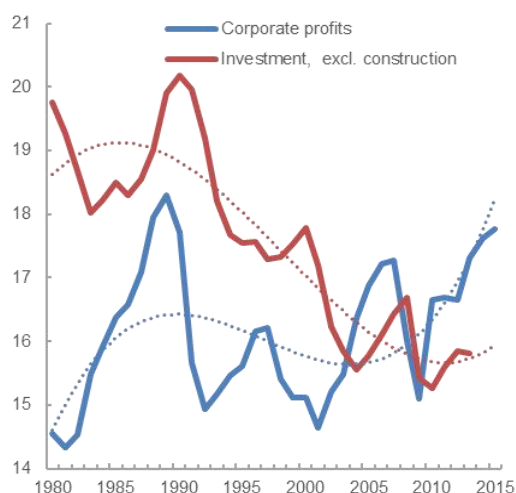
incipient transformation of the economy (see Wade 1990). At the same time, public investment needs to be protected by actions that tackle tax avoidance, evasion and capital flight. Hence, there are many inter-related policies that need to be in place simply to create an environment that encourages re-investment in more standard and profitable activities before the bigger challenge of luring private investment into the SDGs.

Support to public investment – national and regional development banks

In most countries, most of the time, the long-term investment needed for SDG-related activities has been provided by the public sector, not the private. Development Banks are the obvious candidates to lead this kind of investment and they need to be better supported in this role⁴. They will likely have to expand their lending vigorously in order to keep up with growing borrowers’ expectations and demands before the 2030 deadline, and they face a major constraint in their current limited capital base. In some cases, this can be eased by expanding membership, but these risks weaken solidarity or the southern-voice in governance. In addition, the SDGs’ deadline is just eleven years away – not long for the political negotiations potentially required.

Another way is that existing shareholders contribute more capital, which members may do if they want their development institutions to have a prominent role in the years to come. Some advanced countries cite budgetary constraints as a reason not to increase capital contributions to multilateral development banks (MDBs), but this does not necessarily apply to developing countries with young populations and rapid growth rates. Their fiscal space for providing additional funding may be underestimated, especially given that one way to reduce debt to GDP ratios is to increase GDP – the task for which long-term investment by development banks is designed. Alternatively, some countries could draw on their Sovereign Wealth Funds (SWFs) to inject new capital into their development banks, acknowledging that SWFs for the most part

Figure 2: Investment is falling even as corporate profits rise, 1980-2015



Source: UNCTAD (2016), Pg. 143. Based on average values for France, Germany, Japan, the United Kingdom and the United States.

⁴ There are now more than 250 national development banks in the developing world, and some are immense, dwarfing long-standing multilateral institutions such as the World Bank and becoming major lenders for their regions and beyond. The Southern-led multilateral development banks are further changing the game, contributing not only finance but also essential technical expertise and knowledge.

do not have this technical expertise but development banks have it in abundance. While the South holds trillions of dollars of public assets in SWFs, only a few have directed them to SDG-type investments.

Certainly, increasing the capital base could help reduce the current pressure on DBs to “sweat” in risky ways to increase leverage – by taking loans off-balance sheet and the collateralization, securitization, dicing and splicing that caused so many problems in the West. Some of the new modalities that MDBs are adopting or considering adopting to relax their lending constraints may provide significant sums of additional finance, as well as giving new ideas for operational improvements; and certainly loan to gearing ratios vary considerably between banks, due in part of specific structural, institutional or cyclical factors that shape their experiences.

However, others may simply be shifting the risk for the public sector to pick up again at a later stage. Moreover, capital increases may help take off some of the pressure for hasty partnerships with the private sector, enabling governments to form these when appropriate and effective on a case-by-case basis rather than being seen as a default necessity as in the ‘cascade’ approach currently promoted by the World Bank and others. It would also potentially enable DBs to insist on a longer-term view of economic and social returns, rebalancing their reliance on the short-term view of credit rating agencies, which are the gatekeeper to international finance.

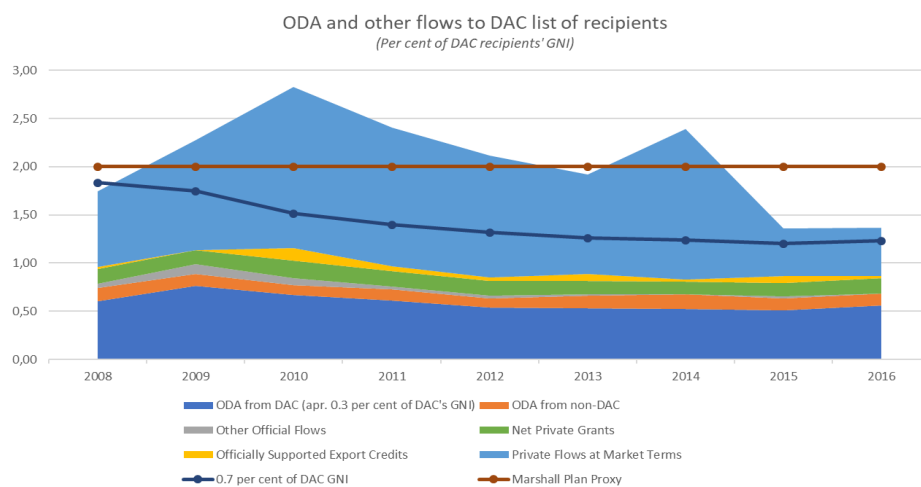
Finally, public support can also go beyond the realm of finance and includes sharing of knowledge capacities, technical expertise and experience - both within countries and within regions. Studies of the successful economic transformation of the Asian Tigers by Amsden and others have long emphasized the role of such capacity building in government and associated institutions. Here the MDBs, and South-South and Triangular Cooperation can play a very significant role, if sufficiently well supported by developmental interests.

Increase Official Development Assistance (ODA) and re-direct its composition

On average, in 2016 OECD DAC countries gave just over 0.3% of national GDP to ODA, meaning this would more than double if they gave the 0.7% actually pledged. Some countries have better records than others, and in constant prices absolute levels has risen, but the evidence is disappointing especially given the hopes of the SDGs. Moreover, some major donors such as the United States and United Kingdom are further showing signs of a worrying new approach to ODA. A second problem is that only a small share of the ODA given is dedicated to productive activities that would help countries to generate income-earning opportunities for future development. This is not to say that humanitarian activities be reduced, but rather that directing more into infrastructure and productive activities means the total envelope needs to be increased. South-South cooperation is helping in some cases to augment aid flows but these are a complement to ODA and not a substitute for what has been pledged (Li, 2018).

The shortfall in today’s ODA is especially marked when compared to the post World War II example given by the Marshall Plan in Europe. One of the most successful transformation pushes ever; it was fuelled by grants equivalent to 1% of United States GDP and a full 2% of

Figure 3: What the Marshall Plan would look like Today



Source: UNCTAD secretariat calculations, based on Aid (ODA) disbursements to countries and regions [DAC2a] and Total flows by donor (ODA+OOF+Private) [DAC1], available at: <https://stats.oecd.org/> (accessed 16 November 2018); and United Nations, Department of Economic and Social Affairs (UN DESA), National Accounts Main Aggregates database.

the GDP recipient countries. Figure 3 is drawn from the perspective of recipient countries and shows that current ODA receipts translate into just over 0.5% of GDP for recipients, so less than one quarter of the Marshall Plan. As the months and years drag on and the 2030 deadline approaches – another lesson from the Marshall Plan is also relevant – its power was not just the generous scale of its funding but its speed – the plan was designed and set up within weeks, and implementing its first reconstruction activities within months, helping create “buy in” for the vision as it unfolded (See UNCTAD 2017). In recent years, only the Asian Infrastructure Investment Bank (AIIB) seems to have moved this quickly.

Coherence with other policies - Expansionary macroeconomics and the value of a plan

The story of the Marshall Plan resonates with the push of public investment during United States President’s New Deal in the 1930s. This was based on three basic principles – *reflation* of the destroyed economy, *redistribution* of resources to rebalance between capital and labour and reduce inequality, and *regulation* of the financial sector to align it to better serve the real economy (see UNCTAD, 2017 and UNCTAD, 2018). The overarching macroeconomic approach was therefore integrated and expansionary.

A similar approach is needed for the SDGs – especially given today’s highly concentrated and hyper-globalized economy. Countries wishing to attract investment into infrastructure, whether national or international, need to support this goal with a broadly expansionary macroeconomic approach that will create jobs, raise incomes and generate demand to pay for whatever goods or services the investors finance. It also requires something that sounds rather obvious but is often overlooked – namely a developmental plan.

In the case of infrastructure, it means that government thinks through the network effects of modern infrastructure with all its complementarities and sequencing requirements and does not approach it simply on a project-by-project basis. Putting these two elements together – the infrastructure plan on one hand, with an expansionary macroeconomic approach on the other – means that planning needs to be a kind of ‘co-ordinating umbrella’ that embraces a wide range of differing interests and strategic choices. It will include deciding which sectors to prioritise and technologies to adopt, alongside an industrial policy that aims to help furnish demand, including by boosting jobs and incomes.

This requires connecting a country’s different stakeholders, including the private sector, and including the firms and individuals who will likely use and pay for the underlying services provided as well as those seeking to construct or operate them. It means considering the macro coordination of investment decisions, including any foreign exchange implications. This may include allowing Central Banks to resume their credit-creating or employment targeting roles rather than fixing just on inflation; and focusing on the GDP denominator and not just the nominator of debt or budgets. It will also include policies to maintain and boost fiscal space, such as reducing tax evasion or other sources of unproductive capital outflows. And finally, it also means giving real support to Development Banks, national and regional, as these will be the institutions tasked with the heavy lifting to meet the SDGs. This includes financial support of course but goes still further, to include a mandate that allows these public banks to play their fully catalytic role (Mazzucato, 2013).

To conclude, there are many issues that overlap with the goal of attracting investment into the SDGs. These make it essential to have coherence and consistency across policy arenas, which in turn requires capacities for planning, project preparation and execution. It also needs a system of monitoring, accountability, and penalties when plans are not followed through correctly. This kind of interface between public investment, private investment, and development is complex and goes far beyond just attracting finance.

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New Perspectives on Financing for Development

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We know that the capital inflows especially in emerging markets have been slowing down. Over the last 10 to 15 years after the global financial crisis, there was a lot of hype in the emerging markets compared to the developed markets. However, we know that things are changing over the last couple of years. As the capital outflows from developing economies are surging, we definitely have to look at new ways of either generating capital or revising how we do the investments.

Our perspective is that we should first reduce waste. We have a lot of waste taking a large portion of our investments down to the trash. One third of the food production in the world is wasted and major portion of that is in the developing countries where food is actually needed. So essentially this is an area that we should focus from both the government side and the private sector side. We should reduce waste especially in food sector by having better distribution channels, having better production schemes and by increasing consumer awareness.

Waste is not just related to food but also energy. This is an area to improve the capacities to generate more renewable energy, especially in Islamic countries. We know that some countries are doing good job in this area. Jordan is one example that is investing a lot into solar energy. Turkey has done some renewable energy projects, and financing did go into these projects. However, hydroelectric energy investments did not progress well due to weak feasibility studies and some legal hassles, especially with regard to environmental problems.

For example, a major portion of these projects is unfortunately unviable for sustained financing. Turkish banks then turned to wind energy and over the last couple of years, solar

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energy has been an area of investment for Islamic banks. Islamic banks have also entered into energy investments but unfortunately, project feasibilities have always been less than perfect. We have had problems with regarding to return on financing in these projects. So better feasibilities, waste management and better productivity is needed.

Another area that we should be looking for is not wasting the financing that we have. Unfortunately, this is an area where banks go with the flow. For example, we have had a lot financing provided to the construction sector in Turkey. As you know, there is a basic demand for housing in Turkey, but it is not necessarily a productive sector and investments going into this sector sometimes overshoot demand especially in certain segments. For example, in Istanbul, you do have a lot of demand from middle-income families but the supply is essentially on the high-income side, so there is a mismatch there. That is currently creating some problems in the Turkish economy. The private sector and the government sector should work together to address the mismatch.

Another important area especially for Islamic countries and Islamic finance is women's engagement. A study shows that as more women participate in the work force and as the work hours of the women increase, there will be huge jumps in GDP over the following years *ceteris paribus*. That is an area where especially Islamic finance could provide impact investments. It should be realized especially in services sector where women participation can be increased without much investment.

Technology is obviously changing our lives but it is also changing the way we live, the way we look at things, the way we organize things. Essentially, the economic model in the agricultural period was based on human muscle. Human resources were more important compared to the other resources. The main resources became capital and knowledge in the industrial age. Especially technical knowledge was important. Now we are entering the new era of digitalization, IT (information technology). Whereby now you are generating value added from knowledge itself.

I think Islamic countries and developing countries have a huge potential in this regard. In many developed countries, the demographics itself does not help them in providing an agile, fast technological changes in the future, because younger population is lacking in these countries. That is not the case in developing countries where you have a large number of young people who can adapt to new organizational structures, working conditions and can be easily reeducated, retrained to acquire new skills.

It is apparent that things will be changing much faster than they did in the past so this kind of demographic advantage is going to be important. We need to do a lot of investment in the educational and the training sector. These sectors are what we are focusing both internally and externally. That is, we are doing this inside the Bank itself and we are also providing financing to the initiatives that actually attempt to do this in the public sphere.

The company management styles are changing compared to the last 10 years. For example, top most valued companies have changed significantly. When you compare the years of 2018

and 2008, you can see that now you have tech companies on top of the ladder rather than big oil giants that we used to see 10 years ago. Research and innovation in the more traditional sectors require plenty of resources and capital. Thankfully, investment in technology, especially in digital technology, requires much less resources and knowledge. It mostly requires open-source knowledge, which is much cheaper, so I think there is a chance for development especially in the technology and IT sector. I believe we might be able to see that companies arising from developing countries could enter the top 100 or top 500 lists in the future.

The way we finance the businesses are changing, so crowdfunding is becoming mainstream, though it is still small comparatively. However, things are changing very fast. We also have crowdfunding in the Islamic finance sphere; there is already a successful model in Dubai that is doing crowdfunding from Islamic perspective. We also have an initiative in Al Baraka that we are funding that is going to provide a crowdfunding platform.

Peer to peer lending is another type of financing. It is especially picking up over the recent years. Angel investments is another area, which actually is in line with Islamic financing methods. As you know, Islamic banks have a larger incentive into this field than conventional banks. They should be doing more financing on the equity side rather than just the leverage side. Angel investment or providing financing to angel investments or private equity especially into startups is an area we need to develop. As Al Baraka Türk, we have established a private equity fund in order to provide equity financing to fintechs. We are more interested in fintechs but this does not mean we have concentrated only on fintechs. Projects in certain fields like renewable energy, energy efficiency transformation projects, women entrepreneurship and women participation in the work force could also be supported through private equity or crowdfunding.

Another important area is blockchain, but not necessarily crypto currency. Islamic finance is essentially structured finance. It is not as simple as conventional finance. We have more paper work, operational overhead and we need to be there during the transaction in order for us to be able to provide financing.

Now digital technologies significantly reduce paper work and operational overhead and I think it will provide Islamic finance a boost. I believe blockchain will allow for a very good infrastructure for Islamic finance in many different sectors, in many different types of projects especially with regard to social development projects. One thing that comes to our mind is compliance issues and money laundering concerns.

Over the recent years charity works -for example- has seen a major hindrance in revenue generation. People are worried about whether their charities would be actually used in the right areas or whether they would have problems in the future concerning compliance and money laundering. Blockchain can provide an infrastructure that could help charity providers trace their endowments all the way to the where the expenses are made. Therefore, I think

that blockchain along with the artificial intelligence and smart contracts can provide us with a major revolution in this area.

In Turkey, Turkish Islamic banks, named as participation banks, have been known for providing the market especially SME market with more funding than conventional banking. Our market share in the banking sphere is 5%, but when you look at the SME credits, we have reached to 10% at one time. Now it has come back to 7%. This is much higher than the banking sector average.

As Al Baraka Türk, we have instituted an incubation center that picks up ideas and turns them into viable products. We also have a fintech collaboration center through which we have instituted a digital only bank in Germany, “insha”. There will be more such collaborative initiatives coming. These are all small companies we are working with; they are not large institutions that have big names. The products themselves are usually prototypes and we let them test these products on us. As such, we help them develop their products. Our experience shows that it is now possible for smaller incentives, small financing to generate high leverage, which allow them to compete even with the larger names.

The Role of Sovereign Wealth Funds in the National Economy

Duncan Bonfield¹

Chief Executive Officer, International Forum of Sovereign Wealth Funds (IFSWF)

Sovereign wealth funds (SWFs) have been active in the financial markets for more than half a century. However, during the 2000s, high prices boosted the assets of commodity-rich nations, and a series of favourable balance-of-trade results in Asia saw foreign exchange reserves rise. SWFs became more prominent as they sought to diversify their resources into foreign assets. From 2007, there was a climate of rising protectionism, and SWFs began to attract suspicion in some quarters, partly due to their role in facilitating the free flow of international capital.

The tenor of the international debate concerned many SWFs and they recognised the need to establish and communicate their role in global financial markets. A constructive dialogue started between the governments of countries receiving SWF investment and the funds from the beginning of 2008. During the meetings of the World Bank and the International Monetary Fund and extensive ongoing dialogue, representatives from 26 SWFs –the International Working Group of SWFs – worked to create a set of Generally Accepted Principles and Practices (GAPP) for SWFs, intended to promote good governance, accountability and transparency.

