Chapters 1, 2 and 12 of

New Sources for Development Finance
edited by A B Atkinson, Nuffield College, OXFORD

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Chapter 1  Innovative Sources for Development Finance\(^1\)

A B Atkinson, Nuffield College, Oxford

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Introduction

Two powerful and divergent forces grip the world at present. On the one hand
the effectiveness of international organisations has been called into question. The role
and functioning of the United Nations is debated. Some nations exhibit frustration
with multilateral co-operation. There is increasing resort to unilateral action. Solutions
are sought in regional groupings rather than in worldwide co-ordination. On the other
hand, the recognition is being cemented that a global economy requires global
institutions. International organisations 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. Regional
blocs such as the European Union are looking more outward. Donor countries have
pledged increases in Official Development Assistance.

\(^1\) The format of this chapter emerged from discussion at the project team meeting in Helsinki in May
2003. I am most grateful to Adrian Wood and Ilene Grabel for valuable suggestions that have
influenced the structure of the chapter, to George Mavrotas for advice on the aid figures, and to Tony
Addison for incisive comments on the drafts of this chapter and Chapters 2 and 12. None of the above
should however be held responsible for the views expressed.
The tension between these two forces pervades discussion of resources for world development. On the one hand, there is talk of “donor fatigue”, and official Development Assistance (ODA) has stood still for many years. The amendment to the IMF’s Articles approved by the Board of Governors in 1997 allowing a special allocation of Special Drawing Rights (SDRs) remains unratified in 2003. Proposals for any form of 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 Millennium Development Goals to be achieved. There are interesting proposals for new sources of revenue such as a global lottery or the International Finance Facility. 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 chapter introduces the work of a project on “Innovative Sources of Development Finance” undertaken at the request of the United Nations. As a result of the Five Year Review of the World Summit for Social Development, the UN General Assembly 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”. As the UN Secretary-General observed, there has been a great deal of innovation in private financial markets, but less in the sphere of public finances. The UN Department of Economic and Social Affairs in turn requested the World Institute for Development Economics (WIDER) in Helsinki to commission the study of Innovative Sources. This book is the first product.
1.1 Innovative Sources to Meet a Global Challenge

It is widely recognised that we need to develop new and innovative sources of funding, both public and private, for dedication to social development and global poverty eradication. This recognition starts from the Millennium Development Goals (MDGs). At the Millennium Summit in September 2000, the 189 states of the United Nations affirmed their continued commitment to sustained development and the eradication of poverty. These goals are summarised in Box 1. They envisage a global partnership for development, directed at the achievement of specific targets. The concrete goals include the halving by 2015 of the proportion of people living in extreme poverty, the proportion hungry, and the proportion lacking access to safe drinking water. The goals 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. Thus, in addition to the financing needs of individual poor nations, there is also the need to finance global public goods in achieving those goals. In this book, we do not consider the problem of providing global public goods, since our concern is with the financing side, but the subject is covered in depth by Kaul, Grunberg, and Stern (1999) and Kaul et al (2003).

Since the declaration of the MDGs, a number of attempts have been made to estimate the financing requirements. In the case of Africa, achieving the MDGs implies an increase in the per capita consumption of over half of its population in order to reach a minimum of $1 per day. To achieve that level of consumption, it is reckoned that

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2 This section draws on an earlier draft by Ernest Aryeetey, and on material provided by George Mavrotas.
African and other low-income countries must, on the average, grow at 8% per annum for the period. This high growth rate requires a much faster rate of investment than countries usually experience, where investment should be viewed broadly to allow for human capital formation and where account needs to be taken of the quality as well as the quantity of investment. UNCTAD (2000) judged it unlikely that the poor nations could find the resources to finance such investment growth from the traditional sources, i.e., domestic savings (both private and public) and foreign savings (existing levels of Official Development Assistance (ODA) and Private Capital Flows). This made it essential to identify sources of additional financing, while boosting the capacity to generate further resources from the traditional sources and to improve the effectiveness with which financing is employed.

At a global level, taking all the above considerations into account, the report of the Zedillo Panel (United Nations, 2001) estimated conservatively that an additional US$50 billion would be required annually to achieve the international development goals. The Panel argued that there was a strong case for international financing of global public goods, and identified the goods that fell in that category as peacekeeping, the prevention of contagious diseases; research into tropical medicines, vaccines, and agricultural crops, the prevention of chlorofluorocarbon emissions, the limitation of carbon emissions, and the preservation of biodiversity. The cost of peacekeeping was estimated at about $1 billion, while the cost of dealing with the HIV/AIDS epidemic and the fight against TB and malaria was given as $7-10 billion a year. The UK Government (HM Treasury and Department for International Development 2003, para 1.11) estimated that to achieve primary schooling for all needs some $10 billion more each year, that to reduce infant and maternal mortality
requires an extra $12 billion a year, and that halving world poverty requires an investment of up to $20 billion a year.

All such figures are estimates, and involve matters of judgment, but there is broad agreement about the magnitude. It seems reasonable to take a figure of additional US$50 billion as being required annually to achieve the international development goals. This is the “ballpark” figure used in what follows. The aim of the analysis that follows is to investigate ways in which such additional resources can be financed. 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. But our spotlight is on the role of rich countries.

Official Development Assistance

An important vehicle for financing development is Official Development Assistance (ODA). The need for an additional $50 billion per year must be seen against the current level of ODA, which was $57 billion in 2002. Of this total, a half was provided by the EU and its Members, and a quarter was provided by the United States. As is well known, ODA stagnated in the 1990s. The 1990-91 average was $55 billion. As a proportion of the gross national income of donor countries, ODA has fallen from 0.33% in the mid-1980s to 0.23% in 2002 (figures published by the OECD Development Assistance Committee (DAC) for net official development assistance from DAC countries to developing countries and multilateral organisations). Few countries reach the UN target of 0.7% of GNP for official assistance: the Nordic countries, together with Luxembourg and Netherlands..
The Zedillo Report for the UN concluded, “the inescapable bottom line is that much more funding is needed for official development assistance” (United Nations 2001, page 10). “Meeting the International Development Goals alone would require almost double the current ODA total of more than $50 billion per year” (United Nations 2001, page 16). At the Monterrey Conference on Financing for Development in March 2002, donor countries recognised that they needed to set more ambitious targets for ODA. The EU prior to Monterrey had committed itself to raising its ODA to 0.39% of Gross National Income, from the then figure of 0.33%. Three countries have given firm dates to reach the UN 0.7% target: Belgium, France and Ireland. The US Government announced that it was increasing its core development assistance by $5 billion annually, these increased funds being placed in a new Millennium Challenge Account (MCA). The new Account is distributed to developing countries showing a strong commitment to “good governance, health and education, and sound economic policies”. (The MCA is discussed again in Chapter 8.)

Viewed in relation to previous aid achievements and aspirations, the $50 billion increase seems quite feasible. As noted by the World Bank, “a return by donors to their early-1990s average aid ratio of 0.33 percent of GNP would provide an extra $20 billion” (2001, page 89). If the average could be raised to 0.5%, then the $50 billion additional ODA would have been realised. The search for alternative sources would become redundant. The ballpark target is less ambitious than asking all G7 countries to reach the UN target of 0.7% of GNP for official assistance. Nor is an increase of ODA by existing donors the only route by which ODA could be increased. The world distribution of income is changing. At present the DAC countries of the OECD account for over 95% of worldwide ODA disbursements, but the future funding of development should take account of the changing world distribution of
income. The growth of middle-income countries means that they can be expected to come into the equation.

The funding of the MDGs could be achieved solely by increasing ODA. At the same time, it would require a step change from the present, going considerably beyond what has so far been promised. The widening of the circle of aid donors is going to take time. Time is however of the essence. For this reason alone, it is necessary to consider new sources.

1.2 New Development Finance: Innovative Sources

The gap between current ODA and the amounts required to meet the Millennium Development Goals is a major reason for looking at innovative sources of development funding, which are the subject of this book. In the chapters that follow, we examine a number of ways in which new funding can be generated. The purpose of the project is not to devise new schemes of funding, of which there is already a bewildering variety. (Although some novel ideas have emerged as part of our work.) Rather our main aim is to consider some of the best known, examining their design and implications.

Specifically, we are considering (see Box 2):

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

Most of these proposals have already been extensively discussed in the literature, and we owe a considerable debt to earlier writing. A number of references are contained in the Box, but we should make specific reference here to the paper prepared by
It will be evident that our coverage is far from exhaustive. There are a number of other global taxes that have been advanced. These include a “brain drain” tax, an international air transport tax, taxation of ocean fishing, taxation of arms exports, a “bit 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 exemplars of the potential for global taxation. If we conclude that they can serve the purpose of raising the necessary $50 billion, this does not mean that these two tax bases should be adopted in preference to others. Alternatives certainly need to be explored. And if we conclude that the two taxes cannot, singly or jointly, serve the purpose, then the other taxes will certainly have to come into play. In this sense the project is a dynamic one, contributing to an evolving debate.

