Maximum Available Resources, Non-retrogression and Minimum Essential Levels in Tax Policy

This is the second in a series of advocacy tools produced by RightingFinance to assist education and dissemination of standards on tax policy and human rights contained in a report produced by the UN Special Rapporteur on Extreme Poverty and Human Rights.[1] (Unless otherwise noted, textual references in the text are from that report).

To progressively realize economic, social and cultural rights entails a prohibition of deliberate retrogression.

Normative basis

Maximum available resources: States must devote the "maximum available resources" to ensure the progressive realization of all economic, social and cultural rights as expeditiously and effectively as possible, even during times of severe resource constraints, whether caused by a process of adjustment, economic recession or other factors. This principle should guide the State's decisions and priorities in generating, mobilizing and allocating resources in order to permit the realization of human rights. The obligation of progressive realization independent of economic growth also exists; it requires the effective use of available resources, including potential resources that could be raised through reasonable efforts, such as taxation measures and international assistance and cooperation." (para. 25)

Non-retrogression: "The obligation to progressively realize economic, social and cultural rights entails a prohibition of deliberate retrogression, namely, of measures that directly or indirectly lead to backwards steps in the enjoyment of rights. There is a strong presumption that such measures are in violation of human rights standards.

States may only adopt such retrogressive measures if they can demonstrate that they have carefully considered all alternatives, including revenue-raising ones, and that they are duly justified by reference to the totality of the rights in the International Covenant on Economic, Social and Cultural Rights, in the context of the full use of the maximum available resources." (para. 28)

Minimum essential levels: "States parties to the International Covenant on Economic, Social and Cultural Rights have an immediate core obligation to ensure the satisfaction of, at the very least, minimum essential levels of all economic, social and cultural rights." (para. 27)

BOX 1

Collecting taxes in the natural resources sector

In a review in 2013, the Africa Progress Panel found significant "evidence of undertaxation." In Liberia, extensive tax concessions to foreign investors involved in ore projects go far beyond the arrangements set out in the Liberia Revenue Code (LRC),to the point that the IMF recommended that if such concessions came up for renegotiation, the authorities should aim to harmonize the terms with the Revenue Code and avoid tax breaks.

In Sierra Leone, foreign investors enjoy very generous concessions on mining exports (including royalty rates as low as 0.5 per cent) and only one of the five major mining companies operating in the country paid corporate tax.

In Zambia an Extractive Industries Transparency Initiative report found that, between 2005 and 2009, half a million Zambians employed in the mining sector were carrying a higher tax burden than companies.[8]

In contrast, the IMF estimates governments should be able to collect 40 per cent to 60 per cent of resource rents for mining and 65 per cent to 85 per cent for petroleum.[9]

Applications in tax policy

Demonstrating the full use of tax policy as a tool to fulfill human rights

“Fiscal policies are a tool that States can employ to comply with their international human rights obligations.” (para. 1)

Although states have discretion to formulate the tax policies most appropriate to their circumstances, several human rights principles set limits to such discretion. (para. 4)

While economic and social rights are, generally, subject to progressive realization, “States that claim resource constraints have the burden of proof to show that every effort has been made to move towards the full enjoyment of economic, social and cultural rights as a matter of priority, and that they are truly unable rather than unwilling to meet these obligations.” (para. 27)

Thus, a state that omits use of a possible tax measure that could generate public revenue should demonstrate why that measure is the best suited to its circumstances. It should also show that in using its discretion to choose the most appropriate tax measure it is not violating principles such as progressive realization or maximum available resources.

Raising revenue

“In some States, despite significant efforts to increase revenue through taxation, the amount actually collected is demonstrably inadequate to realize human rights.” (para. 55)

“Low levels of revenue collection have a disproportionate impact on the poorest segments of the population and constitute a major obstacle to the capacity of the State to finance public services and social programmes.” (para. 44)

“The quality, accessibility and availability of goods and services needed for the realization of human rights, such as the rights to an adequate standard of living, health, education and social security, will hinge on the resources that the State is able to collect.” (para. 43)

When a state claims not to have enough revenue to comply with its human rights obligations, an indicator of whether it is exhausting its room to raise revenue is the tax-to-Gross Domestic Product (GDP) ratio. In developed countries, average tax-to-GDP ratios rates exceed 30 per cent, whereas the average in South Asia is 12 per cent, and in Latin America less than 20 per cent.[2] The International Monetary Fund concurs that in a lot of countries the ratio of actual to potential revenues remains well below what it could be.3

Of course, efforts to raise more revenue should also be compatible with human rights principles.

