



DIRECTORATE-GENERAL FOR EXTERNAL POLICIES
POLICY DEPARTMENT



TAX REVENUE MOBILISATION IN DEVELOPING COUNTRIES: ISSUES AND CHALLENGES

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DIRECTORATE-GENERAL FOR EXTERNAL POLICIES OF THE UNION

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STUDY

TAX REVENUE MOBILISATION IN DEVELOPING COUNTRIES: ISSUES AND CHALLENGES

Abstract

In recent years, domestic revenue mobilisation in developing countries gained increasing prominence in the policy debate. Several factors explain this, including the potential benefits of taxation for statebuilding; independence from foreign aid; the fiscal effects of trade liberalisation; the financial and debt crisis in the “West”; and the acute financial needs of developing countries.

Governments in developing countries face great challenges in mobilising tax revenues, which result in a gap between what they could collect and what they actually collect. Tax gaps are hard to quantify for reasons that are discussed in the report. However we know that significant contributors to tax gaps include tax evasion and avoidance, tax exemptions, and inequitable rent-sharing in the extractive sector, amongst others. The report discussed European and international actions to improve revenue mobilisation in developing countries and it suggests some recommendations for future.

This study was requested by the European Parliament's Committee on Development

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EXECUTIVE SUMMARY

In recent years, domestic revenue mobilisation in developing countries has gained increasing prominence in the policy debate. This is due to several factors, including the potential benefits of taxation for statebuilding; long term independence from foreign assistance and the shifting aid paradigm; the fiscal effects of trade liberalisation; the increased prominence of fiscal issues in the “West” due to the financial and debt crisis; and the continuing acute financial needs of developing countries.

Currently, the governments of developing countries collect much lower proportions of their GDPs in tax revenue than do the governments of the OECD countries: 10-20% rather than 30-40%. Their tax effort indices – revenue collections relative to estimated revenue potentials – are also lower than those of the OECD countries. Experts agree that there is considerable potential to increase tax revenue in developing countries.

The term ‘tax gap’ refers to the difference between revenue collected and what could be collected. It is hard to give numerical estimates for tax gaps in developing countries. Tax evasion and avoidance, tax exemptions, and inequitable rent-sharing in the extractive sector are all significant sources of these tax gaps. As a result of globalisation, competition between countries to attract capital, and large grey areas created by differences in tax legal systems, transnational corporations make widespread use of aggressive tax planning and transfer mis-pricing in order to minimise their tax payments. These practices lead to an estimated revenue loss for developing countries that is three times greater than the amount they receive in foreign aid each year. Although they have proven ineffective at attracting foreign investment, tax incentives still result in large revenue losses. In the extractive sector, rent-sharing agreements are often negotiated directly between companies and politicians, in a way that is often not transparent and which leads to highly favourable terms for investors at the expense of lower public revenues.

Developing countries face extensive political, economic and administrative challenges in closing tax gaps. Tax reform is often difficult due to interest groups who benefit from the current system. Meanwhile, tax authorities suffer from weak capacity due to a shortage of skilled staff and the lack of modern infrastructure such as IT systems and property registers. Developing country economies are also challenging to tax given the large size of their agriculture sectors, small tax bases, and their high degree of informality.

The EU and its member states have demonstrated increasing commitment to aid developing countries in raising revenue, as laid out in several documents and declarations issued recently by the European institutions. While the percentage of aid allocated to domestic revenue mobilisation is small, member states provide technical assistance and training to tax and customs administrations and ministries of finance. Many member states also fund taxation initiatives through intermediaries such as the IMF, the OECD, the International Tax Compact, the International Tax Dialogue, and regional bodies such as the African Tax Administration Forum and the Inter-American Centre of Tax Administrations. EU donors have also supported domestic resource mobilisation efforts through general budget support, basket financing along with other donors, and by providing in-kind support.

The EU has also been increasingly active on the issues of tax evasion and avoidance. It takes part in the OECD’s Global Forum on Transparency and Exchange of Information for Tax Purposes, and member states have been signing new tax information exchange agreements. Member states have been providing assistance to developing countries in implementing the OECD’s guidelines on transfer pricing. The EU’s Common Consolidated Corporate Tax Base (CCCTB) program is currently the

only concrete plan to make country-by-country reporting mandatory for transnational corporations, but it only impacts marginally on developing countries. In 2013 the EC established the Platform for Tax Good Governance, which aims to promote good governance in tax matters in third countries and strengthen the fight against tax fraud and tax evasion. However this Platform includes only European organisations, and is therefore of marginal relevance for developing countries.

The international debate on global tax issues currently focuses on two main agendas: the one on increasing transparency and information exchange, and the other on base erosion and profit-shifting (BEPS). The former involves establishing automatic information exchange as the new global standard for cooperation in tax matters and ending legal secrecy of ownership of companies and trusts, especially those based in tax havens. The latter involves a range of potential actions relating to transfer mispricing, country-by-country reporting by transnational companies, international tax law, standards for international tax treaties, limits on tax planning activities and the tax treatment of the digital economy. These agendas have been endorsed by the G8 and the G20, thus giving them high-level support and momentum. Immediate responsibility for developing the action plans to implement broad commitments lies mainly with the OECD. The actual policy outcomes are still unclear. It does however seem likely that, in the short term at least, poorer developing countries will benefit less than the countries that are driving the current reform process, especially through the G20: the OECD countries and the BRICS and other emerging economies.

This report proposes two preconditions and three recommendations for improved European action in the area of tax revenue mobilisation. The first precondition is coordination with other international actors involved in the area of taxation, to ensure coordination and prevent duplication. The second precondition is the higher involvement of developing countries, through stronger links with European institutions and member states, as well as increased participation in international initiatives. The three recommendations can be summarised as follows:

1. To support and push forward existing international initiatives to reform the global tax system, ensuring that the rhetoric on international tax evasion is followed by actions to support developing countries' tax mobilisation efforts;
2. To provide increased financial and technical assistance to support local capacity in tax administrations, that still face great administrative and capacity constraints;
3. To support existing regional organisations like ATAF in developing, for example, shared principles on tax exemptions, standard tax regimes for natural resource contracts, and proposals for minimum withholding taxes on dividends paid by subsidiaries of TNCs.

EXECUTIVE SUMMARY - FRENCH VERSION: SYNTHÈSE

Depuis ces dernières années, le recouvrement des recettes nationales dans les pays en développement domine de plus en plus le débat sur la politique des pouvoirs publics. Plusieurs facteurs expliquent cette tendance: la possibilité de renforcer l'État grâce aux retombées positives de l'impôt, la conquête d'une indépendance à long terme vis-à-vis de l'aide extérieure, l'évolution conceptuelle de la notion d'aide, les conséquences fiscales de la libéralisation des échanges, l'importance accrue des questions fiscales en Occident à la suite de la crise financière et de la crise de la dette, et la persistance de besoins de financement impérieux dans les pays en développement.

À l'heure actuelle, les recettes fiscales représentent une part du PIB bien plus faible dans les pays en développement (entre 10 et 20 %) que dans les pays de l'OCDE (entre 30 et 40 %). L'indice d'effort fiscal – rapport entre le recouvrement effectif des recettes fiscales et l'estimation des recettes potentielles – y est également moins élevé. D'après les experts, il est possible d'augmenter considérablement les recettes fiscales dans les pays en développement.

Le manque à gagner fiscal désigne la différence entre les recettes réellement recouvrées et les recettes recouvrables. Il n'est pas aisé de chiffrer ce manque à gagner dans les pays en développement, qui s'explique notablement par l'évasion et la fraude fiscales, les exonérations d'impôts ainsi que le partage inéquitable des revenus dans le secteur minier. En raison de la mondialisation, de la concurrence que se livrent les pays pour attirer les capitaux et de l'existence d'immenses zones floues dues aux différences entre les régimes fiscaux, il est très courant que les multinationales choisissent une gestion fiscale musclée et manipulent les prix de transfert pour réduire au minimum leurs impôts. À cause de telles pratiques, les pays en développement subissent des pertes de revenus trois fois supérieures au montant de l'aide extérieure qu'ils reçoivent tous les ans. Bien qu'il ait été démontré que les incitations fiscales n'ont aucun effet positif sur l'investissement étranger, leur application continue de causer d'énormes pertes de revenus. Dans le secteur minier, les accords de partage des revenus sont souvent directement négociés par les entreprises et les responsables politiques, en règle générale d'une manière opaque qui favorise nettement les investisseurs au détriment des pouvoirs publics.

Les pays en développement éprouvent de grandes difficultés politiques, économiques et administratives pour réussir à combler le manque à gagner fiscal. Les réformes fiscales sont souvent difficiles à mettre en place à cause des groupes d'intérêt qui profitent du système en vigueur. Dans les administrations fiscales, les moyens sont insuffisants en raison de l'absence de main-d'œuvre qualifiée et d'infrastructures modernes telles qu'un système informatique ou des registres fonciers. Enfin, les économies des pays en développement posent des problèmes aux administrations fiscales compte tenu de la prépondérance de leur secteur agricole, de l'étroitesse des assiettes de l'impôt et de leur caractère très informel.

L'Union européenne et ses États membres ont de plus en plus à cœur d'aider les pays en développement à accroître leurs recettes, comme le montrent plusieurs déclarations et documents récents des institutions européennes. La part de l'aide destinée au recouvrement des recettes nationales est faible mais les États membres de l'Union offrent une assistance technique et des formations aux administrations fiscales et douanières ainsi qu'aux ministères des finances. De nombreux États membres financent également des initiatives fiscales par l'intermédiaire, notamment, du FMI, de l'OCDE, du pacte fiscal international, du dialogue fiscal international et d'organismes régionaux comme le Forum sur l'administration fiscale africaine et le Centre interaméricain des administrations fiscales. Les bailleurs de fonds européens soutiennent aussi les mesures de

recouvrement des recettes locales grâce à un appui budgétaire général, à des fonds alloués par plusieurs donateurs et à des aides en nature.

L'Union européenne joue également un rôle de plus en plus actif dans la lutte contre l'évasion et la fraude fiscales: elle participe au Forum mondial de l'OCDE sur la transparence et l'échange de renseignements à des fins fiscales. Ses États membres ont signé de nouveaux accords sur l'échange de renseignements en matière fiscale et aident les pays en développement à appliquer les orientations de l'OCDE sur les prix de transfert. L'assiette commune consolidée pour l'impôt sur les sociétés, élaborée par l'Union européenne, est pour l'heure la seule mesure concrète qui oblige les multinationales à remplir une déclaration par pays. Son incidence sur les pays en développement reste cependant mineure. En 2013, la Commission a élaboré un mécanisme de bonne gouvernance fiscale qui s'adresse aux pays tiers et vise à renforcer la lutte contre l'évasion et la fraude fiscales. Son utilité reste toutefois limitée dans les pays en développement car seuls des organismes européens y ont souscrit.

