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Overview Paper on Issues and Challenges in the Financing of Sustainable Development in Asia and the Pacific*

Abstract
Two major factors have characterised the landscape of finance for sustainable development, which emerged since the 1992 Rio summit – a continual decline in official development finance in the total financial flows to developing countries and an opposite upsurge in private capital. These two factors have crucial implications in shaping future challenges and setting new directions to policies for financing sustainable development in Asia and the Pacific. At the same time, a range of innovative funding mechanisms, some of which hold the promise of generating substantial additional financial resources, are being put forward onto the international policy agenda. This paper identifies some of these issues in the context of the regional policy debate on financing sustainable development.

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Introduction

Finance for sustainable development is the subject of chapter 33 of Agenda 21, which was adopted at the World Summit for Environment and Development held in Rio de Janeiro, in 1992. The total cost for implementing Agenda 21 in developing countries was estimated to amount to over US$ 600 billion a year, including about US$ 125 billion to be transferred on grant or concessional terms from the international community. The balance would have to be mobilized from domestic sources.

With regard to Asia and the Pacific, the Asian Development Bank estimated the annual investment costs required to achieve environmentally sound development based on two scenarios. Under a business-as-usual scenario – referring to progress as usual with no major changes in environment and development policies – the cost would be US$ 12.9 billion/year. Under an accelerated progress scenario – scenario which sets the goal for developing countries of Asia and the Pacific to achieve the best practices of OECD countries by 2030 – the cost would be US$ 70.2 billion/year. A halfway estimate set between the high and the low estimates would turn around US$ 40 billion/year.[1] In addition, the ADB[2] estimated that repairing the damage done to the land, water, air and living biota in Asia and the Pacific to require US$ 25 billion/year. Taking into consideration the total financing resources needed, the financing gap for the Asia-Pacific countries to attain sustainable development is estimated to be roughly US$ 30 billion.[3]

I. The Changing Landscape of Finance for Sustainable Development in Asia and the Pacific

A. The decline in official financial flows

ODA flows to developing countries declined in volume since 1992…

There has been a general trend of decline in total ODA since 1992. Between 1992 and 1998, net ODA flows from the Development Assistance Committee declined from 60.9 $billion to 51.9 $billion, corresponding to a decrease in combined GNP from 0.33 to 0.24 per cent.[4] Despite a slight increase recorded in 1998, ODA flows still remain below their level of 1992. While ODA used to be an important source of funding in the past, future strategies need to be built on the postulate that official flows are unlikely to be the major source of funding in the future sustainable development of the region, especially in middle-income countries.

…with important variations in their regional allocation.

While ODA to developing countries as a whole has declined since 1992, there are important variations in the pattern of change. Aid flows, considered in terms of concessional finance, show different trends in their regional allocation in 1999 - rising flows (in absolute terms) to East Asia, the Middle East and North Africa, and Latin America, and falling flows to Europe and Central Asian, South Asia, and Sub-Saharan Africa. The regional increase recorded in parts of Asia and the Pacific, namely East Asia, was driven by an upturn in flows from bilateral institutions.[5]

Table 1. Regional allocation of concessional flows, 1990–99

	Percentage of total concessional flows				Percentage of regional GNP			
Region	1990	1997	1998	1999	1990	1997	1998	1999
East Asia	17.0	14.2	18.4	20.5	0.8	0.2	0.4	0.3
Latin America and the Caribbean	10.2	9.4	9.4	9.8	0.4	0.2	0.2	0.2
Middle East and North Africa	19.9	13.5	11.1	12.3	2.0	0.8	0.7	0.8
South Asia	12.2	8.1	12.6	12.1	1.3	0.5	0.8	0.8
Sub-Saharan Africa	37.2	37.5	33.0	31.2	5.8	3.8	3.9	4.2
Europe and central Asia	3.5	17.3	15.5	14.1	0.1	0.5	0.6	0.6
All developing countries	100.0	100.0	100.0	100.0	1.0	0.5	0.6	0.6

Source: World Bank Debtor Reporting System and Staff Estimates.

Along with the general trend of decline since 1992, aid flows to least developed countries, including those in the Asia and Pacific region have also significantly declined.

Table 2. ODA Net Disbursements to selected LLDCs in Asia and the Pacific, all donors, 1995-1999

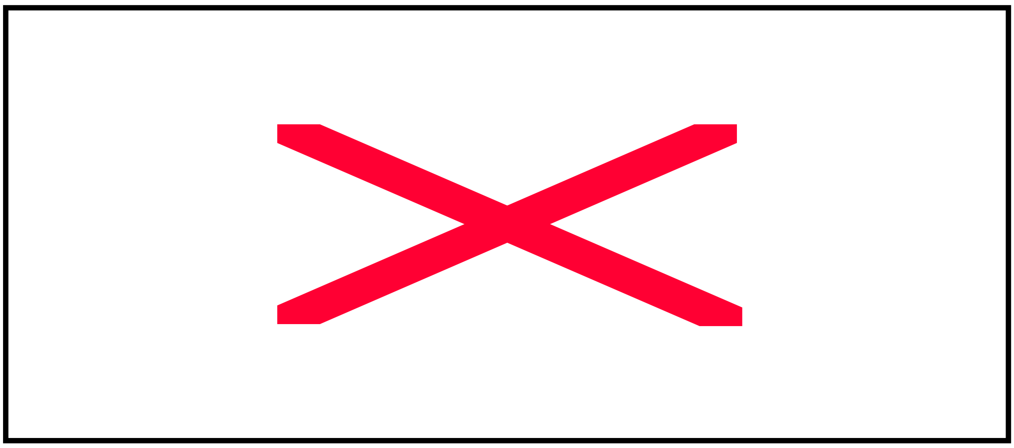
US$million	1995	1996	1997	1998	1999
Afghanistan	214	183	230	154	142
Bangladesh	1277	1235	1010	1251	1203
Cambodia	556	422	333	337	279
Laos	309	332	328	281	294
Myanmar	149	42	34	59	73
Nepal	432	390	401	404	344
Vanuatu	46	31	27	41	37

Source: OECD, Aid Activities in Least Developed Countries, Development Assistance Committee, 1999.

