Issues Paper on Tax Policy and Public Expenditure Management in Asia and the Pacific
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Issues Paper on Tax Policy and Public Expenditure Management in Asia and the Pacific

I. Enhancing revenue potential for the SDGs: A great challenge

The UN Sustainable Development Network has estimated that the attainment of the Sustainable Development Goals (SDGs) in low- and lower-middle income countries will require incremental spending of at least $1.4 trillion per year. This translates into an additional mobilization of 2.5% of the GDP in public revenue for a typical country of the group, even if half of the additional investment needs could be shouldered by the private sector.

The Asia-Pacific region, which as a whole has one of the world’s lowest tax revenue levels, is particularly ill-prepared for this task. In recent years,\(^1\) total tax revenue averaged 17.6% of GDP in the region, compared to the developing country average of 21.3% and developed country average of 26.4%.\(^2\) This level only surpassed Middle East and North Africa, where non-tax resource revenues more than compensated for low taxes.

Meanwhile, the region-average conceals the vast differences between countries. In 2014,\(^3\) for instance, the regional average was 17.6% of GDP, but it came down to only 15.6% if developed countries and the Central Asia sub-region are excluded. Afghanistan has the lowest tax-to-GDP ratio of only 7.3%, while for Bangladesh, Pakistan, Iran and Sri Lanka this figure is below or barely around 10%. In contrast, countries like the Russian Federation, Georgia, Uzbekistan, Maldives, and Fiji have tax-to-GDP ratios close to the OECD average of 25.1%.\(^4\)

The extremely low tax revenue levels in some of the region’s poorest countries are particularly worrying. Given their significant investment needs to raise living standards, build infrastructure, improve education and healthcare, create basic social security networks and promote environmental protection, insufficient public financing is increasingly a primary bottleneck for these countries in the effort to lift dozens of millions out of extreme poverty and effectively pursue the SDGs. For those which consistently collected less than 15% of GDP in tax revenue, mobilizing the additional 2.5% of GDP in the next few years could prove extremely difficult. If decisive actions are not taken urgently, they are likely to fail in achieving the objectives.

However, raising tax-to-GDP ratio is a complex and delicate task. It has to be based on the broad social contract linking responsibilities of paying taxes and accountable public expenditure that delivers on economic, social and environmental outcomes. It has to be achieved through appropriately sequenced and paced reforms to rationalize tax structure, enhance tax administration capacities and improve legislation and transparency. It also requires regional and international cooperation to close loopholes, address the risk of excessive tax competition, and promote a fair distribution of tax revenues across countries. None of these could be achieved in one day, and historical evidence suggests that well-conceived and thoroughly-implemented small steps will outperform an ambitious yet immature and practically unimplementable program.

This leaves the counties with one clear option: maximize the developmental effect of tax policies and public expenditure while seeking gradual but solid progress in revenue mobilization. In particular, tax policies should be viewed not only as a revenue generation tool, but also as a policy tool that can contribute to many different dimensions of development, including to environmental sustainability through green taxes and to social harmony through progressive taxation.

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\(^1\) Three year average between 2012 and 2014, or the 3 latest years with data available.

\(^2\) This figure excludes social contribution, which is normally considered as part of the overall tax revenue in OECD countries. Given that social contribution levels in Asia-Pacific developing countries are significantly lower, separating it from taxes would allow us to better evaluate tax performance of the countries.

\(^3\) Or the latest available year.

\(^4\) Excluding social contribution.
For these reasons, the following sections will discuss the efficient usage of tax incentives to achieve greatest social-economic benefits with least costs, the approaches to enhance subnational public revenues to address the region’s urbanization challenge, the tax policies for shared prosperity and green development, the cross-cutting issue of establishing the benign social contract marked by voluntary tax compliance and accountable public spending, and the prospect of greater regional tax cooperation.

II. Tax incentives, tax competition and the protection of tax bases of developing countries

Tax incentives are employed worldwide as an important policy tool to attract investment, promote exports, strengthen global competitiveness of resident firms, and even for rural sector development. They are more prevalent in the Asia-Pacific region. James (2013) reported that all (100%) of the 7 surveyed South Asian countries provided tax holidays or exemptions, and 92% of the 12 surveyed East Asia and Pacific countries also provide these incentives. This is much higher compared to around 75% in Eastern Europe, Latin America and the Caribbean, Middle-East and North Africa, only 60% in Sub-Saharan Africa, and 21% in OECD countries. South Asia is also top in the world in providing VAT exemption or reduction. East Asia and the Pacific meanwhile tops in the use of reduced tax rates, investment allowances and tax credits, and R&D tax incentives.

Table 1. Tax holiday years in selected Asia-Pacific Countries

<table>
<thead>
<tr>
<th>Countries</th>
<th>Cambodia</th>
<th>Indonesia</th>
<th>Lao PDR</th>
<th>Malaysia</th>
<th>Myanmar</th>
<th>Philippines</th>
<th>Singapore</th>
<th>Thailand</th>
<th>Viet Nam</th>
</tr>
</thead>
<tbody>
<tr>
<td>Max. tax holidays years</td>
<td>9</td>
<td>20</td>
<td>10</td>
<td>10</td>
<td>5</td>
<td>6</td>
<td>negotiable</td>
<td>11</td>
<td>4</td>
</tr>
</tbody>
</table>


Table 2. Types of tax incentives and their prevalence

<table>
<thead>
<tr>
<th>Type of Incentives</th>
<th>Number of Countries Surveyed</th>
<th>Tax holiday/Tax exemption</th>
<th>Reduced Tax rate</th>
<th>Investment allowance/Tax credit</th>
<th>R&amp;D Tax Incentive</th>
<th>Super-deductions</th>
<th>SEZ/Free Zones/EPZ/Freeport</th>
<th>Discretionary process</th>
</tr>
</thead>
<tbody>
<tr>
<td>East Asia and Pacific</td>
<td>12</td>
<td>92%</td>
<td>75%</td>
<td>67%</td>
<td>83%</td>
<td>33%</td>
<td>92%</td>
<td>83%</td>
</tr>
<tr>
<td>Eastern Europe and Central Asia</td>
<td>16</td>
<td>88%</td>
<td>38%</td>
<td>25%</td>
<td>31%</td>
<td>0%</td>
<td>100%</td>
<td>38%</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>25</td>
<td>88%</td>
<td>32%</td>
<td>52%</td>
<td>12%</td>
<td>4%</td>
<td>72%</td>
<td>40%</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>15</td>
<td>80%</td>
<td>40%</td>
<td>13%</td>
<td>0%</td>
<td>0%</td>
<td>80%</td>
<td>40%</td>
</tr>
<tr>
<td>OECD</td>
<td>33</td>
<td>21%</td>
<td>36%</td>
<td>64%</td>
<td>76%</td>
<td>21%</td>
<td>67%</td>
<td>33%</td>
</tr>
<tr>
<td>South Asia</td>
<td>7</td>
<td>100%</td>
<td>43%</td>
<td>71%</td>
<td>29%</td>
<td>71%</td>
<td>71%</td>
<td>43%</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>45</td>
<td>78%</td>
<td>62%</td>
<td>78%</td>
<td>11%</td>
<td>18%</td>
<td>64%</td>
<td>82%</td>
</tr>
</tbody>
</table>


