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Domestic Resource Mobilization for Development: Ideas for U.S. Policy

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Increased tax revenue would enable governments to help people in rural areas, such as this community in Ethiopia, leapfrog directly to sustainable energy technologies.

Key Points

- Even with increases in Domestic Resource Mobilization, low-income countries will lack sufficient resources to achieve the Sustainable Development Goals. The United States should continue to support them through official development assistance and increase funds available to strengthen institutions and administrative capacity, build civil society capacity, and support an enabling environment for DRM.
- The U.S. government needs an approach to DRM that is appropriate for each country's context. In fragile states, U.S. goals should be ensuring that tax collection is fair and transparent and serves to enhance, not weaken, government accountability for public funds and services.
- The success of the Addis Tax Initiative depends on countries building equitable tax systems and using the resulting additional revenue to benefit poor people. U.S. aid for tax reform should help governments develop open budgets and measure how their tax and expenditure policies affect inequality.
- Fiscal transparency helps create better enabling environments for DRM. The State Department could more heavily publicize its annual fiscal transparency review and make more information accessible about the methodology it uses to determine countries' progress.

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In Brief

At the Third Financing for Development Conference in July 2015, the United States pledged, through the Addis Tax Initiative, to significantly increase foreign assistance that supports countries in mobilizing their own domestic resources.[1] Domestic resource mobilization (DRM) encompasses the ways in which countries access their own means of funding national priorities. A wide range of funding mechanisms and financial flows are part of DRM, among them tax revenues, natural resource revenues, remittances, funds from public-private partnerships, public bonds, and philanthropic gifts.

"Peaceful, inclusive, and well-governed societ[ies]" as described in Sustainable Development Goal (SDG) 16 are a necessary condition for countries seeking to end hunger and extreme poverty by 2030. States that build inclusive institutions are more likely to provide social safety nets and achieve the broadly-shared economic growth needed to lift people out of poverty. Low tax revenues, illicit financial flows out of the country, and corruption pose barriers to such institutional development.

While U.S. assistance in countries that are low-income, fragile, or both should aim to help them overcome any of these barriers to DRM, this paper focuses primarily on taxation. Effective tax systems can help strengthen institutions by encouraging citizens to monitor their governments and insist on social services. Yet many fragile and/or low-income countries need support for broader capacity building before they can benefit from tax reform.

Overview

The Sustainable Development Goals (SDGs) reflect broad global consultation and consensus on universal targets that will lead to a "just, equitable, and inclusive"[3] world by the year 2030. At the annual U.N. General Assembly meeting in September 2015, member states officially adopted the SDGs. The Sustainable Development Goals aim to eradicate extreme poverty, end hunger and malnutrition, achieve gender equality, and promote inclusive and sustainable economic growth.[4] Unlike the Millennium Development Goals, the 17 goals and 169 targets laid out in the post-2015 SDG agenda challenge all countries to make significant progress.

Fragile states and stable low-income countries, many located in sub-Saharan Africa (SSA) and South Asia, will face the biggest hurdles to achieving the SDGs. The Organization for Economic Cooperation and Development (OECD) defines a fragile state as one having "weak capacity to carry out basic governance functions, and lack[ing] the ability to develop mutually constructive relations with society."[5] This definition has been broadened to include countries whose governments provide few social services and/or do not respect the rule of law, in addition to conflict countries. Under this definition, 1.4 billion people lived in fragile states in 2014, including 43 percent of the world's extremely poor people.[6] Although they vary widely, fragile states and many stable low-income countries face similar challenges: a lack of capacity to provide basic services, an absence of democratic and inclusive institutions, and an inability to respond adequately to the needs of their most vulnerable residents and communities.

Any country seeking to end hunger and extreme poverty needs to make progress toward becoming a "peaceful, inclusive, and well-governed society," as described in Sustainable Development Goal (SDG) 16.[7] States that build inclusive institutions, respect human rights, and institutionalize the rule of law are more likely to be able to provide safety nets for their most vulnerable people and achieve the level of inclusive economic growth needed to enable more people to lift themselves out of hunger and poverty. The OECD estimated that an additional 150 million people could be lifted out of poverty by 2030 if fragile states saw their institutions improve at a rate similar to that of countries like Georgia that have experienced rapid improvements in their institutions.[8] The International Monetary Fund (IMF) found that countries where the incomes of the people in the bottom income quintile are increasing grow faster than countries where it is those in the top quintile who are adding to their incomes.[9]

Official Development Assistance (ODA) from developed countries is critical to enabling hungry and poor people to

K. Stefanova/USAID

Women and children pick green beans at the Dodicha Vegetable Cooperative in Ethiopia. Globally, most undernourished people work in informal sectors such as smallholder farming.

improve their lives, promoting inclusive institutions, and achieving all the SDGs. Despite the fact that ODA continues to decrease as a percentage of overall financial flows, it is ODA—rather than sources such as foreign direct investment and remittances—that funds capacity building programs, such as judicial sector reform, that enable countries to develop inclusive institutions.

The United States has used ODA to fund Feed the Future, which helped millions of farmers earn more income and has reached 12 million children who suffer from malnutrition. Feed the Future has contributed to 33 percent and 25 percent decreases in childhood stunting in Ghana and Kenya respectively, and in 2014 it enabled 19 million households to increase their revenue by $500 million.[10]

Developing countries will need significantly more resources to meet the SDGs because the goals are so ambitious and wide-ranging. The Brookings Institution estimated that developing countries will need an additional $1 trillion in investment between 2015 and 2030 to achieve the SDGs. This would be a 10 percent increase in investment levels.[11] But despite supporting the level of ambition of the SDGs, developed countries have expressed little desire to give additional ODA. OECD countries increased ODA during the 2000s, yet by 2013, only five member countries had met the longstanding pledge to give 0.7 percent of their GDPs in foreign aid.[12] Developing countries, for their part, have sought to increase their own resources for development to avoid being dependent on donor support.

This was the financial backdrop to the Third Financing for Development (FFD) conference, held in July 2015 in Addis Ababa, Ethiopia. The goal of the conference was to develop a funding mechanism for the SDGs. During the meeting, developing countries committed to raising more of their own resources for development through DRM. In turn, developed countries pledged to support countries' efforts to do this based on the principle of country ownership, meaning countries should control their own development.[13] Domestic resource mobilization encompasses all the ways available for a country to access its own resources for national priorities. A wide range of funding mechanisms and financial flows are considered part of DRM, among them tax revenues, natural resource revenues, remittances, funds from public-private partnerships, public bonds, philanthropic gifts, and funds raised by borrowing in financial markets.

