UNRISD UNITED NATIONS RESEARCH INSTITUTE FOR SOCIAL DEVELOPMENT

Contribution to Element Paper on Financing for Development[1][2]

Introduction

As a contribution to ongoing debates about building new social contracts in crisis times, UNRISD has developed a proposal for a new "eco-social" contract which combines a reformed social contract for inclusion and justice with a contract for nature and future generations.[3] It is centred on principles of human rights, gender justice, peace and solidarity and promotes transformation of economies and societies toward greater sustainability and inclusion. It calls to address historical injustices associated with colonialism, imperialism, patriarchy and climate change and to mobilize resources needed to deliver on eco-social contracts through equitable fiscal policies and international finance.

Fair fiscal contracts: Delivering on eco-social contracts (I)

New eco-social contracts need to be built on fair fiscal contracts between citizens and states that lay out a strategy for mobilizing and allocating financial resources for its implementation. Beyond raising sufficient resources for climate action and SDG implementation, fiscal contracts need to distribute the financing burden within and between countries in line with principles of fairness and equity. A stable fiscal contract with voluntary tax compliance and sufficient tax receipts is an indicator of a stable social contract and a thriving economy. In addition to raising revenues and redistributing income, taxation has the potential to change behaviour by repricing public goods and bads (by taxing, for example, tobacco or carbon-intensive goods and applying lower tax rates to merit goods and social enterprises), and to enhance representation of taxpayers in public affairs, which has an important impact on the quality of state–citizen relations.[4] If designed well, legitimized by inclusive and democratic policy processes, and implemented by capable public administrations in favourable economic contexts of sustainable growth and employment creation (SDG 8), fair fiscal contracts can go a long way to support the necessary eco-social transformation. They need to be complemented by international resource bargains supporting countries in the global South through access to finance and transfers, knowledge and technology in order to address cross-border global challenges such as climate change, as well as compensate for historical injustices.[5]

1 For the full paper and bibliography please refer to: wp-2024-01-system-change-economic-transformations-cdm-hujo-fuentes.pdf (unrisd.org).
2 Contact person : katja.hujo@un.org
3 UNRISD 2022.
4 Brautigam et al. 2008. Tax Justice Network (2023a) conceptualizes the functions of tax in a 5R framework of revenue (mobilization), redistribution, repricing, representation and reparations.
5 Hujo 2020; UNRISD 2022.

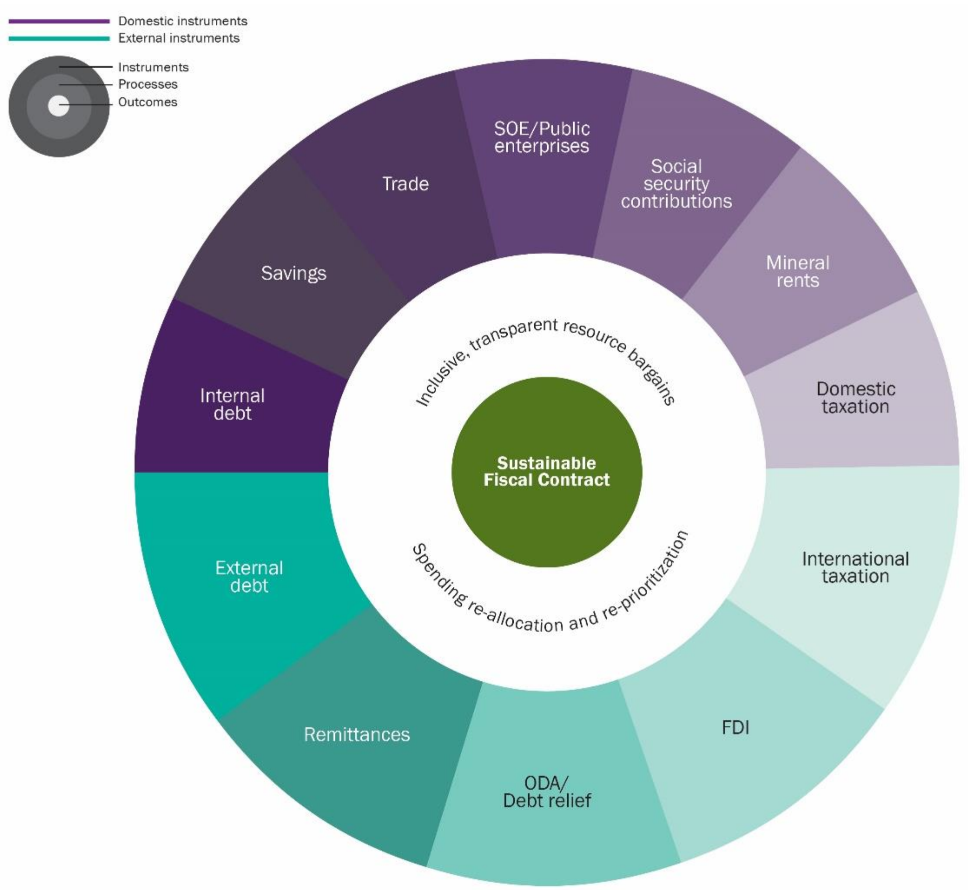
Pathways Toward Fair Fiscal Contracts (I)

