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Summary of the Asia-Pacific Countries with Special Needs Development Report 2022: Financing a Sustainable Recovery from COVID-19 and Beyond

Note by the secretariat

Summary

The *Asia-Pacific Countries with Special Needs Development Report 2022: Financing a Sustainable Recovery from COVID-19 and Beyond* serves to highlight the financing needs and gaps that least developed countries, landlocked developing countries and small island developing States face in their recovery from the coronavirus disease (COVID-19) pandemic and in the achievement of the Sustainable Development Goals. The *Report* contains policy options to mobilize financial resources in those countries for that purpose.

Those countries, collectively referred to as countries with special needs, were not on track to achieve the 17 Sustainable Development Goals even before the COVID-19 outbreak. The prospects to do so have worsened due to the severe economic and social impacts of the pandemic. Moreover, the pre-existing financing gaps to attain the Goals have increased significantly since the outbreak of the pandemic due to a combination of declines in government revenues and expanded fiscal and monetary stimulus measures deployed to cushion its adverse impacts. Securing financing resources to recover from COVID-19 in a way that is also aligned with the 2030 Agenda for Sustainable Development is therefore an urgent task for those countries.

The *Report* serves to highlight that domestic tax revenue, debt and official development assistance will continue to be the main sources of development financing in many countries with special needs. Financing through thematic bonds and debt-for-climate adaptation swaps also have the potential to finance sustainable development projects in those countries. As capacity, policy and regulatory gaps, as well as limited engagement and coordination with stakeholders are real constraints in countries with special needs, strengthened cooperation at the subregional, regional and global level is essential to complement their domestic efforts in mobilizing financing for development.

The Economic and Social Commission for Asia and the Pacific may wish to deliberate on the policy priorities and cooperation needs highlighted in the present document and provide the secretariat with guidance on which of these should be explored to a greater extent. The guidance would give shape to the forthcoming analytical work of the secretariat and inform its planning and formulation of technical cooperation and capacity-building assistance for least developed countries, landlocked developing countries and small island developing States.

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I. Introduction

1. Of the 58 members and associate members of the Economic and Social Commission for Asia and the Pacific (ESCAP) in the region, a total of 37 economies are classified either as least developed countries, landlocked developing countries or small island developing States. Collectively referred to as countries with special needs, those countries are home to more than 400 million people, a quarter of the total population of the Asia-Pacific developing countries, excluding China and India. Their economies are characterized by a combination of geographic remoteness, high trade costs and the lack of scale economies, which hinder structural transformation and resilience to crisis and shocks.

2. The countries with special needs were largely off track to attain the Sustainable Development Goals by 2030 even before the outbreak of the coronavirus disease (COVID-19) pandemic. While some progress was made towards Goal 7 (Affordable and clean energy), Goal 9 (Industry, innovation and infrastructure) and Goal 10 (Reduced inequalities), progress towards most other Goals fell below 50 per cent of 2021 levels. In fact, they regressed in realizing Goal 12 (Responsible consumption and production) and Goal 13 (Climate action), and virtually no progress was made towards Goal 6 (Clean water and sanitation), Goal 8 (Decent work and economic growth) and Goal 11 (Sustainable cities and communities). Lack of timely and complete data also hindered the assessment of progress towards several Goals.

3. The COVID-19 pandemic further dimmed the prospects for achieving the Sustainable Development Goals. It has pushed an estimated additional 7.8 million people into extreme poverty; widespread job losses were reported with unemployment increasing by 1.9 million by 2021; and micro-, small and medium-sized enterprises and informal sector employment were hit hard with youth and female workers impacted disproportionately.

4. Stalled progress towards the Sustainable Development Goals translates into increasing financing gaps. Even before the pandemic, Asia-Pacific least developed countries and landlocked developing countries, for instance, needed to invest an additional 19 per cent and 8 per cent of gross domestic product (GDP) per year, respectively, to attain the Goals by 2030. For the least developed countries, the most pressing priorities included the elimination of poverty and hunger and promoting health and education. For landlocked developing countries, infrastructure-related Goals featured most prominently.

