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**MOBILIZING DOMESTIC RESOURCES FOR DEVELOPMENT
IN ASIA AND THE PACIFIC: AN OVERVIEW***

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MOBILIZING DOMESTIC RESOURCES FOR DEVELOPMENT IN ASIA AND THE PACIFIC: AN OVERVIEW*

INTRODUCTION

Financing for development has engaged the attention of policy makers and development economists for several decades. It needs to be appreciated that the subject is extremely vast, effectively covering the full corpus of strategies, policies and instruments in the financial sphere with a bearing on both public and private sector development. Hence, it is important that the number of topics to be discussed in a seminar or workshop be narrowed down to facilitate a focused consideration of the issues. From the standpoint of this workshop two broad considerations stand out: one, the underlying premise that development is still essentially measured by GDP growth rates is now subject to qualification. Development is widely accepted to be a much broader concept, including in particular progress in the alleviation of poverty within the overall rubric of 'human development'. Issues of development finance need therefore to pass the test, as it were, of their role in reducing poverty, for instance, by the ease of access for the poor to sources of finance. It is the conventional wisdom now that overall growth and poverty reduction depend upon effective financial systems. As a result, policy needs to create and sustain the right institutional infrastructure, such as special arrangements for SMEs and microfinance schemes with the proviso that these arrangements/schemes encourage graduation of the enterprises concerned into the formal financial system and are not props to merely sustain dependency.

Two, in a globalized world economy where ever fewer countries practice exchange control in the traditional sense of the word and where, until 1997 at least, the abolition of capital controls was an avowed objective of policy, an analytical distinction between domestic and international financial resources for development is, at best, fuzzy. While resources for development can be either domestic or foreign in origin, the same factors are likely to influence their volume, composition and cost. Fiscal/monetary prudence, financial market depth, the regulatory regime, standards of governance, property rights etc., would be equally relevant for both sources of finance.

In this overview paper, the focus of discussion is, however, on financial resources for development that are domestic in origin. For the overwhelming majority of economies in the ESCAP region domestic resources constitute the bulk of investment expenditures. It is true, however, that even those economies in East and South-East Asia, i.e. economies with high savings rates, investment rates have been even higher, necessitating external private capital inflows. The saving/investment gap has been reflected in current account deficits that for many of these economies ranged between 5 and 7 per cent of GDP in the 1990s (see table 1). In South Asia, on the other hand, the situation has been both quantitatively and qualitatively different. While domestic savings have been insufficient to finance domestic investment, both savings and investment, measured as ratios of GDP, have been lower than in East and South-East Asia. The resultant current account deficits have been financed by ODA rather than private capital inflows. This holds true also in the least developed economies. However, taking the ESCAP region as a whole and looking at domestic savings and investments as broad aggregates, domestic resources have constituted around four fifths of domestic

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investment in the region over the 1990s. Thus, while external resources have been important as an additional element in financing development, the latter has been primarily based upon domestically raised resources.

For most of the 1980s and early 1990s, the approach of the international community to development was dominated by an emphasis on domestic resource mobilization primarily involving tax reform. The content of tax reform was to be influenced by the move towards creating a market-friendly policy regime. The reform of income, corporate and trade-related taxes and a greater reliance on domestic value-added taxes were the major planks of this strategy. Another element in this approach was the liberalization of the domestic financial sector involving the deregulation of interest rates, the elimination of directed credit and freedom of entry into the financial sector for both domestic and foreign private investors.

The above approach to development financing has come under serious questioning in the late 1990s. Many developing countries have found it very difficult to deal simultaneously with the deregulation of domestic financial markets and challenges associated with globalization.. This was starkly demonstrated by a series of financial crises during the 1990s in Asia and elsewhere. Concomitantly, official aid flows have been on a declining trend for some time. As a result, the subject of domestic resource mobilization has once again taken centre stage.

The mobilization of domestic resources is thus the foundation for self-sustaining development. Domestic resources play the main role in financing gross domestic investment and social programmes. A dual challenge lies in generating an increasing stream of domestic resources and efficiently channeling them to development ends and to increases in productive capacity. This requires an environment conducive to private savings, the consolidation of public finances, efficient and effective mechanisms for the allocation of public expenditure and adequate room for private initiative – in short, sound macroeconomic policies.

Macroeconomic policies play a major role in promoting domestic resource mobilization and development. Proper macroeconomic policy -making depends heavily on the initial conditions that were extant, and how economic and social priorities have evolved, in particular countries. Decisions on particular objectives and choice of policy instruments are thus best left to individual countries. Nevertheless, a sound general principle is that sound policy requires as a foundation medium term objectives that provide a relatively predictable framework for short-term policy decisions. Sound macroeconomic policies, as a bonus, also encourage capital inflows and discourage capital outflow especially in the form of capital flight. A key measure for ensuring long run stability is to manage macroeconomic policy in boom periods in such a way as to avoid deep recurring cycles in economic activity. While individual countries cannot wholly insulate themselves from what happens in the global economy as we have witnessed in recent months, they should aim at achieving sustainable fiscal and current account balances and low or decelerating inflation. This, in turn, implies an exchange rate regime consistent with the other elements of the overall macroeconomic package.

Different groups of countries face different challenges in macroeconomic management. One important factor – other than the level of development itself – is *macroeconomic capacity*. This refers to the level of human skills and the efficacy of instruments and institutions necessary for making and implementing policies. Countries should assess their

capacity in this area realistically and avoid taking on tasks for which they may not be fully prepared. Hence, all countries need to emphasize the strengthening of their public institutions so that policy making can be securely placed in the public domain and provide a credible anchor to private sector households and corporate bodies to plan ahead for the future. The strengthening of institutions is, however, a demanding and complex process and robust institutions tend, on the whole, to evolve rather than be created by administrative fiat.

Mobilizing domestic public resources through fiscal measures, while not stifling private initiative, is the key in achieving sustained long-term growth. In this regard, the domestic financial sector has played, and will continue to play, a critical role in generating resources for development for both the public and private sectors. The purpose of this overview, however, is to focus on the role of the domestic financial sector in mobilizing resources for development and the issues germane to it rather than on issues of fiscal policy, important as the latter undoubtedly are. A financial system that facilitates an efficient allocation of financing for productive purposes and widespread facilities for savings and access to credit is essential for domestic resource mobilization and equitable development. When financial systems function well they mobilize resources and savings and allocate them at low transaction costs to their most productive uses. Well functioning financial markets also facilitate the trading, hedging, diversifying and pooling of risk and the efficient intermediation of external financial resources.

SAVING AND INVESTMENT

Data on savings and investment in the ESCAP region since 1985 show that overall the ratio of savings to GDP has been on a gentle upward trend from around 21 per cent in 1985 to 29 per cent in 1999. This is, on the face of it, a very positive sign for the region. However, when the overall picture is disaggregated, it is clear that this relatively high level of the overall savings rate is mainly accounted for by the high-growth countries in East Asia and South-East Asia. Four ASEAN members (Indonesia, Malaysia, Singapore and Thailand) as well as China; Hong Kong, China; and the Republic of Korea have all had savings rates greater than 30 per cent since 1990 (except Indonesia in the last three years). Savings rates in South and South-West Asia and the new members of ASEAN have historically been and remain, with a few exceptions, below 20 per cent. Most of the Central Asian republics also have quite low savings rates, two (Armenia and Kyrgyzstan) even having negative rates.

