

**Book review**

# The New Public Finance: responding to global challenges

Inge Kaul and Pedro Conceicao (eds)

Reviewed by

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Increased globalization has been creating many opportunities, namely, better allocation of resources, higher output and better living standards, and greater access to foreign goods and services. It is also prompting the countries to manage cross-border risks and respond in a more affordable and sustainable way to global challenges such as avian flu, climate change, excessive financial volatility, commodity price fluctuations, or international terrorism. In fact, the globalization process and its accompanying market forces must be properly designed so that they become inclusive forces for sustainable and human-oriented development. Therefore, all the stakeholders such as governments, international financial organizations, civil society, and so on will have to play a more meaningful role in a cooperative manner to make globalization work in the desired direction and level. Thus, the process of globalization is creating a challenge for the discipline of public finance to combine prosperity and fairness both within and across nations. The book *The New Public Finance*, edited by Inge Kaul and Pedro Conceicao, takes stock of how public finance has responded to its conventional functions of delivering public goods and achieving equity in development to the challenges of the globalization.

*The New Public Finance*, to which more than 20 eminent scholars and experts have contributed, shows that the innovation and adoption of new policy approaches and instruments promise significant cost-savings and welfare gains. Such kind of innovations might,

in fact, keep at bay the fiscal storms that analysts today see brewing on the horizon.

National governments are fostering policy harmonization behind national borders, preventing negative externalities from spilling over or external shocks from spilling in and undermining the country's stability or the security of its people. At the national level, the modern public finance is supposed to blend the state of external and domestic policy demands. The new challenges can be met through mobilizing public and private resources towards making international cooperation *behind* national borders happen, and this is the subject matter of Section I of the book.

Section I comprises six chapters. Kaul, in the chapter on the intermediary state, shows the rapid increase in external expectations on desirable national policies arising from various formal and informal governmental and NGOs (non-governmental organizations). These expectations urge national governments to pursue policies of sustainable globalization. As states respond to these demands, the external concerns become part of the national policy agendas and shape the priorities and allocation of public and private resources. In the chapter *Making policy under efficiency pressures: globalization, public spending, and social welfare*, Tanzi shows that globalization is exerting pressures on governments for increasing efficiency and constraining public spending without compromising important public policy concerns. Similarly, Heller, in the essay on internalizing cross-border spillovers, shows that the governments are struggling to maintain fiscal discipline due to growing pressures of global externalities such as global climate change. He identifies several options for complying with fiscal discipline requirements. The options are extended fiscal accounting, longer-term assessments of budget sustainability, balanced budgeting requirements, creation of fiscal headroom for drawing on as needed, and greater consideration of the political dimensions of the budget process.

As mentioned earlier, the globalization is creating opportunities and new challenges, and the effective way of meeting the challenges could be freeing the resources tied up in reserves for more productive uses. The development of new technologies and opening up of opportunities help in rebalancing the role of markets and governments in risk management. Shiller in the chapter *Managing risks to national economies: the role of macro markets*, while reminding the importance of finance and insurance

industries, proposes GDP (gross domestic product) index bonds as a tool for collective action for managing national policies in a global world. GDP-indexed bonds are a precursor to the more encompassing risk management options in macro markets. He is of the view that creating new markets where risks could be traded would encourage innovations, and so contribute to enhanced economic efficiency.

In the world of globalization, the actions taken by the national governments unilaterally do not result in global efficiency, and the efficiency requires global cooperation of varying degree. Musgrave addresses this issue in the context of taxing the mobile factors of production and Sandler indicates the need for global cooperation for tackling the problem of international terrorism. Musgrave finds efficiency and equity reasons for multilateral cooperation and suggests two principles to guide a multilateral approach—capital export neutrality and intercountry equity. Sandler considers the control of terrorism as global public good: ‘everyone’s participation is essential since the smallest provision level determines the amount of the public good that generate benefits’ (p. 199).

The remaining three sections of the book are devoted to the discussion on international cooperation *beyond* national borders. Many global issues, such as global climate stability, terrorism, communicable diseases, or economic and financial crises require some form of cooperation abroad, *beyond* borders to be resolved effectively and efficiently. The instruments being introduced into the international realm to deal with the issues are increasingly those that reflect new balancing roles for markets and states. As a result, the nature of international cooperation is changing fundamentally.

