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The Production and Financing of Regional Public Goods

Vito Tanzi

Special Initiative on Trade and Integration

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This document is part of the first component of the Initiative.

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THE PRODUCTION AND FINANCING OF REGIONAL PUBLIC GOODS

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I. INTRODUCTION

One does not need to go back too far in time to find a world in which governments spent little and their economic relations with other countries and with the outside world were limited. For example, at the beginning of the last century the average spending of the now-industrial countries was generally less than 15 percent of their gross domestic product (GDP), or much less than what most countries, and especially the industrial countries, now spend.

Although at that time (a) international trade had already become important, (b) there were significant capital movements, and (c) many individuals were emigrating to other parts of the world in search of better economic opportunities (see Baldwin and Martin [1991]), the countries' economic policies were shaped predominantly by domestic needs and considerations. For example, the main functions of embassies and diplomats were to follow political developments abroad and to negotiate political agreements with other countries. As a consequence, most embassy personnel had little training in economic or financial matters.[1] At that time there was no need to harmonize or coordinate the public finances of different countries, because, it was felt that there was little or nothing to coordinate in this area.

This view of the world prevailed until recent decades even though the world was changing and, using a much-abused expression, it was becoming more globalized. This view of the world was evident in the public finance textbooks that, until recently, continued to discuss various economic concepts and tools under the implicit assumption that there is no outside world.[2] The role of the state was identified strictly with domestic public needs and objectives; therefore, it stopped at the frontier of a country. In these textbooks public spending still meant domestic public spending, even though it might have included some foreign aid when foreign political objectives were pursued; and public finance still meant domestic public finance even when it included some foreign borrowings or grants. The same was true for regulations that were directed to domestic activities or to the activities of "citizens".[3]

Consider, for example, the concept of tax incidence and tax shifting. Taxes on consumption (excise or general sales taxes) were assumed to be borne by domestic consumers, often identified as "citizens". The possibility that these taxes could be exported, especially when a country was small and attracted many foreign visitors, was not contemplated. Taxes on income were assumed to be borne by the country's residents and, if levied on enterprises, by the (domestic) owners of the enterprises. These assumptions are, now, no longer necessarily correct.

Some decades ago, in an important paper, Arnold Harberger argued that, in an open economy, capital might emigrate to escape a high corporate tax rate (see Harberger [1958]). Furthermore, in

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[1] Some countries have only recently increased the economic knowledge of embassy staff. This, for example, has been an objective of the current (Berlusconi) Government of Italy.

[2] See almost any public finance textbook until around 1990.

[3] The welfare of foreigners did not enter as an argument in the welfare function of national governments.

later papers, he argued that most economies were open with respect to capital movements. If that was true when Harberger wrote his papers, it must be even truer today, in the era of globalization. In a globalized world, with free movement of capital, financial capital can evade or, at least, avoid taxes by escaping to countries or territories where taxes are lower or can be evaded more easily.

Even more recent is the idea that not only enterprises but also individuals can avoid high tax rates if these individuals are very talented and, as a consequence, are mobile; or if their income is derived from financial sources, (see Tanzi [1995]). They can move their tax addresses or send their financial capital abroad to lower tax countries. The large fall, experienced in the past two decades in the marginal tax rates on the incomes of corporations and individuals, and the introduction of the "dual income tax" in several countries, are indirect acknowledgments that it has become difficult to keep taxable incomes within a country when its tax rates are high.

Concepts such as externalities and public goods have traditionally also been considered within the context of closed economies. The traditional Pigouvian treatment of externalities, that required that the government tax the generators of negative externalities and subsidize those who suffer from the effects of these externalities, assumed, implicitly, that both parties lived in the same country. Otherwise the government would not be able to follow Pigou's suggested policies. Even the Ronald Coase solution that assumed that without the intervention of the government, there could be negotiations between the parties (that would lead to transfers of resources between them aimed at internalizing the externality) implicitly assumed that the transactions occurred within the same political jurisdiction, i.e., within the same country.

The concept of public good, as defined by Musgrave, Samuelson, and others, was also largely a nationally based concept. As in the classic case of defense spending, the public good was assumed to benefit the population of a country; however, because of two technical characteristics (mainly the difficulty of excluding from the benefits that it provides those who do not pay for it; and the fact that, unlike private goods, adding other beneficiaries to the use of the public good does not reduce the benefits to current beneficiaries) it had to be financed by the government. No private individual would have the incentive to provide it.

The world has changed much from the time when most externalities and public goods could be assumed to stop at the frontiers. It is now widely recognized that externalities and public goods (or often "public bads") often cross-frontiers assuming either a global character (as with global warming) or a regional character (as with regional conflicts or regional infrastructure).[4] A key question then is how to deal with these multi-country externalities or public goods in a world that continues to be characterized by national governments.

