

Financing for Sustainable Development Report 2019

Inter-agency Task Force on Financing for Development



United Nations

This report is a joint product of the members of the Inter-agency Task Force on Financing for Development (a full list of members can be found on page x). The Financing for Sustainable Development Office of the United Nations Department of Economic and Social Affairs serves as the coordinator and substantive editor of the Financing for Sustainable Development report.

The online annex of the Task Force (<http://developmentfinance.un.org>) comprehensively monitors progress in implementation of the Financing for Development outcomes, including the Addis Ababa Action Agenda and relevant means of implementation targets of the Sustainable Development Goals. It provides the complete evidence base for the Task Force's annual report on progress in the seven action areas of the Addis Agenda (chapters III.A–III.G). The report is by necessity more concise and selective and should thus be read in conjunction with the online annex.

The online annex also covers several key cross-cutting initiatives that build on the synergies of the Sustainable Development Goals:

- Delivering social protection and essential public services
- Ending hunger and malnutrition
- Closing the infrastructure gap
- Promoting inclusive and sustainable industrialization
- Generating full and productive employment for all
- Protecting ecosystems
- Promoting peaceful and inclusive societies
- Gender equality
- Investing in children and youth
- Addressing the diverse needs and challenges faced by countries in special situations
- Global partnership

Inquiries about the Task Force or its report and online annex can be sent to:

Financing for Sustainable Development Office
Department of Economic and Social Affairs
2 United Nations Plaza (DC2- 2170)
New York, N.Y. 10017
United States of America
+1-212-963-6518

developmentfinance@un.org

<http://developmentfinance.un.org>

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DOMESTIC PUBLIC RESOURCES





Chapter III.A



Domestic public resources

1. Key messages and recommendations

Revenue is not an end in itself; it is a means for Governments to finance the expenditure necessary to achieve sustainable development and policy goals. The fiscal system plays several roles. It finances the provision of public goods, sets incentives for the behaviour of private actors, and promotes equity. It also supports macroeconomic stabilization and can be used to stimulate growth during economic slowdowns. While median tax-to-gross-domestic-product (GDP) ratios have increased, there is still a large gap between public resources and financing needs to achieve the Sustainable Development Goals (SDGs).

As noted in the Addis Ababa Action Agenda, domestic resource mobilization is first and foremost generated by economic growth. With global growth projected to have peaked, as discussed in chapter I, the needed further increases in revenue will require application of political will to tax policy and administrative reform, expanding the tax base and improving compliance. Given the long-term nature of the SDGs, Governments will need plans that operate through political and business cycles. *Embedding medium-term revenue strategies into long-term planning and developing a national consensus that can see revenue reform through political cycles should allow countries to raise more public resources.* A focus on aligning the expenditure side of fiscal policy with sustainable development strategies to deliver public services equitably will create further progress in achieving the SDGs, while stimulating inclusive growth.

Member States of the United Nations can work towards establishment of a new social contract, based on a more equitable and inclusive society with fair contributions by all. The renewed social contract should be reflected in national sustainable development strategies and integrated financing frameworks (see chapter II). Fulfilling the social contract requires that these resources be raised fairly and tied to effective expenditure and the delivery of accountable public services.

Combating inequality and achieving SDG 10

(reducing inequality) requires careful design of the fiscal system. Placing a priority on effective and progressive tax systems and expenditures can make achievement of inequality goals more likely. Governments can *explicitly take account of inequalities, including gender inequalities, in fiscal policy and public financial management.* Gender-responsive budgeting is an effective tool for tracking financial commitments to and actual expenditure on gender equality. Countries with large informal sectors can pursue efforts to formalize business in ways that do not harm the poor. *Policymakers can use relatively high tax-exempt thresholds to incentivize formalization, encourage greater levels of compliance, and ensure that the poor are not burdened by the tax system. Removing means testing for access to social protection* would help remove barriers to participation in the formal economy, while also providing benefits to participation. More effective taxation of large businesses, including multinational enterprises (MNEs), can boost revenue, while contributing to perceptions of fairness in tax systems, as well as reducing inequality.

Incentives set by the fiscal system can be used to effectively target progress on SDG 13 (climate action). Climate change mitigation and adaptation policies, and disaster risk reduction, can be supported by incentives in the fiscal system. *Environmental taxation and the reform of energy and other subsidies have a critical role to play in transitioning the world to a low-carbon economy.*

The international tax environment looks remarkably different than it did just ten years ago. Norm-setting is more inclusive and more information is now available on financial accounts and corporate activity, although profit shifting remains a challenge. Efforts at strengthening international tax cooperation have brought important benefits in enforcement of tax rules. All countries should aim to participate in international efforts to strengthen tax transparency, at the same time more work needs to be done to enable developing countries to benefit from information-sharing networks, especially the poorest countries. Some of the fundamental tenets of the international tax architecture, such as the

arm's length principle and allocation of taxing rights, are now being questioned, particularly as a result of digitalization of the economy.

The international tax architecture needs to continue to be more inclusive and the voices of all countries need to be part of discussions on setting new tax norms. It is in the global interest to seek a consensus, but it needs to reflect the realities and priorities of different countries. It is critical to pay attention to the potential impact on small and poor countries, who already lag behind in their ability to raise revenue. *Putting the needs and capacities of these countries at the forefront of analysis and decision-making would help create a fairer international tax system and advance sustainable development.* Official development assistance (ODA) in support of domestic revenue mobilization remains small. *Donors should continue to increase their contributions to revenue mobilization capacity-building.*

A number of international initiatives aim to ensure MNEs pay taxes where economic activity and value is created, with particular importance placed on efforts for country-by-country reporting of MNEs. *Greater public availability of aggregate data on offshore financial assets and the taxation of MNEs would contribute to more accurate assessment of the distributional effects of tax norm changes and empower countries to choose tax norms that enhance equity.*

The Inter-agency Task Force recognizes the damage done by illicit financial flows (IFFs) and Member States' interest in this issue. *While technological advances pose risks related to IFFs, they can also be used in strengthening tax administration, as well as assisting Member States to combat IFFs.*

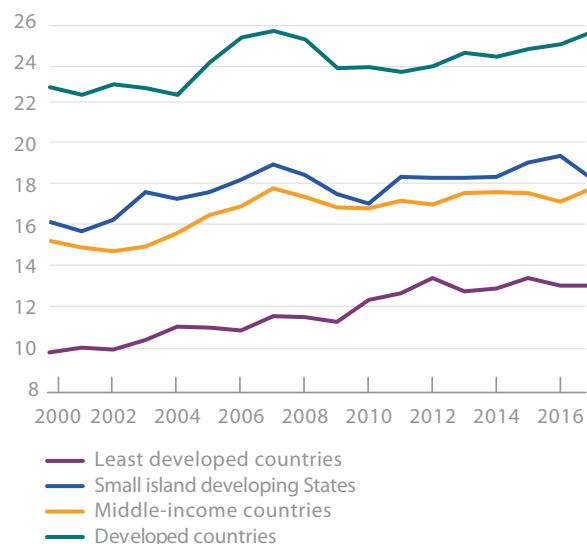
2. Domestic revenue mobilization

2.1 Trends in revenue and taxation

Member States recognized in the Addis Agenda that additional domestic public resources would be needed in order to achieve the SDGs. In 2017, developed countries and middle-income countries again saw rises in tax revenue measured as the median ratio of tax-revenue-to-GDP (figure 1). These annual rises continue a seven-year upward trend, which has brought the ratios back above levels witnessed in 2007 before the 2008 world financial and economic crisis. Least developed countries (LDCs) have generally seen increasing revenue trends: 60 per cent of LDCs saw year-on-year improvements in tax-revenue-to-GDP ratios in 2017, with an average gain of nearly 1 percentage point in the 27 countries making progress. That said, the median ratios in LDCs stayed steady, and the median ratios for small island developing States (SIDS) dipped in 2017.

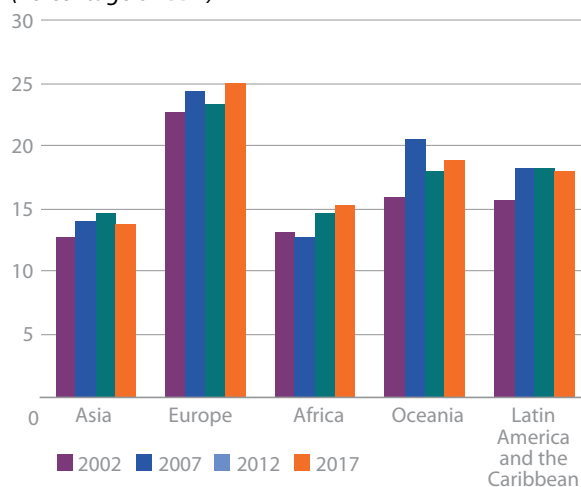
Tax revenues vary widely by region (figure 2) as well as by country. For example, commodity exporting

Figure 1
Median tax revenue, 2000-2017
(Percentage of GDP)



Source: IMF, World Revenue Longitudinal Dataset.
Note: Excluding social security contributions and non-tax revenue.

Figure 2
Median tax revenue, by region, 2000-2017
(Percentage of GDP)



Source: IMF, World Revenue Longitudinal Dataset.
Note: Excluding social security contributions and non-tax revenue.

countries' public revenues (royalties, fees and taxes) are linked to commodity-price cycles. Stagnation in overall revenues in commodity exporting countries is partly explained by low commodity prices since 2015. Regionally, the biggest improvement in revenue occurred in Africa, with 30 countries improving their tax-to-GDP ratios, while 22 saw declines.

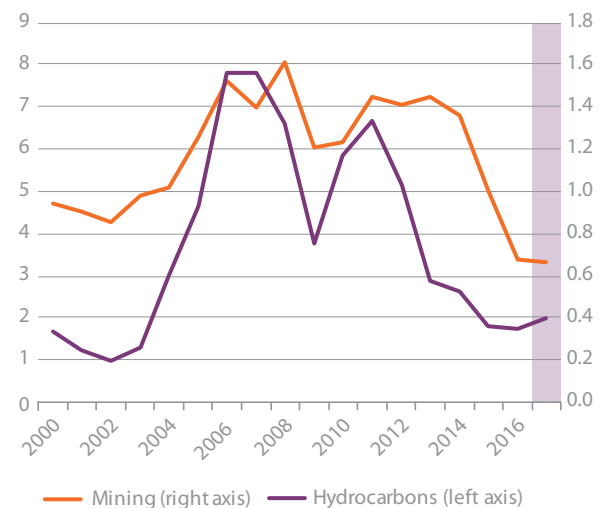
The Latin American and Caribbean region provides an example of the variation that can be found in a single region. Domestic public revenues in aggregate have re-

mained stagnant since 2014, at close to their 2011 levels (figure 2). The 2017 median tax-to-GDP ratio increased slightly, with an equal number of countries recording gains and declines. These aggregate trends hide a more complex interaction between different sources of government funding. Revenue from non-renewable natural resources has been falling, reflecting declines in global commodity prices (figure 3), while public revenues from other sources rose through 2016. Many countries undertook significant tax reforms during this period to raise resources, although the emphasis of reforms varied based on national circumstance. Countries that had large revenues from non-renewable natural resources, made up for falling revenue principally through strengthened direct taxation on personal and corporate incomes. Meanwhile, Caribbean countries, many of which have high debt burdens, have turned to higher levels of indirect taxes, while also raising the expected social contributions from employers and employees towards social protection programmes. The within-region disparities highlight the importance of national analysis of tax reform and structures and their impact on the SDGs, such as inequality and climate change (see below).

