

Enabling Tax Payments:

A Novel Approach to Reducing Violence and Poverty in El Salvador

by Ann Low

Poorly organized governments collect insufficient revenue to pay for police forces and civil administrations whose staff are consistently well trained, highly motivated, and immune from bribery. Inadequate tax collections generate weak institutions and insufficient policing, leading to insecure areas where police do not enforce laws and public services are meager or non-existent. In those locations, crime and unmet social needs breed despair and anger. Left unchecked, criminal and terrorist networks can form, and their activities can corrupt governments and threaten neighboring states' security.

Admiral Kurt Tidd, former Commander of the United States Southern Command, one of the United States' six geographically-focused unified military commands,¹ said “[U.S. Southern Command’s] main effort is countering threat networks.”² He explained, “The illicit flows of goods and people, and the violence and corruption these flows fuel at home and abroad, are the visible manifestations of complex, adaptive, networked threats... These networks operate unconstrained by legal and geographic boundaries, unimpeded by morality, and fueled by enormous profits... They prey on weak institutions and exploit the interconnected nature of our modern financial, transportation and communication systems, and the seams in our organizational boundaries.”³ The International Chamber of Commerce projected that “the negative impacts of counterfeiting and piracy (could) drain US\$4.2 trillion from the global economy and put 5.4 million legitimate jobs at risk by 2022.”⁴ While each threat network is different (e.g. some are international criminal enterprises focused on counterfeiting and transport of illicit cargo, some are small operations that smuggle desperate migrants, others support terrorist organizations through financing and the spread of violent, extremist ideology), all threat networks have a common thread. They proliferated in a municipality where the police and social services were inadequate, allowing criminality, violent extremism, and other

Ann Low is a career diplomat with extensive interagency experience. She has represented the U.S. on executive boards and committees of multiple United Nations' agencies and international organizations evaluating their programs and developing best practices. She is the architect of ger.co, a public-private partnership whose mission is to promote simple online governmental services worldwide.

threats, such as disease or pestilence, to spread across national borders.

But There is Hope

Transparent online tax and administrative systems can be effective weapons against threat networks, enabling governments to trace illegal transactions and deter corruption. Transparent systems provide governments with the data to enforce laws and collect taxes, enabling them to identify and prosecute corruption. Online governmental procedures empower citizens by showing them the official processes and costs for securing services, the amount of time required to fulfill each governmental obligation, and how to complain if services don't meet expectations. Armed with that information, citizens can hold their governments accountable for providing good services, and they can contribute to improving services by suggesting simplifications.

In a 2014 study, Lucy Martin of Yale University set up experiments in Uganda to test the theory that people demand better government—and get it—if they have to pay for it through taxes. In poor countries that depend primarily on foreign aid for their revenues, Martin found, citizens tend to tolerate official corruption and poor provision of public services, but they become less tolerant when they must pay taxes. According to Martin, taxpayers are more likely to enact costly sanctions against corrupt officials and mismanaged governments because taxes take away earned income and individuals are loss averse (caring more about recovering losses than obtaining gains).⁵ Martin concluded, “taxation generates a significant increase in the level of accountability citizens demand from their leaders.”⁶ According to T.R. Reid, who has analyzed tax systems globally, “a regime of taxes considered fair and reasonable, and an honest, efficient agency to collect them, can give people confidence in their own government. Because taxes hit nearly every

citizen in one way or another, everybody has a stake in effective taxation. This is particularly true in young nations or in countries where a corrupt government has traditionally been a fact of life.”⁷

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Catch-22: Why Governments Lack Effective Tax Systems

Some governments fund themselves through state-owned enterprises, high tariffs and sales taxes, foreign aid and other channels that don't rely on their citizens producing increasing amounts of wealth that can be taxed. Those government officials may not want the accountable relationship between a government and its citizens that an efficient income tax system fosters.

However, many poorly organized governments do want effective tax and administrative systems, but their reformers are in a Catch-22. They do not have the systems, so they can neither generate resources to pay for building them nor access data to prove the systems are necessary. Instead, those reformers typically rely on donors' largesse to break the impasse, but donors typically do not fund projects aimed at helping governments create their own independent revenue streams. Donors prefer to fund projects that meet the donors' priorities.

