Key elements for EU statements at the UN FFD thematic debate

11/11/2014 Session on domestic public finance

1. Context

Domestic public finance is a key element in the Monterrey Consensus, the Doha Declaration and also in the ICESDF report. It is the main tool for ownership of the development process. Some countries may want to avoid the discussion at international level, and it will be important to counter such arguments. The discussion needs to go beyond mobilisation/tax revenue, and also discuss effective use and transparency, and institutions for that.

2. Overall issues on the session on domestic public finance

- Domestic public finance covers the mobilisation of domestic revenues as well as the effective use and control of them. An efficient and transparent domestic public finance system, which addresses both dimensions, is an indispensable precondition for sustainable growth. It should efficiently mobilise and channel public funds, and possess the control mechanisms to prevent misuse. Domestic public finance systems are essential for a well-functioning state and the provision of public goods and services. In most developing countries the tax ratio is still below 20% (compared to 35% in OECD countries) and the ratio for non-resource related taxes is even lower in resource-rich countries[1]. The tax optimal tax to GDP ratios differ from country to country. To finance and successfully implement global agreements and the development aspirations of its citizens, states will require more domestic revenues and sound public spending systems.
- The recent financial crisis highlighted the volatility of private finance and demonstrated the importance of increasing domestic revenues to finance sustainable development. Domestic revenue mobilisation is furthermore part of the social contract that underpins government accountability, public participation, increases social cohesion and contributes to good governance and to sustainable and inclusive growth.
- Extractive industries have changed significantly the nature of economic activity in many countries. The recent increased demand and extraction of natural resources suggest that the potential domestic revenue increase would facilitate a breakthrough in investment for human development and inclusive growth in developing countries. The expected revenue potential in Africa is estimated at 15% of African GDP[2]. Over the last decade, many resource-rich countries have embarked on reforms on their revenue management systems and managed to substantially improve their performance. It is important to ensure that such revenues boost fiscally responsible public spending and that expenditure policies are implemented to foster inclusive economic growth and sustainable development.

[1] Keen and Mansour (2009), Revenue Mobilization in Sub-Saharan Africa: Challenges from Globalization
[2] Africa Progress Report, World Bank, 2013

3. Key points on specific issues: Mobilizing domestic public resources

i) Policy reforms

- Efficient, transparent and fair tax policies are an integral element of a functioning state. Compliance of tax policies with minimum standards of good governance in the tax area (transparency, exchange of information and fair tax competition) can be a catalyst for higher revenues, by reducing tax evasion and tax avoidance. The critical nexus between tax policies and the improvement of the business environment can be reinforced by conducting appropriate tax reforms (such as transfer pricing rules) in tandem with regulatory changes that make it easier for businesses to invest, trade and create jobs, without necessarily increasing average tax rates. Fighting corruption is an important part of it. Also, full use of the skills and talents of women, would increase global productivity and thus tax revenues. Furthermore, an environment that promotes the rule of law, sound economic policies and effective multi-stakeholder involvement, fosters efficient tax systems. In that respect, the integration of tax reforms within broader governance efforts and public sector reforms makes it possible to better address the political economy factors that often hinder tax reform efforts. These are key issues that need to be addressed as part of the international Post-2015 implementation framework.

ii) Taxation and capacity development for effective collection

- Tax reform is not only about the introduction of the "right taxes". It also needs to consider a country's specific institutional environment. Strengthened tax administrations capacities and sufficient financial and competent human resources are necessary to guarantee that tax policies are enforced in an effective non-discriminatory manner and that, from the expenditure side, state administrations have the necessary skills for social policies' planning. Governments need to invest their capacity development programmes to that end, and international expertise can help in the process.
- Equally important are administrative improvements such as standardisation, specialisation and simplification of procedures to reinforce tax compliance and to hinder tax evasion and tax avoidance. Strengthening good governance in the crucial area of revenues from natural resources would require further efforts in strengthening capacity within the national administrations in revenue generation, allocation and use, including by enacting legislation requiring financial disclosure of payments from companies to governments and implementing other transparency mechanisms. A stable legal framework and simplified procedures would significantly reduce tax compliance costs for enterprises and encourage investment.

