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**Review of issues pertinent to the subsidiary structure
 of the Commission, including the work of the regional
 institutions: macroeconomic policy, poverty reduction
 and inclusive development**
**Financing for sustainable development in Asia and the
 Pacific**
Note by the secretariat
Summary

The present report provides an overview of the critical importance of finance as a key means of implementation of the sustainable development goals to be agreed in 2015. The report discusses why the region needs to prioritize its financial development as a key component of its development strategy. It assesses the region's financial needs, discusses how those needs can be satisfied through the mobilization of existing resources and takes stock of existing regional initiatives and efforts. There are many opportunities in Asia and the Pacific to tap resources, however, the region needs appropriate institutional arrangements and modalities to suggest ways in which financing for sustainable development may be achieved.

The Commission may wish to review the present report and provide the secretariat with guidance on its recommendations and on any other matters concerning the financing of sustainable development in the Asia-Pacific region.

Contents

	<i>Page</i>
I. Introduction.....	2
II. Key considerations of financing for sustainable development.....	3
III. Financing requirements for sustainable development in the Asia-Pacific region	5
IV. Mobilizing domestic resources	6
A. Scope for domestic taxation	6
B. Public expenditure management.....	8

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V.	Broadening and deepening capital markets.....	8
A.	Equity markets.....	9
B.	Bonds markets	9
C.	Emergence of institutional investors	10
VI.	Financial inclusion.....	11
VII.	Leveraging public-private partnerships.....	12
VIII.	Innovation in climate finance.....	13
IX.	Mobilizing external resources	15
A.	Official development assistance	15
B.	Foreign direct investment.....	15
C.	Remittances	16
X.	Trade finance for small and medium-sized enterprises.....	16
XI.	South-South cooperation and triangular development cooperation	17
XII.	Conclusions.....	18

I. Introduction

1. In 2015, leaders of the Asia-Pacific region will engage with the global community in the daunting task of renewing and recasting a global development agenda, specifically during three momentous events. For three days, from 13 to 16 July, the third International Conference on Financing for Development will be held in Addis Ababa, with the aim to agree upon the financing inputs to the renewed development agenda. The present report will highlight the enormous financing needs of Asia and the Pacific and discuss the approaches and opportunities available to the region to meet those needs. The analysis is potentially an important input to the outcome of the Financing for Development conference in July. In September, a new United Nations development agenda will be agreed. This will replace the Millennium Development Goals, which has served as the basis for development cooperation since the turn of the Millennium. Near the end of the year, from 30 November to 11 December, the United Nations Climate Change Conference will meet in Paris during which participating countries will seek to agree on allocations of emissions rights.

2. Financing for sustainable development has become a significant and integral part of the current development discourse in the United Nations development agenda beyond 2015. To secure “The future we want”, it is critical “to facilitate the mobilization of resources and their effective use in achieving sustainable development objectives”.¹

3. The first step in renewing the global development agenda occurred on 19 July 2014 when the Open Working Group of the United Nations agreed on a draft set of 17 sustainable development goals. This effort was seen as the follow up to the Millennium Development Goals, in which the end-date had been set to 2015. Aside from the 17 specific goals, 169 associated targets were set. From the start, developing countries sought to ensure that the sustainable development goals would correct the inadequacies of the Millennium Development Goals through the incorporation of a more robust global partnership for development and the explicit identification of means of

¹ A/RES/66/288, annex.

implementation. The Open Working Group has emphasized the need to ensure adequate financial resources for investments in sustainable development through, among other things: (a) strengthening domestic resource mobilization; (b) full implementation by developed countries of overseas development assistance (ODA) commitments in line with the agreed formulas and timetables; and (c) mobilization of additional financial resources from multiple sources.²

4. On 18 June 2013, the General Assembly decided to establish an intergovernmental committee of experts on sustainable development financing, as recommended in the outcome document of the United Nations Conference on Sustainable Development. The report of the Intergovernmental Committee of Experts on Sustainable Development Financing was published as an important contribution to the forthcoming financing for development agenda and climate change convention decisions. This report focused on private financing flows and the “blending” of private and public financing flows, as well as on some key issues and challenges facing the region in financing its sustainable development and other priorities.

5. The remainder of the paper is organized as follows. Section 2 provides key considerations of financing sustainable development. Section 3 outlines the financing requirements. Domestic resource mobilization issues are discussed in section 4, after which, section 5 presents ways in which capital markets can be broadened and deepened in the region. Section 6 deals with financial inclusion and section 7 describes how to leverage public-private partnerships. Section 8 illustrates innovations in climate finance. Section 9 provides various ways to mobilize external resources. Section 10 highlights the importance of trade finance, especially for small and medium-sized enterprises, and section 11 emphasizes the importance of South-South cooperation and triangular development cooperation. Finally, section 12 contains concluding comments.

II. Key considerations of financing for sustainable development

6. As member States define the contours of the development agenda beyond 2015, the sources and uses of mobilizing resources and their proper allocation have taken centre stage. The implementation of a new, ambitious development agenda with sustainable development at its core requires more effective incentives and allocation of existing resources, as well as additional funds from domestic, external and innovative sources.

7. The focus on sustainable development introduces new dimensions and challenges to the development financing dialogue. In line with the basic precepts of sustainable development, sustainable development financing must be aligned with development outcomes that integrate and synergize the three dimensions of sustainable development, namely the economic, social and environmental dimensions, as outlined in the United Nations Conference on Sustainable Development outcome document, to ensure intra- and intergenerational equity, as well as recognize planetary boundaries.

8. There is now global interest to use institutional mechanisms and modalities to leverage new, emerging and innovative sources of financing from a variety of domestic and external sources. As noted in General Assembly resolution 65/1, such sources of finance should be stable and predictable. They should also supplement and not be a substitute for

² E/ESCAP/70/INF/8, para. 3.

traditional sources of finance. In the light of the insufficient funding available from traditional sources of development finance, policymakers need to consider mobilizing emerging and innovative sources of financing.

