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New Sources of Development Finance: Funding the Millennium Development Goals

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CONTENTS

LIST OF BOXES IV

LIST OF FIGURES AND TABLE IV

EXECUTIVE SUMMARY 1

A FRAMEWORK 4

- Innovative sources to meet a global challenge 4
- The role of new sources 9
- Global public finance 9
- Lessons from fiscal federalism 10
- Fiscal architecture 11

PROPOSED SOURCES OF FUNDING 13

- Global environmental taxes 13
- The Tobin tax 14
- A double dividend? 15
- Special Drawing Rights for development 16
- The UK International Finance Facility proposal 17
- Private donations for international development 18
- Global lottery and global premium bond 19
- Increasing remittances by emigrants 20

TOWARDS NEW FUNDING 21

- Our conclusions 21
- The way forward 25

TABLE OF CONTENTS OF THE BOOK 27

LIST OF BOXES

Box 1	Summary of Millennium Development Goals	5
Box 2	Innovative sources of development funding considered here	6

LIST OF FIGURES AND TABLE

Figure 1	What role for new sources?	8
Figure 2	Fiscal architecture: national taxation	8
Figure 3	Fiscal architecture in a global setting	12
Table 1	New sources of development financing: summary of conclusions	22

Mobilizing additional finance to meet the challenges of the Millennium Development Goals (MDGs) is an urgent priority. Developing countries are mobilizing resources themselves to meet the MDG targets by 2015, but they will fall short without additional external flows. Increased private and public money is needed in order for the world's poorest countries to invest in the basic services and infrastructure necessary for human development, and to improve livelihoods and employment for poor people.

As a result of the Five Year Review of the World Summit for Social Development, the UN General Assembly in September 2000 adopted a resolution calling for 'a rigorous analysis of the advantages, disadvantages and other implications of proposals for developing new and innovative sources of funding, both public and private, for dedication to social development and poverty eradication programmes'. The UN Department of Economic and Social Affairs in turn requested the World Institute for Development Economics Research (UNU-WIDER) in Helsinki to undertake a project on 'Innovative Sources for Development Finance'.

This Policy Brief summarizes the key findings of the study carried out by UNU-WIDER. Anthony B. Atkinson, Project Director and Warden of Nuffield College, University of Oxford, has written the Policy Brief drawing on the papers prepared for the project. He acknowledges the substantial contribution made by the project authors, but takes full responsibility for the opinions expressed. The papers are published in the volume *New Sources of Development Finance* by Oxford University Press, 2004. The contents of the volume are listed at the end of this Policy Brief.

EXECUTIVE SUMMARY

In order to achieve the Millennium Development Goals (MDGs), substantial additional external funding needs to be mobilized. Estimates differ, but a 'ballpark' figure is an annual increase of US$50 billion. This could be achieved by a doubling of official development assistance (ODA). Welcome steps have been made in that direction, but this takes time, and time is of the essence. For this reason alone, it is necessary to consider new sources.

Here we consider seven new sources:

- Global environmental taxes (carbon-use tax);
- Tax on currency flows (the 'Tobin tax');
- Creation of new Special Drawing Rights (SDRs);
- International Finance Facility (IFF);
- Increased private donations for development;
- Global lottery and global premium bond; and
- Increased remittances from emigrants.

Some of the proposals have multiple objectives. The creation of SDRs was first proposed to ease problems of international liquidity, but here we are concerned with their potential role for development purposes. The Tobin tax was initially advocated as a means of reducing financial volatility, and taxes on energy use are proposed to slow down global warming. In this sense, the taxes can be said to generate a 'double dividend'. However, our primary concern is with the revenue that they could generate for development.

The first conclusion is that the two global taxes considered could yield revenue of the magnitude required (tax on carbon use) or at least half of the requirement (the Tobin tax). Moreover, the tax rates required for this purpose are an order of magnitude smaller than the tax rates proposed by those advocating these taxes on allocational grounds. The Tobin taxes, proposed to discourage excessive currency speculation, have been 10 or 20 basis points, whereas here we envisage a rate of 2 basis points. The energy tax considered here has a rate of one-tenth or one-twentieth of those typically considered in the literature on global warming. The new taxes cannot, therefore, be expected to have a major behavioural impact, discouraging speculation and reducing CO_2 emissions. The idea of a double dividend should not be over-sold. But the much more modest tax rates

envisaged here are more likely to be politically acceptable and less likely to have disruptive economic consequences.

There are alternatives to global taxation. The International Finance Facility proposed by the UK government could, if it attracts sufficient support from other major donors, yield flows over the crucial period up to 2015 of the magnitude required. (Although it is open to question how far this differs at heart from a commitment to expand ODA.) The creation of SDRs for development purposes has been envisaged as raising some US$25-30 billion. This means that it could contribute a significant part of the total, but would need to be combined with other measures, particularly if such allocations were made less frequently than annually. One such additional source is the global lottery, which is potentially the source of significant revenues, if agreement can be reached with national lotteries. A global premium bond could provide a flow of loan funding not otherwise available. Supporting roles could be played by increased remittances from emigrants, and, on a more modest scale, increased private donations.

In each case, however, we have to consider the extent of additionality. There is a distinct risk of crowding out. Countries signing up to the International Finance Facility may implicitly offset this commitment against their regular ODA. The same may apply to countries that transfer any new SDR allocation. Agreement to the introduction of a global tax may mean that governments feel less pressure to increase their ODA, or that firms are less likely to contribute to charitable funding of development. Measures to stimulate private donations may adversely affect other forms of giving. Issuing a global premium bond may crowd out other borrowing for development purposes, although this is less likely if it is targeted at the individual investor.

With all the proposals for new sources, one has to ask—who pays? There are good reasons to expect that new global taxes will be passed on to final users. This applies to energy taxes. People tend to think immediately of the impact of a carbon tax on the fuel and transport costs of households, but energy costs enter also as inputs in other sectors. The operating costs of the financial sector, for example, will be increased, so that part may appear as higher prices for apparently unrelated products. In the case of the Tobin tax, one disadvantage is that the final incidence is not easily determined. Part of the burden may well fall on developing countries: for instance if the tax reduces the effective flow of remittances from emigrants. The other measures too may have costs. The increase in ODA that is effectively envisaged under the International Finance Facility has to be financed, and the future commitments may affect the budgetary position of donor countries. It is illusory to suppose that simply adopting an alternative funding route avoids all cost.

There are serious barriers to the enactment of the proposals for new sources of funding. In part, these obstacles can be overcome by re-design to make the proposals more compelling. In the case of the global lottery, for instance, the prize structure can be constructed in a way that helps differentiate the product from that of national lotteries and to avoid the possibly negative effects of very large prizes. Any realistic programme

is likely to consist of a package of measures. While a carbon tax alone might be sufficient to raise the required funds, this is not true of the other proposals considered here. Judicious crafting of such a package can make its introduction more likely.

Overcoming the obstacles is primarily a matter for political action. Who are the key actors? To begin with, there is an essential role for the *individual citizen*. Individuals can contribute significantly by their private support and by their influence on governments. Individuals make generous donations to charity, but relatively little goes to development purposes. Increased support for development charities serves both the direct purpose of helping poor countries and the indirect purpose of demonstrating to governments of rich countries the concerns of their voters.

