

# FINANCING A SUSTAINABLE RECOVERY FROM COVID-19 AND BEYOND

Asia-Pacific Countries with Special  
Needs Development Report 2022





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# ASIA-PACIFIC COUNTRIES WITH SPECIAL NEEDS DEVELOPMENT REPORT 2022

## Financing a Sustainable Recovery from COVID-19 and Beyond



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# FOREWORD

Least developed countries, landlocked developing countries and small island developing States, collectively referred to as “countries with special needs”, constitute more than a half of ESCAP member States and associate members. However, these countries remain heavily underrepresented in the region’s economic activities, accounting only for 3 per cent of the region’s gross domestic product and trade in goods and services. Given the structural challenges these countries face, which include widespread informality, lack of economies of scale, high vulnerability to external shocks and geographic isolation for landlocked developing countries and small island developing States, these countries were not on track to attain the Sustainable Development Goals even before the onset of the COVID-19 pandemic. The impact of the COVID-19 pandemic has pushed back the likelihood of them doing so even more.

One reason behind this is that the pre-existing financing gaps to attain the Goals have increased significantly since the COVID-19 outbreak, as highlighted in this report. This is due to a combination of declines in government revenue and expanded fiscal and monetary stimulus measures deployed to cushion the pandemic’s adverse impacts along with a decrease in foreign direct investment, remittances and official development assistance. Accordingly, securing financial resources to recover from COVID-19 in line with the 2030 Agenda is an urgent task for these countries.

The analysis indicates that there is significant potential to tap traditional sources of development finance, such as tax revenue, public borrowing and foreign direct investment. Efforts to do so should, however, also be accompanied by enhancing tax administration, improving public expenditure management, aligning government budgets with the 2030 Agenda and incentivizing foreign direct investment in sectors relevant to the Sustainable Development Goals. Going forward, it is clear that countries with special needs must also endeavour to secure financing through innovative instruments and mechanisms, such as thematic bonds and debt-for-climate swaps. To do this, capacity, policy and regulatory gaps must be addressed and engagement and coordination with stakeholders must be strengthened. Indeed, without enhanced partnerships, greater multilateralism and increased solidarity across subregional, regional and global levels, these countries will not be able to recover from the pandemic.

The analysis of this report is timely given the large impact the COVID-19 pandemic has had on the socioeconomic development of the region. In view of the large and increasing financing gaps that countries are facing, policymakers of least developed countries, landlocked developing countries and small island developing States will no doubt be able to draw upon the analysis of this report to identify mechanisms to secure additional urgently needed funding to make the recovery from COVID-19 more sustainable and to galvanize partnerships, solidarity and financing commitments.



**Armida Salsiah Alisjahbana**

Under-Secretary-General of  
the United Nations and  
Executive Secretary of the United Nations  
Economic and Social Commission for  
Asia and the Pacific

# EXECUTIVE SUMMARY

Collectively referred to as countries with special needs, least developed countries (LDCs), landlocked developing countries (LLDCs) and small island developing States (SIDS) are characterized by a combination of geographic remoteness, being burdened with high trade costs, and lacking scale economies and resilience to crises and shocks, all of which hinders the achievement of sustainable development.

**Prior to the COVID-19 outbreak, countries with special needs in Asia and the Pacific were largely off-track to attain the Sustainable Development Goals (SDGs) by 2030. The COVID-19 pandemic has further dampened prospects for achieving the SDGs.**

Estimates of the annual investment needs of Asia-Pacific LDCs and LLDCs to achieve the SDGs by 2030 before the pandemic amounted to approximately 19 and 8 per cent of their respective gross domestic products (GDPs). While data scarcity constrains any estimation for SIDS, the costs are compounded by vulnerabilities to climate change and their small, scattered population bases, which raise the fixed costs of investments.

Owing to a combination of declining government revenue and expanding fiscal and monetary stimulus measures deployed to counter the adverse impacts of the pandemic, the financing gaps in achieving the Goals has further widened. Most COVID-19 response measures taken so far have fallen short of the scope needed to facilitate a sustainable recovery. This is because they were mostly aimed at mitigating the adverse impacts of the pandemic on the population's health and the economy and not designed, at least initially, to provide a basis for "building back better". Moreover, initial policy responses to the pandemic did not promote green development; most of them supported carbon-intensive sectors by providing subsidies, waiving fees or reducing taxes for environmentally harmful activities, such as coal exploration. In addition to the triple threats of COVID-19, climate change and disasters, the evolving crisis in Ukraine has further exacerbated rising energy prices, food inflation, a looming debt crisis and temporary disruptions in global supply chains.

**Mobilizing the necessary resources from traditionally dominant sources has presented challenges to countries with special needs.**

While many countries with special needs have managed to raise tax revenue as a proportion of GDP, the levels attained are still inadequate to finance development needs. In the larger LDCs, such as Afghanistan, Bangladesh and Myanmar, less than 10 per cent of GDP is collected in tax revenue (a ratio of 15 percent is considered a minimum threshold to provide basic services, such as road infrastructure, health care and public safety). The pandemic is projected to have further reduced tax revenue by an average of 5 per cent in 2020.

As a result, many countries with special needs rely heavily on official development assistance (ODA). While it is evident that multilateral donors are stepping up their lending and grant support in the wake of the pandemic, the impact on bilateral ODA and its outlook is still unravelling.

To finance their increasing investment requirements, many countries with special needs are gradually turning to borrowing, especially from external sources. External debt stocks as a proportion of GDP and debt servicing ratios are still manageable in most LDCs and LLDCs, but the source and composition of external debt may be a cause for concern for some countries with special needs, as reliance on commercial and less-concessional loans has increased. This trend has important implications related to debt

servicing obligations, debt roll-over risk and costs of debt restructuring. Debt servicing is especially challenging for SIDS; eight of them are now being classified as facing high debt-distress as the pandemic has squeezed their already narrow revenue base.

Foreign direct investment (FDI), another important source of financing, has been unevenly distributed across countries and proven to be quite volatile over time. Moreover, it has been trending lower since 2017. Notably, in the countries that have attracted FDI, the extractive sectors and low-cost labour sectors have been the primary beneficiaries. Accordingly, relying on FDI as a vehicle to recover from COVID-19 is difficult and uncertain for most of the countries with special needs.

External remittances, on the other hand, have emerged as an important source of financing for many countries with special needs. In some of these countries, remittances account for more than 20 per cent of GDP annually. Despite some disruption caused by the COVID-19 pandemic, these flows have remained resilient, helping households mitigate the impacts of reduced earnings. However, unlike in earlier crises, such as the 2008 financial crisis, the road to recovery this time around is likely to be much more protracted given the widespread impact and continuing disruptions. Accordingly, the ability to sustain these flows are a concern.

Beyond financial resources, institutional shortcomings impede absorptive capacity and spending efficiency. This has become evident during the pandemic, as governments attempted to launch interventions and stimulus measures. Even though funding is available, the ability to spend resources impactfully in areas aligned with the SDGs often has been weak, thereby reducing the effectiveness of response measures.

**Overall, these traditional sources will continue to dominate the financing landscape in the short to medium term in countries with special needs and, therefore, must be strengthened.**

On the domestic revenue front, additional tax revenue ranging from 1.7 to 12.5 per cent of GDP can be raised in countries with special needs. While enhancing the collection of tax revenue is the most enduring form of financing, the current context makes increases in tax rates politically unfeasible, just as expanding the tax base remains challenging due to the largely informal nature of the economies. A feasible avenue in the short to medium term would, therefore, be to improve tax administration systems, particularly by increasing collection efficiency from existing taxpayers and minimizing leakages. Electronic tax registration, filing, payment and dispute resolution, for instance, can help to reduce the risk of officials abusing their discretion and provide citizens clarity regarding the tax-paying process.

Official development assistance will continue to serve as an important financing source given that it can be leveraged and scaled up relatively quickly. Nevertheless, there is much room for improving the efficient and equitable use of ODA and to better channel it towards efforts to achieve the SDGs. The use of recipient national systems to deliver ODA has been identified as an efficient modality for small jurisdictions, such as SIDS, and could thus be pursued further. Given their limited public financial resources, countries must strive for allocative and operational efficiency through approaches, such as SDG budgeting and tagging, and project cycle management.

Debt and risk management is emerging as a key focus area because of the high number of countries with special needs that have been classified as suffering from high debt-distress. This is also important as countries take on debt that is less concessional

and more commercial. From this perspective, the development of domestic sovereign bond markets could enable countries to lay the foundational elements for capital markets, while also harnessing idle domestic resources, which does not entail the type of exchange rate risks associated with external borrowing. However, this may not be an option for all countries. In cases in which the individual economy is too small, collective debt securitization can be explored with a multilateral development agency serving as guarantor.

To complement public flows, private external flows, such as FDI, must be sought with a renewed focus on the digital sector and investments need to be aligned with the implementation of the 2030 Agenda for Sustainable Development. Regarding remittances, in addition to investing in the skills of migrating workers and assisting them to secure better paying jobs abroad, governments can expand the digitization of financial transactions to reduce their costs and facilitate increased flows of remittances.

### **Traditional sources need to be complemented by innovative sources.**

In addition to mobilizing resources through traditional channels, there is a need to explore and leverage new and innovative sources and instruments. Thematic bonds, such as green bonds, blue bonds, social impact bonds and sustainable bonds, are possible options that can be used to address specific themes, such as climate change, marine protection or social inclusion. Risk-transfer instruments, such as catastrophe bonds, could also be explored. Debt-for-climate swaps constitute another innovative source of development finance, which can simultaneously reduce debt exposure and increase investments in climate mitigation or adaptation

To effectively tap these sources, however, legal and regulatory frameworks need to be developed to accommodate policies for a sustainable recovery along with risk disclosure reporting practices that are either domestically oriented or aligned with recognized global standards. As such, countries with special needs could benefit by developing effective monitoring, reporting and verification frameworks, or building on existing global taxonomies and standards to ensure that collected funds are funnelled to related climate mitigation and adaptation projects.

### **Finally, there is an urgent need for strengthened multilateralism as well as regional cooperation and solidarity to mobilize the required resources to attain a sustainable recovery.**

Emerging transboundary challenges on taxation, including the rise of the digital economy, illicit financial flows and profit shifting by multinational firms, require stronger global and regional cooperation. Most existing cooperation platforms are fragmented at the subregional level, while global initiatives are marked by complex rules and standards, which may discourage countries with special needs from acceding to them. Accordingly, scaling up technical assistance to these countries in developing legal, institutional, and administrative capacity to benefit fully from these platforms is necessary.

As many countries with special needs are experiencing debt distress or showing early signs of such distress because of the pandemic, the international community can extend support beyond the current debt initiatives and programmes. More comprehensive debt relief programmes that are suitable for countries with special needs must be designed to ensure long-term sustainability.



The climate crisis has provided further impetus to international and regional cooperation, particularly in climate finance, to support the efforts of developing countries in dealing with this crisis. While commitments on climate actions have some promising features, including additional funding targets, there remains an urgent need to strengthen commitments and scale up the flow of climate finance to countries with special needs, particularly as grants and for climate adaptation. Additionally, the international community can provide legal, administrative and technical support to countries with special needs to develop climate finance instruments. International and regional actions should also foster the engagement of the private sector and other stakeholders to make climate finance mechanisms more effective, broad-based and self-sustaining.

Despite the rapid adoption of the digital technology in finance within countries, cross-border opportunities largely remain untapped, thereby highlighting the need for regional and international cooperation. The international community can promote regional interoperability and the harmonization of laws, regulations and standards in digital finance, which will facilitate easier, quicker and cheaper cross-border remittance transfers. International and regional cooperation could lead to the development of a platform for knowledge exchange, experience-sharing and technology transfer to facilitate the diffusion of technological capabilities and applications in countries with special needs.

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# CONTENTS

|  |            |
|--|------------|
| <b>FOREWORD</b>  | <b>IV</b>  |
| <b>EXECUTIVE SUMMARY</b>   | <b>V</b>   |
| <b>ACKNOWLEDGMENTS</b>   | <b>IX</b>  |
| <b>EXPLANATORY NOTES</b>   | <b>XII</b> |
| <b>ACRONYMS</b>  | <b>XIV</b> |
| <b>CHAPTER 1.</b>  |            |
| <b>TOWARDS A SUSTAINABLE RECOVERY</b>  | <b>1</b>   |
| <b>Stalled progress in achieving the Sustainable Development Goals amid the pandemic</b>         | <b>2</b>   |
| <b>What is a sustainable recovery? Is it on its way?</b>   | <b>7</b>   |
| <b>Why is financing sustainable recovery a major challenge for countries with special needs?</b> | <b>13</b>  |
| <b>CHAPTER 2.</b>  |            |
| <b>MAPPING THE FINANCING LANDSCAPE:<br/>STRENGTHENING EXISTING SOURCES</b>                       | <b>14</b>  |
| <b>An assessment of existing financing flows and options</b>                                     | <b>15</b>  |
| i. Public finance  | 17         |
| ii. Private finance  | 29         |
| <b>Conclusion</b>  | <b>34</b>  |
| <b>CHAPTER 3.</b>  |            |
| <b>LEVERAGING ADDITIONAL FINANCE</b>   | <b>35</b>  |
| <b>What is innovative finance?</b>   | <b>36</b>  |
| i. Thematic bonds  | 37         |
| ii. Digital foreign direct investment  | 43         |
| iii. Debt-for-climate swaps  | 45         |
| <b>Conclusion</b>  | <b>47</b>  |
| <b>CHAPTER 4.</b>  |            |
| <b>ACCELERATING ACTIONS THROUGH MULTILATERALISM</b>  | <b>48</b>  |
| <b>Strengthening global vaccination programmes to reduce the immediate funding gap</b>           | <b>49</b>  |
| <b>Fostering cooperation to address international taxation challenges</b>                        | <b>51</b>  |
| <b>Renewing efforts to meet the official development assistance commitments</b>                  | <b>53</b>  |

# CONTENTS

|  |           |
|--|-----------|
| <b>Addressing immediate debt vulnerabilities and restoring long-term debt sustainability</b>         | <b>55</b> |
| <b>Meeting climate commitments and leveraging innovative climate and environment-related finance</b> | <b>58</b> |
| <b>Addressing cross-border infrastructure financing gaps</b>   | <b>61</b> |
| <b>Promoting capital market development through regional financial cooperation</b>                   | <b>62</b> |
| <b>Accelerating digital finance for financial inclusion</b>  | <b>63</b> |
| <b>Harnessing regional value chain-linked foreign direct investment for sustainable development</b>  | <b>64</b> |
| <b>Promoting multistakeholder approach in the process of sustainable recovery</b>                    | <b>65</b> |
| <b>Conclusion</b>  | <b>66</b> |
| <b>CONCLUSION: GOING FORWARD</b>   | <b>67</b> |
| <b>REFERENCES</b>  | <b>69</b> |

# EXPLANATORY NOTES

Analyses in the report are based on data and information available up to the end of March 2022.

Groupings of countries and territories/areas are defined as follows:

- **ESCAP region:**
  - Members [49]: Afghanistan; Armenia; Australia; Azerbaijan; Bangladesh; Bhutan; Brunei Darussalam; Cambodia; China; Democratic People's Republic of Korea; Fiji; Georgia; India; Indonesia; Iran (Islamic Republic of); Japan; Kazakhstan; Kiribati; Kyrgyzstan; Lao People's Democratic Republic; Malaysia; Maldives; Marshall Islands; Micronesia (Federated States of); Mongolia; Myanmar; Nauru; Nepal; New Zealand; Pakistan; Palau; Papua New Guinea; Philippines; Republic of Korea; Russian Federation; Samoa; Singapore; Solomon Islands; Sri Lanka; Tajikistan; Thailand; Timor-Leste; Tonga; Turkey; Turkmenistan; Tuvalu; Uzbekistan; Vanuatu; and Viet Nam;
  - Associate members [9] — American Samoa; Cook Islands; French Polynesia; Guam; Hong Kong, China; Macao, China; New Caledonia; Niue; and Northern Mariana Islands.
- **Least developed countries (LDCs)** [11]: Afghanistan; Bangladesh; Bhutan; Cambodia; Kiribati; Lao People's Democratic Republic; Myanmar; Nepal; Solomon Islands Timor-Leste; and Tuvalu.
- **Landlocked developing countries (LLDCs)** [12]: Afghanistan; Armenia; Azerbaijan; Bhutan; Kazakhstan; Kyrgyzstan; Lao People's Democratic Republic; Mongolia; Nepal; Tajikistan; Turkmenistan; and Uzbekistan.
- **Small island developing States (SIDS)** [22]:
  - ESCAP member States [15]: Fiji; Kiribati; Maldives; Marshall Islands; Micronesia (Federated States of); Nauru; Palau; Papua New Guinea; Samoa; Singapore; Solomon Islands; Timor-Leste; Tonga; Tuvalu; and Vanuatu;
  - Associate members [7]: American Samoa; Cook Islands; French Polynesia; Guam; New Caledonia; Niue; and Northern Mariana Islands.
- **Countries with special needs/countries in special situations** [37]: LDCs, LLDCs and SIDS.
- Developing ESCAP region — ESCAP region excluding Australia, Japan and New Zealand.
- Developed ESCAP region — Australia, Japan and New Zealand.
- Pacific — American Samoa; Australia; Cook Islands; Fiji; French Polynesia Guam; Kiribati; Marshall Islands Micronesia (Federated States of); Nauru New Caledonia; New Zealand; Niue; Northern Marina Islands Palau; Papua New Guinea; Samoa; Solomon Islands; Tonga; Tuvalu and Vanuatu.
- Due to the limited availability of data, associate members of ESCAP are excluded from the analysis in the Report unless otherwise indicated.

- For the purposes of this report, Singapore is not considered to be a small island developing State because of its high level of development and high-income status, and for simplicity of analysis.

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Growth rates are on an annual basis, except where indicated otherwise.

Reference to “tons” indicates metric tons.

References to dollars (\$) are to United States dollars, unless otherwise stated.

The term “billion” signifies a thousand million. The term “trillion” signifies a million million.

In the tables, two dots (..) indicate that data are not available or are not separately reported; a dash (–) indicates that the amount is nil or negligible; and a blank indicates that the item is not applicable.

In dates, a hyphen (-) is used to signify the full period involved, including the beginning and end years, and a stroke (/) indicates a crop year, fiscal year or plan year.

# ACRONYMS

|                 |   |
|-----------------|---|
| <b>ADB</b>      | Asian Development Bank                                  |
| <b>AP-IS</b>    | Asia-Pacific Information Superhighway initiative        |
| <b>ARTNeT</b>   | Asia-Pacific Research and Training Network              |
| <b>ASEAN</b>    | Association of Southeast Asian Nations                  |
| <b>CAT bond</b> | catastrophe bond  |
| <b>COP26</b>    | 26th United Nations Climate Change Conference           |
| <b>COVID-19</b> | SARS-CoV-2 (corona virus disease 2019)                  |
| <b>ESCAP</b>    | Economic and Social Commission for Asia and the Pacific |
| <b>ESG</b>      | environment, social and governance                      |
| <b>FAO</b>      | Food and Agriculture Organization of the United Nations |
| <b>FDI</b>      | foreign direct investment                               |
| <b>GDP</b>      | gross domestic product                                  |
| <b>GNI</b>      | gross national income                                   |
| <b>ICMA</b>     | International Capital Market Association                |
| <b>ICT</b>      | information and communications technology               |
| <b>IFC</b>      | International Finance Corporation                       |
| <b>ILO</b>      | International Labour Organization                       |
| <b>IMF</b>      | International Monetary Fund                             |
| <b>ITC</b>      | International Trade Centre                              |
| <b>LDC</b>      | least developed country                                 |
| <b>LLDC</b>     | landlocked developing country                           |
| <b>MNE</b>      | multinational enterprise                                |
| <b>MSME</b>     | micro, small and medium-sized enterprise                |
| <b>NDC</b>      | nationally determined contribution                      |
| <b>ODA</b>      | official development assistance                         |
| <b>OECD</b>     | Organisation for Economic Co-operation and Development  |
| <b>PPP</b>      | public-private partnership                              |
| <b>SDG</b>      | Sustainable Development Goal                            |
| <b>SIDS</b>     | small island developing State                           |
| <b>SME</b>      | small and medium-sized enterprise                       |
| <b>UNCDF</b>    | United Nations Capital Development Fund                 |
| <b>UNCTAD</b>   | United Nations Conference on Trade and Development      |
| <b>UNDP</b>     | United Nations Development Programme                    |
| <b>UNEP</b>     | United Nations Environment Programme                    |
| <b>UNICEF</b>   | United Nations Children's Fund                          |
| <b>UNSDG</b>    | United Nations Sustainable Development Group            |
| <b>WEF</b>      | World Economic Forum                                    |



# CHAPTER 1.

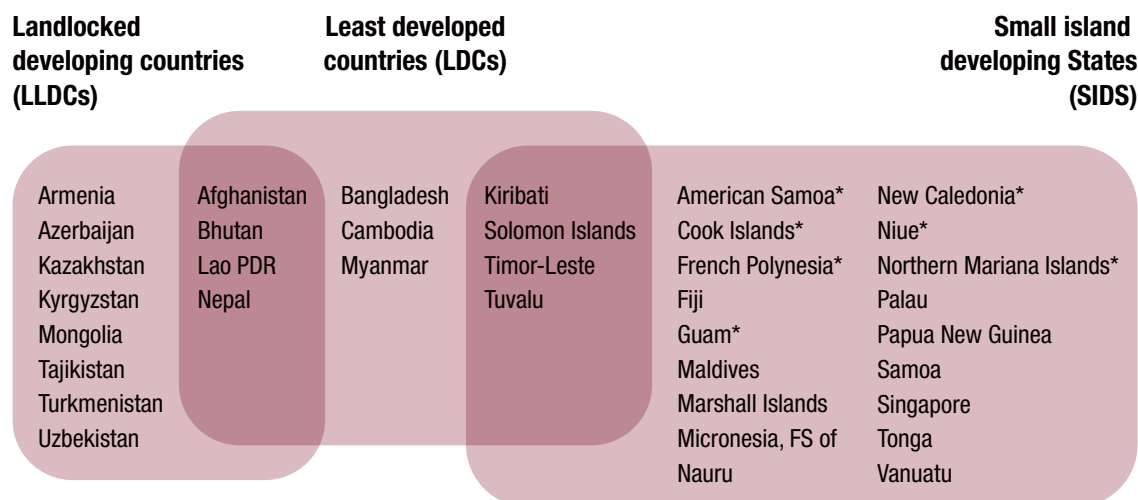
## TOWARDS A SUSTAINABLE RECOVERY



A total of 37 economies in Asia and the Pacific are classified either as least developed countries (LDCs), landlocked developing countries (LLDCs) and small island developing States (SIDS) (see figure 1-1).<sup>1</sup> Collectively referred to as countries with special needs, these countries are home to more than 400 million people, a quarter of the total population of the Asia-Pacific developing countries, excluding China and India. Their economies are marked by persistent structural development challenges, fluctuating economic growth and heavy dependence on a limited number of

commodities or low-wage manufactured products for export earnings. The *Asia-Pacific Countries with Special Needs Development Report 2022* focuses on the financing gaps these countries face to support a sustainable recovery from the COVID-19 pandemic and examines policy options and cooperation needs, especially regarding specific challenges and opportunities for attaining the Sustainable Development Goals, heightened risks posed by climate emergencies and declining capital flows in the forms of foreign direct investment (FDI), official development assistance (ODA), remittances and receipts from tourism.

Figure 1-1: List of Asia-Pacific countries with special needs



Source: ESCAP.

Notes: Lao PDR stands for Lao People's Democratic Republic. Micronesia, FS of, stands for the Federated States of Micronesia. Asterisks (\*) indicate associate members of ESCAP.

## Stalled progress in achieving the Sustainable Development Goals amid the pandemic

Even before the COVID-19 outbreak, the Asia-Pacific countries with special needs were not on track to achieve any of the seventeen Sustainable Development Goals. While they had made some progress towards reaching Goal 7 (affordable and clean energy), Goal 9 (industry, innovation and infrastructure) and Goal 10 (reduced inequalities), their progress was only about two thirds of what should have been achieved by 2021 (see figure 1-2).<sup>2</sup> The achievements in most of the other Goals

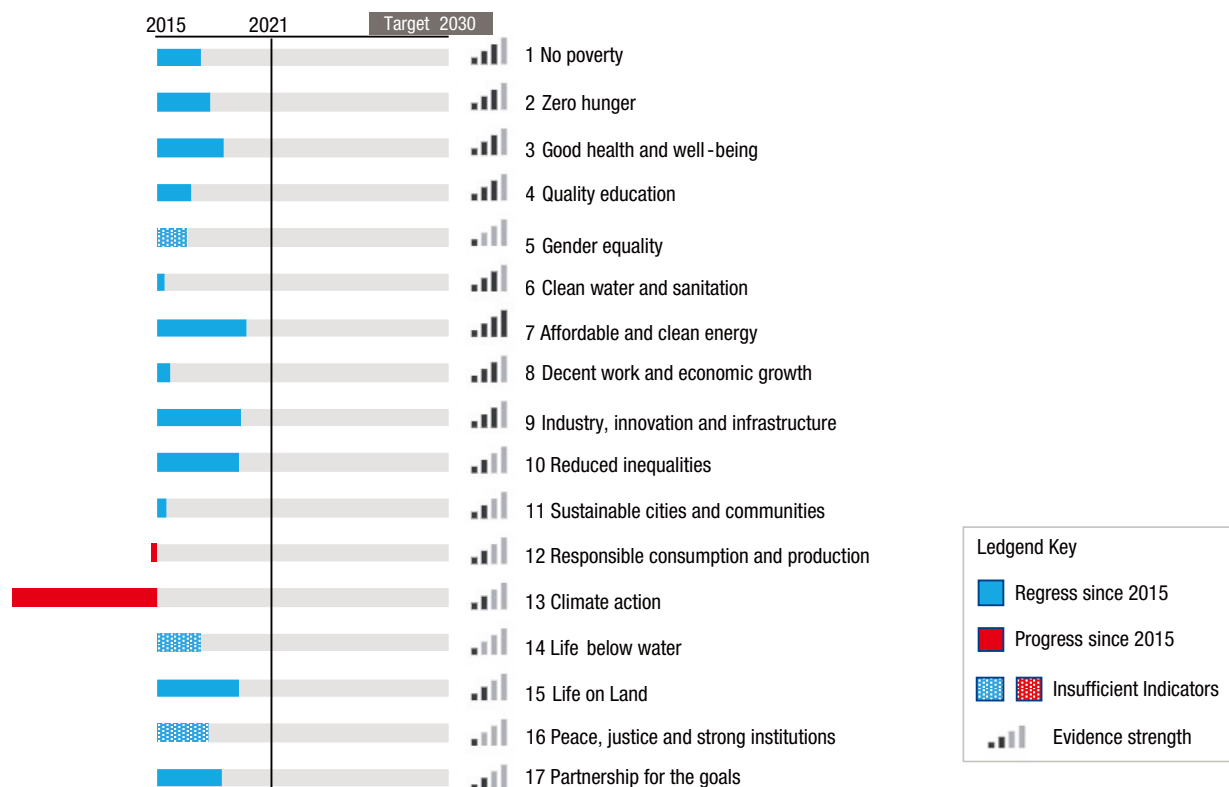
are less than 50 per cent of the target levels of 2021. These countries as a group had also regressed in efforts to realize Goal 12 (responsible consumption and production) and Goal 13 (climate action), and made almost no progress towards achieving Goal 6 (clean water and sanitation), Goal 8 (decent work and economic growth) and Goal 11 (sustainable cities and communities). Furthermore, insufficient or dated data availability makes it difficult to gauge the progress made in achieving most of the Goals, particularly Goal 5 (gender equality), Goal 14 (life below water) and 16 (peace, justice and strong institutions).<sup>3</sup>

1 Of the 53 member States and 9 associate members of ESCAP, 30 member States and 7 associate members belong to at least one of these three country groups.

2 The progress is assessed based on latest data from ESCAP Asia-Pacific SDG Gateway data.unescap.org (accessed on 21 February) 2022. It only partially captures the impact of the COVID-19 pandemic. For most indicators, data collection dates are 2019 or before (namely, pre-pandemic).

3 According to ESCAP (2020d), data availability is limited on Goals with slow progress, highlighting the need to strengthen the policy-data nexus.

Figure 1-2: Snapshot of progress made by Asia-Pacific countries with special needs towards achieving the Sustainable Development Goals, 2021



Source: ESCAP Asia-Pacific SDG Gateway. <https://data.unescap.org/data-analysis/sdg-progress/> (accessed on 21 February 2022).

In addition, global and regional progress has been insufficient regarding revitalizing the partnership to reach the Goals (Goal 17) (United Nations, 2021a; ESCAP, 2021c). This is a cause for concern for countries with special needs, especially for LDCs, because specific targets under Goal 17 on mobilizing financing for these countries and strengthening capacity-building support are not on track to be met. As observed in chapters 2 and 4, disbursement of ODA to LDCs not only continues to be short of the stipulated measure in target 17.2, but also has been declining in recent years.

The prospects to achieve the Goals by 2030 have worsened since the onset of the COVID-19 crisis.<sup>4</sup> The pandemic has had devastating economic, social, and environmental impacts on LDCs, LLDCs and SIDS. For example, it pushed an estimated additional 7.8 million people into extreme poverty in these countries by the end of 2021 (see figure 1-3) despite the goal of eliminating all forms of poverty by 2030 (Goal 1) (ESCAP, 2021d) and unemployment increased by 1.9 million by 2021, which

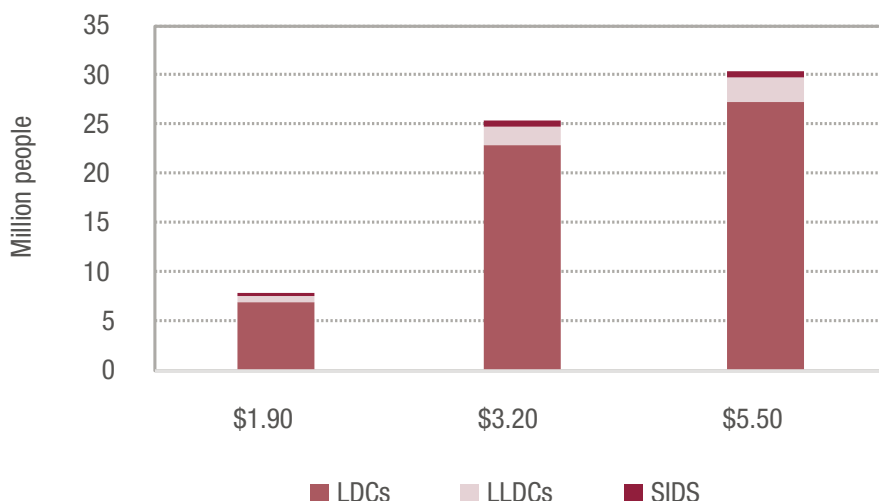
corresponds to an unemployment rate that is 1.1 percentage points higher when compared to the rate in 2019 (Goal 8) (see figure 1-4).<sup>5</sup> Job and income losses have been particularly severe for those engaged in the informal sector, with greater impacts affecting young people, older persons, migrants and female workers (ESCAP, 2021d). Output growth and manufactured exports have virtually collapsed in many countries with special needs, while prospects for immediate recovery are slight. Access to health care and education facilities, particularly by the poor and vulnerable groups, have suffered significant setbacks. Many children from poor and low-income families have dropped out of school, and many of them have permanently discontinued their education, which is increasing the risk of children being pushed into child labour.<sup>6</sup> At the same time, initial policy responses to the pandemic have failed to promote green development. Most of the actions taken have supported carbon-intensive sectors, as many economies of the region have provided subsidies, waived fees or reduced taxes for environmentally harmful activities, such as coal exploration (ESCAP, 2021g).

4 See ESCAP (2021a) and (2022a) for further details.

5 Based on ILO modelled estimates available from [ilostat.ilo.org/data/](http://ilostat.ilo.org/data/) (accessed on 7 February 2021).

6 For further details and discussions, see ILO and UNICEF (2020) and ILO and UNICEF (2021).

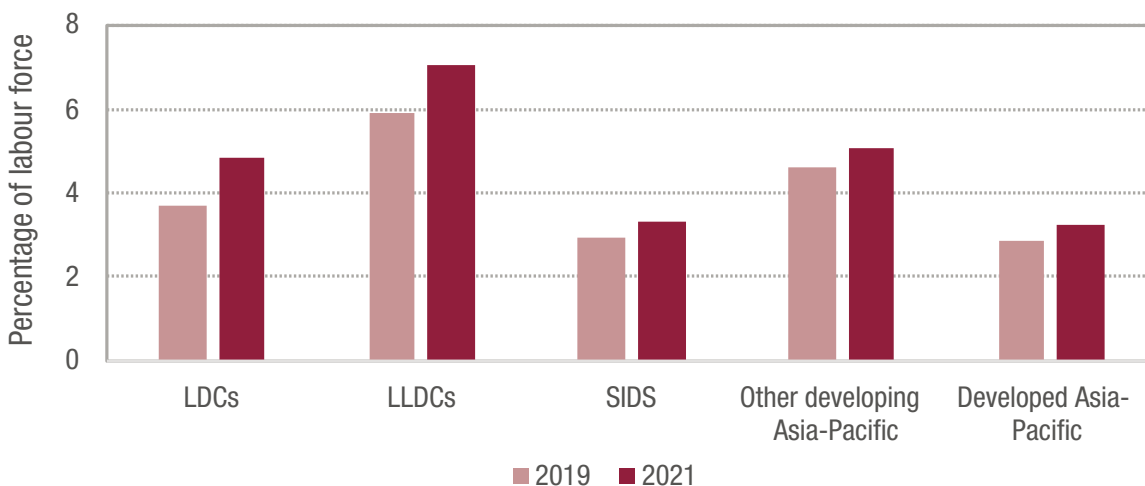
**Figure 1-3:** Number of people pushed into poverty due to the COVID-19 pandemic in Asia-Pacific countries with special needs by the end of 2021



Source: ESCAP estimation based on data from the World Bank Poverty and Inequality Platform [pip.worldbank.org](http://pip.worldbank.org) (accessed on 21 February 2021) and ESCAP (2022b).

Note: The estimation methodology is based on Tateno and Zoundi (2021).

**Figure 1-4:** Change in unemployment rates in the Asia-Pacific region between 2019 and 2021



Source: ILOSTAT, [ilostat ilo.org https://ilostat ilo.org/data/](https://ilostat ilo.org/data/) (accessed on 15 February 2022).

Notes: Unemployment rates of people aged 15 and over are reported. The figures are aggregated for each country group. Those for 2021 are ILO-modelled estimates.

**The countries with special needs require substantial and increasing investment to attain the Sustainable Development Goals.** Investment needs in Asia and the Pacific to achieve the Goals by 2030 before the pandemic were estimated to be an additional 5 per cent of GDP per year or \$1.5 trillion annually (ESCAP, 2019a). This amount was considerably higher for LDCs and LLDCs, at approximately 19 and 8 per cent of their respective GDPs (see box 1-1 for more details on the estimates of the investment needs). Holland and Sirimaneetham (2021) further estimate that only

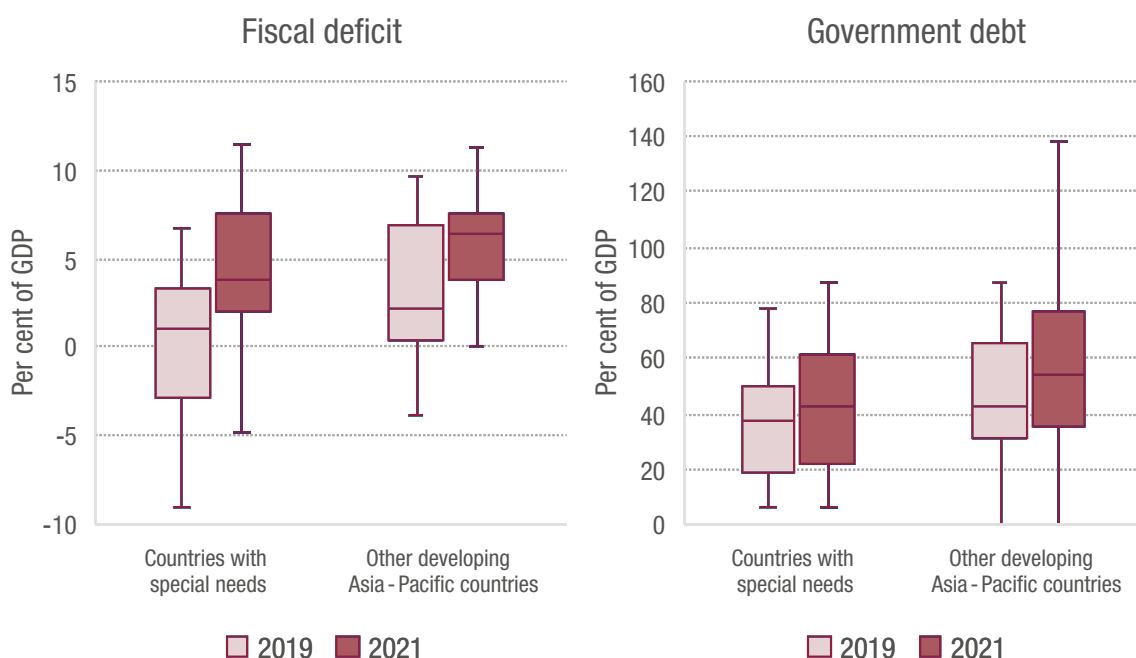
approximately 24 per cent of these gaps could be filled in LDCs based on past trends of financial flows. In cases of LLDCs and SIDS, such ratios are estimated to be higher, but are still low at about 42 and 40 per cent, respectively. Indeed, the financing needs to build back better are substantial and require the strengthening of existing sources and finding newer sources. Implementing a build-forward-better package aimed at providing basic social services would enable countries to close the digital divide and strengthen climate and energy actions. It could also raise

economy-wide productivity, reduce the number of people living in poverty and minimize income inequality, as well as cut carbon emissions by about 30 per cent and improve air quality to a notable extent in the long run (ESCAP, 2021g). This points to an urgent need to mobilize additional fiscal and financial resources for sustainable development in Asia-Pacific countries with special needs.

