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The role of Arab funds in financing for development

Summary

Since the 1960s, Arab development funds (ADFs) have been major providers of financial development assistance in the region. As a result of increasing oil revenues in the 1970s and trade facilitation and liberalization in the 1980s, Arab development funds, through Islamic solidarity, started playing a crucial role in the region and beyond in terms of external aid, especially in sub-Saharan Africa and Asia. From 1975 to 2011, Arab donors have been five times more generous on average than members of the Development Assistance Committee of the Organisation for Economic Co-operation and Development; however, since 2004, Arab aid has considerably decreased.

Around 40 per cent of ADF funding covers energy and transportation and 15 per cent finances education and water and sanitation; but health sector funding is lagging behind. Unlike many other development assistance donors, Arab funds do not tie their recipient countries to specific aid delivery providers. As such, their aid follows the principle of non-interference with limited suggestions on policy matters and policy reform targets. Nevertheless, significant investments in modern irrigation, food production systems and infrastructure are required to meet the Arab region's developmental challenges. Therefore, the financing capacity of Arab funds must increase, especially as official development assistance in the region is decreasing. Currently, financial resources available to Arab funds total around 190 billion United States dollars ($), which must double in the next five years to reach $400 billion to help meet the development challenges facing the Arab region.

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Introduction

1. Arab aid has played an important role in financing global and regional development. The main Arab donors, namely Kuwait, Saudi Arabia and the United Arab Emirates, have been among the most generous in the world in terms of official development assistance (ODA), totalling 259.2 billions of United States dollars ($) between 1975 and 2013,[1] which represents an annual average of 1.7 per cent of their combined gross national income (GNI). Such efforts are more than double the United Nations target of 0.7 per cent, and five times the average of donors from the Development Assistance Committee (DAC) of the Organisation for Economic Co-operation and Development.

2. Facilitated by the sharp increase in oil prices, the levels of Arab aid were exceptionally high by international standards in the 1970s and early 1980s, but could not be sustained over time. Arab aid accounted for one third of total ODA during the 1970s. The GNI share of Arab ODA was very high in the 1970s, exceeding 12 per cent for the United Arab Emirates and hovering at around 8.5 per cent for Kuwait and Saudi Arabia in 1973. Over time, fiscal space in Arab donor countries has declined following drops in oil revenue and increases in national spending on wages, transfers and social services for their growing populations. The annex to the present document shows that Arab ODA has declined but remains well above DAC averages as a share of GNI.

3. Arab ODA has substantially contributed to achievements in the region, since Arab development funds ensure the effective channelling of aid. However, given the significant economic challenges that Arab countries still face, the current resource levels of Arab development funds are insufficient to meet the Millennium Development Goals. More resources should be made available to Arab funds to support the region's development objectives, given that all ODA flows to the region have decreased in recent years, including from Arab donors. These flows would have been even lower without the important support offered by DAC to Iraq after the 2003 war.

I. ARAB OFFICIAL DEVELOPMENT ASSISTANCE: IMPORTANCE AND EVOLUTION

4. Two features distinguish Arab ODA. Firstly, overall, Arab donors are generous compared to members of DAC; the average from 1975 to 2011 indicates that Arab donors have been five times more generous. However, since 2004, Arab aid has began converging with that of DAC donors. In terms of aid provided by donors relative to their economies' size, at present, the differences between Arab and DAC aid are quite small, although they still persist.

5. Secondly, the amount of Arab ODA has decreased considerably over time. During the 1970s, Arab aid accounted for nearly all non-DAC ODA, reaching levels close to 40 per cent of DAC ODA and above 25 per cent of all ODA. However, in 2011, Arab ODA accounted for 63.7 per cent of non-DAC ODA, 4.6 per cent of DAC ODA and 4 per cent of all ODA. Since 1990 onwards, Arab aid relative to non-DAC aid has become much more volatile.