In September 2008, these institutions gathered in Santiago, Chile, to finalise the GAPP. The Santiago Principles, as they became known, have done much to encourage a better understanding of SWFs as commercial investors whose main objective is to deliver financial returns for their sponsoring governments. Following an April 2009 meeting in Kuwait City, the Working Group became a more formal organisation and knowledge-sharing platform: The International Forum of Sovereign Wealth Funds (IFSWF).

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However, while perceptions of SWFs have shifted, confusion lingers as to how they should be defined. This is understandable, as they are a diverse group of institutions. Some SWFs are decades old, others are newly created; some are financed by oil receipts, others have no connection to commodity revenues; some invest primarily in bonds and equities, others allocate the bulk of their capital to alternative assets such as infrastructure and private equity. Many invest outside their own countries, some exclusively at home.

How to define a SWF

During the annual meetings of the World Bank and the International Monetary Fund in 2008, representatives from the founder members of IFSWF formulated the following definition of sovereign wealth funds:

Special-purpose investment funds or arrangements that are owned by the general government. Created by the general government for macroeconomic purposes, SWFs hold, manage, or administer assets to achieve financial objectives, and employ a set of investment strategies that include investing in foreign financial assets.

This definition excludes foreign currency reserves held by central banks for balance of payments or monetary policy purposes. It also excludes state-owned enterprises, government-employee pension funds and assets managed for the benefit of individuals.

In 2014, the IFSWF Board admitted several members that manage only domestic assets, reflecting the changes in the SWF landscape since 2008. Each of these applicants satisfied the Board that they complied with the requirements of a sovereign wealth fund and that their admittance enabled the IFSWF to remain true to its history, founding purpose and obligations.

IFSWF is a heterogeneous community. The Santiago Principle self-assessments carried out by the Forum's members in 2016 reveal great diversity, particularly in the funds' legal structures and how they are managed. However, most SWFs fall within four main sub-groups, categorised by their objectives and the investment strategies they adopt to fulfil them. These are (1) savings funds, (2) stabilisation funds, (3) development funds and (4) funds with hybrid mandates.

1. Savings funds

Savings funds are sometimes referred to as intergenerational savings funds, because they have decades-long investment horizons. The world's oldest SWF, the Kuwait Investment Authority (KIA), is a good example.

Savings funds are often set up by commodity-rich countries to save a portion of their resource wealth for the future. Oil, gas and precious metal reserves are finite: one day they will run out. There is also a risk that these resources will become stranded assets as climate-change regulation and the rise of green-energy alternatives render hydrocarbon extraction uneconomic.

However, by using their SWFs to convert today's resource wealth into renewable financial assets, governments can share the windfalls with the generations of tomorrow. By investing overseas, savings funds in commodity-rich countries can also help prevent Dutch Disease, whereby a surge in commodity exports leads to a sharp rise in foreign-exchange inflows, generating inflationary pressures and damaging the competitiveness of other economic sectors.

Some savings funds are designed to finance future liabilities. Pension reserve funds, such as Australia's Future Fund, the New Zealand Superannuation Fund and Chile's Pension Reserve Fund, typically invest to build capital that will help defray their sponsoring government's future pension obligations. Unlike orthodox pension funds, which must continually pay out to their members, pension reserve funds do not have any immediate liabilities. Therefore, they can put their capital to work in long-term investments (see case study 1).

2. Stabilisation funds

Stabilisation funds are designed as pools of capital which governments can draw on to smooth the budget. Often, commodity-rich nations create these funds to manage revenue streams; the fund will save some of the proceeds from large influxes of revenue and pay out when commodity receipts fall below a specified amount.

Case Study 1: The New Zealand Superannuation Fund (NZSF)

The New Zealand government created NZSF (also known as NZ Super) in 2001 to build savings to defray future pension costs. As is the case in many countries, such costs are likely to rise as the population ages; as the number of older citizens increases, the number of taxpayers relative to the number of retirees falls.

The Guardians of New Zealand Superannuation, a Crown entity independent of the government, manages NZSF. The Guardians invest government contributions, along with the returns generated by these investments, to grow the capital of the fund. Withdrawals are due to begin in the mid-2030s.

As a long-term investor, NZSF can devote a relatively large proportion of its portfolio to private-market assets, taking advantage of the illiquidity premium available on such investments. For example, the fund invests in global forestry assets, transport infrastructure and real estate.

The Guardians use a reference portfolio as a benchmark against which to measure the performance of NZSF and the value added by its various active investment strategies. The reference portfolio is comprised of passive, low-cost, listed investments, split between global equities (80%) and fixed income (20%).

As of 31 March 2017, the Guardians allocated 66% of the fund's \$23.8 billion portfolio to global equities, 13% to global fixed-income and other public market investments, 4% to domestic equities and 16% to alternative investments such as infrastructure, private debt and property.

Stabilisation funds can thus help mitigate the resource curse, an economic phenomenon whereby commodity-rich countries tend to experience slower growth than comparable countries that lack such wealth. The resource curse occurs partly because energy prices are volatile. When prices are high, governments usually increase spending; when they are low, governments must tighten their belts. These fluctuations exacerbate the economic cycle.

By helping to smooth out commodity revenues, stabilisation funds can help governments avoid extreme peaks and troughs in the cycle. These funds are also used to help stabilise the value of the country's currency during macroeconomic shocks. For this reason, stabilisation funds tend to hold a large proportion of their assets in liquid investments so that they have access to capital at short notice.

3. Development and strategic funds

Since the global financial crisis, there has been a marked change in how governments use their liquid and illiquid assets. With interest rates at record lows and global economic growth sluggish, the appeal of traditional savings and stabilisation funds has diminished. Instead, many states have created development funds that form part of their domestic economic policies.

These funds follow the lead of two well-established South-East Asian SWFs, Singapore's Temasek Holdings and Malaysia's Khazanah Nasional. These funds acquire stakes in companies in strategic industries to nurture their development, promoting the growth of the wider

Case Study 2: Economic and Social Stabilisation Fund of Chile (ESSF)

The Chilean government established ESSF in 2007. ESSF superseded an older fund called the Copper Stabilisation Fund, which the government had used to save a portion of its revenues from copper exports. The ESSF inherited much of its \$2.6 billion in start-up capital from this older vehicle.

The timing was propitious. Only a year after the fund was created, the financial crisis hit, reducing demand for commodities. By drawing on the fund's capital, the government could support the Chilean economy without issuing more debt. This is one reason Chile fared better than its Latin American peers during the crash (Chile's GDP growth declined by 1% in 2008; by contrast, Mexico's fell by 4.7%).

ESSF works in tandem with another SWF, the Pension Reserve Fund, in Chile's fiscal setup. According to Chile's Fiscal Responsibility Law, ESSF receives an amount equal to the government's annual surplus once contributions to the Pension Reserve Fund and the Central Bank of Chile have been deducted. As of February 2017, the fund held \$14 billion in assets.

As a stabilisation fund, ESSF needs to keep the bulk of its portfolio in liquid securities that can be accessed at short notice. As of February 2017, ESSF held 33% of its portfolio in money-market assets; 54.5% in sovereign bonds; 8% in developed-market equities; and the rest in inflation-linked bonds.

economy and realising financial returns. Temasek and Khazanah have also been able to build portfolios of overseas assets from the proceeds of the realisation of some of their major investments, as well as using the dividends and other cash distributions they receive from their portfolio companies.

The Irish Strategic Investment Fund (ISIF), one of the more-recent development funds, neatly illustrates how these vehicles differ from traditional savings funds. ISIF's predecessor, the National Pensions Reserve Fund (NPRF), was created in 2001 to build savings for future pension liabilities, much like NZSF, and assembled a portfolio of global financial assets.

Following the government bailout of the Irish banking sector in 2008, the fund was restructured as ISIF under the auspices of the National Treasury Management Agency in 2014, with a new mandate to invest on a commercial basis to support economic activity and employment in Ireland in targeted economic sectors. ISIF's portfolio is now largely comprised of Irish investments. ISIF's recent activity includes the launch of an infrastructure development plan to finance student accommodation across Ireland and a €100 million (\$107 million) fund that will offer loans to Irish milk producers.

Case Study 3: Russian Direct Investment Fund (RDIF)

Founded in 2011, RDIF co-invests in Russian projects with expected attractive returns on investment and economic benefits to the country. It also allocates a small proportion of its assets to overseas investments alongside foreign partners.

Unusually, RDIF is designed to work in tandem with top global investors, including SWFs, acting as a catalyst for direct investment in Russia. To this end, RDIF has formed partnerships with over 20 international institutions. Several of RDIF's investment partners automatically participate in all its deals.

In 2012, RDIF partnered with the China Investment Corporation (CIC) to create the Russia-China Investment Fund, a vehicle that invests primarily in the Russian economy, with each party allocating \$1 billion to the vehicle. RDIF also has similar agreements in place with the Kuwait Investment Authority, Mubadala Investment Company, Qatar Investment Authority, Caisse des Dépôts, CDP Equity, the Korea Investment Corporation, and the Public Investment Fund of Saudi Arabia, among others.

RDIF often makes direct investments alongside more than one international partner at a time. Over 30 deals have been closed across a wide range of sectors in the five years of RDIF's investment activity, with a proportion of funds attracted from partners per each rouble invested by RDIF totalling 9 to 1.

This co-investment model enables RDIF to amplify the economic impact of its investments. As of early-2017, RDIF has invested 92 billion roubles (\$1.6 billion) of Russian government capital while over RUB 768 billion came from its coinvestors, partners and banks. RDIF has also established joint investment platforms with a total value of more than \$27 billion through partnerships with leading international investors.

ISIF shows how development funds may promote the domestic economy in a variety of different ways. They may provide financing to early-stage companies in strategic industries for instance, or buy stakes to facilitate the development of more-mature firms.

Some strategic funds will make direct investments in infrastructure, occasionally using their local expertise to leverage co-investments from peer institutions. The Russian Direct Investment Fund is perhaps the best example of this approach (see case study 3).

4. Hybrid funds

Not every SWF has a single objective. Many funds combine two or more of the functions listed above, mixing stabilisation, savings and development.

While these hybrid funds arise all over the world, and include the China Investment Corporation, the Trinidad and Tobago Heritage and Stabilisation Fund, and the State Oil Fund of Azerbaijan, they are particularly common in developing economies in sub-Saharan Africa. Many of these nations created their SWFs following the commodity super-cycle of the 2000s, which led to a boom in resource revenues.

Case Study 4: Nigeria Sovereign Investment Authority (NSIA)

In 2004, Nigeria created a fund called the Excess Crude Account (ECA), designed to manage its oil revenues for both savings and stabilisation purposes. As oil prices surged during the 2000s, ECA collected a large proportion of the government's revenues. But ECA also had a poorly-defined legal mandate, which meant its savings were subject to wrangles between the federal government and state governors.

In 2012, Nigeria launched a new SWF, NSIA, to rectify these problems. NSIA has a clearer and more-legally rigorous mandate than ECA: it is divided into separate, ring-fenced pools of capital, each of which has a different objective: a Future Generations Fund, an Infrastructure Fund and a Stabilisation Fund.

As of end-2015, the most recent date at which the NSIA disclosed the composition of its investment portfolio, the Future Generations Fund outsourced most of its capital to managers running absolute return fixed-income strategies (26.2%) and hedge funds (25.2%), with the remainder of the portfolio devoted to public- and private-equity managers. The Stabilisation Fund also allocates a portion of its capital to absolute-return fixed-income managers (36%), but devotes the rest of its portfolio to more-liquid assets such as short-duration Treasury bonds (25.5%) and time deposits (35.5%).

The Infrastructure Fund is primarily run by an in-house team and invests domestically, in projects such as bridges and toll roads, alongside commercial partners. For example, NSIA collaborated with construction firm Julius Berger Nigeria to help finance a new bridge over the Niger River connecting the cities of Asaba and Onitsha. The Infrastructure Fund has also made investments in telecommunications and healthcare.

Locking away capital for future generations is clearly inappropriate for countries with high levels of poverty or pressing infrastructure-development needs. For this reason, African countries have created innovative SWF structures that often integrate sub-portfolios dedicated to discrete objectives.

For example, the Fundo Soberano de Angola allocates a third of its portfolio to international securities such as Treasury bonds and developed-market equities, and the remainder of its assets to private-equity investments in Angola and elsewhere in sub-Saharan Africa to support “socioeconomic development”. Similarly, Botswana uses its Pula Fund, sub-Saharan Africa’s oldest SWF, for a combination of savings, stabilisation and development.

Perhaps the clearest example of a hybrid fund that separates its operations between savings, stabilisation and development objectives is Nigeria’s SWF (see case study 4).

Conclusion

There is increasing recognition that sovereign wealth funds can play an important role in national economies, especially those of developing countries. However, in practice there are significant challenges to making SWFs operate successfully in the domestic context. Policy makers should take a rigorous approach, based on best practice and using the Santiago Principles, to the ownership, structure, governance and mandate of a fund. Unless these issues are fully defined and agreed, SWFs run the risk of conflict of interest, crowding out private capital, market distortion and lack of clarity of purpose. But, given the right circumstances and stewardship, SWFs can be highly effective agents of change in national economies.

PART II: BILATERAL AND MULTILATERAL COOPERATION IN FINANCING FOR DEVELOPMENT

Where Do Muslim Countries Stand on Sustainable Development Goals

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The definition and scope of the term ‘economic development’ has gone through significant changes in the past literature. In the early literature, economic growth and economic development were synonymous terms and per capita income was considered as a sufficient measure for assessing the level of economic development. Economic growth was considered as both a necessary as well as sufficient condition for realizing economic development. Nonetheless, later on, it was realized that economic growth does not necessarily lead to economic development. Institutions and economic structures matter a great deal in determining the long-term effects of any growth strategy. Growth that raises income inequalities eventually become unsustainable and can undermine democracy and overall well-being of the society.

In recent decades, the emphasis was placed on human development and now the concept of development also incorporates environmental sustainability. This paper develops a new index to gauge the performance of Muslim countries on each of the Sustainable Development Goals (SDGs) individually and collectively.

The Sustainable Development Goals (SDGs) as successor to Millennium Development Goals (MDGs) represent a broader intergovernmental agreement to foster action on broad-based development encompassing economic development, human development and environmental sustainability. Since the SDGs are ambitious and the time-frame set for these goals is short, it is important that all-encompassing efforts are undertaken involving all sorts of institutions to make the largest leap forward. It is especially crucial for countries that are much behind the targets and need considerable effort and resources to pull themselves up to meet the targets.

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This paper develops a new index to gauge the performance of Muslim countries on each of the SDGs individually and collectively.

The benefit of using an index is that it enables us to get a representation of reality by looking at summary measures. It can be used for relative comparison and assessment of policies, actions, performance and achievement in different socio-economic contexts. Considering this need, we propose a new index that incorporates all the 17 SDGs to measure the state and progress for countries on meeting the SDGs by 2030.

The ranking of countries on the overall Sustainable Development Index (SDI) takes the weighted average sum of all 17 SDI sub-indices. The results reveal that higher-income OIC countries like Malaysia and Turkey feature in the top 10 countries in the SDI. The bottom 10 countries on SDI all include African countries along with Yemen. Even countries with rich natural resources like Iraq and Nigeria rank lower in SDI due to weak institutions. Central Asian states like Kazakhstan, Kyrgyz Republic and Azerbaijan rank higher in SDI. Once affected by persecution and conflicts, Albania and Bosnia show remarkable performance on SDI.

Geographically, a general trend that emerges is that European, Central Asian and South East Asian OIC members rank higher, followed by countries in the Middle East and South Asia and the bottom ranks are mostly filled by African OIC countries along with conflict-hit middle Eastern countries. Among the African region, countries, which rank relatively higher on SDI include Gabon, Morocco and Algeria. Among the Middle Eastern countries, Jordan and Lebanon rank relatively higher, whereas the lowest rank is held up by Yemen. Iran stands better than Iraq, which shows that wars and conflict push countries down on the list by affecting incomes, stability and infrastructure. Higher rank of Central Asian states as compared to some landlocked African countries show two things. First, the rank is not seriously dented if a country lacks in coastal areas for cross-border trade. Secondly, rich natural resources do not necessarily guarantee sustainable development as finite natural resources can lead to short-term gains in income, but due to weaker institutions, these incomes are not reinvested in technology, infrastructure, education and health. Rather, these are taken up political elite as compared to the state's development institutions.

The results show that countries with higher per capita GDP usually have lower poverty, such as the East Asian and Central Asian countries. Most of the countries standing at the bottom of SDG 1 (End Poverty) include African countries. On Hunger, the similar trend is observed. However, some of the vulnerable countries on the depth of food deficit include countries, which have relatively reasonable per capita GDP in excess of \$1,500, such as Pakistan and Sudan. On SDG 3 (Health and Wellbeing), the ranking follows closely the per capita GDP trend with some notable exceptions. Bosnia, Iran, Albania and Algeria have better standing on SDG 3. Natural resources rich countries, such as Nigeria rank very low and even lower than other poor African countries, such as Burkina Faso, Mozambique and Benin.