En ce moment, deux priorités sont au cœur du débat mondial sur les questions fiscales: accroître la transparence et les échanges de renseignements, d'une part, et lutter contre l'érosion de la base d'imposition et le transfert de bénéficiaires, d'autre part. La première de ces priorités suppose que les échanges automatiques de renseignements deviennent la nouvelle norme internationale de la coopération fiscale et qu'il soit mis fin à l'obligation légale de garder le secret sur les propriétaires d'entreprises ou de trusts, en particulier dans les paradis fiscaux. La seconde priorité comporte une série d'actions qui pourraient être entreprises pour lutter contre la manipulation des prix de transfert, obliger les multinationales à remplir une déclaration par pays, renforcer le droit fiscal international, fixer des normes pour les conventions fiscales internationales, limiter les mesures de gestion fiscales et définir le traitement fiscal de l'économie numérique. Ces priorités bénéficient d'un appui de haut niveau et prennent de l'ampleur grâce au G8 et au G20, qui les ont approuvées. Pour l'heure, l'élaboration de plans d'action permettant d'exécuter des engagements de portée générale incombe principalement à l'OCDE. Si les mesures actuelles affichent un bilan encore contrasté, il est néanmoins très probable qu'à court terme, les pays en développement les plus pauvres n'en profitent pas autant que les pays qui auront pris les rênes des réformes, notamment par l'intermédiaire du G20, c'est-à-dire les pays membres de l'OCDE, les BRICS et les autres économies émergentes.

Le rapport mentionne deux conditions et trois recommandations destinées à renforcer l'action de l'Union européenne en matière de recouvrement des recettes fiscales. La première condition suppose une coordination avec d'autres acteurs internationaux dans le domaine de la fiscalité, de sorte à éviter les doublons. Quant à la seconde, elle implique que les pays en développement soient plus actifs en renforçant leurs liens avec les institutions européennes et les États membres de l'Union et en participant davantage aux initiatives internationales. Enfin, les trois recommandations peuvent se résumer comme suit:

1. soutenir et encourager les initiatives de réforme du système fiscal international en garantissant que les déclarations de principe sur l'évasion fiscale seront suivies d'actions qui aideront les pays en développement à prendre des mesures de recouvrement des recettes;
2. accroître l'aide financière et technique pour renforcer les moyens des administrations fiscales locales, qui se heurtent à de lourdes entraves administratives et manquent cruellement de moyens;
3. aider les organismes régionaux tels que le Forum sur l'administration fiscale africaine à, entre autres, définir des principes communs d'exonérations fiscales, mettre en place des régimes fiscaux homogènes pour les contrats d'exploitation de ressources naturelles et formuler des propositions de retenues fiscales minimales sur les dividendes versés par les filiales des multinationales.

1. TAX REVENUE MOBILISATION IN DEVELOPING COUNTRIES

In recent years tax revenue mobilisation has gained a prominent role in the policy debate. Donor agencies, both multilateral and bilateral, have increasingly recognised the central role of taxation in ensuring sustainability and ownership in the development process, amongst others. African governments and pan-African institutions on their part have given higher priority to this issue, engaging in a number of important reforms in the last decade¹ and giving taxation a higher profile in the policy agenda. South-South cooperation amongst African tax administrations has also been encouraged particularly by the African Tax Administration Forum, established in 2008, and by the African Development Bank. Taxation has also become an area of increasing interest amongst researchers, particularly in the field of political science and economics.

Why has taxation (re-)established itself recently as a priority issue in the international debate after decades of living in the shadows of other, apparently more pressing, themes? There are at least five issues that can help answer this question and that are discussed in the next paragraphs: the potential benefits of taxation on statebuilding; long term independence from foreign assistance and the shifting aid paradigm; trade liberalisation; the increased prominence of fiscal issues in the “West” due to the financial and debt crisis; and the continued acute financial needs of developing countries.

One of the reasons why taxation has attracted increasing attention is surely the realisation of its potential beneficial effect on governance and statebuilding. Part of the merit accrues to the academic community that has developed a stream of studies on taxation and development², linking them through the beneficial effects that tax bargaining can have on democratisation, representativeness and statebuilding. As the argument goes, just like taxation played a central role in Europe in consolidating the relation between governments (who needed tax revenues to finance military and other expenditures) and citizens (who were willing to pay in exchange of goods, services and guarantees from the state), it could be crucial for African countries in the area of institutional development and democratisation. The exchange between citizens and the government, based on the payment of taxes from the former against the provision of services from the latter, is based on an underlying social contract that stimulates transparency in the public administration and democratic participation in the policy dialogue.

Secondly international donors are increasingly aware that taxation is the only viable strategy to exit foreign aid dependency in the long run. Developing countries are financing most of their budgets with taxation already, but the least developed countries are still highly dependent on foreign assistance – whether dependency is measured as a ratio of aid to public expenditure or to GDP. The need to increase domestic revenues to make up for potential decreases in aid flows became even more pressing since the financial and economic crisis started in 2008. The crisis has implied a decrease in capital flows to developing countries, including trade, remittances and aid amongst others. For example in 2009 exports from developing countries fell by 7.9% and imports by 8% (Alcorta and Nixon, 2011). Aid from OECD countries also decreased as a consequence of the crisis, for example falling by 2.7% in 2011 compared to the previous year. Bilateral aid to sub-Saharan Africa was USD 28 billion in 2011, having fallen 0.9% in real terms compared to 2010; while the group of Least Developed Countries saw their

¹ Most notably, VAT and semi-autonomous revenue agencies have been widely implemented in African countries in recent years.

² See for example Bräutigam et al. (2008).

bilateral ODA fall by 8.9% in real terms to USD 27.7 billion³. The crisis therefore exposed the dangers of aid volatility for developing countries⁴, particularly the most aid dependent ones, and it made it even more important for donors to ensure their development budget is spent effectively at a time when public resources are scarce. As the international aid agenda is shifting to a post-2015 scenario, with the possibility of gradually reducing the amounts of aid, taxation is the only real source of adequate resources for development. Related to the issue of aid revenues, but with a few important distinctions to make, is dependency on natural resource revenues. Several countries in Africa have, more or less recently, discovered natural resources and many others are set to do so in the future. The effects of this windfall revenue on non-resource revenue are likely to be negative, in addition to exposing budgets of resource-rich countries to the volatility in commodity prices. For example a recent IMF working paper finds that “for each additional percentage point of GDP in resource revenue, there is a corresponding reduction in domestic (non-resource) revenues of about 0.3 percentage points of GDP” (Crivelli and Gupta, 2013). Higher reliance on domestic, non-resource and non-aid, revenues would allow for a higher level of stability, predictability and control in the budget process.

Thirdly governments of developing countries have considerably liberalised international trade, often with the strong encouragement of aid donors and international organisations. Taxes on exports have been dramatically decreased and often eliminated in many developing countries, while taxes on imports have decreased substantially and may be reduced further. African countries are likely to come under increasing pressure to further liberalise their markets. In a context of high reliance on trade revenues this could be damaging, if domestic revenues do not replace losses from trade taxes. This is generally the case in developing countries, where trade taxes represent a high share of total revenues. While trade taxes have decreased by about a third as a share of GDP in Africa⁵, they still represent a high share of revenue with some countries raising almost half of their total revenue from trade (e.g. Gambia, Liberia, Namibia, and Ethiopia). Moreover low-income countries still register a higher share of trade tax revenues on GDP, at about 3.5% of GDP as opposed to about 2% for lower middle income ones. In this context of decreased trade revenue, other taxes, and particularly the VAT, have failed to generate the necessary amounts of revenue to replace losses from trade revenue (Baunsgaard and Keen, 2010). The process of trade liberalisation therefore may imply substantial revenue losses in developing countries and particularly in Africa. It is therefore important to strengthen the capacity of countries to raise revenue from domestic sources to replace potential losses from trade taxes, and allow Africa to reap the potential benefits of further integration with the global economy.

Fourthly fiscal policy in general, and taxation in particular, has gained higher importance in advanced economies as a consequence of the financial and debt crisis of recent years. As European countries and the US have found it increasingly challenging to repay their debts and as tax revenue has slumped due to the economic slowdown, public budgets have become tighter. This situation has contributed to reviving the public interest around tax evasion and avoidance by large taxpayers, both wealthy individuals and large corporations. The recent G8 and G20 declarations (2013)⁶ express commitment to

³These are figures reported by the OECD in April 2012, for more details see

<http://www.oecd.org/newsroom/developmentaidtodevelopingcountriesfallsbecauseofglobalrecession.htm>.

⁴For more evidence on aid volatility, see for example Bulir and Hamann (2008). They find that aid is more volatile than domestic revenue and that this difference is not decreasing in time. They argue that this volatility of foreign aid made macroeconomic management difficult in developing countries. Furthermore aid has been procyclical, no countercyclical therefore failing to play a stabilising role in the economy.

⁵Data from the 2010 African Economic Outlook focusing on the special theme “Public Resource Mobilisation and Aid”.

⁶See G8 leaders Communiqué from the Loch Erne meeting, 18th June 2013 (<http://www.g8.utoronto.ca/summit/-2013lougherne/lough-erne-communiqué.html>), particularly paragraphs 23-29; and G20 Tax Annex to the Saint

establishing systems to automatically exchange information between countries on tax matters, to increase transparency and to address tax avoidance by transnational corporations, including through transfer price manipulation. Besides having direct implications for developing countries, these high level commitments also raise the profile of taxation and contribute to giving it momentum in development policy.

Finally the governments of developing countries need additional financial resources to address the huge development challenges they face. While great progress was made in recent years towards achieving the Millennium Development Goals, a large proportion of people in low-income countries still face poverty, malnutrition, vulnerability to natural disasters and preventable diseases, amongst others. Aid has certainly contributed to alleviating some of these issues, but it is becoming increasingly clear that the development challenge requires increasing domestic resources. While many African countries raise already 15% or more in tax revenue, some countries still do not raise the necessary amount of resources to allow for sound functioning of domestic institutions and basic service delivery⁷.

