European Commission

Collect More – Spend Better

Achieving development in an inclusive and sustainable way

EU approach to domestic public finance

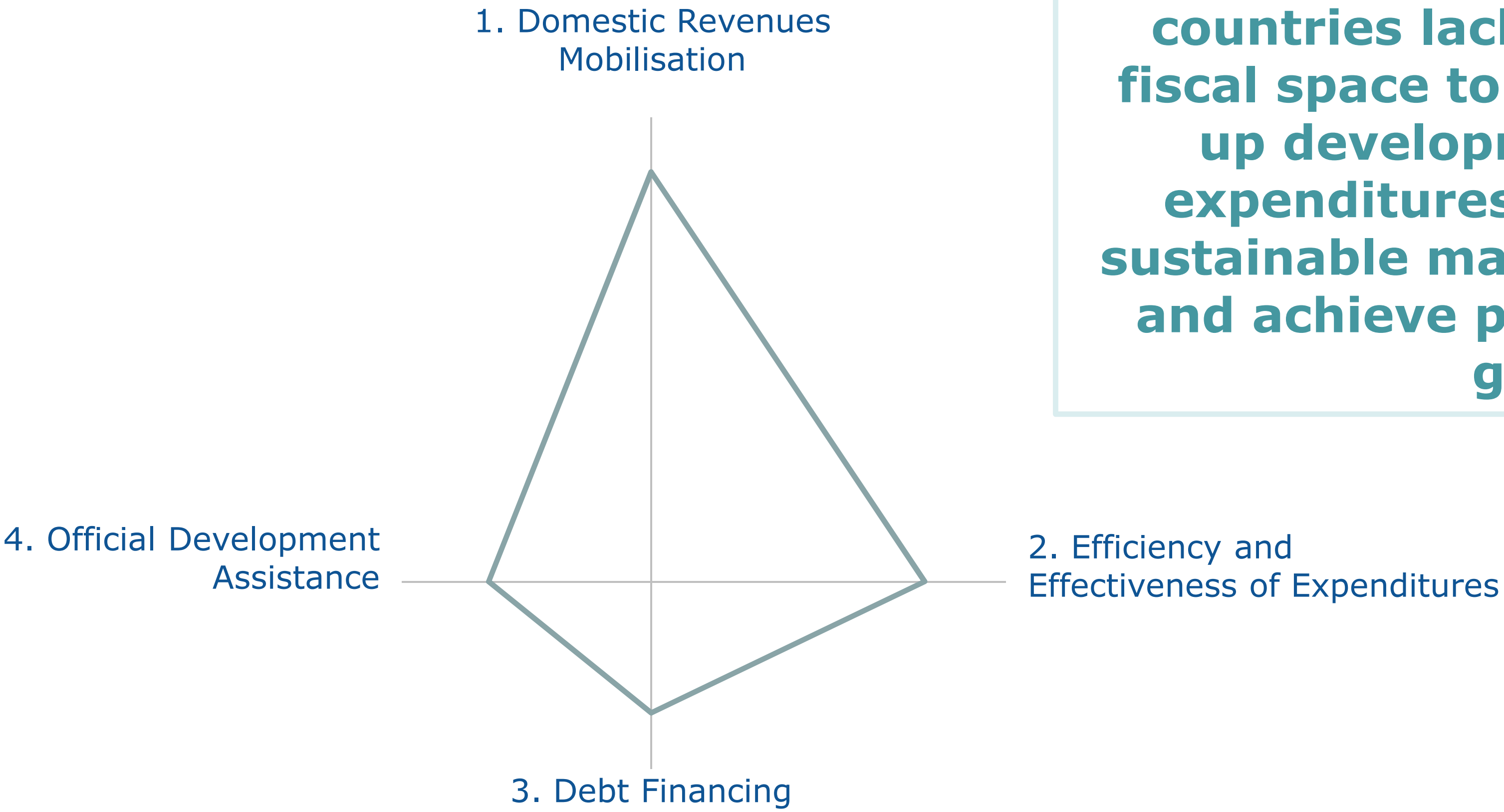
June 2016

DEVCO A4 – Budget Support and Public Finance Management

Basis

- EU Communication "Tax and Development" 2010
- EU Budget Support Guidelines 2012
- Third Financing for Development Conference, July 2015, Addis Ababa
- UN Summit on Sustainable Development, September 2015, NY

Fiscal Space Diamond



Many developing countries lack the fiscal space to step up development expenditures in a sustainable manner and achieve policy goals.

