Will a global corporate tax rate end the practice of shifting profits to low tax jurisdictions?

A survey of European and US economists explores their views on some of the issues surrounding the global deal on corporate taxes: the impact of a global minimum rate on investment, profit-shifting and low-tax jurisdictions; whether a stable international tax system that includes a global minimum rate can be achieved; and a potential move from levying taxes based on where firms' headquarters and production are located to where they make their sales. ***Romesh Vaitilingam*** *sums up the results.*

Leaders of the advanced economies of the G7 recently made what they described as a 'historic commitment' on taxation of multinational corporations. The Initiative on Global Markets Forum asked a panel of experts whether they agreed or disagreed with three statements, and, if so, how strongly and with what degree of confidence. Of the panel's 48 European experts, 38 participated in this survey; of 43 US experts, 37 participated – for a total of 75 expert reactions.

Statement 1. a) A global minimum corporate tax rate would limit the benefits to companies of shifting profits to low-tax jurisdictions without biasing where they invest.

On the first statement, a strong majority of panellists (94%) agrees that a global minimum corporate tax rate would limit the benefits of profit-shifting to low-tax jurisdictions without biasing where firms invest.

Weighted by each expert's confidence in their response, 44% of the European panel strongly agree, 50% agree, 4% are uncertain, and 3% disagree (the totals don't always sum to 100 because of rounding). Among the US panel (again weighted by each expert's confidence in their response), 13% strongly agree, 82% agree, 5% are uncertain, and 0% disagree.

Overall, across both panels, 31% strongly agree, 63% agree, 4% are uncertain, and 2% disagree.

More nuances in the experts' views come through in the short comments that they are able to include when they participate in the survey. Among those who agree with the statement, Jan Pieter Krahnen at Goethe University Frankfurt says: 'This is exactly the argument of the proponents – and I think it is correct as a first order effect.' Nicholas Bloom at Stanford explains: 'Profit shifting is a curse for governments that want to properly tax capital. A global minimum tax is the best tool against this.' His colleague Kenneth Judd adds: 'Tax competition causes wasteful tax avoidance activities. This minimum also makes it easier for countries to bring down their rates.'

A number of panellists mention conditions of a global minimum achieving its objective. First, there's what's in the agreement. Franklin Allen at Imperial notes: 'A lot will depend on the details of the agreement. If there are significant loopholes, the agreement is unlikely to work.' Patrick Honohan at Trinity College Dublin suggests: 'Provided definitions of taxable income are also harmonised.' And Daron Acemoglu at MIT warns: 'But the benefits from such a tax depend on the rate. Multilateral bargaining may lead to an excessively low rate, missing a huge opportunity.'

Next, there's how widely the agreement is adopted, a challenge that OECD negotiators are currently facing with several developing countries and tax havens. Antoinette Schoar at MIT comments: 'The big IF here is whether it will be possible to achieve uniform enforcement.' Alan Auerbach at Berkeley adds: 'It really depends on how widespread and uniform the adoption is.' Pinelopi Goldberg at Yale states: 'As long as the system is truly global, and international cooperation can be sustained.' And Anil Kashyap at Chicago asks: 'If adopted by all important economies and tax havens, but is that realistic?'

Of the panellists who say they are uncertain or disagree, several refer to the potential investment impact. Ricardo Reis at LSE points out that: ‘All taxes (or almost all) bias investment decisions.’ Robert Shimer at Chicago adds: ‘But it will affect where they invest, reducing investment in currently-low-tax countries.’ And Pol Antras at Harvard exclaims: ‘It will certainly bias where they invest, but still seems like a splendid policy. We live in a second-best world!’

Caroline Hoxby at Stanford votes ‘no opinion’, but comments: ‘Such a proposal is pleasant to consider but is unrealistic in practice. Pie in the sky.’ And Pete Klenow at Stanford alerts us to a study of the unintended consequences of eliminating tax havens.

Statement 2. A stable international tax system in which the major advanced economies set a minimum rate on corporate income is achievable.

On the second statement about whether an international tax system with a global minimum rate on corporate income is achievable, there is considerably more uncertainty (with the US panel expressing more uncertainty than the European panel).

Weighted by each expert’s confidence in their response, 7% of the European panel strongly agree, 68% agree, 23% are uncertain, and 2% disagree. Among the US panel (again weighted by each expert’s confidence in their response), 6% strongly agree, 49% agree, 33% are uncertain, 7% disagree, and 5% strongly disagree.

Overall, across both panels, 7% strongly agree, 60% agree, 27% are uncertain, 4% disagree, and 2% strongly disagree.

