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**Regional cooperation****Summary of the economic and social survey of Asia and the Pacific, 2001***Summary*

Following the impressive recovery in 1999, the economic performance of the region strengthened further in 2000. As in 1999, higher gross domestic product growth was achieved in a lower inflationary environment, despite higher energy prices. However, prospects for 2001 are mixed, primarily on account of a less favourable external environment. Overall growth is likely to decelerate somewhat and inflationary pressures are likely to increase slightly during 2001. Needless to say, the performance of individual economies will vary.

For the long term, there is a need for population-related policies to minimize the adverse impacts of demographic changes on economic and social development. Countries suffering from population pressure and having relatively high fertility rates need to enhance their efforts to stabilize their populations. Countries with low fertility rates need to evaluate the implications of slower labour-force growth on development.

Financing for development has acquired a new urgency in view of the difficulties faced by Governments in raising sufficient domestic resources for investment against the backdrop of the increasing mobility of both capital and labour, the decline in official development assistance (ODA) and its highly uneven distribution, as well as the volatility of foreign private resources. The trends and issues related to financing for development are examined in part II of the *Economic and Social Survey of Asia and the Pacific, 2001* and policy recommendations are made in the areas of domestic resource mobilization, external private resources, ODA and international systemic issues.

The present document is based on the *Economic and Social Survey of Asia and the Pacific, 2001*.

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## **I. Recent economic performance, prospects and policy challenges**

### **A. Recent performance**

1. Following the impressive recovery in 1999, the economic performance of the Economic and Social Commission for Asia and the Pacific (ESCAP) region strengthened further in 2000. The average growth rate of the developing economies of the region increased by 1 percentage point, while the developed economies improved their collective growth rate by 1.3 percentage points. As in 1999, both developing and developed economies achieved higher gross domestic product (GDP) growth in a lower inflationary environment, despite rising energy prices and weaker exchange rates in a number of countries. All the main geographical subregions contributed to the higher GDP growth and enjoyed lower inflation, with the exception of the Pacific island economies, where collective GDP growth became negative in 2000. In East and North-East Asia deflation in 1999 was followed by modest inflation in 2000.

2. Of the 25 developing economies in the region listed in the table, 17 improved their GDP growth rates in 2000 as compared with 1999, while one matched its 1999 performance in 2000. Economies enjoying higher growth were spread across the entire ESCAP region. However, the most impressive subregion in terms of growth performance was South-East Asia. It not only improved its 1999 GDP growth by over 2 percentage points, but exceeded significantly the growth forecast made 12 months earlier. The developed economies, too, led by Japan, substantially improved upon, or maintained, their 1999 performance. With respect to inflation, 14 developing economies enjoyed lower inflation in 2000 as compared with 1999, while China saw a marginally positive inflation in 2000 after experiencing deflation in 1999. Hong Kong Special Administrative Region (SAR) of China continued to experience deflation in 2000, as in 1999.

3. A favourable external environment, reflected in the buoyancy of world trade, combined with domestic measures to improve and sustain the momentum of growth in the region. These two factors, in turn, enhanced corporate and consumer confidence, thus providing a more durable underpinning to the growth process.

4. On the external side, world trade surged by over 10 per cent in volume terms in 2000. The strong growth of world trade embodied a robust export performance by the ESCAP region, where the dynamism of intraregional and intra-industry trade revived almost to pre-crisis levels. Several economies in the region registered export growth of 20 per cent or more in value terms. The strong export growth was led by electronics and electronic components, of which the ESCAP region is a major supplier. Foreign capital flows to developing countries as a group fell absolutely and as a share of total capital flows, but flows to the ESCAP region rose marginally. More significantly, their share of flows to the developing economies nearly doubled, from 23 per cent in 1998 to 40 per cent in 2000. Such flows aided the process of financial and corporate sector restructuring.

5. On the domestic side, declining interest rates and continuing fiscal stimulus supported output growth, while exchange-rate weakness and improved capacity utilization enhanced competitiveness and stimulated export growth. Furthermore, there was evidence that private domestic demand was beginning to play a bigger role in the growth process than in 1999.

