SUMMIT FOR A NEW GLOBAL FINANCING PACT

SOMMET POUR UN NOUVEAU PACTE FINANCIER MONDIAL

WHITE PAPER #2

One Planet Lab

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Reinforcing fiscal sovereignty to face the crises of tomorrow

This report reflects ideas and suggestions that have been debated in the group and led to a general consensus. Each suggestion does not necessarily constitute an endorsement of each member. The One Planet Lab is a space for world-renowned experts to reflect on little-explored issues and instruments, to ponder out of the box and feed the formal groups of the Summit with innovative ideas.

1. Context and diagnosis: the need to overcome the current paradox of more funding but less fiscal sovereignty

As recalled in White Paper #1 of the One Planet Lab, the financing needs to achieve the Sustainable Development Goals and drive the ecological and climate transition are immense. **At least additional $4000 billion per year would be needed to reach the UN SDGs, Climate COP21 and Biodiversity COP15 objectives set at the global and national level**. In comparison, ODA totals only $200bn per year, a record in absolute terms, and official climate finance as per the Article 9 of the COP 21 Paris Agreement $83bn in 2020, with some overlap with ODA. International aid for development and ecological and climate transition, whether bilateral or *via* international organisations, is essential and must be continued, **starting with the respect of the commitments already made by countries, one of the objectives of the Summit**.

In addition to its inadequacy in volume, international support today has three shortcomings:

i) **International funding is unpredictable, difficult to access and poorly structured**. Thus, between 2002 and 2020, only 56% of the funds committed in Africa to finance the climate transition have been disbursed. Red taping is a serious issue that most countries and most agencies are facing and which creates frustration. This can be explained by the high recourse to loans (disbursed more slowly than grants), by the operating costs of the funds, or by the difficulties to have as numerous projects as needed being presented meeting the process requirements of international creditors.

ii) **International funding lacks focus and does not address the major liquidity challenge of developing and vulnerable countries**, which are growing in a context of losses and damages and consequences of external crises (Covid, energy, inflation, food shocks, climate shocks). These countries suffer on average from high debt levels, which limit fiscal space and further increase the debt burden. Between 2022 and 2023, the borrowing costs of 68 emerging markets increased from 5.3% to 8.5% (UNCTAD), depriving them of real access to financial markets. International funding is very procyclical: abundant in good times, scarce in times of crisis.

iii) **International funding restricts the fiscal sovereignty of recipient countries**, through its **uncertain nature**, the application of **conditionalities** or because **donors micromanage and predefine their allocations**. This raises a major challenge for countries wishing to self-determine their priority development paths and define their trade-offs as part of their internal social contract and international commitments.

Consequently, **the primary source of public funding for development and ecological transition comes from the developing countries themselves, which devote 75% of their fiscal and budget resources to investment and spending for development in the broadest sense (education, health, transportation, housing,…)**. In sub-Saharan Africa alone, taxes and levies brought in more than $500 billion in 2016 (compared to $43 billion in ODA). Moreover, public funding is largely complemented by private funding of projects, companies and infrastructure, coming also in great proportion from local investors.

However, **there are major disparities in the mobilisation of public domestic resources:** the average tax revenue/GDP ratio in the 31 African countries[1] covered by the publication was 16% in 2020 (compared to 22% for the Latin America-Caribbean region and 34% for the OECD countries). This indicator hides a high degree of heterogeneity, as it exceeded 25% in four countries of the African continent (South Africa, Morocco, Seychelles and Tunisia), but remained below 10% in four countries (Democratic Republic of Congo, Republic of Congo, Niger and Nigeria). While there is no objective tax revenue/GDP ratio below which development is almost impossible, several international organisations have produced reports showing that too low a ratio is a roadblock towards development and inequality reduction[2].

