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Post-crisis economic recovery in OIC member states: Is it sustainable?

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Executive Summary - Due to the global financial crisis of 2008, the economic performance of OIC member states was adversely affected in 2009 in terms of decelerating economic growth and deteriorating current account balances. However, in the post-crisis period, the OIC member states have recovered rapidly. In the medium-term scenario (2011–2015), the economic recovery in OIC states is projected to be robust but real GDP growth and is likely to remain below the level achieved in the pre-crisis period (2000–2007). Among OIC regions, SSA and Asia are projected to achieve pre-crisis growth while MENA and CIT will take a relatively longer period to reach the pre-crisis level of growth. With regard to individual OIC member countries, it appears that 31 out of 57 OIC states are projected to achieve their pre-crisis growth during the medium-term period.

Current account balances of the OIC member states were also hit hard by the global economic crisis. Recovery in the current account balance of OIC states (as a group) remained modest in 2010. In the medium-term scenario, with the expected revival of the global economy and increase in oil and non-oil commodities prices, current account surplus of OIC member states is projected to improve, but it will not be able to achieve the pre-crisis level by 2015. In the medium-term, among four regions, current account balances of SSA and CIT are projected to improve much faster and they are expected to remain significantly above the pre-crisis levels while MENA and Asia will not be able to achieve the pre-crisis level of current account surpluses by 2015.

Due to excess capacity and slow economic recovery, the inflationary pressure is expected to remain moderate in OIC states in the medium-term. However, the recent rise in food prices is a source of concern, which is expected to build inflationary pressures in the coming years.

The major global factors that have affected economic performance of OIC member states during the financial crisis period are still major threats to sustainable economic recovery. They include fragile global economic recovery; slow recovery in world trade; highly volatile oil-and non-oil commodities prices; rising policy interest rates; and deteriorating debt situations in advanced economies. The adverse external factors have also been compounded by a number of domestic factors such as rising youth unemployment, weak economic integration among OIC states, and some fundamental weaknesses in macroeconomic policies, resulting in major threats to sustainable economic performance of OIC member states in the coming years.

Since inception, the Islamic Development Bank (IsDB) Group is playing an active role in socio-economic development of its 56 member countries (all OIC states except Guyana are IsDB member countries). To help member countries to consolidate their economic recovery, the IsDB has maintained its high level of development assistance through sharp scaling up of its operations. The cumulative net approvals of IsDB Group reached $74.2 billion since inception in its member countries. The current core areas of IsDB Group interventions in member countries are poverty alleviation, food security, infrastructure development, human development, Islamic finance and regional cooperation.

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In the post-crisis era, the OIC member states need to adopt somewhat different policies to foster renewed growth and to deal with the structural issues to sustain economic recovery and achieve inclusive economic development. In particular, the OIC member states need to adopt speedy macro and micro reforms; do structural repairs of fiscal consolidation; promote private sector-led growth; adopt labor market reforms to create quality jobs, particularly for the youth; improve competitiveness; enhance regional integration; restore banking system health; and expand Islamic financial institutions.

I. Introduction

1. In line with the global economic recovery, 57 member states of the Organization of Islamic Conference (OIC) (as a group) observed robust economic growth in 2010, achieving the pre-crisis level of growth. Similarly, the current account balances of OIC member states improved significantly in the post-crisis period. This recovery was due to wide-ranging policy actions undertaken during 2008 and 2009 at international, regional, and national levels. Recently, the main challenge facing the OIC states in the post-crisis era is to sustain robust economic recovery in the medium- to long-term. Looking ahead, the medium-term prospects for sustainable economic recovery in member states face some major downside risks. In particular, in the coming four to five years, the sustainability of economic recovery in OIC states will depend upon a number of external factors (i.e., fragile global economic recovery; slow recovery in world trade; highly volatile oil-and non-oil commodities prices; rising policy interest rates; and deteriorating debt situation in advanced economies) and domestic factors (i.e., rising youth unemployment, weak economic integration among OIC states, and some fundamental weaknesses in macroeconomic policies). Therefore, the shape of medium-term recovery of OIC member states (whether U-shape or W-shape) is uncertain yet (Iqbal, 2009a and Iqbal 2009b).

2. The analysis of this paper focuses on 57 OIC member states (as a group) as well as oil-exporting and non-oil exporting member countries. Since the post-crisis economic recovery remained uneven across the regions, the analysis also distinguishes four regions of OIC member states, namely Middle East and North Africa (MENA),[1] Asia,[2] Sub-Saharan Africa (SSA),[3] and Countries in Transition (CIT).[4]

3. The structure of the paper is as follows. Section II provides recent macroeconomic performance (i.e., real GDP growth, current account balance, and inflation rate) and medium-term outlook in OIC member states as a group as well as its four regions. Section III describes key external and domestic factors affecting sustainable economic recovery in OIC states. Section IV provides the role of the IsDB Group in economic recovery of OIC states. In the final Section V, the paper suggests a number of measures to be considered by OIC member states in order to achieve sustainable growth and inclusive economic development.

II. Recent economic performance and medium-term outlook of OIC member states

4. Due to the global financial and economic crisis of 2008, economic performance of OIC member states was adversely affected in 2009 in terms of decelerating economic growth and deteriorating current account balances of both oil-exporting and non-oil exporting member states as well as four regions of OIC states. However, the economic performance improved significantly in 2010. The following sub-sections provide developments in key macroeconomic performance indicators, namely real GDP growth, current account balance, and inflation rate during the pre-crisis period (2000–2007), the first post-crisis year 2010, and medium-term period (2011–2015).

Real GDP growth

5. *In the post-crisis period, the OIC member states (as a group) have recovered rapidly.* The global financial and economic crisis adversely affected economic growth of OIC countries (as a group), which decelerated from 6.3 percent in 2007 to 1.9 percent in the 2009. However, due to strong stimulus packages and wide-ranging policy reforms, OIC states experienced impressive real GDP growth of 5.3 percent in 2010, achieving almost the pre-crisis growth rate (i.e., average growth rate during 2000–2007 was 5.6 percent). Similarly, oil-exporting member states[5] also showed strong recovery with the economic growth of 4.7 percent and non-oil exporting member states[6] with the growth of 6.1 percent in 2010, mainly due to global economic recovery and positive trends in oil and non-oil commodities prices. It appears that non-oil exporting countries recovered much faster and stronger than oil-exporting countries, thereby achieving above the pre-crisis growth (5.2 percent), while oil-exporting countries' growth in 2010 remained below the pre-crisis growth rate of 6 percent. The relatively slow economic growth in oil-exporting countries is attributable to the weakening impact of oil exports on output growth in the post-crisis period (Figure 1).

6. *In the medium-term scenario (2011–2015), the economic recovery in OIC states is projected to be robust but is likely to remain below the pre-crisis growth rate*. The average real growth rate in the medium-term is projected to be 5.1 percent in OIC states (as a group); 4.8 percent in oil-exporting countries; and 5.4 percent in non-oil exporting countries. Strong public policies have supported OIC member states' economic recovery in 2010, but the short-term V-shaped recovery through economic painkillers (i.e., stimulus packages and money injections) faces a number of major risks associated with the medium-term recovery, which will depend upon developments in a number of underlying external and domestic factors.