On SDG 4 (Inclusive and Quality Education), Central Asian countries outperform East Asian countries, such as Indonesia and Malaysia. Jordan, Lebanon and Iran rank relatively better

from the Middle East. Gabon, Algeria and Egypt rank better than other African countries. Bangladesh despite comparable or lower per capita income ranks higher than Pakistan, Sudan and Nigeria. On SDG 5 (Gender Equality), as many as four African countries feature in the top 10 countries. Conservative countries like Pakistan, Sudan and Yemen rank lower on SDG 5. On SDG 6 (Universal Access to Sanitation), the top two countries include Malaysia and Turkey. Water Scarce African countries rank lower on SDG 6. On SDG 7 (Universal Access to Energy), some relatively low-income countries such as Mozambique, Pakistan and Uganda rank higher. Furthermore, the Middle Eastern countries like Jordan and Yemen rank lower.

On SDG 8 (Growth and Employment), some African countries rank higher due to the lower unemployment rate and high employment to population ratio despite lower GDP per capita, which has one-third weight in SDG 8 sub-index. Bosnia having high GDP per capita, but lower employment to population ratio and high unemployment rate ranks low on SDG 8. On SDG 9 (Infrastructure, Industrialization and Innovation), Central Asian, East and European countries rank higher as compared to South Asian and African countries.

On SDG 10 (Reduce Inequalities), some countries with higher per capita income are found to have higher income inequities as well, such as Turkey and Malaysia. African countries like Benin, Guinea-Bissau and Mozambique suffer from both lower per capita incomes as well as high inequities. Pakistan and Bangladesh feature in top 10 countries with relatively lower income inequities as compared to other populous countries, such as Indonesia and Nigeria. On SDG 11 (Sustainable Cities), a similar trend is observed in higher-income countries. Malaysia, Jordan and Turkey rank higher, whereas African countries rank lower. Among the populous countries, Indonesia ranks slightly better than Pakistan and Bangladesh.

On SDG 12 (Sustainable Consumption and Production), African countries rank slightly better than the rest as compared to the trend in other indicators. Among the populous countries, Bangladesh ranks better than Indonesia and Pakistan. In SDG 13 (Combat Climate Change), African countries rank better than the Middle Eastern countries like Iraq, Lebanon, Jordan and Yemen. Higher-income countries like Turkey and Malaysia also rank lower on SDG 13. On SDG 14 (Conserve Marine Resources), Bangladesh ranks better than Indonesia, Malaysia and Maldives. Water-scarce countries usually rank lower on SDG 14. On SDG 15 (Protect Land Resources), Malaysia and Turkey rank relatively higher. Poor income countries with lower per capita GDP rank lower except for Morocco, Egypt and Iran, which feature in top 10 countries on SDG 15.

On SDG 16 (Promote Peaceful Societies), some African countries perform better than others, such as Togo, Benin and Uganda all featuring in the top 10 countries on SDG 16. Pakistan and Jordan rank lower despite having relatively reasonable per capita GDP. On SDG 17 (Strengthen Cooperation among Countries), it is found that OIC countries are open to ODA, Aid and other development assistance provided in the form of money and social intermediation. As compared to African countries, Arab countries and South Asian countries relatively perform less well.

Thus, the policy implications of the results highlight that the poorer countries would require enough development assistance in order to fund the development projects. The priority in assistance should be given to health, education, hunger and creating decent work opportunities by tariff and non-tariff trade concessions. The role of conventional and Islamic development finance institutions is pivotal in funding the targeted development programs timely and transparently.

Finally, the role of Islamic finance is also vital for meeting the SDGs. Islamic social finance institutions like *Zakāt* and *Waqf* can contribute towards scaling up efforts in commercially non-viable, but socially vital projects and programs. There is much potential for Islamic finance to promote sustainable economic development through such approaches as widening access to finance (including microfinance), financing infrastructure projects, and expanding the reach of *Takaful* (Islamic insurance).

The Role of Development Financing Institutions in Achieving SDGs: The Case of Turkey

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The Development and Investment Bank of Turkey (TKYB) was established as the State Industry and Labourer Investment Bank (Devlet Sanayi ve İşçi Yatırım Bankası A.Ş.) in 1975 under the Decree in Force Law No 13. As its name implies, the primary function of the Bank was to support workers' initiatives to build and operate companies with the objective to utilize savings of expatriate workers. Having been encouraged by the success of this initiative the restricted scope of the Bank was broadened to include wider developmental issues, and the Bank's name was changed to Development Bank of Turkey in 1988. In 1989, and again by a decree of the Higher Planning Council of Turkey, all of the assets and liabilities of the Tourism Bank (T.C. Turizm Bankası A.Ş.) were merged to Development Bank of Turkey. On October 14, 1999 the law with number 4456 was ratified by General Assembly of Turkish Republic to further institutionalise the Bank. Finally, the law of establishment has been renewed and investment-banking activities have been added to the scope of operations and Law No 7147 has been published on 24th October 2018 dated official gazette. The Bank's main shareholder is Undersecretary of Treasury with a percentage of 99.08%. Remaining shares of 0.92% are traded at Borsa İstanbul

During the 80s and 90's the Bank was the main actor for implementation of grants to SMEs and incentive loans and special regional development programs. First contact with international finance institutions started in the beginning of 2000s with International Bank for Reconstruction and Development (IBRD), European Investment Bank (EIB) and the Council of Europe Development Bank (CEB). First renewable energy line was received from IBRD in 2004 and apex implementations started in 2007. In the year 2008, the works aiming at making the bank gain ISO 14001 environmental management systems was initiated. The TKYB has signed

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new financing agreements with Islamic Development Bank (IsDB), Japan Bank of International Cooperation and the German KfW in recent years.

The main aspects of Development Financing Institutions can be made as a long list. However, the most important ones are firstly the ability of creation of favorable funding with long maturities and low rates and secondly catalyzing effect of financing projects, which are not so attractive for the other financial institutions aiming profit maximization.

The Sustainable Development Goals are declared in September 2015 and put in affect in the beginning of 2016. The first and seventh goals are as follows:

SDG-1: End Poverty in all its forms everywhere

SDG-2: Ensure access to affordable reliable sustainable and modern energy for all

I will give two examples that the Development and Investment Bank of Turkey implemented regarding these two goals:

Second Access to Finance for Small and Medium Enterprises Project (SME II)

Development and Investment Bank of Turkey had been assigned with a mandate of financing of uncompleted investments in certain less developed regions of Southeast Anatolia by channelizing approximately USD 100 million from Government budget between 1999 and 2001. The program was called “Emergency Support Program” and 525 SMEs have been financed for investment and working capital needs under this program. By implementing the program, more than 9,000 jobs have been created or maintained. *With this experience and know how gained, TKYB has implemented SME II program with a USD 100 Million financing received from IBRD (the World Bank) within its apex/wholesale banking operations.*

Apex banking (wholesale banking) applications that are widespread practices of development banking has taken its place in Development Bank of Turkey’s product set as a major lending tool in serving small size firms. In this model, the TKYB provides financing to companies through financing intermediaries including commercial banks and leasing companies to use them as a distribution channel. The primary objectives of these projects are supporting job creation and enhancing competitiveness of the SMEs.

The TKYB has completed many apex/wholesale banking programs. One of the successful applications of wholesale banking facility at the TKYB is the program of the IBRD named “Second Access to Finance for Small and Medium Enterprises Project (SME II)”. The main objective of the project is to increase SMEs’ access to medium- and long-term finance, in turn contributing to improve their growth. By providing SMEs with access to credit through credit lines, the project was designed to help increase their sales and job creation.

With the completion of the project implementation, 134 SME projects from several different sectors have been financed and 1264 new jobs have been created while having 8,678 jobs preserved. The SMEs, financed through this project, have achieved 80% increase in exports and 30% increase in sales revenues in average.

In conclusion, the IBRD SME-II project proved to be beneficial for all the stakeholders and it is instrumental for TKYB for capacity building in wholesale banking activities. It has provided an opportunity of cash flow based loan implementation to be executed by the intermediary financial institutions. Regarding SDG-1, the IBRD-funded SME II program helped SMEs to gain access to finance and contributed to economy by creating employment opportunities.

Renewable Energy and Energy Efficiency Projects CO2 Reduction

Having appropriate lines with many of the international finance institutions including the World Bank, the European Investment Bank (EIB), the Japanese Bank for International Cooperation (JBIC), the Islamic Development Bank (IsDB) and the German Development Bank (KfW), the Development and Investment Bank of Turkey (TKYB) has financed many renewable energy and energy efficiency projects. TKYB has been supporting Turkey's progress in line with the government plans. Over the last 15 years, it has been allocating loans to renewable energy and energy efficiency projects of private sector enterprises in order to mobilize the private sector savings for utilization of renewable sources of the country.

Turkey's energy supply has been mostly provided through imported fossil fuels for many years. This has been a burden on economy as well as adding CO₂ emissions to atmosphere. On the other hand, Turkey has enormous potentials for generating hydroelectricity, wind, geothermal and solar energy. Government has made legislative arrangements in order to benefit from the existing renewable potential of the country. TKYB, being a state owned development and investment bank, has taken a substantial role in the financing part of this initiative.

In this scope, TKYB, with its deep expertise in project evaluation, has evaluated many projects and allocated loans to renewable energy and energy efficiency projects. The Bank has disbursed the loans to these projects by closely following up the progress of the projects at site with its experienced staff. In this way, 245 projects with 1,830 MW power generating capacity has been credited. As of October 2018, approximately 1,230 MW power plant projects have been financed and 225 MW of which has been financed by IsDB facilities. Financing of projects with approximately 600 MW is ongoing.

As of October 2018, the loan allocation made for approximately 428 projects with 2,802 MW installed capacity. Approximately 1,230 MW power has been financed by TKYB. The annual economic impact of these projects is approximately 4,800 GWh, preventing the equivalent of 2,700,000 tons of CO₂ greenhouse gas emissions per year. Financing of renewable energy and energy efficiency projects contributed to country economy and development regarding the SDG-7.

Creating New Platforms of Cooperation: The Case of D-8 Organization

Dato' Ku Jaafar Ku Shaari¹

Secretary General, D-8 Organization for Economic Cooperation

According to the IMF, since 1990s only a handful of countries managed to advance to the level of developed economies. Out of thirteen countries to achieve that level, eight are located in Southern and Eastern Europe whereas three of them that are located in Asia are city and island states, whose developmental challenges and aspirations differ drastically from those of larger countries. This forces us to make a reality check and rethink the fact that despite the achievements here and there, developing nations did not manage to make the overall leap forward so far. It points out to the fact that development challenges have been rather persistent. It goes without saying that problems of persistent nature call for persistent solutions, which I believe is achievable once we ensure access to ethical, responsible, credible and sustainable finance as a means to improve South-South cooperation agenda.

The noble idea of South-South cooperation has been the cornerstone of collaboration among developing nations to surmount challenges to socioeconomic development. It aids nations of “Global South” in enhancing their creative capacity to find innovative solutions to economic obstacles and provides a framework for multilateral cooperation. Above all, it aims at providing a common, vocal and stronger stance against the pending economic inequalities in the global economic system.

D-8 as an Important Actor in Promoting South-South Cooperation

The D-8 Organization for Economic Cooperation is an intergovernmental organization founded in 1997 by eight developing countries namely, Bangladesh, Egypt, Indonesia, Iran, Malaysia, Nigeria, Pakistan and Turkey, all of which are members of the Global South. The aim of the

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Organization is to increase economic cooperation among its Member States in order to boost economic growth and sustainable development and promote the well-being of our citizens.

Since its establishment, D-8 countries have advanced to an economic powerhouse of 1.1 billion citizens, USD 4 trillion of combined GDP, USD 1.5 trillion of exports and USD 110 billion of intra-trade. The level of economic achievement is astounding. Yet, our countries are still confronted by multifaceted challenges to socioeconomic development. As the D-8 Secretariat, we acknowledge these challenges and work untiringly towards creating new and innovative solutions in all areas of cooperation.

There is no gain saying that one of the major obstacles to socioeconomic advancement is access to reliable and sustainable finance. As the Secretariat, we prioritize this issue and focus our attention to creating new sources of finance for the Member States. One such funding mechanism initiated by the D-8 Secretariat is the D-8 Project Support Fund. The Fund aims at financing prefeasibility and feasibility studies of projects that bear significance for the economic and social endeavours of our Organization. We have initiated discussions with UN agencies such as FAO and UNCTAD in order to make best use of the fund as a leverage for agricultural and trade projects.

At this juncture, I also would like to elaborate on our MoU with the Islamic Development Bank (IsDB), a scheme that has granted us access to one of the world's leading financial resources. The MoU envisages cooperation in areas of implementation of Joint Projects and SME finance as well as allocation of scholarships through IsDB Scholarship Programme and exchange of knowledge and information. We are also actively encouraging our Member States to utilize the science and innovation platforms of IsDB namely "Engage and Transform" networks.

Apart from these existing platforms, we are initiating talks with national development agencies to delve into the possibilities of extending micro-finance to young entrepreneurs. We are also assessing alternative methods of SME finance in our countries including the highly effective method of crowdfunding and alternatives tools of Islamic finance which have been attracting growing attention not only from Muslim but also non-Muslim countries.

Global Development Agenda and International Development Cooperation

We all acknowledge the Addis Ababa Action Agenda of 2015 as the pinnacle of our efforts in building a global framework for financing development in Global South. The Action Agenda identifies seven priority areas, two of which I want to put a special emphasis on. The first action refers to the mobilization and optimal use of domestic financial resources. South-South cooperation, above all, is very much interlinked with the self-reliance and economic sovereignty of the countries.

In this respect, I would like to endorse the laudable achievements of development agencies of the D-8 Member States. The more we deepen our dialogue with these agencies, the better we comprehend their immense potential in assisting development finance, changing the lives of even the most disadvantaged people in the remotest geographies. As D-8, we are recognizing

development agencies as major stakeholders and aim at furthering the cooperation in between.

The second pillar of action I want to highlight is the international development cooperation, which complements domestic efforts and aims at endowing countries with scaled-up international financial support. This, in return, refers to the provision of credible and sustainable finance to the countries of Global South as a means to assist them in surmounting the constraints posed by the national budgets. We as D-8, use all tools at our disposal to channel additional sources of finance to Member States and call international stakeholders to join us in our efforts with their projects and funds, as part of the noble initiative of Corporate Social Responsibility.

Creating New Platforms of Collaboration

Access to sustainable finance is an integral and indispensable part of development agenda. However, on its own, finance does not guarantee results. It has to be complemented by a common vision among developing countries to advance, evolve and rise in unity. As the South-South cooperation agenda suggests, opening of additional channels of communication, strengthening economic integration and creating multiplier effects of technical cooperation lies at the heart of this process. In line with these objectives, the D-8 Secretariat creates new platforms of collaboration among Member States in order to capitalize on the best-practices, know-how and the accrued expertise.

One very recent attempt is the initiation of a tripartite discussion among D-8, FAO and IsDB on agribusiness and global value chains. Our attempt is to investigate the agricultural potential in Member States, seek ways to better integrate our companies to the international markets and eventually move our countries up the ladder of value chains. We primarily aim at capacitating micro and small sized enterprises of agro-industry with the knowledge to access finance and assist them in integrating to the global value chains. We hope that this initiative will foster flow of information among the small-scale shareholders, providing them with the unmatched expertise of FAO and IsDB.

Recognizing the crucial role of foreign direct investment in financing development in D-8 Member States, we have initiated talks with UNCTAD to hold a workshop that aims at empowering D-8 countries in order to modernize their existing stock of old-generation investment agreements. This is in line with the Responsible and Sustainable business models that are being endorsed today. We hope that through this tailor-made workshop, we will be able to familiarize Member States with the new generation investment policy tools, advance their knowledge on optimal policy design and empower them to obtain fair and much-deserved share from international trade.

Apart from these, we are initiating talks with peer institutions and development agencies to foster cooperation in new areas such as e-commerce, block-chain technology and renewable energy. We hope that through our efforts, we will be able to cater for the needs of our

Member States and help them surmount the “seemingly persistent” challenges to socioeconomic development.

Determination, ambition and clear goals always give one a head start, especially in economic affairs. With this in mind, D-8 has formulated the Decennial Roadmap 2020-2030 in line with the lofty targets set by United Nations Sustainable Development Goals. In this pivotal roadmap, among other things, we reiterate our commitment to promote South-South cooperation as a means to enhance the development agenda of our Member States.

I would like to remind that D-8 Member States are forecast to be in the list of the world’s top 24 economies in 2050 and we all together will be the world’s third biggest economic power with a combined GDP of USD 38 trillion. This will only be possible through the combined and resolute effort of our countries, and the adoption of new and fresh perspectives by our Member States in particular and the developing world in general.

New Partnerships for Joint Humanitarian and Development Action

Rashid Khalikov¹

Assistant Secretary-General, United Nations Office for the Coordination of Humanitarian Affairs (OCHA)

The 2030 Agenda for Sustainable Development calls upon us to do more than just meet humanitarian needs year after year. We often focus on the “D” of development in the SDGs; But from a humanitarian perspective, the “S” of Sustainable that is a true game changer for humanitarians. The 2030 Agenda calls on all actors to ensure that development gains in crisis contexts are not rolled back. The commitment to “leave no one behind” and to reach the furthest behind first brings to fore the special needs of the more than 130 million people in dire need of humanitarian assistance to date. There will be no sustainable development if those at the frontlines of war and climate change, forcibly displaced people, migrants, children in conflict settings are not put at the centre of global action. This is a shared responsibility of both humanitarian and development actors.

As it is expected that the majority of the world’s poor people will live in fragile and conflict-affected countries by 2030, it is paramount to advance our global commitments made in Addis on Financing for Development. Ensuring development outcomes in hard to access areas, where most of those furthest behind will live is essential to transform the 2030 Agenda into reality for the 130 million people or so affected by humanitarian crises worldwide.