But there are claims that though declining, aid is being more efficiently allocated…

Despite the reduction in the volume of aid, the argument is being made that there was a more efficient allocation of aid between 1990 and 1997–98, much of which resulting from sharp cuts in aid to countries with poor policies compared to modest cuts in aid to countries with good policies. As a result, the impact of both total ODA and International Development Assistance (IDA) aid flows on poverty reduction is said to have increased significantly over the 1990s, because funds were being allocated to countries with better policies.[6]

While the amount of aid to least developed countries declined, there are indications that with regard to the sectoral breakdown, LDCs received more aid in areas of social infrastructure such as education, health and population. In 1999, aid to social infrastructure and services in developing Asian countries represented 34 per cent of total aid.



Source: OECD.

…and more supportive of the activities of other social stakeholders.

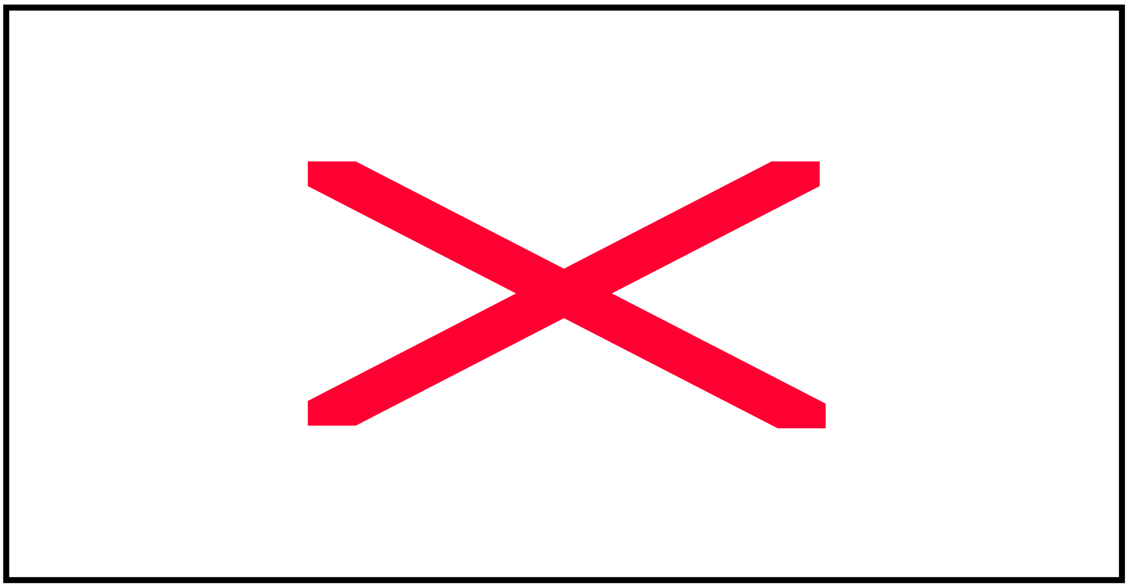
Another important change with respect to ODA trends is that countries increased the volume of contribution to the activities of non-governmental stakeholders, in particular, non-governmental organizations, and enhanced cooperation in conducting joint projects. In the case of Japan, government's subsidies to NGO projects recorded a steady increase up to 1997, much of which went to projects in the area of social development, in particular medical care and workforce development (figure 2).

Table 3. Japan assistance extended to development projects involving NGOs (by type of project)

	FY1991	FY1992	FY1993	FY1994	FY1995	FY1996	FY1997	FY1998
Agricultural and fishing village development	9,524	8,800	7,467	26,800	39,566	38,479	62,164	87,177
Workforce development	40,762	49,348	57,878	101,500	111,893	145,845	114,540	83,841
Women's self-reliance Assistance					39,510	28,500	44,735	62,507
Health and hygiene	26,367	23,900	6,874	8,400	21,056	19,791	45,129	32,084
Medical care	78,120	85,856	154,729	174,113	227,386	218,838	260,479	224,939
Improvement of local industry	46,778	51,431	71,381	79,400	46,144	75,951	66,900	29,724
Improvement of living environment	12,270	31,800	35,400	21,000	42,980	33,168	53,478	22,114
Environmental conservation	22,425	15,272	0	4,300	29,000	35,101	47,168	49,643
Private aid goods transportation		11,300	34,360	11,000	20,100	15,696	17,222	7,600
Transfer and extension of appropriate technology for development cooperation						111,654	167,532	132,848
Comprehensive regional development				19,200	46,757	86,085	38,017	53,282
International volunteer compensation scheme				4,078	6,128	7,751	2,000	2,112
Total	236,246	277,707	368,089	449,791	630,520	816,859	919,364	787,871

Source: Japan Official Development Assistance Report, 1998.

