



NEW WAYS OF FINANCING THE MILLENNIUM DEVELOPMENT GOALS

By

Inge Kaul*

January 2004

Prepared for a Seminar co-Organized by
Agence française de développement (Afd)
Institut du développement durable et des relations internationales (Iddri)
UNDP

22 January 2004, Paris

* Director, Office of Development Studies, UNDP. The views expressed are the author's and do not necessarily reflect those of the organization with which she is affiliated. Please direct all comments and inquiries to the author at inge.kaul@undp.org.

Introduction

The parameters of policymaking have changed in recent decades. Many, perhaps even most parts of the world have witnessed shifts in the dividing lines between the "private" and the "public" as well as the "national" and the "transnational", i.e. regional and global. As shown in figure 1, the frontiers of policymaking have moved from "more public/national" (quadrant 1) to "more private/global" (quadrant 3). "Economic liberalization", "privatization", "re-engineering of the state", "financial engineering", "institutional embedding of markets", "corporate responsibility", "public-private partnerships", "globalization" and "interdependence" are but a few of the key phrases of the accompanying policy debates.

Without doubt, the functioning of both, markets and states has changed as a result of the new policy realities. Markets have deepened and become more diversified--but also often more regulated; and states have been re-oriented, de-emphasizing the direct provision of goods and services and emphasizing more strongly facilitation of private initiative and alignment of private interests with societal concerns and objectives.

Yet many of these changes have so far happened primarily at the national level. International cooperation initiatives--forming the operational side of international cooperation as differentiated from the political negotiating side--have so far remained largely untouched by this revamping of policy approaches and tools. For example, the major financing source of development assistance still is public-revenue and the major aid modality still consists primarily of government-to-government resource transfers between richer and poorer countries. Only very limited use is being made of "modern" financing mechanisms and instruments that reflect today's multi-actor world as well as today's interdependence among countries. Official development assistance (ODA) still requires re-engineering and adjustment to the changed, current realities.

This note describes possible new, modern ways of approaching and financing development assistance, notably the achievement of the Millennium Development Goals (MDGs). It focuses on two aspects:

- What opportunities does today's politico-economic climate of state/nonstate-actor partnerships afford for enhanced MDG financing?
- Do globalization and the interdependence between countries generate new incentives for meeting the MDGs?

I Public-Policy Support for the Involvement of Markets and Firms

Nationally, governments are employing a whole range of policy instruments for encouraging private actors to contribute to public concerns. Mention can, for example, be made of such tools as: orphan drug legislation, differential pricing, subsidy schemes for R&D, and tax credits.

Clearly, some of these measures can be adjusted so as to apply also internationally. For example, national orphan drug legislation could be extended to also cover the diseases of the poor in developing countries. Or, governments could offer tax credits to firms that export urgently needed inputs to development to developing countries (e.g. medicines to prevent mother-child transmission of HIV).

However, in many instances it would be efficient for donor countries not to pursue these measures nationally, i.e. unilaterally, but to organize pooled, international incentive mechanisms for private-actor involvement in development.

Two such measures might be of special relevance for meeting the MDGs:

1 Differential pricing

Access to drugs is a key element in any strategy towards achieving Goals 4 and 6. However, when patent-protected medicines are sold both in industrialized and developing countries, (monopoly) prices tend to be set at a level that the poor cannot reach. This entails a dramatic loss by those in developing countries who are priced-out of access to life-saving drugs. But it also entails losses to the firm that holds the patent since there is a large unmet demand. A solution that benefits both those without access and the firm is to charge a lower price (just above marginal cost, rather than the monopoly price) in developing countries. That is, the firm could adopt differential pricing strategies.

The pharmaceutical industry seems increasingly prepared to adopt differential pricing. Differential pricing also helps to build the reputation of the industry and to create goodwill among the global public. But to ensure that the practice is the norm, rather than an exception, the industry is concerned with re-importation – low price drugs sold in developing countries finding their way back into developed ones.