At the World Humanitarian Summit, the UN Secretary-General outlined a bold *New Way of Working* to transcend the decades-old humanitarian and development divide, by setting collective outcomes to reduce need and vulnerability over time, as set out in the Agenda for Humanity. This vision recognizes the 2030 Agenda as a common framework for results for both humanitarians and development actors.

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To operationalize collective outcomes, we need to ensure that a new financing architecture, aligned with the commitments of financing for development, is created behind the achievement of each collective outcome in a given context. For that, we need to be reaching out to new actors, including Islamic Social Finance and Awqaf. The World Humanitarian Summit emphasized the potential contribution of Islamic social financing instruments. Some experts have estimated that Islamic philanthropy could amount to between USD 250 billion and USD 1 trillion each year.

Financing and operationalizing collective outcomes require a new partnership for joined up humanitarian and development action. While the UN coordinates about 50% of humanitarian assistance across the world, we only channel 10% of development financing. To transform the *New Way of Working* in reality, we need new and traditional bilateral donors, development banks, philanthropists, the private sector and individuals to come together around collective outcomes to reduce need, vulnerability and risk, while accelerating progress towards advancing the 2030 Agenda in crisis contexts.

The OIC can be a strong partner in this endeavour. At the WHS Anniversary event in 2017 in Istanbul, the OIC represented by Ambassador Amb. Hesham Yousef, ASG for Humanitarian Affairs noted the need for new partnerships with regional and global networks. In order to make collective outcomes a reality, we need new partnerships with institutions such as the OIC, based on your comparative advantages in mobilizing political will across the Islamic world.

The Famine Action Mechanism (FAM), co-owned by the World Bank and the United Nations, is a good example of collaboration between the development and the humanitarian communities, not just to end famine, but also to achieve the goal of “Zero Hunger” by 2030. The risk of famine continues to threaten millions of people. In 2017, 124 million people across 51 countries faced crisis-levels of acute food insecurity or worse, requiring urgent humanitarian action—an 11% increase compared to 2016.

Despite strong evidence that earlier interventions save lives and are significantly more cost-effective, financing often follows as opposed to precedes crises. Investments in resilience remain under-resourced, especially in areas most at risk of famine. A global platform to link early warning, finance, and implementation arrangements is needed to increase the impact of international famine mitigation efforts in high-risk countries. FAM will use state-of-the-art technology to help detect and react to risks much faster. FAM will mobilize public and private financing to support upstream prevention/ preparedness to severe food insecurity (category 1; IPC² 2-3), and rapid release of funding for an early response when needed (category 2; IPC 4-5).

² *Integrated Food Security Phase Classification*

Models and Practices Promoted and Implemented by the European Union in Financing Development

Dr. Maria-Francesca Spatolisano¹

Head of Unit for International Organisations and Development Dialogue, European Commission – Directorate-General for International Cooperation and Development (Nov. 2018)

The European Union has many models and practices promoted and implemented in financing development and I am very pleased to present some of them. First of all, one premise: in the EU, we do not speak of development anymore, but only of sustainable development, particularly since 2015 and the adoption of the SDGs and the universal, great agenda for change they represent. Because it is an ambitious agenda, we are all well aware, at the same time, that the financing needs to achieve the Sustainable Development Goals are daunting. We are speaking of several trillion dollars, mostly missing each year.

This means that official development assistance from traditional donors alone cannot provide. International public finance and in particular official development assistance is crucial to help developing countries reach the SDGs; but it is limited. In 2017, net official development assistance (ODA) by members of the OECD Development Assistance Committee (DAC) even slightly decreased, compared to the previous year.

The magnitude of the challenges requires action by all to promote sustainable development. The growing role of emerging economies, that are increasingly active in the international scene and in developing countries, is more than welcome.

While we should continue to increase aid, we will need to work together to shape policies, creating the right set of incentives for all actors. Effective mobilisation of all possible

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stakeholders, including the private sector and effective cooperation among all will be key to achieve sustainable development.

We in the EU have fully reflected the 2030 Agenda and the Addis Ababa Action Agenda into our development policy, by adopting a policy document, the European Consensus on Development, in June 2017, which guides EU member States and EU institutions alike.

In this context, we have stepped up our efforts to promote private investment and innovative instruments, as we all know that we have limited public resources and these should act as a catalyst for further financial flows.

Partnerships can only be really effective in a multilateral world. We need to continue advocating for multilateralism, and in particular for multilateral trade in international *fora* and other global issues.

Main Tools to Attract Private Capital Flows and FDI

Having set this overall picture, in which we trust people can flourish best, I will briefly discuss the main tools to attract private capital flows and FDI, which includes blending and the European Investment Plan.

Blending

The EU has been seeking to encourage more private investment in developing countries for over a decade. We have done so, mainly through programmes that combine EU grants with loans or equity from public financiers and private investors; and they have had considerable success. In 2016 alone, the EU contributed almost EUR 300 million to blending projects, leveraging a total investment of over EUR 2.3 billion. These blended projects have recorded significant results, for instance in increasing access to electricity or improving water supply and sanitation services.

Our key principle is additionality; we ensure that EU funds bring about development gains that would not have come about through the private sector alone.

The European External Investment Plan

To scale up these efforts, the EU launched the European External Investment Plan last year. In line with the 2030 Agenda, the Plan aims to bridge the gap between sustainable development needs and available financing, by providing viable business opportunities for public and private investors, targeted at sustainable development. It is our largest ever investment programme for Africa and the Neighbourhood, aiming to raise EUR 44 billion in private and public investments by 2020 (two years left), including for the most fragile countries.

A major advantage of the Plan is that we involve more than a dozen European and International Development Financial Institutions. They have an important expertise in the field and key sectors of the economy. This way the EIP brings synergies and stimulates innovation, while at the same time reducing risks and unlocking private investment.

One of the key innovations of the Plan is a new guarantee that significantly lowers the perceived risk and can generate billions in private investment. The guarantee comes on top of traditional financial blending and the Plan also puts in place technical assistance to help in particular with the preparation of projects. This way, we aim to generate environmentally and socially sustainable projects, create decent jobs, functioning markets and balanced growth, and open up new opportunities for women and youth. Investment is channelled mostly in sectors such as access to finance for micro, small and medium enterprises, energy and connectivity, cities, digital, environment and agriculture.

The Plan also promotes an enhanced structured dialogue with business and governments in partner countries to improve investment climate by helping identify and address investment constraints in key economic sectors, notably through the Sustainable Business for Africa platform.

In July, we launched the first 12 projects, which will be benefitting from the EFSD guarantee tool and which are expected to leverage EUR 8–9 billion, since we accept to cover a wide range of risks, which would otherwise have prevented investors to go into these countries into these sectors. The new guarantee portfolios allow us to address our key objectives and bring significant private investments into challenging environments.

Talking of impact, here are some examples of the first guarantees under consideration:

- **The NASIRA Risk-Sharing Facility** led by the Dutch Development Bank. With EUR 75 million from the EU, this risk-sharing facility is expected to generate a total investment of up to EUR 1 billion for projects by small and medium enterprises. It will benefit people who currently have difficulty in borrowing money at affordable rates, such as internally displaced people, refugees, and returnees, as well as women and young people aged 18-30. It aims to create or support 800,000 jobs in Africa.
- **The DESCO financing programme** led by the African Development Bank. The programme will help bring solar power-kits to thousands of homes and clean electricity to an estimated 3.5 million people in Sub-Saharan Africa (in particular in the Sahel region). This will be done by offsetting some of the risks that local banks perceive in financing solar power.
- **The European Health Guarantee Platform for Africa** is yet another example, led by the European Investment Bank and engaging the Bill & Melinda Gates Foundation. It will result in better, cheaper healthcare and diagnostic services for people on low incomes. The idea is to mobilise investment from private providers in international-standard laboratory facilities, to provide timely, cost-effective and accurate diagnostic services for diseases, such as tuberculosis, HIV and malaria.

In conclusion, the European External Investment Plan is an innovative game-changer and the impact on people and their everyday life in developing countries is extremely high. Alone in

Africa, we should help create 10 million jobs in the next 5 years, thanks to our EU-Africa Alliance, which is about boosting investments and creating jobs, in particular for youth.

The European External Investment Plan can address market failures and set into motion market development. By doing so, it allows us to carry out sustainable and inclusive development projects, which otherwise may not be possible or would be significantly smaller.

Building on our experience with the European External Investment Plan, the Commission has recently proposed a 30% increase in spending on external action in the next European Multiannual budget, which is quite substantial. We also foresee to have a “European Fund for Sustainable Development *plus*” which will use grants, technical assistance, blending, guarantees and financial instruments to promote investment across the whole of the developing world. We believe it will be possible to mobilise up to EUR 500 billion in investment between 2021 and 2027, the seven years of our Financial Framework. This is more than 10 times the amount leveraged with our first phase.

Contribution of Different Sources of Financing to the Achievement of the SDGs

My second point is about how can the different sources of financing contribute to the achievement of the SDGs. Boosting private sector investment with innovative instruments is good, but it is not the whole story.

The different financial flows (official aid, domestic resources, FDIs, remittances, zakat etc.), which can help bring about sustainable development, all have their comparative advantages.

Private business activity and investment are major drivers of economic growth and employment. However, they will tend to invest in SDG areas where the business case is strong – such as energy, infrastructure and climate action.

To be able to deliver on all our policy objectives, public funding will, on the other hand, be more effective in other, less “bankable” sectors, such as fighting inequalities, inclusion of ethnic minorities or expansion of social protection.

There are some areas where contributions by the private sector cannot and should not replace required public involvement; and the delivery of certain services must remain in public hands. For instance, where there is a need for equitable, guaranteed and sustainable provision of certain services. First example to come to mind is the justice sector.

There are other fields where the private sector might not naturally be attracted to, but where international development cooperation can help de-risk investments and operations, in higher-risk environments and sectors in the Least Developed Countries and post-conflict countries. These currently receive just 6% of all foreign investment towards developing countries. This is the essence of the guarantee under the European Investment Plan. With the blending instruments of the Commission, I am happy to say that 30% of the total financing under our blending facilities go to LDCs.

Then there is the importance of non-financial means of implementation: sound public policies.

The public sector has a strong responsibility when it comes to setting and implementing good policies and standards. Public policies set the enabling environment and the regulatory framework for private sector investment and activity. Public intervention can help foster alignment of private business activity and investment with sustainable development.

For instance, the goal of the new European Commission's Action Plan on financing sustainable growth for a greener, resource-efficient and more sustainable economy is to further connect finance with sustainability.

More globally, the EU promotes a responsible engagement of EU companies in developing countries. The EU Corporate Social Responsibility (CSR) strategy provides a good basis for this engagement. The Commission encourages companies to adhere to international standards. The EU is also committed to improve the transparency of extractive industries and supports initiatives such as Extractive Industry Transparency Initiative (EITI), the Kimberley Process, and the EU Forest Law Enforcement, Governance and Trade (FLEGT) Action Plan.

Through our budget-support-programmes and other instruments, we promote good governance and sound public financial management in partner countries. We are keen to support partner countries in developing sound and effective policies and ambitious standards, through both policy dialogue and technical cooperation, and we do so in all the areas in which we extend support, be it primary education, food security, energy policy etc.

Measuring Resources for Sustainable Development

Finally, my presentation would not be complete, especially in this report edited by the SESRIC, a statistical excellence Centre, without a word on measuring resources for sustainable development.

The EU supports Total Official Support for Sustainable Development (TOSSD) as a new statistical measure for a new global agenda, the SDGs, as it provides a more comprehensive picture of resources for sustainable development. It supports the international community's efforts to achieve the 2030 Agenda and the Addis Ababa Action Agenda and is being developed by an international task force, co-chaired by the EU and South Africa and supported by the OECD.

This international task force is made up of members from different horizons, which helps bring on board experience and knowledge of a wide range of actors. It is an inclusive and transparent process, in line with the recommendation in the AAAA by the international community. The task force is also engaging with CSOs and regional consultations are also envisaged. The SESRIC is already a member of the taskforce, as well as Bangladesh, Nigeria and Tunisia.

TOSSD can give more visibility to the activities beyond ODA – such as non-concessional finance, mobilised resources from the private sector, emerging donors' flows, south-south cooperation

and technical cooperation, support for peace and security beyond strictly UN peacekeeping activities.

It should also help to give more visibility to what you are doing and what we have been hearing about these last two days, but which is not always valued enough. It is foreseen to have specific data on Islamic finance, so we believe it would be in the interest of providers of Islamic finance to report to TOSSD. Moreover, by increasing transparency, TOSSD can help us to coordinate our activities and in our dialogue with the partner governments – as well as providing useful information for our partners.

The Task Force has made enormous progress to develop TOSSD and the draft reporting instructions exist for the Pillar on Cross-Border Flows. Discussions are starting on the second pillar - Development Enablers and Global Challenges. We strongly believe that TOSSD can be useful for recipient countries as well as providers, whether they are traditional or so-called "emerging donors". The instrument is flexible enough to serve the needs of many actors.

Initiatives and Partnerships for Financing Development within the ECO Region

Dr. Hüseyin Avni Bıçaklı¹

Assistant Secretary General, Economic Cooperation Organization

The Economic Cooperation Organization (ECO) is an inter-governmental regional organization established in 1985. It comprises 10 member states; namely Afghanistan, Azerbaijan, Iran, Kazakhstan, Kyrgyzstan, Pakistan, Tajikistan, Turkey, Turkmenistan and Uzbekistan, all of which are also the members of the Organization of Islamic Cooperation (OIC) and the Islamic Development Bank (IsDB). As one of the biggest regional economic groups in the world, the core objective of the ECO is to upgrade welfare and prosperity for its people and enhance sustainable development in our region.

With 10 member countries, covering a land area of over 8 million square kilometres, the ECO region enjoys an incomparable geographical location carrying the corridor status between large markets and an abundance of rich and varied energy resources, extending from China to Europe, from east to west, and from Central Asia to the open seas of the Middle east from north to south. The ECO region is a market comprising of 480 million people with a total trade volume of USD 733 billion value in 2017. The region as a whole nearly doubled its GDP to almost USD 1.9 trillion in the first 15 years of the 21st century.

The ECO's scope of activities now embraces a range of fields with direct and indirect impacts on the social and economic development of individual Member States and the ECO Region as a whole. These includes, among others, trade, transport, energy, agriculture and food security, environment, health, drugs control, and disaster risk reduction.

In recent years, the region attracted growing international attention with the new projects revitalizing the ancient Silk Road, a trans-Asian trade route that connected East and West together. Facilitating long-distance commercial activity, the Silk Road not only helped in

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boosting trade volume, but also served as a conduit for the dissemination of ideas, knowledge, technologies and culture.

Located in such a very strategic region, the ECO is prioritizing sustainable economic development of its Member States through reducing trade barriers and enhancing intraregional trade, enhanced role of ECO region in world trade and its gradual integration with the global economy; development and integration of transport and communications infrastructure within ECO with the world; effective utilization of agricultural and industrial potential; mutually beneficial cooperation with regional and international organizations.

Economic Performance of the ECO Member Countries and Intra-Regional Cooperation

In 2017, the ECO Vision 2025 was adopted to pave the way to a territory of integrated and sustainable economies to realize above mentioned objectives and determined the ways that ECO will follow in the coming decade. Since its establishment in 1985, the ECO paid special attention to work with other international bodies, including the IsDB, ITC and OIC. It has signed 48 MoUs with these partners, including the one we signed with SESRIC in 2018.

The ECO's share in global trade has been hovering around just 2% in relation to ECO region's population of 6.2% of world population. Intra-regional ECO trade accounts for 7.3% of the total trade of the ECO member states. As for the FDI inflows into the ECO region, its share in global FDI flows decreased from 2.5% to 2% between 2000 and 2015. During the period 2000-2015, the total GDP of the ECO countries is more than doubled. Azerbaijan, Turkmenistan, Tajikistan, Uzbekistan and Kazakhstan have all experienced over 7% growth rate.

According to the UNDP development indicators, most of the ECO member countries are ranked among the less developed countries. The region's dependency on natural resources, rural population and rural employment is considerably high. In 2015, number of under-nourished people in the region was about 53 million, almost 12% of the population.

The ECO is committed to increase the cooperation among the member states in different areas to shift upwards the well-being of the countries and sustainable development of the region. In this regard, trade, transport and energy are the sectors it has focused its attention recently.

Initiatives and Partnerships for Financing Development within the ECO Region

The ECO is now involved more than ever in creating sustainable frameworks for energy cooperation. It strives for building up diverse and resilient energy architecture in the ECO region via transformation to sustainable energy. To accomplish this goal, we are pursuing proactive cooperative policy with other international institutions. All of these efforts need focused attention by all stakeholders, notably multilateral institutions.

With this in mind, the ECO has recently been engaged with the UNIDO in the project of establishment of ECO Clean Energy Centre. It is noteworthy that this Centre will act as a catalyst and a think-tank in renewables and energy efficiency, and thus support transformation to sustainable energy in the ECO Region.

The ECO Secretariat continues its engagements with other potential international donors for fund-raising of this mainstream project of the ECO in the energy field. We would warmly welcome if the IsDB or any OIC Member States could express their interest in supporting this pivotal effort, given the fact that the scope of the subject project is fully in line with IsDB's energy priorities.

The financing of projects that target on bridging huge gaps in access to electricity is also of great significance. In this vein, the IsDB or any OIC Member States could step up further their financing to spur electricity access. Specifically, the establishment of ECO Regional Electricity Market (REM), as one of the crucial ongoing project proposals of the Organization along with the ECO Clean Energy Centre are sought to address, among others, the subject gap in the ECO Region.