The innovative sources considered in this book are not confined to taxation. Two of the proposals are close to ODA. 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. The proposal for a new round of Special Drawing Rights involves the high-income countries in making these available for development purposes. 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, which, if channelled into development purposes, can increase the flow of resources available for development. Again however 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.

Classification of Proposals

The seven proposals may be classified in different ways. They differ in the extent to which they represent a radical departure. The encouragement of private donations, or of emigrants’ remittances, may lead to significant changes in scale, but the activities are not new. There would be no major changes in the rules of the game. More radical is the special SDR allocation by the IMF, which is novel to the extent that donor countries would make their share available for development purposes. The International Finance facility works through ODA but would involve a new international treaty. In organisational terms, it would be a significant change; and the extent of pre-commitment would be unprecedented. Both of these proposals represent new uses of existing instruments. The most radical are the global taxes and the global lottery/premium bond. These would be fundamental departures.

The proposals can be classified according to the lead actors. The SDR allocation has the IMF at centre stage, with national governments having to ratify the IMF proposals. The introduction of global taxes requires national governments to

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3 I am grateful to Ilene Grabel for suggesting the structure of this section.
agree to act multilaterally, via a new or existing international organisation. Increased private donations and remittances will only happen if individuals (or enterprises) decide to increase their contributions to development. The global lottery requires the collaboration of national lotteries. In Chapter 2, we explore some of the possibilities opened up by allowing for “flexible geometry”.

The proposals can be classified according to their implications for the use of the new development funds, which depends in turn on the intermedia...
funds. The actual impact of a transfer may differ from that intended because of
misadministration or because funds are fungible, but as long as it remains credible
that there is a link between the transfer and the stated purpose, then donors may
continue to provide funding.

In the case of fiscal measures, there has been a long literature on earmarking.
Generally, it is regarded negatively: “fiscal experts have argued that earmarking is
poor budgeting procedure, since it introduces rigidities” (Musgrave and Musgrave,
1989, page 222). They make an exception for cases where earmarked taxes
approximate benefit taxation, which may have some application – see Chapter 9 on
private donations. On the other hand, political economy considerations may generate
a role for earmarking, as in the article by Buchanan (1963), where public spending is
determined by majority voting. In that taxation depends on voter consent, the situation
may not be so very different from that with private donations.

In this book our primary focus is on the source rather than the use side. At the
same time, one cannot fully separate the two sides, and we return to the use of
development funds at a number of points.

1.3 Origins of the Proposals

In this book we consider the range of innovative proposals described above.
We seek to evaluate them according to a variety of criteria, and these criteria are
explained in the next section. First, however, it is important to consider the political
origins of the proposals. Why are alternatives being sought to ODA? What is the basis
of support for different proposals? What is the political context?

The proposals considered in this book were not developed in a laboratory; they
emerged from a political debate about global policy. They are a product of summit
meetings and of street demonstrations. Understanding their origins and political context helps us in turn understand the form of the proposals and their likely impact. It helps us predict their chance of being put into effect.

If we start with global environmental taxes, then these have been championed on the grounds that they yield a “double dividend”. Such an argument has been made at the national level for corrective taxes on environmental external diseconomies (the damage done to the environment). A tax on the consumption of goods, such as hydrocarbon fuels, that harm the environment has a positive allocational effect, switching spending away from polluting goods towards those causing less or no environmental damage. In contrast to the usual case with taxes, such switching behaviour is desirable. So we have both the revenue and the environmental gain. This is discussed further in Chapters 2 and 5, but for the present the important point is that the tax proposal is designed with two purposes in mind. Revenue is only one objective. Indeed, if we succeed through the Kyoto Agreement and other means in reducing the use of polluting fuels, then the resources available for development will be reduced.

The Tobin tax is another clear example of such a double dividend argument. Indeed, the second purpose historically came first. James Tobin first put forward the idea for a currency transactions tax to enhance the efficacy of macroeconomic policy. The subtitle of the book on The Tobin Tax, edited by Haq et al (1996) was “Coping with Financial Volatility”. The potential of the currency transactions tax as a generator of revenue was suggested “as a by-product of the proposed tax, not as its principal purpose” (Tobin, 1996, page x). This ancestry explains the differences in rates proposed by different authors. As is made clear in Chapter 6, a rate of tax of 1 or 2 basis points may be considered too little sand to restrain the wheels of international
finance but may generate revenue sufficient to make a significant difference to
development funding.

Ideas and policies have their time. Tobin (1996) reflected somewhat ruefully on the fact that his 1978 proposal “did not make much of a ripple. In fact, one might say that it sank like a rock” (1996, page x). A quarter century later it features on many political agendas. In considering the different proposals here, we have to bear in mind their timing and dynamics. The adoption of the Millennium Development Goals represents a moral commitment from which governments will find it hard to withdraw. The poverty target is not a line in the sand that will be gone with the next tide. This in turn means that the search for revenue has acquired greater salience. Governments may reject particular proposals. They may block multilateral action. But they cannot totally evade the question of alternatives. As 2015 approaches, pressure will increase for results to be registered.

Just as policy goals have a degree of durability, so too policies themselves have a high degree of persistence. This applies particularly to those reached after lengthy inter-country negotiation, as is witnessed by the experience of the European Union. The introduction of a global tax would not be easily reversed, if only because some of the revenue would be necessary to finance the collection machinery. A global lottery might be dismantled, but this would be a significant political reverse. In the case of the International Finance Facility, there will be a succession of funding rounds, but the key feature of the proposal is to pre-commit future flows of assistance. Future governments will not be able to go back on the promises made today; nor will they be able to claim credit for the decision.

Proposals for new sources also find their origins in a search for alternatives to ODA. Here it is helpful to distinguish three types of motive for seeking an alternative
to increased ODA. The first is to reduce government spending. Many OECD
governments are under pressure to reduce government deficits. In the case of the euro
zone countries, these pressures are institutionalised in the form of the Stability and
Growth Pact. The reactions of countries in this position will depend on the form of
these constraints. For example, the attractiveness of the International Finance facility
may depend on how the future commitments appear in the government budget. The
second concern is with the level of taxation, which would need to rise to finance
increased ODA. In this case, the alternatives may not offer a solution. A globally
administered Tobin tax may not enter the government budget of a particular country,
but it may contribute to the perceived burden of doing business in that country. The
profitability of London or Frankfurt as financial centres, for example, might be
reduced. Thirdly, governments may be concerned with “donor fatigue” among its
electorate. This would inhibit government participation in the devising of new
sources, as well as discouraging increased ODA. Given the possible importance of
such “fatigue”, it is significant that the OECD study by McDonnell et al (2003)
reports that “public support in OECD DAC Member countries for helping poor
countries has remained consistently high for almost two decades: there is no aid
fatigue” (2003, summary). They caution that concern remains about effectiveness, and
that public understanding of poverty and development issues remains low. This is a
further role for the present book: to contribute to public debate.

1.4 Political Economy

This book is largely about the economics of new sources of finance for
development, but we need also to consider the political economy of new sources. The
political economy is important for at least three reasons. The first is that, as we have
just seen, politics influences the shape of the proposals. In the next chapter we ask a number of questions about the design of the proposals, and the answers reflect the political context. Are the proceeds of a Tobin tax, for example, to be seen as a net addition to the flow of resources or as an alternative to ODA? What is the fiscal architecture: would global taxation be collected by national governments? The second reason for examining the political economy is that it affects the economic consequences of the new sources. The reaction of individuals and businesses to global taxes is influenced by the degree to which the taxpayers accept the purposes for which the taxes are levied. Avoidance and evasion are higher where the tax is regarded as unjustified. In a global context, the economic impact of taxes and other measures depends on the actions of national governments. The third reason is that the feasibility of new sources of development finance is ultimately a political issue. Political acceptability should not be a consideration that influences our economic analysis of given proposals, but it may influence the choice of proposals to study.

The behaviour of the state, and its interactions with citizens, has long been an important part of the subject matter of public economics. Analysis of public policy has to take account of the process by which policy is made. We are, for example, starting 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

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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. In the same way, we can ask how the innovative financing proposals would enter into this equation. Are these new ideas a means to reduce the perceived costs of development finance? Are the new institutions a vehicle for shifting national political balances?