During the conference, a group composed of the United States, the Netherlands, the United Kingdom, and Germany developed the Addis Tax Initiative. The initiative requires participating donor countries to double the amount of foreign assistance they commit to helping developing country governments reform their tax systems and raise additional tax revenue.[14] Twenty-nine countries are part of the initiative, including nine in either Southeast Asia or sub-Saharan Africa. In the lead-up to the Financing for Development conference, the World Bank and the IMF committed to helping lower-income countries increase their tax revenues by 2 percent to 4 percent of their GDP.[15]

DRM reflects, in part, developing countries' desire to manage their own development and foreign aid. In fact, DRM was part of the *first* Financing for Development conference, held in 2002 in Monterrey, Mexico. In Monterrey, countries agreed that DRM would be part of a new partnership between developed and developing countries. The wider principle of country ownership was affirmed at the Paris Conference for Aid Effectiveness in 2005 and reaffirmed at later meetings in Accra, Ghana, and Busan, Korea.[16]

Developing countries particularly emphasized the use of ODA for DRM and the general importance of DRM at the April 2014 High Level Meeting of the Global Partnership for Effective Development Cooperation. Government officials from Nigeria, Cote d'Ivoire, and Venezuela spoke of the need for DRM.[17] In the meeting's final outcome document, countries agreed to use DRM to finance social protection schemes, create progressive tax systems, and develop inclusive domestic financial sectors.[18]

Over the past two decades, the value of DRM and international financial flows has increased relative to the value of aid from donors and, in particular, the U.S. government.[19] ODA now represents only 10 percent of financial flows from the United States to developing countries.[20] In sub-Saharan Africa, for example, DRM rose from $100 billion in 2000 to $530 billion in 2012—more than five times as much—while ODA increased only from $20 billion to $54 billion over the same period. In 2012, global public and private sector DRM in developing countries reached $7.7 trillion.

Efforts to increase ODA for DRM are credited with some remarkable success stories. In El Salvador, whose government used funds from the U.S. Agency for International Development (USAID) to implement tax reforms, tax revenue increased by $1.5 billion between 2005 and 2010.[21] The government of Chile developed an e-filing tax system that increased tax revenues from $13.3 billion in 1999 to $55.9 billion in 2012.[22]

Despite significant increases in the amount of DRM over the last two decades, low-income countries on average collect only 15 percent of their GDP in tax revenues, compared to roughly 30 percent for high-income countries.[23] Wealthier countries tend to have more effective tax administration and the ability to collect property and income taxes, which low-income countries struggle to collect. Low-income countries also lose more tax revenues to illicit financial flows and corruption. Higher tax revenues as a percentage of GDP ensure that governments can provide more public goods, including social safety nets to protect people from hunger. Increasing the amount of DRM and, in particular, tax revenues will depend on improving the capacity of developing country governments to gather resources given the environment they operate in and on improving the capacity of donor governments to work in both the most and least hospitable operating environments.

The rest of this briefing paper focuses on U.S. government opportunities and constraints in using development assistance funds to help developing countries increase their tax revenues. While developing countries will need to mobilize further resources, in addition to taxes, to achieve the SDGs, the U.S. government has focused its commitment on increasing support for mobilizing domestic resources through taxes.

Ideally, tax mobilization can encourage institutional development and more transparent governance, creating an economic environment that encourages local businesses to invest their profits domestically and that is more likely to attract foreign direct investment. The paper argues that the U.S. government risks leaving many countries behind on the path to the SDGs if it focuses only on countries with the most suitable operating environments.

The Development Challenge of Fragile and Low-Income States

The U.S. government funds development efforts in both stable and unstable environments. The largest U.S. aid agency, USAID, works in more than 100 countries, including countries in civil conflict and stable low and middle-income countries.[24] The Millennium Challenge Corporation (MCC) has entered into either compacts or "threshold" agreements (meant to help countries strengthen their weakest areas so that they can qualify for compacts) with 39 countries, primarily stable low-income countries with good governance.[25] ODA can support long-term development goals—such as reducing the number of people who suffer from chronic hunger—in countries that are stable, whether they are low-income or middle-income.

Significant ODA also goes to humanitarian assistance—for example, in 2013, $4.7 billion of a total $30.9 billion in foreign assistance was for humanitarian purposes.[26] This type of aid may be needed for a variety of reasons—war or other violence, natural disaster, a disease epidemic, or a combination. It primarily provides food, medicine, and shelter.

In addition to seeking ODA, most countries have the option of borrowing money from a multilateral development bank. The largest of these is the World Bank, which maintains two distinct financing facilities serving countries at different income levels. The International Development Association (IDA) makes loans to low-income countries at below-market rates. To be eligible for IDA in 2016, countries must have a per capita income of $1,215 or less. The World Bank's International Bank for Reconstruction and Development provides loans to middle income countries.[27] USAID operates in both IDA and IBRD countries, while the MCC works only with IDA eligible countries.

Over the past decade, it has become more common for funders to take into account factors that may make a country more fragile. Fragility has various definitions; the main point is that when a government cannot fulfill its core functions—guaranteeing order and providing social services—the country is at greater risk of conflict and more vulnerable to external shocks. Either can quickly destroy decades of progress in development. Fragile states are virtually always home to people who need humanitarian assistance. But these countries also need longer-term development assistance to address the conditions driving instability. At the Busan conference in 2011, the United States and more than 40 other countries and international organizations agreed to a New Deal for Engagement with Fragile States. It calls on donors to support five peace and state building goals: "foster inclusive political settlements and conflict resolution, establish and strengthen people's security, increase people's access to justice, generate employment and improve livelihoods, and manage revenue and build capacity for accountable and fair service delivery."[28]

Since 2006, the World Bank has primarily assessed fragility using its Country Policy and Institutional Assessment (CPIA), which views fragility as the likelihood of conflict breaking out. To guage this, the CPIA rates a country's macroeconomic management, trade and finance policies, policies on social inclusion and gender equality, and quality of institutions.[29] IDA-eligible countries that score below a cutoff point, as well as small island states and states with an active U.N. Peacekeeping Mission, are added to the World Bank's Harmonized List of Fragile Situations (before 2010, this was known as the Low Income Country Under Stress list).[30] However, the World Bank's Independent Evaluation Group has criticized the CPIA as ignoring many of the factors that drive fragility, pointing out that the CPIA was originally developed for a far more narrow purpose—assessing the risk of lending to a country.[31]

This paper uses the OECD's broader approach to fragility because it assesses a country's wider vulnerability to shocks rather than the risk of conflict alone. The OECD's list of fragile states includes countries that are either on the World Bank's list of fragile states or that score 90 or above on the Fund for Peace's Fragile States.† The Fund for Peace index

Reverie Zurba/USAID

Bringing government services to remote areas, such as this small mountain community in the mountains of Lesotho, requires both resources and creative, flexible approaches to using them.

