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COMMISSION STAFF WORKING DOCUMENT

COLLECT MORE - SPEND BETTER

Achieving Development in an Inclusive and Sustainable Way

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Abbreviations and acronyms

ALSF	African Legal Support Facility
ATAF	African Tax Administration Forum
BEPS	base erosion and profit shifting
CIAT	Inter-American Center of Tax Administrations
CREDAF	*Centre de rencontres et d'études des dirigeants des administrations fiscales*
DMF	Debt Management Facility
DRM	domestic revenue mobilisation
DRMI	Domestic Revenue Mobilisation Initiative
EITI	Extractive Industry Transparency Initiative
EU	European Union
EURTI	EU Resource Transparency Initiative
FDI	foreign direct investment
FfD	financing for development
GDP	gross domestic product
HIPC	heavily indebted poor countries
IMF	International Monetary Fund
LICs	low-income countries
LMICs	low- and middle-income countries
MDRI	Multilateral Debt Relief Initiative
MNEs	multinational enterprises
ODA	official development assistance
OECD	Organisation for Economic Cooperation and Development
PEFA	public expenditure and financial accountability
PFM	public financial management
RA-FIT	IMF Revenue Administrations Fiscal Information Tool
RA-GAP	Revenue Administration Gap Analyses Programme
SDGs	Sustainable Development Goals
TADAT	Tax Administration Diagnostic Assessment Tool
TTF	Topical Trust Fund
UN	United Nations
VAT	value-added tax
WBG	World Bank Group

Executive summary

A key message that emerged from the Third Financing for Development (FfD) Conference in Addis Ababa in July 2015 – and one that signalled an important paradigm shift – is that domestic public finance should be at the heart of all countries' efforts to achieve the overriding objectives of inclusive growth, poverty eradication and sustainable development.

This has also been recognised in the discussion leading up to the September 2015 UN Summit for the adoption of the 2030 Agenda for Sustainable Development. The new agenda acknowledges the vital role of domestic public finance in providing essential public goods and services and in catalysing other sources of finance. It specifically takes into account the harmful effects of illicit financial flows and the need for countries to increase domestic revenue mobilisation, develop effective, accountable and transparent institutions and ensure sustainable debt management.

Many developing countries face significant challenges when it comes to mobilising sufficient domestic revenues. In response, development partners, including the European Union, joined forces to launch the **Addis Tax Initiative** during the Third FfD Conference. In the spirit of the Addis Ababa Action Agenda and the 2030 Agenda for Sustainable Development, the countries subscribing to the Initiative declared their commitment to enhancing the mobilisation and effective use of domestic revenues and improving the fairness, transparency, efficiency and effectiveness of their tax systems in order to address inequalities. Participating development cooperation partners undertook to double their collective support in the area of domestic revenue mobilisation/taxation. Over 30 countries and regional and international organisations signed the Initiative at the launch event in Addis Ababa on 15 July.

This **staff working document** builds on the policies laid out in the European Commission Communication *Tax and development - cooperating with developing countries on promoting good governance in tax matters*[1] and reflects the discussions at the Third FfD Conference.[2] It analyses ways to support developing countries in providing the resources required to ensure the right mix of public goods and services for sustainable development. It aims to explain what the international community can do to support developing countries' efforts to improve their tax systems and to benefit more from their domestic resources, without increasing the tax burden on the poor.

This document has to be seen in the broader context of the EU's support to developing countries to increase **domestic revenue mobilisation** (DRM) and to **use financial resources more effectively**, notably – but not exclusively – through budget support. It follows the objectives of the EU Programme on Global Public Goods and Challenges,[3] which aims to contribute to solving global problems through global development outcomes and will provide the framework for two envisaged EU flagship initiatives: the EU Resource Transparency Initiative (EURTI) and the Domestic Revenue Mobilisation Initiative (DRMI).[4]

The document outlines core elements to expand fiscal space and to support developing countries in three critical areas: **i) improved domestic revenue mobilisation**, **ii) more effective and efficient public expenditure** and **iii) debt management**. It first defines the challenges faced by developing countries, then indicates an overall approach for addressing them, and finally suggests ways to assist developing countries in tackling these challenges.

1. 'Collect More – Spend Better': A contribution to the discussion on financing the 2030 Agenda for Sustainable Development

In order to implement the 2030 Agenda for Sustainable Development, including the ambitious Sustainable Development Goals (SDGs), governments will have the lead role in mobilising domestic revenues, providing the right mix of public goods and services – particularly investment in human capital, infrastructure, social protection and safety nets as well as environmental protection – and creating an enabling environment for broad participation. Despite sustained growth rates and abundant natural resources, many developing countries have not been able to increase their fiscal space to step up expenditures in a sustainable manner and achieve development goals. In addition, widening income inequality is a major challenge with implications for poverty and growth prospects.[5] The reasons for this are multiple and complex.

