Discussion Paper

Third International Conference on Financing for Development

Addis Ababa, Ethiopia

13-16 July 2015

Financing Development Gaps in the Countries with Special Needs in the Asia-Pacific Region

WP/15/12

July 2015






UNITED NATIONS ESCAP

Economic and Social Commission for Asia and the Pacific

Working Paper Series
Macroeconomic Policy and Development Division

FINANCING DEVELOPMENT GAPS IN THE COUNTRIES WITH SPECIAL NEEDS IN THE ASIA-PACIFIC REGION

This discussion paper was prepared for ESCAP by Mustafa K. Mujeri, Former Director General, The Bangladesh Institute of Development Studies, Bangladesh.

For more information, contact:

Macroeconomic Policy and Development Division (MPDD)
Economic and Social Commission for Asia and the Pacific
United Nations Building, Rajadamnern Nok Avenue, Bangkok 10200, Thailand
Email: escap-mpdd@un.org

Series Editor
Dr. Aynul Hasan
Director
Macroeconomic Policy and Development Division

Please cite this paper as:
Mujeri, Mustafa (2015). Financing Development Gaps in the Countries with Special Needs in the Asia-Pacific Region. MPDD Working Paper WP/15/12. Available from www.unescap.org/our-work/macroeconomic-policy-development/financing-development.

CONTENTS

1. INTRODUCTION

The Asia-Pacific region has witnessed impressive growth in recent years which has almost doubled the real income per capita in the region since the early 1990s. While growth in the region has been accompanied by significant declines in poverty, income inequality has also risen in many countries dampening the positive gains of growth. Despite rising inequality and other adverse developments including the global economic crisis, the Asia-Pacific region as a whole has made impressive progress in many MDG indicators, especially in reducing poverty.[1] For several indicators, the Asia-Pacific region has already achieved the targets, e.g. reducing gender disparities in primary, secondary, and tertiary education enrolment; preventing a rise in HIV prevalence; stopping the spread of tuberculosis (TB); reducing the consumption of ozone depleting substances; and halving the proportion of people without access to safe drinking water. On the other hand, the region lags behind in some major areas, such as in reducing the extent of hunger, ensuring that girls and boys reach the last grade of primary education, reducing child mortality, improving maternal health provision, and providing basic sanitation. The overall progress in the Asia-Pacific region, however, masks considerable variations between country groupings and sub-regions. In particular, several of the region's countries with special needs (CSN) have made slow progress in terms of a number of indicators. Indeed, the region still remains home to two-thirds of the global extreme poor.

Against this background, the 2012 triennial review of the Committee for Development Policy (CDP), a subsidiary body of the UN Economic and Social Council, stresses that "financing needs also differ across countries and regions. While financing needs are disproportionately large relative to the size of their economies in many developing countries, there are specific needs in least developed countries (LDCs)".[2] In particular, the CSN in the Asia Pacific would require substantial financing especially through public investment to fill the development gaps faced by these countries. Therefore, strategies for mobilizing resources for financing the development gaps remain one of the critical areas for the CSN in the Asia-Pacific region.

The ESCAP commits 'to assist countries with special needs, especially least developed countries, landlocked developing countries and small island developing States, in taking advantage of opportunities arising from regional economic cooperation and integration, including, as appropriate, through support to enhance their capacities and through technical assistance'. It further recognizes that 'there is a need to implement specific policies that focus on productive capacity-building related to infrastructure development, broadening the economic base, access to finance and providing assistance in overcoming the risks and shocks of entering into a regional trade block.[3]

In addition, ESCAP is currently undertaking research and related programmes on sustainable development financing (SDF) that can significantly contribute to the implementation of the post-2015 development agenda. These activities, among others, are aimed at addressing new

---

[1] See ESCAP, Asian Development Bank (ADB), and United Nations Development Programme (UNDP), *Asia Pacific Regional MDGs Report 2012/13* (Bangkok, 2013). Available from www.unescap.org/resources/asia-pacific-regional-mdg-report-201213-asia-pacific-aspirationsperspectives- post-2015.

[2] United Nations Department of Economic and Social Affairs (UNDESA), *Report of the Intergovernmental Committee of Experts on Sustainable Development Financing.* Available from http://sustainabledevelopment.un.org/content/documents/4588FINAL%20REPORT%20ICESD F.pdf.

[3] See ESCAP, *Implementation of the Bangkok Declaration on Regional Economic Cooperation and Integration in Asia and the Pacific*, E/ESCAP/RES/70/1. Available from www.unescap.org/sites/default/files/E70_RES1E.pdf.

challenges and emerging issues related to mobilization and effective use of financial resources in Asia and the Pacific. One of the important agendas of these efforts is to analyze the scope, trends and potential of all sources of financing at the national, sub-regional and regional levels for the region. In particular, SDF needs to highlight a number of areas, including (i) the scope for domestic resource mobilization through broadening of tax base and capital market intermediation, (ii) infrastructure financing and leveraging resources through public-private partnerships, (iii) greater involvement of institutional investors including pension funds, sovereign wealth funds, insurance companies, (iv) broader and more effective use of trade and small and medium enterprise (SME) finance, (v) expanding the role of financing for science, technology and innovation, (vi) need for financial inclusion for all, (vii) climate finance requirements for adaptation and mitigation including specifics of natural disaster related financing, (viii) external resources with reference to official development assistance (ODA), foreign direct investment (FDI) and private flows, and (ix) efforts to forge new, better and innovative partnerships for financing sustainable development for the CSN.

The present paper (i) reviews various financing options for narrowing development gaps in the region; (ii) examines the complementarities and relationships between various investments in social, economic and climate change areas and identify the trends for the CSN in different areas of the Monterrey Consensus (2002) since its adoption; (iii) analyzes issues of financing for the CSN and identities their links to various aspect of financing instruments; (iv) examines the role of enabling environment and governance measures which are critical to the implementation of financing in these countries; and (v) identifies various policy initiatives at the country level in the region and highlights key messages for appropriate implementation of financing for meeting the development gaps in the CSN. One of the underlying efforts is to contextualize the analyses and policy discussions in the light of the UN global post-2015 development agenda where sustainable development financing is critical for implementing the sustainable development goals (SDGs). This is also expected to contribute towards developing a regional financial cooperation framework in Asia and the Pacific.

2. DEVELOPMENT GAPS IN THE ASIA-PACIFIC CSN

This section provides a brief overview of the major development gaps faced by the CSN in the Asia-Pacific region. In the region, the CSN comprise of 31 countries covering the least developed countries (LDCs), landlocked developing countries (LLDCs) and the small island developing States (SIDS) (see table 1). These countries are home to more than 380 million people, a quarter of the total population of the Asia-Pacific developing countries excluding China and India. The economies of CSN are marked by persistent structural challenges, fluctuating growth and dependence on a limited number of commodities or low-wage manufactured products for export earnings.

Table 1. Countries with special needs in the Asia-Pacific region

Least developed countries (LDCs)	Landlocked developing countries (LLDCs)	Small island developing States (SIDS)
Afghanistan	Afghanistan	Cook Islands
Bangladesh	Armenia	Fiji
Bhutan	Azerbaijan	Kiribati
Cambodia	Bhutan	Maldives
Kiribati	Kazakhstan	Marshall Islands
Lao PDR	Kyrgyzstan	Micronesia
Myanmar	Lao PDR	Nauru
Nepal	Mongolia	Niue
Solomon Islands	Nepal	Palau
Timor-Leste	Tajikistan	Papua New Guinea
Tuvalu	Turkmenistan	Samoa
Vanuatu	Uzbekistan	Solomon Islands
…	…	Timor-Leste
…	…	Tonga
…	…	Tuvalu
…	…	Vanuatu

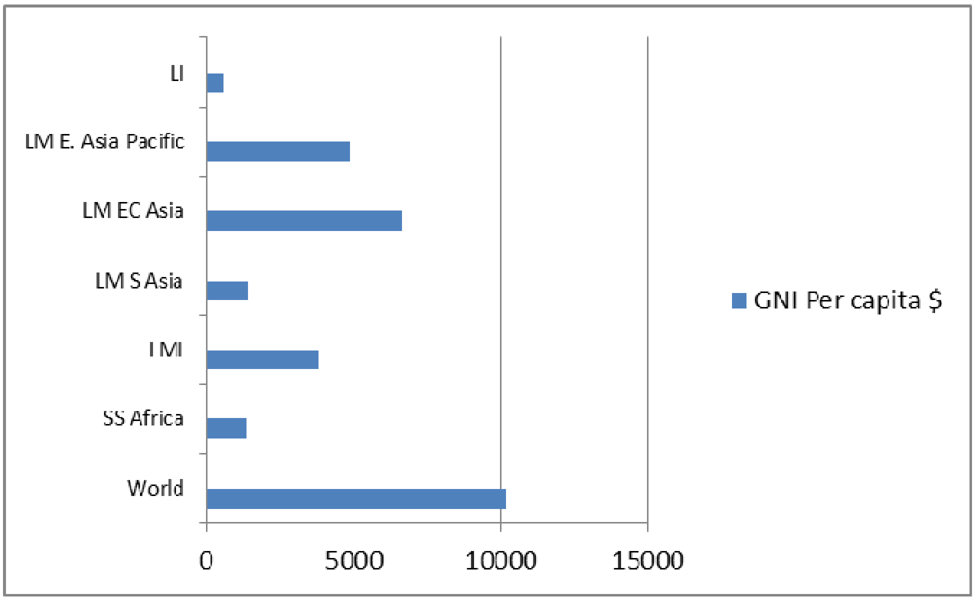
Source: ESCAP.

The UN has adopted a range of strategic actions to address the developmental challenges faced by the CSN through the implementation of global mandates, including the Istanbul Programme of Action for the LDCs, the Almaty Programme of Action for the LLDCs and the Mauritius Strategy for the SIDS. In the Asia-Pacific region, ESCAP along with other UN agencies and development partners are providing assistance to these countries through the implementation of global and related regional mandates emphasizing a number of priority areas including productive capacity, human resources development, private sector development, infrastructure, trade and transport facilitation, targeted use of official development assistance (ODA) and other external assistance, and institutional development including promotion of governance at all levels.

2.1. Key Development Gaps

The fact that the Asia-Pacific CSN belong to the LDC, LLDC and SIDS categories testifies that there persist significant development gaps in these countries. Despite wide variation in their socioeconomic performance over the last decade, many of these countries are the poorest in the Asia-Pacific region and home to a large majority of the poor in the world. As a group, GNI per capita (using the Atlas method) of the Asia-Pacific LDCs is recorded at $868 in 2013 which is only about 16 percent of the average GNI per capita in East Asia and the Pacific and 8 percent of the global GNI per capita (Table 2). There are significant variations in the level of GNI per capita across the CSN with a low of below $1,000 in four countries (Afghanistan $690, Cambodia $950, Nepal $730 and Tajikistan $990). As a region, low and middle income countries in South Asia had GNI per capita of $1,437 in 2012 compared with $590 for low income countries (see figure 1).

Figure 1. GNI per capita $, 2012 (Atlas method)



Source: World Bank, *World Development Indicators 2014*
Note: LI is low income countries; LM E Asia Pacific is low and middle income East Asia and Pacific countries; LM EC Asia is low and middle income Europe and Central Asia countries; LM S Asia is low and middle income South Asia countries; SS Africa is low and middle income Sub Saharan Africa countries.

Most CSN also witnessed limited structural transformation and their vulnerability to external shocks has not been reduced. Changes in the sectoral composition of GDP have been slow with the share of manufacturing, which is the driving force of growth, rising only marginally. There has been rising inequality and the impact of growth on employment creation and poverty reduction has also been rather limited. Overall, economic growth in the Asia-Pacific CSN needs further acceleration along with measures to reduce wide fluctuation for which growth needs to be more broad based and inclusive.[4]

Moreover, the commitments of creating the framework for a strong global partnership were only partially realized. The progress in addressing the needs of the Asia-Pacific CSN regarding financial and technical assistance, ODA, trade capacity, market access, and debt relief was less than expected. Although the aggregate ratio of ODA to gross national income of Development Assistance Committee (DAC) members slightly increased but still remains well below the 0.15-0.20 percent target. As a result, the Asia-Pacific CSN face a huge financing gap despite some success in increasing domestic resource mobilization. Similarly, full realization of the commitments on duty-free quota-free market access for products originating in the Asia-Pacific CSN (especially the LDCs) in conformity with the Hong Kong Ministerial Declaration adopted by the World Trade Organization (WTO) in 2005 is yet to be fully achieved.

[4] For example, only a few LDCs have succeeded in achieving the threshold level of 7 percent growth set in the Istanbul Programme of Action (IPoA). More importantly, several Pacific Island LDCs have witnessed strong growth deceleration after the recent global economic crisis.

Table 2. Population and GNI per capita, Atlas method (current US$)

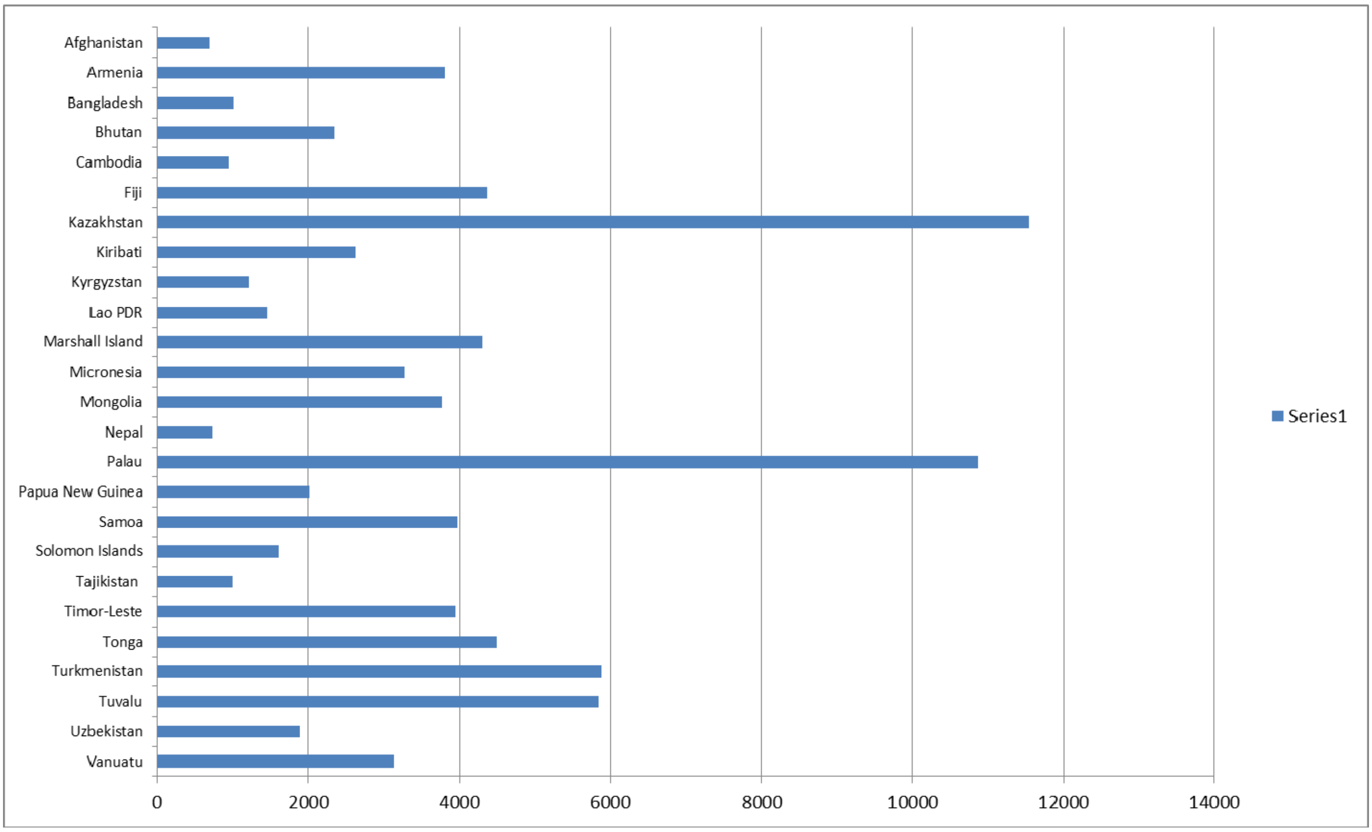
Country	Population (million) 2013	GNI per capita 2013
LDCs		
Afghanistan	30.6	690
Bangladesh	156.6	1,010
Bhutan	0.8	2,330
Cambodia	15.1	950
Kiribati	0.1	2,620
Lao PDR	6.8	1,450
Myanmar	53.3	…
Nepal	27.8	730
Samoa	0.2	3,970
Solomon Islands	0.6	1,600
Timor-Leste	1.2	3,940
Tuvalu	0.0	5,840
Vanuatu	0.3	3,130
LLDCs (excluding countries included in LDCs)		
Armenia	3.0	3,800
Kazakhstan	17.0	11,550
Kyrgyzstan	5.7	1,210
Mongolia	2.8	3,770
Tajikistan	8.2	990
Turkmenistan	5.2	6,880
Uzbekistan	30.2	1,880
SIDS (excluding countries included in LDCs)		
Fiji	0.9	4,370
Marshall Island	0.1	4,310
Micronesia	0.1	3,280
Palau	0.0	10,970
Papua New Guinea	7.3	2,010
Tonga	0.1	4,490
GNI per capita		
East Asia and Pacific	…	5,536
Europe and Central Asia	…	7,118
Pacific Island Small States	…	3,460
South Asia	…	1,482
LDCs	…	868
World	…	10,679

Source: World Bank, World Development Indicators 2014.

