OIC ECONOMIC OUTLOOK 2020

Trade and Integration Challenges amid Rising Uncertainties

SESRIC

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Acronyms

ADB	Asian Development Bank
CEE	Central and Eastern Europe
COMESA	Common Market for Eastern and Southern Africa
DOTS	Direction of Trade Statistics
EC	European Commission
ECB	European Central 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
GTA	Global Trade Alert
GVC	Global Value Chain
HIPC	Heavily Indebted Poor Countries
ICT	Information and Communication Technology
IFS	International Financial Statistics
ILO	International Labour Organisation
IMF	International Monetary Fund
IPR	Intellectual Property Rights
IsDB	Islamic Development Bank
ISIC	International Standard Industrial Classification
ITC	International Trade Centre
LAC	Latin America and the Caribbean
LDCs	Least Developed Countries
MENA	Middle East and North Africa
MVA	Manufacturing Value Added
ODA	Official Development Assistance

OECD	Organisation for Economic Cooperation and Development
OIC	Organisation of Islamic Cooperation
PPE	Personal protective equipment
PPP	Purchasing Power Parity
R&D	Research and Development
RER	Real Exchange Rate
RTA	Regional Trade Agreement
RVCs	Regional Value Chains
SDG	Sustainable Development Goal
SME	Small and Medium-sized Enterprise
SSA	Sub-Saharan Africa
STI	Science, Technology and Innovation
TOT	Terms of Trade
TPP	Trans-Pacific Partnership
TPS-OIC	Trade Preferential System of the OIC
TTIP	Transatlantic Trade and Investment Partnership
UAE	United Arab Emirates
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNIDO	United Nations Industrial Development Organization
UNSD	United Nations Statistics Division
USA	United States of America
US$	United States Dollar
WB	World Bank
WDI	World Development Indicators
WEF	World Economic Forum
WEO	World Economic Outlook
WTO	World Trade Organization

Foreword

It is with great pleasure that I present to you the 2020 edition of the SESRIC`s flagship report "*OIC Economic Outlook 2020*", which analyses and presents the recent economic developments and short-term projections in the world economy and their implications on the economies of the OIC member countries. The report is the only annual publication on the economies of the group of OIC countries that provides a wide-range of useful comparative statistics and insights, which help readers to understand the major economic trends and development challenges in OIC countries.

The 2020 edition of the OIC Economic Outlook report is prepared at a time when the level of uncertainty in the global economy is at its peak due to rising protectionism and the emergence of the COVID-19 pandemic. While the global economy was already in shambles due to lower demand and heightening trade tensions, the COVID-19 pandemic has triggered one of the worst economic recessions in modern history by causing an abrupt halt of all economic activities and widespread disruptions in global value chains. Consequently, the global economy is expected to contract by 4.9% in 2020 with an expected negative growth rate of 8% in the developed economies. The contraction in developing world, where the group of OIC countries is a part of, is expected to be at a more moderate level of 3%. The world economic growth is expected to stabilize in 2021 with the hope that either a vaccine is made or herd immunity is achieved to get back to normalization.

As is the case in other parts of the world, the COVID-19 pandemic constitutes an unprecedented challenge with severe economic and social consequences for many OIC member countries. The situation is particularly alarming given the continuous weakening of the economic performance of many OIC countries in the last few years. As the report highlights, it is the third consecutive year where the average economic performance of the OIC countries, with a growth rate of 2.4% in 2019, remained below the world average. In 2020, the OIC economies are expected to contract and record a negative growth rate of 2.0%, which means with a lower contraction rate than the world average contraction of 4.9%. Overall, 35 OIC countries are expected to experience negative growth rates in 2020. The average unemployment rate in OIC countries (6.7%) continued to remain above the world average of 5.4%, with particularly high unemployment rates observed among the youth population (14.5%) in 2019. Amid the ongoing global economic recession, the total number of unemployed persons in OIC countries would increase from its previously estimated level of 47.7 million to 53.3 million in 2020.

One of the main messages of this report is that the OIC countries should exert more efforts to create an enabling environment to promote production and trade and to attract more foreign investment. This is particularly important in the face of a possible transformation of global value

chains due to rising protectionist trade policies and the spread of the pandemic. In 2019, only around 7% of the global foreign direct investment (FDI) inflows ended up in the OIC countries. On the other hand, OIC countries have witnessed a slowdown in trade activities as their exports declined by 4.4% in 2019, which is higher decline than the fall in global exports (3.0%) in the same year. Moreover, OIC countries accounted for only 10% of global intermediate goods exports, reflecting their lower participation in the global supply chains.

The report also underlines challenges and opportunities concerning the rise of protectionism and economic nationalism, which is expected to affect significantly the current functioning of value chains across the world. In order to benefit from the reorientation of supply chains, the OIC countries need to reduce trade costs, improve technological capacities and increase their preparedness to meet supply chain risks. Existing capacities in many OIC countries are not conducive enough to attract great investments during the post-pandemic period. However, their geographical proximity to major economic hubs could put them in an advantageous position. Right policies during the pandemic period may also provide additional advantages in attracting foreign companies to establish new value chains.

The *OIC Economic Outlook 2020* is a result of a substantial investment in time, effort and dedication by the SESRIC Research Team. 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

Executive Summary

Recent Economic Developments in the World

World Economic Trends and Prospects

Growth

World economy is slowing down and substantial geopolitical and health-related risks are growing. After an acceleration in 2016-2017, growth rates slowed down in both developed and developing countries, causing a decrease in the world real GDP growth rate from 3.6% in 2018 to 2.9% in 2019. The COVID-19 pandemic has overshadowed the economic prospects in 2020. All leading international development institutions have forecasted substantial economic downturn in 2020 and predicted for a very slow and gradual recovery in 2021. However, uncertainties in the world economy are on the rise. For instance, a likely second wave of the COVID-19 pandemic could alter the global recovery expectations that may lead to tremendous additional pressure on both developing and developed countries in 2020 and 2021.

Unemployment

New data provided by the International Labour Organization (ILO) for 2019 points out that the unemployment rate in the world remained at 5.4% as in 2018. However, the number of unemployed people is estimated to increase from 185.8 million in 2018 to 187.7 million in 2019 worldwide. Once the impacts of the pandemic are counted in 2020, the ILO foresees that it will bring a devastating toll on labour market outcomes. Based on different scenarios, the ILO estimates for 2020 indicate an additional rise in the global unemployment of between 5.3 million ("low" scenario) and 24.7 million ("high" scenario) from a base level of 187.7 million in 2019 such as due to the economic closures and containment measures.

Trade

Trade policy remains to be the biggest risk for global economic growth. The growth in the global trade volume of exports and imports of goods and services decreased from 5.9% in 2017 to 4% in 2018. And the negative trend in trade growth continued in 2019 that was measured at 0.8%. In particular, slowdown in the global economy, Brexit discussions in the Europe and the US-China trade tension were among the key reasons behind this picture in 2019. The global trade growth is expected to contract by 13.4% in 2020 amid the spread of the coronavirus. Both the volumes of exports and imports are expected to decline substantially as the containment measures and lockdowns affect both the demand and supply in a negative way.

Investments

The slight recovery in investment share in GDP continued in 2019, reaching 22% for developed countries and 32.7% for developing ones. Projections made before the pandemic were optimistic for 2020 and 2021. Nevertheless, the pandemic is expected to affect investments in a negative way such as due to an increase in spending on the health sector, reductions in tax revenue and growing uncertainties. The global inward FDI flows fell by 12% in 2018, to 1.49 trillion dollars - from 1.7 trillion dollars in 2017. In 2019, it went up again and reached 1.5 trillion dollars. In particular, developed countries benefited more from FDI inflows in 2019 that increased by 5% and reached 800 billion dollars. The new estimates show that global FDI flows are forecast to decrease by up to 40% in 2020 due to the pandemic. This would bring FDI below US$ 1 trillion for the first time since 2005.

Financial Conditions

In the period from December 2018 to December 2019, global financial conditions were relatively stable for the global economic activities. Nevertheless, the pandemic emerged as an unexpected game changer at the beginning of 2020. The containment measures and sudden stop in economic activities not only affected the economic outlook but also deteriorated the expectations and fuelled uncertainty. The tightening conditions in 2020 continue to affect both developed and developing countries alike. Falling equity prices and widening corporate spreads were only marginally offset by declines in interest rates.

Current Account Balance

Current account balances remained relatively stable in developed countries in 2018 and 2019 at the level of 0.7% of GDP. Developing countries saw an improvement where a 0.1% deficit in 2018 turned into a 0.1% surplus in 2019. The pandemic has changed the outlook for 2020 and 2021 dramatically. In 2020, developing countries are expected to generate a current account deficit of 0.9% in 2020 such as due to disruptions in the global value chains, a sudden stop in tourism activities and reduced demand in developed countries. Fall in oil prices due to reduced demand is expected to hit oil exporting countries' current account balances remarkably in 2020.

Fiscal Balance

In developed countries, the average fiscal deficit increased from 2.7% in 2018 to 3.3% in 2019. It is expected to go up to 16.6% in 2020 and is projected to be 8.3% in 2021. In developing countries, the deficit was also on the rise in 2018 and 2019. With the start of the pandemic in 2020, it is expected that the deficit will represent a share of 10.6% in GDP in developing countries. In 2021, this share is projected to go back to 8.5%.

Inflation

The slowdown in the global economy is set to reduce the inflation pressure in major commodities in developed and developing countries. The global inflation rate in 2018 was around 3.6% and stayed almost at the same level in 2019. In 2020, a slight decrease in commodity prices, particularly in energy prices, is projected to further push down the global inflation in 2020.

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$ 17.6 trillion in 2015 to US$ 21.5 trillion in 2019 measured in PPP. As a group, the OIC countries produced 15.1% of the world total output and 25.4% of that of the developing countries in 2019. 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 2019, the top 10 OIC countries in terms of the volume of GDP produced 74.2% of the total output of OIC group.

Growth

The GDP growth of OIC countries has slowed down to 2.4% in real terms in 2019, as compared to 3.0% in 2018. The economies of the OIC countries are expected to contract by more than 2% as a result of the pandemic. Lower income OIC countries have been growing at a lower rate than the OIC average during 2015-2017, implying a widening gap between rich and poor OIC countries. They attained, however, slightly higher growth rates than the OIC average in 2018-2019. At the individual country level, Libya, with a growth rate of 9.9% in 2019, was the fastest growing economy in the group of OIC countries. In total, 33 OIC countries recorded a growth rate higher than the world average of 2.9% in 2019.

Production by Sectors

Although the agriculture sector accounts for an important share of employment in the economy, its share in total GDP is generally low due to lower productivity in the sector. However, it remains an important sector for OIC countries, which accounts for 10.7% of the total economic activity. In terms of the average shares of the value-added of the four major sectors in the GDP of OIC countries in 2018, the services sector got the largest share with 53.8%. The share of the manufacturing sector, which has greater potential to promote productivity and competitiveness, increased from 14.3% in 2014 to 14.6% in 2018.

GDP by Major Expenditure Items

The analysis of global GDP by major expenditure items reveals that the share of final consumption (by both household and government) continued to be the highest in the total GDP over the years. In 2018, household consumption in OIC countries accounted for the lion share of GDP (57.7%) followed by investment (27.5%) and general government expenditure (13.7%). The share of net exports in total world GDP was negligible.

Income and Poverty

Average per capita income in OIC countries increased from US$ 8,785 in 2010 to US$ 10,275 in 2019, corresponding to a 17.0% increase in total. During the same period, non-OIC developing countries attained higher growth rates (41.1%) and exceeded the average per capita income level of OIC countries to reach US$ 11,796 in 2019. Average per capita income growth rate in OIC countries was recorded at 2.2% during 2010-2015, which fell to 1.3% during 2016-2019. Among the OIC countries, Qatar registered

the highest GDP per capita in 2019, which was 17.5 times higher than the average of the OIC countries as a group. Within the group of OIC, 13 countries have poverty rates over 30%.

Unemployment

OIC countries continue to record significantly higher average unemployment rates compared to the world, developed countries and non-OIC developing countries. Since 2014, the total unemployment rate in OIC countries has been on the rise to reach 6.7% in 2019 as compared to 5.9% in 2014. Unemployment rates for the youth labour force are typically higher than the rates for adult in all country groups. Youth unemployment in OIC countries has steadily increased from its level of 12.9% in 2014 to 14.5% in 2019 and reached the highest level as compared to other country groups, while it remains at 10.5% in developed countries and stays at 13.8% 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 1.7% during 2010-2019. As of 2019, average labour productivity in OIC countries was measured as US$ 28,411, as measured in constant international prices based on purchasing power parity (PPP). Output per worker in the developed countries is estimated at US$ 95,523 in 2019, which indicates that an average worker in OIC countries produces only 29.7% of the output produced by an average worker in the developed countries.

Inflation

With the slowdown in global economic activities, inflation rates across the world remain 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 5.8% in 2016 to 9.1% in 2018. However, the rise in average consumer prices slowed down to reach 8.1% in 2019. On aggregate, consumer prices have increased by 51.0% in OIC countries, 25.7% in non-OIC developing countries and 7.8% in developed countries during 2013-2019.

Fiscal Balance

Over the last several years, the OIC member countries witnessed a sharp deterioration in their fiscal balance. High dependence on commodity and primary goods exports makes many OIC countries particularly vulnerable to price fluctuations. There were ten OIC countries with a fiscal balance surplus in 2018. This number decreased to eight in 2019.

Trade and Finance

Merchandise Trade

In line with the global trend, OIC countries have witnessed a slowdown in their total exports to the world and their aggregate exports decreased to US$ 1.79 trillion in 2019. The share of OIC countries in total exports of developing countries fell to 23.8% in 2019, compared to 24.2% in 2018. OIC countries' collective share in total world merchandise exports also slightly decreased to 9.8% in 2019 compared to 9.9% in 2018. In 2019, the top 5 largest OIC exporters accounted for 59.5% of total merchandise exports of all member countries. Similarly, total merchandise imports of OIC countries decreased from US$ 1.78 trillion in 2018 to US$ 1.74 trillion in 2019. The share of OIC

countries in global merchandise imports remained unchanged at 9.2% in 2019. The top 5 OIC importers accounted for 52.1% of total OIC merchandise imports in 2019.

Services Trade

In 2019, world services exports totalled US$ 6.1 trillion. OIC countries exported US$ 427 billion worth of services, which is the highest number recorded by the group of OIC countries. On the other hand, the total services imports of OIC group reached US$ 525 billion in the same year and, hence, the OIC countries as a group continued to remain a net importer of services. As of 2019, OIC countries as a group accounted for 6.9% of global services exports and 9.0% of global services imports. The United Arab Emirates, with US$ 73.5 billion exports and 17.2% share in total OIC services exports, was the top OIC exporter in services in 2019.

Trade Balance

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$ 87 billion. This amount fell to US$ 53 billion in 2019. On the other hand, OIC countries remained continuously a net importer of services over the period under consideration. Altogether, OIC countries recorded only US$ 45 billion trade deficit in 2019, which was recorded at US$ 95 billion in 2018.

Intra-OIC Merchandise Trade

Intra-OIC export flows have been steadily increasing since 2016 from a level of US$ 254 billion to reach to US$ 331 billion in 2019. Over the last three years, intra-OIC exports increased by more than 30%, which is a significant achievement. Yet, it remains below the total values recorded in 2012. The intra-OIC trade flows stuck between 18% and 19% during 2012-2019. Despite the sharp fall to 18.1% in 2018, OIC countries managed to raise the intra-OIC trade flows back to 19% level in 2019. However, the sluggish growth in intra-OIC trade flows reduces the prospects for achieving the target of 25%.

FDI Flows and Stocks

FDI flows to OIC countries generally remained lower than their potential. After reaching US$ 142 billion in 2012, the total US$ value of FDI inflows to OIC member countries followed a negative pattern until 2016 to reach only US$ 103.6 billion. In 2017, the total value of FDI flows to OIC countries increased for the first time since 2011, which was recorded at US$ 109.3 billion, corresponding to 5.5% increase compared to the previous year. It slightly increased in 2018 to reach US$ 110.7 billion. In 2019, FDI inflows to OIC countries decreased by 3.6% and fell to US$ 106.7 billion.

Financial Sector Development, External Debt and Reserves

The level of financial sector development in OIC countries remained shallow. The average volume of broad money relative to the GDP of OIC countries was recorded at 63.9% in 2019, compared to as much as 135% in non-OIC developing countries and 127% of the world average. The total external debt stock of OIC countries continued to increase, which reached US$ 1.68 trillion in 2018. In terms of the maturity structure of the external debt, short-term debts accounted for 15.2% of total external debts of OIC countries, while 30.9% of total debts of non-OIC developing countries were short-term debts. Turkey remained the most indebted OIC member country in 2018 with over US$ 445 billion debt. World total monetary reserves, including gold, reached US$ 13.1 trillion in 2019,

of which US$ 1.6 trillion are owned by OIC countries. The share of OIC countries in world total reserves declined from 14.3% in 2015 to 12.4% in 2019.

ODA and Remittances

In 2018, net ODA flows from all donors to developing countries reached US$ 165.8 billion. While more than 33% of ODA flows remain unexplained (no information available to which countries they flowed), out of the remaining US$ 108.5 billion ODA flows, 57.7% flowed to OIC countries in 2018. The top five countries received 44.1% of total ODA flows to OIC group whereas the top ten received 61.5% of them. The inflows of personal remittances to OIC member countries increased from US$ 142.6 billion in 2014 to US$ 163.3 billion in 2019.

TRADE AND INTEGRATION CHALLENGES AMID RISING UNCERTAINTIES

The Rise of Protectionism and Implications on Trade

Over the last several decades, tariffs and other trade barriers declined substantially as the liberal economic thinking increasingly dominated economic policymaking. Globally applied average tariff rate declined from 8.6% in 1994 to 2.6% in 2017, reflecting the greater economic integration and connectivity among the economies. However, recent years witnessed a growing appetite for more protectionism driven by unilateral motivations. In addition to import tariffs, the use of regulatory measures and non-tariff barriers has been increasing since 2018, leading to an overall surge in trade distortions.

The adoption of protectionist measures has sparked fears of a trade war and has weighed on trade flows and investment decisions due to deteriorating market sentiment and global risk appetite. Global supply chains become under risk due to the rising risk of trade wars. Trade-related uncertainty led businesses to postpone their investment decisions and adopt a wait-and-see approach before judging on the need for a potential reshuffling of supply chains. In a world characterized by complex global value chains, when tariffs are applied to intermediate goods, trade costs accumulate as goods cross borders several times.

OIC countries may be over-proportionally affected by protectionist policies implemented by major economies. Existing policies already indicate an unfavourable stance towards the OIC countries. During the period 2009-2018, 323,200 trade measures were implemented across the world in bilateral terms. Only 12% of them were initiated by the OIC countries, while 48% were implemented by developed countries and 40% by non-OIC developing countries. Despite the major economic power that the developed countries have, it is remarkable to observe that they are inclined to get richer by “beggar-thy-neighbour” policies.

With the emergence of the novel coronavirus (the COVID-19) outbreak that threatens the health of millions of people, the world economy entered into a new crisis. Not every nation produces sufficient medical supplies needed to tackle the pandemic. Most developing countries rely heavily on imports to meet their needs of medical supplies essential. There is also a strong global interdependence in the production of COVID19-related medical products. Policies such as export restrictions are harmful and can raise the prices and delay the production of these essential products. In this connection, there is a clear need to keep trade flowing, both to ensure the supply of essential products and to send a signal

of confidence for the global economy. It is also vital to invest in capacities to achieve self-reliance in critical and strategic products amid rising protectionist and unilateral policies.

Impacts of the COVID-19 on Global and Regional Value Chains and Implications on OIC Countries

It was the stability of the global trading system that encouraged the firms to set up global networks of production and placing different stages of production in different countries. But this situation has changed and uncertainties become more prevalent. The combination of trade-policy shocks and the COVID-19 pandemic generated great uncertainties on the future of global value chains and sparked a rethinking on the sustainability of value chains in long distances. There are stronger arguments pointing that globalization will be rolled back with national security arguments used to justify protectionism.

In this connection, it is imperative for OIC countries to take necessary measures to adapt to the new normal, where economic nationalism and protectionism are likely to become a norm in economic policymaking. Rising economic nationalism may harm some OIC countries that are already well integrated into global value chains, but provide some opportunities as well. In order to benefit from the reorientation of supply chains, OIC countries need to reduce trade costs, improve technological capacities and increase their preparedness to meet supply chain risks.

Existing capacities in many OIC countries are not conducive enough to attract great investments during the post-pandemic period. Yet, their geographical proximity to major economic hubs may put them in an advantageous position. Right policies during the pandemic period may provide additional advantages in attracting foreign companies to establish new value chains. Considering the rising protectionism and growing importance of regionalism, facilitating the regional movement of goods and people during the post-pandemic period may be particularly important in attracting multinationals.

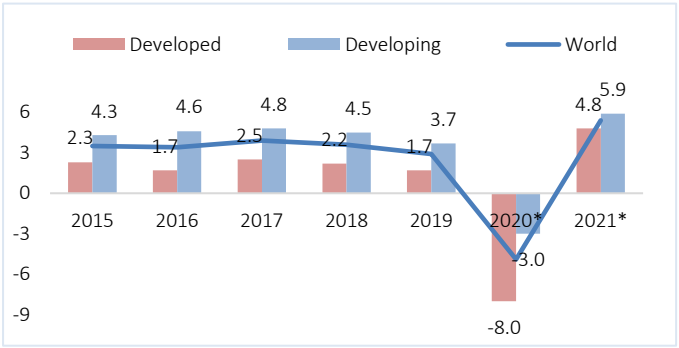
PART I: RECENT DEVELOPMENTS IN THE WORLD ECONOMY

CHAPTER ONE

World Economic Trends and Prospects

World economy is slowing down and substantial geopolitical and health-related risks are growing. A synchronized global recovery that existed after 2016 lost its momentum. The world real GDP growth rate went down from 3.6% in 2018 to 2.9% in 2019. The deceleration of growth has become more visible in 2019 particularly due to increasing geopolitical risks, Brexit and uncertainty in Europe, and trade wars in both developed and developing countries.

Figure 1.1: Real GDP Growth (Per cent)



Source: IMF, World Economic Outlook Update, June 2020.
Notes: Values with* are projections (World: N = 194; Developed: N = 39; Developing: N = 155)

The year 2020 started with bad news for the world. The COVID-19 pandemic is inflicting high and rising human costs worldwide, and the necessary protection and containment measures are severely affecting economic activity from both the demand and supply side in 2020. Accordingly, the International Monetary Fund (IMF) has downsized its projections on the rate of global GDP growth for 2020 and 2021. The global economy will see a contraction of 4.9% in 2020, but it will be on track to stabilize towards 2021 with the hope that a vaccination or herd immunity will help to curb the impacts of the pandemic on economies (Figure 1.1). A wide range of fiscal stimulus packages and tremendous volumes of injection of liquidity by developed and developing countries are expected to contribute to the resumption of economic activities worldwide. Nevertheless, at the individual country level, to what extent those interventions are channelled to more productive sectors could determine the level of their economic effectiveness. The strength of the national health systems is another factor that affects the resilience of economies worldwide during the pandemic and a determinant for the recovery period (IMF, 2020a; SESRIC, 2020).

Figure 1.2: World Real GDP Growth Projections (%)

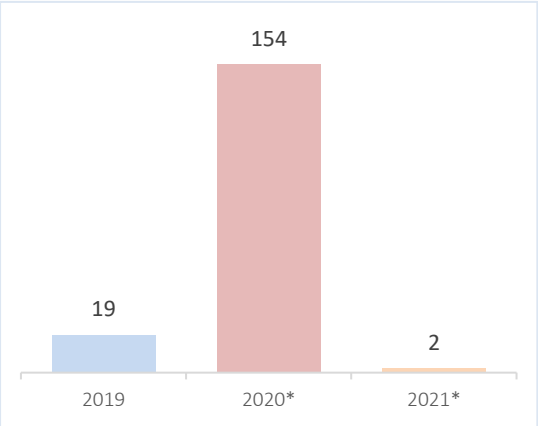
	2020	2021
IMF	-4.9	5.4
World Bank	-5.2	4.2
OECD*	-6.0	5.2
OECD**	-7.6	2

Source: Official projections of mentioned organisations. OECD* single -hit scenario. OECD** double -hit scenario

Compared to the IMF, the world real GDP growth projections of other major international institutions such as the World Bank and OECD are less optimistic and indicating to a greater slowdown in economic activities in 2020. A projection made by the OECD foresees that the global economic contraction will be around 7.6% and the world real GDP will grow only by 2% in 2021 (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 important to note that the number of countries with negative growth rates will significantly jump from 19 in 2019 to 154 in 2020, according to IMF estimations (Figure 1.3). Almost all regions of the world, small and big economies as well as developed and developing countries are expected to see some negative GDP growth rates due to the COVID-19 that makes it a global crisis like no other in previous decades. The IMF also expects that with the start of economic recovery in late 2020, almost all economies in the world will attain some growth in 2021. Nevertheless, it may take several years in some economies to reach their pre-pandemic GDP values as the pandemic has reduced not only domestic demand and supply but also hit hard the global value chains, international trade and capital flows as well as tourism activities (World Bank, 2020).

Figure 1.3: Number of Countries with Negative Growth Rates



Source: IMF, World Economic Outlook database.
Notes: Values with are projections (World: N = 194; Developed: N = 39; Developing: N = 155)*

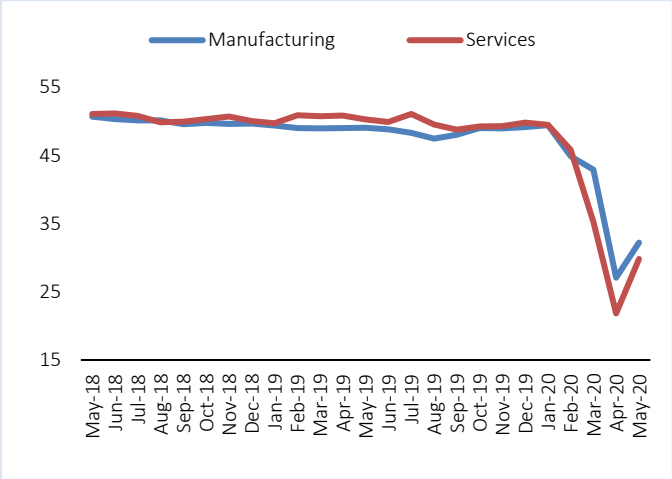
Major economies like the United States and the United Kingdom are expected to contract by 10.2% and 8%, respectively, in 2020. The leading economies of Europe, Germany and France are also expected to record negative growth rates of 7.8% and 12.5% in the same year. As the duration and intensity of the pandemic are uncertain, some international institutions like the OECD foresee that a likely second wave of the COVID-19 pandemic could alter the global recovery expectations that may lead to tremendous additional pressure on both developing and developed countries in 2020 and 2021 (OECD, 2020).

▪ The COVID-19 is undermining the global growth

The slowdown in the world economy in 2019 can be explained with different risk factors, including the rising threat of protectionism, vulnerabilities in emerging markets, the impacts of Brexit, and growing geopolitical factors in Asia. Moreover, the growing tension in the US and China trade relations has emerged as an additional major risk factor in the global economy and international trade. Unfair trade policies and a slowdown in multilateralism have put international cooperation under stress in recent years. As the COVID-19 pandemic has forced countries to reduce international trade relations such as due to containment measures and disruptions in the global value chains, restoring confidence on multilateralism will require additional time and efforts including a series of reforms in international trade mechanisms (e.g. tariffs, non-tariff barriers, and dispute settlement). Such efforts would help to increase

predictability in the global economy in the next few years and accelerate the pace of global economic recovery (WTO, 2020a).

Figure 1.4: Global PMI New Export Orders Indices

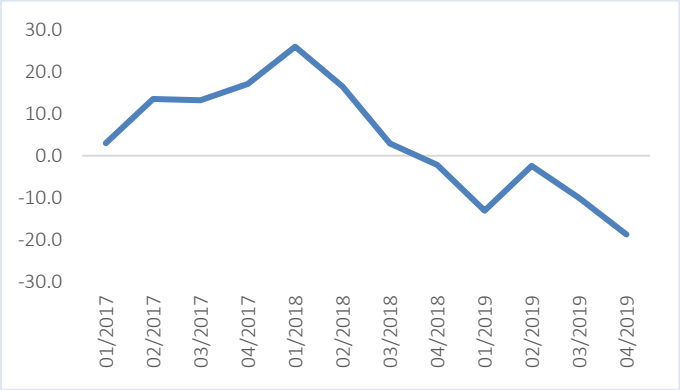


Source: IHS Markit and WTO
Notes: New export orders are measured by Purchasing Managers' Index (PMI). PMI readings above 50 indicate expansion in economic activity; readings below 50 indicate contraction.

The prolongation of above-mentioned risks and disruptions led by the pandemic has already fuelled the worldwide uncertainty that has been negatively affecting global industrial activity and trade in goods. As it is shown in Figure 1.4, in 2019 the global new export orders measured by Purchasing Managers' Index (PMI) lost considerable momentum in both manufacturing and services compared to the beginning of 2018, when the global economic environment was much more favourable. Since the beginning of the pandemic in early 2020, the indices were in free fall until May 2020 and recorded at historically low levels in April (27.1 in manufacturing and 21.8 in services), which started to rebound in May 2020.

According to the findings of the Ifo Institute's quarterly World Economic Survey, the world's economic climate started to decrease in the second quarter of 2018 and the deterioration continued in 2019 due to the unfavourable economic conditions and increased risks as well uncertainties. The indicator dropped from 26 in the first quarter of 2018 to -2.2 at the end of 2018. As the global risks increased and uncertainties became more remarkable, the indicator further decreased and recorded at -18.8 points in the fourth quarter of 2019 (Figure 1.5). As the COVID-19 pandemic hit the global economy in 2020, it is

Figure 1.5: World Economic Climate



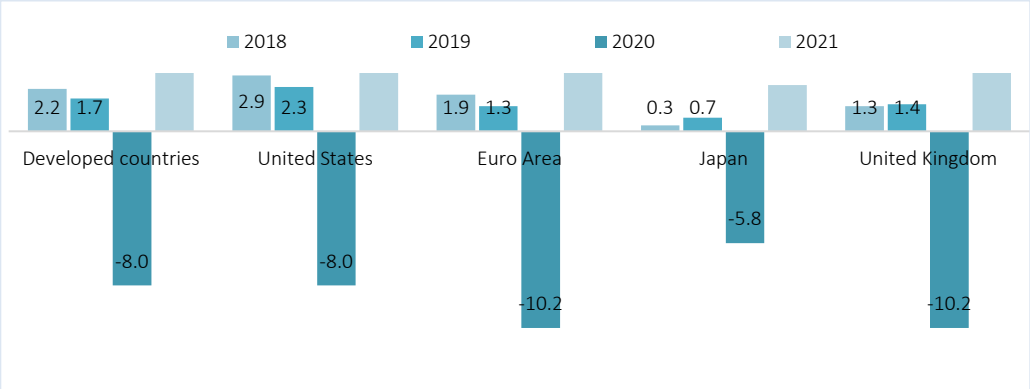
Source: Ifo Institute, CESifo Group
Notes: This graph summarizes results of a quarterly surveys conducted by Ifo Institute. The survey focuses on qualitative information, i.e. assessments of a country's general economic situation and expectations regarding key economic indicators. 0 point means that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

expected that the Ifo indicator on the world economic climate will not turn into positive over the course of 2020.

- **Economic slowdown hit developed economies and negative growth rates are expected**

Real GDP growth figures are on the decline indicating a slowdown in growth in developed countries over the recent years. The growth rate declined from 2.2% in 2018 to 1.7% in 2019. A negative growth rate of 8% is expected in 2020 in developed countries due to the pandemic and major disruptions seen in the global economy. However, 2021 will be a year in which the economic growth rate is foreseen at 4.8% thanks to the global economic recovery expectations and potential gradual increase in the economic activities (Figure 1.6).

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



Source: IMF, World Economic Outlook Update, June 2020.
Notes: Figures for 2020 and 2021 are projections (Developed: N = 39)

The US output growth rate went down from 2.9% in 2018 to 2.3% in 2019. It is projected to contract by 8% in 2020. In 2021, the economic activities in the US are expected to generate a growth rate of 4.5% (Figure 1.6). However, the upcoming elections in fall 2020 is an important uncertainty factor that may affect the growth prospects in 2020 and 2021 in the US economy. The fiscal stimulus package of the Federal Government to reduce the impacts of COVID-19 could potentially increase the pressure on the fiscal balances while helping to restore the domestic demand. The expansionary monetary policy followed by the FED since the mid-2019 and additional policy measures taken in early 2020 to curb the economic impacts of the pandemic could pave the market to restore quickly. Nevertheless, increased business uncertainty from rising trade tensions vis-à-vis countries such as China and Mexico continue threatening the US economy. As there is still not any effective vaccination on the COVID-19, it is possible that a second wave of the pandemic could hit economic activities more severely in the US in 2020 and early 2021.

The economic climate in the Euro Area has deteriorated significantly since the end of 2018, mainly due to the worsening global trade environment and the contraction in the manufacturing sector. The slowdown in Chinese economic growth driven in part by fallout from the trade war has spread to Germany and other European nations that has raised supply chain costs and

softened the global demand. Growing concerns about the future of the EU and Brexit discussions have also fuelled uncertainties. The economic growth in the Euro Area decreased from 1.9% in 2018 to 1.3% in 2019. The IMF expects a contraction of 10.2% in 2020 mainly stemming from the pandemic and containment measures in the continent, which will then increase to 6% in 2021 (Figure 1.6). This trend holds across major EU countries, including Germany - EU's largest economy, where the economy is expected to shrink by 7.8% in 2020. The European Central Bank (ECB) unveiled a package of measures to minimize the impact of the pandemic and to add further stimulus in European economies.

Economic growth in Japan slightly increased from 0.3% in 2018 to 0.7% in 2019. Nevertheless, the slowdown in economic growth in the European and US markets limit the growth prospects in the export-oriented economy of Japan. The contraction in the global economy in 2020 will also significantly affect the growth in the Japanese economy that the growth rate is projected to be -5.8% in 2020. As in other major economies, the recovery will start after the pandemic and the growth rate is expected to hit 2.4% in 2021 (Figure 1.6). Over the recent years, Japan has been facing a demographic challenge due to an aging population, which negatively affects the earnings of some industries such as transportation and construction as well as limiting the growth in domestic demand.

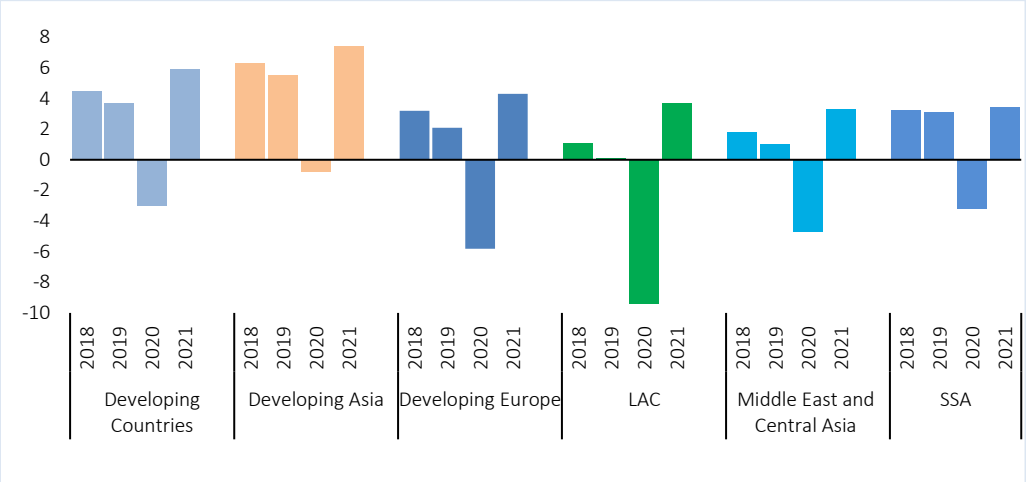
The economic growth in the UK economy was stable in 2018 and 2019 that was recorded at 1.3% and 1.4%, respectively. As one of the most severely affected countries from the COVID-19, the GDP in the UK will contract by 10.2% in 2020 under the questions of health system resilience. The economic recovery in the country and opening up of economies in the world are expected to bring fast-paced economic growth rate of 6.3% in the UK. The generous stimulus package and a set of financial interventions in the country are expected to play a critical role in mitigating the negative impacts of the pandemic on economic activities.

- **Economic growth in developing countries is slowing and the pandemic is expected to deteriorate their growth prospects**

On average, developed economies have been experiencing slower economic growth rates as compared to developing countries. Nevertheless, the average growth rate of developing countries is also in decline and decelerated from 4.5% in 2018 to 3.7% in 2019. The IMF expects that the GDP of developing economies, on average, will shrink by 3% in 2020 due to the pandemic, lockdowns, and containment measures. It is also forecasted that the economic activities in developing economies will gain momentum and the average growth rate will reach 5.9% in 2021 (Figure 1.7). The projections of the IMF reveal that developing economies will see a limited contraction in 2020 and recover faster in 2021 as compared to developed countries.