The factors behind this under-mobilisation of public domestic resources are largely structural and are well known:

i) **Political acceptability**. The consent to pay taxes highly depends on the social contract which exists between the citizens, the companies and their state. If raising more taxes is often an objective, citizens make it only possible if they observe that the spending of these resources is effective, well prioritized and delivering services of quality. Any perception of over-administration, corruption or rent capitation decreases the political acceptability of taxation. Work to improve tax morale, as has been the case in Eastern African countries over the past few years, is essential to change public perception and show the direct link between tax contributions and public services and development. The African Tax Administration Forum should be supported in its action in that direction.

ii) **Institutional and political difficulties** with limited technical and material capacities of tax and customs administrations to combat the leakage of illicit financial flows and to enforce tax policy. In addition, widespread corruption in some countries weakens the population's willingness to pay taxes. UNCTAD estimates that 2.5% of African tax revenues will be lost to tax evasion in 2020[3] (representing USD10-15bn of lost resources). Finally, given the lack of trust in governments and the very low

[1] OECD/ATAF/AUC (2022), *Revenue Statistics in Africa 2022*

[2] Benedek D, Benitez JC, Vellutini C (2022), *Progress of the Personal Income Tax in Emerging and Developing Countries* ; Committee of Experts on International Cooperation in Tax Matters (E/C.18/2018/CRP.19 ; 2018) *The Role of Taxation and Domestic Resource Mobilization in the Implementation of the Sustainable Development Goals*

[3] UNCTAD (2020), *Tacking illicit financial flows for sustainable development in Africa*

income of households, it is politically difficult to increase the average tax rate, despite significant progress in recent years mostly thanks to indirect taxation (VAT). Tax administration capabilities is a top priority: strengthening the skills, ensuring independence and using new technologies, which allow leapfrogging.

iii) **The economic and social structure of the countries**: the strong concentration of the economy on the exploitation of natural resources links tax revenues to fluctuating international prices and can facilitate the capture of budgetary resources. Moreover, the high poverty rate reduces the tax base, which is reinforced in some countries by the importance of the informal sector, which represents between 25% and 65% of the GDP of African economies.

iv) **National tax policy choices** relying on the use of tax exemptions to make the country economically more attractive. These favour multinational companies that exploit natural resources and pay taxes in their country of tax residence, or optimise their taxes (transfer pricing, mis-invoicing, etc.), which leads to a narrowing of the tax base in emerging and developing countries. Many tax exemptions are wasteful tax incentives, in particular in the area of extractive industries. They should end to increase revenue, without a negative impact on competitiveness.

v) **Illicit financial flows** are inhibiting African development by draining foreign exchange, reducing domestic resources, stifling trade and macroeconomic stability and worsening poverty and inequality. These illicit flows undermine transparency and accountability and erode trust in African institutions. Faced with high capital flight, tax avoidance and a marked dependence on corporate income taxes, African Governments face significant constraints to widening their tax base. However, existing instruments to fight illicit financial flows are not necessarily used by developing countries, such as instruments to track offshore assets[4].

Domestic resources to fund development and climate and environment policies are however not only public, and do not only come through taxation. They are also, and massively so, private, stemming from domestic savings, domestic companies, domestic investment. Many factors still exist in many countries hindering the capacity of mobilization of these private domestic resources for the development of countries, notably the lower relative access these resources have to de-risking mechanisms compared with external sources. These domestic private flows are essential to be better retained for the productive and social investments in the developing countries, as they have the characteristic to be exempted by design from exchange rate risk (and therefore lowering the average cost of capital), and provide strong anchors for the currency and balance of payments stability. In addition, retaining domestic savings for domestic investment enhances national sovereignty and consistency between economic and financial choices, protecting the economy from the risk of massive capital outflows and stop-and-go investment cycles.

[4] Global Forum on Transparency and exchange of information for tax purposes (2022), *Tax Transparency in Africa 2022, Africa Initiative Progress Report*

2. First ideas and suggestions by the One Planet Lab

Ahead of COP 28 and to feed in the works of the June Summit for a New Financial Pact, the **One Planet Lab** was reactivated to work on an issue that has been little explored in the economic literature: **design innovative solutions to mobilize new sources of financing for adaptation and loss and damage.**

After a first White paper around the idea of putting to contribution global flows, **the One Planet Lab has acknowledged the importance of extending support to developing countries to increase their fiscal space**. The One Planet is indeed convinced that **a balance has to be preserved between international support and national resources, so as to maintain or bolster the fiscal and political sovereignty of developing countries**.

Virtuous circles are many. Bolstering the fiscal space of developing countries presents strong spill overs, on state building, social justice, wealth distribution, and on debt reduction as long as governance is effective and resources are used wisely. In reverse, lack of sovereignty often appears when fiscal space is reduced in particular in times of crises and external shocks – notably climate crises: giving more stability and predictability to tax incomes as well as stabilizing domestic private financial resources are factors that could ease access to external liquidity in crisis times, as investors have more trust in the capacity of the economy to generate repayment capacity as soon as the peak of the crisis will be passed.