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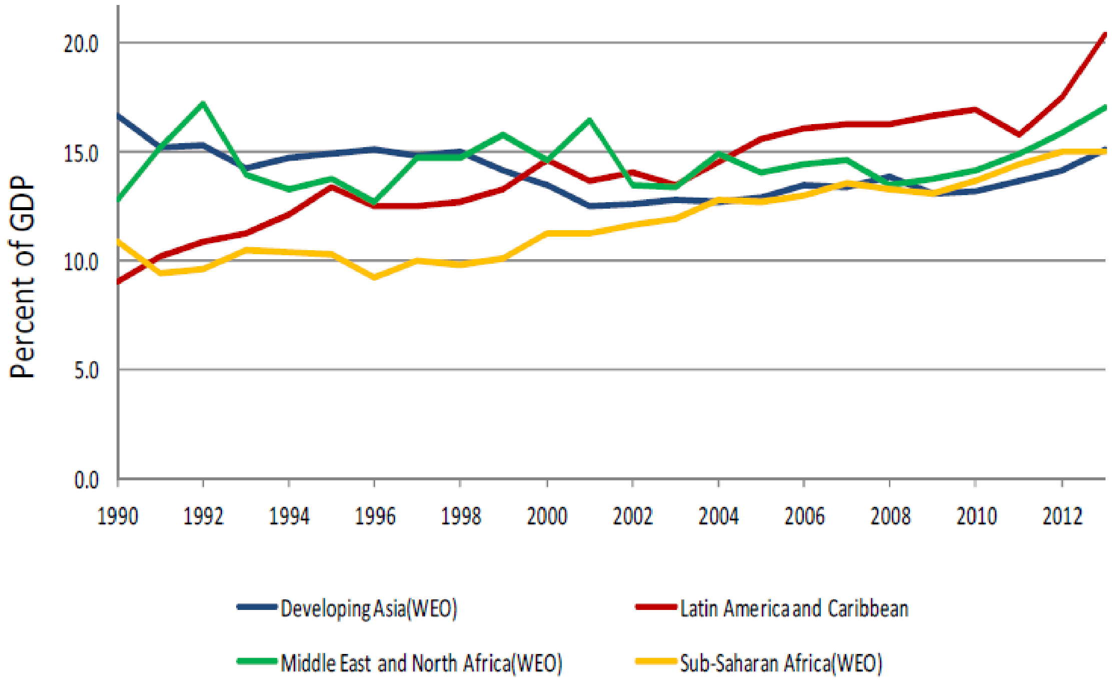
