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Report of the Regional Consultative Meeting on Financing for Development in the Asia and Pacific Region, Jakarta, 2 to 5 August 2000

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Introduction

1. The meeting was inaugurated by Abdurrahman Wahid, President of Indonesia. The President stressed the importance of the meeting in devising concerted approaches to resolve the problems created by a shortage of resources for development. Indonesia, along with other countries in the Asia and Pacific region, had suffered severely during the recent economic crisis. Recovery from the crisis would depend upon following the right economic policies as well as on attaining a positive sense of Asian identity by the people of the region. The meeting provided an opportunity to focus on an Asian identity. Earlier, Alwi Shihab, Minister of Foreign Affairs of Indonesia, had given a brief account of the events leading up to the holding of the meeting in Jakarta as part of the preparatory process of the High-level International Intergovernmental Event on Financing for Development. Dr. Shihab noted that Indonesia attached great significance to the process in view of its adverse experience during the crisis.

2. Statements were also made by Kim Hak-Su, Executive Secretary of the Economic and Social Commission for Asia and the Pacific (ESCAP), Rubens Ricupero, Secretary-General of the United Nations Conference on Trade and Development (UNCTAD), Nitin Desai, Under-Secretary-General for Economic and Social Affairs, and Yoshiro Iwasaki, Director of the Programs Department of the Asian Development Bank. The speakers elaborated on the role of the meeting in Jakarta in providing a regional perspective on key issues related to financing for development as an input to the High-level Event.

3. The meeting was attended by representatives of 49 countries, 11 United Nations bodies and specialized agencies, 3 international organizations, and 7 non-governmental organizations and other entities.

4. The meeting was chaired by Johan S. Syahperi, Director-General for Economic Relations of the Department for Foreign Affairs of Indonesia

Conduct of the meeting

5. The meeting was conducted through a series of panel discussions on the following six themes, with several panellists addressing issues of financing for development:

1. Issues in domestic resources mobilization in the Asia and Pacific context.
2. External private flows.
3. Recent developments in the reform of international financial architecture: regional implications.
4. Regional cooperation and collaboration on money and finance: contemporary experience and lessons for future policy options for the Asia and Pacific region.
5. Innovative sources of financing.
6. Regional issues and perspectives relating to the external sector, including official development assistance and trade issues.

The present report is based on the views and suggestions of member States and panellists, as appropriate, during the very dynamic interactive dialogue. It was felt that, in particular in discussions on the first two issues, there was not adequate time for member States to express their views. The account set out below reflects the views of participants and provides options for future consideration in the appropriate forums; it does not reflect an agreed text.

6. Views were expressed on some general issues that did not necessarily relate to specific agenda items, including:

(a) The diversity of financing for development needs and related concerns in different countries of the ESCAP region;

(b) The need to consider the various agenda items in a coherent and systematic way. It is important to consider the connections and linkages between the various financing for development issues;

(c) The need to keep a development focus in the various economic and financial discussions;

(d) The need to bear in mind the objectives of the High-level Event.

I. Issues in domestic resources mobilization in the Asia and Pacific context

7. The mobilization of domestic resources is a central issue in economic development. It was noted

that national efforts to mobilize resources need to be supported by a conducive external environment. Adverse developments in the prices of exports, sharp fluctuations in exchange rates or instability in the international financial system could severely constrain such efforts. Sound domestic macroeconomic management and transparent governance has to be complemented by transparency in the operations of global financial market operators, such as hedge funds and investment banks. Keeping these aspects in mind, the discussion focused on the regional manifestations of issues related to the raising of government revenue, the role of the banking system, the role of capital markets, the role of government in setting the rules of the game and regulating the financial system, finance for small and medium-sized enterprises (SMEs), social development and areas for regional cooperation.

Government revenue

8. In view of the generally acknowledged role of government in promoting economic and social development, the need for enhancing government revenue was underscored. There are possibilities for increasing tax revenues in countries of the region, particularly by improving the efficiency of tax administration and better enforcement. But in the design of the tax structure, it is important to pay attention to equity aspects and not just simplicity or revenue implications. The view was expressed that it is also important to develop a culture of tax compliance, which can be fostered by the perception that government is honest and fair.

9. There are possibilities for increasing non-tax government revenues through various modalities, such as increasing fees for services, privatization of state enterprises and making regulation at least partially self-financing. However, again, the concern for equity and other trade-offs needs to be taken into account.

