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SUSTAINABLE TAX FOR DEVELOPMENT IN A GLOBAL CONTEXT: SOME AUSTRALIAN EXPERIENCES

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SUSTAINABLE TAX FOR DEVELOPMENT IN GLOBAL CONTEXT

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Contents

Discussion Paper

Macroeconomic Policy and Financing for Development Division

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Abstract

Over the past decade, Australia has attempted to reform its taxation policies on a number of occasions. The outcomes of these reforms can provide some guidance for other countries in the Asia-Pacific region. This paper briefly considers four areas of tax reform undertaken in Australia: attempts by business to increase consumption taxes and reduce company income tax; taxing resource rents; improving the equity of tax expenditures; and linking tax reform to expenditure pressures. The Australian experience presents interesting insight into the international tax discussion and how we can better support tax reform in our region. In particular, it points to the need to revisit how we engage in the tax debate both domestically and internationally and what we as a region can do to strengthen domestic revenue as we seek to find new sources of finance for inclusive development.

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I. Introduction

Financing development has become central to the global development agenda. While much hope and effort is being placed on multilateral taxation and the base erosion and profit shifting (BEPS) agenda, critical to success in the Asia Pacific will be striking the right balance between tax reform that is progressive, funds growing domestic expenditures, and drives growth while ensuring economies remain globally competitive. The issues are both technical and political.

Over the past decade, Australia has attempted to substantially reform its taxation policies on a number of occasions. The outcomes of these reform processes, the success and the failures, can provide some guidance for other countries in the region. This paper briefly considers four areas of tax reform undertaken in Australia: attempts by business to increase consumption taxes and reduce company income tax; taxing resource rents; improving the equity of tax expenditures; and linking tax reform to expenditure pressures. From these experiences a number of lessons on the challenge of tax revenue can be garnered.

These lessons are relevant to the Asia Pacific region as nations grapple with the common challenge of eroding revenues and growing fiscal pressures, while also seeking new sources of growth. What is clear from Australia's experience is that tax reform is never easy, and while technical issues surrounding tax reform are important, it has been the political economy – that is the securing of legislative and community support for reform – which has largely determined the success or failure of attempts at reform.

This experience presents an interesting insight into the international tax discussion and how we can better support tax reform in our region. In particular, it points to the need to revisit how we engage in the tax debate both domestically and internationally and what we as a region can do to strengthen domestic revenue as we seek to find new sources of finance for inclusive development.

II. The Extent of the Problem

Globalisation and the growth of services based industries in which the major output is data is making it increasingly difficult for national jurisdictions to tax corporate and personal income. The large number of different jurisdictions in which business is undertaken and the ability to shift costs and profits between these jurisdictions means corporations have greater choice over where they produce, declare profit and pay tax. There is therefore a need for countries to coordinate and share information with other countries.

The problems of leakage from the tax base and fiscal sustainability arguably affect developing countries even more than developed countries. Developed countries have greater technical capacity to investigate and deal with issues such transfer pricing and debt dumping. Even with these greater domestic resources, developed countries have struggled to combat tax avoidance by multinational companies.

Developed countries also have the advantage of being members of large well-resourced multilateral international organisations. The G20 and the OECD are, by their nature, organisations for developed countries. This has assisted developed countries take action on tax issues through processes designed to specifically deal with BEPS. Developing countries have contributed to the OECD/ G20 BEPS project and there are specific regional networks being established as part of the project. However, the problems faced by developing countries are often very different level from those faced by OECD countries.

It's important that the growing inequality that has characterised much of the growth in the developed world during this period is not repeated in our region in the period ahead.

We are now armed with research from the IMF that shows when the benefits of growth are concentrated, overall growth is weaker. When growth is more fairly shared, overall growth is stronger.

This repudiation of "trickle down" economics from the IMF - the notion that if you give more money to the wealthy everyone will be better off - is powerful support for robust implementation of Goal 10 of the Sustainable Development Goals. This work has important implications for domestic resource mobilisation, or put another way it points to the importance of progressive taxation systems.

At the same time as there is greater pressure on revenue, developing countries in the region have a greater need for government expenditure. While infrastructure in developed countries is for the most part established – albeit in need of repair – rapid urbanisation and industrialisation in developing countries brings with it congestion, concentrated poverty, social exclusion, migrant workers and so on. This means there is a strong need for governments to access funds to provide infrastructure. There is also pressure to fund social welfare systems, particularly as the extended family unit changes and populations go from rapid growth to rapid ageing.

