First session of the Preparatory Committee for the fourth International Conference on Financing for Development

Multi-Stakeholder Round Table Discussion on "Domestic Public Resources"

Thursday, 25 July 2024, 10:00 – 11:30

Issue note

Background

The Addis Ababa Action Agenda (Addis Agenda) outlines a set of commitments and actions to mobilize resources from all sources—domestic and international, public and private—to achieve the Sustainable Development Goals (SDGs). The mobilization and effective use of domestic resources is central to the pursuit of sustainable development financing.

The agenda identifies several key areas for action, including **strengthening domestic resource mobilization, fostering international tax cooperation, combatting illicit financial flows**, **enhancing the efficiency of public expenditure,** and **capacity building and technical assistance**.

Necessary steps to broaden the tax base, enhance tax collection and improve the administration of taxes are highlighted. This includes progressive and equitable tax policy and efficient collection and emphasizes the importance of measures to simplify tax compliance and reduce tax avoidance and evasion.

International tax cooperation should be scaled up and Member States stress that efforts in this respect should be universal in approach and scope and should fully take into account the different needs and capacities of all countries. Countries are encouraged to work together to strengthen tax and beneficial ownership transparency. Furthermore, countries commit to make sure that all companies pay taxes to the Governments of countries where economic activity occurs and value is created.

Member States commit to substantially reducing illicit financial flows (IFFs) by 2023, with a view to eventually eliminating them. This including combatting tax evasion and corruption, and also reducing the opportunities for tax avoidance and acting on money laundering risks. In addition, countries commit to strive to eliminate safe havens that create incentives for transfer abroad of stolen assets. They also pledge to recover and return stolen assets. Countries are urged to implement measures to curb trade mispricing, increase transparency and accountability of financial institutions and the corporate sector, improve customs administration, and strengthen anti-money laundering (AML) and counter-terrorism financing (CTF) efforts.

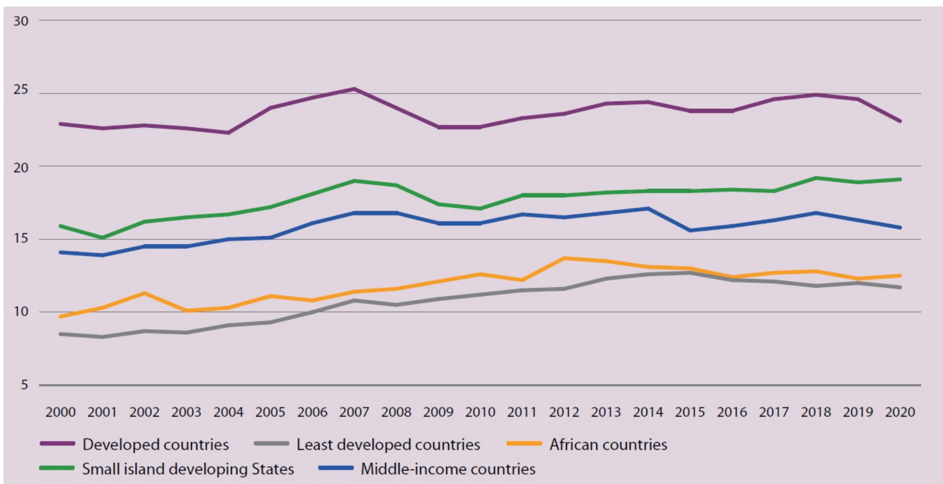
On the expenditure side, the Addis Agenda advocates for improvements in public financial management to ensure that resources are used effectively and efficiently. Medium-term expenditure frameworks and improving budget transparency and accountability are needed alongside gender responsive budgeting. The Agenda calls for the alignment of public spending with national development priorities and the SDGs, ensuring that public resources are directed towards sectors that promote inclusive and sustainable growth.

Many developing countries require support to strengthen their domestic resource mobilization capabilities. The Addis Agenda calls for increased international support in the form of capacity building, technical assistance, and technology transfer. It also encourages the international community to fulfill its commitments to provide development assistance and to support initiatives aimed at building institutional and human capacities in developing countries.

How have we done?

