ESCAP note on the outcomes of regional consultations on the implementation in the Asia-Pacific region of the Monterrey Consensus on Financing for Development

Pursuant to General Assembly resolution 62/187 of 18 January 2008 which called upon UN Regional Commissions, with the support of regional development banks and other related entities, to hold regional consultations on the implementation experiences of the Monterrey Consensus on Financing for Development during the first half of 2008, to generate inputs to the preparatory process of the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus (Doha, 29 November - 2 December 2008), the Economic and Social Commission for Asia and the Pacific (ESCAP) held regional consultations on financing for development: (1) during the ministerial segment (28-30 April 2008) of its sixty-fourth Commission session held in Bangkok; (2) through the Regional Policy Dialogue on Financing for Development (Bangkok, 18-19 June 2008), which involved experts in development and finance, as well as representatives of civil society entities.

A summary of the Asia-Pacific region's progress, issues and challenges, and proposed actions, based on the report submitted to the sixty-fourth session of the Commission and the deliberations by member States during the ministerial segment at that session (28-30 April 2008); and the report on the above-mentioned Regional Policy Dialogue (18-19 June 2008), is provided below as Asia-Pacific inputs for the preparatory process.

Asia-Pacific region: FfD progress, issues and challenges, and proposed action

(i) Mobilizing domestic financial resources for development

Progress, issues and challenges

- The Asia-Pacific region has made substantial progress in increasing savings and foreign exchange reserves. For example, the average savings rate in Asian developing countries increased from 33.6 per cent of GDP in 2002 to 43.5 per cent in 2006 while it accumulated foreign exchange reserves in excess of US$ 4 trillion by end 2007. But much of the increase in savings and foreign reserves was in a few countries such as China, India, Republic of Korea and Singapore.
- The region's financial resources are not fully utilized for its own development due to a lack of available mechanisms and instruments, and under-developed capital markets to mobilize the resources. As a

result a large part (60 - 70 per cent) of the region's savings are invested outside the region, particularly in Europe and North America, while a similar percentage of the region's investment is financed (at a higher cost) by financial flows from outside the region, thus increasing the transaction cost. Similarly, a major part of the region's huge foreign exchange reserves are invested outside the region when there is a large demand for investment (U$220 billion per year) in infrastructure within the region.

- Some countries are experiencing the same conditions as had been seen in Thailand before the 1997 financial crisis, including rising inflation, easy credit, slack monetary and fiscal policies and policy inconsistency. Maintaining macroeconomic stability and policy consistency is key to preventing crises. Macroeconomic instability encourages financial and commodity speculation. Coordination between fiscal and monetary policies, taking into account timing and tailoring of such coordination with conditions of the economy would be necessary to prevent adverse effects.
- Small and medium enterprises (SMEs) face issues, such as, financing, management, marketing and production. Along with financial innovation for SMEs, also important is how SMEs can improve transparency and accounting standards.
- Financing employment intensive productive activities through SMEs and micro-credit schemes which will help the poor needs to be strengthened through developing appropriate instruments for mobilizing required resources.
- Microfinance has an important role in development consumption which formal banking is unable to meet.
- The slum population is increasing. Housing finance has benefited high-income groups but not low-income groups.

Proposed action

- Improve macroeconomic conditions; in particular, provide a positive real interest rate on savings to induce savings.
- Provide income-generating employment opportunities. Increase the efficiency of generating tax revenues by formalizing the informal sector, adopting appropriate tax rates and improving the quality of tax administration.
- Promote pension reforms in the direction of funded schemes, in particular, to ameliorate fiscal pressures arising from the demographic transition.
- Develop domestic capital markets, in particular bond markets, to facilitate domestic resource mobilization.
- Consider the issuance of local currency bonds by multilateral development banks with AAA rating (as is being done by the Asian

Development Bank in a few countries), as a means of avoiding currency and maturity mismatches and exchange risks.

- Develop instruments for SMEs and microfinance and strengthen financing for the poor through micro-credit schemes.
- Overcome the "non-bankability" of SMEs and increase microfinance for SMEs by innovative debt and equity financing through factoring, asset securitization, credit guarantees (by institutions as well as associations) and competency-based collateral loans.
- Consider the feasibility of a specialized bank that could provide a package of consultancy services to address SME issues.
- Support insurance schemes that could address market fluctuations in prices.
- Help improve financing for low-income groups, including through improving legal/regulatory frameworks, land/slum development, provision of affordable financing, as well as improving technology to build low-income housing.