Despite some increase in participation, the share of Asia-Pacific CSN in global trade still remains low. Moreover, multiple global economic and financial crises, rising and fluctuating food, energy and other commodity prices, and global instability during the last decade have increased their vulnerability to global shocks. The investment-GDP ratio remained depressed while other key macroeconomic indicators improved at slow rates.[5]

[5] See ESCAP, *Economic and Social Survey of Asia and the Pacific 2014,* Bangkok, 2014.

Figure 2. GNI per capita in current US$



Source: World Bank, World Development Indicators 2014.

The recent progress of the Asia-Pacific CSN towards reaching the MDGs shows that, while several countries have made notable progress in some areas, there are deficiencies in many other areas.[6] It shows wide divergence in performance across countries and with respect to overall status of the Asia-Pacific CSN showing that the progress in reaching the MDGs has been uneven in these countries. Moreover, even in countries where good progress has been made, there remain glaring disparities between rural and urban areas, between the rich and the poor, between women and men, and between girls and boys. It appears that there would remain a significant unfinished agenda with respect to the MDGs for the Asia-Pacific CSN in the post-2015 period.

The Asia-Pacific CSN face significant development gaps in a number of key areas that constrain their progress towards reaching the national and global development goals including the MDGs.

Poverty and inequality

Since poverty is endemic in these countries, poverty and deprivations manifest the most significant development gap of the Asia-Pacific CSN especially for those belonging to the LDCs. The poor in these countries have many characteristics. The poor people are more concentrated in locations which are away from roads, markets, schools, health facilities, and

[6] ESCAP, Asian Development Bank (ADB), and United Nations Development Programme (UNDP) 2013. *Asia Pacific Regional MDGs Report 2012/13*. Available from www.unescap.org/resources/asia-pacific-regional-mdg-report-201213-asia-pacific-aspirationsperspectives- post-2015.

other social institutions. The economic, social, political, and other forms of exclusion are pervasive for these disadvantaged people. In most cases, the disadvantages of women and girls are also evident at both national and community levels and within the households making them more prone to poverty. The inability of the poor to invest in asset accumulation and education, constrained access to credit and financial markets, and possession of unskilled labour, often as the only means of livelihood, are some of the factors that perpetuate poverty over generations. Moreover, unexpected events like natural and manmade disasters, global economic crisis, and health shocks have pervasive effects on the lives of the poor with little avenues to move upwards.

Low employment creation and insufficient productive jobs

Although the labour force in the Asia-Pacific CSN is increasing rapidly, economic growth is not creating adequate decent and productive employment in most countries. One reason for this is the nature of economic growth and the pattern of structural change in these countries under which most of the workers move from agriculture to the low productivity service sector activities. Under the situation, most workers remain engaged in vulnerable informal sector employment including working on their own in self-employment and working as unpaid family workers. The poor are often forced to engage in low productivity activities because these are less risky relative to high productivity alternatives. Reducing risks also minimizes their chances of falling back on coping strategies that can lead to their falling into poverty traps, e.g. selling of land and other assets, and deprivation of food, schooling, and health services for the children.

It is evident that most of the Asia-Pacific CSN are yet to generate sufficient productive nonfarm employment to absorb the growing labour force seeking employment outside the agriculture sector. In addition, poor workers need to have the health, education and skills, and resources to gain access to such expanded employment opportunities. This implies that macroeconomic, structural, and equity focused policies need to be well integrated to create a rapid expansion of poverty reducing employment. Since informal sector including the small and medium enterprises (SMEs) is the main source of employment of the poor workers in these countries, an integrated policy response is needed taking into account the diversity and heterogeneity of the informal economy. Policies are needed to raise the productivity of informal enterprises through access to capital, business development services, infrastructures, and supportive regulations and policies. In promoting such policies, public investment has to play a key role in growth and development along with massive programmes to strengthen education and training as well as in providing social protection, ensuring representative voice, legal identity and rights, and health services.

Infrastructural deficiencies

The Asia-Pacific CSN suffer from wide gaps in the levels of infrastructural development that remain to be closed within the shortest possible time. The limited availability and low quality of infrastructure in these countries constrains the contribution of infrastructure to economic growth through limiting the values of multipliers in terms of investment, employment, output, income, and ancillary development. The resource requirements for bridging or even narrowing these gaps are substantial and hence appropriate financing mechanisms are needed to meet the resource gap.

Raising the quality of infrastructure is also an important concern for the Asia-Pacific CSN.[7] The low quality of infrastructure disproportionately affects the poor and the rural people due to wide gaps in the quality of infrastructure between the urban and rural areas. Since most of the basic infrastructure in these countries has to come from the public sector, mobilization of finance, commitment to repairs and maintenance, reforms in governance and efforts to increase capacity, bringing better coordination, and paying closer attention to the environmental impact and the implications of climate change are issues that need priority in the Asia-Pacific CSN.

High vulnerability, insecurity and inadequate social protection

In most Asia-Pacific CSN, many households are now facing higher levels of risks from multiple sources such as adverse family and household events, natural disasters, and greater exposure to external economic shocks (e.g. global economic crises). Economic insecurity is heightened in the absence of comprehensive social protection systems in these countries.

Policies that provide social protection in times of adversity and reduce unacceptable levels of deprivation are important for the Asia-Pacific CSN both for reducing poverty and protecting the population from the risk of falling into poverty as a result of unexpected shocks and disasters. Social protection systems are essential to attaining inclusive development through providing automatic stabilizers during periods of crisis by providing additional incomes to the poor and enabling them to maintain access to food and basic services. The Asia-Pacific CSN lack a viable and effective social protection system to address such adversities through various types of programmes, such as employment generation measures, cash transfer programmes, targeted social services, and microfinance programmes.

Low financial inclusion

An inclusive financial system offers access to financial products and services, especially to the poor, including obtaining credit and insurance on favourable terms and conditions and accessing payments services for undertaking transactions and remittances in a secure and cost effective manner. Poor households with access to financial services can improve their economic well being while investing in children’s education and enjoying better nutrition and health status than similar households without such access. Despite such advantages, the vast majority of the population especially the poor households in the Asia-Pacific CSN are typically excluded from accessing financial services offered by the formal financial sector.

In the Asia-Pacific CSN, the barriers to financial inclusiveness exist on both demand and supply sides. In general, development finance institutions and microfinance institutions in these countries have been more successful in reaching out to the poor and small and microenterprises. In addition, public and technology-enabled networks such as post offices, telecommunications companies, and the Internet hold significant potential for bringing financial inclusiveness in these countries. The regulatory environment also needs to encourage diversity in provision of financial services to increase the options available to the poor. A new range of products and services can be provided to the poor through developing innovative partnerships with NGOs, microfinance institutions, and other entities including mobile banking services.

---

[7] A recent study, which rates infrastructure giving a maximum score of 7 points, finds a very weak performance by the Asia-Pacific LDCs. For overall infrastructure, the scores are 2.2 (2.8 for roads and 1.9 for electricity) for Bangladesh, 3.1 (3.1 for roads and 2.5 for electricity) for Cambodia, and 1.9 (1.9 for roads and 1.7 for electricity) for Nepal. See ADBI/ADB, *Infrastructure for a Seamless Asia,* Asian Development Bank Institute and Asian Development Bank, Tokyo and Manila, 2009.

Ecological imbalances and climate change adversities

Poorly managed economic growth and the unsustainable patterns of production and consumption have largely relied on unplanned exploitation of natural resources making the Asia-Pacific CSN increasingly vulnerable to adverse impacts of climate change and other unforeseen developments. In the Asia-Pacific CSN, ecological imbalances are mostly reflected in the degradation of key natural resources such as forests and freshwater, and in unsustainable use of energy.

Such imbalances pose formidable challenges to the sustainability of development of these countries particularly in the long run. The production system, especially of the agriculture sector, and the livelihoods of a large majority of the people living especially in the rural and fragile areas are also adversely affected. Thus, measures are needed to protect the natural capital and address ecological imbalances.

Along with expanding the 'new economy and green industries' through investments in renewable energy and in energy efficient technologies, addressing ecological imbalances of growth would also make substantial contribution to reducing poverty in these countries since the poor usually live in ecologically vulnerable areas and depend more on natural resources for their livelihood. A key to addressing the ecological imbalances will be the implementation of technological innovations to reduce the adverse impacts of production and consumption activities on the environment and unsustainable pressures on natural resources.

It needs to be emphasized that the Asia-Pacific CSN which are disproportionately vulnerable to the consequences of climate change, do not have the financial resources and expertise to develop appropriate and new technologies. The United Nations Framework Convention on Climate Change (UNFCCC) recognizes these constraints by stressing that the developed countries need to provide support to these countries based on the principle of common but differentiated responsibilities. So far not much progress has been made both in terms of providing financing on preferable terms and in enhancing green market access opportunities to these countries.

The new and sustainable sources of growth for the Asia-Pacific CSN are the new green industries that emphasize environmentally sustainable economic growth to foster socially inclusive development. The pillars are: sustainable production and consumption, greening of businesses and markets, sustainable infrastructure, green tax and budget reforms, and investment in natural capital.[8] Similarly, the Asia-Pacific CSN can use the flexibilities provided in the TRIPs Agreement to facilitate the adoption of environmentally sound technologies. Valuable opportunities are also available for sharing development experiences and best practices among these countries as well as other developing countries in the area of sustainable production and consumption. These countries may work more closely on bio-fuels, solar and wind power, waste management, and similar other areas.

Low integration with global development contexts

The development gaps of the Asia-Pacific CSN also emanate from the new contexts of development with trade liberalization creating new challenges as well as new opportunities,

[8] See ESCAP, *Greening Growth in Asia and the Pacific,* United Nations Publication Sales No. E.09.II.F.6, ST/ESCAP/2510, Bangkok, 2008.

technological revolution in ICT bringing in new dimensions of knowledge in development, and the increasing role of migration and remittances in domestic development. One important element of national action in reducing development gaps in these countries is to build and maintain a social compact where the state is committed to reduce the poor's risks through ensuring good governance at all levels, maintaining macroeconomic stability, providing basic services and institutions, and securing citizenship. Addressing gaps in promoting inclusive and sustainable growth requires measures to strengthen social protection along with a focus on agriculture and rural development including enhanced financial inclusiveness.

For effectively mitigating the development gaps, each Asia-Pacific CSN will have to address its own specific needs and constraints and exploit the opportunities for strengthening broad based and inclusive growth. Obviously, this would require these countries to spend more on basic social services, social protection, and basic infrastructure along with measures for boosting the incomes of the poor. It will also be important to boost intra-regional trade and investment flows with more inclusive regional integration that benefits these countries. For ensuring greater intra-regional trade, measures are needed to promote integrated markets, lower tariff and nontariff barriers, greater investments in physical infrastructure, creating robust transportation networks and information platforms, and installing better regulatory structures.

2.2. Priority Policy Agenda for Meeting Development Gaps

The development challenges faced by the Asia-Pacific CSN point out the necessity of a fundamental restructuring of their efforts along with more strategic, comprehensive and sustained strategies based on country-specific, focused, and realistic commitments on the part of the countries and the global community. Rather than treating the Asia-Pacific CSN as distinct groups (such as LDCs, LLDCs and SIDS), the approach to their development needs to adopt specific strategies fully taking into account the country-level constraints, vulnerabilities, and potentials of individual countries. In view of the deep rooted instabilities and vulnerabilities of the global economy, there is a need to refocus strategic thrusts on structural transformation of these economies through complementing export-led growth with strengthened role of domestic productive capacity, diversification of economic activities, improved technological capacity, and strengthened measures to stimulate a more inclusive and equitable economic growth.

For the LDCs, the UN LDC IV Conference in May 2011 adopted the Istanbul Programme of Action (IPoA) for the decade 2011-2020 to address specific needs of the LDCs and help them improve the living conditions of the people through providing necessary support and a framework for a strong global partnership. The IPoA contains eight priority areas of action, each supported by concrete deliverables and commitments. These eight development priorities include: (i) productive capacity; (ii) agriculture, food security and rural development; (iii) trade; (iv) commodities; (v) human and social development; (vi) multiple crises and other emerging challenges; (vii) mobilizing financial resources for development and capacity-building; and (viii) governance at all levels.

One of the major UN mandates to assist the LLDCs is the Almaty Programme of Action (APoA, formulated in 2003) specifically designed to address the special needs of the LLDCs through (i) establishing a new global framework for developing efficient transit transport systems in landlocked and transit developing countries taking into account the interests of both landlocked and transit developing countries; and (ii) promoting trade for development. The identified priorities under the APoA cover several areas including the need to address fundamental transit policy issues, infrastructure development and maintenance, international trade and trade facilitation, enhancing international support measures, and focused attention on implementation and review.

In particular, the APoA aims to: (i) secure access to and from the sea by all means of transport according to applicable rules of international law; (ii) reduce costs and improve services so as to increase the competitiveness of their exports; (iii) reduce the delivered costs of imports; (iv) address problems of delays and uncertainties in trade routes; (v) develop adequate national networks; (vi) reduce loss, damage and deterioration en route; (vii) open the way for export expansion; and (viii) improve the safety of road transport and the security of people along the corridors. It is stipulated that, along with streamlined policies and procedures, international conventions on transport and transit as well as regional and bilateral agreements ratified by landlocked and transit developing countries would be the main vehicles by which harmonization, simplification, and standardization of rules and documents can be achieved. It is expected that, at the international level, development partners especially the multilateral aid agencies would give high priority to sustainable transportation financing.

The draft programme of action for the LLDCs for the decade 2014-2024 adopted in 2014 reiterates the priorities for action including energy infrastructure; trade and trade facilitation; agriculture and rural development; science, technology and innovation; regional integration and cooperation along with specific measures for financing modalities covering domestic resource mobilizaion, external resource flows and innovative mechanisms.[9]

In view of the high level of vulnerabilities and complex development challenges facing the SIDS, more concerted efforts are needed to make use of a wide range of available financing mechanisms for full implementation of the Barbados Programme of Action, the Mauritius Strategy and the Samoa Pathway relevant to the SIDS. In addition, the SIDS have identified their priorities for the post-2015 development agenda through the Third International Conference on Small Island Developing States and other forums.[10]

It is also important to note that the Asia-Pacific CSN vary significantly in terms of their physical environments and socio-economic characteristics. The size of population, for instance, varies from a few thousands in the small island States of the Pacific to nearly 160 million in Bangladesh. The nature of their problems also differs widely along with potentials and development options. For moving forward, it is important therefore to adopt country-specific strategies and actions within the framework of the IPoA and APoA. This is necessary since, despite similarities in the overall status of development, the nature and degree of the constraints facing each country are different and these need country-specific actions. Moreover, although the nature of actions may be similar, their relative priority may be different in view of the country realities.