2.2 Domestic tax avoidance and evasion

Tax avoidance and evasion continues to be a significant barrier to domestic resource mobilization efforts in all parts of the world and can have an impact on both efficiency and equity considerations. It can have also high

Figure 3
Revenues from non-renewable natural resources,
Latin American and Caribbean countries, 2000-2017
(Percentage of GDP)



Source: ECLAC.

Note: For the purpose of maintaining compatibility between total revenues and revenues from non-renewable natural resources statistics the following coverages are used in this figure: Argentina (non-financial public sector), Bolivia (Plurinational State of) (general government), Brazil (general government), Colombia (non-financial public sector), Ecuador (non-financial public sector), Mexico (federal public sector) and Peru (general government). All other countries refer to data from the central government.

Box 1

Municipal land taxation in Asia-Pacific

Providing essential public infrastructure and services to support sustainable development is not a task for central governments alone. In medium or large developing countries, subnational governments can account for more than half of the aggregated public expenditure. Yet, subnational governments often lack tools with which to raise resources. There is no one-size-fit-all strategy for municipal governments given the variety of national legal frameworks and economic circumstances.

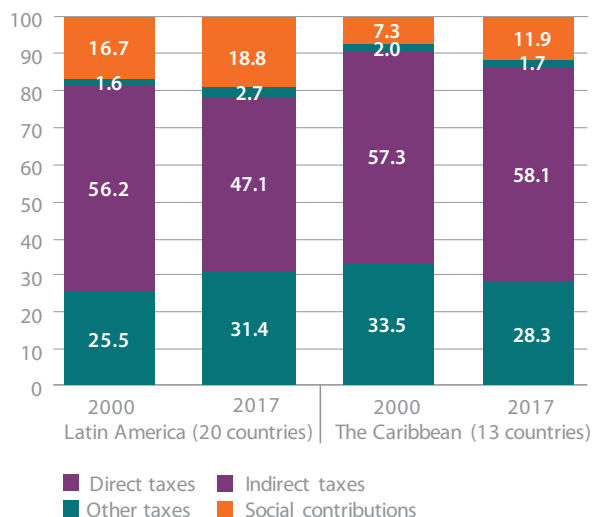
A series of recent municipal revenue case studies⁵² by the Economic and Social Commission for Asia and the Pacific (ESCAP) in the Asia-Pacific region highlighted some examples of land taxation as revenue mobilization options. In most developing countries in the region, property tax remains the only significant revenue tool for municipal governments. However, property tax has underperformed compared to expectations due to its unpopularity and the assessment challenges, although technology solutions can help improve performance. Recurrent property tax in general contributes less than 1 per cent of gross domestic product (GDP) in revenue in developing countries worldwide.

Land value capture can complement property taxes, particularly in countries with fast urban expansion and booming real estate markets. Land value capture can take two general forms. First, the sale of building rights can raise revenues and can be accomplished through imposing fees on changes in the approved use of land, zoning, or floor-area ratio. Second, subnational governments can impose betterment contributions, which are charges on properties that benefit from public improvements or services. Land value capture allows governments to recover a proportion of the unearned increase in land value that results from public investments, while also raising revenues that can be reinvested. Compared to recurrent property tax, land value capture generates revenue streams that are more front-loaded.

The sale of building rights is particularly common in Asia-Pacific. Land lease programmes in China, for example, charge developers for the building rights through public bidding, with municipal governments in aggregate raising, on average, 5.8 per cent of GDP annually between 2013 and 2017.⁵³ Land lease, together with non-recurrent taxes⁵⁴ on land use and real estate, have generated enough revenue in China to finance the entire public infrastructure budget in recent years.⁵⁵ A derivative version of value capture through land lease is the practice of including the sale of building rights in large infrastructure public-private partnership (PPP) projects, as seen in subway PPPs in Hong Kong and Beijing. In India, Mumbai started to collect payment for the right to build additional floor space on a given plot of land in the suburbs in 2015 and in the city centre in 2018.⁵⁶ This is expected to become an important local revenue source and one way for the city government to reclaim part of the economic rent in increased property values.

Source: ESCAP.

Figure 4
Revenue and social security structure in Latin America and the Caribbean, 2000 and 2017
 (Percentage)



Source: ECLAC Tax Revenue Database.

costs in terms of foregone investment in areas related to the SDGs. For example, In Latin America, the Economic Commission for Latin America and the Caribbean (ECLAC) estimates that the costs associated with tax non-compliance of income tax and value-added tax (VAT) reached 6.3 per cent of GDP, or \$335 billion, in 2017 (figure 5). There are indications that VAT non-compliance has dropped significantly over the last decade as a result of consistent investment in administration. Non-compliance on income tax—corporate and personal—is especially acute, ranging from 31 per cent of potential tax take to as high as 73 per cent.¹

Analysis of administrative data also points to significant evasion, including “bunching” in reported income just below tax thresholds and “missing mass” above the threshold.² Such evasion is particularly prevalent for self-employed workers, firms transitioning from being medium-sized to large enterprises, and businesses at the threshold of tax-base changes, particularly when moving from turnover taxes to income taxes on profits. Existing evidence points to bunching effects being driven by manipulated reporting rather than changes in real economic activities.³ Unlike problems of international tax avoidance and evasion by corporations and wealthy individuals (see below), domestic tax avoidance and evasion can be addressed unilaterally.

Modern tax administrations take a multi-tiered approach to reducing avoidance and evasion. First, they promote voluntary compliance. Voluntary tax compliance can be enhanced by education, outreach, simplification, and so-called tax certainty (which refers to having clear and simple tax rules and regulations that minimize disputes) and effective methods of dispute resolution. Second, tax policy changes can reduce avoidance and evasion. Amending tax laws to close loopholes and implementing different tax structures—

such as making use of turnover taxes for the smallest businesses and having withholding taxes—can contribute to reducing avoidance and evasion. While turnover taxes are considered distortionary for productivity, one country case study found that the shift from profit taxation to turnover taxes increased revenue from affected businesses by 74 per cent without reducing profits.⁴ The implementation of withholding taxes is another method used to effectively collect revenue while spurring voluntary compliance, as businesses then have a greater incentive to file tax returns to claim refunds.⁵

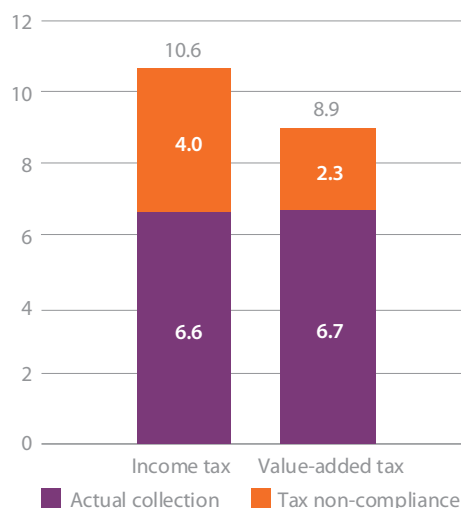
Ultimately, countries do not have the ability to audit and verify all tax filings, but data and better administration can help. To strengthen enforcement, some countries have moved to use third-party information, such as credit card data or customs data, that help to cross check financial transactions.⁶ In one case, such policies led to a small increase in income reported, although firms adjusted other figures on their tax returns to minimize increases in reported profits.⁷ Enforcement will be more effective with better dispute resolution systems and arrears collection processes.

2.3 Putting revenue and expenditure together for the SDGs

In 2018, the Task Force emphasized that revenue collection linked to effective expenditures for quality public service delivery can boost the link between citizen and state and form the basis of the social contract. Short-term political cycles and lack of national consensus on fiscal priorities can undermine efforts to strengthen this social contract.

As described in chapter II, medium-term revenue

Figure 5
Tax non-compliance in Latin America, 2017
 (Percentage of GDP)



Source: ECLAC.

Note: Estimations are GDP-weighted averages based on country-level studies on tax non-compliance. Income tax estimates based on 13 country studies, value-added tax estimates based on 16 country studies.

strategies (MTRS) are an approach to frame tax system reform in a comprehensive and holistic five-to-ten year framework. Embedding MTRS into long-term planning, through integrated national financing frameworks, can boost the link between citizen and states and help ensure the application of sufficient political will through political and business cycles to raise public resources and spend them effectively for sustainable development. MTRS should be coherent with medium-term expenditure frameworks—which integrate policy, planning and budgeting within a medium-term perspective—and cognizant of the approximate future spending needs to achieve the SDGs (see chapter II). Embedding the SDGs into medium-term expenditure planning, medium-term revenue strategies and annual budgeting would promote better informed decisions and support policymakers in promoting synergies among different goals.

Most countries already have ongoing tax policy and administrative reforms, as well as systems for publishing fiscal and budget information and consulting with stakeholders. Transitioning an ongoing tax system reform effort into an MTRS is not a simple task, as it may require rethinking aspects of the existing reform programme and how they fit together with other policies. It requires policymakers to be precise in formulating tax policy packages, revenue administration reforms, and legal adjustments—including clear revenue mobilization objectives and/or other tax policy objectives, such as reducing inequality or preserving the environment. It also requires building a national consensus around the reforms so that the MTRS can outlast short-term political cycles. For these reasons, MTRSs may vary drastically from country to country.

MTRS, like all tax reform, should be guided by efficiency, equity, and ease of administration and compliance. Because the MTRS concept is relatively new, lessons from early adopters are still being learned. The need for political commitment and national buy-in to the MTRS is clear and is a fundamental building block of the MTRS. Creation of an MTRS can leverage existing mechanisms for budget transparency, participation and accountability to generate national agreement on tax reform priorities and how those will be linked to public expenditure. Perceptions that tax reforms will unfairly burden the poor or vulnerable can derail reform efforts and even lead to political instability. This re-emphasizes the need for the open discussion on distributional implications and policy impacts on the poor and vulnerable.