Having underlined the issues that make taxation a central part of the policy debate, the next few paragraphs review the recent trends in taxation in developing countries. In comparative perspective, developing countries raise substantially less revenue than advanced economies. The ratio of tax to GDP in low-income countries is between 10% and 20% whereas for OECD economies it is in the range of 30-40%. Table 1 reports data from the International Monetary Fund (IMF 2011) and similar figures are cited in the EC communication of 2010 on Tax and Development and in the European Parliament resolution of 8 March 2011 on Tax and Development⁸. Table 1 also shows that low-income countries rely more on trade taxes rather than income taxes for raising government revenue.

Table 1. Taxation by income groups

	All	High income OECD	High income non OECD	Upper middle income	Lower middle income	Low income
Government revenue, %GDP	28.7	41.5	33.8	28.5	26.4	18.4
Gov. revenue excl. grants, %GDP	27.8	41.4	33.7	27.9	25.6	15.2
Government taxes, %GDP	20.5	35.4	15.7	20.7	17.7	13.0
Income Tax⁹, %GDP	6.9	12.9	5.9	5.4	5.0	3.5
VAT revenue, %GDP	5.9	6.8	6.2	5.2	5.0	4.9
Trade Tax, %GDP	3.6	0.6	2.7	4.6	4.9	3.7

Source: IMF (2011)

Petersburg G20 Leaders Declaration 5 September 2013 St Petersburg <http://www.g20.utoronto.ca/2013/2013-0905-tax.html>.

⁷ Adam and Bevan (2004) mention a consensus around a tax ratio of 15-20% for post-stabilization countries. International Monetary Fund (2005) suggest that a tax ratio of 15% is a reasonable target for most low-income countries.

⁸ See the EC communication 2010 on tax and Development (http://ec.europa.eu/development/icenter/repository/-/COMM_COM_2010_0163_TAX_DEVELOPMENT_EN.PDF) and the European Parliament resolution of 8 March 2011 on Tax and Development (<http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P7-TA-2011-0082&language=EN>).

⁹ This includes personal income and corporate income taxes

As far as geographical regions are concerned, the lowest tax shares are observed in South East Asia and in the Pacific region at levels close to 10%. Africa, the Middle East and Latin America present a higher average tax-to-GDP ratio¹⁰ (around 18%) that however hides important differences both across and within regions. Latin America and the MENA region (Middle East and Northern Africa) have seen larger increases in tax revenue in recent years than Sub-Saharan Africa. Within Africa, countries differ according to their income level. While upper-middle income countries are converging to OECD levels (the average in this group is 35%), low-income countries (LICs) still lag behind¹¹. Many of them report tax take figures below 15% of GDP, which is generally considered¹² the threshold below which contemporary governments find it hard to finance their basic functioning and services.

These trends show that much is still to be done to improve tax revenue mobilisation, particularly in low-income and Sub-Saharan African countries. However it is important to recognise that progress was made in the last decade. In most emerging and low income countries, government revenues are on an upward path and on average they are increasing more in the post-crisis level than originally expected¹³, partly due to good cyclical conditions and partly, in some cases, due to rising commodity prices. Increases in the tax-to-GDP ratio occur only slowly over time; dramatic increases from one year to the next are rare. On the one hand this underlines the stability and predictability of tax as a source of revenue, as opposed to foreign aid and natural resource revenue. These characteristics make taxation more suitable than other sources of revenue to ensure sustainable budgets and allow for forward planning. On the other hand the stability of tax revenue points to the difficulty to obtain substantial increases in the short run. Progress is underway in developing countries, but it takes time and it is likely that LICs will not reach OECD-level tax shares in the short to medium run.

The tax take (tax revenue as a share of GDP) is a useful and simple measure of how much governments are able to extract in revenue from the economy. However it does not give indications on taxable capacity, that is how much governments would be able to collect *given* the specific characteristics of their economies, such as the level of development and trade openness. The tax effort index captures this information by calculating the ratio of the actual tax take to the estimated tax that a national economy with some specific characteristics should be able to raise. The estimate of tax is typically obtained using econometric models that predict the tax share using “tax determinants” such as: the agricultural share of the economy, the share of manufacturing or industrial activities, GDP per capita, the sum of exports and imports as a share of GDP, inflation, indices of corruption and governance. The tax effort index then tells us what percentage of the potential (estimated) tax take is actually collected.

The tax effort index can be used for comparative analysis across countries, as in Minh Le et al. (2012). An index below one indicates the existence of untapped potential, since actual tax is lower than potential tax. An index above one indicates a good tax performance, as the country collects more revenue than predicted by the econometric model. Appendix 1 reports some comparative results on tax effort from Minh Le et al. (2012). It shows that LICs generally face both low tax collection and low tax effort. As far as Sub-Saharan Africa is concerned, the index is slightly above one on average but it shows a declining trend¹⁴ in the most recent years. As usual, average figures hide important “within” variation. In fact

¹⁰ Data from Minh Le et al. (2012).

¹¹ Data from the African Economic Outlook of 2010 (AfDB/OECD), which also includes country level information for African countries.

¹² Adam and Bevan 2004 and IMF 2005 mention a 15% threshold as a reasonable amount of revenue to ensure basic government functioning.

¹³ See IMF (2013).

¹⁴ Note that the tax effort index can decline even as tax revenue in absolute terms is increasing.

within Sub-Saharan Africa, Namibia, Togo and South Africa are amongst the top ten performers while many other countries fall below the one threshold. While tax effort indices have intuitive appeal and can be informative, it is important to remember that the underlying estimates of tax potential are often imprecise and the degree of precision can vary across country. Tax effort indices are therefore to be used as guidance rather than a precise indication of tax potential or a basis on which to draw conclusions for specific countries¹⁵.

The analysis of trends in tax take and tax effort indicates the existence of a potential for increasing revenue in many developing countries, particularly low income ones. The reasons for the low or non-exploitation of this potential are discussed in the next section.

¹⁵ See Carter (2013) for a critical review of this literature.

2. TAX EVASION, AVOIDANCE AND OTHER TAX GAPS

Experts on taxation in developing countries strongly agree that there is considerable potential to increase tax revenue in most low-income countries. In its 2011 policy paper on the subject, the IMF stated that an increase was not only possible but also desirable (IMF 2011). The findings of the World Bank study presented in the previous section (Minh Le et al. 2012) confirm that most low income countries have both low tax collection and low tax effort, the latter indicating that tax revenues are below their potential level¹⁶. In addition to having revenue below potential, many LICs still face tax shares (of GDP) below 15% which is considered a reasonable threshold for ensuring government functioning.

This difference between potential and actual tax revenue broadly defines the aggregate tax gap. A more strict definition identifies the tax gap as “the difference between tax collected and the tax that should be collected (the theoretical liability). The theoretical liability represents the tax that would be paid if all individuals and companies complied with both the letter of the law and the spirit of the law” (HMRC 2013). The definition used here is slightly broader than that, as it includes sources of missed revenue that are based on laws, regulations and agreements, most notably fiscal incentives and revenue sharing contracts in the extractive sector. The aggregate tax gap is therefore broadly defined as the difference between what a government could collect, given the characteristics of the national economy, and what it actually collects. This aggregate gap is the result of a number of individual tax gaps, or components of the aggregate tax gap, which stem from the economic and political environment as well as from the government’s choices.

While it may initially seem sensible that estimates of the tax gap should be used to shape revenue policy for individual countries, reliable estimates are rare. This is reflected in the fact that the IMF itself does not calculate or use them. Fuest and Riedel (2012) review the literature on tax evasion and avoidance and they argue that many of the results in this literature are difficult to interpret, and therefore to use, because of measurement problems.

The measurement problems related to tax gaps are twofold. Firstly it is impossible to have a precise and reliable estimate of the revenue potential. Part of the reason for this is that the limits to tax collection are political, besides being economic and technical. Even when economic conditions are in place for increasing tax revenue, this increase will hardly materialise if the government does not have the political capacity to command its revenue collection agencies, generate adequate political support, and suppress and/or survive adverse political reactions. So we know there is a tax gap, but its satisfactory measurement is very difficult due to the complexity of factors influencing it. Secondly, even if such measurement were possible, it would be very difficult to quantify the revenue losses due to different causes for the existence of the tax gap. It is likely that closing one specific gap would generate increasing political resistance from taxpayers to closing other gaps.

While this study does not attempt a quantification of tax gaps, it provides an identification of the ones that are most relevant in developing countries. This is a necessary basis to evaluate current and potential actions that the international community may undertake to support tax revenue mobilisation in developing countries.

However before going into further details it is useful to provide a broad categorisation of individual tax gaps, or more precisely of the reasons why tax revenue is low in developing countries. The first broad

¹⁶ Also see Torres (2013).

reason is certainly tax evasion, a concept that can be used in at least two ways, both narrowly and broadly. In a narrow and strict legal sense, tax evasion is the illegal manipulation of an individual's or firm's affairs with the objective of reducing the amount of tax paid¹⁷. In a broader sense, tax evasion is the set of actions, legal or illegal, that individuals and firms can adopt to reduce their tax payments. This broader definition includes tax avoidance and aggressive tax planning – activities that generally are not illegal, but may be considered morally or socially unacceptable. It is tax evasion in this broader sense that matters most for developing countries. An example within this broader definition is the practice of transfer mis-pricing of international trade transactions, which results in financial flows out of developing countries. While issues like transfer mis-pricing are of foremost importance for ensuring that developing countries have enough resources to face development challenges, including meeting the Millennium Development Goals, it is important to underline that they cannot always be classed as (illegal) tax evasion. However the boundary between tax avoidance and tax evasion is often blurry. These two concepts often overlap in practice. Moreover the differences in legal systems between countries, and between countries and organisations like the European Union, result in a lack of international consensus on the legal definitions of tax evasion and tax avoidance. The IMF's 2013 Fiscal Monitor argues that complex tax avoidance practices are “symptomatic of an international tax order under stress—unsurprisingly, since it was built piecemeal on the basis of principles that have become increasingly outdated” (IMF 2013).

Therefore, having underlined these important caveats, this section adopts a broad definition of tax evasion since it is more relevant to developing countries than the narrow legal definition. In addition to the issues falling under the broad definition of tax evasion, this section discusses other constraints to tax revenue mobilisation of administrative, economic and political nature. These constraints result in foregone or missed revenue, and they therefore contribute to generating or widening the aggregate tax gap. In reviewing the specific tax gaps that explain low tax revenue in developing countries, it is important to remember that they often result from a mix of tax avoidance, evasion and other constraints. Moreover they are usually the result of the behaviour of both non-state actors (e.g. individuals, accountants, banks, corporations) and governments, who are ultimately responsible for setting the rules of the game and enforcing them.