In evidence to the World Commission on the Social Dimensions of Globalization, Clunies-Ross (2003) suggests that there are four factors that may reduce the political cost of development funding. The first is where the revenue sources are not highly visible. The global lottery may be an example, where participants are largely focused on the possibility of winning. The second is the time required for legislation and negotiation. Piloting a bill for a global tax through parliament may have a high political cost, whereas measures to encourage private donations may require new laws. The third is described by Clunies-Ross as the “two birds” test: “the collection of revenue is itself linked to the achievement of some widely desired end, such as a recognized global public good, so that two birds can be killed with one stone” (2003, page 5). Finally, from a national perspective, the cost is reduced when the effort is worldwide, and there are no free riders. Thus it may be feasible for the European Union (EU), for example, to introduce a currency transactions tax without the participation of the US, but this may run into political objections. Voters in the EU may object to the Tobin Tax not being levied in the country of its inventor.
It should be emphasised that these considerations are positive statements about political feasibility, not judgments about intrinsic desirability. Indeed, their desirability can be questioned. Low visibility is not a property that would commend itself in an open civil society. Legislation is a proper activity of democratic governments. A country’s policymakers should form their own judgments independently. There is a strong normative element to political economy. Moreover, extension to a global stage raises new normative issues. As is increasingly evident from public debate, there is questioning of the status of international organisations that are only indirectly accountable. If, as we consider in this book, global taxes are to be introduced, then how are the taxpayers to be represented? If tax revenue accrues to the United Nations or to international agencies, there will be heightened pressure for democratic accountability (see Falk, 2002, for a discussion of how a people’s assembly could be developed by the UN). The political structure may therefore itself be influenced by the introduction of new sources of development finance. Just as at a national level, political structures may evolve in response to fiscal developments.

For these reasons, we do not allow considerations of political feasibility to dictate the scope of our analysis of innovative sources. We cannot ignore the political context but one of the key roles of economic analysis is to spell out the menu of options. If a politician asks which sandwiches are available, we should not leave the vegetarian option off the list simply because we know that he comes from a cattle ranching state. As put by Boadway, it is “inconsistent to rule out on a priori grounds options that are normatively superior simply on the basis of a perception that the policy process itself will choose not to adopt them” (1999, page 55). This does not mean that our analysis of the consequences of a particular policy option should ignore
the political context, for the reasons given at the start of this section, but that we should not give it primacy.

Statements about political feasibility are of course predicated on a view about the working of the political process. To illustrate this, let us consider the proposition that the double dividend argument strengthens the case for global taxes on currency transactions or environmental damage as a source of development funding: the “two birds” test. This argument is related to the classic model of “logrolling” where two politicians agree to support each other’s pet projects. However the logrolling model assumes a particular distribution of benefits and losses from the projects, the former being concentrated and the latter diffuse (Drazen, 2000, page 330). In the present case the reverse may be true: the costs may be largely borne by a small interest group, 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. In several of the proposals considered here, the tax required for allocational reasons is likely to be considerably higher than that needed to add significantly to development funding. The Tobin tax can make a major contribution to raising revenue at a much lower rate than that suggested as needed to stabilise exchange rates. (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 double dividend case risks attracting the hostility of opponents of the exchange stabilising level of taxation, who would not necessarily oppose the much lower rate envisaged here. What is required is an analysis of the coalitions likely to form in support or opposition of different proposals.

In what follows, our primary focus is on the economic impact of the different proposals and on evaluation according to a set of economic criteria described in the
next section. But for the reasons outlined at the start of this section, we have to take account of the political context, and to recognise that our analysis is itself part of the political process.

1.5 Criteria for Evaluation

The different proposals are here evaluated, in broad terms, according to the total, and the distribution, of benefits and costs to the citizens of the world. The benefit is seen principally in terms of securing funds for development, and the first question is whether the innovative sources, singly or in conjunction, can raise in a guaranteed way the annual flow of $50 billion judged necessary to achieve the Millennium Development Goals by 2015. How far is it feasible to ensure a stable flow of substantial additional revenue from the proposed source?

“Funds for development” in turn raises the question of the relation between dollars collected and development achieved. The meaning of “development” is one of considerable subtlety, to which we cannot do justice here. The aim of the increased funding is to ensure a lasting rise in living standards broadly interpreted. “Broadly interpreted” is the spirit of the Millennium Development Goals, where the halving of extreme poverty is linked with improved education and health, the empowerment of women, and environmental sustainability. “Lasting” means that the targets are to be reached in 2015 and then sustained. The emphasis is on long-term investment to raise living standards. In concrete terms, we are interested in how the new sources can contribute to, as suggested was necessary in the case of Africa, raising the ratio of investment to GDP to 25%. This means that we have to ask how the use of funds differs across the different sources. Are private donations more or less likely to

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I am grateful to John Micklewright for emphasising the need to address this issue.
contribute to investment than ODA? How far do emigrants’ remittances finance consumption rather than investment? Of course, current consumption is of value. In that case however a continuing transfer is necessary.

Our primary focus is on the cost side, in that we are concerned with the economic impact of the new sources and with the distribution of the burden. This may not be immediately obvious. A new global tax will affect economic activity by households and by enterprises. It will affect – either negatively or positively – the efficiency of the working of the world economy. The reactions of those taxed may allow them to shift the burden onto their customers or onto their workers or onto their shareholders. The reactions may generate additional costs or may have positive economic outcomes.

Who bears the cost is essential from the standpoint of assessing the justice or otherwise of the proposed measures, and this too is a complex matter. To begin with, public debate tends to think in terms of redistribution from rich to poor countries. But a number of the proposed measures could potentially affect people outside rich countries. The Tobin tax would reduce the net sum received by the families of migrant workers. A global lottery will be played all round the world. Nor is the world neatly divided. We have already drawn attention to the potential role of middle-income countries. Even if the impact is confined to rich countries, we have to worry about the distribution of the burden within those countries. An annual flow of an extra $50 billion is only a fifth of 1% of the GNP of donor countries, but there is no reason to suppose that the cost would be shared proportionately. We need to ask how far it is the poor in rich countries that would bear the burden.
1.6 Guide to the Contents of the Book

The rest of the book contains three general chapters, seven chapters considering the different innovative schemes analysed here, and a concluding chapter.

We believe that there are merits in setting different proposals alongside each other. Such a joint analysis helps the reader assess their relative strengths and weaknesses. We hope also that our book makes a contribution in terms of the methods of analysis. This is the main function of Chapters 2-4, which approach the question in a theoretical way, rather than examining individual proposals for sources of funding. They may appear rather abstract to some readers, but there is considerable value in standing back and asking hypothetical questions – such as (Chapter 4) what would happen if there were a central world taxing authority? It may suggest new ways of viewing the problem. What is reality today was often hypothetical in the past. These theoretical chapters deal with over-arching issues, and this is the title of Chapter 2. Its aim is to set out a number of the common questions that arise in considering sources of new revenue for development finance. These concern the precise specification of the proposal, its relation with ODA, and the administrative architecture. One purpose of our study is to bring to bear the accumulated knowledge in the field of national public finance, and more generally public economics. It is for this reason that we have included Chapter 3 on global public finance and Chapter 4 on the lessons from the fiscal federalism literature. The latter highlights some of the similarities and some of the differences between fiscal institutions in federations and those that might apply in a global setting. It draws a number of conclusions about sources of new revenues for development, dealing specifically with taxes on nations, taxes on global externalities, and taxes on internationally mobile tax bases.
The taxation of externalities is the subject of the first of the chapters examining potential sources: *Chapter 5* on environmental taxation. As is noted, much of the literature relates to taxes as instruments of national environmental policy, and their role in relation to economic development has been less discussed. The chapter begins therefore by preparing the ground, setting out the welfare economics of environmental taxation in a national context, including a detailed account of the double dividend issue. This provides the basis for an analysis of global environmental taxation, with specific reference to the carbon tax.

The second major proposal for global taxation considered here is that for a currency transactions tax: the celebrated Tobin Tax. As already noted, 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 *Chapter 6* focuses on the by-product: the Tobin Tax as a source of revenue for development. It examines the technical feasibility and the revenue potential from this source.

There has long been a campaign for the issue of development-focused Special Drawing Rights (SDRs) by the International Monetary Fund (IMF). The original purpose of SDRs was to increase international liquidity, but *Chapter 7* concentrates on the potential role of SDR creation in providing funds for development finance. Calls have been made for developed countries to re-allocate their share of the SDR issue to developing countries. The chapter describes the historical development of SDRs and the recent proposals. It examines the arguments for and against development-oriented SDRs, and the institutional mechanisms necessary for their creation.
A starting point for this study was the observation that innovation in the sphere of public finances has not kept up with innovation in private financial markets. Making use of the latter to enhance the effectiveness of official development assistance (ODA) is the essence of the recent proposal for the International Finance Facility, which is the subject of Chapter 8. Taking the proposal by the UK Government as a case study, the chapter describes the possibility of a limited duration substantial increase in ODA where the value is enhanced by pre-commitment, allowing leverage by borrowing on the international capital markets. It sets out the institutional machinery proposed, and assesses the potential advantages and disadvantages.

Chapter 9 asks how far charitable donations by private individuals and firms can contribute to funding the Millennium Development Goals. What are the prospects for increasing donations for development, whether from small-scale donors, the superrich, or the corporate sector? Charitable giving in rich countries is very substantial: in the US more than 1.5% of national income. People give large amounts of free time. Development, however, commands only a small share. The chapter analyses the under-researched question as to how people determine the objects of their giving, drawing on other subjects, notably marketing. It asks why people give to support the United Nations agencies, notably UNICEF, and whether private donations are crowded out by governmental contributions or by ODA. It examines measures to encourage private funding of development: tax incentives, Global funds, corporate giving, and the Internet.