5 Such as in Bangladesh, Nepal, Pakistan and Lao PDR in the region, which target tax holidays for investment in rural and underdeveloped locations.
6 Sebastian James, Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications, Investment Climate Advisory Services of the World Bank Group (September 2013).
Corporate income taxes have also come under pressure with increased global mobility of capital. While declining corporate tax rates is a worldwide phenomenon, the problem seems to be exacerbated in the region as countries expand tax incentives as well as cut rates in the attempt to attract foreign investment. Keen and Simone (2004) noted that that unlike in other regions, corporate tax reform in Asia and the Pacific has been both rate-reducing and base-reducing. A study by Chen et al. (2012) based on 14 Asia-Pacific countries found support for the hypothesis that countries in the region compete with each other in setting their corporate tax rates. A recent KPMG (2014) study has warned that the paucity of coordination and harmonization on tax matters in the ASEAN region, especially in light of the ASEAN Economic Community, could result in continued tax competition that will have adverse effects on tax bases in the region.

Why do tax incentives seem more popular in Asia and the Pacific? One possible explanation could be that since the region is more deeply integrated into global value chains and has relied more heavily on exports and FDI to sustain its high growth, the competition pressure is also more directly felt. The region is also the origin of, and generally supportive of, the developmental state, which advocates for more proactive public interventions, including through tax incentives, to promote growth, exports and industrial upgrading. Indeed, all the Asian Tigers and later countries like China and Viet Nam have all provided broad tax incentives as a key element of their development strategy. With such successful examples from neighbouring countries, it is hard for other Asia-Pacific countries to refrain from learning their lessons.

**Challenges with cost-benefit analysis**

As noted in the joint IMF/OECD/UN/World Bank report in 2011, “Striking the right balance between an attractive tax regime for domestic and foreign investment, by using tax incentives for example, and securing the necessary revenues for public spending, is a key policy dilemma.” This is a challenging task.

On the one hand, establishing causality evidence between tax incentives and the investment they generate or jobs they create is difficult. In particular, tax incentives are often only part of a broader package of policies to improve the business environment, such as accelerated administrative procedures, priority land usage and utility supply, or loans from development financing institutions. Isolating the effect of tax incentives could be almost impossible. Moreover, even if the impacts of tax incentives could be identified, evaluating their overall benefits is another challenge, due to externalities and problems with quantitative valuation of social objectives.

At the same time, it is hard to quantify the full cost of tax incentives as well. Revenue loss is the most direct cost of tax incentives. While greater efforts to track tax expenditure related to tax incentives should definitely be advocated, the limitations of this approach should also be recognized. First, establishing the benchmark, i.e. the revenue level if incentives were introduced or removed, is difficult, and existing methods often fail to take account of behavioural responses, leakage or abuse. Second, tax incentives also lead to enforcement and compliance costs and more importantly create rent seeking opportunities for corruption.

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9 For an earlier study on ASEAN tax competition, see Ngee Choon Chia and John Whalley, “Patterns in investment incentives among developing countries” in *Fiscal Incentives for Investment and Innovation*, Anwar Shah, ed. (New York, Oxford University Press, 1995).

10 The Republic of Korea, Taiwan Province of China, Singapore and Hong Kong, China.

11 E.g. tax incentives for strategic sectors like steel or heavy machinery could be less accretive in terms of job creation given their capital intensive nature. Yet these sectors also serve as important industrial foundation for the development of many other manufacturing sectors, and the overall benefits could significantly outweigh the costs if such externalities are accounted for.

12 For example, how much dollar benefit should be assigned to agricultural tax incentives if national food security is a concern? How much dollar benefit should be assigned to tax incentives for traditional handicraft manufacturing if protecting local culture is on the policy agenda?

13 IMF, OECD, UN, WB, “Options for low income countries’ effective and efficient use of tax incentives for investment”, A report to the G-20 development working group by the IMF, OECD, UN and World Bank (October 2015).
For these reasons, cost-benefit analysis of tax incentives is more like an art rather than a science. Quantitative techniques to estimate related revenue loss, job creation or investment attracted could significantly contribute to informed policy making, but it is likely that subjective discretion of policy makers based on their first-hand experience and understanding of the national overall development priorities and strategy would remain a key factor regarding tax incentive policies.

**What can Asia-Pacific countries practically do?**

International organizations (IOs) have conducted a number of in-depth studies on the best practices of tax incentives worldwide. Although much useful advice and tips were provided by these studies and any generalized assertion could be misleading, three key messages emerge as the core of the recommendation framework of the IOs.

First, tax incentives in developing countries are often found redundant in attracting investment in developing countries, as broad business surveys show that tax incentives alone are usually not enough to change investment decisions. Second, developed and developing countries differ in tax incentive designs, with simple tax holidays and reduced rates more prevalent in low income countries, preferential tax zones more popular in middle-income countries, and investment tax credits and R&D incentives more common in high-income countries. Third, better governance, which anchors on the rule of law, centralized approval authority with the ministry of finance and, transparent administration and evaluation, is required for the use of tax incentives.

Despite this well-developed broad guidance, many practical questions remain to be answered. Are tax incentives more successful in Asia and the Pacific given the fast growth in East Asian economies that used them very proactively? Or have Asia-Pacific countries used them excessively, especially more simple types like tax holidays or rate reduction? Is removing or radically adjusting tax incentives the correct strategy as often recommended by IOs? Or should countries focus more on how to better target tax incentives and improve complementary policies to boost the effectiveness of the policy package? Does the benefit from switching to more sophisticated tax incentive types justify the additional investment in administration or evaluation given the limited resources and capacity of developing countries? Is the centralized governance approach most suitable for developing countries that may have to rely more on the discretion of local officials who are closer to the ground and better informed than the finance ministry in the capital?

**Tax competition and regional cooperation**

Individual countries are able to achieve greater benefit with lower cost in tax incentives through various domestic reforms. However the overall level of incentives (including lower corporate income tax (CIT rates)) and related costs are largely determined by the external tax competition pressure, especially from neighbouring countries with similar economic structures. As the Asia-Pacific region becomes increasingly integrated, a race-to-the-bottom is a serious risk to take into account. In theory, regional cooperation for better policy coordination and mutual understanding would be the most important mechanism to contain such a damaging risk, yet to operationalize the cooperation Asia-Pacific developing countries would need greater political commitment and wisdom and regional inter-governmental platforms would need to play a more proactive role.

**Changing international tax rules and tax incentive effectiveness**

The effectiveness of tax incentives is also affected by international tax rules. For example, multinationals taxed on a territorial basis in their home countries would be more sensitive to host country tax incentives since they would be able to retain the benefits, while multinationals subject to controlled foreign cooperation (CFC) rules would lose the tax incentive benefits to their home country that taxes corporate incomes abroad. The ongoing international taxation reforms after the 2008 crisis, in particular the OECD/G20-led BEPS\(^{14}\) project, are expected to significantly change international tax rules and practices, and will have profound implications on how tax revenue would be distributed across nations and how tax incentives would be used.

