

Global Policy Innovations Policy Brief

Financing Global Development: Key Proposals and Recommendations

In its September 2000 Millennium Declaration, the member states of the United Nations made a commitment to fulfill by 2015 eight Millennium Development Goals (MDGs) aimed at addressing global extreme poverty and hunger and reducing disease, illiteracy, environmental degradation, and discrimination. This commitment, however, has not been matched by the resources that are necessary to fulfill it. According to recent estimates at least an additional \$50 billion a year—twice the total amount of official development assistance (ODA) currently available to developing countries—is needed to achieve the Millennium Development Goals.

Finding feasible new sources for financing the MDGs is, therefore, an urgent task. This policy brief outlines the following eight widely discussed proposals for financing global development:

Financial Institutions and Rules

1. The International Financial Facility
2. Development-Focused Allocation of SDRs

Global Taxes

3. Currency Transaction Tax (Tobin Tax)
4. Global Environmental Taxes (e.g. carbon tax)
5. Taxes on Global Arms Sales

Voluntary and Market Methods

6. Global Lottery
7. Global Premium Bond
8. Migrant Remittances

THE INTERNATIONAL FINANCE FACILITY

The International Finance Facility (IFF) is a joint proposal of the U.K. Treasury and the U.K. Department for International Development. The IFF aims to raise up to \$50 billion a year until 2015 by selling long-term bonds in the world capital markets. The funds from the sale of the bonds will be disbursed to recipient countries as grants rather than loans through existing bilateral and multilateral mechanisms, such as government agencies and the World Bank or the Global Health Fund.

The IFF will function for a period of thirty years as a bank of the additional aid pledges that donors have made since the 2002 International Conference on Financing for Development in

Monterrey, Mexico. Against the donors' legally binding pledges for future contributions, the IFF will issue bonds in its own name that will have the highest (triple-A) quality and safety rating, and hence will be low interest. During funding rounds every three years, donors will pledge their annual payments to the IFF for the next fifteen years. Donor funding will increase annually for a period of fifteen years, by 4% in real terms from the previous year, beginning with the current donors' commitment of \$16 billion a year; after that, the 4 % increase will occur every three years for the next fifteen years. Disbursements from the IFF will increase from \$10 billion in the first year to \$50 billion in the fifth year; will remain at \$50 billion for the next five years; and will decline to 0 over the final five years.

Revenue potential and other benefits

- Double ODA from \$50 billion in 2006 to \$100 billion a year in 2010–2015 and provide predictable and stable financing for developing countries over the next fifteen years.

Potential challenges and costs

- There is some concern that a sharp fall in aid after the IFF ceases to exist could have a significant disruptive impact on the economies of the recipient countries, potentially threatening the progress achieved during the IFF's existence period.
- The IFF will require significant political coordination among donor countries, including through legally binding financial commitments. While France and the United Kingdom have fully supported it, a number of other key developed countries have yet to express support for the IFF.

DEVELOPMENT-FOCUSED ALLOCATION OF SDRS

Special Drawing Rights (SDRs) are denominations of members' quotas, and a potential claim on the freely usable currencies of IMF members, such as the US dollar, the Euro, the pound sterling, or the Japanese yen. The SDR's value as a reserve asset derives from the commitments of members to hold and accept SDRs. The IMF's board of governors can issue SDRs to the accounts of the Fund's member states, in proportion to their IMF quotas, at an exchange rate determined by a basket of major currencies. Countries that run a deficit in the current account of their balance of payments can transfer their SDRs to surplus countries (and pay the SDR interest rate on the amount used), in exchange for convertible currencies. The SDR is valued daily on the basis of a basket of four currencies (the US dollar, the Euro, the Japanese yen, and the pound sterling). The SDR interest rate is determined weekly as the weighted average of the yields on selected three-month U.S. dollar, Euro, Japanese yen, and pound sterling money market instruments.

Because SDR issues are a costless asset on which interest is neither earned nor paid when in proportion to the member's IMF quota, SDRs may be useful to developing countries in leveraging their domestic financial resources for fighting poverty by reducing the costs associated with the holding of large amounts of reserve currencies—which became widespread after the 1997–1998 Asian financial crisis. Existing proposals range from the recommendation

that the IMF make regular annual allocations of SDRs¹ to offset the costs to developing countries associated with holding large amounts of idle reserves, to a more ambitious proposal made by George Soros that SDRs received by industrialized countries be transferred to a trust fund managed by a board of eminent persons and used for special global development projects as a supplement to existing aid flows.²

