Globalization, Taxation & Inequality

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May 9^{th}, 2023
Fondation France-Israël

Introduction

Our tax systems are largely creations of the 1950s

- $\triangleright$ Value-added tax and payroll taxes account for more than half of global tax revenue
- $\triangleright$ VAT invented in the 1950s in Europe and caught fire
- $\triangleright$ Payroll tax older, but small until 1950s–1960s before surging

$\rightarrow$ We largely rely on flat taxes & consumption taxes to fund government

Introduction

Flat consumption and payroll taxes made sense in the post-World War II, European context:

- ▷ Capital scarce → tax consumption, exempt saving
- ▷ High labor share → tax payroll to fund social state
- ▷ Flat rates not a major issue when inequality was relatively low

→ **But today?**

There is a need for modern tax design

Today's context is the opposite of the 1950s:

- $\triangleright$ Capital is back: wealth/GDP $\uparrow$ from 200% to 600%
- $\triangleright$ Capital share is rising, labor share is falling
- $\triangleright$ Income and wealth inequality rising globally (fast in e.g., US, China, India)

$\rightarrow$ **We need to invent 21st century tax systems** adapted to the inequality challenges of today

Can capital be taxed?

Widespread view that progressive and capital taxation are doomed in a globalized world

- Tax competition, tax avoidance, tax evasion mean "mobile" factors cannot be taxed much
- But tax competition & evasion are not laws of nature, they are policy choices...
- ...Choices that were not very transparently or democratically debated, but choices nonetheless

Other choices are possible: current form of globalization is just one among many

Some progress already, but is it enough?

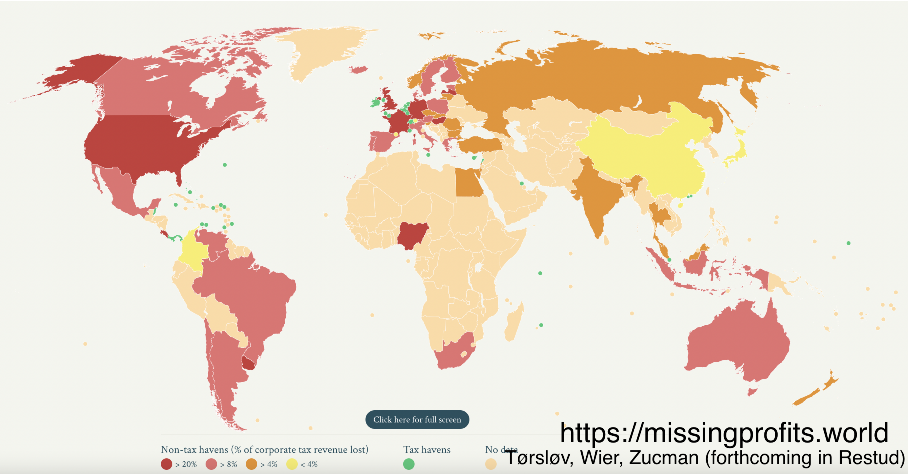
The last decade has seen the emergence of new forms of international coordination:

- ▷ International exchange of bank information since 2017-18
- ▷ Prospect of an agreement on a 15% minimum tax (OECD "two pillars" solution)

Today's talk: Are these policies up to the challenges? If not, what else is needed?

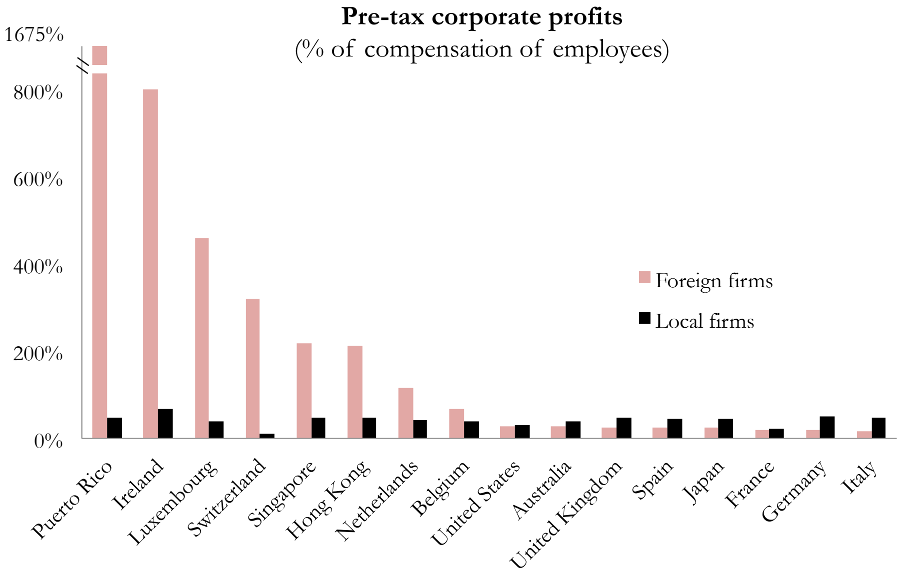
Global Profit Shifting & the Limits of the OECD Two-Pillar Solution

