



No taxes – no development!

Why domestic revenue mobilisation is essential for sustainable development, and how German development cooperation (DC) supports countries to meet this challenge.

For any state, taxes form the basis for financing its core tasks and functions. The design of tax systems therefore plays a key role in reducing poverty and inequality. At the Third International Conference on Financing for Development, held in Addis Ababa in July 2015, the community of states committed to strengthening revenue mobilisation (i.e. taxes, customs duties and levies) in developing and emerging countries, and to fostering the effective allocation and use of such revenues as a central pillar of development financing. Furthermore, with the Addis Ababa Action Agenda (AAAA), the international community pledged to increase official development assistance (ODA) as a way of catalysing action and, in particular, capacity development. Illicit financial flows, specifically from tax evasion, were identified as a key obstacle to mobilising domestic revenues and therefore feature prominently in the AAAA.

With the Addis Tax Initiative (ATI), Germany has committed to redouble its efforts to strengthen the domestic funding capability of German DC partner countries. However, the call for increasing domestic revenues in developing countries is pointless if, at the same time, the tax base of these countries is being eroded by multinational enterprises (MNEs) shifting profits abroad. This is why Germany, as a member of the G20, is actively supporting greater transparency and fair rules in the international taxation of companies. In Germany's 'Marshall Plan with Africa', strengthening domestic revenue mobilisation and combating corruption and illicit financial flows are central initiatives.

This concept paper describes the current state of the development policy debate on the issue of taxation and development, and outlines areas of action for German DC.

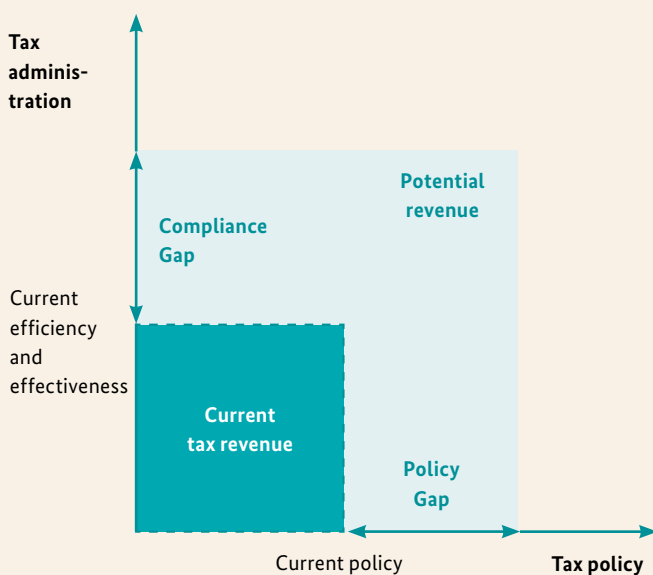


1. Domestic revenue mobilisation

Central pillar of sustainable development financing

Domestic revenue is the backbone of a functioning state, and the ability to effectively collect taxes, customs duties and levies strongly influences how a country develops. Given the enormous additional resources now needed to successfully implement the comprehensive and ambitious **2030 Agenda for Sustainable Development**, this issue has never been more important. Domestic revenue is the most important source of financing for countries and is a prerequisite for predictable planning, for the autonomous implementation of national policies and for moving beyond reliance on external aid. Accordingly, the Addis Ababa Action Agenda for development financing states that, in future, domestic revenue mobilisation (DRM) and efforts to mobilise private investment must be stepped up.

Box 1 Potential revenue from reforms in tax policy and administration



Quelle: Eigene Darstellung.

Assisting partner countries on mobilising domestic revenue is also a central concern for German DC. For the majority of countries, taxes are the most important, most sustainable and most reliable source of state revenue. However, a number of states have tax ratios that are too low to finance sustainable development. For example, in the least-developed countries (LDCs) the tax ratio often falls below 15% of GDP.

