



Private Sector Development and Growth in Developing Countries: The Role of Tax Policy and Administration

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About this report

The K4D Emerging Issues report series highlights research and emerging evidence to policy-makers to help inform policies that are more resilient to the future. K4D staff researchers work with thematic experts and DFID to identify where new or emerging research can inform and influence policy.

This report is based on ten days of desk-based research.

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1. Overview

Strengthening domestic revenue mobilisation in partner countries through efficient, effective, fair and transparent tax systems has received particular attention from the international development agenda in recent years. Vital tax systems will play a crucial role to improve the long-term development prospects of low-income and emerging economies, thereby becoming an important means of implementation for the United Nations Sustainable Development Goals (SDGs). Against this backdrop, many donor countries have decided to intensify their work to domestic revenue mobilisation over the next years. The launch of the Addis Tax Initiative (ATI) at the third Financing for Development Conference in Addis Ababa (2015) provided a landmark in this regards. Development partners joining the ATI commit to collectively double their support to domestic revenue mobilisation and taxation until 2020¹.

The support for tax systems is thereby likely to impact developing countries on a broader scale. Although taxation is first and foremost about raising revenues for financing public goods and services, sound tax policies and effective tax administrations also play an important role for achieving broader social, economic and governance objectives, such as promoting investment and equity, reducing social and economic ills, or strengthening governmental accountability. Tax systems therefore directly impact the development of a competitive private sector and developing countries' prospects for inclusive economic growth through a variety of often interrelated channels.

This rapid review seeks to provide a brief overview on recent contributions to the literature, which is complemented by some empirical findings. A particular focus is on contributions from international organisations that are active in the field of taxation and development, including the Organisation for Economic Development and Cooperation (OECD), the World Bank Group and the International Monetary Fund (IMF), as well as academic work from peer-review journals. Where applicable and useful, the study relates to high-level commitments made by the international community, most notably those of the Addis Ababa Action Agenda. Due to the time frame and the complexity of the topic, the level of detail is limited. This is also due to some gaps in the literature, which might require further research.

A key finding of the report is that there is no generic relationship between taxation (e.g., as expressed by the tax-to-GDP ratio), inclusive development, and the formation of a competitive private sector, which is one of the main drivers of economic growth. By contrast, the role of taxation for economic development is highly complex and requires a more broad-based analysis. The report therefore adopts a holistic perspective by addressing issues that are related to both, tax policies and tax administrations, as well as their interrelations. It also goes beyond the direct economic implications of taxation on growth and discusses normative questions that are related to equity, governance and their impact on growth.

The main findings can be summarised as follows:

Structural factors and good governance

¹ The UK, one the ATI founding members, is highly active in the field of taxation and development. According to the ATI Monitoring Report 2015, the UK is the largest contributor among the ATI development partners and spent USD 47.2 million to support tax policy and administrations in developing countries, which comprises more than 20% of ATI development partners' contributions (Addis Tax Initiative, 2017).

- Low-income countries were able to increase revenue collection (as measured by the tax-to-GDP-ratio) over the last years, but still mobilise much fewer taxes than higher income countries.
- The tax-to-GDP ratios in low-income countries are, on average, slightly below the minimum threshold that is considered necessary for sustainable growth.
- Tax structures (i.e. the relative importance of different taxes) can have serious impacts on growth. Developing countries still tend to rely to some extent on taxes that are economically distorting (such as trade taxes) and thus less growth-friendly than others.
- Good governance and a vital relationship between taxpayers and the state have an important role for state-building and economic growth.

Tax policies

- Taxation of the informal sector can be an important measure to improve growth and productivity, but the effects depend on several factors such as firm-size and policy channels.
- Tax policies aimed to attract domestic and foreign direct investments, such as tax incentives and special tax regimes, are frequently used in developing countries. However, the empirical literature on their effectiveness is very limited and suggests that tax incentives are often not effective in promoting investments.
- The topic of tax certainty has recently received broad attention on the G20 level and might be also important for developing countries. Tax (un)certainty is significantly linked to cross-border transactions, trade, investments and compliance.

Tax administrations

- Developing countries often face capacity constraints in revenue administrations, which can give rise to poor performance.
- Local firms operating in developing countries face significantly larger tax compliance costs than those in high-income and OECD countries.
- Tax compliance costs and tax administration performance can have a significant impact on private sector development, as they negatively affect new market entries as well as firm productivity and growth.

Potential research gaps can be generalised as follows:

- *Lack of empirical literature on developing countries.* Many empirical studies on taxation and its particular role for growth cover high-income and OECD countries rather than developing countries. Although these studies can serve as an input for discussion, they do not allow to draw any general conclusions for developing countries.
- *Reliability and comprehensiveness of data.* The lack of empirical literature is often driven by the absence of appropriate data. Data for developing countries is generally scarce and often of poor quality. This observation holds for many topics covered by this Helpdesk Report. Sometimes data is also non-public, as in the case of the Tax Administration Diagnostic Assessment Tool (TADAT).
- *Integrated analysis of taxation and growth.* The effects of taxation on growth and development are complex and might require additional efforts for an integrated analysis, which at the same time takes into account tax design considerations, the impact of revenue administrations and the effect of other “soft” factors related to good governance.

2. Taxation and growth in developing countries

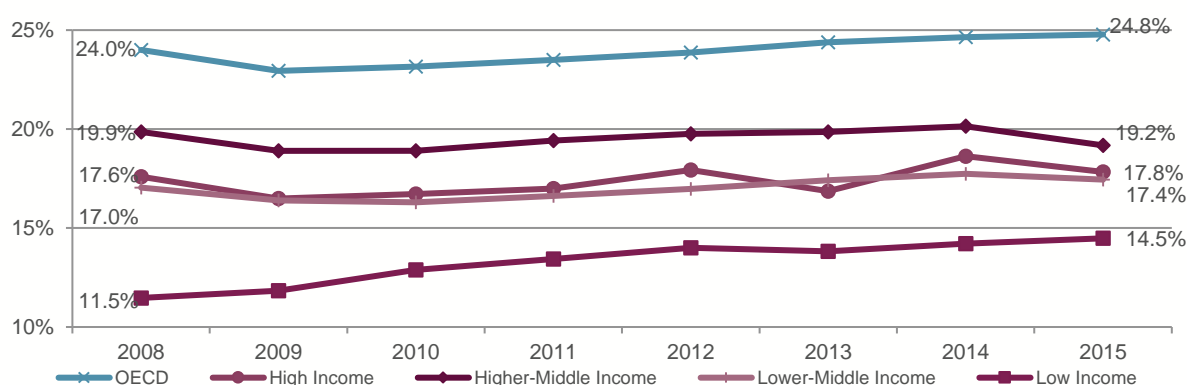
This section addresses the question of how taxation affects inclusive growth, and how tax systems impact the development perspectives of low-income and emerging economies. This general overview shall lay the foundation for the more detailed analysis of the role of tax policies and administrations in the following sections.

The relationship between tax ratios, tax structures and growth

Tax-to-GDP ratios and development

The tax-to-GDP ratio (i.e., tax revenues as a percentage of GDP) is a commonly used indicator for assessing a countries' overall revenue collection (Prichard, 2016a). Cross-country comparisons have shown that low-income economies tend to rely on much lower tax-to-GDP ratios than high-income or OECD countries (Besley & Persson, 2014). Figures 1 and 2 below give an impression of the relationship between country income level and tax revenue mobilisation. The figures show the average tax-to-GDP ratios for different country income groups and OECD countries, covering the period from 2008-2015:

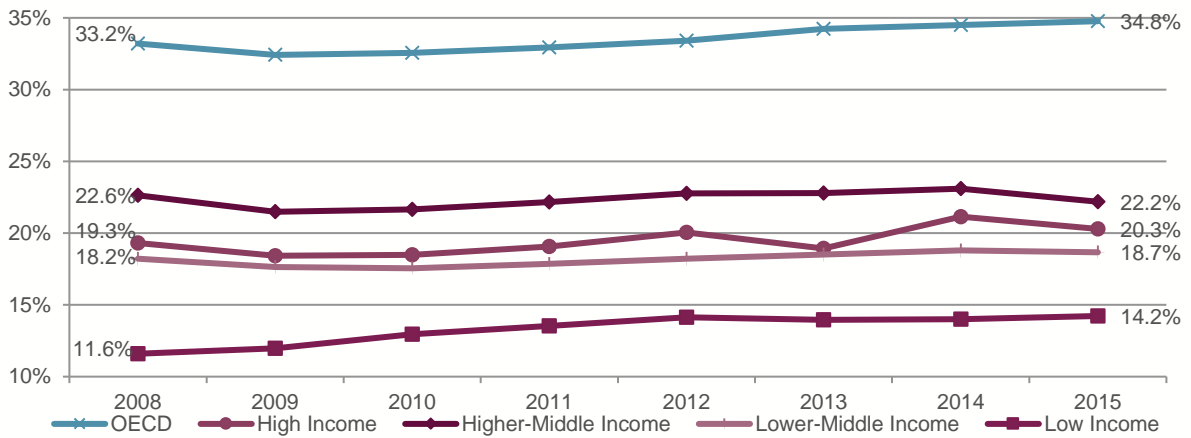
Figure 1: Tax revenues (% of GDP), excluding social security contributions



Source: ICTD Government Revenue Dataset (2015).

