NEW SOURCES OF DEVELOPMENT FINANCE: 
An Annotated Conference Report * 
by 
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Doubling ODA or Finding New Sources of Finance

The need for additional development funding, if the Millennium Development Goals (MDGs) are to be achieved by 2015, is widely recognised. The figure of additional US$50bn per year, roughly the present total of ODA spent by DAC donors, is often quoted (e.g. Zedillo Report); its estimate is of back-of-the-envelope nature, but it seems to be the minimum estimate. If governments exclude the option to abandon the MDGs, they have either to double the existing ODA or to find alternative sources of comparable magnitude – or a balance of the two. The challenge to the international community is mounting by the day...

Hence, the focus of the WIDER conference ‘Sharing Global Prosperity’, held in Helsinki 5-7 September 2003, was rightly on development finance. The meeting was part of a research project on Innovative Sources for Development Finance, funded by the UN Department of Economic and Social Affairs and UNU/Wider, that aimed to look at the policy options to finance the MDGs. As a result of the Five Year Review of the World Summit for Social Development, the UN General Assembly had called 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”. And “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 finance”. (Atkinson, 2003).

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1 These Goals are 1: Eradicate extreme poverty and hunger; 2: Achieve universal primary education; 3: Promote gender equality and empower women; 4: Reduce child mortality; 5: Improve maternal health; 6: Combat HIV/AIDS, malaria and other diseases; 7: Ensure environmental sustainability; 8: Develop a global partnership for development. For each of these goals, targets and indicators have been defined. For details, see www.unmillenniumproject.org.

2 If results are the sum of the fight against communicable diseases (US$ 7-10bn), primary schooling (10bn), infant and maternal mortality (12bn) and halving world poverty (20bn).

Anthony Atkinson, who chaired the UN project, presented the overall conclusions. The project had focussed on the role of rich countries and on the sphere of public finances, but urged not to limit perspectives to a resource transfer from rich to poor countries. Rather, options should also consider income redistribution and tax efforts in China, India and other poor countries to co-finance the MDGs. The UN research project concluded that the additional US$ 50bn could be financed by any or a combination of the following proposals:

- agreement by a sufficient number of DAC donors to increase their ODA, possibly via the International Finance Facility recently suggested by the UK; if DAC donors were to raise their ODA to 0.5% of their GNP, the amount would already have been realised;

- enactment by all major economies of a global tax on carbon use; tax rates smaller than those considered in proposals to halt global warming would raise revenue of US$ 50bn.

- agreement by the US and other major economies to create additional SDRs for development purposes;

- enactment of a currency transaction tax (Tobin tax) of the order of 2 basis points (0.02%) by a significant subset of economies, such as the Euro zone;

- establishment of a Global Lottery in agreement with national lotteries; and issue of a Global Premium Bond (a savings instrument with a lottery ticket), along the lines practised in Bangladesh, Ireland and the UK.

- measures to increase flows of remittances by immigrant workers for development purposes;

- measures to increase private donations for development.

It is evident that there exist additional options not considered in the UN project. A number of other global taxes have been suggested, such as a brain drain tax, an international airport tax, taxation of ocean fishing, taxation of arms exports, a ‘bit’ tax on computer use, or a luxury goods tax. Rightly, the research team led by Prof. Atkinson had not felt constrained by the degree of political obstacles to the various options to finance the MDGs. It was argued that it is the role of economists to lay out the options, their costs and
their benefits; it is upon policymakers to make the respective choices\textsuperscript{4}. Which criteria should govern those choices? One can think of many other (such as administrative feasibility), but in the context of the MDGs the revenue potential, the additionality of new finance sources, their external benefits and efficiency cost, and the incidence of the financing burden should be of particular importance:

- Given the urgent need for additional development finance in view of the 2015 deadline, the revenue potential of the various financing options is of utmost importance. In particular, it has to explored to what extent any new sources are truly additional to existing development finance or whether these new sources would merely offset such finance. As additional finance for development can be achieved either through higher ODA or through new sources of finance, the balance between the two will determine the incidence of the burden in rich countries and the political resistance to financing proposals.

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

Table 1 provides an overview for those innovative funding sources which the UN project has highlighted. Arguably, the inclusion of “Increased Remittances” by the UN research defies logic. First, this is not a capital flow; second, it is a flow from nationals of poor, not rich, countries. On the other hand, the Table excludes a couple of other innovative financing sources, including those practiced within the UN system (such as the UNDCP, the UN Drug Control Program, which is partly financed by seizure and forfeiting of drug-related assets), or Global Funds such as the Global Environment Fund or the Fund Against Aids, Tuberculosis, and Malaria (on which see text below).