There is also a strong incentive for multinational companies to abandon responsibility for providing social services for local employees so as to cut costs. This experience of ‘social dumping’ increases the cost of service provision for governments.

For the Asia Pacific region these challenges are particularly stark. While the region will become the engine room of the global economy over the next decade, it also faces major challenges funding the domestic investment needed to develop and increase living standards. Asia’s share of global production will increase from around 30 per cent today to over 50 per cent by 2050. As the move of the global centre of growth to the Asia Pacific accelerates, the tax issues faced by countries in the region will grow. Large corporations are increasingly focusing their expansion strategies on the region and a greater share of profits are being derived from the region. The need for effective tax regimes in these countries will become more important.

III. Democracy Public Choice Theory and Tax Reform

It is recognised that developing countries experience very different tax environments and fiscal pressures than developed countries. There are, however, some general principles which can be drawn from the success and failure of tax measures in developed countries with democratic systems. Technical design and the implementation of policy is just the beginning of the journey. The difficult part can be how you get it done. That is, how to secure support to legislate your reforms is becoming as important, or more important, than the technical aspects of the reform. The challenge has become how to overcome the diverse vested interests who seek to secure their existing economic rents at the expense of the majority. Tax is a classic example of this.

In economic parlance, pareto optimal outcomes, where the benefits of the reform more than out-ways the costs to losers is key to driving economic growth. In democratic systems the power of interests that will lose can have a significant impact on the process and success of reform.

Public choice theory outlines the impact that organised interests which stand to lose from pareto optimal reform can have on the democratic process. Small groups in society which have one or several political issues in common and which stand to lose significantly from a reform will be well organised and well-funded. (Becker, S, 1983) While the costs of reform are often concentrated in this way on a small group, the benefits, while large in total, are small for individuals or organisations.

An example of this is the removal of tariff protection for a particular industry. The protected industry stands to lose a lot from the removal of tariffs in terms of profits and those losses are centred on one industry. Consumers and businesses that gain from the fall in the price of imported substitutes for locally produced goods gain only a small amount each. The small well organised groups of businesses regularly affected directly by the removal of tariffs can take action in a democracy to retain their privileged position.

This action can take the form of providing financial assistance or open endorsement for a political party that adopts an accommodating policy stance. It can also take the form of public campaigning through unpaid media or in extreme cases through an advertising campaign. This has been the case in Australia and is the subject of all examples in this paper.

Tariff and quota reduction provide a poignant example for developing countries. Tariffs, in an inefficient way, protect entrenched interests and employment at the same time as raising revenue for governments. They are also an example of a tax that can be influenced by a country's involvement in international organisations. Up until the Doha Round, the World Trade Organisation (WTO) provided an effective international body which could assist developed and developing countries prosecute the case for tariff reform as a domestic agenda. The break-down of the Doha Round, in particular – the failure of the development agenda through the WTO – means that there is a need for other bodies to take up the issues that the global body has failed to resolve.

Achieving a progressive tax system means challenging power elites. Frequently official institutions are afraid to take on these vested interests. So what becomes important is not just the technical design of the policy but how you secure the public's support for it. Significant structural reforms which secure inclusive growth nearly always collide with powerful vested interests.

In recent years, corporate tax rates in OECD countries have declined an average of 7.2 per cent between 2002 and 2011. There is a risk of a race to the bottom.

If wealthy developed countries like Australia have seen their tax bases eroded including by large multinational corporates and very wealthy private interests, it is going to be even more difficult for developing countries to put in place progressive tax systems. The progressive nature of taxation in developed countries that remains was put in place in an environment in which governments had much greater sovereignty and power over taxation than is the case today.

It would be a tragedy if developing countries followed the experience of some developed countries down a path of less progressive taxation and wider income and wealth concentration. Australia's examples demonstrate this with some lessons for its neighbouring region. A regional organisation can usefully draw on these and other examples to develop regional strategies for regional concerns.

IV. Examples from Australia

Australia's experience in attempting to undertake tax reform to generate a fairer and more sustainable system is instructive. In particular, Australia's experience over the past decade shows that the political economy has been equally, or even more important than technical issues in tax reform.