This staff working document aims to contribute to the discussions on the **means of implementing the 2030 Agenda for Sustainable Development.** Implementing such a transformative and far-reaching agenda will require the effective mobilisation and use of all types of resources. The Addis Ababa Action Agenda (AAAA) promotes ways to mobilise and use domestic and international resources, reflecting the universality of the agenda, shared responsibility, mutual accountability, fairness and solidarity, the different and evolving capacities of all countries to support the framework, and changes in the global economy.

A key message emerging from the discussions leading up to the UN summit in September 2015 is that all countries need to intensify their efforts to improve domestic revenue mobilisation and their effective use to implement nationally owned sustainable development strategies.

2. Why 'Collect More – Spend Better'?

The mobilisation and effective use of domestic public finance provides by far the **largest and most stable source available for financing sustainable development**. Domestic public finance is also part of the social contract between a government and its citizens, whereby citizens pay for government activities in exchange for the services that government provides for citizens. Citizens are more interested in paying taxes when they feel they are sharing in the country's overall development and getting good value for their money, and can hold their government accountable.

For most developing countries, the central question is whether they have the capacity to expand fiscal space gradually over the long term. It appears relatively easy to create fiscal space over the short term, but the real challenge lies in sustaining fiscal space to ensure governments' long-term expenditure commitments and revenues. Consequently, countries need to mobilise sufficient revenues to increase their fiscal space to step up development expenditures in a sustainable manner and achieve policy goals. However, they also face the challenge of ensuring efficient and effective spending.

The **'Collect More – Spend Better'** approach put forward in this staff working document, which is based on the European Commission Communication *Tax and development* -

cooperating with developing countries on promoting good governance in tax matters[6], reflects the international discussion and provides a holistic take on domestic public finance.

The EU approach for domestic public finance: collect more – spend better

'Collect More' involves **closing the tax policy gap and tax compliance gap** with a particular focus on tax evasion, tax avoidance and illicit financial flows, all of which have a major negative impact on the level of domestic revenues. According to Global Financial Integrity,[7] the average ratio of illicit financial flows to GDP for all developing countries in 2003-2012 was 3.9%. Sub-Saharan Africa had the highest ratio (5.5%) of any region in that period. 'Collect more' goes beyond the important, but often superficial, tax-to-GDP ratio discussion and focuses on the **efficiency, effectiveness, fairness and transparency of tax systems** at national and international levels.

'Spend Better' covers equally relevant aspects of domestic public finance. Public expenditure management is the critical 'throughput' process, which, if properly executed, should lead to revenues being converted **efficiently and effectively** into public goods and services. The distributional aspects of taxation can be meaningfully assessed only in conjunction with public expenditure. This way of thinking about domestic public finance is based on the three main 'deliverables' of a sound public financial management (PFM) system: i) aggregate fiscal discipline, ii) the strategic allocation of resources and iii) efficient and effective public spending. **This document focuses on the third deliverable, efficient and effective public spending**.

All in all, **'Collect More' and 'Spend Better'** are two sides of the same process. The EU has a long-standing record of supporting developing countries in collecting more and spending better, particularly with its budget support programmes in more than 80 countries. In addition, EU direct support for domestic public finance reforms in developing countries amounts to EUR 140 million annually.

2.1. Collect More – Closing the dual tax gap to increase DRM

D**omestic revenue mobilisation** is by far the most important source of the fiscal space required to achieve sustainable development. On average, developing countries raise less than 20% of GDP in taxes, as compared with 30-45% in OECD countries. Around half of all low- and lower-middle-income countries (LICs and LMICs) still have tax-to-GDP ratios of below 15%. Studies comparing tax efforts (a country's actual tax-to-GDP ratio compared with a potential tax-to-GDP capacity based on the country's economy) suggest **there is considerable room for improvement in many developing countries**. An IMF working paper[8] estimates that average tax effort in developing countries is about 65% of tax capacity; some could increase revenue collection by 25-50% in the medium to long term.

As countries commit themselves to increasing DRM, it is important that action is driven by two questions: *'What are the welfare benefits and costs of taxation?'* and *'Who pays a particular tax?'*.

Five main challenges threaten the ability of developing countries to raise more domestic revenue:

- tax avoidance, tax evasion and illicit financial flows;
- the complexity of the international tax architecture;
- tax incentives, particularly to attract foreign direct investment (FDI);
- spillover effects due to international tax competition; and
- the complexity of taxing natural resources along the value chain.

Frequently, the interactions of tax systems result in mismatches and loopholes that open opportunities for tax avoidance. In addition, Governments are often under intense pressure to use taxation to attract new investors with incentives and exemptions granting favourable treatment to particular taxpayers, but without always conducting a comprehensive assessment of the package offered to the investors and the potential harmful effects on other countries. At the same time, countries continue to stretch the boundaries of what is considered acceptable tax competition. This can lead to a 'race to the bottom' and creates negative spillover effects for other countries. Just as frequently, in an international environment revenue administrations are unable to ensure on their own tax compliance and address tax-base erosion and profit-shifting, which favour tax evasion and avoidance. Both are economically inefficient and socially unfair. Both can lead to a misallocation of resources, create information bias, distort macroeconomic policy, affect tax morality and shift excess tax burden to those who are less mobile, primarily workers, or to consumption, mainly by the poor. Many countries that are rich in natural resources have adopted special fiscal regimes that create complex policy and administrative challenges and test the capacity of tax administrations to manage them.