7. *Among various regions of OIC member states, MENA was hit hard by the economic crisis as its real GDP growth dropped from 5.7 percent in 2007 to 0.4 percent in 2009*. The MENA region was adversely affected mainly due to collapse in oil and asset prices, significant decline in domestic demand, and sharp drop in FDI flows. However,

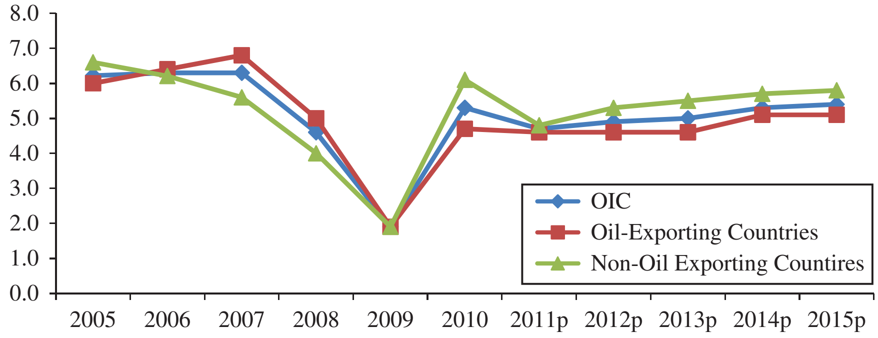

Figure 1. Rreal GDP Growth in OIC Member States, 2005–2015 (% per annum).
Source: Computed by IsDB based on data from the IMF World Economic Outlook database (April 2011).

the region recovered with strong economic growth of 4.7 percent in 2010. In the medium-term scenario (2011–2015), the region's real GDP is projected to grow by 4.4 percent and it will take a longer period to reach the pre-crisis level of growth (5.2 percent). The medium- to long-term economic performance of the MENA region will mainly depend upon the movements in oil prices.

8. *The second region of OIC states affected badly by the economic crisis was CIT, whose output decelerated sharply from an average pre-crisis level of 10.1 percent to 4.7 percent in 2009*. The fallout of the economic crisis on CIT member states has been immense mainly due to a sharp drop in demand, currency devaluations, decline in foreign capital inflows, workers' remittances, and lower energy prices. However, in line with the global economic recovery, the region's output accelerated by 6.6 percent in 2010. The medium-term growth is anticipated to be 5.5 percent during 2011–2015, indicating slow and unsustainable economic recovery compared to other regions of OIC states.

9. *Among OIC regions, the Sub-Saharan Africa (SSA) region remained more resilient as its real GDP growth dropped marginally from the normal growth rate of 6.8 percent achieved during 2000–2007 to 5.3 percent in 2009*, mainly due to collapse of global trade, decline in capital flows (FDI, ODA, and remittances), and sharp decline in oil- and non-oil commodities prices. However, the region showed impressive recovery with a growth rate of 6.4 percent in 2010. In the medium-term, the region is projected to recover with strong and sustainable economic growth of 5.8 percent. The further recovery in the SSA region will depend on the extent of global economic recovery and movement in oil- and non-oil commodities prices in the coming years.

10. *Economies of OIC member states in Asia were relatively less affected as their growth decelerated from the pre-crisis level of 5.3 percent to 3.4 percent in 2009*. In particular, drop in global domestic demand for durable goods, and a decline in investment in the export-oriented emerging economies in the Asia region hurt the manufacturing exports. However, the expansionary fiscal and monetary policies and rebound in the financial markets and capital inflows helped the region's fast recovery with the growth rate of 6 percent in 2010. In the medium-term scenario, only the Asia region is projected to achieve above the pre-crisis growth of 6 by 2015 as the region appears to be more resilient and shock absorbant due to sound macroeconomic reforms adopted during the Asian crisis of late 1990s.

11. *With regard to individual OIC member countries, it appears that 31 out of 57 states are projected to achieve their pre-crisis growth during the medium-term period (2011–2015), while the remaining 26 states will take longer take this period to achieve their pre-crisis growth* (Table 1). The main challenge for those countries that have already achieved their pre-crisis growth rates is to sustain them in the post-crisis period. Those countries that will not be

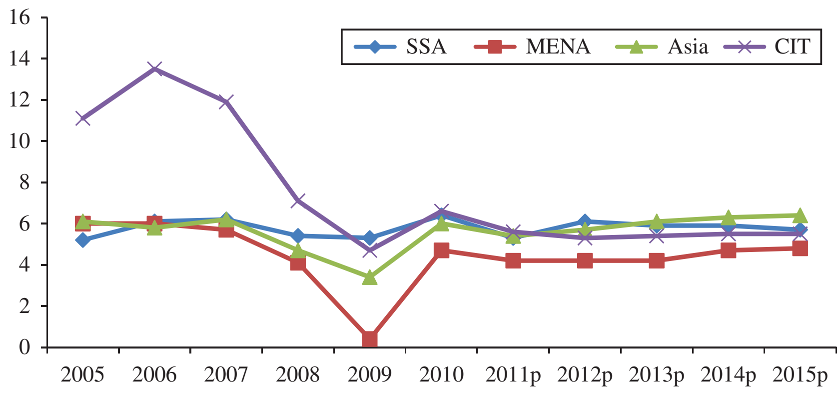

Figure 2. Rreal GDP Growth Regions of IOC States, 2005–2015 (% per annum).
Source: Computed by IsDB based on data from the IMF World Economic Outlook database (April 2011).

Table 1. Real GDP Growth of OIC Member States (% per annum)

OIC Member States	Pre-Crisis Period (2000–2007)	First Post-Crisis Year (2010)	Medium-Term Scenario (2011–2015)	Pre-crisis growth rate in medium-term period will achieve (A)/will not achieve (NA)
Afghanistan	8.0	8.2	8.1	A
Albania	6.0	3.5	4.1	NA
Algeria	4.0	3.3	3.3	NA
Azerbaijan	15.9	5.0	2.6	NA
Bahrain	6.4	4.1	4.9	NA
Bangladesh	5.8	6.0	6.8	A
Benin	4.2	2.5	4.5	A
Brunei	2.2	4.1	2.8	A
Burkina Faso	5.5	5.8	6.1	A
Cameroon	3.7	3.0	4.4	A
Chad	9.5	5.1	4.0	NA
Comoros	2.1	2.1	3.6	A
Côte D'Ivoire	–0.3	2.6	3.3	A
Djibouti	3.1	4.5	5.6	A
Egypt	4.7	5.1	4.4	NA
Gabon	1.7	5.7	3.1	A
Gambia	4.0	5.7	5.5	A
Guinea	2.7	1.9	4.7	A
Guinea-Bissau	2.6	3.5	4.6	A
Guyana	1.7	3.6	4.6	A
Indonesia	5.1	6.1	6.7	A
Iran	5.9	1.0	3.0	NA
Iraq	2.3	0.8	10.1	A
Jordan	6.6	3.1	4.6	NA
Kazakhstan	10.2	7.0	6.0	NA
Kuwait	6.6	2.0	5.0	NA
Kyrgyz Republic	4.5	–1.4	5.6	A
Lebanon	3.6	7.5	3.9	A
Libya	5.0	4.2	..	..
Malaysia	5.6	7.2	5.2	NA
Maldives	8.5	8.0	4.5	NA
Mali	4.8	4.5	5.2	A
Mauritania	4.3	4.7	5.7	A
Morocco	4.6	3.2	4.8	A
Mozambique	7.7	7.0	7.8	A
Niger	4.3	7.5	7.3	A
Nigeria	9.3	8.4	6.4	NA
Oman	4.0	4.2	4.5	A
Pakistan	5.1	4.8	4.7	NA
Palestine	..	..	..	..
Qatar	12.2	16.3	7.9	NA
Saudi Arabia	3.7	3.7	4.6	A
Senegal	4.3	4.2	5.0	A
Sierra Leone	10.9	5.0	5.7	NA
Somalia	..	..	..	..

