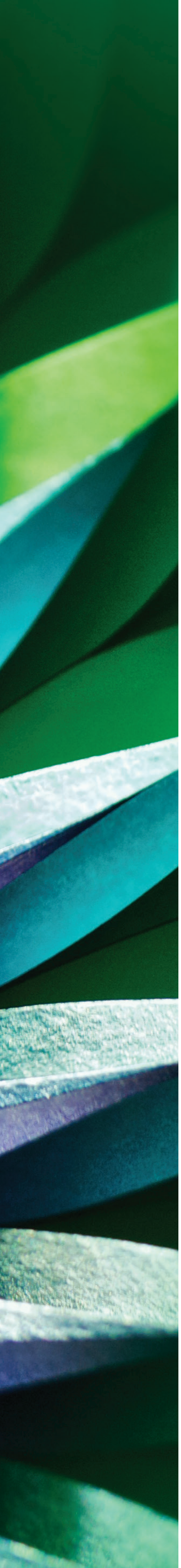

BACKGROUND NOTE

Domestic Resource Mobilization for Supporting Developing Members to Achieve Sustainable Development Goals

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1. Domestic resource mobilization (DRM) is a core of finance resource for developing member countries (DMCs) of the Asian Development Bank (ADB) to achieve Sustainable Development Goals (SDGs) as SDG 17 includes targets to strengthen DRM.[1] DMCs face structural challenges in implementing the SDGs, including globalization, climate change, aging, and digital transformation of their economies. Moreover, many DMCs face significant pressure on national budgets and bigger public debt as results of the large-scale expenditure programs and tax relief measures that have been adopted for pandemic response and recovery. The coronavirus disease (COVID-19) pandemic has made it clear that DMCs will need to make significant investments in public services, such as health care, and institute public governance reforms to address rising income inequality. Given this, DRM has become an even more crucial agenda for developing countries than ever before to ensure that their recovery from COVID-19 crisis will be sustainable, inclusive, and resilient.

2. While tax revenue serves major domestic revenue sources among most countries, DMC tax yields have not increased concomitantly with the strong and steady growth in gross domestic product (GDP) over the last decades. Even prior to the COVID-19 pandemic, many countries did not achieve a minimum tax yield of 15% of GDP—now widely regarded as the minimum level required for sustainable development. According to the latest data available in the ADB Key Indicators Database, from among ADB's 44 DMCs, the tax revenue to GDP ratio is lower than 15% for 17 DMCs, and between 15% and 20% for 11 DMCs.

3. The COVID-19 crisis has adversely impacted the tax revenue collections in countries of the Asia and Pacific region because of the economic downturn and the tax stimulus package. For

[1] United Nations General Assembly. 2015. *Transforming our world: the 2030 Agenda for Sustainable Development*. New York. SDG 17.1: Strengthen domestic resource mobilization, including through international support to developing countries, to improve domestic capacity for tax and other revenue collection.

instance, the countries belonging to relatively more developed East Asian region, witnessed sharp contraction in tax revenues.[2] Japan's tax revenue dropped to 29.4% in April 2020 which was the biggest monthly year-on-year decline since 2009. Similarly, in the People's Republic of China, tax revenue plummeted to 16.4% in the first quarter that ended in March (2020) on year-on-year basis. The Republic of Korea's tax revenues for the first quarter of 2020 fell by about 11% in relation to the first quarter of 2019. Similar impacts were observed in other regions as well. In India, the total tax collection declined by 20% during the period of April–August in fiscal year (FY) 2020–FY2021, against the tax collected in the same period of previous year. In Malaysia, tax revenue declined by 38.1% in the second quarter of FY2020 in comparison to the same period in previous financial year.

4. During this decade, substantial efforts to strengthen DRM have been conducted across the region in collaboration with development partners, including ADB. However, the improvement of the tax revenue to GDP ratio seem diverse among countries. Out of 30 DMCs, 17 DMCs have experienced decrease of the ratio by more than 1% in the past 10 years, or stagnant (between -1% and 1%), while 13 DMCs have achieved significant progress with increase of the ratio by more than 1 %. The reasons for the regression and stagnancy may be diverse among countries. However, both facts would signal that raising tax revenue performance is not straightforward and should be a long-standing process. DMCs can only achieve the SDGs if they develop and implement an ambitious program to mobilize substantial additional revenue.