\(^{14}\) Base erosion and profit shifting.
The extent and direction of the impacts of the BEPS project will depend on its broadness and depth of implementation. Conceptually, if the project provides developing countries greater ability to effectively tax multinationals or reduces the space of aggressive tax planning in developed countries, the role of tax incentives in developing countries would become more important. The challenge here is that developing countries so far have been largely marginalized in the norm-setting process steered by the developed and large countries. It is thus extremely important for developing countries to better understand the implications of the BEPS project, coordinate their positions more closely, and strengthen their capacity to leverage the new rules and norms. This will allow them to be more involved in BEPS implementation and so contribute their voices more meaningfully and defend their strategic interest within this international agenda.

III. Public finance for cities: addressing Asia’s urbanization challenge

The Asia-Pacific region is at the centre of the world’s largest rural-urban transition in history. Between 2001 and 2010, almost 200 million people moved to urban areas in East Asia alone. Today the region has world’s highest urban population growth rate of 1.5% per annum. By 2030, Asia’s total urban population is expected to exceed 2.6 billion, accounting for 60% of the increase in the world’s urban population over the three decades between 2000 and 2030. Even by that time, the region’s overall urbanization rate would be 53%, considerably below the world average of 60% and lower than the 55% in Africa and 83% in Latin America. In other words, this fast rural-urban migration is also likely to last much longer in Asia and the Pacific.

At the same time, Asia’s urbanization is characterized by the dominance of mega cities and the pivotal role of cities and city clusters in the region’s integration into the global economy. The region currently hosts 17 of the world’s 28 megacities (cities with more than 10 million people), and many of its booming cities and city clusters serve as industry and trade centres that link the region’s expanding and deepening value chains. These two features make Asian cities more “capital-intensive” in the sense that they will require more investment in infrastructure and public services per resident.

The unprecedented speed and distinct features of Asia’s urbanization have put enormous fiscal pressure on governments, especially municipal governments. The costs of provision of public transportation, ICT infrastructure, housing, urban environmental management and job creation programs are in the scale of trillions of dollars. Moreover, such enormous expenditures will need to be undertaken in a relatively short time span. In the larger countries of the region, where subnational governments normally play a greater role in the provision of public goods, they already account for more than half of the total public expenditure. And in many smaller ones, this figure has well surpassed 30%.

In contrast to the growing public spending needs, municipal governments of the region are often ill-equipped to meet the challenge. Almost all Asian countries suffer from serious vertical imbalances, with subnational governments’ expenditure well-exceeding their revenues (Table 2). As a result, they heavily rely on central government transfers and borrowing to address their significant fiscal gaps. In particular, the fiscal expansion in the aftermath of the 2008 crisis has exhausted the credit potential of many subnational governments and led to swift accumulation of local government debt in a number of cases, threatening to destabilize the whole financial system.

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16 China alone spends more than RMB 1 trillion ($160 billion) on subsided urban housing each year.
17 For example, China and India.
Table 3. Estimated Subnational Government Shares of Total Public Expenditure and Revenue in Asian Countries, 2009 (%)

<table>
<thead>
<tr>
<th>Country</th>
<th>Share of Total Public Expenditure</th>
<th>Share of Total Public revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Subnational</td>
<td>Upper Tier</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>15</td>
<td>5</td>
</tr>
<tr>
<td>India</td>
<td>66</td>
<td>33</td>
</tr>
<tr>
<td>Indonesia</td>
<td>35</td>
<td>7</td>
</tr>
<tr>
<td>Japan</td>
<td>60</td>
<td>20</td>
</tr>
<tr>
<td>Republic of Korea</td>
<td>45</td>
<td>15</td>
</tr>
<tr>
<td>Pakistan</td>
<td>33</td>
<td>28</td>
</tr>
<tr>
<td>Philippines</td>
<td>25</td>
<td>11</td>
</tr>
<tr>
<td>China</td>
<td>70</td>
<td>20</td>
</tr>
<tr>
<td>Thailand</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>Viet Nam</td>
<td>45</td>
<td>30</td>
</tr>
</tbody>
</table>


Can property taxes carry the weight?

The property tax\(^\text{18}\) is widely regarded as the most appropriate principal subnational government tax revenue source. In OECD countries, it contributes on average 2% of GDP – this figure could exceed 3% such as in the case of the United States and Canada – and is also believed to create greater pressure on the accountability of subnational government spending given that it is a more visible tax. However, property tax has so far performed poorly in developing countries, which on average collects only 0.6% of GDP\(^\text{19}\) and often depends more on one-time taxes on property development and transfers instead of recurrent taxes on property ownership.

One reason for the poor performance is that property tax is politically less desirable compared to alternative indirect taxes or central government transfers for which the burden could be shifted to others through “tax exporting”\(^\text{20}\) or be less directly felt by the local population. More importantly, property tax suffers from a series of administrative challenges such as proper valuation, revaluation and comprehensive land surveys, which are often beyond the capacity of local tax authorities of developing countries. In addition, local governments also have to weigh the benefits of property tax and the potential negative impact on local housing markets. This is particularly an important concern for fast urbanizing Asia-Pacific developing countries that have developed a large real estate sector.\(^\text{21}\)

Despite such challenges, property tax is likely to remain a most important revenue source for Asia-Pacific cities. On the one hand, municipal governments in developing countries often lack other alternative revenue sources and rely more on property tax to finance expenditure. Indeed, property tax accounts for a greater share of subnational spending in developing countries (18.4%) than in OECD countries (12.4%),\(^\text{22}\) and for certain Asia-Pacific metropolitan

\(^{18}\) Property tax can sometimes refer to a group of taxes on property transfers and holding, including tax on property development, tax on property transfers, as well as recurrent taxes on land usage or property ownership. However, in most cases, it puts an emphasis on recurrent taxes on property ownership.


\(^{20}\) For example, the burden of high business tax on locally registered businesses could be partially “exported” to partners and customers outside the jurisdiction.

\(^{21}\) This is one of the main reasons behind China’s hesitation in introducing recurrent property tax on real estate ownership.

governments property tax could well-exceed 20% of their total revenue. Moreover, property tax has the potential to serve as an effective policy tool for redistribution if well-designed, since a large proportion of the wealth of the rich in Asia-Pacific is in the form of real estate. This also increases the political attractiveness of property tax when the general public start to weigh visible redistributive benefits against visible tax burdens.

In view of the high costs of effective property tax administration, some scholars recommend a strategy to focus on increasing property tax revenue significantly instead of only targeting marginal improvements. It is estimated that a comprehensive 1% property tax may mobilize up to 3% of GDP if exemptions are minimized. However, for such ambitious reforms to succeed, governments will have to overcome significant political obstacles like taxing rural land or owner-occupied real estate, address broader economic concerns like supporting the housing market, and mobilize the initial investment required for proper enforcement. How to deal with such dilemmas might be among the most fundamental questions for Asia-Pacific developing countries regarding property tax.