Figure 1 shows that tax revenue mobilisation has increased in low-income countries between 2008 (11.6%) and 2015 (14.5%). The average value of 14.5% is, however, still 10.3 percentage points below the average tax-to-GDP ratio in OECD countries (Figure 1). The other country groups achieved tax-to-GDP ratios in the order of 17% to 19% of GDP, which is also larger than the average of low-income countries (14.5%). The difference between OECD and low-income countries becomes even more apparent when social security contributions are included in the tax-to-GDP ratio (Figure 2). In this case, the difference rises to more than 20 percentage points.

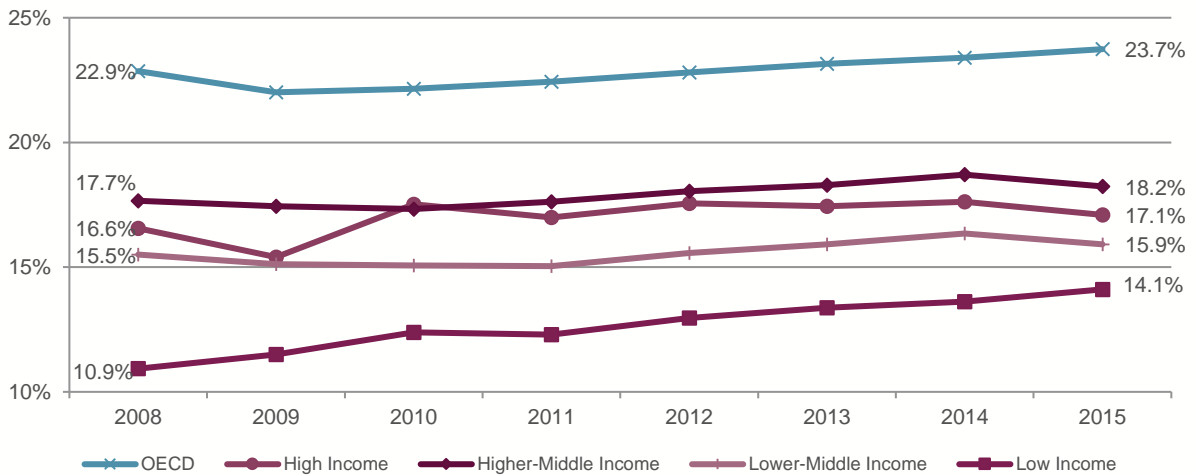
Figure 2: Tax revenues (% of GDP), including social security contributions



Source: ICTD Government Revenue Dataset (2015).

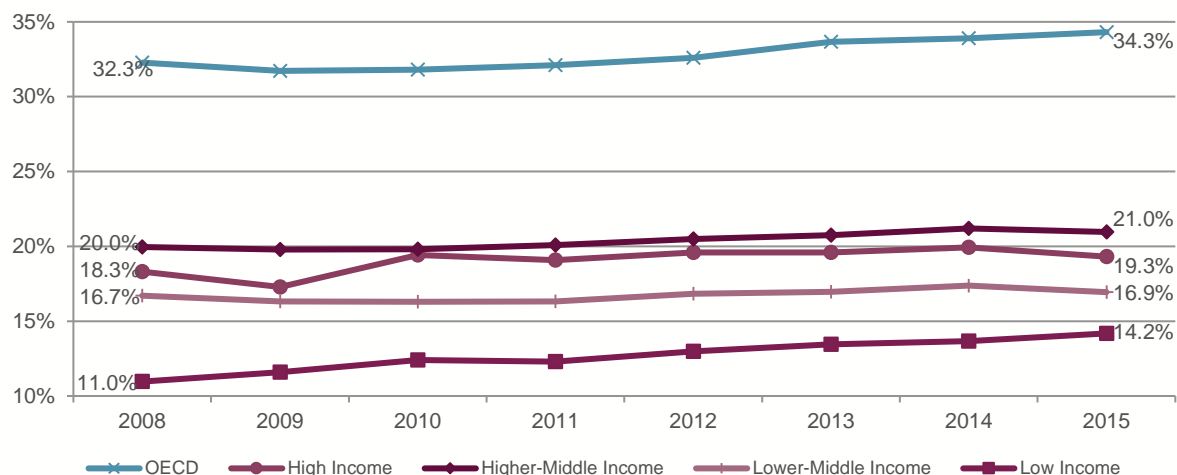
Figures 3 and 4 show a similar pattern, but in this case only cover non-resource tax revenues. As argued by Prichard (2016a), resource taxes are a much more volatile source of state revenues. Given their lack of predictability and robustness, they can pose some serious fiscal stress on countries.

Figure 3: Non-resource tax revenues (% of GDP), excluding social security contributions



Source: ICTD Government Revenue Dataset (2015).

Figure 4: Non-resource tax revenues (% of GDP), including social security contributions



Source: ICTD Government Revenue Dataset (2015).

A minimum tax-to-GDP ratio for sustainable growth

Although the Addis Ababa Action Agenda (UN, 2015) sets no specific revenue targets for developing countries, it has been frequently argued that there might be a minimum tax-to-GDP ratio necessary for sustainable growth. The United Nations, for instance, proposed that a tax-to-GDP ratio of 20% would be consistent with the Millennium Development Goals (UNDP, 2010). Another common threshold, which has long been advocated by international organisations, has been set at a value of 15% (Prichard, 2016a). This value is slightly larger than the observed tax-to-GDP ratio for low-income countries. In spite of the common use of revenue thresholds, there appears to be a lack of empirical support for these minimum values, which Prichard (2016a, p.52) describes as “somewhat arbitrary”.

There is, however, some recent empirical work on the topic. In an IMF study, Gaspar et al. (2016) estimate a tax-to-GDP ratio of roughly 12.9% as a “tipping point” for economic development. Countries exceeding this threshold are supposed to show a sharp and sustainable rise in subsequent GDP growth due to a shift in social norms. The results suggest that, after a period of ten years, the per-capita income in countries just above the tipping point is 7.5% larger than in similar countries below that point. As the authors argue, there is an inherent relationship between a state’s capacities to tax, the social norm of paying taxes, and economic development. A country that is able to improve its tax capacities above the tipping point can demonstrate its effectiveness and legitimacy to the taxpayers. They will regard it as their civic duty to pay taxes on a voluntary basis rather than as a result of pure coercion. Growth is finally triggered through various channels, including improved public spending, formalisation of firms and individuals, and the reduction of market entry barriers such as corruption (Gaspar et al., 2016).

The line of reasoning of Gaspar et al. (2016) emphasises the fact that there is no simple relationship between the tax-to-GDP ratio and growth. Instead, governance and other normative considerations play an important role when it comes to the question how tax systems (directly and indirectly) affect economic growth and private sector development.

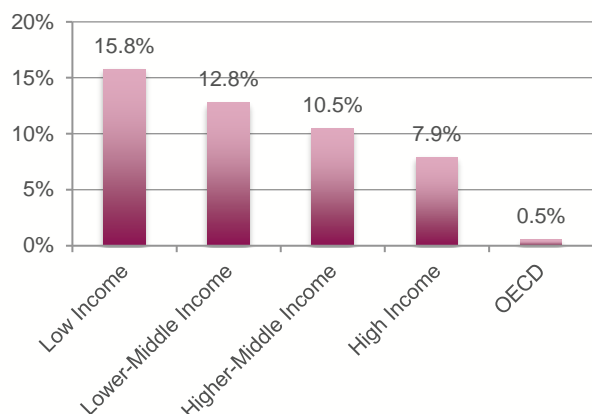
The effect of tax structures on growth

Developing- and higher-income countries do not only differ in their overall level of taxation (as expressed by the tax-to-GDP ratio), there are usually also significant differences in the relative importance of different tax revenue sources (“tax structure”). Developing countries often focus on taxes that are relatively easy to collect, such as taxes on international trade and transactions, as well as on consumption taxes (Besley & Persson, 2014; Morrissey et al., 2016). In ATI partner countries, for instance, the share of taxes on international trade and transactions accounted to 15.5% of tax revenues, compared to 0.5% for ATI development partners (Addis Tax Initiative, 2017). In addition, direct taxes are usually less important than in high-income countries and much more focused on corporate income taxes (CIT) than on personal income taxes (PIT) (McNabb & LeMay-Boucher, 2014). Figure 5 provides an overview on the relative importance of different taxes (as a percentage of non-resource tax revenues) in low-income and other countries. The results are in line with the facts presented above.

