Please cite this paper as:

Reisen, H. (2004), "Innovative Approaches to Funding the Millennium Development Goals", *OECD Development Centre Policy Briefs*, No. 24, OECD Publishing.
doi:10.1787/580523311442

OECD Development Centre Policy Briefs No. 24

Innovative Approaches to Funding the Millennium Development Goals

Helmut Reisen

OECD PUBLISHING

OECD DEVELOPMENT CENTRE

POLICY BRIEF No. 24

Innovative Approaches to Funding the Millennium Development Goals

by

Helmut Reisen

- Despite post-Monterrey donor initiatives, the Millennium Development Goals (MDGs) are underfinanced.
- The *revenue potential*, the *additionality* and the *speed of availability* of new finance sources, and their political feasibility, are of particular importance.
- On these criteria, it is unlikely that global taxes will be introduced in time.
- The International Finance Facility, strengthened use of public guarantees and Global Premium Bonds, perhaps in combination, may stand a better chance of providing additional funds for the MDGs.
- The most straightforward way to avoid underfunding of the Goals is to raise ODA further.

POLICY BRIEF No. 24

Innovative Approaches to Funding the Millennium Development Goals

by

Helmut Reisen

THE OPINIONS EXPRESSED AND ARGUMENTS EMPLOYED IN THIS PUBLICATION ARE THE SOLE RESPONSIBILITY OF THE AUTHOR AND DO NOT NECESSARILY REFLECT THOSE OF THE OECD, ITS DEVELOPMENT CENTRE OR OF THE GOVERNMENTS OF THEIR MEMBER COUNTRIES.

© OECD 2004

Table of Contents

Doubling ODA or Finding New Sources of Finance 5

Criteria for Policy Choices 7

Global Taxes 9

- Global Environmental Taxes 10
- Currency Transaction Taxes 12
- Taxes on Global Arms Sales 14

Voluntary Private-Sector Contributions 15

- Private Donations 15
- Global Lottery and Global Premium Bonds 17
- Topic-Specific Global Funds 19

Financial Engineering 22

- The International Finance Facility (IFF) 22
- A Development-Focused Allocation of SDRs 24
- Public Guarantees 25

A Synopsis 27

Notes 32

Bibliography 34

Other Titles in the Series 36

Doubling ODA or Finding New Sources of Finance

At the United Nations Millennium Summit in September 2000, world leaders adopted the Millennium Development Goals (MDGs), which set clear targets for reducing poverty, hunger, disease, illiteracy, environmental degradation, and discrimination against women by 2015[1]. The need for additional development funding, if the MDGs are to be achieved by 2015, is widely recognized. The figure of additional $50 billion per year, roughly the present total of ODA spent by DAC donors, is often quoted (e.g. Zedillo Report). This estimate is of back-of-the-envelope nature, and it seems to be the minimum estimate[2]. If governments exclude the option to abandon the MDGs, they have either to double the existing ODA or to find alternative sources of comparable magnitude – or a balance of the two. The challenge to the international community is mounting by the day.

The International Conference on Financing for Development, held in Monterrey in March 2002, has indeed improved prospects for higher ODA. Since the Monterrey conference, a number of DAC Members have made further announcements of increases to their development co-operation budgets (OECD, 2003*a*). In March 2002, at the Barcelona EU Council meeting, *EU Members* that had not yet reached the UN target of 0.7 per cent for ODA as a proportion of Gross National Income (GNI) undertook to strive to reach at least 0.33 per cent ODA/GNI by 2006. Some EU Members have since made individual commitments that go beyond the EU Barcelona Council commitment. If all these commitments are realised, EU ODA would average 0.42 per cent of GNI in 2006. For the *United States*, the OECD Development and Co-operation Report 2003 assumes additional $5 billion from the newly created Millennium Challenge Account by 2006, and $2 billion from the Emergency Plan on Aids Relief. Combining these two announcements, the US ODA/GNI ratio is projected to reach 0.17 per cent by 2006. Table 1 provides the details.

The OECD Secretariat estimates that fulfilling these commitments and plans would raise ODA in real terms by 32 per cent – almost $19 billion – by 2006. This would raise the ODA/GNI ratio from 0.23 per cent in 2002 to 0.29 per cent in 2006 (see Table 1). However, these recent donor initiatives leave the annual target to achieve the Millennium Development Goals by 2015 underfinanced by round $25 billion from 2006 and by even more before. Therefore, it seems urgent now to investigate, prioritise and select new forms of financing development in general and the Millennium Development Goals in particular. The debate, however, should not be restricted to the modalities of effecting resource transfers from rich to poor countries: options to be considered

Table 1. **Simulation of ODA Prospects for 2006**

Country	Net ODA in 2002 ($ million)	ODA/GNI in 2002 (%)	Commitment/ Announcement/ *Assumption* (%)	Year to be attained	Net ODA in 2006 ($ million)	ODA/GNI in 2006	Real change in ODA in 2006 compared with 2002 (at 2002 prices and exchange rates)[1] ($ million)	(%)
Austria	520	0.26	0.33%	2006	728	0.33	208	40
Belgium	1 072	0.43	0.7	2010	*1 234*	*0.46*	*162*	*15*
Denmark[5]	1 643	0.96	*>0.7*	n.a.	*1 531*	*0.83*	*-112*	*-7*
Finland	462	0.35	*0.44*	2007	598	0.42	136	29
France[2]	5 486	0.38	0.5% (0.7% by 2012)	2007	7 378	0.47	1 892	34
Germany	5 324	0.27	0.33	2006	7 099	0.33	1 775	33
Greece	276	0.21	0.33	2006	515	0.33	239	86
Ireland[2]	398	0.40	0.7	2007	671	0.63	273	69
Italy	2 332	0.20	0.33	2006	4 195	0.33	1 863	80
Luxembourg	147	0.77	1	2005	206	1.00	60	41
Netherlands	3 338	0.81	0.8	Already	3 566	0.80	228	7
Portugal	323	0.27	0.33	2006	424	0.33	102	31
Spain	1 712	0.26	0.33	2006	2 328	0.33	616	36
Sweden	1 991	0.83	Long term goal 1% (*at least 0.87 in 2006*)		*2 247*	*0.87*	*256*	*13*
United Kingdom	4 924	0.31	0.4	2005-06	6 906	0.40	1 982	40
EU Members, Total	**29 949**	**0.35**	**0.39**	**2006**	**39 627**	**0.42**	**9 679**	**32**
Australia[3]	989	0.26	0.26	in 2003-04	1 089	0.26	100	10
Canada	2 006	0.28	8% annual increase	to 2010	2 730	0.34	723	36
Japan	9 283	0.23	*1998-2002 av. level ($10.5 bn) in 2006*		*10 500*	*0.26*	*1 217*	*13*
New Zealand	122	0.22	*Future level is under review*		*154*	*0.26*	*32*	*27*
Norway	1 696	0.89	1	2005	2 067	1.00	370	22
Switzerland[2]	939	0.32	0.4	2010	1 143	0.36	204	22
United States[4]	13 290	0.13	See footnote 4		19 539	0.17	6 249	47
DAC Members, Total	**58 274**	**0.23**			**76 849**	**0.29**	**18 575**	**32**

1. Assumes average real growth in GNI of 2 per cent p.a. (3 per cent for Canada, 4 per cent for Greece and zero for Japan) from 2002 to 2006.
2. ODA/GNI ratio for 2006 interpolated between 2002 and year target scheduled to be attained.
3. Estimated ODA/GNI 0.26 per cent in 2003/04. As aid volume determined in annual budgets, assumes same ratio in forward years.
4. Assumes, for 2006, additional $5 billion from the Millennium Challenge Account, $2 billion from the Emergency Plan for AIDS Relief, phased spending from Iraq and Afghanistan reconstruction supplements and 2 per cent p.a. inflation in the United States to deflate from 20.
5. The Danish Development Aid budget will be kept constant in real terms. The estimated drop in net ODA from 2002 to 2006 is due to an expected decline in ODA expenditures outside the Development Aid budget, including payments for refugees' temporary settlement.

Source: *Development Co-operation Report 2003.*

should include co-financing the Goals through income redistribution and tax efforts within developing countries as well. After all, the extent to which the better-off in poor countries will participate in the funding of the Goals should encourage contributions from populations in the advanced countries.