For the ESCAP region as a whole there is a relatively close correspondence between the savings rate and the investment rate. This implies that the region is generating almost enough resources itself for its development purposes. However, this is not true across subregions or countries. All South and South-West Asian countries, except the Islamic Republic of Iran, have had investment rates higher than their savings rates, implying a significant inflow of external resources. Much of this has come in the form of ODA, rather than FDI. This is also true overall for many of the Central Asian republics in recent years, where the domestic savings rate is about one half of the investment rate. (As exceptions, the Russian Federation has an increasing excess of savings over investment, whereas in Kazakhstan and Uzbekistan, the two have been almost in balance.) In South-East Asia and the Republic of Korea there has generally been a close balance between the savings and investment rates, except in the heydays of high growth in the early 1990s when FDI and other private flows surged in, and in the aftermath of the recent crisis when savings considerably exceeded investment. In most of these countries, except Indonesia, savings rates have been more or less maintained whereas - investment rates have fallen considerably. Among these countries Singapore appears similar

to China and Hong Kong, China where the savings rate has usually been larger than the investment rate and there has been a net outflow of funds.

INSTRUMENTS AND INSTITUTIONS

The principal instruments in the ESCAP region to attract private-sector (both households and enterprises) savings have been bank deposits of various sorts (see table 2). There has been very limited diversification in most developing economies into the holding of stocks, bonds and related financial instruments, and some development of pension and insurance funds as well as postal savings or unit trust systems, provident funds and other institutional forms for holding deposits. In a large- and medium-sized economy there should be a more diverse financial system with not only banks (and equity markets) but also markets for longer-term instruments such as public and private bonds and mortgage markets, as well as institutional investment groups such as pension funds, life insurance and mutual funds and various non-bank financial institutions. There is also a need for some securitization **modalities** particularly for infrastructure development and real estate markets. For smaller economies, the banking structure might be better complemented with access to capital markets of larger neighbours or regional capital markets, as domestic ones would be too small, too shallow and too thin to be viable. Nevertheless, the development of a professional and modern banking system remains crucial for all countries.

The sound functioning of a financial system requires both the internal discipline provided by market forces and the external governance provided by regulation and supervision. The regulations that impinge on transactions in financial markets relate to governance arrangements, transparency requirements, financial accounting and auditing rules, debt covenants, and bankruptcy procedures. A well-functioning financial sector is one that has a transparent and efficient overall legal framework and administration, complemented by efficient and independent regulatory and supervisory institutions to reduce excessive risk-taking and moral hazard as well as an effective insolvency regime that properly balances the rights and obligations of debtors and creditors. The system should foster good corporate governance, transparency by both financial institutions and enterprises, and high standards of accounting and auditing practices in private and public entities; it should also foster a competitive environment to facilitate efficiency and innovation in financial services, including the encouragement of **in-country** operations of foreign financial institutions. It is not obvious that these conditions are being adequately met in the majority of ESCAP member countries.

The banking sector

The banking sector continues to dominate as the major savings/investment conduit in all financial markets in the ESCAP region. Except for Hong Kong, China; and Singapore, equity markets in the more advanced economies are no more than one quarter of the size of the banking sector and the bond markets in all these countries are no more than 10 to 15 per cent, except in the Republic of Korea. In other economies, capital markets are even smaller. Therefore, the health of the banking sector is central to the ability of countries to mobilize their domestic resources for development. However, it should be noted that heavy reliance on bank financing can lead to a significant mismatch between the maturity structure of assets and liabilities of corporate entities and that of banks. Since a significant number of corporations, both public and private, require funding for long-term investments (such as infrastructure and construction or capital goods projects), a dependence on bank loans, which

are short-term by definition, makes the financial viability of these corporations highly susceptible to short-term swings in the economic environment.

The banking sector in the region has undergone considerable change over the last 10 years, and even more so after the recent financial crisis. The sector has been modernized in the use of IT, liberalized in the ownership and deregulated in terms of being less a direct instrument of government economic and investment policy. There have also been regulatory and supervisory reforms and approaches to solving the NPL problems. There has been considerable progress region-wide, but there are still a number of outstanding issues to be tackled. These are described below.

The structure of the banking sector varies considerably among countries. In some, including Malaysia and Thailand, there is a relatively small number of major banks, mainly private ones; in other countries, such as India and Pakistan, with a relatively small number of banks, the major ones are in the public sector. In yet others, including Indonesia and the Philippines, there is a much larger number of relatively small banks, usually private ones. The reasons for these varying structures are often historical and are directly influenced by the bank licensing policies of the government. Recent post-crisis reforms have included more stringent rules on starting up and operating banks. Thus, in several countries there have been bank closures or mergers leading to a decline in the number of banks. In theory this should increase confidence in the banking sector and leave it with a set of more financially viable banks.

The 1997 financial crisis in the region exposed considerable operational weaknesses in the banking sectors of countries in East and South-East Asia, including problems with cash-flow management; risk identification and management; maturity management; project evaluation and transparency. While these areas are being addressed, much remains to be done as large segments of the banking industry remain undercapitalized and loan growth is minimal. Without further progress, the domestic mobilization of resources and the capacity of banks and the corporate sector to raise funds for investment of various sorts will remain weak.

The financial sectors of most other Asian and Pacific countries are considerably more underdeveloped and weaker than those of the crisis countries. For instance, South Asian countries are, in general, less financially developed in terms of selected quantitative indicators in comparison to both the crisis economies and to world norms. In qualitative terms, a recent [study](#) on the financial markets of selected countries concludes that transparency and bank supervision in a large number of non-crisis countries are not in any better shape than in the crisis countries. Financial weaknesses in these non-crisis countries are due, in part, to distortions arising from the need to finance large government budget deficits (South Asia) or directed lending to state-owned enterprises (such as in China and Viet Nam). State banks in these countries are usually afforded preferential treatment, often in terms of tax concessions and access to public-sector deposits. This can thwart competition and reduce efficient bank intermediation. The poor quality of bank supervision has also led to NPLs being understated and banks being insufficiently capitalized. Reform and liberalization of the financial systems of these countries is under way, with considerable progress noted in [India](#), but enforcement of key legislation remains weak in many countries.

As testified by the high level of NPLs prevalent in the banking systems of almost all developing countries in the ESCAP region, most commercial banks have not followed market

signals in their lending policies. Instead they have been primarily using relation-based lending practices and have been non-transparent about their financial performance. Thus, there is an urgent need to find ways of inducing banks to move towards data-based lending practices, such as credit scoring. One proposal worth considering is to increase the transparency of operations in both the banking and corporate sectors by putting pressure on the banks to improve their disclosure practices. They, in turn, would then have to demand enhanced disclosure (in terms of quantity, quality and timeliness of reports) from their clients, particularly enterprises, in order to meet their own reporting obligations. Pressure on the banks could be through domestic regulatory agencies and could, in addition, be backed up by good practices recommended by BIS or IMF. This would add weight to the regulatory authority's demands and compliance with it could form part of the BIS or IMF country reports which are available worldwide.

