



## Tax in Development – Towards a strategic aid approach

Summary of Working Paper 77 by Olav Lundstøl

The paper represents a step in the direction of thinking systematically about tax related aid efforts from a poverty and development perspective of an aid agency. It sets out a multi-tiered framework of some key indicators to enable a first ranking exercise for most low- and low-middle income countries that are potential candidates for such cooperation from an aid perspective.

Prior to delivering this framework, it briefly sets the background for why tax matters in development across time and place, how tax already finances development across the developing world with an emphasis especially on Sub Saharan Africa, and what has been some of the experience with tax aid.

### **The role of tax in state building and development**

Throughout history, collection of tax has often been closely associated with improved societal organisation, rule-based institutions and state building. It is however not an automatic mechanism that secures 'the governance dividend' of tax, it always matters 'how tax is collected, from whom and how the revenue is spent' (Moore and Prichard 2017:6).

Nevertheless, there is some consensus that for many developing countries, still 65 countries collect below 15% of GDP in

taxes, there is a significant upside in terms of tax collection that can be realised without distorting significantly savings, investments and growth. An estimate of this upside, based on available tax gap and tax effort studies constitute from 20–70% of current tax collection levels for developing countries today.

### **Trends in domestic resource mobilisation and future financing**

Two fundamental historical trends underlie the increased importance of domestic resource mobilisation and thereunder taxation for development. The first is that progress in development is possible at a rate never seen before in history. It is possible with 1/10th of the real income level today to achieve the same life expectancy as in the 19th century. The second is that the optimal size of the public sector and the state to ensure growth and development is much higher than in earlier centuries.

Most financing for development has and will always be domestic. As much as 77 per cent of the Millennium Goals related expenditure was financed from domestic sources and for many sectors, this estimate is higher for the Sustainable Development Goals (SDGs). On average, this has also been the case

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for Africa from 1970 to recent years albeit with significant country differences. Total government revenues from tax and non-tax amount to ten times as much as aid in Africa today, and the bulk of investment and consumption expenditures rely on domestic earning, savings and credit.

## Trends in tax aid and key principles for future assistance

In overall ODA, the emphasis on tax aid has not been prominent except as a minor element of macro- and/or public financial management and decentralisation reform programming. In 2015 tax aid was estimated at 0.13 per cent of ODA. With the SDGs and the 'financing for development agenda' came the Addis Tax Initiative (ATI) and a heightened awareness of domestic resource mobilisation and tax in particular. This included commitments to increase tax aid and align relevant policies and practices both at home and abroad as well.

The international tax aid has so far been somewhat concentrated both on the supply and recipient side, as tends to be the case with most aid, being provided mainly by a few large multilateral (WB, IMF) and bilateral donors (UK, US and Germany). Regarding bilateral tax aid, a small group of countries has received a large share (e.g. Afghanistan, Tanzania and Mozambique) whereas for some of the multilateral aid on average middle income countries have tended to receive more support for example from the WB. A relatively large group of both low income and lower-middle income countries, above 30, according to the OECD, received either limited or no tax aid in recent years. Again such a sub group of 'tax aid orphans' is not a new phenomenon in aid overall where this phenomenon has been observed for a long time across sectors and regions.

From the above it would seem that there is a case for improved coordination among donors and dialogue with developing countries to try to more effectively plan and implement tax aid. There is emerging research and data being made available that

can facilitate such an effort, improving the emphasis on countries and interventions that are in line with where the need, potential and expected benefit-cost is the highest. Tax aid often can be very effective aid, despite the disclaimer of attribution, with cost-benefit ratios of 1:10 or higher.

## Towards a basic framework for assessing priority partner countries for tax aid

A framework to assess the needs and potential of tax aid to improve public revenue systems and tax in particular is developed with an emphasis on the current situation of low income and low-middle income countries when assessing key indicators such as; income, poverty and human development, public expenditure, investment, savings, domestic credit, personal remittances, net aid, net foreign direct investments, tax collection, tax effort, tax aid and institutional-policy quality.

Perhaps not surprisingly, the resulting simple unweighted (albeit indirectly with some differentiation due to a combination of and composite indicators in the summary calculation) ranking from the above exercise shows a predominance of countries from Sub Saharan Africa (SSA) (see table 4 on page 22). As many as 20 out of 26 countries of the top ranking countries in terms of needs and potential are from SSA. Many if not most of these countries have so far received very little tax aid from both multilateral and bilateral sources.

Of course this is not entirely coincidental either, as many of the mentioned countries have overall large governance challenges and seen from an institutional and political economy perspective there can be doubts as to whether effective cooperation in improving tax systems is feasible. It is this author's qualified guess however (based on two decades of country level development work in Africa, Asia and Latin-America), that in several instances there may just be an important element of path dependency and group behaviour-coordination failure involved as well.

## Further reading

Lundstøl, O. (2018) 'Tax in Development: Towards a Strategic Aid Approach' Working Paper 77, Brighton, IDS: May.

## Credits

This paper was written by **Olav Lundstøl**. Olav is Policy Director of Tax and Capital Flight, Norwegian Agency for Development Cooperation (Norad) in Bergen, Norway.

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