### **B. Near-term prospects**

6. Notwithstanding the various positive features in the economic performance of the region in 2000 listed earlier, near-term prospects are mixed. On the external side, growth in the developed countries is likely to slow during 2001, particular imponderables being the slowdown in the economy of the United States of America, which is the biggest single market for several economies in the region, and the strength of recovery of the Japanese economy. A sharp slowdown in the United States and any loss of momentum in Japan would inevitably have adverse effects on growth in the region, directly through lower demand for exports and indirectly through an easing of the prices of both overall commodities and manufactures, such as electronics. However, continuing growth in the region itself and in the European Union (EU) could offset the adverse effects to some extent. The effects of these developments would vary between individual economies, depending upon the pattern of trade and output-mix of the countries concerned.

7. Oil prices are another source of risk and uncertainty. While some easing of oil prices has

**Selected economies of the ESCAP region: rates of economic growth and inflation, 1999-2003**

(Percentage)

	<i>Real GDP</i>					<i>Inflation<sup>a</sup></i>				
	<i>1999</i>	<i>2000<sup>b</sup></i>	<i>2001<sup>c</sup></i>	<i>2002<sup>c</sup></i>	<i>2003<sup>c</sup></i>	<i>1999</i>	<i>2000<sup>b</sup></i>	<i>2001<sup>c</sup></i>	<i>2002<sup>c</sup></i>	<i>2003<sup>c</sup></i>
<b>Developing economies of the ESCAP region<sup>d</sup></b>	6.1	7.1	6.0	6.3	6.6	2.8	2.7	3.7	4.2	4.7
<b>South and South-West Asia<sup>e</sup></b>	5.2	5.6	6.2	6.6	6.8	7.6	8.6	7.2	6.4	6.3
Bangladesh	4.9	5.5	6.0	7.0	7.2	8.9	3.8	10.0	5.0	5.0
Bhutan	6.0	6.0	5.5	..	..	4.5 <sup>f</sup>	..	..	..	..
India	6.4	5.9	6.5	6.9	7.2	3.4	6.5	5.0	5.0	5.0
Iran (Islamic Republic of)	2.4	4.5	5.5	6.5	6.7	21.1	19.9	17.4	15.3	14.0
Nepal	3.9	6.0	6.7	6.5	6.5	11.3	3.3	5.0	5.0	5.0
Pakistan	3.1	4.5	5.0	5.0	5.0	5.7	3.6	4.5	5.0	5.0
Sri Lanka	4.3	5.7	6.0	6.1	6.1	4.7	5.7	6.7	6.0	5.5
Turkey	-5.1	6.0	4.8	5.5	5.0	64.9	54.2	29.3	20.9	21.8
<b>South-East Asia</b>	3.4	5.9	5.2	5.5	5.9	7.3	2.5	4.2	4.6	5.1
Indonesia	0.2	4.4	5.0	5.7	6.1	20.5	3.7	7.0	7.6	8.8
Lao People's Democratic Republic	7.3	6.5	6.9	7.2	7.3	134.0	15.0	10.0	10.0	10.0
Malaysia	5.4	8.2	7.0	7.2	7.5	2.8	1.8	2.9	3.2	3.8
Philippines	3.3	3.7	3.4	3.8	4.6	6.7	4.3	6.1	5.6	5.3
Singapore	5.4	10.1	6.3	6.3	6.2	0.1	1.5	2.1	2.0	2.3
Thailand	4.2	4.5	4.6	4.6	5.2	0.3	1.7	2.6	3.5	3.7
Viet Nam	4.8	6.7	7.0	7.0	7.5	4.3	-1.5	4.5	6.5	7.0
<b>East and North-East Asia</b>	7.6	8.2	6.4	6.5	6.8	-0.6	0.9	2.4	3.4	4.0
China	7.1	8.0	7.8	7.7	8.2	-1.4	0.5	1.8	4.5	5.4
Hong Kong SAR of China	3.0	9.7	6.1	5.2	5.2	-4.0	-3.2	2.1	3.7	4.2
Republic of Korea	10.7	9.2	5.1	5.8	5.9	0.8	2.3	3.4	3.2	3.6
Taiwan Province of China	5.7	6.4	5.8	5.9	6.2	0.2	1.4	2.1	1.6	1.9
<b>Pacific island economies</b>	3.9	-3.1	2.5	4.3	3.8	9.7	7.8	3.5	4.0	3.9
Fiji	6.6	-12.5	1.5	4.0	1.5	2.0	1.0	3.0	2.5	2.5
Papua New Guinea	3.2	0.8	3.1	4.7	5.0	14.9	12.2	3.5	5.0	5.0
Samoa	5.3	3.5	3.5	3.5	3.5	0.3	2.0	2.5	2.5	2.5
Solomon Islands	-1.7	-13.5	-1.5	4.5	5.5	7.8	4.0	8.0	4.0	3.0
Tonga	2.2	5.2	2.5	2.0	2.0	4.4	4.5	6.5	2.5	2.0
Vanuatu	-2.5	4.0	3.0	2.0	1.0	2.8	1.5	3.0	2.0	2.0