Putting development strategies into practice and responding effectively to crisis rests on states' capacity to design and implement transformative policies, create stable and accountable institutions, garner the political support and trust of citizens and business actors, and mobilize the required financial and administrative resources to fully develop their tax potential. The recourse to austerity policies or fiscal consolidation, defined as the reduction of public expenditures to reduce budget deficits and free up resources for debt service in order to regain capital market access (a common response in times of economic distress), presents a formidable obstacle to creating fair fiscal contracts and delivering on development strategies.

As a general rule, countries will need to design their own strategies for creating fair fiscal contracts according to their economic and political structures and specific needs. This means that the combination of sources and instruments—external and domestic, public and private—as well as their weights in the overall financing mix will differ between countries (see figure 1). Some will be able to attract greater amounts of private investment, some will rely more heavily on aid transfers, foreign debt, resource rents and remittances, and some will be able to finance a larger part of their budgets with proceeds from domestic tax systems and national capital markets.[6] Finally, reallocation and reprioritization of expenditures can increase fiscal space and direct public spending away from harmful or inefficient sectors and toward priority issues and SDG related spending.

6 UNRISD 2016.

Figure 1. Mobilizing fiscal space for the SDGs



Source: UNRISD 2016:169.
Notes: SOE: state-owned enterprise; FDI: foreign direct investment; ODA: official development assistance

The revenue side: Mobilizing domestic resources (II.a)

Domestic resources are key for financing the SDGs and for building strong eco-social contracts. Domestic resource mobilization (DRM) has the potential to positively impact state–citizen relations, economic stability and growth, redistribution and SDG implementation.[7] The latest Financing Sustainable Development Report emphasizes that domestic tax systems are foundational to the social contract in which taxpayers contribute to society and governments provide valuable public goods and services, a potentially virtuous circle that has also been recognized in the Addis Ababa Action Agenda.[8]

7 UNRISD 2016; UN 2023b.
8 UN 2023b:35. This resonates with academic literature on the relationship between state-building and taxation. See for example Brautigam et al. (2008) and Levi (1988).

Mixed trends in domestic resource mobilization

Before the pandemic, domestic resources—public domestic resources, in particular—were the most important source of development finance, exceeding private flows as well as international aid.[9] Equally, most African states were not aid-dependent anymore and had evolved into tax states (financing their expenditures mainly through broad taxation) or even fiscal states (having a reliable tax base to borrow at commercial rates in international financial markets).[10] According to the OECD´s Global Revenue Statistics Database, which covers 120 countries and 85 percent of global Gross Domestic Product (GDP), there has been an increase in tax revenues as a percentage of GDP in the last two decades, especially in countries where tax collection has been particularly low: since 2010, tax-to-GDP ratios have increased in about two-thirds of countries covered by the database. The increase has been widespread across different regions. This trend generally continued to advance until the outset of the Covid-19 pandemic.[11]

However, despite this positive trend, tax policies have become more inequitable. Fiscal contracts have been undermined in many countries over the last decades, with big corporations and high-income earners decreasing their contributions, increasing income and wealth inequality. Taxes with greater potential for progressive redistribution have fallen victim to political and market pressures, as can be observed in cuts to personal income tax (PIT) and corporate tax rates, while indirect taxes with regressive distributional impacts, such as value added tax (VAT), have expanded, also as one of the recommended short-term solutions to mitigate fiscal and debt crises.[12] As trade liberalization has reduced tariff rates worldwide, governments have been increasingly forced to raise consumption taxes (such as VAT), which, though regressive, reach a large section of the population and thus have the potential to substantially increase state revenues. Consumption taxes have been complemented by user charges and increased levies on utilities and other services. Reforms of corporate income tax (CIT), on the other hand, have followed a downward trend with few exceptions.[13] Most developing countries have made little progress in more progressive instruments such as taxes on income and profits—which reach only 5.1 percent of GDP on average in LICs[14] compared with 33.6 percent in OECD countries[15]—or property and wealth taxes. Adequately taxing transnational corporations and transactions is a great challenge for tax administrations (see section A New Global Fiscal and Financial Pact), in particular in the global South and in sectors such as mining, tobacco and alcohol, or telecommunications and digital services.[16]