The *absorption capacity* of the recipient countries might also be considered when considering funding options. Increased assistance is likely to run into diminishing capital returns when developing countries fail to create a supporting climate for economic activity. The question is: where is the "saturation point" – the level of aid after which aid no longer has a positive effect on economic growth. This saturation point varies across countries (Collier and Dollar, 2002). In countries with good policies and institutions, the saturation point is about 15-25 per cent of GDP, whereas in other countries it is about 5-10 per cent of GDP. By allocating the $40-$60 billion additional aid only to those countries with "good" policies and institutions, research at the World Bank (Devarajan, Miller and Swanson, 2002) finds that the saturation point is reached in only four of the 65 countries. Heller and Gupta (2002), by contrast, offer calculations that show that if a large increase in aid is to be absorbed effectively, two thirds of it will have go to two countries outside the LDC group, India and China. Not only do these countries house half the world's poor, they also have the necessary absorption capacity.

It is important to bear in mind that the achievements of the MDGs and the build-up of absorption capacities can be interconnected so that increased assistance can turn a *vicious circle* into a *virtuous circle*. With, for example, the Aids pandemic running unchecked, with malaria out of control, or with widespread malnutrition, countries will neither be able to attract private investment, nor tourists, nor will they be able to boost productivity through improved education. It can therefore be argued that funding the Development Goals in education, reduced child and maternal mortality and infectious diseases may be a *precondition* for better absorption capacity, rather than a *constraint*.

Criteria for Policy Choices

There is now a wide array of proposals for new forms of financing the Millennium Development Goals, of which this Policy Brief discusses the nine arguably most "popular". Such proposals can be sorted according to their *funding source*. Firstly, a number of *global taxes* have been suggested, such as currency transaction taxes, environmental taxes, a brain drain tax, an international airport tax, taxation of ocean fishing, taxation of arms exports, a "bit" tax on computer

use, or a luxury goods tax. Another broad group of funding proposals involves the *private sector*, either public-private alliances or exclusively individuals, corporate entities and the civil society. Here the focus is on topic-specific global funds, a shift of charitable giving towards the Millennium Development Goals or Global Premium Bonds and lotteries to stimulate private funding. Thirdly, there are proposals that can be categorised under *financial engineering* (if not money creation), such as a development-focused allocation of Special Drawing Rights at the IMF, the International Finance Facility, and the use of public guarantees to stimulate private funding.

Which *criteria* should govern those choices? The *political feasibility* of new funding forms is important as each year lost in the run-up to the year 2015 will imply the need for higher resources in the remaining period; hence, at this stage, proposals that command support from the international community should be given priority over controversial proposals[3]. In the context of the MDGs and its short deadline, the *revenue potential*, the *additionality* and the *speed of availability* of new finance sources should be of particular importance:

- Given the urgent need for additional development finance in view of the 2015 deadline, the *revenue potential* of the various financing options is very important. This implies that the tax base is big and sufficiently immobile to support a small rate or surcharge for MDG funding without shrinking unduly as result of tax avoidance or running into heavy political opposition.

- Second, what needs to be explored is the extent to which any new sources are truly *additional* to existing development finance or whether these new sources would merely offset such finance. As additional finance for development can be achieved either through higher ODA or through new sources of finance, the balance between the two will determine the impact of the burden in rich countries and the political resistance to financing proposals. Establishing new forms of funding the MDGs will not serve the purpose if traditional ODA suffers from the introduction of new financing mechanisms.

- *Speed* of fund availability is important if the 2015 deadline is to be respected; each year of delay implies higher funding efforts thereafter if donor pledges are to be kept. *Upfront* commitments from donors might help create a virtuous circle as they strengthen confidence in the recipient countries in solid foreign funding of better domestic policies and institutions.

There are certainly other criteria of importance (on which this Policy Brief will focus less). The governments of the recipient countries will only make the proper reforms and investments if they have a reasonable degree of confidence in the *stability* and *trajectory* of external assistance. Hence, new forms of development finance must be credible, reliable and, above all, durable.

To the extent that new sources of development finance are seen as an alternative (rather than just a complement) to existing ODA, a case has to be made that the innovative sources are a better way to finance a given development effort (Atkinson, 2003). In other words, is there a "*double dividend*" in connection with a new form of finance? This may be the case if a tax serves a corrective function, such as a tax on smoking that partly internalises costs to the health system caused by the smoker. In some cases, there may even be a "*global double dividend*" as governments fail to impose corrective taxes because the benefits accrue mostly outside their borders. The "double dividend" argument, however, has to be balanced against the *deadweight cost* of new sources of finance if they distort economic decisions and diminish wages and profits.

Neither the following text nor the synopsis embedded in Table 2 at the end of this Brief will offer a systematic application of all criteria to all nine proposals. The reason is simple: for some proposals, such as private donations, global premium bonds, or a tax on global arms sales, there are too few studies and quantitative scenarios available so far as to allow meaningful judgements of the proposals on all criteria.

Global Taxes

Many NGOs favour new global taxes to fund the MDGs. Most of the ideas for global taxes seek to finance a global public good by imposing a tax on a global public "bad" – such as hot money movements, cross-boundary pollution or global arms sales. There is often an implicit assumption behind these proposals, namely that the imposition of the tax does not undermine the revenue potential. The political support for global taxes may be too low to contribute significant revenues within the 2015 deadline. Selected politicians, however, have voiced support for global taxes; late January 2004, President Jacques Chirac of France, President Luiz Inácio Lula da Silva of Brazil, President Ricardo Lagos of Chile and the United Nations Secretary-General Kofi Annan decided to establish a technical group to pursue the study of different proposals[4], including "taxation on certain international transactions such as, among others, certain kinds of arms sales and certain financial transactions".

A new tax or revenue stream is best when easy to collect – preferably through existing administrative structures – and difficult to evade, according to basic principles of public finance. It should be neutral in its impact on market incentives and on income distribution unless it is deliberately designed (like tobacco taxation or progressive income tax, for example) to influence consumption or to redistribute wealth. Priority should be given to taxes which discourage inappropriate consumption, excessive control of resources, environmentally damaging activities and social inequities. The most "popular" global taxes will be discussed below – global environmental taxes, the "Tobin tax" on currency transactions, and the global arms tax. Note that there are many other tax proposals (see, for example, Jha, 2004) which have received less attention in the public debate, such as taxes on aviation (either on fuel, tickets or airports), the bit tax on data being sent through the internet, or taxes on world trade (the tax base being, exceptionally, a global public good, not a bad). As can be compared in Table 2, global environmental taxes fit best some important criteria of policy choice – revenue potential and external benefits – but their political feasibility must be judged as too low to help fund the MDGs in time.

Global Environmental Taxes

Increasingly, environmental problems cross national boundaries. Good examples of purely global externalities are chemicals that deplete the stratospheric ozone layer, greenhouse gases that lead to global climate change, depletion of ocean fish stocks, and habitat destruction that impairs biological diversity. An issue high on the policy agenda of many OECD member countries is how to reduce greenhouse gas emissions in order to combat climate change and to meet the Kyoto Protocol commitments (OECD, 2001).

The OECD defines "environmentally related" taxes as any compulsory payment to general government levied on a tax base deemed to be of particular environmental relevance. So defined, in 2000 "green" taxes yielded on average 2.5 per cent of GDP in OECD member countries, with a range from 1 per cent in the United States to 4.5 per cent in Denmark. Taxes on transport fuels (both petrol and diesel) yielded some 70 per cent of "green tax" revenues, followed by taxes on the purchase or use of motor vehicles (ca. 20 per cent). A global carbon tax could affect the consumption of coal, petroleum, kerosene and natural gas. Fuel vendors would be likely to collect the tax, as tax authorities would levy carbon taxes directly on the sale of fossile fuels, similar to value added taxes.

Agnar Sandmo (2004) has made a strong economic case for global environmental taxes, primarily to control climate externalities. In theory, a system of global pollution taxes is said to generate a "*triple dividend*:

First, such a tax contributes to improving the global environment as it penalises the producers of carbon dioxide emissions for their adverse effects on the ozone layer. According to the Intergovernmental Panel on Climate Change, taxes of $100 per ton of carbon could reduce emissions up to 5 billion tons by 2020 (quoted in Jha, 2004).

Second, it can lower the efficiency loss of financing public expenditure (to the extent that the "green" tax replaces taxes that impact on incentives to earn money and save) and can reduce the tax burden on employment (in combination with a reduction of the payroll tax). The removal of tax exemptions on aviation fuel would not only serve the environment, but it would also raise efficiency by deleting tax exemptions where other forms of fuel are taxed, often heavily.

Third, it enhances resources for world development. By how much? The revenue potential appears to be large – a tax on carbon dioxide emissions, through taxing fuel consumption, could, by itself, finance the MDGs. A uniform tax (or surcharge) of roughly 0.01 EUR per litre ($0.048 per US gallon) would correspond to a tax of approximately $21 per metric ton of carbon, yielding annual revenue of $130bn per year. However, that would require that the United States be prepared to opt for such a tax: 20 per cent of the tax yields would originate there alone.

