Mobilizing Domestic Resources for Sustainable Development: Toward a Progressive Fiscal Contract

Chapter 6 addresses implementation of SDGs

Domestic resource mobilization (DRM) will be crucial not only to meet the sheer scale of investment needed to implement the 2030 Agenda for Sustainable Development and the Sustainable Development Goals (SDGs), but also because it holds its own broader promise for transformative change. If undertaken successfully, DRM can generate substantial benefits for state-citizen relations, economic stability and growth, and redistribution. Coalitions for progressive reforms, through which the rich pay relatively more than the poor, are a precondition for creating transformative eco-social and fiscal contracts. This is easier in contexts with greater state capacity, where resource bargains are more transparent and inclusive, and where national bargains are supported by global bargains, the latter providing resources and regulation.
1. Introduction

Moving from a sustainable development vision to implementation of the policies outlined in previous chapters rests on the capacity of states to design strategies, create political support, and mobilize the required financial and administrative resources. Domestic resources will be key for financing the eco-social turn necessary for the transformative change committed to in the 2030 Agenda for Sustainable Development. Domestic resources, in particular public domestic resources, are already the most important source of development finance, exceeding private flows as well as international aid (figure 6.1).²

*Domestic resources will be key for financing the eco-social turn*

This challenges the popular belief that budgets in developing countries rely heavily on external funding, and highlights the relevance of domestic resources. At the same time average finance trends tend to hide challenges for specific regions or countries, in particular if investment and spending needs are very high.

Estimates of the amounts needed to finance the 2030 Agenda are in the range of “trillions, not billions”,³ to cover global financing gaps of between USD 1.5 trillion per year⁴ to USD 2.5 trillion or more.³ While this amounts to 2 to 3 percent of global gross national income (GNI), the costs of implementing the 2030 Agenda in proportion to the GNI of developing countries (low- and middle-income) are far higher (table 6.1).

The magnitude of financing requirements at the national level can be illustrated by looking at a subset of the goals related to social protection. National social protection floors (SPFs) for residents benefiting from (i) a defined minimum level of income across their lifecycle (from childhood to old age) and (ii) universal access to health care services would require substantial additional investments. For sub-Saharan African countries, for instance, the resources needed to close the gap for full implementation of SPFs represents, on average, 17 percent of GDP. For Latin American countries, the average gap amounts to 9 percent of GDP (see also box 6.3).⁶

---

**Figure 6.1. Financing trends in developing countries (USD bn, 2013 prices), 2000–2014**

Notes: Public domestic finance is defined here as total government revenue. Gross-fixed capital formation by the private sector was used as indicator for private domestic finance. Private international finance is the sum of foreign direct investment (FDI), portfolio equity and bonds, commercial banking and other lending, and personal remittances. Public international finance equals the total official flows (official development assistance and other official flows). Data on private international finance: (i) for countries in East Asia and the Pacific, data were not available; (ii) for MENA countries, data were available from 2008; (iii) for Latin American countries, data for 2013 and 2014 were not available. Data on public domestic finance were an average of 104 developing countries for 2000–2013 and of 50 developing countries for 2014. The figure illustrates the absolute increase in financing sources; in relative terms, financing sources have largely increased in line with GDP growth. Data sources: ODI et al. 2015: 32; World Bank 2016; OECD 2016a, 2016b; IMF 2016; ICTD and UNU-Wider 2016.
The Addis Ababa Action Agenda, the outcome document agreed by heads of state at the Third Financing for Development (FFD) Conference just ahead of the adoption of the 2030 Agenda, underscores a firm commitment to mobilize funding at global and national levels to finance a new social compact and deliver “social protection and essential public services for all”. It recommends a broad set of financing instruments such as public finance, international development cooperation, trade and debt, while recognizing related policy and governance challenges, such as illicit financial flows, tax evasion and lack of affordable credit and productive investment.

Among this set of instruments, this chapter considers two types of public domestic resources: taxation and revenues from extractive industries, presenting different challenges and opportunities with regard to sustainability and transformative change. Generally speaking, public domestic resources have various social, economic and political benefits if compared to private or external funds. Among these are their linkages with domestic policy making and policy space, their potential for impacting positively on institution building and accountability, their ability to redistribute income and stabilize the economy, and their capacity to make production and consumption more sustainable in

<table>
<thead>
<tr>
<th>Country groups</th>
<th>GNI (in current USD)</th>
<th>Financing gaps as percent of GNI (in current USD)</th>
<th>Lower limit</th>
<th>Upper limit</th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
<td>78,202,649,420,639.80</td>
<td>USD 1,500,000,000,000</td>
<td>1.9</td>
<td>3.2</td>
</tr>
<tr>
<td>High-income countries</td>
<td>53,267,966,729,419.00</td>
<td>USD 2,500,000,000,000</td>
<td>2.8</td>
<td>4.7</td>
</tr>
<tr>
<td>Middle-income countries</td>
<td>24,583,600,542,708.90</td>
<td>USD 2,500,000,000,000</td>
<td>6.1</td>
<td>10.2</td>
</tr>
<tr>
<td>Low-income countries</td>
<td>391,881,917,056.85</td>
<td>USD 2,500,000,000,000</td>
<td>382.8</td>
<td>637.9</td>
</tr>
</tbody>
</table>

environmental, economic and social terms. Public domestic resources are more likely than external resources to trigger transformative structural change of the economy and redistribution, leading to higher equality, inclusion and social protection, in particular in the case of taxation and social contributions. As the chapter will show, this relates to the links with social policy, democratization and rights that emerge from revenue bargains between citizens and states.

To advance the required policy reforms which will “leave no one behind”, countries will need to design their own financing strategies according to their economic and political structures and specific needs. This means that the combination of sources and instruments—external and domestic, public and private—as well as their weights in the overall financing mix will differ between countries (figures 6.2 and 6.3). Some will be able to attract greater amounts of private investment (such as upper-middle income countries/UMICs), others will rely more on aid transfers, foreign debt, resource rents and remittances (least developed countries/LDCs and lower middle-income countries/LMICs), and others—mostly middle-income countries (MICs) and high-income countries (HICs)—will be able to finance a larger part of their budgets with proceeds from domestic tax systems and national capital markets.

While aid will continue to be crucial, scaling up domestic public revenues will make the difference

Aid will continue to be crucial as an international instrument for redistribution, and in particular for least developed and conflict-affected countries that are highly aid-dependent and where overseas development aid (ODA) currently approaches or exceeds tax revenue (almost half the countries in figure 6.4). However for the majority of countries, scaling up domestic public revenues will make the difference. Do countries encounter an enabling context for these endeavours? Looking at the global trends of financial resources, the past decade has seen significant increases in all funding sources. ODA reached its all-time high in 2014, USD 137.2 billion, reflecting a 70 percent increase in real terms since 2000; in 2014, public domestic revenue in developing countries was almost eight times higher than its level in 2000, and private domestic and private international financing increased by more than seven and nine times respectively (figure 6.1). Foreign direct investment (FDI) grew by 63 percent between 2000 and 2012, while long-term debt disbursements grew by 76 percent and remittances increased almost three-fold.

Figure 6.3. Composition of financial flows to developing countries, 2000–2014

Notes: Other lending includes net commercial bank lending (public and publicly guaranteed and private nonguaranteed) and other private credits. Other official flows (OOF) are official sector transactions which do not meet the overseas development aid (ODA) criteria. These include, for example, grants to developing countries for representational or essentially commercial purposes; official bilateral transactions intended to promote development but having a grant element of less than 25 percent; official bilateral transactions, whatever their grant element, that are primarily export-facilitating in purpose. This category includes by definition export credits extended directly to an aid recipient by an official agency or institution (“official direct export credits”); the net acquisition by governments and central monetary institutions of securities issued by multilateral development banks at market terms; subsidies (grants) to the private sector to soften its credits to developing countries, and funds in support of private investment. Data Sources: OECD 2016a; World Bank 2016.
Despite this impressive upward trend in public and private finance from an aggregate perspective, the question remains why so many people remain poor and cannot fully exercise their rights and fulfil their basic needs. Indeed, while the steady increase in financial resources was certainly conducive to the achievements of the MDG agenda, the current context poses a number of challenges (chapter 1). First of all, financial revenues and financial flows mainly increased in line with GDP growth. Second, flows are not distributed evenly across countries. Low-income countries (LICs) and LDCs have made the least progress in terms of generating tax revenues. They also receive a small share of private flows and, despite growth in absolute numbers, a declining share of total ODA, falling from 34 percent in 2010 to 32 percent in 2012. Third, the current decade—already labelled the “decade of fiscal austerity”, with stagnant or volatile growth since the onset of the great recession in 2008, spreading financialization and increasing macroeconomic instability as well as rising inequality—is exerting negative pressure on public and private finance. And finally, the question is whether increased resources have been spent in ways that improve social development outcomes.

