



Financing for Sustainable Development Report 2021

Inter-agency Task Force on Financing for Development



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The online annex of the Task Force (<http://developmentfinance.un.org>) provides additional data and analysis on progress in implementation of the Financing for Development outcomes, including the Addis Ababa Action Agenda and relevant means of implementation targets of the Sustainable Development Goals.

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Domestic public resources



Chapter III.A



Domestic public resources

1. Key messages and recommendations

Governments responded to the COVID-19 crisis with historic fiscal support packages, although the response and reach were uneven, as many developing countries, particularly least developed countries (LDCs), lacked the resources to respond adequately. At the same time, government revenues fell significantly, further reducing countries' fiscal space.

Unprecedented fiscal response to the crisis presents an opportunity to revamp the social contract and to align fiscal policy with sustainable development. But the poorest countries will need international support. In the Addis Ababa Action Agenda, Member States of the United Nations committed "to a new social compact... [including] social protection systems and measures for all, [and to] make every effort to meet the needs of all communities through delivering high-quality services that make effective use of resources".¹ Despite some progress in raising domestic resources since 2015, the COVID-19 crisis laid bare the gaps and lack of progress, including in investments in health and strong social protection systems, which need to be updated to reflect changing realities, such as technological shifts in labour markets.

Governments should

- *Prioritize spending on essential health functions and social protection floors. International support will be needed to help the poorest and most vulnerable countries to redesign and build social protection infrastructure. In the medium term, financing social protection floors can also be supported by scaling up countercyclical financing;*
- *Align fiscal support with sustainable development, including public investment in resilient infrastructure, which can strengthen resilience and stimulate a sustainable recovery; and not withdraw stimulus measures prematurely, as fiscal austerity can be counterproductive, and it risks increasing inequality beyond the immediate COVID-19 impact;*

- *Pursue progressive fiscal systems, and use taxes to better align behaviour and decisions with the 2030 Agenda for Sustainable Development, such as introducing or strengthening carbon pricing and reducing fossil fuel subsidies;*
- *Strengthen public financial management as part of the post-COVID-19 recovery; capacity-building efforts should also be scaled up.*

Fiscal policy choices have become increasingly complex due to the strain of the crisis on public finances, growing debt sustainability, and systemic risks that could potentially trigger future crises.

- *Governments can use integrated national financing frameworks (INFFs) to navigate complex fiscal policy choices, trade-offs and risk management. This process should incorporate fiscal policy tools, such as medium-term revenue strategies (MTRS) and gender-responsive budgeting.*

Strengthening international tax cooperation is essential to supporting domestic efforts. While significant progress has been made in increasing international cooperation and transparency in taxation, as well as addressing cross-border taxation challenges, more remains to be done, especially to ensure all developing countries, including LDCs, benefit from this progress. COVID-19 has accelerated the digital transformation of economies and societies, raising the stakes in discussions over taxation of the digital economy.

- *There is widespread agreement that a consensus-based global solution is the best approach for enabling effective taxation of the digitalizing economy, and avoiding the risks of tax uncertainty, double taxation and retaliatory measures that accompany uncoordinated unilateral measures, if implemented by a critical mass of countries. Developing-country interests and perspectives should be integral to global discussions. Any solution must be simple enough to administer and consistent with the international tax norms, rules and principles observed, such as neutrality and efficiency.*

It is also critical to address illicit financial flows, which drain resources from sustainable development. The High-level Panel on International Financial Accountability, Transparency and Integrity for Achieving the 2030 Agenda (FACTI Panel) has made recommendations for addressing illicit financial flows for Governments to consider, including a Global Pact for Financial Integrity for Sustainable Development that aims to reinforce values for integrity and legitimacy, strengthen policy frameworks, and redesign institutions to foster and strengthen financial integrity for sustainable development.

This chapter begins by outlining the response to COVID-19, with a focus on public expenditures, including social protection. It then provides lessons for public finance risk management. Next, it examines the impact of the pandemic on domestic resource mobilization and lays out issues related to tax policies for sustainable development, including on equality and climate change. It concludes with discussions on international tax cooperation in the context of a digitalizing economy, and on combatting illicit financial flows. The chapter also builds on the work of the discussion group on recovering better for sustainability established after the initial High-Level Event on Financing for Development in the Era of COVID-19 and Beyond (see chapter II).

2. Public expenditure in response to Covid-19

2.1 COVID-19 response, challenges and opportunities

Governments responded to the crisis with historic fiscal support packages, although the size of packages has varied greatly by country. By the end of 2020, announced fiscal measures are estimated at about \$16 trillion, approximately 15 per cent of global gross domestic product (GDP).² Such measures include both additional spending or foregone revenue (e.g., temporary tax cuts), and liquidity support (e.g., loans and guarantees) (table III.A.1). However, while most developed economies were able to inject substantial support, developing countries were more constrained due to limited fiscal space. LDCs in particular found it difficult to finance emergency spending, with average fiscal support at about 2 per cent of GDP, compared to roughly 10 per cent in developed countries (figure III.A.1 and figure III.A.2).

The uneven size and composition of the fiscal response reflects the greater fiscal space of developed economies, as well as the timing and severity of the pandemic. Developed economies responded to the outbreak of the pandemic and the related economic slowdown with huge monetary and fiscal support, including record off-budget assistance in the form of liquidity support and guarantees. In contrast, COVID-19 spread later in many developing countries, including Africa and LDCs, and responses were limited given tighter financing constraints. The relatively higher median fiscal response of small island developing States (SIDS) reflects better financing conditions pre-crisis, particularly for the Asia-Pacific region where a few countries benefited from pre-pandemic fiscal surpluses and large sovereign wealth funds from fishing licenses and oil revenues.³

A range of fiscal support measures helped cushion the socio-economic impacts of the pandemic. Cash and in-kind transfers appear

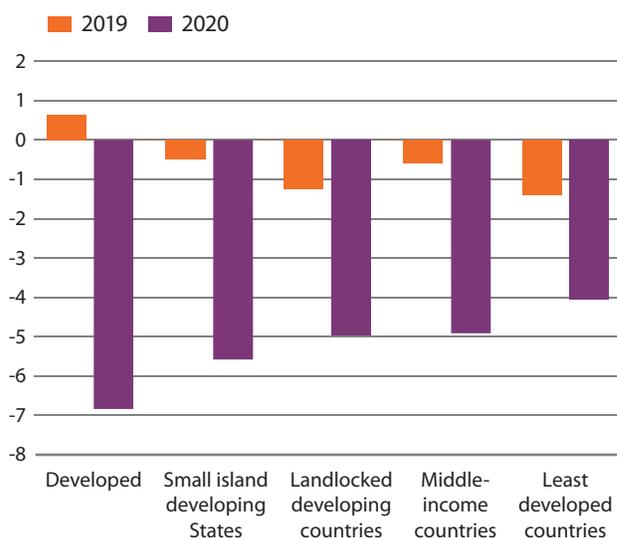
to have been most effective in protecting the poor, while unemployment benefits, wage subsidies and job retention schemes helped support incomes of workers in the formal sector and maintained employment rates (see section 2.2 on social protection). Payment forbearance on mortgages, situations, albeit with limited reach to informal sectors. Quasi-fiscal activities, including support by national development banks as part of stimulus

Table III.A.1
Examples of COVID-19 fiscal support measures

Fiscal support measure	Category	Examples
Additional spending or foregone revenue	Health spending/revenue	<ul style="list-style-type: none"> Expenditure for public health measures to contain the spread of the virus Tariff waivers on medical supplies
	Non-health spending/revenue	<ul style="list-style-type: none"> Household income support: cash or in-kind transfers, unemployment benefits Employment measures to preserve jobs: wage subsidies for furloughed workers or businesses with revenue losses, short-term job-retention schemes Tax measures: temporary deferral of taxes and social security payments, general income tax cuts, accelerated depreciation, progressive taxes
Liquidity support	Equity and loans	<ul style="list-style-type: none"> Equity injections or loans for continuity of operations
	Guarantees	<ul style="list-style-type: none"> Government loan guarantees for banks, firms, or households
	Quasi-fiscal activities	<ul style="list-style-type: none"> Subsidies or loans to targeted sectors undertaken by public corporations or national development banks

Source: UN DESA, adapted from IMF, "Fiscal Monitor: Policies for the Recovery," October 2020.

Figure III.A.1
Median fiscal balance, 2019–2020
(Percentage of GDP)



Source: UN DESA calculations, based on IMF WEO.

Box III.A.1

Transparency and accountability measures in the COVID-19 fiscal response

In normal circumstances, ensuring that Governments are held accountable for their fiscal measures is made harder by lack of transparency and accountability measures. For example, the 2019 Open Budget Survey reported that three quarters of 117 countries surveyed had insufficient levels of budget transparency.^a This is compounded during COVID-19, given the scale and speed of the emergency response. Experience from previous pandemics and disasters indicates that emergency situations have often led to the suspension or circumvention of standard controls, as well as weakening of accountability and oversight systems,^b such as the mismanagement of Ebola relief funds and the misuse of funds in the wake of Hurricane Katrina and Hurricane Maria.^c The scale and depth of the COVID-19 emergency response thus provides heightened risk of fiscal mismanagement, corruption and fraud. Assessments by the United Nations Office on Drugs and Crime (UNODC) in May 2020 in West and Central Africa and Southeast Asia highlighted fraud and corruption complaints, and heightened risks ranging from embezzlement and misappropriation of funds and conflicts of interest to nepotism.^d These risks affect women disproportionately as they are more likely to be victims of corruption and bribery, which also exacerbates gender-based violence.^e

Fiscal responses should be accompanied by transparency measures, including the cost and funding sources of the measures that will be implemented; changes in the originally approved allocations, as well as the possible impacts on the delivery of other services; additional allocations in payroll (e.g., to increase the availability of health services); modifications in public investments, as well as possible delays on planned projects; and tax deferrals and exemptions. Additionally, the impacts on the domestic revenue and macroeconomic framework changes should be made publicly available.^f

Standard transparency and accountability measures can also be used to mitigate risks in the implementation of COVID-19 procurement. Public procurement is one of the government activities most vulnerable to corruption,^g causing losses of over \$500 billion every year in the health sector,^h with 25 per cent of all health procurement spending lost to corruption.ⁱ Several reports of corruption in COVID-19 response procurement across countries relate to the purchases of defective material (personal protective equipment, COVID-19 tests, etc.), price gouging and cronyism.^j There are also similar risks related to the manufacture, allocation and distribution of COVID-19 vaccines.^k Measures include (i) managing procurement processes, even those catalogued as emergency procurement, through the existing e-procurement systems and publishing all public contracts and their related data; (ii) using open and competitive bidding, and using emergency non-competitive processes only when followed by adequate forms of control, auditing and reporting—emergency procurement should be the exception, not the rule; (iii) gathering and publishing beneficial ownership information of companies that are awarded contracts; (iv) empowering existing anti-monopoly agencies to monitor market conditions in critical sectors; and (v) fostering cooperation among various authorities and civil society.^{l,m} International recognized tools such as the MAPSⁿ are useful to diagnose and craft reforms to make this possible.

Role of supreme audit institutions

A key lesson from the Ebola funds scandal is that Governments and donors should have a clear understanding of the role of supreme audit institutions (SAIs) in auditing emergency funds.^b SAIs provide a lead role in overseeing budget management discipline and ensuring transparency and accountability, both during an emergency response and in recovery efforts.^{b,o} With increased inflow of aid, including debt relief initiatives, SAIs can also guard against inefficient or inappropriate use of external resources. Although most countries have weak or inadequate SAIs, as well as low public engagement in audit and oversight processes,^p the pandemic provides an opportunity to enhance SAI capacities as much as possible. SAIs should be supported by an ecosystem of interconnected actors and conditions, including legislative oversight, public engagement and independence.^p

Source: UN DESA.

^a International Budget Partnership, "Open Budget Survey 2019," April 2020.

^b International Organisation of Supreme Audit Institutions (INTOSAI) Development Initiative and others, "Accountability in a Time of Crisis: How Supreme Audit Institutions and Development Partners Can Learn from Previous Crises and Ensure Effective Responses to COVID-19 in Developing Countries," April 2020.