It is not always easy to separate global from regional public goods so that the following discussion will touch on both. However, the main focus of this paper will be on public goods with regional characteristics. Public goods can be "pure" -when they satisfy fully the two characteristics mentioned above- and less pure -when they satisfy only in part those characteristics. To keep the discussion simple, this distinction will be largely ignored. Especially for regional public goods, they tend to be less "pure" in several circumstances.

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[4] For a discussion of global public goods see Kaul, Grunberg and Stern [1991]. For a discussion of regional public goods, Estevadeordal, Frantz and Nguyen [2004]. See also Tanzi [2005].

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II. THE INTERNATIONALIZATION OR REGIONALIZATION OF PUBLIC GOODS

While no global government has been created and while it is still unlikely that one will be created in the foreseeable future, the world community and the communities of some regions have responded to the growing need for roles and functions that such government would fulfill by developing proxies. These take the form of multi-country institutions, agreements, and "soft laws" (i.e. a set of agreed principles) that, to some extent, are expected to fill the gap between the intervention required by the growing importance of global and regional public goods, and the still limited national capacity to deal with them. In Europe, the European Union is an outstanding example of this response. However, more modest responses, in the form of trade agreements, customs unions or in other forms are evident from other regions. These proxies have grown in number and in importance since the end of the Second World War and their scope has been expanding over the years.

When the need for more governmental intervention appears in a specific country, that need is often recognized immediately by some group or lobby in that country. Thus, political forces are set in motions that encourage the policymakers of the country (both within the executive and the legislative branches) to consider those needs and to determine whether public action is needed. Lack of information is rarely the motive for lack of public action within a country. More often it is lack of financial resources and the absence of a political consensus on what to do that lead to inaction.

When the needs are in the global arena, the process of recognizing them and acting on them is inevitably more haphazard and random. Information gaps are likely to be larger, pressures to deal with them less strong, and delays in response longer. Also the response is less full than for domestic needs. The far away or foreign populations needs are likely to generate less intense pressures for governmental action than domestic needs. By nature people tend to think and act locally. As a consequence, the allocation of resources is likely to be distorted in favor of domestic need and action. This, however, is probably more for global public goods than for regional public goods for which information may be more forthcoming and the needs more immediate and evident.[5] Thus the natural progression from national governments toward a global proxy may go through regional arrangements. The experiment with the creation of the European Union will have much to teach the world.

How much scope and resources nations give to the proxies for a regional or, especially, world government to react to multi-country needs often depends on the internal decision-making process of the national governments of the major and richer countries. These are the countries that have the political power and the economic resources. These governments in turn react to the pressures that their citizens exert on them. The existence in these countries of powerful non governmental organizations (NGOs) or of influential individuals with an internationalist view of the world can lead to more resources being allocated to multi-country needs. General attitudes are also important. Over the years, periods of multinationalism, such as the period after the Second World War, in which major countries were more willing to share the decision making process, to delegate functions, to provide resources to multinational institutions, and to commit themselves to international agreements, have been followed by periods when, within some major countries,

[5] On the other hand global needs have the support of the United Nations that regional needs at times do not have.

unilateralist forces have reaffirmed themselves and have reduced the support for multinational actions. However, regional arrangements have been less affected by these considerations than global arrangements.

Since the end of the Second World War, countries have become progressively more aware that economic decisions in monetary, fiscal, environmental, health, safety, immigration, and other areas should take a global or, more often, a regional context into consideration. Decisions by individual countries in these and other areas, should take into account the impact that they are likely to have on other countries as well as the impact that the actions of other countries have on them. They have also become more aware that, to be effective, some decisions can only be taken in a multi-country context.[6] However, major questions remain on how best to do this.

This awareness has been enhanced by technological developments, as, for example, the role of CNN and other media operating globally as well as the growing use of the Internet. These developments have reduced the cost of getting information and have, thus, made much more information availabe than in the past to the citizens and the policymakers of specific countries. For example, information on natural disasters, ethnic wars, or terrorist acts, is now more quickly and more fully available than in the past. This process has been helped by the role of a growing international civil society, that is, of people and institutions that follow these multi-country developments. People are now better and more quickly informed about what is happening in other countries and react more quickly and more strongly to these developments. They can perceive more easily that particular developments abroad (wars, illnesses, pollution, crimes) can, sooner or later, have significant effects in their own countries. Still, what happens in their own countries continues to receive far more attention and to elicit more and quicker action than what happens elsewhere.

Globalization has linked countries in a matrix of economic and social relations that has increased the scope, or at least the perceived scope, of cross-country externalities and public goods. While in the past the main cross-country externalities were connected with wars, invasions or, perhaps, periodic plagues, today they extend to many other areas including even the rate at which the countries' economies grow. A higher or lower growth rate in an important country or region is seen as having an impact on the economies of other countries and, thus, to become a factor in the attitude and policies of these countries. It can lead to pressures on the part of other countries aimed at influencing the former's rate of growth. This has been evident, for example, in the discussions in recent years between the United States, on one hand, and Japan and the European Union, on the other. Even the exchange rate is now seen to create international externalities that can affect negatively other countries as shown, for example, by the current debate over China's exchange rate or the concern over the U.S. current account.