The aim of BMZ's **Marshall Plan with Africa** is to strengthen sustainable investment in Africa. Given the large gap between actual and potential domestic revenue in many African countries, achieving this aim will require reforms for increasing tax revenue. Higher tax revenue can only be achieved if tax administrations operate efficiently, effectively and in line with established rules and regulations, and if reforms in tax policy are implemented (see Box 1).

However, if a country is to realise its full revenue potential, these measures alone are not sufficient; the efficient and transparent use of public revenues must also be promoted. Good public expenditure policy in key sectors such as infrastructure, health and education are essential for promoting economic growth and equal opportunity, thereby expanding the scope for additional tax revenues in the medium-term. At the same time, efficient public expenditure management can also contribute to the availability of more resources. For example, transparent public procurement systems can substantially reduce the cost of public projects and save important resources.

To tap the potential for domestic revenue mobilisation (see SDG 17.1), effective, accountable and transparent institutions (see SDG 16.6) are required, be they institutions responsible for tax policy and administration or those responsible for budget management, public contracting and financial control.

2. Good governance in public finance

Taxes for a capable state

It is hard to find another issue that provokes as much controversy as the fair design of tax systems and the use of tax revenue. This is not surprising, since what is at stake is the distribution of resources within a society. Public finance reforms are therefore not simply technical matters. They build on social norms and, to be successful, require strong political commitment and skilled management on the part of government.

When supporting reforms in the public finance domain, German DC adopts a holistic value-based approach, the details of which can be found in BMZ's 2014 strategy paper **Good Financial Governance (GFG)** (see Box 2). This approach applies the principles of good governance to public finance systems, going beyond conventional technical public financial management (PFM) to include the political and normative dimensions.

A legitimate, transparent and development-oriented public finance system strengthens the relationship between the state and its citizens. A state that finances its activities primarily from tax revenue has a greater incentive to use

public funds in the interests of development and the public good. By contrast, inefficient use of public funds destroys confidence in the state and undermines its legitimacy. This is why GFG is essential for the evolution of statehood and for strengthening resilience, especially in fragile countries.

Strengthening domestic revenue is one aspect of GFG. For this, it is essential to develop a fair tax system, which can only be achieved through concerted reforms in tax policy and administration. Tax policy establishes the overall framework by, for example, defining a proper mix of taxes, removing tax incentives and exceptions in favour of a broad tax base, or taking political measures to counter tax avoidance and evasion. However, when a country's tax administration fails to collect taxes effectively, certain of its citizens will not be fully included in financing the public good, even though they make use of public goods and services.

Using the holistic GFG approach, German DC programmes take into account the interaction of tax revenue and public spending as well as external, political and social-control mechanisms. Also, given their enormous revenue-raising potential, particular attention is paid to countries rich in natural resources.

Box 2 The good financial governance approach in German development cooperation



3. International standards for fair tax systems

Countering tax evasion and avoidance

Economic processes are increasingly linked internationally: capital is mobile. As a result, cross-border tax avoidance and tax evasion have become major challenges for states.

Headline-grabbing revelations, such as those contained in the Panama Papers, underline the extent of these two practices. Tax avoidance is not illegal per se. By exploiting exemptions and gaps in international regulations, tax liability can be reduced to a minimum. Tax evasion, by contrast, is a deliberate and illegal violation of existing tax legislation.

According to OECD estimates, the tax avoidance strategies of multinational enterprises result in a revenue loss of approximately USD 100–240 billion a year. Developing countries lose the largest share of their total domestic corporate tax revenue, around 16%, through aggressive tax avoidance. To compare, this rate is double that of the OECD countries.

Increasing amounts of private assets are being hidden abroad. Around one quarter of Latin America's assets are held out of their owners' home countries. In Africa and the Middle East, as much as one third of private assets are moved abroad. Even though this is, in itself, not illegal, the lack of transparency existing in many countries can be exploited so that income from these assets is not properly reported to domestic tax authorities.