Paul Collier, author of *The Bottom Billion*, wrote that technical assistance (the supply of skilled people paid by a donor) accounts for about a quarter of all money spent on aid.⁸ The payoff for technical assistance, when provided to support a reform-minded minister, can be \$15 for \$1 in aid, yet aid agencies aren't achieving that impact. This is because “technical assistance is

supply-driven rather than demand-driven. The same assistance is poured into the same places without much regard to political opportunity.”⁹

Even when money is available, it is hard to identify competent suppliers of low-cost, easily maintained tax and administrative systems for poorly organized governments. Three factors make it hard for private businesses to profitably build such systems: 1) the overall high failure rate of information technology (IT) projects; 2) a poorly organized government’s need for indefinite and indeterminate amounts of technical assistance that it cannot afford; and 3) vested interests opposing change.

When the project streamlines procedures, government employees may see their jobs threatened and not cooperate.

First, the Standish Group’s 2015 Chaos Report studied 50,000 projects around the world, ranging from tiny systems enhancements to massive systems reengineering implementations. Only 29% of those projects were successful (completed on time and on budget with a satisfactory result), while 19% were considered utter failures.¹⁰ The worst performing projects, with only a 3% success rate, were large ones implemented using a linear method of software design,¹¹ which is the category into which most governmental tax and administrative projects would fall. The high failure rate makes it difficult for risk averse donors to spend money on an IT project when they must also demonstrate good stewardship of their taxpayers’ or charity’s funds.

Second, governments don’t just need networked computer systems, they need collaborative work processes to effectively implement the technology. In short, they need to re-think governmental processes to make compliance easier for small businesses. That means technical assistance. According to Frank

Grozel, the United Nations (UN) Business Facilitation Program Manager, “Poorly organized governments typically need help cultivating intragovernmental relationships so that disparate parts of a government will share information and work together. They need help breaking logjams among ministries and educating colleagues about the benefits of implementing user-friendly digital services. They need help simplifying procedures. If an IT project doesn’t include a lawyer who wants to simplify procedures and can show the government lawyers that the proposed simple process still complies with that government’s laws and regulations, the simplification cannot be implemented. The UN enjoys enormous respect worldwide. That cachet helps my teams build essential relationships across government ministries and with the private sector, which enable us to implement effective IT solutions in poorly organized environments.”¹²

Third, while a reform-minded minister may be fully committed to modernizing his ministry’s IT systems, his staff and colleagues may feel threatened. There may be individuals skimming funds from public coffers, companies avoiding taxation, and criminal networks bribing police who all have vested interests in opposing change. When the project streamlines procedures, government employees may see their jobs threatened and not cooperate. Governments often need ongoing help with change management, and even successful projects may become abandoned as soon as donor funding stops.¹³

UN Business Facilitation Program

For the past decade the UN Business Facilitation Program has defied these odds. The Program has successfully helped 37 countries build 68 user-centric online administrative systems,¹⁴ completing over 90 percent of projects on time and within budget. The UN Business Facilitation teams succeed where private contractors often fail because of their mandate, motivation, and method of work.

Mandate

The UN is a not-for-profit organization, answerable to its 193 member states. All UN projects are demand-driven by those member states. The UN Business Facilitation Program can accomplish low cost IT projects because it cannot earn a profit. It charges one upfront license fee for its systems to cover ongoing development and program costs, but no recurring annual fees, as do most commercial software or database providers.¹⁵ Government officials invest hundreds of hours in project design with a UN Business Facilitation team before seeking funding, so funded projects enjoy high-level buy-in from at least one ministry on day one. Government agencies who may be unwilling to cooperate with each other often will agree to cooperate with UN staff. They perceive the UN as a neutral, reliable partner who has the right mandate and expertise for such a long-term endeavor as improving governance.

Motivation

UN Business Facilitation staff want to improve the world through IT solutions. They can collaborate with experts worldwide because they are not competing for business but trying to solve global problems. They can invest in optimal solutions because their work will benefit not just one immediate project but ongoing and future projects, and it can contribute to the development of global best practices.

