OIC ECONOMIC OUTLOOK 2019

Mobilizing Financial Resources for Development

SESRIC

ORGANISATION OF ISLAMIC COOPERATION

STATISTICAL, ECONOMIC AND SOCIAL RESEARCH AND TRAINING CENTRE FOR ISLAMIC COUNTRIES

Organization of Islamic Cooperation

Statistical, Economic and Social Research and Training Centre for Islamic Countries

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Acronyms

ADB	Asian Development Bank
BIT	Bilateral Investment Treaty
CEE	Central and Eastern Europe
DAC	Development Assistance Committee
DOTS	Direction of Trade Statistics
EIB	European Investment Bank
EU	European Union
FDI	Foreign Direct Investment
GCF	Gross Capital Formation
GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formation
GNI	Gross National Income
GVC	Global Value Chain
HIPC	Heavily Indebted Poor Countries
ICT	Information and Communication Technology
IDB	Islamic Development Bank
IFF	Illicit Financial Flow
IFS	International Financial Statistics
ILO	International Labour Organisation
IMF	International Monetary Fund
IPR	Intellectual Property Rights
ISIC	International Standard Industrial Classification
KILM	Key Indicators of Labour Market

LAC	Latin America and the Caribbean
LDCs	Least Developed Countries
LIFDCs	Low Income Food Deficit Countries
MDB	Multilateral Development Bank
MENA	Middle East and North Africa
MVA	Manufacturing Value Added
NSC	North-South Cooperation
ODA	Official Development Assistance
ODI	Overseas Development Institute
OECD	Organisation for Economic Cooperation and Development
OIC	Organisation of Islamic Cooperation
PPP	Purchasing Power Parity
R&D	Research and Development
RER	Real Exchange Rate
RTA	Regional Trade Agreement
SSC	South-South Cooperation
SDG	Sustainable Development Goal
SME	Small and Medium-sized Enterprise
SSA	Sub-Saharan Africa
STI	Science, Technology and Innovation
TOT	Terms of Trade
TPS-OIC	OIC Trade Preferential System
TYPOA	Ten-Year Programme of Action
UAE	United Arab Emirates
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNECA	United Nations Economic Commission for Africa
UNIDO	United Nations Industrial Development Organization
UNSD	United Nations Statistics Division

USA	United States of America
USD	United States Dollar
WB	World Bank
WDI	World Development Indicators
WEF	World Economic Forum
WEO	World Economic Outlook

Foreword

It is with great pleasure that I present to you the 2019 edition of the OIC Economic Outlook, SESRIC`s flagship report that assesses the recent economic developments in the group of OIC member countries and presents the projections for the near future. This is the only annual publication on OIC economies that provides a wide range of useful comparative statistics and insights to understand the major economic trends and development challenges in OIC member countries.

This edition of the report conveys undesirable news on the global economy, where global growth rate fell to 3.6% by the end of 2018 compared to 3.8% in 2017, which is expected to further decline to 3.2% in 2019. With an estimated growth rate of 4.1% in 2019, the developing countries, being considered as the engine of the world economy, are projected to attain their lowest average growth rate since 2009. A number of key issues of concern will likely determine the path of global economic growth over the next few quarters and years, including the uncertainties about global trade, weak investments, threats to global supply chains and certain geopolitical issues.

The finding that particularly stood out for me in this report is the fact that the average economic performance of the OIC countries in 2018 fell below the world average for the first time in a decade and it is expected to remain so in 2019. In 2018, economic activity in the OIC countries has slowed down to the average growth rate of 3.1%, compared to 3.7% in 2017, and expected to further decline to 2.4% in 2019. However, the encouraging news is that the average economic growth of OIC countries is expected to bounce back and exceed the world average by reaching 3.8% in 2020.

Probably the most worrying finding in the OIC Economic Outlook 2019 is that from 2014 to 2018 the low income OIC countries have been growing below the OIC average. This indicates the necessity of greater economic cooperation among the OIC countries, which will address the issue of widening gap between higher income and the lower income OIC countries, and lead all OIC economies to more growth, employment and competitiveness.

Another important message of this report is that the OIC countries should act together, as much as possible, in order to attract enough Foreign Direct Investment (FDI) and finance their development goals and projects. In 2018, only around 8% of the global FDI inflows ended up in the OIC countries. Considering the huge requirements to finance important infrastructure and development initiatives, availability and accessibility of financial resources remain a major challenge for many OIC countries.

In this connection, we have highlighted the challenges and opportunities related to mobilizing domestic and external financial resources for development in a special section. The need for financing sustainable development of OIC countries is growing, but the actual volume of domestic resources is not increasing enough and is not yet compensated by a symmetric growth of external resources. In this regard, the report not only touches upon the alternative approaches and instruments that are particularly relevant and potentially available for the OIC member countries but also makes more visible the OIC countries' support to other developing economies in their efforts to secure financing for development. It also highlights the strong potential of Islamic finance in promoting social and economic infrastructure development.

The OIC Economic Outlook 2019 is a result of substantial investment in time, effort and dedication by SESRIC staff. I would like to acknowledge their contributions in hope that you will find the report engaging, but above all, useful and informative.

Nebil DABUR
Director General
SESRIC

Acknowledgements

The report has been prepared by a core research team at SESRIC led by Kenan Bağcı and comprising Erhan Türbedar and Cem Tintin. Nosratollah Nafar, Lead Economist, from the Islamic Development Bank (IsDB) also contributed to the report. The research was conducted under the general supervision of Mazhar Hussain, Director of Research Department, and Nebil Dabur, Director General of SESRIC. The team presents its gratitude to the IsDB especially Mr. Salah Jelassi, Manager of IsDB Regional Hub, Turkey, for facilitating the technical contribution of IsDB to the report.

Section 1 on Recent Economic Developments in the World and Section 6 on International Partnership for Development Cooperation are prepared by Erhan Türbedar. Section 2 on Production, Growth and Employment in OIC Countries, Section 3 on Trade and Finance in OIC Countries and Section 4 on Development Challenges and the Role of Finance in OIC Countries are prepared by Kenan Bağcı. Section 5 of the report on Mobilizing Domestic and International Resources for Financing Development is prepared by Cem Tintin. Section 7 on Alternative Financing for Development: The Role of Islamic Finance is prepared by Nosratollah Nafar.

Executive Summary

Recent Economic Developments in the World

World Economic Trends and Prospects

Growth

World economy is growing slower and substantial risks are arising. After acceleration in 2016-2017, growth rates have slowed down in both developed and developing countries, causing a slight decrease in the world real GDP growth rate from 3.8% in 2017 to 3.6% in 2018. Currently, world's major economies - accounting for near 70% of global GDP are slowing, while the major forecasting institutions are indicating to a greater slowdown in global GDP growth in the upcoming two years. The key things to watch over the next period will be rising uncertainty about the global trade, geopolitical issues in Asia and Brexit issue. All these factors are likely to determine the path of global economic growth over the next few quarters.

Unemployment

New data provided by the International Labour Organization (ILO) for 2018 point to some progress in global employment. An estimated 5% (172 million people) worldwide were unemployed in 2018, which averaged 5.1% (174 million people) in 2017. However, the number of unemployed people in the world is expected to increase around one million per year to reach 174.3 million by 2020 as a result of the expanding labour force. Further, low-quality employment is on the rise. In 2018, 45% of employed people in the world were working in difficult conditions for low wages with little security. The global youth and women unemployment rates were 11.8% and 5.4% respectively, higher than total unemployment rate.

Trade

Trade policy remains to be the biggest risk for global economic growth. In 2018 global trade growth has slowed to 3.5% in exports and 4.1% in imports due to worsening in the existing trade tensions. Global trade growth is expected to further slowdown in 2019. According to the Purchasing Managers' Index (PMI), new export orders have lost considerable momentum compared to beginning of 2018, when global economic environment was much more favourable. Due to unfair trade policies, international cooperation is under stress, indicating that dispute settlement mechanism of the World Trade Organisation (WTO) is in urgent need of reform.

Investments

The slight recovery in investment share in GDP has continued in 2018, reaching 21.9% for developed countries and 32.8% for developing ones. Projections for 2019 and 2020 indicate that investment will continue to provide a stimulus to economic growth in developed countries, while it is expected to decline slightly in developing world. Global inward Foreign Direct Investment (FDI) flows fell by 13% in 2018, to 1.3 trillion dollars - from 1.5 trillion dollars in 2017. FDI inflows to developed countries fell by 27%, to 557 billion dollars, while FDI flows to developing countries remained more stable at around 740 billion dollars. As a result of the significant fall in FDI in developed countries, the share of developing economies in global FDI increased to 57% in 2018. Medium-term projection shows that global FDI flows will remain well below the average over the past decade.

Financial Conditions

Global financial conditions became more favourable for developing countries since the start of 2019. The persistent signs of deterioration in global economy combined with low inflation have led major central banks to adopt more accommodative monetary policy stances for the near term and reduce interest rates in 2019. Long-term interest rates have declined accordingly and are at record lows in many countries. As long-term yields in developed economies have eased, external financing conditions for developing countries have improved, supporting a recovery in capital flows into developing economies.

Current Account Balance

Current account balances have slightly deteriorated both in developed and in developing countries in 2018, compared with their 2017 levels. The current account surplus in developed countries has narrowed to 0.7% of GDP in 2018, while current account deficit of developing countries increased form (-0.03% in 2017 to (-0.1%) in 2018. The most notable improvement in the current account balances was realized in oil exporting countries, due to rise in oil prices. Symmetrically, current account fragilities in some oil-importing countries, such as India, Indonesia, Pakistan and South Africa have widened, reflecting their higher oil import bills. The current account balances of oil exporting countries are expected to be adversely affected in near term, as average oil prices are projected to drop from their 2018 level.

Fiscal Balance

The global fiscal developments remained broadly stable. The world general government fiscal balance as percentage of GDP has slightly improved from (-2.9%) in 2017 to (-2.8%) in 2018. However, over the 2019-2020, average global fiscal balance is expected to slightly deteriorate and take values between (-3.1%) and (-3.3%). General trend of fiscal stabilization in the low-income developing countries will continue.

Recent Economic Developments in OIC Countries

Production, Growth and Employment

Production

OIC countries witnessed an increasing trend in economic activity and their GDP increased from US$ 16.8 trillion in 2014 to US$ 20.6 trillion in 2018 measured in PPP. As a group, the OIC countries produced 15.2% of the world total output and 25.8% of that of the developing countries in 2018. In current prices, the share of OIC countries in world total GDP is measured as only 8.2%. The decline in the share of the OIC countries in total GDP of the developing countries indicates that the OIC economies have not performed as good as non-OIC developing countries in expanding their output. In 2018, the top 10 OIC countries in terms of the volume of GDP produced 73.0% of the total OIC countries output.

Growth

The GDP growth of OIC countries has slowed down to 3.1% in real terms in 2018, as compared to 3.8% in 2017. Economic growth in OIC countries is expected to decline to 2.4% in 2019 and continue to remain below the world average. Only in 2020, OIC countries are expected to grow above the world average. Lower income OIC countries have been growing at a lower rate than the OIC average during 2014-2018, implying a widening gap between rich and poor OIC countries. At the individual country level, Libya, with a growth rate of 17.9% in 2018, was the fastest growing economy in the group of OIC countries. In total, 26 OIC countries recorded a growth rate higher than the world average of 3.6% in 2018.

Production by Sectors

Although agriculture sector account for an important share of employment in the economy, its share in total GDP is generally low due to lower productivity in agriculture sector. However, it still remains an important sector for OIC countries, which accounts for 10.2% of total economic activity. In terms of the average shares of the value-added of the four major sectors in the OIC GDP in 2017, service sector recorded the largest share with 50.0%. The share of manufacturing sector, which has greater potential to promote productivity and competitiveness, increased from 14.2% in 2013 to 14.6% in 2017.

GDP by Major Expenditure Items

The analysis of global GDP by major expenditure items reveals that the share of final consumption (both by household and government) continued to be the highest in the total GDP over the years. In 2017, household consumption in OIC countries accounted for the lion share of GDP (52.9%) followed by investment (28.0%) and general government expenditure (12.8%). The share of net exports in total world GDP was negligible.

Income and Poverty

Average per capita income in OIC countries increased from USD 8,779 in 2010 to USD 10,265 in 2018, corresponding to 16.9% increase in total. During the same period, non-OIC developing countries attained higher growth rates (37.1%) and exceeded the average per capita income level of OIC countries to reach USD 11,464 in 2018. Average per capita income growth rate in OIC countries was recorded at 2.2% during 2010-2015, which fell to 1.6% during 2016-2018 and it is further expected to shrink to 1.2% during 2019-2020. Among the OIC countries, Qatar registered the highest GDP per capita in 2018, which was 18.2 times higher than the average of the OIC countries as a group. Within the group of OIC, there are 13 countries that have poverty rate over 30%.

Unemployment

OIC countries continue to record significantly higher average unemployment rates compared to the world, developed countries and non-OIC developing countries. During this period, average unemployment rate in OIC countries fluctuated between 5.8% and 6.9%, which was measured as 6.0%

in 2018. Unemployment rates for youth labour force are typically higher than the rates for adult in all country groups. As of 2019, youth unemployment in OIC countries is expected to increase to 13.9%, while it will remain at 10.7% in developed countries and remain at 11.2% in non-OIC developing countries.

Labour Productivity

Globally, labour productivity has witnessed an increasing trend during the last decade. The output per worker in OIC countries has increased at a compound growth rate of 2.3% during 2000-2009, but this rate declined to 1.8% during 2010-2018. As of 2018, average labour productivity in OIC countries was measured as USD 28 thousands, as measured in constant international prices based on purchasing power parity (PPP). Output per worker in the developed countries is estimated at USD 96 thousands in 2018, which indicates that an average worker in OIC countries produces only 29.4% of the output produced by an average worker in the developed countries.

Inflation

With the slowdown in global economic growth rates, inflation rates across the world remains at moderate levels over the last few years. Although the growth rates have declined in OIC countries between 2016 and 2018, inflation rates have been on the rise during the same period. It increased from 5.7% in 2016 to 9.3% in 2018. However, it is expected that the rise in average consumer prices will decline over the next two years to reach 8.3% in 2020. On aggregate, consumer prices have increased by 39.3% in OIC countries, 29% in non-OIC developing countries and 6.3% in developed countries during 2013-2018.

Fiscal Balance

During the period under consideration, the OIC member countries witnessed sharp deterioration in their fiscal balance. High dependence on commodity and primary goods exports makes many OIC countries particularly vulnerable to price fluctuations. In 2017, there were only three OIC countries with fiscal balance surplus in 2017. This number increased to eleven in 2018.

Trade and Finance

Merchandise Trade

In line with global trend, OIC countries have witnessed an improvement in their total exports to world and their aggregate exports increased to US$ 1.98 trillion in 2018. Due to over-proportional increase of exports from OIC countries, the share of OIC countries in total exports of developing countries bounced back to 25.3% in 2018, compared to 23.6% in 2017. OIC countries' collective share in total world merchandise exports decreased to its lowest level of 8.8% in 2016. However, this ratio increased to 9.3% in 2017 and 10.2% in 2018, reflecting better economic performance of OIC countries compared to other country groups. In 2018, the top 5 (10) largest OIC exporters accounted for 58.1% (77.2%) of total merchandise exports of all member countries. Similarly, total merchandise imports of OIC countries increased from US$ 1.7 trillion in 2017 to US$ 1.8 trillion in 2018. Despite the increase in import volumes, the share of OIC countries in global merchandise imports slightly decreased to 9.2% compared to 9.6% in 2017. The top 5 (10) OIC importers accounted for 55.7% (71.5%) of total OIC merchandise imports in 2018.

Services Trade

In 2018, world services exports totalled US$ 5.8 trillion. OIC countries exported US$ 397 billion worth of services in 2018, which is the highest number recorded by the group of OIC countries. On the other hand, the total services imports of OIC services reached US$ 575 billion in the same year and, hence, the OIC countries as a group continued to remain net importer of services. As of 2018, OIC countries as a group account for 6.8% of global services exports and 10.3% of global services imports. United Arab Emirates, with US$ 71 billion exports and 17.8% share in total OIC services exports, was the top exporter in services in 2018.

Trade Balance

Despite minor improvements observed in 2018, contribution of OIC countries to global flow of goods and services remain below their potential. OIC countries became a net importer of manufacturing products during 2015-2017, mainly due to falling commodity prices. In 2018, OIC countries as a group recorded a surplus again at an amount of US$ 175 billion. On the other hand, OIC countries remained constantly a net importer of services over the period under consideration. Despite the fall in trade deficit in services during 2014-2016, it started to grow over the last two years and reached US$ 177 billion deficit in 2018.

Intra-OIC Merchandise Trade

Intra-OIC trade was falling during 2014-2016 period, but it started to increase again in 2017 and reached US$ 312 billion. In line with continued expansion of global trade, total intra-OIC exports further increased to US$ 350 billion in 2018. Intra-OIC exports increased by 34% over the last two years, yet it still remains below the total values recorded in 2012. On the other hand, the share of intra-OIC trade in total trade of OIC countries constantly have been rising during the period 2014-2017 and reached 19.1% in 2017 compared to its level of 17.9% in 2014. However, it fell to 18.8% in 2018 due to relatively stronger increase in their trade volumes with non-OIC member countries.

FDI Flows and Stocks

FDI flows to OIC countries generally remained lower than their potential. In 2017, the total value of FDI flows to OIC countries increased for the first time since 2011, which was recorded at US$ 108.3 billion, corresponding to 5.5% increase compared to the previous year. However, it slightly decreased in 2018 to reach US$ 107.4 billion. However, due to fall in global FDI inflows and increase in inflows to OIC countries, the share of OIC countries in global FDI inflows has been increasing over the last year years and increased to 8.3% in 2018.

Financial Sector Development

The level of financial sector development in OIC countries remains shallow. The average volume of broad money relative to the GDP of OIC countries was recorded at 60.1% in 2018, compared to as much as 137% in non-OIC developing countries and 124% of the world average. In the same year, the domestic credit provided by the financial sector in OIC countries was on average equivalent to 66.7% of the GDP whereas this figure was 141.8% in non-OIC developing countries and 172.8% in the world. On the other hand, access to finance in OIC countries improved significantly over the years, which increased from 27.8% in 2011 to 46.3% in 2017.

External Debt and Reserves

The total external debt stock of OIC countries continued to increase, which reached US$ 1.6 trillion in 2017. In terms of maturity structure of the external debt, short term debts accounted for 16.1%

of total external debts of OIC countries, while 29.0% of total debts of non-OIC developing countries were short term debts. Turkey remained the most indebted OIC member country in 2017 with over US$ 455 billion debt. World total monetary reserves, including gold, reached US$ 12.4 trillion in 2018, of which US$ 1.6 trillion are owned by OIC countries. The share of OIC countries in world total reserves declined from 13.3% in 2016 to 12.4% in 2018.

ODA and Remittances

In 2017, net ODA flows from all donors to developing countries reached US$ 162.8 billion. While more than 33% of ODA flows remain unexplained (no information available to which countries they flowed), out of remaining US$ 108.5 billion ODA flows, 56.2% flowed to OIC countries in 2017. In 2017, the top 5 countries received 39.5% of total ODA flows to OIC region whereas the top 10 received 61.0% of them. The inflows of personal remittances to OIC member countries increased from US$ 125 billion in 2013 to US$ 152 billion in 2018.

MOBILIZING FINANCIAL RESOURCES FOR DEVELOPMENT

Development Challenges and the Role of Finance in OIC Countries

OIC countries are well endowed with productive resources, particularly with human and natural resources. Efficient use of these resources can bring higher economic growth rates and welfare for the people. Ineffective use of productive resources results in lower growth rates and income levels. This is also due to the fact that OIC economies are mostly characterised by high concentration of export and limited diversification of domestic economy. Another important implication of inefficient use of productive resources is the lack of competitiveness.

In this connection, OIC member countries could not sustain long-term growth as developed countries did over the last century. There are a number of instruments that OIC countries can utilize to address the development challenges and attain higher growth rates. These include investing in human and institutional capacities, facilitating technological progress and innovation, and channelling resources to productive investments through financial development. An important element in the policy mix of boosting productivity and competitiveness is the need to maintain macroeconomic stability, since this would create a business environment free of uncertainty and unanticipated costs. In addition to economic instabilities, political instabilities are also severely affecting the growth trajectories in some OIC countries, where the negative effects of armed conflicts extend well beyond the measurable social and economic costs.

The global level initiatives, regional solution mechanisms and national level efforts fell short in meeting the growing needs of developing countries to finance their development and enable them to graduate from the developing country status. According to the UNCTAD estimations, the total finance requirement including investment needs in the developing world alone range from $3.3 trillion to $4.5 trillion per year. Some OIC countries are rich in terms of resources where such resources offer great potential for fostering development. On the financial front, Islamic finance offers a window of opportunity in OIC countries that could be used in bridging the gap in financing for development.

OIC countries have a long-history of active intra-OIC cooperation in many areas from trade and infrastructure development to capacity-building and investment. This facilitates transfer of capital, know-how and expertise among OIC member countries that are critical for development. This also allows several OIC countries to mutually benefit from each other's experiences and sources while advancing in their development trajectories. Finally, OIC countries have unique instruments and mechanisms including Islamic financial instruments, Zakat and Waqf Funds that have the potential to make a significant positive contribution in financing for development. Overall, these factors would enhance financing for development in OIC countries by helping to go beyond the conventional understanding and benefit from unique solution mechanisms.

Mobilizing Domestic and International Resources for Financing Development

Many developing countries and a number of OIC countries suffer from ineffective use of domestic resources and could not fully benefit from international resources on financing for development due to a number of challenges. In this regard, it is important to pay particular attention to the role and potential contributions of domestic and international resources for financing for development. In the light of the existing literature and international reports, ten major challenges faced by OIC and many developing countries in their efforts to finance development have been discussed from weak macroeconomic governance capacities to limited benefits gained from international capital flows.

A set of eleven solutions from fighting with illicit financial flows to modernizing Official Development Assistance (ODA) have been listed and elaborated that can provide some proper guidance for OIC and many developing countries to mobilize domestic and international resources as well as benefit from international cooperation to a higher extent in their course of development. In addressing those challenges bolstering international as well as intra-OIC cooperation emerge as two key success factors.

In particular, establishing a strong intra-OIC cooperation not only would help OIC countries to exchange experiences and best practices among each other but also to strengthen the solidarity among them in the area of financing for development. In this way, OIC countries would be able to address their financing needs for developmental projects and programmes more effectively and ultimately achieve sustainable development for the betterment of standards of living of their people.

International Partnership for Development Cooperation

Growing needs of countries are seldom accompanied by the resources that are necessary to meet them. Particularly in developing world, leaders repeatedly point to the lack of financing as one of the primary barriers to the long-term development. Resource availability must rise if the Sustainable Development Goals are to be attained. International actors, both public and private, contribute substantive amounts of cross-border finance to the OIC countries. The volume of external finance available to the OIC countries has substantially increased to $720 billion in 2017 from $363 billion in 2015. At $73 billion in 2017, the total of bilateral and multilateral ODA flows to the OIC countries represents a small but important proportion of the external financial flows.

On the other hand, remittance inflows to the 50 OIC countries with available data are steadily growing and have reached a record high of $144 billion in 2017. FDI remain to be critical external source of finance for OIC countries which slightly increased in 2017 at $108.3 billion. In contrast to remittances and FDI, portfolio investments and external debt flows appear to be more vulnerable to global conditions. Still, portfolio investments to the OIC countries peaked at $121 billion in 2017, surpassing the OIC FDI inflows in the same year. A worrying thing is the increase in external debt flows to OIC countries, which is evident for the period after 2015, what calls on the OIC governments to address the challenges linked to debt sustainability to prevent negative impact on long-term development.

In the context of South-South Cooperation (SSC), the OIC countries are also actively supporting other developing economies in their efforts to secure financing for development. Unfortunately, no monitoring mechanisms beyond occasional reports with poor data are available on OIC countries' contributions in the South-South development partnership. Nevertheless, it is well known that some OIC countries are providing significant development aid, such it is the case with Indonesia, Qatar, Saudi Arabia, Turkey and United Arab Emirates. Moreover, since 2014 outward remittance flows from the OIC countries are higher from the remittance inflows to the OIC countries. In 2017, the value of outward remittance flows from the OIC countries was $150 billion, of which 50% fled to the OIC countries themselves, and the second half mostly went to the non-OIC developing economies.

In the period from 1995 to 2018, the OIC countries' aggregated trade to the non-OIC developing countries measured from the export side, increased for 19 percentage points. Further, in 2018, FDI outflows from the 43 OIC countries with available data reached near $68 billion. 58% of these FDI outflows went to developed countries, 29% to OIC economies and 13% to non-OIC developing world.

Alternative Financing for Development: The Role of Islamic Finance

Islamic finance has strong potential in promoting both social and economic infrastructure development. While Islamic re-distributive instruments such as Zakat and Awqaf have great potential to support small sized social projects, sukuk can successfully finance largescale infrastructure (water and sanitation projects, sustainable and affordable energy, transport, roads and shelter.

There are three major constraints, which hinder the effectiveness of Islamic finance in line with the current and emerging financial needs of OIC member countries. They are (i) inadequate awareness about the role of Islamic finance particularly Islamic re-distributive instruments in addressing socioeconomic difficulties in many OIC member countries; (ii) insufficient widely accepted Shariah compliant products enhance financial cooperation among financial institutions to facilitate resource mobilization at regional and international levels; (iii) lack of innovative products in Islamic finance to support dynamic financial needs of OIC member countries on the journey of sustainable development.

At the country level, OIC member countries need to develop a supportive legal and regulatory framework and "proactive" policy targets on usage, access and quality of Islamic finance in line with dynamic needs of their real economies. At the OIC level, there must be a close collaboration among concerned development institutions to support the efforts of OIC member countries to explore the relevant policy, legal, regulatory and institutional interventions necessary to expand the part of Islamic financial institutions in creating new source of finance for socioeconomic development.

Specifically, they may consider (i) supporting the creation of a common platform to enhance dialogue among member countries to with the aim of promoting knowledge and increasing awareness on the role of Islamic finance particularly Islamic re-distributive funds in socioeconomic infrastructure development; (ii) identifying successful case studies and good practices anywhere in the world and having exchange of visits and technical cooperation among OIC member countries in the form of reverse linkage initiative; and (iii) supporting the development of widely accepted Shariah compliant products to boost financial cooperation and facilitate resource mobilization at national, regional and international levels.

PART I: RECENT DEVELOPMENTS IN THE WORLD ECONOMY

CHAPTER ONE

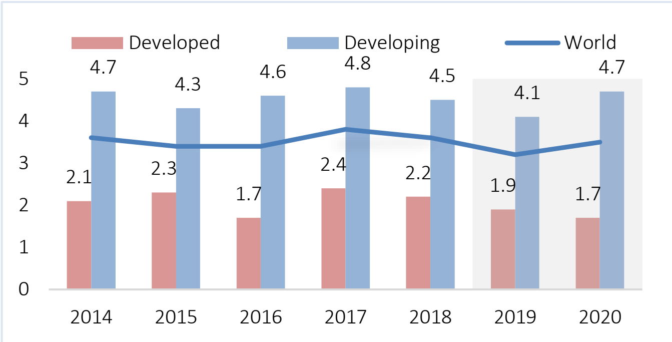
World Economic Trends and Prospects

World economy is growing slower and substantial risks are arising. A synchronized global recovery that existed after 2016 lost its momentum and deceleration of growth is visible now both in developed and developing countries, causing a slowdown in the world real GDP growth rate from 3.8% in 2017 to 3.6% in 2018. In the latest update of World Economic Outlook, the International Monetary Fund (IMF) forecasts that the global economy will further decrease to 3.2% in 2019, but it will be on track to stabilize towards 2020 (Figure 1.1).

Compared to the IMF, world real GDP growth projections of other major forecasting institutions such as the World Bank, the Oxford Economics and the Economist Intelligence Unit (EIU) are less optimistic and indicating to a greater slowdown in GDP growth in upcoming years. For them, towards 2021 world real GDP will continue to grow, but with almost no expansion (Figure 1.2)

Projections for the world economy are based on a number of key assumptions regarding economic policy and the international environment. Although predictions can never be entirely accurate, they are useful to assess future trends in the world economy. In this regard, it is interesting to note that the number of countries with negative growth rates will drop from fifteen in 2018 to thirteen in 2019, according to IMF estimations (Figure 1.3). Those who are expected to close 2019 by negative growth rates are not big economies, therefore it is too much early to be thinking about a world recession. However, out of Top 20 world economies, sixteen countries accounting for 59% of global GDP based on PPP are expected to face a slowdown in real economic growth in 2019. Of the Top 20 world economies, Turkey and Iran are expected to close 2019 with negative growth rates, while Italy, Germany, Japan, United Kingdom, France, Canada, Mexico, Russia and Saudi Arabia are forecasted to be in the list of the slowest growing countries. Globally, by April 2019, economies representing nearly 70% of global GDP were slowing down.

Figure 1.1: Real GDP Growth (%)



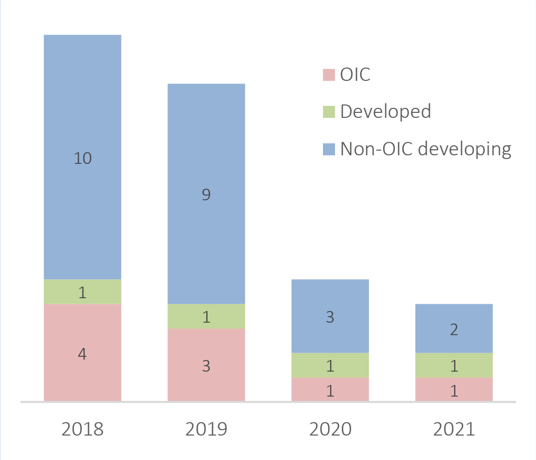
Source: IMF, World Economic Outlook Update, July 2019.
Notes: Shaded area indicates forecasts (World: N = 193; Developed: N = 39; Developing: N = 154)

Figure 1.2: World Real GDP Growth Projections (%)

	2018	2019	2020	2021
IMF	3.6	3.2	3.6	3.6
World Bank	3.1	2.6	2.7	2.8
Oxford Economics	3.2	2.7	2.7	2.9
EIU	3.0	2.7	2.6	2.8

Source: Official projections of mentioned organisations.

Figure 1.3: Number of Countries with Negative Growth Rates (%)



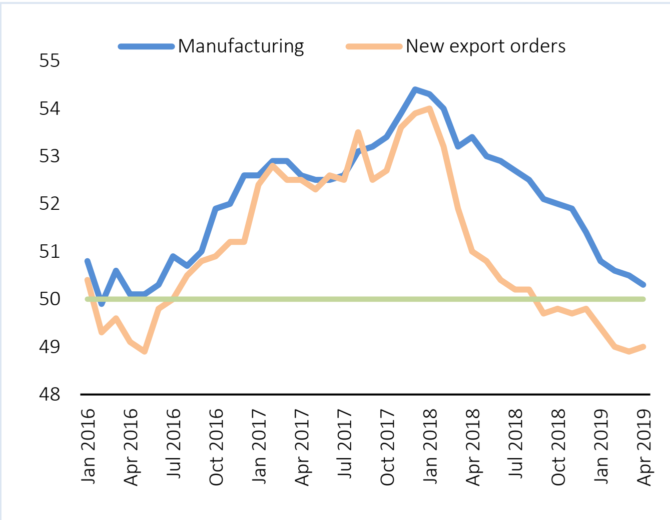
Source: IMF, World Economic Outlook database.
Notes: World: N = 193; Developed: N = 39; Developing: N = 154

Uncertainty in global economy is undermining growth

Sluggishness in the world economy can be explained with different risk factors, including the rising threat of protectionism, vulnerabilities in emerging markets, the Brexit negotiations and growing geopolitical factors in Asia. Particularly due to unfair trade policies international cooperation is under stress, indicating that dispute settlement mechanism of the World Trade Organisation (WTO) is in urgent need of reform. Otherwise, slowdown in multilateralism and attack on specific rules of international trade will continue to adversely affect confidence and predictability in the global economy.

The prolongation of above-mentioned risks has already created uncertainty that is negatively affecting global industrial activity and trade in goods. As it is shown in Figure 1.4, manufacturing and new export orders measured by Purchasing Managers' Index (PMI) have lost considerable momentum compared to beginning of 2018, when global economic environment was much more favourable.

Figure 1.4: Global Manufacturing and New Export Orders



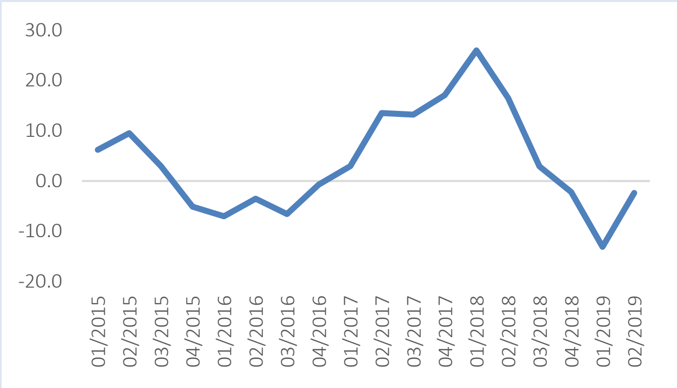
Source: World Bank based on Haver Analytics.
Notes: Manufacturing and new export orders are measured by Purchasing Managers' Index (PMI). PMI readings above 50 indicate expansion in economic activity; readings below 50 indicate contraction.

According to the findings of the Ifo Institute's quarterly World Economic Survey, the world's economic climate deteriorated fourth time in succession after second quarter of 2018, with the indicator dropping from 26 points in the first quarter of 2018 to (-13.1) points in the first quarter of 2019. Accordingly, for the period of one year, the global economy was slowing down more and more. In the second quarter of 2019, the indicator for the world economy rose to (-2.4) points, as economic expectations of the 1,281 experts covering 119 nations brightened (Figure 1.5). This upturn in the Ifo indicator gives hope for the gradual softening of fragility in the global economy over the course of 2019.

- Growth divergences among developed economies are widening

Real GDP growth figures for last three years continue to display slowing growth for developed countries. They are expected to grow 1.9% in 2019, which exceeds their average growth rate realized in the period from 2001 to 2010. However, growth projection for 2020 also indicates to a gradual slowdown in economic activity of developed countries (Figure 1.6).

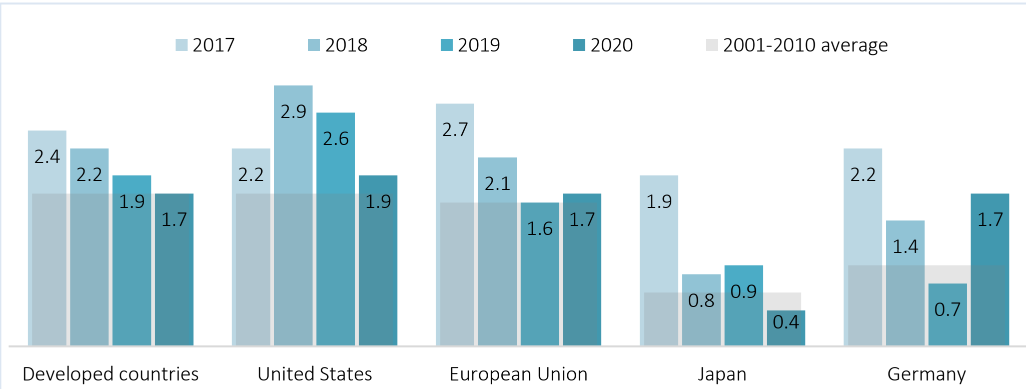
Figure 1.5: World Economic Climate



Source: Ifo Institute, CESifo Group
Notes: This graph summarizes results of a quarterly surveys conducted by Ifo Institute. The survey focuses on qualitative information, i.e. assessments of a country's general economic situation and expectations regarding key economic indicators. The April 2019 survey received responses from 1,281 experts in 119 countries. 0 point means that the share of positive and negative answers is equal.

The United States (US) output slowed notably, which is projected to grow 2.6% in 2019 - a deceleration from the 2.9% expansion in 2018, and then only 1.9% in 2020. Still, by the end of 2020, for US economy it is expected to remain above its average growth rates that existed from 2001 to 2010 (Figure 1.6). Outlook for the US economy in 2018 was strong due to fiscal stimulus and solid gains in the labour market. However, business tax cuts have massively increased the US government's budget deficit, creating the need for severe spending cuts in the coming years. Moreover, increased business uncertainty from rising trade tensions vis-à-vis countries such as China and Mexico and slower consumption growth have prompt the US Federal Reserve to loosen

Figure 1.6: Real GDP Growth in Developed Countries (%)



Source: IMF, World Economic Outlook Update, July 2019.
Notes: Figures for 2019 and 2020 are projections (Developed: N = 39; European Union: N = 28)

monetary policy by mid-2019 - for the first time in nearly 11 years - with the hope that it will effectively lower the odds of a recession in the US.

Economic climate in the European Union (EU) has deteriorated significantly since end-2018, mainly due to the worsening global trade environment and the contraction in manufacturing sector. Weakness in China, driven in part by fallout from the trade war, has spread to Germany and other European nations, raising supply chain costs and softening global demand. In the EU, IMF expects growth of 1.6% in 2019, which will then slightly increase to 1.7% in 2020 (Figure 1.6). This trend holds across major EU countries, including Germany - EU's largest economy, where growth is seen going from 0.7% this year to 1.7% in 2020. The European Central Bank (ECB) is expected to unveil a package of measures, including rate cuts, to add further stimulus in European economy.

Economic growth appears to have slowdown in Japan in 2018, whose economy, mainly the export sector, has been affected by the slowdown in the global economy. In terms of GDP based on PPP Japan is the world's fourth-largest economy, which enjoyed a moderate recovery since 2012. After a slim upward revision in GDP growth predicted for 2019, the outlook for Japan's economy is projected to further moderate in the next year (Figure 1.6). Japan is experiencing its worst labour shortage due to an aging population, which is negatively affecting earnings of some industries such as transportation and construction. The United Nations estimates that Japan's population will decline by a third from current levels by 2100.

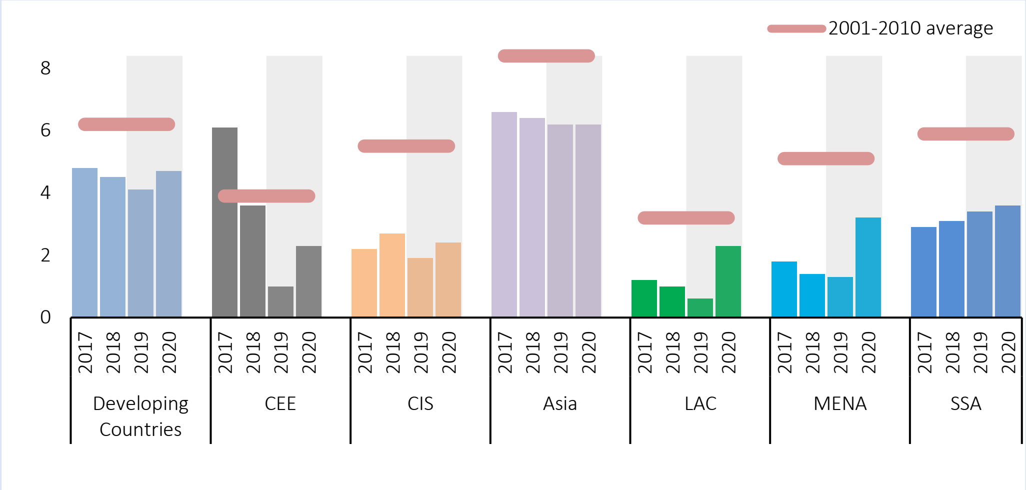
▪ Economic growth in developing countries is slowing, but it is on track to stabilize

Most developed economies experience slower economic growth as compared to developing countries. The IMF expects developing economies to register average growth of 4.1% in 2019, which would be the slowest growth since 2001. However, the developing countries, by contrast to developed ones, are projected to grow faster in 2020, but still below the average growth rates achieved in the period from 2001 to 2010 (Figure 1.7).

In Central and Eastern Europe (CEE) growth is projected to moderate from 3.6% in 2018 to 1% in 2019, then improve to 2.3% in 2020. Approximately 4% growth rate in the CEE economies is quite achievable in short-term by removing the slack in the labour market, particularly with ensuring wider participation of women and youth in the labour market. But in the long-term, growth of CEE economies will depend on improved productivity and entrepreneurship.

Turkey, biggest economy in the CEE region, is experiencing depreciation of its national currency. Further, its structural current-account deficit and the high level of foreign-currency denominated debt held by the private sector are increasing Turkey's external financing needs. Real GDP growth of Turkey accelerated sharply in 2017, to 7.4% (from 3.2% in 2016) owing to government stimulus measures, government credit guarantees to SMEs, improved export competitiveness and major public infrastructure projects. However, rapid depreciation of the Turkish Lira has exacerbated internal and external imbalances and caused real GDP growth of Turkey to decelerate sharply in 2018 to 2.6%. IMF expects Turkey to close 2019 by negative growth rate of (-2.5%).

Figure 1.7: Real GDP Growth in Developing Countries (%)



Source: IMF, World Economic Outlook Update, July 2019.
Notes: Shaded area indicates forecasts (Developing: N = 154; CEE - Central and Eastern Europe: N = 12; CIS - Commonwealth of Independent States: N = 12; Asia: N = 30; LAC - Latin America and the Caribbean: N = 32; MENA - Middle East and North Africa: N = 21; SSA - Sub-Saharan Africa: N = 45).

In the Commonwealth of Independent States (CIS), existing real growth rates are far away from the regions average registered for the 2001-2010 period. Growth in the CIS countries is projected to be at around 1.9% - 2.4% in 2019-2020. The outlook for the Russian economy is not very promising. In 2018, Russia's GDP grew by 2.3%, a record rate since 2012. However, it is not yet clear how sustainable this change is. In the absence of any serious restructuring of the economy, in the middle-term average real GDP growth of Russia is expected to stabilize around 1.6% annually.

Developing Asia remains to be the world's most dynamic region in economic terms, whose real growth is projected around 6.2% over 2019-2020 (Figure 1.7). Still, IMF projections shows that China's real economic growth slowed to 6.6% in 2018, which is significantly below its historical growth levels, that in average accounted 10.5% in the period from 2001-2010. Real growth in China is projected to moderate to 6.3% in 2019 and 6.1% in 2020. China's economy is still robust to increasing trade tensions with the US, as it becomes more domestically and Asia-Pacific centred. However, the economy remains to be burdened by high debt levels of state-owned enterprises and local governments. With 7.1% of real GDP growth in 2018, India continues to take place among fastest-growing economies. Driven by manufacturing and agriculture, India's economy is projected to grow 7.3% in 2019 and 7.5% in 2020. India and China, despite the gradual slowdown of the latter, will remain a core of developing economies' output growth.

In Latin America and the Caribbean (LAC), the recovery is expected to soften from 1% in 2018, to 0.6% in 2019, then significantly strengthen to 2.3% in 2020. Recovery of the regions' biggest economy Brazil remains to be bleak with 1.1% of real GDP growth in 2018, which is projected to increase between 2.1% - 2.5% over 2019-2020. However, political infighting inside the administration, a burdened pension system as well as difficult fiscal picture may negatively affect economic prospects of this country.

Economic growth in the Middle East and North Africa (MENA) region is expected to continue at a modest pace in 2019, after been subdued at 1.4% in 2018. Economy of MENA region is expected to expand 3.2% in 2020, however, this masks greatly differing performances among countries. In Saudi Arabia, the biggest economy of the Arab world, growth has recovered to 2.2% in 2018, following a contraction of (-0.7%) in 2017. Real GDP growth in this country is projected to moderate to 1.8% in 2019, largely due to a cut in oil production, and slightly accelerate to 2.1% in 2020. Iran's economy is expected to contract for the second time in 2019 to (-6%) following the reintroduction of US sanctions. In general, oil prices have supported the outlook for oil-exporting MENA countries, although many of them remain vulnerable to the energy price shocks.

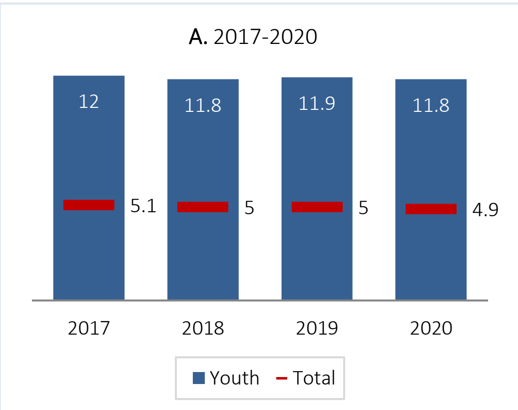
Between 2019 and 2020, the Sub-Saharan Africa will stay on its recovery path, but it will still grow below its potential. Growth in this region is expected to increase from 3.1% in 2018 to 3.4% in 2019, rising further to 3.6% in 2020. A slowdown in global economic growth poses risks to the Sub-Saharan Africa, especially in the area of foreign direct investment and lower prices for commodity exports.

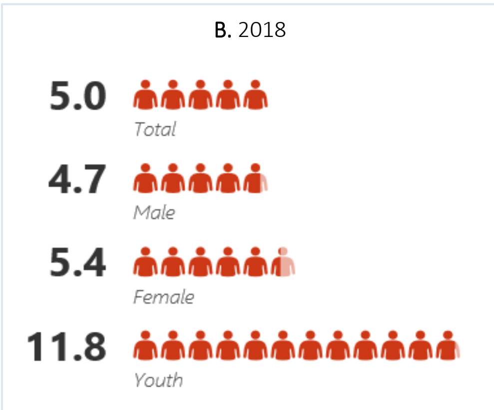
▪ Unemployment remains persistently high in many parts of the developing world

New data provided by the International Labour Organization (ILO) for 2018 point to some progress in global employment. An estimated 5% (172 million people) worldwide were unemployed in 2018, which averaged 5.1% (174 million people) in 2017 (Figure 1.8). Still, the outlook is uncertain, since the slowdown of real GDP growth in the world is already having a negative impact on the labour market in a number of countries.