(Continued)

Table 1. (*Continued*)

Sudan	7.5	5.1	5.6	NA
Suriname	4.4	4.4	5.8	A
Syria	4.2	3.2	4.9	A
Tajikistan	8.7	6.5	5.2	NA
Togo	1.4	3.4	3.9	A
Tunisia	4.8	3.7	5.0	A
Turkey	5.3	8.2	4.3	NA
Turkmenistan	15.2	9.2	7.1	NA
U.A.E.	8.0	3.2	4.0	NA
Uganda	7.3	5.2	6.7	NA
Uzbekistan	6.0	8.5	6.6	A
Yemen	4.2	8.0	4.1	NA

Source: IsDB calculation based on the IMF World Economic Outlook Database (April 2011).

able to achieve the pre-crisis level of growth will need to undertake crucial macroeconomic adjustments in their fiscal and monetary policies with an objective to fix the most binding constraints to their economic growth in the coming years.

ii Current account balance

12. *Recovery in the current account balance (CAB) of OIC states (as a group) remained modest in 2010*. The current account balance of OIC member states was hit hard by the economic crisis as their CAB surplus, which dropped from an average 5.9 percent of GDP during the pre-crisis period (2000–2007) to 2.3 percent in 2009. In particular, CAB surplus of oil-exporting member states dropped from the pre-crisis average level of 10.7 percent of GDP to 5 percent in 2009, due to significant decline in oil prices (i.e., 36.3 percent decline in 2009 compared to 2008). The current account deficit of non-oil exporting member states further deteriorated from 0.5 percent to 1.3 percent of GDP during the same period, mainly due to a sharp decline of 15.8 percent in non-oil commodities prices in 2009. In 2010—in line with the global economic recovery and significant increase in oil prices by 27.9 percent and non-oil commodities prices by 26.3 percent along with 12.4 percent growth in international trade of goods and services—the current account surplus of OIC states improved to 3.3 percent of GDP. In particular, the improvement in CAB of oil-exporting countries was significant, with a surplus of 7.8 percent of GDP, while in contrast CAB deficit further deteriorated in the case of non-oil exporting countries, to 2.5 percent in 2010 (Figure 3).

13. *In the medium-term scenario (2011–2015), with the expected revival of the global economy and increase in oil and non-oil commodity prices, current account surpluses of OIC member states (as a group) are projected to improve (i.e., 5.1 percent of GDP) but they will not be able to achieve the pre-crisis level of CAB surplus (5.9 percent of GDP) by 2015*. In the medium-term, improvement in CAB will mainly depend upon the movement in oil and non-oil commodities prices and movement in their exchange rates.

14. *The post-crisis recovery in the current account balances is not uniform across four regions of the OIC member states*. Due to the global economic crisis, the MENA region experienced a massive deterioration in their current account surpluses. In 2009, the highest deterioration was observed in the case of the MENA region from the average pre-crisis level of 7.4 percent to 1.6 percent of GDP, while

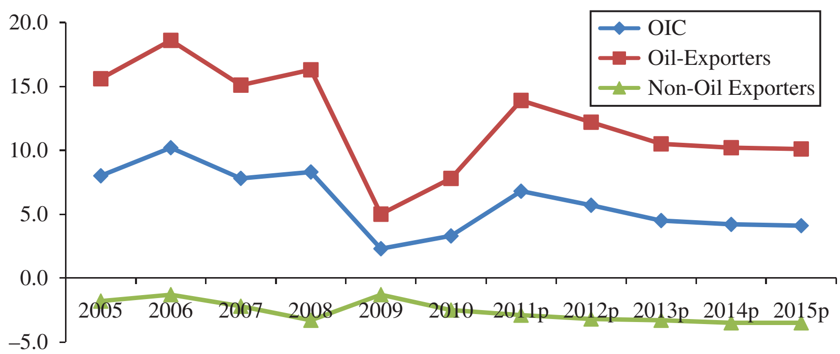

Figure 3. Current Account Balances of OIC States, 2005–2015.
Source: IDB estimates based on data from the IMF WEO database of April 2011.

the Asia region's CAB surplus declined from 4.7 percent to 4.2 percent of GDP during the same period. In contrast, the CAB was improved in the case of SSA (from a surplus of 0.3 percent to 2 percent of GDP) and CIT from a deficit of 0.2 percent to a surplus of 2.3 percent in 2009.

15. *In the medium-term scenario, among four regions, CAB surpluses of SSA and CIT are projected to improve much faster and they are expected to remain significantly above the pre-crisis levels*. In particular, in the medium-term, the increasing trade links with the European Union, China, India and other emerging markets are likely to help the SSA and CIT regions in faster economic recovery and achieving sustainable growth. However, MENA and Asia will not be able to achieve the pre-crisis CAB surpluses by 2015. Medium-term recovery in their CAB surpluses will depend upon the movement in oil prices, global oil demand, and volume of trade (Figure 4).

Inflation rate

16. *Inflationary pressure has been significantly released in OIC member states*. The sharp decline in domestic economic activities and wide gap between actual and potential output in OIC member states have released inflationary pressures in both oil-exporting and non-oil exporting member states. At the OIC level, inflation slowed from the pre-crisis average rate of 9.1 percent to 7.2 percent in 2010. The non-oil-exporting member states experienced a relatively sharp drop in inflation (from 12.1 percent to 7.0 percent), while in oil-exporting member states, it rose slightly from 6.9 percent to 7.3 percent during the same period. In the medium-term, the inflation is projected to slow further to 4.9 percent in OIC states (as a group), 5.4 percent in oil-exporting countries and 4.3 percent in non-oil-exporting countries by 2015 (Figure 5).