**The COVID-19 pandemic has further increased investment needs due to, among other factors, rising poverty incidence and higher public spending to provide health-care services and ensure decent jobs.** Meanwhile, the financing gaps are also set to widen due to significant declines in government revenue and the urgent need to deploy substantial fiscal measures to address the health and socioeconomic consequences of the pandemic (ESCAP, 2020a). In fact, the median fiscal deficit among Asia-Pacific

countries with special needs is projected to increase from 1.0 per cent of GDP in 2019 to 3.9 per cent in 2021 (see figure 1-5). Similarly, the median public debt-to-GDP ratio is projected to increase from approximately 35.7 per cent in 2019 to 39.9 per cent in 2021. This expected quick build-up of debt will result in a higher debt service burden and raises concerns over debt sustainability in several countries. Although debt levels are rising in many countries, countries with special needs have been put in an especially precarious fiscal position because of their limited resource base, overdependence on imports and undiversified economies in addition to the barriers they face to integrate into the global economy. These factors will adversely affect their future growth and stability. Declining capital inflows to these groups of countries are expected to further widen the financing gaps.

Figure 1-5: Fiscal deficit and government debt, 2019 and 2021



Source: ESCAP calculation based on data from IMF World Economic Outlook Database: October 2021, [www.imf.org/en/Publications/WEO/weo-database/2021/October](http://www.imf.org/en/Publications/WEO/weo-database/2021/October) (accessed on 10 February 2022).

Notes: Fiscal deficit represents general government net borrowing. Government debt refers to general government gross debt. Data for 2021 are estimates.

## Box 1-1

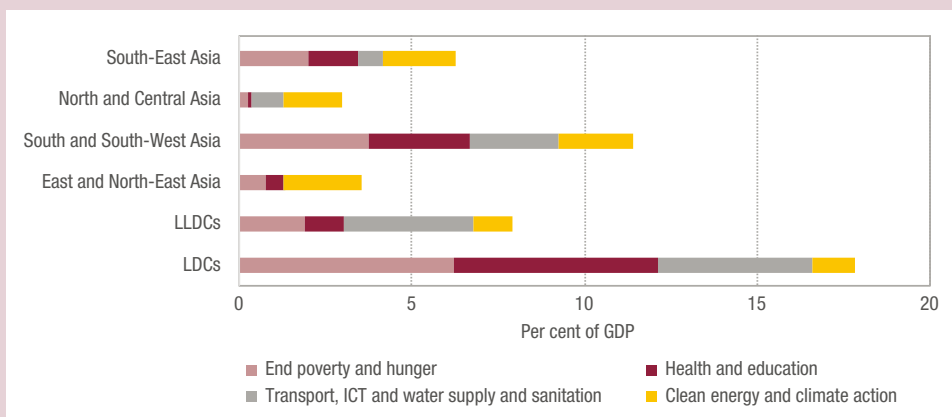
### The scale and types of investment needed to achieve the Sustainable Development Goals in countries with special needs

While estimates of the investment needs vary depending on the approach, they all point to a colossal requirement. Indeed, one of the earliest estimates of the investment needs to achieve sustainable development in developing countries globally ranged from \$3.3 trillion to \$4.5 trillion (UNCTAD, 2014). Against an estimated annual investment of \$1.5 trillion, this equates to an investment gap of approximately \$2.5 trillion (Doumbia and Lauridsen, 2019).

For Asia and the Pacific, an additional \$1.5 trillion would have to be invested annually. This figure is equivalent to approximately 5 per cent of the region's 2019 GDP (ESCAP, 2019a). Given their persistent structural impediments, the corresponding investment requirements were higher for the

countries with special needs, at 19 per cent and 8 per cent of GDP for LDCs and LLDCs, respectively. The analysis also grouped the Goals for which costs could be quantified into five investment areas (ESCAP, 2019a).<sup>7</sup> The estimates are effective in highlighting the most critical spending gaps across country groups. For instance, in the case of LDCs, the pressing priorities are the social areas, such as poverty and hunger, health and education, while in the case of LLDCs, they are related to infrastructure. Accordingly, LDCs need to devote close to 40 per cent of the total cost to end poverty and hunger, followed by providing health care and education for all, which will account for 30 per cent, and sustainable infrastructure comprising 25 per cent (see figure A). For LLDCs, providing sustainable infrastructure would constitute close to half of the total estimated cost, while another 25 per cent would go towards ending poverty and hunger. While no estimates exist for SIDS, it can be surmised that these countries' costs are compounded by their vulnerabilities to climate change and low and scattered population bases, which raised the fixed costs of investments.

**Figure A:** Additional spending requirements across country groups of Asia and the Pacific



Source: ESCAP (2019a).

Note: The graph does not include the spending gaps for the investment areas related to sustainable consumption and production, and biodiversity.

Such disaggregated insights can inform the choice of financing modalities and instruments in different groups of countries with special needs. Accordingly, LDCs may need to focus more on fiscal space as their most pressing investment needs are social oriented, which are not commercially viable in the short run, while LLDCs could pursue private participation to finance infrastructure development. In relation to their vulnerabilities, SIDS could direct their efforts towards targeted supplements of domestic revenue, such as grants, concessional loans, climate finance and thematic bonds, that are critical to address short- to medium-term needs and help with longer term resilience building.

Given the structural impediments and financing difficulties these group of countries face, it is challenging for them to meet the required investments by themselves. Stronger regional cooperation on financing for development is, therefore, critical. At the global level, it is estimated that only a mere 30 per cent of the required resources will be mobilized by the public sector, leaving a 70 per cent gap that must be filled by the private sector or other sources. In addition to being able to mobilize the colossal revenue required, more efficient approaches to ensure that the finances are channelled more effectively to lead to the attainment of the Sustainable Development Goals must be pursued. More recent alternative financing instruments to further bridge these gaps and the required policy options to harness them are further discussed in chapter 3.

<sup>7</sup> These five areas include (a) basic human rights: end poverty and hunger; (b) human capacities: health, education and gender equality; (c) enabling infrastructure: transport, ICT, water and sanitation; (d) securing humanity's future: clean energy and climate action; and (e) living in harmony: sustainable consumption and production, and biodiversity.

**The intensifying impacts of climate change and disasters further add to these challenges and even pose an existential threat to some SIDS.**

While LDCs and SIDS globally are responsible for only 5.75 per cent and less than 1 per cent of global greenhouse gas emissions, respectively, they are struggling disproportionately with severe biodiversity loss, rising sea levels and the increasing severity of extreme weather events (FAO, 2019; Assa and Meddeb, 2021d). In LLDCs, the need to adapt to climate change has been heightened through water stress caused by drought, desertification and land degradation. For the eight LDCs, three LLDCs and three SIDS that have estimated financing needs to address climate change in their nationally determined contributions (NDCs), total adaptation and mitigation costs by 2030 are estimated at \$45 billion and \$42 billion, respectively.<sup>8</sup> These costs are equivalent to 1.8 per cent of their combined GDP per year.

**A renewed partnership and solidarity are essential for confronting these multiple threats.**

In addition to the triple threats of COVID-19, climate change and disasters, the evolving crisis in Ukraine has further affected rising energy prices, food inflation, a looming debt crisis and temporary disruptions in global supply chains. The increased volatility in financial markets is of particular concern for countries plagued by already-elevated debt levels from the pandemic, as it could further increase borrowing costs and the risk of external debt distress (UNCTAD, 2022). Countries with

special needs as a group cannot on their own effectively confront these multiple crises and challenges and sustainably finance their recovery from COVID-19. A renewed partnership with strengthened subregional, regional, and international cooperation and solidarity is required to support efforts to overcome the adverse impacts of COVID-19 and achieve the Sustainable Development Goals by 2030.

**What is a sustainable recovery? Is it on its way?**

**A sustainable recovery from COVID-19 will accelerate progress towards achieving the Sustainable Development Goals.**

In essence, a sustainable recovery refers to an integrated approach to supporting economic recovery from the pandemic while ensuring that the recovery is environmentally sustainable, socially inclusive and resilient to future shocks. It is a process in which all stakeholders should participate and contribute. Amid the rising need for a renewed focus on increased social protection coverage, enhanced resilience and clean energy investment, the importance and necessity of such a recovery is widely recognized by many countries and integrated into the United Nations global, regional, and national frameworks for the immediate socioeconomic response to COVID-19 (see box 1-2). In box 1-3, the importance of social protection as part of promoting a sustainable recovery and building social resilience is highlighted.

## Box 1-2

**United Nations global, regional, subregional and national frameworks for the immediate socioeconomic response to COVID-19**

When the pandemic hit in March 2020, the United Nations quickly responded to the challenges of the pandemic and its devastating impact through a United Nations framework for the immediate socioeconomic response to COVID-19 (United Nations Sustainable Development Group, 2020a). The framework reflects the acute financial and fiscal impacts of the pandemic on many countries and the need to support them in guiding their fiscal and financial responses to ensure macroeconomic policies work, especially to protect people in vulnerable situations, while making certain that multilateral and regional responses are strengthened. For the seventy-fifth anniversary of the United Nations in 2020, member States came together to recognize that their challenges are interconnected and can only be addressed through

reinvigorated multilateralism with the United Nations at the centre of their efforts. While addressing the G20 Riyadh Summit in November 2020 (G20 Information Centre, 2020), the Secretary-General recognized the need to secure sustainable and equitable financing of the recovery to ensure countries are able to mobilize resources to “build back better” and align “recovery efforts with the 2030 Agenda for the Sustainable Development and the Paris Agreement on Climate Change”.

In Asia and the Pacific, ESCAP developed a socioeconomic framework to support its 53 members and 9 associate members. The framework provides regional and subregional solutions in the context of the United Nations global framework for the immediate socioeconomic response to COVID-19 and is in line with the “Regional Roadmap for Implementing the 2030 Agenda for Sustainable Development in Asia and the Pacific” (ESCAP, 2020e). At the subregional level, the United Nations, through ESCAP, set out four priority areas for a sustainable recovery of South-East Asian countries: tackling inequality; building the digital

<sup>8</sup> The NDCs of the following countries with special needs have quantified financing needs: Afghanistan; Bangladesh Cambodia; Fiji; Kiribati; Kyrgyzstan; Lao People's Democratic Republic; Mongolia; Nepal; Palau; Solomon Islands; Tuvalu, Turkmenistan; and Vanuatu.

divide; greening the economy; and upholding human rights and good governance practices (United Nations Sustainable Development Group, 2020c).

At the country level, the Secretary-General requested United Nations Resident Coordinator offices to work closely with respective United Nations country teams and partner Governments to develop more detailed medium-term (12 to 18 months) frameworks of support, called the Socio-Economic Response Plan (SERP) (United Nations Sustainable Development Group, 2020a). These plans were structured around United Nations agency support, under the following principles: (a) Health first – protecting health services and systems during the crisis; protecting people – social

protection and basic services; (b) Economic response and recovery – protecting jobs, small and medium enterprises, and informal sector workers; (c) Macroeconomic response and multilateral collaboration; and (d) Social cohesion and community resilience. This context resulted in the push for a “sustainable recovery”, essentially a renewed integrated focus on the Sustainable Development Goals, with the objective being rapid and strong long-term growth that is ecologically sustainable, economically and socially inclusive, and resilient. These plans detailed the COVID-19 response offers and their funding requirements and highlighted the financial and fiscal challenges being faced by Governments in developing their responses to the health challenges of the pandemic and the socioeconomic impact.

**And yet, the stimulus measures taken so far have often fallen short of the response required to facilitate a sustainable recovery and accelerate progress towards achieving the Goals.** Of the 43 country-specific recovery packages<sup>9</sup> announced before March 2021, OECD (2021b) finds that only 17 per cent of recovery spending have had a positive impact on the environment. The spending on measures with mixed or negative environmental impacts accounts for another 17 per cent, hardly a promising basis for building back better. This is not surprising as many stimulus packages are mainly aimed at mitigating the negative impacts of the pandemic on the population’s health and the economy. These packages are emergency measures

and not specifically designed to achieve the long-term Sustainable Development Goals. While these packages are meant to protect human security during the pandemic and thus are somewhat in line with several Goals, such as Goal 1 (no poverty), Goal 2 (zero hunger), Goal 3 (good health and well-being), Goal 4 (quality education) and Goal 8 (decent work and economic growth), other Goals are in general not, or only marginally addressed in the stimulus packages. Often excluded in the packages were activities related to Goal 5 (gender equality) and the environment, such as Goal 7 (affordable and clean energy), Goal 13 (climate action), Goal 14 (life below water), and Goal 15 (life on Land).<sup>10</sup>

## Box 1-3

### The role of social protection in responding to the pandemic

The COVID-19 pandemic has demonstrated that countries with a well-established social protection system are better at shielding people from destitution and insecurity in time of crisis.

The Government of Mongolia, for example, increased the transfer value of its Child Money Programme from 20,000 Mongolian tukrik (tog) (\$7) to 100,000 tog per month. Designed as a universal social protection scheme, the Programme covers almost all of the children in Mongolia, which made it the most appropriate channel for timely

and precise disbursement of social protection transfers. According to an assessment by ESCAP (2021j), this increase in the Programme’s benefit could decrease the poverty rate by 15 percentage points and boost consumption by 59 per cent for households in the bottom 10 per cent income decile.

The pandemic has exacerbated existing inequalities, as the high prevalence of informal employment in countries with special needs excludes large proportions of the labour force from contributory social protection schemes and offers zero or little coverage of poverty-related assistance or other non-contributory schemes. In the Asia-Pacific region, an estimated 68 per cent of workers engage in informal employment (ESCAP and ILO, 2020). Most of these workers are also disproportionately affected by the labour market shifts and other restrictive measures imposed during the pandemic.

9 Countries included in the analysis are the 38 OECD members, Brazil, China, India, Indonesia and South Africa.

10 Indeed, an assessment of UNCTAD (2020a) on COVID-19 stimulus packages in 20 developed and developing countries finds only a small portion of them is channelled to meet Goals 5 (gender equality) and 7 (affordable and clean energy).

Furthermore, people's ability to protect themselves from the pandemic is highly correlated with household wealth (ESCAP, 2022c). As shown in table A, those who are left behind, as identified by a composite index measuring the "COVID-19

preparedness" (ability to protect from COVID-19), are mostly in the bottom 40 per cent of the wealth distribution, live in rural areas and are younger in age.<sup>11</sup>

**Table A:** The circumstances shaping the furthest behind groups in their ability to protect from COVID-19 in countries with special needs

| Countries                        | Who are those left behind in their ability to protect from COVID-19? |           |                              |                      | Size of the furthest behind group |
|----------------------------------|--|-----------|------------------------------|----------------------|-----------------------------------|
|                                  | Wealth   | Residence | Education                    | Age group            |                                   |
| Afghanistan                      | B40  | Rural     |                              |                      | 39%                               |
| Armenia                          |  | Rural     | Lower or secondary education | 25 - 59 years of age | 14%                               |
| Bangladesh                       | B40  |           | Lower education              | <24 years of age     | 13%                               |
| Bhutan                           | B40  |           |                              | <24 years of age     | 20%                               |
| Cambodia                         | B40  | Rural     |                              | <24 years of age     | 21%                               |
| Kazakhstan                       | B40  |           |                              | <24 years of age     | 17%                               |
| Kiribati                         | B40  |           | Lower education              |                      | 18%                               |
| Kyrgyzstan                       | B40  |           | Lower education              |                      | 12%                               |
| Lao People's Democratic Republic | B40  |           | Lower education              | <24 years of age     | 18%                               |
| Maldives                         |  | Urban     |                              |                      | 41%                               |
| Mongolia                         | B40  |           |                              | <24 years of age     | 17%                               |
| Myanmar                          | B40  |           |                              |                      | 40%                               |
| Nepal                            | B40  |           | Lower education              | <24 years of age     | 11%                               |
| Papua New Guinea                 | B40  |           | Lower education              |                      | 38%                               |
| Timor-Leste                      | B40  |           |                              |                      | 40%                               |
| Tonga                            | B40  |           | Lower education              | <24 years of age     | 12%                               |
| Tuvalu                           | B40  | Urban     |                              |                      | 17%                               |

Source: ESCAP calculations, using data from the latest Demographic and Health Surveys and Multiple Indicator Cluster Surveys for countries with special needs.

Note: B40 refers to the bottom 40 per cent of the wealth distribution.

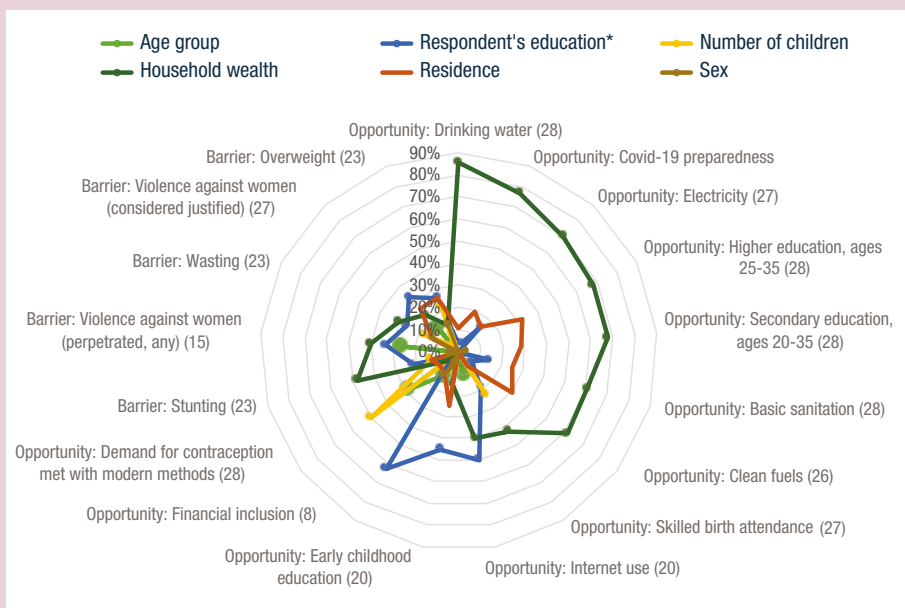
Beyond COVID-19, evidence suggests that household wealth plays the greatest role among a range of circumstances in creating gaps in access to basic opportunities, such as water and sanitation, clean fuels and education (see

figure A). Social protection can ensure that households are protected against situations that prevent them from fulfilling their basic needs.

<sup>11</sup> ESCAP developed a composite index to measure an individual's ability to protect himself or herself from COVID-19, defined as meeting all of these conditions: the individual has access to the Internet, TV, phone, mobile phone or radio; lives in a household with water pipes into the dwelling or yard or another private water source, and with a handwashing facility on premises with soap and water available; there are no more than two people per sleeping room in the household; and lives in a household that has a toilet which is not shared with other households. For more information, see <https://lnob.unescap.org/lnob?indicator=1049>.



**Figure A:** The most prevalent circumstances in creating gaps in access to basic opportunities and experience of barriers

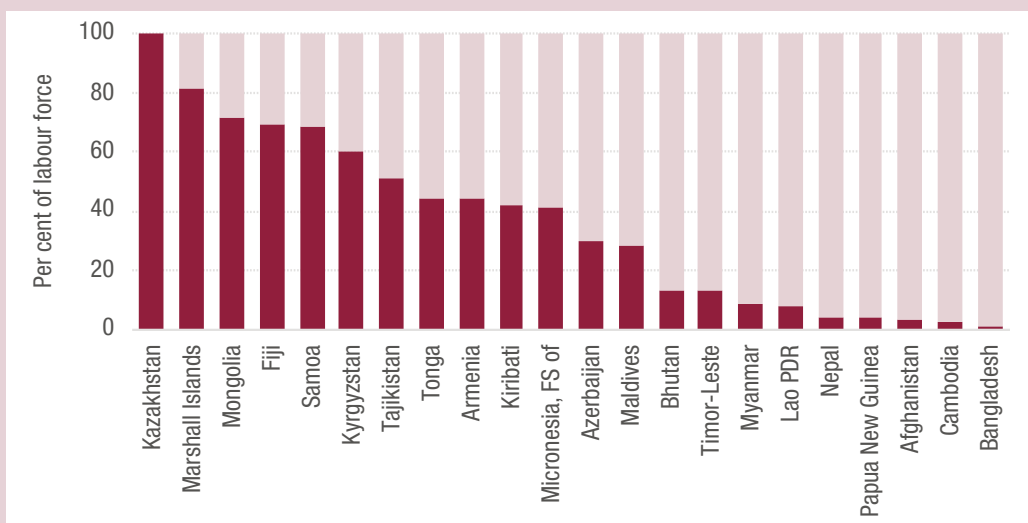


Source: ESCAP calculations, using data from the latest Demographic and Health Surveys and Multiple Indicator Cluster Surveys for 27 countries in the Asia-Pacific region.  
 Notes: The figure shows the share of occurrences in which a specific circumstance, such as household wealth, contributed the most to inequality (splits in Classification and Regression Tree or CART analysis), based on a calculated measure of variable importance of the model. The higher the share, the more times this specific circumstance is responsible for the gaps in access to an opportunity/prevalence of a barrier. In parenthesis is the number of countries where this indicator has been analysed.  
 \* Education is both a desired outcome (opportunity), depicted here as secondary education, ages 20-35 and higher education, ages 25-35 and a circumstance, shaping groups' access to other opportunities or experience of barriers. Respondent's education as a circumstance is not used in analysing gaps in education as an opportunity.

Social protection is critical for all, but even more so for people in vulnerable situations, particularly when they face social and economic risks. Countries, therefore, need to enhance efforts towards offering universal protection. This includes extending coverage to all, making sure that benefit levels are adequate, while removing means-testing and poverty-targeting, and relaxing conditionalities attached to social protection schemes.

Among the countries with special needs, only a fraction of workers is actively contributing to the social protection system (see figure B). Because of the already pronounced informality in these countries, non-contributory social protection schemes play a critical role in preventing vulnerability and poverty. Unfortunately, less than half of the region's population is covered by any social protection scheme.

**Figure B:** Percentage of labour force actively contributing to a social protection scheme, by country, per cent of labour force

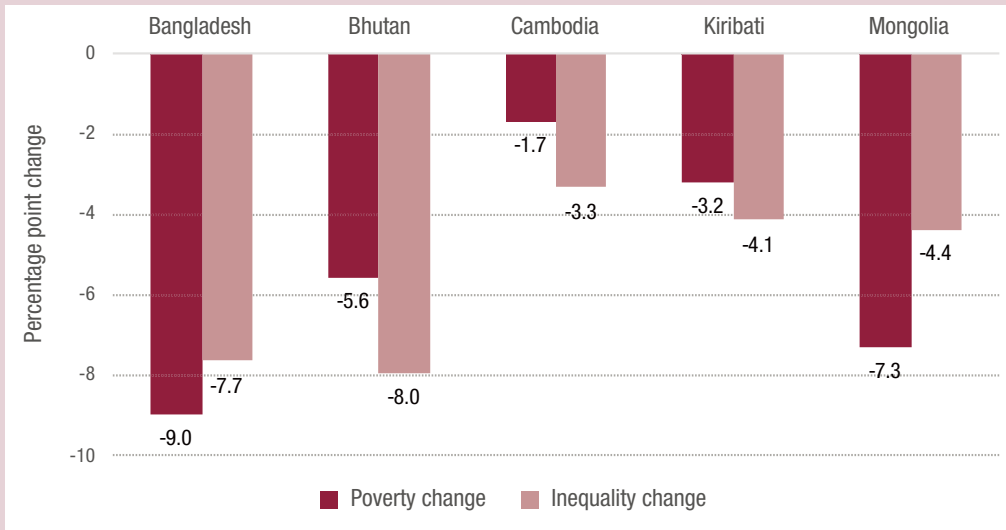


Source: International Labour Organization, World Social Protection Database. <https://www.social-protection.org/gimi/WSPDB.action?id=15>  
 Note: Lao PDR stands for Lao People's Democratic Republic. Micronesia, FS of, stands for the Federated States of Micronesia.

According to an analysis based on the ESCAP social protection simulation tool, a comprehensive social protection package consisting of child, old age and disability benefits

could significantly reduce poverty and inequality in selected countries with special needs, as illustrated in figure C.

**Figure C:** Simulated impact of comprehensive social protection package on poverty and inequality in selected countries with special needs

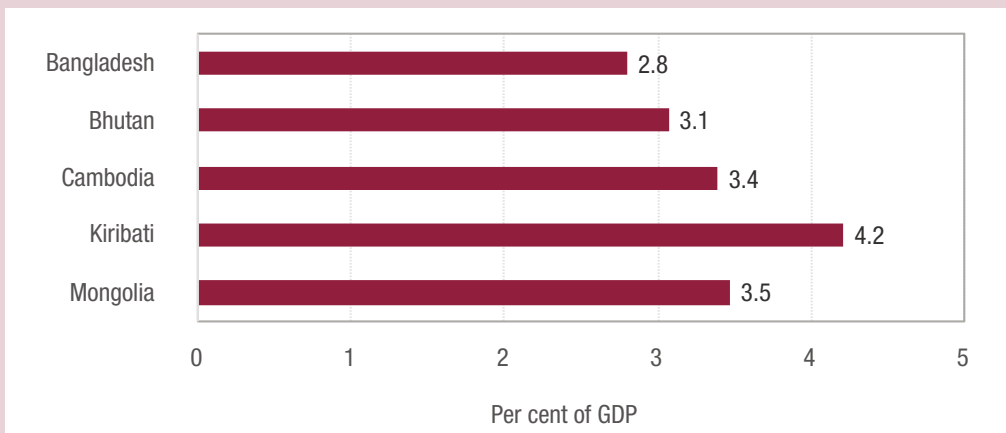


Source: ESCAP estimates, using the ESCAP social protection simulation tool.

The cost of such a comprehensive social protection package differs across countries, but it is affordable for most countries with special needs. The cost of raising the benefit level to the global level would range from 2 to 4 per cent of GDP (See

figure D). This level is still substantially below the unweighted regional average spending level on social protection of 4.9 per cent, noting that the regional average is already below half of the global average spending.

**Figure D:** Cost projection of comprehensive social protection package at global average benefit level per cent of gross domestic product



Source: ESCAP elaboration using the Social Protection Simulation Tool.

**This is also the case for the Asia-Pacific countries with special needs, where COVID-19 stimulus packages have been mainly aimed at coping with the pandemic and mitigating its negative economic impacts.** Box 1-4 presents the composition of the stimulus packages of selected countries. The level of fiscal stimulus is highly uneven across countries: LDCs have allotted 1.7 per cent of their aggregate GDP to stimulus packages since the onset

of the pandemic until December 2020 (ESCAP, 2021d). This, however, is significantly lower than the average of 6.6 per cent of GDP for all developing countries in the region, an indication of their limited fiscal space to respond to the crisis. This also points to a rising risk of a so-called “K-shaped” recovery in which some groups of countries recover much slower than others, contributing to economic polarization during the post-pandemic economic recovery (ESCAP, ADB and UNDP, 2021).

## Box 1-4

### COVID-19 stimulus packages in selected countries with special needs

#### The case of Bhutan

The Government of Bhutan responded to the pandemic with comprehensive measures in which the cumulative resources expended reached about 14 per cent of GDP in 2019/20, the highest allocation among South Asian countries (median value of 2.5 per cent) and one of the highest in the Asia-Pacific region (median value of 5.4 per cent) (ESCAP, 2021c). In addition to direct budgetary allocation for relief activities to ensure an uninterrupted supply of drugs and medical products, fuel, food and other essential goods and services, measures included deferment of various charges, taxes and duties, and a waiver on rents and private debt repayments (Wangchuk, 2022). To further stimulate the economy, the Government also frontloaded certain activities of the twelfth Five Year Plan and harnessed the context to launch various reform and strategic initiatives.

Against the COVID-19 contingencies, the Government formulated a medium-term debt management strategy for implementation over the 2020/21 to 2022/23 financial years. The Royal Monetary Authority of Bhutan reduced the cash reserve ratio from 10 per cent to 9 per cent on 17 March 2020 and further to 7 per cent on 27 April 2020 to provide liquidity relief to the financial institutions. The Government also implemented regulatory relaxations by releasing the capital conservation buffer of 2.5 per cent to enhance the lending capacity of the financial institutions to support the economy.

**Some measures introduced in these countries will, nevertheless, prevent them from deviating too far from the long-term pre-pandemic tracks of the progress on the Sustainable Development Goals.** Most of them increased their public health spending, including treating the COVID-19 patients, building new or expanding capacity of existing hospitals and conducting mass vaccination programmes. Although not designed to achieve the Sustainable Development Goals, this spending will have longer positive impacts on the public health sector and

#### The case of the Lao People's Democratic Republic

The Government of the Lao People's Democratic Republic allocated 30 billion Lao kip (KN) (\$2.6 million) in its 2020 budget to prevent and control the pandemic and KN 24 billion for medical equipment.<sup>12</sup> The Government introduced measures to provide economic and social protection, including electricity price cuts, income tax exemption for low-income workers, profit tax exemption for microenterprises and partial salary compensation for suspended workers who participated in the social security scheme.

The Government allocated KN 100 billion in the 2021 budget to combat the COVID-19 cases; an additional KN 100 billion from state reserves could be further allocated if the situation persists. The stimulus measures in 2021 include tax exemptions for three months for civil servants and private sector employees, price cuts of electricity, water and telecom services for three months, unemployment allowance, cash transfers for poor households and other subsidies for almost 6,000 low-income earners and informal sector workers.<sup>13</sup>

The Lao People's Democratic Republic prepared a comprehensive COVID-19 recovery framework to achieve the development goals of the National Socio-Economic Development Plan and get back on track to achieve the Sustainable Development Goals. In 2020, the Ministry of Planning and Investment formed a multi-stakeholder taskforce to provide policy recommendations related to the COVID-19 pandemic to be included in the ninth National Socio-Economic Development Plan. The work of the taskforce covered five key themes on the effects of COVID-19 related to the following: financing for sustainable development trade and the private sector; value chains and tourism; employment; human capital; and green growth and risk management, with respect to environmental and economic shocks, and provided recommendations on how these can be overcome (United Nations Lao PDR, 2021).

assist in efforts to achieve Goal 3. Sizable stimuli were also channelled to revive their economies towards achieving Goal 8 through credit guarantee for micro, small, and medium enterprises (MSMEs) in, for example, Cambodia, Mongolia, Papua New Guinea and Vanuatu; tax reliefs for businesses, in, for example, Cambodia and Turkmenistan; subsidies for businesses in, for example, Armenia and Uzbekistan; subsidies for farmers in, for example, Myanmar, Tajikistan and Vanuatu; and public work projects to provide temporary jobs in, for example, Nepal and Palau.<sup>14</sup> These countries have

<sup>12</sup> See <https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19#U>.

<sup>13</sup> Ibid.

<sup>14</sup> See [www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19#U](http://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19#U).

also implemented various social assistance programmes, such as direct cash transfers to vulnerable households in, for example, Bangladesh, Cambodia, the Federated States of Micronesia, Kazakhstan, Mongolia and Tuvalu; unemployment benefits in, for example, Kiribati, Palau, and Samoa; provision of food subsidies, food stamps, and/or daily food rations in, for example, Mongolia, Tajikistan and Nepal; exemptions of import duties for imported food and health items, in, for example, Mongolia and Samoa; and waiver, tariff reduction, or payment subsidies for electricity and water bills, in, for example, Maldives, Samoa and Nepal.<sup>15</sup> Albeit temporary in nature, these measures are in line with Goals 1, 2, and 3. Similarly, several measures in line with Goal 4 have been implemented in the forms of education subsidies, including tuition waivers in, for example, Azerbaijan, Tonga and Vanuatu, and distance education services for students in, for example, Samoa, Fiji, and the Solomon Islands.

## **Why is financing sustainable recovery a major challenge for countries with special needs?**

**Financing a sustainable recovery is a major challenge for these countries, not just because of the large investment needs, but also due to their low-financing capacities.** For example, government revenue collection remains low in several LDCs. While the government revenue of LDCs, on average, increased from 19.1 per cent of GDP in 2011 to 22.8 per cent in 2019, the three most populous LDCs in the region, namely Afghanistan, Bangladesh and Myanmar, recorded government revenue below 15 per cent of GDP, which is considered a minimum threshold to provide basic services, such as road infrastructure, health care and public safety (Razzaque and Tateno, 2021). Moreover, actual tax collection in several countries is falling short of its full potential (this was occurring even before the pandemic) (to be further discussed in chapter 2), resulting in tax gaps of approximately 6-8 per cent of GDP in Afghanistan, Bangladesh and Bhutan (ESCAP, 2014). As a result, many Governments have struggled to channel sufficient resources to respond to the rising need to finance a sustainable recovery. In the case of SIDS, their budgets are already overstretched or largely in deficit and they have limited access to foreign capital markets. While in Asia-Pacific SIDS, overall debt ratios of 40 per cent of gross national income (GNI) are lower than in SIDS in the Caribbean (59 per cent) and in Africa (52 per cent), these ratios have been on the rise over the last decade, partly reflecting growing external financial flows for infrastructure development (Tateno and Bolesta, 2020).<sup>16</sup>

**As such, much focus has been on exploring options to expand fiscal space to promote a sustainable recovery from the pandemic.** On one front, a conventional approach to mobilizing public domestic resources remains essential. For example, domestic policy reforms can enhance the efficiency of revenue collection, broaden the tax base and increase the effectiveness of public spending to accelerate the achievement of the Sustainable Development Goals. Domestic policy reforms are also needed to attract and better use traditional sources of external finance, such as ODA, FDI and remittances. Public debt and fiscal risk management could be revisited considering the increasing debt distress in some of these economies, which could be the basis to further expand the discussion on debt cancellation or service suspension.

**Moreover, additional approaches can be explored to attract more private finance for sustainable development or to relieve public debt burdens, including public-private partnerships (PPPs), blended finance, thematic bonds and debt-for-climate swaps.** While funding from such options is still small compared to traditional financing in many Asia-Pacific countries with special needs, significant untapped potential exists, especially when considering their catalytic role in mobilizing private capital. Despite the potential, many of these options are, however, currently only feasible for a small set of countries. Lack of institutional and technical capacity, absence of effective regulatory frameworks and common standards, and underdeveloped financial markets are among the recognized constraints that must be addressed by the countries with special needs and their development partners.

**With only eight years left to achieve the Sustainable Development Goals, greater support from the international community is critical to financing a sustainable recovery of LDCs, LLDCs and SIDS from the pandemic, especially at the initial stage of the recovery.** United Nations organizations, specialized agencies and bodies, and multilateral financial institutions need to accord special priority to these groups of vulnerable countries and adopt significantly strengthened measures and funding support for them. Targeted technical advisory services and policy advocacy through the United Nations and other intergovernmental discussions and processes could enable them to benefit from globally mobilized resources. In the medium to long run, domestic efforts to make gradual improvements in resource mobilization are essential to address the investment needs and to enhance access to and utilization of market-based financing instruments.

<sup>15</sup> Ibid.

<sup>16</sup> Of Asia-Pacific LDCs, LLDCs and SIDS, the following 11 countries are considered to face high public debt distress as of November 2021: Afghanistan; Kiribati; Lao People's Democratic Republic; Maldives; Marshall Islands; Micronesia (Federated States of); Papua New Guinea; Samoa; Tajikistan; Tonga and Tuvalu. Source: World Bank (n.d.). [www.worldbank.org/en/programs/debt-toolkit/dsa](http://www.worldbank.org/en/programs/debt-toolkit/dsa).



