# Innovative Sources of Financing for Development

A Policy Brief to the NGO Committee on Financing for Development

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THE NEW SCHOOL - GRADUATE PROGRAM IN INTERNATIONAL AFFAIRS (GPIA)

## Summary

Innovative Sources of Financing for Development (ISF) can be defined as any progressive idea or mechanism to accumulate funds for socio-economic development aid, aside from or complimentary to Official Development Assistance (ODA) or other traditional methods. This paper highlights several ISF mechanisms that seek to raise funds through taxation and to reduce the debt burden of developing countries. The taxation mechanisms include: 1) Currency Transaction Taxes (CTT) and Financial Taxes (FTT); 2) Carbon Taxes; 3) International Solidarity Levy on Airline Tickets; 4) Arms Trade Taxes; and 5) Tax Cooperation and Competition, Tax Havens and an International Tax Organization. The debt-related mechanisms include: 6) Debt2Health Swaps; 7) Special Drawing Rights (SDR) and 8) IMF Gold Sales. Enhancing funding and resources for aid is essential to reduce world poverty and to secure socio-economic development gains for the future. ISF mechanisms can play an important role in achieving these goals. The NGO Committee on Financing for Development can support progress towards these goals by focusing on appropriate ISF mechanisms in its advocacy efforts. To support the Committee in doing so, this paper analyzes ISF mechanisms, highlights best practices, identifies key stakeholders and provides specific recommendations to support the Committee in its work.

## ISF Mechanisms and Recommendations

### I. Tax-Related ISF

#### a. Currency Transaction Tax (CTT) and the Financial Tax (FTT)

The CTT and FTT are two of the most popular proposed ISF mechanisms. Both envision levying small taxes on the financial sector with the intention of raising significant funds for development. A key challenge in implementing either tax is to convince governments to use revenues raised through these taxes for development instead of allocating them to general revenue. The taxes will have to be designed with a development goal in mind, to allocate at least some part to meeting the MDGs, supplementing ODA commitments, or generally funding development initiatives.

*Recommendations:*

- CTT/FTT can be implemented unilaterally but global cooperation would be more effective
- An international FTT should be implemented with an explicit development component
- Support domestic efforts to implement versions of the FTT building on experiences in various countries
- Support future FTT proposals brought before the G20

#### b. Carbon Tax

Carbon Taxes are an indirect tax on the carbon content of oil, coal and natural gas. The Carbon Tax would have two ostensible goals, to reduce global warming and to raise revenue. It would create incentives to economize on the consumption of fossil fuels, guide producers to less damaging sources of fuels and stimulate scientific research to focus on the problem of saving energy. We advocate for supporting a carbon tax, and as a second-best alternative, to support implementation of cap-and-trade.

*Recommendations:*

- Support a Carbon Tax
  - Where a cap-and trade policy is being implemented:
    - Support a tax on the trade in carbon and related derivatives markets
    - Support derivatives regulation that would require carbon trades to occur on exchanges, not over the counter or through other opaque transactions
    - Support efforts to restrict participants in carbon markets to those with a direct interest in carbon permits, i.e. limit speculation in the carbon markets

### c. International Solidarity Levy on Airline Tickets

The International Solidarity Levy on Airline Tickets is a tax which contributes to development when booking flights. The revenues from the tax are allocated to UNITAID to support its health-related development programs. France and several other nations including Brazil, Chile, the Ivory Coast, France, the Republic of Korea, Madagascar, Mauritius and Niger implemented the tax, and many more have expressed interest in participating. The tax rates vary depending on destination and ticket class. The tax raised €160 million in 2009.[1]

*Recommendations:*

The International Solidarity Levy on Airline Tickets is one of the most successful ISF mechanisms currently funding development work. It is successful because it:

- Provides a significant contribution to development
- Promotes solidarity and a collective effort for nations to work together to make developmental gains
- Is directly aimed at a specific goal of prioritizing public health
- Demonstrates a stable and long-term commitment to development, while supplementing ODA

The International Solidarity Levy on Airline Tickets is an important example of the potential benefits of ISF for development. Advocates should encourage the nations which have expressed interest in participating to adopt it (Congo, Cyprus, Jordan, Luxembourg, Nicaragua and Norway have committed to it but not adopted it, and a great many more have expressed interest).

[1] Leading Group on Innovating Financing for Development. "Globalizing Solidarity: The Case for Financial Levies: Report to the Committee of Experts to the Taskforce on International Financial Transactions and Development." 2010. <http://www.leadinggroup.org/IMG/pdf_Financement_innovants_web_def.pdf>. Accessed November 16, 2010.

## d. Arms Trade Tax

International arms trade taxes to provide funding for international development aid have been under discussion for at least 30 years, beginning with the report of the Brandt Commission. While the ideas expressed in that report were supported by several governments and NGOs, there was also substantial resistance and over time the issue has lost steam. Reaching international agreement on the implementation of an arms tax seems highly unlikely, given the number of logistical, economic and fundamental political problems impeding it. This is especially unfortunate because the tax could potentially provide large amounts of aid funding and promote development, as well as reduce the number of violent conflicts in the world.