iii) Sustainable debt financing and international cooperation for debt resolution

- Debt is an important element in public financial systems, and needs to be considered in the context of the overall public finances. Sustainable debt financing, underpinned by effective debt management, is the cornerstone of financial stability and sustainable fiscal policy. Sustainable borrowing and lending practices are key, especially as most new public debt is owned by private parties.

- Sovereign debt restructurings can entail high costs to debtors, creditors and the international monetary system. Recent developments have underscored the importance of strengthening the existing contractual legal framework for sovereign debt restructuring, as well as the IMF's framework in the context of sovereign debt distress. The EU is following discussions on sovereign debt restructuring closely.

iv) Impact of illicit flows on domestic resource mobilization

- The increasing integration of international markets and economic globalisation infuses new challenges to raising domestic revenues and often hampers countries' national efforts. The leakage of funds through corruption, tax evasion, money laundering and other financial crimes undermines countries' efforts to mobilise domestic revenue. According to recent estimations, developing countries lost US$ 5.9 trillion to illicit outflows stemming from illicit activities from 2002 to 2011.[3] For 2011, the loss was up to US$ 946.7 billion. In Africa, the losses due to illicit financial flows from the region are estimated at as much as 5.7% of GDP annually[4]. According to the OECD initiated Oslo Dialogue, it is estimated that two thirds of all illicit financial flows involve tax evasion.[5] The EU and its Member States will continue to support good governance, including good financial governance, the fight against corruption, tax havens and illicit financial flows.
- Domestic actions to strengthen tax systems and enforcement, including to combat the underlying crimes, are key for addressing the issue. In addition, promoting a transparent, cooperative and fair international tax environment is necessary to efficiently tackle the challenges such as tax evasion, tax avoidance, harmful tax practices and aggressive tax planning. Recently international efforts have been initiated to develop a new international standard of automatic exchange of tax information between tax authorities in order to help tackle tax evasion and avoidance. In addition, efforts have been made to review international tax rules to better tackle base erosion and profit shifting by multinational companies. It is essential that international standards are designed to provide a global solution benefitting all countries and to ensure that national or regional legislations do not have negative effects on the domestic revenue mobilisation abilities of other countries. Therefore, the participation of all countries in international initiatives of tax cooperation is crucial to provide an international level playing field.

4. Key points on specific issues: Effective use of domestic public finance: mainstreaming sustainable development criteria

- Sound public finance systems are an absolute prerequisite to provide public goods and services in line with public policy goals, which promote sustainable development, foster inclusive growth and strengthen democracy. They enable a government to use public resources in line with the principles of good financial governance (effectiveness, efficiency, transparency and accountability). It is important to have strong public finance

[3] Global Financial Integrity, "Illicit Financial Flows from Developing Countries: 2002-2011", 2013
[4] Global Financial Integrity, "Illicit Financial Flows from Developing Countries: 2002-2011", 2013
[5] The Oslo Dialogue – OECD, 2011

systems at national, sub-national and local level, to ensure that budgets are consistent with government policy, are properly implemented, followed-up and controlled, and achieve good value for money, while citizens can monitor how public resources are being used for tangible results. Improved transparency and oversight in domestic public finance, by strengthening external audit, parliament, media and civil society as well as increasing public access to budget information is necessary to ensure that public resources are spent in a transparent and efficient way.

- Good budgeting also addresses the question of subsidies, and countries should consider rationalizing and eliminating inefficient and harmful subsidies. Sustainable development criteria should be mainstreamed in national financing strategies and included in public budgets. Sustainable management of natural and other assets is also a key element in supporting sustainable long term development.