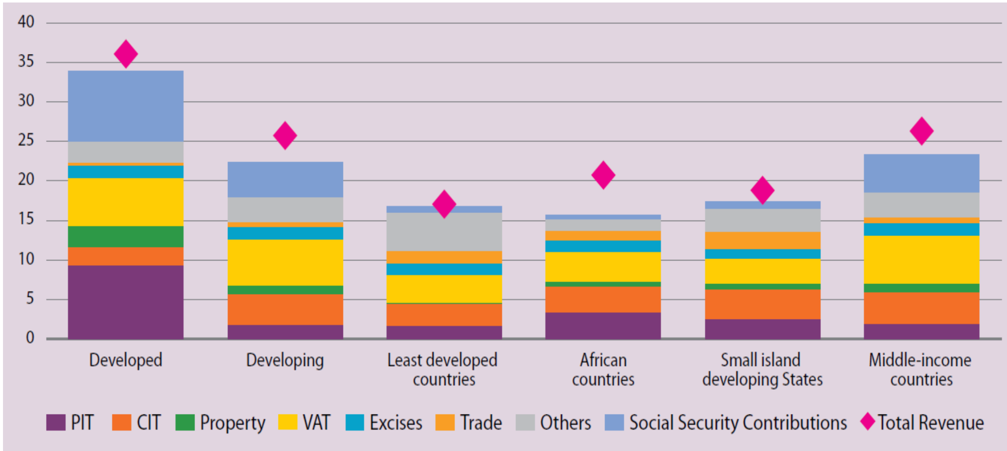
Median tax revenues increased steadily in most categories of countries and regions in the first decade of the century until setbacks from the 2008 crisis and the onset of the COVID-19 pandemic in 2020 (figure 1). Many of the episodes of rapid increases in tax revenue mobilization were in countries that simultaneously embarked on revenue administration and tax policy reforms in parallel. Revenue gains, however, have been volatile.

Figure 1. Median tax revenue, by country groups, 2000–2020 *(Percentage of GDP)*



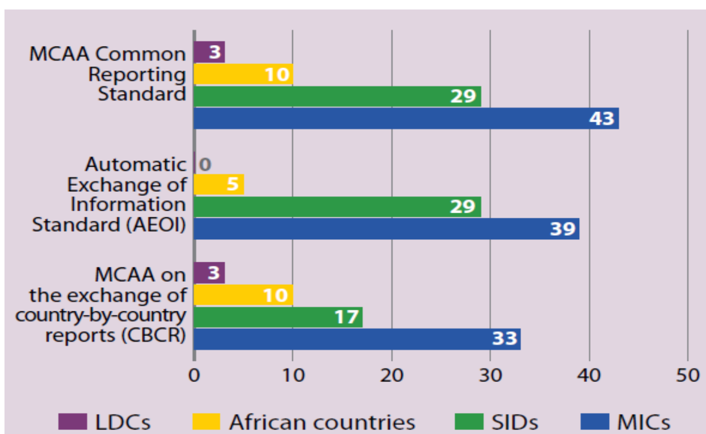
There has been a global shift in the tax mix over the past several decades, with implications for the ability to raise revenue, reduce inequality and enhance revenue mobilization. Developing countries are more dependent on consumption taxes and corporate income taxes, accounting for 5.8 per cent of GDP and 3.9 per cent of GDP, respectively (figure 2). Value added tax is central to revenue mobilization in developing countries, but exemptions and reduced rates erode its performance while its equity implications need to be better addressed. Corporate income tax is an important source of revenue in low-income countries, accounting for a larger share of revenue than in developed countries, where corporate tax rates have been consistently declining for many decades.

Figure 2. Composition of revenue systems, by country group, 2019 *(Percentage of GDP)*



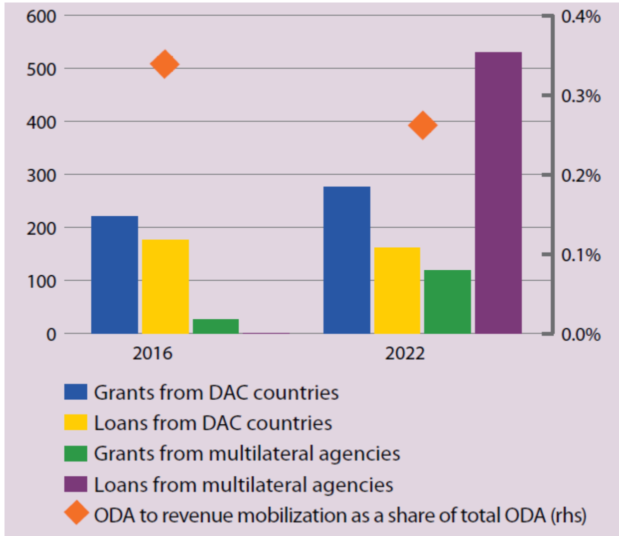
Significant challenges remain in developing countries with regard to accessing and using information for tax enforcement. Developing countries have much lower levels of access to information on tax matters. Furthermore, countries must meet legal, administrative and technical infrastructure requirements before commencing exchanges. Only three least developed countries (LDCs) have signed onto important tax information exchange agreements, and none of them are yet automatically receiving information on financial accounts (figure 3).

