Child Rights Governance

Policy brief:

Using taxation to improve investment in children

Introduction

At a time when most countries are facing fiscal crises and shrinking aid budgets, governments should fully exploit domestic resource mobilization opportunities to improve investment in children. Taxation, in all its various forms, is one sustainable source of revenue that a number of countries have not fully explored. Increasing the amount of money raised from taxation could dramatically improve resources available to spend on children. At the same time, governments have the responsibility of ensuring that tax policy does not perpetuate inequality nor worsen the situation of poor families.

Trends in taxation

Whilst tax revenue contributes an average of 35% of Gross Domestic Product (GDP) in Organization for Economic Cooperation and Development (OECD) countries (this figure however varies across countries), most middle income countries' tax revenue contribute an average of 14% to their GDP.[1] The figure is even lower for low income countries. In general, if developing countries were to increase their tax to GDP ratio to just 15%, they could raise an additional $198 billion every year, that could go a long way towards attaining and sustaining the MDGs[2].

Tax avoidance and evasion, commonplace in a number of both developed and developing countries, have negatively dented the contribution of tax to GDP. Unfortunately, it is developing countries that are hardest hit by tax evasion and avoidance. According to the Global Financial Integrity, international crime, corruption, and tax evasion cost the developing world $858.8 billion in 2010. Out of this figure 61.2 percent of cumulative outflows came from Asia. Latin America, the Caribbean and the Pacific account for 15.6 percent. The Middle East and North Africa (MENA) account for 9.9 percent and developing Europe for 7.0 percent of illicit flows. The balance flows out of Africa (6.3 percent)[3].

Save the Children has calculated that if revenue lost by developing countries due to tax evasion and avoidance was spent according to current spending patterns, it could have saved the lives of 86,000 children under 5 each year, or 1.4 million children over the period of the MDGs (2000-2015). The OECD have estimated a financing gap of $ 62.1 billion annually for achieving the MDGs in middle and low income countries where tax collection is usually weak.

1. Tax Justice Network Africa, 2011, *Tax us if you can, Why Africa should Stand up for Tax Justice*, Nairobi

2. ActionAid, 2009, *Accounting for poverty: How international tax rules keep people poor*, London

3. Kar A and Freitas, 2012, *Illicit Financial Flows from Developing Countries, Global Financial Integrity,* Washington DC

Tax incentives, mostly subsidies and tax holidays, usually offered by governments of most developing countries to attract foreign direct investment also deprive developing countries of the much needed tax revenue to invest in children. International tax competition compounds the situation as many developing countries offer tax incentives to multinational corporations in order to attract investment. In Africa for example, governments of Tanzania, Ghana and South Africa could have earned an additional US$30 Million, US$68 Million and US$359 Million a year respectively from the surge in global prices for metals between 2003 and 2008 if it were not for concessions granted[4].

The informal sector is also a missed taxation opportunity for many countries. For example, 30% of the Asian economy, largely due to informality, is said to be untaxed or under taxed. The figure is 43% for Africa and 16% for Organization for Economic Cooperation and Development (OECD) countries.[5] By bringing the informal sector into the tax net, as much as $101 billion could be mobilized – much more than the current estimated financing gap for the Millennium Development Goals (MDGs)[6].

Photo: Cecilie Jørring/Red Barnet

Taxation and children's wellbeing

The benefits of taxation to children and to development processes in general can be summarized in 4 'R's': 1) Revenue: to finance public services to children; 2) Representation: tax systems often create interest groups that often advocate for their rights as tax payers; 3) Re-pricing: increasing or decreasing the cost of products and services given their potential impact on society (e.g. increase in price of tobacco or fossil fuels and decrease in price of critical products and services to children); and 4) Redistribution: reducing inequality by collecting and utilizing taxes in an equitable way[7].

Taxation is also one way of addressing growing inequalities faced by many children all over the world. A recent study by Save the Children showed that a child in the richest 10% of households has 35 times available income of a child in the poorest 10% of households[8]. Whilst in the past, the majority of poor children were found in low income countries nowadays they are in middle income countries[9]. A progressive tax system[10] will therefore help address inequalities by placing the burden of taxation on those most able to pay (the rich).

'Hidden taxes' with regressive effects have in some countries negatively impacted on households' spending on children. Examples of these might include energy companies charging higher prices for customers not using direct debits/ credit cards. A study by Save the Children UK showed that these tend to be poorer families. The study concluded that in the UK, the costs that poor families bear in acquiring cash and credit, and in purchasing goods and services, can amount to a 'poverty premium' of around 9 per cent of the disposable income of an average-size family[11]. Other examples of regres-

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4. Christian Aid, 2009, *A wealth of development: turning Africa's mineral resources into development through mining tax reform*, briefing paper

5. Somo, 2008, *Taxation and financing for development*, Amsterdam

6. D Itriago, Oxfam, 2011, *Progressive Taxation: Towards fair tax policies*, London

7. A. Cobham, 2005

8. Save the Children, 2012, *Born Equal, How reducing inequality could give our children a better future*, London

9. http://www.cgdev.org/files/1426481_file_Sumner_where_in_the_world_FINAL.pdf

10. A progressive tax system means that the wealthy pay a higher proportion of their income in tax than the poor. This can be achieved through marginal rates of taxation. In addition, governments can also achieve the same through higher taxes or special levies on goods and activities primarily consumed by high income earners such as luxury vehicles, jewelery etc.