5. The COVID-19 pandemic increased financing gaps due to significant declines in government revenues and the urgent need to deploy substantial fiscal and monetary measures to address the health and socioeconomic consequences of the pandemic. In fact, the average fiscal deficit among Asia-Pacific countries with special needs increased by 3 per cent of their GDP in 2020. Declining capital inflows to countries with special needs are expected to further widen the financing gaps.

6. The intensifying impacts of climate change, including biodiversity loss, rising sea levels and more frequent and severe weather events add to these challenges and even pose an existential threat to some small island developing States. Landlocked developing countries have faced increased water stress, droughts, desertification and land degradation. The total adaptation costs and mitigation costs in 14 countries with special needs were estimated at some $45 billion and $42 billion, respectively, by 2030, equivalent to 1.8 per cent of

their combined GDP per year – a magnitude those countries will find difficult to raise domestically.

7. Those multiple challenges highlight the urgent need for a sustainable recovery that is socially inclusive, resilient to future shocks and environmentally sustainable.

8. Most COVID-19 response measures taken so far, however, have fallen short of the scope needed to facilitate a sustainable recovery. Many were mainly aimed at mitigating the adverse impacts of the pandemic on the health of the population and the economy, and they were not designed, at least initially, to provide a basis for building back better. Furthermore, the scale of fiscal stimulus is highly uneven across countries. The least developed countries allocated only 1.7 per cent of their GDP to stimulus packages from the beginning of the crisis to the end of 2020, compared to 6.6 per cent of GDP allocated by developing countries of the region. Consequently, there is rising risk of a K-shaped recovery, whereby some countries recover much slower than others and fall further behind in their recovery efforts.

9. Asia-Pacific countries with special needs have been exploring several options to expand fiscal space in financing a sustainable recovery. While traditional sources of finance will continue to dominate, they will be insufficient to meet the recovery needs of those countries, highlighting the need to harness alternative and innovative financing modalities or instruments, such as public-private partnerships, blended finance, thematic bonds and debt-for-climate adaptation swaps. With only eight years left to achieve the Sustainable Development Goals, greater support by the international community is critical in financing a sustainable recovery from the pandemic, especially at the initial stage of the recovery.

10. Section II of the present document serves to highlight the pre- and post-pandemic financing landscape of Asia-Pacific countries with special needs and some sources to secure sufficient resources to address the financing gaps and barriers to a sustainable recovery. In section III, attention is drawn to the potential of a few selected innovative financing instruments, with an articulation of conditions that need to be attained to ensure successful implementation. Section IV serves to highlight the need for strengthened subregional, regional and international support for the efforts of countries with special needs to finance a sustainable recovery from COVID-19 and beyond. The conclusion and way forward are contained in section V, and issues for consideration by the Commission are contained in section VI.

II. Mapping the financing landscape: traditional sources of finance insufficient

11. Countries with special needs continue to be constrained by inadequate financial resources and limited capacities in financing for sustainable development. The scarcity of financial resources was aggravated by the onset of the COVID-19 pandemic and the need to implement stimulus packages to mitigate the adverse impacts of the crisis.

12. The unique structural features of countries with special needs have produced differential impacts for each of the three groups. For least developed countries, the pandemic revealed weak economic foundations, the lack of social protection and social infrastructure, and limited progress in the digitization of the economy. Landlocked developing countries suffered significantly due to their landlockedness and remoteness from major markets

as the pandemic exacerbated geographic barriers. Small island developing States with fragile economic bases and remoteness experienced significant income losses as entry restrictions and falling demand caused a precipitous decline in revenue from key sources, in particular tourism and fishing.

13. Despite its devastating impacts, the COVID-19 pandemic presents an opportunity to reorient financial flows and resources towards activities aligned with the Sustainable Development Goals. While this may be feasible for government tax revenue, domestic and external borrowings and official development assistance (ODA), Governments generally do not have much influence on private flows, such as foreign direct investment (FDI) and cross-border remittances. However, Governments can incentivize these flows so that they directly or indirectly contribute to achieving the Goals.

