Financing strategies for LDCs graduation in Asia and the Pacific: key sources, trends and prospects

BACKGROUND PAPER*

Regional Meeting on Financing Graduation Gaps of Asia-Pacific LDCs
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1: Introduction

In May 2011, at the Fourth United Nations Conference on the Least Developed Countries (LDCs), [1]the Istanbul Programme of Action (IPoA) for the decade 2011-2010, called upon the global community to commit to a "renewed and strengthened partnership for development" that would allow the LDCs to progress towards closing financing gaps for the graduation, in combination of the national policies and international support measures. The IPoA has explicitly stated that during the course of this decade, the action plan will focus on the objectives with the "*aim of enabling half the number of least developed countries to meet the criteria for graduation by 2020*".[2]

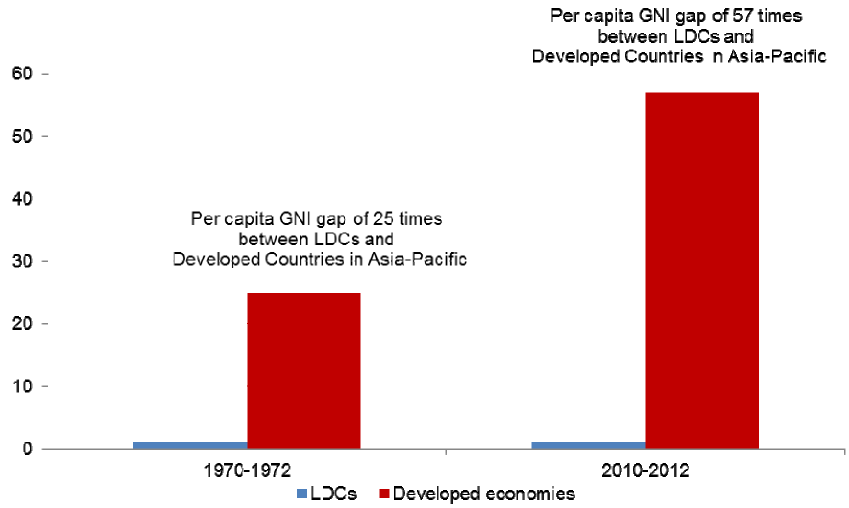
ESCAP resolution 70/1 (Implementation of the Bangkok Declaration on Regional Economic Cooperation and Integration in Asia and the Pacific)[3] also agreed "to assist countries with special needs, especially least developed countries, landlocked developing countries and small island developing States, in taking advantage of opportunities arising from regional economic cooperation and integration, including, as appropriate, through support *to enhance their capacities and through technical assistance*". It further recognised that "there is a need to implement specific policies that focus on productive capacity-building related to infrastructure development, broadening the economic base, *access to finance* and providing assistance in overcoming the risks and shocks of entering into a regional trade block".

The LDCs continue to have one of the lowest per capita incomes in the Asia-Pacific region. Moreover, the income gap with developed economies has increased significantly in recent decades (figure 1), as the region has also been accompanied by one of the highest population rates.

Most importantly, LDCs lack productive capacity due to limited development in the following areas: infrastructure (such as electricity, transport, ICT, water, human and institutional capacity), energy (both production and access to energy), science and technology (for instance, to acquire technologies, skills and innovation) and private sector (e.g. one that is dynamic, broad-based, well-functioning and socially responsible). These features have considerably inhibited LDCs to meet many of the internationally agreed development goals, including the Millennium Development Goals (MDGs), such that most rank close to the bottom of the Human Development Index. Furthermore, it has also contributed to the inability of LDCs to progress towards structural transformation and to build adequate resilience against economic vulnerability.