## CHAPTER 2.

### MAPPING THE FINANCING LANDSCAPE: STRENGTHENING EXISTING SOURCES

The Asia-Pacific countries with special needs face the dual challenge of being confronted by multidimensional impediments to development, while being constrained by limited resources and capacities in pursuit of the SDGs. Their pre-existing vulnerabilities have been exacerbated by the COVID-19 pandemic, which has severely undermined the achievement of the SDGs, and even resulted in some countries regressing in this endeavour.

Although the pandemic was indiscriminate in its geographic and socioeconomic reach, the key distinguishing factor in the case of countries with special needs is their limited coping capacity. Even prior to the pandemic, ESCAP (2018a) highlighted that while countries with special needs and other developing countries were prone to shocks, the lack of coping capacity has made the former particularly vulnerable.

Even within this group of countries, the impacts have varied. In the case of LDCs, the pandemic has exposed their narrow productive capacities and the informal nature of economic activities. The impacts have been compounded by their inadequate social protection, social infrastructure and low levels of digitization, which have affected their resilience and capacity to execute response measures (ESCAP, 2021d). For LLDCs, many of which are also commodity dependent, the pandemic and its associated response measures have compounded their inherently higher transaction costs in trading. These difficulties have been amplified by the increased time and procedures required to fulfil new health protocols. In the case of SIDS, the pandemic has severely dented their primary sources of revenue, as the tourism industry has come to a global standstill. However, indirect tax revenue and remittances have offered some respite. Furthermore, as highlighted earlier the median fiscal deficit in these countries is projected to have increased from 1.0 per cent of GDP in 2019 to 3.9 per cent in 2021, leaving them with very little fiscal space to launch sizeable response measures.

Against this backdrop, the discussion in this chapter focuses on the financing landscape in Asia-Pacific countries with special needs. More specifically, the next section presents the status and trends of the more traditional sources of development financing and includes a cursory assessment of the impact of the pandemic on these sources. Also presented in the section are some recommendations to strengthen these flows using country-case studies to illustrate

various possibilities. The chapter concludes on the note that traditional sources of financing will continue to dominate the landscape, as there remains huge untapped potential from them. Nevertheless, the pandemic has further widened the financing gap. To close this gap, an unprecedented level of policy action and international support are needed to mobilize the required resources, especially ODA, as it can be leveraged relatively quickly. To further complement these traditional sources of financing, newer innovative avenues, such as thematic bonds and carbon taxes, should also be explored.

## **An assessment of existing financing flows and options**

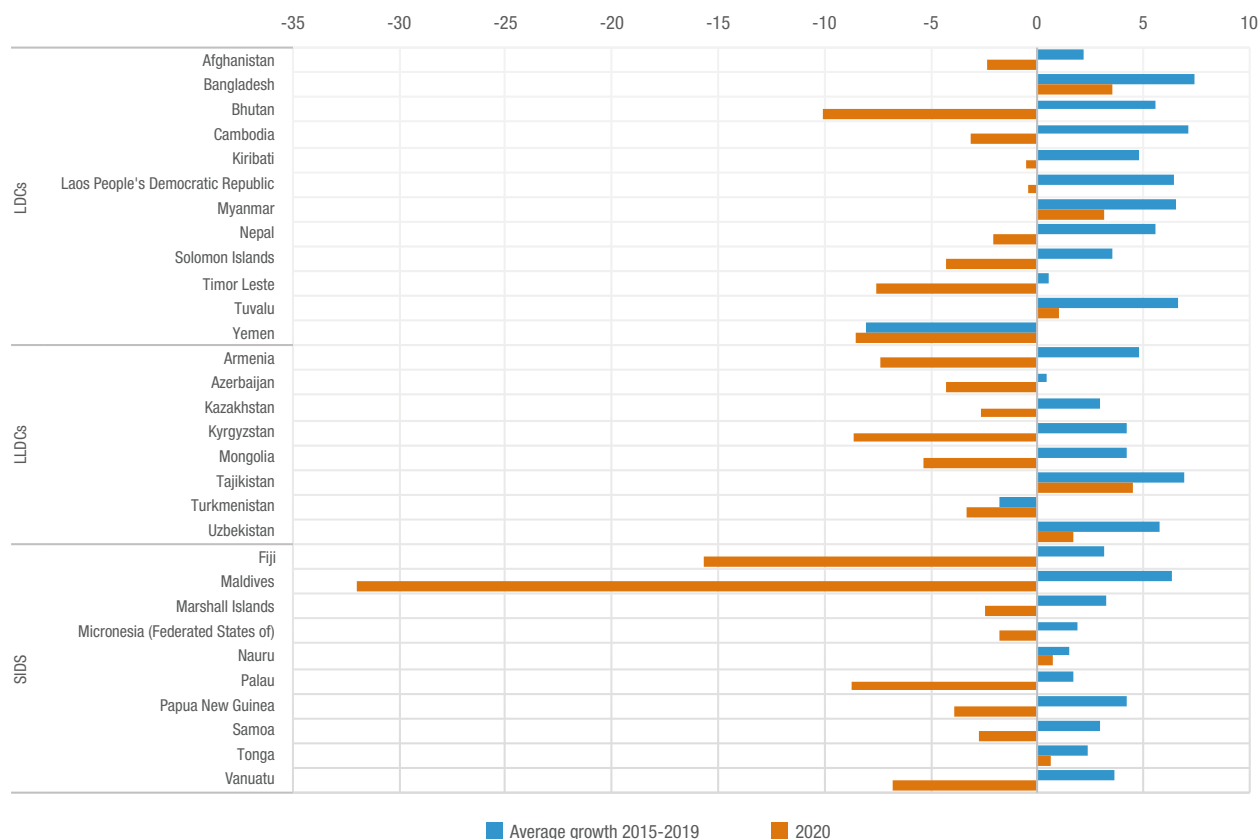
The widespread contraction in economic activity is also adversely affecting financing flows. Across countries with special needs, economic output has contracted, on average, by 4.4 per cent in 2020, with tourism-dependent Maldives taking the biggest hit, recording a decline of 32 per cent (see figure 2-1). Nevertheless, some economies, such as Bangladesh, Mongolia, Myanmar, Tajikistan, Tonga, Tuvalu and Uzbekistan, have managed to grow, albeit at levels significantly lower than the average recorded during the five years prior to the pandemic.

Notwithstanding its widespread impacts, the pandemic also presents an opportunity to reorient financial flows and resources towards activities that are aligned with efforts to achieve the Sustainable Development Goals. Even before the pandemic, trends show that financing was not necessarily aligned with those efforts. For instance, in the case of FDI, it was estimated that the largest shares of greenfield investments between 2010 and 2021 to countries with special needs were in the coal, oil and gas subsector (\$128 billion), while the renewable energy sector received a far lower \$22 billion over the same period.<sup>17</sup>

The Addis Ababa Action Agenda on Financing for Development emphasizes an integrated and coherent approach by all actors (domestic and external, public and private) across the three pillars of sustainable development. Accordingly, the discussion in this section covers some of the more prominent sources of financing in countries with special needs by highlighting their trends prior to the pandemic. Table 2.1 lists some of these sources, which are either one or a combination of domestic, external, public and private finance.

17 Based on data from fDi Markets. [www.fdimarkets.com/](http://www.fdimarkets.com/)

**Figure 2-1:** Growth outcomes in countries with special needs



Source: ESCAP calculation based on data from World Bank, World Development Indicators, <https://databank.worldbank.org/source/world-development-indicators> and IMF World Economic Outlook Database: October 2021, [www.imf.org/en/Publications/WEO/weo-database/2021/October](http://www.imf.org/en/Publications/WEO/weo-database/2021/October).

**Table 2-1:** Financing sources

|                 | Public   | Private  |
|-----------------|--|--|
| <b>Domestic</b> | Tax revenue (direct, indirect)<br>Non-tax revenue<br>State-owned enterprise revenues<br>Public borrowing (sovereign bonds, debt)<br>Sovereign wealth funds | Private savings<br>Domestic private credit<br>Domestic philanthropy<br>Commercial investment |
| <b>External</b> | ODA-grant<br>ODA-loan<br>External public debt and guarantees<br>South-South cooperation<br>Climate finance   | FDI<br>Portfolio investment<br>External commercial credit<br>Remittances<br>Blended finance  |

Source: Adapted from OECD (2020c).

Note: These financing flows are not necessarily distinct, and some may overlap with other categories.

## i. Public finance

### (a) Tax revenue

On the fiscal front, it is inevitable that financing flows have plunged. Steep declines in tax revenue caused directly by the economic slowdown and indirectly by tax policy and administration measures taken in response are expected (IMF, 2020b). As tax data for 2020 are not available, one approach to overcome this is to apply aggregate tax buoyancy to the reduced GDP estimates, although this is likely to underestimate the decline in revenue during the

pandemic.<sup>18</sup> A quick calculation reveals that, on average, tax revenue declined by 5 percent, with the potential decline being as steep as 25.8 percent in tourism-dependent Maldives (see table 2-2). In addition to the projected declines in revenue, the calculations also show that most countries with special needs have low tax buoyancy rates, averaging 1.18. LDCs and LLDCs have lower rates, at 0.90 and 0.95, respectively, suggesting that tax revenue increases at a slower pace than GDP. Resource-rich economies, such as Mongolia, Myanmar, Papua New Guinea and Timor-Leste, have the lowest rates.<sup>19</sup>

Table 2-2: Projected tax revenue changes using average tax buoyancy (2005–2019)

| Country group | Country                          | Tax buoyancy | GDP growth 2020 (per cent) | Projected tax revenue changes (per cent) |
|---------------|----------------------------------|--------------|----------------------------|--|
| LDCs          | Afghanistan                      | 1.22         | -1.9                       | -2.4                                     |
|               | Bangladesh                       | 1.19         | 2.4                        | 2.8                                      |
|               | Bhutan                           | 1.39         | -6.8                       | -9.4                                     |
|               | Cambodia                         | 1.61         | -3.1                       | -5.1                                     |
|               | Kiribati                         | 1.77         | 2.5                        | 4.5                                      |
|               | Myanmar                          | 0.62         | -10.0                      | -6.2                                     |
|               | Nepal                            | 1.39         | -2.1                       | -2.9                                     |
|               | Solomon Islands                  | 0.83         | -4.3                       | -3.6                                     |
|               | Timor-Leste                      | -1.88        | -8.7                       | 16.4                                     |
|               | <b>Average</b>                   | <b>0.90</b>  | <b>-3.6</b>                | <b>-0.6</b>                              |
| LLDCs         | Armenia                          | 1.47         | -7.6                       | -11.2                                    |
|               | Azerbaijan                       | 0.94         | -4.3                       | -4.1                                     |
|               | Kazakhstan                       | 0.59         | -2.6                       | -1.5                                     |
|               | Kyrgyzstan                       | 1.01         | -8.6                       | -8.7                                     |
|               | Mongolia                         | 0.67         | -5.3                       | -3.6                                     |
|               | Uzbekistan                       | 1.00         | 1.6                        | 1.6                                      |
|               | <b>Average</b>                   | <b>0.95</b>  | <b>-4.5</b>                | <b>-4.6</b>                              |
| SIDS          | Fiji                             | 1.09         | -19.0                      | -20.7                                    |
|               | Maldives                         | 0.81         | -32.0                      | -25.8                                    |
|               | Marshall Islands                 | 0.91         | -2.2                       | -2.0                                     |
|               | Micronesia (Federated States of) | 5.05         | -1.8                       | -9.1                                     |
|               | Nauru                            | 2.26         | 1.1                        | 2.5                                      |
|               | Palau                            | 1.48         | -9.7                       | -14.4                                    |
|               | Papua New Guinea                 | 0.31         | -3.9                       | -1.2                                     |
|               | Samoa                            | 1.49         | -2.6                       | -3.9                                     |
|               | Vanuatu                          | 1.09         | -9.2                       | -10.1                                    |
|               | <b>Average</b>                   | <b>1.61</b>  | <b>-8.8</b>                | <b>-9.4</b>                              |

Source: ESCAP calculations based on data from World Bank, World Development Indicators, <https://databank.worldbank.org/source/world-development-indicators>.

Note: For the purpose of this exercise tax buoyancy rates are derived by regressing the log of tax revenue on the log of GDP with available data for the period 2005–2019.

\* For Timor-Leste the counter-intuitive result of a negative tax buoyancy estimate suggests that tax revenue declines when GDP increases and vice versa. This could be due to heavy reliance on petroleum revenue, which can be volatile, and the rapid depletion of major oil fields in recent years. Hence, their interpretation requires caution.

<sup>18</sup> Tax buoyancy is a measure of how tax revenues vary with changes in output. A buoyancy greater than 1 implies that revenue increases by more than 1 per cent when output increases by 1 per cent and vice versa.

<sup>19</sup> In such countries the link between tax revenue and GDP growth is weak because the economy is heavily dependent on commodity exports with limited linkages to other economic sectors. Hence, when the economy grows due to commodity price booms or increased volume, output increases, but tax revenue does not increase proportionally.

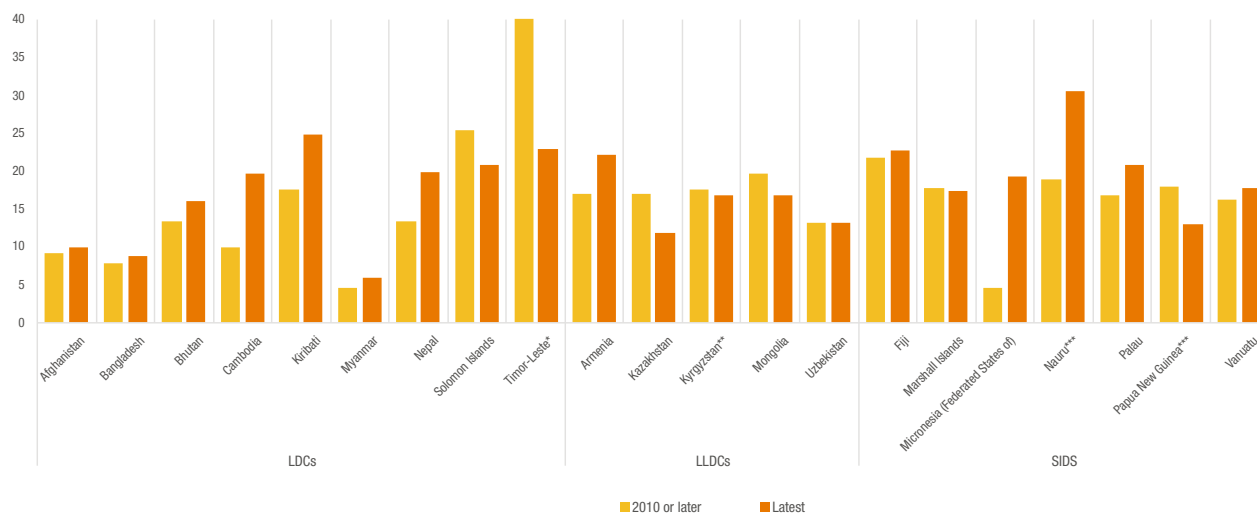


Tax instruments form the bedrock of government finances. On average, they constitute the largest source of development finance, especially in higher-income countries. Tax revenue is also the only long-term, viable source to fund public expenditure (OECD, 2020b). Moreover, strengthening tax revenue is a cross-cutting priority despite country-specific variations, such as some countries being natural resource rich, others able to attract FDI and others being dependent on remittances from the diaspora. As investments in health care, education and basic social services are not typically seen as commercially viable at least in the short-run, tax revenue in addition to ODA will be leading sources of finance to develop these areas for countries with special needs.

Many of these countries have carried out efforts to strengthen their tax administration and expand the tax base, but the outcomes have been mixed, with few countries reporting a modest rise in recent years, and some countries even experiencing a decline (see figure 2-2). On average, the tax-to-GDP ratio in these countries was approximately 16.4 per cent for the most recent five years, a decent level relative to their per-capita income levels. For instance, figure 2-3 shows that several countries for a given level of per capita

income have a higher tax collection rate than the global average, as depicted by the regression line. In the case of the region's LDCs, the median tax-to-GDP ratio increased from 13.5 per cent to 18.8 per cent (Razaque and Tateno, 2021). However, this is not the case for all countries in the group. Three of the most populous LDCs in the region – Afghanistan, Bangladesh and Myanmar – reported tax revenue below 10 per cent of GDP, while, as noted earlier, a ratio of 15 per cent is considered a minimum threshold to provide basic services, such as road infrastructure, health care and public safety (Razaque and Tateno, 2021). Cambodia stands out as a country that has managed to nearly double its tax-to-GDP ratio, from 10 per cent to 20 per cent, within a decade from 2010 to 2020, primarily through administrative modernization efforts (see box 2-1). While such increases in the tax ratios are commendable, the investment requirements in this group of countries are also rising at an increasing rate. If tax revenue fails to keep pace with rising investment needs, borrowing (domestic as well as external) becomes the main financing option. To avoid rising national debt, continuous reforms and other measures must be taken to strengthen tax revenue.

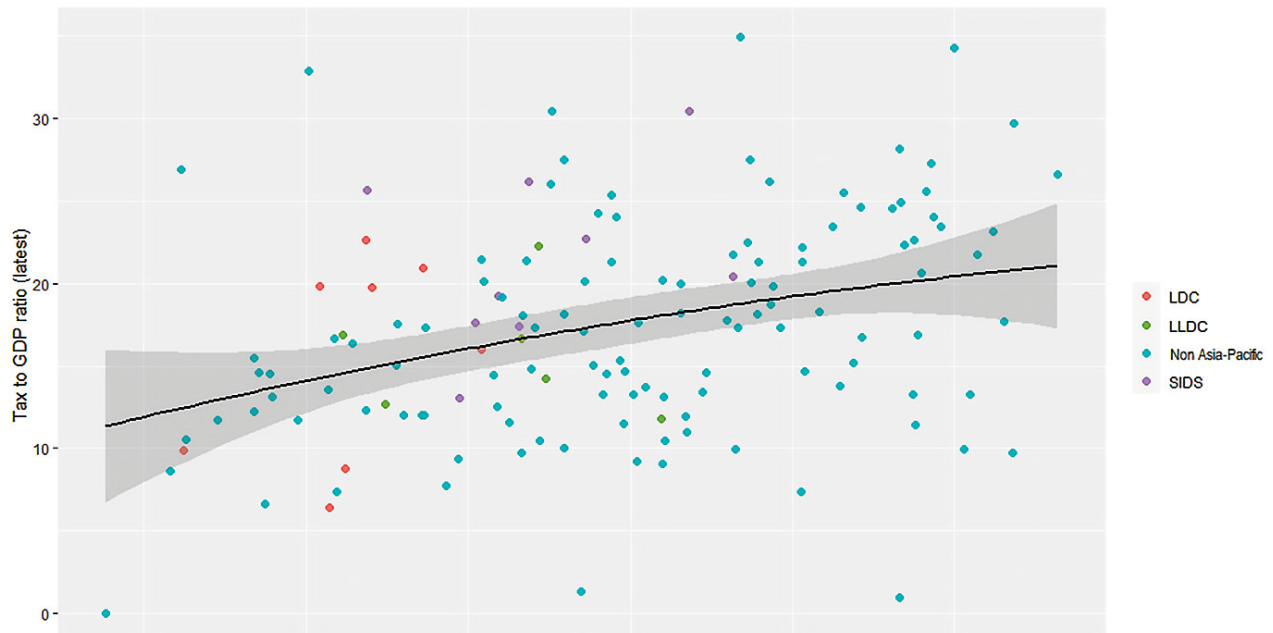
**Figure 2-2:** Change in tax-to-GDP ratios in Asia Pacific countries with special needs for the last decade



Source: World Bank, World Development Indicators, <https://databank.worldbank.org/source/world-development-indicators>.

Notes: \*For Timor-Leste the full bar of the ratio, which is 110 percent in 2010 due to the significantly high inflow of petroleum revenue during this period is not shown because it would skew graph; \*\*Data are only available from 2013; \*\*\*Data are only available from 2014

Figure 2-3: Tax ratio vs. per-GDP product (latest available year)



Sources: ESCAP calculations based on data from World Bank, World Development Indicators, <https://databank.worldbank.org/source/world-development-indicators> and IMF World Economic Outlook Database: October 2021, [www.imf.org/en/Publications/WEO/weo-database/2021/October](http://www.imf.org/en/Publications/WEO/weo-database/2021/October).

Notes: The dark line is the regression line, which captures the relationship between the log of GDP per capita and the tax to GDP ratio. Dots above the line can be interpreted as tax to GDP ratios that are higher than the global average for a given level of per capita income. Dots below can be interpreted vice versa. The shaded area represents the confidence interval.

## Box 2-1

### Leveraging digital technology to enhance administration

Cambodia achieved remarkable progress in establishing a modern tax system and strengthening tax revenue mobilization in recent years. Since 2012, tax revenue collection has consistently exceeded government revenue targets and outpaced GDP growth. Its tax-to-GDP ratio, which was close to 10 per cent in 2012, reached 19.7 per cent in 2019. This revenue level is close to the regional average of 16.8 per cent in the same year and ranks only after Viet Nam and Thailand in the ASEAN region. Comprehensive tax reforms implemented by the Government, with support from international organizations and development partners, have been the main driver behind this success. Prior to embarking on the reform initiative, the low level of revenue collection was attributed to a number of reasons, including, among them, (1) small tax base due to narrow economic structure and undiversified industries; (2) low tax culture and

compliance; (3) weak tax and non-tax administration and (4) growth of tax incentives to qualified investment projects.

Accordingly, the country's Revenue Mobilization Strategy for 2014–2018 set five main reform objectives, which focus on strengthening tax administration, promoting a tax-paying culture and tax compliance, improving management and services for taxpayers, contributing to improving the business environment, and promoting equity and fairness. To implement the strategy, the following goals were identified: (1) increase the total current revenue by at least 0.5 percentage point in addition to the ratio of current revenue to GDP annually, from 15.18 per cent in 2014 to 17.35 per cent in 2018; (2) respond to development needs to maintain high economic growth and achieve national development goals in line with the Rectangular Strategy – Phase III<sup>20</sup> and to prepare to be an upper middle-income country in the near future; (3) expand fiscal space to strengthen macroeconomic and financial stability, manage debt sustainably and alleviate reliance on external financing; and (4) increase the budget for urgent cases, force majeure and other crises or immediate expenditure of the Government in the future.

20 Under the Rectangular Strategy – Phase III, the Prime Minister of Cambodia has highlighted the importance of building a strong national budget revenue system that is efficient and transparent in the light of the social and demographic changes. This is intended to promote a favourable climate for business and investment, as well as create certainty and stability in the collection of revenue to meet the growth in development expenditure.

The strategy prioritized several policy thrusts targeting revenue policy and its institutional framework, revenue administration, and monitoring and evaluation. Eighty-six tangible reform measures were included in the Strategy, including reforms to do the following: improve human resource policies and internal management of the General Department of Taxation; move towards full automation of

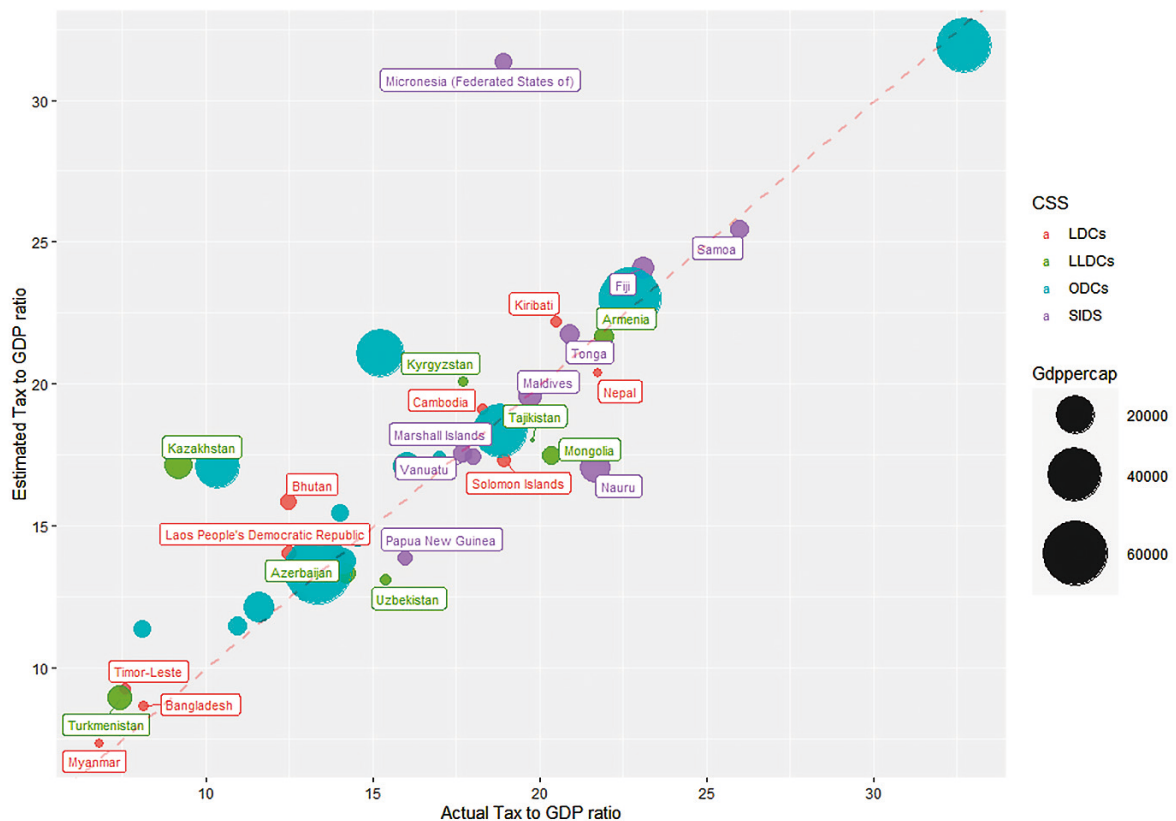
tax administration processes and a centralized taxpayer database; upgrade taxpayer services (including through e-payment options); and strengthen internal audit, investigation and dispute resolution. As of 2018, a total of 71 of the 86 measures had been implemented, while the remaining 15 measures were being implemented.

Sources: Cambodia (2019); Medium-term Revenue Mobilization Strategy 2014-2018, [http://www.cambodianbudget.org/files-tiny/mce/New\\_Pic/Development\\_Policies/Sectoral\\_Policies/Medium\\_Term\\_Revenue\\_Mobilization\\_Strategy\\_2014-2018\\_Eng.pdf](http://www.cambodianbudget.org/files-tiny/mce/New_Pic/Development_Policies/Sectoral_Policies/Medium_Term_Revenue_Mobilization_Strategy_2014-2018_Eng.pdf)

A quantitative estimate replicating the approach taken by ESCAP (2014) with more recent data shows that, while several countries with special needs have significantly closed the tax gap, potential to raise more tax revenue still exists (see figure 2-4). The approach takes into account structural, developmental, institutional and socioeconomic dimensions to estimate a country's tax potential, as captured through variables, such as per capita income, share of agriculture in GDP and trade openness.<sup>21</sup>

The results show varying estimates for the countries with special needs. The additional tax revenue that can be raised ranges from 1.7 to 12.5 per cent of GDP. These countries can mobilize more tax revenue given their level of per capita incomes, trade openness and share of agriculture in GDP.

Figure 2-4: Actual vs. estimated tax to gross domestic product ratio (latest available year)



Sources: ESCAP calculations based on data from World Bank, World Development Indicators, <https://databank.worldbank.org/source/world-development-indicators> and IMF World Economic Outlook Database: October 2021, [www.imf.org/en/Publications/WEO/weo-database/2021/October](http://www.imf.org/en/Publications/WEO/weo-database/2021/October).

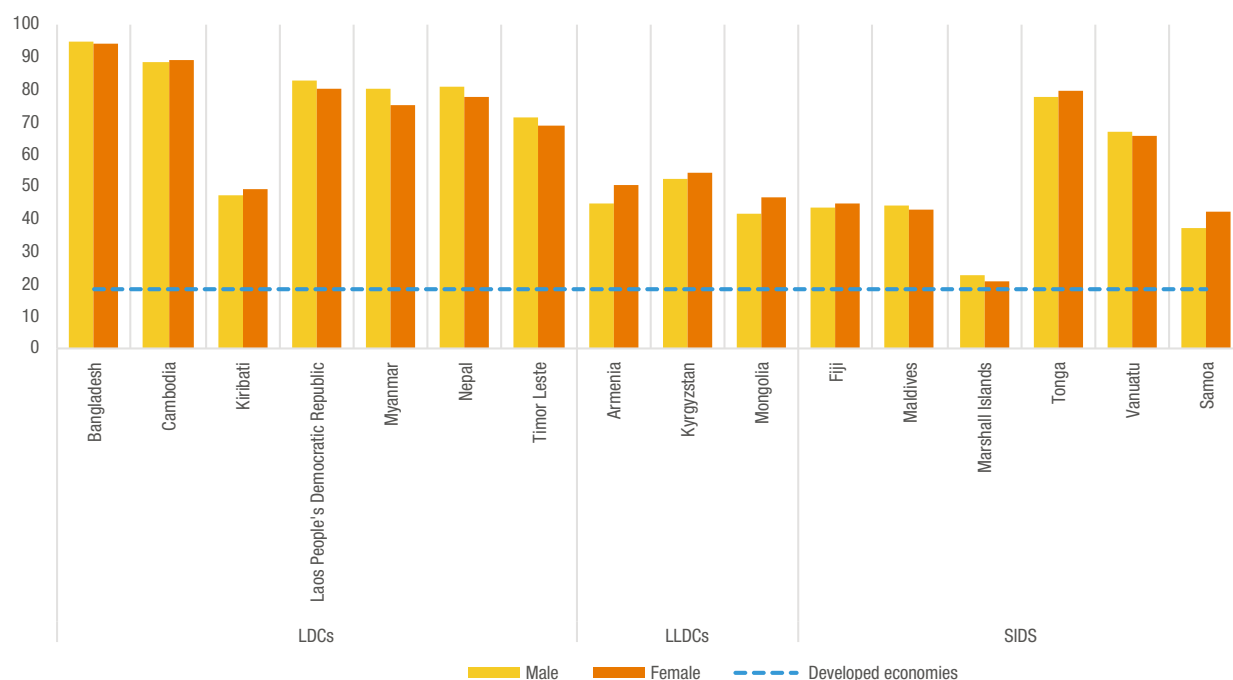
Notes: The graph plots the predicted tax to GDP ratio derived from the panel regression against the actual tax to GDP ratio. Bubbles falling above the diagonal line indicate that a country's predicted tax potential is higher than its actual collection. The size of the bubbles is weighted by per capita GDP.

21 The details of the estimation are presented in the online annex

While per capita income is the most significant factor in explaining variations, differences in tax revenue across countries at a given level of per capita income is primarily due to a low tax base and weak tax administration, which results in widespread tax avoidance and evasion. Informality also impedes tax collection, and it is likely that more people have been pushed into the informal realm following the pandemic. For instance, in South Asia alone, Bussolo, Sharma and Timmer (2020) estimate that 80 per cent of workers are engaged in informal activities and 90 per cent of

the region's businesses are informal, suggesting significant leakages. In some LDCs, such as Bangladesh, it exceeds 90 per cent and in Cambodia, it is just below 90 per cent (see figure 2-5). This further reinforces the importance of strengthening tax administrations. Cambodia was able to achieve a significant gain in tax revenue despite high rates of informality. Beyond tax considerations, informality also effects the competitiveness of formal businesses that are subject to regulatory compliances and taxes.

**Figure 2-5:** Rates of informality in select countries with special needs



Sources: ILO (2019); (2021).

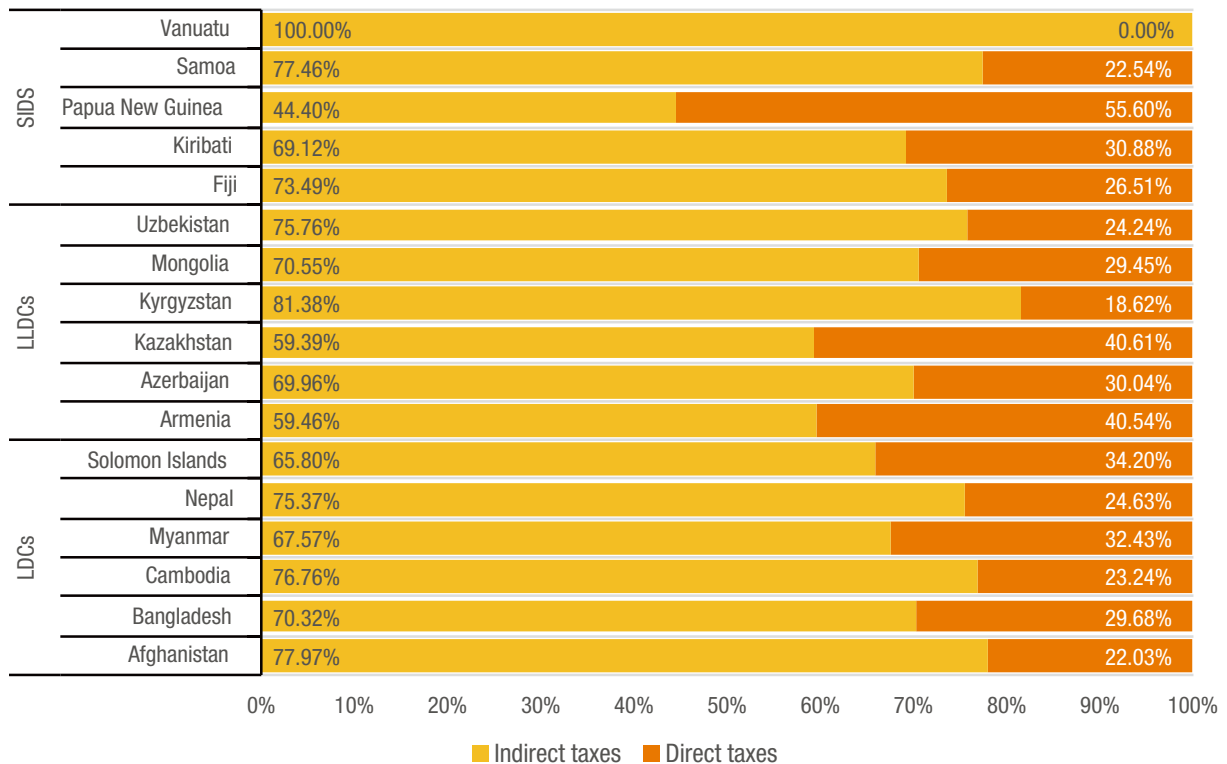
Notes: The grey broken line represents the average value for developed countries.

Notwithstanding the importance of enhancing tax revenue, there are political consequences associated with raising tax rates, which is more feasible when the growth momentum is strong, unlike in the current context. Moreover, given the informal nature of these economies, broadening the tax base in the short run is also challenging. Accordingly, improving the tax administration system by adopting the latest developments in technology is of paramount importance. Indeed, one study has found that the quality of tax administration and tax revenue are correlated (ESCAP, 2018b). A specific case included Cambodia, whereby results showed that if autonomy were to be granted to authorities to design their internal structure, tax revenue would rise by almost 1.7 per cent of GDP. The same analysis showed that if the quality of tax administration could match those of Organisation of Economic Co-operation and Development (OECD) countries, tax revenue in economies, such as Myanmar and Tajikistan, could increase by 8 per cent of GDP. Given that investment gaps are the largest in

the areas of social development, LDCs need to focus on strengthening public finances, as these are areas that do not attract private investment.

In addition to increasing tax revenue in general, countries also need to diversify the sources of tax. In most developing countries, indirect taxes, such as taxes on consumption and international trade, exceed direct taxes, such as personal and corporate income taxes (see figure 2-6). Indeed, in nearly all countries with special needs, the proportion of indirect tax revenue has increased since 2015. For countries, such as Vanuatu, where no income tax exists, the entire tax revenue comes from indirect sources. This is a common phenomenon in developing countries. The natural progression of countries is that as a country develops, more of its tax revenue will be derived from direct sources. A shift to direct taxation is generally desirable. This is because it is also generally more progressive and therefore more equitable, as higher tax rates tend to be applicable at higher levels of income (ESCAP, 2014).

Figure 2-6: Proportion of indirect and direct taxes



Source: ESCAP calculation based on World Bank, World Development Indicators, <https://databank.worldbank.org/source/world-development-indicators>.

Notes: Direct taxes include taxes on income of individuals and corporations and capital gains; indirect taxes include taxes on trade and consumption.

