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Les nouvelles contributions financières internationales

GROUPE DE TRAVAIL
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« **New International Financial Contributions for Development** »

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**groupe de travail
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internationales**

EXECUTIVE SUMMARY

This report was commissioned in November 2003 by President Chirac to a group of independent personalities with different backgrounds and representing a wide range of opinions. Members of the group participated in their personal capacity. The views expressed do not reflect those of the institutions, organizations or companies to which they belong. While none of the group members disagrees with the general thrust and approach of the report, none would, either, fully support or endorse each and every specific reflection or recommendation.

Globalization creates tremendous prosperity. There are strong moral and social justifications to allocate part of that wealth to the fight against poverty and inequality.

Yet this moral and political imperative does not translate easily nor automatically into new financial contributions. The idea itself is very controversial, at least in its most extreme manifestation, that of international taxation.

The legitimacy of international taxation is open to question. There is no such thing as a world parliament to decide and vote on global taxes. From a democratic and legal standpoint, new contributions would require the consent of nation states and by extension, of their citizens. Such consent does not exist today. On the contrary, opposition runs deep in many countries to the principle of international taxation. Motivating the opposition is the fact that national sovereignty is viewed as untouchable, especially in matters of taxation,.

There is also much skepticism, in some countries or parts of world opinion, as to the benefits of development aid. This report does not share that skepticism. Ultimately, all developing countries, including the poorest ones, must aim at achieving -through economic growth- successful integration into the world economy. But growth is impossible without a minimum level of infrastructure and income, and access to health and education. Otherwise, there is no capital accumulation and the poor are left exposed to economic shocks they are not equipped to withstand. Growth is necessary for poverty reduction. But poverty itself may be an obstacle to growth. Aid therefore becomes absolutely necessary to break this reciprocal causality.

Finally, even some of the most sincere and committed people in the development community have their doubts, wondering whether greater priority should be given to increasing national aid budgets to 0.7% of GDP (an objective to which France is committed). They tend to see the search for innovative mechanisms as a diversion, or escape route used by developed countries to avoid fulfilling their obligations and meeting their commitments.

This is a legitimate concern, and is addressed in the first part of the report. It shows why and how new contributions are necessary together with and in addition to existing forms of development aid. Potential economic, legal and financial approaches to an international taxation for development are discussed in the second part. Finally, some technical options for voluntary or compulsory contributions are examined in the third part.

more and better funding for development

It is well known that official aid would have to double, increasing by at least \$50 billion a year, in order to achieve the Millennium Development Goals (MDGs). What is less known is that: less than \$3 bn a year for 10 years would be sufficient to give every single child in Sub Saharan Africa access to primary education; \$2bn annually would finance basic medical research on those pandemics (AIDS, tuberculosis, malaria) specifically affecting developing countries; and \$1 bn a year one could provide the resources needed to perform the ten basic surgical procedures needed all over the world.

These are very small amounts of money when measured on a global scale. And these are priorities that nobody would challenge. Yet, the financing fails to materialize.

This is difficult to explain by a decline in the generosity and altruism in developed countries. Official Development Aid (ODA), which had been decreasing for most of the last decade, has recently picked up and is on an increasing trend. Private foundations, whose interventions were traditionally domestic-oriented, are now diversifying and increasingly supporting international causes.

One therefore has to conclude that the problem is systemic. The procedures for deciding and allocating aid flows are based on permanent negotiations between donors whose strategies change according to their priorities, their (legitimate) foreign and development policy objectives, and whose budgets are decided, for the most part, on an annual basis.

Such a process is bound to produce suboptimal results:

- *insufficient resources* because each donor has built-in incentives to finance its own priorities first, and then to free ride on other countries contributions to finance common objectives
- *high negotiation and transaction costs*, both for donors (in time and resources spent in reaching compromises) and recipients (who find it increasingly difficult to grapple with the system's complexity and uncertainties)
- *aid is inadequate and inappropriate in form*; only one third of disbursements currently go to fighting poverty; grants are insufficient; less than 50% of aid actually translates into cash transfers to developing countries.
- *aid is both volatile* (four times more volatile on average than recipients' GDP) *and unpredictable*. Far from helping countries to cushion economic shocks, it is often an additional source of instability.

What is necessary then is continuity in donors commitments over the long run: first, because human development and the fight against poverty are mainly based on recurrent expenditures in basic social services; second, in order to ensure adequate financing for those public goods especially necessary to poor countries such as medical research on pandemics which particularly affect developing countries.

One crucial element is currently missing in the present development system: a resource that is both totally concessional and predictable. In order to produce such a

resource, new multilateral (and more automatic) financing mechanisms are necessary.