† OECD (2015), *States of Fragility: Meeting Post-2015 Ambitions,* p. 30. In *States of Fragility* for 2015, the OECD proposed a new ranking approach for fragility based on the following five sectors: 1) violence (peaceful societies); 2) access to justice for all; 3) effective, accountable and inclusive institutions; 4) economic foundations; 5) capacity to adapt to social, economic and environmental shocks and disasters. The new approach has the potential to identify more specifically the aspects of fragility that affect each country. The 2015 report was prepared using the existing system.

measures countries' stability based on social, economic, political, and military indicators. It is more likely than the World Bank list to identify countries as fragile based on undemocratic institutions. In 2015, 1.4 billion people were living in fragile states as defined by the OECD list.[32]

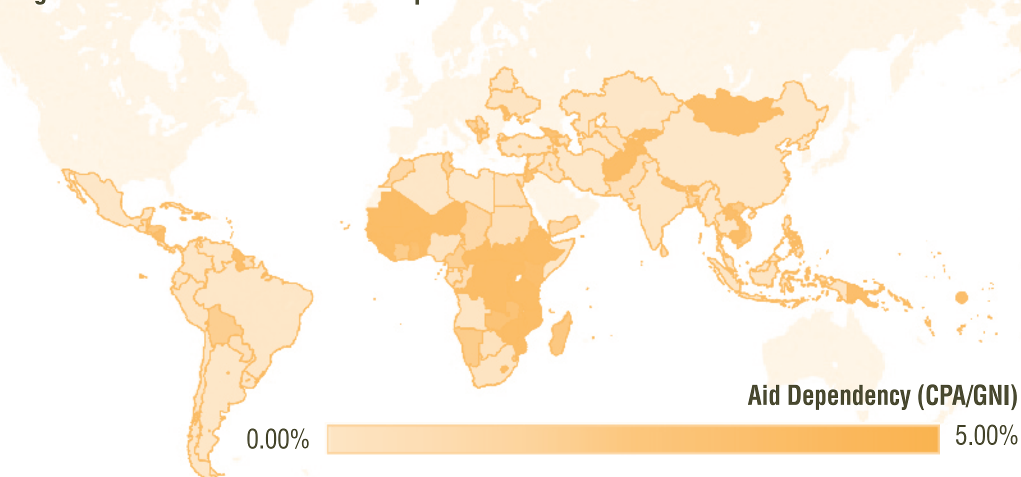
The world will have little chance of achieving the SDGs if governments of fragile countries do not develop the ability to carry out the basic functions of a successful state. The OECD's 2015 list of fragile states has 50 countries and regions, including 27 in sub-Saharan Africa, which are home to 43 percent of the world's extremely poor people.[33] Of the 1.4 billion people who live in fragile states, 424 million live in South Asia. According to the OECD, the percentage of extremely poor people living in fragile states will only increase further by 2030.[34] This increasing share of poor people living in fragile states reflects both the progress China and India have made against poverty and the struggle of fragile states to create opportunities for their growing youth populations. From 2008 to 2011 alone, 232 million people in China and India escaped from extreme poverty.[35] But in a study of fragile states where at least 40 percent of the population is younger than 15, population growth has simply meant more people living in poverty.[36]

Fragile states and stable low-income countries depend to varying extents on foreign assistance. But donor countries' assistance fluctuates. Figure 1 below shows aid dependence by country. Between 2000 and 2009, ODA per capita in fragile states roughly doubled, from almost $20 to $40 per person.[37] But this aggregate figure is misleading, because some countries receive far more than others. For example, in 2011, more than half of all ODA to fragile states went to just seven countries, leaving the remainder with less than half of 1 percent each.[38] Low-income countries with high poverty rates similarly struggle to attract ODA funds. On average, low-income countries receive less than $150 annually in ODA for each person living in extreme poverty, while lower-middle-income countries receive $300 for each of their people in extreme poverty.[39] The amount of aid donors allocate to fragile states fluctuates from year to year. For example, in 2011 donors reduced the ODA they sent to fragile states by 2.4 percent.[40] Without predictable and fairly allocated ODA, governments in fragile and stable low-income states will lack the resources they need to plan for long-term development.

Unpredictable levels of donor assistance are especially problematic because fragile and low-income states have few other financing options available (see figure 2 next page). Among developing countries, stable middle-income countries receive a disproportionate share of foreign direct investment.[41] Only 6 percent of all foreign direct investment went to fragile states in 2012. Moreover, of that 6 percent, the majority went to extractive industries in six countries.[42] Remittances are uneven as well—more than half of all remittances to fragile countries went to three countries (Nigeria, Egypt, and Bangladesh).[43] Sub-Saharan African countries in particular have a very limited number of financial institutions and lack access to outside credit. African countries are charged an interest rate spread that is 2 percentage points higher than the rate charged other low and middle-income countries.[44] Thus, lack of access to financial flows other than ODA further dims the hopes of fragile states and stable low-income countries to attract the funds necessary to achieve the SDGs.

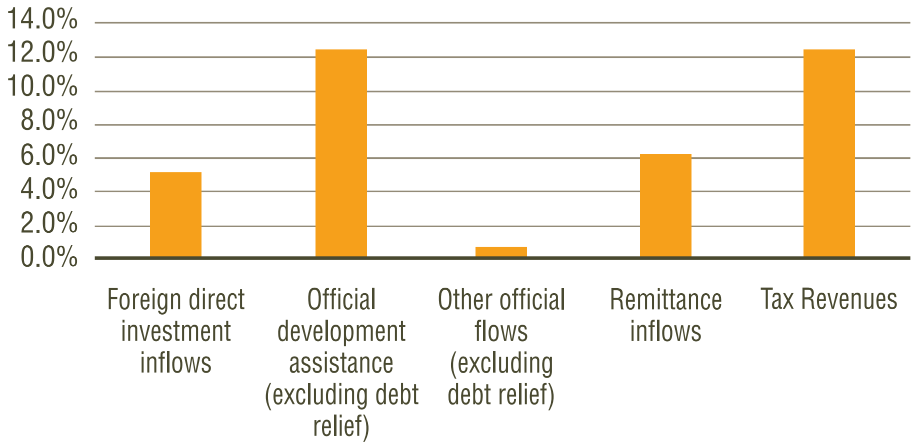
Turning to the possibilities for domestic resource mobilization reveals that the biggest DRM challenge in fragile and low-income states is collecting tax revenues. While high-income countries capture about 30 percent of their GDPs through taxation, fragile states and low-income countries on average only capture 14 and 15 percent respectively.[45] Fragile states have made some progress over the last decade in raising more tax revenue; since 2007, fragile states have had an average annual growth in DRM of 6 percent, some of which is from tax revenue. Since 2011, though, only Bosnia-Herzegovina and Kenya have crossed the threshold of collecting 20 percent of their GNI in tax revenues.[46] It's a vicious cycle, since low tax revenue means that fragile states cannot afford to fund basic public services and pay civil servants. In turn, this lack

Figure 1 The World's Most Aid Dependent Countries in 2012



Source: OECD-DAC CRS (http://www.oecd.org/dac/aid-architecture/cpa.htm)

Figure 2 Financial Flows to Fragile States in 2012 as a Percentage of GDP



Source: Author's calculation based on 2012 data from OECD-DAC CRS and the World Bank's World Development Indicators.

of services and unresponsiveness to the needs of citizens not only limit economic growth and thus tax revenues, but also destroy trust in government and thus willingness to pay taxes.

The large number of people living in fragile states and the revenue challenges of both fragile states and stable low-income countries just discussed mean that in order to be most helpful, donors should support partner countries' proposals to improve governance and build institutional capacity.