A number of additional constraints can be identified with regard to domestic and international financing.

Constraints in domestic financing result from different factors such as insufficient growth performance, informality and unemployment, tax losses due to tax optimization and evasion by multinational corporations (MNCs) and difficulties in expanding personal income tax due to resistance from elites and well-organized wage earner groups. Additional impediments are low national savings rates, lack of accessible and affordable credit in domestic banking systems and underdeveloped capital markets.

Limitations regarding international finance are associated with fiscal and political pressures in traditional donor countries in the aftermath of the global crisis and in the context of the European refugee crisis. These pressures have recently led to significant cuts in ODA in some countries (such as Australia, France, Japan, Portugal and Spain), announcements of cuts in others (Denmark and Finland), or changes in aid allocation that have direct implications for resource flows to developing countries.

Figure 6.4. Aid dependency in LDCs in 2012: Aid (Country programmable aid/CPA) as percent of tax revenue

countries, such as counting expenditures on refugees as aid. We also observe a slow-down in FDI flows, whereas debt has started to rise again, reaching levels of concern in a number of countries, both North and South.

In addition, the global financial and monetary architecture influences the availability and stability of funding sources, for example, through regulation and access to multilateral funding and its conditions. Innovative instruments such as international financial transaction or environmental taxes, global funds and different types of public-private partnerships have been extensively discussed for leveraging additional financing and improving global governance, but implementation has been either slow or fraught with problems (chapters 5 and 7 and box 6.3). Reforming the global financial system will therefore continue to be on the international agenda, as measures implemented post-2008 are seen as insufficient, with significant and persistent challenges in regulation, crisis management, policy coordination and governance (chapter 7).

This chapter examines domestic resource mobilization strategies and their impact on transformative change in middle- and low-income countries, with a focus on taxation and natural resource rents. Particular attention is paid to the political factors that influence resource mobilization and allocation, and the creation of progressive fiscal contracts.

The issues discussed in this chapter point to the following conclusions.

- Transparent and inclusive resource bargains and state accountability regarding distribution and allocation of resources contribute to transformative change and therefore need to be fostered.
- The financing mix at the national level should be diversified and move away from instruments that do not support the transformative change envisioned in the 2030 Agenda. Instead, financing policies need to support policies and activities that facilitate an eco-social turn.
- Domestic resource bargains need to be supported by global bargains, providing resources (capacity building and finance) and regulation (for example, to prevent illicit flows, tax evasion and environmental damage caused by productive activities).
- An enabling environment for resource mobilization needs to be fostered, based on macroeconomic policies that support labour-intensive and sustainable growth and structural change, as well as administrative capacity and technological innovations that facilitate tax enforcement and promote efficiency.
- Global governance regimes need to be reformed, in particular the international financial architecture, to be more coherent with sustainable development and the SDG vision of partnerships.

The chapter is structured as follows: section 2 outlines key analytical concepts; section 3 analyses global trends and national experiences in domestic resource mobilization, with a focus on taxation and mineral rents; and section 4 concludes and identifies implications for policy.

### 2. Sustainable Development Finance and the Role of Resource Bargains

Transformative change requires financial resources that are sustainable in economic, social, environmental and political terms

The current debate about financing sustainable development focuses on mobilizing the trillions of dollars that will be needed to implement the SDGs. Fiscal sustainability in this view implies that governments are able to finance planned expenditures while honouring debt obligations and ensuring solvency in the medium to long term, a challenging task even for more developed countries, as the recent crisis has shown. But financing strategies themselves have developmental impacts that extend beyond the economic to the social, environmental and political dimensions.

This chapter argues that sustainable financing requires more than mobilizing the necessary quantity of resources or safeguarding financial stability. A broader definition of sustainable financing, as employed in this chapter, would rule out prolonged recourse to austerity policies as socially and politically unsustainable (and ultimately unsustainable with regard to growth and employment) and in
violation of human rights standards, even if they were implemented to restore short-term financial and fiscal stability. It brings to the fore questions about the quality of revenues, measured in terms of their transformative impact on production and employment, redistribution, gender equality, sustainable use of natural resources, and inclusion. It also suggests that financing and expenditure policies need to be designed in an integrated way, based on principles of efficiency, equity, fairness, social justice and human rights, while ensuring political processes related to financial issues are inclusive and participatory. However, as a result of unequal power relations, policies and institutions often favour elite groups. In addition, resource allocation can be undermined by institutional incapacity to deliver services and transfers; deviation of resources through corruption, clientelism or rent-seeking practices; or bottlenecks in absorptive capacity of the economy and the implementing bureaucracy.

Mobilizing resources involves contestation and bargaining

These problems highlight the political nature of resource mobilization as well as the governance challenges associated with implementing financing policies. Domestic resource mobilization, such as through taxation, while potentially reaping substantial benefits for state-citizen relations, economic stability and productivity, and redistribution, is a political process of contestation and bargaining over who pays and who benefits. To avoid excessive borrowing, which can lead to unsustainable debt and reduced policy space due to donor conditionality, most countries raise money from citizens to finance social development expenditures such as education, health and social protection. They “trade services for revenue”, otherwise known as a tax or revenue bargain (box 6.1).

While the fiscal contract literature suggests “quasi-voluntary compliance” with tax law as a result of successful bargains, it is clear that a necessary condition to make tax systems work in practice is state capacity to actually enforce tax obligations in a way that is consistent with the rule of law. In Bolivia,

Box 6.1. What is a tax bargain?

A tax bargain, also known as a fiscal contract, is a negotiation between taxpayers and government, where the former agree to comply with tax obligations in exchange for the effective provision of public services. Tax bargains can be made with specific groups of taxpayers or they can be “negotiated” generally. They can be explicit or implicit, and they are generally of a long-term nature. Explicit bargains often consist of targeted quid pro quo negotiations between government on the one hand and taxpayers and/or their representatives on the other. Implicit bargains can be in the form of behavioural adjustments on the part of taxpayers and adjustments that aim to encourage compliance on the part of government, particularly where the latter senses resistance that is likely to undermine its legitimacy.

Constructive tax bargains by taxpayers are more likely where the taxpayers share common interests; trust each other; are well organized; are aware of their rights and obligations; and can draw clear links between taxation and expenditure. On the part of government, effective tax bargains seem to emanate from a combination of democracy and a consolidation of legitimate statehood. Some argue, for example, that where statehood is not consolidated, states are more likely to coerce citizens into paying tax than they are likely to enter into fiscal contracts.

Nonetheless, there is no guaranteed relationship between taxation and democracy. There have been instances, particularly in the developing world, where democracy—or at least the need for electoral votes—has translated into a weakening of the fiscal contract through the abolition of taxes altogether. In Tanzania and Uganda, for example, the abolition of taxes levied on the informal sector and the poor, such as the graduated tax and the development levy respectively, have been closely linked to electoral calculations. Bargains seem more likely to succeed where citizens trust that government will improve governance, that it will not provide special treatment to small interest groups, and where it is important for the government that taxpayers comply voluntarily.

which displays a high tax capacity, one of the factors that contributed to increasing tax revenues since 2006 was a series of measures that aimed to broaden the tax base and fight tax fraud and smuggling. As a result, and discounting taxes from the production and sale of hydrocarbons, tax revenues as a percent of GDP increased from 15 to 19 percent between 2006 and 2013.

Coercive and discriminatory enforcement of tax obligations in many developing countries is problematic in view of potential human rights abuses by state authorities with obvious negative impacts on state-citizen relations. In Uganda, an unpopular direct local tax, the Graduated Personal Tax (GPT) on informal sector activities, was associated with frequent coercive measures such as imprisonment to enforce compliance, which led to repeated tax riots. The GPT was abolished during the 2005–2006 election campaign by incumbent President Yoweri Museveni (box 6.1).

