

**Preparatory Process for the Third International Conference
on Financing for Development**

Session 2: “Domestic Public Finance” (11 November 2013)

Informal Summary by the Secretariat

Morning Session: Raising domestic resources for sustainable development

The second session discussed raising domestic resources for sustainable development. The morning session began with a scene setting presentation by Professor Atul Kohli of Princeton University on the role of states in economic development. This was followed by a roundtable discussion on country experiences with revenue mobilization. The panelists included: Benedict Clements, Division Chief, Fiscal Affairs Department, IMF; Luis Maria Capellano, Undersecretary for Public Revenue, Ministry of Economy and Finance, Argentina; and Pekka Ruuhonen, Director-General of Tax Administration, Finland. Mr. Alvin Mosioma, Director, Tax Justice Network Africa, served as a discussant.

In the scene-setting presentation, Professor Atul Kohli emphasized that while a favorable global setting was important, development was mostly a national challenge. He supported this point with several observations and empirical data. He argued that from a historical point of view, no country has ever industrialized or developed without an active role of the State, or by relying primarily on foreign resources. He used the development trajectories of Asian countries to illustrate his points, including (1) higher domestic savings rates; (2) lower levels of external debt; (3) more diverse FDI; (4) more diversified economies with higher exports of manufactured goods; and (5) lower inequality. He emphasized that no one model fits all countries, but that countries must be strategic and selectively integrate with the global economy. In concluding, Prof. Kohli said successful development requires an effective State that primarily relies on domestic resources, including mobilizing public and private savings, setting political priorities and building bureaucratic capacities in priority areas.

The first speaker of the roundtable, Mr. Benedict Clements, presented recent trends and experiences with revenue mobilization. He reported that tax revenue as a share of GDP had overall increased in low- and middle-income countries in the last two decades, but was still substantially lower than in high-income countries. Developing country revenues from value-added taxes had increased more than revenues from corporate and personal income taxes, while revenues from trade taxes had declined. In addition, he emphasized that developing countries faced significant challenges in protecting their corporate tax base from erosion and profit shifting. He discussed which taxes, including property taxes and corporate and personal income taxes, had proved to be effective in raising revenues and meeting equity objectives. When thinking about the distributional implications he stressed that tax and spending measures need to be thought of together. He also identified priorities for raising domestic resources for sustainable development, including: 1) strengthening tax administrations; 2) building effective real estate and personal income taxes; 3) addressing international avoidance opportunities and scaling back wasteful tax incentives; 4) building effective extractive industry tax regimes; 5) pricing energy to reflect damage to the environment; and 6) deepening experience sharing and cooperation.

Mr. Luis Maria Capellano shared Argentina's experience in mobilizing domestic resources. At the outset, he noted the critical role played by the Government and the challenges faced in raising resources, as well as in making efficient use of them. He underlined the importance of tax instruments to support multiple objectives equally - economic growth, sustainable development and equitable redistribution of resources. He also provided several examples of tax measures implemented in Argentina, which had been effective, including exemptions and reduced tax rates on essential goods and services and progressive rates for personal income and property taxes, as well as special measures aimed at promoting investments, research and employment. He noted that Argentina was strongly committed to fighting international tax avoidance and explained that his country, as a member of the G20, was actively participating in the G20-OECD Project on Base Erosion and Profit Shifting (BEPS), as well as in the Global Forum on Transparency and Exchange of Information for Tax Purposes. Finally, he highlighted the importance of international cooperation, as well as of investments in information technology and human resources, in strengthening the capacity of the national tax administrations.

Mr. Pekka Ruuhonen outlined Finland's experience in collecting tax revenues, with a focus on the role played by the national tax administration in achieving high compliance. He stressed that uncollected taxes (the tax gap) could be as high as 45% of expected tax revenue without efforts by administrations to ensure compliance, but that it is possible for the tax gap to be reduced to as little as 3% - 5%, as it is in Finland. He reported that Finland had achieved a high tax-compliance rate over time because of the trust placed by taxpayers in the tax administration. He emphasized that this trust had been built by improving the efficiency of tax administration, digitalizing of tax services, increasing the accessibility of taxpayer services and other forms of support, including pre-filled-out tax returns.