II. ARAB FINANCIAL ASSISTANCE INSTITUTIONS

6. Arab countries were among those that pioneered the establishment of specialized institutions to help low-income countries. Since the early 1960s, but mainly since the 1970s, Arab donors have committed themselves to providing developmental assistance through bilateral and multilateral development funds. Some countries established national funds, such as the Kuwait Fund for Arab Economic Development (KFAED), the Saudi Fund for Development (SFD) and the Abu Dhabi Fund for Development (ADFD) of the

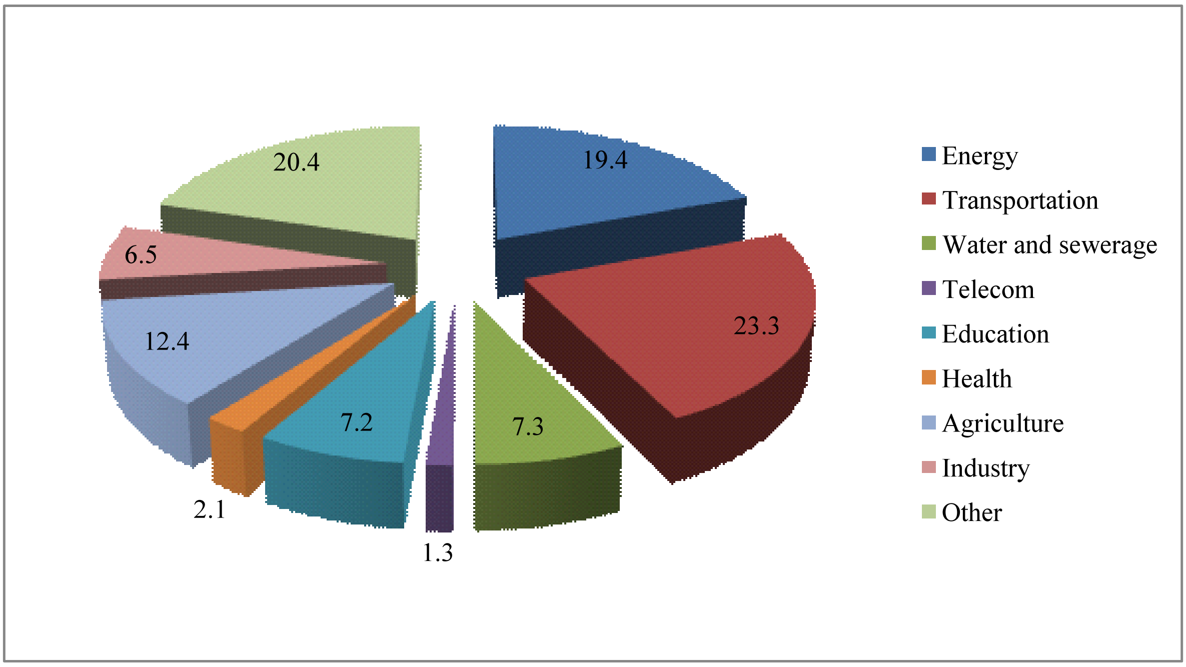
[1] Data are from the OECD Development Assistance database. Available from http://data.oecd.org/oda/net-oda.htm.

United Arab Emirates. In addition, the following six major multilateral agencies were established: Arab Fund for Economic and Social Development (AFESD), Arab Gulf Programme for United Nations Development Organizations (AGFUND), Arab Monetary Fund (AMF), Arab Bank for Economic Development in Africa (BADEA), Islamic Development Bank (IsDB) and OPEC Fund for International Development (OFID). Since their inception, these institutions have grown to become major providers of external financial assistance to developing countries, both in the Arab region and beyond.

7. With the exception of AGFUND, all Arab funds finance their operations primarily from capital subscriptions and loan reflows. Regarding assistance instruments, all Arab funds are involved in the provision of loans, and the majority of them also provide grants and technical assistance. However, the composition of bilateral ODA has shifted in the last decade. Since 2000, the share of grants has dropped from around 65 per cent to 40 per cent. Most aid is now taking the form of soft loans.