In all developing regions, the average growth rates went down in 2019 in comparison with their performance in 2018. Developing Asia remained to be the world's most dynamic region in economic terms, whose real growth rate was 5.5% in 2019 (Figure 1.7). IMF projections show that the growth rate will be -0.8% in 2020 due to the pandemic and other geopolitical risks. Nevertheless, the contraction in 2020 will be followed by a quick economic recovery where the growth rate is projected to be 7.4% in 2021. In China, as the growth engine of the region, the real

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



Source: IMF, World Economic Outlook Update, June 2020.
Notes: Figures for 2020 and 2021 are projections (Developing: N = 155)

economic growth rate is projected to be 1.0% in 2020 and the pace of recovery is expected to lead the Chinese economy to grow by 8.2% in 2021. The projections highlight that China's economy will remain robust despite increasing trade tensions with the US. However, there are domestically driven risks in the Chinese economy, such as the high debt levels of state-owned enterprises and local governments. The likelihood of a second wave of the pandemic in the country in the absence of a vaccine for COVID-19 has also the potential to downsize the growth projections in China in 2020 and 2021. With 6.1% of real GDP growth in 2018, India continued to take place among the fastest-growing economies mainly driven by manufacturing and agriculture. Nevertheless, the worldwide slowdown in 2019 also affected Indian economy and the growth rate was measured at 4.2% in 2019. The economy is projected to contract by 4.5% in 2020. It is expected that India will return to its fast-paced growth pattern in 2021, where the growth rate is projected to be 6% in 2021.

The economic growth rate in developing Europe went down from 3.2% in 2018 to 2.1% in 2019. The projections show that a 5.8% contraction is foreseen in the region in 2020 due to the pandemic and concerns in the European economies. A significant slowdown in the EU economies, which is the main trade partner of the developing Europe region due to the geographical proximity, affected the region's trade and output capacities severely. A recovery is expected in the region in 2021, where the IMF expects a growth rate of 4.3%. As one of the largest economies in the region, Turkey grew by 0.9% in 2019 but it is expected to contract by 5% in 2020. Depreciation of its national currency, structural current-account deficit and the high level of foreign-currency denominated debt held by the private sector are some of the risk factors in the economy particularly in terms of external financial imbalances. The real GDP growth of Turkey is forecasted to be 5% in 2021 thanks to expected momentum in international trade and full recovery in tourism activities in the aftermath of the pandemic.

Among developing regions, Latin America and the Caribbean (LAC) recorded the slowest economic growth in 2019, which decreased from 1.1% in 2018 to 0.1% in 2019. The pandemic started to affect an increasing number of major economies in the region that is projected to lead to a growth rate of -9.4% in 2020. If this projection realizes, the LAC will be the most severely affected developing region in the world in terms of the average economic growth rate. The ongoing political tensions in some countries of the region, dysfunctional and ineffective measures to fight with the COVID-19, and inadequate measures to normalize the economies of the region can be listed among key reasons behind this picture (IMF, 2020a).

Economic growth in the Middle East and Central Asia region slowed down from 1.8% to 1.0% in 2019. The projection on the economic growth rate for the region made by the IMF was 3.2% for the year 2020 before the pandemic. Nevertheless, the pandemic altered all the projections and started to affect countries in the region. The most recent projections of the IMF show that a 4.7% contraction is expected in 2020 in the region that will be followed by a 3.3% expansion in 2021 (Figure 1.7). Saudi Arabia, the largest economy in the region, grew by 0.3% in 2019. The economic slowdown due to the pandemic and decline in global oil prices are expected to lead a contraction by 6.8% in 2020 in the economy. In the aftermath of the pandemic, the economic growth is expected to reach 3.1% in 2021. The real GDP growth in Iran was measured at -7.6% in 2019 and it is projected to register a further contraction by 6% in 2020. The country is forecasted to record a growth rate of 3.1% in 2021.

In 2018 and 2019, the sub-Saharan Africa economies, on average, grew by 3.2% and 3.1%, respectively. The pandemic is expected to take those countries away from their growth trajectories and lead to a contraction of 3.2% in 2020. A slowdown in the global economic growth poses risks to the sub-Saharan Africa, especially in the area of foreign direct investment and international trade due to lower prices for commodity exports. As a region that hosts several least-developed countries, an economic contraction also brings associated risks on increased poverty and inequality. The output of the region will see an increase in 2021 and the growth rate is expected to be around 3.4%.

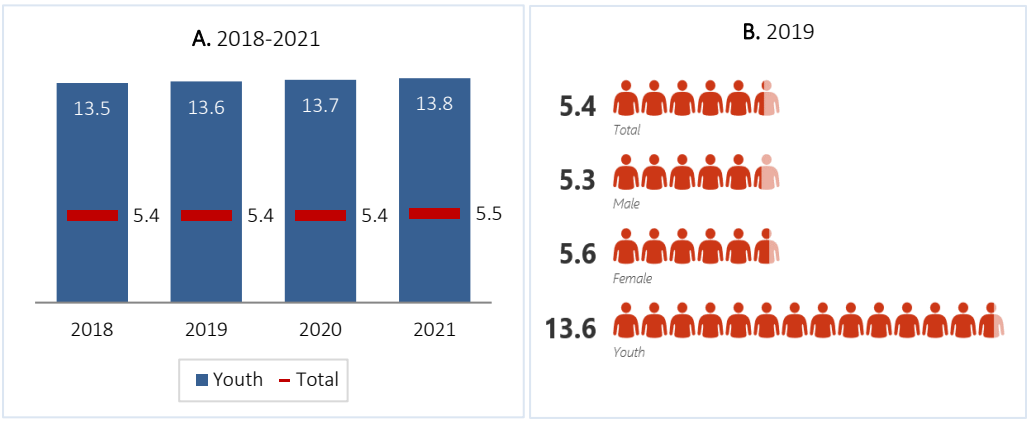
- **The pandemic is expected to bring a devastating toll on labour market outcomes**

New data provided by the International Labour Organization (ILO) for 2019 points out that the unemployment rate in the world remained at 5.4% as in 2018 (Figure 1.8). However, the number of unemployed people is estimated to increase from 185.8 million in 2018 to 187.7 million in 2019 worldwide (ILO, 2020a). The ILO projections before the outbreak of the COVID-19 pandemic indicated that the number of unemployed people will continue to increase in 2020 and it is expected to reach 190.3 million because of the expanding labour force.

Nevertheless, the pandemic started to affect the employment outlook. The containment measures, lockdowns and the slowdown in global GDP growth are all expected to have negative impacts on the labour market outcomes both in developed and developing countries (ILO, 2020b). The use of teleworking with the start of the pandemic also restricted the number of new job openings in certain sectors. Uncertainties and risks stemming from the pandemic have reduced new investments to be made by domestic and foreign investors. As a result, the ILO

foresees a significant rise in unemployment and underemployment in the wake of the COVID-19 pandemic.

Figure 1.8: Unemployment in the World (Percent)



Source: ILO modelled estimates.

Based on different scenarios, the ILO estimates indicate a rise in the global unemployment of between 5.3 million ("low" scenario) and 24.7 million ("high" scenario) from a base level of 187.7 million in 2019. The "mid" scenario suggests an increase of 13 million unemployed people. It is expected that more than half of those people (about 7.4 million) will be in developed countries. According to McKibbin and Fernando (2020), all countries will suffer from the pandemic in terms of its impacts on labour markets. Though estimations remain highly uncertain due to the ongoing pandemic and change in assumptions, various projections indicate a substantial rise in global unemployment. It is also evident that in developing countries it is more difficult to make accurate estimations where informalities in the labour market are more prevalent compared to developed economies (ILO, 2020a). Therefore, it is likely that the pandemic will hit labour force in developing countries to a higher extent where the structural unemployment problem persists, informalities are relatively high and social safety nets are inadequate (World Bank, 2020; SESRIC, 2020).

Labour underutilization is more than twice as high as unemployment, affecting over 470 million people worldwide in 2019 (ILO, 2020a). A higher rate of underutilization of labour associate with reduced labour income earnings, widen income inequalities in societies and increase in poverty rates particularly in developing countries.

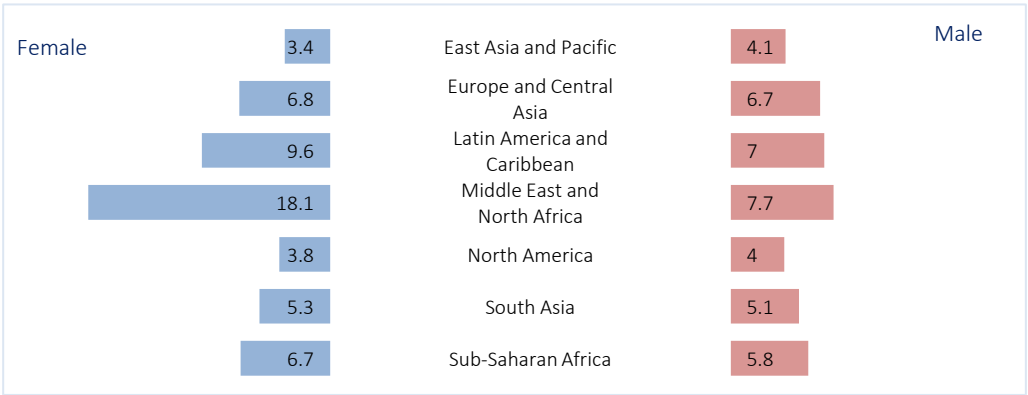
Among young people aged 15 to 24, an estimated 429 million (36%) were in employment in 2019, with another 509 million (42%) in education or training without simultaneously being employed (ILO, 2020a). The lack of employment opportunities for youth remains to be another major global challenge. In 2019, the global youth unemployment rate was 13.6%, or 2.5 times higher than the total unemployment rate (Figure 1.8). This ratio is expected to increase in 2020 and 2021. In particular, the pandemic will further worsen the situation for youth in the labour market by reducing new job opportunities available for them (SESRIC, 2020).

The global unemployment rate of women for 2019 – at 5.6% – is 0.3 percentage points higher than the rate for men, according to the ILO modelled estimates. Further, the global women's

labour force participation rate – at 47% in 2019 – is 27 percentage points below the same rate of their male counterparts. As in youth, female population will be hit to a higher extent in the labour market stemming from the slowdown led by the pandemic. In this context, in 2020 and 2021 women unemployment rate is expected to see an increase (SESRIC, 2020; ILO, 2020b).

Differences in unemployment rates between women and men in developed regions like North America are relatively small. However, in the developing regions such as the Middle East and North Africa, female unemployment rates are more than twice the male rates, due to some social norms and country specific factors (SESRIC, 2018). It is obvious from Figure 1.9 that for women it is harder to get a job in many developing regions of the world.

Figure 1.9: Unemployment by Gender (2019, Percent)

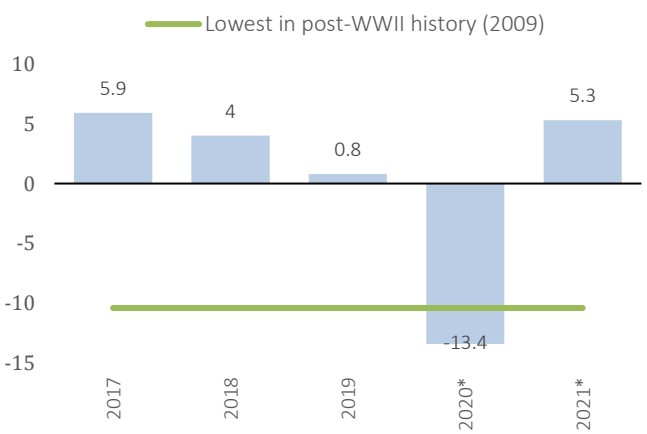


Source: ILO modelled estimates.

▪ International trade is set to plunge amid the spread of coronavirus

The growth in the global trade volume of exports and imports of goods and services decreased from 5.9% in 2017 to 4% in 2018 (Figure 1.10). The negative trend in trade growth continued in 2019 and the growth rate was measured at 0.8%. In particular, slowdown in the global economy, Brexit discussions in the Europe and the US-China trade tension were among the key reasons behind this picture in 2019 (WTO, 2020a). The global trade growth is expected to contract by 13.4% in 2020 amid the spread of the coronavirus. Both the volumes of exports and imports are expected to decline as the containment measures and lockdowns affect

Figure 1.10: Trade Growth in the World (%)



Source: World Bank. Note: 2020 and 2021 values are forecasts. Trade is the average of import and export volumes.

both the demand and supply in a negative way. International transportation and global value chains were also disrupted remarkably during the closures. The projected negative trade growth (-13.4%) in 2020 is expected to exceed the highest negative growth rate (-10.4%) recorded after the World War II. This indicates that the pandemic of COVID-19 is a crisis like no other also in terms of international trade. In 2021, a growth rate of 5.3% is projected with the gradual opening of economies and restoration of confidence in the global trade system.

Export volume of merchandise grew by 9.9% in the world in 2018. The fastest growth was seen in the Middle East (17.7%) and followed by Africa (14.2%) regions (Table 1.1). In 2019, the global growth rate in export volume of merchandise declined to -2.9%, where the biggest slowdown was seen in the Middle East (-12.5%) region. In terms of import volume of merchandise, the global change was 10.4% in 2018 that exceeded the average growth rate (2.5%) recorded during the period 2010-2019 (Table 1.1). The regional disparities in imports exist as in exports. The highest growth in import volume of merchandise was recorded in Asia (13.2%) region in 2018. Unlike 2018, a negative growth rate (-2.8%) was observed in 2019 in the global economy in terms of import volume of merchandise. The negative growth was prevalent in all regions of the world. The highest contraction (-5.5%) was seen in South and Central America and the Caribbean region in the same year.

Export volume of commercial services increased by 9.1% in the world in 2018. The fastest growth was recorded in Asia (12.1%) and followed by Africa (10.8%) regions. Other regions of the world also experienced growth in the export volume of commercial services in 2018. In 2019, the global growth rate in export volume of commercial services was measured at 2%, where all regions experienced some modest growth rates. In terms of import volume of commercial services, the global change was measured at 7.6% in 2018 that exceeded the average growth rate (4.7%) recorded during the period 2010-2019 (Table 1.1).

The best performing region was Africa, where the import volume grew by 13.7% in 2018. There was a slowdown in the global economy in 2019, and therefore the import volume of commercial services grew only by 2.2%. Positive growth rates were prevalent in three regions of the world (North America, Europe, and Africa) in 2019. Other regions namely South and Central America and the Caribbean (-4.1%), the Middle East (-1.9%) and Asia (-1.2%) experienced a contraction in their import volume of commercial services in 2019.

The WTO predicts that 2020 will be a year that the global trade will be hit hard by the pandemic (WTO, 2020a). The measures taken by countries to slowdown the spread of the pandemic, uncertainty about the near future of the pandemic, reduced confidence in multilateralism and ongoing tension between the US and China particularly on trade issues are expected to affect the performance of the global trade system. In particular, trade-related risks have become quite significant in recent years before the pandemic started to affect the world economy adversely. 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 World Bank (2020) 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. In this context, moving towards protectionism and

Table 1.1: Percentage Change in the World Merchandise Trade and Trade in Commercial Services by Selected Regions, 2010-2019

Exports				Imports		
2010-19	2018	2019		2010-19	2018	2019
Merchandise						
2.3	**9.9**	**-2.9**	**World**	**2.5**	**10.4**	**-2.8**
3.0	8.0	-0.5	North America	3.0	8.4	-1.7
0.0	8.4	-6.4	South and Central America and the Caribbean	0.5	11.6	-5.5
2.3	9.6	-3.0	Europe	1.9	9.8	-3.2
-1.3	14.2	-4.5	Africa	1.9	11.7	-1.2
0.7	17.7	-12.5	Middle East	2.4	1.5	-0.2
3.2	8.5	-1.5	Asia	3.3	13.2	-3.7
Commercial services						
5.0	**9.1**	**2.0**	**World**	**4.7**	**7.6**	**2.2**
4.6	3.9	1.6	North America	3.4	3.0	3.4
3.9	3.3	0.3	South and Central America and the Caribbean	2.5	1.1	-4.1
4.8	9.9	1.6	Europe	4.8	8.2	5.0
2.8	10.8	2.6	Africa	2.4	13.7	3.0
...	6.6	3.8	Middle East	...	6.3	-1.9
...	12.1	2.8	Asia	...	9.2	-1.2

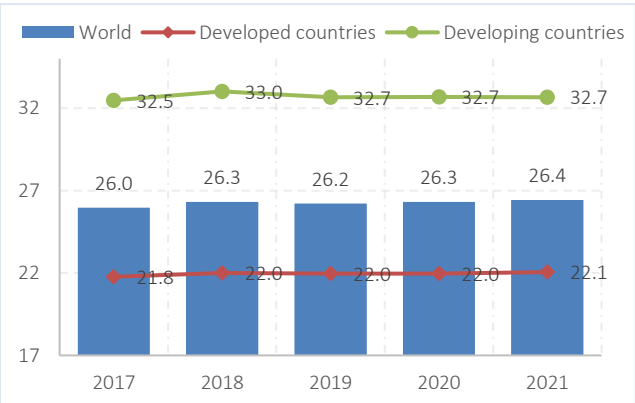
Source: WTO (2020a)

taking more trade restrictive measures should not be the response of countries to reduce the impacts of the pandemic in their respective economies. Strengthening multilateralism and ensuring a greater international and regional cooperation would help countries to restore the confidence and associate with greater gains from international trade both for exporter and importer countries.

- **Increase in domestic investments is followed by decrease in FDI**

Figure 1.11 shows that there exists a slight acceleration in world investments since 2017. Both among developed and developing economies, the slight recovery in investment share in GDP has continued, reaching 22.0 % in 2019 for developed countries, and 32.7% for developing ones. Projections for 2020 and 2021 indicates that investment will continue to provide a stimulus to economic growth in the world.

Figure 1.11: Investment Share in GDP (Percent)

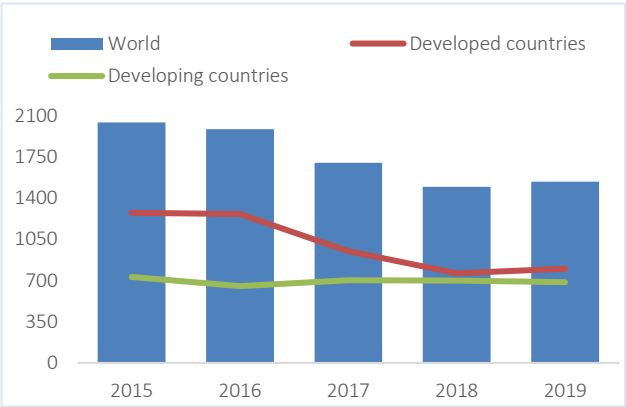


Source: IMF, World Economic Outlook Oct. 2019 database.
Notes: Figures for 2019, 2020 and 2021 are projections. Projections do not include the COVID-19 impact.

Investment levels varied more among different regions in 2019. For instance, investment as a share of GDP was measured at as high as 39.5% in developing Asia region. However, in SSA and LAC regions it remained at relatively lower levels of 21.2% and 19.4%, respectively. The COVID-19 pandemic is expected to affect the share of investment in GDP in 2020 negatively as compared to previous projections due to increased uncertainty across the globe. Investors would prefer waiting rather than realizing investments in times of high uncertainty. Public investments may also see a decline due to an increase in public spending on the health sector, reductions in tax revenue and allocation of additional sources for social safety nets (SESRIC, 2020).

Foreign direct investment (FDI) remains an important reliable source for economies of both developed and developing countries. In particular, for a number of developing countries, it is the largest external source of finance (UNCTAD, 2020a). As shown in Figure 1.12, FDI inflows in the world decreased significantly from 2015 to 2019. In particular, the global inward FDI flows fell by 12% in 2018, to US$1.49 trillion - from US$ 1.7 trillion in 2017. In 2019, it went up again and reached US$ 1.5 trillion in 2019. Inward FDI flows to developed countries increased by 5% to 800 billion dollars. FDI flows to developing countries decreased by 2% and measured at US$ 685 billion in 2019. As a result of an increase in FDIs in developed countries, the share of developed economies in global FDIs went up from 51% in 2018 to 52% in 2019.

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



Source: UNCTAD (2020a).

FDIs in Asia declined from US$ 498.6 billion in 2018 to US$ 473.9 billion. However, Asia remained the largest FDI recipient in the world (US$ 473.9 billion) in 2019 in contrast to Africa where FDI flows amounted only 45.4 billion dollars in 2019. Africa remains at sub-potential given its young and dynamic population with abundant natural resources.

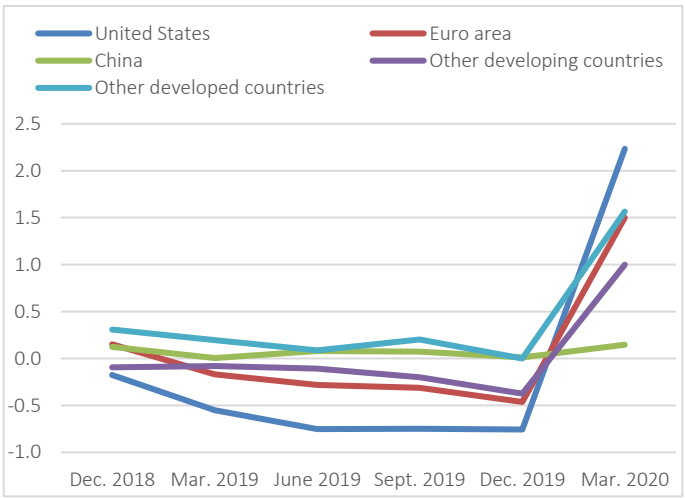
UNCTAD (2020a) assessed the potential impact of COVID-19 on FDI. The study estimates that global FDI flows are forecasted to decrease by up to 40% in 2020, from their 2019 value of US$ 1.5 trillion. This would bring FDI below US$ 1 trillion for the first time since 2005. The negative FDI trend in the world will be mainly driven by the disruption in the global value chains, increasing protectionism, and industrial shift on sustainability. This change process will bring huge challenges especially for developing countries as their development and industrialization strategies have heavily dependent on attracting FDI and increasing participation into global value chains. For instance, due to the COVID-19, FDI flows to Africa are forecasted to fall by 25% to 40% in 2020 (UNCTAD, 2020a). Reduction in FDI flows may also force some developing countries to seek alternative sources of external finance.

▪ Global financing conditions are tightening

Financial conditions are crucial for economic activity, because they often dictate the spending, saving and investment plans. In the period from December 2018 to December 2019, global financial conditions were relatively stable for global economic activities. Nevertheless, the pandemic emerged as an unexpected game changer at the beginning of 2020. The containment measures and sudden stop in economic activities not only affected the economic outlook but also deteriorated the expectations and fuelled uncertainty. In particular, the shape and duration of future recovery remain highly uncertain. However, as COVID-19 spread globally, the prices of risky assets and commodities started to fall at unprecedented speed while the prices of safe-haven assets, such as gold and US Treasuries, gained as investors look for stability rather than profitability during the crises (IMF, 2020b).

Global financial conditions, which had been easing steadily over the course of 2019 and into the beginning of 2020, tightened sharply in March 2020 (Figure 1.13). The tightening conditions affect both developed and developing countries. Falling equity prices and widening corporate spreads were only marginally offset by declines in interest rates. Nevertheless, it is not easy to restore the confidence of investors as the second wave of the pandemic is being pronounced. IMF (2020b) claims that the unexpected change in economic outlook and worsened expectations due to the pandemic in 2020 lead to a significant increase in downside risks to growth and financial stability. Such a remarkable deterioration in major financial and economic indicators makes the pandemic crisis the most severe shock in the near history of the world economy. The developing countries particularly least developed ones will have difficulties in accessing external financial sources while they need them the most due to uncertainties and deteriorated financial outlook.

Figure 1.13: Global Financial Conditions Indices (Standard deviations from mean)



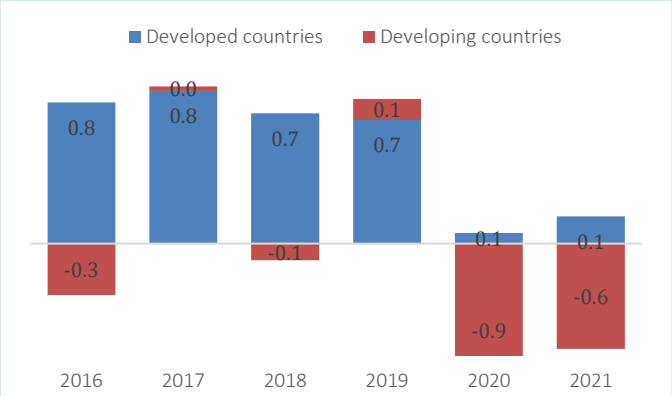
Source: IMF Global Financial Stability Report April 2020

▪ The pandemic increased current account fragilities in some developing countries and regions

Current account balances remained stable in developed countries in 2018 and 2019 at 0.7% of GDP. Developing countries witnessed and improvement where a 0.1% deficit in 2018 turned into a 0.1% surplus in 2019. Nevertheless, the outlook for 2020 and 2021 have dramatically changed stemming from the pandemic. It is expected that developed countries will experience a decline

in their current account surpluses, on average, that is forecasted to go down from 0.7% in 2019 to 0.1% in 2020. Developing countries are expected to see a greater current account deficit of 0.9% in 2020. The slowdown in economic activities, disruptions in the global value chains, a sudden halt in tourism activities and reduced demand in developed countries are projected to drive the current account deficits in developing countries in 2020 and 2021 (Figure 1.14).

Figure 1.14: Current Account Balance (Percent of GDP)



Source: IMF, World Economic Outlook April 2020 database.
Notes: Figures for 2020 and 2021 are projections (Developed: N = 39; Developing: N = 155).

As the pandemic led to a slowdown in economic activities and reduced global demand for oil, the negative trend seen in oil prices has started to affect particularly current account balances of oil exporting countries. Symmetrically, current account balances are expected to deteriorate in major emerging economies like China and India due to disruptions in the global value chains. The tension between the US-China trade relations is also another risk factor that could affect the global economy and current account balances in 2020.

Table 1.2: Current Account Balance (Percent of GDP)

	2017	2018	2019	2020	2021
Developing Asia	0.9	-0.1	0.6	0.1	0.5
Developing Europe	-0.4	1.7	1.4	-0.4	-0.5
Latin America and the Caribbean	-1.6	-2.4	-1.7	-1.5	-1.6
Middle East and Central Asia	-0.7	2.5	0.4	-5.7	-4.6
Sub-Saharan Africa	-2.2	-2.5	-4.0	-4.7	-4.2

Source: IMF, World Economic Outlook April 2020 database. *Notes: 2020 and 2021 values are projections.* (Developing Asia: N=30; Developing Europe: N=16; Latin America and the Caribbean: N= 33; Middle East and Central Asia: N=31; Sub-Saharan Africa: N=45

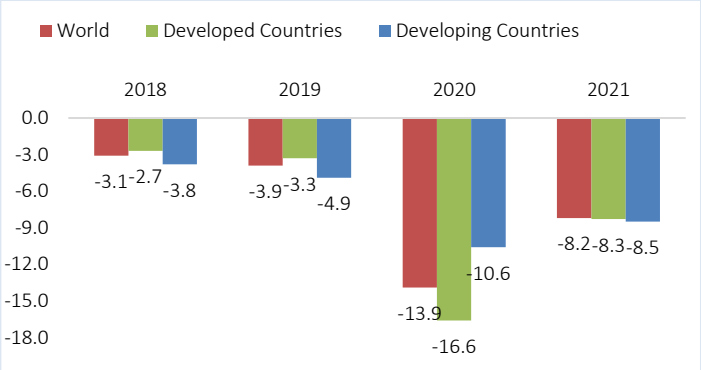
The US continues to have a trade deficit that resulted in a current account deficit of 2.3% in 2019. It is expected that in 2020 this deficit (as a share of GDP) will climb up to 2.6%. Germany and Japan generated significant trade surpluses that helped them to report a current account surplus of 7.1% and 3.6% in 2019, respectively. Both countries will be affected by the slowdown stemming from the pandemic in 2020. As a result, their surpluses are projected to be around 6.6% and 1.7%, respectively. Current account balances have slightly worsened in developing

Europe, Middle East and Central Asia, and SSA regions in 2019. The current account deficits are projected to widen in SSA region in 2020 (Table 1.2). Developing Europe and Middle East and Central Asia regions are projected to generate deficits rather than surpluses in 2020 due to the economic slowdown, reduced trade potentials and declining oil prices.

- **Fiscal balances are set to deteriorate**

As illustrated in Figure 1.15, the global fiscal balance has been deteriorating since 2018 that went up from -3.1% to -3.9% in 2019. In 2020, the average global fiscal balance is expected to deteriorate further and is projected to reach -13.9%. A slow global recovery is expected to take it down to -8.2% in 2021. The economic slowdown and significant reduction in demand in the vast majority of developed and developing countries started to reduce public revenues remarkably in 2020. The additional spending of governments on containment measures of the COVID-19 and financial stimulus packages to mitigate the impacts of the pandemic led to an increase in the worldwide government fiscal deficit (IMF, 2020c).

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



Source: IMF, World Economic Outlook June 2020 database. Notes: Figures for 2020 and 2021 are projections (Developed: N = 39; Developing: N = 155).

In developed countries, the average fiscal deficit increased from 2.7% in 2018 to 3.3% in 2019. It is expected to go up to 16.6% in 2020 before declining to 8.3% in 2021. In developing countries, the deficit was also on the rise in 2018 and 2019. With the start of the pandemic in 2020, it is expected that the deficit will represent a share of 10.6% in GDP in developing countries. In 2021, this share is projected to decrease to 8.5%.

Among developed countries, the US faced a great fiscal deficit that reached 6.3% in 2019 and is expected to increase up to 23.8% of GDP in 2020. Within the group of developing countries, in China, the deficit will go up by 5.8 percentage points and hit 12.1% mark in 2020, according to IMF projections. Countries like Brazil, Turkey and Saudi Arabia will all see significant deterioration in their fiscal balances. As summarized in Table 1.3, the increase in deficits mainly stems from additional spending and foregone revenues as well as loans, equity, and guarantees. In developed countries, additional spending and foregone revenues represent a share of 8.9% in GDP whereas; it is 3.1% of GDP in developing countries. Spending on loans, equity, and guarantees to mitigate the impacts of COVID-19 are expected to represent 10.9% of GDP in developed countries whereas in developing countries this share is forecasted to be around 2% level in 2020.

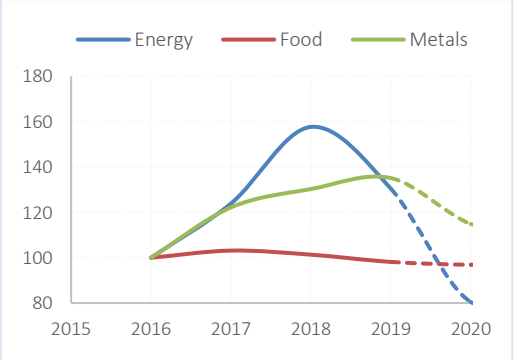
Table 1.3: Summary of Fiscal Measures in Response to the COVID-19 Pandemic (percent of GDP) by Selected Regions and Countries, 2020

	Additional spending and forgone revenue	Loans, equity, and guarantees
Indonesia	2.4	1.1
Turkey	0.2	9.1
Saudi Arabia	2.3	0.9
France	2.7	16.2
Korea	3.1	9.7
Spain	3.4	10.6
Italy	3.5	34.0
China	4.1	0.5
United Kingdom	6.2	16.9
Brazil	6.5	5.4
Germany	9.4	31.5
Japan	11.3	24.0
United States	12.3	2.6
Developing countries	3.1	2.0
Developed countries	8.9	10.9

Source: IMF, Fiscal Monitor Database of Country Fiscal Measures in Response to the COVID-19 Pandemic (June 2020)

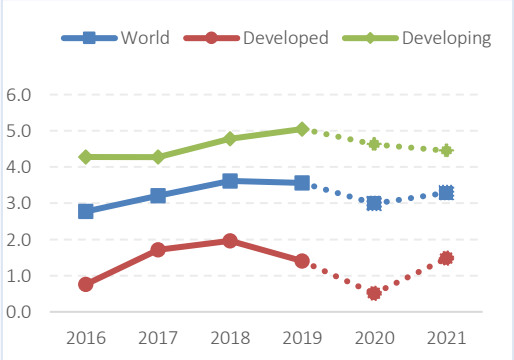
Figure 1.16 shows that energy price index regressed from 158 in 2018 to 130 in 2019. It will further decline to 80 mainly due to reductions in the global energy demand. This will bring additional financial challenges to many oil exporting economies. Due to the slowdown in global demand, the period from 2018 to 2019 also witnessed a slight fall in the food price index. In 2020, the food price index is estimated to be 97 that is lower than the base year (2016) value of 100. The metals price index slightly increased from 130 in 2018 to 135 in 2019. The slowdown in the global economy is set to bring the index value down to 115 by the end of 2020. The global inflation rate in 2018 was around 3.6% and stayed at the same level in 2019. In 2020, a slight decrease in

Figure 1.16: World Commodity Prices (2016 = 100)



Source: IMF, World Economic Outlook April 2020 database. *Notes:* Dashed lines are projections (World: N = 194).

Figure 1.17: Inflation (% Change)

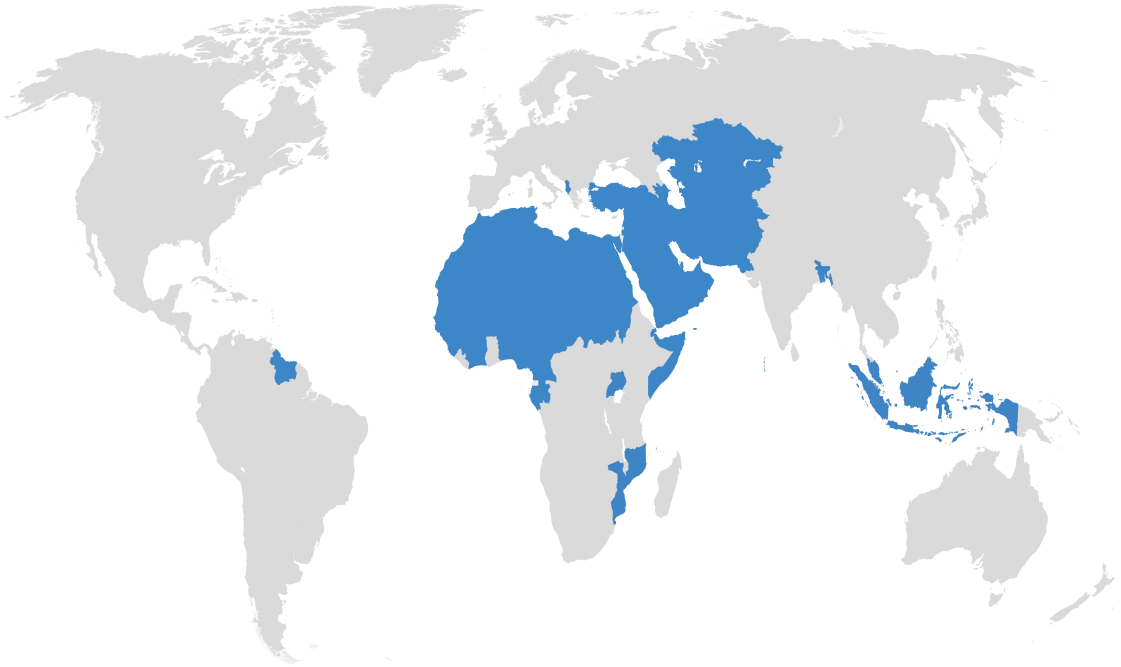


Source: IMF, World Economic Outlook April 2020 database. *Notes:* Average consumer prices (World: N = 194; Developed: N = 39; Developing: N = 155)

commodity prices, particularly in energy prices, is projected to push down the global inflation in 2020 (Figure 1.17). In 2020, both developed and developing countries are expected to see reduced inflation mainly stemming from cooling down of economies. In 2021, inflation rates in developed countries are projected to go up thanks to the economic and financial stimulus packages and eased monetary policies. Developing countries are expected to follow a more balanced inflation path in 2020 and 2021.

As a conclusion, it could be said that the global economy was under increasing stress as economic growth slowed and trade tensions increased during 2019. In 2020, the start of the pandemic has brought additional and significant uncertainties. The pandemic has emerged as a crisis like no other in the near contemporary history. The risk of a second and larger wave of the pandemic is a real and credible risk factor that can affect developed and developing countries alike. The ongoing geopolitical issues and tensions are also causing panic and fuelling risk factors particularly for investors in Asia. The debate on how Brexit process will be managed and discussions on the future of the EU are also among the key issues that can affect the performances of the EU and UK economies as well as their major trade partners.