10. The borrowing of a government from its domestic capital markets should be undertaken with caution. In small countries, the distortions created in the domestic financial system by such borrowing put a limit on its feasibility. However, in larger countries with more developed capital markets, government borrowing can help the market by setting benchmark curves for returns on bonds etc.

11. The view was expressed that fiscal and monetary policies of government should be used primarily for maintaining macroeconomic stability in order to provide a conducive environment for savings and investment. The view was also expressed that government cannot be indifferent to allocative decisions, especially because the liberalization of the financial sector may lead to a higher propensity to consume.

12. It was suggested that tax systems need to be made more supportive of long-term domestic investment rather than short-term speculative investment.

Domestic financial markets

13. It was recognized that commercial banks should follow market signals in their lending policies but that they needed to improve significantly their credit assessment capabilities.

14. One suggestion was to encourage the development of credit bureaus that are supported by an adequate legal and institutional framework so as to help with checking the credit standing of clients.

15. It was suggested that the discussion of private and public roles is oversimplified, and that public sector specialized banks could have a role to play in mobilizing savings and investment in sectors of little or no interest to commercial banks, such as the agricultural sector or low-cost housing. They could also play an important anti-cyclical role in the economy.

16. It was recognized that as the dominant role of the banks in the domestic financial system of many of the larger economies in the region declines, with more firms seeking to raise finance from the share and bond markets, this may add some degree of stability to the economy. However, the development of viable domestic capital markets is a time-consuming process that needs to be supported by regulation aimed at encouraging disclosure, transparency, and better accounting and auditing practices for firms raising funds through the markets. There are positive signs for increasing the stability of capital markets, with the emergence of mutual funds, provident funds, the use of fund managers and the concomitant decline in reliance on individual domestic investors and foreign investors. However, secondary markets often lack sufficient liquidity to be viable.

17. The regulators/supervisors of capital markets, including the banking system, should be independent

and should push the movement towards international norms of various sorts. Also, efforts should be made to develop independent domestic credit rating agencies.

18. There is a critical need for further capacity-building in the financial system, both for government regulators and financial institutions, especially for better credit analysis, proper risk management and to enforce the discipline of disclosure. The private sector should be encouraged to play a positive role in human resources development. There is a need to increase assistance from developed countries to contribute to the capacity-building of the developing countries in the region in the financial industries. It was suggested to establish a regional mechanism to implement this pattern of cooperation.

Role of the Government

19. It was suggested that the role of government in the region should evolve so that its primary role becomes one of formulating and enforcing prudential regulation and not managing the economy directly. It should refrain from directing credit and otherwise interfering in the operations of the financial system if it wishes to be a credible supervisor of this system. Such interventionist practices can easily distort the rules of the game and subvert the fairness and transparency of rules. The government should rather limit its interventions to clear cases of market failure, and should make efforts to minimize government failures where its interventions are warranted. It should, of course, continue to provide public and merit goods.

20. There was a proposal for countries to create a quasi-judicial court of regulation that could examine and evaluate government regulations and order a repeal or revision if an appeal by those subject to the regulations is found to be justified.

Finance for small and medium-sized enterprises

21. Financing the investment needs of SMEs which have traditionally not had access to bank or capital market funds due to lack of assets or a track record will become increasingly important. This need can be addressed through more diversified financial systems, including such mechanisms as venture capital funds, second boards of stock market, and commercial credit reference agencies which can collect information on their debt exposure. Instead of collateral, lenders and investors need to consider credit exposure, long-term prospects and repayment capability. This would require overcoming information asymmetries through improving the procedures for SMEs to provide the required information. However, in the process of encouraging the financing of SMEs, one has to ensure that investors' interests are protected.

Revenue for social development

22. It was noted that provident funds could be used to encourage savings, with the funds raised used for investment in such areas as health, education and housing, which contribute to social development.

Areas for regional cooperation

23. There is a need for the coordination and harmonization of tax policies to avoid unnecessary competition, such as through the provision of tax incentives for investment. A beginning in this respect could be made within the framework of subregional organizations.

24. The idea of a regional clearing system for bond markets was proposed to overcome the problems associated with small bond markets.

25. A proposal was made for a regional mechanism for cooperation on capacity-building for the financial sector for both regulators and the financial institutions, focused on meeting international norms of behaviour.

