

Fiscal Contracts and Local Public Services: Bridging Tax Justice and Inclusive Cities for the New Urban Agenda

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ABSTRACT

The task of financing inclusive urban development has been one of the largest challenges facing the implementation of the New Urban Agenda (NUA)— yet Habitat III discussions on this issue reveal an apparent neglect of concerns bearing upon tax justice. Situating itself in the midst of debates concerning Habitat III and the post-2015 Financing for Development agenda for cities and local governments, this report furnishes a review of these overlooked challenges as well as strategic responses for funding the long-term attainment of fair, inclusive and sustainable cities, insofar as progressive public revenue sources are concerned.

Focusing on pressing fiscal issues such as tax competition, tax avoidance, fiscal austerity, constraining investment agreements, uneven fiscal decentralization, and compromised local institutional fiscal capacity, the report finds that multi-level institutional reform addressing adverse fiscal governance processes from the global to municipal levels will be of paramount importance for empowering existing public revenue-raising systems to finance the NUA in inclusive directions. While there are no quick-fixes for strengthening municipal revenue-raising systems, policy options in relation to local taxation nonetheless exist, which, if coupled with the formation of mutually-beneficial state-citizen fiscal contracts, can promise improved revenue-raising, fiscal stability, and significant pro-poor and governance benefits for local governance. Lessons from experiences with national and local fiscal reform can serve to guide government officials, civil society organizations and trade unions' efforts for promoting such contracts, and creating durable political and institutional foundations for financing equitable and sustainable urban development in both the Global North and South.

I. INTRODUCTION

At no point since the 1990's have cities and urban regions been more prominent in the global governance community. On one hand, following years of advocacy by urban development experts and transnational urban movements, the post-2015 development agenda has been crafted with a landmark Sustainable Development Goal (i.e. SDG 11) dedicated explicitly towards making cities more “*inclusive, safe, resilient and sustainable*”¹. On the other, with negotiations for the 3rd United Nations Conference on Housing and Sustainable Urban Development (Habitat III or HIII) having concluded in October 2016, the global community has approved a New Urban Agenda (NUA) aimed at formulating a common framework for addressing the most pressing urban challenges of the 21st century. Due to these and other developments, urban questions have moved to the front and center of the global development agenda, particularly in 2016: as voiced by Leilani Farha, the UN's Special Rapporteur on the Right to Adequate Housing: “*While the SDG's took the first step in demonstrating international commitment to addressing housing and urban challenges, Habitat III will be crucial in defining concrete frameworks and approaches to achieve these goals and targets.*”²

The critical question is: how will resources be mobilized for all these promised interventions, especially at the municipal level? The theme of funding local quality public services, infrastructure and development interventions has been a fixture within the HIII debate, with numerous discussions linked to the conference's preparatory process having endorsed the strengthening of municipal financing systems as a key pillar of the global urban agenda. Last March 11, 2016, for instance, the Mexico City Declaration for the HIII Thematic Meeting on Financing Urban Development indicated: “*Central government agencies alone will not be able to secure the investment necessary for the green cities that we need across the world... Business as usual will not provide towns and cities with the finance they need [for the post-2015 agenda].*”³ This same focus has likewise been reaffirmed in the final adopted draft of HIII's NUA, which recognized “*effective, innovative and sustainable financing frameworks and instruments enabling strengthened municipal finance and local fiscal systems*” as one of its four “*fundamental drivers of change.*”⁴

To be sure, engaging with multiple sources of development financing— spanning from the international to local levels, the public, private and social sectors, as well as endogenous and exogenous resources— will be crucial to crafting a comprehensive and coherent funding framework for the post-2015 agenda. Yet while proposals forwarded by the NUA are commendable for attempting to touch upon all these facets of the transnational urban funding challenge, a number of independent observers and participants within the HIII process have nonetheless contended that serious institutional and political obstacles continue to stand in the way of adequately financing a sustainable and equitable global development agenda for cities. For one, just as during the 2015 UN International Financing for Development (FfD) Conference at

¹ Carey Biron, “Long-awaited SDG's negotiating text includes landmark goal on cities,” *Citiscopes*, <http://citiscopes.org/habitatIII/news/2015/06/long-awaited-sdgs-negotiating-text-includes-landmark-goal-cities> (Accessed December 4, 2016)

² Leilani Farha, “A Step in the Rights Direction: Housing in the New Urban Context,” *United Nations Office of the High Commissioner for Human Rights*, <http://www.ohchr.org/FR/NewsEvents/Pages/DisplayNews.aspx?NewsID=16779&LangID=E> (Accessed December 4, 2016)

³ United Nations Conference on Housing and Sustainable Urban Development Thematic: Meeting on Financing Urban Development, *Mexico City Declaration for Habitat III Financing Urban Development: The Millennium Challenge*, 9-11 March 2016, http://www.fmdv.net/fileadmin/user_upload/documents/Mexico_City_Declaration_for_Habitat_III.pdf, 1 (Accessed December 4, 2016)

[Hereinafter Habitat III Mexico Declaration]

⁴ United Nations Conference on Housing and Sustainable Urban Development, *New Urban Agenda: Quito Declaration on Sustainable Cities and Human Settlements for All*, concluded 10 October 2016, 5 [Hereinafter New Urban Agenda]

Addis Ababa, much policy discussion during HIII— particularly among G20 governments and multilateral development banks— has seemingly granted less attention to international aid commitments for urban initiatives and established public-based modes of funding local infrastructure and service delivery responsibilities, in favor of business-oriented and mixed public-private financing strategies⁵. This has occurred even while HIII negotiations have sidestepped several prominent challenges severely constraining governments’ capacities to raise necessary public revenues, such as but not limited to large-scale global tax avoidance, multi-level tax competition and the widespread adoption of austerity-oriented fiscal regimes at national and local levels of government⁶.

Within this context, this report furnishes a review of various existing challenges as well as strategic responses and options for funding the long-term attainment of fair, inclusive and sustainable cities, insofar as local public revenue sources are concerned⁷. Situating itself in the midst of ongoing debates concerning HIII, global tax justice as well as the post-2015 FfD agenda for cities and local governments, the paper argues that the long-term realization of well-serviced, public and inclusive cities fundamentally hinges on attaining effective and publicly-legitimate fiscal systems at different layers of governance, spanning from local tax processes to the formulation of international tax and investment agreements. While doing this will necessarily entail the adoption of various policy strategies for upgrading multi-level fiscal arrangements, no less critical to ensuring the coherence and durability of such interventions will be the realignment of fiscal relations between government bodies, citizens, trade unions, civil society, businesses, and other key urban actors in processes of bargaining over tax and public spending-related matters.

The report proceeds in four parts. Following this introduction, the paper proceeds in Section II to examining the Habitat III process in order to contextualize several critical, yet still neglected, public financing issues generally involved in implementing the NUA and broader urban development. Section III afterwards discusses key reform directions for addressing these challenges in a manner conducive for attaining fair and inclusive cities. Section IV, in addition to summarizing the overall arguments made throughout the paper, offers several practical guidelines central, local and regional governments, civil society organizations and trade unions on how to establish fiscal contracts that can serve as a durable political foundation for financing equitable and sustainable urban development in localities in both the Global North and South.

II. HABITAT III AND THE LOCAL PUBLIC FINANCING CHALLENGE IN CONTEXT

⁵ Naki Mendoza, “Lessons Learned at Habitat III,” *Devex International Development*, 24 October 2016 <https://www.devex.com/news/lessons-learned-at-habitat-iii-88986> (Accessed December 4, 2016)

⁶ Habitat III General Assembly of Partners, “Trade Union and Workers’ Group Response to the Habitat III Zero Draft of the New Urban Agenda,” *Public Services International*, http://www.world-psi.org/sites/default/files/attachment/news/tuw_group_response_to_the_nua_zero_draft_2.0.pdf (Accessed December 4, 2016)

⁷ **NOTE:** While municipal finance systems comprise four major components (i.e. expenditures, revenues, financial management, and borrowing), and while distinctions are often made of infrastructure financing systems which entail large upfront capital costs, this report focuses on the revenue-raising dimension of municipal financing, encompassing transfers and own-source revenues. The reason for this is because substantial and sustainable access to most other financing mechanisms (i.e. borrowing, municipal bonds, public-private partnerships, pooled financing, municipal development funds, etc.) remain predicated on local and regional governments’ assembling a robust and stable revenue base. Generating increased municipal revenues, in this regard, can be justifiably seen as the foundation for municipal fiscal health, as has been recognized by numerous HIII players.

Concluded last October 20, 2016 in Quito, Ecuador, the HIII process represents the first major opportunity in twenty years for the international community to take stock of global urban trends and to formulate a collective, if non-binding, framework for pursuing sustainable urbanization over the next few decades, particularly in developing country contexts. Having brought together more than 40,000 people from various sectors in 167 countries— the greatest degree of participation yet at a single United Nations summit—, the outcomes of the conference have been particularly lauded for espousing a more comprehensive and holistic approach to the multifaceted dimensions of urbanization processes,⁸ while making historic references to the notion of the “*Right to the City*” for all urban dwellers at the forefront of the NUA’s “*shared vision*” for urban development⁹. In addition, several dozen commitments towards promoting economically-dynamic, inclusive, resilient and sustainable urban development are woven into different segments of the 20-page outcome document, such as but not limited to the specific pledges displayed in Table 2.1. In all these, the NUA presents itself as heralding a “*paradigm shift*” in the cities and human settlements are planned, financed, developed, governed and managed over the next two decades¹⁰.

Table 2.1. Selected Commitments from the New Urban Agenda

| Transformative Commitments for Sustainable Urban Development | | |
|--|---|--|
| <i>Leave no one behind, ensure urban equity and eradicate poverty</i> | <i>Achieve Sustainable and inclusive urban prosperity and opportunities for all</i> | <i>Foster ecological and resilient cities and human settlements</i> |
| <ul style="list-style-type: none"> “promoting national, subnational and local housing policies that support the progressive realization of the right to adequate housing” (par. 31) | <ul style="list-style-type: none"> “promoting access to adequate, inclusive and quality public services; a clean environment... ; and social infrastructure and facilities” (par. 55) | <ul style="list-style-type: none"> “supporting local provision of goods and basic services and leveraging the proximity of resources” (par. 70) |
| <ul style="list-style-type: none"> “promoting safe, inclusive, accessible, green and quality public spaces” (par. 37) | <ul style="list-style-type: none"> “promoting, as appropriate, full and productive employment, decent work for all and livelihood opportunities in cities and human settlements” (par. 57) | <ul style="list-style-type: none"> “promoting international, national, subnational and local climate action, including climate change adaptation and mitigation, and supporting the efforts of cities and human settlements, their inhabitants and all local stakeholders to be important implementers” (par. 79) |

Source: New Urban Agenda

This is not to say that the HIII process and the NUA have thus far evaded criticism. To be sure, numerous critics and participants have lamented the overly-general language of the NUA, its dearth of concrete and immediate proposals for action, its uneven harmonization with the other major post-2015 agreements (i.e. the SDG’s, Paris Agreement, and the Addis Ababa Action Agenda), and its dependence on expert inputs as opposed to grassroots and local decision-maker

⁸ **NOTE:** This is in comparison to the 1996 Habitat II conference in Istanbul, which focused mainly on the provision of adequate housing for all and other issues related to urban poverty.

⁹ Naki Mendoza, “Lessons Learned at Habitat III,” *Devex International Development*;

; Vanesa Broto, “So what happened at Habitat III,” *CityMetric*, 28 October 2016, <http://www.citymetric.com/politics/so-what-happened-habitat-iii-2555> (Accessed December 4, 2016)

¹⁰ New Urban Agenda, 5.

perspectives¹¹. Yet on a practical level, among the most prominent challenges continue to be financing-related ones. As summarized by Ada Colau, the mayor of Barcelona and one of the most prominent local executives at the HIII conference: “*The problem is, cities are underfunded.*”¹² Though the HIII process effectively foregrounded the issue of municipal financing as a core means of implementation of sustainable urban development to a far greater extent than previous Habitat conferences in Istanbul (1996) and Vancouver (1976)— with specific recognition made in NUA of the role of fiscal decentralization (par. 130), domestic resource mobilization (par. 132), private (foreign direct) investment (par. 132, 133), land-based finance (par. 138, 152), municipal borrowing and pooled financing (par. 139), and multilateral funds and official development assistance (par. 143, 145) in funding sustainable urban development, the very same document has neglected to provide more precise detail as to *how* countries and cities can or should pursue these different options in their overall efforts to strengthen their municipal financing systems¹³.

Yet these already widely-recognized limitations in the formulation of the NUA remain far from exhaustive, as far as the need to marshal tremendous sums of additional revenue for inclusive urban development and public service delivery is concerned. Even more seriously, from the standpoint of equity, accountability and tax justice, a whole series of incoherencies have persisted in how the NUA’s urban funding framework of HIII has been formulated and expressed. Where these limitations are exactly located and what their implications are on inclusive and sustainable municipal financing are the subject of the following section.

2.1. *The Role of Public Finance and the Scale of Needed Urban Financing*

To pin down what these financing challenges are and how they can be addressed, it helps to revisit how previous spending levels for international development goals have been sustained. According to findings by Oxfam International and Development Finance International (a London-based advisory group), government revenues accounted for 77% of all Millennium Development Goal-related global spending as of 2014¹⁴. Strikingly, despite considerable hype made over the potential contributions of private financing to sustainable urbanization— with the World Economic Forum and PricewaterhouseCoopers even maintaining that private sector involvement is “*increasingly required for all aspects of the urban value chain, including policy-making, planning, design, implementation, operation and maintenance, and monitoring, as well as financing of urban service delivery*”¹⁵—, it has instead been public financing mechanisms which have effectively shouldered most development funding burdens and which, by most indications, will continue to be the most reliable source of financing for long-term investments in infrastructure and broader urban development. In this vein, one might note that HIII’s February 2016 own policy paper on municipal financing explicitly asserted that private financing and public-private partnerships should neither be deemed a “*panacea*” nor a “*substitute*” to strengthening suboptimal public finance mechanisms in developing countries— whose effective governance and revenue-raising robustness at any rate remain prerequisites for

¹¹ Vanesa Broto, “So what happened at Habitat III,” *CityMetric*; Teresa Ribera, “Want sustainable urban development? It’s time for Local Agenda 2030,” *Citiscopes*, 5 January 2017, <http://citiscopes.org/habitatIII/commentary/2017/01/want-sustainable-urban-development-its-time-local-agenda-2030> (Accessed January 5, 2017)

¹² Ada Colau, “After Habitat III: a stronger urban future must be based on the right to the city,” *The Guardian*, 20 October 2016, <https://www.theguardian.com/cities/2016/oct/20/habitat-3-right-city-concrete-policies-ada-colau> (Accessed December 4, 2016)

¹³ New Urban Agenda, 17-18; Gregory Scrubbs, “New Urban Agenda good on ‘what’ but not on ‘how,’” *Citiscopes*, 20 September 2016, <http://citiscopes.org/habitatIII/news/2016/09/new-urban-agenda-good-what-not-how-critics-warn> (Accessed December 4, 2016)

¹⁴ Matthew Martin and Jo Walker, *Financing the Sustainable Development Goals: Lessons from government spending on the MDGs*, London: Government Spending Watch, 2015. 4.

¹⁵ World Economic Forum and PricewaterhouseCoopers, *Harnessing Public-Private Cooperation to Deliver the New Urban Agenda: Executive Summary*, Geneva: World Economic Forum, October 2016. 4.

tapping into significant amounts of private finance.¹⁶ Though it is hard to quibble with the proposition that maximizing different sources of development financing will be necessary for funding the long-term realization of sustainable, inclusive cities, given the likely range of estimates of how much finance would be required to meet SDG targets (see Box 2.1), it appears unrealistic that private sources will be able to fund much the delivery of such infrastructures and services, especially among lower-income demographics and urban areas. This same view also appears to be shared by organizations with a decidedly centrist outlook such as the Brookings Institution, which recently averred that “*Private-sector investments have proven ineffective at closing the global infrastructure gap...*”¹⁷

Box 2.1. SDG Urban Financing Needs Estimates in Developing Countries

How much financing will be needed to meet the various urban investment demands of the SDG’s and the NUA in the years ahead? While no figures concerning expected *total urban funding requirements* have been generated, an entire spectrum of funding needs estimates has been generated of infrastructural investments typically concentrated in urban areas— ranging from an average of an additional \$684-billion per year (by Oxfam and Development Finance International), from \$819-billion (as forecasted by the World Bank) to \$867-billion per year (by the UN Sustainable Development Solutions Network), to even at total \$2.5-trillion yearly (by UNCTAD) for infrastructure investments in power, transport, water and sanitation and telecommunications across developing countries. In particular, the requirements of investments in power/energy and transportation infrastructure are found to be highly resource-intensive. The table below presents the breakdown of these figures in more detail, though it should be kept in mind, that there is ultimately no fully objective way to estimate how much infrastructure stock a country needs at a given time¹⁸.

Estimated annual SDG-related infrastructure financing needs in developing countries (USD billions)

| Investment Area (Upper Limit) | Oxfam / Development Finance International (2015)* | World Bank (2015)** | UN SDSN (2015)*** | UNCTAD (2014)**** |
|---------------------------------|---|---------------------|-------------------|-------------------|
| Access to Modern Energy / Power | n/a | 320 | 289 | 950 |
| Transport | n/a | 255 | 189 | 770 |
| Telecommunications | n/a | 187 | 361 | 400 |
| Water and Sanitation | n/a | 57 | 28 | 410 |
| Total | 684 | 819 | 867 | 2,530 |

Source: UNCTAD (2014); Ruiz-Nunez and Wei (2015); Schmidt-Traub (2015); Oxfam and Development Finance International (2015)

* - Figures on annual additional public spending needed, and breakdown not specified in report

** - Estimates for all countries included in the World Bank’s “Emerging Markets and Developing Economies” category until 2020

*** - Estimates for low-income and lower-middle income countries

**** - Upper-bound figures only presented

Even the most modest of these estimates points towards major gaps between present levels of infrastructure spending and the total amount of anticipated infrastructure financing needed in the upcoming years. The World Bank, for example, finds that an annual USD248-billion shortfall

¹⁶ Habitat III Policy Paper on Municipal Finance and Local Fiscal Systems, 6, 21.