	Real GDP					Inflation <sup>a</sup>				
	1999	2000 <sup>b</sup>	2001 <sup>c</sup>	2002 <sup>c</sup>	2003 <sup>c</sup>	1999	2000 <sup>b</sup>	2001 <sup>c</sup>	2002 <sup>c</sup>	2003 <sup>c</sup>
<b>Developed economies of the ESCAP region</b>	0.5	1.8	2.1	2.5	2.8	-0.2	-0.2	0.2	0.6	1.0
Australia	4.7	4.3	3.4	3.4	3.6	1.5	4.6	3.6	2.2	2.7
Japan	0.2	1.6	2.0	2.4	2.7	-0.3	-0.6	-0.1	0.5	0.9
New Zealand	3.9	4.0	3.5	3.0	2.8	1.1	2.8	3.1	1.8	1.5

Sources: ESCAP, based on data from the International Monetary Fund, *International Financial Statistics*, vol. LIII, No. 9 (September 2000); Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries 2000* (Hong Kong SAR of China, Oxford University Press, 2000); and *Asian Development Outlook, 2000* (Hong Kong SAR of China, Oxford University Press, 2000); United Nations, "Project LINK World Economic Outlook" (October 2000); The Economist Intelligence Unit, *Country Report: Myanmar* (London, November 2000), and *Country Forecast: Turkey* (London, December 2000); and national sources.

Note: Two dots (..) mean data are unavailable.

<sup>a</sup> Referring to changes in the consumer price index.

<sup>b</sup> Estimate.

<sup>c</sup> Forecast/target.

<sup>d</sup> Based on data for 25 developing economies representing about 95 per cent of the population of the region (excluding the Central Asian republics); gross domestic product (GDP) at market prices in United States dollars in 1995 has been used as a weight to calculate the regional and subregional growth rates.

<sup>e</sup> The estimates and forecasts for countries relate to fiscal years being defined as follows: fiscal year 2000/01 = 2000 for Bhutan, India and the Islamic Republic of Iran; fiscal year 1999/00 = 2000 for Bangladesh, Nepal and Pakistan.

<sup>f</sup> Referring to annual inflation in December.

occurred in recent months, they appear nonetheless to have stabilized at a relatively high level, more than twice their average level in 1998. Any pickup in the global economy, say, in the second half of 2001, would almost certainly generate renewed upward pressure with adverse consequences for inflation and consumer demand in the oil-importing countries. Moreover, the relative volatility of oil prices in 2000 and in the early part of 2001 creates uncertainty for business investment and household spending.

8. On the domestic side, three years of budget deficits have raised the level of public debt. Likewise, higher recovery-induced imports have narrowed the current-account surpluses of several economies. This has resulted in weaker exchange rates and some increase in investor nervousness, the latter reflected in declining stock market indices in most countries of the region. On the other hand, external debt, especially short-term debt, has declined, while external reserve positions have improved or stabilized in virtually all the economies of the region. These developments, combined with improving corporate balance sheets, suggest that vulnerability to a slowdown is much less than in 1997.