2.1 Tax gaps in developing countries

A first large source of missed revenue for developing countries is the result of international issues related to transnational corporations. Particularly governments miss a potentially substantial amount of revenue through transfer pricing. This practice involves mis-pricing goods and services that are transferred within a transnational corporation (TNC) amongst subsidiaries/affiliates or between a subsidiary and the mother company, mainly with the aim of transferring profits to low tax jurisdictions. Transfer mis-pricing results in the erosion of the tax base, through the outflow of capital from high to low-tax jurisdictions, and thus in lower tax revenue. However transfer mis-pricing is only one of the increasingly complex set of actions and practices¹⁸ that TNCs can and do adopt to shift profits to their advantage. Typically transfer pricing and other practices aimed at tax avoidance are not illegal and they therefore cannot be strictly labelled as tax evasion. Instead they are the result of increased globalisation in production processes, international competition amongst countries to attract capitals, and the aggressive exploitation of grey areas in tax laws. The latter is particularly important for transnational

¹⁷ This definition is reported for example in James and Nobes (2009).

¹⁸ See for example IMF (2013), pp. 47-48

corporations that operate across several jurisdictions and that have many and good resources to dedicate to tax planning. Moreover since international cooperation across countries on tax matters remains limited, for example in the area of transparency and exchange of information, it is difficult for individual tax administrations to control transfer mis-pricing and other tax avoidance practices. This is particularly true in low-income countries where the resources available to the government to fight capital flight and base erosion are scarce compared to those available to transnational corporations to plan their tax matters aggressively.

While it is difficult to obtain precise estimates of the amount of revenue losses due to international capital flight, various organisations have attempted to quantify them. Christian Aid (2009) estimates that transfer mis-pricing costs developing countries USD 160 billion in lost revenues every year. An investigation by ActionAid into the food giant Associated British Foods found that by shifting over a third of its subsidiary's profits out of Zambia, the company has denied the Zambian government USD 17.7 million since 2007 (Lewis, 2013). The Zambian subsidiary has overall paid less than 0.5% of its profits in corporate tax (Lewis, 2013). ActionAid (2010) also found that SABMiller, one of the world's largest beer companies based in the Netherlands, deprived African governments of as much as USD 20 million per year by routing profits to sister companies through tax havens as "management fees", and running procurement through a subsidiary based in Mauritius. The report, which received much public attention¹⁹, underlined the inherent inequality of the current system by showing that tax payments from SABMiller's subsidiary Accra Brewery in Ghana are lower than the amount paid by a woman selling the transnational's products from a small food stall of the capital.

More generally, the amount developing countries lose through illicit financial flows, mainly in the form of tax avoidance by multinational corporations, is estimated to be between EUR 660 and EUR 870 billion each year (Eurodad, 2013). Global Financial Integrity estimates that the developing world lost USD 946.7 billion in illicit outflows in 2011, which was an increase of 13.7% over the previous year (Kar and LeBlanc, 2013). According to the same report, between 2002 and 2011, developing countries lost USD 5.9 trillion to illicit outflows. Sub-Saharan Africa suffered the biggest loss, with outflows from the region averaging 5.7% of GDP annually. These capital outflows from developing countries are often directed towards tax havens and they eventually benefit developed countries. Since these flows are larger than official development assistance, developing countries can be considered as net creditors of advanced economies. Estimates for the amount of these capital flows vary widely, so it is difficult to establish exactly how much larger than aid they are. However the OECD estimated that developing countries lose an estimated three times more to tax havens than they receive in foreign aid each year²⁰.

A second important tax gap in developing countries is related to tax incentives. Governments from low-income countries typically offer various tax exemptions with the aim of attracting investors and fostering economic growth. Such fiscal benefits are widespread in developing countries, in the form of tax holidays and a myriad of tax exemptions and exceptions that are difficult to categorise and control,

¹⁹ For example see the article published by The Guardian on 29th November 2010 (<http://www.theguardian.com/business/2010/nov/29/sabmiller-india-africa-actionaid-report>) and the blog post of 7th March 2014 on the "Africa at LSE" blog (<http://blogs.lse.ac.uk/africaatlse/2014/03/07/tax-evasion-the-main-cause-of-global-poverty/>).

²⁰ This estimate was first mentioned by the OECD's Secretary General Angel Gurría in an article published by The Guardian published on 27th November 2008 (<http://www.theguardian.com/commentisfree/2008/nov/27/comment-aid-development-tax-havens>). It is also cited in the blog post of 7th March 2014 on the "Africa at LSE" blog (<http://blogs.lse.ac.uk/africaatlse/2014/03/07/tax-evasion-the-main-cause-of-global-poverty/>) and in the ActionAid report (<http://www.actionaid.org.uk/news-and-views/almost-half-of-all-investment-into-developing-countries-goes-through-tax-havens>).

and that eventually result in low effective tax rates. However evidence shows that tax incentives are not an important driver of foreign investment²¹, if they are one at all. Investors are more likely to be driven into a country by a stable economic and political environment, good infrastructure and availability of basic services. A recent IMF paper shows that in Sub-Saharan Africa “taxation is not a significant driver for the location of foreign firms, while other investment climate factors, such as infrastructure, human capital, and institutions, are” (Kinda, 2014). By providing tax incentives, governments in low-income countries forego substantial revenue that instead could be used to foster the elements that really drive foreign investment (e.g. infrastructure, education and electricity). Eliminating or substantially reducing tax incentives is usually seen as a low-hanging fruit in tax revenue mobilisation. Since most of the companies involved are already in the tax net, additional revenue could be obtained at a relatively low administrative cost. For example, in 2006 Mauritius²² removed most of the large set of tax incentives for investment through a major tax reform. In the years following the reform both FDI and corporate income tax revenue have grown strongly. Of course the issue of tax incentives involves a debate regarding competing policy objectives (i.e. increasing revenue and promoting industrial development) that needs to be considered carefully at the country level.

On the basis of a range of partial estimates, it seems likely that the losses of revenue by developing countries from profit shifting by TNCs and through tax exemptions for investors are typically around the order of magnitude of 20% to 30% of actual revenue collections in each case. Therefore the two issues of taxation of TNCs and fiscal incentives are major causes of the tax gap in developing countries.

A third major cause of revenue losses is related to revenues generated in extractive industries. An increasing number of African countries are discovering natural resources or scaling up efforts to do so. Therefore issues related to how resource revenue is shared between investors and governments are crucial for developing countries. The fiscal treatment of mining investments varies widely across countries, with different mixes of royalties, taxes on rents and on business profits. The type of rent sharing agreements between governments and investors also varies, with the former in some cases retaining only a small portion of rents. An IMF study in 2012 suggested that governments are generally able to retain about 30% of the revenue in the mining sector. The paper also provides simulations that suggest higher shares of revenue retained by the government, particularly in the petroleum sector, therefore raising concerns over fiscal regimes that cannot secure such revenues (IMF 2012). The fact that arrangements in the extractive sector are often ad-hoc and not very transparent is also a source of concern. When such arrangements are negotiated directly between politicians and companies, outside the tax system and without clear guidelines, the potential for corruption and for a lower share of revenue retained in the country, perhaps in exchange for political benefits, can become high. It is therefore crucial to design fiscal regimes and rent sharing agreements in a way that ensures a fair amount of revenue for the producing country. They should be dictated by transparent rules and guidelines that prevent the proliferation of ad-hoc agreements. The IMF advice²³ is generally to combine a royalty and a tax targeted explicitly on rents, in addition to the corporate income tax applied on all businesses. This allows countries to ensure revenue from the start of production and to enhance

²¹ For a discussion on the effectiveness of fiscal incentives and for additional references, see the draft report on “Principles to Enhance the Transparency and Governance of Tax Incentives for Developing Countries” produced at the Fourth plenary meeting of the OECD Task Force on Tax and Development on 30-31 October in Seoul, Korea (http://www.oecd.org/ctp/tax-global/Transparency_and_Governance_principlesENG_June2013.pdf).

²² The example of Mauritius is reported in the draft report of the OECD Task Force on Tax and Development (http://www.oecd.org/ctp/tax-global/Transparency_and_Governance_principlesENG_June2013.pdf).

²³ See IMF (2012) for further details on taxation in the extractive sector.

the stability of the fiscal regime by ensuring that revenues increase in correspondence with higher commodity prices.

In addition to these three main sources of missed revenue, developing countries face a number of constraints of political, administrative and economic nature. First, political constraints are related to the power relations around taxation. Tax collectors and tax administrators can be quite powerful groups in developing countries, since their specific expertise makes them difficult to replace. They therefore have the bargaining power to resist reform and to get away with extracting revenues from inefficient or even illicit tax practices for private gain. A distinct category, also in the public administration, is formed by politicians and officials involved in setting tax policy. Moore (2013) argues that these elites can use taxation as a direct instrument of power by favouring specific people or companies, through tax exemptions, and by disadvantaging others, for example through punitive tax audits. The possibility of using taxation as a direct instrument of rule can grant political benefits to the elite, such as favours and financing, but it can result in substantial revenue losses. Finally socio-economic interest groups are likely to lobby governments to obtain fiscal benefits and to exert continuous influence on officials related to both tax policy and administration. The influence and effectiveness of these groups is particularly high in presence of high levels of inequality, as is often the case in developing countries. However, as countries develop, a new middle class is likely to emerge, which may change fiscal politics in favour of increased fiscal bargaining and a more widespread use of social contracts²⁴. To the obstacles presented by the powerful groups described here and others, are to be added more general issues related to corruption and governance that may seriously impair tax revenue mobilisation.

Administrative constraints relate to the capacity of tax administrations to enforce the law and ensure compliance. Tax administration is a very detailed and increasingly complex area of expertise, particularly as far as international issues related to TNCs are concerned. From a personnel point of view, it is difficult to find tax officials that have the necessary capacity to effectively run a tax administration with all its complexities. The problem of highly skilled officials draining towards international organisations and firms is well known in developing countries and tax administrations (but also ministries of finance and economic development) are no exception. International organisations are increasingly interested in tax matters, while tax consultancies and accounting firms are expanding their presence in developing countries. These organisations typically offer substantially higher salaries than local public administrations, even when considering revenue agencies that often have higher salaries with respect to the broader public sector. The drain of skilled personnel away from tax administration poses a serious obstacle to improving capacity there and therefore to increasing tax revenue in developing countries. From an institutional point of view, tax authorities still make insufficient use of advanced tax administration practices. These include, amongst others, the structuring of agencies by taxpayer type with a unit specifically dedicated to large taxpayers; friendly practices based on trust and increasing reliance on self-assessment; and the simplification of tax systems and procedures²⁵. For example a recent IMF paper shows that there are still opportunities in many countries to improve tax administration, for example by promoting self-compliance through self-assessment systems and by adopting client-focused taxpayer service programs (Okello, 2014). Of course a good tax administration should ultimately be able to enforce the law even in presence of tax evasion and avoidance, so that a balance of trust and coercion is usually necessary.

