Roundtable background note:

Capacity development for domestic resource mobilization and taxation

Stockholm, 13 June 2019

About this document

The objective of this document is to give input to discussions on support for domestic resource mobilization through taxation provided by Sweden and other donors including through the Addis Tax Initiative (ATI). The document was developed as a background note to a roundtable in Stockholm 13 June 2019 organized by Concord Sweden and Diakonia with participants from Sida, the Swedish Tax Agency, the Ministry of Finance, the Ministry of Foreign Affairs and civil society organizations. The document does not present clear-cut recommendations but rather raises questions for consideration on how to take this issue forward.[1] Please send comments to penny.davies@diakonia.se, Senior Policy Adviser.

Domestic resource mobilization and the "SDG-financing gap"

According to UNCTAD, developing countries will need an additional 2.5 trillion USD per year in order to achieve the Sustainable Development Goals (SDGs).[2] This sum is referred to as the SDG-financing gap. A similar estimate of 2.6 trillion USD of additional spending in 121 emerging market economies and low-income countries is put forward in an IMF discussion note.[3] The questions at the heart of the Financing for Development (FfD) Agenda are from *where* this substantial sum of money will be mobilized, and *how* it can be geared towards development objectives.

Raising domestic revenue is essential for developing countries to pursue the SDGs. In fact, domestic resources constitute the biggest part of the financing available to developing countries, and are also the most sustainable in the long term. Domestic resource mobilization (DRM) is a central theme of the Addis Ababa Action Agenda (AAAA), the main outcome of the third UN FfD Conference in 2015. More efficient tax collection is a key part of this, albeit for low-income countries taxes will not be enough to finance the SDGs.[4] For these countries additional and external resources including Official Development Assistance (ODA) will be needed to fill the financing gap. However, ODA is declining - bilateral ODA to the least developed countries fell by 3 per cent in real terms in 2018 compared with 2017[5] – and ODA

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[1] The roundtable will serve as input to the development of positions on capacity development, DRM and taxation within the Policy and Advocacy Department of Diakonia, Sweden, as well as a joint recommendation paper on development finance being developed within CONCORD Sweden.
[2] UNCTAD, 2014. *World Investment Report 2014, Investing in the SDGs: An Action Plan* https://unctad.org/en/PublicationsLibrary/wir2014_en.pdf
[3] Gaspar, Vitor et.al. January 2019. *Fiscal Policy and Development: Human, Social, and Physical Investments for the SDGs*
[4] Ibid.
[5] OECD 10 April 2019. "Development aid drops in 2018, especially to neediest countries", http://www.oecd.org/newsroom/development-aid-drops-in-2018-especially-to-neediest-countries.htm Visited 27 May 2019.

is increasingly driven by donors' interests as opposed to partner countries' domestic development plans. Whilst other external sources of finance, including private finance, can play a key role (depending on how it is done) data from the OECD demonstrate a 12 per cent drop in overall external finance to developing countries from 2013-2016. Furthermore, in parallel to the decline in inflows of financial resources, the number of countries facing unsustainable debt levels has grown. As a result the payment of interest rates as share of tax revenues has doubled in the past ten years in low-income countries, whilst tax revenues have barely grown in the same period.[6] Another concern is the fact that illicit financial flows, large-scale tax dodging (tax evasion as well as tax avoidance) by multinational companies result in tax losses in developing countries. UNCTAD has estimated that one type of corporate tax avoidance alone is costing developing countries around US$100 billion per year.[7]

In addition, we also see a trend of a race to the bottom in harmful tax practices (badly designed tax incentives, corporate "sweetheart deals", falling global corporate tax rates etc.) that is putting at jeopardy the ability of developing countries to mobilize the resources needed to fulfil the SDGs.

It is not just about more money, politics matter

It is clear that DRM remains insufficient in most developing countries and more revenues are needed to reach the SDGs. However, as spelled out by Oxfam, "DRM is not about just collecting more, it is about collecting better".[8] Depending on how revenues are mobilized, this can play a negative or a positive role on for example the objective to reduce inequality.

Developing countries need to avoid a narrow focus on raising revenues without considering the wider implications thereof, and the effects on other societal goals. For example, regressive tax systems such as indirect taxes, including Value Added Tax (VAT), is widely recognized as having a negative impact on people living in poverty, whilst progressive systems have the potential to address inequality. "Combatting inequality, and re-commit to enhancing revenue administration through modernized, progressive tax systems, in line with the Addis Agenda", is part of the FfD commitment.[9] The simple measure of tax-to-GDP ratio does not capture the effects of how revenues are raised. Political will to address inequality, ensure gender equality and design tax systems that serve this purpose is crucial.