It is worth noting that, over the years, among the efforts to improve tax administration are adoption of available technologies, primarily to facilitate tax collection by making it more efficient (OECD, 2021c). Against this backdrop, tax administration could be improved by increasing the use of information technology in tax operations (Estevão, 2020). Digital-based revenue collection strategies can yield many benefits, including, among them, enhanced transparency and trust. Electronic tax registration, filing, payment and dispute resolution, for instance, can help to reduce the risk of officials abusing their discretion and provide citizens with clarity regarding the tax-paying process. Platforms using information technology could also help to streamline and simplify procedures, which would reduce the compliance burden faced by taxpayers and improve administrative efficiency. Because of the increasingly widespread use of information technology, tax administration could also play an expanding role in ensuring data availability in achieving non-tax related objectives (Estevão, 2020). Taxpayer data, for instance, could be used to verify beneficiaries under cash transfer programmes and identify vulnerable target groups for new public socioeconomic programmes.

Another critical challenge for developing countries in strengthening tax administration involves effective decentralization. This is exemplified by the efforts of Nepal to pursue fiscal decentralization for 753 municipalities and seven provinces. The Constitution provides a firm basis for the allocation of roles and responsibilities to federal and provincial authorities towards economic and social development, infrastructure development, environmental management and sustainability. Accordingly, municipalities have the authority to mobilize internal revenue through taxes, fees and charges, and are entitled to receive transfers in the form of revenue-sharing and grants from federal and provincial governments. However, to overcome observed capacity challenges, it has been suggested that further efforts must be taken to enable subnational governments (provincial and local governments) to use their authority to raise tax and non-tax revenue. Efforts must also be redoubled to enhance the institutional and human resource capacity of subnational governments to formulate revenue policy, acts, regulations and a medium-term expenditure framework, identify potential revenue sources, make projections, build an integrated database necessary for taxation and collect revenue (Kharel, 2022).

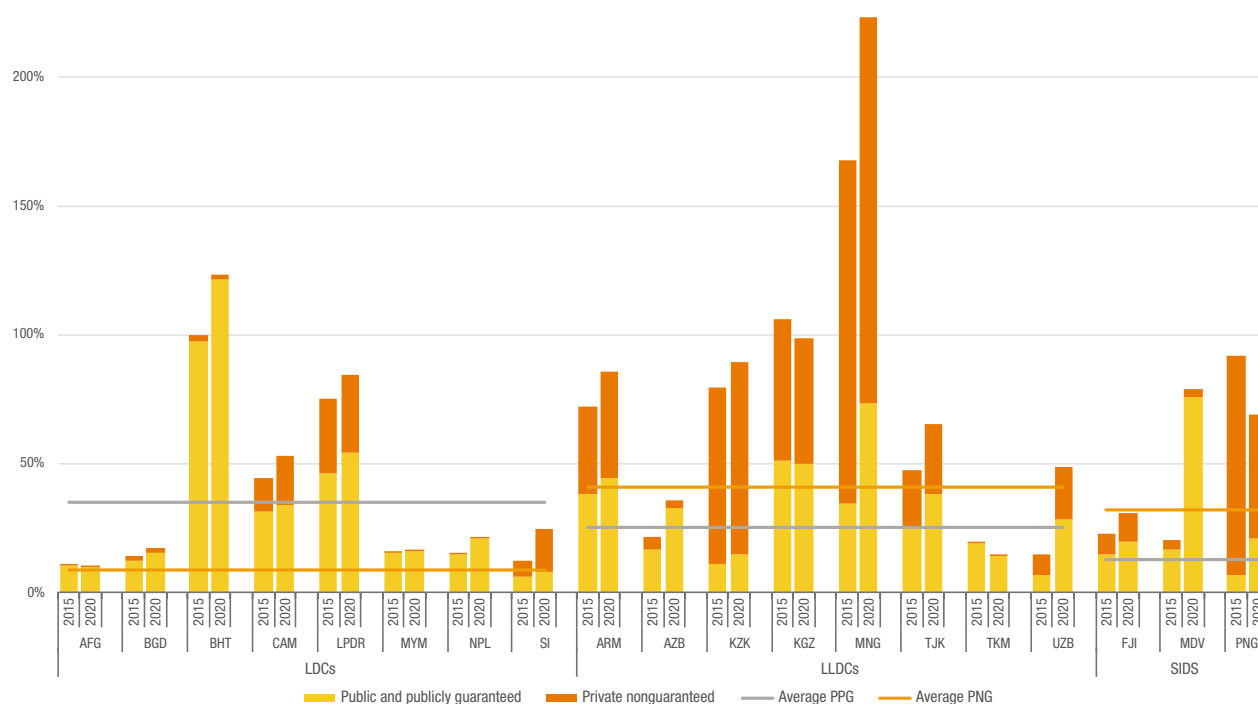
## (b) External debt

Borrowing is an important tool for financing investment aimed at achieving sustainable development. Sovereign borrowing allows government finance to play a countercyclical role over economic cycles.

While in general countries with special needs exhibit moderate levels of external debt to GDP ratios, the levels for some countries, especially LLDCs, are much higher. In 2020, the debt to GDP ratios of four LLDCs crossed 85 per cent. In the case of Mongolia, debt levels were already elevated five years ago and in 2020, they exceeded 220 per cent of GDP (see figure 2-7). However, most LLDCs still are in a position to service their debts, thereby posing lower risks.

LDCs, as a group, have the lowest levels of debt among the groups of countries with special needs, with the exception of Bhutan and the Lao People's Democratic Republic, which have invested heavily in hydropower projects. Despite having moderate debt levels, these countries must remain cautious because of their precarious situations. For most of these countries, their underlying economy and sources of financing remain undiversified such that a shock to any one of them, such as commodity price swings or the current pandemic, can alter their risk status instantly. The moderate levels of debt also mask the obligation to service these debts and external shocks can weaken their positions to repay instalments. In the case of SIDS, between 2000 and 2019, their external debt-to-GDP ratio increased by 24 percentage points and accounted for 62 per cent of GDP on average.

Figure 2-7: Changes in the level and composition of external debt (% of gross domestic product, 2015–2020)



Source: World Bank, IMF

Notes: AFG, Afghanistan; BGD Bangladesh; BHT, Bhutan; CAM, Cambodia; LPDR, Lao People's Democratic Republic; MYM, Myanmar; NPL, Nepal; SI, Solomon Islands; ARM, Armenia; AZB, Azerbaijan; KZK, Kazakhstan; KGZ, Kyrgyzstan; MNG, Mongolia; TJK, Tajikistan; UZB, Uzbekistan; FJI, Fiji; MDV, Maldives; PNG, Papua New Guinea.

A distinguishing factor among these groups of countries is the higher level of external private debt in LLDCs, as opposed to LDCs and SIDS. This suggests that most of the borrowing in LLDCs are commercial, especially in resource-rich countries, such as Kazakhstan and Mongolia.

As a result of the pandemic-induced pressure on fiscal space, most countries with special needs are facing rising public debt levels. Nevertheless, the extent of the debt increase can be modest if recovery efforts are accompanied by fiscal measures, such as the introduction of carbon taxes and abolishment of fuel price subsidies, which will offer

environmental benefits over the long run (ESCAP, 2021g). Such instruments are discussed in chapter 3.

The average public debt-to-GDP ratio is projected to have increased from approximately 51 per cent in 2019 to 61 per cent in 2020 and 63 per cent in 2021. SIDS, in particular, need urgent support to avoid debt defaults. Even though their debt levels are not very high, their ability to service debts is considerably limited, as almost all of them are classified as having a high risk of external debt distress (table 2-3). Overall, 11 countries with special needs are classified as "high risk", out of which eight are SIDS (including two LDCs that are also SIDS).

Table 2-3: External debt distress classifications of countries with special needs

| Risk Category | Low risk   | Moderate risk  | High risk   |
|---------------|--|--|---|
| Country       | <ol style="list-style-type: none"> <li>1. Bangladesh</li> <li>2. Cambodia</li> <li>3. Myanmar</li> <li>4. Nepal</li> <li>5. <b>Timor-Leste</b></li> <li>6. Uzbekistan</li> </ol> | <ol style="list-style-type: none"> <li>1. Bhutan</li> <li>2. Kyrgyzstan</li> <li>3. <b>Solomon Islands</b></li> <li>4. <b>Vanuatu</b></li> </ol> | <ol style="list-style-type: none"> <li>1. Afghanistan</li> <li>2. <b>Federated States of Micronesia</b></li> <li>3. <b>Kiribati</b></li> <li>4. Lao People's Democratic Republic</li> <li>5. <b>Maldives</b></li> <li>6. <b>Marshall Islands</b></li> <li>7. Mongolia<sup>22</sup></li> <li>8. <b>Papua New Guinea</b></li> <li>9. <b>Samoa</b></li> <li>10. Tajikistan</li> <li>11. <b>Tonga</b></li> <li>12. <b>Tuvalu</b></li> </ol> |

Source: Debt Sustainability Analysis, World Bank and IMF, <https://www.worldbank.org/en/programs/debt-toolkit/dsa>.

Note: SIDS are highlighted in bold. 8 of the 12 high risk countries are in this group.

Although external public debt is an important source of development finance, it comes with a certain level of risk, namely currency and maturity mismatches. Most external debt is channelled towards domestic projects, such as to develop infrastructure, that do not necessarily yield convertible currency returns. Accordingly, it is crucial that countries with special needs balance immediate liquidity pressures with long-term debt sustainability to avoid widespread insolvency crises occurring during and in the aftermath of the pandemic. Moreover, the composition of the external debt of LDCs has gradually shifted towards more expensive and riskier sources of finance, and towards a growing share of commercial and bilateral non-Paris Club creditors, all of which could have profound implications for debt-servicing obligations, debt roll-over and costs of negotiating potential restructuring. It is, therefore, critical that countries engage in risk management as part of a wider structural and strategic debt management framework.

Developing robust debt and risk management frameworks requires that countries focus on enhancing their institutional capacity by strengthening the legal framework, institutional arrangements, accountability and transparency mechanisms related to the operations of government debt and risk managers, as well as ensure that the government's organizational structure is designed with clear roles and responsibilities of each stakeholder, including clear reporting lines (World Bank, 2019a). Efficient coordination mechanisms involving debt management, monetary policies, fiscal and budget planning processes, and cash management should be established, while information technology could be deployed for debt management transactions with the aim

to reduce operational risks and increase debt management efficiency. Strengthening capacity and management of internal operations, improving debt management and contingent liability strategies that are based on sound analysis of costs, risks and the country's public debt portfolio are also important.

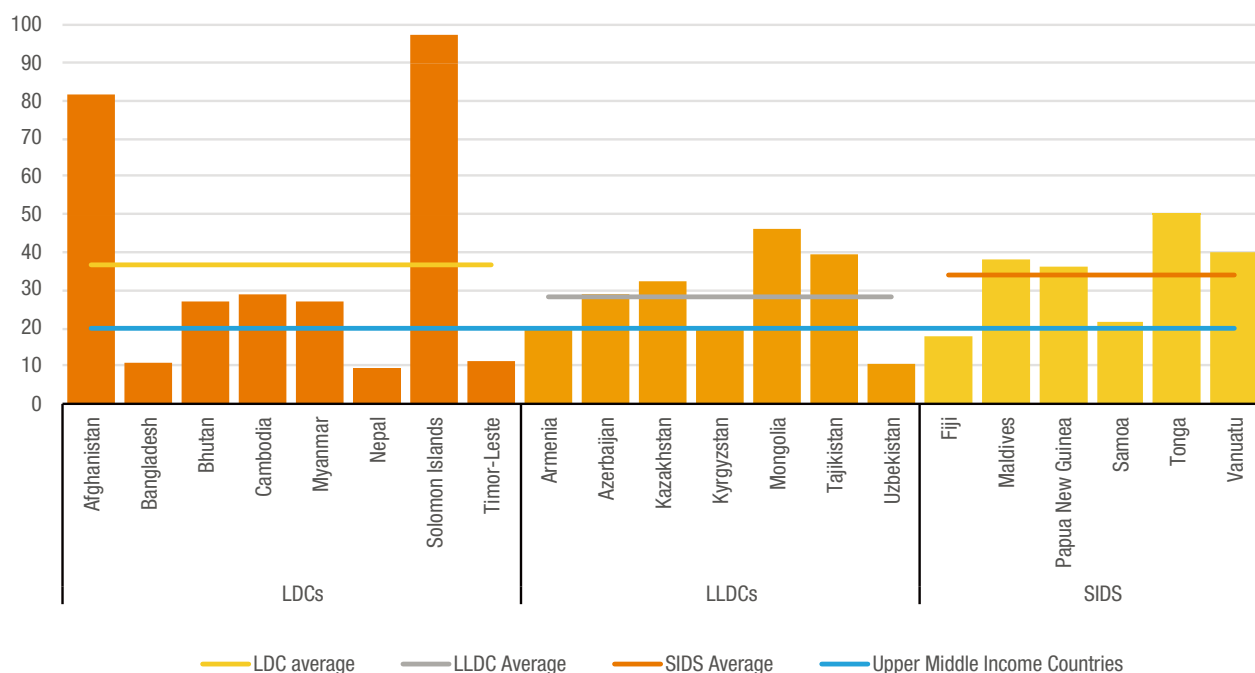
### (c) Local currency sovereign bonds and domestic capital market development

An underexplored avenue to overcome currency mismatches, while also raise financing is issuances of domestic sovereign bonds, as they offer numerous attractive outcomes. First, if such bonds are denominated in the local currency, they mitigate exchange rate risks. Second, the bonds offer an avenue for domestic institutional investors thereby mitigating speculative investing to a certain degree. Beyond addressing such risks, sovereign bonds are also the bedrock of any capital market, as they provide a benchmark against which all other financial instruments can be priced.

ESCAP (2019a) points out that commercial banks in countries with special needs have tended to accumulate cash holdings due to the dearth of bankable investment opportunities and the risk profile of the private sector. While some of these holdings may be the consequence of macroprudential obligations to hold safe and liquid assets, they also present an untapped source of financing that can be harnessed using sovereign bonds. Indeed, in some countries with special needs, such as Solomon Islands, the ratio of cash holdings to commercial bank assets is close to 100 per cent (see figure 2-8).

22 Based on IMF's article IV consultation. <https://www.imf.org/en/Publications/CR/Issues/2021/11/29/Mongolia-2021-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-510086>

Figure 2-8: Cash holding of commercial banks in countries with special needs (five-year average)



Source: ESCAP calculations based on data from World Bank, World Development Indicators, <https://databank.worldbank.org/source/world-development-indicatorsWDI>

Most of the countries with special needs have underdeveloped and bank-dominated financial markets. The development of an equity market and debt securities markets are critical for reducing a country's overdependence on its banking sector. For private companies, the cost of debt securities and equity financing is typically cheaper than bank loans. For countries with special needs, the debt securities market provides alternative sources of funding for the budget deficit and development projects. Within the region, Bhutan issued its first sovereign bond in September 2020 with a completed offering of \$41 million and an annual coupon rate of 6.5 per cent (ESCAP, 2020c) (see box 2-2).

In cases in which an individual economy is too small to attract bond investors, collective debt securitization can be explored with the caveat that these instruments are to be guaranteed by either a major economy, a multilateral development agency or credible international financial institutions. Depending on the issuer and the source of capital, debt securities can be subcategorized into several types, including sovereign bonds, PPP financing and other blended financing instruments.

## Box 2-2

### First sovereign bond issuance of Bhutan\*

Similar to many developing countries, the financial sector of Bhutan is bank dominated. Credit to the private sector, of which banks supplied 84 per cent of it, increased from 46 per cent of GDP in 2015 to 69 per cent in 2020. The country's only stock exchange, Royal Securities Exchange

of Bhutan, is small, trading both equities and debt securities. As of the end of 2020, the equity market capitalization of the 20 (out of 22) listed companies was 47.5 billion Bhutanese ngultrum (Nu) (\$650 million), or approximately 26.6 per cent of the GDP, while total outstanding value of bonds was Nu 8.7 billion or 4.8 per cent of GDP.

Debt securities of the Government of Bhutan have not been assigned a rating by an international credit rating agency, thus making it difficult for the Government to lure foreign



bond investors to invest. In September 2020, Bhutan issued its first sovereign bond. The offering was completed as three-year domestic bonds of Nu 3 billion, with an annual coupon rate of 6.5 per cent, to support increasing fiscal needs amid the COVID-19 pandemic. The transaction was very well received with an oversubscription of more than 300 per cent, indicating unprecedented private sector participation, including many individual investors.

In cooperation with the United Nations Country Team, ESCAP provided technical assistance to the Government of Bhutan to enhance its institutional capacity for bond market development. The assistance included establishing a bond working committee, developing bond issuance rules

Source: Adapted from ESCAP (2020c).

and regulations, conducting workshops, study tours and consultations, and providing relevant pre-issuance services.

Going forward, Bhutan could benefit further by continuing to develop the yield curve by issuing more bonds of different types and maturity and creating a secondary market to promote market trading and liquidity. Building on a more mature bond market, Bhutan could also consider issuing thematic bonds. This outcome highlights the underexplored potential of traditional instruments. For many financial institutions in similar underdeveloped and shallow markets, macroprudential regulations force them to hold cash deposits, which could instead be channelled towards such bonds.

In preparing to issue sovereign bonds, countries should also be aware of the risks associated with currency denomination when seeking external investors. This is particularly relevant to less developed countries, as they are unable to issue sovereign bonds denominated in their own currency to external investors due to the risks accompanying investment in such countries. These countries tend to lack investment transparency and are susceptible to economic instability.<sup>23</sup> The lack of transparency would imply that government investments might be funnelled towards unproductive areas, while economic instability could lead to higher inflation rates, both of which would undermine the real rates of return that the investors receive. As such, less developed countries tend to lean towards borrowing in foreign currencies for their sovereign bonds, further endangering their economic stability and debt sustainability due to exchange rate fluctuations. It is, therefore, advisable to start by tapping the savings of domestic institutional investors to develop the necessary expertise, while gradually opening up to external investors. Such sequencing could be considered by countries with special needs that are planning to issue their first sovereign bonds, such as Cambodia and Timor-Leste.

While the benefits and risks of issuing sovereign bonds are evident, many factors need to be considered for successful issuance. Among them are institutional and legal frameworks, regulations and policies to support the transparent issuance and management of the bonds, financial and political stability, and the overall structure of the bond itself. The technical capacity and a clear understanding of the bond

by domestic stakeholders, including government officials of relevant ministries and public agencies, is equally crucial to ensure successful issuance and management of the sovereign bond. Addressing these factors could boost investor confidence in the sovereign bond being issued.

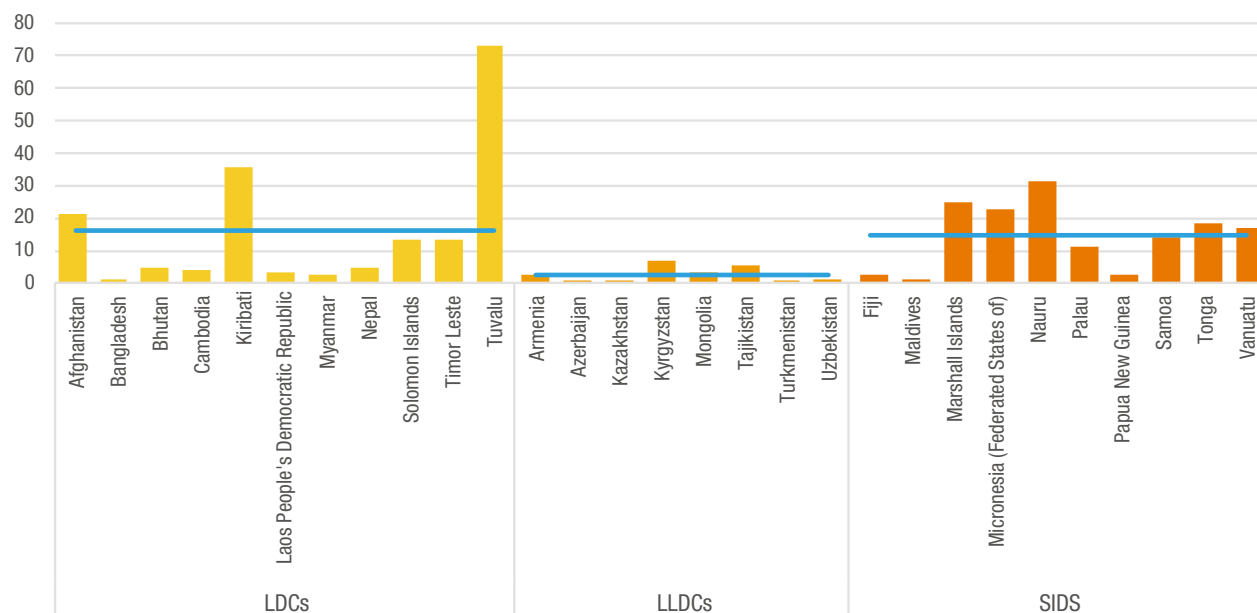
Further down the line, there are several variants of sovereign bonds, including diaspora bonds and bonds that include environmental, social and governance (ESG) dimensions, such as green, social and thematic bonds. These types of bonds are discussed in the next chapter.

#### (d) Official development assistance

Even before the pandemic, donor countries fell short of the commitment to provide 0.15 to 0.2 per cent of their gross national income (GNI) as ODA to least developed countries. Nevertheless, ODA constitutes the single most important source of external finance for countries with special needs; some countries, such as Tuvalu, received more than 70 percent of their GDP on average between 2015 and 2019 (see figure 2-9). As a group, LDCs (16.11 per cent) and SIDS (14.65 per cent) were more reliant on ODA than the LLDCs (2.4 per cent) on average during the period 2015–2019. The figure for SIDS would be much higher if the two small-island LDCs (Kiribati and Tuvalu) were also included in the group. Given that ODA is the most readily available form of development finance that can be scaled up quickly, its role, especially for the short to medium term, in recovering from COVID-19 and achieving the SDGs must be underscored.

<sup>23</sup> <https://corporatefinanceinstitute.com/resources/knowledge/trading-investing/sovereign-bond/>

**Figure 2-9:** Average overseas development assistance as a share of gross domestic product (2015–2019)



Source: ESCAP calculations based on data from World Bank, World Development Indicators, <https://databank.worldbank.org/source/world-development-indicators> and IMF World Economic Outlook Database: October 2021, [www.imf.org/en/Publications/WEO/weo-database/2021/October](http://www.imf.org/en/Publications/WEO/weo-database/2021/October).

Notes: The solid lines represent averages for each group.

While the impacts of the pandemic on bilateral ODA is still unravelling, global trends show that declines in ODA in 13 Develop Assistance Committee countries have been offset by an increase in aid from 16 countries (Ahmad and Carey, 2021). However, it is evident that international financial institutions have stepped up lending efforts to provide liquidity relief and execute containment and stimulus measures. Recent estimates at the global level show that aid commitments to LDCs, LLDCs and SIDS from these international financial institutions, between January 2019 and September 2020, increased by 66 per cent (Dodd and Breed, 2021).

Although the growth in private finance has reduced the relative importance of foreign aid in many countries, the capacity of LDCs, LLDCs and SIDS to attract flows beyond aid remains limited. Concessional finance, in particular, continues to account for the bulk of external financial resources across LDCs, LLDCs and SIDS. Between 2010 and 2019, ODA loans to LDCs, in particular, have grown fivefold.

Against this backdrop, bilateral aid has emerged to align the purpose of the aid budget with developmental priorities. For instance, climate-related development finance to SIDS totalled 34 per cent of the total bilateral sector allocable aid in 2017–2018 (OECD, 2020a). There is much room to

promote more efficient and equitable use of ODA in the countries with special needs. In the post Covid-19 phase, proper use of ODA is likely to receive greater attention. Towards this, countries need to augment their institutional capacity and improve governance to channel ODA towards achieving the SDGs and make their recovery from Covid-19 more impactful. For instance, the use of recipient national systems to deliver ODA has also been mentioned in various forums as being efficient for small jurisdictions. On one hand, it is crucial that these economies tap into aid budgets with earmarked purposes that align with their countries' development priorities. On the other hand, it is equally critical that donors better target their aid budget towards the developmental context and priorities of the recipient economies.

### (e) Public expenditure management

Mobilizing additional resources must be complemented with improvements in public expenditure management. This became evident during the pandemic as governments attempted to launch interventions and stimulus measures. Even when funding was available, the ability to spend resources effectively in areas that were aligned with the SDGs were weak, thereby reducing the effectiveness of response measures. For instance, a study of the performance of Bangladesh revealed that it was not the lack of resources

or potential fiscal space that constrained fiscal interventions in the country, but rather the limited institutional capacity of the Government to deliver its public expenditure programme (Bhattacharya, Khan, and Mursalin, 2021).

It is common practice for donor countries to assess the recipient country's public expenditure framework before extending ODA. To ensure common standards for the assessments, the European Commission, the International Monetary Fund (IMF), the World Bank, and some European countries introduced the Public Expenditure and Financial Accountability programme. This programme has three objectives: (a) strengthen the ability of governments to assess systems of public expenditure, procurement and fiduciary management, and contribute to a government-led reform agenda; (b) support the development and monitoring of reform and capacity-development programmes and facilitate a coordinated programme of support; and (c) contribute to the pool of information on public finance management. The Public Expenditure and Financial Accountability assessments are based on seven pillars: (i) budget reliability; (ii) transparency of public finances; (iii) management of assets and liabilities; (iv) policy-based fiscal strategy and budgeting; (v) predictability and control in budget execution; (vi) accounting and reporting; and (vii) external scrutiny and audit.

Based on the Public Expenditure and Financial Accountability 2020 Global Report, the Governments of 136 countries surveyed showed improvements in public financial management over time, generally performing strongest in budget preparation and weakest in the effectiveness of internal audit and external audit and scrutiny. Many of the countries with special needs also showed improvements in their Public Expenditure and Financial Accountability scores, including, among them, Armenia, Azerbaijan, Bangladesh, Cambodia, Kyrgyzstan, the Lao People's Democratic Republic, Myanmar, Nepal, Tajikistan, Timor-Leste, Tonga, Tuvalu and Uzbekistan. On the other hand, countries that had declining Public Expenditure and Financial Accountability scores were Bhutan, Papua New Guinea and Vanuatu.

### Enhancing allocative efficiency

Considering the financial and technical resource constraints that countries with special needs face, ensuring allocative efficiency and further down the line, operational efficiency are priorities. Essentially, this requires that the SDGs and other national development priorities be reflected in the annual budget framework. Accordingly, an in-depth understanding of the budget planning and preparation system is necessary, along with ensuring that the budget is aligned with the country's national development strategies and the SDGs.

To ensure that resources are allocated towards realization of the SDGs, Governments in many countries have adopted a set of budgeting frameworks that focus on delivering high-level and cross-cutting priorities, such as gender or green budgeting. SDG budgeting, or SDG budget "tagging" in the sense that budget items and performance targets are "tagged" to relevant SDGs, is one such approach being explored. The OECD defines SDG budgeting as "the systematic application of analytical tools and processes, as a routine part of the budget process, to highlight how budget policy progresses the SDGs and to help further inform, prioritize and resource SDG-responsive policies" (OECD, 2022). While this concept has yet to be mainstreamed widely across developed and emerging economies, it has been shown to result in diverse approaches. For instance, country differences exist in terms of methods and methodology, which greatly depend on such factors as the country's progress towards achieving the SDGs, priorities and strategies for national development, budgeting and public finance management systems, and the degree of decentralization (Nicol and Salazar, 2021). The extent of SDG budgeting differs significantly as well – in some cases all SDGs are reflected while, in others, a few are prioritized with the aim to gradually cover all 17 SDGs. Some countries have taken into account SDGs throughout the budgetary process starting from planning up to evaluation, while others have applied an SDG-oriented perspective to certain phases of the budgetary scheme.

Despite the divergence, SDG budgeting is gaining momentum in ensuring that finance is available and earmarked to achieve the 2030 Agenda. Particularly, in the context of recovering from the COVID-19 crisis, countries are considering the use of budget tagging to identify recovery measures that contribute towards achieving specific SDGs and to screen budget requests based on their contributions towards the global agenda (Nicol and Salazar, 2021). Synergies across projects and programmes, as well as ministries and public agencies could be pursued throughout this process, leading to more efficient usage of the limited resources.

However, on many occasions, a significant share of the budget is earmarked for certain social programmes or multi-year infrastructure projects, resulting in legal obligations that reduce the government's flexibility to accommodate and allocate funds towards new and expanding socioeconomic needs (United Nations, 2018). The integration of SDGs into national budget processes has also proven to be far more limited compared to the integration of SDGs into national development plans (United Nations, 2019). Institutional challenges also hinder the streamlining of national development goals with the budgetary process. Among the

challenges are limited interministerial collaboration in the budgeting process, weak linkages of regulatory mechanisms that evaluate the impact of policies with the budgetary cycle, and lack of available data to measure progress and transparency.

Against this backdrop, it is important that enabling factors towards the adoption and implementation of SDG budgeting are rooted. First and foremost, the country's political commitment towards the 2030 Agenda must be emphasized. This is because strong leadership is required in order to coordinate and collaborate across ministries and different levels of the government and ensure that the budgetary process is aligned with the national development goals and, at a broader level, the SDGs. Strategic objectives and priorities, including medium-term (three to-five years) fiscal objectives, need to be clearly set prior to discussions with ministries and relevant departments (Schick, 1998). Second, sound budgetary processes and public finance management systems need to be in place. Finally, budget allocation and expenditure data, as well as SDG-related impact data, need to be available and publicized to ensure that the budget spending is contributing towards the advancement of the SDGs. Availability of data would also contribute towards ensuring that the control mechanisms play their role in enhancing government accountability and transparency (Schick, 1998).

### **Improving operational efficiency**

Reprioritizing and reallocating budgets towards pursuing the SDG is an urgent necessity and must be complemented by improving the operation of a limited budget. In this sense, it is important that countries also focus on improving the efficiency of their project cycle management, particularly in areas related to the SDGs. Project cycle management is the process of planning, organizing, coordinating and controlling a project effectively and efficiently throughout all the phases of a project, from planning to evaluation.

To begin with, it is critical that all development projects in countries with special needs, as in other countries, include (1) clearly identified stakeholders, including primary target groups and final beneficiaries; (2) clearly defined objectives, coordination, management and financing

arrangements; and (3) a monitoring system to oversee and support project implementation and management (European Commission, 2004). These principles are equally applicable to projects related to the SDGs. Projects should be designed with feasibility considerations in the sense that the defined objectives can be achieved within the political, institutional, technical and financial constraints of the operating environment and the implementing agency has the competencies to achieve the objectives (European Commission, 2004). Building on such arrangements, efficient project cycle management helps to ensure that all projects are aligned with the implementation strategy that has been agreed with the relevant stakeholders and addresses the challenges or issues that the projects were developed to solve.

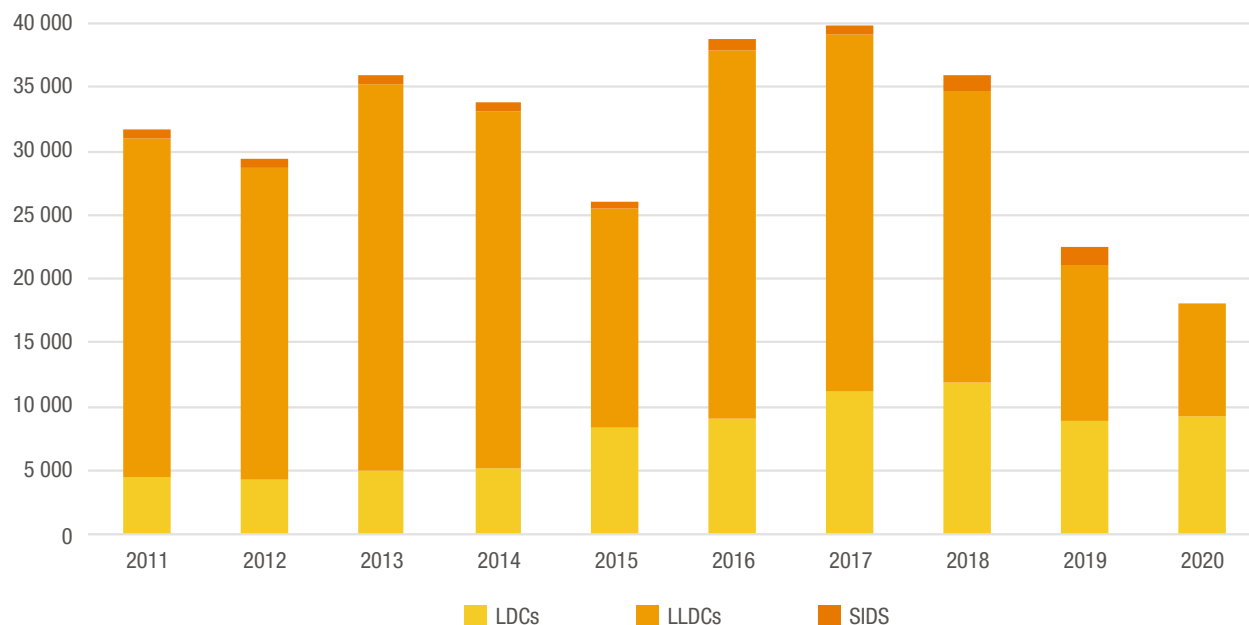
## **ii. Private finance**

### **(a) Foreign direct investment**

Beyond its role as an important source of development financing, FDI can also support industrial upgrading and facilitate regional and global value chain integration of MSMEs. Through this, it can also catalyse other sources of financing, such as foreign exchange earnings. However, many countries with special needs have struggled to attract such flows, which also have been volatile and unevenly distributed across their economies over the past decade. FDI flows to Asia-Pacific LDC, LLDCs and SIDs peaked at \$40 billion in 2017 and has been on a steady decline since then. The pandemic caused FDI to reach its lowest level in more than 12 years, with inflows bottoming out at \$18 billion in 2020 (see figure 2-10).

The handful of successful cases involve the resource-rich countries or the countries that have managed to leverage their abundant supply of low-cost labour to integrate themselves into the global value chains of labour-intensive sectors, such as the garments industry. Among the resource-rich countries that have attracted sizeable flows are Kazakhstan, Mongolia and Turkmenistan, while examples of countries that have integrated themselves into global value chains are Bangladesh, Cambodia and Myanmar.

**Figure 2-10:** Total foreign direct investment flows to Asia-Pacific countries with special needs (2011–2020)



Source: ESCAP calculations based on UNCTADSTAT, [unctadstat.unctad.org](http://unctadstat.unctad.org) (accessed on November 2021).

Compared to other countries with special needs, FDI flows to LDCs increased from \$4 billion in 2011 to \$9 billion in 2020, with the three economies mentioned above attracting a significant share, which was directed to the ready-made garments industry, a sector that has very limited backward linkages and is mainly dependent on imported inputs. This sector has been highly successful in creating additional manufacturing jobs for first-time migrant women and young girls. This, in turn, has helped to empower women and boost incomes of rural households, and contributed to SDG achievement in terms of poverty reduction, employment generation and increasing school enrolment. Unfortunately, the COVID-19 pandemic has set back many of these gains, as the sector has been severely disrupted during this crisis.

Flows to LLDCs fluctuated around the \$26 billion mark between 2010 and 2018. They reached a record high of \$31 billion in 2013, before dropping to \$18 billion in 2015. FDI inflows to LLDCs have trended lower since 2018 due to commodity price shocks and the COVID-19 crisis.

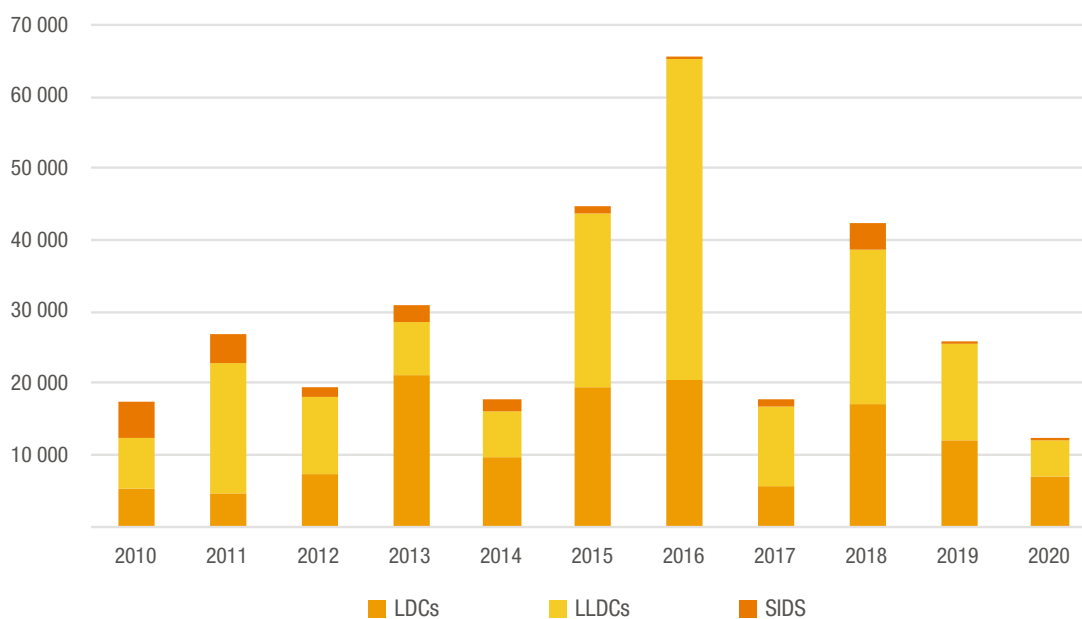
Foreign direct investment inflows to SIDS have also been declining steadily since 2012. FDI peaked at nearly \$4 billion in 2012 and has headed downward before bottoming out at \$300 million in 2020. The spillover from the pandemic has hit the tourism sector particularly hard, which has also affected FDI inflows (ESCAP, 2021j).