Under existing conditions, the ILO projects that world unemployment will remain at roughly the same level during 2019 and 2020. However, the number of people unemployed is expected to increase by near 1 million per year to reach 174.3 million by 2020 as a result of the expanding labour force. Unemployment in developed countries is expected to reduce to 32.2 million people

Figure 1.8: Unemployment in the World (%)





Source: ILO modelled estimates.

in 2020 - the lowest number since 2007. The labour situation has improved in some developing economies as well. However, in many parts of the developing world the employment growth is under shadow of increased number of people entering labour market, thus paving the way for unemployment to remain persistently high.

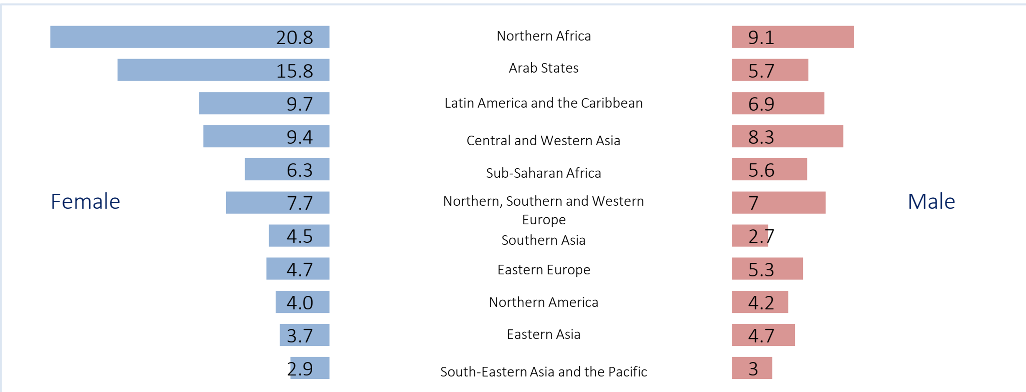
Unfortunately, low-quality employment is on the rise. In 2018, 45% of employed people in the world were working in difficult conditions for low wages with little security, and an additional 35 million are expected to join them by 2019. This vulnerable employment ratio is particularly high in the Sub-Saharan Africa (74%), South Asia (73%), East Asia and Pacific (%42), Latin America and the Caribbean (33%) and the Middle East and North Africa (excluding high income countries) - where in 2018 vulnerable employment accounted for 31% of total employment.

The lack of employment opportunities for youth (i.e. those between 15-24 years of age) remains to be another major global challenge. In 2018, the global youth unemployment rate was 11.8%, or 2.4 times higher than total unemployment rate (Figure 1.8). This ratio is expected to remain almost same over 2019-2020. The challenge is particularly acute in Northern Africa and Arab states, where respectively almost 30% and 20% of young people in the labour market are expected to remain without a job in 2019 and 2020.

The global unemployment rate of women for 2018 – at 5.4% – is 0.4 percentage points higher than the rate for men, according to the ILO modelled estimates. Further, the global women's labour force participation rate – at 48% in 2018 – is 26.9 percentage points below the same rate of their male counterparts.

Differences in unemployment rates between women and men in developed countries are relatively small. But in the developing regions such as Northern Africa the Arab States, female unemployment rates are more than twice as large as men's, due to social norms that obstruct women's participation in employment. It is obvious from Figure 1.9 that for women it is harder to get a job in many regions of the world.

Figure 1.9: Unemployment by Gender (2019, Percent)



Source: ILO modelled estimates.

▪ Trade policy remains to be the biggest risk for global economic growth

Global trade volume of exports and imports of goods and services has strengthened to 5.4% in 2017 – highest rate since 2011. However, in 2018 global trade growth has slowed to 3.5% in exports and 4.1% in imports due to worsening in the existing trade tensions. Global trade growth is expected to further slowdown in 2019 and take values of 3.2% in exports and 3.6% in imports.

Export volume of goods and services grew 3.1% in developed countries and 4.3% in developing countries in 2018, down from 4.4% and 7.2% respectively in the previous year (Figure 1.10). The IMF predicts that this year export volume will further deteriorate and grow by only 2.7% in developed countries and 4% in developing ones. Although disadvantages from the weakness of exports were felt across all regions (except for the CIS region) in 2018, in percentage points they were most pronounced in developing Asia and CEE regions. Among developing economies, only SSA and MENA regions are expected to perform better in exports in 2019, with significant improvements in SSA region compared to 2018. By 2020, the IMF predicts slight improvement in export performance for almost all regions (Table 1.1).

As shown in Figure 1.10, annual growth in import volume of goods and services was considerably stronger in developing countries in 2018 (5.6%) than in the developed ones (3.3%). United Kingdom and Germany saw significant decrease in year-on-year growth in imports in 2018, whereas import growth remained almost stable in US and Japan. Among developing regions, import growth in CIS and CEE economies significantly slowed in 2018 while year-on-year import change in the MENA region was negative. However, projections for these three regions indicates to slight increase in import volume for 2019, while growth in imports in Asia, SSA and LAC regions is expected to slow down.

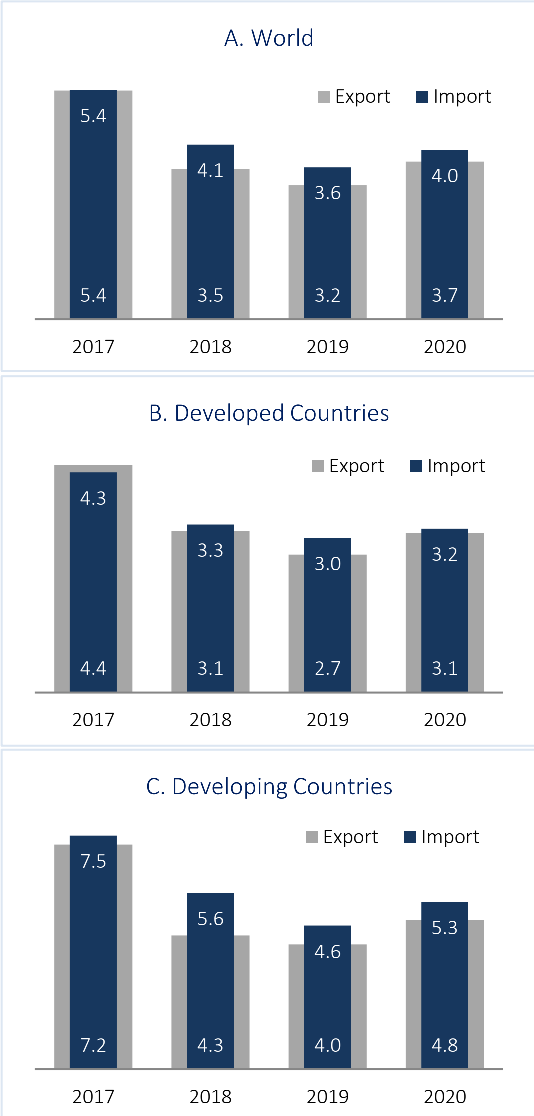
Table 1.1: Growth in Global Trade (%)

Export Volume of Goods and Services					Import Volume of Goods and Services			
2017	2018	2019	2020		2017	2018	2019	2020
4.4	**3.1**	**2.7**	**3.1**	**Developed Countries**	**4.3**	**3.3**	**3.0**	**3.2**
3.0	3.9	2.7	2.6	United States	4.6	4.6	3.9	3.0
6.8	3.1	2.1	2.5	Japan	3.4	3.2	2.2	1.7
5.3	2.2	3.0	3.8	Germany	5.3	3.5	3.9	4.7
5.6	0.2	2.5	1.8	United Kingdom	3.5	0.7	3.2	1.2
7.2	**4.3**	**4.0**	**4.8**	**Developing Countries**	**7.5**	**5.6**	**4.6**	**5.3**
9.3	6.5	4.9	4.8	CEE	9.2	2.6	3.1	6.7
5.2	5.6	3.7	4.0	CIS	12.0	3.9	4.4	5.6
9.8	5.5	5.1	5.6	Asia	9.4	8.5	6.1	6.3
4.9	3.0	2.6	3.8	LAC	4.7	4.3	3.2	4.0
0.6	-1.1	0.4	2.8	MENA	2.7	-0.6	1.5	1.8
4.2	3.0	5.7	5.0	SSA	1.4	6.2	5.5	5.1

Source: IMF, World Economic Outlook database.
Notes: Figures for 2018 and 2019 are projections (Developing: N = 154; Developed: N = 39; CEE - Central and Eastern Europe: N = 12; CIS - Commonwealth of Independent States: N = 12; Asia: N = 30; LAC - Latin America and the Caribbean: N = 32; MENA - Middle East and North Africa: N

In general, trade-related risks became quite significant. Global real GDP growth rates could be at risk of slowing further if trade protectionism increases between the US and its major trading partners. The US president Donald Trump has made steady use of tariffs to punish trading partners, like China, EU, Canada and Mexico, that he says have destroyed American jobs by flooding the US with cheap products. He is also threatening to escalate trade measures further if these trading partners does not make bigger concessions in trade talks. Obviously, Donald Trump is shifting his country's previous qualified support for free trade in a protectionist direction, what is harmful not only because of the direct impact on trade but because of business confidence generally, investments and global supply chains. If a trend of reciprocal trade restrictions last for a long time, their global consequences will be inevitable.

Figure 1.10: Export and Import Volumes of Goods and Services (% Change)



Source: IMF, World Economic Outlook database.
Notes: Figures for 2019 and 2020 are projections.

The good news is that US protectionism is incentivising countries to develop regional trade agreements and diversify their trade partners, as it is a case with EU and Asian countries, including China and Japan, who are speeding up the opening of their markets for closer economic ties. Another example is the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) - a free trade agreement between Canada and 10 other countries in the Asia-Pacific region (Australia, Brunei, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam). Once fully implemented, the 11 countries will form a trading bloc representing 495 million consumers and 13.5% of global GDP. These developments suggest that global flow of trade may undergo changes in the future.

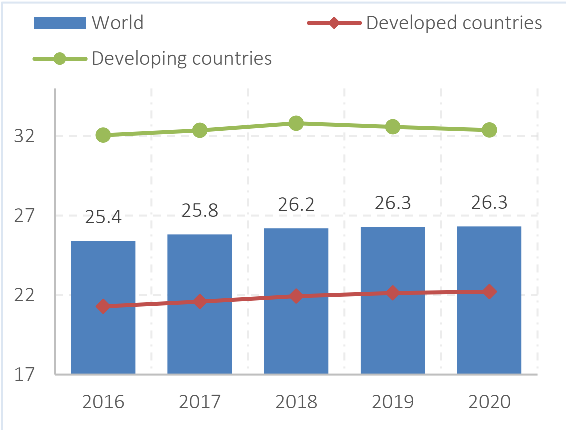
The World Bank in its Global Economic Prospects report warns that protectionist trade policies may affect developing economies more severely than developed ones, with the message that policy and institutional reforms supportive to increase in investments are needed now more than ever.

▪ Slight increase in domestic investments is followed by strong decrease in FDI

Figure 1.11 points out to slight acceleration in world investments since 2016. Both among developed and developing economies, the slight recovery in investment share in GDP has continued, reaching 21.9% in 2018 for developed countries, and 32.8% for developing ones. Projections for 2019 and 2020 indicates that investment will continue to provide a stimulus to economic growth in developed countries, while investments in developing world are expected to decline slightly.

Investment levels varied more among different regions in 2018. For instance, domestic investment fell as a share of GDP in CIS and CEE regions, remained more or less stable in the MENA and SSA economies, while marked increase in developing Asia and LAC regions. In 2019, CIS economies are projected to lead in domestic investment growth, whereas a slowdown in investments is expected for CEE region and Asia.

Figure 1.11: Investment Share in GDP (%)



Source: IMF, World Economic Outlook database.
Notes: Figures for 2019 and 2020 are projections. (World: N = 193; Developed: N = 39; Developing: N = 154)

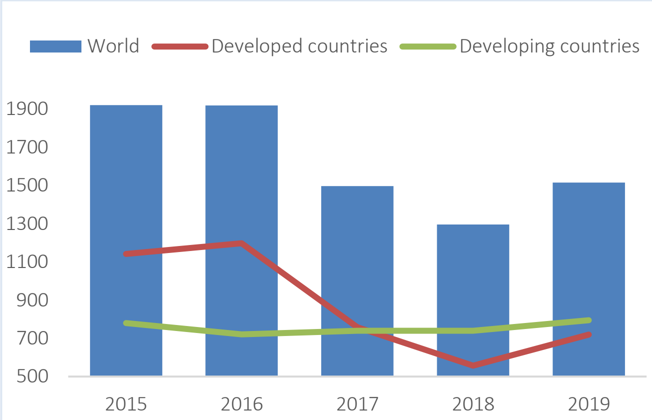
Reduction in domestic investment increases the importance of foreign direct investment (FDI), which remains the largest external source of finance for developing economies. According to the United Nations Conference on Trade and Development (UNCTAD), in 2017 FDI made up 39% of total incoming finance in developing countries as a group.

As shown at Figure 1.12, FDI inflows in the world have decreased significantly from 2016 to 2018. Global inward FDI flows fell by 13% in 2018, to 1.3 trillion dollars - from 1.5 trillion dollars in 2017. Inward FDI flows to developed countries fell by 27%, to 557 billion dollars, while FDI flows to developing countries remained more stable at around 740 billion dollars. As a result of the significant fall in FDI in developed countries, the share of developing economies in global FDI increased to 57% in 2018.

Asia remains to be the largest FDI recipient in the world (512 billion dollars), in contrast to Africa where FDI flows amounted only 46 billion dollars in 2018. However, compared to 2017, this is 11% increase for Africa, mainly boosted by opening to signature of the African Continental Free Trade Agreement in March 2018.

The UNCTAD observed that the negative FDI trend in the world is caused in large part by a decrease in rates of return, geopolitical risks and trade tensions. Although best-case projections for FDI in 2019 point to a 14% increase to near 1.5 trillion dollars (Figure 1.12), this number is still below the average of the last 10 years. The projected increase of FDI flows is highest in developed countries, which are expected to see an increase of 22.6%. FDI flows to developing economies are expected to increase by only 7%.

Figure 1.12: FDI Inflows in the World (Billion Dollars)



Source: UNCTAD, World Investment Report 2019: Special Economic Zones, Geneva: 2019.
Notes: Shaded area indicates forecast under best-case scenario (World: N = 163; Developed: N = 39; Developing: N = 124)

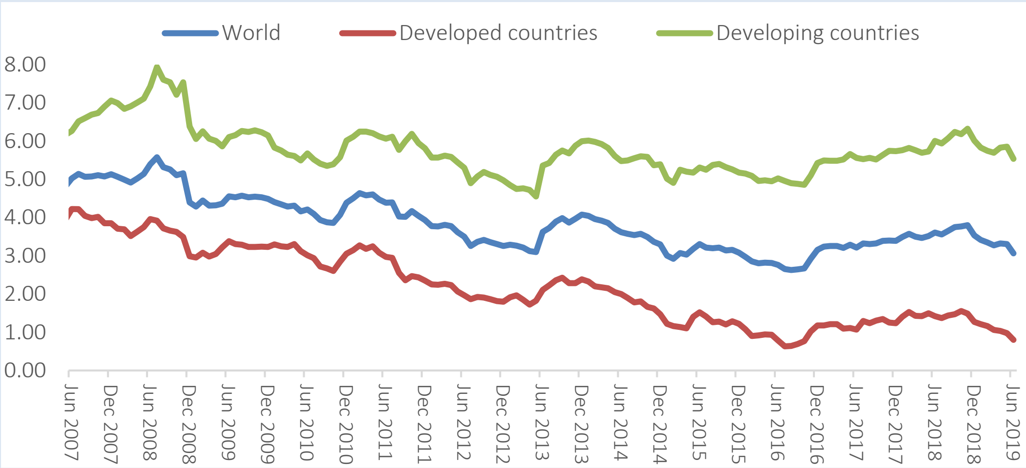
- **International financing conditions have eased, providing a respite to countries with large external financing needs**

Financial conditions are crucial for economic activity because they often dictate the spending, saving and investment plans. In the period from 2016 to 2017, global financial conditions were quite convenient for the global economic recovery. Financial condition indices were below the historic averages, due to monetary policies that boosted investor confidence and risk appetite. However, in 2018, US, UK, Japan and a number of developing countries have started to tighten their monetary policies. In general, officials of many countries were removing the emergency policy settings that dominated the last decade.

US Federal Reserve has raised interest rates twice in 2018. With higher interest rates, some US assets became more attractive and investors were responding by pulling funds out of developing economies. Further, rising US interest rates have pushed up the value of dollar in 2018, paving the way for financial vulnerabilities in some countries, sharp falling in value of some currencies such as Argentine Peso and Turkish Lira, and making debt denominated in US dollars more expensive to service.

Global financial conditions became more favourable for developing countries since the start of 2019. The persistent signs of deterioration in global economy combined with low inflation have led major central banks to adopt more accommodative monetary policy stances for the near term and reduce interest rates in 2019. Long-term interest rates have declined accordingly (Figure 1.13) and are at record lows in many countries. The US Federal Reserve has cut rates by 25 basis points and placed its tightening cycle on hold, while the European Central Bank has delayed the end of its negative interest rate.

Figure 1.13: Long-Term Interest Rates



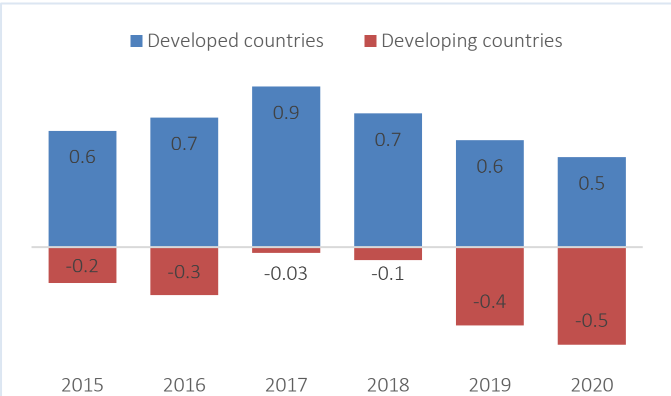
Source: Federal Reserve Bank of Dallas, Database of Global Economic Indicators; Haver Analytics.

As long-term yields in developed economies have eased, external financing conditions for developing countries have improved, supporting a recovery in capital flows into developing economies. Still, even if the borrowing costs are currently lower, many developing countries do not have a fiscal space and are constrained with rising debt levels.

▪ Current account fragilities serious in some developing countries

Current account balances have slightly deteriorated both in developed and in developing countries in 2018, compared with their 2017 levels. The current account surplus in developed countries has narrowed to 0.7% of GDP in 2018. Stronger domestic demand is projected to increase imports and further shrink the current account surplus of developed countries over 2019 and 2020 (Figure 1.14).

Figure 1.14: Current Account Balance (% of GDP)



Source: IMF, World Economic Outlook database.
Notes: Figures for 2019 and 2020 are projections (Developed: N = 39; Developing: N = 154).

Average current account deficit of developing countries has widened form (-0.03%) in 2017 to (-0.1%) in 2018, and it is expected to further increase in 2019 and 2020. The most notable improvement in the current account balances was realized in oil exporting countries, due to rise in oil prices. Symmetrically, current account fragilities in some oil-importing countries, such as India, Indonesia, Pakistan and South Africa have widened,

Table 1.2: Current Account Balance (% of GDP)

	2017	2018	2019	2020
Central and Eastern Europe (CEE)	-2.5	-2.2	-0.9	-1.4
Commonwealth of Independent States (CIS)	1.0	5.0	3.8	3.4
Developing Asia	0.9	-0.1	-0.1	-0.2
Latin America and the Caribbean (LAC)	-1.4	-1.9	-1.9	-2.0
Middle East and North Africa (MENA)	-0.3	3.1	-0.5	-0.4
Sub-Saharan Africa (SSA)	-2.1	-2.6	-3.7	-3.7

Source: IMF, World Economic Outlook database.
Notes: (CEE: N = 12; CIS: N = 12; Asia: N = 30; LAC: N = 32; MENA: N = 21; SSA: N = 45).

reflecting their higher oil import bills. The current account balances of oil exporting countries are expected to be adversely affected in near term, as average oil prices are projected to drop from their 2018 level.

The US continues to have the largest trade deficit in the world in absolute terms (468.8 billion dollars in 2018), while Germany and Japan have by far the largest trade surplus in the world, again in absolute terms. However, trade deficits or surpluses are larger as a share of the GDP in a number of other countries. In 2018 the US current account deficits remained almost stable at (-2.3%) of GDP. Driven by expansionary fiscal policy, US current account deficits is projected to reach (-2.4%) in 2019. Current account balances have slightly worsened in developing Asia, LAC and SSA regions in 2018, and improved on average in CIS, CEE and MENA regions. In 2019, the current account deficits are projected to widen modestly in MENA and SSA regions, especially in those countries with relatively strong domestic demand growth.

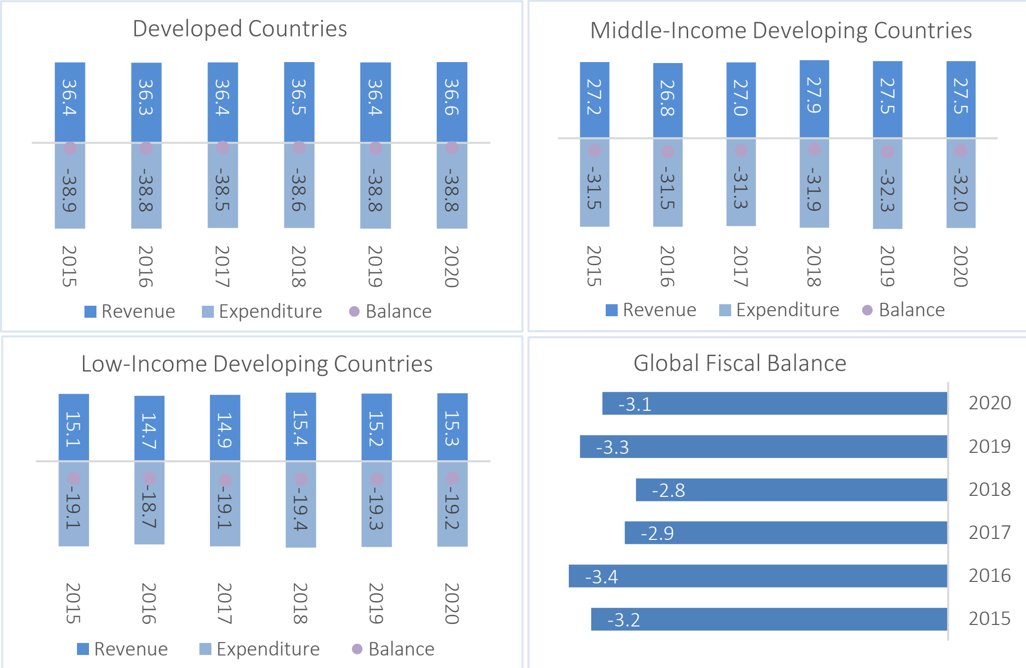
▪ Fiscal balances remain to be broadly stable

As illustrated in Figure 1.15, the global fiscal developments remained broadly stable, with the slight improvement in the world general government fiscal deficit from (-2.9%) in 2017 to (-2.8%) in 2018. However, over the 2019-2020, average global fiscal balance is expected to slightly deteriorate and take values between (-3.1%) and (-3.3%).

Developing countries have triggered the most recent global fiscal recovery. Average fiscal balance of the middle-income developing countries drops to (-4%) of GDP in 2018, up from -4.3% in 2017. In same period, fiscal balance remained unchanged in developed countries (-2.1% of GDP), and slightly improved in the low-income developing economies (-4% of GDP in 2018). In 2019, a deterioration in fiscal balance is expected for developed and middle-income developing countries in average. On the other hand, in the low-income developing countries general trend of fiscal stabilization is expected to continue.

Among developed countries, US faces greatest fiscal deficit, which reached (-4.3%) in 2018 and is expected to increase to (-4.6%) of GDP in 2019. Within the group of developing countries, deficit in general government fiscal balance in 2019 is expected to be significantly higher in countries such as Venezuela (-29.8%), Libya (-10.9%), Oman (-9.9%), Sudan (-8.8%), Egypt (-8.6) and Saudi Arabia (-7.9%), according to IMF projections.

Figure 1.15: General Government Fiscal Balance (% of GDP)

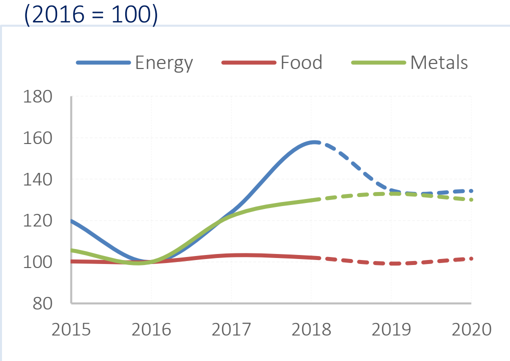


Source: IMF, Fiscal Monitor 2019.
Notes: Figures for 2019 and 2020 are projections (World: N = 115; Developed: N = 35; Middle-income developing countries: N = 40; Low-income developing countries: N = 40)

Developing countries with large government budget and current account deficits, small foreign currency reserves and a large share of foreign currency-denominated debt will remain to be highly vulnerable to sudden changes in market conditions.

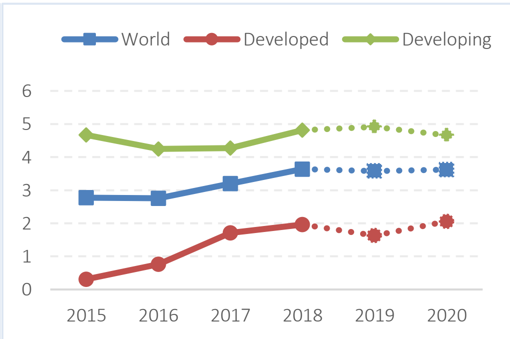
Figure 1.16 shows that energy prices are expected to fall during 2019, bringing financial challenges to some oil exporting economies. Due to slowdown in global demand, period from 2018 to 2019 is also witnessing to slight fall in other commodity prices, such as food and

Figure 1.16: World Commodity Prices (2016 = 100)



Source: IMF, World Economic Outlook database.
Notes: Dashed lines are projections (World: N = 193).

Figure 1.17: Inflation (% Change)

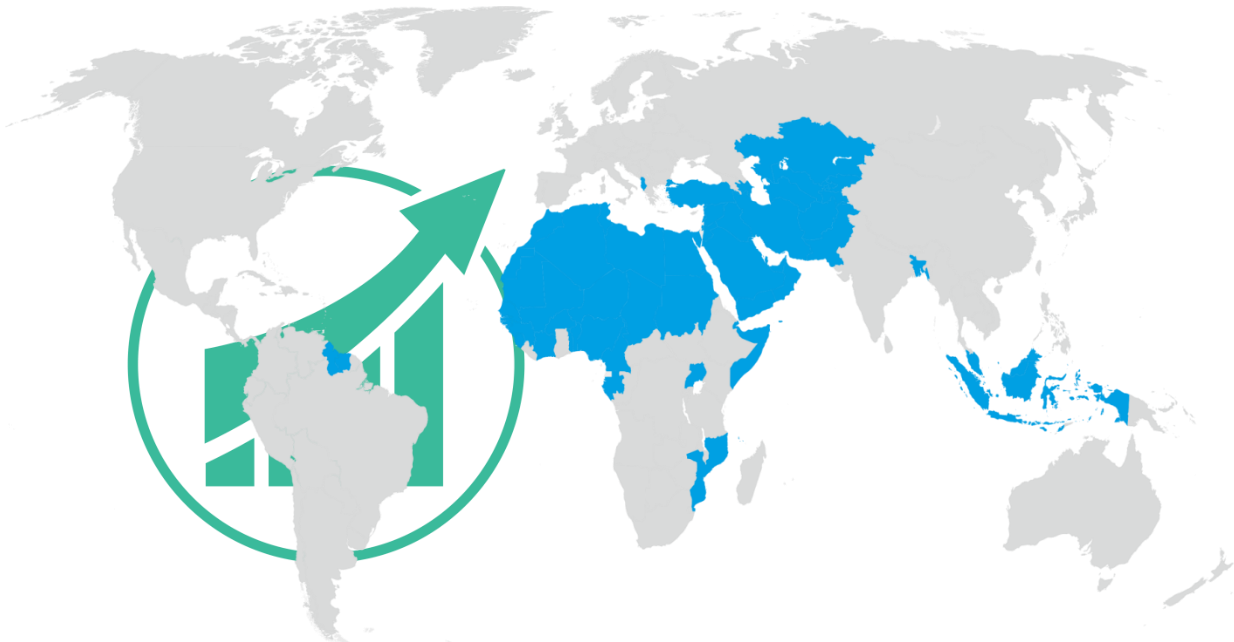


Source: IMF, World Economic Outlook database.
Notes: Average consumer prices (World: N = 193; Developed: N = 39; Developing: N = 154)

beverages, which are lower from 2016 base year. The global inflation rate in 2018 was around 3.6%. Slight decrease in commodity prices, particularly energy prices, is projected to push down the inflation rate of developed countries in 2019 (Figure 1.17). In the period from 2015 to 2017, on average, inflation rates in developed and developing countries have moved in opposite directions – increasing in developed and decreasing in developing economies. Currently, for developing countries relatively faster growth in inflation rates is projected for 2019. Geographically this year in CIS region inflation rates are expected to rise most substantially, and decrease in MENA and SSA regions.

As a way of conclusion, it could be said that the global economy is under increasing stress as economic growth cools and trade tensions rise. Geopolitical issues are also causing panic for investors in Asia. Moreover, if no deal on Brexit is reached until 31 October 2019, the UK and EU economy in general may be adversely affected. All of these factors are likely to determine the path of global economic growth over the next few quarters and years.

PART II: Recent Economic Developments in OIC Countries



CHAPTER TWO

Production, Growth and Employment

2.1 Production and Growth

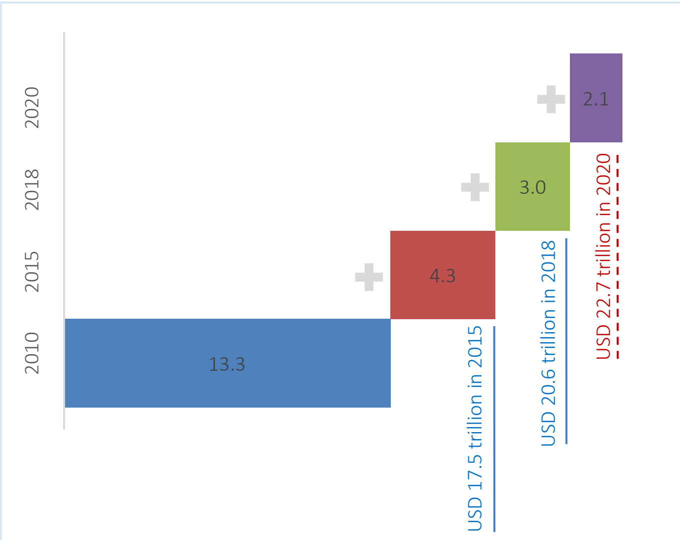
The global economy has been experiencing a fundamental transformation caused by remarkable economic performance of developing countries over the last few decades. While poverty rates are falling in many parts of the developing world, health, education and employment outcomes are improving. As developing countries continue to grow faster than developed countries, they are increasingly moving up the global value chain, leading the global economic centre of gravity to move toward the South. The expansion in South-South cooperation, which reached to unprecedented levels, can be understood as part of this global transformation driven by growing prosperity in the South.

Since its establishment five decades ago, the Organisation of Islamic Cooperation (OIC) has worked to maintain a climate of dialogue, solidarity and cooperation among its Member States. Today, with 56 active member countries, the OIC is one of the largest intergovernmental organizations that promotes economic cooperation among its members as part of its mission. Noting the diversity of the OIC countries in terms of resources and development levels, the OIC countries are considered as a heterogeneous group of countries with great potential of collaboration in many economic sectors.

- **Production:** Share of OIC countries in total world GDP remained at 15.2% in 2018

Over the years, the OIC countries reasonably improved their productive capacities to generate more output through greater economic activities. Total output of OIC countries has increased by almost 50% during 2010-2018 and reached USD 20.6 trillion – expressed in current USD and based on PPP – in 2018 compared to USD 13.3 trillion in 2010 (Figure 2.1). Around 9% more increase is projected until 2020 for OIC countries to reach USD 22.7 trillion worth of productive capacities.

Figure 2.1: Gross Domestic Product of OIC Countries (Trillion USD, PPP Current Prices)



Source: SESRIC staff calculations based on IMF World Economic Outlook Database April 2019. Data Coverage: 55 OIC countries.

Despite the achievements made over the past decades, economic and human development levels in many OIC countries remained below what has been aspired. In 2018, having accounted for almost 24.0% of the world total population, OIC member countries produced as much as 15.2% of the world total GDP – expressed in current USD and based on PPP (Figure 2.2a). When

Figure 2.2a: Gross Domestic Product, PPP Current USD (2018)

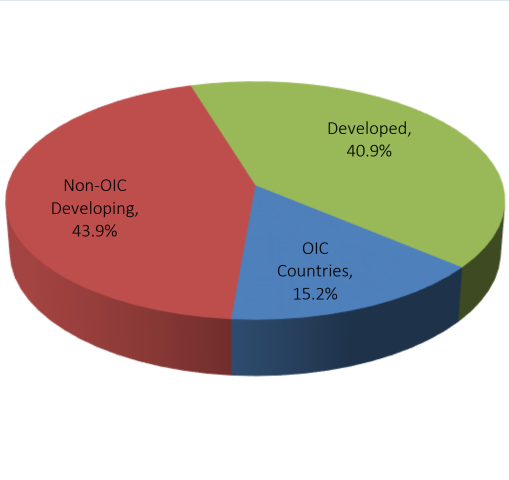
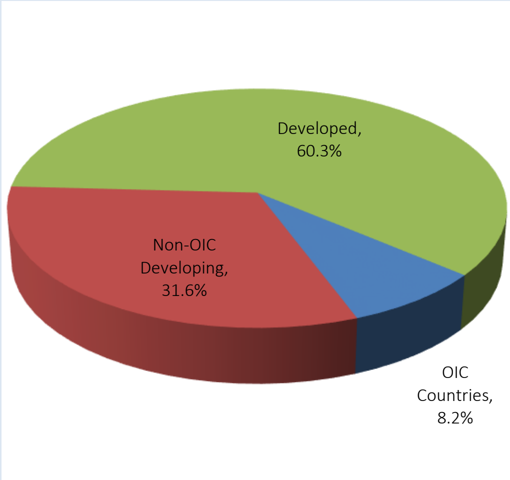


Figure 2.2b: Gross Domestic Product, Current USD (2018)

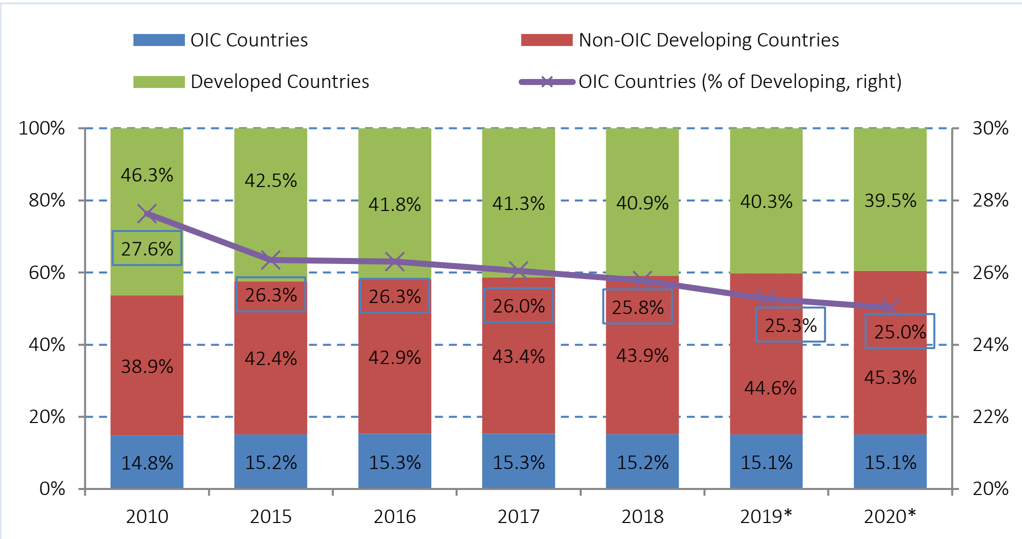


Source: SESRIC staff calculations based on IMF World Economic Outlook Database April 2019. Data Coverage: 55 OIC, 98 non-OIC, and 39 developed countries.

measured in current prices, however, OIC member countries account only 8.2% of global production in 2017 (Figure 2.2b).

During 2010-2017, the group of OIC countries has increased its share in the world output by 0.5 percentage points to reach 15.3% in 2017 (Figure 2.3). However, their share has fallen to 15.2% in 2018 and it is further expected to decline to 15.1% in 2019 and 2020, despite the positive growth rates projected for the OIC countries. Noting the fact that the share of some individual countries such as United States and China (15.2% and 18.7%, respectively in 2018) are higher

Figure 2.3: Gross Domestic Product, PPP Current USD



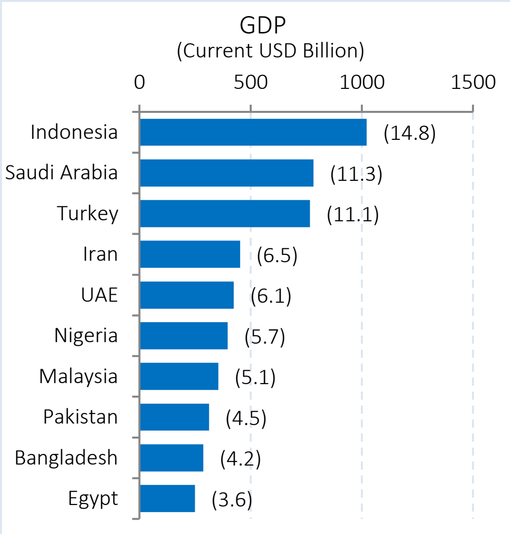
Source: SESRIC staff calculations based on IMF WEO Database April 2019. Data Coverage: 55 OIC, 98 non-OIC, and 39 developed countries. (*) Forecast.

than the collective share of OIC countries, the contribution of the OIC countries as a group to the world output is not highly significant. On the other hand, the share of the OIC countries in the total GDP of developing countries has declined steadily and was recorded at 25.8% in 2018, a decrease by 0.5 percentage points since 2015 (Figure 2.3).

The decline in the share of the OIC countries in total GDP of the developing countries indicates that the OIC economies have not performed as good as non-OIC developing countries in expanding their output. During the same period, non-OIC developing countries experienced a more rapid increase in their output as the total GDP in these countries reached US$ 59.2 trillion in 2018, a level which is well above the US$ 49.0 trillion they recorded in 2015.

Furthermore, it is observed that the total GDP of the OIC countries is still produced by a few member countries. In 2018, the top 10 OIC countries in terms of the volume of GDP produced 73.0% of the total OIC countries output (Figure 2.4). In current prices, Indonesia has the highest share in OIC GDP (14.8%) followed by Saudi Arabia (11.3%), Turkey (11.1%), and Iran (6.5%). The overall economic performance of the group of OIC member countries remained highly dependent on the developments in these ten countries. As a matter of fact, fuel is the main source of export earnings for 4 out of these 10 OIC countries; namely Saudi Arabia, Iran, United Arab Emirates, and Nigeria.

Figure 2.4: Top 10 OIC Countries by GDP (2018)



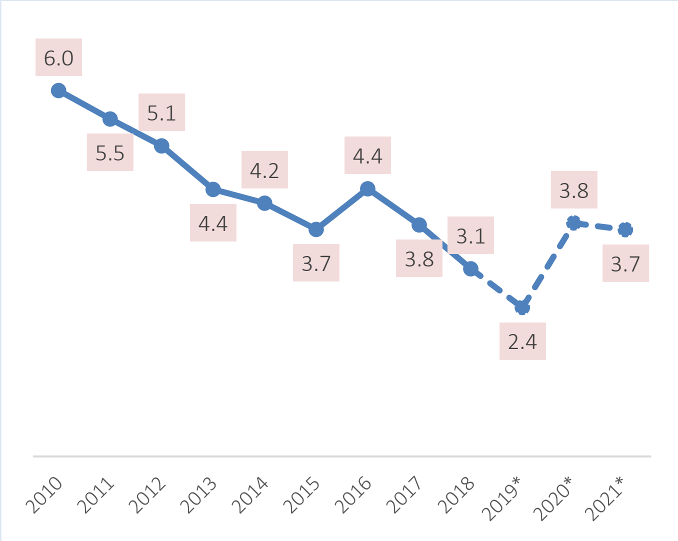
Source: IMF WEO Database April 2019. The numbers in round brackets indicate the share of the related country's GDP in the overall GDP of the OIC countries as a group.

- **Economic Growth:** Growth rates in OIC countries further decelerates in 2018

Decline in the share of OIC countries in global GDP can be explained by the fall in economic growth rates in OIC countries. The GDP growth of OIC countries has slowed down to 3.1% in real terms in 2018, as compared to 6% in 2010 and 4.2% in 2014 (Figure 2.5). However, the growth rates of OIC countries, on average, were higher than the world average until 2017, which led to an increase in the share of OIC in global GDP. In 2018, with an average growth rate of 3.1%, growth in OIC declined below the world average. Economic growth in OIC countries is expected to decline to 2.4% in 2019 and continue to remain below the world average (Table 2.1). Only in 2020, OIC countries are expected to grow above the world average.

Noting the diversities in economic resources and capacities of individual OIC countries, a desired outcome for the OIC is to achieve prosperity for all member countries. In order to analyse the convergence patterns of OIC countries, they are grouped into three main groups based on their

Figure 2.5: GDP Growth Rates in OIC Countries (%)



Source: SESRIC staff calculations based on IMF WEO Database April 2019. Data Coverage: 55 OIC countries. (*) Forecast.

per capita income levels. Then, average growth rates are calculated for countries under lower income, middle income and higher income OIC countries. Higher growth rates of lower income countries compared to higher income countries would be an indication of an income convergence among the member countries of the OIC.

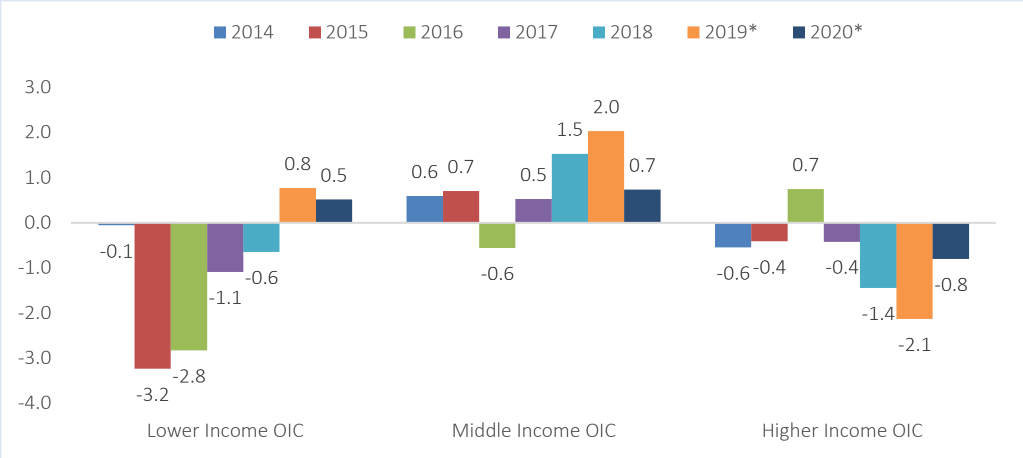
Figure 2.6 presents the difference between the growth rates achieved by countries in specific income group and average growth

Table 2.1: GDP Growth Rates (%)

	2014	2015	2016	2017	2018	2019*	2020*
World	3.6	3.4	3.4	3.8	3.6	3.3	3.6
OIC	4.2	3.7	4.4	3.8	3.1	2.4	3.8
Egypt	2.9	4.4	4.3	4.2	5.3	5.5	5.9
Indonesia	5.0	4.9	5.0	5.1	5.2	5.2	5.2
Nigeria	6.3	2.7	-1.6	0.8	1.9	2.1	2.5
Saudi Arabia	3.7	4.1	1.7	-0.7	2.2	1.8	2.1
Turkey	5.2	6.1	3.2	7.4	2.6	-2.5	2.5
Non-OIC Developing Countries	4.9	4.5	4.6	5.1	5.2	5.1	5.2
Brasil	0.5	-3.5	-3.3	1.1	1.1	2.1	2.5
China	7.3	6.9	6.7	6.8	6.6	6.3	6.1
India	7.4	8.0	8.2	7.2	7.1	7.3	7.5
Russia	0.7	-2.5	0.3	1.6	2.3	1.6	1.7
South Africa	1.8	1.2	0.4	1.4	0.8	1.2	1.5
Developed Countries	2.1	2.3	1.7	2.4	2.2	1.8	1.7
Germany	2.2	1.5	2.2	2.5	1.5	0.8	1.4
Japan	0.4	1.2	0.6	1.9	0.8	1.0	0.5
Switzerland	2.5	1.3	1.6	1.7	2.5	1.1	1.5
United States	2.5	2.9	1.6	2.2	2.9	2.3	1.9

Source: IMF WEO Database April 2019. Data Coverage: 55 OIC, 98 non-OIC, and 39 developed countries. (*) Forecast.