²⁴ See Moore (2013) for more details and for a more in-depth discussion on the political constraints to tax revenue mobilisation.

²⁵ See Moore (2013) and Brautigam et al. (2008) for a more detailed discussion.

Political and administrative constraints are partly responsible for missed revenue in the context of land and property taxes, which are largely underused in developing countries. On the political side, it is generally difficult to introduce new taxes and particularly so if they affect the relatively wealthier people who have more political influence. This would be the case for property taxes since house owners are likely to be relatively wealthier individuals. In addition political issues may arise in the relation between sub-national and central governments, as the former typically levies property taxes. In many low-income countries taxation and spending at the local level is very low, and central governments may have few incentives to change that situation by empowering local authorities with a potentially large²⁶ source of revenue. On the administrative side, tax administrations in developing countries may not have the necessary infrastructure to implement property taxes effectively. For example property registers, which are the basis for the assessment of the property tax, may contain out-dated information and may require substantial human and financial resources to be updated.

Finally, economic constraints are typically related to the small tax base that developing countries can count on. Amongst others, incomes below a certain threshold are not and should not be taxed due to considerations related to poverty and equity. This implied that in countries where a large proportion of the population lives in poverty, a considerable share of GDP is not taxable. Additionally, due to low economic development, the industrial sector is typically underdeveloped while agricultural sectors are large. This has revenue implications since taxes from the former sector are usually considered easy to collect due to visibility and accessibility of firms, while taxes from the latter are typically hard to collect²⁷. In agricultural areas it is more likely for consumption and production to occur in the same unit (i.e. the household), particularly in low-income countries. This makes it harder to track transactions and therefore to tax them. Small domestic tax bases have pushed countries to rely more on trade for revenue mobilisation. As a result the structure of tax revenue in developing countries is often not consistent with the structure of their economy, with a disproportionate share of public resources coming from trade. While this may make sense in efficiency terms, in that trade is easy to tax as it flows mainly through a few known points along the border, it exposes budgets to volatile commodity prices and it does not provide scope for expanding tax revenue. In fact the international pressure to liberalise markets implies that trade taxes are more likely to decrease rather than increase, if not in absolute terms surely as a proportion of trade flows. However trade also represents an opportunity for economic development and remains an important tax base, so it is not the major obstacle to increasing tax revenue.

Furthermore, informality represents a constraint to revenue mobilisation, particularly in developing countries where it is a widespread phenomenon both in urban and in rural areas. The administrative costs of reaching the informal sector are potentially very high, since by its nature it falls under the radar of tax officials. This sector is usually composed of a multitude of small and micro enterprises that are likely to be below the threshold for paying tax or just above it. Therefore on efficiency grounds, the high costs and low potential revenue may not make it sensible for tax officials to reach out to the informal sector. While this is true to a certain extent, two considerations are due. First, informality does not only concern entire businesses but also it occurs within firms that are officially registered. Second, political considerations suggest that bringing the informal sector in the tax net would allow for a broader engagement of citizens on tax matters, with potential beneficial effects related to state-building and democratisation.

²⁶ Property taxes are the single most important source of revenue for local governments worldwide (Moore 2013).

²⁷ See Burgess and Stern (1993).

3. EUROPEAN ASSISTANCE IN THE AREA OF TAXATION

EU policy on tax and development is set out in the 2010 Communication on Tax and Development, which was followed up by the European Parliament with the resolution of March 2011 and by the European Council in its “Conclusions on Tax and Development - Cooperating with Developing countries in promoting good governance in tax matters” of June 2010²⁸. This process of political consultation on taxation and development within the EU institutions gave rise to the several recommendations, which can be summarised as follows²⁹:

- Supporting developing countries in tax policy, administration, and reforms including the fight against tax evasion and other illicit practices.
- Supporting existing regional tax administration frameworks, such as CIAT (Centro Inter-Americano de Administraciones Tributarias) and ATAF (African Tax Administration Forum), and IMF regional technical centres, with a particular emphasis on supporting demand driven reforms and enhanced donors coordination;
- Working towards country-by-country reporting as a standard for multinational corporations, a global system for exchange of tax information, reducing transfer mis-pricing practices, and promoting asset recovery;
- Encouraging the participation of developing countries in structures and procedures of international tax cooperation; and
- Increasing support to the Extractive Industries Transparency Initiative (EITI) and expanding similar practices to other sectors.

This agenda was reinforced through the 2011 European Commission’s communication on ‘The Future Approach to EU Budget Support to Third Countries’ and the 2011 ‘Agenda for Change’³⁰, which was endorsed by the Council in May 2012. In September of the same year the EU adopted new budget support guidelines, which state that domestic revenue mobilisation “should be given greater attention in policy dialogue and capacity development” and advocate including it as part of the eligibility criteria for budget support (European Commission, 2013). In the 2012 Communication on ‘Improving EU Support to Developing Countries in Mobilising Financing for Development’ the EC called for Member States to facilitate the virtuous process of revenue collection, public spending and development by incorporating “tax administration and fair tax collection, including rationalising tax incentives and good governance in tax matters, into policy dialogue with partner countries.”

²⁸The EC Communication can be found at

http://ec.europa.eu/development/icenter/repository/COMM_COM_2010_0163_TAX_DEVELOPMENT_EN.PDF; the EP resolution at <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P7-TA-2011-0082&language=EN>; and the Council Conclusions at http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/115145.pdf.

²⁹The EC accountability report (European Commission 2013) summarises these conclusions, see in particular page 23, http://ec.europa.eu/europeaid/what/development-policies/financing_for_development/documents/-financing_for_dev_2013_accountability_report_01_en.pdf.

³⁰See http://ec.europa.eu/europeaid/how/delivering-aid/budgetsupport/documents/future_eu_budget_support_en.pdf for the former, and http://ec.europa.eu/europeaid/what/development-policies/documents/agenda_for_change_en.pdf for the latter.

Looking at the activities supported by the EU and its Member States in the area of taxation, a few general elements emerge. Firstly they cover a relatively wide scope, but the most commonly reported activities include developing financial management systems, research programmes, training, and study tours. As far as the final beneficiaries are concerned, the majority are ministries of finance as well as tax and customs administrations, while very little to no support is given to audit institutions, civil society organisations and parliaments. Most of the final beneficiaries are located in African Caribbean and Pacific (ACP) countries as well as Latin America.

It is also common for the EU and for many Member States to rely on intermediaries that have a specific expertise in supporting tax reform. The International Monetary Fund (IMF) is by far the most important actor in this sense, as it can count on wide and long experience in the area of taxation. The IMF therefore receives the most financial support, which it directs to its regional technical centres, the Trust Fund on Tax Policy and Administration, and the Topical Trust Fund on Managing Natural Resource Wealth. Other intermediaries include the OECD, the International Tax Compact (ITC) and International Tax Dialogue (ITD). The ITC is an initiative to strengthen international cooperation with developing countries in order to promote effective, fair, and efficient tax systems and combat tax evasion and inappropriate tax practices. Currently, the core group partners include the European Commission (EC), France, Germany's GIZ, the Netherlands, and Spain. The ITD is a collaborative arrangement to encourage discussion of tax matters among national tax officials, international organisations and a range of stakeholders. The EC, Denmark, France, Ireland, the Netherlands, Spain, and the UK are contributors to the ITD.

Three-quarters of Member States provide no or limited support for domestic resource mobilisation (DRM) in the context of public financial management (PFM) reforms. Only Portugal reports allocating more than 50% of PFM funding to DRM (EC 2012). Still, the EU and about a third of Member States monitor DRM, usually through financial management criteria in the context of budget support operations. Austria and Finland rely on specific indicators to monitor DRM, while Sweden and Germany refer to indicators embedded in joint assessment frameworks. Germany also conducts annual fiduciary risk assessments in all countries receiving budget support, where a revenue-to-GDP ratio below 10% is considered grounds for exclusion. DFID monitors DRM indirectly, through project monitoring of interventions that aim to improve revenue collection. Although there is no standard diagnostic framework for assessing tax programmes, there appears to be support among EU Member States to develop such a framework styled after the Public Expenditure and Financial Accountability (PEFA) framework, which is widely used for budget assessments.

A recent study funded by the OECD and Germany examined and evaluated the various modalities through which donors can provide assistance to developing country tax systems. These consist of: 1) general budget support 2) sector budget support 3) basket financing 4) other multi-donor instruments such as trust funds 5) stand-alone bilateral projects, 6) supporting south-south organisations, and 7) providing in-kind support. Each of these have their benefits and drawbacks and have been used by EU member states to varying degrees. The next few paragraphs discuss these modalities in more detail in the specific context of the EU and Member States' experience in supporting tax revenue mobilisation in developing countries.

Within the different modalities, stand-alone bilateral projects account for a large share of European taxation aid. This method can lead to duplication of effort, fragmentation, inconsistency and higher transaction costs. Nonetheless, some aid agencies and recipients prefer stand-alone arrangements. When there is strong ownership and leadership by the host country, they can be very successful. For example, DFID supported the establishment of the Rwanda Revenue Authority, helping organise its office building and management systems, as well as the laws and regulations under which it operates.

During the 10-year period of support, taxes collected increased six-fold, and in 2010 the Authority was awarded ISO 9001 accreditation (UK Parliament, 2012). The Authority's effectiveness has been a major factor in Rwanda's impressive development progress.

Other examples of bilateral projects are France's bilateral aid to sub-Saharan countries through its Solidarity Priority Fund, focusing on supporting local tax systems as part of decentralisation processes. Furthermore Portugal delivers its aid to Portuguese-speaking African (PALOP) countries through Integrated Programmes for Cooperation and Technical Assistance in Public Finance, or PICATFins. These are financed and implemented by the Portuguese Ministry of Finance, which signs a memorandum of understanding with its peer in each country. PICATFins consist of capacity development interventions such as training, consultancies, and sometimes the provision of new software and equipment. In total, Portugal has allocated EUR 7.5 million to PICATFins in Angola, Cape Verde, Guinea-Bissau, Sao Tome and Principe, and Mozambique between 2007 and 2011, with an average of EUR 1.5 million per country (IPAD, 2011).