^c Claude Wendling and others, "Keeping the Receipts: Transparency, Accountability, and Legitimacy in Emergency Responses," Fiscal Affairs Special Series on Fiscal Policies to Respond to COVID-19 (IMF, 2020); Kubai Khasiani and others, "Budget Execution Controls to Mitigate Corruption Risk in Pandemic Spending", Fiscal Affairs Special Series on Fiscal Policies to Respond to COVID-19 (IMF, 2020).

^d UNODC, "Covid-19 Emergency Support Packages in West and Central Africa—An Overview and Analysis of Fraud and Corruption Risks," 2020; UNODC, "Covid-19 Emergency Packages in Southeast Asia: An Overview and Analysis of Fraud and Corruption Risks," 2020.

^e Transparency International, "COVID-19 Makes Women More Vulnerable to Corruption," September 21, 2020.

^f Global Initiative for Fiscal Transparency, "Fiscal Data for Emergency Response: Guide for COVID-19, Version 1.1," August 2020.

^g OECD, "Preventing Corruption in Public Procurement," 2016.

^h Transparency International, "The Ignored Pandemic: How Corruption in Healthcare Service Delivery Threatens Universal Health Coverage," 2019.

ⁱ Natalie Rhodes, "First, Do No Harm: Spending the Global Coronavirus Response Pledges Properly," Transparency International, May 14, 2020.

^j Theo Nyrreröd and Giancarlo Spagnolo, "Combating Misuse of Public Funds in COVID-19 Emergency Procurement," FREE Network, September 27, 2020.

^k UNODC, "COVID-19 Vaccines & Corruption Risks: Preventing Corruption in the Manufacture, Allocation and Distribution of Vaccines," COVID-19 Policy Paper, December 9, 2020.

^l Rachel Hanna, "Transparency in Emergency Procurement - Ten Recommendations for Policymakers," *Center for the Study of Corruption University of Sussex Working Paper*, no. 8 (November 2020).

^m Sally Torbert, "A Call to Action on Open Budgets during the COVID-19 Response," International Budget Partnership Open Budgets Blog, May 7, 2020.

ⁿ Methodology for Assessing Procurement Systems.

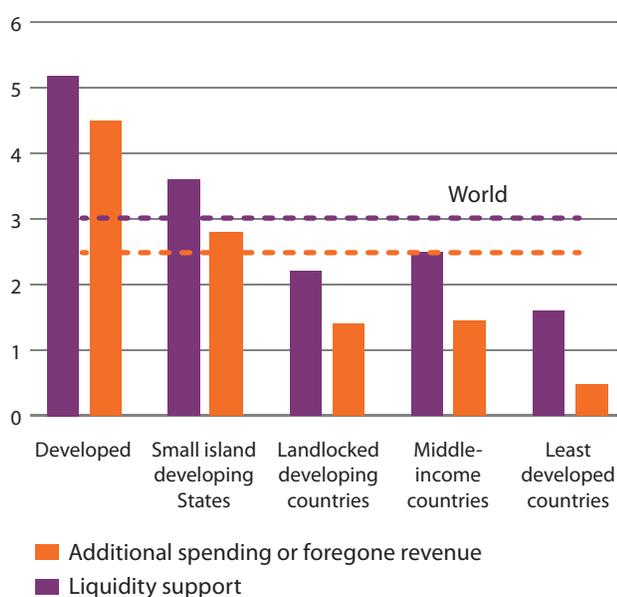
^o World Bank Group, "COVID-19, Role of Supreme Audit Institutions (SAIs) in Governments' Response to COVID-19: Emergency and Post Emergency Phases," Governance & Institutions, Response to the COVID-19 Pandemic, June 2020.

^p International Budget Partnership and INTOSAI Development Initiative, "All Hands on Deck: Harnessing Accountability through External Public Audits, An Assessment of National Oversight Systems," Paper, November 2020.

packages, provided support to struggling businesses, particularly small and medium-sized enterprises (SMEs) (see chapter II), and equity injections helped bail out hard-hit firms in strategic sectors, such as national airlines.⁴ However, there are risks of transparency and accountability issues (box III.A.1).

Fiscal measures should not be prematurely lifted. Fiscal support will remain important beyond the immediate response to the pandemic. Lessons from past crises indicate that fiscal austerity in the wake of crises can be counterproductive as it typically reduces output, and raises

Figure III.A.2
Median COVID-19 fiscal support as of September 2020
(Percentage of GDP)



Source: UN DESA calculations based on IMF, “Fiscal Monitor: Policies for the Recovery,” October 2020.

unemployment in the short-term.⁵ Evidence also shows that fiscal austerity can intensify inequality and that women often shoulder more of the negative impacts of spending cuts, including those that affect the availability of essential public services.⁶ Public health and emergency lifeline measures may need to be extended even as economies gradually reopen. For example, SMEs may require longer-term support for access to finance, through extension of grants, loans or guarantees (see chapter III.B).⁷ Vulnerable countries, such as LDCs, will likely continue to be fiscally constrained, requiring international support to recover from the pandemic (see chapter III.C). When Governments are in a position to address fiscal deficits, tax administrations could focus on the largest taxpayers and those least affected by the crisis in a phased approach.

The unprecedented fiscal packages and low global interest rates present an opportunity for Governments to invest in resilience, reduce inequalities, and stimulate economic growth. COVID-19 has highlighted the need for reducing risk and building resilience, including through investing in resilient infrastructure; addressing inequalities,

including gender inequalities; and pursuing a low-carbon and sustainable recovery. Increasing public investment by 1 per cent of GDP in advanced and emerging economies could create 7 million jobs directly, and more than 20 million jobs indirectly. For example, investments in sustainable and resilient infrastructure would create jobs and stimulate sustainable economic growth and development, with positive knock-on effects across the Sustainable Development Goals (SDGs). Public development banks can play an important role in supporting such investment (see chapter II).⁸ However, good governance is critical to effective public investment, including in ensuring that the right projects are selected, delivered in a way that is environmentally and fiscally sustainable, cost-efficient, affordable, transparent, and, most importantly, that they effectively deliver value for money to the public sector and end users.

Fiscal responses can also support climate and biodiversity goals.

Several countries have included green fiscal measures in their stimulus packages, such as the green recovery package of the European Union (EU) that includes targeted measures to reduce dependence on fossil fuels, investments in preserving and restoring natural capital, and green conditional recovery loans and grants. However, immediate fiscal responses have so far largely failed to support climate and biodiversity goals. Of the national support packages of the Group of Twenty (G20) countries, 16 have been shown to have a net negative environmental impact, given inclusion of measures that support fossil fuel industries or suspension of environmental regulations.⁹ About 30 per cent of total announced packages is expected to flow into environmentally relevant sectors that impact climate, biodiversity or local air quality.¹⁰

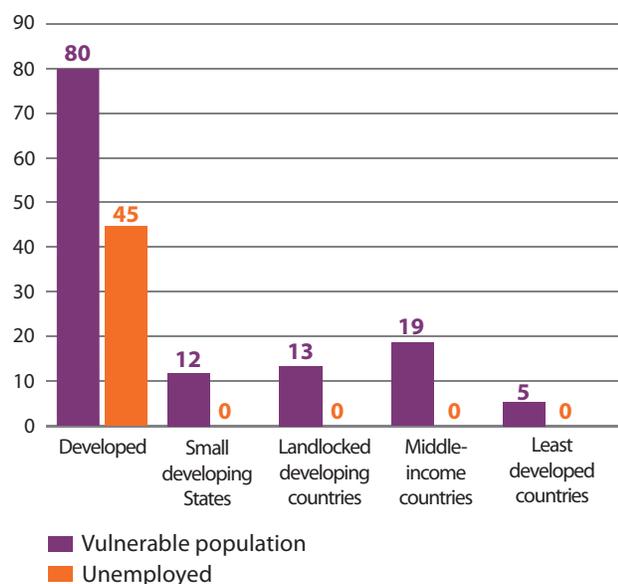
Well-designed fiscal policies can help mitigate the negative and disproportionate impacts of the crisis on women and girls, and prevent even more detrimental setbacks. Public investments in social infrastructure (including education¹¹), social protection, and care services can also drive economic recovery and resilience.¹² Gender-responsive budgeting (GRB) integrates gender analysis and gender data into fiscal policy.¹³ GRB can support stronger fiscal transparency, enabling scrutiny of the extent to which socioeconomic response measures promote gender equality. In the pandemic context, GRB can support Governments in identifying gender gaps and allocating resources to actions such as (a) protection of women’s employment, in formal and informal sectors; (b) elimination of gender-based violence; and (c) expansion of care services and social protection.¹⁴

2.2 Social protection

COVID-19 highlighted gaps in social protection systems in both developed and developing countries. The crisis has illustrated the shortcomings of relying on “patchy” safety nets that provide limited protection, as opposed to a more comprehensive social protection floor (SPF)¹⁵ that is guaranteed for all. Prior to the outbreak of the pandemic, 55 per cent of the world’s population had no access to any form of social protection.¹⁶ Even in developed countries, only 80 per cent of vulnerable populations were covered. This coverage fell to 19 per cent in middle-income countries, and only 5 per in LDCs (figure III.A.3). Countries had to introduce new measures to address vulnerabilities in response to COVID-19. Developed countries focused their support on income/job protection and unemployment measures, whereas middle-income countries concentrated on a range of special allowances/grants and health

measures, and LDCs prioritized food security and adequate nutrition (possibly reflecting both the higher incidence of poverty and larger informal sector) (figure III.A.4).

Figure III.A.3
Median proportion of vulnerable population receiving social assistance cash benefits, and unemployed persons receiving unemployment cash benefits, 2019
 (Percentage)



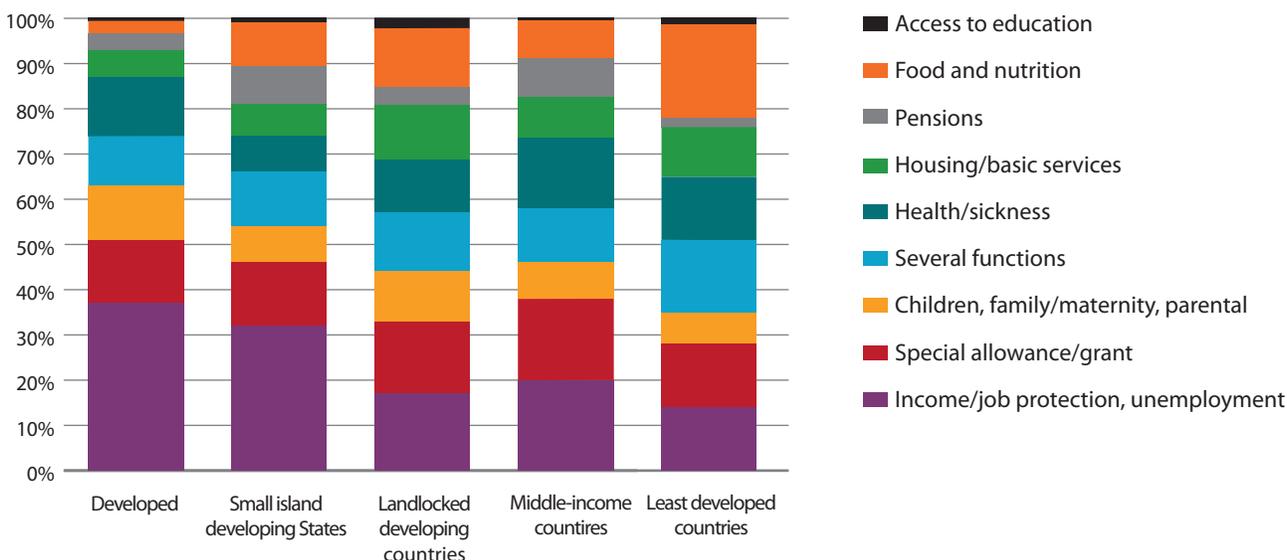
Source: UN DESA calculations based on ILOSTAT.
 Note: 0 = no programme or severance payment.