[1] The current list of LDCs includes 48 countries (the newest member being South Sudan); 12 in Asia and the Pacific region. These countries are the following: Afghanistan, Bangladesh, Bhutan, Cambodia, Kiribati, Lao PDR, Myanmar, Nepal, Solomon Islands, Timor-Leste, Tuvalu and Vanuatu.
[2] http://unohrlls.org/UserFiles/File/IPoA.pdf.
[3] www.unescap.org/sites/default/files/E70_RES1E.pdf.

Figure 1. Income divergence between LDCs and developed economies of Asia-Pacific



Source: ESCAP calculations based on ESCAP Statistics online. Available from www.unescap.org/stat/data/statdb/DataExplorer.aspx (accessed 20 October 2014).
Note: LDCs-Asia-Pacific consists of 12 countries, developed economies consists of Japan, Australia and New Zealand (US Dollars at current prices)

LDCs graduation requires making progress in three criteria: per capita gross national income (GNI), human assets and economic vulnerability to external shocks. Apart from increasing GNI per capita, the other two criteria are measures of structural impediments in LDCs. For the Human Assets Index (HAI), the four indicators are based upon the following: (a) nutrition: percentage of population undernourished; (b) health: mortality rate for children aged five years or under; (c) education: the gross secondary school enrolment ratio; and (d) adult literacy rate.

Similarly, for the Economic Vulnerability Index (EVI), the measure is based on indicators of (a) population size; (b) remoteness; (c) merchandise export concentration; (d) share of agriculture, forestry and fisheries in gross domestic product; (e) share of population living in low elevated coastal zones; (f) instability of exports of goods and services; (g) victims of natural disasters; and (h) instability of agricultural production. With the growing uncertainty in global economic and financial markets, as well as the concerns of the consequences of climate change, LDCs need to be vigilant and need to focus on mobilizing significant resources, including climate finance, to reduce their economic vulnerability.

Apart from these structural impediments[4], LDCs lack physical infrastructure and seamless connectivity within their national borders. This is inhibiting their productive capacity and reducing their prospects of creating “enabling business environments” for crowding in more private investment for long-term investment projects.

[4] ESCAP, *Economic and Social Survey of Asia and the Pacific 2014* (Sales No. E.14.II.F.4). Available from www.unescap.org/resources/economic-and-social-survey-asia-and-pacific-2014.

Against this background, according to the 2012 triennial review of the Committee for Development Policy (CDP)[5], the final Report of the Intergovernmental Committee of Experts on Sustainable Development Financing stressed that "Financing needs also differ across countries and regions. While financing needs are disproportionately large relative to the size of their economies in many developing countries, there are specific needs in least developed countries (LDCs)".[6] For any country to reach thresholds in three criteria would require substantial financing, especially through public investment, among others sources, as indicated in ESCAP (2013).[7] Therefore, strategies for mobilizing resources for financing the graduation gaps remain one of the critical areas for LDCs in the Asia-Pacific region.

This paper argues that traditionally, LDCs experience lack of availability and access to financial resources, both from domestic and external sources, especially in international capital markets, to finance their graduation as well as overall development gaps. The paucity of financial resources often acts as an obstacle for them to increase their economic activity. It further reduces their potential for investing in human capital and reducing vulnerability from multiple shocks, such as higher energy prices or climate change, as recognized in the three criteria for the graduation of LDCs.

As underscored in the IPoA, LDCs require an urgent action plan to improve their access to finance which can support their special needs and priorities, together with enhanced policy coordination and development partnership, including in areas such as official development assistance (ODA), international trade, foreign direct investment (FDI), and debt relief.

Apart from low levels of per capita income, the key challenges that LDCs face in terms of mobilization of financing resources are related to low domestic savings and investment, especially in social sectors (figure 2) and physical infrastructure which are related to transport and trade –related infrastructure (figure 3) and a small tax base.