There is an increasing number of areas in which the links between the policies or the actions of one country and those of other countries have become important. Therefore, multi-country action or policy coordination can produce desirable "public goods", defined these in a broad and non-technical sense. For some of these public goods the relevant space is the whole world and thus they can be referred to as "global public goods". For others, the relevant space is a group of countries

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[6] For example, the Italians have been arguing that immigration is a European problem and have been arguing for a European solution.

or a region and, thus, they can be referred to as "regional public goods". We must recognize the growing scope of the concept of public good from the original narrow, local definition (the classic lighthouse, or the clock on the bell tower), to the larger, national definition (national defense), to the regional and global definitions. One day we may even talk about universal public goods. In this paper we focus on regional public goods but keep in mind that, often, the whole world can be the reference area and it may be difficult to distinguish regional from global public goods. We shall outline, briefly, areas which can be associated with regional public goods. The listing cannot be exhaustive and undoubtedly some important areas could be added.

A. Taxation

Because of potentially damaging tax competition, taxation has become an important area for regional cooperation. This issue has become particularly significant within the European Community where several "directives" have tried to eliminate from the tax systems of member countries elements or features that interfere with the smooth functioning of a common market. If, within a region, some aspects of the tax system have the potential to damage the allocation of resources or to give unfair advantages to one country over others, a regional public good would be created by the elimination of these features. The regional public good is the better functioning of the market.

A good example, relevant for the Latin American region, is the case of tax incentives provided by particular countries to attract investment by foreign enterprises that, without the incentive, might have gone to some other country of the region. Multinational enterprises have often "shopped" for the most attractive tax incentives. Therefore, the countries of a region may feel forced to provide these incentives by the fear of losing foreign investment to a neighboring country that gives these incentives. The result is that all the countries lose while the foreign corporations gain. A regional agreement not to give these incentives could produce an important public good. Also, agreements among countries to eliminate features that distort trade would produce positive regional public goods.

B. Environment

Economic development, and the pressure that it puts on the physical environment, has created cross-country negative externalities and "public bads". For example, it is likely that the pollution created by the rapid economic growth in China will inevitably affect Japan. In some cases (global warming) the effects are global. Often, however, environmental problems are regional as with acid rain, pollution of rivers that flow in more than one country, regional disposal of garbage, excessive pollution of the air, and so on. Regional cooperation can produce a public good, in the form of a reduction of pollution, that is valuable and that cannot be achieved by the uncoordinated action of the countries in the region.

C. Health

The control of infectious diseases is likely to be more effective when several countries cooperate. Many of these diseases are regional (malaria, dengue, West Nile, etc.) even when they have the ability to spread more widely. For example, SARS appeared in a specific geographical area and regional cooperation in that area was necessary and will continue to be necessary to prevent the spreading of this disease. Clearly this cooperation can produce an important regional (or even global) public good that is the prevention of illnesses and a healthier environment.

D. Criminal Activities

Criminal activities range from purely local to truly global. Most crimes are perpetrated by individuals who operate within the area in which they live. A few are perpetrated globally (illegal sale of weapons, money laundering). However, a growing number of crimes have a regional dimension in the sense that the criminals operate in more than one country of a given region (see Tanzi [2001]). This is true for prostitution, the smuggling or illegal traffic of individuals and, to a certain extent, of drugs, and other similar crimes. Once again, cooperation among relevant countries that succeeded in reducing these regional crimes would, de facto, produce an important regional public good in the form of increased safety.

E. Infrastructure

Because of autarkic economic policies, in the past countries tended to favor national over regional physical infrastructure. However, with the increasing openness of countries and with growing trade and integration and movement of individuals, the need for regional infrastructure has become evident. In fact this is an area in which there is not much point in talking about global infrastructure. Regional infrastructure has characteristics of regional public goods, because it may contribute to the economic development or the economic integration of a region. To be created in a sufficient and efficient way, it requires full cooperation of the countries that form the relevant regional grouping.

There are many other areas in which regional cooperation is required to produce what could be called regional public goods. These areas include, inter alias, agreements on the use and sharing of fresh water; harmonization of rules related to the financial market to develop more efficient regional uses of financial capital; harmonization of regulations concerning security to reduce acts of terrorism; coordination in the fight against corruption and for better governance, for example, through agreed definitions of what constitutes corruption and through common penalties for acts of corruption; coordination for freer movement of goods and services within particular regions; agreements on the promotion of democracy and peace in particular countries; and even agreements on protecting forests and biodiversity within a region.