The Importance of Inclusive Institutions and Taxation for Development Success

In the past two decades, developing countries have made tremendous progress in reducing poverty and hunger. Most of this success is due to actions countries have taken and the hard work of poor people themselves. Half of developing countries will meet the MDG target of reducing extreme poverty by 50 percent, and since 1990, they have as a group lowered their percentage of malnourished children from 24 percent in 1990-1992 to 13 percent in 2012-2014.[47]

ODA has contributed to this progress, but donors do not provide sufficient resources to serve all the world's poor and hungry people, and they often target aid based on strategic considerations rather than need. Since the Paris Declaration in 2005, donors have recognized the need for developing countries to own their own development and to strengthen their institutional capacity. Countries ultimately eliminate poverty and hunger by fostering inclusive economic growth, investing in human capacity, and developing social safety nets. Inclusive growth lifts the income of society as a whole, while social safety nets ensure that the basic needs of the country's most vulnerable people are met.

Both sustainable economic growth and social safety nets require governments to develop inclusive institutions able to respond to the needs of citizens. An OECD study found that some factors matter more than others in determining which countries make significant gains against poverty. Those key factors are improvements in government effectiveness, regulatory quality, and voice and accountability.[48]

Mick Moore, CEO of the International Centre for Tax and Development, argues that when governments depend on taxes for their revenue, they have a vested interest in their citizens being economically productive.[49] If governments rely instead on natural resources for revenue, they have little incentive to invest in their citizens so that they earn higher incomes and therefore pay more in taxes. It follows that taxation can help prompt governments to develop effective and inclusive institutions. Researcher Michael Ross describes a "fiscal contract" where citizens accept higher taxes in exchange for more and better services.[50] In this scenario, if a government raises taxes, the public will demand increased government services rather than protest and call for taxes to be lowered again. However, a country must be progressing toward democracy if a fiscal contract is to be forged. Historically, among countries with similar income levels, it is the more democratic countries that achieve higher rates of taxation and provide more social services.[51]

The fiscal contract also depends, of course, on government earning the trust of its citizens. When people do not trust the government to provide services and govern effectively, they will resist taxes as unjust. During the 2000s, Ugandans and Tanzanians used their countries' move toward more competitive elections to vote against poll taxes, which voters believed placed an unfair burden on poor rural people.[52] In states with weak institutions, citizens may prefer foreign aid programs over government programs, because these weak institutions make them hesitant to trust the government to provide more services in exchange for higher taxes. In a survey of Ugandans in 2012, Milner et al. found that Ugandans saw foreign aid projects as less corrupt than government projects, and 80 percent of Ugandans wanted aid to be increased.[53] The researchers also observed that Ugandans were more willing to lobby donors for projects than their own government officials.[54] If taxation is to contribute to a more effective government, it must be based on trust and consent, not on force.

"Citizens" are not a monolith. The government may, for example, form a fiscal contract with the middle class rather than with the population as a whole. Since the middle class has more political power than the poor, it can demand a less progressive tax structure and government services that disproportionately benefit middle-class people, such as free university tuition—and sometimes get them.

As a whole, developing countries tend to have less progressive tax and expenditure systems than OECD countries. The Overseas Development Institute looked at a subsection of OECD and Latin American countries and found that OECD tax and expenditure policies reduced economic inequality by an average of 30 percent, while the policies of the Latin America sample reduced inequality by only 3.6 percent.[55] Even worse, tax policy in some developing countries, including Armenia, El Salvador, Ethiopia, Guatemala, and Peru, actually makes the extreme poor even poorer rather than providing them with resources to lift themselves out of poverty.[56] There is a risk that the poorest people will actually end up paying more in taxes as countries develop more effective tax collection systems, because they have fewer resources and less time than the middle class to lobby for lower taxes and better government services.

The concept of a fiscal contract also includes national budgets and the budgeting process. Of course, citizens can better hold their government accountable when the government makes its budgets publicly available. Public budgets force the executive branch to show legislators and ordinary people how they plan to use revenues raised through taxation or from natural resources for the public good. In post-2001 Afghanistan, the parliament has relied on the budgeting process as one of the few tools it has to constrain the executive branch. The Afghan parliament has continually rejected presidential budget requests based on the belief that the budget does not fairly allocate development funds across Afghanistan.[57] Citizens can also monitor public budgets to demand changes from the government in how it intends to allocate funds.

Participatory budgeting is a special type of budgeting that allows citizens a greater role in the budgeting process by requiring the government to allow citizens or civil society organizations to decide on some line items of the budget during public meetings. Participatory budgeting was first used in 1989 in Porto Alegre, Brazil, when the Workers' Party gave citizens a role in the budgeting process. The process resulted in improved sanitation, infrastructure, and land rights in poorer areas.[58] More generally, participatory budgeting can help poor neighborhoods access public services and reduce corruption.[59] When people play an active role in overseeing government budgets, they can demand that the government live up to the promises it made when collecting taxes.

The International Budget Partnership (IBP) found that improved budget transparency has led to higher spending on agriculture in Ghana and on education in Malawi and Tanzania.[60] More generally, IBP found that countries that have improved their budget transparency since 2008 have tended to outperform their peers on social spending and outcomes, although the relationship was not strong enough to be statistically significant.[61]

However, many developing countries provide little or no public budget information. In 2015, IBP found that only three countries in sub-Saharan Africa provided extensive or significant information about their budgets to the public.[62] When the public lacks access to basic details about the budget, people cannot, of course, demand changes in how the government spends public funds, nor can they help ensure that government expenditures reach their intended destination.

Beyond making budgets publicly available, two other strategies can help improve government accountability and service delivery: open contracting and public expenditure tracking surveys. Countries with low state capacity routinely lose government funds "along the way"—during the procurement process and the transfer of funds from the central government to local government officials. According to Transparency International, developing countries lose between 20 and 25 percent of the funds they spend on procurement to corruption.[63] "Open contracting" means that the government makes procurement contracts publicly available so that citizens can monitor the funds involved in the contract. Public expenditure tracking surveys (PETS) require the central government to track how much of its allocated funding reaches its intended destination.[64] They are often necessary to ensure that the revenue collection and budgeting processes are functioning correctly. In Uganda, when the government implemented PETS in combination with wider reforms, the amount of federal funding that reached schools increased from 13 percent to 90 percent of the amount sent.[65] Open contracts and PETS allow the public to more directly monitor the particular areas and services that matter to them.

Barriers to Taxation in Fragile and Low-Income Countries

Both fragile countries and stable low-income countries face structural economic barriers to developing effective and equitable tax systems. They may have low urbanization rates, a population skewed toward youth and children, and large numbers of people employed in the agricultural and/or informal sectors.[66] Tax bureaus in rural areas struggle to assess the production and thus the tax liability of agricultural workers, who may consume much of the food they grow and often face the threat of poverty and hunger. Economies with large informal sectors may encounter another dilemma: governments lack the information needed to assess fair taxes on informal sector businesses, yet increasing tax rates for formal sector businesses may simply push them into the informal sector.[67] In these situations, governments may be more likely to succeed in increasing their tax revenues by lowering restrictions and costs for businesses to enter the formal sector, rather than by strengthening the tax administration system.


USAID

It's important to build government's capacity to provide public services. Here, police officers in Sierra Leone are trained to manage election security.

