


Economic and Social Commission for Asia and the Pacific

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Regional financial cooperation
Regional financial cooperation: recent developments and the way forward
Note by the secretariat
Summary

Regional financial cooperation in Asia and the Pacific has pursued three objectives: (a) to equip countries with tools to cope with financial volatility, including through cooperative arrangements for the provision of liquidity support; (b) to strengthen national financial markets and link financial markets across countries; and (c) to promote an effective mobilization of resources — across and within countries — towards investments in infrastructure and other priority areas. The present note contains a discussion of recent developments and suggestions to deepen regional financial cooperation in the three areas.

The Committee is invited to provide their perspectives on the stocktaking exercise and to discuss the policy recommendations included in this note. The Committee may also wish to provide the secretariat with guidance on its future strategic direction in the area of regional financial cooperation.

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I. Introduction

1. The 2013 Bangkok Declaration on Regional Economic Cooperation and Integration in Asia and the Pacific issued by ministers and representatives of members and associate members of the Economic and Social Commission for Asia and the Pacific (ESCAP) articulated a comprehensive, four-pronged agenda towards the realization of a long-term vision of an economic community of Asia and the Pacific. The agenda called upon countries in the region to work closer together towards an integrated market, seamless connectivity, regional financial cooperation, and cooperation to address shared vulnerabilities and risks in areas such as food security and disaster risk management.

2. While the four elements of the Bangkok Declaration's agenda are interrelated and support each other, finance plays a central role. Without it, it would not be possible to build the region-wide infrastructure network required to connect all countries of the region, which in turn is needed to promote intraregional trade. Finance is also necessary for countries to build resilience to disasters and adapt to climate change. Furthermore, finance is critical for the successful implementation of the 2030 Agenda for Sustainable Development. The commitments to be included in this agenda will require substantial investments in the social sectors, infrastructure and enhancing environmental sustainability — which will call for new and additional finance.

3. The present report draws partly on the report of the Working Group on Regional Financial Cooperation, one of the four working groups of experts from ESCAP member States that were set up to implement the Bangkok Declaration. That report reflects discussions during the working group meetings and inputs by the ESCAP secretariat and two eminent experts.

4. Regional financial cooperation in Asia and the Pacific has pursued three objectives:

(a) To equip countries with tools to cope with financial volatility, including through cooperative arrangements for the provision of liquidity support;

(b) To strengthen national financial markets and link financial markets across countries;

(c) To promote an effective mobilization of resources — across and within countries — towards investments in infrastructure and other priority areas.

5. The first objective, protecting economies in the region from financial volatility including through the provision of liquidity support, became a priority in the aftermath of the Asian financial crisis of 1997-1998. Two major initiatives of the countries constituting the Association of Southeast Asian Nations Plus Three (ASEAN+3)¹ that were launched after the crisis,

¹ ASEAN+3 includes the 10 members of ASEAN plus China, Japan and the Republic of Korea.

the Chiang Mai Initiative of May 2000 and the Asian Bond Markets Initiative of August 2003, aimed, respectively, at providing emergency liquidity to countries affected by financial crises and at developing local currency bond markets to minimize risks arising from currency and maturity mismatches.

6. The second objective was partly related to the objective of making the economies of the region more resilient to financial crises. This is the case of the Asian Bond Markets Initiative. However, besides reducing the risks of currency and maturity mismatches, the development of local currency bond markets has also contributed to the development of financial markets in the region. The objective of linking financial markets has been associated with subregional economic integration schemes. For instance, the ASEAN Roadmap for Monetary and Financial Integration of August 2003 covers four areas, namely capital market development, financial services liberalization, capital account liberalization and monetary cooperation, on which much progress has been achieved in the first three.

7. The third objective, promoting the effective mobilization of resources towards investment in infrastructure and other priority areas, has become particularly important in the context of the 2030 Agenda for Sustainable Development and the Addis Ababa Action Agenda of the Third International Conference on Financing for Development. Without mobilizing additional resources, it will be very difficult for most countries to implement these linked agendas. With the exception of the Asian Development Bank (ADB), which was established in 1966, most regional initiatives for cooperation on infrastructure investment, such as the ASEAN Infrastructure Fund and the Pacific Region Infrastructure Facility, the Asian Infrastructure Investment Bank and the New Development Bank, are fairly recent. Tax cooperation is an important emerging area.

8. The rest of the report discusses recent developments and makes suggestions to deepen regional financial cooperation in the three areas mentioned above. The third area is divided into two sub-areas: infrastructure financing and cooperation in tax matters.

II. Financial stability

9. Following the global financial crisis of 2007-2008, securing financial stability became a major economic objective in the region. This section first takes stock of two complementary mechanisms to protect economies of the region from financial instability: regional economic surveillance and monitoring, and short-term liquidity support arrangements. Then, it discusses ways to enhance regional cooperation to secure financial stability.

A. Taking stock of regional economic surveillance and monitoring

10. The goal of economic surveillance is to identify (a) risks to national macroeconomic and/or financial stability and (b) the necessary adjustments to minimize them. Discussions focus mainly on monetary, exchange rate, fiscal and financial policies, as well as macro-relevant structural issues. The surveillance process facilitates discussions on economic and financial conditions of individual, regional and global economies and assessments of national policies and the potential for policy adjustments.

11. The ASEAN Surveillance Process started in October 1998 as a mechanism for peer review and the exchange of views among the senior officials of central bank and ministries of finance on recent economic developments and policy issues. Key achievements to date include the

establishment of a dedicated unit at the ASEAN Secretariat and national surveillance units in selected countries. The Surveillance Process produces the annual ASEAN Surveillance Report using economic and financial data provided by ASEAN countries. The Surveillance Report is a main input for policy discussions and exchanges during the annual meetings of ASEAN finance ministers.