The areas mentioned above, and others not mentioned, are characterized by common features: the existence of cross-country spillovers externalities; the need for public intervention that generally transcends single countries; and the need for the coordination of the interventions. Because of these features, there is often an underproduction of these public goods. Putting it differently, all the areas mentioned above point to the need to "coordinate" and to finance multi-country actions. If world or regional governments existed, these are areas in which they would be active by coordinating and financing the provision of these public goods. In other words, they would prevent the underproduction of these regional or global public goods. To a limited but still significant extent, this is what the European Union has been trying to do with varying degrees of success. It can be argued that the creation of the European Union has reduced the underproduction of regional public goods in Europe. Other regional institutions, such as the Andean Community of Nations, CARICOM, SIECA and other regional associations have had a more limited assignment of responsibilities and fewer resources to carry them out.

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III. A DIGRESSION ON DISTRIBUTIVE JUSTICE AT THE INTERNATIONAL LEVEL

All the examples of international public goods mentioned above deal with the allocation of resources. The argument made was that in the absence of adequate interventions at the regional or global level, too few resources would go toward the provision of these (regional or global) public goods. The list of areas that justify action at the multi-country level could be extended, and, in fact, it is often extended to introduce the more controversial area of income redistribution across countries.

There is now a lot of statistical information that indicates that the distribution of income within countries -measured, for example, by the Gini coefficient- is very uneven. In several countries the Gini coefficient is well above 0.50. The distribution of income is also very uneven at the international level. A few rich countries have a very large share of the world income, while some countries in Sub-Saharan Africa and in the South of Asia have populations that live on very low incomes. The World Bank has reported that in 1999 there were 45 countries that had per capita incomes of less than US$ 500 a year, while 12 countries had per capita incomes that exceeded US$ 25,000 a year (World Bank [2000]).

This very uneven international distribution of income has led some observers to argue in favor of distributive justice at the international level that would call for some leveling of per capita incomes across countries. This leveling can come from pursuing programs, such as those that would liberalize trade for agricultural products, that would make it possible for developing countries to grow more rapidly.

From a public finance point of view some might argue that programs should be developed that would "tax" rich countries and "subsidize" poor countries. This policy could be adopted internationally or within a region. To some limited extent, the European Union has been trying to do this with the structural funds given for the development of poor areas in Europe. A world government or even a super national, regional government would probably wish to do this if it could be done without major costs in terms of efficiency and if it were possible to tax the richer individuals in all countries and to use the resources to help the poorer individuals in all countries. However rich countries have poor people in them and poor countries have rich people in them. Thus, it would not be desirable to simply tax a rich country (as a country) and simply transfer the resources to the governments of poorer countries. However, the existing international organizations, whether they are global or regional, do not have the power or the means to tax the citizens (qua citizens) of member countries because the national governments have not given them this power.

It is, perhaps, worth recalling in this connection that the view that the role of the state in a market economy must include the redistribution of income across income classes -this is the "distribution branch" in Musgrave's popular classification- reflects relatively recent thinking. There is no mention of this role in Adam Smith's famous description of what the state should do. In fact, there was hardly any mention of this role in the public finance literature until the early part of the 20th century. This role should not be confused with that envisioned by socialist writers of the 19th century, including Karl Marx, who proposed to abolish private property and private activities. These writers would transfer the decisions on income distribution and on wealth ownership from the market to the state as it was done in centrally planned economies. In other words, they would abolish the free market.

In market economies, the redistributive role, as one of the fundamental and legitimate functions of the state, reflects a 20th century innovation. It conflicts with a fundamental right of a market economy -the right to property. In order to redistribute, the government must appropriate resources that legally belong to some taxpayers. It must do so not to provide them with public goods and services but to provide them with a society with a better distribution of income. Thus, redistributive taxation must be justified on the principle of ability to pay and not on that of benefits received from the state's activity. In this latter case the taxes can be considered payments for the public services that the state provides. Thus in a way they do not violate property rights. To continue to base taxation on the principle of benefit received, it is necessary to assume, as some writers have argued, that a better distribution of income is a public good that benefits everyone.

Musgrave seemed to recognize this difficulty when he wrote that it is difficult "to decide what the proper state of distribution should be." He added that decisions on redistribution "cannot be made by a market process" and, added, "that a political process… is needed" (Musgrave [1958], p. 19). In the 20th century, it was mainly the redistributive role that led to the great expansion in public spending observed in industrial countries (Tanzi and Schuknecht [2000]). Without that role, public spending would have grown far less as a share of GDP. However, theoretically and politically that role remains controversial.

In industrial countries, which are the ones where the so-called "redistributive public spending" has played a large role in the growth of public spending, redistribution has not been pursued through the taxation of the rich and the direct transfer of cash resources to the poor. There has been little targeting. Rather, the objective of the distributive branch of Musgrave's framework has been pursued through public programs for the whole population such as public pensions, public education and health, unemployment compensation, and other similar programs. In other words, countries have developed general programs that, in many cases, have allowed poorer individuals to benefit. The decisions on these programs were made, democratically, by the national governments and were approved by the national legislatures that represented the countries' citizens. Thus, Musgrave's political process was in operation.