Figure 2.6: GDP Growth Rates across Income Groups

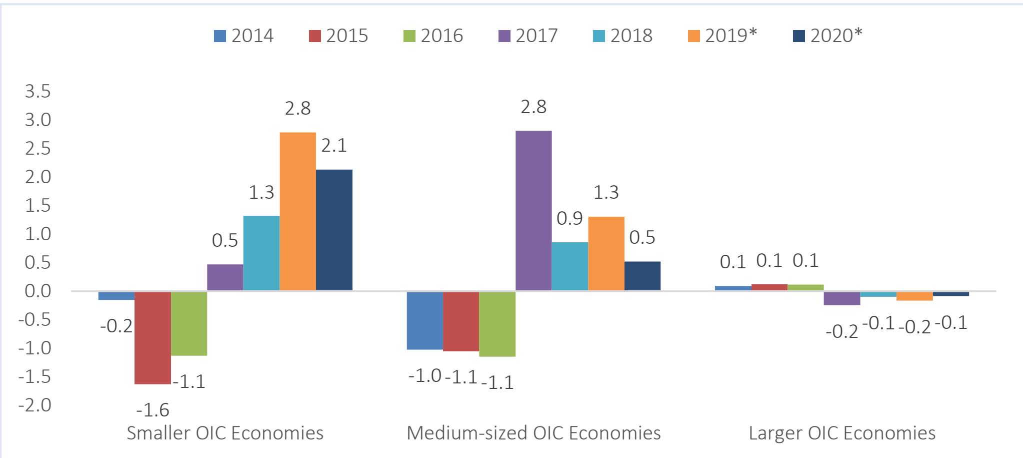


Source: SESRIC staff calculations based on IMF WEO Database April 2019. Data Coverage: 55 OIC countries. (*) Forecast.

rate achieved by the OIC countries as a group. Lower income OIC countries have been growing at a lower rate than the OIC average during 2014-2018, implying a widening gap between rich and poor OIC countries. However, it is expected that they will grow more than the OIC average during 2019-2020, which will allow them to partially narrow the gap with richer countries. An important observation is that higher income counties are also growing at relatively lower rates than the OIC average. The figure overall reveals that middle income countries are catching up with higher income countries, but income disparity with lower income OIC countries are expanding with other OIC counties.

When a similar exercise is made with OIC countries with different economic sizes, we observe that smaller and medium-sized OIC economies are growing at a higher rate than larger OIC

Figure 2.7: GDP Growth Rates across Economic Sizes



Source: SESRIC staff calculations based on IMF WEO Database April 2019. Data Coverage: 55 OIC countries. (*) Forecast.

Figure 2.8a: OIC Countries with Highest Growth Rates in 2018

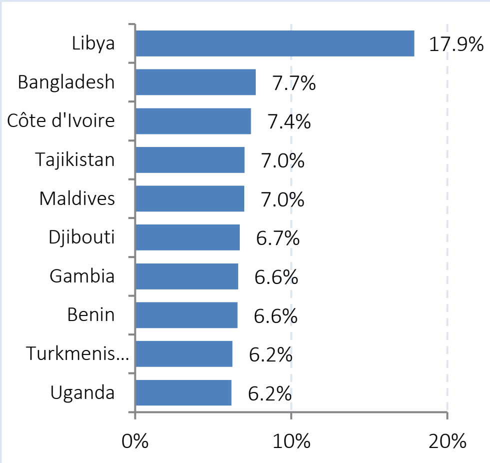
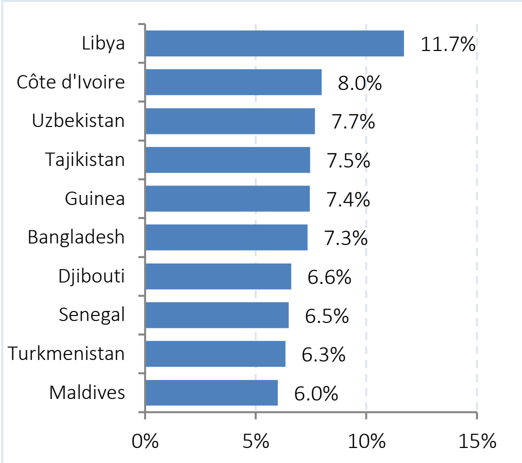
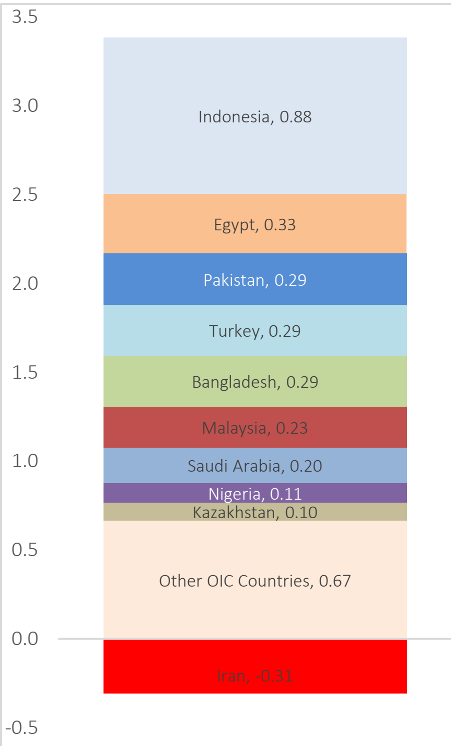


Figure 2.8b: OIC Countries with Highest Growth Rates over the Last 5 Years (2014-2018)



Source: SESRIC staff calculations based on IMF WEO Database April 2019 by using GDP expressed in constant national prices . Data coverage:55 OIC Countries.

Figure 2.9: Contribution of OIC Countries to OIC Growth, 2018



Source: SESRIC staff calculations based on IMF WEO Database April 2019. Data Coverage: 55 OIC Countries. (*) Forecast.

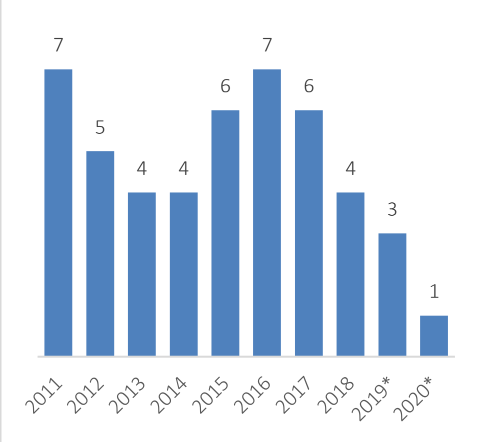
economies (Figure 2.7). This shows that economic expansion of smaller OIC economies are greater than the larger OIC economies, indicating a potential convergence among OIC countries in terms of economic sizes.

At the individual country level, Libya, with a growth rate of 17.9% in 2018, was the fastest growing economy in the group of OIC countries, followed by Bangladesh (7.7%), Côte d'Ivoire (7.4%), Tajikistan (7.0%) and Maldives (7.0%), as shown in Figure 2.8a. In total, 26 OIC countries recorded a growth rate higher than the world average of 3.6%. While some OIC countries recorded high growth rates in 2018, what is more important is to sustain the growth rates over longer periods. To see which OIC countries succeeded to sustain their growth rates, average annual growth rates over the last five years are depicted in Figure 2.8b. Seven OIC countries that recorded the highest economic growth rate in 2018 are also among the top OIC countries that achieved to grow fastest over the last five years. Libya (11.7%), Côte d'Ivoire (8.0%), Uzbekistan (7.7%), Tajikistan (7.5%) and Guinea (7.4%) were among the top performing OIC countries during 2014-2018.

The average growth rate of OIC countries is highly dependent on the economic performance of larger economies. Better performance of these countries also raises the total growth rate of the OIC as a group. In 2018, good economic performance of Indonesia, Egypt, Pakistan, Turkey and Bangladesh contributed significantly to the overall performance of the OIC. On the other hand, contraction in Iranian economy caused a negative impact on the aggregate score of the OIC (Figure 2.9).

In fact, a significant number of OIC countries have been experiencing contraction in their economies during 2015-2017. In 2016, seven OIC countries attained negative growth rates. This number fell to six in 2017 and four in 2018. With improving economic conditions, only three OIC countries are expected to remain in stagnation in 2019 (Figure 2.10).

Figure 2.10: Number of OIC Countries with Negative Growth Rates (2011-2020)



Source: SESRIC staff calculations based on IMF WEO Database April 2019. Data Coverage: 55 OIC countries. (*) Forecast.

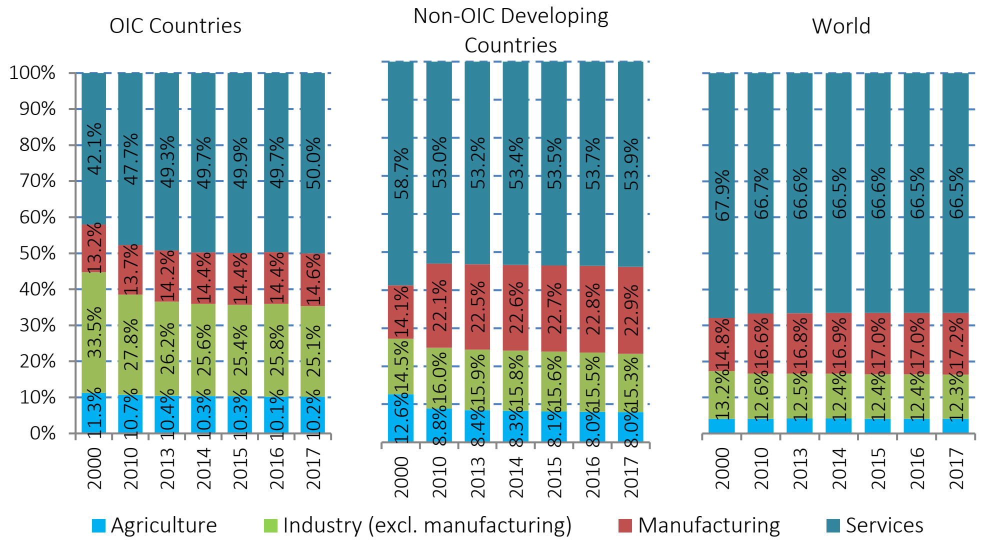
- **Structure of GDP:** Services sector accounts for half of economic activity within the OIC region

The analysis of value-added by major sectors in the total GDP of the OIC countries reveals important insights on the structure of the economies. Although agriculture sector account for an important share of employment in the economy, its share in total GDP is generally low due to lower productivity in agriculture sector. However, it remains an important sector for OIC countries, which accounts for 10.2% of total economic activity (Figure 2.11). The share of non-manufacturing industry, which mainly includes mining, utilities and construction, has been falling slowly over the years. It was measured as 26.2% in 2013 and 25.1% in 2017, reflecting 1.1 percentage point fall. On the contrary, the share of manufacturing sector, which has greater potential to promote productivity and competitiveness, increased from 14.2% in 2013 to 14.6% in 2017.

The services sector, on the other hand, continued to play a major role in the economies of many OIC countries as the most important source of economic activity. The average share of the service sector in total GDP of OIC countries increased from 49.3% in 2013 to 50.0% in 2017. For non-OIC developing countries, the services sector kept accounting for over half of the total GDP and its share was recorded at 53.9% in 2017 (Figure 2.11). Due to much higher share of services sector in total value added of developed countries, global share of services sector in total GDP remains at 66.5%.

At the individual country level, in 2017, the agricultural sector accounted for more than 30% of the total value-added in eight OIC member countries; namely in Somalia, Sierra Leone, Sudan, Niger, Guinea-Bissau, Mali, Chad and Comoros – all of which were listed among the LDCs in the

Figure 2.11: Value-added by Major Sectors of the Economy (% of GDP)



Source: SESRIC staff calculations based on UNSD National Accounts Main Aggregates Database, June 2019. GDP breakdown at constant 2010 prices in US Dollars. Data Coverage: 56 OIC, 116 non-OIC, and 38 developed countries.

same year according to the UN classification. In only four countries, the services sector accounts more than 66.5%, or above the world average, namely Maldives, Lebanon, Djibouti and Palestine.

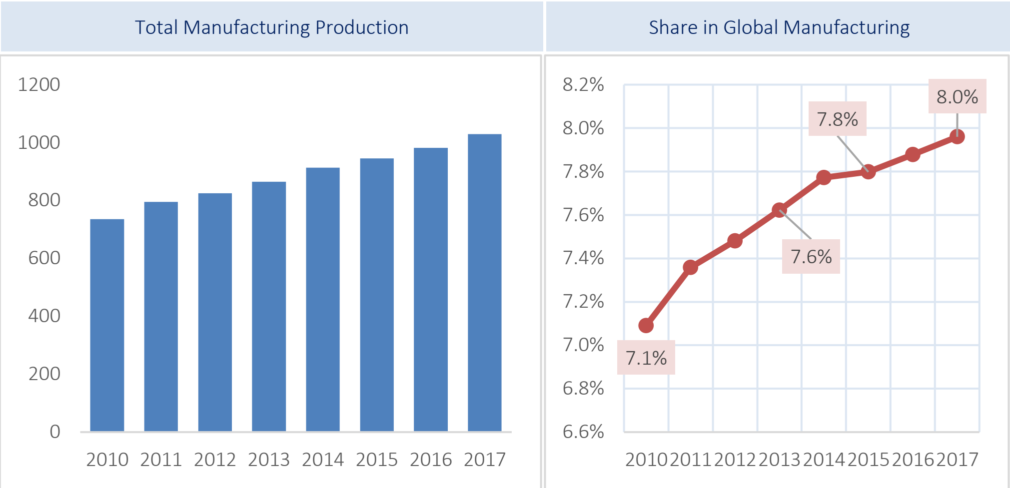
- **Manufacturing Activities:** Upward trend in the share of OIC countries in total world industrial production continues in 2017

Economies of a significant number of OIC countries are characterized by high dependence on primary commodities. Prices of primary commodities have been quite volatile, which deteriorate macroeconomic management and economic development perspectives. For such economies, it is particularly important to diversify manufacturing production base in order to reduce the macroeconomic risks associated with dependence on primary commodities.

The share of manufacturing value added (MVA) in total value added has been slightly increasing over time, but it accounts a greater share of total GDP in non-OIC developing countries. Rapid industrialization in several non-OIC developing countries has substantially increased the share of MVA in non-OIC developing countries from 14.1% in 2000 to 22.9% in 2017.

The collective manufacturing production of OIC countries are increasing steadily over the years (Figure 2.12). It exceeded USD 1 trillion threshold in 2017, compared to USD 736 billion in 2010. More importantly, the share of OIC countries in global manufacturing activities is rising. The share of OIC countries in total MVA was only 4.9% in 1990, which increased to 5.8% in 2000 and 7.1% in 2010. As of 2017, they account for 8.0% of global MVA. Despite the steady increase and given the existing potentials in terms of human capital, energy resources, and market potential, the current level of contribution to global MVA is far from being satisfactory.

Figure 2.12: Manufacturing Activity in OIC Countries (Billion USD)



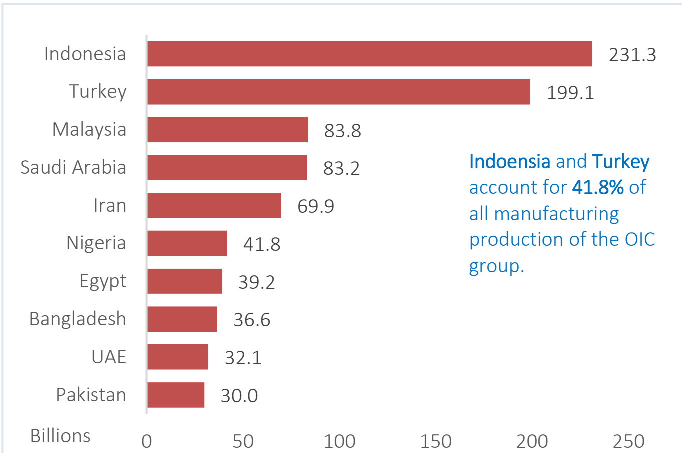
Source: SESRIC staff calculations based on UNSD National Accounts Main Aggregates Database, June 2019. Constant 2010 prices in US Dollars. Data Coverage: 56 OIC countries.

Notwithstanding the varying growth performances across OIC countries, total MVA in the group of OIC countries continued to be dominated by few member countries. With a collective share of 41.8%, Indonesia and Turkey alone accounts more than two-fifth of all MVA in OIC countries, followed by Malaysia (8.1%), Saudi Arabia (8.1%) and Iran (6.8%). Top five OIC countries account for 64.8% of total MVA in OIC countries.

Evidently, there is a strong growth in MVA in some OIC countries since more than two decades, but the share of manufacturing in total employment and value added is still low. There is a strong growth in trade deficit in manufacturing products, reflecting the inadequate manufacturing production capacity in OIC countries. However, a well-diversified economy requires a strong and sophisticated manufacturing industry in order to enhance and retain its competitiveness in the global economy.

International experience has decisively indicated that excessive inward-looking policies inhibit development in the long run because domestic economies were denied a great source of information, technology and, most importantly, competition. In order to identify the major causes of

Figure 2.13: Top OIC Countries in Manufacturing (Billion USD)



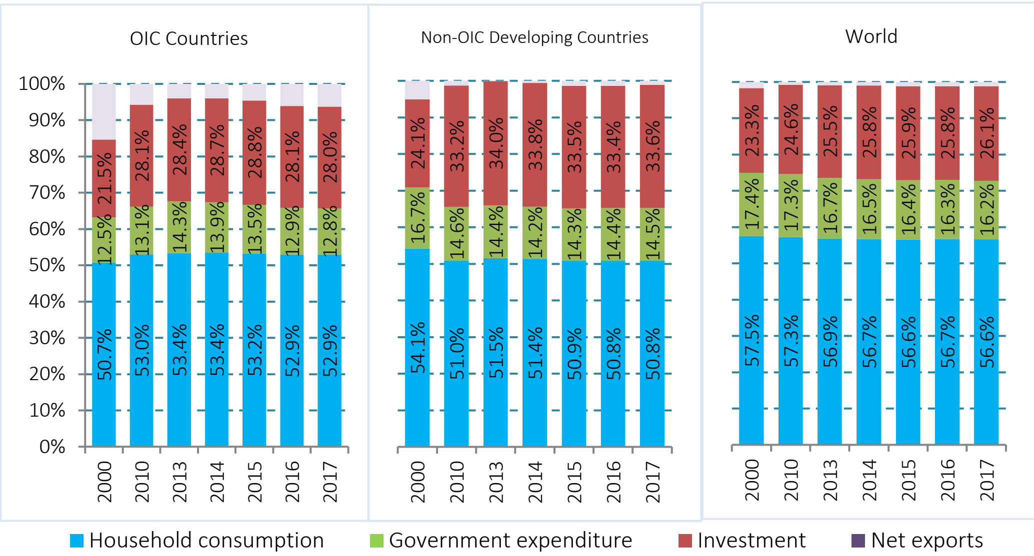
Source: SESRIC staff calculations based on UNSD National Accounts Main Aggregates Database, June 2019. Constant 2010 prices in US Dollars. Data Coverage: 56 OIC countries mostly failed industrialization policies, country specific experiences should be investigated from very initial phase of designing the policies to particular approaches used in the implementation processes.

- **GDP by Expenditure Items:** The share of investment in the total GDP of OIC countries continued to decline in 2017

The analysis of global GDP by major expenditure items reveals that the share of final consumption (both by household and government) continued to be the highest in the total GDP over the years. As shown in Figure 2.14, in 2017 household consumption in OIC countries accounted for the lion share of GDP (52.9%) followed by investment (gross capital formation) (28.0%) and general government expenditure (12.8%). The share of net exports in total world GDP was negligible.

The relative shares of the major expenditure items in the total GDP of OIC and non-OIC developing countries registered significant variation from the world. In 2017, household consumption and government expenditure accounted for 65.7% of the total GDP of OIC countries. As constituents of the final consumption expenditure, expenditure by households and governments accounted for 52.9% and 12.8% of the GDP, respectively. These figures marked a slight increase in the shares of household consumption compared to the year 2000. However, the share of net exports in the total GDP of the OIC member countries has decreased by 9.0 percentage points since 2000 whereas the share of gross capital formation has increased by 6.5 percentage points over the same period. The decrease in the share of net exports was mainly accommodated by an expansion in the share of gross capital formation from 21.5% in 2000 to 28.0% in 2017. On the other hand, the share of final household and government consumption in

Figure 2.14: GDP by Major Expenditure Items (% of GDP)



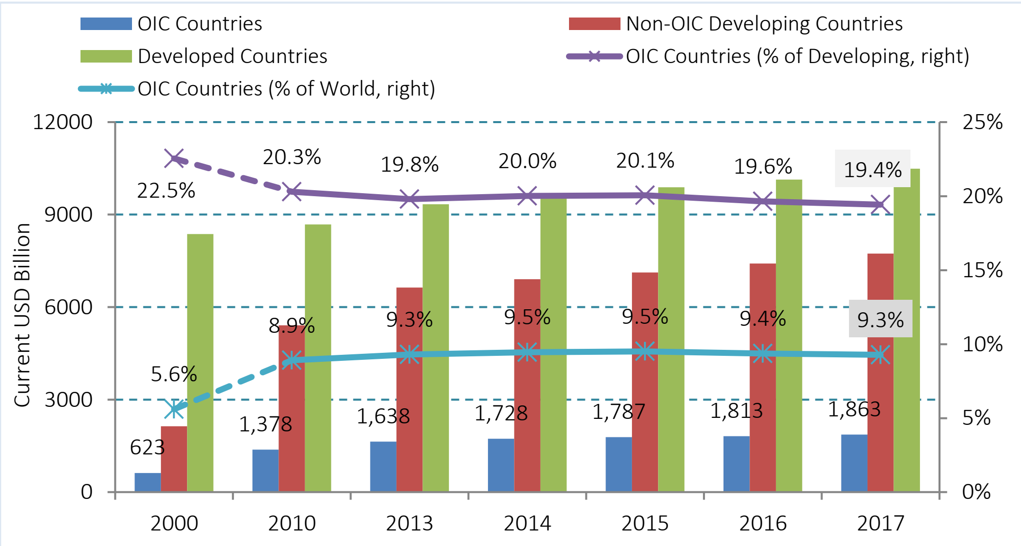
Source: SESRIC staff calculations based on UNSD National Accounts Main Aggregates Database, June 2019. GDP breakdown at constant 2010 prices in US Dollars. Data Coverage: 56 OIC, 116 non-OIC, and 38 developed total GDP of non-OIC developing countries was recorded at 65.3% in 2017 and household consumption, with a 50.8% share in GDP, was again the main source of final consumption expenditure in these countries.

- **Gross Fixed Capital Formation:** In 2017, 28.0% of the total GDP generated in OIC countries was invested in productive assets

Gross capital formation measures the amount of savings in an economy which are transformed into investments in production. As the analysis of GDP by major expenditure items revealed in Figure 2.14, 28.0% of the total GDP generated in the OIC member countries was invested in productive assets in year 2017. In comparison, non-OIC developing countries on average channelled 33.6% of their GDP into productive investments. The share of gross capital formation in the GDP of OIC countries as a group has not changed significantly since 2010, while it increased by only 0.4 percentage points in the group of non-OIC developing countries over the same period. Yet, one can argue that gross capital formation, as an indicator, is flawed primarily by the significant fluctuations in inventories and, most of the time, non-availability of the industry-level inventory information. Gross fixed capital formation, on the other hand, is promoted as being a better indicator on the net additions of productive assets created during a specific year.

In view of the above argument, Figure 2.15 offers a look at the gross fixed capital formation trends in the OIC countries in comparison to non-OIC developing as well as developed countries. According to Figure 2.15, the share of the OIC countries in world total fixed capital formation reached 9.3% in 2017. This marks 3.7 percentage points increase since year 2000 and 0.4 percentage points increase since 2010. Despite this upward trend, the share of the OIC countries

Figure 2.15: Gross Fixed Capital Formation, Volume and Share (right)

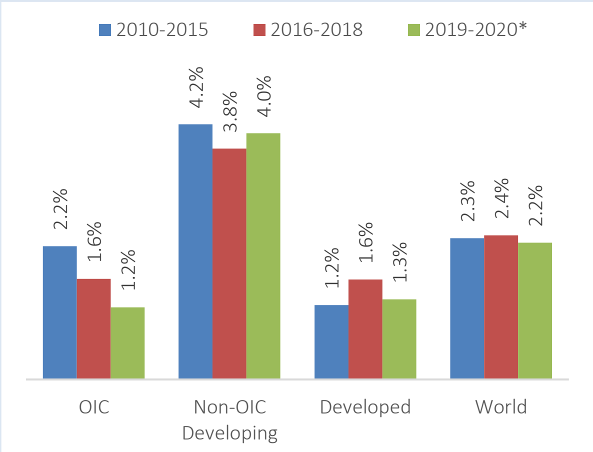


Source: SESRIC staff calculations based on UNSD National Accounts Main Aggregates Database, June 2019.Gross fixed capital formation (including Acquisitions less disposals of valuables) at constant 2010 prices in US Dollars. Data Coverage: 56 OIC, 116 non-OIC, and 38 developed countries in the total gross fixed capital formation of the developing countries has been on decline and contracted from 22.5% to 19.4% over the same period. This indicates the relatively poor performance shown by the OIC countries in accumulating investment capital, as compared to other developing countries.

2.2 Income, Employment and Prices

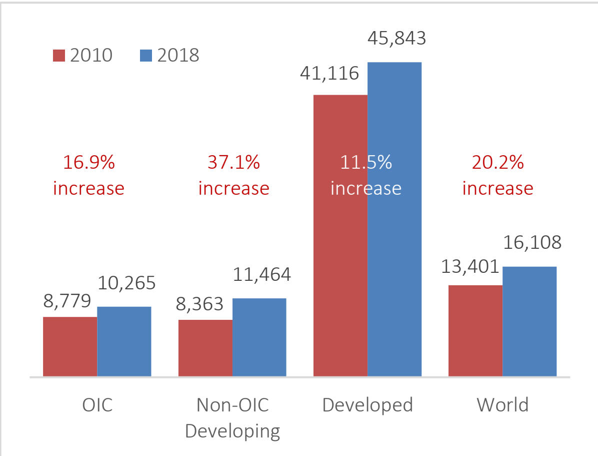
- **GDP Per Capita:** Income growth decelerated in OIC countries

Figure 2.16: GDP Per Capita Growth Rates



Source: SESRIC staff calculations based on IMF WEO Database April 2019. Annual compound growth rates. Data Coverage: 55 OIC, 98 non-OIC, and 39 developed countries. (*) Forecast.

Figure 2.17: GDP Per Capita Income Levels



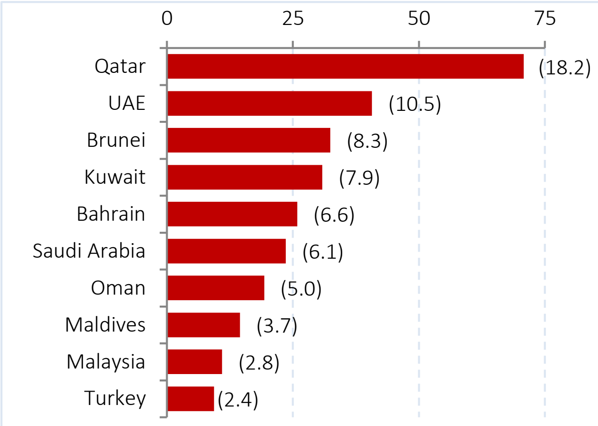
Source: SESRIC staff calculations based on IMF WEO Database April 2019. Expressed in constant prices and PPP. Data Coverage: 55 OIC, 98 non-OIC, and 39 developed countries.

The slowdown observed in total economic growth in OIC countries is also reflected in per capita income growth rates. Average growth rate during 2010-2015 was recorded as 2.2% in OIC countries, which fell to 1.6% during 2016-2018 and it is further expected to shrink to 1.2% during 2019-2020 (Figure 2.16). During the same periods, growth in non-OIC developing countries remained around 4%. Per capita income growth rates in developed countries are expected to be higher than the OIC countries over the next two years.

Per capita growth rates are also below the world average, which indicates that standards of living are not increasing at higher rates than the rest of the world and income per capita in OIC countries is not converging to the world average and income disparity between OIC and non-OIC countries are increasing. As shown in Figure 2.17, average per capita income in OIC countries increased from USD 8,779 in 2010 to USD 10,265 in 2018, corresponding to 16.9% increase in total. During the same period, non-OIC developing countries attained higher growth rates (37.1%) and exceeded the per capita income levels in OIC countries to reach USD 11,464 in 2018. This number was recorded as USD 45,843 in developed countries with growth rate of 11.5% observed since 2010. The world average has also increased by 20.2% and average per capita income in the world exceeded USD 16,000, when expressed in purchasing power parity adjusted values.

Among the OIC countries, Qatar registered the highest GDP per capita in 2018 followed by United Arab Emirates and Brunei Darussalam (Figure 2.18). The per capita GDP of Qatar was 18.2 times higher than the average of the OIC countries as a group, a situation that reflects a high level of income disparity among the OIC countries. Among the top 10 OIC countries by GDP per capita, six are from the Middle East region. Most of them are also resource-rich countries. In 2018, Qatar was ranked 7th in the world in terms of per capita income levels.

Figure 2.18: Top 10 OIC Countries by GDP capita (2018, Current USD, Thousand)

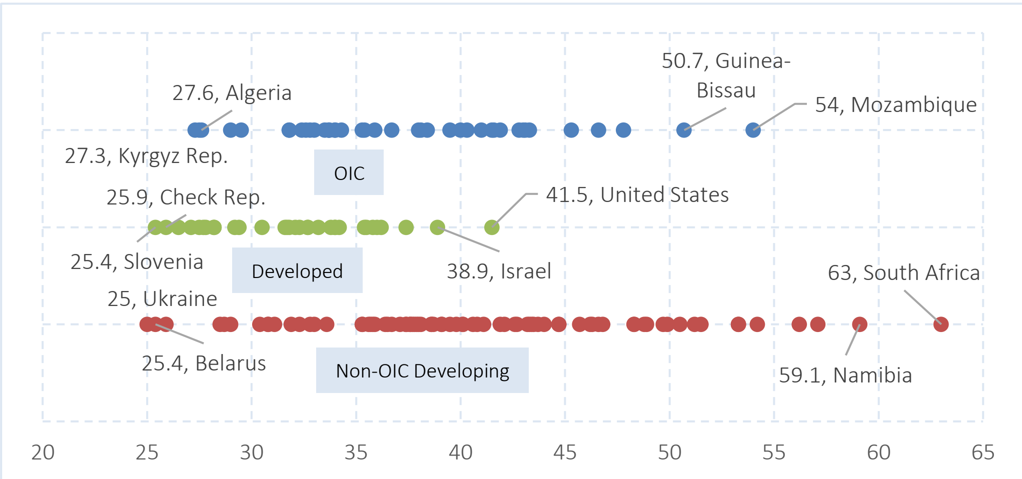


Source: IMF WEO Database April 2019. The numbers in brackets indicate the ratio of the related country's GDP per capita to the average GDP per capita of the OIC countries as a group.

- **Income Distribution and Poverty:** There are 13 OIC countries in which poverty rates remain above 30%.

It is imperative for a healthy economy and society that citizens have access to economic opportunities to earn their living through a decent work. Lack of access to education and skills

Figure 2.19: Income Distribution, Gini Coefficient



Source: World Bank WDI Database June 2019. Data coverage: 41 OIC, 32 Developed, 79 Non-OIC Developing Countries. Latest year available during 2008-2017.

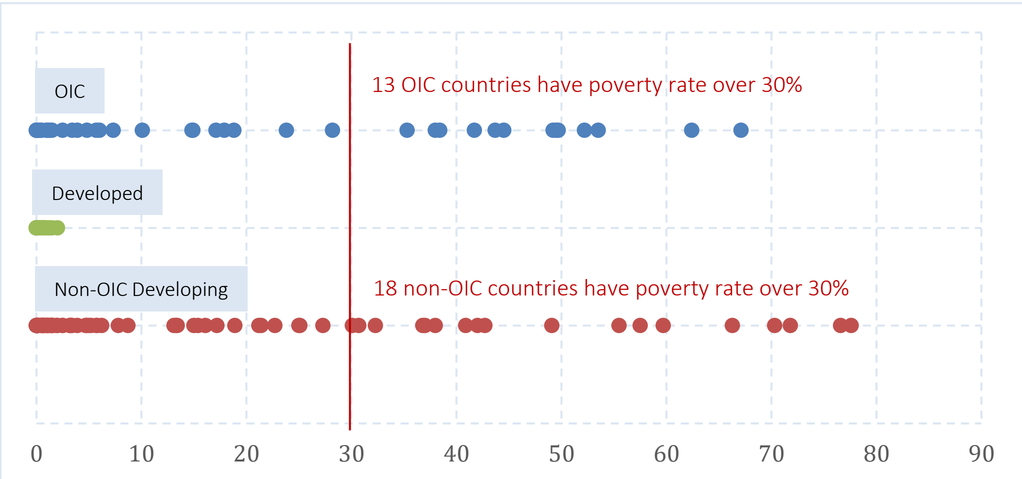
development programs pushes low skilled labour further down in occupational ladder or force them to exit the labour market altogether. This will have severe consequences on the welfare and standards of living of people with further implications on income distribution and poverty.

Income distribution, measured by Gini coefficient, is very diverse across the OIC region. The Gini coefficient or Gini index is a statistical measure of distribution often used to assess economic inequality and income distribution among a population. The coefficient ranges from 0 (or 0%) to 1 (or 100%), with 0 representing perfect equality and 1 representing perfect inequality. There are 15 OIC countries in which the score is above 40, where the OIC countries with highest income inequality are Mozambique, Guinea-Bissau, Benin, Cameroon and Comoros. On the other hand, Kyrgyz Republic, Kazakhstan, Algeria, Albania and Iraq have the lowest income disparity among 41 OIC countries for which data are available. The lowest inequality in the world is observed in Ukraine, Slovenia and Belarus, while highest is observed in South Africa, Namibia and Zambia.

An important indicator of healthy economies and societies is the level of poverty. Eradicating poverty was one of the most important goals of millennium development goals and it remains an important constituent of global development agenda. While global poverty rates have been cut substantially since 2000, there are still millions of people who are still living with their families on less than the international poverty line of US$1.90 a day. Within the group of OIC, there are 13 countries that have poverty rate over 30%. Guinea-Bissau, Mozambique, Nigeria, Sierra Leone and Mali are the most affected countries with highest poverty rates. On the other hand, out of 41 OIC countries, three OIC countries report no poverty at the international poverty line of US$1.90 a day, namely Kazakhstan, Lebanon and Malaysia. (There are probably some other OIC countries with no poverty, but their statistics are not included at World Bank database).

Economic growth must be inclusive to provide sustainable jobs and promote equality. Economic security is today, more than ever, the main challenge of ordinary people. Poverty, unemployment and inequality threaten the everyday security of average citizens in the OIC area. For that reason,

Figure 2.20: Poverty Headcount Ratio at $1.90 a Day (2011 PPP) (% of population)



Source: World Bank WDI Database June 2019. Data coverage: 41 OIC, 32 Developed, 79 Non-OIC Developing Countries. Latest year available during 2008-2017.

OIC countries should primarily target to offer a context for more growth, employment and competitiveness in the OIC countries, through result-oriented activities. For that to happen, governments of OIC Member Countries should create a more supportive environment for economic development and the OIC economies should rely on deeper regional cooperation and economic integration, as the best option for positive development.

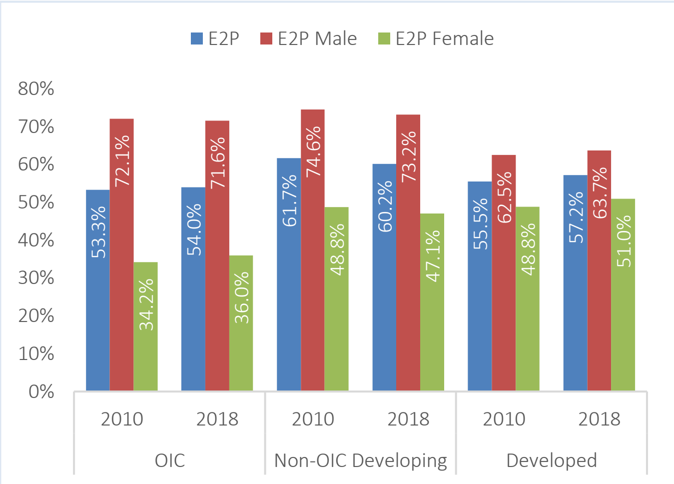
- **Employment:** Employment ratio in OIC countries remains below the averages of other country groups

Economic growth has evidently remained insufficient to tackle the widespread poverty and growing inequality in many countries around the world. This clearly indicates that there is still a need for more inclusive growth strategies that can address the challenges of most deprived populations. An effective way of supporting such disadvantaged groups is to enable them to earn their own income by supporting their participation to economic activity. Therefore, inclusive growth strategies should include prudent labour market policies that aim at increasing the rate of participation in labour force and thus decreasing the scope of economic inactivity in the country.

Employment is the most important source of income generation. A high employment-to-population ratio means that a large proportion of a country's working age population is employed, while a low ratio means that a large share of the population is not involved directly in market-related activities, because they are either unemployed or out of the labour force altogether. As shown in figure 2.21, the average employment to population ration in OIC countries has slightly increased from 53.3% in 2010 to 54.0% in 2018.

Although, OIC countries registered globally comparable performance in terms of total and male employment rates, their performance in case of female employment rate remained significantly lower. In case of employment rate for the male population, OIC countries recorded a rate of 71.6% compared to 63.7% in developed and 73.2% in non-OIC developing countries. Female employment rate in OIC countries was recorded at 36.0% in 2018, which is significantly lower than the averages of non-OIC developing countries (47.1%) and developed countries (51%). However, the gender gap has declined from 37.9 percentage points to 35.6 percentage points.

Figure 2.21: Employment to Population Ratio (2010 vs 2018)



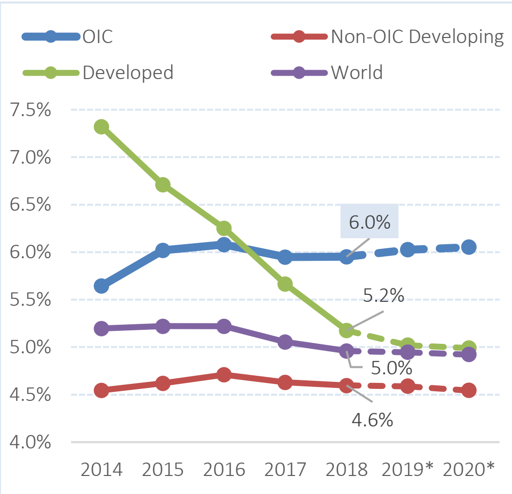
Source: ILO Modeled Estimates November 2018. Data coverage: 56 OIC, 93 non-OIC, and 38 developed countries.

- **Unemployment:** Average unemployment rate in OIC countries continue to remain well above the world average

Unemployment remained one of the most challenging issues across the globe. According to the ILO World Employment and Social Outlook 2019 report, an estimated 172 million people worldwide were unemployed in 2018, which corresponds to an unemployment rate of 5.0%. Due to ongoing uncertainties about world economic developments, little improvement is expected in the global labour market in 2019, whereas the number of unemployed is projected to grow by 1 million per year to reach 174 million by 2020, reflecting the fact that employment is not expanding sufficiently fast to keep up with the growing labour force. Global uncertainty and the lack of decent jobs accordingly contribute to social unrest and migration in many parts of the world.

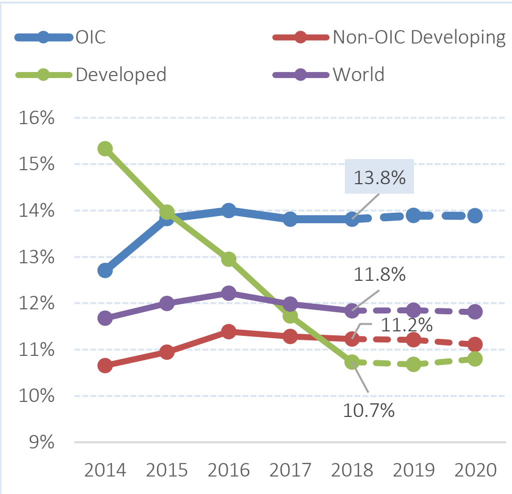
According the latest available data, OIC countries recorded significantly higher average unemployment rates compared to the world, developed and non-OIC developing countries during the period 2000-2018 (Figure 2.22a). Since 2000, total unemployment rate in OIC countries remain highest compared to other country groups and fluctuated between 5.8% and 6.9% (these and other related statistics might differ from those reported at previous editions of Economic Outlook due to a change in the estimation of the ILO). The high unemployment rates in developed countries constituted the only exception, which exceeded the rate in OIC countries during 2009-2016. Since 2017, average unemployment rate in developed countries fell below the rates observed in OIC countries and reached 5.2% in 2018, compared to 6.0% in OIC countries. Average unemployment rate in non-OIC developing countries remained visibly lower than the OIC average throughout period under consideration, which is estimated to remain at 4.6% in 2018.

Figure 2.22a: Unemployment, 15+ Ages (2014-2020)



Source: ILO Modeled Estimates November 2018. (*) Forecast. Data coverage: 56 OIC, 93 non-OIC, and 38 developed countries.

Figure 2.22b: Youth Unemployment, 15-24 Ages (2014-2020)



Source: ILO Modeled Estimates November 2018. (*) Forecast. Data coverage: 56 OIC, 93 non-OIC, and 38 developed countries.

A similar picture is observed for the youth population. Youth (aged 15 to 24 years) continue to suffer from lack of decent job opportunities across the globe. They are significantly more likely than adults to be unemployed, exhibiting an unemployment rate of 11.8% in 2018. A major global challenge is the phenomenon of young people who are not in education, employment or training (NEET). According to ILO, 30% of young women and 13% of young men were globally classified as NEET in 2018.

The figures on youth unemployment rates in OIC countries are not quite promising. The rate remained constantly stable around 14% since 2015 and also well above the world and non-OIC developing averages since 2000. After the financial crisis that hit developed economies, the problem of youth unemployment in these countries became even more serious compared to that in OIC countries during the period in consideration (Figure 2.22b). As of 2018, youth unemployment in OIC countries is expected to remain at 13.8%, while it will decline to 10.7% in developed countries and 11.2% in non-OIC developing countries.

At the individual country level, unemployment rates greatly varied among OIC countries (Figure 2.23a). The unemployed people in 2017 constituted less than one 1% of total labour force in Qatar (0.1%), which is also the lowest rate in the world. Niger (0.3%) and Bahrain (1.0%) are also reported by the ILO among the ten countries in the world with lowest unemployment rates. However, unemployment is a serious concern in Palestine (30.2%), Gabon (19.5%) and Libya (17.3%) and

There are again wide discrepancies in youth unemployment rates across OIC countries (Figure 2.23b). The highest youth unemployment rate was observed in Palestine (46.8%), followed by Libya (41.9%), Jordan (37.2%), Gabon (35.1%) and Tunisia (34.8%). In 2018, youth unemployment rate was above 20% in 20 OIC countries and above the world average of 11.8% in 34 OIC countries.

Figure 2.23a: Top 10 OIC Countries by Unemployment Rates (2018)

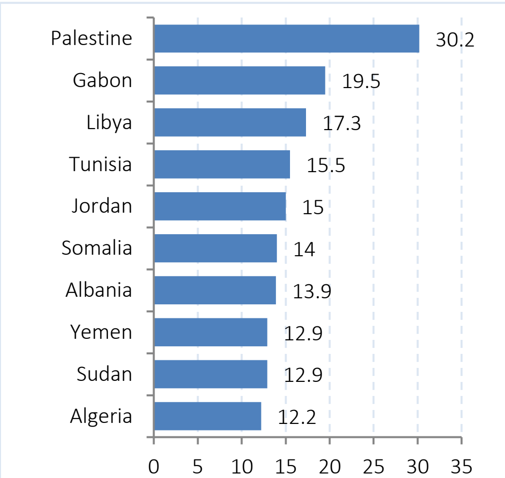
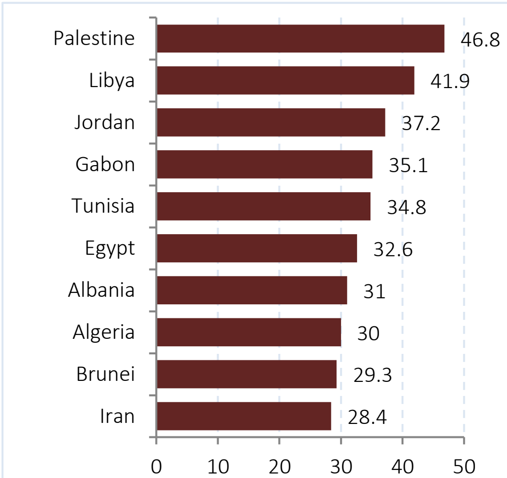


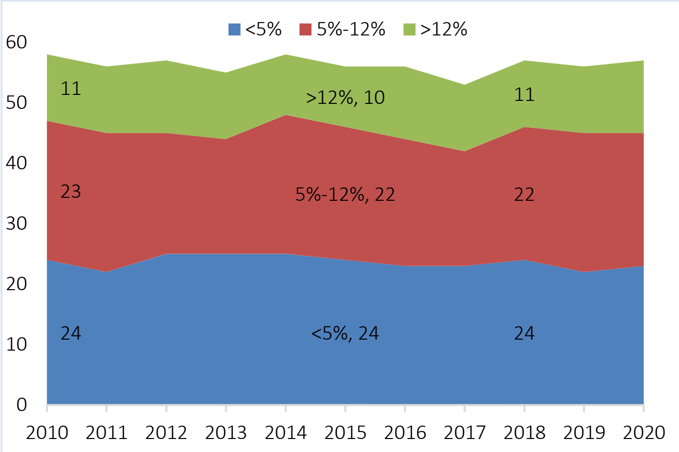
Figure 2.23b: Top 10 OIC Countries by Youth Unemployment Rates (2018)



Source: ILO Modeled Estimates November 2018. Data coverage: 56 OIC Countries.