PART II: RECENT ECONOMIC DEVELOPMENTS IN OIC COUNTRIES



CHAPTER TWO

Production, Growth and Employment

2.1 Production and Growth

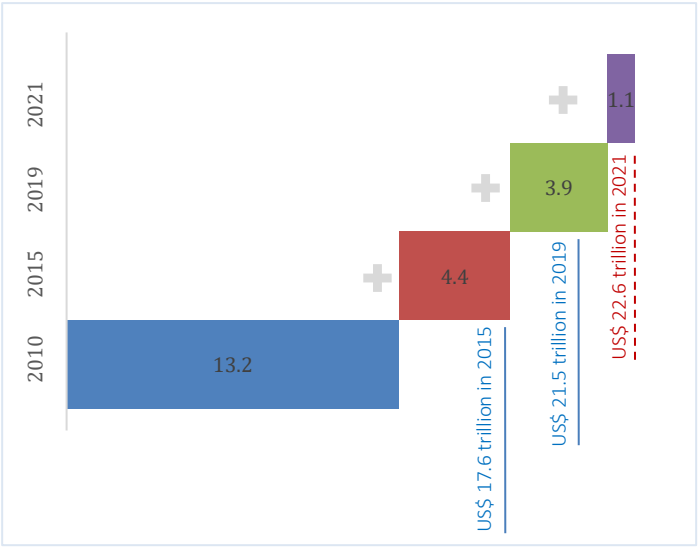
The global economy has been experiencing a fundamental transformation caused by the remarkable economic performance of developing countries over the last few decades. While poverty rates are falling in many parts of the developing world, health, education and employment outcomes are improving. As developing 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.

Yet, the COVID-19 pandemic disrupted economic activities all around the world. The pandemic has two major effects on the economies: one is related to the supply of goods and services due to value chain disruptions at both national and international levels, and the other is related to demand for goods and services due to loss of income and rising uncertainties. This exposes firms to revenue losses, reduced investments and production capacity, workers lay off, and ultimately default. Households and firms tend to spend less and save more as a response to growing uncertainties, which lower aggregate demand and prices for major commodities and assets. Moreover, the demand for liquidity and rising risk aversion cause major stress in the financial markets with significant effects on asset pricing and debt financing. While this part of the report will mainly concentrate on realizations in major economic indicators, the next part will pay greater attention to the impacts of the pandemic on OIC economies.

- **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. The total output of OIC countries has increased by 63% during 2010-2019 and reached US$ 21.5 trillion – expressed in current US$ and based on PPP – in 2019 compared to US$ 13.2 trillion in 2010 (Figure 2.1). It is projected to increase by additional 5% until the end of 2021 to reach US$ 22.6 trillion worth of productive capacities, notwithstanding the harmful effects of the COVID-19 pandemic.

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



Source: SESRIC staff calculations based on IMF World Economic Outlook Database April 2020. Data Coverage: 55 OIC countries.

Despite the achievements made over the past decades, economic and human development levels

Figure 2.2a: Gross Domestic Product, PPP Current US$ (2019)

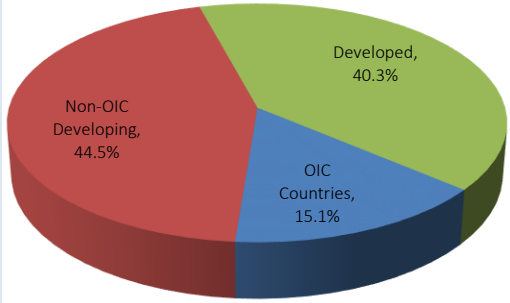
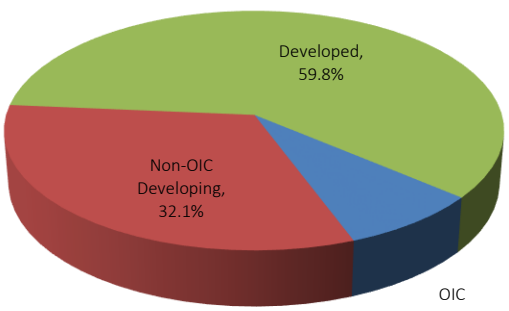


Figure 2.2b: Gross Domestic Product, Current US$ (2019)

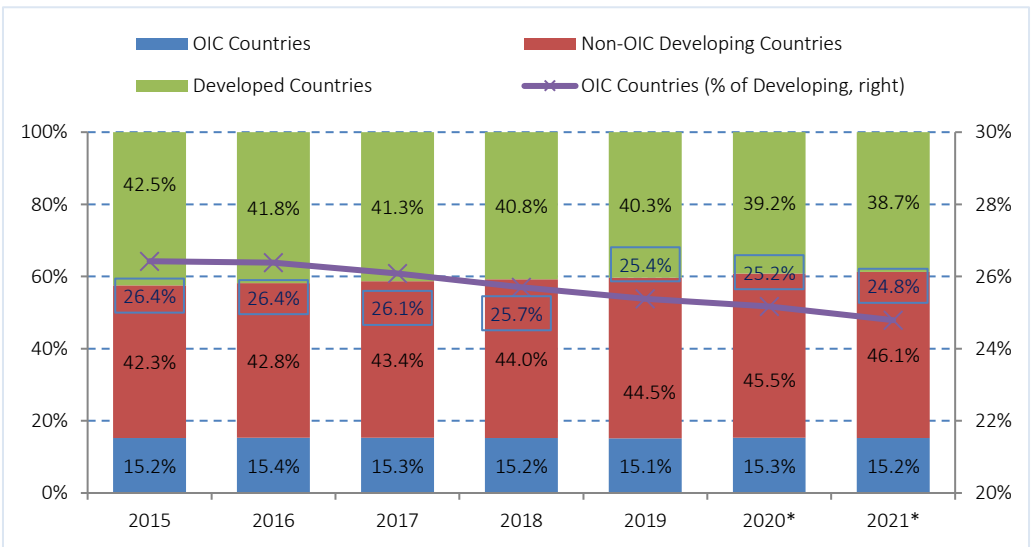


Source: SESRIC staff calculations based on IMF World Economic Outlook Database April 2020 and October 2019. Data Coverage: 55 OIC, 99 non-OIC, and 39 developed countries.

in many OIC countries remained below what has been aspired. In 2019, having accounted for almost 24.3% of the world total population, OIC member countries produced as much as 15.1% of the world total GDP – expressed in current US$ and based on PPP (Figure 2.2a). When measured in current prices, however, OIC member countries accounted for only 8.2% of global production in 2019 (Figure 2.2b).

During 2015-2019, the group of OIC countries could not increase its share in the world output, which even fell to its lowest level of 15.1% in 2019 (Figure 2.3). However, their share is expected to increase slightly to 15.3% in 2020, but then to decline back to 15.2% in 2021, despite the

Figure 2.3: Gross Domestic Product, PPP Current US$

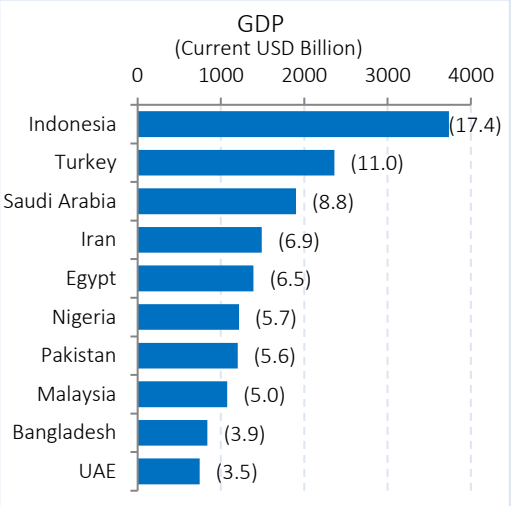


Source: SESRIC staff calculations based on IMF WEO Database April 2020. Data Coverage: 55 OIC, 99 non-OIC, and 39 developed countries. (*) Forecast.

negative growth rates projected for the OIC countries in 2020 due to the pandemic. Noting the fact that the share of some individual countries such as the United States and China (15.1% and 19.2%, respectively in 2019 based on PPP) is higher than the collective share of OIC countries, the contribution of the OIC countries as a group to the world output is relatively low. On the other hand, the share of the OIC countries in the total GDP of developing countries has declined steadily and was recorded at 25.4% in 2019, a decrease by one 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$ 63.2 trillion in 2019, a level that is well above the US$ 49.1 trillion they recorded in 2015.

Figure 2.4: Top 10 OIC Countries by GDP (based on PPP, 2019)



Source: IMF WEO Database April 2020. 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.

Furthermore, it is observed that the total GDP of the OIC countries is still produced by a few member countries. In 2019, the top 10 OIC countries produced 74.2% of the total GDP of OIC countries (Figure 2.4). In current prices, Indonesia has the highest share in OIC GDP (17.4%) followed by Turkey (11.0%), Saudi Arabia (8.8%), and Iran (6.9%). 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.

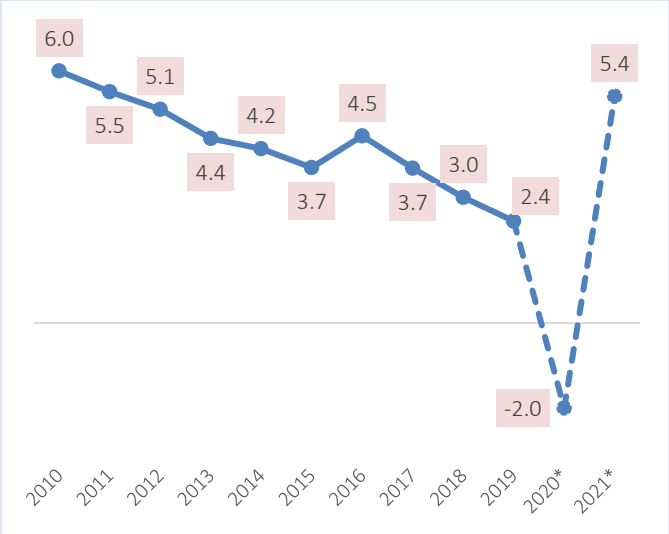
▪ Economic Growth: Growth rates in OIC countries further decelerate in 2019

The decline in the share of OIC countries in global GDP can be explained by lower economic growth rates recorded in OIC countries. The GDP growth of OIC countries has slowed down to 2.4% in real terms in 2019, as compared to 6% in 2010 and 4.5% in 2016 (Figure 2.5). However, the growth rates of OIC countries, on average, were higher than the world average until 2016, which led to an increase in the share of OIC in global GDP. In 2017, with an average growth rate of 3.7%, growth in OIC declined below the world average (Table 2.1).

The COVID-19 pandemic, however, caused major disruptions in the global supply chains and interruptions in manufacturing activities. Preventive measures and restrictions to contain the outbreak brought in dire consequences for all economic activities, including services and

agricultural activities. Falling commodity prices and financial market turmoil due to growing uncertainties led to a significant fall in asset prices and stock markets, further exacerbating the economic impacts and lowering average income levels. Capital outflows, dollar shortages and currency depreciations in developing countries, including OIC countries, constrain their ability to service their debts and take adequate supportive measures to stabilize the economy.

Figure 2.5: GDP Growth Rates in OIC Countries



Source: SESRIC staff calculations based on IMF WEO Database April 2020. Data Coverage: 55 OIC countries. (*) Forecast.

Table 2.1: GDP Growth Rates

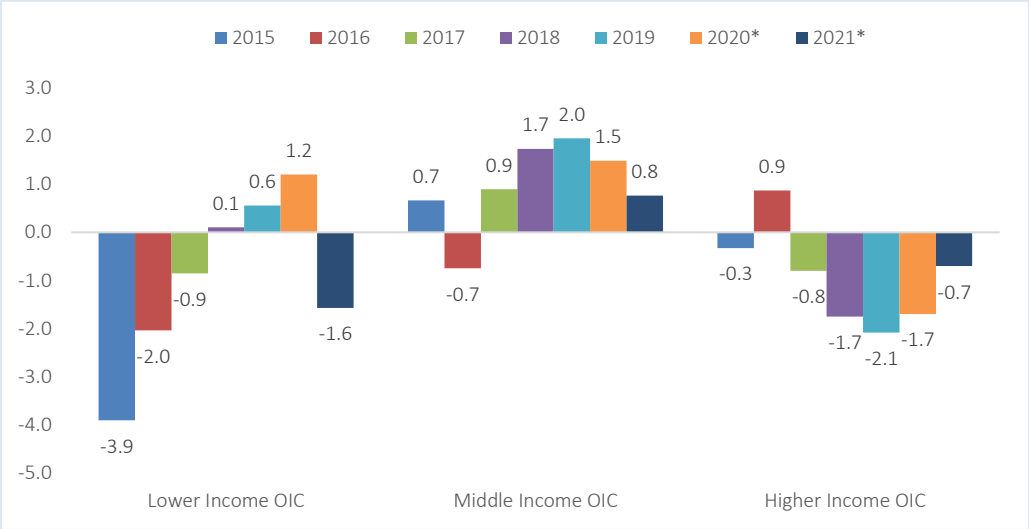
	2015	2016	2017	2018	2019	2020*	2021*
World	3.5	3.4	3.9	3.6	2.9	-4.9	5.4
OIC	3.7	4.5	3.7	3.0	2.4	-2.0	5.4
Egypt	4.4	4.4	4.1	5.3	5.6	2.0	2.0
Indonesia	4.9	5.0	5.1	5.2	5.0	-0.3	6.1
Nigeria	2.7	-1.6	0.8	1.9	2.2	-5.4	2.6
Saudi Arabia	4.1	1.7	-0.7	2.4	0.3	-6.8	3.1
Turkey	6.1	3.2	7.5	2.8	0.9	-5.0	5.0
Non-OIC Developing Countries	4.5	4.7	5.2	5.0	4.1	-0.7	7.1
Brazil	-3.6	-3.3	1.3	1.3	1.1	-9.1	3.6
China	6.9	6.9	7.0	6.7	6.1	1.0	8.2
India	8.0	8.3	7.0	6.1	4.2	-4.5	6.0
Russia	-2.0	0.3	1.8	2.5	1.3	-6.6	4.1
South Africa	1.2	0.4	1.4	0.8	0.2	-8.0	3.5
Developed Countries	2.4	1.7	2.5	2.2	1.7	-8.0	4.8
Germany	1.7	2.2	2.5	1.5	0.6	-7.8	5.4
Japan	1.2	0.5	2.2	0.3	0.7	-5.8	2.4
United Kingdom	2.4	1.9	1.9	1.3	1.4	-10.2	6.3
United States	2.9	1.6	2.4	2.9	2.3	-8.0	4.5

Source: IMF WEO Database April 2020 and June 2020. Data Coverage: 55 OIC, 98 non-OIC, and 39 developed countries. (*) Forecast. Projected data for 2020 and 2021 are based on IMF WEO June 2020 update, except for the averages of OIC and non-OIC developing countries.

As a result, OIC countries are initially estimated to contract by 2% in 2020 with a strong recovery to be followed in 2021. However, late estimations revealed that the economic contraction across the world is expected to be more severe than initially projected. According to June 2020 estimations of the IMF, the global economy is expected to recover at a rate of 5.8% in 2021 following a 3% decline in global GDP in 2020. When compared to other country groups, OIC countries are expected to be affected less severely than the developed countries but at around the same levels with non-OIC developing countries (Table 2.1).

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 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 income convergence among the member countries of the OIC.

Figure 2.6: GDP Growth Rates across Income Groups



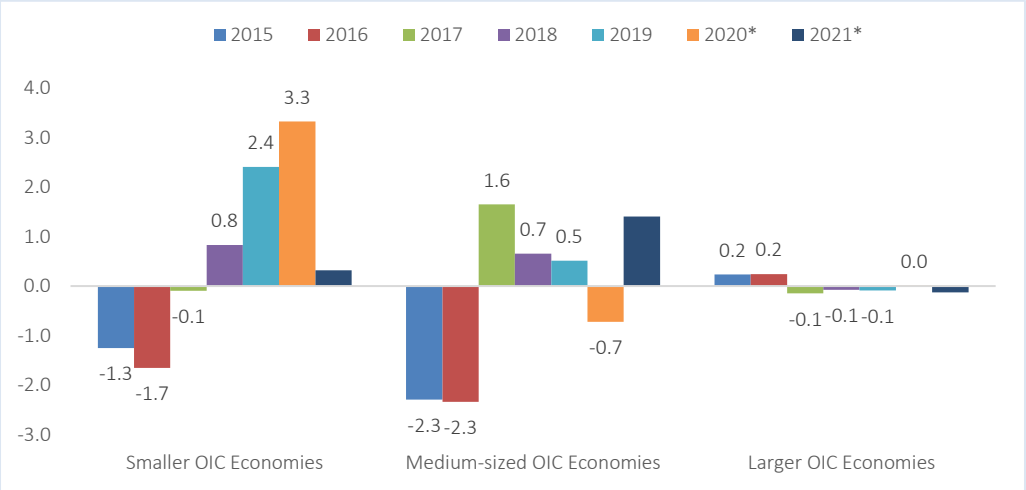
Source: SESRIC staff calculations based on IMF WEO Database April 2020. Data Coverage: 18 lower income, 19 middle income and 19 higher income OIC countries. Classification of countries based on 2019 GDP PPP values.

Figure 2.6 presents the difference between the average growth rates achieved by countries in specific income groups and average growth 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 2015-2017, implying a widening gap between rich and poor OIC countries. However, it is expected that they will grow more than the OIC average during 2018-2020, 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 done 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 economies (Figure 2.7). This shows that smaller OIC economies are performing better 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 9.9% in 2019, was the fastest growing

Figure 2.7: GDP Growth Rates across Economic Sizes



Source: SESRIC staff calculations based on IMF WEO Database April 2019. Data Coverage: 18 lower income, 19 middle income and 19 higher income OIC countries. Classification of countries based on 2019 GDP PPP values.

economy in the group of OIC countries, followed by Bangladesh (7.9%), Tajikistan (7.5%), Djibouti (7.5%) and Côte d'Ivoire (6.9%), as shown in Figure 2.8. In total, 33 OIC countries recorded a growth rate higher than the world average of 2.9%. While some OIC countries recorded high

Figure 2.8: OIC Countries with Highest Growth Rates in 2019

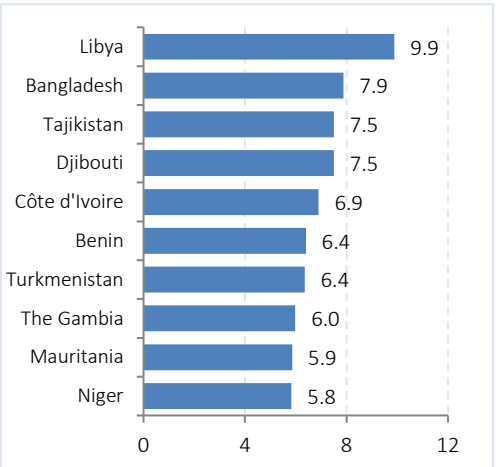
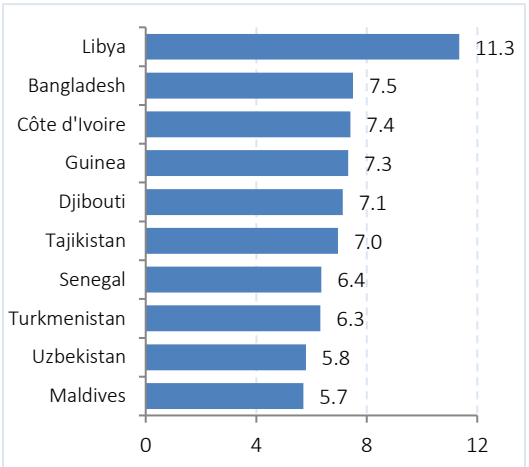


Figure 2.9: OIC Countries with Highest Growth Rates over the Last 5 Years (2015-2019)



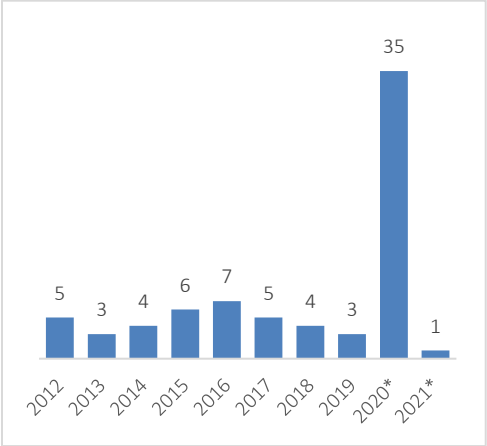
Source: SESRIC staff calculations based on IMF WEO Database April 2020. Data coverage: 55 OIC countries.

growth rates in 2019, 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 2.9. Six OIC countries that recorded the highest economic growth rate in 2019 are also among the top OIC countries that achieved to grow fastest over the last five years. Libya (11.3%), Bangladesh (7.5%), Côte d'Ivoire (7.4%), Guinea (7.3%) and Djibouti (7.1%) were among the top performing OIC countries during 2015-2019.

In fact, very few economies in the OIC region have been experiencing contraction in their economies since 2012. In 2019, only three OIC countries attained negative growth rates. This number is expected to reach 35 due to the inevitable impacts of the COVID-19 pandemic on OIC countries in 2020. Yet, only one OIC country is expected to remain in stagnation in 2021 (Figure 2.10).

Figure 2.10: Number of OIC Countries with Negative Growth Rates (2012-2021)



Source: SESRIC staff calculations based on IMF WEO Database April 2020. Data Coverage: 55 OIC countries. (*) Forecast.

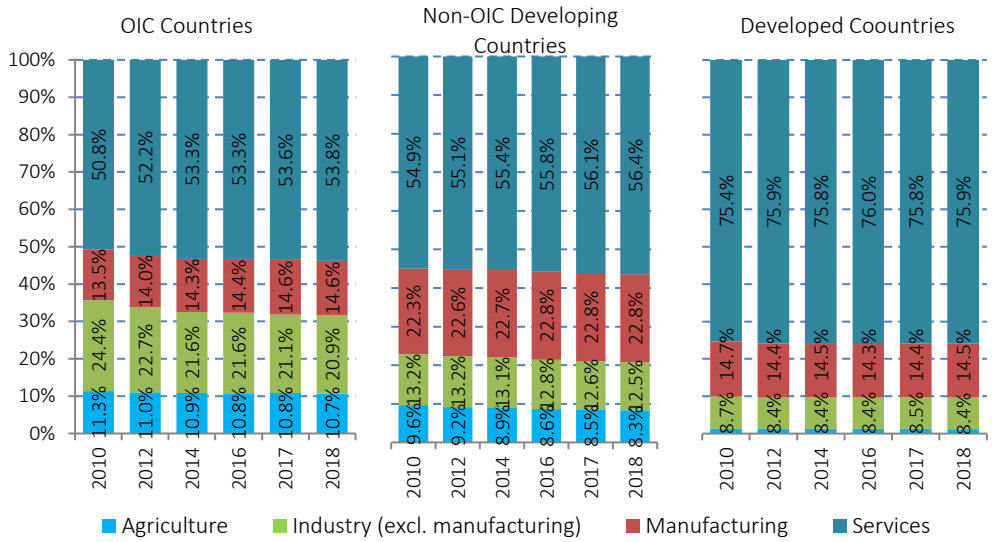
- **Structure of GDP:** Services sector accounts for half of economic activity within the OIC region

The analysis of value-added by major sectors in the total GDP of the OIC countries reveals important insights into the structure of the economies. Although the agriculture sector accounts for an important share of employment in the economy, its share in total GDP is generally low due to lower productivity in the sector. However, it remains an important sector for OIC countries, which accounts for 10.7% 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 24.4% in 2010 and 20.9% in 2018, reflecting a 3.5 percentage-point fall. On the contrary, the share of manufacturing sector, which has greater potential to promote productivity and competitiveness, increased from 13.5% in 2010 to 14.6% in 2018.

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 services sector in the total GDP of OIC countries increased from 50.8% in 2010 to 53.8% in 2018. In non-OIC developing countries, the services sector kept accounting for over half of the total GDP and its share was recorded at 56.4% in 2018 (Figure 2.11). Due to a much higher share of services sector in total value added of developed countries, the global share of services sector in total GDP exceeds at 75% level.

At the individual country level, in 2018, the agricultural sector accounted for more than 30% of the total value-added in nine OIC member countries; namely Sierra Leone, Somalia, Guinea-

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 2020. GDP breakdown at constant 2010 prices in US Dollars. Data Coverage: 56 OIC, 116 non-OIC, and 38 developed countries.

Bissau, Mali, Chad, Niger, Sudan, Uzbekistan and Comoros – all of which, except Uzbekistan, were listed among the LDCs in the same year according to the UN classification. In only four countries, the services sector accounted for more than 67.6%, or above the world average, namely Djibouti, Maldives, Lebanon and Palestine.

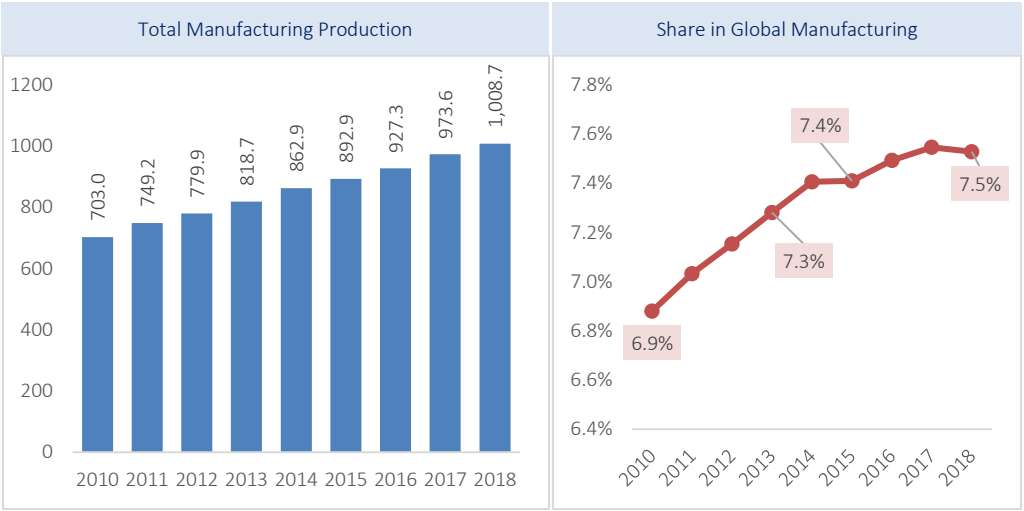
- **Manufacturing Activities:** Upward trend in the share of OIC countries in total world industrial production halted in 2018

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 in OIC countries, but it accounts for a greater share of total GDP in non-OIC developing countries (Figure 2.11). 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 22.8% in 2018.

The collective manufacturing production of OIC countries has increased steadily over the years (Figure 2.12). It exceeded US$ 1 trillion mark in 2018, compared to US$ 703 billion in 2010. More importantly, the share of OIC countries in global manufacturing activities has also been rising during 2010-2017. The share of OIC countries in total MVA was only 4.9% in 1990, which increased to 5.8% in 2000 and 6.9% in 2010. As of 2018, they accounted for 7.5% of global MVA.

Figure 2.12: Manufacturing Activity in OIC Countries (Billion US$)

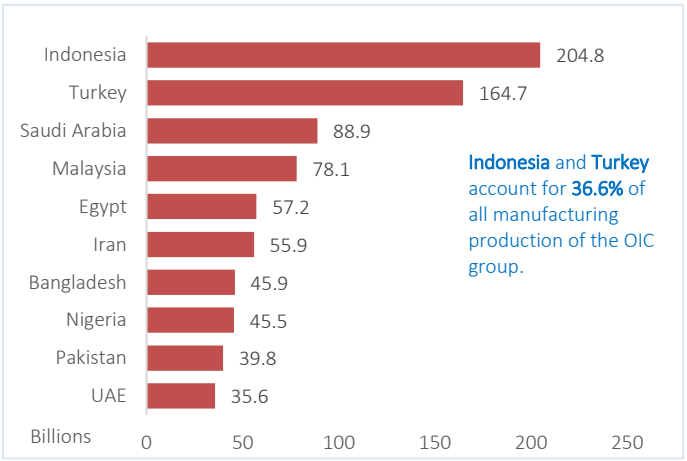


Source: SESRIC staff calculations based on UNSD National Accounts Main Aggregates Database, June 2020. Constant 2010 prices in US Dollars. Data Coverage: 56 OIC countries.

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.

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 36.6% in 2018, Indonesia and Turkey alone accounted for more than one-third of all MVA in OIC countries, followed by Saudi Arabia (8.8%), Malaysia (7.7%) and Egypt (5.7%). Top five OIC countries account for 58.8% of the total MVA in OIC countries.

Figure 2.13: Top OIC Countries in Manufacturing (Billion US$), 2018



Source: SESRIC staff calculations based on UNSD National Accounts Main Aggregates Database, June 2020. Constant 2010 prices in US Dollars. Data Coverage: 56 OIC countries

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

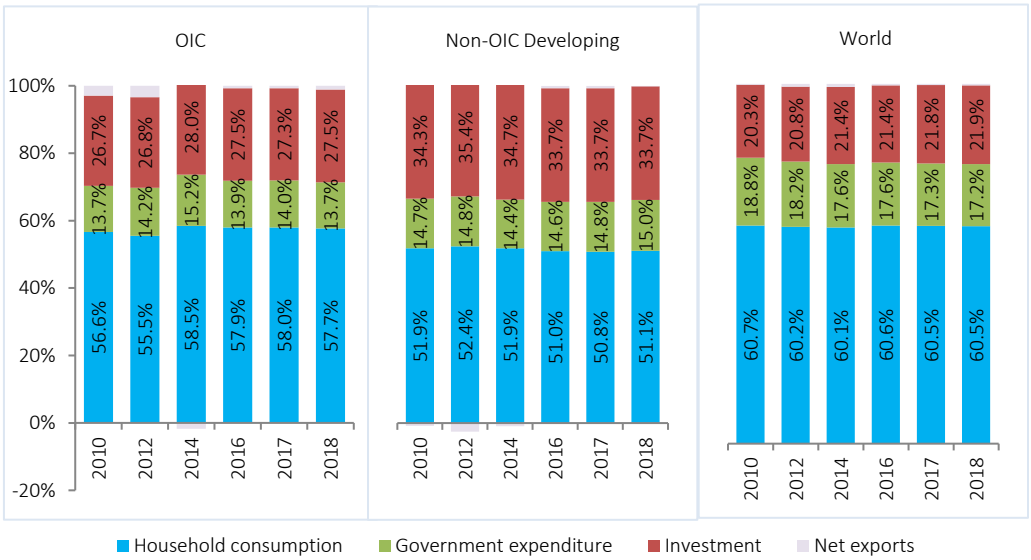
manufacturing industry in order to enhance and retain its competitiveness in the global economy.

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 mostly failed industrialization policies, country specific experiences should be investigated from the initial phase of designing the policies to particular approaches used in the implementation processes.

The analysis of global GDP by major expenditure items reveals that the share of final consumption (by both household and government) continued to be the highest in the total GDP over the years. As shown in Figure 2.14, in 2018 household consumption in OIC countries accounted for the lion share of GDP (57.7%) followed by investment (gross capital formation) (27.5%) and general government expenditure (13.7%). The share of net exports in the total world GDP was negligible.

The relative shares of the major expenditure items in the total GDP of OIC countries registered significant variation from the non-OIC developing countries and the world. In 2018, household consumption and government expenditure accounted for 71.4% of the total GDP of OIC countries, but 66.1% in non-OIC developing countries and 77.9% in the world. These figures marked a slight increase in the shares of household consumption compared to the year 2010. However, the share of net exports in the total GDP of the OIC member countries has decreased by 1.8 percentage points since 2010 whereas the share of gross capital formation has increased by 0.8 percentage points over the same period.

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



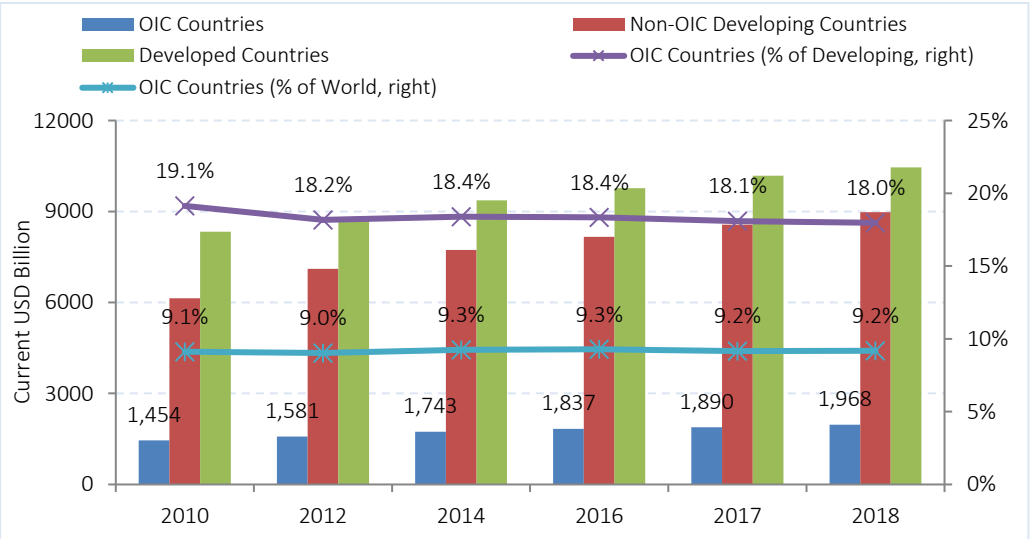
Source: SESRIC staff calculations based on UNSD National Accounts Main Aggregates Database, June 2020. GDP breakdown at constant 2010 prices in US Dollars. Data Coverage: 56 OIC, 116 non-OIC, and 38 developed countries

- **Gross Fixed Capital Formation:** In 2018, 27.5% of the total GDP generated in OIC countries was invested in productive assets

Gross capital formation measures the amount of savings in an economy that is transformed into investments in production. As the analysis of GDP by major expenditure items revealed in Figure 2.14, 27.5% of the total GDP generated in the OIC member countries was invested in productive assets in the year 2018. In comparison, non-OIC developing countries on average channelled 33.7% 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 remained at 9.2% in 2018. This marks 0.1 percentage points increase since the year 2010 and 0.1 percentage points decrease since 2016. Despite having rather a stable share in the world, the share of the OIC countries in the total gross fixed capital formation of the developing countries has been on the decline and contracted from 19.1% to 18.0% during 2010-2018. This indicates the relatively poor performance by the OIC countries in accumulating investment capital, as compared to other developing 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 2020.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

2.2 Income, Employment and Prices

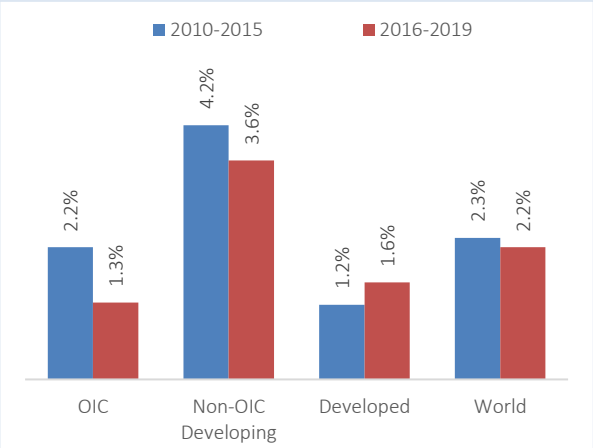
- **GDP Per Capita:** Income growth decelerated in OIC countries

The slowdown observed in total economic growth in OIC countries is also reflected in per capita income growth rates. The average GDP per capita growth rate during 2010-2015 was recorded as 2.2% in OIC countries, which fell to 1.3% during 2016-2019 (Figure 2.16). These rates are below the world average of 2.3% and 2.2% for the periods under consideration. During the same periods, growth in non-OIC developing countries was 4.2% and 3.6%, respectively.

Per capita growth rates below the world average indicate that standards of living in OIC countries are not increasing at higher rates than the rest of the world. Moreover, income per capita in OIC countries has not been converging to the world average and income disparity between OIC and non-OIC countries has been increasing. As shown in Figure 2.17, average per capita income in OIC countries increased from US$ 8,785 in 2010 to US$ 10,275 in 2019, corresponding to a 17.0% increase in total. During the same period, non-OIC developing countries attained higher growth rates (41.1%) and exceeded the per capita income levels in OIC countries to reach US$ 11,796 in 2019. This number was recorded as US$ 46,592 in developed countries with a growth rate of 13.2% observed since 2010. The world average has also increased by 22.1% and average per capita income in the world exceeded US$ 16,000 when expressed in purchasing power parity adjusted values.