The **'Collect More'** approach is based on two concepts:

- **closing the tax policy gap** between the tax due under an optimal tax policy and that due under current tax policy. The focus is on tax policies to broaden the tax base where appropriate, close loopholes and fight tax avoidance; and
- **closing the tax compliance gap** between the tax due under the current tax policy and that actually collected. The focus is on improving the efficiency and effectiveness of tax administration, reinforcing voluntary tax compliance, good tax governance, and fighting tax evasion and illicit financial flows.

Closing the dual tax gap requires an understanding of its causes and a sequenced approach to policy and capacity constraints. This comprehensive approach to tax policy reforms and tax administration capacity-building emphasises i) a better understanding of the political economy and policy implications of tax reforms, ii) tackling capacity constraints undermining tax administration performance, iii) addressing tax avoidance, tax evasion and illicit financial flows and iv) addressing the international governance dimensions of taxation 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.

i) International drivers of the dual tax gap

The two main international drivers of the dual tax gap are **illicit financial flows** and **harmful tax competition** between countries.

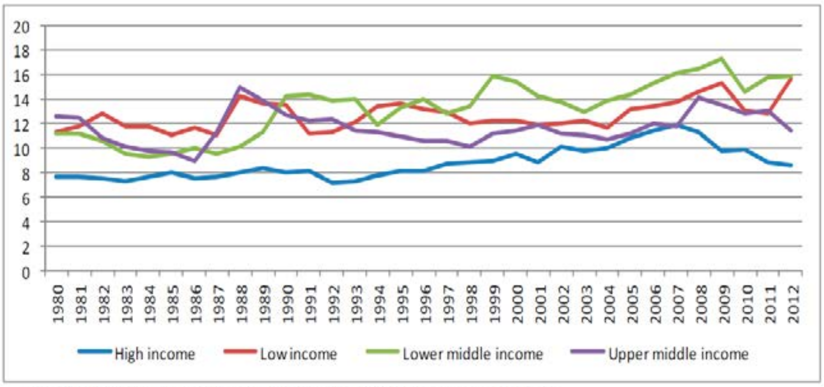
While taxation takes place at national level and improving DRM is primarily the responsibility of each country according to its own context and choices, external changes also have a significant impact on the effectiveness and fairness of DRM.

Global Financial Integrity estimates that corporate tax evasion makes up 60% to 65% of illicit financial flows.[9] The role of national revenue systems in tackling **illicit financial flows** is made more difficult by the increasing international mobility of taxpayers, the globalisation of economic activities, high volumes of trade and capital flows, new technologies, uncooperative tax jurisdictions and aggressive tax planning, including multinational enterprises' (MNEs') abusive transfer pricing and trade misinvoicing practices. Illicit financial flows transcend national borders and affect a multitude of countries.

Tax competition creates spillover effects that arise from the interactions of national tax policies. The potential economic impact of international spillover effects goes well beyond tax revenues, with wider implications for the distribution of welfare across nations. Developing countries are badly affected; for LICs and LMICs in particular, corporate income tax accounts for a higher proportion of total tax revenues (16%) than for developed countries

(8%). Estimated spillover effects involve large revenue losses for developing countries and require better international tax governance and cooperation.

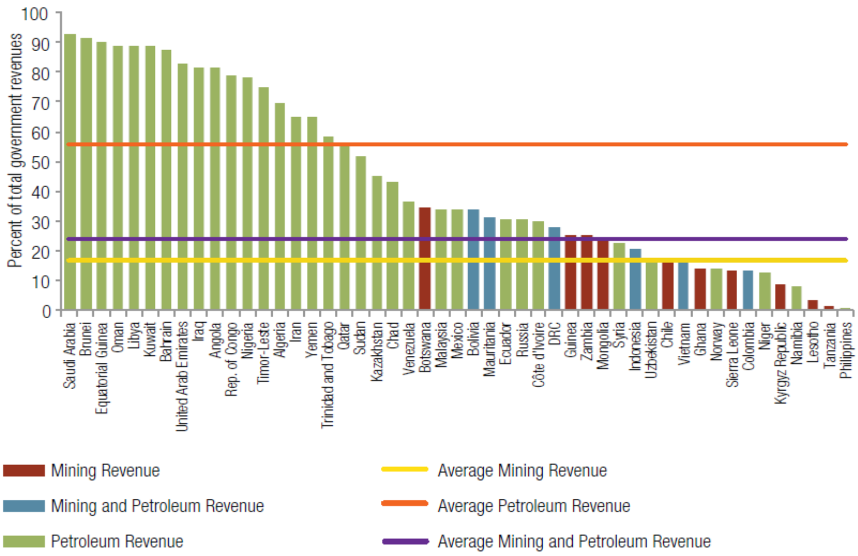
Figure 1: Revenue from the corporate income tax as a percentage of total revenue[10]



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.

