Making the international corporate tax system work for all

by Joseph Stiglitz

The international community seems to be moving towards a historic agreement on the taxation of multinational corporations. The hope is to end the race to the bottom by imposing a global minimum tax. At their meeting in Rome, the G20 leaders endorsed the underlying framework created under the auspices of the OECD.

The current 100-year-old system is not fit for purpose. Over time, the effective tax rate on multinationals has slowly eroded, in turn increasing the burden on workers and small businesses that cannot join the global tax avoidance schemes available to corporate behemoths.

But the details of the newly endorsed framework, reported in the press and seemingly still under negotiation, are concerning. To start, there is the manner in which the agreement was reached – quickly, with the voices of big countries and their corporations heard far more readily than those of civil society and developing countries. Some note the irony between the reality of the document and the label on the process, sometimes referred to as the 'Inclusive Framework'. But this is not a surprise given that it was headquartered at the OECD, the club of the advanced countries.

The G24 – the Intergovernmental Group of Twenty-Four on International Monetary Affairs and Development that coordinates the position of the developing countries and emerging markets – put forward a thoughtful and detailed commentary on earlier draft proposals. Virtually none of those suggestions have been incorporated so far. And the result is that **this widely heralded reform will leave most countries with hardly more than a pittance** at a time when Covid-19 has rendered them bereft of funds.

Proposals for a global effective minimum tax of 21 per cent have been rejected in the pursuit of the lowest common denominator of 15 per cent – a success for Ireland and the other tax havens, a loss for the rest of the world. It is a percentage that is lower than the average current rate as legislated, but higher than the effective rate, given how the corporate income tax is actually implemented. That is why knowing the details of the deal – and the opportunities it provides for tax avoidance – is so important. For example, **at least for the next 10 years, there are large carve-outs that were increased in the final version under pressure from Hungary, Ireland and other tax havens**, making it likely that corporations with enough activity in those countries will still be able to pay less than 15 per cent.

The so-called first pillar, which deals with where the largest multinationals pay taxes, is particularly disappointing: it enshrines bad economics into a global trade agreement. It defines a concept of residual profits and allocates taxing rights on only a small fraction of this artificial construct, which is itself a fraction of profits properly defined. It seemingly forgets that in almost all countries not only are wages deductible but also capital costs. So, the corporate profits tax is best thought of as a tax on pure profits, not a tax on capital, and those pure profits are generated by the joint activity of the corporation operating in all of its jurisdictions, most properly allocated by a formula taking into account where both production and sales occur.

Choosing to reallocate taxing rights by reference to sales alone will create winners and losers both in developed and developing countries, and disadvantaged countries with relatively small domestic markets or those with a large tourism sector and substantial exports, particularly of natural resources. **As rich countries consume more, allocation of profits by sales only is likely to result in an inequitable distribution between countries, in favour of developed countries**, a problem identified in the recent study *A European formula for global tax reform*, by FEPS, FES and TASC.

The developing countries are also being asked to give up the right to 'unilateral measures', in particular concerning digital taxation, in return for the 'deal' – but earlier research from Oxfam estimated that 52 developing countries could gain similar revenues by introducing a 3 per cent digital service tax. **For many developing countries and emerging markets, what they get out of Pillar I of the newly endorsed framework, may be less than they could have had, had they imposed even a modest digital tax.** Unsurprisingly, Kenya, Nigeria, Sri Lanka, and Pakistan have refused to endorse the deal. No wonder, too, that Argentina's Minister of Economy Martín Guzmán concluded that developing countries and emerging markets were being "forced to choose between something bad and something worse. Worse is to get nothing. Bad is what we are getting. It is very little".

With all the compromises and carve-outs demanded by the tax havens and the corporate interests that they serve, it is no wonder that an agreement supposedly trying to ensure that the largest and most profitable firms in the world pay their fair share of taxes and that all multinationals pay at least a minimum tax, is estimated to generate so little. And of this little, the developing countries and emerging markets will get very little. Emblematic of the one-sided nature of the deal are provisions considering who gets to tax any 'undertaxation', a necessary step to bring the tax rate to the agreed minimum. There is not likely to be any or much money on the table – why would any country undertax, given that it would simply mean that some other country would get the revenue and the company should be indifferent?

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The advanced countries could have used this as an opportunity for a demonstration of magnanimity, allocating the money to the desperately poor. Or they could have abided by longstanding principles, with revenues allocated to where the economic activities generating the profit occur. But in an unmitigated act of selfishness, they gave the taxing rights to the home countries of the corporations – almost exclusively advanced countries.

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This is a moment in which vaccine nationalism has left global solidarity in tatters – with just 4 per cent of people in the developing world vaccinated. A few, mainly European, countries are standing in the way of a World Trade Organization waiver on Covid-19 intellectual property rights that holds out the promise of increased supplies. Many advanced countries, including the US and Canada, have engaged in massive vaccine hoarding, obtaining options to buy vaccines several times their needs.

We will need global solidarity to address a host of global problems. But with the advanced countries demonstrating such selfishness on multiple fronts, how can we expect them to sacrifice their growth and development for a global public good like, for example, fighting climate change? **Neither does this tax agreement serve well those in the West who believe we are in a battle with authoritarian regimes and illiberal democracies for the hearts and minds of the global population.** The brute exercise of economic power by the advanced countries is a reminder of the yoke of oppression during the colonial era. Old colonialism has been replaced by neo-colonialism, military power by economic power and exploitation. The inequalities and inequities remain.

It is not, however, too late to make amends. The tax negotiators doubtless were not mindful of the bigger picture surrounding these negotiations. But **with the global situation in mind, as the final details of the agreement are hammered out, the international community should not give up on the chance to fashion a final agreement that treats all countries fairly**, at least more fairly than seems the case so far.

There is an old Swahili proverb that says when two elephants fight, it is the grass that gets trampled.


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