9. This is particularly important owing to the need to fund necessary but expensive developmental expenses, such as for closing infrastructure gaps within and across countries in the region and for addressing the impacts of climate change. For such purposes, the creation of appropriate institutional and regulatory frameworks for the development of domestic capital markets and for supporting the development of domestic institutional investors, for example, could help mobilize much needed additional financial resources.

10. Once adopted, the new and ambitious agenda with sustainable development at its core will require more tailored approaches, modalities and incentives. While the mobilization of resources through existing and new sources of domestic, external and innovative financing is challenging, there is also a need to deploy resources efficiently towards the right sustainable development outcomes.³

11. The sustainable development agenda, as it is emerging, will require significant investments in public goods, such as social services and clean air, water and the continued flow of ecosystem services, upon which economies and people depend.^{4,5,6} As those kinds of investments are characterized by high social rates of return, but low private rates, funding them is more likely to originate and be leveraged from public resources.

12. The funding of necessary but expensive developmental programmes to close infrastructure gaps within and between countries in the region and to address the impacts of climate change requires mobilizing public finances and supportive domestic and international capital markets. It is important to recognize that timely and anti-cyclical public sector spending can boost growth rates, augmenting fiscal resources, and that public investment can actually crowd in private investment.⁷ In addition, innovative sources of finance, such as carbon taxes, diaspora bonds and financial transaction taxes, could be drawn upon.⁸

13. In going forward, Governments of Asia-Pacific economies must take into account potential macroeconomic challenges of funding inclusive and

³ See the work of the Leading Group on Innovative Financing for Development, the Task Force on International Financial Transactions for Development and the Task Force on Innovative Financing for Education. Available from www.leadinggroup.org/rubrique69.html.

⁴ The Working Document of the Open Working Group on the Sustainable Development Goals (SDGs). Available from http://sustainabledevelopment.un.org/focussdgs.html#_edn33.

⁵ United Nations, *A New Global Partnership: Eradicate Poverty and Transform Economies Through Sustainable Development, The Report of the High-Level Panel of Eminent Persons on the Post-2015 Development Agenda* (New York, 2013).

⁶ ESCAP, ADB and UNDP, *Asia-Pacific Aspirations: Perspectives for a Post-2015 Development Agenda: Asia-Pacific Regional MDGs Report 2012/13* (Bangkok, 2013).

⁷ Development Committee, "Fiscal policy for growth and development: an interim report", Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund On the Transfer of Real Resources to Developing Countries, Washington D.C., 6 April 2006. Available from <http://siteresources.worldbank.org/DEVCOMMINT/Documentation/20890698/DC2006-0003%28E%29-FiscalPolicy.pdf>.

⁸ World Bank, *Financing for Development Post-2015* (Washington D.C., 2013).

sustainable development by maintaining fiscal sustainability and price stability. Furthermore, they will need to be concerned about whether their growth would be sufficient to generate enough resources to keep public debt and inflation at manageable levels. Macroeconomic stability can be achieved as long as policies are designed carefully and implemented effectively.

III. Financing requirements for sustainable development in the Asia-Pacific region

14. Home to two thirds of the world's poor, the Asia-Pacific region faces enormous development challenges, the financing of which requires even more effective public sector governance and leadership and new and innovative institutions, agents and tools.⁹ This section provides a brief overview of recent estimates of the region's needs to finance its sustainable development, taking into account the following: the actual size of the financing requirements; the region's extensive geographical area; the presence of large countries; the subregional diversity in terms of the level of development; and the state of infrastructure.

15. Despite those characteristics, the potential for mobilizing resources from domestic and external sources is large, but often constrained by the limited borrowing and absorptive capacity of many countries emanating from underdeveloped markets and institutions. This is especially the case among countries with special needs, which is comprised of least developed countries, landlocked developing countries and small island developing States.¹⁰

16. In 2013, the Economic and Social Commission for Asia and the Pacific (ESCAP) estimated that the Asia-Pacific region would need between \$500 billion and \$800 billion per annum merely to close development gaps in the areas of education, health, employment, social protection and access to energy services between 2013 and 2030.¹¹ The cost estimates were prepared for 10 countries, which account for more than 80 per cent of the population and 80 per cent of the gross domestic product (GDP) of the developing Asia-Pacific economics, namely Bangladesh, China, Fiji, India, Indonesia, Malaysia, the Philippines, the Russian Federation, Thailand and Turkey.¹²

17. Notwithstanding the significant investment requirements to tackle social development challenges, infrastructure is a critical and additional component of sustainable development. Recently, ESCAP estimated that the cost of investment projects in selected areas of transport exceeded \$350 billion per year. This is due to large demand for investment in the

⁹ ESCAP estimated that 763 million people lived below the \$1.25/day poverty line in the Asia-Pacific region in 2011.

¹⁰ UN System Task Team on the Post-2015 UN Development Agenda, "Countries with special needs" (OHRLLS, 2012). Available from www.un.org/millenniumgoals/pdf/Think%20Pieces/1_countries_with_special_needs.pdf.

¹¹ ESCAP, *Economic and Social Survey of Asia and the Pacific 2013* (United Nations publication, Sales No. E.13.II.F.2).

¹² In an earlier study, ESCAP estimated that the region needed \$636 billion per annum to achieve the Millennium Development Goals by 2015. See ESCAP, *Financing an Inclusive and Green Future* (Bangkok, 2010). Available from www.unescap.org/sites/default/files/themestudy2010-fulltext.pdf.

transport sector in terms of infrastructure and services, as well as for maintenance.¹³

18. Regarding environment-related investments in the Asia-Pacific region, the International Energy Agency estimated that investment of nearly \$14.3 billion per year (from 2011 to 2030) would be required to achieve universal energy access by 2030.¹⁴ Similarly, according to the World Bank, the costs for adaptation to climate change would amount to \$25 billion annually from 2010 to 2030.¹⁵ Asia and the Pacific remains the most disaster-prone region of the world, but efforts pertaining to disaster risk finance have had mixed success. The region needs to invest between \$11.7 trillion and \$19.9 trillion by 2035 in order to modernize its energy sector. This investment includes costs associated with adapting to new technologies and renewable forms of energy.¹⁶

19. In sum, based on estimates from various sources, the cost to close the region's infrastructure gaps, provide universal access to social protection, health and education and implement climate change mitigation and adaptation measures could run as high as \$2.5 trillion per year.