The juxtaposition of four specific tax debates in Australia in the past decade are examples of how these issues can play out and are instructive on factors that drive success and failure in achieving reform in a modern democracy. These examples are proposals to increase consumption tax in order to reduce company tax, the Resources Super Profit Tax (RSPT), the additional Medicare Levy to fund the National Disability Insurance Scheme (NDIS) and reform of tax expenditures.

A. Increasing consumption tax to fund a reduction in company tax

Australia's recent debate on raising the rate of consumption tax, that is, the goods and services tax (GST), is a good example. The business community, through the Business Council of Australia (BCA), had being advocating for an increase in the GST from 10 to 15 per cent, to fund a reduction in company tax.

A common tax reform in developed economies over the past 20 years has been greater reliance on consumption taxation. Consumption taxes, however, are regressive, that is they impose a heavier burden on lower income earners for two reasons. The amount paid for a given item does not vary according to the purchaser's income or ability to pay. The result is that the tax hits lower income people harder.

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In countries with highly uneven income distributions, higher tax revenue should come significantly from taxes on higher income individuals. Value added taxes can be made to generate more revenue by broadening their bases and eliminating exemptions.

A flat consumption tax is regressive. For example, consider paying a tax of $100 on the purchase of a new fridge. This represents a greater burden for someone earning $20,000 a year than it does for someone earning $100,000. Consumption taxes don't apply to things that aren't consumed. Since low or moderate income earners consume more of their income than high income earners, they pay a greater share of their income in consumption tax.

The regressive nature of the GST means that if its rate were raised, it would lead to a reduction in equality in Australia. If the GST were raised to 15 per cent, and the exemptions kept the same, Australian families in the lowest quintile would end up spending 11 per cent of their income on this tax. (Leigh, 2015) That compares with only 8 per cent for those in the top quintile. While this debate was running in Australia, and as discussed later in this paper, new tax transparency legislation came to fruition in which had a significant impact in the debate. Through the Australian Tax Office's (ATO) disclosure of tax paid by the largest Australian and multinational corporations operating in Australia, it became clear that these companies were already paying less than 25 per cent company tax when the headline rate is 30 per cent. This had a significant impact on public opinion on increasing the GST to fund company tax cuts. The conservative liberal Government, which had hitherto been considering the business community's proposal, walked away from the idea.

In this example, the inequity of the business community's proposal came to clear through greater tax transparency. The flow of information meant that the electorate was better informed and was able to make a judgement based on clear facts counter to a well-funded and organised groups. This information was not available in the next example - the proposal to tax mining company rents which had a critical impact on the outcome.

B. Resources Super profit tax

Australia experienced a boom in the international prices paid for its major resource commodities between 2007 and 2012 with the price of iron ore, Australia's largest exports more than tripled during this period. The Australian Government sought to reform state based royalties which didn't effectively capture the worth of non-renewable resources and varied from state to state. Recognising the fact that mineral resources are non-renewable, the tax sought to raise revenue to ensure that mining companies paid a fair share of tax from exploiting this resource and distributed the benefits of the boom to ensure long-run economic growth. The tax was linked to other reforms and expenditure to distribute the benefits of the reform, including a cut in company tax, an increase in compulsory private pension payments (superannuation), and a tax write off for small business.

Designing a resources rent tax was always going to be technically challenging. However, the difficulties experienced with the mining tax were not just with its design. It ran into the implacable opposition of a sector that was unprepared to pay any additional resource rent tax under any circumstances.

The large mining companies in Australia, through their lobby group, the Minerals Council of Australia (MCA) mounted a sustained attack on the reform in the media and through an advertising campaign in print, radio, TV and social media which was valued at tens of millions of dollars. (The Guardian 24 Feb 2016) The mining industry's mis-information campaign was extraordinary. Its main message was "tax grab", yet it only applied to a few very profitable multinationals who threatened to leave Australia without any real intention to do so. The returns to shareholders of some of these companies were extraordinary. Had the true information and data on taxes currently paid by the mining industry been public, then the debate would have had an entirely different character.

In this instance a small well organised and well-resourced group of multinational companies first agreed to a new design with the government but then turned around and continued to oppose the policy. The Liberal Government was elected in October 2013 with a mandate to abolish the tax.