Most banks have used rudimentary credit assessment methodologies, when these have been applied at all. A significant improvement in their credit assessment capabilities is urgently required. The bank regulatory authorities need to verify use of these assessments for the granting of loans and impose appropriate penalties in the event of any breach. While this can be done with concerted in-house training in larger banks, it is difficult and expensive for smaller ones. It is necessary to devise some modalities for coping with this problem: BIS standards for data-based credit rating and assessment of risks could be a useful reference. Banks need to reduce their high percentage of NPLs before implementing improved credit assessment methods.

One of the problems facing banks is how to conduct credit assessments of SMEs, which usually have no track record and no proper financial recordkeeping. One initiative which has proved somewhat successful in Hong Kong, China is to establish an independent credit bureau, supported by an adequate legal and institutional framework, whose job it is to check the credit standing of SMEs and other firms not listed on any equity market. Such bureau could provide a useful service for banks until they can undertake such functions themselves or until firms of all sizes develop track records on loans. However, the large number and variety of SMEs make such a proposition very difficult to implement in an economy of any size.

The ownership structure of banks in some of the crisis countries has changed dramatically in the last few years. This has been due to liberalization, allowing the ownership of banks, finance and security firms by foreigners, and the consequent inflow of FDI to buy significant equity stakes in such firms. There has been a similar but slower liberalization of ownership of banks in the other economies of the region. There are arguments for and against an increase in foreign participation in the banking sector. While foreign competition can increase pressure for consolidation and modernization and for the introduction of new products and services, there can also be a flight to quality as domestic clients might prefer to deal with banks having foreign participation, leaving domestically owned banks to service less attractive and more risky segments of the market. This could negatively influence the financial viability of the latter institutions.

In many countries the number of finance companies, which had soared in the East Asian and South-East Asian high-growth economies in the early 1990s, has declined substantially and only the more viable firms are left in the market. Nevertheless, the importance of banks in providing commercial lending in the medium to large economies of the region is slowly declining, and capital (stock and bond) markets are of increasing importance as a modality

for mobilizing domestic funds. This is partly the result of a deliberate government response, and it is expected over time to increase the stability of the economy through the diversification of modalities to finance investment. In the longer run, banks should assume a less dominant role in the financial structure and learn how to cope with competition from a more diversified set of institutions.

While banks have been the traditional modality for savings and loans for both individuals and enterprises, they have not catered well to the needs of the poor, the remote, the landless, the asset-less, or the dispersed population, nor of SMEs and the informal sector. In many countries both public and private banks have extended their geographic coverage within national borders over the past decade, thus making bank savings available to a wider proportion of the population. The increased use of information technology in the banking sector, particularly the use of ATMs (automatic teller machines), has assisted this development. However, there is still a need to expand bank networks, including taking advantage of new technologies for electronic banking, in several countries where such services are mainly urban-based. The unmet demands for service from the disadvantaged groups could then be met through the banks as well as through other means (see the next section).

In most countries, irrespective of their level of development, there are public-sector specialized banks with a distinct focus on a specific sector, such as agriculture or housing. These banks often have an important role to play in mobilizing savings (and intermediating these into investment) in sectors which are of little or no interest to commercial banks, either private or public. The promotion of these specialized banks needs to be undertaken with care so that they operate as closely as possible on commercial terms and yet are able to service their particular clients. Sometimes they play an important anti-cyclical role in the economy, encouraging savings and making loans when other banks are reluctant to do so. This has been the experience, for example, in Thailand in the last couple of years with the Government Savings Bank and the Bank for Agriculture and Agricultural Cooperatives.

Policy issues

The reform of the banking sector in almost all ESCAP member countries, developed and developing alike, has been an ongoing process over many years. Much has been written about the reforms needed. IMF and the World Bank as well as ADB have been promoting reform packages and governments have taken selected reforms on board. However, much remains to be done if the banking sectors of the developing countries are to be ready and able to face the challenges of continuing to be the main conduit for the mobilization and use of domestic resources for development in an open, competitive and globalized financial system. The reforms required have several components. These include:

- (1) Increasing the ***clarity of objectives*** for the operation of the central bank and the lines of its reporting (accountability) to the government. Usually the central bank is responsible for the operation of the exchange rate regime and for the money supply and related monetary variables such as inflation. It is generally accepted that, given the inherent conflict of interest between the objectives of the central bank to keep inflation low and the exchange rate reasonably stable and those of the government in its fiscal operations, the more independent the central bank, the better it performs in relation to its objectives. However, there are limits to this independence as it is the government which is ultimately responsible for the development policy of the country.

- (2) Clarifying the division of responsibility between various *supervisory and regulatory agencies* on the supervision and regulation of the banking sector and their relationship with supervision and regulation of other financial firms, some of which are owned at least in part by banks. Several countries have or are considering making the supervisory agencies independent of the central bank to avoid any conflict of interest between the modalities used to achieve macroeconomic policy objectives and those for the effective supervision of banks. However, there may be problems of duplicating information and reporting functions, with each agency wishing to collect its own data, as well as of coordination.
- (3) Implementing the *Core Principles for Effective Banking Supervision* developed by the Basle Committee on Banking Supervision, including a capital adequacy ratio and standards for credit/risk assessment and auditing of banks. The Core Principles are now becoming part of IMF conditionality and training on them is increasingly available from BIS, IMF and the World Bank. Being able to state that banks are supervised according to these standards would certainly increase both domestic and foreign confidence in the soundness of a country's banking sector. However, the capital adequacy ratio was constructed for more mature banking sectors and many developing countries should consider developing their own responses in the light of their individual circumstances to the BIS standards, especially those embodied in the new Basle Capital Accord.
- (4) Demanding an increase in the *levels, quality and timeliness of disclosure* by banks and using BIS or IMF to back up standards of bank reporting and disclosure as discussed earlier.
- (5) Dealing with *NPL problems* in an orderly and definitive manner and implementing a legal process for intervening in, rehabilitating or liquidating banks in financial straits. Recent exchanges of experience among the crisis countries on the treatment of NPLs reveal that the responsible authorities are aware of the need to improve their handling of this problem. However, the large volume of NPLs poses a problem for financing development in many countries in the region, not just the ones affected by the crisis.
- (6) Promoting *information-based professional credit and risk assessment procedures* in banks, including through the flexible and phased application of BIS standards and enhanced disclosure by banks of their operating procedures.
- (7) Promoting the *use of information technology* and new ways of conducting business to - improve efficiency in the banking sector for the benefit of depositors, including the spread of ATMs and ATM pools, e-banking and new products of interest to savers supported by professional investment counselling services.
- (8) Promoting *human resources development* in the central bank and in other banking - institutions in a wide variety of areas, including all those mentioned above.
- (9) Reducing the *direct use of banks* by the government as a source of funds or as a modality for directing credits, and putting public-sector and government-specialized banks progressively on the same footing as commercial banks.
- (10) Ensuring *competition* within the banking sector, including further cautious liberalization

of entry by foreign banks or financial firms.

