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Tax (Evasion), Inequality and Human Rights

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Inequality and crisis resilience

- Poverty eradication is a necessary, but not a sufficient condition for sustainable development and the sustained fulfillment of human rights
- A large portion of households in the bottom 20%-40% of the income distribution tend to live above the extreme poverty line, but in a precarious situation of high vulnerability
- External shocks (food price hikes and financial/economic crises) may push these households into the poverty trap

Inequality and financial crises

- High inequality increases the risk of financial instability and crises
  - As the bottom 20%-40% have no purchasing power, demand for investment in the real economy is insufficient
  - The highly concentrated income (and wealth) of the top 10% gets invested in financial speculation, increasing the risk of yet another unsustainable financial bubble
- The inability of the real economy to absorb highly concentrated incomes may also be one of the main reasons why inequality leads to slow economic growth.
- Another reason is that inequality tends to produce social unrest.

Inequality and economic growth

- Economic growth does not generally lead to a more equal income distribution, but may increase inequality
- Conversely, inequality decreases economic growth
- Hence, non-inclusive growth is not sustainable (not even in an economic sense)

Some preliminary conclusions

- Inequality *increases* the risk of financial shocks and crises…
- …and *decreases* the ability of households in the bottom 20%-40% of the income distribution to cope with the consequences
- Economic growth is not the answer to the problem; it may increase inequality, which in turn leads to slower growth

Fair and effective taxation – the “four R‘s”

- ***R****evenue creation:* effective tax systems creates revenues to finance public goods
- ***R****edistribution:* progressive tax systems decrease inequality
- ***R****epricing:* taxes can be used to turn socially undesired behaviour more costly and/or subsidise desired behaviour
- ***R****epresentation:* “[T]axes are also the primary platform for political negotiations amongst a country’s stakeholders. They are part of the social contract between a state and its citizens.” (AfDB/OECD 2010, 79)

Tax evasion / avoidance

- The global network of secrecy jurisdictions (“tax havens”) still provides considerable opportunities for tax evasion and avoidance
- Wealthy individuals and transnational corporations are better equipped than others to use these opportunities (“hard to tax”)
- Tax evasion and avoidance create massive revenue gaps; states tend to address these gaps by
  - cutting down on social spending *and/or*
  - accumulating new debt *and/or*
  - putting a higher tax burden on “easier-to-tax” low-income households and small and medium sized local enterprises (thereby making potentially progressive tax systems highly regressive)

The good and the bad news

- The OECD has made substantial progress in directing secrecy jurisdictions ("tax havens") towards increased transparency and measures against corporate profit shifting
- However, there is a risk that developing countries will be excluded from the benefits of this progress.
- The case of Switzerland is instructive:
  - It is still unclear if, when, and how, Switzerland will establish the automatic exchange of tax information with developing countries
  - Nor do we know if, or how, Switzerland will give these countries access to country-by-country reports of Swiss-based transnational corporations
  - Switzerland seeks bilateral tax treaties with developing countries that limit source country taxation of dividends, interest and royalties

Some recommendations

- In order to benefit from tax information exchange on request, developing countries should join the multilateral Convention on Mutual Administrative Assistance in Tax Matters
- As the benefits from information exchange on request are limited, secrecy jurisdictions such as Switzerland should urgently include developing countries in the system of *automatic* information exchange
- Low-tax jurisdictions should make transnational corporations' country-by-country reports *public* (or at least provide easy access to developing country tax authorities)
- Developing countries should avoid/renegotiate tax treaties that limit source country taxation of dividends, interest and royalties

Annex:
Facts and figures

Revenue losses

- Estimates of annual tax losses in developing countries due to:
  - internal „shadow economy": USD 285 billion (Cobham 2005)
  - corporate transfer mispricing: USD 35-160 billion (cf. Fuest/Riedel 2009)
  - individual tax evasion: USD 50 billion (Cobham 2005)
- All estimates are contested (Fuest/Riedel 2009)
- However, there is consensus that tax-related capital flight is (several times) larger than ODA inflows

„Hard-to-tax" taxes

- "Personal income tax commonly accounts for less than 10 per cent of all tax revenue in low-income countries – compared to an average of more than 25 per cent in OECD countries" (Keen 2012, 10).
- As wealthy individuals often bypass personal income tax, it is "widely recognized as essentially a tax on the labour income of those working in the public sector or large private enterprises." (Ibid.)

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