A relatively new idea for new development funding is that of a global lottery, which has received attention particularly on account of the recent proposal by the Crisis Management Initiative. World sales of gaming products are large and growing.
Chapter 10 considers the prospects for tapping this market for the purposes of development finance by means of a global lottery and – a new idea – a global premium bond (a loan instrument where the interest takes the form of a lottery prize, the capital being repayable on request). The chapter investigates the feasibility of these mechanisms and their potential as revenue sources for development. It assesses their strengths and weaknesses, including both economic and ethical issues.

Remittances from migrants are a growing force, and Chapter 11 considers the role that they can play in financing development. To an important extent, they finance consumption. As Chapter 11 notes, they are an international mechanism of social protection based on private transfers. They can also contribute to financing investment, providing community infrastructure (such as schools) and funds for the financing of new enterprises. The chapter considers the motives for making such remittances, and the problems of measuring their extent. Remittances are channelled through a variety of financial entities, ranging from the formal to the highly informal. The chapter considers policies to reduce the cost of remittances and to enhance their development potential.

The final Chapter 12 summarises the key points to emerge and considers the way forward.
<table>
<thead>
<tr>
<th>Goal</th>
<th>Description</th>
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<tbody>
<tr>
<td><strong>Goal 1: Eradicate extreme poverty and hunger</strong></td>
<td>Halve, between 1990 and 2015, the proportion of people whose income is less than $1 a day. Halve, between 1990 and 2015, the proportion of people who suffer from hunger.</td>
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<tr>
<td><strong>Goal 2: Achieve universal primary education</strong></td>
<td>Ensure that by 2015 all children will be able to complete a full course of primary schooling.</td>
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<td><strong>Goal 3: Promote gender equality and empower women</strong></td>
<td>Eliminate gender disparity in all levels of education by 2015.</td>
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<td><strong>Goal 4: Reduce child mortality</strong></td>
<td>Reduce by two-thirds, between 1990 and 2015, the under-5 mortality rate.</td>
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<tr>
<td><strong>Goal 5: Improve maternal health</strong></td>
<td>Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.</td>
</tr>
<tr>
<td><strong>Goal 6: Combat HIV/AIDS, malaria and other diseases</strong></td>
<td>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.</td>
</tr>
<tr>
<td><strong>Goal 7: Ensure environmental sustainability</strong></td>
<td>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.</td>
</tr>
<tr>
<td><strong>Goal 8: Develop a global partnership for development</strong></td>
<td>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.</td>
</tr>
<tr>
<td>Source</td>
<td>Description</td>
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<tr>
<td>Currency Transactions Tax (&quot;Tobin tax&quot;)</td>
<td>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). See Haq, Kaul and Grunberg 1996, Spahn 1996, Mendez, 1997, Patomäki and Denys 2002)</td>
</tr>
<tr>
<td>Global environmental taxes</td>
<td>Tax on goods generating environmental externalities, with specific reference to a tax on use of hydrocarbon fuels according to their carbon content. See Pearce 1991, Poterba 1991 and Cooper 1998.</td>
</tr>
<tr>
<td>Global lottery or Global Premium Bond</td>
<td>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. See Ahde, Pentikäinen and Seppänen 2002. Global premium bond, parallel to national bonds with lottery prizes.</td>
</tr>
<tr>
<td>Creation of new Special Drawing Rights (SDRs)</td>
<td>Creation of SDRs for development purposes, with donor countries making their SDR allocation available to fund development. See Soros 2002.</td>
</tr>
<tr>
<td>Increased private donations for development</td>
<td>Charitable donations by private individuals and firms. Measures to encourage private funding of development: tax incentives, Global funds, corporate giving, and the Internet.</td>
</tr>
<tr>
<td>International Finance Facility (IFF)</td>
<td>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. See HM Treasury and Department for International Development. 2003.</td>
</tr>
</tbody>
</table>
References for Chapter 1


Chapter 2 Over-Arching Issues

A B Atkinson, Nuffield College, Oxford

Introduction

2.1 What is the Role of New Sources?
2.2 What Fiscal Architecture?
2.3 Leaky Bucket or Double Dividend?
2.4 Is there a Transfer Problem?
2.5 Equivalent Measures?

Conclusion: Contribution to the Policy Debate

Introduction

Proposals for new sources of development finance are considered in detail in the later chapters. Each of them raises a number of distinct issues, which are properly discussed in the individual chapters. But there are also over-arching issues. What is the role of new sources in relation to existing overseas development assistance (ODA)? Should we be seeking new sources that generate a double dividend? Can the key elements of a proposal be achieved by another route? It is with these general concerns that the present chapter deals. Its aim is to set out a number of the common questions that arise in considering sources of new revenue for development finance.

One purpose of our study is to bring to bear on global public finance the accumulated knowledge in the field of national public finance, and more generally public economics. It is for this reason that we have included Chapter 3 on global public finance and Chapter 4 on the lessons from the fiscal federalism literature. This

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6 I am most grateful to members of the project team for their comments on this chapter. An earlier version was presented at the World Bank ABCDE Conference in Paris, May 2003. I would like to thank the World Bank staff for written comments, and P-B Spahn, Adrian Wood and participants for their comments at the conference. None of the above should be held responsible for the views expressed in the chapter.
process is two-way. Public economics has increasingly had an international dimension, as evidenced by the founding in the early 1990s of the journal *International Tax and Public Finance*. There has been a close link between public economics and development planning (the opening sentences of the article on optimum taxation by Diamond and Mirrlees 1971 refer to planning and investment criteria). However, changes in the world economy mean that a global perspective has to be built in from the start. For both national governments and for individual households and firms, we need to analyse public policy taking account of the inter-relations between countries. As was observed a decade ago by Mendez, “a critical element lacking in the fields of finance and international relations is a theory and system of international public finance” (1992, page 11).

The application of the public economics approach leads one to ask a number of key questions. Those considered here are set out in the titles of Sections 2.1-2.5. The aim is not to provide definitive answers, but to clarify the questions being asked and to suggest possible answers that are not immediately apparent. To illustrate the issues, I refer at different points to the seven schemes studied in this book. These schemes differ considerably. They include actions close to existing ODA (the International Finance Facility), and actions related to the International Financial Institutions (SDR creation); they include measures to increase the benefits in terms of development funding from flows of private funds (remittances and charitable contributions); they include totally new departures such as global taxation and a global lottery. There is of course a risk that by considering together such disparate measures we may be confounding the issues. The different instruments raise different concerns. However, one of the key lessons of modern public economics is that it is
often valuable – indeed necessary - to consider within a common framework different forms of government policy.

The first two questions concern the specification of the proposals; the remaining three questions involve the economic impact of the proposals. In each case, precision requires a degree of economic reasoning, but every attempt has been made to render this accessible. Bearing in mind the dictum of Stephen Hawking that each equation halves the number of readers, there are no equations.

2.1 What is the Role of New Sources?

The first question we need to address is the relation between new sources of development finance and an expansion of ODA. Are these to be seen as alternatives? As we have seen in Chapter 1, many proponents of new sources view them as a way of achieving an increased flow of development resources without recourse to increased ODA. Other people see this as a reason for opposing the exploration of new sources: Tobin taxes or other new schemes would, on this view, weaken the resolve of rich countries to meet the UN ODA target. Or the new sources would “crowd out” other forms of finance. The new Global Lottery may generate new revenue but reduce the receipts of existing lotteries that have been used to fund development projects. According to this school of thought, the new sources should be a net addition to the flows of ODA.

In this book, both kinds of argument are treated, and it is important to distinguish between the case where the new sources are a net addition to the total of development resources and the case where they are a substitute for ODA. Figure 2.1 seeks to clarify the issue. We are agreed that additional resources are required to meet the development targets. This involves moving from the starting point O in Figure 2.1.
This could be achieved by increased ODA, moving from O to B horizontally in Figure 2.1. Alternatively, it could be achieved by exploiting new sources, which is the move from O to A vertically in Figure 2.1. In both cases, we have a package of increased resource flows and increased development spending. On the other hand, proponents, or opponents, of new sources may contrast them with increased ODA. They may say that, holding the total transfer constant, the position A is better or worse than the position B. The proposition that a global lottery is a better (or worse) way of funding the MDG than ODA is clearly a different proposition from the statement that we should introduce a global lottery to fund the MDG.