These issues are all the more important when they concern the natural resource sector. Revenues from extractive industries (oil, gas, mining and forestry) have major macroeconomic and fiscal implications, since they account for over half of government revenue in petroleum-rich countries and for over 20% in mining countries.[11]

Figure 2: Revenues from natural resources in 2011[12]



Source: IMF staff estimates.

Most countries have adopted special fiscal regimes for the natural resource sector, which is dominated by a few MNEs. Some fiscal regimes tend to create complex policy and administrative challenges.[13] Weak administrative capacity to manage such complex regimes and to deal with profit-shifting by MNEs can lead to huge revenue losses in developing countries. Moreover, from the macro-economic perspective, the price volatility of natural resources makes domestic revenues significantly pro-cyclical, requiring sound fiscal policies to manage natural resource wealth efficiently over the medium term.

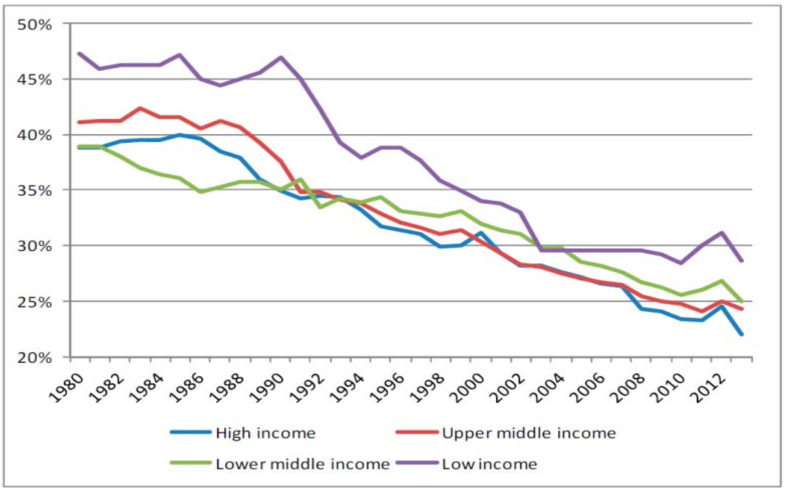
ii) Domestic drivers of the dual tax gap

Less visible in the international debate, but also very important, is the domestic component of tax policy and compliance gaps. Three kinds of difficulty must be overcome if these ‘internal gaps’ are to be reduced:

- **political constraints –** in all countries, special interest groups lobby governments and tax administrations for tax incentives or a favourable treatment. Transparency and strong political backing are necessary to the design and implementation of fair tax rules;
- **administrative constraints –** tax administrations in developing countries can face capacity constraints, lose skilled personnel to international organisations and private-sector firms, lack tax-collection infrastructure and have difficulties adapting to the taxation challenges of globalisation and technological development; and
- **economic constraints –** developing countries typically have a narrow tax base, a large proportion of the population living in poverty, a large portion of their economic activity in the informal and agricultural sectors, heavy dependence on natural resources and tax rules that grant tax incentives to investors with little justification.

A particularly important factor in the tax policy gap is the large amount of potential revenue given away by governments in the form of tax incentives. The use of such incentives is widespread in developing and developed countries. When well designed, they may serve useful social and economic purposes, if the benefits they generate outweigh the revenue foregone. However, they are often poorly designed, ineffective, inefficient and linked to abuse and corruption. The drawback to using them to attract investment, particularly FDI, is the increasing competition between countries and a 'race to the bottom' as regards corporate income tax.

Figure 3: Corporate income tax rates 1980-2013[14]



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

In addition to the tax policy gap created by tax incentives, the complexity of tax systems has a negative impact on tax compliance, particularly in developing countries where tax administrations may not have the capacity to manage complex regimes. More broadly, low tax morale can be an important factor in the domestic dimension of tax compliance. In some developing countries, the VAT compliance gap is about 50-60% of potential VAT,[15] mainly due to the size of the 'shadow' or informal economy.

2.2 Spend Better – Improving the effectiveness and efficiency of public spending

Good public expenditure management – improving the efficiency, transparency and accountability of public expenditure – increases fiscal space in the same way as receiving additional resources: government can provide more and better public goods and services with the same amount of financial resources if it uses its resources more effectively.