Turning to announced greenfield FDI<sup>24</sup> projects, namely new sectors and activities, in recent years, LLDCs were the largest recipients (see figure 2-11). The largest shares between 2011 and 2020 to these economies were in the coal, oil and gas subsector (\$128 billion), followed by the renewable energies subsector, which received \$22 billion over the same period. The majority of investment into LDCs were in the manufacturing sector (43 per cent); in LLDCs, the primary sector received the largest share of investments (43 per cent); and among SIDS, the services sector received the largest share of greenfield investments (49 per cent).

Beyond the overall trends in FDI, the origin of investment flows also has important implications. More recently South-South FDI has become prominent, propelled by rising per capita incomes in origin countries, resource endowments and lower regulatory burdens in host countries. Southern value chains also have lower barriers to entry (Saha and others, 2020). These value chains inherently make it easier for enterprises to move up the value chain, increasing their competitiveness. Technological advances in Southern countries and similar environments benefit recipient countries by providing access to cost-effective technologies that are more suited to their contexts. Accordingly, targeting investors in the global South could also be a priority for investment promotion agencies.

24 Greenfield investment is new investment as opposed to investment through mergers and acquisitions.

**Figure 2-11:** Announced greenfield foreign direct investment flows to Asia-Pacific countries with special needs (2010–2020)



Source: ESCAP calculations based on FDI Markets data, [www.fdimarkets.com/](http://www.fdimarkets.com/) (accessed on October 2021).

The road to recovery from the COVID-19 pandemic will be hard and gradual in countries with special needs, and it will require a significant influx of resources. Although FDI is mostly low and declining in some of these countries, it will, nonetheless, an important resource as public financing will be tight and foreign borrowing will be difficult to attain. Prospects for FDI in these countries are expected to remain weak and subdued in 2022 and 2023. Domestically, capacity gaps related to investment promotion and facilitation, along with underdeveloped infrastructure, limited supply of skilled workers and poor regulatory frameworks, have impeded foreign investment in these economies. Lack of digitization has also discouraged FDI. Additionally, external political and economic risks, such as increased trade tensions regionally and the retreat of multilateralism globally, have disrupted FDI flows to these economies. To make FDI more attractive, immediate and longer-term measures are needed. In the immediate term, a review of the effectiveness of existing policies and incentives are critical, and corresponding repositioning must be pursued. In chapter 3, there is a discussion on the digital economy as one of the possible targets for investment promotion in these countries. In the longer term, more comprehensive measures ranging from addressing infrastructure bottlenecks to augmenting human capital are indispensable.

Under the changing circumstances, there is need to be more strategic and adopt measures that incentivize FDI so that new investments either flow to activities aligned with the SDGs projects or play a complementary role in achieving the

SDGs. Towards this, the ESCAP Sustainable FDI Indicators provides a framework to quantify sustainable development impacts of FDI projects through two sets of weighted general and sector specific indicators.<sup>25</sup>

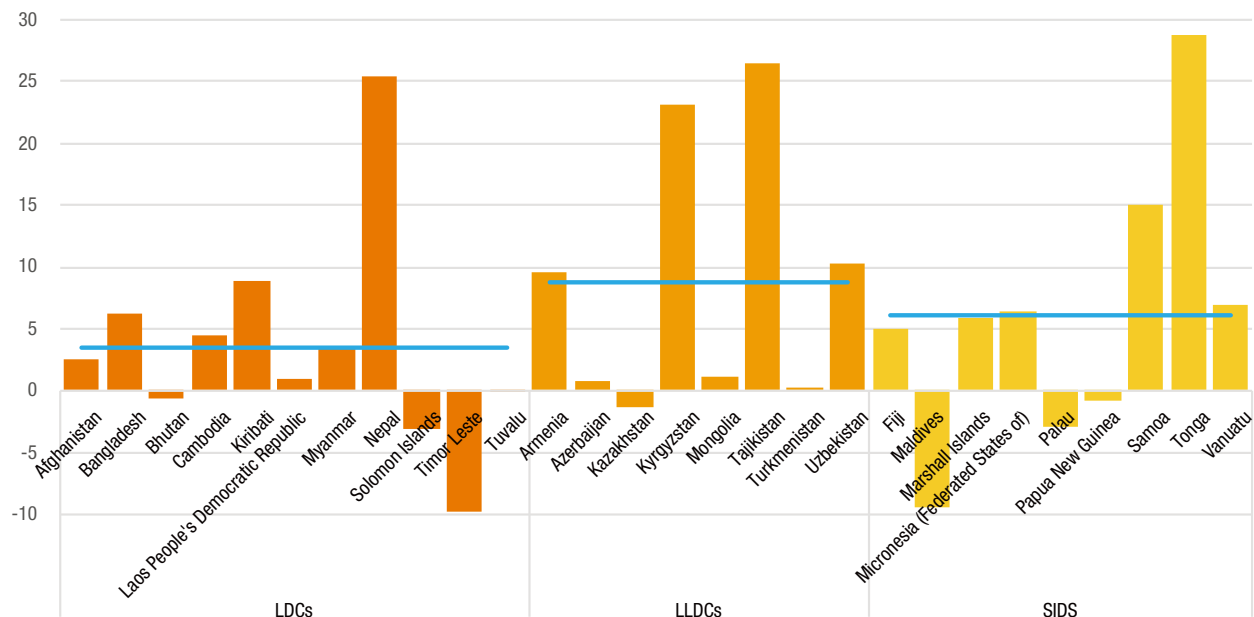
### (b) Remittances

Cross-border remittances often function as a critical lifeline for low-income households in countries with special needs, particularly during economic shocks, such as the ongoing pandemic. In most of these countries, the bulk of the remittances are directed to rural households, which help in reducing rural poverty and the rural-urban income gaps. Remittances also tend to have a favourable impact on many SDG-related domains in rural areas, such as increased investments in health and education of recipient households, and in helping them operate income-generating microenterprises.

Relative to GDP, remittances in countries with special needs form a significant share for SIDS (6.1 per cent) — such as Tonga (33 per cent) or Samoa (18 per cent) — as well as in LLDCs (8.8 per cent), such as Kyrgyzstan (20 per cent) and Tajikistan (26 per cent). While on average, LDCs (3.5 per cent) are the least reliant on remittances, there is considerable variations within this group, with Nepal reporting more than 25 per cent of GDP as inflows and a few countries also experiencing net outflows (see figure 2-12). Despite some disruption caused by the COVID-19 pandemic, these flows have remained fairly resilient, helping households mitigate the impacts of reduced earnings.

<sup>25</sup> For details see Dadkhah (2021).

Figure 2-12: Average net remittance flow (2015–2019)



Source: ESCAP calculations based on World Bank, World Development Indicators, <https://databank.worldbank.org/source/world-development-indicators> and IMF World Economic Outlook Database: October 2021, [www.imf.org/en/Publications/WEO/weo-database/2021/October](http://www.imf.org/en/Publications/WEO/weo-database/2021/October).

Notes: The solid lines represent averages for each group.

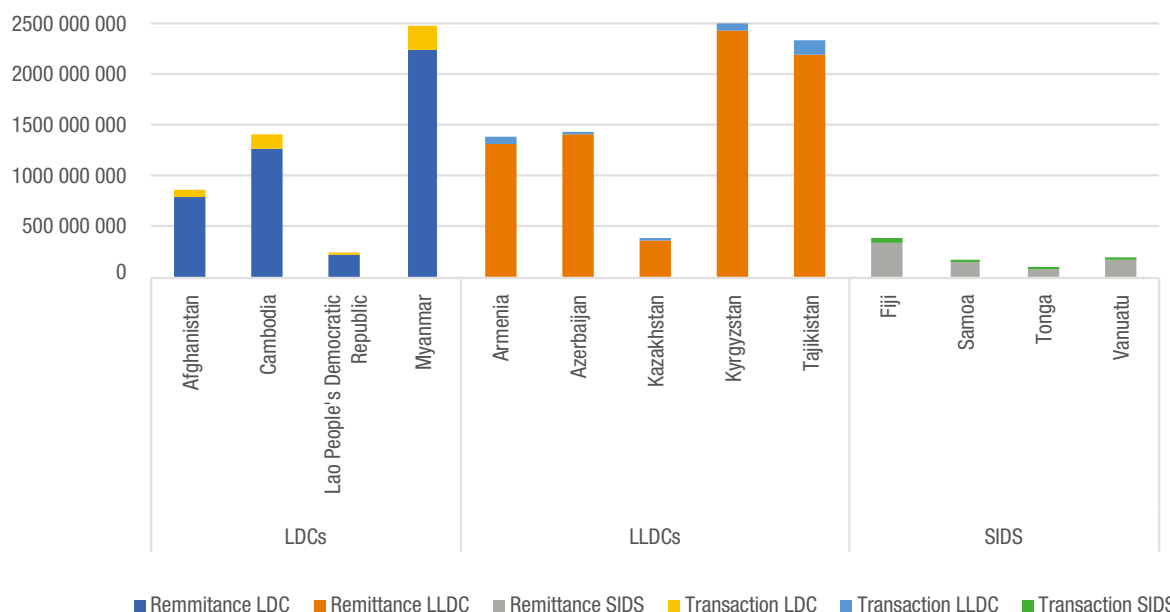
The cost of remitting money across borders varies across countries. For instance, in Samoa and Tonga, the most remittances-dependent countries in the region, transaction costs for a \$200-remittance are nearly 10 per cent — among the most expensive globally. Because of the high cost of remittances through formal channels, many remitters to low-income countries rely on informal channels to send funds to family members, but this puts their funds at risk of theft or losses. A quick estimate using the cost of remittances for 16 countries with special needs indicates that between 2016 and 2020, a total of \$10.7 billion was expended simply on transaction charges. Figure 2-13 captures the relative magnitude of these expenses for select countries with special needs.

Significant progress has been made over the past few years supported by digitalization in developing instant, low-cost remittances globally. The formalization of remittances is critical, not only to allow safe and affordable last-mile access, but also to reduce illicit financial flows. In the Mekong region alone, it is estimated that transitioning informal remittances to formal channels has the potential to add \$6 billion to 17 billion to the total volume of remittances, which exceeds the \$6.8 billion of ODA inflows in the region (UNCDF, 2017).

Prior to the pandemic, remittances were trending higher in most countries with special needs. Recent estimates from the World Bank show that remittances dropped by a modest 1.6 per cent, as opposed to the initially projected 20 per cent. These flows were kept afloat by fiscal stimulus in host countries, a shift in flows from cash to digital and from informal to formal channels, and cyclical movements in oil prices and currency exchange rates (World Bank, 2021). However, unlike in earlier crises, such as the 2008 financial crisis, the road to recovery is likely to be much more protracted.

While remittances play an essential role in the financing flows of these economies by supporting the balance of payments and helping to smooth household consumption, it is crucial that economies do not fall into a “remittance trap” (ESCAP, 2019a). Such a situation is characterized by protracted periods of low economic growth and emigration. However, for some of these economies, low growth rates are not necessarily correlated with dependence on remittances, especially for LDCs and LLDCs (see figure 2-14). It is common to find relatively high growth rates and high levels of remittances, suggesting that, in most instances, other factors, such as the search for better-paying employment, are the main causes behind emigration. This is in contrast to the situation of SIDS where a correlation between low growth rates and high levels of remittance dependence exists.

Figure 2-13: Total vs. cost of remittances for select countries (2020)

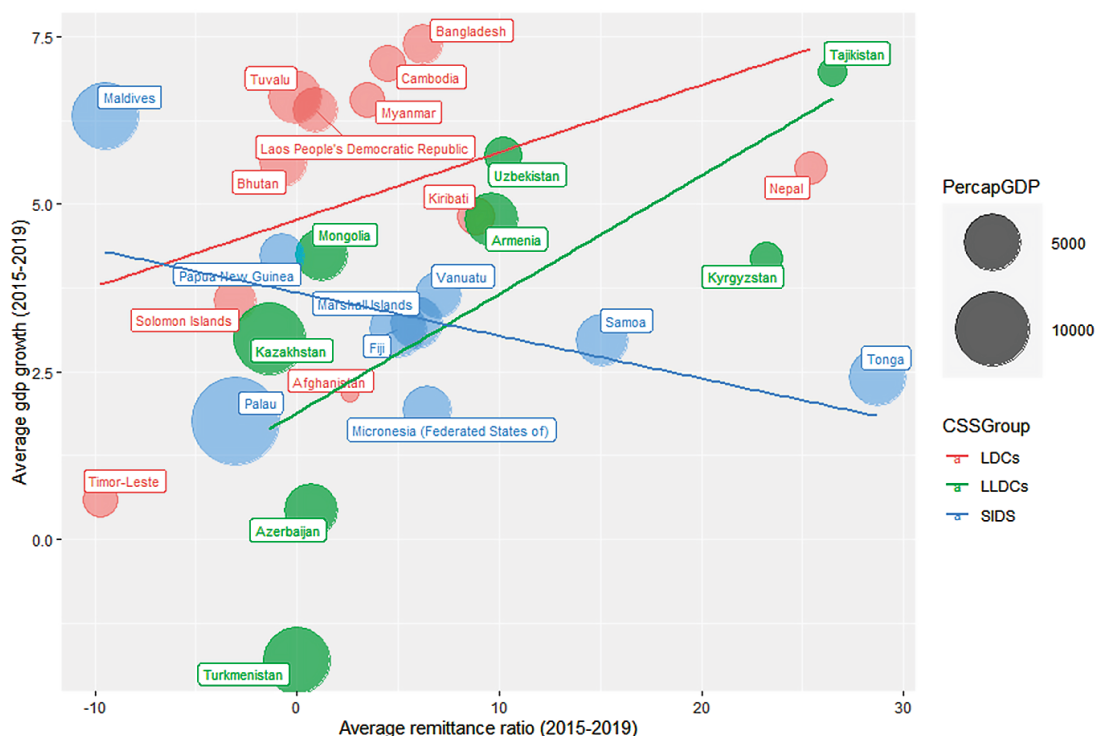


Sources: World Bank, World Development Indicators, <https://databank.worldbank.org/source/world-development-indicators> and IMF World Economic Outlook Database: October 2021, [www.imf.org/en/Publications/WEO/weo-database/2021/October](http://www.imf.org/en/Publications/WEO/weo-database/2021/October).

Note: Bangladesh, Nepal and Uzbekistan are excluded as they receive significantly larger volumes of remittances, which skews the figure.

In addition to investing in the skills of migrating workers and assisting them to secure more well-paying jobs abroad, countries with special needs should proactively encourage digitization of all financial transactions so that remittance costs can be reduced to competitive levels.

Figure 2-14: The relationship between remittance dependence and growth



Source: ESCAP calculations based on data from World Bank, World Development Indicators, <https://databank.worldbank.org/source/world-development-indicators>.

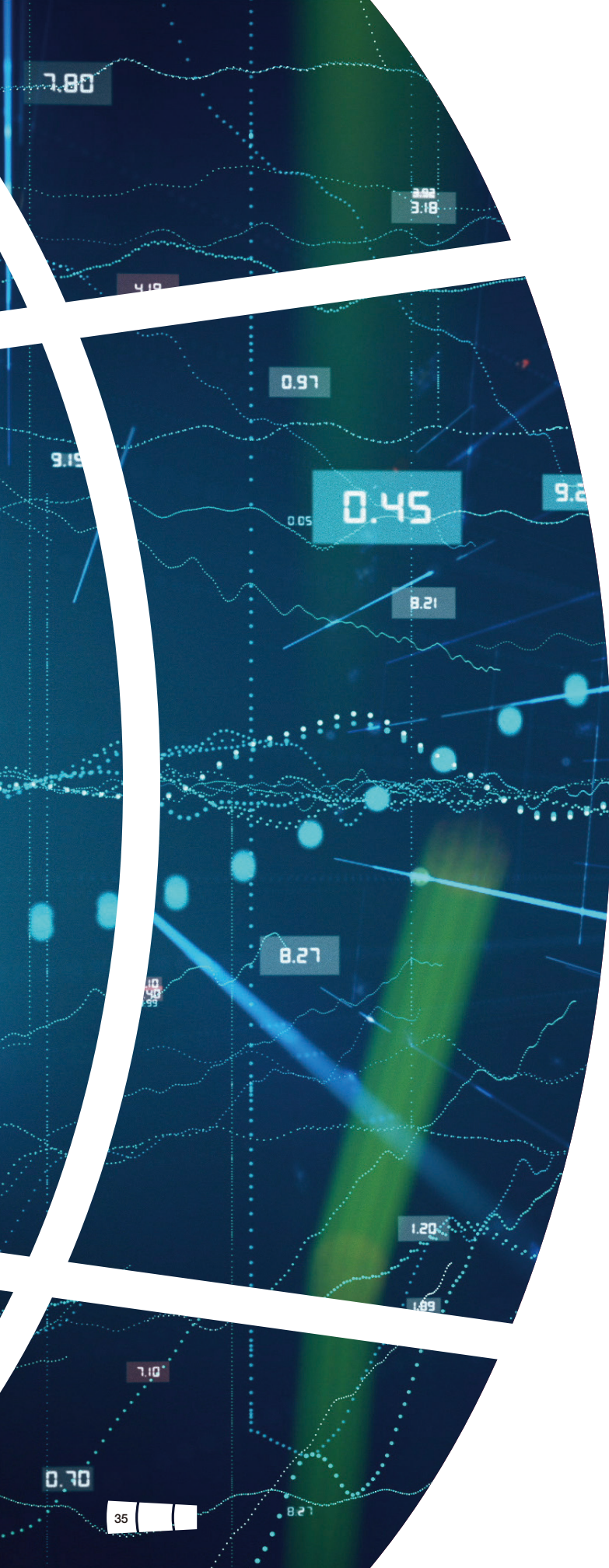
Notes: The size of the bubbles represents per capita GDP.



## Conclusion

Countries with special needs continue to depend on traditional sources of finance to meet most of their SDG investment needs. In addition to being confronted by multidimensional impediments to development, resulting in relatively larger investment needs, these countries are also constrained by limited resources and capacities, hindering their ability to recover swiftly from the Covid-19 crisis and achieve the SDGs. Available information suggests that traditional sources of financing will continue to dominate the financing landscape in these countries, as the alternative sources of finance available to them are limited. Fortunately,

huge untapped potential still exists to raise additional resources from traditional sources. In particular, these countries need to adopt more robust policies and reforms to enhance tax administration, improve public expenditure management systems, align government budgets with SDGs, incentivize FDI flows to SDG-related areas, ensure remittances contribute to their development process and strengthen institutional and human capacities so that resources are spent more efficiently, equitably and effectively in areas aligned with SDGs-related projects. However, these traditional sources are inadequate and accordingly, countries need to explore newer sources of financing, which are discussed in the following chapter.



## CHAPTER 3.

### LEVERAGING ADDITIONAL FINANCE

With exogenous shocks, including pandemics and climate-related disasters, leading to a surge in costs to promote an inclusive, sustainable and resilient development pathway, in the preceding chapter, it is made clear that traditional sources of finance in countries with special needs are proving to be inadequate in financing the SDGs and recovering from the adverse consequences of COVID-19. Collective efforts, including financing availability, coming from both the public and the private sectors, have proved to be crucial in addressing the socioeconomic challenges surfaced and deepened by the pandemic. It has become imperative that countries with special needs explore and use innovative financing instruments that involve using information technology, promoting engagement with different stakeholders across sectors and leveraging public and private capital in bridging the financing gaps that have emerged while coping with COVID-19 and striving to achieve the SDGs.

### What is innovative finance?

While there is no single agreed definition, innovative finance is widely understood as a set of financial solutions and mechanisms that channel private and public resources towards the achievement of a sustainable development agenda. Innovative finance is also often broadly described

as “anything different from standard investing or financing practice that has the potential to deliver significant socioeconomic or environmental impact”.

Instruments categorized as innovative finance are extremely diverse. Some instruments can be considered as an expansion of the existing traditional instruments – as a subcategory of sovereign bonds, for instance, bonds issued by a country to its expatriates, or “diaspora bonds” are being considered by countries with special needs (see box 3-1). Israel, India, South Africa and Sri Lanka have successfully issued diaspora bonds, implying that countries with special needs with relatively high and stable inward remittances from their diaspora, such as Tonga (net remittance to GDP ratio was 33 per cent in 2020), Tajikistan (26 per cent), and Nepal (24 per cent)<sup>26</sup>, could benefit from this instrument. More recently, the rising need to mainstream social and environmental aspirations onto finance has led to the further expansion of traditional financing instruments and the development of innovative instruments. For instance, broad-based green taxes and emissions charges aimed at internalizing costs related to pollutive activities and resource usage throughout business decision-making are being considered in the Asia-Pacific region (see box 3-1). Carbon tax is another example of governments intending to mainstream social and environmental considerations onto traditional tax policies.

## Box 3-1

### Expansions of traditional financing instruments – green tax, diaspora bonds and carbon pricing instruments

#### (Tourist) green tax

The Maldives Inland Revenue Authority defines tourist green tax as a tax payable by tourists staying in tourist resorts, hotels and vessels. Applied since November 2015, tourists are required to pay the green tax at the rate of \$6 per day for stays at resorts, hotels and vessels, and since October 2016, \$3 per day for stays at guesthouses. Liable tourist establishments have been automatically registered for green tax and have been given the responsibility to file tax returns and pay the green tax each month. Maldivians and resident permit holders are not required to pay the green tax even if they stay in resorts, hotels, vessels and guesthouses.

The green tax was introduced as part of the Maldivian Intended Nationally Determined Contribution to the United Nations Framework Convention on Climate Change

(UNFCCC) (ESCAP, 2017). The tax was applied on tourism, considering the magnitude of the industry in Maldives and that the industry is recognized as the largest energy consumer in the country. In addition, the tax has been recognized as a means to address the energy mix in the country since, as of late 2015, 99.2 per cent of the country’s electricity is provided by diesel generators and only 0.8 per cent by renewable energy (ESCAP, 2017). Since its application, the green tax has contributed towards generating domestic revenue. In the first six months of 2019, for instance, the Maldives Inland Revenue Authority reported that it had collected \$29.75 million as green tax from foreigners and tourists (The News, 2019). By using part of the collected revenue towards environmental purposes, such as increasing investment in energy efficiency, the green tax has also helped the country transition towards a green economy by increasing the costs for environmentally harmful technology and reducing costs for cleaner technology.

#### Diaspora bonds

Diaspora bonds could offer a fixed-rate source of income for countries with limited access to foreign capital. This is particularly relevant to the countries with special needs in

26 Based on data for 2020 from the World Bank World Development Indicators and the ESCAP calculation.

the region, as countries, such as Kyrgyzstan, Tajikistan and Tonga, reported an average annual remittance that exceeds 25 per cent of GDP during the period 2017–2019, while LDCs, such as the Lao People’s Democratic Republic and Myanmar, are contributing heavily to the region’s annual diaspora savings account, which is estimated to be at least \$1 billion throughout the region (ESCAP, 2021g). As these bonds are formed by mobilizing savings of the countries’ diasporas, it is notable that the contributors to these bonds tend to withstand financial crises and may have a more positive perspective towards their economies compared to international investors. Considering the opportunities that diaspora bonds present, several countries in the region have issued or are considering issuing such bonds. India, for instance, issued five-year diaspora bonds starting as early as in 1991, and again in 1998 and 2000, generating US\$32 billion in total (ESCAP, 2021g). More recently, Armenia has considered using diaspora bonds to expand SDG investment, while Georgia has also expressed such an interest.

Leveraging diaspora bonds, however, requires developed domestic capital markets and related legal and regulatory frameworks to make the most of the remittances and also a thorough understanding of the willingness and abilities of diasporas towards bond investments. As developing domestic capital markets could take time, governments could start by building communication channels with diasporas to reinforce the citizens’ trust towards the government and its bond investments. Georgia, for instance, has established the Ministry on Diaspora Affairs, which organizes regular gatherings among the diasporas (ESCAP, 2021g). Governments could also benefit from collaborating with international partners, particularly in cultivating the

necessary technical capacity and formulating the institutional frameworks to issue and manage diaspora bonds.

### Carbon-pricing instruments

Carbon-pricing instruments have been spotlighted as important financing venues for the post-COVID-19 recovery efforts aligned with low carbon development pathways. Overall, 16 countries in the region, including several countries with special needs, such as the Marshall Islands, Solomon Islands and Uzbekistan, are at different stages of developing and implanting different types of such instruments, including carbon tax and emission trading schemes at the national and subnational levels (ESCAP, 2021i). It is estimated that introducing a carbon tax across the region could generate approximately \$1.6 billion in additional tax revenue per year in 25 of the Asia-Pacific countries with special needs.

However, there is still a lack of internationally agreed terms and references, including the actual price of carbon and also no coordinated regional action towards carbon-pricing initiatives, enhancing the risks of “carbon leakage” in production and/or investment.

While the macroeconomic impact of such uncertainty may be multifaceted, the anticipated benefits of carbon prices cannot be disregarded. In addition to its evident push towards low-carbon and no-carbon energy sources, increased costs of carbon-related activities can also help to expand fiscal space that can be channelled back into the economy through tax cuts and incentives for low-carbon innovation. At a more mature stage, carbon revenue policies could be refined to ensure targeted spending towards other development priorities, such as poverty reduction, while still being mindful of being energy efficient and staying green.

Considering how the above-introduced instruments are relatively well-known and used in the region, the focus of this chapter is on three instruments that are gaining traction and being spotlighted by countries in the region, including countries with special needs. Specifically, this chapter covers the following: thematic bonds; digital FDI; and debt-for-climate swaps. The discussion for each instrument includes the introduction of good practices seen in countries, particularly countries with special needs, within the region, and identification of the prerequisites in adopting and implementing the instruments in the longer-term.

#### i. Thematic bonds

While the issuance of sovereign bonds is not a recent trend, interest has gained traction link these fixed-income instruments to ESG dimensions of sustainable development.

The growth of green bonds in Asia and the Pacific, for instance, has been strong over the past five years, the value of issued green bonds increased by approximately ten times in 2020 compared to 2015 (ESCAP, 2021d). These thematic bonds are aimed at allowing investors to finance specific investment themes, such as climate change and target-specific SDGs projects. Thematic bonds include green bonds oriented towards a green agenda, blue bonds with an emphasis on the sea and ocean, social impact bonds aimed at raising funds for social projects and sustainability bonds, or SDG bonds, aimed at exclusively financing a combination of green and social projects (UNDP, 2021b).

#### (a) Green bonds, Sukuk and SDG bonds

By March 2021, a total of 24 national Governments around the world had issued sovereign green, social and

sustainability bonds, among which four countries were from Asia and the Pacific (Fatin, 2021). The Republic of Korea and Thailand issued sovereign sustainability bonds, while Fiji and Indonesia issued sovereign green bonds. Among these countries in the region, the bonds issued by Fiji stands out, as the country broke new ground for developing economies by issuing the first sovereign “green bond” in the Pacific subregion in 2017, drawing on technical support from the World Bank and Australia, to raise \$50 million to finance climate change adaptation and mitigation (see box 3-2).

Several countries with special needs in the region have also gained experience issuing different types of thematic bonds, both sovereign and non-sovereign. Landlocked developing countries, such as Kazakhstan, have issued green bonds that were not sovereign bonds, during the pandemic

(see box 3-2). Several countries in the region, including Bangladesh, have issued Islamic bonds, also known as “sukuk”, which must adhere to Islamic law. Some countries, such as Indonesia and Malaysia, have gone one step further by greening their issued sukuk by adhering to environment-friendly standards (see box 3-3). A greening sukuk issuance has its advantages in that it appeals to a broader set of investors than non-green sukuk because it attracts green investors, Shariah-compliant investors, non-green investors and conventional finance investors (World Bank, 2020b). In terms of SDG bonds, Uzbekistan recently issued a SDG bond in two tranches, consisting of \$635 million and \$235 million, to finance education, water management, health, green transportation, pollution control, management of natural resources and green energy (ESCAP, 2021b).

## Box 3-2

### Experience issuing green bonds – Fiji and Kazakhstan

#### Fiji

The Fiji Sovereign Green Bond was issued in October 2017. It raised \$46.5 million in 2017 and 2018. Technical and advisory assistance for the issue was provided by the International Finance Corporation (IFC) (Emose, 2021). The bond was well-received by domestic and foreign investors and well supported by commercial banks, the national superannuation fund, unit trusts, insurance companies and other institutional investors.

Approximately \$75.4 million worth of bids were submitted for financing (Emose, 2021). Under the Fiji Green Bond Framework, the bond proceeds were used to finance green projects related to renewable energy and energy efficiency; building resilience to climate change for highly vulnerable areas and sectors; clean and resilient transport; reducing pollution and greenhouse gas emissions; water efficiency and wastewater management; sustainable management of natural resources; and eco-efficiency. By 2019, the full proceeds from the bond issuance had been used and it is projected that the bond has benefited more than 129,000 Fijians (ESCAP, 2021b). Through initiatives funded by the bond proceeds, for instance, it is estimated that CO<sub>2</sub> emissions are reduced annually by approximately 2,000 tonnes of and 1.39 million kilowatt hours of renewable energy are generated (ESCAP, 2021b).

While reflecting on this successful sovereign green bond issuance, IFC observed that three key aspects could be seen: (i) a steering committee structure to organize and coordinate the relevant stakeholders; (ii) identification of potentially eligible projects that help to determine the structure of the bond; and (iii) addressing capacity gaps with external expertise. In the case of Fiji, the Government drew on support from the World Bank Group during each phase of the issuance.

#### Kazakhstan

In 2020, Kazakhstan issued its first green bond, supported of the United Nations Development Programme (UNDP) and the Climate Bonds Initiative, and funded by the Global Environment Facility. The bond issuance was in line with the country’s “De-risking Renewable Energy Investment” project, which is aimed at promoting inbound investment in renewable energy. Approximately \$500,000 was raised by the Damu Entrepreneurship Fund JSC, a major state-chartered fund that supports business development, enabling the Fund to expand its green bond activities to cover areas, such as energy efficiency, biodiversity and waste management.

During a side event on green investment held during the 26th United Nations Climate Change Conference (CoP26), representatives of the Kazakhstan Ministry of Ecology, Geology and Natural Resources, Green Finance Center and Damu Fund and UNDP experts echoed that cooperation across stakeholders is crucial when issuing green bonds to ensure a project-based approach. Such an approach is still being taken in Kazakhstan, especially as the relevant stakeholders are now working to develop a green taxonomy for nationwide use.

Source: Content on the case of Kazakhstan taken from UNDP (2021c)

## Box 3-3

### Sukuk – Experience of Indonesia and Malaysia

A sukuk is an Islamic financial certificate, similar to a bond, that complies with Islamic religious laws commonly known as Sharia. Sukuk differs from bonds in the sense that while bond investors lend financial resources to the issuer, indicating an obligation for repayment at bond maturity, Sukuk investors gain partial ownership on an issuer's assets until maturity (Azhgaliyeva, 2021). That is, Sukuk securities are structured around paying a profit, not interest. Among the types of sukuk is the rise in green sukuk – Sharia-compliant investments in renewable energy and other environmental assets, which explicitly address the Sharia concern on protecting the environment. In the case of Indonesia and Malaysia, internationally recognized standards, such as the International Capital Market Association (ICMA) Green Bond Principles and the ASEAN Green Bond Standards set by the ASEAN Capital market Forum, were used to label the sukuk "green", in addition to the countries' own national bond frameworks (Climate Bonds Initiative, n.d.).

#### Indonesia

Indonesia raised \$1.25 billion in February 2018, when it issued the world's first sovereign green Sukuk (Government of Indonesia, 2021). The issuance was followed by two annual issuances in 2019 and 2020. Despite being issued amid the COVID-19 pandemic, the third sovereign green sukuk was well-received by investors, as the offering was oversubscribed 7.37 times. The Government also issued the world's first retail green sukuk in 2019 and a second one in 2020, broadening the domestic investor in addition to addressing the growing demand for green and sustainable investment. Through these instruments, the Government has raised \$3.24 billion, which includes \$2.75 billion raised through a global issuance and 6.86 trillion Indonesian rupiah (RP) (\$490 million) raised through domestic retail issuances (Government of Indonesia, 2021).

The country's sukuk were issued based on its national development policies, such as the National Action Plan on Green House Gas Emission Reduction and the Adaptation published in 2011 and 2014, respectively (ESCAP, 2021b). These policies include a set of targets, programmes and projects related to climate mitigation and adaptation which, also have been mainstreamed into the country's 2015–2019 National Midterm Development Plan and, more recently, in the current 2020–2024 Midterm Development Plan. Mindful of these policies, the proceeds of the sukuk have been mainly used to fund projects aimed at building resilience to climate change for highly vulnerable areas and sectors and disaster risk reduction. Remaining proceeds were directed to support upgrading of the double track railway in the Southern Java line and improving waste management (Government of Indonesia, 2021).

#### Malaysia

In April 2021, Malaysia issued the world's first sovereign United States dollar Sustainability Sukuk via the issuance of \$800 million 10-year Trust Certificates (Government of Malaysia, 2021). The sukuk was well-received by investors; the offering was oversubscribed by 6.4 times. The Ministry of Finance has stated that the proceeds will be used for eligible social and green projects aligned with the 2030 Agenda. The sukuk was issued under the country's new SDG Sukuk Framework, which is aligned with the Social Bond Principles 2020, the Green Bond Principles 2018 and the ASEAN Sustainability Bond Standards 2018 (ICMA, 2021a; ICMA, 2021b). The Social Bond Principles and the Green Bond Principles are a collection of voluntary process guidelines managed by ICMA – a not-for-profit membership association comprised of private and public sector issuers, banks and securities dealers, asset and fund managers and central banks, among others, that recommend transparency and disclosure with regard to issuing a social or green bond. The framework is comprised of four components: use of proceeds; project evaluation and selection; management of proceeds; and reporting. It also covers external review.

### (b) Impact bonds

Countries in the region have also been actively issuing impact bonds — an alternative way of financing in which private investors provide up-front capital for social services and are repaid by an outcome funder, such as the government or a donor, on the achievement of agreed-upon results – with thematic purposes (Gustafsson-Wright and others, 2017). The Philippines and Thailand, for instance, have issued

social impact bonds, or impact bonds in which the objectives are linked to social outcomes (see box 3-4). Another type of impact bond is the development impact bond, which is specifically targeted for low- or middle-income countries. Multilateral agencies and non-governmental donors have issued these bonds in some developing economies, such as Cameroon, Papua New Guinea, Peru, Tajikistan and Uganda (Gustafsson-Wright and others, 2017).

## Box 3-4

### Impact bonds – Experiences from the Philippines and Thailand

#### Philippines

In August 2020, the Central Bank of the Philippines issued a 21.5 billion Philippine peso (Pts) (\$438 million) social bond to finance or refinance loans to MSMEs. The bank described its targeted impact as a response to COVID-19 through lending support to MSMEs negatively affected by natural and health disasters, based on the bank's Sustainable Funding Framework aimed at supporting MSMEs response to disruptions in order to minimize economic and social impacts. This aligns with the Government's MSME Development Plan, 2017–2022, which seeks to make local businesses more resilient to natural hazards. The target population is twofold – it directly reaches MSMEs that have been significantly affected by the pandemic and, indirectly and it reaches employees of MSMEs, which account for 60 per cent the of the country's labour force. Notably, this social

Source: ADB (2021)

bond is also compliant with the Association of Southeast Asian Nations Social Bond Standards.

#### Thailand

In October 2019, Bank of Ayudhya (Krungsri) issued a social bond in Thailand to finance the growth of women-led small and medium-sized enterprises (SMEs). The bond raised \$20 million and was, notably, the first bank-issued gender bond in Asia and the Pacific. It was also the first social bond issuance in a developing Asian country that complied with the International Capital Market Association Social Bond Principles and the Association of Southeast Asian Nations Social Bond Standards. The impact areas addressed by this bond are gender equity; women-led SME support; financial inclusion for the underserved; the promotion of sustainable, resilient, and inclusive growth; and the support of women as the drivers of the Thai economy and society. The bond's impact will be tracked by following employment generation through women-owned SMEs, socioeconomic advancement through financing to low-income women and disadvantaged female groups, and total SME loans outstanding and use of proceeds.