3. Fiscal systems and inequality

Fiscal systems can be an important tool for combatting inequality (SDG 10) while promoting inclusive economic growth (SDG 8), along with other public policies, such as labour policies. There is a special place for fiscal policy when considering income and wealth inequalities because of the efficacy of using taxation and expenditure to address the distribution of resources. While some redis-

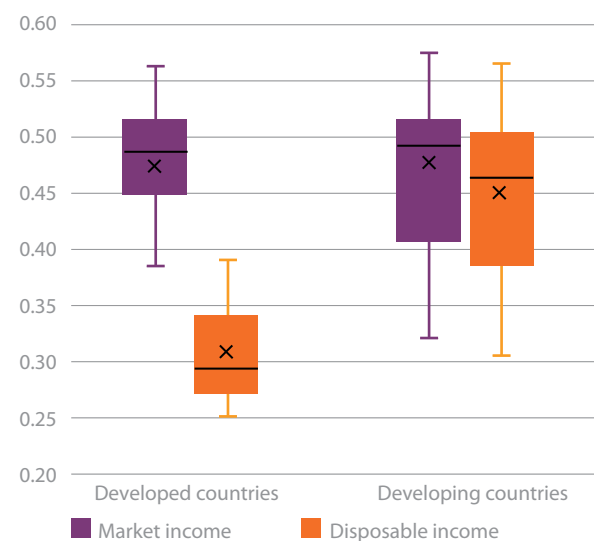
tributive policies may have conflicting effects on growth and distribution, empirical evidence shows it is possible to achieve growth that is inclusive and sustainable.

3.1 Fiscal system progressivity

Reducing inequality will require careful design of the fiscal system. There are two separate policy areas that need to be addressed. Countries wishing to scale up or redesign redistributive policies need to look at the effects of both taxes and expenditures. The progressivity of revenue systems determines who is bearing the burden of financing public expenditure, while expenditure policies determine who is benefitting from public resources and the alignment of resources with the SDGs. The two systems must be analysed together.

The impact of fiscal policy on inequality can be seen by comparing data before and after taxes and transfers (figure 6). In developed countries, fiscal policy offsets about one third of market (before-tax-and-transfer) income inequality, on average, with 75 per cent of the offset coming from transfers. In-kind transfers, such as those for education and health, also affect market income inequality over time. In developing countries, fiscal redistribution is much more limited, reflecting lower and less effectively progressive taxation, greater reliance on regressive indirect taxes, and difficulties on the spending side in implementing universal social programmes and conducting transfers to the poor and vulnerable.

Figure 6
Inequality effect of fiscal policy, various years
(Gini index)



Sources: Commitment to Equity Institute Data Center on Fiscal Redistribution (2019); OECD Income Distribution and Poverty (2018)
Note: Chart shows medians, averages, 25th and 75th percentile and minimum and maximum of Gini coefficients excluding outliers; disposable income is after income taxes, social security contributions and other transfers; developed countries based on 30 OECD countries in 2015; developing countries based on most recent data for 29 countries in CEQSI database.

3.1.1 Progressivity of taxes and revenues

Tax progressivity aims at having the wealthier parts of society finance a greater proportion of public goods, thus helping to redistribute income. Tax progressivity has declined over the past four decades in Organization for Economic Cooperation and Development (OECD) countries (figure 7). This decline is consistent with the drop in top personal income tax rates in those countries from an average of 62 per cent in 1981 to 35 per cent in 2015. In developing countries, indirect taxes, which are more regressive, represent a significant portion of revenues. Indirect taxes have increased over time, largely to compensate for the decline in trade taxes that accompanied the reduction of trade tariffs in the late 1990s and early 2000s (figures 8-10).

Direct taxes on income can be the most progressive form of taxation if they have increasing marginal tax rates and are able to reach the full incomes of the richest citizens. In particular, exemptions and low rates of tax on capital sources of income often prevent higher effective taxation of the wealthy, who may not have large labour income but have disproportionate amounts of capital income. In poorer countries, the incidence of personal income taxes is mainly on wage-earning people in the middle of the income distribution, not the elite. Indirect taxes, which are often levied as sales taxes or VAT, tend to be more regressive as consumption makes up a higher share of the income of the poor. Nonetheless, consumption taxes can contribute to fiscal redistribution if they are used to finance progressive spending, as discussed below. They can also be made more progressive by including higher excise taxes on luxury goods such as yachts and luxury

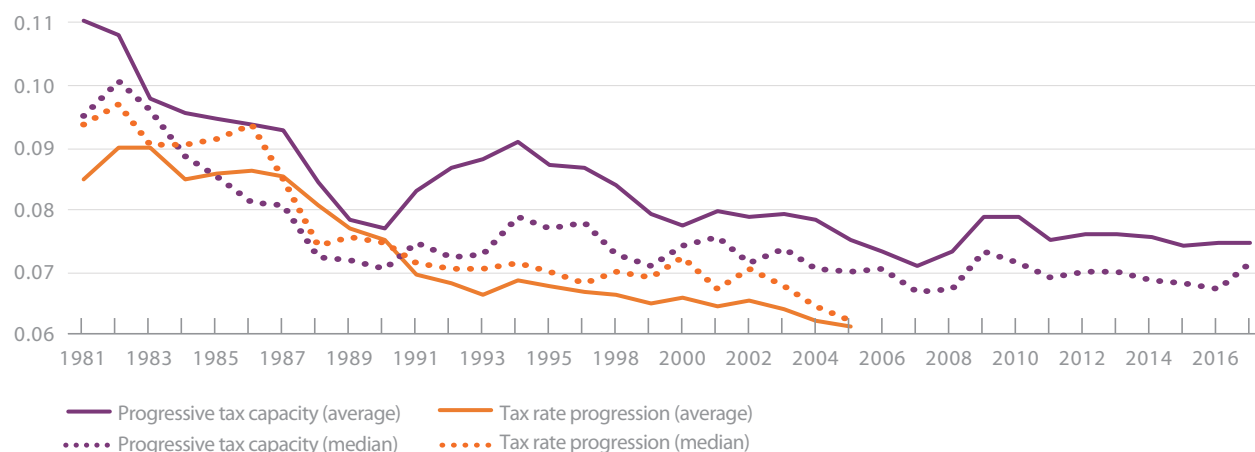
cars. Special provisions of the tax code, such as exclusions, deductions, deferrals, credits, and tax rates that benefit specific activities or groups of taxpayers, also have strong inequality impacts. However, these often result from lobbying by an interest group that already wields political and economic power for its own interest, which can itself have regressive impacts.

Different types of wealth taxes—such as recurrent taxes on property or net wealth, and inheritance and gift taxes—as well as certain types of transaction taxes can also be sources of progressive taxation. Taxes on real estate or land are particularly efficient but remain underused in many countries (box 1). An even stronger impact on equity can be achieved through higher taxes on second homes.⁸ The degree of progressivity of each of these types of taxes will depend on both the design of the tax policy and how it is administered. Overall, the data suggests that it is possible to increase the degree of tax progressivity while preserving growth, at least for levels of progressivity that are not excessive.⁹

In developing countries, improving tax capacity is critical for increasing the distributive role of fiscal policy while ensuring fiscal sustainability. In many developing countries, widespread informality contributes to corporate and personal income tax revenues being low and most citizens not filing tax returns. For example, the personal income tax in Latin America, on average, reduces income inequality by 2.0 per cent, as opposed to 12.5 per cent in Europe,¹⁰ due to lower maximum marginal tax rates, narrow tax bases resulting from a large number of exemptions and deductions, and high levels of non-compliance.

Efforts at formalizing businesses can raise revenues and have important non-fiscal effects on equality, as formalization can allow better enforcement of labour rights and workplace safety rules. There are however,

Figure 7
Tax progressivity in OECD countries
(Index, percentage)



Source: IMF Fiscal Monitor October 2017.

Note: The average tax rate progression is the slope coefficient from regressing actual average tax rates on log of gross income. The progressive tax capacity index is calculated as twice the area between the Lorenz curve for income and taxation, using uniform distribution of income.

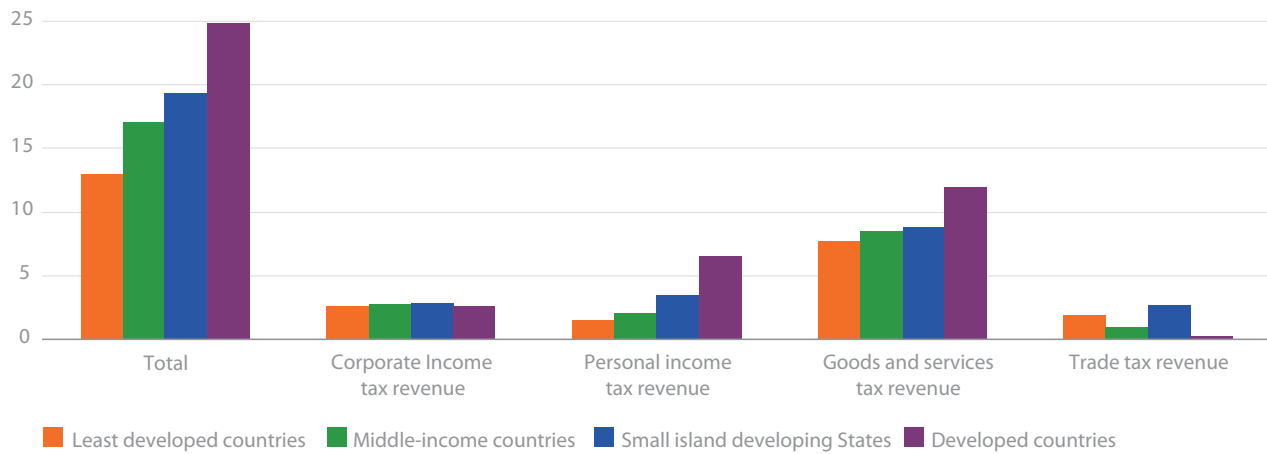
important inequality implications of formalization. Informality generally comprises two types of taxpayers: (i) micro and small enterprises, including smallholder farmers and the poor, and (ii) self-employed professionals, large land owners or other forms of enterprise with relatively high incomes.¹¹

Efforts to tax the former group would yield little revenue, have high administrative and compliance costs and likely lead to greater inequality, as this group is relatively poor. Developing countries with lower administrative capacity and larger informal sectors may find it advisable to set a relatively high tax-exempt threshold—combined with low initial tax rates but which escalate rapidly—to ease the administrative burden, strengthen tax compliance, and enhance progressivity. This can encourage greater levels of tax

compliance and ensure the poor are not burdened by the tax system. High tax-free thresholds can also lead to formality in the sense of encouraging people’s broader engagement with the state without becoming subject to tax—for example, through participation in social protection systems (see below).

