

Financing sustainable development and policy issues for capital market development¹

Financing for sustainable development – a significant component of the United Nations’ post-2015 development agenda – is critical for Asia and the Pacific. Home to two thirds of the world’s poor, the region will require the mobilization of vast resources to address its development challenges, with estimates of annual investment requirements amounting to around \$2.1 trillion (see figure 1).

region’s large pool of savings to finance its sustainable development, as recognized in the 2002 Monterrey Consensus on Financing for Development and its follow-up 2008 Doha Declaration.

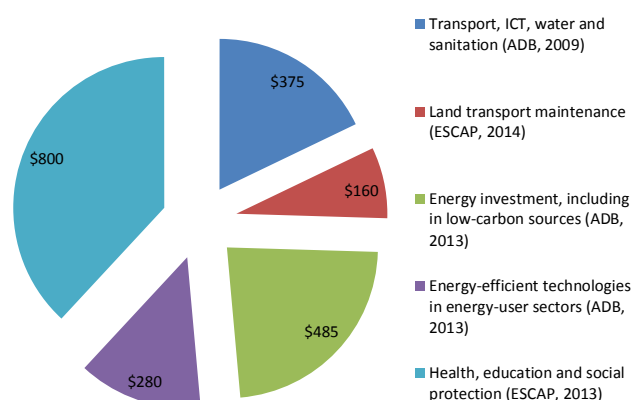
Equity and bond markets

Overall, the region accounts for 31% of global equity market capitalization, of which the stock markets of Tokyo, Hong Kong and Shanghai represent more than half. However, market capitalization, at close to \$15 trillion, is on average relatively small as a proportion of the total assets of the region’s financial sector. Particularly in smaller economies, the breadth and depth of equity markets is often quite limited due to lack of liquidity, a low level of corporate listings and weak regulatory frameworks and corporate governance. *Cross-border listings offer a potential solution for such economies.*

Following the Asian financial crisis of 1997/98, the development of local currency (LCY) bond markets received a boost in the region. Aimed at reducing the currency mismatches in banks’ and corporates’ balance sheets that precipitated the Asian financial crisis, the value of domestic bonds outstanding in China; Hong Kong, China; Indonesia; Malaysia; Philippines, Republic of Korea; Singapore; and Thailand soared from 21% to 64% of the GDP between 1997 and 2010, largely exceeding Latin America (34%) and Eastern Europe (33%) in the latter year. Growth of LCY bond markets was particularly fast in India, reaching 90% per year between 2009 and 2013. During this period, LCY bond markets also grew rapidly in the Russian Federation (23.5% pa), China (22% pa), Thailand (18% pa), Australia and Pakistan (13.9% pa).

While LCY bonds issued by Governments represent on average more than three quarters of the total LCY bonds issued by Asia-Pacific countries in 2013, the share of corporate LCY bonds increased by almost 50% between 2005 and 2013. The demand for LCY bonds has been supported by a broadened investor base including both domestic and foreign institutional investors. As of December 2013, the foreign holdings of LCY government bonds as a share of the amounts outstanding were 32.5% for Indonesia, 29.4% for Malaysia, 17.4% for Thailand, 9.2% for the Republic of Korea and 8.3% for Japan.³

Figure 1. Asia and the Pacific needs to invest \$2.1 trillion/year in sustainable development



Sources: ESCAP based on data from references cited in the text.
Notes: Asian Development Bank (2009), *Infrastructure for a Seamless Asia*. (Manila); ESCAP (2013), *Review of Developments in Transport in Asia and the Pacific 2013: Transport as a Key to Sustainable Development and Regional Integration*; Asian Development Bank (2013), *Energy Outlook for Asia and the Pacific* (Manila); ESCAP (2013), *Economic and Social Survey of Asia and the Pacific 2013*.

While the region’s financial requirements are huge, its financial resources are also very large. Its gross national saving amounted to \$8.4 trillion in 2012, representing more than half of the world’s total savings. The region also held \$7.3 trillion in foreign exchange reserves in 2012. In addition, the region’s high net worth individuals had \$12.7 trillion in assets in 2012, while the region’s mass affluent had \$20.5 trillion in assets. These values are forecast to increase, respectively, to \$22.6 trillion and \$43.3 trillion by 2020.²

As many investments are characterized by high social rates of return but low private rates, supportive policies will be needed to attract private savings. In addition, efficient capital markets will be required to mobilize the

Giving the potential of LCY bonds to raise funds for investments in sustainable development, it would be useful to facilitate the issuance of such bonds across borders. For that purpose, the Asian Bond Market Forum (ABMF), which was established in September 2010 by ASEAN+3, has provided a platform for bond market experts from the region to foster the standardization of market practices and harmonization of regulations relating to cross-border bond transaction in the region. The ABMF is developing an intra-regionally standardized bond issuance framework, which would ultimately allow bond issuers in ASEAN+3 to issue bonds in all participating economies with one set of standardized documentation and information disclosure requirements, subject to compliance with the legal and regulatory requirements of each economy.⁴

Institutional investors

Institutional investors play a critical role in the global provision of long-term finance, part of which could be tapped for the funding of sustainable development.