26. There is a need for an international bankruptcy procedure. It should also be ensured that private debt does not become government debt.

II. External private flows

Mobilizing and managing foreign private capital

27. Although the Asian financial crisis has revealed problems inherent in foreign private capital flows, they will nevertheless continue to play a vital role in the region's economic development. It was noted that foreign private capital can have substantial benefits if it is properly managed at the macro level. Foreign capital can fill the domestic resource gap. In addition, long-term capital inflows in the form of foreign direct investment (FDI) bring a range of dynamic benefits, such as the transfer of technology and improved management practices, market access, stimulating competition among companies, lowering the cost of

capital and building market confidence in the host country. However, as the recent financial crisis in Asia has amply demonstrated, private capital flows do potentially carry enormous risks and costs.

- It is clear that capital account liberalization needs to be accompanied by properly regulated financial sector and good economic management if it is not to lead to a banking and currency crisis.
- It was underscored that the costs or risks involved in foreign private capital are closely related to management issues. If the financial authorities at the macro level prudently manage foreign capital flows, costs and risks can be minimized and benefits maximized.

Prospects for foreign private flows to low-income countries

28. Net private capital flows to the Asia and Pacific developing economies reversed from an inflow of $104 billion in 1996 to an outflow of $42.5 billion in 1998; the outflow moderated to US$ 27 billion in 1999. The major cause of the collapse in private capital inflows to both the crisis and non-crisis countries in Asia was the sharp contraction in bank lending, reflecting substantial net repayments to banks. Portfolio inflows, comprising bonds and equities, have declined sharply since 1997. In contrast to these private market flows, foreign direct investment remained stable, with annual net inflows amounting to $50 to $60 billion.

29. Though foreign private capital is now starting to return to the region, investors are still cautious. Long-term prospects are bright given strong longer-term fundamentals in the East Asian economies. However, there is a concern that foreign private capital is most likely to bypass the low-income and least developed countries. It was also indicated that private flows would increasingly differentiate among countries based on credit risk.

- There is a need to take actions at the country, regional and global levels to facilitate the flows of foreign private capital into the low-income and least developed countries.

Policies for mobilizing foreign private capital

30. Several domestic policy options for mobilizing foreign private capital were discussed.

- The absorptive capacity of the financial and corporate sectors should be strengthened. To this end, financial and corporate restructuring needs to be expedited, financial management techniques modernized and corporate governance reformed.
- It was also suggested that panic withdrawal of bank loans by foreign commercial banks could be restricted.
- Issuance of private debt securities to international investors should be encouraged.

31. Raising foreign funds through issuing bonds has an advantage in terms of securing funds for a longer time than bank loans or equity investments. Asia's financing method, which is bank-centred, could be diversified through bond market development. There are two methods to raise foreign funds by issuing bonds: opening of local markets to foreigners to buy local bonds (in local currency terms) and selling of bonds in international financial markets (in foreign currency terms).

- It was underscored that developing Asian bond markets is critically important to increase bond financing.
- In the case of equity markets, a possible approach is to open them gradually to foreign investors. The indicative suggestion is that a country initially open only 1 per cent of the shares of a company, and gradually increase this offering to 3, 5 and 10 per cent. To change the maturity structure of foreign capital, indirect restrictive measures, including taxation and reserve requirements for flows of equity market funds, would be preferred to direct capital controls, though in emergency situations direct control measures could be applied temporarily.
- Foreign direct investment (FDI) has to be strongly encouraged given that FDI is a significant long-term commitment to the host country. It was emphasized that for low-income nations in particular, FDI would be most desirable given their very limited absorptive capacity for portfolio investment and commercial bank loans.
- Since foreign concessional long-term assistance is increasingly being focused on poverty alleviation, institutional capacity-building and soft sectors, there is a need to increase reliance on private

investors to fund hard sectors (manufacturing and large-scale physical infrastructure).

- It was noted that the investment ombudsman system in the Republic of Korea provided a method of protecting foreign investors in order to increase FDI.

Strategy for managing external capital flows

32. The view was expressed that there is the need for developing countries to successfully manage the flows of foreign private capital at the national level in order to prevent financial distresses or crises while maximizing their benefits. Three factors — the magnitude needed by the country, envisaged productivity of different kinds of foreign capital and their volatility — should be carefully examined in deciding policies on the composition of a foreign private capital portfolio. As domestic and overseas economic conditions evolve, the composition needs to change. It was noted that this type of strategy was not made use of in the crisis economies, with detailed information on the capital flows being unknown to the Governments in many cases. The lack of such portfolio management at the national level caused the serious currency and maturity mismatch in the crisis economies.