The mining industry in Australia is dominated by a small group of very large companies which stood to lose from the reform. One group of beneficiaries of the proposed MRRT were individuals who would gain through higher private pensions in 30 or 40 years time. While the superannuation industry did support the plan to boost compulsory contributions, the message didn't resonate with the community and could not be heard over the noise the mining industry was creating.

There were clearly beneficiaries from the new expenditure and the total benefits outweighed the costs. However, the beneficiaries were diffuse, spread widely through society and gained a small amount and often in a way that was not immediately clear.

C. Increasing the Medicare Levy to fund the National Disability Insurance Scheme (NDIS)

The experience of the Resources Super Profit tax contrasts to the successful increase the Medicare levy to fund the National Disability Insurance Scheme (NDIS). In response to concerns that Australia's disability services and funding was severely inadequate and inconsistent across states and territories, the Rudd Government tasked the Productivity Commission (PC) to investigate new approaches to funding a social insurance model and long-term disability care. The PC found:

> "*The current disability support system is underfunded, unfair, fragmented, and inefficient. It gives people with a disability little choice, no certainty of access to appropriate supports and little scope to participate in the community.*" (Productivity Commission, 2011)

This substantial and thorough research made the case for a major reform of the provision of disability services in Australia.

The NDIS provides funding to support people with a significant and permanent disability, their families and their carers. The Federal Government proposed a scheme to share the cost of the NDIS with state governments. To fund the Federal Government's commitment, a levy of 0.5 per cent on top of the existing 1.5 per cent Medicare Levy was used to partially fund the Australian public health system. While there was some initial opposition, public opinion swayed state governments and the Federal opposition to support the NDIS and the associated levy. Polling showed that the scheme was very popular and that there was an acceptance in Australian society to pay for the cost of the scheme through a special levy. (Essential Report)

A further advantage of the NDIS was that the government had years to prepare, to war-game and build public support. This compares to the mining tax where the government had less time to build a case for the public to accept that multinationals should pay a greater of tax on the rents received from a non-renewable resource.

In this example linking the case for increasing an existing tax for a specific purpose that was considered important by the public meant the tax and the social program it funded was accepted by the electorate and could not be used by the then opposition as an election issue as the mining tax was.

D. Reforming tax expenditures – negative gearing

A significant risk to fiscal integrity are tax expenditures which are built into budgets and economies. Tax expenditures allow for exemptions, deductions or tax credits for individuals or organisations. The same forces that affect tax reform also act as barriers to removing tax expenditures which, if left unchecked, can grow over time.

As the reduced taxes for individuals and businesses become entrenched through behavioural change, they can be very difficult to remove in democratic systems. Apart from individuals who can change their vote if they stand to lose from the removal of a tax expenditure, lobby groups coalesce around these issues and begin to influence policy outcomes directly by representations to government, or indirectly through campaigning to the electorate.

Australia has several tax expenditures which it has struggled to reform. An example playing out currently is the attempt to reform property taxes in Australia. The Australian tax system allows individuals to claim expenses for an investment against all income. Where the cost of the investment is greater than revenue from that investment, the loss can be deducted from an individual's income for the calculation of their income tax. If the deductions from the cost of the investment are larger than the income derived from the investment, the loss can be deducted from wage income the individual earns. This is known as negative gearing.

While any investment can be negatively geared, in Australia its greatest use has been for housing for investment purposes. Costs such as interest payments, renovations, property management fees and so on can be deducted from the income derived from the property. Over time, negative gearing for property has dramatically expanded. The cost of negative gearing to the budget through reduced income tax payments is $2.4 billion per annum and 1.9 million Australians make use of negative gearing.

Tax expenditures also are more likely to be less fair than budgetary expenditures and negative gearing for property is case in point. The current regime gives investors an advantage over first home buyers in Australia. Sydney is now the second most unaffordable city in the world and Melbourne the fourth most unaffordable. Some argued that 67 per cent of tax payers who claim negative gearing earn a taxable income of less than $80,000. However, “taxable income” takes into account the deductions from negative gearing. There are 64,000 Australians with zero incomes who have investment properties. These individuals have used negative gearing to get their taxable income down to zero. A better indicator is an individual’s taxable income, which shows that surgeons claim 100 times the benefit that cleaners do and 16 times the benefit nurses receive.