The global environmental challenges have immensely increased impacts on our region. Realizing this grim situation, ECO has recently launched "ECO Land Care Program (2018-2030)" with a view to cope with incessant regional challenges of land degradation; desertification; land use, management and conservation, and formulate future regional roadmap. Beyond the technical supervision of the project implementation, a key component of the project is the need to scale up financial support from the bilateral/multilateral available funds, which will have important implications on project's overall success.

In the transportation sector, the ECO provides support to the projects that will facilitate the interconnection among the countries of the region themselves and the region with different parts of the world. The ECO supports important projects such as the commercialization of the KTI (Kazakhstan-Turkmenistan-Iran) railway. Investing in Agriculture & Industry can boost economic growth of the region through increasing productivity.

In trade and finance sector, ECO's collective endeavours are to lay down the necessary framework for investment opportunities. On trade, the most important initiative of the ECO is the ECOTA agreement, which will facilitate the economic integration of the countries of the region.

Regarding the financing of regional development ECO has also established the ECO Trade and Development Bank (ETDB) (ECOBANK) to meet the financing needs of the countries of the region which provides ample opportunities for investors. Primary objective of the Bank is to provide financial resources for projects and programmes in Member States. The sectoral focus of the Bank is Infrastructure, Manufacturing, Agriculture, Energy, Transport & Communications.

Regarding the south-south cooperation, the ECOBANK launched a new mechanism to enhance cooperation and mobilise resources under the title of "ECO Regional Partnership Forum" at the end of 2017. The main aim of this mechanism is to promote cooperation of members to identify development projects. It also aims to support innovative ways and mechanisms to encourage joint investments. Furthermore, this mechanism is to review the trends in international development cooperation and financing.

A regional program of the IsDB Group that is aimed at supporting cooperation efforts of its member countries in Central Asia for enhancing their competitiveness, increasing trade and economic growth is the "Special Program for Central Asia", (SPCA). This program may offer ECO Countries in Central Asia valuable projects with high regional impacts.

ECO and IsDB has a long history of working closely to increase the living standards of the people and sustainable development since 1990s. There are three MOUs signed between IsDB and ECO. We also have special cooperation and joint Project on implementation of ECO-TTFA agreement signed in 2009. IsDB provided technical assistance to ECO. In Road and Railway sectors these resulted in the ECO Railway network development plan; Study on 'third party liability insurance' during transit transport; and finally, Feasibility study on customs transit provisions under TTFA & facilitation at border crossing points. This study will be implemented in 2nd phase for harmonization of custom provisions at ECO level.

The cooperation between the ECO and IsDB is open to cooperation in other dimensions as well, as in the case of ongoing project of Joint IsDB/UNECE initiative on Transport GIS mapping of ECO Region countries. Another good example of collaboration between ECO & IDB is on social welfare. Since ECO as a region encounters disasters such as, earthquakes, floods and drought, an expert of Disaster Risk Reduction was hired by the IDB to assist ECO Secretariat and 10 Member States in developing their regional framework for DRR, which is in line with the Sendai Framework. In this regard, Action Plan 2018-2020 of the Asia Regional Plan for Implementation of the Sendai Framework for Disaster Risk Reduction 2015-2030", has linked up the role of ECO as an Intergovernmental Organization and it recognizes the ECO Regional Framework on DRR. Furthermore, as mandated by the ECO Vision 2025, two of the activities to be done by the ECO Secretariat, Member States in collaboration with International Partners are to establish the "ECO Regional Disaster Information System" and ECO Disaster Insurance System, by 2025. Therefore, we would welcome OIC members' and/or IDB's contributions to DRR and Health projects of ECO Member States as well.

ECO prepared some project concepts as per ECO Vision 2025 priorities and shared it with the Bank in June 2017. These include among others, Operationalization of ECO Istanbul Tehran Islamabad (ITI) road corridor; Institutional strengthening of ECO Secretariat; Development of the regional strategy for sustainable Tourism in the ECO region; Expansion of ECO global and intra-regional trade through trade capacity building; Control and eradication of TADs in the ECO Region.

In this regard, new potential cooperation mechanisms can also be established. ECO and IDB may sign 'strategic partnership agreement' under IDBs 'Regional Cooperation and Integration (RCI) Strategy to implement sub-regional program as partners in the ECO Region. We may also create an IDB-ECO 'inter-agency co-ordination committee' to meet regularly (at-least once a year) and supervise implementation of joint programs and projects. For 2019, ECO has planned projects hence, co-operation opportunities in many sectors amounting to 12 million USD.

Facilitating Partnership among Turkic Speaking Countries

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Cooperation Council of the Turkic Speaking States (Turkic Council) is an intergovernmental organization, whose overarching aim is to promote comprehensive cooperation among the Turkic speaking states. The organization was established pursuant to the Nakhchivan Agreement, which was signed at the Summit of the Heads of Turkic Speaking States held in Nakhchivan in 2009. The founding and current members of the organization are Azerbaijan, Kazakhstan, Kyrgyzstan, and Turkey.

Turkic States account for a population of around 150 million, covering an area of over 4.5 million square kilometres, and have a total GDP exceeding USD 1.3 trillion, ranking 13th in the world as a whole. This untapped common potential is an important tool in leveraging the Turkish-speaking States' comparative advantage to the benefit of their peoples and the world.

Turkic Council's long-term objective is the gradual creation of conditions for the free movement of goods and services, capital and labour, further simplification and harmonization of customs and transit procedures, the creation of advantageous transport corridors, the integration into the global transportation network and the realization of transit potential of the Member States. Therefore, the Turkic-speaking States have an opportunity to become the main passage route for the transnational projects and to turn into a trade hub between China and European Union, the Central Asia and the Black Sea regions.

With the finalization of Baku-Tbilisi-Kars Railway (BTK) and operationalization of the Road Transportation Agreement between Turkey and China, the cargo flow passing through the Trans-Caspian Corridor is expected to boost considerably. The intensification of the preparations for China's Belt and Road initiative and concomitant bilateral transport

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agreements inked with the enroot countries has added a great value to the efficiency of the corridor.

The "economic cooperation" identified as the main theme of the Turkic Council 1st Heads of State Summit has a priority in the framework of the partnership between our member countries. In this context, the very foundation of the actual cooperation mechanisms of the Turkic Council was originally laid at the first Meeting of Ministers in charge of Economy. New mechanisms for transportation, tourism, education and business were established within the framework of the decisions taken at the meeting, which clearly proves that the Economic Ministers' Meetings are the "driving force" of the continued cooperation in the Turkic Council.

Turkic Council regularly brings together members of the private sector of the Member States by organizing technical visits for investors/businessmen, holding Business Forums and meetings of Turkic Business Council, Round Tables for the Businessmen with the aim of further strengthening economic ties among its members.

At the 6th Turkic Council Summit held in Bishkek, Heads of States reaffirmed the importance of reviving the cooperation in the field of economy through increasing investment opportunities and further exploring natural and geographic advantages of the Member States located on the Silk Road.

In accordance with the instructions of our Presidents, we are currently working to further elaborate vibrant projects in the field of economy, such as establishing a common fund, and preparing a comprehensive research paper on investment climate and international trade complementarities of the Member States in cooperation with the Statistical Economic and Social Research and Training Center for Islamic Countries (SESRIC)

A Common Fund of Turkic Integration and the Joint Investment Fund is planned to be established. Upon the suggestion of Turkey with the support of Kazakhstan and Kyrgyzstan, the Secretariat will host a technical meeting with the participation of relevant institutions of the Member States in the first quarter of 2019 in Istanbul.

In addition to establishing the Fund, our Secretary General also proposed to establish a Turkic Investment and Development Bank. Establishing such a Bank is important in terms of attracting funds from different sources thus ensuring capital accumulation and increasing credit lines for investors in our Member States. He met with Vice President of the Islamic Development Bank Mr. Sayed Aqa on October 10, 2018.

IsDB is ready to share their experience on establishment of Funds and provide technical support to our organization. Furthermore, Vice President informed the Secretary General that they could allocate funds up to 25% of the total capital in case of an establishment of the Turkic Investment and Development Bank as well. The Secretariat will continue the necessary negotiations with the Islamic Development Bank.

We also deepened our relations with the UNOSSC in a short period of time. The Turkic Council contributed to the preparation of UNOSSC Regional Report where the Turkic Council is

referred to as one of the key actors contributing to the expansion of the South-South. Furthermore, Turkic Council and UNOSSC jointly published the Report entitled *“South-South in Action: How the Turkic Council uses South-South cooperation to promote regional and global development”* which was launched in New York on the margins of 72nd Session of the UN General Assembly.

Moreover, The Turkic Council was among the implementing partners of Global South-South Development (GSSD) Expo 2017 on *“South-South Cooperation in the Era of Economic, Social and Environmental Transformation”* on 27-30 November 2017 in Antalya together with TİKA and SESRIC.

At the end of the closing ceremony, Turkic Council received the GSSD 2017 Appreciation Award presented by the UNOSSC to the Turkic Council for the firm support to the materialization of the EXPO.

PART III: ROLE AND IMPORTANCE OF ISLAMIC FINANCE SERVICES FOR FINANCING DEVELOPMENT

Hidden Potentials of Islamic Finance Services Industry for Financing Development

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Islamic finance has gained traction around the globe with rapid and sustained growth rates through its systematic importance in a number of countries in different regions, including Asia, Middle East and Africa. The role of Islamic finance as an alternative tool for financing development is indeed appropriate and timely as to catch on the development of the sector and its potentiality that can contribute to medium and longer-term economic development in countries through using unique financing instruments of Islamic finance.

Few questions that I would like to highlight, which are swirling around my mind intrigue me to be answerable on the hidden potentials of the Islamic finance services industry (IFSI):

- (i) Does the growing Islamic financial services industry have the potential to grow further over the longer-term?
- (ii) Can *shukūk* be an alternative approach for infrastructure financing to make a green future?
- (iii) Are there any unique features of Islamic finance that can make a difference in socio-economic growth addressing vulnerability and inequality?
- (iv) How do the multilateral and international bodies in Islamic finance including the Islamic Financial Services Board (IFSB) play an active role for country's long-term growth prospects?

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Does the Growing Islamic Financial Services Industry Have Potential to Grow Further?

According to the IFSB's Islamic financial services industry *Stability Report 2018*, the global assets of the Islamic financial services industry (IFSI), across the three main sectors of banking, capital markets, and Takaful, have surpassed USD 2 trillion marks (estimated at USD 2.05 trillion in 2017).

Footprints of Islamic finance are not anymore limited to only the Middle East and Asia. Rather, it has gained strong recognition in Europe as well as Central Asia and it is ripe for growth in Africa, the Americas, and Australia. Islamic banking, which is now systematically important in 12 jurisdictions², expanded globally at a compound annual growth rate (CAGR) of 8.8% between 2013-Q4 and 2017-Q2 in terms of assets.

The global *ṣukūk* outstanding surged to 25.6% closing at USD 399.9 billion as of 2017 as compared to USD 318.5 billion in 2016, realizing on the back of strong sovereign and multilateral issuances in key Islamic finance markets to support respective budgetary expenditures. Total contributions written in the global Islamic insurance markets are estimated to have reached USD 26.1 billion in 2016, maintaining the CAGR over the last five years at 8.8%.

The industry expanded over 50 jurisdictions offering a range of financial products in Islamic banking, Islamic capital markets, and *takāful* sectors and demonstrated sustained growth rates over the periods. Regionally, the Gulf Cooperation Council (GCC) continues as the largest domicile for Islamic finance assets in 2017 (42.0% of the global IFSI). The share of the Middle East and North Africa excluding GCC (MENA ex-GCC) is 29.1% as stated in the 2017 IFSB IFSI Stability Report. Asia has the most improved market share of 24.4% of the global IFSI, with expansions in key markets such as Malaysia, Indonesia, Pakistan and Bangladesh.

The industry also showed resilience during and after the global financial crisis, as it was not immune to the overall macroeconomic environment and turbulence in the financial systems of various jurisdictions. Sustained development of the industry reflected in all the key indicators indicates the readiness of this sector in participating long-term growth trajectory towards the development goals.

Since the IFSI fostered with sustained growth rates and maintained its stability over the longer periods, the industry has now more ability to strengthen savings-investment channel and increase investors' confidence, which are the prerequisites of creating a better environment for the financing of business innovation and longer-term growth, including green growth.

Can *Ṣukūk* Be an Alternative Approach for Infrastructure Financing to Make a Green Future?

The paradigm shift toward a more sustainable investing has geared up awareness of increasing green finance for a green economy. Investment in sustainable infrastructure is key to tackling the central challenges facing the global community such as reigniting growth, delivering on

² Iran, Sudan, Brunei, Saudi Arabia, Kuwait, Qatar, Malaysia, UAE, Bangladesh, Djibouti, Jordan, and Bahrain.

the Sustainable Development Goals (SDGs), and reducing climate risk in line with the Paris Agreement.

Estimates show that the world needs up to USD 90 trillion worth of infrastructure investment by 2030. It is estimated that investments in oil, coal and gas must decrease by about one-third by 2030, while investments in renewables and in energy efficiency must increase by at least a similar portion if we are to keep global average temperature rise below 2°C.³

This presents a significant opportunity for green finance to be part of the mainstream investment and financing activities. The broad scope of green finance involves the financing of investments that generate benefits for the environment with the ultimate aim to achieve inclusive, resilient and sustainable development. This includes low-carbon transport, such as rails, metros, trams, cable cars, electric or hybrid buses and low-emission buildings for new constructions and retrofitting existing buildings.

The funding needs of green projects present an opportunity for Islamic finance to play a much greater role in this space. The aspiration to issue green *ṣukūk* carries the virtue of contributing to global sustainable developments, one of the essentials of *maqāṣid al-Sharī'ah*.

Indeed, the principle of Islamic finance, particularly adherence to the principles of fairness and social responsibility as well as being responsible to the environment are in line with the core values of a global model of sustainable development.

Since Islamic finance has marked significant credentials in supporting infrastructure funding needs and contributed to the growth of private sector developments, the growth potential for the green *ṣukūk* market is indeed timely with rising global interest in green financing.

The *ṣukūk* markets have gradually revitalized its potential, particularly as an economically viable financial instrument to support developmental expenditure. In many countries, *ṣukūk* is gaining greater acceptance as a mainstream financial instrument facilitating growth through funding economic needs of real economic sectors. Malaysia, Saudi Arabia, Indonesia, UAE, Qatar, Bahrain, and Turkey dominated the *ṣukūk* markets, particularly across the infrastructure, real estate, power and utilities, and transportation sectors.

Altogether, there are now seven non-OIC member states with *ṣukūk* outstanding, including three from the European Union (Germany, Luxembourg and the United Kingdom); two in Asia (Singapore and Hong Kong); and one each in Africa (South Africa) and North America (the United States).

In 2017, sovereign *ṣukūk* issuances by both existing and new issuers are once again pushing annual issuances activity to close to the USD 100 billion mark, with the momentum coming from the Gulf region where sovereigns have embraced *ṣukūk* as a way to meet their fiscal

³ The Sustainable Infrastructure Imperative: Financing for Better Growth and Development, United Nations.

deficit and other budgetary needs. So far, the *ṣukūk* market has also proven to be resilient to various geopolitical risk events.

Overall, Islamic capital markets have been experiencing positive developments, including sizeable growth in *ṣukūk* markets driven by large sovereign issuances, an increase in the volume of Islamic assets under management, as well as strong performances by Islamic equities. Therefore, the evolution of the global *ṣukūk* markets provides potential scopes of investing for longer term growth including green growth, not only for contributing to SDGs but also for adhering the principles of fairness and social responsibility to the environment in line with *Sharī'ah*.

Are There Any Unique Features of Islamic Finance That Can Make a Difference in Socio-Economic Growth Addressing Vulnerability and Inequality?

As a whole, Islamic social finance tools such as *Zakah*, *Waqf*, and *Sadaqah* have significant potentials to address marginalization and vulnerability, promoting social, economic and financial inclusion. Early Islamic history demonstrates that *Zakah* was used as an effective distributive scheme in taking care of the poorer sections of the population in Muslim societies.

Al-Quran identifies specific categories of *Zakah* beneficiaries, including helping the poor and needy, refugees and displaced people, and liberating those in bondage – providing a strong alignment between *Zakah* and the SDGs' commitment. The Islamic Development Bank (IsDB) has estimated that between USD 230 and USD 560 billion is given in *Zakah* each year globally. Many Muslim populated countries including Malaysia, Pakistan, Indonesia, Saudi Arabia, Libya, Jordan, Bahrain, Kuwait, and Sudan, have developed *Zakah* collection mechanisms under enacted laws. Indonesia recently took initiatives to apply *Zakah* funds towards SDG plans, in renewable energy projects for the unserved communities.

While the potential role for *Zakah* is increasingly being harnessed for sustainable development, the role of *Waqf* is less so. The guidelines on utilizing *Waqf* are explained in the Qur'an Surah Ali-Imran: 92, "*You will not attain virtuous conduct until you give of what you cherish. Whatever you give away, God is aware of it.*" *Waqf* (plural *awqaf*) is a voluntary charitable act that has wide economic implications can play an important role in increasing sources of welfare. *Waqf* is also a charitable form of giving and is more flexible than zakat while also being longer-term and can be used for economic growth and income generation.