12. The Economic Review and Policy Dialogue, introduced in May 2000, is the regional economic surveillance forum of the ASEAN+3 finance ministers and central bank governors. The ASEAN+3 Dialogue process encompasses: (a) assessing global, regional and national economic conditions; (b) monitoring regional capital flows and currency markets; (c) identifying macroeconomic and financial risks as well as policies to reduce such risks; (d) strengthening banking and financial system conditions; and (e) providing an Asian voice in the reform of the international financial system. To strengthen the Dialogue process, in April 2011 the ASEAN+3 authorities established the ASEAN+3 Macroeconomic Research Office, a unit in charge of regional economic surveillance based in Singapore.

13. The Executives' Meeting of East Asia-Pacific Central Banks also provides a surveillance function.² In particular, its Monetary and Financial Stability Committee, established in 2007, discusses recent economic and financial developments based on its "Macro-Monitoring Report", which gathers macroeconomic and financial information from member countries. The members of the Committee are the same as those of the Deputies' Meeting.

14. Although the South Asian Association for Regional Cooperation (SAARC) does not have a surveillance mechanism, the need for it has been identified. The Fifth Meeting of SAARC Finance Ministers in 2012 agreed that the region should evolve joint strategies for facing the impact of global economic crises in a spirit of mutual cooperation and that it may be necessary to examine the need to develop a regionally coordinated surveillance mechanism to forecast the fallout of external shocks.

15. In the Pacific, the Association of Financial Supervisors of Pacific Countries, created in 2002, meets regularly to discuss supervisory and surveillance-related developments. Members, consisting of representatives of central banks and banking commissioners from the Cook Islands, the Federated States of Micronesia, Fiji, Palau, Papua New Guinea, the Marshall Islands, Samoa, the Solomon Islands, Tonga and Vanuatu, share recent macroeconomic and financial developments in each other's economies. The International Monetary Fund's Pacific Financial Technical Assistance Centre acts as secretariat, with administrative backing from the Reserve Bank of Fiji.

16. In North and Central Asia, the Eurasian Economic Community launched the Anti-Crisis Fund in 2009 as a regional financial arrangement to help member countries overcome the consequences of global financial and economic crises, to ensure their long-term economic and financial stability and to foster economic integration among them. To be effective in supporting its members' adjustment programmes, the Fund operates its own surveillance mechanisms, including regular data reporting, ongoing policy dialogue and closer dialogue with the borrowing Governments. Under the Eurasian Economic Union, which replaced the Eurasian Economic Community on

² The meeting is a forum of central banks that aims to strengthen cooperation among its 11 members: Australia; China; Hong Kong, China; Indonesia; Japan; Republic of Korea; Malaysia; New Zealand; Philippines; Singapore; and Thailand.

1 January 2015, the Fund's name was changed to the Eurasian Fund for Stabilization and Development.

B. Taking stock of short-term liquidity support arrangements

17. In 1977, the original five ASEAN monetary authorities created an ASEAN Swap Arrangement with an initial value of \$100 million, primarily to provide liquidity support for members experiencing balance of payments difficulties. The duration, coverage and size of the Arrangement have expanded markedly since its inception, and by 2000 it covered all ASEAN members. In May 2005, the total amount for the Arrangement was raised to \$2 billion.

18. The Chiang Mai Initiative started as a combination of: (a) a network of bilateral swap agreements among the Plus Three countries — China, Japan and the Republic of Korea — and between one of these countries and a select ASEAN member; and (b) the ASEAN Swap Arrangement. The Chiang Mai Initiative Multilateralization, launched in March 2010, pooled all these networks of bilateral swap agreements into a single reserve pooling arrangement governed by a single contractual agreement. The initial size of \$120 billion was later expanded to \$240 billion. The ASEAN+3 Macroeconomic Research Office, mentioned above, has the role of monitoring and analysing regional economies to contribute to the early detection of risks, the swift implementation of remedial action and effective decision-making of the Chiang Mai Initiative Multilateralization, thus enhancing the current surveillance mechanism.

19. An important feature of the Chiang Mai Initiative Multilateralization is that crisis-affected members requesting short-term liquidity support can immediately obtain financial assistance up to an amount equivalent to 30 per cent of their quota, with the remaining 70 per cent provided to the requesting member under an International Monetary Fund (IMF) programme. Thus the Chiang Mai Initiative Multilateralization is closely linked with an IMF programme and its conditionality. The Chiang Mai Initiative Multilateralization's link with the IMF was designed to address the concern that the liquidity shortage of a requesting country may be due to fundamental policy problems, rather than a simple liquidity problem, and that moral hazard could be a significant problem in the absence of rigorous conditionality. The lack of the region's capacity to formulate and enforce effective adjustment programmes in times of crisis was a major reason for requiring the Chiang Mai Initiative Multilateralization to be linked to IMF programmes.

20. The Reserve Bank of India decided to offer a swap arrangement of \$2 billion in foreign currencies and Indian rupees in 2012. The facility is made available to all SAARC member countries. The swap is offered in United States dollars, euros or Indian rupees against domestic currency or the domestic currency denominated Government securities of the requesting country. India contributed the entire fund of \$2 billion. The swap amount available to the central banks of member countries is broadly based on two months of imports of the borrower with a floor of \$100 million and a maximum of \$400 million per country.

21. The Eurasian Fund for Stabilization and Development of the Eurasian Economic Union mentioned in the previous section is worth about \$8.5 billion and includes two types of financial instruments — financial credits and investment loans. Financial credits are extended to central Governments to support stabilization programmes with the aim of making

their economies more resilient to external and domestic shocks. The Anti-Crisis Fund Council is composed of finance ministers and is chaired by the Russian Federation. Decisions are based on the recommendations of the Council of Experts, comprised of senior finance ministry officials. The Eurasian Development Bank serves as the Anti-Crisis Fund resources manager.