\textsuperscript{4} Arguably, the economists’ role is too narrowly conceived. A full policy analysis should include examine administrative, if not political, feasibility as well. See, e.g. the Sagasti and Bezanson (2001) study for Sweden’s Ministry of Foreign Affairs.
Global Environmental Taxes

As argued convincingly by Prof. Agnar Sandmo (Norwegian School of Economics and Business Administration) in his paper, the economic case for global environmental taxes, primarily to control climate externalities, is very strong. A system of global pollution taxes could generate a triple dividend: a better global environment, a second dividend as the environmental tax implies no efficiency loss nor a burden on employment (as do other forms of taxes that can be reduced accordingly), and resources for world development.

While there is widespread pessimism concerning the political realism of introducing such taxes, earmarking the revenues for development may actually enhance their political acceptability. Further, the revenue potential appears to be large as tax on carbon dioxide emissions, through taxing fuel consumption, could alone finance the MDGs. Calculations in Clunies-Ross (2003) show that a uniform tax of roughly 0.01 EUR per litre (US$ 0.048 per US gallon) would correspond to a tax of approximately US$ 21 per metric ton of carbon, yielding annual revenue of US$ 130bn per year.

Several institutional arrangements might be considered for collecting the tax and spending the revenue. It might be considered to put a new international agency in charge of collecting revenues or, alternatively, change the Kyoto Protocol in view of funding the MDGs. Cost advantages and the problem of ‘leaky buckets’ presumably militate in favour of national tax collection. Taxes in each individual country (that is party to an international MDG treaty) would have to be collected by the national tax authorities and paid by it to an international agency, which in turn passes the revenue on to institutions that are in charge of allocating resources to development projects.

Currency Transaction Taxes

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

Machiko Nissanke (2003) estimates the revenue generated at US$ 17-19bn for a tax rate of 0.01% on a worldwide level, and at US$ 31-33bn for a rate at 0.02% as suggested in the options menu by the Atkinson team\(^5\). Even such a low tax rate would double the spread currently experienced in US$/EUR transaction. Kenen (1996) and Reisen (2002) have pointed to problems that may negate the estimated revenue potential and the double dividend of a global tax on currency transactions; these problems arise from

- the recently observed shrinking of the tax base (the introduction of the euro -12 currencies becoming one-, the growing share of electronic broking in the spot interbank market and consolidation in the banking industry appear to explain this fall),
- the importance of hedging activities in the foreign exchange market so that a tax would actually lead to more rather than less volatility across key currencies,
- tax avoidance through migration of the FX market to tax-free jurisdictions and substitution of tax-free for taxable transactions.

It is thus fair to say that taxes on currency transactions are much more controversial than global environmental taxes; whence they were not recommended by the Zedillo Report.

**The International Finance Facility (IFF)**

The IFF – a joint UK Treasure/DFID proposal to increase development aid, published in January 2003, aims at bridging the gap between the resources that have already been pledged and what is needed to meet the MDGs by 2015\(^6\). The Facility would be built on long-term donor commitments, comprising a series of

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

\(^6\) At the International Conference on Financing for Development donors pledged to increase aid so as to help achieve the MDGs and eradicate poverty. Since the conference, a number of DAC Members have made further announcements of increases to their development co-operation budgets. The OECD Secretariat estimates that fulfilling these commitments and plans would raise ODA in real terms by 31% - about USD 16 billion - by 2006. This
pledges (each of them lasting 15 years) by donors for a flow of annual payments to the IFF. Each pledge would be a binding commitment, subject to high-level financing conditionality exerted by donors on the recipients. On the back of these pledges, the IFF would issue bonds in its own name. The Facility would thus frontload long-term aid flows so that the MDGs can be financed and reached by 2015. The IFF would thus serve the function of a temporary finance facility; it would be replenished at regular intervals, and at each replenishment donors would make a fresh series of annual long-term funding pledges (each lasting 15 years) as the basis for further borrowing; after raising and disbursing funds for 15 years, the repayment phase would continue for another 15 years after which the Facility would be wound up.

In his comment, George Mavrotas (2003) of WIDER questioned the assumptions (on which the IFF is built) (a) about continuous commitment on behalf of the donor community towards the implementation of the IFF during the life of the Facility, and (b) its heavy reliance on political co-ordination among donor countries. Teresa Ter-Minassian, the Director of the IMF Fiscal Affairs Department, argued that the proposal failed to clarify the disbursement criteria and priorities; further, the Facility might lead to a significant drop in development finance after its existence.