Despite the large number of emergency social protection measures put in place, vulnerable groups, such as women, have not been adequately reached. Unlike the 2008 world financial and economic crisis, where job losses for men were much higher than women, COVID-19 is estimated to have a disproportionate impact on women due to their higher representation in service occupations and the informal sector, and to the increased demand for unpaid care work.¹⁷ More women than men are therefore expected to be pushed into extreme poverty.¹⁸ However, only one in eight countries have specific measures in place targeted to women.¹⁹

In the post-pandemic period, investments in social protection floors can help build resilience. Social protection systems can be ramped up in times of crisis, to provide quick support to those in need. Once implemented, they not only protect the vulnerable against downside risks, but also increase human capital, contribute to aggregate demand and growth, and promote stability and social cohesion. Some components of SPFs act as “automatic stabilizers” that lessen the contraction phase of macroeconomic cycles.

Financing for social protection generally comes from the budget; nonetheless, it also has some unique features. Because social protection expenditures tend to rise during economic slowdowns, financing needs to be countercyclical. Some countries have earmarked revenues from a particular source, such as commodity-related revenue, or experimented with the reallocation of pre-tax fossil fuel subsidies towards social protection systems. Creating dedicated fiscal reserve funds has been a successful strategy of some countries to create countercyclical financing. This has been a particularly popular choice for commodity-exporting countries, although building a reserve fund during periods of low commodity prices could be difficult. Another possibility for countercyclical financing—which applies to the entire budget, not just SPF finance—is

Figure III.A.4
COVID-19 social protection measures, by country group, 1 February–30 November 2020
 (Percentage)



Source: UN DESA calculations, based on ILO, “Social Protection Monitor,” ILO Brief, November 30, 2020.

the use of state-contingent debt instruments (see chapter III.E). Employer and worker contributions to social insurance systems have played an important role in financing social protection in many countries—but these can be procyclical, in that an economic shock that leads to a loss of formal sector jobs will have negative consequences for coverage.

Official development assistance and transfers can help countries such as LDCs that do not have sufficient domestic capacity in the set-up and design of social protection systems. The design and implementation of SPFs requires initial start-up investments for (i) formulating policies and strategies; (ii) developing legal frameworks; (iii) identifying sustainable financing mechanisms; and (iv) building technological, administrative, actuarial and statistical capacities, including training of government officials. The recurrent costs of SPFs are affordable in the majority of developing countries (the International Labour Organization estimates that, in 90 developing countries, recurrent resources needed to operate cash transfers and administrative costs amount to 2.2 per cent of GDP, on average),²⁰ but some countries may also need external financial support, especially during crisis periods such as the COVID-19 pandemic. Official international financing remains crucial for addressing such temporary financing needs (see chapter III.C/III.E).

Social protection systems need to be viewed within the larger fiscal framework; indeed, the design and financing of social protection floors affects the progressivity of the fiscal system. Increasing domestic resources is critical to the financing of social protection. One good practice that is relevant to all countries is to link social protection contributions and payments to tax compliance and enforcement. Building synergies between the social protection and tax systems can strengthen the social contract between citizen and state, as expansion of the tax base coincides with provision of benefits. Efficient operation of a social protection system also helps maintain public confidence in its effectiveness.

3. Lessons for public finance risk management and sustainability

Public financial management systems are central to ensuring the efficacy of the fiscal response and in mitigating fiscal risks. Public financial management (PFM) refers to the set of laws, rules, systems and processes used to mobilize revenue, allocate funds, undertake spending, account for funds and audit results. Many actors (political parties, civil society, legislature, etc.) engage in this “PFM cycle” (figure III.A.5) to ensure it operates effectively and transparently, while preserving accountability. Thus, strengthened PFM institutional capacities and accountability mechanisms can help monitor and respond to fiscal risks.²¹ While PFM processes need to be flexible, they also must ensure resources are spent effectively, which can be difficult to achieve in an evolving situation. An average country loses about 30 per cent of the returns on its investment to inefficiencies;²² therefore, strengthening effective management of public investments is imperative to maximizing the potential impact of domestic public resources. Policymakers need to ensure fiscal transparency, safeguard public accountability and maintain institutional legitimacy.²³ PFM measures are also key to evaluating and managing fiscal risks associated

with policy choices. For example, while on-budget measures have a predictable impact on fiscal deficits and debt, off-budget measures, such as contingent liabilities, can intensify fiscal risks.

Figure III.A.5
Public financial management cycle



Source: UN DESA.

Transparency, accountability and legitimacy standards should be included in the design, implementation and oversight of COVID-19 fiscal response packages.²⁴ Fiscal packages should include clearly defined ex ante measures (e.g., transparent criteria to access social protection or to award contracts or for off-budget measures) and outline distinct goals and indicators to facilitate ex post assessment and oversight. Fiscal transparency and accountability measures can also be an effective tool to mitigate mismanagement, corruption and fraud, particularly in procurement. The 2019 Open Budget Survey also reported modest improvements in global average budget transparency scores, but scores remain insufficient, with gaps in oversight by the legislature and SAI (see box III.A.1).²⁵ Legal authorization and public scrutiny, as well as oversight by relevant institutions such as SAIs, are critical for institutional legitimacy (see box III.A.1).

Many developing countries, particularly LDCs, have weaker PFM architecture to disburse, track, report and account for COVID-19 funds. Lessons from assessments of PFM reforms highlight the importance of political will, institutional capacity, coordinating mechanisms, country context and policy space, stakeholder engagement, as well as the need for adaptive, iterative and inclusive processes.²⁶ Prior to the crisis, Public Expenditure and Financial Accountability (PEFA) scores trended upwards, albeit at a relatively slow pace, with differences across income groups and regions.²⁷ Low-income countries and almost all LDCs scored much lower than other income groups, with sub-Saharan Africa consistently the lowest-performing region.²⁸

Box III.A.2

Using public sector balance sheets to manage fiscal risks

Public sector balance sheets (PSBSs) provide a comprehensive picture of public wealth, bringing together all the assets and liabilities that government controls, including public corporations, natural resources and pension liabilities.^a It is an accrual-based assessment of a government's total assets and liabilities, modelled on the reporting requirements common for private-sector companies, that can bring out risks and opportunities that might otherwise go undetected.^b Only a few Governments currently compile PSBSs: Australia, New Zealand and the United Kingdom of Great Britain and Northern Ireland use PSBSs to manage public wealth, while Uruguay uses a PSBS approach to manage its debt.^a However, the PSBS approach has also been tried in some emerging countries—such as Georgia, Indonesia and Malawi—with support from the International Monetary Fund.

The PSBS approach supports fiscal policy analysis in three ways. First, it outlines the full scale and nature of public assets and non-debt liabilities to help uncover areas for boosting returns (e.g., assets under governmental control that are producing returns below reasonable benchmarks). Improved management of non-financial public corporations and government financial assets could amount to 3 per cent of gross domestic product a year, equivalent to annual corporate tax collections across advanced countries. Second, it improves identification and management of risk by taking a long-term view through an intertemporal balance sheet, which allows a comparison of current wealth against future fiscal pressures. For example, a PSBS can bring attention to accruing governmental liabilities in a failing, government-owned business venture, as well as future positive returns from an investment. This approach would be helpful both to manage contingent liabilities in the post-COVID-19 recovery and to better allocate investments. Third, it improves fiscal policy, allowing for a systematic evaluation of the impact of policies on public finance by recognizing their short- and long-term effects.^{a,c}

However, the analysis of PSBSs has several limitations, including data quality; difficulties in valuations (particularly for non-financial assets); complexity of public sector entities that may require separate analysis; and sensitivity of the PSBS approach to assumptions over the long term.^a There may also be areas where the PSBS approach—based on government financial statistics, according to the System of National Accounts, which is a statistical measure—needs to be reconciled with international accounting standards, primarily International Public Sector Accounting Standards (IPSAS),^d as many Governments are adopting IPSAS in their move to accrual-based fiscal reporting.^e Finally, the PSBS approach should be in line with the 2030 Agenda for Sustainable Development and climate goals in considering the management of non-financial assets, much of which represent oil reserves.

Nevertheless, the PSBS approach can be an important supplement to other traditional budgetary and fiscal risk analyses, improving overall risk assessment and fiscal transparency.

Source: UN DESA.

^a IMF, “Fiscal Monitor: Managing Public Wealth” (Washington, D.C., October 2018).

^b James C. Carpretta, “The Promise and Challenges of Public Sector Balance Sheets,” American Enterprise Institute - AEI, 24 January 2019.

^c See also Alex Metcalfe and Michael Taylor, “Sustainable Public Finances through COVID-19” (Association of Chartered Certified Accountants, July 2020).

^d Manj Kalar, “The Public Sector Balance Sheet Is on the Rise,” Public Finance Focus, October 25, 2018.

^e International Federation of Accountants and The Chartered Institute of Public Finance & Accountability, “International Public Sector Financial Accountability Index: 2018 Status Report,” 2018.

Accrual-based reporting can be used to compile public sector balance sheets to better manage fiscal risks.

Most Governments record fiscal activities using cash-based accounting, although 98 of 150 jurisdictions are expected to move to accrual-based fiscal reporting by 2023. While cash-based accounting (recording transactions when they occur) is simpler, accrual-based reporting (i.e., recording transactions when they are due) provides more complete financial information that can better support risk analysis and decision-making.²⁹ Using accrual-based reporting, a public balance sheet approach can help Governments analyse the positive benefits—as well as overall risks—presented by assets and liabilities to better determine fiscal space (see the *Financing for Sustainable Development Report (FSDR) 2020* for a discussion of the balance sheet approach in the context of debt sustainability) and better align investments with sustainable development (box III.A.2).

Integrated national financing frameworks can help post-COVID-19 PFM reform processes.

As a planning and delivery tool to help countries strengthen processes and overcome impediments to financing, INFFs can support PFM reforms, as well as bring together other tools, such as gender-responsive budgeting (see *FSDR 2019*) and greater use of digital technology (see *FSDR 2020*), as well as accrual-based fiscal reporting.

4. Domestic resource mobilization in the COVID-19 era

COVID-19 provides an opportunity for taxation reform. As called for in the Addis Agenda, domestic resource mobilization reform efforts should aim to enhance “revenue administration through modernized, progressive tax systems. . . [with improved] fairness, transparency, efficiency and effectiveness,”³⁰ and support achievement of the SDGs. This includes (i) continuing efforts to strengthen tax administrative capacity and transparency; (ii) implementing more progressive taxes and reducing gender bias in taxation (box III.A.3); and (iii) better aligning incentives with sustainable development, such as achieving climate, biodiversity, or health goals.

4.1 Impact of COVID-19 on revenues

COVID-19 is eroding pre-pandemic gains in tax revenues, although the extent is unclear. Median tax revenues (measured as the median tax revenue-to-GDP ratio) for developing countries, which had been rising

prior to the pandemic (figure III.A.6), are projected to have fallen in 2020 (figure III.A.7). Early indications are that median general government revenue (includes non-tax revenue) as a percentage of GDP fell from 41 to 39 per cent for all developed countries, and 26 to 24 per cent for middle-income countries (figure III.A.7). The fall in revenue (at about 0.3 basis points) is expected to be less severe for LDCs, in part due to the delayed spread and shock from COVID-19 (figure III.A.7).

A rebound is expected in most country groups in 2021 and 2022, but the trajectory should remain below pre-crisis trends (figure III.A.7). The evolving situation makes it difficult to predict future revenues with any certainty and, as tax burdens and elasticities vary by sector, the impact of COVID-19 is not expected to be uniform.³¹ For example, tax receipts from hospitality and transportation sectors are expected to have plummeted, while revenue from the telecommunications sector is anticipated to have risen. Large businesses with diversified portfolios are also expected to have been less impacted than small businesses. Consumption tax revenues are expected to have fallen along with corporate income tax revenues, due to the adverse effect of social distancing measures and lockdowns. The collapse in employment and wages in some countries is expected to have led to lower personal income tax revenues, while customs revenue will be affected by the decline in trade.³² The impact on tax revenues across country groups will also vary according to tax structures (figure III.A.8). SIDS and LDCs, who are heavily dependent on trade-related revenue, are more vulnerable to a fall in trade tax revenues. SIDS, heavily dependent on tourism, have seen sharp contractions in growth and a broad-based decline in revenues.