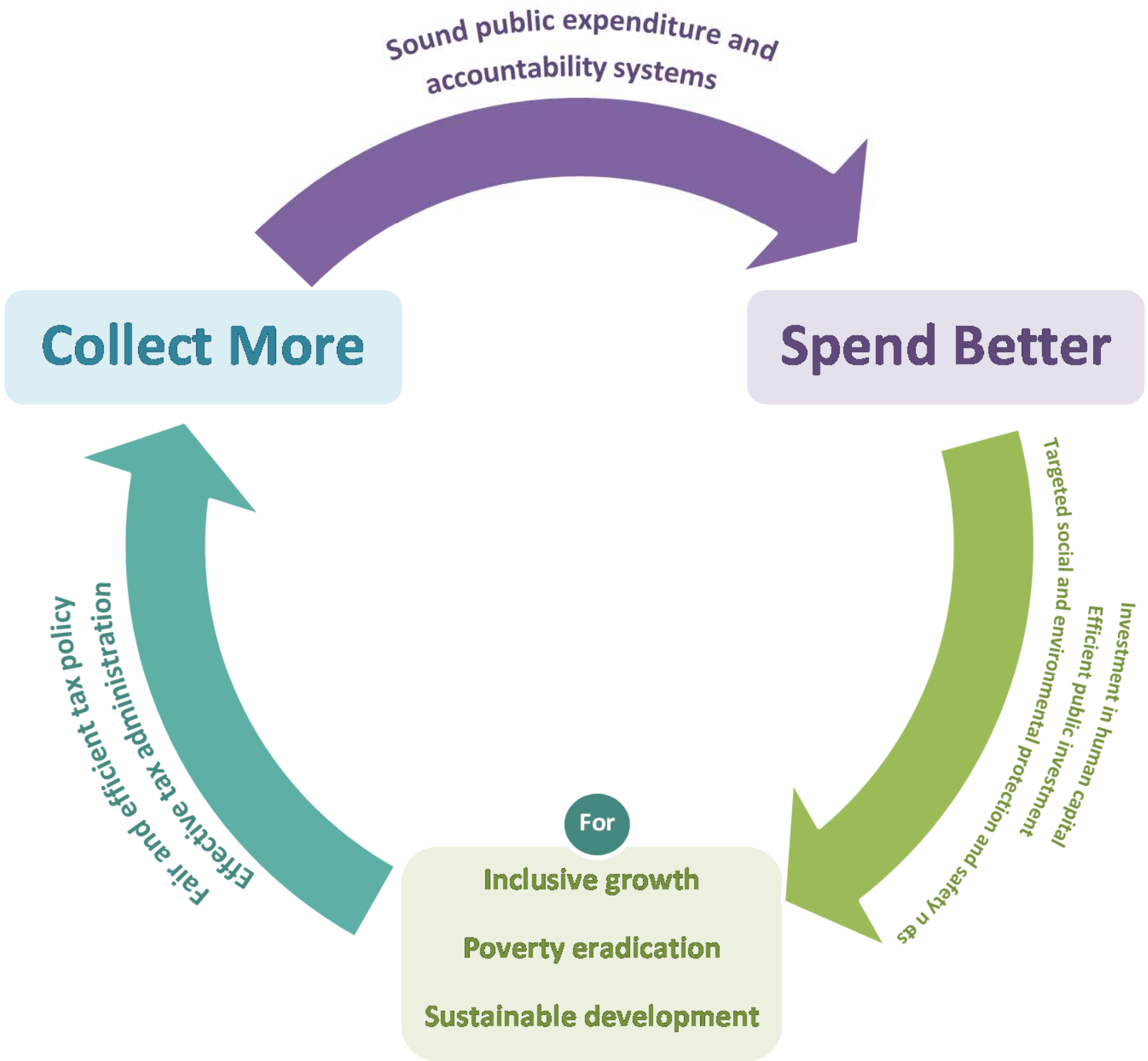
Trends in Tax Ratios in Developing Countries