Another barrier to collecting higher tax revenues is low public "tax morale" in many countries. When people do not believe that their fellow citizens pay taxes, they become less likely to pay taxes themselves. People also do not pay taxes when they believe their government is corrupt or will not use the tax revenues wisely. As a result, fragile states often collect taxes from only a limited number of people. In post-conflict states, a few large taxpayers, typically numbering around 300, provide most of the government's tax revenues.[68] For example, following conflicts in the Democratic Republic of the Congo, Rwanda, and Uganda, large taxpayers' contributions made up between 40 percent and 70 percent of overall tax revenues.[69] Improving tax morale requires citizens to both see the benefits of paying taxes and to believe the government will use tax dollars effectively. In Rwanda, the Rwanda Revenue Authority improved people's willingness to pay taxes by launching a public information campaign explaining how tax revenues are linked to social services such as the One Cow per Poor Family Program, which provides dairy cows to help families boost their incomes.[70] In the Philippines, the Bureau of Internal Revenue sought to convince professionals to pay taxes by launching an ad campaign showing a doctor sitting on a teacher's shoulder, symbolizing how schools suffer when doctors do not pay their taxes. Ultimately, improving tax morale requires governments to demonstrate credibly that they are fulfilling their end of the fiscal contract bargain.

Countries also face administrative barriers to effective taxation.[71] Governments often pay low wages to tax collectors, leading some to resort to corruption, and wage structures often provide no incentive for tax workers to increase collection rates. In some countries, foreign accounting firms recruit some of the best government workers. Tax bureaus may also face significant turnover—sometimes a new political party in office means turmoil because there are large numbers of political appointees. In Honduras, the entire staff of the tax bureau is replaced after virtually every election.[72] Even once a stable, experienced staff is in place, there may be barriers created by other parts of the government—for example, suppose the judicial system is reluctant to convict people who have been proven guilty of tax evasion. Effective taxation also requires well designed IT systems and regular information-sharing between tax agencies and the judicial sector. Low-income and fragile states often lack the funds and capacity to develop these. All of these factors can combine to create tax bureaus whose staff lack the capacity and/or the motivation to increase tax collection rates.

Donors often prefer projects that help governments remove administrative barriers to taxation since this does not require wider, more ambitious political reform. But this will accomplish little if a country has not first developed the political will and political coalitions to support tax reform. There must be government leaders who seek to reform tax policy and create more effective tax collection systems. Unless they operate in an authoritarian context, tax reform leaders also need wider coalitions to support them.

Countries that lack well-developed political parties and political coalitions that can connect the public to their government tend to have lower rates of tax compliance. When taxpayers evade paying taxes, they signal their lack of support for the government. Political coalitions, however, unite disparate groups in society around common interests.

Researchers found both in South Africa and Brazil that racial and regional based coalitions accepted higher tax rates because they saw taxes as benefiting their own identity group.[73]

Using tax policy for political gain is, of course, inimical to tax reform. Which people pay taxes and which people receive tax exemptions mirror a government's larger relationship to society.[74] Governments may use tax exemptions as a way to show favoritism, ensuring that their supporters within certain industries do not pay taxes. Even if countries develop more effective tax bureaus, such as Peru and Uganda did in the early 1990s by designating independent revenue authorities, governments can weaken them again when public opinion turns against higher tax rates.[75] In sum, developing effective tax systems cannot be divorced from the political environment in which the tax bureaus *operate*.

Low tax collection rates are not the result solely of developing countries' policies—in many situations, this is far from the truth. Extractive industries and international corporations contribute to the tax struggles of fragile states and stable low-income countries. The ONE Campaign estimates that developing countries as a whole lose $1 trillion a year in illicit flows from their economies to holdings outside their borders—losses caused by tax evasion, non-transparent natural resources deals, and money laundering.[76] While only a portion of those flows would have been tax revenue—the rest of the money has in effect been taken from the population as a whole—illicit financial flows are accompanied by lower rates of investment in developing economies.

Citizens of countries that are low-income but resource rich suffer the most from illicit flows.[77] They lose access to natural resource revenues if corrupt government officials use non-transparent deals for self-enrichment and also if their government lacks the necessary expertise to negotiate fair revenue sharing agreements. One effort to prevent these losses is the Extractives Industries Transparency Initiative, which aims to increase revenues for resource rich countries by requiring both corporations and governments to report how much money the governments receive in payments from revenue sharing agreements. But the initiative does little to increase the capacity of governments to negotiate fair revenue sharing agreements in the first place.[78]

Developing countries as a whole also suffer higher levels of corporate income tax evasion than developed countries. Developing countries receive limited revenues from personal income taxes and property taxes, so they are more dependent on corporate income taxes for revenue. But corporations have several options to reduce their tax payments to developing countries, including treaty shopping, transfer pricing, and tax havens.[79] Multinational corporations provide products and services that rely on operations in several countries, so they must price their products and services at each stage of the production process. Corporations can significantly reduce the amount of taxes they pay in developing countries by the way they choose to determine their transfer pricing. Corporations tend to have the best tax compliance in the country where they face the biggest risk of audit, which means that in practice they are likely to pay more taxes to wealthy rather than developing countries.[80] Christian Aid estimates that developing countries lose $160 billion a year due to transfer mispricing, while the IMF has put that figure at $212 billion per year.[81] If developing countries could prevent transfer mispricing, estimates are that they could gain an average of an additional 10 percent in tax revenues.[82]

However, at the Financing for Development conference in July 2015, wealthy countries resisted attempts by developing countries to gain more control over international tax policy and information sharing.[83] The OECD currently has the most power to determine international tax issues, although the U.N. Committee of Experts on International Cooperation in Tax Matters, as the name indicates, also deals with tax cooperation. India and other developing countries proposed elevating the role of the U.N. Committee of Experts, enabling it to focus on issues that impact developing countries such as illicit flows from extractive industries, transfer pricing, and tax evasion.[84] This would have shifted the power to make decisions on tax issues from industrialized OECD countries to developing countries. However, the United States, the United Kingdom, and Japan opposed this proposal and eventually prevented the U.N. Committee of Experts from being upgraded to a U.N. agency. Unless developing countries win a larger role in international tax policy and information sharing, the international tax system will likely continue to favor wealthy countries.

Donor Initiatives on Tax Administration

Donors have pursued tax administration reforms in a variety of country contexts, although ODA for DRM represents a small portion of donors' overall spending. Donors have supported DRM in stable low-income countries such as Tanzania and Ghana, post-conflict fragile states such as Liberia and Afghanistan, and other fragile states such as Zimbabwe. The OECD estimates that the share of ODA specifically for DRM rose from 0.05 percent in 2006 to 0.22 percent in 2012.[85] Development Initiatives drew on the OECD data to estimate that in 2011, donors spent $700 million in 75 developing countries on projects that had DRM as either a primary or secondary objective.[86] Development Initiatives found that the U.K. was the largest donor for core DRM in absolute terms, followed by the EU and Germany.