The reflection has followed a triple track:

- **no narrative for a renewed international financial system** to improve global capacity to tackle poverty, climate change and biodiversity losses **should deprive beneficiary governments and societies from their decision-making power, but instead reinforce their sovereignty and freedom of policy choice**
- the call for a new global financial system cannot let some companies and financial actors outside from this global pact, and **more support should be given to developing countries to fight illicit flows and tax evasion**
- **domestic resource mobilization should aim to enlarge fiscal space of countries, not only by increasing capacity to raise taxes but also by increasing domestic investments of domestic savers and companies to support economic development**

At this stage, several avenues to increase fiscal space have been considered to give a new impetus to many of the commitments made notably in Addis Ababa in 2015:

1. **Clamp down on illicit financial flows (IFF)**. The UN High Level Panel estimated that between 2000 and 2015, the African Continent lost about USD 88 billion due to capital flight and illicit financial flows, mainly from the extractive sector as well as stemming from corruption and money-laundering. IFFs constitute a major drain on capital and revenue, particularly in Africa, which further undermines the productive capacity and the continent's prospects of mobilizing its own resources for climate finance. As IFFs mostly happen in the extractive sector, the increasing demand for critical minerals will bring a new dimension to this problem and therefore require renewed mobilisation. The One Planet Lab could suggest enhancing a better use of banking information, exchange of information as promoted

by the 147 signatories of the OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters, or revisit taxing rights as regards to extractives where IFF are highly significant.

2. **Reinforce the consistency of corporate tax across countries**. The OECD pillar 2 agreement should come into effect in the next few years in developing countries and constitutes a first step to reintroduce solidarity and curb tax evasion. The application of the second pillar should generate between USD175 and 261 billion of global revenues, with a large part directed linked to a larger taxable basis in developing countries. In order to facilitate this, the One Planet Lab recommends that developing countries implement the "top up tax" to end tax incentives that deprive developing countries from valuable resources.
3. **Massively increase fiscal and technical tax capacity-building**. Cross-border tax avoidance impacting developing countries is likely to exceed ODA by a considerable margin. A good example would be OECD/UNDP "Tax Inspector without borders", an initiative which deploys experts to developing country tax administrations to provide practical, hands-on assistance on current audit cases and related international tax issues. It has already helped participating countries to increase tax revenues (+ $1.7 billion since 2012) and tax assessments (+ $3.9 billion since 2012). With the endorsement of the Addis Tax Initiative Declaration 2025, more than 70 member countries of the Addis Tax Initiative (ATI) pledged to promote fair, equitable and effective domestic revenue mobilization, and ATI partners committed to maintain or surpass the 2020 global target level (USD 441.1 million) of cooperation for country-owned tax reforms. The launch in 2018 of the Global Tax Program (GTP), housed at the Fiscal Policy and Sustainable Growth Unit of the World Bank, has already received UDF90M in contributions and launched 78 advisory and technical assistance projects in over 85 countries, with a special focus in Africa.
4. **Invest in tax administrations and tax policy**: new technologies allow for leapfrogging and move directly from paper-based tax administrations to Administration 3.0. Donor agencies should direct more resources to building modern and stronger tax administrations. Training officials to tax administration and tax policy, including on their international dimensions would yield significant return, and would ensure more independent tax administrations and better assertion of countries sovereignty. Some targeted programs deserve to be better known, as the Local Government Revenue Initiative (LoGRI) lead by the International Centre for Tax and Development (ICTD) based at the University of Toronto, to support the Africa Property Tax Initiative (APTI) by developing technologies of satellite imagery to assess and collect property taxes in urban areas which are developing fast. Since 2021, it has been active in 16 countries.
5. **Support countries in improving tax design**. Beyond tax enforcement, tax designs matter as some taxes are easier to collect than others, especially when taking the most of digital tools which allow to design and collect low-rate and broad basis taxes at a very low cost. Focusing capacity building on VAT definition and collection, notably on e-commerce and e-services, proves particularly effective (South Africa raised $1bn since it implemented VAT on e-services in 2014). Strengthening VAT collection not only provides a broad base and internal consistency checks, but it also helps with information for other taxes, including personal and corporate, and income taxes, and has therefore indirect positive features. These changes in tax design are all the more urgent as many countries still

largely rely on border tariffs and custom inflows (15% of revenues of Senegal are "customs and other import duties[5]", 35% in Sudan and up to 65% in Somalia), and are in the process of removing these border tariffs to create regional free-trade spaces, such as the ZLECAf on the African Continent. On these urgent and needed changes, the support of the IMF Revenue Mobilization Thematic Fund (RMTF), in particular in Sub-Saharan Africa, is game-changing.