22. Bilateral currency swap arrangements have been established by China, Japan and other countries. China has signed bilateral currency swap agreements with over 30 countries since 2009 with the stated objective of supporting trade and investment that promotes the international use of renminbi. However, these funds can potentially be used for liquidity shortages, as was the case of Argentina in 2014. Japan's bilateral currency swaps with China, India, Indonesia, the Philippines and Singapore are mostly intended to address liquidity shortages in the balance of payments. The total value of these swaps arrangements is close to \$320 billion, \$230 billion of which are provided by China and about \$90 billion by Japan.

23. A new option opened to the so-called BRICS countries (Brazil, the Russian Federation, India, China and South Africa) is the Contingency Reserve Arrangement. The Arrangement is a framework for the provision of support through liquidity and precautionary instruments in response to actual or potential short-term balance of payments pressures. It was established in 2015 by the BRICS countries. The legal basis is given by the Treaty for the Establishment of a BRICS Contingent Reserve Arrangement, signed at Fortaleza, Brazil, on 15 July 2014. The initial capital of the Arrangement is \$100 billion. In a similar fashion to the Chiang Mai Initiative Multilateralization, participants can borrow up to 30 per cent of the maximum amount they are entitled to, subject to the approval of the other participants only. Access to the remaining 70 per cent requires signing a conditionality-based agreement with the IMF.

C. The way forward for enhancing financial stability

24. As capital markets in the region continue developing and start linking with each other, risks associated with volatility in capital flows and exchange rates are likely to increase. Managing these risks is already a critical issue for financially open economies in the region, and it will be even more important going forward. Furthering cooperation will be necessary in this area, particularly with regard to the implementation of macroprudential policies and capital flow measures.

25. Macroprudential policies directly target the source of instability of capital flow volatility, namely the domestic asset markets in which capital flows are invested. They aim at reducing systemic risks and safeguarding the stability of the financial system, ensuring that it continues to function effectively. They usually take the form of regulatory policies to minimize the expansion of credit to areas in which central bankers see a build-up of financial risk. Macroprudential policies, which are usually undertaken by central banks, can be complemented by fiscal measures, such as increasing taxes on investment in specific sectors.

26. Despite the increasing popularity of macroprudential measures in the region in recent years, significant risks to financial stability across the region continue to build up. In particular, property prices have continued to rise in a number of economies, while credit growth by the banking sector is a source for concern. In general, GDP growth in the region has become more credit-intensive since the 2008 crisis, making economies more susceptible to a hike in global interest rates.

27. Macroprudential policies differ from capital flow measures, which are meant to limit capital flows by non-residents. Capital flow measures can be foreign-currency based, such as limits on foreign exchange borrowing, reserve requirements on foreign exchange deposits and provision requirements on foreign exchange lending. Or they can be residency-based, such as unremunerated reserve requirements on non-resident deposits, withholding taxes or restrictions on non-resident holdings of domestic assets. Occasionally, macroprudential policies include capital flow measures, such as in the case of policies to discourage foreign-currency borrowing.

28. Regional cooperation on macroprudential policies and capital flow measures is necessary because their implementation may lead to a flow of capital to comparable countries that do not institute such policies and measures. To enhance regional cooperation in this area, an Asia-Pacific financial stability dialogue could be established. This entity should include the participation of finance ministries, central banks, financial market regulators and supervisors, and deposit insurance corporations. Its objective would be to monitor factors affecting regional financial stability, including national financial market conditions and capital flows, and to induce appropriate policy actions including macroprudential policy and coordination of capital flow measures.

29. The Asia-Pacific financial stability dialogue could identify systemically important regional financial institutions and discuss how national authorities can improve cross-border supervision over them. It could also provide a regional counterpart to the Financial Stability Board, an element of regional institutional architecture that is currently missing. In particular, it could liaise between the Financial Stability Board and Asia-Pacific countries that are not members of the Board. The Asia-Pacific financial stability dialogue could build on existing information exchanges and policy dialogues. By focusing on national and cross-border risks within the region, it could serve as a regional financial risk early-warning system.

30. With respect to the provision of liquidity support, the region has made progress in establishing mechanisms such as the Chiang Mai Initiative Multilateralization, new bilateral swaps arrangements, the Contingency Reserve Arrangement of the BRICS countries and the Eurasian Fund for Stabilization and Development, all of them described above. However, these mechanisms do not cover all countries in the region and are weak in the area of surveillance. Furthermore, both the Chiang Mai Initiative Multilateralization and the Contingency Reserve Arrangement require borrowers to engage in IMF programmes if they wish to borrow more than 30 per cent of their quotas. This is problematic in light of the stigma associated with borrowing from the IMF that is still prevalent in Asian countries after their experience during the Asian financial crisis of 1997-1998.³

31. In order to improve the capacity of the region to provide short-term liquidity support in case of financial emergencies, the first question to ask is whether the region counts with enough resources for that purpose. At the moment, the pool of funds of the Chiang Mai Initiative Multilateralization and the Contingency Reserve Arrangement combined amounts to \$340 billion. This represents about a third of the total lending capacity of the IMF of \$1 trillion. If the Eurasian Fund for Stabilization and Development, the swap arrangements of SAARC and the network of bilateral swaps offered by China and Japan are added, the total funds available in the region for

³ Takatoshi Ito, "Can Asia overcome the IMF Stigma?", *American Economic Review*, vol. 102, No. 3 (May 2012), pp. 198-202.

liquidity support would double to \$680 billion or about two thirds of the lending capacity of the IMF. This is a significant sum, and it could be further expanded if countries in the region were willing to pool part of their vast foreign exchange reserves.