The United States was the seventh-largest donor for DRM.[87] Based on the OECD data, donors provided the majority of ODA for DRM support to countries with the lowest level of government expenditures (in the category of less than $500 per person).[88] While all these numbers suggest that donors could devote more resources to DRM and tax mobilization, we do not have data on donors' capacity to provide more technical assistance or on how many countries may be able to make immediate use of increased assistance.

Donors typically provide aid for tax administration projects in the form of technical assistance (TA) missions—45 percent of the total in 2011.[89] The IMF has found that long-term technical assistance missions allow advisers to better support partner countries, although short-term TA missions can also be helpful in identifying weaknesses in tax policy and tax collection methods. Long-term TA missions can support tax reform by, for example, advising countries on reforming their court systems; developing the capacity of the Ministry of Finance to conduct tax analysis; improving the tax bureau's practices in human resources, auditing, and risk management; installing new IT systems; and implementing systems for e-filing of tax returns.[90] The World Bank Independent Evaluation Group has concluded that such technical assistance missions tend to enjoy more support within partner governments than other governance-assistance programs since they generally see tax reforms as less threatening to existing political coalitions.[91] Donors should, however, seek to ensure that tax programs complement wider governance programs.

A typical tax reform effort begins with either the IMF or a donor agency assessing a country's overall tax system. The IMF has the most expertise in conducting such a tax diagnosis, and it is active in more than 120 countries.[92] During short-term TA missions, the IMF uses a tax diagnostic tool to assess how a country's tax system is functioning and whether there are readily identified weaknesses. Starting in November 2015, the IMF and the World Bank will begin using a new tool, the Tax Administration Diagnostic Assessment Tool.[93] Once the IMF completes its tax diagnosis, it seeks to connect countries with donors that can provide long-term technical assistance in implementing reforms.

The IMF usually recommends that countries simplify and broaden their value-added tax system, reduce the number of tax exemptions, and, often, reduce overall tax rates.[94] The IMF prefers to recommend reforms that reduce distortions to economies rather than those that would help create a progressive tax system, such as through the establishment of an income tax and property tax system.[95]

Bilateral donors such as the U.S. government fund some tax reform programs directly. Bilateral donors can also provide general budget support for finance ministries and tax bureaus, sector budget support such as for public finance management, basket financing which funds specific programs, multi-donor trust funds, and off-budget funding as part of bilateral projects. The U.S. government also funds multilateral development banks that provide tax reform assistance, including the IMF, the World Bank, the African Development Bank, and the Inter-American Development Bank. Regional organizations such as the Inter-American Center for Tax Administration and the African Tax Administration Forum provide South-South assistance.[96] Another resource is the OECD Base Erosion and Profit Sharing project, which shares information on how corporations are conducting transfer pricing.

Among donor-funded tax reforms, partner governments and donors have made little effort to measure how tax reforms impact economic inequality within their countries. This impact is important but rarely measured. It requires governments to do a joint analysis of tax payment and the receipt of social services to see how inequality is impacted by government tax and expenditure policy.[97] Donors tend to fund DRM in countries with good governance environments and whose governments are committed to reform. As a result many of the tax reforms are likely to reduce inequality, although this does not guarantee that they will be pro-poor.

Measuring inequality further matters because countries with high levels of inequality may lack the political coalitions necessary to sustain good governance. In sub-Saharan Africa, many countries have extremely high levels of inequality. The low tax revenue rates as a percentage of GDP reflects that elites within these countries often pay little taxes. This is evident in the tax exemption policies of governments, which reward the political allies of elected officials. Yet since donors and partner governments do not measure the relationship between tax reforms and economic inequality, the full impact of tax reforms in creating pro-poor outcomes and sustained political will cannot be assessed.

Existing U.S. Efforts on Tax Reform

The U.S. Treasury Office of Technical Assistance

Within the U.S. government, a group in the U.S. Treasury's Office of Technical Assistance (OTA), the Revenue, Policy, and Administration team, shares responsibility with USAID for carrying out projects that help countries improve their tax administration. Other U.S. government agencies, the IMF, and U.S. embassies often help establish contact between foreign tax authorities and the OTA, but the OTA team only provides technical assistance upon receiving a formal request from a government. In response to a request, the OTA team meets with the government's tax bureau officials to evaluate their goals and current capacity and OTA's ability to assist.[98] Before entering into an agreement for technical assistance, the OTA team verifies that the country meets corruption criteria and that the tax officials have the support of key political officials. OTA then either provides a long-term advisor or establishes a program of short-term advisors.

The OTA team provides various types of technical assistance, including improving audit practices, arrears management, risk management, anti-corruption efforts, using new IT systems, and the functioning of large taxpayer units.[99] The OTA does not work on tax policy changes, although it may advise on improving how other government agencies share information with tax bureaus. The scope of OTA programs is limited by resources; on average, OTA projects cost $550,000 a year, which makes large-scale reforms such as the introduction of a new IT system cost-prohibitive.[100] Wider scale tax reforms require funding from USAID or the Millennium Challenge Corporation (MCC), which may use OTA as a sub-contractor for technical assistance.

The OTA Revenue and Policy Administration team has experience in advising fragile and low-income states. In 2015, the OTA had ongoing tax projects in 15 countries, including 10 fragile countries and 9 low-income countries (see table 1 for details). Most of these countries, however, outperform their peers on the MCC country scorecard, which assesses a country's commitment to ruling justly, investing in people, and encouraging economic freedom.[101] Eight of OTA's partner countries pass the MCC scorecard and 13 perform above the median in half the indicators used on the MCC scorecard. The fact that OTA partner countries are relatively well governed reflects the fact that governments need resources and staff if they are to commit to reforms. Poor countries with very low rates of tax collection often simply lack the resources and capacity to commit staff to reform efforts rather than to their main tax-collecting responsibilities.

Table 1 Overview of Countries with 2015 OTA-Funded Technical Assistance for Tax Reform

Country	Fragile Status	Income Status	Democratic Threshold	Corruption Threshold	Pass half of Indicators
Burma	Yes	LMIC	No	No	No
Cambodia	Yes	LIC	No	No	Yes
Georgia	No	LMIC	Yes	Yes	Yes
Guatemala	Yes	LMIC	Yes	No	Yes
Haiti	Yes	LIC	Yes	No	Yes
Liberia	Yes	LIC	Yes	Yes	Yes
Malawi	Yes	LIC	Yes	Yes	Yes
Mongolia	No	UMIC	Yes	Yes	Yes
Niger	Yes	LIC	Yes	Yes	Yes
Paraguay	Yes	UMIC	Yes	No	Yes
Rwanda	Yes	LIC	No	Yes	Yes
Tanzania	No	LIC	Yes	Yes	Yes
Ukraine	No	LIC	Yes	Yes	Yes
Zambia	Yes	LIC	Yes	Yes	Yes

USAID

USAID has more funds than OTA for larger-scale tax reforms. USAID has DRM projects in about 11 countries at any given time, which in total have a budget of about $20 million a year. Two of the most successful projects so far have been in El Salvador and Georgia. In addition to El Salvador and Georgia, USAID has also supported tax reform in post-conflict countries such as Bosnia and Herzegovina, and the agency has a long history of activity in public financial management.

