tax notes international
Volume 80, Number 9 ■ November 30, 2015

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by Daniel A. Witt

Reprinted from *Tax Notes Int'l*, November 30, 2015, p. 759

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Daniel A. Witt is the president of the International Tax and Investment Center (ITIC). He presented the following report at ITIC's 23rd annual Board of Directors' meeting in London on November 3.

Globalization and Governance

Since ITIC's founding in 1993, globalization has become a reality. Barriers between national markets continue to fall. The share of world trade represented by multinational enterprises (MNEs) continues to grow, and new technology facilitates cross-border activities. Countries continue to compete for foreign direct investment while trying to maintain domestic investments. Companies that were once national enterprises have become MNEs. Many of the so-called capital-importing "emerging markets" have become net capital exporters while continuing to attract inward investment. We have witnessed a dramatic transformation in investment opportunities and investment flows.

In some ways, we are now in a different stage of globalization, as many of the BRIICS[1] — and I include Indonesia in that list — see a slowdown in their rates of growth, and more challenging "frontier" markets gain attention. The ongoing developments in China and the reactions in more mature capital markets have highlighted the need in the BRIICS, and in other prominent emerging markets, for deeper structural reforms. Many believe that the "low-hanging fruit" of policy reforms in these markets has largely been picked; more challenging work lies ahead. And for many frontier markets, the path is even harder. The Institute of International Finance is forecasting negative net capital flows to emerging markets for the first time since 1988.[2]

The world has recognized the need for effective economic governance. Global economic institutions did not perform well during the 2008 financial crisis, and better coordination is needed to adapt to 21st Century realities. As former U.S. Treasury Secretary Hank Paulson said in a recent article, initiatives like the G20 recognize that while advanced industrial democracies share interests, they "cannot monopolize global economic governance if it is to be effective in tackling current challenges and future crises."[3]

Some have called for a more active role for the UN as the only global organization that has an inclusive membership and therefore political legitimacy. The post-2015 (to 2030) development agenda approved at the recent UN General Assembly outlines a pro-growth development agenda that includes many fiscal, governance and anti-corruption linkages. Many of these have the potential to significantly expand domestic revenue bases. However, it is unclear whether the UN has the administrative capacity to support full implementation.[4]

Finally, we are seeing the emergence of more regional economic communities (RECs), some of which are becoming fully functional customs unions, while others are more aspirational. The Eurasia Economic

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[1]Brazil, Russia, India, Indonesia, China, and South Africa.

[2]1 October 2015, Cash Flows to Emerging Markets Quarterly Report, Institute of International Finance (https://www.iif.com/publications/capital-flows).

[3]https://www.washingtonpost.com/opinions/why-chinas-economic-reforms-are-critical-to-the-united-states/2015/09/18/b2227

[4]United Nations General Assembly, *Draft Outcome Document of the United Nations Summit for the Adoption of the Post-2015 Development Agenda*, 12 August 2015, Sixty-ninth session.

Union and several of the African RECs, including the East African Community, UMOA and ECOWAS, are examples of the former, while the ASEAN AEC is on the front edge of economic integration. Tax and customs reforms must play a critical role if these unions are to become true single markets and create attractive, hospitable investment environments. For example, as ASEAN, a market of 500 million people, moves towards closer economic integration, it must be careful that taxation does not become a barrier to creating a single market. Careful attention to direct and indirect tax coordination within RECs will be essential.

Growing Risks

The past two years have presented some of the greatest challenges in countries where ITIC works. Just as the global economy recovered from the 2008 economic crisis, political and economic events in many emerging economies, especially in the BRIICS, have created significant financial volatility and uncertainty for investors and government budgets. Adding to these concerns are the strength of the U.S. dollar and the decline in commodity prices, notably crude oil. Some of the results include greater pressures to fragment globalization and advance a protectionist agenda under the banners of nationalism and income equality.