That is why the European Commission, affirming a commitment to the concept of a “global tiered pricing system” for essential medicines in a letter of communication to the European Council and Parliament, mentioned the need for “effective safeguards” to “prevent product diversion to other markets,” such as labeling products as preferentially priced for specific markets, “special enforcement procedures” and contractual arrangements between importers and exporters. The report recommends that the United Nations or the World Trade Organization manage international coordination. And Canada’s government presented legislation to change the country’s patent laws - including drug laws - to permit exports of lower-cost generic medicines to developing

countries. Canada is first industrialized country proposing laws that would make available cheaper generic treatment, including antiretroviral medication, to the areas hardest-hit by the HIV/AIDS epidemic.

Still, voluntary action by the pharmaceutical industry and policy initiatives by individual countries and the European Commission may not be enough to ensure that differential pricing becomes the norm. As the Commission for Macroeconomics and Health suggested (CMH 2001: 88-89), a more general multilateral framework for action is required. This framework would be based on a joint agreement encompassing the pharmaceutical industry (both holders of patents and generics producers), the WHO, and industrialized and developing countries, assigning clear responsibilities and obligations to ensure that the system would work. The industry would agree to license their technology to reputable generics producers in developing countries, who could change the physical aspect of the drugs to distinguish them from those sold in developed countries. And developing countries would enforce the prohibition to export these low-price drugs back into developed countries.

Differential pricing can be applied more generically whenever what is at stake is the fact that the poor cannot access an existing technology or product. Therefore, the same principle could be applied to environmental friendly technologies, for which developing countries may be priced out. In this case, slight adaptations to the specific characteristics of developing countries would mean that re-importation would not be an issue.

The broad message is that differential pricing affords an opportunity to enhance access as well as profits. It helps to further both equity and economic efficiency.

2 Purchase guarantees

If differential pricing is effective when existing products and technologies are available, other mechanisms are required when there is a need to encourage technological innovation to generate new needed products. And the ideal would be if the mechanism that encourages innovation has in it embedded the guarantee of widespread diffusion. For example, vaccines for HIV/AIDS, malaria and TB would certainly go a long way in contributing towards meeting Goal 6, as long as after they exist they are rapidly spread-out in developing countries.

For example, a commitment to purchase units of a potential vaccine could provide a strong enough incentive to the private sector to engage in the costly process of developing a vaccine for which markets are small, thin, or uncertain (Kremer 2000a, 2000b). Based on past precedent, publicly advertised awards are legally binding, and therefore purchase commitments backed by wealthy governments or multilateral institutions should be perceived as trustworthy, and that therefore funds do not need to be set aside in advance. Estimates (Kremer and Glenester 2000) indicate that a commitment to purchase new vaccines for HIV/AIDS, TB and malaria at an average of 3\$ US per dose

would require a total commitment of \$285 million from donors and an additional \$50 million from developing countries to be seen as a credible incentive for investment.

As with differential pricing, the scope of application is broader. For example, purchase commitments could also be put in place to encourage the development and deployment of environmental friendly technologies. And there have also been proposals to use purchase commitments to provide incentives for the generation of new knowledge to improve agricultural productivity in developing countries. The structure of the commitments would be set up in a way similar to the one outlined above for vaccines, ensuring both that technological innovation and R&D are encouraged, as well as the deployment and diffusion of the ensuing technologies.

II Responding to Interdependence: International Cooperation in Enlightened Self-interest

Not achieving the MDGs could potentially generate a host of global public "bads", e.g.: deeper poverty, more diseases, exacerbated inequity, more intense feelings of political discontent, loss of confidence in the existing political system and its policy framework, and hence, more social unrest, conflict, violence, international terrorism, disrupted commerce, halted economic growth, or environmental destruction. The costs of failure would be high--for developing and industrial countries.

However, the costs of failure are often spread across society; and they are difficult to trace. In order to accelerate and re-enforce policy action in support of the MDGs in donor countries, what would thus be important is:

- Gaining a full understanding of the costs of inaction and comparing them with the costs of corrective action--to demonstrate the irrationality of inaction and improve the willingness to pay in donor countries; and
- Identifying ways of keeping the costs of corrective action off budget and spreading them as broadly and as fairly as possible across different segments of society. This could be accomplished by fostering enhanced coherence between such policy measures as foreign aid, on the one hand, and the multilateral trade regime or the international financial architecture, on the other hand.