Method of Work

UN Business Facilitation projects are small (\$200,000 to \$1.5 million). They use agile development methods and a common IT architecture. Due to their size and methodology they fall in the Chaos Report's sweet spot where IT projects have the greatest likelihood of success and least chance of failure.¹⁶ The Chaos Report identifies key factors which work together to make projects more successful, such as executive sponsorship, emotional maturity

(UN Business Facilitation project leaders speak multiple languages and often work together over many years and diverse projects) and standard architecture (UN Business Facilitation systems each have different content but they all have the same look and feel).¹⁷

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The El Salvador Pilot Project

In 2016, the U.S. Department of State collaborated with the UN Business Facilitation Program and three Central American governments to design a project targeting root causes of illegal migration by unaccompanied Central American children to the U.S., specifically violence, corruption and poverty in El Salvador, Guatemala, and Honduras, and better public services in the U.S. In 2015, El Salvador was labeled the most violent country in the world with 104 intentional homicides per 100,000 population¹⁸ versus 4.9 intentional homicides per 100,000 population in the U.S.¹⁹ According to the UN Development Program's *2018 Human Development report*, Americans have an average of 13.4 years of schooling and a per capita income of \$54,941, while Salvadorans have 6.9 years of schooling on average and a \$6,898 per capita income.²⁰ Guatemalans and Hondurans each have 6.5 years of schooling on average and per capita incomes of \$7,278 and \$4,215, respectively.²¹

The project designers recognized that parents must see immediate improvements in the quality of governance and their family's own physical safety and welfare to reduce the allure

of illegally migrating to the U.S., despite all the inherent dangers in that choice. They reasoned that if the governments in Central America collected more taxes, they could provide better public services, including more policing to stop gang violence and extortion, better schools, and better infrastructure to enable economic growth. If parents knew how to comply with laws and regulations, including business registration and tax payment, and could do so easily, they would not be afraid to interact with the police and to hold government officials accountable for providing good services. If government employees had modern IT systems and training, they would be inspired to provide better services and have the capacity to do so.

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The concept was to use technical assistance, novel IT approaches, public-private partnerships, creation of a citizen's hotline, and training to help each government automate and incentivize business registration and tax payment, and then run communication campaigns at the national and municipal levels to register businesses. Those new tax payments could sustain and expand the effort.

The project could be ambitious because it leveraged existing UN Business Facilitation systems in the three countries, which had been funded by the government of Luxembourg, and which the three countries had already requested UN technical assistance to expand. The project design was informed by expert advice from the U.S. Department of State's Bureau of International Narcotics and Law Enforcement, Bureau of Economic and Business Affairs, and Bureau of Western Hemisphere Affairs and by the UN Business Facilitation Program's

experience formalizing businesses in Mali.

The U.S. Department of State funded the project for Santa Ana, El Salvador's third largest municipality (population 272,554²²) to test the concept. The project was titled "Formalization of Small Businesses in El Salvador to Improve Governance, Enhance Security, and Build Trust in Government." Informal businesses employ over 60 percent of the labor force in El Salvador, yet those businesses have no legal right to exist.²³ Consequently, informal businesses and their employees are vulnerable to extortion from gangs and bribery from unscrupulous government officials. Business registration, or "formalization," creates records letting the national and municipal governments know a business exists and is taxable. Incentivizing business registration and enabling tax payment to build accountable, sustainable public services was the project's lodestar.

Accomplishments: Salvadoran Project Leader's Perspective

The results are best explained by Nelson Pérez, the Salvadoran Project leader. "We developed or expanded nine IT systems to improve government services, and we built a mobile app to track progress. Initially, we planned to document the process to pay taxes, create an anti-corruption hotline (call center) in Santa Ana, register businesses and issue identity cards to entrepreneurs to prove their legal status. However, the processes for small businesses to register and pay taxes were so complex that we were unable to promote massive business registration because we first needed to identify and document all the steps to pay taxes, which was much harder than we anticipated. Then we needed to begin simplifying processes so entrepreneurs could fulfill their obligations without having to hire an accountant or spend several days each month on governmental paperwork.