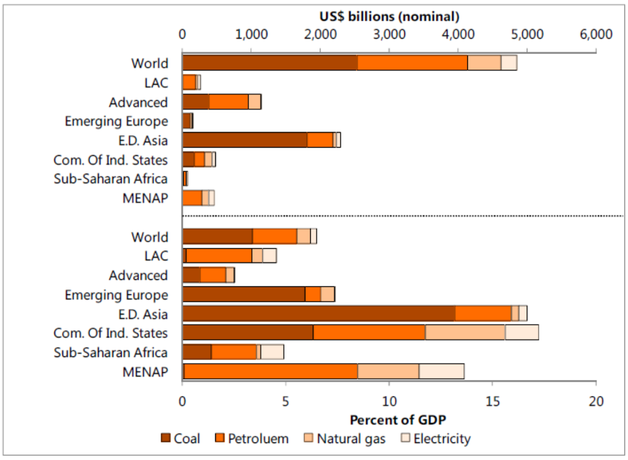
Four areas deserve particular attention:

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

While **subsidy programmes** can be a positive policy instrument in redistributing wealth and addressing challenges of inequality, they appear frequently to be ill-targeted and ineffective, in that they cost a lot while delivering limited benefits to deserving target groups, particularly compared with well-targeted safety-net programmes. Some subsidies need a substantial rethinking of their economic and social objectives. For example, a recent IMF working paper[16] estimates that energy subsidies cost 6.5% of global GDP in 2013, more than global public spending on health and education (6% and 5% of global GDP respectively). The currently low oil prices present an opportunity not to be missed to gradually phase out environmentally harmful fossil fuel subsidies which would make renewable energy sources more viable and competitive.

Figure 4: Energy subsidies by region and energy product in 2013[17]

(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

Public investment in social and physical infrastructure is important for inclusive growth, sustainable development and poverty eradication as well as for attracting FDI. However, for money to produce results, the process of public investment must be sound.[18] Low returns on public investment arise from poor planning, allocation and implementation of projects due to limited information, waste and leakage of resources, and weak technical expertise and institutional capacity. The average inefficiency in public investment across countries, as measured by comparing the value of public capital with infrastructure coverage and quality, is estimated at around 30%.[19] The country with the most efficient public investment gets more than twice the economic return of the country with the least efficient.

A transparent **public procurement** system is the *sine qua non* of efficient public expenditure. From a public finance perspective, public procurement is how public authorities spend public money to procure goods and services. From an economic perspective, it offers considerable business opportunities to the private sector and attracts FDI. The size and significance of public procurement are such that it does not make sense to discuss sustainable, inclusive growth without properly addressing the efficiency of public procurement. It represents an estimated 15-28% of countries' GDP, i.e. about 50% of public expenditure,[20] and therefore has important policy implications when it comes to improving public expenditure efficiency.

Borrowing is a way of leveraging public resources to increase fiscal space. By contracting debt on the international or domestic markets, government *de facto* leverages its own resources to finance public investment. In a positive scenario, the latter should provide the basis for medium- to long-term growth levels that keep the debt-to-GDP ratio at manageable levels. For various reasons, this has not always been the case and debt has soared in many developed and developing countries. Increasing public investment by contracting debt in a sustainable manner requires a strong emphasis on the quality of public investment and sound debt management, based on a debt strategy aimed at raising the required amount of funding at the lowest possible cost consistent with a prudent degree of risk.

3. A call for global action

As outlined in previous chapters, the mobilisation and effective use of domestic revenue face challenges at multiple levels. In addition to the challenges developing countries face at national level to increase their fiscal space, the international dimension of domestic public finance imposes new challenges. The magnitude of these international challenges has hampered developing and developed countries alike in their ability to mobilise and use domestic revenues, including those from natural resources. National approaches alone are unlikely to succeed; global action is needed to tackle global challenges and provide the global public good of an international tax environment that is efficient, effective, fair and transparent.

This 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 therefore 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.

3.1 Good tax governance in the EU – Leading by example

The EU has consistently shown leadership on good governance in tax matters and promoted the principles of transparency, information exchange and fair tax competition that are now gaining traction worldwide. It has intensified its efforts to improve tax governance within its own borders and has been at the forefront of the push for an ambitious global agenda. Major improvements have been made in tax governance in the EU internal market while taking into account implications for other countries.

In 2009, the European Commission issued a Communication on *Promoting Good Governance in Tax Matters*[21] to promote the principles of good governance in taxation in order to improve tax cooperation and tackle tax evasion and tax avoidance, both within the EU and beyond.

In 2012, it presented an Action Plan with over 30 measures to combat tax fraud and evasion[22], together with two recommendations on aggressive tax planning and on measures to encourage third countries to apply minimum standards of good governance in tax matters.[23]Important progress has been made in taking these measures forward, with a number of key initiatives already implemented. The revision of the Directive on Administrative Cooperation, adopted by the Council in December 2014,[24] was a significant achievement. It ensures that the EU has a solid legislative framework for the automatic exchange of information. It requires Member States automatically to exchange a wide range of financial information with each other, in line with the new OECD/G20 global standard for the automatic exchange of information between jurisdictions. Other achievements relating to the 2012 Action Plan include the adoption of the revised Parent-Subsidiary Directive to prevent certain abusive tax practices by companies, the creation of a Platform for Tax Good Governance and the launch of the VAT Forum for business/tax authority dialogue.