Some pessimism concerning the political realism of introducing such taxes is justified. US Congress has passed legislation that makes it illegal for the United States to participate in any global taxes. Carbon taxes have also been opposed because they are alleged to be regressive and to hurt lower-income families. In fact, the average share of income spent on gasoline is less than 4 per cent and varies little by income class, according to the US Consumer Expenditure Survey of 2000. Even a big tax increase would thus have only a small impact on the typical poor family's standard of living. Moreover, there is no evidence that EU members with a carbon-related tax have any intention of reserving it for aid purposes.

Despite strong opposition, in principle the concept of a global environmental tax would finally reflect an acknowledgement through international law that dumping toxic materials in the oceans or greenhouse gases in the atmosphere is not "free" and that pollution carries real long-term costs. Several European countries, mostly EU members, have already levied energy/carbon taxes at the national level. This might be the beginning of an important political grouping of

countries, which could incite other countries to join in, especially if global warming and climate change are seen to worsen over time. However, the MDG deadline is 2015, and there is little realistic chance that a global carbon tax will be able to contribute in time.

Currency Transaction Taxes

A tax on currency transactions was proposed in 1972 by James Tobin, as a way of throwing "sand in the wheels" of international finance, and so combat market volatility. What may explain its appeal to some governments and NGOs is that even a very small tax rate imposed on such a large tax base as the foreign exchange market would, at least in theory, yield sizeable revenues. However, tax rates have to be very low in view of the extreme mobility of the underlying tax base – the spot, forward, future and swap market for currency transactions. In a study for the German Ministry for Co-operation and Development, Paul Bernd Spahn (2002) has therefore suggested a dual tax rate: a usual tax rate of 0.01 per cent which would according to his estimates yield around EUR 17 billion if the tax was limited to the European time zone; and a very high tax of between 50 and 100 per cent in times of heavy currency market turbulence, to combat currency fluctuations during extremely short periods. The Spahn proposal would need ratification by the EU Council and Parliament and would be used as a European contribution to finance the MDGs.

Machiko Nissanke (2003) estimates the revenue generated at $17-19 billion for a tax rate of 0.01 per cent on a worldwide level, and at $31-33 billion for a rate at 0.02 per cent[5]. Note that even a tax rate as low as 0.01 per cent would double the spread currently experienced in $/EUR transactions. Kenen (1996) and Reisen (2002) have pointed to problems that may negate the estimated revenue potential and the double dividend of a global tax on currency transactions. These problems arise from:

- A declining tax base. A survey of foreign exchange market activities (spot, forward, swaps) released by the Bank of International Settlements in 2001 estimated the daily turnover at $1 210 billion in 2001, down 19 per cent from $1 490 billion in 1998. The introduction of the euro (12 currencies becoming one), the growing share of electronic brokering in the spot interbank market and consolidation in the banking industry appear to explain this fall. The trend may continue, as the determinants responsible for a shrinking turnover seem of permanent, not transitory, nature.

- The importance of hedging activities in the foreign exchange market implies that a tax would actually lead to more rather than less volatility across key currencies. Trading between dealers (rather than with other financial institutions or with non-financial customers) makes up more than half of foreign exchange turnover. Most daily transactions are done for purposes of hedging between traders to avoid over-exposure in currencies accumulated from deal-making. Hedging activities are known as "hot potato trading", as any speculative selling of, say, the US dollar could leave the seller with a supply of unwanted euros, which he or she will then try to off-load to other dealers. The practice helps to spread risk more evenly. The Tobin tax would tend to discourage hedging, since its multiple transactions would each be taxed. Consequently, the tax base of daily foreign exchange transactions would shrink.

- Tax avoidance through migration of the foreign exchange market to tax-free jurisdictions and substitution of tax-free for taxable transactions should be considered as well. Migration could occur unless all jurisdictions with major foreign exchange market turnover adopted the tax. Trading could be drawn to new sites, such as an offshore tax haven somewhere. This migration could be prevented by a punitive tax on all transactions with that haven, enabling trading to continue with complying sites. This penalty would reduce the risk of a migration floodgate being opened by a "first mover", but it would only work with small jurisdictions. If one of the larger established markets did not adopt a Tobin tax, plenty of dealers would shift to that tax-free market and trade among themselves, without being affected by any punitive measures. The tax base would clearly be eroded as a result. To stop substitution of taxable foreign exchange transactions by tax-free ones, the Tobin tax would have to cover several financial instruments and keep up with new ones created to circumvent the tax. For instance, a tax on spot transactions can be avoided easily by using short-dated forward transactions. So these would have to be taxed as well. And as swap combines a spot with an offsetting forward contract, they would also have to be taxed. Moreover, taxing currency swaps alone will not do, as a foreign exchange transaction can be replicated by a combination of a currency and treasury bill swap, thereby evading the currency market (and the tax) to some extent.

Even assuming the Tobin tax was feasible to operate, would it be economically desirable? Put another way, would it lower distortions in international capital markets and encourage less volatility, or crisis-prone investment and help alleviate poverty? For a stable world economy, short-term volatility (which can be hedged) is less important than longer term misalignment of exchange rates,

notably those of emerging markets. Such misalignment may at times be rooted in boom-bust cycles of private lending and investment to developing countries. The Tobin tax would not be large enough to counter these cycles, whose risk-adjusted returns would, given the sudden swings from euphoria to panic, require extremely high tax rates to balance them.

Taxes on Global Arms Sales

In early 2004, Presidents Luiz Inacio Lula da Silva of Brazil and Jacques Chirac of France, backed by UN Secretary-General Kofi Annan and Chile's President Ricardo Lagos, relaunched the idea of international taxes on arms sales to revitalise the flagging global drive against hunger and poverty. In its most recent overview on "World Military Expenditures and Arms Transfers", released in February 2003, the US Department of State estimated the annual value of the arms trade (either exports or imports) at $51.5 billion for 1999. Even without conceding that the *legal* and *documented* trade of arms is tax-elastic, the revenue potential of taxes on conventional arms must be quite limited: a 5 per cent tax would not yield more than $2.5 billion annually. The risk is high that taxation of *documented* trade would stimulate *illicit* trade of arms.

The UN Register of Conventional Arms contains information provided by around 110 governments on exports and imports of conventional arms. The Register covers battle tanks, armoured combat vehicles, large-calibre artillery systems, attack helicopters, combat aircraft, warships, missiles and missile launchers. The UN Register of Conventional Arms Report is made available to all member states, encouraging bilateral and regional dialogues on security concerns. It represents therefore a useful effort of the international community for higher transparency on arms transfers (and hence lower mistrust among governments). One has to wonder whether governments would maintain transparency in this highly delicate area if the information provided by the UN Register was used as a basis for a tax liability.

The biggest obstacle for deriving funds for the MDGs from a tax on global arms sales comes from *illicit* trade, in particular in small arms and light weapons. The *Small Arms Survey 2003* produced by the Graduate Institute of International Studies in Geneva estimates the global small arms trade in 2000 as worth $4 billion a year, and illicit trade at $1 billion. It states that the *majority* of (some 95) countries involved in small arms trade fail to provide annual reports on their arms exports and imports. The clandestine nature of the small arms trade suggests that the share of the illicit arms trade could further rise as a result of

taxation. As for the world leader of arms production, the United States, a series of law suits in the 1980s and 1990s consistently failed to convince the US courts that the firearms industry was responsible for the illegal use of its products.

Embargoed countries provide an illustration of the difficulty of imposing taxes on the global arms trade as they provide evidence of the easiness of circumvention. A UN report on arms transfers to embargoed Liberia during the summer of 2002 demonstrates the depth and comprehensiveness of lawbreaking (Small Arms Survey, 2003). The 210 tons of weapons and ammunitions imported to Liberia during that period required the systematic evasion of legal prohibitions, including false end-user certificates, false shipping manifests, violations of the ECOWAS moratorium and UN sanctions, flouting of the ban on travel by Liberian officials, as well as reliance on payment through prohibited trade in diamonds and other contraband materials.

Voluntary Private-Sector Contributions

While funding the Millennium Development Goals will always involve a higher burden on the private sector in the donor countries, it must not necessarily be compulsory. Higher awareness for the Goals, either the entire set or selected goals, will stimulate voluntary funding possibilities. Charitable giving has a long tradition in financing worthy development projects; the idea of tapping lotteries and in particular global premium bonds, promoted by WIDER in Helsinki, is fairly new, however. Global funds, which combine a set of various actors to pursue a specific set of objectives, have a successful precedent – UNICEF, the United Nations Children's Fund, which covered 33 per cent of its income from NGO and private-sector contributions, according to the last (2003) Annual Report. As argued below and as summarised in Table 2, voluntary private-sector contributions will only be able to make a partial contribution to fund the MDGs as they encounter limits either with respect to revenue potential or additionality.

