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'Aid financing for International Public Goods?'

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Introduction

The UK chancellor Gordon Brown recently called for a doubling of world aid to around US$100 billion annually. The announcement has come at a time when rich countries are actively looking for ways to reduce poverty and support growth in the poorest countries. Failing to achieve poverty reduction will directly affect the well-being of rich countries through fuelling conflict, exacerbating communicable diseases or environmental damage.

Similar opinions have been used to underpin financing the provision of international public goods (IPGs) from aid funds. By definition, IPGs confer global benefits (see Box 1) so aid financing of the provision increases welfare in poor and in rich countries. Furthermore, the provision of IPGs requires complementary financing for national public goods (NPGs), such as spending on social sectors (to ensure health and knowledge benefits are delivered). Can increased aid be used effectively to meet increasing demands for the provision of IPGs and associated NPGs? This would include allocating more aid to areas such as peace-keeping, protecting the environment, disseminating global knowledge and tackling communicable disease, such as AIDS or TB.

Box 1 What are International Public Goods?

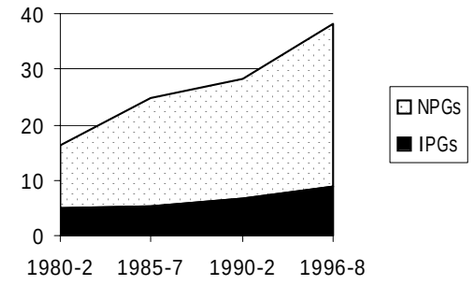
International public goods (IPGs) are public goods whose provision or associated benefits spill over national boundaries. For example, reducing communicable disease or conflict in one country benefits at least neighbouring countries, and benefits may extend globally. This can be contrasted with national public goods (NPGs) that benefit only residents in a country. It is common to identify five sectors of public goods: environment, health, governance, security and knowledge. In each sector are NPGs, such as primary health care, and IPGs such as eliminating or preventing the spread of disease across borders. National education systems provide an NPG, international research on agriculture an IPG, as an example in the case of knowledge.

Aid finance for IPGs – why, and what is the record?

There are three building blocks underpinning the case for aid financing of IPGs. First, the private sector will not provide a sufficient amount of public goods, as it considers only private and not social benefits. This calls for some public sector engagement. Second, individual countries have insufficient incentives to make an optimal contribution to IPGs, given that not all benefits accrue nationally. This calls for some form of co-operation between countries. Finally, poor countries lack the resources to make a full contribution to the provision of IPGs. This justifies aid finance.

The chart shows that the share of total aid by the Development Assistance Committee (DAC) donors allocated to financing IPGs has nearly doubled over the past two decades to 9%. The share allocated to National Public Goods increased to 30%. Since the value of aid by DAC donors, US$56 billion in 1999, did not grow over 1991-9, financing of IPGs has replaced other uses of aid. This is potentially worrying for recipient countries as aid for IPGs may not be 'better' than aid for other uses. It is also worrying as the concept of IPGs provides a rationale for additional aid. Good news, then, to hear voices to *increase* aid when the demand for IPGs is increasing.

Allocation of aid commitments to provision of public goods, % of aid



Exploring different ways to spend additional aid

Assuming that donors do raise an additional US$50 billion a year, how might this be spent? One could suggest spending it entirely on financing IPGs. Doing this will boost the share of total aid going to IPGs to 53%. However, who will benefit from aid flowing to infectious disease control, when, for example, national health sectors cannot cope with delivering Malaria vaccines to the vulnerable in the rural areas? Some capacity at national level is required for effective and efficient provision of IPGs. Thus, if aid is used for the financing of IPGs as well as NPGs, according to their shares in aid for public goods at present, the percentage of aid going to IPGs increases to 16%, that of NPGs to 52%.

But it is important to consider aid for uses other than for public goods, because it is difficult to judge *a priori* whether aid for public goods is better than other aid (in addition to defining public goods). Investing in infrastructure, which is not usually considered a public good, can be important for development. Humanitarian aid may save many lives. If aid is allocated to different uses according to shares in aid extrapolated from past trends, then 'other' aid will increase to US$37 billion, US$3 billion short of the 1990 level. Thus, even a US$50 billion aid increase will soon be insufficient to restore the level of 'other' aid to its 1990 level. This emphasises the economic notion of opportunity cost, with aid for public goods gradually replacing other types of aid.

Donors do not allocate aid to public goods in equal proportion. Thus, it matters whether aid is doubled by all bilateral DAC donors or by the G7 donors that currently allocate under 0.7% of GDP to aid. In this context, the additional funds would be realised if the G7 donors increased their aid to the UN target of 0.7% of GDP. Generous donors, those that exceed the UN target, give proportionally more to IPGs. Box 2 shows additional funds available for financing IPGs by sector when US$50 billion aid is allocated according to current donor spending patterns.

The two different options yield similar implications for financing IPGs, although if all of the increase was financed by G7 countries only, spending on IPGs would increase by less than if additional aid was provided by all DAC donors together. Most of the US$4 billion increase in aid for IPGs will go to environmental IPGs, while spending on conflict prevention will increase by only US$180 million. Health IPGs attract increased spending of just US$600 million, less than a tenth of what has been estimated as required to resolve the current AIDS crisis.

Box 2 Allocating an additional US$50 billion aid based on allocations made in 1996–8

	IPGs		NPGs	
	All DAC donors	G7 donors	All DAC donors	G7 donors
IPGs (total)	4.25	4.13	14.27	14.17
Environment	2.84	2.72	5.92	6.29
Health	0.60	0.62	1.92	1.77
Conflict prevention	0.18	0.16	0.38	0.29
Knowledge	0.63	0.62	2.07	1.76
Governance	na	na	3.98	4.06

It can be doubted whether this is satisfactory, given the recent interest in preventing conflict and in eliminating communicable diseases. Aid finance to NPGs will increase by US$14 billion, of which around US$2 billion would go to education. This is a quarter of additional aid required to achieve the Millennium Development Goal of universal primary education in 2015 (see the *OPINIONS* on Millennium Development Goals).

Additional aid should be welcomed. Increasing demands to provide public goods, especially IPGs, provide a justification for additional aid. However, even if all the additional aid was allocated to public goods it may not be sufficient to meet the demands for resources, while aid for other uses would suffer. In considering how to link the needs that justify increased aid with the uses to which such aid can be put, two trends must be reconciled:

- Aid finance for the provision of public goods has replaced other uses of aid. This may well be desirable, but there is a need for careful discussion of what aid spending contributes to the provision of public goods, and what other uses deserve aid funding.
- Most aid funding for IPGs has been allocated to Environmental IPGs. Increased aid may have to be allocated to other IPG categories, such as health and conflict prevention.

Our estimates show that if the increased aid is allocated in the same way as current aid, the increased spending on public goods would not provide the resources needed even to meet development health and education targets. Financing such public goods would require a dedicated allocation of additional aid. This has implications for other types of aid, and for discussions about financing different types of public goods. There is a need for increased funds to finance public goods, and now is the time to begin analysis of how such funds can be used effectively.

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