¹⁷ Alaina Harkness, “Financing the “New Urban Agenda”: Multi-Level metropolitan finance for 21st century cities,” *Brookings Institution*, 7 October 2016, <https://www.brookings.edu/blog/metropolitan-revolution/2016/10/07/financing-the-new-urban-agenda-multi-level-metropolitan-finance-for-21st-century-cities/> (Accessed December 4, 2016)

¹⁸ Philipp Krause, “There are no trillion dollar infrastructure gaps,” *Overseas Development Institute*, November 10, 2015, <https://www.odi.org/comment/10088-%E2%80%8Bthere-no-trillion-dollar-infrastructure-gaps> (Accessed December 4, 2016)

persists in infrastructure financing for developing countries¹⁹. Yet adding further still to these massive funding gaps is the financing burden of climate mitigation and adaptation, of which cities are increasingly being recognized as a frontline sector. According to the Cities Climate Finance Leadership Alliance, yet another estimated \$0.4-trillion to \$1.1-trillion in additional investment per year will be necessary to align planned urban infrastructure investments with low-emission and climate resiliency concerns in sectors such as buildings and industry, energy, transport, water, waste, and telecommunications²⁰. While tapping into various sources of funding will be necessary to filling in these combined gaps (e.g. ODA, borrowing, etc.), the sheer scale of investments demanded leaves little question as to the crucial role of national and local public financing systems.

In fact, this recognition of the centrality of domestic public financing has been at least partially featured in the final text of the NUA. Paragraph 131 of the said document affirms that the “*primary responsibility*” for “*financing urbanization*” and “*economic and social development*” remains with individual countries; similarly, the phrasing of the following paragraph suggests that the principal financing commitment among such governments will be to “*mobilize endogenous resources and revenues generated through the capture of the benefits of urbanization,*” even while being underpinned by the “*principle of national ownership.*”²¹ While an unclear relationship between private sources of financing to public revenue-raising still persists, with paragraph 133 particularly identifying “*private investment, particularly foreign direct investment*” as “*an essential element of development efforts,*”²² it must also be kept in mind that the final text of the NUA has already diluted even more pronounced overtures to an “*optimized partnership with the private sector*” for funding urban development that were present in earlier drafts, including explicit proposals to encourage and establish “*public-private partnership units*” as one “*important means to financing urbanization.*”²³ All told, it appears that this heightened prominence given to public domestic resource mobilization may represent a limited advance for guaranteeing effective and sustainable municipal financing: as further discussed in Box 2.2, even beyond the demonstrated importance of harnessing public-based financing systems vis-à-vis private financing modes, the poor track record PPP’s in lowering the costs of infrastructural developing, and delivering promised service provision, efficiency and welfare gains provides further grounds for curbing the enthusiasm for such modes of private funding often displayed in global development financing discussions.

Box 2.2. Excerpt: Public-Private Partnerships and the 2030 Agenda for Sustainable Development: Fit for Purpose?

PPPs have recently undergone somewhat of a renaissance in the international policy discourse with many countries and organizations pointing to their potential to generate new resources and increase efficiency for public service provision.

However, the evidence suggests that PPPs have often tended to be more expensive than the alternative of public procurement while in a number of instances they have failed to deliver the envisaged gains in quality of service provision, including its efficiency, coverage and development impact. In other words, they have failed to yield ‘value for money’ in its broadest sense taking into account not just the financial costs and efficiency gains deriving from a project but also its longer-

¹⁹ Fernanda Ruiz-Nunez and Zichao Wei, “Infrastructure Investment Demands in Emerging Markets and Developing Economies,” World Bank Policy Research Paper 7414, World Bank Group, September 2015. 13-14.

²⁰ Cities Climate Finance Leadership Alliance, *The State of City Climate Finance 2015*, New York: Cities Climate Finance Leadership Alliance, 2015. 24.

²¹ New Urban Agenda, 18.Kaj Fischer, “How have the New Urban Agenda drafts dealt with municipal finance?,” *Citiscopes*, 24 August 2016, <http://citiscopes.org/habitatIII/news/2016/08/how-have-new-urban-agenda-drafts-dealt-municipal-finance> (Accessed December 4, 2016)

²²New Urban Agenda, 18.

²³ United Nations Conference on Housing and Sustainable Urban Development, 6 May 2016 Zero Draft of the Habitat III New Urban Agenda (6 May 2016), 3, 19. [Hereinafter 6 May 2016 Zero Draft of the New Urban Agenda]

term fiscal implications (including the risks of any contingency liabilities) as well as the broader welfare benefits for society such as the impact on poverty and sustainable development.

[...]

Despite a recent rise in the private sector's participation in infrastructure finance in developing countries, especially in electricity and telecommunications, private finance continues to provide just a small portion of aggregate infrastructure investment in the developing world. If PPPs are to be scaled up, there has to be sound understanding as to their ultimate purpose, namely to add value for money, i.e. to improve the coverage, access, quality and efficiency of a given service to the citizen. A commonly accepted definition of PPPs, something that is still sorely lacking, should be firmly anchored in such an understanding.

Source: Jomo KS, Anis Chowdhury, Krishnan Sharma, Daniel Platz, "Public-Private Partnerships and the 2030 Agenda for Sustainable Development: Fit for Purpose?" *United Nations Department of Economic and Social Affairs* (2016)

2.2. *National and Local Challenges: Intergovernmental Fiscal Relations, Tax Capacity and Inter-Local Tax Competition*

Even while the case for public finance in realizing inclusive and sustainable cities is beyond dispute, and while the final NUA provides some recognition of its importance, it is hardly certain whether such national and local systems will be given the policy space, political commitment and institutional opportunity to reach their full potential for funding the global urban agenda. This owes to how the functioning of such public revenue-raising systems continues to be obstructed by a variety of obstacles and adverse dynamics—several of which have gone unrecognized within the final text of the NUA. In fact, in this regard, the ambition and comprehensiveness of the NUA's development financing components may even be weaker than those which were featured in the outcome document of 2015 UN FfD Conference, which has already elicited disappointment from major urban actors such as the United Cities and Local Governments (UCLG) over its "level of ambition," and failure to robustly tackle different "systemic issues."²⁴ Ranging from the local to global levels, the combined effects of these impediments have not only severely constrained the fiscal space of governmental entities for raising public funds; they have, in many cases, contributed to further entrenching problems of inequity, unaccountability and mis-governance in their systems of taxation and public spending, and compromised the ability of affected authorities from accessing external finance.

Intergovernmental Fiscal Relations. At both national and local levels, the first of these problems involves significant resource and institutional constraints placed on sub-national and municipal governments in developing countries, owing to the intergovernmental fiscal frameworks in which they are embedded. Though in recent years it has become commonplace to speak of cities as the frontlines of efforts for tackling governance challenges²⁵, in practically all episodes of administrative and fiscal decentralization that have transpired across the world since the 1980's, the increased local delegation of expenditure responsibilities related to delivering basic public services, furnishing public infrastructures, and performing other governance functions, has not been matched by a proportionate reassignment of revenue-raising powers²⁶. While various reasons exist as to why such fiscal capabilities have not been adequately downscaled— including ill-designed inter-governmental arrangements, poor local

²⁴ United Cities and Local Governments, "UCLG take on the Addis Ababa Action Agenda," United Cities and Local Governments, Undated, https://www.uclg.org/sites/default/files/uclg_take_on_the_addis_ababa_action_agenda.pdf (Accessed December 4, 2016)

²⁵ Brock Carlton, "Cities will be the front lines of implementing the global goals," *United Cities and Local Governments*, 1 January 2016, <https://www.uclg.org/en/media/news/cities-will-be-front-lines-implementing-global-goals> (Accessed December 4, 2016)

²⁶ Catherine Farvacque-Vitkovic and Mihaly Kopanyi (eds.), *Municipal Finances: A Handbook for Local Governments*, Washington, D.C.: World Bank, 2014. 149-150.

administrative capacity, and the need for sufficient centralization of revenues for pursuing macroeconomic stabilization and the subnational spatial equity²⁷—, also among the common reasons has been the opposition of established governing elites, due to the prospect of heightened political competition under more fiscally-decentralized governing arrangements and reluctance to cede control over some sources of their revenues²⁸.

As a result, municipalities’ capacities for local revenue generation have almost-always been outstripped by their spending needs: according to preliminary data from the OECD and UCLG on subnational public finances in 95 countries across the world (see Table 2.1), subnational spending levels have far outstripped the capacities for local forms of taxation to finance them, more of than not resulting in “*fiscal gaps*” that must somehow be bridged. On average, while such government units on average spent 9.0% of GDP for addressing subnational expenditure needs in 2013, their average tax revenue during that same year remained pegged at almost one-third that level (3.2%)— a pattern that has held in practically all income groupings, save in low income countries where this divide is even larger. In the midst of such significant fiscal gaps, local governments have generally required the extension of large volumes of central-local grants and fiscal transfers to cover for their spending responsibilities (see “*Total Revenue*” in Table 2.1), which even when accounted for still prove insufficient to relieve the risk of being assigned “*unfunded mandates*.” For instance, total subnational revenues in 2013 among the 95 featured countries continued to fall below their total spending rates (8.6% vs. 9.0% of GDP). This same shortfall, moreover, has generally been more marked among subnational states in the developing world (e.g. 6.3% vs. 6.0% for lower middle income countries).

Table 2.2. Subnational government spending vs. revenues in 2013, by income groups

| <i>Country Income Grouping</i> | <i>Spending as a % of GDP</i> | <i>Total Revenue as a % of GDP</i> | <i>Total Public Tax Revenue as % of GDP</i> |
|--------------------------------|-------------------------------|------------------------------------|---|
| Low Income | 1.7% | 1.6% | 0.4% |
| Lower Middle Income | 6.3% | 6.0% | 2.1% |
| Upper Middle Income | 8.3% | 7.8% | 2.8% |
| High Income | 13.2% | 13.0% | 4.9% |
| All 95 Countries | 9.0% | 8.6% | 3.2% |

Source: Organization for Economic Cooperation and Development / United Cities and Local Governments *Global Observatory on Local Finances* (2016)

Two facets of effective fiscal decentralization have been especially relevant to HIII discussions. On one hand, the imbalances between local revenues and spending requirements make it crucial to devise more coherent, reliable and substantive systems of inter-governmental fiscal transfers between different tiers of government. Yet parallel to establishing such frameworks, there are compelling reasons why fostering greater reliance of municipal governments on their own-source revenues should be prioritized. As local states can do little to control the amount of fiscal transfers allocated to them, and since the provision of fiscal transfers in developing countries is usually prone to inefficiency, if not arbitrary influence, heightened local revenue authority can promise both greater effective autonomy and flexibility in the fulfillment of their development, welfare and administrative priorities. Moreover, increased ability to amass locally-based

²⁷Odd-Helge Fjeldstad and Kari Heggstad, “Local Government revenue mobilization in Anglophone Africa,” ICTD Working Paper 7, International Center for Tax and Development, October 2012. 6-7.

²⁸ Jorge Martinez-Vazquez and Francois Vaillancourt (eds.), *Decentralization in Developing Countries: Global Perspectives on the Obstacles to Fiscal Devolution* (Northampton: Edward Elgar Publishing, 2011), 3-8.

revenues has been confirmed in studies to generally translate into heightened responsiveness to local taxpayers' prosperity, and improved self-reliance over local decisions, policies, and interventions. And especially when the kinds of revenues being collected by government are highly visible to taxpayers (e.g. property taxes), greater dependence on own-revenue sources has can contribute to deepening state accountability to local residents, oftentimes as a response against the possibility of popular resistance to increasing the rates of levies²⁹.

Unfortunately, while rhetorical pledges towards fostering “*appropriate*” decentralization have been rife in the Habitat III negotiations, the evolution of the NUA drafts' language on the devolution of revenue-raising powers reveals a disappointing level of ambition concerning the promotion of more substantive revenue transfers and the strengthening of local fiscal authority. Compared to the original May 6 NUA zero draft, which explicitly committed to “*increased local government autonomy over taxes*” (paragraph 131) as well as dedicating a minimum 20% share of the national government budget to fiscal transfers (paragraph 130), the final NUA instead adopted considerably more generic language of supporting “*appropriate policies and capacities that enable sub-national and local governments to register and expand their revenue base*” (paragraph 134) and promoting “*sound and transparent systems of financial transfers*” (paragraph 135)³⁰. Far from representing the “*urban paradigm shift*” called for in the final draft's paragraph 15, the framework of intergovernmental fiscal relations currently endorsed in the final text appears to have become largely incrementalist in orientation, and fails to provide assurance that signatories of the NUA will commit to substantially realizing the cardinal precepts of effective fiscal decentralization.

Institutional Constraints on Tax Capacity. Related to intergovernmental fiscal challenges are deep-seated governance capacity problems that are pervasive in local state institutions, especially across the developing world. Even when heightened fiscal transfers and revenue-raising powers are devolved towards subnational state units, local governments' tax systems, particularly in the Global South, have regularly been found to have been found to be poorly, inefficiently and even arbitrarily administered, managed with little concern for potentially disruptive and regressive effects, ill-coordinated with broader policy and governmental arrangements, and prone to outright corruption and mismanagement³¹. In low-income, highly-agrarian, under-regulated contexts, local tax and customs arrangements have even been documented to partake of manifestly coercive practices such as arbitrary assessment and extortionary collection³². Thus, even beyond the formal frameworks of intergovernmental fiscal relations, an entire set of institutional challenges in how actually-existing local fiscal systems are put into practice in the developing world threatens to constrain concrete efforts by which municipalities might be able to realize revenues from their existing revenue bases.

The persistence of such capacity problems may owe in part to limitations in the skills and staff compensation packages, effective administrative mechanisms, coherent tax regulations, as well as the revenue bases (due to underdeveloped economic structures) available for revenue officials in local government units in both urban and rural areas³³. Yet across the developing world, most of these governance malpractices also remain intertwined with the impacts of elite activities upon the functioning of local fiscal systems and of state officials tied to them. Indeed, apart from

²⁹ Catherine Farvacque- Vitkovic and Mihaly Kopanyi (eds.), *Municipal Finances: A Handbook for Local Governments*, 156, 158.

³⁰ 6 May 2016 Zero Draft of the New Urban Agenda , 18.

³¹ Odd-Helge Fjeldstad and Lise Rakner, “Taxation and tax reforms in developing countries: Illustrations from Sub-Saharan Africa,” CMI Reports No. 6, CHR. Michelsen Institute, 2003, Bergen, 7.

³² Mick Moore, “Between coercion and contract: competing narratives on taxation and governance,” *Taxation and State-Building in Developing Countries*, Deborah Brautigam et al . (eds). (Cambridge: Cambridge University Press, 2008), 40-44.

³³ Jonathan di John, “The Political Economy of Taxation and Tax Reform in Developing Countries,” UNU-WIDER Research Paper 2006-74, United Nations University World Institute for Development Economics Research, 3, 5.

simply functioning as revenue-raising mechanisms, tax systems in developing countries are usually riven by elaborate schemes of rent-seeking among economic and political elites, who are often able to assert unprecedented influence in order to exact particularistic exemptions from tax obligations, the selective application of tax powers to favor or disadvantage certain interests, and skew overall tax burdens in regressive directions.³⁴ With tax mechanisms in such contexts effectively serving as instruments of rent-extraction and political control, the trust and confidence of majority of taxpayers is bound to be seriously jeopardized, and the institutional integrity and revenue-raising capacity of the local fiscal system compromised³⁵.

The implication of such governance obstacles lies in how they reveal the task of strengthening subnational and municipal fiscal systems— a task referred to in the NUA as a seemingly rational, straightforward process— to be a highly unpredictable, contentious and political affair, which can only be attained in a lasting manner through politically-informed strategies of reform and implementation. To be sure, the discussions of the Habitat III process provide some recognition of the institutional difficulties that hound local fiscal systems in developing-country municipalities: drafts of the NUA have consistently attested to the importance of the “*capacity development*” of subnational governments in harnessing different financing mechanisms; of adopting various anti-corruption, transparency, accountability, and gender-responsive measures; and of building medium to long-term administrative and technical capacity in public financial management systems³⁶. But if these actions have important roles to play in overcoming entrenched fiscal governance problems, they still do not provide concrete indication whether such endorsed measures will translate into a substantive commitments for fostering favorable political and institutional conditions that will enable fiscal reform and governance improvements to occur over the medium and long term. It will be critical for the sustainability of envisioned local tax capacity enhancements that committed, effective and strategically-situated political champions for fiscal upgrading be fostered at municipal, national and even international levels; that broader coalitions able to shepherd reforms and consolidate long-term supra-local support structures for their activities be assembled, even against resistance from elite interests; and that the trust and confidence of taxpayers in those same arrangements ultimately be secured, by aligning them with public norms of fairness, legitimacy and an equitable distribution of burdens and benefits³⁷. Unfortunately, few of these aspects of the political and institutional dynamics of fiscal reform and institution-building appear to have been reflected in statements and outcome documents related to the Habitat III process³⁸.

Race-to-the-bottom tax competition. A third major difficulty affecting both national and subnational governments concerns the corrosive effects of tax competition at international and inter-municipal levels. With the increased mobility of capital that has accompanied the spread of economic globalization and the implementation of fiscal decentralization programs, the extension of tax incentives and the adjustments of tax rates have emerged as a key area of competition in attracting supra-local investment. Various described as generating practices of

³⁴Mick Moore, “Obstacles to Increasing Tax Revenues in Low Income Countries,” *ICTD Working Paper 15*, International Center for Tax and Development, December 2013,, 20-21, 23.

³⁵ Wilson Prichard, *Citizen-State Relations: Improving Governance Through Tax Reform*, Paris: Organisation for Economic Cooperation and Development, 2010. 30, 32.

³⁶ New Urban Agenda, 18-20.

³⁷ John Sidel, “Achieving Reforms in Oligarchical Democracies: The Role of Leadership and Coalitions in the Philippines,” Research Paper 27, Developmental Leadership Program, University of Birmingham, April 2014, 25-26.

³⁸ **NOTE:** For the UN FfD Conference, however, considerations of the importance of “*political will*”, “*high-level political support*”, “*broad-based dialogue*,” and “*building coalitions for reform*” make appearance in the text of the Addis Tax Initiative, a parallel effort by 30 countries and international organizations to promote stronger domestic tax systems. None of these are also recognized in the conference outcome document itself, however.

“fiscal war” between municipalities,³⁹ or “race to the bottom” dynamics in the tax policies of national governments, the adverse fiscal impacts of such competition have been argued by tax practitioners to be arguably the single biggest impediment to controlling the erosion of countries’ and subnational governments’ revenue bases at the present time⁴⁰. Given the opaqueness with which many such tax breaks tend to be granted by state authorities, no conclusive figures concerning the total amount of foregone revenues that have resulted from such tax competition dynamics across the world exist. Nevertheless, in 2014 Oxfam International estimated that developing countries were losing at least \$USD 55-billion a year as a result of tax breaks being granted to national and transnational corporations⁴¹— with billions more in revenues being prematurely forfeited due to pressures faced by states to cut their effective business and corporate tax rates down to “competitive” levels. From the 1980’s up to the present, for example, statutory corporate income tax rates have fallen from roughly 45% to an average of 20% for developed economies; 40% to 25% for middle-income countries; and 45% to 30% for low-income countries⁴².

