Call for Contributions: Taxation, illicit financial flows and human rights

To
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The Independent Expert on Foreign Debt

Joint Submission to the Independent Expert on the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, particularly economic, social and cultural rights on "Taxation, illicit financial flows and human rights"

This is a joint submission from the TaxEd Alliance. We welcome the opportunity to make our submission on the proposals outlined in the consultation document. We premise our submission through the following lens for context:

Current challenges to financing for development including education

Twenty years after the First International Conference on Financing for Development in Monterrey, the effects of COVID-19 and the war in Ukraine threaten to derail the progress made in these two decades, resulting in hundreds of million people falling back into extreme poverty, and a growing backlog in the implementation of the 2030 agenda. Following years of austerity policies and privatisation, public services, particularly education and health, faced a devastating crisis in financing even before Covid. Foregone revenue as a result of illicit financial flows and tax incentives, reduces governments fiscal space, and governments resort to regressive tax policies and debt accumulates often associated with conditions that constrains public sector wage bills and thus impacts human rights. The current situation has been amplified by the socio-economic impacts of the pandemic, the war, and the climate crisis, resulting in inflation in food and fuel prices, all disproportionately affect women and girls.

Governments are the largest funders of education in all country income groups. Funding for education as a share of national income has not changed significantly over the last decade for any country income group. Prior to the COVID-19 pandemic, it averaged 3.5 percent of GDP for low-income countries and 4.3 percent of GDP for middle-income countries (World Bank/UNESCO, 2021. Education Finance Watch). In a growing number of countries, debt servicing is consuming a greater share of spending than education. Low tax-to-GDP ratios can mean that governments who allocate a fair share of national spending to education still lack the necessary resources. Wider macroeconomic policies like budget austerity can also affect spending on education, particularly with regard to addressing teacher shortages when constraints are placed on overall public sector wage bills (https://actionaid.org/publications/2021/public-versus-austerity-why-public-sector-wage-bill-constraints-must-end). Budget austerity might exacerbate disparity, as households in low-income countries tend to pay more (compared to income) for education, (which proves to be a very regressive and unfair way of financing education), while governments also tend to spend less on them – the public education spending to a child of the poorest 20% families is only a quarter of his peer from the richest 20% families. Official Development Assistance (ODA) accounts for approximately 2 percent of education spending in lower middle-income countries and 18 percent in low-income countries (WB/UNESCO 2021. Education Finance Watch).

To address these challenges and reverse these trends, we need bold new strategies and actions to ensure adequate financing for the SDGs. The present global financial and tax architecture is regressive, gender-biased and inadequate to deliver the 2030 agenda. The major leaks from government revenue budgets include domestic and international tax gaps and debt service and the major gaps in the global financial architecture are in the management of sovereign debt and cross border tax affairs. We discuss these gaps and the potential if these were reduced with respect to the right to education.

Maximum available resources

States need resources to meet their obligation to respect, protect and fulfil rights, that is the case not only for the right to education, but for other economic, social, and cultural rights, and indeed for all rights. States have the legal obligation to progressively realise economic and social rights to 'the maximum of available resources' (article 2(1) of ICESCR). States are obliged take steps towards the full realisation of the right to education and to do this, they must use the maximum available resources. These resources are not only economic resources, but also legal, administrative, technical, educational, among others. Equally, the obligation to allocate the maximum available resources go beyond the resources currently at the government disposal, but also include those that could potentially be mobilised both by the state itself, and through international cooperation and development. Mobilising these resources must be done while complying with human rights, which is why increasing tax revenue through progressive taxation reform is a good way to increase revenue, redistribute wealth, reduce inequality, and fund education in a fair and sustainable way. In cases of retrogression in terms of providing free public quality education, the state must demonstrate that this failure is the consequence of a real inadequacy of resources, rather than lack of political will to mobilise internal and external, economic, and non-economic resources. Furthermore, even in the cases of demonstrated inadequacy of resources, the failure or backward steps must be temporary, proportionated and adequately monitored, and must ensure that the core obligations of non-discrimination, accountability, transparency, and participation are respected.