*Recommendations:*

- Inform people of the complexity and unrealistic nature of the tax to therefore identify and advocate for concrete proposals
- Attend and advocate at PrepCom's meetings in 2011 & the UN Conference on the Arms Trade Treaty in 2012
- Support the taxation of specific weapons (e.g. landmines)

## e. Tax Cooperation, Competition, Tax Havens and an International Tax Organization

Action on tax has the potential to deliver gains to poor and middle-income countries that are far greater than what can be achieved with aid. Impediments to taxation efforts include tax competition and tax havens. Tax competition occurs when countries change their tax laws to make themselves more attractive to business, and other countries must follow suit or risk losing business, often resulting in tax policies that are not their best interests. The answer to the problem of tax competition is to set up a framework of rules to protect national tax bases, giving electorates more freedom to achieve the tax systems that are right for their countries. This must happen on a global level. The fundamental components of this would be international co-operation and transparency. Tax Havens involve losses to revenue authorities of other countries. Tax havens include Bahrain, Cayman Islands, Jersey, Singapore and others; but also some of the world's biggest financial centers – notably the City of London and New York – are tax havens. As elites in developing countries move their capital to financial centers, their economies are deprived of local investment capital and their governments are deprived of much-needed tax revenue. International cooperation in combating tax evasion could actually constitute an innovative source of finance for development by reducing revenue leakage. An international tax organization could help resolve some of the international challenges that impede progress on tax matters. The United Nations should broaden and intensify its tax cooperation work and play a greater practical role in dealing with tax matters.

*Recommendations:*

- Promote tax cooperation through international agreement on norms as might be proposed by the UN tax committee
- Promote automatic exchange of tax information between jurisdictions
- Target aid towards building capacity in revenue administrations.

- Support the creation of an International Tax Organization as a permanent body to promote tax cooperation and monitor implementation of agreed policies and recommended norms.

## II. Debt-Related ISF

External debt acquired by developing nations from the developed world, banks and other institutions can be a very powerful positive or negative factor in the development of poor nations. Problems arise when governments over-borrow (and creditors over-lend) due to overly-optimistic expectations of their ability to repay. ISF mechanisms may be able to support the legitimate international credit needs of developing countries without increasing their risk of accumulating excessive debt. Many organizations and institutions are currently working on debt problems and debt-related ISF.

### f. Debt2Health Swaps

Debt2Health is an ISF initiative of the Global Fund to Fight HIV/AIDS, Tuberculosis and Malaria in the developing world. The purpose of the program is to channel resources of indebted nations away from debt repayment and towards health development.[2] To create Debt2Health agreements, the Global Fund initiates the motion, classifying and negotiating the debt conversion and facilitating a three-party agreement among the creditors, the recipient nation and the Global Fund itself. Once a settlement is reached, donor nations (or institutions) relinquish a portion of their debt claim under the condition that the indebted nation invests a certain portion of these funds on health related programs of the Global Fund. At this moment, two creditor nations have signed on, Germany and Australia, absolving debt and funding health initiatives in Pakistan and Indonesia.

#### *Recommendations*

- Promote Debt2Health as an example of ISF 'best practice'
- Advocate for future participation and growth of Debt2Health

### g. Special Drawing Rights & IMF Gold Sales

Special Drawing Rights (SDRs) are international foreign exchange reserves allocated to nations by the International Monetary Fund (IMF) which supplement member countries' official reserves and represent a claim to freely usable member currencies for which they can be exchanged. Allocations of SDRs specifically for poor nations could serve as a mechanism to promote affordable and condition-free access to financial resources, such as outside finance which could then be used for development projects or to relieve debt.[3]

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[2] The Global Fund. "Debt2Health, Basic Information: Fact Sheet." June, 2009. <http://www.theglobalfund.org/documents/innovativefinancing/Factsheet_d2h_en.pdf>. Accessed November 7, 2010.

[3] ActionAid. "ActionAid Factsheet: Special Drawing Rights (SDRs) & the Global Reserve System." 2009. <http://www.actionaid.org/assets/pdf/ActionAid%20Factsheet%20Special%20Drawing%20Rights%20%20the%20Global%20Reserve%20System.pdf>. Accessed November 7, 2010.

The IMF is the third largest holder of gold after Germany and the United States, and currently holds 93.8 million ounces of gold, with a market value of $109.6 billion.[4] The idea of using IMF gold reserves for development is not new, as between 1976 – 1980, $3.3 billion of IMF gold sales were used to create a trust fund to finance concessional loans to poor nations. In recent years, dialogue in the international community surrounding the sale of IMF gold with the intent to provide debt relief to the developing world has grown considerably, but imbalanced distribution quotas and bureaucracy have made the process problematic and slow.

### *Recommendations*

Special Drawing Rights (SDRs) and IMF gold sales are currently both being discussed by international civil society organizations as potential debt relief mechanisms and under consideration of the IMF, but it is undecided if and how these mechanisms will be applied and what their outcomes would be. Both mechanisms are important for development progress and for reducing external debt. Advocates of these proposals should:

- Support the fair distribution of SDRs
- Mandate that SDRs be targeted at low income nations to support their development
- Promote a wider agenda of IMF gold sales, focused on external debt or multilateral payments
- Encourage the creation of a trust fund to support the World Bank's International Development Association (IDA)
- Lobby the nations with the highest IMF quotas (United States, Japan, Germany, the United Kingdom and China) for their support in protecting the voice and voting power of smaller and poorer nations

[4] International Monetary Fund (IMF) Factsheet, "Gold in the IMF." September, 2010. <http://www.imf.org/external/np/exr/facts/gold.htm>. Accessed October 15, 2010.

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