32. The main capacities that need to be developed to enhance the effectiveness of current liquidity support mechanisms are: (a) to conduct regional surveillance; (b) to formulate independent conditionality associated with crisis lending; and (c) to monitor policy and economic performance.⁴ While the Chiang Mai Initiative Multilateralization already has the ASEAN+3 Macroeconomic Research Office, which can be strengthened, a dedicated macroeconomic surveillance and research facility is currently lacking in the Contingency Reserve Arrangement. If the ASEAN+3 Macroeconomic Research Office strengthens its surveillance and monitoring capacities and the Contingency Reserve Arrangement establishes an office similar to it with strong surveillance and monitoring capacities, both arrangements would be able to increase the share of members' quotas that can be borrowed without linkage to IMF programmes. This could increase the willingness of member countries to utilize both mechanisms.

33. While strengthening surveillance and monitoring is the key priority, in future the establishment of a region-wide arrangement covering all countries in Asia and the Pacific — an Asia-Pacific monetary fund — could be considered. This could be based on merging the Chiang Mai Initiative Multilateralization, the Contingency Reserve Arrangement and other existing arrangements, including bilateral swaps, in a similar fashion to the multilateralization of the Chiang Mai Initiative. Such regional arrangements should count with strong surveillance and monitoring capabilities, which could build on the current and future experience of the ASEAN+3 Macroeconomic Research Office and perhaps a dedicated office in the context of the Contingency Reserve Arrangement.

III. Financial market development and integration

34. There is much heterogeneity in the level of cooperation amongst financial authorities for the development of financial markets in the Asia-Pacific region. East Asian countries, covered by multiple initiatives under ASEAN, ASEAN+3 and the Executives' Meeting of East Asia-Pacific Central Banks, are the most advanced. However, other subregions are also making progress.

A. Taking stock of financial market development and integration

35. As mentioned above, efforts to develop domestic currency bond markets in the region were expected to reduce the currency and maturity mismatches that were at the root of the Asian financial crisis of 1997-1998. These efforts aimed at mobilizing the region's vast pool of savings towards the region's long-term investment without the need of intermediation through financial centres outside the region. Two key regional initiatives have been the Asian Bond Fund under the aegis of the Executives' Meeting of East Asia-Pacific Central Banks and the Asian Bond Markets Initiative under the auspices of the ASEAN+3 finance ministers.

⁴ Masahiro Kawai, "From the Chiang Mai Initiative to an Asian Monetary Fund", ADBI Working Paper Series No. 527 (Tokyo: Asian Development Bank Institute, 2015). Available from www.adb.org/sites/default/files/publication/160056/adbi-wp527.pdf.

36. The Executives' Meeting of East Asia-Pacific Central Banks introduced the Asian Bond Fund Initiative in June 2003. The idea was to help expand the bond market through demand-side stimulus from purchases by central banks of sovereign and quasi-sovereign bonds issued by eight emerging members of the Executives' Meeting (China; Hong Kong, China; Indonesia; Malaysia; Philippines; Republic of Korea; Singapore; and Thailand) using the foreign exchange reserves of the 11 members. Asian Bond Fund 1 involved the purchase for \$1 billion in United States dollar-denominated bonds, and Asian Bond Fund 2 involved purchases for \$2 billion in local currency-denominated sovereign and quasi-sovereign bonds. Asian Bond Fund 2 was designed to facilitate investment by public and private sector entities through the listing of local currency exchange-traded bond funds in Hong Kong, China, Malaysia, Singapore and other stock markets.

37. The ASEAN+3 finance ministers' process launched the Asian Bond Markets Initiative in August 2003. The Initiative aimed at creating robust primary and secondary markets through: (a) facilitating market access to a diverse issuer and investor base; and (b) enhancing market infrastructure for bond market development. As a result of this Initiative, local currency bond markets expanded in size in several economies, particularly in China, Malaysia and the Republic of Korea.

38. In 2008, the ASEAN+3 finance ministers agreed on the Asian Bond Markets Initiative New Roadmap, which focuses on four key areas: (a) promoting the issuance of local currency bonds; (b) facilitating the demand of local currency bonds; (c) improving the regulatory framework; and (d) improving the related bond market infrastructure. The New Roadmap resulted in a number of new institutions and platforms to support the development of local currency bond markets in ASEAN+3. A one-stop clearinghouse of information on sovereign and corporate bonds of economies in the ASEAN+3 region, AsianBondsOnline, was launched in 2009. In 2010 ASEAN+3 members established a Credit Guarantee and Investment Facility, with an initial capital of \$700 million, to allow corporate issuers with marginal ratings to issue local currency corporate bonds.

39. ASEAN+3 moved from the development of domestic bond markets to their integration through the establishment of the ASEAN+3 Bond Market Forum. The Forum provides a platform for bond market experts to seek ways to harmonize and standardize market practices, regulations, and clearing and settlement procedures of cross-border bond transactions in the region. One of the subforums of the ASEAN+3 Bond Market Forum, Subforum 1, has agreed to develop an intraregionally standardized bond issuance framework, which would ultimately allow bond issuers in ASEAN+3 to issue bonds in all participating economies with one set of standardized documentation and information disclosure requirements, subject to compliance with the legal and regulatory requirements of each economy. The deliberations of this subforum resulted in a 2014 proposal to establish the ASEAN+3 Multi-Currency Bond Issuance Framework.

40. ASEAN has been moving further towards financial integration, as part of its ASEAN Economic Community project, by following its Roadmap for Monetary and Financial Integration. To implement the Roadmap, there are several working committees. The Working Committee on Capital Market Development is developing a Bond Market Development Scorecard to identify gaps and take stock of progress. The ASEAN Capital Market Forum, established in 2004, is composed of capital market regulators. It initially focused on harmonization of rules and regulations, before shifting towards more strategic issues to achieve greater integration of the region's capital

markets under the ASEAN Economic Community Blueprint 2015. Recent key achievements of the Capital Market Forum include the ASEAN capital market disclosure standards for cross-border offerings of securities and the capital market integration plan.

