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AN IDEA ON TAXATION THAT IS WORTH A TRY

Relevant for: International Relations | Topic: Effect of policies and politics of developed & developing countries on India's interests

Let's make a wise move!

United States Secretary of the Treasury Janet L. Yellen's proposal for global coordination of corporate taxation has huge implications. She has proposed a global minimum tax rate. If the major world economies agree and the U.S. Congress approves the increased tax rates, it would constitute a reversal of the trend in tax policies since the collapse of the Soviet Bloc 30 years back. Would Ms. Yellen succeed in convincing OECD countries and the U.S. Congress? David R. Malpass, President of the World Bank, representing the interest of global capital, has voiced his opposition. He was shooting from the shoulders of the poor countries when he said the proposal "...would hinder poor countries' ability to attract investment".

The initiative which has been long overdue is being forced on the rich countries by the impact of the pandemic. Presently, governments need resources to help people through transfer of incomes, provision of more public services and also prevent business failures. But their resources have been adversely impacted by the economic downturn. Consequently, fiscal deficits have reached record high levels. In the pre-pandemic era, such levels of deficit would have led to the tanking of the stock markets but now they are booming in anticipation of demand being pumped in by these high deficits. The result is a massive increase in inequality between those who have gained in the stock markets and those who have lost employment and incomes.

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The Joe Biden administration is proposing a massive $3 trillion package to boost the economy. A large part of this will be spent in 2021 but some of it will be staggered. This will be in addition to the $1.9 trillion package of relief already approved soon after the Biden administration took office. This package came after former President Donald Trump signed on the $900 billion stimulus package in end December 2020 and more than $2 trillion in mid-2020. Thus, in addition to the pre-existing deficits in the budget an additional 15% of GDP is being added in both 2020 and 2021. These are unprecedented levels.

Additional tax collections can help reduce these large deficits and that is the reason for the U.S. administration's current proposal. But businesses and conservative legislators will resist. However, some rich Americans like Jeff Bezos have supported the idea of taxing the rich more. Such proposals have been around since 2011 when many of the rich in the U.S. and Europe had supported higher taxation on the rich. Warren Buffet had floated this proposal to strengthen capitalist economies after the global financial crisis of 2007-09. Subsequently, this proposal has come up several times. But, instead of raising the tax rate on corporations, the Trump administration cut the highest marginal tax rate from 35% to 21% with effect from January 1, 2018. This gives a hint as to why it is both difficult to raise corporation tax rates and why Ms. Yellen has proposed a global agreement on corporate taxation.

When the Soviet Bloc collapsed in 1990, nations in east Europe were badly hit and needed capital infusion to overcome their economic woes. To attract global capital, they cut their tax rates sharply. This resulted in a 'race to the bottom'. Nations in Europe were forced to cut their tax rates one after the other to not only attract capital but also to prevent capital from leaving their shores. This had global implications.

Nations became short of resources and cut back expenditures on public services and encouraged privatisation. Governments lacked resources for education, health and civic amenities. The developing countries followed suit even though private markets do not cater to the poor. Thus, disparities increased within nations.

The world experienced Base Erosion Profit Shifting (BEPS). Namely, companies shifted their profits to low tax jurisdictions, especially, the tax havens. For instance, many of the most profitable companies like Google and Facebook are accused of shifting their profits to Ireland and other tax havens and paying little tax. EU has levied fines on Google and Apple for such practices. Former U.S. President Barack Obama in 2009 had said that the U.S. was losing $100 billion in taxes due to such practices.

Since all the OECD countries have suffered due to cuts in tax rates and BEPS, initiatives have been taken to check these practices. But they will not succeed unless there is agreement among all the countries. Any country facing economic adversity can cut its tax rates to attract capital and force others to follow suit. India has also cut its tax rates since the 1990s. Most recently in 2019 the corporation tax rate was cut drastically to match those prevailing in Southeast Asia. Such cuts have implications for both inequality as well as for funding the schemes for the poor and the quality of public services.

Another implication of the reductions in direct tax rates has been that governments have increasingly depended on the regressive indirect taxes for revenue generation. Value-Added Tax and Goods and Services Tax have been increasingly used to get more revenues. This impacts the less well-off proportionately more and is inflationary. Direct taxes tend to lower the post-tax income inequality. The rising inequalities result in shortage of demand in the economy and to its slowing down which then requires more investment and that calls for more concessions to capital. However, that does not guarantee revival because investment in response to a tax cut is uncertain. Instead, increased government expenditures are sure to raise demand.

Global financial capital which is highly mobile has effectively used tax havens and shell companies to shift profits and capital across the globe. This mobility has enabled it to extract concessions from countries by making them compete with each other to match the concessions given by another — that is the ‘race to the bottom’. So, without global coordination, corporation tax rates cannot be raised.

The U.S. is crucial to this coordination — without its cooperation and agreeing, other countries cannot raise the rates. Now that the U.S. is taking the lead, perhaps this will happen even though it will not be easy given the clout of global capital in the corridors of power in all countries. There will also have to be cooperation among countries to tackle the lure of the tax havens by enacting suitable global policies. The impact of all this will be far-reaching impacting inequalities, provision of public services and reduction of flight of capital from developing countries such as India and that will impact poverty. So, a global minimum tax rate is worth a try in spite of the objection raised by the World Bank President.

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To reassure Indian Muslims, the PM needs to state that the govt. will not conduct an exercise like NRC

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