6. **Reduce fiscal exemptions and especially climate-harmful ones**. Indeed, the potential of revenues is real from ending fossil fuel production and consumption subsidies (in particular in fossil-fuel exporting countries which distributed half of the global consumption subsidies in 2022) which further increased massively in 2022 in a context of price energy surge[6], and/or putting in place carbon pricing, as it is done in some coalitions like the Coalition of Ministers for Climate Action. More proactive action to also introduce levies and contributions on polluting activities are necessary, beyond removing subsidies and exemptions on fossil fuel uses. The Environmental Tax Workstream of the Global Tax Program of the World Bank provides very useful support to countries on these issues.
7. **Explore ways to simplify international tax rules for the least developed countries**. There is understanding among stakeholders in developing countries that the rules of taxation are designed in a way that they give priority to the advanced economies. For instance, the Subject to Tax Rule (STTR) - a treaty-based rule to permit source jurisdictions to impose limited sources of taxation on certain payments that are taxed below a minimum rate in the country of residence, is of extreme significance for the developing countries. A suggestion to make STTR simpler for developing countries to administer could be made.
8. **Increase health-related taxes in countries where they are not implemented**. Indeed, health taxes represent on average 0.4% of GDP in very low-income countries, compared to 0.8% for high income countries. Taxes on alcoholic beverages, sugar or tobacco have excellent externalities. Firstly, they reduce the consumption of harmful products through a signal effect: thus, a 50% increase in taxes on alcoholic beverages would "avoid" 21.9 million deaths over 50 years according to WHO figures. In addition, their fiscal potential is very high, making it possible to finance national health policies. A 50% global increase in taxes on tobacco products would raise $3,000 billion over 50 years[7]. As an example, in two years, from 2012 to 2014, the Philippines was able to raise almost one percentage point of GDP in revenue (€2.2bn) after increasing taxes on tobacco and alcohol.
9. **Support private sector from developing economies**. Investors and entrepreneurs from developing countries face similar difficulties than their counterparts from developed countries, with reputational, financial, operational and prudential risks. They often have better knowledge of markets and their development generate several spills over, especially on their country. However, domestic investors and entrepreneurs have no access to MDBs guarantees and de-risking instruments which could be extended to the private sector of developing and emerging countries, and not only to transnational ones. Such domestic increased investments would lead to more

[5] Source: World Bank, International Monetary Fund, Government Finance Statistics Yearbook and data files

[6] In 2022, subsidies worldwide for fossil fuel consumption skyrocketed to more than USD 1 trillion, according to the IEA's latest estimate. First estimates for 2022 show that subsidies for natural gas and electricity consumption more than doubled compared with 2021, while oil subsidies rose by around 85%. The subsidies are mainly concentrated in emerging market and developing economies, and more than half were in fossil-fuel exporting countries.

[7] Bloomberg task force on fiscal policy for health (2019), *Health Taxes to Save Lives: Employing Effective Excise Taxes on Tobacco, Alcohol, and Sugary Beverages*

economic growth and larger savings pools, which in turn would help countries to have a more stable fiscal situation.

10. **Accelerate the implementation of the Addis Ababa Action Agenda by which countries committed to considering not requesting tax exemptions on goods and services delivered as government-to-government aid, beginning with renouncing repayments of value-added taxes and import levies**. Since 2015, some progress has been made, in particular thanks to the UN Committee of Experts on Tax which issued Guidelines on this issue in 2021 and to the OECD efforts to monitor the implementation of this commitment to a dedicated hub. Coordinated efforts by the Platform for Collaboration on Tax (PCT) should be further supported and donor agencies and other aid actors should follow the UN Guidelines and share their best practices to enable developing countries to better collect tax revenue, including on aid.

In addition to this agenda, to further increase fiscal space of middle and low income countries, **it has been suggested to support all the initiatives of reduction of debt levels and climate-resilience-debt clauses**. Debt to nature swaps, increased debt services suspension as well as SDR rechannelling have to be supported in their developments, evaluation and deployments at scale.