(ii) Mobilizing international resources for development: foreign direct investment and other private flows

Progress, issues and challenges

- The Asia-Pacific region continues to attract foreign resources for development, particularly foreign direct investment (FDI). In 2006 developing countries in the Asia-Pacific region attracted US$ 258 billion more than doubling the inflow in 2002. The region has become not only a major destination for FDI inflows but also the source of outflow. The region accounted for US$ 196 billion FDI outflow, or around 16 per cent of the world total in 2006.
- However, the progress across developing countries in the region in attracting FDI is uneven. For example, two countries and one territory (China; Hong Kong, China; and Singapore) accounted for almost 50 per cent of the FDI inflows to the Asia-Pacific region.
- Regional Sovereign Wealth Funds (SWFs) could be another instrument that could be used for the region's development by allowing SWFs to put funds in Special Purpose Vehicles (SPVs) designed for investment in Asia-Pacific development projects, particularly in social infrastructure. Such investments, however, have to take into account political economy considerations, to avoid the apprehension of receiving countries and as such may require a code of conduct on SWFs to address transparency concerns. The resources of SWFs have to be utilized prudently. However, the target should be a socially acceptable rate of return rather than being pure commercial ventures.
- The growth of infrastructure in Asia lags behind its economic growth. The region's infrastructure funding gap is more than US$ 200 billion a

year. It is not a question of a lack of funds in most cases, but a reflection of the lack of bankable projects, good governance and political will and commitment.

- Among the challenges to addressing infrastructure financing are the provision of an enabling environment for infrastructure investment (legal, policy, institutional capacity, customs, governance), coordination among multiple stakeholders (public/private sector, central/local government), the development of "bankable" projects (design, cost estimate, technical preparation, risks pricing, economic and political credit), mobilization of Asia's private savings, and promotion of innovative financial instruments. Political drive and policy continuity are also important
- Most countries have provincial governments, and infrastructure finally becomes a function of provincial governments.

Proposed action

- Improve the business environment and macroeconomic conditions to attract FDI.
- Promote South-South cooperation to enhance FDI flows within the region.
- Introduce low-cost funds transfer systems through formal channels.
- Establish a regional mechanism for financing for infrastructure development.
- Develop regional bond markets (expanding the Asian Bond Fund to cover more countries could be an easy option).
- Introduce a nominal Tobin-type FfD tax on short-term capital flows at a flat rate by all countries in the region. This would not only discourage short-term speculative flows, but also act as a source for development finance. While such a tax could be administered by individual countries separately, a regional cooperation mechanism could be established to channel part of the proceeds of the region-wide tax from developed and advanced developing countries to financially constrained countries. However, any short-term gains from taxes or other controls on capital flows would likely lead to greater long-term costs by hindering foreign investment, preventing the deepening of financial markets and delaying fundamental reforms of economic policies and institutions.
- Make arrangements for multilateral development banks to deal with federal governments and to go down the risk ladder, and take higher but calculated risks than at the present level.
- Make non-bankable projects bankable by addressing issues relating to the pre-investment phase.
- Channel technical assistance from multilateral development banks that is crucial for the pre-investment phase, together with mechanisms to provide political risk insurance apart from commercial risk.

- Encourage public-private partnerships (PPPs) as an attractive solution in which both the private and the public sectors could share risks and rewards.
- Encourage multilateral development banks to play a larger role in infrastructure development and financing through co-financing, guaranteeing provision, arranging currency swaps and developing bond markets.