Figure 3. Participation of countries in special situations in international tax instruments and forums, 2023
(Number of jurisdictions)



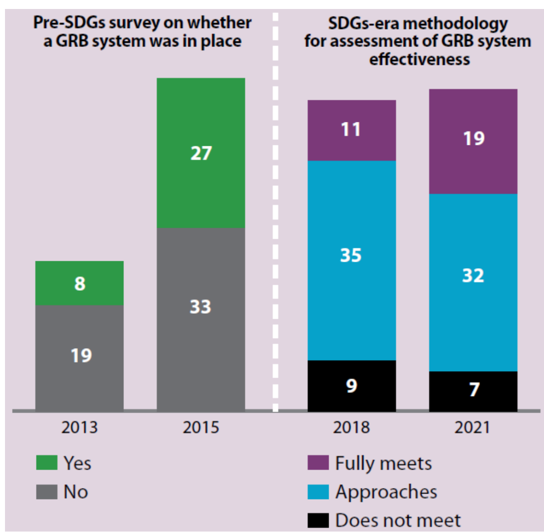
Donor-funded capacity-building related to domestic public revenue mobilization has increased dramatically since 2015 but has levelled off in recent years just as new international tax norms will require increased administrative capacity. Disbursements of ODA for domestic revenue mobilization fell short of donor targets to double by 2020 but hit $437 million in 2022 (figure 4).

Figure 4. Official development assistance disbursements for domestic revenue mobilisation, 2016 versus 2022
(Millions of United States dollars, percentage)



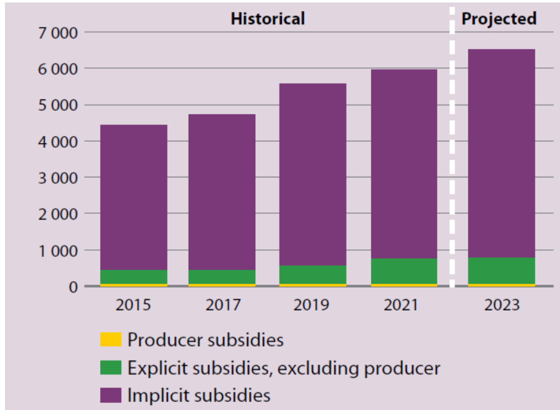
Strengthening the alignment of domestic expenditure with gender equality goals is imperative, and gender responsive budgeting (GRB) can enhance the effectiveness of public finance's contributions to gender equality. Over time, GRB has been introduced in more countries globally and tracking systems have become increasingly comprehensive and effective, but gaps remain. Globally, only one in four countries currently has a comprehensive gender responsible budgeting system (figure 5).

Figure 5. Existence and comprehensiveness of gender-responsive budgeting systems, 2013–2021
(Number of countries)



Both implicit and explicit fossil fuel subsidies have grown over time, with noticeable increases in 2022 at the time of significant energy price volatility. Estimated global fossil fuel subsidies were $7 trillion in 2022, including $1.3 trillion in explicit subsidies (figure 6).

Figure 6. Global fossil fuel subsidies, 2015–2023 *(Billions of United States dollars)*



Actions and Challenges

Strengthening tax revenue mobilization and administration

Since the adoption of the Addis Agenda, several developing countries have reformed their tax systems, including through broadening the tax base and improved tax administration. The adoption of modern and digital tax administration systems in some countries have also led to significant improvements in domestic revenue mobilization, enhanced tax collection efficiency and strengthened governance. As a result, tax-to-GDP ratios in developing countries improved slightly from an average of 15.1 per cent in 2015 to 16.4 per cent in 2023.

Despite these advances, many developing countries struggle with tax evasion and avoidance from multinational enterprises and high-net worth individuals. Lack of tax transparency, loopholes in domestic and international tax laws and overburdened tax administrations continue to hinder effective tax collection in many developing countries. The gap between potential and actual tax revenue remains significant in many. Tax revenues in low-income countries remain at an average of 12.6 per cent of GDP, which is insufficient to finance essential public services.

Enhancing the efficiency of public expenditure

Many countries have undertaken reforms to improve public financial management systems, including the adoption of medium-term expenditure frameworks, performance-based budgeting, and integrated financial management information systems. These reforms have contributed to better planning, execution, and monitoring of public expenditures. International initiatives have provided valuable frameworks and tools for assessing and improving public financial management systems.

Yet, several challenges persist in enhancing public financial management efficiency. These include weak institutional capacities, limited technical expertise, and the need for greater transparency and accountability in public spending. Fragmented budgeting processes and weak links between planning and budgeting further hinder the effective allocation and use of public resources. Strengthening anti-corruption measures and promoting good governance are also essential to ensuring that public funds are used effectively and contribute to sustainable development.