To a lesser degree, the EC and some Member States provide taxation aid through General Budget Support (GBS) and Sector Budget Support (SBS). These modalities have the advantage of providing unified funding that is well aligned with host country priorities. On the other hand, the breadth of these programs may weaken domestic focus on taxation and accountability. To counteract this, introducing variable tranche funding mechanisms linked to carefully defined revenue targets is recommended. A successful example of budget support is the "Good Financial Governance" project in Ghana funded by Germany's BMZ and KfW Entwicklungsbank, as well as Switzerland's SECO. The funds supported Ghana's Ministry of Finance and Economic Planning (MOFEP) in integrating the income tax and VAT authorities into a new unified Ghana Revenue Authority. The program also supports the MOFEP's Tax Policy Unit with technical and organisational advice. Partly due to the gains in capacity and efficiency brought by the program, Ghana's income from taxation rose four-fold in nominal terms between 2004 and 2011³¹. The number of taxpayers has also grown continuously, and the state has created an effective legal framework for petroleum sector revenues.

Member States can also pool their resources for designated taxation projects through basket financing. This approach is more suitable than GBS or SBS for addressing specific tax issues, although it can be less aligned with host country systems. The UK, Netherlands, and Belgium used the basket method to finance the modernization of Uganda's Revenue Authority. The program delivered significant improvements, including a reduction of the Authority's costs from 2.89% to 2.35% of gross revenue (Nathan Associates Ltd., 2011). However, the revenue ratio was not increased as much as was hoped for. An assessment of the program found that this was due to lack of Ugandan ownership and management of the reform process, inadequate attention to support functions such as human resources and procurement, and inferior sequencing of reforms³². Despite the implementation problems that may emerge, many officials favour the basket approach because it simplifies coordination, it supports an integrated approach, and it lowers transaction costs.

Some European aid agencies also deliver technical assistance through in-kind support such as twinning, offering training opportunities, equipment, or the secondment of experienced tax officials. Nearly all the activities of the GIZ, for example, take the form of in-kind technical cooperation. Developing country authorities are especially eager for the involvement of experienced tax officials from foreign countries.

³¹ For more details, see the GIZ's project description for "Good financial governance" at <http://www.giz.de/en/worldwide/19422.html>.

³² See Nathan Associates Ltd. (2011), page 31.

In-kind support makes this possible because tax experts who work for donor government revenue agencies are usually unavailable as consultants, and the procedures for procuring their assistance under funding arrangements can be very complex. Conversely, in-kind support can be provided flexibly and on short notice. Potential risks of this approach include lack of buy-in from local clients, fragmented technical approaches, and weak quality control. Thus, donors providing in-kind support should collaborate closely with recipient country officials in identifying needs and ensuring quality control and coordinate with other aid agencies to harmonize approaches and prevent inconsistency.

Furthermore an important aspect of European support to taxation is the support of regional bodies such as the African Tax Administration Forum (ATAF) and the Inter-American Centre of Tax Administrations (CIAT). The EU, Germany, Ireland, the UK, Netherlands, and Sweden support the ATAF, while the Netherlands, Spain, Portugal and Italy are members of CIAT. These organizations are an important platform for networking, knowledge sharing, and regional collaboration among tax officials from the South and merit strong support. However, there are limits to their absorptive capacity in terms of funds and particularly for relatively new organisations such as ATAF.

In countries where government systems do not warrant budget support, donors can also jointly fund joint projects through instruments such as trust funds. For example, Germany, Belgium, Luxembourg and the Netherlands support the IMF's Topical Trust Fund targeting Tax Policy and Administration, which will allot USD 30 million over five years to finance IMF experts in providing technical assistance to 15-20 developing countries that are not already benefitting from major donor funding in the tax area (Nathan Associates Ltd., 2011).

3.1 European actions related to existing tax gaps

Through these various modalities and other international activities, the EU institutions and member states can and do address some of the tax gaps identified in the previous section.

As far as evasion is concerned, the EU and its member states have been increasingly active. The EU and 26 member states take part in the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes. According to the OECD, 16 Member States signed a total of 36 new Tax Information Exchange Agreements with 27 developing countries in 2012 (EC, 2013). Members also provide technical assistance and training seminars on the issue, including Germany in East Africa and Central America, France in Chad, and the UK in Kenya and Ghana. Germany, Ireland, Luxembourg, the UK, the Netherlands and the Slovak Republic supported initiatives such as the ITC and the OECD tax and development programme, which are aimed at helping developing countries to fight tax evasion. In line with this goal, Member States also provide assistance to developing countries on implementing the OECD's guidelines on transfer pricing. The European Commission, Netherlands and Belgium participated in the OECD task force on transfer pricing, and Belgium, Spain, France, Slovenia, and the UK organised training seminars on the subject. The EU and some member states also supported developing countries in drafting transfer pricing regulations, such as the EU in Vietnam, Germany in Ghana, and the UK in Kenya.

The EC has also taken steps to combat corruption. Since 2009, the Commission has allocated over EUR 93 million on 69 projects dedicated to the fight against corruption around the world (EC, 2013). EU member states have participated in initiatives such as the UN Convention Against Corruption, although Germany and the Czech Republic have not ratified it. Twenty-two member states are party to the OECD's convention on combating the bribery of foreign officials. However, according to Transparency International, only four actively and seven moderately enforce it. Nine member states participated in the Stolen Asset Recovery Initiative launched by the World Bank and the UN in 2007. Finally, 10 member states and the Commission supported the EITI in 2012, either through direct support to the Secretariat,

bilateral support at the country level, or through the Multi-Donor Trust Fund. For example, the UK contributed EUR 30 million to a World Bank project in the Democratic Republic of Congo, and Belgium contributed EUR 1 million to the Extractive Industries Technical Advisory Facility (EC, 2013). While there is no consensus on whether or how the EITI approach should be extended to other sectors, some are in favour of applying it to forestry, and Germany is supporting the Constructive Sector Transparency Initiative.

In 2013, the EC established the Platform for Tax Good Governance. The members of the Platform are the tax authorities of all Member States and 15 organisations representing business, civil society, and tax practitioners. All the member organisations are from European countries, with no representation of developing countries. Its goal is to assist the Commission in developing initiatives to encourage third countries to apply minimum standards of good governance in tax matters and on aggressive tax planning. It aims at strengthening the fight against tax evasion and avoidance by developing an automatic exchange of information instrument, in line with the G20's agreement that this be the new global standard of cooperation between tax administrations. The Platform also aims at cooperating with the OECD's Base Erosion and Profit-Shifting (BEPS) process to curb international corporate tax avoidance. Finally, it may take action on tax havens by developing criteria for identifying tax havens, publicly blacklist the countries that do not comply with the minimum standards, and identify measures that EU states can take against non-compliant countries and in favour of compliant ones. However the works of the Platform are still at an early stage and it is not clear if, and how, developing countries are going to be affected by it.

While the EU and member states' efforts in the field of tax evasion are to be appreciated, they also present a number of drawbacks, related to developing countries participation amongst others. For example the main contribution of the EU in promoting country-by-country reporting, the Common Consolidated Corporate Tax Base (CCCTB) program, currently has a negligible impact on developing countries. The Platform for Tax Good Governance discussed in the previous paragraph notably does not include representation of developing countries' interests. Suggested recommendations for improvement are presented in section 5.

As far as tax exemptions are concerned, the 2010 Communication on Tax and Development strongly conveyed that reducing tax incentives should be a priority for EU countries in their technical cooperation. Germany, Spain, Hungary and the UK provided support on this issue through the IMF and the OECD. Meanwhile, direct support was provided in the area by Belgium to Burundi, by Germany to African and Latin American countries, and by Finland to Tanzania. It is fairly widely accepted that tax incentives for private investment may imply more losses, through missed tax revenue, than benefits, by attracting investment (see the discussion on fiscal incentives in section 3). However there is still no consensus between member states on whether or not tax exemptions should apply to projects financed by external aid.

Last but not least, Europe can help developing countries to better manage their natural resources and the revenues deriving from them. This type of assistance is particularly effective when it is provided by resource-rich countries that have first-hand experience in the government's options and responses in relation to extractive industries. For example Norway³³ has been particularly active in this area, being one of the biggest donors for projects related to extractive industries along with the World Bank, the

³³ Norway is not a member state of the European Union but it is closely associated with Europe, for example by being part of the European Economic Area and the Schengen Area.

European Commission and the African Development Bank³⁴. In September 2013, Norway contributed USD 4.9 million to the AfDB's African Legal Support Facility (ALSF). Resource rich countries can use this facility to increase their negotiation capacity and thus obtain better contracts in the extractive sector, as well as to increase the financial transparency of agreements³⁵. Furthermore, Norwegian assistance to Zambia helped establish a new regime for mining taxation in 2008, which moved the country away from ad-hoc agreements to a general tax system with an increased corporate tax rate and royalty rate, and a windfall tax levied when copper prices reach high levels³⁶.

³⁴ See Swanson and Aasland (2009) for a review of donor-funded assistance in extractive industries in Africa.

³⁵ For more details, see <http://www.afdb.org/en/news-and-events/article/norway-empowers-african-legal-support-facility-with-us-4-9-million-12225/>.

³⁶ See NORAD (2012) for more details on NORAD's involvement on taxation and development.

4. THE INTERNATIONAL COMMUNITY'S INVOLVEMENT IN TAX MATTERS

The actions by the EU and MS are to be considered in the broader context of the international community's involvement on taxation and development, both because of the need to ensure coordination and because some EU/MS actions are implemented through international institutions such as the OECD or the IMF. Most of the international community's efforts were precisely directed to tackling the tax gaps and constraints underlined in section 2, both at the policy and administrative level. In particular, it is possible to identify four interrelated categories in which international actions on taxation tend to fall: technical assistance and training, diagnostics and policy advice, financial aid, action on global issues.

Technical assistance and training are crucial aspects of support to tax mobilisation in developing countries and they are virtually always included in aid programs. They can be either provided in kind or through funding for tax projects/programs. The main goal of these activities is to relax capacity constraints within the public administration, while at the same time informing government policy, supporting exchange of information across countries and stimulating debate around tax matters. Technical assistance on taxation can be related to short-term projects or to broader reforms, which may encompass capacity building in the public administration as a whole in the longer run. The OECD's Tax Inspectors Without Borders (TIWB) is an example of a recent initiative to support tax administrations in developing countries by transferring tax audit knowledge and other skills³⁷. To do this, TIWB adopts a "learning by doing" approach whereby experts from tax administrations are deployed to work directly with tax official in developing countries.