9. Taking all these factors into account, the prognosis is a moderate deceleration in the rate of GDP growth in the developing economies of the ESCAP region, of about 1 percentage point in 2001 as compared with 2000. Two subregions, South-East Asia and East and North-East Asia, are likely to account for much of the slowdown. By contrast, the developed economies of the region, South and South-West Asia and the Pacific island economies are likely to maintain or slightly increase their growth rates in 2001. Within the developed economies, the performance of the Japanese economy will have a considerable bearing on the overall outcome. In South and South-West Asia, external factors are comparatively less important; hence, the growth momentum of 2000 is likely to be maintained or improved in 2001, provided implementation of the domestic reform agenda is sustained. In the Pacific island economies, it is expected that the contractions in output that political problems caused in 2000 would be reversed.

10. The growth slowdown is forecast to be accompanied by a pickup in inflation of 1 percentage point in 2001. This phenomenon is also likely to be particularly evident in South-East Asia. East and North-East Asia should experience a modest increase in price pressures. The "flow-through" effect of firm

oil prices superimposed upon weak exchange rates is likely to be the principal causes of a pickup in inflation. Among the developed countries in the region, inflation is expected to remain stable. Japan is not expected to overcome price deflation in 2001.

### C. Policy challenges

11. The principal policy challenge confronting the region as a whole is to maintain the momentum of growth in 2001 and beyond in the face of potential unfavourable developments in the external environment. Slower GDP growth would add to the public debt, and possibly constrain vital social expenditures. Maintaining the momentum of growth within a framework of macroeconomic prudence requires action in a number of areas at the national or subregional level.

12. At the national level, all Governments need to maintain a strong commitment to macroeconomic balance. In view of the rising levels of public debt, countries need to take a fresh look at streamlining and rationalizing public spending in order to avoid the debt trap in which debt-servicing obligations rise faster than revenues. This has to be complemented by improved revenue collection. Measures to enhance domestic savings should continue to be emphasized, alongside efforts to deepen and widen financial markets.

13. Some of the economies of the region have become very dependent on electronics as a source of export earnings. While this is a dynamic new source of export growth, there appears to be evidence of overcapacity in this line of manufacturing, making the relevant corporate entities and economies more vulnerable to an external slowdown. Governments need to help domestic businesses to prepare for a possible worsening in the external environment over the next few months through improved information on alternative markets and with advice on how to diversify their activities in the coming months.

14. Weaker exchange rates have stimulated exports but will, should they persist, increase the risk of inflation. In addition, stable exchange rates are important as anchors for investment decisions, particularly by foreign investors. A moderate degree of instability in the exchange rate is unlikely to do significant harm in the short term; over the medium to long term it could reduce the flow of foreign

investment and thus reduce access to vitally important foreign technology and markets. Some countries have adopted inflation-targeting and others are considering doing so, as an alternative to fixed exchange rates. However, countries need to carefully examine the efficacy of inflation targeting as an alternative to stable exchange rates.

15. At the subregional level, Governments need to consult more frequently on a wider range of policy questions than before. One area in this respect could be progress in the implementation of agreements concerning regional trading arrangements and the maintenance of market access if international trade growth slows down. Another area is the need to avoid national actions in trade and financial matters that could have a destabilizing impact on others.

16. A number of Governments in the region are looking at bilateral deals to maintain the momentum of trade liberalization, in view of the fact that progress on global and regional trade liberalization appears not to have been satisfactory. In this connection, it is important to ensure that an increase in the number of bilateral trade pacts does not undermine regional trading arrangements or reduce pressure for a new round of negotiations at the World Trade Organization itself.

17. An issue of particular concern is the problem of weak stock markets in the region and their growing correlation with developments in the stock markets of the developed countries, particularly the United States. Weak stock markets lower business and household confidence, induce stronger risk aversion on the part of investors and make it harder to raise capital, regardless of the prospects of particular companies or business sectors. It would be very difficult to insulate regional stock markets completely from developments elsewhere. However, it would be useful to explore or find alternative routes for capital-raising by domestic businesses and thus maintain investment levels in the economies of the region. State-funded or State-guaranteed equity participation funds could be one short-term solution. Their viability needs to be critically examined. Another solution could lie in the investment of pension or provident funds in equities within prudent limits.