In El Salvador, USAID supported the Directorate General for Internal Taxes to install a new IT system, create a taxpayer assistance center with a network of regional offices, and establish a taxpayer advocate unit.[102] In Georgia, USAID supported the Climate Reform Project (2005-2009), which funded an e-filing tax system that helps prevent tax collectors from seeking bribes.[103] USAID also assisted Georgia's Ministry of Finance in creating a legal framework to support information sharing among taxpayers, the financial sector, and tax officials.

USAID explains that its tax reform programs in El Salvador and Georgia demonstrate how ODA for tax mobilization can significantly increase the government revenue that is available for social spending. According to USAID, the $5.8 million it has invested in El Salvador's tax reforms since 2004 led to a $350 million increase in the country's annual tax revenue and a $160 million increase in annual social spending.[104] Following Georgia's 2004 "Rose Revolution," USAID's investments in the country's tax reforms, along with those of the IMF and the EU, resulted in an increase in the ratio of tax revenue to GDP—specifically, from 12 percent of GDP to 25 percent.[105]

The situations in El Salvador and Georgia, however, had one relatively unusual factor in common: new governments had recently come to power that were publicly committed to eliminating corruption and increasing social spending. Georgia in particular was a best-case scenario for DRM. Georgia has made rapid improvements in government processes such as regulation; in fact, its average rate of improvement in the World Bank's evaluation of country regulatory quality and government effectiveness put it among the world's top three countries over the 1996 to 2012 time period.[106] The OECD paper on DRM success stories, released to build support for the July 2015 Addis Tax Initiative, further demonstrates the uniqueness of the Georgia and El Salvador cases. In the seven success case studies, the OECD found that tax revenue as a percentage of GDP increased far more slowly on average, taking 5 to 10 years to achieve an increase of 2 to 5 percentage points[107] (e.g., increasing from 12 percent of GDP to 16 percent). These are genuine successes, but they are modest.

The Millennium Challenge Corporation

The Millennium Challenge Corporation (MCC) works on longer-term projects with IDA-eligible countries that are committed to good governance and investing in their people. The MCC country scorecard assesses the government's performance in protecting citizens' political and civil rights, providing social services, and promoting a free market economy. [108] Countries need to score above a specific threshold in control of corruption, in democratic political rights or civil liberties, and should ideally score above the median country in their income group for half of all scorecards indicators to be eligible for a compact.

When it comes to ODA for tax reforms and other types of DRM, however, MCC requirements often exclude countries that have low tax mobilization rates. For example, countries that raise little tax revenue but fail the corruption or political and civil rights hurdle, such as Ethiopia and Nigeria, cannot receive country compacts. Some that are close to being eligible for a compact can qualify for the MCC's threshold program, which supports countries in improving in their areas of weakness so that they can later receive full compacts. In the Philippines, the MCC entered into a $21 million threshold agreement in 2006 to help the government reduce corruption by strengthening the ability of the Office of the Ombudsman to prosecute corrupt government officials and tax evaders.[109] In 2015, the MCC similarly signed a $28 million threshold agreement with Guatemala that focuses on DRM for spending on social services.[110] If the MCC had greater funds for threshold agreements, it could use the agreements to expand the number of countries with low tax mobilization rates that are compact eligible.

So far, the only full MCC compact that includes DRM through tax improvements is with the Philippines. The country qualified for a compact in 2011, signing a five-year $434 million agreement[111] that includes a Revenue Administration Reform Project (RARP). The MCC and the Philippines government funded RARP as part of the compact because the MCC's analysis confirmed the view of the IMF and Asian Development Bank that the government's lack of domestic revenues impeded the Philippines' growth. RARP has promoted reforms within the Bureau of Internal Revenue to improve its VAT audit, arrears management, and tax compliance efforts. The compact also includes support to improve the country's tax administration platform and software, use automated auditing tools, and launch a new public awareness campaign.[112] Under the RARP, the MCC does not directly provide TA but rather pays for TA advisors provided by both the IMF and the OTA. The RARP project is one of three in the Philippines' compact; the others support road construction and a range of community-sponsored development projects. The compact is managed by an independent entity, Millennium Challenge Account–Philippines, which is responsible for contracting and oversight.

The MCC's use of growth constraint analysis when deciding on priority sectors for compacts has meant that it often focuses on projects other than DRM. Before signing a compact, the MCC uses growth constraint analysis to determine what factors prevent countries from achieving higher growth rates that would lead to poverty reduction. Many MCC compact countries face constraints on their growth rates that are not directly related to revenue collection although likely related to public expenditures, such as a lack of infrastructure or access to electricity. For example, under the Ghana compact, the MCC has primarily funded improvements to the country's power sector.[113] However, the MCC could still pursue DRM projects without abandoning its use of growth constraint analysis by encouraging all projects to have a DRM component.

The President's Emergency Plan for AIDS Relief

In its current—third—phase of operations, the President's Emergency Plan for AIDS Relief (PEPFAR) has begun to focus on using DRM to increase the sustainability of its programs.[114] PEPFAR's annual $6.5 billion budget supports programs in 29 countries, the majority in sub-Saharan Africa.[115] Phases I and II of the program, from 2003 to 2012, focused primarily on HIV/AIDS prevention and treatment rather than on building health systems.[116]

In September 2014, Secretary of State John Kerry announced that PEPFAR would commit $63 million over three years to help Kenya, Tanzania, Zambia, Nigeria, and Vietnam conduct DRM in order to sustainably finance their own HIV/AIDS programs.[117] Tanzania is a low-income country, but the others are lower-middle-income countries; these generally have more resources and capacity to sustain complex new initiatives such as a national HIV/AIDS effort.

PEPFAR has sought to use its DRM funds to increase the country ownership of its program rather than to encourage countries to collect more tax revenue. As part of this approach, PEPFAR will use the DRM funds to enable countries to raise their own resources, ensure those funds reach their intended destination, and help countries to conduct analysis to ensure funds are spent in areas where they will have the largest impact on HIV/AIDS treatment. None of the initial five countries that PEPFAR chose for DRM efforts have requested help on tax reforms since they have other development priorities beyond fighting HIV/AIDS. For example, PEPFAR is using its DRM funds in Vietnam to help the country extend health insurance coverage to a wider portion of the population, which could ensure that HIV positive individuals are tested and receive treatment. In Kenya, PEPFAR will use the DRM funds towards basic capacity building of district governments to combat HIV/AIDS since the central government has devolved authority to the district level. Although PEPFAR has the freedom to pursue DRM due to its large budget, its effort to go beyond tax collection reflects how developing countries face many constraints to effective expenditures.

PEPFAR has created a sustainability index to measure progress on partner countries' taking ownership of their HIV/AIDS initiatives. The index assesses to what extent countries are producing and managing data, providing services, financing and providing strategic investments, following principles of accountability and transparency, and demonstrating political will to manage and support the programs. PEPFAR piloted an initial version of the index and is now working on a second draft. Researchers, governments, and people in recipient countries do not yet have access to the index and its data on progress in promoting sustainability.