8. Over time, Arab donors have expanded their recipients, going beyond Arab and predominantly Muslim countries to include poor countries in sub-Saharan Africa and Asia. Similarly, the sectoral concentration of Arab ODA has evolved, shifting from infrastructure projects towards social sectors, such as education. Approximately 42.7 per cent of all resources are spent on energy and transportation alone, and education and water and sanitation account for 7.2 per cent and 7.3 per cent, respectively. Some sectors lag behind, however, including health care that accounts for only 2.1 per cent of allocated resources.

Sectoral allocation of Arab financial institution lending
(Cumulative since end of 2007)
(*Percentage*)



Sources: Annual reports of various agencies; and data from the Coordination Group secretariat.

III. COMPARATIVE OVERVIEW OF THE ARAB DEVELOPMENT FUNDS

9. The mandates of all Arab development institutions are aimed at fostering economic and social development in beneficiary countries. While development cooperation between Arab funds and recipient countries is based on consultation, financial assistance is generally granted on the basis of priorities set by recipient countries.

10. Another key feature of Arab development aid is its untied nature; recipient countries are not required to use donor country suppliers for aid delivery. Arab financial institutions do not have local offices; they operate from their headquarters and usually do not prepare specific country assistance strategies. This describes to a large extent the nature of Arab financial assistance as being untied and offered without explicit restrictions, therefore allowing recipient countries to flexibly express their requests for assistance. Arab donors follow the principle of non-interference in recipient country policies, thus limiting suggestions on policy matters and not explicitly linking external financing to policy reform targets.

11. Since there are several institutions that provide ODA and often work in the same sectors and countries, the risk of overlap exists. To address this issue, Arab development funds established the Coordination Group in 1975 to organize aid policies and common projects between national and regional development institutions. The Coordination Group has developed a set of common practices and procedures that are used by all its members, and occasionally meets to discuss harmonization of development assistance and formulate initiatives. At present, Arab aid is usually co-financed and, in most cases, one institution prepares and supervises an operation on behalf of all parties involved.

12. According to a comprehensive appraisal of Arab development funds, conducted by the Arab Monetary Fund on behalf of the League of Arab States in 2005, the number of autonomous agencies within the Arab region providing development assistance has been satisfactory to cover the needs of both Arab and non-Arab developing countries in terms of institutional capacity. The most important conclusion of this study is that new Arab aid agencies are not needed, and that their establishment could lead to an inefficient overlap with existing ones. Instead, the main challenge is improving the performance of existing institutions. Most Arab development funds have experienced an increase in paid-up capital over the last five years, including during the political transitions that have been taking place in the Arab region since 2010. Evidence suggests that they have supported the development and humanitarian efforts in the region to date. For instance, in December 2013, the Islamic Development Bank agreed to launch a programme worth over $500 million to support the Egyptian economy in the energy and infrastructure sectors. In October 2014, the Board Members of the Islamic Development Bank approved $128 million for the Greater Beirut Water Supply Augmentation Project in Lebanon.

IV. ASSESSMENT OF THE FINANCIAL RESOURCES AVAILABLE TO ARAB DEVELOPMENT FUNDS VERSUS DEVELOPMENT CHALLENGES

13. Although not all Arab aid is channelled through Arab funds, they have played a central role in supporting the development process in the Arab region and beyond. With time, Arab assistance has expanded to include more than 6,000 operations in over 100 countries, totalling $100 billion since inception. The average project size ranges from $6 million under OFID to $40 million under AFESD.[2]

14. Over the last four decades, Arab aid agencies have been funded through paid-up capital. As their lending reached its limits, more resources have been injected through two channels, namely subscriptions to the capital base and accumulated reserves. The financial resources available to Arab development funds reached $190 billion in the form of authorized capital by the end of 2013, significantly bolstered by the decision of the Islamic Development Bank to triple their authorized capital to $150 billion.

15. Challenges in the water, food and infrastructure sectors reflect some of the urgent development needs in Arab countries. Substantial investments in modern irrigation methods are required to boost the efficiency of the region's fragile water sector. Below are some of the priority sectors Arab development funds could contribute to.

