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Luxembourg High-level Symposium: Preparing for the 2012 DCF

**Panel 2: Using aid to help developing countries
to promote domestic revenue mobilization
18 October 2011**

**Contribution by
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Excellencies, dear colleagues, Ladies and Gentlemen:

Good afternoon to everybody!

First of all, I would like to thank the United Nations Department of Economic and Social Affairs and the Luxembourg Foreign Ministry for organizing this event and for inviting me to represent the German Federal Ministry for Economic Cooperation and Development in this panel on using aid to help promote domestic resource mobilization.

Let me briefly introduce myself: within our Ministry, I am in charge of our programs in the field of public financial management, including the International Tax Compact, and I have the great honor of chairing the Steering Committee of the new IMF Tax Policy and Administration Topical Trust Fund.

I will try in my contribution to follow the three guiding questions that were outlined for this panel:

- What are key challenges and success factors for using aid effectively to improve tax revenues which visibly impact on MDG achievement?
- What aid modalities should be used?
- What is the bare minimum level of aid required to ensure an optimal level of domestic resource mobilization?

However, I beg your understanding should my contribution go a little bit beyond that outline in some aspects.

Key challenges and success factors

Support for tax administrations and tax reforms is not a new topic for international development cooperation. Many donors, including Germany, can look back on more than 30 years' experience in this field. Up to now, we have had mixed results: some developing countries have implemented wide-ranging reforms and made impressive advances in raising their nominal tax revenues. But over the years we have not seen that much change in the average tax ratio, which is still around 17% of GDP in developing countries, contrasting with an average of 35% of GDP in OECD countries. Mainly we are not dealing with progressive tax systems, but with regressive systems which allow elites to escape responsibility for the development of their own countries. Moreover, it is estimated that the money lost to developing countries due to tax evasion and tax avoidance exceeds several times the amount of global ODA each year.

These figures are alarming. They are not a good basis for convincing taxpayers in donor countries that more money should be spent on development cooperation. And they are water on the mills of fundamental critics such as the economist Sir Péter Tamás Bauer, who - since the early days of development cooperation - has always seen it as nothing more than "an excellent method for transferring money from poor people in rich countries to rich people in poor countries". The whole legitimacy and the purpose of development cooperation are at stake.

Before this background, it is not astonishing to find that the topic of Domestic Resource Mobilization is now a top priority of the international development agenda. It is now being promoted not only at the UN level, where everything started with the Financing for Development Conferences in Monterrey in 2002 and Doha in 2008, but also at the level of the OECD, the G-8, the G-20, the EU and the IMF, which launched its new Topical Trust Fund on Tax Policy and Administration in December 2010. Europe's current debt crisis dramatically shows how important it is to maintain sound public finances. The slogan of the Kenya Revenue Authority puts it in a nutshell: "Pay your taxes - and set your country free!"

In international development cooperation, the agenda is already set - it is now time to get operational.

However, in spite of all the ongoing activities, there is still no common understanding of the underlying problems and no common strategy for tackling them. Donor support for tax reform is often limited, still highly fragmented and lacks coordination and harmonization. Most programs are still following old patterns, and concentrate more on technical aspects than on political dialogue and advocacy, and do not sufficiently reflect the development dimension of tax reforms.

What aid modalities should be used?

This is the background against which my Ministry started the initiative for an International Tax Compact, the ITC. The ITC has been designed as an informal platform for dialogue and action to assist developing countries in establishing fair and efficient tax systems. ITC's role is to be a facilitator and catalyst for joint activities at the country, at the regional and at the international level, and for analytical work and studies, and also networking and dialogue.

We feel that the ITC initiative has already done fairly well on this. When we started in March 2009, we had 30 participants from 13 partner countries and 4 international organizations. By contrast, the last ITC workshop in September 2011 was attended by some 100 participants from 33 partner countries and 8 international organizations and was co-hosted by Germany, Spain, France and the European Commission.

The ITC is by no means exclusive. On the contrary, it aims to add value to existing international efforts without duplicating them, and it cooperates very closely with all other existing initiatives.

On the eve of the upcoming G-20 Summit in Cannes and the High-Level Forum on Aid Effectiveness in Busan, the last ITC workshop focused on a question similar to the one that was raised for this panel: What should appropriate modalities for tax cooperation look like? Our colleagues from the African Tax Administration Forum, ATAF, have summarized the answer: "There is no one-size-fits-all solution or a universal fix. Each country has unique requirements." - And donors have to align their efforts with that.

Accordingly, the ITC workshop came out with some very interesting recommendations, which I would like to share with you. You will also find them in the ITC documentation, which I brought with me. It is laid out on the documentation table in the foyer.

First of all, domestic resource mobilization should not be an excuse for reducing ODA:

- Improving domestic resource mobilization aims at achieving national and international development goals and should accompany international efforts for raising ODA commitments, in line with the outcomes of the FfD conferences in Monterrey (2002) and Doha (2008).

Secondly, the development dimension must prevail:

- Enhancing tax revenues is not an end in itself; taxation is at the center of resilient state-society relations and must therefore be linked with governance efforts and public service delivery and shall be undertaken "with an overarching view to make tax systems more pro-poor" (2008 Doha Declaration).

