

# TAX AND THE POST-2015 AGENDA

This briefing calls for a much stronger focus on tax in the debate around the framework to follow the Millennium Development Goals, and it argues that taxation has an important role to play in financing for development, strengthening governance and accountability, and tackling inequality.

## Introduction

Every year, developing countries lose more to tax dodging than they receive in official development assistance (ODA) – an annual loss of around US\$160bn, as revealed by a 2008 Christian Aid report.<sup>1</sup> In that same year, the total ODA committed by members of the OECD-DAC (the Development Assistance Committee of the Organisation for Economic Co-operation and Development) was US\$119.8bn.<sup>2</sup> While ODA rose and peaked in 2010, it has been estimated that in 2011 there still remained a **'delivery gap' of US\$166.8bn**<sup>3</sup> between the total required to meet the UN's 0.7 per cent target and the actual amount pledged in aid.

Christian Aid's argument is not that tax should replace ODA. Indeed, the distribution of these missing tax revenues would be very different to the targeted distribution of ODA. However, we contend that there should be a **much stronger focus on mobilising domestic resources within a post-2015 sustainable development framework**. Development has often been synonymous with aid alone, but as the above figures show, additional tax revenues generated from addressing tax evasion and avoidance have the potential to meet and even exceed the amount raised from ODA to date.

Financing is not the only rationale for considering taxation in the context of post-2015 Sustainable Development Goals (SDGs); consequently, in designing a new development framework, policy-makers should also ask whether tax could help

them achieve other objectives as well. In this vein, this paper considers taxation from three different angles:

- 1 taxation as a source of post-2015 development finance**
- 2 taxation as key for effective governance**
- 3 taxation as a tool for reducing inequality, domestically and globally.**

## Taxation as a source of post-2015 development finance

To date, very little coverage has been given to the topic of financing any post-2015 SDGs, and perhaps rightly so. The focus on establishing a vision has been prioritised. However, without an honest discussion on financing a new framework, there is a risk that grand ambitions for a rights-based post-2015 framework will not be realised.

The Millennium Development Goals (MDGs) were developed on the premise that ODA would provide the majority of financing for development and, in some countries, debt relief. MDG 8, 'Develop a Global Partnership for Development', made some reference to trade, but there was really no effective way of holding developed country governments to account for the rather vague target to *'develop further an open, rule-based, predictable, non-discriminatory trading and financial system'*. ODA, therefore, has underpinned delivery of the MDGs and there is now some evidence that donors have indeed used the MDGs to direct their support.<sup>4</sup>

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POVERTY

Between 2000-2010, ODA from OECD-DAC donors continued to rise in accordance with this development funding model, although it remained far off the stated goal of 0.7 per cent. However, in 2011 total contributions from OECD-DAC donors, excluding debt relief, fell by three per cent: this resulted in the provision of US\$133.5bn, an average of only 0.31 per cent of GNI.<sup>5</sup> In 2011, 16 DAC donors reduced their aid budgets, with the biggest cuts perhaps unsurprisingly taking place in countries like Spain and Greece, in response to economic crisis.<sup>6</sup> These recent developments confirm that aid is often an unreliable source of development finance, beholden to conditions in the donor country rather than responding to the needs of those in poverty.

At the same time, we have seen a number of economies growing at a rapid rate, and the 'distribution of absolute poverty' has shifted somewhat. According to analysis carried out by development economist Andy Sumner, *'half of the world's poor live in India and China (mainly in India); a quarter of the world's poor live in other MICs [middle-income countries], (primarily populous LMICs [lower middle-income countries] such as Pakistan, Nigeria and Indonesia); and a quarter (or less) of the world's poor live in the remaining LICs [low-income countries].'*<sup>7</sup> In this context there are increasing challenges, not least political, for ensuring that resources still reach people living in poverty, wherever they may be. There will clearly be a need for continued ODA in many contexts, to address poverty and social exclusion, but the growing role of taxation must also be recognised.