41. Because financial integration is an area where the pace of reforms differs across countries, ASEAN has thus taken a flexible approach, known as “ASEAN minus X”. For instance, only Malaysia, Singapore and Thailand have so far adopted the cross-listing of stocks through the ASEAN Trading Link. The ASEAN Trading Link is an initiative of ASEAN Exchanges, a collaboration of seven exchanges in six ASEAN member countries.⁵ The ASEAN Trading Link provides a single entry point to three of the largest stock markets of the ASEAN Exchanges collaboration. These three markets offer access to nearly 2,200 listed companies with a market capitalization of \$1.4 trillion, about 70 per cent of the total market capitalization of ASEAN.

42. Financial services liberalization has been pursued under the ASEAN Framework Agreement of Services and the ASEAN Financial Integration Framework through the progressive liberalization of financial services (banking, insurance, securities and others) except for some subsectors and modes with pre-agreed flexibilities. This liberalization process aims at the gradual removal of restrictions on ASEAN banks, insurance companies and investment companies in providing financial services in other member States. In addition, the ASEAN Banking Integration Framework provides an operating framework for integration in the banking sector through the harmonization of domestic regulations, building infrastructure to stabilize the financial sectors, developing the banking capabilities of the less-developed members and setting criteria for qualified ASEAN banks. The ASEAN Financial Integration Framework concept of integration is based on the commercial presence of qualified ASEAN banks across the ASEAN region.

43. Capital account liberalization has been pursued through the removal of capital controls and restrictions to facilitate a freer flow of capital, including through the elimination of restrictions on current account transactions and foreign direct investment (FDI) and portfolio flows (inflows and outflows). The liberalization of capital movements is to be guided by the following principles: (a) ensuring an orderly capital account liberalization consistent with member countries’ national agendas and the readiness of their economies; (b) allowing adequate safeguards against potential macroeconomic instability and systemic risks that may arise from the liberalization process, including the right to adopt necessary measures to ensure macroeconomic stability; and (c) ensuring that the benefits of liberalization are shared by all ASEAN countries.

44. In a similar fashion to ASEAN Exchanges, the South Asian Federation of Exchanges, established in 2000, aims to work towards common standards of listing, trading, clearing, settlement and investor protection, and encourages cross-border listings and securities trading. To understand the potential benefits of increased integration, the Indian example may be relevant. Until the early 1990s, there were many local stock markets, which made the capital market fragmented and inefficient. Since then, significant progress has been made in market infrastructure, market structure and regulation. There are now two national stock exchanges. As a result, transaction costs have fallen substantially, more innovative and diverse

⁵ The exchanges are: Bursa Malaysia Stock Exchange; Hanoi Stock Exchange; Ho Chi Minh Stock Exchange; Indonesia Stock Exchange; Philippine Stock Exchange; Stock Exchange of Thailand; and Singapore Exchange.

products are available for investment and risk management, and foreign investors have been attracted.

45. In North and Central Asia, Kazakhstan and the Russian Federation have fairly developed capital markets and some integration efforts are being undertaken under the Eurasian Economic Community. In many other North and Central Asian economies, however, capital market development remains at a nascent stage. With regard to exchanges-led cooperation, it is worth noticing that the Kyrgyz Stock Exchange has a trading system developed by Kazakhstan Stock Exchange.

46. In the Pacific Islands, capital market development is very limited. In 2000, the Suva Stock Exchange was renamed the South Pacific Stock Exchange, with a view to becoming a regional exchange. In 2010, it launched an electronic trading platform.

B. The way forward on financial market development and integration

47. The Asia-Pacific region needs to develop its domestic capital markets to facilitate the mobilization of domestic funds, to finance with an appropriate mix of debt and equity, high-priority, bankable infrastructure investment projects. An important element for the development of capital markets is the development of financial infrastructure. The latter refers to both the organization of trading activities and the regulations that govern trading. A well-functioning infrastructure is essential for trades to be executed rapidly and safely, thereby contributing to the liquidity of the market. It also contributes to building confidence among issuers and investors in the integrity and fairness of the process of price discovery, elements that are necessary for their participation in the market.

48. One way to facilitate the development of the financial infrastructure of domestic capital markets could be the adoption of harmonized regulations and institutions, in a similar manner to the experience of the ASEAN Capital Markets Forum. Besides facilitating the development of domestic financial markets, the adoption of harmonized regulations and institutions could contribute to facilitating the trading of securities across countries in the future, eventually laying the groundwork for the development of a regional capital market at a later stage.

49. An important priority for supporting the financial development of the region is to facilitate the development of domestic institutional investors such as pension funds, insurance companies and asset management companies. This is critical in providing the required liquidity to capital markets. Domestic institutional investors will contribute to increasing the demand for domestic, long-term assets, including of the infrastructure asset class.

50. One concern about developing capital markets in small economies is that the price discovery process may not work very well because these markets are illiquid. In fact, it is necessary to have investors with heterogeneous time horizons and risk profiles to bring liquidity to markets. From that point of view, small economies may not need to develop all aspects of capital markets. They could rely, instead, on linking their markets to other, larger markets in the region through the adoption of harmonized rules.

51. Most enterprises in Asia and the Pacific are very small and have no access to capital markets. Therefore, fostering financial inclusion — such as facilitating access by micro, small and medium-sized enterprises to credit from banks or other specialized financial institutions — should be an

important consideration in the context of the development of the region's financial markets.

52. To move forward in the development of financial markets in the region, ESCAP could undertake studies and consultations leading to a road map for Asia-Pacific capital market development.

IV. Infrastructure financing

53. Several arrangements for the financing of infrastructure and development projects have been implemented in the region in recent times, and two new multilateral banks are expected to start operations in the near future.