New international financial contributions

One such mechanism would be the International Finance Facility (IFF), which has been proposed by the British government and is supported by France. The objective is to frontload the disbursement of expected future increases in ODA. The IFF would issue bonds on financial markets, backed by pledges from participating governments. It would produce a stable resource, whose availability would not be dependant on the time schedule of donors' budgetary contributions. It would be flexible and could be implemented, if necessary, on a regional basis or with a limited number of participating countries. However, as with any borrowing mechanism, the final burden would be shouldered by future generations, with no guarantee as to the return on expenditures that would be financed this way. There is thus a central question regarding what happens after 2015, when a significant part of ODA expenditures, in developed countries, would be devoted to IFF repayments rather than being transferred to developing countries. And yet, many such countries, especially in Sub Saharan Africa, will still need aid. For those countries, frontloading aid entails a significant risk if, in the meantime, other stable sources of finance have not been created.

Another possible mechanism: international taxation.

International taxation can only result from a decision by nation states to cooperate, since they – and only they- have the power to tax. It means that this power, which is a basic attribute of sovereignty, is subordinated to an international common objective. This can only be achieved when there is a high degree of convergence between those objectives. International taxation may therefore prove difficult to negotiate and agree upon.

Once created however, it would deliver the precise kind of resource needed to finance human development, one which is both totally predictable and concessional. It would put the financing of poverty reduction on a sound and stable basis and would protect it from the vagaries of politics and the uncertainties of international

cooperation. It would ensure stable and predictable aid flows, even in the long run. It would dispense from the difficult yearly negotiations and would solve, once and for all, the burden sharing problem. Finally, it would not increase the financial burden on future generations.

Contrary to widespread perception, no new institutional arrangement or international organization is necessary. International taxes can be created for a limited period of time. They can initially aim at financing only core programs, those that need stable and predictable resources most. Even small amounts, at the start, would make a difference by increasing the return on other aid flows and creating an environment which would increase their overall efficiency.

The IFF and international taxes have strong complementarities: one mechanism or the other may be more appropriate according to the time horizon or the type of expenditure. They can be combined in an integrated approach to human development finance, encompassing both the medium and long run.

consequences for the development aid system

Once a predictable and concessional resource is created, three issues would have to be addressed:

- **additionality.** New resources would have to be truly additional and not simply substitute existing aid flows. It may be necessary to establish a more direct and visible link between the new sources of finance and the programs to which they are allocated. One question to be considered is how to organize and manage financial channels so as to make this kind of earmarking compatible with good fiscal management
- **conditionality.** It is a condition for efficiency. It may also be a source of excessive volatility when resulting from changes in donors' priorities and preferences. Forms of conditionality adapted to a stable financing of human development would have to be defined and devised.

- governance. The management of any new stable resource would have to be discussed in order to define the role and interaction of all potential participants : IFIs, global funds and civil society (NGOs and private sector)

which international tax system ?

efficiency, justice, equity

All tax systems are based on a trade-off between efficiency and equity. Similarly, international taxes could be created with different objectives such as: correcting international externalities (as with environmental taxes); moralizing international transactions (which would be the purpose of a tax on arms sales); redistributing income and reducing inequalities (something that all national tax systems do to varying degrees); and finally, financing public expenditures decided with a common purpose.

Here, the report makes choices and defines priorities. At this stage, the aim of international taxation should be to raise the necessary resources in order to achieve the MDGs. At the world level, there is no democratic process to determine what the extent of income redistribution should be. But there is a universally accepted goal in terms of poverty reduction. The international community has decided to focus on the situation of the poorest people, not on the gap between different levels of income around the world. This approach is based on well established philosophical and ethical premises and best legitimises international taxation.

International taxes should therefore be devised first and foremost according to their financing potential.

Once this priority is met, however, other objectives can and should be pursued.

First, economic efficiency. International taxes can improve development financing by reducing the distortions normally associated with any taxation. Corrective taxes, such as environmental taxes, do not create any new economic distortions, and actually eliminate some. Equally, taxes levied at a very low rate on internationally mobile tax

bases may be less distortionary than an increase in national taxes, whose rates are already much higher. In both cases, however, it may be impossible to create such taxes without strong international cooperation.

