Funding the Future

Oxfam know their tax facts: it's Tim Worstall who is pe...

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One of my regular opponents, the thoroughly distasteful Tim Worstall, decided to lay into Oxfam's new report on corporate tax in developing countries on Forbes. His blog was entitled Apparently Oxfam Is Entirely Ignorant Of The Economics Of Taxation. It continues all his usual fantasies, his fundamental argument beingthat if capital is taxed then the return on investment is reduced, and that reduces labour productivity and because everybody in a market is paid a sum exactly equivalent to their marginal productivity then, inevitably, increasing corporate tax in developing countries will have the consequence of reducing real wages, which Worstall presumes is the exact opposite of what Oxfam wants.

I could tear this nonsense to pieces. Perhaps the easiest way to do so would be to quite his own defence of it, which is that 'None of the above is a secret, it’s in all of the textbooks, this really is the basics of the subject'. Those are, of course, the same textbooks that include a theory of money which the Bank of England has had to admit recently is entirely fictitious, and wrong. However, I don't need to partake in an exercise because Claire Godfrey of Oxfam posted the following response on Forbes, which is worth quoting in full it is so good:

Our report showing how developing countries have been marginalised in the process of reforming the rules for taxing multinational enterprises has been well received — unsurprisingly, perhaps, since the evidence of political marginalisation and of lost revenues is fairly clear.

Yet, here we are accused of such a lack of understanding that our suggestions “would actually reduce the wages of the workers in those poor countries”.

Tim Worstall of the Adam Smith Institute argues in his blog, ‘Apparently Oxfam Is Entirely Ignorant Of The Economics Of Taxation’, the following:

1. Taxing corporate income (returns to capital) will discourage investment, so the optimal corporate tax rate is zero;
2. Average wages in a country are determined by average productivity, which in turn depends on the level of capital; and therefore
3. If the rules are changed to allow developing countries to tax corporate income more

effectively, the effect will be to discourage investment and depress (average) wages.

On this basis, Mr Worstall concludes that: "Oxfam is, quite literally, arguing that the wages of the poorest in the world must be reduced."

It should be clear that we are neither literally nor indeed metaphorically making such an argument. Here's why.

First, Mr Worstall's view — on its own, somewhat narrow economic terms — is unlikely to be realistic because it rests on a highly stylised model. The assumptions necessary are heroic, not least in relation to costless adjustment processes. As such, using this as the basis for understanding the likely effects of changes in corporate taxation globally may not give a terribly accurate picture.

As leading conservative economist Greg Mankiw has written, "The theory of optimal taxation has yet to deliver clear guidance on a general system of history-dependent, coordinated labor and capital taxation for a realistically-calibrated economy." Major issues include the difficulties of constructing effective alternatives that generate sufficient revenue and are not deeply regressive. Elsewhere, Mr Worstall has recognised at least some of these complexities of the real world approach to corporate tax — for example, here, where he considers a disagreement between Mankiw and Paul Krugman. In addition, many studies including those from the IMF and McKinsey's have shown that corporate tax rates have little bearing on investment location in developing countries.

Mr Worstall's second point, that productivity depends on capital, is also unrealistic. Tax revenues are vital to the kind of social spending and public infrastructure investments that will raise productivity over time, making countries more attractive for investors — and given relative scarcity, simple economics would suggest higher returns to public spending in lower-income, lower-revenue states (all else being equal). Neither of the foundational statements to support Mr Worstall's conclusion can therefore be supported.

The more important errors in Mr Worstall's criticism, however, are political. The approach taken fails to recognise all of the central features of the current context:

- that nearly all countries still tax corporate income (despite the long-standing theoretical result), suggesting that there may be good reasons to do so;
- that the G8 and G20 have instigated a major action plan to combat the failure of the OECD's rules to align profit with actual economic activity, suggesting that they want to tax corporate income more effectively; and
- that lower-income countries, in general, suffer more this misalignment (that is, their share of total taxable profits declared is disproportionately small compared to their share of economic activity).

Mr Worstall's criticism is to argue that because simple economic theory suggests corporate taxation in general may distort, we should not be concerned with its effectiveness in developing countries. If the power to operate such taxation effectively *has been made a priority for the richest countries, should we not be concerned if developing countries are marginalised from that process, or if the changes made do not reflect their challenges? If developing countries in fact suffer worse under-reporting of taxable profit, does it not make a case for rule changes that reflect this?*

There may one day come a time when the context allows countries to eliminate corporate taxation (in favour, presumably, of much more effective individual income, capital gains and wealth taxation). Until such time, however, poorer countries and their citizens should not be deprived of the power sought by OECD members to tax effectively the profits of multinational enterprises. Not only is this clearly unjust, but it is likely to undermine economic, political and social development progress. To paraphrase Mr Worstall's rather aggressive headline: Oxfam could only support such a position if we were entirely ignorant of the reality of international taxation.

Whatever Worstall argues now he can't and won't win this debate: he is simply wrong. But in that case you have to wonder what his motive is. Might it just be that he really does want to perpetuate a situation where the poor are oppressed, capital is rewarded, and profits moved to tax havens where they are hidden from view and remain beyond the reach of the tax authorities who should have the right to assess them? I leave that to you to decide.