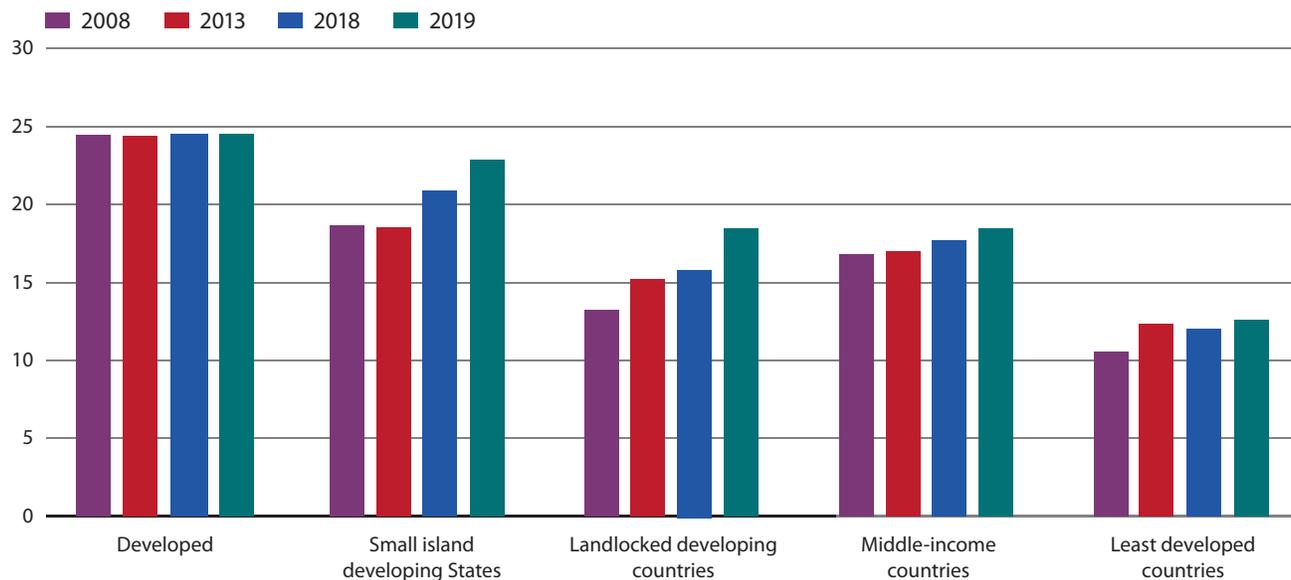
**Box III.A.3
Gender bias in taxation during COVID-19**

While tax provisions that explicitly disadvantage women are rare, tax systems can, in practice, have hidden, implicit bias that may worsen gender inequalities, particularly during COVID-19. For example, in Organization for Economic Cooperation and Development (OECD) countries, women make up a large majority of secondary earners. Faced with working from home, remote schooling and unpaid care and domestic work (much of which falls on women), there is a higher risk of women leaving the workforce in dual-earner households. Consumption taxes on services such as cleaning and childcare make it cheaper to produce these services at home, especially for low-income households, thus pressuring second-earner women to leave their jobs. These situations also reinforce women’s role in providing unpaid care work. In developing countries, the challenge on women is amplified as the majority are in informal employment. COVID-19 fiscal responses that focus on officially labelled taxes miss the disproportionate impact that user fees and informal taxes (e.g., payments to doctors and teachers) have on female-headed households, which may discourage access to health care.

To avoid inadvertently reinforcing gender biases through the tax system, a key policy dimension in tax policy responses to COVID-19 is the assessment of the impact of taxes on gender equality. In this regard, this could be a good time to redesign taxes that may further exacerbate existing gender inequalities (for example, removing tax provisions that discriminate against the secondary earner).

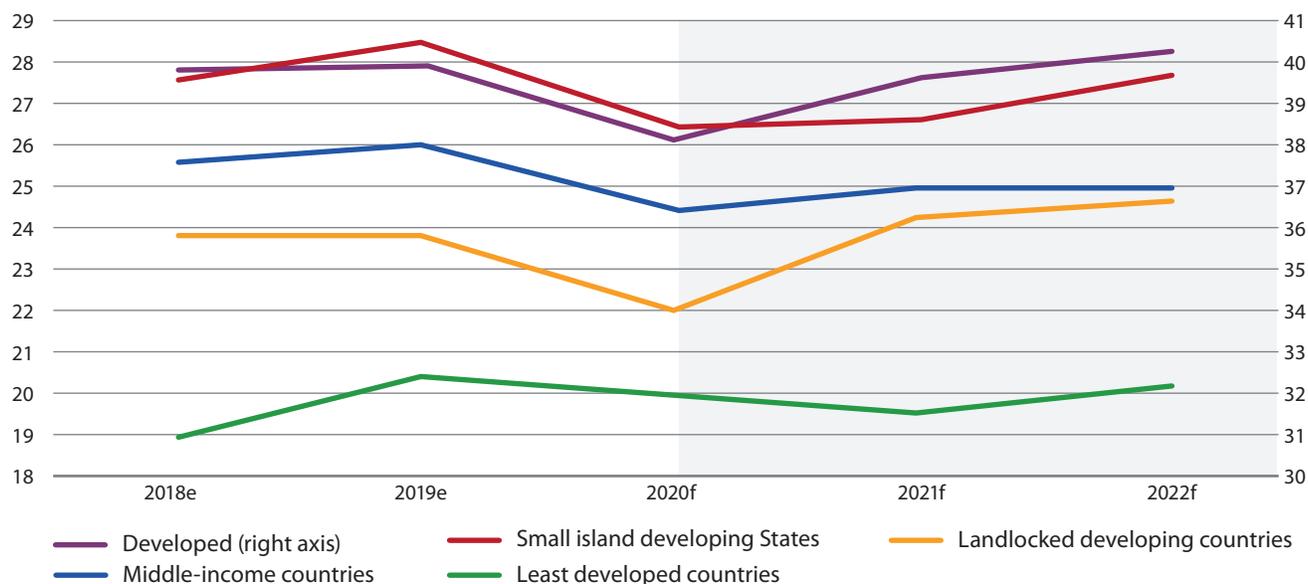
Source: Michelle Harding, Grace Perez-Navarro, and Hannah Simon, “In Tax, Gender Blind Is Not Gender Neutral: Why Tax Policy Responses to COVID-19 Must Consider Women,” ECOSCOPE - An Economic Lens on Policies for Growth and Wellbeing, June 1, 2020.

Figure III.A.6
Median tax revenue by country group, 2008–2019
(Percentage of GDP)



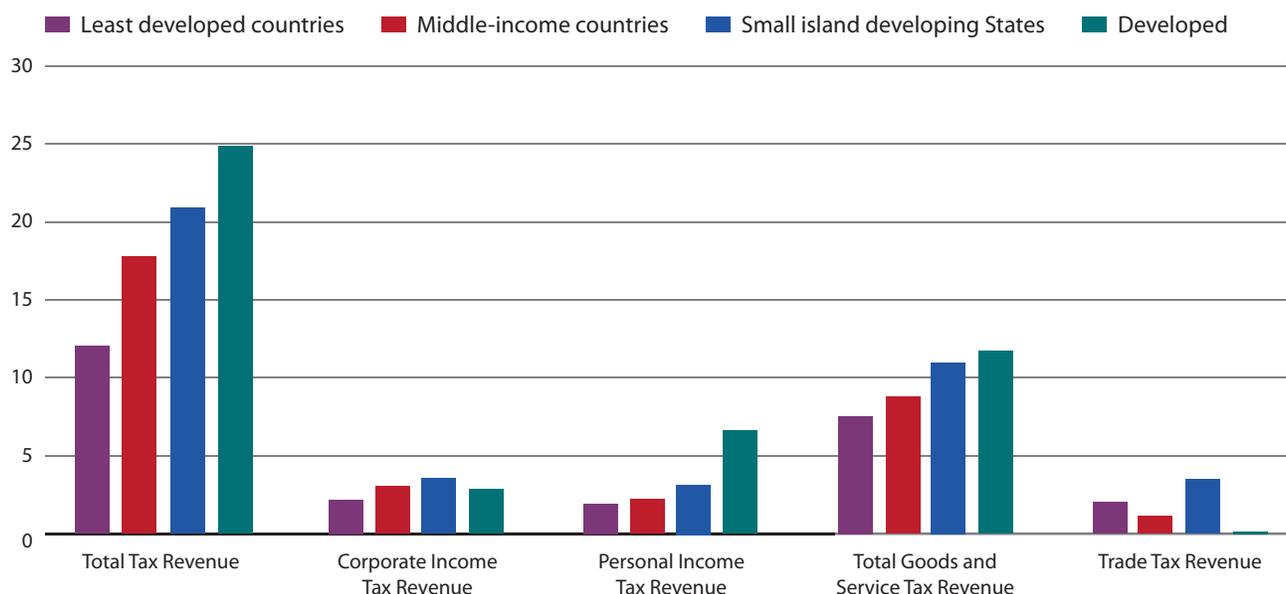
Source: IMF.

Figure III.A.7
Median general government revenue, 2018–2022
 (Percentage of GDP)



Source: UN DESA calculations, based on IMF, *World Economic Outlook*, October 2020.
 Note: e = estimate; f = forecast.

Figure III.A.8
Median tax revenue by type of tax, 2018
 (Percentage of GDP)



Source: IMF.

4.2 Tax policy, administration and compliance and the opportunity for reform

Tax policy measures are playing an important role in COVID-19 stimulus support packages. Fiscal response packages (see section 2.1) include tax filing extensions, tax deferrals, suspension of penalties and interest, tax debt relief options, quicker tax refunds (e.g., for value added tax), possibilities of tax loss carrybacks and suspension of tax audits.³³ Among these measures, temporary tax deferrals are the main tool used to provide liquidity support.³⁴ Tax administrations have also shifted operations and processes quickly to deliver services digitally, including contact-free administration and electronic filing.³⁵ This may have long-lasting effects on accelerating the shift to digitalization, which can improve the efficiency of tax administration and tax transparency. Administrations in developed countries had a better base to work from, given their higher use of digital technology pre-COVID-19, compared to countries with less capacity, such as LDCs (see *FSDR 2020*).