Figure 2. Japan assistance extended to development projects involving NGOs (by type of project)



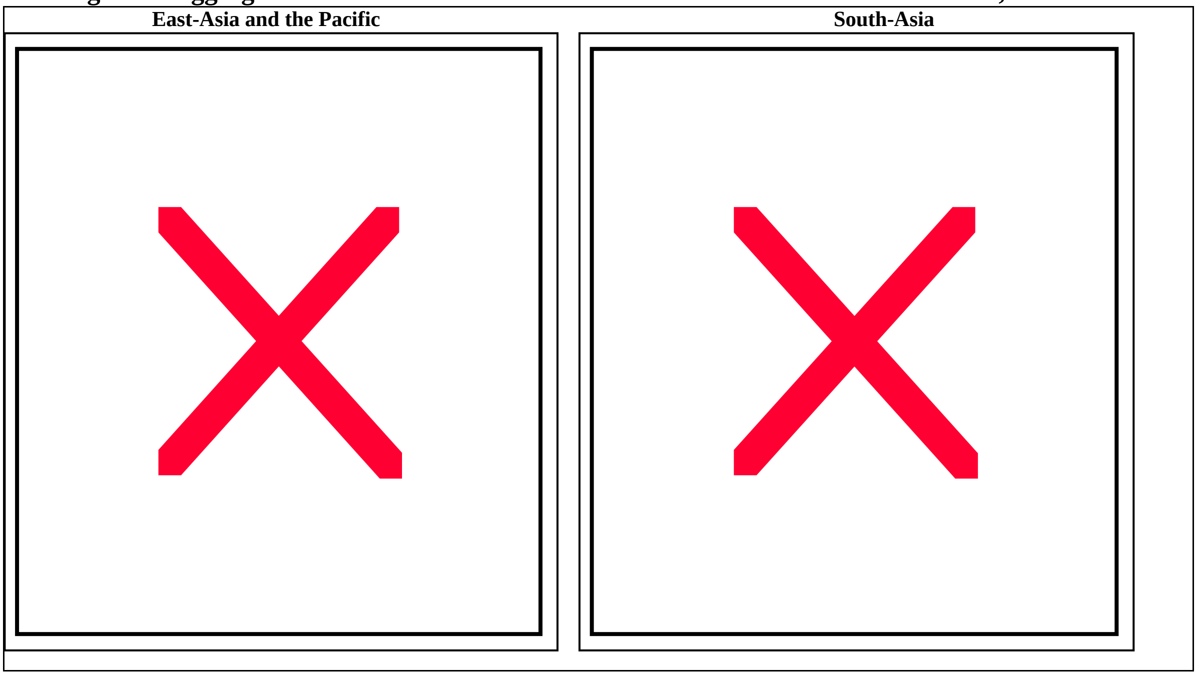
Source: Japan Official Development Assistance Report, 1998.

B. The upsurge of private finance

Private flows have largely surpassed official flows…

Since the early 1990s, international private financial flows have largely surpassed official flows, and gained greater importance as alternatives for financing in East Asia and Pacific countries. For middle-income countries in particular, private financial flows have become the largest source of external finance for sustainable development. In South Asia, official flows remained at an important level, despite a significant increase in private flows.

Figure 3. Aggregate net resource flows to East-Asia and the Pacific and South Asia, 1992-1999



Source: World Bank, Global Development Finance, 2000.

The pattern of increase in private financial flows to Asia and the Pacific follows the general trend observed in developing countries as a whole.

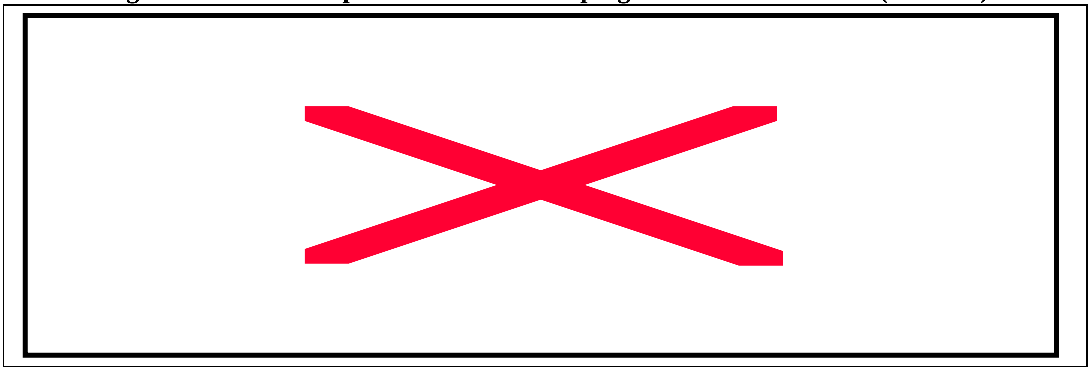
Great fluctuations in portfolio investment and bank lending…

There has been great fluctuation, especially with respect to portfolio investment and bank lending. Net portfolio investment in developing countries reached a peak of $90 billion in 1994 and then fell sharply in 1998. Other private flows, primarily bank lending, have fluctuated from net inflows of about $70 billion in 1991, to net outflows of $36 billion in 1994, inflows of $80 billion in 1995 and outflows of $77 billion in 1999.[7]