UN Human Rights experts and committees have recognised the impact of foregone revenues on children's rights, including the right to education. For example, with regards to tax abuse, the United Nations Committee on the Rights of the Child (Review of Ireland)

CRC/C/IRL/QPR/5-6 (UNCRC, 2020) requested that the country *'Ensure that tax policies do not contribute to tax abuse by companies operating in other countries, leading to a negative impact on the availability of resources for the realisation of children's rights in those countries'* (para 10c).

The potential for the right to education of foregone revenue

Government expenditure on education as a percentage of total government revenue is higher in low-income countries than other countries, see figure 1. However, the foregone revenues from tax abuse and debt service as percentages of government revenues is very significant. If we combine tax abuse (SOTJ 2021) and debt service (Debt Justice 2022) as a percentage of government revenue (from UNU-WIDER), we see in some low-income countries that the foregone revenue is greater than that spent on education as a percentage of government revenue, see figure 2.

Figure 1 Tax abuse, debt service and government expenditure on education by income level.

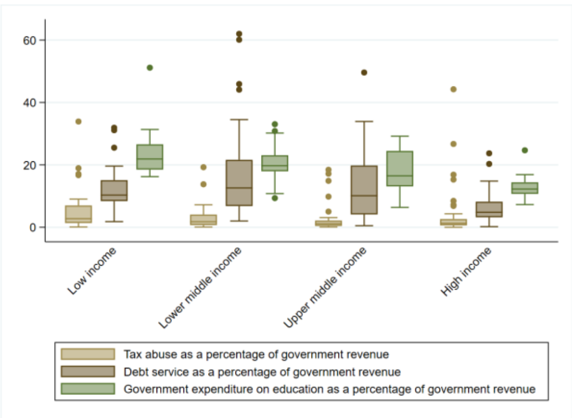
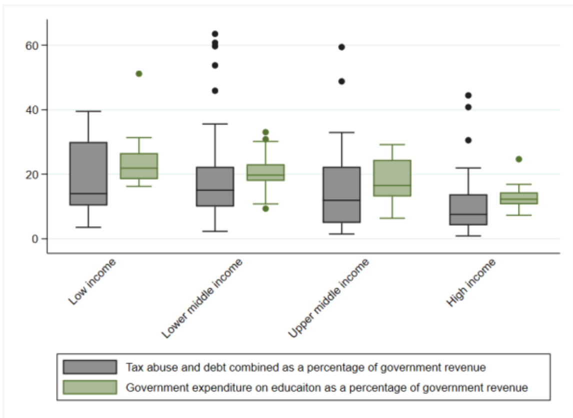


Figure 2 Tax abuse combined with debt service compared to government expenditure on education as a percentage of government revenue by income level