Revenue potential and other benefits

- The use of SDRs for development purposes has the potential to generate an additional US \$25 billion, nearly half of the amount needed to achieve the Millennium Development Goals and reduce extreme poverty throughout the world by 2015.³
- Once the allocation of SDRs has been agreed upon by IMF member states, its administration could be easily implemented within the current IMF structure, without significant additional administrative or bureaucratic costs.
- In the presence of SDRs developing countries will not have to borrow reserve assets at interest rates above those that they would earn on them, or set aside capital that could otherwise be invested in poverty alleviation projects. SDRs will significantly reduce the costs of borrowing and allow that financing that has a higher social rate of return be used for human development, instead of reserve assets.
- In light of the experience of the Asian financial crisis, during which the demand for reserve currencies of affected countries grew sharply as they sought to bolster market confidence to prevent capital flight, SDRs are seen as a way to hold the Fund to account for pursuing policies that might lead to reserve currencies crises. If there are SDRs, the Fund would be more cautious in pressuring countries to keep their capital accounts open—a policy that many have argued played a crucial role in severely deepening the Asian financial crisis—since it will face the prospect of paying its own debt.

Potential challenges and costs

- No allocations of SDRs to IMF members have been made since 1981. The main obstacle to the resumption of SDRs comes from reserve-currency countries. For example, the 1997 special allocation of SDRs was blocked by the U.S. Congress. In addition, redistribution of SDRs might involve lost interest income to the SDR provider—provided that the donor countries pay the interest. However, provided that the authorities that then take or spend these assets recompense the original recipients for the interest that the latter will still have to pay (as proposed by Soros), the SDRs can be passed on without loss by the original recipients.
- Currently, SDRs are allocated in proportion to a member's quota, which is broadly determined by the member's economic position relative to other members. This system excludes low-income countries because in practice they cannot be allocated SDRs. Therefore, the proposed allocations that are not in proportion to the existing quotas require an amendment in the IMF's Articles of Agreement, which needs to be ratified by 110 member countries with 85% of voting power. Alternatively, if the quota rule is left in

¹ Clark and Polak, "International Liquidity and the Role of the SDR in the International Monetary System"; and High-Level Panel on Financing for Development, Report to the Secretary-General of the UN."

² Soros, *George Soros on Globalization*.

³ Reisen, "Innovative Approaches to Funding the Millennium Development Goals."

place, SDRs can still be used to finance development—but this option relies entirely on the voluntary donations by developed countries.

- In the past, allocations of SDRs have been opposed on the grounds that they could have inflationary consequences. However, such claims have never been substantiated, and, today, in the face of a global recession, would prove more difficult to make.⁴

CURRENCY TRANSACTION TAX: THE “TOBIN TAX”

The currency transactions tax (CTT), known as the Tobin tax after its proponent Nobel laureate James Tobin, will be a small tax imposed on all transactions in the foreign exchange market. Revenues will be collected on a market basis by the monetary authorities (since they supervise and regulate banks and exchange transactions) and/or tax authorities of countries in which the major financial markets are located.

Revenue potential and other benefits

- Even a modest tax rate is likely to raise sizable revenues. A tax rate of 0.01% will generate an annual revenue of \$17 billion to \$19 billion, while 0.02% will generate \$30 billion to \$35 billion.⁵ At very low rates the CTT will be unnoticeable to the general public.
- Imposing the CTT at a significantly higher rate could have a positive stabilizing effect on international financial markets by deterring short-term speculative currency flows and stabilizing exchange rates.

Potential challenges and costs

- Higher-rate CTT that could stabilize financial markets has faced significant opposition from governments with major financial centers, including from the U.S. Congress. Although lower tax rates may have a negligible impact on the overall functioning of the market, they could also be more politically feasible, and still have significant revenue generating potential.
- There is significant debate concerning the appropriate level at which a CTT should be set. While some argue that a high tax rate might create liquidity problems that could impede the functioning of the market, others argue that a very low tax rate might not suffice to deter short-term speculators. To address this trade-off, some have proposed a two-tier tax system in which a low tax rate such as 0.01% is levied on normal transactions and a very high tax is imposed on profits from very short-term transactions.⁶
- Some caution that a high-rate tax could lead to tax avoidance through capital flight to offshore tax havens or by switching from taxable transactions to tax-free ones. This “migration” of the foreign exchange market can be avoided if the CTT is applied universally. It can also be prevented by the imposition of punitive tax rate on all transfers of funds to or from such havens. To avoid substitution of taxable foreign exchange

⁴ Ibid.

⁵ Nissanke, “Revenue Potential of the Currency Transaction Tax for Development Finance.”

