

Briefing Note #1

Using yesterday's policy tools may be costly and ineffective

NEW PUBLIC FINANCE IS EMERGING WITH CHEAPER AND MORE EFFECTIVE POLICY OPTIONS PROMISING GREAT GAINS.

Every time a global challenge captures the world's attention, political leaders run to convene a meeting—seeking a joint plan, a strategy or a treaty. Multilateral organizations promise more public spending to address the challenge—to contain a virus, to stave off a financial crisis, to limit the damage from a natural disaster.

While governments deliberate and private actors wait for the outcomes, the costs of inaction pile up, and the challenges often remain underfunded, possibly turning into major crises.

The world often appears to be caught in a mismatch between today's global challenges and the tools it uses to address them.

New public finance is emerging with cheaper and more effective policy

New public finance is taking hold. New tools and policy approaches are emerging as governments and other actors accept a fundamental insight: addressing global challenges does not always require official meetings, universal agreements, coercive rules and huge amounts of public money. It is possible to use decentralized, incentive-based tools that draw on the resources and capabilities of both public and private actors.

Consider the challenge of ensuring international financial stability. One factor contributing to the high cost of some financial crises is the disorganized debt workout process, where many creditors seek payment when a debt-issuing government is in distress or default. To deal with this, some debt-issuing countries are imbedding clauses in their bond contracts to make the debt workout, if needed, easier, cheaper and more predictable. These collective action clauses subject all lenders to rules of collective action.

The process is decentralized, not dependent on any treaty or international agreement. It draws on a tacit partnership between public and private actors—since the investors that buy these bonds accept some loss of freedom in exchange for a more orderly debt

* *The New Public Finance: Responding to Global Challenges* (edited by Inge Kaul and Pedro Conceição; New York: Oxford University Press, 2006).

workout, both to their benefit and to the issuing government's. And the clauses are relatively cheap, with no new bureaucracy required, no major disbursement of public funds.

The clauses illustrate another characteristic of the new public finance: that the response to global challenges can take place *behind* national borders. Their inclusion is by the issuing government alone, in response to concerns from investors and the international financial community as a whole. More countries are using these clauses to harmonize international debt issuance in ways that address external exigencies.

The new public finance shows that international cooperation is indeed required to address global challenges—and cooperation happens both *behind* and *beyond* national borders. And it involves both *public* and *private* actors working together.

Collective action clauses are just one of the many innovative tools and policy approaches addressed in *The New Public Finance*. Needed now is to take proposals and emerging policy innovations into mainstream policy practice—to move from innovation to adoption. Estimates of the benefits of doing this with just half a dozen such tools reach trillions of dollars in net present value (see table below).

Six tools, \$7 trillion in gains

Tool	Challenge addressed	Primary beneficiary	Annual gain (billions of U.S. dollars)	Net present value of gain ^a
Guarantees issued by aid agencies	Infrastructure investment	Developing countries	1.1	22
Securitization of future flow receivables	External borrowing	Developing countries	1.5	31
Advanced purchase commitments ^b	Malaria control	Malaria-endemic regions, especially Sub-Saharan Africa	1.4	47
GDP-indexed bonds	Public expenditure/debt repayment smoothing	Developing countries	30.0	600
Macro markets ^b	Risk management	Group of Seven industrialized countries	145.1	2,902
International pollution permit trading	Reduction in greenhouse gas emissions	Industrialized countries	182.0	3,640
Total ^c			~360	~7,000

Note: For more details on the calculations, see www.thenewpublicfinance.com.

a. The sum of the gains is provided here for illustrative purposes only, since the methods used to estimate the gains refer to different base years.

b. The gains from these tools are expressed net of costs.

c. The discount rate is 5 percent for all the tools, except for advanced purchase commitments, where a discount rate of 3 percent is used in line with the common practice of using lower discount rates in health-related cost-benefit analyses.

About the book

The New Public Finance: Responding to Global Challenges is published by Oxford University Press for the United Nations Development Programme (UNDP).

For more background information visit: www.thenewpublicfinance.org

The Overview of the book is available in Arabic, Chinese, English, French, German, Portuguese, Russian, and Spanish on the website above or, for hard copies, from:

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New York, NY 10017
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