Close to 40% of multinational profits are shifted to tax havens

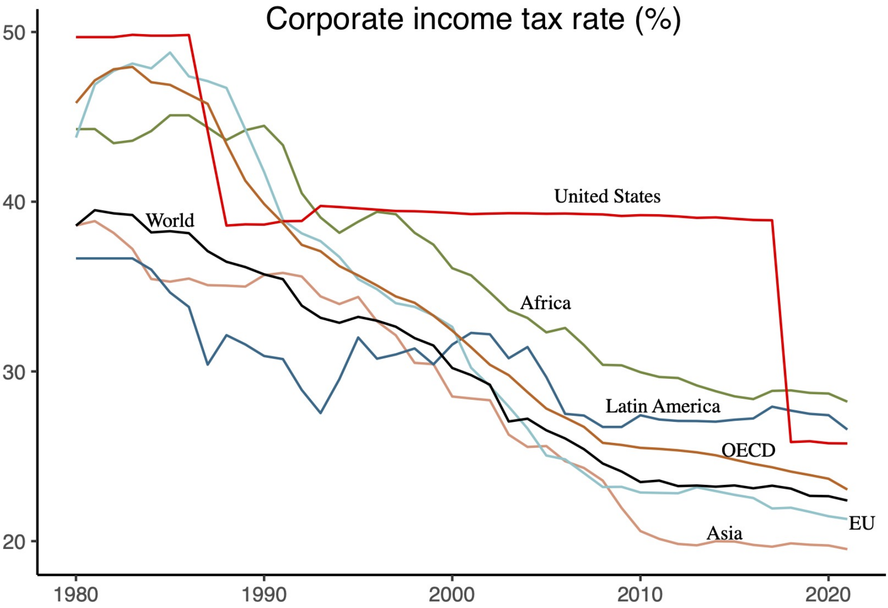


https://missingprofits.world
Tørsløv, Wier, Zucman (forthcoming in Restud)

In tax havens, foreign firms are much more profitable than local firms



The race-to-the-bottom with corporate income tax rates



Pillar II: ending or embracing tax competition?

Initially presented as a way to "end the race to the bottom", Pillar II in fact embraces tax competition

- ▷ 15% minimum tax on country-by-country profits
- ▷ But: with a carve-out for substance: 8% of tangible assets + 10% of payroll can be excluded
- ▷ It addresses shifting to zero-tax, substance-less havens
- ▷ But encourages firms to move activities to low-tax places with real production

$\rightarrow$ **Legitimizes the view that no limits should be put to tax competition.**

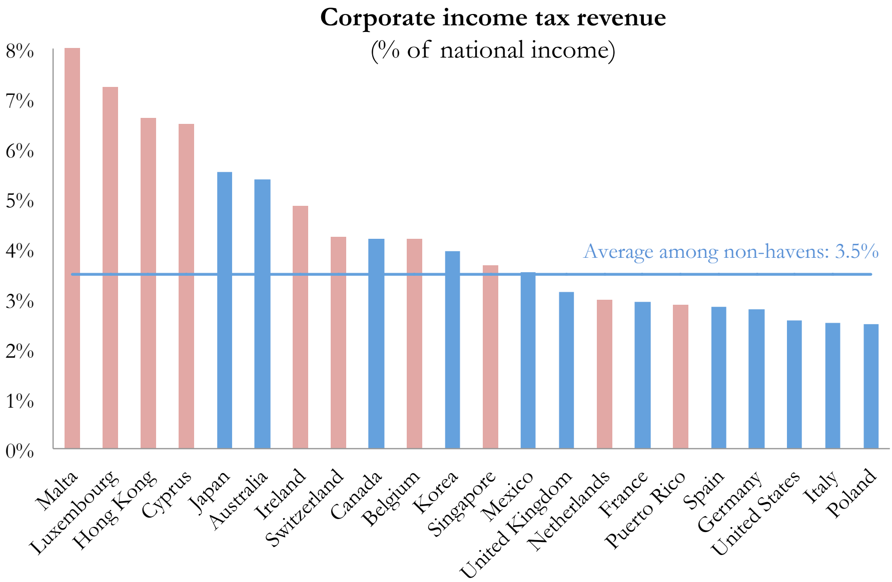
Global vs. multilateral agreements: The pitfalls of unanimity