3. The Politics of Mobilizing Public Domestic Resources

The scale of all types of domestic revenues has increased in all country groups over the past decade (figure 6.1), but despite this progress at the aggregate level, two challenges are evident: first, most countries need to mobilize more resources to cover spending gaps; this leads to the question of how to increase the quantity of revenues. Second, the quality of revenues in terms of their potential to trigger transformative change toward greater economic, social, political and environmental sustainability differs, and the question is how to increase revenue quality in this broad sense. Highly political and an outcome of bargaining and contestation, both questions cannot be answered by resorting to best practice models in tax reform or technical-administrative solutions. Instead, they require careful analysis of the political drivers of and obstacles to progressive fiscal reforms. While domestic resources include private finance as well as monetary policy and debt instruments, financing options that are particularly relevant for middle-income and advanced countries, this chapter will focus on taxation and public revenue from extractive sectors (figure 6.3).

Obstacles to increasing tax revenue are manifold

For most countries, tax income is the most important national revenue source, accounting for 85 percent of government revenues in high-income countries of the Organisation for Economic Co-operation and Development (OECD), and around 70 percent in developing countries (table 6.2). However, for a number of countries, in particular LDCs, other revenues such as ODA are equally or even more important (figure 6.4), with aid exceeding tax revenue in countries such as Afghanistan, Liberia and Malawi. While conflict and emergency situations often explain aid dependency, another reason for the challenges developing countries face in developing their tax capacity and mobilizing domestic resources is that tax systems are sticky. That is, revenue collection changes little over relatively short periods of time, given the complex governance tasks involved in taxation as well as the structural determinants of tax takes, such as per capita income level, urbanization and size of the non-agricultural sector and international trade.

Revenue collection changes little over relatively short periods of time

Moreover, in each country, tax performance depends on historical legacies. The so-called labour reserve economies of Southern Africa, for example, display higher tax takes based on direct tax, compared with, for example, Western African cash-crop economies with lower tax takes and reliance on trade taxes. Another important structural factor impacting on tax capacity are the types of citizenship regimes existing in a country. Citizenship regimes create links between governments and certain social actors or groups by establishing them as legitimate participants in political processes and claimants on public resources and authorities. These groups are more likely to be included in fiscal compacts. Applying this concept to the cases of Brazil and India, for example, it appears that India has expanded social rights in recent years without generating new revenues and keeping a low tax/GDP ratio, while Brazil expanded revenues both as part of fiscal adjustment and to expand social spending. The explanation for this difference lies in the incorporation of both middle classes and popular sectors in Brazil, in particular under the leadership of the Partido dos Trabalhadores.
(PT/Workers Party). This was achieved through expanded social policy and labour market policies that resulted in higher formal employment, social protection and consumption, though the tax system remains fragmented and regressive. In the case of India, fragmented and shifting social coalitions have led to a fragmented tax system and to privileges for the dynamic economic sectors, while attempts to form cross-class coalitions and to mobilize for greater redistribution have thus far failed.

The capacity-building efforts promoted by donors over the past decade to improve tax administrations in developing countries that did not take account of these political factors have yielded only limited results, not least because they often targeted technical capacity to the neglect of state capacity (understood as being able to reach political settlements with domestic actors in defining public policies). A case in point is the introduction of independent revenue agencies, an institutional innovation that gained traction in sub-Saharan Africa (SSA) in the 1990s to increase tax collection. As the case of the Uganda Revenue Authority (URA) shows, institutional strength and organizational performance are ultimately a function of linkages with political leadership, because such links guarantee greater financial and political support.

Revenue mobilization is also constrained by economic strategies and economic crises that result in low growth, increasing inequalities and low

Table 6.2. Summary statistics on sources of government revenue, by country category

<table>
<thead>
<tr>
<th>Country category</th>
<th>Number of countries</th>
<th>Low-income</th>
<th>Lower-middle income</th>
<th>Upper-middle income</th>
<th>High-Income non-OECD*</th>
<th>High-Income OECD</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>(37)</td>
<td>(48)</td>
<td>(41)</td>
<td>(18)</td>
<td>(30)</td>
</tr>
<tr>
<td>a. Government revenue as a % of GDP</td>
<td>18</td>
<td>26</td>
<td>29</td>
<td>34</td>
<td>42</td>
<td></td>
</tr>
<tr>
<td>b. Government revenue, excluding grants, as a % of GDP</td>
<td>15</td>
<td>26</td>
<td>28</td>
<td>34</td>
<td>41</td>
<td></td>
</tr>
<tr>
<td>c. Government taxes as a % of GDP (excludes non-tax revenue)</td>
<td>13</td>
<td>18</td>
<td>21</td>
<td>16</td>
<td>35</td>
<td></td>
</tr>
<tr>
<td>Taxes as a % of total government revenue</td>
<td>71</td>
<td>67</td>
<td>73</td>
<td>46</td>
<td>85</td>
<td></td>
</tr>
<tr>
<td>d. Income taxes as a % of GDP</td>
<td>4</td>
<td>5</td>
<td>5</td>
<td>6</td>
<td>13</td>
<td></td>
</tr>
<tr>
<td>e. Corporate income taxes as a % of GDP</td>
<td>2</td>
<td>3</td>
<td>3</td>
<td>2</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>f. Personal income taxes as a % of GDP</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>g. International trade taxes as a % of GDP</td>
<td>4</td>
<td>5</td>
<td>5</td>
<td>3</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>h. Taxes on goods and services, including value added tax (VAT), as a % of GDP</td>
<td>5</td>
<td>6</td>
<td>7</td>
<td>5</td>
<td>11</td>
<td></td>
</tr>
<tr>
<td>i. Corporate income taxes (CIT) as a % of government revenue</td>
<td>12</td>
<td>11</td>
<td>12</td>
<td>7</td>
<td>7</td>
<td></td>
</tr>
<tr>
<td>j. Personal income taxes (PIT) as a % of government revenue</td>
<td>9</td>
<td>7</td>
<td>8</td>
<td>8</td>
<td>23</td>
<td></td>
</tr>
<tr>
<td>k. Ratio of CIT to PIT revenue</td>
<td>1.4</td>
<td>1.5</td>
<td>1.5</td>
<td>0.9</td>
<td>0.3</td>
<td></td>
</tr>
</tbody>
</table>

Note: The numbers show the means within each category and relate to recent years. * These are mainly countries with high levels of income from energy or mineral extraction. Source: Moore 2013: table 1.
The turn toward neoliberal policies in the early 1980s, spearheaded by the Ronald Reagan and Margaret Thatcher administrations in the United States and the United Kingdom and quickly applied to the developing world, resulted in lower public revenues and redistribution of the tax burden from corporations and higher income groups to consumers and lower income groups. Recent trends in tax reform follow a similar logic as part of the toolkit that governments used to boost economic recovery after the onset of the global economic and financial crisis in 2007/2008. Governments generally reduced the rates and broadened the base for corporate income tax while increasing the rates for consumption or value added tax (VAT), a trend that had already started during the Washington consensus period when shortfalls in trade taxes due to trade liberalization had to be compensated. Such moves have made tax systems more regressive in terms of income distribution and gender equality, as both poorer people and women spend a higher share of their income on consumption goods. Explicit and implicit gender biases in personal income and indirect (value added and excise) taxes can reinforce existing inequalities through their impact on women’s participation in paid employment and unpaid care work.

Indeed, most developing countries have made little progress in more progressive instruments such as personal income tax (PIT)—which reaches only 2 percent of GDP on average versus 10 percent in OECD countries (table 6.2)—and few countries significantly raised property taxes as part of their fiscal consolidation efforts. Carbon pricing and environmentally related taxes have also made little progress (chapters 5 and 7).