To see number of countries within a certain range of unemployment, Figure 2.24 groups the OIC countries into three main groups. While some countries face high unemployment rates, the others enjoy relatively lower rates. On average, around 11 OIC countries have an unemployment rate over 12%, around 22 between 5% and 12% and around 24 OIC countries have a rate below 5% during 2010's (Figure 2.24).

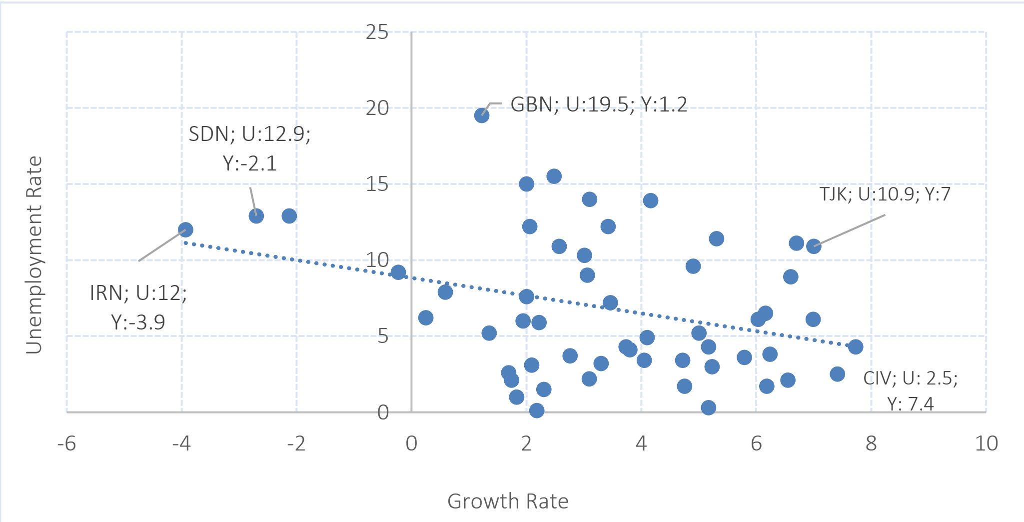
Figure 2.24: Distribution of Unemployment in OIC Countries



Source: ILO Modeled Estimates November 2018. Data coverage: 56 OIC, 93 non-OIC, and 38 developed countries.

It is common to observe that countries prioritise economic growth to create more jobs and reduce unemployment. Therefore, attaining high growth rates remains at the core of policies aiming to reduce unemployment. When we look at the relationship between economic growth and unemployment, we observe that countries with higher economic growth tend to have lower unemployment rates (Figure 2.25). However, this relationship is not very straightforward. There are countries with high growth rates but also relatively high unemployment rates, such as Tajikistan. In general, it could be argued that faster growing OIC countries tend to have lower unemployment rates.

Figure 2.25: Economic Growth vs Unemployment in OIC Countries



Source: ILO Modeled Estimates November 2018. Data coverage: 56 OIC, 93 non-OIC, and 38 developed countries.

- **Labour Productivity:** Only four OIC countries recorded output per worker higher than developed countries' average

Productivity plays a pivotal role in the development of an economy. It helps to increase real income and improve living standards by catalysing the economic growth. Labour productivity is usually defined as the output per unit of labour input or output per hour worked. It helps to identify the contribution of labour to the GDP of a country and provides a base for cross country comparison and explanation of income disparities.

At the global level, labour productivity has witnessed an increasing trend during the last decade. As shown in Figure 2.26a, output per worker in OIC countries has increased at a compound growth rate of 2.3% during 2000-2009, but this rate declined to 1.8% during 2010-2018. Average labour productivity growth in non-OIC developing countries remained above 4% annually. As of 2018, average labour productivity in OIC countries was measured as USD 28 thousands, as measured in constant international prices based on purchasing power parity (PPP). The labour productivity gap between the developed and developing countries remained substantial throughout this period as output per worker in the developed countries is estimated at USD 96 thousands in 2018 compared to just US$ 25 thousands in non-OIC developing countries and USD 28 thousands in OIC countries. This means that an average worker in the group of non-OIC developing countries produces only 25.9% of the output produced by an average worker in the developed countries and an average worker in OIC countries produces only 29.4% of the output produced by an average worker in the developed countries.

Figure 2.26a: Average Labour Productivity Growth (2000-2009 vs 2010-2018)

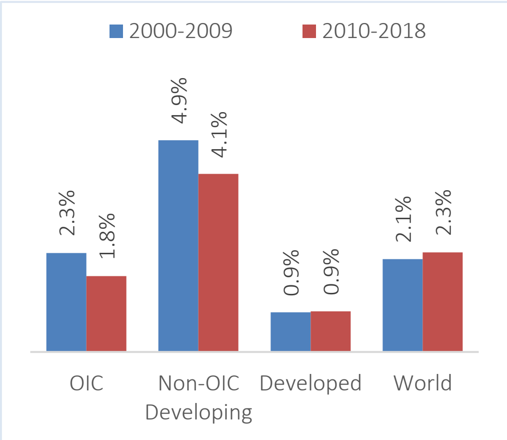
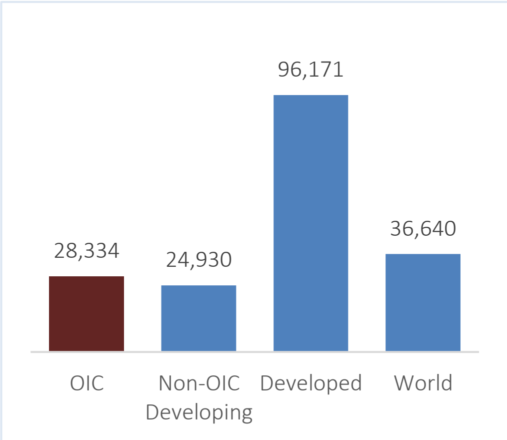


Figure 2.26b: Average Labour Productivity (2018)



Source: ILO Modeled Estimates November 2018. Data coverage: 56 OIC, 93 non-OIC , and 38 developed countries.

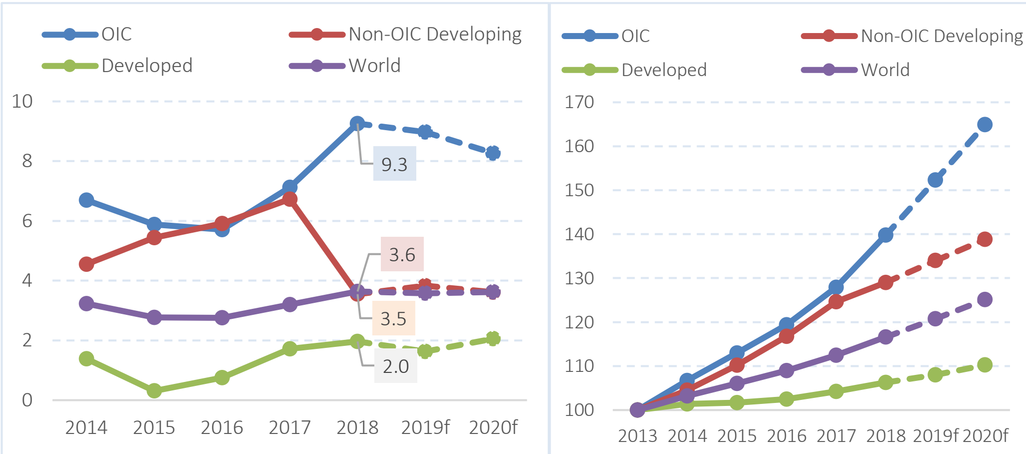
At the individual country level, Qatar registered the highest output per worker (USD 158 thousands) in 2018, followed by Saudi Arabia (USD 124 thousands), Kuwait (USD 116 thousands) and United Arab Emirates (USD 98 thousands). Among the OIC countries, the lowest labour productivity level was recorded in Niger (USD 2,415) followed by Mozambique (US$ 2,744) and

Togo (US$ 3,289). Only four member countries recorded output per worker higher than the average of developed countries.

- **Inflation:** Inflation in OIC countries remained higher than the global average

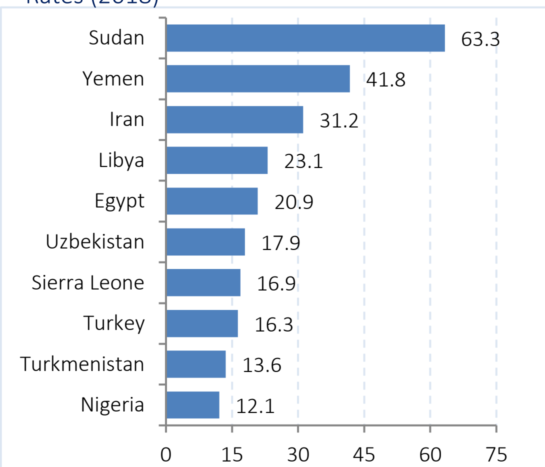
With the slowdown in global economic growth rates, inflation rates across the world remains at moderate levels over the last few years. The latest estimates show that global inflation rate has increased from 3.2% in 2014 to 3.6% in 2018; and it is expected to stay at the same levels during 2019 and 2020 due to ongoing economic slowdown.

Figure 2.27: Average Inflation Rate, Annual Change (left) and Index (right)



Source: SESRIC staff calculations based on IMF WEO Database April 2019. Data Coverage: 55 OIC , 98 non-OIC developing, and 39 developed countries. Global and regional price indices are calculated as a weighted average of national price indices, with the weights being each respective country's GDP in current international dollars based on PPP.

Figure 2.28: Top 10 OIC Countries by Inflation Rates (2018)



Source: IMF WEO Database April 2019 . Data coverage: 55 OIC Countries.

As seen in Figure 2.27, price volatility remained a major concern especially for the developing countries. Although the growth rates have declined in OIC countries between 2016 and 2018, inflation rates have been on the rise during the same period. It increased from 5.7% in 2016 to 9.3% in 2018. However, it is expected that the rise in average consumer prices will decline over the next two years to reach 8.3% in 2020. Non-OIC developing countries were experiencing a similar trend in consumer prices, but it has sharply declined to 3.5% in 2018. Expected inflation rate in non-OIC developing countries is 3.8% in 2019. On aggregate, consumer prices have increased by 39.3% in OIC countries, 29% in non-OIC developing countries and 6.3% in developed countries since 2013.

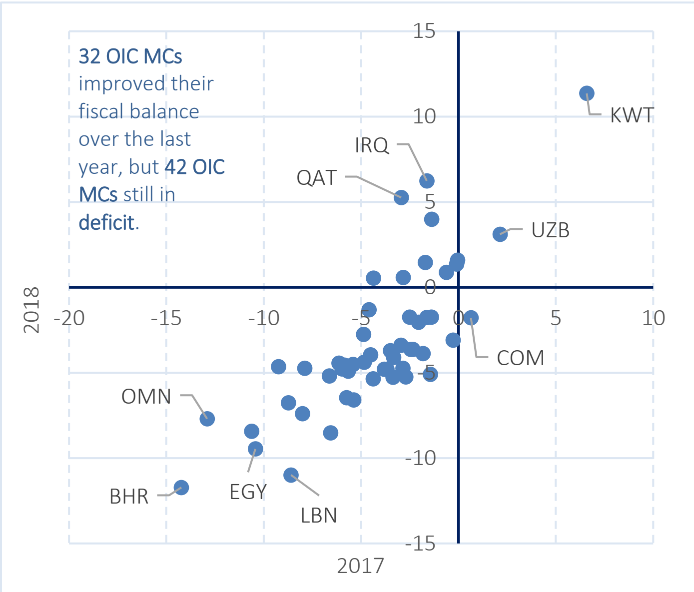
At the individual OIC country level, Sudan recorded the highest average consumer prices inflation rate of 63.3% in 2018 (Figure 2.28), which was also the 3rd highest in the world after Venezuela and South Sudan. Yemen (41.8%), Iran (31.2%), Libya (23.1%) and Egypt (20.9%) were the other OIC countries with highest inflations rates in 2018. These five OIC countries were also among the top 10 countries in the world with highest increase in consumer prices.

- **Fiscal Balance:** 32 OIC countries improved its fiscal balance in 2018

Latest statistics show that the fiscal tightening policies adopted in the after math of financial crisis have led to improvement in fiscal balances across the world. Nevertheless, sharp decline in commodity prices especially for oil in 2014/15 lead to increase in fiscal deficits in all major oil exporting countries in the developing world. Particularly, developed countries witnessed improvement in their fiscal situation and their fiscal balance deficit. On the other hand, developing countries registered significant deterioration in their fiscal situation over the last decade.

During the period under consideration, the OIC member countries witnessed sharp deterioration in their fiscal balance. High dependence on commodity and primary goods exports makes many OIC countries particularly vulnerable to price fluctuations. In 2017, there were only three OIC countries with fiscal balance surplus in 2017. This number increased to eleven in 2018 (Figure 2.29). Among the top 10 countries, only Kuwait and Uzbekistan recorded fiscal surplus of 4.0 and 0.9 % of GDP, respectively. During 2017-2018, many oil exporting OIC countries have witnessed some improvement in their fiscal balances amid the rebound in oil prices. On the opposite side of the scale, Libya recorded the largest fiscal balance deficit (43.2%) followed by Bahrain (15.1%), and Brunei (-12.4%).

Figure 2.29: Change in Fiscal Balance in OIC Countries, % of GDP (2017 vs 2018)



Source: IMF WEO Database April 2019. Data coverage: 54 OIC Countries.

Chapter Three

Trade and Finance

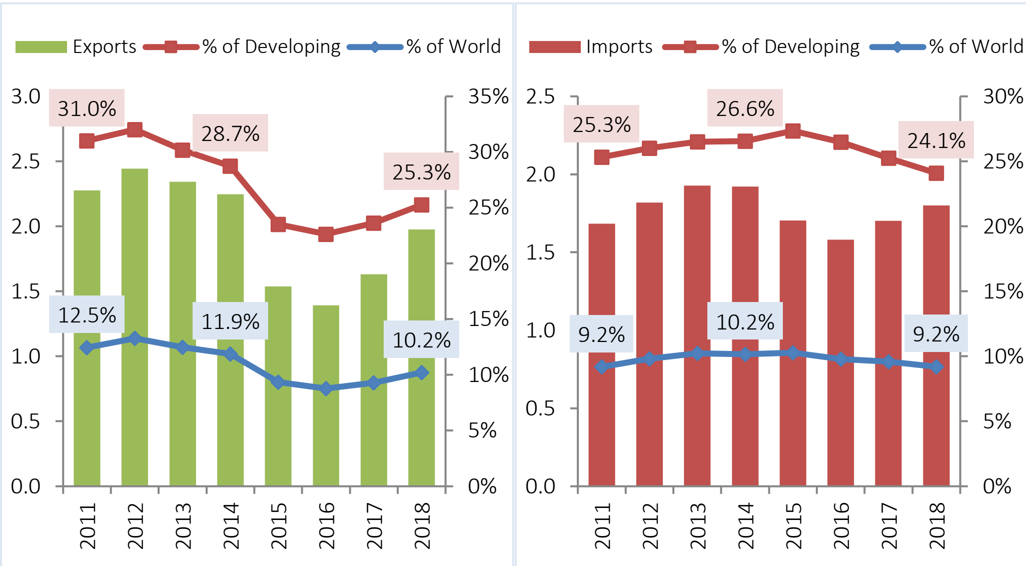
3.1 Trade in Goods and Services

- **Merchandise Trade:** Share of OIC countries in world's total exports further improved in 2018 to reach 10.2%.

The total value of world merchandise exports, according to the IMF Directions of Trade Statistics (DOTS), was recorded at US$ 19.4 trillion in 2018, as compared to US$ 17.6 trillion in 2017. According to World Trade Organisation (WTO), however, world merchandise exports increased from US$ 17.7 trillion in 2017 to US$ 19.5 trillion in 2018. Despite small disparities in global trade estimations, global exports increased around 10.2% in 2018. After strong growth rates for two consecutive years, the global trade reached historically its highest level, reflecting improving global economic activity.

In line with this global trend, OIC countries have also witnessed an improvement in their total exports to world. After constantly falling during 2012-2016 and reaching its lowest level in 2016 since 2008, their aggregate exports increased to US$ 1.63 trillion in 2017 and US$ 1.98 trillion in 2018, as reported by IMF DOTS (Figure 3.1). This corresponds to an increase by 21.5%. This upward trend was even stronger than those observed in non-OIC developing countries and the world, resulting in an increase in the shares of OIC countries in total developing country and world exports in 2018, which was also constantly falling during 2012-2016. Accordingly, the share of OIC countries in total exports of developing countries bounced back to 25.3% in 2018, compared to 23.6% in 2017. OIC countries' collective share in total world merchandise exports also followed a similar trend between 2012 and 2016, and decreased to 8.8% in 2016, which is the lowest ratio observed since 2005 and largely to be explained by falling commodity prices, where OIC countries have significant concentration. However, this ratio increased to 9.3% in 2017 and 10.2% in 2018,

Figure 3.1: Merchandise Exports and Imports (US$ Trillion)



Source: IMF Directions of Trade Statistics (DOTS), August 2018.*Data coverage*: 56 OIC countries, 37 developed countries and 116 non-OIC developing countries.

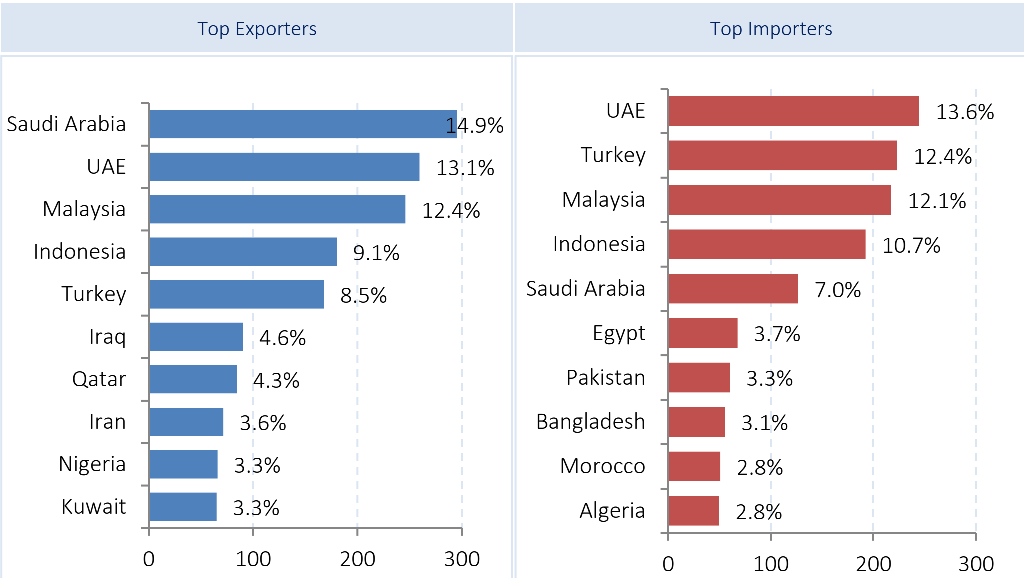
reflecting better economic performance of OIC countries compared to other country groups. Moving forward, to achieve long-term sustainable growth in merchandise trade and higher share in total world exports, OIC countries will apparently need more competitive economic sectors with significant diversification levels and higher technological intensity.

Similarly, total merchandise imports of OIC countries increased from US$ 1.7 trillion in 2017 to US$ 1.8 trillion in 2018 (Figure 3.1, right). Despite the increase in import volumes, the share of OIC countries in global merchandise imports slightly decreased to 9.2% compared to 9.6% in 2017, while its share in total imports of developing countries fell from 25.3% in 2017 to 24.1% in 2018.

In terms of the shares of the individual member countries in total merchandise exports from the OIC region, it has been observed that the bulk of total exports from the OIC countries continued to be concentrated in a few countries (Figure 3.2, left). In 2018, the top 5 largest OIC exporters accounted for 58.1% of total merchandise exports of all member countries whereas the top 10 countries accounted for 77.2%. Saudi Arabia, with over US$ 295 billion worth of merchandise exports and 14.9% share in total OIC exports, became the largest exporter in 2018 within the group of the OIC. It was followed by United Arab Emirates (US$ 259 billion, 13.1%), Malaysia (US$ 246 billion, 12.4%), Indonesia (US$ 180 billion, 9.1%) and Turkey (US$ 168 billion, 8.5%). In general, increase in commodity prices raised the shares of commodity exporting countries compared to manufacturing goods exporters.

As in the case of exports, merchandise imports of OIC countries were also heavily concentrated in a few countries. As depicted in the right panel of Figure 3.2, with US$ 245 billion and US$ 223 billions of imports, United Arab Emirates and Turkey, respectively, took the lead in 2018 in terms

Figure 3.2: Top OIC Merchandise Exporters and Importers (2018, US$ Billion)



Source: IMF Directions of Trade Statistics (DOTS), August 2018. *Data coverage:* 56 OIC countries.

of volume of merchandise imports and together accounted for 29.3% of total OIC merchandise imports. They were followed by Malaysia (US$ 217 billion, 12.1%), Indonesia (US$ 192 billion, 10.7%) and Saudi Arabia (US$ 127 billion, 7.0%), which collectively accounted for a further 28.2 % share in the OIC merchandise imports. Accordingly, the top 5 OIC importers accounted for 55.7% of total OIC merchandise imports, whereas the top 10 countries accounted for 71.5% in 2018.

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

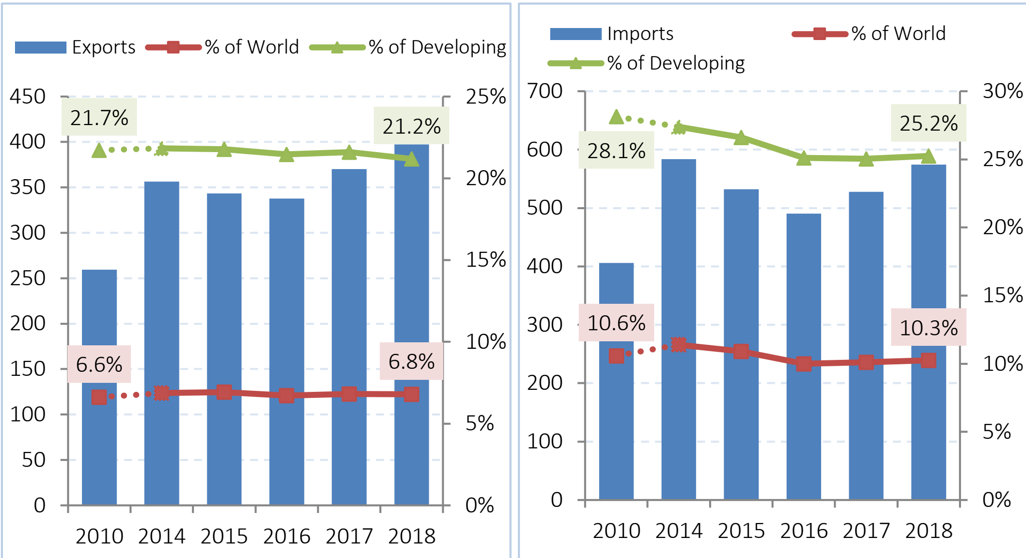
- **Services Trade:** Services exports of OIC countries reached its highest level in 2018, but they continue to account less than 7% of global services exports.

The services sector plays an increasingly important role in the global economy and the growth and development of countries. It is also a crucial component in poverty reduction and access to basic services, including education, water and health services. The services sector has emerged as the largest segment of the economy, contributing growing shares in gross domestic product (GDP), trade and employment. According to 2019 editions of the World Bank's World Development Indicators and United Nations' National Accounts Main Aggregates Databases the services sector accounted on average for 66%-67% of the global value-added during 2010-2017 and it is expanding more rapidly than the other two main sectors of the economy, namely, agriculture and the industry. The sector accounts for more than 50% of employment worldwide. Trade in services constitutes more than 20% of world trade of goods and services, with a significant share of global foreign direct investment (FDI) flowing into the sector (UNCTAD, 2019).

Yet these figures do not translate into a strong presence in world trade. In 2018, world services exports totalled only US$ 5.8 trillion, compared to US$ 19.4 trillion of merchandise exports in the same year. According to UNCTAD statistics, OIC countries exported US$ 397 billion worth of services in 2018, which is the highest number recorded by the OIC (Figure 3.3, left). On the other hand, the total services imports of OIC services reached US$ 575 billion in the same year (Figure 3.3, right). Hence, the services exports and imports of OIC countries increased for two consecutive years since 2016.

OIC countries continue to contribute to the global services exports at low rates. The collective share of OIC countries in the total world services exports fluctuated between 6.2% and 6.9% during the period 2010-2018, while the share in global services imports fluctuated between 10.0% and 11.4% during the same period. As of 2018, OIC countries as a group account for 6.8% of global services exports and 10.3% of global services imports. On the other hand, the share of OIC member countries in services imports of developing countries have followed a downward

Figure 3.3: Services Exports and Imports (US$ Billion)

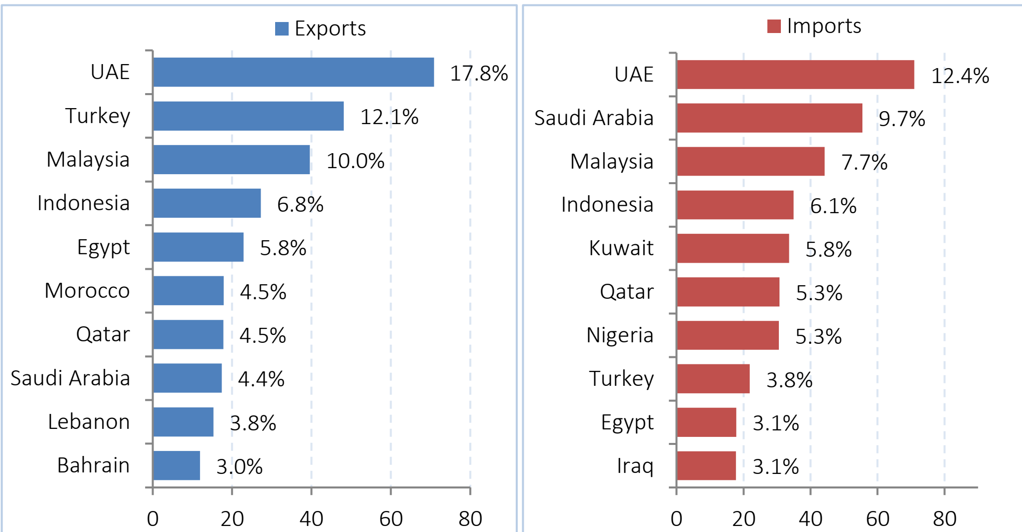


Source: UNCTAD STATS. July 2019. Data provided by UNCTAD as aggregate for the group of OIC countries.

trend during the period 2010-2018 and fell to 25.2% in 2017, while its share in services exports remained around 21.2% in the same year (Figure 3.3).

Figure 3.4 shows the top 10 OIC countries according to the sizes of their services exports and imports. United Arab Emirates, with US$ 71 billion exports and 17.8 % share in total OIC services exports, was the top exporter in services in 2018 (Figure 3. 4, left). It was followed by Turkey (US$ 48 billion, 12.1%), Malaysia (US$ 40 billion, 10%), Indonesia (US$ 27 billion, 6.8%) and Egypt (US$

Figure 3.4: Top 10 OIC Services Exporters and Importers (2018, US$ Billion)



Source: WTO. *Data coverage:* 42 OIC countries. Percentages indicate the share of respective country in total OIC exports or imports.

23 billion, 5.8%). In 2018, top 10 OIC countries accounted for 72.7% of total OIC services exports. As far as the service imports are concerned, the United Arab Emirates again registered the highest service imports with an amount of US$ 71 billion and 12.4% share in OIC total services imports. It was followed by Saudi Arabia (US$$ 55 billion, 9.7%), Malaysia (US$$ 44 billion, 7.7%), Indonesia (US$ 35 billion, 6.1%) and Kuwait (US$ 34 billion, 5.8%). The top 10 OIC services importers collectively accounted for 62.3% of total services imports of OIC countries.

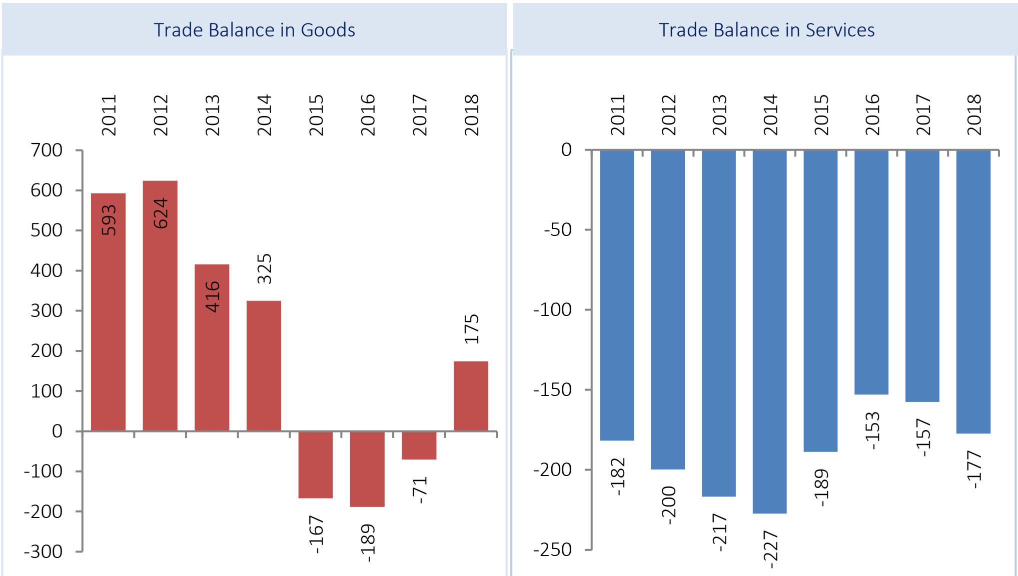
- **Trade Balance:** OIC countries are again net exporters of goods but remain net importers of services in 2018.

The analyses on merchandise trade and services above indicate that OIC countries are not taking enough role in global economic activities. Despite minor improvements observed in 2018, their contribution to global flow of goods and services remain below their potential. Inadequate level of capacity in manufacturing and services make them net importers of both goods and services.

As shown in Figure 3.5 (left), OIC countries became a net importer of manufacturing products during 2015-2017, mainly due to falling commodity prices. In 2018, OIC countries as a group recorded a surplus again at an amount of US$ 175 billion. On the other hand, OIC countries remained constantly a net importer of services over the period under consideration. Despite the fall in trade deficit in services during 2014-2016, it started to growth over the last two years and reached US$ 177 billion deficit in 2018.

Altogether, OIC countries recorded only US$ 2 billion trade deficit in 2018, which was recorded at US$ 228 billion in 2017. In order to become net exporter of both goods and services and attain

Figure 3.5: Trade Balance of OIC Countries in Goods and Services (US$ Billion)



Source: IMF DOT and UNCTAD STATS. *Data coverage*: 56 OIC countries.

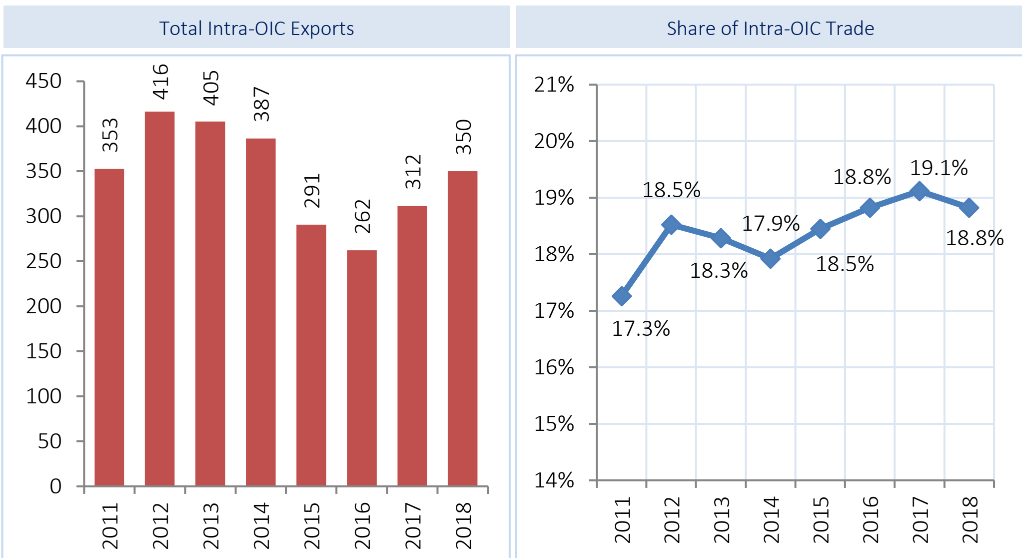
constant surpluses in trade, OIC countries need to upgrade their existing productive capacities to transform their economics towards more value-added sectors and products.

- **Intra-OIC Trade:** Share of intra-OIC trade in total trade of OIC countries fell in 2018 despite the increase in trade volumes.

As in the case of trade of OIC countries at global level, their trade with other OIC countries were also falling during 2014-2016 period. It started to increase again in 2017 and reached US$ 312 billion. In line with continued expansion of global trade, total intra-OIC exports further increased to US$ 350 billion in 2018 (Figure 3.6, left). Over the last two years, intra-OIC exports increased by 34%, which is a significant achievement. Yet, it remains below the total values recorded in 2012. On the other hand, the share of intra-OIC trade in total trade of OIC countries constantly have been rising during the period 2014-2017 and reached 19.1% in 2017 compared to its level of 17.9% in 2014 (Figure 3.6, right). However, it fell to 18.8% in 2018 due to relatively stronger increase in their trade volumes with non-OIC member countries. This reduces the prospects for achieving the 25% target set in the OIC Ten-Year Programme of Action (OIC-2025), but further efforts should be made to invigorate upward momentum through bilateral and multilateral trade and investment agreements and partnerships among the OIC countries.

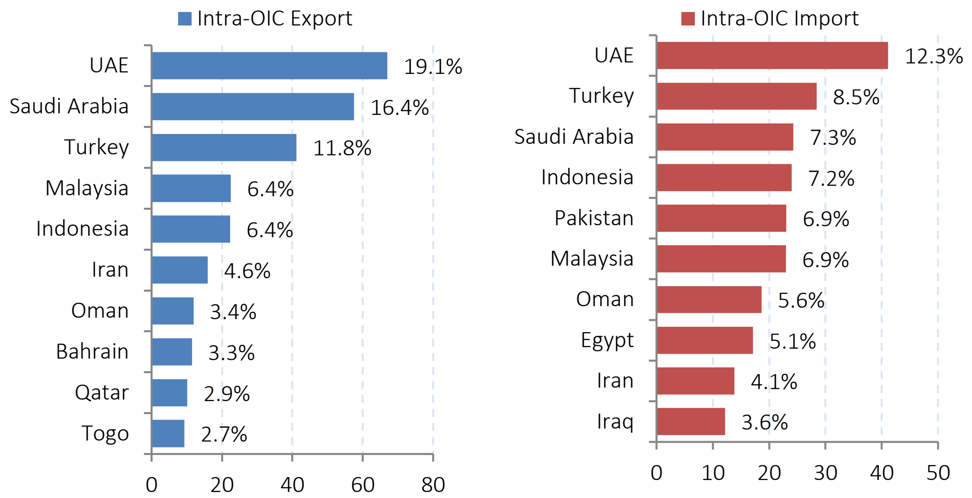
In order to increase the share of trade among them in their total merchandise trade even further, OIC countries should not only focus on operationalizing the OIC Trade Preferential System (TPS-OIC) with broader participation from the member countries, but also promote diversification and competitiveness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

Figure 3.6: Intra-OIC Merchandise Trade (US$ Billion)



Source: IMF Directions of Trade Statistics (DOTS), July 2019. *Data coverage*: 56 OIC countries.

Figure 3.7: Intra-OIC Merchandise Exports and Imports (2018, US$ Billion)



Source: IMF Directions of Trade Statistics (DOTS), August 2018. *Data coverage*: 56 OIC countries.

At the individual country level, Figure 3.7 (left) depicts the top 10 member countries in terms of the volume of their intra-OIC exports. In 2018, top 5 OIC intra-OIC exporters accounted for as much as 60.1% of total intra-OIC exports whereas the top 10 exporters for 76.9%. United Arab Emirates ranked first with US$ 67 billion and 19.1% of total intra-OIC exports, followed by Saudi Arabia (US$ 57.5 billion, 16.4%), Turkey (US$ 41.2 billion, 11.8 %), Malaysia (US$ 22.5 billion, 6.4%) and Indonesia (US$ 22.3 billion, 6.4%).

The top OIC countries in terms of intra-OIC imports are also depicted in Figure 3.7 (right). In 2018, United Arab Emirates, with US$ 41.1 billion total volume and 12.3% share in total, was the largest importer from OIC countries. It was followed by Turkey with US$ 28.4 billion and 8.5% share and Saudi Arabia with US$ 24.3 billion and 7.3% share. Top 5 OIC countries accounted for 42.2% of total intra-OIC imports and top 10 countries accounted for 67.6% in 2018.

Table 3.1 shows the number of country pairs with zero trade flows. IMF DOT database provides information for 3021 OIC country pairs. 802 of which did not report any import in 2018. This figure was 1404 in 2000 and 996 in 2010. Falling number of country pairs with zero trade flows

Table 3.1: Number of OIC Pairs with Zero Imports

	Zero Import	Import < 1 Million	Import > 1 million	Import > 1 billion	Total Obs.
2000	1,404	814	802	17	3021
2005	1,186	831	1,004	32	3021
2010	996	877	1,148	69	3021
2015	879	926	1,216	62	3021
2018	802	960	1,259	76	3021

Source: SESRIC staff calculations based on IMF Direction of Trade Statistics (DOTS) is an indication of growing partnership among the OIC countries. Table 3.1 also shows the number of countries with trade flows over 1 million and over 1 billion as well. The number of country pairs with a total imported goods of over US$ 1 million and US$ 1 billion is increasing over time. This shows that OIC countries are not only trade with each other, they also trade in increasing volumes over time.

3.2 Investment and Finance

- **FDI Inflows:** Share of OIC countries in total world FDI inflows started to increase in 2017 after constantly falling over the recent years

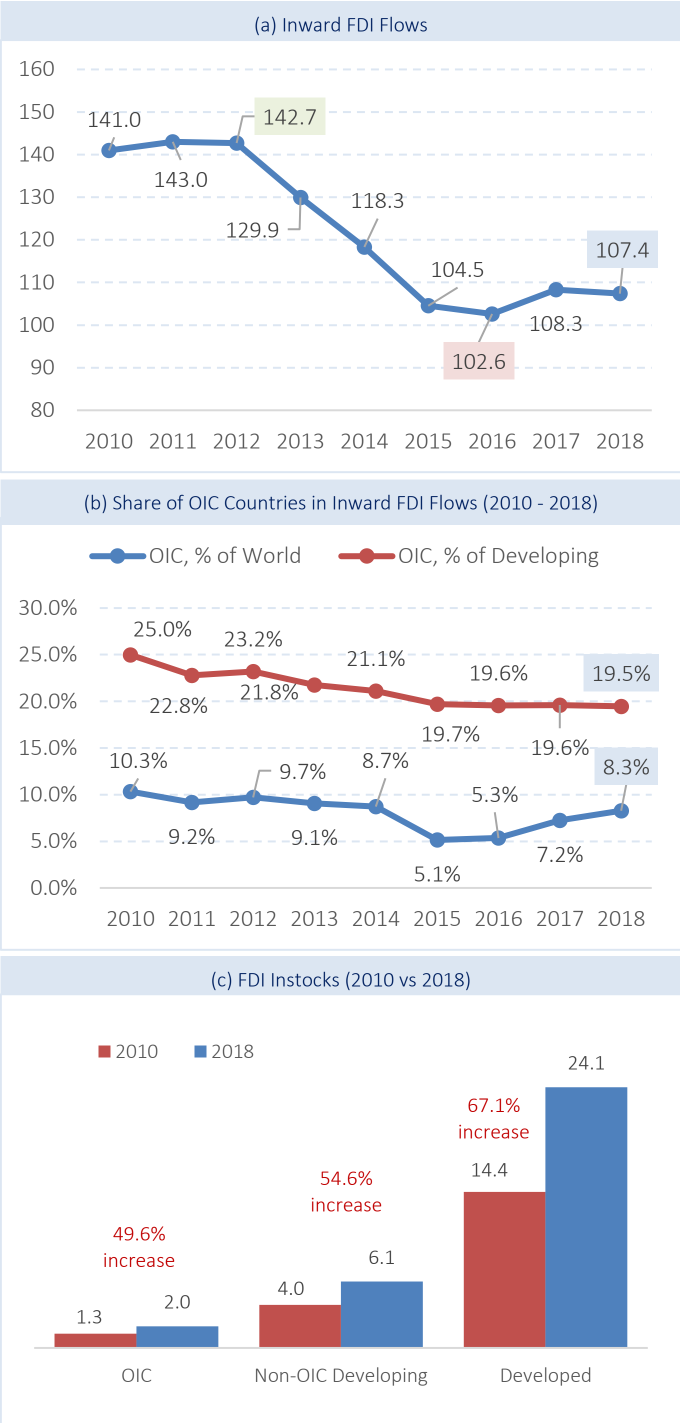
World total foreign direct investment (FDI) inflows amounted to US$ 1.3 trillion in 2018, marking a decrease of more than US$ 200 billion over previous year's value of US$ 1.5 trillion and corresponding to 13% fall. It is the third year in row that the volume of global FDI inflows recorded a contraction. However, the fall in global FDI inflows was due to the fall in FDI inflows to developed countries, which contracted more than 26% over the last year. On the other hand, total FDI inflows to developing countries, including the OIC countries, remained rather stable over the last few years.

Figure 3.8a depicts the total FDI flows to OIC countries in comparison to non-OIC developing and developed countries. It is observed from the Figure that, during the period under consideration, FDI flows to OIC countries generally remained lower than their potential. After reaching US$ 143 billion in 2011, the total US$ value of FDI inflows to OIC member countries constantly fell until 2016 to reach only US$ 102.6 billion. In 2017, the total value of FDI flows to OIC countries increased for the first time since 2011, which was recorded at US$ 108.3 billion, corresponding to 5.5% increase compared to the previous year. However, it slightly decreased in 2018 to reach US$ 107.4 billion. The share of OIC countries in global FDI inflows, on the other hand, has been on decline during 2010-2015 and reached its lowest value in 2015 with 5.1% (Figure 3.8b). However, due to fall in global FDI inflows and increase in inflows to OIC countries, the share of OIC countries in global FDI inflows has been increasing over the last year years and increased to 8.3% in 2018. Its share in FDI inflows to developing economies continue to decline and recorded 19.5% in 2018.

Global inward FDI stock reached US$ 32.3 trillion in 2018. OIC countries collectively recorded US$ 2.0 trillion stock of FDI in 2018. Although inward FDI stocks in OIC countries raised almost 50% since 2010, this increase was lower than the growth in other country groups, which led to a fall from 6.8% share in global FDI stock in 2010 to 6.2% in 2018 (Figure 3.8c). Furthermore, the bulk of the inward FDI stock was hosted by developed countries, which collectively recorded over 75% share in global inward FDI stock in 2018.

Like in the case of other major macroeconomic aggregates of the OIC group, FDI flows to OIC countries also exhibited a high level of concentration, with bulk of it persistently being directed to a few of them. The top 5 OIC countries with largest inward FDI flows together accounted for 56.1% of total FDI flows to OIC countries, whereas the top 10 countries accounted for 73.5% (Figure 3.9, left). In 2018, Indonesia took the lead in FDI inflows with US$ 22 billion of inward FDI

Figure 3.8: Inward FDI Flows and Stocks in OIC Countries (US$ Billion)



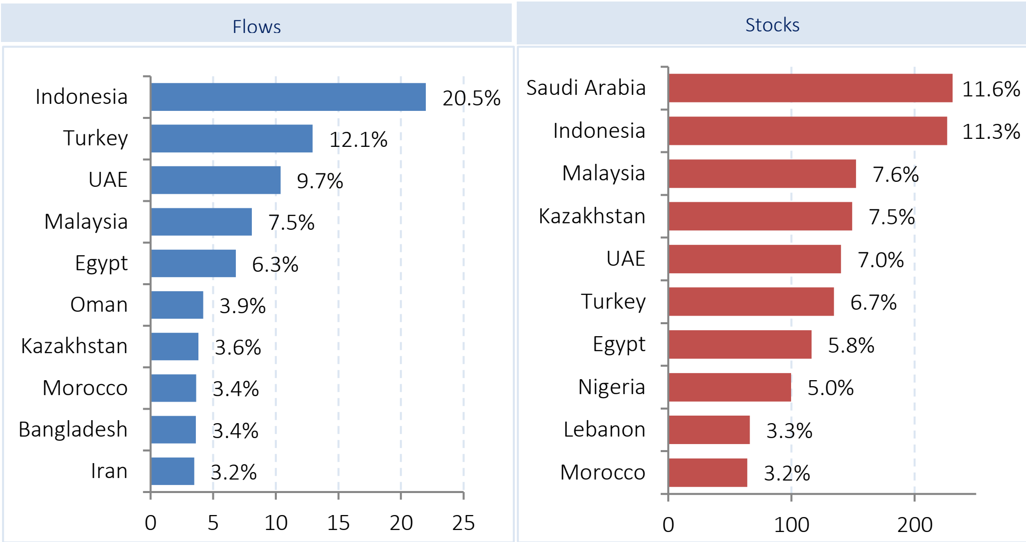
Source: SESRIC staff calculations based on UNCTAD STAT Database June 2019. Data Coverage: 56 OIC, 111 non-OIC, and 37 developed countries.

flow, and a 20.5% share in total FDI flows to OIC countries. It was followed by Turkey (US$ 12.9 billion, 12.1%), United Arab Emirates (US$ 10.4 billion, 9.7%), Malaysia (US$ 7.5 billion, 7.5%) and Egypt (US$ 6.8 billion, 6.3%).