The redistributive effects of profit shifting

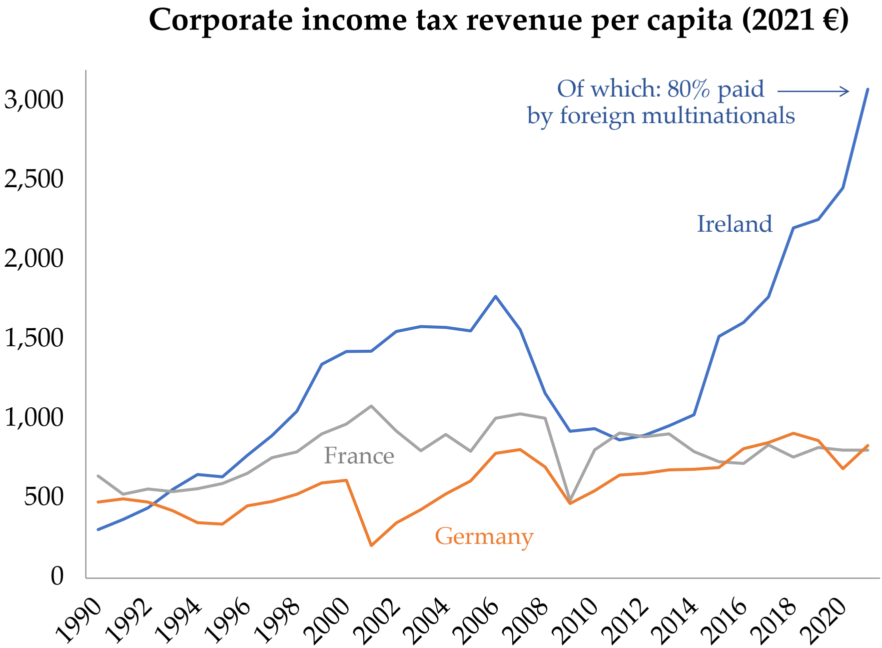
Tax havens have no interest in ending the race-to-the-bottom

- With tax competition, revenue-maximizing corporate rate τ^* is low for small countries, $\approx 5\%$.
- Havens with $\tau \approx \tau^*$ generate large tax revenue at the expense of other countries (and to the benefit of global shareholders)
- Insisting on global agreements (or unanimity in EU context) means carving tax competition into stone, fueling inequality

Many havens collect a lot of tax revenue



The redistribution of corporate income tax revenues



A way forward: unilateral or multilateral action to collect tax deficits

There is no need for unanimity:

- Any number of countries could chose to collect the taxes that tax havens refuse to collect
- ... playing the role of **tax collector of last resort**
- ... making it pointless for firms to book profits in tax havens
- See EU Tax Observatory report #1 (Barake, Chouc, Neef, and Zucman, 2021) for simulations

Taking the interest of developing countries seriously

Although allegedly inclusive, **the two-pillar agreement prioritizes the interest of high-income countries**

- Pillar I (allocation of tax base to destination markets): small and uncertain future because of US resistance
- Pillar II minimum tax: collected by headquarter countries (though some evolution)
- Developing countries are de facto given less weight than tax havens in current framework

In the future: apportionment of profits based on population, number of users?