Redistribution across countries, justified on the basis of differences in per capita incomes, raises difficult questions that do not arise when the redistribution is within a country. How would the decisions be made? Who would make them in the absence of a legislature that represents the global or regional community?[7] The political process mentioned by Musgrave is largely missing and it is difficult to think of an acceptable substitute.

Suppose, for example, that it were possible to tax the rich countries with the objective of transferring the resources thus raised to the poor countries, assuming that the line between "rich" and "poor" countries could be drawn. How would the transfer take place? To whom would the money go? Who would decide on how to use these funds? The policymakers of the rich countries, who could claim to represent the taxpayers; those of the poor countries; or the employees of international or regional institutions? How would one insure that democratically based processes play a significant role? How would the creation of what is sometimes called a "democratic deficit" be avoided? Democratic deficits arise when non-elected individuals end up making decisions that should be

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[7] Within the European Community, the European Parliament approves these decisions.

made by elected representatives of taxpayers. This would happen if the employees of international or regional institutions ended up making these decisions.

An equally important question is how to prevent situations where the middle classes of the rich countries may end up subsidizing the Swiss bank accounts of the government officials of some poor countries. How would one prevent major public choice problems from arising in this process?

For all these reasons it must be concluded that the objective of global income redistribution, though a clearly important and noble one, must be kept separate from decisions or processes that relate to the existence of important cross-countries externalities and global public goods. These latter decisions refer to the allocation role of the public sector. The assumption of this role on the part of the agencies or institutions that we have referred to as proxies for a world government is likely to be less controversial. Thus, in this allocation role, national governments may be more willing to assign to international agencies and institutions a more important and permanent responsibility. For the redistributive role, however, national governments are less likely to assign permanent responsibilities to the international agencies but would want to act more directly. Of course this does not exclude that, from time to time, as for example with the Poverty Reduction and Growth Facility Program, aimed at reducing the burden of foreign debt on very poor countries, the rich countries may assign to an international institution the task of pursuing a program with a largely redistributive objective.

At the regional level, the arguments presented above may have to be amended. If a "region" is made up of relatively closely integrated countries and if the exchanges in these countries (including the movement of persons) become relatively easy, the region may begin to look like a country. In this case the population of the region may acquire an interest in promoting a better distribution of income to eliminate pockets of poverty and underdevelopment that can generate cross-countries negative externalities such as cross-border crime and excessive emigration from poor areas to rich areas within the region. These factors inevitably affect crime rates and put a burden on the welfare payments of the receiving countries. A better distribution of income promoted by income transfers may thus acquire aspects of a regional public good. These considerations may be clearly important for regions such as Central America and the United States, or Bolivia and Argentina.

The European Union has promoted a program of cohesion policies based on transfers from the Union budget to poorer regions of the Union. These transfers absorb a significant share of the Union’s budget, a budget that is financed by two main sources: the proceeds from the Union’s revenue from the common tariffs imposed on goods that come from the rest of the world; and a share of revenue from the value-added tax. The Union’s budget is about one percent of the Union’s gross domestic product. There has, so far, been great resistance on the part of the countries’ governments to increase this budget. There is also concern as to how the addition of new members will affect the distribution of the Union’s budget.

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IV. THE FINANCING OF REGIONAL PUBLIC GOODS

The institutions and agencies -such as the United Nations, the World Trade Organization, the World Health Organization, the regional developments banks (IDB, ADB, etc.), the Andean Community of Nations, the European Union, and so on- that operate as proxies for non-existing multi-country governments, need to be able to finance their activities including those connected with the provision of global and regional public goods. Thus, they need to have some controls on the instruments of "finance". At the same time national governments will inevitably continue to take unilateral actions that provide "finance" for their international activities not channeled through the super national institutions.

The instruments of finance can be grouped in different categories. The first is obviously spending. Just as national governments pursue many of their objectives through spending, international or regional institutions and agencies need financial resources to sustain a staff with expertise in various areas and to finance particular activities. This staff can use its expertise to solve or deal with problems that are likely to arise in the regional or global arena. This staff-related spending could be defined as ordinary. However, there may be situations, as for example those that arise in chaos-related activities, when extraordinary spending may be required.

The allocation of resources for spending by international institutions has followed different patterns. In some cases (IMF), the countries have provided the international institutions with a kind of extended access to a given amount of resources. That is, they have provided resources for various years. This has happened to a certain extent also with respect to regional banks such as the IDB and the ADB. This endowment is adjusted periodically, as for example through the quota increase exercise at the IMF or with capital replenishment for regional banks. The availability of resources over several years allows an institution to better plan its activities. In some cases, when the funds are partly used for lending activities, the institutions have been allowed to borrow from the international financial market or even from some member countries, with the member countries assuming some risk for the loans given. In other cases, including that of the United Nations, the approach has been closer to that of clubs whereby the members contribute fees that are related in some ways to the members' sizes or to their economic importance. This approach creates occasional difficulties for the institutions when important countries refuse to pay or are late in paying their dues.