Private Donations

As famously stated by Adam Smith in his 1759 *Theory of Moral Sentiments:* "However selfish soever man may be disposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it". Indeed, charitable donations by private individuals, both

small-scale donors and the super-rich, and by firms can help fund the MDGs. A recent OECD study of the role of philanthropic foundations in development (OECD, 2003*b*) emphasises the important contributions that such foundations have made, particularly in agriculture ("Green Revolution"), family planning, and control of infectious diseases. The study also finds that the most effective philanthropic interventions have been long-term investments, which were based on "vision and solid science" and well integrated with local capacities.

To help fund the MDGs through private donations requires the huge pool of charitable giving available in OECD countries to be activated and partly attributed to development purposes. Private donations are most popular in the United States, where they have hovered around 2 per cent of Gross National Product during the last two decades (in 2002, US GNP was around $11 trillion; hence the sum of private donations was $220 billion). By contrast, the total annual expenditure by philanthropic *foundations* is estimated by the OECD at only $3 billion. There seems to be no reliable method for gauging the extent to which MDG financing might benefit from philanthropic efforts. It is clear, however, that an attempt to raise the share of philanthropic money devoted to fund the MDGs needs an understanding of the determinants of that very share. This understanding simply is not yet established.

A poll with 26 US-based practitioners in small charitable organisations has shed some badly needed light on the barriers to raising the overseas share of charitable giving (Humphrey, 2003). Raising the share of MDG-devoted philanthropic spending needs removing those barriers. In the United States, the poll unearthed the following barriers as particularly relevant:

- inward orientation and lack of transparency, geography and understanding about global issues in the perception of the majority of US citizens;
- a widespread impression in the US public that their government provides a significant amount of money to the outside world so that there is no need for foundations to become involved;
- fear of funding terrorism, especially relevant for individual potential donors, and coping with the requirements of the Patriot Act since September 2001, a particular barrier for grassroot organisations.

Generally, it was felt by poll respondents that the return to a dollar of grant is higher in poor countries than in the United States and, to the extent that the above barriers could be at least partly removed by awareness campaigns, the inclination to spend for international causes should also be considerable in the United States.

While charity begins at home, efforts must be made that it does not stop there. The UN can make philanthropy's contribution to the MDGs more visible – including *vis-à-vis* the governments in donor countries, which might also help advocacy for a more favourable tax environment for charitable donations. The United Nations Fund for International Partnerships (UNFIP) was established in 1998 in order to promote and help build new alliances in furtherance of the Millennium Development Goals with a variety of organisations, including foundations and businesses; UNFIP also acts as facilitator of dialogues and resources.

Global Lottery and Global Premium Bonds

Proposals to establish a global lottery to fund UN development activities have circulated since the early 1970s. According to www.lotteryinside.com, the world gaming industry news site, the total size of world lottery sales was $126 billion in 2001 (Addison and Chowdhury, 2003); 2001 global lottery gross profit was $62 billion. How much of this could contribute to fund the MDGs, would depend on the amount generated by new players (such as from "development altruists"), on substitution away from other forms of gambling, and on the amount a global lottery would capture from existing lotteries. In United States Lotteries, for example, proceeds in general are divided between winning players (50 per cent), administration (20 per cent), and beneficiaries (30 per cent). Therefore, 30 per cent of lottery sales newly attracted by a global lottery could be used to fund the MDGs. It is impossible, however, to estimate how much new lottery sales could be attracted by a global lottery to fund the MDGs. This would also depend on how the global lottery would be constructed, as compared to competitors. Addison and Chowdhury (2003) summarise the sparse empirical evidence, according to which lottery demand is stimulated by higher mean prizes, skewness toward very large prizes and low variance of the prize distribution.

A global lottery could function in two ways. The first is for national lotteries to run national versions of the global-lottery game. The second is a single global lottery sold worldwide and run by one organisation. Instant products such as ticket lotteries ("scratch cards") and video lottery terminals require less organisational infrastructure than number games; for this reason they are a preferred option for MDG funding.

Global lotteries may face political opposition if they are seen to take money away from national charities (Andersson, 2003). Moreover, the incidence of lottery funding may be regressive; low-income groups spend a higher proportion of their income on lotteries than higher-income groups (the better-off gamble on

the stock markets…). To the extent that MDG-funding lotteries compete successfully with established lotteries, more will be spent on gambling, reinforcing the regressive incidence of funding the MDGs this way. Another objection may be that, for religious or ethical considerations, gambling is not universally practised.

A related, but new, funding idea is being promoted at WIDER. Addison and Chowdhury (2003) suggest a *global premium savings bond*, modelled on similar schemes currently practised in the Bangladesh, Ireland and the United Kingdom. A premium bond is like a lottery ticket in that the return depends on a random prize draw, but otherwise it is a bond, hence a savings instrument where the capital is not at risk. Annual premium bond sales are presently running at $34 billion in the United Kingdom. The authors suggest a single organisation to sell and administer the bonds; the bond itself is a savings instrument, but the rate of return has a random element. In the United Kingdom, for example, people buy savings bonds, each with a unique number that is entered every month in a prize draw where a random number generator picks the winners. Unlike for pure lotteries, investors in a global premium savings bond never lose their initial investment, though the return on that investment depends on luck. The authors hope that such bonds might meet strong demand in the growing market for ethical investment by both institutional and individual investors.

Unlike a global lottery, which can be administered in either national versions or in a single international version, global premium bonds are best issued and followed by a single organisation, preferably in a basket of major currencies, such as the IMF's Special Drawing Rights. Addison and Chowdhury envisage that the bond proceeds are used for funding the MDGs. They discuss one drawback of their proposal, namely that bond proceeds are best matched by loans rather than grants. It remains fairly unclear, however, how bond investors would be protected against the possibility of widespread default by those countries that are recipients of the proceeds of the bond issue. Alternatively, only what remains from the lottery return component (after payment to the prize winners and cover of administrative cost) could be used. While that variety would amount to much smaller funds for the MDGs, they could be provided in the form of direct cash outlays[6]. As such, the WIDER proposal cannot be a stand-alone proposal from a revenue perspective, but it can usefully complement other proposals, such as the International Finance Facility, which would be built around bond issues.

Topic-Specific Global Funds

Topic-specific global funds – such as the Global Fund to Fight AIDS, Tuberculosis and Malaria (the "Global Fund", see Box 1) or the Global Environment Facility – are administered and financed by multi-actor coalitions of governments, international organisations, the private sector and civil society. The advantages of such funds, also called "vertical funds", are that they can serve as focal points for generating additional public and private resources to address urgent global problems. Such funds have a long history, starting with the United Nations Children's Fund (UNICEF), established in late 1946, which has currently an annual income of $1.5 billion, of which a third is contributed by the private sector. Their focus on a particular issue or on a small set of closely related issues can help draw public attention to specific problems and mobilise donor resources. Nevertheless, the concern has been voiced that they may also result in a less coherent response to global problems, duplicate existing structures and be weak in terms of democratic accountability.

By March 2004, $4.9 billion had been committed to the Global Fund through 2008 by donor countries, foundations and the private sector, while $2 billion had been paid out to the Global Fund (for regular updates, see www.theglobalfund.org). While the Fund has collected an impressive "war chest" against communicable diseases in record time (1½ years), the question is whether these figures are "*additional*" resources and whether they are *sustainable*[7]. The original intent for the Global Fund was to funnel non-profit and private-sector donations into a single streamlined process, rather than to create many separate bureaucracies to deliver aid. Looking at the pledges in greater detail (see the Global Fund's Annual Report 2002/2003), the private sector has made very few commitments, apart from the *Bill and Melinda Gates Foundation*, which has played a central role in the fight against AIDS for some time and contributed $100 million to the Fund. To the extent that the Global Fund fails to attract funds from private sources, the question arises as whether its important contributions are based on shifts within donor budgets rather than additional ODA; the question is currently being investigated at the OECD Development Centre.

Another concern relates to the *sustainability* of resources collected by the vertical funds. While the amounts mobilised by the Global Fund have been impressive, uncertainty about where the money will come from in the future can strain scarce secretariat resources and divert attention towards fund-raising.

The *Financial Times* quotes Global Fund officials as saying "they are beginning to feel a little like itinerant beggars, spending a disproportionate amount of their time wandering the globe trying to squeeze money out of recalcitrant donor governments" [8].