…Steady increase in FDI…

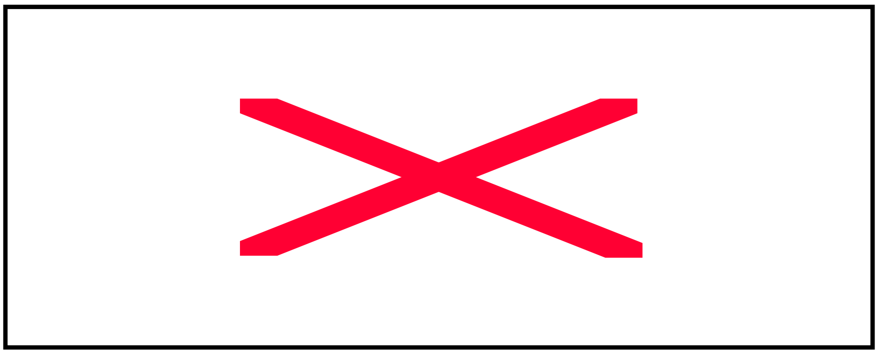
Foreign direct investment (FDI) has been the only form of private capital that has grown steadily since 1990. Since the mid-1990s, FDI has significantly increased worldwide to become the largest source of foreign private capital to developing countries. Between 1990 and 1999, net FDI flows to developing countries had grown from about 20 $billion to 126 $billion.[8]

Figure: 4. Private Capital Flows to Developing Countries 1990-1998 ($ billion)



Source: ECOSOC 2000.

A similar pattern of flows emerges from the Asia-Pacific region. Net private capital flows to the Asian-Pacific developing economies reversed from an inflow of $104 billion in 1996 to an outflow of $42.5 billion in 1998. The outflow moderated to US$27 billion in 1999. Portfolio inflows, comprising bonds and equities have declined sharply since 1997. In contrast to these private market flows, foreign direct investment remained stable with annual net inflows amounting to $50 - $60 billion.[9]



Source: UNCTAD, *World Investment Directory* – Volume VII Asia and the Pacific, 2000, Part 1.

The Asia-Pacific region has traditionally been a major destination and source of foreign direct investment. Since 1986, the Asia-Pacific region has become the largest recipient of FDI among developing countries, accounting for more than half of all flows to the developing world.

In 1998, FDI flows declined for the first time in 13 years, but remain well above the average annual flows recorded during the first half of the 1990s. A record level of $143 billion in inflows – a 44% increase over 1999 was recorded in the year 2000.[10] There however, is a great regional variation in FDI inflows. The traditional pattern of concentration of FDI into a few host countries – the newly industrializing economies, a few countries in Southeast Asia (Indonesia, Malaysia, Philippines and Thailand), and China, accounting for about 95% of inflows to developing Asia-Pacific countries remain unchanged since the early 1980s.[11]

…along with increasing importance of intra regional investment.

While the newly industrialized countries continue to depend to a large extent on investment from advanced countries, especially the United States, Asia's share of the FDI stock to the countries of the region has significantly increased, particularly for middle and low-income countries. In 1997, the share of Asia in the FDI inward stock was 63.2 in Bangladesh; 82.6 in Cambodia; 71.5 in China; 39.7 in Malaysia; 54.1 in Nepal and 44.0 in Vietnam.[12]In most countries, a general trend of increase in intra-regional FDI can be observed, which indicates that greater efforts could be devoted to mechanisms that can further liberalize and support the flow of capital among countries in the region.

FDI generated substantial economic benefit…

The level of inflows does not necessarily give an indication of the actual contribution of FDI as a source of financing for sustainable development. A closer look at the breakdown of such inflows into the various sectors of the economic, social and environmental components of sustainable development gives a better understanding.

From an economic perspective, the financial importance of FDI to national economies is reflected in two measures: the ratio of FDI flows to gross fixed capital formation and the ratio of FDI stock to GDP. With regard to the ratio of FDI inflows to gross fixed capital formation, the average for developing Asia-Pacific countries is relatively small, at around 10 per cent. This is due partly to the traditionally high levels of domestic savings in many economies of the region and their relatively high domestic investment ratios. As for the ratio of inward FDI stock to GDP, it has substantially increased over the years, reaching 23 per cent in 1998.[13] There however, is a great deal of variation in these measures across countries.[14]

Box 1. Economic impact of FDI in China

- 27% of total industry output value
- 14.79% of the total investment for fixed assets in 1997
- 41% of total export, 54.59% of total imports
- 12% of total employees

Source: Zhang (2001)

…but played a limited role in financing social development and environment.

The contribution of FDI to the financing of social development and environmental protection is more difficult to measure due to the limited information available in terms of sectoral breakdown. The overall picture, however, indicates that inflows to the social and environmental sectors tend to be marginal in comparison to those in the primary and industrial sectors. One reason for this is that most host countries tend to put priority in attracting FDI on sectors earning foreign exchange such as export-oriented manufacturing, the tourism industry, and economic sectors directly supporting exports. Considered from the perspective of firms, a factor limiting investment in social sectors is that compared with other sectors, the financial rate of return of investments in social development tend to be low and only accruing in the long term.

As a result of these factors, only exceptionally were important inflows in the social and environmental sectors recorded. For example, in 1997, FDI directed to the health and social services sectors of China amounted to 2183 $ millions (realized value of FDI), a figure above inflows to the primary sector (1568 $ millions).[15]

One major positive environmental benefit than can be expected from FDI is that by operating under uniform environmental standard based on those of home countries, multinationals can introduce environmental and social standards that may be stricter than those required by host countries and induce positive change in the industry concerned. In that respect, clear supportive policies in home and host countries as well as monitoring by civil society are important factors.

