Chapter 11

Principles for supporting developing countries in revenue matters

These principles have been initiated by the OECD's Task Force on Tax and Development and drafted by the OECD's Tax and Development Secretariat. An initial draft was welcomed by GOVNET members, involving the African Tax Administration Forum, at a meeting in November 2011. Further drafts were well received by the Sub Group on State-building, Taxation and Aid in February 2012 and by the Task Force plenary in Cape Town in May 2012. The current version includes comments made at these events. The Task Force has also recognised the importance of testing and validating the principles in developing countries to ensure their relevance before seeking OECD Committee agreement. This set of principles is a living document and will be validated before being endorsed by the Committee on Fiscal Affairs and the DAC in 2013.

Preamble

Revenue from taxation and customs provides governments with the funds needed to invest in development, relieve poverty and deliver public services; and 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 in increasing their revenue from domestic sources. These include 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.[1] Moreover, in Africa the increase has been primarily driven by resource-related tax revenues in oil-producing countries (OECD, 2010).

Developing countries and development partners have identified the mobilisation of domestic financial resources for development as a priority. This is the case, for example, in the *Doha Declaration on Financing for Development* (UN, 2009) and the *Busan Partnership for Effective Development Co-operation* (Fourth High Level Forum on Aid Effectiveness, 2011). 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.

The principles presented here are meant to enable developing countries to benefit from the G20-inspired era of transparency in international tax matters. They are anchored in the *2005 Paris Declaration on Aid Effectiveness* (OECD, 2005) – with its commitments to ownership, harmonisation, alignment, results and mutual accountability – but they focus specifically on revenue matters. Based on the experience of different countries and recent research, the purpose of the principles is two-fold: 1) to offer guidance for international assistance providers – donor agencies, revenue authorities and finance departments – on how to approach revenue matters within developing countries; and 2) to provide a tool for developing countries in engaging with international partners to maximise 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 for international engagement in revenue matters

- **Follow the leadership of government and co-ordinate at the country level.** Governments in developing countries are responsible for deciding their policy and administration needs for 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 co-ordinated, 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 in partner countries.
- **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 crystallise 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.

- **Take a whole-of-government approach to maximise policy coherence and aid effectiveness.** Countries providing international assistance have a responsibility to ensure a coherent and co-ordinated national support approach to developing countries on revenue matters. This whole-of-government approach should involve regular co-ordination among development, revenue and finance officials to maximise policy coherence. The various ministries can co-ordinate efforts on a broad range of issues, from helping to deliver technical assistance for capacity building in developing countries (in revenue authorities, tax policy and data analysis for example) through to assessing changes to their own policy (trade agreements for example) in light of the possible negative implications for developing countries, including any undue trade advantage. 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, to contribute to the debate on the impact of non-co-operative jurisdictions on developing countries and to agree to spontaneous 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 type of funding used, exit strategies should be in place and regularly reviewed.

- **Take account of international aspects of taxation.** Globalisation is creating new and complex international cross-border revenue challenges to which developing countries must respond. 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 of supporting domestic tax policy and revenue administration in developing countries to help build capacity in international tax policy, transfer pricing and exchange of information. Supporting North-South and South-South co-operation through regional organisations of revenue administrations such as the African Tax Administration Forum (ATAF) and the Inter-American Center of Tax Administrations (CIAT), can play a critical role in promoting the exchange of experience. At the international level, aid providers should work with developing countries to enhance their participation in fora 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. More broadly they can help them to prepare for the adjustments that accompany accession to the World Trade Organization and entering into free trade agreements.

- **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 by furthering the reach of the state. International partners can also promote fairness and equity in revenue systems (through progressive taxation, 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.

- **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 granting and administering 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. For the sake of coherence, donor governments should be transparent in the technical assistance they provide to developing countries and move to make the exemptions they claim on aid-funded goods and services fully transparent, in line with the *2011 Busan Partnership for Effective Development Co-operation*.

- **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 economic and social development, 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 the increasing decentralisation in many countries, recognising the respective responsibilities and revenue sources available to national and sub-national governments is important. In addition, international assistance missions can analyse the distributional effects of tax and spending reforms, highlight how they achieve multiple objectives (including fiscal and poverty reduction), and encourage the communication of the impacts of such reforms.

- **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.

- **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 also 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 – in a context of increasing decentralisation – sub-national levels can complement the efforts made to build revenue capacity. Such actions can strengthen the policy dialogue on national resource mobilisation and build broad coalitions for reform.

- **Measure progress and build the knowledge base for revenue matters.** Measuring progress on revenue matters is in the interest of all stakeholders. It can assess the effectiveness of developing country efforts and investments, and help international assistance providers to demonstrate the results of their assistance. Developing countries should lead the development of country-specific indicators for measuring progress, but with the support of development partners, including regional organisations. Although tax/GDP ratio is a valuable indicator for measuring overall progress over time, other indicators are also important. These include indicators on the tax effort, compliance, progressivity, ease of doing business, poverty reduction and perceptions of ordinary tax players. These all measure different aspects of revenue progress and permit both developing countries and international partners to move beyond narrow revenue collection targets to include 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.

Note

1. A report by the international organisations mandated by the G20 to support the development of more effective tax systems.

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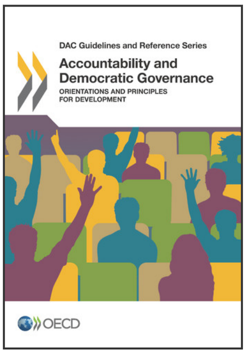

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