Country-led and country-owned medium-term revenue strategies, including in the context of integrated national financing frameworks, can be the foundation for effective and inclusive tax reform. A medium-term revenue strategy (MTRS) is a comprehensive approach to tax reform, based on revenue goals that are aligned with development needs and country priorities. An MTRS can be integrated into a broader INFF, which allows policymakers to exploit synergies and manage possible trade-offs across different policies (see *FSDR 2019*). While disruptions caused by the COVID-19 pandemic slowed down their progress, as of 2020, 23 countries are in the process of developing or implementing an MTRS. Early experiences with MTRSs and INFFs indicate the importance of strong leadership and political will in implementation, as well as good oversight and coordination arrangements, emphasizing the importance of a country-led and country-owned process.³⁶

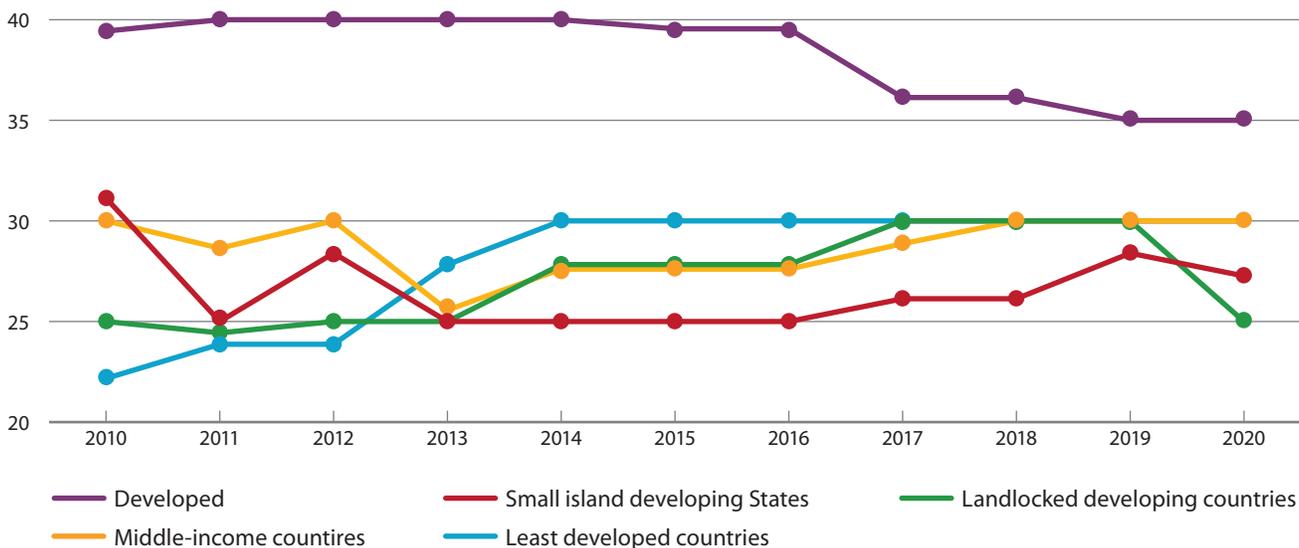
Lessons from countries that have successfully increased tax collection indicate the importance of both tax policy and tax administration reforms.³⁷ Countries can build on their experience with technological tools during COVID-19 to further strengthen tax administration capacity.³⁸ Implementing relief packages transparently, efficiently, and equitably can strengthen the social contract by building trust with taxpayers during the crisis.³⁹ Countries with large informal sectors can pursue efforts to formalize business in ways that do not harm the poor. Policymakers can use relatively high tax-exempt thresholds to incentivize formalization, encourage greater levels of compliance, and ensure that the poor are not burdened by the tax system (see *FSDR 2019*).

4.3 Progressive tax systems

Prioritizing effective and progressive tax systems will be an important step in combatting inequality, which has widened ever further during COVID-19. Tax progressivity⁴⁰ has declined since the 1980s. Personal income tax progressivity fell sharply in the 1980s and 1990s across all countries,⁴¹ and continued to fall over the last 10 years. This is evident in the decline in median top personal income tax rates, particularly for developed countries (figure III.A.9). However, in LDCs the median top personal income tax rate increased in the first half of the 2010s, while the rate for middle-income countries initially fell before increasing.

The COVID-19 crisis provides a good opportunity for progressive tax reform. Indeed, several countries have introduced or are contemplating net wealth taxes, which strengthen progressivity, in the context of their COVID-19 revenue recovery plans. In the *FSDR 2019*, the Inter-Agency Task Force on Financing for Development (Task Force) provided analysis on how fiscal systems can address inequality through the progressivity of taxes, including using net wealth taxes and property taxes.⁴²

Figure III.A.9
Median top personal income tax rates, 2000–2020
(Percentage)



Source: UN DESA calculations, based on KPMG Global, "Individual Income Tax Rates Table," KPMG, November 11, 2020.

4.4 Tax policy for sustainable development, including carbon pricing

Excise taxes,⁴³ including environmental taxes, not only raise resources, they also provide incentives to better align behaviour with sustainable development. The revenue yield of excise taxes (e.g., between 1.5 and 2.5 per cent of GDP), has trended upwards between 2008 and 2018, particularly in LDCs.⁴⁴ Environment-related taxes, such as fuel excises, can incentivize a reduction in carbon emissions and emissions of other pollutants, as well as raise revenue. Many countries also have financial transaction taxes (e.g., the stamp tax in the United Kingdom). These taxes tend to be progressive, and, depending on the structure and margin, may also help reduce high-frequency trading and volatility. Countries are also considering, or have implemented, excise on telecommunications services. However, the size and structure of these types of taxes need to be explored carefully, as their incidence may create market distortions⁴⁵ (see discussion on taxation of the digitalized economy in section 5.3).

Effective excise taxes on tobacco, alcohol and sugary beverages can raise resources, while reducing unhealthy behaviour. Tobacco and alcohol excise taxes are in place in 170 and 155 countries, respectively. However, in 2018, only 38 (mostly high-income) countries levied total taxes as high as the World Health Organization recommends, at 75 per cent or more of the retail price of a pack of cigarettes.⁴⁶ Excises on unhealthy foods are more recent, with 74 countries levying some form of sugar-sweetened beverage tax.⁴⁷ Earmarking revenue can improve the political economy of such tax increases and may increase spending for underresourced priority health programmes, such as the prevention and treatment of non-communicable diseases. Due to budget fungibility,⁴⁸ the potential for earmarks to result in additional spending on health is context specific and depends on a country's political priorities and budget process.⁴⁹ There have been some notable successes in earmarking—for example, in Thailand, where earmarking helped launch a health promotion

programme, and in the Philippines, where earmarking supported the expansion of a national health insurance programme.⁵⁰

The deployment of carbon taxes and emissions trading systems has grown significantly in the last ten years, covering a larger share of greenhouse gas emissions and almost tripling revenues for G20 countries, from \$17 billion to \$48 billion.⁵¹ Fuel excise taxes, which also discourage the use of fuels and the associated emissions, are increasingly scrutinized to improve their alignment with carbon content.

Policymakers can use several mechanisms to raise the relative price of carbon-intensive activities and lower the relative price of sustainable technologies, each with advantages and disadvantages (table III.A.2). The two main explicit carbon pricing mechanisms are a carbon tax and an emissions trading scheme (ETS). A carbon tax is arguably the more powerful measure for mitigating climate change.⁵² Fuel taxes also effectively result in a carbon price. Regulations, such as emission rates or energy efficiency standards, are based on quantitative targets (i.e., limits). These typically leave less flexibility to households and businesses and therefore can be less efficient, but are sometimes more politically palatable. Related mechanisms include abatement payments that reward less carbon-intensive products (e.g., home solar panels or electric cars) while penalizing more intensive ones (feebates); subsidies and price guarantees (e.g., feed-in tariffs); direct public investment; and research and development.⁵³ The United Nations Tax Committee's Handbook on Carbon Taxation for Developing Countries provides guidance on different options for the design and administration of a carbon tax, taking into account the existing policy and legal framework of a country. The Handbook also provides an overview of how to address the issue of public acceptability, including how to allocate revenues generated from the tax.⁵⁴ The Tax Committee is also updating its Handbook on Taxation of the Extractive Industries by Developing Countries, to support decarbonization efforts.

Table III.A.2
Advantages and disadvantages of carbon tax and other instruments

	Definition	Advantages	Disadvantages
Carbon tax	Tax on carbon-based (equivalent) emissions	<ul style="list-style-type: none"> ▪ Generation of revenues ▪ Certainty in costs for economic actors ▪ Depending on the format, can require more or less administration ▪ Cost-effective 	<ul style="list-style-type: none"> ▪ A-priori uncertainty in quantity of emission reduction (though the tax rate can be adjusted over time to meet emission reduction goals) ▪ Can be politically challenging to implement
Regulation	Introduction of standards in the quality of the environment (e.g., regulations/quantity targets, reporting requirements, emission licensing, etc.)	<ul style="list-style-type: none"> ▪ Often requires less administration ▪ Easier to enforce ▪ Sometimes less political resistance 	<ul style="list-style-type: none"> ▪ Generally less efficient than price mechanisms ▪ May be insufficient to achieve carbon reduction goals, depending on the design ▪ Does not generate revenues
Emissions trading scheme	Market-based approach to controlling pollution that includes a limit (or cap) on pollution, and tradeable allowances	<ul style="list-style-type: none"> ▪ Generation of revenues (although generally less public revenues than with a carbon tax, in case permits are not auctioned) ▪ Provides certainty in emission reduction goals ▪ Cost-effective 	<ul style="list-style-type: none"> ▪ Uncertainty in costs does not necessarily incentivize investment in low-carbon technology ▪ Can be administratively complicated due to the need to set up a carbon market, auctions, etc.

Source: Adapted from Committee of Experts on International Cooperation in Tax Matters, "Environmental Tax Issues, Chapter 2: An Introduction for Policymakers; and Annex 1: Carbon Taxation in the Context of the United Nations, Carbon Taxation Handbook, Note by the Secretariat," October 8, 2020.

As noted, COVID-19 provides an opportunity to introduce or strengthen carbon pricing. Lessons from the 2008 world financial and economic crisis, where there was also a push for green recovery packages, was that support for low-carbon investments fizzled out without clear commitments to long-term carbon pricing.⁵⁵

Nonetheless, carbon pricing has grown significantly over the last decade, despite some slowdown due to COVID-19. As of 2020, there were 61 carbon pricing initiatives in place or scheduled for implementation, consisting of 31 ETSs and 30 carbon taxes, covering 22 per cent of global greenhouse gas emissions (see box III.A.4 for developments in the Asia-Pacific region).⁵⁶ This compares with only 19 initiatives in 2010, which covered about 5 per cent of emissions. Carbon taxes account for 53 per cent of revenues from carbon pricing, of which two thirds were from EU member countries, with revenues mostly dedicated to the general budget or reserved for specific environmental or broader development projects. However, when taking a broader approach that considers the carbon price signal from excise taxes together with carbon taxes and ETS, progress is real but slower, with 90 per cent of emissions not priced at €30 per tonne of CO₂, a modest target given the Paris Agreement carbon abatement goals.⁵⁷

Although carbon prices are increasing, they remain significantly lower than what is required to achieve climate goals. It is estimated that a carbon price of at least \$40–\$80 per ton is required to incentivize a reduction in emissions that would limit global warming to the temperature goal of the Paris Agreement,⁵⁸ with some experts estimating that an even higher price is needed.⁵⁹ Yet, currently, almost half of the covered emissions are priced at less than \$10 per ton,⁶⁰ with the global average carbon price estimated at \$2 per ton—significantly below estimated thresholds. In 2020, eight initiatives increased their carbon taxes, but only one was higher than \$50 per ton, and other jurisdictions deferred

plans. COVID-19 further reduced demand and lowered prices, with some additional jurisdictions deferring plans to increase carbon taxes.⁶¹

International cooperation on a global carbon price floor between high-emitting countries can help scale up mitigation efforts, as well as prevent carbon tax competition.⁶² High-emitting countries could agree to set a minimum carbon price on their domestic emissions, which would be sufficiently high to bring about emission reductions across participating countries to meet climate goals. To address equity issues across countries, the minimum price could be applied only to developed countries; or there could be more countries involved, but with differentiated floors based on the size of emissions. These arrangements could also allay concerns of taking unilateral action to raise carbon prices that could adversely affect international competitiveness from higher domestic energy costs.

Reforms to fossil fuel subsidies, which have been rising, must also be considered. Revenue gains for removing subsidies are estimated at about 4 per cent of global GDP.⁶³ Yet, fossil fuel support in 44 Organization for Economic Cooperation and Development (OECD) and G20 economies rose by 10 per cent to \$178 billion in 2019, ending a five-year downward trend.⁶⁴ Coupled with other indirect support—such as corporate debt relief, infrastructure investments and tax provisions—overall support for fossil fuels rose by 38 per cent. As part of the COVID-19 support packages, almost half of G20 relief funds committed to energy-intensive sectors were dedicated to fossil fuels.⁶⁵

Yet, implementing carbon pricing reforms can be politically challenging. Prior to COVID-19, opposition to higher energy prices hampered efforts in implementing carbon taxes, and even led to social unrest. Addressing the political implications is thus necessary for a successful carbon pricing programme. The supply and demand shocks brought on by COVID-19 and an increasing focus on disaster risks could make carbon pricing reform less disruptive in the current environment; however, the fall in incomes, job losses and growing inequality could mean low appetite for higher prices, even if commodity prices are now lower than pre-COVID-19 levels. In some cases, regulations, which limit quantities rather than prices, may be more politically palatable alternatives. Indeed, they have been highly successful in reducing pollution and emissions, for example, through building codes and auto emission and fuel economy standards around the world.