Increasing tax revenues through reforms of corporate income tax (CIT) has led to mixed results. On the one hand, there were increasing receipts from CIT during periods of robust growth and high commodity prices, especially between 2003 and 2008. Argentina, for example, has raised CIT rates with relative success since the 1990s, up from 20 to 35 percent, now the highest rate in Latin America. In addition, it pushed through an administrative reform which allowed the tax agency to access bank information to detect and deter evasion. Finally, it managed to increase export taxes during the commodity and mining sector boom. As a result, between 2007 and 2012, Argentina increased its tax take by 8 percentage points, reaching the highest figure in Latin America with 37.3 percent of GDP in 2012. Other countries that have benefited from taxing rising business profits were Brazil, Chile and Uruguay as well as a number of countries in SSA and Asia. On the other hand, reaping the full benefits from CIT in developing countries (which often rely on the tax because large informal sectors and elite resistance limit income from PIT, see table 6.2) has been undermined by race-to-the-bottom style policies to attract FDI, and by tax evasion or avoidance practices by MNCs such as profit shifting.

Indeed, multinational tax avoidance delivers a major blow to development financing, to the tune of USD 100 billion annually. Illicit financial flows (IFFs) are pervasive in the developing world and have a huge impact on the world’s poorest economies. Between 2008 and 2012, average illicit outflows in Ethiopia were 1,355 percent of the foreign direct investment flowing into the country. Likewise, IFFs from Nicaragua were estimated to equal 20.4 percent of the country’s GDP. In Rwanda, illicit outflows were estimated at 51.7 percent of the government’s total tax revenues over the time span. In addition, corporate tax receipts are often affected by price volatility on international commodity markets, in particular in the mining sector, as can be seen in countries such as Bolivia, Chile or Mongolia from 2010 onwards.

Reform of international corporate taxation is a priority in international tax debates and was a key subject of the Addis negotiations. While innovative reform proposals are not in short supply (box 6.2), it is challenging to create a more transparent and fair international system, while at the national level unequal power relations and non-inclusive bargaining processes undermine better tax deals (see section below).
Finally, public revenues from mandatory social insurance contributions, mostly levied on both employers and employees, and which can be considered the most direct form of taxing income for social purposes, have increased in most developed countries as a result of maturing systems that have progressively incorporated more affiliates. Expansion of social insurance coverage in the Global South has, in some cases, been pushed by deliberate efforts to expand citizenship regimes, as is the case in various Latin American countries (Argentina, Brazil and Uruguay), although systems continue to favour organized formal sector workers as well as male employees.61

In the Global North, expenditure has often increased more quickly than revenues because ageing populations have led to higher health and pension spending, or due to redistribution measures within the group of insured toward those with lower income, caregivers or students, for example. This has prompted many countries to adjust contribution rates and benefit levels, and to increase subsidies from general taxation. On the other hand, while some developing countries have increased legal contribution rates and brought more people into insurance programmes, contribution revenues have stagnated, shifting the balance between contribution and tax financing of social insurance toward the latter.62 As figure 6.5 shows, public revenues (comprising mandatory social contributions and tax revenues) and social expenditure as a share of GDP are on average positively related to income.

The increasing importance of tax financing or public subsidies in social insurance systems is largely the result of two parallel processes: on the one hand, stagnation or decreases in collecting contribution revenues due to informality, unemployment or evasion, and as a result of market-oriented policies that aim to lower payroll taxes in order to make business more profitable;63 on the other hand, increases in tax-financed benefits such as cash transfers, social pensions or child grants in the context of poverty reduction strategies.64 Extension of non-contributory pensions in several Latin American countries has, for example, resulted in expenditures on social pensions reaching levels that are equivalent to 45 percent of contributory pensions in Argentina, over 30 percent in Bolivia, and over 75 percent in Trinidad and Tobago (figure 6.6). This new tendency of increased tax financing of social security benefits, such as pensions or child

Box 6.2. Reform of international corporate taxation

Calls for reform of international corporate taxation have increased over recent years, brought forth from a variety of perspectives. These include human rights advocates; investment experts; trade unions; civil society; and numerous multilateral organizations—all of whom vary in their ambitions. While the High-Level Panel on Illicit Financial Flows focuses on capacity building and transparency aspects of reform, the OECD Base-Erosion-and-Profit-Shifting (BEPS) initiative exemplifies an attempt to address deficiencies within the existing framework of tax governance. Media and international organizations are currently paying a high level of attention to BEPS, which aimed to close tax loopholes in the international tax system and was set up by G20 governments. One criticism of the process has been the exclusion of developing countries (although they were consulted by OECD in the BEPS process). But most developing countries do not have a place at the table where global corporate tax rules are set.a More ambitious proposals, such as the Independent Commission for the Reform of International Corporate Taxation (ICRICT) and International Centre for Tax and Development (ICTD)’s unitary taxation research, seek to reform fundamental inadequacies of the system by changing the way multinational corporations are taxed—from a set of separate individual companies to a globally integrated firm. The latter approaches respond best to the working of today’s globalized economy. However, it would require the greatest political will to scale up international cooperation.b A recent, major, reform proposal was the creation of an intergovernmental tax body within the United Nations that would replace the current UN Committee of Experts. The initiative failed, blocked by developed countries at the Addis Ababa conference in July 2015,—which insisted that tax cooperation should take place under the leadership of the OECD.c

Some countries have increased tax revenue and made systems more progressive

Despite multiple constraints and structural causes of low tax performance, some countries have managed to strengthen their capacity to tax and made the tax system fairer. Key questions are which political factors shaped reform outcomes, and what role the economic context and historical legacies played.

While most developing countries managed to increase the volume of tax receipts over the last decade, and some also increased social contributions, for example, pension contributions in Brazil and the Republic of Korea, the cases of Argentina and Uruguay represent success stories in making tax systems more progressive. In other countries, such as Brazil, India and Uganda, elites have defended their interests to the detriment of tax equity and universality. The key factors that can explain elites’ bargaining power and ability to shape tax reform in these cases (analysed below) include the organizational capacity of interest groups, their internal cohesiveness as well as their relations to the political sphere. Opposition to tax reforms by affected groups of taxpayers tends to be highest in the case of increases in corporate or personal income tax, as gains and losses are more easily
Identifiable for these taxes and taxpayers tend to be more organized, as the cases of Argentina, Bolivia and Chile illustrate.\textsuperscript{66}

\textbf{Opposition to tax reforms by affected groups of taxpayers tends to be highest in the case of increases in corporate or personal income tax}

In Chile, well-organized and cohesive business groups have traditionally opposed more progressive tax systems, and despite the fact that CIT could be raised after the return to democracy from 14 percent in the early 1990s to 20 percent in 2013, levels remain low compared with the Latin American average. This picture should gradually improve after implementation of the latest comprehensive tax reform adopted by the second Bachelet government in 2014, which sets out to raise more taxes from the richest percentile and the corporate sector to increase equity of the tax system and fund investments in education, health and social protection—a clear attempt to deepen the social contract in the country.\textsuperscript{67} Argentina, in addition to raising CIT (see above), also increased export taxes in the 2000s during the commodity boom, supported by an export-friendly exchange rate. However, frequent reforms that increased the tax burden on exporters as well as the effects of the financial crisis resulted in concerted action and mobilization by the formerly fragmented corporate groups in 2008,\textsuperscript{68} and eventually to the abolishment of most export taxes after a business-friendly government was voted into office in December 2015. In Bolivia, the government of President Sánchez de Lozada was inclined to follow the advice of the International Monetary Fund (IMF) and introduce an income tax on salaried employees to close a rising fiscal deficit in 2003. When the planned tax led to violent confrontations between the government and affected wage-earner groups, including the army and police, and a subsequent steep decline in government popularity, the government withdrew the reform proposal.\textsuperscript{69}

Resistance from high-income earners and large companies often obstructs reforms that aim to increase progressivity and equity in tax systems, especially if income and wealth are highly concentrated and a few big companies account for the majority of corporate tax revenues, which grants them considerable bargaining power.\textsuperscript{70} This is the case in India, where despite increases in direct taxation now accounting for 43 percent of revenues (2009/2010),\textsuperscript{71} the total number of taxpayers is still very low: approximately 3 percent of the population, or 35 million persons.\textsuperscript{72} The case of Uganda is similar: the tax system relies heavily on a small number of taxpayers, mostly multinational companies, with around 35 top taxpayers accounting for 50 percent of revenues collected by the URA.\textsuperscript{73} Revenue bargains between the government and investors have in the past often led to tax exemptions (for example, from VAT) or favourable conditions and guarantees (for example, in the case of the oil industry),\textsuperscript{74} shrinking the tax base and making future changes, for example, of investment agreements in the oil sector, more challenging. Lack of inclusiveness and transparency in tax negotiations adds to this result. Many tax deals are brokered behind closed doors, without participation of civil society organizations (CSOs) or parliamentarians. In contrast to international organizations such as the IMF, and large business actors, these actors are not well versed in the technical aspects of taxation, and lack the financial means that private actors have to engage in tax bargaining.\textsuperscript{75}