11. Save the Children UK and The Family Welfare Association, *The Poverty Premium: How poor households pay more for essential goods and services*, London

sive taxation common in both developed and developing countries include a rise in parking fees, cuts in the subsidy paid to bus companies; value added tax (VAT) on fuel and lighting, TV licenses and other essential services.

An effective taxation system is therefore an indicator of overall governance capability to achieve positive outcomes for children. This, in part, is due to the strengthening of the 'fiscal social contract' between citizens and the state. When governments are dependent on their citizens for money, they are more likely to act in their interest. In turn, citizens are also justified to demand accountability from their government. Governments should therefore strengthen their taxation systems. This can be done in a variety of ways.

a) Ensuring that tax policy addresses inequality

Governments should develop progressive policies for both direct and indirect taxes in order to ensure that poor families remain with household income to invest in children. For instance, governments should ensure that basic commodities used by children such as bread attract very low or no valued added tax. In the past, policies pushed by International Financial Institutions, particularly in the 1980s and 90s largely focused on the revenue mobilization aspects of taxation and ignored equity issues. For example, Value Added Tax (VAT) was emphasized over other taxes[12]. Yet VAT can weigh heaviest on the poor, as they spend the greatest proportion of their income on essential goods. Socially and environmentally harmful products such as tobacco may need to be taxed more.

b) Transparency and accountability in taxation

Tax policy should be designed and implemented within a transparent and accountable framework. Lack of transparency and accountability breeds corruption, operational inefficiencies and leakages in revenue collection and sharing. Tax havens typically thrive on high financial secrecy. Governments should therefore work towards open revenue collection.

c) International cooperation in taxation

To combat tax evasion and avoidance, international cooperation on tax matters is urgently required. This cooperation can start at regional level such as African Union and European Union. Many countries, especially developing ones, are usually ill-equipped to monitor and combat tax evasion and avoidance by multi-national companies. A Christian Aid report estimated that trade mispricing is likely to cost developing countries US$160 billion in lost revenue per year[13]. Weak policy and institutional frameworks as well as lack of transparency in tax and investment issues contribute to this.

d) Missed taxation opportunities

It is about time that governments do everything in their means to expand their tax base by bringing to the tax fold individuals and organizations that may have escaped whilst at the same time reducing its tax expenditure through tax incentives. In addition, governments should consider the opportunity of generating additional revenue by imposing 'sin' taxes on goods and services that are socially and environmentally harmful such as tobacco. Environment related taxes such as carbon tax can also generate significant revenue to support children in disaster prone areas as a result of climate change.

Governments can also consider increasing taxes on luxury goods. Proceeds from such taxes can be earmarked for children. An example of this is the airline ticket tax launched in 2006 by the Governments of Brazil, Chile, France, Norway and the United Kingdom. Nine countries now participate in this initiative. A significant component of this money goes to UNITAID[14], which by 2012 had raised close to US$2 billion to help provide treatment for approximately 47 million people worldwide[15]. However, innovative taxation should be consistent with principles of good tax policy and practice and it should remain progressive. As indicated above, governments also need to find ways of progressively taxing the informal sector.

12. Marshall, J., 2009, *One size fits all? IMF tax policy in sub-Saharan Africa*. Christian Aid Occasional Paper No. 2. Eurodad and Action Aid, 2011, IFIs tax policy in developing countries, http://www.eurodad.org/uploadedFiles/Whats_New/Reports/Approaches%20and%20impactsTAX_June11

13. Christian Aid, 2008, *Death and Taxes: the true toll of tax dodging*, London

14. UNITAID is an international facility for the purchase of drugs against HIV and AIDS, Malaria and Tuberculosis. It was founded in September 2006 on the initiative of Brazil and France. It is hosted by the World Health Organization in Geneva

15. UNDP, 2012, Discussion Paper, *Innovative Financing for Development: A New Model for Development Finance?*, New York

Recommendations

To donors and multi-lateral institutions

- Donors and multilateral institutions should support the strengthening of tax systems and fiscal policy reforms especially in developing countries, in order to ensure that they contribute to efforts by governments towards more and better spending on children.

- The United Nations and other regional inter-governmental organizations should strengthen international tax cooperation, including development of a tax transparency Convention to curb tax evasion and avoidance.

To governments

- Governments should conduct cost-benefit analyses of their tax policies with the aim of eliminating or reducing tax incentives that undermine their capacity to improve investments in children. At the same time they should disclose information on how much they are losing through these incentives (tax expenditures).

- Governments should periodically conduct child rights impact assessments of their fiscal and tax policies to ensure that they do not undermine the progressive realization of child rights.

- Governments should work towards more open revenue collection systems. This includes greater transparency and accountability in crucial sectors such as extractive industries. Governments should review and harmonize laws, policies, systems and institutions in place in order to create conditions for improved tax collection. These include development of specific policies that respond to any missed taxation opportunities whilst at the same time strengthening programmes against in-country tax evasion and avoidance.

- Governments should explore innovative but progressive taxation opportunities in order to mobilize additional resources to invest in children. Where necessary, they can consider earmarking the tax revenues towards attainment of specific child rights policy goals.

To private sector

- The private sector should fulfill its legal obligation to pay full tax and not engage in any activities that deprive the state of much needed revenue such as tax avoidance and evasion in line with Child Rights and Business Principles.

- Private companies should publish their financial position in every country in which they operate (country by country reporting).

Photo: Lars Hartmann

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