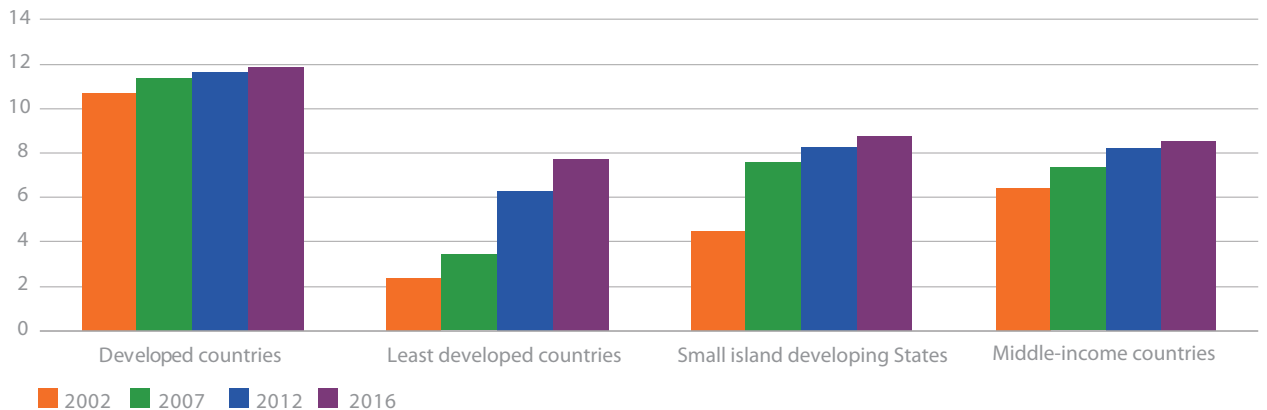
The second group of informal businesses represents a more serious problem of tax avoidance, which increases inequality and reduces the fairness of the overall tax system. Bringing self-employed professionals and large land-owners into tax compliance often presents a political challenge more than a technical one. International Labour Organization recommendation 204 emphasizes combining incentives with compliance measures and the role of social dialogue in creating an integrated policy framework to facilitate the transition to the formal econ-

Figure 8
Median tax revenue by type of tax, 2016
(Percentage of GDP)



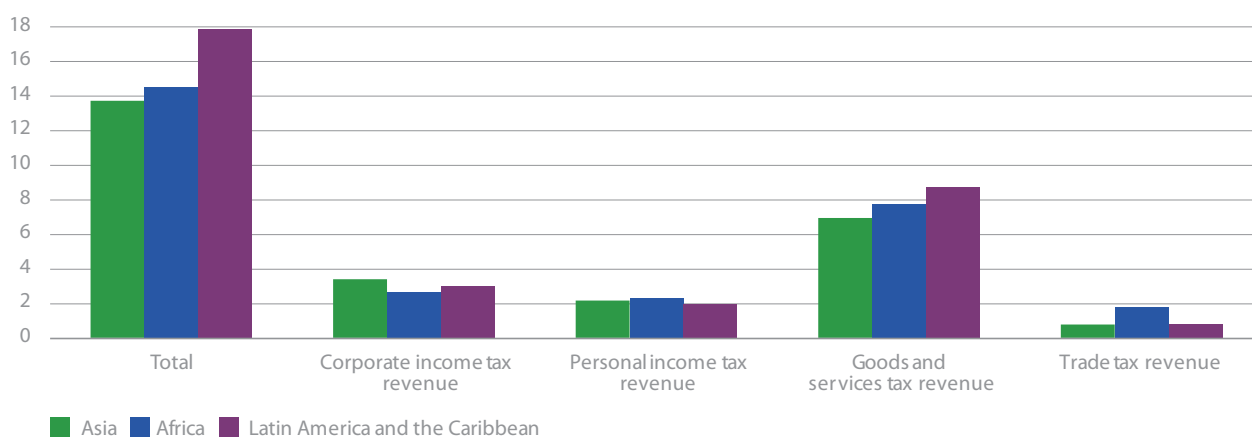
Source: IMF, World Revenue Longitudinal Dataset.

Figure 9
Median goods and services tax revenue, 2002-2016
(Percentage of GDP)



Source: IMF, World Revenue Longitudinal Dataset.

Figure 10
Median tax revenue by type of tax, by region, 2016
 (Percentage of GDP)



Source: IMF, World Revenue Longitudinal Dataset.

omy.¹² While corporate income tax revenue is relatively more important in developing countries (figure 8), and can contribute to tax system progressivity, challenges in enforcement due to lower tax administration capacity and the complexity of international rules need to be tackled (see below). The political challenges and the need for national agreement emphasize the importance of long-term planning embodied in the MTRS approach.

3.1.2 Progressivity of spending

This Task Force has emphasized that revenue and expenditure should not be analysed in isolation.¹³ The recommendation for comprehensive impact analysis of fiscal systems applied to all forms of inequalities and incidence should be an important part of every fiscal system.

The provision of public services is usually progressive, although the level of progressivity differs based on the quality of the service, the geographic scope of its distribution and the user base. Investments in public education and health help reduce income inequality over the medium term and can enhance social mobility. Yet public expenditure on social services, including in developed countries, has not been sufficient to close gaps in access to education and health, let alone address excessive inequalities in outcomes.

While existing social protection systems and social services can be universally available (including to specific groups, such as children and the elderly) or means-tested based on income, the 2030 Agenda for Sustainable Development urges countries to achieve universality. While means testing has been thought of as a way to make public spending more progressive, in practice, administrative costs are high and the errors in targeting have sometimes meant that public spending fails to reach the poorest.¹⁴ Although universality can be costly, it also lowers administrative costs.

The design and financing of social protection systems affects the progressivity of the overall fiscal system. Nationally designed and owned social protection floors (SPFs) are meant to convey a nationally defined set of basic social security guarantees, which can be cash benefits or in-kind services, provided equitably to all people at every stage in their life cycle (children, mothers with newborns, support for those without jobs, persons with disabilities, the elderly).¹⁵ Administrative costs are an important consideration in SPF design. For example, one African country shifted social transfer distribution from a cash system to a mobile-money-based system, which resulted in a 20 per cent drop in the variable administrative costs.¹⁶ However, such shifts could exclude beneficiaries because of lack of access to technology or reduce the value of transfers because of fees for use of electronic payments systems.

Universal basic income (UBI) is an approach to SPFs being tested in some countries. UBI is usually thought of as a cash transfer of an equal amount to all individuals in a country, but can be implemented in different manners. The idea, while not new, is receiving growing attention, partly in response to the possible effects of artificial intelligence and automation on jobs (see chapter III.G). A UBI has the potential to have a significant impact on inequality and poverty, but implementation should not put existing labour and social security rights at risk. As with any public service reforms, consideration should also be given to fiscal sustainability as well as the progressivity and efficiency of any systems being replaced by a UBI. Frequently mentioned trade-offs to UBI implementation include reduced subsidies on basic necessities or reduced spending on public services. Replacing inefficient and inequitable fuel subsidies with a UBI would likely lower inequality. However, if the UBI took resources away from high-priority spending on public services such as health and education, this may increase inequality and poverty.

3.2 Gender and the fiscal system

Fiscal systems can also be shaped to address gender inequality. The 2018 report of this Task Force described in detail the importance of comprehensive gender impact analysis of both individual taxes and overall fiscal systems to promote gender equality. Gender responsive budgeting (GRB) is a strategic policy approach that enables fiscal authorities to structure tax and spending policies and/or public financial management in ways that can reduce gender disparities and promote equality.

Implementation of GRB supports stronger linkages between policy commitments to gender equality and resources allocated for their implementation. The international standard for GRB (SDG Indicator 5.c.1) measures the proportion of countries with systems to track and make public allocations for gender equality and women's empowerment progress. Preliminary 2018 data from the monitoring exercise of the Global Partnership for Effective Development Cooperation, indicates that 90 per cent of countries¹⁷ fully met or are approaching the requirement of "having a system in place" for GRB. Despite progress, gaps remain in the comprehensiveness and transparency of systems. In particular, assessment of outcome and impact, including ex ante and ex post assessments, and gender budget audits, are often absent even among countries with aspects of tracking systems

in place. As part of its regular GRB programming, UN-Women provides technical support to Governments to develop comprehensive tracking systems to collect high quality, accurate and reliable data on gender budgeting as well as strengthening the capacity of national institutions for gender equality and civil society organizations to scrutinize and validate the data.

4. Environment, climate change and fiscal policy

The use of economic instruments for environmental protection is fairly limited in many countries, with the principle that a polluter pays for the negative externalities of their pollution being applied only partially, at best. The fiscal system can be designed to address environmental problems, with the dual benefit of shifting tax burdens to incentivize sustainability while also raising additional revenue.¹⁸

4.1 Carbon pricing

Carbon pricing¹⁹ can mobilize substantial amounts of new revenue. If carbon pricing were integrated into existing fuel tax regimes or fiscal regimes for fossil fuel

Box 2

Tertiary education and tax reform in Chile

In 2015, Chile enshrined free universal tertiary education in its laws. Higher education is a right "that should be available to all persons, according to their abilities and merits...and special income mechanisms should be promoted in accordance with the principles of equity and inclusion".⁵⁷

Before 2015, higher education institutions financed their teaching, research and extension primarily through fees charged to their undergraduate and graduate students. Chilean public tertiary institutions charged higher tuition than the fees in private institutions, contributing to the country having the second highest fees among countries in the Organization for Economic Cooperation and Development in 2016.⁵⁸

Since 2015, Chile has implemented new measures in favour of inclusion in higher education, related to Sustainable Development Goal target 4.3 on equal access to tertiary education. Today students from households with income in the lowest 60 per cent of the country attend Chile's free universities. In addition, in line with universality, the threshold will advance to the poorest 70, 80, and 90 per cent of households as the economy grows, and finally to all students.

However, this new system had significant associated costs. Chile's annual investment in education (at all levels, public and private) was equivalent to more than 6 per cent of gross domestic product (GDP) in 2016. In 2017, higher education made up 36 per cent of the education budget, equivalent to 2.5 per cent of GDP. The contribution of households to the financing of higher education dropped from 68 per cent in 2016 to 64 per cent in 2017, and is expected to drop further as the free tertiary education policy becomes universal.