The Asia-Pacific CSN face a number of challenges that highlight the need for domestic policy reforms and changes in global environment geared towards more inclusive and sustained growth of their economies. It needs also to be remembered that many of these countries are significantly affected by the global economic crisis because of their high vulnerability to global

[9] See *Draft Programme of Action for Landlocked Developing Countries for the Decade 2014-2024,* A/CONF 225/PC/L4, 11 September 2014, General Assembly, United Nations.
[10] See *Draft Outcome Document of the Third International Conference on Small Developing States.* Apia, 1-4 September, 2014, A/CONF223/3, General Assembly, United Nations.

developments, primarily through trade and financial channels. The degree of vulnerability of individual countries varies with the extent of dependence on trade, nature of demand structure, depth of fiscal space, extent of foreign exchange reserves, and strength of other macroeconomic fundamentals. Moreover, the ability of individual countries to adopt counter-cyclical macroeconomic policies depends on the fiscal capacity to meet the necessary costs and the institutional capacity to implement such policies, especially if they are to contribute to protecting the poor and the vulnerable groups in society. While most CSN have adopted policies to stimulate their economies out of the downturn, the response varies among the countries depending on the fiscal and policy space they have in accommodating expenditure increase and implementing relevant programmes.

As noted before, despite widely divergent performance, the Asia-Pacific CSN suffer from slow and fluctuating economic growth, rising inequalities, and inadequate structural transformation. Changes in the sectoral composition of GDP have been slow with the share of manufacturing, which is the driving force of growth, rising only marginally. Income inequality has shown rising trend in most countries showing that economic growth has not been sufficiently equitable and inclusive. With rising inequality, the impact of growth on employment creation and poverty reduction has also been limited. Overall, economic growth in the CSN needs further acceleration along with measures to reduce wide fluctuation for which growth needs to be more broad-based, equitable and inclusive. This requires productive capacities in all areas to enhance for producing efficiently and bringing about required diversification in the economy.

Many development gaps in the CSN arise from high and rising levels of inequality in assets, opportunities, social networks, and participation. High inequality reduces the poverty impact of economic growth and creates social and political tension that hinders sustainable and inclusive growth. In this context, gender is an important dimension of inequality. Rising inequality is not an inevitable consequence of economic growth in these countries. These countries need to adopt a mix of policies that addresses both growth and distributional concerns, strengthens empowerment, and deals with gender, ethnicity, and other biases.

For narrowing the socio-economic gaps, it is necessary for these countries to strengthen the employment nexus between economic growth and poverty reduction. Along with high economic growth, this requires improvements in the quantity and quality of employment supported by integration of the poor with employment opportunities. The poor workers need to have the health, education and skills, and resources to gain access to such expanded employment opportunities.

Financing, however, is an obvious challenge given the considerable amount of resources that are required for narrowing the current development gaps that persist in the Asia-Pacific CSN. Against this backdrop, developing innovative financing solutions is necessary to complement public investments in these countries.

2.3. Harnessing Complementarities between Investments in Social, Economic and Climate Change Areas

In line with global imperatives, the focus of the Asia-Pacific CSN is on sustainable development which introduces new dimensions and challenges relating to harnessing the complementarities between investments in social, economic and climate change areas. The basic precepts of sustainable development requires that financing must be aligned with development outcomes which integrate and synergize the three dimensions of sustainable development e.g. economic, social and environmental dimensions, as outlined in the Rio+20 outcome document, to ensure intra- and intergenerational equity as well as recognize planetary boundaries.

For the Asia-Pacific CSN, the implementation of the sustainable development agenda requires significant investments in public goods, such as social services, clean air, water and the continued flow of ecosystem services, upon which economies and people depend.[11] For these countries, harnessing the complementarities between investments in social, economic and climate change areas is critical for deriving sustainable and efficient outcomes and narrowing the development gaps that prevail in these countries. While economic goals are relatively straightforward, the complementarities between the three broad groups (economic, social and climate change) of investments are somewhat complex to comprehend but are essential to opening up new frontiers of investments in these countries and exploiting market forces for positive social change and for adapting to climate change impacts.
In general, social investments in these countries are varied as social impact and complex social relationships play a large role in determining their outcomes. In terms of composition, social investments are also dependent on several sources such as traditional instruments like public and private investments, short and long term debts, equity including public-private partnerships (PPP) and other hybrids. Grants are also a factor in social finance as are quasi-equity and other structured products.

In view of the horizontal nature of adaptation to climate change and disaster prevention, careful consideration of economic, social and other policy areas is necessary for pursuing synergies along with each specific activity taken into account. Synergies should be pursued with activities under all major activities including technological development and innovation for adaptation to climate change, support for small and medium enterprises (SMEs), taking up adaptation measures and technology, knowledge transfer and information actions, and actions to preserve and protect the environment and promote resource efficiency. In particular, the inter-sectoral links are important since many of the priorities and measures dealing with adaptation, risk prevention, water management, and eco-system preservation could be designed to maximize the synergies and complementarities among different aspects of development and human welfare.

While being closely interrelated for many aspects, adaptation to climate change on the one side and risk prevention and management on the other side should not be considered as similar. Natural disasters can be seen as impacts of a changing climate but can also have other root causes (such as urbanization and over abstraction of ground water). Adapting to climate change is a much broader challenge than only preventing natural disaster: indeed, reducing the vulnerability of the society to the effects of global warming means an overarching adaptation effort of many sub systems like the health sector, electricity generation, transport infrastructure, water management and others.

For adopting an integrated view and harnessing the potentials, it is important to ensure coordination, complementarities and synergies and avoid overlapping with segmented approaches. For instance, adaptation to climate change is related to water issues and hence, where relevant, the links with water management in a given country and region/sub-region need to be carefully taken into account as well as the synergies with possible investments in other

[11] See, for example, The Working Document of the Open Working Group on the Sustainable Development Goals (SDGs). Available from http://sustainabledevelopment.un.org/focussdgs.html#_edn33; United Nations, *The Report of the High-Level Panel of Eminent Persons on the Post-2015 Development Agenda* (New York, 2013); and ESCAP/ADB/UNDP, *Asia-Pacific Regional MDGs Report 2012/13,* Bangkok, 2013.

water-related sectors. Moreover, given the horizontal nature of adaptation to climate change and disaster prevention, careful consideration of and synergies with other policy areas and regional policies have to be taken into account. Synergies and complementarities between overall structural and investment opportunities, particularly in agriculture and rural development sectors should also be looked at.

Such an approach is likely to make a significant contribution towards achieving the targets and objectives of the strategies underlying the development thrusts of the Asia-Pacific CSN for achieving sustainable and inclusive growth. For harnessing the complementarities, the countries need to:

- develop strategies and action plans in social and economic areas and adapt these to climate change and risk prevention and management plans at national, regional and local level and for building up knowledge base and information observation and monitoring capacities, and mechanisms for the exchange of information;
- increased investments in all areas including adaptation to climate change and risk prevention and management as well as for avoiding damage and increasing resilience to the built environment and other infrastructure; protecting human health; decreasing future pressure on water resources; investing in flood and coastal defenses; and decreasing the vulnerability of ecosystems in order to increase ecosystem resilience and enable ecosystem-based adaptation;
- development of tools (detection, early warning and alert systems, risk mapping and assessment); and increased investment in disaster management systems, to facilitate disaster resilience and risk prevention and management for natural risks, including weather-related risks (such as storms, extreme temperature events, forest fires, droughts, floods) and geophysical risks (such as avalanches, landslides, earthquakes, volcanoes), and to support societal responses to industrial risks (early warning systems, risk mapping).

In addition, higher investment in adaptation and risk prevention means preserving socioeconomic development and enhancing the capacity for further development in these countries. It is widely recognized that the cost of inaction may significantly be higher than the required investments for harnessing the complementarities and synergies between social, economic and climate change areas and decreasing the overall vulnerability to climate impacts. In the Asia-Pacific CSN, there exists a situation of apparent market failure in these respects as institutions and individuals cannot afford the high risk premiums needed to ensure integration and cover potential losses due to climate change impacts. Also, returns on investment may not be in line with the timeframe of the infrastructure investments, increasing potential economic losses at a later stage. Moreover, exploring complementarities between social, economic and climate change areas has spillover effects on downstream activities (e.g. infrastructure users) not necessarily integrated into infrastructure and other investment decisions. Hence, it makes economic sense for these countries to explicitly consider complementarities across all relevant dimensions to ensure sustainable and efficient investment decisions.

It must also be recognized that for harnessing the complementarities, a relatively long term perspective is needed especially for taking into account possible climate impacts. For the purpose, the CSN may develop sector specific plans through carrying out comprehensive vulnerability assessments to underpin integrated social and economic policies based on adequate climate change consequences. Effective monitoring and evaluation is also needed based on measurable indicators and prudent monitoring methodologies.

Given the importance and the magnitude of the impacts, it may be useful for the Asia-Pacific CSN to treat the complementarity issues at a strategic level especially for the countries facing highest danger to climate change impacts. For the purpose, the critical starting point is to develop the 'knowledge base' for which regional efforts can support investments into the acquisition of needed studies, reports, scientific data and knowledge to set up complementarity exploring strategies, plans and programmes. It can also support information dissemination and capacity building of relevant stakeholders at the country level. For ensuring effectiveness, the adoption of a place-based approach is critical taking into account the effects of exposure to different types of risks to climate change and other adverse developments.

For the CSN, development of the needed ICT tools (e.g. Geographic Information Systems, detection and monitoring systems, early warning and alert systems, risk mapping and assessment and similar other areas) often represents an important need and is the key enabler for proper strategies and measures to be designed and implemented for incorporating climate change dimensions into the socioeconomic policy framework. Thus an important cornerstone within the regional policy is 'risk management' that could include: investments in disaster management systems (mostly ICT based) and infrastructure to deliver the adequate disaster management services. In a broader perspective, adapting to climate change and making the socioeconomic system more responsive to climate change impacts must aim at increasing the resilience of the society as a whole and of its sub-systems including investments in building ‘climate proofing’ infrastructure in transport, water system, health, energy, buildings (built environment and infrastructure), protecting human health, decreasing pressure on water resources, building flood and coastal defenses, and decreasing the vulnerability of ecosystems in order to increase ecosystem resilience and enable ecosystem-based adaptation (floodplains, wetland preservation, forest management etc.).

In actual practice, harnessing the complementarities between social, economic and climate change issues would involve a process which is mostly horizontal in nature. This means that solid and effective governance should be in place to ensure the required quality of investments. This would require that the responsibilities among ministries and agencies, in particular for the cohesion of policy related aspects, should be clearly established, including the involvement of relevant local authorities. In addition, weak capacities, including at the administrative level, can often act as a major hurdle that would require necessary investments in trainings and capacity building.

2.4. Narrowing Development Gaps: Financing Implications

For narrowing the development gaps of the Asia-Pacific CSN and meeting the challenges of the development agenda beyond 2015, the critical concern involves two aspects of financing: (i) raising the availability of development resources; and (ii) proper allocation and use of these resources keeping sustainable and inclusive development at its core. The priority is therefore to ensure a more effective allocation of existing resources and procure additional resources from domestic, external and other innovative sources.

The 2002 Monterrey Consensus of the International Conference on Financing for Development calls for adoption of sound policies, good governance at all levels and the rule of law along with mobilizing domestic resources, attracting international flows, promoting international trade as an engine for development, increasing international financial and technical cooperation for development, sustainable debt financing and external debt relief, and enhancing the coherence and consistency of the international monetary, financial and trading systems.

The Monterrey Consensus, while acknowledging that each country has the primary responsibility for its own economic and social development, maintains that the national development efforts need to be supported by an enabling international economic environment. For financing development especially of developing countries and countries with economies in transition (which include the Asia-Pacific CSN), a six-pronged leading action has been suggested.

i. **Mobilizing domestic financial resources for development**

Actions are needed to ensure necessary internal conditions for mobilizing domestic savings, both public and private, sustaining adequate levels of productive investment and increasing human capacity. In this context, a crucial task is to enhance the efficacy, coherence and consistency of macroeconomic policies. An enabling domestic environment is vital for mobilizing domestic resources, increasing productivity, reducing capital flight, encouraging the private sector, and attracting and making effective use of international investment and assistance.

ii. **Mobilizing international resources for development: FDI and other private flows**

Private international capital flows particularly FDI, along with international financial stability, are vital complements to national and international development efforts. To attract and enhance inflows of productive capital, countries need to continue their efforts to achieve a transparent, stable and predictable investment climate, with proper contract enforcement and respect for property rights,

iii. **International trade as an engine for development**

To benefit from trade, which is one of the single most important external sources of development financing, the establishment of appropriate institutions and policies in the Asia-Pacific CSN is needed. Meaningful trade liberalization is an important element in the sustainable development strategy of these countries. A particular concern of these countries is to enhance the capacity to finance their development, including addressing trade barriers, trade-distorting subsidies and other trade-distorting measures, particularly in sectors of special export interest to these countries including agriculture and trade in services.

iv. **Increasing international financial and technical cooperation for development**

In most Asia-Pacific CSN, ODA plays an essential role as a complement to other sources of financing for development, especially to reach adequate levels of domestic resource mobilization over an appropriate time horizon, while human capital, productive and export capacities are enhanced.

v. **External debt**

Sustainable debt financing is an important element for mobilizing resources for public and private investment. National comprehensive strategies to monitor and manage external liabilities, embedded in the domestic preconditions for debt sustainability, including sound macroeconomic policies and public resource management, are a key element in reducing national vulnerabilities. External debt relief can play a key role in liberating resources that can then be directed towards activities consistent with attaining sustainable growth and development.

As discussed earlier, most countries belonging to the Asia-Pacific CSN group have one of the lowest per capita incomes in the region (see table 2). Moreover, the income gaps with the region's developed economies have been widening significantly over the years. Most importantly, these countries lack the needed productive capacity due to limited progress in several areas including key infrastructure (covering such growth supportive areas as electricity, transport, ICT, water, human and institutional capacity), sustainable production and uninterrupted and adequate access to energy, skills and capacity to adapt cutting edge technologies and the slow development of rule-based institutions supportive of a dynamic and well-functioning private sector. For closing the development gaps and creating the capacity of the CSN to meet the internationally agreed development goals including the MDGs, these countries need adequate resources to bring about required structural transformations to build human assets and resilience against economic vulnerability.[12]

The Asia-Pacific CSN must work together to build bridges between development, finance, and trade organizations and initiatives within the framework of holistic global development. Greater cooperation among existing global institutions is needed based on a clear understanding and respect for their respective mandates and governance structures.

2.5. Investment Needs of the Asia-Pacific CSN

As discussed earlier, the Asia-Pacific CSN would require investing in a range of activities to meet the income, infrastructure, human assets, socioeconomic vulnerability and other development gaps.

In general, the CSN can access financial resources from two broad sources: domestic and foreign, both from public and private. Domestic investable resources include household, corporate and government savings. Foreign investable resources include funds from multinational corporations (e.g. FDI), international banking system (commercial short- and medium-term loans), international capital markets (foreign private portfolio investments), bilateral donor governments (e.g. ODA) and from multilateral development financial institutions such as the World Bank, ADB and other international organizations.

A regional perspective in terms of the development financing strategy options that could facilitate the mobilization of new and additional resources to close the development gaps of the Asia-pacific CSN would be useful for these countries especially for accessing funds like climate finance such as the mitigation and adaptation financing needs, availability of funds and policy options.

[12] For example, in order to graduate from the LDCs category, apart from increasing GNI per capita, the other two criteria mostly involve structural impediments that exist in the Asia-Pacific LDCs. For the Human Assets Index (HAI), the four indicators cover: (i) nutrition: percentage of population undernourished; (ii) health: mortality rate for children aged five years or under; (iii) education: the gross secondary school enrolment ratio; and (iv) adult literacy rate. Similarly, for the Economic Vulnerability Index (EVI), the indicators relate to (i) population size; (ii) remoteness; (iii) merchandise export concentration; (iv) share of agriculture, forestry and fisheries in gross domestic product; (v) share of population living in low elevated coastal zones; (vi) instability of exports of goods and services; (vii) victims of natural disasters; and (viii) instability of agricultural production. With rising global economic uncertainties and growing concerns regarding adverse consequences of climate change, the Asia-Pacific LDCs need to focus increasingly more on mobilizing resources from all sources to move towards successful graduation.