**Alternative subnational government revenues**

Apart from property tax, subnational governments can also collect revenue through excises, local income taxes, payroll tax, sales tax and local business tax. Efforts have been made to identify the pros and cons of these alternatives, and the optimal tax mix would entirely depend on local context. Non tax revenues, such as from public land lease/sales or from fees and service charges, are important complements as well. In particular, taxes are usually better for smoothly distributed recurrent spending but incapable of financing the large greenfield investments of fast urbanizing cities, and non-tax revenues could play a greater role. In China, for instance, revenues from public land lease have exceeded 6% of GDP in recent years and have been a key factor in the country’s impressive infrastructure progress.

**Intergovernmental transfers**

Intergovernmental transfers account for more than half of total subnational government revenue in most Asia-Pacific developing countries and would continue to be a corner stone of subnational public financing. While they play a crucial role in equalizing territorial fiscal disparities within countries, addressing nationwide externalities and improving overall tax administrative efficiency, they may also lead to problems like weak predictability, distortive conditionality and additional bureaucratic frictions. International best practices and regional lessons would be valuable for Asia-Pacific developing countries in improving the efficiency of their intergovernmental transfer systems.

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IV. Tax policies for shared prosperity

Debates over tax and public expenditure policy are often about what kind of society we want. With widening income gaps between the top and bottom in some major economies, stagnant wage growth compared to GDP growth, and continuing concentration of wealth in the top 1%, stronger public policy efforts to check extremely inequality, make the rich pay their fair share of taxes, and mobilize additional resources to finance public job creation, education and social welfare programs are increasingly policy priorities and a popular concern worldwide.

Asia and the Pacific, historically, had been relatively more equal compared to other developing regions, partly due to the large presence of socialist regimes and the early success of the “Asian Tigers” in growing with equity. However, the picture started to change dramatically in the late 1980s. On the one hand, fast economic growth in East and South East Asia started to be accompanied by sharp increase in inequality when the more populous countries, especially China, embraced the market economy. On the other hand, the turmoil in former Soviet Union member states shattered their previous social-economic structures and plunged the countries into extreme inequality almost overnight.

In most of these cases, the rich reaped the bulk of the benefits created by economic growth. In India, Bangladesh, Lao PDR and Sri Lanka for instance, the top quintile in income increased their share in the overall income pool, while all the other four quintiles suffered decrease in their share. In China, while growth succeeded in lifting hundreds of millions out of poverty and nurtured a broad middle class, the bottom 10% was still deeply marginalized in the process. Their share in the overall income pool almost halved from 3.18% to 1.69% between 1993 and 2010. As a result, estimated Gini based on household income jumped from 37 to 48 between 1990 and 2014.27

More alarming is the fast wealth concentration in the region. Normally wealth inequality builds up as income inequality accumulates and peaks after income inequality peaks, yet it is already extremely high in several cases. In the Russian Federation, the richest top 5% is estimated to control 82% of the nation’s total private wealth, and the top 1% control 70%. In Indonesia, Thailand and India, the top 5% control close to 70% and the top 1% take more than half of the total wealth pool.28 Asia-Pacific is also topping the world’s High Net Worth Individuals (HNWI)29 list and Forbes’ billionaire list.30

Such significant inequality increase in just two decades has created great pressure on regional governments to address widening income gaps more seriously. And there are some initial signs of turning for the better: inequality levels started to stabilize in the region’s emerging economies and also experienced a substantial drop in former Soviet Union member states in recent years. Yet continued efforts would be required to consolidate the early achievements and prevent deterioration in future. In addition, the ongoing economic slowdown and uncertainty in the aftermath of the 2008 economic crisis also add to the urgency of this task, as downward economic pressure is often disproportionally felt by the poor and when the fairness of existing domestic and international economic institutions is increasingly questioned worldwide.

Tax policies: how much can they do?

Taxes play an important role in reducing inequality through two main channels. First, they provide the financial backbone for public spending on healthcare, education and capacity development programs to increase the productive assets owned by the poor and enable them to better explore economic opportunities, and for public spending on social protection and welfare schemes that help the poor hedge against external shocks and improve their livelihood. Second, taxes and transfers are also primary policy tools for direct redistribution. In the

26 The Republic of Korea, Singapore, Hong Kong China and Taiwan.
27 If estimated based on household expenditure data, the Gini grew from 33.5 to 37.5 in the same period.
28 ESCAP calculation based on Credit Suisse.
29 Those with more than $1 million in net wealth.
30 The region has the worlds’ largest HNWI population, whose total wealth almost doubled between 2009 and 2015, reaching $17.4 trillion. It is also beating North America and Europe in Forbes’ billionaire list, with China, India and Russia all ranking in the top 5.
OECD for example, taxes and transfers on average brought down average Gini from a rather high market level of 47.5 to a somewhat moderate level of 31.1 in 2013.  

Asia-Pacific developing countries fall far behind in both these fronts. In 2014, they on average mobilized only 15.6% of GDP from tax revenues compared to an average of 25.1% in OECD countries. OECD countries also received 9.1% on average from social contributions, while such revenue in many Asia-Pacific developing countries remains minimal. More importantly, direct taxes, which are normally considered more progressive, only accounted for 37.6% of the total tax revenue in developing Asia and the Pacific, while for OECD countries 55.8% was mobilized from direct taxes. Personal income tax (PIT) collection in particular is extremely weak, which stood at 2.0% of GDP in 2014 less than a quarter of the 8.8% level in OECD countries. The potential for Asia-Pacific developing countries to better leverage direct taxes is obvious.

In addition, recent debate on increasing inequality and wealth concentration internationally further adds to the argument for greater use of income and wealth taxes for redistribution. It is noted that wealth concentration could be a self-reinforcing trend, and would require more proactive use of income and wealth taxes to contain. Meanwhile, stronger public spending on education, capacity development, social protection and welfare would be necessary to help the poor navigate through continuing difficulties in the aftermath of the 2008 crisis, and to restart economic growth by investing in their productivity. The bulk of this additional spending should be funded from closing tax loopholes exploited by big firms and the rich and by obliging them to shoulder their fair share of tax responsibilities.

In view of these facts and trends, it is clear that gradually enhancing tax revenues, especially raising the share of direct taxes in the overall tax mix, eliminating distortive loopholes and more proactively leveraging PIT and wealth taxes to check extremely high incomes and wealth concentration should be integral components of long term national strategies for promoting equality and equity.

On the other hand, countries should also be fully aware of the institutional and capacity challenges of tax policy implementation, and of the fact that the optimal tax structure and tax policies depend on the development stage, readiness of market infrastructure (like accounting), and local social-economic context, instead of one-size-fit-all standards modelling on developed countries. For example, Bird and Zolt (2005) suggests that the potential of progressive PIT for addressing inequality could be very limited in many developing countries due to impartial coverage, weak compliance and PIT’s small size, and the overall social-economic costs of distortive designs and flawed implementation of the tax could significantly outweigh the real benefits generated.

Therefore, a pragmatic approach of progressive taxation with gradual but solid progress should be advised while keeping in mind the long-term direction and potential. This would allow necessary policy flexibilities for countries to make choices based on their domestic realities, improve implementation success and find better balance between competing objectives.

**The way forward**

The potential public finance policy actions for Asia-Pacific developing countries to address inequality can be roughly divided into three groups: policies to enhance PIT and wealth taxes, policies to close corporate income tax (CIT) loopholes, and policies to promote pro-poor public spending.