Speed of disbursement may well militate for global funds rather than for more traditional donor instruments in the funding of global public goods and the MDGs. The World Bank, for example, has a limited capacity to make grants as most of its financing has traditionally been built around loans. Further, the World Bank spends against statements of expenditure by the recipients, while money is advanced by the Fund in an initial instalment, which subsequently is followed by additional disbursements against periodic requests. The Global Fund aims at a short time interval between initial calls, approvals by its review panels, signature and finally disbursement of funds. The lag between calls and approval has averaged four months so far, as was the lag between approval and signature; then, another month was needed to disburse the funds. There are trade-offs to be considered between speed of disbursements and quality of country requests, hence the lag between calls and approvals has lengthened somewhat over the several "rounds" from early 2002 to late 2003.

Through broadened *public-private partnerships* (PPPs) the Global Fund aims at raising the effectiveness of country-driven programmes. As grants are disbursed to a wide array of recipients – not only to governments (50 per cent after rounds 2&3), but also to NGOs (29 per cent), the private sector (5 per cent), faith-based organisations (4 per cent), academic organisations (3 per cent), community-based organisations(3 per cent), and people with HIV/malaria/tuberculosis (3 per cent) – it is claimed that PPP is broadened compared to common donor practice that is tilted towards directing funds through governments.

Two major criticisms have been advanced against PPPs, which some see as an attempt by governments to privatise aid and to "flee" their ethical responsibilities: *a)* that they generate *windfall profits* to the private sector; and *b)* that they foster so-called "*project islands*", i.e. an incoherent and uneven distribution of project coverage[9].

An unpublished consultancy report for the German BMZ found that PPPs are characterised by important windfall profits, as private firms get subsidies on investments that they would have carried out anyhow. While this thesis merits exploration, *prima facie* the Global Fund finances a global public good that in principle is defined by not being provided by the market alone. Hence, in the case of funds which focus on funding global public goods there is unlikely to be a windfall profit as can happen with subsidies for private industries.

Box 1. The Global Fund To Fight Aids, Tuberculosis and Malaria

First proposed at the July 2000 G-8 Summit in Okinawa, Japan, and endorsed by the UN General Assembly Special Session on HIV/AIDS in June 2001, the Global Fund has collected and distributed a large amount of money to fight AIDS, tuberculosis and malaria since its inception in January 2002. Yet the Fund has been the subject of very little analysis. It defines itself as a public-private partnership to serve as a partner to governments, NGOs and international agencies and as a financing instrument, not as an implementing agency. The mandate of the Global Fund is to raise and disburse large amounts of additional resources to reduce the impact of the three diseases.

The Global Fund's Board of Directors acts as its ultimate decision-making body. The 23-member Board is composed of both voting and non-voting members. Its 18 voting members are composed of two groups: nine donors, including seven governments, a foundation representative, and a representative of the for-profit private sector, and nine recipients, including seven governments and two non-governmental organizations, one from the developing world and one from the developed world. A Technical Review Panel (TRP) is charged with reviewing all proposals to ensure that they are scientifically and technically sound. The Panel is composed of an independent group of 17 experts in the three diseases, and in the fields of prevention, clinical care, health education, and health economics.

As of March 2004, the Global Fund had managed three rounds of proposals (April 2002, January and October 2003) and distributed $2.1 billion to 224 programmes in 121 countries and 3 territories. Proposals are submitted through an inclusive, broad-based partnership in each country, referred to as a Country Coordination Mechanism (CCM), which brings together national and local governments, NGOs, and the private sector. In countries where a CCM either does not exist, or does not function adequately due to unusual circumstances (such as conflict, natural disaster, or questions of government legitimacy), NGOs can submit proposals directly to the Fund. All proposals must be technically and developmentally sound, must demonstrate that added resources will bring results, and must meet high programmatic and financial accountability standards. The Technical Review Panel reviews all proposals and makes funding recommendations to the Board. The Board makes all final decisions on grant awards. Priority for funding is given to proposals from countries and regions with the greatest need, including the highest burden of disease and poverty, and those at high risk for disease emergence. The Board stipulated that no funds for any projects would be disbursed until satisfactory financial, monitoring, and evaluation controls have been agreed upon for each programme.

Source: http://www.theglobalfund.org/.

Financial Engineering

This section lists three proposals: one aims at transforming donor commitments into existing financial-market instruments in order to frontload ODA for the MDGs; the second targets the IMF's Special Drawing Rights in order to redistribute funds from rich donor countries to poor countries which qualify for MDG funding; the third suggestion is to lever private funds in high-risk countries, both by local and foreign investors, through stimulating the use of public guarantees by low-risk donor countries. This Policy Brief, as summarised in Table 2, argues in favour of both the International Finance Facility – in particular for speeding up ODA to fund the MDGs – and a better "scoring" of public guarantees as aid to stimulate risk-taking by both local and foreign investors for infrastructure finance.

The International Finance Facility (IFF)

The IFF – a joint UK Treasury/DFID proposal[10] to increase and frontload development aid, published in January 2003, aims at bridging the gap between the resources that have already been pledged and what is needed to meet the MDGs by 2015. The Facility would be built on long-term donor commitments, comprising a series of pledges (each of them lasting 15 years) by donors for a flow of annual payments to the IFF. Annual commitments would start from the $15 – $16 billion of aggregate Monterrey and post-Monterrey additional sums pledged and would rise by 4 per cent (in real terms) per year. Each pledge would be a binding commitment, in order to provide security against which investors could lend. On the back of these pledges: its assets – the IFF would issue bonds in its own name: its liabilities. For prudential reasons, therefore, the IFF will have to limit the degree to which the donor commitments may be levered; at each disbursement the Facility will allocate a fixed proportion of the donor commitment to that disbursement, taking into account the prevailing cost of long-term debt for the IFF in the donor country's currency and the leverage limit.

The Facility would thus frontload long-term aid flows so that the MDGs could be financed and reached by 2015. The IFF would serve the function of a temporary finance facility; it would be replenished at regular intervals, and at each replenishment, donors would make a fresh series of annual long-term funding pledges (each lasting 15 years) as the basis for further borrowing. After raising and disbursing funds for 15 years, the repayment phase would continue for another 15 years. The Facility would be wound up by 2030. The funds raised by donor commitments and by market borrowing could be quickly disbursed

through existing mechanisms, in the form of grants rather than loans. It is notable that the IFF will not disburse funds directly to recipient countries, but will instead provide funds for disbursement (subject to conditionality) by existing aid delivery channels who would act as agents on behalf the IFF.

Some overarching principles would have to be met before funds from the IFF were disbursed: funds would have to be targeted at low-income countries and used in an untied fashion for poverty reduction and other MDGs, meaning that much of the funding would be directed towards education and health. Money could also be used to fund additional debt relief. One big advantage of the IFF, given that 2015 is quickly approaching, is that it is a concrete proposal that would deliver the necessary increase in aid to meet the MDGs. Crystallizing the political commitments made by donors and by providing a stable, predictable source of aid that would enable donor countries to factor aid into their budget planning, the IFF would allow a critical mass of finance to be used simultaneously for a range of projects and an improvement in co-ordination between donors. However, the assumptions on which the IFF is based, viz., *a)* the continuous commitment of the donor community towards the implementation of the IFF during the life of the Facility; and *b)* its heavy reliance on political co-ordination among donor countries has be questioned (Mavrotas, 2004).

A key advantage of the IFF proposal is its revenue-raising potential. The Facility could double existing ODA from $50 to $100 billion per year during the crucial period 2010-2015. Another advantage of the IFF is that it accelerates grant finance rather than loans to the recipient countries participating in the IFF. Another positive potential of the IFF lies in the need for donor co-ordination, avoiding the need for poor countries to court myriad donors and deal with different regulations.

A weak spot of the IFF is that it destabilises the time profile of aid commitments: The IFF proposes to borrow funds in order to achieve a faster increase in aid in the short term at the cost of reducing future aid when the funds have to be repaid. Growing pension and social security burdens in ageing OECD countries, for example, mean that the opportunity cost of aid will be rising to most donor countries; hence, a continuous commitment towards the IFF might be difficult to sustain. Heller and Gupta (2002) therefore develop a proposal exactly opposite to the IFF: donors should spend today into trust funds, to be used to fund expenditures on behalf of the poor countries over a longer time horizon as absorption capacity increases. It will also have to be examined more thoroughly whether the initiative is not in conflict with *constitutions* in donor countries as it shifts some of the funding burden from current governments (and generations) to the next.

A Development-Focused Allocation of SDRs

Special Drawing Rights, or SDRs, are a form of money that the International Monetary Fund's board of governors can create by crediting accounts of the Fund's member states, at an exchange rate determined by a basket of major currencies. Countries that run a deficit in the current account of their balance of payments can transfer their SDRs to surplus countries, and the latter must provide them with convertible currencies in exchange. The idea of issuing SDRs for development purposes is as old as it is untried – at least going back to the 1970 Brandt Commission's report (Aryeetey, 2004); but it has recently been revived by George Soros (2002)[11].