National governments are, indeed, crucial. First, they have considerable independent impact. Acting alone, the government of a rich country can take steps to increase the flows of finance for development. A single country could, for example, allow income tax deductions for taxpayers sending remittances to fund community projects. A single country could launch a premium bond dedicated to development funding. A single country could decide to allocate to development purposes part of the proceeds from its national lottery. A single country could match out of public funds the amounts donated by its citizens to development charities.

Matching also applies at the international level, and governments may be more willing to provide funding where other countries are also participating. The logic of the International Finance Facility is that a number of countries join together in making the commitment. This brings us to the class of proposals where common action is required but it is sufficient for a significant subset of countries to agree. This includes the International Finance Facility and the global lottery. Finally, there are those proposals where the involvement of all donor countries is effectively necessary. This includes the creation of new SDRs and (probably) the carbon tax.

Our focus has been on the role of high-income countries, but our report is not directed only at these countries. Middle-income countries are becoming increasingly significant as potential sources of development funding. There is much that developing countries can do to facilitate the effective enactment of the proposals considered here and to take forward the necessary dialogue. Urgent action on all sides is imperative.

A FRAMEWORK

Two powerful and divergent forces grip the world at present. On the one hand the effectiveness of international organizations has been called into question. The role and functioning of the United Nations is much debated. Some nations exhibit frustration with multilateral cooperation. On the other hand, the recognition is being cemented that a global economy requires global institutions. International organizations are viewed by many as the key to the free movement of goods, services and capital. We have seen the adoption of ambitious development targets in the form of the Millennium Development Goals (MDGs). Donor countries have pledged increases in official development assistance (ODA).

The tension between these two forces pervades discussion of resources for world development. On the one hand, there is talk of 'donor fatigue'. Ratification is blocked of the amendment to the IMF Articles allowing a special allocation of Special Drawing Rights (SDRs). Proposals for global taxation meet immediate opposition from powerful elements in the US Congress. On the other hand, there is widespread appreciation of the need for new resource flows to allow the MDGs to be achieved. There are interesting new proposals for revenue sources such as a global lottery or the International Finance Facility (IFF). Individuals continue to support development charities. US billionaires are personally funding development and world health activities.

The direction taken at this juncture will depend largely on political events and political decisions. But sober economic analysis has an important role to play. This project on 'Innovative Sources of Development Finance', undertaken at the request of the United Nations, examines a range of sources of new development funding. The ideas are not necessarily new. The proposal for a Tobin tax on currency transactions, for instance, has been on the table for more than 30 years. But the project report provides a new analysis and sets the different ideas in a common analytical framework based on the application of modern public economics. Moreover, it discusses some proposals of recent origin, such as the IFF devised by the UK government, and comes up with one totally novel suggestion, a global premium bond.

Innovative sources to meet a global challenge

At the Millennium Summit in September 2000, the member-states of the United Nations affirmed their continued commitment to sustained development and the eradication of poverty. They set out a vision of a global partnership for development, directed at the achievement of specific targets. Specifically, the world's leaders signed up to the MDGs summarized in Box 1. The concrete goals include the halving by 2015 of the proportion of people living in extreme poverty, of the proportion hungry, and of the proportion lacking access to safe drinking water. The objectives include the achievement of

universal primary education and gender equality in education, the achievement by 2015 of a three-fourths decline in maternal mortality and a two-thirds decline in mortality among children under five. They include halting and reversing the spread of HIV/AIDS and providing special assistance to AIDS orphans, while improving the lives of 100 million slum dwellers.

BOX 1

SUMMARY OF MILLENNIUM DEVELOPMENT GOALS

Goal 1 Eradicate extreme poverty and hunger	• Halve, between 1990 and 2015, the proportion of people whose income is less than US$1 a day. • Halve, between 1990 and 2015, the proportion of people who suffer from hunger.
Goal 2 Achieve universal primary education	• Ensure that by 2015 all children will be able to complete a full course of primary schooling.
Goal 3 Promote gender equality and empower women	• Eliminate gender disparity in all levels of education by 2015.
Goal 4 Reduce child mortality	• Reduce by two-thirds, between 1990 and 2015, the under-5 mortality rate.
Goal 5 Improve maternal health	• Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.
Goal 6 Combat HIV/AIDS, malaria and other diseases	• Have halted by 2015 and begun to reverse the spread of HIV/AIDS. • Have halted by 2015 and begun to reverse the spread of malaria and other major diseases.
Goal 7 Ensure environmental sustainability	• Integrate principles of sustainable development into country policies and reverse the loss of environmental resources. • Halve, by 2015, the proportion of people without sustainable access to safe drinking water. • Have achieved, by 2020, a significant improvement in the lives of at least 100 million slum dwellers.
Goal 8 Develop a global partnership for development	• Develop the world trading and financial system. • Address the special needs of the least developed and landlocked and small island countries. • Deal comprehensively with the debt problems of developing countries.

Since the declaration of the MDGs, a number of attempts have been made to estimate the financing requirements. At a global level, the Report of the Panel chaired by President Ernesto Zedillo of Mexico estimated conservatively that an additional US$50 billion would be required annually to achieve the international development goals. In addition to the financing needs of individual poor nations, there is also the necessity to finance global public goods. The Zedillo Panel argued that there was a strong case for international financing of global public goods, and identified the goods that fell in that category such as peacekeeping; the prevention of contagious diseases; research into tropical medicines, vaccines, and agricultural crops; the prevention of chlorofluoro-carbon emissions, the limitation of carbon emissions, and the preservation of biodiversity. The UK government estimated that to achieve universal primary schooling needs some US$10 billion more each year; that to reduce infant and maternal mortality requires an extra US$12 billion a year, and that halving world poverty requires an investment of up to US$20 billion a year. All such figures are estimates, and involve matters of judgement, but it seems reasonable for present purposes to take a figure of an additional US$50 billion as being required annually to achieve the international development goals. This is the 'ballpark' figure used here.

BOX 2
INNOVATIVE SOURCES OF DEVELOPMENT FUNDING CONSIDERED HERE

Source	
Global environmental taxes	Tax on goods generating environmental externalities, with specific reference to a tax on use of hydrocarbon fuels according to their carbon content.
Currency transactions tax ('Tobin tax')	Tax on foreign currency transactions, collected on a national or a market basis, covering a range of transactions to be defined (spot, forward, future, swaps and other derivatives).
Creation of new Special Drawing Rights (SDRs)	Creation of SDRs for development purposes, with donor countries making their SDR allocation available to fund development
International Finance Facility (IFF)	Long-term, but conditional, funding guaranteed to the poorest countries by the donor countries. Long-term pledges of a flow of annual payments to the IFF would leverage additional money from the international capital markets.
Increased private donations for development	Charitable donations by private individuals and firms. Measures to encourage private funding of development: tax incentives, global funds, corporate giving, and the Internet.
Global lottery or global premium bond	Global lottery operated through national state-operated and state-licensed lotteries, with proceeds shared between national participants and an independent foundation established in conjunction with UN. Global premium bond, parallel to national bonds with lottery prizes.
Increased remittances from emigrants	Logistics (reducing cost of remittances), financial institutions (encouraging repatriation) and citizenship rather than residence basis for taxation.

The aim here is to investigate ways in which such additional resources can be financed. How can we find an extra US$50 billion for development funding? Our focus is on flows of resources from high-income to developing countries. In so concentrating, we are not denying the importance of resources channelled into development by developing countries themselves; nor are we seeking to under-play the potentially significant contribution of middle-income countries to development funding. A second delimitation is that our primary concern is with the funding side, not with the spending side. The two sides cannot of course be fully separated: uses of resources may affect their availability. But our ultimate objective in this report is to analyse possible sources of funds.