Source: African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the Inter-American Development Bank, the International Monetary Fund, and the World Bank, (2015), "From billions to trillions: transforming development finance. Post-2015 financing for development: multilateral development finance", page 8.



Sound public expenditure and accountability systems
Collect More
Spend Better
Targeted social and environmental protection and safety n ets
Efficient public investment
Investment in human capital
For
Inclusive growth
Poverty eradication
Sustainable development
Fair and efficient tax policy
Effective tax administration

Closing the Dual Tax Gap

The tax policy gap between the tax due under an optimal tax policy and the tax due under current tax policy.	Not increase the tax burden on the poor / broaden tax base / closing loopholes in tax policies/ improving transparency and fairness / fighting tax avoidance.
The tax compliance gap between the tax due under the current tax policy structure and the tax actually collected.	Improving the efficiency and effectiveness of tax administration / reinforcing voluntary compliance and good tax governance / fighting tax evasion and illicit financial flows.

Comprehensive approach to tax policy and administration reforms

i) A better understanding of the political economy and policy implications of tax reforms

ii) Tackling capacity constraints undermining tax administration performance

iii) Adressing tax avoidance, tax evasion and illicit financial flows

iv) Adressing the international governance dimension of tax and development, including the setting of international tax standards

Closing the dual tax gap expands fiscal space in a sustainable manner, building fiscal resilience against external economic shocks and aid fluctuations

International drivers of the dual tax gap

1| Illicit financial flows

Increasing international mobility of taxpayers, globalisation of economic activities, high volumes of trade and capital flows, uncooperative tax jurisdictions and aggressive tax planning, including multinational enterprises' (MNEs') abusive transfer pricing and trade misinvoicing practices

2| tax competition

Harmful tax competition → negative spillovers in developing countries

Domestic Drivers of the Dual Tax Gap

- ***Political constraints*** *– lobbies, corruption,…*

- ***Administration constraints*** *– draining of skilled personnel, lack of tax collection infrastructure, need to update IT systems,…*

- ***Economic constraints****– narrow tax base, weak administrative capacity, informal sector, tax exemptions,* ***tax incentives****,…*

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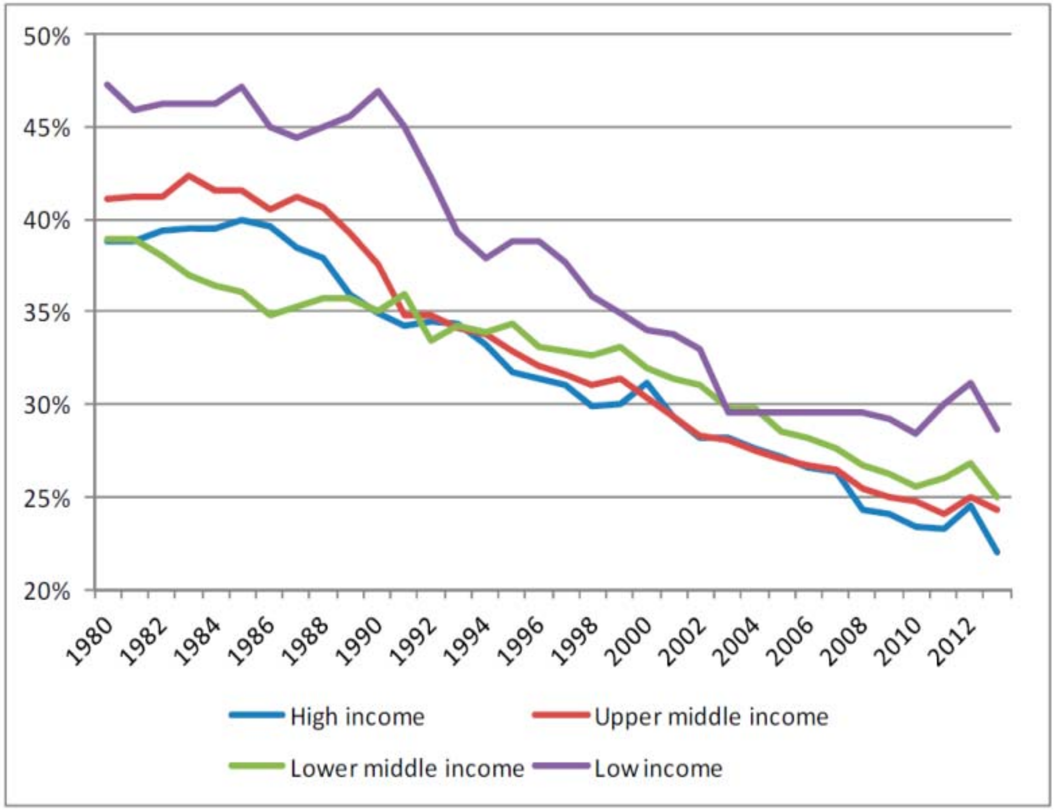
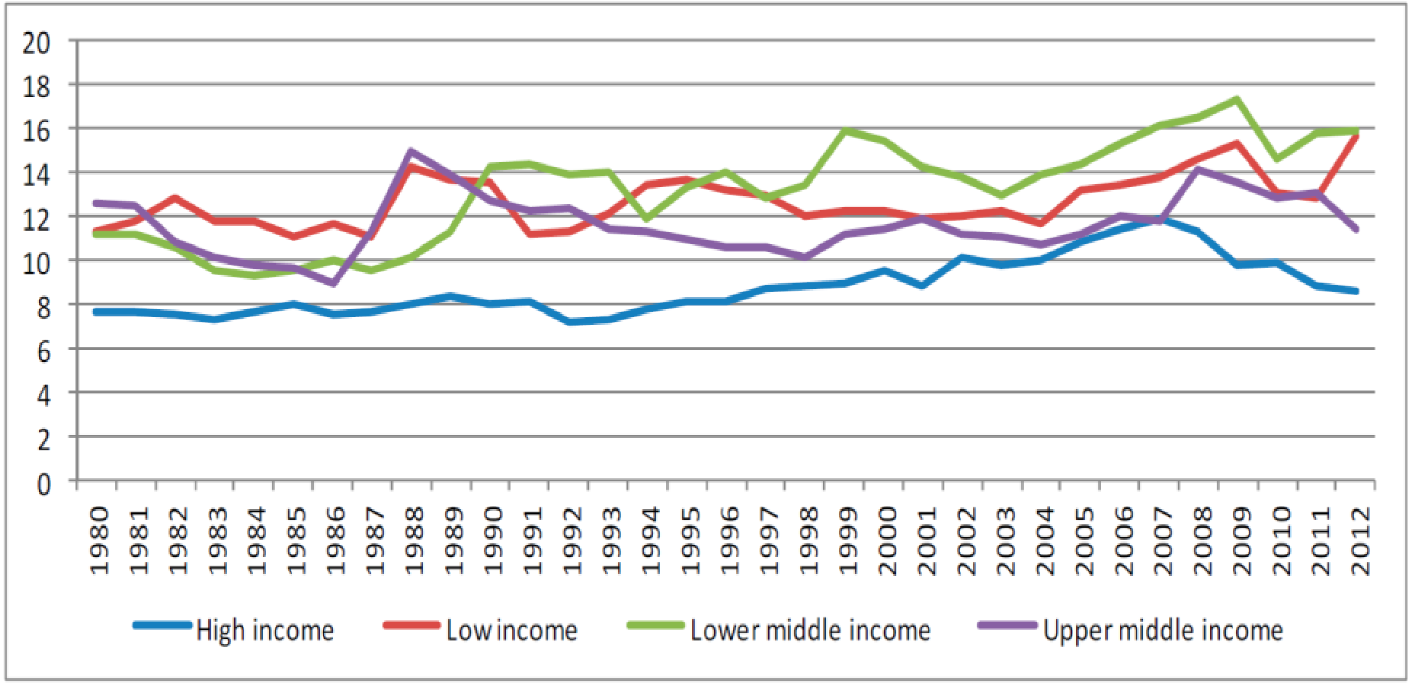
Corporate Income Tax Rates, 1980-2013