Over the years, due to LDCs' exposure to the global economy through trade, investment and financial markets, the global economic and financial crisis of 2008-2009 combined with food and fuel crises, have adversely impacted hard-won development outcome of LDCs.[8]

Under these circumstances, many LDCs in the Asia-Pacific region, from Myanmar to Bangladesh, have undertaken several policy reforms to mobilize domestic resources, both public and private. These reforms are expected to further crowd-in international support measures, including renewed participation of the private sources. If successful, they could significantly increase resources for financing progress towards closing the graduation gaps and other development goals.

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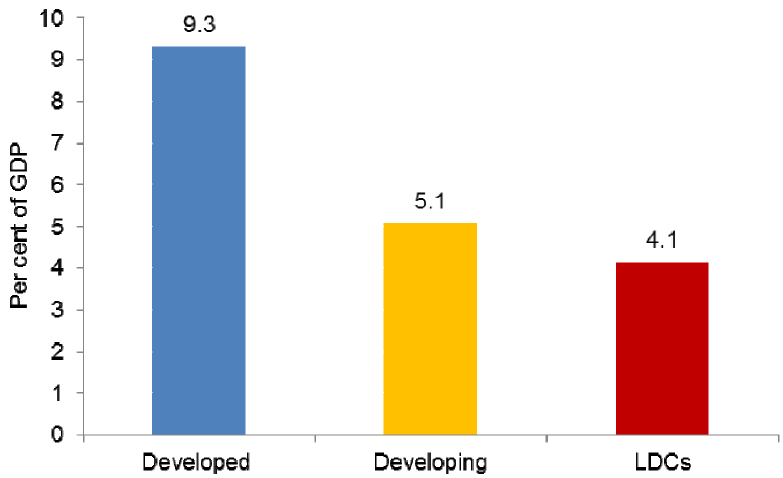
[5] The Committee for Development Policy (CDP), a subsidiary body of the UN Economic and Social Council, is – inter alia – mandated to review the category of LDCs every 3 years and monitor their progress after graduation from the category. Available from http://unohrlls.org/about-ldcs/criteria-for-ldcs/.

[6] Report is available from http://sustainabledevelopment.un.org/content/documents/4588FINAL%20REPORT%20ICESDF.pdf.

[7] ESCAP, *Economic and Social Survey of Asia and the Pacific 2013* (Sales No. E.13.II.F.2). Available from www.unescap.org/sites/default/files/yearend-update2013.pdf.

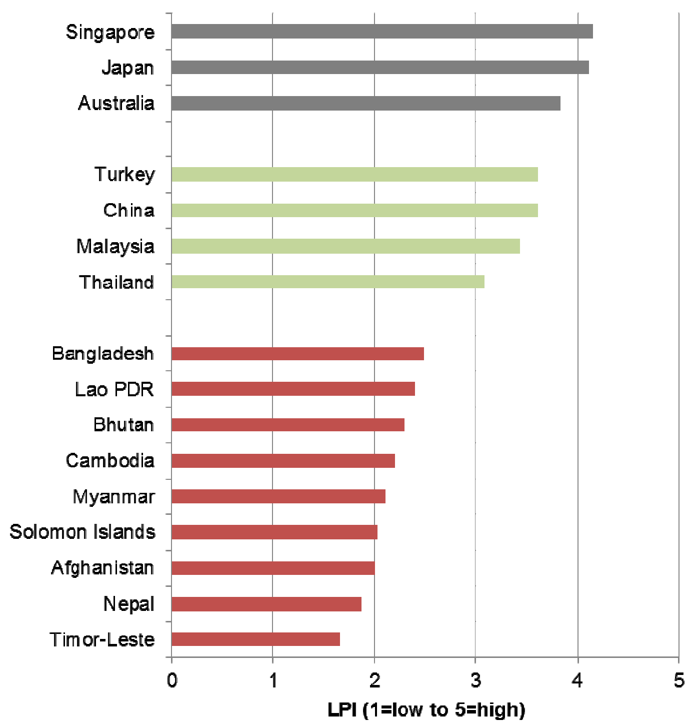
[8] ESCAP, *Economic and Social Survey of Asia and the Pacific 2012* (Sales No. E.12.II.F.9). Available from www.unescap.org/sites/default/files/Survey_2012.pdf.