"We added national level tax payment

information for individual merchants and companies to the national business registration website (<https://miempresa.gob.sv>). We established 32 public-private partnerships to offer immediate benefits from business formalization, such as access to lower cost credit,” said Pérez. For the first time in El Salvador’s history a small business can find all the information it needs to pay national level taxes on one website, including downloadable forms, and it can compare an array of benefits (health services, insurance, credits and guarantees, technical assistance etc.) available to formalized businesses from 32 private sector suppliers.

“We simplified some of the most cumbersome processes for operating a business. We put the mandatory annual statistical solvency certificate online, so companies no longer need to travel to the [National Statistical Office (DIGESTYC)] in San Salvador to file. That office estimated the online process saves each of El Salvador’s 26,000 registered companies about \$40 per year in opportunity costs, or \$1 million annually. We automated the process to renew business licenses, which must be done annually and requires submission of the preceding document. We described four other annual filings and six monthly-filings online but did not have time to automate them.

“In July 2017, my government made the national business registration website (<https://miempresa.gob.sv>) the unique channel for registering a business and complying with national-level laws and regulations for business operations in El Salvador. The number of registrations through the online system increased 392% from 1,735 in 2016 to 8,528 in 2018, representing a significant improvement in legal compliance and potential increase in tax revenues.²⁴

“At the municipal level, we automated the process by which municipal employees in Santa Ana search databases to issue a municipal tax solvency declaration, which is required

to register a business and then annually to renew business licenses. Automating that process reduced the time required to issue a tax solvency by 86% and eliminated the possibility for municipal agents to delete files or forgive obligations as happened in the past.²⁵ Businesses in the Municipality of Santa Ana can now go to the city hall and get the tax solvency declaration in less than an hour.²⁶

For the first time in El Salvador’s history a small business can find all the information it needs to pay national level taxes on one website...

“We identified the requirement that a new business show a municipal tax solvency declaration as a precondition to registering as an inconsistency in the law. A new business typically would not have paid municipal taxes and so would be ineligible for the municipal tax solvency declaration required to start the formalization process. We started working with the government to overcome this legal inconsistency that poses a barrier to formalization.

“We interviewed small businesses and discovered that not only were the registration and tax payment forms still too numerous and too complex - many businesses didn’t have a reliable way to calculate how much taxes they owed. My Program Manager, Frank Grozel, and his team of developers, responded by creating one of the world’s simplest accounting systems which we tested with 20 entrepreneurs. We learned that a third of our sample entrepreneurs suffered from extortion and half had considered migrating to the U.S. to escape corruption. We also learned that the amounts the entrepreneurs paid the extortionists were typically greater than the taxes they owed, and that the extortionists were typically gang members who threatened the entrepreneurs’ families with violence. Were

entrepreneurs able to pay taxes and count on police services to keep their persons and property safe, everyone would be better-off.

“When we launched the anti-corruption hotline in Santa Ana in mid-2017, operators received many calls about inefficient municipal services. Gross administrative inefficiency is considered corruption under Salvadoran law. We realized that to rebuild trust in government, we had to create an online administrative system for Santa Ana, so the operators could direct complaints, such as poor electricity services or missed garbage collections, to offices who could fix those problems. We discovered many municipal offices didn’t have, or enforce, standard operating procedures for providing services, so service levels were inconsistent. We worked with government agents to document 44 municipal procedures online, involving 210 steps, 124 documents, 17 laws, and 19 municipal employees (<https://santaana.eregulations.org>). In that process, we discovered Santa Ana had over 200 taxes, permits, and fees, which were not well publicized and inconsistently collected, giving the impression that compliance was unnecessary or arbitrary.

...by analyzing information in Santa Ana’s new tax database, the tax manager identified 30,000 accounts that didn’t receive invoices...

“Santa Ana received 870 calls on the hotline through January 2019, including calls about gang members infiltrating the municipal police, bribes to municipal agents in exchange for incorrect registrations, public employment in exchange for money, and extortion. This cooperation led to eight corruption cases being transferred to the General Prosecutor’s office.”