A. Domestic resources and public finance

14. Tax revenue constitutes by far the largest source of domestic development finance in the least developed countries and landlocked developing countries and in many small island developing States. Even before the pandemic, Governments struggled to raise tax revenue, and the pandemic is projected to have reduced tax revenue in 2020 by an average of 5 per cent in countries with special needs.

15. Low tax bases, weak tax administration, tax avoidance, dominance of the informal sector and leakages have combined to hold back most of the countries with special needs from realizing their full potential to raise public revenue. Given the growing importance of tax revenue in financing development in the medium to long run, in particular the Sustainable Development Goals and the pandemic recovery process, Governments of countries with special needs must redouble their efforts in mobilizing tax revenue by introducing tax reforms, broadening the tax base, strengthening tax administration and preventing leakages. The Governments of countries with special needs could institute decentralized approaches in collecting tax revenue and empower local institutions in raising and allocating such revenue.

B. Foreign direct investment

16. Foreign direct investment can play a valuable role in promoting economic growth, generating employment, diversifying economic structures, generating exports, supporting industrial and technological upgrading, and facilitating integration into regional and global value chains. Compared to other countries in the Asia-Pacific region, FDI flows to countries with special needs have been low, unevenly distributed and quite volatile. Over the past decade they have averaged approximately $33 billion, peaking at $40 billion in 2017. They have since declined, reaching an all-time low of $18 billion in 2020. Even in those countries that have attracted FDI, the primary beneficiaries have been extractive sectors and low-cost labour sectors.

17. In 2020, FDI flows to the least developed countries increased to $9 billion from $4 billion in 2011. However, most FDI went to Bangladesh, Cambodia and Myanmar. In terms of sectoral distribution, the lion’s share went to the ready-made garments sector, which has limited backward linkages and is mainly dependent on imported inputs. While the sector has been successful in creating additional manufacturing jobs for migrant women and young girls, thereby empowering women and boosting the incomes of rural households, the sector was severely disrupted by COVID-19 and many of the gains were destroyed. Flows to landlocked developing countries have fluctuated significantly, largely reflecting external conditions. They reached a high in

2013 of $31 billion before declining to $18 billion in 2015. Due to commodity price shocks and COVID-19, FDI flows to landlocked developing countries have declined further to $8.9 billion in 2020. For small island developing States, trends indicate a steady decline in FDI flows since 2012. After peaking at nearly $4 billion in 2012, they reached an all-time low of $300 million in 2020, largely due to the COVID-19 pandemic.

18. Fragmented regulatory frameworks and low facilitation capacity have held back FDI flows to countries with special needs. Adverse external conditions, in particular the pandemic, have also inhibited FDI flows. In the short run, countries with special needs have very limited leverage in boosting FDI flows into their economies, and resource-rich countries and those with significant tourism potential have a comparative advantage.

19. Using FDI to recover from COVID-19 will be difficult and uncertain for most of the countries with special needs. They can improve their investment climate, invest more in human resource development with a particular focus on creating a skilled workforce, promote digitization and build their institutional capacity. They can also be much more strategic in attracting FDI and in aligning those flows with the Sustainable Development Goals as much as possible.

C. Remittances

20. External remittances have emerged as one of the most important development financing resources for many countries with special needs. Relative to GDP, external remittances amount to 33 per cent in Tonga and 18 per cent in Samoa. They account for 25 per cent of GDP in Nepal, 20 per cent in Kyrgyzstan and 26 per cent in Tajikistan. The flows played a key role in supporting household consumption, boosting private investment in micro- and small enterprises, promoting health and education, and reducing rural/urban income gaps. Despite some disruption caused by the COVID-19 pandemic, these flows have remained fairly resilient, helping households to mitigate the impacts of reduced earnings.

21. An ongoing concern has been the high transaction costs of remittances through formal channels. In Samoa and Tonga, for example, it costs $20 to remit $200. High transaction costs in the formal sector drive remittances into informal channels, depriving recipient countries of access to significant volumes of foreign exchange. However, rapid digitization is lowering transaction costs while enhancing the security and speed of transactions. In addition to investing in the skills of labour migrants and assisting them to secure better-paying jobs abroad, Governments can proactively encourage digitization of financial transactions to reduce remittance costs to competitive levels.