18. A connected problem in this regard is the perceived slow pace of progress in many countries in financial and corporate sector restructuring. This, too,

is undermining the stock markets in the region. While much has been achieved in this area over the last three years, the sheer scale of the remaining problems — for instance, resolving the non-performing loans in the banking systems of several countries — suggests that a great deal remains to be done. Any perception of reform fatigue needs to be countered. It is therefore important to accelerate the pace of financial and corporate sector restructuring, with time-bound targets in the months ahead, and to strengthen the relevant institutions and procedures, such as debt-recovery agencies and bankruptcy courts.

19. Governments should insist on greater transparency in the corporate sector to facilitate greater participation by both domestic and foreign investors and continued improvement of standards of supervision and regulation in the financial and corporate sectors. However, Governments themselves should also seek to meet the highest standards of governance.

20. Over the last few years, the rise of the new economy and the development of information and communication technologies (ICT)-related activities have put a large premium on technological upgrading in both industry and services. As a consequence, many old economy skills are becoming obsolete. The enhancement of human resource skills to facilitate the introduction of ICT in order to remain competitive in world trade and to attract foreign capital has become an urgent necessity in the region. Governments need to make a greater investment in education and training, particularly in those countries having to make a transition from labour-intensive, relatively low value added activities to higher-technology, relatively high value added activities.

21. International financial system reform continues to be of critical importance for the region, with its need for substantial access to global capital flows on a stable basis. The absence of concrete progress in this regard has encouraged some countries in the region to strike out on their own. The Chiang Mai Initiative of the Association of Southeast Asian Nations (ASEAN) is a case in point. While such initiatives have their merit, care must be taken to ensure that they do not lead to a weakening of the resolve of all countries to participate actively and meaningfully in multilateral initiatives in this area.

## II. Socio-economic implications of demographic dynamics

### A. An overview

22. The foregoing highlights some of the policy challenges posed by recent developments. However, Governments cannot be oblivious to the need to deal with longer-term development issues. From this perspective, the socio-economic implications of demographic dynamics deserve attention.

23. In 2000, 3.7 billion people lived in the ESCAP region, constituting more than three fifths (61.8 per cent) of the world population. Because of this large base, the population is expected to have increased further by 1 billion by 2025, despite the fact that annual population growth will have slowed considerably, from 1.4 per cent in the period 1990-2000 to 0.7 per cent in 2020-2025. Regarding age composition, the share of younger population will have fallen from 29.1 per cent in 2000 to 21.6 per cent in 2025, the share of working-age population will have increased from 61.6 to 62.9 per cent and the share of older population will have risen from 9.3 to 15.5 per cent in the region.

24. There is considerable diversity in the demographic dynamics of the region. Two of the world's most populous countries, China and India, are in this region, as are some countries that are tiny in size, mostly in the Pacific. The average population growth rate during the past decade ranged from over 4.0 per cent to negative numbers. There are also wide differences in age structures and patterns of mobility.

25. Chapter III of the *Economic and Social Survey of Asia and the Pacific, 2001*<sup>1</sup> examines the implications of demographic dynamics for poverty, environment, labour force and employment, education, health and domestic savings. The analysis brings out some potential adverse consequences of the prevailing demographic dynamics in the region.

### B. Policy issues

26. There is clearly a need for population-related policies to minimize the adverse impacts of demographic changes on economic and social development. Three groups of countries can be identified for policy purposes: countries with high

fertility rates, those with low fertility rates and those with increasingly larger shares of older population.

27. Countries suffering from population pressure and having relatively high fertility rates need to increase their efforts to stabilize their populations. Both the development process and reproductive health programmes have to play major roles in reducing fertility. The Programme of Action of the International Conference on Population and Development,<sup>2</sup> held in 1994, adopted a broad and holistic approach to population issues, encompassing reproductive health and gender equality, equity and the empowerment of women. A lasting solution to the diverse problems caused by rapid population growth lies in investment in human resources. Female education should be accorded priority, since it is negatively related to fertility.