During economic downturns, it is often easy to blame the outside world and look inward. This trend is likely to be magnified in those countries that are being forced to tackle the more difficult structural reforms. Thus, the backlash to globalization runs the risk of increased protectionism and discrimination, and taxation is often the policy instrument of choice. Yet technology continues to change the global business environment. For example, cloud computing, 3-D printing and other borderless technologies are making it even harder to determine where value is created and where it should be taxed.

The G20 process has refocused attention on the taxation of global business, not least through the Action Plan on BEPS. New principles with global application, inspired mainly by the U.S. and the EU, are likely to be enacted into laws that significantly increase compliance burdens for both tax administrations and taxpayers around the globe. The unintended consequence is interruption of financial flows and heightened risk of the selective application of laws that harm MNEs. And uneven application of these new regimes, whether arising from misperceptions of the role of MNEs or from simple lack of capacity, increases the risks for MNEs.

Another unintended consequence of BEPS is that the competition for real economic activity (e.g., physical plants and production sites) will increase, and likely lead to continued downward pressure on corporate income tax (CIT) rates. Governments must maintain a balance between protecting their domestic tax bases and not allowing BEPS-imposed tax reforms to lead to declines in FDI, which is still 16% below the pre-crisis (2008) level.[5]

Many allegations of harmful MNE tax practices made by NGOs and politicians illustrate a lack of economic and fiscal awareness and understanding. Paradoxically these inward, discriminatory policies are being considered while governments are searching for ways to make their economies more competitive, attract new investment, and expand their domestic tax bases. ITIC's programs address this paradox and strive to provide economic policymakers with fact-based arguments in support of open and fair tax and investment regimes.

Competition for Investment

In spite of these geopolitical risks, policy trends and recent financial volatility, there have never been as many countries competing for FDI. Business expansion and investment opportunities have extended far beyond the BRIICS. There are new mineral frontiers through West and East Africa. Countries in the Middle East and North Africa are looking to diversify their economies and budgets beyond petroleum revenue. Countries in Eastern and Central Europe and Central Asia have never been so acutely aware of the need to improve their competitiveness and diversify their economies. While challenges remain in the short term, these markets represent long-term growth opportunities for MNEs. New frontier markets such as Myanmar and Mozambique are opening up, while many challenging markets such as Angola, Kazakhstan and Bangladesh show increased promise due to the sheer size of their domestic markets and improved macroeconomic position. Even more interesting, new possibilities are emerging in places like Cuba and Iran.

Continuing Trend: Shifting Economic Power Beyond the OECD

Despite the political and financial turmoil that has taken place in the BRIICS, economic power continues to shift away from the OECD countries. The OECD estimate that the BRIICS will be the principal drivers of the world economy by 2050 remains valid. However, we should not oversimplify statistical realities. While there are many similarities, the differences among the BRIICS are significant, as are the challenges they face. We should therefore look beyond the six BRIICS countries and the dynamic economies of Southeast Asia for the next high-growth markets. Countries such as Egypt, Colombia, Tanzania, Ghana, and even Nigeria are among those with great potential.

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[5] "Tax and Investment: UNCTAD Contribution to the Ongoing BEPS Debate," Jeffrey Owens, International Tax Review, 29 September 2015.

New Risks

As we have seen this year in China, in times of economic hardship it is easy for a country to lose confidence in a global system of economic norms and to look for national solutions. Since 2008, when emerging markets were creating jobs and economic growth at a faster pace relative to the U.S. and the EU, the economic performance indicators for the developing economies and the advanced economies have reversed. Yet the need for pro-growth, open economic policies in emerging markets is even more urgent. As the BRIICS and others in a similar economic position start making the deeper structural reforms that are necessary, ITIC will need to continue to remind them of the importance of open, simple, transparent, and predictable tax and investment regimes.

The Political Economy of Tax Reform

ITIC's ability to communicate this central message relies upon an ongoing dialogue with all stakeholders on fiscal reform.