To tackle tax evasion and avoidance on a global scale, an international agenda for tax issues is required. [The G20/OECD Action Plan against Base Erosion and Profit Shifting \(BEPS\)](#) comprises 15 individual measures to close loopholes in international regulations and harmonise international standards for reducing aggressive tax avoidance. The [Common Reporting Standard \(CRS\)](#) was introduced as a basis for the automatic exchange of information on financial accounts ([Automatic Exchange of Information – AEOI](#)). In addition, France, Germany, Italy, Spain and the UK adopted an initiative in 2016 to exchange [beneficial ownership](#) information in order to increase transparency.

BEPS and AEOI can only be effective if non-G20/OECD countries are included as well. Germany therefore supports developing countries' involvement in the design and implementation of international tax standards and, within the [BEPS Inclusive Framework](#), works to ensure that these countries' needs and capacities are taken into account. While this Framework currently has over 90 members, the AEOI network covers 100 countries. Examples of AEOI implementation in developing countries include the [Africa Initiative](#) and [pilot projects](#) between industrialised and developing countries led by the [Global Forum on Transparency and Exchange of Information for Tax Purposes](#).

There are signs of initial successes: the announcement of AEOI alone increased tax revenue within the OECD and G20 states by an estimated EUR 37 billion. If developing countries are also to benefit from the implementation of this initiative and are to participate effectively in the AEOI mechanism, the required capacities must be created within their tax administrations. To give these countries a bigger voice, regional tax administration networks such as the African Tax Administration Forum (ATAF) and the Inter-American Center of Tax Administrations (CIAT) must also be supported.

Alongside its bilateral and regional development cooperation, German DC works closely with multilateral organisations such as the IMF, OECD, World Bank and UN (UN Committee of Experts on International Cooperation in Tax Matters) to jointly shape the international tax agenda. Key themes are the reduction of tax avoidance, combating tax evasion and illicit financial flows, the active integration of developing countries in the design of international tax processes, and greater capacity building in partner countries.

4. Capacity development

Improving tax systems in partner countries

Promoting tax systems in developing countries is an investment in the future that is already paying off. It is not unusual for investments in tax systems to yield many times their value in tax revenue. Projects around taxation have great leverage.

German DC has longstanding partnerships in place with a number of countries for working on the reform of tax policy and administration. Its programmes focus initially on establishing the basic capacities required to formulate and implement national tax policies (basics first). To reap the full potential of domestic-tax revenue, it is necessary to address both tax policy and tax administration:

- ▶ Tax policy should include all beneficiaries of public services in the tax base, make tax exemptions transparent and review them for effectiveness, and strengthen direct taxes that are tied to ability to pay.
- ▶ Efficiently and effectively operating tax administrations can improve tax morale and compliance. This applies to all aspects of the tax administration process – from tax assessment and audit to the management of subsequent demands and rebates or mechanisms for settling disputes. It is also necessary to prevent corruption in tax administration.

The more these aspects are taken into account, the better the tax burden can be equitably distributed and a fair tax system created.

German DC is a responsible partner in the politically sensitive field of tax reforms, and it is currently working bilaterally with some 30 countries, including El Salvador, Ghana, Guatemala, Kosovo, Malawi, Nepal, Rwanda, Serbia, Tanzania, Uganda and Zambia.

Since 2011 German DC has been supporting El Salvador's public finance reforms. To target tax evasion in the country, a modern risk analysis system was installed in the tax administration and tax officials were trained to better understand the practices of tax evaders. German DC also worked with the Ministry of Finance to set up its anti-corruption unit. As a result of these efforts, and despite the country's weak economic development, El Salvador has improved its tax revenue.

Since 2003 German DC has worked with Ghana to improve good financial governance in the country and has played a decisive role in integrating previously separate operating areas into a modern tax administration. This, in tandem with the targeting of tax avoidance and evasion, has seen tax revenues increasing over time. German DC has supported the Ghana Revenue Authority and the Ministry of Finance and Economic Planning on their organisational development, and has provided technical advisory services on tax and tariff policy and administration. For example, revenue authority staff received training on risk management in the context of revenue mobilisation.