Among the comments of panellists who agree, Austan Goolsbee at Chicago says: ‘The big economies are still hugely desirable and essential places to do business, not powerless small open economies in a race to the bottom.’ Pete Klenow adds: ‘Because of diminishing returns, not all capital will flee to the lowest tax location’, pointing us to his own research on relative prices and relative prosperity.

Others remark on the potential need for additional actions beyond the global minimum. Patrick Honohan notes: ‘But loopholes remain likely, thanks to effective corporate lobbying.’ Franklin Allen comments: ‘It may be achievable but if there are countries outside of the agreement that can become tax havens, then it may not work very well.’ Daron Acemoglu suggests: ‘Tax havens need to be regulated as well. There will be many more accounting tricks for tax evasion by MNEs. But feasible to close loopholes.’ And Jordi Gali at Barcelona calls for: ‘With heavy penalties for countries that do not abide.’

There are similar concerns among the panellists who say they are uncertain. Nicholas Bloom comments: ‘The incentives to deviate are too large to make this easy, or even achievable. Look at the troubles coordinating across US states or the EU.’ Jan Pieter Krahnen adds: ‘The devil is in the details – as we can already see from the responses from Ireland, the Bahamas, and the UK.’

Robert Hall at Stanford refers to research evidence on collective action: ‘The literature on the instability of cartels suggest there is a problem.’ Steven Kaplan at Chicago, who disagrees with the statement, adds: ‘Suspect it is very hard to get all relevant countries to agree/implement.’ But Karl Whelan at University College Dublin responds: ‘International economic policy co-operation is possible once there is recognition of common interests, e.g., Basel process for banking.’

Several panellists mention politics. Daniel Sturm at LSE suggests: ‘This is less a question about economics than political will or skill. Cooperation is the obvious best outcome for governments in this area.’ Christian Leuz at Chicago agrees: ‘More a political than an economic question. Answer largely depends on how much pressure major countries exert on tax havens. EU is case in point.’ And Richard Schmalensee at MIT notes simply: ‘I view this as an almost purely political question.’

Statement 3. A global corporate tax system that is based on the location of final consumers would be more efficient than one based on the location of corporate headquarters and production facilities.

The third statement asks whether taxes based on where firms make their sales would be more efficient than taxes based on where their headquarters and production are located. While over half of panellists agree, more than a third express their uncertainty (including nearly half of the European panel).

Weighted by each expert's confidence in their response, 19% of the European panel strongly agree, 32% agree, 47% are uncertain, and 2% disagree. Among the US panel (again weighted by each expert's confidence in their response), 9% strongly agree, 63% agree, 27% are uncertain, and 0% disagree.

Overall, across both panels, 14% strongly agree, 47% agree, 38% are uncertain, and 1% disagree.

Among those who agree with the statement, Christopher Udry at Northwestern comments: 'Not as easy to manipulate.' Robert Hall says: 'Consumption taxes make sense.' And Kenneth Judd explains: 'Taxes should not distort intermediate goods and production decisions, such as headquarters locations.'

Many of the panellists who say they are uncertain explain why they take that view. William Nordhaus at Yale says simply: 'Very complicated and untested.' Nicholas Bloom adds: 'This is a complex issue that will vary by industry, country and company, so this is hard to answer.' And Christian Leuz comments: 'Many open questions and depends on details that are not spelled out in the question; such a system involves complex transfers across countries.'

A couple of panellists refer to specific issues of implementation. Franklin Allen states: 'It depends how such a system is structured and which country receives the revenues.' And Robert Shimer says: 'Forcing small companies to pay taxes in any small country where people buy their products would be inefficient and anti-competitive.'

Others refer to tax theory. Caroline Hoxby suggests: 'The location of consumers is an inferior system to the location of the owners of the capital.' Karl Whelan remarks: 'Effectively this would be a switch to a sales tax rather than a corporate income tax. I'm not sure this is necessarily more efficient.' And Pol Antras comments: 'Lacks theoretical foundation, and production-based approach is better in a first-best world. But it may improve upon current, flawed system.'

Daron Acemoglu also explains what underpins the uncertainty: 'Headquarter location should be irrelevant. Uniform taxation is a good benchmark. Less clear whether based on consumption or production is better.' And Daniel Sturm concludes: 'The main point here should be distributional questions rather than narrow economic efficiency in the form of deadweight losses.'

Notes:

- *All comments made by the experts are in the full survey results.*
- *This blog post expresses the views of its author(s), and do not necessarily represent those of LSE Business Review or the London School of Economics.*
- *Featured image by Dave Simbosa on Unsplash*
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