D. Official development assistance

22. Official development assistance has played a significant role in the economic and social development of countries with special needs. This includes enhancing connectivity in landlocked developing countries and thereby promoting subregional and regional connectivity among countries. This, in turn, has facilitated greater private investment, including FDI. In least developed countries ODA has been channelled towards building physical and social infrastructure, which has facilitated participation in the subregional and regional connectivity and integration processes. In small island developing States, ODA is the most prominent external financing source, with several of those countries receiving amounts exceeding 70 per cent of their GDP from

2015 to 2019. For many of those countries, ODA is also a significant portion of government budgets and therefore constitutes a key resource for achieving the Sustainable Development Goals.

23. While the impact of the pandemic on bilateral ODA is still unfolding, a decline in flows from some countries has been offset by an increase from others. However, it is evident that multilateral donors are stepping up their lending and grant support because of the pandemic. The trend is expected to continue, especially as climate finance is expected to receive new impetus following the twenty-sixth session of the Conference of the Parties to the United Nations Framework Convention on Climate Change in Glasgow, Scotland, and countries with special needs may be prioritized given that they face unprecedented climate distress.

24. Nevertheless, there is much room for improving the efficient and equitable use of ODA in countries with special needs. More must be invested in institutional capacity and governance to enable them to better use ODA to achieve the Sustainable Development Goals. The use of recipient national systems to deliver ODA has been identified as an efficient modality for small jurisdictions such as those in small island developing States, thus it could be pursued to a greater extent.

E. Debt and risk management

25. Prudent debt and risk management is a critical area of attention as countries with special needs increase domestic and external borrowing to finance sustainable development and smooth out economic cycles. Greater exposure to external debt, however, makes those countries even more vulnerable to external shocks that could adversely impact export earnings and capital flows.

26. Stocks of external debt as a proportion of GDP and debt servicing ratios are still manageable in most of the least developed countries and landlocked developing countries. There is however a growing concern regarding the external debt situation in many small island developing States, with eight of them facing high risk of external debt distress. The ongoing pandemic and the weak economic fundamentals of those countries keep them highly vulnerable to debt distress.

27. The source and composition of external debt may also be a cause for concern for some countries with special needs as they have shifted to more expensive sources, with increased reliance on commercial loans and loans that are less concessional. The trend has important implications for debt servicing obligations, debt rollover risk and costs of debt restructuring.

28. Many countries are borrowing vast sums of money to fund physical infrastructure development projects, which tend to have long timelines and do not generate sufficient revenue in the short run. As a result, countries could face difficulties if repayment periods are not sufficiently long. Moreover, foreign currency debt poses a risk of currency mismatch and exchange rate risks. Countries with special needs therefore need to pay particular attention to debt and risk management.

III. Leveraging additional finance: new and innovative sources and instruments

29. While traditional sources of finance remain critical to the sustainable recovery from COVID-19 and to sustainable development, new and innovative sources and instruments of finance must be explored and leveraged to augment existing resources and close financing gaps. Some of these sources and instruments received new impetus from the response to the climate crisis and the various commitments that countries and multilateral agencies made in 2021 at the conclusion of the twenty-sixth session of the Conference of the Parties. Innovative finance has also emerged as an effective way to mobilize and channel both private and public resources towards achieving national development objectives.

30. There is significant diversity in innovative financing instruments, and many of them are either an extension or improvision of traditional sources of finance, including diaspora bonds (which are issued to expatriates to mobilize external resources) and green taxes, such as carbon taxes and emissions charges. While diaspora bonds are suitable for countries with relatively high and stable levels of external remittances, green taxes can internalize the negative externalities arising from emissions-intensive and resource-extractive activities. Innovative finance is generally understood to be a set of financial solutions and mechanisms that can be used to mobilize both private and public financial resources towards achieving sustainable development. Innovative financing instruments can be broadly divided into thematic bonds, digital FDI and debt-for-climate adaptation swaps.