[2] World Bank, *Arab Development Assistance: four decades of cooperation* (Middle East and North Africa Region, June 2010).

16. *Water scarcity*: The Arab region accounts for more than 5 per cent of the world's population, yet contains less than 1 per cent of global water resources. The World Bank estimates that currently half of the Arab population does not have adequate access to water and per capita water is less than a fifth of average global access rates.[3] Water resources in Arab countries are under severe stress owing to demographic growth of 2.6 per cent per annum, urbanization, industrialization and the expansion of irrigated agricultural land, which have all contributed to a dramatic and unsustainable increase in water consumption over the past few decades. Furthermore, frequent droughts have greatly reduced the availability of both renewable and non-renewable water resources. The transition to modern irrigation techniques could save Arab countries about 100 billion cubic metres of water but will cost billions of dollars to install. Bridging the wheat gap in the Arab region, estimated at 25 million tons, would require about 50 billion cubic metres of water for irrigation with traditional techniques, but only 25 billion cubic metres if modern irrigation techniques are applied.[4]

17. *Food insecurity*: Food insecurity has long been a development challenge in Arab countries, resulting in a food import bill of $42 billion per annum and relatively high levels of child undernutrition and poverty in the region. Arab countries import at least 50 per cent of the food calories they consume. As the largest net importers of cereal, Arab countries are more vulnerable than others to severe fluctuations in agricultural commodity prices, which will likely be exacerbated in the coming years by strong population growth, low agricultural productivity and dependence on global commodity markets.[5]

18. Arab countries need to act urgently to improve food security given that projections on the region's food balance indicate that dependence on imports will increase by almost 64 per cent over the next 20 years. Buying land overseas for food production, particularly outside the Arab region, is one solution, although it might cause controversy and political unrest. Along with other development institutions, such as the World Bank, Arab funds should expand their operations to increase agriculture productivity and irrigation efficiency through investments in technology, research and development and improved agricultural water management.

19. Government spending on agriculture in most Arab countries has been very low. To achieve long-term prosperity and stability, Arab countries urgently need to ensure food security through policies that direct public and private investments towards the agricultural sector, especially in countries with great potential for agricultural development. A comprehensive road map for development and poverty reduction requires a broad food security programme for the region, accompanied by country-specific strategies. Arab national and regional development funds will continue to strengthen their support to the agriculture and water sectors, but the huge investments needed to carry out a comprehensive agricultural development strategy in the Arab region have urged some economists to call for the creation of an Arab food security fund,[6] which could also finance intra-Arab trade in agriculture and food products.

20. *Infrastructure*: Arab countries could significantly reduce their food imports by investing in road, rail and electricity infrastructure to produce, store and transport food. The Arab region needs to invest between $75 billion and $100 billion a year in infrastructure to sustain the growth rates achieved in recent years and boost economic competitiveness. As the population grows, electricity consumption is also set to increase

[3] World Bank, "World Bank and partners join efforts to tackle Arab world infrastructure challenge". Available from http://water.worldbank.org/node/83721.

[4] Arab Fund for Economic and Social Development and Kuwait Fund for Arab Economic Development, "An overview of the agriculture and food security in the Arab countries", presentation at the Joint Technical Meeting of the Arab Coordination Group Institutions and the OECD Development Assistance Committee, Vienna, 29-30 April 2010.

[5] World Bank, *Improving Food Security in Arab Countries* (Washington, D.C., 2009).

[6] United Nations Development Programme, *Development Challenges for the Arab Region: Food Security and Agriculture, Volume 2* (New York, 2009).

significantly over the next few years and will require investments of $30 billion a year to meet demand.[7] The World Bank estimates that the infrastructure sector has a financing gap of $40 billion per annum. The World Bank and the Islamic Development Bank established a $1 billion infrastructure fund in 2011 to finance regional projects, but this fund leaves a wide financing gap that will be extremely difficult to fill with private sector resource mobilization.

