How can we tax footloose multinationals?

By Joseph E. Stiglitz
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Apple, Google, Starbucks, and companies like them all claim to be socially responsible, but the first element of social responsibility should be paying your fair share of tax. Instead, globalization has enabled multinationals to encourage a race to the bottom, threatening the revenues that governments need to function properly.

In the last few years, globalization has come under renewed attack. Some of the criticisms may be misplaced, but one is spot on: globalization has enabled large multinationals, like Apple, Google, and Starbucks, to avoid paying tax.

Apple has become the poster child for corporate tax avoidance, with its legal claim that a few hundred people working in Ireland were the real source of its profits, and then striking a deal with that country's government that resulted in its paying a tax amounting to .005% of its profit. Apple, Google, Starbucks, and companies like them all claim to be socially responsible, but the first element of social responsibility should be paying your fair share of tax. If everyone avoided and evaded taxes like these companies, society could not function, much less make the public investments that led to the Internet, on which Apple and Google depend.

For years, multinational corporations have encouraged a race to the bottom, telling each country that it must lower its taxes below that of its competitors. US President Donald Trump's 2017 tax cut culminated that race. A year later, we can see the results: the sugar high it brought to the US economy is quickly fading, leaving behind a mountain of debt (which increased by more than $1 trillion dollars last year).

Spurred on by the threat that the digital economy will deprive governments of the revenues to fund function (as well as distorting the economy away from traditional ways of selling), the international community is at long last recognizing that something is wrong. But the flaws in the current framework of multinational taxation – based on so-called transfer pricing – have long been known.

Transfer pricing relies on the well-accepted principle that taxes should reflect where an economic activity occurs. But how is that determined? In a globalized economy, products move repeatedly across borders, typically in an unfinished state: a shirt without buttons, a car without a transmission, a wafer without a chip. The transfer price system assumes that we can establish arms-length values for each stage of production, and thereby assess the value added within a country. But we can't.

The growing role of intellectual property and intangibles makes matters even worse, because ownership claims can easily be moved around the world. That's why the United States long ago abandoned using the transfer price system *within* the US, in favor of a formula that attributes companies' *total* profits to each state in proportion to the share of sales, employment, and capital there. We need to move toward such a system at the global level.

How that is actually done, however, makes a great deal of difference. If the formula is based largely on final sales, which occur disproportionately in developed countries, developing countries will be deprived of needed revenues, which will be increasingly missed as fiscal constraints diminish aid flows. Final sales may be appropriate for taxation of digital transactions, but not for manufacturing or other sectors, where it is vital to include employment as well.

Some worry that including employment might exacerbate tax competition, as governments seek to encourage multinationals to create jobs in their jurisdictions. The appropriate response to this concern is to impose a global minimum corporate-income tax. The US and the European Union could – and should – do this on their own. If they did, others would follow, preventing a race in which only the multinationals win.

Since its inception, the OECD/G20 Base Erosion and Profit Shifting Project has made an important contribution to rethinking the taxation of multinationals by advancing understanding of some of the fundamental issues. For example, if there is true value in multinationals, the whole is greater than the sum of the parts. Standard tax principles of simplicity, efficiency, and equity should guide our thinking in allocating the "residual value," as the Independent Commission for the Reform of International Corporate Taxation (of which I am a member) advocates. But these principles are inconsistent either with retaining the transfer price system or with basing taxes primarily on sales.

Politics matters: the multinationals' objective is to gain support for reforms that continue the race to the bottom and maintain opportunities for tax avoidance. Governments in some advanced countries where these companies have significant political influence will support these efforts – even if doing so disadvantages the rest of the country. Other advanced countries, focusing on their own budgets, will simply see this as another opportunity to benefit at the expense of developing countries.

The OECD/G20 initiative refers to its efforts as providing an "Inclusive Framework." Such a framework must be guided by principles, not just politics. If the goal is genuine inclusiveness, the top priority must be the wellbeing of the more than six billion people living in developing countries and emerging markets.

Joseph E. Stiglitz, a Nobel laureate in economics, is University Professor at Columbia University and Chief Economist at the Roosevelt Institute.