The emphasis on progressive PIT significantly weakened in the 1980s and 1990s, and fewer brackets, flatter rates, “untaxing” the poor and better enforcement has been the overall trend in Asia and the Pacific. India, for example,
successfully transformed from a highly distortive system of confiscatory top marginal rates and wide-spread evasion to a much streamlined but comprehensive system of only 3 brackets but which taxes different income types consistently. It collected 1.9% of GDP from PIT in 2014, compared to only 1.1% of GDP in China despite the later having much a lower exemption threshold and higher top rate (45% in China vs 30% in India). This clearly shows the advantages of a strategy that focuses on implementation quality and policy soundness rather than benefits on paper.

Despite such progress, plenty of unfinished tasks for improving PIT quality exist. How to better track non-wage incomes? How to deal with business owners who hide their income in company expenses? How to decrease compliance costs when PIT becomes more comprehensive? How to switch from an individual based region to household based region to reflect differences in family burdens? How to address territorial income differences in large countries? All these questions remain to be answered or even asked in some cases.

In addition, it is necessary to reconsider if the approach of the past is adequate to address growing public pressure on governments to make greater efforts in combating inequality or if the potentials of PIT in developing Asia-Pacific countries have really been fully exploited in that way. For instance, Georgia, whose GDP per capita is only half of the Chinese level and which does not necessarily have much superior institutional or administrative capacities, managed to collect 6.6% of GDP from PIT in 2014, 6 times the level that China collected. Similarly, Fiji collected 4.1% of GDP in 2014, while Maldives collected only 0.1% in the same year. What are the explanatory factors behind such dramatic difference? If Georgia and Fiji could do it, why should other developing countries of the region be content with a 2% level of PIT revenue or lower?

Regarding wealth taxes, like property and inheritance tax, the greatest challenge is compliance. Even in developed countries, inheritance tax for instance is often plagued with loopholes and the rich are often more resourceful in exploiting them. In developing countries where property and wealth registration is highly incomplete, the challenges of effectively implementing these taxes could be exponentially greater. More importantly, with the loopholes and low compliance by the rich, the fairness of such taxes would be questioned, damaging their overall credibility even in the long run. On the other hand, with the accelerating wealth concentration and fast growing number of the superrich, governments may be subject to increasing pressure to take action. The more advanced countries of the region, in particular Japan and the Republic of Korea, already mobilize a substantial amount from wealth taxes and also have the world’s highest inheritance tax rates respectively at 55% and 50%.

Closing CIT loopholes could be the most popular topic at the moment. However, whether developing countries have the capacity and resources to chase down the big multinationals and how much they can seriously mobilize from such efforts remain questions. Furthermore, even if developing countries succeed in closing some of the loopholes, the ultimate tax incidence of CIT is again debatable. As globalization deepens with greater cross-border capital mobility, it could become easier for big firms to shift the tax burden to local employees. The cost-benefit analysis of their efforts on this front would be a challenging task for Asia-Pacific developing countries.

Enhancing pro-poor public spending could be the most promising area. Asia-Pacific’s public spending on education, health, and social protection ranks as the lowest in the world. Moreover, recent empirical evidence suggests that public spending on social protection and housing in the region actually increases inequality, which is contradictory to the international experience. This is possibly due to the bias favouring public or formal sector employees in such programs, which indicates that more needs to be done to ensure that public spending is really pro-poor rather than enhancing the privileges of groups in better-off positions.

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35. 97.5% in the 1970s.
36. In the sense that it covers all different income types for an individual rather than only a few types (like salaries).
V. Green taxes and charges

Global political interest in environmental taxation has been rising in line with a progressively greater need to address environmental challenges, the rapidly advancing international climate agenda and the expediency to raise additional revenues to reduce debt and borrowing.  

Environmental taxation is a market-based instrument that typically targets multiple objectives, such as economic, environmental and social ones. It is rarely implemented solely for its revenue potential, as this is – and will likely remain – quite limited within the broader tax revenue picture, especially when compared to labour taxation or value added tax. Environmental taxation serves to internalise the true costs of producing goods and services, thereby correcting for absent markets that would have priced in such costs had they existed. This ensures that polluters pay for the oftentimes crippling costs they impose on society and the environment. Moreover, in the context of broader environmental taxation reform, the revenues generated from environmental taxes can be used to offset or displace other distortionary taxation, such as labour or capital tax, also known as tax-shifting from ‘economic goods’ to ‘economic bads’ to maintain revenue neutrality. This allows countries to reap a so-called ‘double dividend’ on top of the environmental improvement, which raises the overall efficiency benefits of environmental tax reform. Although earmarking of green tax revenues is prevalent in both developed and developing countries, the economic rationale for doing so is weak as tight earmarking can excessively constrain the effective management of the public finances.  

Environmental taxes have many advantages. As market-based instruments, they constitute the most economically efficient way to reduce environmental damage by deferring to private firms and individuals to find and exploit the best and lowest cost ways to do so, especially when compared to regulatory tools such as standards. They can also act as a market signal to spur innovation in environmentally-friendly products and processes. Environmental taxes have another distinct advantage over regulatory instruments. They do not require the environmental regulator to have detailed information about the costs of abatement technologies or about the economic activities of polluters. For this reason, environmental taxation is associated with lower regulatory and compliance costs than non-market instruments. However, environmental taxes have specific challenges which limit their potential. These include the potential loss of competitiveness of domestic industries in countries operating environmental tax regimes, relative to those that are not. High environmental tax rates may encourage business to relocate to lower-tax countries. Model simulations indicate that such instruments may have negative impacts on international competitiveness if they are not implemented globally. Second, there are regressive distributional implications of such taxes in that they fall disproportionately on the lower income quintiles of the population. Third, the existence of environmentally harmful subsidies such as those directed to fossil fuels, can impinge on the effectiveness of environmental taxation. Fourth, due to the unknown price elasticities, the actual environmental outcome of a tax remains unknown. Fifth, while the tax rate should be commensurate with the environmental damage, in practice, it is difficult to determine the rate and these have often been set too low to change behaviours. Finally, political economy considerations suggest that taxes are politically ‘visible’, and hence may be less amenable to easy adoption and compliance. 

Box 1 – Definitions of environmental taxes and charges

The UN defines an environmental tax as one whose tax base is a physical unit (or a proxy of it) of something that has a proven, specific, negative impact on the environment. This definition does not consider its environmental motivation or purpose but, instead, identifies the tax base as the only objective way of identifying and comparing tax data internationally. Environmental taxes are called ‘unrequited’ in the sense that benefits provided by government to taxpayers are not proportionate to their payments. Environmental taxes are distinct from environmental tariffs, fees or charges, which are paid for the provision and delivery of a specific service, for example in the areas of water supply, wastewater or waste. Payments are commonly seen as ‘requited’ in the sense that they tend to go directly into specifically-administered environmental funds or water management boards. Although tariffs, fees and charges are also market-based instruments, they serve a different public policy purpose from environmental taxes in that they implement the ‘user-pays’ principle, while environmental taxes serve as an instrument for implementing the ‘polluter pays’ principle.