“When we focused on creating the entrepreneur card, we discovered that many small business owners did not have time

to comply with the multiple documentary requirements and complex formalities that are mandatory to register a business and work formally,” said Pérez. “We partnered with the Small Business Administration and the National Registry of Natural Persons (a national register of adults ages 18 and older), to create the “MYPE” register, which entrepreneurs can join with just a copy of their national ID. The MYPE register allows small businesses to identify and categorize the areas in which they work, so that they can access tailored benefits for their business development, such as technical assistance, fairs, and expositions.²⁷ As of March 2019, 3,700 entrepreneurs had joined the MYPE register.

“During the project’s two-year life span, we trained over 500 government officials and trusted third parties, such as lawyers and accountants, on how to use the new systems, including how to harvest productivity data to identify bottlenecks and improve services. For example, by analyzing information in Santa Ana’s new tax database, the tax manager identified 30,000 accounts that didn’t receive invoices because the addresses were located in dangerous areas and that 54% of the households that did get bills had not paid their municipal services taxes.

“We partnered with the National School of Public Training to create a certificate program for public officials to begin institutionalizing the training and systems. We also partnered with the electric company, so they provided information about the citizen’s hotline to over 70,000 households in their January 2018 electric bills.

“We completed the two-year pilot project in July 2018 on time and within its \$1.5 million budget. We benefited from substantial in-kind contributions from the government of El Salvador and the Municipalities of Santa Ana and San Salvador, excellent cooperation with the U.S. Embassy, the Millennium Fund (FOMILENIO) projects financed by the Millennium Challenge Corporation, and [the

U.S. Agency for International Development], which were simultaneously managing huge development projects in El Salvador. The Minister of Economy, the Mayor of Santa Ana, and my UN Program Manager in Geneva, provided critical leadership and problem-solving to keep the project on track.

“Altogether the government of El Salvador and the Municipality of Santa Ana assigned 45 staff to the project, whose combined salaries equate to over a \$1 million in-kind contribution. In addition, the government of El Salvador and Municipality of Santa Ana provided office space, equipment, and transportation to the project, and officials from 11 different Salvadoran government agencies were part of our team.”

“My government still needs to make the process for paying taxes much easier to enable widespread compliance. Ideally agencies will agree to simplify their processes so small businesses can use one form to pay taxes. More government agencies and other municipalities should implement content management systems to track complaints and provide better services. Rebuilding trust in government requires a sustained effort, but we are headed in the right direction.”²⁸

The Mayor’s Perspective: Transparency and Next Steps

According to Milena de Escalon, the Mayor of Santa Ana (2018-2021), the “Línea ciudadana unidos contra la corrupción” (citizens hotline), Santa Ana’s online administrative systems, and the behind-the-scenes work processes that those systems track have increased productivity and transparency in the municipality and improved municipal services. “Since the Citizen’s line was launched, 870 cases have been addressed, resulting in improvements to public lighting services, solid waste collection services, maintenance of public works (sidewalks, walkways, streets), and inspections of businesses that were reported to violate regulations. At the

same time, the system has motivated municipal officials in all departments of the municipality to be more responsive to requests for public services, so that citizens don’t complain about them. And the system has made it possible to detect acts of bribery by municipal employees.

“The population can now communicate directly with the municipality through four channels: telephone, in person, the municipal website (santaana.eregulations.org), or online chat. The municipal website shows the costs and time needed to carry out several municipal procedures, such as opening or closing a business, installing signs or obtaining building permits, so citizens can report any anomalies in the application of those municipal regulations and suggest ways to streamline the processes.