Donors need to recognize that support to DRM and taxation is not a technocratic issue but a political one. Support to strengthen tax administrations is important but if this is not put into a broader context of looking at the effects of the tax system in place, such support might be inefficient or even counterproductive from the perspective of addressing inequality and poverty.

At the same time, donor support to DRM and taxation needs to be in line with the internationally agreed development effectiveness principle of "ownership of development

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[6] Development Initiatives, July 2018. *ODA for Domestic Revenue Mobilization*. Figure 1. http://devinit.org/post/oda-for-domestic-revenue-mobilisation

[7] UNCTAD, June 2015. *World Investment Report 2015: Reforming international investment governance,* http://unctad.org/en/PublicationsLibrary/wir2015_en.pdf , p. 201

[8] Oxfam GB, May 2019. *It's not all about the money, Domestic revenue mobilization, reducing inequality and building trust with citizens* *https://policy-practice.oxfam.org.uk/publications/its-not-all-about-the-money-domestic-revenue-mobilization-reducing-inequality-a-620754* p.11.

[9] Draft 2019 ECOSOC Financing for Development (FfD) Forum (09.04.2019) available at: https://www.un.org/esa/ffd/ffdforum/wp-content/uploads/sites/3/2019/04/2019-FfD-Forum_Draft-Outcome-Document.pdf Visited 27 May 2019.

priorities by developing countries"[10] as tax reforms can only be effective if they are rooted in domestic social and political processes, as opposed to driven by donors.

Moreover, the broader political context of taxation also needs to be taken into account including how to address: harmful tax treaties, poorly designed tax incentives given to multinational companies, the race to the bottom in terms of cuts in corporate tax rates to attract investment, tax avoidance and evasion etc. Also, it is crucial to create trust between governments and citizens ensuring an open and democratic debate on taxation. These are often politically sensitive issues that governments as well as donors need to take into consideration. Some of these issues are the responsibility of governments in developing countries to take on in transparent, democratic processes whilst others are issues that need to be addressed through international cooperation. Donor countries in turn have the responsibility to ensure their tax systems do not impact negatively on developing countries ability to raise revenues in an equitable manner, and to enable developing countries to participate in international decision-making on tax on an equal footing.

Nordic support for DRM and the Addis Tax Initiative

The members[11] of the Addis Tax Initiative (ATI), launched in 2015, have made the following three commitments:

1. providers of international support commit to collectively double their technical cooperation in the area of domestic revenue mobilisation/taxation by 2020;
2. partner countries commit to step up domestic revenue mobilisation as a means of implementation for attaining the SDGs and inclusive development;
3. all signatories commit to ensure Policy Coherence for Development (PCD).[12]

According to the latest available data most donors are not on track to meet the first quantitative commitment.[13] In terms of the third commitment, which also concerns donors, this is more complicated to measure as there is currently no comprehensive indicator to assess policy coherence and monitoring relies on self-reporting.

Diakonia together with Nordic sister organizations (Tax Justice Norway as lead together with Action Aid Denmark, Finnish FINGO and Norwegian Church Aid) commissioned a study, looking into the support of Denmark, Finland, Norway and Sweden to DRM, taxation and the ATI. The objective was to compare the experiences of official support to DRM and taxation and engage in dialogue on challenges and ways ahead with relevant actors.[14] According to the study, published in May 2019, the Nordic countries' support demonstrates both similarities and differences.[15] However, as all Nordics are expanding their aid under the ATI and moving into a range of similar activities, the differences are reducing. Some of the findings include:

Mixed bag on the doubling of technical assistance: Nordic countries demonstrate a mixed picture in terms of fulfilling the first ATI commitment. **Denmark,** with the smallest program of the Nordics, is rather a long way from meeting its financial commitments and **Finland** is also lagging behind quite substantially. Sweden and Norway are on track.

[10] The development effectiveness principles are available at the Global Partnership for Effective Development Cooperation (GPEDC) webpage: http://effectivecooperation.org/about/principles/ Visited 27 May 2019.
[11] Currently more than 55 countries, regional and international organisations have signed up to the Addis Tax Initiative. ATI webpage https://www.addistaxinitiative.net/ Visited 21.05.19.
[12] The Declaration also includes an Annex with ten principles.
[13] The available data is from the 2016 ATI Monitoring Brief and the 2017 OECD Creditor Reporting System.
[14] The roundtable dialogue in Stockholm June 13, 2019, is part of the dialogue initiatives.
[15] Lines, Thomas, May 2019. *Nordic Countries' Support for Tax and Development*, soon to appear on Diiakonia's website.

Norway, with the largest DRM program of the four, may achieve its commitments a year ahead of time taking the 2019 budget into account. **Sweden's** disbursement doubled from 2014 to 2018.