A similar picture is observed in the case of inward FDI stock as well: top 5 countries hosted 45.1% of total OIC inward FDI stocks whereas the top 10 countries 69.2%. With US$ 231 billion of inward FDI stocks (11.6% of the OIC total), Saudi Arabia ranked first among the list of OIC countries with largest inward FDI stock in 2018. Saudi Arabia was followed by Indonesia (US$ 226 billion, 11.3%), Malaysia (US$ 153 billion, 7.6%), Kazakhstan (US$ 149 billion, 7.5%) and UAE (US$ 140 billion, 7.0%).

Overall, this state of affairs suggests that a significant majority of the OIC countries are still not able to set up favourable economic frameworks and to provide the foreign businesses with adequate regulatory as well as physical infrastructure to attract more FDI flows. Consequently, OIC countries, in general, need to take swift measures to foster an environment conductive to

Figure 3.9: Top 10 Hosts of Inward FDI Flows and Stocks (2018, US$ Billion)



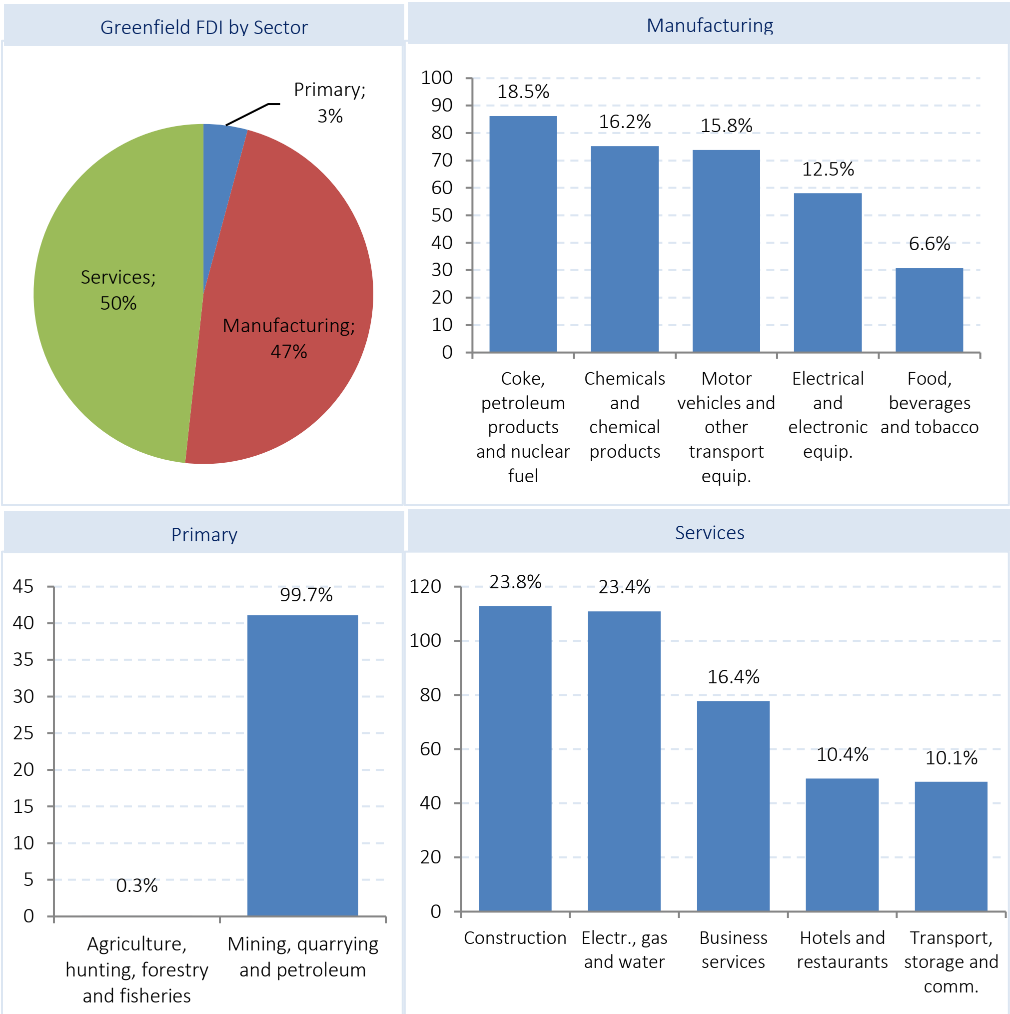
Source: UNCTAD STAT, June 2019. Data coverage: 56 OIC countries.

attracting more foreign investments. To achieve this goal, reforms are needed to improve the business climate and to introduce investment incentives tailored to the needs of both domestic and foreign investors. This, in turn, requires building adequate infrastructure as well as investing in modern technologies to enhance their productive capacities, which is still a significant challenge to majority of them.

An important indicator for assessing future trends is the value of greenfield investments. Its distribution also gives important information in which sectors and sub-sectors investors are willing to invest more. Global distribution of announced greenfield investments indicates that only 3% will go to primary sectors (Figure 3.10, upper left), while almost all these investments to be allocated for mining, quarrying and petroleum industries (Figure 3.10, lower left). Manufacturing sector is expected to receive 47% of future investments, where petroleum products, chemical products and motor vehicles are the top industries that are expected to receive investment globally (Figure 3.10, upper right). On the other hand, half of the investments will flow into the services sector, with construction and electricity, gas and water expected to receive the largest share in investment flows to services sector (Figure 3.10, lower right). This distribution of investments across sectors will have also implications for industrial development.

Figure 3.11 shows the value of announced greenfield investments since 2010. OIC countries, on average, are the source of global investment flows at around 7% (left). On the other hand, around 20% of global investment flows were announced to flow into OIC countries during the period under consideration (right). Accordingly, it is observed that OIC countries are receiving much more investment that they made abroad, according to the announced greenfield investment statistics. However, the share of OIC countries in announced greenfield investment remain well below the rate they attained in 2016 with 27.7%.

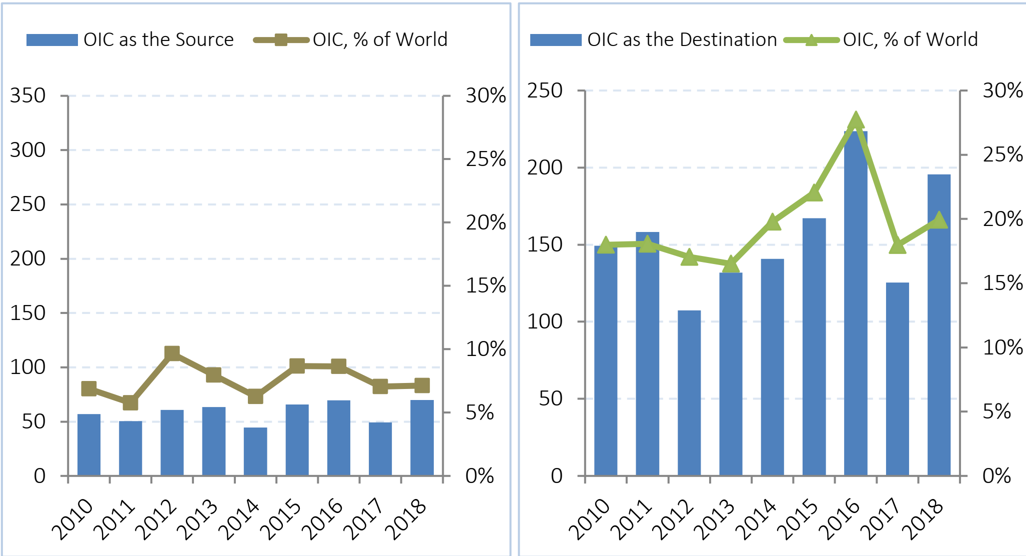
Figure 3.10: Distribution of Greenfield Investment across the World, by Sector (2018, US$ Billion)



Source: UNCTAD STAT, July 2019. Data reported as aggregate.

Evidently, investment flows into OIC countries are not at desired levels and announced investments offer limited prospects for improvements. In this respect, more policy-interventions are needed to reduce investment barriers and improve business climate to promote investment inflows to OIC countries. It is also important to promote intra-OIC investment flows. The success on reaching the potential in intra-OIC FDI are closely linked to the determination of policymakers of OIC countries to adopt some concrete policy measures for reducing trade and investment barriers, abolishing/easing visa regimes, and facilitating capital transfers among OIC member countries.

Figure 3.11: Greenfield Investments in OIC Countries (US$ Billion)



Source: SESRIC staff calculations based on UNCTAD STATS. Data coverage: 56 OIC countries.

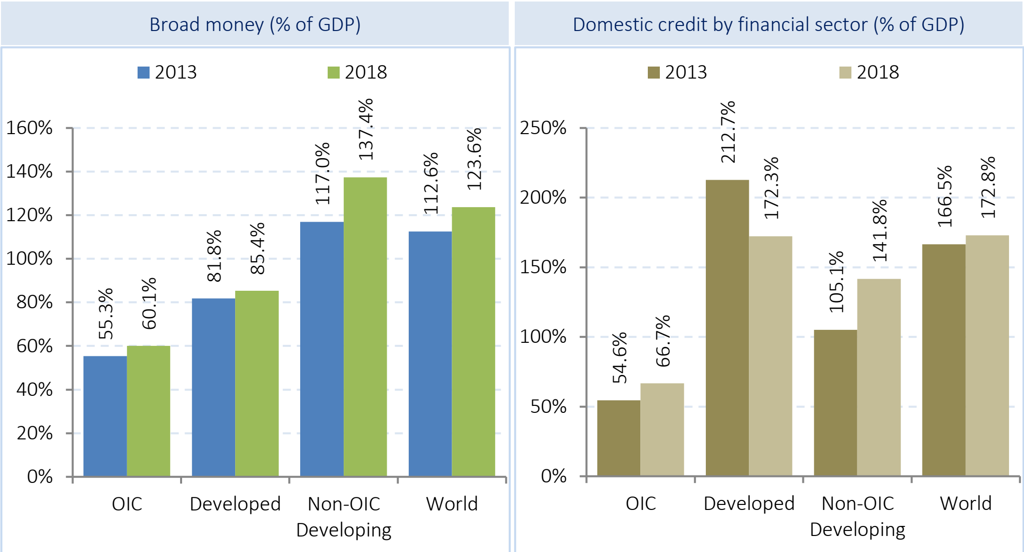
- **Financial Sector Development:** Degree of financial deepening in OIC countries remained unsatisfactory

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

A commonly used indicator for determining the degree of financial deepening is the ratio of broad money to GDP. A higher ratio is generally associated with greater financial liquidity and depth. As shown in Figure 3.12 (left), the average volume of broad money relative to the GDP of OIC countries was recorded at 60.5% in 2018, compared to as much as 137% in non-OIC developing countries and 124% of the world average. Apparently, the financial sector in the member countries lags behind in the provision of sufficient liquidity and better investment opportunities to the economy at lower cost. This state of affairs partially manifests itself in low levels of credit provided by the financial sector as % of GDP. In 2018, the financial sector on average provided credit to the domestic economy as much as 66.7% of the GDP in OIC countries whereas, in non-OIC developing countries, this figure was 141.8% (Figure 3.12, right). In the same year, the average of developed countries was recorded at 172.3% that significantly exceeded the average of both OIC countries and non-OIC developing countries.

The degree of financial development varies substantially across the OIC countries. While some member countries have relatively more advanced financial systems including vibrant banking, insurance and other financial institutions, and effective financial regulatory and supervisory

Figure 3.12: Financial Sector Development



Source: World Bank WDI. *Data coverage [LEFT]*: 41 OIC countries, 14 developed and 75 non-OIC developing countries; *[RIGHT]*: 41 OIC countries, 32 developed countries and 75 non-OIC developing countries.

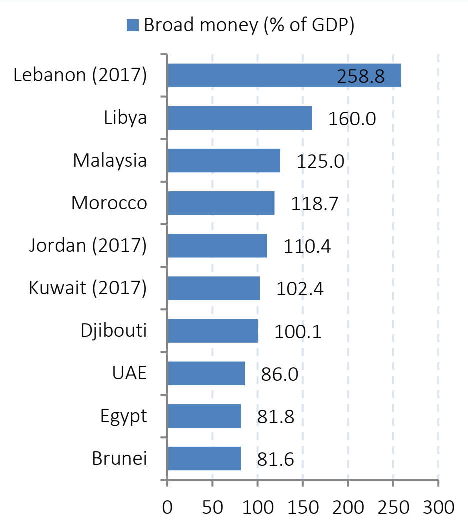
regimes; many others lag behind in terms of their stages of financial development. This, in turn, offers a significant room for improvement of financial systems in OIC countries.

Considering the widely accepted view that the financial deepening confers important stability benefits to the economy, albeit with caveats, many OIC countries are apparently deprived of these stability benefits. Yet, there are some exceptions to this, such as Lebanon, Libya and Malaysia, where financial depth, as measured by the volume of broad money relative to GDP, is above the average world level. In Lebanon, for instance, the total size of broad money which includes, inter alia, all narrow money and deposits, was more than twice the size of the GDP (258.8%), as shown in Figure 3.13. In Morocco, Jordan, Kuwait and Djibouti the relative size of broad money to GDP also exceeded 100% threshold.

A report by IMF argues that financial deepening, through an increase in financial transaction volumes, can enhance the capacity of the financial system of a country to intermediate capital flows without large swings in asset prices and exchange rates (IMF, 2011). Deeper financial markets are argued to provide alternative sources of funding domestic financial market during times of international stress, limiting adverse spill-overs, as evidenced in the recent global financial crisis. Figure 3.14, in this regard, supports this argument for OIC countries by depicting the strength of relationship between broad money and availability of credit in 2018.

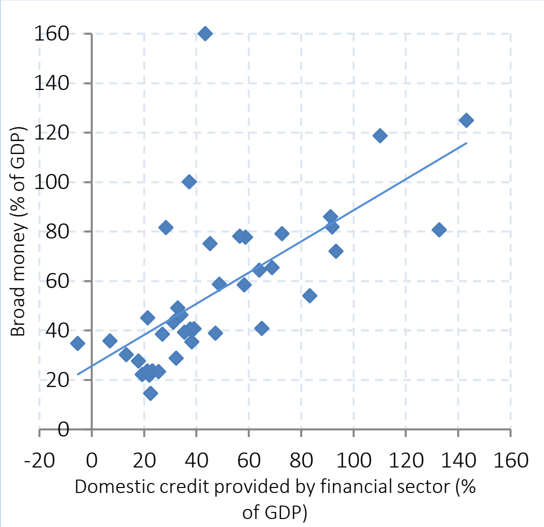
Yet, the evidence suggests that deeper financial markets can also attract volatile capital inflows, complicating macroeconomic management of the country's economy. Moreover, financial deepening can occur too quickly, leading to credit booms and subsequent busts. At the systemic level, all these factors,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

Figure 3.13: Financial Sector Development, Top OIC Countries (2018)



Source: World Bank WDI. *Data coverage:* Out of 49 OIC countries.

Figure 3.14: Liquidity versus domestic credit (2018)

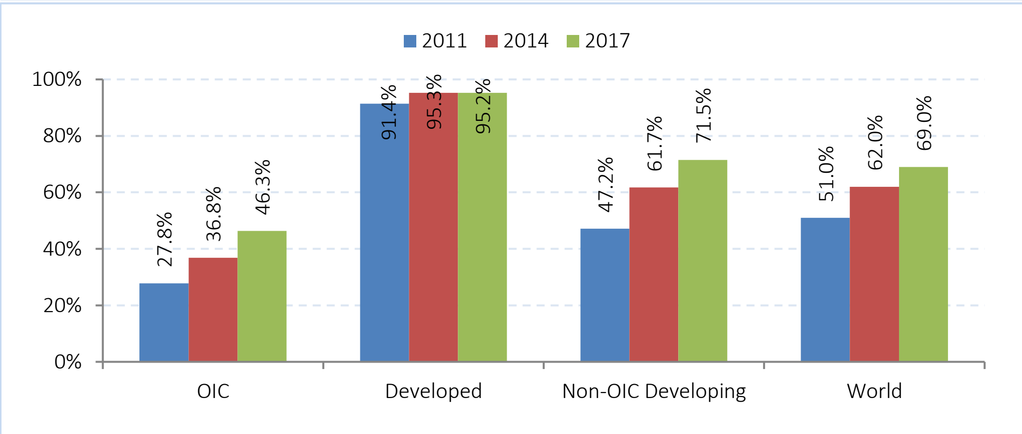


Source: World Bank WDI. *Data coverage:* 49 OIC countries.

Finally, there is also a widening effort to improve the access to finance in developing countries, including the OIC countries. A recent publication by the World Banks presents key findings from the Global Findex database, with detailed insight into how adults in more than 140 economies access accounts, make payments, save, borrow, and manage risk. According to this database, access to finance in OIC countries improves significantly over the years, which increased from 27.8% in 2011 to 46.3% in 2017. However, when compared with other country groups, they remain far behind the averages of those country groups (Figure 3.15).

Figure 3.15: Access to Finance

Percentage of Population (15+) with Bank Account



Source: World Bank Global Findex Database 2018. *Data coverage*: 37 OIC countries, 32 developed countries and 56 non-OIC developing countries.

- **External Debt:** External debt stocks of OIC countries increased by 139.5% since 2005, while long terms debts accounting for more than 83% of total debts in 2017.

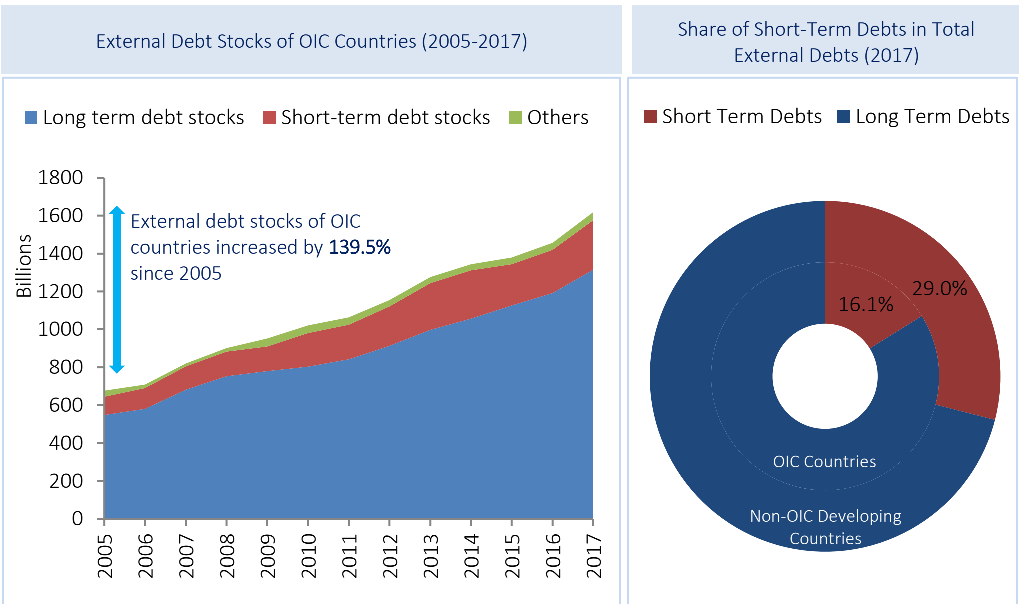
The total external debt stock of OIC countries showed an increasing trend during the period under consideration. In 2017, the total external debt of OIC countries grew by 11.1% compared to previous year and reached US$ 1.6 trillion. On the other hand, 21 OIC countries continue to be classified as Heavily Indebted Poor Countries (HIPC) by the World Bank. In line with the increasing amount of debt in absolute terms, Figure 3.16 (left) illustrates that both the size of the total debts of OIC countries and its distribution over the years. External debt stocks of OIC countries increased by 139.5% since 2005 and 58.5% since 2010.

In terms of maturity structure of the external debt, the share of short-term debts remained low compared to non-OIC developing countries, but its share in OIC countries increased over time. As of 2017, short term debts accounted for 16.1% of total external debts of OIC countries, while 29% of total debts of non-OIC developing countries were short term debts (Figure 3.16, right).

At individual country level, Turkey remains the most indebted OIC member country in 2017 (Figure 3.17, left). The country held US$ 455 billion in debt, which made up around 28% of total external debt the OIC countries for which data are available. Turkey was followed by Indonesia (US$ 354 billion), Kazakhstan (US$ 168 billion), Pakistan (US$ 85 billion) and Egypt (US$ 83 billion). Turkey and Indonesia collectively account for 50% of total external debts of the OIC countries.

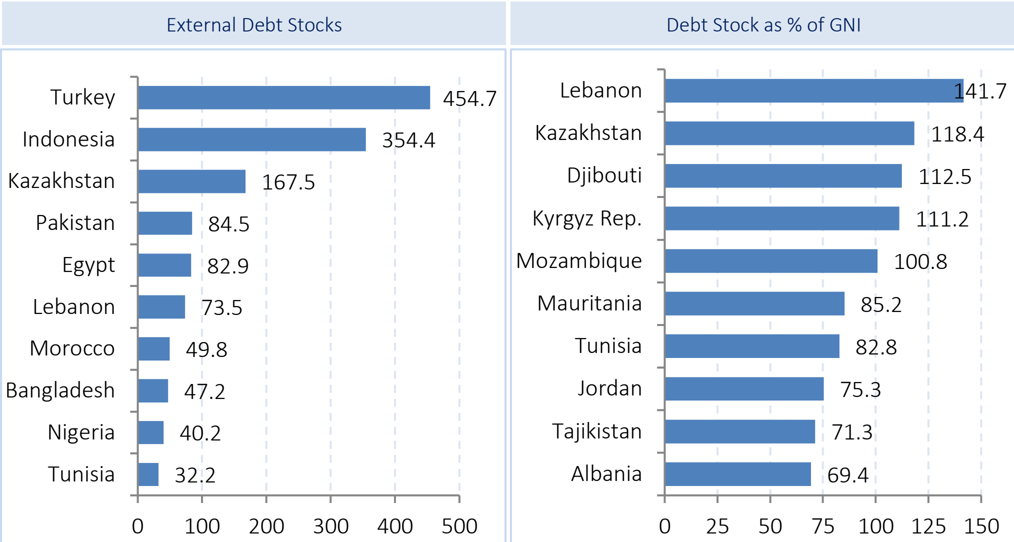
However, given the size of a country's economic output, looking at the absolute size of debt stock might be misleading. Debt-to-GNI ratio, in that sense, is argued to give a more accurate view of

Figure 3.16: External Debt Stocks



Source: World Bank WDI, June 2019. *Data coverage: [LEFT]*30 OIC countries; *[RIGHT]* 30 OIC countries, 50 non-OIC countries

Figure 3.17: Top Indebted OIC Countries (2017)



Source: World Bank WDI, June 2019. *Data coverage:* 45 OIC countries.

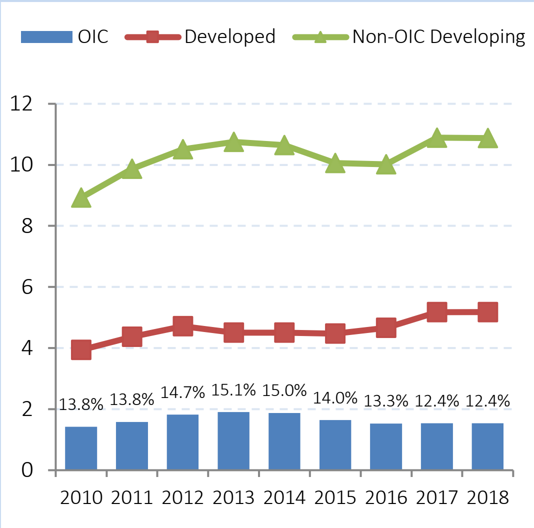
a country's indebtedness, adjusting it for the size of gross national income. In terms of relative size of external debt to GNI, Lebanon, with a 141.7% debt-to-GNI, was the most indebted OIC country in 2017 (Figure 3.17, right). It was followed by Kazakhstan (118%) Djibouti (113%), Kyrgyzstan (111%) and Mozambique (101%).

- **Reserves:** Total reserves of OIC countries remain stable at around US$ 1.5 trillion since 2016.

Reserves are usually considered as an important instrument to safeguard the economy against abrupt external shocks. World total monetary reserves – including gold – declined from its value of US$ 12.7 trillion to US$ 11.6 trillion during 2013-2016, but it increased to US$ 12.4 trillion in 2017 and remained unchanged in 2018. Of this amount, US$ 5.2 trillion are possessed by developed countries while the remaining US$ 7.2 trillion was owned by developing countries (Figure 3.18). Total reserves of OIC countries followed a similar trend with the world aggregate, which fell during the period between 2013 and 2016 from US$ 1.9 trillion to US$ 1.5 trillion. However, it remained stable at US$ 1.6 trillion during 2017 and 2018. The share of OIC countries in global reserves further declined from 13.3% in 2016 to 12.4% in 2018.

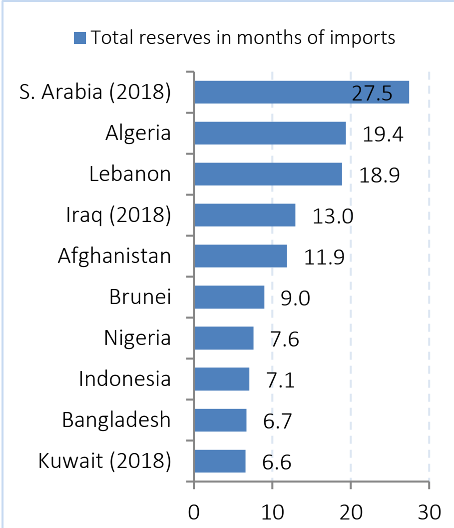
As of 2018, developing countries possessed 58.3% of the world total reserves. Growing share of developing countries in global reserves can largely be explained by the increasing trade flows from, and the resulting trade surpluses of, some emerging economies such as China, other newly industrialized countries in Asia, as well as oil exporting countries in the Middle East. Financial reform efforts in some developing countries (mainly, those with chronic current account deficits) to improve their reserves position also played a role. Capital account liberalization in some developing countries has apparently brought about the need for accumulating reserves as an insurance against financial volatilities including sudden stops/reversals of capital influx.

Figure 3.18: Reserves including Gold (US$ Trillion)



Source: World Bank WDI. Data coverage: 42 OIC countries, 37 developed countries and 88 non-OIC developing countries.

Figure 3.19: Top 10 OIC Countries by Total Reserves in Months of Imports (2017)



Source: World Bank WDI, June 2019. Data coverage: 36 OIC countries.

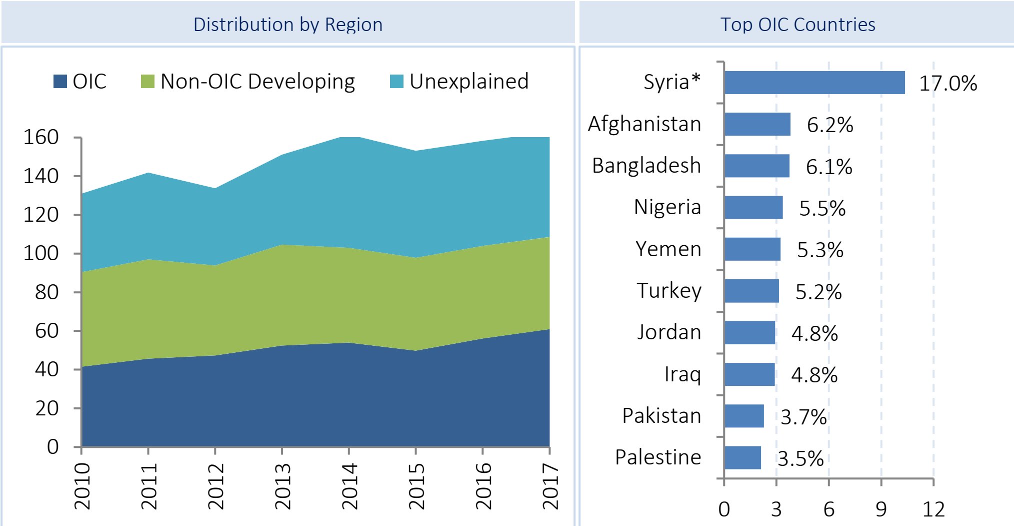
Figure 3.19 displays the top 10 OIC countries by volume of reserves in months of imports during the period 2017-2018. Saudi Arabia, with reserves equivalent to 28 months of imports, topped the list, whereas Algeria followed it with reserves equivalent to 19 months of imports. Together with Lebanon and Iraq, only in four OIC member countries, the reserves were equivalent to more than 12 months of their imports.

- **ODA and Remittances:** Both the official development assistance and personal remittance flows to OIC countries increased over the last year.

Official development assistance (ODA) continues to be an important source of financing for many developing countries, including some OIC countries. In 2017, net global ODA flows reached US$ 162.8 billion compared to US$ 151.2 billion in 2013 (Figure 3.20, left). However, statistics do not show where all this money flowed, as data shows that individual countries account for 66% of global ODA flows. Accordingly, more than 33% of ODA flows remain unexplained. Out of US$ 108.5 billion ODA flows, for which individual country data exists, 56.2% flowed to OIC countries in 2017. This is also the highest share observed since 2006.

ODA inflows to OIC countries show similar characteristics, when their concentration level is concerned. In 2017, the top 5 countries received 39.5% of total ODA flows to OIC region whereas the top 10 received 61.0% of them (Figure 3.20, right). Syria, with total inflows of US$ 10.4 billion and 17% of OIC total, ranked first. It was followed by Afghanistan (US$ 3.8 billion, 6.2%), Bangladesh (US$ 3.7 billion, 6.1%), Nigeria (US$ 3.4 billion, 5.5%) and Yemen (US$ 3.2 billion, 5.3%).

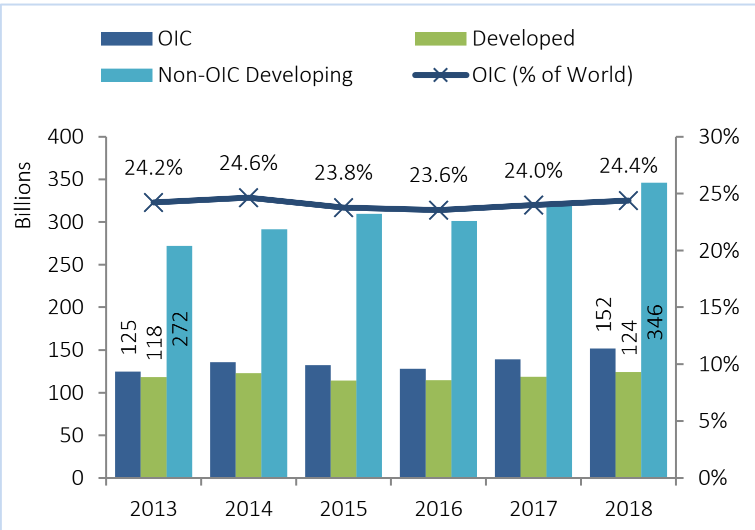
Figure 3.20: Official Development Assistance, Received, US$ Billion



Source: World Bank WDI, June 2019. Data coverage: 50 OIC countries and 89 non-OIC developing countries. Note: Around 35% of global statistics are not reported at country level. (*) Membership to OIC is currently suspended.

Figure 3.21, on the other hand, shows that the inflows of personal remittances to OIC member countries increased from US$ 125 billion in 2013 to US$ 152 billion in 2018. The share of OIC countries in world total remittance flows remained around 24% during the period under consideration. Remittance flows to non-OIC developing countries continued to grow during the same period and increased from US$ 272 billion in 2013 to US$ 346 billion in 2018.

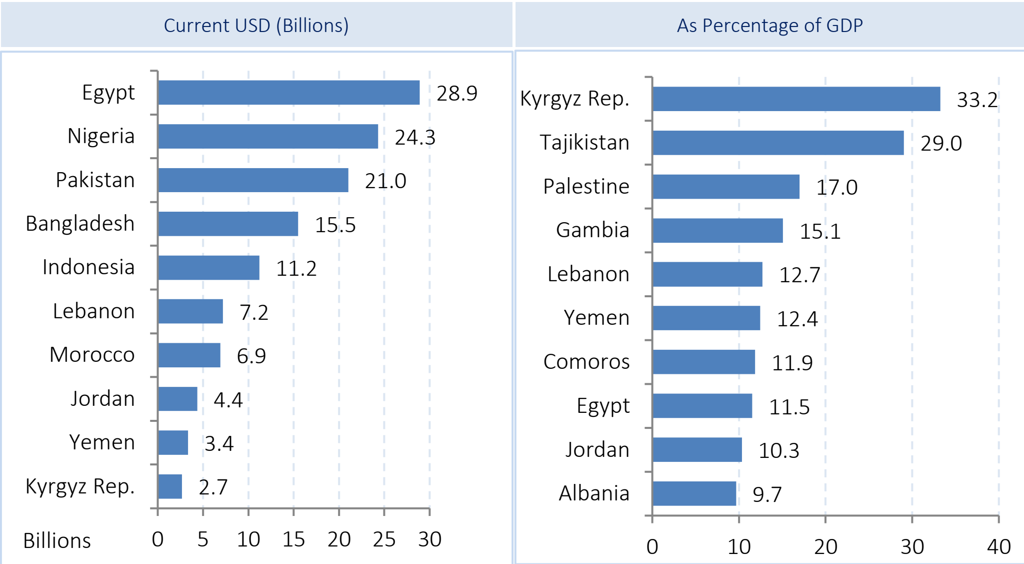
Figure 3.21: Personal Remittances, US$ Billion



Source: World Bank WDI. Data coverage: 51 OIC countries, 35 developed countries and 93 non-OIC developing countries.

At the individual country level, it is observed that even a more significant portion of inward remittance flows to OIC countries concentrate on a few members in 2018. In the list of top remittance receivers in the OIC region, Egypt took the first place with US$ 28.9

Figure 3.22: Personal Remittances (2018), Received, US$ Billion



Source: World Bank WDI. Data coverage: 47 OIC countries.

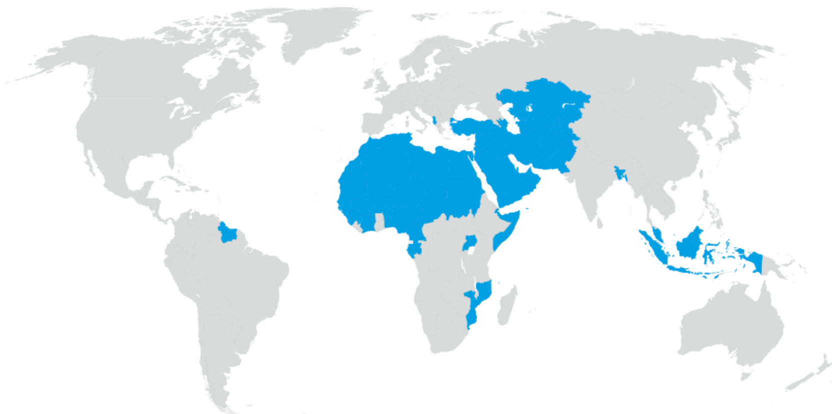
billions of remittances inflows (Figure 3.22, left). It was followed by Nigeria (US$ 24.3 billion), Pakistan (US$ 21.0 billion), Bangladesh (US$ 15.5 billion) and Indonesia (US$ 11.2 billion). These five countries collectively accounted for 66.5% of total remittance inflows to OIC countries, while top ten countries accounted for 82.7% of total inflows.

In order to assess the relative importance of remittance flows at individual country level, the share of remittance inflows in total GDP would be a good indicator. As shown in Figure 3.22 (right), personal remittance flows reached 33.2% of total GDP of Kyrgyz Republic in 2018, followed by Tajikistan (29.0%), Palestine (17.0%), Gambia (15.1%) and Lebanon (12.7%).

PART III: MOBILIZING FINANCIAL RESOURCES FOR DEVELOPMENT

CHAPTER FOUR

Development Challenges and the Role of Finance in OIC Countries



OIC countries are highly diversified in terms of their level of economic development and many of them require substantial amount of resources to finance their development. Due mainly to lack of adequate resources and ineffective use of existing ones, some countries continue to face persistent development challenges. On the other hand, a growing number of OIC countries are active in supporting development in other economies, but their role in development assistance is not properly recognized at global levels.

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.

In this connection, the special part of the OIC Economic Outlook 2019 deals with mobilizing financial resources for development. This chapter reviews the common economic growth and development challenges faced by the member countries of the OIC and stresses the importance of finance in development. The next chapter elaborates on how to mobilize domestic and international resources in financing development. Chapter 6 focuses on the South-South cooperation and pays attention to the growing role of some OIC countries in actively supporting development in other economies. Final chapter of this part presents the Islamic finance instruments as an alternative tool for financing development.

4.1 Growth and Development in OIC Countries

A large variation has been observed in the growth experiences of countries over time. The differences in growth experiences make it challenging for economists to explain the drivers of higher growth rates across time and countries. Some models are able provide an explanation for the growth experience of developed countries but fail to do it for low income countries.

What Explains Diverging Growth Patterns?

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

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

Consequently, countries with different capital endowments and productivity rates are explained to experience different growth rates. However, it would not be satisfactory enough to explain the process of economic growth and cross-country income differences with level of technology, human capital and physical capital. In this connection, economic literature provides additional dimensions in explaining divergent growth patterns, such as institutional quality, geography, policy choices and culture. Institutions are about rules and regulations that affect economic incentives and thus the incentives to invest in technology, physical capital and human capital though protection of property rights, ensuring proper functioning of markets, and enforcing contracts. Accordingly, it is expected that societies with economic institutions that facilitate and encourage factor accumulation, innovation and the efficient allocation of resources to prosper and attain higher growth rates.

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

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

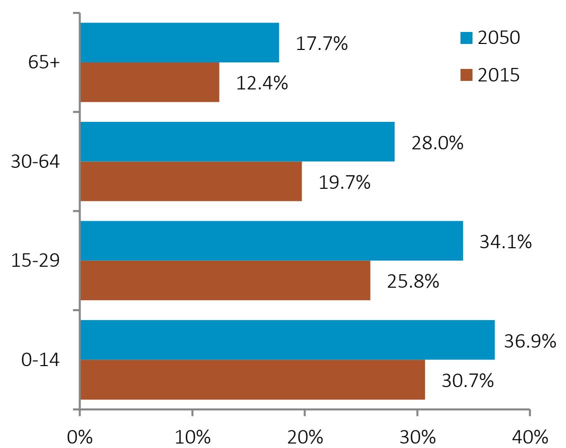
Against this background, this section provides an alternative perspective on main development challenges faced by OIC countries by briefly assessing its productive resources, economic outcomes, growth catalysts and growth barriers.

Productive Resources

OIC countries are well endowed with productive resources, particularly with human and natural resources. Efficient use of these resources can bring higher economic growth rates and welfare for the people.

As presented in Figure 4.1, 34.1% of population in OIC countries was under age 15 compared to 23.6% in non-OIC countries in 2015. Young people at age 15-29 accounts for 27% of total OIC population, whereas it is only 23.8% in non-OIC countries. The share of OIC countries in total population of age group 0-14 is expected to reach 36.9% in 2050 compared to 30.7% in 2015 and that of age group 15-29 to reach 34.1% in 2050 compared to 25.8% in 2015 (SESRIC, 2016). Therefore, it is fair to argue that current and prospective population structure offers a window of opportunity for OIC countries to grow faster with effective utilization of this dynamic force.

Figure 4.1: Share of OIC in Different Age Groups



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

Human capital is one of the main determinants of long-term growth. Skilled and well-educated workforce facilitates the absorption of foreign knowledge and technology from other countries through channels including international trade and foreign direct investments that smooth the spill-over of this stock of knowledge and technology. But it is the absorptive capacity that determines the level of diffusion. Investment in human capital accumulation or education has, therefore, the potential to increase the capacity to obtain and utilize the knowledge developed elsewhere. Since the majority of the OIC member countries occupy lower ranks in economic development, the issue of human capital development remains critical in widening the potentials to achieve long-term sustainable growth.

Many developing countries are highly dependent on the exploitation of their natural resources to secure their needs and develop and meet the needs of future generations. Such resources offer great potential for fostering development if appropriate policies are developed and implemented for reinvestment of windfall gains in more productive and dynamic sectors. By having almost 60% of world total reserves in oil and gas, OIC countries possess a critical advantage in managing major fossil energy sources in the world, which can potentially support growth and development in the OIC region.

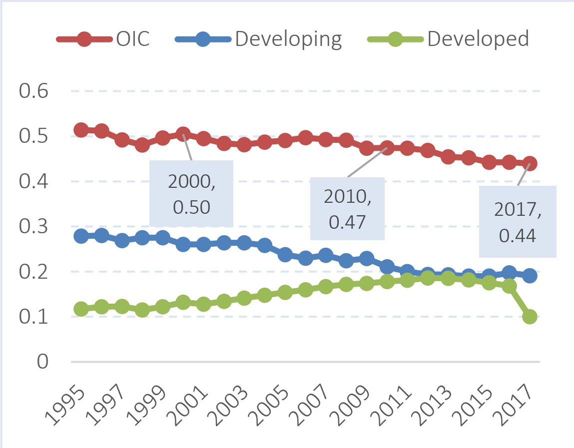
Despite having rich natural resources, many OIC countries are listed among the group of least developed countries. Poverty, unemployment and income inequality not only constitute barriers for development in least developed OIC countries but also stay as important socio-economic challenges for the rest of the OIC countries. One of the core reasons behind this sobering picture in OIC countries is the existence of capacity problems in exploitation and efficient use of existing natural resources for the benefit of people living in OIC countries. In order to maximize the potential contribution of natural resources, OIC countries need to upscale their capacity not only in terms of extracting these sources but also adding more value into them through appropriate polices and investments.

Economic Outcomes

Ineffective use of productive resources results in lower growth rates and income levels. As discussed in section 2, OIC countries can still account around 8% of global production when measured in current USD prices. As a matter of fact, OIC countries showed a good performance in increasing their per capita GDP and labour productivity levels over the years. Yet, in absolute terms, the levels achieved by the OIC countries, are still well below the world averages. This indicates the necessity of even more efforts by OIC member countries to reach higher standards of living both in terms of per capita GDP and productivity. It also became clear that the existence of cross-country differences among OIC member countries should not be neglected. Many OIC member countries are still classified as low-income countries that need to undertake major changes in their economic growth policies, particularly in the polices related to enhancing their productivity and competitiveness.

Moreover, OIC economies are mostly characterised by high concentration of export and limited diversification of domestic economy. Over the years, diversification of OIC economies have been increasing slowly, but their concentration remains well above the average of developed and developing economies (Figure 4.2). While lack of diversification increases the exposure of countries to adverse shocks and macroeconomic instability, high concentration of economic activity in sectors with limited potential for productivity growth may not bring about much growth and development to the country.

Figure 4.2: Diversification Index



Source: UNCTAD STAT. Data reported by UNCTAD as group averages.

If investments are made in sectors that are to become more competitive and more strategic for the development of an economy, then critical achievements can be made in enhancing overall productivity and growth in medium and long term. The standard argument for diversification for resource-rich economies is to mitigate the effects of the so-called Dutch disease. In small economies with narrowly defined production structure, volatility of resource prices can be a source of economic volatility, therefore these countries need to expand their range of export commodities in order to reduce the impact of external volatility.

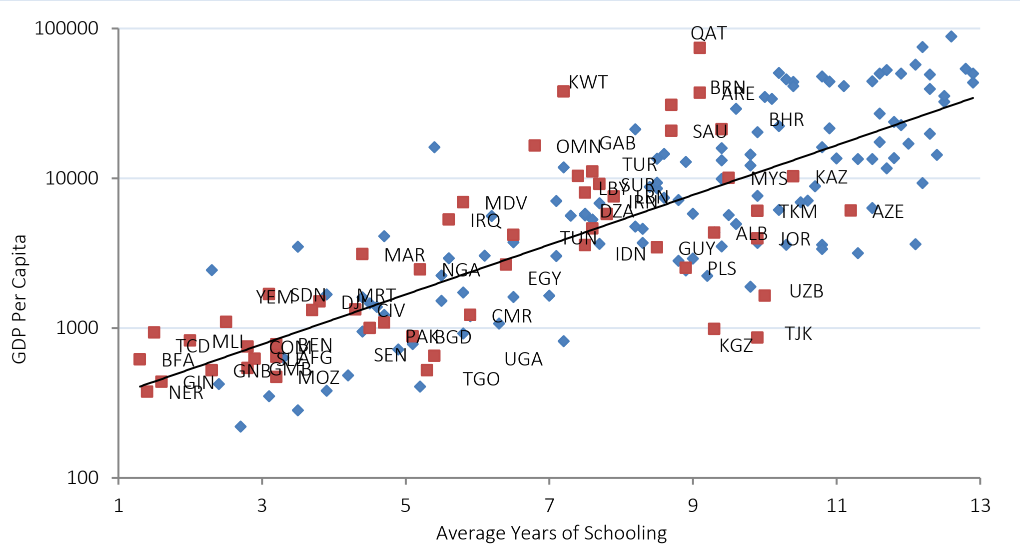
Another important implication of inefficient use of productive resources is the lack of competitiveness. OIC countries are placed in lower ranks in global rankings of competitiveness. Competitiveness is a reflection of the overall circumstances including institutions, policies and factors that have impact on the level of productivity. More competitive economies with higher productivity levels generate higher income levels for their citizens. Therefore, greater efforts need to be made to achieve higher competitiveness in global markets.

Growth Catalysts

There are a number of instruments that OIC countries can utilize to address the development challenges and attain higher growth rates. These include investing in human and institutional capacities, facilitating technological progress and innovation, and channelling resources to productive investments through financial development.