Figure 5: Relative importance of different tax types (% of non-resource tax revenues)



(e) Taxes on International Trade and Transactions



Source: ICTD Government Revenue Dataset (2015).

It is a common prediction that some tax structures are less economically distorting and thus more growth-friendly than others (McBride, 2012; Prichard, 2016a). The IMF and other international institutions have advocated that developing countries should put stronger emphasis on consumption taxes instead of trade taxes, and to reduce corporate- and personal income tax rates (Prichard, 2016a). In the same vein, the 2008 OECD Report on “Tax and Economic Growth” proposed a “ranking” of taxes with respect to their effects on economic growth, with taxes on immovable property having the least negative impact on long-term growth, followed by consumption taxes, personal income taxes, and corporate income taxes² (Johansson et al., 2008).

This international advice is supported by a series of empirical studies. In a systematic review of the empirical literature, McBride (2012) summarises the results of 26 academic studies. Most of these studies find a significant negative effect of taxation on growth, particularly when revenues are generated via the CIT or the PIT. The results of the studies, however, mostly apply for higher income countries rather than for developing countries, which makes it hard to derive any general conclusions. Prichard (2016a) relates this lack of evidence for developing countries to the generally limited data coverage for these countries.

In one of the studies using data for developing countries, Acosta-Ormaechea & Yoo (2012) find a negative effect of direct taxes on GDP growth rates in high- and middle-income countries, while consumption taxes have an opposite effect. For low-income countries, however, Acosta-Ormaechea & Yoo (2012) do not find any significant results. Using a similar econometric approach, McNabb & LeMay-Boucher (2014) study the growth effects of revenue-neutral changes in the tax structure. Their results suggest that reducing trade taxes in favour of personal income taxation significantly decreases growth in low- and middle-income countries. By contrast, moving away from consumption taxes to personal income taxes has a significantly negative effect on growth in middle-income and OECD countries, but not for the subsample of low-income countries. In another paper, Martínez-Vázquez & Vulovic (2011) study tax structures in the Latin-American region. They find a negative and significant growth effect for an increase in the ratio of direct to indirect taxes.

² The same ranking of taxes has been more recently proposed by Acosta-Ormaechea & Yoo (2012).

Tax design considerations and broader governance implications

Efficiency vs. equity considerations

International advice on the appropriate tax composition for developing countries is often driven by efficiency considerations, which means that distortionary taxes should be favoured over taxes that are less economically distorting. There is however increasing attention on the *equity* implications of tax structures, which are directly linked to the notion of *inclusive growth* (Brys et al., 2016). Inclusive growth hereby means that growth benefits the society as a whole, and that development prospects are shared more equally (Brys et al., 2016).

Based on the concept of inclusive growth, a recent OECD publication by Brys et al. (2016) re-examines the 2008 OECD report on “Tax and Economic Growth” cited previously. The authors make an extensive tax-by-tax assessment based on the ranking that has been proposed by the OECD and other international organisations. The idea is to focus on tax policies that either reduce the potential trade-off between efficiency and equity, or that improve economic efficiency and inclusiveness at the same time. It would be out of the scope of this report to present detailed information on equity and efficiency considerations for each single tax.

As noted in Brys et al. (2016), taxation and inclusive growth in developing countries depends on structural factors such as the tax mix and appropriate tax design. It is crucially affected by tax capacities and broader topics of good governance, with the latter being often regarded as a main driver of economic growth.

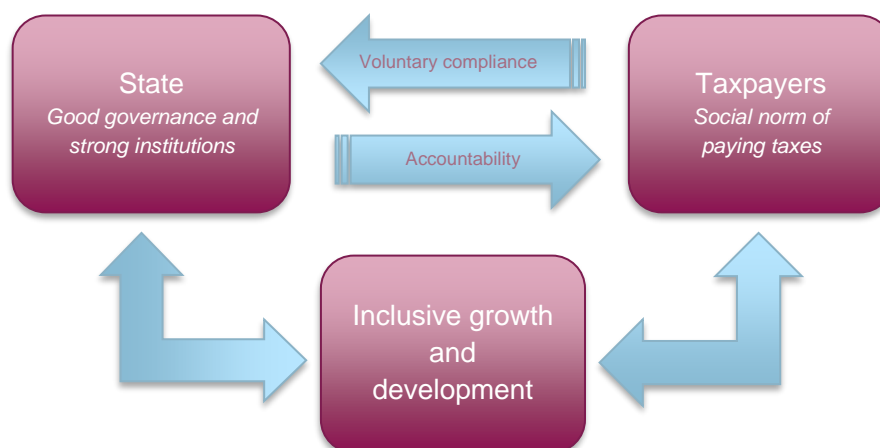
Good governance and the relationship between taxpayers and the state

Over the last years, donors and international organisations have increasingly stressed the role of good governance in taxation. A vital relationship between taxpayers and the state that is based on the principles of accountability and mutual trust is regarded as a key precondition for state-building, democratic participation as well as inclusive and sustainable development (Addis Tax Initiative, 2015; Platform for Collaboration on Tax, 2016; Prichard, 2016b).

This relationship is often described as an informal “fiscal contract” between taxpayers and the state (Figure 6). A basic premise of the fiscal contract is that taxpayers hold the state accountable for the use of their tax payments (i.e. they expect something in return) (Fjeldstad, 2014) and that they are more likely to feel ownership for governmental activities when they are required to pay taxes (Prichard, 2016b). By promoting good governance and effective institutions, the state can signal its accountability and legitimacy, which in turn will give rise to a social norm of voluntary tax compliance (Gaspar et al., 2016).

Regarding growth, the “virtuous circle” (Gaspar et al., 2016, p.9) of strong institutions and good governance on the one hand and social norms of compliance on the other hand can support growth through several channels. A high degree of voluntary tax compliance enlarges the tax base and thus allows to finance further improvements in state capacities. The formalisation of markets will increase growth, and greater accountability of a larger number of taxpayers will improve governance, decrease corruption and reduce barriers for market entries (Gaspar et al., 2016). Finally, governments that depend on the payment of taxes will have a strong incentive to promote growth, because growth is translated into taxpayers’ prosperity, and prosperity ultimately into additional tax payments (Fjeldstad, 2014).

Figure 6: The fiscal contract and growth



Source: Based on Gaspar et al. (2016).

It is important to note that governance aspects of taxation, despite their wide recognition, have received relatively little empirical support so far (Prichard, 2016b). This might be an area for future research.

Potential research gaps

- There are only some studies that address the question how tax structures affect growth in developing countries.
- There is growing attention on the good governance dimension of taxation and its relation to growth and development. At the same time, empirical evidence on the topic is scarce and might require further research.

3. The role of tax policy in private sector development

The previous section dealt with general issues related to domestic revenue mobilisation and taxation in developing countries and their relation to growth, namely the overall level of taxation (tax-to-GDP ratio), the growth-effects of different tax structures and some principle tax design considerations. This section focuses on some more concrete tax policy options that are discussed in the literature.

Developing countries can, in principle, draw on a broad set of tax policy options to improve inclusive growth and to support the formation of a competitive private sector. Decisions are likely to be driven by a broad set of factors, including a country's general state of economic development, the socio-economic background, the political system as well as political economy factors, the existence of natural resource wealth, etc. It would be out of the scope of this rapid review to address all these factors in detail. Instead, this section focuses on policy areas that have been commonly addressed by the literature, and how they relate to inclusive growth. These include the taxation of the informal economy, the role of taxation for foreign direct investments (FDI), particularly through the use of tax incentives, and the topic of tax certainty, which has been recently addressed by the G20. These topics are, of course, neither meant to be exhaustive, nor

to cover all areas that are included in the taxation and development agenda. Some other areas of taxation are also addressed in Section 4, which deals with the role of tax administrations.

Taxation of the informal economy³

A large informal sector is found to be a persistent phenomenon in many developing countries (Besley & Persson, 2014). Some estimates suggest that the informal sector accounts to 30-40% of total economic activities in low-income countries (La Porta & Shleifer, 2014). Firms are usually referred to as being “informal” when they choose to remain unregistered and fail to comply with the relevant legislations, of which tax laws and regulations are an important aspect (Joshi et al., 2014).

The taxation of the informal sector can have some important impacts on inclusive growth and economic activity. Informal firms are generally regarded as being much less productive than formal firms because they are typically smaller, less efficient and often run by entrepreneurs that are poorly educated (La Porta & Shleifer, 2014). According to Besley & Persson (2014), it is also much more difficult for small informal firms to benefit from economies of scale and from opportunities to export, given that they operate outside of the legal system. Finally, as argued by Singh (2014), state capacities and strong institutions depend on the formalisation of economic activities. The informal sector, by contrast, limits state capacities and ultimately hinders the expansion of a productive formal sector.