However, while the role of taxation may be increasing, the revenues themselves are not. IMF analysis suggests that tax-to-GDP ratios in MICs and LICs have been fairly uniform since 1980.<sup>8</sup> For LICs, this is just 15 per cent of GDP, compared with over 30 per cent in most rich countries.<sup>9</sup> This is surprising given the growth rates in some economies, but the simple truth is that many developing countries are struggling to convert growth into tax revenues. According to ODI analysis, net foreign direct investment (FDI) inflows to MICs rose from US\$146bn to over US\$500bn between 2000-2010, and in LICs from US\$2.4bn to US\$13bn in the same period.<sup>10</sup>

One might have expected tax revenues to increase due to the inward investment from multinational corporations (MNCs), but converting these flows into sustainable domestic resources is not automatic. Tax incentives both offered by and demanded from governments often forgo huge sums (sometimes over five per cent of GDP<sup>11</sup>) for no clear returns; and when deals are kept secret, the opportunity for rent-seeking and corruption to distort tax incentives is great. MNCs' ability to use complex structures and tax havens further

**In context: Zambia<sup>12</sup>**

Zambia has a growing economy and is now classified as an LMIC. Yet, 60.5 per cent of its population still live under the national poverty line and it currently ranks 163 out of 187 countries on the Human Development Index. The country has exceptional natural resources: the mining industry in particular has boomed in recent years. However, this has not necessarily translated into strong development outcomes: one reason for this is a failure to convert FDI into tax revenues. In 2010, the tax-to-GDP ratio stood at around 16.6 per cent, a slight increase on the previous year – but it is worth noting that in 2009-2010 FDI increased from US\$695m to US\$1.7bn.<sup>13</sup>

A 2010 Christian Aid report highlighting the problem of trade mispricing – which focused on copper, Zambia's primary export – found that the price declared for Swiss copper exports was considerably higher than the Zambian price.<sup>14</sup> If the Zambians had received Swiss export prices for their own exports to Switzerland, the total value received in 2008 would have been almost six times higher than it was, adding US\$11.4bn to Zambia's GDP, which in 2008 was just US\$14.3bn.

Zambia is now increasing the amount collected in mining taxes after a decision to double royalties charged, but the government estimates that it is still losing around US\$2bn every year through tax avoidance.<sup>15</sup> Moreover, the tax-to-GDP ratio is actually projected to fall to just 12.6 per cent this year, further highlighting the challenge Zambia faces as it seeks to develop its tax system.

increases the challenges for translating FDI into a growing tax pot.

Illicit financial flows in the other direction further compound the problem and may be costing developing countries over US\$1tn a year – a figure that is increasing.<sup>16</sup> These flows include corruption, drug trafficking and terrorism, but the largest contribution is tax evasion. Financial secrecy, exemplified but not restricted to tax havens, facilitates these flows, stripping developing countries not only of tax revenues, but also vital domestic capital to invest for development.

With this context in mind, Christian Aid would like to see a post-2015 sustainable development framework that seeks to maximise domestic resource mobilisation, including tax revenues and the retention of capital. Without doubt, there is still a crucial role for ODA and climate finance, and politicians must continue to make a strong political case for this, even during tough economic times. However, tax should also be a central part of the debate on financing and implementing a new global plan.

### **Taxation as key for effective governance**

Within the post-2015 debates, the UK prime minister has often spoken of the 'golden thread' of development: those building blocks that underpin strong economies and secure a stable basis for prosperity. Among those oft-cited institutions are a strong judiciary, property rights and the rule of law. However, Christian Aid believes that a fair and transparent taxation system is also a foundational requirement of a healthy democracy and strong economy. Where the state does not have a monopoly over the collection of taxes, other actors are sometimes able to step in to demand payments, and thus challenge the state's legitimacy and even finance unrest. This has been a significant problem in countries impacted by the drugs trade or where there is a large informal sector. For example, the World Bank has estimated that in Tanzania, only 20 per cent of the charcoal industry is subject to taxation – largely due to the resistance of influential dealers, transporters and traders, and resulting in a loss in annual revenue of approximately US\$100m.<sup>17</sup>

Moreover, it has been argued that an over-reliance on ODA may actually diminish democratic accountability, leading to an unhealthy dependence on external donors. Home-grown demands and campaigns are overwhelmingly more attractive and appropriate in the long term, as illustrated by Christian Aid's partners working on accountable governance worldwide.

#### **In context: India**

India has made some progress in granting basic rights and entitlements to its citizens in recent years. Examples include the 'right to education' agreed in 2010 and the 'right to food' discussed by the Indian Parliament in the same year. When India's poor communities discovered they were paying taxes on everything from matchboxes to rice, they demanded to see the government's accounts, using 'We will know, we will live' as their rallying cry. Initially, they were declined access to this financial information, but during the 2005 campaign for the 'right to information', tax campaigners seized the opportunity to demand clarity on government income and expenditure. With the passing of the Right to Information Bill, citizens in India are now entitled to know how their tax money is spent and they are using this knowledge to challenge existing tax policies.