While it is true that tax incentive systems may have an occasional role to play in encouraging certain kinds of investments and economic activities⁴³, a particularly pressing concern in relation to their provision has been their proneness to excessive usage and politicization by governments, especially in contexts where competitive pressures to lower tax rates already exist. In fact, in numerous countries, the lion’s share of tax incentives can even be said to be functionally “redundant”— that is, that investors availing of such incentives would have continued investing in their chosen destination even without them. Not surprisingly, based on investor surveys that have been undertaken around the world, countries such as Guinea, Rwanda, Tanzania and Uganda have been found to have had redundancy rates exceeding 90% of all fiscal incentives granted to investors (see Table 2.3)⁴⁴. In individual countries, the fiscal leakage posed by these redundant incentives can be enormous: as of 2016, Kenya was losing USD1.1-billion a year to tax breaks, almost twice the level of its annual health budget, while for Nigeria the amount was USD2.9-billion, or almost twice its annual education spending levels⁴⁵.

³⁹ Aaron Schneider, “Political Economy of Citizenship Regimes: Tax in Brazil and India,” UNRISD Working Paper 2015-11, United Nations Research Institute for Social Research, July 2015, 8.

⁴⁰ Michael Durst, “Beyond BEPS: A Tax Policy Agenda for Developing Countries,” ICTD Working Paper 18, International Centre for Tax and Development, June 2014, 3, 7.

⁴¹ **Note:** This figure was arrived at by extrapolating from fiscal incentive losses previously calculated by ActionAid.

From: Oxfam International, “Turn the Tide: The G20 must act on rising inequality, starting with fairer global tax reform,” *Oxfam International*, 11 November 2014, https://www.oxfam.org/sites/www.oxfam.org/files/file_attachments/oxfam_media_brief_-_turn_the_tide.pdf (Accessed December 4, 2016)

⁴² Independent Commission for the Reform of International Corporate Taxation, “Four Ways to Tackle International Tax Competition,” *Independent Commission for the Reform of International Corporate Taxation*, November 2016, 9.

⁴³ **NOTE:** In the past, the costs of such tax incentives for investment purposes have been argued to have been outweighed by the economic benefits of their use, particularly in the form of foreign direct investment. Yet more recent empirical analyses of their effectiveness as an investment attraction mechanism in the developing countries have found that the presence of such incentives (save for tax holidays) have much less significance in determining inflows of FDI than factors such as political and macroeconomic stability, the integrity of property rights, enhancements in infrastructure and services, and other investment-supporting policies.

From: OECD, IMF and World Bank, *Options for Low Income Countries’ Effective and Efficient Use of Tax Incentives for Investment*, Washington, D.C.: World Bank, October 2015.

⁴⁴ OECD, IMF and World Bank, *Options for Low Income Countries’ Effective and Efficient Use of Tax Incentives for Investment*, 11.

⁴⁵ Oxfam International, “Tax Battles: The dangerous global Race to the Bottom on Corporate Tax,” *Oxfam International*, 12 December 2016, https://www.oxfam.org/sites/www.oxfam.org/files/file_attachments/bp-race-to-bottom-corporate-tax-121216-en.pdf, 6 (Accessed December 14, 2016).

Table 2.3. Redundancy of Tax Incentives in Selected Countries based on Investor Surveys

| Country | Redundancy Rate | Country | Redundancy Rate |
|--------------------|-----------------|-----------------|-----------------|
| Burundi (2011) | 77 | Rwanda (2011) | 98 |
| El Salvador (2013) | 37 | Serbia (2009) | 71 |
| Guinea (2012) | 92 | Tanzania (2011) | 91 |
| Jordan (2009) | 70 | Tunisia (2012) | 58 |
| Kenya (2012) | 61 | Uganda (2011) | 93 |
| Mozambique (2009) | 78 | Vietnam (2004) | 85 |
| | | Thailand (1999) | 81 |

Source: OECD, IMF and World Bank (2015)

Despite all such adverse impacts, the problems of tax competition has by and large gone unrecognized in the Habitat III process. Whereas the UN FfD outcome document acknowledged the need to address “*excessive tax incentives*”⁴⁶, little recognition of the deleterious impacts of such incentives and the competitive pressures undergirding them has materialized in the NUA. Moreover, if the original zero draft of the NUA at least demonstrated an understanding that the “*standardization and publication of permitting, registration and taxation processes is a crucial first step, along with labor and environmental standards [of creating an enabling and fair business environment],*”⁴⁷ such clauses have been entirely stricken from subsequent versions of the document. In this vein, the Habitat III negotiations have gradually sidelined tax competition as a major constraint facing fiscal improvement efforts for local governments, especially within lower-income countries.

2.3. *Global Challenges: Global Tax Avoidance, Tax-Related Investment Arbitration and Fiscal Austerity*

Just as serious as national and local institutional obstructions against the strengthening of municipal fiscal systems are various transnational obstacles, the proposed solutions for which now comprise some of the most heated items of debate in the global governance community. Within this roster of policy problems related to financing inclusive and sustainable cities, three are especially pressing: the entrenched problem of global tax avoidance/evasion, emerging constraints to national and local governments’ policy space presented by features of “*next generation*” trade and investment agreements, as well as the adoption, or in many cases, the imposition of fiscal austerity regimes upon national and local governments, particularly in the wake of the 2007/2008 Global Financial Crisis.

Global Tax Avoidance and Evasion. To begin with, at the international level, an overwhelmingly deleterious source of revenue erosion of both national and local governments has been the massive scale in which systematic tax avoidance and evasion has been taking place. Certainly, several variants of international tax dodging exist, involving practices such as “*treaty-shopping*” (i.e. exploiting inconsistencies between different taxation treaties in line with the location of multinationals’ affiliates), the use of offshore banking and financial services for wealthy individuals in tax havens, and more recently, “*qualification mismatches*” and derivatives (i.e. leveraging different treatments of hybrid corporate entities and financial instruments in

⁴⁶ United Nations, Department of Economic and Social Affairs, *Addis Ababa Action Agenda of the Third International Conference on Financing for Development* (27 July 2015), 13. [Hereinafter Addis Ababa Action Agenda]

⁴⁷ May 2016 NUA Zero Draft, 9.

different countries)⁴⁸. Yet arguably the most serious form of tax abuse for both developing and developed countries alike has been the phenomenon of *transfer mispricing*— namely, the proliferation of transnational transactions within multinational corporate groups which artificially increase the reported value of company profits in low-tax jurisdictions, while decreasing those within jurisdictions with higher tax obligations⁴⁹. Achieved historically through the distortion of intra-firm trade prices in physical goods, such mispricing practices have more recently become increasingly prominent with regards to the use of intangible goods (e.g. brands, licenses, patents, etc.) as well as intra-firm loans.

While a serious problem too in the Global North, international corporate tax avoidance holds critical importance for developing countries' revenue-raising capacities, since reliance on corporate as opposed to personal income tax is significantly higher in the Global South: based on data from the International Monetary Fund (IMF), the ratio of Corporate Income Tax to Personal Income Tax was 1.4:1 for low-income countries in 2011, 1.5:1 for lower-middle and higher-middle income countries, and only 0.3:1 for high-income OECD countries⁵⁰. Consequently, the fiscal losses posed by avoidance activities by multinational companies are staggering. In its 2015 World Investment Report, UNCTAD estimated that for transfer mispricing alone, the amount of revenue erosion for developing countries stands at around \$100-billion annually— or roughly one-third of their total corporate income tax obligations⁵¹. Such avoidance losses often tend to manifest at the level of local governments through diminished central-local transfers and local tax takes, as well as unfair tax burdens on local businesses. These figures, however, should only be considered lower-bound estimates: in a May 2015, IMF researchers calculated that non-OECD countries were losing more than USD200-billion a year to global tax dodging⁵².

The losses from international tax avoidance to both developed and developing economies has prompted an entire array of initiatives for plugging global tax loopholes, including measures once considered to be impossible (e.g. automatic information exchange among tax administrations) and an OECD/G20-led initiative (the Base Erosion and Profit-Shifting Initiative) that has been lauded as bringing “*the most fundamental changes to international tax rules in almost a century.*”⁵³. As will be discussed in the next section of the report, concerns still remain as to whether such efforts will be sufficient for tackling the entirety of the global tax avoidance issue— yet even more disappointingly, developments within the Habitat III process suggest that recognition of the issue has in fact diminished in the NUA. While the original zero draft of the NUA explicitly stated that, “*Tax avoidance should also be addressed along with considering the insertion of anti-abuse clauses and transparency mechanisms,*”⁵⁴ any such mentioning of the challenges wrought by global tax avoidance on local revenue-raising efforts— whether upon local tax takes or the availability of central-local transfers— has been removed in subsequent drafts of the agenda. Neither has the issue garnered significant headway in supporting documents such as the Mexico Declaration, whose discussion on avoidance concerns

⁴⁸ Gabriel Zucman, “Taxing across Borders: Tracking Personal Wealth and Corporate Profits,” *Journal of Economic Perspectives*, 28:4, 2014, 124, 137-138; Markus Henn, “Tax Havens and the Taxation of Transnational Corporations,” *Dialogue on Globalization*, Friedrich Ebert Stiftung, June 2013, 4-5.

⁴⁹ Independent Commission for the Reform of International Corporate Taxation, *Declaration of the Independent Commission for the Reform of International Corporate Taxation*, June 2015, 8.

⁵⁰ Mick Moore, “Obstacles to Increasing Tax Revenues in Low Income Countries,” 7, 14.

⁵¹ United Nations Conference on Trade and Development, *World Investment Report 2015: Reforming International Investment Governance*, Geneva: United Nations Conference on Trade and Development, 2015. 200.

⁵² Ernesto Crivelli, Ruud de Mooij, and Michael Keen, “Base Erosion, Profit Shifting and Developing Countries,” IMF Working Paper 15/118, *International Monetary Fund*, May 2015, 21.

⁵³ Judith Ugwumadu, “OECD finalizes global tax reform package,” *Public Finance International*, 5 October 2015, <http://www.publicfinanceinternational.org/news/2015/10/oecd-finalises-global-tax-reform-package> (Accessed December 4, 2016).

⁵⁴ May 2016 NUA Zero Draft, 18.

was mainly limited to the potential of new ICT's for "reinforcing the fight against corruption and tax evasion."⁵⁵ This stands in contrast to the historic level of attention placed on the issue during the UN FfD Conference, whose outcome document expressly committed to "ensuring that all companies, including multinationals, pay taxes to the Governments of countries where economic activity occurs and value is created..."⁵⁶

Diminished Policy Space from Trade and Investment Agreements. Even more recently than the dilemma of global tax avoidance have been escalating threats to national and local governments' policy space resulting from more than 3,000 bilateral investment agreements between countries that have been signed between 1983 and 2015 as well as nascent, if increasingly contested, "mega-regional" trade and investment agreements, such as the *Trans-Pacific Partnership* (TPP), the *Transatlantic Trade and Investment Partnership* (TTIP), and the *Trade in Services Agreement* (TISA)⁵⁷. While the provisions of these agreements are exceedingly complex, with the TPP alone harboring more than 5,000 pages of text, of particular concern have been the implications of *Investor-State Dispute Settlement* (ISDS) mechanisms that such treaties have established in a growing number of countries— involving the use of *ad hoc*, 3-person international tribunals through which multinational investors can file charges against governments. Though argued by proponents to institutionalize more impartial and politically-insulated systems of legal protection for investors against undue domestic risks,⁵⁸ the workings of the ISDS regime have been widely documented for furnishing investors with the means to challenge an entire spectrum of government policies meant to advance social, health, environmental, and crisis-response objectives⁵⁹. Not surprising, former International Court of Justice judge Bruno Simma asserted in a 2011 conference that "Giving adequate consideration to economic and social rights is the exception rather than the rule in investor-state arbitration."⁶⁰

Yet more recently, it has become apparent that even governments' powers to tax investors also stand to be constrained by the proliferation of ISDS mechanisms. Though many states have incorporated "carve-out" clauses in trade and investment agreements to preclude investor-state disputes in tax matters, such treaty provisions have nonetheless failed to prevent a rising tide of companies from initiating arbitral proceedings against a wide range of sovereign tax decisions⁶¹. By 2016, at least 24 countries have been filed charges by multinationals on tax-related grounds in over 40 separate lawsuits⁶². As a selection of tax-related ISDS cases presented in Table 2.3 indicate, the expansion of the global ISDS regime has provided multinationals with the legal means to challenge national and local governments' tax policies and activities virtually across the board, from disputes over energy and mineral fiscal regimes, capital gains taxes, tax reassessments, tax exemptions, excise taxes, and even the use of value-added tax revenues.

⁵⁵ Habitat III Mexico Declaration, 7.

⁵⁶ Addis Ababa Action Agenda, 11-12.

⁵⁷ United Nations Conference for Trade and Development, *World Investment Report 2014: Investing in the SDG's: An Action Plan*, Geneva: United Nations Conference for Trade and Development, 2014. 114-115..

⁵⁸ **NOTE:** such by covering, for instance, state obligations of "fair and equitable treatment", the right to transfer investments and profits out of hosts states, and adequate compensation in state-directed expropriations.

See: Vaughan Lowe, "Changing Dimensions of International Investment Law", Oxford Legal Studies Working Paper No. 4/2007, March 2007, Oxford *Legal Studies*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=970727 (accessed January 2, 2015)

⁵⁹ Pia Eberhardt and Cecilia Olivet, *Profiting from Injustice: How law firms, arbitrators, and financiers are fuelling an investment arbitration boom*, The Hague: Transnational Institute and Corporate Europe Observatory, 2012. 19.

⁶⁰ Sebastian Perry, "Arbitrators and Human Rights", *Global Arbitration Review*, 13 June 2011,

<http://globalarbitrationreview.com/news/article/29527/arbitrators-human-rights/> (accessed January 2, 2015).

⁶¹ Claire Provost, "Taxes on trial: How trade deals threaten tax justice," Transnational Institute, Global Justice Now, February 2016, 2, 7.

⁶² Claire Provost, "Taxes on trial: How trade deals threaten tax justice," 4.

Table 2.3. Selected ISDS Tax-Related Cases from 1995 to 2015.

| Case | Year Began | Summary |
|--|------------|---|
| Goetz vs Burundi | 1995 | Precious metal investors sue after the government allegedly withdraws incentives including tax and customs exemptions |
| Feldman vs Mexico | 1999 | Investors sue under NAFTA over Mexico's application of tax laws to the export of tobacco products |
| Enron vs Argentina | 2001 | Investors challenge tax assessments allegedly imposed by Argentinean provinces related to a gas transportation business, as well as alleged refusals by the government to let the company increase tariffs |
| Occidental vs Ecuador | 2002 | Oil giant claims decision by Ecuadorian tax authority not to refund VAT paid, and its demand that the company repay already reimbursed taxes, is in violation of bilateral treaty with the US |
| Duke Energy vs Peru | 2003 | Energy company claims Peru breached prior agreements when the company's tax authority changed how it interpreted a law regarding companies' restructuring |
| Cargill vs Mexico | 2005 | US grain giant sues Mexico's 2002 adoption of a new tax on beverages containing high fructose corn syrup |
| Quiborax vs Bolivia | 2006 | Investors say Bolivia expropriated their property after it rescinded their mining concession citing the company's lack of cooperation with customs officials and alleged tax evasion |
| ConocoPhillips vs Venezuela | 2007 | Investors challenge state measures including increased royalties and income taxes on oil projects |
| Tza Yap Shum vs Peru | 2007 | Shareholders in a Peruvian company engaged in the purchase and export of fish flour to Asian markets sue over the seizure of the company's bank account due to tax debt and other alleged actions by Peru's tax authorities |
| MTN vs Yemen | 2009 | Mobile phone giant's claims include complaint over Yemen's alleged refusal to grant it exemptions on profits' tax and customs duties on machinery and equipment transported into the country |
| Ryan and others vs Poland | 2011 | Investors claim that Poland had acted with bias in improperly levying taxes and sanctions on their company, leading to its bankruptcy |
| Bogdanov vs Moldova | 2012 | Investors in a paint-manufacturing company sue over tax and environmental policy changes, which they say negatively impact their business |
| Federal Elektrik Yatirim vs Uzbekistan | 2013 | Energy investors sue over alleged wrongful prosecution, denial of justice and expropriation by government authorities investigating tax evasion offences |
| Vodafone vs India | 2014 | British telecoms giant sues, via its Dutch subsidiary, over a multi-billion dollar retrospective capital gains tax bill related to its acquisition of an Indian mobile phone business |
| Total vs Uganda | 2015 | French oil company sues via its Dutch subsidiary over a tax dispute related to its sale of oil and gas block in the Lake Albert Rift basin |

| | | |
|------------------|------|--|
| Hanocal vs Korea | 2015 | Former majority shareholder in Hyundai Oilbank, an oil refinery in the city of Seosan, sues over taxes levied on the 2010 sale of its controlling stake in the project |
|------------------|------|--|

Source: Transnational Institute, Global Justice Now (2016)

Given the intensely secretive processes with which investment arbitration cases have unfolded, conclusive estimates of the foregone revenues posed by the proliferation of ISDS mechanisms have been elusive— yet the risks posed to strengthening national and local fiscal systems for the NUA’s realization are nonetheless evident. On one hand, the potential compensation figures in ISDS cases, paid from taxpayers’ monies, reach into billions of US dollars: in 2014, for instance, Exxon Mobil Corp. was awarded a USD1.6-billion in an ISDS proceeding against Venezuela, for assets and projects which the country had expropriated in 2007⁶³. But even when the results of arbitration rulings are favorable for governments, just the legal fees alone of hiring specialized law firms can already pose a significant drain on public finances. In 2012, the OECD estimated that states spend an average of USD 8-million in mounting its legal defense in a given ISDS proceeding⁶⁴. More indirectly, but no less troubling, have been the disincentives posed even by the possibility of an ISDS lawsuit against the adoption of new state policies or actions— a trend that has been termed the “*regulatory chill*” effect of investment arbitration⁶⁵. As elaborated by arbitration lawyers themselves in international law journals, “*States face real difficulties in determining, in advance, whether they will be the subject of a successful investment claim in relation to their taxation policies...*”⁶⁶

Owing to all these impacts, the proliferation and threat of ISDS claims by multinationals, as enabled by investment agreements, can seriously erode the space for national and local governments to adopt measures for tapping into critical sources of public revenues (e.g. corporate incomes, mineral rents), plugging fiscal loopholes (e.g. ending tax exemptions), or implementing a wide range of policies for attaining fair, inclusive and sustainable cities. Yet again, however, these effective policy space curbs, as well as their disruptive effects on public efforts to finance the implementation of the NUA, have continued to be neglected throughout the Habitat III process. Insofar as the imbalanced distribution of rights and obligations between states and multinational companies in ISDS mechanisms persists, it is highly possible that legal challenges against national and municipal governments attempting to overcome several of the fiscal issues so far discussed in this report will only increase in the immediate future.