In a comprehensive review of the literature, Joshi et al. (2014) find that the effects of taxing the informal economy are rather complex and mainly depend on the size of informal firms. The authors note that there is a growing body of empirical and experimental studies which stress the benefits of entering into the formal economy. These include access to capital markets, new market opportunities, less exposure to police and municipal officers, and access to training and capacity building. In addition to that, Brys et al. (2016) argue that informal workers might benefit from formalisation through the access to social protection, more adequate contracts, higher wages, and reduced vulnerability in case of losing their jobs or getting retired. Overall, Joshi et al. (2014) conclude that there is growing empirical support for the positive growth effects of informal sector taxation. More research is however necessary to study the relationship of taxation and firm size and the importance of different channels.

Taxation and foreign direct investments

The Addis Ababa Action Agenda (UN, 2015) recognises that foreign direct investments can make an important contribution to sustainable development, especially when investments are aligned with regional and national sustainable development strategies. It also critically notes that FDI in developing countries is often concentrated on a few sectors, and that there are investment gaps in key sectors for sustainable development.

In general, the economic effects of FDI have been intensively studied in the theoretical and empirical literature. Although findings are sometimes mixed, there are some general observations on how FDI contributes to growth, productivity and competition. In a review of the literature, Freckleton et al. (2012) outlines some important growth channels of FDI, which

³ This section only focuses on the growth-related effects of taxing the informal economy. For a comprehensive overview of the topic, see Joshi et al. (2014).

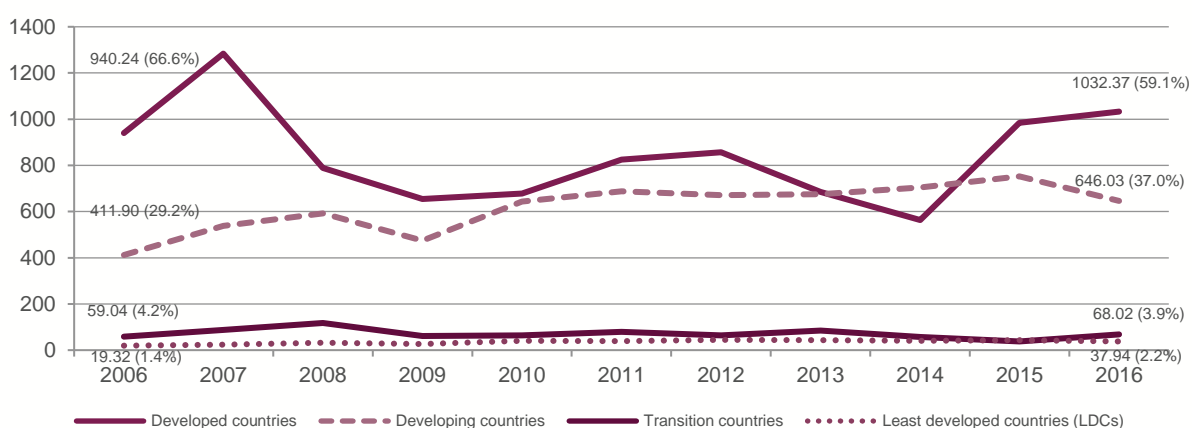
include: increases in the domestic capital stock; technology spillovers; increased domestic competition which leads to greater productivity, as well as impacts on human capital formation through training and imitation. Freckleton et al. (2012) also note that the impact of FDI largely depends on the absorptive capacities of the host countries. The effects of technology spillovers can be, for instance, limited due to a lack of human capital and inadequate infrastructure.

Taxation is often regarded as an important determinant of foreign direct investments. In a recent business survey, the OECD found that the overall tax environment ranks among the top three reasons for investments and location decisions (IMF & OECD, 2017). Taxation can thus be an important factor for FDI and subsequent growth. Having this in mind, the following sub-section first provides an overview on FDI flows to developing countries, and then discusses the role of taxation for foreign direct investments in more detail.

FDI inflows in developing countries

Figures 7 and 8 summarise information on FDI inflows in developing and transition countries. Data is for a ten-year period from 2006-2016 and comes from the UNCTAD World Investment Report 2017 (UNCTAD, 2017).

Figure 7: FDI inflows 2006-2016 in developing and transition countries (billion USD)



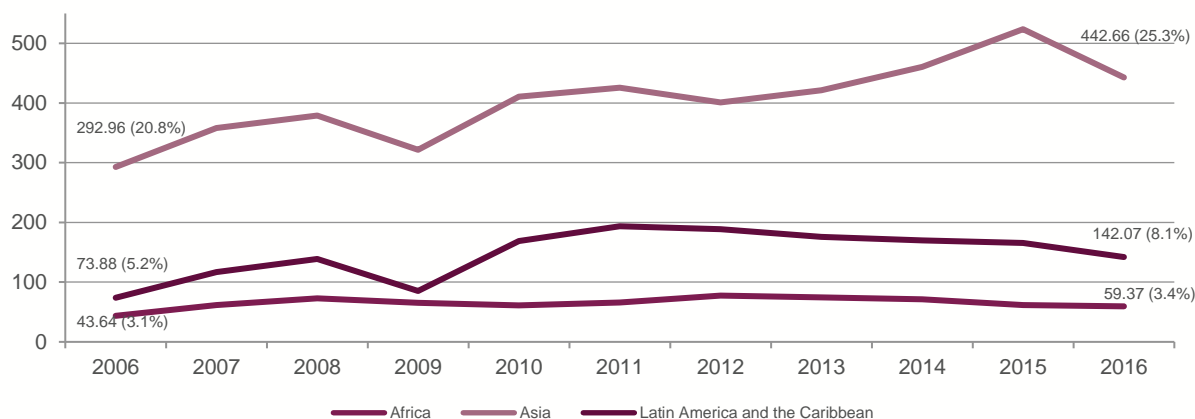
Source: UNCTAD (2017).

Notes: FDI as a percentage of total worldwide inflows in parenthesis.

In absolute terms, FDI flows to developing countries accounted to USD 646.03 billion in 2016, which accounts for 37.0% of worldwide FDI (Figure 7). From 2015 to 2016, flows to developing countries have significantly declined by 14%, whereas at the same time, flows to developed countries increased by 4.9%. FDI to transition countries remained relatively stable over time and accounted to USD 68.02 billion in 2016. Figure 6 also shows that FDI flows to the Least Developed Countries (LDCs), which are often regarded as the most vulnerable economies (UN, 2015), have nearly doubled from 2006-2016 (USD 19.32 billion vs. USD 37.94 billion). However, its share of 2.2 % of total worldwide inflows is still comparably low⁴.

⁴ This observation is also stressed in the Addis Ababa Action Agenda (UN, 2015, p. 23): “We note with concern that many least developed countries continue to be largely sidelined by foreign direct investment that could help

Figure 8: FDI inflows 2006-2016 by development regions (billion USD)



Source: UNCTAD (2017).

Notes: FDI as a percentage of total worldwide inflows in parenthesis. FDI inflows to Oceania (not displayed) were 1.41 billion USD (0.1%) in 2006 and 1.92 billion USD (0.1) in 2016.

Figure 8 shows that FDI inflows in developing countries are mostly concentrated on the Asian region. In 2016, total inflows to Asia were USD 442.66 billion: 25.3% of worldwide inflows, and 68.5% of FDI to developing countries. The second largest flows (USD 142.07 billion, 8.1%) are recorded for Latin America and the Caribbean. By contrast, FDI inflows accounted to only USD 59.37 billion in developing Africa (3.4% of worldwide inflows, 9.2% of inflows to developing countries), but increased by 36% from 2006 to 2016.

The role of taxation for FDI

There is comprehensive empirical evidence on the effect of tax rates on foreign direct investments. According to the OECD (2008), studies on cross-border financial flows on average suggest that a one-percentage point increase in tax rates leads to a decrease in FDI of 3.7%. The results of these studies vary however, with effects ranging from 0% to 5%. In a more recent meta-analysis of the literature, Feld & Heckemeyer (2011) use a total of 704 primary estimates to calculate the sensitivity of FDI to tax changes. The authors find that foreign direct investments decrease by 2.49% in response to a one percentage-point increase in tax rates; this value drops to 1.8% when firm-level rather than aggregated data is employed.

As James (2014) argues, studies on the effect of taxation on FDI mostly focus on investments in OECD countries, which is mainly due to the limited data available for developing countries. However, studies focusing on developing countries deliver similar results, albeit on a smaller scale. These studies find that a ten-percentage increase in corporate tax rates decreases FDI by 0.45 percentage points of GDP (James, 2013). A similar result is reported by Klemm & Van Paris (2012) who estimate values of 0.31 to 0.32 percentage points, depending on the econometric technique.

to diversify their economies, despite improvements in their investment climates. We resolve to adopt and implement investment promotion regimes for least developed countries”.

Studies on FDI and taxation often rely on statutory tax rates (i.e. as defined in the tax laws). As argued by the OECD (2015), statutory tax rates might not be sufficient to reflect the whole tax environment, which is better captured by *effective average* or marginal tax rates. Effective tax rates combine information on statutory tax rates with information on other tax provisions that might affect companies' effective tax burden (Abbas & Klemm, 2013). They can be particularly sensitive to the provision of tax incentives and special regimes (OECD, 2015), which are discussed in detail in the next sub-section.