The role of education in increasing the productivity and efficiency of labour force by increasing the cognitive stock of economically productive human capability is well acknowledged in the literature. OIC countries have comparative advantage in terms of its demographic structure. Given the shortage of skilled workers, however, effective policies and programmes need to be devised and implemented for better education and training as they are critical factors for technological readiness to raise productivity and diversify into more sophisticated products. Figure 4.3 shows the relationship between average years of schooling and GDP per capita. Mean number of years that a representative worker has spent at school roughly determines the absorptive capacity of a worker. Obviously, there is a strong relationship between income levels

Figure 4.3: Average Years of Schooling vs Per Capita Income (2013)



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

and educational attainment both in OIC countries (square) and non-OIC countries (diamond). Enhancing firm productivity, upgrading technologies, developing high value-added services and achieving more competitive status in the world economy necessitate the assurance of better educated and trained human resources that match the needs of the labour market.

Long-run growth is determined by the level of technological progress, because growth cannot be sustained by increases in capital per worker or increases in the number of workers. In order to expand the efficiency with which an economy uses its inputs, productive capacities of each production factors should be improved. In this context, human capital development and technological innovation are the essential factors in enhancing productivity and competitiveness.

Innovation requires significant investment and long-term perspective. Therefore, available resources for research and innovation need to be allocated according to national development strategies and priorities. Today's knowledge economies heavily rely on research and development activities and innovative technologies to sustain their competitive status vis-à-vis other countries. However, R&D expenditures in OIC countries are significantly lower than advanced economies. Moreover, ideas need an innovation-friendly environment to grow and generate benefits to all societies through new products and/or services. If enterprises in OIC countries are to become competitive in the global economy, policies in OIC countries should focus on creating an environment that promotes innovation.

Another critical driver of growth is institutional quality and good governance. Institutions promote productivity and competitiveness by reducing transaction costs including search and information costs, negotiation costs, policing and enforcement costs. According to the WB Governance Indicators, OIC countries show lower level of institutional quality compared to other developing countries. OIC countries, particularly low-income member countries, can reap productivity gains by further strengthening the quality of their institutional frameworks that protect property rights, including intellectual property. Property rights and the ability to enforce contracts are two critical elements of a country's institutional and legal framework and they are critical conditions for market-based economic activity.

Further strengthening institutions would have many repercussions on other key factors of raising productivity. It could help promote private investment and entrepreneurship and foster financial sector development. Even if total investments are rising, inefficiencies in public investment management and weak governance often distort the impact of public spending on capital accumulation and inadequate protection of investors discourage investments. Therefore, it is essential to improve the quality of institutions and governance in order to improve the quality and outcome of investments.

The role of financial development is particularly important in allocating resources to their most productive use. Moreover, the services provided by the financial sector can contribute to economic growth by: (i) producing ex-ante information about investment opportunities; (ii) improving ex-post monitoring of investment and exerting corporate governance; (iii) facilitating risk management and diversification; (iv) mobilizing and pooling savings; and (v) easing the exchange of goods and services (Levine, 2005). The analyses in section 3 show that financial depth in OIC countries remains shallow and needs to be further improved.

Without access to finance, it would be difficult to expect entrepreneurial activities to flourish and contribute to economic development. Access to finance in OIC countries remains among the most important constraints faced in promoting entrepreneurial activity. Moreover, small firms consistently report higher financing obstacles than medium and large companies, and they are also more adversely affected in their operation and growth by these obstacles. Therefore, innovative approaches are needed to solve the financing constraints of businesses for them to invest in productive investment opportunities. More detailed discussions will be made in the following chapters on the issue of mobilizing resources for financing development.

The fact that economic performances of OIC member countries have been relatively weaker than the western countries does not imply that OIC countries do not have enough capacity and resources to perform better. It is just a matter of identifying the productive resources and potentials and then developing correct mechanisms and instruments to effectively utilize them in welfare improving economic activities. Every country has different resources and potentials to catalyse for their economic development programs.

Growth Barriers

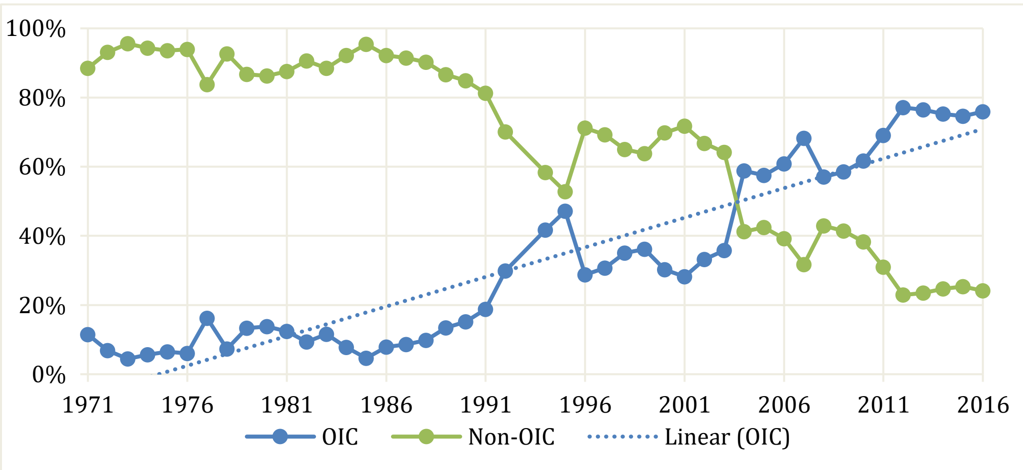
Economic development trajectory of OIC countries has been highly rippled in shape, while the resulting development landscape of OIC countries is multiplex. In general, OIC member countries could not sustain long-term growth as developed countries did over the last century. Despite comprising few high-income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

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

An important element in the policy mix of boosting productivity and competitiveness is the need to maintain macroeconomic stability, since this would create a business environment free of uncertainty and unanticipated costs. A stable macroeconomic environment would entail lower volatility in inflation rate, interest rate, exchange rate and a low fiscal deficit as a percentage of GDP. It would also require less volatility in terms of the size of economic transactions with the rest of the world.

In addition to economic instabilities, political instabilities can also severely affect the growth trajectories. Many OIC countries are prone to various natural and man-made disasters and conflicts. In 2017, 30 of 49 conflicts recorded worldwide occurred in OIC countries, of which the overall majority were internationalized internal conflicts and internal conflicts. As depicted in Figure 4.4, since 2003, most of the terrorism has also occurred in OIC countries. In 2017, collectively OIC countries account for around 69% of all attacks and more than 90% of fatalities. The rise in terrorism and violent extremism in OIC countries has created severe security threats as this growing phenomenon has resulted in death, destruction and instability in the countries and regions where terrorist groups operate.

Figure 4.4: The Share of Global Terrorism incidents



Source: SESRIC staff calculations based on Global Terrorism Database

Conflicts may result in the physical destruction of production capacity, infrastructure, factories, machinery, agricultural production capacity, physical destruction of land and higher military expenditure. In addition to these direct effects, further deterioration of economic activities can be observed due to repercussions on other factors such as capital flight, dislocation of labour, discouragement of new foreign investments, brain drain and reduction of trade. A fall in total factor productivity due to reduction in economic efficiency and technology absorption can be manifested in the contraction of output, acceleration of inflation, a loss of reserves and weaker financing systems (Sab, 2014).

The relationship between development, peace and stability is also strong and goes in both directions. While peace and security are prerequisites for development and prosperity, failures in development substantially increase proneness to civil conflict. The negative effects of armed conflicts also extend well beyond these measurable social and economic costs. It destroys essential infrastructure, including schools, hospitals, and energy systems; destroys social cohesion; and triggers forced displacement of people.

4.2 Role of Finance in Achieving Development

Since the 2000s, marking the adoption of Millennium Development Goals (MDGs), many developing countries including several OIC Member Countries have faced considerable developmental challenges, and some have fallen further behind. The global level initiatives, regional solution mechanisms and national level efforts fell short in meeting the growing needs of developing countries to finance their development and enable them to graduate from the developing country status.

The global financial crisis in 2008 and its long-lasting impacts have just deteriorated the outlook of financing for development. Increasing number of donor countries started to allocate limited amounts of sources to finance development and decided to use these sources more carefully in targeted projects. As a result, inequalities within many countries as well as across developing countries have increased. This necessitated development of a new global agenda on development.

The preparation and adoption of ambitious Sustainable Development Goals (SDGs) in 2015 after long discussions reflect a global level political commitment to achieve sustainable development and improve the well-being of people. Nevertheless, the lack of enough resources to finance development as well as limited availability of data and indicators to measure the progress overshadow the potential success of SDGs. According to the UNCTAD estimations, the total finance requirement including investment needs in the developing world alone range from $3.3 trillion to $4.5 trillion per year, for basic infrastructure (roads, rail and ports; power stations; water and sanitation), food security (agriculture and rural development), climate change mitigation and adaptation, health, and education. At given current levels of investment in SDG-relevant sectors estimated at $1.4 trillion, developing countries including OIC countries face an annual gap of $2.5 trillion.

Bridging such a gap between what is needed and what is available in financing for development may seem a daunting task. Nevertheless, OIC countries are rich and diverse in terms of resources where such resources offer great potential for fostering development. Some of them are endowed with rich natural resources. Many of these OIC countries have already benefited extensively from their rich natural resources in their course of development and accumulated remarkable amount of capital. A group of OIC counties are also very rich in terms of human capital especially in terms of the high share of youth in total population. Every OIC country has different resources and potentials to catalyse for their economic development. As previous studies showed that many OIC countries could not reach their economic potentials due to a number of factors, and therefore are lagging behind in many development-related indicators when compared with the averages of developed countries as well as the global averages.

On the financial front, Islamic finance offers a window of opportunity in OIC countries that could be used in bridging the gap in financing for development. Islamic finance, including Zakat, is estimated to be valued at around $2 trillion in 2015, which is expected to climb to $3 trillion by 2020. For instance, making zakat contributions through formal institutions can ensure it reaches more people and reaching those in greatest need and therefore could help achieving sustainable development.

Many OIC countries need to exert more efforts to achieve sustainable development that requires allocation of more financial resources for their development. As set out in the Addis Ababa Action Agenda (AAAA), these financial resources need to be used in main seven action areas from trade to capacity building in order to make a strong and positive impact on development. Yet, it is usually difficult to secure resources while making improvements in all these areas as donor countries have their own priority areas. Even lack of resources sometimes leads to the termination of some critical development programmes such as in the domain of vaccination or food assistance that put life of people in danger in some parts of the world.

Overall, OIC countries have specific challenges as well as unique solution mechanisms in financing for development that could help them avoid solely relying on a classical donor-recipient relation. A growing number of OIC countries are actively contributing to financing developmental efforts in other OIC as well as non-OIC countries.

OIC countries have a long-history of active intra-OIC cooperation in many areas from trade and infrastructure development to capacity-building and investment. This facilitates transfer of capital, know-how and expertise among OIC member countries that are critical for development. OIC countries also actively take part in the South-South Cooperation. This allows several OIC countries and other developing countries to mutually benefit from each other's experiences and sources while advancing in their development trajectories. Finally, OIC countries have unique instruments and mechanisms including Islamic financial instruments, Zakat and Waqf Funds that have the potential to make a significant positive contribution in financing for development. Overall, these factors would enhance financing for development in OIC countries by helping to go beyond the conventional understanding and benefit from unique solution mechanisms.

CHAPTER FIVE

Mobilizing Domestic and International Resources for Financing Development

This chapter discusses the role and potential contributions of domestic and international resources for financing for development by reviewing the existing literature and international reports with a special emphasis on OIC countries. The chapter also elaborates on major challenges faced by OIC and other developing countries in mobilizing domestic as well as international resources. Finally, it lists and discusses a set of solutions that can provide a proper guidance for OIC and many developing countries to mobilize domestic and international resources as well as benefit from international cooperation to a higher extent in their course of development.

5.1 Synergizing Domestic and International Resources

Achieving sustainable development is a challenging task for any nation. Such a challenging task could be accomplished by utilizing human capital and mobilizing domestic resources in the most effective way. Many developing countries and a number of OIC countries suffer from ineffective use of domestic resources. Some of those countries also could not fully mobilize available domestic resources to be used in their development efforts, and therefore such resources stay mostly idle. In this regard, it is of importance to benefit from available international resources in the course of development in order to be able to finance vast amount of investments needed to achieve sustainable development.

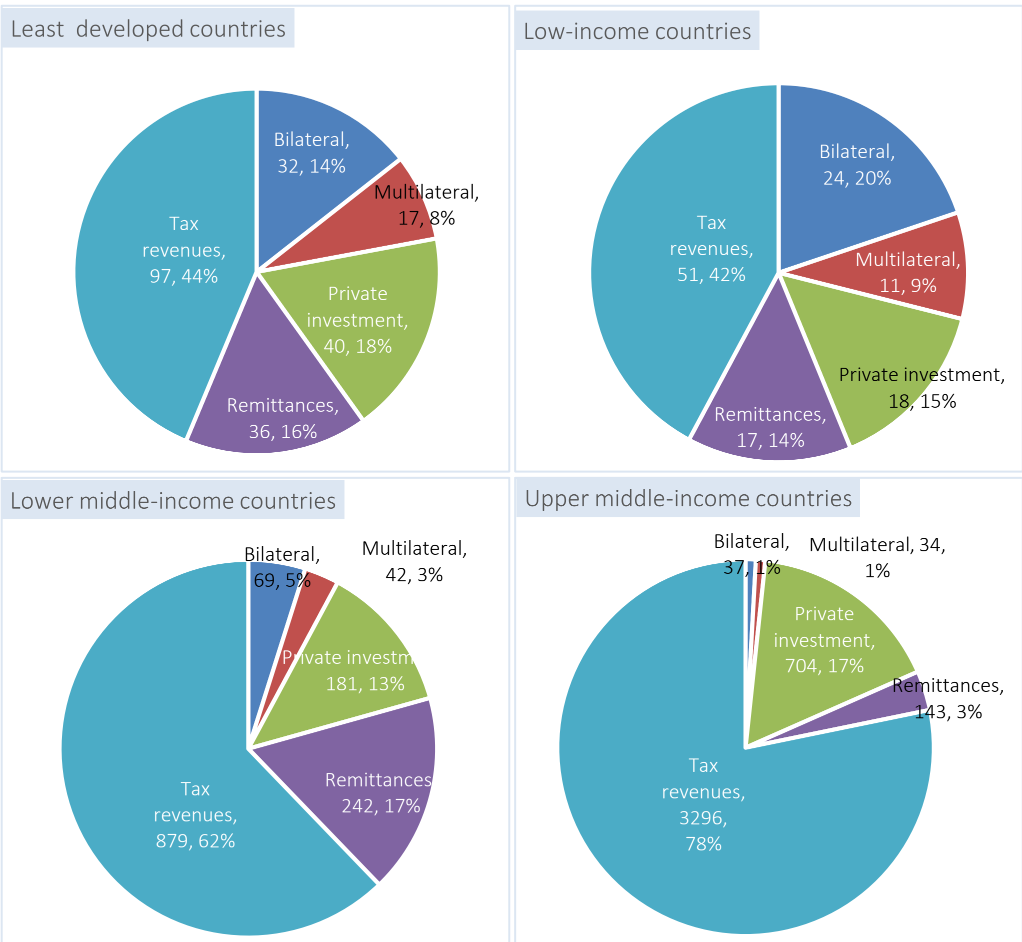
In this picture, domestic and international resources usually do not substitute each other, rather they embody complementarity in the development process of developing countries as they need resources to finance their investments and projects. Due to existing strong complementarity between domestic and international resources to finance development, the rest of the chapter identifies major challenges and provide a set of solutions as identification of challenges and listing proper solutions would be critical to design a more effective resource allocation architecture for the developing world including many OIC countries.

Strengthening domestic public resource mobilization is crucial for developing countries in financing national sustainable development strategies, implementing Agenda 2030 for Sustainable Development as well as the Addis Ababa Action Agenda. Moreover, effective domestic public resource mobilization in many developing countries will be vital to achieve development and meet the Sustainable Development Goals (SDGs). Even though domestic public resources are by far the largest public resource to meet the SDGs, without contributions of international resources and power of international cooperation it is unlikely that many OIC and developing countries will meet the ambitious SDGs. The estimations made by the United Nations Conference on Trade and Development (UNCTAD, 2014) show that the annual investment needed to finance the SDGs in developing countries ranges from USD 3.3 trillion to USD 4.5 trillion, with a USD 2.5 trillion annual shortfall in key sectors. While differing figures exist for this funding gap and challenges remain on how to fill this gap, it becomes even more critical to mobilize and effectively utilize existing domestic and international resources.

On the other hand, prevailing global imbalances mainly stemming from unregulated financial flows, speculative attacks and vulnerable macroeconomic governance in a number of countries constitute a negative economic growth pressure on the developing world and developed countries by curbing the global demand. The global economic growth prospects and existing vulnerabilities as a result create an unfavourable overall economic environment for financing for development that is characterized by boom-and-bust cycles. It is therefore crucial to exert efforts to form a synergy between domestic and international efforts to mobilize financial resources for creating an enabling environment for achieving the development goals. Establishing such a strong synergy, cooperation and common understanding will be instrumental on addressing various challenges faced by many OIC countries and the developing world.

Domestic resources are the central pillar of the financing for sustainable development landscape. In 2016, tax revenues amounted to USD 4.3 trillion, more than twice the volume of cross-border flows (OECD, 2018). But the tax revenue-to-GDP ratios in low-income and least developed countries average 14% and in many cases are far below the 15% threshold recommended as necessary for effective state functioning.

Figure 5.1: Mix of Financial Resources in Developing Countries, 2016 (USD Billions)



Source: OECD (2018).

As seen in Figure 5.1, tax revenues are the largest source of finance, exceeding the volumes of any single cross-border resource. In 2016, tax revenues in developing countries amounted to USD 4.3 trillion. The share of tax revenues in the overall finance mix varied from 42.7% in least developed countries and 42.4% in low-income countries to 62.2% in lower middle-income countries and 78.2% in upper middle-income countries (OECD, 2018). Therefore, it is particularly important to manage domestic resources in most effective way to achieve sustainable development.

5.2 Challenges on Mobilization of Domestic and International Resources

Challenges faced by developing countries may differ due to specific country characteristics. This section identifies and elaborates on ten common challenges faced by developing and OIC countries in their efforts to finance development from weak macroeconomic governance capacities to limited benefits gained from international capital flows.

5.2.1 Weak Macroeconomic Governance Capacities

Governments are responsible for collecting taxes in fair basis to provide services to the public with a view to improving the well-being of its citizens. Nevertheless, managing huge amount of public funds requires full accountability, transparency and lack of corruption, which are also indispensable components of good macroeconomic governance. Yet, macroeconomic management is beyond having effective and fair tax regimes. A strong macroeconomic management capacity is needed in order to have a business environment where predictability and transparency are high, markets are regulated to ensure competitiveness of companies, and protect rights of consumers and enterprises.

It is widely hypothesised that sound macroeconomic management promotes growth by providing a more secure environment for private sector investment decisions (Bleaney, 1996). The stability of the overall economy is a measure to track a country's macroeconomic governance capacities and its readiness for shocks. Nevertheless, many developing countries including several OIC countries suffer from the lack of a strong macroeconomic stability that hinders their investments for development, and therefore limit their progress towards meeting SDGs.

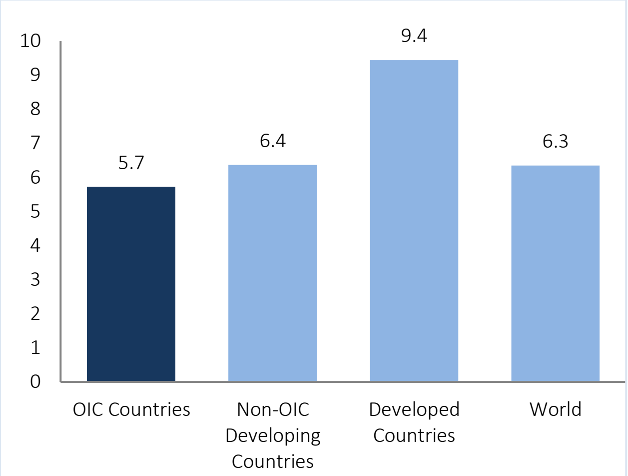
Figure 5.2 shows the state of macroeconomic stability in OIC countries with comparison to other country groups. A lower score in the macroeconomic stability index is associated with a lower level of stability. The average score of OIC countries (5.7) in terms of macroeconomic stability index in 2018 points out the existence of relatively lower levels of stability, on average, in comparison with the averages of non-OIC developing countries (6.4) and the world (6.3). The index score unsurprisingly reveals that developed countries, on average, have the highest level of macroeconomic stability in 2018, reflected with a score of 9.4.

For that reason, developing countries and many OIC countries need to make reforms to improve their macroeconomic management capacities in order to advance predictability and effective utilization of domestic and international resources in their development efforts.

5.2.2 Ineffective Tax Systems

Public financing has a unique role to play in supporting development. In particular, fiscal revenues in public resource mobilization play a great role as they provide relatively stable and predictable resources to finance development compared to other resources. In this context, having effective tax systems are of importance both for developing countries and developed countries.

Figure 5.2: State of the Macrostability, 2018



Source: The Bertelsmann Stiftung's Transformation Index (BTI). Scale: 10 (best) - 0 (worst). Note: OIC sample size: 47; Non-OIC sample size: 73; Developed sample size: 9; World sample size: 129

Nevertheless, developing countries and a number of OIC countries face major challenges in having effective taxation frameworks and capacities stemming from high presence of shadow economy, sluggish economic growth, high dependence on natural resources related revenues and erosion of tax base. As a result of such factors, these countries experience difficulties in managing their fiscal space and mobilizing financial resources for development.

Given the level of poverty and income inequalities, developing countries inevitably have more limited tax bases than developed countries. Nevertheless, their domestic public resource base has been diminished by tax incentives and lost revenues such as stemming from the use of offshore financial centres and illicit financial flows. For instance, UNCTAD (2017) estimated USD 100 billion annual tax revenue loss for developing countries which is related to inward investment stocks directly linked to offshore financial centres. No doubt, in presence of a weak and ineffective tax system it is difficult to detect and track such (illicit) financial transactions that associate with loss of significant amount of public revenues, which are critical for development finance.

As a result, developing countries and many OIC countries should exert major efforts to improve effectiveness of their tax systems that would help to increase their tax base, limit illicit financial flows, reduce informal economic activities, and generate more stable and predictable public revenues for financing development. Tax systems generate not only income for national investment plans but also emerge as a major source for development aid to developing countries. In this regard, improvements in tax systems would also likely to increase the level of public sources directed to development aid in a number of OIC countries.

5.2.3 High Inequality and Low Savings

Developing countries and many OIC countries are characterized with the prevailing high level of inequalities and low savings ratios. High inequalities and low savings negatively affect their efforts on financing development such as by reducing public revenues and triggering shadow economy in which inflows of international resources stay quite limited. In 2016, the median ratio among low-income countries was just 13% (IMF et al, 2016) – that is, below the 15% threshold recognised as the minimum level necessary to sustain development outcomes. For comparison, the median ratio in OECD countries stood at 34.3% in 2016 (OECD, 2017).

On the other hand, in OIC countries as a group, national savings as a percentage of GDP stand at nearly 30% and total investment is below 26% of GDP over the last five years (Nafar, 2019). These figures indicate that OIC countries need to find alternative effective ways and means to channel idle domestic savings into investments for development.

In this respect, the financial sector can make an important contribution by helping to increase the savings ratio and the availability of resources (savings) for investment. Zhang and Naceur (2019) showed that financial development (access, depth, efficiency, and stability) can significantly reduce inequality and poverty. As a result, domestic and international resources can be more effectively mobilized for development. Nevertheless, (uncontrolled) financial liberalization tend to exacerbate inequality and poverty. While fighting with inequality and exerting efforts to improve savings, designing effective regulations on financial markets becomes more critical. Otherwise, such efforts could produce counter-cyclical effects by reducing available domestic resources and curbing the potential positive effects of international resources on development.

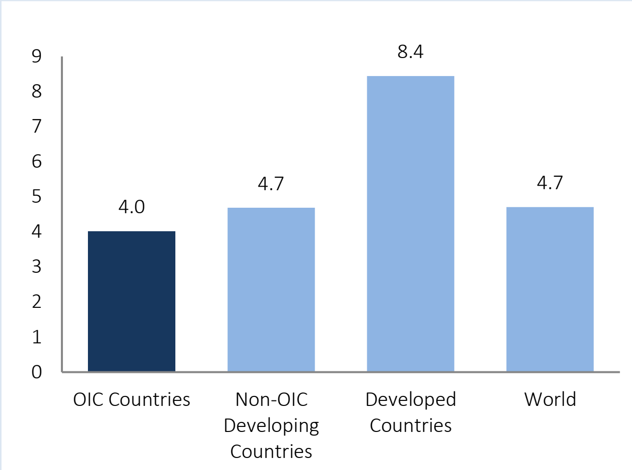
5.2.4 Heavy Debt Burden on Developing Countries and Debt Sustainability

Due to low public revenues and growing needs of investment for development, the reliance on the level of public debts in many developing countries have climbed up over the past decade. The total external debt stocks of developing countries are estimated to have grown by 8.5% annually over the past decade, having reached USD 7.64 trillion in 2017. For developing countries, the share of external public and publicly guaranteed debt owed to private creditors increased from 41% in 2000 to over 60% in 2017 (UNCTAD, 2019). In other words, developing countries have made a continuous net negative transfer of their resources to developing nations particularly in recent decades.

One estimate suggests that since 1980, developing countries have been net providers of resources to the rest of the world, amounting to about USD 16.3 trillion (UNCTAD, 2018). This net transfer especially to the developed countries did not reduce the total amount of their debt services as the demand for borrowing did not shrink. In fact, inefficient use of assets in the developing world including many OIC countries not only increase their total stock of debt but also reduces their capabilities for future repayments.

There are some figures that support this argument. For instance, Figure 5.3 presents the index score on the efficient use of assets (public budget and human resources) in comparative perspective in 2018. OIC countries, on average, use the assets not very effectively that obtained a score of 4.0 compared to the average of developed countries (8.4). Non-OIC developing countries, on average, obtained a score of 4.7 that was slightly better than the average of OIC countries. These inefficiencies seen in the use of assets in the developing world in general and more specially in OIC countries need to be addressed to enable them reach targets under SDGs.

Figure 5.3: Efficient Use of Assets, 2018



Source: The Bertelsmann Stiftung's Transformation Index (BTI). Scale: 10 (best) - 0 (worst). Note: OIC sample size: 47; Non-OIC sample size: 73; Developed sample size: 9; World sample size: 129

The growing debt vulnerabilities in developing countries and many OIC countries poses a challenge on the timely implementation of the 2030 Agenda for Sustainable Development and meet SDGs. There is already a common agreement that investment requirements to meet SDGs range in the trillion dollars rather than million dollars. In some developing countries, the resources currently dedicated to debt-servicing far exceed the budget allocated for development related investments.

The inefficient use of assets of developing countries to meet their development financing needs usually end up with a treasury bond issuance. The treasury bonds had raised the capacity to access more funds but increasing vulnerabilities for future investments.

Another risk to sustain debt repayments in the developing world is the currency risk. As external debt is usually denominated in USD in the developing countries, volatilities in national currencies against USD usually exacerbate the risk of default especially in the case of a shock in the economy.

As a result of such factors, approximately 40% of low-income developing countries currently found themselves either in or at a high risk of encountering debt distress (UNCTAD, 2018 and OECD, 2017). It is therefore debt burden on developing countries need to be addressed in a way where they could sustain their debt repayments without reducing their capacities on development related investments. Otherwise, developing countries and several OIC countries could not be able to meet SDGs and they will be in a vicious circle of borrowing (domestic and external) and debt repayment rather than borrowing for financing for development.

5.2.5 Poor Data and Monitoring Capacities

Data and monitoring both at the national and international levels are critical to have a well-functioning financial architecture that is pro-development. Many developing countries and a number of OIC countries have problems on producing statistics and data at international standards such as on debt, fiscal balances, financial flows, and development assistance. The timely, reliable and comprehensive data could help developing countries and decision makers to monitor the state of economy, identify risks, and mitigate shocks. The improved data and monitoring capacities would also help to increase transparency and accountability both for donor and beneficiary countries particularly for official financial flows. And reliable statistics are a key element towards better measurement, monitoring and management of the results of development assistance (EUROSTAT, 2018).

In particular, deficiencies in data quality, such as completeness, timeliness, accuracy and reporting regarding domestic and international resources not only create problem for national policy makers in their decision-making processes but tend to misguide international actors and resources for development. As a result, poor data quality associates with increased financial vulnerabilities, difficulties in securing funding, higher costs of borrowing and debt distress for many developing countries (Griffiths, 2017).

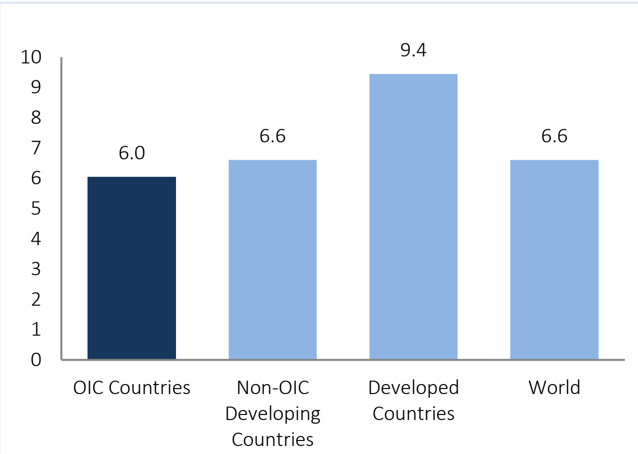
5.2.6 Weak International Cooperation

International cooperation would help developing countries and many OIC countries to achieve development and meeting SDGs. International cooperation not only help developing countries to improve national capacities but also bring know-how, experience and best practices on development finance and capacity building issues. On the other hand, international cooperation would tend to help developing countries and many OIC countries to increase public revenues through supporting them in fighting with tax evasion and avoidance. Cobham (2005) estimated the total cost to developing countries of leakages stemming from tax evasion and tax avoidance as USD 385 billion annually.

Harmful tax competition among developing countries to attract international funds and investors also hits their development trajectories by reducing potential public revenues. The prevailing weak international cooperation on such important issues from tax evasion to harmful tax competition overall emerge as an important challenge that needs to be addressed by developing and many OIC countries.

Figure 5.4 reports the level of engagement in international cooperation for country groups in 2018 by taking three dimensions into account: effective use of support, credibility, and regional cooperation. On average, OIC countries obtained the lowest score (6.0) compared to other country groups where the world average is measured at 6.6. Nevertheless, developed countries, on average, are well-advanced in terms of international cooperation that got a score of 9.4, which implies the existence of strong will and ability to cooperate with external supporters and organizations.

Figure 5.4: State of International Cooperation, 2018



Source: The Bertelsmann Stiftung's Transformation Index (BTI). Scale: 10 (best) - 0 (worst). Note: OIC sample size: 47; Non-OIC sample size: 73; Developed sample size: 9; World sample size: 129

In that context, developing countries and many OIC countries need to improve their institutional capacities and cooperation frameworks for mobilizing domestic resources and attracting more international resources for financing development. Otherwise, weak international cooperation seen in the developing world and many OIC countries would go on staying as an important impediment for financing for development.

5.2.7 Coordination and Capacity Issues at National Development Institutions and Multilateral Development Banks

National development banks and institutions play a vital role in mobilizing domestic resources through such by matchmaking and supporting entrepreneurs. They assume the role of catalyst usually by directly filling financing gaps avoided by private financial institutions, such as those involving large-scale infrastructure projects with long maturation periods that required long-term finance (UNCTAD, 2017 and 2018). These banks and institutions also invest in areas where the private sector has low willingness to undertake investment projects alone.

On the other hand, weak institutional capacities, limited domestic assets for funding, and human capital shortages affect the overall impact of national development institutions on development finance. In some developing countries, national development institutions/banks could not get a strong political support to align their mandates with national development strategies and act accordingly. Their cooperation and active engagement with regional development cooperation institutions including Multilateral Development Banks (MDBs) would be then of particular importance. Nevertheless, developing countries and some OIC countries can be said to have not been benefiting from opportunities and funds provided by such regional and international agencies at optimum levels due to communication and information gaps, weak knowledge on procedures and their working formalities, and the lack of political will and proper guidance.

In this context, developing countries and many OIC countries need to assess capabilities and capacities of their national development banks/institutions with a view to aligning their strategies with national development plans as well as SDGs. Throughout this process, regional and international institutions including MDBs could be important facilitators and catalysts for achieving such a transformation by providing expertise, consultancy and knowledge. Moreover, MDBs have the potential to play a greater role in financing development provided that developing and OIC countries approach them with concrete and bankable development projects.

5.2.8 Illicit Financial Flows

Illicit financial flows (IFFs) are illegal movements of money or capital from one country to another. In other words, cross-border capital movements for the purposes of concealing illegal activities and evading tax. The direct economic impacts of illicit financial flows from developing countries cannot be precisely quantified given that there are different views on its definition and scope. For instance, some experts claim that some portion of profit transfers made by multinational companies are not fully in line with the legal international transfers, and therefore can be considered as part of IFFs due to tax avoidance and the abuse of monopoly power (Chowla and Falcao, 2016).

Although there are different views regarding the definition and scope of IIFs, there is a broad consensus in the political and economic literature about its consequences. IFFs pose major challenges to developing countries and several OIC countries in their course of development.

According to Herkenrath (2014), IFFs deprive the affected countries of appreciable amounts of investment funds, which could otherwise spur economic growth and usefully complement foreign loans and aid payments in funding the public sector. It is estimated that developing countries experience a financial loss up to USD 1 billion every year through illicit financial flows. This is six times more than they receive in official development assistance (GIZ, 2019).

Overall, the direct and indirect effects of IFFs are especially devastating for developing countries and increasingly undermine domestic and international efforts to promote sustainable development. In particular, IFFs undermine such efforts by reducing available domestic resources and weakening international cooperation for financing for development. As a result, it is unlikely to reach SDG target 16.4 under the 2030 Agenda for Sustainable Development that aims to “significantly reduce illicit financial and arms flows” without ensuring strong international cooperation and restoring trust between multinational companies and developing economies.

5.2.9 Ineffective and Limited Official Development Assistance

Official Development Assistance (ODA) has been the primary quantitative measure of international development cooperation since 1969, with a target for developed countries to provide 0.7% of their income (The 0.7% commitment was adopted by a UN resolution in 1970, and has been recommitted to at major international summits related to financing ever since, most recently in the Addis Ababa Action Agenda in 2015. The ODA figures are compiled by the OECD’s Development Assistance Committee). The international community has an important responsibility to garner enough international public financing to support domestic efforts in resource mobilization for sustainable development. Aid remains a vital source of financing, in particular in the least developed countries, where it accounts for over two-thirds of external finance and in fragile and conflict-affected contexts, where it is often the only available resource for the provision of basic services (OECD, 2018). However, only a small number of countries have ever reached the targets regularly since the inception of the ODA mechanism.

Global macroeconomic environment remained unfavourable to efforts to scale up development finance and questions remained about the longer-term sustainability of growth in a number of developed countries (UNCTAD, 2017). Consequently, many developed countries have not fulfilled their commitments regarding the ODA. ODA as a share of gross national income fell from 0.32% in 2016 to 0.31% in 2017. Net ODA from DAC members was measured at USD 146.6 billion in 2017, a slight fall of 0.6% in real terms from 2016 (OECD, 2018).

Apart from undershooting the targets on ODA, there are several issues that needs to be addressed that hamper effectiveness of ODA on financing for development. First, donor countries can also report debt cancellation as part of ODA in the year of restructuring, and therefore the beneficiary country may not receive this portion of ODA. Second, there are some estimates that these flows disproportionately benefit upper and lower middle-income countries over low-income countries. Third, increased and better-targeted allocations of ODA are necessary for achieving progress in reaching the furthest behind. Fourth, better track and monitoring capacities are essential to measure on ODA both for donor and beneficiary countries (OECD, 2018). Finally, the usefulness of the ODA figures as a measure of international development cooperation resources available to developing countries is weakened by the inclusion of several categories of in-donor costs, particularly refugee costs (UNCTAD, 2017). All these issues pose challenges for many OIC countries and developing countries in benefiting from ODA at desired levels and limiting their achievements and capabilities on financing for development through ODA.

5.2.10 Limited Benefits Gained from International Capital Flows

International capital flows including both portfolio and Foreign Direct Investment (FDI) can help developing countries in several ways in their efforts to finance development. Capital flows bring additional capital into the economy and tend to trigger economic growth. In particular, FDI can bring new technologies and boosts international trade. Taxes paid by multinational companies help to increase public revenues. Employment created by multinational companies not only reduces the unemployment but also generate additional income for many households.

Nevertheless, some evidence in a number of developing countries revealed that short-term capital flows especially in the form of portfolio investments may hamper economic growth in the case of capital flight when there is a shock. In particular, if financial markets are not well-regulated as in the case of many developing countries, markets stay unprotected when there is a speculative attack. When it comes to FDI, some developing countries could attract mostly greenfield type of FDI with environmentally friendly technologies. A good number of multinational companies prefer brownfield type of FDI where they purchase an existing company in a host country that often uses a less-advanced technology compared to its home country. Consequently, the positive impacts expected from FDI in a number of developing and OIC countries stay relatively limited. For instance, the share of OIC countries in announced greenfield investment fell from 27.4% in 2016 to 17.9% in 2017 (SESRIC, 2018). In this context, OIC countries and developing world should not only focus to attract more FDI but also try to attract multinational companies that align with their development aspirations. Moreover, it is essential to develop financial market rules and regulations with a view to minimizing possible speculative attacks that can hamper efforts on financing for development.

5.3 Potential Solutions to Overcome the Challenges

Considering ten major challenges identified in the previous section, this section lists and discusses on eleven solution areas to be focused by developing and OIC countries in their efforts to finance development from improving capacities on macroeconomic governance to benefiting more from international capital flows.

5.3.1 Improving Capacities on Macroeconomic Governance

Without sound macroeconomic governance, developing countries and many OIC countries are unlikely to fully mobilize domestic resources and benefit from international resources. In this regard, OIC countries need to design policies to strengthen their macroeconomic governance in all three dimensions namely regulatory, legislative and administrative capacities both at monetary and fiscal fronts. It is essential to establish a strategic coordination between monetary and fiscal policies to create conditions consistent with strong domestic investment, stable and predictable exchange rate dynamics, and external debt sustainability over long periods of time.

In this context, the first step should be to define the problematic areas related with the quality of macroeconomic governance and prepare a strategic roadmap with the involvement of relevant stakeholders. Political willingness and strong commitment emerge as two key success factors in this reform process. As improving the quality of macroeconomic governance requires time, patience and tireless efforts, long-term policies with concrete Key Performance Indicators (KPIs) need to be set and implemented. This would help OIC countries not only reduce the number of shocks in the economy and ensure macroeconomic stability but also help them to better utilize domestic and international resources for development.

5.3.2 Making Effective Tax Regime Reforms for a Sound Public Financial System

A sound public financial framework could help developing and many OIC countries to improve governance, transparency and accountability. This would in turn help them to mobilize idle domestic resources and attract international capital to finance development. The effective tax regime reforms should focus on improving overall public finance stance by generating sustainable and predictable public revenues to finance development rather than to maximize public revenues at the cost of discouraging domestic economic activities. It is therefore a sound planning mechanism is needed to have a healthy composition of public revenue and expenditure, given their distributive implications and role in generating incentives for particular components of demand and supply.

Finally, fiscal space is dynamic. Some developing countries and OIC countries have greater revenue collection capacities, and therefore tend to have greater fiscal space that enable them to invest more for development. Some of those countries achieved to establish centralized fiscal monitoring mechanisms to track and control public expenditures in order to minimize frictions. Such wide range of experiences and best practices of OIC countries could provide some practical information and guidance for other OIC countries that would like to benefit and learn. In this regard, the potential roles of intra-OIC cooperation and South-South cooperation should not be underestimated in the process of tax regime reforms.

5.3.3 Fighting with Illicit Financial Flows

Tackling of illicit financial flows are essential to fight with tax avoidance and evasion and therefore should be an essential component of a wider tax regime reform. Fighting with IFFs would help to generate more public revenues and domestic resources to finance development. In order to achieve those ambitious objectives, having effective international tax cooperation is necessary not only to fight with illicit financial flows but also to have a tax regime that can facilitate the implementation of SDGs. Fighting with tax havens, ensuring a high level of tax transparency, timely exchanging of information on suspicious financial international flows are some of the ways to reduce illicit financial flows.

Without having strong cooperation among countries such illicit financial flows cannot be fully minimized. International and regional efforts taken at this front would help many OIC countries to make such reforms and take relevant measures relatively easier. For instance, the Platform for Collaboration on Tax, comprised of the International Monetary Fund, the Organization for Economic Cooperation and Development, the United Nations and the World Bank Group, held its first global conference on taxation and the Sustainable Development Goals in February 2018. By actively being part of such regional and international discussions on the matter, OIC countries would also have chances to shape the international policy solution mechanisms to be established in fighting with illicit financial flows. Moreover, such platforms provide a space to share country specific challenges with a wider group of countries.

5.3.4 Empowering National Development Banks/Institutions and Cooperating with Multilateral Development Banks

National development banks and institutions contribute to the development process of developing countries including many OIC countries through providing finance at a lower cost with long-term maturity. They usually support projects where the private sector and banks are not very ambitious to provide financing due to lack of short-term profitability or inherited uncertainties in some projects. They also provide technical assistance for some important projects that would have great impact on domestic resource mobilization and long-term development. National development banks could also help fill financing gaps at the regional level and help fund economic development in other countries as part of a broader South–South development cooperation strategy.

In many OIC and developing countries such institutions suffer from the lack of strong financial resources to fund projects unlike many well-established regional and multilateral development banks. They also face difficulties to attract and retain high quality human capital due to weak institutional structures or less attractive financial rewards for the staff. It is therefore of importance to empower national development banks and institutions in terms of financial outlook, human resources, and available technical capacities/instruments. In this picture, cooperation with MDBs can play a critical role as they have giant financial resources and well-equipped institutional mechanisms. Moreover, they have vast experience gained in various developing as well as OIC countries such as on technical and financial assistance, experience sharing and knowledge brokering. Moreover, effective network of cooperation opportunities should be explored between national, regional and multilateral development banks. Such networks could be instrumental to address financial difficulties in funding some development projects.

5.3.5 Focusing on South-South Cooperation and Intra-OIC Cooperation

South-South cooperation has a potential to play a key role in building domestic resource mobilization capacities in the developing world. Efforts in this area could be bolstered by the creation of regional working groups/mechanisms on various issues that are common concern in development finance such as tackling with tax evasion. Such working groups and mechanisms could facilitate the exchange of information and best practices among developing countries as well as OIC countries. In a similar vein, within the framework of South-South cooperation developing countries along with many OIC countries could work on establishing some regional tools to facilitate analysis of international transactions such as to cope with illicit financial flows.

In order to have strong partnership among developing countries and OIC countries, it is key to raise awareness among all relevant economic authorities at the national level regarding the importance of South-South cooperation. These efforts would also help to eliminate some prejudices against some developing countries on various cooperation areas. In particular, intra-OIC cooperation should be strengthened such as to encourage sharing best-practices and success stories about mobilization of domestic resources and effective international cooperation on financing development.

OIC countries need to seize existing opportunities such as the UNCTAD intergovernmental machinery (e.g. annual meetings/workshops/training programmes) in the financing for development process of the United Nations system. Being part of these machineries and discussions not only would help to strengthen multilateral cooperation but also create opportunities to establish dialogue with relevant partner institutions and countries.

5.3.6 Improving Data and Monitoring Capacities

It is a daunting task to fully mobilize domestic and international resources for financing development. Another challenging task is to measure and track them in a timely manner to allow for precise policy responses. Therefore, sound data and monitoring capacities are necessary to measure, detect, track and direct financial flows in the most effective way for development. Nevertheless, complex financial systems, weak institutional frameworks, low staff capacity and insufficient management systems make it difficult to establish such strong mechanisms in the developing world as well as in many OIC countries. In this regard, capacity-building is particularly important. In this picture, international best practices are crucial that experiences of various countries could shed lights on where and how to start to build up strong data and monitoring capacities. To meet these challenges OIC countries could benefit both from the experiences of international community such as UNCTAD and OECD as well as experiences of other OIC countries. These experiences and support would enable them to access the available solutions and build up such capacities for their national contexts.

In building up such capacities a particular concern should be to generate high quality data that allow for international comparisons. In this regard, there are various standards and initiatives at international and regional levels where OIC countries are recommended to consider. For instance, to overcome data quality issues on aid flows and development finance, UNCTAD developed a framework that set out eight basic principles that developing countries are advised to take into account from counting flows only to ensuring a development purpose in counting flows (UNCTAD, 2018).

5.3.7 Deepening International Cooperation to Fight with Illicit Financial Flows and Tax Havens

Fighting with illicit flows would help developing and many OIC countries to gain additional domestic resources that could be mobilized for development. Nevertheless, it is very difficult to

Box 5.1: Project on combating illicit financial flows

German Federal Ministry for Economic Cooperation and Development (BMZ) developed a project that will run from 2015 to 2022. It links initiatives of key players on combating illicit financial flows at global and regional level in Africa, Latin America and the Western Balkans and in selected countries in these regions.

The project operates in three fields of action:

Prevention: The project supports the development of coherent strategies to prevent illicit financial flows in countries. Global anti-money laundering and transparency standards are being introduced nationally, with measures including registers indicating the true economic owners of companies.

Financial investigation: The project advises the relevant authorities in countries on new methods and ways of investigating illicit financial flows. National financial investigation units, anti-corruption authorities, public prosecution departments and tax fraud investigation authorities are key partners.

Asset recovery: The project assists with the recovery of assets stolen in developing countries and emerging economies. Regional networks strengthen the cooperation between law enforcement agencies and other authorities. Policy-makers and law enforcement agencies are developing solutions in the field of mutual legal assistance at international events.

Source: German Federal Ministry for Economic Cooperation and Development (BMZ)

detect, measure and fight with illicit financial flows. In particular, the scope and details of financial transactions made to tax havens constitute a significant portion of the problem.

