SYMPOSIUM PAPER

Globalisation, taxation and inequality

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Abstract

Today's tax systems, in which value-added taxes and payroll taxes play a prominent role, are largely creations of the 1950s. We need to invent modern tax systems adapted to the reality of the 21st century: the growing importance of capital and the rise of inequality. This article reviews some of the challenges involved with increasing the progressivity of tax systems in a globalized world and discusses how these challenges could be overcome. I make the case for new and more ambitious forms of international cooperation and for modern forms of wealth taxation.

KEYWORDS

Taxation, globalization, tax avoidance, international cooperation, wealth

JEL CLASSIFICATION

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1. INTRODUCTION

Today's tax systems, in which value-added taxes and payroll taxes play a prominent role, are largely creations of the 1950s. The VAT was first experimented with in France in that decade and then spread like wildfire: with a few exceptions, most notably the United States, all the world's countries have a VAT today. Payroll taxes – that is, taxes on wage income – are a bit older but were small until after the Second World War, when they grew dramatically to fund the creation of modern social security systems. Today, the VAT and payroll taxes account for more than half of tax revenues globally.[1]

The choice to rely so heavily on the VAT (a tax on consumption, thus exempting saving) and payroll taxes (which exempt capital income) could be justified in the post-Second-World-War European context. First, capital was scarce after the world wars. There had been massive destruction and wealth was at a historically low level relative to output. In that context, it seemed important to provide incentives to restore the capital stock, for instance by exempting saving from taxation. Second, the labour share of income was relatively high, partly due to relatively powerful labour unions, partly due to regulations that restricted the power of capital. It could make sense in that context to fund the newly created social security systems by primarily taxing wage income, a relatively dynamic tax base. Last, although the potentially unequalising effects of VAT and payroll taxes on the distribution of income and wealth were well understood, they were not a salient concern in a context when inequality was at a low-water mark.[2]

Today's context is very different from the 1950s. First, capital is back. The ratio of private wealth to national income has increased tremendously, from about 200 per cent in the 1950s to 600 per cent today in the US, in Western Europe, in China and in many other economies.[3] In the 1950s, the market value of the wealth of households was the equivalent of around two years of national income in many countries; today, it is the

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[1] Bachas et al., 2022.

[2] See, for example, Piketty (2014).

[3] Piketty and Zucman, 2014; Chancel et al., 2022.

equivalent of six years of national income. Second, the capital share of national income has been rising since the 1970s. Out of any dollar, euro or yuan of value-added made in the corporate sector, a growing fraction goes to the owners of corporations, as opposed to workers. Last and perhaps most importantly, income and wealth inequality has risen globally. The rise has not been uniform – inequality has increased particularly fast in countries such as China, India and the US, less so in Western European countries or Japan – but it is a global phenomenon.

In that context, funding the bulk of public expenditures by taxes that exempt saving and capital, levied at flat rates, is now a serious issue. We need to invent modern tax systems adapted to the reality and to the challenges of the 21st century: the growing importance of capital and the rise of inequality.

There is, however, a widespread view that capital and progressive taxation – which would be the most direct way to address these challenges – are nearly impossible today. It is easy to understand the rationale behind this view: globalisation has exacerbated international tax competition; it has opened new forms of tax avoidance and evasion, making it harder to tax mobile factors of production.

It is worth taking that argument very seriously, and I have done so in my research. A lot of my work has indeed been concerned with quantifying these new forms of avoidance and evasion: the magnitude of offshore household wealth,[4] the rise of corporate profit shifting to tax havens,[5] the growth of the tax-planning industry,[6] and the consequences of these trends for government revenue and inequality.[7]

But it is even more important to understand that, fundamentally, tax competition, tax evasion and tax avoidance are not laws of nature. They are policy choices. As

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[4] Zucman, 2013 and 2015; Alstadsæter, Johnnesen and Zucman, 2018.

[5] Zucman, 2014; Wier and Zucman, 2022; Tørsløv, Wier and Zucman, 2023.