The importance of distinguishing between the two types of movement illustrated in Figure 2.1 is a key lesson from the public finance literature. The incidence of taxation depends on what else is being varied at the same time. As Musgrave set out in his classic *Theory of Public Finance* (1959), one possibility is “tax/expenditure incidence”, where revenue is increased and spending goes up by the same amount. As shown in Figure 2.1, the introduction of new sources involves moving vertically. ODA remains unchanged and the benefit from the additional revenue is seen in the contribution to development goals. In this case, we have to consider the effectiveness of aid in achieving these goals and the absorptive capacity of the recipient countries. Alternatively, we can move along a line holding development-spending constant, while varying the sources of funding. In Musgrave’s terminology, this is “differential tax incidence”: the differential implications of different means of securing a given flow of resources. For example, if a global Tobin tax raises new revenue, and this is used to reduce the need for additional ODA, then it allows domestic taxation to be lower. The case for the new tax then turns on the differential impact of the two kinds of taxation – and their relative political appeal.
The distinction between two different types of incidence is drawn from the
taxation literature, but similar questions arise with other proposals for new sources.
Consider the global lottery discussed in Chapter 10. Opponents criticise this proposal
on the grounds that the burden falls predominantly on poorer people in rich countries
and on poor countries, whereas the cost of ODA financed through income taxation is
borne by the better off. This distributional analysis relates to a differential analysis of
substituting a global lottery for increased ODA (moving from B to A in Figure 2.1).
In contrast, a global lottery as an addition to existing funding may have quite different
implications. The transfer from rich countries may be distributionally progressive in
world terms, and the redistribution within the rest of the world may favour
development. We may think differently about a lottery that moves us from O to A
than about one which moves us from B to A. The International Finance Facility,
discussed in Chapter 8, involves an increase in ODA but of limited duration, timed to
achieve the MDG by 2015, and donors making a pre-commitment, so that the
promises can be “banked”. We can consider the proposal either as a net addition to
existing ODA (moving from O to A) or compare it with the alternative of a steady
annual flow of “un-precommitted” ODA of the same present value (comparing A and
B).

Conclusion

When considering innovative sources, we need to be clear whether they are
seen as a complement to expanding ODA or as an alternative. In the former situation,
the case has to be made in terms of enhanced funding for development; in the latter
situation, the case is being made that the innovative sources are a better way of
funding a given development effort.
2.2 What Fiscal Architecture?

New sources of development finance potentially involve a number of actors. In some cases, private individuals acting alone, like Ted Turner, or the person putting coins in the UNICEF Change for Good envelope, can make the key decision. In many cases, national governments are involved. They can simply involve a country acting unilaterally. A single country could provide matching funds for private funding of development by its citizens. A government could decide that a fraction of the proceeds from its state lottery are to be allocated to development aid. A country acting unilaterally could decide to allow emigrants’ remittances as a deductible item against its national income tax. But in most cases it is envisaged that there would be a multilateral agreement. Indeed, in the case of the creation of new Special Drawing Rights, the constitution of the IMF requires a (super 85%) majority of members to ratify the agreement before it can be put into effect. Where the source involves multilateral action, then two questions arise under the general heading of “architecture”. In discussing this, I am presupposing that the participating countries have agreed on the form and scale of the action to be undertaken. What we are considering is the shape of the necessary institutions. (The political economy of countries acting together has already been considered in Chapter 1.)

Flexible Geometry

The first question is - does the success and effectiveness of any particular proposal depend on complete adhesion of all countries or 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, it may be better to start from the position that universal agreement may be impossible and to 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, but it does not follow that other measures are also blocked. 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. Partial adhesion has had costs. For instance, a Member State opting out of social protection may (or may not) enjoy a competitive advantage, exporting unemployment to the rest of the Union. These costs have to be placed in the balance. But the issue becomes one of balance, rather than of an absolute block on action.

We have to ask therefore in the case of each proposal whether we can have a “flexible geometry”, where it is viable to go ahead with a subset of countries? The likely answer to this question varies from one proposal to another. The costs of incomplete coverage depend on the nature of the source of funding. Failure of countries to participate in the International Finance Facility means that the scale of the operation is reduced, but the proposal is not undermined. The same applies to the Global Lottery, or the Global Premium Bond; indeed insofar as these schemes offer a new product (see Chapter 10), those not participating may lose out. With global taxation, the free-riding problems become potentially more significant. With a carbon Significant opting out from a global carbon tax may erode the tax base, as producers
relocate to non-participating countries, and expose participating countries to intense lobbying from domestic interests. With a currency transactions tax, ease of relocation of financial activity depends on how extensive is the taxing jurisdiction. The larger the jurisdiction, the less elastic the response, and hence the greater the revenue potential.

**Fiscal Architecture**

The second question concerns the institutional arrangements under which multilateral action takes place. Where countries are acting in concert, then the organisational structure is important, as is illustrated in this section by reference to global taxation. A flow chart for national taxation is shown schematically in Figure 2.2. National governments determine the rates of taxation and the tax base. 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, for example, pays the aircraft departure tax to the airline, which then accounts for the revenue to the government. Employers collect payroll taxes. Retailers or wholesalers collect excise taxes.

One evidently cannot apply exactly the same process to global taxation (Figure 2.3). 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 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 heavy lines in Figure 2.3). 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 2.3 show this. Whether or not such a World Tax Authority is envisaged is one of the questions that have to be considered. (This may be different from an international tax organisation – see Tanzi 1999.) The feasibility of creating such a tax authority depends on the universe of taxpayers. In the case of airlines, there is already an international organisation (IATA) and the international air travel tax could be seen as part of a membership subscription. The formation of an international body conveys certain privileges and the tax could be seen as a rent for the use of global air space. A World Tax Authority could not deal with taxes paid by individual households, but one could envisage it operating a tax levied on multi-national corporations, which would have to be registered where their cross-border activity exceeded a certain amount (just as there is an exemption level for VAT registration in national systems). In the literature on the corporation tax, one of the arguments for such a tax base is that the status of incorporation confers benefits on organisations adopting this legal form. It is normally agreed that this does not justify present levels of corporate income taxation, but a more modest rate of global corporation tax could be seen as a form of benefit taxation for engaging in cross-border economic activity.

Moving in the opposite direction from the introduction of a World Tax Authority is the case shown by dotted lines in Figure 2.3, 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 tax base. We would then have a two-tier structure, with the national tax
obligation requirement being agreed multilaterally, but the tax implementation being
chosen locally. One reason why, under the subsidiarity architecture, a national
government may choose a different tax base is that it faces political opposition to a
particular form of taxation. The fuel tax protests of 2000 in Europe provide a good
illustration.

Fiscal Federalism

The United States and other federal states, such as Canada and Australia, came
into existence by a voluntary adhesion of previously sovereign states. The formation
of the United States of America represented a pooling of sovereignty, just as the
acceptance of a global responsibility for development involves some limitation on the
freedom of action of national governments. This leads us to ask what lessons we can
learn from the extensive literature on fiscal federalism, and this is the subject of
Chapter 4. The reader may object that fiscal federations involve a degree of symmetry
among participants that invalidates the application to the global context, where it is
the inherent asymmetry in the world that generates the very problem with which we
are concerned. But many of the federations that came into existence involved
participating states that were unequal to a significant – if not the same – extent. Much
of the debate about federal finance is concerned with the treatment of unequals: the
design of equalisation formulae.

Conclusions

Proposals for new forms of development funding raise important issues of
institutional shape. In designing the architecture of global fiscal system, there is
considerable scope for choice and it should not be assumed that all depends on
universal support by donor countries. As the references to “flexible geometry” and to
“subsidiarity” illustrate, we can learn usefully about the range of alternatives from the
experience of supra-national groupings such as the European Union. The parallel with
the public finances of federal states seems worth exploring.

2.3 Leaky Bucket or Double Dividend?

As Arthur Okun expressed it in his book Equality and Efficiency (1975),
transfers are made using a leaky bucket. To raise $10 billion for new development
purposes may cost more than $10 billion. Put another way, the marginal cost of $1
extra public funds for development may be more than $1, because taxes and other
interventions distort economic decisions. “The cake gets smaller as we seek to share it
out.” On the other hand, there are arguments, usually put under the banner of “double
dividend”, that there may be efficiency gains, so that the amount in the bucket is
actually increased. And the literature on the marginal cost of public funds has shown
that there are circumstances when the marginal cost of $1 is less than $1 (see
Atkinson and Stern 1974, Fullerton 1991 and Sandmo 1998). In this section, I
consider these two different perspectives.
Why are buckets leaky? The first source of leakage is the cost of administration. Currency transactors may pay $X billion in tax but $(X-A) billion is the net revenue, where A is the cost of operating the tax collection and enforcement agencies. It may for this reason be preferable to raise an existing tax, such as income tax, than to institute new taxes with all the fixed costs of administration. The second source of leakage is that a new revenue source may crowd out other sources of development funding. One of the lessons of public finance is that in calculating the change in revenue resulting from an increase in one tax, one has to take account of the possible impact on the revenue from other taxes. A good example would be an international tourist tax (not considered in this study). As Clunies-Ross (1999) points out, tourism is an important source of government revenue for a number of poor countries. To the extent that visiting tourists have less to spend after they have paid the tourist tax, these countries will be receiving less sales tax on the purchases made by tourists and would have to be compensated before the tax yields net additional revenue. Similarly the introduction of a global lottery will affect national budgets. Part of the customer base will be drawn from existing national state lotteries, reducing their revenue. Part will be drawn from spending on private gambling subject to national taxes, so that fiscal revenue will fall.

