Tax Matters:
An outline of UN-ESCAP’s ongoing work

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2030 Agenda for Sustainable Development and tax matters

The 2030 Agenda for Sustainable Development and the Addis Ababa Action Agenda on financing for development provide the overarching guidance for UN system's work on tax matters.

- Sufficient and robust public revenues are critical to achieve the Sustainable Development Goals (SDGs) worldwide by 2030.
- Enhancing revenue mobilization, improving the fairness, transparency, efficiency and effectiveness of tax systems, ending harmful practices that jeopardize sustainable development, and scaling up international tax cooperation are the key elements of the Addis Ababa Action Agenda.
- Respecting national ownership, building broad consensus, promoting equal and inclusive cooperation, and prioritizing least developed countries, landlocked developing countries, and small island developing States are the main guiding principles for implementation.

What is UN-ESCAP doing on tax issues?

Facilitate rethinking and recalibration of tax policies in view of the new demands and principles of sustainable development.

Promote broad-based regional tax cooperation, in collaboration with existing tax cooperation mechanisms and other stakeholders.

Address Asia-Pacific's unique challenges and leveraging the region's own policy experiences and lessons in addition to international best practices.

Champion for least developed countries, landlocked developing countries, and small island developing States to strengthen their voice in international tax cooperation and enhance technical and capacity support for them.

What is the current focus of ESCAP's work on tax issues?

Provide a broad-based platform for knowledge exchange and policy debate and coordination, leveraging on ESCAP's inclusive inter-governmental mechanisms.

Strengthen policy understanding of priority issues for Asia and the Pacific

- Tax and equity: the potential of income, property and wealth taxes
- Tax incentives: lessons from Asia and the Pacific
- City finance: municipal revenue vehicles, sub-national fiscal governance, inter-governmental transfer systems
- Environmental taxes: addressing the region's environmental challenge

Contribute regional inputs to international tax cooperation through UN follow-up mechanisms of 2030 Agenda and financing for development.

Example of ESCAP's work: Eminent Expert Group

Eminent Expert Group (EEG) on Tax Policy and Public Expenditure Management for Sustainable Development.

- An independent advisory board to provide ESCAP with strategic guidance, suggest policy priorities and contribute technical inputs. Have 18 renowned experts and experienced policy makers from both within and outside the Asia-Pacific region

Main messages from the inaugural meeting of the EEG in December 2016.

- Prioritize public finance as a key pillar of the implementation strategy for the 2030 Agenda, with support from regional intergovernmental bodies;
- Create an inclusive regional platform for cooperation on public finance to promote knowledge exchange and policy debates, including between tax policy makers and administrators, and to facilitate participation of the region in international tax or public finance cooperation initiatives.;
- Advance policy research on public finance issues directly linked to the new demands of sustainable development and to the unique challenges of the Asia-Pacific region;
- Strengthen effectiveness of advisory and capacity building activities through better coordination and better tailoring according to local contexts and policy experiences.

Example of ESCAP's work: policy paper on tax incentives

Revisit and complement existing best practice recommendations based on Asia-Pacific's local context and policy experience.

Address two puzzles in this vein:

1. Why do tax incentives remain prevalent in developing countries even through best practice studies repeatedly conclude that they are ineffective and costly?

2. Why did different successful economies of the region follow very different tax incentive strategies/policies, rather than a single set of best practices?

Example of ESCAP's work: policy paper on tax incentives

Base-protection could also be an important driver for tax incentives in developing countries, especially in the presence of large informal sector.

- Keeping effective tax rates low in sectors where firms can easily shift into informal sector while imposing high rates on sectors where there is little opportunity to operate in informal sector to compensate for lost revenues is a rational second-best choice;

- By imposing higher taxes on large and/or capital intensive firms, taxes can be lower for remaining firms to keep them inside the formal sector, and the revenue benefit of such practice could outweigh the distortionary costs.

- Vice versa, the competition pressure from the informal sector could also become an excuse for formal sectors lobby groups for preferential tax treatment.

- Efforts to abolish harmful tax incentives in developing countries need to take into account such dynamics and be complemented by policies to address the informal sector challenges.

