International Tax Competition and Emerging Markets: economic implications and policy responses

Professor Valpy Fitzgerald

ICRICT and Oxford University

G24 Technical Group Meeting, Addis Ababa *February 27-28 2017*

motivation

- Tax competition (for both CIT and PIT) has become a key international policy theme for a number of reasons (globalization, civil society campaigns, fiscal stress etc)
- Speak as a Commissioner of the Independent Commission on the Reform of International Corporate Taxation (ICRICT), a taskforce led by Joseph Stiglitz and José Antonio Ocampo. More at www.icrict.org
- Today I will address the consequences of tax competition for emerging economies; cooperative policy responses to this problem; and look at the potential effect of possible US CIT reform this issue. More details at http://www.icrict.org/taxcompetition/

Why direct taxation (both CIT and PIT) matters for economic development

- CIT not bad for growth
  - Despite simplistic economic theory (CIT = less savings = less growth) little empirical evidence of negative growth effect, and modern growth theory suggest that effect will be positive if spent on education, infrastructure etc. No robust evidence that CIT levels affect growth or employment; because longterm investment decisions based on other factors.
- CIT promotes social justice
  - CIT is essentially a withholding tax on dividends, and thus a progressive tax on wealth a central tool to reduce inequality; also a redistributive channel between rich and poor countries. Otherwise a mobile factor (capital) shifts tax burden towards the immobile one (labour). The alternative (VAT) is highly regressive.
- CIT supports sustainable development
  - Moreover, a regressive tax system leads to a more unequal society; and as is now agreed, unequal societies perform more poorly, are more divided, and their economies grow more slowly and are subject to more instability.

International tax competition - a zero sum game with high cost to EMs

- Recent econometric work suggests that MNEs as a whole transfer 30 percent or more of their income earned from affiliate entities in high-tax jurisdictions to those in lower-tax jurisdictions.
- The United States, for instance suffered estimated losses in 2004 and 2008 of $60 and 90 billion respectively or about 30 percent of CIT revenues (one of the motivations for the current US tax proposal).
- OECD estimated base erosion and profit-shifting causes revenue losses worldwide of $100 - 240 billion annually; IMF offers higher estimate of approximately $200 billion (1.3 percent of GDP) for non-OECD countries and between $400 and $500 billion for OECD countries (1 percent of GDP).
- 'Spillover' effects of one country's tax policy on other countries include both base shifting of this kind through rates and concessions; *and* pressure to change their tax policies as well. Global welfare loss in consequence.
- Effective domestic direct tax collection (large firms and HNWIs) almost impossible without international tax cooperation on both CIT and PIT

ICRICT proposals

1. PUT A FLOOR UNDER TAX COMPETITION

Agree on a global minimum effective tax rate and work towards a common definition of the tax base.

2. ELIMINATE ALL TAX BREAKS ON PROFITS

Grant tax breaks sparingly and only on local costs to support new productive investment.

3. ESTABLISH A LEVEL PLAYING FIELD

End special tax treatment for foreign and/or large companies, and publish existing agreements.

4. ENSURE PARTICIPATION

Enable citizen engagement in tax debates and provide civil society access, information and training to productively engage in those debates.

Outstanding Issues in EM participation in multilateral tax discussions

- OECD as forum for multilateral cooperation
  - Participation: OECD membership (2/24 of G24); BEPS ‘inclusive framework’ (13); global forum membership (15); multilateral convention on information exchange (8)
  - Agenda: armslength principle; lack of price data; arbitration; apportionment
- OECD/BEPS process does not (yet?) cover:
  - Beneficial ownership, automatic information exchange and capital gains
  - Full cooperation in collection (also PIT)
  - Spillovers from G7 tax policy (tax base, tax rules)
- Marginalisation of the UN (Tax Committee) from international tax negotiations; and thus explicit developing country representation. Also tax issues excluded from UN initiatives on global public goods, infrastructure provision, SDGs etc.

US tax reform plan and the US economy

- Main elements of DBCT
  - Corporate profits replaced by cash flow
  - Full CIT (20%?) on imports (not costed), none on exports; full costing of investment, none on loan interest
- Much easier to collect (sales territorially bound) and allows full taxation of financial sector; considerable advantage in strengthening base and thus allowing reduced rate; possibly fiscally neutral if increases investment and growth
- Potentially major redistributive effect from exporters to importers; and on consumers of imported goods; could be compensated by welfare spend; yet economic argument is that exchange rate will appreciate so domestic prices unaffected.

Implications of US tax reform for emerging markets

- Explicit intention to pass tax cost onto import suppliers; stimulate domestic import substitution; attract back flight capital. Transfer pricing should disappear on imports to US (but might emerge on exports?)
- Expected revaluation of dollar (20%?) due to border adjustment also passes on cost to RoW. But net dollar asset holders will gain and net debtors lose.
- Explicitly intended to reduce outsourcing, to cut supply chains. Liable to affect price-sensitive products more than higher tec ones; though US growth rise might compensate. So exports to US Though effect on FDI rather less.
- Repatriation of funds (if occurs) will mainly affect OFCs; No evidence that repatriation will lead to higher real investment, growth; and but will further overvalue dollar.

RoW response to US tax reform

- DBCT not compatible with WTO rules (technically an export subsidy unlike VAT) but unclear who will challenge US on this.
- Consumption as criterion makes collection easier (eg patent boxes) and better taxes financial sector (though unlikely to reduce debt leverage) consumption are territorially bound
- But DBCIT not appropriate where foreign export firms drive economy. And severe distributional shift between foreign and domestic firms. Productive assets and employment better apportionment criteria (as in EU proposals).
- Zero US tax on repatriated profits makes low tax regimes appear even more attractive and stimulate avoidance measures (eg patent boxes) in RoW. In other words OFCs would still have a major role in reducing RoW tax liability of US firms.

Possible G24 initiatives on international tax competition

- Collate and exchange country experience on international tax negotiation; and how this affects domestic revenue initiatives.
- Work towards consensus on common principles of corporate tax (rates, base, FDI base incentives) and positions on international tax arrangements (information exchange, beneficial ownership etc)
- Locate progressive income tax reform as a central feature of sustainable economic development strategies; and relate international fiscal cooperation as key to development assistance.
- Discuss the multilateral institutional changes (OECD, UN, regional) required to better reflect G24 interests