Box 3 Cooperation with regional tax administration networks

African Tax Administration Forum (ATAF)

Together with German DC, ATAF offers a 15-month master's degree course on **tax policy and tax administration**, as only few African countries have specialised training for the tax administration. The course addresses the specific challenges in tax law and tax administration in the African context.

Centro Interamericano de Administraciones Tributarias (CIAT)

German DC has been a long-standing supporter of CIAT, which is today the leader in training and CPE of tax officials, and provides region-specific support in designing and implementing measures under the OECD BEPS action plan.

The regional expert networks for the tax administrations of Africa (ATAF) and Latin America (CIAT) also play a decisive role in improving the inclusion of developing countries in the international tax agenda (Box 3). They seek to strengthen their member's administrations and perform important work on the formulation and implementation of international and regional standards.

German DC is also collaborating with other international partners on the development and practical application of an analytical instrument to assess the relative strengths and weaknesses of a country's tax administration. At the end of 2015, the IMF officially launched its **Tax Administration Diagnostic Assessment Tool (TADAT)**, which has already been applied in several German DC partner countries, including Malawi, Uganda and Zambia. The results of a TADAT assessment make it possible to identify partner countries' reform needs and to plan and implement reform measures effectively.

In 2009 Germany also founded the **International Tax Compact (ITC)**, an impartial platform for action that has contributed decisively to putting tax administration strengthening firmly on the international DC agenda. Currently, German DC and the European Commission cofinance the ITC.

Finally, German DC is able to call on the services of the German Development Institute (DIE), a research facility that provides evidence-based policy advice on aspects of tax policy and administration in developing countries.

5. Turning point in development financing

The Addis Tax Initiative is a pioneering approach for the sustainable funding of the 2030 Agenda

German DC recognised the importance of mobilising domestic revenue at an early stage. At the UN's Third International Conference on Financing for Development (see Box 4), Germany along with the Netherlands, UK and USA initiated the **Addis Tax Initiative (ATI)** to promote efficient and effective tax administration and fair tax systems in developing countries. Under the ATI, participating donor countries make the commitment to collectively double their technical cooperation in the area of domestic revenue mobilisation by 2020, partner countries commit to step up domestic revenue mobilisation for sustainable development, and both parties commit to ensure policy coherence for development.

Since its formation in 2015, the ATI has developed into an internationally recognised brand and has raised broad awareness of the relevance of tax reforms for mobilising domestic revenues in developing countries.

Box 4 Addis Tax Initiative – ATI

The Addis Tax Initiative (ATI) was created in July 2015 at the **3rd UN International Conference on Financing for Development (FFD3)** in Addis Ababa.

Currently, the ATI has 37 member states, plus ten **'Supporting Organisations'**.

By signing up for ATI membership, participating developing countries demonstrate their **commitment** to increasing their domestic revenues. Getting these countries' commitment is key for German DC engagement, because successfully carrying out public finance reforms requires the political commitment of the governments in question. The ATI Secretariat is hosted by the **International Tax Compact (ITC)**.

The GFG approach provides the conceptual framework for expanding the German DC portfolio. The results of the TADAT tool are a starting point for providing efficient and effective support to Germany's partner countries. Overall, Germany is supporting some 70 projects in Africa, Asia and Latin America with an annual contribution of around EUR 40 million. Through its cofinancing of the ITC, Germany is taking a lead on ensuring the transparent monitoring of ATI commitments.

Germany is also stepping up its provision of advisory services to partner governments in the fields of budget planning and implementation, and financial control to support expenditure policies, both of which promote development. Strengthening domestic revenue is no longer just a feature of conventional public finance related projects; it is becoming increasingly important in other sectors. Accordingly, Germany will expand its cooperation in the fields of fiscal decentralisation, the promotion of commodity or tariff revenue, trade, combating illicit financial flows and anti-corruption in order to meet its commitments to the ATI.