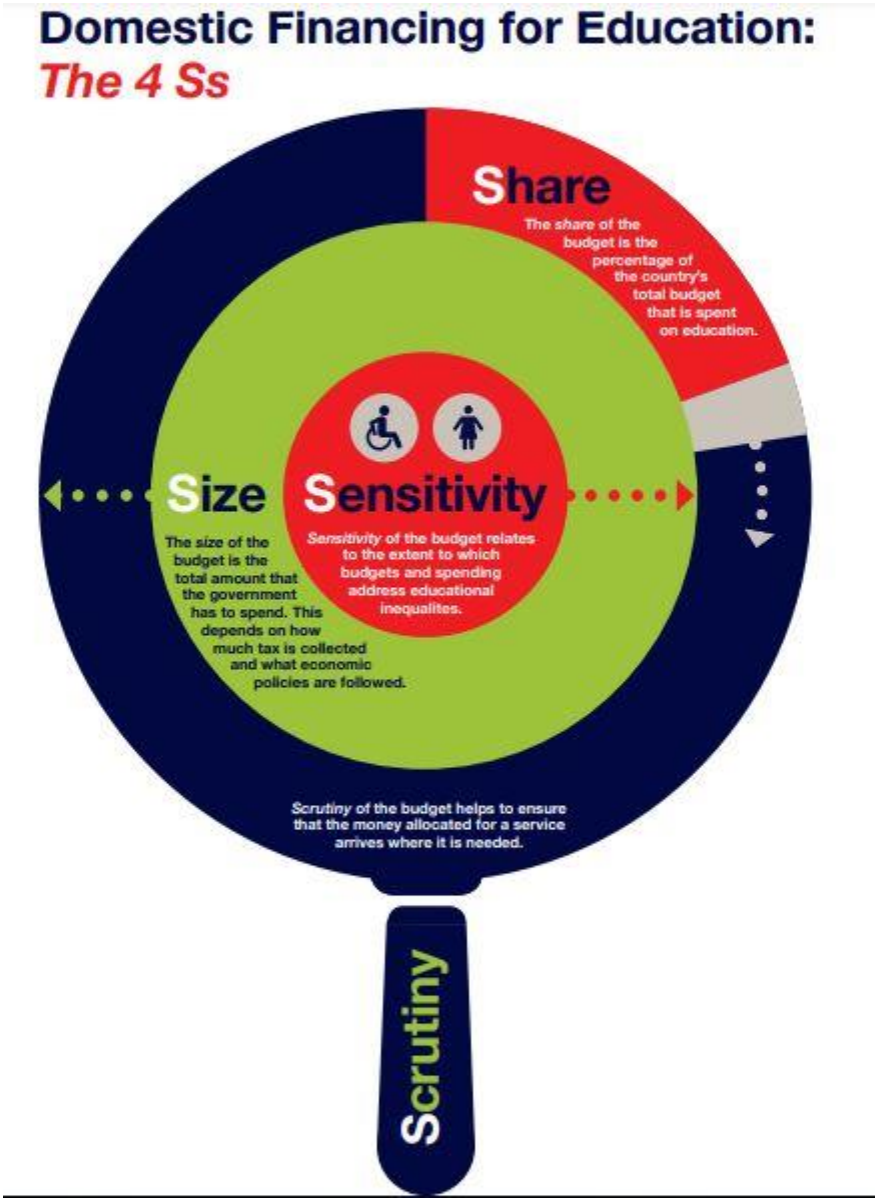


Financing education and out of pocket spending

Government spending as a percentage of GDP has been constant across all income groups over the last ten years, ranging from 3.5% in low-income countries to 4,7% in high-income countries. However, given the different sizes of the economies this translates into vast differences in absolute spending per capita, ranging from just under $50 to almost $1100 spending per capita In low- and middle-income countries. Most of the spending is by governments (82%), the next largest spending is by households (17%), while development assistance contributes <1%. In low-income countries aid to education represents 18% of total education spending while in lower-middle-income countries this figure is 2%.

When government revenue falls short there are increases in the proportion of education spending borne by households, which now reaches 38% in low-income countries compared to 16% in high-income countries (EFW, 2021). This is a profoundly regressive way of financing education, which exacerbates gender and other social inequalities, widening vertical and horizontal inequalities, within and between countries.

Considering that the abolition of school fees in the early 2000s was pivotal to gains in school enrolment and achieving gender parity in many countries, the growing discourse on 'affordability' leading to more costs passed on to families, is deeply problematic and can undo the progress we have achieved in the last couple of decades and lead to violation of human rights. If we are serious about achieving SDG4, we need to focus on sustainable domestic resource mobilisation, both increasing revenue and reducing revenue loss through illicit financial flows, tax expenditures and corruption. Countries must fulfil their obligations to provide free public education of the highest attainable quality by increasing the size, share, sensitivity, and scrutiny of the budget, to give the necessary resources to public schools, and to adequately regulate private providers.



Is privatisation the solution?

