Ending the Race to the Bottom

The Global Minimum Tax Deal Is About More Than Fairness

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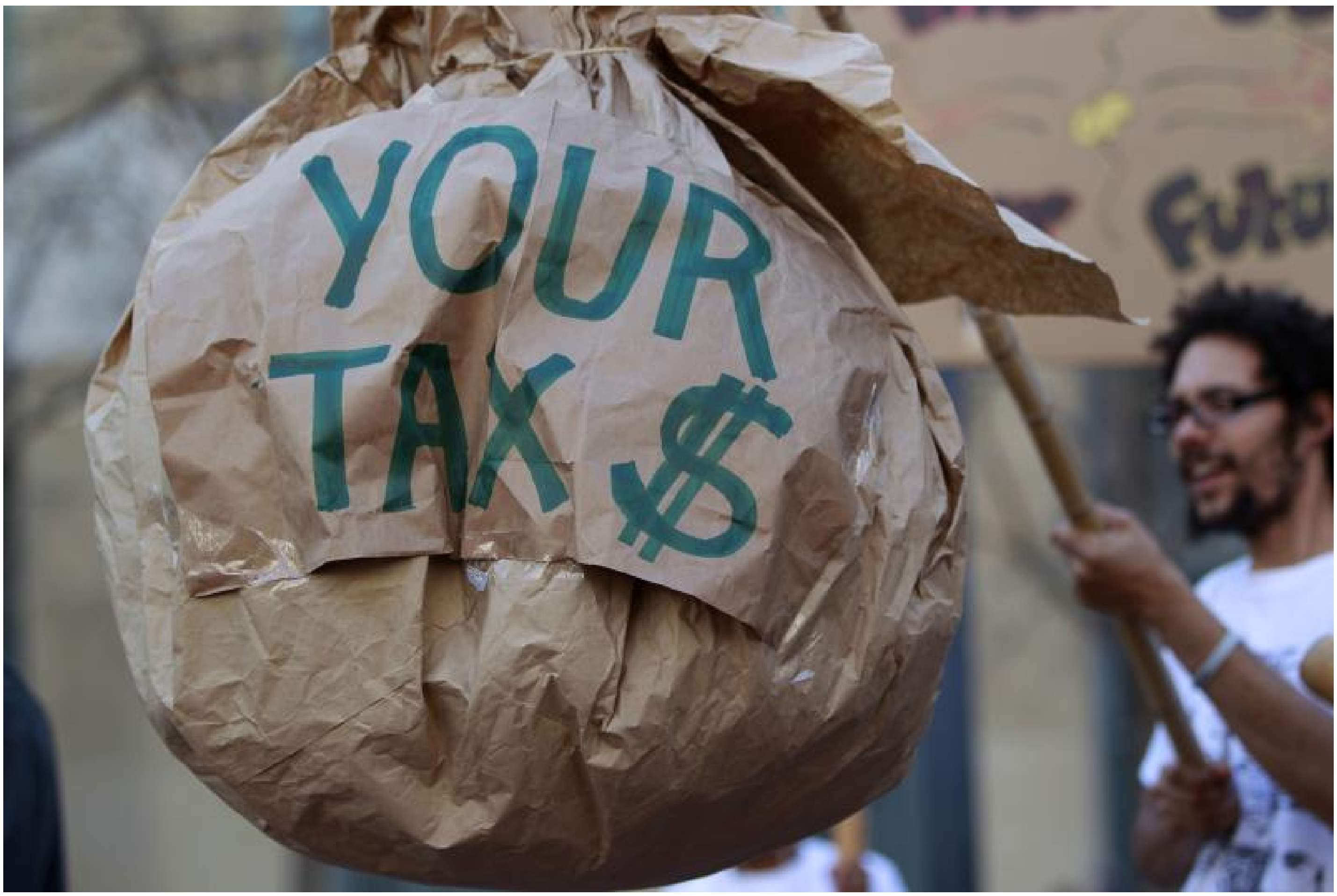

At a tax day protest in Oakland, California, April 2012
Stephen Lam / Reuters

The year is 2100. Humanity has averted the worst impacts of climate change, as economies around the world decarbonized by 2050 and even went "carbon negative" in the decades that followed. Since the end of the U.S. occupations of Iraq and Afghanistan, there has not been a major war, and after initial escalation of tensions between the United States and China earlier in the century, there was no new Cold War. Instead of the competition for resources that characterized earlier periods of humanity's history, an ethos of cooperation emerged.

Historians debate when the turning point occurred, but the leading school of thought pinpoints 2021 as the moment of change. Prior to that point, it was seen as acceptable and even smart economic policy to charge little to no tax on society's wealthiest individuals and corporations. Countries even competed with one another so that if one nation raised taxes to tackle inequality's corrosive effects on economic growth and democracy, its neighbor would respond by cutting taxes. This engendered a shift of profits on paper from the first to the second country, even if no actual productive activity shifted its location. In this world, wealth was unmoored from the communities that helped produce it, spawning a global elite that plundered with impunity. This helped spark populist and authoritarian movements around the world.