- Officials in transition and emerging economies will often readily concede that the technical path forward on reform is clear, but the political will is lacking. This reinforces the importance of ongoing, active engagement through ITIC programs. The Regional Tax Forums provide a unique platform for facilitating this dialogue.
- Fiscal policy is no longer controlled by a small group of dominant actors, even within a single country. Numerous finance ministers comment on the important role played by parliaments, and in some countries, judges, both of whom should be included in education and outreach efforts. Legislators and the policy support institutions that advise governments are as important as senior Ministry of Finance officials.
- Over the past few years, the role and influence of international organizations working on taxation issues has evolved significantly. While in the past the OECD has acted as the primary thought leader and norm setter in global tax rules, we now see an increasingly ambitious policy agenda from the UN and the IMF. Further, the World Bank, and to a lesser extent, the regional development banks such as the Asian Development Bank, have started to influence tax policy due to their important role in providing financing for capacity development and modernization programs for tax administrations.
- New players such as the BRICS Bank and the new Asian Infrastructure Bank have changed the paradigm of development financiers. We need to monitor their thinking on trade, investment and tax policy, which is likely to be driven by different policy imperatives.
- NGOs are raising their voices; international financial institutions and finance ministers are listening.
- There is a growing need to educate the mass media and the public on the economic complexities of tax reforms. ITIC is considering ways to engage not only governments but broader stakeholder constituencies and disseminate our work to a wider audience.

Consequently, there are more voices contributing to fiscal debates. Democracy, though often in a form different than we know it in the U.S. or Europe, is manifesting itself in new ways. The result is slower, more complex policy-making processes. On the positive side, these policies will have broader support and thus will remain in effect longer, which in turn provides more certainty to business. It is essential that as governments consider broader economic objectives, the case for pro-growth economic policies continues to be made and that the voice of business is heard along with global actors such as the IMF and the UN, whose roles and influence are growing. On tax rules in emerging and frontier markets, the forum for engagement will increasingly be these organizations. Stressing an OECD-led approach may be counter-productive. And while the G20 process brings together leading emerging economies with the industrial West, it is important to recognize that not all emerging economies are necessarily signed up to full implementation of the new norms being developed. ITIC therefore sees a very significant need to take its key messages directly to the countries concerned.

ITIC in the New Environment

These changing dynamics should be reflected in ITIC's initiatives and its messaging on policymaking and implementation.

While BEPS signals the new environment in international tax reforms, this new landscape also includes bodies such as the IMF questioning double-taxation agreements and NGO accusations of transfer ''mispricing'' by MNEs. As a result, there is a real risk that governments in emerging and frontier markets will ''squeeze'' the best taxpayers even harder, as they focus their limited resources on capturing ''easier'' additional revenue rather than, for example, expanding the tax base by bringing parts of the shadow economy into the formal sector.

First, ITIC will seek to mitigate these risks by promoting:

- Programs that encourage emerging economies to develop a more risk-based approach to tax administration and auditing, and to develop capacity in tackling the shadow economy.
- Approaches that will help countries develop cooperative compliance programs and other solutions to avoid, or more quickly resolve, tax disputes with ''good taxpayers.''

Second, at a global policy level, ITIC will continue to demonstrate the link between fair taxation and expanding a domestic tax base, and in particular the role taxation can play in making the formal sector more ''hospitable'' and welcoming to investors and taxpayers, including those moving from the shadow-economy into the formal sector. We hope that the renewed G20 Finance Ministers' mandate in Ankara on pro-growth policies will refocus the global tax policy debate, and will continue to advocate such policies at the global, regional, and national levels. ITIC will continue our active engagement working with the UN, IMF and World Bank as their fiscal roles continue to grow.

Finally, we will continue to stress that tax policy should be managed by Ministries of Finance as the most appropriate tax authority. This fiscal responsibility should remain the prerogative of the Ministry of Finance, although Ministries of Trade, Environment, Health, or other agencies such as Boards of Investment, should be part of a consultative process.

The Path Forward

As the world changes, so will the mandate of ITIC evolve to meet the changing needs of its sponsors and stakeholders. We must refocus our mission to clarify our most significant value-added proposition since our inception: to promote mutual understanding and trust between governments and businesses on taxation issues. This unique niche is reflected in all ITIC programs, and we will continue to build on it with tenacity of purpose and confidence in market principles. ◆