Carbon pricing and environment-related taxes, while still limited, are slowly increasing, in particular in OECD countries, with governments raising nearly USD 45 billion in carbon pricing revenues in

9 Hujo and Bangura 2020.
10 Moore 2021.
11 OECD 2022.
12 HRW 2023.
13 OECD 2020b.
14 Akitoby et al. 2018.
15 OECD 2018a.
16 Moore 2021.

2019.[17] In Latin America and the Caribbean (LAC), environmentally related tax revenues (ERTRs) amounted to 1.0 percent of GDP on average in 2021 in the 25 LAC countries for which data are available, below the OECD average of 1.9 percent. More than two-thirds of ERTRs in the LAC region were derived from taxes on energy, most commonly excises taxes on diesel and petrol (0.7 percent of GDP on average).[18]

Finally, as result of the pandemic, overall tax revenues decreased while fiscal recovery post-pandemic has been uneven: about 70 percent of countries saw declines in their tax-to-GDP ratios in 2020, with almost 50 percent experiencing declines of more than 0.5 percentage points. Nominal taxes fell even more as GDP also declined in most countries.[19] Most countries showed a strong recovery from 2021 onwards in a context of economic recovery, end of temporary tax relief measures and higher commodity prices: the average tax-to-GDP ratio in Latin America and the Caribbean region was 21.7 percent in 2021, an increase of 0.8 percentage points from the level in 2020, when the tax-to-GDP ratio fell by 0.8 percent.[20] However, fiscal space is severely limited in most countries in the global South in a context of tightening financial conditions due to rising interest rates, devaluation pressures and unsustainable debt levels.

What needs to be done

What would a fair fiscal contract, with a distinct emphasis on fostering collective responsibility for both environmental preservation and societal well-being, look like? How can domestic resource mobilization be improved in terms of quantity and quality? Several countries in the global South have made significant progress in tax capacity in recent years. Positive examples are the greater mobilization of fiscal resources from the mining sector for public investments and social expenditure in Bolivia and Chile,[21] reforms that increased tax progressiveness and revenues in Argentina, tax reforms that were explicitly tied to the creation of a national care system in Uruguay, the formalization policies as well as innovative taxes such as financial transaction taxes to fund the Bolsa Familia programme implemented in Brazil, past and ongoing reforms in tax administration in several African countries, including Kenya and Rwanda, and the convening of national tax dialogues in Morocco, to name only a few.[22]

Recommended measures to enhance tax capacity tend to include measures such as tax base broadening for core taxes (CIT, PIT, VAT), simplification of tax systems, better use of real property taxes, and improvements in institutions governing tax policy, for example investments in tax policy units and strengthening and digitalizing revenue administrations, as well as increased use of digital services and processes, taxpayer segmentation, risk-based compliance management, creation of robust legal frameworks and convening inclusive tax dialogues.[23] In addition, enforcement of both

17 World Bank 2020; On the topic of green taxes and climate finance, see also the Club de Madrid Position Paper of Working Group 2 on "Social Dimensions of Climate Change."
18 OECD et al. 2023.
19 UN 2023b.
20 OECD et al. 2023.
21 Paz Arauco 2020.
22 UNRISD 2016; ILO 2019; Benitez et al. 2023.
23 Benitez et al. 2023; UN 2023b.

income taxes on the wealthy (supported by better data sharing within tax administrations and with third parties, also outside of national jurisdictions such as offshore centres) and property taxation is vital. Addressing tax exemptions, collusion and poor enforcement in the mining sector and of VAT and customs duties are further measures to improve domestic tax collection.[24] Addressing transfer pricing of multinational corporations (MNCs), the shifting of profits from higher tax to lower tax jurisdictions, requires capacity development for tax administrations as well as transfer pricing laws and regulations. The potential additional revenue is substantive, but it requires a long-term strategy to build the necessary capacity.[25] Introducing or increasing so-called "sin taxes" on tobacco, alcohol, sugary beverages, arms, flights, carbon-intensive goods, etc. can discourage consumption, improve social outcomes such as health and increase fiscal revenues. In the Philippines, the 2012 tobacco and alcohol tax reform earmarked a significant part of increased revenues to help finance universal health coverage (UHC) for the bottom 40 percent of the population.[26]