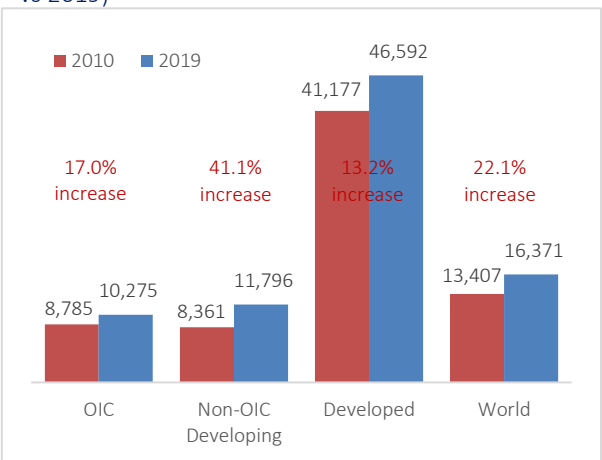
Among the OIC countries, Qatar registered the highest GDP per capita in 2019 followed by United Arab

Figure 2.16: GDP Per Capita Growth Rates



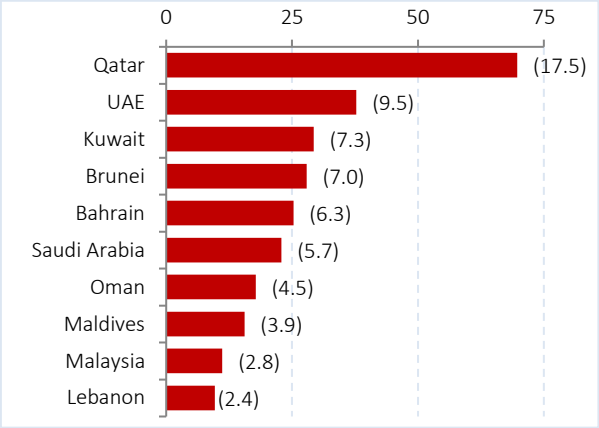
Source: SESRIC staff calculations based on IMF WEO Database October 2019. Data Coverage: 55 OIC, 98 non-OIC, and 39 developed countries. (*) Forecast. Annual compound rates for period averages.

Figure 2.17: GDP Per Capita Income Levels (2010 vs 2019)



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

Figure 2.18: Top 10 OIC Countries by GDP capita (2019, Current US$, Thousand)



Source: IMF WEO Database October 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.

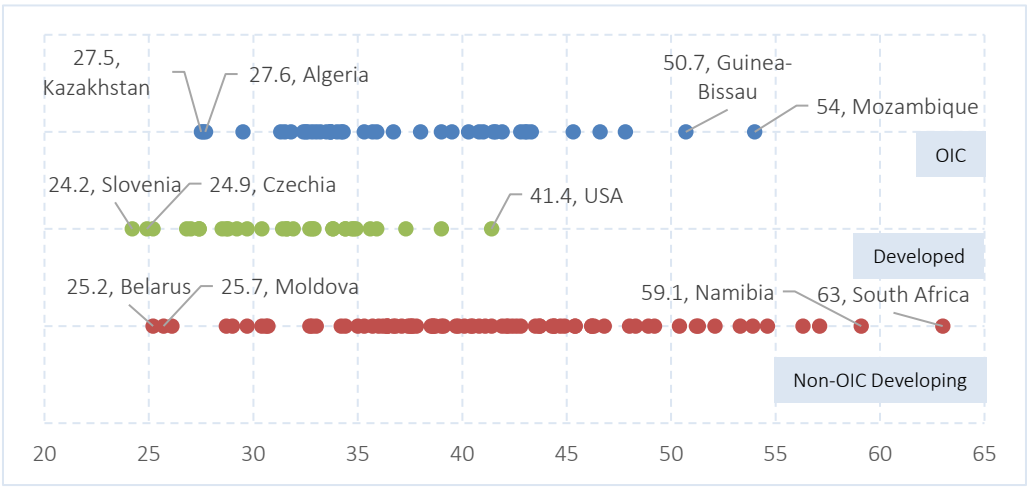
Emirates and Kuwait (Figure 2.18). The per capita GDP of Qatar was 17.5 times higher than the average of the OIC countries as a group, a situation that reflects a high level of income disparity among the OIC countries. Among the top 10 OIC countries by GDP per capita, seven are from the Middle East region. Most of them are also resource-rich countries. In 2019, Qatar was ranked sixth in the world in terms of per capita income levels.

- **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 development programs pushes low skilled labour further down in the 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 the 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 zero to one

Figure 2.19: Income Distribution, Gini Coefficient



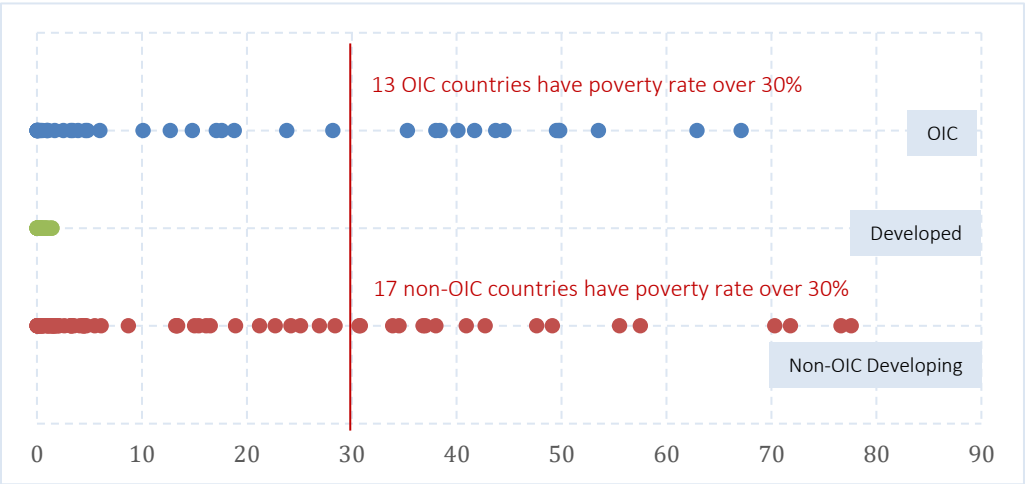
Source: World Bank WDI Database July 2020. Data coverage: 42 OIC, 32 Developed, 79 Non-OIC Developing Countries. Latest year available during 2009-2018.

(or 0% to 100%), with zero representing perfect equality and one representing perfect inequality. There are 15 OIC countries in which the score is above 40, where the OIC countries with the highest income inequality are Mozambique, Guinea-Bissau, Benin, Cameroon and Comoros. On the other hand, Kazakhstan, Algeria, Kyrgyzstan, Maldives and Egypt have the lowest income disparity among 42 OIC countries for which data are available. The lowest inequality in the world is observed in Slovenia, Check Republic and Slovakia, while the 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 the 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, 13 countries have poverty rate over 30%. Guinea-Bissau, Mozambique, Nigeria, Sierra Leone and Mali are the most affected countries with the highest poverty rates. On the other hand, out of 42 OIC countries, five OIC countries reported no poverty at the international poverty line of US$1.90 a day, namely Kazakhstan, Lebanon, Malaysia, Maldives and United Arab Emirates. 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 wellbeing and welfare of average citizens in the OIC group. For that reason, OIC countries should primarily target to offer a context for more growth, employment and competitiveness in their economies, through result-oriented activities. For that to happen, governments in OIC members should create a more enabling environment for economic

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



Source: World Bank WDI Database July 2020. Data coverage: 42 OIC, 32 Developed, 79 Non-OIC Developing Countries. Latest year available during 2009-2018.

development and the OIC economies should rely on deeper regional cooperation and economic integration, as the best option for a more inclusive and sustainable development.

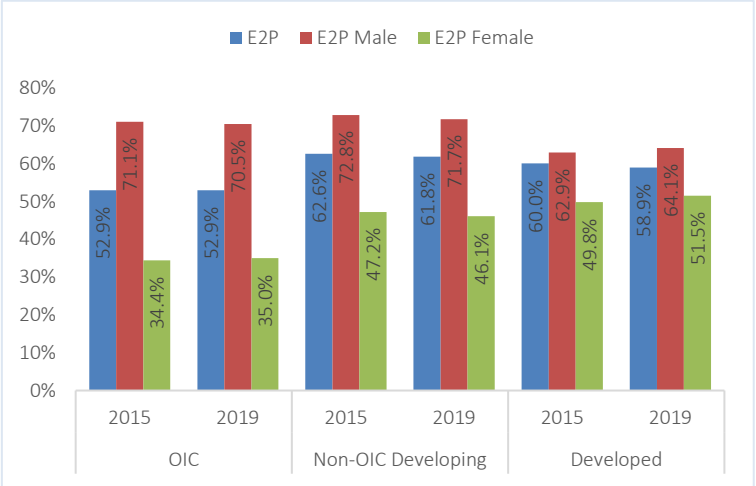
- **Employment:** Employment ratio in OIC countries remains well below the averages of other country groups

Economic growth has evidently remained insufficient to tackle 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 in 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 remained unchanged at 52.9% during 2015-2019. However, the male employment rate slightly decreased while the female employment rate is increased during the same period, reducing the gender gap from 36.7 percentage points to 35.5 percentage points.

Although OIC countries registered globally comparable performance in terms of 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 70.5% compared to 64.1% in developed and 71.7% in non-OIC developing countries. The female employment rate in OIC countries was recorded at 35.0% in 2019, which is significantly lower than the averages of non-OIC developing countries (46.1%) and developed countries (51.5%). However, the gender gap has declined.

Figure 2.21: Employment to Population Ratio (2015 vs 2019)



Source: ILO Modeled Estimates November 2019. Data coverage: 56 OIC, 93 non-OIC, and 38 developed countries.

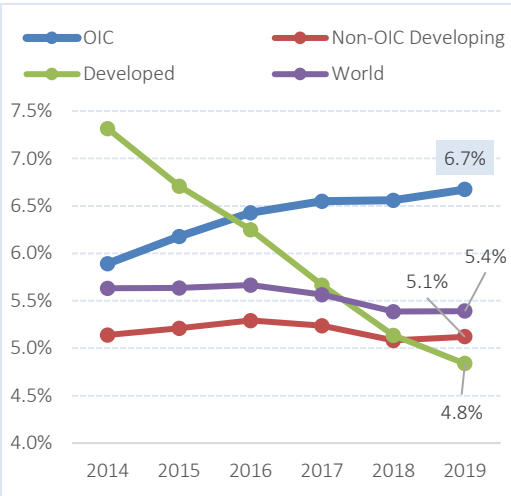
- **Unemployment:** Average unemployment rate in OIC countries continued to remain above the world average

Unemployment remained one of the most challenging issues across the globe. According to the ILO World Employment and Social Outlook 2020 report, an estimated 188 million people worldwide were unemployed in 2019, which corresponds to an unemployment rate of 5.4%. Due to ongoing uncertainties about world economic developments affected by the COVID-19 pandemic, significant deteriorations are expected in the labour markets in 2020 across the world (ILO, 2020a). While millions of workers are vulnerable to layoffs, the ultimate number of annual job losses in 2020, which is projected to be more than 25 million, will depend critically on the evolution of the pandemic and the measures taken to mitigate its impact.

According to the latest available data, OIC countries recorded significantly higher average unemployment rates compared to the world, developed and non-OIC developing countries (Figure 2.22a). Since 2014, the total unemployment rate in OIC countries has been on the rise to reach 6.7% in 2019 as compared to 5.9% in 2014. The high unemployment rate in developed countries following the 2008-09 global financial crisis has sharply declined over the recent period. Thereby, average unemployment rate in developed countries fell below the rates observed in OIC countries in 2016 and non-OIC developing countries in 2019 and reached to 4.8% in 2019, compared to 6.7% in OIC countries. Average unemployment rate in non-OIC developing countries remained visibly lower than the OIC average throughout the period under consideration, which is estimated at 5.1% in 2019.

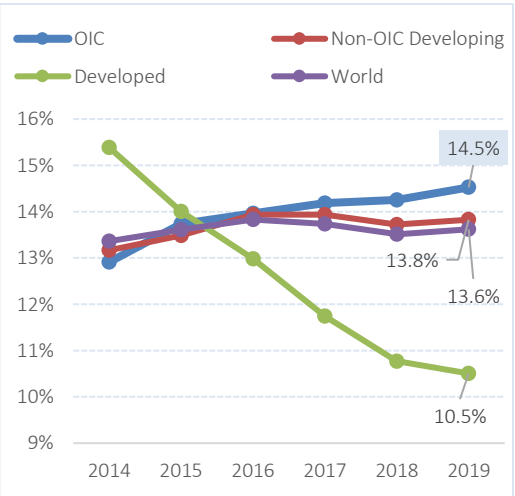
A similar picture is observed for the youth population. Youth (aged 15 to 24 years) continue to suffer from lack of decent job opportunities across the globe. They are significantly more likely to be unemployed than adults, exhibiting an unemployment rate of 11.8% in 2018. A major global

Figure 2.22a: Unemployment, 15+ Ages (2014-2019)



Source: ILO Modeled Estimates November 2019. Data coverage: 56 OIC, 93 non-OIC, and 38 developed countries.

Figure 2.22b: Youth Unemployment, 15-24 Ages (2014-2019)



Source: ILO Modeled Estimates November 2019. Data coverage: 56 OIC, 93 non-OIC, and 38 developed countries.

challenge is the phenomenon of young people who are not in education, employment or training (NEET). According to the ILO estimations, 31% of young women and 14% of young men were globally classified as NEET in 2019, exceeding 267 thousand young people.

The figures on youth unemployment rates in OIC countries are not quite promising. The unemployment rate has steadily increased from its level of 12.9% in 2014 to 14.5% in 2019 and reached the highest level as compared to other country groups (Figure 2.22b). 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, however, they managed to reduce the rate significantly since then. As of 2019, youth unemployment in OIC countries is estimated to be at 14.5%, while it is at a level of 10.5% in developed countries and 13.8% in non-OIC developing countries.

Initial projections on unemployment are rather dismal. If the rate of unemployment increases at the same rate in the group of OIC countries and reaches 7.4% (from 6.7%), the total number of unemployed persons would increase from its previously estimated level of 47.7 million to 53.3 million in 2020. If unemployment rates would further increase to 7.7% (by 1%), this number would exceed 55 million people. This would result in huge policy challenges for OIC governments in accommodating an additional 8 million unemployed people and tackling the socio-economic problems of affected populations during the post-crisis period.

At the individual country level, unemployment rates greatly varied among OIC countries (Figure 2.23). The unemployed people in 2019 constituted less than 1% of the total labour force in Qatar (0.1%), which is also the lowest rate in the world. Niger (0.5%) and Bahrain (0.7%) are also reported by the ILO among the ten countries in the world with the lowest unemployment rates. However, unemployment is a serious concern in Palestine (26.2%), Gabon (20.0%) and Libya (18.6%).

Figure 2.23: Top 10 OIC Countries by Unemployment Rates (2019)

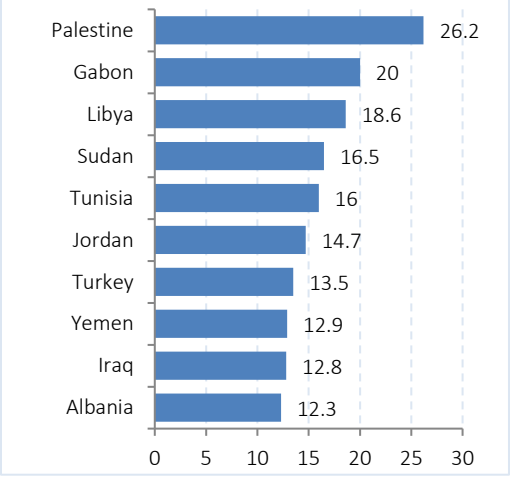
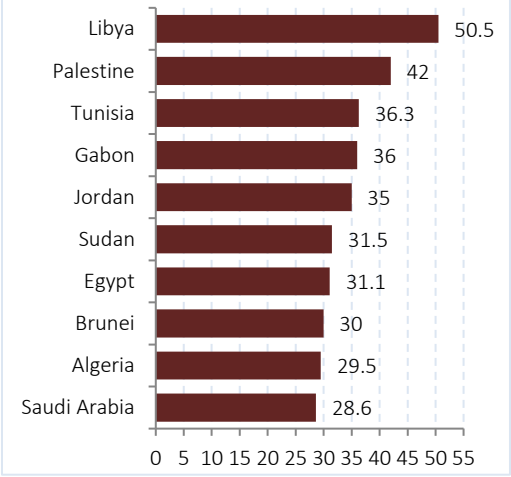


Figure 2.24: Top 10 OIC Countries by Youth Unemployment Rates (2019)

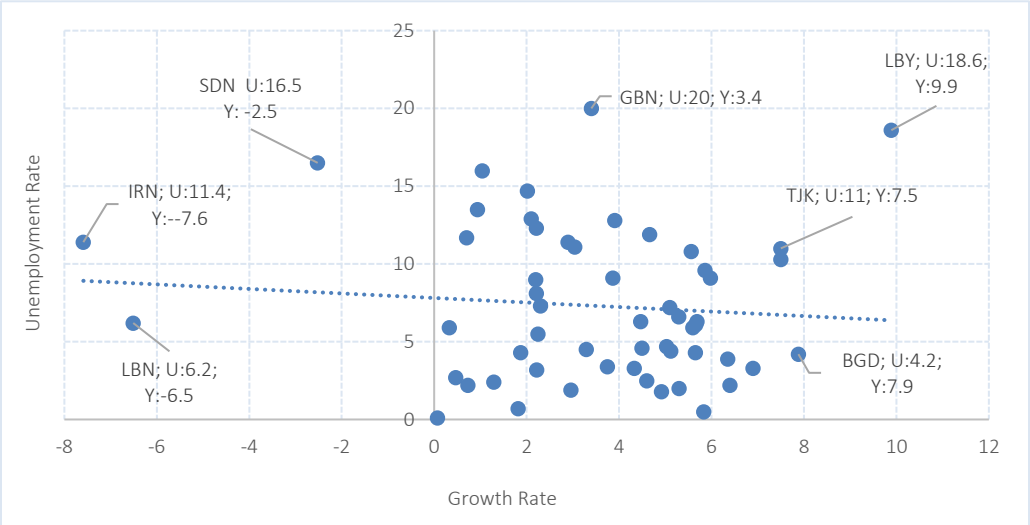


Source: ILO Modeled Estimates November 2019. Data coverage: 56 OIC Countries.

There are again wide discrepancies in youth unemployment rates across OIC countries (Figure 2.24). The highest youth unemployment rate was observed in Libya (50.5%), followed by Palestine (42.0%), Tunisia (36.3%), Gabon (36.0%) and Jordan (35.0%). In 2019, the youth unemployment rate was above 20% in 20 OIC countries and above the world average of 13.6% in 32 OIC 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 Libya. 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 (2019)



Source: World Bank WDI Database and ILO Modeled Estimates November 2019. Data coverage: 55 OIC countries.
Notes: U: Unemployment rate, Y: Growth rate. BGD: Bangladesh, GBN: Gabon, IRN: Iran, LBN: Lebanon, LBY: Libya, SDB: Sudan, TJK: Tajikistan.

- **Labour Productivity:** Only five 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.

Figure 2.26a: Average Labour Productivity Growth (2000-2009 vs 2010-2019)

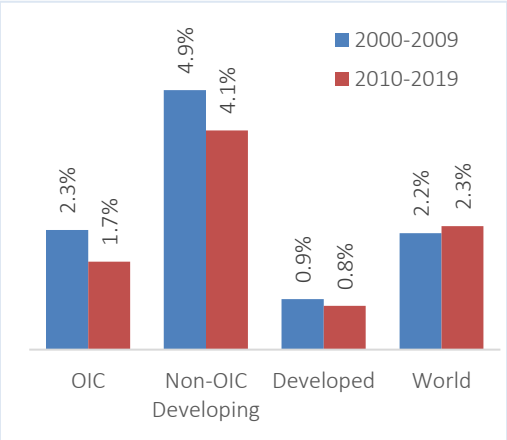
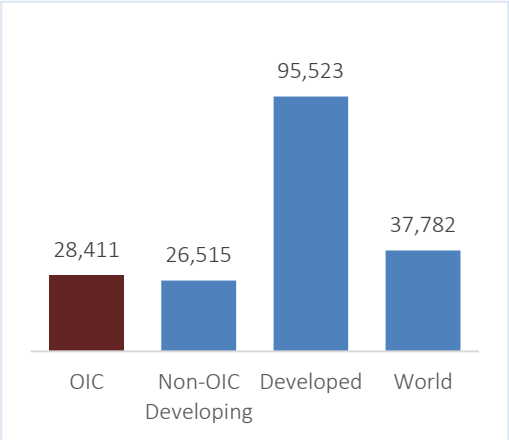


Figure 2.26b: Average Labour Productivity (PPP constant prices, 2019)



Source: ILO Modelled Estimates November 2019. Data coverage: 56 OIC, 93 non-OIC, and 38 developed countries.

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 1.7% during 2010-2019. Average labour productivity growth in non-OIC developing countries remained above 4% annually. As of 2019, average labour productivity in OIC countries was measured as US$ 28.4 thousand, 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 US$ 95.5 thousand in 2019 compared to just US$ 26.5 thousand in non-OIC developing countries and US$ 28.4 thousand in OIC countries. This means that an average worker in the group of non-OIC developing countries produces only 27.8% of the output produced by an average worker in the developed countries and an average worker in OIC countries produces only 29.7% of the output produced by an average worker in the developed countries.

On the other hand, reduced working hours, teleworking and home-office type of working for certain jobs during the pandemic times will directly affect labour productivity. This is not only because many people are unwell or struggling to work at home, but also because of a sharp decline in output. Having adequate and effective infrastructure for digital communication and telecommuting can partly eliminate productivity losses for certain jobs, but many firms in OIC countries, particularly small and medium sized enterprises (SMEs), are less likely to have such facilities.

At the individual country level, Brunei Darussalam registered the highest output per worker (US$ 159 thousand) in 2019, followed by Qatar (US$ 150 thousand), Saudi Arabia (US$ 122 thousand) and Kuwait (US$ 114 thousand). Among the OIC countries, the lowest labour productivity level was recorded in Somalia (US$ 1,026) followed by Niger (US$ 2,654) and Mozambique (US$ 2,776).

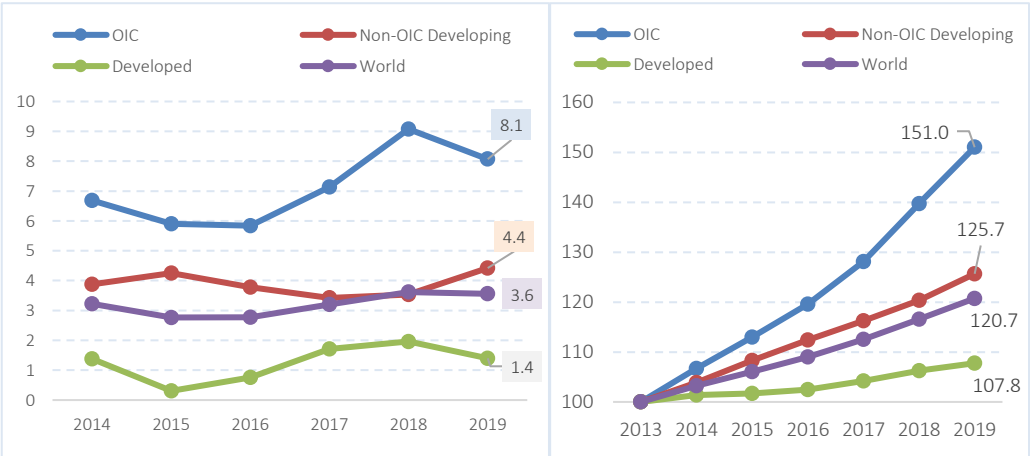
Only five OIC member countries recorded output per worker higher than the average of developed countries.

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

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

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 2019, inflation rates have been mostly on the rise. It increased from 5.8% in 2016 to 9.1% in 2018. However, the rise in average consumer prices declined to 8.1% in 2019. Non-OIC developing countries were experiencing a rather stable increase in consumer prices at around 4% level, but it increased to 4.4% in 2019. On aggregate, consumer prices have increased by 51.0% in OIC countries, 25.7% in non-OIC developing countries and 7.8% in developed countries since 2013.

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



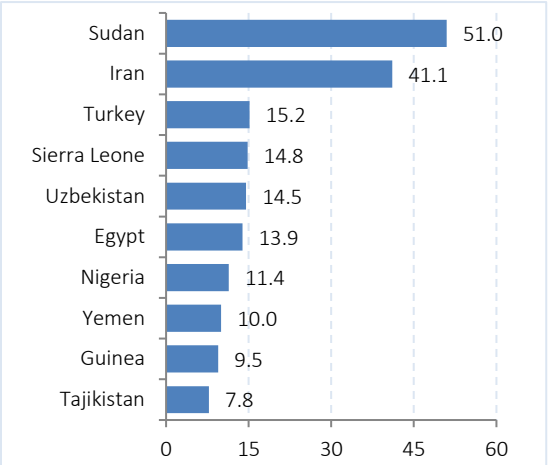
Source: SESRIC staff calculations based on IMF WEO Database April 2020 (world and developed) and October 2019 (OIC and non-OIC). Data Coverage: 55 OIC, 97 non-OIC developing and 39 developed countries. Global and regional price indices are calculated as a weighted average of national price indices, with the weights being each respective country's GDP in current international dollars based on PPP. Venezuela excluded from the sample of non-OIC developing countries.

At the individual OIC country level, Sudan recorded the highest average consumer prices inflation rate of 51.0% in 2019 (Figure 2.28), which was also the fifth highest in the world after Venezuela, Zimbabwe, Argentine and South Sudan. Iran (41.1%), Turkey (15.2%), Sierra Leone (14.8%) and Uzbekistan (14.5%) were the other OIC countries with highest inflations rates in 2019. Together with Egypt and Nigeria, these seven OIC countries were also among the top 15 countries in the world with the highest increase in consumer prices.

- **Fiscal Balance:** 23 OIC countries improved their fiscal balance in 2019

Latest statistics show that the fiscal tightening policies adopted in the aftermath of financial crisis have led to the improvement in fiscal balances across the world. Nevertheless, a 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 fiscal balances. On the other hand, developing countries registered significant deterioration in their fiscal situation over the last decade.

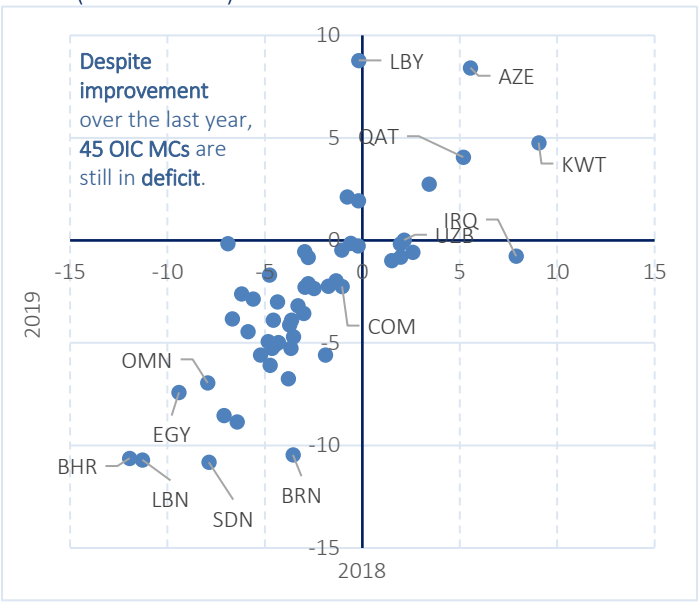
Figure 2.28: Top 10 OIC Countries by Inflation Rates (2019)



Source: IMF WEO Database April 2020. Data coverage: 54 OIC Countries.

During the period under consideration, the OIC member countries witnessed a sharp deterioration in their fiscal balance. High dependence on commodity and primary goods exports makes many OIC countries particularly vulnerable to price fluctuations. In 2018, there were ten OIC countries with fiscal balance surplus. This number decreased to eight in 2019 (Figure 2.29). During 2018-2019, 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, Sudan recorded the largest fiscal balance deficit (10.8%) followed by Lebanon (10.7%), and Bahrain (-10.6%).

Figure 2.29: Change in Fiscal Balance in OIC Countries, % of GDP (2018 vs 2019)



Source: IMF WEO Database April 2020. Data coverage: 54 OIC Countries.

CHAPTER THREE

Trade and Finance

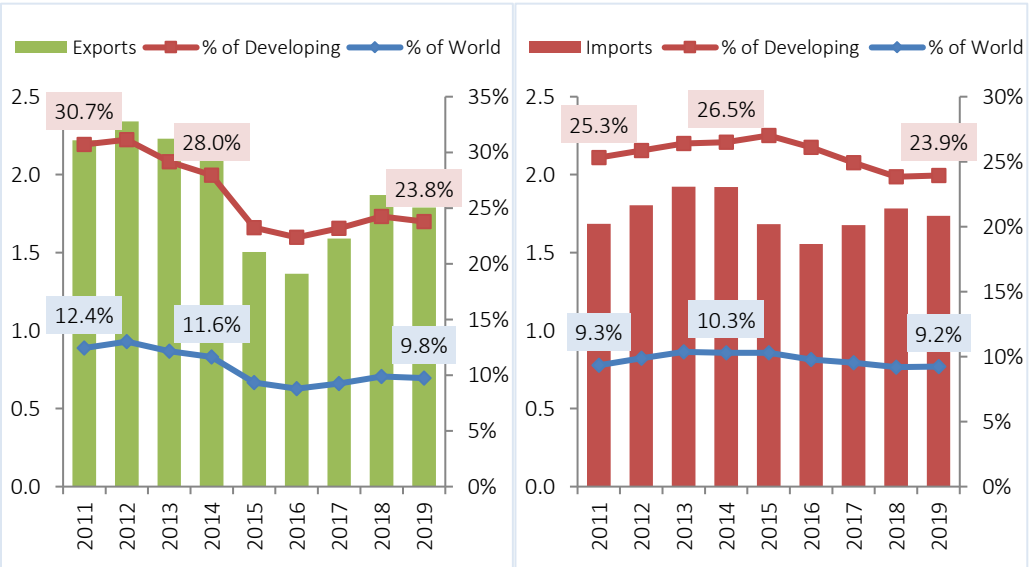
3.1 Trade in Goods and Services

- **Merchandise Trade:** Share of OIC countries in world's total exports slightly fell to 9.8% in 2019.

The total value of world merchandise exports, according to the IMF Directions of Trade Statistics (DOTS), was recorded at US$ 18.3 trillion in 2019, as compared to US$ 18.9 trillion in 2018. According to the World Trade Organisation (WTO), however, world merchandise exports decreased from US$ 19.5 trillion in 2018 to US$ 18.9 trillion in 2019. After recording strong growth rates for two consecutive years, the global trade flows appear to slow down as a result of heightening trade tensions among major economies. Despite small disparities in global trade estimations, global exports decreased by more than 3% in 2019. The recent COVID-19 pandemic creates additional uncertainties, negatively affecting the trade relations. Accordingly, the global estimations on trade flows have been significantly revised downward. According to WTO estimations, global trade flows are expected to decline by between 13% and 32% in 2020.

In line with this global trend, OIC countries have also witnessed a slowdown in their total exports to the world. After constantly falling during 2012-2016 and reaching its lowest level in 2016 since 2008, their aggregate exports increased to US$ 1.87 trillion in 2018, as reported by IMF DOTS (Figure 3.1). However, it fell back to US$ 1.79 trillion in 2019, corresponding to a 4.4% decline in total export flows. This downward trend was stronger than that observed in non-OIC developing countries and the world, resulting in a fall in the shares of OIC countries in total developing countries and world exports in 2019. Accordingly, the share of OIC countries in total exports of developing countries declined to 23.8% in 2019, compared to 24.2% in 2018. OIC countries' collective share in total world merchandise exports also followed a similar trend between 2012

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



Source: IMF Directions of Trade Statistics (DOTS), July 2020. *Data coverage*: 56 OIC countries, 37 developed countries and 116 non-OIC developing countries.

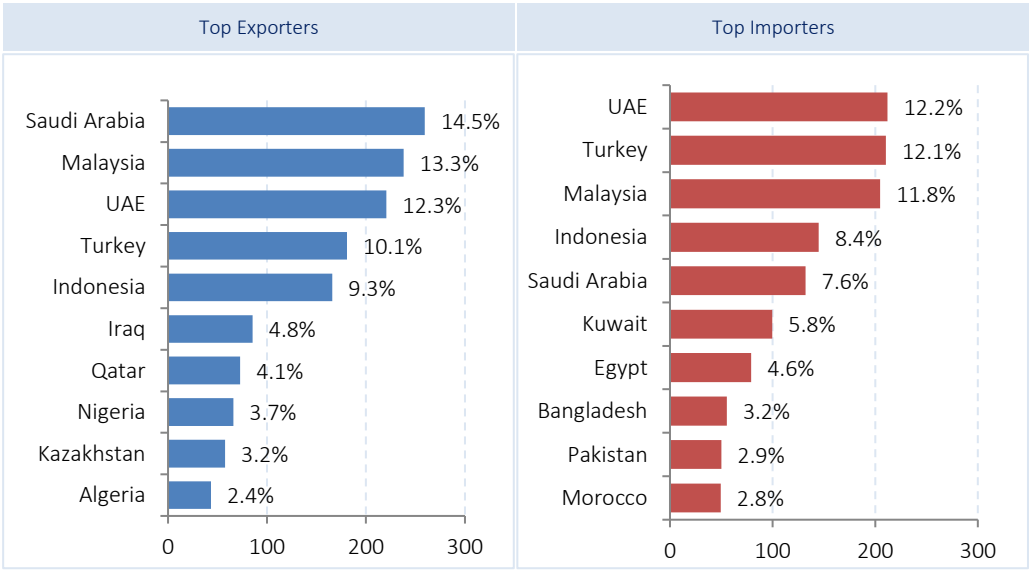
and 2016 and decreased to 8.8% in 2016, which is the lowest ratio observed since 2005. This is largely to be explained by falling commodity prices, where OIC countries have significant concentration. However, after increasing back to 9.9% in 2018, it slightly fell to 9.8% in 2019. Moving forward, to 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 also decreased from US$ 1.78 trillion in 2018 to US$ 1.74 trillion in 2019 (Figure 3.1, right). Despite the fall in import volumes, the share of OIC group in global merchandise imports remained stable at 9.2% in 2019 compared to 10.4% in 2013, while its share in total imports of developing countries slightly increased from 23.8% in 2018 to 23.9% in 2019.

In terms of the shares of the individual member countries in total merchandise exports from the OIC group, 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 2019, the top five largest OIC exporters accounted for 59.5% of total merchandise exports of all member countries whereas the top ten countries accounted for 77.7%. Saudi Arabia, with over US$ 259 billion worth of merchandise exports and 14.5% share in total OIC exports, became the largest OIC exporter in 2019. It was followed by Malaysia (US$ 238 billion, 13.3%), United Arab Emirates (US$ 221 billion, 12.3%), Turkey (US$ 181 billion, 10.1%) and Indonesia (US$ 166 billion, 9.3%). In general, an 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$ 212 billion and US$ 210

Figure 3.2: Top OIC Merchandise Exporters and Importers (2019, US$ Billion)



Source: IMF Directions of Trade Statistics (DOTS), July 2020. *Data coverage:* 56 OIC countries.

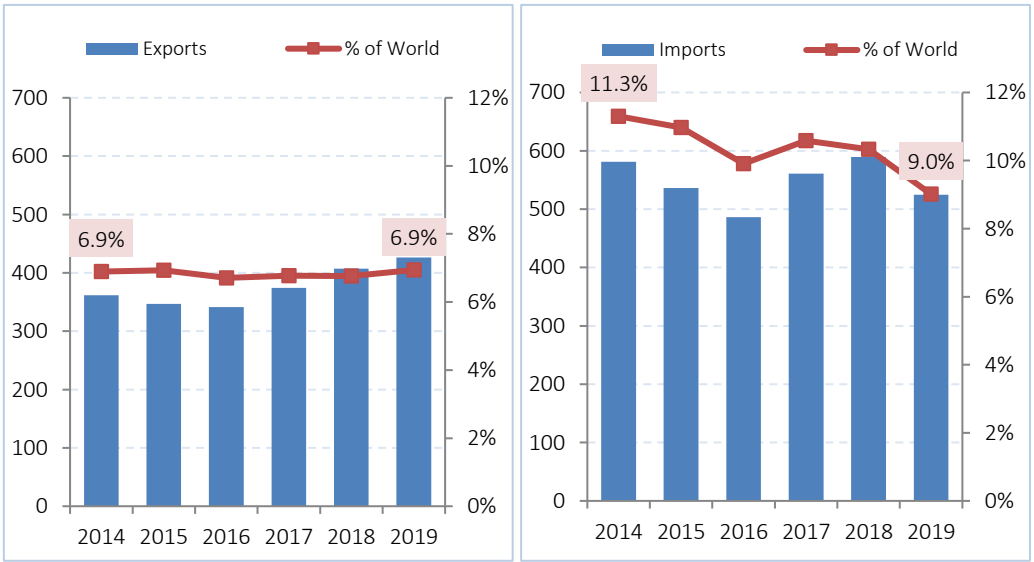
billion of imports, United Arab Emirates and Turkey, respectively, took the lead in 2019 in terms of volume of merchandise imports and together accounted for 24.3% of total OIC merchandise imports. They were followed by Malaysia (US$ 205 billion, 11.8%), Indonesia (US$ 145 billion, 8.4%) and Saudi Arabia (US$ 132 billion, 7.6%), which collectively accounted for a further 27.8 % share in the OIC merchandise imports. Accordingly, the top five OIC importers accounted for 52.1% of total OIC merchandise imports, whereas the top ten countries accounted for 71.3% in 2019.