The case of the 2007 tax reform in Uruguay stands out because it aimed explicitly to enhance the equity and sustainability of the tax system, making it more transformative, and because reforms of the revenue system were part of broader and innovative social policy reforms extending social rights to the population (chapter 3), an illustration of successful policy integration. Interestingly, the reform was not met with major resistance from the high-income population, who were to be the “losers” of the reform. This can be explained by both political and economic factors. First, with the upper class ideologically and organizationally divided, and a comfortable majority of the left-wing party Frente Amplio in parliament at the time, economic elites lacked close links to the government in power, which in turn counted on a broad electoral constituency. Second, a context of robust economic growth and profit opportunities made increasing tax rates more palatable. And finally, support for the reform was garnered through the use of rigorous poverty, social and distributional analysis to inform policy dialogue and communication campaigns. As soon as the new law was passed, the tax collection agency, the Dirección General Impositiva (DGI/
**Uruguay stands out because it aimed explicitly to enhance equity and sustainability of the tax system, making it more transformative**

Tax Administrative Department, implemented a national information campaign, setting up advisory services throughout the country that allowed taxpayers to understand exactly how much tax they were going to pay under the new regime.76

The key innovative feature of this reform was the introduction of a dual personal income tax system (Impuesto a la Renta de las Personas Físicas/IRPF), which combined a progressive tax schedule for labour income with a low flat tax rate on capital income. The higher burden placed on labour income was, however, compensated for by a reduction of VAT rates and a broadening of the tax base. The results of the reform, which also included tax administration modernization measures, were: a growth in tax revenues at a yearly average of 7.3 percent, a decrease of the contribution of indirect taxes from 74 to 54 percent, and a growing contribution of direct taxes from 17 to 35 percent.77 As a consequence, the tax burden of the poorest taxpayers decreased while that of the richest grew, reducing income inequality by 2 Gini points.78

**Mobilizing resources from extractive industries presents challenges and opportunities**

Many of the countries that managed to scale up domestic revenues over the last decade, including those analysed in the previous section, benefited from a booming natural resource sector and rising international prices for agricultural, mining and fuel products, in particular between 2003 and 2010.79 Natural resource rents present opportunities for development, in particular in contexts where financial and fiscal resources are otherwise scarce. In many countries, it is the one avenue to development that is available. Realistically, not extracting the resources is often not an option—despite the recognition that the sector is intrusive to the environment, has high risks for pollution and disasters, and fossil fuel production and consumption exacerbates the problem of climate change (chapter 5).

Therefore, the opportunities of the sector in terms of transformation lie in using it to kick-start longer term development processes through structural change of national economies, sustained economic growth and overall improvements in the welfare of citizens. Yet many countries that base their development models on the extraction of resources have not been successful in ensuring longer term development.80 Indeed, there is research that sees mineral wealth as a "resource curse".81

Resource abundance, however, need not be a curse.82 Rather, it is the quality of political processes, policies and institutions guiding decisions about whether and how to extract resources, and how to capture, distribute and allocate natural resource revenues, that determines the economic and social yields from the sector, as well as the level of environmental costs society (both national and international) is willing to accept. As technical innovations are unlocking new natural resource stocks and driving new industries, how mineral wealth can be harnessed for development that is sustained, socially inclusive and minimizes the impacts extraction has on the environment, is becoming a pressing question.

Government revenues from the extractive industries (EI) can be substantial, although data tend to be poor. This holds true, in particular, for some developing countries (figure 6.7).

Using natural resource rents as a key financing source for sustainable development encounters several challenges:

- before revenues from the extractive sector can be spent through public policies, they have to be captured by the government;
- revenues from natural resources accruing to governments need to be distributed among producing and non-producing regions, which requires negotiations between different state levels; and
- in order to contribute to sustainable development, these revenues have to be allocated in ways which result in positive economic and social outcomes while minimizing negative environmental impacts.
Rent capture

Several of the country examples presented in the previous section show how governments have managed to get a higher share of rents from natural resource sectors and extractive industries. In the case of Argentina, this concerned windfall profits accruing to agricultural exporters, in particular of soybeans, in a context of rising world market prices and an undervalued national currency. High commodity prices, in particular of copper, allowed the Chilean government to push through a reform introducing an additional royalty payment on private mining in 2005. Several other Latin American countries increased business taxes, which then produced higher yields over the period, thanks to the boom in the commodity sectors.

Bolivia shows how increased rent capture from oil and gas production was driven by a failed resource bargain of the preceding government (the attempt to introduce PIT) and electoral promises of indigenous leader and later president Evo Morales to harness the country’s natural wealth for greater social justice and prosperity. The Morales government, which assumed power in 2006, managed to mobilize alternative revenues through the nationalization of the hydrocarbon sector, a measure that was called for during a referendum in 2004 and promised in the election campaign. A subsequent increase in fuel taxes through introduction of a direct tax on hydrocarbons complemented this domestic resource mobilization strategy. Nationalization was strongly supported by the electorate, in particular the social movements that had brought Morales into power. In addition, a combination of rising fuel prices, the specific design of the nationalization decree No. 28701 (which avoided direct expropriation, while increasing the stake and say of the government in the sector), and the strategy used by the government to renegotiate the 44 existing contracts with 12 gas and oil companies, yielded higher revenues for the government from the sector as well as greater autonomy in decision making and lower risks for the public sector. Revenues were used to finance a new social development strategy in a context of declining aid receipts (figure 6.8). After public revenue had stagnated at 31 percent of GDP between 1990 and 2005, it increased to 39 percent in 2006 and peaked at 48.4 percent in 2008. The shift in the financing mix toward higher shares of domestic resources (to over 80 percent of total social investment in 2014, see figure 6.8) was supported by booming energy prices and economic growth, so that the government boasted a fiscal surplus up to 2013.
Another case of significant rent capture from EI is Mongolia, which for several years has been one of the fastest growing economies in the world, thanks to its booming mining sector based on extraction of coal, copper, gold and other minerals. Per capita income has increased five-fold to USD 3,000 over the last decade, and in 2011, the economy grew by more than 17.5 percent. The world’s largest coal mine (Tavan Tolgoi) and the third-largest copper and gold mine (Oyu Tolgoi/OT) are located in the Gobi desert. Mongolia’s fiscal revenue from mining increased substantially after 2006 when a set of measures were adopted to capture higher mineral rents, most importantly, the introduction of a windfall profit tax, which at 68 percent of profits was the highest in the world. However, the sharp fall in global commodity prices cut the share of natural resources as a percentage of GDP from 58.9 percent in 2011 to 33.1 percent in 2013. More recently, in response to growing tensions with foreign investors and international financial institutions (IFIs), including a major tax dispute with the main investor in the OT copper mine, Rio Tinto, the tax regime has been made more investor-friendly, and tax rates as well as royalties have been lowered.

While Argentina, Chile and Mongolia have been relatively successful in capturing higher shares of resource rents, at least for some years, other countries struggle to strike favourable bargains with foreign MNCs, or rent capture is largely privatized in the hand of powerful elites, as in the Philippines and Zimbabwe.

**Rent sharing**

Extractive industries are by nature enclave industries, which is not only problematic in terms of economic diversification and linkage effects, but also for income equality across regions, an important equity indicator for sustainable development. In contexts where fiscal governance is decentralized and specific revenues are raised at subnational levels, revenue-sharing arrangements that equalize the receipts from mineral rents across regions can redress these tendencies. However, political factors such as the nature of the relationship between national and subnational political actors and the related degree of bargaining power of subnational actors, shapes the outcomes of bargaining processes between different state levels about rent distribution.