Example of ESCAP's work: policy paper on tax incentives

Table 2.1 Tax Structure in Developing and Developed Countries, 2013

	Tax Revenue	Personal Income Tax and Social Security Contributions	Corporate Income Tax	Consumption Taxes	Property Taxes	Border Taxes	Shadow Economy
	% GDP	% of Total Tax Revenue					% GDP
Developing countries average[1,2]	24.5	27.1	14.8	45.4	2.1	7.2	39.3
Developed countries average[1,2]	34.1	49.3	9.9	33.5	4.0	0.3	20.2

Source: IMF, *Government Finance Statistics*; Hassan and Schneider (2016).

1. Unweighted averages
2. Countries are classified according to IMF (2016) classification: 39 developing countries and 35 developed countries.

Example of ESCAP's work: policy paper on tax incentives

Figure 2.1 Shadow Economy and Tax revenue, 2013

Examples of ESCAP's work: policy paper on tax incentives

Republic of Korea	Singapore	Hong Kong
- Less dependent on FDI - Large informal sector - Strong domestic manufacturing & innovation	- Highly dependent on FDI and trade - Small informal sector	- Highly dependent on FDI and trade - Relatively small informal sector in recent period
- Broad incentives for investment, with little special preference for FDI - Investment climate for FDI even less attractive than China & Japan - A possible reason for this policy choice is to protect domestic tax base as FDI is susceptible to BEPS - The dominance of large domestic firms also contributed to this choice	- Aggressive use of tax incentives as part of overall development strategy - Broad-based incentives to almost all manufacturing & financial activities at early stage, to compensate for unfavorable investment climate - Streamlined in recent years with focus on entrepreneurship & R&D - Steady decline in CIT rates to 17% on a par with HK	- Simple tax regime with low and uniform rates - Emphasis on improving general investment climate - Limited tax incentives on target activities, few distortionary incentives

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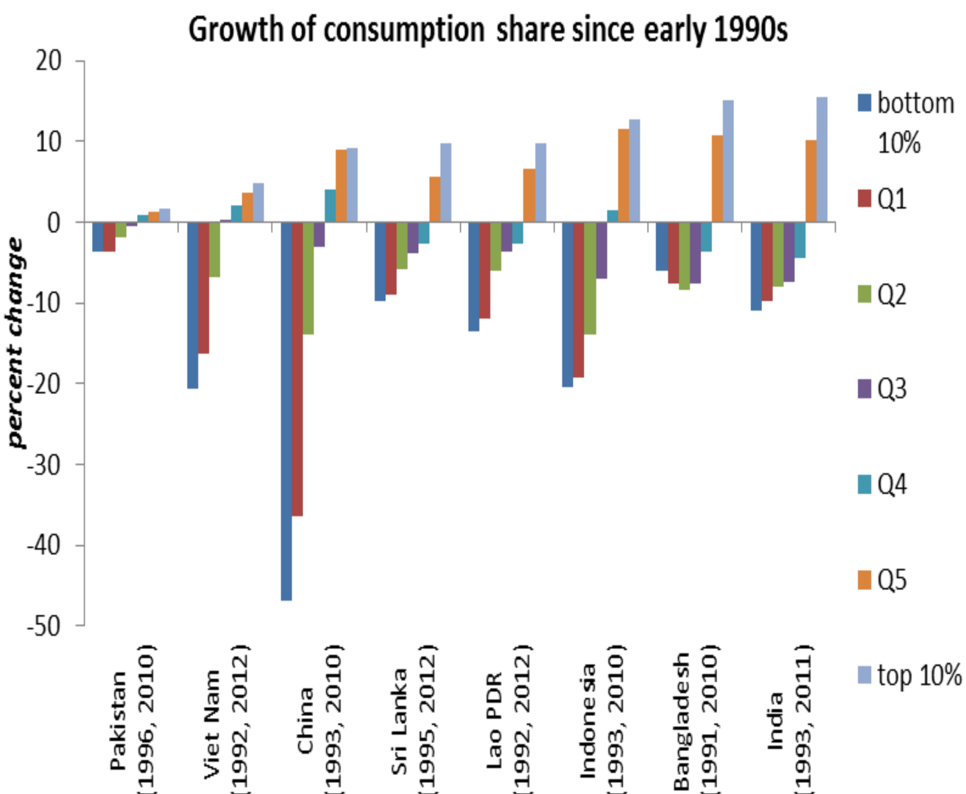
Examples of ESCAP's work: policy paper on tax incentives

