



The Commonwealth

Discussion Note

Commonwealth Senior Finance Officials Meeting 2016

Domestic Revenue Mobilisation, Tax Reform and the Role of Finance Ministries

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Abstract

There has been a recent upsurge in focus on international tax co-operation and particularly the need to support developing country domestic resource mobilisation (DRM) efforts. Despite the additional support, governments continue to face difficulties in championing tax reform. A possible approach to tackling the existing

challenges is through the strengthening of tax policy networks between countries. This paper therefore examines how the bolstering of such networks can play an essential role in overcoming existing challenges and sets the stage for a broad-based discussion on the role of the Commonwealth Secretariat within this space.

Guiding questions

- *What are members' recent experiences with tax policy reform and what challenges have ministries faced in supporting reform efforts?*
- *Do officials see value in strengthening tax policy networks generally? Are there any particular areas where the Commonwealth could provide support?*
- *Do officials support the Secretariat's efforts to identify ways of leveraging the Commonwealth's tax administration network (the Commonwealth Association of Tax Administrators – CATA) to help inform strategic and policy discussions within the Commonwealth?*

1. Introduction

The development of more effective taxation systems is a critical and ongoing task for all governments. For countries that already collect sufficient revenues to meet their budgetary expenditures, choices about the tax base composition can have a significant impact on economic growth. In the case of developing countries, reforms to both tax policy frameworks and collection and administrative systems are required to increase revenue mobilisation and support economic growth and development.

The ongoing international tax reform agenda, which recognises the importance of assisting developing countries to improve DRM, has resulted in unprecedented levels of international tax co-operation. This has resulted in greater co-ordination amongst international organisations, increased funding commitments for capacity-building by key donors and the development of analytical toolkits to assist developing countries. However, despite these developments countries continue to experience significant challenges in seeking to undertake tax reform.

The next section briefly examines resource mobilisation efforts in the Commonwealth's developing country and small state members. It then considers recent developments regarding available support and reflects on the critical role of the central finance ministries. The paper then concludes with a discussion on the value of

strengthening tax policy networks and a possible role for the Commonwealth in doing so.

2. Resource mobilisation in the Commonwealth and international support

The Commonwealth's membership is diverse. It includes 23 low-income or lower-middle-income countries, 15 higher-middle-income countries and 15 high-income countries. Within the Commonwealth, there are also 31 small states and 14 least developed countries (LDCs).

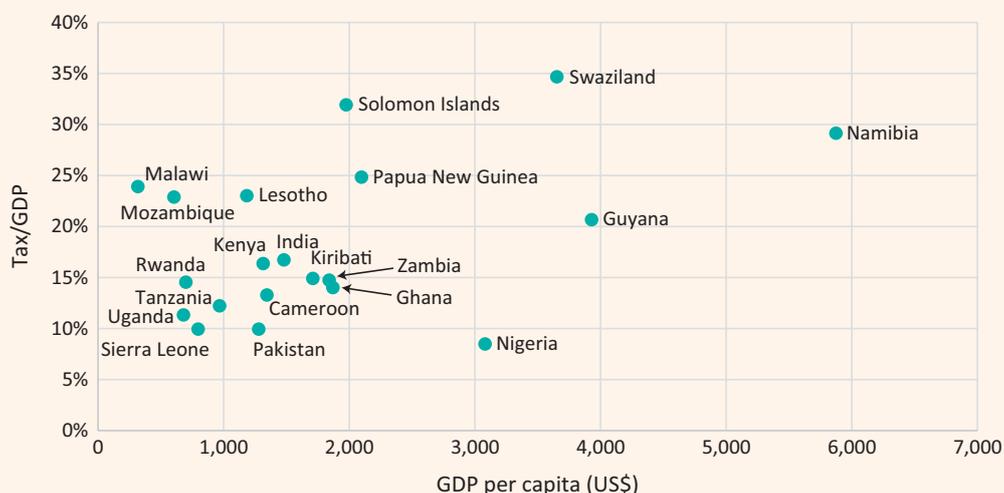
This diversity also extends to tax administrative capacity, tax policy settings and the overall level of resource mobilisation.