The State Department

While the State Department does not support tax reform initiatives, its responsibilities include making an effort to promote fiscal transparency overseas. Under the annual State, Foreign Operations, and Related Programs Appropriation Act, Congress mandates that the State Department assess the fiscal transparency of governments that receive foreign assistance funds from the U.S. government. Governments that receive aid are required, at a minimum, to make publicly available budget documents that show expenditures at the ministry level and the sources of revenue. Budgets must also be reliable and complete, with the proposed budget, the enacted budget, and an end of the year report all included. Governments that receive revenue from extractive industries must make publicly available contracts and licensing for natural resources.

In 2012, the State Department began publishing an annual fiscal transparency report that assesses countries' progress on various elements of budget and natural resource transparency.[118] The 2015 report found that only nine countries had made progress on fiscal transparency.[119] As yet, the State Department has done little to promote media coverage of its annual fiscal transparency review, or to criticize governments for failing to show progress on budget transparency—in contrast to the publicity surrounding the agency's more established annual report on human rights.

USAID

U.S. Secretary of State John Kerry plays with a young child whose family has received treatment at a PEPFAR-supported HIV clinic in Addis Ababa, Ethiopia.

The U.S. Government and the Way Forward with the Addis Tax Initiative

Under the Addis Tax Initiative, the United States and other donors committed to doubling their support for technical cooperation on taxation systems by 2020, in exchange for partner countries' agreement to use DRM as a way of achieving the SDGs.[120] Donors agreed to fund significant capacity building for tax administration and support for revenue management of natural resources to countries that demonstrate good financial governance and that commit to achieving the SDGs. Donors also pledged to support regional and international tax bodies, adhere to the OECD's Principles for International Engagement in supporting partner countries in revenue matters, and better integrate partner countries into the global tax discussion. Partner countries recognized that DRM requires political will and strong domestic governance. They also agreed to use additional revenue for public services in accordance with their national SDG targets. Both donors and partner countries agreed to support policy coherence on tax laws and to apply the principles of transparency, efficiency, effectiveness, and fairness.

As part of the U.S. government's increased commitment to DRM, both USAID and OTA are seeking to increase the funds they will devote to tax revenue mobilization. Both the Senate and House Appropriations Subcommittees on State, Foreign Operations, and Related Programs have released statements in support of developing countries' increasing their own spending for development.[121] Yet only the Senate foreign operations subcommittee has called on USAID to create a plan to fund DRM projects. While USAID's level of funding for DRM is still in doubt, the Treasury has already committed to doubling the OTA's budget.

USAID and OTA are the right agencies to lead the U.S. government's increased efforts on DRM. USAID and OTA have a longer history of conducting tax reform assistance programs than any other agency of the U.S. government agency, and OTA is the premier technical assistance unit on tax issues within the government.

The U.S. government should use the Addis Tax Initiative to link taxation reform to better expenditure policies. Under the initiative's annex of principles, donors and partner countries are committed to creating fair, efficient, and transparent tax systems that have equitable tax burdens and benefits along with equitable delivery of services. However, assessing the fairness of tax burdens will be easier than evaluating the fairness of tax benefits. While partner countries made a commitment to transparency in their tax systems, they made no similar commitment to transparency in budgeting and expenditure policy. Additionally, some of the partner country signatories have demonstrated only a limited commitment to transparency and freedom of information. Freedom House ranks several of the partner countries' presses as either not free or only partly free.[122] The U.S. government should encourage countries to make a greater commitment to freedom of information and to budget transparency so that their citizens can assess the fairness of tax policy and tax benefits.

Conclusion and Policy Recommendations

The U.S. government can use ODA for DRM in a variety of country contexts to help ensure that all countries achieve the SDGs. U.S. donor agencies are most likely to successfully use ODA for DRM-driven development in countries with good governance whose political leaders have committed to transparency and to eliminating or significantly reducing corruption. This was the case in the Philippines, which also had better scores on governance indicators than many other low-income countries[123] and a high economic growth rate. All three factors helped the country increase its tax revenue collection. It follows that tax reforms for DRM in other countries are likely to be more difficult.

If the U.S. government limits ODA to strengthen taxation and other forms of DRM to countries that already have

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Urbanization necessitates stronger infrastructure—for example, multiple reliable routes for food to reach the growing number of people who do not grow it themselves.

favorable environments, many countries are likely to be left behind. Thus, the U.S. government should develop a DRM program that is appropriate for the environment in each country that requests assistance.

> **Recommendation 1:** In fragile states, the goal should be to ensure that tax collection is fair, transparent, and helping to enhance, not weaken, government accountability for spending public funds and providing public services. The United States should enhance funding for expenditure tracking surveys, participatory budgeting, and citizen scorecards in fragile states that do not yet demonstrate a strong commitment to reform.

For countries to use tax revenues to achieve the SDGs, they need to develop inclusive institutions. To complement DRM for tax reform, the U.S. government can use foreign aid to promote and expand transparent and democratic institutions. In the 2015 Quadrennial Diplomacy and Development Review (QDDR), the State Department and USAID identified "promoting open democratic societies" as a core strategic priority. As the QDDR pointed out, "We know from experience that a lack of pluralism, transparency, and democracy exacerbates instability and violent extremism, suffocates inclusive economic growth, and is inconsistent with the advancement of human rights."[124]

However, in recent years Congress and the White House have not placed a similar priority on creating inclusive democratic institutions. Since 2009, the U.S. budget for democracy, human rights, and governance has been cut by 38 percent overall (by about 20 percent when the funding cut for programs in Iraq and Afghanistan is not included).[125]

> **Recommendation 2:** The United States should take steps to ensure that its development assistance helps strengthen institutions and administrative capacity, builds the capacity of local civil society, and promotes a better enabling environment for domestic resource mobilization.

It is important to note as well that ODA will still be critical to achieving the SDGs in many cases, even in nations that are successful in significantly increasing DRM, especially in low-income and fragile countries that lack the resources needed to achieve the SDGs.

> **Recommendation 3:** The U.S. government should commit to continue to increase official development assistance.

The success of the Addis Tax Initiative depends on countries' success in creating equitable tax systems and redistributing additional revenue to services for poor people. However, governments do a poor job of measuring how their tax and expenditure policy impacts economic inequality. Reducing economic inequality matters, both for achieving pro-poor outcomes and for creating the inclusive institutions necessary for long-term economic growth.

> **Recommendation 4:** The United States should support and make publicly available tax and expenditure analysis in the DRM projects that it funds.

> **Recommendation 5:** The success of DRM projects should be evaluated based on progress in reducing economic inequality and improving budget transparency.

By emphasizing fiscal transparency, the State Department can help create new norms that will establish more enabling environments for DRM. U.S. influence is otherwise limited. The U.S. government's budget for DRM is small compared to overall aid flows, meaning that partner governments will not fear losing DRM funds if they do not commit to transparency. Another risk is that countries will be tempted to cheat on budget scoring—rather than promote reforms—if DRM funds are tied too tightly to a high budget transparency standard.

> **Recommendation 6:** The State Department should more heavily publicize its annual fiscal transparency review and should be more transparent about the methodology it uses to determine countries' progress.

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