The proposals considered here are summarized in Box 2. They cover a wide range, including global taxes but also other sources. They differ in the degree to which they would represent a radical departure. In some cases, such as private donations or remittances by emigrants, the aim is to raise the scale of already existing flows of resources. In other cases, such as the IFF, a new mechanism would have to be put in place. Both global taxes and the global lottery/premium bond would be fundamental departures.

It will be evident that our coverage is far from exhaustive. In the case of global taxes, there are a number of other candidates: a ‘brain drain’ tax, an international air transport tax, taxation of ocean fishing, taxation of arms exports, an Internet tax, and a luxury goods tax. Each of these warrants examination. We are not arguing that the global taxes investigated here are superior to those not covered. Rather we have taken two of the most widely discussed—the Tobin tax and environmental taxes—as examples of possible global taxes. Similarly, it should be stressed that the coverage of non-fiscal measures is not exhaustive. We do not, for example, cover measures to raise capital funds in developed countries or measures to leverage the funds arising from trade. Nor do we consider the important role of foreign direct investment.

Global taxes require agreement by national governments. The proposal for a new round of Special Drawing Rights (SDRs) requires high-income countries to agree to make these available for development purposes. The UK government proposal for an International Finance Facility in effect involves a pre-commitment of future ODA in a way that allows leveraging on the capital market. In contrast, the remaining three schemes involve a degree of voluntary choice by individuals. The choices range from a voluntary transfer, as where people give their small change to UNICEF or make regular payments to Oxfam, to buying tickets in a global lottery, where the transfer of profits to development purposes is only a subsidiary motive. It includes proposals to increase the remittances sent home by workers abroad that can increase the flow of resources available for development.

FIGURE 1
WHAT ROLE FOR NEW SOURCES?

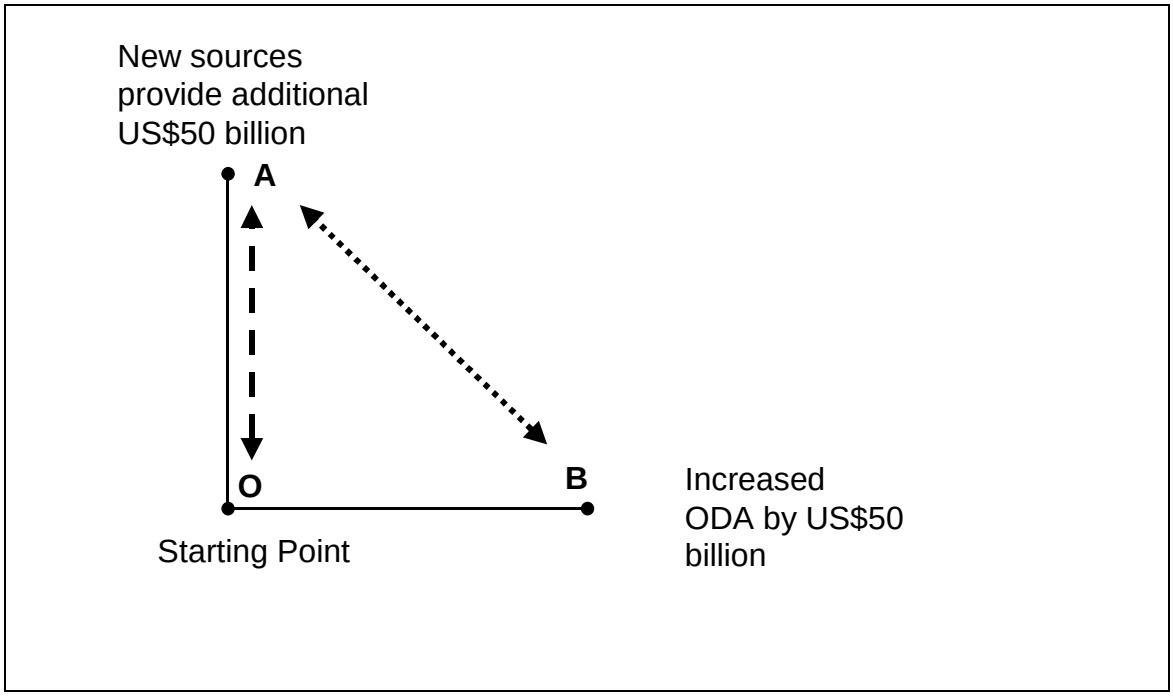
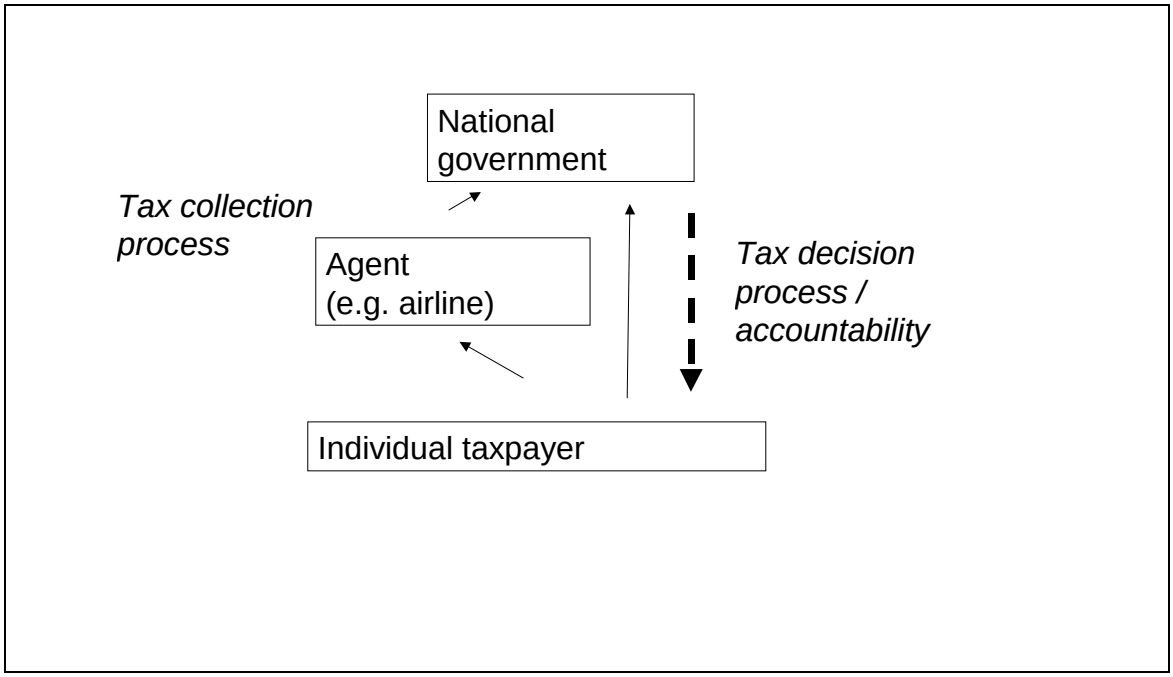


FIGURE 2
FISCAL ARCHITECTURE: NATIONAL TAXATION



The role of new sources

Each of the proposals outlined in Box 2 raises distinct issues, and these are considered in the separate sections below. But one of the contributions of the report is to bring out a number of over-arching issues. First, there is the relation with ODA. The target of an additional US$50 billion could be achieved by a doubling of ODA, and a number of donor countries have recently pledged to increase the proportion of their national income devoted to ODA. If all donors reached the UN target of 0.7 per cent of GNP, then the search for new sources would become redundant. Welcome steps have been made in the direction of increasing aid flows, but this takes time, and time is of the essence. For this reason alone, it is necessary to consider new sources, as we do here.

