BETTER POLICIES FOR BETTER LIVES

TAX AND DEVELOPMENT

PRINCIPLES FOR INTERNATIONAL ENGAGEMENT IN SUPPORTING DEVELOPING COUNTRIES IN REVENUE MATTERS

Preamble

Revenue from taxation and customs provides governments with the funds needed to invest in development, relieve poverty and deliver public services directed toward the physical and social infrastructure required to enhance long term growth. Strengthening domestic resource mobilisation is not just a question of raising revenue: it is also about designing a revenue system that promotes inclusiveness, encourages good governance, improves accountability of governments to their citizens, and cultivates social justice. Revenue system design and delivery is also closely linked to domestic and international investment decisions, including in terms of transparency, anti-corruption and fairness, as it may serve to improve the framework for attracting increased private investment.

Low income countries face a number of challenges to increasing their revenue from domestic sources such as a small tax base, a large informal sector, misuse of transfer pricing, low levels of per capita income, domestic savings and investment plus weak governance and capacity. Though many economies have made noticeable progress in revenue collection in the past decade, half of sub Saharan African countries mobilise less than 17% of their GDP in tax revenues, below the minimum level considered by the UN as necessary to achieve the Millennium Development Goals. Several Asian and Latin American countries fare little better. Moreover, in Africa, the increase has been primarily driven by resource-related tax revenues in oil-producing countries.

Developing countries and development partners have identified the mobilisation of domestic financial resources for development as a priority, for example, the Doha Declaration on Financing for Development and the Busan Partnership for Effective Development Cooperation. The international development community is gearing up support to developing countries in the area of domestic resource mobilisation and taxation. The track record is not poor but performance could be improved, not least to keep up with the rapidly evolving policy environment, changing needs and new players.

These principles are meant to enable developing countries to benefit from the G-20 inspired era of transparency in international tax matters. They are anchored in the 2005 Paris Declaration on Aid Effectiveness, with its commitments to ownership, harmonisation, alignment, results and mutual accountability but focus specifically on revenue matters. Based on the experience of different countries and recent research, the purpose of the principles is two-fold: i) to offer guidance for international assistance providers - donor agencies, revenue authorities and finance departments - on how to approach revenue matters with developing countries, and ii) to provide a tool for developing countries on how to engage with international partners to maximize the effectiveness of assistance for revenue issues. They can inform the design of new projects and activities, and over time, be used to measure the changing behaviour of the main assistance providers and help them reflect on, and improve, their collective efforts to support domestic resource mobilisation in developing countries.

The Principles

1. Follow the leadership of government and coordinate at the country level

Governments in developing countries are responsible for articulating their policy and administration needs with regards to mobilising domestic resources for development. For their part, international assistance providers should operate according to the Paris Declaration commitments of ownership and alignment, and follow the lead of partner country governments. International partners should collaborate to ensure that their support, including advice on tax policy, capacity development and training for revenue authorities and customs, is coordinated, delivered at the right time, appropriately sequenced and covers the various sources of revenue. International partners have the responsibility to organise their assistance in a harmonised way, with an agreed division of labour, using appropriate co-ordination and dialogue mechanisms at the country level.

2. Do no harm

International partners are responsible for ensuring that their actions do not damage the revenue prospects of developing countries. Fundamentally, this involves supporting the independence of revenue authorities to operate in accordance with their country's legal framework. It also involves being sensitive to local conditions when providing support, particularly in situations where there is a notable imbalance between the revenue collected from taxpayers and the public services citizens expect. Most donors acknowledge political will as the essential determinant of revenue system reform and of whether outsiders can help. In practice, a smarter approach is needed to ensure that support for reformers is in line with political realities. Political economy analysis can help determine opportunities for change. For instance, when a country confronts a fiscal crisis or political transition, such analysis can help to understand whether public and/or political support for reform might crystallize or fragment. In extreme cases, there is a risk that aid may dampen the tax effort in highly aid dependent countries and distort accountability between governments and their citizens.

3. Take a 'whole of government' approach to maximize policy coherence and aid effectiveness

Countries providing international assistance have a responsibility to work internally to ensure a coherent and coordinated approach to supporting developing countries in revenue matters. This 'whole-of-government' approach should involve regular coordination between development, revenue and finance officials to maximise policy coherence. The various ministries can coordinate efforts on a broad range of issues, from helping to deliver technical assistance for capacity building in developing countries (in revenue authorities and tax policy for example) through to understanding how development policy objectives can be achieved through non-classical policy levers (for example through trade policy agreements).

Ministries of Finance in particular can require nationally registered Multinational Enterprises operating in developing countries to improve transparency and fully comply with applicable tax laws; contribute to the debate on the impact that non co-operative jurisdictions have on developing countries; and provide direct assistance, for example, in the form of technical advice or by agreeing to information sharing in international tax fraud cases. In addition, to maximise aid effectiveness, donor agencies should avoid taking a supply-driven approach and respond with a flexible and complementary mix of short- and longer-term support (including technical assistance, policy dialogue, basket funds and general budget support) appropriate to each case. Regardless of the modality or modalities used, exit strategies should be in place and regularly reviewed.