The new EU Anti-Money Laundering Directive[25] feeds into the goal of greater transparency in capital flows and includes provisions for the identification of beneficial ownership. The EU also revised its Funds Transfers Regulation[26] in ways which will make more information available to financial intelligence units and law enforcement authorities and improve traceability of payments.

In 2013, the EU adopted the Accounting Directive[27] and the Transparency Directive,[28] which require the disclosure of payments by listed and large unlisted companies with activities in the oil, gas, mining and forestry sectors to governments on a country-by-country and project-specific basis. The revised Directives have brought EU regulation to the forefront of global efforts to increase transparency and accountability in the management of natural resources and will benefit developing countries, particularly those that are rich in natural resources. They will promote the adoption of the Extractive Industry Transparency Initiative (EITI) standard in developing countries and encourage countries that host major extractive companies to implement mandatory reporting rules equivalent to these EU standards.

The European Commission intends to continue reforms to foster good governance in tax matters[29] and to fight tax evasion and tax avoidance in the EU internal market and internationally. It presented in March 2015 a package of tax transparency measures as part of its ambitious agenda to tackle corporate tax avoidance and harmful tax competition in the EU. This aims to ensure that Member States are equipped with the information they need to protect their tax bases and effectively target companies that try to avoid paying their fair share of taxes. In addition, the European Commission adopted in June 2015 a tax package for a fair and efficient corporate taxation system in the EU[30]. The action plan sets out a series of initiatives to tackle tax avoidance, secure sustainable revenues and strengthen the Single Market for businesses, with 5 key areas for action: re-launching the Common Consolidated Corporate Tax Base (CCCTB), ensuring fair taxation where profits are generated, creating a better business environment, increasing transparency, and improving EU coordination. Collectively, these measures aim at significantly improving the corporate tax environment in the EU, making it fairer, more efficient and more growth-friendly. In addition, natural capital accounts can help countries rich in natural resources to enhance their governance and transparency in contributing to economic growth.

With these above mentioned initiatives, the European Commission not only aims to lead by example; it also creates positive spillover effects for other countries and regions.

3.2 Good international tax governance – A global partnership

With the 2010 Communication *Tax and development – cooperating with developing countries on promoting good governance in tax matters*,[31] the European Commission laid out the basis for its DRM support to developing countries. The Communication focused specifically on the synergies between tax and development policies and ways in which the EU could assist developing countries in building efficient, fair and sustainable tax systems. The EU is engaged in global partnerships with the UN, G20, OECD, IMF, World Bank and other international and bilateral partners to support developing countries in strengthening their tax policies and administration.

The EU actively supports developing countries and regional bodies such as the African Tax Administration Forum (ATAF), the Inter-American Center of Tax Administrations (CIAT) and the *Centre de rencontres et d'études des dirigeants des administrations fiscales* (CREDAF), encouraging them to participate and raise their voice in international discussions and standard-setting processes, including in the Global Forum on Transparency and Exchange of Information for Tax Purposes and the G20/OECD Base Erosion Profit Shifting (BEPS) Initiative.

The EU has also been active in its cooperation on transfer pricing, working closely with the UN Committee of Experts on International Cooperation in Tax Matters on the establishment of a UN *Practical manual on transfer pricing for developing countries*[32] and launching a tripartite partnership with the World Bank and OECD to support developing countries in their efforts to set up transfer pricing regimes.

Promoting better governance in extractive industries has become a priority for the EU. Its approach combines a series of regulatory and voluntary measures aimed at increasing transparency, enhancing government accountability and fighting corruption. The disclosure requirements of the Accounting Directive and the Transparency Directive, including country-by-country reporting, will have a series of benefits at international level and enhance other EU supported initiatives such as the EITI.

EITI reports have helped to inform a debate on the benefits and challenges of extractive industries in developing countries in a way that was not possible half a decade ago. They have shed light on numerous gaps in revenue collection and distribution mechanisms, leading to a vast body of recommendations for improving government and company systems.

The EU supported African Legal Support Facility (ALSF) has enhanced African countries' ability to negotiate complex contracts with large (often foreign) investors. This has led to a better use of natural resources for development and growth, fostered good governance in natural resources and helped to tackle corruption, tax evasion, tax avoidance and illicit financial flows.

3.3 From Addis to New York and beyond

Implementing the 2030 Agenda for Sustainable Development will require sound domestic public finance systems to foster effective domestic revenue collection and use. Countries would need to cooperate on an ambitious agenda to create such an environment, with the overall objectives of:

i) **'Collect more'**: closing the tax policy gap and tax compliance gap by increasing the efficiency, effectiveness, fairness and transparency of DRM and tackling tax avoidance, tax evasion and illicit financial flows; and

ii) '**Spend better**': improving the efficiency and effectiveness of public spending by addressing public investment expenditures, public procurement and debt management for sustainable development

It will be crucial to carefully monitor progress in the achievement of these objectives; this can be measured using international assessment tools (see examples in Annex 3).