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 the competitiveness of tradable products in international export markets.

- **Services Trade:** Total OIC services exports recorded highest level in 2019, but accounted for 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 GDP, trade and employment. According to 2020 editions of the World Bank's World Development Indicators and United Nations' National Accounts Main Aggregates Databases, the services sector accounted on average for 67%-68% of the global value-added during 2010-2018 and it has been expanding

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



Source: WTO Database. July 2020. Data coverage: [Exports] 53 OIC, 36 developed and 87 non-OIC developing countries. [Imports] 40 OIC, 36 developed and 88 non-OIC developing countries.

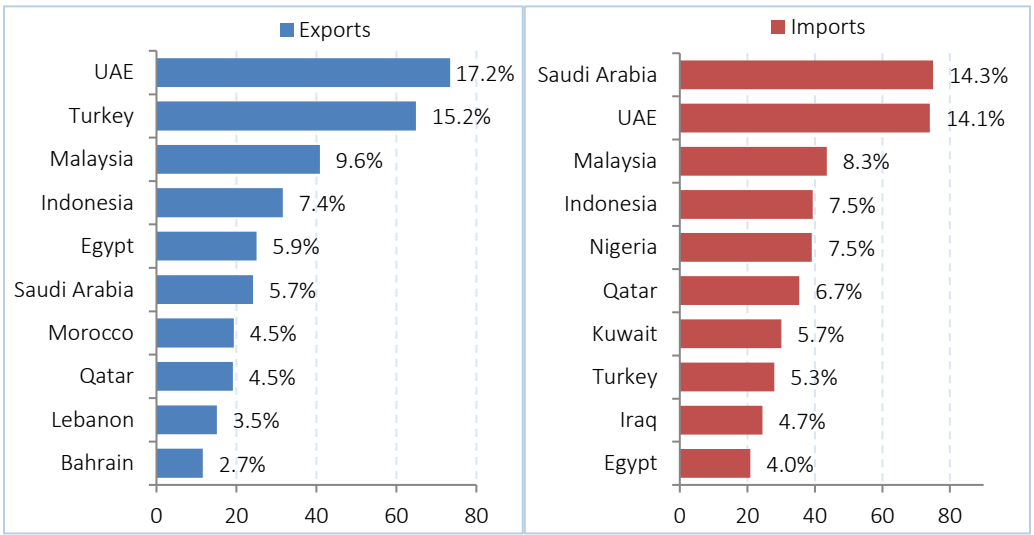
more rapidly than the other two main sectors of the economy, namely, agriculture and the industry. This sector accounts for more than 50% of employment worldwide. Trade in services constitutes more than 20% of world trade of goods and services, with a significant share of global foreign direct investment (FDI) flowing into the sector (UNCTAD, 2019).

Yet these figures do not translate into a strong presence in the global trade volume. In 2019, world services exports totalled only US$ 6.1 trillion, compared to US$ 18.3 trillion of merchandise exports in the same year. According to WTO statistics, OIC countries exported US$ 427 billion worth of services in 2019, which is the highest number recorded by the OIC (Figure 3.3, left). On the other hand, the total services imports of OIC fell to US$ 525 billion in 2019 from US$ 589 billion in 2018 (Figure 3.3, right), which helped to reduce the trade deficit in services, as discussed later in the section.

Yet, OIC countries continue to contribute to the global services exports at relatively lower rates. The collective share of OIC countries in the total world services exports remained stable at around 6.7% - 6.9% during the period 2014-2019, while the share in global services imports fluctuated between 9.0% and 11.3% during the same period. As of 2019, OIC countries as a group accounted for 6.9% of global services exports and 9.0% of global services imports (Figure 3.3).

Figure 3.4 shows the top ten OIC countries according to the sizes of their services exports and imports. United Arab Emirates, with US$ 73.5 billion exports and 17.2% share in total OIC services exports, was the top exporter in services in 2019 (Figure 3. 4, left). It was followed by Turkey (US$ 64.9 billion, 15.2%), Malaysia (US$ 40.9 billion, 9.6%), Indonesia (US$ 31.6 billion, 6.8%) and Egypt (US$ 23 billion, 5.8%). In 2019, the top ten OIC countries accounted for 76.2% of total OIC services exports. As far as the service imports are concerned, Saudi Arabia registered the highest service imports with an amount of US$ 75 billion and 14.3% share in OIC total services imports. It was

Figure 3.4: Top 10 OIC Services Exporters and Importers (2019, US$ Billion)



Source: WTO Database. *Data coverage: [Exports]* 53 OIC countries; [Imports] 40 OIC countries. Percentages indicate the share of respective country in total OIC exports or imports.

followed by United Arab Emirates (US$$ 74.1 billion, 14.1%), Malaysia (US$$ 43.5 billion, 8.3%), Indonesia (US$ 39.4 billion, 7.5%) and Nigeria (US$ 39.1 billion, 7.5%). The top ten OIC services importers collectively accounted for 78.1% of total services imports of OIC countries.

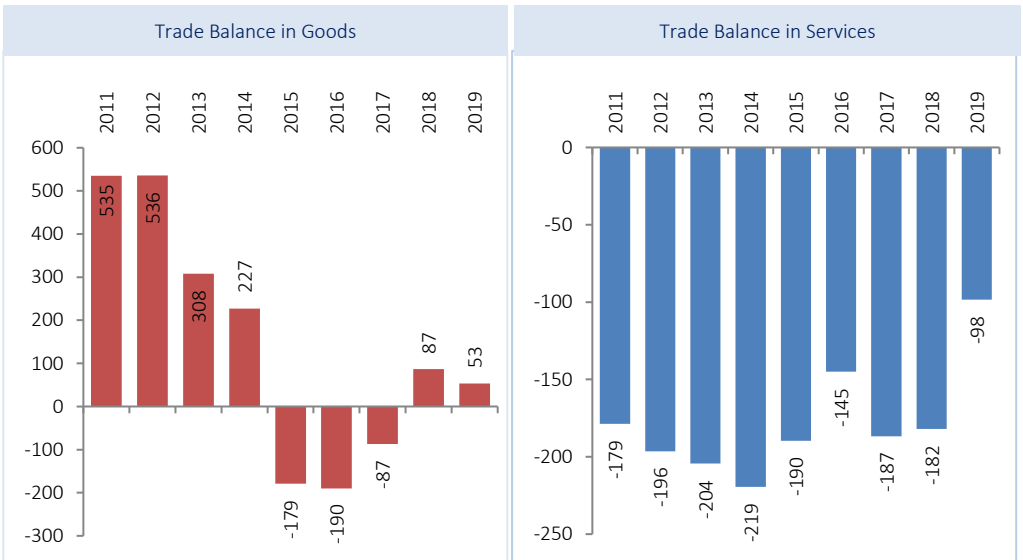
- **Trade Balance:** OIC countries remain net exporters of goods, but net importers of services in 2019.

The above analyses on merchandise and services trade indicate that OIC countries are not taking enough role in global economic activities. With over-proportional decline in trade flows observed in 2019, their contribution to global flow of goods and services remained below their potential. Inadequate levels of capacity in manufacturing and services make them less competitive in international markets to become net exporters 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$ 87 billion. This amount fell to US$ 53 billion in 2019. On the other hand, OIC countries continued to remain a net importer of services over the period under consideration. However, the trade deficit in services showed some signs of improvement and fell to its lowest level of US$ 98 billion in 2019.

Altogether, OIC countries recorded only US$ 45 billion trade deficit in 2019, which was recorded at US$ 95 billion in 2018. In order to become a net exporter of both goods and services and continue to generate surpluses in trade, OIC countries need to upgrade their existing production capacities to transform their economics towards more value-added sectors and products and become more competitive in global markets in a greater number of products.

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



Source: IMF DOT and WTO Database. *Data coverage*: [Goods] 56 OIC countries, [Services] 53 OIC countries.

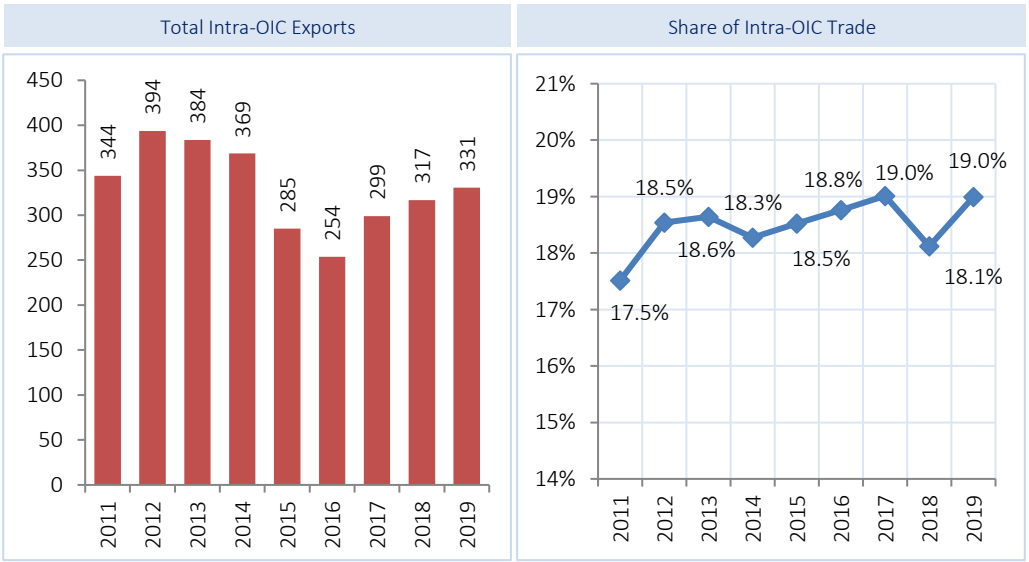
- **Intra-OIC Trade:** Share of intra-OIC trade in total trade of OIC countries bounced back to 19% in 2019.

Intra-OIC export flows have been steadily increasing since 2016 from a level of US$ 254 billion to reach US$ 331 billion in 2019 (Figure 3.6, left). Over the last three years, intra-OIC exports increased by more than 30%, which is a significant achievement. Yet, it remained below the total values recorded in 2012. Considering the slight fall in global exports of OIC, the increase in intra-OIC exports in 2019 translates into a higher share of intra-OIC trade flows. The intra-OIC trade flows actually stuck between 18% and 19% during 2012-2019 (Figure 3.6, right). Despite the sharp fall to 18.1% in 2018, OIC countries managed to raise the intra-OIC trade flows back to the 19% level in 2019. However, the sluggish growth in intra-OIC trade flows reduces the prospects for achieving the 25% target set in the OIC Ten-Year Programme of Action (OIC-2025). This requires further efforts to invigorate upward momentum through bilateral and multilateral trade and investment agreements and partnerships among the OIC countries.

In order to increase the intra-OIC share of trade 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 the operationalization of the system is rather sluggish.

At the individual country level, Figure 3.7 (left) depicts the top ten member countries in terms of the volume of their intra-OIC exports. In 2019, the top ten OIC intra-OIC exporters accounted for as much as 61.0% of total intra-OIC exports whereas the top ten exporters for 76.2%. United Arab Emirates ranked first with US$ 58.8 billion and 17.8% of total intra-OIC exports, followed by Saudi

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

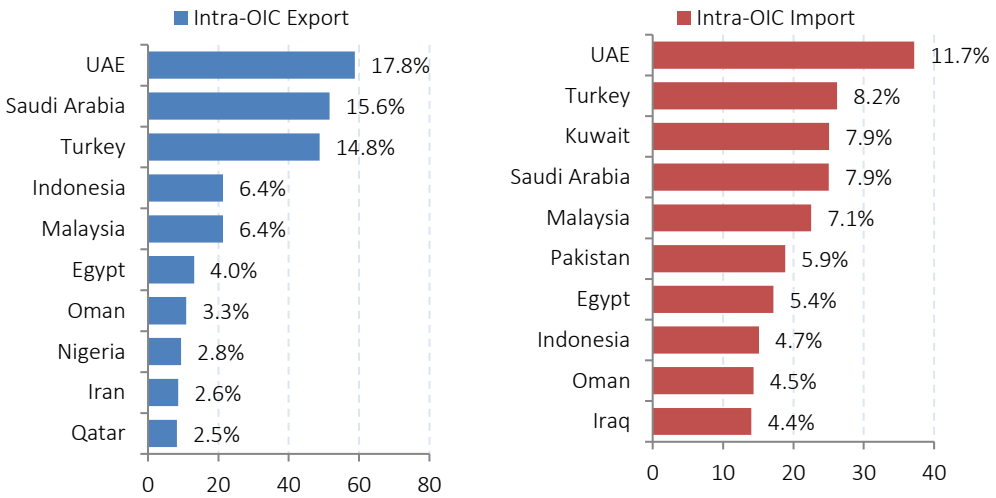


Source: IMF Directions of Trade Statistics (DOTS), July 2020. *Data coverage*: 56 OIC countries.

Arabia (US$ 51.7 billion, 15.6%), Turkey (US$ 48.8 billion, 14.8 %), Indonesia (US$ 21.3 billion, 6.4%) and Malaysia (US$ 21.3 billion, 6.4%).

The top OIC countries in terms of intra-OIC imports are also depicted in Figure 3.7 (right). In 2019, United Arab Emirates, with US$ 37.2 billion total volume and 11.7% share in total, was the largest importer from OIC countries. It was followed by Turkey with US$ 26.2 billion and 8.2% share, and Kuwait with US$ 25.1 billion and 7.9% share. The top five OIC countries accounted for 42.7% of total intra-OIC imports and the top ten countries accounted for 67.7% in 2019.

Figure 3.7: Intra-OIC Merchandise Exports and Imports (2019, US$ Billion)



Source: IMF Directions of Trade Statistics (DOTS), July 2020. *Data coverage*: 56 OIC countries.

Table 3.1 shows the number of country pairs with zero trade flows. IMF DOT database provides information for 3192 OIC country pairs. 1041 of which did not report any imports in 2019. This figure was 1357 in 2005 and 1053 in 2015. The falling number of country pairs with zero trade flows 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. The number of country pairs with a total value of imported goods of over US$ 1 million and US$ 1 billion has increased over time. This shows that OIC countries are not only trading with each other, but they are also trading in increasing volumes over time.

Table 3.1: Number of OIC Pairs with Zero Imports

	Zero Import	Import < 1 Million	Import > 1 million	Import > 1 billion	Total Obs.
2005	1,357	826	984	25	3192
2010	1,171	869	1,094	58	3192
2015	1053	922	1,157	60	3192
2019	1041	922	1,152	77	3192

Source: SESRIC staff calculations based on IMF Direction of Trade Statistics (DOTS)

3.2 Investment and Finance

- **FDI Inflows:** Share of OIC countries in global FDI inflows dropped to 6.9% in 2019 after rising for two consecutive years

World total foreign direct investment (FDI) inflows amounted to US$ 1.54 trillion in 2019, marking an increase of more than US$ 45 billion over the previous year's value of US$ 1.5 trillion and corresponding to a 3% rise. After dramatically falling from a historically high level of US$ 2 trillion in 2015 to US$ 1.7 trillion in 2017 and US$ 1.5 trillion in 2018, this slight increase could be a sign of improvement in global investment flows. Yet, the COVID-19 crisis is expected to cause a dramatic drop in FDI flows in 2020 and 2021. According to UNCTAD (2020a), global FDI flows are forecasted to decrease by up to 40% in 2020, bringing FDI below $1 trillion for the first time since 2005. FDI is projected to decrease by a further 5% to 10% in 2021.

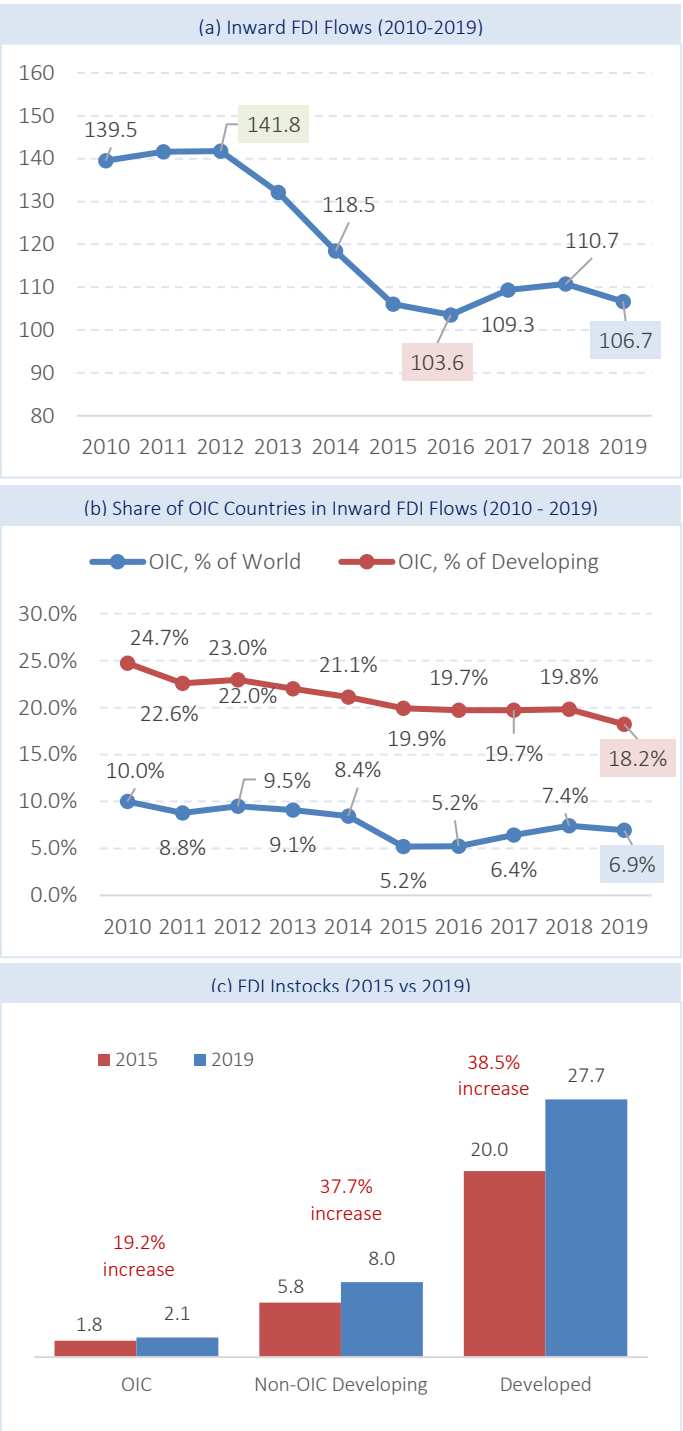
Figure 3.8a depicts the total FDI flows to OIC countries in comparison to non-OIC developing and developed countries. It is observed that, during the period under consideration, FDI flows to OIC countries generally remained lower than their potential. After reaching US$ 142 billion in 2012, the FDI inflows to OIC member countries constantly fell until 2016 to reach only US$ 103.6 billion. In 2017, the total value of FDI flows to OIC countries increased for the first time since 2011, which was recorded at US$ 109.3 billion, corresponding to a 5.5% increase compared to the previous year. It slightly increased in 2018 to reach US$ 110.7 billion. In 2019, FDI inflows to OIC countries decreased by 3.6% to US$ 106.7 billion.

The share of OIC countries in global FDI inflows, on the other hand, has been on the decline during most of the years over the last decade. After reaching its lowest value of 5.2% in 2015 and 2016, it bounced back to 7.4% in 2018 (Figure 3.8b). However, due to the increase in global FDI inflows and fall in inflows to OIC countries, the share of OIC countries in global FDI inflows declined again and remained at 6.9% in 2019. Their share in FDI inflows to developing economies, however, has been constantly on decline over the years and was recorded at 18.2% in 2019.

The projections for the next years are also rather bleak. Assuming the OIC countries will experience a decline at the same magnitude of around 40% in 2020, it is being projected that the FDI flows to OIC countries may fall to below US$ 64 billion in 2020. This is a much stronger decline in investment flows as compared to the 2008-09 global financial crises, in which OIC countries experienced a drop from US$ 173 billion in 2008 to US$ 132 billion in 2009, corresponding to around 23% fall in total inflows. To reduce the impacts of the pandemic, many countries across the world are trying to speed up investment approval procedures, promote the extensive use of online tools and e-platforms, and offering incentive schemes for health-related R&D to alleviate the impact on investment flows and local firms (UNCTAD, 2020b).

In terms of FDI stocks, global inward FDI stock reached US$ 36.5 trillion in 2019. OIC countries collectively recorded US$ 2.1 trillion stock of FDI in 2019 (Figure 3.8c). Although inward FDI stocks in OIC countries grew by more than 50% since 2010, this increase was lower than the growth in other country groups, which led to a fall in its share in global FDI stock from 6.5% in 2010 to 5.5%

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



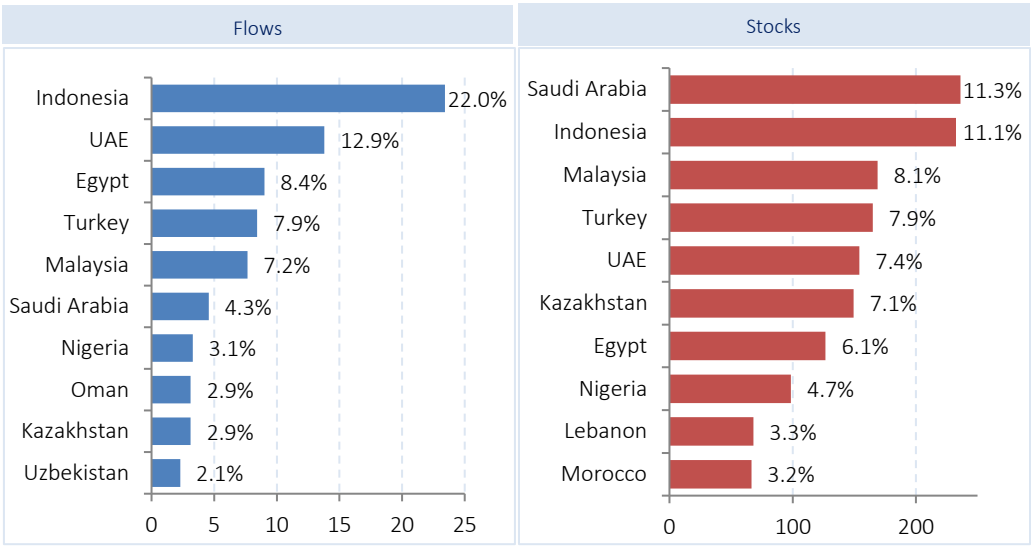
Source: SESRIC staff calculations based on UNCTAD STAT Database July 2020. Data Coverage: 56 OIC, 109 non-OIC, and 37 developed countries.

in 2019. 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 2019.

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 the bulk of it persistently being directed to only a few of them. The top five OIC countries with the largest inward FDI flows accounted for 58.4% of total FDI flows to OIC countries, whereas the top ten countries accounted for 73.8% (Figure 3.9, left). In 2019, Indonesia took the lead with US$ 23.4 billion of inward FDI flows, and a 22.0% share in OIC total. It was followed by United Arab Emirates (US$ 13.8 billion, 12.9%), Egypt (US$ 9.0 billion, 8.4%), Turkey (US$ 8.4 billion, 7.9%) and Malaysia (US$ 7.7 billion, 7.2%).

A similar situation is also observed in the case of inward FDI stock as the top five countries hosted 45.7% of total OIC inward FDI stocks whereas the top ten countries accounted for 70.1%. With US$ 236 billion of inward FDI stocks (11.3% of the OIC total), Saudi Arabia ranked

Figure 3.9: Top 10 Hosts of Inward FDI Flows and Stocks (2019, US$ Billion)



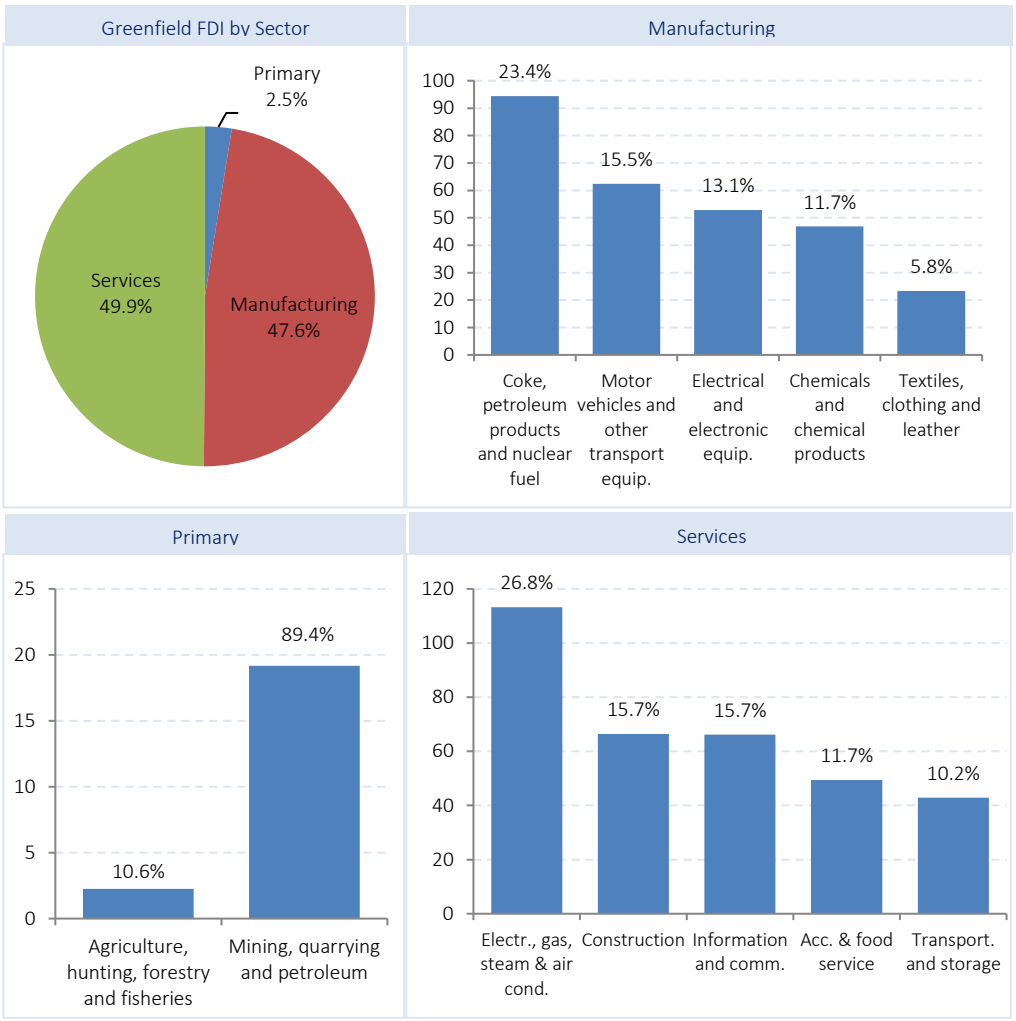
Source: UNCTAD STAT, July 2020. Data coverage: 56 OIC countries.

first among the OIC countries with the largest inward FDI stock in 2018. It was followed by Indonesia (US$ 233 billion, 11.1%), Malaysia (US$ 169 billion, 8.1%), Turkey (US$ 165 billion, 7.9%) and UAE (US$ 154 billion, 7.4%).

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 conducive to attracting more foreign investments. To achieve this goal, reforms are needed to improve the business climate and to introduce investment incentives tailored to the needs of both domestic and foreign investors. This, in turn, requires building adequate infrastructure as well as investing in modern technologies to enhance their productive capacities, which is still a significant challenge to the 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 less than 3% will go to primary sectors (Figure 3.10, upper left), while almost all of these investments to be allocated for mining, quarrying and petroleum industries (Figure 3.10, lower left). Manufacturing sector is expected to receive 47.6% of future investments, where petroleum products, electrical equipment and motor vehicles are the top industries that are expected to receive higher investment globally (Figure 3.10, upper right). On the other hand, half of the investments will flow into the services sector, with electricity, gas and water, and construction expected to receive the largest share in investment flows to the services sector (Figure 3.10, lower right). This distribution of investments across sectors will have also implications for industrial development.

Figure 3.10: Distribution of Greenfield Investment across the World, by Sector (2019, US$

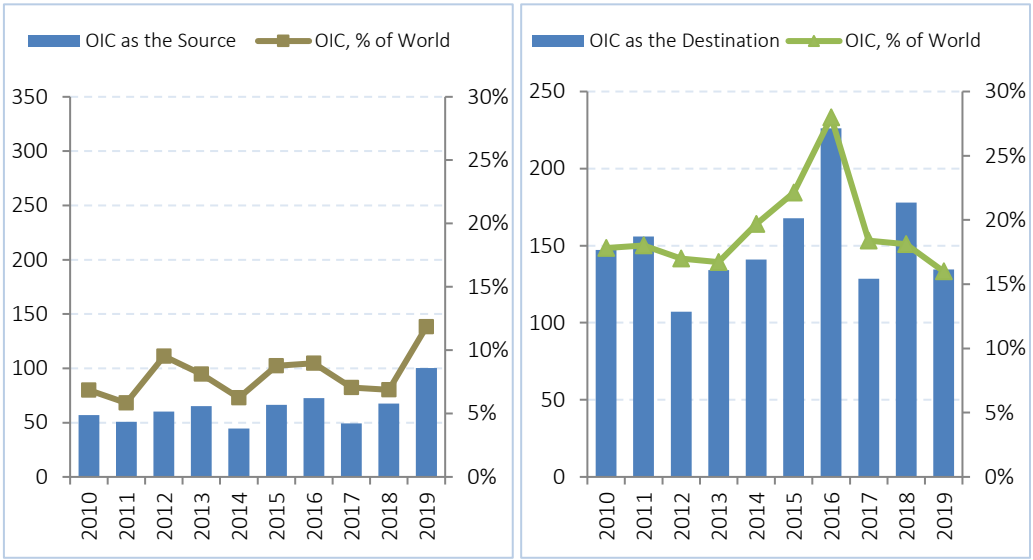


Source: UNCTAD STAT, July 2019. Data reported as aggregate.

Figure 3.11 shows the value of announced greenfield investments since 2010. OIC countries, on average, has been the source of global investment flows at around 7%, but this ratio increased to 11.8% in 2019 (left). On the other hand, around 20% of global investment flows were announced to flow into OIC countries during the period under consideration, which is expected to fall to 16% in 2019, a ratio that is well below the rate attained in 2016 with 28% (right). Accordingly, OIC countries continue to receive more investment than that they made abroad, according to the announced greenfield investment statistics.

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 the business climate to promote investment inflows to OIC countries. It is also important to promote intra-OIC investment flows. The success of reaching the potential in intra-OIC FDI is closely linked to the determination of

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



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

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.

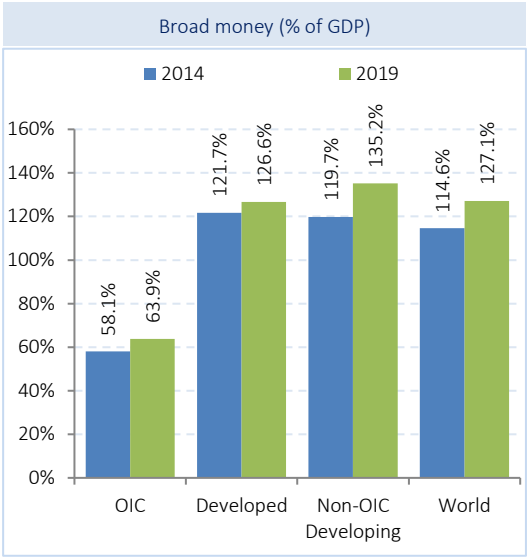
- **Financial Sector Development:** Degree of financial deepening in OIC countries remained unsatisfactory

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, the average volume of broad money relative to the GDP of OIC countries was recorded at 63.9% in 2019, compared to as much as 135% in non-OIC developing countries and 127% 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 a lower cost.

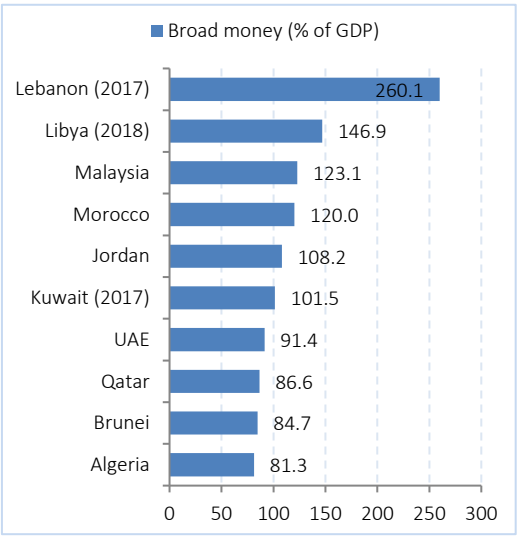
The degree of financial development varies substantially across the OIC countries. While some member countries have relatively more advanced financial systems including vibrant banking, insurance and other financial institutions, and effective financial regulatory and supervisory regimes; many others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

Figure 3.12: Financial Sector Development



Source: World Bank WDI. *Data coverage*: 51 OIC, 15 developed and 86 non-OIC developing countries.

Figure 3.13: Financial Sector Development, Top OIC Countries (2019)



Source: World Bank WDI. *Data coverage:* Out of 51 OIC countries with available data after 2017.

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 (260.1%), as shown in Figure 3.13. In Libya, Malaysia, Morocco, Jordan and Kuwait, the relative size of broad money to GDP also exceeded the 100% threshold.

A report of the 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 for the domestic financial market during times of international stress, limiting adverse spillovers, as evidenced in the recent global financial crisis.

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.

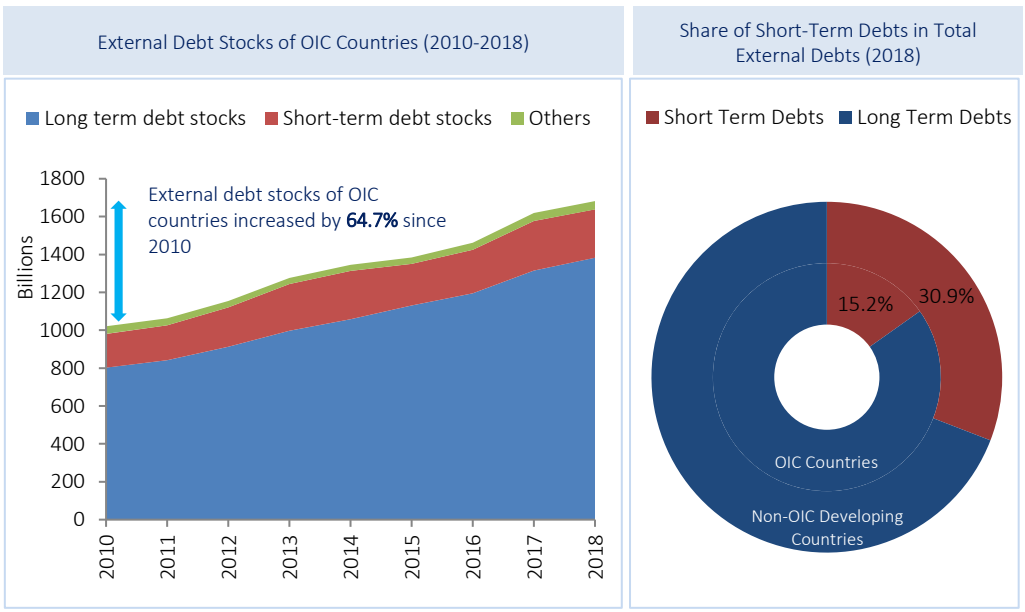
- **External Debt:** External debt stocks of OIC countries increased by 64.7% since 2010, while long terms debts accounting for more than 84% of total debts in 2018.

The total external debt stock of OIC countries showed an increasing trend over the last decade. In 2018, the total external debt of OIC countries grew by 3.9% compared to the previous year and reached US$ 1.68 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 3.14 (left) illustrates both the size of the total debts of OIC countries and its distribution over the years. External debt stocks of OIC countries increased by 64.7% since 2010. During the same period, the external debt of non-OIC developing countries increased by 81% to reach US$ 6.13 trillion in 2018.