Application of environmental taxation

OECD countries have been pioneers in environmental taxes. Currently there are about 375 such taxes in OECD countries, raising revenues in the order of 2-2.5% of GDP. About 90% of this revenue stems from taxes on motor vehicle fuels and motor vehicles, whereas revenue-raising is not a prime motivation for many other taxes applied.

In the European Union, the total revenues from environmental related taxes were equivalent to 2.5% of the GDP and to 6.3% of total tax and social contributions revenues in 2014. The main types of environmental taxation are taxes on energy, including taxes on carbon or on transport fuels; vehicle taxes, such as on ownership or annual levies on vehicles; and pollution or resource taxes. In European countries, energy taxes constitute three-quarters of total environmental taxation, vehicle taxes make up one-fifth; and pollution and resource taxes the small remainder (4 per cent).

In the Asia-Pacific region, internationally comparable data on environmental taxes from the OECD showed that environmental taxation (except in Korea) is generally smaller than the OECD average. There is also a discernible trend of declining shares of revenue since 2000. This can be due to different reasons including that not all countries maintain real tax rate levels; the economic crisis (2000-2014) depressed the environmental tax base; and increasing environmental tax rates may increase revenues in the short- and medium-term but in the longer-run, the decrease in harmful emissions that they induce will lead to a reduction in the tax base over time and in the revenues resulting from it.

For example, in the case of the EU, although the number of environmental taxes has increased over the past decade and a half, the revenues they generate as a proportion of GDP has decreased. Other environmental policies may also overlap to further reduce the tax base. Finally, in terms of sectors, Asia-Pacific countries made less use of energy taxes (three-fifths of total environmental taxation) than the OECD average, but more use of motor vehicle taxation (just over one-third).

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44 Energy taxes are mostly levied on fossil fuels, which are coal, oil and natural gas. Carbon tax applied on producers of raw fossil fuels based on the relative carbon content of those fuels. Please see OECD Glossary of Statistical Terms. Available from https://stats.oecd.org/glossary/
45 For the difference between taxation and user charges/tariffs, see B. Dafflon and S. Daguet, “Local environmental user charges in Switzerland: Implementation and performance” EuroEconomica vol. 5, No. 31 (2012).
46 A database operated in co-operation between OECD and the European Environment Agency (EEA), currently details about 375 such taxes in OECD countries in addition to some 250 environmentally related fees and charges. Database OECD-EEA on environmental taxes. Available from http://www2.oecd.org/ecomst/queries/.
47 EEA (2016), Environmental Taxation and EU environmental Policies (Luxembourg, 2016).
49 EEA (2016), ibid.
Table 4: Total environmental taxation in Asia-Pacific region, as a proportion of GDP, 2000-2014

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<td>3.74</td>
<td>3.63</td>
<td>4.06</td>
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</table>

Source: OECD.

Box 2 – Examples of environmental taxes and charges from Asia and the Pacific region

Countries in Asia-Pacific are showing increased interest in environmental taxes as a multi-faceted policy instrument. Environmental taxes in the region have been mostly energy- and fuel-related. Australia has a few environmental tax instruments with most of its revenues originating from excise tax on fuel and liquefied petroleum gas (LPG). India has introduced a levy on domestic and imported coal in 2010, and in 2014 it raised the excise tax on petrol and diesel aimed at reducing the fiscal deficit. Japan levies taxes on fossil fuels and introduced a tax for climate mitigation in 2012. The Republic of Korea has a transportation-energy environment tax levied on gasoline and diesel. Thailand has taxes on diesel, LPG and gasoline.

**Singapore** imposes a water conservation tax levied on water charges, and regional governments in Indonesia charge a waste water discharge fee. Singapore has also adopted several complementary tax initiatives to address traffic congestion, air pollution, and limited land availability for transport infrastructure, by aiming at limiting private car ownership and road usage. The costs of acquiring a car in Singapore have significantly increased with the measures directed at private vehicle ownership. The multi-tier taxation and fee structure includes, among others, the payment of registrations fees, 20% excise duty, 7% Goods and Services Tax, and the requirement to secure a Certificate of Entitlement under a Vehicle Quota System. It also operates a road pricing charges (ERP) to further control vehicle usage. With the congestion measure, drivers are charged for the use of roads and highways based on location and time. The rates are adjusted freely and reviewed quarterly to achieve optimal average traffic speed in certain times of the day and areas of the city.

The success of the EPR is deemed by its robust enforcement mechanism, in which electronic gantries allow the instantaneous deduction of the ERP though inserted cash cards, and high-resolution cameras capture the vehicle registration plate to fine those who fail to ensure sufficient balance in the card cash. An equally effective measure to limit congestion at peak hours have been tax-incentives for private vehicles registered for use only during the weekend and off-peak use. They include tax rebates and reduced road taxes, and owners have the flexibility to pay a daily supplementary fee for use of the car outside if the regulated areas.

Since 1979, **China** has been imposing pollution discharge fees on air pollutants, waste water, solid waste and noise. Measures to discourage sulphur dioxide emissions, including higher charges on electricity produced without desulphurisation technologies, have been an important element of this framework, contributing to declining emissions of around 1.8 million tons per year annually. However, due to their broad scope and enforcement difficulties, these fees are widely regarded as not very effective.50 The introduction of new and more efficient environmental taxes to target air pollution, including a new environmental tax law (Aug 2016) aims to correct the implementation and administrative loopholes. Provincial governments can adjust the rates considering local economy and pollution conditions. The proposal is estimated to yield from 22.8 to 44.7 million yuan.

Since 2004, the **Philippines** has imposed a water co-discharge fee. Singapore has also adopted several complementary tax initiatives to address traffic congestion, air pollution, and limited land availability for transport infrastructure, by aiming at limiting private car ownership and road usage. The costs of acquiring a car in Singapore have significantly increased with the measures directed at private vehicle ownership. The multi-tier taxation and fee structure includes, among others, the payment of registrations fees, 20% excise duty, 7% Goods and Services Tax, and the requirement to secure a Certificate of Entitlement under a Vehicle Quota System. It also operates a road pricing charges (ERP) to further control vehicle usage. With the congestion measure, drivers are charged for the use of roads and highways based on location and time. The rates are adjusted freely and reviewed quarterly to achieve optimal average traffic speed in certain times of the day and areas of the city.

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**Vietnam** introduced environmental taxes in 2012 aimed at providing incentives to shift to more sustainable production and consumption behaviors. Taxes are applicable to the import and production of environmentally damaging goods which include hydrochlorofluorocarbons (HCFs), plastic bags and harmful substances used in agriculture, in addition to energy taxes on petrol and coal taxes.52

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VI. Promoting voluntary tax compliance and accountable public spending

“No doubt, expert advice on tax reform can be very useful in making men of good will—ministers and officials—conscious of the precise nature of the legislative and administrative changes that are required. But what can actually be accomplished does not depend merely on the individual good will of ministers on the correct intellectual appreciation of the technical problems involved. It is predominantly a matter of political power. (Kaldor, 1963)”

A growing literature on tax morale has analyzed the importance of behavioral and cultural aspects in explaining tax compliance, or the willing of taxpayers to fulfill their tax obligations. A major conclusion of this literature is that citizens are more likely to comply with their tax obligations when they perceive that their government also performs well its commitments in terms of delivering services and other public goods. In other words, the ability of governments to collect tax revenue depends to a significant extent on people’s perception of the quality and responsiveness of the state. This means that taxation should be considered an integral component of the social contract underlying the state.