Conclusion

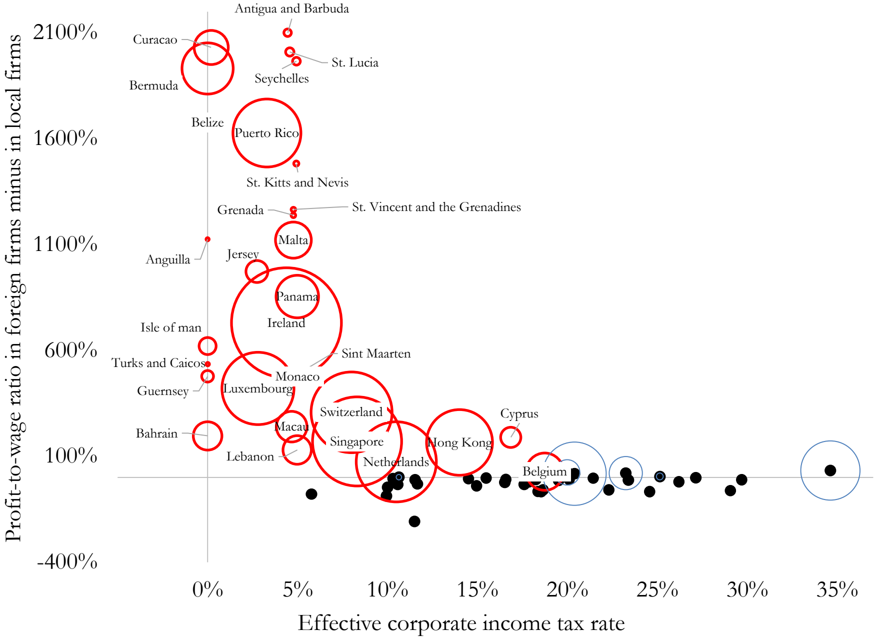
Policy perspectives

We need new instruments, new forms of cooperation & new institutions

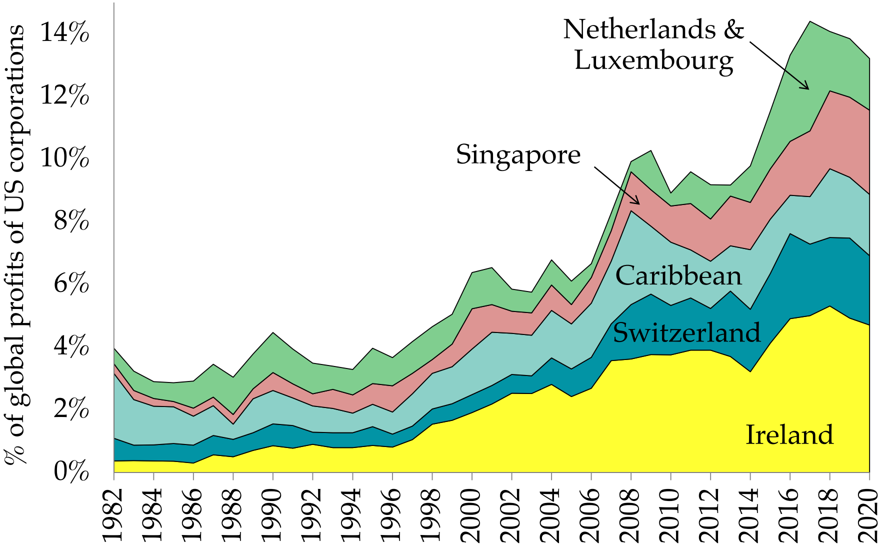
- Beyond the automatic exchange of bank information: the case for a global asset registry
- Beyond the Two-Pillar agreement: global minimum tax on billionaires
- Escaping from the straight jacket of unanimity: the case for unilateral and multilateral actions

Supplementary Slides

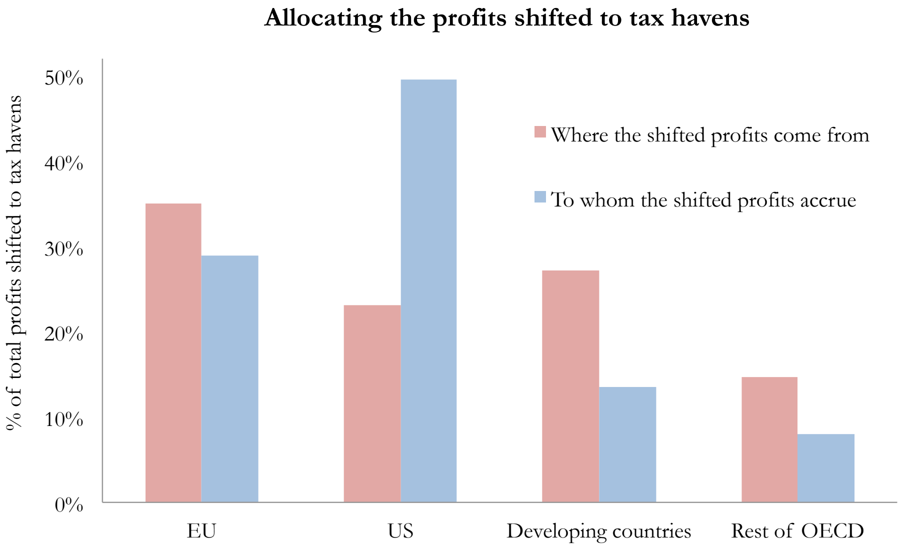
In tax havens, foreign firms are much more profitable than local firms