The use of tax incentives and special regimes

Prevalence of tax incentives

Over the last years, the topic of tax incentives has been one of the focus areas of international organisations (IMF et al., 2015). Tax incentive policies play an important role for the attraction of domestic and foreign direct investments (OECD, 2015) and have been frequently used by governments of developed and developing countries around the world. Table 1 gives an overview of the prevalence of several types of tax incentives and special regimes in different world regions and country groups. The percentages indicate the share of countries in the respective samples that rely on tax incentives:

Table 1: Tax incentives and special regimes in different world regions

Region (number of countries)	Tax holiday/Tax exemption	Reduced Tax Rate	Investment Allowance/Tax Credit	R&D Tax Incentive	Super-deductions	SEZ/Free Zones/EPZ/Freeport	Discretionary process
East Asia and Pacific (12)	92%	75%	67%	83%	33%	92%	83%
Eastern Europe and Central Asia (16)	88%	38%	25%	31%	0%	100%	38%
Latin America and the Caribbean (25)	88%	32%	52%	12%	4%	72%	40%
Middle East and North Africa (15)	80%	40%	13%	0%	0%	80%	40%
OECD (33)	21%	36%	64%	76%	21%	67%	33%
South Asia (7)	100%	43%	71%	29%	71%	71%	43%
Sub-Saharan Africa (45)	78%	62%	78%	11%	18%	64%	82%

Source: James (2014).

Effects, costs and benefits of tax incentives

According to the OECD (2015), there might be compelling reasons to rely on tax incentives to promote new investments, especially for governments of developing countries. For example, it is easier to offer tax incentives rather than to correct for structural weaknesses that might affect investment decisions, such as skilled workforce and spending on infrastructure. From a political economy perspective, tax incentives might also be easier to communicate than public spending (e.g. funds or cash subsidies) because tax incentives do not cause any direct expenditure to investors. In addition, James (2013) argues that tax incentives can be a less obvious way of providing benefits to certain businesses. Governments can also demonstrate their political willingness to attract investments. Finally, ministries other than the Ministry of Finance might be

more generous in offering tax incentives because they do not face any direct revenue consequences (James, 2013).

The international reception of tax incentives in developing countries has been rather critical. The Addis Ababa Action Agenda outlines that “[t]ax incentives can be an appropriate policy tool” (UN, 2015, p.13), but at the same time invites developing countries to discuss the role of tax incentives in order to end harmful tax practices. The Agenda also stresses the commitment to address the excessive use of tax incentives for extractive industries (UN, 2015). Some years earlier, the IMF report “Revenue Mobilization in Developing Countries” (2011) presented some critical arguments on the widespread use of tax incentives in developing countries. According to the IMF (2011), tax incentives can only help to attract investments when overall business conditions are sufficient, with the latter often found to matter more. Incentives can be hard to control and their benefits might be shifted from incentive to non-incentive companies via transfer pricing schemes. The willingness to offer tax incentives might also give rise to special pleading and corruption.

In a recent publication, the IMF et al. (2015) provide comprehensive guidance on the effective and efficient use of tax incentives in low-income countries⁵. *Effective* thereby means that tax incentives lead to their intended objective, while *efficiency* means that the objectives are achieved at low social costs. In addition, the provision of tax incentives should adhere to the principals of good governance, in particular with respect to the transparency of governmental decisions. Transparency thereby encompasses: (a) *legal transparency* (i.e., tax incentives are codified in relevant tax laws), (b) *economic transparency* (i.e., costs and benefits of tax incentives are assessed ex-ante and ex-post, and made public), and (c) *administrative transparency* (i.e., tax incentive criteria are clear, simple, specific and objective) (IMF et al., 2015).

In summary, for tax incentives to be beneficial, it is crucial that their positive effects (social benefits) outweigh their negative effects (social costs) (James, 2013), which are summarised in Table 2 below:

Social benefits	Social costs
+ Higher revenues from increased investments	– Revenue losses from redundant tax incentives and abuse
+ Net impact of investments on jobs and wages	– Administrative and – compliance costs
+ Productivity spillovers of investments	– Costs due to distorted resource allocation

Sources: James (2013), IMF et al. (2015).

⁵ The report is the one of eight base erosion and profit shifting (BEPS) Toolkits.

Effectiveness of tax incentives

Despite their widespread use, there is a lack of recent evidence on the effectiveness of tax incentives in developing countries (Klemm & Van Paris, 2012). Observations are also often based on anecdotal evidence (James, 2013). The few studies available however suggest that tax incentives do not always appear to be effective in attracting investments in developing countries.

Klemm & Van Paris (2012) used a sample of over 40 countries from Latin America, the Caribbean and Africa to study, among others, the effectiveness of tax incentives in mobilising (a) foreign direct investments, and (b) total private investments. The authors focused on three types of tax incentives, namely reduced tax rates, tax holidays (i.e. temporary tax exemptions or reductions), and investment allowances. As shown in Table 1, these incentives play an important role in Latin America and Sub-Saharan Africa. Results of Klemm & Van Paris (2012) suggest that the effectiveness of tax incentives varies by types of incentives and regions. For Latin America and the Caribbean, the authors observed that CIT rates have a significantly negative impact on FDI. In addition, the length of tax holidays is positively related to FDI. There is however no such effect observable for Africa. Investment allowances have no effects on FDI in both regions, and none of the tax incentives affect total private investments.

Similar results are reported by Abbas & Klemm (2013) as the authors find that the tax incentive regimes significantly reduce effective average tax rates (EATR). Under the most generous tax regimes, EATR in Africa are close to zero. Special tax regimes again do not appear to lead to increased investments. The econometric results show that EATR, under the most generous tax incentive regimes, are not significantly related to private fixed investments and FDI (Abbas & Klemm, 2013).

Regarding the redundancy of tax incentives, there is some evidence that companies often decide to invest in a country even when no incentives had been granted. In general, tax incentives rank very low in companies' decisions to invest, which are much stronger driven by factors such as economic and political stability, as well as the costs of raw material (IMF et al., 2015). The same results apply when it comes to the role of specific tax aspects for investments. A recent business survey carried out by the OECD reveals that companies, on average, do not regard tax incentives as an important factor for investments and location decisions as compared to other tax factors (IMF & OECD, 2017). Finally, drawing on results from investor surveys, James (2013) shows that redundancy ratios (i.e., share of firms that would have invested if incentives had not been granted) can be extremely high in developing countries, with top ratios of sometimes more than 90%.

The role of tax certainty

The topic of tax (un)certainty has received particular attention at the G20 summit during the Chinese presidency in 2016 and the German presidency in 2017. From a growth perspective, a lack of tax certainty can be particularly harmful because it seriously impacts cross-border transactions, trade, investments and compliance (IMF & OECD, 2017; Zangari et al., 2017). Two recent publications by the IMF & OECD (2017) and the European Commission (Zangari et al., 2017) extensively study the role, causes, and consequences of tax uncertainty and provide new survey evidence on the topic.

Causes and consequences of tax uncertainty

In general, tax certainty is affected by both domestic and international tax policies, as well as their implementation through tax administrations. At the domestic level, tax uncertainty mainly arises from a lack of precision in the tax laws and frequent legal changes, and from conflicting tax provisions and their interpretation over time (Zangari et al., 2017). Implementation issues are mostly related to the effectiveness of tax administrations. Even in the presence of well-defined and transparent tax laws, tax administration procedures may cause some serious uncertainty among taxpayers. Post-filing procedures such as claiming VAT refunds, for example, are often found to be less effective in low-income countries (see Section 4). Tax uncertainty can be due to discretionary and incoherent interpretation of the tax laws and procedures by the tax authorities, as well as a generally weak relationship between taxpayers and tax administrations (IMF & OECD, 2017).

At the international level, tax uncertainty especially impacts cross-border transactions. The causes for tax uncertainty on the international level mainly lay at the lack of tax coordination and cooperation between countries, and the application of existing tax laws to new business models (Zangari et al., 2017). In particular, dispute resolution mechanisms, which aim to resolve open tax questions, may take a long time and cause unpredictable extra costs for businesses. This kind of uncertainty is not restricted to international transactions, but might also apply at the domestic level (IMF & OECD, 2017).

The impacts of tax uncertainty on investments are, from a theoretical perspective, not straightforward and depend on the underlying assumptions of the models. This view is not necessarily supported by (scarce) empirical studies, which find an adverse impact of tax uncertainty on trade and investment (IMF & OECD, 2017). The results of two recent surveys on tax certainty are summarised below.

Recent survey evidence

The OECD has recently conducted two comprehensive surveys on the sources of tax uncertainty and their implications for investments. The first business survey was carried out in late 2016 among 724 companies with headquarters in 62 countries and jurisdictions. The second tax administration survey was carried out among members of the OECD Forum on Tax Administration (FTA), of which 25 (out of 47) answered the survey (IMF & OECD, 2017).