⁶ Spahn, “The Tobin Tax and Exchange Rate Stability” and Spahn, “On the Feasibility of a Tax on Foreign Exchange Transactions,” both cited in Nissanke, “Revenue Potential of the Currency Transaction Tax for Development Finance.”

transactions for tax-free ones, the CTT would have to cover several financial instruments such as swaps, forwards, options, and futures besides spots transactions.

GLOBAL ENVIRONMENTAL TAXES

A global carbon tax will discourage the consumption of fossil fuels by taxing countries in proportion to their emissions. Domestically, the carbon tax will resemble the value added, or sales, taxes: tax authorities could levy carbon tax directly on the sale of fossil fuels, and in turn fuel vendors will transfer part of the tax onto buyers. Governments will then pay the collected tax to an international agency, which could either be a new and separate institution or a new agency within an existing institution, and which will have a developed system for passing the revenue onto the institutions responsible for allocating resources to development projects.

Revenue potential and other benefits

- A uniform, global tax on carbon use at a rate of \$21 per metric ton of carbon could generate astounding annual revenue of about \$130 billion a year—over two-and-a-half times the amount needed to halve global poverty by 2015. If imposed only on high-income countries, such a tax would still generate about \$61 billion a year.⁷
- By providing an incentive for R&D in renewable energy sources, the global carbon tax will lead to environmental improvements in the long run by permanently lowering the demand for carbon fuels. That is, a carbon tax that was imposed and later removed will not lead to a return to the pre-tax level of carbon fuel consumption because the existence of the tax will have resulted in structural changes in the industry that supplies energy sources.

Potential challenges and costs

- The collection and distribution of a global environmental tax would require significant administrative and political coordination among, and commitment by, both developed and developing countries. A significant political challenge is the fact that the U.S. Congress has passed legislation banning the United States' participation in global taxation schemes.
- If introduced uniformly across all countries, the tax might have negative impact on a number of poor countries as expenditure on energy, particularly for heating and cooking, weighs more heavily in low-income budgets. However, this problem of effectively regressive taxation could be resolved through numerous mechanisms, including the introduction of a tiered taxation system based on the countries' income level, with a possibility that the tax could be confined to rich countries only.

⁷ Clunies-Ross, "Resources for Social Development," cited in Sandmo, "Environmental Taxation and Revenue for Development."

TAXES ON GLOBAL ARMS SALES

The proposal of taxing international arms sales, made by Brazil's President da Silva in early 2004, involves the imposition of a tax on the sale of conventional arms such as battle tanks, armored combat vehicles, large-caliber artillery systems, attack helicopters, combat aircraft, warships, missiles, and missile launchers, covered in the UN Register of Conventional Arms. The global arms sales tax would affect approximately 110 governments involved in the trade of conventional arms. Although a concrete scheme about the collection of the tax has not yet been spelled out, it is likely that it will rely to a considerable extent on governments' taxing themselves and transferring the proceeds to an international authority that would then pass them to institutions in charge of the allocation of resources to development projects.

Revenue potential and other benefits

- The global arms sales tax has a modest revenue potential. Given that the value of arms trade for 1999 was \$51.5 billion (as estimated by the U.S. State Department) a 5% tax would yield only \$2.5 billion a year.⁸
- Because of the clear relationship between conflict and poverty there is a strong moral case for introducing taxes on global arms trade, with the aim of financing human development goals.

Potential challenges and costs

- Because the illicit trade in small arms and light weapons is significant—in 2000, a quarter of the \$4 billion-worth global small arms trade in 2000 was illicit⁹—the effectiveness of a global arms sales tax will be low and there is concern that it might create an adverse incentive to trade illegally.

GLOBAL LOTTERY

There are currently two proposals for developing a global lottery system for financing development. The first involves national lottery operators, administered by national regulatory authorities, that will run national versions of a global lottery that will be overseen for compliance with standards by an international body. The World Lottery Association, a respected international organization with a large membership of national and state lotteries, could play an important role in this regard.

The second proposal involves a global lottery sold worldwide and run by one organization, such as the United Nations. If such lottery is sold on the Internet, then the issue of regulation will be closely related to resolving the larger issue of effectively regulating e-commerce.

⁸ Reisen, "Innovative Approaches to Funding the Millennium Development Goals."

⁹ Graduate Institute of International Studies, *Small Arms Survey 2003—Development Denied*, cited in Reisen,

Revenue potential and other benefits

- If the global lottery were to take 10% of what is the total gross profit from lottery of all countries in 2001—\$62 billion—it could raise \$6.2 billion a year.¹⁰
- There are low regulatory and administrative costs, especially in the case of a single global lottery run via the Internet.