A. Taking stock of existing facilities for infrastructure investment

54. The Asian Development Bank (ADB) was founded in 1966. In 2014, the operations of ADB totalled \$22.93 billion, \$13.29 billion of which was financed by its ordinary capital resources and special funds and \$9.24 billion by co-financing partners. Most ADB loans are on commercial terms but the Bank also offers loans on concessional terms through its Asian Development Fund. In 2015, the ADB Board of Governors approved the proposal to combine the Asian Development Fund lending operations with the Ordinary Capital Resources balance sheet, with a view to increasing the financing capacity of ADB by up to 50 per cent by 2017. Under the new initiative, ordinary capital resources equity is expected to almost triple to about \$53 billion from about \$18 billion. Together with co-financing, the annual assistance of ADB could reach as much as \$40 billion.

55. China announced the initiative of establishing an Asian Infrastructure Investment Bank during the APEC CEO Summit in Bali in October 2013. The initial memorandum of understanding for the establishment of the Bank was signed in October 2014. The Bank is open for membership to all countries in the region as well as interested countries from outside the region, although the former will be given priority. As of May 2015, a total of 57 countries announced that they will be founding members of the new Bank, including 26 from outside of the region. The subscribed capital of the Bank is \$100 billion, 75 per cent of which is available to Asian countries.

56. Three leading emerging economies of the Asia-Pacific region — China, India and the Russian Federation — along with Brazil and South Africa launched the New Development Bank during the BRICS summit in July 2014. The \$50 billion starting capital of the Bank is expected to increase to \$100 billion over time, which will provide the Bank with an estimated lending capacity of \$34 billion per year. The five founding members will make equal capital contributions to the Bank and will share equal voting rights. Although membership of the Bank will be eventually open to other countries, the BRICS countries will retain a controlling share of 55 per cent. The headquarters will be in Shanghai, the president will be rotated among the five countries, and an African regional office will be set up in Johannesburg.

57. The Eurasian Development Bank was established in 2006, led by Kazakhstan and the Russian Federation. Since then, Armenia, Kyrgyzstan and Tajikistan as well as Belarus have become members. It is a multilateral development bank specializing in regional integration. The Bank's charter capital totals \$7 billion, including \$1.5 billion of paid-in capital and \$5.5 billion of callable capital. It has provided financing totalling more than \$5.3 billion to investment projects in its member countries.

58. ASEAN finance ministers decided to create an ASEAN Infrastructure Fund in 2011. The Fund was created as a corporate entity, domiciled in Malaysia. All investors — ASEAN member States and ADB — are represented on the ASEAN Infrastructure Fund Board for oversight functions. ADB is an equity investor, co-financier and administrator of the Fund. The Fund is composed of: (a) core equity of \$485 million provided by nine ASEAN countries and ADB plus hybrid capital of \$162 million raised in capital markets; and (b) debt issued to central banks through foreign exchange reserves to leverage 1.5 times the equity. The Fund's total lending commitment through 2020 is expected to be about \$4 billion. Assuming a co-financing ratio between the Fund and ADB of about 30:70, the Fund can leverage more than \$13 billion for infrastructure investment by 2020. The Fund is expected to finance about five infrastructure projects each year, with a \$75 million lending cap per project. Projects will be selected based on sound economic and financial rates of return and their potential development impact.

59. The leaders of SAARC operationalized its Development Fund in 2010, with a paid-up capital of \$300 million, to extend financial support to economic, social and infrastructure programmes. The Fund succeeds a previous arrangement, the South Asian Development Fund. The Fund has a permanent secretariat and its lending operates through three windows. The social window primarily focuses on poverty alleviation and social development projects. The infrastructure window covers projects in such areas as energy, power, transportation, telecommunications, environment and tourism, among others. The economic window is primarily devoted to non-infrastructure economic programmes.

60. The Pacific Region Infrastructure Facility is a multi-agency coordination mechanism established in 2008 aimed at improving the delivery of development assistance from donors and development partners to the infrastructure sector in the Pacific region. Since 2009, the Facility has invested over \$2 billion in infrastructure projects in 13 Pacific island countries. The funding for these projects comes mostly from grants (30 per cent), loans (28 per cent) and technical assistance (21 per cent).⁶ The Facility's Technical Assistance and Research projects are supported by ADB, the Australian Government, the European Union, the European Investment Bank, Japan International Cooperation Agency, New Zealand's Ministry of Foreign Affairs and Trade and the World Bank Group. In addition to funding investments, the Facility offers advisory services in areas such as sector planning, policy and regulatory and institutional reforms, and acts as a knowledge hub for information-sharing, benchmarking and sharing of best practices.

61. In addition to multilateral investment banks and subregional funds, there have been a number of national initiatives to fund infrastructure investments outside national borders. The Silk Road Fund announced by China in 2014 to support mega projects of the "One Belt, One Road" initiative has already made its first investment in the Karot hydropower project in Pakistan. The Fund's capital will reach \$40 billion. More recently, Japan also announced its plan to provide \$110 billion to support high-quality infrastructure projects in Asia. Half of the funds will be extended by

⁶ ESCAP Pacific Office, "Financing for development: infrastructure development in the Pacific Islands", draft discussion paper submitted to the Asia-Pacific High-Level Consultation on Financing for Development meeting, Jakarta, 29-30 April 2015.

State-affiliated agencies in charge of aid and loans and the rest in collaboration with ADB.⁷

B. The way forward on infrastructure investment

62. There is broad consensus in Asia and the Pacific that adequate infrastructure investment will be vital for strong growth and sustainable development in the region in the coming decades, and that the financing needs will be huge. It is estimated that a cumulative infrastructure investment of close to \$30 trillion between 2013 and 2030 will be needed for the region to meet the international infrastructure stock benchmark of 70 per cent of GDP.⁸

63. Although some Asia-Pacific countries, like China, have been exceptionally successful in resource mobilization for infrastructure development and have significantly increased their infrastructure stock, the majority of the countries in the region still face enormous infrastructure investment deficits due to their lack of access to long-term financing, as well as their lack of preparation and implementation capacities for complex infrastructure projects. To close those gaps, efforts should go beyond national borders. This includes further expansion of multilateral infrastructure financing mechanisms and enhanced facilitation for cross-border deployment of the region's vast savings.