IV. Mobilizing domestic resources

20. Mobilizing domestic resources to increase financing for development is a key pillar of the development agenda beyond 2015. An important component of this will be for Governments to raise the resources required to invest in sustainable development. Governments have several options to unlock the fiscal space for such spending. Among them are: increasing borrowing, either domestically or from abroad; making existing public expenditure more efficient; and reprioritizing public expenditure to make it more development-oriented. Countries can also mobilize domestic resources by strengthening tax and non-tax revenues.

A. Scope for domestic taxation

21. There is significant potential to increase tax revenues in the Asia-Pacific region.¹⁷ The collection of tax revenues in the developing countries of Asia and the Pacific is low, not only compared with developed regions or countries, such as the European Union or the United States of America, but also with other developing regions. In 2011, the average tax-to-GDP ratio in Asia and the Pacific was only 14.8 per cent of GDP for central Government

¹³ ESCAP, *Review of Developments in Transport in Asia and the Pacific 2013: Transport as a Key to Sustainable Development and Regional Integration* (Bangkok, 2013).

¹⁴ International Energy Agency, *World Energy Outlook: Energy for All – Financing Access for the Poor* (Paris, 2011). The International Energy Agency estimated that average annualized additional investment would amount to \$910 billion for mitigation through 2050, while the World Bank estimated the amount to be about \$100 billion for the same period. See Climate Policy Initiative, *The Global Landscape of Climate Finance 2013* (San Francisco, 2013).

¹⁵ World Bank, "Economics of adaptation to climate change - synthesis report" (Washington, D.C., 2010) Available from <http://documents.worldbank.org/curated/en/2010/01/16436675/economics-adaptation-climate-change-synthesis-report>.

¹⁶ Asian Development Bank, *Energy Outlook for Asia and the Pacific* (Manila, 2013).

¹⁷ See, for further discussion, 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.

revenues, compared with 17.1 per cent of GDP in Latin America and the Caribbean and 16.3 per cent in sub-Saharan Africa. In the same year, the average tax revenue of the general Government was 16.9 per cent of GDP for the region's developing economies, compared with 24.2 per cent for its developed economies.

22. An important way to boost tax-to-GDP ratios is to tax capital gains more effectively, something that is rarely done. This may arise from the difficulty in valuing capital gains, but is more likely due to the potential negative impact on competitiveness vis-à-vis countries that do not have such a tax.

23. Many countries have shifted from taxation of trade to taxation on goods and services by introducing and expanding their value added tax (VAT) or general sales tax (GST). Between 1990 and 2014, VAT or GST revenue rose from less than a fifth of indirect tax revenue to about one half. Despite raising significant amounts of revenue, collection efficiency of VAT/GST is quite low in many countries, indicating tax exemptions and difficulties in implementation of the tax. ESCAP estimates that in China, collection efficiency is less than 50 per cent. In Bangladesh, India, Malaysia and Pakistan, collection efficiency is less than 40 per cent. In Indonesia, estimates of VAT "gaps" have been put at 50-60 per cent.¹⁸

24. In many Asia-Pacific countries, a large part of tax revenue is also eroded by exemptions and concessions as countries aim to promote investment and, in particular, attract foreign direct investment (FDI). Those exemptions include policies, such as tax holidays, reduced corporate income tax rates, investment tax allowances and partial profit exemptions, to reduce the cost of capital.

25. In South-East Asia, for instance, those tax policies have been pursued extensively to encourage investment and to promote exports, research and development and skills training. In countries, such as Indonesia, Pakistan, the Republic of Korea, Sri Lanka and Thailand, small companies are taxed at substantially lower rates, with some of them also offering preferential tax treatment for a whole sector — in Sri Lanka, for tourism, construction and insurance, and in Pakistan, for power generation.

26. Corporate tax concessions are worthwhile if they lead to higher investment, especially in employment-intensive sectors. Extending special incentives to foreign investors is useful if they provide technological or other forms of expertise not available in the country. However, preferential tax treatment for foreign investors often distort competition by putting local companies at a disadvantage, making it necessary to carry out a careful cost-benefit analysis to evaluate the usefulness of such tax policies.

27. Realizing their tax potential fully could raise more than \$440 billion in tax revenues in 17 countries in the region, of which \$306 billion would be raised in developing countries. In several economies, the tax potential is quite sizeable, amounting to several percentage points of GDP. In Afghanistan, Bangladesh, Bhutan, the Islamic Republic of Iran, Maldives and Singapore, the tax potential is equivalent to between 5 and 7 per cent of GDP. In Hong Kong, China, the tax potential exceeds 12 per cent of GDP. If economies were to tap this potential, tax revenues would increase by 70 per cent or more in several of them.

¹⁸ ESCAP, *Economic and Social Survey of Asia and the Pacific 2014* (United Nations publication, Sales No. E.14.II.F.4).

28. Policymakers are currently discussing other innovative and emerging sources of resource mobilization from both domestic and external sources that would help build momentum for sustained economic growth.¹⁹

B. Public expenditure management

29. Rationalization of public expenditure and more effective allocation and management could free significant resources for development. Governments could significantly scale up resources by improving expenditure management of their budgets. In 2013, defense expenditure among the countries of the Asia-Pacific region, amounted to about \$342 billion.²⁰

30. Significant resources are spent on subsidies. In South-East Asia alone, energy subsidies amounted to \$51 billion in 2012. Such subsidies are a drain on resources. Rationalizing subsidies could, therefore, be a key reform in efforts to raise public resources for productive development investment in the region. According to ESCAP estimates, savings from those subsidies would be sufficient to finance a comprehensive policy package comprising income security for the entire elderly population and the people living with disabilities, as well as extending universal access to health and education in several large countries.