In summary, the results of the surveys show that tax certainty is a major issue for both tax administrations and businesses. For the latter, tax uncertainty causes additional resource expenditures (including management time) and leads to less economic or profitable investments. Tax uncertainty is also linked to reduced investments and changes in location. Regarding the causes of tax uncertainty, results from the tax administration survey and the business survey turn out to be nearly identical, but the causes of tax uncertainty, on average, appear to be regarded as less severe from the perspective of tax administration. For details, see Appendix.

The results of the surveys should be treated with caution, because they only apply to G20 and OECD countries. The particular challenges in developing countries might be different from those of high-income countries, which makes it hard to draw any general conclusions. However, the surveys might provide a valuable input for further discussion of tax certainty in developing countries (IMF & OECD, 2017). In addition, some of the respondents might indeed have dealt with developing countries in cross-border transactions and thus experienced issues of tax

uncertainty in these countries, given that more than 50% of the companies in the sample are multinationals.

Potential research gaps

- Although there is a growing body of literature, it is still difficult to assess the effects of taxing the informal economy to support growth and private sector development. As outlined in Joshi et al. (2014), future research might be particularly necessary to evaluate the magnitude of growth effects, the advantages or disadvantages for informal firms of different sizes and the role of specific policies.
- There is a limited number empirical studies on the effectiveness of tax incentives in developing countries. Given the prevalence of tax incentives, it might be necessary to study their role for FDI in more detail.
- The topic of tax certainty has received particular attention at the G20 agenda. Recent empirical findings only relate to OECD and G20 countries, and research on the role of tax certainty for developing and emerging economies might need to be extended in the future.

4. The role of tax administrations

As noted earlier, strengthening inclusive growth and a competitive private sector requires strong state institutions, of which revenue administrations are a particularly important component. Building efficient and effective tax administrations is primarily linked to strengthening domestic revenue mobilisation, and there is increasing international recognition that reform efforts should aim at promoting broad-based capacity building in developing countries' revenue administrations (Fjeldstad, 2014; Addis Tax Initiative, 2017). It should however be noted that support to tax administrations and tax policy design cannot always be treated in isolation, as poorly-designed tax policies, for instance, can cause control problems for tax administrations and may give rise to corruption among tax officials (Fjeldstad, 2014). Well-designed tax policies, on the other hand, might not become effective if the capacities for their appropriate implementation are missing.

In addition to their revenue-generation role, strong revenue administrations also have some important positive impacts on growth and the overall business environment. Poor tax administrations can cause serious compliance costs especially for small companies, which can affect their overall productivity and growth (Dabla-Norris et al., 2017), and may even disincentivise new firms to enter the market (Braunerhjelm & Eklund, 2014). Inefficient tax administrations may signal a low "value-for-money" (i.e. tax payments vs. services offered in return), thereby negatively affecting taxpayers' willingness to voluntarily comply with the tax laws (Brys et al., 2016) and ultimately growth⁶.

Finally, Prichard (2016b) argues that capacity building in tax administrations can affect overall good governance and state building through three principle channels:

- a) *Demonstration effects*: Investments in tax administrations can set new standards for other parts of public services (e.g. career opportunities);

⁶ See Section 2 "Good governance and the relationship between taxpayers and the state" regarding "fiscal contract".

- b) *Spillover effects*: Modernising revenue administrations needs to go hand-in-hand with investments in parallel agencies (e.g. ministry of finance or business registration), and
- c) *Information sharing effects*: Data gathered by tax administrations can be a valuable input to support, among others, informed political decision making.

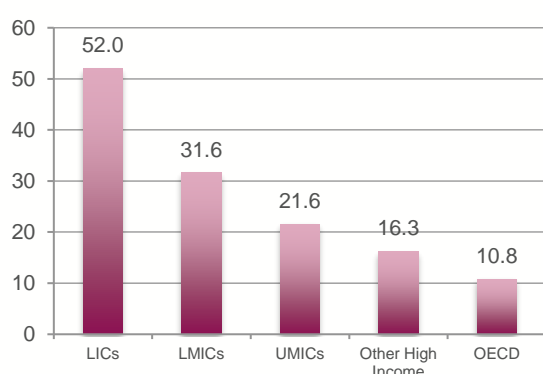
The next sections provide an overview on tax compliance costs of firms operating in developing countries. These costs can be comparably large in low-income countries and can have a strong disincentive effect on economic activities. In particular, there is some recent (though limited) empirical evidence that tax administrative costs significantly impact the number of firm entries into the market, and the productivity of young and smaller firms.

Tax compliance costs in developing countries

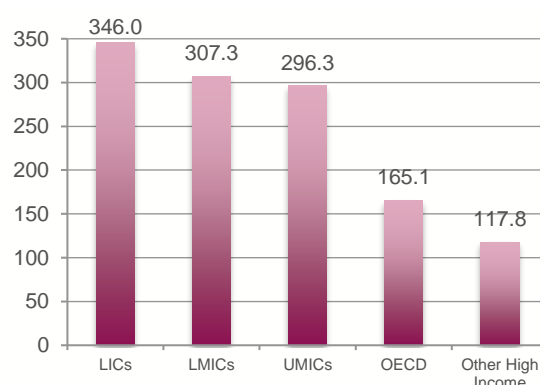
Figure 9 presents an overview on selected tax compliance costs indicators for developing countries. Data comes from the World Bank Doing Business Database (subsection “ease of paying taxes”) for the fiscal year 2015, and is disaggregated by country income groups (World Bank, 2016). Figure 9 covers (a) the average number of payments per year, (b) the average time to pay (in hours per year), and (c) the post-filing index (from 0-100). The post-filing index has been first introduced in the Doing Business Database 2017 (World Bank, 2016) and is related to all costs emerging after the filing of taxes, such as claiming VAT or sales tax refunds, and the costs of corporate income tax audits⁷.

▪ Figure 9: Tax compliance costs in developing countries

▪ (a) Number of payments (per year)

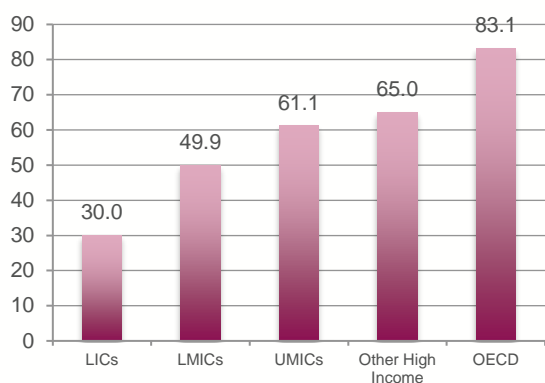


▪ (b) Time to pay (hours)



▪ (c) Post-filing index (0-100)

⁷ For details, see: <http://www.doingbusiness.org/methodology/paying-taxes>.



Source: World Bank, 2016.

Notes: Country classification is based on OECD (<http://www.oecd.org/about/membersandpartners/>) and World Bank Open Data (<https://data.worldbank.org/>).

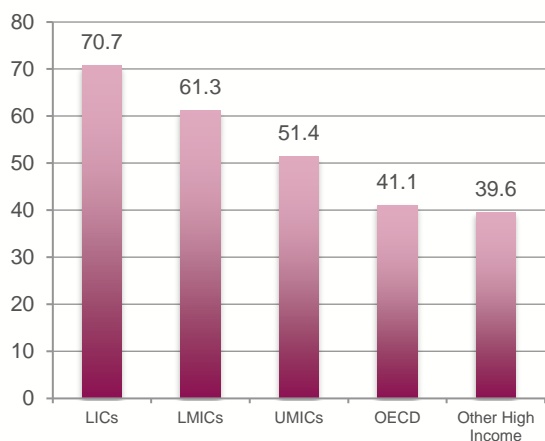
Figure 9 shows that particularly firms in the least developed countries face significantly larger compliance costs than those in high-income or OECD countries. The average number of tax payments in low-income countries is nearly five times larger than in OECD countries (52 vs. 10.8 payments), and it takes firms close to three times longer to pay taxes (346 vs. 177.8 hours). In addition, the post-filing procedures are much less burdensome in OECD countries, where the average post-filing index is 83.1 (of 100) as compared to 30.0 (of 100) in the LDCs. Figure X also reveals that the cost of paying taxes significantly decrease with country income size. This is in line with the general observation that institutional quality increases with per-capita income (Gaspar et al., 2016).

It should be noted that the Doing Business data on the ease of paying taxes covers medium-sized companies. The costs of paying taxes can be expected to be even larger for small- or micro enterprises, given that they represent a comparably larger fixed component for these firms. In addition, larger firms might also benefit from specialised tax departments, and are more experienced in post-filing procedures than smaller firms (Dabla-Norris et al., 2017). It is also worth noting that the World Bank Doing Business Indicators might not only reflect tax administration performance, but a “mixture” of compliance costs related to tax administration quality on the one hand and compliance costs related to the tax system on the other hand (e.g., due to the complexity of tax rules and regulations) (Braunerhjem & Eklund, 2014; Dabla-Norris et al., 2017).