Corporate tax incentives

“Many least developed countries. . . offer extremely favourable tax deals to foreign investors in agriculture and mining owing to the perceived competition between countries for this investment. These incentives warrant a heightened level of scrutiny in human rights terms, because they restrict the State’s revenue and therefore the resources it is able to devote to rights realization.” (para. 64)

Tax incentives or tax holidays for corporations represent foregone public revenue in amounts frequently large, especially when compared with the human rights needs that could have been met with such revenue. However, it is possible that tax incentives are offered for purposes that also would advance human rights, in which case the said purposes will need to be spelt out clearly:

“As in any case where a State is allegedly failing to use its maximum available resources to fulfil obligations to progressively realize economic, social and cultural rights, incentives would have to be justified by a clear description of deliberate, concrete and targeted advances towards the fulfilment of human rights that can be expected from their implementation. States parties to the International Covenant on Economic, Social and Cultural Rights would also have the burden of proving periodically that the granting of corporate tax breaks was the least restrictive policy option from the perspective of economic, social and cultural rights.” (para. 67)

For instance, states commonly justify granting incentives on the need to attract foreign investment. So, based on jurisprudence from the Committee on Economic, Social and Cultural Rights, in a case like that the state will have the burden of showing which human rights the investment meant to be attracted by the incentives will advance. It will also have to show that the incentive was the option least restrictive to economic, social and cultural rights.[5]

Given evidence that the success of fiscal incentives to attract foreign investment is limited, the link between offered incentives and incoming investment cannot be lightly presumed. So the state will need to show that the investment would not have come absent the incentive and that the benefits from the investment outweigh its cost.

“Incentives sometimes take the form of a “tax stability” “or “advance pricing” agreement, signed with foreign investors to

insulate them from future changes in the domestic tax rates for an extended period of time. These types of agreement should also be examined with caution under human rights law, because they reduce public resources regardless of the evolving impact on human rights." (para. 66)

The length of incentives and the form –a "tax stability agreement" – are elements to take into account in evaluating their restrictiveness. Since the financing needs to comply with human rights obligations are harder to determine the longer the time horizon in question, agreements to freeze tax rates could run counter to the Guiding Principle on Business and Human Rights that requires states to "maintain adequate domestic policy space to meet their human rights obligations when pursuing business-related policy objectives with business enterprises, for instance through investment treaties or contracts."[6]

Taxes on the financial sector

"Low tax demands of the financial sector . . . may therefore be indicative of a State's unwillingness (rather than inability) to use its maximum available resources. . . . Taxes on certain types of financial transactions have been introduced in various jurisdictions (including in India, Peru, South Korea and Sweden) as a way to raise revenue from the financial sector as well as to deter speculative trading activities that generate risks for the whole of society (in the form of crises or fluctuations in food/fuel prices). This measure could also enable States to better comply with several human rights obligations, in particular those regarding economic, social and cultural rights."(para. 69)

Natural resource taxes

"A State allowing or directly undertaking exploitation of natural resources without ensuring that a fair share of the proceeds are taxed and/or allocated towards fulfilling human rights could be an indication of a failure to mobilize adequate resources." (para. 72)

"Natural resources can be a vital source of revenue that the State can use to comply with its human rights obligations. The financial and social benefits of natural resource exploitation are, however, increasingly bypassing people in producing countries." (para. 70) (See Box 1)

"[T]he rightful benefits in terms of revenue often go abroad (sometimes to tax havens), aided by the fact that extractive industries are often not required to disclose their profits on a project-by-project basis. The public revenue generated through taxes on the sector remains well below potential; the revenue secured by many resource-rich countries is very low in relation to the value of exports." (para. 71)

Contractionary macroeconomic policies (crisis prevention and response)

"Even during times of severe resource constraints, States must demonstrate that every effort has been made to use all resources that are at its disposal, including resources that could potentially be collected through taxation, or tackling tax evasion and other illicit financial flows, in an effort to satisfy, as a matter of priority, minimum essential levels." (para. 27)

A close examination of tax policies becomes all the more relevant in times when there is pressure to curtail enjoyment of economic and social rights due to budgetary shortfalls, such as in crisis situations.