- One policy option is to maintain a target portfolio of foreign capital at the macro level, which aims to keep the best composition of foreign private capital, namely, commercial bank borrowings, equity investments, bond investments and FDI.

- Developing countries should pursue a policy of using mainly long-term and medium-term capital and FDI, and should make efforts to put most of the private capital into productive sectors.

33. It was emphasized that monitoring and managing foreign private capital is vital in developing economies, particularly low- and middle-income economies, given the underdevelopment of the financial sector, limited financing choices and weak balance of payments position.

- It was suggested that a host government may need to operate a government office whose main functions are to:

  (i) Monitor flows of foreign private capital and keep a database on capital flows that includes information on outstanding, maturity, type, borrowers and lenders/investors, repayment schedule (principal and interest) etc.;

  (ii) Assess on a regular basis (e.g., monthly) the flows of foreign capital, examining whether too large or too small a level of inflows or outflows is taking place, which types of the capital is more volatile or stable, which investors/lenders are more volatile and what policy actions need to be taken at the macro and micro levels;

  (iii) Maintain the optimum portfolio composition of foreign capital at the national level;

  (iv) Establish a long-term foreign debt/investment strategy;

  (v) Guide and assist the private sector in terms of legal aspects of their borrowing decisions or receiving of foreign funds;

  (vi) Assist the private sector in developing financing techniques and managing various risks;

  (vii) Keep a cooperative network with other countries and international financial organizations.

34. Also, there was a generally shared view that developing countries should not liberalize their capital accounts until they put in place effective regulatory and supervisory regimes for their financial systems and appropriate macroeconomic policies, including appropriate exchange rate regimes.

35. It was suggested that foreign private capital be guided to flow into foreign exchange earning sectors in view of the limited capability of low-income developing countries to service their foreign debt and investment.

- Priority sectors for FDI should be those earning foreign exchange, such as export-oriented manufacturing, the tourism industry, and those directly supporting the export sectors. Foreign fund-based investment generally requires large-scale importation of foreign goods, including capital equipment, which consumes foreign exchange reserves. As debt services and investors' remittances start to pick up, non-exporting foreign projects can also severely constrain the balance of payments.

36. It was also pointed out that there is a need to increase the efficiency in usage of foreign resources by Asian developing economies.

- It is essential to continue financial and corporate reforms and strengthen reforms of governance and policy and regulatory frameworks in order to increase efficiency in using financial resources in the post-crisis period.

37. It was suggested that developed countries have an obligation to help developing countries make full use of private capital by creating a supervision and regulatory mechanism for the flows of private capital, highly leveraged funds and offshore financial centres. They must also take into consideration the possible impact on developing countries of their own macroeconomic policies.

38. It was suggested that Asia needs to maximize its use of regional financial resources under a regional cooperative framework. Strengthening regional financial cooperation is one of the most important tasks faced by Asian economies in the post-crisis period. It was noted that the Association of South-East Asian Nations (ASEAN) countries are moving in the direction of monetary/financial cooperation in addition to the trade cooperation. The ASEAN surveillance process is operational and a number of initiatives were agreed by the Finance Ministers of the ASEAN countries, China, Japan and the Republic of Korea (ASEAN+3) at a meeting held in Chiang Mai, Thailand, on 6 May 2000. The Asian Development Bank has been operating its Regional Economic Monitoring Unit to support these initiatives.

39. It was indicated that recovery indicators should reflect social sector developments and changes because of their long-term socio-economic implications.

III. Recent developments in the reform of international financial architecture: regional implications

40. The view was expressed that progress in the reform of the international financial architecture is slow and the changes introduced to date are incremental. An alternative view was that a robust and substantive dialogue on reform of the international financial architecture is ongoing within the International Monetary Fund (IMF) and other institutions that has already resulted in significant progress. Another view was that the reform of international financial architecture is a process on which substantial progress has been made but much more needs to be done. It is important to keep in mind that the ultimate objective is to promote growth and alleviate poverty, and reform efforts should be linked to this objective. Regional cooperation can play a key role in attaining greater stability and faster economic growth and development. Hope was expressed that the ESCAP member countries would be able to hold a shared view on current discussions on the reform of international financial institutions.