In 2014, Chile undertook a broad reform of its tax system, with the explicit objective of permanently increasing public spending on education and other social sectors. The reform aims to raise additional revenue equivalent to 3 per cent of GDP, while making the tax system more progressive. It included changes in the taxation of income of companies and individuals, changes to the tax incentives for saving and investment, and substantial increases in taxation on the consumption of goods harmful to health (tobacco, alcohol and sugary drinks). The reforms also strengthened tax enforcement, adopted special anti-avoidance rules, and included a general anti-avoidance clause in the tax code. Changes in taxation on capital gains sought to equalize taxation on capital and labour to further the progressivity of the entire tax system. As a result, taxes paid by the richest 1 per cent of the population are expected to rise from 2.4 per cent of GDP to 3.5 per cent, with almost 80 per cent of that rise coming from the richest 0.1 per cent.⁵⁹

Source: UNESCO.

extraction there would also be minimal extra administrative burdens to implement such pricing. The revenues need not be earmarked for climate-related spending, and policymakers can choose to cushion the impact on the poorest households, lower other burdensome taxes, reduce deficits, or fund other investments related to achieving the SDGs.

Carbon pricing can be implemented in two main ways: through carbon emissions trading schemes (ETS) or through carbon taxation. ETS may be designed to provide revenue for the Government through auctions of credits, but can also be non-revenue generating. ETS provide less certainty on the price of carbon, but can be designed to have greater specificity on the level of emissions. To date, several schemes have been implemented. However, prices are relatively low, at around \$5 to \$25 per ton of CO₂. Overly permissive exemptions, typically on transportation and heating fuels, and insufficient ratcheting down of emissions caps have reduced the effectiveness of some of these systems.

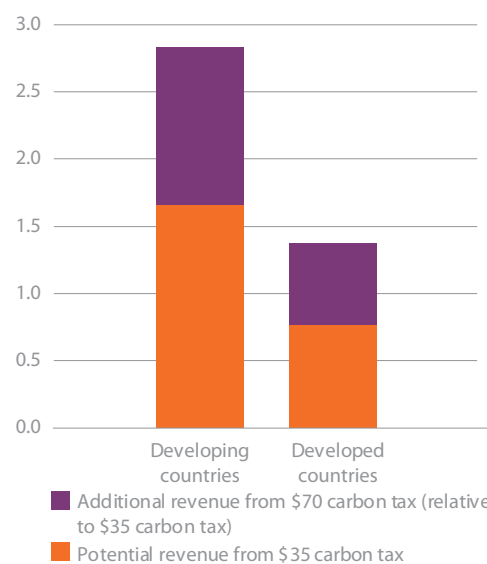
Direct carbon taxation provides more certainty about the price of carbon, and thus can be better for long-term planning by Government or businesses. However, it provides less certainty on the levels of emissions. As of 2018, 21 Governments had introduced carbon taxes (table 3) with several more scheduling implementation for 2019, although typically with partial coverage (e.g., some exempt natural gas). For Group of Twenty (G20) countries as a whole, research suggests that a carbon price of \$35 to \$40 per ton in 2030 is about sufficient to meet mitigation pledges²⁰—with lower prices estimated for developing countries, and higher prices, often above \$70 per ton, estimated for developed economies.²¹ Revenues from comprehensive carbon pricing are potentially large (figure 11)—for example, typically around 1.0 to 2.5 per cent of GDP for the \$70 carbon price in G20 countries in 2030, and substantially higher in a few emissions-intensive countries.

To date, 44 per cent of carbon tax revenues have been used for lowering other taxes, 28 per cent for general funds, and 15 per cent for environmental spending globally. ETS have been more targeted, with 70 per cent of revenues used for environmental spending, 21 per cent for general funds, and 9 per cent for lowering other taxes.²² Excise taxes on polluting goods (see below) have tended to be more frequently used for general funds.

Regulation, which can be seen as an alternative tool to manage carbon emissions, could provide certainty on the level of emissions, depending on design, but does not raise any revenues and may impose higher costs for mitigation. Regulations, standards and controls are often used in conjunction with carbon taxes. Implementation of emissions control in practice may be most easily achieved by combinations of multiple kinds of carbon pricing alongside direct regulation (restrictions on the sale of fossil-fuel powered vehicles, for example).

Carbon tax competition, which in this case refers to carbon intensive industries relocating to or growing

Figure 11
Potential revenue from carbon pricing in 2030, G20 countries
(Percentage of GDP)



Source: Parry and others (2018).

Note: Averages weighted by projected 2030 GDP.

in jurisdictions with low or no carbon taxes, is a challenge. However, empirically the size of such competition may not be large, carbon pricing may stimulate firms to adopt more productive or energy-efficient capital, and policies can aim to minimize competition. Policy options to minimize the effect of carbon tax competition include: tax rebates for exporters; border-tax adjustment for imports;²³ and multilateral agreement on carbon taxes.²⁴ As with other “sin taxes”, a carbon tax—if introduced effectively—will, over decades, reduce its own tax base and thus requires proper planning of long-term revenue strategies.

The United Nations Committees of Experts on International Cooperation in Tax Matters formed a subcommittee on environmental taxation in 2018. It is mandated to consider, report on and propose guidance on environmental tax issues and opportunities for developing countries in particular. The subcommittee plans to prepare a Handbook on Carbon Taxation for publication in 2021. The subcommittee will also address how carbon tax mechanisms can interact with other environmental policy instruments, with other tax instruments and with other influences on the price of energy.

4.2 Other environmental taxation efforts

There are a variety of well-developed practices on taxing harmful pollutants beyond carbon emissions. Pollution charges can be placed on emission of air pollutants, discharges of wastewater into water bodies or generation and disposal of waste, although pollution is

Table 1
Carbon taxation schemes around the world, 2018

Country	Year implemented	Price (US dollars/ton CO ₂)	Coverage (percentage of emissions)
Chile	2017	5.00	39%
Colombia	2017	4.92	24%
Denmark	1992	26.45/22.91	40%
Estonia	2000	2.28	3%
Finland	1990	70.64	36%
France	2014	50.81	35%
Iceland	2010	28.87	29%
Ireland	2010	22.79	49%
Japan	2012	2.56	68%
Latvia	2004	5.13	15%
Liechtenstein	2008	95.71	26%
Mexico	2014	2.73/0.34	46%
Norway	1991	59.87/3.47	62%
Poland	1990	0.08	4%
Portugal	2015	7.80	29%
Slovenia	1996	19.71	24%
Spain	2014	22.79	3%
Sweden	1991	126.84	40%
Switzerland	2008	95.71	33%
United Kingdom	2013	23.25	23%
Ukraine	2011	0.01	71%

Source: World Bank Carbon Pricing Dashboard.

Note: Coverage rate is for total greenhouse gas emissions. Cover rates for fossil fuel CO₂ emissions would be significantly higher.

often controlled through regulation rather than taxes. Waste handling charges are widespread and can be differentiated based on the severity of the environmental impact of the waste. Like carbon taxes, effective pollution charges should be set sufficiently high to discourage the pollution, be adjusted frequently as needed to make up for inflation, and be differentiated according to the type and characteristics of pollutants. Pollution charges are often ineffective at changing behaviour because they are set too low, enforcement is insufficiently funded and fines or other sanctions are not costly enough.

There are also indirect environmental taxes—those levied on specific products or inputs—such as gasoline, vehicles or plastic bags and bottles. Taxes on motor vehicle registration, congestion charging on roadways, or parking fees can contribute to a reduction in driving and help drivers internalize the economic, social and environmental costs of their activities, while also being a desirable alternative for subnational revenue mobilization. Taxes on single-use plastics have also become a prominent fiscal policy tool designed to reduce the use of plastic bags and other items, although the revenue effects are relatively small. While there is no systemic data gathered on the prevalence of this type of instrument, it is reported that almost 50 countries have national, regional or local charges in place for plastic bags, while over 50 have total bans on these products. The regime of environmental taxation and subsidies should be

coherent within itself and with national sustainable development strategies.

4.3 Inequality, energy pricing and environmental taxation

Environmental taxes applied to consumption goods, such as heating and cooking fuels, could represent a higher proportion of a poor household's income than a rich household's income, depending on the design and national circumstances. There is popular perception that the regressive effects make environmental taxes undesirable despite their environmental benefits. This concern is most prominent in relation to energy and fossil fuel pricing, as many countries use fossil fuel subsidies to try to reduce the price of necessities. Indeed, in the last few years many national efforts at fossil fuel subsidy reform and environmental taxation have been derailed by popular protest against the perceived inequities of the policies, while other countries have successfully implemented reforms.

Despite the perception of regressivity, if properly structured, the effect of reforms on the poor can be offset by using the revenue for redistributive expenditure, similar to other taxes. A large portion of the value of some subsidies may be captured by the rich. For example they may have greater access to vehicles, often with low fuel efficiency. Country experiences show that the likelihood of success in subsidy reform almost triples with strong political support and proactive public communications.²⁵ Clear communication about beneficiaries is important because political acceptability may be tied to the use of the revenue.

Despite much analytical work and many practical guidelines,²⁶ including by Task Force members, some countries proceed without coherent plans that encompass: (a) timetables for slowly phasing in reforms; (b) administration mechanisms; (c) mitigation measures for the poor or vulnerable; and (d) strategies for consultation and communication. Implementation of mitigation measures before subsidies are fully phased out or taxes fully phased in—such as larger cash transfer programmes—can demonstrate the political commitment to using revenue to reduce inequality. Such approaches can be summed up in the concept of just transition, a principle that is embedded in the Paris Agreement. Examples of successful just transitions from both developed and developing countries can serve as useful references for countries planning reforms.²⁷

4.4 Disaster risk reduction

Economic losses due to disasters, including those related to climate change, increasingly undermine both sustainable development progress and the financing available for SDG-related investment. Most studies find that disasters also reduce future economic growth.²⁸ However, most countries do not have systems for disaster risk reduction and management in their public financial management systems.²⁹ Political leadership, and

greater engagement by ministries of finance, economy, planning and environment are needed to enhance the integration of disaster risk reduction into medium-term integrated national financing frameworks (see chapter II) and into annual fiscal plans.

The expected loss due to disasters,³⁰ measured as a share of capital investment, is concentrated in low- and middle-income countries, in particular SIDS.³¹ In general, national fiscal strategies related to disasters focus on ex ante financing for post-disaster response, recovery and reconstruction. Disaster risk financing, including well-designed national and regional insurance schemes and contingency funds, can create incentives for disaster risk reduction, earlier response and “building back better”.³²

The cost of disaster risk financing is likely to grow due to climate change. National and local strategies to reduce disaster risk should include a clear financing component. Financing strategies can use a risk-layered approach, planning differently for frequent, small-scale disasters (e.g., seasonal localized flooding and landslides), for which investment in risk reduction may be cost-efficient, than for less frequent large-scale disasters, for which risk reduction may need to be accompanied by risk financing.³³ Risk reduction strategies should also be gender responsive, drawing upon comprehensive gender analysis and recognizing women’s contributions.