A Development-Focused Allocation of SDRs

The idea to issue Special Drawing Rights (SDRs) for development purposes is as old as unsuccessful – at least going back to the 1970 Brandt Commission’s report; it has recently been revived by George Soros (2002)7. Mrs. Ter-Minassian highlighted the following difficulties associated with the Soros proposal:

- linking SDR allocation to finance the MDGs requires a change in the Articles of Agreement of the IMF, has to be ratified by 100 IMF Member countries with 85% of voting power, and has so far never happened;

would raise the ODA/GNI ratio from 0.22% in 2001 to 0.26% in 2006 (see DCD/DAC (2003)8, ODA Prospects after Monterrey: Update, 9. April 2003.

7 Ariel Buira, formerly Deputy Governor of the Central Bank of Mexico and currently Director of the G24 Secretariat, had advanced a similar proposal at the International Conference on Financing for Development in Monterrey, with the aim to use SDR allocation as a counter-cyclical policy (Buira, 2002).
redistribution of SDRs involves lost interest income to the SDR provider; the SDR rate of interest is the weighted average of the short-term Treasury bill rates of France, Germany, Japan, the United Kingdom, and the United States (currently 2.25 percent a year).

In the past, even modest allocations of SDRs have been opposed on the grounds that they would be inflationary. Today, in the face of a widespread recession, excessive foreign exchange holdings by emerging markets for fear of financial crises, and the need to expand liquidity to support the expansion of international trade, this argument would be harder to make.

**Global Lottery and Global Premium Bonds**

Nobel Prize winner James Mirrlees qualified in his speech on global public economics at the end of the conference global lotteries as the only possibility of a profitable supranational authority. Proposals to establish a global lottery to fund UN development activities have circulated since the early 1970s. According to www.lotteryinside.com, the world gaming industry news site, the total size of world lottery sales was US$ 126bn in 2001 (Addison and Chowdhury, 2003); 2001 global lottery gross profit was US$ 62bn. How much of this could contribute to fund the MDGs, would depend on the amount generated by new players (such as from ‘development altruists’), on substitution away from other forms of gambling, and on the amount a global lottery would capture from existing lotteries.

A global lottery could function in two ways. The first is for national lotteries to run national versions of the global-lottery game. The second is a single global lottery sold worldwide and run by one organisation. Instant products such as ticket lotteries (‘scratch cards’) and video lottery terminals require less organisational infrastructure than number games, whence they are a preferred option for MDG funding. Global lotteries may face political opposition if it is seen to take money away from national charities (Andersson, 2003). Moreover, the incidence of lottery funding may be regressive; low-income groups spend a higher proportion of their income on lotteries than higher-income groups (the better-off gamble on the stock markets…). Another objection may be that gambling is not universally practised for religious or ethical considerations.

A related, but new, funding idea is being promoted by Tony Addison of WIDER. He and his co-author (Addison and Chowdhury, 2003) suggest a global premium savings bond, modelled on similar schemes
currently practised in the UK, Ireland and Bangladesh. The authors suggest a single organisation to sell and administer the bonds; the bond itself is a savings instrument, but the rate of return has a random element. In the UK, for example, people buy savings bonds, each with a unique number that is entered every month in a prize draw where a random number generator (ERNIE) picks the winners. Unlike for pure lotteries, investors in a global premium savings bond never lose their investment but the return on that investment depends on luck. The authors hope that such bonds might meet strong demand in the growing market for ethical investment.

**Multisectoral Global Funds**

Jeremy Heimans (2003) presented an interesting piece on Multisectoral Global Funds – such as the Global Fund for AIDS, Tuberculosis and Malaria or the Global Environment Facility. These funds are administered and financed by multi-actor coalitions of governments, international organisations, the private sector and civil society. The advantages of such funds are that they can serve as focal points for generating additional public and private resources to address urgent global problems. Nevertheless, they may also result in a less coherent response to global problems, duplicate existing structures and be weak in terms of democratic accountability.

Charitable donations by private individuals, both small-scale donors and the super-rich, and by firms can help fund the MDGs. Private donations are most popular in the United States, where they have hovered around 2 percent of Gross National Product during the last two decades (in 2002, US GNP was around US$11trn; hence the sum of private donations was US$ 220bn). However, there seems to be no safe avenue to raise the extent to which the finance of MDGs could benefit from philanthropic efforts (Micklewright and Wright, 2003). It is fair to say that further research is required here, and that the UN project has not advanced on that very issue.