17. *The drop in inflation remained uneven across various regions*. In the MENA region, inflation rate fell from the pre-crisis average rate of 10.7 percent to 7.2 percent in 2010, followed by CIT from 9.9 percent to 7.0 percent, and Asia from 6.3 percent to 6.2 percent, while the SSA region observed a rise in inflation (from 8.1 percent to 9.8 percent). Due to excess capacity and slow economic recovery, the inflationary pressure is expected to remain moderate in the medium-term. However, the recent rise in food prices is a source of concern in terms of building inflationary pressures in the coming years (Figure 6).

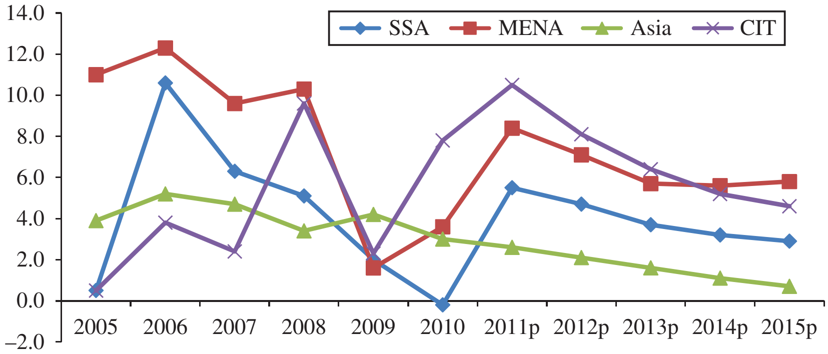

Figure 4. Current Account Balances of OIC State by Regions, 2005–2015 (% of GDP).
Source: IsDB estimates based on data from the IMF WEO database of April 2011.

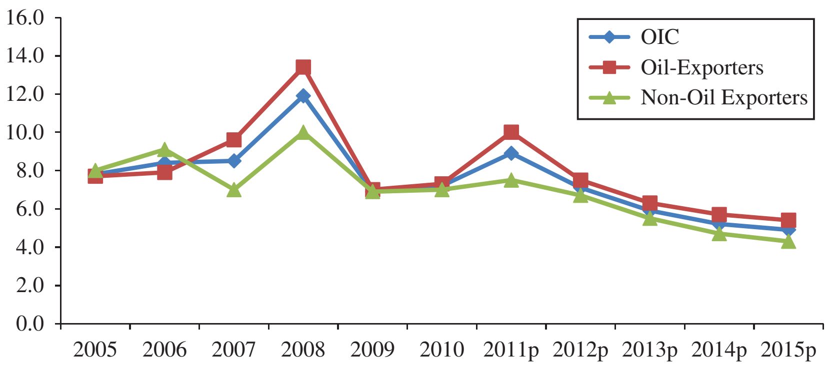

Figure 5. Inlfation Rates in OIC States 2005–2015 (% per annum).
Source: IDB estimates based on data from the IMF WEO database of April 2011.

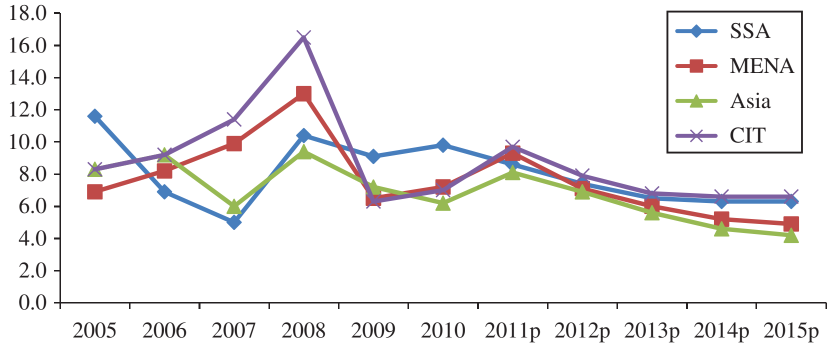

Figure 6. Inflation Rates in OIC State by Regions, 2005–2015 (% per annum).
Source: IsDB estimates based on data from the IMF WEO database of April 2011.

Key external and domestic factors affecting sustainable economic recovery in OIC member states

Major external factors

18. *The major global factors that have affected economic performance of OIC member states during the global financial and economic crisis and are still threats to sustainable economic recovery in the medium-term*. They include fragile global economic recovery; slow recovery in world trade; highly volatile oil-and non-oil commodities prices; rising policy interest rates; and deteriorating debt situation in advanced economies.

Fragile global economic recovery

19. *In the post-crisis period, the uneven economic recovery in various regions of the globe has been observed in 2010*. For example, the global economy performed quite well in the first year of post crisis recovery as the world output accelerated by 5 percent in 2010, compared to negative growth of 0.5 percent in 2009 and pre-crisis average growth of 4.2 percent achieved during 2000–2007. Similarly, the real output in advanced economies was also accelerated by 3 percent compared to pre-crisis growth of 2.6 and developing economies by 7.3 percent compared to pre-crisis growth of 6.5 percent (Figure 7).

20. *The recent global economic recovery appears to be a fragile and is projected to decelerate in the medium-term*. Over the next five years (2011–2015), the global economy is projected to grow, on average, by 4.5 percent, developed economies by 2.5 percent and developing economies by 6.6 percent, thereby all achieving the pre-crisis level of growth. However, the global economy is not yet out of the crisis, particularly the Eurozone and the US economy. With regard to the biggest world economy, a recent Gallup Survey (20–23 April 2011) shows that more than 50 percent of the US citizens believe that the USA is still in Recession or Depression. The medium-term global recovery will very much depend upon the movement in oil and non-commodity prices, exchange rates, cost and availability of external financing, and the policies adopted by the national authorities.[7] Therefore, the sustainability of economic recovery of the OIC states in the medium-term will also depend upon the overall global recovery as well as recovery in developed and developing economies.

Slow recovery in world trade

21. *In line with the global economic recovery, the recent expansion in global trade has been impressive*. The adverse impact of the economic crisis on world trade was more pronounced but its recovery in the post-crisis period was also robust. The year 2008 and 2009 witnessed collapse in the volume of world trade as both advanced and developing economies were badly affected by the global financial and economic crises. The growth in volume of world trade declined from the pre-crisis average growth of 7.0 percent in 2000–2007, to 3 percent in 2008, and negative 10.9 percent in 2009. Both imports and exports of advanced economies declined by 12.6 percent and 12.2 percent, respectively, in 2009. Similarly, imports of developing economies dropped

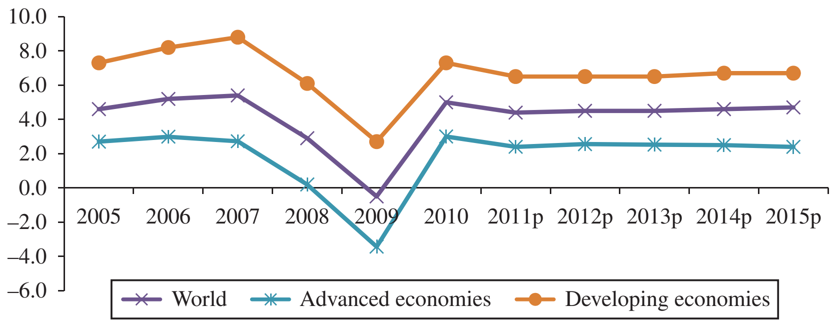

Figure 7. Real GDP Growth in World, Advanced and Developing Economies, 2005–2015 (% per annum).
Source: IMF World Economic Outlook (various issues).

by 8.3 percent and exports by 7.5 percent in 2009. However, in 2010, recovery in global trade appears to be robust with 12.4 percent growth over 2009. Recovery in both exports and imports in developing countries was relatively faster with growth rates of 13.5 percent and 14.5 percent, respectively, compared to developed countries (11.2 percent and 12.0 percent) (Figure 8).