The Effects of Fiscal Austerity. No less significant as a global hurdle to the strengthening of national and local governing fiscal capacities, has been the wave of fiscal adjustment that has swept countries in the aftermath of the Global Financial Crisis of 2007-2008, though earlier forms of austerity have been imposed throughout the Global South via now-infamous World Bank/IMF Structural Adjustment Programs. Even if a phase of fiscal expansion, exemplified by the roll-out of Keynesian stimulus packages, characterized the initial reaction of most governments to the crash, by late 2009, premature moves to contract public spending had begun to take hold despite the ongoing economic recession— a trend which escalated dramatically with the onset of the Greek debt crisis⁶⁷. In effect, such measures have instigated

⁶³ Pietro Pitts and Nathan Cooks, “Exxon Wins \$1.6 Billion Settlement for Venezuela Seizure,” *Bloomberg*, 10 October 2015, <https://www.bloomberg.com/news/articles/2014-10-09/exxon-wins-1-6-billion-settlement-for-venezuela-seizure> (Accessed December 4, 2016).

⁶⁴ OECD (2012): Investor-State Dispute Settlement. Public Consultation: 16 May–23 July 2012; <http://www.oecd.org/investment/internationalinvestmentagreements/50291642.pdf>, 19.

⁶⁵ Pia Eberhardt, “Investment Protection at the Crossroads: The TTIP and the Future of International Investment Law,” *Dialogue on Globalization*, Friedrich Ebert Stiftung, July 2014, 7.

⁶⁶ Matthew Davie, “Taxation-Based Investment Treaty Claims,” *Journal of International Dispute Settlement*, 6:1 February 2015.

⁶⁷ Paul Krugman, “The Austerity Delusion,” *The Guardian*, 20 April 2015, <https://www.theguardian.com/business/ng-interactive/2015/apr/29/the-austerity-delusion> (Access December 4, 2016)

fears of what some observers have described as a potential “*decade of austerity*”— indeed, according to data from the IMF’s *World Economic Outlook* forecasts for 2015, reduced public budgets are expected to remain the norm in two-thirds of all countries until at least 2020, with upper-middle income countries’ populations likely to be especially affected⁶⁸.

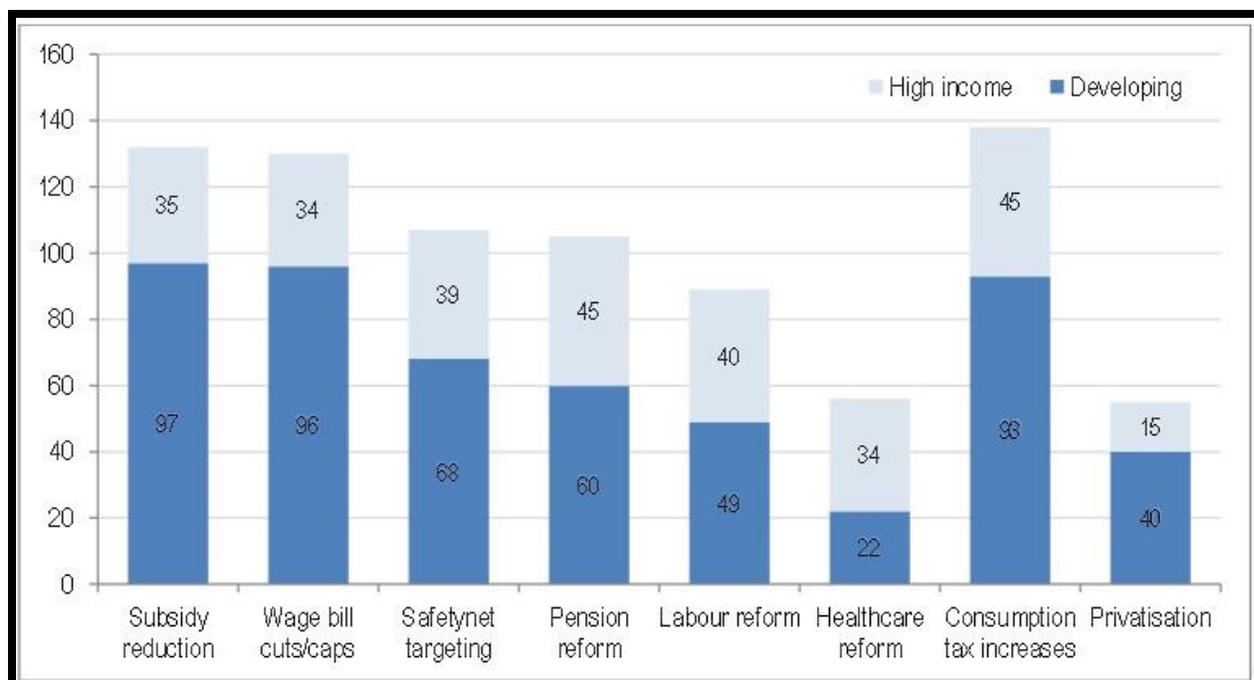
How has the adoption of austerity programs manifested across countries and cities? As shown by research from Ortiz et al. based on IMF reports (see Table 2.4), from 2010 to 2015, the selected cuts on public austerity have been markedly regressive, with the heightening of consumption taxes (138 countries); the elimination of public subsidies for energy, food and agriculture (132 countries); wage and benefits cuts for local civil servants (130 countries); and the rationalization of spending on welfare and social protection measures (107 countries); the reforms to lower pension benefits or to render them more selective (105 countries); and promoting labor flexibility measures (89 countries), having been the most common forms for austerity-oriented adjustments. And far from being confined to high-income countries, the proliferation of austerity fiscal regimes has been even more widespread in the developing world. Though claimed by proponents to be necessary for reducing government budget deficits, preventing defaults on state debts, and sustaining business confidence and growth, the effects of adopted austerity measures have been little short of disastrous. As a plethora studies have demonstrated, the adoption of such measures have harmed countries’ long-term growth and crisis-recovery prospects, threatened their wage-earning populations with heightened unemployment and socioeconomic vulnerability; and intensified socio-spatial inequalities, particularly through their disproportionately negative impacts on already-poor and vulnerable populations⁶⁹. Through their effects particularly on inequality, austerity has even been recently recognized by the IMF to have “*undercut growth, the very thing the neoliberal agenda is intent on boosting.*”⁷⁰

Table 2.4. Incidence of Austerity Measures in 183 countries, 2010-2015

⁶⁸ The International Monetary Fund, *World Economic Outlook October 2013: Transitions and tensions*, Washington, D.C.: International Monetary Fund, October 2013.

⁶⁹ Betsy Donald et al., “Austerity in the City: economic crisis and urban service decline,” *Cambridge Journal of Regions, Economy and Society* 7 (2014), 12.

⁷⁰ Jonathan Ostry, Prakash Loungani and Davide Furceri, “Neoliberalism: Oversold?” *IMF Finance & Development* 53:2 (June 2016).



Source: Ortiz et al., “The Decade of Adjustment: A Review of Austerity Trends 2010-2020 in 187 Countries” (2015)

While policy discussions of austerity tend to focus on national contexts, local and municipal governments have actually been at the forefront of those layers of governments experiencing considerable pressure to impose fiscal austerity measures. Moreover, due to major declines in central-local transfers associated with market-oriented reform even before the Global Financial Crisis, cities have been both victims as well as early innovators of austerity measures, having been compelled to adopt entrepreneurial and business-oriented modes of governance, whether through retrenching local public services, increasing regressive taxes, and privatizing public assets and services⁷¹. Not only have these restructuring of municipal fiscal regimes realigned their governments’ priorities away from welfare and quality public service provision towards more investor-friendly forms of revenue-raising and public spending, they have usually been accompanied by the weakening of local democratic processes— whether in terms of the appointment of unelected administrators over local financial decision-making or in the concentration of power in informal political networks of local elites and entrepreneurial officials. All told, through local revenue decreases (i.e. via diminished central-local transfers), budget crunches (particularly to universal public services), redefined pro-investor spending priorities, and diminished public influence over local public finance decisions, the imposition of municipal austerity regimes has often served as an immediate cause for dramatic increases in social and spatial inequality at local levels, undermining prospects for the realization of equitable and inclusive cities⁷².

Like the other challenges discussed above, the threat posed by fiscal austerity to financing inclusive cities has not been featured nor addressed in the NUA itself. Yet despite this, the March 2016 Mexico Declaration made a notable acknowledgement that, “*In recent years, local infrastructure and local basic services investments through public financing has considerably slowed down, partly due to fiscal austerity measures, leading to underinvestments in the*

⁷¹ Betsy Donald et al, “Austerity in the City: economic crisis and urban service decline,”. 5-6.

⁷² Ibid., 6, 12.

*necessary infrastructure for urban development.*⁷³ While this recognition is a welcome development, it is nonetheless disappointing that an express commitment towards avoiding the re-imposition of austerity fiscal measures, as a widely-demonstrated threat against urban dwellers' enjoyment of the "*Right to the City*," has not been included in the outcome document of HIII. This is especially disappointing, given that the debate on austerity in the economics profession has been settled in favor of austerity opponents. Tellingly, in 2015, Nobel prize-winning economist Paul Krugman maintained, "*Events had utterly failed to play out as the austerians predicted, while the academic research that allegedly supported the doctrine had withered under scrutiny.*"⁷⁴

III. RECLAIMING PUBLIC FINANCE: TAX JUSTICE AND POLICY RESPONSES FOR EFFECTIVE AND PROGRESSIVE FISCAL SYSTEMS

Whatever these weaknesses the NUA and its affiliated documents, it is hardly as if concerns related to tax justice and progressive public finance have not been included in HIII discussions. Indeed, in the collective position of the HIII's General Assembly of Partners (GAP), which was released in May 2016, both "*tax justice for local governments and communities*," and "*adequate investment in and enforcement of tax avoidance systems*," were featured prominently among the GAP's fiscal recommendations⁷⁵. Similarly, throughout the HIII process, the Trade Union and Workers' sector, along with many of the global civil society organizations engaged in the 2015 UN FfD Conference, have been vocal in championing the inclusion of tax justice issues (in addition to decent work, labor and social rights, and universal access to public services) in the text of the NUA. This engagement has been exemplified in the issuance of several sector-wide statements responding to the drafts of the NUA, as well as the release of a widely-publicized "*2030 spotlight*" report by the global SDG Reflection Group, which featured recommendations for granting more prominence to "*tax justice for local governments and communities*," "*universal access and public investments in essential public services*," and "*securing policy coherence between an inclusive New Urban Agenda and their tax and trade policies*" (see Box 4.1) in the NUA.

Box3.1: Excerpt: A 10-Point Agenda for the New Urban Agenda from the Trade Union and Workers' Sector

Habitat III, the United Nations Conference on Housing and Sustainable Urban Development, will be convened in Quito, Ecuador, 17–20 October 2016. The objective of this conference is to reinvigorate the global commitment to sustainable urbanization and to focus on the implementation of a "New Urban Agenda." This agenda can also be seen as the implementation programme for SDG 11 on inclusive, safe, resilient and sustainable cities.

These are the 10 key points for a New Urban Agenda:

- The generation of decent work opportunities for all as a precondition to urban socio-economic inclusion and local economic development;
- Universal access and public investment in essential public services such as water, energy, health care, transportation, waste management, social services, education etc.;
- The protection of public spaces and commons from privatization and gentrification;

⁷³ Habitat III Mexico Declaration, 2.

⁷⁴ Paul Krugman, "The Austerity Delusion"

⁷⁵ HIII General Assembly of Partners, *Partnerships for the New Urban Agenda*, Nairobi: UN-Habitat, May 2016, 8.

- The inclusion of labour and environmental clauses in public procurement and public contract transparency and disclosure;
- The empowerment of local government;
- Decent working and living conditions and capacity-building for public sector and municipal workers who will have to implement the New Urban Agenda;
- An integrated approach to fight corruption;
- Tax justice for local governments and communities;
- The right to housing for all;
- The need for national governments to secure policy coherence between an inclusive New Urban Agenda and their tax and trade policies.

Source: Sandra Vermuyten, "Towards a New Agenda," *Spotlight on Sustainable Development: Report by the Reflection Group on the 2030 Agenda for Sustainable Development* (2016)

What specific strategies for strengthening national and local fiscal systems might such a “*tax justice*” approach endorse, were it to be adopted? Against technically-oriented approaches to fiscal upgrading which have been predominated among international organizations (e.g. the IMF), a tax justice perspective instead sees taxation and public spending matters as intrinsically linked with the fulfillment of economic justice and citizens’ social and economic rights. As such, while the promotion of tax justice remains integrally concerned with raising public revenues for meeting the basic needs of its citizens and ensuring fiscal stability, it also views the reform of tax systems as a key opportunity to achieve other socially-progressive objectives, particularly facilitating the *redistribution* of wealth from wealthier to poorer income groups, strengthening government *accountability* and citizen *representation*, *reclaiming* public policy space of governments viz. development donors and international financiers, and *repricing* the social and environmental costs of certain products (e.g. tobacco, fossil fuels) to minimize agreed public “*bads*” and maximize public “*goods*.”⁷⁶

Though normally advocated with national-level tax systems in mind, each of these objectives are nonetheless integral to the challenge of raising revenues for well-served, equitable, inclusive and sustainable cities. With the reform of national and local fiscal systems being especially well-positioned to achieve additional benefits for equity, accountability, broader social benefit and environmental sustainability, the case for adopting interventions along the lines prescribed by tax justice lens becomes even more compelling. To be sure, there are no silver-bullet solutions to the wide array of problems obstructing the improvement of countries and municipalities’ capacities for revenue mobilization— but a number of institutional reforms and policy options still exist which can contribute significantly towards heightening prospects for publicly financing the realization of inclusive cities. And just as constraints against fiscal upgrading are located at multiple levels, so too must any coherent and systematic effort to strengthen fiscal systems for achieving the NUA demand coordinated action and intervention from the global to the national and subnational echelons of government. In this light, the following sections lay down some of some overall directions that efforts for fiscal and institutional change can take, especially if they are to fulfill the multiple social, economic and governance goals sought by tax justice approaches.

⁷⁶ Sally Golding et al., *Tax Justice Advocacy: A Toolkit for Civil Society* (London: Christian Aid, 2011), 2.

3.1. *Reforming the International System of Fiscal Governance*

With tax processes around the world being constrained by deficiencies in various global governance regimes, institutional reform over fiscal matters comprises one of the foremost items on the global policy agenda. Yet even beyond interventions addressing conventional central-local and global-national intergovernmental relations, institutional advances more directly linking fiscal governance processes at global and municipal levels are increasingly vital for empowering local public finance systems. Indeed, as was recognized in paragraph 34 of the outcome document of the UN FfD Conference, efforts for “*scaling up international cooperation*” for strengthening the financing capacities of local governments have come to fore as an increasingly decisive area for policy action⁷⁷. In this light, the global regimes for corporate taxation, international public financing, and international investment stand as some of the most pressing areas for generating an integrated enabling environment for subnational revenue-raising, particularly from the vantage point of the Global South.

International Corporate Tax Reform. Owing to the magnitude of problems posed by international tax avoidance, broad-based interest and support for the cause for global tax reform has grown by leaps and bounds across the past decade. Said by some observers to even be tantamount to a “*great tax awakening*,”⁷⁸ calls for “*international tax reform*” have now become commonplace in international policy-making bodies, with high-level commitment for reform having been displayed by multilateral institutions, and Northern and Southern governments (i.e. UN, the G8, the G20, the IMF, the OECD, the EU, the African Union⁷⁹). Among these actors, moreover, combating corporate transfer mispricing specifically has been recognized to be of utmost importance to ensuring the integrity of national and local fiscal systems in developing countries.

A detailed discussion of the reforms needed to comprehensively address corporate transfer mispricing deserves its own report— but at its core, it would require a long-term shift away from the prevailing “*separate entity*” approach in the international corporate tax system, which allows member firms of a multinational corporate group (whether parent or subsidiary companies) to be treated as legally separate entities. Laid down during the pre-World War II period, and currently embedded in over 3,000 tax treaties,⁸⁰ the approach prescribes that related companies within a multinational group should be made to price their transactions with one another as if being conducted at market rates with unrelated third parties⁸¹. As present tax avoidance dynamics demonstrate, however, the difficulties of administering this separate entity approach have regularly proven to be nearly insurmountable in practice, opening tremendous scope for abuse for transnational companies to artificially shift their profits to low-tax jurisdictions⁸².

⁷⁷ Addis Ababa Action Agenda, 16.

⁷⁸ Mick Moore, “The Great Tax Awakening? Three Reservations,” *International Centre for Tax and Development*, 23 May 2013, <http://www.ictd.ac/blogs/entry/the-great-tax-awakening-three-reservations> (Accessed December 11, 2015)

⁷⁹ Erika Dayle Siu, “International Corporate Tax Reform is Critical to Financing Sustainable Development,” *UNRISD: The Road to Addis and Beyond Series*, 6 July 2015, <http://www.unrisd.org/road-to-addis-siu> (Accessed December 11, 2015)

⁸⁰ Sol Picciotto, “International Corporate Taxation,” *ICTD Summary Brief 3*, International Center for Tax and Development, May 2016, 2; Sol Picciotto, “Is the International Tax System Fit for Purpose, Especially for Developing Countries?” *ICTD Working Paper 13*, International Center for Tax and Development, September 2013, 10-12.

⁸¹ **Note:** This is a principle known as the “*arm’s length principle*,” which in practice has been tremendously difficult and expensive to enforce successfully and consistently over intra-firm trading activities and has been even further complicated by the rise of intangible assets.

⁸² Sol Picciotto, “Is the International Tax System Fit for Purpose, Especially for Developing Countries?” 16-17.

The collective problems with implementing the separate entity approach have been of such magnitude that an increasing number of global tax campaigners and reformers have championed a legal approach towards the taxation of multinational corporate groups premised on treating them as *single firms* rather than them as a loose array of independent entities. This *unitary* approach to the taxation of transnational companies has been maintained to hold the most long-term potential for curbing international corporate tax avoidance. Under envisioned unitary arrangements, multinational companies would be obliged to submit a worldwide consolidated report of activities to tax administrations in each country where they retain economic presence, which would then enable tax officials to aggregate the taxable global profits of those companies and distribute the resulting revenues according to an agreed-upon formula for determining a multinational corporation's country-by-country economic activities. Not only would this arrangement effectively eliminate multinationals' leeway for artificially shifting profits across countries, it would also serve to significantly lessen the transactions costs and demands of both companies and tax agencies⁸³.