Geographical reach: Sweden has the oldest program, initiated already in 1985 in Tanzania, and has the widest geographical reach. Since 2015 projects have been conducted in nine countries on four continents including Europe. **Denmark, Finland and Norway** work in fewer countries, all of them in Africa with overlap in coverage (Mozambique, Tanzania and Zambia).

Tax twinning: Sweden pioneered the model of tax twinning where tax administrators of the Swedish Tax Agency (STA) work over long periods side by side with the counterparts in the partner countries.

Taxation and resource extraction: Norway is drawing on its own experiences and engaging in the improvement of tax compliance in the natural resources sector, including through Norway's Oil for Development program.

Support to civil society: All Nordics have provided support to research and civil society organisations working on DRM and taxation. Finland and Norway are particularly active in expanding public awareness on tax and development, including working with/through civil society to create public understanding and pressure.

Bilateral support vs. multilateral engagement: Sweden's support is concentrated on bilateral aid but has begun to change. In general, more funding from the Nordics now goes to multilateral organisations. All the Nordics have participated in organisations involved in taxation/DRM and provided funding to multilateral organisations including the OECD.

Limited Nordic cooperation: According to the study, the countries have not operated together at the Nordic level but there has been local cooperation on specific projects in countries, including in Tanzania.

Demand driven vs. promoting progressive taxation: In line with development effectiveness principles all Nordics emphasize local ownership and providing assistance based on local demands. **Sweden's** approach is described as demand driven and ”technocratic”, mainly concerned with the efficiency of tax administrations as opposed to the more political aspects of taxation systems. In some cases, the **Nordic** support is said to leave regressive tax regimes unchanged and there are questions to what extent the support contributes to progressive and gender sensitive taxation systems.

Policy Coherence for Development (PCD) remains a challenge: The findings are less clear as to what extent the **Nordic** countries support tax policies that contribute to PCD. The task of putting what is described as “technocratic capacity development projects” into the wider context of taxation systems is one such matter. Additionally, the tax related policies of the Nordics themselves, including their tax treaties with developing countries, is one area raised where more should be done to ensure the Nordics are fulfilling the objective of PCD and contributing to development objectives in partner countries.

Another question raised in the study is the Nordic engagement through multilateral organisations including the IMF and World Bank and whether their policy advice and conditionality in developing countries is aligned with PCD.

Lacking evidence: In **Sweden**, very few of the capacity development projects have been evaluated. According to a study by EBA (2018), only six out of 29 projects financed by Sida and carried out by the Swedish Tax Agency have been evaluated. This makes it difficult to draw firm conclusions on the results of the projects. On a similar note, of 15 projects financed by the EU none have been evaluated. [16]

Suggestions of ways forward and questions for consideration

Below are some questions that could be explored in the discussion on Nordic countries' support to capacity development, DRM and taxation in developing countries.

- **Political context - impacts on inequality and gender equality:**
  - How can Sweden and other Nordics contribute to the strengthening of equitable revenue mobilisation? More specifically, how can the objective of progressive taxation in developing countries be supported as a means to address inequality and strenthen gender equality?
  - How can such support be promoted without compromising on the principles of national democratic ownership?
  - What further analysis, if any, is needed to ensure support for DRM and taxation is put into a wider context beyond focussing on the efficiency of tax administrations?

- **Theory of change and best practices:**
  - Is there a need to clarify the theory of change on taxation and development in the capacity development initiatives?
  - What best practices are there? How can evaluations and learning be improved to ensure evidence-based decision-making in this area?

- **Internal coordination and policy coherence for development:**
  - What need is there for internal coordination and a coherent strategy across government ministries and agencies (the Swedish Tax Agency, Sida etc.) on capacity development for DRM and taxation? How can for example coordination mechanisms be strengthened for PCD in this area?
  - How can Sweden, with its Swedish Policy for Global Development, ensure its capacity building efforts are not neutralized or even undermined by its own tax policies, including tax treaties with developing countries? Could spillover analyses of tax policies be conducted to ensure they do not impact negatively on the ability of developing countries to raise revenues in an equitable manner?

- **Nordic cooperation:**
  - What added value could Nordic cooperation on DRM and taxation have? Is there "a Nordic model" building upon the countries' own experiences, or a "Nordic take" on DRM and taxation?
  - How can Nordics work together to promote PCD in the area of taxation within institutions such as the IMF, the World Bank and the OECD?

[16] Markensten, Klas, April 2018. EBA Working Paper: *Sweden's Development Support to Tax Systems* https://eba.se/wp-content/uploads/2018/04/Taxes-Markensten-Webb.pdf