Work that has been undertaken by the G7+ countries and others has resulted in five Peacebuilding and Statebuilding Goals (PSGs) that are relevant to discussions about a 'golden thread' and the need for strong institutions. The five goals – framed as a 'crucial foundation to enable progress towards the MDGs' – address legitimate politics, security, justice, economic foundations, and revenues and services, the last of which is explicitly linked to taxation. The indicators currently under consideration include:<sup>18</sup>

- state control/monopoly over tax, customs and fee collection
- tax revenue as a share of total revenues
- tax effort (calculated as the ratio of actual tax revenue compared with potential tax revenue, based on a state's level of economic development)

**Christian Aid would like to see a post-2015 sustainable development framework that seeks to maximise domestic resource mobilisation**

- perception of tax collection and fairness
- capacity of tax administration.

There is a strong rationale for building on this existing work in a post-2015 sustainable development framework. It is too early to know how governance issues will ultimately be dealt with post MDGs, but there is almost universal recognition that the enabling environment for development, and in particular the need to address conflict and fragility, should be central discussions moving forward.

Christian Aid would also stress the need for 'good global governance' under this heading. Good governance is in no way a 'developing world problem'. Concerns around tax avoidance, for example, are shared from country to country; if you dig deep, it becomes clear that corruption and tax evasion are often facilitated by service providers, such as banks and lawyers, based in the global North. We believe a post-2015 development framework should also stimulate better global governance and require both individual countries and multilaterals such as the G20 to take steps in support of a more transparent financial system. There has been growing recognition of the need for this, including in a report to the G20 by the UN, OECD, World Bank and IMF.<sup>19</sup> However this recognition has yet to evolve into significant action: most of the report's recommendations remain ignored. Integration within a post-2015 framework may assist in producing outcomes.

The need for action from wealthier nations is relevant to a number of areas under discussion, and is consistent with the European principle of 'policy coherence for development'. It was recently recognised in a parliamentary report from the UK's International Development Committee, which stated: *'The post-2015 agenda should set specific and measurable goals for all countries, including traditional donors and middle-income countries, in key areas of international cooperation such as development aid, climate change, tax, trade, transparency, migration and intellectual property rights.'*<sup>20</sup>

Lastly, Christian Aid would also highlight the potential role that businesses could play in supporting efforts towards good governance and transparency. We have long called for MNCs to publish comprehensive data on payments, profits,

employee numbers, assets and other matters, on a country-by-country basis, and believe there is strong rationale for legislation in this area. However, we would also encourage companies to ensure that information on tax policy, practice and implementation across their global operations is publicly available, as a matter of good practice. The availability of this information is essential for driving cultural change and ensuring that companies regard taxation as a core dimension of corporate social responsibility.

### Taxation as a tool for reducing inequality

An effective tax administration is one thing, but it can of course be used for good or for ill. In a recent Christian Aid report focusing on inequality across Latin America,<sup>21</sup> we highlighted a number of countries where inequality has been rising, often as a result of regressive taxation systems. In the Dominican Republic and Guatemala for example, our research found that the concentration of wealth at the top had worsened since 2002. In Nicaragua, the poorest quintile spend 31 per cent of their income on tax, while the richest quintile spend only 12.7 per cent.<sup>22</sup> Evidently, it is very hard to build broad-based support for increased taxation if the proceeds are raised in a way that favours the wealthy or other privileged members of a society. But it is also clear that taxation is one of the most important public policy tools available to governments serious about tackling inequality, including gender inequality.

Inequality is now widely recognised as a barrier to sustainable development. Actors from all quarters, including business, government and civil society, stress that the fight against inequality must be central to a new global development framework. The Rio+20 outcomes affirmed the need to promote *'equitable economic growth, creating greater opportunities for all, reducing inequality'*, while the global Beyond 2015 coalition, of which Christian Aid is a member, has proposed that addressing inequality and inequity is a *'must-have'* of any future framework.<sup>23</sup> The UN Task Team report on post-2015 has equality as one of its three guiding principles,<sup>24</sup> and inequality was even identified at the Davos World Economic Forum as *'a top global risk'*.