31. Public resources for development could be raised by curbing illicit financial flows, including those related to tax evasion and avoidance. The Asia-Pacific region accounts for more than 60 per cent of the estimated \$5.9 trillion that flowed out of developing countries illegally between 2001 and 2010 to avoid taxation.²¹ Of the 10 countries with the largest illicit capital flows, six are in the Asia-Pacific region; among least developed countries, illicit outflows from Bangladesh have been the largest, reaching \$35 billion between 1990 and 2008.²²

V. Broadening and deepening capital markets

32. This section highlights the need to exploit the potential of capital markets to facilitate the channelling of private savings towards sustainable development. The ultimate objective of policies to broaden and deepen capital markets is to mobilize more funds and longer-term financing arrangement for sustainable investment. This would enable greater volumes of socially productive investment in new economic activities and social infrastructure.

33. Strategies to broaden and deepen financial markets must take into account the role of the State beyond deregulatory and liberalization actions. Effective regulation and State measures are needed to facilitate the

¹⁹ See Communiqué, Meeting of Finance Ministers and Central Bank Governors, Sydney, 22-23 February 2014. Available from https://g20.org/wp-content/uploads/2014/12/Communique-Meeting-of-G20-Finance-Ministers-and-Central-Bank-Governors-Sydney-22-23-February-2014_0.pdf.

²⁰ For more information, please refer to World Bank, World DataBank. Available from <http://databank.worldbank.org/data/home.aspx>.

²¹ Dev Kar and Sarah Freitas, *Illicit Financial Flows from Developing Countries: 2001-2010* (Washington, D.C., Global Financial Integrity, 2012).

²² Dev Kar, "Illicit financial flows from the least developed countries: 1990-2008", United Nations Development Program Discussion Paper (2011). Available from http://works.bepress.com/dev_kar/3.

channelling of resources to desired investment areas. The region has a large pool of savings that could be deployed for development purposes. In fact, the stock of financial assets of the region's most wealthy individuals amounted to \$35 trillion in 2013.

A. Equity markets

34. Although the share of equity markets as a proportion of total financial sector assets in Asia and the Pacific is small, its key stock markets have experienced impressive growth in recent years. As a result, the region's share of total world market capitalization stands at 31 per cent. Notably, the stock markets of: Tokyo; Hong Kong, China; and Shanghai, China, account for more than 50 per cent of market capitalization in the region. In addition, other dynamic markets in the region have strong potential to accommodate cross-border listings.

35. A few key trends are worth highlighting: stock market capitalization in Asia and the Pacific is close to \$15 trillion, well over the combined value of the markets of Eastern Europe, Middle East and Africa. In total, almost 20,000 companies were listed in the region's stock markets at the end of 2012, well above comparative figures for other continents. Stock markets in Asia and the Pacific, however, vary significantly in terms of market capitalization, ranging from 144 per cent of GDP in Malaysia to 0.3 per cent of GDP in Armenia. In smaller economies, the breadth and depth of markets are often quite limited, owing to lack of liquidity, a low level of corporate listings and weak regulatory frameworks and corporate governance.

B. Bonds markets

36. The development of local currency bond markets in the region received a boost after the 1997 Asian financial crisis.²³ The rationale for supporting its development was to reduce the extent of currency mismatches, which prior to the crisis were associated with banks borrowing overseas in United States dollars and lending domestically in domestic currency. After 1997, domestic bond markets expanded rapidly in some Asia-Pacific developing economies.²⁴ The value of domestic bonds outstanding in: China; Hong Kong, China; Indonesia; Malaysia; Philippines; Republic of Korea; Singapore; and Thailand represented only 21 per cent of GDP in 1997.²⁵ These figures were comparable to developing countries from Latin America (20 per cent) and Eastern Europe (17 per cent). However, by 2010, the value of domestic bonds outstanding increased to 64 per cent of GDP for Asia-Pacific developing economies, largely exceeding their counterparts in Latin America (34 per cent) and Eastern Europe (33 per cent) in the same year.²⁶

²³ Mah-Hui Lim and Joseph Lim, "Asian initiatives at monetary and financial integration: A critical review?", background paper for the Economic Cooperation and Integration among Developing Countries Report 2012, UNCTAD, 2012.

²⁴ In Seok Baek and Pil-Kyu Kim, "Determinants of bond market development in Asia", in *Asian Capital Market Development and Integration: Challenges and Opportunities*, Asian Development Bank and Korea Capital Market Institute, eds. (Oxford, Oxford University Press, 2014).

²⁵ Data obtained from Bank for International Settlements.

²⁶ In Seok Baek and Pil-Kyu Kim, "Determinants of bond market development in Asia", in *Asian Capital Market Development and Integration: Challenges and Opportunities*, Asian Development Bank and Korea Capital Market Institute, eds. (Oxford, Oxford University Press, 2014).

37. The region is leading a global trend towards local currency-based finance. International issues by both Governments and corporations of local-currency bonds and notes have increased sharply since 2000. For China, Thailand and Turkey, this share exceeded one third of the total. Governments have opened domestic debt markets to foreigners. This shift was also facilitated by currency appreciation in the 2000s, abundant global liquidity and high commodity prices.

38. Domestic bonds issued in the region's developing economies increased at an average annual rate of 16.8 per cent between 2005 and 2013, compared with 4.9 per cent per annum for developed economies. On average, growth of those markets was more rapid over the period 2005-2009 compared with 2009-2013, especially for the region's developed economies. As of September 2013, Japan remained the largest issuer of domestic currency bonds in the region, but its share decreased to 44.3 per cent from 66 per cent in September 2005. Issues of domestic currency bonds have increased most rapidly in India, from only \$0.2 billion in September 2005 to \$2 billion in September 2013.