Governments can conduct a “risk-sensitive budget review”³⁴ using disaster loss data and probabilistic risk assessments to find gaps between risk levels and budget allocations. Establishing disaster risk reduction labeling in budgets or dedicated budget lines can then help Governments quantify their investments and estimate the resulting costs and benefits. Budget markers can also capture “embedded” investment by distinguishing between stand-alone versus integrated disaster risk reduction investment. Ultimately, creating risk-sensitive budgets provides an opportunity for policymakers to actively consider the importance of investing in prevention through disaster risk reduction and will bring about improved efficiency and accountability.

5. International tax cooperation

The increase in cross-border economic activity over the last several decades underscores the need for international tax cooperation. There are a variety of issues that need international attention. For many years, international tax cooperation focussed on the conclusion of bilateral tax treaties, which had the principle aim of avoiding double taxation. More recently, international tax cooperation has looked at setting tax norms to reduce double non-taxation and international corporate tax avoidance and increasing the exchange of information between tax authorities to help limit tax evasion. The international conversation has also moved towards the allocation of the tax base more broadly, especially in the context of the digitalization of the economy.

5.1 Tax incentives and competition for investment

The Addis Agenda recognizes that tax incentives can be an appropriate policy tool. For example, as discussed in chapter III.B, policymakers may want to incentivize investment in SDG-related sectors that are aligned with their national sustainable development strategies.³⁵ But the Addis Agenda also notes that States should be careful of excessive incentives as there are trade-offs between the benefits and costs in terms of reduced tax base. Competition to attract private investment can lead to a race to the bottom in corporate income tax rates. Such tax competition can be particularly salient in developing countries, which often rely more on corporate taxation (figure 8). Replacing lost tax revenues with other forms of taxation may worsen inequality and, given the declining labour share of income (see chapter I), it may become increasingly challenging in some countries to raise tax-revenue-to-GDP ratios.

National tax policies can have international spillovers through multiple channels. First, there can be tax policy spillovers, with other countries changing their tax rates. IMF staff estimated that in one recent case, a national corporate tax policy reform was likely to lead to other countries lowering their tax rates in by up to 4 percentage points.³⁶

Second there can be impacts on real investment. There are questions as to the effectiveness of attracting investment by granting tax incentives, modifying broader tax structures or lowering tax rates, as compared to other factors. There is evidence that economic growth and market size are the most important factors in the location decisions of MNEs for long-term investment, with tax rates just one of a number of other factors.³⁷ However, another recent IMF study found that the adoption of effective anti-tax-avoidance measures in countries hosting investment, can lead to lower levels of real investment in the country and higher investment elsewhere due to spillovers.³⁸

This emphasizes that Governments wishing to attract investment through incentives—or to mobilize revenues through adoption of anti-tax-avoidance measures—can do so more effectively if they coordinate, at least regionally, to implement rules as a group of countries so that negative spillovers can be reduced. One of the proposals for tax reform in response to the digitalization of the economy could serve to reduce tax competition pressures by instituting a minimum tax scheme (see below).

5.2 International corporate tax avoidance

The Addis Agenda calls for taxes to be paid “where economic activity occurs and value is created”.³⁹ A major challenge to revenue mobilization in both developed and developing economies is the ability of MNEs to avoid taxes through base erosion and profit shifting (BEPS), using highly sophisticated techniques to artificially move profits to different jurisdictions without any changes in the underlying real economic activity.

Once an MNE has established a presence in a jurisdiction, the business profits from that presence can be taxed. The amount of profits declared in a jurisdiction needs to take into account, where applicable, transfers between separate entities within an MNE. Implicit prices, called transfer prices, are used to value those transfers. Transfer prices for tax purposes are based on the arm's length principle, which states that the price used for transactions between two related entities (e.g., a company's headquarters and its local subsidiary) should be the same as if the two parties were unrelated. This arm's length principle is designed to assist taxpayers in meeting their obligations, help tax administrations value transactions, and accord countries a fair share of the tax base. Despite concerted efforts by tax jurisdictions, there remains a mismatch between economic activity and value creation, with significant MNE profit declared in no- or low-tax jurisdictions in which there is minimal physical presence. Companies engaging in BEPS sometimes use transfer prices that do not reflect the true value of the underlying transaction—that is, transfer mispricing. Digitalization has contributed to the growth of hard-to-price intangible goods and services, such as trademarked brands or copyrighted software, making monitoring of transfer pricing more difficult. The complexity of these issues, and the rules designed to address them, can make it difficult for countries to effectively apply and enforce tax norms on MNEs, a problem that is particularly acute for low-capacity tax administrations.

This Task Force has previously reported on efforts to estimate revenues lost to international corporate profit shifting. Two new estimates published in 2018 present evidence that the sensitivity of profit declarations with respect to tax rates is greater in developing economies than in developed countries, indicating that BEPS is a relatively more important problem in developing countries. This challenge is compounded by developing countries' higher reliance on corporate tax revenue (see above).

A recent International Monetary Fund (IMF) paper that attempted to quantify the effects of tax rates on profit shifting, found that one country reducing the corporate income tax rate by one percentage point (keeping rates elsewhere constant) raises reported profits there by 1.5 per cent, with negative spillovers for the other economies which see less profit reported.⁴⁰ Recent IMF work considered two spillover channels—changes in real ac-

tivity and artificial shifts in profit declarations—in an assessment of the US tax reform, and found that they can both be large.⁴¹ Other research shows that BEPS leads to broader challenges in interpreting international economic statistics. Income from investment abroad—much of it in the form of intangible investment in intellectual property rights of various kinds, which is owned by entities in low-tax or no-tax jurisdictions—can create “phantom trade flows”.⁴² With trade and investment locations reported for tax arbitrage purposes, they increasingly do not align with real economic activity.

To reduce the scope for profit-shifting, the international community has undertaken a range of initiatives, such as the OECD-G20 BEPS project and the OECD-housed Inclusive Framework for BEPS implementation. Participation in these and other related initiatives is summarized in table 3. As an example, more robust rules for transfer pricing of valuable intangibles were agreed as part of the BEPS project. While important, these initiatives cannot close all profit-shifting channels. They also do not address tax competition over real investment and may even, by reducing the available channels for BEPS, intensify incentives for direct competition over tax rates.

Country-by-country (CbC) reporting of MNEs, one of the actions that came out of the OECD/G20 BEPS project, gives tax administrations the ability to understand where businesses have activities and generate revenues. Currently, the scope of CbC reporting is limited to MNEs with annual group revenue of more than €750 million. For fiscal years beginning in 2016, which is the first full year of CbC reporting, 7,000 CbC reports were filed by ultimate parent entities or surrogate parent entities. The first exchange of CbC reporting took place in June 2018. Exchange of CbC information on MNEs requires countries to have direct bilateral arrangements or activation of a bilateral match through a multilateral agreement. As of January 2019, more than 2,000 relationships for the exchange of CbC reports have been activated. Of these, 745 involve middle-income countries, up from 477 in 2017, although to date no LDCs have matches. The CbC reporting system is due for review in 2020.

5.3 Progress on tax transparency

Exchange of tax information among countries allows tax authorities to learn about taxpayers' offshore assets,

Table 2
Selected international corporate tax avoidance estimates

Volume estimate	Underlying data used to estimate profit shifting	Estimate provider
Tax loss estimate of 0.07% of world gross product in 2015 (approx. \$50 billion) from profit shifting	Meta-analysis of estimates of impact of tax rates on profit declaration	IMF Working Paper (Beer, de Mooij, Sorbe, & Liu) 2018
Tax base change estimate of \$600 billion of corporate profit shifting in 2015	Differential profitability of corporate subsidiaries	NBER Working Paper (Tørsløv, Wier, and Zucman) 2018

Source: Inter-agency Task Force on Financing for Development.

Note: Volume estimates are not comparable.

tackle tax evasion and better enforce tax rules. Even countries with well-earned reputations for tax compliance have concerns, with research estimating that one quarter of the 0.01 per cent richest households in Scandinavia evade taxes.⁴³ The main initiative in this area has been the Global Forum on Tax Transparency and Exchange of Information for Tax Purposes, which conducts peer reviewed assessments of member countries for compliance with international standards for transparency and information exchange. Table 3 summarizes the number of countries that participate in some of the key multilateral legal instruments as well as different forums for cooperation and standards implementation. The two most high-profile areas of work are exchange of tax information and the availability and exchange of beneficial ownership information.

Exchange of tax information, such as financial account information held in one country regarding assets of other countries' residents, is now handled automatically for some jurisdictions. This practice represents an augmentation of the information-on-request standard. By the end of 2018, 86 jurisdictions were exchanging information automatically, covering over 4,500 bilateral exchange relationships, leaving 14 jurisdictions delaying implementation despite commitments to exchange. Further work is needed in making use of this information to reduce tax evasion.

To further discourage hiding of income and wealth in offshore accounts, countries are implementing stronger rules on the availability and exchange of beneficial ownership⁴⁴ information. Through published peer reviews, the Global Forum tracks the progress of its 154 members in collecting beneficial ownership information for relevant legal entities, including companies, partnerships, trusts and private foundations. There are different ways

to organize this information, but a growing number of countries have centralized databases. Some of these databases are public, although even countries with public registers have territories and protectorates that do not yet participate in these publication schemes. There remain no mechanisms for the automatic sharing or the publication of this information, although regional schemes are being proposed in Europe.

5.4 Digitalization of the economy and taxation

The growth of digitalization and its impact on business models is making it more difficult to determine the location of economic activity and value creation, especially when intangible assets are an important part of value creation. Traditional tax treaties require foreign enterprises to have a physical presence in a jurisdiction in order for that jurisdiction to have a right to tax the business profits of the enterprise. Yet, some digitalized business models do not require a physical presence in countries to take and use data from users to earn profits. This renders many jurisdictions unable to tax some companies that are actively and profitably participating in their domestic markets.

As discussed in the 2018 report of this Task Force, the issue of how best to tax profits from cross-border digital transactions is being widely debated. Multiple international forums – including the United Nations Committee of Experts on International Cooperation in Tax Matters, the OECD-housed Task Force on the Digital Economy and Inclusive Framework on BEPS, and the European Union – are discussing how to revise relevant international rules, but there are different views on how to best adapt international tax rules to the digitalization challenge.