22. *In the coming few years, growth in global trade is projected to slowdown*. The speed of recovery in world trade volume of goods and services is projected to slow to 7.4 percent in 2011 and 6.9 percent in 2012; however, achieving the pre-crisis growth (i.e. 7% achieved during 2000–2007). Advanced countries are projected to achieve pre-crisis growth faster in their imports (5.5 percent in 2012 compared to pre-crisis growth of 5.6 percent) than their exports (5.9 percent in 2012 compared to pre-crisis growth of 5.7 percent), while developing economies will not be able to achieve their pre-crisis growth in both imports (9.4 percent in 2012 compared to pre-crisis growth of 11.5 percent) and exports (8.7 percent in 2012 compared to pre-crisis growth of 10.2 percent).

Highly fluctuating oil and non-oil commodities prices

23. *Economic prospects of both oil-exporting and non-oil exporting OIC member states are closely linked to movements in oil and non-oil commodity prices*. Given the close link between growth and the oil and non-oil commodity prices, the economic performance of oil-exporting and non-oil exporting member countries depends on the developments arising from these prices. The oil price, which increased by 36.4 percent in 2008, was accompanied by real GDP growth of 5.0 percent in oil-exporting member countries. In 2009, oil prices declined by 36.3 percent, dropping their real GDP growth rate to 1.9 percent.

24. *Similarly, non-oil commodity prices, which increased by 7.5 percent in 2008, fell by 15.8 percent in 2009; consequently GDP growth in non-oil exporting decelerated*

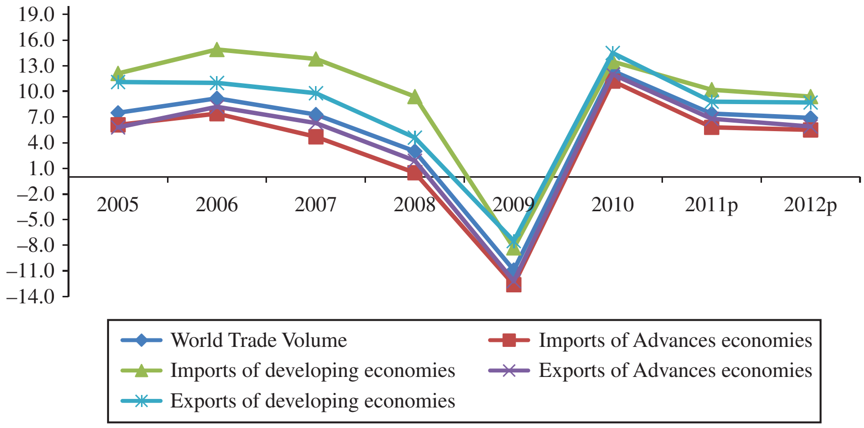

Figure 8. Trade (good and services) Volume of Wolrd, Advanced and Developing Countries, 2005–2012 (% change per annum).
Source: IMF World Economic Outlook (various issues).

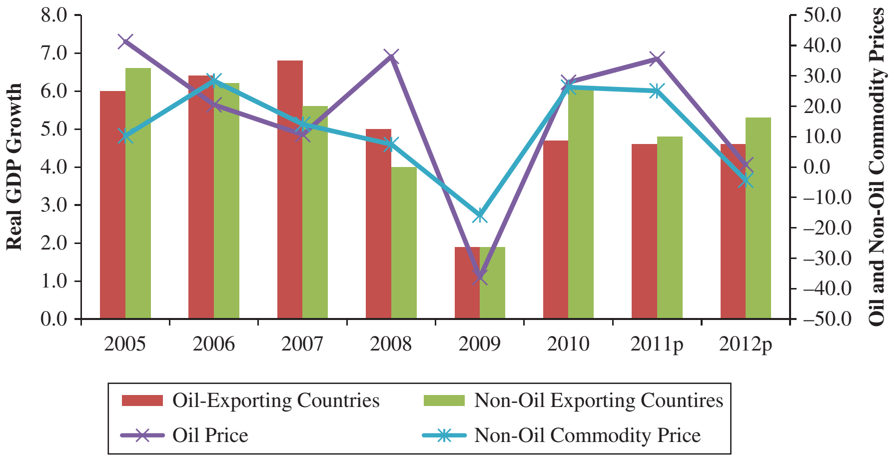

Figure 9. Real GDP Growth in Oil and Non-Oil Exporting OIC States, and Oil- and Non-Oil Commodities Prices, 2005–2012 (% change per annum).
Source: IMF World Economic Outlook (various issues).

from 4.0 percent to 1.9 percent. With the global economic recovery and increasing demand, the oil prices rose by 27.9 percent and non-oil commodities prices by 26.3 percent in 2010, which was accompanied by acceleration in output in oil-exporting member countries (4.7 percent) and non-oil exporting countries (6.1 percent) in 2010.

25. *In the medium-term, sustainability of economic growth in oil- and non-oil exporting OIC member states will depend on the movement in oil- and non-oil commodities prices, which in turn, will depend on the speed and scale of global economic recovery*. In 2011, the rising trend in oil- and non-oil commodity prices is projected to remain but later is likely to decelerate. In line with the continued recovery in global economy (i.e. 4.4 percent growth in 2011 and 4.5 percent in 2012), the oil prices are projected to jump further to 35.6 percent and non-oil prices by 25.1 percent in 2011 as projected by the IMF (WEO, April 2011) (Figure 9).

Rising policy interest rates

26. *Low policy interest rates helped recover global economy in the post-crisis year 2010*. In order to stabilize economies in the face of global economic crisis, monetary authorities reacted quickly with exceptionally large interest rate cuts in 2008 and 2009 as well as unconventional measures to inject liquidity and sustain credit. In particular, policy interest rates were brought down considerably in many advanced economies. For example, LIBOR on US$ deposits declined from 5.3 percent in 2007 to 0.5 percent in 2010. Similarly, LIBOR on euro deposits was reduced from 4.3 percent in 2008 to 0.8 percent in 2010, while the LIBOR on Japanese yen deposits declined from 0.9 percent to 0.4 percent during the same period. In the short-term, policy interest rates are expected to rise i.e. LIBOR on US$ deposits to 0.9 percent and LIBOR on euro deposits by 2.6 percent in 2012, while LIBOR on Japanese deposits is projected to decline slightly to 0.3 percent in 2012.