Potential challenges and costs

- The prospect of a global lottery competing for revenue with the national lotteries may lead to opposition by governments. How the collected funds will be distributed between national authorities and the development fund also raises questions.

GLOBAL PREMIUM BOND

The proposal for a global premium bond is modeled after the U.K.'s premium, or "ERNIE," bond scheme. The return to the bondholder depends on a random prize draw as in the case of a lottery. However, unlike a lottery ticket, which is non-refundable, the premium bondholder does not lose the initial stake and is guaranteed repayment upon request. In the U.K. premium bond scheme, the size of the total prize allocation is set so that the expected return is equivalent to the total yield on U.K. government bonds, but individual returns (the actual prizes) from premium bonds can be well below or well above the individual return from regular bonds.

Because of its complexities, a global premium bond scheme can only be run by a single organization, which would sell bonds worldwide through national sales offices and/or the Internet. The global premium bonds will be denominated in a basket of major currencies. Because a premium bond is a debt instrument, in which the seller makes a promise to repay the buyer, a global premium bond is better suited as a source of loans for developing countries (as opposed to lottery proceeds, which are nonrefundable, and could be given out as grants).

Revenue potential and other benefits

- Although there has been no estimate of the revenue generating potential of a global premium bond, a useful point of reference could be the annual premium bond sales in the U.K., which are presently \$34 billion.¹¹
- The global premium bond will be an attractive savings instrument for people in, or closer to, retirement whose main concern is to protect their accumulated capital.

Potential challenges and costs

- Potential default of borrower countries on the loans from the proceeds of the bond scheme raises questions regarding how bondholders will be protected. A large-scale default of borrowers might jeopardize the repayment of the principle and put the existence of the scheme into question. Moreover, because its projected revenue is relatively low, it cannot be a stand-alone proposal, but can be used to complement other

¹⁰ Addison and Chowdhury, "A Global Lottery and a Global Premium Bond."

¹¹ Ibid.

proposals, such as the International Finance Facility, which will be built around bonds issues.

MIGRANT REMITTANCES

Migrant remittances entail resource transfer—monetary or in-kind—by a migrant to his home country. Migrant remittances are overall the second largest component of external resource flows to developing countries after foreign direct investment (FDI), and more important in some regions than FDI. Since 1997, migrant remittances have become more important as a source of flows to developing countries as a whole than ODA. Monetary transfers in dollars directly increase the availability of foreign exchange in the migrant’s home country, whereas in-kind remittances save foreign exchange for the recipient country. When remittances are sent through the formal channels, they are recorded in the receiving country’s balance-of-payments current account. Yet the circumstances in which they occur are often such as to discourage them or reduce their value. Several ways have been suggested to encourage remittances and maintain their value: legalizing migrants’ status to make it easier for migrants to use formal cash-transfer mechanisms; licensing nonbank transfer institutions more readily; encouraging cooperation between banks on the two sides to reduce currency-exchange costs; and the creation of bonds valued in a low-inflation currency or currency basket, in which migrant funds could be accumulated.

Revenue potential and other benefits

- Currently, even without these proposals being implemented, migrant remittances amount to 10% of GDP in some countries. They have increased from around \$15 billion in 1980 to \$80 billion in 2002. In some countries they amount to more than 10% of income.¹² Migrant remittances are less stable as source of financing than institutionalized schemes, but more stable than bank credit and portfolio investment.

Potential challenges and costs

- Channeling remittances for development purposes poses significant scale and coordination challenges. Although large in aggregate, individual remittances tend to be quite dispersed by nature, thereby making it difficult to channel for official development purposes.

IMPLEMENTING REFORM

The innovative proposals outlined in this brief have the potential of raising the additional financing needed to fulfill the governments’ promise at the UN Millennium Assembly to halve severe global poverty by 2015. Importantly, these proposals are feasible—both technically and politically. There are, of course, significant challenges to their implementation. However, these challenges are only comparable to challenges that policymakers have encountered and

¹² Solimano, “Remittances by Emigrants: Issues and Evidence.”

successfully addressed in the past when confronted with serious global issues—as the creation of the Bretton Woods institutions at the end of the Second World War attests. By any means the challenges to implementing these proposals are surmountable if governments bring their political will to match in actions the urgency of global poverty.