Table 3
Participation in international tax cooperation instruments, 2019

(Number of countries)

Instrument/Institution	Total membership/ signatories	Middle-income countries	Least developed countries	Small island developing States
MCAA Common Reporting Standard —on financial account information	103 (98)	30 (27)	1 (0)	22 (17)
MCAA exchange of country-by-country reports —related to MNE activity	74 (68)	17 (18)	2 (2)	5 (4)
Mutual Assistance Convention — for exchange of tax information on request	126 (117)	48 (42)	6 (3)	25 (18)
Automatic Exchange of Information Standard —for exchange of tax information between countries	108 (102)	33 (29)	1 (1)	25 (24)
Global Forum on Transparency and Exchange of Information for Tax Purposes —OECD-housed body for review of implementation of tax transparency standards	154 (149)	66 (63)	17 (17)	32 (31)
Multilateral Instrument (MLI) —to implement tax-treaty related measures for reducing BEPS	85 (79)	27 (27)	2 (2)	7 (7)
Inclusive Framework on BEPS —OECD-housed body for the implementation of the 2015 BEPS package	125 (112)	47 (42)	10 (10)	24 (15)

Source: OECD.

Note: Figures as of 31 December 2018, previous year figures in parenthesis. Two countries graduated from middle-income status between 2017 and 2018, so were included in last years' figures for middle-income countries but not in the end-2018 figures.

Box 3

Platform for Collaboration on Tax

The Platform for Collaboration on Tax is a joint effort, launched in April 2016, by the United Nations, World Bank Group, International Monetary Fund, and the Organization for Economic Cooperation and Development to intensify cooperation on tax issues. It formalizes regular discussions on the design and implementation of international tax standards, strengthens coordination of capacity-building support to developing countries, and prepares joint guidance. The Platform has three workstreams: coordination, analytical and outreach activities. Coordination will include consolidating data from the four partner organizations on domestic resource mobilization in an online platform.

In 2018, the Platform published a revised draft toolkit on the Taxation of Offshore Indirect Transfers for a second round of public consultations, with the final version to be published shortly. Future analytical toolkits will be on transfer-pricing documentation, base erosion and profit shifting (BEPS) risk assessment, tax treaty negotiation, base-eroding payments and other issues. The Platform will also provide guidance on the tax treatment of goods and services funded by official development assistance.

The Platform will hold biennial global conferences on technical issues that will help advance the global dialogue on tax and, where possible, align with the processes for reviewing the 2030 Agenda on Sustainable Development and the Financing for Development outcomes.

Source: UN/DESA.

Several proposals have been made to address this and are now under discussion.⁴⁵ One proposal is to allow the taxation of MNE profits derived from the use of “marketing intangibles” (non-physical and non-financial assets that have promotional value, such as trademarks) in a country, even if the MNE has no physical presence in that country. This would allow the country to tax all businesses’ “non-routine income”⁴⁶ related to these intangibles, while all other income would be allocated based on existing principles. No precise definition of “marketing intangibles” has yet been agreed globally, so a clearer definition of this term, or specific bright-line tests and exclusion lists, is needed to ensure a consistent outcome.

Another proposal is to allow the taxation of MNE profits derived from “user participation” for certain digital business models, even if the MNE has no physical presence in that country. This would focus on value generated by user participation, such as providing personal data, particularly affecting social media platforms, search engines and online marketplaces. The non-routine profits of the MNE would be allocated to jurisdictions in which it has engaged users based on an agreed allocation metric, such as revenues. The formula that seeks to approximate the value of users would need to be established. As with the marketing intangibles proposal, other income would continue to be allocated based on existing principles. The definition of what constitutes an engaged user would need to be agreed.

A third proposal is to redefine the test for whether a business is established so that it does not rely only on physical presence, but could also rely on a “significant economic presence”. A country would be able to tax the profits of an MNE if the MNE had a purposeful and sustained interaction with the economy of a country, which could be assessed based on revenue, user base, data generation, digital content creation, or other factors. Several countries have already adopted or proposed this type of test. The term “significant economic presence” would, as

with other terms in this area, need to be defined clearly to allow for uniform legal interpretation.

A fourth proposal, dubbed “global anti-base-erosion” (GLOBE), falls under a general category of minimum taxation rules rather than addressing the question of how to determine which businesses can be taxed. This proposal would allow countries to tax income of an MNE branch or controlled entity that is subject to a low effective rate of taxation and tax base-eroding payments of an MNE that are not subject to a minimum rate of tax. GLOBE would operate similarly to some existing alternative minimum taxes. The minimum tax proposals would help combat tax competition and seek to limit tax-motivated corporate decisions on investment locations and legal structures. GLOBE effectively allocates more income to shareholders and so favours capital exporting countries. This proposal could be adopted alongside any of the other proposed reforms, as it addresses the broader questions in BEPS and is not limited to addressing digitalization of business. The potential impact on smaller jurisdictions, especially those with low tax rates, needs consideration. Recent work by the IMF notes that such minimum taxes set in major economies can have positive spillovers for low-capacity countries by setting an effective floor under global tax competition.

Each of these proposals has advantages and challenges for implementation. All have implications for fundamental aspects of the current international tax architecture, especially for either the physical presence test or the arm’s length principle, which is used in transfer pricing to help allocate profits within an MNE. It is not yet clear to many countries what the proposals would mean for their tax bases. It is essential that any proposed international tax reforms undergo a thorough analysis of the implications for developing countries, with a special focus on their unique needs and capacities, as well as distributional implications and impact on sustainable development more broadly.

There are several dimensions of analysis that are important for an assessment of these and any other proposals. First, it is important to examine the enforceability of the proposals, given the administrative capacities of countries. Some aspects of the above proposals could add significant further complexity to a system that is already challenging to apply. Highly complex rules will disadvantage smaller and poorer countries with less capacity, but simple rules that are not well designed could shield tax avoidance. Some developing countries also lack the appropriate legal frameworks to confront the tax challenges from digitalized economic activity. Those countries that are most in need of increased revenue for implementing the SDGs may be those least able to realize it, exacerbating international inequality in ability to raise revenue.

Second, there is a need to analyse how different proposals would impact existing tax policies. For example, the ability to tax the fees for technical services provided by MNEs in a country has recently been added in the United Nations Model Double Taxation Convention (though it has not been added to the OECD Model Tax Convention on Income and Capital), and there is a growing developing country practice of this type of taxation. New rules emanating from the discussion on digitalized economy taxation may affect the ability to tax these transactions, differentially impacting countries based on whether they tax fees for technical services. The possible interactions between the new proposals and existing implementations of VAT, which can be difficult to collect from customers of digitalized goods and services when the provider has no physical presence, will need to be considered.

Third, the distributional impact of the proposals should be considered. Reforms may not be zero sum because they can increase aggregate global tax revenue from corporate income, but they could impact the tax base of LDCs and other developing countries. Data gaps unfortunately continue to prevent full understanding of the implications of tax norm changes for developing countries, partly because of the secrecy of CbC reports of MNEs, and partly due to the long-standing problem of the limited details available on MNE operations in poor countries. As noted in the previous reports of this Task Force, greater publication or sharing of data will enable better understanding of the potential implications of the reforms on the poorest countries. Some countries have already made aggregate CbC data available, and the OECD plans to publish some aggregate CbC information later in 2019.

Transparency of rules and the decision-making process through which new rules would be adopted will improve policymaking by allowing an open discussion of the pros and cons of each proposal. The United Nations Committee of Experts on International Cooperation in Tax Matters' subcommittee on this issue has agreed that it will pursue an approach which is independent of similar work being pursued in other forums, but is informed by such work. The Committee will likely agree any necessary changes to the United Nations Model Double

Taxation Convention before autumn of 2021. The steering committee of the Inclusive Framework, with the support of the Task Force on the Digital Economy, will submit an interim report for all members of the Inclusive Framework by June 2019 before it is sent to G20 finance ministers, while aiming for a final consensus in 2020. Ultimately any agreed outcome would have to be incorporated in domestic legislation and tax treaties.

5.5 Capacity building

Regional and international organizations conduct training and capacity building for revenue authorities in developing countries. The Addis Tax Initiative, launched in July 2015, commits donor countries to doubling the resources they provide for capacity-building on tax. However, official development assistance dedicated to domestic revenue mobilization, from OECD Development Assistance Committee (DAC) members and reported as disbursed in the OECD creditor reporting system, fell significantly from 2016 (\$329 million) to 2017 (\$193 million), accounting for 0.18 per cent of ODA. The partners in the Platform for Collaboration on Tax (box 3) are coordinating their provision of technical assistance.

6. Illicit financial flows

Cross-border tax evasion is one of the three main components of IFFs, alongside corruption and the transfer of the proceeds of crime.⁴⁷ IFFs reduce the availability of resources for financing sustainable development and impact the economic, social and political stability and development of societies, especially in developing countries. The scope and complexity of IFFs and the continued need for the recovery and return of stolen assets necessitates international cooperation.

Each component of IFFs has relevant policy responses, which are discussed elsewhere in the report and in other forums. The tax transparency reforms being introduced, discussed above, will be relevant for tracking and stopping IFFs. In particular, strengthened beneficial ownership registries and mechanisms to share that information will be critical to penetrating the trusts, shell corporations and other financial vehicles used to hide IFFs and their resulting assets.

6.1 Volume estimates

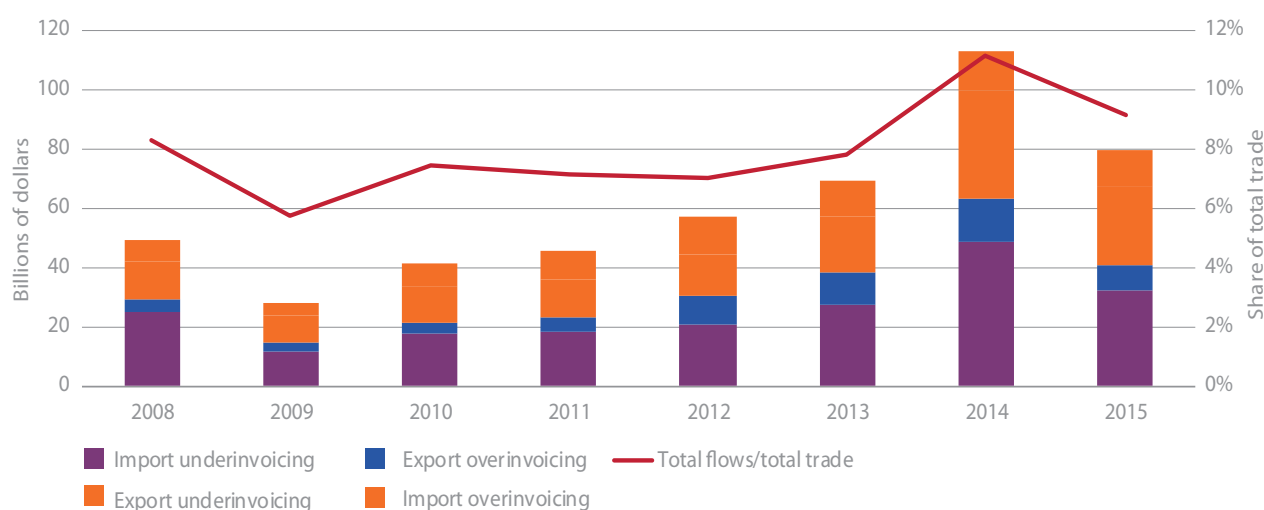
There remains no universally agreed definition of what constitutes IFFs, although there are some parameters for identifying them. There are generally three components of IFFs, although these are not mutually exclusive or comprehensive: IFFs originating from transnational criminal activity; corruption-related IFFs; and tax-related IFFs. As the different components of IFFs are not comparable, aggregation across channels and components could result in double counting, and the Task Force has noted that separate analysis of channels or components is more effective.