**Aid Allocation and Global Public Goods**

The scarcity of public resources in donor countries and the rapidly approaching deadline of 2015 for the MDGs raise important issues for the principles of aid allocation. Work at the OECD Development Centre (Reisen, Soto, Weithoener, 2003) has addressed some of these issues.
First, should aid be partly earmarked towards international public goods, in view of the evidence (advanced by DFID) that the cost of lifting one person out of poverty is estimated to be much lower for global public goods (such as agricultural research) than the cost of the same impact through traditional aid to poor countries? Yes: a highly stylised model of public goods shows that if ODA is used by developing countries at will they would prefer to use it on local goods. Poor countries may derive relatively less utility from the provision of global public goods (and relatively more from spending ODA on local goods) than donors. Hence, global public goods might be under produced.

Second, what is the impact on aid to the poorest countries and on traditional aid projects if ODA is allocated to the provision of international public goods? The two concerns, namely that more ODA spending on global public goods might benefit the relatively better-off developing countries to the detriment of the poorest countries and that traditional aid projects might be crowded out, have limited the financing of global public goods through ODA (DFID, 2003). Research at the Development Centre finds some evidence of crowding out, insignificant though in the case of crowding out of aid to the poorest countries, and significant in the case of traditional aid, with an offset coefficient of 25%.
<table>
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<th>Source</th>
<th>Global “Dirt” Tax</th>
<th>Tobin Tax</th>
<th>Creation of SDR</th>
<th>International Finance Facility</th>
<th>Global Lottery and Premium Bonds</th>
<th>Increased Remittances</th>
<th>Increased Private Donations</th>
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<tr>
<td>Brief Description</td>
<td>Specific reference to a tax on use of hydrocarbon fuels according to carbon content.</td>
<td>Tax on foreign currency transactions (spot, forward, future and swap markets), possibly with dual rates (Spahn tax).</td>
<td>Periodic creation of SDRs, with donor countries making their SDR allocation available for MDGs (Soros Proposal)</td>
<td>Long-term pledges of a flow of annual donor funding would leverage more funds from private sources (UK Treasury/DFID) through bond issues</td>
<td>Lottery proceeds to be shared between national lotteries and UN fund; bond issue with lottery prizes instead of interest; capital value preserved</td>
<td>Logistics, financial institutions and legal incentives to raise remittances</td>
<td>Tax incentives, Global Funds, corporate giving, Internet measures to raise charitable donations</td>
</tr>
<tr>
<td>Revenue Potential</td>
<td>A uniform gasoline tax of 0.01€ per litre (.048$ per gallon) yields US$180bn per year if imposed worldwide. Limited to imposition in high-income countries, figure drops to US$61bn.</td>
<td>A tax equivalent to 0.01% yields 17-19bn US$: Higher tax rates yield less as tax base shrinks.</td>
<td>Depends on periodicity and political willingness. Annual allocation of SDR to poor countries could free US$25bn.</td>
<td>Could achieve annual flows of US$50bn for 2010-2015, building up from 2006 and falling to zero by 2020. Provides predictable flows with agreed disbursement mechanism.</td>
<td>No estimates so far. Lottery could reach US$6bn per year</td>
<td>Not applicable.</td>
<td>Total charitable giving sizeable, e.g. 1.5% of GNP in the US, Revenue potential large; depends on degree of giving for development rather than other purposes, and on tax (income, inheritance) incentives.</td>
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<tr>
<td>Degree of additonality to traditional development finance</td>
<td>High, but important administrative costs involved. National taxes may be affected, hence the public budget</td>
<td>High, but important administrative structure costs involved.</td>
<td>Can crowd out traditional development finance</td>
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<td>High</td>
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<tr>
<td>Other Benefits</td>
<td>Environmental, and allocational as external cost of final energy uses internalised</td>
<td>Reduces foreign exchange volatility (?)</td>
<td>Counteracts deflationary pressures that arise for excessive FX holdings of crisis-prone countries.</td>
<td>Could raise credibility of donors’ commitments</td>
<td>--</td>
<td>Investments, know-how, market access</td>
<td>--</td>
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<tr>
<td>Major costs and obstacles</td>
<td>The US and other countries could resist carbon taxes.</td>
<td>Mobile tax base, -- tax may destabilize exchange rates</td>
<td>Could be inflationary. Hard to ratify by 100 IMF members with 85% of voting power.</td>
<td>Requires sufficient donor countries to sign up, and to continue to make commitments.</td>
<td>Competition with national lotteries.</td>
<td>Problems with money laundering and financing of terrorism.</td>
<td>Unpredictability, as dependent on individual, voluntary, action.</td>
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