Secondly, the international community assists developing countries in diagnosing challenges in their tax system and in providing policy advice for reform. The International Monetary Fund's tax missions are a typical example of this advisory role, and indeed the IMF is a major driver of tax reform in developing countries, and particularly in Africa. The IMF's advice on revenue mobilisation is based on a few elements of "conventional wisdom" that are summarised in table 2.

Table 2: Conventional wisdom: IMF advice on revenue mobilisation

Recommendation	Rationale
Exploit <i>consumption taxes</i> more fully, expanding the base of the value-added tax (VAT) before raising standard rates (using the transfer system to protect the most vulnerable as needed), and reviewing excise levels.	Most rate differentiation under the VAT is rationalized by distributional concerns that could be better achieved by direct transfers; excises better handle environmental and other concerns requiring differentially high tax rates.
Look for opportunities to broaden the base of the <i>personal income tax</i> – a first step being to quantify all tax expenditure – and, while recognizing that increased inequality might call for increased progressivity, avoid very high	Exemptions and deductions remain significant in many countries, and their cost should be transparent; raising effective rates can have strongly adverse effects on incentives, in terms of both real and avoidance activities.

³⁷ For further details, see <http://www.oecd.org/tax/taxinspectors.htm>.

Recommendation	Rationale
marginal effective tax rates.	
Resist increasing <i>social contributions</i> and consider combining a cut in the employers' contribution with an increase in consumption taxation - a fiscal devaluation.	Unless increased contributions are perceived as carrying matching increased benefit entitlement, they can have strong incentive and employment effects. With a fixed exchange rate, a fiscal devaluation can boost net exports – temporarily – by reducing the foreign currency price of exports and increasing the domestic relative consumer price of imports.
For the <i>corporate income tax</i> , quantify and review tax expenditures, resisting further inappropriate base erosion and pressure to cut statutory rates; reduce the tax bias toward debt finance.	Intense international tax competition is likely to continue, and addressing it will require strong international cooperation; tax distortions can jeopardize financial stability by encouraging excess leverage.
Increase <i>property taxes</i> , especially recurrent charges on residential properties; scales back transaction taxes.	Property taxes appear to be relatively growth-friendly and can serve equity and accountability aims; transaction taxes impede efficient trades.
Implement effective <i>carbon pricing</i> , either by carbon taxation or by full auctioning under cap-and-trade schemes; eliminate fossil fuel subsidies and review environmental taxes more generally.	Pricing measures are essential to encourage efficient mitigation and so are a particularly efficient source of revenue; fuel subsidies are very poorly targeted to distributional aims.
In the <i>financial sector</i> , adopt tax measures to discourage volatile financing as well as financing improved resolution mechanisms; counteract the VAT exemption for financial services by adopting a financial activities tax (FAT).	These measures would ensure a “fair and substantial contribution” of financial institutions to the fiscal costs of their potential distress and failure; as a tax on the sum of wages and profits of financial institutions, a FAT would provide ad fix, albeit an imperfect one, for a major distortion in the VAT.
Strengthen tax compliance by identifying and acting on compliance gaps, aggressive tax planning, and offshore tax abuse.	Improving tax compliance would promote fairness and reduce distortions.

Source: IMF (2013)

While there is little doubt of the central IMF role, other multilateral and bilateral donors have been increasingly active. One of the most remarkable elements emerging in the area of support to tax mobilisation is the degree of agreement within the “epistemic community” composed of experts, practitioners and researchers concerned with tax reform in developing countries (and this includes the IMF). In particular there is wide agreement on a global tax reform agenda³⁸ that includes three main elements: the introduction of broad based consumption taxes such as the VAT, simplified tax design,

³⁸ For more details on the “global reform agenda” see Brautigam et al. (2008), chapter 10, and Fjeldstad (2013).

and improved tax administration. This agenda has largely influenced tax reform in African countries, although it has sometimes been criticised for not being suitable to their specific needs. For example, the introduction of VAT has failed to generate the necessary revenues needed to compensate potential fiscal losses due to trade liberalisation³⁹, although it remains an important source of revenue, with the potential of generating still more revenue in the future. The global reform agenda has also represented a platform for coordinating donors' recommendations in the area of taxation.

Thirdly aid as a financial flow has helped release constraints in tax administrations. For example aid funding has often supported the introduction of IT systems, thus releasing financial constraints that made new technologies otherwise not affordable in developing countries. The OECD reports that in 2007, aid for "tax and revenue-related" tasks comprised USD 185.6 million, which accounts for 0.16% of all overseas development assistance and 2.7% of aid supporting the strengthening of public sector capacities (ECOSOC, 2011). Thus, although aid to domestic revenue mobilisation has increased since 2007, it still represents a small component of overall aid. Only 0.07% of official development assistance to fragile states is directed towards building more effective tax systems, when these are crucial to state-building (OECD, 2014). Econometric studies⁴⁰ that analyse the relation between aid amounts and the share of tax to GDP increasingly find a positive relation between aid and tax, indicating that the positive effect of financial flows overcomes the potential negative effect due to a possible crowding out of domestic resources due to aid.

Last but not least, the international community has been increasingly active in discussing possible actions to tackle global issues such as international tax evasion and avoidance. There are two main areas of discussion in the international community aimed at tackling evasion and avoidance: the transparency/exchange of information agenda and the BEPS (base erosion and profit shifting) agenda. Both agendas are primarily driven by advanced economies and BRICS countries, while developing countries play a minor role.

As far as the former is concerned, a recent OECD report provides a new global standard⁴¹ for exchanging information automatically (rather than on request) across tax administrations, which should help countries control international capital flows and prevent tax evasion. Automatic exchange of information is one of the provisions that could help tackle tax havens and improve transparency in international tax, as well as paving the way for increased international cooperation in tax matters. While these developments are certainly welcome, concerns have been expressed regarding their effects on developing countries. In particular the Tax Justice Network (TJN) noted⁴² that low-income countries may be effectively excluded by the potential benefits of such initiatives that are primarily designed for advanced economies and BRICS. For example, by making automatic exchange of information reciprocal, the new global standard may effectively exclude low-income countries that do not have the resources and the capacity to set up the necessary infrastructure to collect and manage the required information. In addition TJN notes that tax havens are mostly based in advanced countries and transparency of information is needed particularly from these countries that host havens rather than from low income countries that are instead largely victims of capital out-flows. Low-income countries simply do not have

³⁹ For more details, see for example Baunsgaard and Keen (2010).

⁴⁰ See for example Clist and Morrissey (2011) and Benedek et al. (2012).

⁴¹ For more details on this new standard and a link to the report, see <http://www.oecd.org/ctp/exchange-of-tax-information/automatic-exchange-of-financial-account-information.htm>.

⁴² The response of TJN to the OECD report can be found here: <http://www.taxjustice.net/2014/02/13/press-release-tjn-responds-new-oecd-report-automatic-information-exchange/>.

the capacity to access, manage and process the information under the international standards of automatic exchange of information. A big constraint regards human resources more than funds, as tax administrations find it hard to retain experienced people who are usually lost to international institutions, transnational companies, banks or professional services firms – typically the “Big Four” (Deloitte, PwC, KPMG and Ernst & Young) that are quickly expanding their operations in Africa.

The second agenda is aimed at tackling base erosion and profit shifting (BEPS), including for example transfer mis-pricing and country-by-country reporting. This agenda was endorsed by the G8 and G20 in their 2013 meetings, but progress has been slow since then. In particular the Lough Erne declaration and the Leaders Declaration⁴³ that came out of those meetings endorsed proposals that were only receiving marginal attention and mostly amongst organisation such as Tax Justice Network, Action Aid, Christian Aid and Oxfam. These proposals include for example increasing the exchange of information among tax authorities internationally; ending legal secrecy on the ownership of companies and trusts, especially in tax havens; and increasing the transparency about the jurisdictions where the profits of TNCs are actually generated, as opposed to those where these profits are transferred by accountants. By bringing these issues to the centre of the policy debate, these declarations have contributed to shifting the rhetoric significantly in favour of more action on the BEPS agenda. However issues remain regarding both the implementation of this agenda and the benefits that it will bring to developing countries. Progress has been slow on the BEPS agenda so far, and it is likely to be challenged by the larger degree of competition, rather than cooperation, that still exists amongst countries that compete to attract investment and tax revenues. Even assuming that this agenda will be implemented, low-income countries are likely to benefit disproportionately less⁴⁴ than advanced and large emerging countries, including BRICS.

The actions summarised so far usually involve both bilateral and multilateral actors. However naturally in the area of technical assistance and aid, bilateral donors represent the bulk of commitments; while in the area of global standard and international coordination multilateral institutions play a central role. On the multilateral side, the most active actors are certainly the OECD and IMF. Individual countries are part of the initiatives promoted by these institutions to a varying degree.

What emerges from a review of the international community’s commitment in the area of taxation is somewhat of a divide between aid for tax and international tax issues. While the former involves support from donors to developing countries and it often takes the form of aid or of advisory/technical assistance activities related to it, the latter is also a direct concern of advanced countries since tax havens and transnational corporations are typically based there rather than in developing countries. In the former, developing countries have a central role as most actions take place in, and for, their tax administrations and ministries; in the latter instead, actions are largely designed by and for advanced economies, potentially resulting in the exclusion of developing countries from the benefits of international coordination and increased transparency on tax matters.

The international community has proved rather consistent in expressing interest in tax revenue mobilisation in developing countries and at recognising it as a central issue. However aid-related

⁴³ See G8 leaders Communiqué from the Loch Erne meeting, 18th June 2013 (<http://www.g8.utoronto.ca/summit/2013lougherne/lough-erne-communication.html>), particularly paragraphs 23-29 and G20 Tax Annex to the Saint Petersburg G20 Leaders Declaration 5 September 2013 St Petersburg (<http://www.g20.utoronto.ca/2013/2013-0905-tax.html>).

⁴⁴ For a more detailed discussion on how and if changes in the international tax system will benefit developing countries, see the IDS Rapid Response Briefing, issue 6 of January 2014 (<http://opendocs.ids.ac.uk/opendocs/bitstream/handle/123456789/3359/RRB6.pdf?sequence=1>).

actions for tax revenue mobilisation risk being undermined by international tax issues that, on the other hand, damage developing countries by causing revenue losses. Advanced economies play a central role in setting the international rules and standards that could potentially prevent these revenue losses. Developing countries on the other hand are largely under-represented. This divide between aid and international tax issues is discussed for example in a recent report coordinated by Eurodad that criticises Europe for “giving with one hand and taking with the other” (Eurodad, 2013). A greater degree of alignment, between political rhetoric related to aid for tax on the one hand and actions on global tax issues on the other, would be needed to ensure effectiveness in tax mobilisation efforts in developing countries. In other words, the substantial revenues subtracted from developing countries, through tax avoidance and evasion, can seriously undermine the efforts that the international community is putting in supporting tax revenue mobilisation through various aid-related initiatives.