In 2015 a number of key decisions were taken for the future of development cooperation. The 2030 Agenda set comprehensive goals for a sustainable and decent future, and it defined domestic revenue mobilisation as a conceptual framework for achieving these goals through sustainable financing. German DC was a pioneer in supporting this process and is now using its participation in the ATI as a way to expand its engagement in the field of public finance.

What we want to do:

- ▶ We work with our partner countries to help them achieve their revenue potential. To do this, we support reforms in tax policy and administration and build capacity in public expenditure management. Our strengths include providing technical advisory services on human resource development and supporting tax administrations to improve their organisational structure, procedures and processes.
- ▶ We involve German tax officials in our work with partner countries in order to (a) enhance the transfer of technical information on national and international tax avoidance practices, and (b) support the implementation of the institutional changes in tax administration required to deal with these forms of tax avoidance.
- ▶ We promote dialogue between industrialised and developing countries by supporting our partner countries' involvement in the international tax debate. Improving transparency in taxation and successfully implementing international standards both require that developing countries have a strong voice. We therefore support our partner countries' participation in the BEPS Inclusive Framework process and strengthen the UN Tax Committee of Experts on International Cooperation in Tax Matters.
- ▶ We strengthen the regional tax administration networks for Africa (ATAF) and Latin America (CIAT) and, in so doing, contribute to the implementation of regional and international standards.
- ▶ We work with our partner countries on creating legal certainty in the field of taxation, which mobilises private investment and improves the reliability of revenue for tax administrations.
- ▶ We support the Addis Tax Initiative (ATI) in its work to (a) obtain commitments from donor and partner countries by encouraging the further participation of G20 members and African partners and (b) improve donor country coordination.

Sources and further reading

BMZ (2014):

Good Financial Governance in German Development Cooperation (Strategy Paper).

BMZ (2016):

Agenda 2030 für nachhaltige Entwicklung.

BMZ (2017):

Africa and Europe – A New Partnership for Development, Peace and a better Future. Cornerstones of a Marshall Plan with Africa.

Global Forum on Transparency and

Exchange of Information for Tax Purposes (2014):

Automatic Exchange of Information: A Roadmap for Developing Country Participation.

IWF (2013):

Understanding Countries' Tax Effort.

IWF (2015):

Current Challenges in Revenue Mobilization: Improving Tax Compliance.

IWF (2015):

IMF Survey: Closing Efficiency Gaps Means Big Gains for Public Investment.

OECD (2014):

Fairer Taxation for Trusts: The Time is Now!

OECD (2015):

Strengthening Tax Systems to Mobilise Domestic Resources in the Post-2015 Development Agenda.

OECD (2015):

Transparency in Public Procurement – Moving Away from the Abstract.

OECD (2015):

Measuring and Monitoring BEPS.



Contact
Division Sectoral and thematic policies;
governance, democracy; rule of law

RL301@bmz.bund.de

Published by

Federal Ministry for Economic Cooperation
and Development (BMZ)

The BMZ's
postal address

BMZ Berlin | Im Europahaus
Stresemannstraße 94
10963 Berlin
T +49 (0)30 18 535-0
F +49 (0)30 18 535-2501

BMZ Bonn
Dahlmannstraße 4
53113 Bonn
T +49 (0)228 99 535-0
F +49 (0)228 99 535-3500

poststelle@bmz.bund.de
www.bmz.de

Editor

Deutsche Gesellschaft für
Internationale Zusammenarbeit (GIZ) GmbH

Headquarters
Bonn and Eschborn

Dag-Hammarskjöld-Weg 1-5
65760 Eschborn

T +49 61 96 79-11 75
F +49 61 96 79-11 15

www.giz.de

Design

kipconcept gmbh, Bonn

Photos

Nadine Stiller/GIZ (1); veronicadana/iStockphoto (2)

As at

05 / 2017