If systematically directed towards SDG outcomes, *Waqf* could become a game-changer in support of the country's commitment to reducing poverty and lessening inequality. However, several limitations prevent the use of *Waqf* towards effectively supporting the SDGs. These include the need for standards and principles governing the management of *Waqf* assets, as well as the need for new institutional arrangements that build on pre-existing initiatives to move from current models of parallel financing to actual SDG-related financing.

Recently, in October 2018, IsDB and Bank Indonesia jointly launched international *Waqf* Core Principles, which is a very welcome step in the right direction, as they will provide sound supervisory *Waqf* management and enhance its disclosure and transparency.

How Do the Multilateral and International Bodies in Islamic Finance, Including IFSB, Play Active Role for Country's Long-Term Growth Prospects?

As an international standard-setting organisation, the IFSB aims at promoting and enhancing the soundness and stability of the IFSI by issuing global prudential standards and guiding principles. In this respect, the IFSB serves Islamic finance in a way that is comparable to our counterparts in conventional finance – the Basel Committee on Bank Supervision (BCBS), the International Association of Insurance Supervisors (IAIS), and the International Organization of Securities Commissions (IOSCO).

In addition, the IFSB also collaborates with other multilateral organisations such as the Asian Development Bank (ADB), Islamic Development Bank (IsDB), the World Bank, and the International Monetary Fund. These institutions have not only recognised the importance of the role which Islamic finance can play in the global financial system but have also offered their support for its promotion and for capacity building of supervisory authorities and industry players.

The IFSB is working in building capacity of supervisory authorities and industry players through issuing regulatory and supervisory standards for Islamic financial services industry and providing training in this regard. IFSB organizes workshops, provides technical assistance and policy advice to member countries, organizes public lectures, and conducts research to facilitate the implementation of IFSB standards, guidance notes and technical notes.

The IFSB, now, is devoting greater effort and attention to the key issues of creating depth and breadth of cross border Islamic financial markets, including Islamic capital markets and *sukūk* by facilitating the issuance and adoption of common international standards for prudential safeguards and risk management capabilities in Islamic capital market (ICM).

Other than Islamic banking and *Takaful* sectors, for the ICM sector, the IFSB issued IFSB-6 – *Guiding Principles on Governance for Islamic Collective Investment Schemes, 2008* and more recently IFSB-19 – *Guiding Principles on Disclosure Requirement for Islamic Capital Market Products, 2017*.

In addition, the IFSB has included some important provisions on *sukūk* and securitisation in IFSB-7 (*Capital Adequacy Requirements for Sukūk, Securitisations, and Real Estate Investment*) and IFSB-15 (*Revised Capital Adequacy Standard for Institutions Offering Islamic Financial Services*). The IFSB-21 on *Core Principles for Islamic Finance Regulation: Islamic Capital Market segment* is a part of IFSB's series on Core Principles for various sectors of Islamic finance.

The new Core Principles for the ICM will be the next in series that complements ISOCO's Core Principles titled "*Objectives and Principles of Securities Regulation*" (2011) and its 'Methodology' (May 2017). The main objectives of this standard are as follows:

- To provide a minimum international standard for sound supervisory practices for the regulation and assessment of the ICM;
- To protect consumers and other stakeholders by ensuring that the claim to *Shari'ah* compliance made explicitly or implicitly to any ICM product or service is sound and supported by appropriate disclosures;
- To enhance the soundness and stability of the ICM – as an integral part of the IFSI and the global financial system – by helping RSAs to assess the quality of their relevant supervisory systems and identify areas for improvement as an input to their reform agenda.

Therefore, the IFSB is playing an active role in formulating regulatory and supervisory guidelines that help national and multilateral bodies in their policy formulation for longer term financing, aligning with SDGs in a country. The IFSB guidelines, including the standard on governance of *Sukūk* markets, can be a benchmark for national and international authorities to implement the regulatory requirement, risk management, and governance issues for the longer term financing of a country based on *Sukūk* products.

Conclusion

As a system, Islamic finance helps to stimulate economic activity and entrepreneurship towards addressing poverty and inequality, ensure financial and social stability, and promote comprehensive human development and fairness – all are relevant to SDGs announced by the United Nations.

Therefore, the growing IFSI now needs to cover and address an extensive range of development challenges including poverty, inequality, climate change, planetary body, sustaining ecosystem and cities, health, education, shelter etc. All these are in the areas of economic, social and environmental subdivisions, which form the pillars of sustainable development.

Conventional development finance has been the main avenue for financing SDGs in most developing countries through government initiatives and donor countries. However, given the fact that Islamic finance has been used in certain countries to finance sustainable infrastructure (for example, the *Khazanah SRI Sukuk* in Malaysia and the syndicated financing of USD 50 million for wind turbines in Pakistan), it is imperative to think about the role Islamic finance that can play in closing the funding gap with regards to achieving the SDGs.

Islamic Re-Distributive Instruments and Financing Infrastructure Development

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Introduction

Despite widespread recognition of the importance of infrastructure services for poverty reduction, many developing countries including OIC member countries are experiencing severe infrastructure needs, owing to growing populations, economic growth, and increasing urbanization. An estimated 1.1 billion people live without safe water, 1.6 billion people live without electricity, 2.4 billion people live without sanitation, and more than 1 billion people are without access to an all-weather road or telephone services. For example, the infrastructure need of Sub-Saharan Africa exceeds US\$93 billion annually over the next 15 years; less than half that amount is being provided thus leaving a financing gap of more than US\$50 billion to fill. This study aims at introducing Islamic re-distributive instruments as an effective financial instrument to support additional funding for infrastructure investment particularly social infrastructure. Despite the existence of huge potentiality, little has been invested in this area. For example, Waqf can be established in many forms to support infrastructure development. Moreover, Waqf has a greater part in countries with high levels of exclusion and deprivation as it can play a critical role in protecting the poor and vulnerable against sudden risks of unemployment, hunger, illness, drought, and other calamities.

Infrastructure Development and SDGs

The Sustainable Development Goals (SDGs) are a new set of global development targets adopted through wide and extensive consultations with the member countries of the UN in September 2015. The SDGs are composed of 17 goals and 169 targets, which are integrated and inseparable. The SDGs cover a wide spectrum of development challenges including poverty, inequality, climate change, planetary body, sustaining ecosystem and cities, health, as well as education. While infrastructure outcomes affect many the SDGs, SDG 9 specifically

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addresses the infrastructure – build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation— and it encompasses 9 targets. The scale and ambition of SDGs requires a revitalized Global Partnership to ensure its implementation, which can bring huge gains to all countries regardless of their level of income or stage of development. Investment in both economic and social infrastructures will be critical for the achievement of these ambitious goals.

Global Investment Gap

The global infrastructure demand is estimated at about US\$ 3.7 trillion (5.4% of global GDP) while the supply of new infrastructure is about US\$ 2.7 trillion (4% of global GDP) annually. This indicates that the high infrastructure demand is not being met with current pace of infrastructure supply because of various impediments; notably, the public sector's budget constraints following the global financial crisis, and the reluctance of private financiers to commit capital to long-term and risky investment particularly in low-income countries. Government budgets are the biggest source of funds, accounting for about three of every four-infrastructure dollars, while the private sector provides the rest. Yet in the aftermath of the financial crisis, governments have seen their fiscal deficits grow and their budgets shrink. Even if fiscal conditions in developed and emerging economies improve, the need introduced by the infrastructure-financing gap is unlikely to be met from public sources alone. This generates an expectation that private capital and user charges must be mobilized to fill these gaps. However, most private funding flows to upper middle-income countries. Therefore, across all sectors of economic and social infrastructure, the global investment gap in infrastructure amounts to at least US\$ 1 trillion per year, which corresponds to about 1.4% of global GDP².

According to the Africa Infrastructure Country Diagnostic (AICD), the infrastructure need of Sub-Saharan Africa exceeds US \$93 billion annually over the next 10 years. To date, less than half that amount is being provided thus leaving a financing gap of more than US \$50 billion to fill. The poor state of infrastructure in Sub-Saharan Africa – its electricity, water, roads and information and communications technology (ICT) – cuts national economic growth by two percentage points every year and reduces productivity by as much as 40% (AfDB, 2017). According to a study by the World Bank of 2009, Africa needed USD 93 billion per year to fill the infrastructure deficit. For instance, Africa's power sector alone is experiencing a finance shortfall of USD 40-45 billion every year since achieving universal access to electricity in Africa requires investment of about USD 55 billion per year until 2030.

Financing Infrastructure Development in OIC MCs: Challenges and Priorities

Developing the domestic financial sector is a key challenge for OIC MCs. In OIC member countries as a group, national savings as a percentage of GDP stand at nearly 30 percent and total investment is below 26 percent of GDP over the last five years. This indicates that OIC member countries need to find alternative ways and means to channel idle domestic savings

² The Global Infrastructure Gap, World Economic Forum (2014).

into investments effectively. In this respect, the financial sector can make an important contribution by increasing the savings rate and the availability of savings for investment. Nonetheless, domestic credit ratios for OIC member countries are markedly low, compared to the world average, and even to developing countries averages. While the average ratio of domestic credit to GDP is below 48 percent for OIC member countries, the world average is 164 percent. OIC member countries need to expand the financial sector and diversify their products to (i) meet the needs of all segments of the economy; and (ii) move from being just credit providers towards becoming more holistic financial services providers. The challenge, therefore, is to strike a right balance between financial policies, measures and investments in activities that target both hard and soft infrastructure.

Promoting new and innovative sources of finance with a special focus on blended finance is the way forward. Given the limited ability of the public sector to support long-term investments, finding new and better ways to attract private-sector financing is critical. At national level, the institutional investors such as pension funds, insurance companies, and mutual funds, have potential as pools of non-bank capital for supporting the development goals. At the OIC level, there is a huge amount of Sovereign Wealth Funds (SWF) particularly in oil exporting countries. However, the challenge is how to direct these funds towards productive investments in other member countries to support the achievement of development objectives with rational economic returns. Public private partnerships (PPPs) can be an effective model for financing large-scale investments, particularly in low-income member countries. In this context, OIC member countries need to formulate a clear policy framework that define the roles, responsibilities and potential gains of private sector firms; design a transparent and competitive procurement framework; and (iii) increase the capacity of both private banks and the public sector in designing mutually beneficial framework agreements for infrastructure PPPs.

Mainstreaming Islamic finance into the financial system will improve resources mobilization. Islamic finance has strong potential in promoting both social and economic infrastructure development. While Zakat and Awqaf have great potential to support small size and social infrastructure, sukuk (Islamic bonds) can successfully finance largescale infrastructure (water and sanitation projects, sustainable and affordable energy, transport, roads and shelter. In order to fully utilize Islamic finance in promoting economic and social infrastructure, OIC member countries need to: (i) strengthen infrastructure building blocks of the Islamic financial services industry; (ii) accelerate the implementation of Shariah and prudential standards and rules to facilitate the creation of a more stable, efficient, and internationally integrated Islamic financial services industry; and (iii) create a common platform for the regulators of the Islamic financial services industry to enhance constructive dialogue.

Islamic Re-Distributive Funds and Social Investment Gap

Given the large scale of the needed financial resources to support both economic and social infrastructure, the funding goes beyond the available public financial resources. It is, therefore, important to explore alternative and complementary innovative financing

mechanisms such as Islamic finance³. Traditionally, Islamic finance possesses models for solidarity-based financing with important features of social sustainability. For example, Redistributive instruments such as zakat, waqf (endowment) and sadqaat (charity) have played vital role in alleviating poverty and have led to wider social and financial inclusion. Particularly, Waqf funds have played an important role in the provision of social infrastructure such as education, hospitals as well as economic infrastructure such as roads and bridges, etc. (Sadeq, 2002). It has been argued that the entire health, education and welfare budget during the Osman Caliphate based in Istanbul came from its charitable foundations (Cizakca, 2000)). Historically, education has been the second largest recipient of Waqf revenues after religious matters, which was its original purpose. Since the beginning of Islam, in the early seventh century, education has been financed by Waqf and other voluntary contributions. The third big beneficiary of Waqf is the category of health services⁴. Of course, the social welfare role of Waqf institutions depend on their type and size. Waqf can be established in many forms depending on its purpose or nature of its outcome⁵. Interestingly, all forms could significantly support economic and social infrastructure development thus fulfil the society's needs adequately.

A bulk of studies show that a large pool of waqf assets in most Muslim countries are dormant and not being used for socio-economic development purposes⁶. For example, Kahf (1989) estimates the potential range of zakat revenue in different countries to be from 0.9 percent to a high of 7.5 percent of GDP based on various assumptions. The average of the lower and higher ranges equals 1.8 and 4.3 percent of GDP. The effective way of using zakat and waqf can enhance productive capacities of the Society. In this context, Cizakca (2004) suggests a model in which cash waqf would be used to provide microfinance to low skilled labour force.

Several OIC member countries such as Lebanon, Turkey, Jordan, Sudan, Morocco, Qatar, Kuwait, Malaysia, Iran, Brunei and Algeria have taken significant steps to revive and develop the properties of Waqf. They have ratified new laws of Awqaf which help recovering, preserving and developing several Awqaf properties to support the needs of their economy. In line with the efforts of these countries and expand the usage of Islamic re-distributive in some other Islamic countries, there is a need to enhance Islamic re-distributive mechanism by adopting an innovative element to support many socioeconomic activities in the process of

³ According to the most recent World Islamic Banking Competitiveness Report, global Islamic banking industry assets amounted to USD \$2 trillion in 2014, growing at a rate of approximately 20% and has the potentiality to cater the most of the banking and finance needs of modern economies.

⁴ One of the examples of the health Waqf is the Shishli Children Hospital in Istanbul which was founded in 1898. Many educational services, which are financed by the Turkish government budget, were financed by Waqf foundations existed during the Ottoman era.

⁵ On the basis of its purpose, waqf can be classified into waqf ahli (waqf zhurri), waqf khayri, waqf al-sabil, and waqf al-awaridh.

⁶ For example, IRTI & TR (2013) report that Indonesia has 1400 sq. km of waqf land valued at US\$ 60 billion. If these assets yield a return of 5% per annum, then US\$ 3 billion could be used for various socio-economic purposes.

inclusive economic development. To do so, a holistic approach should be developed to achieve harmonization and coordination of rules and principles between various Islamic institutions at national, regional and global levels. Central banks or monetary authorities in OIC member countries shall play critical role in mobilizing resources generated by Islamic redistributive tools. Specifically, they can develop a supportive legal and regulatory framework (as in the case of Indonesia) and “proactive” policy targets on usage, access and quality, the three main dimensions of effective usage of Waqf and Zakat. Formalizing and standardizing of these instruments will improve the efficiency and facilitate the achievement of inclusive development. Using the results of other studies, the experience of Malaysia, Indonesia and Bangladesh also shows that there is strong indication that Waqf can be a viable alternative model for supporting social infrastructure (health and education). However, there are variations in the selected countries in terms of funding and implementing agencies for supporting socioeconomic programs. For example, in Malaysia, even the implementing agencies are very much government-backed or government-assisted, whereas in Bangladesh. Non-governmental organizations (NGOs) are playing a leading role in this context.

Summary and Conclusion

Given the large scale of the needed financial resources to support both economic and social infrastructure, the key question is how to design a broader suite of financing instruments to increase the amount of financing for infrastructure development in ways that make sense to each country, as there is no one-size-fits-all solution. As a system, Islamic finance has strong potential in promoting both social and economic infrastructure development. While Zakat and Awqaf have great potential to support small size and social infrastructure, sukuk (Islamic bonds) can successfully finance largescale infrastructure (water and sanitation projects, sustainable and affordable energy, transport, roads and shelter.

Islamic re-distributive instruments such as zakat, waqf (endowment) and sadaqah (charity) have played vital part in alleviating poverty and have led to wider social and financial inclusion. Particularly, Waqf funds have played an important role in the provision of social infrastructure such as education, health as well as economic infrastructure such as roads and bridges, etc. Historically, education has been the second largest recipient of Waqf revenues after religious matters, which was its original purpose. The third big beneficiary of Waqf is the category of health services.

Given the significant potentiality of Waqf Funds in financing social and economic infrastructure, a number of IDB member countries such as Lebanon, Turkey, Jordan, Sudan, Morocco, Qatar, Kuwait, Malaysia, Iran, Brunei and Algeria have taken significant steps to revive and develop the properties of Waqf. Using the results of other studies, there are three major constraints, which hinder the effectiveness of Waqf funds in line with the current and emerging financial needs of IDB member countries. They are (i) inadequate awareness about the role of Waqf in addressing socioeconomic difficulties in many IDB member countries; (ii) insufficient widely accepted Shariah compliant products to integrate these Islamic redistributive institutions (i.e., Waqf and Zakat) to inclusive development; (iii) lack of

innovative products to use Waqf funds under certain programs such as, Poverty Entrepreneurship Schemes that can be used for creating employment opportunities.

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Economic Empowerment: An Innovative Approach for Poverty Alleviation and Sustainable Development

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Poverty today is most commonly defined by economists using hard facts and figures based on income level and access to human necessities. However, poverty is a multifaceted and a multilayered issue going far beyond numbers crunched in economic models. We have indeed succeeded in lifting nearly one billion people out of chronic poverty over the last two decades, which is a good news.

However, the big picture and the reality is much murkier: huge wealth transfers incurred in the same period resulting in a great wealth disparity as the poorest 20% of the world's population is using a mere 1.3% of global resources in contrast to the richest 20% using 86% of the world's resources. In 1990, 35% of the world's population lived on less than US\$1.90 a day; today we are only at 10.7%. Nonetheless, this reduction is mainly driven by China, Indonesia and India. Numbers of extreme poor in the Sub-Saharan Africa only fell by 4 million with 389 million people living on less than US\$1.90 a day in 2013, more than all the other regions combined.