This conclusion is particularly relevant in the discussion of the means of implementation of the Sustainable Development Goals (SDGs). The attainment of the SDGs in developing countries will require a substantial increase in the quantity and quality of public goods, for which the revenue adequacy of their tax systems will need to increase. This is particularly important in a number of Asia-Pacific countries where the tax-to-GDP ratios are rather low. How can revenue adequacy increase in those countries?

According to the literature on tax morale, the implementation of tax reforms or improvements in tax administrations alone will not suffice. Case study evidence from Latin America and other regions shows that while tax reforms are often effective in changing tax structures, they often fail to raise tax-to-GDP ratios. A study for Mexico, for example, finds that tax reforms have been undermined by ad hoc policy measures such as special tax regimes for specific sectors or by a relaxation on tax administration efforts. The relative constancy of tax effort over time in individual countries, even amid tax reforms resulting in important changes in tax structures, calls for an explanation.

A critical explanatory factor is the linkage between expenditure and revenue decisions. As Bird et al. (2014, p. 196) put it, “the key to good fiscal outcomes lies less in any particular budgetary or financing procedure than in implementing a public finance system that, to the extent possible, links specific expenditure and revenue decisions as transparently as possible.” This suggests that it is a mistake to look at tax compliance in isolation from the expenditure side.

An extensive empirical literature supports this point. For instance, Daude and Melguizo (2010) find that satisfaction with the government and with public services is an important contributor to a tax compliant attitude in Latin America and the Caribbean. According to Alm, Martinez-Vazquez, and Torgler (2006) trust in the state and the quality of governance are important in the case of the Russian Federation, while, according to Levi and Sacks (2009), government effectiveness and procedural justice matter in the context of Africa.

The discussion above suggests an important link between targets of the 2030 Agenda for Sustainable Development that are part of Goals 16 and 17. In particular, it suggests a link between target 17.1 “Strengthen domestic resource mobilization, including through international support to developing countries, to improve domestic capacity for tax and other revenue collection” and targets 16.5 “Substantially reduce corruption and bribery in all their forms”, 16.6


See e.g. Richard M. Bird, Jorge Martinez-Vazquez and Benno Torgler (2014).

“Develop effective, accountable and transparent institutions at all levels” and 16.7 “Ensure responsive, inclusive, participatory and representative decision-making at all levels”.

According to a recent OECD study, there are a number of policies that governments could consider to increase tax morale through improvements in governance. These include strengthening and clarifying the links between revenue and expenditure. This could be done through earmarking revenues from specific sources to specific expenditures. Although earmarking has been traditionally criticized by budgetary experts on the grounds that it can distort the allocation of expenditures, a strong case for it was made by Wicksell more than a century ago and revived by Buchanan (1963). In his view, earmarking is not only a way to secure political consent for a tax increase but also a highly efficient way of providing people with the public services they want.

As an example of the use of earmarking in Asia, Thailand applies sur-taxes on the excise duties to alcohol and cigarettes to fund two government agencies, the Thai Health Promotion Foundation and Thai Public Broadcasting Service, and the provincial government where the taxes are collected.

OECD (2013) also suggests building taxpayer profiles to understand attitudes and perceptions towards tax issues of different groups of taxpayers, with particular attention to those that operate in the informal sector. Another important recommendation is to increase the transparency of tax policy making and modernize tax administration procedures, including through a greater use of information technology, to reduce opportunities for corruption and improve the “taxpayer experience”.

But beyond such punctual measures, the 2030 Agenda for Sustainable Development provides a unique opportunity to reshape the social contract in the developing countries of Asia and the Pacific. In light of the generalized support for the SDGs and the enthusiasm with which many developing countries in the region are planning to adopt them to their national needs, they could consider devising a new social contract that includes the priority SDG targets a country expects to achieve plus a transparent link between the expenditures to be undertaken to achieve those targets and the taxes needed to fund them.

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VII. Prospects of greater regional cooperation in tax matters in Asia and the Pacific

Recognizing the significant additional domestic public resources needed to achieve the Sustainable Development Goals, the Addis Ababa Action Agenda (AAAA) commits to scaling up international tax cooperation. Areas of cooperation include voluntary discussions on tax incentives in regional and international forums and dialogues among national tax authorities on international tax matters. The AAAA stresses that efforts in international tax cooperation should be universal in approach and scope and should fully take into account the different needs and capacities of all countries. In that respect, it recognizes the need for technical assistance through multilateral, regional, bilateral and South-South cooperation and supports the strengthening of regional networks of tax administrators.

Following up on the AAAA’s commitment to scale up international tax cooperation, a number of new initiatives have been established. The Addis Tax Initiative (ATI), initiated by the governments of Germany, the Netherlands, the United Kingdom, and the United States, was launched during the Third International Conference on Financing for Development. Its aims are for participating donor countries to double resources available for capacity building in the area of domestic resource mobilization, and for recipient countries to step up domestic resource mobilization as a key means of implementation for attaining the SDGs. As of November 2016, the initiative had 40 members.

The Platform for Collaboration on Tax (PCT), launched in April 2016, is a joint effort by the International Monetary Fund (IMF), the Organization for Economic Co-operation and Development (OECD), the United Nations (UN) and the World Bank Group (WBG) that aims to better support governments in addressing the tax challenges they face. The first result of this collaboration was a report prepared to the G20 on ways to improve the effectiveness of technical assistance in tax matters. Its recommendations include (a) increasing partnerships and support for regional tax organizations and (b) facilitating developing countries’ meaningful participation in international tax policy discussions and institutions.

The Asia-Pacific region has a number of regional tax organizations, including the Study Group on Asian Tax Administration and Research (SGATAR), the Pacific Islands Tax Administrators’ Association (PITAA), and the Association of Southeast Asian Nations (ASEAN) Forum on Taxation (AFT). These organizations have played a useful role in knowledge sharing and in facilitating networking of tax officials across countries through annual meetings. However, their financial resources are insufficient to provide technical assistance and capacity building to their members, as well as recurrent research and technical studies on relevant tax issues for their members.

Regional tax cooperation in Asia and the Pacific is relatively underdeveloped compared to other regions. Regional tax organizations such as the African Tax Administration Forum (ATAF), the Inter-American Center of Tax Administrations (CIAT), and the Intra-European Organization of Tax Administrations (IOTA) have significantly larger budgets consisting of membership fees and donor support, which allow them to assist their members through technical assistance and capacity building programs. These organizations have also contributed to the enhancement of tax skills of officials through various training and certification courses. They also have the capacity to support their members in seeking country-specific solutions towards setting revenue adequacy goals and implementing tax reforms.