To be sure, the scale of practical changes needed by a full shift towards unitary taxation and the need for robust international agreement on such a system make it unlikely that worldwide unitary approaches will materialize in the near future. Unsurprisingly, concrete advances towards unitary systems of international corporate taxation have remained elusive. Even as the past few years have witnessed high-profile international corporate tax reform initiatives, particularly the G20/OECD Base Erosion and Profit Shifting (BEPS) initiative, leading tax experts have continued to characterize the OECD BEPS effort as marked by "*hesitant*" and only partial steps towards unitary taxation, having remained firmly attached to the separate entity approach in the most critical respects (i.e. the allocation of company profits)⁸⁴. This does not mean that examples of unitary tax approaches have been completely absent, however. Indeed, subnational instances of unitary corporate tax systems having been located in countries with federal systems of government, such as in Argentina, Canada, Switzerland and the United States, whose the experiences of which attest to the importance of guaranteeing the uniformity of rules across jurisdictions in determination, consolidation and apportionment of tax bases; and of the sufficiency and completeness of information (through consolidated reporting of all income-producing activities of the entire unitary business in all jurisdictions) to ensure the administrative viability of the unitary tax system⁸⁵. Such lessons can serve to guide the design transnational unitary arrangements, particularly, in the medium term, among regionally-integrated economic blocs in Europe (i.e. the European Union), Southeast Asia (i.e. ASEAN), East Africa (i.e. the EAC), and in Latin America (i.e. CAN).

Even before adopting unitary approaches, however, a wide suite of measures and incremental adjustments to international corporate tax rules can already be adopted as part of efforts to advance anti-avoidance objectives in the short term. Such initiatives include, but are by no means limited to, imposing criminal penalties on abusive tax practices; heightening resources and legal protection to tax administrators to collect taxes from multinationals; improving transparency requirements for corporate activities; establishing public centralized registers of companies; strengthening tax deductibility restrictions; introducing country-by-country reporting for corporations; widening the use of withholding taxes; as well as reforming tax treaties to revise rules governing profit-split methods and to include heightened anti-avoidance

⁸³ Sol Picciotto and Miles Dean, "The Debate: Should we move to a system of unitary taxation," *Tax Journal*, 18 December 2012, <https://www.taxjournal.com/articles/debate-should-we-move-csystem-unitary-taxation-18122012> (Accessed December 4, 2016)

⁸⁴ Sol Picciotto, "Taxing Multinational Enterprises as Unitary Firms," ICTD Working Paper 53, International Center for Tax and Development, June 2016, 15, 21.

⁸⁵ Erika Dayle Siu et al., "Unitary Taxation in Federal and Regional Integrated Markets," ICTD Research Report 3, International Center for Tax and Development, September 2014, 10, 51-52.

measures to⁸⁶. These and other measures feature prominently in the recommendations of the Independent Commission for the Reform of International Corporate Taxation (ICRICT), which presented the most public interest-oriented agenda for global corporate tax reform during the 2015 UN FfD Conference (see Annex I)⁸⁷.

International Public Finance Mechanisms. Beyond the reform of international corporate taxation, another pressing concern will be that of reorienting international public financing regimes that directly impact upon the fiscal activities of subnational governments— whether in terms of tax-oriented official development assistance (ODA) for subnational governments, or the kinds of fiscal regimes currently being purveyed by national states and international financial institutions (especially when linked to sovereign debt issues). For one, in recent years, development donors have increasingly attempted to link ODA provision to the achievement of heightened tax effort: in 2013, the Development Cooperation Directorate of the OECD itself endorsed the extension of improved aid modalities for tax capacity-building, through mechanisms like general budgetary support, sectoral budgetary support, basket financing, multi-donor trust funds, funding South-South organizations, and in-kind support⁸⁸. This same thrust has likewise been demonstrated by developments during the *Third International Conference for Financing for Development* in 2015, with over 30 countries and international/regional organizations (including the United States, the United Kingdom, Germany, the World Bank, the OECD, and the IMF) pledging, among others, to double their support for development cooperation in taxation by 2020 with the launching of the *Addis Tax Initiative*⁸⁹.

But while this “turn” of ODA to domestic revenue-raising is certainly a welcome development, to what degree this redoubled focus will translate into significant increases in support for subnational and municipal forms of taxation remains an open question, given that the bulk of such commitments have largely tended to focus on the activities of national revenue authorities⁹⁰. According to UCLG and the Global Taskforce of Local and Regional Governments, even in the midst of heightened attention to tax matters, an “*inadequate focus*” on the fiscal resources needed by local and regional governments to achieve sustainable urban development has thus far persisted, while the inclusion of measures to ensure the “*localization*” of financing has remained insufficient⁹¹. This makes it all the more imperative that subnational and municipal governments be granted more opportunities by central states and international organizations for accessing tax-oriented international public financing mechanisms. Along with creating new aid modalities that more directly support municipal financing activities, there also remains a pressing need to establish new consultative mechanisms able to bring together both traditional and non-traditional actors (e.g. local and municipal governments, emerging Southern donors, civil society organizations) in aid initiatives for fiscal upgrading as well as multi-actors platforms able to foster longer-term cooperation among them in improving local resource mobilization capacity⁹².

⁸⁶ Markus Henn, “Tax Havens and the Taxation of Transnational Corporations,” 12.

⁸⁷ Independent Commission for the Reform of International Corporate Taxation, *Declaration of the Independent Commission for the Reform of International Corporate Taxation*; Michael Durst, “Beyond BEPS: A Tax Policy Agenda for Developing Countries,” 10, 14.

⁸⁸ OECD, *Tax and Development: Aid Modalities for Strengthening Fiscal Systems*, Paris: OECD, 2013. 15-16, 17.

⁸⁹ International Tax Compact, “Financing for Development Conference: The Addis Tax Initiative – Declaration,” July 2015, https://www.taxcompact.net/documents/Addis-Tax-Initiative_Declaration.pdf, 2 (Accessed December 4, 2016)

⁹⁰ Mick Moore, “Obstacles to Increasing Tax Revenues in Low Income Countries,” 31.

⁹¹ Global Taskforce of Local and Regional Governments for Post-2015 Development Agenda Towards Habitat III, “Financing Urban and Local Development: the Missing Link in Sustainable Development Finance,” *United Cities and Local Governments*, March 2015, <http://delog.org/web/wp-content/uploads/2015/01/Background-Paper-of-LRGs-on-FfD3.pdf>, 3 (Accessed December 4, 2016); United Cities and Local Governments, “UCLG take on the Addis Ababa Action Agenda”

⁹² Global Taskforce of Local and Regional Governments for Post-2015 Development Agenda Towards Habitat III, “Financing Urban and Local Development: the Missing Link in Sustainable Development Finance,” 15-16.

An arguably even more immediate task than the extension of tax-oriented ODA, however, lies in discontinuing the austerity policy packages that have been recently adopted by governments or imposed upon them by international financial institutions. Given the regressive and counterproductive impacts of such austerity programs, it is clear that harnessing different counter-recessionary strategies are imperative to ensuring that local and regional governments are sufficiently resourced for maintaining the spending levels that realizing the NUA will entail.

At the subnational levels, espousing such regimes of “*fiscal activism*”⁹³ will necessarily hinge upon both local governments’ undertaking counter-cyclical measures, as well as establishing policy frameworks conducive to heightened local public spending and progressive revenue-raising. In case of the US, for instance, economic downturns that have previously elicited austerity measures can instead be countered by several subnational policy options, such as raising progressive subnational taxes focusing on wealthier households; realigning local government loan-taking and procurement activities to prioritize banks and suppliers committed to supporting local business and job-generating investments; harnessing local government reserves or “*rainy day funds*”; increasing local government borrowing and spending for long-term infrastructure investments; and cooperating to retract excessive local fiscal incentives for investors. Such local fiscal activism, naturally, will stand to benefit considerably when collaborative, coordinated dynamics exist between central and subnational governments. The local interventions just mentioned, for instance, can be strongly complemented by federal-level action to strengthen the provision of central funds for local and regional governments (whether or not as a direct component of a national stimulus package), while lowering borrowing constraints on subnational governments⁹⁴. Though which options are available to subnational governments to undertake counter-recessionary programs will depend on the specific intergovernmental fiscal frameworks of the country at stake, the more important point is that, if a modicum of fiscal decentralization has already been achieved, most local states will often have a number of tools already at their disposal to undertake socially-progressive, growth-recovery efforts without recourse to fiscal austerity measures.

When central governments are under high international pressure to adopt austerity-oriented policy regimes (e.g. in relation to sovereign debt repayments), however, the development of new multilateral frameworks for responsible sovereign debt borrowing, lending and restructuring is of paramount importance for securing a conducive macroeconomic environment for sustained national government spending even while meeting debt obligations. In this regard, ongoing efforts at the United Nations for laying the groundwork for a fair and inclusive sovereign debt workout mechanism deserve further political support for ensuring that orderly debt workout options remain accessible to debtor nations already in financial distress⁹⁵. In like manner, within the Eurozone, joint debt management approaches between creditor and debtor nations have likewise been argued by observers to be a critical facet of both individual debt restructuring efforts and the crafting of a prospective “*European Marshall Plan*,” which could contribute to the zone’s post-crisis recovery through a long term investment program in, among other things, green energy and infrastructures, employment-generating initiatives, and social services⁹⁶. As the post-crisis experiences of Iceland (2008-2011) and Ecuador (1998-2000) show (see Box 4.2), successful efforts to restructure sovereign debt, when complemented by a parallel

⁹³ Raj Nallari, “Is Fiscal Activism Back?” *World Bank Blogs*, 3 August 2010, <http://blogs.worldbank.org/growth/fiscal-activism-back> (Accessed December 4, 2016)

⁹⁴ Robert Pollin and Jeff Thompson, “State and Municipal Alternatives to Austerity,” *New Labor Forum* 20:3 (2011), 24-28.

⁹⁵ United Nations Conference for Trade and Development, *Development-Led Globalization: Towards sustainable and inclusive development paths*, Geneva: United Nations Conference for Trade and Development, 2011. 70-72.

⁹⁶ Michael Dauderstadt and Ernst Hillebrand (eds.), *Alternatives to Austerity: Progressive Growth Strategies for Europe*, Bonn: Friedrich Ebert Stiftung, December 2013. 36-38.

measures to expand domestic finances, can contribute significantly to preventing the highly regressive effects of austerity, and instead increasing countries' fiscal capacity for securing a socially-inclusive recovery trajectories. Such parallel measures can potentially include increasing progressive tax revenues, curbing illicit financial flows and tax evasion, improving tax collection efficiency, raising domestic borrowing, and using fiscal and central bank foreign exchange reserves⁹⁷.

Box 3.2. Excerpt: A Decade of Austerity is not Inevitable – The Examples of Iceland and Ecuador

Iceland repudiated private debt to foreign banks and did not bail-out its financial sector, pushing losses on to bondholders instead of taxpayers. The government also imposed temporary capital controls to shield itself from capital outflows and focused on supporting households and businesses in a difficult fiscal context. From Iceland's IMF Article IV Consultation (2012:5-6): "A key post crisis objective of the Icelandic authorities was to preserve the social welfare system in the face of the fiscal consolidation needed. Wage increases, agreed among the social partners in May 2011, led to a rise in nominal wages of 6 per cent and the unemployment rate fell to about 7 per cent in 2012.../...In designing fiscal adjustment, the authorities introduced a more progressive income tax and created fiscal space to preserve social benefits. Consequently, when expenditure compression began in 2010, social protection spending continued to rise as a percentage of GDP, and the number of households receiving income support from the public sector increased. These policies, led to a sharp reduction in inequality. Iceland's gini coefficient—which had risen during the boom years—fell in 2010 to levels consistent with its Nordic peers."

Ecuador, a country challenged like Europe by not having a national currency (it uses the US\$) and therefore has limited capacity for policy maneuver, creatively managed to restore growth and improve living conditions. The government kept interest rates low and expanded liquidity by requiring banks to keep at least 45 per cent of their reserves in Ecuador. On the other hand, it took a partial default on its illegitimate external debt (private debt that had been made public); the freed public resources were invested in human development, which included doubling education spending between 2006-09, nearly doubling housing assistance programs to low-income families and expanding its main social protection program, the cash transfer *Bono de Desarrollo Humano*. The results are impressive: poverty fell from a recession peak of 36.0 per cent to 28.6 per cent, unemployment dropped from 9.1 per cent to 4.9 per cent and school enrollment rates rose significantly.

Source: Ortiz et al., "The Decade of Adjustment: A Review of Austerity Trends 2010-2020 in 187 Countries" (2015)

Trade and Investment Agreements. With the risks posed by ISDS mechanisms to the regulatory powers and fiscal burdens of states across the world, efforts to reorient the increasingly pro-multinational global investment regime are likewise crucial for ensuring that governments retain sufficient policy space to adopt tax, fiscal and sectoral policies at both national and subnational levels. On one hand, this weighs in favor of renegotiating existing investment treaties, including "mega-regional" treaties such as the TPP, TTIP, and TISA. The global reaction against international investment arbitration has been such that a number of countries have outright terminated a number of their investment treaties with ISDS instruments. As for writing, for example, Brazil has refused to sign any investment treaties which allow for ISDS mechanisms; South Africa has decided to terminate majority of its bilateral investment treaties; Indonesia has opted to eventually discontinue its 67 existing bilateral investment treaties; while Bolivia, Ecuador and Venezuela have withdrawn from the International Centre for the

⁹⁷Isabel Ortiz et al., "The Decade of Adjustment: A Review of Austerity Trends 2010-2020 in 187 Countries" ESS Working Paper No. 52, Geneva: International Labor Organization, 2015, 37.

Settlement of Investment Disputes— the leading organizational and institutional framework for administering ISDS procedures⁹⁸.

At the same time, given that such treaties tend to have a number of in-built “*self-defense mechanisms*,” such as tacit renewal clauses and “*survival clauses*” which render the rights of investors and obligations of states relatively immune to short-term change (i.e. extending the effects of treaties for existing investments up to 15 years after termination)⁹⁹, unilateral action to attempt nullifying ISDS-enabling investment agreements may not be enough. Renegotiating bilateral and multilateral investment treaties to introduce amendments, in this light, has been held up as one potential option to establish greater legal shields for states against investment arbitration while bypassing the application of survival clauses¹⁰⁰. However, even more broadly, provided the sheer volume of bilateral and multilateral investment treaties currently in existence, a more thoroughgoing and comprehensive process to restructure the global investment protection landscape is also called for. In this vein, it is worth noting that key investment reform actors such as the United Nations Conference for Trade and Development (UNCTAD), South Centre and the G-77 have in fact been championing the systematic reform of the international investment regime, as an opportunity to bring international investment flows into greater coherence with the pursuit of the SDG’s.

As further elaborated in Table 3.1, the UNCTAD systematic reform framework for the international ISDS regime endorses collective action among states in five different areas: namely, (1) safeguarding states’ right to regulate while providing protection to investors from arbitrary action (e.g. via “*safety valves*” for public policies such as measures to prevent tax evasion), (2) improving investment dispute settlement (e.g. through clauses that limit investor access, adding new elements like an ISDS appeals facility, or even moving towards state-state dispute settlement or a standing international investment court), (3) adding a component of investment promotion and facilitation to the regime, (4) ensuring responsible investment, and (5) enhancing the systematic consistency of the regime¹⁰¹. Interestingly, UNCTAD itself maintains that using “*carve-out*” clauses to install “*filters*” in investment agreements that refer “*sensitive cases*” to State-State dispute mechanisms, which will be thereafter be binding on ISDS tribunals, represents a promising avenue to pursue with regards to safeguarding existing policy space for states’ powers of taxation¹⁰². Though subnational governments are unlikely to be highly involved in the realization of such reforms beyond ensuring internal coordination between national and subnational state levels, the attainment of such long-term advances is bound to have significant repercussions on their policy space as well, given that more than 50% of ISDS claims result from measures adopted by subnational governments and specialized regulatory agencies¹⁰³.

Table 3.1. UNCTAD: 5 Reform Objectives and Areas for ISDS Reform

⁹⁸ Philippa Maister, “Breaking BITs: why are countries withdrawing from bilateral investment treaties,” *FDI Intelligence*, 12 February 2015, <http://www.fdiintelligence.com/Companies/Breaking-BITs-why-are-countries-withdrawing-from-bilateral-investment-treaties?ct=true> (Accessed December 4, 2016)

⁹⁹ Federico Lavopa, Lucas Barrios, and Maria Victoria Bruno, “How to Kill a BIT and not die trying: Legal and Political Challenges of Denouncing or Renegotiating Bilateral Investment Treaties,” (July 9, 2012). Society of International Economic Law (SIEL), 3rd Biennial Global Conference. Available at SSRN: <https://ssrn.com/abstract=2102683>, 3, 14-15.

¹⁰⁰ *Ibid.*, 15-17.

¹⁰¹ UNCTAD, “Taking Stock of IIA Reform,” UNCTAD IIA Issues Note No. 1 March 2016, UNCTAD, March 2016, 2-3.

¹⁰² United Nations Conference on Trade and Development, *World Investment Report 2015: Reforming International Investment Governance*, 148-149.

¹⁰³ Roberto Echandi, “Finding a Constructive Use for IIAs: Regulatory, Transparency and Investment Retention,” *World Bank Group: Investment Policy and Promotions Week*, 13 October 2015, https://olc.worldbank.org/sites/default/files/Module-3_Session-4-Roberto-Echandi.pdf (Accessed December 4, 2016)

| Reform objectives | Reform areas |
|--|--|
| 1. Safeguarding the right to regulate | Circumscribed (clearly defined) IIA standards of protection <ul style="list-style-type: none"> ♦ Fair and equitable treatment ♦ Indirect expropriation ♦ MFN "Safety valves"; e.g. exceptions for <ul style="list-style-type: none"> ♦ Public policies ♦ National security ♦ Balance-of-payments crises |
| 2. Reforming investment dispute settlement | Clauses that <ul style="list-style-type: none"> ♦ Fix the existing ISDS mechanism by improving transparency, limiting investors' access, enhancing the contracting parties' control and introducing local litigation requirements ♦ Add new elements to the existing ISDS mechanism (e.g. building in effective alternative methods of dispute resolution, introducing an appeals facility) ♦ Replace the existing ISDS mechanism (e.g. by creating a standing international investment court, reliance on State-State dispute settlement and/or reliance on domestic dispute resolution) |
| 3. Promoting and facilitating investment | Clauses that <ul style="list-style-type: none"> ♦ Strengthen promotion measures (inward and outward) ♦ Target promotion measures to sustainable development ♦ Foster cooperation in this regard |
| 4. Ensuring responsible investment | Clauses that <ul style="list-style-type: none"> ♦ Prevent the lowering of environmental or social standards ♦ Ensure compliance with domestic laws ♦ Strengthen corporate social responsibility (CSR) and foster cooperation in this regard |
| 5. Enhancing systemic consistency | Clauses and mechanisms that manage interaction between <ul style="list-style-type: none"> ♦ IIAs and other bodies of international law ♦ IIAs and domestic investment and other policies ♦ Different IIAs within a country's network |

Source: UNCTAD, *World Investment Report 2015: Reforming International Investment Governance* (2015)

Tax Competition. Finally, given its impact of fiscal dynamics at both international and subnational levels, curbing the various forms of revenue erosion posed by tax competition will itself require integrated responses at multiple levels of government action. For addressing “*race-to-the-bottom*” pressures in setting tax rates, for instance, global public finance reformers associated with ICRICT have maintained that the single most effective measure for national governments to enact would be to jointly adopt minimum effective tax rates for the specific levies concerned both across subnational jurisdictions (e.g. for business tax rates) as well as between countries (e.g. for corporate income tax rates, especially on multinationals). While agreement on such a minimum tax rate, particularly at the global level, remains unlikely in the immediate future, given the missed opportunity in the 2015 UN FfD Conference to establish a global tax body enabling equal participation for developed and developing countries, as well as the likelihood of protracted contestation over the details of tax floor proposals, most countries can already work towards adopting such minimum rates as part of regional groupings (e.g. the EU, ASEAN) in the short-term¹⁰⁴. Indeed, such interventions can comprise part of broader initiatives to leverage upon regional economic blocs as platforms for international tax cooperation, especially for averting the erosion of developing countries’ corporate tax bases¹⁰⁵.