Reform of the international financial architecture

41. Concern was expressed over inadequate participation of developing countries in the formal process of reform of the international financial architecture and in the governance of international financial institutions, which was considered a major reason for the lack of responsiveness of these institutions to the needs of developing countries. The view was expressed that regarding its treatment of developing countries, IMF was not meeting the objectives of its articles of agreement.

- IMF remains the appropriate forum for the reform of the international financial architecture.
- There is a need to review IMF quotas.
- A transparent and democratic international financial governance is required, with improved representation and participation of developing countries in decision-making.
- There should be improved cooperation and coordination between United Nations system organizations, including the United Nations Conference on Trade and Development (UNCTAD), the Bretton Woods institutions, the International Labour Organization (ILO), and the World Trade Organization (WTO) with a view to avoiding financial crises and promoting prosperity by the facilitation of the expansion and balanced growth of international trade, promotion and maintenance of a high level of employment and real income and development of the productive resources.

42. The view was expressed that the world economy has undergone major structural changes since the creation of the Bretton Woods institutions, which necessitated a more radical rethinking of their role.

- Even if IMF were given a more formal role of lender of last resort, it should place more attention on the prevention of financial crises, putting in place appropriate mechanisms for early warning. An alternative view is that IMF is paying attention to crisis prevention and should continue to do so.
- Many developed countries are suffering from the ill effects of excessive currency volatility, and action is needed to deal with such volatility and to smooth adjustment.

43. A suggestion was made that the country-specific model of interaction with the developing and least developed countries prevalent in the Bretton Woods institutions could be improved by adding an issue-based model of interaction to deal with the predominant and common problems of the third world. It was hoped that, through this approach, major global problems, such as poverty, sanitation, environmental degradation and illiteracy, could be dealt with globally, without subjecting such consideration to credit rating and other country-based standards.

Transparency and disclosure

44. While transparency and disclosure are necessary for greater stability, they do not constitute a panacea. In any case, improvement in this area is not optional since this is required by the international financial markets.

- Transparency and disclosure should apply equally to financial markets themselves, including not only the banking system but also other financial institutions, notably the highly leveraged institutions.
- Public disclosure of information could aggravate rather than reduce market volatility, as might happen during negotiations of IMF programmes.
- Developing countries may find it difficult to comply with requirements in this area and they need a special and differential treatment.
- It is important to avoid that provision of information becomes part of IMF conditionality.

Surveillance

45. It was suggested that IMF surveillance over the macroeconomic and financial policies of major industrial countries must be strengthened, particularly with a view to their impact on international capital flows, exchange rates and the debt burden of developing countries. The view was expressed that some industrial countries are subject to rigorous surveillance, with considerable effect on their policies.

- For developing countries, a single prescription for all circumstances should be avoided and the Bretton Woods institutions should be more responsive to the needs of developing countries.
- A strong opposition was voiced against the inclusion of such issues as labour standards in IMF conditionality.

Capital account liberalization

46. As regards capital account liberalization, a number of views were expressed.

- The need for appropriate sequencing of capital account liberalization was highlighted. It should be predicated on domestic conditions that may not be ripe for many developing countries.
- The view was also expressed that a revision of the IMF articles of agreement in this respect would be premature.

47. A number of additional suggestions were made.

- Some monitoring and surveillance of private flows and capital markets is necessary in both developing and developed countries, and inflows as well as outflows may need to be regulated to improve stability.
- It is also necessary to review those regulatory norms that seem to encourage short-term capital flows, bring offshore markets under regulation and supervision, and regulate currency trading.
- It is important to give careful consideration to the implications for the capital account of liberalizing trade in financial services, ensuring that undertaking commitments under the General Agreement on Trade in Services (GATS) does not entail a commitment to liberalize the capital account.

- The principles of special and differential treatment for developing countries and progressive liberalization should be upheld in negotiations under GATS.
- The view was expressed that an agreement should be sought to regulate currency trading in the context of GATS.

Involving the private sector

48. A number of views were expressed on the question of involving the private sector.

- Greater participation of the private sector was imperative to ensure an equitable distribution of the costs of financial crises between debtors and creditors, but there is no agreement yet on how to "bail in" private lenders.
- Such measures as conditionality clauses in bond contracts, standstills and improved bankruptcy legislation are desirable but not exhaustive.
- Since most of lenders are in the developed countries, a suggestion was made that greater transparency, supervision and regulation of international lenders and investors by these countries themselves was needed.