A strengthening of regional tax cooperation in Asia and the Pacific is warranted in light of the new demands for domestic resource mobilization arising from the AAAA and the 2030 Agenda for Sustainable Development. For that purpose, ESCAP has recently proposed the set-up of a new, region-wide Asia-Pacific Tax Forum for Sustainable

61 Ibid., para 27.
62 Ibid., para 29.
63 Ibid., para 28.
64 Only 6 of the ATI members are from Asia and the Pacific: Australia, Georgia, Indonesia, Republic of Korea, Philippines, and Solomon Islands. Please see Addis tax initiative. Available from www.addistaxinitiative.net/#slider-1.
65 IMF, OECD, UN and WBG, “Enhancing the effectiveness of external support in building tax capacity in developing countries”, Prepared for submission to G20 Finance Ministers (July 2016).
Development (AP-TFSD). Table 3 below describes the main characteristics of the proposed tax forum and compares it with existing tax fora in the region.

**Table 5: Main characteristics of the proposed Asia-Pacific Tax Forum for Sustainable Development**

<table>
<thead>
<tr>
<th>AP-TFSD</th>
<th>Existing Tax Fora in the Region</th>
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<tbody>
<tr>
<td><strong>Policy-oriented:</strong></td>
<td><strong>Practice-based and issue-specific:</strong></td>
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<tr>
<td>• Fostering dialogue and actions to optimize the design of tax systems and maximize the social-economic outcomes of tax policies</td>
<td>• Focusing on adoption of specific standards and practices in reaction to particular problems and challenges</td>
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<tr>
<td><strong>Priority issues:</strong></td>
<td><strong>Priority issues:</strong></td>
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<tr>
<td>• Revenue enhancement and targeted tax policies to support inclusive growth and sustainable development.</td>
<td>• General tax compliance and administration issues</td>
</tr>
<tr>
<td>• Reducing tax competition in the region.</td>
<td>• Negotiations on double taxation and bilateral tax treaties</td>
</tr>
<tr>
<td>• Strengthening and rationalizing municipal financing for sustained and high-quality urbanization</td>
<td>• Addressing BEPS challenges(largely driven by OECD/G20 agendas)</td>
</tr>
<tr>
<td>• Promoting greater regional cooperation to strengthen Asia and the Pacific’s voice in international tax negotiations and counter harmful tax competition</td>
<td>• Promoting information exchange for tax purposes</td>
</tr>
<tr>
<td><strong>Institutionalized support offered:</strong></td>
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<tr>
<td>• A broad-based knowledge network of policy makers and renowned experts, supported by permanent in-house research and advisory capacity</td>
<td>• Capacity building, which normally lacks a permanent knowledge base for in-depth research and the accumulation of technical expertise</td>
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<tr>
<td>• Targeted support for the tax reform agenda support in line with the regional and country-specific priorities and needs</td>
<td>• General support and experience sharing platforms on cross-cutting tax issues</td>
</tr>
<tr>
<td>• A forward-looking approach to aligning regional tax systems and policies toward addressing the region’s long-term development challenges, with support of fresh thinking from independent experts</td>
<td>• Focusing more broadly on current challenges and agendas</td>
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<tr>
<td>• Technical support and capacity building with special focus on the least development countries and other countries of special needs</td>
<td></td>
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The proposed forum would adopt the best practices among existing regional tax organizations such as ATAF, CIAT and IOTA, while at the same time would align its work with the objectives of the AAAA and the 2030 Agenda for Sustainable Development. The set-up of such forum will require extensive consultations with ESCAP member States and with existing regional tax organizations such as SGATAR, PITAA and ATF. It will also require consultations in the context of the global Platform for Collaboration on Tax, to which the proposed forum could act as a regional counterpart.

The goal would be not to set up a completely new organization in parallel to existing tax cooperation efforts but to coordinate and align such efforts, so that they most effectively contribute to the enhancement of tax capacities of the region’s developing countries in support of the SDGs. Last but not least, it is important that this new tax forum abides by the principle of “leaving no one behind” and assigns particular attention to support the countries that are most in need of such support, including the region’s least developed countries.

VIII. The role of ESCAP

ESCAP is an inclusive and oldest intergovernmental body in the broad Asia-Pacific region for joint action, policy coordination and policy debate. Established in 1947, it has 54 member States and 9 associate members, covering all the least developed countries in the regions. ESCAP played an important role in the region’s recovery from World War II and has since been a major thought leader on development policies, advocating for proactive and progressive measures for sustained and shared prosperity.

As the main regional branch of the UN system, ESCAP is mandated to concentrate its efforts in supporting the implementation of the 2030 Agenda for Sustainable Development and the Addis Ababa Action Agenda in Asia and the Pacific. Effective domestic resource mobilization, enhancing public revenues and rationalizing spending are essential means of implementation and integral components of both agendas.

ESCAP has long been an advocate for proactive, well-designed and pro-poor fiscal policies for the region’s long-term development as reflected in its annual flagship publication – the Economic and Social Survey of Asia and the Pacific. In Survey 2013, for example, it argued for stronger investments in job creation, education, health and social protection to strengthen growth potential, boost consumption and help the more vulnerable populations navigate through post-crisis economic difficulties. In Survey 2014, it analysed the public revenue potential of Asia-Pacific developing countries, and argued for reforms to rationalize tax structure, broaden the tax base, close loopholes and eliminate wasteful tax expenditure.

Between 2014 and 2016, ESCAP also organized 3 consecutive ministerial-level regional conferences on financing for development, where tax policies and public expenditure were among the major topics. Recognizing the growing necessity for its member States to fine-tune their tax and expenditure systems to SDG implementation, ESCAP is expanding its efforts in this area to better support member States, especially the least developed ones.

The way forward

ESCAP is looking to play a more active and substantive role in regional tax cooperation and policy debate, and to contribute real value addition through three main channels:

1. To provide an inclusive regional platform for tax policy debate and coordination, with special focus on the smaller and low income countries;

2. To serve as a trusted independent advisor for developing countries on tax issues, especially in norm-setting processes related to international taxation that will have profound implications on their interests; and

3. To conduct well-targeted capacity building on taxation for the achievement of the SDGs.
For point 1, ESCAP expects to better leverage its intergovernmental platform to promote cooperation on tax matters in the region. At the same time, it is proposing the establishment of the Asia-Pacific Tax Forum for Sustainable Development, possibly as an integral component of its annual regional consultations on financing for development. The forum would have the objective of promoting policy debates on tax issues that are relevant to smaller and low income developing countries or directly related to sustainable development.

For point 2, ESCAP expects to continue developing its technical expertise on tax matters, specializing on taxation as a means of implementation of the SDGs and including the protection of tax bases of developing countries. For this purpose, it aims to complete a series of policy studies on selected strategic issues with the aim of better understanding the Asia-Pacific context and to provide pragmatic policy guidance and suggestions.

For point 3, ESCAP expects to align its own research and expertise with the policy priorities of Asia-Pacific developing countries and utilize its knowledge products for targeted capacity building that support the implementation of national development and reform programs that are in line with the SDGs. It will also seek to build constructive partnerships with relevant international organizations, regional tax organizations, donors and independent think tanks to generate synergies with similar ongoing efforts in the region and to maximize the overall benefits of ESCAP’s member States.
Issues Paper on Tax Policy and Public Expenditure Management in Asia and the Pacific