1 Meeting the MDGs makes economic sense for donor countries, too: a comparison between the costs of inaction and the costs of corrective action

Not achieving the MDGs will not only be harmful to developing countries. As noted above, not achieving the MDGs has consequences for everybody. In other words, incompletely achieving the MDGs will mean that will have to continue to live with persistent "global public bads," which impose costs associated with dealing with their consequences across the globe. For example, if we fail to achieve Goal 6, we do not only

fail people in developing countries that are currently affected by high disease burdens. We are equally imposing a cost upon industrial countries, associated with the lack of enhanced provision of the global public goods “communicable disease control.”

Clearly, achieving the MDGs will imply resource mobilization, even though a lot could be accomplished using innovative financing instruments, as this note has shown. An important exercise would be to consider the costs “of inaction” (that is, of dealing with the consequences of not having achieved the MDGs and that include the persistence of global public “bads”) and the costs of corrective action.

As an illustration, consider that the costs of corrective action are systematically lower than the costs of inaction for a set of communicable diseases the control of which is important to meet Goal 6 (Conceição 2003). It is particularly important to note that in some cases the benefits will accrue mostly to developed countries. For example, if we eradicate polio, most of the financial benefits resulting from eradication will be associated with stopping vaccination in industrial countries, which would represent over \$1.5 billion a year in direct savings.

Looking at the costs of meeting the MDGs from this perspective – that is, realizing that not meeting them can be, and usually is, a much more expensive proposition – can be important to persuade industrial countries that the cheapest option is to make investments that will contribute towards meeting the MDGs.

2 Fostering policy coherence

Although they are distinct, the foreign aid and GPG agendas are also in many ways linked. For example, if aid is being re-allocated to GPG purposes, and thus, withdrawn from the still rather long unmet poverty-reduction agenda, poverty conditions could become more severe and potentially spill negative externalities across borders—in the form of illegal migration, spread of communicable diseases, international terrorism, or environmental destruction, among others. Excessive poverty in developing countries could affect the well-being of people in industrial countries. Hence, the issue of coherence between the aid and GPG agendas is of paramount concern.

Yet often, there is a case of “what one hand gives, the other takes,” particularly when current trade policies are compared to aid policies. Clearly, the aid agenda is often undercut by the lack of policy reforms in industrial countries. Greater policy coherence on the part of industrial countries, including more decisive implementation of agreed-upon rules, could enhance resource availability in developing countries. Thus, GPGs do not only need financing—more importantly, they can also help generate financing.

Developing countries could gain a lot from international agreement on correcting some of the malprovided (misshaped) GPGs, i.e. those that entail costs (rather than net-benefits) for developing countries, and probably, for the international community as a whole. Some dimensions of the multilateral trade regime or of the international financial

architecture would fall into this category. The projected cost of implementing the World Trade Organization (WTO) Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS), for instance, runs to about \$38 billion per year for technology importing countries. Furthermore, developing countries lose an estimated \$20 billion per year in agricultural export revenues due to Northern protectionist trade barriers. In the area of international finance, reserve hoarding—a widely practiced form of self-insurance against financial crises—imposes massive costs on developing countries; up to \$10 billion a year for developing countries according to one estimate. Such costs could be mitigated with concerted policy action that would make these regimes more public in benefits. For the trade regime, concrete policy actions could include a more flexible application of TRIPS, particularly for countries in need of costly medicines, as well as decreased subsidies in the industrialized countries. For the IFA, a resumption of regular special drawing rights (SDRs) allocations would be a pragmatic step to mitigate the costs of holding reserves, specially for the poorest countries.

Confounding aid and GPG financing, as is often done today, thus siphons off scarce resources from the still long unmet poverty reduction agenda and deprives developing countries of a potential new and additional income stream. The present undifferentiated use of ODA for GPG purposes is an undesirable practice. It does not do justice to either agenda.