A. Thematic bonds

31. Thematic bonds, such as green bonds, blue bonds, social impact bonds, and sustainable bonds, are fixed-income instruments that countries with special needs can explore and use to address particular themes, such as climate change, marine protection or social inclusion. The expansion of the green bonds market in particular is noticeable with the value of issued green bonds in the region having increased tenfold between 2015 and 2020. Several countries with special needs have benefited from issuing green bonds. Supported by the Government of Australia and the World Bank, for instance, Fiji issued its first sovereign green bond in 2017 and raised $50 million to finance climate change adaptation and mitigation. The issuance of green Islamic bonds, or green *sukuk*, presents an opportunity to some of the countries with special needs to funnel investments toward renewable energy and other environmental assets.

32. However, not all countries with special needs are able to enter the green bond market due to limited institutional and technical capacity. Among other things, the development of legal and regulatory frameworks that accommodate policies for sustainable recovery as well as risk disclosure reporting practices could be recommended, either independently or aligned with recognized global standards. Recognized global standards for green bonds and other types of thematic bonds include those established by the Climate Bonds Initiative and the International Capital Market Association, such as the Green Bond Principles and the Social Bond Principles.

33. Risk-transfer instruments such as catastrophe bonds are another financing instrument that countries with special needs could explore. These are specialized securities that enable issuers to transfer natural disasters risks to capital markets. Recent examples in the region include the Pacific Catastrophe Risk Insurance Company, established in 2016 with support from the World

Bank. It provided the participating Pacific countries with increased coverage of $45 million for the 2017–2018 cyclone season, and it provided a $4.5 million pay-out to support Tonga in 2020.

B. Digital foreign direct investment

34. Increased digitization has brought about enormous opportunities for countries with special needs to move proactively to attract FDI in the digital economy, in particular as they go through their recovery process. However, digital FDI will require an enabling environment, a conducive regulatory framework and dedicated investment policies and programmes. Governments need to carry out thorough assessments of the requirements in digital infrastructure development, digital business creation and digitization within the wider economy.

35. Countries with special needs can pursue FDI opportunities in the telecommunication and information and communications technology (ICT) sectors that drive the development of digital infrastructure. The software development sector and firms that create software applications for digital connectivity offer further opportunities. Telecommunication firms and ICT multinational enterprises can be key players in developing digital connectivity.

36. In terms of policy and regulatory architecture, countries must have effective policies and practices in data security, data privacy, source code disclosure, content monitoring and access to foreign websites, and protection of intellectual property rights and smooth enforcement of contract law. It is imperative for policymakers to ensure that digital investments are firmly aligned with the 2030 Agenda for Sustainable Development. In addition, in promoting digital FDI, investment promotion and facilitation agencies and other government entities need to leverage digital technology in their daily operations and delivery of services throughout the investment cycle.

C. Debt-for-climate adaptation swaps

37. The basic idea behind debt swaps is that donors forgo a certain portion of the debt owed by a developing country in exchange for climate adaptation projects implemented in that country. Although the countries with special needs have limited experience with debt swaps, experience from other regions suggests that such swaps can be effective in conserving the environment as well as reducing the external debt burden. The Pacific Resilience Facility of the Pacific Islands Forum Secretariat, for instance, may be used to facilitate the implementation of debt swaps to fund climate projects in the Pacific small island developing States.

38. Legal, technical and institutional gaps and weaknesses, however, have held back countries with special needs from developing and leveraging those instruments. Countries with special needs could benefit from developing effective monitoring, reporting and verification frameworks or building upon existing global taxonomies and standards to ensure collected funds support climate mitigation and adaptation projects. Data availability and publication is a crucial factor to consider in that regard. In addition, strong political and local support across relevant stakeholders could reduce transaction costs related to the development and implementation of debt swaps while also maintaining national ownership over the projects funded by debt swaps.

IV. International cooperation for sustainable recovery and accelerated progress towards the Sustainable Development Goals

39. Notwithstanding the efforts of countries with special needs to mobilize domestic financial resources, they remain dependent on ODA and other concessional assistance to sustain their growth and development, especially given the impact of the COVID-19 pandemic. They have acute needs for strengthened multilateralism as well as regional cooperation and solidarity to mobilize necessary additional resources.