28. While high population growth is a problem in many countries, low growth is causing worries in others. Countries with low fertility rates will have to evaluate the implications of those rates for the labour force. In some countries, labour-force growth is expected to slow considerably and such countries may face labour shortages in the near future.

29. It is important for these countries to invest more in human resources development to raise productivity in order to remain competitive in the international market. Raising the retirement age is one option, given the fact that life expectancy is on the increase and older people remain productive beyond current specified retirement ages in most countries. There is also potential to enhance female labour force participation in countries expected to face labour shortages.

30. Another solution is increasing the reliance on international migrant workers. Given the trend of globalization and growing interdependence among countries and their varied demographic situations, migration in the future is likely to remain substantial. For migration to be orderly and to minimize social tensions in the receiving countries, there is a need for greater cooperation between sending and receiving countries. Bilateral and regional consultations can help in sorting out problems related to international migration; otherwise, the field remains open for marketplace abuses in the forms of exploitation of illegal immigrant labour and trafficking of women and children.

31. The share of older population has been rising in most countries and it is expected to accelerate in

countries with low fertility rates. With the gradual erosion of extended family support systems, Governments will have to provide or facilitate the establishment of social security and pension systems. In most countries, government employees enjoy retirement benefits, but private sector employees and the self-employed usually do not. There is a need to explore viable options vigorously to ensure that adequate social security coverage can be expanded to a much larger share of the population in all countries.

32. The need for health services and hospitalization is usually greater for older persons than for other age groups. Therefore, better health-care facilities for older people should be planned and access to these services facilitated. A related issue of concern is that there will be a shortage of caregivers for the elderly population. Greater investment will also have to be directed towards housing, entertainment goods and other industries catering to the needs of the elderly.

33. Countries where the share of working-age population will start dropping in relation to the elderly population may experience a reduction in savings. This can influence their investment and growth rates. If such countries wish to maintain or raise their growth rates, they will have to look for investments with higher productivity or new ways of raising domestic savings.

### **III. Financing for development**

#### **A. Introduction**

34. The subject of financing for development has engaged the attention of policy makers and development economists over the past several decades. However, it has acquired new importance of late, necessitating a fresh look at the subject. Many developing countries are finding it increasingly difficult to raise sufficient domestic resources to finance investment and are dependent on foreign capital as a result. Against this, official development assistance (ODA) flows have declined, while private capital flows, although much increased, contain an easily reversible, and volatile, short-term component. More strikingly, the bulk of private flows has tended to be concentrated within a few countries.

35. Part two of the *Economic and Social Survey of Asia and the Pacific, 2001* discusses the subject of financing for development from the perspective of the

ESCAP region. It examines the trends and pattern of (a) domestic resource mobilization, (b) external private resources, (c) official flows, and (d) international systemic issues; and offers suggestions for actions at both the national and international levels. Highlighted below are the main findings and recommendations.

### **Domestic resource mobilization**

36. The largest share of financing for development originates domestically. Data for the ESCAP region show that the overall ratio of savings to GDP rose from 21 per cent in 1985 to 29 per cent in 1999. However, much of the rise is accounted for by the high-growth economies of East and South-East Asia. Elsewhere the picture is less encouraging. Furthermore, the contribution of government savings has been small or even negative. Most of the rise in savings has come from households. Savings and investment rates tend to be closely correlated, but this is not so everywhere in the region. A significant number of countries have higher investment than savings rates. These countries require access to foreign capital for financing investment.

37. The determinants of household savings are complex. The level and growth of per capita income are an important determinant of savings. In addition, a diversified array of savings outlets and instruments provided by well-regulated and sound financial institutions encourage savings in a financial form. The banking system is the main vehicle for savings in most countries of the region and the main source of investment finance.