The above list should not be seen as exhaustive. Given the continuing need to rely on the banking sector as a primary engine for intermediating domestic resources, it requires ongoing attention to enable it to serve a country well; no country can afford to let its banking system fail as this would severely disrupt the flow of funds and development. The reform process is thus not static and its contents have to be specific to the country context and to the evolution of banking standards worldwide.

Other institutional arrangements

Mandatory provident funds, state-sponsored unit trust schemes or fully-funded pension schemes have been employed very effectively in Japan, Malaysia and Singapore, among others. **They have the potential to raise the savings rate by 3 to 4 per cent of GDP, and also to provide an ideal source of institutional finance**, mainly for the public sector. However, the impact of such schemes on aggregate savings depends on the extent to which they substitute for other voluntary savings. Evidence on the fully-funded Central Provident Fund in Singapore shows that it has stimulated aggregate saving. Nevertheless, such schemes so far have been successfully organized in countries that have a significant proportion of the labour force in the formal sector.

Pension funds add to the modalities for savings. But more importantly they provide a valuable addition to the institutional investor pool for domestic capital markets, as well as a source of social security and a safety net for the retired. In most Asian and Pacific countries, there is no universal retirement system beyond the public sector that fosters the regular contribution of funds from both employers and employees. With the increasing age of the population in many countries, pension funds could potentially be quite large. However, starting new schemes is a long-term proposition as they take years to build up a sufficient financial base; many smaller pension funds in the region have inadequate capital and high operating costs. In addition, it does not seem currently feasible to organize pension funds on a sustainable basis for the informal or unregistered sector.

Insurance schemes offer another form of savings with the funds collected being invested in various financial instruments. Life insurance, unemployment insurance and other forms of insurance in the ESCAP region exist mainly in the government sector and in the formal sectors of the economy. The coverage varies from country to country; 11 per cent of the population of Thailand have life insurance compared with 80 per cent in Japan and 70 per cent in Hong Kong, China. In India, premium payments for all forms of insurance are a tiny proportion of financial savings. However, the liberalization of this sector is under way and a number of firms have applied to offer life and general **insurance**. In the aftermath of the recent crisis and in line with WTO agreements on services, this sector is being opened up to foreign investment. For example, in Thailand in 2000, foreign companies had stakes in 13 out of 25 life insurance companies. One of the constraints facing expansion in this area is that many insurance schemes lack credibility because of unscrupulous brokers who deal with the individuals buying and claiming under the schemes. It appears difficult to supervise all brokers even through a viable national association of dealers which undertakes self-regulation and stresses ethical behaviour.

Using the postal system as a vehicle for collecting household **savings** has been a modality in a number of countries for quite some time. As post offices tend to have a wide

geographic distribution, they are often accessible by rural households in areas where there are no banking outlets. They have been a natural vehicle for uses beyond postal services. In addition, governments have given incentives to households to save through post offices and, with governments being the holder of the deposits, they have used the funds to invest in more projects, including social infrastructure, than they could have without access to these funds. However, as private banks and other financial institutions have improved their outreach, postal savings systems have tended to die out. There have also been problems with the viability of some of the government investments made with postal savings deposits, affecting the financial sustainability of the system. Nevertheless, there is some renewed interest in postal savings systems, especially for remote rural areas, as a modality for encouraging households to save in forms available for intermediation to government investment.

Microfinance schemes provide savings and credit mechanisms for those beyond the reach of the formal banking system, often the poor who lack collateral. Many have been successful in inculcating the habit of savings and so provide a way to intermediate resources at a micro level. It is likely, though, that the effect on the overall savings rates in an economy is rather small. According to the World Bank, there are at least 120 microfinance institutions in East Asia and South-East Asia, and about 100 in South Asia. In East Asia and South-East Asia, about 44 per cent of the funding for microfinance comes from donors; this figure is larger, about 54 per cent, in South Asia. About 32 per cent of the funding in East Asia and South-East Asia is from deposits (savings) and only 4 per cent from governments. In South Asia, deposits contribute about 30 per cent. It is interesting that for the microfinance schemes run by banks or credit unions, around 70 per cent or more of the funding comes from savings deposits, whereas for NGO-run schemes, over 50 per cent comes from donor contributions. However, in South Asia, NGO schemes obtain about 22 per cent of funding from deposits, the highest percentage in any region.

The proliferation of microfinance institutions has led to the need to reassess their role as a tool for resource mobilization and as a poverty alleviation mechanism. The question is whether users (savers and borrowers) can “graduate”, that is, if people go on saving or borrowing small amounts, has their situation really changed? Evidence on this is very mixed as it is difficult to conduct counterfactual studies. It would appear desirable to graduate some of the users with good savings and loans track records to regular savings accounts and larger loans.

Some microfinance institutions themselves have graduated into the regular financial system. Some, including the Grameen Bank of Bangladesh, are registered banks and so follow rules on capital adequacy etc. This means that users have reduced risks in saving with and borrowing from the institution. Another option under consideration in countries with a history of microfinance is to use an apex-type organization as an intermediary between local NGO microfinance schemes and formal financial institutions. Such an organization can, as one of its functions, borrow funds from the formal institutions and lend them on to the microfinance institutions, presumably at a better rate of interest than the individual NGOs could. Palli Karma-Sahayak Foundation plays this role in Bangladesh and recently has provided as much as 17 per cent of the funds for NGO microfinance. Such an arrangement should increase the willingness of individuals to save with NGO institutions. However, when microfinance schemes are sustained by injections of funds from governments or donors, both of which may be unpredictable sources of funds, their future is quite uncertain. There is, thus, a need to increase the number of savers and the percentage of loans covered by saving deposits. All schemes should work towards being more self-supporting as a way of

encouraging more micro-level domestic resource mobilization.

Policy issues

The main issues for government policy in the area of mobilizing domestic resources for development through non-bank institutions include:

- (1) Whether to create or strengthen ***mandatory savings schemes***. The benefits of mobilizing funds for government investments through these modalities need to be weighed against the efficiency of the investment decisions and a judgement as to whether the savings generated are additional or a diversion from the other modes.
- (2) How to encourage ***pension and insurance schemes***. The decision on whether to legislate such schemes nationwide or to leave this area to private initiatives under better developed regulation and supervision is a country-specific one. However, with an increase in the older-age population in many countries of the region, pension and life insurance schemes are definitely likely to be on the agenda. The regulatory legislation for these schemes and their effective enforcement are crucial to their being viewed as an attractive form of savings for households.
- (3) How to make ***microfinance schemes*** an attractive and secure modality for small-scale savings and how to provide ways and means for users to graduate to formal-sector financial institutions. The following options need to be considered: registering microfinance institutions under banking legislation; using an apex organization to provide intermediary services between the microfinance institutions and the banking sector; and increasing the security of funding of microfinance schemes, inter alia, through increased reliance on deposits as a source of loan finance.

