Raising Tax Revenues

Supporting developing countries' ability to raise tax revenues

Tax: a sustainable financing source

Domestic tax revenues are the most sustainable source of financing for public expenditure in developing countries. Until recently, however, tax policy and practice has received relatively little attention in development initiatives, policies and research. In 2009, SOMO, Tax Justice NL, CIDIN, Oxfam Novib, the Oikos foundation, and the Ministry of Foreign Affairs therefore organised a one-year process to enhance information exchange and cooperation among relevant actors related to taxation and development.

Various studies have shown that tax revenues are more stable and more predictable than foreign aid. In addition, tax revenues allow for more policy space because they lack conditionalities that are often attached to loans or grants. Enhancing direct tax revenues also has the potential to strengthen a government's accountability towards the country's citizens rather than to external donors or national elites.

The ability of developing countries' governments to raise direct tax revenues is constrained by a number of internal and external factors. Internal factors include a lack of capacity of revenue authorities and low tax compliance. Moreover, governments of developing countries may offer irrational tax breaks to large investors. External factors include trade liberalisation, which reduces revenues from customs duties, and tax avoidance and evasion by multinational corporations and wealthy individuals.

Process organisation

The 'Supporting developing countries' ability to raise tax revenues' process was carried out within the framework of the Development Policy Review Network (DPRN) by:

- The Centre for Research on Multinational Corporations (SOMO)
- The Netherlands Ministry of Foreign Affairs
- The Centre for International Development Issues Nijmegen (CIDIN)- Radboud University
- Oxfam Novib
- Tax Justice
- Oikos

SOMO

Ministerie van Buitenlandse Zaken

Oikos

CIDIN Centre for International Development Issues Nijmegen

tax justice nl

Oxfam Novib

In the past, development agencies and NGOs have not paid a lot of attention to domestic resource mobilisation through tax, especially compared to other issues related to financing for development, such as aid volume, debt and trade. While various NGOs are already engaged in monitoring the allocation of government budgets, there are very few initiatives to monitor government revenues. In donor countries there tends to be a lack of cooperation between staff from government departments involved in development cooperation, tax departments and ministries of finance. This is partly because attention to taxation in relation to development is a relatively new phenomenon. Although substantial progress has been made in research on the relation between taxation and development, this has not yet resulted in a similar progress in development policies.

The expert seminar provided an important networking opportunity.

How aid can help raise tax revenues

On 2 December 2009, the Raising Tax Revenues consortium organised a conference in Amsterdam. For this conference, SOMO, Tax Justice NL and CIDIN prepared three papers: addressing respectively (i) international barriers to raising taxes; (ii) domestic barriers to raising taxes; and (iii) the relation between aid and tax revenues. A wide range of experts discussed these issues at the conference. It became clear that development assistance can help developing countries in their efforts to raise tax while, at the same time, donor countries have a role to play in stopping multinationals from siphoning off profits from poor countries through tax evasion and avoidance.

The most important conclusions of the conference were:

Papers on tax revenues

The process generated three research papers:

1. 'International barriers to raising tax revenues' by Thijs Kerckhoffs (SOMO).
2. 'Raising taxes in developing countries; domestic constraints' by Andrina Sol (Tax Justice NL).
3. 'Development assistance and tax revenues' by Ruerd Ruben and Ioana Pop (CIDIN).

The first two papers are the result of a literature study, for which both academic studies and reports of civil society organisations were used. These papers benefited from reviews by experts from the field. New research, which analyses the effects of aid on the tax share in gross domestic expenditures, formed the basis of the third paper.

- Governments in the South should be supported with putting into place efficient and well-equipped structures to ensure that tax can be raised in an equitable manner.
- Improving the accountability of governments in the South and strengthening general administrative and bureaucratic capacities are prerequisites for raising tax revenues.
- Taxes should be raised for a collective good, otherwise there will be no willingness to pay, and poverty will not be tackled. However, tax collection can also be used as a controlling tool by elites and it is therefore not *by definition* an instrument for development.