Poverty alleviation efforts focused on improving these indicators. What happens if the ruler's scale was a bit tilted or was completely wrong? Poverty is far more complex and dynamic in nature. One definition of poverty alleviation is to address poverty in all of its social, economic and cultural dimensions simultaneously: income level, housing, access to financial services, health, education and social justice. Microfinance has proved, based on numbers, its efficiency in reducing poverty. However, after nearly four decades of activity, the broad picture indicates that microloans do not eventually lead to the poor getting out of poverty.

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In fact, facts indicate that microloans are more beneficial to borrowers living above the poverty line than to borrowers living below the poverty line. Clients with more income are willing to take the risks, such as investing in new technologies that will most likely increase income flows. Poor borrowers, on the other hand, tend to take out conservative loans that protect their subsistence. The vast majority of poor clients are caught in subsistence activities. The poor obtaining a microloan will eventually become a poor in debt with the only concern of protecting the newly created business. Microfinance institutions have the ability to offer him this protection with more microcredit. Thus, microfinance falls short of its true objective and addresses the issue partially. Poverty alleviation is indeed about addressing a much broader set of needs. Amartya Sen, the Nobel Prize-winning economist, eloquently argues that development can be seen as a “process of expanding the real freedoms that people enjoy.”

Economic Empowerment and Poverty Alleviation

These freedoms can be achieved by focusing on the productivity and the economic sustainability of the activities of the vulnerable groups. Poverty alleviation starts with *Economic Inclusion*. The objective of economic inclusion is to establish a genuine relationship between the recipient of the financing and the economy. The economic inclusion of a person involves a process linking her to the real economy by discovering investment opportunities adapted to his/her skills and needs, opening up communication channels with economic players, setting up a technical and managerial capacity building plans, and, of course, funding. Value chain financing plays an important role in developing financial products suited for economic inclusion.

The process of economic inclusion is an innovative approach to reach and finance vulnerable populations. The process is triggered with the identification of the economic and strategic partner (Value Chain Leader) and obtain a firm commitment from its side to absorb the production of the beneficiaries of the financing over a specific period of time. Then, the financial institution should develop and engineer its own development project and expand its scope of services to business development for the benefit of the poor. Once all the variables and components of the project are sealed in a realistic business model, capacity-building modules are developed and beneficiaries are contacted and selected to be part of the project. Ultimately, funding is dispensed and a partnership is concluded between the marginalized populations and the strategic and commercial partner. Finally, assistance and project follow-up is to be done during the lifetime of the contractual agreement.

Economic Empowerment is the name given to this approach. The International Labor Organization (ILO) states that “nothing is more fundamental to poverty reduction than employment”. This model will indeed act as a structure for business and employment generation. Economic empowerment is an approach aligned with the United Nation’s Sustainable Development Goals (SDGs).

In fact, this approach has the ultimate goal of reducing poverty. Before executing economic empowerment projects, a special diagnostic of the targeted population is made: The objective

is to clearly map the scale of poverty. The development institution will be able to efficiently execute its projects once the extreme poor, poor and vulnerable has been clearly identified. This step is crucial, as the particularities of each economic empowerment project proposal must respond to the challenges of each group. The initial target will be the extreme poor, with a medium-term objective of reducing poverty and integrating it to the next group or higher at the end of the economic empowerment project and with an ultimate goal of them exiting poverty.

A vast majority of the global poor lives in rural areas and are mostly employed in the agricultural sector and over half are under 18 years of age. Thus, the focus of economic empowerment projects will naturally be designed to offset poverty by developing business opportunities for the challenged in this sector. In fact, a pillar in developing economic empowerment projects is to establish a sustainable business relationship with the poor where capacity building is key. The poor is exposed to education and training modules responding to the sectors needs in terms of the latest agriculture techniques, environment protection and land exploitation for food security purposes. By doing this, the poor will be well versed with sustainable consumption and production techniques and prevent resource wasting. This will lead to higher levels of economic productivity, income, decent and better work conditions.

The fruits of these developments efforts are nonetheless limited to the quality of the infrastructure where the poor populations live. In fact, achieving higher income will undoubtedly make it easier to access health, education, clean water and quality housing. However, executing development projects without taking into consideration the complications related to infrastructure is certainly a flawed approach with punctual results. Hence, a pillar in developing Economic Empowerment projects is to build solid and sustainable partnerships with the public sector, private sector and civil society. The result is to develop effective synergies between all the partners to build a solid ecosystem with a direct impact on healthcare, education, housing, water and sanitation services. This collaboration will eventually lead to a more balanced and broader intervention for a better life quality.

The goal of economic empowerment projects is to generate business opportunities with a high added value for the targeted populations and the society. To achieve this, economic empowerment entities will focus on building 'intelligent' partnerships leading to greater investments in infrastructure. Economic empowerment entities will have the mandate of engineering economic empowerment projects to the benefit of the poor in collaboration with the 'intelligent' partners. Innovation is key during the engineering process. Impacts of such an approach will be tangible in many sectors like energy, recycling and industry.

The Role of Zitouna Tamkeen in Supporting Economic Empowerment

Zitouna Tamkeen promotes sustained economic growth, higher levels of productivity and technological innovation. Encouraging entrepreneurship and job creation are key to this. With these targets in mind, our goals are aligned with that of the United Nations to achieve full and productive employment, and decent work, for all women and men. Zitouna Tamkeen was

founded with the goal of promoting the financial and economic inclusion of Tunisia's youth and disadvantaged populations. Through an innovative approach, we are committed to offer financial and non-financial services to promote the development of projects offering major socio-economic impact, especially in the marginalized regions of Tunisia. Since the beginning, Zitouna Tamkeen has set ambitious targets for economic empowerment projects, sustainable development, progressive coverage of regions through fixed and mobile branches, interventions in promising sectors, and entrepreneurship capacity-building programs.

Our economic empowerment approach is focused on value chain financing. The objective is to scan for high potential value chains in terms of job creation and to calibrate the intervention points to reach the greatest number of beneficiaries via the financing of economic empowerment projects.

In the long run, Zitouna Tamkeen's branches will act as development entities where their fundamental role is to explore promising local and regional value chains and fully integrate its clients using the appropriate business development services. Hence, micro projects will no longer represent free electrons exposed to the hazards of offer and demand, but rather real businesses integrated in a solidly built ecosystem linked to the real activities of the economy. Furthermore, Zitouna Tamkeen has developed its own projects' post implementation indicators monitoring economic empowerment projects. In fact, Zitouna Tamkeen has developed a specially tailored MIS that encompasses socio-economic indicators based on the UN's SDG. For example, Zitouna Tamkeen monitors gender ratios, ease of access to education, healthcare services, impact on the environment, household income and capital preservation.

Early performance indicators of our approach are very promising and the model is attracting the interest of local and international partners. This is why we are building today the international centre for economic empowerment. A consulting services company offering advisory services to build and develop the economic empowerment business projects and institutions worldwide. It will contribute to equip banks and Microfinance institutions with Economic Empowerment business methodologies and strengthen their corporate and human capital capacities. The focus will be on producing customized development program proposals for global clients interested in achieving sustainable development goals. Leading technical assistance, training and advisory services will be at the forefront of the offer.

Socially Responsible Investment *Sukuk* as an Innovative Funding Mechanism to Promote the Development of Islamic Microfinance

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Maintaining financial sustainability has been one of the major challenges facing Islamic microfinance institutions (MFIs). Continuous efforts to diversify sources of funding through innovative instruments would go a long way in ensuring financial sustainability of the Islamic MFIs. This study explores the viability of SRI *sukuk* as a fund-raising mechanism to enhance sustainability of the Islamic MFIs as well as to promote financial inclusion in the Muslim countries. It also aims to identify the associated issues and challenges in implementing the SRI *sukuk* for microfinance purpose.

Despite the rapid growth in the *sukuk* market over the years, most of the *sukuk* issued were sovereign *sukuk*, meant for infrastructure development predominantly in the developing Muslim countries. The social sector in these countries has remained relatively underdeveloped with many of these countries sustained high rate of poverty. Thus, Islamic finance industry in general has continued to receive the brunt of criticisms. Islamic banking and finance has yet to make meaningful contribution to the socio-economic improvements of the majority of the Muslims as reflected by the low financial inclusion in many of these countries. More alarmingly, it is estimated that around 50% of the world's poverty incidences are happening in the Muslim countries, even though the total number of Muslims form only 24% of the world's population (Mughal, 2018).

The weakness of the Islamic finance is being witnessed through the underdeveloped social sector within Muslim countries, which suffers from high poverty, illiteracy, unemployment and lack of social welfare. While the ultimate objective of Islamic finance is achieving socio-economic well-being and justice among all members of the society, these objectives have yet to be realized through the current practice of Islamic finance; hence, the urgent need to

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explore new areas in which Islamic finance would be able to achieve its real intrinsic establishment purposes.

In this regard, socially responsible investment (henceforth, SRI) has a high potential to reduce the gap between the ideals and practices of Islamic finance by expanding the frontier of Islamic finance to be more inclusive in nature (Kassim and Abdullah, 2017). The introduction of a new *sukuk* type that is sustainable, responsible, and socially impactful would enable Islamic finance to achieve multiple objectives.

First, the SRI *sukuk* can be considered as innovation in the Islamic finance industry as the SRI *sukuk* is the combination of ethical investment through the issuance of *sukuk* which is the highest growing Islamic financial instrument. Second, through *shari'ah*-compliant financial instruments such as SRI *sukuk*, Islamic finance has the potentials to contribute to the socio-economic objectives such as alleviating poverty among the low-income group, reducing illiteracy in the education field, improving health conditions among the community, and taking care of the environment to achieve better standard of living for all levels of the society.

The unique aspect of the SRI *sukuk* is that it is a type of investment that is based on personal and social values, rather than merely commercial values driven by purely profit motive. Currently, there is an increasing demand for value-based investments to bridge the gap between all sectors of the economy and society. Apart from the financial criteria, socially responsible investors also base their investments on non-financial criteria, because they want their investments to be consistent with their values, and to create positive social change. Consequently, by introducing SRI *sukuk* in the area of microfinance, this effort would help to achieve multiple social objectives. Galema (2011) proposes that SRI *sukuk* for microfinance “belongs to the realm of socially responsible investment”.

Existing Issuances of SRI *Sukuk*

Currently, there are several issuances of SRI *Sukuk*, experiences of which can be taken as examples for new issuances. These are:

- i. The SRI *Sukuk Ihsan*, the first-ever SRI *sukuk* issued in the Islamic finance industry, issued by Khazanah Nasional Berhad (KNB), the investment arm of the Malaysian government in 2015. The *sukuk* comprised of a RM100 million seven years *sukuk* issued via an independent Special Purpose Vehicle (SPV) known as *Ihsan Sukuk Berhad* for a RM1 billion *sukuk* program;
- ii. The Orasis Green *Sukuk*, the first green *sukuk* being issued in France in August 2012 by Legendre Patrimoine, a solar energy company;
- iii. The SRI *sukuk* issued by the International Finance Facility for Immunization (IFFIm), a charity institution established in 2006 operating in the UK. It is a collaboration among four parties, namely donors, the IFFIm board, the World Bank and Gavi – the vaccine alliance (a non-profit foundation based in Switzerland);

- iv. The Green SRI *Sukuk* Tadau, issued in 2017 in Malaysia for the purpose of providing green energy. It is a RM250 million SRI *sukuk* issued by Edra Power Holdings Sdn Bhd's unit, Tadau Energy Sdn Bhd to undertake a large scale solar project of 50MWac in Kudat, Sabah. The Green *Sukuk* Framework has been certified by the Center for International Climate and Environmental Research – Oslo, Norway. The *sukuk* Tadau has a tenure of two to 16 years and has been assigned a long-term rating of 'AA3' by RAM Rating Services Bhd.

Issuance of Bonds for Microfinance

To date, there are no issuances of SRI *sukuk* for Islamic microfinance. In developing this instrument, it is highly relevant to study the experiences of the European Bank for Reconstruction and Development (EBRD) in issuing social impact bond for microfinance projects, as well as the experiences of selected Latin American countries in their domestic bond issuances for their microfinance projects.

Global Issuances: Experience of European Bank for Reconstruction and Development

Since 2010, the EBRD has issued bonds worth of EUR1.2 billion, which is used in 235 microfinance projects by the first half of 2017 (EBRD, 2017). These bonds were issued for the purpose of funding sustainable projects. The funds were disbursed by the EBRD by providing a loan to one of its local partners to finance micro and small enterprises. As the local partner has the database of the enterprises in need of funds, it makes the task easier to channel the funds and enable more effective supervision of the projects being funded. The proceeds from a single bond can be utilized in various geographical areas to diversify the risk as well as to promote financial inclusion at the international level (EBRD, 2017).

In particular, the EBRD micro-projects involve debt financing through partner institutions in the countries of operation including microfinance banks, non-bank microfinance institutions and universal banks. Apart from debt products, the partner institutions could also issue equity with stakes in the MFIs. The program also involves technical assistance to create lending expertise, supported by donor programmes, investment in microfinance funds, and micro-leasing to create solution for asset finance for smaller companies in production sector, particularly to address the issue of collateral.

Domestic Issuances: Experiences of Latin American Countries

At the domestic level, the microfinance industry has witnessed several bond issuances, which could not reach international markets. According to Rhyne and Reddy (2006), MFIs usually approach the domestic markets for fund raising for several reasons. First is the cost factor, where fund raising in the local currency would help to reduce costs and mitigate the currency risk. Another reason is that the domestic market players are familiar with the local microfinance industry and in most cases, they are aware of the peculiarities, issues and challenges facing the local MFIs. As a result, the local investors might find microfinance projects as attractive investment because of the few identified investments offered to local

investors. Thirdly, the international markets are more oriented towards funding in large scale in which this is not the case for majority of the MFIs. There are three examples of microfinance bonds issued at the domestic level in Latin America, namely:

- i. *Compartamos* MFI is a Mexican finance company, which was looking for new investors to target rather than depending uniquely on two major sources of fund, the foreign lenders or the credit lines with the Mexican banks. The amounts of issuance have increased significantly, with increasing interests of the institutional investors accounting for 70% of total investors.
- ii. *Mibanco* in Peru is a commercial bank wanting to diversify its sources of funds, while simultaneously obtaining a longer tenor and better rates. With a guarantee of 50% by the US Agency for International Development (USAID), the first bond was issued in 2002 for approximately \$6.0 million, which was totally purchased by the private sector by pension and mutual funds. Interestingly, when the public entities and banks started subscribing to the second issues, Mibanco continued to issue other bonds and other capital market instruments.
- iii. *Women's World Banking (WWB) Cali* is a non-profit MFI in Colombia in which it aimed to diversify its sources of funds and get long-term financing. For this purpose, this unregulated MFI found bond as a better solution. The WWB Cali bonds were issued in three tranches and it has opened the door of Colombian capital market for MFIs to issue financial instruments for raising funds. The proceeds from this issuance will be utilized to finance micro projects aiming to develop the local microfinance industry.

SRI Sukuk for Microfinance

SRI *sukuk* is a form of social impact bond that is arranged using a combination of *shari'ah* based contracts; nonetheless they share the same commitments towards better social outcomes, as well as some commonalities such as the result-based approach since the returns are paid in accordance to the success of the programs. As *sukuk* has been an efficient tool to raise funds for projects, there is a high potential to use *sukuk* for raising funds in order to finance micro-projects as what has been done by the EBRD and the local MFIs in the Latin American countries.

An important question arises about the eligibility of the MFIs to tap funding from the capital markets through the issuance of an Islamic or conventional bond and the possibility to approach markets. In this regard, Otero (2006) argues that not all MFIs are eligible to tap the funding from the capital markets, with especially the newly established institutions are still in need of more technical support or guarantee to improve their day to day operations and governance. On the other hand, there are other MFIs sitting at the top end of the industry where they are attractive to investors as well as their ability to absorb investments on competitive commercial terms. In essence, the stability and reputation of the MFIs play important roles in easing the path for the accessibility to the capital markets.

The proposed SRI *sukuk* for microfinance is based on *Mudarabah* (profit sharing) contract to be issued by an Islamic MFI in order to raise funds for financing micro and small projects that are in compliance with *shariah*. The modus operandi of the SRI *Sukuk* for the Islamic microfinance are as follows:

- i. Issuance of the *sukuk* certificate by the MFI in which investors will subscribe into, then investors will be considered as *sukuk* holders, while the Islamic MFI is the obligor.
- ii. Both parties undertake the contract of partnership and specifically under the *shariah* contract of *Mudarabah*.
- iii. The proceeds of the issuance will be utilized mainly for two purposes, 80% (as an example) of the funds raised in order to finance the micro projects.
- iv. Financing will be on the bases of several contracts depending on the nature of the projects, for example *Murabahah* for some financing facilities (cash), *Salam* for agricultural financing, *Ijarah* for machineries (tailoring).
- v. The other 20% of the raised fund will be utilized by the MFI for the protection of the micro-enterprises through participation in micro-*takaful* fund where by this will mitigate the risk of micro projects and this might be a source of an additional income for investors in case of surplus in the *takaful* fund.
- vi. After the micro projects starts operating, their managers will start paying periodic profits to the MFI (*mudarib*) upon a pre- agreed ratio (ex: 70% - 30%).
- vii. Additionally, the micro projects managers will start paying the asset redemption amount to the *sukuk* holders. This is for the micro projects managers to own the projects at the end of the day (the redemption remains with the MFI until maturity and then redeems it on one time to the *sukuk* holder).
- viii. The MFI will be paying periodic profits to the *sukuk* holders and it will be paying the redemption amount at maturity.