¹⁰⁴ Independent Commission for the Reform of International Corporate Taxation, “Four Ways to Tackle International Tax Competition,” 1-2.

¹⁰⁵ Michael Durst, “Beyond BEPS: A Tax Policy Agenda for Developing Countries,” 14.

Apart from establishing minimum effective tax rates, another key mechanism that can be undertaken to curtail tax competition would be through the elimination of most tax breaks granted by national and local governments to business investors— or at minimum, their rationalization so as to significantly tighten the conditions for which they might be granted, to ensure transparency over the decision-making processes and the final outcomes (e.g. foregone tax revenues) behind such them, and to establish a level playing field for both residents and non-residents in accessing them¹⁰⁶. In particular, tax breaks associated with the establishment of special economic zones (e.g. income tax holidays), special tax privileges accorded to multinational companies via bilateral tax treaties (e.g. stability agreements), as well as discretionary incentives extended to politically-influential investors, have been identified to be among the most harmful to developing countries' and municipalities' treasuries¹⁰⁷. Abolishing these kinds of tax breaks alone will already do much to plug some of the most severe fiscal leakages affecting central and subnational governments in the Global South.

In addition, a variety of other measures can also be adopted to further reinforce the expanded fiscal and policy space that the removal of such tax breaks should bring. On a national level, for example, this can be done by moving decision-making authority over tax incentives from local governments and investment-promotion agencies to finance ministries; by requiring that all new incentive packages are grounded in legislation and subject to parliamentary approval; by performing periodic public reviews and audits of all tax incentives extended by national and local governments; and by publishing regular public bulletins about the costing, justification and conditions of incentives. Internationally, strengthened regional-level coordination, involving mandatory automatic information exchange; annual, comparable and publicly-available reporting on fiscal incentive packages and costs; and the development of shared codes of conduct on the granting of statutory tax incentives can likewise do much to alleviate competitive pressures among states for granting excessive, redundant tax breaks to foreign investors¹⁰⁸. Both the EU's existing Code of Conduct on Business Taxation, and the EAC's proposed Code of Conduct on Harmful Tax Competition provide cases of international tax cooperation that other regional groups could emulate and further build upon¹⁰⁹.

3.2. *Municipal Fiscal Systems: Areas and Options*

Even while the scale of several of the international governance changes mentioned above will depend on factors lying outside most national and subnational governments' immediate influence, various policy and institutional interventions nonetheless exist which many can already undertake for improving their fiscal systems in equitable and inclusive directions. Indeed, as already mentioned, several of these options have received widespread attention throughout the 2015 UN FfD Conference and the 2016 HIII process— including effective fiscal decentralization, registering and expanding local revenue bases via multipurpose cadasters, local taxes, fees and service charges, land value capture mechanisms, and so on¹¹⁰. How would viewing these different instruments from economic justice and human rights perspectives affect their desirability as revenue-raising options?

Fiscal Decentralization. To begin with, which of these options national and subnational governments can opt for and to what extent they can pursue them will depend on the existing intergovernmental fiscal frameworks between central and subnational levels of government. It

¹⁰⁶ Independent Commission for the Reform of International Corporate Taxation, "Four Ways to Tackle International Tax Competition," 2-4.

¹⁰⁷ ActionAid, *Give Us a Break: How Big Companies are Getting Tax-Free Deals*, London: ActionAid, June 2013, 5.

¹⁰⁸ Tax Justice Network – Africa and ActionAid International, "Tax Competition in East Africa: A race to the bottom?" April 2012, http://www.actionaid.org/sites/files/actionaid/eac_report.pdf, 24 (Accessed December 4, 2016).

¹⁰⁹ ActionAid, *Give Us a Break: How Big Companies are Getting Tax-Free Deals*, 11.

¹¹⁰ New Urban Agenda, 18-19.

would be pointless to exhort local governments to raise their own taxes, charges and other funding sources, if prevailing fiscal institutions and arrangements do not grant such government units control over such revenue-raising instruments. On a similar note, what pressures subnational governments will experience for mobilizing (or failing to fully mobilize) resources from their revenue bases will be highly influenced by both the volume and design of fiscal transfers allotted to them by central governments. For these reasons, substantially realizing pledges of substantive fiscal decentralization will necessarily remain one of the fundamental priorities of countries and cities implementing the NUA.

Driving substantive fiscal decentralization entails a process of broad institutional restructuring, touching upon reforming the dynamics of fiscal transfers, the allocation of tax powers, the fiscal capacities of subnational governments, the rules and regulations for accessing other streams of finance, even while considering the distribution of expenditure tasks among different levels of government. Given that fiscal transfers in developing countries typically tend to account for more than half of the revenue of municipalities¹¹¹, yet as shown earlier, still regularly fall short of the expenditure needs of local and regional governments, changes in both the volume and the design of fiscal transfers from central to subnational levels of governments remains a cardinal priority for ensuring that local governments are well-financed, and sufficiently judicious in the use of the limited resources provided to them. While concrete prescriptions on how much revenues should be transferred from central to subnational levels of government is difficult to determine due to vast country differences in the inter-governmental assignment of expenditure functions, it is striking that the outcome document of the 5th UCLG Congress of 2016 (i.e. the Bogota Commitment and Action Agenda), which represented the views of UCLG's member cities, regional governments, and partner organizations, expressly recommended ensuring an *“equitable sharing of national resources to reach a minimum percentage going to local governments – at least 20% of the total public budget – in the next decade.”*¹¹² This very same proposal had been integrated into earlier drafts of the NUA, though it had been removed afterwards.

No less important as increases in fiscal transfers is the need to rework the institutional architecture undergirding their distribution and delivery. Though the design of such schemes differs across countries, a number of issues concerning them have chronically hounded such systems in developing countries, like the unreliability and inefficiency of their delivery; the lack of clarity, transparency and appropriateness in their allocation; and the potential revenue-raising disincentives they pose to subnational governments¹¹³. In turn, for addressing such institutional problems, reform practices usually shown to improve such transfer systems in specific fiscal decentralization episodes include espousing clarity, simplicity and consistency in the application of grant objectives; minimizing the scope for arbitrary influences by apportioning transfers according to objective, transparent and easy-to-use formulas; adopting additional *“performance-based grants”* and other capability-building inputs that tie fiscal transfer allocation with the promotion of, among others, good governance, improved revenue mobilization and fiscal management, and better service-delivery; and fostering collaborative approaches such as consultations with grant beneficiaries and mutually-binding, performance-

¹¹¹ Habitat III Policy Paper on Municipal Finance and Local Fiscal Systems, 12.

¹¹² United Cities and Local Governments, *The Bogota Commitment and Action Agenda*, 5th UCLG Congress: World Summit of Local and Regional Leaders, 15 October 2016, https://www.bogota2016.uclg.org/sites/default/files/bogota_commitment.pdf, 10 (Accessed December 4, 2016).

¹¹³ Global Taskforce of Local and Regional Governments for Post-2015 Development Agenda Towards Habitat III, “Financing Urban and Local Development: the Missing Link in Sustainable Development Finance,” 9-10; United Cities and Local Governments, *Second Global Report on Decentralization and Local Democracy: Local Government Finance: The Challenges of the 21st Century* (Mexico: United Cities and Local Governments, 2010), 16-17.

based “*municipal contracts*.”¹¹⁴ Likewise, as a means of preventing dependency on transfers, fiscal decentralization experts often advise imposing a “*hard budget constraint*” on subnational units, compelling them to self-sufficiently balance their budgets without end-of-year assistance from central governments¹¹⁵.

Beyond central-local fiscal transfers, also among the chief precepts for fiscal decentralization is that “*finance should follow function*”— namely, that local governments should be sufficiently empowered for raise the needed revenues to fulfill all the administrative and expenditure responsibilities assigned to them¹¹⁶. In practice, this means that subnational states should be granted adequate authority to establish local revenue sources, set local tax rates, collect local taxes, and to allocate amassed local revenues to financing local urban development and public service delivery. In this vein, a key rule-of-thumb that leading tax experts have proposed is that sufficient taxing power should be granted to at least allow *the richest subnational government units* to fund the delivery of functions for which they are responsible, hence rendering them fiscally autonomous. Achieving this should, it is argued, allow the delivery of intergovernmental fiscal transfers to be more directly linked to the promotion of regional equalization, and to enable subnational governments to be faced more fully with the tax demands of their spending decisions¹¹⁷. But despite the importance of such guidelines, the devolution of taxation to subnational governments regularly runs into major difficulties: central agencies, for example, tend to have inherent revenue-raising advantages compared to local government over key tax bases (e.g. personal and corporate income taxes, custom duties, value-added taxes and taxes on royalties) and various practical challenges faced by local governments (e.g. the mobility of most potential local tax bases, and the possibility of tax burdens being exported to non-residents) impose limits on which kinds of taxes can be reasonably devolved¹¹⁸. Indeed, in the view of many tax practitioners, when all such factors are taken into account, it appears to be only property taxes and user charges which can be readily reassigned to local government discretion¹¹⁹.

This is not to say that these challenges cannot be overcome. Even beyond the extension of fiscal transfers, a variety of taxing mechanisms have been devised that allow subnational units to leverage upon the advantages of central governments over certain kinds of tax bases while preserving some degree of local fiscal autonomy. Along the same vein, in recent years, a number of new streams of revenue-raising (e.g. land-based financing, environmental taxes) have gained prominence. In tapping into these and other local tax options, however, implementers of fiscal decentralization programs would be well-advised to keep in mind that there are no readymade

¹¹⁴ Habitat III Policy Paper on Municipal Finance and Local Fiscal Systems, 34-36; Catherine Farvacque- Vitkovic and Mihaly Kopanyi (eds.), *Municipal Finances: A Handbook for Local Governments*, 24-26; United Cities and Local Governments, *Second Global Report on Decentralization and Local Democracy: Local Government Finance: The Challenges of the 21st Century*, 14-15.

¹¹⁵ Roy Bahl, “Implementation Rules for Fiscal Decentralization,” International Seminar on Land Policy and Economic Development,” 17 November 1998, Taiwan, 15.

¹¹⁶ Catherine Farvacque-Vitkovic and Mihaly Kopanyi (eds.), *Municipal Finances: A Handbook for Local Governments*. 4-6.

¹¹⁷ Roy Bahl and Richard Bird, “Subnational Taxes in Developing Countries: The Way Forward,” *Public Budgeting & Finance* 28:4 (2008) 12.

¹¹⁸ **NOTE** This is due to two overall reasons. On one hand, due to economies of scale, higher administrative capacities, and wider jurisdictional spans, central governments tend to be far more efficient than local governments at collecting most taxes and are in much better positions to promote overall fiscal objectives of redistribution and stabilization. On the other, when additional design considerations that potential local taxes be (a) easy to administer locally, (b) are imposed mainly on local, non-mobile tax bases, and (c) do not raise competition with other local governments or the central government, are also factored in, the range of potential taxes that can be effectively delegated to local governments narrows without eliciting complex tax problems tends to narrow considerably.

For more Catherine Farvacque-Vitkovic and Mihaly Kopanyi (eds.), *Municipal Finances: A Handbook for Local Governments*, 149; Richard Bird, “Subnational Taxation in Developing Countries: A Review of the Literature,” World Bank Policy Research Working Paper 5450, World Bank, October 2010, 5, 15.

¹¹⁹ Roy Bahl and Richard Bird, “Subnational Taxes in Developing Countries: The Way Forward,” 4.

packages on how tax responsibilities should be assigned between different tiers of government, and that there are no quick-fix financing strategies that will address the bulk of their financing constraints at once. Analogous to the reform of national fiscal dynamics, the task of improving “sticky” local tax systems that generally do not change on a year-to-year basis is one that requires sustained institutional commitment into the long term, the investment of considerable organizational resources, and no small amount of technical and political savvy¹²⁰. In this regard, it should hardly be surprising that numerous local governments have regularly been documented to resort to raising taxes by their own accord only when deprived of practically all other revenue sources (e.g. special transfers, borrowing, etc.)¹²¹.

Local Taxation Options. So what options are available, then, for local governments to increase their own-source revenues for realizing the NUA’s vision of “cities for all”? Provided that subnational governments are sufficiently capacitated with revenue-raising powers as part of broader fiscal decentralization processes, and provided that credible commitments towards widening the fiscal space of subnational governments are supported by central governments, international organizations like the IMF and the OECD, the global community of tax practitioners and urban financing experts, and not least the officials of local governments themselves, a number of potential progressive local revenue sources are especially worth exploring as key items for local and municipal officials to consider in crafting their portfolio of revenue-raising strategies. To be sure, none of measures implemented in these areas, in themselves and even in most cases collectively, will be sufficient to address the financing constraints faced by subnational governments, especially in developing countries— yet if pursued in concerted fashion, they can serve as critical instruments for enabling the attainment of inclusive and sustainable cities.

Property Taxation: Widely considered by tax experts as the “ideal local tax” due to its revenue potential and stability, the immobility of its tax base, its visibility to taxpayers, and, when implemented without exemptions, its progressivity (as property owners tend to be wealthier households), property taxes are almost, without exception, delegated to local government control, and yet remain chronically under-used in developing countries¹²². But while hampered from reaching their potential as a means of local financing due to reasons of local political dynamics (i.e. opposition by politically-influential local elites), institutional factors (i.e. legacies of centralization in tax policy-making and public spending), and policy neglect (i.e. by influential international organizations like the OECD and the IMF), both renewed national and international commitment to municipal financing issues because of HIII, and the administrative impacts of numerous technological innovations— such as the application of Geographic Information Systems to property registers, and the digitalization of governance processes (e.g. property tax accounts, billings, collections)—, have appreciably increased the prospects for heightening property tax takes in lower-income nations¹²³.

In this context, different country and city experiences suggest that successful improvements of property taxes as a local revenue mechanism will most likely occur when (a) property taxes are explicitly framed as a “benefit tax,” establishing visible links between higher tax rates/collection and increased public services and infrastructure provision, (b) they are embedded within broader programs of accountability-enhancing public sector management reforms, (c) tax reforms are implemented in a comprehensive and strategic manner, giving particular priority to the quality of tax administration (i.e. ensuring that coverage, valuation and collection ratios are close to 100%), and (d)

¹²⁰ Mick Moore, “Obstacles to Increasing Tax Revenues in Low Income Countries,” 4, 8.

¹²¹ Caroline Poschl, “Revenue Pressure on Mexican Municipalities: Does it Lead to Greater Accountability?” ICTD Working Paper 29, International Center for Tax and Development, 2015, 38, 41.

¹²² Roy Kelly, “Making the Property Tax Work,” International Center for Public Policy Working Paper 13-11, Georgia State University International Center for Public Policy, April 2013, 2, 4.

¹²³ Mick Moore, “Obstacles to Increasing Tax Revenues in Low Income Countries,” 31

both sustained political will and technical capacity are manifested among key local leaders and stakeholders.¹²⁴

Local Business Taxes: While typically labelled by economists as an inefficient and distortive tax, subnational business taxes and business licensing fees have proven a highly-popular complement to the property tax both among developed and developing countries. This popularity largely owes to the greater responsiveness of business-related levies to economic growth, the significant levels of revenue they promise, and not least, their political expediency (for allegedly taxing nonresidents) relative to oft-resisted property taxation. While it is true that, in themselves, ill-designed and excessive levies of this sort may serve as a major disincentive against business investment and activity, business taxes may nonetheless be more economically-viable when framed as a local benefit tax for the services and infrastructures provided by subnational governments, including for business actors¹²⁵.

Various kinds of local business taxes exist, ranging from local corporate income taxes, capital taxes, special commercial property taxes, to operations licenses and charges. But in recent years, there has been growing attention to the proposed Business-Value Taxes (BVT)— business levies similar to value-added taxes, but imposed on production instead of consumption, on origins (i.e. exports) rather than destination (i.e. imports), and based on annual accounts of the factors of production employed by businesses rather than on transactions and invoices¹²⁶. Whatever the form of local business taxes and/or license fees taken, however, such taxes must be carefully designed to minimize any potential local economic inefficiencies that they pose, and harmonized with those of surrounding municipalities to circumvent deleterious “*race-to-the bottom*” tax competition. In this regard, it may be advisable for central governments to impose both business tax rate floors (against tax competition) and ceilings (against tax exporting) across subnational jurisdictions and municipalities¹²⁷.

Local Income Surtaxes: Even while central governments have strong advantages versus subnational states in implementing progressive income taxes, the addition of local income surtaxes to central-level income taxes can present a viable revenue option in large developing-country localities. Though the locally-administered personal income taxes have been present in a number of country contexts (e.g. Nordic countries), both the tremendous administrative expenses and institutional demands of implementing such taxes, as well as the reluctance of central governments to cede control over one of their main revenue bases to subnational governments, have kept national authorities in most countries from exploring this option¹²⁸. Increasingly common has been the application of a flat-rate, locally-established, add-on income tax levied on the same tax base as centrally-collected individual income taxes, and which is afterwards shared in full with the local governments in question. Importantly, such a flat-rate tax would not conflict with the promotion of progressivity in central personal income taxes, and due to their visibility, could also fulfill the function of an accountability-promoting subnational benefit tax between local officials and their resident-taxpayers¹²⁹.

Yet as with local business taxes, the possibility of inter-municipal income tax competition provides some justification for cross-municipal harmonization of local income tax levels¹³⁰. However, in developing countries in particular, the limited effectiveness of centrally-set and collected income taxes, coupled with the relatively small size of the national income tax net to begin with (due to widespread conditions of informality), place real limits on how far such a tax can go to finance the implementation of the NUA. Though piggybacked local income taxes can, in this sense, play a key supplementary role to property and business taxation as a means of financing inclusive urbanization, especially in middle-income contexts, its reliance on already-constrained national income tax systems makes its full realization contingent on the realization of the national and international tax reform,

¹²⁴Roy Kelly, “Making the Property Tax Work,” 29-31.

¹²⁵ Richard Bird, “Subnational Taxation in Developing Countries: A Review of the Literature,” 39-40.

¹²⁶ UN-Habitat, *The Challenge of Local Government Financing in Developing Countries*, Nairobi: UN-Habitat, 2015. 19-20; Richard Bird, “Subnational Taxation in Developing Countries: A Review of the Literature,” 42-43.