A related issue is the insufficiency of support, particularly ODA, available to overcome structural impediments of the Asia-Pacific CSN and how these countries could explore possible synergies between international support measures and national resources. These issues are related to the creation of global and national enabling environment, market access, trade facilitation, Aid for Trade, ODA, private (financial) flows, technology transfer, science-technology-innovation, and south-south and triangular cooperation. Along with greater availability and access to the international support measures, a key issue is the use of these support measures and science-technology innovation (STI) in creating the necessary national capacity to close the development gaps. Moreover, it is also necessary to emphasize that mobilizing financial resources is necessary but not a sufficient condition for closing the financing gaps in these countries. Perhaps an equally important issue is how the Asia-Pacific CSN manage to use these resources to close their development gaps and put them on an accelerated and sustained development path. In addition to political commitment, this requires adequate absorptive and institutional capacities and capabilities including human resources to formulate and implement country-focused development strategies. In fact, these capacity building efforts need to be an integral component of mobilizing and utilizing financial resources for development supported by a robust monitoring and evaluation system.

The Asia-Pacific region as a whole still remains the home to two-thirds of the world's poor and the region faces enormous development challenges and significant development gaps.[13] The financing of the development gaps requires substantial development resources in order to put the region on a sustainable development path. While some estimates of the region's needs to finance its sustainable development agenda are available, it is important to recognize that these estimates are at best underestimates. In terms of the region's large size, wide diversity of different sub-regions and the low level of development of the majority of the countries (out of 52 countries in the region, 31 countries belong to countries with special needs categories), the actual size of financing requirements is likely to be quite large. Moreover, despite greater potential for mobilizing resources from domestic and external sources, the CSN are constrained by their limited borrowing and absorptive capacity resulting from regulatory and institutional barriers.

According to the estimates of ESCAP in 2013, the Asia-Pacific region needs between $500 billion and $800 billion per annum during the period 2013 to 2030 only for closing the development gaps in the areas of education, health, employment, social protection and access to energy services.[14] The ESCAP also maintains that the Asia-Pacific CSN would require relatively more resources than other regional countries to implement the inclusive and sustainable development agenda. For example, these estimates indicate that Bangladesh and Fiji would require on average about 16.4 percent and 9.9 percent of their GDP respectively over the period 2013-2030 to provide universal access to modern energy services compared with an average of 8.2 percent of GDP for other countries in the region.

For the CSN in Asia and the Pacific, infrastructure is another critical component of the development gaps. The ADB estimates that the region would need $800 billion per year to close

[13] According to ESCAP estimates, 763 million people lived below the $1.25/day poverty line in the Asia-Pacific region in 2011.

[14] ESCAP, *Economic and Social Survey of Asia and the Pacific* (Sales No. E.13.II.F.2). Available from www.unescap.org/publications/survey/surveys/survey2013.pdf. These estimates are based on the need assessment of 10 countries (Bangladesh, China, Fiji, India, Indonesia, Malaysia, Philippines, Russian Federation, Thailand and Turkey) which account for over 80 percent of the population and 80 percent of GDP of the developing Asia-Pacific region. In an earlier study, UNESCAP estimated that the region needed $639 billion per annum to attain the MDGs by 2015. See UNESCAP, *Financing an Inclusive and Green Future,* Bangkok, 2010.. Available from www.unescap.org/sites/default/files/themestudy2010-

the infrastructure gaps by 2020.[15] According to ESCAP, the cost of investment projects in selected areas of transport exceeds $350 billion per year.[16] This is due to large demand for investment in the transport sector in terms of infrastructure and services, as well as for maintenance. Another World Bank study conducted in 2014 estimates that the South Asian sub-region alone would require between $1.7 trillion and $2.5 trillion to close its infrastructure gaps by 2020.[17] Moreover, the Asia-Pacific CSN need to mobilize additional resources to meet the challenges of their unprecedented urbanization and to fill the gaps in urban investment that undermine the transition of many of these countries to the middle-income status.

The Asia-Pacific CSN also need to pay greater attention to climate change issues including investments in mitigation and adaptation to climate change to address its adverse consequences and associated environmental impacts. The International Energy Agency (IEA) estimates that investments of nearly $14.3 billion per year from 2011 to 2030 are required to achieve universal energy access by 2030 for the Asia-Pacific region. Needless to say, most of these investments are needed in the CSN.[18] It is also estimated that the region needs to invest between $11.7 trillion and $19.9 trillion until 2035 in order to modernize the energy sector, including adaptation of new technologies and renewable forms of energy.[19] Similarly, according to the World Bank estimates, the costs for adaptation to climate change in the region would amount to $25 billion annually from 2010 to 2030.[20] It also needs to be remembered that the Asia-Pacific region is the most disaster prone region of the world.

The above estimates make it clear that the Asia-Pacific region needs to invest significantly higher amount of resources to bridge the existing development gaps and pursue the path of sustainable development. The estimates cover several critical areas including closing infrastructure gaps, providing access to sustainable energy, ensuring universal access to health, education and social protection, and implementing climate change mitigation and adaptation measures which will ensure both sustainable and inclusive development as well as enhance the potential for generating higher savings and investments which will create positive spillover effects on sustainable development investments. Although the above estimates of the region's investment needs for closing the development gaps are not strictly additive, ESCAP maintains that it could cost as much as $2.5 trillion per year to close the Asia-Pacific region's infrastructure gaps and implement climate change mitigation and adaptation measures.[21] The majority of these investments are needed in the Asia-Pacific CSN.

---

[15] Asian Development Bank, *Infrastructure for a Seamless Asia,* Manila, 2009. Available from www.adbi.org/files/2009.08.31.book.infrastructure.seamless.asia.pdf.

[16] ESCAP, *Review of Developments in Transport in Asia and the Pacific 2013: Transport as a Key to Sustainable Development and Regional Integration,* Bangkok, 2013.

[17] World Bank, *Reducing Poverty by Closing South Asia's Infrastructure Gap,* Washington D.C. 2014.

[18] International Energy Agency, *World Energy Outlook: Energy for All – Financing Access for the Poor,* Paris, 2011. The IEA estimates that average annualized additional investment would amount to $910 billion for mitigation through 2050, while the World Bank estimates the amount to be about $100 billion for the same period. Climate Policy Initiative, *The Global Landscape of Climate Finance 2013,* San Francisco, 2013.

[19] Asian Development Bank, *Energy Outlook for Asia and the Pacific* (Manila, 2013). Available from www.adb.org/sites/default/files/pub/2013/energy-outlook.pdf.

[20] See World Bank, *Economics of Adaptation to Climate Change - Synthesis Report,* Washington, D.C. Available from http://documents.worldbank.org/curated/en/2010/01/16436675/economics-adaptation-climate-changesynthesis-
report.

[21] See ESCAP, *Sustainable Development Financing: Perspectives from Asia and the Pacific,* Background Paper for the Asia-Pacific Outreach Meeting on Sustainable Development Financing, Jakarta, 10-11 June 2014.

3. FINANCING OF DEVELOPMENT GAPS: SOME ISSUES

For narrowing the development gaps in the CSN, an important concern that a realistic development agenda must confront is the issue of resource gaps to meet the required expenses. Within the financial framework for the post-2015 development agenda, it is important to include financial resource flows towards the priority sectors in an explicit manner. For example, there could be targets for both domestic and ODA spending for priority areas like infrastructure, health, education and social protection which were mentioned only for ODA expenses in the MDG framework in a loose form; and even these were weakly monitored. In this context, one important issue which needs to be examined is: Are there any better approaches that can be adopted? How should the lack of serious specific domestic commitments towards priority spending towards basic services be addressed in the future development framework? What are the concrete ways in which the development framework can be integrated with a resource framework and firm commitments in the post-2015 context?

For meeting the development gaps, there seems to exist a broad agreement that Asia-Pacific CSN need long-term planning as well as short-term resource allocation and policy formulation. For the purpose, a range of actions is needed at the country level, including identifying appropriate strategies, reforming policies and institutions, and investing sufficient resources in a coordinated manner to build local capacity to deliver and scale up interventions. Within the framework, an assessment of the required financial resources is a critical first step in formulating, implementing, and monitoring progress of strategies to achieve the development goals.

Box 1. Innovative approaches to bringing electricity to off-grid communities

There are about 628 million people in the Asia and the Pacific region who do not have access to electricity. Many of these people live in the rural areas of the countries with special needs. The ESCAP has taken up innovative initiatives with the private sector through its 'Pro-Poor Public-Private Partnership' (5P) project to provide access to electricity to the unserved population.

The focus of 5P programme is on electrifying off-grid communities by developing partnership opportunities for the private sector and the concerned communities for creating an energy utility-- such as a mini solar grid-- in the form of a joint-venture which allows the community to earn returns on its ownership share. The community can use the earned revenue for financing community and development activities. The model, first initiated in Cinta Mekar in Indonesia ten years ago, has now been piloted in Lao PDR and Nepal.

A comprehensive analysis of 5P within the local context by the Global Institute for Tomorrow (GIFT) Global Leaders Programme provides private sector perspectives on business, financing and policy recommendations for replicating the model. The analysis redefines what the goals of rural electrification are, taking an approach in which market expansion and enterprise development through venture capital can lead to community development, based on access to energy services. The recommendations are being incorporated into the 5P framework for implementation in Xayabouly Province of Lao PDR. The programme's business-oriented outlook is an important perspective to incorporate into the 5P and similar other projects which will enhance the innovation and sustainability of the public-private approach to off-grid electrification.

The issue of mobilizing finance for development has always been a central concern for the Asia-Pacific CSN. Indeed, Goal 8 of the MDGs, *'Develop a Global Partnership for Development'* recognized that MDG achievements would require enhanced international cooperation and partnerships, including a significant scaling up of resources for investing in MDG outcomes of these countries.[22]

[22] It may be mentioned here that the MDG framework did not include financial resource flows to MDGs explicitly

Along with a substantial rise in aid inflows, the Paris Declaration (2005) emphasized several principles to enhance aid effectiveness, such as national ownership and aid alignment, aid harmonization, and aid predictability. Although the 2005 Paris Declaration on Aid Effectiveness represents the most comprehensive effort to date to improve aid coordination and alignment with national priorities, in view of the slow progress in meeting the Paris targets for 2010, the Accra High Level Forum on Aid Effectiveness in 2008 urged to accelerate efforts to improve the predictability of aid, and reduce aid fragmentation and high transaction costs in the administration of aid resources.

The later years, however, did not witness any commensurate rise in aid inflows to match the requirement especially in the CSN in Asia and the Pacific. For example, the absolute amount of ODA received by the Asia-Pacific LDCs declined for almost all countries; and the aggregate volume received by the 13 Asia-Pacific LDCs declined from US$ 2,924 million in 2000 to US$ 2,174 million in 2009.[23] Moreover, there has been no explicit target for allocating domestic resources by the countries to MDG related sectors such as health, education, social protection and other priority areas. Of course, one should also emphasize that mere availability of resources is not sufficient; many other conditions are necessary for accelerating development including rapid and high quality inclusive growth, improved policies, and performing institutions.

In the case of aid, there seems to exist some evidence that, in recent years, the shift in terms of quality is more pronounced in multilateral rather than in bilateral aid, perhaps because of geopolitical and other bilateral interests. There exists some evidence that increase in ODA in specific areas does not necessarily mean availability of more resources in that particular area. Sometimes increased ODA may lead the recipient countries to substitute away domestic resources to other purposes. For example, according to IHME data, for every $1 of development assistance for health (DAH) channeled through the government, governments on average diverted $0.43 to $1.14 away from the health sector. This, however, may not necessarily be problematic if these resources were diverted to investments which themselves can provide basic services and benefits, such as water supply and sanitation, food security, rural roads, electrification and other priority areas. In addition, there seems to be a bias among both the donors and the recipient countries alike to achieve easily monitored and visible results rather than priority outcomes requiring system wide approaches whose impact may be more difficult to measure and achieve.

Obviously, there should be a re-thinking about the adequacy and appropriateness of the current strategies for financing development especially for the Asia-Pacific CSN. For instance, the focus on economic growth and investment in social sectors with little thinking on how economic growth or social sectors could be made more inclusive and pro-poor has produced somewhat biased outcomes in the past decades. On the other hand, investments in infrastructure, agriculture or other productive activities were inadequate. Probably a broader approach to meeting the development gaps is required in future with a right balance between investments in social sectors with development strategies that seek to combine economic growth with employment creation and participatory development. This is not only about reformulating policies, but also about rethinking of the development paradigm in the Asia-Pacific CSN.

---

except in the context of ODA under Goal 8.

[23] See ESCAP, *Asia-Pacific Least Developed Countries in the Next Decade: Strategy and Policy Agenda for Building Productive Capacities,* MPDD Policy Briefs No. 8, Macroeconomic Policy and Development Division, ESCAP, Bangkok, May 2011.

Further, relative to earlier years, the development outcomes in the Asia-Pacific CSN would be increasingly shaped by international contexts during the post-2015 period as a consequence of increasing globalization and economic integration. This will encroach more on the domestic policy space in these countries. There are also rules under the WTO regime and conditionalities imposed by the international organizations and donor countries. The policy space problem would be further compounded by rapid integration of these countries into the international financial markets. For the international community, it would be useful to make existing rules less unfair and introduce new and more equitable rules. The goal should be to enlarge, as much as possible, the policy space available for pursuing national development objectives by these countries.

For meeting the key challenge of reducing poverty further in the post-2015 era, the main strategy would be to promote growth that leads to fast increases in household consumption. Empirically, it is seen that as countries become richer, the poverty reducing effect of economic growth declines. As such, the Asia-Pacific CSN will have to increasingly depend on redistributive policies for poverty reduction which would become both more affordable and more effective as these countries grow at faster rates. In addition, closing the development gaps in the post-2015 era, as we have noted earlier, will require substantial rise of expenditures on education, health, sanitation, and other basic infrastructure facilities and services. While funding the additional investments does not seem daunting, these costs can be steep in terms of share of GDP especially for many of the Asia-Pacific CSN. This indicates continued relevance and case for stepping up ODA to meet the challenges.

For many of the Asia-Pacific CSN, remittances have emerged as a much larger and more stable source of external financing than aid inflows. Thus, it might be worth examining the policies and mechanisms which could more effectively use remittances for development. Moreover, access to other than financial options such as markets in the form of trade and access to knowledge in the form of technology is important for these countries to achieve the desired goals.

3.1. Extending and Enlarging the Fiscal Space

For the Asia-Pacific CSN, a prudent financing strategy during the post-2015 period would increasingly depend on enhancing the fiscal space to scale up expenditure in relevant areas in order to close the development gaps. For the purpose, four major mechanisms may be conceived: (i) enhancing domestic revenues from tax and non-tax sources; (ii) increasing ODA including grants, concessional loans and debt relief; (iii) reprioritizing expenditures, including enhancing their allocative and technical efficiency, and (iv) financing public expenditures by borrowing from domestic and international sources.

In practice, the extent to which the Asia-Pacific CSN could expand the fiscal space would depend critically on two elements: (i) scope of generating fiscal savings from improved allocative and technical efficiency of existing spending; and (ii) capacity to raise additional fiscal resources from new revenue measures, additional aid or new borrowing.

To the extent that a country already raises significant revenue, it has a high initial stock of debt, or receives relatively high aid inflows, the scope to raise additional revenue from any of these sources would be limited. On the other hand, the lower the allocative and technical efficiency of the existing budget and the larger the volume of such spending, the greater would be the scope for efficiency gains as a source of expanding the fiscal space. In reality, the scope of raising additional revenues from all the above sources appears to be wide for most Asia-Pacific CSN.