Box 2. BSH technology switch from CFC to HC refrigerators
In 1999, Bosh und Siemens Hausgerate Gmbh (BSH) launched the hydrocarbon refrigerators in China, in its worldwide switch from chlorofluorocarbons (CFC) to hydrocarbons (HC) refrigerators. This change, largely driven by external pressure from Greenpeace drove a partial change in the production of Chinese competitors, which now offer HC technology as well.
Source: Paschen von Flotow (2001)

Foreign investment in infrastructure has dramatically increased in Asia, but remains concentrated in power, communication and transportation sectors rather than environmental facilities. Promoting FDI in the areas of cleaner production, environmental conservation and social development remains a challenge, which recorded only limited progress since 1992. While the sectoral direction of investment is not fully responding to concerns for sustainable development in its multiple dimensions, there are indications of increasing efforts from the part of firms to increase their environmental and economic performance.[16]

C. External debt

Huge and unsustainable external debt has been a major constraint on the ability of poor countries to pursue sustainable development. The number of countries in Asia and the Pacific that are considered severely indebted is fairly limited. Following the 1998 economic crisis, however, the debt burden of some of the countries most severely affected has worsened. In 2000, Indonesia and Lao PDR joined Myanmar in the group of severely indebted low-income countries, a worsening of their indebtedness in the classification of the Debtor Reporting System economies. A regression in classification was also recorded for Pakistan, Papua New Guinea and Russian Federation.

Initiatives undertaken since 1992 in the area of debt relief feature two major initiatives – the Heavily Indebted Poor Countries (HIPC) Debt Initiative and the enhanced HIPC Initiative. The HIPC Debt Initiative was proposed by the World Bank and International Monetary Fund and agreed by governments around the world in 1996. The program aims at a comprehensive approach to reduce the external debt of the world most heavily indebted poor countries within an overall framework of poverty reduction. In September 1999, the international community endorsed an enhanced HIPC framework during the annual meeting of the World Bank and the IMF. The enhanced program lowers the qualifying criteria for debt relief and speeds the delivery process. Three countries in Asia and Pacific belong to the group of HIPC - Lao PDR, Myanmar, and Vietnam. None of these countries has yet reached a decision point for debt relief approval.

D. Mobilizing domestic finance

The bulk of the financial requirements to implement Agenda 21, an estimated sum of US$ 500 billion/year was expected to be mobilized from domestic sources. On a country level, however, the requirement varies greatly, especially when considering a region as diverse as Asia and the Pacific. The Asian Development Bank[17] suggested one per cent of GNP as domestic resource allocation for developing countries of Asia and the Pacific to meet their financial requirements for environmentally sound development. It is assumed that by raising the domestic resource allocation for environmentally sound development to 1 per cent, the region's domestic resource contribution would approximately be US$ 26 billion/year.[18]

Environmental spending remains below needs…

In 1997, few countries had a percentage of GDP spent on environment reaching 1 per cent. Some countries have made substantial progress in recent years (1.5% in China).[19] However, for the great number of developing countries in the region, expenditure for environmentally sound development remained relatively limited and was further reduced along with general budget restructuring in the aftermath of the Asian economic crisis of 1997-98.

Table 4. Spending on environment (% of GDP) in selected Asia-Pacific countries

Country	1997	2003
China	<0.5%	government target 1.5%
India	<0.5%	0.5%
Indonesia	<0.5%	0.5-0.7%
Japan	1.8%	1.9%
Malaysia	0.9%	about 1.2%
Philippines	0.5%	0.9%
Singapore	1.2%	1.3%
South Korea	about 1.3%	1.6%
Sri Lanka	about 0.3%	0.5%
Taiwan	about 1%	1.3%
Thailand	0.8%	about 1.1%
Vietnam	0.1 - 0.2%	<0.5%

Source: Alliance for Environmental Technology, 1999.

…but governments social spending substantially increased in several countries.

Public funding has remained the major source of finance for social development. With few exceptions, figures on resources devoted to social spending for 1990 and 1998 indicate an increase in most countries across Asia and the Pacific. In the case of Indonesia, the percentage of government spending on social development doubled, while it remained constant in the Republic of Korea. The increase in public social spending has contributed to achieve substantial gains in the area of social development.

Table 5. Social services* as a percentage of total government expenditures in selected Asia and the Pacific countries

Country	1990	1998
Australia	50.7	66.3
India	8.1	9.2
Indonesia	13.2	26.2
Iran	49.3	41.8
Japan	52.0	..
Korea, Rep.	27.8	27.8
Malaysia	35.6	42.5
Mongolia	24.7	25.4
Nepal	24.4	28.9
Philippines	22.5	26.5
Sri Lanka	27.5	30.0
Thailand	32.2	38.3

Source: World Bank, World Development Report 2000/2001.
Note: *Refers to education, health, social security, welfare, housing, and community amenities.

There is a myriad of new ideas and strategies being proposed to increase domestic financial capacities. In a number of countries, economic instruments have gained recognition as an increasingly important source of domestic funding.