In debating the merits of new sources of development funding, and contrasting them with increased ODA, there is risk of confusion. We need to distinguish carefully two different comparisons. The first is between the current position, labelled 'Starting Point (O)' in Figure 1, and a situation, labelled 'New sources (A)' in Figure 1, where there are new sources raising US$50 billion to fund the MDGs. We are then comparing the economic costs of the tax with the benefits from the MDG funding (the comparison shown by the dashed line in Figure 1). To argue against the new sources, one would have to say that the cost is too great, compared with the benefits from achieving the MDGs. The second comparison is between new sources raising US$50 billion, labelled 'New sources (A)' in Figure 1 and increased ODA of the same amount, labelled point B in Figure 1. We are then holding constant the contribution to development funding and considering different methods of financing. (This is the comparison of A with B shown by the dotted line in Figure 1.) It would be a legitimate argument against the new sources to say that their cost is too great, compared with the cost of raising the domestic taxes necessary to fund the increased ODA by donors.

Global public finance

How far can we bring to bear on the funding of the MDGs the accumulated knowledge in the field of national public finance? One interesting point of departure is to consider the taxes and transfers that might be instituted by a world government. There is no possibility of such an institution being created in the relevant timeframe, but it provides a reference point to illuminate the actual policy issues. It may also serve as a moral challenge.

If such a global government were to act in the interests of world citizens as a whole, then global welfare maximization is likely to imply substantial positive taxes on almost everyone in richer countries and substantial transfers to the majority of people in low-income countries. It is important here to distinguish between low-income people and low-income countries, since there are obviously well-off people living in poor countries and these well-off people would be expected to be taxpayers. Within rich countries, optimal tax scheme does not necessarily mean higher *marginal* rates of tax. The greater

transfers could be accomplished by raising the average tax rate, for example by cutting the tax thresholds. One implication is that much of the cost of increased transfers could fall on those in the middle of the distribution in rich countries (and on those in middle-income countries), since those in the middle ranges account for a large fraction of total income. On the other hand, there has been a major shift in the distribution of income towards the top in Anglo-Saxon countries such as the United States, Canada and the United Kingdom. The share of the top 1 per cent in the US has doubled in 20 years. There is much greater scope for raising tax revenue from the globally rich.

This brings us to the political economy of new sources. The feasibility of new sources of funding for development is ultimately a political issue; and we have to consider not only how a government *should* behave but also how governments *do* behave. What is the likelihood of different proposals being adopted? How can they be designed to increase their political acceptability at a global level?

Lessons from fiscal federalism

Any foreseeable global tax will be introduced, not by a unitary world government, but as the result of concerted action by nation states. This leads one to ask what lessons can be drawn from fiscal relations in federal states. Within many countries, there are sub-national governments with independent fiscal responsibilities. Indeed, a number of these nation states emerged as a result of the voluntary association of previously independent states. The parallel is, of course, inexact. The economic, social, cultural and institutional differences among nations are more pronounced than those within the typical federation. There are, however, interesting lessons. The fiscal powers of sub-governments mean that we cannot envisage taxing people independently of their fiscal residence. The notion of distributional justice that can be pursued in a federation is that of inter-state equity, with fiscal equalization being carried out between governments.

What may induce individual governments to back new sources for development funding? We start from a position where donor countries make significant transfers via ODA and where the citizens of those countries make private donations. The co-existence of public and private transfers means that either the government is not providing aid of the quantity and/or type that its electorate prefers or that there are differences of views among voters. Citizens cannot spend less than their government chooses, but they can add private transfers to official aid. How, in such a context, can we interpret the impact of the adoption of the MDG? Have donor governments moved closer to the level of ODA that their voters preferred? In that case, we might expect the expansion of public transfers to be partially offset by a scaling back of private donations. Have governments sought to bring about a shift in public opinion in favour of increased support for development? In this case, we may even see an increased flow of private donations.

Fiscal architecture

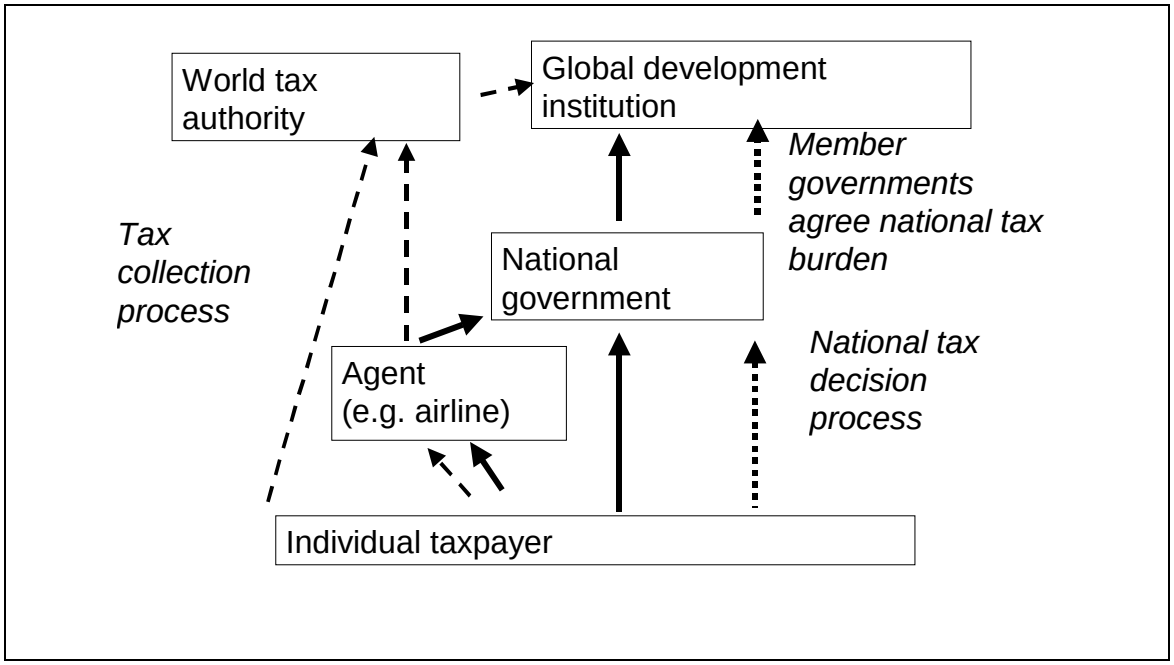
If the new sources require government action (as we have noted, not all do), then does the success and effectiveness of any particular proposal depend on complete adhesion of all donor countries? The natural instinct of many people is to assume that there is an inherent free-rider problem and that there has to be general, if not universal, agreement. In the present climate, with multilateralism under question, this presumption provides grounds for pessimism about the chances of making progress. On the other hand, suppose that we start from the position that universal agreement may be impossible and examine the implications of going ahead with a subset of countries. The US has so far prevented the creation by the IMF of Special Drawing Rights, and in this case no action seems possible. But it does not follow that other measures are also blocked. With the other six proposals, it would be possible, at least theoretically, for progress to be made even without the agreement of all major countries. Here we can learn from the internal experience of the European Union (EU). The EU has in the past faced situations where one member state chose to 'opt out' of collective decisions. In these circumstances, flexibility in the resulting institutions has allowed the majority to respect the opting-out decision but still make progress towards the majority objectives. There is 'flexible geometry'. Partial adhesion has costs, but the issue becomes one of balance, rather than an absolute block on action.

