Economic and Social Survey of Asia and the Pacific 2024

Boosting affordable and longer-term financing for governments

6 June 2024
Overall steady economic performance is masking **declining purchasing power of people** and **rising poverty** and **socioeconomic inequalities**.

Increasing public investments for SDGs is looking difficult, due to **higher government borrowing costs** and **shorter loan maturities**.

Domestic policy measures related to taxes and capital markets can help lower borrowing costs and boost supply of long-term capital.

International development partners – donors, multilateral development banks and credit rating agencies – can revisit their approaches to increase affordable and long-term financing.

Fiscal policymakers need to keep in view **global megatrends** (such as demographic shifts, climate change and technological advancements) while pursuing affordable and long-term financing.
Macroeconomic prospects and challenges
Steady, yet below-trend GDP growth and declining, yet relatively high inflation

Source: ESCAP estimates and projections as of February 2024.
Subdued post-pandemic job recovery and weaker purchasing power

Number of persons employed (Q4/2019 = 100)

- Accommodation and food services
- ICT
- Manufacturing
- Wholesale and retail

Declines in inflation-adjusted national minimum wages in 2022 (%)

- Türkiye
- Sri Lanka
- Lao PDR
- Samoa
- Palau
- Vanuatu
- Republic of Korea
- Bangladesh
- Thailand
- Nepal
- India
- Pakistan
- Solomon Islands
- Kiribati
- Timor-Leste
- Philippines
- Cambodia
- China
- Marshall Islands

Source: ESCAP, based on CEIC.

Source: ESCAP, based on ILOSTAT database.
Millions of people in Asia-Pacific who could have been pushed into poverty in 2022

<table>
<thead>
<tr>
<th>Country</th>
<th>2019</th>
<th>2022</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maldives</td>
<td>41.9</td>
<td>155.8</td>
<td>113.9</td>
</tr>
<tr>
<td>$2.15 per day</td>
<td>$3.65 per day</td>
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</table>

Source: ESCAP estimates.

Change in income shares between 2019 and 2022 (percentage points)

Source: ESCAP, based on World Inequality Database.
Key risks to the economic outlook

- **Uncertain inflation trends** and monetary policy stance within Asia-Pacific and beyond
- Weak **debt repayment ability** of households, businesses and governments amid a high interest rate environment
- Uncertainty around economic growth momentum in **China**
- Escalation of **geopolitical tensions** and **trade fragmentation**
The need for affordable and long-term financing for governments in developing Asia-Pacific
Government borrowing costs in Asia-Pacific are rising, with shorter loan maturity

**Average interest on new external debt commitments (%)**

- All creditors
- Private creditors
- Official creditors

**Average local-currency sovereign bond yields (%)**

- United States
- Developing Asia-Pacific

**Average maturity on new external debt commitments (years)**

- All creditors
- Official creditors
- Private creditors

Source: ESCAP, based on World Development Indicators database and Bloomberg.
Strong macroeconomic fundamentals keep government borrowing costs at low levels

Government borrowing costs have been higher in Asia-Pacific economies with...

- Higher inflation and policy interest rates
- More volatile exchange rates
- Higher perceived fiscal risks
- Less financial market liquidity

Source: ESCAP analysis.
What can governments do to increase affordable long-term financing?

Closing the tax collection gaps to reduce fiscal risks
Low tax-to-GDP ratios and wide tax collection gaps in several Asia-Pacific countries

Estimated tax gap and potential (% of GDP)

Source: ESCAP, based on the IMF World Revenue Longitudinal Data set.
Less conventional fiscal policy tools to close the tax gaps

### Property-based fiscal revenue

- **Property tax**
  - Negligible property tax revenues
  - A low hypothetical property tax rate of 0.5% with no exemption can generate **sizeable additional fiscal revenue**

- **Land value capture**
  - Governments could **leverage part of higher land and property values** brought about by public infrastructure
  - Complementing property taxes
  - Being implemented in **China** and explored in many other regional economies

### Tax morale

- **Raising society’s willingness to pay taxes**
  - Ensure and communicate that taxes are well spent on development
  - Self-pride and image
  - Peer and social pressures
  - Increase the perceived probability that tax avoidance will be caught
What can governments do to increase affordable long-term financing?