In terms of the 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 2018, short-term debts accounted for 15.2% of total external debts of OIC countries, while 30.9% of total debts of non-OIC developing countries were classified as short term debts (Figure 3.14, right).

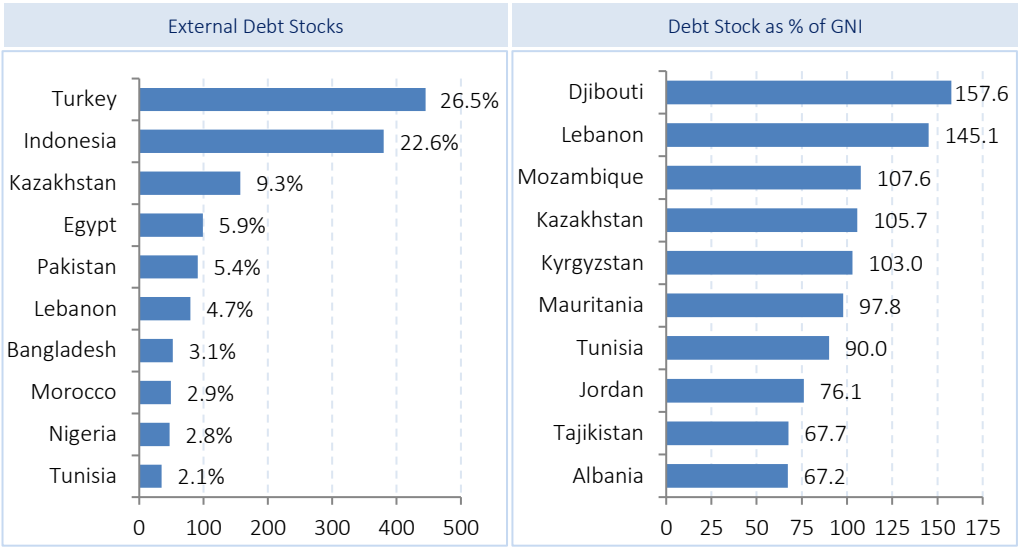
At the individual country level, Turkey remained the most indebted OIC member country in 2018 with US$ 445 billion in debt, accounting for 26.5% of total external debt of the OIC countries for which data are available. Turkey was followed by Indonesia (US$ 380 billion), Kazakhstan (US$ 157 billion), Egypt (US$ 99 billion) and Pakistan (US$ 91 billion). Turkey and Indonesia collectively account for 49% of the total external debts of the OIC countries in 2018 (Figure 3.15, left).

Figure 3.14: External Debt Stocks



Source: World Bank WDI, July 2020. *Data coverage: [LEFT]* 44 OIC countries; *[RIGHT]* 44 OIC countries, 77 non-OIC countries.

Figure 3.15: Top Indebted OIC Countries (2018)



Source: World Bank WDI, July 2020. *Data coverage:* 44 OIC countries.

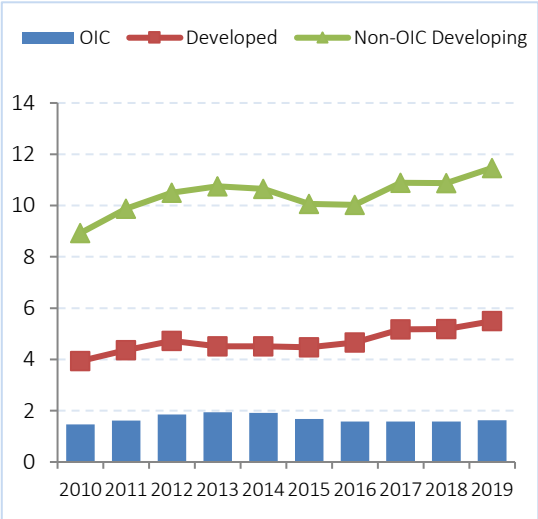
However, given the size of a country's economic output, looking at the absolute size of debt stock might be misleading. The Debt-to-GNI ratio, in that sense, is argued to give a more accurate view of a country's indebtedness, adjusting it for the size of gross national income. In terms of the relative size of external debt to GNI, Djibouti, with a 157.6% debt-to-GNI, was the most indebted OIC country in 2018 (Figure 3.15, right). It was followed by Lebanon (145.1%) Mozambique (107.6%), Kazakhstan (105.7%) and Kyrgyzstan (103%).

In the face of the COVID-19 pandemic, many OIC countries adopted significant economic stimulus packages to buffer the impacts of the pandemic and protect affected businesses and households. Some of them face considerable constraints in operationalizing effective stimulus packages due to revenue losses and fall in their reserves. Financial turmoil in global financial markets has already triggered capital flights, a reversal of investment flows and currency devaluations. Together with significant revenue losses, debt servicing becomes particularly challenging for governments, with a higher likelihood of bankruptcies and further economic failures. As a result, total external debts are expected to grow in many countries across the world, including the OIC countries due to huge public spending in response to the pandemic.

- **Reserves:** Total reserves of OIC countries remain stable at around US$ 1.6 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 – increased from its value of US$ 11.7 trillion in 2015 to US$ 13.1 trillion in 2019. Of this amount, US$ 5.5 trillion are possessed by developed countries while the remaining US$ 7.6 trillion are owned by developing countries (Figure 3.16). Total reserves of OIC countries followed a similar trend with the world

Figure 3.16: Reserves including Gold (US$ Trillion)



Source: World Bank WDI. Data coverage: 44 OIC countries, 37 developed countries and 91 non-OIC developing countries.

Figure 3.17: Top 10 OIC Countries by Total Reserves in Months of Imports (2019)

Source: World Bank WDI, July 2020. Data coverage: 38 OIC countries with available data after 2018

aggregate, which fell during the period between 2013 and 2016 from US$ 1.94 trillion to US$ 1.57 trillion. However, it remained stable at US$ 1.58 trillion during 2017 and 2018. It slightly increased to US$ 1.63 trillion in 2019. The share of OIC countries in global reserves has been constantly falling from 15.3% in 2013 to 12.4% in 2019.

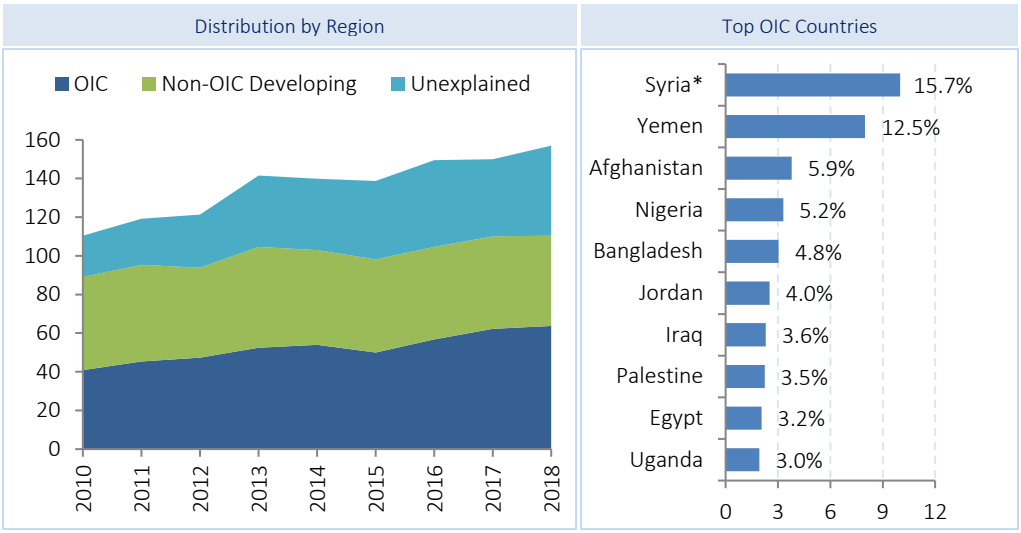
As of 2019, developing countries possessed 58.1% of the world total reserves. The growing share of developing countries in global reserves can largely be explained by the increasing trade flows from, and the resulting trade surpluses of, some emerging economies such as China, other newly industrialized 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 3.17 displays the top 10 OIC countries by volume of reserves in months of imports during the period 2018-2019. Libya, with reserves equivalent to 50.6 months of imports, topped the list, whereas Saudi Arabia followed it with reserves equivalent to 28.1 months of imports. Together with Lebanon, Afghanistan, Iraq and Uzbekistan, only in six OIC member countries the reserves were equivalent to more than 12 months of their imports.

- **ODA and Remittances:** 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 2018, net global ODA flows reached US$

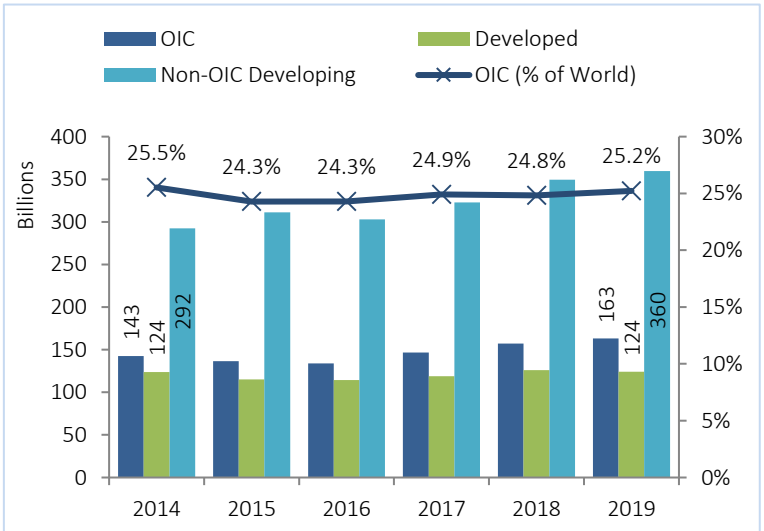
Figure 3.18: Official Development Assistance, Received, US$ Billion



Source: World Bank WDI, July 2020. Data coverage: 50 OIC countries and 97 non-OIC developing countries.
Note: Around 28% of global statistics are not reported at country level. (*) Membership to OIC is currently suspended.

165.8 billion compared to US$ 146.7 billion in 2015 (Figure 3.18, left). However, statistics do not show where all the money flowed, as data shows that individual countries account for 66% of global ODA flows. Accordingly, more than 33% of ODA flows remained unexplained. Out of US$ 110.5 billion ODA flows, for which individual country data exists, 57.7% flowed to OIC countries in 2018. This is also the highest share observed since 2006.

Figure 3.19: Personal Remittances, US$ Billion



Source: World Bank WDI, July 2020. Data coverage: 49 OIC countries, 35 developed countries and 92 non-OIC developing countries.

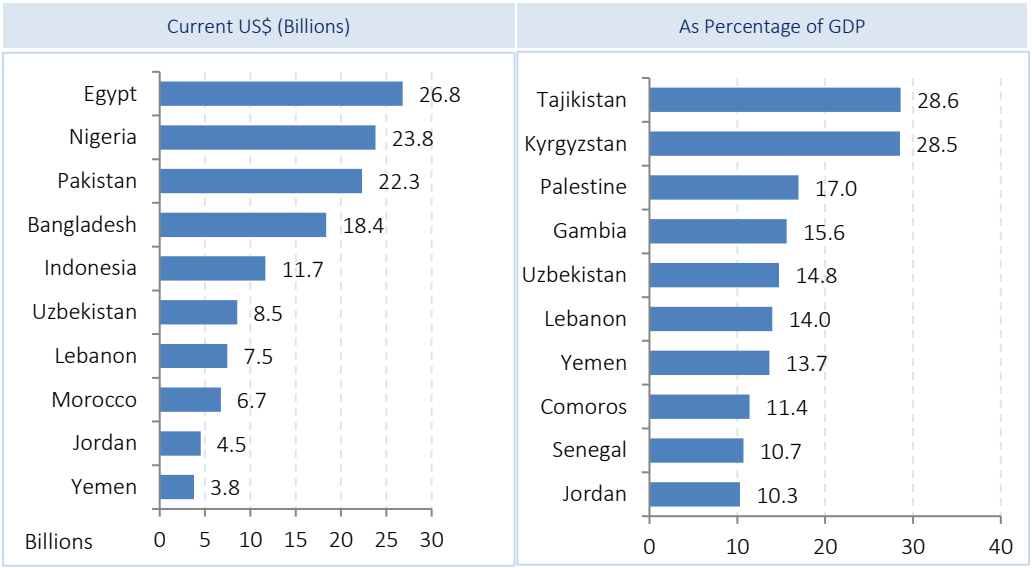
In 2018, the top five countries received 44.1% of total ODA flows to OIC region whereas the top ten received 61.5% of them (Figure 3.18, right). Syria, with total inflows of US$ 10.0 billion and 15.7% of OIC total, ranked first. It was followed by Yemen (US$ 8.0 billion, 12.5%), Afghanistan (US$ 3.8 billion, 5.9%), Nigeria (US$ 3.3 billion, 5.2%)

and Bangladesh (US$ 3.0 billion, 4.8%).

Figure 3.19, on the other hand, shows that the inflows of personal remittances to OIC member countries increased from US$ 142.6 billion in 2014 to US$ 163.3 billion in 2019. The share of OIC countries in world total remittance flows increased slightly from 24.8% in 2018 to 25.2% in 2019. Remittance flows to non-OIC developing countries continued to grow during the same period and increased from US$ 292 billion in 2014 to US$ 360 billion in 2019.

At the individual country level, it is observed that even a more significant portion of inward remittance flows to OIC countries concentrate in a few members in 2019. In the list of top remittance receivers in the OIC region, Egypt took the first place with US$ 26.8 billion of remittances inflows (Figure 3.20, left). It was followed by Nigeria (US$ 23.8 billion), Pakistan (US$ 22.3 billion), Bangladesh (US$ 18.4 billion) and Bangladesh (US$ 18.4 billion). These five countries collectively accounted for 63.1% of total remittance inflows to OIC countries, while the top ten countries accounted for 82.1% of total inflows.

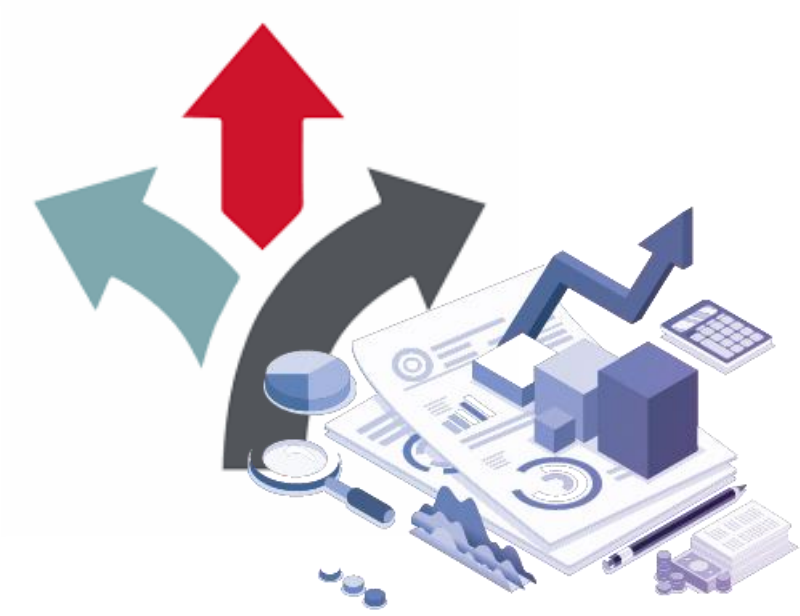
Figure 3.20: Personal Remittances (2019), Received, US$ Billion



Source: World Bank WDI, July 2020. Data coverage: 49 OIC countries.

In order to assess the relative importance of remittance flows at the individual country level, the share of remittance inflows in total GDP would be a good indicator. As shown in Figure 3.20 (right), personal remittance flows reached 28.6% of the total GDP of Tajikistan in 2019, followed by Kyrgyzstan (28.5%), Palestine (17.0%), the Gambia (15.6%) and Uzbekistan (14.8%).

PART III: TRADE AND INTEGRATION CHALLENGES AMID RISING UNCERTAINTIES



CHAPTER FOUR

The Rise of Protectionism and Implications for Trade

Economic literature demonstrates a strong correlation between trade, economic integration and growth. Deepening economic integration among the countries with the support of advancements in technology and transportation facilitated the movement of goods, services, money and people across borders. Greater economic integration helped countries to specialize in products and components in which they have a greater comparative advantage. This further improved productivity and income across the world. A joint report by the IMF, World Bank and WTO (2017) reiterates the academic findings where trade liberalization and openness has brought about higher productivity, greater competition, lower prices, and improved living standards.

Over the recent years, especially after 2018, protectionist sentiments re-emerged on the international economic policy agenda as a response to various concerns raised by policy makers. There are two major concerns: the dislocations of labour induced by globalisation and so-called global imbalances (Duetsche Bundesbank, 2017). Extensive surplus and deficit positions are interpreted by some politicians as a sign of an uneven distribution of the current world trading system's benefits. This heightened the calls for higher barriers to imports from other countries in an attempt to "rebalance" the unevenness in trade.

This chapter provides an analysis of the growing protectionist attitudes towards international trade flows by looking at factors that lead to such policy shifts. The chapter also elaborates on potential impacts of growing protectionism. Lastly, the chapter discusses on the escalation of trade barriers due to the COVID-19 pandemic and how such measures affect the response capacities of the countries to the disease outbreak.

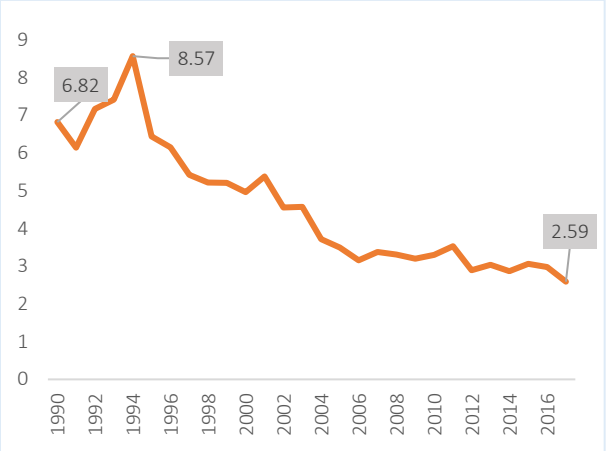
4.1 The Threat of Protectionism in the Global Economy

Over the last several decades, tariffs and other trade barriers declined substantially as the liberal economic thinking increasingly dominated economic policymaking. As shown in Figure 4.1, globally applied average tariff rate declined from 8.6% in 1994 to 2.6% in 2017, reflecting the greater economic integration and connectivity among the economies (Figure 4.1). However, recent years witnessed a growing appetite for more protectionism driven by unilateral motivations.

Traditionally, there are various motives for protectionism. The main arguments for protectionism include (i) protecting infant as well as declining industries (ii) protecting strategic sectors and industries, (iii) deterring unfair competition such as dumping by foreign firms, (iv) protecting industries to save jobs created by these industries, (v) limiting damage to their environment, and (vi) other political motivations. The current trade measures appear to be motivated mainly by

bilateral trade imbalances. Actions are taken unilaterally to resolve such imbalances. Although such measures have important impacts on trade flows and growth, the real threat posed by such protectionist measures comes from its unilateral nature, not from its quantitative effects. In such an economic policy environment, benefits of globalization will fade away as multilateralism falls apart.

Figure 4.1: Global Applied Tariff Rate, weighted mean, all products (%)



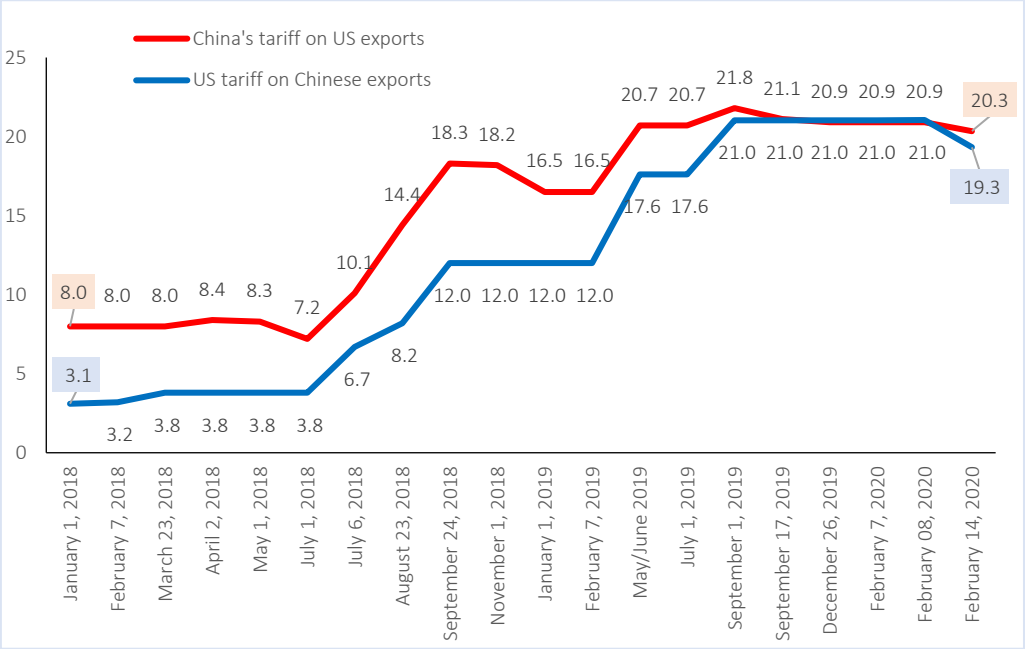
Source: World Bank WDI, August 2020.

The initial signs of protectionist measures started in 2017 when the US decided to withdraw from the Trans-Pacific Partnership (TPP), a free trade treaty between 12 Pacific countries, and the interruption of trade negotiations with the EU on the Transatlantic Trade and Investment Partnership (TTIP). However, in early 2018 the US administration began to introduce a series of concrete trade measures in an attempt to rebalance its trade with China and some other countries. These measures resulted in immediate retaliation by the affected countries, including the EU, Canada, Mexico, Russia, India and Turkey (Viani, 2019). Rounds of de-escalation and re-escalation of the trade war, mainly between the US and China, have significantly increased the global economic uncertainty.

New trade policies have their own costs. Tariffs introduced in 2018 and 2019 have raised prices for domestic consumers, implying welfare losses of about $50 billion, according to the OECD (2020a). Many US producers and consumers have reaped billions of dollars of gains from the complex relationship that they developed with China. Rising concerns over trade imbalances, employment effects in manufacturing and loss of competitiveness in knowledge-based industries ignited the protectionist attitude.

Before the protectionist measures, the average tariff rates between the US and China were at relatively low levels, but it was much lower for imports of goods from China to the US. After a series of retaliatory tariffs on certain goods and sectors, the average rates exceeded 20%. As of February 2020, the average US tariffs on imports from China remain elevated at 19.3%, a rate that is six times higher than *ex ante* situation in 2018, and affecting almost two-thirds of goods coming in from China (Bown, 2020a). Average Chinese tariffs on imports from the US also remain high at an average of 20.3% (Figure 4.2). These rates may further increase above the level of 25% (Bekkers and Schroeter, 2020).

Figure 4.2: Bilateral Tariff Rates between US and China



Source: Bown (2020a).

Hence, the adoption of protectionist measures has sparked fears of a trade war and has weighed on trade flows and investment decisions due to deteriorating market sentiment and global risk appetite. Global supply chains become under risk due to the rising risk of trade wars. Trade-related uncertainty led businesses to postpone their investment decisions and adopt a wait-and-see approach before judging on the need for a potential reshuffling of supply chains. This led many intellectuals to question the end of globalization.

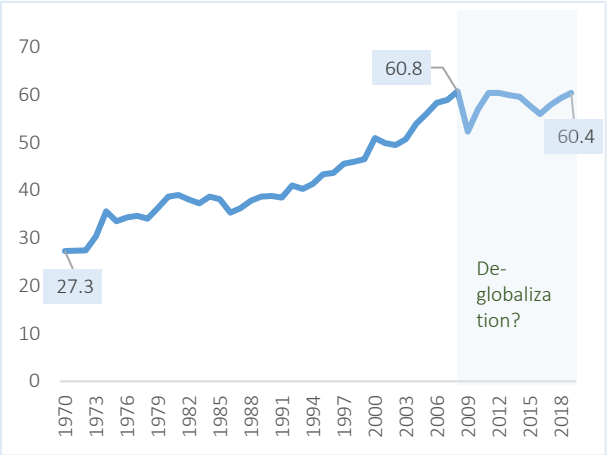
In fact, the rapid spread of globalization halted after the global financial crisis in 2008. The share of trade in total GDP, as a measure of openness, has been increasing since 1970's to reach from 27.3% in 1970 to 60.8% in 2008. Since then, however, the share remained on average at around the same levels (Figure 4.3). Trade volume grew by an average of 3.5% from 2009 to 2018, which is much slower than the 7.6% average growth before the 2008 financial crisis.

Due to reduced trade flows and growing uncertainty in the global economy, cross-border investment flows have also declined. As partly discussed in chapter 1 and 3, global FDI flows fell from more than US$ 2 trillion in 2005 to US$ 1.5 trillion in 2019. According to UNCTAD, it is further expected to decline to below US$ 1 trillion in 2020 due to the pandemic. Portfolio flows to developing countries have also sharply declined over the past period. The much lower FDI and portfolio nowadays could be seen as a critical sign of the fragmentation of global capital markets (Herrero, 2019).

While some argue that this is a sign of a possible de-globalization process and rise of unilateralism, it is important to recognize that this period is characterized by a lower level of aggregate demand and a slower economic growth. When economic growth is strong, trade

growth tends to be even stronger. But the reverse is also true: when economic growth is weak, trade growth is even weaker. However, lower economic growth could be a result of declining cross-border trade and rising protectionism as well.

Figure 4.3: Trade Openness (Total trade as % of GDP)



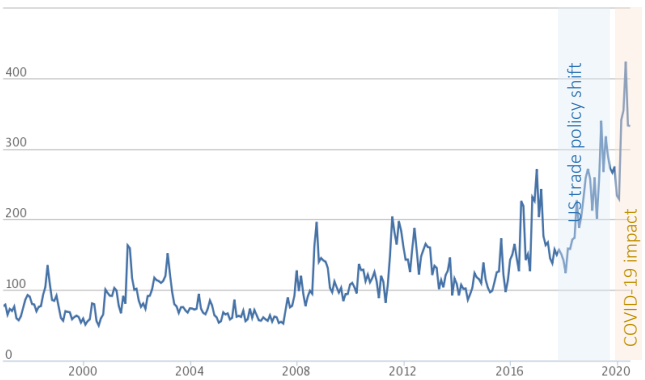
Source: World Bank WDI, August 2020.

Therefore, we are now at a zero growth rate in trade, which is mainly explained by falling demands as well as protectionist policies involving the US-China trade war and several other protectionist waves, such as the US with Europe but also between Japan and Korea. Moreover, the fate of some previously proposed trade agreements, which would have reduced trade barriers — such as that between the EU and the South American trade bloc Mercosur — is now uncertain.

Uncertainty exists in not only trade agreements but also in global economic activities. Owing to escalating trade tensions and the COVID-19 pandemic, global economic uncertainty reached its highest levels, at least over the last two decades (Figure 4.4). According to the global economic policy uncertainty index developed by Backer et al. (2016), the global economic policy uncertainty was already rising due to the US trade policy shift, but this has further exacerbated following the coronavirus outbreak. The research by Constantinescu et al. (2019a) suggests a negative association between the world trade growth and policy uncertainty.

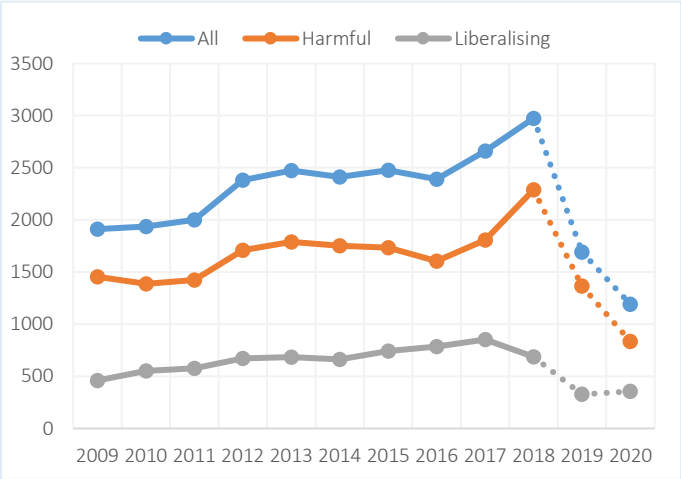
In addition to import tariffs, the use of regulatory measures and non-tariff barriers (such as export subsidies, restrictions on licensing, and domestic clauses in public procurement) has also been increasing since 2018, leading to an overall surge in trade distortions. According to data from the Global Trade Alert database encompassing traditional and non-traditional trade measures, the number of new discriminatory actions has risen steadily since 2012 and reached its highest level in 2018. Although the data provided by the GTA database after 2018 are

Figure 4.4: Global Economic Policy Uncertainty Index, Monthly



Source: Policyuncertainty.com, August 2020.

Figure 4.5: Number of New Trade Interventions Implemented per Year since 2009



Source: Policyuncertainty.com, August 2020.

yet incomplete, it is evident that the number of new trade restrictions have further surged in 2019 and 2020.

Such trade measures increase trade costs and, in the presence of complex global production supply chains, cost effect can be further intensified. Intermediate inputs incur tariff costs every time they are shipped to another country for further processing. By the time the finished goods have reached the final consumer, the final price may have risen significantly (ECB, 2019). Higher production costs due to tariffs on intermediate goods are likely to be passed on through the various stages of the value chain, negatively affecting demand, production and investment in all phases. Kutlina-Dimitrova and Lakatos (2017) estimate that potential increases in worldwide barriers to bound tariff rates could translate into an annual decline of global trade of 9% —more than was experienced during the global financial crisis of 2008-09.

Protectionist measures could become more pervasive and persistent during the coming period. According to a recent Global Fund Manager Survey conducted by the Bank of America Merrill Lynch with approximately 200 institutional, mutual and hedge fund managers around the world, 43% of investors surveyed believe the U.S.-China trade war is the “new normal”. As protectionist policies become more widespread in the face of the pandemic, trade measures are now also being introduced to support the health-related response capacities of countries.

The total impact on economic activity will be determined by a number of factors including whether trade tensions escalate and turn into a major trade war or deescalate and remain confined to a small number of countries and products. Falling trade has implications on productivity and growth. Productivity will decline as a result of lower exposure to global competition and innovation, limited exploitation of comparative advantages and reduced chance to benefit from economies of scale. This could negatively affect the global economic growth potentials. In an IMF study, Furceri et al. (2019) found that increase in tariff rates have adverse domestic macroeconomic and distributional consequences, leading to declines of output and productivity in the medium term, as well as increases in unemployment and inequality. In contrast, they do not find an improvement in the trade balance after tariffs rise, as expected by some politicians in favour of protectionism.

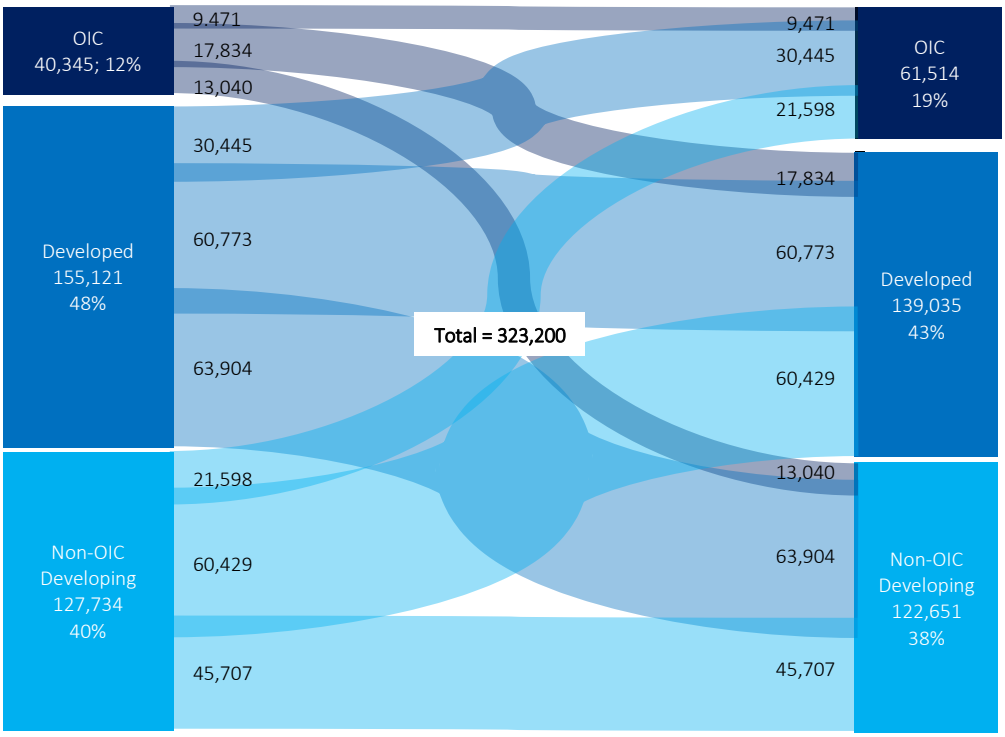
4.2 Implications of Trade Protectionism for OIC Countries

OIC countries may be over-proportionally affected by protectionist policies implemented by major economies. Existing policies already indicate an unfavourable stance towards the OIC countries. During the period 2009-2018, there were 323.2 thousand trade measures implemented across the world in bilateral terms. Only 12% of them were initiated by the OIC countries, while 48% were implemented by developed countries and 40% by non-OIC developing countries (Figure 4.6). Despite the major economic power that the developed countries have, it is remarkable to observe that they are inclined to get richer by "beggar-thy-neighbour" policies.

In terms of the country groups that are affected by trade measures, OIC countries are individually affected by 19% of all new trade policy measures implemented during 2009-2018. On the other hand, 43% of new policy measures affected developed countries and 38% non-OIC developing countries. Evidently, more trade policy measures affected OIC countries than the policies implemented by them.

Nevertheless, implemented trade policies do not necessarily imply a restriction on trade. Out of 323.2 thousand cases where bilateral trade is affected, 114 thousand (35%) were interventions that liberalise on a non-discriminatory (i.e., most favoured nation) basis or improve the transparency of a relevant policy. More than 60% of all cases were in the nature of discriminating against foreign commercial interests (Table 4.1).

Figure 4.6: Number of Trade Measures Implemented (2009-2018)



Source: Global Trade Alert Database, August 2020.

More than 58% of policies implemented by OIC countries were discriminatory, but around 55% of policies affecting the OIC countries were in the same nature. However, the total number of discriminatory policies affecting the OIC countries were almost 50% more than the policies that they implemented. Nonetheless, OIC countries benefited more from liberalizing policies than they provided to non-OIC countries. In the case of developed countries, they implemented more restrictive as well as liberalizing policies than the policies affecting them. A similar picture is also observed for non-OIC developing countries.

Table 4.1: Trade Policies by Direction of Change

	OIC		Developed		Non-OIC Developing		Total
	IMP	AFF	IMP	AFF	IMP	AFF	
Discrimination	23,530	34,158	97,351	88,186	73,465	72,002	194,346
Likely discrimination	1,283	2,828	8,926	6,450	4,515	5,446	14,724
Liberalization	15,532	24,528	48,844	44,399	49,754	45,203	114,130
Total	40,345	61,514	155,121	139,035	127,734	122,651	323,200

Source: Global Trade Alert Database, August 2020. IMP: Implementing country; AFF: Affected country.

These numbers provide only some general observations on the past structure of trade policies across the main comparison groups. Proving more accurate magnitude of these policies and estimating their effects precisely is, however, a daunting task. Studies providing some estimates on the impacts of the protectionist trade policies are rich in the economic literature. Based on the common findings of these studies, the following observations can be made on the potential implications of such policies on OIC economies.

Higher protection reduces demand for imported goods and services

The tariffs imposed on foreign goods make them more expensive for consumers in domestic markets. Higher prices for foreign commodities reduce the demand for them and consumers look for substitutes either at local markets or from other foreign markets not affected by tariff rises. At the initial stages of US-China trade tensions, large exporters, such as Brazil, the European Union, Malaysia, and Mexico were among the major aggregate beneficiaries, with Brazil exporting almost US$ 6 billion additional goods relative to the previous year in product categories where US goods face tariffs (Freund et al., 2019).