In the case of a global tax, we have to ask how it would be administered. A typical flow chart for national taxation is shown in Figure 2. National governments determine the rates of taxation and the taxbase. Individual taxpayers pay the taxes to the government, which both enforces payment and is in turn accountable to the electorate. Many taxes involve intermediary agents. The individual taxpayer is shown in Figure 2, for example, as paying the aircraft departure tax to the airline, which then accounts for the revenue to the government.

One evidently cannot apply exactly the same process to global taxation (Figure 3). We have both global institutions and national governments, and it is the latter which have to agree to the taxes being levied and which are accountable to their electorates. It could indeed be the case that the global tax is treated as simply a glorified domestic tax, with the revenue being forwarded by national governments to a global spending body (the solid lines in Figure 3). But there are more possibilities, as shown by the dashed and dotted lines. If there were an international air transport tax determined at the global level, then the airline could transfer the money, not to the national government, but to a global tax authority, in which case the new source of finance would bring a new actor into play. The dashed lines in Figure 3 show this. Whether or not such a world tax authority is envisaged is one of the questions that have to be considered. Moving in the opposite direction from the introduction of a world tax authority is the case shown by dotted lines in Figure 3, where national governments retain not only control over the administration of the tax process but also discretion over the tax rates. In this case, participating governments would agree on their national tax liability but retain freedom to decide how the revenue is to be raised. This would in effect be applying the principle

of subsidiarity adopted by the European Union. To give a concrete illustration, suppose that the participating governments agree that each country should pay a tax related to national carbon emissions. This determines the amount that each participating country has to pay, but the national government would remain free to raise the revenue in whatever manner it thought fit. The national government might consider, for example, that a tax on air journeys was unfair on those living in remote rural areas, and choose for domestic reasons a different taxbase. We would then have a two-tier structure, with the national tax obligation requirement being agreed multilaterally, but the tax implementation being chosen locally. Countries with more emissions would pay more total tax, but this would not necessarily mean higher fuel taxes. Income tax or a broad-based value-added tax could be raised instead. One reason why, under the subsidiarity architecture, a national government may choose a different taxbase is that it faces political opposition to a particular form of taxation. The fuel tax protests of 2000 in Europe provide a good illustration.

FIGURE 3
FISCAL ARCHITECTURE IN A GLOBAL SETTING



PROPOSED SOURCES OF FUNDING

Global environmental taxes

The taxation of environmental externalities is an obvious potential source of revenue, not least because—as discussed later—such taxes are often thought to give rise to a 'double dividend', both generating revenue and helping reduce environmental damage.

Much of the economics literature relates to taxes as instruments of national policy. There are, however, useful lessons for global environmental taxes. Calculation of the optimal tax should include an element that reflects the marginal environmental damage (external diseconomy) associated with an activity, such as the consumption of fuel. The tax should be targeted as far as possible to directly influence the activities and to be neutral with respect to other decisions. The main alternative to taxes is the use of quantitative regulations and quotas. The auction of tradable emission permits may, under certain conditions, generate the same revenue and be as effective in reducing pollution.

Moving to a global level, one has to ask why, if a carbon use tax would reduce external diseconomies, is this not already reflected in domestic taxes? One response is that the dividend is in part global rather than national. National governments may not impose sufficient corrective taxes because the benefits accrue disproportionately outside their boundaries. A switch from general taxation to carbon use taxation may be a positive sum game globally but a negative sum game nationally. There may, therefore, be a case for a supplementary global tax. Does this mean that the global tax should be levied at the same rate on all countries? To the extent that emissions impose environmental damage wherever they occur, the corrective tax should be the same. However, this needs to be moderated to take account of the unequal distribution of world income—the very reason for our current interest in the tax. Considerations of global justice point to poor countries bearing less of the cost burden, and may justify the tax being levied only on high-income or middle-income countries.

A global tax on carbon use at a rate equivalent to a tax on gasoline of 4.8 cents per US gallon (approximately €0.01 per litre) levied only on high-income countries could indeed raise some US$50 billion a year. Such a rate of global tax would represent a very small addition to those applied by many national governments, and is an order of magnitude smaller than the increases considered in proposals to halt global warming.

How is this potential argument for additional environmental taxation affected by the fiscal architecture? We are presupposing that the tax is indeed levied on individuals and firms in the form of a carbon levy (or another environmental taxbase). Suppose, however, that we have subsidiarity, where the burden on national governments is determined by their carbon emissions, but the national governments are free to decide

how to raise the revenue. As noted above, they may for political or other reasons choose another taxbase. It is still, however, the case that the government faces a financial incentive to reduce its emissions by other policies, such as auctioning emission permits or regulation.

The Tobin tax

The second major proposal for global taxation considered here is that for a currency transactions tax (CTT): the celebrated Tobin tax. James Tobin first put forward the idea for a currency transactions tax as a means of combating financial volatility. The potential of the currency transactions tax as a generator of revenue was suggested as a by-product. Here we focus on the by-product: the Tobin tax as a source of revenue for development. One important difference is that we are talking about much lower rates of tax. Some proponents have considered taxes as high as 0.25 per cent on a transaction, referred to as 25 basis points, to discourage excess currency speculation. In contrast, a rate of 1 or 2 basis points could be adopted for revenue-raising purposes. Such a global tax could, it has been estimated, raise annual revenue around US$15 billion (tax of 1 basis point) or US$28 billion (2 basis points).

Much of the debate has revolved around the technical feasibility of the CTT. The financial markets are continuously developing, with new financial instruments being devised. The market structure is evolving with technological progress and in response to competitive pressures and regulation. Even at rates of 1 or 2 basis points, the tax may shift financial activity and encourage banking consolidation. These considerations lead one to suggest that, if implemented, the CTT should be introduced cautiously with a very low tax rate. The very high expectations raised in the past with respect to the revenue contribution of a CTT are not as yet warranted. Moreover, the final distributional effects, and the impact on real transactions, are hard to predict. We can treat the CTT as an excise tax on all purchases according to their foreign exchange content. Some transactions are particularly affected, notably the remittances from emigrants discussed later.

Introduction of a CTT requires wide agreement. Whether it requires universal agreement, and in particular the agreement of the United States, is actively debated. Proposals have been made that the Tobin tax could be implemented by a group of countries such as the EU plus Switzerland. Such an approach based on flexible geometry may offer a way forward politically but it introduces a further element of uncertainty regarding the impact of the tax. The effect on the euro-zone, and on Europe’s financial centres of Frankfurt and London, is hard to predict. The financial community tends only to see a loss of competitiveness, but if the tax performs its original function of increasing stability, then the euro may become more attractive.

A double dividend?

The standard analysis of tax incidence is based on examining a world of perfectly competitive, perfectly functioning markets. In such a 'first-best' context, government intervention—whatever its distributional advantages—has an efficiency cost. Real world economies, however, are not characterized by perfect markets, and one of the major contributions of modern public economics has been to explore the implications of market failure. Both of the global taxes discussed above are in fact directed at *improving* the allocation of resources. A tax on the consumption of goods that harm the environment has a positive allocational effect, switching spending away from polluting goods towards those causing less or no environmental damage. The currency transactions tax was proposed to dampen destabilizing currency speculation.