The development of institutional investors in the region differs across type of investor. In 2012, the Asia-Pacific region accounted for only 9.7%, or \$6.65 trillion, of global assets held by the world's top 500 asset management firms; most of this (85.2%) is managed by firms from Japan and Australia. The share of the region in assets under management by the world's top 300 pension funds was 26.3%, or \$3.68 trillion, of which 31.5% was held by developing countries. As of March 2014, the region accounted for 45%, or \$2.85 trillion, of the world's total assets held under management by sovereign wealth funds, most of which (96%) belonged to developing countries.

Globally, the portfolio allocation of institutional investors has tended to shift from equities to investments in bonds and the so-called alternative asset classes. The shift from equities to bonds started in the early 2000s but accelerated after the global financial crisis, as investors sought to reduce risks. However, the low-yield environment prevailing in recent years pushed some institutional investors to take additional risks in the search for higher returns by investing in alternative assets, such as hedge funds, real estate, private equity and most recently infrastructure.

Pension funds have traditionally invested in infrastructure through listed companies and fixed income instruments. However, over the last two decades they have started to recognize infrastructure as a distinct asset class which, although illiquid, could be beneficial to enhance portfolio diversification. Because of their long investment horizons, pension funds and other institutional investors can afford the risk of investing in less liquid and longer-term assets such as infrastructure. Nevertheless, a survey of large

pension funds and public pension reserve funds revealed that in 2012 their investment in unlisted infrastructure equity was equivalent to only 3% of the total assets.⁵ It seems that obstacles for this type of investment include high up-front costs and the large scale of projects, and the required expertise that can take a long time to build and that may be beyond the means of smaller pension funds. However, the experience of Chile and Mexico has demonstrated that Governments can assist pension funds' investment in infrastructure by developing infrastructure corporate bond markets.

The investor base is an important consideration with regard to the role of institutional investors as an increasingly significant source of funding for long-term investment. The participation of foreign investors in Asia-Pacific LCY bond markets is likely to have enhanced liquidity and market efficiency; however, the potential disruptions that foreign investors could cause are also a matter of concern. In particular, the increasing participation of global institutional investors in emerging markets, particularly in LCY bond markets, has heightened exposure to global financial conditions, contagion and herding.⁶ In fact, sudden large capital outflows can still induce financial distress through their effects on exchange rates and the balance sheets of banks, firms and household despite large volumes of international reserves and flexible exchange rates arrangements.

Therefore, it would be important to develop a larger local investor base and create better institutions. For that purpose, countries would need to design tailored policies and create a regulatory framework that encourages institutional investors to provide a stable source of capital for long-term investment purposes. A recent report by the G20 and OECD provides valuable guidelines to policymakers on how to promote the development of long-term savings and institutional investors, governance and regulatory arrangements. Yet, further refinement according to specific country and institutional contexts would be needed and is an area for further research to promote the development of institutional investors in Asia and the Pacific.

¹ This policy brief summarizes perspectives from the region discussed at the Asia-Pacific Outreach Meeting on Sustainable Development Finance, which was organized by ESCAP and the Ministry of Finance of Indonesia that took place in Jakarta on June 2014. See <http://www.unescap.org/events/asia-pacific-outreach-meeting-sustainable-development-financing>

² High net worth individuals own \$1 million or more in assets; mass affluent individuals own between \$100,000 and \$1 million in assets. See PwC, *Asset management 2020: a brave new world* (PricewaterhouseCoopers International, 2014).

³ Asian Development Bank, *AsianBondsOnline*. Available from <http://asianbondsonline.adb.org>.

⁴ See ADB, *Proposal on ASEAN+3 Multi-Currency Bond Issuance Framework (AMBIF)* (Manila, 2014).

⁵ Organization for Economic Cooperation and Development, *Report on pension funds' long term investments: survey of large pension funds and public pension reserve funds* (Paris, 2013).

⁶ International Monetary Fund, *Global Financial Stability Report* (Washington, D.C., 2014, p. 69). Available from www.imf.org/external/pubs/ft/gfsr/2014/01/index.htm.

The MPDD Policy Briefs aims at generating a forward-looking discussion among policymakers, researchers and other stakeholders to help forge political will and build a regional consensus on the needed policy actions and pressing reforms. Policy Briefs are issued without formal editing. This issue has been prepared by Sudip Ranjan Basu, Alberto E. Isgut, Oliver Paddison of the Macroeconomic Policy and Development Division, ESCAP. For further information on the policy brief, please contact Anis Chowdhury, Director, Macroeconomic Policy and Development Division, ESCAP (escap-mpdd@un.org)