Economic instruments revealed to be an important source of additional funding…

In particular, economic instruments are regarded as having a potential to increase efficiency in the use of resources. It is estimated that in Asia and the Pacific, system losses in energy and water supply turn around 30-40 per cent on an average, which translate into some billion dollar a year.[20] The adoption of economic instruments could increase the efficiency of economic systems and motivate behavioural change. The fact that charges and taxes can induce changes in the behaviour of businesses and consumers is a crucial side effect. It was pointed out that preferred financial instruments are those that not only raise revenue, but also change production and consumption patterns in ways that promote sustainable development.[21]

In addition, economic instruments have a great potential for generating additional internal financial resources for sustainable development. In Japan and the Republic of Korea, which have adopted most of the economic instruments currently applied in the OECD member countries, environmental taxes and levies generate important financial resources (table 6. 7). In 1999, the revenue from environmentally related taxes in per cent of total tax revenue was over 6 per cent and around 13 per cent respectively in Japan and the Republic of Korea, generating over 1.5 per cent and over 3 per cent of GDP respectively.[22]

Table 6. Revenues raised by environmentally related levies in Japan (Taxes, Fees and Charges)

Tax	Year	Million $US
Aircraft noise charges	1999	-
Automobile acquisition tax	1998	3799.4
Automobile tax	1998	13269.9
Aviation fuel tax	1998	813.7
Charge on abstraction of water from rivers	1997	0.22
Charge on municipal waste collection / treatment	1999	-
Charge on packaging	1998	12.98
Fee for use of water in reservoirs (dams)	1998	1.2
Gasoline tax	1998	20349.9
Light motor vehicle tax	1998	885.5
Light oil delivery tax	1998	9810.5
Liquefied petroleum gas tax	1998	220.8
Local road tax	1998	2177.4
Motor vehicle tonnage tax	1998	8317.7
Petroleum tax	1998	3642
Promotion of power resources development tax	1998	2729.8
Wastewater user charges	1996	54.8

Source: OECD, Environmentally Related taxes Database.
Note: “ - ” in the revenue columns means that information is lacking. Data reflect latest year available

Table 7. Revenues raised by environmentally related levies in Korea (Taxes, Fees and Charges)

Tax	Year	Million $US
Acquisition tax on vehicles -- local	1999	325.1
Automobile tax – local	1999	1909.6
Charge on air pollution	1996	8.5
Education tax on automobile tax	1999	542.7
Education tax on petroleum products	1999	874.6
Environmental Improvement Charge	1997	159
Fee on natural park entrance	1997	15
Licence tax	1999	184
Reforestation charge	1997	23
Registration tax on vehicles -- local	1999	640.2
Sewage Treatment Fee	1999	-
Special excise tax on passenger vehicles	1999	543.6
Special excise tax on petroleum products	1999	1235
Transport tax on petroleum products	1999	6095.9
Volume-based collection fee for municipal waste	1999	-
Waste disposal charge	1999	-
Water effluent charges	1996	8.5
Water Quality Improvement Charge	1999	-
Water use charge	1999	-

Source: OECD, Environmentally Related taxes Database.
Note: “ - ” in the revenue columns means that information is lacking. Data reflect latest year available.

…however economic instruments are still not widely used in the Asia-Pacific.

Despite their advantages, economic instruments have not been widely used in the Asia-Pacific. The ADB considers that there are good models in Asia and the Pacific for integrating values and charges on resource use and pollution. Several options exist for applying broad-based pollution charges in respective sectors, including an economic resource value model for valuing coastal resources in the Philippines, China’s approach to wastewater charges that apply to all pipe water supply consumers. The Chinese approach, in addition to rising revenue, enables cross-subsidizing of low-income households.[23] The Asian Development Bank pointed out that the lack of effective market-based instruments in the Asia and Pacific region is conditioned by institutional and financial considerations and only rarely by technical constraints.

While there is a general consensus about possibilities to increase tax revenues in countries in the Asia-Pacific region, particularly by improving the efficiency of tax administration and better enforcement, and the introduction of environmental taxes, concerns have been voiced that in the design of the tax structure, it is important to pay attention to equity aspects and not only revenue implications.[24] Otherwise, despite increasing the government revenue base, additional taxes, including environmental taxes, might put additional charges on poor communities and increase inequity. One possible way of avoiding this would be to set the greening of the tax system through environmental charges and taxes in a way shifting the tax base away from economically valued activities, such as employment and income, and towards economically damaging activities like pollution. This could be combined with cross subsidizing as in the case of china's wastewater charges system.

II. Emerging Challenges and Policy Directions

The future challenges as well as new policy directions with regard to the financing of sustainable development in the Asia-Pacific will have to be shaped on the postulate that private capital will continue to take over official flows as the major source of funding for sustainable development.

A. Setting new priorities in ODA strategies

In all political as well as experts meetings, the need for financial transfers from the developed to the developing countries through official development assistance, with the aim of meeting the United Nations' target of 0.7 per cent of GNP of the developed countries for ODA pursuant to Chapter 33 of Agenda 21 was strongly reaffirmed.

At the same time, the policy debate is trying to stay in tune with the reality of reduced official flows and formulate priorities based on that reality. In addition, there is little indication that the level of ODA will significantly increase in the near term. Despite the slight increase in ODA flows observed in 1998, the United Kingdom appears to be the only donor country that announced a firm stance to increase ODA in the coming years.[25] Based on that contention, two issues are of importance:

First is the need to concentrate aid on least-developed countries, which generally have a limited capacity to benefit from international private capital. Poverty reduction is another area that will require sustained official inflows. Finally, social infrastructure and the so-called global goods such as global diseases and environmental crisis situations would figure in priority areas. Because only a marginal share of private flows tends to be directed to these sectors, there is a need to ensure continued flow of official finance.