For these countries, it is also important not to assign the role of fiscal policy as a tool for reducing government deficits or restoring macroeconomic balances alone. Its role as a powerful instrument for promoting employment and economic growth should also be recognized. Similarly, monetary policy is not only a means of controlling inflation rather it should be treated as a versatile instrument through which both the price and volume of credit can be effectively used in the pursuit of development objectives. The policy framework needs to adopt a developmental approach based on an integration of short-term counter-cyclical fiscal and monetary policies with long-term development objectives. In addition, the term 'resource' should be interpreted having a wider connotation covering not only financial but also human, institutional, social, technical and other forms of capital that play important roles in the process of development of these countries.

For the Asia-Pacific CSN, the pre-2015 era has seen significant gaps in delivering on the commitments in the areas of aid, trade, debt relief, and access to new technologies. A number of crucial commitments including increased aid volume, improved aid effectiveness, and the conclusion of the Doha Round of trade negotiations have not been met as yet. Moreover, there has been significant adverse impact of the global crisis on meeting many targets in these countries. The post-2015 agenda needs to pay more attention to policy coherence covering not only the issues of coherence across various dimensions of the global partnerships, but also the extent to which those partnerships are aligned behind national development strategies of these countries.

While exploring domestic and regional policy options to scale up resource mobilization, the Asia-Pacific CSN need to have an enhanced flow of ODA and other development assistance. In this context, the ESCAP proposal to re-direct the region's large foreign exchange reserves and private savings to productive investments in the region, particularly in infrastructure, by establishing a region-wide large-scale lending facility in addition to modernizing and linking capital markets across the region deserves careful consideration.

3.2. Sustainable Financing: Regional and Country Level Issues

Financing for development is an important agenda for the Asia-Pacific CSN where wide development gaps persist in most countries. The countries need substantial additional resources to bridge the gaps in critical investments including MDGs related areas and basic infrastructure such as electricity, roads and safe water and for introducing and expanding social protection programmes and various growth and employment supporting measures in the light of global economic crisis and volatile food prices. This calls for a comprehensive resource mobilization agenda covering both increased domestic resource mobilization and enhanced flow of ODA while exploring innovative and regional policy options to scale up resource mobilization.

One of the major financing challenges facing the development agenda of the Asia-Pacific CSN is to mobilize adequate resources to meet significant investment needs in public goods, such as closing huge infrastructure gaps; providing required education, health and other basic services; ensuring continued flow of ecosystem services in view of the threats of climate change and other challenges; and creating the environment for enhanced private investments both from domestic and external sources. In most of these countries, such investments need to be leveraged from public resources as these investments are characterized by high social rates of return but having low private returns. In addition, both supportive public finances and domestic capital markets are needed to be ensured including innovative sources of finance such as carbon taxes, diaspora bonds, financial transaction taxes and similar other revenue sources.[24]

An important policy agenda for the CSN is to create and maintain a development-oriented macroeconomic framework including fiscal sustainability and price stability. For the purpose, the countries must also manage domestic and external public debt in a prudent manner in order to minimize the adverse effects on economic growth, inflation, exchange rate, interest rate, and other macroeconomic fundamentals.

The present scenario of private capital inflows is characterized by high concentration in a small number of Asia-Pacific CSN. Such uneven flows bring significant difference in financing challenges facing these recipient countries from the countries that do not receive such private resource inflows. While the policy priority of the former group of countries is to maintain large and stable inflows, the need for the latter is to put in place appropriate policy packages to encourage further inflows of resources. These countries need to put greater attention on two critical aspects of the macroeconomic framework for attracting foreign private financial resources: (i) strengthen domestic market regulations; and (ii) improve infrastructure services. As such these countries need more ODA to supplement existing resources.

The present analysis on financing the development gaps in the Asia-Pacific CSN indicates that these countries need to explore different options based on country-specific and adequately tailored approaches, modalities and incentives to mobilize needed resources. The resource mobilization efforts must involve existing and new sources of domestic, external and innovative financing. There is also a need for deploying resources efficiently towards achieving the desired development outcomes within a broad framework covering several common characteristics:

- Prioritize investments that ensure greater integration of economic, social and environmental dimensions to harmonize the development efforts and derive maximum synergies;
- Follow a development path that generates inclusive, employment-intensive, and resource-efficient growth to promote socioeconomic equity and sustainability;
- Increase both the quantity and quality of public investments in key areas including infrastructure, energy, transportation, social services such as health, education, water and sanitation, and social protection systems;
- Strengthen institutions and governance structures, ensure conducive climate for both domestic and foreign private investments, create adequate market incentives and inclusive finance; and promote investments in climate mitigation and adaptation;
- Ensure proper pricing of resources and products to close existing gaps in social and private returns due to social and environmental externalities.

In addition to traditional domestic resource mobilization and existing external financing mechanisms (e.g. ODA), financing development gaps in the Asia-Pacific CSN also needs to explore innovative financing mechanisms. The need for the CSN is to adopt a new and

[24] For details, see *The Working Document of the Open Working Group on the Sustainable Development Goals (SDGs).*, Available from http://sustainabledevelopment.un.org/focussdgs.html#_edn33; United Nations, *The Report of the High-Level Panel of Eminent Persons on the Post-2015 Development Agenda,* 2013, New York, 2013 and ESCAP/ADB/UNDP, *Asia-Pacific Regional MDGs Report 2012/13,*Bangkok, 2013, World Bank, *Financing for Development Post-2015,* Washington D.C., 2013. Available from www.worldbank.org.

ambitious financing strategy for each country depending on its level of development and state of existing financing. While mobilizing additional resources through existing domestic and external sources remains a priority, supplementing these sources through adopting prospective and innovative financing is a big challenge for these countries.

In this context, it is important to note that success in many of these efforts, especially involving the private sector, in the Asia-Pacific CSN requires significant investments in public goods and services including infrastructure, energy, ICT and environment to ensure continued flow of ecosystem services. With high social returns and relatively low private returns, these investments need leveraging of public domestic resources along with complementary role of ODA. One must also recognize that the Asia-Pacific CSN reflect greater vulnerability when confronted with economic, social and environmental challenges.

3.3. Resource Mobilization: Mobilizing Domestic and External Resources

Mobilizing domestic and external resources to increase financing for development is a key pillar in the development agenda beyond 2015 especially for the Asia-Pacific CSN. For these countries, the most important component of financing relates to raising additional domestic resources by strengthening tax and non-tax revenues.

In view of the urgent need to close the development gaps in the Asia-Pacific CSN, there is now a renewed interest in strengthening the existing institutional mechanisms and modalities for financing the sustainable development agenda for these countries along with leveraging new, emerging and innovative avenues of financing from different sources, both domestic and external. In this context, the United Nations General Assembly resolution 65/1 mentions that such sources of finance should be stable and predictable and they should supplement – and not substitute – traditional sources of finance.[25]

This section examines both domestic and external sources of funding and also looks at both public and private dimensions of these sources (table 3). Although these sources are treated as distinct, it is important to recognize that resource mobilization from public sources and supportive policies can leverage private financing to meet the growing and emerging requirements of finance in the Asia-Pacific CSN.

Table 3. Different sources of financing for closing development gaps in Asia-Pacific CSN

Traditional		**Innovative**	
Domestic	**External**	**Domestic**	**External**
Public -Tax revenues -Other (non-tax) revenues	*Public* -Bilateral and multilateral donors (e.g. ODA) -Multilateral development financial institutions	*Public* -Leveraging financial inclusion -Islamic banking finance -Introducing new and innovative taxes (e.g. carbon tax) -Ensuring trade finance for SMEs and other small entrepreneurs -Encouraging PPPs	*Public* -Accessing climate finance -Using aid for trade -Deepening South-South cooperation and triangular development cooperation

[25] See General Assembly resolution 65/1. Available from www.un.org/en/mdg/summit2010/pdf/mdg%20outcome%20document.pdf.

Private -Household saving -Corporate saving	*Private* -Global financial market -FDI -Multinational corporations -Remittances from overseas migrant workers	*Private* -Developing capital markets -Involving institutional investors	*Private* -Blended finance -Loans, equity investments, guarantees

3.3.1. Domestic taxation

For the Asia-Pacific CSN, there exists significant potential for increasing tax revenues as the collection of tax revenues in these countries is low, not only compared with the developed regions or countries but other developing regions in the world.[26] In 2011, average tax-to-GDP ratio in the Asia-Pacific region was only 14.8 percent for central government revenues compared with 17.1 percent in Latin America and the Caribbean and 16.3 percent in sub-Saharan Africa. In the same year, the average tax revenue of the general government was 16.9 percent of GDP for the region's developing economies compared with 24.2 percent for the developed economies. One must also note that most of the Asia-Pacific CSN have the lowest tax-GDP ratios in the region. Figure 3 shows that only five of the Asia-Pacific CSN (most of which are resource-rich e.g. Armenia, Kirgizstan, Kiribati, Mongolia and Vanuatu) collected tax revenues higher than 15 percent of GDP in 2012. On the other hand, there are a few countries whose tax-to-GDP ratios are in the single digits.

There exist a number of reasons for the low tax-GDP ratios in the Asia-Pacific CSN. A major factor is that the majority of the labour force in these countries is employed in the agriculture and informal sectors which are usually untaxed. Moreover, the personal income tax collection system is at an early stage of development and the tendency of the wealthier individuals to evade income tax (either partially or fully) is very high. Similarly, taxing capital gains more effectively could contribute to higher tax-GDP ratios in these countries but this is often constrained by difficulties in valuing capital gains and the perceived negative impacts about the tax. The countries need to strengthen the mechanisms for taxing capital gains in securities or property and explore the possibility of introducing dual income tax systems which not only impose increasing marginal rates on income but also taxes income on labour and capital separately. Obviously, there are significant challenges and complexities in operationalizing a dual tax system in these countries where tax systems do not treat labour and capital income separately. But these countries need to explore various options and possibilities of improving the tax systems.

Although many of the Asia-Pacific CSN have introduced value added tax (VAT) or general sales tax (GST) since the 1990s leading to significant increase in revenues, the collection efficiency of VAT and/or GST remains low.[27] A large part of tax revenue in these countries is also eroded by exemptions and concessions in the tax system often introduced to attract FDI which include policies such as tax holidays, reduced corporate income tax rates, investment tax allowances and partial profit exemptions to reduce the cost of capital. According to ESCAP, if 17 countries in the Asia-Pacific region can fully tap their tax potential, they could raise more

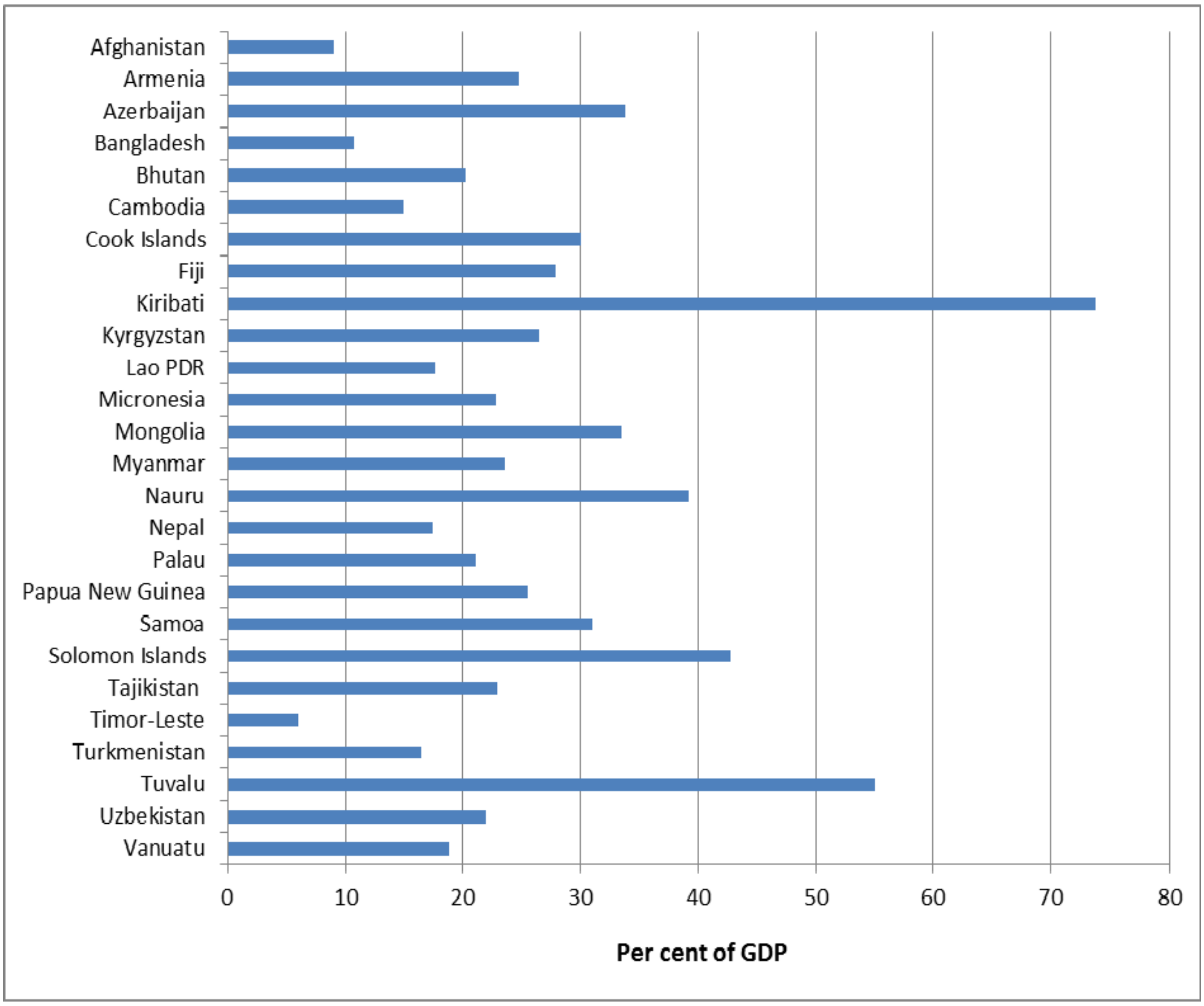
[26] See ESCAP, *Shifting from Quantity to Quality: Growth with Equality, Efficiency, Sustainability and Dynamism,* Bangkok, 2013. Available from www.unescap.org/sites/default/files/Shifting%20from%20quantity%20to%20quality.pdf.

[27] The ESCAP estimates that the collection efficiency is less than 40 percent in Bangladesh, India, Malaysia and Pakistan and the VAT gaps are 50–60 percent in Indonesia. As a result, additional revenue from these taxes has often fallen short of offsetting the declines in trade tax revenue. See UNESCAP, *Economic and Social Survey of Asia and the Pacific 2014,* Bangkok.

than $440 billion in tax revenues yearly of which $306 billion would be raised in developing countries in the region. At present, most countries in the region collect tax revenues which are well below their potential (see table 4). As the table indicates, several CSN have tax potential which is quite sizeable, amounting to several percentage points of GDP. In other CSN for which quantitative data are not available, the situation is likely to be very similar. If these countries could tap these potentials, tax revenues would increase substantially in these countries.

In recent years, several Asia-Pacific developing countries have been exploring the possibilities of introducing innovative financing mechanisms for investing in key development efforts. For example, several countries in the region have explored payments for ecosystem services to create incentives for sustainable use and conservation of natural resources. In Vietnam, this has already created measurable impacts on poverty and forest loss.[28] There are examples of other innovative financing mechanisms in the region as well (see box 2). The Asia-Pacific CSN need to explore these and other innovative sources of resource mobilization from domestic sources for enhancing the availability of investible resources for development.