The case of Bolivia is again illustrative. With the introduction of the Direct Tax on Hydrocarbons (IDH) in 2005, the government adopted a distribution formula that devolves 63 percent of revenues from extractive industries to subnational actors such as municipalities and prefectures in total, in tandem with sharing resources across producing and non-producing districts. After assuming power, Morales and the Movimiento al Socialismo (MAS/Movement for Socialism) government revised the IDH distribution criteria, realizing that political opponents were using the revenues to build their own political base. The proposed formula recentralized tax revenues to finance centrally sponsored social

---

**Figure 6.8. Evolution of public investment and financing sources in Bolivia (2000–2014)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Public investment (USD, millions)</th>
<th>Internal resources (%)</th>
<th>External resources (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>2,000</td>
<td>10%</td>
<td>90%</td>
</tr>
<tr>
<td>2001</td>
<td>2,200</td>
<td>10.5%</td>
<td>89.5%</td>
</tr>
<tr>
<td>2002</td>
<td>2,400</td>
<td>11%</td>
<td>89%</td>
</tr>
<tr>
<td>2003</td>
<td>2,600</td>
<td>11.5%</td>
<td>88.5%</td>
</tr>
<tr>
<td>2004</td>
<td>2,800</td>
<td>12%</td>
<td>88%</td>
</tr>
<tr>
<td>2005</td>
<td>3,000</td>
<td>12.5%</td>
<td>87.5%</td>
</tr>
<tr>
<td>2006</td>
<td>3,200</td>
<td>13%</td>
<td>87%</td>
</tr>
<tr>
<td>2007</td>
<td>3,400</td>
<td>13.5%</td>
<td>86.5%</td>
</tr>
<tr>
<td>2008</td>
<td>3,600</td>
<td>14%</td>
<td>86%</td>
</tr>
<tr>
<td>2009</td>
<td>3,800</td>
<td>14.5%</td>
<td>85.5%</td>
</tr>
<tr>
<td>2010</td>
<td>4,000</td>
<td>15%</td>
<td>85%</td>
</tr>
<tr>
<td>2011</td>
<td>4,200</td>
<td>15.5%</td>
<td>84.5%</td>
</tr>
<tr>
<td>2012</td>
<td>4,400</td>
<td>16%</td>
<td>84%</td>
</tr>
<tr>
<td>2013</td>
<td>4,600</td>
<td>16.5%</td>
<td>83.5%</td>
</tr>
<tr>
<td>2014</td>
<td>4,800</td>
<td>17%</td>
<td>83%</td>
</tr>
</tbody>
</table>

Note: External resources include HIPC II debt relief as part of donations. Source: Paz Arauco forthcoming.
schemes, especially cash transfers for children and older persons (see below). To overcome resistance from subnational actors, the government negotiated maintaining the percentage of IDH revenue going to municipalities and only reduced the transfers to prefectures. This political move managed to neutralize a potential united front made up of municipalities and prefectures, while still having an equalizing effect across the country.95

In Mongolia, in order to ensure that the benefits of mining revenues trickle down to rural communities and promote equality between regions, the Budget Law and the Human Development Fund Law were amended in 2015.96 The amendment assigns 65 percent of mineral resource royalties to the centralized Human Development Fund (HDF) and 5 percent to the General Local Development Fund. Furthermore, the amendment requires 50 percent of exploration and production licence fees to be transferred to the Local Development Fund.97

While decentralization of revenues can exacerbate regional inequalities, it does not guarantee poverty reduction in regions where extraction takes place. Examples are Papua New Guinea, Peru and the Philippines, where a greater concentration of mining revenue in producing regions has not resulted in significant reduction of poverty.98

Rent allocation

The social outcomes of mineral-led development, an important element of its transformative potential, depend to a large extent on how fiscal revenues from the extractive sector are spent. Inclusive and transparent budgetary processes are likely to be conducive to more equitable results. While most of the resource bargains related to mining are made between governments and corporate actors, and sometimes also include the IFIs, distribution and allocation of mining revenues often becomes a subject of public debate, in particular in highly mineral-dependent countries (such as Bolivia or Mongolia) or where civil society and communities organize opposition against mining projects because of environmental or social concerns.99 Unless earmarked for special expenditure purposes, revenues from mining activities flow into the general budget and are spent according to the policy priorities set by the government. It is therefore the general policy framework and the quality of government institutions, in addition to the incentives arising from external factors such as donor preferences and international commodity and capital markets, that determine whether revenues are allocated and spent in sectors and projects with positive impacts on structural change and social development, and whether this is done in an efficient way.100 It also depends on the participation of specific social groups or their representatives in relevant policy processes, for example, women, children or community actors, and whether their specific needs are taken into account.101

Mongolia has chosen to spend an important part of the social budget—50 percent in 2013—on children.102 The Mongolian Child Money Programme, financed out of fiscal receipts from mining, was initiated in 2005 as a targeted social assistance programme, and was reformed subsequently into an unconditional grant, then a universal citizenship grant, and back to a universal and unconditional child grant in October 2012. The grant now covers all children under 18 years of age—994,000 children, a coverage rate of 99 percent—with a monthly transfer of tugrik 20,000 (USD 14.30)—1.5 percent of GDP— in 2014.103

In Bolivia, Renta Dignidad, a universal social pension for citizens introduced in 2008, is financed by taxes on oil and gas production, together with profits of state-owned companies. The pension reaches 91 percent of Bolivians over age 60, compared with just 14 percent covered by contributory pensions, and costs around 1 percent of the country’s GDP.104 It has resulted in significant increases in income and consumption, and reductions in poverty rates, which have declined by an estimated 14 percent.105 Similarly, Bono Juancito Pinto, a cash transfer introduced in 2006 to enhance school access, attendance and completion, and Bono Juana Azurduy, a mother-child cash transfer programme introduced in 2009, have helped to make inroads into entrenched inequalities and poverty.106 Bono Juancito Pinto is fully financed by the direct tax on hydrocarbons (IDH). Bono Juana Azurduy is financed mainly by the IDH, but also from resources from international development cooperation.107

Social outcomes of mineral-led development, and therefore its transformative potential, depend to a large extent on how fiscal revenues from the extractive sector are spent.
4. Toward a Progressive Fiscal Compact: Resource Mobilization and Transformative Change

DRM is a political process of contestation and bargaining over who pays and who benefits. This process is marked by differences and asymmetries of power at different levels, from the local to the global. Building coalitions for progressive reforms, through which the rich pay relatively more than the poor, and overcoming political obstacles, are preconditions for creating transformative eco-social fiscal contracts. This is easier in times of growth that produces decent work, in contexts of greater state capacity, where resource bargains are more transparent and inclusive, and where national bargains are supported by global bargains, the latter providing resources (finance, technology and capacity building), and regulation (for example, against illicit flows and tax evasion).

Achieving the SDGs will require resource bargains that propel transformation

Country examples analysed in this chapter demonstrate that financing debates cannot be separated from questions on how resources are spent. Implementing the SDGs requires both more and better finance. Financing strategies can contribute to economic development, environmental sustainability and progressive redistribution while also strengthening societal links between different population groups and between citizens and governments. The concept of the resource bargain used in this chapter connects public social policy to how governments extract resources from citizens, investors and donors in ways that create or consolidate a social contract.

Transformative resource bargains are inclusive and transparent and establish links with social policy

The links between revenue mobilization and social spending are most visible in taxation. Taxation, like no other source of state revenue, can embody a purposeful and mutually accountable state-citizen relationship where public services are provided in exchange for the payment of taxes by citizens and corporate actors. Earmarked taxes as well as social contributions maximize this contribution-benefit link, which can be beneficial in terms of increasing compliance with contributory obligations. Bringing more citizens into such bargains with defined benefits, as was shown in the cases of Brazil and Uruguay, is therefore crucial for strengthening state-citizen relations. Resource bargains enhance transparency and legitimacy in the use of revenues, which can yield positive governance returns and claims making on public policy. Such resource bargains can also raise tax collection through building a tax culture and expanding the pool of taxpayers, and they provide incentives for citizens to hold governments to account on revenue distribution and allocation, contributing to greater budget transparency and spending efficiency.