[6] Alstadsæter, Johnnesen and Zucman, 2019; Bustos et al., 2022.

[7] See, for example, Saez and Zucman (2019a) for a synthesis focused on the US.

interconnected nations, as citizens, we can choose to accept them, just like we can choose to regulate and curb them.

Since the 1980s, a certain number of choices have been made that have tended to tolerate – and even sometimes to encourage – international tax competition and tax evasion. These choices have not always been transparently or democratically debated, but they are choices nonetheless, and other choices are possible. The current form of globalisation, characterised by no limit to tax competition and considerable financial opacity, is just one among many other potential institutional arrangements.

The best proof of this is that change has already started to happen over the last decade. Since the second half of the 2010s, new forms of international coordination have emerged, along with serious attempts at limiting international tax evasion.

Two particularly important initiatives deserve to be noted. The first is the creation of an automatic exchange of bank information between offshore financial institutions and foreign tax authorities, which has been in place globally since 2017/18. Until 2018, if a resident of, say, Germany had a bank account in Switzerland, the Swiss bank would not notify the German tax authority except in exceptional cases, making it quite easy for that person to fail to report his or her income and to evade taxes through this Swiss account. Today, it is much harder because Swiss banks are supposed to automatically send the full list of their German clients to the German tax authority each year, their French clients to the French tax authority, and so on.

This is a new form of international coordination that was deemed utopian 10 or 15 years ago. At that time, the notion that there could be an automatic exchange of bank information was viewed with a great deal of scepticism. How could one compel Switzerland or the Cayman Islands to abandon their bank secrecy laws and to cooperate with other countries? If these countries, the argument went, want to have strict bank secrecy rules, surely that is their right and what could other countries do? We can now see clearly that there was a lot that other countries could do. There had long been a choice to let offshore tax havens not cooperate, and other choices are being made today.

The second form of cooperation that has emerged is the international agreement on a minimum corporate income tax, which is known as Pillar 2 of the OECD two-pillar solution to base erosion and profit shifting. In 2021, around 140 countries and territories agreed in principle to tax multinational profits at a minimum rate of 15 per cent. Although the agreement has not yet been ratified by all its signatories, it is important to realise that at least conceptually it is a leap forward, because it is the first time that countries have agreed on a minimum tax *rate*. There have been numerous international agreements that regulate the definition of the tax base, such as how profits ought to be measured and allocated across countries. Until now, however, there was no agreement on tax rates, arguably the most important aspect of tax policy – no restriction to how low tax rates can go. Corporate tax rates of 0 per cent, or income tax rates of 0 per cent on high earners, are perfectly compatible with all international economic agreements, including all EU treaties. The 15 per cent corporate minimum tax is a first and important departure from this (non-)regulation of globalisation. A comprehensive introduction to, and set of perspectives on, the specifics of this global minimum corporate income tax is provided in the special issue of *Fiscal Studies* on that topic (volume 44, issue 1, published in March 2023).

These steps forward must be celebrated, but they are not sufficient. We need to invent new and more ambitious forms of international cooperation, and we need to reform wealth taxation.

2. THE NEED FOR EXTENDED INTERNATIONAL COOPERATION

2.1 The limits of the automatic exchange of bank information

The automatic exchange of bank information is an important achievement, but it also has serious limitations. First, many developing countries do not participate in this system. Second, there is a lack of incentives to report information truthfully. It is a good idea to ask bankers in offshore tax havens to send information to other countries' tax authorities. But it would be a bit naïve to believe that the very same bankers who for decades have been helping their clients evade taxes (in some cases, even by

smuggling diamonds in toothpaste tubes[8]) are now all very truthfully reporting about all the holdings of all their clients. Many of them are surely honest people and abide by the laws, but some of them may not. Third-party reporting of information is a powerful tool to reduce tax evasion domestically because local authorities can audit domestic firms and make sure they comply with their duties. But there is no cross-border audit mechanism, making the effectiveness of international third-party reporting less obvious. We need ways to verify the accuracy of what is reported by offshore banks and to sanction misreporting.