### (c) Catastrophe bonds

Another type of instrument that could be included in this category are risk-transfer financial instruments, particularly catastrophe (CAT) bonds. CAT bonds are specialized securities that allow issuers to transfer natural disaster risk to capital markets, with specified triggers attached to them following a particular natural disaster, such as an earthquake. The logic behind this is that if the bond is triggered, the obligation to pay interest and repay the principal is either partially or fully forgiven (IMF, 2020a). Considering their link with the event of a natural disaster, CAT bonds tend to be characterized by high yields and short maturity dates of between three and five years (Edesess, 2014). Primary investors in this type of security, while not exclusive, tend to be hedge funds, pension funds and other institutional investors. The design of the bond differs by bond – some bonds are structured so that the payout occurs only if the total natural disaster costs exceed a specific amount over the coverage period, while other bonds are pegged to the strength or number of natural disasters (Edesess, 2014).

As the interest rates paid by CAT bonds are not generally linked to the financial markets or economic conditions of a

country, these bonds offer investors relatively stable interest payments that tend to offer higher yields compared to other traditional bonds (Edesess, 2014). The relatively short coverage period of the CAT bonds also can attract investors, as the probability that an event triggering a payout occurring would be low. To take advantage of these benefits, Mexico and Turkey have issued CAT bonds, while the World Bank has issued the first joint sovereign CAT bonds for members of the Pacific Alliance (Chile, Colombia, Mexico and Peru) (Cebotari and Youssef, 2020).

While less common than catastrophe insurance, countries in the region have also joined together to issue CAT bonds. For instance, the World Bank issued two tranches of CAT bonds in 2019 to provide financial protection of up to \$75 million for losses from earthquakes and \$150 million for losses from tropical cyclones to the Philippines (World Bank, 2019b). Considering the small size of the economies of SIDS, this group of countries, could benefit from jointly issuing this financial instrument. In June 2016, the Pacific Catastrophe Risk Insurance Company was established as a regional catastrophe insurance platform that gives Pacific Governments parametric climate and seismic coverage that is focused on cyclones and earthquake risks.<sup>27</sup> Six Pacific

<sup>27</sup> As opposed to indemnity insurance in which the size of the payout is dictated by the size of the actual loss, for parametric (also called index-based) insurance, the amount of the payout is dictated by an objective measure of the causal event, such as the speed of the wind in a cyclone, though in more sophisticated modelled loss parametric mechanisms, this objective measurement is translated into an actual loss estimate. Accordingly, the speed of an insurance payout is much quicker with parametric insurance because the event's occurrence simply has to be recognized and verified. This is in contrast to indemnity insurance in which the loss adjustment has a high cost and results in payment delays (ESCAP, 2018c).

countries are participating in the platform – Cook Islands, the Marshall Islands, Samoa, Tonga, Vanuatu, and, most recently, Solomon Islands. Since its establishment, the company has secured increased coverage of \$45 million for the 2017–2018 cyclone season to five countries and a \$4.5 million payout to Tonga in 2020 (World Bank, 2020d). The Pacific Catastrophe Risk Insurance Company is supported by the Pacific Catastrophe Risk Assessment and Financing Initiative Multi-Donor Trust Fund, which is administered by the World Bank.

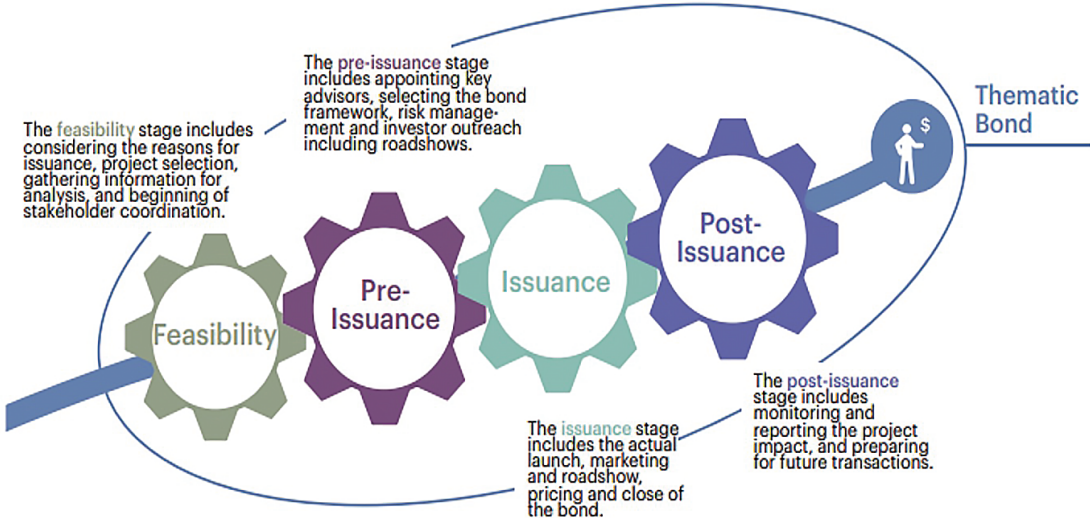
Such reinsurance mechanisms have also been pegged to microinsurance schemes with social purposes. In Sri Lanka, for instance, the Yasiru Mutual Provident Fund offers microinsurance products for families against disabilities, accidents, and hospitalization (de Schutter and Sepulveda, 2012). Families can choose from five different levels of coverage. The Fund cooperated with the Rabobank Group (Netherlands) and received financial and technical support, including IT hardware and software training, through the Rabobank Foundation. By targeting the poorest segments of the population, this Fund serviced approximately 24,000 people in 2004 and 76,000 in 2008 (ILO, 2008).

Despite these benefits, CAT bonds need to be approached with caution as there is always the possibility of partial or complete payout occurring. The scope of such bonds is also often limited to specific categories of damage and few types of disasters, implying that the issuance of such financial instrument might not actually be of use when disaster strikes (ESCAP, 2021g). Delays in payout also tend to occur due to the stringency of the activation criteria, including the risk modelling behind it. Considering the importance of such emergency financing mechanism, regional cooperation is crucial in ensuring joint solutions that extend beyond financing can be brainstormed and implemented. For these

joint solutions to work, however, it is important that the diversity of country-level situations is recognized and that room for customization is given to countries and related development partners (ESCAP, 2021g).

Overall, considering the diversity of the types and purpose of thematic bonds, it is important that the issuer identifies not only the need to borrow and ability to repay, but also the particular bond to issue that fits the purpose of issuing the bond in the first place. Once this is identified, several prerequisites need to be taken into consideration (see figure 3-1). For instance, despite the potential of employing such innovative bonds, financial institutions in countries with special needs tend not to be progressive enough to nurture the emerging thematic financial markets. Countries with special needs tend to have constrained fiscal space, however, much of their spending is prioritized towards short-term measures, such as combating the immediate impacts of the pandemic, rather than linking to long-term development objectives in line with development plans and recovery frameworks. Underdeveloped capital markets can also be considered a negative factor, which is partially the result of limited regulations and laws on government and non-government securities. Aligning national legal and regulatory frameworks with internationally recognized standards and taxonomies could help to address this issue. The weak technical and institutional capacity of the countries with special needs surrounding the emerging financing instruments, including the lack of dedicated agencies with sufficient resources to pursue the long-term objectives of the three dimensions of the sustainable recovery, is also an issue that needs to be addressed (ESCAP, 2021b). In addition, limited data collection and analysis capacity also tends to be a challenge faced by these countries, which could be a barrier throughout the process of issuing bonds, particularly during the feasibility and monitoring phase.

Figure 3-1: Key stages in issuing thematic bonds



Source: ESCAP (2021b).



In line with the above figure, legal and regulatory frameworks that accommodate policies for sustainable economic recovery should be developed. Specifically, theme-specific frameworks need to be established that include and specify taxonomy; linkages and alignments with wider socioeconomic and environmental policies; types of eligible expenditures; systems and practices for monitoring, tracking and reporting, including for a post-issuance assessment; and an overarching legislative foundation that justifies the issuance and management of the innovative financial instrument (UNDP, 2021b). For instance, the Georgia Global Utilities JSC, a wholly owned subsidiary of Georgia Capital, which operates water supply systems and invests in renewable energy projects in Georgia, developed the Georgia Global Utilities Green Bond Framework. The objective of the Framework is to provide guidelines for issuing green bonds and using the proceeds to finance and refinance, whole or in part, existing and future projects related to the following five areas: renewable energy; energy efficiency; pollution prevention and control; sustainable

water and wastewater management; and climate change adaptation (Sustainalytics, 2020). These areas are aligned with those recognized by the Green Bond Principles 2018 and will help to advance SDGs 6, 7 and 13. Other countries with special needs in the region, including Mongolia, have explicitly expressed interest and willingness to develop ESG regulatory measures in their national capital markets (see box 3-5).

While some countries have their own thematic frameworks, for most countries it would be more practical to align issuances with recognized global standards as it would make it easier for global investors to understand the country's offer and readiness due to the common and global language on bond issuance. Recognized global standards for thematic bonds issuances include those established by the Climate Bonds Initiative and the International Capital Market Association (ICMA) (ESCAP, 2021b). The Association of Southeast Asian Nations (ASEAN), for instance, uses the ICMA Green Bond Principles when issuing regional green bond standards.

## Box 3-5

### ESG disclosure and reporting standards to be introduced in Mongolian capital markets

The Mongolian Sustainable Finance Roadmap provides an integrated, multi-stakeholder and strategic approach towards accelerated development of a sustainable financial system by 2030 that is aligned with the national sustainable development and climate targets, which are also integrated into the National Financial Market Development Programme 2025. The road map includes short-, medium- and long-term plans to achieve its objective and activities that are endorsed by the Sustainable Finance Advisory Committee, which is comprised of the Ministry of Finance, the Ministry of Environment and Tourism, the Bank of Mongolia, the Financial Regulatory Commission, the Mongolian Stock Exchange, the Mongolian Bankers Association, and the

Mongolian Sustainable Finance Association (UNEP, IFC and Mongolian Sustainable Finance Association 2018).

As a pillar activity within the road map, Mongolia plans to establish ESG disclosure and reporting requirements to be applied to its capital markets (UNEP, IFC and Mongolian Sustainable Finance Association 2018). For the Mongolian Stock Exchange, for instance, ESG reporting and disclosure requirements are being considered to be introduced into its listing rules – voluntary “comply or explain” guidelines followed by a mandatory model once sufficient capacity is built in the sector - alongside the provision of guidance and training to issuers. In this regard, a memorandum of understanding on promotion of a sustainable capital market was signed in May 2021 between the Mongolian Stock Exchange and the Mongolian Sustainable Finance Association (UNDP, 2021a). Leveraging this cooperation, the parties will work together to develop ESG reporting standards and guidance, conduct market capacity building and promote responsible investment and sustainable business practices.

Underlying such frameworks would be the interconnected national development plans and the SDGs, available data, and technical capabilities of relevant stakeholders and staff in analysing the impact of investment and managing the instruments. This is particularly important as all thematic bond frameworks require continuous disclosure and reporting on the use of funds and their impact towards the original objective of the project (ESCAP, 2021b). The lack of such a foundation would contribute to the uncertainty and instability of the countries with special needs in the eyes of the private investors, as it would provoke information asymmetries and could raise doubt on whether the funds are used towards the promised purpose, further alienating the countries with

special needs from a sustainable development and finance trajectory. In this sense, third-party verifications and an established practice towards risk disclosure and reporting could also play substantive roles in providing more certainty regarding the quality and impact of the projects, signalling a positive investment opportunity to current and future investors (ESCAP, 2021b).

To ensure that the bonds are issued, and well-managed, multi-stakeholder engagement is also important. Prior to issuing the bonds, it is critical that sufficient discussion is taken to ensure cross-collaboration across different ministries to facilitate the identification of eligible projects and that early

buy-in is obtained from the Ministry of Finance considering its budgetary and debt management responsibilities. For this, a wider whole-of-government approach towards the issuance and management of the bond is recommended. The discussion could further be expanded to include external stakeholders, including the private sector, to seek feedback and wider support throughout the process of issuing the bond.

Building on such a foundation, it is important that investment-ready thematic projects are developed to be offered to interested investors. Despite the interest shown

by many Asia-Pacific financial institutions towards financing regional thematic projects, in many developing countries, the capacities to develop pipelines of suitable bankable projects are often lacking (ESCAP, 2021b). In this context, strategies that aim to establish a portfolio of bankable projects, including green and social projects, should be considered along with the bankability of the green, social, or sustainability-linked projects. It is important that, while the projects are designed to guarantee financial returns, they also encompass socioeconomic improvements stated through the objectives of the projects (see box 3-6).

## Box 3-6

### Dangers of greenwashing thematic bonds

Despite the increasing interest in sustainability-linked bonds, the rapid increase of the bond market has invited scepticism about the authenticity of the purpose of the bond, in other words, “greenwashing” (Temple-West, 2021). Greenwashing is the process of conveying a false impression or providing misleading information about how a company’s product, or in this case, an issued bond is environmentally sound.

Such scepticism has been raised, as while bonds may be adhering to ESG principles, these principles can sometimes be applied, at times, excessively. This has prompted

individual portfolio managers to consider carefully whether a social and green bond can actually be considered as such. The discussion on what needs to be considered for a bond to be classified as a truly green and social bond is being expanded to include not only companies but also regulators (Temple-West, 2021). For instance, the Financial Conduct Authority of the United Kingdom published a discussion paper – “Sustainability Disclosure Requirements (SDR) and investment labels” (United Kingdom Financial Conduct Authority, 2021) – on the disclosures fund managers should make. Globally, the increasing importance of third parties – second party opinion providers – are being recognized as important verifiers to determine if the green or social proceeds are being directed as intended and are appropriately aligned with international standards and principles (Temple-West, 2021).

## ii. Digital foreign direct investment

Countries with special needs could benefit from digital FDI. Attracting FDI in the digital economy, or digital FDI, is critical as countries progress through the COVID-19 crisis into the recovery period. Nonetheless, the operationalization of an enabling and fit-for-purpose regulatory framework is a prerequisite for facilitating such investments (Sen and Stephenson, 2020). To this end, governments together

with investment promotion agencies need to develop an investment policy for the digital economy. This policy would set the conditions by which foreign (and domestic) firms can contribute to local digital sector development. For this reason, digital investment policy should be clear about the specific objectives in seeking foreign participation and developed based on a thorough assessment of the requirements in digital infrastructure development, digital business creation and digitalization within the wider economy (see table 3-1).

**Table 3-1:** Investment requirements for digital infrastructure development, digital business creation and wider digital adoption

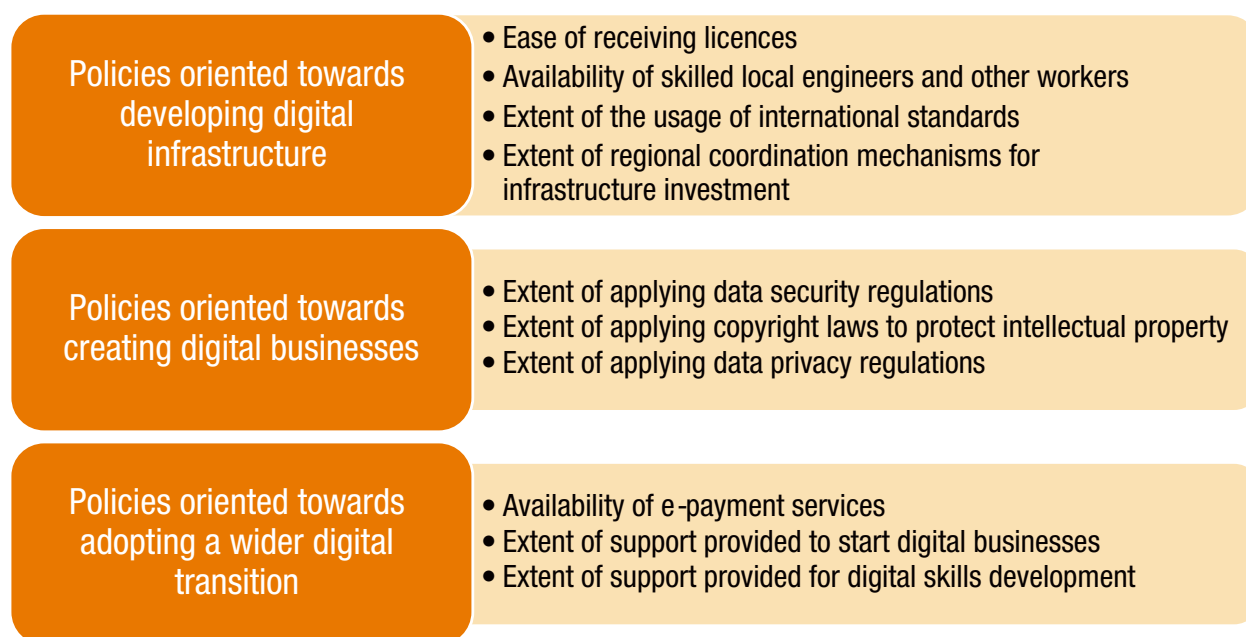
|                                    | Developing digital infrastructure   | Creating digital businesses   | Adopting a wider digital transition   |
|------------------------------------|---|---|---|
| Who are the main investors?        | <ul style="list-style-type: none"> <li>• (Mobile) network operators and Internet service providers)</li> <li>• Global digital firms</li> <li>• Governments</li> </ul> | <ul style="list-style-type: none"> <li>• Global digital firms</li> <li>• Data centre providers</li> <li>• Venture capital, private equity, other funds</li> <li>• Local firms (such as, media firms)</li> </ul> | <ul style="list-style-type: none"> <li>• Local businesses</li> <li>• Public institutions and governments</li> </ul> |
| What are the investors' key needs? | <ul style="list-style-type: none"> <li>• International, national, last-mile connectivity</li> <li>• Internet exchange points (IXPs)</li> </ul>                        | <ul style="list-style-type: none"> <li>• Local platforms (such as social networks, e-commerce)</li> <li>• Local enterprise development data centres</li> <li>• Training and capacity-building</li> </ul>        | <ul style="list-style-type: none"> <li>• ICT adoption/devices Training</li> </ul>                                   |

Source: UNCTAD (2017).

A detailed and individualized approach to each component of the digital economy systematizes investment policy and yields considerably greater development impact (UNCTAD, 2017). Investment policy should, thus, include customized subpolicies that (a) address the specific developmental needs of a country within each component and (b) speak to the unique investment drivers of the types of firms that will be targeted to fulfil them. For instance, telecommunications firms and ICT hardware multinational enterprises (MNEs) can be principal investors in digital infrastructure, with complementary participation by software firms that create the software applications used to control the operation of digital connectivity systems. Mixed digital firms and purely digital MNEs would invest in creating local e-platforms and other digital businesses. Hardware, software, purely digital and mixed digital MNEs would drive business and consumer-focused investments that encourage wider digital adoption throughout the economy.

In terms of what is important for firms in an investment policy, a recent survey by the World Economic Forum (WEF) sheds considerable light on this (see figure 3-2). As is evident, the principal concerns of digital infrastructure investors mirror those of counterparts in traditional economic sectors. So, there is much policy precedent in addressing these. Facilitating digital adoption should also not be too difficult, and governments already are carrying out a variety of initiatives in this area. The challenge for governments, especially in countries with special needs, is to devise a successful policy in completely novel and complex areas, such as data security, data privacy, source code disclosure, content monitoring and access to foreign websites, and to rework the existing physical world policy to have a digital context — especially intellectual property protection and contract law. The WEF survey finds that these are the areas of critical concern for digital and digitizing firms.

**Figure 3-2:** Decisive points in investment policies



Source: Stephenson (2020).

Finally, it is also critical that a digital investment policy encourages investors to contribute towards the implementation of the 2030 Agenda and the associated 17 SDGs. This could occur by encouraging investors in the digital economy to adhere to responsible business conduct. Governments could be further guided by the expert recommendations given to the G20 on advancing sustainable digital investment, as presented in the policy

brief by the task force on trade, investment and growth prepared for the G20 Think 20 (T20) Saudi Arabia Summit in late 2020 (Stephenson and others, 2020). These could be adopted by non-G20 countries as they draw on universal concepts. First is to incorporate the key ideas and provisions of internationally accepted standards and guidelines for responsible investor behaviour in domestic investment policy frameworks and international investment agreements.<sup>28</sup>

<sup>28</sup> Leading among these are the United Nations Guiding Principles on Business and Human Rights, the International Labour Organization Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy, the OECD Guidelines for Multinational Enterprises (OECD, 2011), and sector-specific standards, such as for mining and agriculture.

Second is to obligate firms above a certain size to engage in corporate social responsibility. Third is to require corporate sustainability reporting. Fourth is to reward projects and investors that contribute to sustainable development. Fifth is to ensure that all new digital infrastructure is “green”: maximizing its reliance on renewable energy, enhancing energy efficiency and minimizing carbon emissions and negative environmental impact.

In addition to designing and implementing a digital FDI policy, governments and especially investment promotion agencies, need to better leverage digital technology to alleviate the administrative burdens and reduce the bureaucratic hurdles impeding the delivery of products and foreign investment. In practice, this means offering more efficient digital services, in particular about investment facilitation through online one-stop facilities throughout the investment cycle.

Lockdown measures have prompted investment promotion agencies to provide remote investor services through telephone and videoconferences and strengthen their online presence through providing necessary information to investors. This has been particularly important, as it

relates to policy, financial and regulatory changes related to COVID-19 on a centralized, easily accessible online platform and through social media. During times when it may be difficult to attract new FDI, the retention of existing FDI is very important and may require investment promotion agencies to scale up their online investment services for existing investors.

While some of the region’s investment promotion agencies have established good practices in this area, among them, agencies in Malaysia, the Republic of Korea, Singapore and Thailand, countries with special needs have struggled to offer these services because they lack access to cloud-based or virtual files and investor information (World Bank, 2020c). Without such services, countries with special needs continue to face an uphill battle to retain existing investors and attracting new ones during the crisis. In the forthcoming ESCAP publication the *Handbook on Policies, Promotion and Facilitation of Sustainable FDI in Asia and the Pacific*, this issue is covered in detail and guidance is given to countries with special needs on how to better harness digital tools to attract and facilitate FDI (see box 3-7).

## Box 3-7

### Developing digital foreign direct investment strategies with the Economic and Social Commission for Asia and the Pacific

Support from international organizations is critical to helping countries with special needs promote and attract digital FDI. To this end, ESCAP has been organizing capacity-building workshops to help its developing country member States, including countries with special needs, develop digital

FDI strategies. Furthermore, the secretariat’s forthcoming *Handbook on Policies, Promotion and Facilitation of Sustainable FDI in Asia and the Pacific*<sup>29</sup> is geared towards helping guide and support developing and countries with special needs in Asia and the Pacific in designing and implementing a conducive regulatory environment to better attract digital FDI. The policy guidebook draws on examples of countries that have successfully done this and the needs of firms operating in the digital economy and takes into account the country contexts of developing and countries with special needs to suggest the types of policies and incentives required to boost FDI in the digital economy.

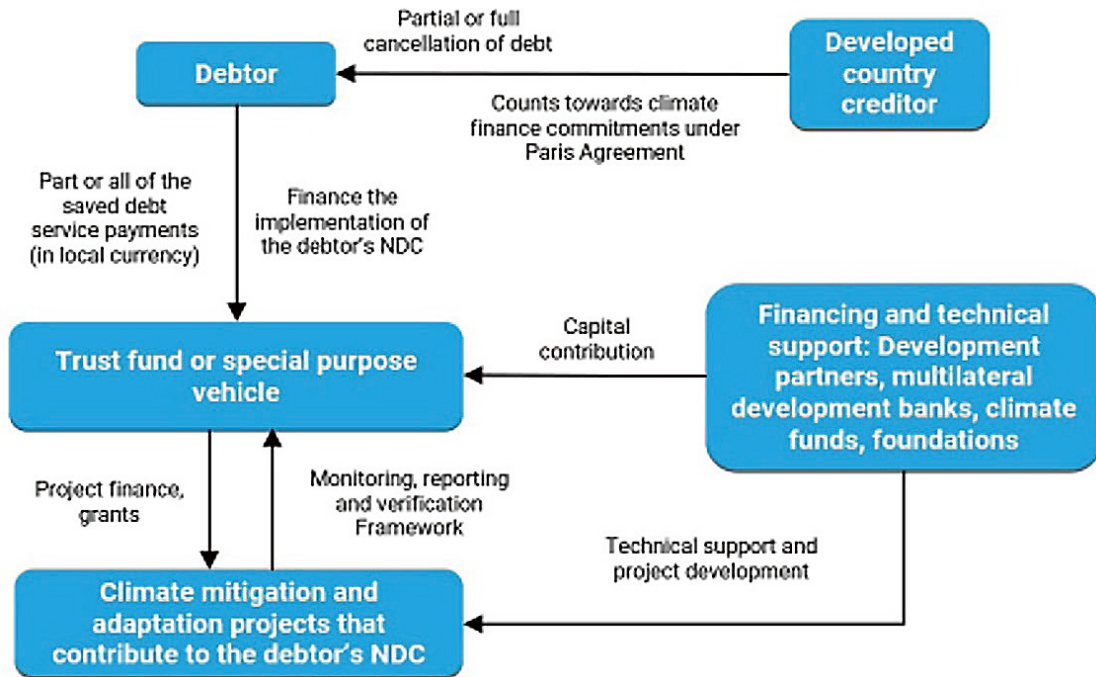
### iii. Debt-for-climate swaps

The basic idea behind a debt swap is that the donors forgo a certain portion of the debt owed by a developing country in exchange for climate adaption projects undertaken by the debtor country (see figure 3-3). Debt-for-climate swaps, in particular, are intended to help with debt relief and promote a green recovery at the nexus of climate and health. Focus on debt-for-climate swaps can be traced back to the Addis Ababa Action Agenda, which encourages conducting studies on innovative financial instruments for developing

countries, particularly least developed countries, landlocked developing countries and small island developing States experiencing debt distress, while noting experiences of debt-to-health and debt-to-nature swaps. Under the Paris Agreement and the increased debt levels spurred by the COVID-19 pandemic, there has been increased support for using debt-for-climate swaps as a solution to reduce sovereign debt burdens and increase financing towards investments in climate mitigation and adaptation projects (ESCAP, 2021f).

29 The Handbook will be accessible at <https://artnet.unescap.org/fdi/handbook>

Figure 3-3: General debt-for-climate swap scheme



Source: ESCAP (2021f).

OECD (2007), through a report prepared by its Task Force for the Implementation of the Environmental Action Programme for Central and Eastern Europe entitled “Lessons learnt from experience with debt-for-environment swaps in economies in transition”, reported that the debt-for-climate swaps have successfully been implemented in Bulgaria and Poland, but met negotiation deadlocked in the case of Georgia and Kyrgyzstan due to differing perspectives between their ministries of finance and other relevant agencies within the government. Jamaica is another case involving a successful debt-for-climate financing in a debt swap that was concluded with the Government of the United States and the Nature Conservancy (Fuller and others, 2018). Debt-for-climate swaps are very viable for the Asia-Pacific region, as they could help to simultaneously reduce participating country’s debt exposure and increase investments in climate mitigation or adaptation. The Pacific Resilience Facility of the Pacific Islands Forum Secretariat, for instance, may be used as a vehicle to implement debt swaps. This facility aims to provide grants to governments to fund small-scale, community level, disaster risk reduction projects, such as retrofitting critical infrastructure, community centres, and schools, or small-scale coastal protection projects. While the facility is expected to be funded by capital contributions from development partners and multilateral development banks, a debt-for-climate swap mechanism is also being considered as a complementary way to fund climate projects in the Pacific SIDS. ESCAP, in collaboration with the Pacific Islands Forum Secretariat, is assessing the feasibility of such a mechanism (ESCAP, 2021f).

Despite the anticipated benefits, countries tend to face challenges in implementing debt-for-climate swaps, as identified in the ESCAP policy brief entitled “Climate swaps as a tool to support the implementation of the Paris Agreement”. First, agreeing on the terms of the debt swaps requires considerable planning and negotiation involving many stakeholders, increasing the transaction cost related to implementing the debt swap. Second, as these debt swaps are intended to relieve debt in exchange for specific climate actions and results, consensus, ownership and a long-term commitment is required from the relevant multi-stakeholders, including the public sector and local communities that potentially face the direct impacts of the climate actions. Finally, as local currency is used to fund the climate actions, this poses the risk of devaluing the real value of the funding, further endangering the already quite small size of the debt swaps (ESCAP, 2021f).

Against this backdrop, it is critical that countries conduct thorough consultations with the relevant stakeholder prior to implementing debt swaps to ensure strong political and local support, while maintaining national ownership over the projects to be funded by the debt swap (ESCAP, 2021f). The ESCAP policy brief on debt for climate swaps mentions the possibility of developing a term sheet or, further down the line, a binding agreement, detailing the main terms and conditions of the debt swap and using existing global taxonomies and standards to reduce transaction costs throughout the planning and implementation phase. An effective monitoring, reporting and verification framework

should also be considered as a key element of the debt swap to ensure that the funds are used for effective climate mitigation and adaptation projects. Data availability and publication is a crucial factor to consider when developing and implementing the framework, along with technical support to ensure that adequate actions are being taken in relation to the climate mitigation and adaptation project linked to the debt swap.

## Conclusion

In the medium- to longer-term, significant potential exists for countries with special needs to leverage additional finance by tapping into the innovative financing instruments discussed above. To do so, however, three key issues must be dealt with by countries with special needs and their development partners prior to issuing the innovative instruments: (i) address the policy and regulatory gaps to

establish a clear government authority, enhance market transparency, and provide investors with certainty as to their rights and responsibilities regarding investment and market participation; (ii) improve the technical and human capacity to adopt and implement the innovative financing instruments, including capacity to leverage existing and emerging technologies and datasets and harnessing digital tools that can help in the decision-making process, and attract innovative venues of finance; and (iii) leverage multi-stakeholder engagement, particularly with the private sector, to understand and address their needs and interests, and ensure that the necessary actions are taken to respond to the uncertainty faced by investors interested in placing funds in countries with special needs. Experience seen within and outside of the region in leveraging these instruments suggests that countries with special needs must address these three key issues urgently.



## CHAPTER 4.

### ACCELERATING ACTIONS THROUGH MULTILATERALISM

COVID-19 has been disrupting the world, causing a massive public health crisis and overwhelming economic and social impacts. It has also potentially reversed the hard-won development gains achieved over the past decade by leading to widespread job losses, a reverse in the poverty trend and a deepening in inequality everywhere. The least developed and most vulnerable countries have been the hardest hit by the pandemic, as they had very limited capacities and financial resources to manage the resulting socioeconomic crisis and restore their damaged economies. If not addressed in a timely manner, the crisis will contribute to further social, economic and environmental divergence among countries, undermining long-term resilient, inclusive and sustainable development trajectories.

This points to an acute need for the international community to mobilize the necessary additional resources to support countries in needs to scale up sustainable development finance. While there have been significant coordinated interventions from the international community to support countries in tackling the immediate fall-out from the pandemic and its economic repercussions, those actions are not sufficient enough. The international community must go beyond providing immediate relief packages and carrying out succinct efforts and plans to facilitate a sustainable and resilient recovery for all countries. The support should be tailored more effectively by taking an inclusive approach and focusing on the most vulnerable countries, such as countries with special needs.

The Addis Ababa Action Agenda highlights the importance of increased and more effective international support, including both concessional and non-concessional financing, in support of the 2030 Agenda. It emphasizes the need to extend the most concessional resources to countries that are most in need and have the least ability to mobilize resources. Other global agreements, frameworks and programmes are already in place. The Paris Agreement, the Sendai Framework for Disaster Risk Reduction 2015–2030, the Programme of Action for the Least Developed Countries for the Decade 2011–2020 (Istanbul Programme of Action), the Vienna Programme of Action for Landlocked Developing Countries for the Decade 2014–2024 and the SIDS Accelerated Modalities of Action (SAMOA) Pathway also provide an inclusive approach to support those countries to build back better. While the COVID-19 shock has posed a great threat to efforts and progress made towards

multilateral cooperation, it also provides an opportunity for the international community to renew its ambition and commitment to build consensus over the necessary reforms, address systemic issues of the pandemic, climate change, poverty, inequalities and other global issues, and bring back on track efforts aimed at achieving the SDGs.

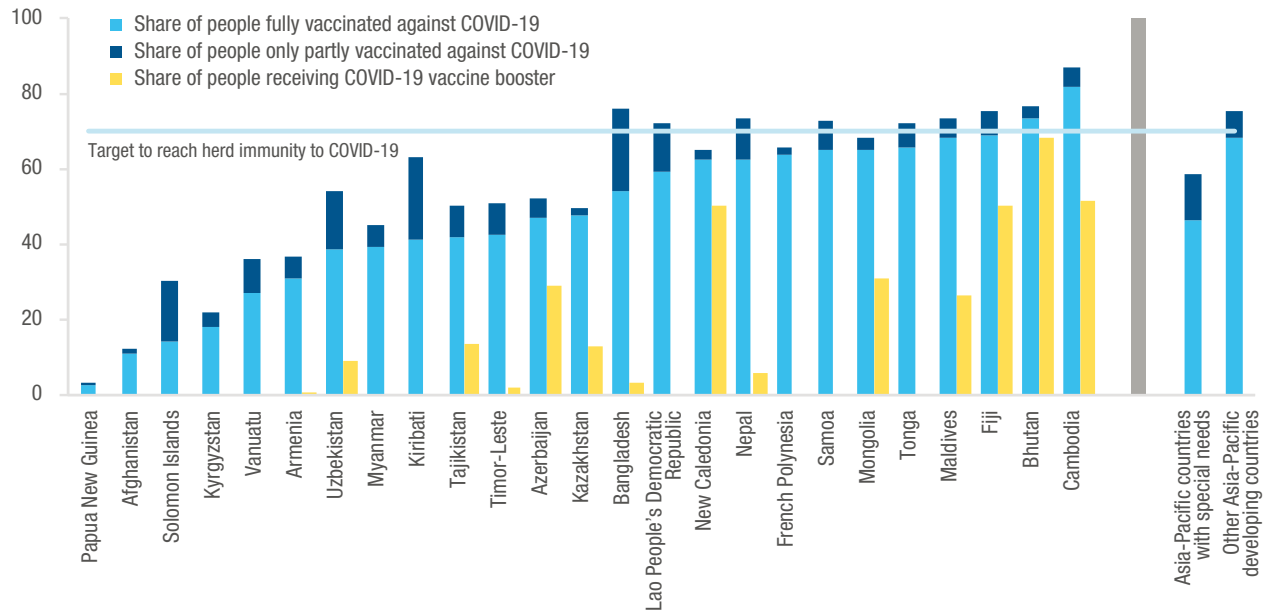
This chapter features the role of multilateralism and regional cooperation and solidarity in enabling accelerated actions in certain priority areas discussed in chapters 1 and 2. In addition, the role of ESCAP in complementing countries' efforts to scale up financial resources to overcome the crisis and steer the recovery towards a sustainable one is presented.

## **Strengthening global vaccination programmes to reduce the immediate funding gap**

As the COVID-19 infections continue to spiral with unprecedented health and socioeconomic consequences, the only way out of the pandemic is to ensure vaccine equity and that 70 per cent of the population of every country is vaccinated by the middle of 2022 (WHO, 2021). Although immunization is under way throughout the world, progress in this regard has been uneven. As of 17 March 2022, only 14 per cent of the population in low-income countries had received at least one dose of vaccines, compared to 78.8 and 80.7 per cent of the population in high-income and upper-middle-income countries, respectively (Our World in Data, 2022). In Asia and the Pacific, approximately 46 per cent of the population in countries with special needs were fully vaccinated as of 17 March 2022, compared to 68 per cent in other developing Asia-Pacific countries (see figure 4-1). Even among the countries with special needs, progress has been uneven; more than 70 per cent of the population is fully vaccinated in Bhutan and Cambodia, compared to less than 20 per cent in Afghanistan, Kyrgyzstan, Papua New Guinea and Solomon Islands. Similarly, more than 50 per cent of the population in Bhutan, Cambodia and Fiji have received vaccine boosters, while less than 5 per cent of the population in several other countries with special needs have received them. The inequality in access to vaccines among countries has undermined the ability to build global immunity and created loopholes for the viruses to flourish and mutate into more contagious and deadly variants, that has led to new waves of infections and fatalities and set back the recovery of the economic activities.



**Figure 4-1:** Share of population having received partial and full COVID-19 vaccination and booster, as of 17 March 2022



Source: ESCAP based on Our World in Data, ourworldindata.org (accessed on 17 March 2022)

Notes: WHO (2021) set a target of 70 per cent COVID-19 vaccination coverage in all economies as a global imperative to reach herd immunity to COVID-19. Data on the share of the population having received COVID-19 vaccine booster are not available for many economies, such as Afghanistan, French Polynesia, Kiribati, Kyrgyzstan, the Lao People's Democratic Republic, Myanmar, Papua New Guinea, Samoa, Solomon Islands, Tonga and Vanuatu.