Second, along with these emerging focal areas, there is an emerging consensus both in donor and recipient countries of the need to ensure a greater effectiveness and better coordination of aid. In this perspective, the Regional Platform has called for a regional meeting of donors for better coordination of aid.

A. Making private finance more supportive to the goals of sustainable development

While ODA could be primarily directed at least-developed countries with a limited potential to attract other financial flows, with respect to high and middle-income countries that are successfully being integrated into the global economy in terms of international trade and investment, efforts should aim at enhancing the flow of capital through a more open and stable international environment and making such flows more supportive of the goals of sustainable development.

There is a strong view that to be effective, innovative mechanisms should be actively promoted with the bulk of new resources coming from, and invested by, the private sector.[26] The net aggregate flows of capital to Asia and the Pacific since 1992 indicates a great dominance of private capital over official flows and this trend is likely to continue in the foreseeable future.[a]

In particular, emphasis should be put on enhancing the role of foreign direct investment in financing sustainable development. With inflows to developing Asia alone reaching $143 billion in 2000, FDI has revealed to be a crucial, stable and long-term source of finance in the Asia-Pacific region. The attractiveness of the region to FDI remains strong in terms of the underlying determinant of FDI.[b] There is however, no correlation between the amount of FDI and its effective contribution to sustainable development in the absence of adequate policy.

Making private capital more contributive to sustainable development revolves around two major challenges - channeling more private investment in the social and environmental sectors, and ensuring better environmental and social performance in the operation of firms. Actions needed in that perspective would require a holistic approach involving home and host countries, multinational corporations, market actors and civil society.

Making use of environmentally sound government incentives

- Government fiscal and non-fiscal incentives will remain essential in order to direct greater flows to the areas of cleaner production, environmental conservation and social development and to support the development of environmental industries. At the regional level, investment arrangements such as the Agreement on the ASEAN Investment Area and the APEC Non-Binding Investment Principles could serve as a basis for a more pro-active approach for inducing FDI in environmental and social sectors.[c]

Creating financial markets to support investment in environmental industries

- Along with government incentives, the creation of new financial markets for environmental investments in order to support the development of environmental industries and technological development will be crucial. In the long-term perspective, such market-driven financial mechanisms should play a central role, the function of government being confined to setting up and overseeing the institutional framework for their development.

[a] Both the ADB and UNCTAD project continued inflows of private capital in Asia.
[b] The World Investment Report 2001 considers that the Asia-Pacific's longer-term investment prospects as "bright" with countries such as Hong Kong, China; the Republic of Korea; and Taiwan Province of China said to be "the brightest spot for FDI in the developing world."
[c] Both instruments already contain dispositions encouraging member countries to prevent from relaxing health, safety, and environmental regulations as an incentive to encourage foreign investment.

Making use of environmental guidelines in export credit and investment insurance

- Financial institutions, in particular export credit agencies (ECA) by providing cover to exporting firms, investment guarantees and political risk insurance to companies operating overseas have an important role in investment decisions, particularly in large infrastructure projects. Compelling export credit agencies use their financial leverage to ensure an adequate integration of environmental and social concerns in their commitments have been a point of recent policy debate which led to the formulation of guidelines such as the OECD Environmental Guidelines for Export Credit Agencies. It is expected that such guidelines will ensure that client firms incorporate sound social and environmental concerns in their overseas operations. Most ECA are agencies of developed countries. These countries, therefore, need to take the lead in making ECA commitments more consistent with the goals of sustainable development. However, given that most clients are in the developing countries, integrating the views of such countries in the formulation of environmental and social guidelines would enhance their chance of successful implementation.

Promoting socially responsible investment

- There has been a growing interest in socially responsible investment (SRI) and eco funds, which enable investors to meet both their financial needs and ethical and environmental values. While SRI has become well known in many parts of the Western world, it is said to be slowly developing in the Asian region. There however are prospects that given the growing interest of new investors in the concept of SRI, it holds good promise for a rapid development. To date, this move has been driven by civil associations, corporate managers mainly. Possible action in this area could include the passing of legislation in support of socially responsible investment.

International taxation on currency markets?

- It is estimated that over $1.5 trillion are exchanged daily in currency markets around the world, of which 80 per cent is speculative. In order to generate revenues from these capital transactions for promoting sustainable development, the proposal for the establishment of a “Tobin tax”, which would set a tax between 0.1--.25% - generating $100 billion to $250 billion per year is making its way onto the international policy debate. In 1999, Canada approved the concept of “Tobin tax” and other donor governments are expected to follow.[27] In addition to generating additional resources, the expectation that such taxes will help tame currency market volatility have given them greater support among the general public and governments, especially in the aftermath the recent currency crisis in Asia.

III. Enabling full effect of new financial mechanisms

Several new approaches have emerged in the financing of sustainable development over the last decade. This section will be limited to two mechanisms having particular relevance to the Asia-Pacific region.

A. The Clean Development Mechanism

The Clean Development Mechanism, one of the “flexibility mechanisms” of the Kyoto Protocol to the United Nations Framework Convention on Climate Change is expected to be a new and important source of finance for sustainable development by enabling developing countries not subject to binding emissions reductions to be involved in GHG mitigation.