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INNOVATIVE SOURCES FOR DEVELOPMENT FINANCING

PROPOSAL	FINANCIAL ENGINEERING		GLOBAL TAXES		
	International Finance Facility (IFF) proposal of the UK government	Development-Focused Allocations of SDRs	Currency-Transaction Tax (CTT) (Tobin Tax)	Global Environmental Taxes (e.g., carbon tax)	Taxes on Global Arms Sales
DESCRIPTION	Donor countries pledge their aid commitments in the IFF, which issues against them long-term bonds to borrow financing through 2015.	Periodic creation of SDRs, with a possibility that developed countries transfer their SDRs allocation for MDGs	Tax on foreign currency transactions possibly with a two-tier tax system consisting of a low tax rate for normal transaction and an exchange surcharge on profits from very short-term transactions.	Tax on the carbon emissions of countries. Domestically, this tax takes the form of a VAT, or sales tax on hydrocarbon fuels	Tax on trade of conventional arms covered in the UN Register of Conventional Arms
REVENUE POTENTIAL	Stable flows of \$50 billion to \$100 billion a year in 2010–2015.	\$25 billion depending on periodicity and political willingness for annual allocation of SDR to poor countries.	\$17 billion to \$19 billion with a low tax rate of 0.01%; \$30 billion to \$35 billion with a tax rate of 0.02%.	\$130 billion a year if levied at a uniform rate on all countries at a modest tax rate (\$21 per metric ton of carbon). \$61 billion a year if progressive tax with lower rate for poorer countries.	\$2.5 billion a year for a tax rate of 5 % of arms sales provided the current volume of legal arms trade.
OTHER BENEFITS	Increased credibility of donors' commitment	Decreases the high cost of holding reserves by developing countries and frees up reserve capital for uses in areas with higher social rate of return.	At high rates, expected to reduce exchange rate volatility; at very low levels a tax unnoticeable by the public	Leads to long-term environmental improvements by altering the structure of the energy sector; if introduced in combination with a reduction of the payroll tax, lowers costs to employers and increases demand for labor, thus reduces unemployment.	Reduces arms trade, the severity of conflict, and the resulting from them poverty
COSTS AND POTENTIAL SHORTCOMINGS	Heavy reliance on political coordination; requires continuous legally-binding commitments; absorbing capacity constraints in developing countries; results in higher debt-to-GDP ratios in donor	Allocation of SDRs other than the exact proportion to IMF quotas requires amendment of the IMF Articles of Agreement, which would be opposed by reserve-currency countries, who currently have the	At very high rates, possible market migration to offshore tax havens and decrease in market efficiency resulting from liquidity problems and reduced volume of foreign exchange transactions;	Requires coordinated action; possible resistance by industrialized countries, especially the U.S.; costs occurring today with the prospect of future benefits; lack of knowledge about the effects of greenhouse gas	Might encourage illicit arms trade; volatile market

countries

largest IMF majorities, especially the U.S.

difficult to reach universal agreement in order to implement it universally.

emissions on the global climate in the future; possible regressive tax impact on the poor.

VOLUNTARY AND MARKET METHODS

PROPOSAL	Global Lottery	Global Premium Bond	Private donations	Migrant Remittances
DESCRIPTION	National versions of a global lottery game or a single global lottery sold worldwide and run by one organization	Modelled on the U.K. premium bonds and denominated to a basket of major currencies. The return to bondholders depends on a random prize draw. Administered by a single global body, which lends the proceeds from the bond sale to developing countries	Tax incentives for donation by the super-rich in the developed world; volunteering jobs; Global Funds; Corporate giving in terms of “cause-related marketing” and “corporate social responsibility”; The use of the Internet as a way of fostering online giving	Monetary or in-kind resource transfer by a migrant to his home country.
REVENUE POTENTIAL	Assuming the new global lottery takes 10% of the 2001 total country lottery gross profit (\$62 billion) then it will raise a potential of US\$6.2 billion.	No estimates so far. Annual premium bond sales presently running at \$34 billion in the U.K.	Given that total charitable giving in the U.S. constitutes 1.5% of GNP (\$150 billion in 1999) great revenue potential, depending on degree of allocating money for development and on tax incentives.	No estimates for the case of increased remittances for development financing. In 2002, they amounted \$80 billion.
Other benefits	Likely to increase awareness on the urgency over the need to finance MDGs; easy to administer	Likely to increase awareness on the urgency over the need to finance MDGs	Educational value in that it can foster global responsibility	More stable than credit and portfolio investment

Costs and potential challenges

Competition between the global lottery and national lotteries; regressive tax impact since the poor are likely to spend more on lotteries

Need for rich-country guarantors

Most existing private donations in the developed world are domestically oriented; not a stable revenue source as it is donor-driven

Inefficient international market for transfers; donor-driven