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“We hope to continue expanding the project with the United Nations and the Department of State of the United States, so that we can offer more municipal procedures online and facilitate the declaration and payment of taxes. I have personally guaranteed the transparency of this project by requiring that cases be sent from the Citizens hotline Contact Center to the Mayor’s office, which distributes the cases to the corresponding dependencies within the Municipality, tracks them to resolution, and ensures that citizens are notified through the Contact Center of actions taken to resolve their complaints.”²⁹

The Vice President’s Perspective: Improved Business Climate

Oscar Samuel Ortiz, Vice President of El Salvador (2014-2019), wrote “The technical

assistance we received from the UN has enabled my government to simplify and automate procedures, resulting in lower costs and faster processing times for users...For example, we have facilitated business by documenting or updating 414 administrative procedures online, encompassing 1,163 steps, 4,823 forms and documents, 208 laws and regulations, and the contact information for 454 public agents. The information is freely available on the national business website: <https://tramites.gob.sv>. We have also simplified and automated all business start-up procedures on the national portal <https://miempresa.gob.sv>.” The project has improved the business climate by increasing transparency and deterring corruption. The government of El Salvador appreciates the generous financial support from the United States. We have requested additional technical assistance from the United Nations to help us continue reducing corruption and improving the business climate by simplifying governmental procedures and putting them online.³⁰

The project has improved the business climate by increasing transparency and deterring corruption.

The UN’s Perspective: Scalable Model to Improve Governance

According to Frank Grozel, the UN Business Facilitation Program Manager, who oversaw the project’s implementation from Geneva, “The El Salvador project funded by the US Department of State brought the world closer to a replicable model of technical assistance that can enable widespread business registration and tax payment. My team had a decade of experience helping governments reduce corruption and enable economic growth through administrative systems and trade portals. Now we have experience simplifying tax processes

and integrating IT solutions with a citizens’ hotline and public-private partnerships.

“I believe many reform-minded governments could improve governance in a few years through a four-tier process of technical assistance. First, simplify one ministry’s processes and put them online (estimated costs \$200,000). Second, pursue a more complex project to standardize more administrative functions online, implement a citizen’s hotline, and provide businesses with a simple accounting system modelled on the prototype we created for the El Salvador project (estimated costs \$750,000 annually for two years).

Third, re-think tax rules themselves to make compliance easier for small businesses, who are over 90% of potential taxpayers in most countries. Ideally, a government would simplify to one single tax declaration and one single tax payment for all administrations that collect revenue as opposed to the multiple declarations and payments on complex forms now required by most poorly organized governments. Fourth, after simplifying and automating tax payment to the extent possible, implement a massive communications campaign educating entrepreneurs about how to register businesses and pay taxes (estimated costs \$1 million annually). Throughout the process continue improving all government services and expanding partnerships with the private sector, so new taxpayers experience immediate benefits from legal compliance, such as access to lower cost credit and the ability to bid on government contracts.”³¹

Additional Project Accomplishments: Highlights

- Contributed to a **22-place improvement in El Salvador’s World Bank 2018 Ease of Doing business rating**, which constitutes a significant improvement in conditions for foreign direct investment.³²

- Created **baseline statistics** for the nation and municipalities of Santa Ana and San Salvador against which progress can be measured.
- Implemented a system for the **secure exchange of information** among government ministries and with the user.
- **Continuity:** Upon the project's completion, the government of El Salvador committed 15 staff to continue maintaining, updating, and improving the online business registration and tax information system (<https://miempresa.gob.sv>), the municipality of San Salvador committed staff to maintaining its system (<https://sansalvador.eregulations.org>), and the municipality of Santa Ana committed 5 staff to maintaining the citizens' hotline and updating its administrative system (<https://santaana.eregulations.org>).
- Created a prototype government **central board** which the government could build out to track business registrations and compliance with rules for businesses in El Salvador, so the government would know when payments are overdue and registrations missing.

Conclusion

In *War and the Art of Governance*, Nadia Schadlow wrote, “success in war ultimately depends on the consolidation of political order, which requires control over territory and the hard work of building local governmental institutions.”³³ We are now engaged in a war against threat networks with poorly organized governments at the vanguard. The El Salvador project is an innovative way to combat threat networks and deprive them of the conditions they need to exist. It provides reform-minded governments and donors with a tested, low-cost model to improve government services and potentially increase tax collections through technical assistance that includes IT solutions, collaborative work processes, public-private partnerships, training, and a citizens' hotline. **IAJ**

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SCHOLARSHIP

CGSC Foundation Scholarship Program

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Lora Morgan, Director of Operations
 913.651.0624
lora@cgscf.org