"Meanwhile, the recent devastating austerity measures taken in some countries could have been avoided entirely if some of the annual revenue lost from tax evasion had been recovered." (para. 59) "The compatibility of, for example, austerity measures (such as those that many States implemented in the wake of the 2008/09 financial crisis) with the Covenant would therefore depend partly on whether the State has sought revenue-raising alternatives before making cuts in areas that are important for ensuring the enjoyment of economic, social and cultural rights, such as cuts in public sector employment, public services or social protection." (para. 28)

Tax abuse

"A State that does not take strong measures to tackle tax abuse cannot be said to be devoting the

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maximum available resources to the realization of economic, social and cultural rights." (para. 60)

Measures to tackle tax abuse should, arguably, be part of steps towards the fulfillment of rights that states are required to report. They may include legislative measures such as provisions making different forms of tax evasion illegal and judicial remedies to ensure appropriate prosecution and reparation for violators. Government diplomatic action seeking cooperation with other states towards, for instance, individual country reporting of profits by foreign companies or the acquisition of information necessary for monitoring of tax payments, would be potential measures to consider.

"Tax abuse is thus not a victimless practice; it limits resources that could be spent on reducing poverty and realizing human rights, and perpetuates vast income inequality." (para. 59)

"Levels of tax evasion are extremely high in many countries; globally, approximately $3 trillion of government revenue is lost to tax evasion every year. While high-income countries are the biggest losers in absolute terms, low- and middle-income countries are particularly affected by the losses, and also face particular constraints when tackling tax abuse. In 2011, developing countries lost $946.7 billion owing to illicit financial flows (a substantial portion of which relates to tax abuse..." (para. 58)

While tax evasion is a universal phenomenon, developing countries face proportionally greater challenges stopping it. Illicit financial flows, in particular, represent amounts lost to tax evasion by companies or individuals operating across borders. Thus, it requires a cooperative response and engages not just the responsibility of the country where the resources are lost, but also that of countries that could have contributed to the realization of losses with their actions or omissions.[7]

Questions for reflection

- Are there tax measures suitable to the state's particular circumstances that it neglected to implement and could have yielded more resources for meeting human rights?
- Does the state have room to increase taxes in a way compatible with human rights and, if so, is it making efforts to gradually do so? (for instance, what is its tax-to-GDP ratio and how does it compare to other countries in the region, or the world?)
- Does the state grant tax incentives to companies? If so, does it abide by a human rights-based framework to present and evaluate their benefits against revenue losses on a transparent, participatory and periodic basis? What about any of the incentives emanating from treaties or tax stabilization agreements with companies?
- Are the financial and natural resources sector paying a fair share of taxes?
- In situations of financial crisis, has the state explored all possible sources of revenue including raising taxes, before resorting to spending cuts that retrogress over existing levels of enjoyment of rights?
- What steps is the state taking or planning to take to tackle tax evasion? Do they include seeking international cooperation, where needed, to tackle cross-border tax evasion?

Endnotes

1. A/HRC /26/28, May 22 2014 (available at http://www.rightingfinance.org/?p=1195).
2. Oxfam 2011. Towards fair tax policies.
3. IMF 2011. Revenue Mobilization in Developing Countries.
4. See also first advocacy tool in this series: "Equality and non-discrimination in tax policy."
5. Committee on Economic, Social and Cultural Rights 2007. Statement on Maximum Available Resources, 8(d) and (e).
6. UN Guiding Principles on Business and Human Rights, Principle 9.
7. See also fourth advocacy tool in this series: "Tax policy and international cooperation and assistance for the achievement of human rights."
8. Africa Progress Panel 2013. Africa Progress Report, p. 63-64.
9. Organization for Economic Cooperation and Development 2013. African Economic Outlook, p. 157.