Do we then have a 'double dividend'? Global taxes can generate a double dividend in two ways. If the new tax is seen as an alternative to ODA, then it can both make its own efficiency contribution *and* allow a reduction in the taxes presently used to finance ODA. Taxing air transport, for example, not only reduces the environmental damage of tourism but also allows the income tax to be reduced. Taxing carbon may allow payroll taxes to be reduced, leading to a fall in unemployment. There is an 'employment dividend' as well as an 'environmental dividend'. The second possibility is that the new source is a net addition to development resources. In this case, the double dividend consists of the reduced environmental damage *and* the benefit from achieving the MDGs.

The double dividend idea appeals to the imagination. Two notes of caution should, however, be entered. First, we have seen that the tax required for allocational reasons is likely to be considerably higher than that needed to add significantly to development funding. The carbon use tax can make a major contribution to raising revenue at a much lower rate than that suggested as needed to halt global warming. (Taking this argument to the limit, we may note that a carbon tax that reduced emissions to zero would be an environmental success but a revenue failure.) The second caution concerns political economy. Linking together two causes—saving the planet and funding the MDGs—may appear to be building a stronger coalition of support. This argument is related to the classic model of 'log-rolling' where two politicians agree to support each other's projects. However, the log-rolling model assumes a particular distribution of benefits and losses from the projects, the former being concentrated and the latter diffused. But the reverse may be true: the costs may be largely borne by a small interest group (such as energy producers), and the benefits widely dispersed. To be more concrete, opening up two fronts also invites attack from both directions, particularly if the two objectives require taxes at very different levels.

Special Drawing Rights for development

There has long been a campaign for the issue of development-focused Special Drawing Rights (SDRs) by the International Monetary Fund. The original purpose of SDRs was to increase international liquidity, but attention has focused more recently on the potential role of SDR creation in providing funds for development finance. Proponents, such as George Soros, have argued that new SDRs should be created and that the developed countries should re-allocate their share of the SDR issue to the funding of global public goods and to supplementing aid flows to individual developing countries. These calls have to be seen in a context where developing countries have been accumulating substantial reserves in order to reduce their vulnerability to crises. To the extent that these reserves are held in US government bonds, there is an obvious link with the funding of US deficits. The Zedillo Panel argued that 'substantial SDR allocations might help shrink the US deficit while allowing other countries to continue to build up the reserves they feel they need'.

An allocation of US$25-30 billion SDRs would represent a sizeable sum in relation to the MDG funding needs. Its contribution would, however, depend on whether it is repeated at regular intervals. Moreover, the contribution to development from SDR creation has to be identified more precisely. The problem arises from the obligation to make interest payments on the total allocation. If the obligation is transferred to the recipient country or to a global public goods agency, then the financing amounts to a low-interest loan. On the other hand, if the donor countries bear the interest cost, then it would be equivalent to ODA. In the latter case, the advantage of the SDR route may be questioned.

Issues also arise concerning governance. There needs to be greater clarity as to the criteria by which the priorities for global public goods should be established, not least because there are significant differences in the lists usually given.

The UK International Finance Facility proposal

Innovation in the sphere of public finances has not always kept up with innovation in private financial markets. Making use of the latter to enhance the effectiveness of ODA is the essence of the recent proposal by the UK government for an International Finance Facility (IFF). The IFF involves the creation of a new Facility, designed to achieve the additional finance and to ensure effective use of the funds for development purposes.

The key elements in the proposal are:

- Significant increase in annual ODA for a limited duration, timed to achieve the MDGs by 2015.
- A pre-commitment, so that the promises can be securitized.
- Allowing a substantial immediate increase in development spending.

The IFF would effectively 'front load' long-term aid flows.

The IFF has the advantage that it does not require universal agreement; it is an example of the power of flexible geometry. The involvement of all rich countries is not required. Providing only that sufficient like-minded countries participate, the IFF could generate an increase in funds of the US$50 billion magnitude required. This assumes that the sums pledged would be *additional* to those already being provided by donor countries. To the extent that the IFF displaces existing aid, there would be the advantage of ensuring a predictable and stable flow of aid, but the net gain would be much less impressive in magnitude.

Providing that the donor commitments are achieved, the disbursement of funds from the IFF would increase from US$10 billion in the first year to US$50 billion in five years, remaining constant at that level for five years before declining to zero over the final five years. The central aim of the IFF is indeed to change the time path of aid flows. This may bring with it certain problems. Advancing disbursements raises issues of absorptive capacity and the impact on the macro economies of recipient countries. The new Facility builds in safeguards but a great deal may depend on domestic economic policies. The other side of the coin is the subsequent scaling back of flows to zero. Extra donor contributions (above the 2002 base) are projected to continue from 2020 to 2032, with the entire sum allocated to debt servicing and replenishment of the IFF reserves.

Private donations for international development

Charitable giving in rich countries is very substantial: in the US more than 1.5 per cent of national income. People give, in addition, large amounts of free time. Development, however, commands only a small share. A great deal of philanthropic activity in rich countries is aimed at domestic concerns, although there are differences across countries, with Germany being a country where a larger fraction goes to fund overseas development. The amount raised by UNICEF national committees ranges from 9 US cents per capita in New Zealand to nearly US$4 per capita in Luxembourg. Overall giving in the US and the UK appears to be a larger proportion of total income for both poor and rich households. At the upper end, there are a number of charitable foundations with development interests, such as the Ford, Rockefeller, and, more recently, the UN Foundation, set up by Ted Turner, and the Gates Foundation.

Present flows of private donations for development purposes are small when viewed in relation to the needs of funding the MDGs, but they are significant for psychological reasons. The example of individual citizens may encourage governments to be more generous. It is, therefore, important to examine the potential for raising private donations. We have, however, to recognize that development funding lacks many of the features that attract charitable giving. It is concerned with long-term development rather than urgent relief; it involves communities that are geographically distant, where there is little direct contact; there is little scope for the volunteering of time. Possible policy directions include; more generous tax incentives for donors, measures to encourage payroll giving, the establishment of global funds to focus the attention of large private donors, new forms of corporate giving, Internet giving, and donor education programmes.

Global lottery and global premium bond

The use of lotteries by national and local governments to raise funds for public sector projects is now commonplace. World sales of gaming products are large: some US$120 billion per year. The idea of a global lottery to raise money for development has received attention particularly on account of the recent proposal by the Crisis Management Initiative, under the impetus of President Martti Ahtisaari of Finland. The proposal is for national lotteries to run national versions of the global lottery game, with part of the net proceeds being transferred into a global lottery fund to be run by the United Nations or another agency. The net yield is hard to estimate, but could be around US$6 billion a year.

The design of a global lottery faces the same issues as a national lottery, with regard to its form (an instant product such as a scratch card or a regular draw such as Lotto) and the prize structure. But there are additional matters to be resolved. In order to secure acceptance by national lottery operators, and to avoid opposition from their beneficiaries, it may be necessary to differentiate the prize structure: for example, by reducing the size of the top prizes. This may lead to the global lottery offering different rewards across countries, with the attendant problems of cross-border betting. The market place has become even more crowded with the rapid growth of online gambling.