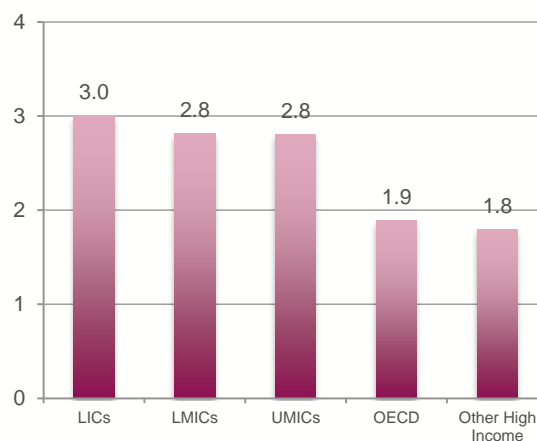
Figure 10 provides some additional information on tax administrative costs. Data is from the World Bank Doing Enterprise Survey and includes information on (a) the percentage of firms that have to meet with tax officials, (b) the average number of visits (if there are any), and (c) the percentage of firms that identify tax administrations as a major obstacle for doing business. Data is again disaggregated by country-income groups:

Figure 10: Meetings with tax officials / tax administration as a major obstacle

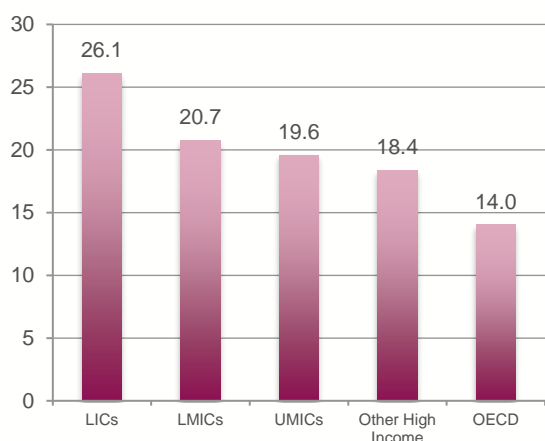
▪ **(a) Firms visited or required to meet with tax officials (% of firms)**



(b) Visits or required meetings with tax officials (average number)



(c) Firms identifying tax administration as a major constrain (% of firms)



Source: Data is from the World Bank Enterprise Surveys (<http://www.enterprisesurveys.org/data>).

Notes: Country classification is based on OECD (<http://www.oecd.org/about/membersandpartners/>) and World Bank Open Data (<https://data.worldbank.org/>).

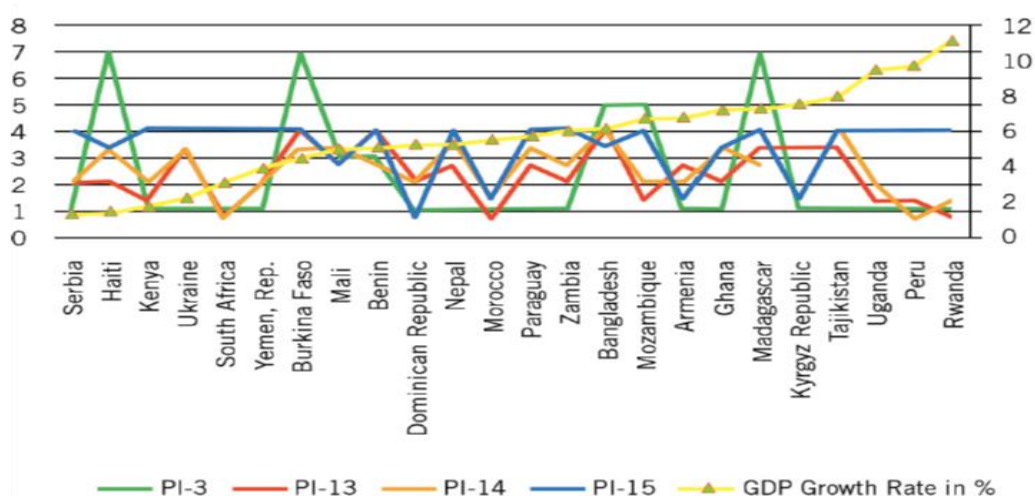
The findings presented in Figure 10 are in line with those above. In low-income countries it is much more common for firms to meet with tax officials (70.7% of firms, compared to 41.1% in OECD countries, and 39.6% in other high-income countries). Firms that have to meet with tax officials do this on average three times per year. In high-income and OECD countries, the average value is only 1.8 and 1.9. The potential compliance costs due to meetings with tax officials again decrease with country income, and apply to a smaller share of firms. Finally, a significantly larger percentage of firms (26.1%) think that tax administrations are a major obstacle for their business compared to firms in OECD countries (14%).

Effects of tax administration quality and -performance on growth and productivity

As noted above, poor tax administration performance is likely to have a negative impact on productivity and growth, as it causes significant compliance costs especially for small- and medium enterprises. It may also signal taxpayers that the state is ineffective in providing state capacities in return for tax payments, which might impact taxpayers' willingness to voluntarily comply. The literature research for this rapid review only found a limited number of recent studies that focus on developing countries.

In 2012, the International Tax Compact (ITC) presented a study on tax-related indicators in the Public Expenditure and Financial Accountability (PEFA) Framework (ITC, 2010). There are four distinct indicators in the framework that relate to taxation, namely PI-3: *Aggregate revenue out-turn compared to original approved budget*; PI-13: *Transparency of taxpayer obligations and liabilities*; PI-14: *Effectiveness of measures for taxpayer registration and tax assessment*; and PI-15: *Effectiveness of collection of tax payments*. While the first indicator focuses on revenue forecasting, the latter three are more closely linked to tax administration performance. The study concludes that there is no relationship between annual GDP growth-rates and the PEFA results of the developing and emerging countries in the sample (Figure 11).

Figure 11: Tax-related PEFA indicators and GDP-growth



Source: International Tax Compact (2012)

Braunerhjem & Eklund (2014) studied the effect of tax administrative burden on new market entries. Their data comes from the World Bank Doing Business Database (see above) and the World Bank Group Entrepreneurship Snapshots. As the authors point out, the relationship between market entries and tax administrative costs has been hardly addressed by the literature so far. They argue that new market entries contribute to welfare and economic growth by promoting innovation and productivity, and by strengthening competition between firms. In their study, Braunerhjem & Eklund (2014) show that a ten-percent decrease in the tax administrative

burden (as measured by the number of tax payments and the time to pay taxes) leads to a three-percent increase in annual market entries, regardless of corporate income tax rates.

In a recent IMF study, Dabla-Norris et al. (2017) use data from the Tax Administration Diagnostic Assessment Tool (TADAT) to assess the impact of tax administration quality on the productivity of small and young firms in developing- and emerging economies. The authors argue that TADAT data can be particularly useful to study tax administration quality because TADAT assessments capture all core functions of a tax administration. The use of TADAT data also allows for separating the impacts of tax administration performance on firm productivity from the impacts of the tax system in general. Dabla-Norris et al. (2017) use 33 TADAT measurement dimensions to compile a novel Tax Administration Quality Index (TAQI). Their results suggest that a higher TAQI score (which is associated with a lower tax compliance costs) significantly increases the productivity of small and young firms. In addition, the authors show that the productivity gap between smaller and larger firms is much smaller in countries with comparably higher TAQI scores.

Capacity building in tax administrations: current trends

International organisations and donors have long recognised that developing countries' revenue administrations frequently suffer from significant capacity constraints (IMF, 2011; Fjeldstad, 2014), which may have serious implications for revenue collection, as well as growth and private sector development as described above. In addition, poor institutions that deliver a low “value-for-money” are likely to have a negative impact on voluntary tax compliance (Brys et al, 2016). Building effective tax administrations is thus one of the priorities of international support to low-income countries (Addis Tax Initiative, 2015 & 2017; Fjeldstad, 2014).

Efforts to improve the effectiveness of tax administrations and to lower compliance costs especially for small enterprises can encompass a broad range of measures, including improved taxpayer information, less demanding filing- and post-filing procedures, easier payment of taxes, as well as accountability and transparency of the tax administrations (Dabla-Norris et al., 2017). As noted by Fjeldstad (2014), current advice from international organisations is thereby primarily focused on improved taxpayer services (“customer orientation”), the use of e-systems and human capacity building in specialised audit areas and issues of international taxation.

It is out of the scope of this report to draw general conclusions on the effectiveness of support in the above areas, among others because the direct effects of capacity building are hard to assess and existing evidence is fragmented and/or anecdotal.