Another issue is that tax authorities do not yet make systematic use of the data collected through that automatic exchange of bank information. This system has now been in place for five years, but when the authorities are asked what fraction of offshore wealth is covered by it, whether tax compliance has improved, or whether the progressivity of the system has increased due to better enforcement, the information they provide is often limited. Many tax authorities do not appear to be using the reports they receive in a systematic manner. Part of the reason might be resource constraints within the tax authorities. Another might be that most countries do not have a wealth tax. Absent a wealth tax, information about the wealth that domestic taxpayers have abroad is not directly relevant for tax enforcement. It is only indirectly relevant because wealth generates income, and so if the wealth is not reported, the income produced is likely also not reported, leading to income tax evasion. Whatever the reason, the real value of the automatic exchange of information will become clearer when the authorities are more transparent about the information they obtain from foreign banks and make more systematic use of it.

2.2 The rising importance of offshore real estate

The automatic exchange of information also has an important loophole: it only covers financial assets and excludes real assets, such as real estate, works of art, yachts, private jets and the like.

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[8] See Zucman (2014).

Recent work with Annette Alstadsæter, Bluebery Planterose and Andreas Økland on the case of Dubai illustrates the importance of this issue.[9] We were able to access data on the ownership of real estate in Dubai, one of the emirates of the United Arab Emirates. This data set covers the universe of all properties in Dubai (about 800,000 in total), including the nationality of their owners. Using these data, we can analyse the size and country distribution of offshore real estate in Dubai (i.e. properties owned by non-residents) and shed light on the tax evasion involved.

Starting with the big-picture numbers, we find that the total value of real estate owned in Dubai by non-residents is large, at around $146 billion in 2019. In comparison, all residential real estate in France owned by non-residents – imagine apartments in Paris or villas on the Riviera – is the same order of magnitude at $140 billion. If one looks at the ownership of real estate in London through shell companies, which are the main way through which wealthy non-residents own real estate in the UK, this is about $66 billion. The sheer size of offshore real estate in Dubai is impressive, given that Dubai is so much smaller than France or London.

Who owns these properties? Proximity and historical ties matter a great deal. The number-one non-resident owners of Dubai real estate are Indian nationals, with about $30 billion. British nationals come next, with $15 billion, and Pakistanis and Saudi Arabians own about $10 billion each. To get a sense of the magnitudes involved, it is worth comparing these numbers with the officially recorded foreign asset positions of these countries. In Pakistan, according to official data, all foreign assets held by the private sector add up to about $10 billion. In other words, the amount held in Dubai real estate by Pakistanis is as large as the officially reported total foreign assets of Pakistan.

Another way to assess the size of these holdings is to scale them by GDP. Real estate holdings in Dubai are equivalent to 12 per cent of GDP for Jordan, around 7 per cent for conflict-ridden countries such as Syria and Afghanistan, and 3–5 per cent of GDP for some very low-income countries such as Sudan and Eritrea. To get a sense of the

[9] Alstadsæter et al., 2022.

inequality involved, one can compare the average value of offshore real estate owned in Dubai by each country and the average income in the country of the owner. For example, the average value of the apartment or villa that Sierra Leoneans own in Dubai is 3,748 times the average income (i.e. GDP per capita) in Sierra Leone. The holding of offshore real estate is a form of wealth that is extremely concentrated at the top of the distribution.

Do these offshore holdings evade taxation? It is typically legal to own foreign assets, including real estate abroad. The tax law of most countries simply requires people to report these holdings and to pay taxes if income is earned from these assets, or if there is a wealth tax. We looked at the case of Norway, a country that has a wealth tax. We were able to match Norwegian taxpayers who own real estate in Dubai to their wealth tax returns, so we could check whether they had properly reported their Dubai holdings. The patterns are revealing. There are 371 Norwegian nationals in our data who own real estate in Dubai, of whom 227 are tax residents in Norway. We found that only 66 (about a quarter) duly reported their Dubai properties on their wealth tax returns. In other words, in about three-quarters of the cases, tax evasion was involved.