Conclusion

The study shows that the SRI *sukuk* has high potentials to be developed as an innovative *shari'ah*-compliant mechanism based on the successful experiences of the EBRD in issuing the microfinance bonds, the domestic issuances of microfinance bonds by the Latin American MFIs, as well as the Malaysian experience in issuing the SRI *sukuk* to develop socially-related projects including the educational and green energy sectors. This study provides important inputs to the relevant stakeholders in implementing new financial tools to develop the social sector, especially Islamic microfinance in improving financial access and empowering the poor to become economically independent.

New innovative tools for raising funds in microfinance are highly needed to achieve sustainability of the Islamic microfinance industry and improve financial inclusion especially in the Muslim countries. The benefits that can be obtained through raising funds through *sukuk* for financing micro-projects are unlimited, and this was proven throughout the years, where

several issuances of SRI *sukuk* have been witnessing a positive impact on the society even before maturity.

With the clear trend of increasing interest of investors for SRI, the prospects of offering the SRI *sukuk* for Islamic microfinance is bright. The SRI *sukuk* for microfinance is not an ordinary financial instrument for several reasons. The funds raised will promote to financial inclusion, while at the same time, it will be generating profits for the socially-responsible investors.

The MFI plays an important role due to its database that contains a list of micro projects that have been studied but due to the lack of financing, the projects could not take place. Moreover, the existing databases will reduce the cost of feasibility study because the projects have been already studied by the MFI previously. Another important role is being played by the *takaful* institution in providing coverage for the micro projects and this will result in a more viable and sustainable business.

In addition, there are several advantages of issuing such *sukuk* in microfinance. The issuance of such *sukuk* will result in more contribution to the economic sector and will give the opportunity to micro projects to participate significantly to the economic activities. Another advantage of this issuance is the promotion a better risk-sharing environment between stakeholders. As SRI *sukuk* in microfinance is a combination of the private, public and third sector in economic activities, the sharing of risks among them will reduce the amount of risks for each party.

The SRI *sukuk* will also serve as an innovative financial instrument for social finance and an alternative to traditional existing financing tools which are missing the lack innovation and diversity of financing products especially the excessive dependence and use of debt financing as *sukuk* in the essence represents a financial tool that is based on equity. It will lead to a new alternative asset class that might be more attractive compared to some of the existing ones.

Notwithstanding that with all the sustainable potentials offered by SRI *sukuk* mentioned above, a number of hindrances could potentially jeopardize their steady development. Perhaps, the easily spotted constrain is the small size of the secondary market, mainly caused by the modest number of private and institutional investors who operates with *sukuk* funds, and consequently are in need of players to boost the secondary market, in order to meet their liquidity expectation (MIFC, 2016).

Another challenge is the absence of standardization and the establishment of a verification system for performance measurement not only for *sukuk* but all the SRI bonds; even with the existence of various voluntary guidelines. The *sukuk* industry is already struggling to keep pace with the rapidly changing regulatory environment, and the process of reaching consensus among governments, investors and the *sukuk's shari'ah* boards is taking significantly long (Natoor, 2017). Also, microfinance is still facing some challenges to be considered as a good asset class (Rhyne and Reddy, 2006).

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Cash Waqfs as a Fund Collection Instrument for Turkey

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One of the biggest problems of the modern era for developing countries is that they are not able to develop/grow with their own insufficient savings. The developing countries generally use the savings of developed countries for development and pay interest to developed countries for the loan. Therefore, the development gap between the developing countries, which need savings for development, and the developed countries, which have very large interest income, is not closed. In order to overcome this development gap, especially the labor force (overpopulation) and low labor cost methods are being tried. These methods only straighten the general economy in terms of growth not development and the developing countries cannot make a serious breakthrough in total welfare of people. The majority of Islamic countries are in the category of developing countries. In other words, the Islamic countries also need capital for new investments. For this reason, it is important to establish funds that will be managed according to the procedures accepted in Islamic fiqh, which will provide capital accumulation and resources for Islamic countries. In this study, the proposal of the Cash *Waqf* Fund (CWF), which can be used for Islamic countries as a financial instrument for development, will be examined.

Unlike real estate waqfs, the entire or some part of capital consists of cash money at CWs. The CWs became quite widespread during the Ottoman period. The main priority of these institutions was charity. On the other hand, the funding needs of entrepreneurs in the market were provided by CWs. Another feature of CWs is that they are the pioneers of Islamic financial institutions with their operation methods for cash. The CWs, which lent money to the entrepreneurs through Islamic financial methods, spent the income of this money for the purposes of the waqf. In this way, while the continuity of the charity activities, the market's need for cash was provided. Thanks to the CWs, the financial institutions of capitalism, like the

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banks, could not enter the Ottoman geography for many years. In this study, a fund proposal for Turkey in the implementation of the CWFs, will be presented.

Introduction

Funds are portfolios in which banks or authorized financial institutions distribute the savings among various types of derivatives in order to gain income for capital owners. These derivatives include government securities, stocks, foreign exchange and precious metals or other income-generating securities. In addition to this, another definition for fund is the money that is set aside to perform a particular investment service (Afşar, 2007).

When used in place of the money definition, funds that are in excess can be invested directly by the owners or brokers. These funds are requested by entrepreneurs who want to make investments and develop their projects. The fund transfers may also be in the form of interest-rate transactions within the credit system or profit-loss partnerships that are not based on interest. Equity instruments such as bills, bonds and stocks are securities that meet the cash requirement. The stocks offer partnership opportunities, while papers such as bills and bonds are credit-based securities and they generate interest income. Today, participation-based funds are also being established. Therefore, the applications and importance of interest-free securitization are a current debate issue (Bayındır, 2007: 250).

Capital accumulation is inevitable for economic growth and development. Funds play an important role in ensuring capital accumulation. Thus, the provision of fund-raising proposals is important in society. The main benefit and reason of establishing a CWF is to provide sustainable resources for the wellbeing of society. The CWF will be operated for many years because it only distributes income of the fund. Moreover, establishing a fund based on the partnership model will minimize the damage to the debt-based financial system. In this study, we will examine the establishment, effects, and importance of the CWF proposal for Turkey in economic and financial development.

Importance of Capital Accumulation and Equitable Economic Development

If a country wants to be strong in social and political terms in the world today, one of the most important steps is to gain economic power. One of the indicators of the economic power is having enough capital accumulation for development and growth. However, the capital accumulation in today's world is largely assessed in the conventional (interest-based) financial sector. The share of participation (interest-free and partnership-based) banks from this pie is quite low. One of the reasons to have a low share in the financial system of participation banks in Turkey is the lack of capital accumulation of people those do not want to engage with interest bearing transactions. Income and wealth inequality caused by the capitalist system has led to the accumulation of large amounts of capital and wealth in certain groups and individuals. However, one of the most fundamental principles of Islamic economics is to spread the wealth in all layers of society and to prevent unfair distribution of income. In the Islamic states established throughout history, the middle class were strengthened in general. The religious principles and choosing the middle way method (between overdoing/ifrat and

understatement/tefrit) that are recommended by Islam prevented the formation of extreme rich and extreme poor groups. Thus, the economic and social life of middle-class became the largest and most important part in Islamic societies with the establishment of income justice. For this reason, the sharp class differentiations such as the bourgeois and the proletariat, distinctions and conflicts were not shown up in Islamic societies. For example, while the distinction between serfs and lords in the West during the period of feudalism was very specific and sharp, the conflicts between the rights of the peasants and the positions of the timariots (sipahis) in the Ottomans were not extreme hierarchical. Even the peasants are protected against the timariots because they are one of the basic elements of production (Tabakoğlu, 2009).

The Islamic economic mentality establishes an economic system free of appetite for gaining wealth without stint. Therefore, Islamic financial institutions prioritize spiritual development before material gain. Many studies have revealed that the capitalist system leads to income injustice. In a socially segregated society, the income gap between the richest and the poorest will increase as long as there is no fair distribution of income, capital and wealth. It is important to act in line with the aim of spreading wealth to all segments of society if there is an aim to provide income justice. Furthermore, the CWF prioritized distribution rather than accumulation. The proposed CWF in this study is an infaq institution from that the donator do not have income expectation.

It is possible to create an alternative financial system and provide economic growth and development within the framework of economic principles envisaged by Islam for Muslim societies. In this respect, CWF can be directed to the predetermined important industrial branches. As a result, even capital and wealth holders who do not participate in the CWF will have a desire to make investment on these important preferential areas, which is based on real production and trade. The CWs financed production and trade in the past and they still have the potential to do it today.

Historical Background of CWs

The meaning of the word *waqf*, which is an Arabic term, can be defined as “stopping, making to stop and incarceration” terms. From the history to the present, cooperation and solidarity have existed among people. The concept of solidarity gained institutional character with recommendations in the religion of Islam. Waqfs play an important role in the institutionalization of solidarity. The waqfs found the chance to develop in Islam that has also institutions such as infaq, sadaqah, and zakat etc. Thus, the legal organizations and definitions of waqf also included in Islamic fiqh books. When looking the definitions, it can be seen that the faqihs have very different opinions on waqf. Abu Hanifa, who was the founder of Hanefi sect to which Ottomans were subjected, defined the waqfs with religious and social aspects. Abu Hanifa stated that the real estate waqfs in the form of renting could be allocated for religious services, needs or social purposes of society. Abu Yusuf and Imam Mohammed emphasized the religious size of the waqfs and they evaluated waqf term with a large meaning.

Hanafi faqihs claimed that the waqf goods are belong to Allah and they use *Vakfullâh* term (Kurt, 2010: 180).

The CWs were closely influencing social and economic life in Ottomans. Thus, the Ottoman scholars also discussed CW issue and decided that they were important and necessary for society. In the past, only rich and wealthy people were able to form waqfs. Thanks to the CWs, the waqfs were not established by only the rich class. Ordinary citizens, called *reaya*, came together and could establish CWs with their small savings. With the expansion of the Ottomans and the growth of the economy, the need for cash for enterprises and investments increased the need for capital in society. In order to eliminate the financing need in the society, CWs had a very important function. Thanks to CWs, the banks could not enter the Ottoman society either for corporate or mentally for many years.

The CWs are different from the banks. The profit of capital did not transfer to the founder in CWs. The profit was distributed according to the purposes of the waqf. The benefits of CWs were for welfare of the society. The Ottoman CWs were established not only in the city centers, but also in the most remote villages. The CWs financed the religious services, educational institutions and infrastructure. Thanks to the CWs, entrepreneurs in need of cash were able to make investments by providing financing in appropriate proportions. The structure of CWs in the Islamic world did not changed despite years.

CWs show the financial mentality of the Ottomans. It was requested as a waqf condition that the donated money should be operated with halal methods. This is defined as *mu'âmele-i sher'iyye* (shari transactions) on the waqfiyahs. In addition, the conditions of avoiding interest risk were added to the waqfiyahs. Especially, the methods such as istiglal, bidaa, mudarabah and murabahah used in CWs are the pioneers of the today's Islamic financial instruments. Moreover, there are conditions about financing only merchants and artisans in some CWs. This shows that CWs financed production and trade.

Cash Waqf Fund (CWF)

It is aimed that the goods and money that are donated will be in the service of the people longer with CWF. The cash operated by Islamic methods also will be useful to those who benefit from this money through debt or business finance. In addition, thanks to the distribution of the income of the fund instead of the main capital, continuous help is provided for needs. Thanks to the based on Islamic financial principles, interest-based bank loans will not be required in production-based areas. In addition, other funds will be encouraged to invest in relevant production fields. It should not be forgotten that this fund will bring loss as well as profit. With this fund, the accumulated capital and wealth will be evaluated in large production projects, not in interest banks.

It should not be forgotten that the development of Islamic countries is possible through production-based growth. Therefore, investments based on production should be encouraged. These targets also overlap with the financing instruments of the Islamic economy. Therefore, the establishment of a financial system structured in the light of the principles of

Islamic economics, not modern economic practices, is very important for Muslim countries. The proposal presented in this study aims to deepen and expand the Islamic finance practices in addition to the aim of developing this infrastructure.

There are those who claim that CWs are institutions that provide capital accumulation, as well as those who claim that they are capital distribution institutions because they are waqf. In studies claiming that CWs provide capital accumulation, it is supported that CWs financed consumption rather than investment. These claimants show the mortgages that the CWs demanded while lending money. However, in other studies, it is seen that CWs did not want large collateral when lending and they can only ask for a guarantor (Kaya, 2003: 191). Consequently, if the CWs are operated in accordance with the purpose of establishment, they have the potential to be the determining institutions in the fair accumulation and distribution of capital.

Conclusion

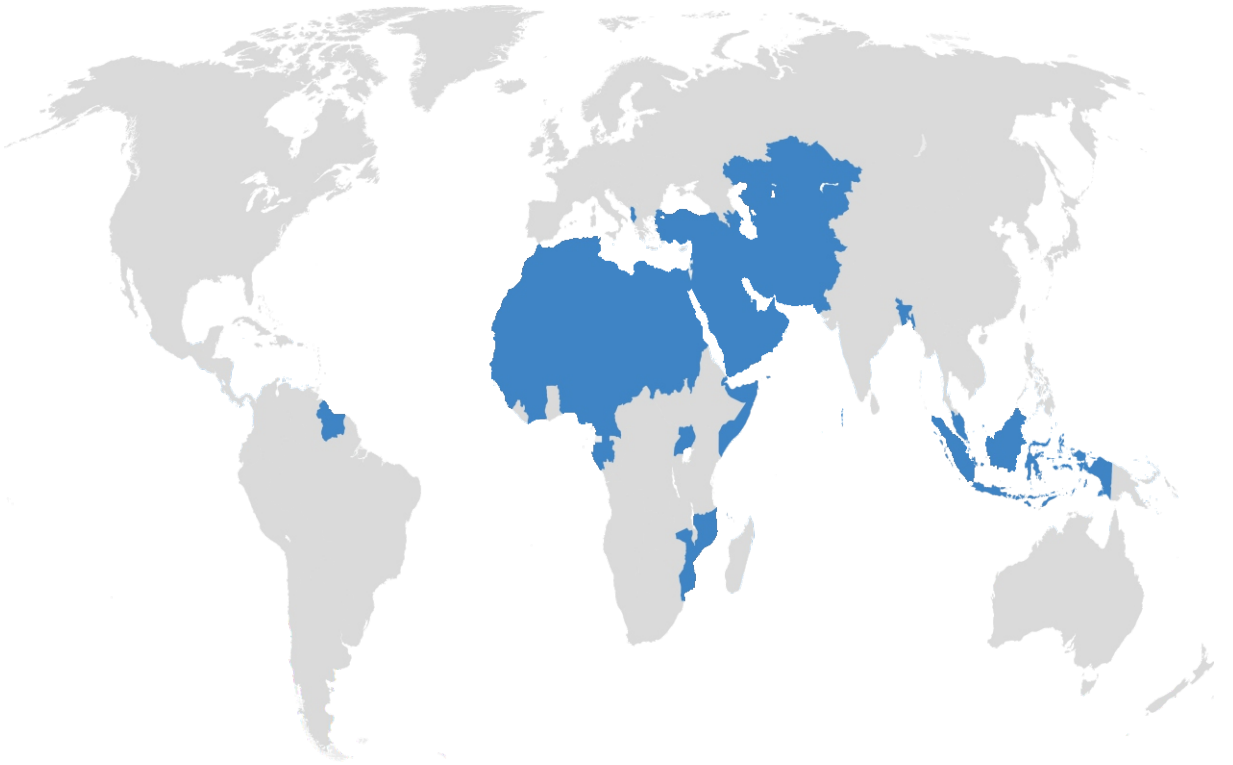
The economic thought that prevails in the world today is the result of capitalism, which developed as a continuation of mercantilism in the West from the 15th century. Therefore, if the solution of today's economic and financial problems is to be sought, first of all the birth and roots of this system should be examined. It is a mistake to wait for the system causing the problem to produce solutions to these problems. Today, the banking and reserve system, which has a great weight in the global economy, has created a significant difference between the financial sector and the real sector with the money creation mechanism in the market for many years. Due to this difference, virtual growth has been extinguished and crises occurred after a while. The definition of economy based on the principles of mainstream economic ideas cannot offer a solution to problems. We need to find the solution to these problems in the institutions of our civilization. This knowledge is in our history.

The CWs operate and serve for the basic needs of the society. Moreover, CWs supplied the financial needs of the important factors of economic life such as farmers, tradesmen, entrepreneurs, merchants and producers with Islamic financial procedures and practices. CWs unlike banks prevented capital from collecting certain classes. In addition, they established a mechanism that distributed wealth from rich to poor.

Nowadays, after the financial crises caused by the modern financial system, the search for alternatives brings the Islamic finance methods to the forefront. The Islamic thought and the practices in history provide a serious alternative to modern financial problems. One of these alternatives is CWF, which are both charity-based and financing-based institution. In this regard, the CWF establish the connection between financial sector and real sector again because of using Islamic/interest-free financial methods based on partnership. Moreover, CWF can prevent moral problems since it is not a commercial institution. The primary function of CWF is charity. CWF has the necessary features to provide solutions to current financial problems. There is enough experience for the establishment of this fund in Turkey.

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