¹²⁷ Roy Bahl and Richard Bird, “Subnational Taxes in Developing Countries: The Way Forward,” 24.

¹²⁸ Catherine Farvacque-Vitkovic and Mihlay Kopanyí (eds.), *Municipal Finances: A Handbook for Local Governments*, 172.

¹²⁹ Roy Bahl, “Implementation Rules for Fiscal Decentralization,” 7.

¹³⁰ UN-Habitat, “The Challenge of Local Government Financing in Developing Countries,” 21.

continued income growth, and the expansion of the formal sector share of the population, which will most only unfold over a more extended period¹³¹.

Local Excise Taxes and Health/Environmental Taxes: When formulated as a benefit tax for public infrastructure development, excise taxes represent a revenue option that can yet be harnessed to a greater degree in developing countries, though subject to the dynamics of cross-jurisdictional licit and illicit trade (i.e. smuggling). In this regard, two forms of excise taxes of this sort are salient as potential benefit taxes. On one hand, if subnational governments have been assigned with public transport infrastructure construction and maintenance (e.g. roads), the adoption of vehicle-related excise taxes (e.g. vehicle licensing fees, fuel taxes) bears particular potential as an easily-administered, highly growth-responsive subnational revenue stream that can establish clear benefit links between taxpayer and public goods provision. Similarly, imposing excise taxes on “*sin*” products such as alcohol and tobacco has also received increasing attention as another potential benefit levy, particularly during the 2015 UN FfD Conference as another means of generating revenue for health and education spending¹³². Though such sin taxes and “*solidarity tobacco contributions*” have been largely undertaken by central governments for the fulfillment of national health objectives¹³³, there is a strong case that can also be made for them as surtaxes or locally-administered taxes, when subnational governments are assigned major roles in health and educational expenditure.

Beyond their revenue-generating roles, however, both vehicle-related and sin excise taxes have also been well recognized to be useful instruments for achieving broader public objectives: for curbing the adverse effects of motor vehicle use (e.g. pollution, traffic) and of tobacco and alcohol-related diseases (possibly accidents). These additional functions for such excise taxes open the possibility for a broader category of potential taxes for subnational governments: namely, local “*repricing*” taxes for discouraging the production and consumption of socially-agreed “*bads*,” which can also serve to raise supplementary revenue for local spending. The most obvious, though by no means the only, candidates for such subnational taxes would be local health and environmental excise taxes. To this end, subnational governments may have access to direct product taxes (e.g. levies on oil/gas products, taxes on alcoholic beverages), subsidies (e.g. moving subsidies from coal-based to renewable energy), and taxes on harmful substances and activities (e.g. carbon taxes, air pollution fees) for advancing health and environmental objectives while raising additional revenues for their own expenditure needs¹³⁴.

The measures mentioned above are by no means the only revenue options available to numerous subnational governments around the world— yet they have been noteworthy for their ability to raise funding in a way that is can easily devised to be, on balance, fiscally equitable and progressive. Other common types of local revenue-raising strategies exist which can be used to finance the implementation of the NUA, but closer examination shows that certain features of such taxes may either lend themselves to some degree of regressivity, or can serve, if ill-designed to incentivize unsustainable and unaccountable practices by a variety of actors. While the practicalities of driving local and urban development processes on the ground will likely have local governments deeming such measures as attractive options, they would be wise to approach such varieties of local revenue instruments with a view towards substantive coherence between the NUA’s avowed goals of producing “*just, safe, healthy, accessible, resilient, and sustainable cities and human settlements...*”¹³⁵

User Charges and Fees: Although the application of user charges for public services and infrastructure use has been viewed in some quarters, along with property taxes, as “*the most*

¹³¹ Roy Bahl and Richard Bird, “Subnational Taxes in Developing Countries: The Way Forward,” 35.

¹³² Addis Ababa Action Agenda, 36; UN-Habitat, “The Challenge of Local Government Financing in Developing Countries,” 20.

¹³³ Gail Hurley, “Innovative Financing for Development: A New Model for Development Finance?,” United Nations Development Programme Discussion Paper, United Nations Development Program, January 2012, 19-20.

¹³⁴ OECD, “Environmental Fiscal Reform for Poverty Reduction,” OECD DAC Guidelines and Reference Series, OECD, 2005, 31-36.

¹³⁵ New Urban Agenda, 3.

appropriate revenue for local governments,¹³⁶ attempts to raise such charges and fees often threaten to deny access to such services to poorer and lower-income demographics. Even while modest levels of user charges remain justifiable as a means of preventing resource wastage— including on unneeded subsidies for higher-income groups— by both providers and users¹³⁷, notions that local governments need to reprice their services with a view towards “*cost-recovery*” levels and cultivating a “*user pays*” culture¹³⁸ can easily conflict with the “*Right to the City*” approach of the NUA, where urban dwellers are seen as holders of rights to basic goods and public services. Furthermore, the prevailing consensus among urban fiscal experts is that due to constraints in the administrative systems that control access and metered use of public services, it is unlikely that user charges could be imposed in the immediate future at high enough rates to cover the expenses of municipal governments, especially in relation to informal sectors in developing countries¹³⁹.

This is not to say that incremental increases in user charges— which avoid the inequity effects, the political opposition, and increased commercialism of providers that are likely to accompany unmoderated shifts towards full cost-recovery approaches— have no place in a wider mix of subnational revenue-raising strategies. Based on experiences with subnational fiscal reform, however, initiatives to impose such increases would work best if adopted in gradual fashion, with a view to promoting accountable and collaborative arrangements between local governments, users and taxpayers (e.g. via the establishment of user committees), and are preceded by pilots and sufficient evaluation thereof before wider adoption¹⁴⁰. Of utmost importance will be the development of arrangements that prevent low-income and vulnerable populations from being excluded from the enjoyment of services, whether through the crafting of targeted subsidies, differential pricing mechanisms, or tariff structures which are based on prior research into the service-use patterns of the poor. User charge increases achieved in way would thus differ markedly from the pricing reforms being espoused by market-oriented advocates, who generally seem to endorse cost-recovery approaches as a means of enhancing the attractiveness of PPP’s in local service delivery processes¹⁴¹.

Local Consumption Surtaxes: Subnationally-administered general consumption taxes (e.g. regional VATs), while having been adopted by countries like Canada, Brazil and some US states, are strongly discouraged in the global tax community for reasons of central government opposition, possible diminutions of macroeconomic control, and the complexities wrought by inter-jurisdictional trade in consumption goods (e.g. too high consumption taxes leading to cross-border shopping)¹⁴². Akin to income taxes, however, attaching a small surtax to central or state-level consumption levies (e.g. sales taxes) has become a technically and politically viable means of administering subnational consumption taxes, and have been argued to even be feasible to implement in countries with less-developed tax administrations¹⁴³.

Yet while the adoption of local sales surtaxes may furnish subnational governments to an easy-to-collect and growth-responsive revenue source, from the standpoint of tax justice in cities, there are some reasons why the tax options discussed earlier remain superior options. Firstly, consumption taxes in general are highly regressive in nature, with numerous studies having confirmed the tendency of the tax burden of such levies to fall more on immobile, unskilled, lower-income groups’ expenditures (particularly those of women) as opposed to that of richer individuals¹⁴⁴. Moreover, as an *indirect* tax, consumption taxes tend to be far less visible to taxpayers than direct levies like the

¹³⁶ UN-Habitat, “The Challenge of Local Government Financing in Developing Countries,” 18.

¹³⁷ Richard Bird, “User Charges in Local Government Finance,” in Richard Stern and Maria Emilia Freire (eds.), *The Challenge of Urban Government* (Washington, D.C.: World Bank, 2001), 172.

¹³⁸ Julie Kim, *Handbook on Urban Infrastructure Finance*, New Cities Foundation, 2016, 69-72

¹³⁹ Habitat III Policy Paper on Municipal Finance and Local Fiscal Systems, 15.

¹⁴⁰ Paul Smoke, “Why Theory and Practice are Different: The Gap Between Principles and Reality in Subnational Revenue Systems,” International Center for Public Policy Working Paper 13-13, Georgia State University International Center for Public Policy, April 2013, 15, 22-23.

¹⁴¹ Julie Kim, New Cities Foundation, *Handbook on Urban Infrastructure Finance*, Montreal: New Cities Foundation, 2016. 70.

¹⁴² Richard Bird, “Subnational Taxation in Developing Countries: A Review of the Literature,” 37.

¹⁴³ Richard Bird, “Subnational Taxation in Large Emerging Countries: BRIC Plus One,” International Center for Public Policy Working Paper 12-01, Georgia State University International Center for Public Policy, January 2012, 18.

¹⁴⁴ United Nations Research Institute for Social Development, *Combating Poverty and Inequality: Structural Change, Social Policy and Politics*, Geneva: UNRISD, 2010. 212.

property tax, hence failing to realize potential governance dividends for accountability, institution-building and strengthened state-citizen relations¹⁴⁵. In both of these, overreliance on local consumption surtaxes will likely remain suboptimal in facilitating the achievement of the NUA's broader vision of inclusive and cities.

Natural Resource Rents: Particularly in oil- and mineral-rich countries, natural resource endowments have permitted a number of local states the option to benefit from natural resource taxes as a means of financing local infrastructure and services. Indeed, in line with fiscal decentralization processes, local governments' shares in natural resource revenue-sharing arrangements has increased, with countries like Bolivia, Brazil, Peru and Nigeria having devised intergovernmental frameworks where subnational governments received more than 50% of resulting tax proceeds.¹⁴⁶

Yet there are also several drawbacks to fostering excessive levels of local government reliance on this stream of revenue. Apart from the disruptive environmental and social impacts of natural resource extraction, as well as potential horizontal imbalances generated by the site-specificity of available rents for local governments (particularly against cities), the ensuing revenue returns tend to be particularly unstable due to volatile world commodity prices and are thus risky to bank on for long-term local financing¹⁴⁷. Moreover, increased fiscal dependency of both national and local governments has long been argued to raise dangers of being subjected to "resource curse" dynamics of diminished accountability, heightened corruption, and overall heightened tendencies towards authoritarian political processes¹⁴⁸.

Land Value Capture Measures: Throughout the HIII process, few local revenue-raising instruments have gained as much attention as land value capture financing, which have been hailed as "one of the most potentially powerful but underutilized sources" of subnational revenue, especially for financing urban infrastructure¹⁴⁹. While different kinds of value capture finance exist, with land value taxes, betterment levies, special assessments, tax increment financing, development impact fees having been particularly prominent (see Table 3.2), the common idea undergirding such mechanisms is that local and municipal governments can and should "capture" (whether by tax or fees), the incremental and unearned increases in land values that result from public investments and/or infrastructural enhancements, which would otherwise accrue to private landowners¹⁵⁰. The returns from deploying such value capture instruments can be quite significant: for instance, in Colombian cities the use of betterment levies as a cost-recovery mechanism for public investment has often been able to generate over 25% of local own-source revenues for municipal governments¹⁵¹. In recent years, moreover, there has been increased discussion on land value taxes as a potential anti-gentrification measure. Essentially, it has been argued that such taxes can contribute to averting gentrification dynamics, if used to redirect land value increases from neighborhood improvements away from landowners, land speculators and buy-to-let investors, and back to residents in the form of additional community investments (e.g. in public housing)¹⁵².

Table 3.2. Examples of Land Value Capture Instruments

| <i>Funding Instrument</i> | <i>Description</i> | <i>Sector Application</i> |
|---------------------------|---|-----------------------------------|
| Tax Increment Financing | Income, property, or sales tax increments from infrastructure improvements into a separate escrow account to retire existing debt, fund | Transit/Housing/Urban Development |

¹⁴⁵ Wilson Prichard, *Citizen-State Relations: Improving Governance Through Tax Reform*, 37-38.

¹⁴⁶ Javier Arellano-Yanguas and Andres Mejia-Acosta, "Extractive Industries, Revenue Allocation and Local Politics," UNRISD Working Paper 2014-4, UNRISD, March 2014, 3.

¹⁴⁷ United Nations Research Institute for Social Development, *Policy Innovations for Transformative Change: UNRISD Flagship Report 2016*, Geneva: UNRISD, 2016, 176, 180.

¹⁴⁸ Mick Moore, "Between coercion and contract: competing narratives on taxation and governance," 60-61.

¹⁴⁹ Global Taskforce of Local and Regional Governments for Post-2015 Development Agenda Towards Habitat III, "Financing Urban and Local Development: the Missing Link in Sustainable Development Finance," 9.

¹⁵⁰ Habitat III Policy Paper on Municipal Finance and Local Fiscal Systems, 25.

¹⁵¹ Lawrence Walters, "Land Value Capture in Policy and Practice," *Journal of Property Tax Assessment and Administration* 10:2 (2013).

¹⁵² Oliver Wainwright, "Gentrification is a global problem. It's time we found a better solution," *The Guardian*, 29 September 2016, <https://www.theguardian.com/cities/2016/sep/29/gentrification-global-problem-better-solution-oliver-wainwright> (Accessed December 4, 2016)

| | | |
|------------------------|---|-----------------------|
| | improvements, or use as a pledge to secure a new debt | |
| Special Assessments | Property tax increase applied only to specific districts that benefit from infrastructure investments | Roads/Public Transit |
| Land Value Tax | Tax assessed on land value rather than property value (e.g., building); better incentive for development than property tax | Various |
| Betterment Tax | Benefit assessment or betterment levy imposed on beneficiaries of infrastructure investments | Water/Sewer/Transport |
| Development Impact Fee | Impact fees on developers to fund additional service capacity; can be conditioned on project approval | Roads/Safety/Schools |
| Joint Developments | Cost sharing between public operator (e.g., rail transit) and private developer; both benefit from property value increases | Rail/Public Transit |

Source: Kim, “Handbook on Urban Infrastructure Finance” (2016)

If harnessed, not just for revenue-raising purposes, but also as a means for curbing gentrification processes, value-capture instruments would appear to be an important addition to local governments’ portfolio of instruments for financing inclusive and sustainable urban development. At the same time, however, it seems that numerous difficulties have hampered the effective use of such measures— which may partly help explain why value capture instruments have been lauded as an “*innovative*” idea by urban financing experts, despite having been discussed and practiced in some cases for more than a century (e.g. land value taxes, for instance, already having been famously promoted by economist Henry George in the 1880’s)¹⁵³. In practice, for instance, the tasks of (a) determining land values in themselves, (b) isolating the land value impacts of public investments from all other factors, (c) projecting land value appreciation from investments, (d) assembling the requisite political, institutional and technical capacities, and (e) preventing the factors which may lead land value declines instead of appreciations (e.g. from congestion, noise, and other infrastructure effects), have all remained tremendously difficult to implement on the ground¹⁵⁴.

No less troubling, far from being unambiguous in their anti-gentrification uses, certain kinds of value-capture instruments— such as tax-increment financing and CEPAC bonds (i.e. an urban financing instrument in Brazil that combines value capture, the sale of development rights, and development exaction)— have been often found to bring their own risks of accelerated gentrification, especially when value capture revenues are used in a manner that overly prioritize the interest of business entities¹⁵⁵. Even more broadly, by redirecting focus from general tax-funded infrastructure, some value-capture approaches may threaten to mainstream municipal fiscal views that future “*beneficiaries*” must pay for infrastructural development and service-delivery improvements¹⁵⁶— an transactional approach that may be problematic with regards to certain kinds of demographics (e.g. low-income homeowners). While this is not to say that value-capture tools cannot contribute to addressing urban financing needs, it must be stressed that such instruments cannot substitute for developing a broad collection of subnational tax instruments, and should be carefully assessed on a case-by-case basis for their equity implications.

IV. TOWARDS PROGRESSIVE FISCAL CONTRACTS?: LESSONS ON THE POLITICS OF TAX BARGAINING

¹⁵³ Lawrence Walters, “Land Value Capture in Policy and Practice,” 11-12.
¹⁵⁴ Minnesota Center for Fiscal Excellence, “Value Capture for Transportation Finance in Minnesota: Untapped Potential or “Field of Dreams?”” Issue Brief No. 10, Minnesota Center for Fiscal Excellence, February 2015, 5-6.
¹⁵⁵ Martim Smolka, “Implementing Value Capture in Latin America: Policies and Tools for Urban Development,” Policy Focus Report, Lincoln Institute of Land Policy, 2013, 57, 59.
¹⁵⁶ Minnesota Center for Fiscal Excellence, “Value Capture for Transportation Finance in Minnesota: Untapped Potential or “Field of Dreams?”” 11.

The completion of the Habitat III last October 2016 and the adoption of the New Urban Agenda in critical ways represents a milestone for the global urban movement and the pursuit of urban development worldwide, with its historic enshrinement of the “*Right to the City*” as the cardinal principle of its shared vision, its fully-integrated view of the collective challenges and required measures promoting sustainable urban development, and its relatively detailed treatment of municipal financing concerns. Spanning measures to increase the mobilization of endogenous resources, improving the design of financial transfers, enhancing land value-capture mechanisms, expanding access to municipal-level borrowing and private investment, and furthering international public finance and multilateral funds for sustainable urbanization, the NUA, if falling short of the degree of specificity aspired to by various actors, nevertheless represented a significantly more ambitious attempt to reckon with the demands of financing sustainable and inclusive urban development than was the case with Habitat II in Istanbul in 1996.

Yet as has been argued throughout this report, when viewed via the lens of tax justice, the problems acknowledged and the pledges advanced by the NUA appear to have suffered from an entire chain of oversights. Critical fiscal issues at global, national and subnational levels—particularly tax competition, tax avoidance, fiscal austerity, constraining investment agreements, uneven fiscal decentralization, and compromised local institutional fiscal capacity—have either been entirely neglected in the final outcome document of HIII, or have been severely diluted throughout the conferences’ long preparatory process. That many of these omissions or dilutions have occurred in HIII despite substantial inputs by key stakeholders such as UCLG, the General Assembly of Partners, and the Workers and Trade Union Sector, attests to an entrenched incoherence in the formulation of the NUA, where one of the largest drivers today of urban inequality and municipal fiscal fragility has been inadequately addressed by the document, despite its claiming to promote inclusive urbanization and strengthened local fiscal systems. Unless these adverse dynamics are addressed head-on at local, national and global, there is every reason to expect that the ability of cities, municipalities and other subnational jurisdictions to sustainably finance and ultimately achieve equitable and inclusive development will continue to prove elusive.

The question of “*who pays*” for development has been found in key studies to be intimately intertwined with the likely spending patterns that governments are incentivized to undertake, and hence the distribution of the benefits from state fiscal policy¹⁵⁷. In that light, this report discussed and recommended several major tax-just reform directions that may promise considerable direct and indirect fiscal dividends for local and regional governments in their efforts to finance the realization of inclusive cities. At the international level, governments stand to significantly benefit from undertaking actions that will increasingly shift the international corporate tax processes from “*separate entity*” towards “*unitary*” approaches (beginning on a regional basis) and narrowing the scope for global corporate tax avoidance by means of different anti-avoidance measures; replacing fiscal austerity with “*fiscal activism*” counter-recessionary measures at national and local governments; strengthening subnational governments’ ability to access international public financing mechanisms; renegotiating bilateral and multilateral investment treaties to safeguard states’ policy space and right to regulate; and curbing international tax competition through moving towards internationally-coordinated minimum effective tax rates and tax incentive policies (starting again at the regional level).