Section II comprises four chapters and shows that the involvement of non-governmental actors such as global markets, civil societies, and private foundations in decision-making lowers the risks and corrects public policy failures. Kaul in the chapter *Exploring the policy space between markets and states: global public private partnerships* shows that the public–private partnerships throughout the world are expanding rapidly and contributing to global public goods provision and foreign aid. Similarly, Conceicao points out that though the multilateral organization such as the United Nations and World Bank are still major channels for global cooperation, the picture is changing as other actors are entering the scene. The change is driven by the

changes in the international policy agenda, the fiscal constraints of the governments, opportunities presented by the international financial markets, and public choice considerations.

Conceicao, Rajan, and Shah show that the involvement of private sector in resource mobilization for project financing and delivery of international cooperation results in increased efficiency. The authors propose to establish *International Finance Facility* to get around the budgetary constraints facing donor countries. Jones, through public choice analysis of international cooperation, shows that the involvement of NGOs (for profits and for non-profits) helps in correcting the intergovernmental cooperation failure.

Section II shows how intergovernmental organizations are being re-engineered and Sections III and IV take forward this analysis. Each of these sections consists of seven chapters. Section III suggests considering the provision of global public goods from efficiency perspective. The efficiency perspective should also be met in the allocation and utilization of foreign aid, and this is the subject matter of Section IV.

The global public good provision should follow a five-tier hierarchy of preferences, with each succeeding preference considered only if the preceding one is insufficient: a preference for national action, a preference for market-based intervention, a preference for regulatory intervention, a preference for incentive provision, and international pooling and direct spending of public revenue.

Conceicao and Mendoza are of the view that the new investment thinking must ensure net economic gains, that is, the public goods provision should be based on the principle of subsidiarity. Barrett emphasizes on equity in distribution of the benefits of new international cooperation, and this approach helps in bringing on board countries that otherwise would not be net beneficiaries from the enhanced provision of the goods. Similarly, King highlights the incentives and compensation functions related to financial transfers. Sandor's analyses the development of Chicago Climate Exchange. Access to markets is an important dimension for ensuring the gains of market system. Morgan shows that facilitating access to markets to developing countries would help in harvesting unexploited efficiencies. Shifts in markets are changing role of governments in the provision of public goods. Eichengreen discusses the role of markets in managing the sovereign debts through market-based instruments. Laffan describes the evolution of the provision of the global public goods using the provision of the subsidiarity principle.

Section IV is concerned with the efficient and effective utilization of foreign aid and discusses the measures for using loans and grants more rationally. As Collier points out that the 'current pattern of using grants and loans has little economic rationale' (p. 471). He addresses how to choose between them to ensure that aid is allocated efficiently across countries. Since loans from multilateral organizations is a crucial part of foreign aid, Akyuz explores the rationale for continuing multilateral lending. The rationale for multilateral lending in the changed scenario is stronger than ever for developing countries since these countries are more vulnerable to external shocks. Like Collier, Radelet suggests that assistance strategies should be based on a country's commitment to governance and development.

Regional public goods are highly promising yet under-funded development opportunities; Birdsall shows that the proper provision and utilization of foreign aid not only helps in harnessing efficiency gains but also results in identification of economies of scale. Polak and Clark show that the issuance of new Special Drawing Rights can significantly reduce the cost of maintaining foreign exchange reserves for many developing countries and protect these countries against financial crisis.

Kremer and Zwane and Griffith-Jones and Lima discuss how to facilitate involvement of private actors in development. Kremer and Zwane show that advanced purchase commitments will provide incentives for private participation in generating and diffusing pro-poor knowledge. Similarly, Griffith-Jones and Lima discuss the benefits of sovereign guarantees in developing countries. These guarantees provide incentives for investment without explicitly requiring financial resources by the host countries. They propose three guarantee-related instruments: contingent liquidity facilities, counter-cyclical guarantees, and sovereign guarantee pools.

The policy approaches to global challenges are changing. Economic efficiency requires the understanding of how financing of international cooperation efforts actually works. It is generally a chaotic and non-transparent process. Lack of an integrated and cohesive theoretical framework, and of consolidated empirical and operational knowledge are two major stumbling blocks in this area. *The New Public Finance* tries to remove these blocks. Nobel Laureate Joseph Stiglitz called the book 'a landmark text [that] provides the important beginnings of a field that will be tilled for years to come'. Overall, this book is a must read for policy-makers and researchers.