The United Nations Conference on Trade and Development (UNCTAD) and the United Nations Office on Drugs and Crime (UNODC), as custodians of the SDG indicator related to IFFs (16.4.1), continue joint work on developing a methodology for the statistical measurement of IFFs. A June 2018 expert meeting in Geneva provided input to this process.⁴⁸ The meeting concluded that the methodologies will need to build on research findings and pilot studies and that capacity building will be needed. Pilot testing is planned to be done by national statistical offices, with UNODC working with five coun-

tries in Latin America, and UNCTAD and the United Nations Economic Commission for Africa (UNECA) working with nine countries in Africa. The inaugural technical meeting for Latin America was held in Mexico City in November 2018. An UNCTAD-UNODC Task Force on the statistical measurement of IFFs started activities in January 2019, and will work through October 2021 on conceptual and measurement challenges.

The United Nations regional economic commissions have proceeded with their work on estimating goods trade misinvoicing, which involves the manipulation of

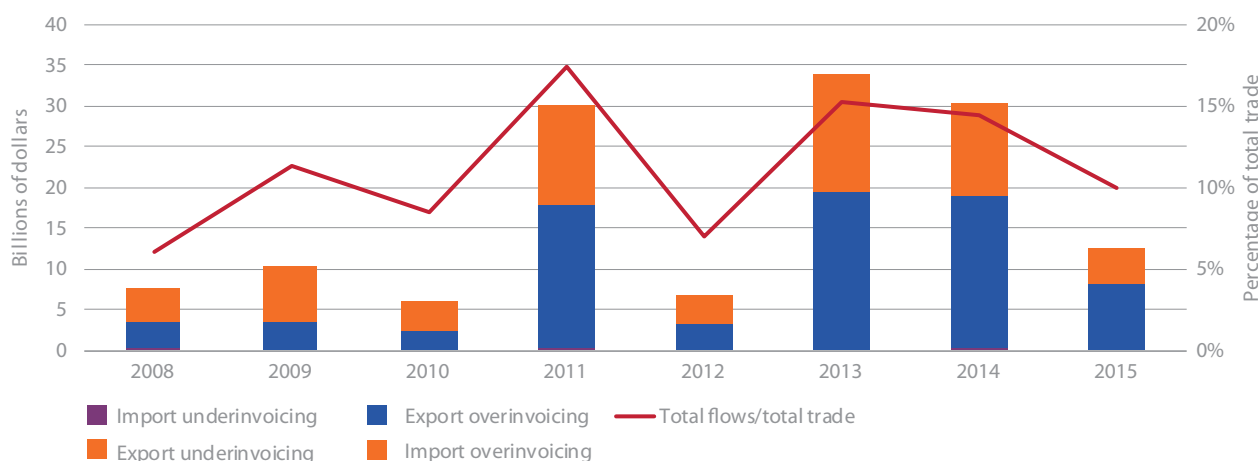
Figure 12
Non-oil trade misinvoicing, Arab region, 2008-2015
(Billions of United States dollars, share of total trade)



Source: ESCWA.

Note: Gross flows for bilateral differences between export and import values at the product level (Harmonized System six-digit codes) covering 22 jurisdictions in the Arab region, in current prices. Differences due to limited data or values of less than \$1 million between countries and products were excluded.

Figure 13
Oil trade misinvoicing, Arab region, 2008-2015
(Billions of United States dollars, share of total trade)



Source: ESCWA.

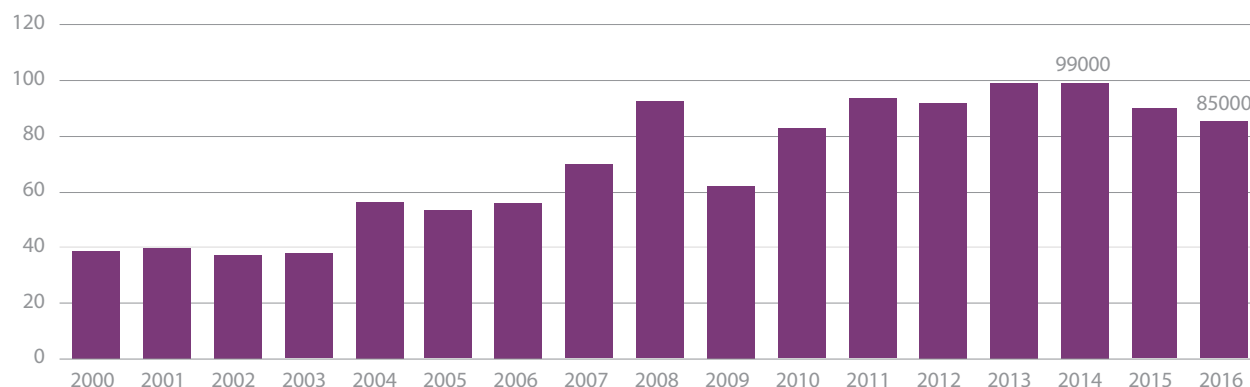
Note: Gross flows for bilateral differences between export and import values at the product level (Harmonized System six-digit codes) covering 22 jurisdictions in the Arab region, in current prices. Differences due to limited data or values of less than \$1 million between countries and products were excluded.

the reporting of international trade transactions (figures 12-15). The three regions with updated data—Africa, the Arab region and Latin America and the Caribbean—report that trade misinvoicing, while still large, has declined. Mismatched trade figures in non-renewable natural resource exports were large factors in these estimates. As noted previously, caution must be exercised when interpreting these estimates as mismatches between import and export figures may be due to factors other than illicit transactions, such as statistical errors. The estimates also cannot capture all types of misinvoicing, such as invoicing fraud, and the value of misinvoicing is not equal to the revenue impact. However, the patterns can be indicative of areas and sectors where Governments may want to focus enforcement attention.

6.2 Advancing AML/CFT and anti-bribery work

Work on anti-money laundering and combating the financing of terrorism (AML/CFT) and tackling their predicate offences continues to be addressed by many international organizations, including the Financial Action Task Force, UNODC, the IMF, and the World Bank. Implementing effective, risk-based AML/CFT frameworks is a challenge for all Member States, although the poorest countries have the least capacity to apply the available tools. Bank and non-bank financial sectors in low-income and conflict-affected countries have special needs, with the focus of AML/CFT work remaining on cash disruptions and the supervision and regulation of money transfer services.

Figure 14
Gross outflows due to goods trade misinvoicing, Latin America and the Caribbean, 2000-2016
(Billions of dollars)



Source: ECLAC.

Note: Aggregated gross outflows for the bilateral differences between export and import values at product level (Harmonized System six-digit codes) for 33 ECLAC Member States. Results are inversely weighted for differences in volume of goods to correct for inadvertent misreporting.

Figure 15
Outflows due to goods trade misinvoicing, African countries, 2000-2016
(Billions of United States dollars)



Source: ECA.

Note: 'Gross excluding reversals' aggregation is a procedure for obtaining a lower-bound estimate of gross outflows through trade mis-invoicing, which aggregates all outflows for individual observations and does not offset inflows. Net outflows for bilateral differences between export and import values at sector level (Harmonized System two-digit codes) for 36 jurisdictions within ECA Member States, in 2017 prices. The methodology has been updated since 2018 to strip out discrepancies in trade statistics that can result from transit times and asymmetric reporting of re-exports.

Money laundering, terrorist financing and corruption can impact the stability of the international monetary system, so the IMF has fully integrated these issues into its surveillance, lending, Financial Sector Assessment Programs (FSAPs), capacity development, and other relevant policy discussions.⁴⁹ The cost of implementing AML/CFT rules has also been one of the factors associated with the decline in the number of correspondent banking relationships (see chapter III.F). In April 2018, the IMF's Board approved for staff to take an enhanced approach to addressing governance and corruption related issues among its member countries, in line with the IMF's policy paper on this issue.⁵⁰

The United Nations Convention Against Corruption (UNCAC) remains an integral tool for enhancing cooperation on combatting corruption and bribery. Under UNCAC, States Parties to the Convention conduct implementation peer reviews, to ensure that countries have the necessary legal and institutional frameworks. In 2016 and 2017, peer reviews of 77 countries are expected to be completed. States parties to the UNCAC should continue to proactively cooperate on extradition, mutual legal assistance, law enforcement and other related matters, using the Convention as a legal basis for action.

6.3 Asset recovery and return

Efforts to recover stolen assets are part of the overall effort to combat IFFs. The term "stolen assets" is used to describe the proceeds of corruption that have been transferred abroad. Their recovery and return is provided for in the UNCAC and is included in the Addis Agenda and the 2030 Agenda for Sustainable Development. Return of stolen assets is different from and cannot substitute for any other types of financial flows.

The joint World Bank/UNODC Stolen Asset Recovery (StAR) Initiative works with developing countries to facilitate more systematic and timely return of stolen assets. The StAR Asset Recovery Watch database now contains information on over 250 past and current asset recovery cases involving corruption. Since the last Task Force report, there has been extensive country and regional level work in this area. Globally, the UNCAC Open-ended Intergovernmental Working Group on Asset Recovery agreed in June 2018 that more study should be made of the practice of freezing assets before convictions are secured. They also supported the further study of and discussions on guidelines on the timely sharing of information between countries on the proceeds of crime in order to facilitate recovery of assets, with the aim of encouraging more spontaneous sharing of information among asset recovery practitioners.⁵¹

Endnotes

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