In such cases, more diversified economies are more likely to benefit from trade tensions among third countries due to diversion of trade. The EU, for example, with its large and diversified export basket, has benefited from higher tariffs imposed on bilateral trade between US and China – increasing exports to the US and China as a result. OIC countries are, however, less diversified and less competitive to take advantage of such opportunities. There are examples where some OIC countries benefited from the US-China trade dispute. While Kuwait could increase its exports to China due to Chinese tariffs on American propane, Malaysia has seen substantial increases in

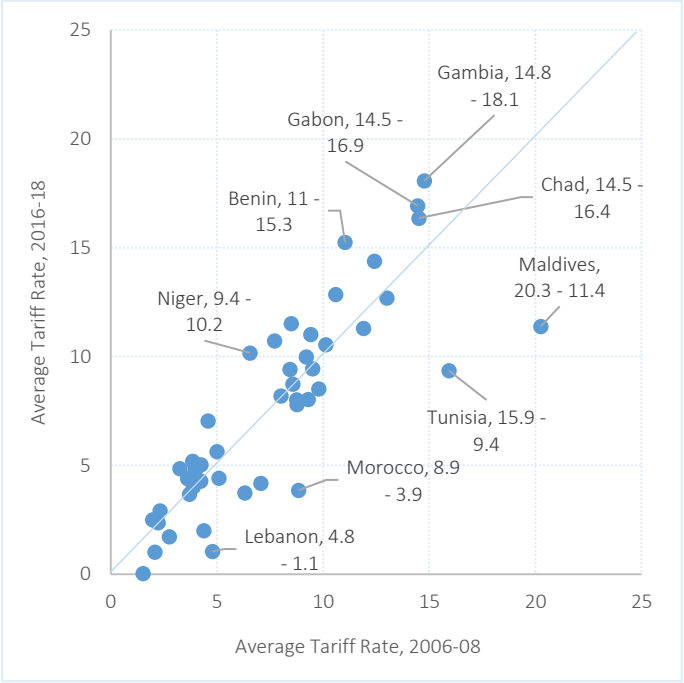
exports due to exports of electronic integrated circuits to the US and copper waste and scrap to China (Freund et al., 2019). Some developing countries, including OIC countries, can benefit in the short-run from trade disputes among major economies. Yet, global impacts of tariff escalations will be substantial in the longer term, with detrimental consequences for developing countries. If the trade tensions fuel the global uncertainty and lead to depressed investments in developing countries, Freund et al. (2018) estimate that the income losses in developing countries could range between 0.9% for South Asia and 1.7% for Europe and Central Asia.

Higher protection reduces exposure to competition and weakens technology transfer

Openness to trade is an important factor in promoting productivity in a country. Firms' exposure to international competition forces them to differentiate their products through innovative approaches. This fosters investment in research and development, facilitates technology development and increase productivity in the country. Lower exposure to international competition eliminates part of this motivation for firms to differentiate their products. If the domestic market is not competitive at all, firms operating in a largely closed economy will demonstrate very limited incentives to introduce new products and to become more productive.

Considering the limited domestic competition in many OIC countries, it is particularly important for OIC countries to remain open to global trade to facilitate technology transfer, encourage firms to be innovative and support the economic diversification. Empirical findings confirm that rounds of retaliation and further expansion of trade barriers would only harm developing countries. For example, Devarajan et al. (2018) explore the impact of possible strategies that could be implemented by developing countries in response to the escalating protectionist measures and a potential trade war between major economies. They find that retaliatory action by developing countries is the least desirable strategy in the face of new protectionist measures. No action is preferred to retaliation, as aggregate losses are found to be near twice as big when developing countries impose retaliatory measures. On the other hand, trade liberalization and improved intra-regional integration

Figure 4.7: Average Tariff Rates in OIC Countries, Applied, Weighted, 2016-18 vs 2006-2008



Source: World Bank WDI Database, August 2020.

could not only help offset the negative terms of trade effects of increased protectionism on developing countries, but also generate significant benefits. Evenett and Fritz (2015) also argue that protectionist measures implemented between 2009 and 2013 slowed exports growth from least developed countries (LDCs) significantly, costing them an equivalent of about one-third of the total exports. According to Figure 4.7, however, average applied tariff rates have increased in 28 OIC countries during 2016-18 as compared to 2006-08, as compared to 21 OIC countries that reduced the tariff rates during the same period.

Lower demand and international competition reduce growth and productivity

Tariffs imposed on imported products raise the prices for both consumers and producers. Higher prices naturally cause a fall in demand for goods and services. Together with limited exposure to foreign competition, lower demand in an economy reduces productivity and growth. In order to attain higher income levels, developing countries, including OIC countries, need to diversify their economies by investing in new technologies and increasing their competitiveness. This would be hardly possible in the presence of lower demand, limited technology spillovers and partial international competition.

Emerging developing countries have been the engine of the world growth over the last two decades. In order to meet their demand for production and consumption, they require a significant amount of import of raw materials, including oil and gas. Slower growth will reduce demand for energy sources, on whose exports some OIC countries heavily rely. Therefore, OIC countries, on average, would not benefit from a fall in demand for raw products and mineral resources. This would cause a substantial loss of income and create major economic imbalances in affected countries.

Higher protection increases uncertainty and reduces investment sentiments

Escalating trade tensions significantly hurt the investment behaviour of firms due to increased policy uncertainty. Rising uncertainty leads to the deferral of investment decisions by firms, while consumers also cut back their spending and banks increase their cost of finance. Those factors reduce aggregate demand and lower economic growth. Lower growth in turn affects trade and investment flows around the world. Therefore, it is not straightforward to infer a causal relationship between policy uncertainty and trade because policy itself responds to economic circumstances and is likely to be forward-looking (Constantinescu et al., 2019b). Yet, there is a negative association between world trade and investment growth and policy uncertainty. Risk taking behaviour usually diminishes as economic uncertainty increases.

As discussed in chapter 3, due to ongoing uncertainty following the pandemic, global investment flows are estimated to decline by around 40% in 2020. OIC countries are expected to be affected at around the similar levels. FDI inflows to OIC countries were already following a declining trend over the last several years. Exacerbation of this process due to economic policy uncertainty will make it difficult for many OIC countries that need external capital and technology to achieve better economic performance.

4.3 Responding to the COVID-19 in the Face of Growing Protectionism

With the emergence of the novel coronavirus (the COVID-19) outbreak that threatens the health of millions of people, the world economy entered into a new crisis. While major disruptions have been observed in both local and international production, greater uncertainty that emerged as a result of broken supply chains intensified the arguments for breaking up global value chains and reshoring production to closer locations. Reducing dependence on imports has been particularly a strong judgement among governments in the face of an urgent need for protective equipment and medical supplies.

Not every nation produces sufficient medical supplies needed to tackle the pandemic. Most developing countries rely heavily on imports to meet their needs of essential medical supplies. A recent WTO paper examining the trade in COVID-19 related medical products shows that imports and exports of medical products totaled about US$ 2 trillion, corresponding to almost 5% of total world trade in 2019 (WTO, 2020b). Germany, the USA, and Switzerland supply 35% of medical products. China accounts for 25% of world exports of facemasks, and together with Germany and the US, the three contribute to almost half of the world facemask supply (EC, 2020). Breathing apparatus, including respirators and ventilators, are similarly supplied by a small number of countries notably, where Singapore and the US collectively account for 34%. Therefore, any disruption in exports from these economies will have a major impact on the global availability of these products.

As a response to urgent requirements for personal protective equipment (PPE) and medical supplies, many exporting countries adopted protective trade policies, putting developing countries in an extremely vulnerable situation in terms of availability as well as affordability. Global Trade Alert data show that 83 countries have executed a total of 150 export controls on COVID-19 medical equipment since the start of 2020 (EC, 2020). According to the International Trade Centre (ITC), 170 restrictive policies were implemented until 25 August, 115 of which are still active (see Figure 4.7). In a World Bank study, Espitia et al. (2020) estimated that export restrictions could increase prices of COVID-19 relevant goods by 23% on average.

During the early period of the pandemic, while major PPE suppliers, such as the European Union (EU) and United States (US), have suddenly imposed limits on exports; China, as a supplier of more than 40% of PPE imports, was also a major initial contributor to the global shortage due to huge domestic demand for such products. As a result, global PPE markets are in chaos, with reports of piracy, defective products, hoarding and price gouging, in addition to the shortages (Bown, 2020b). Many poor and vulnerable countries face uncertainty over their current and future access to imported PPE. They also lack domestic manufacturing facilities to suddenly scale up production. Many of them will remain entirely reliant on imports as a source of supply, but export restrictions by major economies have the potential to affect many LDCs negatively in accessing the critical medical supplies needed for the pandemic.

In this connection, Table 4.2 shows the import dependence of OIC countries on selected protective equipment from the European and Chinese markets. More than 50% of the face shield

imported by eight OIC countries and mouth-nose-protection equipment imported by six OIC countries from the EU reflect excessive dependence of these countries to the EU.

Table 4.2: Import Dependence of OIC Countries on EU and China

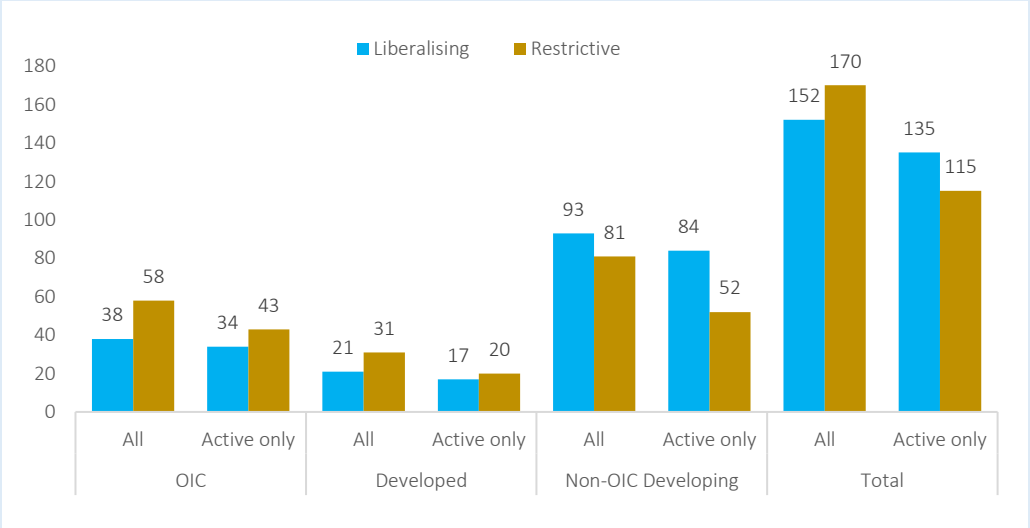
EU [1]				China [2]			
Face shields		Mouth-nose-protection equipment		Respirators and surgical masks		Protective garments	
C. Code	%	C. Code	%	C. Code	%	C. Code	%
TUN	85.5%	ALB	73.7%	TGO	82.8%	BEN	92.0%
MAR	78.3%	NER	70.9%	IRN	81.8%	UZB	91.6%
ALB	77.3%	TUN	63.3%	PAK	75.6%	IRN	91.1%
SEN	55.3%	SEN	61.0%	MYS	64.2%	TUR	88.4%
DZA	54.7%	MAR	53.7%	UZB	62.5%	KGZ	83.0%
NGA	54.6%	MRT	52.3%	BEN	61.9%	SUD	78.4%
NER	54.0%	NGA	44.6%	PSE	60.8%	TGO	75.5%
TUR	53.6%	TUR	43.8%	CIV	57.7%	PAK	75.4%
CIV	46.8%	EGY	43.2%	KGZ	57.5%	NGA	69.5%
EGY	45.7%	CMR	42.2%	IDN	53.0%	SAU	67.7%
BFA	42.1%	QAT	39.9%	SUD	52.6%	MYS	66.5%
QAT	40.7%	AZE	38.6%	DZA	48.6%	CIV	64.7%
CMR	39.6%	KAZ	36.4%	UGA	47.9%	LBN	64.0%
AZE	38.0%	GMB	34.6%	CMR	47.3%	ARE	61.8%
MRT	37.4%	CIV	34.3%	TUR	43.2%	KAZ	59.8%
TGO	36.4%	BFA	31.0%	EGY	42.0%	ALB	57.3%
BEN	36.0%	MLI	31.0%	GMB	41.3%	CMR	57.1%
ARE	33.0%	BEN	30.7%	KWT	39.1%	AZE	56.9%
BHR	29.6%	ARE	28.4%	QAT	37.0%	QAT	56.4%
LBN	28.7%	LBN	27.7%	BHR	35.3%	JOR	52.6%
KAZ	28.4%	OMN	24.1%	JOR	35.3%	PSE	52.4%
SAU	27.7%	DZA	22.4%	ARE	34.0%	BFA	50.5%
UGA	26.8%	BHR	22.3%	SEN	33.3%	DZA	43.6%
KWT	25.2%	KGZ	21.8%	SAU	32.0%	MAR	42.9%
OMN	25.0%	TGO	21.5%	AZE	31.1%	IDN	42.2%
PSE	22.3%	SAU	18.9%	MAR	29.8%	UGA	41.2%
JOR	20.9%	UZB	18.6%	KAZ	27.4%	EGY	36.0%
MOZ	19.1%	MDV	17.9%	NER	25.2%	BHR	33.9%
IRN	15.9%	IRN	17.0%	MDV	24.0%	MDV	33.0%
UZB	15.9%	KWT	16.3%	BRN	20.7%	GMB	31.2%
MLI	15.4%	JOR	15.8%	OMN	19.4%	MLI	25.8%
PAK	12.4%	UGA	14.7%	NGA	19.2%	OMN	21.3%
SUD	10.9%	IDN	13.1%	MOZ	17.6%	BRN	18.9%
BRN	10.1%	PAK	12.7%	ALB	17.1%	MRT	17.0%
MDV	10.0%	BRN	12.4%	TUN	14.3%	MOZ	15.4%
KGZ	9.1%	MOZ	11.5%	COM	12.3%	SEN	10.3%
IDN	6.9%	PSE	7.4%	BFA	8.8%	TUN	8.0%
MYS	6.6%	SUD	6.9%	MRT	7.0%	KWT	8.0%
GMB	4.1%	MYS	5.5%	MLI	6.1%		

Source: Various blogs by C. P. Bown at Peterson Institute for International Economics. (1) Percentage of imports from EU based on 2018 data. (2) Percentage of imports from China based on 2016-18 data. See UNSTAT at https://unstats.un.org/unsd/tradekb/knowledgebase/country-code for description of country codes.

Similarly, 11 OIC countries in importation of respirators and surgical masks, and twenty-two OIC countries in importation of protective garments rely mostly on China with over 50% share. It would create vulnerabilities for the concerned OIC countries if major exporters apply certain restrictions on the trade of these products. Import reliance of OIC countries to the EU can be partly explained by geographical proximity, but this relation is not that visible in the case of China, demonstrating the dominant role of China as a global supplier.

On the other hand, many countries started to invest in their own capacities to produce PPE and medical supplies to reduce their dependence on imports. For example, Turkish defense and electronics firms teamed up to support a technology enterprise to begin mass production of the mechanical ventilators. They managed to start mass production in less than three weeks. According to the reports, it is possible to domestically produce the ventilator for $6,500 while an

Figure 4.8: Trade Policies Implemented during the Pandemic



Source: International Trade Centre, MacMap COVID-19 Temporary Trade Measures Database, v. August 25, 2020. Active policies are as of 25 August 2020.

imported equivalent would cost some 20,000 euros (Reuters, news article). Turkey also started to export to other developing countries including Brazil or donate to some LDCs, such as Sudan and Somalia.

In the current crisis, global demand for a variety of medical supplies has increased intensely. The trade barriers in place limit access to these products and make them unnecessarily costly. Trade policies implemented during this period targeted mainly the medical supplies. Governments around the world continue to enact temporary trade measures that aim to restrict exports of vital medical supplies and to liberalize imports of vital medical supplies, as well as other essential products. By monitoring the trade policies related to PPE, pharma products, hand sanitizer, food and certain other products, the ITC MacMap database provides an up-to-date list of such policies. As of 25 August 2020, a total of 170 restrictive trade policies and 152 liberalizing trade policies were initiated. While 135 out of 152 liberalizing policies are still in force, only 115 out of 170 restrictive policies are currently active (Figure 4.7). Apparently, countries lift the protective

measures once they believe they have an adequate amount of medical supplies for the use of their own people.

OIC countries were also relatively restrictive during this period. 31 OIC countries initiated 58 restrictive measures, 43 of which are still effective. The highest number of protective measures were taken by Kazakhstan (6), Turkey (5), Iran (4) and Uzbekistan (4). On the other hand, 27 OIC countries introduced 38 trade-facilitating measures with the emergence of the pandemic, 34 of which are still active. Indonesia (5) and Pakistan (4) introduced the higher number of trade liberalizing policies (Table 4.3). Obviously, while all these policies are considered to be temporary, liberalizing policies tend to remain effective for a longer time than restrictive policies.

In view of the above analysis, there is a clear need to keep trade flowing, both to ensure the supply of essential products and to send a signal of confidence for the global economy. In the current context, as put by OECD (2020b), trade is essential to save both lives and livelihoods. Therefore, it is necessary to keep supply chains flowing, especially for essentials such as

Table 4.3: Trade Policies Implemented by OIC Countries during the Pandemic

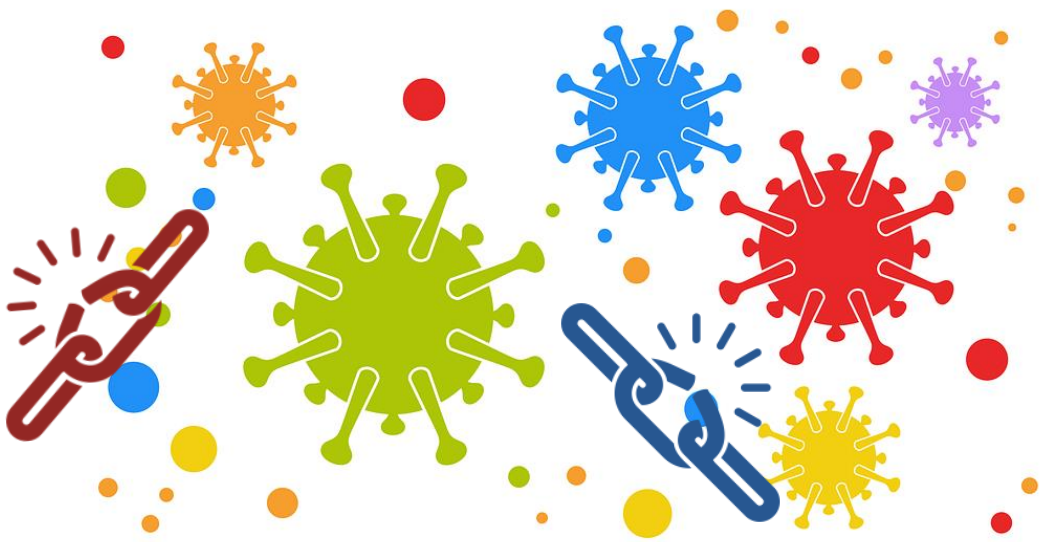
	Liberalizing		Restrictive	
	All	Active	All	Active
Albania	0	0	1	1
Algeria	1	1	1	1
Azerbaijan	2	1	1	1
Bahrain	0	0	1	1
Bangladesh	2	2	1	0
Brunei Darussalam	1	1	0	0
Burkina Faso	1	1	0	0
Cameroon	1	1	0	0
Chad	1	1	0	0
Côte d'Ivoire	1	1	1	1
Egypt	0	0	3	3
Guyana	1	1	0	0
Indonesia	5	3	3	2
Iran	0	0	4	2
Iraq	0	0	1	1
Jordan	0	0	2	1
Kazakhstan	0	0	6	4
Kuwait	0	0	1	1
Kyrgyzstan	0	0	2	2
Lebanon	0	0	1	1
Libya	0	0	1	1
Malaysia	2	2	1	1
Maldives	1	1	0	0
Mali	1	1	1	1
Mauritania	1	1	0	0
Morocco	1	1	2	1
Mozambique	1	0	0	0
Niger	1	1	0	0
Nigeria	1	1	0	0
Oman	1	1	2	2
Pakistan	4	4	3	2
Qatar	1	1	0	0
Saudi Arabia	1	1	2	2
Senegal	1	1	0	0
Somali	0	0	1	0
Sudan	0	0	1	1
Suriname	1	1	0	0
Syria	0	0	2	1
Tajikistan	0	0	1	1
Togo	1	1	0	0
Turkey	1	1	5	3
Turkmenistan	0	0	1	1
Uganda	0	0	1	0
United Arab Emirates	0	0	1	1
Uzbekistan	2	2	4	3

Source: International Trade Centre, MacMap COVID-19 Temporary Trade Measures Database, v. August 25, 2020.

health supplies and food, without making things worse by excessive trade restrictions. It is also critical to boost confidence in trade and global markets by improving transparency about trade-related policy actions and intentions. It is evidently in the long-term interest of industrial and developing countries that trade tensions are resolved through a multilateral approach and WTO reforms and not by unilateral approach.

CHAPTER FIVE

Impacts of COVID-19 on Global and Regional Value Chains and Implications for OIC Countries



Global value chains (GVCs) have become a central characteristic of world trade and investment, tremendously shaping the economic relations among developing, emerging, and developed economies. Major advances in information, communication and transport technologies have made it possible to fragment production across national boundaries. The increasing number of trade agreements signed at bilateral or multilateral levels also significantly reduced barriers to world trade. Accordingly, the process of producing goods, from raw materials to finished products, is increasingly carried out wherever the necessary skills and materials are available at competitive prices and quality. This international fragmentation of production has significantly contributed to the rise in world trade and investment over the past decades.

Fragmentation can be observed not only in the manufacturing process but also at all stages of production, such as research and development, design, marketing and distribution. This interconnectedness of manufacturing and services activities also contributed to the rise of trade in the services sector. This process enabled economic integration, growth and poverty reduction across the developing world. Rising productivity and income levels helped them to attain higher standards of living.

Today, there is lesser optimism to consider trade as an engine of growth and prosperity. Since the global financial crisis of 2008, the growth of trade has been sluggish, and the expansion of GVCs has decelerated. Moreover, recent technological developments, such as automation and 3D printing, reduce the significance of proximity to low-cost labour. Growing disputes over trade imbalances are causing the trade barriers to rise again. And these trends are only being exacerbated by the ongoing global COVID-19 pandemic.

This chapter discusses the implications of recent developments on GVCs and potential transformation of manufacturing activities in the face of recent supply chain disruptions. It starts by summarizing the major drivers of GVCs as well as causes of disruptions during the COVID-19 pandemic. Then it discusses the current integration of OIC countries to GVCs. This section concludes with some discussions on potential reshoring (the process of returning the production and manufacturing of goods back to the company's original country) of GVC and implications for OIC countries.

5.1 Supply Chain Disruptions amid the Covid-19 and Rise of Protectionism

Over two-thirds of the world trade occurs through GVCs, in which production crosses at least one border before final assembly (WTO, 2019). One-third of the world's production is done by multinational enterprises and they account for half of the world trade (OECD, 2018).

GVCs have constantly expanded during the 1990's and 2000's as they have brought many benefits by allowing firms to source their inputs more efficiently, to access knowledge and capital beyond the domestic economy and to expand their activities into new markets (OECD, 2013). GVCs have also played a pivotal role in reducing poverty and offering an opportunity for developing countries to grow and catch up with richer countries (World Bank, 2019). However, a slowdown in this trend was already observed before the trade tensions and the pandemic. Since 2011, there has

been less trade in intermediate goods and services, highlighting that firms are reducing their use of foreign inputs (OECD, 2020c).

Participation in GVCs was mainly determined by factor endowments (labour, capital, and natural resources), market size, geography, and institutional quality (World Bank, 2019). Low-skilled labour and foreign capital are central to backward participation in GVCs at the early stages. An abundance of natural resources drives GVC integration forward. Small countries are more dependent on imported inputs and foreign markets, which requires them to participate in GVCs. Overcoming remoteness by improving connectivity can promote GVC participation. Finally, regional integration with legal frameworks and harmonized procedures can enhance institutional quality and increase GVC participation (COMESA, 2020).

Participation in GVCs entails both benefits and costs. While it enables developing countries to transfer knowledge and know-how on production processes and business methods, GVCs may lead low-income countries to be trapped in low value-added stages of production with very limited possibilities for innovation and technology transfer. Therefore, it is critical for developing countries to upgrade steadily within GVCs to benefit from potential productivity and competitiveness advantages. Establishing highly dependent relations with external investors and foreign technology may also create additional vulnerabilities in times of shocks.

GVCs in the Time of COVID-19

Although participation in GVCs was already in decline, uncertainty related to future trade policies and the global COVID-19 pandemic has done more substantial damage to GVC expansion, as factories shut down and economic activity declines amidst worldwide stay-home orders and containment measures. International Trade Centre (ITC) estimates that the combined reduction of manufacturing inputs by China, USA and EU will amount to US$ 228 billion, or 11% of total GVC trade. The affected sectors would be the machinery, plastics and rubber, chemicals, and electronic equipment sectors, which will experience more than 7% loss of exports due to supply-chain disruptions (Solleder and Velasquez, 2020). Moreover, 55% of enterprises surveyed by the ILO expect shortages of supply to last throughout the year 2020 (ILO, 2020c).

The COVID-19 pandemic has given momentum to discussions on the establishment and strengthening of national and regional supply chains. Small economies that are already well integrated into GVCs are likely to suffer the most from nationalization and regionalization of GVCs. These countries have usually invested their resources to be part of the global production networks, but the destruction of these networks would cause significant troubles in economic activities in these countries, particularly if they are too small to develop their own production systems. Another concern would be their competitiveness in global market, even if they achieve to produce their own products for international markets. In order to counter the surge of protectionism and rise of nationalism, these countries would promote regional partnerships to stimulate economic activities and diversification process.

Adapting to New Normal

The overall sentiment emerging from the dual shock of trade tensions and COVID 19 pandemic indicates that protectionism will deepen, and governments will adopt policies to incentivise firms to reduce reliance on foreign products, producers or service providers (Anukoonwattaka and Mikic, 2020). The current architecture of GVC is already vulnerable to various shocks. Some firms develop more flexible supply chain models to adapt to such shocks. Historically, such shocks were mainly due to natural disasters, such as earthquakes, tsunamis and floods hitting some Asian economies including Japan, Thailand and Indonesia. These shocks were affecting one or several countries without disturbing the whole value chain.

The current crisis caused a much stronger impact on the GVCs, hence on global economic activities. The deliveries of most products were disrupted due to closure of factories and borders. Although there are measures to adapt to these circumstances, firms and governments see that this is not a reliable and sustainable approach in the longer term. There is no doubt about the need for adopting accommodative policies to counter potential damages out of these shocks. However, such policies should maintain a balance between short-term interventions related to maintaining existing linkages and long-term interventions related to establishing new linkages. It is important to maintain the critical production networks particularly related medical and agricultural products. It would be unwise to suggest that countries should drastically reduce their reliance on imports and embark on a path towards de-globalisation.

Rebalancing Between Supply Chain Efficiency and Resilience

Efficiency was the main driver of the GVCs. With reduced trade costs and improved connectivity, it was more efficient to outsource the different stages of production in different locations. However, in many industries, China has become a dominant supplier at the global level. With the emergence of trade-policy shock and the COVID-19 crisis, the priority started to shift from efficiency to resilience. In an attempt to rebalance between supply chain efficiency and resilience, countries have started to ponder strategies to reduce single-country or single-source dependencies. They will try to shorten the supply time by sourcing more products from nearby locations and producing the final product closer to the end users. The very first reorientation of production is expected to realize in the health sector, as countries are in urgent need to secure critical health products. However, relocation of factories in electronics, automotive and other sectors are not expected in immediate future, as it will require considerable investment to reorganize supply networks for such industries. However, it will be certainly on the agenda of the global companies and major industrialized economies.

In the longer-term, the COVID-19 is expected to bring a more careful examination of global value chains across a multitude of sectors, with a greater focus on diversification and resilience in global supply networks. Individual countries are likely to focus on their comparative advantages more than before, by investigating the opportunities for establishing regional production networks. They may target to attract industries seeking reshoring or near-shoring, particularly those where supply chains have been highly disrupted and where export controls have been imposed by governments.

Digital infrastructure is becoming more critical in the face of the pandemic. The medium-term policy response to the disruption of GVCs should focus on building sets of skills and infrastructure required for the digitalization of supply chains. Countries with inadequate skill levels, mechanisms and infrastructure required for digital transformation will miss the opportunity to participate in supply chains in the post-COVID-19 crisis period (Anukoonwattaka and Mikic, 2020). This new order also should take into account related social and environmental concerns to increase supply chain resilience and improve sustainability.

Jobs Connected with the GVCs at Risk

The GVCs have expanded primarily with the purpose of utilizing low labour costs and accessing resources and markets. Therefore, a significant share of jobs in developing countries is connected to the supply chains in the world. According to the ILO (2020d), almost 60% of all imported inputs were disrupted due to mandatory closures of all but essential workplaces in April 2020. This ratio remained at 35% at the beginning of June 2020. Around 255 million workers are estimated to be in sectors with a high or medium vulnerability to imported input supply disruptions, corresponding to 69% of manufacturing employment. The sectors with high vulnerability account for 49 million of these jobs, which includes jobs in the electronics, motor vehicles, and other transport equipment (ILO, 2020d).

In its estimations covering 64 countries (or 74% of the global labour force), the ILO reports that 292 million jobs in manufacturing supply chains are at high risk due to the COVID-19-related drop in consumer demand, and a further 63 million jobs are at medium risk. Taken together, more than one in two jobs in manufacturing supply chains, and more than one in seven of all jobs, are currently at medium or high risk, despite the easing of lockdown measures in many countries (ILO, 2020d). Among the jobs that are at high risk, 167 million jobs are in the manufacturing or other industrial sectors, 29 million jobs are in agriculture and 96 million jobs are in services, which supply inputs into manufacturing.

About 73 million jobs are at high risk in textiles and garments supply chains, representing one in four of all jobs at high risk (Table 5.1). This is also the sector where some OIC countries have a competitive advantage, including Turkey, Pakistan and Bangladesh. Additionally, an estimated 54 million jobs in motor vehicles supply chains are at high risk (ILO, 2020e). Morocco, Turkey and Malaysia are among the countries that provide significant inputs for motor vehicles supply chains at regional levels and the jobs are at high or medium risk in these sectors.

Overall, the closure of businesses and the collapse of consumer demand imply significant job losses in the supply chains of various manufacturing sectors. Most of these workers are likely to suffer from unemployment, reduced working hours and lower income. Firms supplying inputs for multinationals are also expected to suffer from reduced orders, cuts in investments and layoffs.

Table 5.1: The Number of Jobs Affected by Disruption of Supply Chains due to COVID-19

	Share of supply chain jobs in total employment (%)	Jobs sustained by consumer demand in different countries, by level of stringency of lockdown measures in place (millions)		Total jobs at high risk due to drop in consumer demand (millions)	Share of female jobs in supply chain jobs (%)
Supply Chains		High stringency	Medium stringency		
Food & beverages	10.1	174	75	0	36.8
Textiles & garments	3.0	40	34	73	46.2
Motor vehicles	2.2	29	25	54	35.6
Machinery & equipment	2.0	34	15	34	37.6
Electronics	1.4	17	17	17	49.8
Chemicals & pharmaceuticals	1.1	16	11	0	39.5
Electrical equipment	0.9	15	8	15	40.2
Other manufacturing	4.3	52	54	99	32.5
All manufacturing	25.0	376	239	292	38.1

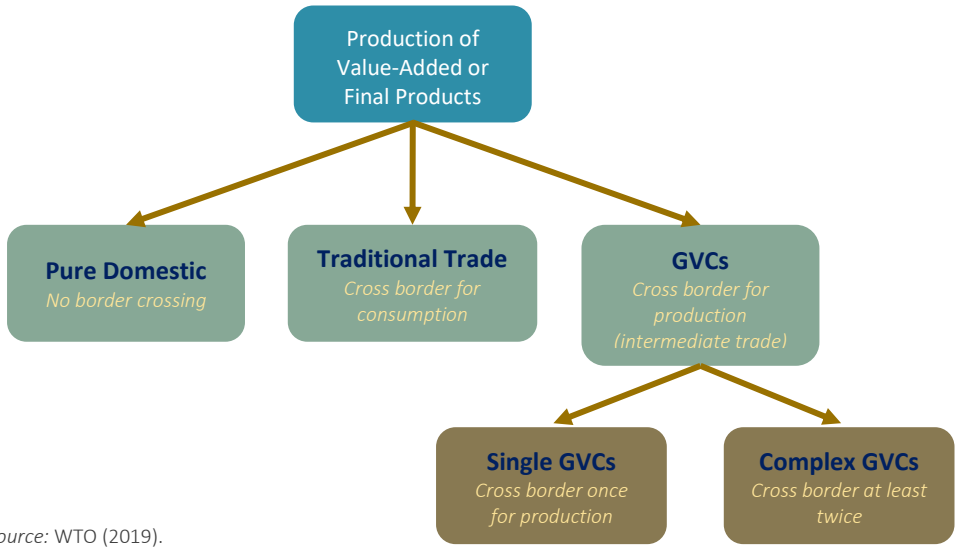
Source: ILO (2020d). Estimates are based on data for 64 countries that account for 74% of the global labour force. Orange cells indicate workers at high risk. Blue cells indicate workers at medium risk. Grey cells indicate workers at high or medium risk. Green cells indicate workers at low risk.

5.2 Trade in Intermediate Goods and Participation in Global Value Chains

With the expansion of the GVCs, trade in intermediate products is growing faster than the trade in final products. Today, almost every exported commodity involves some imported inputs, whether in the form of goods or services. The trade statistics capture trade flows in final products, but it is possible to disaggregate the trade data between capital, intermediate and consumption goods based on broad economic categories (BEC) classification of international trade. However, the use of trade data often leads to double counting due to this growing network trade, where intermediate products cross boundaries frequently. Therefore, they are unable to capture the net value added gains under international fragmentation of production

To measure net domestic value added created by trade, input-output (I/O) analyses provide a useful alternative to trade data. An important advantage of I-O tables is that they classify goods according to their use, which also include information on inputs of/in services sectors (Banga, 2013). The OECD TiVA database is the most comprehensive database on trade in value added across 55 industries; but it covers only 64 countries, including eight OIC countries, until 2015. There are various measures to generate value chain participation of countries from intermediate trade flows (see Box 5.1). In this section, despite its shortcoming, trade data classified under BEC category will be used to provide some general observations on the participation of OIC countries to global manufacturing activities.

Box 5.1: Decomposition of Production Activities



Source: WTO (2019).

In order to decompose production activities, a recent study divides them into 4 broad types depending on whether they involve production sharing between two or more countries and constructs a related dataset (Wang et al., 2017). The first type is value added produced at home and absorbed by domestic final demand without involving international trade. No factor content crosses national borders in the entire production and consumption process. The second type is domestic value added embodied in final product exports, that is, traditional trade: products are made completely by domestic factors and factor content crosses a national border once for consumption only. The third type is domestic value added embodied in a country-sector's intermediate trade that is used by the partner country to produce its domestic products consumed locally, or is foreign value added that is imported directly from partner countries and used for domestically consumed products. Factor content is used in production outside the home country and crosses a national border once for production. The last type is value added embodied in intermediate exports/imports that is used by a partner country to produce exports (intermediate or final) for other countries. In this case, factor content crosses a national border at least twice, so is referred to as complex GVC activities.

Trade in intermediate goods has also strong implications for global trade. A preliminary analysis by the UNCTAD shows that even a relatively small decline in trade in intermediate goods can have strong repercussions. For example, it is estimated that a 2% reduction in exports of intermediate inputs from China to automotive manufacturers in the EU, Japan, North America and other major automotive-producing economies could lead to a US$7 billion reduction in automotive exports from these economies to the rest of the world (UNCTAD, 2020c).