27. *Rising policy interest is likely to affect global economic recovery as well as recovery in OIC member states*. The large increases in fiscal deficits and public debt in advanced countries are likely to put further upward pressure on policy interest rates, thereby affecting global economic recovery as well as achieving sustainable economic growth in OIC member states (Figure 10).

Deteriorating debt situation in advanced countries

28. *Worsening public debt burden and rising debt service payments in advanced economies are major threats to global financial stability as well as global economic recovery in the post-crisis period*. According to IMF latest Fiscal Monitor (April 2011 and June 2011 Update) and World Economic Outlook (WEO, April 2011 and June 2011 Update), the level of aggregate net government debt in the world rose from $21.9 trillion in 2007 to an expected $34.4 trillion in 2011. IMF forecasts also indicate that the level is expected to reach $48.1 trillion in 2016. Similarly, the ratio of world net debt to world GDP rose from 42 percent in 2007 to 56.4 percent in 2011, and is projected to reach 57.7 percent in

Table 2. Net Debt Situation in Developed and Developing Economies

	2007	2011	2016
	(US$ trillion)		
World	21.9	34.4	48.1
Advanced Economies	18.1	29.5	41.3
Emerging Economies	3.8	4.9	6.7
OIC Member States*	1.3	1.6	..
	(percent of GDP)		
World	42.0	56.4	57.7
Advanced Economies	46.3	70.0	79.7
Emerging Economies	29.2	26.1	21.5
OIC Member States*	34.7	30.4	..
	(Per Capita in thousand US$)		
World	4.3	6.5	8.7
Advanced Economies	18.6	29.6	40.4
Emerging Economies	0.9	1.1	1.5

Sources: Brookings, Global Economy and Development, *Islamic Development Bank (2010), Annual Report.

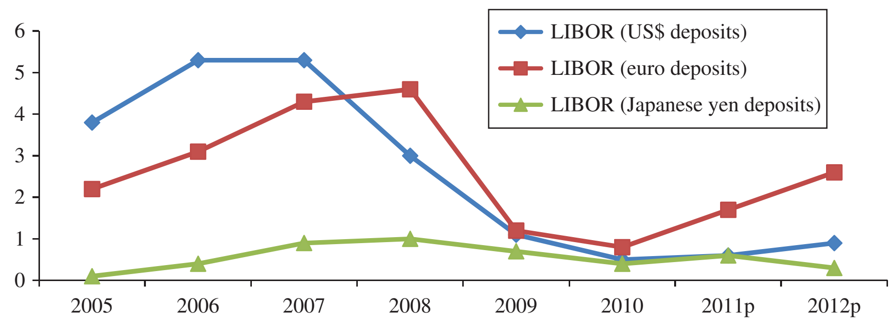

Figure 10. London Interbank Offered Rates (LIBOR), 2005–2012 (% per annum). Source: IMF World Economic Outlook (various issues).

2016. Another way to understand the burden of public debt is to examine it in terms of the level of debt per capita. The average per capita debt in advanced economies increased from $18.6 thousand to $29.6 thousand in 2011 and is expected to rise further to $40.4 thousand in 2016. In case of developing economies, the average per capita debt increased marginally from $0.9 thousand in 2007 to $1.1 thousand in 2011 and is projected to increase to $1.5 thousand in 2016.

29. *In order to support their own weak economic recoveries as well global economic recovery, the advanced economy governments need to bring down their rising debt burden in the medium- to long-term*. Advanced economies need to learn the lessons of fiscal discipline that for so long they preached to the emerging markets.[8] In particular, recent worsening debt situation in Greece, Ireland, Portugal in the Eurozone and the rise in ceiling in USA debt may jeopardize the global economy recovery, in turn, recovery in the OIC member states and other developing countries.

30. *The OIC member states also need to curtail their rising external debt in order to sustain economic recovery*. The level of external debt of OIC states rose from $1.3 trillion in 2007 to $1.6 trillion in 2011, registering a 21 percent increase just in the last five years.

Major domestic factors

31. The adverse external factors described above have been compounded by a number of domestic factors such as rising youth unemployment, weak economic integration among OIC states, and some fundamental weaknesses in macroeconomic policies, resulting threats to sustainable economic performance of OIC member states. The major domestic factors are described in the following sub-sections.

Rising youth unemployment

32. *Rising Youth unemployment is posing a major challenge for OIC member states*. The current speed of economic recovery is insufficient to decrease unemployment, particularly youth unemployment. The impact of global economic recession on unemployment varied across regions of the globe. The latest estimates by the ILO (2011) indicate that all regions experienced high youth unemployment rate in 2010. Region-wide unemployment trends show that Middle East experienced the highest rate of youth unemployment at 25.1 percent in 2010, followed by North Africa (23.6 percent); Southeast Asia and Pacific (14.2 percent); Sub-Saharan Africa (12.3 percent); and South Asia (9.5 percent) (Figure 11). Creation of jobs requires new investment, the pre-requisites of which include political and economic stability, existence of proper legal and regulatory framework, appropriate policy environment, existence of basic infrastructure, and adequate economic incentives.

33. *The economic recession has further compounded the youth unemployment in a number of OIC states in the MENA region*. Currently, a number of countries in the MENA region are facing major development challenges, including lack of social justice; poor access to public utilities; high levels of poverty and inequality; high unemployment especially among youth and women; and rising food and energy prices. All these factors have contributed to political discontent among the people. The most important issue is the high youth unemployment in the region (25.1 percent in the Middle East and 23.6 percent in North Africa), which is highest in the world, and economic loss to the region is estimated to be between $40–50 billion per year (IDB-IFC, 2011). Further, 40 percent of the Middle East and 32 percent of the North African working population live on less than US$2 a day. In order to tackle youth unemployment, the governments of a number of countries in the MENA region are implementing speedy reforms at the political, economic, and social fronts in order to improve the lives of ordinary citizens. They are implementing short-term and long-term reforms both on the political and socio-economic fronts. Particularly, the governments' spending programs are focusing on providing unemployment benefits and insurance schemes; increasing public investment in infrastructure and the housing sector; providing jobs to youth; enhancing support to small- and medium-enterprises; increasing social inclusion; improving quality and relevance of education; and adopting labor-intensive projects.

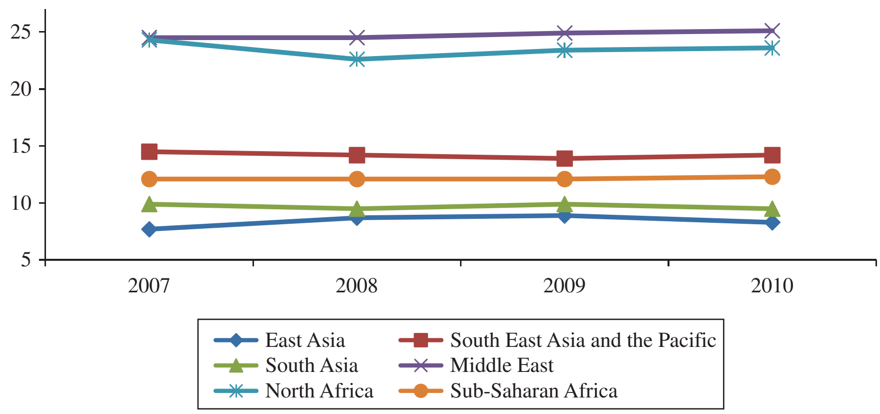

Figure 11. Youth Unemployment Rates in Various Regions, 2007–2010 (%).
Source: ILO (2011), Global Employment Trends.