Profit shifting by US multinationals shows little sign of abating post-Trump reform

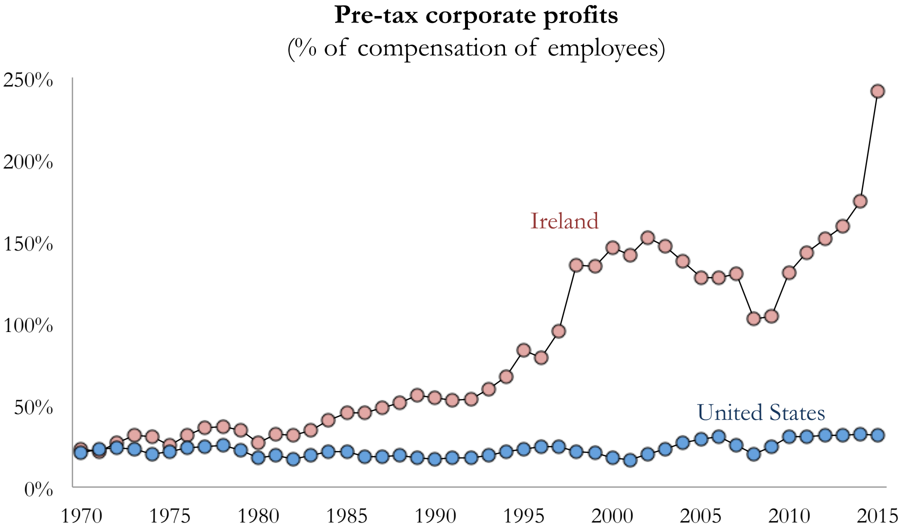


Allocating shifted profits

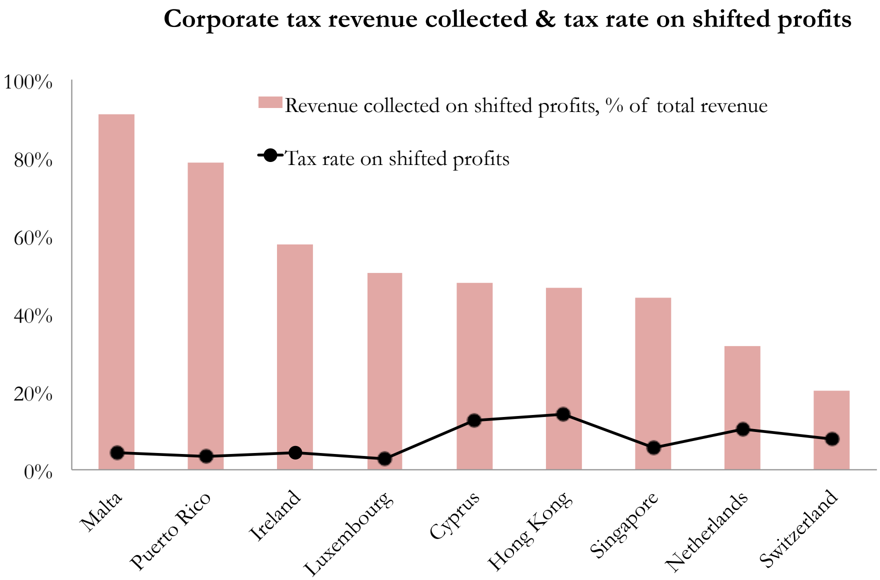


Corporate tax losses caused by profit shifting