Compensatory measures as part of a green fiscal package can help build support and mitigate the regressive effects of higher carbon prices. Carbon taxes can be—but are not always—regressive, as they raise the prices of gasoline, electricity and related goods for all consumers, irrespective of their incomes, which can disproportionately impact the poorest households. Rising income inequality can also make the distributional effects of carbon taxes more regressive.⁶⁶ As part of the overall green fiscal strategy to support carbon pricing reform, carbon revenues can be used for lump-sum payments to households (e.g., to compensate them for higher energy prices), labour income tax cuts, or for investments (e.g., in low-carbon or climate-resilient infrastructure) that will create jobs and offset employment losses in carbon-intensive sectors.⁶⁷

The Task Force reiterates support for a just transition to a low-carbon economy, as a core part of achieving the SDGs. In assessing the interaction of the environment, climate change and fiscal policy in

Box III.A.4

Carbon pricing and environmental taxes in the Asia-Pacific region

A growing number of national and subnational governments are implementing or planning to implement a carbon tax or an emissions trading system (ETS). In Asia and the Pacific, this includes initiatives in Australia, China, Japan, Kazakhstan, New Zealand, Republic of Korea and Singapore. China is transitioning to a national ETS for the electricity sector from eight pilot subnational systems. Although the national system will only start with the electric power sector, other sectors considered in earlier proposals will eventually be included. Singapore introduced a carbon tax, but based on a “fixed-priced, credit-based” approach, which offers the flexibility to align it with an ETS of other jurisdictions at a later stage. Among countries currently at pilot or preparation stage, Thailand has developed a framework for monitoring, reporting and verification, and is piloting a voluntary ETS with companies from sectors ranging from petrochemicals and cement to food and feed. In Indonesia, a 2017 government decree mandates the establishment of an ETS before 2025.

Source: Daniel Jeong-Dae Lee, “Raising the Level of Ambition on Carbon Pricing in Asia and Pacific,” *UNESCAP Macroeconomic Policy and Financing for Development Division Policy Briefs*, April 2020.

its 2019 report,⁶⁸ the Task Force highlighted the importance of coherent plans that cover reform timetables, administration mechanisms, mitigation measures for the poor, and strategies for consultation and communication. These remain valid to ensure that the transition to a low-carbon economy safeguards disproportionately affected workers and communities.

5. International tax cooperation

Crisis-induced pressure on public finance is expected to increase focus on international tax cooperation to clamp down on corporate tax avoidance and evasion; address taxation of the digital economy as urgently as possible; and reduce illicit financial flows (see section 6). International tax cooperation, including through tax transparency and exchange of information initiatives, will be key to recouping revenues lost through tax planning by multinational entities (MNEs) and offshore tax evasion. Developing countries will require enhanced support to better recover revenues.

5.1 Progress on tax transparency and exchange of information for tax purposes

International cooperation to combat tax evasion and avoidance has continued, despite the added pressures on the international community due to COVID-19.⁶⁹ In 2020, several additional countries committed to improving transparency and disclosure practices through instruments and frameworks that allow tax authorities to better enforce tax rules and tackle cross-border tax evasion and avoidance (table III.A.3).

Tax transparency and exchange of information generates additional revenues.⁷⁰ Revenue administrations in low-capacity countries should focus on the development of their data management—that is, devise a data strategy and reliable methods to access, integrate, cleanse, govern, store and prepare data for analytics and risks mitigation. This approach will improve domestic revenue collection and lay the groundwork for international exchange of information. Voluntary disclosure programmes and offshore tax investigations helped identify €107 billion in additional revenue (tax, revenue, penalties), of which developing countries identified €29 billion. Exchange of information on request (EOIR) alone aided tax administrations in collecting an additional €10 billion. Revenue gains could be larger, as only 30 per cent of Global Forum members are able to track additional revenues collected through EOIR and only 15 per cent monitor revenues generated by automatic exchange of information (AEOI).

LDCs and African countries are underrepresented in international cooperation on tax transparency and exchange of information. Only eight of 46 LDCs and 20 of 60 African countries have joined the Multilateral Convention on Mutual Administrative Assistance, with even fewer countries having become part of the Multilateral Competent Authority Agreement Common Reporting Standard and commencing AEOI (see table III.A.3). Financial, human resource and institutional constraints are the main challenges, particularly for AEOI.⁷¹ According to non-member responses to a survey by the Global Forum's Africa Initiative, exchange of information (EOI) was not a priority or even a low priority, the level of knowledge was low, the network of EOI partners was limited, basic infrastructure non-existent, and EOI was not generally used in enforcing

tax legislation.⁷² However, the potential of additional revenue from EOI is high: eight African countries identified \$189 million in extra tax proceeds from EOIR between 2014 and 2019 and two African countries collected \$378 million through voluntary disclosure programmes prior to their first AEOI exchanges.⁷³ Support from multilateral and bilateral donors should help increase countries' engagement in the tax transparency agenda and implementation of EOI.

Steady progress was made in country-by-country reporting of multinational entities.⁷⁴ Country-by-country reporting and the compulsory spontaneous exchange of information in respect of certain tax rulings are two minimum standards of the Base Erosion and Profit Shifting (BEPS) Package that relate to tax transparency and complement the EOIR and AEOI standards monitored by the Global Forum. By the end of 2020, more than 90 countries (28 middle-income countries and 1 LDC) had introduced a country-by-country reporting obligation, establishing more than 2,700 EOI bilateral relationships.⁷⁵ Consequently, there are only a few remaining MNEs above the consolidated group revenue threshold of €750 million that are left to be captured by country-by-country reporting, although information may be available in the jurisdictions where the MNE subsidiaries operate. In February 2020, the OECD launched a public consultation process for the review of country-by-country reporting (BEPS Action 13), with outcomes expected in 2021. To ensure that developing countries profit from country-by-country reporting, it will be essential to ensure that (i) the necessary information reaches them and (ii) capacity development initiatives aid countries in developing analytical and interpretative skills and in using country-by-country reporting as a risk assessment tool and as the basis for enquiries during audits.

5.2 Corporate tax avoidance

International tax cooperation in combating corporate tax avoidance is central to recovering potential revenues, particularly for LDCs and African countries. A major barrier to domestic resource mobilization is the high and persistent level of corporate tax avoidance and evasion, particularly the ability of MNEs to avoid taxes through BEPS.

Publication of aggregated MNE country-by-country reporting provides fresh insight on corporate tax planning strategies. In July 2020, for the first time, the OECD made public the aggregated country-by-country reporting statistics for 26 countries for 2016, covering nearly 4,000 MNE groups—information on their locations and amounts of profits, employees, assets and other financial variables.⁷⁶ Preliminary analysis indicates that there is a misalignment between the location where MNE profits are reported and the location where certain economic activities occur.⁷⁷ For example, high- and middle-income jurisdictions account for a higher share of employees (32 and 37 per cent of total employees, respectively) and tangible assets (35 and 23 per cent of total tangible assets, respectively) than of profits (28 and 18 per cent, respectively). Revenues per employee tend to be higher where statutory corporate income tax rates are zero. In investment hubs,⁷⁸ MNEs reported a relatively high share of profits (25 per cent) compared to their share of employees (4 per cent) and tangible assets (11 per cent). MNEs also reported that their predominant activity in investment hubs is “holding shares and other equity instruments.” A concentration of holding companies can be related to genuine commercial arrangements but is a risk factor and could be evidence of certain tax planning structures.⁷⁹

Table III.A.3
Participation in international tax cooperation instruments, 2020
(Number of jurisdictions)

<i>Legal instrument/ intergovernmental body</i>	<i>Background</i>	<i>Purpose</i>	<i>Total membership/ signatories</i>	<i>Middle-income countries</i>	<i>Least developed countries</i>	<i>Small island developing States</i>	<i>Africa</i>
Multilateral Convention on Mutual Administrative Assistance in Tax Matters (MAC)—multilateral instrument available for all forms of tax cooperation	Developed jointly by OECD and Council of Europe in 1988 and amended in 2010	Administrative cooperation	141 (+6)	59 (+3)	8 (+1)	27	21 (+1)
MCAA Common Reporting Standard—specifies the details of what financial account information will be exchanged and when	Requested by G20 and approved by OECD in 2014		110 (+3)	31 (-2)	2	25 (+1)	7 (5)
Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum)—OECD-housed body for review of implementation of transparency and exchange of information standards, both on request and automatic	Intergovernmental body restructured by G20 in 2009	Tackle offshore tax evasion and end bank secrecy	162 (+5)	71 (+1)	19 (+1)	33 (+1)	32
Automatic Exchange of Information Standard—exchanges financial account information for tax purposes	Standard developed in 2014 under Global Forum		115 (+6)	37 (+2)	2 (+1)	26 (+1)	8 (+3)
Inclusive Framework on BEPS—OECD-housed body for the implementation of the 2015 BEPS package and the follow-up work	Intergovernmental body originating from the 2013 OECD/G20 BEPS Project		139 (+4)	61 (+4)	10	26 (+1)	25
Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI)—implements the minimum standards of Action 6 on tax treaty abuse and Action 14 on dispute resolution, and other tax treaty related BEPS measures (Action 2 on hybrid mismatch arrangements and Action 7 on permanent establishment status avoidance)	Negotiated within the framework of the OECD/G20 BEPS Project, adopted in 2016	Combat tax avoidance by MNEs	95 (+3)	36	2	9	14(+2)
MCAA on the exchange of country-by-country (CbC) reports—sets out the specific terms for the exchange of CbC Reports prepared by MNEs with jurisdictions in which the MNE operates to facilitate transfer pricing risk assessments and audits	BEPS Action 13 on CbC reporting, first exchanges began in 2018		89 (+6)	23(-1)	1	10(+1)	8

Source: OECD.
Note: Figures as of 31 December 2020. Figures in parentheses denote change in number of countries in 2020. Negative numbers reflect the graduation of countries from middle-income status. MCAA stands for Multilateral Competent Authority Agreement. MNE stands for multinational enterprises.

COVID-19 put the spotlight back on low-tax or no-tax jurisdictions.

In January 2021, the European Parliament called for the reform of the EU list of non-cooperative tax jurisdictions, including refining and fully disclosing country screening and assessment methodology; automatic listing of jurisdictions with zero corporate tax rates; and accounting for the resource constraints of LDCs and other developing countries in implementing tax standards.⁸⁰ The EU list, in place since 2017, is based on non-compliance with transparency standards (AEOI and EOI standards, ratification of

the multilateral Convention), fair tax competition (principles of the EU Code of Conduct or the OECD Forum on Harmful Tax Practices) and BEPS implementation.⁸¹ It has previously drawn criticism for being arbitrary, and limited in scope, particularly within European territories.⁸² These criticisms have resurfaced in response to the use of this list to limit COVID-19 bailout programmes, which may affect SIDS on the list, who are struggling to combat the pandemic. Several EU countries also excluded corporate groups from support if they had presence in a jurisdiction on the list.⁸³

5.3 Taxation of the digitalized economy

COVID-19 has accelerated the digital transformation of economies and societies, raising the stakes in the discussions over taxation of the digitalized economy. Digitalization has exacerbated underlying longstanding concerns about the allocation of taxing rights under the current international tax framework, being skewed in favour of large, industrialized countries.⁸⁴ Both developed and developing countries recognize that, without a consensus-based global solution, proliferation of unilateral tax measures is expected. Countries need to judge the likelihood of a genuine consensus being carried through to domestic implementation by a sufficient number of States of an international law instrument. They also need to consider whether there are alternatives (even transitionally) that might allow efficient and effective taxation of the digitalized economy while also minimizing tax and trade disputes that could undermine investment and economic growth, at a time when the global economy is at its most fragile due to COVID-19.⁸⁵