The analysis of different country experiences with tax reform, in particular the Latin American cases discussed in this chapter, has helped to identify a range of factors that are conducive to increasing tax capacity and equity. These include political leadership and bargaining power vis-à-vis elites and big corporations, design and marketing of reforms (including information campaigns), technological innovations (to improve tax enforcement and administrative efficiency), inclusive and transparent bargaining processes, a positive growth context, extension of citizenship rights, and electoral competition.

When policy reforms related to rent capture or rent distribution from extractive industries or natural resource sectors have been linked with social policy, countries have benefited more from EIs, as seen in Bolivia and Mongolia. However, increasing social spending, while a necessary condition, is not sufficient. Mineral-led development also hinges on macroeconomic policies and productive strategies that foster diversification while safeguarding stability and environmental protection. In turn, investments in education, health and the knowledge economy support productive diversification, and create an enabling environment for development. Investing in future generations, for example in child development and human capabilities through education and health policies, can extend yields from revenues beyond the lifespan of mining sites. This requires, however, that the interests of children and other social groups, for example,
women, are represented in mining revenue bargains and budget processes, a condition that international organizations and advocacy groups should closely monitor.111

The financing mix for funding the SDGs should support the eco-social turn

The financing mix in a particular country should be diversified and move away from instruments that do not support the transformative vision of the SDGs. Instead, financing policies, including of national and international development banks, need to support policies and activities that facilitate an eco-social turn.

Taxation systems, if progressively designed (so that tax rates increase with income level), can contribute to redistribution and improve equality, including gender equality. They can be used to provide incentives for more sustainable consumption and production patterns, and they contribute to inclusive growth and human rights by financing income guarantees and universal social services. Country examples discussed in this chapter have shown some successes in increasing taxes on higher income groups or corporations (for example, Argentina, Bolivia and Chile), and to reduce the burden of consumption taxes, which are especially detrimental for poor people and women (for example, Uruguay). More innovative instruments such as environmental taxes or taxes on harmful economic activities, including short-term speculative capital inflows, are used less for fear of deterring investors, but they are increasingly discussed and some countries have included them in recent tax reform packages.112 It is such instruments that have the greatest potential for transformative change.

Mineral rents provide resources for developing countries which are often stripped of other types of funding sources. But they pose risks and challenges with regard to their impacts on structural change, employment, gender equality and environmental protection. While improving the governance of rent distribution and allocation is crucial for harnessing the transformative potential of these resources, the ultimate recommendation is to diversify away from mineral dependence, both in the interest of developing more dynamic economic sectors with greater employment and innovative potential and for safeguarding the environment.

National resource bargains need to be complemented by global bargains

Aid is often said to undermine efforts to mobilize domestic resources such as tax, which may be politically difficult to implement113—a hypothesis confirmed in the case of Bolivia’s failed attempt to introduce an income tax in 2003, though the revenue alternative in Bolivia was not increased aid, but nationalization of the oil and gas sector. However, evidence is not entirely conclusive on this point, and even in Bolivia it only holds true for the failed PIT reform, whereas other tax reforms under Morales, such as implementation of new taxes and tax administration reforms, have been implemented successfully, complementing resource mobilization from EI and aid.114 Aid can also have a catalytic effect on mobilizing additional domestic resources for social policies, especially in low-income settings. This has been the case where foreign aid actors gave weight to national actors in support of social policy and helped upgrade public institutions entrusted to deliver social services, as the example of several social protection programmes in sub-Saharan Africa and the impact of aid funding on the longer term sustainability of these programmes has shown.115

Whether aid has a transformative effect depends on how sustainable and reliable it is, how it is distributed and allocated, and whether it enhances state accountability and institution building. This is an ongoing debate, especially as emerging donors as China, or the Alianza Bolivariana para los Pueblos de Nuestra América (ALBA/Bolivarian Alliance for the Peoples of our America) at the regional level, have a different approach to policy conditionality compared with the IFIs and traditional Western donor countries. Their approach is welcomed by many recipient governments in Africa and Latin America,116 but equally criticized by civil society for lack of transparency and accountability mechanisms.117 In the context of the SDGs and the Addis agreement, donors promised to relate aid more closely to DRM by strengthening tax capacity and combating illicit flows and tax avoidance practices by MNCs.118 And while the ultimate goal of many developing countries is to grow out of aid dependency, global resource mobilization will continue and become more relevant to fund cross-border challenges such as migration, climate change and humanitarian disasters, and global public goods.119
The transformative potential therefore lies in linking global resource bargains with national bargains and long-term institution building. Domestic resource bargains can in this way be supported by global bargains through the provision of resources such as capacity building and finance, and regulation, for example, against illicit flows, tax evasion and productive activities with adverse impacts on the environment. Box 6.3 presents an example of how a global fund for social protection could support implementation of national social protection floors in countries that are currently unable to mobilize sufficient domestic resources.

Box 6.3.
A global fund for social protection

In June 2012, the global community adopted ILO Recommendation No. 202, deciding that all countries have to ensure access to at least a minimum level of social protection to their citizens. Such basic elements of national floors of social protection constitute a vital investment in social and economic development, and are affordable in most countries. While R202 states explicitly in Article 12 that “National social protection floors should be financed by national resources”, some countries cannot yet meet the financing requirements. For instance, estimates on government revenue increases required between 2015 and 2030 to meet the social protection targets of the SDGs in selected Asian countries range from 4.9 to 12.1 percent for Cambodia, 9 to 12.8 percent in Lao PDR, and 5.2 to 14.9 percent in Nepal. A one option to extend national social protection systems in such settings is a global solidarity financing mechanism that pools resources and redistributes them between states, organizations and individuals. Article 12 of R202 recognizes this need, stating that “members whose economic and fiscal capacities are insufficient...may seek international cooperation and support that complements their own efforts”. A global fund that finances the extension of national social protection schemes could also serve as a reinsurance mechanism in the case of major shocks, become an important instrument of global social policy and lay the foundation for a national social contract with more comprehensive domestically financed social protection in the longer run.

Source: Adapted from Cichon 2015.

Public policies need to support an enabling environment for DRM

While many revenue sources have the potential to contribute to transformative change as defined in this report, realization of this potential depends not only on the specific design of policies, but also on whether financing strategies are supported by an enabling environment. Enabling factors at the national level include economic policies which support labor-intensive growth, are conducive to structural change, and lead progressively to higher rates of formalization, household income and equality. Other enabling factors are investments in state capacity, both in terms of capacity to create political consensus and support for progressive reforms, and to broker investment deals with MNCs that are favourable for the country, and administrative capacity to implement reforms and enforce compliance with tax laws and regulations, especially by high-income earners and big corporations.

At the global level, enabling factors are more equitable and inclusive trade and financial regimes; access to affordable and stable external funding and debt restructuring/relief; effective regulation and monitoring of the international financial system in order to avoid systemic crisis, illicit flows and tax evasion; and reforms of international institutions leading to more equal power relations between the Global North and the Global South.

5. The Way Forward: Implications for Policy

This chapter provides guidelines for policy makers in the design of more sustainable and transformative financing strategies (adapted to their specific context), with positive impacts on economic, social and environmental outcomes. It also identifies necessary reforms at the international level that are likely to increase vertical coherence between global regimes and national efforts to expand fiscal space and to make fiscal policy more sustainable. Policy makers should be finely attuned to the political nature of resource bargains, and to the need for policy integration of revenue and expenditure policies.
In order to mobilize more and better finance at national, regional and global levels, the chapter suggests the following measures.

- Actual and potential taxpayers and other relevant stakeholders need to be involved in transparent and inclusive tax bargains that establish links with social policy. They need to hold governments to account for the agreed distribution and allocation of resources.

- The financing mix at the national level should be diversified and move away from instruments that do not support the transformative change envisioned in the 2030 Agenda. Instead, financing policies need to support policies and activities that facilitate an eco-social turn.

- An enabling environment for resource mobilization needs to be built, based on macroeconomic policies that foster labour-intensive and sustainable growth and structural change, as well as administrative capacity and technological innovations that facilitate tax enforcement and promote efficiency.

- Domestic resource bargains need to be supported by global bargains, providing resources (capacity building and finance) and regulation (for example, to prevent illicit financial flows, tax evasion and environmental damage caused by productive activities).

- Global governance regimes need to be reformed, in particular the international financial architecture, to be more coherent with sustainable development and the SDG vision of partnerships.