In line with the outcome of the Addis and New York landmark events, key elements of such a common agenda could include:

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

    - develop a basis of underlying international principles to guide work on standards and regulations for revenue mobilisation and the fight against illicit financial flows;
    - support policy outreach activities to promote the **principles of good governance in tax matters** – transparency, exchange of information, fair tax competition – at international level;
    - support the G20/OECD Action Plan on **Base Erosion and Profit Shifting (BEPS)**, particularly by incorporating developing countries' views and cooperating with key international partners; and
    - support the G20/OECD **Automatic Exchange of Information Roadmap** and foster the participation of developing countries and international partners;

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

    - support the **UN Committee of Experts on International Cooperation in Tax Matters**, a forum that enables a broad participation of developed and developing countries;
    - share experiences, benchmarking and peer reviews of good practices through international and regional forums;
    - support global initiatives of the UN, G20, OECD, IMF and WBG to strengthen developing countries' representation in international discussions;
    - support developing countries' participation in international and regional tax forums to ensure that they are represented on an equal footing and that international standards take account of their specific needs;
    - participate in international forums and joint initiatives, such as the International Tax Compact; and
    - support regional tax forums such as ATAF, CREDAF and CIAT;

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

    - support developing countries in the fight against the misuse of transfer pricing practices; and
    - cooperate with the UN and other international and regional organisations to provide technical and policy support to developing countries on transfer pricing, strengthening their legislative and regulatory frameworks and their implementation and enforcement capacity;

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

    - support capacity-building initiatives such as the IMF Topic Trust Funds, those of regional organisations and national programmes; and
    - support research institutions and training initiatives at national, regional and international level;

5. **Improving revenue statistics**

- support initiatives to provide developing countries with the necessary tools to collect internationally harmonised, comparative data on tax structure and tax collected;
- support international initiatives from regional and international organisations to provide data, analysis and policy advice, such as the OECD Revenue Statistics Initiative and the IMF Revenue Administrations Fiscal Information Tool (RA-FIT); and
- promote close cooperation between these organisations to ensure the consistency of the collected data and reduce the administrative burden on the revenue authorities in developing countries providing the data;

6. Supporting the development and implementation of fiscal assessment tools

- support the development and implementation of fiscal assessment tools to assess the strengths and weaknesses of partner countries' tax and expenditure systems and promote public finance reforms, including the TADAT, RA-GAP and the PEFA PFM Performance Measurement Framework;
- continue using PEFA, TADAT and RA-GAP as assessment tools in the context of EUs budget support programmes and in conjunction with capacity building support; and
- invite partner countries to implement RA-GAP to measure progress in closing the dual tax gap;

7. Improving transparency and accountability in the extractive industry sector

- promote the adoption of legislation in other countries on country-by-country reporting to ensure a level playing field internationally;
- promote the adoption of the EITI Standard; and
- support regional and international initiatives such as the EITI and the ALSF;

8. Improving transparency, accountability and oversight in domestic public finance

- support international and regional initiatives to foster good governance in public finance, such as the Open Budget Survey and the Collaborative African Budget Reform Initiative;
- support the participation of civil society organisations and the general public in the budget process; and
- support international and regional initiatives strengthening the capacities of governments, oversight bodies and civil society organisations in their work on domestic revenues, expenditures and illicit financial flows;

9. Promoting efficiency in public investment and public procurement

- support international and regional initiatives to promote efficiency in public investment management and public procurement;

10. Strengthening sustainable debt management

- following the successful Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI), support the strengthening of debt management capacity in developing countries; and
- support the Debt Management Facility (DMF).

The two envisaged EU flagship initiatives (see Annexes 1 and 2) and the European Commission contribution to the call for global action will be implemented on the basis of the above indicated key elements. They should be seen alongside the European Commission's overall support to developing countries in the area of economic governance, notably – but not exclusively – through budget support operations.

Annex 1: Flagship Domestic Revenue Mobilisation Initiative[33] under the Global Public Goods and Challenges thematic programme[1]

Domestic revenue mobilisation is essential for the well-functioning of the state and the provision of public goods. Beyond providing fiscal space for priorities, DRM is also part of a social contract that underpins participation, social cohesion and contributes to shaping good governance. It thus supports sustainable and inclusive growth, good financial governance and accountability.

While the primary responsibility for improving DRM lies with individual countries, the increasing integration of international markets and economic globalisation lend a supranational or global dimension to the challenges of raising domestic revenues and often hamper national efforts. Therefore, a joint approach by developing and developed countries and international organisations is needed to provide the global public good of an international tax environment that is efficient, effective, fair and transparent. An EU flagship initiative in this area responds to this need for a joint approach, including *inter alia* to the G20 Declaration making a strong commitment to tackling tax evasion and avoidance, harmful practices and aggressive tax planning. Illicit financial flows alone cause developing countries an estimated loss of €442 billion per year in domestic revenues. Illicit financial flows out of developing countries, difficult to measure and probably significantly underestimated, are therefore more than double the amount of ODA from OECD countries to those countries.