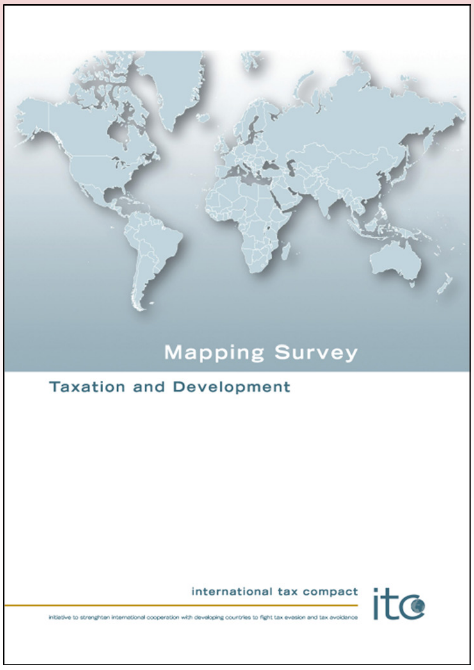
- Capacity-building of civil society in developing countries is crucial to ensure accountability of governments.
- Although the distributional effects of various tax measures are country specific, it is generally found that the non-progressive collection of *direct* taxes, such as income tax, will affect the poor more adversely than the rich.
- In low-income countries, *indirect* taxes – such as value added (or consumption) tax – is likely to have a disproportional effect on people in the lower-income bracket because the poor spend a higher proportion of their income on basic consumer goods (e.g. a tax on kerosene). Research shows that indirect taxation benefits more strata of society in middle-income countries.
- Tax-related policies and obligations are enforced at national level. At the same time, however, any solution for tackling barriers to raising tax revenues has to include measures at international level, due to the transnational nature of the problem. There should, for example, be a code of conduct to prevent tax competition, preferably within the UN framework.
- Fiscal constructions by multinational corporations through international tax treaties can be harmful to developing countries.
- In the North, regulations should be developed to tackle tax evasion and avoidance by Northern multinationals.

Leaders of the G20 countries have a key role to play in raising tax revenues in developing countries.

Mapping tax initiatives

One of the activities in the 'Raising Tax Revenues' process was the mapping of existing work on taxation and development. Various organisations provided information about their work via an online questionnaire, but the response was low.

Despite the limited response, the mapping exercise was very fruitful as it led to an exchange of information with the German government initiative International Tax Compact (ITC) (www.taxcompact.net), which happened to carry out a similar mapping exercise at the same time. The ITC was set up by the German Ministry for Economic Cooperation and Development (BMZ) and provides an informal platform of bi and multilateral development partners that intends to increase cooperation on tax matters and strengthen developing countries' tax systems. To avoid duplication and ensure alignment and targeted cooperation, the ITC conducted a mapping survey, providing both a country-specific and a thematic overview of activities and initiatives undertaken to improve revenue systems in developing countries. The DPRN process organisers shared the outcome of the online questionnaire with the ITC, which published its final report in May 2010.



Follow-up

The key result of the process was that policymakers, scientists and practitioners came together to discuss the potential and constraints of raising taxes in developing countries. As such, an important pool of expertise has been created and a range of activities will ensure that the process is continued.

Selected follow-up activities are:

- The process organisers entered into a dialogue with multinational corporations through existing forums such as the Vereniging van Nederlandse Ondernemers (VNO), MVO Nederland, and the National Contact Point for OECD guidelines about the need to include tax practices in Corporate Social Responsibility criteria.
- The process organisers remain in regular contact with the Ministry of Foreign Affairs and the Ministry of Finance within the framework of the informal Roundtable on Tax and Development, hosted by the Ministry of Finance. This roundtable discussion with stakeholders such as multinationals operating in developing countries, NGOs and representatives of VNO, focuses on issues relating to tax justice and raising taxes in developing countries.
- The documents collected during the process were included on the Tax Justice NL website. This database is regularly updated with new reports and initiatives in the field of taxation and development.
- Following the process, the organisers started educating advisors and consultants about tax and development through dialogue, trainings and presentations. Organisations involved in these sessions included the International Bureau for Fiscal Documentation (IBFD), which advises governments and sometimes the private sector, to present the tax justice vision on tax and development.

Furthermore, contacts with large accountancy firms were intensified. Discussions with these firms centre on the type of transparency rules the accountancy firms can integrate into their work, such as the 'Total Tax Contribution' initiative by Pricewaterhouse-Coopers, which encourages its clients to subscribe to more transparent financial reporting.

Process output

The 'Supporting developing countries' ability to raise tax revenues' process included the publication of three research papers, the building of an online library, a mapping exercise of existing tax initiatives, and an expert seminar.

This resulted in the following publications:

- Research paper: 'International barriers to raising tax revenues' by Thijs Kerckhoffs (SOMO).
- Research paper: 'Raising taxes in developing countries; domestic constraints' by Andrina Sol (Tax Justice NL).
- Research paper: 'Development assistance and tax revenues' by Ruerd Ruben and Ioana Pop (CIDIN).
- Seminar report: on the expert seminar held on 2 December 2009.
- DPRN process report.

All publications are available on the website: http://taxrevenues.global-connections.nl

Development Policy Review Network

This infosheet was made by DPRN. With a view to stimulating informed debate and discussion of issues related to the formulation and implementation of development policies, DPRN created opportunities to promote an open exchange and dialogue between scientists, policymakers, development practitioners and the business sector in the Netherlands and Flanders from 2003-2011.