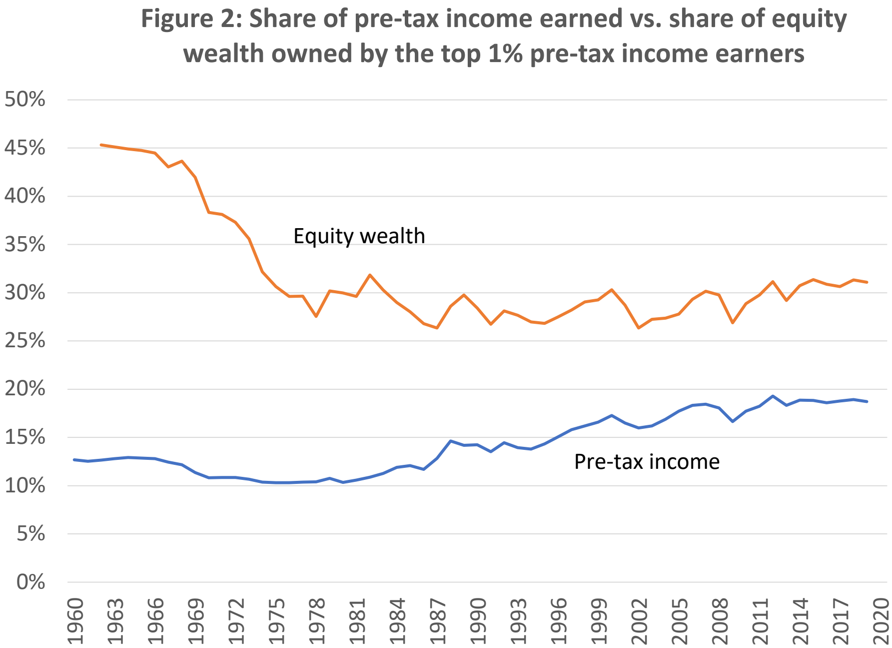
Profit shifting has dramatically increased since the 1980s



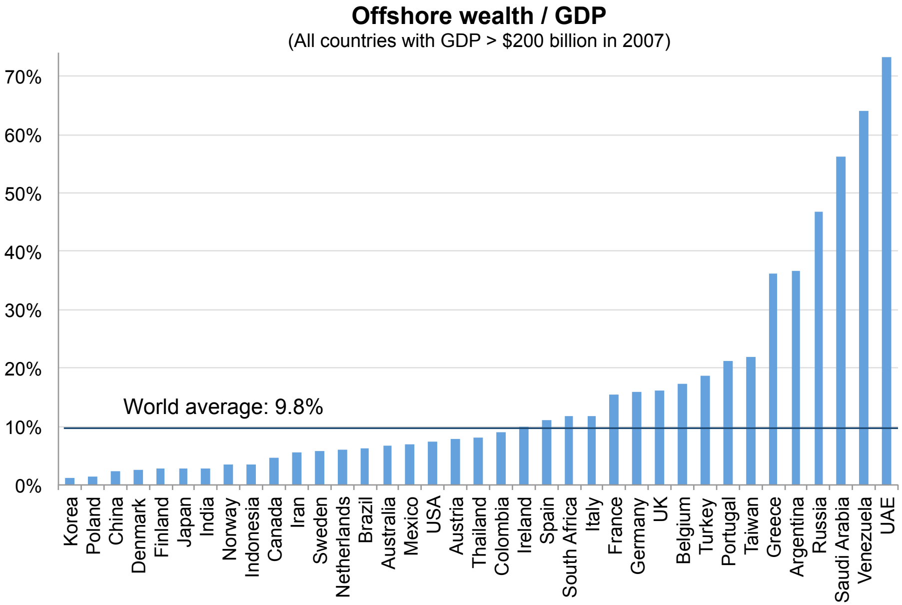
… By applying low rates to the large tax base they attract