Figure 2. Health expenditure in LDCs and other economies of Asia-Pacific, 2009-2011



Source: ESCAP calculations based on ESCAP Statistics online. Available from www.unescap.org/stat/data/statdb/DataExplorer.aspx (accessed 20 October 2014).
Note: Total health expenditure is the sum of general government and private expenditure on health, which is expressed as a percentage of GDP. The figure is based on average of the ratio for 2009 to 2011. According to ESCAP classification, the figures show Developed (Australia, Japan and New Zealand) and Developing countries.

Figure 3. Logistics performance index in LDCs and other economies of Asia-Pacific, 2011



Source: The World Bank Logistics performance index.
Available from http://data.worldbank.org/indicator/LP.LPI.INFR.XQ (accessed 20 October 2014).
Note: LPI measures the quality of trade and transport-related infrastructure (1=low to 5=high).

2: Key sources for mobilizing resources

In most LDCs, the low quality of social and physical infrastructure disproportionately affects poor and vulnerable communities and widens the growing rural-urban divide. Since most basic infrastructure services are driven by public sector investment, there is a growing gap between the availability and the demand for services, resulting from population growth, urbanization and climate change consequences. There is now recognition across these countries that the existing approaches, sources and governance modalities are limited in their scope to close the widening gaps for LDCs. This is reflected in the ongoing discussion of the international community on the contours of the post-2015 development agenda for sustainable development.

There are several sources for mobilizing financial resources for the LDCs in the Asia-Pacific region. Apart from traditional domestic public resource mobilization, and through existing external financing mechanisms which mostly take the form of ODA, the public discourse on financing graduation gaps and sustainable development is now aimed at exploring innovative mechanisms.