Resource mobilisation targets are generally established at national level, and they are usually monitored using the tax to gross domestic product (GDP) ratio as a key metric (IMF et al., 2016). In low-income countries, tax revenue to GDP grew at an annual average rate of 1.6 per cent between 1990 and 2014 (IMF and World Bank, 2016).

The tax to GDP ratio in Commonwealth low-income or lower-middle-income countries stands at an average of about 15 per cent (Figure 1), way below the average tax to GDP ratio for Organisation for Economic Co-operation and Development (OECD) countries of about 34 per cent.

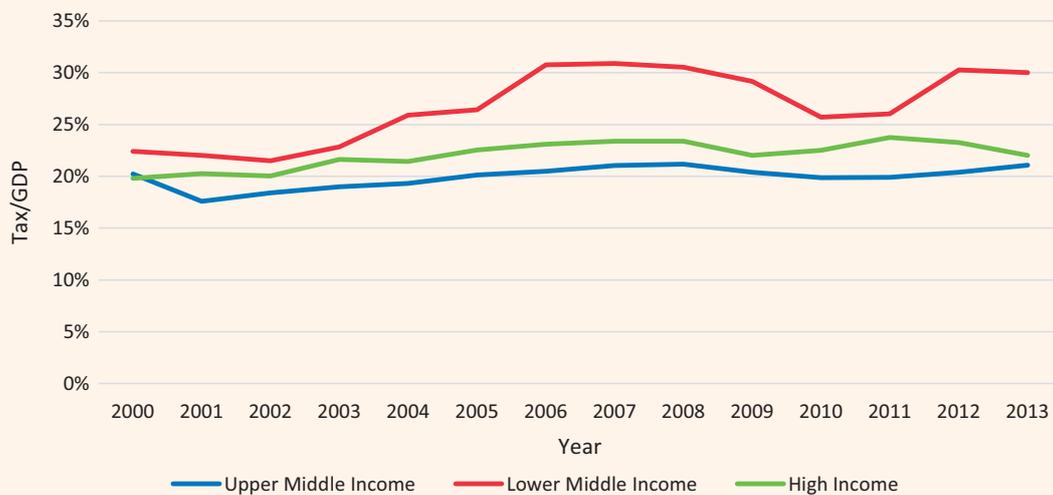
Developing countries face significant challenges in collecting revenue. This includes weak

Figure 1 Tax revenue as a percentage of GDP for Commonwealth low-income and lower-middle income countries, 2013



Source: IMF revenue longitudinal dataset (WoRLD) available at <http://data.imf.org/revenues>

Figure 2 Average tax revenue as a percentage of GDP for Commonwealth small states (by income level), 2000–2013



Source: IMF revenue longitudinal dataset (WoRLD) available at <http://data.imf.org/revenues>

tax administrations, low taxpayer 'morale' and the presence of large informal sectors, which are inherently difficult to tax. However, Commonwealth small states, at all income levels, have on average been relatively successful in mobilising domestic revenues (Figure 2). Small states, however, have a narrower tax base and therefore continued efforts are required to improve the efficiency of revenue collections.

Fortunately, the support available to countries to address the challenges of DRM has been substantially enhanced.

External support to improve tax systems can be one of the most cost-effective and impactful forms of official development assistance (ODA). In 2012, an estimated 0.1 per cent (US\$118.4 million) of total ODA was channelled towards supporting tax systems in developing countries, which suggests that DRM was not a major priority area. The focus of the international community is being reshaped on this issue and the importance of providing systems to support DRM to help finance individual countries' sustainable development goals is gaining increasing prominence.