Weak economic integration among OIC states

34. *The OIC Ten-Year Program, adopted in December 2005, called on member countries to expand the scope of intra-trade in order to achieve greater economic integration by raising its level to 20 percent of the overall trade volume by 2015*. The latest estimates show that the intra-trade performance of OIC member countries (as a group) has improved gradually from 15.3 percent in 2005 to 16.8 percent in 2009 (Figure 12). However, the 20 percent intra-trade target can only be achieved through further strengthening and expanding the scope of Framework Agreement on OIC-Trade Preferential System (TPS) in its full spirit. The global financial and economic crisis has created an opportunity for OIC states to reconsider their trade and investment strategies and learn how to cope with a dramatically transformed international financial landscape. For instance, member states need to enhance intra-trade through additional measures aimed at providing greater access to their markets. The OIC-TPS has been signed so far by thirty-four member states but ratified by twenty-five members, having the required number of ratifications for its enforcement (COMCEC 2009). Another opportunity is in the area of encouraging investments by the Sovereign Wealth Funds in long-term infrastructure projects in member countries with adequate and competitive risk-return profile. Further, enhancing intra-trade and intra-investment also require removal of tariff and non-tariff barriers, particularly free movement of labor and capital across regions.

Weaknesses in macroeconomic policies

35. The macroeconomic policies adopted in OIC states have certain flaws such as resistance to macro reforms (i.e., generalized subsidies instead of targeted subsidies) and micro reforms (i.e., poor business climate for firm-level investment); lack of focus on inclusive growth (i.e., lack of productive employment opportunities, unequal access to opportunities, and inadequate social safety nets); weak linkage between the financial sector and real sector; and weak corporate governance in the financial institutions. All these policy factors appear to be major impediments to achieving sustainable growth and inclusive economic development.

Role of the (IsDB) group in economic recovery of OIC member states

36. *The Islamic Development Bank (IsDB) group is playing an active role in socio-economic development of the OIC States by scaling up of development assistance*. The IsDB Group through all of its entities namely, the Islamic Corporation for the Development of the Private Sector (ICD), International Islamic Trade Finance Corporation (ITFC), Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC), and Islamic Research and Training Institute (IRTI), is helping its 56 member countries (out of 57 OIC states)[9] in their economic recovery process in the post-crisis era. The IsDB Group responded through various initiatives and activities at global, regional, national, and Bank levels to help its member countries to mitigate the adverse impacts of global financial and economic crisis and achieve post-crisis economic recovery. To help member countries to consolidate their economic recovery, IsDB maintained its high level of development assistance, attained through the sharp scaling up of its operations. Since inception, the cumulative net approvals of IsDB Group reached $74.2 billion for 7,087 operations. Trade financing accounted for 52.2 percent while the remaining 48 percent included project financing, and technical and special assistance.

37. *With regard to Region-wise, members countries in the MENA region received the lion's share of the IsDB Group financing of $38.7 billion (52.1 percent)*, followed by Asia $21.5 billion (28.9 percent), SSA $8.5 billion (11.5 percent), and CIT $3.6 billion (4.8 percent). The current core areas of IDB Group interventions in member countries are poverty alleviation, food security, infrastructure development, human development, Islamic finance, and regional cooperation.

38. *With regard to sector-wise distribution of IsDB Ordinary Capital Resources (OCR), transportation received the largest share of 25 percent*, followed by energy (23 percent), water, sanitation and urban services (13 percent), agriculture (11 percent), industry and mining (9 percent), education (9 percent), health (5 percent), finance (4 percent), and information and communication (1 percent) (Figure 13).

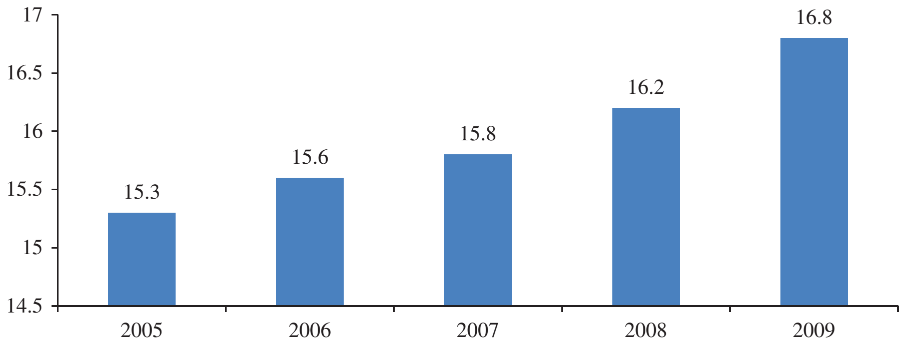

Figure 12. Intra-OIC Trade, 2005–2009 (% of Total Trade Volume).
Source: Islamic Development Bank, Annual Report (various issues).

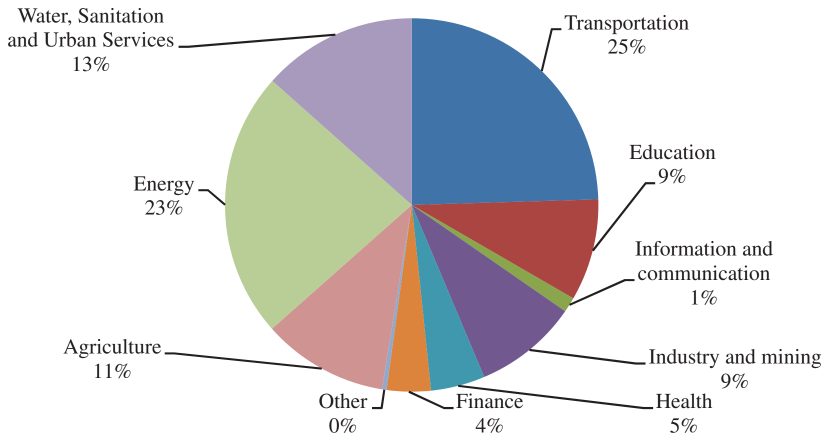

Figure 13. IsDB-OCR Approvals by Sectors Since Inception.