Multilateral discussions on taxation of the digital economy continue at the OECD-housed Inclusive Framework on BEPS and the United Nations Committee of Experts on International Cooperation in Tax Matters (Tax Committee).⁸⁶ The Inclusive Framework (table III.A.3) is seeking to build consensus on taxation of the digital economy through a two-pillar approach. The key elements of the Inclusive Framework's pillar one is grouped in three components: (i) allocation of a treaty taxing right for market jurisdictions over a share of MNE residual profit allocated by formula (Amount A) (figure III.A.10); (ii) a fixed return for certain baseline marketing and distribution activities conducted physically in a market jurisdiction, in line with arm's length pricing (Amount B); and (iii) processes to increase "tax certainty" through dispute prevention and resolution mechanisms. Pillar two aims to ensure that all MNEs pay a global minimum level of tax regardless of where they are headquartered or the jurisdictions in which they operate, known as the "global anti-base erosion (GloBE) proposal" (see box III.A.5). Economic assessments that accompanied the blueprints indicated that amount A of pillar one and pillar two could increase global corporate income tax revenues by \$50 billion to \$80 billion.⁸⁷

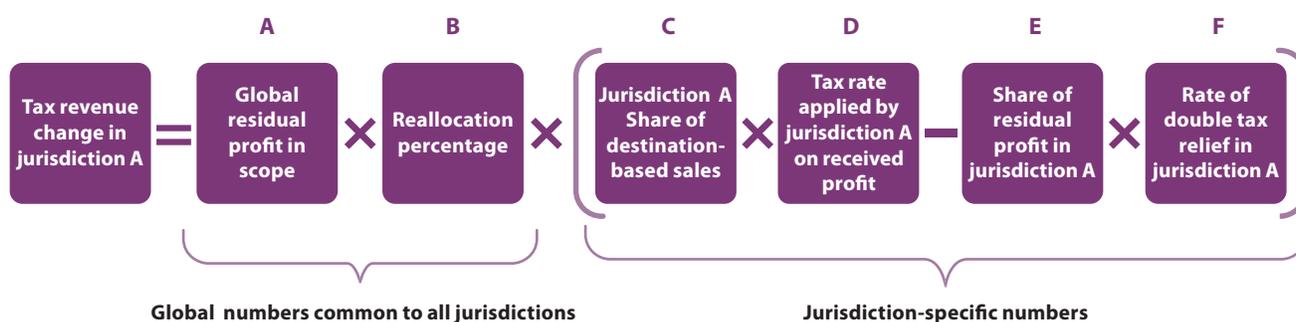
Public submissions on the blueprints also highlight ongoing concerns over complexity, fairness and inclusivity. The *FSDR*

2020 outlined the debate and disagreements that the initial proposals on pillars one and two generated, particularly the complexity of the proposals, their scope, concerns over a possible safe harbour mechanism and opposition to mandatory binding arbitration or panel decisions on tax disputes, particularly in relation to disputes relating to long-standing profit allocation rules. Although the safe harbour mechanism has been withdrawn,⁸⁸ the elaboration of the two-pillar proposal through the blueprints has not dispelled these concerns.⁸⁹ There are also added concerns, such as design features of the proposed GloBE rules that place small developing countries at a disadvantage, including the rule order and revenue thresholds; and allowances for carve-outs that open opportunities for tax avoidance (see box III.A.5).⁹⁰ Negotiations on these and related issues are ongoing and expected to conclude in mid-2021.⁹¹

Recognizing the challenges of the two-pillar approach for developing countries, the United Nations Tax Committee is pursuing a simplified treaty-based approach to taxing the digitalized economy.⁹² In May 2020, the Tax Committee set up a drafting group to develop a bilateral tax-treaty provision in the United Nations Model Tax Convention⁹³ to allow source States to tax income from payments for automated digital services—either on a gross basis at a bilaterally negotiated rate or on a net basis. In both cases, the residence country would be obliged to provide relief from potential double taxation.⁹⁴ This work has been led by developing countries. The drafting group proposed the addition of Article 12B to the United Nations Model Convention in 2021, expanding the taxing rights for States from which payments for automated digital services are made; and the Committee decided for such an inclusion in the 2021 Model. The proposed provision will enable jurisdictions to apply their domestic legislation levying taxes on income derived from digital business models, as the provision has no carve-outs, and thus has the potential to increase source-state taxation in a manner that is moderate and easy to administer. The Committee's approach has been to find a solution that is relatively simple for businesses to comply with, as well as tax administrations, especially through a withholding tax approach, and at the same time, results in a definite share for market jurisdictions. One of the benefits of a Model provision and commentary is that both views on the provision will be fairly expressed. The Model will recognize that many Committee Members do not agree with the policy behind the developing country led proposal, and/or have

Figure III.A.10

Simplified formula summarizing the approach on pillar one



Source: OECD, *Tax Challenges Arising from Digitalisation – Economic Impact Assessment: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project (OECD, 2020).

Box III.A.5**Global anti-base erosion proposal: key rules and factors**

The GloBE proposal seeks to (i) ensure minimum taxation while avoiding double taxation or taxation where there is no economic profit; (ii) cope with different tax system designs by jurisdictions, as well as different operating models by businesses; (iii) ensure transparency and a level playing field; and (iv) minimize administrative and compliance costs. To ensure a minimum level of effective taxation, jurisdictions would have the right to “tax back” when other jurisdictions have not exercised their primary taxing rights, or when the payment is otherwise subject to low levels of effective taxation. These rules are designed to prevent multinational entities (MNEs) from diverting taxable income to low-tax jurisdictions by imposing minimum tax levels on their global income.

The suggested GloBE effective tax rate calculations are based on a jurisdictional blending approach, requiring assignment of the income and taxes among the different jurisdictions. A GloBE tax liability would arise when the effective tax rate of the jurisdiction in which the MNE operates is below the agreed minimum rate.

The proposed rules also allow for carve-outs or adjustments to be made to top-up tax calculations, permitting (i) MNEs to carry losses or excess taxes paid in prior periods forward into subsequent periods, with the aim of smoothing volatility arising from the mix of taxes imposed under local law or resulting from timing differences; and (ii) formulaic carve-outs to exclude a fixed return for substantive activities within a jurisdiction from the scope of GloBE rules.

Source: OECD, *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project (OECD, 2020).

concerns about its administrability. Often such Members have expressed views, for example, that a more comprehensive approach is preferable. A more comprehensive approach (such as a multilateral treaty) that achieves consensus and participation would inevitably “switch off” otherwise conflicting treaty provisions for parties to it, so that there is no ultimate conflict with the Article 12B approach, but it would remain an option where one or more bilateral treaty partners has not joined the multilateral treaty. The Committee also acknowledges the challenge emanating from the fact that many developing countries do not have extensive treaty networks. While negotiation of treaties with such a clause will take time and will often be resisted, this provision would also (more immediately) act as guidance for countries in drafting provisions to tax automated digital services in their domestic law.

The Task Force reiterates that international tax cooperation efforts must accord greater priority and attention to the interests and voices of developing economies. The Addis Agenda underscores the importance of inclusive cooperation and dialogue among national authorities on international tax cooperation. Countries without access to information, and without sufficient domestic capacity to enforce increasingly complex international tax norms, will be unable to boost

revenue mobilization related to cross-border activity. This is increasingly important as countries tackle emerging issues on taxation of the digital economy, such as taxing virtual currencies and ensuring tax transparency for crypto assets.⁹⁵ The global community should ensure effective inclusion in tax norm-setting processes; adaptation of tax norms and practices to the realities and needs of developing countries; and greater investment in capacity-building from development partners.

5.4 Capacity-building**Capacity building efforts continued despite the COVID-19 crisis.**

The Addis Agenda calls for international support for capacity-building in developing countries, including in the areas of domestic revenue mobilization, public finance, gender-responsive budgeting and debt management. Prior to COVID-19, official development assistance (ODA) for capacity-building (for areas that can be tracked) almost doubled between 2015 and 2019 (see figure III.A.11). The multilateral partners of the Addis Tax Initiative (ATI) were on track to double ODA for capacity-building on domestic resource mobilization by 2020, albeit with the support of loans. The ATI has since committed to maintain or surpass the level achieved in 2020.⁹⁶ In addition, many capacity-building programmes adjusted to remote delivery, including the United Nations and the Platform for Collaboration on Tax (box III.A.6) workshops. The OECD-United Nations Development Programme Tax Inspectors Without Borders initiative was able to adjust to a virtual model in 2020, enabling most programmes to continue despite COVID-19 restrictions. The Global Forum continued its capacity-building programme to support developing countries in improving tax transparency.

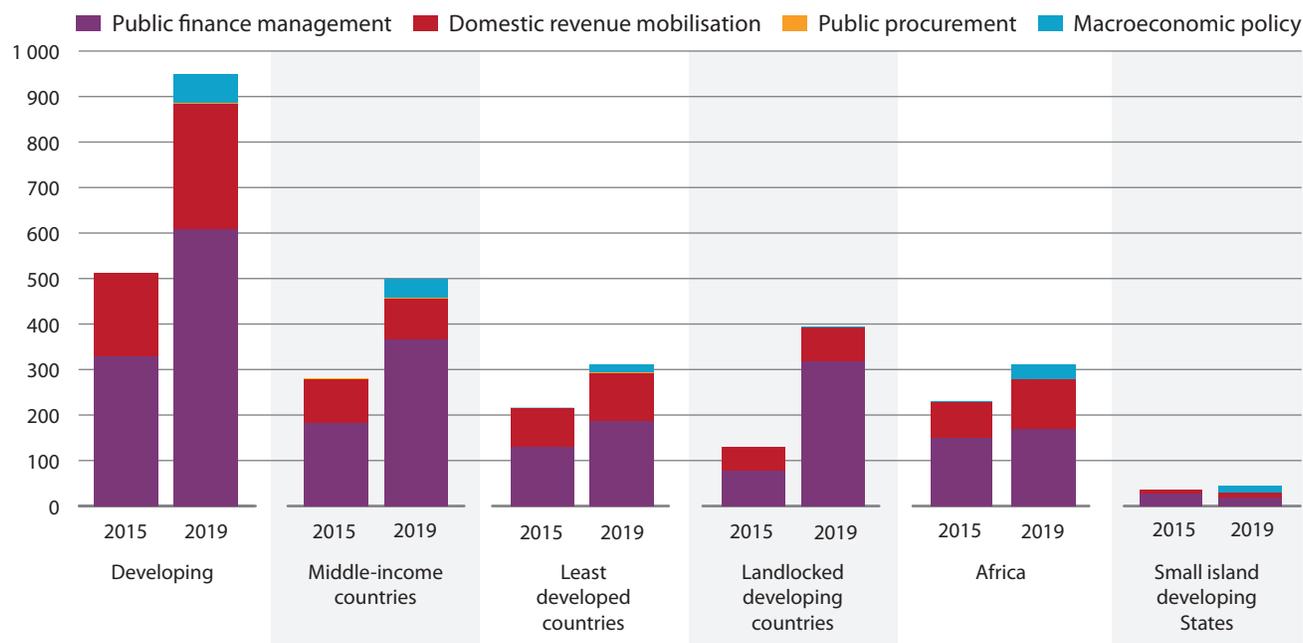
6. Illicit financial flows

Combating illicit financial flows takes centre stage in global discussions on financing for sustainable development amid the COVID-19 outbreak. While there is no agreed definition on what constitutes illicit financial flows (IFFs), the Task Force agreed in 2017 that there are generally three types of IFFs (although not mutually exclusive or comprehensive): (i) IFFs originating from transnational criminal activity; (ii) corruption-related IFFs; and (iii) tax-related IFFs. Member States recognized the importance of addressing these flows to protect vital resources for the COVID-19 response and recovery in high-level discussions held over the course of 2020 (box III.A.7).

The presidents of two of the main organs of the United Nations launched a high-level panel to assess shortcomings in current international legal and institutional frameworks that cover illicit financial flows. In early March 2020, the seventy-fourth President of the General Assembly and the seventy-fifth President of the Economic and Social Council jointly launched a High-level Panel on International Financial Accountability, Transparency and Integrity for Achieving the 2030 Agenda (FACTI Panel). The FACTI Panel reviewed existing international institutional and legal frameworks related to financial accountability, transparency and integrity, with a view to identifying gaps, impediments and vulnerabilities in their design and/or implementation.