The increased interest in supporting DRM systems has resulted in the development of a number of 'toolkits' to improve revenue systems in countries deemed deficient. The Tax Administration Diagnostic Assessment Tool (TADAT) – developed in partnership between the IMF, the World Bank, the European Union and other organisations – has already been used in a number of Commonwealth

countries² to identify required reforms in tax administration. The IMF and the World Bank are also in the process of designing a tax policy assessment framework (TPAF) to assess the effectiveness of national tax policy frameworks and help identify policy options for reform. A number of international organisations have also been asked by the G20 to develop a series of toolkits to help developing countries address base erosion and profit shifting (BEPS) and related issues. The first such toolkit, relating to the management of tax incentives, has already been delivered.

The increased focus has also resulted in an unprecedented level of co-operation on tax technical assistance. This is evidenced by the number of joint initiatives being undertaken, particularly by the key international organisations that provide such support. This includes a joint IMF and World Bank initiative to strengthen tax systems in developing countries and foster inclusive policy discussions, as well as a partnership between the OECD and the United Nations Development Programme (UNDP) on the Tax Inspectors Without Borders Initiative. It has also led to the development, by the IMF, the OECD, the UN and the World Bank, of a platform to enhance co-ordination on the provision of tax technical assistance.

Many of the world's largest bilateral aid donors have also recognised the value in increasing contributions to build tax capacity in developing

countries. The Addis Tax Initiative, first announced at the sidelines of the Addis Financing for Development Conference in 2015, has now been joined by over 30 countries. This includes 11 Commonwealth countries,³ both developed and developing. CATA is also a supporter of the initiative. Significantly, development partners that are signatories to the initiative have committed to considerably increase support for tax capacity building by 2020.

A recent research report produced by Development Initiatives provides a useful snapshot of current support, in terms of recipients, providers and the forms of support being provided (Development Initiatives, 2016).

Commonwealth countries are already some of the leading providers of assistance to support developing country tax systems. The United Kingdom is the lead bilateral donor for 'core' aid, providing almost US\$30 million across 29 projects the primary focus of which is DRM. Australia is also a significant provider of assistance, providing, for example, over US\$30 million across 33 projects of which DRM forms part. Three-quarters of all developing countries receive in varying forms and at varying scales core assistance to support DRM. There is a particular focus on sub-Saharan Africa, with two Commonwealth countries, Tanzania and Mozambique, being two of the top three recipients of assistance.

In terms of the nature of the support being provided, in DRM projects identified as involving the delivery of core aid, technical co-operation is the most significant type of aid (accounting for over half). This includes a number of 'twinning' relationships between jurisdictions, such as that between the Australian Taxation Office and the Papua New Guinean Internal Revenue Commission. Grants to governments or to multilateral initiatives such as the IMF's Tax Policy and Administration Topical Trust Fund also account for significant levels of assistance.

3. A central role for central economic agencies and the value of tax policy networks

The increased focus on DRM and, in particular, the increased support for tax reform efforts, is positive for developing countries. Increased donor support to fund much-needed tax administration reform or support tax policy reform processes, through the provision of technical experts and

the development of new toolkits, can assist developing countries to take the necessary steps to develop their tax systems.

The existing and increasing support, although vital, is a necessary but not sufficient condition to ensure success. As recognised in the Addis Tax Initiative, tax reform is a significant undertaking that must be owned and championed by each jurisdiction.⁴ There is no one-size-fits-all model. By its nature, tax reform creates winners and losers, and it involves the emergence of a consensus among the economic and political interests within each country. Successful tax reform also requires a government-wide effort, thus ensuring that tax policy is consistent with national objectives (IMF et al., 2016).

This creates challenges not only for ministers but also for those responsible for advising them. For central finance ministries that are responsible for the tax policy function,⁵ this involves applying often limited resources to advising ministers on reform options and their sensitive aspects, as well as managing or leading consultation processes with key stakeholders who may ultimately be critical to the success of reform efforts. Regardless of where the tax policy function sits, central finance ministries also need to play a critical role in ensuring a 'whole of government' approach to reform that is consistent with national development objectives and meets budgetary needs.