V. WAY FORWARD

21. The financing capacity of Arab development funds must increase, especially given that ODA in the region is decreasing. Furthermore, fiscal space in the region is limited, with some countries having no margin for domestic resource mobilization in the short term. If Arab development funds are to continue playing a significant role in the region's development (assuming all financial resources are allocated exclusively to the Arab region) the authorized capital of those funds should be doubled in the coming five years to reach $400 billion. Other things being equal, a big enough increase in authorized capital will enable the Arab funds to fill financing gaps in several economic sectors, particularly infrastructure.

22. Furthermore, Arab funds can resort to global financial markets to raise financial resources. The Islamic Development Bank had a successful experience in issuing *sukuk* (bonds) in 2010. While it was initially planned to raise $1.5 billion from the financial market, the ceiling was raised to $3.5 billion. The Bank also came to the market in May 2011, when it priced a $750 million five-year bond at a spread of 35 basis points over mid-swaps to yield 2.35 per cent.

[7] World Bank, "World Bank and partners join efforts to tackle Arab world infrastructure challenge".

Annex

OFFICIAL DEVELOPMENT ASSISTANCE FLOWS FROM ARAB COUNTRIES
(*Percentage*)

Year	Arab ODA/DAC ODA	Arab ODA/ Non-DAC ODA	Arab ODA/Total ODA	Arab ODA/GNI	DAC ODA/GNI
1975	39.51	98.37	28.19	6.64	0.38
1976	36.20	97.71	25.81	4.88	0.35
1978	29.08	97.72	21.88	3.32	0.35
1980	34.60	98.22	24.92	2.66	0.37
1977	30.55	98.60	22.45	5.72	0.37
1979	35.07	98.51	25.05	4.73	0.38
1981	32.58	98.70	23.41	2.94	0.35
1982	20.52	97.92	16.34	2.18	0.38
1983	16.61	97.66	13.63	1.86	0.36
1984	15.47	97.48	12.80	1.80	0.35
1985	12.67	96.53	10.73	1.58	0.35
1986	12.67	97.30	10.74	2.14	0.36
1987	9.39	97.79	8.22	1.72	0.35
1988	5.10	95.11	4.59	1.11	0.36
1989	5.02	96.69	4.53	1.01	0.34
1990	13.01	99.44	11.04	2.96	0.37
1991	5.93	94.18	5.30	2.05	0.40
1992	3.09	91.48	2.81	0.97	0.36
1993	3.00	92.95	2.74	0.90	0.34
1994	2.83	91.72	2.55	0.88	0.32
1995	2.20	87.96	1.99	0.65	0.29
1996	2.49	89.82	2.23	0.63	0.28
1997	2.88	86.65	2.55	0.61	0.25
1998	3.22	89.40	2.85	0.84	0.26
1999	2.20	82.34	1.97	0.54	0.25
2000	2.14	80.79	1.92	0.45	0.25
2001	2.37	85.38	2.09	0.36	0.24
2002	5.37	92.49	4.68	0.85	0.26
2003	4.96	91.82	4.32	0.83	0.28
2004	3.08	69.81	2.70	0.48	0.29
2005	1.81	54.50	1.62	0.28	0.36
2006	2.92	60.74	2.56	0.37	0.34
2007	4.02	67.63	3.46	0.42	0.31
2008	5.21	72.11	4.46	0.50	0.34
2009	3.66	65.92	3.16	0.42	0.35
2010	3.31	59.29	2.89	0.38	0.35
2011	4.65	63.74	4.00	0.46	0.34
Average	11.33	87.42	8.84	1.65	0.33

Sources: ODA data are from the OECD DAC online database (accessed on 12 October 2012). GNI data are from the World Bank's World Development Indicators (2012).

Notes: The main Arab donors are Kuwait, Saudi Arabia and United Arab Emirates, but available data for Algeria, Iraq, Libya and Qatar are also included. The OECD GNI data figures take into account the year in which member countries (Greece, Ireland, Luxemburg, Portugal, Republic of Korea and Spain) joined OECD. The results reflect ESCWA calculations based on current United States dollar figures.