C. Emergence of institutional investors

39. Institutional investors include pension funds, mutual funds, insurance companies, sovereign wealth funds and investment managers. Globally, most of the assets managed by them are in member countries of the Organisation for Economic Co-operation and Development (OECD). As of the end of 2012, those countries held \$70 trillion of the \$85 trillion in assets being managed globally. Institutional investors can play an increasingly critical role in the global provision of long-term finance, part of which could be tapped for the funding of sustainable development.²⁷

40. The following paragraph contains a brief description of the current status of institutional investors in Asia and the Pacific. The top institutional investors in the region can be placed in three categories: asset management firms, such as insurance companies and mutual funds; pension funds; and sovereign wealth funds. Of the \$68.30 trillion in assets under management by the world's top 500 asset management firms, the share of Asia and the Pacific was only 9.7 per cent or \$6.65 trillion at the end of 2012. The vast majority of this amount was managed by firms from the region's developed countries: \$4.82 trillion (72.4 per cent) by Japan and \$850 billion (12.8 per cent) by Australia.²⁸

41. In contrast, in the category of sovereign wealth funds, the Asia-Pacific region had a larger global presence — \$2.85 trillion or 45 per cent of the world's total assets under management. In addition, sovereign wealth funds from developing economies represented 96 per cent of the region's total assets under management, of which China represented \$1.31 trillion or 45.8 per cent; Singapore, \$493 billion or 17.3 per cent; Hong Kong, China, \$327 billion or 11.4 per cent; and the Russian Federation, \$187 billion or 6.6 per cent. In addition, smaller economies, such as Timor-Leste, Azerbaijan

²⁷ OECD Task Force on Institutional Investors and Long-Term Financing, "G20/OECD High-level principles of long-term investment financing by institutional investors" (Paris, September 2013). Available from www.oecd.org/finance/private-pensions/G20-OECD-Principles-LTI-Financing.pdf.

²⁸ Towers Watson, "The world's 500 largest asset managers, year-end 2013", 2014. Available from www.towerswatson.com/en/Insights/IC-Types/Survey-Research-Results/2014/11/The-worlds-500-largest-asset-managers-year-end-2013.

and Brunei Darussalam, each had sovereign wealth funds that exceeded \$10 billion.²⁹

42. The share of Asia and the Pacific in assets under management of the world's top 300 pension funds was 26.3 per cent or \$3.68 trillion at the end of 2012. Although the developed economies of the region represented the lion's share of that amount (Japan, \$2.03 trillion or 55 per cent; Australia, \$478 billion or 13 per cent), developing economies, including the Republic of Korea, China, Singapore, Malaysia, the Russian Federation and India, represented 31.5 per cent of the total.

43. Pension funds have traditionally invested in infrastructure through listed companies and fixed-income instruments. However, over the last two decades, they have started to recognize infrastructure as a distinct asset class which, although illiquid, could be beneficial to enhance portfolio diversification. Owing to their long investment horizons, pension funds and other institutional investors can afford the risk of investing in less liquid and longer-term assets, such as infrastructure.³⁰

44. This development would be highly desirable to increase the level of financial intermediation and the availability of funding for investment projects in the region. In addition, as also noted in the previous section, a stronger presence of domestic institutional investors in the region's capital markets will reduce the potential for disruptive capital flows by international investors. A major challenge for the development of domestic institutional investors is to set up proper institutional and regulatory frameworks, an issue that deserves further research and discussion.

VI. Financial inclusion

45. In many developing countries, large proportions of the population are excluded from the financial system. Therefore, fostering financial inclusion is key to strengthening domestic demand in the region in order to rebalance the global economy and to address rising inequality and social progress.

46. Despite progress in the area of financial inclusion, the large majority of the adult population in Asia and the Pacific, especially in the poor and vulnerable sections of society, have low financial literacy and capability and is excluded from core financial services — savings, credit, insurance and remittances. Recent data show that 50 per cent of adults worldwide have an account at a formal financial institution, such as a bank, a credit union, a cooperative, a post office, or a microfinance institution, with most developing Asia-Pacific countries falling below this average.

47. The cross-country variation in access to financial services can be partly explained by such factors as per capita incomes, urbanization and financial depth, but this is not the whole story. Countries, such as India and Thailand, for instance, have higher-than-predicted penetration rates. Financial inclusion differs by individual characteristics, such as gender, education level, age and rural or urban residence. In India, for instance, women are

²⁹ SWF Institute, Sovereign wealth fund ranking. Available from www.swfinstitute.org/fund-rankings/.

³⁰ OECD, "Report on pension funds' long term investments: survey of large pension funds and public pension reserve funds" (Paris, October 2013). Available from www.g20.org/sites/default/files/g20_resources/library/LargestPensionFunds2012SurveyFINAL.pdf.

41 per cent less likely than men to have a formal account, compared with 22 per cent in the rest of the developing world.³¹

48. The cost of credit is an important factor determining financial inclusion in the region. The targeting of credit to, for example, State-owned enterprises, is limiting credit availability to the private sector, while high interest rates are crowding out people. Lack of awareness of what is available and services not suited to specific needs are also driving exclusion from financial services. In addition, banks may be concerned about the potential profitability of poorer customers, the risks they are thought to present and the costs of dealing with a larger number of small transactions. Also of note, basic consumer protection requirements have been set in most economies, but enforcement mechanisms are weaker than legislative requirements and institutional structures are ineffective.

49. Financial inclusion is an important tool for achieving the objectives of sustainable development. Therefore, different types of domestic financial institutions, such as commercial banks, microfinance institutions, development financial institutions, post offices and other public networks, have a role to play in serving the poor and addressing the growing income and social inequality. The financial markets need to be more efficient and allocate resources more effectively. To move forward, it would be useful to identify lessons learned in countries of the region on innovative approaches to providing financial services for the poor and on successful regulatory and policy approaches.

VII. Leveraging public-private partnerships

50. The use of public-private partnerships has significantly increased in the Asia-Pacific region over the last few decades. A public-private partnership involves a long-term contractual arrangement between a governmental body and a private firm. Both central and subnational governments are involved in such partnerships.