Capital markets

Stock markets

Stock markets have assumed, as yet a small, but increasing, role as a means of mobilizing domestic resources and providing a wider range of financial services (see figure 1). This has been facilitated by deregulation and liberalization measures, as well as by specific policies to foster their development. Until recently, domestic capital markets have had a rather restricted clientele, mainly urban and relatively well-off groups, and sometimes foreign investors. The robustness of these markets is thus positively associated with a widening of their participants, including through the emergence of mutual funds and provident funds which collect individual savings into funds for investment by professional managers.

The market capitalization of stock exchanges fluctuates on a day-to-day basis. More recently, following greater international integration of stock markets, markets in the region have become strongly correlated with stock markets in the United States. However, taking a broad view of the last few years the following trends are evident. Except for Malaysia, all developing countries that are not financial centres have markets less than 100 per cent of GDP. The ASEAN members Indonesia, Philippines and Thailand, as well as China and India, have shown considerable growth over the last decade in both the number of companies listed and the capitalization relative to GDP; for the other countries the stock market remains

small, less than 20 per cent of GDP. Consequently, their stock markets are too thin and too shallow to be a viable place for investing or raising funds. They are rather vulnerable to corners, speculative runs and other forms of manipulation. There are doubts about the future of these markets unless ways can be found to increase their robustness. Another issue that needs intensive examination is whether countries without stock markets should be encouraged to develop small ones or other more viable ways of diversifying their financial sectors.

In general, almost all the major stock markets in the region, including those that were most severely affected by the Asian currency crisis, suffered dramatic drops in size and turnover during the crisis but recovered by the end of 1999 to levels that exceeded their respective levels in 1990, then experiencing another drop in 2000 that has, by and large, persisted into 2001. Most of these markets had opened trading to participation by foreign investors during the 1990s. A few markets that were not so affected by the crisis, including China, have continued to grow. The turnover ratios in developing country markets tend to be quite variable and generally reflect both efforts to widen the investor base and investor sentiment (including sentiment by foreign investors) about the strength of the **economy**. A higher turnover reflects more confidence, but this is almost impossible to achieve in small, thin or narrow markets.

Despite signs of stability and continued positive private savings behaviour, most corporations in the region are experiencing difficulties in raising funds. This is caused by three factors: (a) banks and other financial institutions have become more reluctant to approve new loans or to roll over existing credit lines; (b) alternative means of financing (for example, structured financing and syndicated loans) have become almost unavailable; and (c) the weak performance of individually listed companies on stock markets makes it difficult for them to raise funds through this market. The difficulties in the financing process appear to be a manifestation of an information asymmetry problem for these corporations. As a result of the recent financial crisis, there is a general decline in the credit standing of borrowers. Given a general lack of credible information from the stock-issuing companies to investors and lenders, investors tend to focus on the larger better-known corporations with a perceived higher level of credit performance. Corporations that are unable or unwilling to demonstrate their creditworthiness, as exhibited through company financial reports, suffer from a deterioration in access to funding sources. The most seriously affected firms are those listed on stock markets with small capitalization (which suffer from a lack of investor interest) and SMEs (which suffer from the reluctance of banks to provide financing and which have limited or no access to other forms of finance).

An illustration of this phenomenon is found in Hong Kong, China, where blue chip companies have enjoyed significantly better performance than the broad market index. The Hang Seng Stock Index comprises 33 blue chip stocks whereas the All Ordinaries Index is an aggregation of all listed companies (approximately 700 as of 1999). In terms of market capitalization, the 33 Hang Seng Stock Index constituent companies represent approximately 70 per cent of the total market size. For the period January 1997 through June 2000, the Hang Seng Stock Index increased by 52 per cent whereas the All Ordinaries Index rose by merely 22 per cent. Among the constituent stocks of the Hang Seng Stock Index, China Mobile (previously China Telecom) and Hutchison Whampoa are among the largest and highest rated companies. From 1997 through June 2000, the value of the stocks of the two companies increased by 500 and 200 per cent, **respectively**. The discrepancy in stock price - performance illustrates the fact that only a handful **of** good name companies are regarded by

investors as worthy of investment; the rest of the corporations are still very constrained in their ability to raise funds on the stock market. Some governments, such as that of Thailand, have encouraged their stock market regulators to improve rules on disclosure and -accounting/auditing. However, much remains to be done and it would be beneficial to Asian stock markets to promote best practices in shareholder communication and in related corporate governance.

The financial infrastructure for stock markets refers to the environment in which financial transactions are carried out; it includes the legal and regulatory framework, the financial institutions involved and the trading mechanisms. An important component of the financial infrastructure is the trading, clearing and settlement system. An efficient and effective trading environment can enhance investor (saver) participation and reduce systemic risk, such as the inability to complete a trade. These benefits are translated into a higher liquidity and a reduced cost of capital for listed companies. Improvements in the infrastructure of local stock markets can stimulate local investors (savers) to hold domestic stocks, thereby enhancing the robustness of the market. In India, for example, much progress has been made recently in three areas, trading modalities, depositories and settlements. Most trading is now automated and investors should be soon reaping benefits in terms of cheaper transaction costs and better service.

Bond markets

Countries in the ESCAP region are generally characterized by underdeveloped longer-term investment (bond) markets. With the exception of the Republic of Korea, bond markets are very small as compared with bank loan and equity markets. The lack of a functioning bond market means that a domestic economy is vulnerable to sudden and short-term changes in investor confidence. When confidence dissipates, investors (local and foreign) do not have a more secure and stable investment alternative on which to hold. The ensuing flight to quality leads to withdrawal of funds from the country. The presence of a (high quality) bond market with sufficient market depth would thus enhance long-term economic development prospects. However, the current state of capital markets in the region is not favourable to the development of such markets. Factors accounting for the slow development include poor financial infrastructure, the lack of benchmark bonds, fragmented capital markets, the lack of competitive credit markets, a general low credit standing for Asian corporations, the lack of pertinent financial information of the borrowers, and the inadequacy of investor protection. In most of the countries, in fact, the financial sector itself is the dominant holder of -government debt instruments because secondary markets are not fully developed. Without secondary markets for debt instruments it is difficult to conceive that a large number of investors would be attracted.

Japan has the most active bond market with a size that accounts for some 85 per cent of the entire Asian bond market. The Republic of Korea is the second largest market, approximately 6 per cent of that of Japan. Singapore is the only other major Asian debt market; all other markets in publicly listed bonds are very small. For example, in India and Pakistan, the government dominates the issuing of bonds but only a very small proportion of the stock of bonds is traded daily, most bonds being held to maturity, mainly by banks and other financial institutions to meet their statutory liquidity requirement. It should be noted, however, that in several economies (for example, Hong Kong, China; Indonesia; and the Philippines) bonds are only or mainly traded over-the-counter among investors (mainly banks and financial institutions) and as a result it is difficult to obtain reliable information on the

actual size of the bond market.