The FACTI Panel made far-reaching recommendations for addressing systemic shortcomings and promoting financial integrity for sustainable development. The FACTI Panel proposals related to international tax

Figure III.A.11

Gross ODA disbursements for capacity building, 2015–2019*(Millions of United States dollars)*

Source: OECD Creditor Reporting System database.

Box III.A.6**Platform for Collaboration on Tax: adjusting support in the context of COVID-19**

The Platform for Collaboration on Tax (PCT) was launched in April 2016 by the United Nations, World Bank Group, International Monetary Fund, and the Organization for Economic Cooperation and Development. PCT partners have worked together to cooperate and coordinate their support for developing countries on domestic resource mobilization. Their three workstreams were adapted to support countries dealing with the COVID-19 crisis:

- i **Cooperation on capacity development activities.** PCT members had regular exchanges on the impact of COVID-19 on partners' delivery of capacity support; The PCT launched an online integrated platform that provides information on partner activities, including advice on tax policy and administration resources for the COVID-19 crisis;
- ii **Analytical activities.** The PCT published a Toolkit on the taxation of offshore direct transfers, with several other toolkits in preparation, including one on tax treaty negotiations. Partners were also involved on the discussions on the tax treatment of official development assistance government-to-government aid at the United Nations Committee on Tax;
- iii **Outreach activities.** Several training workshops were held virtually.

The PCT also continues to support the formulation and implementation of the medium-term revenue strategies, including in the context of integrated national financing frameworks.

Source: PCT Secretariat, "PCT Progress Report 2020," 2020.

cooperation, financial and beneficial ownership transparency, bribery and corruption, money-laundering, and asset recovery and return (see box III.A.8). Many items, such as improving capacity-building, are already under way, and the Panel calls for strengthening these further. Other items include broad institutional changes which the Panel suggests will improve the legitimacy of institutional arrangements, enhance coordination, and build trust in international systems among Member States and citizens. The FACTIPanel's recommendations relate to both United Nations and non-United-Nations bodies.

6.1 Volume estimates**Efforts to better measure illicit financial flows are under way.**

In October 2020, the United Nations Office on Drugs and Crime (UNODC) and the United Nations Conference on Trade and Development (UNCTAD) published a Conceptual Framework, including a statistical definition and approach to measuring IFFs.⁹⁷ The Framework defines IFFs as "financial flows that are illicit in origin, transfer or use, that reflect an exchange of value, and that cross country borders." It defines IFFs as arising from four

main activities: (i) tax and commercial IFFs;⁹⁸ (ii) illegal markets;⁹⁹ (iii) corruption; and; (iv) exploitation-type activities¹⁰⁰ and financing of crime and terrorism. The statistical definition also captures flows that may not be strictly illegal, such as cross-border tax avoidance. The Framework proposes to measure IFFs “by analysing the functioning of relevant illicit activities, identifying the set of flows that can be identified as IFFs, and producing estimates for each.” UNODC and UNCTAD are conducting a series of pilot studies to refine the framework and develop methodological guidance to measure IFFs.

6.2 Financial and beneficial ownership transparency

Beneficial ownership information is an important tool in combating illicit financial flows. Perpetrators of illicit financial flows rely most commonly on secrecy in some form, including secretive assets (i.e., assets where ownership is not recorded), secretive legal vehicles, and the use of complex chains of ownership across jurisdictions to disguise activity.¹⁰¹ In many cases, only the legal owners of an asset or legal vehicle are known to authorities. In contrast, the beneficial owner is the person who ultimately owns, controls or benefits from legal vehicles. It is

essential that country authorities know the beneficial owner of financial assets and of legal vehicles operating in their jurisdictions, regardless of where they are legally constituted, to properly investigate and eventually prosecute tax evasion and financial crimes. This information is also crucial in asset recovery, highlighting the importance of exchange of beneficial ownership information across borders.

The Financial Action Task Force (FATF) requires countries to implement measures to ensure the availability of beneficial ownership information to country authorities. The FATF is an inter-governmental body that develops policies to combat money-laundering, terrorist financing and the financing of proliferation of weapons of mass destruction. The FATF standards require that competent authorities have timely access to accurate and up-to-date beneficial ownership information.¹⁰² Countries can use three different mechanisms to meet beneficial ownership information requirements: (i) the company approach (the entity collects information on itself and authorities can access it upon request); (ii) the registry approach (usually accomplished by establishing a centralized database/register to hold beneficial ownership information); (iii) or the existing information

Box III.A.7

Combating illicit financial flows: discussions in the context of COVID-19 financing

The discussion group on illicit financial flows (IFFs) set up through the High-level Event on Financing for Development in the Era of COVID-19 and Beyond sought to identify measures to expand fiscal space and foster domestic resource mobilization by preventing IFFs and base erosion and profit shifting, and facilitating contributions of the digital economy. States Members of the United Nations, international institutions and civil society were part of the high-level policy discussions.

The discussion group made several recommendations, including prioritizing fiscal transparency and national measures to address tax avoidance. The group suggested establishing anti-corruption, anti-money-laundering and anti-tax evasion solutions to protect COVID-19 emergency funds, including aid and stimulus measures. Other priorities included improving tax administration through more effective use of digital technologies; strengthening implementation of the United Nations Convention Against Corruption and other international frameworks, such as AML/CFT^a frameworks; fully integrating financial integrity into all sustainable development policies and plans; taking national actions to intensify cooperation on recovery and return of assets; and strengthening beneficial ownership information collection and transparency at the national level in line with Financial Action Task Force standards (see section 6.2).

In the medium and long term, the discussion group proposed fighting IFFs through

- Developing whole-of-government approaches to tackling IFFs;
- Striving to eliminate safe havens that create incentives for the transfer abroad of stolen assets and illicit financial flows;
- Strengthening anti-money-laundering/combating the financing of terrorism frameworks while better understanding de-risking, and helping affected countries re-establish correspondent banking relationships;
- Working to eliminate base erosion and profit shifting and to ensure that all companies, including multinationals, pay taxes to the Governments of countries where economic activity occurs, and value is created;
- Cooperating, in accordance with applicable bilateral or multilateral agreements, in the areas of mutual legal assistance, administrative assistance, and information exchange in tax matters;
- Encouraging the next membership of the United Nations Committee of Experts on International Cooperation in Tax Matters to provide advice, by the end of its first year of work, on tax policies that can best contribute to post-COVID-19 recovery; and
- Continuing dialogue, including within the United Nations Committee of Experts on International Cooperation in Tax Matters and the High-level Panel on International Financial Accountability, Transparency and Integrity for Achieving the 2030 Agenda.

Source: United Nations, “Financing for Development in the Era of COVID-19 and Beyond, Menu of Options for the Consideration of Heads of State and Government, Part II,” September 2020.

a Anti-money-laundering/combating the financing of terrorism.

approach (relying on information already held by, for example, financial institutions or other authorities). The FATF recommends that countries follow a multipronged approach.¹⁰³

Availability of beneficial ownership information is weak but improving. FATF mutual evaluations generally show low effectiveness in the collection of beneficial ownership information. The United Nations Convention against Corruption (UNCAC) peer reviews also show weakness in the ability of countries to identify owners of funds and beneficial owners of high-value accounts.¹⁰⁴ However, more recently an increasing number of countries have started adopting the registry approach in their legal framework, with the total now reaching almost about 80 countries, although implementation varies among the countries.¹⁰⁵ A new wave has also started to give public access to beneficial ownership information, mainly in the European Union¹⁰⁶ and the United Kingdom, but now extending to countries in Africa, Asia, Eastern Europe and Latin America and the Caribbean. However, this new trend is not universal, and does not address all weaknesses—such as insufficient information collection, inconsistent definitions, limited scope, lack of verification, limited cross-border information availability, and weakness of sanctions for non-compliance—in countries' current implementation of the practice.¹⁰⁷ Nevertheless, since the Global Forum introduced beneficial ownership information requirements in its standards, one third of recommendations from the second round of the EDIR peer reviews are related to improvements in this area; a large majority of jurisdictions are indeed working towards these improvements.¹⁰⁸

Box III.A.8 Report of the FACTI Panel

The High-level Panel on International Financial Accountability, Transparency and Integrity for Achieving the 2030 Agenda (FACTI Panel) report states that illicit financial flows are a systemic problem requiring a systemic solution. The report further calls for an entire ecosystem approach to address the shortcomings of the present patchwork of structures and adapt them to ever-evolving risks.

The Panel proposes a Global Pact for Financial Integrity for Sustainable Development, a compact through which all countries agree to take comprehensive action to foster and strengthen financial integrity for sustainable development and commit to using the proceeds released by this action to make additional investments in achieving the Sustainable Development Goals. The Panel calls for three types of actions: reinforcing values for integrity, strengthening policy frameworks, and redesigning institutions.

“Values” refers to the ideas that are contained in the definition of financial integrity for sustainable development, and the report elaborates on accountability, legitimacy, transparency and fairness. In addition to accepting these values, policies that relate to enablers of crime, non-State actors, international cooperation, dynamism, and capacity-building are needed. To address the limited reach of existing international bodies, the Panel proposes better data collection and publication; strengthened implementation review systems; better national coordination; and more coordinated and inclusive global governance arrangements.

Source: FACTI Panel secretariat.

6.3 Money-laundering

The COVID-19 crisis impacted anti-money-laundering/combating the financing of terrorism (AML/CFT) activities, including changed financial behaviours. Under UNCAC, countries committed to combating money-laundering, which involves processing of the proceeds of crime to disguise their illegal origin, and is a common feature of all financial crimes. FATF standards promote effective implementation of legal, regulatory and operational measures for combating money-laundering, terrorist financing and other related threats to the integrity of the international financial system. The COVID-19 pandemic impacted government and private sector ability to implement AML/CFT obligations, primarily due to confinement and social distancing measures.¹⁰⁹ For example, AML/CFT on-site inspections were postponed, and operations of financial intelligence units (FIU) were scaled back. While COVID-19-related AML/CFT risks were identified, such as exploiting stimulus measures and insolvency schemes for money-laundering, there were no extraordinary reports of money-laundering due to the pandemic, but there were changes in predicate offences and changes in money-laundering and terrorist financing activity.¹¹⁰

Lack of resources hinder enforcement of regulations. Frequently, money-laundering is enabled by lawyers, accountants and financial institutions, and other actors. To comply with money-laundering regulations, they are required to report suspicious transactions to country authorities (e.g., FIUs). However, prosecutors, investigators and FIUs often lack the resources to investigate all suspicious transactions, and many reports are defensive filings by banks who want to avoid liability and are not useful to authorities in some countries. Even in the European Union, which has some of the highest capacity for monitoring and investigation, authorities use, on average, just over 10 per cent of reports submitted, a percentage that has not changed since 2006.¹¹¹ Countries should adopt a risk-based approach to ensure that limited resources are used effectively in addressing their most important money-laundering/terrorist financing risks in a country.

There is, however, growing global momentum to strengthen anti-money-laundering mechanisms. In July 2019, FATF launched a strategic review of its AML/CFT assessment architecture, which coincides with the conclusion of the fourth round of FATF mutual evaluations.¹¹² The review is considering how to make future mutual evaluations more timely, risk based, and effective, as well as considering changes to the standards, such as whether there is a need to strengthen beneficial ownership requirements. The strategic review, which concludes in 2021,¹¹³ coincides with significant country-level advancement of legal and regulatory frameworks, often in response to the previous update of the standards and round of mutual evaluations. For example, in January 2021, the United States passed the Anti-Money Laundering Act of 2020, the most comprehensive set of reforms in 20 years, including its first centralized, non-public register for beneficial ownership information targeted at smaller businesses and shell companies.¹¹⁴ The European Union also recently agreed to set up an EU body to combat money-laundering and work is under way to harmonize anti-money-laundering rules and improve coordination among FIUs. Legislative work to adopt this is expected to conclude in 2021.¹¹⁵

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