Apart from the resources that are made available to the international institutions for regional or global activities, several countries have national programs that directly finance foreign activities and, especially, activities in developing countries. This, for example, includes the activities of the Agency for International Development (AID) in the United States, the Canadian International Development Agency (CIDA) in Canada and similar national agencies in other countries. It also includes aid given through agencies of the European Union.

Countries that put resources in these national programs of assistance, rather than channeling them through the existing multinational institutions, do it either to achieve national political objectives, or even national economic objectives, when there are requirements that the aid given must be used in the country of the giver, or because they may feel that these resources can be used more effectively when the countries themselves monitor the programs. Thus, the reputation of the multinational institutions may play a role in this allocation of resources between national programs and programs sponsored by multinational institutions. However, the political reasons are likely to be the more important ones. Some of these reasons may originate from historical links with particular developing countries (Italy and Somalia; France and Ivory Coast; United States and Haiti, etc.); or they may derive from geographic vicinity (United States and Central American countries).

Industrial countries can also "finance" international activities and regional public goods through "tax expenditures", by allowing tax deductions for taxpayers who contribute to particular global or regional activities. These activities may be carried out by foundations (as for example the one set up by Bill Gates). They may represent direct financing of international institutions (as in Ted Turner's donation to the United Nations). Or they may represent contributions by individual taxpayers to non governmental organizations that operate predominantly in developing countries (e.g. doctors without borders).

Finally, regional global activities can be "financed" through the proper use of a regulatory budget. It is well known that economic regulations can often be decomposed into taxes for some and subsidies for others (see Tanzi [1998]). If the subsidies are to the regional environment and the costs are to the country or to a group of countries, the regulation can be thought of as the analog of a financial assistance. An example of this might be a regulation not to pollute a river that flows into other countries. In this case, the regulation acts as a tax on the polluting country and as a subsidy to the country that is being polluted.

It is not always easy to identify those who benefit from the subsidy and those who pay the cost. Analytically, policies based on explicit taxes and subsidies may be more efficient in achieving particular objectives because they can be calibrated or targeted more precisely. However, administratively, regulations are generally easier to apply. For example, the Kyoto Round of pollution control was intended to be based mainly on the use of regulations.

Regulations aimed at affecting the regional or global environment can be introduced unilaterally by countries. For example, through regulations a country could reduce domestic pollution that could have international ramifications such as global warming or abatement of regional pollution or it can reduce money laundering that promoted regional criminal activities. Regulations can be introduced collectively or multinationally, through agreements with other countries. Alternatively, they can be promoted by international or multi-country organizations, authorized by member countries to regulate particular activities. Some international organizations (WTO, BIS, IMF) have been authorized by their member countries to impose regulations on their member countries with respect to particular activities (tariffs, capital requirements for banks, exchange rates, etc.).

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V. FACTORS THAT INFLUENCE "FINANCE"

In a world in which countries were totally altruistic and in which they had total trust in the objectivity and in the effectiveness of regional or international institutions in pursuing the regional or global public welfare, countries would promote regional or global objectives through the activities of regional or global institutions or, when necessary, through multi-country agreements or rules. However, various reasons exist why countries may not follow this path.

In the first place, different levels of development by countries may create different objectives in the international sphere. For example, countries that have already reached a high level of per capita income may have a stronger preference for a physical environment with lesser pollution as compared with countries that are still relatively poor. Compare, for example, Japan with China. Some may believe that there is a trade-off between growth and a cleaner environment even though in reality this trade-off may or may not exist. This trade-off has become a major issue in China. This means that the contribution that countries would want to make to the "finance" of a cleaner environment will be different. These differences may exist even within groups of countries at similar levels of economic development depending on their assessment of the causes of a polluted environment (say of the factors leading to global warming or regional pollution) or of the science behind the measures suggested to improve the environment. These conflicts have become apparent in the countries' attitudes *vis-à-vis* the Kyoto Agreement on Global Warming.

In the second place, the size of a country may influence its attitude towards delegating some of its objectives to an international bureaucracy. It is likely that the smaller a country is, the more it may wish to live in a world in which general rules apply to all. Large countries may be guided by their own rules and may not wish to be restrained by rules developed by others. They may pursue what could be called the rule of the strongest or the golden rule, that is, the one who has the gold makes the rule.