Source: IMF Staff estimates; data from IMF's Fiscal Affairs Department database.

Source: International Monetary Fund, (2014), "Spillovers in International Corporate Taxation". IMF Policy Paper, page22.

Revenue from the Corporate Income Tax
in percentage of total revenue



Source: IMF Staff estimates; data from IMF's Fiscal Affairs Department database.
Note: Total tax revenue including grants and excluding social contributions; resource-rich countries excluded.

Source: Crivelli, E. et al., (2015), "Base Erosion, Profit Shifting and Developing Countries", IMF Working Paper (WP/15/118), page 4

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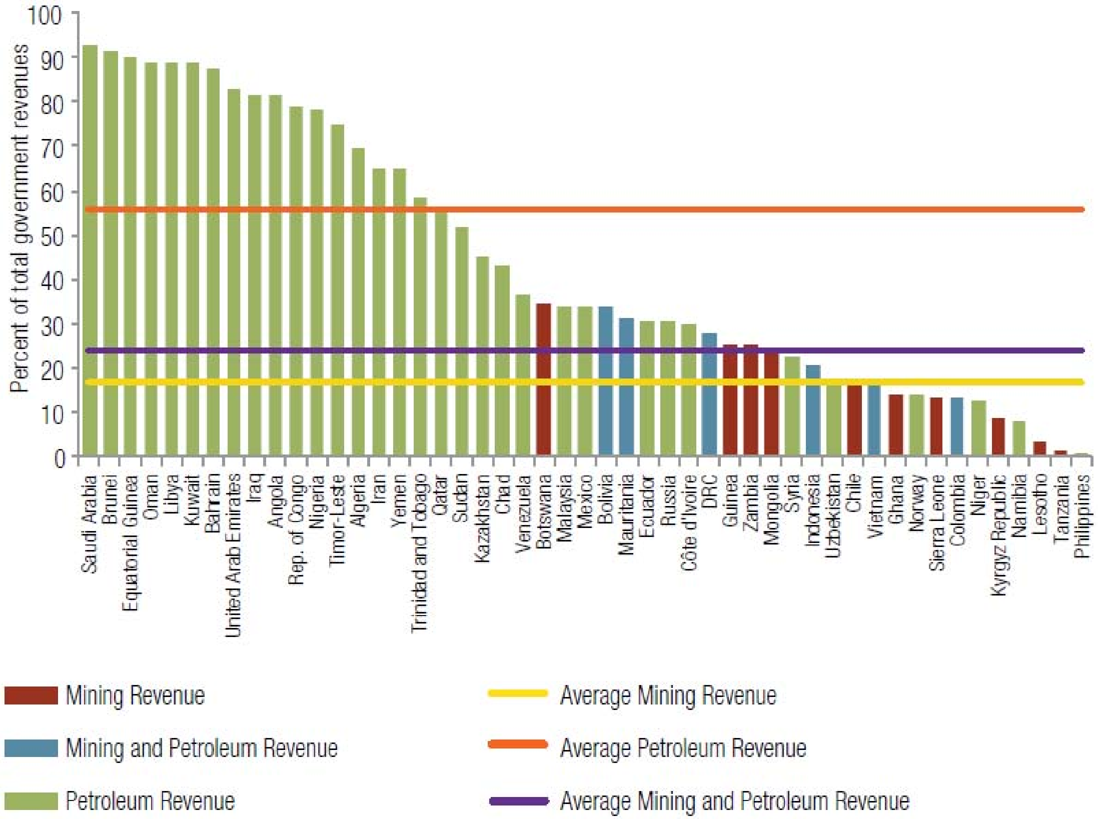
Revenues from Natural Resources, 2011



Source: IMF staff estimates.

Source: Lemgruber, A. and Shelton, S., (2014), "Revenue Administration: Administering Revenues from Natural Resources—A Short Primer", International Monetary Fund Fiscal Affairs Department – Technical Notes and Manuals, page 4.

Spend Better

Objective:

Ensure fiscal discipline, strategic allocation of resources and improve efficiency and effectiveness of public spending

4 critical areas

- ***subsidy programmes;***
- ***public investment;***
- ***public procurement; and***
- ***debt management.***

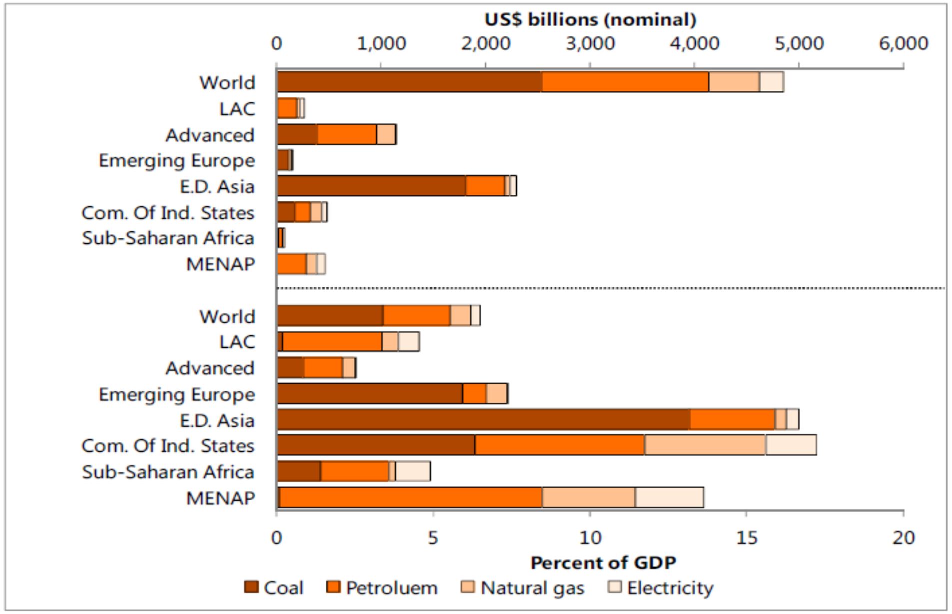
1| subsidy programmes → often ill-targeted, inefficient, costly, usually fail to reach the target population (better well targeted safety net programmes