Despite high interest and demand for vaccines, developing countries face significant challenges to access them to safeguard lives, and, as mentioned previously, revival of their economies remains a great challenge. This is partly due to fiscal and financial constraints, including the need to continue to service debts and the rise of vaccine nationalism in which developed countries stock up vaccines for domestic use as much as enough to give them to their population several times. As of 12 October 2021, high-income countries representing approximately 16 per cent of the global population had received almost half (48.6 per cent) of the world's COVID-19 vaccine supply, while low-income countries, representing 8 per cent of the global population, had received only 1 per cent of the total supply (Malpani and Maitland, 2021). Developed countries were also more

likely to pay higher average prices per dose than developing countries (OECD, 2021a). Accordingly, developing countries have encountered difficulties in attaining a critical number of vaccines for their vulnerable citizens, and must rely on multilateral initiatives to achieve immunity targets.

The COVAX initiative was launched in April 2020 by the Coalition for Epidemic Preparedness Innovations, the Global Alliance for Vaccines and Immunisation and the World Health Organisation (WHO), with the objective to expedite the development and manufacturing of COVID-19 vaccines and ensure fair and equitable access to every country. It raises funds from various sources to purchase sufficient vaccines for 92 low- and middle-income countries under the COVAX Advance Market Commitment scheme.<sup>30</sup> Many countries

<sup>30</sup> The COVAX Advance Market Commitment is an innovative financing mechanism used to secure COVID-19 vaccines from manufacturers for 92 ODA-eligible countries. It functions by guaranteeing the vaccine manufacturers with a commitment to purchase a large quantity of vaccines and then uses donor funds to purchase and distribute them to low- and middle-income countries at a reduced price per dose. This commitment addresses the issues of market failure driven by the perception of inadequate demand and market uncertainty in those countries and thus, incentivizes the vaccine producers to develop and expand their production capacity. See Berkley, Seth (n.d.).

with special needs in Asia and the Pacific are eligible to receive vaccines under the initiative,<sup>31</sup> but the pace of COVAX roll-out programmes has been slow. The initiative had targeted to deliver 170 million doses by 31 May 2021, but it distributed only 76 million doses. In July 2021, the target was set to deliver 2.2 billion doses by January 2022, and then later reset to 1.2 billion doses by December 2021 (Loft, 2022). Total delivery by the programme reached one billion doses in early January 2022 (Msirikale, 2022). The slower-than-expected progress is mainly due to underfunding, poor logistic infrastructure and lack of refrigeration facilities, and vaccine nationalism and hoarding (OECD, 2021a).

The Secretary-General, at the seventy-fifth General Assembly session in September 2021, called for joint collaboration between vaccine producers and relevant development partners to implement an immediate global vaccination plan to at least double vaccine production and ensure that vaccines reach the immunization target in all countries in the first half of 2022 (United Nations, 2021).

Vaccinating 70 per cent of the total population in low- and middle- income countries globally requires total financing of approximately \$55 billion, based on a combined procurement and programmatic delivery cost of \$10 per dose (WHO, n.d.b.). Considering the vaccination status as of 16 November 2021 and the number of the vaccines secured by the financing support already confirmed through COVAX and multilateral and bilateral donors' contracts, UNICEF (2022) estimates the remaining financing gap is between \$1.3 billion and \$6.9 billion for low and middle-income countries. This would need to be addressed either through further external financing support or by government self-financing.<sup>32</sup> Broken down by country, the size of financing gaps varies. The gaps may be less than 5 per cent of the general government health expenditure in many countries, including, among them, Armenia, Azerbaijan, Bangladesh, Kazakhstan, Kyrgyzstan, Nepal, Solomon Islands, Timor-Leste, Turkmenistan and Uzbekistan, close to or more than 10 per cent in, for example, Kiribati, Marshall Islands, Micronesia (Federated States of), and Myanmar, or reach nearly half of the government health expenditures in Afghanistan. Relying on government self-financing adds a significant fiscal burden, particularly for countries required to scale up their health budgets by more than 10 per cent in a short time to achieve the immunity target by 2022.

To this end, global and regional cooperation is urgently needed to strengthen the global vaccination programmes, including COVAX, as the most prominent solution to attain fair and equitable access to vaccines. Further support and

commitment are needed from the international community, in particular, developed countries, to secure or expand vaccine funding and sharing to the programmes (WHO, n.d.a). Countries that have excess stocks of vaccines should donate to countries with the greatest need, and while doing so, ensure that the unearmarked vaccines are supplied in sufficient and predictable quantities with an adequate shelf life. This will accelerate progress in reaching herd immunity, lessen the fiscal pressure of governments in countries with special needs and allow them to allocate their limited resources towards a sustainable recovery and attainment of the SDGs.

## Fostering cooperation to address international taxation challenges

Emerging challenges related to taxation, including transboundary ones, require stronger global and regional cooperation. New business models and the changing global economic landscape are making traditional taxation models based on territory and tangible assets more challenging. The rise of the digital economy, illicit financial flows, profit shifting by multinational firms, offshore evasion by wealthy individual, and a race across economies to offer tax benefits to attract foreign investment are some of the driving forces. These factors create the need for countries to cooperate to combat tax evasion and harmful tax competition and eliminate legal but harmful tax practices.

At the global level, the United Nations and OECD lead efforts to promote international tax cooperation and coordination (ESCAP, 2019c). At its annual special meeting on international cooperation in tax matters, the United Nations system, through the Economic and Social Council, along with the Committee of Experts on International Cooperation in Tax Matters provide international platforms for discussion, reviewing progress made towards international tax cooperation, building international consensus over tax matters, setting norms and standards for international taxation, and supporting technical assistance and capacity-building on taxation issues. Through its universal membership and commitment to leaving no one behind, the United Nations system gives special attention to addressing the issues and priority needs of the developing countries related to international taxation. One of the Committee's main norm-setting works is to review and update the United Nations Model Double Taxation Convention and the *Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries* to avoid double taxation of profits to encourage investment flows to developing countries (ESCAP, 2019c).

31 Afghanistan, Bangladesh, Bhutan, Cambodia, Democratic People's Republic of Korea, Fiji, Kiribati, Kyrgyzstan, the Lao People's Democratic Republic, Micronesia (Federated States of), Maldives, Marshall Islands, Mongolia, Myanmar, Nepal, Papua New Guinea, Solomon Islands, Marshall Islands, Samoa, Timor-Leste, Tajikistan, Tonga, Tuvalu, Uzbekistan and, Vanuatu

32 The gaps differ depending on assumed scenarios regarding varying human resource surge recruitment, namely the number of additional staff required to be recruited to meet the surge in needs, and the strategy for vaccine delivery, which are particularly sensitive to the cost analysis.

The Organisation for Economic Co-operation and Development runs two multilateral initiatives. One is the Inclusive Framework on the Base Erosion and Profit Shifting (BEPS) Project, which consists of a two-pillar blueprint<sup>33</sup> to provide standards and rules for countries to deal with corporate tax avoidance and tax challenges related the digitalization and to strengthen the coherence of international tax rules (OECD, n.d.). The other is the Global Forum of Transparency and Exchange of Information for Tax Purposes, which serves as a multilateral body to promote common standards for tax transparency and effective exchange of information for tax purposes (OECD, 2017). While these two initiatives have potentially significant implications for the Asia-Pacific countries with special needs, as of November 2021, only eight of them (Armenia, Cook Islands, Kazakhstan, Maldives, Mongolia, Papua New Guinea, Samoa and Singapore) are members of the Inclusive Framework, and 15 countries with special needs (Armenia, Azerbaijan, Cambodia, Cook Islands, Kazakhstan, Maldives, Marshall Islands, Mongolia, Nauru, Niue, Palau, Papua New Guinea, Samoa, Singapore and Vanuatu) are members of the Global Forum. The complexity of the new rules and standards coupled with institutional and capacity constraints and incompatibility to developing countries' context will likely impose significant burdens and impede their participation. Some countries, especially countries with

special needs, need technical assistance to join and benefit from these initiatives.

In Asia and the Pacific, tax cooperation platforms are mostly subregional (see table 4-1). However, the coverage of membership and areas of strategic policy discussion and reforms remain limited (ADB, n.d.). The platforms, in addition, differ substantially in institutional capacity and maturity, are inadequately funded, and have limited cross-platform dialogue and interaction (ESCAP, 2019d). The region-wide tax cooperation only came about recently, when the Asian Development Bank (ADB) launched the Asian Tax Hub in May 2021 with the objective to foster policy dialogue, exchange of knowledge and best practices, capacity-building and development coordination among its member countries and development partners on issues related to international tax cooperation and domestic resource mobilization (ADB, n.d.). The presence of regional cooperation platforms, such as the Asian Tax Hub, is critical to increase the voice of the region on global platforms, enhance cooperation among existing subregional tax bodies, scale up international tax cooperation and promote consensus building. It can also promote strong institutional reforms and harmonization of appropriate tax policies and practices, including for multinational enterprises reporting and advancement towards region-wide automatic exchange of tax information among tax authorities, as appropriate.

**Table 4-1:** Global, regional and subregional cooperation initiatives and platforms on taxation and memberships of countries with special needs

| Global cooperation  | Regional and subregional cooperation  |
|---|---|
| <p><b>United Nations Committee of Experts on International Cooperation in Tax Matters</b><sup>34</sup> (established in 2004)</p> <p>193 United Nations member countries, including all countries with special needs.</p>  | <p><b>Asian Tax Hub</b> (established in 2021)</p> <p>68 ADB member countries, including 32 countries with special needs: Afghanistan; Armenia; Azerbaijan; Bangladesh; Bhutan; Cambodia; Cook Islands; Federated States of Micronesia; Fiji; Kazakhstan; Kiribati; Kyrgyzstan; Lao People's Democratic Republic; Maldives; Marshall Islands; Mongolia; Myanmar; Nauru; Nepal; Niue; Palau; Papua New Guinea; Samoa; Singapore; Solomon Islands; Tajikistan; Timor-Leste; Tonga; Turkmenistan; Tuvalu; Uzbekistan; and Vanuatu.</p> <p><b>Study Group on Asian Tax Administration and Research</b> (established in 1970)</p> <p>17 member countries, including four countries with special needs: Cambodia; Mongolia; Papua New Guinea; and Singapore.</p> <p><b>Pacific Islands Tax Administrators Association</b> (established in 2003)</p> <p>16 member countries, including 15 countries with special needs: Cook Islands; Marshall Islands; Federated States of Micronesia; Fiji; Kiribati; Nauru; Niue; Palau; Papua New Guinea; Samoa; Solomon Islands; Tonga; Timor-Leste; Tuvalu and Vanuatu.</p> |
| <p><b>The OECD Inclusive Framework on the Base Erosion and Profit Shifting (BEPS)</b> (established in 2016)</p> <p>141 member countries, including eight countries with special needs: Armenia; Cook Islands; Kazakhstan; Maldives; Mongolia; Papua New Guinea; Samoa and Singapore</p>   |   |
| <p><b>The OECD Global Forum of Transparency and Exchange of Information for Tax Purposes</b> (established in 2000)</p> <p>163 member countries, including 15 countries with special needs: Armenia; Azerbaijan; Cambodia; Cook Islands; Kazakhstan; Maldives; Marshall Islands; Mongolia; Nauru; Niue; Palau; Papua New Guinea; Samoa; Singapore and Vanuatu.</p> |   |

33 Pillar One aims at adapting the international income tax system to new business models, including the digital models, giving market jurisdictions additional taxing rights over the residual profits of the world's largest and most profitable multinational companies. Pillar Two aims at preventing tax competition by which jurisdictions try to attract FDI through reduced or often zero taxation. It introduces a global minimum tax of 15 per cent on the foreign source income of large multinationals.

34 It was initially called the Ad Hoc Group of Experts on Tax Treaties between Developed and Developing Countries, established in 1968 pursuant to the Economic and Social Council resolution 1273 (XLIII) of 4 August 1967. In 1980, the Economic and Social Council gave a broad title to the Group, namely, "Ad Hoc Group of Experts on International Cooperation in Tax Matters." The mandate of the Group of Experts has been broadened gradually, and in 2004, the Economic and Social Council renamed it the Group the Committee of Experts on International Cooperation in Tax Matters.

| Global cooperation | Regional and subregional cooperation  |
|--------------------|---|
|                    | <p><b>ASEAN Forum on Taxation</b> (established in 2011)</p> <p>10 member countries, including three countries with special needs: Cambodia; Lao People's Democratic Republic; and Myanmar.</p> <p><b>Belt and Road Initiative Tax Administration Cooperation Mechanism</b> (established in 2019)</p> <p>20 member countries and 23 observer countries, including five countries with special needs: Afghanistan; Bangladesh; Cambodia; Kazakhstan and Mongolia, and four countries with special needs as observers: Armenia; Myanmar; Singapore and Timor-Leste.</p> <p><b>Initiative under the South Asian Association for Regional Cooperation (SAARC)</b> (established in 1985)</p> <p>Eight member countries, including five countries with special needs: Afghanistan; Bangladesh; Bhutan; Maldives; and Nepal.</p> <p><b>Initiative under the Eurasian Economic Commission</b> (established in 2012)</p> <p>Five member countries, including three countries with special needs Armenia; Kazakhstan and Kyrgyzstan.</p> |

Sources: United Nations, Department of Economic and Social Affairs, Committee of Experts on International Cooperation in Tax Matters: Terms of reference ([un.org/esa/ffd/tax-committee/about-committee-tax-experts.html](http://un.org/esa/ffd/tax-committee/about-committee-tax-experts.html) (accessed on 12 January 2022)); OECD, Inclusive Framework on the Base Erosion and Profit Shifting (BEPS) ([oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf](http://oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf)); OECD, Global Forum of Transparency and Exchange of Information for Tax Purpose ([oecd.org/tax/transparency/who-we-are/members](http://oecd.org/tax/transparency/who-we-are/members) (accessed on 12 January 2022)); SGATAR, Study Group on Asian Tax Administration and Research ([sgatar.org/public/about](http://sgatar.org/public/about) (accessed on 12 January 2022)); PITAA, Pacific Islands Tax Administrators Association ([nto.tax/sites/default/files/resources/PITAA%20Factsheet.pdf](http://nto.tax/sites/default/files/resources/PITAA%20Factsheet.pdf)); BRITACOM, Belt and Road Initiative Tax Administration Cooperation Mechanism ([britacom.org/xw\\_7086/jzdt/202109/W020210909811337559442.pdf](http://britacom.org/xw_7086/jzdt/202109/W020210909811337559442.pdf)); SAARC, South Asian Association for Regional Cooperation ([saarc-sec.org/index.php/about-saarc/about-saarc](http://saarc-sec.org/index.php/about-saarc/about-saarc) (accessed on 12 January 2022)); EEC, Eurasian Economic Commission ([eurasiancommission.org/en/Pages/about.aspx](http://eurasiancommission.org/en/Pages/about.aspx) (accessed on 12 January 2022)).

For countries with special needs, participating in regional platforms may be beneficial. It could increase their representation in global and regional tax cooperation platforms, allowing them to extend their positions, voice their concerns and protect their interest in the negotiation or reform process (ESCAP, 2019c). These countries can use the opportunities to learn from more advanced countries or their regional peers of good practices on tax policy and institutional reforms and benefit from shared information. At the same time, access to offshore information through tax information exchange at the regional level enables them to identify and timely address tax avoidance and evasion and illicit financing flows, including corruption and money laundering.

It is of paramount importance that the international community, including the United Nations and other international organizations, encourage countries with special needs and other developing countries to participate more actively in global and regional cooperation, particularly by ensuring that their membership is on equal footing and benefits are inclusive and outweigh potential risks. Upon their participation, the international community needs to provide regular capacity-building and technical advisory support to enable these countries to effectively leverage cooperation

frameworks and platforms to accelerate domestic tax system development and reform. The capacity support should not be limited to awareness-raising or dissemination of international rules and standards, but should also address the country-specific priorities and challenges in legal, institutional and administrative capacities and reduce any possible adverse shocks that can arise from the introduction of international tax reforms and new complex rules and standards (ESCAP, 2021h).

## Renewing efforts to meet the official development assistance commitments

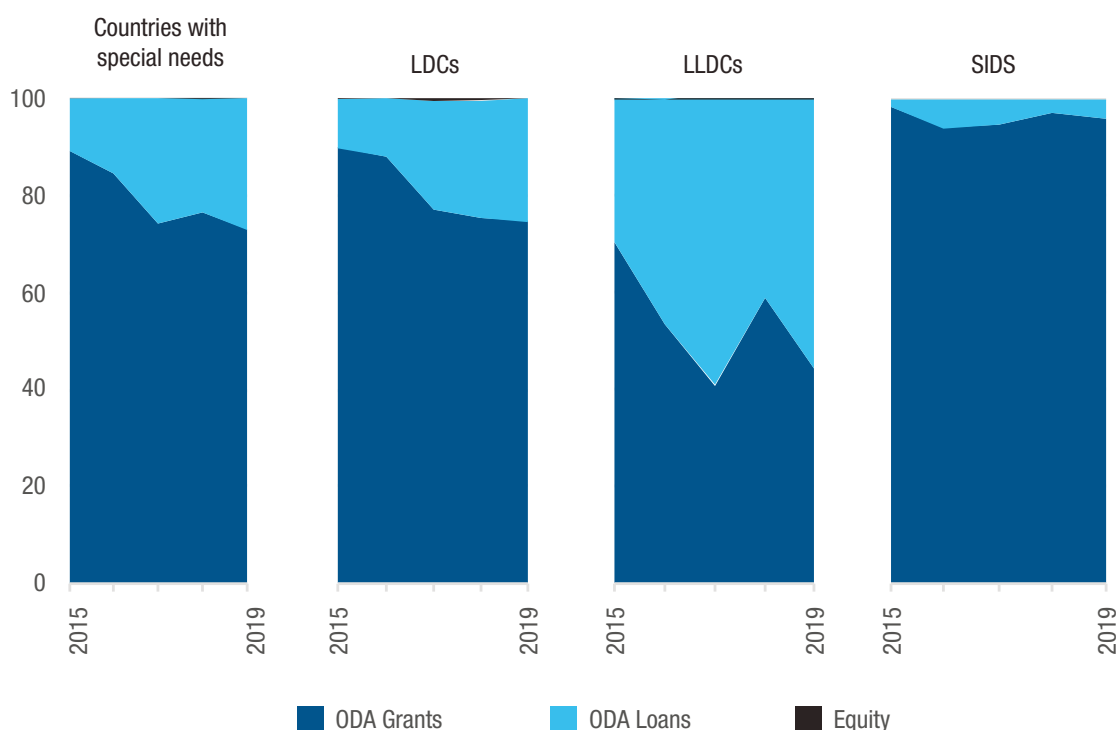
As the demand for ODA is greater for poorer and more vulnerable countries, including countries with special needs, in the context of the COVID-19 pandemic, the international community can be a supportive force to protect and expand the level of ODA budgets. The overall level of ODA has been well below the target of 0.7 per cent of GNI as reiterated in the 2015 Addis Abba Action Agenda. Globally, ODA dedicated to LDCs in 2019 represented only 0.06 per cent of Development Assistance Committee countries' GNI, which was below the 0.15-0.20 per cent commitment for LDCs. Average ODA to LDCs, LLDCs and SIDSs also

declined by 6.7, 5.6 and 14.1 per cent, respectively, from the 2010–2014 period to the 2015–2019 period.<sup>35</sup> ODA to Asia-Pacific LDCs and SIDS, on average, also decreased by 14.7 and 8.7 per cent, respectively, during the same period, while that to Asia-Pacific LLDCs increased by 10.9 per cent, albeit from a relatively low base. Although developed countries, including Development Assistance Committee member countries, were committed to continuing ODA during the pandemic, the target will not be met.

Grants represent the largest share of ODA in Asia Pacific countries with special needs, especially in LDC and SIDS, accounting for approximately 75 per cent and 96 per cent in 2019, respectively. However, the trend indicates that the share of grants for LDCs and LLDCs has been declining

since 2015 (see figure 4-2). This is being substituted by ODA loans. Although the ODA loans provided to LDCs are expected to have high concessionality, OECD reported that the terms of loans to LDCs globally have hardened since 2015, as the interest rates have increased from an average of 0.34 per cent in 2015 to 0.8 per cent in 2018 and the maturity of the loans have decreased from 35.7 years to 28.3 years over the same period (OECD, 2021). This highlights the need to encourage the Development Assistance Committee members and other development partners to strengthen their ODA commitment and reverse the declining share of grants and concessional loans for countries with special needs, especially as these countries are facing tighter fiscal space and looming risks of debt distress as a result of the COVID-19 (United Nations, 2020).

**Figure 4-2:** Gross official development assistance disbursements by Development Assistance Committee countries by instruments to countries with special needs in Asia and the Pacific, 2015–2019 (percentage of total)



Source: OECD, DAC Data: Aid (ODA) disbursements to countries and regions (stats.oecd.org/viewhtml.aspx?datasetcode=TABLE2A&lang=en (accessed on 27 January 2022)).

The international community can also support countries with special needs in aligning ODA with their national priorities, targeting pressing public health issues and social protection needs for the most vulnerable, and reversing the increasing trends of poverty and inequality observed during the pandemic. This can be done, for example, by strengthening and expanding general budget support to

countries with special needs, which can be an effective modality in development finance when combined with improved accountability, transparency and robust monitoring mechanisms in recipient countries (Pacific Islands Forum Secretariat, 2021). Support can also be channelled towards strengthening the linkage between planning and budgeting to enhance allocative efficiency.

<sup>35</sup> ESCAP calculations based on data from OECD, Development Assistance Committee Data: Aid (ODA) disbursements to countries and regions. Available at <https://stats.oecd.org/viewhtml.aspx?datasetcode=TABLE2A&lang=en>. Accessed on 27 January 2022.

Particular attention should also be given to migrants and their families, who are often overlooked and excluded from the benefits and access to social, economic and civil rights, but contribute significantly to productivity, knowledge and innovation in countries of destination and support poverty reduction and economic activities in countries of origin through their remittances (ESCAP, 2020b). In this respect, there is need for strengthened global and regional actions to ensure safe, orderly and regular migration involving full respect for human and labour rights, free from any form of discrimination, abuse and exploitation.<sup>36</sup>

## Addressing immediate debt vulnerabilities and restoring long-term debt sustainability

A number of global initiatives and regional solutions to address debt risks have emerged since the onset of the COVID-19 pandemic. One prominent example is the G20 Debt Service Suspension Initiative, launched in April 2020 to temporarily suspend official debt service payments by eligible countries and thus reduce their fiscal pressures during the difficult time. The initiative initially allowed for a debt service standstill until end-2020, which was extended twice to mid-2021 and further to end-2021. As of December 2021, 48 countries out of 73 eligible countries had requested suspension of their official bilateral debts through this window. But participation remains low among Asia-Pacific countries with special needs, with only 10 countries, namely, Afghanistan, Fiji, Kyrgyzstan, Maldives, Myanmar, Nepal, Papua New Guinea, Samoa, Tajikistan, and Tonga, having requested a suspension.

**Table 4-2:** Potential Savings from the Debt Service Suspension Initiative for Asia-Pacific countries with special needs, May 2020–December 2021

| Country                          | Participation | Risk of external debt distress | Potential Debt Service Suspension Initiative savings (May–Dec 2020) |              | Potential Debt Service Suspension Initiative savings (Jan– Dec 2021) |              | Percentage of official bilateral debt service due out of total external debt service due (Jan-Dec 2021) |
|----------------------------------|---------------|--------------------------------|---|--------------|--|--------------|---|
|                                  |               |                                | Percentage of GDP   | USD millions | Percentage of GDP  | USD millions |   |
| Afghanistan                      | Yes           | High                           | 0.2   | 39.3         | 0.4  | 72.9         | 55.3  |
| Bangladesh                       | No            | Low                            | 0.1   | 331.9        | 0.2  | 615.4        | 26.4  |
| Bhutan                           | No            | Moderate                       | 5.8   | 145.4        | 5.7  | 143.7        | 77.4  |
| Cambodia                         | No            | Low                            | 0.8   | 219.2        | 1.4  | 378.4        | 74.8  |
| Fiji                             | Yes           | ...                            | 0.2   | 13.4         | 0.5  | 29.6         | 57.6  |
| Kyrgyzstan                       | Yes           | Moderate                       | 0.6   | 52.1         | 1.3  | 117.7        | 46.8  |
| Lao People's Democratic Republic | No            | High                           | 1.7   | 315.0        | 3.4  | 619.3        | 62.0  |
| Maldives                         | Yes           | High                           | 0.9   | 50.7         | 4.1  | 228.7        | 60.5  |
| Mongolia                         | No            | ...                            | 0.5   | 69.9         | 1.0  | 134.2        | 12.0  |
| Myanmar                          | Yes           | Low                            | 0.6   | 379.9        | 1.0  | 793.7        | 86.9  |
| Nepal                            | Yes           | Low                            | 0.1   | 24.8         | 0.1  | 51.2         | 16.8  |
| Papua New Guinea                 | Yes           | High                           | 1.3   | 326.9        | 0.3  | 72.9         | 20.0  |
| Samoa                            | Yes           | High                           | 1.1   | 9.5          | 2.1  | 18.0         | 55.0  |
| Solomon Islands                  | No            | Moderate                       | 0.1   | 1.5          | 0.1  | 1.5          | 18.9  |
| Tajikistan                       | Yes           | High                           | 0.8   | 63.8         | 1.3  | 104.1        | 46.0  |
| Tonga                            | Yes           | High                           | 1.2   | 6.3          | 2.8  | 14.3         | 79.7  |
| Uzbekistan                       | No            | Low                            | 0.4   | 257.3        | 0.9  | 525.9        | 43.3  |
| Vanuatu                          | No            | Moderate                       | 0.7   | 6.2          | 1.4  | 13.0         | 63.1  |

Source: World Bank, COVID-19: Debt Service Suspension Initiative, December 2021 ([worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative](https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative) (accessed on 12 January 2022)).

<sup>36</sup> In 2018, the so-called Global Compact for Safe, Orderly and Regular Migration was endorsed as the first intergovernmentally adopted framework, prepared under the auspices of the United Nations, covering all dimensions of international migration in a holistic and comprehensive manner. In parallel, the United Nations established the United Nations Network on Migration to ensure effective, timely and coordinated United Nations system-wide support to its member States in the implementation, follow-up and review of the Global Compact. Drawing on the global network, the regional United Nations Network on Migration for Asia and the Pacific, in which ESCAP is one of the executive members, was established to promote migration policies that support the well-being and realization of the human rights of migrants and their communities and support the implementation and review at the regional level. The first regional review and appraisal was held in 2021 for member States to discuss the progress, challenges, opportunities and ways forward for successful implementation.

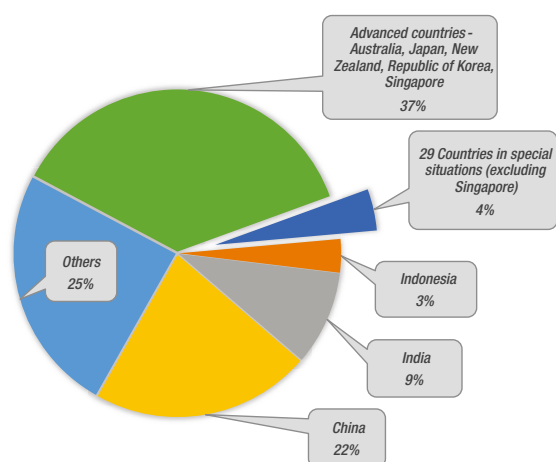
While the initiative intends to provide a degree of breathing space, the amount of actual relief covers only bilateral official debt, and not every bilateral creditor offers equal terms. Multilateral creditors are not included in the initiative, while private creditors are only invited to participate on a voluntary basis. Table 4-2 indicates that the potential savings between May 2020 and December 2021 for countries with special needs participating in the Debt Service Suspension Initiative may be less than 1 per cent of GDP for some countries, such as Afghanistan, Bangladesh, Fiji, Nepal and Solomon Islands. The share of official bilateral debt service due in 2021 accounted for less than 20 per cent of the total official debt service due for Mongolia, Nepal and Solomon Islands, and for less than 30 per cent for Bangladesh and Papua New Guinea. Moreover, some countries are reluctant to participate over concerns that their participation may lead to market misperception of a potential default on their private debt and trigger a downgrade of their sovereign credit ratings (OECD, 2020c) and the need for full disclosure of all public sector debt obligations (except commercially sensitive information) (World Bank, 2020a).

Beyond the Debt Service Suspension Initiative, G20 and Paris Club countries have endorsed the Common Framework for Debt Treatments to provide a coordination and cooperation framework among participating creditor countries for the provision of debt relief to Common Framework for Debt Treatments eligible countries on a case-by-case basis. The Framework also brought in new official creditors to participate in the process and required private creditors to provide comparable debt relief. However, as of February 2021, no Asia-Pacific country has expressed interest in participating in the Framework. Globally, three

countries, namely Chad, Ethiopia and Zambia, requested for the debt treatment more than a year ago, but none of them have completed the process or received any temporary debt service suspension in the interim. This long-drawn out process, mainly due to challenges in coordination not only among creditors and multiple government institutions within creditor countries, but also with the private sector, has created potential uncertainty over future debt positions in debtor countries that may hamper their access to financial markets and discourage other countries to participate in the Framework (Ahmed and Brown, 2022).

At the same time, in response to the COVID-19 pandemic, the International Monetary Fund (IMF) has launched its historically largest allocation of special drawing rights (SDRs), the Fund's international reserve assets, totalling SDR 456 billion (equivalent to \$650 billion), to its members to boost global liquidity and assist developing countries in addressing external debt service payments (IMF, 2021a). Irrespective of countries' actual financial needs, SDRs are allocated to countries in proportion to their existing membership quotas.<sup>37</sup> The current quota allocation formula, however, could result in countries with strong financing needs receiving small shares of the SDR funding. Specifically, Figure 4-3 suggests that out of approximately \$133 billion allocated to 48 Asia-Pacific countries that are members of IMF, only \$5.5 billion, or 4 per cent of the total amount is accessible by countries with special needs as a whole. Five high-income countries with strong external positions, namely, Australia, Japan, New Zealand, Republic of Korea and Singapore, receive approximately 37 per cent, while large economies, such as China and India receive 22 and 9 per cent, respectively.

Figure 4-3: Allocation of the International Monetary Fund special drawing rights in 2021, percentage



| Country in Special Situations    | SDR Allocation (in millions) | Country in Special Situations | SDR Allocation (in millions) |
|----------------------------------|------------------------------|-------------------------------|------------------------------|
| Afghanistan                      | 310.3                        | Mongolia                      | 69.3                         |
| Armenia                          | 123.4                        | Myanmar                       | 495.3                        |
| Azerbaijan                       | 375.4                        | Nauru                         | 2.7                          |
| Bangladesh                       | 1 022.3                      | Nepal                         | 150.4                        |
| Bhutan                           | 19.6                         | Palau                         | 4.7                          |
| Cambodia                         | 167.7                        | Papua New Guinea              | 252.3                        |
| Fiji                             | 94.3                         | Samoa                         | 15.5                         |
| Kazakhstan                       | 1 110.3                      | Solomon Islands               | 19.9                         |
| Kiribati                         | 10.7                         | Tajikistan                    | 166.8                        |
| Kyrgyzstan                       | 170.2                        | Timor-Leste                   | 24.5                         |
| Lao People's Democratic Republic | 101.4                        | Tonga                         | 13.2                         |
| Maldives                         | 20.3                         | Turkmenistan                  | 228.7                        |
| Marshall Islands                 | 4.7                          | Tuvalu                        | 2.4                          |
| Micronesia, Federated States of  | 6.9                          | Uzbekistan                    | 528.3                        |
|                                  |                              | Vanuatu                       | 22.8                         |

Source: ESCAP based on IMF (2021c).

37 The current IMF quota was formulated as a weighted average of GDP (50 per cent weighted), openness (30 per cent), economic variability (15 per cent), and international reserve (5 per cent). The quota determines the members' financial commitment to IMF, their voting rights and access to the Fund's financial resources. For more details, see IMF (2021b).

Debt suspension initiatives following the outbreak of COVID-19 help, to some extent, cushion the governments' fiscal pressures amid wider fiscal deficits and higher debt levels. Greater participation from countries with special needs will ensure that they are not excluded from any benefit that can be obtained from such initiatives. Although debt suspension programmes, such as the Debt Service Suspension Initiative, are attached with conditionalities,<sup>38</sup> countries with special needs should take those conditionalities as opportunities for necessary reform and improvement of debt management, and leverage support from the international community for those purposes. It is indicated that the Debt Service Suspension Initiative helps participating countries improve transparency of external debt and, through new piloted methodologies of IMF and the World Bank, savings from suspended debt payments are used for SDG-related expenditure (OECD, 2020c).

As the Debt Service Suspension Initiative ended at the end of 2021, the participating countries are starting again to pay the debt services and these payments will increase over time as a result of newly accumulated debts over recent years. As such, there is need to explore new, additional options and strategies that are more inclusive and comprehensive to address the debt challenges. For instance, any debt relief initiative should be designed for countries with debt distress and vulnerability to participate upon their request, independent of their per capita income. This will benefit some middle-income LLDCs and SIDS that were not eligible to participate in the Debt Service Suspension Initiative despite their financial vulnerabilities and unsustainable debt position. In addition, efforts to bring in multilateral and private creditors into the debt relief programmes may ensure that more resources can be freed up during times of crises, and that the freed-up resources from the relief programme can be safeguarded against the use for debt repayments of non-participating creditors.

In addition to debt suspension, the international community can join forces to develop well-designed debt relief programmes as part of the long-term solutions. For example, mixing temporary debt suspension with sovereign debt reprofiling and restructuring will not only reduce short-term debt pressures, but it will also induce long-term debt restructuring and sustainability (UNCTAD, 2020b). This is of particular relevance considering that the existing

mechanisms, including the expansion of lending facilities by multilateral institutions and bilateral donors, for developing countries to address the economic crisis do not provide long-term solutions, but create new debts for developing countries, despite being concessional in nature.

At the same time, relief packages should be designed to be used as a lever to promote a greener and more resilient growth path in developing countries (OECD, 2020b). The international community can actively encourage the greening of debts and employing of innovative instruments, such as debt-for-nature swaps, debt-for-climate swaps and SDG bonds.

Additional steps can be taken as part of the longer-term reforms or enhancement of the international debt architecture that favours countries with special needs. Specifically, the international community can help countries with special needs develop long-term debt sustainability analyses that systematically take into account risks related to SDGs and benefits of SDG-related investments in the medium and long terms (United Nations, 2021b). With the experience of the 2008 global financial crisis and significant impacts of COVID-19 pandemic on global economic activities, the international community needs to review the roles and possible reforms of credit rating agencies to ensure accurate ratings and information, which have critical implications for debt sustainability and the stability of the international financial system (United Nations, 2021b).

The Economic and Social Commission for Asia and the Pacific, in collaboration with the Pacific Islands Forum Secretariat, will host the Regional Debt Conference involving the Pacific SIDS, all relevant creditors and development partners in 2022, to discuss increased risks and vulnerabilities of debt distress resulting from the COVID-19 pandemic and climate-related disasters. The Conference will explore feasible options and strategies for debt relief and restructuring, including through innovative financing tools and mechanisms, such as the Pacific Resilience Facility,<sup>39</sup> debt for climate swaps and contingent disaster financing. It will also serve as a platform to facilitate greater negotiations, commitments and actions by all stakeholders at national and regional levels to mitigate debt and climate risks and support the post-pandemic sustainable recovery.

38 The Debt Service Suspension Initiative conditionalities include an active borrowing status with IMF (or a request for financing from IMF), the use of the temporarily freed-up resources for increased health and economic spending in response to the COVID-19 crisis, and full disclosure of all public sector debt obligations (with the exception of commercially sensitive information).

39 The Pacific Resilience Facility, which was endorsed for its establishment by the Pacific Islands Forum leaders in November 2021, is intended to be a self-sustaining, subregional led facility with a goal of \$1.5 billion to provide full-grant financing to the Pacific countries, targeting community-level projects, for reduction in climate and environment-related risks without any increase in debt.