This leads to a difficult issue that can only be mentioned briefly. How should the voting power be distributed among the member countries in multi-country institutions in which the members are independent countries and where decisions are made by voting? Should each country get one vote regardless of its size, as in the UN general assembly; or should the vote be weighted to reflect some important characteristics of the countries such as economic weight (as in the IMF) or perhaps population? It is easy to find faults with each of these alternatives, but it is clear that the voting system is likely to affect significantly the willingness of a country to "finance" a given institution or to be guided by its decisions. This in turn will affect the capacity of a multi-country institution to deal with regional/global public goods or externalities.[8]

Third, cultural factors will affect a country's disposition *vis-à-vis* the financing of regional or global public goods. Apart from the importance that comes from their sizes, Anglo-Saxon countries may be differently disposed towards this financing compared, say, to Scandinavian countries. Also cultural factors may affect the perception of the extent to which intervention solves problems. Countries in which "public choice" arguments have been popular, in the sense that many believe

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[8] As global and regional public goods become more important, the relationship between systems of voting within the multinational institutions and willingness to finance their activities is likely to attract more attention.

that public sector's intervention may worsen a problem, rather than solve it, are likely to carry this attitude *vis-à-vis* public intervention to the multinational level. For example, some observers have argued that, by creating moral hazard problems, the IMF intervention in financial crises has made these crises more likely and deeper. This was a popular argument during the South East Asia financial crises of 1997-98.

Cultural factors can also be linked to a country's history or geography. It is likely that former colonial powers, such as France and the United Kingdom, will have a preference for helping particular countries, while geography may lead other countries to give preference to some activities in some countries compared to others. Some observers have pointed out that the United States has shown greater willingness to help, say, Mexico, compared to its willingness to help, say, Indonesia during financial crises.

Even the religious background of some countries, or the language they speak, or their belonging to some group of countries (EU, Commonwealth) may influence the attitude of their governments to finance regional activities conducted through super national institutions.

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VI. COORDINATION WITHIN A COUNTRY

Up to this point we have discussed issues of coordination among countries in the financing of international institutions and or multinational activities related to cross-countries externalities and regional public goods. There is, however, another problem of coordination that needs to be mentioned. This is coordination within a country's government. Governments are not monolithic institutions with a well-defined nerve center where all important decisions are made. Rather, they are often made up of many parts, each with a diverse objective or area of interest. In such an environment, different parts (for example, different ministries) will be concerned with different areas and will promote the area of direct concern to them. For example, a health ministry will have a strong interest in health issues, an interior ministry in security issues, a finance ministry in tax issues, and so on. Given these different interests, it will not be unusual for different parts of the same government to react differently toward the activities of a multinational institution. For example, ministries of finance have been less enthusiastic than spending ministries toward external loans for regional infrastructure projects.

It is not rare that a multinational or international agency or institution receives at the same time conflicting pressures, on some issue, from two ministries of the same country. For example, at a given time the IMF was being sharply criticized by some European countries' ministries for not showing concern for environmental issues while the finance ministries of the same countries were criticizing the Fund for paying any attention to environmental issues. The same happened when the Fund began to show some concerns for equity aspects of policies.

In general within-country coordination is easier in presidential governments, where there is a kind of nerve center at the presidential level so that decisions on the allocation of the budget among domestic activities and between domestic activities and global activities are made more explicitly. But even then there may occasionally be disagreements. In parliamentary forms of government such a nerve center is often missing so that there is more confusion and less coordination on the allocation of resources. Often the political power of individual ministers and their personality play more of a role.

In these domestic decisions the role of information is very important. As already mentioned earlier, regional or global needs tend to be seen as less important or less urgent than domestic needs. A democratic government that wishes to remain in power will often get more votes if its public spending is for domestic activities. When it pays significant attention to regional or global activities it is often accused of spending money abroad or on foreigners when there are unmet domestic needs which, undoubtedly, there always are. Only a forceful distribution of relevant information, accompanied by repeated explanations of why it is important to be engaged into, and to support, regional or global activities can reduce, if not eliminate, this bias for domestic spending. The multinational community and the relevant NGOs can help in providing this information. Thus the role of institutions such as the Asian Development Bank and the Inter-American Development Bank is important. Ironically non-democratic governments may be less bound by these biases.

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VII. SUMMARY AND GENERAL CONCLUSIONS

The role of the state in the economy has been traditionally considered to be limited to the territory controlled by the government of a country. This could be referred to as the territoriality principle. But globalization has been creating public needs that cut across and transcends national frontiers and that cannot be dealt with by the market alone. These needs might require multinational governments to fully identify them and deal with them to the extent possible. However, there are no such governments and it is unlikely that they will come into existence anytime soon. In the absence of a world with multinational governments, a plethora of international and multinational institutions and agencies, as well as various agreements among countries, soft laws or rules, have been created which provide some kind of proxy for such governments. In some incomplete and approximate way these proxies try to fill the gaps created by the absence of super national governments. Some of these agencies or institutions have been given clearer mandates than others. None of them has been given the power to tax that characterizes national governments. The European Union is the institution that has come closest to achieving some taxing power. Thus, to different degrees, these institutions depend on financial contributions and on other forms of financial backing on the part of national governments.