51. Many governments resort to the public-private partnerships due to their potential to close gaps in national and regional development financing. In addition to mobilizing private sector resources, these partnerships are viewed as a way to exploit private sector efficiency and innovation capacity while shifting some risks to the private partner. By deploying the more efficient management practices of the private sector, the public-private partnership approach has the potential to generate more efficient project outcomes.

52. Public-private partnerships have the potential to upgrade the quality of public services to the benefit of users and consumers³² and can reduce the burden on taxpayers on developing and operating public services. Thus, these partnerships can be of importance to public authorities with the responsibility to provide basic infrastructure and services. However, a positive outcome from such partnerships is only possible if the public sector can effectively

³¹ Asli Demirguc-Kunt and Leora Klapper, "Measuring financial inclusion: the global index database", Policy Research Working Paper, No.6025 (Washington, D.C., World Bank, 2012). Available from <http://elibrary.worldbank.org/doi/pdf/10.1596/1813-9450-6025>.

³² Ehtisham Ahmad and others, "Involving the Private Sector and PPPs in Financing Public Investments: Some opportunities and challenges", Asia Research Centre Working Paper 67 (London School of Economics and Political Science, September 2014). Available from www.lse.ac.uk/asiaResearchCentre/_files/ARCWP67-AhmadBhattacharyaVinellaXiao.pdf.

harness the private sector's technical expertise and access to financing. The relationship must, therefore, be configured in a way that the project risks and costs are assigned between partners based on the party that is in best position to handle them.

53. The potential of public-private partnerships is highlighted by the spectacular increase in private investment in infrastructure since 1990. In the preceding seven years to the 1997 Asian financial crisis, private investment committed to infrastructure in developing countries expanded more than twentyfold from \$2 billion to \$48.9 billion. Subsequently, the average annual growth rate of private sector investment reached 25.4 per cent between 2002 and 2008. Stimulus policies adopted by many countries in the region since the crisis further boosted private investment, especially those tackling infrastructure bottlenecks, to an unprecedented level of \$120.1 billion in 2010.³³

54. Some Governments have secured, partly or wholly, the future cash flow of infrastructure projects, thereby making it easier for the project company to access commercial loans. This has been done by providing State guarantees, such as "minimum revenue guarantees", "exchange rate guarantees"³⁴ or even "default guarantees"³⁵ or signing offtake agreements, whereby the Government commits to buy the product/service that will result from the infrastructure project on a long-term basis. For example, "power purchasing agreements", which are a type of offtake agreement, have been critical to the success of public-private partnerships in the energy sector. To facilitate access to credit, commercial insurance can also provide some risk coverage and national or multilateral development financing institutions can issue credit guarantees or extend their preferred creditor protection to private lenders.

VIII. Innovation in climate finance

55. Climate change is one of the key emerging development challenges in the Asia-Pacific region, owing to its related negative impact of environmental degradation, such as air pollution and depletion of biodiversity.

56. According to the World Risk Report 2013, of the 15 countries most exposed to natural hazards and climate change-related risks exposure, nine are in the Asia-Pacific region. The total estimated losses due to natural disasters in the region during the period 2003-2013 totalled \$750 billion, representing 49.5 per cent of the global economic losses. The average annual losses in the Asia-Pacific region over the same period amounted to 48.3 per cent of the global losses.³⁶

57. To follow up on the Copenhagen Accord of 2009, the Cancun Climate Change Conference in November 2010 and the Durban Climate Change Conference in November 2011, developed countries committed to jointly

³³ ESCAP, based on data from the World Bank PPI database. Available from <http://ppi.worldbank.org>.

³⁴ Due to limited availability of long-term financing in local currency, project companies might have to borrow in United States dollars, while their revenue stream is in the local currency, thereby creating a currency mismatch. An exchange rate guarantee is aimed at protecting the private partner from local currency devaluation.

³⁵ "Default guarantee" means that the Government agrees to carry out the obligations of the public-private partner company vis-à-vis its lenders upon default in order to enhance the creditworthiness of the operation.

³⁶ ESCAP, based on data from EM-DAT. Available from www.emdat.be/ (accessed on February 2014).

mobilize \$100 billion a year by 2020 for climate finance from public and private sources. Key players in climate finance are private commercial banks and infrastructure funds, which have distributed about \$38 billion, including project-level debt and direct investments.³⁷

58. An overview of the Asia-Pacific climate finance landscape highlights the importance of financing requirements to advance the sustainable development agenda. The Asia-Pacific region received about 54 per cent of the total approved spending of global climate funds, which has amounted to nearly \$11.5 billion since 2002.³⁸

59. In 2012, multilateral development banks disbursed \$27 billion in climate finance, of which 78 per cent or \$21 billion was dedicated to mitigation and the remaining to adaptation. Of the total commitments, 8 per cent, or \$2 billion, came from external resources, such as bilateral or multilateral donors, including the Global Environment Facility and the Climate Investment Funds.

60. According to one regional report, the amount of climate finance required during the period 2010-2020 is \$10 trillion globally or about \$1 trillion per year.³⁹ The Green Climate Fund is expected to contribute only \$100 billion per year by 2020. With the current level of climate finance ranging between \$200 billion and \$360 billion, the gap to be filled ranges between \$640 billion and \$800 billion. The geographic allocation of investment is distorted, with India and Thailand receiving more than 80 per cent of the funding alone.

61. The private sector's share of climate finance in 2012 was estimated to be \$230 billion; therefore, in order to fill the gap, it has to roughly triple in size.⁴⁰ The share is structured as follows: \$35 billion were pledged by donor countries; \$26 billion were deposited into climate funds globally; and \$9 billion were approved to finance projects globally.

62. An innovative area in leveraging funds to tackle climate change is the financing raised from green bonds. In 2013, \$11 billion was raised globally through green bonds; this amount is expected to reach about \$50 billion by 2015.⁴¹ Institutional investors contributed globally only about 0.2 per cent of total financing raised for climate change mitigation and adaptation.⁴² At the regional level, the Asia-Pacific region received one fourth of all global

³⁷ Climate Policy Initiative, *The Global Landscape of Climate Finance 2013* (San Francisco, 2013).