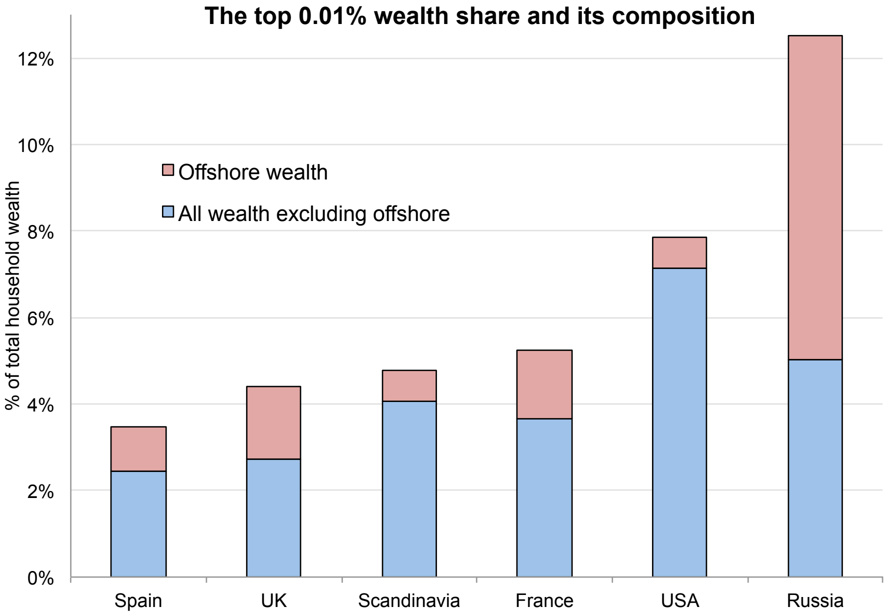
The concentration of corporate equity ownership: the case of the United States



The equivalent of 10% of world GDP is held in tax havens



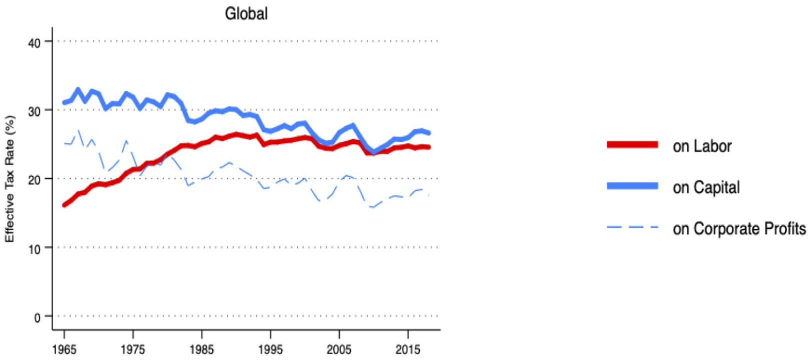
The weight of offshore wealth at the top



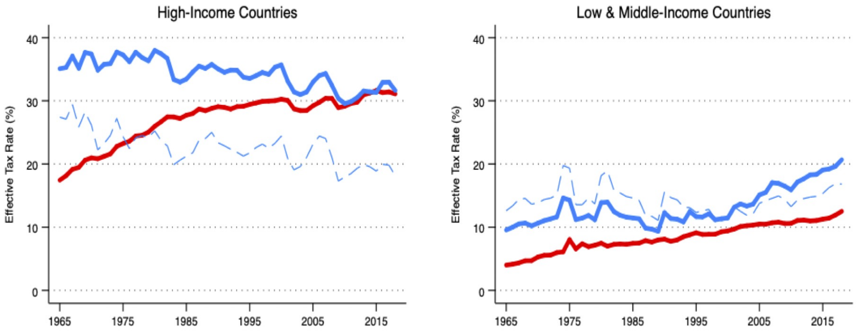
The decline in capital taxation and rise in labor taxation

Effective Taxation of Capital and Labor

Source: Bachas, Fisher-Post, Jensen & Zucman (2022)