Mr. Soros proposes that the developed countries create new SDRs to raise the supply of "global public goods'. Rich countries would donate their SDRs to a trust fund managed by a board of "eminent persons" (not public authorities); the rich countries would pay the interest on the SDRs. The board would identify a menu of worthy projects with global or regional benefits, and rich country governments would then select from among the menu of options those which they wish to support. Once the SDRs are put to use (e.g. when trust funds receive hard currency), it is the rich-country governments which pay in their own hard currency, hence charging their public budgets. However, there are the following difficulties associated with the Soros proposal:

- linking SDR allocation to finance the MDGs requires a change in the Articles of Agreement of the IMF, has to be ratified by 100 IMF Member countries with 85 per cent of voting power. This has so far never happened;
- redistribution of SDRs involves lost interest income to the SDR provider; the SDR rate of interest is the weighted average of the short-term Treasury bill rates of France, Germany, Japan, the United Kingdom, and the United States (currently 2.25 per cent a year).

In the past, even modest allocations of SDRs have been opposed on the grounds that they would be inflationary. Today, in the face of a widespread recession, excessive foreign exchange holdings by emerging markets for fear of financial crises and the need to expand liquidity to support the expansion of international trade, this argument would be harder to make. At times when Asia's central banks have accumulated hundreds of billions of foreign exchange reserves in order to stay competitive in view of the declining US dollar, the Soros proposals could be extended to those very countries. In fact, the dollar peggers might face a higher incentive than dollar floaters (such as the Euro zone countries) to buy SDRs as these provide a promising alternative to low-coupon (and depreciating)

US treasury bonds, which are usually bought by the central banks when they buy dollars against selling their own currencies. Rather than providing cheap savings to the US public budget, such countries might consider the potentially lucrative alternative of investing their rising reserves in SDRs, which entail a lower devaluation risk.

Public Guarantees

The *Camdessus* Report "Financing Water for All", issued in March 2003 by the World Panel on Financing Water Infrastructure, has emphasised the importance of public guarantees to stimulate private investment, local and foreign. This emphasis has to be seen in the context not just of the Millennium Development Goal of clean water supply, but in a broader context of infrastructure investments. Such investments are characterised by high capital intensity, long gestation periods and, where they are ODA financed, by front-loading. The inherent sovereign risks are not covered by commercial banks, at least not for long maturities in the poorest countries. What are then the specific arguments of the *Camdessus* Report?

1) As a general principle, ODA should be used to facilitate private flows, instead of replacing or discouraging them. This is a bit analogous to food aid, where the availability of food for free can discourage local food producers. Likewise, the availability of grant aid can "crowd out" commercial lending and discourage water authorities from becoming more financially self-sustaining. Here guarantees are the better instrument of ODA as they are catalysts to mobilise other flows and empower local players.

2) Guarantees deserve to be properly reflected alongside other forms of official assistance, in the ODA statistics of the DAC. The current reporting conventions reflect guarantees only when they give rise to actual disbursements – for instance, after default by the recipient. The World Panel on Financing Water Infrastructure believes that this does not fully reflect the real size of the contingent liabilities accepted at a given moment by a donor country. This is being examined by the DAC Working Party on Statistics.

3) Multilateral financial institutions (MFIs) could lend more without a proportionate increase in their borrowings or callable capital, if certain constraints were relaxed. A number of MFIs are barred from lending without a sovereign guarantee, which complicates lending to sub-sovereign entities who cannot avail themselves of a government guarantee. Moreover, guarantees by the MFIs are "scored" as if they were loan exposure for 100 per cent of the amount, discouraging their use through the current practise of capital provisioning.

The broader development argument to strengthen the role of public guarantees resides in *i)* the stimulus it provides for risk taking, both by local and foreign residents, in a high-risk environment; *ii)* the allocation of scarce local and added foreign savings to projects with potentially high social returns; and *iii)* the fostering of a sense of ownership in the recipient countries.

Such guarantees, however, have to be tailored in a way to avoid excessive risk taking (moral hazard), political interference by well-connected elites and lobby groups (rent seeking), unsustainable debt burdens and misallocated resources. An important conclusion to emerge from a review of IFC (2003) – the International Finance Corporation, the World Bank's private-sector arm – operational experience is that the efficiency of private infrastructure provision depends very much on the policy and regulatory environments that are created by governments. At each stage of a project's life cycle (which will usually include bidding, negotiation, financial closure, construction and operation), government agencies play a fundamental role that can mean the difference between success and failure. The quality of the enabling environment, perhaps more so than country risk or income levels, will determine much of the pace at which private infrastructure is implemented in the coming years.

In the wake of the World Summit on Sustainable Resources held in Johannesburg in 2002, donors have introduced a range of initiatives to facilitate the mobilisation of finance from domestic and international financial markets. Among them: extended partial credit risk enhancements to lever additional debt finance into the sector in otherwise non-creditworthy sub-sovereign investment opportunities in low income developing countries. For example, the Emerging Africa Infrastructure Fund (EAIF), a PPP debt fund making long-term loans to private infrastructure projects in sub-Saharan Africa, is now in operation. It uses donor equity as a risk cushion to leverage more than twice the amount of senior/subordinated debt from private lenders in support of African private sector infrastructure projects. GUARANTCO, the UK Local Currency Debt Guarantee Facility, has been established to address domestic debt market failure and thereby facilitate long-term local currency debt issues to finance private infrastructure opportunities. Just like the existing multilateral and bilateral risk insurance schemes, these agencies and their guarantees constitute important *contingent liabilities* for DAC donor governments.

Contingent liabilities will only be recognised under cash accounting if and when the contingent event actually occurs and a payment is made. Even under accrual accounting, many contingent liabilities would not be recognised as liabilities, unless they can be quantified and are judged likely to require a future payment by the government. But where possible, major contingencies should be

quantified. Contingent liabilities can, in principle, be accounted for by multiplying the *ex ante* default probability with the amount guaranteed and the net present value over the guarantee maturity.

Disclosure of contingent liabilities in the annual budget, the mid-year report to the legislature and the final accounts is included in the OECD best practice guidelines. These should be classified by major category, and information on the past calls on the government to meet contingent liabilities should be disclosed[12]. The IMF Manual on Fiscal Transparency stipulates that where there is a portfolio of similar contingent liabilities, such as a large portfolio of loan guarantees with similar characteristics, there may be sufficient reliable historical data on loan loss experience to allow a reliable estimate of the expected cost of the guarantee programme to be made. This estimate might then be appropriated as expenditure in the budget. It can also be envisaged, as suggested by Daniel Cohen (2002), that contingent liabilities, such as public guarantees, could be handled by setting up an independent trust fund that itself will have limited liabilities. Such funds would be endowed by capital that corresponds to the size of public guarantees; the capital would be raised by an equivalent amount of debt.

A Synopsis

The comprehensive discussion of the most prominent proposals for new forms of financing the Millennium Development Goals can lead to the conclusion that the most straightforward way to avoid under funding of the Goals is to raise ODA. Given the recent post-Monterrey donor pledges and initiatives, the extra effort needed to double ODA is no longer out of reach. On the other hand, no proposal for an innovative approach is without at least one serious side risk, as discussed in the preceding sections. Moreover, whether through traditional or innovative approaches, funding the MDGs will imply a budgetary problem: the transfer to poor countries must ultimately be borne by the private sector in the donor countries. Yet, there are some innovative approaches to funding the Goals which could entail considerable "double dividends".

Table 2 provides an overview of those innovative funding sources which this Policy Brief has highlighted. Among the most popular global taxes discussed above – global environmental taxes, the Tobin tax on currency transactions, and the global arms tax, the environmental tax might satisfy the normative criteria stipulated by public finance. It is also a tax with a revenue potential high enough to finance the Goals by itself and it has several fringe benefits, as environmental taxes help reduce pollution and do not entail distortions to work incentives.

However, so far political opposition has denied environmental taxes on a global scale and hence they are unlikely to play any role in financing the Millennium Development Goals by 2015.

Among the nine proposals discussed in this Policy Brief, the *International Finance Facility* suggested by the UK Government, perhaps in combination with a *Global Premium Bond* as advocated by Wider, and the strengthened use of *public guarantees* as called for by the Camdessus Report on (waste)water finance are the preferred options for new development finance in view of the looming 2015 deadline. They muster important political support, but not yet unanimity. The International Finance Facility would provide predictable flows and raise the credibility of existing donor commitments towards the Goals. Global funds with a focus on specific Millennium Development Goals can help draw public attention to specific problems and mobilise donor resources. Public guarantees help stimulate risk taking, both by local and foreign residents, in a high-risk environment, which can be incited towards some of the Goals, most notably in infrastructure. The Global Premium Bond, such as suggested by Wider and practised so far on a local basis in the United Kingdom, Ireland and Bangladesh, and the creation of Special Drawing Rights, as recently suggested by George Soros, can provide useful complements to the IFF in particular.