39. *In particular, in the immediate aftermath of the recent events in the MENA region, the IsDB Group's recent interventions in the region include supporting youth employment generation and social safety nets, strengthening infrastructure and human development, promoting the SME sector and microfinance, and enhancing vocational training*. In particular, in order to meet the infrastructure needs of the MENA region between $75 and $100 billion (Akhtar, S. 2010), the IsDB, World Bank, and the International Finance Corporation (IFC) have recently launched a joint IsDB-WB-IFC Arab Financing Facility for Infrastructure (AFFI), which aims to raise up to $1 billion in new financing that will leverage infrastructure investment in Arab countries in an effort to drive inclusive economic growth and meet the needs of growing young population. In order to help member countries in tackling youth unemployment, recently the IsDB approved an additional financing package of $250 million targeting reduction of youth unemployment in the affected countries in the MENA region. Further, the IsDB and IFC have recently launched the Education for Employment (E4E) initiative in the Arab world, aiming to mobilize $1.5 - 2 billion to be invested in the region over the next five years, while engaging the private sector to create new job opportunities for employment-based education, and enhancing labour market skills for Arab youth and women for productive employment. Among the crisis-ridden countries, the IsDB Group announced its programs support to Egypt ($2.5 billion) and Tunisia ($900 million) over 2011–2013. In order to help the governments of the region in their reform process, the IsDB is broadening and strengthening its partnership with Arab regional multilateral institutions especially the Arab Coordination Group.

40. *In order to help its member countries in achieving sustainable economic growth in the medium-term, the IsDB Group launched Member Country Partnership Strategy (MCPS) in 2010*. The MCPS is a Group-wide undertaking involving all entities. It forms the foundation and cornerstone of the IsDB Group's dialogue with member countries, aligning with their development priorities and thematic priorites identified in the IsDB 1440H Vision.

The MCPS process includes extensive consultations, internally and externally with the governments of client countries, the civil society, the private sector, multilateral development banks, and other development partners active in the client country. Through the MCPS process, the instruments of IsDB Group support to member countries are not only direct financing and knowledge-based diagnostics, but also the mobilization of domestic resources, forging strategic partnerships with other development partners and more importantly, promoting fruitful partnerships among member countries through 'Reverse Linkages', (defined as IDB MCPS member country supporting other member countries), thereby promoting south-south cooperation. So far, the IsDB Group has completed MCPS exercise for five member countries (Turkey, Indonesia, Mali, Uganda, and Mauritania)[10] while MCPS exercises for Pakistan, Bahrain, Malaysia, Egypt, Kazakhstan, Morocco, and Niger are in progress.

Proposed measures to improve socio-economic outlook of OIC member states

41. In the post-crisis era, the OIC member states need to adopt somewhat different policies to foster renewed growth and to deal with the structural issues to sustain economic recovery and achieve inclusive economic development.

i. OIC states are required to do structural repairs of fiscal consolidation, promote private sector-led growth, adopt labor market reforms to create quality jobs particularly for youth, and improve competitiveness and enhance regional integration.
ii. The policymakers in OIC states need to focus on the imperatives of structural healing of their socio-economic policies, particularly, to help limit the impact of higher food and oil prices on the poor. Headline inflation has sharply risen in the OIC states. As per IMF projection (WEO, April 2011), global fuel prices and non-oil commodities prices are expected to rise by a 35.6 percent and 25.1 percent, respectively, in 2011, building inflationary pressures in the years ahead.
iii. Reducing regional imbalances of OIC member states is essential (i.e., shifting resources from resource-rich regions to resource-deficient regions through enhancing intra-trade and intra-investment).
iv. Restoring banking system health must be given key priority in government policies. In particular,

re-regulation of the financial sector in order to make it stable and respond to the needs of the priority economic sectors and support economic recovery. Also, not only to enhance regulations but also to enforce them effectively.

v. Expanding Islamic financial institutions would be a best alternate as Islamic financial structure creates clear links between the financial sector and real sector and contributes more to the development of an economy.

vi. The government needs to adopt macro reform (i.e., targeted subsidies instead of generalized subsidies) and micro reform (i.e., improve the efficiency of firm-level investment through improving business climate).

vii. Since the economic recession has fueled to rising youth unemployment and poverty in OIC member states, increasing employment opportunities, providing equal access to opportunities and adequate social safety nets will be essential in the coming years.

Notes

1. Middle East and North Africa (MENA) region includes Algeria, Bahrain, Egypt, Iran, Iraq, Jordan, Kuwait, Lebanon, Libya, Morocco, Oman, Palestine, Qatar, Saudi Arabia, Syria, Tunisia, Turkey, UAE, and Yemen.
2. The Asia region includes Afghanistan, Bangladesh, Brunei, Indonesia, Malaysia, Maldives, Pakistan, and Suriname.
3. The Sub-Saharan Africa (SSA) region includes Benin, Burkina Faso, Cameroon, Chad, Comoros, Côte d'Ivoire, Djibouti, Gabon, Gambia, Guinea, Guinea-Bissau, Mali, Mauritania, Mozambique, Niger, Nigeria, Senegal, Sierra Leone, Somalia, Sudan, Togo, and Uganda.
4. Countries in Transition (CIT) region includes Albania, Azerbaijan, Kazakhstan, Kyrgyz, Tajikistan, Turkmenistan, and Uzbekistan.
5. Oil-exporting member states include Algeria, Azerbaijan, Cameroon, Chad, Cote d'Ivoire, Egypt, Gabon, Iran, Iraq, Kazakhstan, Kuwait, Libya, Malaysia, Nigeria, Qatar, Saudi Arabia, Sudan, Syria, Turkmenistan, U.A.E, Uzbekistan and Yemen.
6. Non-oil exporting member states include Afghanistan, Albania, Bahrain, Bangladesh, Benin, Brunei, Burkina Faso, Comoros, Djibouti, Gambia, Guinea, Guinea-Bissau, Indonesia, Jordan, Kyrgyz, Lebanon, Maldives, Mali, Mauritania, Morocco, Mozambique, Niger, Oman, Pakistan, Palestine, Senegal, Sierra-Leone, Somalia, Suriname, Tajikistan, Togo, Tunisia, Turkey and Uganda.
7. A number of assumptions have been adopted for the projections presented in the *World Economic Outlook (April 2011)*. It has been assumed that real effective exchange rates remained constant at their average levels during February 8–March 8, 2011, except for the currencies participating in the European exchange rate mechanism, which are assumed to have remained constant in nominal terms relative to the Euro; that established policies of national authorities will be maintained (for specific assumptions about fiscal and monetary policies for selected economies; that the average price of oil will be $107.16 a barrel in 2011 and $108.00 a barrel in 2012 and will remain unchanged in real terms over the medium term; that the six-month London interbank offered rate (LIBOR) on U.S. dollar deposits will average 0.6 percent in 2011 and 0.9 percent in 2012; that the three-month euro deposit rate will average 1.7 percent in 2011 and 2.6 percent in 2012; and that the six-month Japanese yen deposit rate will yield on average 0.6 percent in 2011 and 0.3 percent in 2012. The estimates and projections are based on statistical information available through late March 2011.
8. Eswar Prasad (28 July 2011) Senior Fellow, Global Economy and Development, Mengjie Ding, Student, MIT, Financial Times.
9. Fifty-six out of 57 OIC States are IsDB member countries (i.e. only Guyana is not IsDB member country).
10. MCPS Reports of Turkey, Indonesia, Mali, Uganda, and Mauritatania are available on the IsDB website (www.isdb.org).

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