To effectively fight with illicit flows and have an international financial system that would benefit all, it is essential to deepen international cooperation where inputs and efforts from both developed and developing countries need to be put in place. A broad range of possible measures have been discussed at the global level to cope with illicit financial flows. These include the automatic exchange of information in tax matters; extended administrative assistance allowing for supplementary requests for information in addition to the tax data automatically shared; the systematic registration and disclosure of the effective economic beneficiaries of companies, trusts, and foundations; and the detailed breakdown of corporate group accounts by country and by project (Herkenrath, 2014).

5.3.8 Benefiting from Potentials of Blended Finance and Islamic Financial Instruments

Developing countries have limited available resources of the public sector to finance development. In addition, in many cases, the ability of the public sector to support long-term investments is not strong enough due to weak institutional set up and governance. Therefore, finding new and better ways to mobilize private sector for financing development is critical. As mentioned in the Addis Ababa Action Agenda, blended finance was a mechanism to leverage additional finance for development. At national level, funds accumulated by pension funds and insurance companies have potential to support and provide finance for development projects. Several OIC countries have accumulated significant amount of capital in their national Sovereign Wealth Funds (SWF) particularly in oil exporting countries. If such capital could be directed towards productive investments for development projects in other OIC countries, the existing investment gaps could be filled to a certain extent. In this regard, blended finance is an effective financial resource mobilization tool for development when properly used.

Another unique avenue that could be used by many OIC countries is to explore potentials of Islamic finance for financing development. Islamic finance has a strong potential in promoting both social and economic infrastructure development and could be an effective tool to mobilize idle savings and capital into productive investments for development. Several Islamic financial instruments from Zakat to Sukuk could be used for various purposes from supporting social infrastructure to financing largescale infrastructure projects. Nevertheless, to benefit from the potentials of blended finance and Islamic finance, OIC countries need to develop certain institutional mechanisms from regulatory arrangements to administrative measures to mobilize resources for development.

5.3.9 Bolstering International Cooperation for Debt Restructuring

Many developing countries and several OIC countries have accumulated a remarkable amount of public as well private debt. Debt and interest repayments tend to put a high pressure on such countries and hinder their development process through shifting their focus from development to debt sustainability. In simple words, higher debt levels tend to translate into higher debt servicing burdens that reduce available resources to finance programmes and projects that ultimately hinder achievement of the Sustainable Development Goals.

One way of addressing this issue is to considering debt restructuring that include debt relief and cancellation options. Nevertheless, debt restructuring requires an effective dialogue and cooperation between developing and developed countries to find out the best way to address the issue. Moreover, effective public financial management required to draw and implement a successful debt management strategy. Debt restructuring should pave the way to support investment projects that promote diversification and structural transformation in the national economy rather than postponing contemporary debt problem to the future.

At the multilateral level, international and regional institutions should support to improve transparency of debt statistics. They also need to strengthen debt management capacities of developing countries such as offering technical assistance and capacity-building programmes. In this context, intra-OIC cooperation could play a role that some OIC countries have strong capacities and experiences in designing debt-restructuring strategies and translating additional resources into transformative development projects.

Nevertheless, it should be noted that management of debt and its sustainability requires a holistic approach that various stakeholders at the national level need to exert concerted efforts including fiscal, monetary and industry policy makers.

5.3.10 Modernizing Official Development Assistance

Official Development Assistance (ODA) continues to play important roles in financing for development, in particular for the least developed countries. Nevertheless, modernization of ODA could be instrumental in generating additional funds for development as well as utilizing

Box 5.2: Paris Club

The Paris Club is an informal group of creditor nations who meet each month in the French capital whose objective is to find workable solutions to payment problems faced by debtor nations. The group is organized around the principles that each debtor nation be treated case by case, with consensus; conditionality, solidarity, and comparability of treatment. In addition to 22 permanent member nations, there exist observers.

- Creditor countries meet ten times a year in Paris for Tour d'Horizon and negotiating sessions.
- To facilitate Paris Club operations, the French Treasury provides a small secretariat, and a senior official of the French Treasury is appointed chairman.
- Since 1956, the Paris Club has signed 433 agreements with 90 different countries covering over USD 583 billion.

Source: Paris Club website: http://www.clubdeparis.org/

them more effectively for development purposes. To start with, transparency and measurements issues need to be addressed. Some donor countries tend to downsize their aid allocations by replacing ODA with other forms of financing under the total official support for sustainable development framework, and therefore many of them are not able to meet the United Nations target of 0.7% of GNI for ODA (UNCTAD 2017).

Double counting and addition of climate finance with regard to existing ODA definitions were also areas of concern where modernization efforts need to focus on. Moreover, refugee-related donor costs are another grey area where clear-cut definitions need to be formulated how these costs should be reported in a standardized and international comparable manner within ODA.

During the modernization efforts of ODA, both developing and developed countries need to be listened carefully. This would help to understand why a number of developed countries have not fulfilled their commitments on ODA and to identify ways and means on how to incentivize them to do so.

5.3.11 Benefiting More from International Capital Flows

Over the last two decades, many OIC countries have benefited from international capital flows. Some of these countries have benefited to a higher extent but many of them could not see expected positive outcomes due to short-term structure of capital flows, negative environmental impacts, lack of technology transfer and extensive profit transfer to home countries. Many developing countries and a number of OIC countries require to maintain stable access to international liquidity given their limited domestic savings either in the form of portfolio investments or FDI.

In this context, developing countries and many OIC countries need to restructure their financial architectures to benefit more from international capital flows in line with their developmental aspirations. Developing necessary regulatory and administrative systems to cope with speculative capital attacks and capital flight could be part of these reforms. These measures help reduce international capital flow volatility and ensure that external finance can be channelled reliably into long-term productive investment for development.

Other elements of these efforts should include policies to target attracting long-term portfolio investors with a keen interest on development projects. Developing countries and OIC countries should not only target attracting more multinational companies into their economies but also selecting ones with high impact on development and less harmful for the environment. Following export-led growth strategies may facilitate attraction of multinational companies with interests on high value-added products and services and comply with emission standards.

Both developed and developing countries also need to work together to create an international financial system that is more development friendly. The asymmetry in the current international financial system results in developing countries having to seek additional external financing – exposing them to higher risks of exchange rate or debt. The system does not avoid waste of resources such as through allowing for speculative attacks in developing countries. The global financial system should be designed in a way to facilitate structural transformation in developing countries through mechanisms that support their long-term access to financing for development, encourage high productivity and promote competitiveness.

5.4 Final Remarks

Mobilizing domestic resources and benefiting more from international resources for financing development are two are closely interrelated objectives. As a result, many challenges and policy issues discussed in this chapter are interlinked and not easy to address in isolation.

In this context, it should be noted that OIC countries need to follow a holistic approach in addressing challenges that limit their access to domestic and international finance for development. Therefore, a multidimensional cooperation among national stakeholders, regional agencies and international institutions should be effectively established. A particular attention should be given to the potential roles of South-South and intra-OIC cooperation.

Establishing a strong intra-OIC cooperation not only would help OIC countries to exchange experiences and best practices among each other but also to strengthen the solidarity among them. Moreover, these cooperation avenues would lead them to learn more about their developmental challenges especially in the area of development finance. Identification of existing commonalities in challenges faced by them such as in access to long-term finance or coping with illicit financial flows would even further open new avenues of cooperation for future.

Meeting all SDGs with given available domestic resources is not possible for many OIC countries. In this regard, international resources could play a constructive role in their efforts to achieve sustainable development. Nevertheless, the existing modalities on external financing do not always fully fit their needs and national contexts and are far from meeting their level of investment needs for development. Therefore, the global community, development partners and OIC countries must altogether scale up their efforts on financing for development to achieve the SDGs It is also essential to improve allocation mechanisms in order to identify and reach the countries and sectors where financial needs are greatest for development.

CHAPTER SIX

International Partnership for Development Cooperation

In 2015, the international community adopted the 2030 Agenda for Sustainable Development, which challenges the conventional growth-based development wisdom with the people-centered logic and calls for making transformative changes to achieve more equal and inclusive development goals - "leaving no one behind". All OIC countries are adopting national strategies and plans to achieve the ambitious set of seventeen Sustainable Development Goals (SDGs). They are also trying to adapt their institutions to the requirements of this new development paradigm, made up of not only the 2030 Agenda for Sustainable Development, but also the Paris Agreement on Climate Change, the Sendai Framework for Disaster Risk Reduction, the New Urban Agenda and the Addis Ababa Action Agenda. However, achieving the goals of these documents remain to be a challenge for many OIC countries, due to different stages of development, different priorities and insufficient resources for investments.

Growing needs of countries are seldom accompanied by the resources that are necessary to meet them. Particularly in developing world, leaders repeatedly point to the lack of financing as one of the primary barriers to the long-term development. Developing countries are also challenged by the inadequate capacities and in most cases, they need help for building local capabilities, institutions, expertise and human resources, in contribution to national development priorities. Consequently, governments are searching for the new ways to finance their development needs, because all sources of finance -public and private, domestic and international- have an important role to play in financing the new investments across sectors.

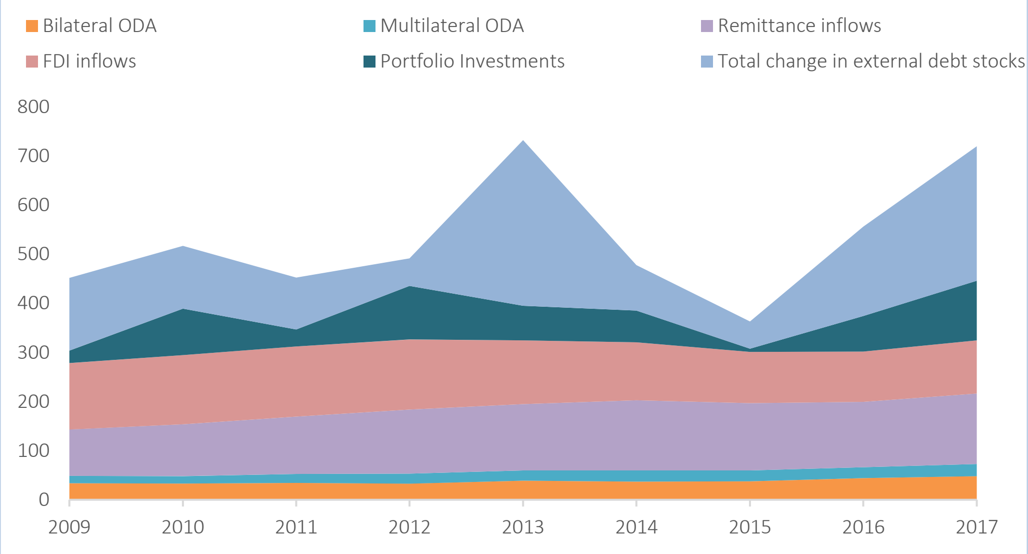
Global investment needs are in the order of \$5 trillion to \$7 trillion per year. The annual investment gap in major SDG sectors in developing countries alone range from \$2.5 trillion to \$4.5 trillion per year, mainly for basic infrastructure, food security, climate change mitigation and adaptation, health, and education (UNCTAD, 2014). Last two figures represent 36 to 65% of aggregated GDP in current prices of OIC countries, which accounted \$6.92 trillion in 2018.

It is obvious that resource availability must rise if the SDGs are to be attained. However, even four years after adopting the 2030 Agenda for Sustainable Development, mobilising enough financial support to meet the resource gap in SDG implementation remains to be a critical challenge, including for the OIC countries.

6.1 Trends in External Financing for Development of OIC Countries

The international development cooperation has always played an important role in supporting and boosting the economic development. Conventional practice has been to treat development cooperation narrowly as the Official Development Assistance (ODA) provided by the member countries of the OECD's Development Assistance Committee (DAC). Commitments of these countries from the Global North are also set out in the Addis Ababa Action Agenda (UN, 2015). But given the growing gap between the demand for resources in developing countries and the flow of resources from provider countries, foreign aid is not enough, and mobilizing additional resources for development as well as increasing the effectiveness of existing resources has become more pertinent than ever. As can be seen from Figure 6.1, international actors, both public and private, contribute substantive amounts of cross-border finance to the OIC countries.

Figure 6.1: External Financing to the OIC Countries by Sources (Current prices, billion USD)



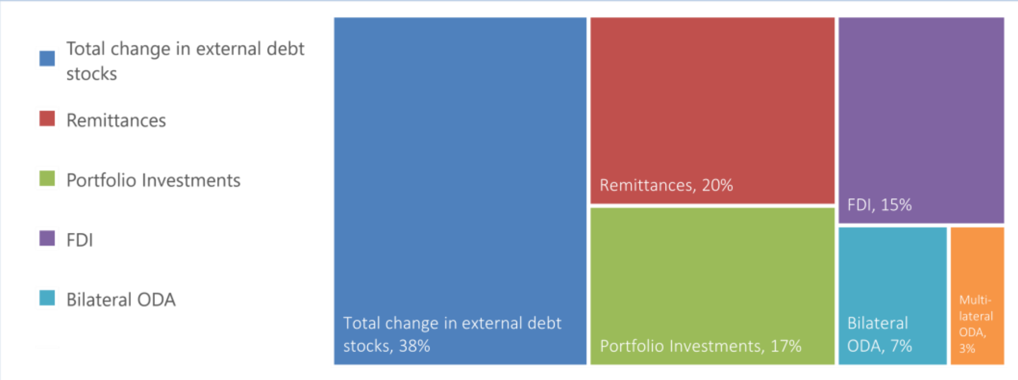
Source: Author's calculations based on OECD "Creditor Reporting System" database for official bilateral and multilateral gross disbursements flows (OIC: N = 51). Bilateral ODA flows are calculated based on 29 DAC countries and 20 non-DAC countries that are reporting to the OECD); World Bank "Migration and Remittances Data" for remittances (OIC: N = 50); UNCTADSTAT data on FDI (OIC: N = 57); IMF "Balance of Payments Database" for portfolio investments (OIC: N = 49); and World Bank data for external debt (OIC: N = 56). Existing estimations used to fill in just a few missing values for external debt.

The volume of external finance available to the OIC countries has substantially increased to $720 billion in 2017 from $363 billion in 2015. Figure 6.1 also witness the change in the global landscape of foreign aid, where increased volumes of FDI, cross-border remittances, loans and other commercial interactions have reduced the significance of foreign aid (ODA) in relative terms.

At $73 billion in 2017, the total of bilateral and multilateral ODA flows to the OIC countries represents an important but small proportion of the external financial flows (Bilateral ODA comprises of 29 DAC countries and 20 reporting countries beyond the DAC. Share of non-DAC reporting donors in total bilateral ODA accounted for %16.5 in 2017). While the proportion of ODA declined to around 10% of total external finance transfers to the OIC countries in 2017 (Figure 6.2), it continues to provide critical inputs for the central government expense in many OIC countries. For example, according to the World Bank data, in 2017 net ODA received as percentage of central government expense accounted for 631% in Palestine, 155% in Sierra Leone, 76% in Mozambique, 71% in Mali, 67% in Guinea Bissau and 58% in Uganda. In terms of total volumes, the US is the largest bilateral ODA provider to the OIC countries, with $9.3 billion (in constant 2017 prices).

Turkey is the second largest provider to the OIC with ODA increasing to $7.6 billion in 2017 (most of this amount is spent for the Syrian refugees), followed by the Germany with $6.6 billion and Japan with $4.8 billion (Figure 6.3). Five OIC countries that are reporting to the OECD, namely

Figure 6.2: Shares in External Financing to the OIC Countries (2017, percent)

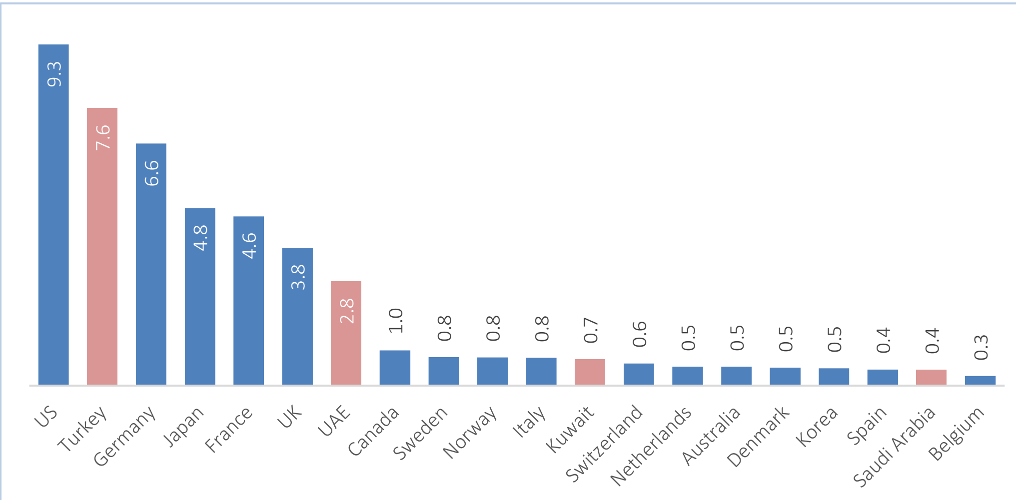


Source: Author's calculations based on databases listed in the source of Figure 6.1.

Azerbaijan, Kazakhstan, Kuwait, Saudi Arabia, Turkey and United Arab Emirates in 2017 contributed a total of $11.6 billion as financial assistance to the OIC countries.

There are other OIC countries such as Qatar and Indonesia that should also be mentioned among emerging donor countries. For example, according to a recent study, through spending by various government agencies, Indonesia has expanded its development cooperation budget by more than 21%, from $8.4 billion in 2015 to $10.2 billion in 2016 (Sato and Santikajaya, 2019). However, this kind of occasional reports are not enough to track the real contributions of the OIC countries to the development cooperation.

Figure 6.3: Top 20 Bilateral ODA Providers to the OIC Countries (Gross disbursements, constant prices, billion USD, 2017)

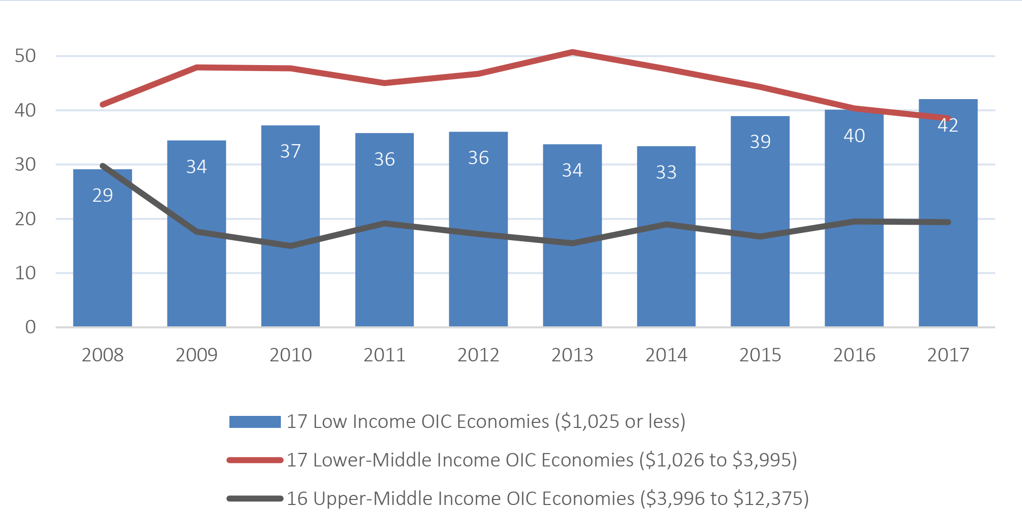


Source: OECD.Stat, Creditor Reporting System.
Notes: A disbursement is the placement of resources at the disposal of a recipient country or agency, or in the case of internal development-related expenditures, the outlay of funds by the official sector. Bilateral ODA flows are calculated based on 29 DAC countries and 20 non-DAC countries that are reporting to the OECD.

Multilateral institutions, international and regional banks and funds, including those newly established by developing countries, are also providing financial support to the OIC countries. For example, during 2018, the Islamic Development Bank approved projects worth $1.27 billion and achieved record disbursement of $2.64 billion (IsDB, 2019). However, the share of multilateral ODA in total external financing to the OIC countries has declined from 6% in 2015 to 3% in 2017. The United Nations (UN) funds play a key role in supporting development in OIC through multilateral ODA programmes. The OIC countries are also funding the UN operational activities for development, but their contributions remain at symbolic levels. For example, the funding of UN operational activities for development reached $33.6 billion in 2017, and only 3.1% ($1.06 billion) came from the 57 OIC countries (UNGA, 2019). On the other hand, at the same year, 31% of staff working in the UN Specialized Agencies and Programmes was national of OIC countries (CEB, 2018).

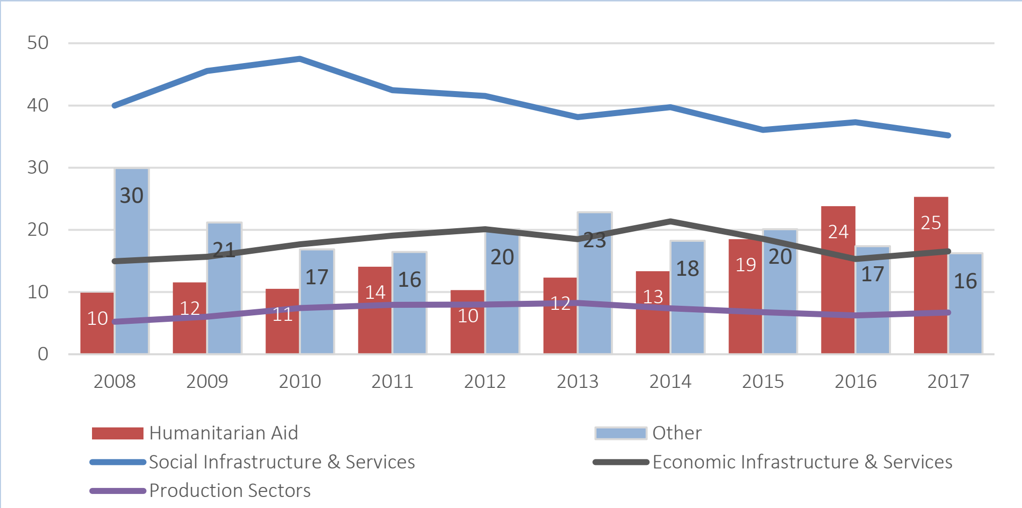
Many developed countries still fall short of their ODA commitments, including the commitment to achieve the target of 0.7% of gross national income for ODA. On the other hand, frequently the North-South development cooperation expressed in terms of ODA is criticized as an unequal form of cooperation, where developed countries are imposing to the developing countries neo-liberal policies calling for significant reductions in public sector expenditures (IBON, 2018). Moreover, moral imperative of ODA is to support development in countries most in need – including least developed countries, small island developing states, and fragile states. However, it seems that the ODA priorities for poverty reduction are being somewhat eroded, as can be drawn from Figure 6.4.

Figure 6.4: ODA Flows to the Different OIC Income Groups (Gross disbursements, %)



Source: OECD.Stat, Creditor Reporting System
Notes: A disbursement is the placement of resources at the disposal of a recipient country or agency, or in the case of internal development-related expenditures, the outlay of funds by the official sector. Bilateral ODA flows are calculated based on 29 DAC countries and 20 non-DAC countries that are reporting to the OECD. The World Bank country classification by income groups for the 2020 fiscal year was used.

Figure 6.5: Sectoral Distribution of ODA Flows to OIC Countries (Gross disbursements, %)

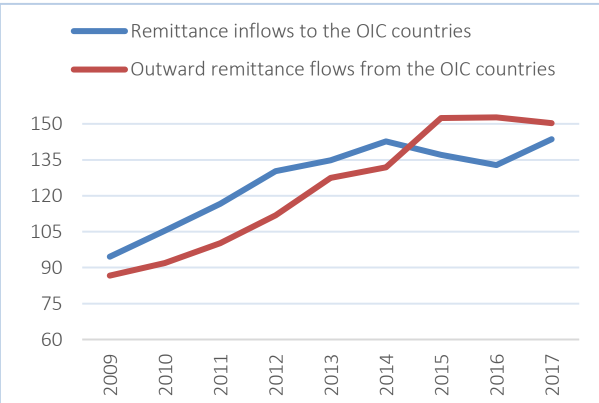


Source: OECD.Stat, Creditor Reporting System
Notes: A disbursement is the placement of resources at the disposal of a recipient country or agency, or in the case of internal development-related expenditures, the outlay of funds by the official sector. Bilateral ODA flows are calculated based on 29 DAC countries and 20 non-DAC countries that are reporting to the OECD (OIC: N = 51).

From 2008 to 2015, the value of ODA directed to the 17 low income OIC economies ($1,025 GNI per capita or less) was significantly below the ODA amounts received by the 17 lower-middle income OIC economies ($1,026 to $3,995 GNI per capita). In 2017, middle income OIC economies were still receiving 58% of total ODA directed to the OIC countries. Good news is that ODA directed to the low income OIC economies has increased by 13 percentage points since 2008 (Figure 6.4).

As an unprecedented number of people are affected by conflict or extreme climate events in the OIC countries, ODA resources are increasingly shifting towards humanitarian assistance, which is not consistent with sustainable approach to financing development - needed to achieve 2030 Agenda targets. Share of humanitarian aid within the ODA flows to the OIC countries has increased from 10% to 25% in the period from 2008 to 2017. Only 52% of ODA flows to the OIC countries was directed to social and economic infrastructure development, which includes sectors important for affecting poverty.

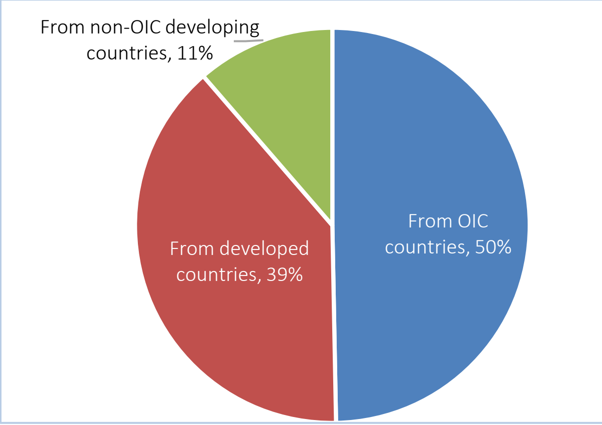
Figure 6.6: Remittance Flows (Current prices, billion USD)



Source: World Bank, Migration and Remittances Data. Note: OIC: N = 50.

As it is shown at Figure 6.6, remittance inflows to the 50 OIC countries - money or other assets that migrants send to individuals in their home countries- are steadily growing and have reached a record high of $144 billion in 2017. This is an 8% increase from 2016, when the amount was $133 billion. It is interesting to note that remittance inflows were second largest source of external finance for OIC countries in 2017 (Figure 6.1), and that 50% of remittance inflows came from the OIC countries themselves (Figure 6.7). Seven OIC members were in the list of Top 20 remittance providers to the OIC countries, where Saudi Arabia was at the first place with $27 billion, followed by United Arab Emirates with $13.3 billion (Figure 6.8).

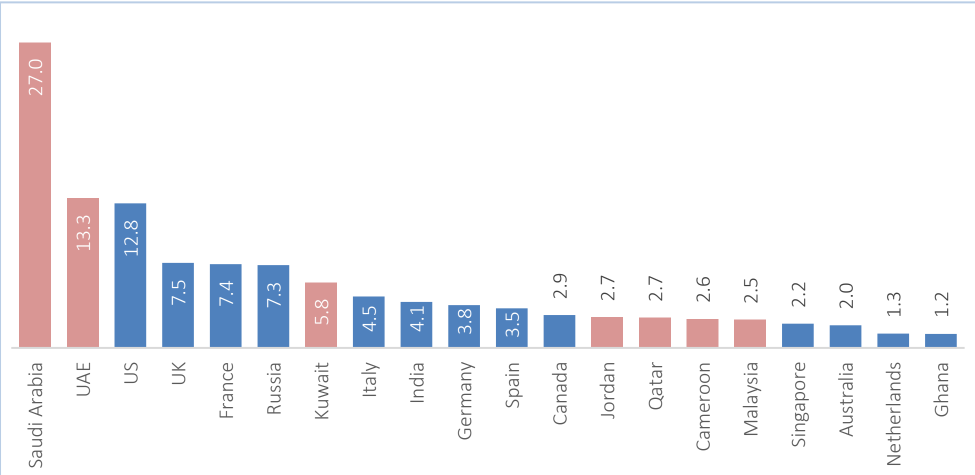
Figure 6.7: Remittance Providers to the OIC by Country Groups (2017, current prices, %)



Source: World Bank, Migration and Remittances Data.

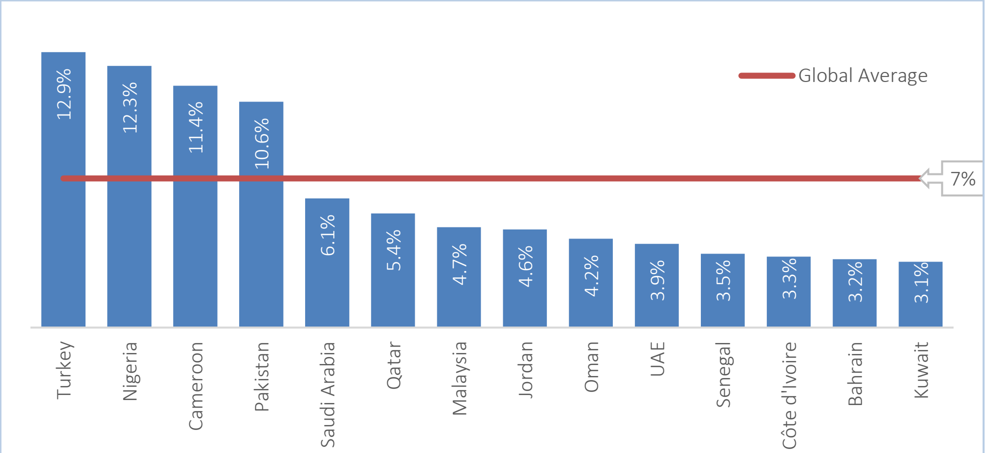
The share of developed countries in remittance inflows to the OIC countries was 38% in 2017. OIC migrant workers and others sent home an estimated $12.8 billion from US and $7.5 billion from UK (Figure 6.8). As migration flows from the OIC countries continue to rise, most probably remittance inflows will continue to grow. Particularly in times of economic downturn, natural disaster or political crisis, when private capital tends to leave and even official aid is hard to administer, remittances inflows will continue to help boost the OIC countries' balance of payments.

Figure 6.8: Top 20 Remittance Providers to the OIC Countries (2017, current prices, billion USD)



Source: World Bank, Migration and Remittances Data.

Figure 6.9: Average Cost of Sending $200 from OIC Countries (2018)

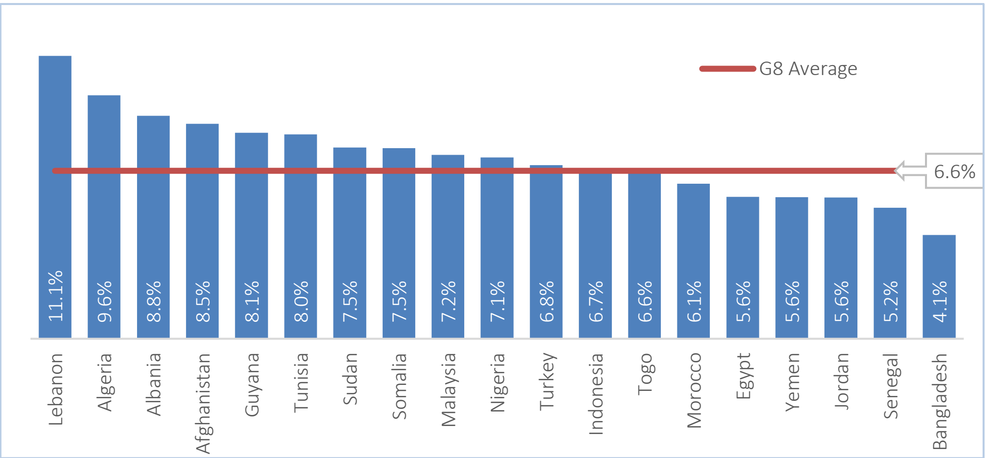


Source: World Bank, Remittance Prices Worldwide, available at http://remittanceprices.worldbank.org.

When speaking about remittance flows, it should be noted that since 2014, aggregated outward remittance flows from the 50 OIC countries are higher compared to remittance inflows to the OIC countries. In 2017, the value of outward remittance flows from the OIC countries was $150 billion, less for $3 billion from 2016 (Figure 6.6). As 50% of these outward remittance flows fled to the OIC countries in 2017 (Figure 2017), the second half mostly went to the non-OIC developing countries, and this is one of many examples that illustrates how the OIC countries support other developing countries in their efforts to secure financing for development.

Unfortunately, high costs of money transfers reduce the benefits of remittances. The G8 and G20 countries have committed to reduce global average cost of money transfers to 5% (World Bank, 2019), while SDG 10.C of the 2030 Agenda for Sustainable Development targets to reduce to less than 3% the transaction costs of remittances. However, by the end of 2017, the global average

Figure 6.10: Average Cost of Remitting $200 from the High Income Countries (2018)



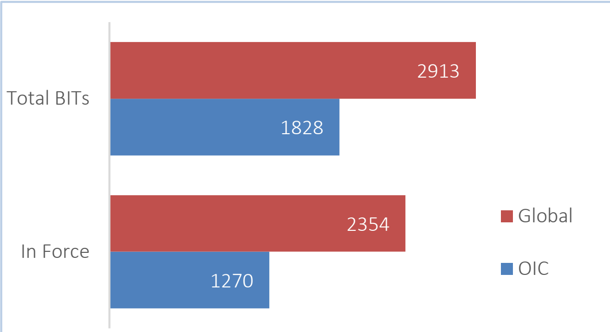
Source: World Bank, Remittance Prices Worldwide, available at http://remittanceprices.worldbank.org.

cost of sending $200 remained high, at 7%. In the OIC countries such as Turkey, Nigeria, Cameroon and Pakistan, average cost of sending $200 was even higher, remaining above 10%. On the opposite side, in 2017 the OIC countries such as Kuwait, Bahrain, Côte d'Ivoire and Senegal were very close to achieving the SDG 10.C (Figure 6.9). As it is shown in Figure 6.10, for many OIC countries, average cost of remitting from high income economies also continues to be well above the 3% target (Figure 6.10).

FDI remain to be critical external source of finance for OIC countries and one of the major sources of financing Agenda 2030 (See Figure 6.1). Compared to portfolio investments, FDI provide a more stable stream of investment. FDI flows to the OIC countries slightly increased in 2017 at $108.3 billion, seeing 5% recovery compared to 2016. However, the figure for 2017 is still 24% less from aggregated FDI inflows that the OIC countries have attracted in 2012.

There appears to be awareness among many governments of the OIC countries that entering into binding international investment agreements is important for attraction of FDI and stimulating growth. Out of the 2913 Bilateral Investment Treaties (BITs) signed at the global level by July 2019, 1828 (63%) were concluded by OIC countries (Figure 6.11). Turkey (109), Egypt (100), United Arab Emirates (87), Kuwait (83) and Morocco (69) are at the forefront of total concluded BITs. Some other OIC countries have chosen to conclude only a few BITs, as it is the case with Afghanistan, Brunei, Comoros, Djibouti, Guinea-Bissau, Guyana, Iraq, Maldives, Niger, Sierra Leone, Somalia, Suriname and Togo.

Figure 6.11: Number of Bilateral Investment Treaties Concluded by OIC Countries (as of July 2019)



Source: UNCTAD, Investment Policy Hub. *Note:* OIC: N = 57)

In contrast to remittances and FDI, portfolio investments and long and external debt flows appear to be more vulnerable to global conditions, particularly global interest rates. Still, portfolio investments to the OIC countries peaked at $121 billion in 2017, surpassing the OIC FDI inflows in the same year for near 11% (see Figure 6.1). However, the increase in external debt flows to OIC countries is evident for the period after 2015, what calls on the OIC governments to address the challenges linked to debt sustainability in order to prevent negative impact on long-term development.

6.2 South-South Partnership for Development Cooperation

A couple of decades have passed since the Bandung Conference (1955) - a landmark event for rethinking the Global South, and the Buenos Aires Conference (1978), at which the grounds of South-South Cooperation (SSC) were laid. This was a symbol of the determination of nations of the South to be actors of their own development, and of the need to find new international order which is more equitable and more inclusive.

The world has undergone major economic and political transformations in the four decades after the Buenos Aires Conference, and became increasingly interdependent. Transformations in the Global South have been intensive and challenging. The SSC became strengthened to the extent that even the less developed countries share some knowledge with others (Li, 2018). Today, countries of the South have a significant role not only in enhancement of truly global partnerships for development, but also in solutions to various contemporary crisis such as climate, migration and security. Their vision of development has also been incorporated into the 2030 Agenda for Sustainable Development.

The nature, modalities and responsibilities that apply to SSC differ from those that apply to North-South cooperation (NSC), i.e. aid development. While there are some areas of convergence and both work towards the same objective, SSC and NSC operate in very different realms. The first thing that should be underlined in this regard is the fact that SSC cannot be equalized to ODA, although 2000s witnessed the rising prominence of emerging donors or Southern providers, which are more and more influencing the landscape of international development finance.

The UNCTAD estimates that foreign aid from emerging donors increased by 43% from $14.1 billion in 2011 to $24.6 billion in 2015. Aid flows from emerging donors represented approximately 16% of total ODA in 2015 (Table 6.1). Having in mind that most of the financial flows from Global South have not been reported, including those from the OIC countries, it is natural to expect the share of emerging donors in total ODA to be much higher. Besides this, it should be emphasized that Southern-led multilateral development banks, such as the Islamic Development Bank (IsDB) and the Development Bank of Latin America (CAF) have become crucial drivers of regional infrastructure growth.

The emerging donors that had been multiplying their development cooperation efforts for some time, such as China, Brazil, India, United Arab Emirates, Turkey and Russia, have brought into the agenda "burden-sharing negotiations" between established and rising middle-income aid

Table 6.1: Estimated Global Development Cooperation Flows

(Net disbursements, current prices, billion USD)

	2011	2012	2013	2014	2015	% of total (2015)
ODA from 28 DAC countries	135.0	126.9	134.7	137.4	131.4	84.2%
ODA from 20 reporting countries beyond the DAC	8.9	6.2	16.4	24.7	17.7	11.3%
Estimated development co-operation flows from 10 non-reporting countries beyond the DAC	5.2	5.6	6.8	7	6.9	4.4%
Subtotal flows from non-DAC providers	*14.1*	*11.8*	*23.2*	*31.7*	*24.6*	*15.8%*
Estimated global total	149.1	138.7	157.9	169.1	156.0	100%

Source: UNCTAD.

providers (for discussions in this regard see OECD, 2011). However, these emerging donors are still greatly challenged by poverty and inequality at home, as such, they still form part of the DAC list of recipient countries and are eligible to receive ODA. For that reason, they have a mostly negative attitude on sharing with developed countries the burden of responsibilities for international development.

On a conceptual level, SSC is not just concessional aid, it is not only for developmental purposes, and it is not always done through 'official' channels. Further, historically, the SSC has supported investment in a number of areas that many of the traditional providers have tended to avoid. For that reason, the SSC is a complement rather than a substitute for the NSC (Neissan A. Besharati, 2019). More detailed comparison of SSC and NSC is summarized at Table 6.2. As can be observed from the Table, no monitoring mechanisms beyond occasional reports with poor data is available

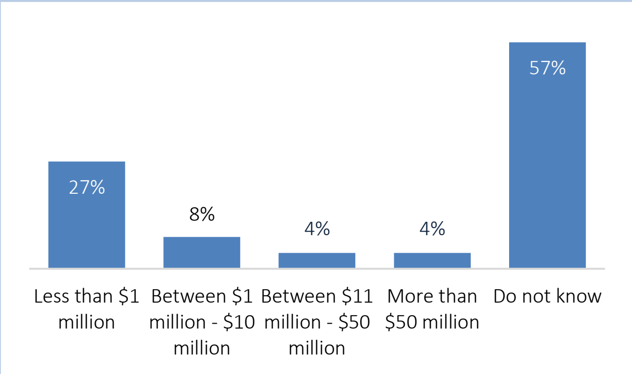
Table 6.2: Comparison of North-South and South-South Development Partnership

	Aid programmes (North-South)	Development partnership (South-South)
Nature and purpose of support	*ODA. Stated to be altruistic in nature*	*Mutual benefits and growth*
Philosophical perspective	Framework approach	Ingredient approach
Participants	*At least one participant has very high per capita income*	*Both partners may have very low per capita income*
Level of development	Large differences in stages of economic development between donors and recipient	Both partners almost at same stage of economic development
Role of participants	*Donors and recipient of ODA*	*Relationship of equality, both may contribute to the process*
Conditionality	'Top-down' with policy conditionality and no predictability	Request-driven and generally free from conditionality of any kind, so largely within timelines
Flexibility	*Multi-layered time-consuming bureaucratic structures, hence added transaction cost*	*Highly decentralised and relatively fast with few implications for transaction cost*
Priority sectors	Grant assistance and budget support for social sectors	Economic and technical cooperation largely confined to projects in infrastructure and productive sectors investment
Adherence to global governance framework like Paris Declaration	*Donors use guidelines of Paris Declaration, which they evolve as an instrument for effectiveness*	*Providers are out of the purview of any global arrangement such as Paris Declaration, in which they were not involved. Hinges on mutual trust of partner countries*
Data, monitoring and evaluation	Peer-reviewed by DAC-OECD. Data is compiled and periodically released by the national governments and DAC-OECD	No monitoring mechanisms beyond occasional reports of data and anecdotal details
Role of NGOs	*Extensive*	*Limited*
Role of Private Sector	Limited	Extensive

Source: Sachin Chaturvedi, "Features of South-South Cooperation and Global Dynamics", Forum for Indian Development Cooperation, Policy Brief No: 1, January 2014.

in the South-South development partnership. Overall, very little empirical evidence exists on the quality, effectiveness and impact of SSC on the developing world. Measurement efforts are further challenged by the lack of common conceptions, shared standards and consistent recording. Still, everyone today acknowledges the huge contribution SSC makes to sustainable development at global, regional and national level.

Figure 6.12: Annual Expenditure on South-South Cooperation (2017)



Source: UN DESA (2018). Report on QCPR Monitoring Survey of Programme Country Governments in 2017, United Nations, Development Cooperation Policy Branch Department of Economic and Social Affairs, 23 February. *Notes:* N = 118 developing countries.

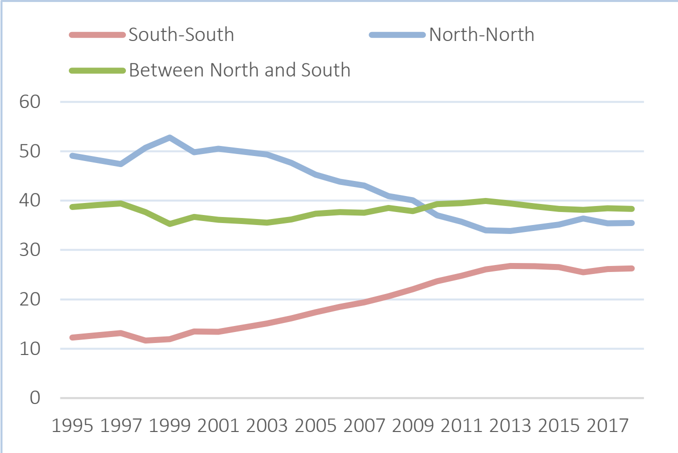
According to a survey conducted by UN DESA, 74% of developing countries provided some form of development cooperation in 2017, up from 63% in 2015, which means that the SSC is becoming an increasingly favoured modality of development cooperation. A growing number of countries have either created agencies dedicated to SSC or have boosted the SSC capacities within their cooperation institutions (UN DESA, 2018). While many countries reported modest expenditures on SSC, with only 16% of countries reporting expenditures of $1 million or more per year, several Southern partners have and continue to make major financial contributions to SSC (Figure 6.12).

The OIC countries are also actively taking part in SSC. Solidarity with the countries of the Global South, regulating the terms of trade between developed and developing countries, and economic assistance to least developed Islamic countries have always been on the agenda of OIC. Today, the OIC provides an important platform to reinforce the South-South cooperation, especially through linking countries that have development needs with those that have solutions, and through enabling sharing of technical or economic knowledge and skills necessary to facilitate the development. In this context, activities conducted by OIC organs and institutions became impressive over the years, and billions of dollars have been spent in support to different projects (look for example OIC, 2013 and OIC, 2018).

Some aspects of financial contributions of OIC countries in the South-South development partnership have already been evaluated in the context of ODA and remittance outflows. However, as Besharati A. Neissan (2019) pointed out, finances and technical cooperation are only one aspect of SSC and capturing the contribution of trade, investment, lines of credit and other forms of economic cooperation is also essential to measure real value of the South-South development cooperation.

International trade, at all levels, plays a vital and dynamic role in enhancing cooperation and is an important source to finance development. In 2018, of the total $19.5 trillion of global good exports, $5.1 trillion (26%) were exchanged between developing economies (South-South exports), $6.9 trillion (35%) between developed economies (North-North exports) whereas exports from developed to developing economies and in the opposite direction (North-South and South-North trade) accounted for $7.5 trillion (38%) (Figure 6.13).