## Meeting climate commitments and leveraging innovative climate and environment-related finance

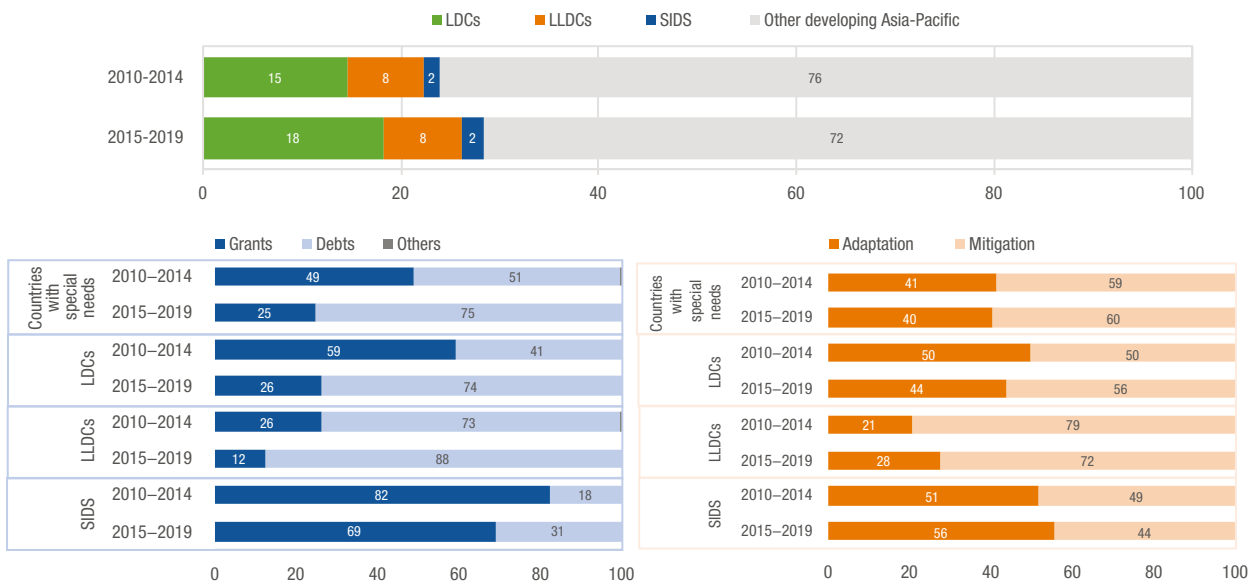
Even prior to the COVID-19 pandemic, it was clear that international cooperation efforts on climate, including international finance, needed to be scaled up significantly to support developing countries to implement more ambitious NDCs and the 2030 Agenda. The COVID-19 pandemic has elevated the urgency and challenges of mobilizing international finance for climate actions, as many countries face more challenging debt and financing situations, and priorities have shifted towards addressing health and economic impacts.

At the fifteenth session of the UNFCCC Conference of the Parties (COP15), held in 2009, developed countries pledged to scale up new and additional joint funding from various sources – private, public, bilateral and multilateral – with a goal to mobilize \$100 billion annually by 2020 to address needs of developing countries (UNFCCC, 2009). While some progress has been made with funding increasing gradually from 52.2 billion in 2013 to \$78.9 billion in 2018, the goal was not met. At the COP26 meeting in 2020, a number of

developed countries pledged additional funding with new and more ambitious targets for climate actions; however, even with new pledges, the \$100 billion promise would only be fulfilled in 2023 (United Kingdom, 2021). This calls for the developed countries to live up to their climate finance commitment and set more ambitious targets to scale up climate finance, which would be a key step towards greater accountability, trust and assurance to developing countries of necessary support.

There is a need to increase climate finance for countries with special needs, particularly the grant component, and for climate adaptation, to accelerate climate efforts and support recovery from the COVID-19 pandemic. Despite steady growth of climate finance to LDCs and SIDS over the past decade, the shares allocated to them were still low. LCDs, LLDCs and SIDS received, on average, 18, 8 and 2 per cent of the total climate flows in the region over the period 2015–2019, respectively (see figure 4-4). Delving into the components of the climate finance, LDCs and LLDCs received the largest share of the climate finance in the form of loans – 74 per cent for LDCs and 88 per cent for LLDCs over that period, while for SIDS, it was much less, at 31 per cent.

**Figure 4-4:** Climate-related development finance by country groups, instrument and purpose, Asia and the Pacific, 2010–2014 and 2015–2019 averages (percentage of total)



Source: ESCAP based on OECD, Climate Change: OECD DAC External Development Finance Statistics, 2021, [oecd.org/dac/financing-sustainable-development/development-finance-topics/climate-change.htm](https://oecd.org/dac/financing-sustainable-development/development-finance-topics/climate-change.htm) (accessed on 26 January 2022).

It should be noted that the share of the grant component has significantly declined for all groupings of countries with special needs. At the COP26 meeting, an agreement to increase the grant component of the governments' climate finance was reached, but details of that commitment were not provided. While financing climate adaptation is of essence for LDCs and SIDS, which are very susceptible to climate change, the amount allocated for climate adaptation was insufficient – 44 per cent for LDCs and 56 per cent for SIDS during the period 2015–2019 – and the share for LDCs declined over time.

Although meeting climate finance commitments by developed countries is critical for efforts to combat climate change, governments and the international community need to explore ways to mobilize financial resources from the private sector and through innovative financing strategies to advance the low-carbon transition.

Advocacy for the use of debt-for-climate swaps to increase climate financing has emerged, supported by mutual benefits it offers to developed and developing countries. As discussed in chapter 2, for developing countries, the swaps incentivize them to strengthen their NDC commitment and scale up investments in climate adaptation and decarbonization projects, while developed countries can use these swap schemes to partially fulfil their climate-related commitments under the Paris Agreement.

Although it seems that the swaps mainly involve the creditor and debtor countries taking main roles in negotiating the deals, the international community can be a key stakeholder, initiating discussion, supporting the negotiation and providing grants, technical assistance and capacity development to developing countries. One example is the support extended by the Nature Conservancy, an international environmental non-governmental organization (NGO), to pursue debt restructuring in exchange for environmental conservation in Seychelles. The organization spends \$20.2 million received from donations and private impact investors to purchase a proportion of the country's debts from the Paris Club at a discount rate and allows the Government to place its scheduled debt repayments, which is on instalment, in local currency, and at discount rate, into a trust fund, which is then used for environment conservation projects and the marine spatial planning process (Blythe and others, 2021). To support Pacific SIDS to fund climate projects, ESCAP and the Pacific Islands Forum Secretariat are jointly conducting a feasibility assessment of such swaps (ESCAP, 2021h). If found feasible, debt-for-climate swap instruments can be used as to complement direct capital injections by development partners and multilateral development banks for funding climate-related projects in the Pacific SIDS.

There has been a growing interest in and recognition of thematic bonds, including green bonds, SDG bonds and sustainability-linked bonds, as an innovative tool to finance climate adaptation, resilience and sustainable development. Many developing countries in the region have issued thematic bonds, particularly green bonds, to finance green infrastructure projects; however, only a few countries with special needs, namely Fiji, Kazakhstan and Uzbekistan, can take advantage of this financing instrument. Green bond issuance is still a largely untapped opportunity for many developing countries with special needs due to limited institutional and technical capacities, lack of legal, regulatory and policy frameworks and underdeveloped capital markets, as discussed in chapter 2.

The international community can provide technical support and institutional capacity for countries with special needs to develop the required legal, regulatory and policy frameworks for thematic bond issuance. Considering diversity and specificity among these countries, the technical and capacity support needs to be tailored to each country's specific priorities and context through feasibility studies and legal and policy advice at the national level. ESCAP has carried out various initiatives to enhance the capacities of countries with special needs on this front. For example, between 2017 and 2020, ESCAP worked with the United Nations Country Team to assist the Government of Bhutan to implement reforms and build the necessary infrastructure for a bond market, including establishing a bond working committee, rules and regulations for bond issuance, and relevant pre-issuance work. As a result, the Government issued its first sovereign bonds in 2020 to meet its financial needs to combat the COVID-19 pandemic (ESCAP, 2020d) (see also chapter 2). The country's successful sovereign bond issuance and established bond infrastructure will provide a concrete foundation for it to issue more green bonds. Building on this experience in technical assistance, ESCAP also supports other member States to issue and list green bonds.

As the engagement of the private sector and other stakeholders can accelerate the achievement of climate goals, concerted international and regional actions to foster this are needed. ESCAP partners with the private sector through its solid, long-established ESCAP Sustainable Business Network (see box 4-1). The Network is crafting an Asia-Pacific green business deal, which would leverage business innovation and ambition, emerging technologies and new industries in search of a "green" competitive advantage, and develop key principles and actions for inclusive partnership between government, private sectors and communities (ESCAP, n.d.).

## Box 4-1

### ESCAP Sustainable Business Network

The ESCAP Sustainable Business Network is a regional platform for convening companies and relevant private sector actors to work together to scale up business ambition and action to accelerate the achievement of the 2030 Agenda and associated sustainable development frameworks in the Asian and Pacific region. Members of the Network consist of business leaders, representatives from small and medium enterprises and heads of sustainability from companies with substantial operations in the “Asia-Pacific” region.

The work of the Network is led by an executive council, and its activities and initiatives are carried out through designated taskforces and joint activities to enable adoption and practice of inclusive, resilient and sustainable development policies and approaches. The Network has five dedicated taskforces covering (1) sustainable and inclusive finance, (2) digital economy, (3) disaster and climate risk reduction, (4) green economy and (5) youth and women entrepreneurship.

The ESCAP Sustainable Business Network is also the co-organizer of the Asia Pacific Business Forum, a public-private sector regional dialogue and networking event that engages businesses committed to sustainable development across Asia and the Pacific. Since its inception in 2004, the Forum, held annually, has provided a platform to discuss the role and responsibilities of business in sustainable development and to showcase the sustainable solutions that business can offer in a variety of sectors to meet the development needs of Asia and the Pacific. The multi-stakeholder setting of the

Forum has enabled engagement between policymakers, business representatives, international agencies, civil society organizations and academics.

In 2020, Network members put forward the concept of the Asia-Pacific Green Deal with the aim of advocating business action and innovation in the transition to low-carbon, sustainable and climate resilient pathways.

Recognizing that sustainable development requires action by governments, businesses and society, the Green Deal proposes to call on businesses in the Asia-Pacific region to commit to business innovation and ambition to transition to a green economy. The Green Deal has proposed five business actions to pursue, as follows:

1. Advancing a zero-carbon, affordable and resilient energy system;
2. Building smart, low-carbon, water-secure and climate-resilient cities, infrastructure and mobility;
3. Mobilizing public and private finance for green transformation;
4. Accelerating and scaling up innovations for sustainable development;
5. Changing towards a more circular economy.

The Asia Pacific Green Deal declaration is currently being refined by the Network and representatives from the business community and is expected to be tabled for adoption at the Asia-Pacific Business Forum in 2022. Once adopted, businesses in the region will be called on to pledge their support and to rally action across the five business actions.

There are growing interest and pressure from the regulators as well as investors and financial institutions to integrate ESG factors into asset allocation and risk decisions in the Asia-Pacific region. Governments and financial regulators in several countries are working towards the development of green and sustainable markets, and in some cases, push for the establishment and enhancement of ESG disclosure and reporting standards and data collection. However, progress in this regard, has varied across countries and remained limited in countries with special needs due to limited understanding of the ESG issues and comparable ESG data (CFA Institute, 2019). In many cases, there are issues related to the lack of common definitions of sustainable activities, diverse ESG frameworks and standards, and greenwashing (Asia Securities Industry and Financial Markets Association and Future of Sustainable Data Alliance, 2020).

These require increased efforts by the international community to explore ways to address those issues and support awareness-raising and capacity development for countries with special needs to enable them to unlock additional ESG investment market opportunities that support the transition to a low-carbon, climate-resilient economy. In this context, ESCAP collaborates with the Association of Development Financing Institutions in Asia and the Pacific and the International Chamber of Commerce to conduct a survey that measures the extent to which financial institutions in the region are integrating environmental and social risks into their operations and gauges their interest in committing to sustainable finance (ESCAP, 2021h). The survey can raise awareness among businesses and support policymakers to better understand and formulate policy options to integrate environmental and social risks into business operations.

## Addressing cross-border infrastructure financing gaps

Large infrastructure financing gaps in countries with special needs underline the importance of regional cooperation to support the post-pandemic economic recovery. Cross-border infrastructure development, due to the complexity and needs for intensive coordinated efforts, in particular, can benefit from regional frameworks and agreements, transnational policy frameworks and harmonized technical standards, which are mainly supported by international and regional organizations. Those common frameworks and standards can foster effective coordination among different governments and with stakeholders on critical decisions pertaining to design, financing and operations from the early stage of infrastructure projects, thus easing implementation and avoiding potential conflicts and disputes. It is often recognized that a regional approach is the best option for the implementation of cross-border projects. Especially when these projects involve management of shared resources, policies and regulations among countries must

be harmonized or competing development objectives of different countries must be reconciled (ESCAP, 2019b).

Regional cooperation platforms can facilitate dialogue and promote knowledge-sharing among member States, including on identification and prioritization of cross-border infrastructure projects, instruments and modalities by which infrastructure financing can be enhanced. The Infrastructure Corridors Simulator and Partnership Portal on Co-deployment developed by ESCAP are examples of such platforms (see box 4-2). In addition, the international community can provide countries with technical assistance and capacity-building in support of cross-border infrastructure projects. International financial institutions with more resource capacities can help explore possible financing facilities directly through grants or loans for projects in developing countries with special needs or indirectly by providing risk management tools (through guarantees, risk insurance, PPPs and other forms of blended finance) to attract private investment and finance. Such support is critical for countries with special needs to increase their infrastructure development and narrow infrastructure financing gaps.

### Box 4-2

#### Interactive online tools to address infrastructure financing gaps

The Economic and Social Commission for Asia and the Pacific, in cooperation with the International Think Tank for Landlocked Developing Countries, developed and launched two online interactive tools in 2022, the Infrastructure Corridor Simulator and the Partnership Portal on Co-deployment to facilitate the dialogues among policymakers and practitioners and provide assessments on economic benefits of integrated infrastructure development

The Infrastructure Corridor Simulator supports the ranking of the compatibility and cost-effectiveness of more than 100 potential integrated information and communications technology (ICT) co-deployments with energy and transport infrastructure facilities (more than 70 types) along 62 land borders of ESCAP member States. The simulator can work at a collaborative workspace and a virtual co-location platform as the online teamwork. Professionals can use it to work together for joint planning, designing infrastructure co-deployment, and developing integrated infrastructure corridors across borders and between countries, regardless of the distance of their locations. The simulator has already proven to save capital and operational costs in a pre-

feasibility assessment through the results of three pilot test cases involving a few LLDCs. For the simulation of the newly identified transboundary infrastructure corridors, technical expert groups should be established with a collection of parametric socioeconomic data, accompanied with in-depth training, collaborative research and an online data assessment of the economic and technical flows, site specific data set and partnership type.

The Partnership Portal on Co-deployment is aimed at strengthening virtual co-working space for the co-deployment of ICT with road transport or energy infrastructures and providing information on priority areas for investment in economic corridor segments within total land lengths that exceed 75,000 km. The portal provides developers and owners of infrastructure and other stakeholders with an opportunity to (1) register new infrastructure facilities and find other compatible infrastructure development projects (planned or those at early stage), (2) assess technical compatibility and cost-effectiveness of infrastructure co-deployment and (3) promote partnership and knowledge-sharing on co-deployment. ESCAP, in partnership with the International Think Tank for Landlocked Developing Countries, national networks, regional and subregional knowledge centres and institutions, has generated interest from the Asia-Pacific LLDC policymakers to institutionalize infrastructure-deployment cooperation and collaboration, including through the portal.

Realizing the potential role of infrastructure financing in support of the 2030 Agenda, ESCAP has established a regional network on infrastructure financing and PPPs to provide a platform for policymakers and experts from Asia and the Pacific to review the region's infrastructure financing landscape, discuss the opportunities and gaps and advocate the establishment and harmonization of legal and regulatory frameworks for PPPs (see box 4-3). The

network also encourages the private sector to participate and make a strong contribution to policy dialogue, sharing of good practices, and consensus-building on that front. Many countries with special needs are members of the Network, including Afghanistan, Bangladesh, Bhutan, Cambodia, Fiji, Kazakhstan, Kyrgyzstan, the Lao People's Democratic Republic, Mongolia, Myanmar, Nepal, Samoa, Tajikistan, Timor-Leste and Vanuatu.

## Box 4-3

### Infrastructure Financing and the PPP Network of Asia and the Pacific

With its role as a regional think tank and being the most representative intergovernmental body for Asia and the Pacific, ESCAP established the Infrastructure Financing and PPP Network of Asia and the Pacific in 2018 to support member States to develop PPP projects and infrastructure financing strategies that contribute to regional connectivity and sustainable development.

The Network provides capacity support to member States to design and develop bankable infrastructure projects. It has advanced the pilot-project demonstration dialogue by offering project-based training, focusing on early-stage

project development and targeting country-specific issues in order to strengthen the enabling environment, enhance the capability of PPP units, and further develop and integrate capital markets to support long-term investments in infrastructure in accordance with the SDGs. The Network also engages with the private sector, capital market experts and other development partners to support governments to engage in PPP knowledge exchange, project transaction promotion and development project matching.

At its fourth meeting in 2020, the Network launched the Infrastructure Financing and PPP Network (InfraPPPnet) web portal to serve as an information-sharing resource. The web portal consolidates information on PPP institutions, commercially viable project preparation techniques and project pipelines, and the market environment in the region to facilitate project transactions, knowledge exchange, and capacity-building for designing PPP policies.

## Promoting capital market development through regional financial cooperation

Financing through capital markets, for example, bond issuance, continues to offer untapped opportunities for countries with special needs, making it an important subject for regional cooperation. The international community can play an important role in providing capacity-building, technical and funding support to countries with special needs through regional cooperation to enhance the legal and regulatory framework for capital market to establish the necessary market infrastructure and design and develop financial instruments.

Considering the diversity in the level of development of capital and bond markets in countries with special needs, the technical assistance and capacity-building need to be targeted and contextualized towards specific needs and priorities of each country with special needs. For countries where bond markets are not yet developed or at the early stage of development, the support, for instance, should be directed towards the establishment or expansion of

sovereign bond markets. For countries with relatively developed capital market, the support should aim at fostering market depth, liquidity and efficiency and protecting investor rights; innovative bonds or financial instruments can be created when the required market fundamentals are in place (ESCAP, 2019b).

Promoting regional financial cooperation would support the development of the capital market in countries with special needs. The 1997 Asian financial crisis demonstrated a strong need for regional financial cooperation and for countries to develop a local-currency bond market as an alternative source of financing to short-term foreign currency-denominated bank lending. In particular, the development of market infrastructure for local currency-denominated bonds would support countries to secure more stable, long-term funding sources and minimize the risk from maturity and currency mismatches, which, in turn, reduce vulnerabilities to the sudden stops or reversal of capital flows. Regional cooperation mechanisms can provide a direct impetus for countries to carry out the necessary reforms to deepen financial markets at the national level and better prepare

themselves for the regional market integration. It also supports the development of national and regional financial market infrastructure, including harmonization of settlement systems, rules, regulations, standards and practices, which helps to facilitate cross-border transactions, payments and settlements, and promotes sharing of knowledge, experiences and good practices among regional peers. Through regional cooperation, developing countries with special needs can attain greater technical and financial assistance from their developed peers and enjoy more opportunities through lessons learned and technology transfers.

The example of ASEAN+3 Finance Cooperation indicates shared benefits among its member countries. In 2003, ASEAN+3 launched the Asian Bond Markets Initiative, which aims at establishing local currency-denominated bond markets as an alternative source of financing to foreign currency denominated bank loans by expanding access to bond markets, building the necessary bond market infrastructure and strengthening regulatory frameworks. Under this bond initiative, the Credit Guarantee and Investment Facility was established to provide guarantees on corporate bonds issued by firms in the ASEAN+3 countries and thus promote issuance of local currency-denominated bonds. A dedicated website ([www.AsianBondsOnline.adb](http://www.AsianBondsOnline.adb)) was launched to share information on the conditions and characteristics of domestic bond markets in each ASEAN+3 country to facilitate demands from investors. In addition, the ASEAN+3 Bond Market Forum promotes harmonization of legal and regulatory frameworks and standardization of market practices and conditions for bond issuance, such as disclosure standards and common documents. Supported by this framework, the Government of the Lao People's Democratic Republic started issuing baht-denominated government bonds on the market in Thailand to financing infrastructure investment in 2013. Cambodia plans to issue its first local-currency sovereign bonds in the near future under the umbrella of the initiative. Other countries with special needs that lack a well-functioning domestic bond market can learn from this and consider a similar approach to bond issuance in their neighbouring countries with more developed capital markets.

## Accelerating digital finance for financial inclusion

To leverage the potential of the digital technology in finance, the Secretary-General, in 2018, set up the Task Force on Digital Financing of Sustainable Development Goals with a mandate to advise and catalyse the adoption of digitalization in fast forwarding SDG financing. In a report, the Task Force highlighted the potential role of digital financial products,

such as digital payment, digital transfers, digital insurance, crowdfunding and blockchain-based supply chain finance, to help mobilize additional resources in developing countries and LDCs (United Nations Sustainable Development Group, 2020b). Despite numerous transformations brought by digitalization, the Task Force notes the need to align them with the 2030 Agenda and empower people to decide on how their resources are used. The rapid emergence of digitalization is also an opportunity for international and regional cooperation to ensure that everyone benefits from the digital dividend and no country or person is left behind.

International and regional cooperation can accelerate the progress made in digital finance and foster financial inclusion, which, in turn, can reduce poverty and inequality, empower citizens and promote inclusive growth. Financial technology (FinTech) has the potential to close gaps between the “banked” and the “unbanked or underbanked” and empowers them to invest, save, borrow, lend, pay taxes and use public services in more efficient and effective ways. The successes of FinTech are well documented in many countries, including countries with special needs, through its ability to reduce the cost of remittances and expand access finance for MSMEs, for instance. However, those cases mostly are within-country examples, while the cross-border opportunities largely remain untapped. Regional initiatives on digital technology and finance can, accordingly, build on successful of domestic initiatives and be expanded through coordinated regional actions and mechanisms.

Specifically, the international community can promote the regional interoperability and harmonization of laws, regulations and standards in digital finance that would facilitate easier, quicker and cheaper cross-border money and remittance transfers (ESCAP, ADB and UNDP, 2021). The international community can also establish data exchange and information-sharing mechanisms, for example, through the ESCAP-facilitated Framework Agreement on Facilitation of Cross-Border Paperless Trade in Asia and the Pacific, a United Nation treaty that enables all participants in global value chains to exchange data and information electronically. Enabling accumulation of data and information in the integrated/shared database helps to streamline credit risk assessment and allows MSMEs that increasingly engage in e-commerce platform to gain more access to financing, including from outside national boundaries.

Because of the rapid pace of emerging digital technology and digital finance innovations driven by technology firms from developed countries, there is urgent need for the international community to build the capacity of countries with special needs to address lagging regulatory oversight and develop robust regulatory policies that encourage innovations and tackle digitalization-related risks. International and regional

cooperation can enable a platform for knowledge exchange, experience-sharing and technology transfer, facilitating the diffusion of technological capabilities and applications in the least developed countries.

While connectivity is at the heart of any digital finance application and innovation, concerted international and regional efforts to address the digital divide remain a critical agenda. To ensure that no one is left behind, the remaining half of the region's population who lack access to basic Internet must be connected, with a particular target to those from countries with special needs who stay largely

unconnected (Okuda, Meng and Bauman, 2020). Otherwise, digital transformations will further exacerbate social and economic inequalities between the digitally "connected" and "unconnected". ESCAP, through its Asia-Pacific Information Superhighway initiative (AP-IS), supports member countries to promote regional digital connectivity and address the digital divide, especially by facilitating negotiations among countries for expansion of cross-border digital infrastructure and mobilizing cooperation and partnerships for closing last-mile connectivity gaps, and offering technical assistance, advisory services and capacity-building (see box 4-4).

## Box 4-4

### Asia-Pacific Information Superhighway initiative

With more than half of the Asia-Pacific population lacking basic Internet access, the Asia-Pacific Information Superhighway (AP-IS) initiative was launched in 2015 with the objective to bridge the digital divide and accelerate digital transformation by promoting digital connectivity, digital technology and data use in the Asia Pacific region. In particular, it provides an intergovernmental platform to promote regional policy dialogues and negotiation, mobilize cooperation and partnerships, promote research, capacity-building, knowledge-sharing, technology-transfer and exchange of good practices, and explore potential solutions common to the region.

The Asia-Pacific Information Superhighway initiative comprises four pillars: (1) Connectivity: nurture effective physical network design, development, financing mechanism and management across the region through intergovernmental negotiation and by improving regulations

based on open access; (2) Traffic and network management: improve Internet traffic and network management at regional, subregional and national levels; (3) E-resilience: promote resilient ICT networks to support disaster management systems and ensure last mile disaster communication; and (4) Broadband for all: bridge the digital divide by promoting affordable access to underserved areas and providing policy and technical support to governments.

The initiative's master plan, which was adopted in 2017 and is updated on a rolling basis, outlines the key initiatives, targeted goals and timelines to drive future development of digitalization and seamless digital connectivity, in line with the four pillars. The ESCAP secretariat is working with partner organizations to prepare a draft of the updated AP-IS action plan (2022–2026). The final draft action plan was reported to the fifth AP-IS Steering Committee in 2021 and will be submitted to the Committee on Information and Communications Technology, Science, Technology and Innovation in 2022 for consideration and adoption. Upon adoption, the master plan will function as a regional blueprint for cooperation and a guide for promoting digital connectivity and transformation in the region.

## Harnessing regional value chain-linked foreign direct investment for sustainable development

Multilateral cooperation and a political commitment to keep investment open is required to help countries with special needs and businesses build back better in the recovery period and harness the potential of a regional value chain linked to FDI. Moreover, countries with special needs must

take advantage of available opportunities to encourage FDI inflows tied with technology-transfer to ensure maximum spillover effects in terms of skills upgrading, improving productivity and better management practices. Such approaches to FDI policies can help pave the way towards a green recovery in the region, attract and facilitate investments to address transboundary challenges, make national and international investment governance more coherent and sustainable development-oriented, and enable countries to harness intraregional investment flows.<sup>40</sup>

40 For each country with special needs, priorities differ based on their needs and ability to absorb FDI flows in relevant FDI sectors. Some of the most relevant sectors to target are infrastructure, health, education and power. Illustrating the need for tailored-based strategies to boost sustainable FDI flows, Bhutan for instance, has encouraged FDI flows into green technology sectors. To this end, ESCAP has been providing the country with support on how to attract and target sectors, including waste management and renewable energy, among others. To identify the sectors in which countries should focus on boosting sustainable FDI, investment promotion agencies need to assess national priorities set in national sustainable development plans, conduct national consultations and work with stakeholders to develop a local value proposition strategy to boost FDI into those sectors.

Vigorous efforts to re-energize multilateral cooperation on investment, particularly on investment facilitation for development, is especially critical to open up a path to recovery for countries with special needs. Such cooperation can help spark domestic reforms focused on enhancing the transparency and predictability of investment regimes and streamlining administrative procedures. Unilateral efforts must be carried out to enable a transparent, reliable and conducive regulatory environment, which is necessary to attract FDI. Studies in the context of South Asian LDCs indicate that high regulatory restrictions, trade barriers that diminish the benefits of cross-border investments and weak institutional protection afforded to foreign investors are some of the reasons impeding them from tapping the FDI potential (ESCAP, 2020f). Domestic reforms would send a positive signal to investors and encourage more flows to be channelled to countries with special needs.

Regional cooperation and technical capacity-building support are essential to help these countries achieve a sustainable recovery. ESCAP supports countries with special needs in developing their investment policies to ensure FDI can be leveraged for sustainable development. Its intergovernmental platform and FDI Network can help facilitate discussions among countries on investment cooperation and support them in reviewing and revising their investment policies, and measures and international investment governance strategies. To this end, ESCAP has developed several knowledge products, including an e-learning course for investment promotion agencies to train them on how to evaluate an FDI project proposal against national sustainable development priorities, a digital FDI policy guidebook, and the second edition of the *Handbook on Policies, Promotion and Facilitation of Foreign Direct Investment for Sustainable Development in Asia and the Pacific*. In the aftermath of the COVID-19 adverse impacts on FDI flows, ESCAP is taking steps to use the platform of the Asia-Pacific Research and Training Network (ARTNeT) on FDI to partner with various investment promotion agencies to deliver national capacity-building workshops for developing digital investment policies.<sup>41</sup> In 2022, ESCAP also plans to release a digital FDI policy guidebook that will provide examples of good policies used to attract FDI in the digital economy and recommendations for countries with special needs, in particular. Meanwhile, countries with special needs should participate actively in the World Association of Investment Promotion Agencies to benefit from regular and valuable trainings offered by the association on attracting digital FDI and in using digital tools in the developing country context to attract investment.

## Promoting a multistakeholder approach in the process of sustainable recovery

An integral part of financing sustainable recovery is the involvement of different stakeholders. Civil society organizations, NGOs, academia, think tanks and the private sector can support governments in defining issues and priorities, developing plans, and delivering economic and social services needed to recover from the COVID-19 pandemic and achieve the SDGs. Such partnerships would ensure that different resources and capacities from all actors, sectors and approaches are mobilized and used to complement each other and create synergies from the full diversity of resources and expertise in collective pursuit of sustainable development.

According to OECD and UNDP (2019), many countries observe a paradigm shift made by governments to improve stakeholder participation by adopting a whole-of-society approach as one of the key areas of institutional reforms. However, the quality of engagement as well as the legal and regulatory frameworks to facilitate the operations of civil society organizations and protection are still lacking and therefore subject to improvement by governments and development partners. The engagement of stakeholders needs to be strengthened not just for consultations, but in a more meaningful, inclusive, participatory process from planning to implementing and monitoring stages to ensure strong ownership and responsibility-sharing. Moreover, governments and development partners need to extend protection from harassment and guarantee freedom of expression for civil society organizations.

Even though civil society organizations are often primarily involved in supporting economic and social outcomes at the grass-roots level, they also face capacity challenges (United Nations, 2020). Accordingly, governments and development partners should extend support to, as well as recognize them as equal partners. Subregional and regional cooperation can complement the efforts by facilitating broader participation of other stakeholders from different countries, promoting cross-country learning, knowledge transfer and experience-sharing. ESCAP has initiated the South Asia Network on the Sustainable Development Goals to provide a virtual platform for facilitating knowledge-sharing and intermediating the partnerships among subregional stakeholders, including governments, the private sector, development practitioners and civil society organizations. Through its dedicated web portal,<sup>42</sup> the Network also provides a repository of good practices and policy lessons for building back better from the

41 The Committee on Trade and Investment, in January 2021, endorsed activities to promote digital FDI. For details, see ESCAP (2021k).

42 For more details see <https://www.unescap.org/projects/sans>.



COVID-19 pandemic and accelerating the implementation of the 2030 Agenda in the South Asian subregion. This initiative can be fostered and replicated in other subregions, which would fast track the multi-stakeholder partnership approach in countries with special needs.

## Conclusion

A spirit of multilateralism and solidarity at subregional, regional and global levels plays a critical role in supporting the national efforts in the fight against the COVID-19 pandemic and accelerating a sustainable recovery. The public health and socioeconomic consequences of the pandemic and unequal access, capacity and resources between developed and developing countries to cope with it underscore the need for strengthened multilateral

cooperation frameworks and a financing mechanism for more effective responses. Especially needed is a more inclusive approach to multilateralism to support less developed and more vulnerable countries, such as countries with special needs, to mobilize necessary additional resources through traditional channels and innovative mechanisms. Despite unprecedented multilateral responses to address the immediate health and socioeconomic impacts of the pandemic, multilateral cooperation should be strengthened. In partnership with all stakeholders, long-term solutions of the countries with special needs should be identified, such as resource mobilization strategies, capacity-building, institutional and regulatory reforms, technological transfer, technical and financial assistance to tackle existing and emerging challenges and set the path for inclusive, resilient and sustainable recovery.



CONCLUSION:  
GOING  
FORWARD

While countries with special needs have made considerable progress towards socioeconomic development during the decade to 2020, the COVID-19 pandemic afflicted them with a severe setback to their efforts in implementing the 2030 Agenda. These countries had to divert scarce resources to cushion the widespread social and economic impacts of the pandemic, further widening financing gaps in achieving the Sustainable Development Goals. Even before the pandemic, none of the countries with special needs were on-track to achieve these Goals by 2030. Financing a sustainable recovery from COVID-19 and achieving them by 2030 are presenting formidable challenges.

As such, these countries need to redouble their efforts in mobilizing domestic resources and external finance. Traditional sources of finance have proven to be insufficient to close the financing gaps. Tax revenue as a proportion of GDP remains low, FDI flows have been declining, remittances and receipts from tourism have not recovered from the recent shocks, and ODA has remained uncertain. This all is exacerbated by the increased debt distress several countries with special needs are facing.

While increasing tax revenue is the most enduring form of financing, current conditions make a possible increase in tax rates politically unfeasible or any expansion of the tax base challenging due to the largely informal nature of their economies. Accordingly, a feasible avenue in the short run appears to be the improvement of tax administration systems, particularly by increasing collection efficiency from existing taxpayers and minimizing leakages. Adopting the latest developments in digital technology is of paramount importance, as exemplified by the case of Cambodia in which the country managed to double its tax to GDP ratio within a span of 10 years. Electronic tax registration, filing, payment and dispute resolution, for instance, can help to reduce the risk of officials abusing their discretion and provide citizens clarity regarding the tax paying process.

Policies and programmes targeting the promotion of FDI need to be sharpened so that countries with special needs can become more attractive destinations for labour-intensive and climate friendly flows, including South-South FDI. Facilitating remittances and reducing their costs through digitalization and formalization can encourage greater inflows. More also needs to be done to improve the efficient use of ODA. For example, additional resources must be invested in institutional capacity and governance to enable countries with special needs to more efficiently use ODA to achieve the SDGs. The use of recipient national systems to deliver ODA has been identified as an efficient modality for small jurisdictions, such as many of the SIDS, so it could be pursued to a greater extent.

Current circumstances provide a unique opportunity to introduce wide-ranging policy reforms and improve administrative and technical capacities to mobilize resources from traditional resources. However, mobilizing more resources must be complemented with the ability to spend it impactfully in areas aligned with efforts to realize the SDGs. This requires strengthened public expenditure management.

New and innovative instruments and approaches to leverage private capital or to relieve debt burdens hold considerable promise for the countries with special needs. Several of them have issued diaspora bonds to their overseas citizens, introduced carbon taxes and issued green bonds to fund their sustainable development projects. Increased digitization of the economy has brought opportunities in attracting digital FDI, especially in telecommunications, office automation, software development and the provision of financial services. Debt swaps can reduce the countries' external repayment burden as well as contribute towards protecting their environment.

Leveraging innovative finance, however, has been constrained by the lack of administrative, legal and technical capacities in these countries. The international community, therefore, needs to extend additional technical assistance to improve the capacity of countries with special needs to benefit from these sources of finance. Considering the difficulty of developing national legal and regulatory frameworks for thematic bonds, for instance, many countries have benefited from aligning bond issuances with recognized global standards, such as the ICMA Green Bond Principles and the Social Bond Principles. Capacity-building support is being provided by international organizations – ESCAP, for instance, is supporting its member States to design and develop bankable infrastructure projects through its Infrastructure Financing and Public-Private Partnerships Network of Asia and the Pacific.

Finally, these countries need strengthened technical and funding support from their international and regional development partners. A renewed partnership and solidarity can play a significant role. For example, reinforcing fair and equitable access to and distribution of vaccines will reduce the immediate funding gaps caused by the decline in government revenue and external income of the countries with special needs. Strengthening ODA and climate-related commitments on development finance and matching them with actual disbursements will support their transition to sustainable and resilient economies against climate change and other shocks. Fostering global and regional cooperation in taxation, addressing debt vulnerabilities, enhancing infrastructure connectivity, developing capital markets, digital finance and FDI will also offer significant opportunities for countries with special needs as they strive to achieve a sustainable recovery and realize the Sustainable Development Goals.

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The *Asia-Pacific Countries with Special Needs Development Report 2022* highlights the significant financing needs and gaps that least developed countries (LDCs), landlocked developing countries (LLDCs) and small island developing States (SIDS) face in their recovery efforts from the COVID-19 pandemic and in the attainment of the Sustainable Development Goals (SDGs). The Report also examines policy options to mobilize financial resources in these countries for that purpose.

Collectively referred to as countries with special needs, these groups of countries were not on track to achieve the seventeen SDGs even before the COVID-19 outbreak. The prospects to do so have worsened due to the severe economic and social impacts of the pandemic. Moreover, the pre-existing financing gaps to attain the SDGs have increased significantly since the COVID-19 outbreak, owing to a combination of a decline in government revenue and expanded fiscal and monetary stimulus measures deployed to cushion its adverse impacts. Securing financing resources to recover from the pandemic in a way that is also aligned with the 2030 Agenda is, therefore, an urgent task for these countries.

This Report highlights that domestic tax revenue, debt and official development assistance will continue to be the main sources of development financing in many of these countries. Innovative instruments and mechanisms, such as thematic bonds and debt-for-climate swaps, also have the potential to finance sustainable development projects in these countries. As capacity, policy and regulatory gaps, as well as limited engagement and coordination with stakeholders, continue to be constraints in these countries, strengthened cooperation at the subregional, regional and global levels is essential to support these countries to complement their domestic efforts in mobilizing financing for development.