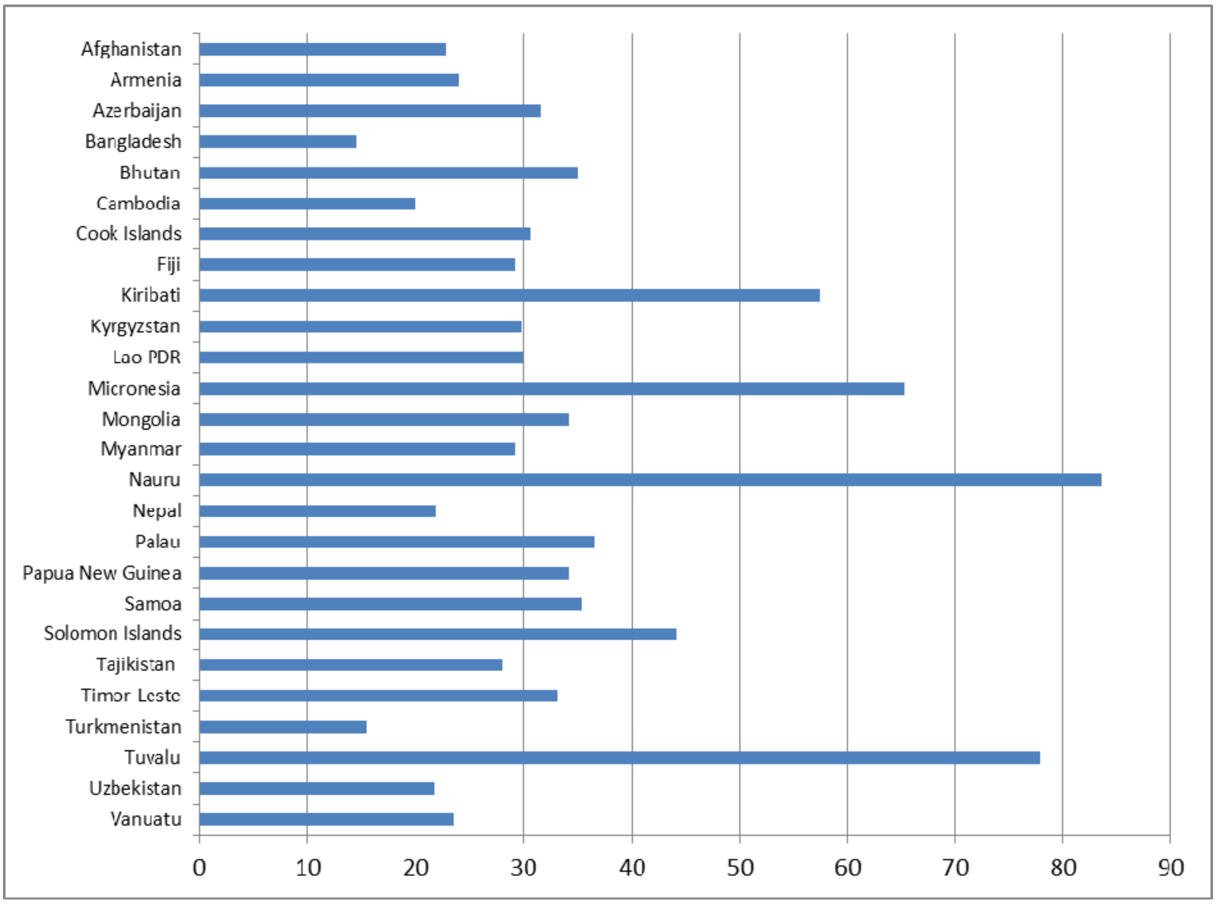
Figure 3. Tax-to-GDP ratio in selected Asia-Pacific CSN



Source: World Bank, *World Development Indicators 2014.*

[28] See P. Xuan and C. Santiago, “Vietnam leads Southeast Asia in payments for ecosystem services”.

Figure 4. Government expenditure as % of GDP in selected Asia-Pacific CSN



Source: World Bank, *World Development Indicators 2014*

Key challenges

For enhancing domestic revenues, the Asia-Pacific CSN should explore multiple ways to strengthen the overall tax system including harmonizing and rationalizing income tax rates, broadening the tax base, plugging loopholes and tax evasion, and make the tax administration more efficient and tax-payer friendly; strengthening VAT and capital gains tax and other potential sources. One general principle that needs to be followed is to avoid very high rates which result in greater incentives for tax evasion and higher welfare losses. Similarly, high tariffs encourage smuggling, illicit trade and under-invoicing of imports.

For raising income tax collection, the Asia-Pacific CSN need to put greater efforts to broaden the tax base and promote a fair income tax system that ensures the right balance between growth and equity. For VAT and GST, the critical issues are raising the collection efficiency, tackling non-compliance and evasion, and extending coverage to different sectors which currently remain exempt. The CSN need to put more efforts for taxing capital gains effectively particularly in securities and property.

Table 4. Estimated tax potential in selected Asia-Pacific CSN

Country	Year	Tax-GDP ratio		Tax gap	Tax gap in million US$
		Actual	Potential		
Afghanistan	2011	8.8	15.0	6.2	1,268
Azerbaijan	2012	12.9	15.1	2.1	1,425
Bangladesh	2013	10.5	18.0	7.5	8,774
Bhutan	2009	9.2	16.0	6.7	120
Cambodia	2011	10.0	13.0	3.0	427
Nepal	2013	15.2	16.1	0.9	163

Source: ESCAP, *Economic and Social Survey of Asia and the Pacific 2014,* Bangkok.

The key challenge, however, is to address tax evasion which is pervasive across most SCN in Asia and the Pacific. For minimizing such evasion, several mechanisms may be attempted such as through deducting more taxes at source through withholding or advance taxes, introducing minimum taxes on companies and associations, and dealing with tax havens and tackling transfer pricing by multinational corporations through greater regional cooperation.

Box 2. Innovative methods of financing basic education and road network in India

In India, financing of the *Sarva Siksha Abhiyan* (education for all campaign), is being done through levying a 2 percent surcharge on income tax payable by any assessment which is collected as 'education cess'. The revenue thus collected is used to finance universal access to good-quality basic education. Similarly, the Indian Parliament passed an Act in 2000 to establish the Central Road Fund. The Fund is used to finance the development and maintenance of national highways, state highways and rural roads and for provision of roads over bridges and under bridges, and other safety features at unmanned railway crossings. The Fund is generated through introducing a levy ('cess') of Rs. 2 per litre on petrol and high-speed diesel oil.

Source: ESCAP.

3.3.2. More prudent management of public resources

The Asia-Pacific CSN can release significant public resources for development through rationalization and more effective allocation and management of the budget and overall public expenditure framework.

Many CSN can reduce non-developmental expenditures, including defense expenditure, which may appear relatively high (e.g. more than 10 percent of total public expenditure in the case of Bangladesh) in relation to their level of development. In the case of several countries, defense expenditure exceeds that on health and education taken together. These countries need to find out ways to reduce such non-development expenses. This will significantly increase the ability of these countries to enhance capital and development expenditure in the public sector. Similarly, many CSN spend significant resources on subsidies especially on fuel and food.[29] In view of the pressing need to invest resources in more productive activities, rationalizing subsidies is a key reform to raise public resources for productive investment in these countries.

[29] For example, in Uzbekistan energy subsidies exceeded 50 percent of total government revenue in 2011 while in Turkmenistan the share exceeded the government revenues by more than a fifth. In Bangladesh and Kyrgyzstan, energy subsidies consumed between a quarter and half of total government revenues. Energy subsidies exceeded 3 percent of GDP in Bangladesh and 5 percent of GDP in Kyrgyzstan, Turkmenistan and Uzbekistan. See, *Energy subsidy reform: lessons and implications,* IMF 2013. Such subsidies often benefit the rich in society the most and are considered environmentally harmful.

Despite the fact that removing or reducing subsidies involves decisions that is often politically challenging, a pragmatic approach to reforming energy subsidies would enable the Asia-Pacific CSN to significantly increase resources for financing development.[30] According to ESCAP estimates, savings from these subsidies would be sufficient to finance a comprehensive policy package comprising income security for the entire elderly population and all those with disabilities, as well as providing universal access to health and education in Bangladesh.

Another promising avenue for raising public resources for development by the Asia-Pacific CSN is through curbing illicit financial flows including various methods of tax evasion and avoidance. According to some estimates, more than 60 percent of the estimated $5.9 trillion that flowed out of the developing countries illicitly or illegally between 2001 and 2010 to evade or avoid taxation is accounted for by the Asia-Pacific region.[31] The LDCs, which are among the poorest in the world, are also not immune from such illicit outflows as the estimate for such outflows reached $35 billion between 1990 and 2008 for Bangladesh.[32]

One popular and widely used mechanism for avoiding tax payments is through mispricing of trade (e.g. over-valuation of imports or under-valuation of exports). Through such manipulation, profits are transferred from one country to another, generally from countries with high- to countries with low-tax regimes. Estimates of such mispricing run into millions of dollars for many Asia-Pacific CSN. Similarly, multinational corporations (MNCs) often price transactions between subsidiaries in different countries in such a manner that enables to divert profits to low-tax countries and thereby minimize their tax liabilities. In order to plug such loopholes, it is necessary to develop mechanisms for proper apportionment of costs between the domestic and foreign operations of firms operating within countries so that there is no loss of tax revenues, especially in the presence of treaties for avoidance of double taxation.[33] Overall, the critical agenda for the countries would be to make the existing pattern of public expenditure more effective and development oriented through reprioritizing existing expenditure more towards development and making it more effective by reducing low priority and unproductive expenditures.

3.3.3. Banking sector

The banking sector provides the bridge between the savers and the entrepreneurs and acts as the primary allocator of funds among different activities in an economy. In the Asia-Pacific CSN, the banks are increasingly engaged in financial intermediation and, in several of these countries, banks account for more than 90 percent of total domestic private credit. In many CSN, the banking sector has witnessed rapid growth in the past decade leading to significant progress in financial deepening in these countries.[34] However, despite commendable performance in achieving financial depth, these economies need to move much faster to reach comparable levels of the more advanced country groups in the region.

[30] See ESCAP, *Sustainable Development Financing: Perspectives from Asia and the Pacific,* Background Paper, Asia-Pacific Outreach Meeting on Sustainable Development Financing, Jakarta, 10-11 June 2014.

[31] See D. Kar, and S. Freitas, *Illicit Financial Flows from Developing Countries: 2001-2010,* Global Financial Integrity, Washington D.C. 2012.

[32] See D. Kar, *Illicit financial flows from the least developed countries: 1990-2008*, United Nations Development Programme Discussion Paper, 2011. Available from http://works.bepress.com/dev_kar/3.

[33] In this regard, the Asia-Pacific CSN may adopt appropriate transfer-pricing rules in their tax laws and methods to compute the ‘arm’s length price’ based on international best practices. In this respect, the countries may also consider some degree of harmonization of taxation of profits of MNCs.

[34] For example, domestic credit to the private sector in Timor-Leste surged from 1.5 percent of GDP in 2002 to 24.1 percent in 2006 before being hit by the global economic crisis. Bhutan registered almost five-fold growth in domestic private credit between 2000 and 2013 while similar growth in Cambodia was seven-fold.

In most of these countries, ongoing financial sector reforms have been playing key roles in rationalizing banking regulation, addressing structural problems, strengthening prudential norms and promoting greater competition among the banks and other financial institutions. However, available evidence suggests that there still exists significant space for further improving efficiency in performance of the sector. The countries need to adopt prudent and flexible policies which would strike a right balance between financial liberalization necessary for efficiency and growth and strengthened regulation necessary for stability and sustainability.

3.3.4. Capital market development

Although the capital market is relatively underdeveloped and weak in Asia-Pacific CSN, the countries need to exploit the potential of the capital market to facilitate the channeling of private savings to productive investments. Despite being poor in the region, these countries have large savings which are mostly untapped for investment in development activities.[35]

Equity market

The equity market as a share of total financial sector assets is relatively small in the Asia-Pacific CSN although stock markets in several of these countries have experienced impressive growth in recent years. However, dynamic markets are almost non-existent in these countries that have strong potential for cross border listing. In the CSN, the stock markets also vary significantly in terms of market capitalization. In smaller CSN, the breadth and depth of markets is quite limited because of lack of liquidity, low level of corporate listings, weak regulatory frameworks and lack of effective corporate governance. With proper policies and effective measures, equity markets can emerge as important sources of corporate financing in these countries.

While it is important to adopt policies to make these markets vibrant so as to offer high returns, it would be necessary to take adequate precautionary measures to discourage excessive speculative trading and short term volatile capital inflows that could destabilize the equity markets. In addition, the regulatory framework should be strengthened such that the pricing of stock issues may truly reflect economic and corporate fundamentals reducing the potential for market price volatility. The Asia-Pacific CSN have the scope for pursuing reforms to address a range of constraints holding back the growth of equity markets including weaknesses in the legal, regulatory and governance frameworks.

Bonds market and institutional investors

Although there has been rapid growth of the markets for local currency (LCY) bonds in many Asia-Pacific countries especially after the 1997/98 Asian financial crisis, the CSN significantly lag behind in this development. This shows the inability of these countries to reduce dependence on foreign borrowing through meeting their financial needs with domestic resources which is necessary to reduce the extent of currency mismatches. One of the major factors behind the slow development of the market for LYC bonds is the virtual absence of both domestic and foreign institutional investors such as mutual funds, pension funds and insurance companies in these countries which could broaden the investor base creating the demand for LCY bonds.

---

[35] The importance of capital market development as a part of the domestic resource mobilization strategy has been recognized in the 2002 Monterrey Consensus on Financing for Development and its follow-up 2008 Doha Declaration.

There exists a variety of institutional investors including pension funds, mutual funds, insurance companies, sovereign wealth funds (SWFs) and investment managers. In the Asia-Pacific region, top institutional investors include asset management firms such as insurance companies and mutual funds, pension funds and SWFs and most of these funds are managed by firms from the region's developed countries. For the CSN, the role of institutional investors such as asset managers, pension funds and SWFs can be conceived as an increasingly important source of funding for long-term investment, including in infrastructure.

It is important, however, to remain cautious regarding increasing participation of global institutional investors in the nascent markets of the CSN, particularly in the LCY bond markets, which could result in heightened exposure to global financial conditions, contagion and herding. For instance, sudden large capital outflows from these markets can induce financial distress through their effects on exchange rates and the balance sheets of the banks, firms and the households.

In view of the risks of relying too much on global institutional investors for the development of domestic capital markets, the CSN should emphasize more on developing a larger local investor base and better institutions and adopt prudential norms and guidelines in designing policies and regulatory frameworks to encourage institutional investors to invest in long term infrastructure and other projects. In addition, the CSN can benefit from the development of regional bond markets which would require several measures such as harmonizing tax rules, setting common standards for bond issuance, developing cross-border clearing, settlement and payment, and depositary systems, as well as regional credit rating agencies. Many CSN in the Asia-Pacific region could also consider the development of innovative finance institutions, such as Islamic banking (see box 3).

Overall, the policy agenda of the Asia-Pacific CSN needs to identify the fostering of financial inclusion as a critical factor in strengthening development financing and addressing rising inequality and widening development gaps in the region. In most of these countries, the large majority of the adult population, especially the poor and vulnerable sections in society, typically remains excluded from core financial services (e.g. savings, credit and insurance), lack access to reliable financial services and suffer from low financial literacy and capability. The cross-country variation in access to financial services is partly explained by several factors e.g. per capita income, urbanization and financial depth but also in terms of individual characteristics such as gender, education level, age, and rural or urban residence.[36]

One of the key messages that come out of the success of microcredit is that the poor need not only credit but also savings, insurance and other financial services to come out of poverty and social deprivations. An innovative way to enhance access to these services is through adopting explicit financial inclusion policies which, coupled with the explosion of mobile penetration and the launching of Mobile Financial Services (MFS), have now created an environment for reaching unbanked populations in all locations in the CSN of the Asia-Pacific region.

Since the digital payment systems have already taken hold especially in the rural communities of several Asia-Pacific CSN, the governments in these countries should work with banks, insurance companies, and other financial service providers to increase the range of financial services that the poor people, especially the small and marginal farmers and women, can access in digital

[36] See A. Demirguc-Kunt, and L. Klappe, *Measuring Financial Inclusion: The Global Findex Database*, Policy Research Working Paper, No.6025, World Bank, 2012, Washington, D.C.

form. As a reasonable degree of connectivity in the rural areas of these countries is already established, the efforts should be to extend the reach of digital payment systems into rural communities and encourage the poor people to adopt these systems through digital interface. In this respect, payment systems would be crucial since they enable people to collect payments, purchase goods, pay for water, electricity and other services and send money to family and business partners. They would also enable the governments to collect taxes and disburse social payments.