- Development partners should strengthen the policy dialogue on domestic resource mobilization, both with each other and with representatives of parliaments, civil society and private sector organizations and other stakeholders.

- Support to domestic resource mobilization must be delivered under government leadership according to country needs and must respect the 2005 Paris Declaration principles for country ownership, alignment, harmonization, managing for results and mutual accountability.

- Donors should therefore further strengthen their efforts towards coordination and harmonization under country leadership and with each other.

- Support must be based on more realistic assessments which take sufficiently into account the political economy of tax reforms in developing countries and existing capacity constraints and needs of tax administrations.

- Support should be monitored on the basis of jointly developed indicators for measuring domestic resource mobilization progress and of harmonized, transparent and jointly implemented diagnostic reviews and performance assessments.

- Support for domestic revenue mobilization should become an integral component of all international support to public financial management systems and should be closely linked with expenditure planning.

- Support for domestic revenue mobilization should take a balanced approach between direct and indirect taxation, taking into account especially the potential for taxation of personal income and real estate.

- Support at the country level should also take into account the experiences and implementation potential of regional and subregional organizations which are dealing with tax matters, and should foster South-South sharing of successful tax practices.

- Support should enhance attention to the effective fight against tax evasion, illegal financial flows and corruption.

Let me try to give a brief answer to the last question:

What is the bare minimum level of aid required to ensure an optimal level of domestic resource mobilization?

In my opinion, there is no bare minimum. Tax reform depends on the political will of the governing elites, not on external financing. The international donor community stands ready to offer support where support is really wanted. Therefore, I cannot see any "aid orphans" in development cooperation for tax reforms.

We are very often confronted with the claim that donors do not spend enough on tax issues. But the OECD figures on ODA for tax reform give the wrong picture: they do not take into account the fact that many projects are implemented under the wider umbrella of macroeconomic or public financial management programs. Thus, ODA for tax reform is far higher than OECD figures suggest. And, once again, tax reform depends more on political will than on additional financing. In my opinion, it is much more important to integrate issues of domestic resource mobilization into ongoing programs and projects and to allocate investments well, than to make a lot more money available.

Moreover, donors should be very careful to do no harm with their external aid and not dampen domestic revenue mobilization efforts or distort domestic accountability. There are high pay-offs from tax reform. You will get back what you invest quite soon, even without a lot of external financing.

So far my contribution.

Thank you very much for your patience and your attention.

Annex: Concluding Communiqué of the International Tax Compact Workshop 2011

Annex

Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung

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International Tax Compact

Workshop

How to Operationalize the International Tax and Development Agenda

Bonn, 12-13 September 2011

- Concluding Communiqué -

At the invitation of the German Federal Ministry for Economic Cooperation and Development, the French Ministry for Foreign and European Affairs, the Spanish Ministry for Foreign Affairs and Cooperation and the European Commission, some 100 representatives from 33 partner countries and 8 international organizations participated in the International Tax Compact (ITC) workshop "How to Operationalize the International Tax and Development Agenda" from 12-13 September 2011 in Bonn.

Participants reaffirmed the importance of the ITC as an informal forum for dialogue and action, which brings together policymakers and other experts from developing and industrialized countries as well as from international organizations that deal with tax matters in development cooperation. They welcomed the ITC's role as a facilitator and catalyst for joint activities (i) at the country and regional levels, (ii) at the international level and (iii) in analytical work and studies as well as (iv) in networking and dialogue.

Focussing on the demands and expectations of ITC partners from developing countries, the workshop participants shared and discussed good practices for enhanced South-South cooperation and for stronger development coordination in tax matters at the country and regional levels. They also tackled taxation of small and medium-sized enterprises as well as the results of studies on donor mapping, appropriate aid modalities, transfer pricing and tax performance assessment and made relevant proposals for the next steps in implementing their findings in the field of development cooperation.

With regard to appropriate cooperation modalities in tax matters, participants included in their statements the following recommendations:

- Improving domestic resource mobilization aims at achieving national and international development goals and should accompany international efforts for raising ODA commitments, in line with the outcomes of the FfD conferences in Monterrey (2002) and Doha (2008).

- Enhancing tax revenues is not an end in itself; taxation is at the center of resilient state-society relations and must therefore be linked with governance efforts and public service delivery and shall be undertaken "with an overarching view to make tax systems more pro-poor" (2008 Doha Declaration).

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- Support should enhance attention to the effective fight against tax evasion, illegal financial flows and corruption.

Participants are looking forward to discussing the outcomes of the workshop with representatives of civil society and private sector organizations at an event to be held on 14 September 2011, in order to foster dialogue and networking among all relevant actors.

The ITC Secretariat will disseminate the outcomes of the workshop and feed them into the international tax and development agenda, including within the framework of G-20 and OECD approaches.

The host institutions - the German Federal Ministry for Economic Cooperation and Development, the French Ministry for Foreign and European Affairs, the Spanish Ministry for Foreign Affairs and Cooperation and the European Commission - will continue and strengthen their cooperation on the ITC. They will consult with the other ITC Core Group partners on next steps for ITC work and on the design and program of the next ITC workshop, planned to take place in 2012.