### **External private resources**

38. There are basically two types of external resources: foreign direct investment (FDI) and various forms of loans and securities (international bank loans, both short- and long-term, international equity and bond issues and foreign participation in local capital markets). Besides adding to domestic financial resources, external resources have significant indirect positive spillovers in the form of technology transfer, the transfer of management and marketing know-how, and the strengthening of domestic financial markets.

39. The share of developing countries of the ESCAP region in FDI had risen from 48 per cent of the total for all developing countries in the 1980s, to peak at over 65 per cent in 1995. It fell back to under 47 per cent in

1999. In 1999, of FDI flows of \$96 billion to the developing countries of the region, only nine developing economies of the region accounted for nearly 99 per cent.

40. Access to other forms of foreign private capital is, as with FDI, concentrated in a handful of countries in the ESCAP region. Yet such capital flows have become the principal sources of external finance in the region. In 1999, bonds exceeded FDI flows by a factor of two, and bank loans outstanding exceeded FDI by a factor of more than five.

41. New modalities in external private capital, and in infrastructure financing through structured finance, access to venture capital funds for small and medium-sized enterprises and the use of derivatives for minimizing risk provide opportunities for developing countries to diversify their sources of financing and to reduce risk.

### **Official flows**

42. ODA has fallen both absolutely and relatively as compared with private capital flows. However, for the vast majority of developing countries that do not (yet) have access to private capital, this is the only source of needed foreign capital. Other than in moral imperatives, the justification for ODA lies in the provision of a global public good and the mutuality of economic interests.

43. Developing countries of the ESCAP region as a whole are not significant recipients of ODA, but the least developed countries, the Pacific island economies and the economies in transition are very dependent on this form of capital. Rather disturbingly, ODA has declined for these countries. "Aid fatigue" and a perception that recipient countries do not make effective use of ODA are considered to be factors in the decline.

### **International systemic issues**

44. In view of several bouts of instability in the international financial system over the last two decades, its reform is integral to having a stable flow of international resources for development. The principal objectives of reform are to prevent periodic crises, contain contagion, provide liquidity to pre-empt crises, have an agreed framework for financial sector reform and establish principles for debt workouts. These objectives can be achieved through the provision of

public goods at the international level to establish guidelines, benchmarks and rules for private capital flows and to overcome asymmetric information which adversely affects decision-making by investors.

## **B. Policy recommendations**

### **Domestic resource mobilization**

45. For a country to be able to finance its development, its Government should devise and implement a consistent set of macroeconomic policies, including an obligation to manage domestic and external public debt in a prudent manner.

46. Taxes play a key role in raising domestic resources. However, there is a perception that tax revenues are not used efficiently to achieve development objectives. Most Governments in the region need to enhance the transparency of the budget process on both the revenue and expenditure sides.

47. To finance fiscal deficits, Governments resort to borrowing from local capital markets. This should be undertaken with care to avoid distorting the market or crowding out the private sector. However, in some countries, government borrowing could help develop bond markets.

48. Banking sector reform and its modernization have to be the main focus of efforts to strengthen the financial sector. Banking reform has three key components: improvement of credit risk assessment, enhanced transparency and disclosure practices embodied in strict reporting systems, and more effective management of the problem of non-performing loans.

49. To reduce dependence on the banking system, the use of new instruments for household savings should be encouraged, such as mutual funds, pension funds, life insurance schemes and venture capital funds. Government-sponsored mechanisms include postal savings, unit trusts and provident funds. The spread of microfinance institutions for mobilizing savings and investment for the poor should be promoted, with the intention of graduating both users and institutions into the formal, regulated financial system over time.

50. Stock markets are more appropriate for the larger economies of the region. These markets need to be robust, that is to say, wider and deeper, if stocks are to be viewed by investors as viable savings instruments.

Possibilities exist for enhancing cooperation with markets outside the region and among exchanges in the region (through cross-listings, mergers, Internet trading and so forth) in order to increase the product range and robustness of the markets. Smaller economies should allow their investors to list and trade securities on other markets in the region.

51. In the aftermath of the recent financial crisis, considerable effort has been made in certain economies to promote the development of national bond markets, including benchmark curves; to set up institutional investor groups independent of banks; to encourage the use of small-scale retail bonds; and to increase the use of securitization techniques, particularly for mortgages and infrastructure. These efforts should be extended across the region as appropriate.

