Ifo Viewpoint

Munich, 6 September 2016

No. 178
Impact of Globalisation on Taxation*

The globalisation of the economy raises basic questions for the financing of public spending. Capital, goods and a growing number of people are mobile across borders. Many companies can relocate their production facilities, jobs and immaterial assets like patents internationally.

Can national tax policy still generate sufficient tax revenues to finance public spending in this environment? Does politics still control the distribution of the tax burden between capital and labour, and between rich and poor?

Experience with globalisation to date suggests that although government budgets can still be financed, the distribution of the tax burden is shifting in the direction of less mobile tax bases, albeit very slowly.

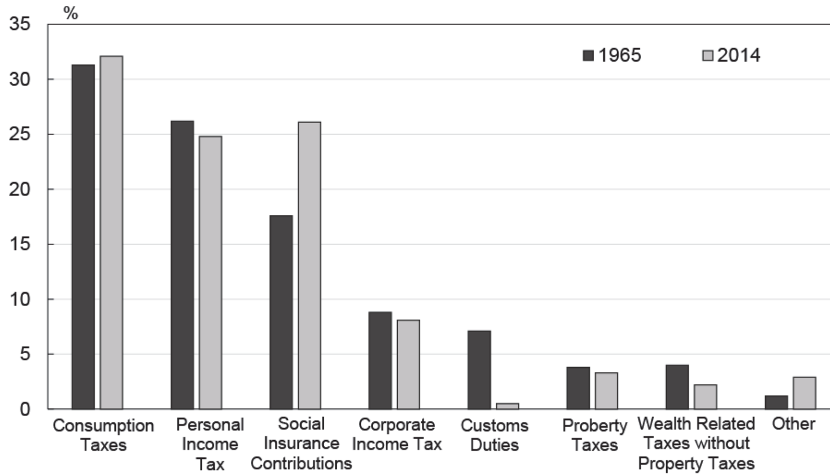
No erosion has been seen in government revenues to date. Public revenues as a share of gross domestic product rose by around 25 percent to 34 percent on an OECD average between 1965 and 1995. Since then they have remained more or less constant. In Germany tax revenue is higher than the OECD average and reached a level of around 36 percent back in the 1970s. Despite a few fluctuations, it has remained astonishingly stable over the last forty years.

It could be argued that growth in tax revenues in the 1960s and 1970s might have continued into the 1980s without globalisation. In that scenario globalization did indeed cause a decline in tax revenues. This point is open to speculation, but that there is no convincing proof. In countries that are more exposed to globalisation, for example, public revenues are not systematically lower than anywhere else.

The picture is different when it comes to the structure of the tax system and the distribution of the tax burden, where there are visible shifts. An important aspect of the globalization process, which has directly impacted public budgets, is the reduction in import duties. In 1965 duties accounted for 7.1 percent of public revenues on OECD average, versus 0.5 percent today. The influence of globalisation is also visible in the field of wealth-related taxes, which include net wealth taxes, as well as property and inheritance tax. Plots and land cannot migrate abroad, which is why property taxes are an attractive source of revenues for countries that are exposed to international tax competition. Taxes on mobile wealth, by contrast, lead to an outflow of capital or wealthy individuals. It is therefore hardly surprising that wealth taxes, apart from property taxes, are waning internationally. They were never particularly important. Such taxes accounted for around 4 percent of tax revenues in 1965. By 2014 their share was down to just two percent. The development in property tax revenues has been more stable, but also less dynamic than tax revenues on the whole.

How have the revenue shortfalls created by the decline in duties and wealth taxes been compensated for? Taxes on internationally less mobile tax bases have gained importance. One of these tax bases is consumption – value-added tax has gained significance in nearly all OECD countries. Moreover, the tax burden on labour income has grown. The greatest increase can be found in the area of social security contributions. Their share of public revenues was 18 percent in 1965, versus 26 percent today.

The rising burden is primarily the result of growth in the welfare state. Unlike other taxes, social security contributions are often earmarked for pension payments or health care provision. Many employees nevertheless try to avoid paying social security contributions, but that is not easy. Despite growing mobility, moving abroad is not an option for most employees. That has certainly boosted the increase in the tax burden.