(iii) International trade as an engine for development

Progress, issues and challenges

- Reliance on international trade has grown faster with a growing trade and current account surpluses. Reflecting the gains in international trade, the current account surplus of developing Asia-Pacific economies increased from US$ 38 billion (1.7 per cent of GDP) in 2000 to US$ 278 billion (5.9 per cent of GDP) in 2006.
- China's economic growth has been the main factor for the expansion in trade, which has also created market opportunities for developing countries within the region through intra-regional trade. Over 66 per cent of the increased share of all developing and transition economies of Asia-Pacific share in the world trade from 19.8 per cent in 2002 to 24.5 per cent in 2007 can be attributed to China.
- Restrictions, mostly in the form of non-tariff barriers, on access to developed country markets and some other emerging markets are hurting many developing countries, particularly the LDCs, despite the region's remarkable progress in international trade.
- Progress in aid-for-trade has been slow. In recent times, trade-related assistance to LDCs in the region was only US$ 6 million annually.
- Internal bottlenecks (such as quality and availability of raw material, labour shortage, cumbersome rules and regulations, custom procedures) also prevent countries from benefiting fully from international trade.
- The existing comparative advantage in agriculture could not be utilized by developing countries in the region due to restrictions on trade in agriculture goods, including access to developed country markets and distorting agricultural subsidies. It is also important to consider providing duty free and quota free market access to industrial and agriculture products of LDCs.
- Aid-for-trade should be an additional source of finance and should not be a substitute for ODA. It should not be linked to new conditionalities and should go beyond short-term adjustment costs and aim at compensating lost revenue, increasing capacity for production and trade negotiation, among others.

- Improvements in trade facilitation by transforming from paper to paper-less transactions, as in ASEAN single window initiative could help generate large savings in terms of time and cost
- Investment protection provisions in bilateral trade agreements (BTAs) are much stronger than under WTO. In BTAs, developing countries have much weaker leverage when facing trading giants, as compared with the scenario of a multilateral setting of the WTO.
- Trade flourished because of improvements in transport technologies. However, the escalating cost of fuel has increased freight cost to such a level that, in the case of some commodities, the cost of freight is more than the cost of the commodity itself. This could severely impede trade, if the supply chain is not shortened. This could, in turn, adversely affect developing countries. There is a need to respond to these new challenges.

Proposed action

- Press for a successful and speedy conclusion of the Doha Round negotiations, while continuing to liberalize and facilitate trade within the Asia-Pacific region through deepening and strengthening existing regional and bilateral arrangements (e.g., Asia-Pacific Trade Agreement [APTA], ASEAN plus agreements and similar South-South agreements).
- Facilitate financial flows associated with trade and trade-creating FDI.
- Promote aid-for-trade at bilateral and regional levels and improve its effectiveness
- Improve supply capacity by addressing issues such as low quality and non-availability of raw material, skilled labour shortage, and trade facilitation by targeted removal of cumbersome rules and regulations, and improvement of custom procedures.
- Improve policy-oriented trade research.
- Combine trade policy with domestic reforms to ensure coherent economic and social policies.
- Promote and facilitate connection of producers and exporters from low-income and the LDCs with regional and global supply and production chains.
- Support reform of the decision making process associated with trade policy formation at national, regional and global levels, including in setting the negotiation agenda and moving the negotiation process at WTO, to enable developing countries to play a more effective role in the global trading system.

(iv) Increasing international financial and technical cooperation for development

Progress, issues and challenges

- Declining ODA in relative terms (from 0.9 per cent of GDP in 1990 to 0.3 per cent in 2005), despite ODA being a major source of finance for development in all 12 LDCs in the region.
- Aid effectiveness needs to be strengthened to increase the development impact of ODA.
- FDI flows have been more into brown fields such as mergers & acquisitions (M&A) than green fields with limited positive externalities.
- Some developing countries in the region have emerged as donors by providing zero tariffs, ODA and FDI to neighbouring countries to set examples for others to follow.
- National governments on the other hand, could improve the country conditions to ensure a stable policy environment, improved transparency, and accountability particularly in bidding and contracting.
- Technical assistance from multilateral development banks is crucial for the pre-investment phase of infrastructure projects in order to make non-bankable projects bankable.

Proposed action

- Call for greater aid disbursement, particularly to LDCs:
    - ✓ Strengthen existing partnerships and explore new ones (particularly under South-South cooperation).

- Address the need for greater aid effectiveness in aid utilization in a scenario of declining ODA:
    - ✓ Build absorptive capacity;
    - ✓ Strengthen country ownership of programmes;
    - ✓ Improve the quality of country development strategies;
    - ✓ Address governance issues.

- Improve technical and financial cooperation within the region, including through the development of local and regional bond markets, provision of guarantees (acting as a mono line) on bond issues by multilateral development banks to local issuers to make them attractive and pass on technology and expertise to local banks and help them design bankable projects.
- Promote South-South cooperation to help all parties, particularly in tapping huge energy resources in the region.