A global lottery will raise money from those who switch their loyalty from existing lotteries and from new players, motivated by the use of funds for development purposes. While empirical evidence suggests that low-income groups in developed countries spend a larger proportion of their income on lottery products, the new players may be drawn from higher up the income scale. It remains possible, however, that compared with ODA financed though income tax, the global lottery is regressive in its effect on the distribution of income in developed countries. But, compared with nothing (i.e. lower development funding), it is likely to be progressive in terms of the world income distribution.

A related but different idea is a global premium bond. This is a loan instrument where the interest takes the form of a lottery prize, the capital being repayable on request. Premium bondholders never lose their investment but the return depends on their luck. In fact, the premium bond is financially equivalent as a transaction to placing money in a regular savings bank and drawing out the interest each month to buy lottery tickets. But experience in the UK suggests that this appeals to a different market, with the middle- and upper-income groups participating, whereas they do not play the national lottery. This may in part be explained by differences in the prize structure and in the tax treatment, but it may also reflect a difference in perception. A global premium bond may also attract those who wish to lend for development purposes (the same function could of course be performed by a conventional savings bond for development). The scale of loan finance permitted by issuing global premium bonds is very difficult to estimate, but this novel idea seems well worth pursuing further.

Increasing remittances by emigrants

Remittances from migrants are a market-based external source of development finance, which have, according to published estimates, increased steadily from around US$15 billion in 1980 to US$80 billion in 2002. These are large flows, second only to foreign direct investment as a component of external resource flows to developing countries. To an important extent, remittances finance consumption, and may be seen as an instrument of global redistribution: an international mechanism of social protection. But they are also a source of finance for capital formation, providing community infrastructure (such as schools) and funds for the financing of new enterprises. Remittances are channelled through a variety of financial entities, ranging from the formal to the highly informal, and the latter may not be fully reflected in the official statistics quoted above.

There are several different motivations for remittances. Transfers may be made because the migrant wishes to help family members who have stayed at home; transfers may be a form of saving, providing for a later return home; there may be repayment of loans that allowed the migrant to study and travel abroad; and emigration may be part of a co-insurance strategy, with remittances being made when the migrant is successful and the family at home guaranteeing support in the case of failure. The balance of these different motives will affect the likely time path of remittances over the life-cycle of the migration process, and the extent to which remittances augment savings as opposed to consumption.

The most obvious means to increase the scale of remittances is via policies to reduce the cost of sending money. Many migrants face difficulties accessing bank services; the bank services are not well tailored to their needs. Competition could increase bank receptiveness to the requirements of migrants, and measures can be taken to facilitate entry into the money transfer business, such as reducing license costs. It is, however, hard to predict the quantitative impact of such measures; and it must be recognized that a number of the measures run counter to the recent trend to tighten regulation, so as to counteract money-laundering and the finance of terrorism.

TOWARDS NEW FUNDING

Our conclusions

Our objective in this report is to determine the contribution of new funding sources to financing the MDGs. Many of the proposals have multiple objectives. The creation of Special Drawing Rights (SDRs) was first proposed to ease problems of international liquidity, but here we are concerned with their potential role for development purposes. The Tobin tax was first proposed as a means of coping with financial volatility; here we are primarily concerned with its potential as a generator of revenue to be used to finance development.

Our main conclusions concerning the new sources of funding are summarized in Table 1. The *first conclusion* is that the two global taxes considered could yield revenue of the magnitude required (tax on carbon use) or at least half of the requirement (Tobin tax at a rate of 2 basis points). Moreover, the tax rates required for this purpose are an order of magnitude smaller than the tax rates proposed by those advocating these taxes on allocational grounds. The Tobin taxes proposed to reduce excessive currency speculation have been of the order of 10 or 20 basis points—ten times that considered here. The energy tax considered here has a rate of a tenth or a twentieth of those typically considered in the literature on global warming. The taxes are not, therefore, guaranteed to have the major behavioural impact, discouraging pollution and speculation, which has been sought. This conclusion has both negative and positive aspects. On the minus side, it means that the double dividend—of increased revenue plus improved functioning of the economy—may fall short on the latter dimension. But it is revenue that is our concern here. The second aspect is positive, which is that the much more modest tax rates envisaged here are more acceptable and less likely to have disruptive economic consequences.

The *second conclusion* is that there are alternatives to global taxation. The International Finance Facility (IFF) proposed by the UK government could, if it attracts sufficient support from other major donors, yield flows over the crucial period up to 2015 of the magnitude required. (At the same time, it is open to question how far this differs at heart from a commitment to expand ODA.) The creation of SDRs for development purposes has been envisaged as raising some US$25-30 billion. This means that it could contribute a significant part of the total, but would need to be combined with other measures, particularly if such allocations were made less frequently than annually. One such additional source is the global lottery, which is potentially the source of significant revenues, if agreement can be reached with national lotteries. A global premium bond could provide a flow of loan funding not otherwise available. Supporting roles could be played by increased remittances from emigrants, and, on a more modest scale, increased private donations.

TABLE 1
NEW SOURCES OF DEVELOPMENT FINANCING: SUMMARY OF CONCLUSIONS

Source	Brief description	Potential to fund development?	Double dividend & cost?	Disadvantages	Main obstacles
Global environmental taxes	Tax on goods generating environmental externalities, with specific reference to a tax on use of hydrocarbon fuels according to their carbon content.	Tax on high-income countries alone could raise revenue of US$50 billion. Tax rates required are order of magnitude smaller than those considered in proposals to halt global warming.	Environmental gain as well as revenue. Tax borne according to final energy use.	Distributional effect on households within high-income countries needs to be offset. Administrative cost of operating global tax.	Requires general agreement of high-income countries. Account has to be taken of existing national taxes.
Currency transactions tax (Tobin tax)	Tax on foreign currency transactions, covering a range of transactions (spot, forward, future, swaps and other derivatives).	Tax could generate US$15-28 billion for global public use. Tax rate considerably smaller than those considered in proposals to reduce exchange rate volatility.	Reduces foreign exchange speculation. Tax passed on to final users.	Final distributional effect and impact on real transactions hard to predict. Administrative cost of operating global tax.	Requires general agreement.
Creation of new Special Drawing Rights (SDRs)	Creation of SDRs for development purposes, with donor countries making their SDR allocation available to fund development.	Allocation of US$25-30 billion could make significant contribution, but depends on frequency.	Could have positive effect on the global macroeconomy.	Impact on world economy not clear.	Has to be ratified by 100 members with 85% of voting power.
International Finance Facility (IFF)	Long-term, but conditional, funding guaranteed to the poorest countries by the donor countries. Long-term pledges of a flow of annual payments to the IFF would leverage additional money from the international capital markets.	If introduced as planned could achieve flow of US$50 billion for 2010-15, building up from 2006 and falling to zero by 2020. Provides predictable and stable flows with agreed disbursement mechanism.	Could have positive effect on the global macroeconomy.	Cost of negotiation and administration of new organization. Difficult to ensure additionality. Administrative cost of establishing new institution. Problem of what happens after 2020.	Requires sufficient donor countries to sign up, and to continue to make commitments. Involvement of all rich countries not required. Requires agreement on conditions to be attached to outflows.