### **International private capital flows**

52. In a globalizing world, countries wishing to participate in world financial markets have little choice but to move the regulation of their financial and corporate sectors towards international norms and standards. However, greater input from developing countries is needed in defining these norms and standards.

53. There has to be careful sequencing of the liberalization of the capital account of a country in line with the development of the necessary institutions and regulations and human resources capacity. Sequencing applies particularly to the management of short-term inflows, which are usually intermediated by the domestic banking system.

54. Measures for enhancing FDI flows to developing countries include improving the transparency of approval procedures and reducing lists of restricted areas. Tax and other financial incentives can be minimized, as they usually have little to do with investment decisions and may contribute to non-productive competition among countries.

55. It is advisable to encourage the issuance of bonds by domestic corporations on international markets and so obtain an international credit rating.

56. Regional or subregional cooperation measures to supplement national ones to enhance the prospects of FDI include accelerating subregional trade liberalization arrangements, promoting growth triangle and growth zone arrangements and facilitating

information flows on investment and trade possibilities.

### Official development assistance

57. There is a need for enhanced ODA to the least developed countries, Pacific island developing countries and the economies in transition. Even doubling ODA to these countries would amount to less than \$5 billion, a minuscule proportion of the gross national product (GNP) of donor countries.

58. However, there is simultaneously a need to combat the feelings of aid fatigue in donor countries. The Governments of donor countries should educate their public on the smallness of their contributions and the mutuality of interests in providing aid. At the same time, it is imperative for the recipient countries to demonstrate judicious use of the aid they receive.

59. There is a need for greater aid coordination among the recipient Governments, donors and international agencies.

### International systemic issues

60. Reform of the international financial system is an integral part of the recommendations designed to mobilize a larger and more stable flow of resources for development. This involves, inter alia, action to prevent crises and contain contagion, an explicit recognition of the option of using capital controls as a temporary standstill measure and the provision of emergency liquidity or the establishment of a lender of last resort facility to pre-empt or mitigate crises. An idea that requires more serious international discussion is the application of a Tobin-type tax<sup>3</sup> to reduce instability on a global basis.

61. Increased cooperation at the subregional and regional levels among officials, central bankers and regulators is a useful way of increasing confidence, transparency and the sharing of good practices in the financial sector and macroeconomic management, including an appropriate exchange-rate regime. The viability of an emergency subregional fund to resuscitate insolvent banks needs to be explored.

62. Given the need for broad principles to guide the process of debt workouts, coordination between official and private creditors should be promoted ab initio. Similarly, there need to be developed broad principles to assess the maximum level of debt that a country or a

corporation should incur against benchmarks such as foreign exchange earnings or gross revenues.

63. Until such time as a world financial organization is established, the International Monetary Fund (IMF) could be viewed as the apex institution for the world financial system. It should operate with contributions from (a) other international bodies on standards and norms in their areas of expertise; (b) subregional and regional bodies in the areas of surveillance and early warning and in pooling of risks and liquidity; and (c) international private sector bodies on their perceptions of problematic issues and from national regulatory bodies in matters of coordination and policy advice. Such an arrangement could help provide needed international public good services such as information and analysis and thus facilitate improved institutional management of cross-border transactions.

64. Forums for discussion, exchanges of experience and technical assistance to countries of the ESCAP region regarding international financial system reform and management should be provided through the cooperative efforts of ESCAP, the Asian Development Bank, the Bank for International Settlements, IMF and the World Bank. ESCAP and other regional and subregional organizations could offer an assessment of different policy options in various areas.

### Notes

<sup>1</sup> Available at <http://www.unescap.org/drpad/survey2001/index.htm>. Accessed on 11 April 2001.

<sup>2</sup> *Report of the International Conference on Population and Development, Cairo, 5-13 September 1994* (United Nations publication, Sales No. E.95.XIII.18), chap. I, resolution 1, annex.

<sup>3</sup> Tobin taxes are excise taxes on cross-border currency transactions.