National government exists to satisfy domestic needs which, for a variety of reasons, often appear more important to their citizens and their political leaders than non-country needs. This creates a bias in favor of domestic expenditure. Thus, some constituency is necessary: first, to establish that there are genuine multinational social needs; second, to convince the citizens of the countries that these multinational social needs can be met by the existing multinational institutions and agencies, provided that they have adequate finance for their activities; and third, to reduce opportunistic or free-riding attempts on the part of some national governments aimed at shifting the financing burden on others.

To move to an international allocation of resources closer to the optimum -interpreted as what well-informed multinational governments, acting in the interest of the international community, would do- particular actions will be needed on the part of the existing multinational institutions and national governments. The more effective these actions are, the closer the total output of public goods will approach the optimum.

The multinational institutions and agencies must, first of all, make sure that they remain faithful to their original mandate and, if necessary, campaign for a clarification, or a streamlining, of that mandate. One of the major problems, especially for international institutions, has been a confused, opaque, or anachronistic mandate. Another has been overlapping mandates. This, for example, has been a problem over the years between the World Bank and the IMF that has required, more than once, agreements between them on which institution should do what. The same problem can exist to some extent between the World Bank and the regional development banks such as the IDB and the ADB.

Confusion with respect to mandates has often led to what is defined as mission creep, that is, the gradual or progressive expansion of an institution’s sphere of action into areas that may not have been contemplated by the national governments that finance the institutions. Mission creep may result from justified, or at times not fully justified, attempts by an institution to deal with new problems or to extend its influence over new areas. Ambitious managers may encourage this expansion. More often, however, mission creep may be the reaction, on the part of an institution, to the pressures that come from some powerful national governments to induce the institution to operate outside of the envelope represented by its original mandate. These pressures must be resisted and, when they persist, an explicit discussion of the institution's mandate must be requested. It must be realized that some governments may see particular international institutions as convenient instruments for pursuing their own policy objectives, which may or may not coincide with those of the regional or global community.

A second important line of action on the part of the regional or international institutions must be that of generating needed information while reducing the cost for the governments and the citizens of the member countries of getting access to it. In some way the generation of this information may itself be seen as an important public good. These institutions exist because there are super national needs that can be met by their actions. Thus, they must be able to explain the existence of these multinational needs and the consequences of not meeting them. They must also explain how their actions are making a difference and how, for example, more finance would produce benefits that exceed the cost.

This information must be validated by respectable and competent, independent evaluators. Furthermore, it must be available at low cost to any interested citizen. Internet web sites now provide ideal tools for this dissemination even though only relatively few people access them so far. An opaque mandate, combined with some mission creep, and with an absence of reliable information on the activity of an international agency or institution, is likely to be a damaging combination for the long run support of an institution that deals with multinational needs.

A third line of action on the part of the institution must be its capacity to propose realistic solutions to real problems. An institution cannot wait for suggestions from the governments of member countries for solving particular problems. These suggestions are likely to reflect some biases on the part of the proponents. These biases may lead to the proposal of solutions that benefit some countries or regions more than others. Solutions proposed by the multinational institutions themselves, including those related to their financing, are likely to reflect more information and fewer biases than those suggested by national governments. The proposal of solutions by the institutions must be accompanied by a diplomatic effort, on the part of their staff, to "sell" the solutions to the member countries. This effort at coordination is very important and must receive the full attention of the senior staff of the institutions. Through this effort attempts at free riding on the part of some countries, or at applying what we have called the "golden rule" on the part of others, could be contained.

Finally, and perhaps most obviously, the multinational institutions must make great efforts at being, and at being seen, as places where inefficiency, incompetence, favoritism, and corruption do not find a fertile environment. They must be places of excellence if they do not wish to create reasons that reinforce the already natural biases against the financing of their activities as compared with the domestic or the direct foreign activities of member countries.

It is more difficult to discuss the action on the part of the governments of the member countries. As we have already mentioned: (a) there are biases (both political and those created by informational problems) in favor of domestic spending; (b) there are biases in favor of direct action abroad to promote specific national interests; (c) there are pressures on the part of powerful countries to use multinational institutions as instruments for their own political objectives; (d) there may be conflicting views within a government, and within different ministries, on which international activities or institutions to finance; (e) there may even be biases among the civil society, represented by non governmental organizations (NGOs), on which activities to finance. In fact, NGOs may, at times, see themselves as competitors in some areas with the multinational institutions.

In this domestic process the role of information is fundamental as it is that of well informed and idealistic leaders that are able to get over the natural biases that come from "preferred habitats" and that are able to see that in the long run we are all citizens of a world that is becoming more and more like a village. Without concrete actions, the under financing of regional and global public goods can only grow overtime, implying a progressively growing misallocation of world or regional resources.

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