As a solution to decreasing government budgets, many voices are pushing for stronger partnerships with private actors. However, the negative effects on equity of increasing privatisation of public services, particularly education, is becoming a major concern for education, development and human rights scholars and practitioners. The GEM Report for 2021 rallying call: "Who choses, who loses?" is very telling of the impact of the increasing privatisation of education, with growing evidence in terms of exclusion, segmentation, segregation, inequality of opportunities, stigmatisation of public education, diversion of essential funds, lowering teaching standards, narrowing of the curriculum, etc. which the GEMR partly analyses.

Our study in Ghana, Kenya and Uganda and the collaborative research in Malawi, Mozambique, Nigeria and Tanzania conclude that privatisation is not a solution, but rather a symptom of the lack of availability and quality of public education. This is partly the result of the chronic inadequate financing of education. As our research shows, many countries fail to allocate their maximum available resources and have often taken retrogressive steps, lowering the education budget without justification. Our factsheets on Ghana, Kenya, Nepal, Malawi, Mozambique, Nigeria, Senegal, Tanzania, Uganda, and Zambia, provide a brief outline of the current issues affecting education financing, focusing on harmful tax incentives, and propose sustainable solutions based on progressive taxation to adequately fill the financing gap not just for education, but for other SDGs. These countries have staggering losses to tax incentives that can be seen in table 1.

Table 1 Estimated revenue losses from tax incentives in five countries

Nepal	Senegal	Zambia	Ghana	Uganda
Estimated annual revenue foregone from tax incentives $1.68 billion	Estimated annual revenue foregone from tax incentives $1.19 billion	Estimated annual revenue foregone from tax incentives $406 million	Estimated annual revenue foregone from tax incentives $1.34 billion	Estimated annual revenue foregone from tax incentives $922.6 million
20 per cent of this sum would amount to: $336.6 million	20 per cent of this sum would amount to: $238 million	20 per cent of this sum would amount to: $81.2 million	20 per cent of this sum would amount to: $267.9 million	20 per cent of this sum would amount to: $184.5 million
This money could pay for: School places for all the out-of-school places for children left out of primary and lower-secondary school+ The basic salary for 5,000 primary and 5,000 lower secondary teachers + Free school meals for 600,000 children + Expanding the annual scholarships for vulnerable groups to an additional 1 million young people+ The estimated annual financing gap (US$81 million in 2021) in the Nepalese School Sector Development Plan (SSDP) mid-term review	This money could pay for: School places for all around half (350,000) of the primary aged children currently out-of-school+ 10,000 teachers (of the 35,000-gap required to be filled by 2030) + Double the number of children who receive a free school meal annually	This money could pay for: School places for 350,000 children in primary school (around 2/3rds of the current out-of-school primary school children) + 4,000 extra primary school teachers (the estimated current primary school teacher gap) + Free school meals for ½ million children annually	This money could pay for: School places for all the children left out of primary school and all the Adolescents left out of lower secondary + An extra 10,000 qualified teachers + Free school meals for 1 year for 1 million children	This money could pay for: School places for all the children left out of primary school + The salary for 22,000 newly qualified teachers (the teacher gap in 2019) + Free school meals for 1 million children + 10,000 new classrooms blocks

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Debt and financing of public services

Governments are the largest funders of education in all country income groups, but debt servicing is increasingly consuming a greater share of spending than education. Low tax-to-GDP ratios coupled with macroeconomic policies like budget austerity, are diminishing spending on education, particularly with regard to addressing teacher shortages when constraints are placed on overall public sector wage bills (https://actionaid.org/publications/2021/public-versus-austerity-why-public-sector-wage-bill-constraints-must-end).