(v) External debt

Progress, issues and challenges

- Total external debt outstanding for the Asia-Pacific region as a percentage of GDP declined from 28 per cent in 2000 to 19 per cent in 2006. As a percentage of goods and services exported, total external debt declined from 94 per cent to 47 per cent during the same period, indicating its strong debt servicing capacity.
- Nevertheless, some low-income countries such as Bhutan, Kyrgyzstan, Lao People's Democratic Republic, Myanmar and Tajikistan, in particular, are facing severe debt problems.
- Rising short-term debt is also exposing the region to vulnerability. For example, the region has witnessed a 30 per cent increase in short-term debt during 2000-2006 and an increasing shift from official borrowing to borrowing from private sources.
- Stringent conditions have prevented some eligible Asian developing countries from benefiting from the HIPC initiative.

Proposed action

- Encourage more prudent economic management to prevent exposure to shocks.
- Promote effective debt management, including balancing between private and public debt, its maturity, the level of contingent liabilities and reserve management.
- Consider a regional mechanism to monitor private debt, to mitigate the destabilizing effects on financial markets at times of crisis.
- Build institutional and human resource capacity in debt management.
- Relax the conditions needed by low-income countries to benefit from the HIPC initiative.

(vi) Addressing systemic issues: enhancing coherence and consistency of the international monetary, financial and trading systems in support of development

Progress, issues and challenges

- Many countries in the region have embarked on initiatives to strengthen their financial systems, including improving regulatory and supervisory mechanisms, as well as adopting minimum standards for capital adequacy under the Basel II Framework.

- Many new initiatives, such as the Chiang Mai Initiative (CMI) and the Manila Framework, also emerged in the period following the Asian financial crisis, to address systemic issues. However, they remain focused on a few countries and their depth is limited.
- The focus has also been mainly on self-insurance (accumulating reserves), which is costly. Weak institutional frameworks, in which financial markets operate, is also a problem.
- Financial globalization has exacerbated market volatility and contributed to the emergence of new sources of systemic instability. High leverage is dangerous when markets are falling, but multiplies instability for the system. Leveraged "Buy Outs" and private equity fuelled by cheap credit and excess liquidity can cause further instability. As a result, financial systems have increasingly and inherently become more unstable.
- Vigilance and control of excess liquidity in the financial system and prudential norms are important in addressing financial crisis. Regularity of financial crises and the cost of cleaning them up (privatization of gains and socialization of risks) imply that capital is not allocated efficiently as it produces highest rate of return to holders without considering adverse effects on the rest.
- The existing surveillance system has flaws and need to be addressed. Regional monetary policy cooperation could also play a vital role in financial stability of the region. An Asian stability forum such as the world stability forum to monitor currency and maturity mismatch could also be considered.
- Loose monetary policy, wealth and income imbalance are the primary causes of the sub-prime crisis.
- Regularity of financial crises and the cost of cleaning them up (privatization of gains and socialization of risks) imply that capital is not allocated efficiently, as it produces the highest rate of return to holders, without considering adverse effects on the rest.
- Financing adaptation to, and mitigation of, the adverse effects of climate change.
- Asia's regional public goods are quite weak, especially in areas such as food security and combating human trafficking. There is a need for increased financing to strengthen regional public goods.

Proposed action

- Build credibility by pursuing a sound macroeconomic policy, enforcing prudential regulations, and discouraging short-term external borrowings through price-based or quantitative capital controls.
- Establish effective international mechanisms to make available adequate liquidity in times of crisis and provide contingency financing for countries in difficulties.

- Improve institutional framework by ensuring transparency in information provision to financial markets, adopting common minimum standards in prudential regulations.
- Address flaws in the existing surveillance system and the need for region-wide effective surveillance and early warning to prevent future financial crises, given the growing financial flows. One option could be to expand the scope and coverage of existing initiatives such as the Chiang Mai Initiative to cope with disruptive capital flows, and the Manila Framework to improve early warning under a full-fledged regional surveillance mechanism.
- Exercise vigilance over and control excess liquidity in the financial system and adhere to prudential norms in addressing financial crises.
- Consider imposing capital gains taxes (social insurance tax), to mitigate volatile short-term financial flows and their adverse effects.
- Encourage regional monetary policy cooperation to play a vital role in the financial stability of the region.
- Convene an Asian stability forum, such as, the world stability forum to monitor currency and maturity mismatch.
- Pursue, at the level of the Regional Commission, comprehensive discussion on financing for development issues.

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