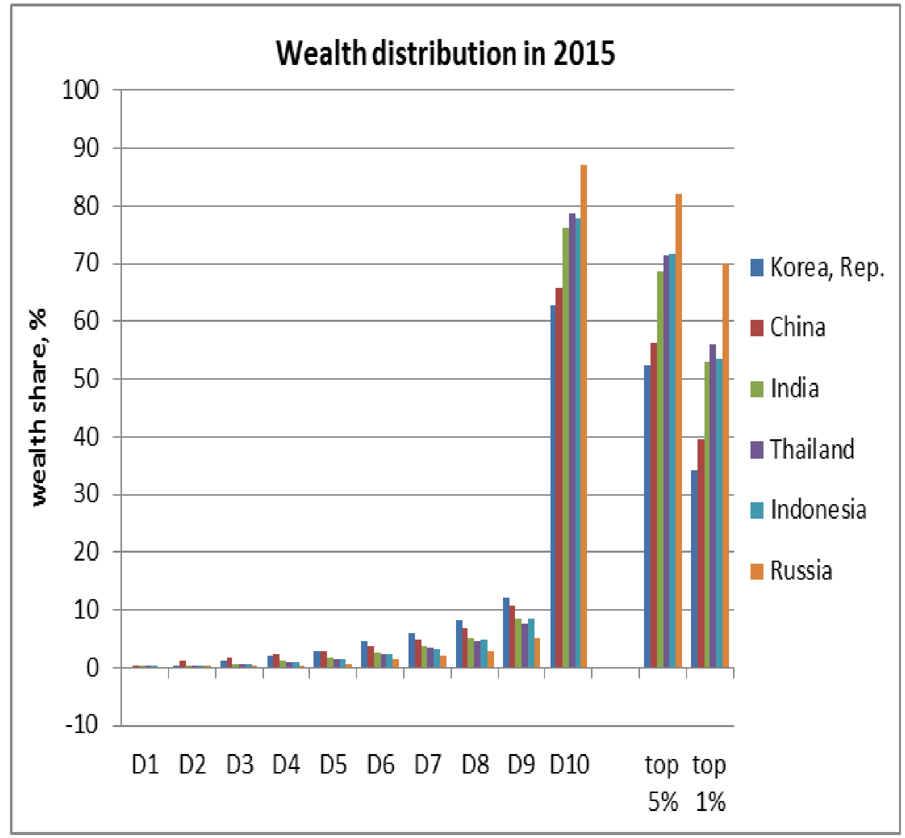
Tax incentive policies should be assessed and designed according to national economic context and the overall development strategy, rather than a rigid set of principles or best practices.

- Economic structure: manufacturing vs service/finance; size of informal sector.
- Overall development strategy: promoting domestic industries or attracting FDI.
- Competitive edge: resource rent, large integrated domestic market, strategic location, favorable investment climate.
- Government abilities and quality of economic governance.