Our study ZAMBIA'S DEBT AND EDUCATION FINANCING reviews Zambia's debt, its effect on education financing and possible alleviation mechanisms. The main reference point is the Heavily Indebted Poor Countries (HIPC) Initiative, which led to Zambia's debt cancellation in 2005. A review of education financing five years post HIPC shows that the country scored numerous successes in almost all sectors including education. Accomplishments posts HIPC are not only attributed to the reduced debt stock, but also to prudent management of the economy. A change of government and policies in 2011 quickly reversed these achievements as the debt started mounting once again- this time through non-traditional lenders such as China and other commercial entities. Zambia now has a huge debt stock that has contributed to a reduction in funding to the education sector. The 2021 education budget is the lowest in fifteen years and there is no sign that this will change as the economic growth is projected to be very minimal. This study concluded that the current levels of funding to the education sector cannot support the country in meeting SGD 4. Options to aid the country involve short-, mid- and long-term debt alleviation mechanisms. They include debt-for-education swaps, cash repurchases using externally donated funds, senior bonds, bailouts, self- financed buybacks, and debt cancellation. Some of these measures involve a significant reduction of the debt stock while others simply provide some minor relief as shown from the various cases particularly in Latin America and the Philippines in the 1990s. Since there is only nine years to the end of the SGDs 2030 timeline, this study has recommended solidarity on the matter by national and international actors. China is expected to play a significant role as one of the major lenders even though its loans came through commercial entities – Exim Bank and China Development Bank.

Tax abuse and financing education

In 2021 The State of Tax Report (SOTJ) estimated that $483 billion is foregone in tax revenue each year to global tax abuse committed by multinational corporations and wealthy individuals. For the former this estimate is based on aggregate country-by-country reporting data published by the OECD. For the latter, the estimates use a methodology based on "abnormal deposits"[1] . The scale of tax abuse, conservative in estimation because of the absence of fully

[1] Global Alliance for Tax Justice, Public Services International, and Tax Justice Network, The State of Tax Justice: 2021 (16 November 2021) <https://taxjustice.net/wp-content/uploads/2021/11/State_of_Tax_Justice_Report_2021_ENGLISH.pdf> [accessed 7 May 2022]. P.45

public available data, would if curtailed, reduce future debt and put in place sustainable revenue for public education. The impact of continued tax abuse leaves governments forgoing revenue that would ensure their citizens and those citizens living in other jurisdictions can enjoy their rights including the right to receive and choose equal education.

Researchers at GRADE project (St. Andrews University, Scotland) have used data from the State of Tax Justice Report to illustrate the impact of tax abuse on fundamental rights. The researchers estimated the impact of increased revenue on key determinants of health including education and child school life expectancy. The GRADE modelling estimates that an increase in government revenue equivalent to the most recent estimates on tax abuse, projected over 15 years, would be associated with an additional 22 million years of schooling. This is assuming governments allocate the increase in revenue as they normally do, which is closer to the real world situation.

It is critical that human rights principles are integrated into the design, development, and application of international tax rules. A human rights lens has largely been absent from international tax rule making under the governance of the OECD and the BEPS project. Looking to alternative proposals for international tax governance will require a deeper understanding and adherence to principles of transparency, accountability, and participation and of social justice.

There is broad agreement that the current regime for setting tax rules is flawed and that the recent efforts to reform international tax rules have stalled within the so-called BEPS (2013 - 2020) process. International tax governance within the BEPS project has, both in form and in substance, been exclusive. The OECD and by implication the BEPS project, is dominated by a small group of wealthy countries. Meanwhile, lower income countries have been largely excluded from the BEPS process and yet are often the 'victim' of wealth extraction from illicit financial flows and other forms of tax abuse. As evidenced in the focus countries above, although the scale of revenue losses from tax abuse in high income countries is much higher than lower income countries, the impact on lower income countries is disproportionately greater as a share of GDP and of government revenue and therefore on specific public services such as education.

Conclusions

States have the obligation to raise enough revenue to ensure full realisation of human rights, including the right to education, **without a large budgetary deficit and the need to accumulate a huge debt burden**. Domestic resource mobilisation, with progressive taxation at its centre, is key to sustainable and democratic financing, and the best solution to close the gap not only for the financing of education but for the estimated trillions of dollars gap to achieve the SDGs. With an estimated annual tax revenue loss to tax havens of US$427billion, and extra US$245billion lost to corporate tax abuse by multinational corporations,[2] it seems clear that states are not doing enough to control illicit financial flows and, consequently, states are not using their maximum available resources.