Mr. Alvin Mosioma, in commenting on the previous presentations, noted that there was a wide consensus that taxation was the most important and reliable source of finance for sustainable development. He argued that in implementing tax reforms to increase domestic public resources for development and mitigate inequality, the distributional implications should be analyzed and monitored very carefully, especially with respect to consumption taxes, which could have detrimental regressive effects. He noted the importance of broadening the tax base and tackling base erosion and profit shifting and the need for enhanced tax transparency, both at national and international level. He also suggested an overall reconsideration of tax incentives, which may have little real benefit. He called for increased international tax cooperation and the establishment, under the aegis of the United Nations, of a new intergovernmental body responsible for leading an inclusive process of reform of international tax rules.

Points made in the subsequent interactive discussion included the following:

- A key theme was around effective bureaucracies and efficient tax administration and the role that capacity building might play in this regard. There was a debate about how much emphasis should be placed on trying to build trust through effective communication and the aura of compliance, versus simple reforms and administrative efficiency and compliance. However all agreed that the investment of a larger share of ODA into tax administration capacity building would be useful.
- There was a suggestion that redistributive policies aimed at reducing inequality should be the foundation of any development-led tax reform. The efficiency of accomplishing this through different types of exemptions or taxes would depend on

each country's unique situation. While some speakers favored consumption taxes, other interventions indicated that consumption taxes were problematic because of the regressive impacts. There was also discussion about how taxation can affect women's rights and gender equality.

- Speakers also emphasized the need to address harmful tax competition. Interventions emphasized the lack of efficacy of tax holidays and incentives in terms of attracting foreign investment. Other speakers said evidence on the effectiveness of tax incentives is mixed and that good governance is a pre-requisite to bringing additional investment through tax incentives. Some suggested minimum corporate tax floors and regional cooperation on setting tax rates. The IMF is doing a study on tax incentives and avoiding a race to the bottom.
- Addressing illicit financial flows was also a major theme, with a focus on commercial tax evasion and avoidance through base erosion and profit shifting. Some expressed that enhanced tax transparency and exchange of information mechanisms should be top priorities for developing countries to prevent losses of tax revenues. Enhanced international tax cooperation was also thought to be critical to support inclusive and participatory processes aimed at implementing more development-oriented approaches. There was also a desire to make greater progress on the return of stolen assets. In this area the upgrading of the UN Tax Committee was mentioned by a number of speakers, including some Member States and civil society organisations.
- For countries in special situations, such as SIDS, domestic resource mobilization was considered by some interventions to be insufficient for delivery of their national priorities due to economic factors such as limited resource base, increasing costs associated with the adverse impacts of climate change, sea level rise and frequent natural disasters. Accordingly, for such countries, it is expressed that they should be provided with increased and more effective, ODA, as well as with better market access and improved access to finance.
- It was also emphasized that there are other forms of resource mobilization than taxation and that raising non-taxable domestic resources by Governments is important. Additionally, efforts to mobilizing household savings would be important, for example, through creation of national savings institutions and a variety of other programmes.

Afternoon session: Domestic Public Finance - Mainstreaming sustainable development criteria and effective use of public finance

The afternoon session heard perspectives on six areas related to incorporating sustainable development criteria into fiscal policies. The session was moderated by Mansur Muhtar, Co-chair of the United Nations Intergovernmental Committee of Experts on Sustainable Development Financing. The speakers included: Mr. Benedict Clements, Division Chief, Fiscal Affairs Department, IMF; Mr. Vinicius Pinheiro, Deputy Director, ILO; Mr. William Dorotinsky, acting Director, Governance and public sector management, World Bank; Mr. Yoganath Sharma Poudel, Undersecretary, Ministry of Finance, Nepal; Mr. Rainer Kattel, Professor of Innovation Policy, Tallinn University of Technology; and Ms. Claire Schouten, International Budget Partnership.

Mr. Benedict Clements spoke on energy subsidy reform. The IMF study he presented found that energy subsidies are worth approximately \$2 trillion worldwide, with approximately \$500 billion of this in explicit pre-tax subsidies. He identified the ingredients for successful subsidy reform from 22 country case studies, including: (1) a comprehensive reform plan with clear long-term objectives; (2) a far-reaching communications strategy; (3) appropriate phasing and sequencing of reforms; (4) improvements in the efficiency of state-owned enterprises including improved collection of energy bills; (5) targeted mitigating measures to protect the poor, with a preference for targeted cash transfers; and (6) depoliticizing price setting.

Mr. Vinicius Pinheiro spoke about the financing of social protection, which he characterized as at the core of the post-2015 agenda. He said that the financial crisis showed that the positive counter-cyclical impact of social protection is enormous because it supports aggregate demand and recovery. He also argued that these programmes pay for themselves because expenditure has high multiplier effects. The main constraint was political will. He stressed that there were no magic bullets for financing and gave five options: (1) domestic resource mobilization; (2) reorienting existing expenditure; (3) efficiencies savings; (4) international resources; and (5) debt relief and debt restructuring.