In the aftermath of the 1997 crisis, bond trading and bond issuance declined significantly in the second half of 1997 and in 1998. In particular, investors typically bought bonds with a high credit standing and refrained from investing in ones with a low credit standing, thus creating a polar development in the bond market similar to that in the stock market. Secondary market activity picked up in 1999 and the bond turnover appears to have recovered to pre-crisis levels in most developing countries, but not in Japan. Bond issuance began to pick up in 1999, but in many markets it has still not recovered to the pre-crisis levels. In addition, the bonds issued in 1997 and 1998 are of significantly shorter maturity. In other words, Asian bond markets are still unable to provide a stable source of long-term funds for corporations.

Domestic investors in the developing countries of the ESCAP region have generally exhibited a weak demand for long-term fixed income securities. This phenomenon is associated with the underdeveloped systems of institutional investors. In fact, it is often claimed that without the participation of a significant number of institutional investors, such as mutual funds, pension funds or insurance schemes which are independent of the banking sector, bond markets are not viable and their pricing is suspect. In turn, a lack of investor demand leads to illiquid markets and high transaction costs, and weakens the incentive for issuing bonds. In the case of Hong Kong, China, for example, high-quality private bond issuers typically raise debt financing in Luxembourg where the institutional demand for fixed-income securities is comparatively high.

Thus one measure for enhancing bond market development is to adopt a nationwide retirement benefit system. For example, Hong Kong, China is launching a mandatory provident fund (MPF) scheme for all employees. Under this defined benefit scheme, employees need to contribute 5 per cent of their monthly income (subject to a certain ceiling) and the employer contributes another 5 per cent. The funds will be invested in qualified MPF programmes organized by approved MPF providers. There are investment guidelines for MPF providers, including the portion that is to be invested locally and the portion that should be invested in fixed income securities. In the long run, the funds from MPF programmes will likely increase the demand for bonds and promote bond market development. However, the MPF scheme is unlikely to show immediate results since it will take time for MPF contributions to grow to any significant size.

Many governments of the crisis countries have recognized that their long-term debt markets are underdeveloped, their corporations over-leveraged, and a vicious circle of NPLs had developed. For many governments the development of a corporate bond market is a priority. For example, measures taken in Thailand have included the removal of the tax bias against bond holding and the development of a benchmark curve based on government issues. Starting from September 1999, the Bank of Thailand has been holding auctions of baht-denominated treasury bills so that yields for debt instruments of the same or lower maturities can be determined. More auctions are planned, but the secondary market liquidity is still very small. In the Republic of Korea, measures include reform of the bond-issuing procedure, introduction of new debt products (such as repurchase agreements), and reorganization of the secondary bond market. There have also been efforts to promote participation from a wider range of retail investors. The case of the Philippine treasury securities is an example of the promotion of a local bond market with sufficient market depth. In South Asia there is quite a lengthy, but not very positive, experience with retail bonds

which are not traded (there is hardly a secondary market). This experience indicates that unless the investment of the small savers is adequately protected, it is difficult to sell them bonds. Accordingly, financial intermediaries need to be registered, regulated and provided with adequate training in order for them to be able to generate investor confidence.

The development of a risk-free benchmark yield curve as the reference for the estimated rate of return on bonds is usually done by promoting a government treasury securities market. Its risk-free yield curve facilitates private issuance as investors normally price non-government securities based on a spread over the equivalent risk-free or government security with the same maturity. Several governments have used this technique (for example, Australia; Hong Kong, China; and Singapore) and maintain benchmark curves using treasury securities even when there is no need for the government to raise funds. Except for these economies, mid- and long-term benchmark government bonds do not exist; rather there are short-term benchmark government securities (such as the central bank issues in Thailand) or quasi-benchmark bonds such as guaranteed corporate bonds in the Republic of Korea. These are not a good substitute for longer-term government bonds which have very low risk. Hong Kong, China provides an interesting example of the process of developing longer-term bond benchmarks.

Bond markets would clearly benefit from reforms in corporate governance, as good corporate governance enhances the protection of the legitimate interests of the holders of corporate bonds. The elements of governance requiring attention include corruption, lack of transparency in financial transactions, use of accounting methods which do not meet international standards, and unclear ownership structures. While the crisis countries have tackled some of these practices, the adoption of best practices should be expanded. Investor perceptions of intangibles such as corporate integrity, prevention of asymmetric availability of corporate information, and enforcement capabilities of securities market regulators are key determinants of an investor's interest in corporate bonds.

Policy issues: approaches to further capital market development

Despite the myriad difficulties outlined above, establishing capital markets with sufficient depth should be achievable in several economies in the region for a variety of reasons. First, the savings rate in much of East Asia and South-East Asia has been high, at over 30 per cent. This high rate should provide sufficient funding sources to support the development of capital markets. Second, economic growth is likely to continue to be significant in the region. The last two years have seen many Asian and Pacific economies demonstrating a remarkable recovery. As the regional economies continue to grow at a respectable rate, successful firms will emerge and asset quality in general will improve. Third, many governments in the region are paying serious attention to the potential contribution of domestic capital markets in the economic development process. Such enhanced awareness provides a good foundation for governments to work towards identifying and implementing means to enhance capital market development. Outlined below are issues that are pertinent to the basic framework needed for healthy markets to thrive.

- (1) ***Coping with fragmented markets.*** The economies in the region each have their own language, culture, customs and legal framework. Hence, the market structure and its mode of functioning in one country cannot automatically be translated into that of a -

second country. This contributes to the existence of fragmented capital markets, making regional investment difficult and sometimes more risky than necessary. As few of the economies (notable exceptions being China, India and Japan) are large enough to provide economies of scale in information processing, capital market development will be difficult. Given this situation, it would appear more rational to work towards a common set of basic structures and standards so that the regional development of equity markets becomes possible and each economy can see the benefits from contributing to this process. However, the predominance of national interests and a view that markets in the region are competitive rather than complementary mean that this is at best a long-term proposition.

- (2) ***Dealing with the lack of disclosure.*** Both the quantity and quality of information disclosed to investors are limited in most countries of the region. The consequence is that savers inherently assume that investments are risky and demand a steep risk premium. It would be beneficial to all if sufficient relevant information were accessible to investors, either through a mandatory or a voluntary process. The proposal made above to enhance corporate disclosure through enforcing disclosure by banks would certainly benefit the capital markets as well. The standards for such disclosure could also be harmonized among countries. As information technologies continue to improve, regulatory bodies have to constantly review the disclosure guidelines to make sure that corporate managers utilize the most efficient and effective means of communication with investors.
- (3) ***Varying accounting standards*** from place to place with some exceptions, such as Hong Kong, China; Malaysia; and Singapore which use British standards. It would be a very positive step if regional or subregional accounting and regulatory bodies could agree on a common set of accounting standards. Furthermore, efforts are needed to ensure that all investors have access to the same set of sensitive information at the same time.
- (4) ***Reducing government intervention.*** Traditionally, governments in the region tend to offer subsidies to activities that fit their policy thrust. An example is the provision of low-cost housing finance which exists in many countries. By pursuing this course, the return on the relevant capital market instrument, for example, mortgage products in the case of housing, becomes distorted and can substantially deviate from the market rate of return. When the instruments involved are suitable to be part of the development of a viable capital market, such as securitization of home mortgages, the existence of a significant distortion in the rate of return makes this difficult. The reduction and ultimately elimination of such government intervention could contribute to the smoother development of viable capital markets.
- (5) ***Developing benchmark securities.*** As discussed earlier, typically the fixed income securities issued in the region are short term in nature. Therefore, it is impossible to construct a good benchmark yield curve from which efficient bond pricing can be done. It would be desirable if high-quality bonds with longer maturities were available.
- (6) ***Enhancing the role of credit-rating agencies.*** One solution to the information asymmetry problem affecting capital markets is to have the issuers of securities (stocks or bonds) analysed and rated by a credible credit-rating agency. The role of such an agency is to provide an objective analysis of the borrowing firm. Potential lenders can then derive valuable pricing information and assess the risk of holding the security