Table 1 continues

Table 1 (con't)
New sources of development financing: Summary of conclusions

Source	Brief description	Potential to fund development?	Double dividend & cost?	Disadvantages	Main obstacles
Increased private donations for development	Charitable donations by private individuals and firms. Measures to encourage private funding of development: tax incentives, Global funds, corporate giving, and the Internet.	Present flows marginal but important for psychological reasons. No sign of crowding out. Total charitable giving sizeable and potential for development to attract larger share.	Giving benefits both donors and recipients.	To the extent that total giving increased, through shifting consumer preferences, no direct cost; to extent that achieved at expense of other recipients, there is opportunity cost.	Primarily *individual* action, but *national governments* can stimulate by income tax deduction. Link with use of funds important.
Increased remittances from emigrants	Logistics (reducing cost of remittances), financial institutions (encouraging repatriation) and legal (regularising the status of migrants).	Remittances are a large, growing and relatively stable flow of funds. They can contribute to infrastructure projects. A reduction in transfer costs could significantly increase remittances.	Transfer benefits both donors and recipients.	Link to development uncertain.	May run into money laundering and counter-terrorism legislation.
Global lottery	Global lottery operated through national state-operated and state-licensed lotteries, with proceeds shared between national participants and an independent foundation established in conjunction with UN.	Hard to estimate but could reach US$6 billion a year.	—	Ethical issues. Distributional burden borne by lower income groups, including low-income countries.	Competition with national lotteries.
Global premium bond	Global premium bond, parallel to national bonds with lottery prizes in place of interest; capital value preserved.	Provides loan finance, volume hard to estimate.	—	Crowding out of other government debt. Administrative cost.	Competition with other borrowing.

In each case, however, we have to consider the extent of additionality. The *third conclusion* is that there is a distinct risk of crowding out. Countries signing up to the IFF may implicitly offset this commitment against their regular ODA. The same may apply to countries that transfer any new SDR allocation. Agreement to the introduction of a global tax may mean that governments feel less pressure to increase their ODA, or that firms are less likely to contribute to charitable funding of development. Measures to stimulate private donations may adversely affect other forms of giving. Issuing a global premium bond may crowd out other borrowing for development purposes, although this is less likely if it is targeted at the individual investor.

How far do the proposals have other advantages apart from the revenue raised? As already noted, the proposed tax rates are much lower than those advocated for other purposes, but both energy use and currency transactions taxes have potential to act as corrective taxes. There is an allocational benefit rather than a deadweight loss. In the same way, tax incentives to private donations and remittances by emigrants may act to encourage an activity that is undersupplied, a gift benefiting the recipient as well as the sender. The *fourth conclusion* is that there are possible double dividends, but they are a by-product not the primary rationale of the proposals. The double dividend argument should not be over-sold.

The existence of a double dividend does not mean that there is no cost. With an ordinary tax, the burden of a tax generating US$1 billion can be said to consist of two parts: the US$1 billion that taxpayers hand over, and the additional deadweight cost (excess burden) due to the distortion of economic decisions. Where there is a double dividend, the second element becomes a benefit: decisions are improved by the corrective tax. But the first element remains: revenue is still raised. There are good reasons to expect that the taxes will be passed on to final users. This applies to energy taxes, where we have to follow through the full input-output implications. People tend to think immediately of the impact of a carbon tax on the fuel and transport costs of households, but energy costs enter also as inputs in other sectors. The operating costs of the financial sector, for example, will be increased, so that part may appear as higher prices for apparently unrelated products. In the case of the Tobin tax, one disadvantage of the tax is that the final incidence is not easily determined. Part of the burden may well fall on developing countries: for instance if the tax reduces the effective flow of remittances from emigrants. The other measures too may have costs. The increase in ODA that is effectively envisaged under the IFF has to be financed, and the future commitments may affect the budgetary position of donor countries. Tax relief for remittances by emigrants has a cost to the host countries. The *fifth conclusion* is that it is illusory to suppose that simply adopting an alternative funding route avoids all costs.

In considering both double dividends and cost burdens, one important consideration is the impact on the macroeconomy. It is the specific purpose of some measures, such as the creation of SDRs, to stimulate the world economy. Given significant unemployment, and under-use of productive capacity, it may be possible to generate new resources at little or no real cost. Donor countries may, via the IFF, be able to engage in borrowing in

a way that acts as a macroeconomic stimulus. In the opposite direction, a significant increase in funding for development may run into absorption problems. Here, we have not attempted to assess these macroeconomic arguments, but they are potentially important. A *sixth conclusion* is that the policy towards funding the MDGs has to be seen in conjunction with stimulating the global economy and with an eye to the absorption issue.

The way forward

The final column in Table 1 lists the main obstacles to the proposals. This naturally leads one to ask how they can be overcome. This is in part a question of design to make the case for the new sources more compelling. In the case of the global lottery, for instance, the prize structure can be constructed in a way that helps differentiate the product from that of national lotteries and to avoid the possibly negative effects of astronomical prizes. We have described ways of increasing the efficiency of the market for remittances. Any realistic programme is likely to consist of a *package of measures*. While a carbon tax alone might be sufficient to raise the required funds, this is not true of the other proposals considered here. Such a package could be constructed by the UN and other international agencies, which would monitor its introduction.

Overcoming the obstacles is, however, primarily a matter for political action. Who are the key actors? To begin with, there is an essential role for the *individual citizen*. Individuals can contribute significantly both by their private support and by their influence on governments. Individuals make generous donations to charity, but relatively little goes to development purposes. We have seen how there is considerable scope for the globalization of charitable giving. Increased support for development charities serves both the direct purpose of helping poor countries and the indirect purpose of demonstrating to governments of rich countries the concerns of their voters.

National governments are indeed crucial. First, they have considerable independent impact. Acting alone, the government of a rich country can take steps to increase the flows of finance for development. A single country could, for example, allow income tax deductions for taxpayers sending remittances to fund community projects in the home country. A single country could launch a premium bond dedicated to development funding. A single country could decide to allocate to development purposes part of the proceeds from its national lottery. A single country could match out of public funds the amounts donated by its citizens to development charities.

Matching also applies at the international level, and governments may be more willing to provide funding where other countries are also participating. The logic of the International Finance Facility is that a number of countries join together in making the commitment. This brings us to the class of proposals where common action is required but it is sufficient for a significant subset of countries to agree. This includes the IFF and the global lottery. Finally, there are those proposals where the involvement of all donor

countries is effectively necessary. This includes the creation of new SDRs and (probably) the carbon tax.

Our focus has been on the role of high-income countries, but our report is not only directed at these countries. Middle-income countries are becoming increasingly significant as potential sources of development funding. There is much that developing countries can do to facilitate the effective enactment of the proposals considered here and to take forward the necessary dialogue.

TABLE OF CONTENTS OF THE BOOK

New Sources of Development Finance

Edited by A. B. Atkinson

Oxford University Press, 2004

Chapter 1 Innovative Sources to Meet a Global Challenge
A. B. Atkinson

Chapter 2 Over-Arching Issues
A. B. Atkinson

Chapter 3 Environmental Taxation and Revenue for Development
A. Sandmo

Chapter 4 Revenue Potential of the Tobin Tax for Development Finance: A Critical Appraisal
M. Nissanke

Chapter 5 A Development-Focused Allocation of the Special Drawing Rights
E. Aryeetey

Chapter 6 The International Finance Facility Proposal
G. Mavrotas

Chapter 7 Private Donations for International Development
J. Micklewright and A. Wright

Chapter 8 A Global Lottery and a Global Premium Bond
T. Addison and A. Chowdhury

Chapter 9 Remittances by Emigrants: Issues and Evidence
A. Solimano

Chapter 10 Global Public Economics
J. A. Mirrlees

Chapter 11 National Taxation, Fiscal Federalism and Global Taxation
R. Boadway

Chapter 12 The Way Forward
A. B. Atkinson

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