¹⁵⁷ Jeffrey F. Timmons, “The Fiscal Contract: States, Taxes and Public Services,” *World Politics*, 57:4 (2005), 547.

Meanwhile, domestically, central and subnational governments can likewise enhance their fiscal standing by eliminating or decisively rationalizing the granting of tax breaks, as well as restructuring the processes by which such fiscal incentives are granted; and forwarding effective fiscal decentralization processing such as heightening and adopting better-designed fiscal transfer systems, and increasing the revenue-raising powers allotted to subnational governments. If granted with such powers, local, municipal and regional governments must be encouraged to use the all capacities and resources at their disposal to raise the levels of their own-source revenues— with heightening property taxes, local income surtaxes, local business taxes, and local health/environmental excise taxes being especially viable options from the standpoint of equity, progressivity and broader sustainability goals. Other possible choices, but which must be approached with caution for their potential equity, social, environmental and governance effects, include incremental increases in user charges, local consumption surtaxes, land value capture instruments, and natural resource taxes.

Pursuing each of these options will prove an exceedingly demanding, challenging, and protracted processes for which there are no silver bullets to overcoming the various technical and political obstacles that underline the “stickiness” of national and local tax takes¹⁵⁸. Nonetheless, as has become increasingly recognized by fiscal practitioners, linking increases in national and local tax measures to the establishment of “*fiscal social contracts*” between governments and taxpayers, whereby “*citizens accept and comply with taxes in exchange for government providing effective services, the rule of law and accountability,*” can serve to spur transformative cycles of sustained long-term enhancements in public finance systems, accountable governance, and improved public service provision¹⁵⁹. In fact, several scholars have argued that such fiscal contracting dynamics have been at play in relative advances towards increased revenues, more redistributive tax burdens, and increased pro-poor public spending regimes across several Latin American countries from the 1990’s until the late-2000’s¹⁶⁰. While how such processes manifest at *municipal* governance levels still remains an ongoing area of study, the case of six Mexican municipalities in the aftermath of the global financial crisis presented in box 5.1, attests to the possibility of subnational fiscal bargaining processes, with attempts to raise local taxes typically being preceded or accompanied by improvements in accountability and services in order to secure increased citizen trust, satisfaction, and tax compliance¹⁶¹.

Box 4.1. Implicit Fiscal Contracting in Six Mexican Municipalities

How relevant is establishment of fiscal contracts to the municipal efforts to increase taxes? Based on case studies of the Mexican municipalities of Acapulco, Centro, La Paz, Aguascalientes, Merida and Saltillo from 2009 onwards, Pöschl (2015) highlights the central role of implicit fiscal contracting processes in local revenue-raising efforts— usually involving indirect signaling as well as pre-emptive actions between local officials and their constituents. In all municipalities examined, no coercive taxation dynamics were observed, with officials particularly expressing appreciation of the importance of extending improved accountability measures, public services, and overall municipal management (e.g. establishing citizen’s observatories, publishing regular revenue and expenditure data, preemptive service upgrading campaigns) to build trust with constituents and generate tax compliance. As one municipal councilor from Acapulco reportedly stated, “*If people don’t receive anything for their money, they threaten not to pay any more.*”

¹⁵⁸ Moores, Obstacles to increasing Tax Revenues in Low-Income Countries, 13.

¹⁵⁹ Wilson Prichard, *Citizen-State Relations: Improving Governance Through Tax Reform*, Paris: Organisation for Economic Cooperation and Development (201), 30.

¹⁶⁰ Aaron Schneider, “Political Economy of Citizenship Regimes: Tax in Brazil and India,” Richard Bird and Eric Zolt, “Fiscal Contracting In Latin America” *World Development*, 67 (2015) 327, 329-330.

¹⁶¹ Caroline Poschl, “Revenue Pressure on Mexican Municipalities: Does it Lead to Greater Accountability?” 39-40.

*Now the government is saying it will help, but if we don't do a good job people won't pay their taxes... If the government is corrupt, then people don't want to pay.*¹⁶²

Despite the role of implicit fiscal contracting, however, the degree to which accountability gains were maintained was complicated by numerous other factors. In some municipalities, violence resulting from drug gangs with a vested interest in controlling property registries, friction with different levels of government and future electoral dynamics were among the chief reasons why revenue-raising and accountability-enhancement efforts were not sustained. Even more generally, however, institutional framework surrounding Mexican local governments posed considerable obstacles to tax bargaining. For instance, a prohibition on reelection of municipal leaders by the Mexican Constitution dis-incentivized longer-term projects to upgrade local fiscal systems; limited local government expenditure autonomy of local governments constrained the capacity of local officials to robustly adapt to their constituents' demands; and the lack of transparent accounting methods inhibited citizens' accurate assessments of local government performance and the causes for accountability/service delivery improvements. The prominence of these other dynamics demonstrate the importance of country-specific intergovernmental frameworks and local political and institutional contexts in shaping subnational efforts to raise revenues and improve fiscal governance.

Source: Pöschl, "Revenue Pressure on Mexican Municipalities: Does it Lead to Greater Accountability?" (2015)

Yet such fiscal contracting processes between local and municipal governments and their respective taxpayers need not only occur implicitly. In fact, the adoption of proactive measures by governments to foster transparency, trust between taxpayers and public officials, informed participation, and constructive bargaining over revenue measures, public spending, and overall fiscal governance has often represented one most reliable and mutually-beneficial means to strengthening domestic resource mobilization systems over the long term¹⁶³. In this regard, experiences with governance-focused efforts to fiscal reform already have offered critical lessons that can help guide government officials, civil society organizations and trade unions' efforts to strengthen the functioning national and local fiscal systems, to promote fiscal contracts that are progressive, equitable, sustainable and mutually-beneficial for states and citizens, and to arrive at "*virtuous circles*" of heightened taxation, improved governance and better public services¹⁶⁴. Namely, these lessons are¹⁶⁵:

- Encouraging *open, inclusive and participatory negotiations* over national/local revenue-raising and spending policies that are *responsive to citizens' demands* can be a major catalyst for initiating constructive bargaining processes between state officials and taxpayers, and diffusing potential dissent to envisioned tax measures. Without such negotiations, local revenue-raising efforts are far more likely to be bogged down by unneeded resistance from taxpayers as well as unwillingness to comply with tax obligations.
- Promoting *transparency and accountability* in fiscal governance is critical to strengthening the legitimacy and credibility of local governments in dealings with taxpayers and citizens. Oftentimes, adopting advance transparency and accountability measures by local governments (or alternatively, visible public service improvements) can serve as a highly useful first move for

¹⁶² Caroline Pöschl, "Revenue Pressure on Mexican Municipalities: Does it Lead to Greater Accountability?" 17

¹⁶³ Wilson Prichard, *Citizen-State Relations: Improving Governance Through Tax Reform*, 14.

¹⁶⁴ Max Everest-Phillips, "State-Building Taxation for Developing Countries: Principles for Reform," *Development Policy Review*, 28:1 (2010), 80.

¹⁶⁵ Sources for these lessons from:

Wilson Prichard, *Citizen-State Relations: Improving Governance Through Tax Reform*; Paul Smoke, "Why Theory and Practice are Different: The Gap Between Principles and Reality in Subnational Revenue Systems"; Max Everest-Phillips, "State-Building Taxation for Developing Countries: Principles for Reform,"; United Nations Research Institute for Social Development, *Policy Innovations for Transformative Change: UNRISD Flagship Report 2016*; Moores, Obstacles to increasing Tax Revenues in Low-Income Countries.

shoring up a modicum of necessary trust between public officials and taxpayers for bargaining over tax measures to take place.

- More directly *linking taxation to improved public services* and an *agenda/vision for shared prosperity* has been documented to be a strong motivating factor among taxpayers for complying higher taxes as well as their general willingness to pay taxes. Especially at the local and regional level, formulating revenue measures as benefit taxes and making judicious use of revenue earmarking— when implemented effectively and honestly — can prove highly beneficial as strategies to secure public acceptance for tax measures.
- Increasing the *visibility and directness* of the proposed tax measures is critical to ensuring that both taxpayers and local governments are sufficiently incentivized to engage in tax bargaining. Oftentimes, citizens are unmotivated to negotiate simply because they are unaware of how much taxes they are actually paying (e.g. with VAT's, excise taxes), which, in turn, fails to compel governments to link increased taxation to better governance and service provision. Fostering reliance on direct taxes (e.g. income, property) thus makes it far more likely that fiscal bargaining take places, which can be reinforced by measures to make the burdens of indirect taxes more publicly visible (e.g. adding sales taxes to prices at the point-of-sale).
- Ensuring that tax measures and enforcement practices address citizen-taxpayers' *perceptions of fairness and equity* as well as other social norms can be highly significant in orienting citizens to building a culture of tax compliance both within and between groups of different taxpayers. The legitimacy of the tax system is heavily undermined by existence of perceived free-riders, and addressing ending such behavior crucial in two respects: both with the informal business sector (vs. formal businesses), but even more so with regards to elites (vs. non-elite taxpayers).
- Fostering *citizens' awareness, capacity and organization* in tax matters can help democratize public discourse on often highly-technical tax reform agendas as well as enabling taxpayers and their representatives in civil society, parliament and trade unions to competently and collectively bargain around tax-related matters in the first place. Given the relative neglect of tax issues in most civic discussions, capacity-building by organizations in the trade union and civil society sectors, as well as the formation of taxpayers' associations and community-oriented tax clinics, can do much heighten the robustness of informed engagement on fiscal concerns and to ensure that such engagement takes upon a collective rather than an individualistic character.

None of these lessons and their implications on processes for local revenue-raising will amount to much if no political coalitions— able to overcome a continuum of obstacles to fiscal reform and institution-building— are present at key institutional arenas¹⁶⁶. Strikingly, as studies of the establishment of equitable fiscal contracts in cities such as Porto Alegre, Brazil (which mobilized funds for its now-iconic participatory budgeting scheme mainly from property tax hikes) show, the centrality of effective, cross-class coalitions in the formation of local public finance regimes that combine progressive revenue-raising burdens, pro-poor patterns of public spending, and accountable, democratic governance, cannot be understated¹⁶⁷.

What seems certain is that in the cities of today and the future, trade unions, civil society organizations and mass-based, left-leaning political parties have and will continue to have indispensable roles in such coalitions as public-interest brokers between the broader concerns of tax justice, the need to finance and govern cities in an increasingly-urbanized world, and the vulnerable, working populations at risk of being excluded from the wealth and opportunities that are poised to be further concentrated in urban areas There are, as already said, no quick

¹⁶⁶ Roy Bahl, "Implementation Rules for Fiscal Decentralization," 16-17; Paul Smoke, "Why Theory and Practice are Different: The Gap Between Principles and Reality in Subnational Revenue Systems," 19-20.

¹⁶⁷ Aaron Schneider and Marcelo Baquero, "Get What You Can Get, Give What you Can: Embedded Public Finance in Porto Alegre," Institute of Development Studies Working Paper 266, Institute of Development Studies, May 2006, 8, 15-16, 26.

fixes for financing the development of the cities of future in equitable fashion— yet a variety of revenue-raising options nonetheless lie within reach, that if undergirded by progressive fiscal contracts, can make substantial headway towards improving local fiscal space, governance, and, ultimately, advancing inclusive urban development. In the years to come, it will be efforts to facilitate such contracts by local and national governments, trade unions, civil society organizations, and all other actors seeking tax justice that will be at the heart of realizing the promise of sustainable, equitable and fair urban development for all the world's cities.

ANNEX I. Independent Commission for the Reform of International Corporate Taxation: *Recommendations for Reform*

Preamble

We are a group of leaders from government, academia, and civil society, including the faith community. Our backgrounds, experience, and expertise span the globe. With the conviction that our system of taxing the global profits of multinational corporations is broken and that the rules and institutions governing the international corporate tax system must change, we have formed an Independent Commission for the Reform of International Corporate Taxation. As a Commission, we have concluded that proposals to reform the current system are clearly insufficient, and the institutions promoting international tax cooperation are not inclusive enough. We hope that the following principles and recommendations for reform will promote a wider public debate, which we believe is essential to ensure the creation of an international tax system that works for all people.

Statement of Principles

1. Tax abuse by multinational corporations increases the tax burden on other taxpayers, violates the corporations' civic obligations, robs developed and developing countries of critical resources to fight poverty and fund public services, exacerbates income inequality, and increases developing country reliance on foreign assistance.
2. Abusive multinational corporate tax practices are a form of corruption that weakens society and demands urgent action. This is even true when the practices of corporations are within the law, and especially so when corporations have used their political influence to get tax laws that provide them scope for such abuses.
3. Multinational corporations act – and therefore should likewise be taxed – as single firms doing business across international borders. This is essential because multinational corporations often structure transfer pricing and other financial arrangements to allocate profits to shell operations in low tax jurisdictions.
4. Tax havens facilitate abusive tax practices with enormous negative effects on the global community.
5. Greater transparency and access to information are critical first steps to stop tax abuses
6. Every individual and country is affected by corporate tax abuse, and therefore the debate over multinational corporate tax avoidance should be widened and made more accessible to the public
7. Inclusive international tax cooperation is essential to combat the challenges posed by multinational corporate tax abuse.

Recommendations for Reform

I. Tax Multinationals as Single Firms

1. States must reject the artifice that a corporation's subsidiaries and branches are separate entities entitled to separate treatment under tax law, and instead recognize that multinational corporations act as single firms conducting business activities across international borders.
2. States should develop model bilateral and multilateral agreements to enable participating jurisdictions to apportion revenues and costs attributable to a multinational corporation operating in those jurisdictions.
3. Instead of attributing income from the control or ownership of intellectual property to a low tax jurisdiction, the income should be apportioned to the jurisdictions where the intellectual property was developed or, if sold, apportioned according to objective economic factors such as sales and employment.
4. States should treat a company affiliate of a resident multinational corporation that carries out business activity in a jurisdiction as a presumptive permanent establishment with tax nexus in that jurisdiction.

5. States should revise the permanent establishment rules to provide that when a corporation sells or provides downloads of products from the internet to customers in a jurisdiction, exceeding a specified threshold, that business activity creates a permanent establishment.
6. In the long term, the system for taxing a multinational corporation's subsidiaries as separate entities should be replaced by a system of taxing multinational corporations as single and unified firms, using formulary apportionment based upon objective factors, such as sales and employment, and with adequate consideration of the source principle.
7. International cooperation for reform must go beyond the current OECD's BEPS initiative and begin to research and negotiate the specific elements of an international consolidation and apportionment system, including what rules would apply to determine the tax base and apportion profits among countries where multinational firms operate, and how to avoid the vertical disintegration to which it may give rise.

II. Curb Tax Competition

1. Developed nations, possibly through the OECD, should take the first step to stop the current race to the bottom in corporate taxation, by agreeing on a minimum corporate tax rate.
2. States should also examine spillover effects of their tax preferences for multinational corporations and eliminate those that facilitate tax avoidance in another country.
3. All states should proactively disclose to the public tax incentives, tax preferences, and income exclusions provided to multinational corporations
4. States should refrain from advocacy, through diplomatic or other means, for their multinational corporations involved in a tax dispute with other countries.
5. European states should bring additional legal actions before the European Commission to clarify the factors that qualify certain corporate tax preferences as illegal state aid and to stop the use of those tax preferences.
6. States should promote cooperation to curb tax competition, along the lines of such efforts in the East African Community, through its efforts to harmonize tax incentives, and in the European Union, through the development of the Common Consolidated Corporate Tax Base.

III. Strengthen Enforcement

1. States should impose criminal penalties on abusive tax practices.
2. Multilateral organizations should develop a model tax withholding system that requires the withholding of taxes from interest, dividend, royalty, and other payments made between affiliate companies of multinational corporate groups before those outbound payments cross international borders.
3. Multilateral organizations should develop model provisions to protect whistleblowers who disclose abusive corporate tax practices.
4. States should ensure that their tax administrators have adequate resources, independent authority, and legal protection to collect taxes owed from multinational corporations.
5. Multinational corporations should publish and adhere to a set of ethical principles related to paying taxes, and enunciate an explicit acknowledgement of their civic obligation to pay taxes to support the countries in which they operate.

IV. Increase Transparency

1. States must require multinational corporations, both public and private, to file country-by-country reports and, upon filing, make those reports freely available to all tax administrators, without requiring separate treaty or other agreements, so as not to disadvantage developing countries compared to developed countries and to facilitate efficient and cost-effective tax administration.
2. States should make country-by-country reports available to the public within 30 days of filing.
3. States should obtain the names of natural persons who are the ultimate beneficial owners of the shares in corporations and update those names in public corporate registries.
4. Multinational corporations in the extractive industries should also publicly disclose, on a country-by-country and project-by-project basis, the payments they make to governments, based on their

reports under Section 1504 of the Dodd-Frank Act in the United States and the Accounting and Transparency Directives in the European Union.

5. Multinational corporations should identify in their annual, publicly available corporate reports all of their subsidiaries, and not just the subset of “significant” subsidiaries.
6. States should publicly disclose advance pricing agreements and the outcomes of mutual agreement procedures and develop a model form to make key elements publicly available.

V. Reform Tax Treaties

1. States should avoid restrictions on tax withholding in tax treaties.
2. Multilateral organizations should expand the objectives of model tax treaties to include preventing double non-taxation, curbing abusive tax practices, and enabling information exchange to facilitate effective tax administration
3. Multilateral organizations should amend the model tax treaties to include a general anti-avoidance rule.
4. States should avoid the inclusion of provisions in investor protection treaties, resource extraction agreements, or other agreements that weaken or circumvent tax law.

VI. Build Inclusivity into International Tax Cooperation

1. Member States should upgrade the UN Committee of Experts on International Cooperation in Tax Matters to an intergovernmental Commission and provide it with adequate resources
2. The G20/OECD BEPS project is a step in the right direction, but should be made more inclusive to reflect the priorities of developing countries, including through equal voting rights and equal rights to amend the action plan
3. Multilateral and other governmental organizations should provide increased resources for capacity building in developing countries for tax administration, including through South-South cooperation.
4. The UN Global Compact and the OECD Guidelines for Multinational Enterprises should be strengthened by explicitly recognizing the obligation to pay tax as a preeminent corporate social responsibility
5. Member States should initiate negotiations to draft a UN convention to combat abusive tax practices, which should evolve into a convention that would adopt a consolidation and apportionment system for taxing global corporate profits.
6. The international community should continue to search for the most effective and inclusive mechanisms to regulate corporate taxation at the global level.