A. Fostering global and regional cooperation to address international taxation challenges

40. Emerging transboundary challenges on taxation, including the rise of the digital economy, illicit financial flows and profit shifting by multinational firms, require stronger global and regional cooperation. At the global level, the United Nations and the Organisation for Economic Co-operation and Development (OECD) lead international cooperation and coordination, setting norms and standards to address double taxation, corporate tax avoidance, and transparency and tax challenges concerning digitalization, as well as supporting technical assistance and capacity-building for developing countries. Similarly, in Asia and the Pacific, the Asian Development Bank established the Asia Pacific Tax Hub in May 2021 to provide region-wide tax cooperation. Most of the pre-existing cooperation platforms function at the subregional level with fragmented coverage of membership and areas of strategic policy discussion, inadequate funding, varying institutional capacity and limited cross-platform interaction.

41. The global initiatives have complex rules and standards which may discourage countries with special needs from joining. Institutional and capacity constraints may also hinder their participation. Indeed, many countries with special needs are not members of the global initiatives. While the global, regional and subregional tax cooperation initiatives have a critical role in increasing the voice and participation of Asia-Pacific countries with special needs and learning from each other, the countries need considerable technical assistance to develop their legal, institutional and administrative capacity to benefit fully from participation in tax cooperation initiatives. Countries with special needs must be assured that they can participate in tax cooperation initiatives on an equal footing and that benefits and risks of participation are equitably shared.

B. Renewing efforts to meet the official development assistance commitments and align them with national priorities

42. The total volume of ODA remains below the commitments highlighted in the Addis Ababa Action Agenda of the Third International Conference on Financing for Development in 2015. Globally, ODA to least developed countries in 2019 represented only 0.06 per cent of the gross national income of OECD Development Assistance Committee members, which was below the 0.15–0.20 per cent commitment level. Average ODA to least developed countries, landlocked developing countries and small island developing States dropped by 6.7 per cent, 5.6 per cent and 14.1 per cent, respectively, from the 2010–2014 period to the 2015–2019 period. Although developed countries, including the members of the Development Assistance Committee, were committed to continuing ODA during the pandemic, the target was not met.

Furthermore, the share of grants in ODA to least developed countries and landlocked developing countries has gradually declined over the past years, and grants have been substituted by loans (on concessional terms).

43. Since ODA has been important for the socioeconomic development of countries with special needs, the international community can be a supportive force to protect and expand ODA budgets. There is a particular need to encourage members of the Development Assistance Committee and other development partners to strengthen their ODA commitments and reverse the declining share of grants and concessional loans for countries with special needs, in particular as many countries with special needs are at high risk of debt distress and expanded fiscal deficits because of the COVID-19 pandemic.

44. The international community can also support countries with special needs in aligning ODA with their national priorities, targeting pressing public health issues and social protection needs for the most vulnerable and reversing the increasing trends of poverty and inequality observed during the pandemic. This can be done, for example, by strengthening and expanding general budget support to countries with special needs which can be an effective modality in development finance when combined with improved accountability, transparency and robust monitoring mechanisms in recipient countries. Support can also be channelled towards strengthening the linkage between planning and budgeting to enhance allocative efficiency.

C. Addressing immediate debt vulnerabilities and restoring debt sustainability

45. Many countries with special needs are undergoing debt distress or showing early signs of such distress as a result of the pandemic. Several initiatives have been taken to address debt issues arising from the crisis, including the Debt Service Suspension Initiative adopted by the Group of 20 in April 2020. However, only 10 countries with special needs (Afghanistan, Fiji, Kyrgyzstan, Maldives, Myanmar, Nepal, Papua New Guinea, Samoa, Tajikistan and Tonga) have requested relief under the initiative. Several factors are likely to have discouraged wider uptake, including low potential savings from participation in the initiative, mandatory disclosure of all public sector debt obligations (except commercially sensitive information) and the perception that participation may raise market fears about possible loan default and the possibility of credit downgrading.