III From Distributive (zero-sum game) Thinking to Integrative (win-win) Perspectives

International cooperation – perhaps due to the “foreign aid” component that has for long dominated its operational activities – is often seen as a transfer of resources, a “giving money away”.

Slowly, as the foregoing discussion has shown, a self-interest perspective is emerging, and the fact is that “donor” benefits are being recognized. Yet, one could go one step further: to exploring pro-actively win-win strategies.

For example, as the history of the EU has shown, a constant quivering about budgets has huge transaction costs. A multi-year framework may be a more efficient tool. Or, as information economics has taught us, lack of information is often causing serious market or public policy failure.

Thus, in order to better recognized current inefficiencies or unexploited opportunities for promoting development, an important step would be to enhance international cooperation measures by making them more transparent and accountable.

The measures that could be taken towards this end, and that would in particular help to achieve goal 8, include possibilities such as:

- Costing externalities (cross-border spillins and spillovers) and (as discussed above) comparing costs of inaction and costs of corrective action, including incremental cost calculations;
- Preparing Industrial-country PRSPs and Global PRSPs – to make problems or achievements of policy coherence in or supporting poverty reduction more visible at the level of individual industrial countries and at the level of global policy regimes (such as the multilateral trade regime).

Conclusion

This note has made two fundamental points.

First, that financing the MDGs is more than just mobilize new and additional resources – a lot can be accomplished by reverting to innovative financing mechanisms that mobilize the market and create incentive structures that lead actors, public and private, towards actions that contribute towards meeting the MDGs.

Second, that meeting the MDGs is in the interest of all, developing and developed countries alone, in a world of increasing interdependencies. These interdependencies manifest themselves clearly when one considers that not achieving the MDGs has substantial costs to industrial countries. And also when one considers the importance of policy coherence, so that what is given with one hand is not taken with the other.

References

- Clark, Peter and Jacques Polak. Forthcoming. “A New Perspective on SDR Allocations.” UNDP-ODS. New York.
- Commission for Macroeconomics and Health (2001). *Macroeconomics and Health: Investing in Health for Economic Development*. Geneva: WHO.
- Conceição, Pedro. 2003. “Assessing the Provision Status of Global Public Goods” in Inge Kaul, Pedro Conceicao, Katell Le Goulven and Ronald U. Mendoza, Eds. *Providing Global Public Goods: Managing Globalization*. New York: Oxford University Press.
- Kaul, Inge and Katell Le Goulven. 2003. “Financing Global Public Goods: A New Frontier of Public Finance” in Inge Kaul, Pedro Conceicao, Katell Le Goulven and Ronald U. Mendoza, Eds. *Providing Global Public Goods: Managing Globalization*. New York: Oxford University Press.
- Kaul, Inge. 2002. “Financing Global Public Goods Without Jeopardizing Aid.” Presented in the seminar on global public goods at the European Policy Centre. Brussels, October 17, 2002.
- Kremer, Michael. 2000a. *Creating Markets for New Vaccines Part I: Rationale*. NBER Working Paper. Cambridge MA. May.
- Kremer, Michael. 2000b. *Creating Markets for New Vaccines Part II: Design Issues*. NBER Working Paper. Cambridge MA. May.

- Kremer, Michael, and Rachel Glennerster. 2000. *A World Bank Vaccine Commitment*. The Brookings Institution, Washington, DC. May.
- Mendoza, Ronald U. 2003. "The Multilateral Trade Regime: A Global Public Good for All?" in Inge Kaul, Pedro Conceicao, Katell Le Goulven and Ronald U. Mendoza, Eds. *Providing Global Public Goods: Managing Globalization*. New York: Oxford University Press.
- OXFAM Community Aid Board. www.caa.org.au/campaigns/trade/wto/agriculture.html
- Picciotto, Roberto. 2003. "GPGs and realigning MDGs to create a level playing field." Contribution to the gpgNet Discussion Forum V on *Achieving The Millennium Development Goals: A Global Public Goods Perspective*. Posted 12 Nov. 2003. Available at: www.gpgnet.net.