5. CONCLUSIONS AND RECOMMENDATIONS

The European institutions have in recent years clearly recognised the importance of enhanced revenue raising in developing countries and better governance of that process, and the potentially perverse effects of some international and global forces and actors impinging on developing countries. The 2010 Communication on Tax and Development, the 2012 Action Plan on Fraud and Tax Evasion, and the Report on Transfer Pricing and Developing Countries⁴⁵ are examples of the work done in this direction. They have declared in favour of a number of progressive goals that can potentially benefit developing countries by ensuring that they can generate enough revenues to finance their development strategies.

Any decisions about what European Institutions might do to help developing countries realise these progressive goals needs to be informed by an understanding of the broader context, notably the number of other international organisations that are seeking to promote similar goals. These include the G8 and the G20, of which Europe is a member. The most important organisations, especially in the technical sense, are the OECD and the IMF. All these organisations are currently cooperating to change the rules of the global tax system, with at least some significant regard for the interests of developing countries. Amongst the various initiatives at the global level, the two most important ones are the transparency and information exchange agenda, and the BEPS agenda (see section 4 for more details). In both cases, primary responsibility for developing the technical agenda lies with the OECD. The OECD is currently in the process of developing the BEPS program and, through the Global Forum on Transparency and Exchange Information for Tax Purposes, advancing the objective of improving the flow of information between national tax agencies. Arguably, the distinctive contribution of the European institutions is the Common Consolidated Corporate Tax Base (CCCTB) program, which is the only concrete plan in existence at present to make mandatory country-by-country reporting by transnational corporations. In the long term, the extension of country-by-country reporting is likely to benefit developing countries. However, the current CCCTB proposals have only a marginal impact on developing countries. Compared to the OECD and the IMF in particular, the European institutions do not have the advantage of strong institutional and personal links with tax institutions in developing countries. It is noticeable that the membership of the EU Platform for Tax Good Governance is entirely European. Strengthening these linkages might be almost a precondition for effective action to support revenue raising and anti-evasion activities in developing countries.

Therefore if European institutions are willing to shape the future policy dialogue in addition to supporting and contributing to existing initiatives, two preconditions should be met.

Firstly actions of European institutions and member states need to be informed by and coordinated with existing initiatives in the international community, to avoid un-necessary duplication of efforts. This is even more important in the context of the increasing interest that taxation is attracting at the international level, implying a potentially larger involvement of several donors in this area. Europe should identify the areas where it has a comparative advantage, both at the MS and institutional level, with respect to other institutions involved in this field, and contribute particularly on those. As far as

⁴⁵ The report on Transfer Pricing and Developing countries is available at http://ec.europa.eu/europeaid/what/economic-support/documents/transfer-pricing-study_en.pdf; the EC Action Plan of 2012 at http://ec.europa.eu/taxation_customs/resources/documents/taxation/tax_fraud_evasion/com_2012_722_en.pdf; and the EC communication on tax and development of 2010 at http://ec.europa.eu/development/icenter/repository/COMM_COM_2010_0163_TAX_DEVELOPMENT_EN.PDF.

development assistance and capacity building are concerned, demand-based requests should be given priority.

Secondly, if Europe is to make substantial contributions in advancing the current agendas on global tax issues and in making them work for developing countries, it has to promote increased participation of, and linkages with, developing countries – not BRICS only but mostly low-income countries. European initiatives are currently largely focussed on European countries and on issues of relevance for member states. This is the case for both the Platform for Tax Good Governance and CCCTB. At present, these initiatives are not sufficiently engaged with developing countries and they therefore cannot be effective in helping them face the issue of international tax evasion. A similar drawback can be observed more generally on international tax issues that are currently discussed mostly amongst advanced economies and that therefore naturally benefit them disproportionately with respect to developing countries. The concerns over the recent OECD proposal on automatic exchange of information are an example of this (see section 4). Since the progress of developing countries on issues such as automatic exchange of information is likely to be slow, it is important not to make participation on such initiatives a condition for participation in other initiatives and platforms.

Furthermore there are broadly three ways in which the European institutions might support more effective tax governance and anti-evasion activities in developing countries.

First, Europe should simply continue to support and push forward the range of existing international initiatives to reform the global tax system mentioned above. This is almost certainly the most important area for action. Most of the problems around tax evasion in developing countries have a very significant international element, as underlined in section 2. Tax evasion and avoidance are the first set of problems, and tax gaps related to fiscal incentives and the extractive sector also have an important international dimension since the companies and actors involved are often operating internationally. In addition to supporting international activities, with a focus on increased participation of developing countries, strengthening and empowering ministries and tax authorities with the necessary tools to deal with transnational economic transactions, would likely be the most efficient and most significant contribution to reducing tax evasion problems.

Second, at the aid and development end, the European institutions should continue, like other aid donors, to give financial assistance to the national tax administrations of developing countries. However, unlike the IMF and to a lesser extent the OECD, the European institutions are not generally in a position to provide significant technical assistance along with financing. High-quality technical assistance, provided in ways that are adequately negotiated between the provider and the governments of developing countries, is almost certainly a more valuable resource than financial assistance to national tax agencies. The review of European assistance in section 3 shows that Europe is generally active in this area, with many bilateral projects in place in the area of technical assistance. There is no evidence that lack of financial assistance is a major constraint in developing countries. However financial resources for tax matters still represent a small proportion of aid (see section 4), and increasing them is likely to be beneficial as it could allow, for example, for increased efforts to release capacity constraints.

It is important to note that these first two areas of recommended intervention for Europe, namely the global tax agenda and aid/technical assistance, have to display a higher degree of coherence than they do at present. There seem to be a gap currently between international issues related to tax evasion and avoidance, and efforts related to development assistance. While the latter recognises the importance of revenue mobilisation in low-income countries and it provides financial and technical support for it, large amount of capitals are still flowing out of developing countries therefore depriving them of potential tax revenues. The political rhetoric on international tax issues, including the information

exchange and BEPS agendas, is going in the right direction, but it is not clear whether developing countries will benefit from it in the implementation phase. There are a number of practical things that Europe could do to support a greater alignment between the debate on international issues and development objectives – in addition to ensuring the effective participation of developing countries in the international debate through their inclusion in initiatives like CCCTB and the Platform for Tax Good Governance. For example European countries should make sure that existing double taxation treaties are not detrimental to developing countries and change them if they are; European institutions should also promote provisions to exchange information and tackle international capital flight that are consistent with developing countries' needs and capacity. At present, it does not seem that developing countries can benefit from a system of automatic exchange of information that works on a reciprocal basis.

Thirdly, the European institutions should continue to give assistance to regional tax organisations in the developing world, not only to simply strengthen those organisations but in order to support them in working with national organisations to develop regional programmes to combat the adverse effects of international tax competition on their performance. The strongest regional organisation is CIAT. Although most members are from Latin America and the Caribbean, CIAT also represents North America. The extent to which it would wish to develop a regional agenda to benefit its low-income members is not clear. ATAF represents Africa. It is however a new organisation that is already faced with an excess of demands, especially from aid donors. Any program with ATAF would have to be carefully negotiated to ensure that it met their priorities.

There are a number of things that Africa, for example, might do on a coordinated regional basis, with the support of Europe, to protect itself from excessive competition among governments for private investment, and thereby protect its revenue base. Through example and indirect effects, these measures might also benefit the rest of the world. Four possibilities in this direction are the following:

- A set of principles covering the criteria for the granting of tax exemptions for investors, the procedures through which those decisions will be taken, and, ideally, some upper boundaries on the amount of exemptions.
- A regional agreement to subject all contracts with foreign investors, especially in the extractive sector, to standard national tax regimes and therefore to forego special arrangements for certain types of investment.
- A regional agreement to move towards the levying of minimum withholding taxes on all dividend payments made by locally-incorporated subsidiaries of transnational groups. This may require the modification of double-taxation treaties.
- A regional agreement to adopt Brazilian-style presumptive minimum or normal profit margins or markups when assessing subsidiaries of transnationals for corporate income tax.

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ANNEX 1: Classification of Countries Based on Tax Efforts and Tax Collection, from Minh Le at al. (2012)

		TAX EFFORT			
		LOW		HIGH	
TAX COLLECTION	LOW	<u>Developing Countries</u>	<u>Developed Countries</u>	<u>Developing Countries</u>	<u>Developed Countries</u>
		Albania	Dominican Rep.	Oman	Canada
	Argentina	Egypt, Arab Rep.	Panama	Japan	Cote d'Ivoire
	Armenia	El Salvador	Paraguay	Korea, Rep.	Ghana
	Azerbaijan	Ethiopia	Peru	United States	Honduras
	Bahamas, The	Guatemala	Philippines		Kenya
	Bahrain	Guinea	Senegal		Mali
	Bangladesh	India	Sierra Leone		Nicaragua
	Burkina Faso	Indonesia	Sudan		Pakistan
	Cameroon	Kazakhstan	Thailand		Sri Lanka
	China	Lebanon	Uganda		Syrian Arab Republic
	Colombia	Madagascar	Yemen, Rep.		Togo
	Congo, Dem. Rep.	Malaysia			Zambia
	Congo, Rep.	Mexico			
HIGH	<u>Developing Countries</u>	<u>Developed Countries</u>	<u>Developing Countries</u>	<u>Developed Countries</u>	
	Bulgaria	Czech Republic	Belarus	New Zealand	Australia
	Estonia	Denmark	Botswana	Papua New Guinea	Austria
	Jordan	Germany	Brazil	Poland	Belgium
	Latvia	Iceland	Chile	Slovenia	Cyprus
	Lithuania	Ireland	Costa Rica	South Africa	Finland
	Moldova	Luxembourg	Croatia	Trinidad and Tobago	France
	Romania	Spain	Hungary	Tunisia	Greece
	Russian Federation	Sweden	Jamaica	Uruguay	Italy
	Slovak Republic	Switzerland	Mongolia	Vietnam	Malta
	Turkey		Morocco	Zimbabwe	Netherlands
	Ukraine		Namibia		Norway
					Portugal
					United Kingdom

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