Boosting and channeling domestic savings to increase supply of long-term capital
Strengthening capital markets to channel sizeable domestic savings for investment

### Domestic savings (% of GDP)

- **Africa**
- **Latin America and the Caribbean**
- **Middle East and Central Asia**
- **Asia and Pacific**
- **Europe**
- **Developed economies**

### Capital market development index

- **Africa**
- **Middle East and Central Asia**
- **Asia and Pacific**
- **Europe**
- **Developed economies**

#### Further developing capital markets

- Widen the investor base
- Increase secondary market liquidity
- Improve risk-sharing mechanisms
- Protect investor rights

**Source:** ESCAP, based on World Development Indicators database and IMF Financial Development Index database.
Increasing domestic savings: policy options at country and individual levels

Source: ESCAP, based on World Development Indicators database.

**Domestic savings (% of GDP)**

- **Enhance the ability of households to save**
- **Boost labour productivity**
- **Ensure social protection to cut precautionary savings**

**Raise household saving rates**
- **Provide financial incentives and platforms**
- **Improve financial access and literacy**

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Source: ESCAP, based on World Development Indicators database.
As domestic policy actions take shape, how can international development partners help?
Donors: towards a larger and fairer concessional finance system

Provision

- Official development assistance (ODA) in 2022 at half of the commitment of 0.7% of gross national income (GNI) made since 1970
- Official climate finance should not be counted as part of ODA commitments

Allocation

- Bilateral ODA is often shaped by historical and political factors
- Multilateral ODA still uses GNI per capita as a starting allocation criterion
- The UN-led initiative on the multidimensional vulnerability index is a way forward
Multilateral development banks: addressing underutilized resources and capacities

**Boost lending capacities**

- Increase capital
  - New round of capital injections
- Optimize existing capital
  - Adjust the capital adequacy frameworks

**Improve lending terms**

- Increase lending in local currencies
  - Now 80% is in US dollar
- Cut administrative burden of loan packages
  - Safeguard assessments for a World Bank project costs $13.5 million on average

**Strengthen systemic coordination and resource allocation among MDBs**
Credit rating agencies: more development-aligned and long-term sovereign ratings

What should global credit rating agencies do?

- Clearly distinguish judgement-based ratings from those that purely rely on objective information
- Incorporate long-term issues into assessments, e.g. public investment in SDGs raises fiscal credibility
- Increase dialogues with governments and other stakeholders in developing countries to reduce bias

What should international financial and development communities do?

- Reduce mechanistic reliance on credit ratings in making investment decisions
- Explore the idea of setting up a new regional credit rating agency for Asia-Pacific
Wider perspectives: what do global megatrends mean to fiscal policymakers?
Global megatrends affect fiscal policy through various channels

- Demographic shifts
- Climate change and environmental degradation
- Technologies and digitalization

Fiscal space and public debt sustainability
- Revenue
- Expenditure
- Borrowing cost

Fiscal policy conduct
- Design and implementation
- Effectiveness
Potential fiscal impacts are notable, diverse and sometimes uncertain: examples

<table>
<thead>
<tr>
<th>(Lower) revenue</th>
<th>(Higher) expenditure</th>
<th>Borrowing cost</th>
<th>Design and implementation</th>
<th>(Lower) effectiveness</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shrinking workforce</td>
<td>Old-age health care and social protection</td>
<td><strong>Higher</strong> inflation</td>
<td>Disaster risk-informed fiscal planning</td>
<td>Old-age consumption responds less to fiscal stimulus</td>
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<td>Lower production capacity</td>
<td>Public investment in climate projects</td>
<td>Green taxes &amp; investment</td>
<td>Digitalizing public financial management</td>
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<td>Profit shifting in digital economy</td>
<td>Post-disaster rebuild of public infrastructure</td>
<td>Output loss due to natural disasters</td>
<td>Stronger multilateral tax cooperation</td>
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<td></td>
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<td><strong>Lower</strong> inflation</td>
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<td></td>
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<td>Less demand for durable goods</td>
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Poverty and socioeconomic inequality concerns persist despite steady economic performance.

Urgency of boosting affordable and long-term financing for governments:
- Governments: increase fiscal credibility and the supply of long-term capital
- International development partners: adopt fresh perspectives to guide operations.

Implications of demographic shifts, climate change and technological advancements for fiscal policymaking should not be ignored.