issued by the firm. Since the early 1980s, many countries have set up their national credit-rating institutions. In some countries it is required by law that debt issuers be rated by a designated credit agency. However, the existing set-ups do not seem to provide sufficient information for lenders or to promote the bond and stock markets effectively. Most of the credit agencies are either government departments or affiliated to the government. Thus, when a state-owned enterprise issues a bond, the credit agency may be reluctant to give the enterprise a negative rating. In addition, the quantity and quality of financial and non-financial information may be inadequate for the credit-rating agency to provide a comprehensive and timely analysis of the borrower's situation.

In some countries borrowers tend to get around the mandatory credit-rating procedure by issuing alternative types of debt. For example, the majority of bonds issued in the Republic of Korea are guaranteed bonds backed by a holding company. In this way, the issuing (subsidiary) company need not obtain a credit rating and hence is not required to disclose the relevant pricing information. In addition, national credit-rating agencies do not appear to provide the information on borrower quality required by international investors. In the more developed capital markets of Hong Kong, China; and Singapore, there is no local credit-rating agency and issuing firms tend to use the service of international agencies, such as Moody's or Standard and Poor's. International credit agencies actually play a significant role in the capital markets of the Asian and Pacific economies as their analyses of the risk profiles of the country, industries and specific firms are often taken by international investors as an authoritative measure of a particular local market. In fact, a few countries have set up their domestic credit-rating agencies in collaboration with an international agency. For instance, in Indonesia, PEFINDO was established in 1994 on the initiative of the Ministry of Finance and the Bank of Indonesia under a partnership agreement with Standard & Poor's. PEFINDO has rated some 200 companies involving about 250 debt securities. This partnership has contributed to PEFINDO gaining international credibility.

The options for future action in this area include establishing a regional credit-rating agency or, at least, coordination among national ones to work towards common credit assessment standards pertinent to the region and performance of unbiased analysis and - disclosure. In general, rating agencies should operate according to a professional code of conduct and should be financially independent from both government and corporations. It may be desirable to invite the international credit agencies as founding members so they can participate in the process of setting up the criteria and assessment standards.

- (7) ***Improving the regulatory framework.*** A prerequisite for both equity and debt market development is a good regulatory framework. The general framework should aim at legislating relevant laws, setting reporting and trading requirements for relevant financial institutions, and developing enforcement measures to implement the laws. Usually, a good regulatory framework should promote self-regulation and self-monitoring by financial institutions themselves; it should leave sufficient room for the market participants to act in a flexible manner. At the same time, the system should have measures to encourage good practices and punish offences. The underlying principles include increased transparency and disclosure, enhanced corporate governance and recognition of the accountability of regulators. The outcome of good regulation is a market infrastructure that promotes investor (especially creditor)

protection, has an effective judicial system, and facilitates high-quality economic information. Other than Hong Kong, China; and Singapore, there is evidence of considerable room for improvement. As regulatory requirements vary widely in the region, closer cooperation among regional regulators is needed to work towards a common understanding on these. Such cooperative efforts will also enhance enforcement by filling the information gap, especially for cross-border transactions. It may also be possible over the longer term to explore the establishment of a common trading platform to allow investors to trade securities on a regional basis. This could especially help smaller, thinner and shallower markets to become part of a more viable market system or to allow firms from countries without markets to issue securities on the markets of neighbours rather than develop unviable markets of their own.

- (8) ***Investor education.*** The percentage of savers (investors) holding equity is low in the Asian and Pacific region. The percentage of investors holding other types of securities is even lower. Educating potential investors is critical for increasing the general investor base and empowering investors to perform the analysis of risk and return in the investment process. Investor education is especially important for the promotion of bond markets since Asian investors exhibit a general reluctance to hold fixed-income securities. It should aim at building positive attitudes towards investing as an integral component of managing one's finances and as an important tool for planning retirement and other major consumption purchases, such as houses. It is hoped that the mutual funds being established will provide a good conduit for this exercise, and not be seen as a vehicle for cheating investors. Appropriate regulation and monitoring of mutual funds could go a long way in increasing investor confidence. In fact, various forms of mutual funds, provident funds, insurance schemes and retirement schemes (institutional investors) can be the backbone of capital market revival or development.
- (9) ***Venture capital funds.*** These are sometimes used to stimulate new and riskier investments in SMEs, and sometimes for investment in a country that does not have a stock market (such as Viet Nam until very recently). Venture capital funds are viewed by investors as viable instruments as the monies are not invested in one firm but spread out over many. They can be national or they can also involve external investors. However, they are inherently risky and buyers can be misled about the returns possible, seeing only the upside. Therefore, the tradeability of venture capital shares, say on a stock market, is important in order to get a market valuation of the risk and return. An issue which arises with venture funds is the choice of regulator and the type of regulation and transparency rules to which they should be subject without stifling them.
- (10) ***Increased cooperation among stock exchanges.*** There is plenty of room for cooperation among both exchanges in the region and with those of the developed countries. Alliances with exchanges in the United States and Europe can form a market place for 24-hour trading. Furthermore, such alliances can promote technology innovation. For example, in 2000, seven NASDAQ listed stocks were to be listed and traded on the Stock Exchange of Hong Kong. The listing of these stocks is part of a pilot programme that will potentially develop into the linkage of the exchange with NASDAQ and other major international stock exchanges. Another notable joint venture is the alliance between Singapore International Monetary Exchange, Chicago Mercantile Exchange and the Marché à Terme Internationale de France. This alliance allows the development of joint trading and clearing systems. However, linkages among the exchanges in the region have always been weak. This may be due to differences in the

cultural background. Another reason is that individual stock exchanges consider the other exchanges as competitors. One form of cooperation is to encourage the cross-listing of Asian stocks in the region. This development would probably be a long-term goal as most Asian corporations are relatively less known to investors outside their home countries. In addition, investors have to face different disclosure and regulatory standards across countries. Nevertheless, there are already some high-quality firms from ASEAN countries which are listed on the Singaporean stock market.