Source: OECD Revenue Statistics; OECD average.

At the heart of the debate over taxation policy and globalisation lies corporate taxation. Countries are competing ever more strongly for mobile investments. Taxes are only one of many factors in the choice of location. Political stability, a reliable legal system, the population's education level, a country's geographical position and the size of its sales market are all of fundamental importance. However, governments seeking to attract investors to their countries cannot influence these factors, or can only change them in the very long term. But they can influence taxes, which is why taxes are a key instrument in international location competition.

In recent decades the tax rates on corporate profits have dropped steadily. In 1983 the OECD average figure was 46 percent, but this figure fell to 25 percent by 2016. Germany proved no exception to this trend towards lower rates, and reduced its statutory tax rate on companies from almost 63 percent to around 31 percent over this period.

Interestingly, the falling tax rates were not accompanied by falling profit tax revenues. The revenue from profit taxes as a share of total tax revenues was just above 8 percent across the OECD in the 1960s and remains at a similar level today. There are various reasons for this phenomenon. Above all, many countries lowered their tax rates, but widened their tax bases to offset revenue losses over this period – depreciation allowances were reduced, and loss carry forward rules were made more restrictive. As far as the attractiveness of a location is concerned, there is nothing to be gained if the advantages of a low tax rate are neutralised by a broader tax base. But the lower tax rate helps in another form of tax competition: competition for book profits. When organising their financing structures, for example, companies have incentives to shift their profits to countries with low tax rates.

A lower tax rate is therefore an advantage in competition for taxable profits. Other factors that may explain stable tax revenues include rising corporate profits and income shifting from the sphere of personal income tax to corporate taxation in order to benefit from the lower corporate tax rates.

Another stabilizing factor in company taxation is that governments want to attract investments and win jobs for their country. At the same time, however, they would like to tax as large a share of global corporations' profits in their own country as possible. In the future many countries will try to impose higher taxes on companies that have a large customer base in their country, but few production facilities or employees. In such cases, the country in question does not need to have concerns that it will lose investment or jobs through higher taxation. The EU, for example, is currently trying to force companies in the digital sector to pay higher taxes in Europe.

Apple, for instance, has been asked to pay additional taxes totalling EUR 13 billion in Ireland. The European Commission argues that Ireland offered Apple tax breaks that distorted competition in the European internal market. This is effectively less about defending competition than collecting taxes and attacking US primacy in the digital sector. The US Ministry of Finance reacted by threatening to tax European companies operating in the US more aggressively. This demonstrates that competition

among countries can also drive up taxes. Many multinational companies fear that the desire of several countries to tax their global profits may lead to multiple taxation of their profits.

All this means that although there is growing competition in the globalisation of company taxation, there are also factors that offset pressures to reduce corporate taxes.

As a response to the globalization of the economy there are often calls to globalise taxation, or to shift tax policy decision-making to an international level. Such initiatives, however, often fail due to the diverging interests of the countries involved. One example is the call to introduce a minimum tax rate on corporate profits. Countries that are handicapped by a peripheral geographical location or a low level of development, for example, need tax policy as an economic policy instrument. If a minimum tax rate on corporate policy were to be introduced, their position in terms of competing as a location would be far poorer than that of large and more favoured countries like Germany or France.

The bid to combat tax avoidance by multinational firms has also given rise to conflicts. Although an agreement was reached that companies should be taxed where their value creation takes place in the future as part of the OECD initiative on "Base Erosion and Profit Shifting", that is a typical compromise formula and almost no agreement was reached on how this concept should be implemented.

What are the implications for German tax policy? The problem with demands for greater redistribution through net wealth taxes or higher corporate taxes is that this kind of taxation policy is damaging to an open economy like Germany. It drives capital and wealth owners abroad. Property and land taxes are the only area in which there is still scope for action in wealth-related taxes.

With its export-oriented economy, Germany's primary concern is to ensure that global economic activity is not repressed by double taxation or the reintroduction of customs duties. Germany also has to come to terms with the fact that tax authorities in German companies' export markets wish to tax a larger share of their profits. Here the task is to defend German taxation rights.

* Published in German under the title "Eine Frage der Macht" (A Question of Power), *Handelsblatt*, 6 September 2016, p. 10.

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