4. Take account of international aspects of taxation

The consequences of globalisation are creating new and complex international cross-border revenue challenges developing countries must respond to. These include the taxation of multinational enterprises, international tax evasion, illicit financial flows, and facilitating cross-border flows while managing the associated risks. At the country level, international assistance providers can build on a reasonably strong track record in supporting domestic tax policy and revenue administration in developing countries to help build capacity on international tax policy, transfer pricing and exchange of information. Supporting north-south and south-south cooperation, through regional organisations of revenue administrations such as ATAF and CIAT, can play a critical role in promoting the exchange of experience. At the international level, international providers should work with developing countries to enhance their participation in for a where international revenue matters, norms and standards are debated and agreed. In particular, they can support developing countries efforts to consider or join new instruments such as the Multilateral Convention on Mutual Administrative Assistance in Tax Matters which allows for exchange of tax information between countries and more broadly to prepare for the adjustments that accompany accession to the World Trade Organization and the entering into of free trade agreements.

5. Balance revenue collection imperatives with fairness, equity and governance considerations

How revenue is collected matters as much as how much is collected. International support should aim to encourage compliance but avoid unwarranted coercion and an over targeting of the most easily taxed corporate entities based in capital cities. More broadly, international support should encourage consideration of the trade-offs between revenue imperatives, effective enforcement mechanisms and social and governance objectives. For example, taxation of the informal sector may be labour intensive but could drive broader governance objectives by linking more people and traders to the state. Equally, extending the geographical coverage of the state may be costly but could promote state legitimacy through furthering the reach of the state. International partners can also promote fairness and equity in revenue systems (progressivity, or the mix of direct and indirect taxes, for example). Although taxation is not the panacea for reducing inequalities in income and wealth, perceptions of fairness mean that taxation is a key instrument for addressing this issue.

6. Encourage transparency in revenue matters

Transparency in revenue matters can improve accountability and answerability in several key ways. At the country level, the public disclosure of revenue statistics and budgets can help to build accountability for taxes paid and public services delivered, strengthening the legitimacy of the state and the revenue authority. Encouraging transparency in the granting and administration of investment-related tax incentives (for example, tax holidays for Multinational Enterprises) is consistent with encouraging debate on tax simplification objectives and efforts to reduce discretionary decision making. At the international level, greater transparency can help to address issues such as misuse of transfer pricing. Transparent financial reporting by Multinational Enterprises can also help to improve tax compliance.

7. Strengthen revenue and expenditure linkages

International assistance providers can reinforce the linkages between the revenue and expenditure sides of the public finance equation, strengthening accountability and policy dialogue. While the primary purpose of revenue collection is to fund the activities of government, especially those in pursuit of economic and social development objectives, the revenue and expenditure sides of the public finance equation are often treated separately. International assistance providers can promote linkages between the two by, for example, challenging corrupt practices, linking support in the revenue area with other Public Financial Management reforms, reinforcing the role of audit institutions, bolstering parliamentary scrutiny over both revenue and expenditures and supporting non-state actors to monitor the effective use of public revenues. Given increasing decentralisation in many countries, recognising the respective responsibilities and revenue sources available to national and sub-national governments is important in this regard. In addition, international assistance missions can provide analysis of the distributional effects of tax and spending reforms, highlighting how they achieve multiple objectives (including fiscal and poverty reduction), and encourage the communication of the impacts of such reforms.

8. Promote sustainability in revenue collection systems

International support can play an important role in building sustainable national revenue systems in developing countries. Efforts to ensure sustainability start with careful consideration of the main sources of revenue available (natural resources, personal income tax and customs revenue, for example) and their respective weights in order to help strike a sustainable balance between revenue collection and public expenditures. In countries where revenue largely depends on taxation of personal income, factors that build taxpayer confidence and compliance such as the quality of service delivery and governance are particularly important. In countries with significant natural resources, international partners can encourage the sustainable tax treatment of such resources while encouraging good governance and social investments that build a relationship with citizens. In general, diversified, broad-based revenue systems linked to counter-cyclical fiscal policy better adapt to the volatility of revenue. International partners can also help make the links between taxation and broader issues of sustainability by considering environmental issues in national revenue systems for example.

9. Encourage broad-based dialogue on revenue matters that includes civil society, business, and other stakeholders

Combined local, national and global actions are critical to progress on revenue matters. Most international partner interventions focus, sometimes exclusively, on capacity building efforts in revenue administrations in developing countries. This is important work but some donors are well placed to engage other stakeholders in their efforts to participate in tax dialogue, to monitor the operations of revenue authorities, and to hold governments to account for their revenue and expenditure policies. Actions to support parliaments, civil society, labour unions, media, and business associations at the national and, given increasing decentralisation, sub-national levels, can for example, complement the efforts made to build revenue capacity. Such actions can strengthen the policy dialogue on domestic resource mobilisation and build broad coalitions for reform.

10. Measure progress and build the knowledge base on revenue matters

Measuring progress on revenue matters is in the interest of all stakeholders. For developing countries this is to assess the effectiveness of their efforts and investments while international assistance providers need to demonstrate results from their own assistance efforts. Developing countries should lead the development of country specific indicators for measuring progress with the support of development partners, including regional organisations. Although tax/GDP provides a valuable indicator to measure overall progress over time, there is a need to look to other indicators. Indicators relating to the tax effort; compliance; progressivity; ease of doing business, poverty reduction and perceptions of ordinary tax players – all measure different aspects of revenue progress and permit both developing countries and international partners to move beyond narrow revenue collection targets towards other governance and social objectives. The development and use of harmonised diagnostic and monitoring tools should be encouraged. In addition, international providers should build on existing efforts to ensure that externally funded interventions are evaluated and lessons are shared for use at both the country and international levels.

Contact

Ben Dickinson, Head of
Tax and Development Programme
ben.dickinson@oecd.org

TaxandDevelopment@oecd.org