The opposition, Australian Labor Party (ALP), has proposed a reform of negative gearing to limit the impact on housing affordability. The proposal is to allow negative gearing for newly built property only. As this article is being written, the Liberal Government is also reported to be considering reforming negative gearing.

The response of the property industry to the ALP’s policy and the prospect of other potential reforms has been to mount an advertising campaign. The aim of the campaign is to influence the electorate’s opinion on property taxes with a view to changing their vote. The mining industry’s response to the proposed tax ratcheted up lobbying activities by lobby groups in Australia. It has led to a trend for industry lobby groups escalating their response to tax reforms that improve equity and protect the tax base.

E. Lessons from Australia’s experience of tax reform

The outcomes of these four tax policy proposals provide some guidance for countries seeking to reform their tax and welfare systems:

i. Pairing a new or reformed tax with expenditure on a specific, well defined and understood purpose which is recognised in the community as necessary, will have a greater chance of being accepted by the electorate and is less open to opposition.

ii. A new or reformed tax in which those standing to lose are a small and well organised group while beneficiaries and diffuse and stand to only gain a small amount is less likely to succeed particularly if the use of the revenue is complex and difficult for the electorate to understand.

iii. The threat of the Australian mining industry to shift investment to other countries shows the capacity for multinational corporations to divert resources to lower taxing economies when one country unilaterally introduces a new or reformed tax. Without coordinated action across countries, multinationals will be able to respond by redirecting investment to other countries.

iv. Tax expenditures become quickly entrenched, grow rapidly if they are not held in check, and create groups of interest who will organise to protect those expenditures. The best way to avoid long term budget costs from tax expenditures is to avoid introducing them

v. Tax reform is difficult for developed countries like Australia and technical expertise alone is not sufficient to ensure success. Countries will need to give consideration to not only tax design but also political economy issues. International support to developing countries should also reflect this priority.

vi. Given the difficulty Australia had in undertaking unilateral tax reform in which multinational corporations stood to lose, there is a need for countries across the region to coordinate their efforts.

V. So What is Necessary as We Look to the Future of Tax Reform?

The above examples suggest a number of prerequisites that are critical to successfully delivering tax reform. Amongst these is a need for greater transparency to inform policy design but also support public discussion, and the need for governments to think internationally even in relation to domestic tax reform. The examples briefly discussed above also suggest the need to reconsider how and what development assistance for tax reform is delivered as developing nations seek to strengthen their domestic sources of revenue. Finally, in light of the challenges discussed, the need to consider other sources of revenue must also be part of the discussion of sources of revenue for development.

A. Transparency

Central to the success of any reform is access to information that can inform the design of the policy but also public discussion. In the rapid media age and as campaigning techniques become increasingly direct and sophisticated it is all too easy for good ideas to be discredited by bad information. As a starting point, access to information and data is critical to supporting sound and accurate policy debate.

Australia has had some success in changing the perceptions of the electorate on tax paid by large companies, including multinationals, by disclosing levels of tax paid by public and private companies. In 2013, the then Labor Government, passed legislation which required the Australian Tax Office (ATO) to disclose tax information for corporate tax entities with annual net income in excess of $100m. While there have been attempts to water down the legislation by excluding private companies, the legislation has remained almost in-tact and is having a significant impact on the debate on tax in Australia.

The ATO published tax data for 2014 for 1539 large public and foreign owned companies. (Riordan 2015) The figures revealed that 579 companies paid no tax. The release of this information generated significant coverage in the media of those companies paying little or no. Tax information on 300 privately owned companies with turn-over of more than $200 million will be published by the time this paper is released. (Mather 2016) The publication of this tax information is having an impact on the debate on tax in Australia. While there are often legitimate reasons for companies to pay no tax, the scrutiny of the media and the public on each company paying low or zero tax has had three effects.

First, it has focused the mind of the electorate on the low levels of tax paid by some companies and built support for a tax regime that captures more revenue from multinational companies.

Second, corporations are beginning to feel the pressure of public opinion about their tax arrangements. This could, in time, lead to better voluntary behaviour by companies. It is possible that we might see a move to the kind of behaviour corporates exhibited at the height of public interest in climate change when many companies undertook unilaterally to become carbon neutral. A company that portrays itself as a good corporate citizen because it is carbon neutral, has a large foundation and allows or requires staff to participate in pro bono work, cannot retain this image while being outed as a serial avoider of tax. The pressure comes not just from consumers but from employees and potential employees.