A wealth tax represents a compelling approach to enhancing progressive fiscal systems and building fair fiscal contracts. Such a tax has the potential to address growing wealth inequality[27] and to improve the distribution of the tax burden. In an era where the wealth of the world's richest individuals continues to soar while many struggle to make ends meet, a wealth tax can serve as a rebalancing tool. Governments can generate additional revenue to fund vital social programmes, infrastructure development and other public services by targeting the wealthiest in society, with the added benefits of fostering greater economic and social stability while protecting the planet. Moreover, a well-designed wealth tax can promote financial transparency and discourage tax evasion, reinforcing the principle that those who have benefitted most from a society's resources should contribute more.

Surveys from many countries show support for taxing the rich across the political spectrum. Oxfam notes that that several recent polls show that most people support taxing rich individuals. Polling in the US shows that in the last decade, for the first time, the majority of Americans have begun to agree that their "government should redistribute wealth by heavy taxes on the rich." An estimated 80 percent of Indian citizens are in favour of increasing taxes on the rich, and 85 percent of Brazilians are in favour of increasing taxes on the super-rich to finance essential services. In Africa, 69 percent of people polled across 34 countries agreed that it "is fair to tax rich people at a higher rate than ordinary people in order to fund government programmes to benefit the poor."[28]

Finally, strengthening tax morale, based on a comprehensive approach toward building trust and accountability in tax, is both a strategy to improve tax capacity as well as an outcome of various efforts to build better systems.

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24 Moore and Prichard 2020.
25 Moore and Prichard 2020.
26 ILO 2019.
27 While the trend of global wealth increase was reversed in 2022 mainly due to inflation, the appreciation of the USD and rising interest rates, the aggregate wealth of high-net-worth individuals possessing more than 1 million USD in wealth has grown five-fold from USD 41.4 trillion in 2000 to USD 208.3 trillion in 2022, and their share of global wealth has risen from 35 to 46 percent over the same period (Credit Suisse 2023).
28 Oxfam 2023:13.

A New Global Fiscal and Financial Pact (II.c)

The creation of fair fiscal contracts at the national level will require strong action and coordination beyond nation-states. Global governance will be central for achieving collective action—globally and regionally—as well as transformative change. Addressing climate change requires a harmonized global approach where nations collectively set policies and targets to mitigate environmental degradation; identify the resources needed to restitute loss and damage and finance adaptation; promote just, effective and rapid renewable energy transition; and agree on emission reductions, among others. More often than not, these policies would transcend borders and require the mobilization of collective financial resources. Durable solutions also require collaborative efforts to establish binding agreements, create mechanisms for monitoring and enforcement, and foster mutual accountability.

Beyond climate policies, the concept of collective global resources is central to the idea of fair fiscal contracts. Official Development Assistance (ODA), global corporate taxation and innovative mechanisms for addressing the debt problem will need to be part of a portfolio for financing the policies and agreements embedded in the new contracts. ODA needs to better support less affluent countries to implement policies geared towards sustainable development, adapting to climate challenges and ensuring social justice. Global corporate taxation could ensure that multinational corporations contribute their fair share to support collective endeavors, channeling funds toward environmental protection and equitable growth. Debt-for-nature-swaps—a mechanism through which a portion of a nation's debt is exchanged for commitments to invest in conservation and ecological restoration—are another potential source for resource transfers, in particular if the swaps are supplemented by additional concessional financing or transfers to address climate change.[29] These three mechanisms are just elements of a potential global portfolio of instruments required to finance shared prosperity and sustainability.

Global governance for fair fiscal contracts will also require deliberative processes and spaces facilitating dialogue, reaching agreements and ensuring collaboration among nations, as fiscal issues often transcend national boundaries. In addition to climate change fora, there is a need for global and regional tax dialogues. These dialogues would bring together diverse stakeholders—including governments, international organizations, civil society, business, workers' representatives and experts—to discuss and deliberate on taxation principles and policies that underpin sustainability, long-term public investment and equity within and across countries. Some regions are already moving along this direction. A recent meeting in Cartagena, Colombia—where 16 officials from Latin American countries gathered in late July 2023—concluded with the establishment of the Regional Tax Cooperation Platform for Latin America and the Caribbean.