Endnotes

1. ODI et al. 2015.
2. According to a joint report by Development Finance International and Oxfam, 77 percent of spending on the Millennium Development Goals (MDGs) came from government revenues, with taxation accounting for around three-quarters of government revenue in all income groups. See Oxfam and DFI 2015 and Moore 2013: 7. Except for high-income non-OECD (Organisation for Economic Co-operation and Development) countries, which are largely oil-rich countries. See also table 6.2. See Development Committee 2015.
4. UNCTAD 2014: 140.
5. Within sub-Saharan Africa, the financing gaps as percentage of GDP (USD 1.90/day in 2011 PPP, 2012) range from 0.9 for South Africa to 31.0 in Malawi, 32.9 in Burundi and 44.9 in the Democratic Republic of Congo. In Latin America, Costa Rica and Uruguay are already ensuring a social protection floor, while Haiti displays the greatest financing gap at 16.1 percent of GDP (Bierbaum et al. 2016).
7. Similar goals are stated in the SDGs (for example, targets 1.b, 8.10, 9.3,10.5, 10.6, 10.b, 16.4 and 17.1) as well as in the COP 21 agreement.
8. For a discussion of other financing instruments, see UNRISD 2010: chapter 8.
11. However, most countries will not be completely self-sufficient. External resources—such as aid and debt instruments—or more innovative approaches using blended finance and multistakeholder arrangements—such as Global Funds or international PPPs—will be used to finance the SDGs, especially in contexts where DRM is less successful. While foreign capital can indeed play a useful role in financing the SDGs, and FDI can help promote domestic productive capacity, part of the challenge is that an increasing proportion of the inflows are of a short-term, more risky and speculative nature, while debt levels quickly become unsustainable in the wake of economic crises and currency devaluation. This calls for close monitoring and effective debt restructuring mechanisms, especially in the case of sovereign debt default.
14. GDP (in 2013 prices) in low- and middle-income countries increased by 7.2 times from 2000 to 2014.
15. UN DESA 2015, based on data from OECD.
17. Rising inequality requires more fiscal spending while driving down fiscal revenues (UN DESA 2015: 26, Moore 2013).
18. Growth patterns vary according to country context and policy regime (see UNRISD 2010), but shared features are increased interdependence between countries, dependence of LICs and MICs on volatile commodity markets, and frequent global crises.
19. UNRISD 2010b; UN 2015.
21. The chapter draws mainly on new research findings and in-depth country case studies from two recent UNRISD projects, for further information see www.unrisd.org/pdrm and www.unrisd.org/eiandchildren.
The literature on debt sustainability, an important component of fiscal sustainability, is vast—at a minimum, variables such as a country’s growth rate, exports, remittances, interest rates, revenue elasticities, composition of existing debt in terms of interest rates, maturity, currency denomination and so on, have to be taken into account (see Heller 2005). For a broader concept of fiscal space, see Roy et al. 2007; Development Committee 2006. Investor confidence plays an important role for how much debt can be issued, which is also backed up by factors such as political or military power.


The abolished tax was compensated for by a 1 percent increase in VAT, a tax that is administered by the central government. This led to a power shift from local governments, some ruled by the opposition, toward the central government (Kangave and Katusiimeh 2015).

There is also the option to reallocate existing spending according to new priorities, and to make expenditures more efficient; one prominent example is to reduce defence spending, or to remove fossil fuel subsidies and replace them with cash transfers (chapter 2; see also a variety of country examples in Ortiz, Cummins and Karunanethy 2015). There is also a debate on using social funds or sovereign wealth funds, including central bank reserves, for public investments. This, however, requires a careful analysis of associated benefits and risks considering the primary purpose of the fund or reserves.

Bangura 2006.

The interested reader will find a vast literature on issues of finance for development with a focus on debt and financial sector instruments. On financing social policy, see UNRISD 2010: chapter 8; Hujo and McClanahan 2009, as well as Bastagli 2015 and ILO 2014: chapter 6.5.

Moore 2013; Bird 2012.

A major explanation for high taxation in the labour reserve economies of Southern Africa was the racially exclusive welfare regimes that were set up for the white minority population, while the reliance on a large low-wage sector resulted in minimal social protection for the native population and reliance on communities and households (Mwandawire 2016, 2010).

Schneider 2015.

The interested reader will find a vast literature on debt sustainability, an important component of fiscal sustainability, is vast—at a minimum, variables such as a country’s growth rate, exports, remittances, interest rates, revenue elasticities, composition of existing debt in terms of interest rates, maturity, currency denomination and so on, have to be taken into account (see Heller 2005). For a broader concept of fiscal space, see Roy et al. 2007; Development Committee 2006. Investor confidence plays an important role for how much debt can be issued, which is also backed up by factors such as political or military power.


The abolished tax was compensated for by a 1 percent increase in VAT, a tax that is administered by the central government. This led to a power shift from local governments, some ruled by the opposition, toward the central government (Kangave and Katusiimeh 2015).

There is also the option to reallocate existing spending according to new priorities, and to make expenditures more efficient; one prominent example is to reduce defence spending, or to remove fossil fuel subsidies and replace them with cash transfers (chapter 2; see also a variety of country examples in Ortiz, Cummins and Karunanethy 2015). There is also a debate on using social funds or sovereign wealth funds, including central bank reserves, for public investments. This, however, requires a careful analysis of associated benefits and risks considering the primary purpose of the fund or reserves.

Bangura 2006.

The interested reader will find a vast literature on issues of finance for development with a focus on debt and financial sector instruments. On financing social policy, see UNRISD 2010: chapter 8; Hujo and McClanahan 2009, as well as Bastagli 2015 and ILO 2014: chapter 6.5.

Moore 2013; Bird 2012.

A major explanation for high taxation in the labour reserve economies of Southern Africa was the racially exclusive welfare regimes that were set up for the white minority population, while the reliance on a large low-wage sector resulted in minimal social protection for the native population and reliance on communities and households (Mwandawire 2016, 2010).

Schneider 2015.

The interested reader will find a vast literature on issues of finance for development with a focus on debt and financial sector instruments. On financing social policy, see UNRISD 2010: chapter 8; Hujo and McClanahan 2009, as well as Bastagli 2015 and ILO 2014: chapter 6.5.

Moore 2013; Bird 2012.

A major explanation for high taxation in the labour reserve economies of Southern Africa was the racially exclusive welfare regimes that were set up for the white minority population, while the reliance on a large low-wage sector resulted in minimal social protection for the native population and reliance on communities and households (Mwandawire 2016, 2010).

Schneider 2015.
Arellano and Acosta 2014: table 1.

Arellano and Acosta 2014.


EITI 2015: 105.

Hujo et al. forthcoming; Arellano and Acosta 2014. In the case of Papua New Guinea, this is said to result from distribution of mining rent to the traditional landowner elite (Macdonald forthcoming) and lack of comprehensive national social programmes, while in the case of the Philippines it seems to be related to structural conditions of widespread poverty and lack of social services in the concerned communities; insufficient direct impacts on livelihoods through employment generation in the sector; and budget decisions of local authorities, which often do not prioritize social spending in their communities (Magno 2016). In Peru, in addition to the pervasive lack of managerial capacity in the subnational governments, political incentives for short-term spending, rent seeking, and the distortion of local labour and services markets have been responsible for the lack of positive results (Arellano and Acosta 2014).

Examples for this are Nicaragua and the Philippines: see Gutierrez 2015; Njem Singh et al. 2016.

See UNRISD-UNICEF project on Extractive Industries and Children, www.unrisd.org/eiandchildren. Participatory budget processes at local levels as well as child or gender budgeting are useful tools in this regard.

One example is Chile’s tax reform under President Bachelet in 2014, which in addition to corrective taxes (on tobacco, alcohol and sugar-rich beverages) has included a carbon tax targeted at the power sector to reduce carbon dioxide emissions from 2018 onward (Cossio and Andres 2016). For a discussion of ecological fiscal reforms in Latin America, see Fanelli et al. 2015.


Bibliography


Fanelli, José María, Juan Pablo Jiménez and Isabel López Azcúnaga. 2015. La reforma fiscal ambiental en América Latina. Documento de Proyecto. Santiago de Chile: CEPAL and EU.