2| public investment → in social and physical infrastructure can boost inclusive growth, sustainable development and poverty eradication and attract FDI
IMF estimates the average inefficiency in public investment across countries at around 30%.

3| public procurement → sine qua non of efficient spending, can have positive effect on private sector and FDI. Estimated to amount to up to 50% of public expenditures

Energy Subsidies
by Region and Energy Product, 2013

(US$ billions on top axis; percent regional GDP on bottom axis)



Note: CIS = Commonwealth of Independent States; ED Asia = Emerging and Developing Asia, LAC = Latin America and the Caribbean; MENAP = Middle East, North Africa, Afghanistan, and Pakistan

Source: Coady, S. et al., (2015), "How large are the energy subsidies?" IMF Working Paper (WP/15/105), page 23.

4| debt management→ way to leveraging public resources to increase fiscal space

- ***Debt-to-GDP ratio at manageable levels** >> quality of public investment and sound debt management, based on a debt strategy that aims at raising the required amount of funding at the lowest possible cost, consistent with a prudent degree of risk.*
- ***Partnerships with the private sector** (such as public private partnerships or PPPs) → longer term benefit is dependent on efficiency gains.*

A call for global action

- *seeks to ensure that countries' policies do not have negative spillover effects in other countries; and*

- *that common international standards are developed in an inclusive and participatory manner.*

It is based on two principles:

- ***Lead by example:*** *focusing on national or regional regulations and their spillover effects on other countries; and*

- ***Global partnership:***
  - *addressing the international dimension of tax governance and domestic public finance, fighting tax evasion, tax avoidance and illicit financial flows*
  - *and promoting an international environment that is efficient, effective, fair and transparent.*

EU Contribution

- *Initiating partner of the Addis Tax Initiative,*
  - Commitment to double its support in the area of domestic revenue mobilisation
  - Commitment to improve the fairness, transparency, effectiveness and efficiency of its tax systems
- *Continuing its long-standing record of supporting developing countries in collecting more and spending better, particularly with its budget support programmes in more than 80 countries and with EU direct support for domestic public finance*
- *Implementing a special support programme of 42 million to specifically addressing issues in the area of tax evasion, tax avoidance and illicit financial flows*

Key elements of common agenda

1. ***Promoting the principles of good tax governance at national and international level and developing international standards***

2. ***Improving coordination among key players at international and regional levels***

3. ***Strengthening transfer-pricing legislative and regulatory frameworks***

4. ***Strengthening capacity-building in tax policy and tax administration***

5. ***Improving revenue statistics***

Key elements of common agenda (2)

6. **Supporting the development and implementation of fiscal assessment tools**
7. **Improving transparency and accountability in the extractive industry sector**
8. **Improving transparency, accountability and oversight in domestic public finance**
9. **Promoting efficiency in public investment and public procurement**
10. **Strengthening sustainable debt management**

On-going EU HQ support to developing countries effort to improve DRM – Main programmes

- IMF topical trust fund (Tax policy and administration – TTF TPA - ; Managing natural resources wealth – TTF MNRW-)
- Tax administration diagnostic assessment tool (TADAT)
- Public expenditure and Financial Accountability (PEFA)
- UN tax Committee
- Tripartite initiative on transfer pricing (with OECD and WB)
- BEPS inclusive framework (in preparation)
- OECD revenue statistics
- Extractive industries transparency initiative (EITI)
- Addis Tax initiative (ATI)
- African tax administration forum (ATAF)

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Thank you