IV. Regional cooperation and collaboration on money and finance: contemporary experience and lessons for future policy options for the Asia and Pacific region

49. Strong support was expressed for increasing regional cooperation in monetary and financial matters as a means of promoting development and improving prevention and management of financial crises. Measures to increase cooperation were viewed as being complementary to the process of reforming international financial architecture. The discussions on reform so far have tended to ignore the importance of developing a regional financial architecture.

50. It was generally felt that the Asia and Pacific region had great potential for increasing regional cooperation.

- Implementation of regional cooperation should be a phased process, beginning with those measures that are easiest to implement.
- The measures agreed by the ASEAN+3 Finance Ministers in Chiang Mai were good examples, and strong support was expressed in favour of pursuing actions in this direction.
- The use of the inter-bank swap arrangements agreed in Chiang Mai should allow for the participation of countries at different levels of openness and development in regional arrangements. They provide the potential for deeper cooperation in this area.
- Another area for regional cooperation involves establishing a legal and regulatory framework for international banks operating in the region.

51. It was stressed that an important objective of the extension of regional cooperation should be the prevention of financial crises and ameliorating their adverse effects, including by spreading risks and impact over a greater number of countries. However, there were notable differences in the capacity of countries, including least developed countries, to participate in these processes.

- Measures are needed to address their specific needs. There are already programmes in place for financial and technical cooperation among countries in the Asia and Pacific region to address the issue of capacity-building.
- Some countries have been excluded from certain current regional arrangements and facilities; this should be taken up in the discussions relating to the High-level Event.
- The proposal for the establishment of an Asian Monetary Fund needs to be pursued; such an institution could be an important step towards the prevention and management of financial crises.

52. The European experience in monetary and financial cooperation provides an important model for the Asia and Pacific region. It was noted that the successful implementation of such cooperation is a long-term process.

V. Innovative sources of financing

53. Discussion in the session considered the modalities and relevance of innovative sources of financing to expand the resources available to support development. It was noted that although innovative

ways of raising finance have relevance at both the domestic and international levels, they have differing levels of practical relevance for economies at different stages of development. Moreover, innovative sources of finance should not be considered as distinct from traditional sources, such as trade and aid, but as additional and complementary to them. The relevance of innovative sources lies primarily in their ability to leverage additional private sources of finance for developmental purposes.

Domestic modalities

54. Innovative sources in a domestic context are relevant in the area of increasing the access of the poor to financial services. Microfinance schemes have been established in a number of countries. Such schemes have been successful in their own right and have attracted resources from foreign donors, both public and private, but success in "graduating" their users/clients into the formal financial system have been limited because access still depends on collateral, which users of microfinance schemes continue to lack.

55. It was observed that simply providing finance to the poor is not enough; some form of "social intermediation" in the form of assistance for utilizing opportunities to build assets is also needed to enable the users of microfinance schemes to graduate viably into formal finance.

56. A number of ways to increase financial resources for microfinance schemes and improve their effectiveness were noted.

- Grouping together a number of such schemes and exploiting economies of scale in their operations could help to reduce the relatively high interest rates that are charged by microfinance schemes in order to offset their high administrative costs.
- Systems could be created whereby certain public services are outsourced through networks of microfinance schemes, but whether Governments would be willing to pay for this is considered doubtful.
- Social and provident funds, as well as postal saving schemes, provide ways of having funds for investment in social infrastructure (schools, medical centres, housing, transportation and SME development). They are alternatives in that in some cases the fund-raisers also direct the investment, whereas for some which are government run the funds are channelled through specialized agencies.

57. A major gap in most domestic financial systems is the lack of access available to SMEs. SMEs have proved to be one of the engines of development in developing countries but are largely excluded from the formal financial system on account of their weak balance sheets and lack of specialist personnel.

- A credit reference system would be useful for SMEs since it could help to establish their overall debt profiles and enable financial institutions to enlarge their exposure to them given SMEs normally low levels of debt.
- Venture capital funds of various sorts are another possibility for involving both domestic and foreign investors.
- Developing second boards on stock markets for smaller companies on the lines of the National Association of Securities Dealers Automated Quotation (NASDAQ), as has been done in the Republic of Korea, should be encouraged.
- Developing linkages between different capital markets in the region would increase the possibilities for designing appropriate instruments.