Policy makers might want to pursue a *combination* of innovative approaches of funding, rather than a single form. A menu approach will stimulate donor generosity as existing tax schemes and institutions shape preferences with respect to the various forms of funding. More choice, then, should stimulate the supply of funding, by appealing to the comparative preferences of donors. Some options, in particular with respect to global taxes, might be feasible when operated on a regional level (as, for example, suggested by the *Spahn* proposal for currency transaction taxes). A combination of approaches will also be better able to cater to the most urgent needs in the recipient countries. For example, the *International Finance Facility*, relying on traditional disbursement channels, arguably suits the low-income countries more than a strengthened role for *public guarantees*, the development impact of which will be felt stronger in poor countries with an intermediate risk level.

Table 2. **New Sources for Development Funding**

TYPE	GLOBAL TAXES		
Source	Global "Dirt" Tax	Tobin Tax	Global Arms Sales Tax
Brief description	Specific reference to a tax on use of hydrocarbon fuels according to carbon content.	Tax on foreign currency transactions (spot, forward, future and swap markets), possibly with dual rates (Spahn tax).	Not specified by proponents yet, but presumably on arms covered by the UN Register of Conventional Arms.
Revenue potential	$180 bn per year if imposed worldwide at a uniform gasoline tax of 0.01 per litre ($.048 per gallon) . Limited to imposition in high-income countries, figure drops to $61 bn.	$17-19 bn per year with a tax equivalent to 0.01 per cent on global turnover of foreign exchange; $31-33 bn for a rate at 0.02 per cent. Higher tax rates might yield less as tax base is likely to shrink disproportionately.	$2.5 bn max. per year for a tax rate of 5 per cent of arms sales if documented trade were not pushed into illicit trade by taxation.
Degree of additionality to traditional development finance	High, but important administrative costs involved. National taxes may be affected, hence the public budget	High, but important administrative structure costs involved.	High. UN Register of Conventional Arms could be used for administration.
Other benefits	Environmental, and allocational as external cost of final energy uses internalised	Reduces foreign exchange volatility (?)	Reduces arms trade (?)
Major costs and obstacles	The United States and other countries could resist carbon taxes.	Mobile tax base – tax may destabilise exchange rates	High tax rate elasticity as illicit trade important.

Table 2. **New Sources for Development Funding** (continued)

TYPE		PRIVATE-SECTOR CONTRIBUTIONS	
Source	Increased Private Donations	Global Lottery and Premium Bonds	Global Funds
Brief description	Tax incentives, Global Funds, corporate giving, Internet measures to raise charitable donations	Lottery proceeds to be shared between national lotteries and UN fund; bond issue with lottery prizes instead of interest; capital value preserved	A public-private partnership to serve governments, NGOs and international agencies, and a financing instrument, not as an implementing agency, with the mandate to raise and disburse large amounts of additional resources
Revenue potential	No estimates so far. Total charitable giving sizeable, e.g. 1.5 per cent of GNP in the United States. Revenue potential large; depends on degree of giving for development rather than other purposes, and on tax (income, inheritance) incentives.	No estimates so far. Lottery could reach $6 bn per year	Considerable. Example: The Global Fund to Fight Aids, Tuberculosis and Malaria has received $4.9 bn in commitments through 2008 in 1½ years of existence.
Degree of additionality to traditional development finance	High	High	Subject to debate; more empirical analysis needed to support judgement.
Other benefits	--	--	Awareness raiser.
Major costs and obstacles	Unpredictability, as dependent on individual, voluntary, action.	Competition with national lotteries. Diversion of funds for 'needy' projects in donor countries. Regressive 'tax' impact.	May duplicate existing ODA structures if DAC harmonisation principles not respected.

Table 2. **New Sources for Development Funding** (end)

TYPE	FINANCIAL ENGINEERING		
Source	International Finance Facility	Creation of SDRs	Public Guarantees
Brief description	Long-term pledges of a flow of annual donor funding would leverage more funds from private sources (UK Treasury/DFID) through bond issues	Periodic creation of SDRs, with donor countries making their SDR allocation available for MDGs (Soros Proposal)	Use of risk mitigation instruments offered by public (local or international) bodies; covers guarantees, lending and insurance products available for political, contractual, credit and foreign exchange risks .
Revenue potential	$50 bn for 2010-2015, building up from 2006 and falling to zero by 2020. Provides predictable flows with agreed disbursement mechanism.	$25 bn, depending on periodicity and political willingness for annual allocation of SDR to poor countries.	No evidence yet other than anecdotal.
Degree of additionality to traditional development finance	Can crowd out traditional development finance	Can crowd out traditional development finance	High as private risk-taking induced.
Other benefits	Could raise credibility of donors' commitments	Counteracts deflationary pressures that arise for excessive FX holdings of crisis-prone countries. Can integrate Asian mega-reserve countries into MDG funding.	Levers private investment from local and foreign agents to infrastructure; can foster sense of ownership.
Major costs and obstacles	Requires sufficient donor countries to sign up, and to continue to make commitments. Not in line with dynamic pattern of ability to pay in donor countries. Constitutional concerns.	Hard to ratify by 100 IMF members with 85 per cent of voting power. Lost interest income to SDR providers. Could be inflationary (?).	Excessive risk taking (moral hazard), political interference by well-connected elites and lobby groups (rent seeking), unsustainable debt burdens.

Notes

1. These Goals are *i)* eradicate extreme poverty and hunger; *ii)* achieve universal primary education; *iii)* promote gender equality and empower women; *iv)* reduce child mortality; *v)* improve maternal health; *vi)* combat HIV/AIDS, malaria and other diseases; *vii)* ensure environmental sustainability; *viii)* develop a global partnership for development. For each of these goals, targets and indicators have been defined. For details, see www.unmillenniumproject.org.

2. Its results are the sum of the fight against communicable diseases ($7-10 billion), primary schooling ($10 billion), infant and maternal mortality ($12 billion) and halving world poverty ($20 billion). See also Devarajan, S., M. Miller and E.V. Swanson, "Development Goals: History, Prospects and Costs", World Bank Policy Research Working Paper No. 2189, April 2002, who estimate that an additional $40-60 billion in ODA is needed each year to meet the goals in 2015.

3. This Policy Brief has benefited considerably from the project "Innovative Sources for Development Finance" under the direction of Tony Atkinson (2004) at the UN World Institute for Development Economics Research, WIDER. Atkinson says that he had not felt constrained by the degree of political obstacles to the various options to finance MDGs. He argues that it was the role of economists to lay out the options, their costs and their benefits, and that it is upon policy makers to make the respective choices. Arguably, his position conceives the economist's role too narrowly. A full policy analysis should include political and administrative feasibility as well, if it wants to be effective. See, for example, the Sagasti and Bezanson (2001) study for Sweden's Ministry of Foreign Affairs.

4. Embassy of Brazil in London, 002/2004 – Meeting of Presidents Lula, Chirac, Lagos and UN SG Annan, 02/02/2004.

5. Nissanke arrives at a somewhat lower revenue potential than Spahn as her estimates include consideration of the recently observed shrinking of the tax base.

6. Particularly for highly-indebted countries with a high degree of susceptibility to shocks, hence with low debt tolerance, aid should be provided in the form of grants or direct cash outlays.

7. In principle, the issue can be investigated on the basis of the DAC Creditor Reporting System data base; however, empirical research has to wait for the 2003 figures (as that is the first year where the Fund has been fully running). The working hypothesis would be that there is no structural break in the donor data on health-related ODA if the hypothesis of additionality is to be confirmed. Another empirical approach would be on the recipient side, where eventually spending data on communicable diseases (possibly on the basis of data provided by the World Health Organisation) could be checked for a structural break.

8. Alan Beattie, Agencies Distracted by Worries About the Future, *Financial Times*, Special Report Business and Aids, 28. November 2003, page 4.

9. See, for example, the debate on PPPs in the German development review *Development & Cooperation*, June 2003.

10. For further details, see the Technical Note provided by the UK Treasury and DIFD under www.hm-treasury.gov.uk/media/35BA7/IFF2003.pdf. See also Mavrotas (2003) for an excellent description and analysis.

11. Ariel Buira, formerly Deputy Governor of the Central Bank of Mexico and currently Director of the G24 Secretariat, had advanced a similar proposal at the International Conference on Financing for Development in Monterrey, with the aim to use SDR allocation as a counter-cyclical policy (Buira, 2002).