Examples of ESCAP's work: taxing for shared prosperity

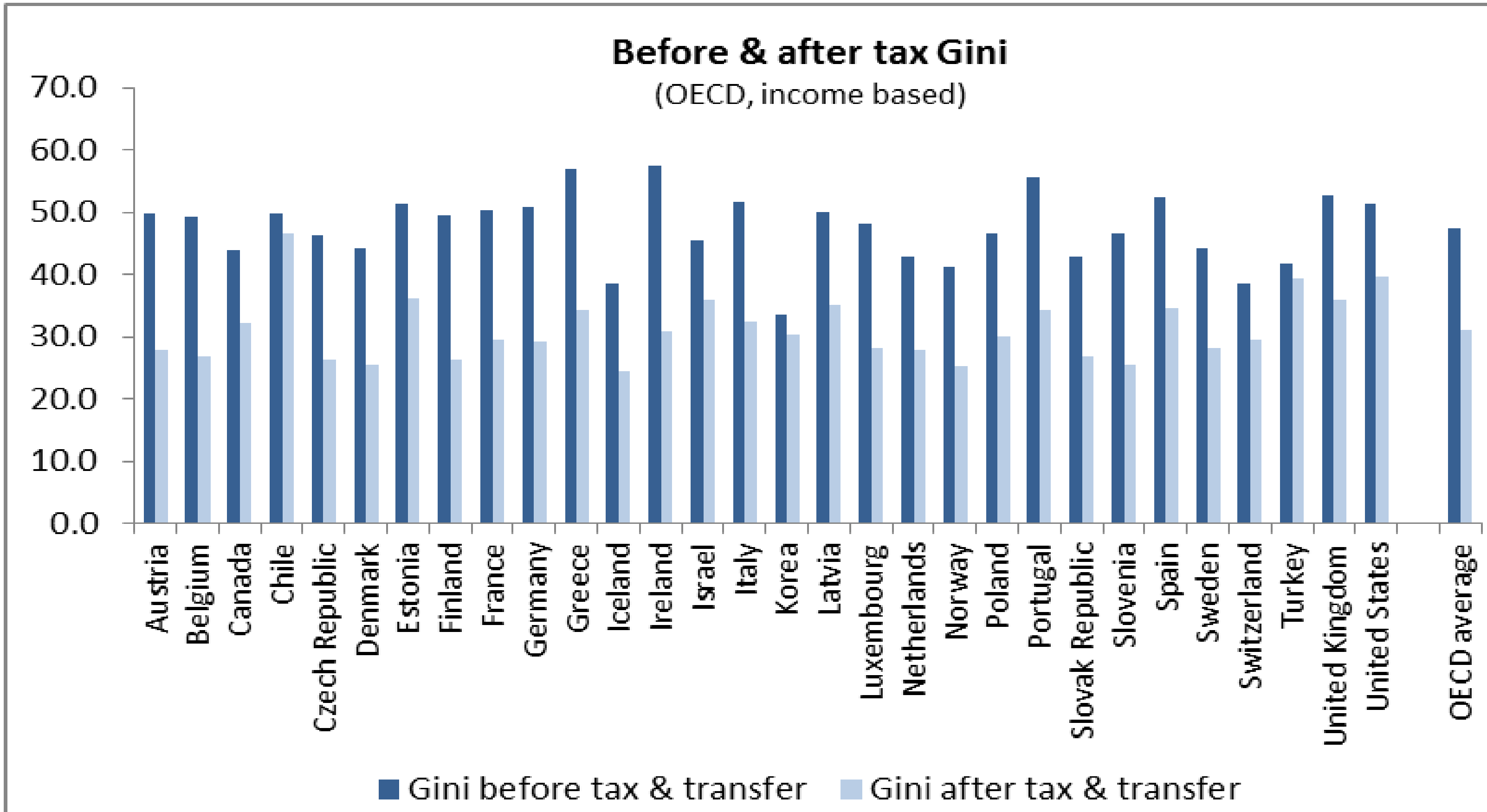
Widening inequality is a serious challenges for inclusive and sustainable development in the AP region