³⁸ www.climatefundsupdate.org/listing.

³⁹ USAID, "Fast out of the gate: how developing Asian countries can prepare to access international green growth financing", presentation presented at the Asia LEDS Partnership Workshop, Manila, Philippines, April 2013.

⁴⁰ Barbara Buchner and others, "The Global Landscape of Climate Finance 2013". Climate Policy Initiative (CPI). Available from <http://climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2013/>.

⁴¹ The Economist, "Spring in the air: bonds tied to green investments are booming", 22 May 2014. Available from www.economist.com/news/finance-and-economics/21599400-bonds-tied-green-investments-are-booming-spring-air.

⁴² The United Nations estimated in 2012 that pooling innovative mechanisms could generate over \$400 billion annually. United Nations, *World Economic and Social Survey 2013* (United Nations publication, Sales No. E.12.II.C.1).

climate finance investments. Private investment into renewable energy projects in China was \$68 billion and India received \$5 billion.⁴³

IX. Mobilizing external resources

63. External resources are important to augment domestic financial resources to meet development financing requirements. In many developing economies, especially in least developed countries and fragile States, substitution of domestic resources for foreign exchange is often difficult in short-to-medium-term development policymaking.

A. Official development assistance

64. Traditional external sources of financing, including ODA, only partially meet the region's resource requirements for sustainable development. ODA flows to the Asia-Pacific region stood at \$30 billion in 2012, representing only 23 per cent of the global ODA flows. However, ODA remains a significant source of development finance for the region's least developed countries and small island developing States. The least developed countries received \$12.4 billion in 2012, or 44 per cent of the region's ODA, more than double their share of 21 per cent in 1990.

65. Policies need to be in place to raise ODA. In addition, overall aid policies should be discussed in the context 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/coordination. Two recent global conferences underscored the importance of aid effectiveness, the fourth High-level Forum on Aid Effectiveness, in Busan, Republic of Korea in 2011,⁴⁴ and the first High-level Meeting of the Global Partnership for Effective Development Cooperation, in Mexico City in 2014, to anchor effective development cooperation in the global development agenda beyond 2015.⁴⁵

B. Foreign direct investment

66. FDI flows to the region are larger than those of ODA. FDI was also affected by the global financial crisis, dropping from \$469 billion to \$330 billion between 2008 and 2009. It, however, recovered subsequently to \$506 billion in 2012.^{46,47} In 2013, developing Asia-Pacific economies accounted for more than one third of global FDI of \$1.46 trillion.⁴⁸

⁴³ Sam Barnard and others, "Climate finance regional briefing: Asia and Pacific", Climate Finance Fundamentals, No. 8 (November 2013). Climate Funds Update. Heinrich Böll Stiftung and ODI. Available from www.odi.org.uk/sites/odi.org.uk/files/odi-assets/publications-opinion-files/8679.pdf.

⁴⁴ 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.

⁴⁵ See the Communiqué for the first High-Level Meeting of the Global Partnership. Available from <http://effectivecooperation.org/2014/03/30/draft-communicue-for-the-first-high-level-meeting-of-the-global-partnership/>.

⁴⁶ ESCAP, *Statistical Yearbook for Asia and the Pacific 2011* (United Nations publication, Sales No. E.11.II.F.1).

⁴⁷ ESCAP, *Statistical Yearbook for Asia and the Pacific 2013* (United Nations publication, Sales No. E.13.II.F.1).

⁴⁸ UNCTAD, *Global Investment Trends Monitor* (Geneva, 2014).

67. In this changing FDI scenario, Governments in the region regularly promote policies to ensure that FDI projects promote inclusive growth by investing more in Greenfield FDI, which can create employment and increase the technological capacity of national economic sectors. As FDI inflows are driven by market fundamentals and profit motives, little investment tends to be directed to social and environmental projects as these sectors do not yield sufficient economic returns.

C. Remittances

68. There has been a burgeoning discussion centred on remittances as a source of development finance. The level and rate of growth of remittances are often contrasted to the inflows of ODA and FDI. Remittances of workers employed overseas to the region during the global financial crisis increased from \$114 billion in 2008 to \$117 billion in 2009. Migrant remittances to developing economies rose from \$200 billion in 2010 to \$260 billion in 2013.^{49,50} For some economies, such as Kyrgyzstan, Nepal, Samoa, Tajikistan and Tonga, remittances represent more than 20 per cent of GDP.

69. There is no doubt that remittances play an important role in supporting the incomes of the poor in recipient countries, but given the private nature of these flows, the possibilities of utilizing them for financing public goods are limited.⁵¹ Besides the quantity of remittances, there are issues related to their overall cost to human lives. These are mostly linked to conditions of migrant workers' quality of life and labour rights and protection, as well as safe working and pay conditions.

X. Trade finance for small and medium-sized enterprises

70. Some 80-90 per cent of the businesses in Asia and the Pacific are small and medium-sized enterprises, which as a group are less likely to export than larger companies.⁵² Small and medium-sized enterprises tend to have limited access to trade finance, making it difficult for them to engage in international trade or to participate in international supply chains. The limited access can be attributed to the following: high transaction costs; imperfect information; high default risk; and limited collateral.⁵³

71. Trade finance is the lifeline of trade as more than 90 per cent of trade transactions in the world involve some form of credit, insurance or

⁴⁹ ESCAP, *Statistical Yearbook for Asia and the Pacific 2011* (United Nations publication, Sales No. E.11.II.F.1).

⁵⁰ ESCAP, *Statistical Yearbook for Asia and the Pacific 2013* (United Nations publication, Sales No. E.13.II.F.1).

⁵¹ An interesting scheme to encourage investments in public goods using remittances income is the 3x1 programme of Mexico, by which municipal, state and federal governments matched funds sent to Mexico by migrant organizations abroad to fund the provision of public and social infrastructure in the migrants' communities of origin. See, for example, Rodolfo García Zamora, Xóchitl Bada and Luis Escala-Rabadán, "Mexican migrant social and civic participation in the U.S.: the case of hometown associations in Los Angeles and Chicago", Mexican Migrant Social and Civic Participation in the United States, Washington D.C., 4-5 November 2005.