Box 3. Islamic banking finance: A potential source for Asia-Pacific CSN

Islamic finance (*Shari'ah*-compliant finance) has the potential of emerging as one of the innovative sources of bond financing especially for infrastructure. It can also deepen financial inclusion due to its interest-free character. The defining principle of Islamic banking relates to its prohibition of charging and paying of interest but it promotes profit-sharing mechanisms. By developing innovative profit-sharing mechanisms, Islamic financing can provide investors with new instruments that minimize the risks of long-term investment. While many of the high-growth Islamic banking countries are located in the Asia-Pacific region (e.g. Iran, Indonesia, Malaysia, Turkey and Saudi Arabia), the potential for increasing the depth of Islamic finance is considered bright in several CSN including Kazakhstan, Tajikistan and Azerbaijan.

It is likely that the implementation of Basel III will increase the capital requirement ratios which will put pressure on Islamic banks to restructure, seek innovative ways to provide financing for business, and have instruments of diversifying risk-based performance assessments. Due to differences in Islamic banking relative to traditional commercial banking, national and regional regulatory frameworks may have to identify ways to improve surveillance of Islamic banking and customize institutional mechanisms in a manner that meets international banking standards including capital adequacy ratio, accounting standards and risk management practices.

Source: Global Islamic Finance Report, BMB Islamic UK, London, 2013

3.3.5. Innovative Approaches: Blended Finance

An innovative financing tool consists of 'a class of development financing opportunities called "blended finance" that pool public and private resources and expertise. Blended finance encompasses a large portfolio of potential instruments, including instruments provided by DFIs to leverage private finance (e.g. loans, equity investments, guarantees etc.), as well as traditional public private partnerships (PPPs)'.[37]

The Asia-Pacific CSN have significant opportunities of realizing the potential of these new and innovative financing strategies. Many of these opportunities will involve structured public-private funds and create synergies and innovative implementing partnerships across different stakeholders including the government, private institutions, civil society, development banks and financial institutions, and not-for-profit institutions. Adoption of such blended financing strategies can significantly help the CSN to meet the financing requirements for bridging their development gaps.

[37] See UNDESA 2014, *Report of the Intergovernmental Committee of Experts on Sustainable Development Financing*, Available from http://sustainabledevelopment.un.org/content/documents/4588FINAL%20REPORT%20ICESD F.pdf.

Box 4. Harnessing digital financial services for inclusive development in Asia-Pacific CSN

It is well established that access to finances is necessary to promote the growth of enterprises through the provision of credit to both new and existing businesses and individual entrepreneurs. It benefits the economy in general by accelerating economic growth, intensifying competition, as well as expanding employment opportunities. With proper targeting of financial services, incomes of those in the lower end of the income ladder will typically rise hence reducing income inequality and poverty. The lack of financial access limits the range of services and credits for households and enterprises. Poor individuals and small enterprises need to rely on their personal wealth or internal resources to invest in their education and businesses, which limits their full potential leading to the cycle of persistent inequality and diminished growth. Moreover, if individuals are to become self-reliant and institutions to become productive and sustainable, they need access to finance.

In the Asia-Pacific CSN, digital finance holds an enormous opportunity for greater financial inclusion and expansion of basic services. For example, around 115 million people own a mobile phone in Bangladesh. As such digital finance can be used as a powerful means to expand access beyond financial services to other sectors, including agriculture, transportation, water, health, education, and clean energy. Obviously, digital solutions and new technologies will offer great potential to overcome the massive challenge of providing access to financial services to the poor.

It is also likely that the benefits of digital finance will extend well beyond the conventional financial services. This may also emerge as a powerful tool and an engine for job creation in these countries. In Bangladesh, a single company, bKash Limited launched in the second half of 2011, grew to 2 million accounts by the end of 2012, and shot up to 11 million registered accounts by the end of 2013. Unlike large mobile money businesses in other countries, bKash is not a mobile network operator (MNO) and did not have an existing customer base to which it added mobile financial services. bKash acquired each client on its own. Three factors have combined to drive bKash's fast start: a specialized organization built to deliver mobile financial services, a shared vision for scale among a diverse investor group and an enabling and flexible regulatory environment.

Public-private partnerships

Over the last few decades, public-private partnerships (PPPs) have emerged as attractive options in the Asia-Pacific region in view of their potential to close financial gaps in various development efforts (e.g. in infrastructure financing). In addition to mobilizing private resources, PPPs provide a mechanism to take advantage of private sector efficiency and innovation capacity along with shifting some risks to the private partner.

Since there exists relatively narrow fiscal space in most of the Asia-Pacific CSN, PPPs have high potential in supplementing public expenditure in these countries. However, differing socioeconomic characteristics including shallow domestic financial market in these countries call for appropriate adjustments in the PPP model to fit with local conditions and specific situations in a country. For success in such efforts, an important prerequisite is to establish an enabling environment for PPP development. This requires the setting out of a clear policy to create a stable and long-term vision for PPP development in these countries. In this context, legal and regulatory frameworks and adequate dispute resolution mechanisms are critical for protecting the rights and creating the confidence of the private sector. These countries also need to develop appropriate institutional arrangements for building internal capacity in implementing PPP projects that are by nature complex and require specific expertise.[38]

[38] Kazakhstan, for example, has established the Kazakhstani Private-Public Partnership Centre in 2008 which is a special joint-stock company fully owned by the government. Its role includes: (i) examining PPP projects at all stages of their preparation; (ii) preparing recommendations for governmental agencies on the development of legislation and methodological frameworks for PPP projects; (iii) monitoring PPP projects during the course of development and construction; and (iv) organizing seminars, training courses, conferences and other events related to PPPs.

Accessing innovative finances by Asia-Pacific CSN

For the Asia-Pacific CSN, accessing innovative finances especially in the area of climate change is critical since climate change has become one of the key development challenges in these countries. The Asia-Pacific CSN are mostly vulnerable to climate related disasters due to their exposure to earthquakes, storms, floods, droughts and sea-level rise. It is reported that of the world's 15 countries most exposed to natural hazards and climate change-related risks exposure, nine are in the Asia-Pacific region of which six are CSN (Vanuatu, Tonga, Bangladesh, Cambodia, Solomon Islands and Fiji).[39]

The Asia-Pacific CSN need to implement policies and strategies to minimize the economic and human costs of climate change through adopting smart climate financing mechanisms in two major areas: mitigation and adaptation to adapt to the consequences of climate change and make these countries more resilient to natural shocks. As a follow up to the Copenhagen Accord 2009, and the Cancun and Durban meetings, developed countries have committed to jointly mobilize $100 billion a year from public and private sources in climate finance by 2020.

Although the Asia-Pacific region has so far received about 54 percent of the total approved spending of global climate funds (amounting to about $11.5 billion) since 2002, the distribution of climate funds in the region appears very uneven with the most vulnerable Asia-Pacific CSN receiving little of their necessary financing to address the climate change related impacts.[40] It is reported that a total of 21 climate funds and dedicated initiatives are active in the Asia-Pacific region including 15 multilateral funds, 5 bilateral initiatives and 1 national fund. These are initiatives from different organizations and countries including Global Environment Facility and the Climate Investment Funds, Asian Development Bank, World Bank, Clean Technology Fund of the World Bank, European Global Energy Efficiency and Renewable Energy Facility, Green Climate Fund, Low Emissions Asian Development, investments to reduce emissions from deforestation and forest degradation (REDD), Germany, Japan, Australia, Norway and the United Kingdom. The share of the Asia-Pacific CSN in these financing facilities, however, is very low and the countries need to work together in order to leverage additional green investments.

3.4. External Resources Mobilization

For the Asia-Pacific CSN, external resources are important to augment domestic financial resources to meet the huge financing requirements needed to meet the development gaps. In this context, the countries need to explore the full potential of all available sources of external financing including ODA, FDI and remittances. In addition, the countries need to tap other innovative and emerging sources such as foreign portfolio investment, South-South and triangular development cooperation, international borrowings, lines of credit through the export-import banks, and public-private partnerships with foreign entities which can provide additional channels and important instruments of financing the development gaps.

[39] See Alliance Development Works, *World Risk Report 2013,* Berlin, 2013. Available from www.worldriskreport.com/uploads/media/WorldRiskReport_2013_online_01.pdf.

[40] See www.climatefundsupdate.org/listing. For example, the share of the Asia-Pacific LDCs is estimated at only 6.9 percent of the total received by the region.

Official development assistance

For the Asia-Pacific CSN, official development assistance (ODA) contributes only partially in meeting their resource requirements for bridging the development gaps. In 2012, ODA flow to the Asia-Pacific region is recorded at $30 billion which is only 23 percent of the total global ODA flows. In the total ODA flows to the region, the share of the CSN is around 55 percent (41 percent for the LDCs, 9 percent for the LLDCs and 5 percent for the LIDS). As a group, ODA thus remains an important source of development finance for the Asia-Pacific CSN especially the LDCs.

In view of the critical role that ODA needs to play in the Asia-Pacific CSN during the post-2015 era, policies are needed not only to increase ODA but also to raise the quality and effectiveness of aid within a broader framework such as involving the issues of project aid versus budget support; conditional programme aid versus unconditional/untied budget support, and whether aid should be allocated to countries with good governance especially in the context of aid management and coordination. Two recent global conferences underscored the importance of aid effectiveness: The 2011 Fourth High-Level Forum on Aid Effectiveness in Busan and the First High-Level Meeting of the Global Partnership for Effective Development Cooperation in Mexico City in 2014 have underscored the importance of aid effectiveness and anchor effective development cooperation in the global development agenda beyond 2015.[41]

It is expected that the OECD-DAC members would meet their commitments of fulfilling the overall target of 0.7 percent of GNI for all developing countries and 0.15 percent-0.20 percent of GNI as ODA to the LDCs.[42] In addition to focusing more on effectiveness and adopting allocation mechanisms that can align ODA more with the national developmental requirements of the recipient countries, the CSN need to strengthen their institutional structure of aid effectiveness and aid delivery to produce the desired outcomes. Also, it must also be realized that the share of the Asia-Pacific CSN in global ODA is significantly low which deserves more attention in the global discourse.

Foreign direct investment

Although the Asia-Pacific region has increased its share of global foreign direct investment (FDI) inflows from 16 percent in 1990 to nearly 38 percent in 2012, these flows are highly skewed towards larger emerging countries and in resource sectors. FDI flows are extremely limited in the CSN who need the resources most. The Asia-Pacific CSN need to promote more effective policies to attract higher levels of FDI especially in areas of inclusive growth through investing more in Greenfield FDI, which can create employment and increase the technological capacity of their economies. For the purpose, the countries must ensure market fundamentals and proper regulatory measures to strengthen social and environmental pillars to direct FDIs in sustainable development pursuits.

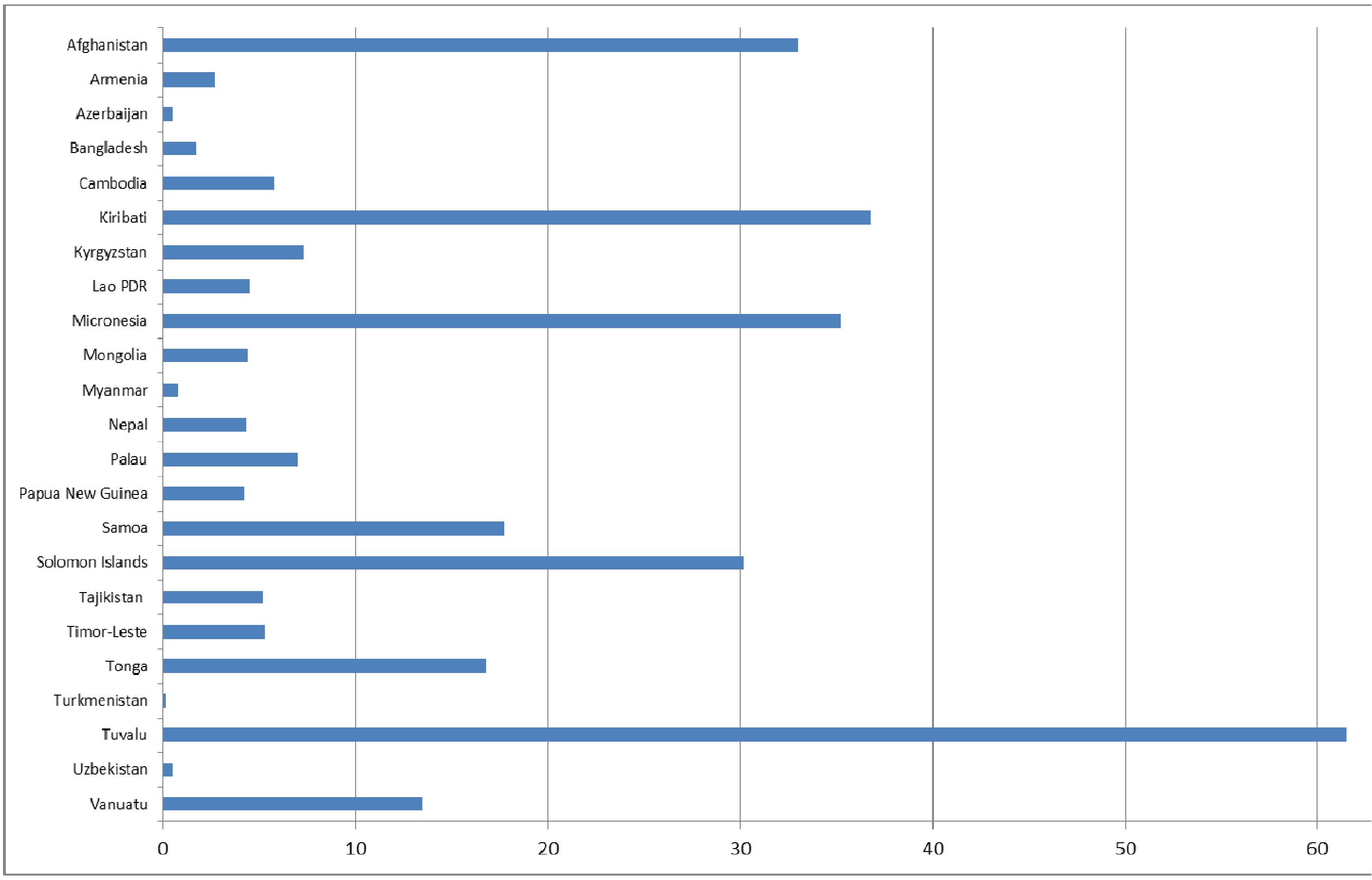
[41] See the outcome document of the meeting High-Level Forum on Aid Effectiveness in Busan. Available from http://effectivecooperation.org/files/OUTCOME_DOCUMENT_-_FINAL_EN2.pdf and the Communiqué for the first High-Level Meeting of the Global Partnership. Available from http://effectivecooperation.org/2014/03/30/draft-communique-for-the-first-high-level-meeting-of-the-globalpartnership/.

[42] Along with necessary financing to close the development gaps, the Asia-Pacific CSN are also required to invest resources to promote the objectives of the post-2015 development agenda. This has been highlighted by the Open Working Group (OWG) of the UN General Assembly established on 22 January 2013 by its decision 67/555. According to the OWG Report (submitted on 28 July 2014), Goal 17 is related to 'Strengthen the means of implementation and revitalize the global partnership for sustainable development'. More specifically, Goal 17.2 recognizes that 'developed countries to implement fully their ODA commitments, including providing 0.7% of GNI in ODA to developing countries of which 0.15-0.20% to least-developed countries'.

Remittances

Remittances by the migrant workers to the developing economies in the Asia-Pacific region increased from $114 billion in 2008 to $200 billion in 2010 and further to $260 billion in 2013.[43] For several Asia-Pacific CSN, such as Kyrgyzstan, Nepal, Samoa, Tajikistan and Tonga remittances represent more than 20 percent of their GDP. Despite significant importance in these economies, the potential of remittances for financing development efforts in the countries is somewhat limited. Studies on the use of remittances by the recipient households indicate that a major share of these funds is used to finance consumption expenditures including durable consumption although these are also used as investments in housing or improvements in family farms and enterprises.