64. New financing institutions and facilitation mechanisms are opening new opportunities for countries in Asia and the Pacific to address their infrastructure bottlenecks. However, the involvement of multiple countries, multiple financing providers at the national, regional and international levels and multiple facilitation mechanisms create a need for enhancing regional coordination and cooperation. The goal of such coordination is to ensure that the prioritized projects are the most beneficial for the region as a whole, ensuring that they contribute to connecting countries with special needs, such as least developed countries, landlocked developing countries and small island developing States to the main markets in the region. The harmonization of social and environmental safeguards and standards is also important with regard to the implementation of the 2030 Agenda for Sustainable Development.

65. The Asia-Pacific region currently lacks a broad-based and regular platform for knowledge-sharing and policy coordination on infrastructure investment among different stakeholders, including Governments, financing institutions, facilitation bodies and the private sector. In this context, it would be useful to consider the establishment of an annual Asia-Pacific infrastructure investment forum:

(a) A broad-based, knowledge-sharing and policy coordination platform on infrastructure investment for Governments and their partners;

⁷ Leika Kihara and Linda Sieg, "Japan unveils \$110 billion plan to fund Asia infrastructure, eye on AIIB", Reuters, 21 May 2015. Available from www.reuters.com/article/2015/05/21/us-japan-asia-investment-idUSKBN00617G20150521.

⁸ McKinsey Global Institute, "Infrastructure productivity: how to save \$1 trillion a year", January 2013. Available from www.mckinsey.com/insights/engineering_construction/infrastructure_productivity. Some 70 per cent of GDP is a "rule of thumb" benchmark, which the value of infrastructure stock in most economies averages around.

(b) A knowledge-sharing and coordination platform for infrastructure financing institutions to share regional best practices and harmonize social-environmental safeguard procedures;

(c) An information exchange and collaboration platform for infrastructure investment facilitation bodies, and their target beneficiaries, to share and consolidate data pools and coordinate technical assistance and capacity-building efforts;

(d) A transparent and broad-based communication platform that brings together policymakers, financing institutions and project contractors with local communities and civil society groups.

66. The proposed Asia-Pacific infrastructure investment forum, which could be organized by ESCAP in collaboration with the regional multilateral development banks, could include four segments:

(a) An intergovernmental segment for knowledge-sharing and policy coordination among Governments;

(b) An infrastructure financing segment for knowledge exchange between leading infrastructure financing institutions in the region and between policymakers, infrastructure financing institutions and the private sector;

(c) A project facilitation and capacity-building segment for better information exchange and synergy of the facilitation and capacity-building efforts championed by infrastructure investment facilitation bodies, financing institutions and Governments;

(d) A social-environmental safeguard segment for knowledge-sharing and harmonization of social-environmental safeguard procedures and for dialogue with local communities and civil society groups.

67. The need for the proposed platform is particularly urgent, as the scale and complexity of infrastructure projects, especially regional and cross-border projects, are expected to increase swiftly in the coming years. A transparent and broad-based communication platform would be the best mechanism for the voices of local communities and civil society groups to be heard and for project planners, financing institutions and contractors to engage local stakeholders and build mutual trust in the most efficient manner.

V. Cooperation in tax matters

68. Cooperation in tax matters is emerging as a critical element for the implementation of the 2030 Agenda for Sustainable Development and the Addis Ababa Action Agenda. This section reviews existing cooperation forums in Asia and the Pacific, which cover various subregions and groupings of countries, and it proposes to set up a region-wide forum for cooperation in tax matters under the aegis of ESCAP.

A. Taking stock of cooperation in tax matters in Asia and the Pacific

69. Existing forums in the Asia-Pacific region can be divided into two types: those that facilitate the sharing of best practices and experiences, such as the Study Group on Asian Tax Administration and Research, and those that are under political bodies with specific mandates, such as the ASEAN Forum on Taxation.

70. The Study Group on Asian Tax Administration and Research is the oldest forum, and it has the widest membership — 17 members, 16 of which are ESCAP members or associate members. However, it is primarily an East Asian forum, with no members from South and South-West Asia or North and Central Asia and only Papua New Guinea from the Pacific islands. The Study Group has annual meetings, working-level meetings, joint training programmes and a biennial meeting of heads of training institutions. It does not have a dedicated secretariat and, until recently, its primary role seemed to be networking, as opposed to capacity-building, policy coordination or research.

71. The ASEAN Forum on Taxation was established in 2011 to provide a platform for dialogue on taxation issues in support of the ASEAN Economic Community. It has two subforums. Subforum 1 on Double Taxation and Withholding Tax focuses on developing a comprehensive treaty network and a timetable for reduction of withholding tax rates among ASEAN members. Subforum 2 on Enhancing Exchange of Views and Dialogue concerns sharing of experiences on best practices in taxation systems, developing strategies for cooperation, and building capacity support and training for tax administrations. The Forum is also conducting a study on a regional taxpayer identification number.

72. SAARC has promoted cooperation on tax issues among its members through the SAARC Limited Multilateral Agreement on Avoidance of Double Taxation and Mutual Administrative Assistance in Tax Matters signed in 2005. Its first meeting was held in 2011. SAARC has a secretariat, but most activities consist of ad hoc seminars hosted by members on a rotational basis. At the third meeting of SAARC tax authorities in 2014, members discussed proposed amendments to the multilateral agreement and considered a draft SAARC tax information exchange agreement prepared by Pakistan.

73. Since 2003, the Pacific Islands Tax Administrators Association has provided a platform for 16 economies in the Pacific to discuss tax-relevant concerns. It was originally set up by the IMF Pacific Financial Technical Assistance Centre, but the Fiji Revenue and Customs Authority has acted as the secretariat since 2012. So far, the Association has been primarily a platform for exchange of experiences and for capacity development. It also serves as a platform for coordinating the work of development partners and donors in the area of taxation and public finance management.