58. It was recognized that enhancing the breadth and depth of capital markets could allow them to play a bigger role in financing development. This is needed both in order to widen the availability of finance to corporate bodies through new instruments, such as bonds, and to deepen them by attracting a larger pool of investors through diverse investment products, such as retail savings instruments.

- New applications of information technology (IT) offer opportunities to reduce costs of intermediation and increase the security of these markets.
- The increased complexity of regulation and supervision and the capacity to monitor and enforce them had to be taken into account.

International modalities

59. The view was expressed that, given the advances in information and communications technology, developing stock market links between the countries of

the region was a viable option. An integrated region-wide capital market had huge potential and would be of a size comparable to the capital markets of developed countries. Two possibilities were noted.

- The possibility of developing an "Asian index" based on the top firms in participating countries could be considered. Such an index could help to draw funds into the region by providing a benchmark for national indices and to keeping regional funds in the region for the benefit of local investors.
- Another possibility was the cross-listing of shares on the regional markets. However, before this could be done there needed to be some convergence in the accounting and listing requirements of national stock markets and in the establishment of credibility in company reporting standards.

60. The areas of structured finance and securitization offered new opportunities for developing countries to reduce the cost of finance and limit the importance of country and enterprise risks by concentrating on transaction risk. The method could be used for trade-related investment deals of any size. Such finance, however, required significant expertise in negotiation.

- Most developing countries would require technical assistance in order to be able to put together financing packages in these areas. It was suggested that, although the costs of negotiation were high, they were more than offset by the lower costs of finance and the higher quantum of loan. The real benefit of structured finance lay in the cumulative savings in costs by means of repeating the transactions after the initial one. Despite their advantages, however, such modes of finance were rather complicated for many developing countries to utilize.
- A unit at a national or regional level to assist countries in taking advantage of structural finance possibilities, share common costs and share experience would be a good first step.

61. The need was noted to raise awareness of and ability to use hedging instruments of various sorts for prices and currencies.

62. The multilateral financing agencies were encouraged to enhance their joint financing with the private sector and to increase their leverage to help countries and firms to tap international capital through a variety of forms.

63. A suggestion was made that a small percentage of the interest payments on loans from international financing institutions be set aside to provide finance to SMEs.

64. It was suggested that there was a need to find ways of forging new private/public partnerships to raise funds, in particular for poverty alleviation. Recent experience with such partnerships in the area of environment could provide some useful models.

65. The view was expressed that there was a need to develop some new international instruments to generate finance for development to complement or augment ODA flows. This was especially required for countries which had no access to international capital markets, and so remained dependent on ODA. A proposal made was for a currency transaction tax. Such a tax would simultaneously reduce volatility in the financial markets and provide a major source of revenue, far in excess of current levels of ODA, for development.

66. While innovative sources of finance were growing in importance, the role and importance of traditional sources should not be neglected. Innovative sources of finance should be an addition to ODA and not a substitute. It was clear that for many countries, especially the least developed countries, innovative sources may not have a major significance for some time to come.

- It was stressed that innovation should be geared specifically towards enlarging the flow of resources for development per se, and should not merely consist of new modes of financing and financial techniques.

VI. Regional issues and perspectives relating to the external sector, including official development assistance and trade issues

67. The discussion in the session focused the on external dimensions of raising finance for development, particularly on trade as a source of finance and ODA. Both were considered critical for supporting the development efforts of the developing countries in the region. The success of such efforts was

dependent on a conducive external environment in an interdependent world. From this perspective, there was a need for consistency and coherence in the approaches to development among donor and recipient countries and among international institutions in the support provided for quality development (development that is sustainable, inclusive and poverty-reducing).

Trade issues

68. Trade remains a viable engine of development and an important source of development financing for many developing countries, as it was for the East Asian countries for several years. Trade, however, is only one element in development process and should be seen in this light. For example, a sound financial system and a coherent set of economic and social policies are a necessary condition for trade to contribute to development. Technology transfer is also necessary to facilitate trade and development. To use trade as an engine, it is necessary for countries to open their economies to FDI and reduce tariffs. However, new constraints have arisen, in particular as a result of the WTO agreements, which restrict the use of some incentive techniques and so narrow the national policy space. Also, technological change and the new IT-based economy implies a need for adjustment in export strategies. In addition, the wider participation in decision-making processes within the international and national settings, while enhancing a sense of empowerment, complicates the process.