- (11) **Internet trading.** The recent explosion of Internet stock trading offers opportunities for the development of and cooperation among stock markets in the region. In the United States, Internet trading has been established as an efficient and reliable means of securities trading. The emergence of Internet brokerage companies puts significant downward pressure on the commissions charged by securities brokers. The result is that more investors have the accessibility to trade and can trade at a lower cost. Such pressure can be especially intense for markets with regulated commission rates such as Malaysia or Thailand. It is expected that commission rates will ultimately be deregulated in most markets. Such a change, coupled with the increasing ease of trading using the Internet, will likely be associated with more investor participation. In most countries, personal computer ownership and Internet penetration are still at an early stage, but it is expected that the growth in Internet usage will be substantial in the next few years. The Republic of Korea is the most active Internet stock trading market, with over 50 per cent of stock transactions done over the Internet. Internet trading is also active in Taiwan Province of China, with about 15 per cent Internet trading. It is plausible that Hong Kong, China; and Singapore will also pick up the trend of Internet trading in the next two or three years. The Internet can provide a good basis on which national stock exchanges can cooperate, as investors can conveniently access pricing information in other markets. When a common trading platform across different markets is available, it can be expected that the integration of investor activities will speed up.

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Taking the situation in the ESCAP region as a whole the subject of domestic resource mobilization poses three central issues from both an immediate, short term perspective as well from the standpoint of the next few years: one, how do countries cope with the situation of ample liquidity in the financial system and low and declining interest rates, on the one hand, with a virtual absence of creditworthy borrowers, on the other. The so-called 'credit crunch' problem has been much discussed in the region over the last few years with little, or no, indication as to what monetary authorities might do to overcome it. Two, the contribution of micro-finance schemes in providing access to the poor who lack collateral to relatively assured sources of finance is now generally accepted as having been positive. The real question, however, is the efficacy of such schemes in enabling their users to graduate to the formal financial system i.e. how effective the schemes have been in nursing their users to grow to a size where they can access and utilize the banking system and financial markets. Three, a well-developed financial system, i.e. one with appropriate institutional depth in the capital markets, is clearly an essential pre-requisite for sustained developed. This leaves, however, a considerable problem for the smaller economies to overcome. The issue that arises therefore is what could small economies, such as in the Pacific, do to either access or, over the long term, develop viable capital markets for themselves.

Table 1. Resources gap of selected developing economies in the ESCAP region, 1995 and 2000

(Percentage)

	Savings/GDP		Investment/GDP		Resources gap	
	1995	2000	1995	2000	1995	2000
South and South-West Asia						
Bangladesh	16.7	21.4	19.1	22.4	-2.4	-1.0
India	25.1	22.7	26.8	23.5	-1.7	-0.8
Pakistan	14.2	14.0	18.3	15.0	-4.1	-1.0
Sri Lanka	15.3	19.0	25.7	29.0	-10.4	-10.0
South-East Asia						
Indonesia	30.6	22.0	31.9	17.9	-1.3	4.1
Malaysia	39.7	46.9	43.6	27.0	-3.9	19.9
Philippines	14.5	17.0	22.5	17.6	-8.0	-0.6
Singapore	50.2	49.8	34.6	31.3	15.6	18.5
Thailand	33.8	30.0	41.8	22.0	-8.0	8.0
Viet Nam	13.6	25.0	27.1	23.0	-13.5	2.0
East and North-East Asia						
China	42.5	38.0	40.8	37.1	1.7	0.9
Hong Kong, China	30.5	32.2	34.8	27.5	-4.3	4.7
Republic of Korea	35.4	30.9	37.2	28.7	-1.8	2.2
Taiwan Province of China	27.0	24.8	25.3	22.8	1.7	2.0
Pacific island economies						
Fiji	12.9	12.0	13.1	12.0	-0.2	0.0
Papua New Guinea	28.9	34.4	19.4	42.0	9.5	-7.6

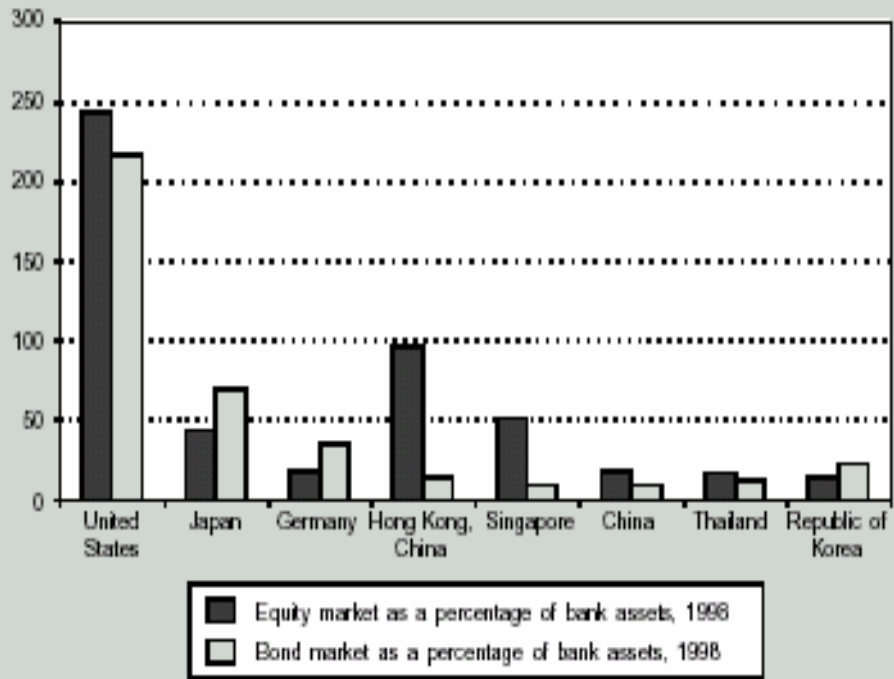
Sources: ADB, *Asian Development Outlook 2001* (Oxford University Press, 2001); and national sources.

Table 2: Size of the financial sector in selected ESCAP economies (average 1998-1999)

	<i>Deposit money banks/GDP (1)</i>	<i>Stock market capitalization/GDP (2)</i>	<i>(1)+(2)</i>
Indonesia	0.36	0.35	0.71
Malaysia	0.99	1.65	2.64
Philippines	0.45	0.59	1.04
Thailand	1.11	0.39	1.50
Republic of Korea	0.76	0.56	1.32
Hong Kong, China	1.66	2.11	3.77
Singapore	1.08	1.12	2.20
Bangladesh	0.30	0.02	0.32
India	0.26	0.33	0.59
Nepal	0.28	0.06	0.34
Pakistan	0.25	0.10	0.35
Sri Lanka	0.24	0.11	0.35
World average	0.43	0.44	0.87
Average of non-Asian developing countries	0.30	0.19	0.49

Sources: World Bank, *World Development Indicators* (Washington DC), various issues; IMF, *International Financial Statistics* CD-ROM, November 2000; and World Bank web site <<http://www.worldbank.org/data/databytopic/GDP.pdf>> (28 November 2000).

Figure 1: Diversification of financial markets



Source: Standard & Poor's, *Emerging Stock Markets Factbook 2000* (June 2000).