Figure 5: ODA received as % of GDP in selected Asia-Pacific CSN, 2012

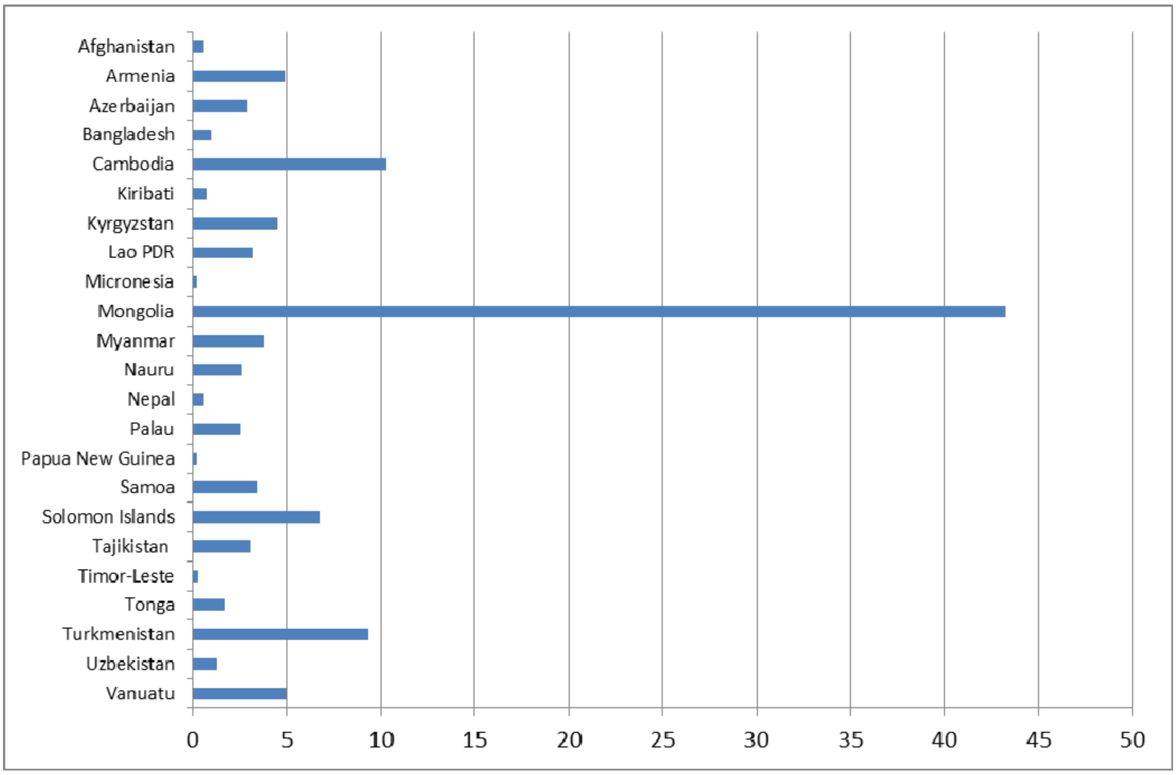


Source: World Bank, *World Development Indicators 2014.*

Although remittances play an important role in improving the economic conditions of the recipient households, the possibilities of using these resources for financing development expenses in the public sector are limited in view of the private nature of these inflows. Governments of the Asia-Pacific CSN need to take measures to facilitate more efficient transactions of remittance money by reducing the costs of money transfer and devising mechanisms that would enable them to tap more remittances for development through, for instance, diaspora bonds or other innovative mechanisms.

[43] See UNESCAP, *Statistical Yearbook for Asia and the Pacific* 2011, 2013, Bangkok

Figure 6. FDI inflows (as % of GDP) in selected Asia-Pacific CSN. 2012



Source: World Bank, *World Development Indicators 2014*

Adjusting roles of multilateral and bilateral DFIs

The nature and scope of development financing has been changing rapidly in the region especially in relation to the financing needs of the Asia-Pacific CSN. In order to meet the demands of the evolving financing scenario, the development financial institutions (DFIs), both multilateral and bilateral, can significantly adjust their traditional financing role to accommodate new scopes and directions of financing including blended finance for the CSN in the region. For the purpose, the DFIs (including the Asian Development Bank and the World Bank) can adopt several instruments such as concessional/blended loans, equity, guarantees, non-concessional financing and other innovative instruments. On the other hand, the CSN can adopt policies to promote the participation of DFIs for mobilizing private funds for narrowing the development gaps in strategic areas.

At the regional level, several new initiatives are being taken to generate resources for development. Notable among these is the initiative taken up by China to set up a new regional development institution to help infrastructure development and promote sustainable growth. As founding members, 21 countries from the Asia-Pacific region have signed the Memorandum of Understanding (MOU) on establishing the Asian Infrastructure Investment Bank (AIIB) on 24 October 2014 in Beijing.[44] Another initiative of the BRICS (Brazil, Russia, India, China and South Africa) countries is to create a new development bank which will provide financing and expertise required for the development of infrastructure in the region, especially for meeting the

[44] The MOU specifies that the authorized capital of AIIB is $100 billion and the initial subscribed capital is expected to be around $50 billion. The remaining member countries are Brunei, China, India, Kazakhstan, Kuwait, Malaysia, Mongolia, Oman, Pakistan, Philippines, Qatar, Singapore, Sri Lanka, Thailand, Uzbekistan and Vietnam. Other signatories of this MOU are Bangladesh, Cambodia, Lao PDR, Myanmar and Nepal. For more information see: http://news.xinhuanet.com/english/business/2014-10/24/c_133740149_2.htm.

huge financing gaps in the low income countries. It is likely that these new financing institutions will significantly expand and improve the modalities of funding available for the Asia-Pacific CSN.

Enabling better access to trade finance

Better access to trade finance is critical to expanding trade of the Asia-Pacific CSN as more than 90 percent of the current global trade transactions involve some form of credit, insurance or guarantees to minimize risks and other uncertainties.[45] In particular, small and medium enterprises (SMEs) which account for 80 to 90 percent of the businesses in the CSN are less likely to export, as among others, these SMEs have limited access to trade finance making it difficult for them to participate in international supply chains and international trade. Several factors act as barriers which prevent the SMEs from accessing trade finance such as high transaction costs, imperfect information, high default risk and limited collateral.[46]

Most of the Asia-Pacific CSN have limited capacity to address trade finance constraints on their own especially due to lack of national trade finance institutions and infrastructure. The government- promoted export credit insurance and guarantee institutions and/or export-import (EXIM) banks are either non-existent or still at initial stages to provide the required support. Similarly, credit rating institutions are also weak or absent in most of these countries.

Since the bulk of the trade finance usually comes from the commercial banks operating in the domestic market, the development of a credible and well-functioning banking and insurance sector is the key to providing access to all kinds trade finance instruments to the exporting institutions in the CSN. An essential prerequisite in this respect is the development of appropriate prudential regulations based on international best practices and adoption of a pragmatic approach to financial sector liberalization.

Technological innovation can also play an instrumental role in reducing the costs of trade financing and expanding its access. Electronic trade finance (ETF), for example, offers an integrated and paperless process that reduces costs and enhances efficiency from the stages of purchase to delivery. This also makes assessments of credit worthiness easier, especially important for the SMEs given the limited availability of their records. At the global and regional levels, the launching of trade finance facilitation schemes can assist the SMEs and other institutions in the CSN to get better access to trade finance.[47] In addition, broader financial and technical assistance to the Asia-Pacific CSN is needed to ensure that they can derive the full benefit from trade for which the expansion and more effective participation of these countries in the global Aid for Trade initiative would be important. These initiatives can help in mobilizing required resources to address the trade-related constraints specific to the Asia-Pacific CSN.

South-South and triangular cooperation

For the Asia-Pacific CSN, harnessing the opportunities of South-South cooperation (SSC) and triangular development cooperation (TDC) would be critical to closing the development gaps in an effective and efficient manner. Over the last decade, the Asia-Pacific region has significantly

---

[45] See International Trade Centre, *How to Access Trade Finance: A Guide for Exporting SMEs,* 2009, Geneva.
[46] For details, see Asian Development Bank, *Trade Finance Survey: Major Findings*, ADB Brief No. 11, March 2013. Available from www.adb.org/sites/default/files/pub/2013/trade-finance-survey-major-findings.pdf.
[47] In the Asia-Pacific region, ADB's Trade Finance Programme (TFP) supports billions of dollars of trade throughout the region, which in turn helps create sustainable jobs and economic growth in Asia's developing countries. Efforts are needed to provide greater access to such facilities by the CSN.

strengthened economic linkages among the countries including partnerships and development cooperation in areas such as trade, investment, finance, technology and capacity-building. The CSN can significantly benefit from these developments.

For the CSN, SSC provides new and innovative opportunities to share best practices, skills and expertise between the region's developing countries and the CSN. These regional skills and capabilities are likely to be more appropriate and relevant to the Asia-Pacific CSN than similar knowledge from developed countries or other regions as the region shares common development challenges and development potentials. For these reasons, TDC can provide higher benefits relative to traditional North-South development partnerships. Within the region, the developing countries should be encouraged to undertake various SSC activities keeping the needs and potentials of the CSN.

The recent decades have been associated with greater potential of relying more on SSC and TDC in the Asia-Pacific region due to fast growth and dynamism of a number of emerging countries including China and India. The SSC activities could be related to several areas including capacity-building and sharing of development experiences. Several important areas for cooperation for the Asia-Pacific CSN which have emerged in recent years include trade, investment, technology transfer, poverty reduction, gender equity, agriculture and rural development, food security, infrastructure, ICT, environment, disaster relief and mitigation, debt relief, banking sector, governance, and professional services.

4. CONCLUSIONS

This paper provides an overview of the current state of financing and future possibilities of financing the development gaps in the CSN of the Asia-Pacific region. The CSN in the region have large financing requirements, but there also exists wide scope of raising significant resources from the traditional sources and tapping new and innovative sources of finance at national and regional levels. The available estimates of financing requirements vary widely and at best are tentative. For the Asia-Pacific region as a whole, financing requirements to bridge the social development gaps are up to $800 billion per year, infrastructure gaps up to $900 billion per year, and investments to provide energy security including adaptation of new technologies and renewable energy could cost as much as $800 billion per year.

While the above numbers may appear quite large and beyond the available resource mobilization capacity, these annual estimates form less than 8 percent of the total assets of the region's mass affluent and high-net-worth individuals in 2012. In addition, it may be highlighted that the region's foreign exchange reserves amounted to $7.3 trillion in 2012 and its gross national savings were $8.4 trillion which was equivalent to 51 percent of the world gross national savings in 2012.[48] These figures show that the Asia-Pacific region has enough savings to finance its resource requirements for bridging the development gaps. The challenge, however, is how to mobilize these savings for financing the development gaps in the CSN.

An essential prerequisite for collecting increased revenues for development by the CSN is to promote and nurture strong, diversified and stable financial system which is the key to ensuring financial inclusion along with financial stability and sustainability. For developing a more inclusive financial system and generate increased development resources, the Asia-pacific CSN

[48] See ESCAP, *Economic and Social Survey of Asia and the Pacific 2014*, Bangkok.

need to:

- Raise tax-GDP ratio through different measures such as broadening tax bases, addressing loopholes, removing irrational exemptions, improving collection and administrative efficiency and adopting other revenue generating measures;
- Rationalize and reorient public expenditures towards more productive activities, increase expenditure efficiency, reduce unproductive expenditures including high defense expenses and subsidies;
- Undertake effective measures to create well-diversified and competitive financial systems that would facilitate the broadening and deepening of equity and debt markets, create the conditions for expanding the institutional investment sector to generate required liquidity;
- Strengthen the legal and regulatory frameworks and supervisory systems to heighten investor confidence and promote financial inclusion especially for providing financial services to the low-income groups, women and micro-entrepreneurs;
- Create conducive environments and well-designed incentive frameworks for leveraging innovative models of blended finance and PPPs in infrastructure and other key areas of development;
- Undertake measures for developing the regional capital market having high potential for raising regional resources for financing development. In this context, a critical issue for the CSN is to increase their capacities to install effective regulatory frameworks for efficient functioning of capital market institutions.

The Asia-Pacific CSN also need to take effective measures to rapidly develop the domestic institutional investors especially in the areas of asset management and pension fund. The CSN should prepare themselves to exploit the large potential of the rapidly growing presence of high-net-worth and mass affluent sections of individuals in the Asia-Pacific region. The countries should increasingly exploit all potential domestic sources of financing and work together to ensure a fair share of ODA commitments and distributions. The private sector must also be given proper incentives to participate in development activities for which the countries need to create supportive policy framework for blended finance and PPPs, adapt innovative climate financing mechanisms, provide financial services to all, and promote South-South and triangular development cooperation especially for expanding their knowledge base and building development capacities.

Recent MPDD Working Papers

WP/15/01	Infrastructure Financing, Public-Private Partnerships, and Development in the Asia-Pacific Region by Gilberto Llanto, Adoracion Navarro, Ma. Kristina Ortiz
WP/15/02	Financing for Development: Infrastructure Development in the Pacific Islands by ESCAP Pacific Office
WP15/03	Capital Market Development and Emergence of Institutional Investors in the Asia-Pacific Region by Hans Genberg
WP/15/04	Trade Finance for Sustainable Development in Asia and the Pacific by Sailendra Narain
WP/15/05	Financing Small and Medium Sized Enterprises for Sustainable Development: A View from the Asia-Pacific Region by Nick Freeman
WP/15/06	Financing the Social Sector: Regional Challenges and Opportunities by Social Development Division, ESCAP
WP/15/07	Inclusive Finance in the Asia-Pacific Region: Trends and Approaches by Md. Ezazul Islam
WP/15/08	Climate finance in the Asia-Pacific: Trends and Innovative Approaches by Ilaria Carrozza
WP/15/09	Financing Disaster Risk Reduction for sustainable development in Asia and the Pacific by Disaster Risk Reduction Section, ICT and Disaster Risk Reduction Division, ESCAP
WP/15/10	Financing Statistics Development in Asia and the Pacific by Statistics Division, ESCAP
WP/15/11	Financing Sustainable Development – What Can We Learn from The Australian Experience of Reform? by Wayne Swan
WP/15/12	Financing Development Gaps in the Countries with Special Needs in the Asia-Pacific Region by Mustafa K. Mujeri
WP/15/13	Polarizing world: GDP, development and beyond by Michael Shashoua and Sudip Ranjan Basu

READERSHIP SURVEY

The Macroeconomic Policy and Development Division of ESCAP is undertaking an evaluation of this publication, *Financing Development Gaps in the Countries with Special Needs in the Asia-Pacific Region*, with a view to making future issues more useful for our readers. We would appreciate it if you could complete this questionnaire and return it, at your earliest convenience, to:

Director
Macroeconomic Policy and Development Division
ESCAP, United Nations Building Rajadamnern Nok Avenue Bangkok 10200, THAILAND

QUESTIONNAIRE

	Excellent	*Very good*	*Average*	*Poor*
1. Please indicate your assessment of the *quality* of the publication on:				
• Presentation/format	4	3	2	1
• Readability	4	3	2	1
• Timeliness of information	4	3	2	1
• Coverage of subject matter	4	3	2	1
• Analytical rigour	4	3	2	1
• Overall quality	4	3	2	1
2. How *useful* is the publication for your work?				
• Provision of information	4	3	2	1
• Clarification of issues	4	3	2	1
• Its findings	4	3	2	1
• Policy suggestions	4	3	2	1
• Overall usefulness	4	3	2	1

---

3. Please give examples of how this publication has contributed to your work:

....
....
....
....
....

4. Suggestions for improving the publication:

....
....
....
....

About Economic and Social Commission for Asia and the Pacific (ESCAP)

ESCAP is the regional development arm of the United Nations and serves as the main economic and social development centre for the United Nations in Asia and the Pacific. Its mandate is to foster cooperation between its 53 members and 9 associate members. ESCAP provides the strategic link between global and country-level programmes and issues. It supports Government of countries in the region in consolidation regional positions and advocates regional approaches to meeting the region's unique socio-economic challenges in a globalizing world. The ESCAP office is located in Bangkok, Thailand.

WWW.UNESCAP.ORG

TWITTER.COM/UNESCAP

FACEBOOK.COM/UNESCAP

YOUTUBE.COM/UNESCAP