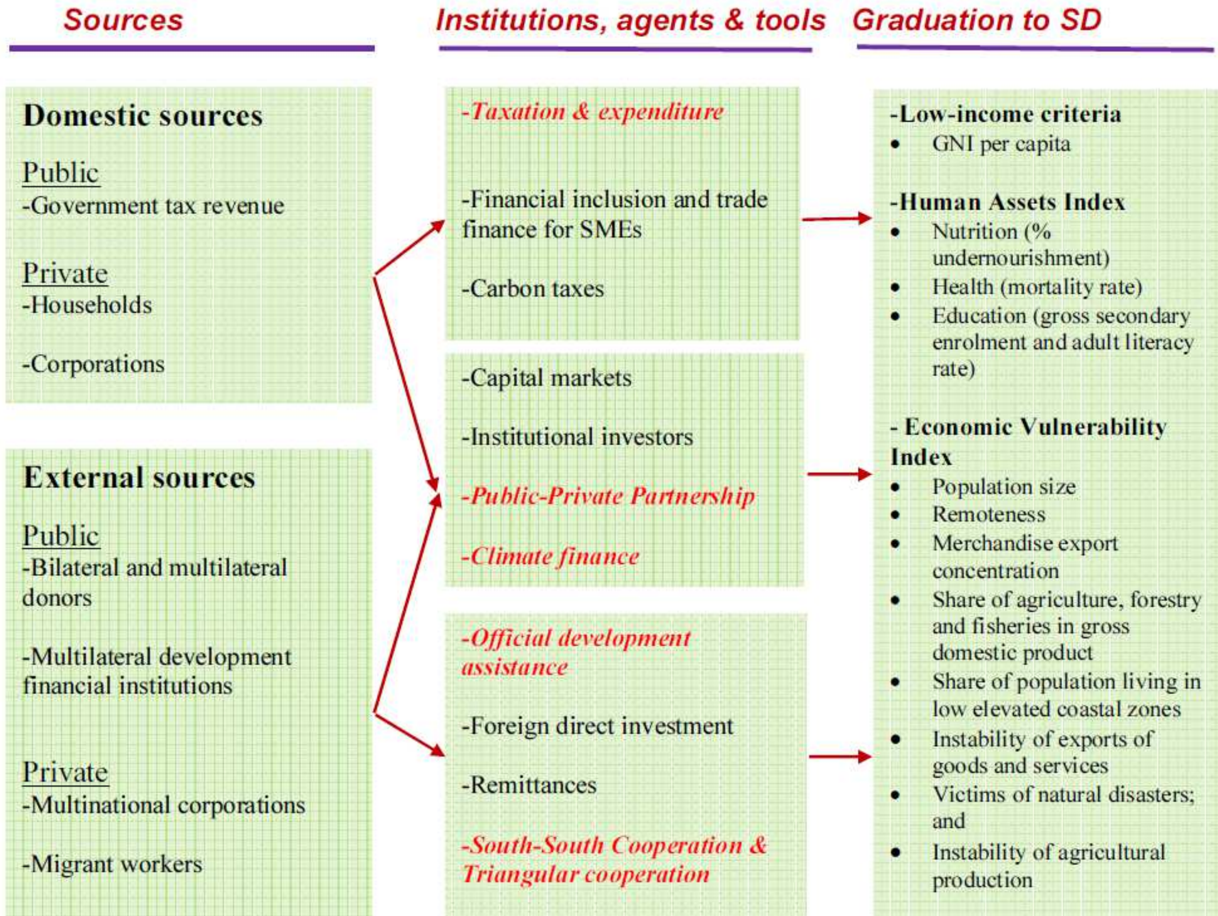
To meet the thresholds in three criteria, it is particularly important for LDCs to raise financial resources to enhance access and availability of physical infrastructure (such as roads, ICT, electricity) and to address the impacts of climate change, which are also closely linked to some indicators of the EVI criterion. To increase investment in LDCs, governments need to create appropriate institutional and regulatory frameworks for the development of domestic private sector participation as well as to increase financial intermediation by broadening and deepening capital markets. Similarly, LDCs policies to develop domestic institutional investors, for example, could help mobilize financial resources that could be invested to reduce the financing gaps.

The schematic view of financing the graduation gaps is shown in Figure 4. This paper examines both domestic and external funding sources and looks at public and private sources that will provide support to efforts of the graduation progress. There is need to reflect on how resource mobilization from these sources can be catalyzed to meet growing and emerging requirements for these economies in the region, and how public funds can leverage private funds to finance graduation which will eventually further boost government initiatives towards the sustainable development agenda.

The framework also suggests that LDCs require a new and ambitious financing strategy at its core. This should be tailored to the state of their individual level of development and their progress towards the graduation thresholds. While the mobilization of resources through existing and new sources of domestic, external and innovative financing is challenging for many of the LDCs, there is also a need to effectively use development partnerships and increase the role of the private sector in the process.

The financing strategy will also require significant investment in public goods, such as clean air, water and the continued flow of ecosystem services and other forms of environmental sustainability, upon which economies and people depend. The funding of such investments, which are characterized by high social rates of return but low private rates, is more likely to originate and be leveraged from public domestic resources. ODA should remain crucial as it acts as a complementary and mutually reinforcing element. Although LDCs in the region have been able to attract foreign private financial resources, the availability of existing resources is far from satisfactory.

Figure 4. A schematic view of the sources of financing for closing the graduation gaps



Source: ESCAP.
Note: The conceptual framework is based on the ESCAP, "Sustainable development financing: perspectives from Asia and the Pacific", paper presented at the Asia-Pacific Outreach Meeting on Sustainable Development Financing. Jakarta, Indonesia, 10-11 June 2014. Available from www.unescap.org/events/asia-pacific-outreach-meeting-sustainable-development-financing. The graduation objectives are based on the 2012 triennial review of the