74. In North and Central Asia, the Eurasian Economic Commission has a Consultative Committee for Tax Policy and Tax Administration to discuss tax issues related to economic integration. Its members include Armenia, Kazakhstan, Kyrgyzstan and the Russian Federation. In a recent meeting, members discussed a draft protocol on electronic information exchange between tax authorities as regards certain types of individual and corporate income and assets and a draft agreement on tax policy in the field of excise duty rates on alcohol and tobacco products. Under the Commonwealth of Independent States, there is also a Coordination Council of Heads of CIS Member States' Tax Administrations.

75. The Asia-Pacific Tax Forum was co-founded by the International Tax and Investment Center and the Public Finance Institute of the Philippines in 2005.⁹ Its annual meetings bring together leading tax policy officials from the

⁹ The International Tax and Investment Center is an independent, non-profit research and education organization based in Washington, D.C. It was founded in 1993 to promote tax reform and public-private initiatives to improve the investment climate in transition and developing economies.

public sector, academic experts and industry representatives. Topics discussed in its annual meetings and research programme include global and regional tax trends, transfer pricing, regional cooperation and coordination in indirect taxation and tax administration reforms.

76. The Asian Tax Authorities Symposium has been meeting since 2010, supported by the International Bureau of Fiscal Documentation, the United Nations, the Organization for Economic Cooperation and Development and other partners. The Symposium brings together officials responsible for both tax policy and tax administration to discuss international tax issues and developments and their impact on the Asia-Pacific region. It aims at giving a voice to developing countries in the region to raise issues uniquely relevant to them, whilst allowing them to share and learn from the experiences of the more developed countries in the region.

B. Towards an Asia-Pacific forum for cooperation on tax matters

77. Enabling the region to develop and implement the 2030 Agenda for Sustainable Development will require significant levels of financing. While it is important that development partners continue to meet their existing official development assistance commitments, developing countries must also strive to mobilize more resources domestically. Strengthening tax revenues could provide an important source of finance for development in the Asia-Pacific region. As highlighted in the 2014 issue of the *Economic and Social Survey of Asia and the Pacific*, tax collection by central Governments in developing Asia-Pacific countries averaged 14.8 per cent of GDP in 2011, below the 16.3 per cent of the GDP collected in sub-Saharan Africa.

78. Tax revenues might be low for a number of reasons. While the low capacities of tax administrations play an important role, a major concern in the Asia-Pacific region is low tax bases. In many countries, large parts of the economy, such as the agriculture sector, are exempt from taxation. In addition, widespread tax avoidance and tax evasion erodes tax revenues. It is thus not surprising that the Asia-Pacific region accounted for more than 60 per cent of all illicit financial outflows, including tax evasion, from the developing world between 2001 and 2010,¹⁰ while in countries such as Bangladesh, India and Pakistan less than 3 per cent of the population pays income tax.

79. Countries in the region are also grappling with low revenues from corporate taxation. While corporate tax rates are relatively low in the region, averaging 28.2 per cent in 2013, compared with 32.2 per cent in Latin America and 29.8 per cent in Africa, revenues are eroded further by tax exemptions and allowances — such as tax holidays, reduced corporate income tax rates, investment tax allowances and partial profit exemptions — to attract foreign direct investment. Base erosion and profit-shifting practices of multinational corporations weaken tax collection further.

80. In light of the above, the Asia-Pacific region has a significant potential to increase its tax collection. As shown in the *Economic and Social Survey of Asia and the Pacific 2014*, several countries of the region could increase their tax revenues by 5 per cent of GDP or more. Closing tax gaps and introducing policies to broaden the tax base and raise more revenues poses challenges due

¹⁰ See Global Financial Integrity, “Illicit financial flows from developing countries: 2001-2010”, December 2012. Available from http://iff.gfintegrity.org/documents/dec2012Update/Illicit_Financial_Flows_from_Developing_Countries_2001-2010-HighRes.pdf.

to the international character of taxation and the mobility of capital — for which regional cooperation can play an important role.

81. The proposal is therefore to create an Asia-Pacific forum for cooperation in tax matters to provide a platform for tax experts and officials to share best practices in tax policies, tax administration and tax reforms. The forum could facilitate greater coordination in tax policy and monitoring of tax legislation and regulations across the region, as well as be used as a platform to provide capacity-building activities to tax administrations.

82. The proposed forum could review the legal and regulatory frameworks of tax jurisdictions and analyse past and current tax reforms. Such stocktaking could highlight existing and emerging challenges that developing countries in the region are facing in their revenue collection processes. In doing so, the review could provide recommendations on how to address these challenges through: (a) legislative changes to the tax code; (b) improved capacities of national tax administrations; (c) improved regional cooperation in tax matters; and (d) other relevant measures. Such an exercise would also identify and share best practices in tax administration and revenue collection. Appropriate recommendations could then be made on how to tailor these best practices to the individual circumstances of other countries.

83. An important contribution of the proposed forum would be to strengthen the capacities of tax administrations and ministries of finance:

- (a) To develop more effective and efficient tax systems, with a view to supporting the desired levels of public and private investment;
- (b) To increase tax transparency;
- (c) To foster exchanges of information between national tax administrations to combat tax evasion and the illicit transfer of funds;
- (d) To tackle tax competition.

84. Such capacity-building could take place through specialized seminars or other types of training courses. The forum could act under the aegis of ESCAP since it would draw its membership from the region. Moreover, it could also function as a regional chapter of the Committee of Experts on International Cooperation in Tax Matters, a subsidiary body of the Economic and Social Council. Last but not least, the proposed forum could cooperate with existing cooperation arrangements on tax matters in the region, which were mentioned in section II above, such as the Study Group on Asian Tax Administration and Research.