46. The Group of 20 and the Paris Club countries have endorsed a Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative which aims to serve as a coordination and cooperation framework for participating creditor countries. Yet, so far, countries with special needs have not participated in this framework. In response to the pandemic, the International Monetary Fund launched the largest allocation of special drawing rights, amounting to 456 billion, to boost global liquidity and assist developing countries to meet their external debt service payments. However, countries with special needs from the region have access to only $5.5 billion under the current quota system, indicating countries can expect limited relief from the fiscal pressure on Governments due to the pandemic. There is a need to design debt relief programmes that are more attractive to countries with special needs, keeping in view their unique economic and other vulnerabilities.

47. Yet, debt suspension can only be a temporary solution and efforts must be made to develop and implement comprehensive debt relief programmes that provide long-term solutions. Debt relief programmes can be combined with

efforts to promote green growth and issue innovative financing instruments, such as debt-for-nature swaps, debt-for-climate adaptation swaps and Sustainable Development Goal bonds.

D. Meeting climate commitments and leveraging innovative finance

48. International cooperation on climate change has become much more urgent in the aftermath of COVID-19 considering the need for a sustainable recovery and to achieve the Sustainable Development Goals. The climate crisis has added a new impetus for international cooperation, in particular in climate finance supporting the efforts of developing countries, including several countries with special needs, to deal with the existential threat of climate change.

49. Commitments made at the twenty-sixth session of the Conference of the Parties have some promising features as several developed countries announced additional funding support with new and more ambitious targets for climate actions. However, even with new pledges, the promise of $100 billion annually by 2020 will be met only in 2023. In addition, there is an urgent need to increase the flow of climate finance to countries with special needs, in particular the grant component, as they struggle with the impacts of the COVID-19 pandemic and strive to achieve the Sustainable Development Goals. Although climate finance to least developed countries and small island developing States has increased steadily over the past decade, shares going to countries with special needs are still low, with least developed countries, landlocked developing countries and small island developing States receiving on average 18 per cent, 8 per cent and 2 per cent, respectively, of total climate flows in the region during 2015–2019. Most of those climate finance flows consisted of loans.

50. Efforts are needed to mobilize additional finance through innovative instruments and mechanisms, as was highlighted in section III, and increase the participation of the private sector. To that end, the international community, including the United Nations and multilateral funding agencies, can provide technical cooperation to build the required legal, administrative and technical capacities of countries with special needs, taking their particular and diverse needs into account. The private sector and other stakeholders need to be fully engaged in leveraging innovative sources of climate finance to make them more effective and self-sustaining.

51. As the capital market is the cornerstone of new and innovative financing instruments, the international community can provide support in this area for countries with special needs. For instance, the technical assistance ESCAP provided to Bhutan to issue its first sovereign bond in September 2020 can be replicated in other countries. Regional financial cooperation can be leveraged to support the development of the domestic capital market. Through the Asian Bond Market Initiative and Association of Southeast Asian Nations plus China, Japan and the Republic of Korea (ASEAN+3) Bond Market Forum, for example, the Lao People's Democratic Republic issued baht-denominated bonds in Thailand, and Cambodia is planning to issue its first local currency sovereign bond. Such a regional mechanism can incentivize countries to make necessary reforms, support the development of national and regional financial market infrastructure through the harmonization of settlement systems, rules, regulations, standards and practices, and it can promote the sharing of knowledge, experiences and good practices among regional peers that benefit the participating countries.

E. Accelerating digital finance for financial inclusion

52. Recognizing the growing importance of digital technology in finance, the Secretary-General established the Task Force on the Digital Financing of the Sustainable Development Goals in 2018. In its report, the Task Force highlighted the potential role of digital financial instruments, such as digital payments, digital transfers, digital insurance, crowdfunding and blockchain-based supply chain finance in mobilizing resources in developing countries. The Task Force noted the need to align digital finance with the 2030 Agenda and empower people on how their resources are used.