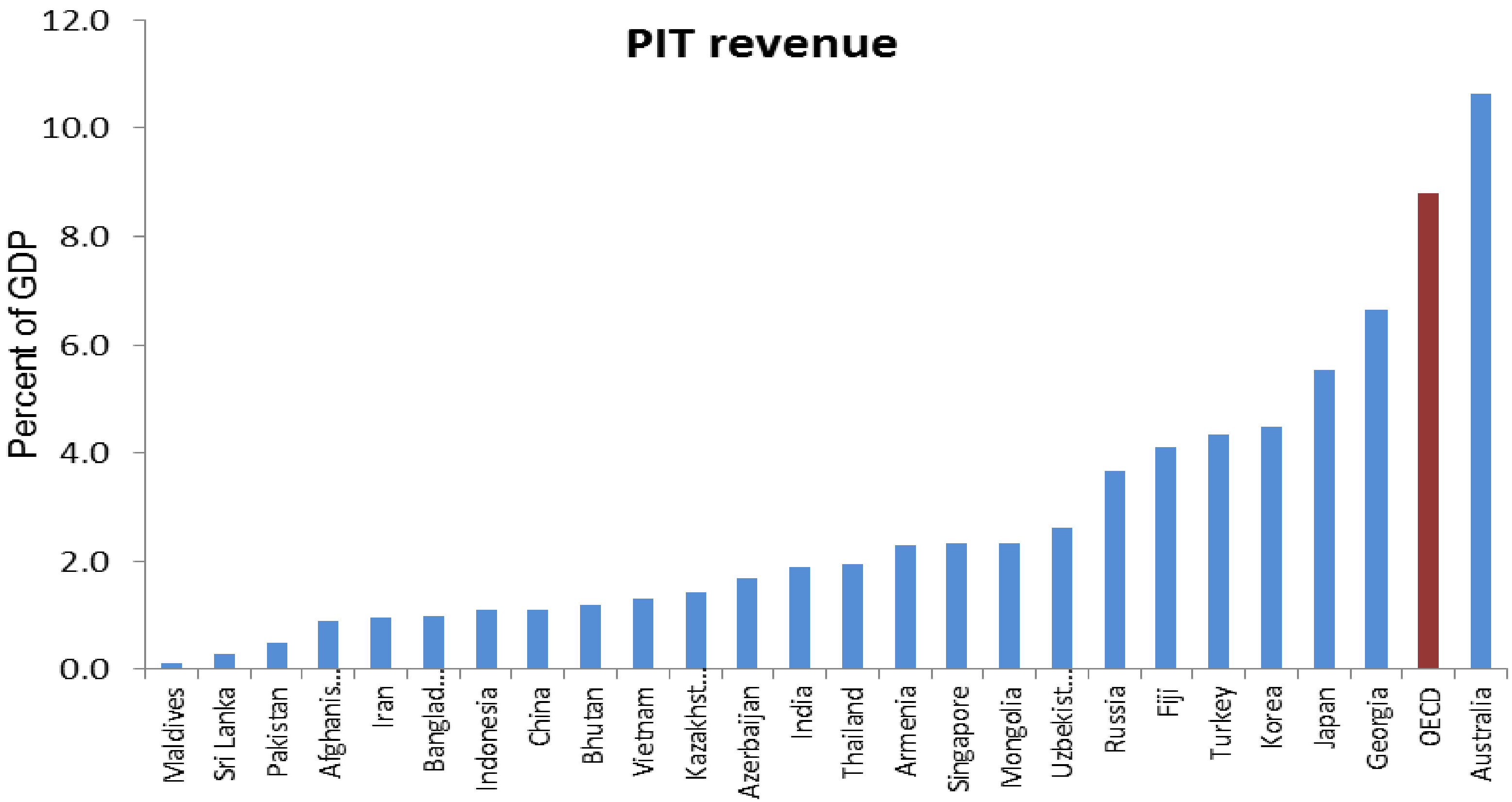
Examples of ESCAP's work: taxing for shared prosperity

Taxes have a potential to play a bigger role in adjusting income distribution.



Examples of ESCAP's work: taxing for shared prosperity

Direct taxes remain under-leveraged in most AP developing countries.



