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OECD TAX PROPOSALS MAY STRIKE AT THE HEART OF GLOBAL INEQUALITY

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Minimizing the scope of tax arbitrage by firms would help correct a capital-labour imbalance

The Credit Suisse annual *Global Wealth Report 2019* is out. It contains more good news than bad for those who are concerned about inequality. The report notes that inequality between countries declined in the first few years of the new millennium. But, inequality within countries kept rising, even as the global economic boom that lasted until 2008 showered more benefits on the rich than on the bottom deciles and quintiles of the population. This trend appears to have continued until 2016. The good news in the report is that the undesirable trend—rising inequality within countries—appears to have peaked in 2016. It even ventures to predict that global inequality would edge down in the immediate future.

For India, in particular, the report had some encouraging news. That is, the share of wealth of the top 1%, 5% and 10% has come down from the previous year's levels. Especially, the top 1%, which had 51.5% of the country's wealth, as per the 2018 report. The report for 2019 states that the share had dropped to 44.6%. That is good news. The total wealth in India appears to have increased from around $12 trillion last year to $12.6 trillion. However, the jump reported in gross wealth per adult by more than 100% (from $7,867 to $15,915) defies explanation.

While some of these findings are encouraging at the margin, they do not constitute a trend. Much work remains to be done. A screenshot received from a friend on the share of profits, inputs and labour that goes into the production of an iPhone highlights the enormity of the imbalance that has built up between labour and capital. An iPhone's value is apportioned as follows: 5% labour, 22% inputs and 72% profit. In response to such imbalances, candidates of the Democratic Party for the US presidential elections next year have proposed a wealth tax, estate tax and higher income tax rates for high income earners. Some of these proposals are reasonable, but some may bear bad consequences for economic growth and employment.

There is a belief that a rise in inequality is one of the important reasons for slowing economic growth in advanced nations. For example, the number of billionaires exploded in the US in the 1990s and the 2000s from around 100 to over 600. During this period, the annual growth in per capita income dropped to 1.1%, compared to an annual growth rate of 2.2% between 1950 and 1990.

Well, correlation is not causation; and, second, while the explosion in the ranks of billionaires might not have helped, shrinking their ranks might hurt growth. In short, the asymmetric effects of taxation proposals have to be kept in mind. Lowering tax rates for high income earners may not result in higher employment and economic growth, but raising them too much might prove to be negative for both. That might be especially so in an environment of low growth.

In this regard, the quiet work on taxes done by the Organisation for Economic Co-operation and Development (OECD) offers hope. In fact, this could be one of the most far-reaching tax reforms to be proposed in recent years. OECD proposals would minimize the scope for tax arbitrage that multinational corporations routinely engage in. They do not pay taxes in the countries where most of their business activity takes place.

The path-breaking elements of the OECD proposal are: One, it breaks the principle that countries only have a right to tax activities from companies that have a physical presence on their soil. Two, countries will have the right to tax a proportion of global profits of highly profitable companies no matter where these profits are shifted (“OECD takes aim at tech giants with plan to shake up global tax", Financial Times, 9 October).

Without checking the erosion of the tax base of nations due to profit shifting by multinational corporations, any redistribution of a surplus between labour and capital would remain a non-starter. However, it is chastening to note that the OECD has been at it at least for six years, if one goes just by the first-page hits while searching the internet for the “OECD Tax Proposal". Hence, implementation would not be easy and it might be rendered toothless by legal challenges. One hopes that this pessimism proves unfounded.

An article that appeared in *Finance & Development*, a publication of the International Monetary Fund, in September 2019 showed that tax havens that attract money from those seeking to avoid paying taxes at higher rates in their host countries end up suffering from the curse of “too much finance". Their tax-haven status attracts capital flows, leads to misallocation of capital and attracts talent to high-paying but largely economically unproductive jobs that are geared to help individuals and corporations avoid taxes. The financial sector becomes too big. Thus, the tax havens suffer too. So, there is some karmic or poetic justice, after all.

The tax proposals of OECD, if they become a reality, will help us reverse the four-decade long skew in favour of capital over labour and also chip away at the problem of “too much finance". That would be the best news of 2019.

These are the author’s personal views.V. Anantha Nageswaran is the dean of IFMR Graduate School of Business, Krea University

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