Finally, as already stated, the broader tax debate has been influenced. The business community, through the Business Council of Australia (BCA), had being advocating for an increase in Australia's consumption tax, the goods and services tax (GST), to fund a reduction in company tax. Although the argument for an increase in the GST gathered some momentum, a significant factor that ended this debate was the Business Council's linking it to a reduction of the company tax rate at a time when it was being revealed that many Australian and multinational companies were paying little or no tax at all.

A strong message from the Australian experience is that greater disclosure has led to the public debate on being more informed and brought to bear pressure on entities that have not being paying a fair amount of tax. Efforts like Publish What You Pay (PWYP), a global civil society initiative, and the Extractives Industries Transparency Initiative (EITI), a global standard developed to promote open and accountable management of natural resources, are important movements advocating for transparency. Their efforts to not only call for transparency but also set standards and mechanisms by which that transparency are rightly being increasingly headed by governments. Their work should not only continue but governments should also utilise the knowledge they bring and can also communicate to inform public discussion on the need for reform.

B. Avoiding 'beggar thy neighbour' policies

A particular problem for developing countries is "beggar thy neighbour" policies through which countries, in seeking to solve a domestic economic problem by implementing reforms, have a negative impact on neighbouring countries. This becomes a race to the bottom with each country competing to outdo its neighbours with more and more generous and economically distorting tax changes. That is, each country progressively lowers rates of tax to attract investment resulting in all countries being worse off. This raises the particular problem of Singapore's impact on the region. With exceptionally low income tax rates, company tax and withholding tax, Singapore is succeeding in establishing itself as the financial services hub in the region. The impact of Singapore on the region highlights the need for multilateral coordination of tax policy.

In the Asia Pacific region there is a preponderance of ineffective taxes which are resulting in large tax losses. Tax holidays encourage companies to set up operations in one country at the expense of another only to shift operation when the holiday is over without leaving any long term investment in infrastructure and even human capital. Tax holidays and competition between countries merely is a zero sum game.

Through multilateral agreement, countries in the region can work towards tax and subsidy regimes that do not simply siphon investment from one country to another. There is a need for a regional body that can act as a forum for countries to discuss these issues.

C. Moving technical assistance to the political

Australia's experience in a number of tax reform processes is that political economy issues have come to dominate technical issues. While capacity building on technical matters is important it needs to be paired with complimentary capacity building in dealing with political economy issues. It is also clear that the BEPS process could better reflect the circumstances and requirements of developing countries.

It is clear from Australia's experience of tax reform that greater pooling of resources and knowledge will be necessary to support developing countries hoping to overcome vested interests to finance their own development and support growth.

A regional body focused on the particular experience, stage of development and revenue challenges facing nations in the Asia Pacific is needed. Such a body could work with of international organisations and reflect the diverse views of the region in international tax discussions. The body should have a strong advocacy role and work with government, the private sector and civil society.

VI. Recommendations

1. Countries should pass legislation requiring the publication of the amount of tax paid by large companies that operate in that country to build the case for payment of fair levels of tax by all companies including multinationals.
2. To overcome political barriers to tax reform in democratic countries there is a need for assistance in political economy aspects to ensure pareto optimal tax policies are implemented.
3. Developing countries should avoid tax expenditures as they can grow rapidly, become entrenched in the economy and culture of a country and are difficult to remove.
4. There is a need for greater adherence and understanding of the needs of developing nations in discussion of international/multinational taxation. Efforts to reform international tax arrangements won't be effective if the Asia Pacific aren't engaged sufficiently or can't adopt the model developed.
5. A regional body focused on the particular experience, stage of development and revenue challenges facing nations in the Asia Pacific is needed. Such a body could work with international organisations and reflect the diverse views of the region in international tax discussions. The body should have a strong advocacy role and work with government, the private sector and civil society. The regional body can:
    5.1. Gather tax information from the countries tax systems;
    5.2. Assess developing tax problems;

5.3. Provide a forum for discussion of tax matters in the region;
5.4. Potentially play a surveillance function over tax reforms that might have negative implications for other countries of the region; and
5.5. Perform other related tasks.

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