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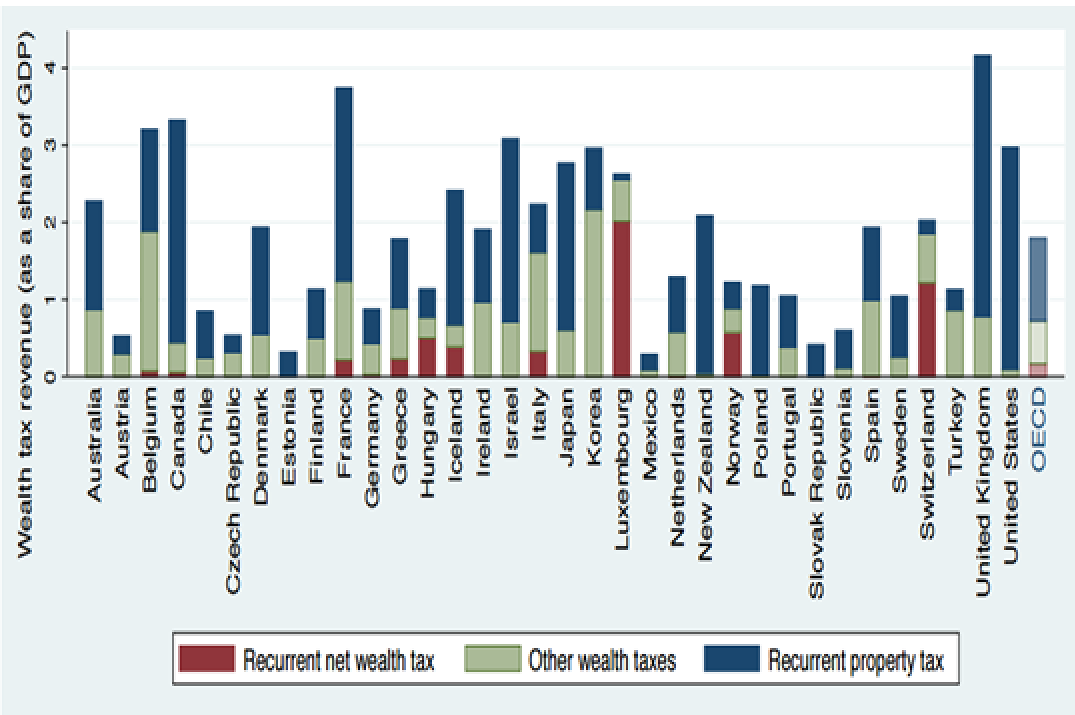
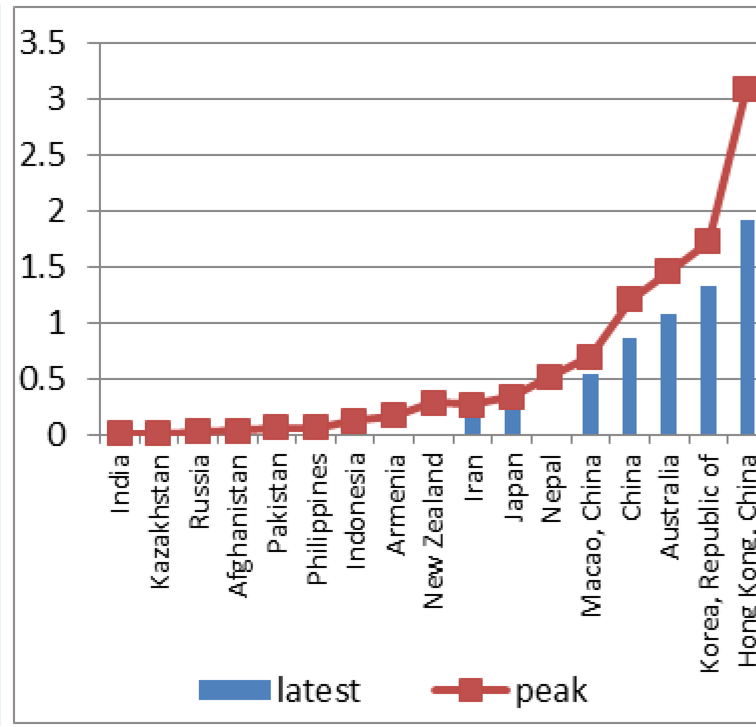
Examples of ESCAP's work: taxing for shared prosperity

Property and wealth taxes are largely missing in developing Asia.

a. Wealth taxes in OECD countries



b. Property tax in Asia-Pacific



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Examples of ESCAP's work: taxing for shared prosperity

The answer is not to simply tax more or tax the rich more.

- A narrow PIT targeting, mainly salary income, could be regressive overall despite having seemingly progressive schedule.

- Hiding personal income and expenses in cooperate activities is a widespread practice of business owners when top PIT rate is higher than CIT rate.

- The rich are usually more sophisticated in exploiting the loopholes of property and wealth tax regimes, leaving the emerging middle class bearing the bulk of the tax burden.

- The income/wealth adjustment benefits of progressive taxation could be small as PIT and wealth taxes themselves are small in developing countries. At the same time, it could be highly distortionary and administratively costly, especially for countries with imperfect institutions and weak capacity.

Examples of ESCAP's work: taxing for shared prosperity

A differentiated, pragmatic and prudent approach should be followed.

- Countries at different stages of the 'Kuznets curve' should follow differentiated strategies.
- Need to pay attention to actual redistributive effects of tax design and policies rather than theoretical assumptions, which requires policy making to take into account behavioural responses from tax payers and institutional/capacity constraints.
- Understand that there is a learning curve of policy design and implementation when it comes to progressive taxation.

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