2 Jones, A. (2020). UN tax convention could overcome EU and OECD blind spots. International Tax Review.

The volume of resources raised for the educational needs of the global population, particularly the most vulnerable, is inadequate, undermining the right to education. Public money for education comes principally from i) domestic revenue (net debt servicing), ii) deficit finance, iii) ODA, and iv) reprioritising government expenditure - and there are also household, off budget, and private flows. Consultations with Ministries of Education indicate that mobilising enough domestic revenue and allocating enough to education are the biggest challenges but are the subject of few donor initiatives.

Recommendations

1 **A single intergovernmental body is needed to underpin its reforms and regulation with human rights principles including of social justice, transparency, accountability and participation.** The current flawed international tax system needs transformation. The scale of in country and between country inequalities can be reduced by mobilising tax revenue and redistributing wealth and income. The current international architecture and financial secrecy serves the interests of a few wealthy economies dominated by G7 countries. It also continues to compound the wealth of individuals. A reprogrammed global financial architecture is needed; one which is fully inclusive and rebalances the interests of lower income countries from which wealth is extracted. A single entity established to reform international tax rules and architecture would be under the auspices of the United Nations, aligned with the FACTI Panel recommendations, where human rights principles are a central concern and underpinning concept.

2 **Comprehensive reforms of international tax through an intergovernmental body would serve to establish a progressive model of unitary taxation** where the shift in taxing rights serves the interests of lower income countries largely excluded from OECD BEPS negotiations and rulemaking. **This should be accompanied by a genuine and fair, minimum effective corporate tax rate.**

3 **The importance of transparency and accountability should be underlined by making tax and other transparency data publicly available. A Centre for Monitoring Taxing Rights should be established, as recommended by FACTI panel.** The Centre **would supply** consistent aggregate statistics and analysis and would also ensure ongoing accountability for the intergovernmental body, for its progress globally and at national level.

4 **A single reforming institution would operate using the principle of equity at its heart and would serve the interests of all nations and in doing so reflect the relative capacities and resources in different economies within which to reform.** Lower income economies who struggle to meet the suggested threshold for per capita GDP spending ratio on education, are similarly also hampered by tax abuse in resourcing tax administrations and technical and legal capacity in international tax reforms. An incremental approach to compliance with tax reforms should be assured to avoid, for instance reciprocal arrangements with high income countries, that would be punitive. See for example the OECD Common Reporting Standard for automatic exchange of information between jurisdictions' tax authorities which by design disadvantaged lower income countries.

5 **A single entity for the reform of international tax would require financial transparency to support domestic resource mobilisation and curtail tax evasion. International reforms would require comprehensive adoption of the ABC financial transparency policy platform:** *automatic exchange of information* on financial accounts; B of beneficial ownership transparency, where public registers of company ownership are adopted as standard; and C, country by country reporting by multinational companies.

6 **There is an urgent need to increase fiscal space for education**, through:

• Taking bold international action on the debt crisis and global debt architecture so that debt servicing does not prevent countries expanding spending on education (UNCTAD);

• Supporting the IMF to issue another round of Special Drawing Rights and to support unconditional reallocation of these to low income countries (CEPR); Supporting governments to deliver on the IMF's projection that most countries can increase tax to GDP ratios by five percentage points by 2030 – that would allow a doubling of spending on education and health (and more in most countries).

• Resisting the return to austerity that is widely happening post-Covid (despite projections of the damage this will cause) (Global Austerity Alert) and specifically moving away from the use of public sector wage bill constraints– that directly block progress on education.

• Shifting the view of Ministries of Finance and many governments that see education as pure 'consumption' and helping them to factor in the long term returns to investment in education within short term economic and political cycles,

• Deepening the dialogue between Ministries of Education and Ministries of Finance on strategic financing issues that affect education – and doing the same globally so that the education community proactively engages with and has a voice with the IMF and in key global negotiations affecting tax, debt, and austerity.

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