Potential research gaps

- There is hardly any comprehensive and detailed country-level data for tax administration performance available. The TADAT Performance Assessment Reports, which provide highly detailed and evidence-based data on tax administration quality, are non-public for most of the countries assessed. Only 7 out of 40 countries decided to make assessment results public (status as of August 30, 2017. See: www.tadat.org). During this literature review, only one study could be identified that relied on TADAT data to analyse the effects of tax administration quality on growth and productivity (Dabla-Norris et al., 2017).

5. Conclusions

The mobilisation of domestic revenues, particularly through efficient, effective, transparent and fair taxation, plays a pivotal role to improve the development prospects of low-income and emerging economies, and is a central means of implementation for the UN Sustainable Development Goals. Advice of international organisations and donors is often focused on the direct revenue implications of taxation, and increasingly on the question how good governance can improve the relationship between taxpayers and the state, which is regarded as central for state-building and growth.

In addition to their revenue-generating role, sound tax policies and effective tax administrations are also key for strengthening a competitive private sector and supporting inclusive economic growth. This rapid review focused on this particular impact of tax administrations and –policies, and the results of this desk research can be summarised as follows:

- *Structural factors and good governance.* Developing and emerging countries typically raise fewer taxes than high-income and OECD countries, with average tax-to-GDP ratios (i.e. tax revenues as percentage of GDP) in the order of 14%. For developing countries, it is critical to reach a certain tax-to-GDP ratio of approximately 13%-15% to ensure sustainable subsequent growth path. A pro-growth tax mix should focus on less-distortive taxes such as consumption taxes or property taxes, and at the same time consider equality implications of specific tax designs. Good governance in taxation requires a vital relationship between taxpayers and the state (“fiscal contract”) and strong institutions. This can give rise to a “virtuous circle” of accountability, mutual trust and growth, built around a social norm of paying taxes.
- *Tax policies.* Developing countries have various tax policy options to foster sustainable growth and to strengthen a competitive private sector. There is emerging evidence that the taxation of the informal sector can have positive impacts on growth through various channels. Foreign direct investments (FDI) remain on a comparably low level particular in Africa and the Least Developed Countries. FDI are affected by statutory corporate tax rates, but effective tax rates can be even more important. Tax incentives, which are widespread in developing countries, have proven to be somehow ineffective in the attraction of domestic private- and foreign direct investments, and their benefits crucially depend on an appropriate design that takes into account principles of good governance. Tax certainty is a central topic at the G20 agenda and relates to domestic and international tax policies, as well as their implementation through tax administrations. While current evidence on tax certainty merely relates to G20 and OECD countries, tax certainty is also an important topic for developing and emerging countries, and some of the lessons from recent business and tax administration survey might feed into the discussion how to improve tax certainty in developing countries.
- *Tax administrations.* Tax administrations in developing countries frequently suffer from capacity constraints, and their performance is often regarded to be poor. A lack of quality may give rise to serious tax compliance costs for taxpayers, which turn out to be significantly larger than in high-income and OECD countries. These costs can be, however, related to both a lack of tax administration performance and general weaknesses of the tax system (e.g. complex tax laws). Although there is limited empirical evidence on the effects of tax administration performance on growth for developing countries, some studies find that tax administration performance can affect the market entry rates of new firms and the productivity of small and young firms. International

advice on capacity building in tax administrations is currently focused on some particular topics, including taxpayer services, e-systems and human capacity building in specific areas (including international taxation). The effectiveness of these measures is, however, hard to assess and out of the scope of this rapid desk research.

A recurring theme of the report was the lack of (empirical) evidence for developing and emerging countries, which applies to many topics discussed in the report, and which is often related to poor data quality and availability for these countries. While evidence for developed countries might be to some extent generalizable, informed and robust support to developing countries will crucially depend on more accurate data for these countries. An emerging number of developing countries, for instance, have undertaken TADAT assessments, which can provide a valuable input for tax reforms. In summary, the lack of evidence for developing countries is an important research gap identified in this report.

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Key websites

- International Centre for Tax and Development (ICTD) Government Revenue Dataset: <https://www.wider.unu.edu/project/government-revenue-dataset>
- Tax Administration Diagnostic Assessment Tool (TADAT): <http://www.tadat.org>
- World Bank Doing Business Database: <http://www.doingbusiness.org/data>
- World Bank Enterprise Surveys: <http://www.enterprisesurveys.org/data>

7. Appendix:

Survey results on tax certainty

The results of the business surveys can be summarised as follows:

- The most important factor for investments and location decisions is corruption (mean rating: 3.9 out of 5)⁸ followed by political certainty (3.8) and the overall tax environment (3.8)
- Among the specific tax factors, uncertainty about the effective tax rate on profit is ranked highest (3.9), followed by the anticipated effective tax rate on profit (3.7) and uncertainty about input tax credits, refunds, place of supply issues for VAT/GST purposes and/or uncertainty about the tax burden of other consumption taxes (e. g. excises, sales taxes, custom duties) (3.6)⁹.
- Regarding the impact of tax uncertainty on business operations, the option “*Additional resource expenditures (including management time) incurred to manage tax uncertainty*” was most frequently chosen by respondents (326 selections), followed by “*Led to less economical/profitable investments*” (310) and “*Reduced or changed location of investment*” (289). Only a small number of firms appear to benefit from tax uncertainty: “*The firm took advantage of tax uncertainty to reduce firm's tax liability in a country*” was chosen 59 times and “*Tax uncertainty provided some positive opportunities*” only 19 times.
- Finally, respondents provided information on the sources of tax uncertainty with respect to tax policy design and legislation, tax administration, dispute resolution, and specific international dimensions. Table below 3 displays the top three answers:

Table 3: Causes of tax uncertainty from business perspective (top three causes)

Tax policy design and legislation	Tax administration
<ul style="list-style-type: none"> • Complexity in the tax legislation (e.g. different definition of permanent establishment for VAT/GST and CIT purposes) (3.30) • Unclear, poorly drafted tax legislation (3.25) • Frequent changes in the statutory tax system (rates, deductions, credits, new taxes, etc.), regulations and guidance (3.18) 	<ul style="list-style-type: none"> • Considerable bureaucracy to comply with tax legislation, including documentation requirements (3.54) • Unpredictable or inconsistent treatment by the tax authority (3.53) • Inability to achieve early certainty proactively through rulings or other similar mechanisms (e.g. Advance Pricing Arrangement) (3.20)
Dispute resolution	International dimensions
<ul style="list-style-type: none"> • Lengthy decision making of the courts, tribunals or other relevant bodies (3.34) 	<ul style="list-style-type: none"> • Inconsistencies or conflicts between tax authorities on their interpretations of international tax standards (e.g. on

⁸ Respondents were asked to provide a rating from 1 (not important at all) to 5 (extremely important) for each factor.

⁹ Tax incentives, as mentioned earlier, rank among the bottom three, with an average rating of 3.2.

- Unpredictable and inconsistent treatment by the courts (3.26)
- Lack of published decisions clarifying interpretation (2.99)
- transfer pricing or VAT/GST) (3.38)
- Tax legislation not in line with the evolution of new business models (3.26)
- Lack of expertise in tax administration on aspects of international taxation (3.22)

Source: IMF & OECD (2017).

The tax administration survey came to the following results:

- Tax administrations see tax uncertainty as a major issue for their country, with an average rating of 4.2 (1 = low priority, 5 = high priority). In addition, tax administrations think that tax uncertainty is a also significant problem for taxpayers (4.6)
- Tax administrations also provided information on the sources of tax uncertainty, again with respect to tax policy design and legislation, tax administration, dispute resolution, and specific international dimensions. The results of tax administrations are nearly identical to those of the business survey, but the causes of tax uncertainty, on average, appear to be regarded as less severe (Table 4):

Table 4: Causes of tax uncertainty from tax administration perspective (top three causes)

Tax policy design and legislation	Tax administration
<ul style="list-style-type: none"> • Complexity in the tax legislation (e.g. different definition of permanent establishment for VAT/GST and CIT purposes) (3.12) • Unclear, poorly drafted tax legislation (2.80) • Frequent changes in the statutory tax system (rates, deductions, credits, new taxes, etc.), regulations and guidance (2.76) 	<ul style="list-style-type: none"> • Considerable bureaucracy to comply with tax legislation, including documentation requirements (2.48) • Inability to achieve early certainty proactively through rulings or other similar mechanisms (e.g. Advance Pricing Arrangement) (2.20) • Corruption in the tax system (1.96)
Dispute resolution	International dimensions
<ul style="list-style-type: none"> • Lengthy decision making of the courts tribunals or other relevant bodies (3.00) • Unpredictable and inconsistent treatment by the courts (2.48) • Lack of published decisions clarifying interpretation (2.32) 	<ul style="list-style-type: none"> • Inconsistencies or conflicts between tax authorities on their interpretations of international tax standards (e.g. on transfer pricing or VAT/GST) (2.64) • Lack of understanding of international business (2.44) • Tax legislation not in line with the evolution of new business models (2.40)

Source: IMF & OECD (2017).