But these are not the only potential leakages. Most taxes have an impact on the decisions of taxpayers apart from the pure effect of reducing their incomes. An income tax may cause people to work less hard, or it may cause them to work harder to maintain their level of expenditure. In the conventional public finance format, there is a deadweight loss, or excess burden associated with taxation. The currency transactions tax causes people to avoid activities that attract the tax. They will, for example, be inhibited from switching their investment portfolio away from domestic
securities towards those denominated in other currencies. This has an efficiency cost, since they are not allocating their investments according to the return at the margin. In the case of the income tax, the choice between income and leisure is distorted (this applies whether the tax causes the person to work more or to work less). Moreover, there is a presumption that the distortionary cost increases with the tax rate. The distortion is much more significant with a transactions tax rate of ten basis points (0.1%) than for one with a rate of two basis points (0.02%). This may be an argument for seeking a new tax base, rather than increasing existing taxes such as income tax.

Adjustments in behaviour in turn may induce market reactions. If a tax on carbon use is passed on in higher consumer prices, then demand will shift away from goods that are intensive in their direct or indirect use of fuels. This will make worse off those people who cannot shift easily from working in those industries, as well as those whose budgets are particularly weighted towards those goods. The ultimate incidence of the tax may be rather different from its initial incidence. In order to establish this, we need to follow through the full general equilibrium effects, allowing for market clearing.

A Double Dividend?

The standard analysis of tax incidence is indeed 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. In the currency transactions tax example, if it were not for the tax the market would be efficient. The economies of the world are not however well characterised by perfectly competitive, perfectly functioning markets, and one of the major contributions of modern public economics has been to explore the implications of
market failure. This has led to arguments that taxes may serve a corrective function: that the excess burden may become a benefit. The classic example is a corrective tax on environmental external diseconomies. 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. In these circumstances, switching behaviour is desirable. Moreover, if the revenue is used to reduce other taxes that have a negative allocational effect, we have a “double dividend” (for overviews, see Goulder, 1995, and Sandmo, 2000).

The double dividend can arise in the present case in two ways. If the new source 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. This is a good example of the differential incidence argument in operation. Taxing air transport will not only reduce the environmental damage of tourism but also allow the income tax to be reduced, so making staying in the office financially more attractive at the margin. 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 development goals.

**Questioning the Double Dividend Argument**

The double dividend idea appeals to the imagination. However one has to ask why, if a new revenue source can generate a positive sum outcome, have national governments not already adopted such a policy? Why do OECD countries not operate lotteries to raise funds to finance their ODA? If a carbon use tax would reduce
external diseconomies, why is this not already reflected in domestic taxes? If governments could reduce unemployment by a switch in taxation, why have they not already done so? To this central question there are several responses. Here I consider two. First, in a dynamic world there may well be unexploited opportunities. Secondly, it may be that the dividend is global rather than national.

In a dynamic world, new opportunities are always arising and reaction speeds are not instantaneous. It takes time for new policy needs to become apparent and for governments to react. A good example is provided in the present context by the issue of remittances. The arrival of immigrant workers in a city creates a demand for money transfer services. If entry into this industry is slow, then a few firms, able to extract monopoly rents, may dominate it in the early stages. Government policy to encourage competition in the sector can increase the proportion of the transfer that arrives in the destination country. In this case, competition policy may combine with development policy to yield a positive sum outcome.

A Global Double Dividend?

National governments may not impose corrective taxes because the benefits accrue disproportionately outside their boundaries. The switch from general taxation to carbon use taxation may be positive sum globally but negative sum nationally. The revenue calculations of governments take account only of receipts and payments to the national treasury. The impact of spillovers from one state to another is a staple of fiscal federalism. Under certain circumstances, local governments may under-supply public goods that benefit people living outside their borders; and they may over-tax where taxpayers come from outside. There are fiscal externalities. In the present case, there is a possible undersupply of fiscal correction to external diseconomies because
the costs spill over to others. It could be said that we have externalities squared: there is a possible undersupply of fiscal correction to external diseconomies because there are externalities in these very costs.

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 other environmental tax base). 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 tax base. 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.

Conclusion

The calculation of the leakage, or extra dividend, is a complex matter. Depending on the circumstances, it may strengthen or weaken the case for new sources as opposed to existing taxes. The framework needs to be broadened to recognise the departures of real-world economies from the textbook world of perfectly competitive, perfectly clearing markets with full information. These departures may mean that there is a double dividend, where new taxes have a beneficial impact on resource allocation. Moreover, the double dividend may be global in character, not taken fully into account in national decision-making.
2.4 Is there a Transfer Problem?

Economists worry about the effect of policy changes on market prices. A substantial resource transfer between countries may lead to changes in the prices of different goods – those exported and imported, and those not traded - that have implications for recipient and donor countries. These price changes may undermine, or re-enforce, the benefits from the original transfer.

Keynes addressed this problem after the First World War, when he was concerned with the impact of reparations being paid by Germany. He identified the "transfer problem” that a country making a transfer might suffer an additional loss through a shift in demand against their products, causing the terms of trade to turn against them. The “terms of trade” refer to the price of a country’s exports divided by the price of its imports. If the terms of trade worsen, then a country has to export more units to get the same number of units of imports. Applied to transfers for development, this would mean that the recipient countries could enjoy a further benefit from improved terms of trade, if demand switches towards the products they produce. As clarified by Ohlin (1929) and subsequent writers (see Bhagwati and Srinivasan, 1983, Lecture 12 and Brakman and van Marrewijk, 1998, Chapter 2), international trade theory shows that the direction of the terms of trade effect depends on the relative marginal propensities to consume in the donor and recipient countries and the magnitude depends on the price elasticities.

It may be tempting to dismiss the terms of trade effects as of only footnote importance. However, international trade economists take them seriously. Referring to the inflows of loans to the US in the early 1980s, Krugman and Obstfeld say “the transfer effect was a major contributor to the large temporary improvement in the U.S. terms of trade” (1994, page 102). According to them, US residents spend about 80
cents of a dollar of additional income on US goods, whereas foreign residents spend only 10 cents. What then is the relevance of the transfer problem in the present context? First, it should be noted that, as far as the impact on recipient countries is concerned, the issue is only relevant when new sources of funding are a net addition. (When considering the differential effect of new sources versus increased ODA, the total size of the transfer is assumed constant.) The transfer problem arises when we contemplate increasing the scale of transfers. In that case, we have to consider the use made of the funds. Here the balance between investment and consumption may be significant. If the transfer is largely used to fund investment, then the pattern of demand may shift towards manufactured capital goods exported by the donor countries. (This is of course one of the possible functions of the practice of tying aid.) Account has also to be taken of the intertemporal impact. If there is a process of catch up over time, then the production possibilities of developing countries will come to resemble more closely those of rich countries, and the terms of trade effects will become smaller. If the pattern of transfers is advanced, as with the International Finance Facility, then the terms of trade effect may be accentuated relative to a smoother time path. This may not outweigh the advantage of earlier disbursement, but needs to be put into the balance.

The transfer problem also potentially affects the donor countries, and this may be the case even when the total transfer is held constant. If we consider the differential effect of new sources and increased ODA, then they may impact on different income groups. In her analysis of the transfer problem, Chichilnisky (1980) distinguished two income groups in the donor country, and identified circumstances in which the recipient country only gained if the poorer group in the donor country were made worse off. Reduced international inequality was achieved at the expense of increased
within-country inequality. Put differently, this is another example of the possibility that, when we allow for the changes in market-clearing prices, the ultimate incidence of a new source of funding may differ from the initial incidence.

_Absorption and the “Dutch Disease”_

For a small developing country, with no specific natural resources, it may appear fanciful to suppose that its receipt of increased aid could affect the world prices for the goods it exports and imports. As commonly assumed in economic analysis, many countries are “small”, facing fixed world prices. If they wish to import new investment goods, then there is an unlimited supply on the world market. In this sense, there is no problem of “absorbing” the increased flow of funds.

The position is however different once we allow for non-traded goods or services, the prices of which reflect domestic supply and demand (see Corden and Neary, 1982). To the extent that the transfer increases demand for the non-traded good, its price tends to rise. There is a real appreciation, in that domestic goods/services become more expensive relative to the goods traded on the world market. This can cause the movement of labour out of the sectors producing traded goods. This movement is in the reverse direction from that required for development and worsens the foreign balance. As is noted in Chapters 8 and 11, domestic policy has to take account of the possible impact on domestic demand and inflation. As with the transfer problem, the issue potentially applies to all proposals for increased transfers of aid.
Stimulus to World Economy

The treatment by Keynes of the transfer problem was “notable ... for the classical, or pre-Keynesian, way he analysed the problem, concentrating on relative price movements” (Skidelsky, 1992, page 309). The existence of involuntary unemployment and excess capacity can however change the conclusions, in that the responses may be purely in terms of expanded output, not price changes. One of the arguments for the creation of SDRs is indeed that they would provide a macro-economic stimulus to the world economy. This depends on the extent to which the transfers of SDR allocations from rich to poor countries lead the latter to increase spending. Clark and Polak (2002) argue that a regular allocation will not lead to a rise in spending, most countries adding to their reserves (which in itself has a development benefit), but this may not apply where there are substantial transfers of SDRs to poor countries.