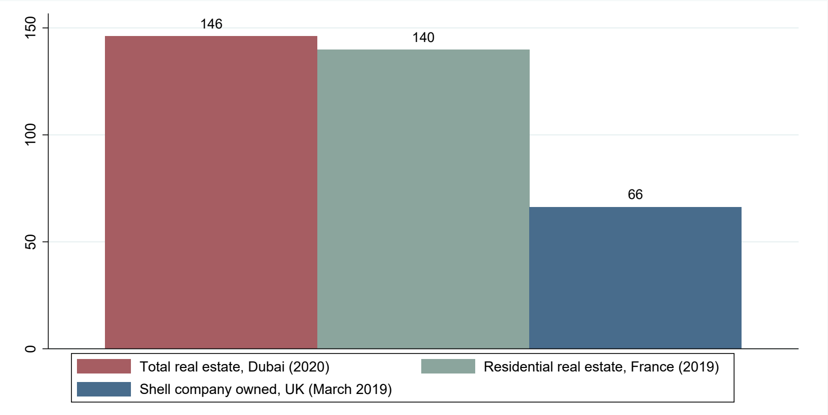


The rise of capital taxation in developing countries



Offshore real estate in Dubai is large: at least $146 billion

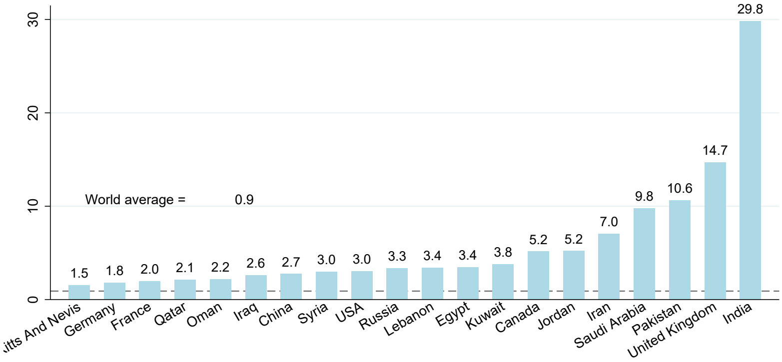
(a) Estimates of offshore real estate wealth



Who owns real estate in Dubai? Proximity and historical ties matter

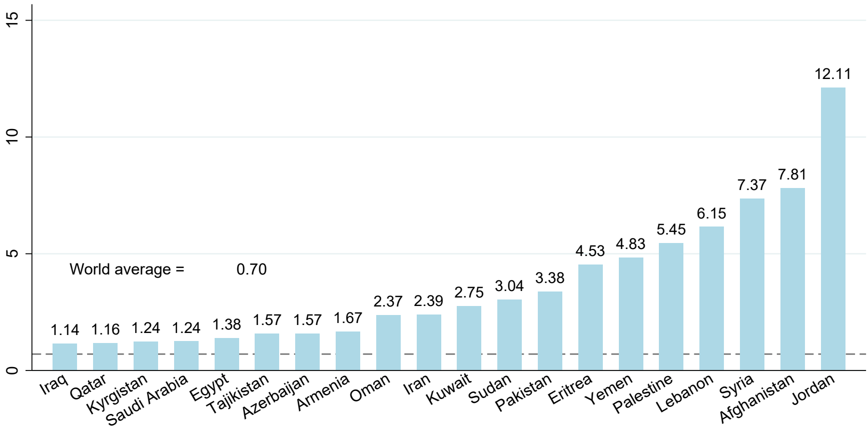
Figure 4: Real Estate Held in Dubai in 2020: Top 20 Countries

(a) Total Value (billions of USD)

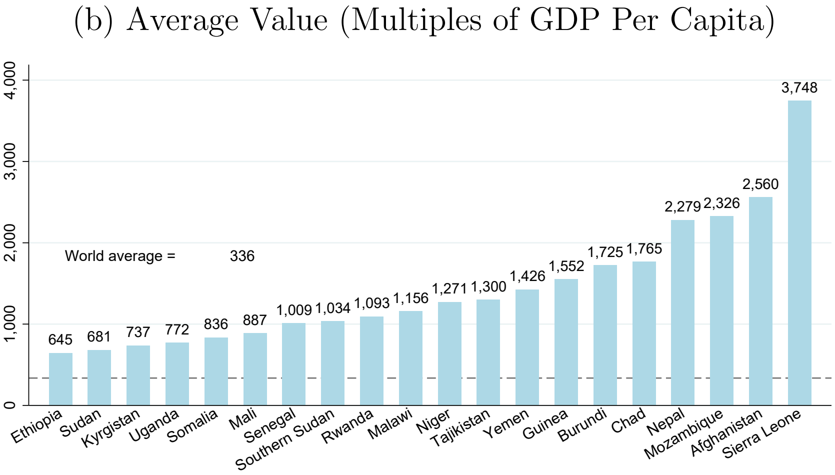


For some low-income countries, Dubai real estate = as much as 5%-10% of GDP

(a) Total Value (% of GDP)



Dubai properties are worth 1,000s × the average income of home country's owners



About 70% of properties owned by Norwegians not reported for tax purposes

Figure 10: Reported vs. Total Dubai Real Estate of Norwegians

(a) Number of properties