[29] UNGA 2023b:7. The political declaration by world leaders at the SDG summit endorses these instruments while "recognizing that debt swaps cannot replace broader debt treatments in unsustainable debt situations."

Debates are also progressing on how to improve international tax cooperation at the UN in order to achieve a better representation of countries of the global South in global tax governance and to reduce tax evasion and illicit financial flows (IFFs). In addition, proposals on global corporate minimum tax rates are discussed as well as reforms to enhance tax collection. Finally, debt reduction and cancellation initiatives are urgently needed to avoid imminent debt crises or sovereign default in various countries of the global South, which risks creating social and political instability and undermining SDG implementation.

Conclusions and Recommendations (V.)

Social policy and a fair fiscal contract play a key role in shifting the current development model toward social and climate justice. They are at the core of a new eco-social contract, benefiting economy and society, strengthening social cohesion and trust, and providing legitimacy and credibility to governments. The implications for policy are clustered into four themes: 1. Fostering an enabling environment for system change; 2. Making DRM equitable, effective and sustainable; 3. Creating fair global fiscal pacts; and 4. Delivering on eco-social contracts through public investment and transformative policies.

Foster an enabling environment for system change

An enabling economic and political environment is likely to have positive impacts on fiscal policy as it increases fiscal receipts by broadening the number of tax payers and improving compliance (see box 3) while also reducing the need for redistribution due to more egalitarian market outcomes. To create an enabling environment for system change, governments and international agencies need to:

- Implement labour-intensive, sustainable and inclusive growth strategies that are conducive to green structural change and lead to higher levels of formalization, household income and equality.
- Invest in state capacity—both in terms of capacity to create long-term political consensus and support for progressive reforms, and to broker investment deals with transnational corporations that are favourable for the country—and administrative capacity to implement reforms and enforce compliance with tax law and regulation, especially by high-income earners and big corporations, including MNCs.
- Build democratic, transparent and accountable institutions and create inclusive political processes that provide an environment where citizens, business actors and donors are more likely to collaborate effectively and to deliver on their commitments.
- Reduce power asymmetries in North-South relations and harness the multilateral system to strengthen international cooperation and solidarity.
- Promote a public discourse that emphasizes shared interests, values, responsibilities and benefits, moving away from polarization and a harmful "us against them" attitude.

- In political discourses and advocacy, convey urgency without resorting to top-down measures or approaches that undermine processes of participation and consensus building.

Make domestic resource mobilization equitable, effective and sustainable

There are many elements constituting a fair fiscal contract. Improvements in the quantity and quality of DRM are crucial. A robust tax framework is essential to address prevailing challenges, aligning with the core role of the state. This framework should encompass two key aspects: ensuring adequate total tax collection and incentivizing private sector contributions toward societal challenges, while also implementing penalties for counterproductive tax malpractices, such as tax evasion and tax avoidance. A fundamental principle should be that those with greater capacity pay more, underscoring the shift from consumption-based taxation to income and capital taxation. An equitable tax strategy should resonate with the needs of marginalized sections of society and invest in protecting the planet, now and in the future. In order to strengthen DRM through fair fiscal contracts, it is recommended to:

- Prioritize wealth taxes and make advances in taxing the rich through progressive corporate and personal income taxes; inheritance, property and land taxes; and levies on capital income such as interest, dividends and capital gains, as well as windfall taxes on excess profits and taxes on luxury carbon emissions.
- Strengthen tax capacity through better enforcement of taxes on wealthy individuals and large corporations, for example through creation of asset registries, implementation of unitary taxation of MNCs and country-by-country reporting, reduction of tax exemptions and fiscal subsidies, better taxation in the mining sector, enforcement of VAT and customs duties, and renegotiation of bilateral tax treaties.
- Align tax policy and incentives with sustainable development and national goals and tailor tax instruments to national context and administrative capacity.
- Increase fiscal and tax transparency, for example through fiscal and financial reporting, publication of forecasts and budgets, fiscal risk management, fiscal incidence analysis and data collection and sharing, and better coherence across tax and budgets.
- Create an enabling environment for taxation and tax compliance by investing in good governance, inclusive sustainable growth, equitable institutions and policies, and strong anti-corruption measures.
- Make tax systems fair for vulnerable and marginalized groups—including women, low-wage workers, informal workers, and racial and ethnic minorities, among others—as well as for social enterprises and SMEs.
- Allow for greater participation in tax debates and reform processes through inclusion of civil society, experts, business associations and trade unions.
- Strengthen global tax regulation to support DRM by increasing the minimum tax on large MNCs to 25 percent, addressing problems of tax havens, IFFs, tax avoidance and evasion, and lack of accountability and transparency of MNCs.