5. Aligned with ADB's Strategy 2030's operational priority 6: strengthening governance and institutional capacity, in developing the program to mobilize substantial additional revenue, these efforts by DMCs are important to note: (i) broadening and protecting the domestic tax base; (ii) enhancing tax compliance, including improved risk management, audit and enforcement, and taxpayer services; and (iii) developing more transparent and efficient tax administration with streamlined business processes and digital technologies.[3] As weak capacity in revenue

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[2] Tapas K. Sen. 2021. *Exit Strategy to Ease or Eliminate Tax Responses to the COVID-19 Pandemic*. The Governance Brief. Issue no. 43. Manila: ADB.

[3] ADB. 2018. *Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific*. Manila; and ADB. 2019. *Strategy 2030 Operational Plan for Priority 6: Strengthening Governance and Institutional Capacity, 2019–2024*. Manila.

administrations still remain because of emerging challenges, including significant and rapid changes in the business circumstances (i.e., expansion of cross-border supply chain and digitalized platform), scaling up capacity-building initiatives to address these challenges will be required.[4]

6. Along with these existing efforts, a world reshaped by the COVID-19 pandemic requires that ADB address the issue of DRM with a wider perspective, which will include striking a balance between raising tax revenues and promoting investments that will contribute to robust recovery from the pandemic. To improve tax yields in a fair and equitable manner, governments must strengthen international tax cooperation to address aggressive tax planning particularly related to tax challenges from digitalization of economy, and combat tax evasion through a higher level of participation in international initiatives, such as the Inclusive Framework on Base Erosion and Profit Shifting and the Global Forum on Transparency and Exchange of Information for Tax Purposes. Tax policy measures may be leveraged to achieve wider policy objectives through DRM. Those policy objectives would include achieving SDGs and green and social development in an effective manner and, in the context of ADB operation, how DRM can be utilized in a collaborative manner with other operational priorities.

7. One of the good examples in this aspect is the use of property tax as it is stated in the operational plan for operational priority 4: making cities more livable.[5] The property tax is often considered as an appropriate tax to provide subnational governments with meaningful revenue autonomy in fiscally decentralized systems, and an important revenue source to improve local service delivery and finance smaller-scale infrastructure projects reflecting community requirements. As about 65% of the 169 targets underlying the 17 SDGs will not be reached without proper engagement of and coordination with subnational governments, DRM in subnational governments should be important in achieving SDGs.[6] Also, the effort on improving the property tax management leads to development of the property management itself, as proper property registration and valuation would be preconditions for proper property tax management. However,

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[4] ADB. 2020. *Technical Assistance Completion Report: Strengthening Tax Policy and Administration Capacity to Mobilize Domestic Resources*. Manila.

[5] ADB. 2019. *Strategy 2030 Operational Plans – Operational Priority 4: Making Cities More Livable, 2019–2024*. Manila.

[6] European Commission. 2018. *Delivering the Sustainable Development Goals at Local and Regional Level: Recommendations to the European Commission*. Brussels.

this revenue potential seems to be largely untapped in many countries, due to both policy and administration issues. Given this consideration, ADB has been supporting property tax managements for a long time. Recent development in this domain is the use of advanced technology, namely satellite imagery and artificial intelligence for property management in a cost-effective manner.

8. Other possible options would be to address the income and inequality gap with the adoption of a more progressive income tax system, and to introduce taxes which have policy objectives in addition to simply raising revenue, including environmental tax for achieving green development through incentivizing environment-friendly economic activities. Sin taxes can be leveraged to reduce the consumption of harmful produces to health, such as tobacco and alcohol. Social security contribution would be a key to address aging society and other social development challenges. It may be relatively untouched across the region and encompass room for rationalization including cooperation between the relevant agencies to simplify administration and to improve monitoring compliance. One of the policy considerations underlying those measures would be the linkage between revenue and expenditures. Generally, citizens in many countries perceive only a weak relationship between paying taxes and receiving services, leading to a weak fiscal contract.[7] One solution to this problem is to explicitly strengthen revenue and expenditure linkages by requiring that revenue earned from one source be solely dedicated to specific expenditures, including hypothecation or earmarking of revenue. While there are several downsides in using hypothecation, the measures mentioned above may gain public support though having the nature of earmarking of revenue.

9. For supporting DMCs to strengthen DRM and international tax cooperation, ADB announced the establishment of an effective regional hub on domestic resource mobilization and international tax cooperation in Asia and the Pacific (Asia Pacific Tax Hub) in the ADB 2020 Annual Meeting. This hub will serve as an open platform where countries and development partners can collaborate closely to share experiences and practical knowledge and can coordinate on development support.

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[7] Overseas Development Institute. 2015. *Linkages between public sector revenues and expenditures in developing countries.* London.