⁵² Estimates by the International Finance Corporation suggest that only 15% of regional small and medium-sized enterprises are already exporters. See International Finance Corporation, *Scaling-Up SME Access to Financial Services in the Developing World* (Washington D.C., October 2010).

⁵³ International Trade Centre, *How to Access Trade Finance: A Guide for Exporting SMEs* (United Nations publication, Sales No. 09.III.T.12).

guarantee.⁵⁴ Both buyers and sellers face credit risks and their needs for financing can be related to inventory, production, and shipping. However, a recent survey conducted by the Asian Development Bank revealed a gap in trade finance of unmet demand for lending and guarantees to support \$1.6 trillion in trade globally, \$425 billion of which is in developing Asia-Pacific countries.⁵⁵ Estimates are that an increase of 5 per cent in the availability of trade finance could result in an increase of 2 per cent in production and employment.⁵⁶

72. Many developing countries in the region have limited capacity to address trade finance shortages on their own as they lack the required national trade finance institutions and infrastructure. Government-backed export credit insurance and guarantee institutions and/or export-import banks are inefficient or have not been set up in many developing countries of the region. Similarly, in some developing countries, credit rating institutions are also weak or nonexistent.

73. In the long term, as the bulk of trade finance is provided by commercial banks operating in the domestic market – often as part of short-term, multipurpose loans (non-trade specific working capital) – a strong, credible and well-developed banking and insurance sector is key to ensuring access to a full array of trade finance instruments. Good and stable prudential regulations and a pragmatic approach to financial sector liberalization are essential to achieve this goal.

XI. South-South cooperation and triangular development cooperation

74. The growing diversity in the developing world has created new opportunities for South-South cooperation and triangular development cooperation. Within the Asia-Pacific region, economic linkages among countries have significantly strengthened partnerships in development cooperation in areas such as trade, investment, finance, technology and capacity-building.

75. Developing countries of the region have undertaken South-South cooperation activities over the past decades with varying degrees of engagement and size. The two largest contributors to such activities have been China and Turkey, with sums amounting to \$2.8 billion and \$2.5 billion, respectively, in recent years. Other important contributors to these activities are India, Indonesia, the Republic of Korea, the Russian Federation and Thailand.

76. The creation of the Asian Infrastructure Investment Bank is a formalized form of South-South cooperation that uses a multilateral development bank with an intended \$50 billion capitalization. The Bank's functions are similar to those of the World Bank. Drawing on the many lessons learned with regard to the operations of existing international financial institutions can be useful to efforts to set up this bank.

⁵⁴ Ibid.

⁵⁵ “Developing Asia-Pacific” refers to the 45 developing member countries of the Asian Development Bank.

⁵⁶ Asian Development Bank, “Trade finance survey: major findings”, ADB Briefs, No. 11 (March 2013). Available from www.adb.org/sites/default/files/pub/2013/trade-finance-survey-major-findings.pdf.

XII. Conclusions

77. This work-in-progress paper attempts to provide an overview of the landscape and state of play of Asia-Pacific development finance. The region has large financing requirements, but there is also scope for identifying and tapping the regional resource potential. The estimates of regional financing requirements vary depending on the source used. At best, most estimates remain tentative. Financing requirements to strengthen social development are up to \$800 billion per year, for infrastructure up to \$900 billion per year, and investments to modernize the region's energy sector, including adaptation of new technologies and renewable forms of energy could cost as much as \$800 billion per year.

78. These annual estimates represent, however, less than 8 per cent of the assets of the region's mass affluent and high-net-worth individuals in 2012. In addition, the region's foreign exchange reserves amounted to \$7.3 trillion in 2012, and its gross national savings were \$8.4 trillion, equivalent to 51 per cent to the world gross national savings in 2012. Thus, the savings in Asia and the Pacific are great enough to finance the region's sustainable development. The real challenge, however, is how to mobilize these savings.

79. Going forward, the region should work collectively to ensure that it nurtures strong and stable financial systems. To achieve this, policymakers and regulators need to work with the private sector to develop more diversified and balanced financial sectors, which are key to reinforcing financial stability and sustainability, as well as to extending finance to meet the people's needs and the region's development. This calls for raising tax-to-GDP ratios by broadening tax bases, removing exemptions — be they for individuals, corporations or indirect taxes — and improving collection and administrative efficiency.

80. It is important to move from bank-dominated to well-diversified and competitive financial systems, which can be achieved by broadening and deepening equity and debt markets, fostering the development of the institutional investment sector to impart the required liquidity and strengthening regulatory frameworks to restore investor confidence.

81. Furthermore, the region needs to advocate and position public-private partnerships, leveraged through well-designed incentive frameworks, to encourage financial systems and institutions to finance sustainable development projects; and lay the groundwork for development of regional capital markets, which have the greatest potential for raising the required resources for financing sustainable development.

82. Local currency bond markets in the region's major developing countries have been expanding rapidly, with the amount outstanding more than trebling in eight years, to \$7.4 trillion by September 2013. A critical issue that remains to be addressed is how to enhance country capacities to set up and improve the functioning of capital markets institutions and regulatory frameworks, particularly in least developed countries and in small island developing States.

83. Besides developing institutions and regulatory frameworks to strengthen the region's capital markets, it is important to foster the development of domestic institutional investors, particularly in the asset management and pension fund industries. There is large expertise and potential in the region to develop the asset management and pension industries, given its growing number of high-net-worth and mass affluent

individuals. In parallel, renewed efforts need to be employed to exploit domestic sources of financing and to ensure that ODA commitments and distributions are met. The private sector must also be catalysed and incentivized to support sustainable development.

84. ESCAP is positioning itself to continue facilitating intergovernmental dialogues on financing for development involving the private sector and other stakeholders, and to examine approaches and options for enhancing South-South cooperation and triangular development cooperation frameworks. These forms of cooperation will supplement – not be a substitute for – North-South flows.