Macroeconomic stimulus is another form of potential double dividend. Again we have to explain why this cannot already be achieved. Global spillovers apply at the macro-economic as well as the micro-economic level. The macro-economic literature has extensively discussed the problem of international policy co-ordination failure. The existence of failure does not mean that policy co-ordination necessarily leads to efficiency gains, but it is possible that there may be a global positive sum outcome to a creation of additional liquidity. More concretely, those European governments seeking a way to re-stimulate their economies should be particularly aware of the potential mutual benefit. Increased flows of resources for development, generating additional world demand, may allow Europe to escape the constraints of its macro-policymaking.
Conclusions

Consideration of the effect of new sources of finance takes us into the working of the international economy. Substantial transfers may lead to changes in the terms of trade with implications for both recipient and donor countries. They may affect the relative prices of traded and non-traded goods, causing domestic inflation. Even holding the level of transfers constant, different sources of funding and different timing of the flows may have different effects on demand patterns. Once we allow for involuntary unemployment and excess capacity, there may be a global double dividend through stimulus to the world economy. Such a macro-economic bonus would benefit both developing and developed countries.

2.5 Equivalent Measures?

Policy tools may look different but have equivalent effects. International trade theory and public finance have demonstrated a number of important equivalences. A government can set a tariff on the import of a commodity, or it can set a quota and auction the import permits. If the quota is set at the level of imports generated by the tariff, then in a competitive economy the impact is the same, including the revenue to the government. An income tax with an exemption of all savings is equivalent to a uniform value added tax (see Atkinson and Stiglitz, 1980). Such equivalences operate at the level of the impact on individuals and firms. It is of course quite possible that individuals and firms perceive them differently (an example is given below) and that their economic consequences are different. Moreover, the political attractiveness may be quite different. Recasting a proposal in an equivalent form may convert it from an election-loser to a vote-winner.
In the present context, consideration of such equivalences may allow one to see existing proposals in a new light or the creation of new ideas. Pursuing the parallel with tariffs and quotas, we can see for instance that there is a potential equivalence between a global carbon tax, considered in Chapter 5, and the auction of tradeable permits (see Sandmo, 2000 and Pearson, 2000). Attention has focused on the global carbon tax, but another possibility is to auction permits, to produce the same level of revenue, and, in a world of certainty and perfect competition, the same level of pollution. There are reasons why in reality the two approaches may differ, but we need to ask, when considering the global carbon tax proposal, whether it is clearly superior to the alternative of auctioning permits.

A second example is provided by the discussion of the global lottery in Chapter 10. The authors come up with the novel alternative proposal of a global premium bond, which is a government bond where the capital is maintained (in money terms) but the interest takes the form of lottery prizes. 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. Yet 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. There are of course differences in the prize structure and level, and in the tax treatment, but we need to ask what lies behind the differences in reaction.

The third example concerns the International Finance Facility. Understanding this imaginative proposal is aided by considering whether or not it is equivalent to a particular time path of ODA. As noted earlier, it involves bringing forward the disbursement of funds, but it goes beyond a variation in the time shape in that donors are precommitted. We have therefore to ask how far the guarantee of funding by
donor countries increases the net value of ODA. How much net additional resources are generated by the certainty of underwritten flows rather than annual allocations by donor governments?

Conclusions

Consideration of the equivalence of different policy instruments is a good discipline and a source of new ideas. For each proposal we have to consider how far there are equivalent ways of achieving the same objectives.

Conclusion: Contribution to the Policy Debate

The answers given to the questions posed in this chapter have been given in the Conclusions to each section. Here I end with a reflection on the contribution of economic analysis to the policy debate. As discussed in Chapter 1, the proposals for new sources of development funding have to be seen in a political context. They have been put forward in the light of political objectives and perceived constraints. This does not imply that economic analysis should accept these objectives uncritically or that it should be bound by these constraints (see Boadway, 1999). But economic analysis has a role to play in elucidating the implications of proposals for the achievement of the professed objectives, and in identifying the costs of political constraints. We might for example conclude that the constraint that the tax base be chosen by national governments weakens the contribution of a carbon tax to environmental goals and hence reduces the double dividend. We might for example conclude that the objectives of the global lottery are better served by designing a prize structure that does not compete with that of national lotteries. Analysis of this type is intended to contribute to the public debate.
References


Figure 1 Net Addition to Development Resources or Alternative Source

New Sources

Increased ODA

Differential Incidence

Equal Revenue

Tax/Spending incidence

Starting Point
Figure 2  Fiscal Architecture: National Taxation
Figure 3  Fiscal Architecture in Global Setting
Chapter 12  The Way Forward

A B Atkinson

12.1  The Challenge

12.2  Conclusions: New Sources of Finance

12.3  The Way Forward

The aim of this project has been to advance thinking about new sources of finance for development. This final chapter draws together the main conclusions and considers how we can move forward towards concrete action.

12.1 The Challenge

Our starting point has been the widely recognised need for additional development funding if the Millennium Development Goals (MDGs) are to be achieved by 2015. All figures are estimates, and involve matters of judgment, but there is broad agreement about the magnitude. It seems reasonable to take a figure of additional US$50 billion, about the present total of Official Development Assistance (ODA), as being required annually to achieve the international development goals. This means that we have either to double existing Official Development Assistance or to find alternative sources of comparable magnitude or to abandon the MDGs. Here, we do not accept the third answer. The choice in raising additional funds is therefore between ODA and alternative sources – or a balance of the two.

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Project members have not yet seen this chapter, so they should not be held responsible for my interpretation of their findings. I have however benefited from a number of valuable suggestions, and I should particularly acknowledge the contribution of Ilene Grabel.
This sharp presentation of the problem serves to focus our treatment of new and alternative sources of funding. *First, we are primary concerned with the contribution of these sources to the finance of development.* 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 (Chapter 7) 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 (Chapter 6) we are primarily concerned with its potential as a generator of revenue to be used to finance development. Remittances from emigrants are used for many purposes, notably the financing of consumption by their families who have stayed. This consumption is very important, but our concern here (Chapter 11) is with the contribution of remittances to funding investment for the future.

Our focus means secondly that we are *principally concerned with comparing different ways of funding the MDGs.* If a particular proposal is found to have shortcomings, this is not the end of the matter. We have to ask – what is the alternative? In the course of the book, we have made use of the insights of public economics, applied at a global plane. One of these insights is that one needs to specify the comparison. If the proposal were not to be adopted, what would come in its place? Here, in considering proposals for new sources, we ask how they would differ from an increase in ODA. How would their economic and social impact differ from that of an ODA increase? Or, more cynically, how far are different proposals simply different ways of dressing up an increased transfer from rich to poor countries?

In comparison with ODA, the closest are the proposal for the International Finance Facility (Chapter 8), involving a forward commitment by donors of development funding, and for a development-focused allocation of SDRs (Chapter 7),
which again involves the sovereign actions of governments. The other proposals are distinctly different, involving either global taxation or a global lottery or increased private transfers.

What’s New?

Some of proposals discussed in the book have been the subject of a large literature: the Tobin Tax for example. There have been a number of valuable overviews of the field, to which we have referred in Chapter 1. But our book is not without novelty. Even in the case of the Tobin Tax, the fact that we are concentrating primarily on its revenue potential gives a different emphasis to Chapter 6, reflected in its title. In other cases, the field is less well tilled. In the case of the International Finance Facility, Chapter 8 provides, to our knowledge, the first external analysis of this proposal. There is relatively little economic literature on private donations for international development and the reasons why people give for one cause rather than another (Chapter 9). By applying approaches from public economics, we can derive new insights. This applies to the lessons from fiscal federalism (Chapter 4) that can be applied to multi-level policy-making with global concerns and national governments. It applies to the equivalence of taxes and the auctioning of quotas (Chapter 5).

The book contains some new ideas. Attention has been paid recently to the global lottery, but Chapter 10 comes up with a totally new mechanism – the global premium bond. The analysis of fiscal architecture in Chapters 2 and 4 has suggested the novel idea that national and individual tax bases can be divorced. By applying a method of subsidiarity, the national liability can be determined according to one formula, but national governments can choose to raise the revenue by other means. There is the
application of the ideas of stochastic dominance to competition between the prize structures of different lotteries (Chapter 10).

12.2 Conclusions: New Sources of Finance

Table 12.1 summarises the main conclusions with regard to the seven proposals for new sources of development finance considered here. In each case, there is a brief description, and a summary of the potential contribution to the funding of 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 (CTT at a wholesale 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 “put sand in the wheels of international finance” have been of the order of 10 or 20 basis points – ten times that considered here. The energy tax considered in Chapter 5 has a rate per metric ton 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 revenue plus improved functioning of the economy – may fall short on the second 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 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. It is of course 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 $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 only to be 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 that would not be otherwise be available. Supporting roles could be played by increased remittances from emigrants, and, on a more modest scale, increase private donations.