International tax cooperation

There is heightened global attention to making international tax cooperation fully inclusive and more effective, including examination of how international tax rules respond to the need, priorities and capacities of developing countries. This is coupled with the realization that international tax cooperation should go beyond corporate income taxes to include, for example, the fight against tax-related illicit financial flows and environmental taxation. In December 2023, the United Nations General Assembly established an ad hoc committee, engaging all Member States, to develop by August 2024 draft terms of reference for a United Nations framework convention on international tax cooperation. The Committee will submit the draft terms of reference to the General Assembly for consideration at its seventy-ninth session.

Although international policy discussions on updating international corporate income tax rules to address digitalization and globalization have been ongoing for more than a decade, they have yet to yield an agreement that sufficiently addresses allocation of taxing rights, tax avoidance and evasion, and that has the full support of all Member States. There is a need for international tax cooperation that is universal in scope and responds to the needs, priorities and capacities of all countries.

Combatting illicit financial flows (IFFs)

To date, robust data on the prevalence and scope of IFFs is lacking. While technological advancements and enhanced regulatory frameworks have made some strides in improving the detection and fight of IFFs. Initiatives such as the Financial Action Task Force (FATF) have set global standards to combat money laundering and terrorist financing. Efforts to repatriate stolen assets have seen some success, with countries recovering billions of dollars in illicit funds. The implementation of national beneficial ownership registries in several countries has increased transparency and reduced opportunities for IFFs in those countries. Regional initiatives, such as the African Union's High-Level Panel on IFFs, have raised awareness and coordinated actions to combat IFFs across borders.

Developing countries are disproportionately affected by IFFs, losing significant revenue that could otherwise be invested in sustainable development. The rise of digital assets, such as crypto-assets, has facilitated new avenues for tax avoidance and evasion and money laundering. Stronger international norms and better enforcement capacities are needed to address these emerging threats.

In addition, limited resources and capacity in many developing countries hinder effective enforcement and prosecution of IFF-related crimes. Cooperation between countries and joint investigations is often weak, allowing perpetrators of IFFs to exploit regulatory and enforcement gaps.

Capacity building and technical assistance

International initiatives have provided valuable support to developing countries, helping to build tax administration capacity and improve tax collection systems. Countries benefiting from technical assistance have shown notable improvements in revenue mobilization and tax compliance. International organizations have developed comprehensive training programs to enhance the skills of tax officials in developing countries. Partnerships with academic institutions and think tanks have produced research and policy recommendations to improve tax systems and administration.

However, donor funding for capacity building has not met pledged commitments. Many countries still lack the necessary technical infrastructure and skilled personnel to implement effective tax policies and administration. Sustained investment in capacity-building programs is needed to ensure developing countries can continuously improve their tax systems and adapt to new challenges.

The way forward and guiding questions for discussion

Despite the progress made, there remains a large unmet tax potential in developing countries and a pressing need to reform fiscal systems to tap that potential and generate resources on the scale required for achieving the SDGs. Since 2015, attention has shifted dramatically towards multilateral tax cooperation instruments, transforming the international tax cooperation landscape and enabling progress on combating tax avoidance and evasion, but also risking leaving a subset of countries further behind. Efforts to coordinate internationally to ensure adequate domestic expenditure on agreed international goals have often faltered, but new measures and proposals to align fiscal systems with the SDGs, such as increased financing for social protection systems and carbon pricing mechanisms, have gained traction.

Solutions to outstanding challenges across all of these areas have been proposed, which deserve further consideration to foster robust and resilient fiscal systems that can be a lever for sustainable development.

1. Strengthening tax revenue mobilization and administration

    - What domestic and international tax reforms are needed to enable developing countries to enhance revenue mobilization?
    - How can new technology and digitalization be leveraged to improve tax administration and compliance?
    - How can growing openness to international cooperation in the area of wealth taxes contribute to increased commitments to make progressive taxation and wealth taxation more effective?

2. Enhancing the efficiency of public expenditure

    - How can the efficiency of public expenditure and public financial management systems be improved?
    - What international commitments and targets based on coverage or expenditure could help scale up universal social protection?
    - What accountability mechanisms would deliver effective gender responsive budgeting?

3. Combatting illicit financial flows

    - What strategies can be employed to strengthen the regulatory frameworks and enforcement mechanisms necessary to combat illicit financial flows effectively?
    - How can international cooperation be enhanced to improve the detection, deterrence, and recovery of illicit financial flows?

4. International tax cooperation

    - How can international tax cooperation be universal in scope and respond to the needs and capacities of all countries?

- What are the most pressing issues that international tax cooperation should address?

5. Capacity building and technical assistance

   - What are the most critical areas for capacity development in tax and customs administration and in the area of public financial management in developing countries?
   - How can multilateral, regional, bilateral and South-South cooperation work together to deliver technical assistance and maximize impact?
   - How can the system of national development banks be strengthened to increase their impact on sustainable development?