Second, solidarity. New international contributions would encompass a broader aspiration of greater global stability, more security and more justice in global development. They should not result in new burdens or handicaps for poor countries. New contributions should never be regressive but rather neutral or progressive.

architecture

Once the decision is made to finance development through more automatic mechanisms, several options are available to the participating countries. They can be combined into a wide array of different formulas:

- the mechanism can be legally binding to a greater or lesser extent. It could be: a simple statement of intentions to contribute according to specified criteria; a system of contributions akin to those made to international organisations, paid out of national budgets with countries, in effect “taxing themselves” (a tax on arms would be very close to such a scheme, with countries contributing in proportion to their military expenditures)
- financial flows could transit through national budgets where they would be treated either as expenditures (as VAT contributions by member states to the EU budget) or a deduction on receipts (as own resource contributions to the EC budget). Alternatively, as was the case for ECSC and still is for the Universal Postal Union, financial flows could bypass national budgets and go directly to the recipient institution.
- above all, choices would have to be made as to the underlying political and fiscal approach. Several such approaches are described in the report:
 - enhancing voluntary contributions through tax incentives in a coordinated way across donor countries;

- contributions in addition to existing taxes (which would replicate a GDP based contribution, as corrected by existing differences in tax bases);
- creating new international taxes levied, either on internationally mobile tax bases (which cannot be taxed by any country acting on its own), or on “global common goods” whose value cannot legally or practically be appropriated by any individual nation (global environmental taxes can be included in this category).

global or regional taxes ?

Universal consensus on international taxation might prove difficult to achieve in the immediate future. Is there then, a possibility to create regional taxes? This question is especially important for those who would like to see the European Union expanding its role in development assistance. There would be obvious adverse consequences for the competitiveness of participating countries and important risks of evasion. But it might be useful to start a process which could later lead to broader acceptance and participation. Both sides of the argument can be made with equal force. Clearly, some taxes would more easily applicable in a regional framework than others. Countries that would decide to implement such regional taxes should also ensure (in the allocation and management of the resources) that sufficient incentives exist for others to join in.

orientations

Possible contribution instruments and mechanisms are described and discussed in the final chapter of the report. They have been selected according to a common set of characteristics: all are technically feasible; all yield significant, stable and permanent resources to finance the MDGs ; all are economically rational since they have been constructed so as to minimize new distortions, or eliminate existing ones ; none (except an arms tax) would be levied on developing countries ; none could be made to work without strong international cooperation (thus providing a justification for allocating their proceeds to development).

Instruments discussed include:

- Environmental taxes. Long-term prospects for a carbon tax are examined. In the short run, it is suggested to focus the reflection and debate on sectors not covered by the Kyoto Protocol and currently not subject to taxation, such as maritime and air transport.
- Taxes on financial transactions (with a special case on foreign exchange transaction taxes). They are not considered in the report for their anti-speculative properties but purely as revenue raising instruments. Consequently, the rates would be set very low so as to minimize or eliminate any adverse impact on market efficiency. The report concludes that (1) such taxes are technically feasible ; (2) their “economic cost” is limited (3) all major financial centres should participate in order to avoid large scale evasion (but not necessarily every single country in the world) (4) market making and very short term transactions would have to be exempted since they carry very low profit margins and could not bear the burden of any tax ; and, as a consequence (5) revenues raised would be significantly lower than currently expected, but nevertheless quite significant.
- a surtax on the profits of multinationals could be seen as a normal counterpart to the benefits they derive from globalisation (although inter-country differences in the definition of tax bases would make such a contribution rather arbitrary in terms of burden sharing)
- a tax on arms would have to be levied on all purchases -whether domestic or international – and implemented by all producing countries in the world to be morally significant and economically non-distortionary.
- voluntary contribution schemes could be proposed or encouraged by associating voluntary donations with credit card purchases, utility bill payments or when filing tax returns. Such schemes might be more appropriate than taxes when addressing households, even if they do not deliver as stable a resource as other contribution forms.

- finally, the use of Special Drawing Rights (SDRs) and the creation of a Global Lottery for development purposes are examined.

conclusion

Overall, the report concludes that there is a gap in the financing of MDGs ; that the search for innovative forms of financing is justified, in a spirit of solidarity; and that technical solutions are available which combine moral generosity and economic efficiency.

It was not in the group's remit to choose between different possible solutions. The report does not make any specific recommendation. But some principles, which could help make progress on the political front are enumerated in the conclusion. New financial contributions, if created, must find in themselves their own justification and meet with maximum acceptance.

This means:

- universal consensus on goals, which should be seen as absolutely legitimate by the whole international community
- programs with high visibility, and whose impact must be proven and easily measurable
- economic efficiency, which leads to either corrective taxes or taxes at very low rates and broad bases
- equity in burden sharing
- total transparency in governance and management, both from the point of view of recipients and the international community