53. While some progress has been made in using digital technology such as fintech to deliver financial services to a wider community and reduce the gap between banked and unbanked people, there is great potential for regional and international cooperation in accelerating progress in digital technology and digital finance. In particular, significant opportunities exist in promoting regional interoperability and harmonization of laws, regulations and standards in digital finance, leading to easier, quicker and cheaper transfer of remittances. To fully exploit these opportunities, the international community can assist countries with special needs in developing their institutional and technical capacity in framing regulatory policies that are conducive to the adoption of financial innovations and the minimization of digitization-related risks, promoting knowledge exchange and technology transfer, and strengthening regional digital connectivity and endeavours to reduce the digital divide.

V. Conclusions and way forward

54. Countries with special needs had to divert scarce resources to mitigate the widespread social and economic impacts of the pandemic, further widening financing gaps in achieving the Sustainable Development Goals. Those countries will have to redouble their efforts in mobilizing domestic resources and external finance. However, traditional sources of finance have proven to be insufficient to close the financing gaps. Tax revenue as a proportion of GDP remains low, FDI flows have been declining, remittances and receipts from tourism have yet to recover from recent shocks and ODA has remained uncertain. Those factors are exacerbated by the increased debt distress of several countries with special needs.

55. While enhancing tax revenue is the most enduring form of financing, a feasible avenue in the short run appears to be an improvement of tax administration systems, in particular by increasing collection efficiency from existing taxpayers and minimizing leakages. Adopting the latest developments in digital technology is of paramount importance as exemplified by Cambodia which managed to double its tax to GDP ratio within a span of 10 years. Electronic tax registration, filing, payment and dispute resolution, for instance, can help to reduce the risk of officials abusing their discretion and provide citizens clarity regarding the tax paying process.

56. Policies and programmes to promote FDI need to be sharpened so that countries with special needs can become more attractive destinations for labour-intensive and climate-friendly FDI, including South-South FDI. Facilitating remittances and reducing transaction costs through digitalization and formalization can encourage greater inflows. More also needs to be done to improve the efficient use of ODA. The current context provides a unique opportunity to introduce wide-ranging policy reforms and improve administrative and technical capacities to mobilize resources from traditional sources. However, mobilizing more resources must be complemented by the

ability to spend more impactfully in areas aligned with the Sustainable Development Goals, which requires strengthened public expenditure management.

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

58. However, the ability of countries with special needs to leverage innovative finance has been constrained due to their lack of administrative, legal and technical capacities. The international community therefore needs to provide additional technical assistance to improve the capacity of countries with special needs to benefit from innovative finance. Considering the difficulty of developing national legal and regulatory frameworks towards thematic bonds, for instance, many countries have benefited from aligning bond issuance with recognized global standards. International organizations are providing capacity-building support, for instance, ESCAP is supporting its member States to design and develop bankable infrastructure projects through its Infrastructure Financing and Public-Private Partnership Network of Asia and the Pacific.

59. Finally, technical and funding support from international and regional development partners must be significantly strengthened for countries with special needs. Renewed partnership and solidarity can play a significant role. For example, reinforcing fair and equitable access to and distribution of vaccines will reduce the immediate funding gaps caused by drops in government revenue and external income of countries with special needs. Strengthening ODA and climate-related development finance commitments and matching with actual disbursements will support the transition of countries with special needs to become sustainable and resilient against climate change and other shocks. Fostering global and regional cooperation in taxation and addressing debt vulnerabilities, infrastructure connectivity, capital market development, digital finance and FDI will also offer significant opportunities for countries with special needs to have a sustainable recovery and achieve the Sustainable Development Goals.

VI. Issues for consideration by the Commission

60. A more detailed examination of the above-mentioned issues and recommendations is provided in the *Asia-Pacific Countries with Special Needs Development Report 2022: Financing a Sustainable Recovery from COVID-19 and Beyond*.

61. The Commission may wish to deliberate on the policy priorities and cooperation needs highlighted in the present document and provide the secretariat with guidance on which of these should be explored to a greater extent. The guidance would give shape to the forthcoming analytical work of the secretariat and inform its planning and formulation of technical cooperation and capacity-building assistance for least developed countries, landlocked developing countries and small island developing States.