Although the nature of these challenges will vary between jurisdictions, there will no doubt be commonalities. This raises the question of whether or not there may be value in strengthening tax policy networks between officials, particularly between countries sharing the same or similar challenges.

The value and importance of taxation networks has long been recognised. Tax administration networks, such as the Commonwealth's own CATA, continue to provide important forums for tax administrators to come together to share their experiences and discuss collaborative approaches to tackling shared problems. These administrative networks also played a role in channelling developing country perspectives into the G20/OECD BEPS project.

Tax policy networks, particularly among developing countries, are, however, less formalised and less well established. From discussions with a number of tax policy units in Commonwealth

developing countries, it is clear that officials responsible for tax policy seek, where possible, to engage in and develop networks through tax administration forums. Opportunities may also be provided by broader international tax events, such as those hosted by groups such as the International Tax Compact and the International Bureau for Fiscal Documentation. There has also been an increased focus by a number of international organisations on promoting a policy dialogue with and between developing countries in certain regions. Examples include the OECD's Latin America and Caribbean Fiscal Initiative and the IMF/World Bank initiative noted above, which seeks to deepen the policy dialogue with developing countries on international tax issues.

4. A role for the Commonwealth?

Informal discussions between the Commonwealth Secretariat and a number of tax policy units in Commonwealth developing countries have highlighted the potential value in strengthening tax policy networks between Commonwealth countries. Indeed, through these contacts the Secretariat has also recently sought to link one Commonwealth member undertaking a substantive tax reform process with another member that had recently been through a similar process.

In addition, following on from holding a Commonwealth international tax roundtable for small states hosting international financial centres in the wake of the release of the 'Panama Papers' (a matter that will be considered at this year's ministerial meeting), the Secretariat has sought to establish a virtual network to maintain links and encourage information sharing between such jurisdictions that share similar challenges.

The development of any further such networks would need to complement broader international efforts (as described above) and recognise the already limited resources of member countries, particularly developing member countries. However, the development of such networks need not be resource intensive and can be aided by technology. In June, for example, the Commonwealth announced the development of a new app that creates a secure messaging system to help law enforcement and prosecutors in different Commonwealth countries co-operate more effectively on criminal investigations.⁵ This could provide an innovative model for linking jurisdictions more effectively.

Greater engagement with tax policy officials could also assist the Commonwealth in developing stronger links between existing forums and leveraging those links. The Commonwealth has already demonstrated a willingness to engage in a dialogue on emerging tax issues at a political level, and it also has the world's largest and oldest tax administration network in CATA. As has been demonstrated in the BEPS process, the perspective of tax administrators is critical in informing policy, including on issues that require international collaboration. To the extent that Commonwealth ministers see value in a strategic dialogue on issues relating to international tax, the engagement of Commonwealth tax policy officials could help leverage the Commonwealth's administrative network to contribute to informing those discussions.

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Notes

- 1 Lucas Rutherford, Economic Adviser, Economic Policy Division (l.rutherford@commonwealth.int).
- 2 Zambia, Namibia, South Africa, Malawi, Mozambique, Rwanda, Uganda, Malaysia and Fiji Islands.

- 3 Australia, Cameroon, Canada, Ghana, Kenya, Malawi, Namibia, Rwanda, Sierra Leone, Tanzania and the United Kingdom.
- 4 The second commitment of the initiative provides for developing country signatories to step up DRM efforts, recognising that the significant challenges associated with tax reform can be met only with sufficient political will.
- 5 The manner in which the tax policy function is established differs between jurisdictions. In most OECD countries,

the tax policy function sits with the Ministry of Finance or the Treasury, whereas in around half of developing countries the policy function sits with the revenue authority (Allen et al., 2015).

- 6 See <http://thecommonwealth.org/media/press-release/commonwealth-announces-new-app-fight-cross-border-crime#sthash.Nrh838fH.dpuf>