The Asian Development Bank estimates that the GHG abatement cost and the supply of GHG abatements from developing countries under the Clean Development Mechanism would suggest an annual potential value of carbon trades as high as $ 36.4 billion to $47.3 billion if the market for carbon is competitive, with conservative estimates ranging from $5 billion to $21 billion annually and a “best estimate” of $10 billion.[28]

Policy measures needed to make full use of the CDM would include the development of simple and transparent procedures for CDM projects with clear sustainable development criteria and the establishment of efficient institutions to limit transaction costs.

B. A regional extension of the Global Environment Facility

The Global Environment Facility (GEF) has been an important source of new funding for projects in the area of biodiversity, climate change, international waters, and ozone. Projects to address land degradation, as it relates to the four focal areas, are also eligible for funding. As of November 2001 GEF had a total of 171 member countries.

Between its inception in 1991 and June 2001, the GEF total allocations and disbursements reached 3,422.31 and 1,244.30 million respectively. For countries in Asia, total allocations and disbursements over the same period totalised respectively 978.19 million and 377.60 million.[29] After a $ 2 billion pledge by 34 donors in 1994 and a $2.75 billion pledge by 36 donors in 1998, the GEF has now initiated negotiations for its third replenishment, which are expected to be completed in February 2002.

There has been a proposal to create a Regional Environment Facility (REF) in Asia and the Pacific region to fund projects of transboundary and regional importance not covered by the GEF. The possible operational areas of the REF would be areas related to poverty and environment, and environmental quality and human health issues, freshwater and other areas identified in the Regional Action Programme for Environmentally Sound and Sustainable Development.[30] The ADB, ESCAP, UNDP, UNEP and other agencies have been identified as possible implementing agencies. The proposal for the REF, which was endorsed at the Asia-Pacific High-level Regional Meeting for the World Summit on Sustainable Development when elaborated for operationilization, would be an important additional funding mechanism for the region. In particular, the Regional Action Programme has identified a range of priority programmes areas for implementation between 2001-2005 and beyond, but for which no regional funding mechanism has yet been secured. Since many of the programme areas identified fall outside GEF operating areas, the REF could act as funding mechanism.

Conclusions and outlook

Progress made in the mobilization of financial resources for the implementation of sustainable development since the 1992 UNCED has been uneven. Raising domestic resources sufficient to meet the requirements of Agenda 21 remains a challenge in most countries, whereas official finance has declined to even below its level of 1992. Parallel to that, private capital has increased in volume in most parts of the world.

The change in the importance of the various sources of finance in the Asia-Pacific region also reveals differences across sub-regions. While private capital has overwhelmingly outpaced public fund as a source of funding in East-Asia and to a lesser extent in Southeast Asia, official flows remain very significant in South Asia, central Asia and small Pacific island countries. It is therefore essential to duly take into consideration these important changes in the landscape of global and regional finance when devising innovative strategies.

A range of new mechanisms is being explored, ranging from new forms of international taxation to regional funds. Many of these issues, while having grown in importance and the attention received in the international policy debate, remain far from generating global consensus, at least unlikely any time before the WSSD. A more pragmatic approach would focus on those mechanisms already existing, and which have proven to be effective and only need to be enhanced for greater effectiveness.

These would include first a greater emphasis on mobilizing domestic sources of finance, budgetary reallocations and enhancing the introduction of economic instruments, which could contribute to increased efficiency in the use of resources, rising government revenue along with cross subsidizing for poor communities. In this direction, attention could be devoted to the removal of institutional and financial obstacles identified by the ADB as causing the lack of effective market-based instruments in the Asia and Pacific region.

Further promoting sustainable private flows such as FDI, reducing their concentration and making them more supportive of the objectives of sustainable development. These will require a political consensus on new forms of market as well as regulatory mechanisms. New initiatives in this direction could include a step towards a pro-active approach in regional arrangements pertaining to investment, incorporate inducing measures to channel investment in social and environmental sectors, expand the use of environmental and social guidelines in export credit and investment insurance. The Asia-Pacific region being the largest recipient of FDI among the developing world, it could significantly influence the future of the global agenda with regard to these issues in their relation to sustainable development.[d] In addition to government incentives, promoting investment in social and environmental sectors should involve local initiatives able to drive multinational corporations in community development projects.

Increasing ODA targeting particularly countries that do not attract sufficient private flows. While the drive to use official finance to address global issues should continue, this should not be a mere shift of resources from bilateral to multilateral assistance. A prime policy

[d] The International Conference on Financing for Development, the World Summit on Environment and Development as well as the fifth WTO Ministerial Conference scheduled for fall 2003, at which occasion members will decide modalities for launching negotiations on investment, will provide opportunities to put forward perspectives from the Asia-Pacific region.

objective should be that addressing problems at the local and national levels would be the best way to prevent them from generating global crisis situations.

Finally, as the East Asia Roundtable pointed out, while recognizing financial resources as essential for sustainable development, they are on their own not sufficient for achieving it. Without proper policies, consumer and producer behaviour will not shift to more sustainable patterns, and the financing gap will remain wide. Good policies hold the promise of not only being able to mobilise new financial resources but also reducing such a need.

This would involve issues the reallocation of resources within government budget towards sustainable development causes,[e] which has been enshrined in many of the strategy documents formulated in recent years.[f]

[e] The Asian Development Bank pointed out that in the Asia and Pacific region, expenditure on environmental programs rarely exceeded 1 to 2 per cent of the GDP compared to defense budgets, which range from 0.8 to 6 per cent of the GDP.
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