Figure 6.13: Shares in Global Export of Goods (Share of exports within the Group, %)



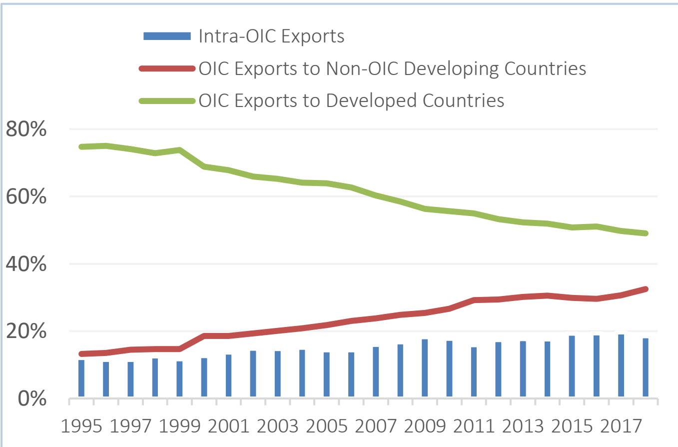
Source: UNCTADSTAT, "Merchandise: Intra-Trade and Extra-Trade of Country Groups by Product". *Notes:* North refers to developed economies (N=52; South to developing economies (N = 197).

Calculations indicate to an upward trend in the South-South trade measured from the export side, which compared with 1995 increased for 14 percentage points in 2018. In the same period, intra North-North exports have decreased for near 14 percentage points, while exports share between developed and developing economies remained almost unchanged (Figure 6.13).

As it is shown in Figure 6.14, in the period from 1995 to 2018, the OIC countries' aggregated export of goods to the developed countries decreased by 26 percentage points, and to non-OIC developing countries increased for 19 percentage points. The intra-OIC exports are also in an upward trend, which counted for 19.8% of total good exports of OIC countries in 2018.

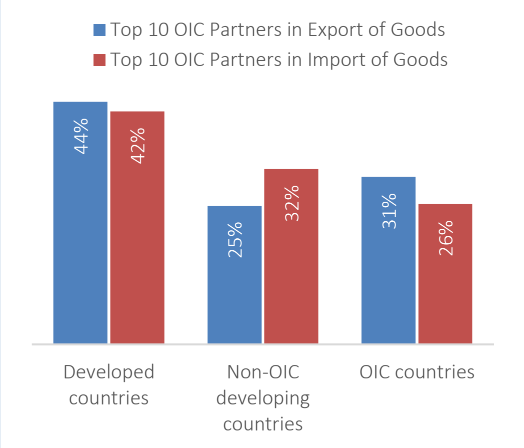
It is obvious from Figure 6.14 that, in terms of trade, the contribution of the OIC countries to the SSC is significant. However, developed countries continue to be biggest partners in the aggregated OIC trade. Moreover, analyses of the top ten 10 trade partners of OIC countries, classified according to country groups, shows that in 2018 on average in 44% of cases developed economies were top 10 export destinations of OIC countries.

Figure 6.14: OIC Merchandise Exports to Country Groups (Share of the Group within the OIC Exports)



Source: IMF, Directions of Trade Statistics (DOTS).
Note: Non-OIC Developing Countries: N = 114; Developed Countries: N = 39; OIC: N = 57.

Figure 6.15: Top 10 OIC Trade Partners Classified According to Country Groups (2018, %)



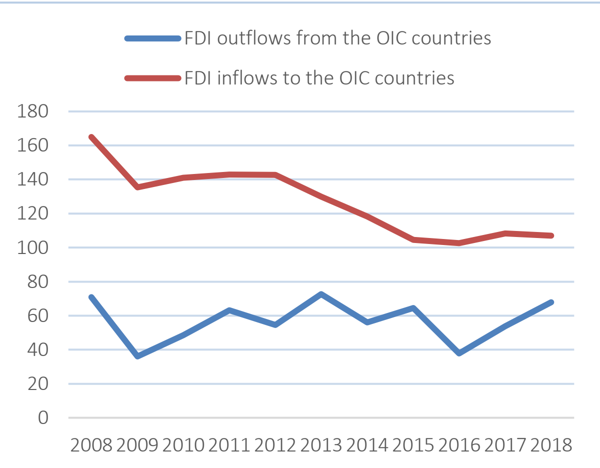
Source: IMF, Directions of Trade Statistics (DOTS). *Note:* Developing Countries: N = 193; Developed Countries: N = 39; OIC: N = 57.

In 2018, FDI outflows from the 43 OIC countries with available data reached near $68 billion, an increase of near 21% compared to 2017. If data for all OIC countries were available, obviously the aggregate number of OIC FDI outflows would be much higher.

What can be concluded from the existing data shown in Figure 6.16 is the fact that the gap between FDI inflows to the OIC countries and the FDI outflows from the OIC countries is becoming narrower. Apart from this, according to the UNCTAD estimates, total contribution of the 57 OIC countries in the global FDI stock in 2017 was $575.1 billion, which actually made up only 1.9% of the global FDI stock. 58% of FDI outflows from the OIC countries went to developed countries, 29% to OIC economies and 13% to non-OIC developing world. Top 20 recipients of the OIC outward FDI are presented at Figure 6.17.

As a conclusion to this chapter, it could be argued that the need for financing for sustainable development of OIC countries is increasing, but the actual volume of external resources is not increasing enough and is not yet compensated by a symmetric growth of domestic resources. Together with taking care on debt sustainability, the OIC governments should do their best to improve coordination between various national actors dealing with financing for sustainable development and ensure that country development strategies are better linked with available financing. In this regard, developing the Integrated National Financing Frameworks and focusing on channelling external financial resources to productive sectors and to poverty eradication would be essential. Otherwise, if external capital inflows instead associate with more public current spending, the sustainable development goals will not be achieved.

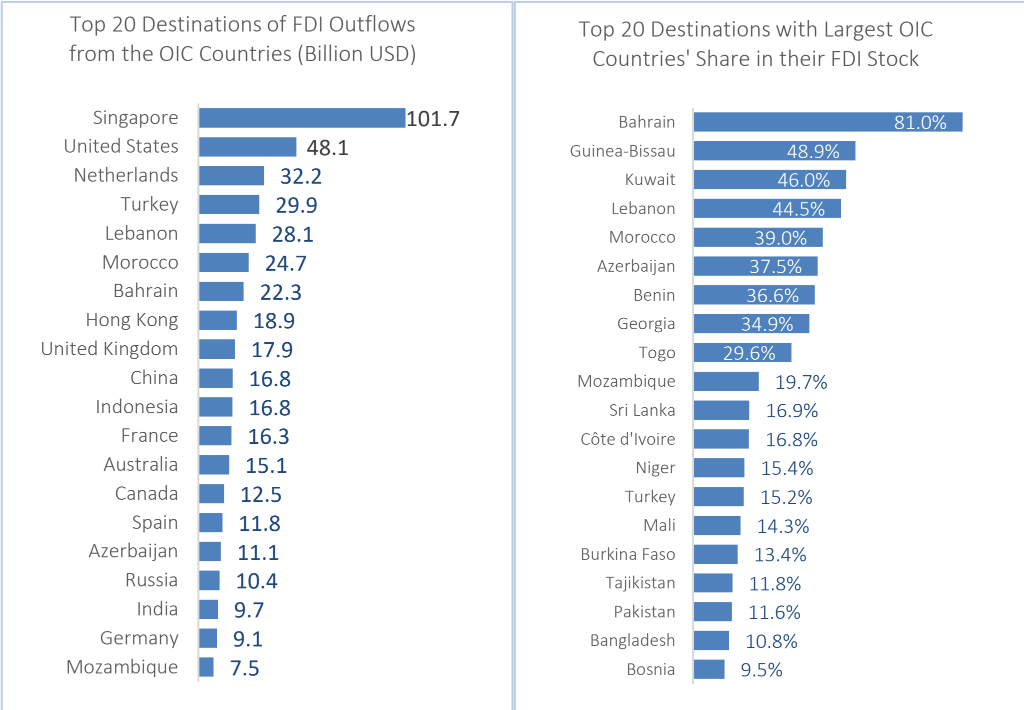
Figure 6.16: FDI Inward and Outward Flows



Source: UNCTADSTAT data. Note: FDI outflows (OIC: N= 43); FDI inflows (OIC: N=57)

On the other hand, accounting flows of technical, financial and economic

Figure 6.17: FDI Outflows from the OIC Countries



Source: UNCTADSTAT data (FDI outflows - OIC: N= 43)

transfers from the OIC countries to non-OIC developing countries and reporting on their impact for the achievement of sustainable development remains a challenge for many OIC governments. Measurement must expand beyond aid to all flows from the OIC countries, thus make more visible the OIC countries' support to other developing economies in their efforts to secure financing for development.

Chapter Seven

Alternative Financing for Development: The Role of Islamic Finance

Despite the essential role played by financial services in economic growth at global level, two billion people still lack access to regulated financial services and most of them are economically active. In addition, due to the low level of financial development, many developing countries including OIC member countries are experiencing severe infrastructure needs as about 1.1 billion people live without safe water, 1.6 billion people live without electricity, 2.4 billion people live without sanitation. According to UN, financial needs to implement SDG-relevant targets in developing countries range from US$ 3.3 trillion to US$ 4.5 trillion per year, representing an annual gap of US$ 2.5 trillion at current levels of investment which goes beyond the available conventional financial resources (UNCTAD, 2014). It is, therefore, important to explore alternative and complementary innovative financing mechanisms.

Islamic finance has strong potential in promoting both social and economic infrastructure development. While Islamic re-distributive instruments such as Zakat and Awqaf have great potential to support small sized social projects, sukuk (Islamic bonds) can successfully finance largescale infrastructure (water and sanitation projects, sustainable and affordable energy, transport, roads and shelter.

This chapter aims to measure the financial development gap and recognize the role of Islamic finance in supporting both economic and social development projects. Despite the existence of huge potentiality, little has been invested in this area. For example, Waqf can be established in many forms to support economic and social infrastructure development thus fulfil the society's needs adequately. 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.

Generally, there are three major constraints, which hinder the effectiveness of Islamic finance in line with the current and emerging financial needs of OIC member countries. They are (i) inadequate awareness about the role of Islamic finance particularly Islamic re-distributive instruments in addressing socioeconomic difficulties in many OIC member countries; (ii) insufficient widely accepted Shariah compliant products enhance financial cooperation among financial institutions to facilitate resource mobilization at regional and international levels; (iii) lack of innovative products in Islamic finance to support dynamic financial needs of OIC member countries on the journey of sustainable development.

At the country level, OIC member countries need to develop a supportive legal and regulatory framework and "proactive" policy targets on usage, access and quality of Islamic finance in line with dynamic needs of their real economies. At the OIC level, there must be a close collaboration among concerned development institutions to support the efforts of OIC member countries to explore the relevant policy, legal, regulatory and institutional interventions necessary to expand the part of Islamic financial institutions in creating new source of finance for socioeconomic development.

Specifically, they may consider (i) supporting the creation of a common platform to enhance dialogue among member countries with the aim of promoting knowledge and increasing awareness on the role of Islamic finance particularly Islamic re-distributive funds in socioeconomic infrastructure development; (ii) identifying successful case studies and good practices anywhere in the world and having exchange of visits and technical cooperation among OIC member countries in the form of reverse linkage initiative; and (iii) supporting the development of widely accepted Shariah compliant products to boost financial cooperation and facilitate resource mobilization at national, regional and international levels.

7.1 Introduction

Setting up an appropriate financing framework to support the achievement of the sustainable development goals (SDGs) is critical as it facilitates channeling the existing financial resources into the productive investment as well as maximizing the use of innovative financing sources in the journey of economic development. Despite changes in development paradigms in the last two decades, the promise to bring inclusive development remains unfulfilled. 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 (UNICEF, 2017). These figures show the fact that poor people have very little enjoyed the benefit of the development programs implemented over the last decade.

Achieving inclusive development is not an easy task. It requires a committed journey of reform of economic and financial systems, institutions and governments. It requires the participation of all stakeholders including the donor community, civil societies, philanthropists, and private sectors to provide sufficient technical and financial support. In terms of financing, the global development community emphasizes on using all sources of financial resources including domestic public, domestic private, international public and international private finance with the special focus on new and innovative sources of financing.

According to UN, financial needs to implement SDG-relevant targets in developing countries range from US$ 3.3 trillion to US$ 4.5 trillion per year, representing an annual gap of US$ 2.5 trillion at current levels of investment (UNCTAD, 2014). From all available reports on SDGs financing, it is very clear that there is a strong emphasis on using domestic revenues to finance the new goals. Specifically, the UN Report notes that "*domestic revenues are the most important source for the funds needed to invest in sustainable development, relieve poverty and deliver public services. Only through sufficient domestic resource mobilization can countries ensure fiscal reliance and promote sustainable growth*".

Against this backdrop, large amounts of investable resources, mostly private, are available in advanced and emerging economies. Developing countries particularly least developed countries (LDCs) are mostly less able to mobilize the required amount of finance to achieve the sustainable development and most likely they will remain heavily depend on the external development assistance and other sources. It is, therefore, important to explore alternative and complementary innovative financing mechanisms such as Islamic finance to stimulate economic activities towards inclusive economic development, financial and social stability, and comprehensive human development.

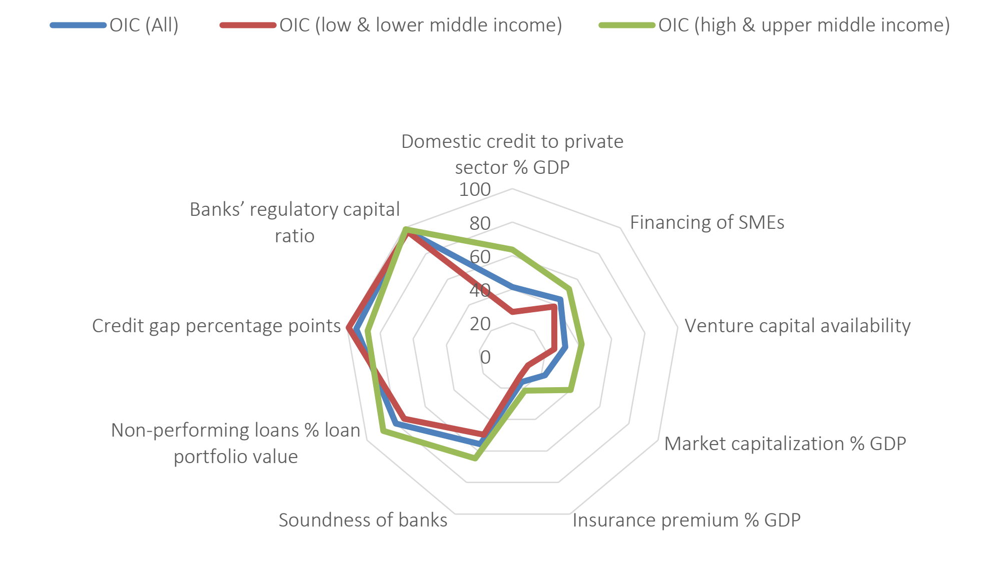
The main objective of this chapter is to recognize the role of Islamic finance in supporting sustainable and inclusive development. Specifically, it aims at introducing Islamic finance as an effective financial instrument to generate additional funding for development. It explores issues and challenges in financing development in OIC member countries and introduce the Islamic finance as a strong instrument in the journey of development. Section 7.1 explores the global investment gap in supporting development. Section 7.2 discusses the issues related to financing development and relevant challenges and priorities in OIC member countries as well as overviews the role of Islamic finance in supporting development. Finally, summary and conclusion are offered in Section 7.3.

7.2 Financing Development: Challenges and Opportunities

Figure 7.1 and Table 7.1 display some financial indicators of OIC member countries in two categories based on the income level, as per the World Bank classification[1]. The OIC low-income group, consisting of low and lower middle-income countries, generally have a weak performance in terms of resource mobilization mostly due to underdeveloped financial systems, relatively low savings, and limited access to private finance. Generally, OIC member countries need to develop well-functioning financial systems to facilitate the allocation of resources to the best uses as it could, in turn, have long-lasting effects on the rate of economic growth and the degree of development. They need to strengthen their financial capacities to accommodate new and innovative sources of financing with the special focus on:

Improving domestic public resource mobilization: Historically, public sector has been the principal source of financing for development. However, the current limited fiscal space due to economic

Figure 7.1: Main Elements of Financial System in OIC Countries



Source: Global Competitiveness Report, 2018.

Table 7.1: Selected Global Financing Indicators (2014-2018)

	I	II	III	IV	V
Domestic financing					
Budget revenue (% of GDP)	23.5	28.5	22.2	24.2	36.2
Budget expenditure (% of GDP)	28.0	35.4	25.8	26.4	39.0
Gross National Savings (% of GDP)	24.9	25.2	16.1	25.7	21.6
Total Investment (% of GDP)	27.3	28.6	24.3	24.4	21.6
Domestic credit provided by financial sector (% of GDP) *	50.2	68.0.	36.2.0	173.8	202.4
Market capitalization of listed companies (% of GDP) *	47.1	58.7	30.1	99.9	122.3
External financing					
Net ODA received (% of GNI) *	0.6	0.4	1.4	0.2	0.6
Total debt % GDP	37.2	44.6	38.9	na	103.7
International Reserve % total debt	77.8	360.7	39.1	na	na
FDI, net inflows (% of GDP) *	3.5	3.6	3.4	2.7	3.1
Remittances, received (% of GDP) *	5.1	3.0	6.9	0.7	0.3

I= OIC MCs; II= High and upper middle income OIC MCs; III= Low and lower middle income OIC MCs; IV=World; V= Advanced Countries. Note: * means (2014-2017)
Data sources: IMF, EIU, and the World Bank.

recession confines to effectively support inclusive development as the countries with high budget deficits will have more difficulty raising funds to finance expenditures, than those with lower deficits. It is, therefore, important for OIC member countries particularly low-income countries to keep their growing fiscal pressures under control particularly through countercyclical macroeconomic policies, improve macroeconomic management and fiscal consolidation. This will enable them to deal with the limited fiscal policy space to support development particularly in the event of economic downturn avoiding transmitting of budget deficit into pressure on foreign exchange reserves, mainly because foreign reserves are among the most reliable sources of financing budget deficits.

Narrowing financial gap is a key challenge: In OIC member countries as a group, national savings as a percentage of GDP stand at nearly 24.9% and total investment is about 27.3% of GDP over the last five years (2014-2018). This indicates that OIC member countries face resource deficits and the trend is likely to remain so due to the structural difficulties such as low productivity and international competitiveness. Given the fact that the gap will not be closed quickly as it requires dynamic economic reforms, OIC member countries particularly low-income countries will continue to rely on external resources in the short run to finance their development. In long run, they need to continue progress on key structural reforms, boosting human capital, strengthening the business environment, and improving the functioning of the labor market to enhance productivity towards more sophisticated economy with higher value-added manufacturing and services that generates higher incomes and jobs leading to more domestic savings.

In addition, governments may also create formal institutions such as pension funds, insurance companies, sovereign wealth funds, mutual funds and promoting diversification and other sound institutional investment principles to encourage people to save more appropriately in line with the needs of the economy. Nonetheless, domestic credit ratios for OIC member countries are markedly low, compared to the world average, and advanced countries. While the average ratio of domestic credit to GDP is about 50% for OIC MCs, the world average is 174%. Stock markets are at an early stage of development in most of the OIC member countries, especially the low-income MCs. In terms of market capitalization[2], the average ratio for OIC member countries stands at 47% of GDP over 2014-2017. Over the same period, the world average ratio is around 99.9%.

This indicates that the corporations in OIC member countries have limited access to capital, through capital markets, they need for innovation, value creation and growth. The 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.

External sources of financing can be further mobilized through enhanced policies and institutional framework. In many OIC member countries domestic resources will be insufficient and international finance such as ODA, FDI and remittances will continue to play a significant part, especially in low-income countries where they have lower capacity to raise domestic resources. In low-income OIC member countries, ODA plays critical role in financing development. Available data shows that the net ODA received by OIC member countries represented less than 1% of GNI on average over the last five years. This figure is little higher around 1.4% in OIC low-income group. With respect to FDI inflows, there is not a marked difference between the two OIC income groups. FDI stands at 3.5% in OIC member countries, 3.4% in the low-income group, and 3.6% of GDP in the high-income group over 2014-2017. To attract more FDI, OIC MCs needs to develop certain programs and incentives to direct FDI into the key economic sectors with higher spillover impact on the pace of economic growth and development.

Promoting new and innovative sources of finance is critical on the journey of development. 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 should play more critical role in supporting the development goals. At OIC level, there is a huge amount of Sovereign Wealth Funds (SWF) particularly in oil exporting countries to be mobilized to the low-income countries. However, the challenge is how to direct these funds towards productive sectors in these countries on a market base with the rational economic returns.

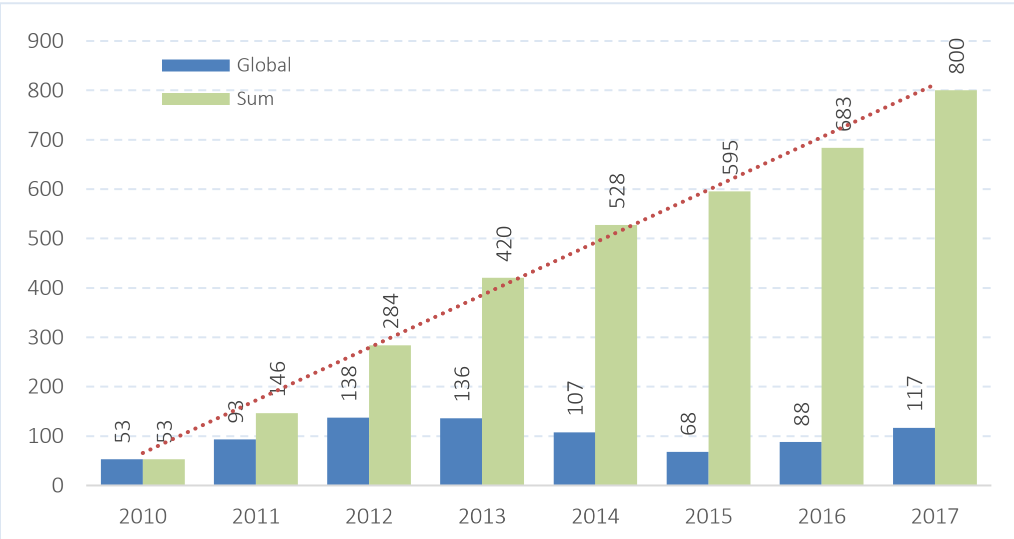
In addition, public private partnerships (PPPs) can be an effective model for financing large-scale investments. However, the success of effective implementation of PPP requires improved governance and stronger institutions to build new forms of public-private dialogue to strengthen the voice of the private sector in designing and developing national economic strategies.

Mainstreaming Islamic finance into the financial system will improve resources mobilization.[3] The existing financing patterns clearly indicate that the need for funding long-term investments is so huge and the existing resources of the governments, private sector, multilateral development banks, and other traditional development partners using traditional means remain insufficient. Islamic finance as an alternative finance has strong potential to bring additional funds to promote development. As a solidarity-based system, it covers Islamic banking, *takaful* (Islamic insurance), ijara (Islamic leasing), *sukuk* (Islamic bonds), Islamic welfare resources (*zakat*, *awqaf* etc.) which makes it unique in terms of its contribution to the financial and economic development.

In terms of financial stability, Islamic finance can (i) narrow the financial inclusion gap particularly in OIC low income countries[4]; (ii) provide support for SMEs as it is an asset-backed financing and; (iii) pose less systemic risk than conventional finance due to its risk-sharing features and prohibition of speculation (IMF 2015).

Generally, Islamic financial industry covers several areas with a number of viable modes of financing which could address the diverse financing requirements of OIC member countries. Its products are contract-based and may be classified into three broad categories: (i) debt-like financing structured as sales such as (*Murabahah*) or purchases, (*Salam* for basic products and *Istisna'* for manufactured products), and lease (*Ijārah*) with different options to buy; (ii) profit-and-loss-sharing with two modalities: (a) profit-sharing and loss-bearing (*Mudarabah*) whereby the financier (investor, bank) provides capital and the beneficiary provides labor and skills (profits are shared and (b) pure profit and loss sharing (*Musharakah*) where the two parties have equity-like financing of the project and would share profits and losses; and (iii) services, such as safe-keeping contracts (*Wadi'ah*) as for current deposits, or agency contracts *(Wakalah)*, which are also increasingly used for money market transactions.

Figure 7.2: Global Sukuk Issuance, 2010-2017 (Billion US$)



Source: IIFM

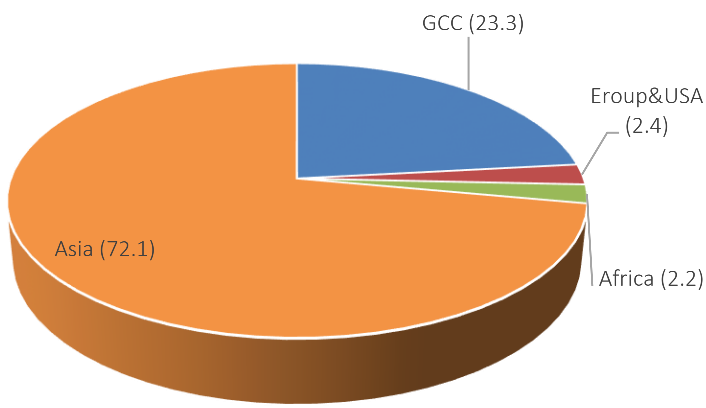
Given the above classification, there are two instruments that have strong potential in promoting socioeconomic development (IMF 2015). While Islamic redistributive instruments such as Zakat and Awqaf have great potential to support small size and social projects/programs, sukuk (Islamic bonds) can successfully finance largescale projects including water and sanitation projects, sustainable and affordable energy, transport, roads and shelter.

Sukuk and Economic Investment Gap: Market factors under existing conditions, together with systemic biases toward short-term debt and risk transfer mechanisms, substantially reduce the availability of funding for long-term financing to support inclusive development particularly in OIC low income countries. The ongoing financial gap, particularly in the long term, proposes the use of alternative finance including sukuk, which is based on risk sharing rather than risk transfer. As many OIC member countries struggle to develop sources of long-term financing, sukuk appear as a relevant means to help deepen the pool of capital to finance investments and support development.

Sukuk is one of the key flagship capital market instruments of the Islamic Industry and its returns are linked to returns and cash flows generated by the assets purchased or created through the proceeds of the sukuk (Salman A. 2019). As a financing tool, sukuk enables more diversified financing for both government and private sector as well as those small sized investors who follow Sharia principles strictly and do not approach traditional financial sector. It, therefore, has a great potential to mobilize financing and savings for a large segment of population that would not be otherwise served by conventional finance vehicles.

Sukuk is built around the two main asset classes (Islamic bonds and equities) and the investment horizon tied to the long-term nature of their liabilities in terms of risks and returns. The most common sukuk are *Sukuk al Murabahah (*a partial ownership in receivables; *Sukuk al-Ijara* (leasing transactions); *Istisna (*a contract for a future delivery of manufactured or constructed assets); *Sukuk al-Salam* (a forward contract, usually commodity); *Sukuk al-Mudharaba* (a partnership or profit-sharing agreement between capital providers and an entrepreneur*);* *Sukuk al-Musharaka* (a joint venture with an obligor); and *Sukuk al-Wakala* (a contract with an agency that makes investment decisions on behalf of the investors).

Figure 7.3: Global Sukuk Issuance (2010-2017, %)



Source: IIFM

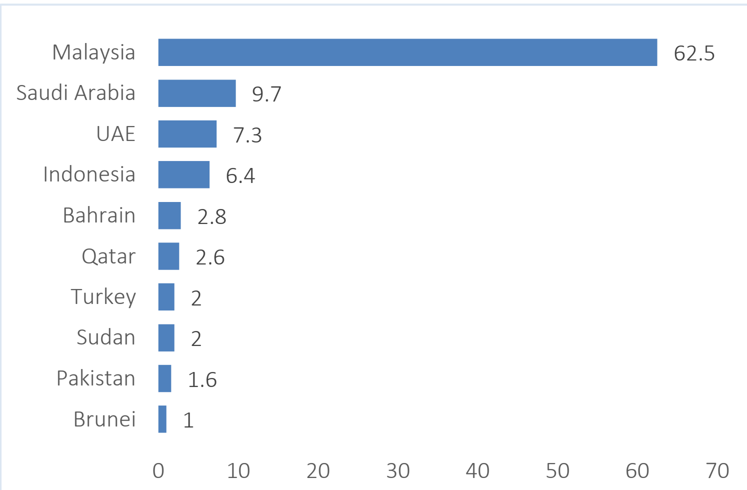
Available data show that the growth of global sukuk issuance has been impressive over the last decade as the accumulative global market for sukuk reached $800 billion in 2017 and forms about 38% of the global Islamic-compliant assets (Figure 7.3).[5] Despite the recent global financial tight and economic downturn, the growth of global sukuk issuance has been very impressive as it increased from US$ 88 billion in 2016 to US$ 116.7 billion in 2017, a remarkable growth of 32%. The increase was mainly due to sovereign sukuk issuances by Saudi Arabia coupled with steady issuances from Asia, GCC, Africa and other countries (Global Sukuk Market Outlook, 2018). Governments account for a larger share of sukuk issuances comparing with the corporate sukuk.

While the domestic sukuk issuance forms 68% of the total sukuk issuance in 2017, the share of the international sukuk is much lower around 32%. This figure indicates that the sukuk is mainly used for domestic resource mobilization while it has huge potential to facilitate regional and international resource mobilization particularly from rich OIC member countries to the low-income member countries.

In short, while countries with sufficient Islamic savings have great potential to mobilize domestic resources to the key economic sectors, many other OIC countries suffering from domestic savings could tap international funds for strategic investments, given the critical mass of Islamic investors all over the world. In terms of regional distribution, sukuk issuance is still concentrated in Asia accounting for 72.1% of total sukuk issuances and the GCC is the second largest destination of sukuk issuance with a market share of 23.3% (Figure 7.3). According to Moody's Investors Service (2018), the global sukuk market is expected to further expand as many countries are seriously engaged in efforts to develop their domestic sukuk markets by supporting a range of factors, including rising sovereign issuance, product innovation, increasing demand from retail banks and a narrowing of spreads over conventional bonds.[6]

As shown in Figure 7.4, Malaysia stands out for its dominating market share around 62.5% of total sukuk issuance during the period of 2001-2017. The GCC countries and a growing number of other OIC member countries have also initiated attempts to develop such markets. Saudi Arabia's share in sukuk issuance is about 10%, UAE (7.3%), Bahrain (2.8%) and, Qatar (2.6%) over the same period. Other than Malaysia and the GCC region, sukuk is expanding as a financing tool in markets such as Indonesia (6.4%), Pakistan (1.6%), Sudan (2%) and Turkey (2%).

Figure 7.4: Top 10 of Global Issuance (2010-2017, %)

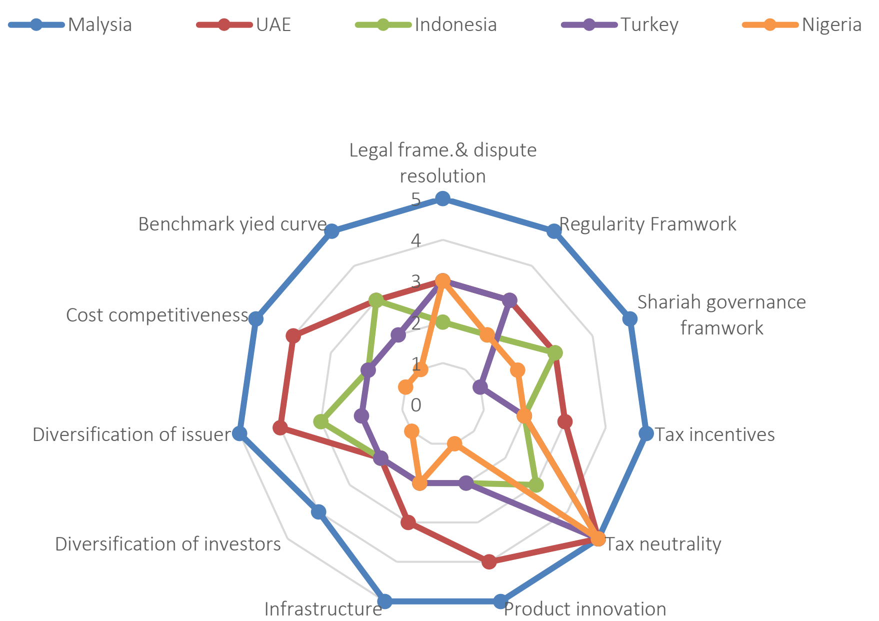


Source: IIFM

Despite its impressive growth, the development of sukuk markets has been impeded by several factors as shown in Figure 7.5. The key factors influencing the growth of Sukuk vary across the countries, depending on their macroeconomic conditions and the level of the financial development. The lack of standardization of sukuk structures and practices, issues surrounding investor protection, and product innovation as well as the limited diversification of investors are the key issues impeding the growth of sukuk markets. Lack of standardization arises from a religious background (sukuk face a challenge coming from different interpretations of Sharia principles). Lack of investors diversification means that the sukuk issuance is far from inclusiveness as it does not include large segments of the investors. A diversified investor base comprising segments of investors such as banks, mutual funds, insurance companies, pension funds, retail, and foreign investors which provides the foundation for sustainable demand and deepening of any type of sukuk market. A diversified group of investors reduces the risk of oligopolistic behavior in the sukuk markets.

On the country base, Malaysia has the best position in supporting the key driving factors of the growth of sukuk except the diversification of investor base, which remains a heavily regulated industry (COMCEC 2018). Indonesia has a moderate score in most factors, indicating a requirement for the further enhancement of each factor to boost its sukuk market. While tax incentives gained the lowest score in Indonesia, shariah governance framework is the biggest issue in Turkey. Turkey shows a keen interest in developing its sukuk market. Nonetheless, it still

Figure 7.5: Key Factors Influencing the Development of Sukuk Markets in OIC Countries



Source: RAM, ISRA

faces a number of challenges in the process. It ranks highest in tax neutrality while other factors require further development. Many countries have put more efforts to mainstream sukuk-based resource mobilization into their financial sectors, but a well-functioning financial market requires a supporting Islamic financial ecosystem.

Sukuk cannot stand alone but should and will grow together with Islamic financial institutions, such as Islamic banking, insurance, and funds. In this context, there are three major constraints hindering the effectiveness of Islamic finance: (i) inadequate awareness about the role of Islamic instruments in addressing socioeconomic difficulties in many OIC MCs; (ii) Insufficient widely accepted shariah compliant products to facilitate regional and international cooperation of Islamic financial institutions and; (iii) lack of innovative products to integrate the Islamic finance to inclusive development.

Islamic Redistributive Funds and Social Investment Gap: Islamic finance possesses models for solidarity-based financing with important features of social sustainability. Islamic principles for income redistribution require an annual donation (Zakat) to the needy as an essential obligation of all Muslims who possess a minimum level of wealth. In addition, it strongly encourages establishing endowments (awqaf) and its return is dedicated to the social objectives.

The Islamic redistributive instruments are how Islam attempt to address socioeconomic issues meet the needs of the marginalized segment of the society. These instruments have great potential to leverage the resources needed to achieve inclusive development; leave no one behind. From supply side, Islamic redistributive instruments are simple means to raise fund from a large number of people which is similar to the crowdfunding.

Generally, there are three types of crowdfunding namely, donation-based, equity-based, and loan-based. The first two types are in line with Islamic teachings, and the last one is not shariah compatible as it requires a fixed rate of return. Islamic Crowdfunding in the form of redistributive instruments has become popular as a successful alternative financing to address the dynamic financial needs of OIC member countries to support poverty alleviation programs and achieve wider social and financial inclusion particularly in lower-income countries.

Particularly, waqf funds have played an important role in the provision of social infrastructure such as education and health (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). 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 services[7]. 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 outcome[8]. Interestingly, all forms could significantly support economic and social infrastructure development thus fulfil the society's needs adequately. The instrument of awqaf is ideal for generating enough income-earning opportunities and ensuring a flow of resources to support the provision of both quantity and quality of social infrastructure (education, sanitation, health care) and other social goods.

The role of waqf has great significance 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. It is also worth to mention that they are not restricted to the Muslim community and can be shared beyond religious, cultural, racial and sectarian boundaries.

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. Similarly, Elgari (2004) proposes establishing a nonprofit financial intermediary to provide interest-free loans (qard hassan) to the poor who are mostly excluded from financial systems.

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 purposes.[9] For example, Kahf (1989) estimates the potential range of zakat revenue in different countries to be from 0.9% to a high of 7.5% of GDP based on various assumptions. According to the Islamic Development Bank (IsDB), Zakat contribution to finance sustainable development may exceed US$ 500 billion per year. This is about 20 times more than total global humanitarian aid (UNDP 2017). Therefore, 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 labor force. Similarly, Elgari (2004) proposes establishing a nonprofit financial intermediary to provide interest-free loans (qard hassan) to the poor who are mostly excluded from financial systems. Financial inclusion is a very vital factor in the process of inclusive development. Analysis of the usage and access of financial services by adults and firms shows that most of Muslim countries lag behind other emerging economies in both aspects with only 27% of financial inclusion. The issue of financial inclusion can also be addressed through other specific Islamic redistributive channels (zakat, sadaqa, and awqaf).

Given the significant potentiality of Islamic re-distributive instruments in financing social and economic infrastructure, many attempts have been made to revive them particularly waqf institutions in recent years. For example, a number of 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 redistributive in some other Islamic countries, there is a need to enhance Islamic redistributive mechanism by adopting an innovative approach to support many socioeconomic activities in the process of inclusive 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.

Using the results of other studies, there are three major constraints which hinder the effectiveness of Islamic re-distributive funds in line with the current and emerging financial needs of OIC member countries. They are (i) inadequate awareness about the role of Islamic-re-distributive funds in addressing socioeconomic difficulties in many OIC member countries; (ii) insufficient 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 these funds under certain programs such as, Poverty Entrepreneurship Schemes that can be used for alleviating poverty and creating employment opportunities.

In this context, creating a diverse range of financial services for using Islamic re-distributive resources through competition and innovation is essential. Central banks or monetary authorities 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.

7.3 Summary and Conclusion

Given the large scale of the needed financial resources to support development, the key question is how to design a broader suite of financing instruments to increase the amount of financing for inclusive 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 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.

As many OIC member countries struggle to develop sources of long-term financing, sukuk appear as a relevant means to help deepen the pool of capital to finance investments and support development. Sukuk is one of the key flagship capital market instruments of the Islamic Industry; its returns are linked to returns and cash flows generated by the assets purchased. As a financing tool, sukuk enable more diversified financing for both government and private sector as well as those small sized investors who follow Sharia principles strictly and do not approach traditional financial sector. Many OIC member countries working on mainstreaming sukuk-based resource mobilization into their financial sectors, but a well-functioning financial market requires a supporting Islamic financial ecosystem.

Sukuk cannot stand alone and needs to grow with Islamic financial institutions, such as Islamic banking, insurance, and funds. In this context, there are three major constraints hindering the effectiveness of Islamic finance: (i) inadequate awareness about the role of Islamic instruments in addressing socioeconomic difficulties in many OIC MCs; (ii) Insufficient widely accepted shariah compliant products to facilitate regional and international cooperation of Islamic financial institutions and; (iii) lack of innovative products to integrate the Islamic finance to inclusive development.

Islamic redistributive instruments such as zakat, waqf (endowment) and sadaqat (charity) have also played vital role in alleviating poverty and achieving wider social and financial inclusion. 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. Various studies show that the large pool of waqf assets in most Muslim countries are dormant and not being used for socio-economic development purposes properly.

The effective way of using zakat and waqf can enhance productive capacities of the society and provide interest-free loans (qard hassan) to the poor who are mostly excluded from financial systems. Analysis of the usage and access of financial services by adults and firms shows that most of Muslim countries lag behind other emerging economies in both aspects with only 27% of financial inclusion. Cost, religious belief, distance and documentation requirements are among important obstacles. The issue of financial inclusion can also be addressed through specific Islamic redistributive channels (zakat, sadaqa, qard al-hassan and awqaf).

A number of 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.

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 OIC member countries. They are (i) insufficient knowledge about the role of waqf in addressing socioeconomic difficulties; (ii) absence of appropriate shariah compliant products to integrate these Islamic redistributive institutions (i.e., waqf and Zakat) to inclusive development programs; (iii) inadequate innovative products to use waqf funds under certain programs such as, Poverty Entrepreneurship Schemes that can be used for creating employment opportunities and fostering inclusive development.

At the country level, governments need to play critical role in mobilizing resources generated by waqf endowments. Specifically, they should develop a supportive legal and regulatory framework 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. As the experience of Malaysia, Indonesia and Bangladesh shows, there is strong indication that waqf can be a viable alternative model for supporting social infrastructure (health and education). However, there are variations in these 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.

Endnotes for Chapter 7:

[1] Low-income economies are defined as those with a GNI per capita, calculated using the World Bank Atlas method, of $1,006 or less in 2017; middle-income economies are those with a GNI per capita of more than $1,006 but less than $12,235; high-income economies are those with a GNI per capita of $12,235 or more.

[2] Market capitalization ratio is one of the most common indicators used to measure the performance of the stock market. It measures the overall market size and the ability to mobilize capital and diversify risk on an economy-wide basis. A higher ratio means better capability of the stock market to mobilize capital.

[3] Mainstreaming Islamic finance into the financial system not only improve resource mobilization to support infrastructure needs of OIC member countries but also it improves financial inclusion. With greater financial inclusion, all segments of the society, including the low-income and rural residents will enable to undertake financial transactions, generate income, accumulate assets and protect themselves financially against unexpected adverse events, thereby enabling them to benefit from economic progress.

[4] According to COMCEC Financial Outlook, 2018, about 72% of population in OIC member countries do not access to financial services.

[5] The size of global Islamic-compliant assets is estimated at $2.1 trillion including banking assets, sukuk, and funds in 2017.

[6] Sukuk can be also considered as a form of Public-Private Partnership (PPP), allowing the public sector to concede the construction of public assets to the private sector.

[7] 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.

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

[9] 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.

Annex: Country Classifications

A. Major Country Groups used in the Report

OIC Countries (56+1)

Afghanistan
Albania
Algeria
Azerbaijan
Bahrain
Bangladesh
Benin
Brunei Darussalam
Burkina Faso
Cameroon
Chad
Comoros
Cote d'Ivoire
Djibouti
Egypt
Gabon
Gambia
Guinea
Guinea-Bissau
Guyana
Indonesia
Iran
Iraq
Jordan
Kazakhstan
Kuwait
Kyrgyz Republic
Lebanon
Libya
Malaysia
Maldives
Mali
Mauritania
Morocco
Mozambique
Niger
Nigeria
Oman
Pakistan
Palestine
Qatar
Saudi Arabia
Senegal
Sierra Leone
Somalia
Sudan
Suriname
(Syria)
Tajikistan
Togo
Tunisia
Turkey
Turkmenistan
Uganda
United Arab Emirates
Uzbekistan
Yemen

Non-OIC Developing Countries (98)

Angola
Antigua and Barbuda
Argentina
Armenia
Bahamas
Barbados
Belarus
Belize
Bhutan
Bolivia
Bosnia and Herzegovina
Botswana
Brazil
Bulgaria
Burundi
Cabo Verde
Cambodia
Central African Rp.
Chile
China
Colombia
Dem. Rep. of the Congo
Rep. of Congo
Costa Rica
Croatia
Dominica
Dominican Rep.
Ecuador
El Salvador
Equatorial Guinea
Eritrea
Ethiopia
Fiji

Georgia	Marshall Islands	Philippines	Swaziland
Ghana	Mauritius	Poland	Tanzania
Grenada	Mexico	Romania	Thailand
Guatemala	Micronesia	Russia	Timor-Leste
Haiti	Moldova	Rwanda	Tonga
Honduras	Mongolia	Samoa	Trinidad and Tobago
Hungary	Montenegro	São Tomé and Príncipe	Tuvalu
India	Myanmar	Serbia	Ukraine
Jamaica	Namibia	Seychelles	Uruguay
Kenya	Nauru	Solomon Islands	Vanuatu
Kiribati	Nepal	South Africa	Venezuela
Kosovo	Nicaragua	South Sudan	Vietnam
Lao P.D.R.	Palau	Sri Lanka	Zambia
Lesotho	Panama	St. Kitts and Nevis	Zimbabwe
Liberia	Papua New Guinea	St. Lucia	
FYR Macedonia	Paraguay	St. Vincent and the Grenadines	
Madagascar	Peru		
Malawi			

Developed Countries* (39):

Australia	Germany	Lithuania	Singapore
Austria	Greece	Luxembourg	Slovak Rep.
Belgium	Hong Kong	Macao SAR	Slovenia
Canada	Iceland	Malta	Spain
Cyprus	Ireland	Netherlands	Sweden
Czech Rep.	Israel	New Zealand	Switzerland
Denmark	Italy	Norway	Taiwan
Estonia	Japan	Portugal	United Kingdom
Finland	Rep. of Korea	Puerto Rico	United States
France	Latvia	San Marino	

(Based on the list of advanced countries classified by the IMF. Last update 22 April 2019.)*

B. Geographical Classification of OIC Countries

(Based on World Bank Classification)

Sub-Saharan Africa (21): OIC-SSA

Benin	Gabon	Mozambique	Sudan
Burkina Faso	Gambia	Niger	Togo
Cameroon	Guinea	Nigeria	Uganda
Chad	Guinea-Bissau	Senegal	
Comoros	Mali	Sierra Leone	
Côte d'Ivoire	Mauritania	Somalia	

Middle East and North Africa (18+1): OIC-MENA

Algeria	Iran	Morocco	(Syria)
Bahrain	Jordan	Oman	Tunisia
Djibouti	Kuwait	Palestine	United Arab Emirates
Egypt	Lebanon	Qatar	Yemen
Iraq	Libya	Saudi Arabia	

East and South Asia and Latin America (9): OIC-ESALA

Afghanistan***	Brunei Darussalam*	Indonesia*	Pakistan***
Bangladesh***	Guyana**	Malaysia*	Suriname**
		Maldives***	

ESALA is combination of countries in (*) East Asia and Pacific, (**) Latin America and Caribbean, and (***) South Asia.

Europe and Central Asia (8): OIC-ECA

Albania	Kazakhstan	Tajikistan	Turkmenistan
Azerbaijan	Kyrgyzstan	Turkey	Uzbekistan

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