- Create green taxes and remove harmful subsidies based on careful impact assessments and complementary measures to avoid negative effects for poor and vulnerable groups.

Create fair global fiscal and financial pacts

National fiscal pacts need to be complemented by global pacts such as ODA and improved global financial governance. ODA can have a catalytic effect on mobilizing additional domestic resources for social policies, especially in low-income settings. This has been the case where foreign aid actors supported national actors in investing in social policy and helped upgrade public institutions entrusted to deliver social services. Whether aid has a transformative effect depends on how sustainable and reliable it is, how it is distributed and allocated, and whether it enhances state accountability and institution building. Furthermore, global governance is important to guarantee macroeconomic stability and crisis prevention, curb IFFs, and promote developing countries' access to affordable and reliable external finance and markets.[30] The following measures can help to make sure that the international financial architecture works for the global South:

- Achieve immediate debt relief through debt reduction and cancellation (including mechanisms for commercial bank debt) and advance on sovereign debt workout mechanisms.
- Reinvigorate the aid effectiveness agenda (ownership, alignment, harmonization, results, accountability).
- Increase ODA to reach the 0.7 goal (0.15 to 0.20 for LDCs) and tighten classifications of what counts as ODA to make sure it supports national development strategies in the global South.
- Mobilize new concessional, non-debt financing available for LICs and MICs and implement the SDG Stimulus.
- Harness ODA to strengthen domestic fiscal institutions.
- Strengthen global governance, cooperation and solidarity.
- Increase the minimum tax threshold for large MNCs to 25 percent.
- Implement new transborder tax instruments for eco-social transformation (for example a global carbon tax on the shipping industry or an international financial transaction tax).
- Strengthen global and regional tax dialogue and cooperation mechanisms.
- Strengthen the role of the UN in the international financial architecture through the creation of a UN tax body and a UN framework convention on international tax cooperation.
- Consider creation of a UN high-level expert group on fiscal policy.

30 Hujo 2020.

Deliver on eco-social contracts through public investment and transformative policies

A fair fiscal contract requires states to deliver on their responsibilities to ensure that all people living in their jurisdiction enjoy basic human rights and have access to employment, social services and political participation and that governments deliver on their international commitments such as the SDGs, human rights and the Paris agreement. Institutionalized, long-term, universal and human rights-based approaches to social protection that empower all segments of society to play a role in the development of their communities are key to reducing inequalities and building resilience in the face of future shocks and crises. Social protection schemes and public services can support climate change adaptation and just transitions and mitigate negative impacts of various types of crises. Policy recommendations emerging from the working group are:

- Invest in universal, rights-based social policy, including social protection, social services and inclusive labour market policies.
- Strengthen key principles of transformative social policy: human rights, social security standards, universalism, public provisioning, gender justice and equitable financing.
- Move beyond sectoral approaches and promote integrated policy approaches such as care systems and eco-social policies.
- Improve quality and efficiency of public spending and conduct ex-ante and ex-post impact assessments of public spending (related to SDG achievement and climate transition, inequality and human rights impacts, employment and productivity, etc.).
- Support the sustainability transition and move toward labour-intensive, sustainable, inclusive growth paths through green industrial policy, just transition strategies, Social and Solidarity Economy, macroeconomic policy reforms, green deals, investments in new technologies and decarbonization, and incentives for sustainable consumption.
- Create spaces for meaningful and informed citizen participation and public debate about new eco-social contracts and fair fiscal contracts by promoting democratic governance, direct citizen engagements, tax dialogues, taxpayer information and education.

System change for economic transformation needs to go beyond creating fair fiscal contracts. Fiscal policy can only develop its full potential when supported through a thriving economy and democratic political processes that offer opportunities for political, economic and social participation to all people. In addition to transformative social policies based on a fair fiscal contract, as well as reformed and strengthened multilateralism and solidarities, this also requires alternative economic approaches that centre environmental and social justice and rebalance state–market–society–nature relations.[31] Finally, renegotiating eco-social contracts will not work without developing new mechanisms for citizen engagement and building of strong cross-sectoral alliances and multi-stakeholder coalitions.[32]

31 UNRISD 2022: Chapter 5.
32 UNRISD 2022; Norton and Greenfield 2023.