**Taxation is one of the most important public policy tools available to governments who are serious about tackling inequality**

Inequality not only impedes poverty eradication but also perpetuates unequal power relations, which Christian Aid understands as being a root cause of poverty. Although inequality is not only about the distribution of income, this is a crucial dimension – and it is one that taxation is able, in part, to address through the way money is both raised and spent. Indeed, the potential for taxation policy to reduce inequality is evidenced by Belgium, a country that is more unequal than Colombia, Guatemala and Peru before taxes, but more equal than France, Korea and Canada once taxes and transfers are taken into account.<sup>25</sup>

**In context: Brazil**

Brazil remains one of the world's most unequal nations, with a Gini<sup>26</sup> of around 51.9. Nevertheless it is known for its recent efforts to reduce inequality, including its focus on job creation and implementation of the minimum wage.

The way in which revenue has been spent has had an important impact, and the much-acclaimed Bolsa Familia programme has helped to reduce poverty while favourably growing the incomes of the bottom quintile compared with the top quintile. It is estimated that the Bolsa Familia programme, combined with the introduction of a universal pension, was responsible for 28 per cent of the fall in income inequality between 1995-2004.

However, a 2012 study by Christian Aid partner CEBRAP, which we commissioned, shows that structural inequalities are persistent and perhaps most obvious in land ownership and property.<sup>27</sup> In 2008, Brazil's main property tax contributed only 0.06 per cent of tax revenues. INESC, another Christian Aid partner in Brazil, has shown how the federal tax transfer system has in some cases worsened geographic inequality by transferring more funds to richer municipalities, compared with the poorest 20 per cent.

**Recommendations**

**With this in mind, decision-makers should consider integrating tax into the post-2015 framework in the following ways:**

**1. A revised 'global partnership for development' goal or supporting mechanism.** Among other things, this sets clear targets aimed at curbing illicit financial flows, preventing tax dodging and establishing 'fair and equitable economic rules'. A new goal in this vein should have an overarching objective to ensure that developing countries have the ability to devise and implement sustainable 'financing for development' solutions, with both bilateral and multilateral support from other countries. This could be underpinned by a number of clear universal commitments, including for example:

- a commitment to transparency and exchange of information
- a commitment not to undermine another country's revenue base
- a commitment to prioritise development concerns in international tax treaties and negotiations
- universal participation in processes to change global tax norms.

Success in fulfilling these commitments could be measured, among other methods, by global progress towards public disclosure of beneficial ownership of companies and bank accounts, country-by-country reporting of MNCs, and automatic tax information exchange.

**2. Targets, potentially under a governance or state-building goal aimed at supporting the development of effective and transparent taxation systems.** National targets could be set, incorporating some or all of the proposals currently being considered under the PSGs:

- state control/monopoly over tax, customs and fee collection
- tax revenue as a share of total revenues
- tax effort
- perception of tax collection and fairness
- capacity of tax administration.

We would also suggest the addition of targets to incentivise greater budget transparency, including freedom of

**Decision-makers should consider integrating tax into the post-2015 framework in a number of different ways**

information, the publication of timely and comprehensive data, and open contracting that includes publication of information relating to the use of tax incentives.<sup>28</sup>

**3. A clear goal or target for all countries to reduce income inequality.** There are ongoing debates about whether there should be a standalone goal on inequalities, but a target to reduce income inequality could easily fit under a number of headings including 'inclusive growth'. The most important thing is that this is captured within a new framework and regarded as absolutely central to the pursuit of sustainable development.

A number of indicators should be used: not only the Gini coefficient, but also those able to give a better distributional picture – such as the

'Palma ratio' as recently proposed by Save the Children.<sup>29</sup> Oxfam's recent proposal for countries to reduce inequality to at least 1990 levels could also be a useful baseline.<sup>30</sup>

More specifically on tax, there could also be a requirement for publication of data, linked to the point above, providing a clear picture of the overall tax burden, including the ratio of direct to indirect taxes. Data on the perception of 'tax fairness', as outlined above, would also help in this regard. Christian Aid would also like to see national targets set on gender-responsive budgeting.

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## Endnotes

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**Poverty is an outrage against humanity. It robs people of dignity, freedom and hope, of power over their own lives.**

**Christian Aid has a vision – an end to poverty – and we believe that vision can become a reality. We urge you to join us.**

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