Mr. William Dorotinsky presented the positive correlation between good governance and growth; as well as the pernicious effect of corruption on service delivery and private investment. He explained that there are technical tools and interventions that facilitate improvements in governance, but these are not necessarily sustainable over the long-run. The World Bank is focusing not just on the technical interventions, but also tackling governance and corruptions at a broader level with a more open approach, that looks at the systems involved and engages citizens, private enterprise and governments in tackling corruption. He gave examples of successful improvements in service delivery including using participation and transparency. He also stressed the importance of the political landscape and governance at the highest levels.

Mr. Yoganath Sharma Poudel focused on gender-responsive budgeting in Nepal. He pointed out that underinvestment in women and girls is costly in terms of human development outcomes and growth. He mentioned that in Nepal there were targeted policies and programmes for gender equality and women's empowerment and other initiatives included enhancing the representation of women in school management and the recruitment of women as primary health care workers. Looking ahead, opportunities will arise from a gender responsive new constitution and aid effectiveness agenda that incorporates financing for gender equality. He said the way forward should include evaluating past work on gender responsive budgeting and he pointed out that the government has prioritized gender equality in its development cooperation policy. There is also the need to implement social protection measures that target women and to address the disproportionately low economic participation of women.

Mr. Rainer Kattel spoke on public procurement as development finance. He began by emphasizing the importance of public funding for development via innovation. In that regard, procurement is an important source of funding for the private sector as well as a way of diffusing technologies. He explained that thinking on procurement was shifting from a focus sole on the efficient use of resources and stopping corruption, to also considering innovation and new technology. He mentioned that there were two types of procuring innovations. Type A entailed creating new technological solutions and markets for these solutions. This includes procuring mission critical technological solutions (such as the internet, semi-conductors, fighter jets) and procuring R&D intensive solutions. Type B entailed diffusing new and

existing technological solutions that serve to enhance markets and competitiveness. Either way he stressed that governments need to build capacity and skills in procurement including by utilizing skilled staff such as engineers or other professionals in order to plan and evaluate procurement.

Ms. Claire Schouten discussed budget transparency and citizen participation. She made three recommendations: (1) guaranteeing full transparency on government revenues, aid and spending targeted to each of the development goals; (2) governments should create appropriate mechanisms for public participation in budgeting; and (3) monitoring government spending on each sustainable development goal as part of the ‘means of implementation’. This will require defining a process for global and national level monitoring of government spending targeted towards each goal.

Points made during the interactive discussion included the following:

- A key theme was around targeting of spending, including on vulnerable people such as those with disabilities. Interventions discussed the use of databases and registries to track citizens that can be helpful in targeting. Connecting together policies and information on cash transfers, education, food and health care can help. Use of technology can help with this.
- Interventions also focused on the need to strengthen the capacity of the state to spend wisely – this includes technical assistance, as well as information exchange at international level. This can include sharing of fiscal and technical solutions and best practices across countries.
- Subsidies other than fossil fuel subsidies were also discussed. Speakers stressed a practical approach with a general preference for targeted subsidies, and focusing resources on access to basic services rather than on other types of subsidies. One speaker suggested that rather than subsidies, governments can become employers of last resort and that social employment programmes in some countries, such as India, have met with success.
- Corruption was a recurring topic, with a number of interventions discussing how the leakage of funds through corruption can undermine effective spending. It was highlighted that corruption and lack of transparency can sometimes be an issue with procurement, but that care needed to be taken to not exclude domestic businesses due to too onerous bidding requirements related to interventions to tackle corruption. Electoral campaign finance can also prove an interrelated problem.
- Further discussion on social protection floors included mention of the possibility to use corporate compliance with social security contributions as a condition of bidding in government procurement tenders. There was also a proposal that all governments could commit to a minimum spending package for social services that would be adapted to their country income level. It was noted that the ICESDF had deliberated exhaustively on this topic and it encouraged fiscal policies to provide social services to the poor to reduce inequality and boost productivity.
- Another point of discussion was the importance of national governance and transparency through strengthening oversight and supreme audit institutions. Another suggestion was that all firms be required in their financial disclosures to list all payments to government. It was also suggested that the governments should publish documents they already have, like budget data and procurement contracts, to improve transparency and accountability.