12. OECD Best Practices for Budget Transparency (PUMA/SBO(2000)6/FINAL) states on contingent liabilities: "Where feasible, the total amount of contingent liabilities should be disclosed and classified by major category reflecting their nature; historical information on defaults for each category should be disclosed where available. In cases where contingent liabilities cannot be quantified, they should be listed and described."

Bibliography

ADDISON, TONY AND ABDUR R. CHOWDHURY (2003), "A Global Lottery and a Global Premium Bond", *WIDER Discussion Paper* 2003/80.

ANDERSSON, GUN-BRITT (2003), "Financing Global Public Goods for Health", 714th Wilton Park Conference, http://www.egdi.gov.se/pdf/speech_wiltonpark.pdf.

ARYEETEY, ERNEST (2004), "A Development Focussed SDR Allocation", *WIDER Discussion Paper* 2004/, forthcoming.

ATKINSON, ANTHONY (2003), "Innovative Sources for Development Finance: Over-Arching Issues", *WIDER Discussion Paper* 2003/88.

BUIRA, ARIEL (2002), "Allocating Special Drawing Rights to Increase International Financial Stability", http://www.undp.org/ods/monterrey-papers/buira.pdf.

COHEN, DANIEL (2002), "Fiscal Sustainability and a Contingency Trust Fund", in HANA POLACKOVA BRIXI AND ALLEN SCHICK (eds.) *Government at Risk: Contingent Liabilities and Fiscal Risk*, World Bank, Washington, D.C.

COLLIER, PAUL AND DAVID DOLLAR (2002), "Aid Allocation and Poverty Reduction", *European Economic Review* 46, 1475-1500.

DEVARAJAN, S., M. MILLER AND E.V. SWANSON (2002), "Development Goals: History, Prospects and Costs", World Bank Policy Research Working Paper No. 2189, April.

GRADUATE INSTITUTE OF INTERNATIONAL STUDIES GENEVA (2003), *Small Arms Survey 2003: Development Denied*, Oxford University Press, Oxford.

HELLER, PETR S. AND SANJEEV GUPTA (2002), "Challenges in Expanding Aid Flows", *Finance & Development,* Vol. 39.2.

HM TREASURY AND DFID (2003), *The International Finance Facility*, WIDER.

HUMPHREY, RACHEL (2003), "International Grantmaking – A Matter of Will", *Alliance Extra,* June, www.allavida.org.

JHA, RAGHBENDRA (2004), "Innovative Sources of Development Finance: Global Cooperation in the Twenty-first Century", *The World Economy* Vol. 27.2, 193-214.

KENEN, PETER (1996), "The Feasibility of Taxing Foreign Exchange Transactions", in HAQ, MAHBUB UL, INGE KAUL AND ISABELLE GRUNBERG (eds.), *The Tobin Tax*, Oxford University Press, Oxford.

MAVROTAS, GEORGE (2003), "UK HM Treasury-DFID Proposal to Increase External Finance to Developing Countries: The International Finance Facility", *WIDER Discussion Paper* 2003/79.

NISSANKE, MACHIKO (2003), "Revenue Potential of the Tobin Tax for Development Finance: A Critical Appraisal", *WIDER Discussion Paper* 2003/81.

OECD (2001), *Environmentally Related Taxes: Issues and Strategies*, OECD, Paris, November.

OECD (2003*a*), Development Co-operation Report 2003, OECD, Paris.

OECD (2003*b*), "Philanthropic Foundations and Development Co-operation", *DAC Journal* Vol. 4.3, OECD, Paris.

REISEN, HELMUT (2002), "The Tobin Tax: Can It Work?", *OECD Observer*, May.

SAGASTI, FRANCISCO AND KEITH BEZANSON (2001), *Financing and Providing Global Public Goods. Expections and Prospects,* prepared for the Ministry for Foreign Affairs Sweden, Stockholm.

SANDMO, AGNAR (2003), "Environmental Taxation and Revenue for Development", *WIDER Discussion Paper* 2003/86.

SOROS, GEORGE (2002), "George Soros on Globalization", *Public Affairs,* New York.

SPAHN, PAUL BERND (2002), *On the Feasibility of a Tax on Foreign Exchange Transactions*, Federal Ministry for Economic Cooperation and Development, Germany.

UNITED NATIONS (2001), Technical Report of the High-Level Panel on Financing for Development (Zedillo Report), New York, http://www.un.org/reports/financing/report_full.htm.

UNITED STATES DEPARTMENT OF STATE (2003), *World Military Expenditures and Arms Transfers (WMEAT) 1999-2000*, 28th edition, February.

WORLD PANEL ON FINANCING WATER INFRASTRUCTURE (2003), *Financing Water for All*, March.

Other Titles in the Series

Adjustment and Equity (No. 1)
by Christian Morrisson (January 1992)

Managing the Environment in Developing Countries (No. 2)
by David O'Connor and David Turnham (January 1992)

Privatisation in Developing Countries: Reflections on a Panacea (No. 3)
by Olivier Bouin (April 1992)

Towards Capital Account Convertibility (No. 4)
by Bernhard Fischer and Helmut Reisen (April 1992)

Trade Liberalisation: What's at Stake? (No. 5)
by Ian Goldin and Dominique van der Mensbrugghe (May 1992)

Towards Sustainable Development in Rural Africa (No. 6)
by David Turnham, with Leif E. Christoffersen and J. Thomas Hexner (January 1993)

Employment Creation and Development Strategy (No. 7)
by David Turnham (July 1993)

The Disarmament Dividend: Challenges for Development Policy (No. 8)
by Jean-Claude Berthélemy, Robert S. McNamara and Somnath Sen (April 1994)

Pension Fund Investment from Ageing to Emerging Markets (No. 9)
by Bernhard Fischer and Helmut Reisen (January 1995)

What Institutional Framework for the Informal Sector? (No. 10)
by Christian Morrisson (October 1995)

The Policy Challenges of Globalisation and Regionalisation (No. 11)
by Charles Oman (June 1996)

Policies for Economic Take-off (No. 12)
by Jean-Claude Berthélemy and Aristomène Varoudakis (September 1996)

The Political Feasibility of Adjustment (No. 13)
by Christian Morrisson (October 1996)

Biotechnology Policy for Developing Country Agriculture (No. 14)
by Carliene Brenner (April 1997)

Pension Reform: Lessons from Latin America (No. 15)
by Monika Queisser (January 1999)

After the Great Asian Slump: Towards a Coherent Approach to Global Capital Flows (No. 16)
by Helmut Reisen (January 1999)

Participatory Governance: The Missing Link for Poverty Reduction (No. 17)
by Hartmut Schneider (April 1999)

Multilateral Tariff Liberalisation and the Developing Countries (No. 18)
by Sébastien Dessus, Kiichiro Fukasaku and Raed Safadi (September 1999)

Health, Education and Poverty Reduction (No. 19)
by Christian Morrisson (October 2001)

The New Regionalism in Sub-Saharan Africa: More Than Meets the Eye? (No. 20)
by Andrea Goldstein (March 2002)

Beyond Johannesburg: Policies and Finance for Climate-Friendly Development (No. 21)
by Georg Caspary and David O'Connor (August 2002)

Strengthening Participation in Public Expenditure Management: Policy Recommendations for Key Stakeholders (No. 22)
by Jeremy Heimans (October 2002)

Corporate Governance in Developing, Transition and Emerging-Market Economies (No. 23)
by Charles Oman, Steven Fries and Willem Buiter (September 2003)

DEVELOPMENT CENTRE POLICY BRIEFS

In its research activities, the Development Centre aims to identify and analyse problems the implications of which will be of concern in the near future to both member and non-member countries of the OECD. The conclusions represent a contribution to the search for policies to deal with the issues involved.

The *Policy Briefs* deliver the research findings in a concise and accessible way. This series, with its wide, targeted and rapid distribution, is specifically intended for policy and decision makers in the fields concerned.

While the United Nations' Millennium Development Goals (MDGs) are broadly supported, their financing remains problematic. Taking into account recent pledges for more ODA from OECD countries, the MDGS will still require an additional $35 billion per year to 2015. The most straightforward way to avoid underfunding of the Goals is to raise ODA further. Doubts, however, about the feasibility of raising "traditional" aid enough or in time have led to a search for new ways of financing development. This Policy Brief evaluates some of the more finished options and finds that a combination of some of these options may stand a chance of accelerating funding for the MDGs.

OECD DEVELOPMENT CENTRE
Le Seine Saint-Germain
12, boulevard des Îles
92130 Issy-les-Moulineaux
France
Tel.: +33 (0) 1.45.24.82.00 Fax: +33 (0) 1.44.30.61.49
www.oecd.org/dev