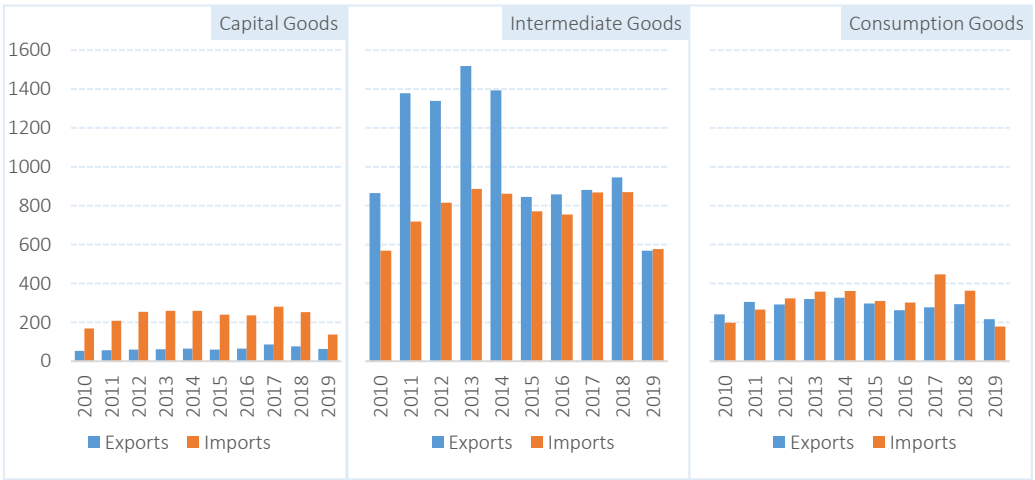
Trade in Intermediate Goods

The classification of international trade statistics by broad economic category (BEC) allows the conversion of international trade data based on the standard international trade classification (SITC) into goods by end-use category, namely capital, intermediate and consumption goods. This

facilitates a range of analytical applications, such as the relative integration of economies in global value chains. Capital goods are those goods, which help in the manufacturing of the consumption goods or intermediate goods. The capital goods are in themselves final goods but are not used by people but are used by the industry to manufacture other goods. They generally include the machines, tools and equipment. Intermediate goods are those goods, which are necessary for the manufacturing of final goods. These may include semi-finished parts/equipment or output of an industry that is used as input for another industry. Finally, consumption goods are obviously meant for consumption, which can be durable or non-durable. This classification does not provide information on the value added by individual countries, but will be used to make some general observations.

Figure 5.1 shows that OIC countries have been exporting mostly intermediate goods, which includes mineral products and raw materials. More than 75% of exports during 2010-19 were classified as intermediate goods, which are used by importing countries for further processing. During the years in which commodity prices were high (2010-14), OIC countries were attaining major surplus in intermediate goods, but after 2014 they could hardly attain a surplus, which then turned to a deficit in 2019. Capital goods accounted for less than 5% of their total exports, but they accounted for more than 17% of total imports. It is understandable that most of the OIC countries require capital goods (and inherent technology transfer) to build up their productive capacities.

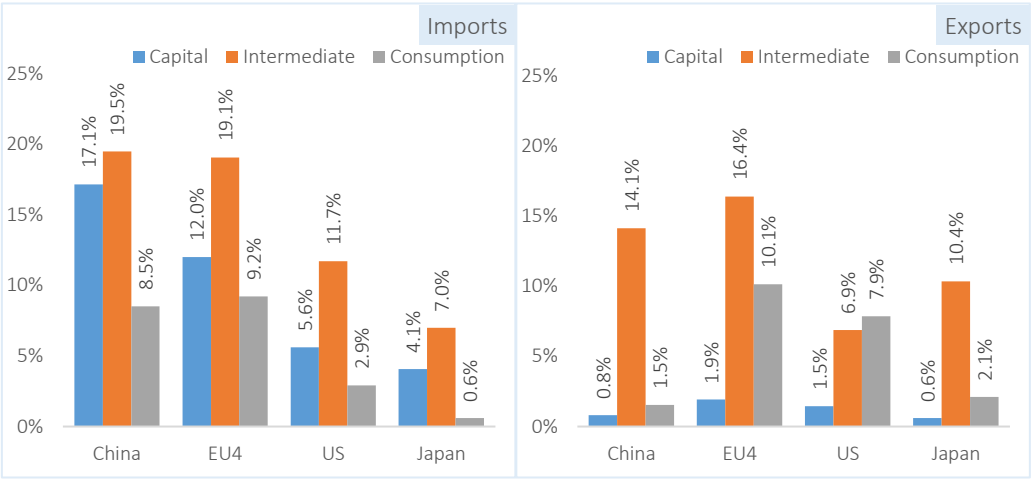
Figure 5.1: Total Trade of OIC Countries in Capital, Intermediate and Consumption Goods (Average of 2010-19)



Source: Author's staff calculations based on UN Comtrade Database.

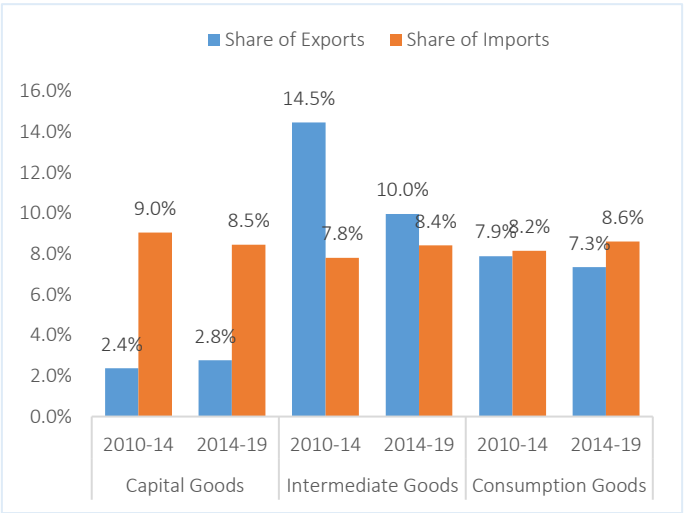
As witnessed during the COVID-19 crisis, overdependence on a single market may create important vulnerabilities. Figure 5.2 (left) depicts that almost 20% of intermediate goods are imported from China and around 19% from four major European economies, including Germany, France, UK and Italy. Together with the USA, more than 50% of imports of intermediate goods came from six major economies in the world. Similarly, more than 47% of intermediate goods are exported by OIC countries to seven major economies including Japan (Figure 5.2, right).

Figure 5.2: Total Trade of OIC Countries with Major Economies (Average of 2010-19)



Source: Author's staff calculations based on UN Comtrade Database. EU4 includes Germany, France, UK and Italy.

Figure 5.3: Share of OIC Countries in Global Exports and Imports

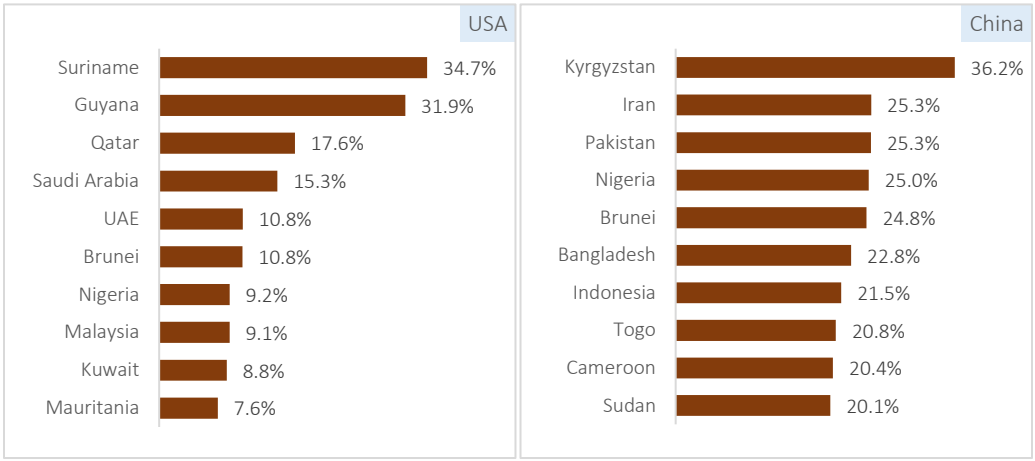


Source: Author's staff calculations based on UN Comtrade Database.

On average, OIC countries accounted for 14.5% of global exports of intermediate products during 2010-14, but this ratio fell to 10% during 2014-19 (Figure 5.3). In terms of imports of intermediate goods, the ratio increased from 7.8% to 8.4% during the period under consideration. This indicates that the relative importance of OIC countries in supplying intermediate goods is regressing over the years. Only a slight increase in the share of capital goods' exports is observed, but this ratio is already too low (2.8%).

When the import dependence of individual OIC countries to major economic hubs is analyzed, it is observed that there is a greater dependence on China as compared to other major economies in the world. OIC countries in Latin America have relatively higher dependence on imports of intermediate goods, exceeding 30%. Other OIC countries with strong dependence on USA are Qatar, Saudi Arabia and UAE (Figure 5.4, left). On the other hand, there are ten OIC countries that have import dependence to China above 20%, which are mainly Asian OIC countries, reaching 36% in the case of Kyrgyzstan (Figure 5.4, right).

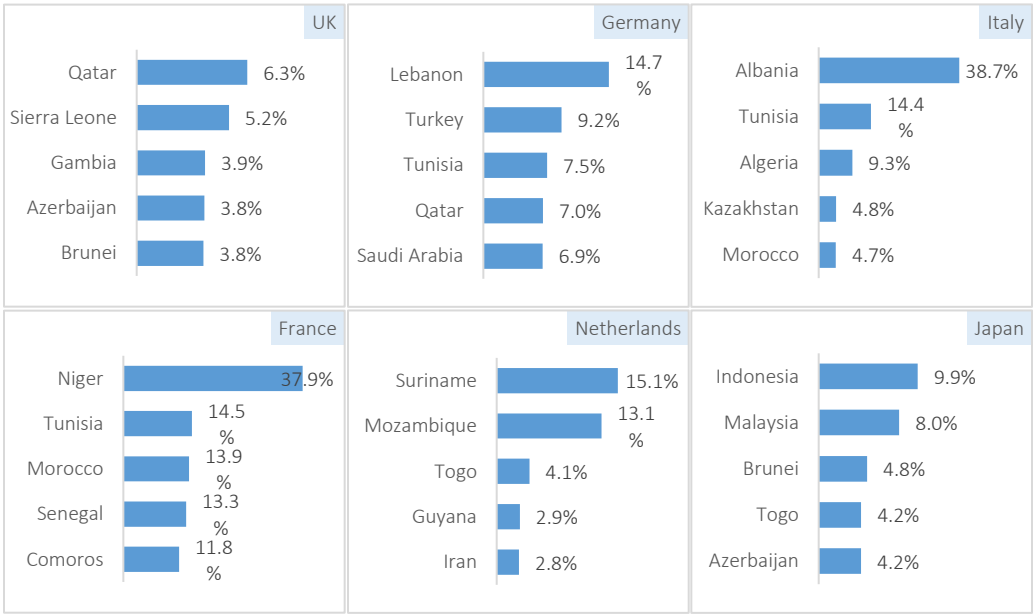
Figure 5.4: Import Dependence of OIC Countries to USA and China, Top OIC Countries, 2015-2019



Source: Author's staff calculations based on UN Comtrade Database.

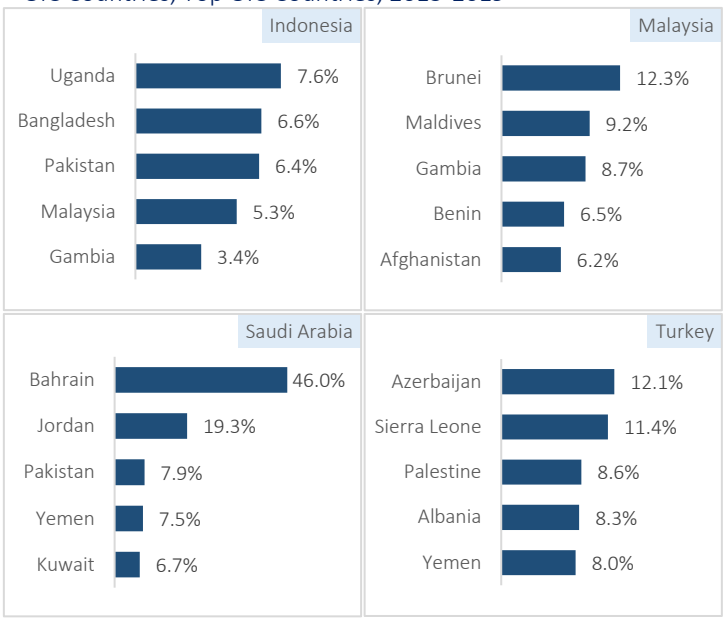
Import dependence on individual European countries and Japan are not excessively high (Figure 5.5). Albania appears to have a high dependence on Italy (38.7%) and Niger on France (37.9%). However, when the European countries are considered as a single economy, there would be a number of OIC countries whose dependence exceeds 50%. Finally, when the import dependence of OIC countries on some major OIC economies is investigated, it is observed that Uganda has

Figure 5.5: Import Dependence of OIC Countries to Major European Countries and Japan, Top OIC Countries, 2015-2019



Source: Author's staff calculations based on UN Comtrade Database.

Figure 5.6: Import Dependence of OIC Countries to Some Other OIC Countries, Top OIC Countries, 2015-2019



Source: Author's staff calculations based on UN Comtrade Database.

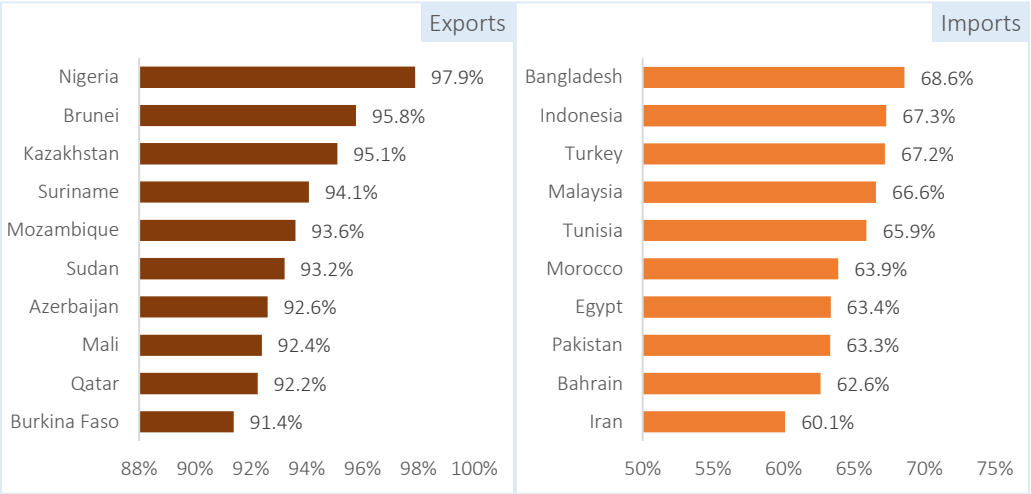
the highest dependence on Indonesia (7.6%), Brunei Darussalam has the highest dependence on Malaysia (12.3%), Bahrain has the highest dependence on Saudi Arabia (46%) and Azerbaijan has highest dependence on Turkey (12.1%) (Figure 5.6).

Before concluding the analysis on trade in intermediate goods, Figure 5.7 demonstrates the OIC countries with the highest share of intermediate goods exports and imports. Almost 98% of all exports from Nigeria are classified as intermediate goods, which are used by importing countries for producing greater value added products. It is followed by Brunei Darussalam (95.8%), Kazakhstan (95.1%), Suriname (94.1%) and Mozambique (93.6%). In terms of imports, Bangladesh (68.6%), Indonesia (67.3%), Turkey (67.2%), Malaysia (66.6%) and Tunisia (65.9%) have the highest share of imports in intermediate products. These countries are also among the top OIC countries with highest manufacturing capacity.

In general, the characteristics of OIC countries with higher share of exports in intermediate products are resource rich OIC countries exporting mainly mineral products and other raw materials. On the other hand, OIC countries with a higher share of imports have relatively stronger manufacturing activities importing intermediate products to add value and re-export in the form of intermediate or final products.

The above analysis does not provide sufficient information about the exact nature of participation of OIC countries to the GVCs, but provides some insights on their current pattern of trade in intermediate as well as capital and consumption goods. There is hardly any product that is produced 100% domestically and sold in foreign markets without further processing. Therefore, if there is an export activity, whether in capital, intermediate or consumption goods, this indicates some form of participation to the GVCs. Unfortunately, the shares of OIC countries in global exports and imports of products at different stages of production are found to be very low (see Figure 5.3). Even if these products were assumed to embed a high level of domestic value addition, the participation of OIC countries to the GVC would be very low.

Figure 5.7: OIC Countries with Highest Share of Trade in Intermediate Goods, 2015-2019



Source: Author's staff calculations based on UN Comtrade Database.

Current crises could bring new opportunities for OIC countries. Some OIC countries are geographically closer than other non-OIC economies in supplying major economic hubs and they have important comparative advantages. OIC countries in the Mediterranean region have strong advantages in supplying European countries, particularly in textile, automotive and chemical products. Given the preferential market access that some of them have with the EU and the proximity to the large European market, those OIC countries could benefit from the potential diversification and reshoring of the GVCs. In order to attract multinational companies and benefit from the recalibration of the GVCs, OIC countries should develop their physical and digital infrastructure, improve the overall investment climate and reduce non-tariff and administrative barriers.

There are also greater opportunities and economic justifications for regional economic integration. Even though some OIC countries are competing on various similar products in international markets, there are important complementarities among various OIC countries, which could be better exploited in the current economic setting. In the presence of a strong political will, the development of regional value chains in certain industries could create important economic benefits in the form of productivity, economies of scale and competitiveness, which would further strengthen the opportunities arising from the reshoring and diversification of GVCs.

5.3 Potential Reshoring of Global Value Chains and Alternative Directions

The expansion of global value chains has historically made important contributions in terms of supporting the economic participation of developing countries, reducing poverty, and increasing employment and productivity. In this framework, advanced countries focused mostly on knowledge-intensive production, branding, design, marketing, and other intangibles; while developing countries hosted manufacturing or assembly activities where FDI is welcomed.

The economic consequences of the pandemic have already triggered discussions on the need for reengineering the global supply chains. Strengthening regional operations by concentrating supply chains in closer locations is one of the possible strategies. Yet, the resilience to such shocks does not require GVCs to rely on self-sufficiency only. Moreover, shifting global trade policy dynamics raise trade barriers, create uncertainty over future trade policy, which leads firms to postpone or cancel their investment decisions abroad, and shift them back to their country of origin. Before the pandemic, trade policy shifts were already creating incentives for firms to reconfigure supply chains towards countries with lower tariffs.

In certain sectors, a relatively accelerated reshoring is expected after the pandemic, particularly in which supply chains have been highly disrupted and stricter export controls have been imposed, such as the health sector. In other more complicated sectors, no immediate actions are expected. However, in the middle and long term, there is a tendency to reconsider the GVCs. This tendency is further supported by the rise of automation and the fall of the need for a low cost labour force.

The pandemic and trade tensions might also lead to structural changes in supply chains to increase supplier diversity and increase inventories of critical components and products, for example in the case of goods and services perceived to have strategic importance at the national level (ILO, 2020f). In a recent survey conducted by PricewaterhouseCoopers (PWC) in a cross-section of 55 enterprises in the United States and Mexico, the majority of respondents answered either "yes" (42%) or "not sure" (27%) when asked whether they would make changes to the breadth of their supply chain because of the coronavirus (PWC, 2020). Generally speaking, the future of GVCs is determined by various factors including production costs, trade costs, technological innovations, global geographic distribution of demand, and preparedness to meet supply chain risks (Choi, 2020).

According to the Kearney Reshoring Index report, many US companies did seek out alternative supply chains. COVID-19 will not improve the reshoring trend for the USA. On the contrary, companies are diversifying their suppliers and subcontractors in countries in closer markets but not necessarily in the USA itself (Kearney, 2020). The "de-Sinification" of manufacturing will make China lose its central position in many global supply networks to certain emerging markets including Brazil, Mexico and some other Southeast Asian countries.

Considering the current crises and ongoing economic transformations, UNCTAD (2020a) presents four possible trajectories for international production configurations for the decade to 2030. They all point to a retreat of international production to various degrees. Three trajectories – reshoring, regionalization and replication – involve some form of downscaling of GVCs. The fourth one, diversification, projects further growth, but with a greater concentration of value added and downward pressure on investment in physical productive assets.

In reshoring, the direction is towards a simplification of the production process and the use of onshore or nearshore operations. Advanced robotics-driven automation plays a key role in this trajectory. In the manufacturing sector, this trajectory is primarily relevant for higher-technology, GVC-intensive industries. Some high-tech industries are likely to experience further protectionist

pressures, either because they provide essential goods – such as medical equipment or because they are considered strategically important from an economic or a technological perspective. Other manufacturing industries have a more limited scope for reshoring as they have structural ties to locations for access to raw materials or other factors of production.

In regionalization, value chains take place increasingly at the regional or local level. From the perspective of developing countries, regional value chains (RVCs) break dependency from developed markets and technologies, stimulating the process of local development; they allow higher participation in value chains; they foster internal specialization and industrial diversification within the region and open opportunities for structural transformation and value chain upgrading. However, RVCs are not easy to establish. For a region to attract or develop an entire value chain is a more difficult task than for a country to attract investment in an industry segment. RVCs require regional coordination and conducive systemic conditions. Even if the political momentum for a shift to regionalism is settled, the implementation will not be immediate.

In the case of diversification of GVCs, digitalization of the supply chain is pivotal. Digitalization allows MNEs to extract further efficiencies from international production networks, by reducing governance and transaction costs and enhancing centralized coordination and control. Applications of digital technologies to foster international diversification and build supply chain resilience include real-time visibility into the availability of raw materials and finished goods; enhanced control over processes, people and assets, including the tracking of external suppliers down to the bottom of the supply chain. It also includes the use of AI and machine learning to ensure more timely responses to shocks and discontinuities.

In a similar vein, centrally coordinated manufacturing activities are replicated so as to become closer to the point of consumption by the help of new production technologies. This is characterized by short value chains, with manufacturing production steps bundled together and replicated in many locations. Consequently, geographic dispersion of economic activities is high, with the concentration of high-value activities in a few locations but broad participation in the manufacturing process through 3D printing or other automation tools.

Significant uncertainty on the exact path of the transformation of international production remains, particularly concerning the timeline and scope of the transformation. On the other hand, there is no warranty that the world economy will benefit from rising regionalism and nationalism. OECD (2020d) conduct a set of economic model simulations to explore two stylised versions of the global economy, one with production fragmentation in GVCs and another where production is more localised and businesses and consumers rely less on foreign suppliers. The report found that re-localisation of supply chains would not only increase costs for businesses and for consumers, but also, importantly, would fail to shelter economic actors from uncertainty. All countries would lose from a shift away from interconnected economies to a localised regime of production.

5.4 Policy Challenges and Opportunities for OIC Countries under "New Normal"

Current supply chains are characterized by optimization of activities to minimize costs, reduce inventories and increase asset utilization. Even though such optimizations take various risks into consideration, combined shocks that firms experience today could not be anticipated a few years ago. Existing directions in economic policy making indicate greater uncertainty resulting from trade tensions and the pandemic. Rising regionalism, protectionism and economic nationalism are expected to affect the current functioning of value chains across the world.

Under this "new normal" (referring to the significant change of the prevailing situation), there will be both challenges as well as opportunities for OIC countries. Rising economic nationalism may harm some OIC countries that are already well integrated into global value chains. It is not realistic to expect a world where each product is produced without the participation of another country. A high level of value chains, perhaps even in greater complexity than what already exists, will be the prevailing form of production. However, it is expected that countries will try to attain self-sufficiency on production of certain critical products.

Another challenge would be the heightened competition as a result of growing economic nationalism and protectionism. While advanced countries with strong and diversified economic structure will have competitive advantage in many fronts, developing countries with weak and concentrated economic structure will struggle to diversify their economies and achieve competitiveness in a wider set of products. This may further escalate trade tensions; as individual countries will adopt policies to protect their industries. This scenario is more likely to be realized in sectors that are considered as strategic.

Firms require greater flexibility and stronger buffers to absorb delays and disruption. It will not be easy for firms to reengineer their value chain thoroughly, but they will be looking for greater flexibility in their supply chains. Even if OIC countries cannot attract the substantial part of value chains due to various constraints on the part of firms or host countries, they could offer firms some form of flexibility by proving their capacity to supply certain product items. Over time, they may gradually become key suppliers, instead of back-up suppliers.

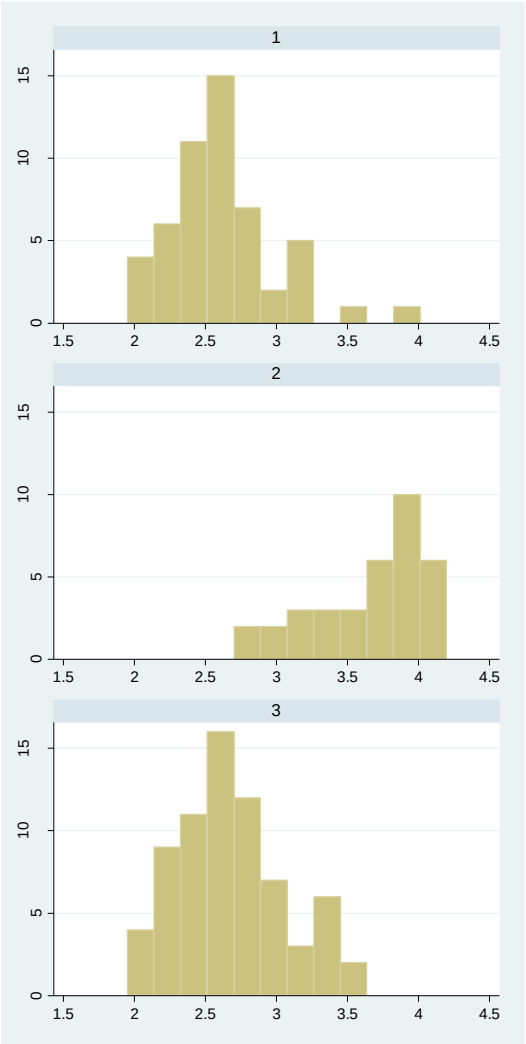
Implications of potential reshoring or near-shoring differ depending on various factors such as the size, geographic proximity, institutional quality and resource endowments. Smaller economies are, on average, more vulnerable to imported input supply disruptions than larger countries. These countries are less likely to have the capacity to produce all components of a final product, particularly the sophisticated products. Their economic linkages in terms of supplying imported components are also not diversified enough to quickly outsource the needed parts from alternative suppliers. Even Germany is reported to experience up to 70% disruptions of imported inputs due to the pandemic, despite having the most diversified network of suppliers (ILO, 2020d).

In order to benefit from the reorientation of supply chains, OIC countries need to reduce trade costs, improve technological capacities and increase their preparedness to meet supply chain risks. In order to reduce trade costs, they can sign regional trade agreements, improve physical and digital infrastructure and reduce burdensome trade measures. Investments in transport and communication infrastructure are critical to provide an enabling environment for firms seeking alternative value chain networks. In order to improve technological capacities, they need to invest in human capital, increase R&D expenditures and protect intellectual property rights. Finally, measures should be taken to increase preparedness to supply chain risks and improve resilience to these risks, such as failure of transportation and communication networks, financial market risks, epidemic and pandemic risks, and cyber security risks.

An analysis of these measures would be rather excessive for the purpose of this chapter. However, to provide some overall observations on the current state in OIC countries, brief discussions will be made on selected indicators. Figure 5.8 shows the distribution of logistics performance index (LPI) score across three comparison groups, where higher scores reflect better logistics performance. The distribution of LPI scores in OIC countries resemble that in non-OIC developing countries, but much lower than developed countries. There are 13 OIC countries with LPI scores above the world average of 2.87.

As an indicator of innovation and technological development capacity, the number of researcher per million people is depicted in Figure 5.9. In the majority of OIC countries, this number is below 1000. Only Malaysia has more than 2000 researcher per million. While physical and human capacities are significantly lower than in developed countries, average tariff rates applied by OIC countries are higher (Figure 5.10). While the median OIC country has an

Figure 5.8: Logistics Performance Index, 2018

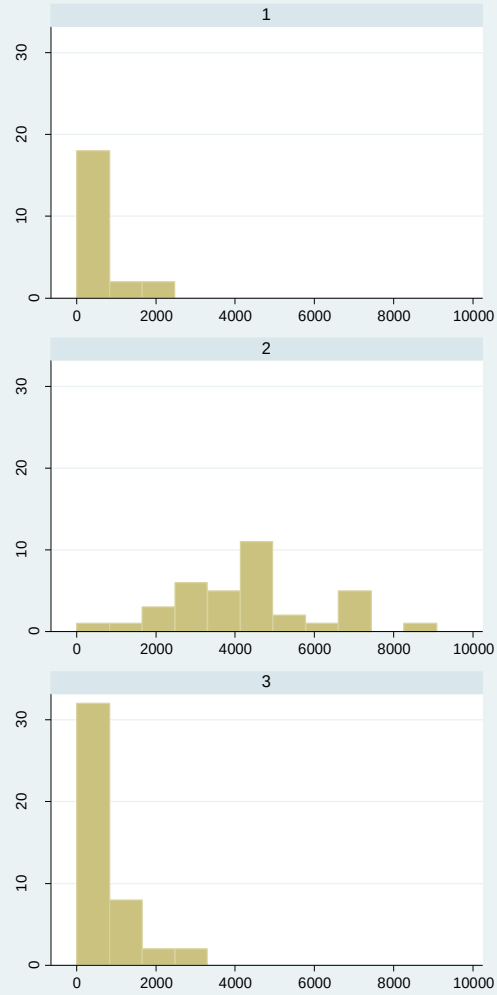


Source: World Bank WDI Database. 1: OIC Countries (n=52); 2: Developed Countries (n=35); and 3: Non-OIC Developing Countries (n=70). Y axis shows the number of countries.

average tariff rate is 8%, this level is 1.7% in developed countries and 4.2% in non-OIC developing countries, indicating relatively higher protectionism applied by OIC countries.

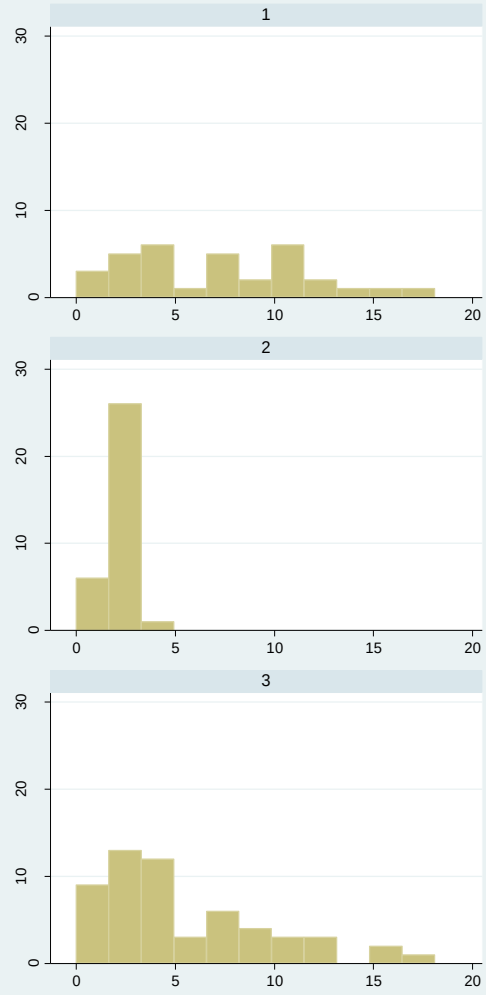
Overall, existing capacities in many OIC countries are not conducive enough to attract a significant amount of investments during the post-pandemic period. However, their geographical proximity to major economic hubs may put them in an advantageous position. Right policies during the pandemic period may provide additional advantages in attracting foreign companies to establish new value chains. Considering the rising protectionism and growing importance of regionalism, facilitating the regional movement of goods and people during the post-pandemic period may be particularly important in attracting multinationals.

Figure 5.9: Number of Researcher per Million



Source: World Bank WDI Database. Latest year available after 2010. 1: OIC Countries (n=22); 2: Developed Countries (n=36); and 3: Non-OIC Developing Countries (n=44). Y axis shows the number of countries.

Figure 5.10: Average Tariff Rates, 2018



Source: World Bank WDI Database. Weighted mean of applied tariff rates. 1: OIC Countries (n=33); 2: Developed Countries (n=33); and 3: Non-OIC Developing Countries (n=57). Y axis shows the number of countries.

In this connection, the following recommendations are made for OIC countries in the wake of the potential transformation of international production:

Minimize policy uncertainty: Escalating trade tensions significantly hurt the investment behaviour of firms due to increased policy uncertainty. Rising uncertainty leads to a deferral of investment decisions by firms, while consumers also cut back their spending and banks increase their cost of finance. These reduce aggregate demand and lower economic growth. OIC countries should minimize policy uncertainty by the timely and clear communication of future changes in trade policy to support investment and consumption behaviours.

Attain self-reliance in strategic products: Regardless of their level of development, many countries experienced a shortage of critical health products in response to the rapid outbreak of the COVID-19 pandemic. This reminded the critical importance of attaining self-sufficiency in strategic products. In order to be more resilient in the presence of similar shocks, it is necessary for OIC countries to attain their self-reliance in products that are considered critical or strategic.

Reduce dependency on a single supplier: It became evident that the high dependency on imported as opposed to domestic input supply, and the high concentration of their foreign input supplier networks on only one or a few countries, renders these sectors more vulnerable to current and future workplace closures. Therefore, in establishing value or supply chains, it is critical to avoid dependency on a single market or supplier.

Focus on intra-regional value chains: A substantive nationalization or regionalization of supply chains has the risk to further reduce the diversification of suppliers in the world economy and reduces opportunities for developing economies to benefit from GVC-associated capital flows and technology transfer. A potential outcome would be a significant reduction in developing countries' potential to industrialize through linking into GVCs and impede the socio-economic progress that has been recorded in many developing regions (Seric et al., 2020). A remedy would be to focus on intra-regional value chains, instead of inter-regional ones. Intra-regional value chains are expected to be more resilient than inter-regional ones and they can be a continuous catalyst for capital and technology transfer for OIC countries. This would also contribute to achieving greater economic integration among OIC countries, as postulated in OIC-2025 TYPOA.

Exploit the proximity to major economic hubs: OIC countries with sufficient combination of skilled and low-skilled labour force at the neighbourhood of the European Union may become more attractive for certain manufacturing projects, relative to East Asian locations. If these countries offer an environment for the gradual upgrading of production facilities with the rise of automation and smart factories, they would sustain their role as a key partner in the regional value chain. In this situation, it would be possible to attract cutting-edge investments to offer a full range of support services in these countries. Such long-term strategy is need to avoid countries participating in GVCs not to be locked into low value added activities.

Avoid non-transparent trade policy measures: A longer recovery from the economic recession caused by the COVID-19 pandemic is likely to cause protectionism to prevail over longer periods, as the motivation to protect domestic industries from import competition will be stronger by governments. During this period, it is important to avoid resorting to non-transparent forms of

trade measures outside of the rules-based system. This would further discourage foreign investors in their potential decision to rethink their supply chains.

Engage in regional free trade agreements: Under new normal, proximity to suppliers and consumers with adequately developed infrastructure will be of utmost importance. In addition to geographic proximity and sufficiently developed infrastructure, free trade agreements with large trading blocs would be another attraction for multinational firms to consider investing in OIC countries.

Establish regional clusters: At regional context, establishing regional clusters for different sectors would also attract firms operating certain sectors. Clusters establish a geographic concentration of interconnected businesses, suppliers, and associated institutions. They provide important cost advantages by creating direct and indirect synergies among the firms in clusters and contribute to the productivity and competitiveness of countries. This would be particularly functional when the countries engaging regional clusters are economically small and economic activities are not diversified enough. Establishing regional clusters in OIC countries would require strong political will and greater economic integration at the regional level.

Invest in improving connectivity: Some OIC countries do not have geographic proximity … Remoteness can be overcome by improving connectivity and lowering trade costs. Costs related to delay and uncertainty can be reduced by customs reform, introducing competition in transport services, and improving port structure and governance (WB, 2019).

Establish logistic clusters: In order to support their regional competitiveness, OIC countries can also establish regional logistic clusters to ensure timely and effective delivery of intermediate products. Through processing large volumes of freight, it is possible to attain economies of scale and scope in clusters. Additionally, logistics clusters offer advantages based on the interchangeability of transportation and logistics assets. This would increase the competitiveness of countries utilizing the cluster and facilitate expedited delivery of goods.

Invest in automation and artificial intelligence: Automation and artificial intelligence (AI) are also emerging factors that are expected to shape the GVCs in the medium term. Companies are in the stage of transformation towards digital supply networks through digital technologies including the Internet of Things (IoT) and AI. Recent shocks have stimulated the firms on the urgency of this transformation. These would not also diminish the importance of low-cost labour, but also minimize the disruptions in the supply chain. The rising demand for reduced human interaction is also expected to accelerate investments in robotics and automation that were already underway. In this connection, OIC countries should invest in advanced technologies, or at least adapt their manufacturing industries into these new technologies to remain competitive.

Annex: Country Classifications

A. Major Country Groups used in the Report

OIC Countries (56+1):

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

(Membership to the OIC is currently suspended.)*

Non-OIC Developing Countries:

Angola	Barbados	Bosnia and Herzegovina	Cabo Verde
Antigua and Barbuda	Belarus	Botswana	Cambodia
Argentina	Belize	Brazil	Central African Rp.
Armenia	Bhutan	Bulgaria	Chile
Bahamas	Bolivia	Burundi	China
			Colombia

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

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 April 2020.)*

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	
Iraq	Libya	Saudi Arabia	Yemen

(Membership to the OIC is currently suspended.)*

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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