69. A number of suggestions were made.

- There is a need to diversify markets for exports not only within but also outside the region, and to be more conscious of changing conditions in demand and competitiveness to add robustness to export sectors.
- The proliferation of regional trading arrangements, while stimulating trade, adds complexity to rules to be observed, and they need to be kept consistent with global arrangements.
- The trading system must be made more conducive to development, and in this context market access problems need to be addressed urgently.
- Based on the principle of universality and democratic practices, all United Nations Member States should be included in international and relevant regional trading systems and arrangements.
- There is an urgent need to implement the commitments made under the Uruguay Round of agreements before launching a new round of negotiations; another view is that work towards launching a new round should continue.
- WTO needs to strengthen its dispute settlement, and at the same time small and low-income developing countries must be provided with technical assistance to be able to comply with WTO obligations.
- WTO should not deal with non-trade issues, such as labour and environmental standards; an alternative view is that these issues are important for broad-based development.
- Capacity-building is crucial to enable developing countries to meet their obligations under WTO and to take full advantage of the opportunities the WTO system provides to participate more fully in the world trading system.
- There is a clear need to develop a comprehensive package to tackle the special problems of least developed countries, including special market access conditions, debt relief and capacity-building to enhance supply capabilities.

Official development assistance

70. It was emphasized that ODA remains critical for many developing countries, particularly the least developed countries and the Pacific island developing countries. Although global ODA flows have been declining and they have become small relative to private flows of capital, it was reported that aid to the Pacific island developing countries has been maintained and will be required for some decades to come. Even for the larger developing countries, ODA continues to have major qualitative significance; due to their low economic development and limited domestic resources, ODA is still irreplaceable for them. ODA should assist all developing countries in moving out of aid dependency over time.

71. A number of suggestions were made.

- There is a need to reinvigorate support for ODA budgets in donor countries. This involves, inter alia, improvements in aid utilization and macroeconomic governance, and a visible commitment to poverty reduction on the part of the recipient countries.

- ODA quantity should be increased since nearly half of the world's population still live in poverty. Developed countries should fulfil their commitment to devote 0.7 per cent of their GNP to ODA.
- The inadequacy of official resources is not the only problem: there are also problems in the supply and management of those resources. Due attention should be given to the allocation and distribution of ODA resources at the international level.
- It is important to go beyond generalities and focus on specific actions in the area of ODA. These include: (i) streamlining aid delivery and improving the quality of aid; (ii) more expeditions disbursement; (iii) better understanding of priorities between the donors and the recipients, with due respect for the opinions of the recipient countries; and (iv) appropriate measures to ensure availability of counterpart funds.
- ODA should have a clear focus on social sectors including human resources development and physical infrastructure development that has a direct impact on poverty alleviation.
- New modalities for delivery of ODA could include support for public/private partnerships to facilitate trade and investment.
- ODA is a useful instrument for creating linkages between trade, investment and development, particularly for small island developing States.
- Further improvements in aid coordination among donors are needed. This would help countries to cope with the administration burden associated with aid flows, avoid duplication and reduce multiplicity of conditionalities.
- Debt relief is needed for many poorer countries, and must be structured to complement other forms of development assistance.
- The debt relief issue should be a distinct item in the financing for development process.
- Poorer countries, including the Pacific island developing countries, need official assistance to improve their attractiveness to foreign investors, as well as to build up their capacity to negotiate with potential foreign investors and to present commercially attractive investment projects. It was observed that a number of financing mechanisms already exist to address these issues.

72. The view was expressed that the failure of aid is due to a combination of insufficient resources relative to the implications of the policy reforms being sought and a lack of ownership of the programmes by the recipient country, where the benefits of the reforms are not clearly visible. A greater use of aid for social areas, including safety nets, could enhance the ownership of reforms.

73. The suggestion was made to direct more of the global aid package to low-income countries and to try to assist them in tapping private capital. This meant increasing their productivity through investment in infrastructure, co-financed by aid and the private sector; providing tax incentives for investment in disadvantaged countries; and financing insurance for foreign investors.

74. Small island developing States have small domestic markets and narrow resource bases, which leave them highly reliant on trade and ODA. As a consequence, they have special needs and concerns relating to financing for development.

Annex

Programme of sessions