The flagship initiative will:

- promote a transparent, cooperative and fair international tax environment at global level in order efficiently to tackle international challenges such as tax evasion, tax fraud and illicit financial flows, and therefore contribute to an international environment that is conducive to DRM;
- enhance the participation of all countries and regions in the global tax dialogue in order to help them build up effective, efficient, fair and sustainable national DRM systems; and
- seek to give civil society more of a voice so as to improve accountability, government effectiveness, regulatory quality and compliance.

[1] The Global Public Goods and Challenges thematic programme is financed under the Development Cooperation Instrument, Regulation(EU) N° 233/2014 of the European Parliament and of the Council of 11 March 2014 OJ L77 of 15 March 2014

Annex 2: Flagship EU Resource Transparency Initiative[34] under the Global Public Goods and Challenges thematic programme[2]

Extractive resources, including oil, gas and minerals, affect the economic conditions of countries that represent half of the world's population: some four billion people live in countries whose economic trajectories have been shaped to a large extent by their natural resource endowments. Some developing countries have succeeded quite well in transforming their natural resources into assets for change, but many others still experience their abundance of natural resources as a curse, unable to translate natural wealth into economic and human development. In many (e.g. conflict-affected and high-risk) countries, resource exploitation and trade fuel instability, which is why the Commission and the High Representative proposed an integrated EU approach to stop the profits from trading minerals being used to fuel conflicts and to promote the responsible sourcing of a number of key minerals.

With the aim of contributing to the effective regulation in extractive industries and capacity building in the domain of domestic revenue mobilisation through taxation regimes, the EU and the African Union Commission worked together back in 2011 to present a set of recommendations[3] that have contributed to strengthen the implementation of the Africa Mining Vision and inspired other EU initiatives related to resource transparency in the extractive sector.

The Extractive Industries Transparency Initiative (EITI) was launched at the World Summit on sustainable development in 2002 with a view to remedying the lack of transparency in the governance of payments and revenues from extractive resources. Building on EU legislation (Accounting and Transparency Directives) adopted in June 2013, which requires EU oil, gas, mining and timber companies to publish their payments to partner governments, the proposed flagship initiative will help partners at various levels to comply with the enhanced transparency requirements. The reporting of extractive industries' payments to government will provide local authorities and civil society with significantly more information and enable local communities and civil society organisations to hold their government accountable for the use of these revenues and for ensuring adequate consideration of the environmental and social cost that can result from the exploitation. The initiative will promote this policy *vis-à-vis* all investor countries and build on relevant existing international initiatives to fulfil the relevant objectives in Section 5.2 of the Global Public Goods and Challenges thematic programme.

The scope of the initiative will be extended to cover development aspects of other EU initiatives linked to transparency in the supply chain, addressing in particular the conflict-free and responsible exploitation of resources. It could also be extended to include possible follow-up of the mapping exercise on raw materials (keeping in mind the need for complementarity with regional and national programmes and other external action instruments).

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[2] The Global Public Goods and Challenges thematic programme is financed under the Development Cooperation Instrument, Regulation(EU) N° 233/2014 of the European Parliament and of the Council of 11 March 2014 OJ L77 of 15 March 2014

[3] Concrete proposals were approved at second African Union Conference of Ministers responsible for Mineral Resources held on 12-16 December 2011.

Annex 3: Fiscal assessment tools

The **Revenue Administration Gap Analysis Programme** (RA-GAP) is a methodology developed by the IMF for estimating the tax policy gap and tax compliance gap. It consists of a top-down element comparing taxes actually collected with potential taxes estimated from economic statistics and a bottom-up element using a sample of tax audits to estimate the gaps for individual taxes. The RA-GAP does not estimate the value of tax expenditures, for which well-established techniques already exist.

The **Tax Administration Diagnostic Assessment Tool** (TADAT) is a new diagnostic instrument to help governments measure the performance of their tax administrations. It is designed to deliver an objective, standardised assessment of the most critical outcomes of any country's system of tax administration. TADAT helps create a shared view of the quality of tax administration among stakeholders, set the reform agenda, evaluate the success of reforms and coordinate external support.

The **Public Expenditure Financial Accountability** (PEFA) programme is a multi-donor programme established in 2001 by seven organisations, including the EU, to support public financial management reforms. The PEFA PFM Performance Measurement Framework is an evidence-based diagnostic tool for:

(i) assessing country revenue, public expenditure, procurement and financial accountability systems;

(ii) supporting the design of PFM reform and capacity-building action; and

(iii) providing a common source of information for dialogue among stakeholders.

The main deliverables of a sound PEFA system are:

- aggregate fiscal discipline – keeping public spending in line with available resources and the government's macroeconomic and fiscal stability goals;
- the strategic allocation of resources – planning and executing the budget in line with government priorities in order to achieve government's policy objectives; and
- efficient and effective use of resources – using public resources in such a way that public goods and services are delivered efficiently and provide good value for money (maximum benefit from available resources).

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