There was no way to accomplish the big transformations humanity needed without redirecting resources away from ultrawealthy individuals and massively profitable firms and toward investments in the common good. Disrupting this extractive pattern required governments to make it harder for corporations to move money and economic activity across borders for the purpose of minimizing their tax bills. The key was setting a global minimum tax rate, which countries finally achieved in 2030, inaugurating a new form of globalization in which international cooperation prevailed, wages rose with productivity, and inequality receded.

This speculative future is not implausible. It is, in fact, a potential outcome of the historic tax squashing the global tax-avoidance industry is not only vital to establishing a sense of fairness in the international economic system; it is also an important tool for coping with climate change and addressing the myriad other issues facing the world today. Warming temperatures are disrupting food supply systems, infrastructure, and global health. Governments need revenue to deal with these changes. Whether the new global tax deal helps provide countries with the resources they need will depend in part on whether they can summon the political will to finalize it and rigorously enforce it.

NO MORE SHELL GAMES

The tax deal was a significant step toward making it harder for multinational corporations to exploit tax havens that charge little to no tax by establishing a global minimum tax of at least 15 percent on corporate profits.

The administration of U.S. President Joe Biden has laid out an innovative way to remove the incentive for a country to charge a lower tax rate in order to attract capital: if a country chooses not to charge the minimum rate, the U.S. government will collect the difference. (So, for example, if a corporation reports its profits in a country that charges a mere three percent tax, the U.S. government would take the additional 12 percent.) To reduce the risk that this might induce U.S. companies to merge with foreign corporations to avoid being treated as U.S.-based —and thus reduce their tax bill—the plan includes strict rules to prevent such so-called tax inversions.

When companies don't pay their fair share of taxes, it threatens the stability of economic and political systems.

These changes will reduce the incentives for major corporations to "country shop" when it comes to deciding where to locate. They will no longer receive a tax benefit by reporting profits that they have earned from activities in one jurisdiction as if they actually earned them somewhere else. This change will tie taxation more closely to real economic activity and could increase government revenues by tens of billions annually.

There exists some chance that negotiators could water down the deal to the point where it would not substantially change the existing global taxation regime. Although the 15 percent rate was seen as necessary to garner international consensus, it is much lower than what working-class and middle-class people typically pay in high-income countries. It is also lower than the average statutory rate that corporations face in those places. It is even lower than the effective rate in many countries, which means that if this minimum became the norm, governments globally would collect even less corporate tax revenue than today. And, of course, the 15 percent rate is far lower than the 40 to 50 percent tax rate that corporations faced in the United States for all but four years from 1942 to 1987. The Biden administration should insist that the global minimum rate be raised to at least 21 percent and preferably 25 percent.

The agreement also includes a troubling provision that allows corporations to challenge the determination about which countries they should pay taxes in through a secretive arbitration system. Decades of abusive investment arbitrations have demonstrated that "who decides" can be even more important than the written rules themselves. Arbitrators, acting outside of the public eye and paid on a case-by-case basis, will have every incentive to interpret the new rules in ways that favor corporations—and generate future cases for them to arbitrate. Firms on K Street or in Geneva that have thrived for decades by helping wealthy people and companies avoid taxes cannot be entrusted to police a global tax regime. If negotiators believe some kind of system is necessary to resolve disputes, they could set up a standing international tax court, with tenured judges.

BE CAREFUL WHAT YOU WISH FOR

For the past four decades, globalization has provided a fertile field for innovative corporations to avoid paying their fair share of taxes. Less innovative firms quickly learned from more innovative ones—to the point where ordinary individuals in rich countries now pay far higher taxes than major corporations. Ironically, even these corporations may be losing out as they freeinfrastructure, education, and research. Growing inequality, moreover, leads to a weakening consumer base, and that ultimately erodes companies' profits. A global minimum tax will serve the long-term interests of even the most profit-hungry, aggressive multinationals—even if they don't realize it.

There is an alternative vision to the utopian one presented in the beginning of the article, a dystopian outcome in which global anger at corporations writ large explodes. There are ample reasons for the growing fury with the corporate sector. Consider the financial crisis of 2008, the opioid epidemic, and the exploitive and manipulative behavior of digital monopolies such as Amazon and Facebook. When companies make their profits at the expense of ordinary citizens and use their money to ensure that they don't pay their fair share of taxes, it adds to the public's ire and threatens the stability of economic and political systems.

As demonstrated by the survival of the perverse tax rules that shaped the twentieth century, the choices that countries make in the coming months will be hard to change. That is why it is so important to get the details right. It is not an overstatement to say that societies' capacity to survive and thrive depends on it.

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