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. Measures to Countries signing up to the IFF may implicitly offset this commitment against its 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.

The next box in Table 12.1 summarises the contribution to generating a double dividend. In other words, 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 but 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 $x billion can be said to consist of two parts: the $x 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 revenue is still raised. There are good reasons to expect that the taxes will be passed on to final users. This means in the case of energy taxes that 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, we can regard it as an excise tax on all purchases according to their foreign exchange content. 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 International Finance Facility (IFF) has to be financed, and the future commitments may affect the budgetary position of donor countries. Tax relief for remittances by emigrants have 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 cost.

In considering both double dividends and cost burdens, one important consideration is the impact on the macro economy. It is the specific purpose of some measures, such as the creation of SDRs, to stimulate the world economy. Given that there is 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 macro-economic stimulus. In the opposite direction, a significant increase in funding for development may run into the absorption, or transfer, problems considered in Chapters 2 and 8. We have not attempted here to assess these macro-economic arguments. However, a fifth 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 fourth line in Table 12.1 identifies the main disadvantages of the different proposals. One common element is, sixth conclusion, the fact that we have only limited understanding of the economic impact of the different proposals, which is of course highly relevant to judging their final cost, as noted above. The final incidence of a global tax, such as the carbon tax, depends on the responses of firms and households that determine the ultimate general equilibrium. We can only guess that the impact of a currency transactions tax will be larger in countries more engaged in international trade. Views about the macro-economic impact of SDR creation depend on how one believes that the world economy operates. We know relatively little about the impact of remittances from migrant workers. We know little about what influences the destination of private giving.
In considering the disadvantages, we need to bear in mind that we are comparing alternative ways of increasing development funding. Take, for example, the argument that the burden of a Global Lottery falls on low-income groups (discussed in Chapters 2 and 10). If the choice is a Global Lottery or nothing, then it seems likely that the recipients of the benefits from Global Lottery funding have lower incomes than the poor in rich countries who play the lottery. If, however, the alternative is increased ODA financed by higher income taxation, then the distributional argument does not favour the Lottery.

The final line in Table 12.1 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. How can they be made more compelling? In this book, we have identified a number of routes by which the design can be refined. In the case of the Global Lottery, 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.

Overcoming the obstacles is in part a matter for political action. In the next section, we consider the possible role of different actors.

12.3 The Way Forward

How can we achieve the target level of an annual increase of $50 billion in resources for development? The first point to be made is that the increase could quite realistically be achieved via official development assistance (ODA). Viewed in relation to previous aid achievements and aspirations, the $50 billion increase seems quite feasible. If donors were to raise their ODA to 0.5 percent of GNP, then the $50
billion additional ODA would have been realised. Nor is an increase of ODA by existing donors the only route by which ODA could be increased. The world distribution of income is changing. The growth of middle-income countries means that they can be expected to come into the equation.

The funding of the MDGs could be achieved solely by increasing ODA. At the same time, it would require a step change from the present, going considerably beyond what has so far been promised. This is not going to be achieved overnight. The widening of the circle of aid donors is equally going to take time. Time is however of the essence. For this reason alone, it may be necessary to consider new sources. It may indeed be that consideration of negative aspects of alternatives may lead donor countries to be more willing to make the step change in ODA.

In this book we have considered seven such sources. While a carbon tax on its own might be sufficient to raise the required funds, this is not true of the other proposals and it is likely that any programme will consist of a package of measures. Such a package could be constructed by the UN and other international agencies, which would monitor its introduction. The enactment of the package would however involve a large cast of actors. Indeed, it is important from the standpoint of democratic accountability that there should be the widest possible engagement.

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 globalisation 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 the key actors. 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 making contributions to Home Town Associations (Chapter 11) that are funding 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 national 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, (probably) the Tobin Tax (for example enacted by the euro-zone), 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, as stressed at the outset, we do not believe that this is the only important aspect. Within the context of the proposals considered here, there is much that developing countries can do to facilitate their effective enactment and to take forward the necessary dialogue.

To sum up, the $50 billion that we have taken as the necessary annual flow of additional funding to fulfil the Millennium Development Goals, could be achieved by

Any one of
• Agreement by a sufficient number of major donors to increase their ODA, possibly via the International Finance Facility;
• Enactment by all major economies of a global tax on carbon use.

A combination of scaled down versions of the above and/or a combination of
• Agreement by the US and other major economies to create additional SDRs and transfer for development purposes;
• Enactment of a Tobin Tax of 2 basis points by a significant subset of economies (such as the euro zone);
• Establishment of a Global Lottery in agreement with national lotteries;
• Issue of a Global Premium Bond;

A significant supporting role can be played by
• Measures to increase flows of remittances from emigrant workers for development purposes;
• Measures to increase private donations for development.
Table 12.1  New Sources of Development Funding: Summary of Conclusions

<table>
<thead>
<tr>
<th>Source:</th>
<th>Global environmental taxes</th>
<th>Currency Transactions Tax (“Tobin tax”)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Brief Description</strong></td>
<td>Tax on goods generating environmental externalities, with specific reference to a tax on use of hydrocarbon fuels according to their carbon content.</td>
<td>Tax on foreign currency transactions, covering a range of transactions (spot, forward, future, swaps and other derivatives).</td>
</tr>
<tr>
<td><strong>Potential to Fund Development?</strong></td>
<td>Tax on high-income countries alone could raise revenue of $50 billion. Tax rates required are order of magnitude smaller than those considered in proposals to halt global warming.</td>
<td>Tax could generate at a minimum $15-28 billion for global public use. Tax rate considerably smaller than those considered in proposals to reduce exchange rate volatility.</td>
</tr>
<tr>
<td><strong>Double Dividend and Cost?</strong></td>
<td>Environmental gain as well as revenue. Tax borne according to final energy use.</td>
<td>Reduces foreign exchange speculation. Tax passed on to final users.</td>
</tr>
<tr>
<td><strong>Disadvantages</strong></td>
<td>Distributional effect on households within high-income countries needs to be offset. Administrative cost of operating global tax.</td>
<td>Final distributional effect and impact on real transactions hard to predict. Administrative cost of operating global tax.</td>
</tr>
<tr>
<td><strong>Main obstacles</strong></td>
<td>Requires general agreement of high-income countries. Account has to be taken of existing national taxes.</td>
<td>Requires agreement of major subset of high-income countries.</td>
</tr>
<tr>
<td><strong>Creation of new Special Drawing Rights (SDRs)</strong></td>
<td><strong>International Finance Facility (IFF)</strong></td>
<td><strong>Increased private donations for development</strong></td>
</tr>
<tr>
<td>-----------------------------------------------</td>
<td>-------------------------------------------</td>
<td>------------------------------------------------</td>
</tr>
<tr>
<td>Creation of SDRs for development purposes, with donor countries making their SDR allocation available to fund development.</td>
<td>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.</td>
<td>Charitable donations by private individuals and firms. Measures to encourage private funding of development: tax incentives, Global funds, corporate giving, and the Internet.</td>
</tr>
</tbody>
</table>

**Potential to Fund Development?**
Allocation of $25-$30 billion could make significant contribution, but depends on frequency.

If introduced as planned could achieve flow of $50 billion for 2010-2015, building up from 2006 and falling to zero by 2020. Provides predictable and stable flows with agreed disbursement mechanism.

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.

**Double Dividend and Cost?**
Could have positive effect on the global macro-economy.

Could have positive effect on the global macro-economy.

Giving benefits both donors and recipients.

**Disadvantages**
Impact on world economy not clear.

Cost of negotiation and administration of new organisation. Difficult to ensure additionality. Administrative cost of establishing new institution.

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.

**Obstacles**
Has to be ratified by 100 members with 85% of voting power.

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.

Primarily *individual* action, but *national governments* can stimulate by income tax deduction. Link with use of funds important.
<table>
<thead>
<tr>
<th>Increased remittances from emigrants</th>
<th>Global Lottery</th>
<th>Global Premium Bond</th>
</tr>
</thead>
<tbody>
<tr>
<td>Logistics (reducing cost of remittances), financial institutions (encouraging repatriation) and legal (regularising the status of migrants).</td>
<td>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.</td>
<td>Global premium bond, parallel to national bonds with lottery prizes in place of interest; capital value preserved.</td>
</tr>
</tbody>
</table>

**Potential to Fund Development?**
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.

| | Hard to estimate but could reach $6 billion a year. | Provides loan finance, volume hard to estimate. |

**Double Dividend and Cost?**
Transfer benefits both donors and recipients.

| | ~. | ~. |

**Disadvantages**
Link to development uncertain.

| | Ethical issues. Distributional burden borne by lower income groups, including low-income countries. | Crowding out of other government debt. Administrative cost. |

**Obstacles**
May run into money laundering and counter-terrorism legislation.

| | Competition with national lotteries. | Competition with other borrowing. |