To be sure, as one can see from the list of countries with the largest holdings in Dubai, there are obviously many non-tax reasons for owning properties there (and for owning cross-border real estate more generally). But this form of wealth may also increasingly be used to hide wealth and escape taxation – think of Dubai properties as the new Swiss bank accounts. An emerging body of evidence suggests that the automatic exchange of bank information has indeed led some individuals to shift away from offshore financial assets towards offshore real estate.[10] The most direct way to address this concern would be for countries to exchange information on the ownership of real estate, just like they do for financial assets. This would work best if combined with improved reporting on the ownership of shell companies, which are often used as nominal owners for luxury real estate.

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[10] Bomare and Le Guern Herry, 2022.

3. TOWARDS MODERN WEALTH TAXATION

Almost all countries have wealth taxes, but archaic and regressive wealth taxes, which are known as property taxes. These taxes are based on real estate, which is the main form of wealth for the middle class, but they exempt financial assets, the main form of wealth for the rich. Property taxes can be quite large – 1 per cent or more annually – and thus can represent a significant burden for middle-class taxpayers, especially when they do not have a lot of disposable income. Property taxes, however, are trivial for the rich, because as one moves up the distribution of wealth, the share of real estate in assets converges to nearly 0.

How to replace this archaic, regressive form of wealth taxation by modern, progressive wealth taxation is going to be one of the most important tax policy questions in the 21st century.

3.1 From property taxes to net wealth taxes

Starting from existing property taxes, several improvements can be considered. To begin with, countries should include all net wealth – total assets, financial and non-financial, minus debts – in the base, instead of real estate only. One problem with property taxes is that debts are not deducted: someone with a house worth $300,000 and a mortgage of $300,000 (i.e. zero net wealth) pays as much tax as someone with a house worth $300,000 and zero debt (i.e. $300,000 in net wealth). The much bigger problem is that financial assets are also excluded. Including these assets – equities, bonds, stakes in private companies, etc., net of all debts – in the base would address these issues.

Next, governments could introduce graduated rates, instead of flat rates as in current property taxes in most countries (exceptions exist). The rate could be zero below an exemption threshold. For instance, if you have $300,000 or less in net worth, you pay zero tax – effectively a big tax cut for middle-class households who today pay the property tax. In the wealth tax proposals formulated in the US by Senators Bernie Sanders and Elizabeth Warren in 2019, the exemption threshold was very high – $32

million and $50 million respectively – and the rates increased to up to 8 per cent for net wealth above $10 billion.[11]

3.2 Lessons from the historical experience with wealth taxation

Policymakers also need to learn from the mistakes of past net wealth taxes.[12] Many countries, especially in Europe, have experimented with wealth taxation. In 1985, according to statistics collected by the Organisation for Economic Cooperation and Development,[13] 11 European countries had such a wealth tax, including Germany, France, Spain, Sweden and Denmark. In most cases, these were old taxes, first created in the late 19th and early 20th centuries. They applied above an exemption threshold often located around the 90th to 99th percentile of the wealth distribution, though some were broader (e.g., on the top 25 per cent in Switzerland). Rates typically ranged from about 0.5–1 per cent above the exemption threshold to about 2–3 per cent for the largest fortunes.

These taxes had critical flaws. They were not based on pre-populated returns like the income tax, but on self-reported information, greatly facilitating tax evasion. In some cases, taxpayers were not even required to provide a detailed breakdown of their assets, just a total number for their self-assessed wealth.[14] With modern technology, tax authorities have a lot of information at their disposal about not only the income that people earn, but also the assets that they own (including in foreign banks). All that information could be collected at low cost to fill out pre-populated wealth tax returns, dramatically reducing the scope for tax evasion.

Another flaw of past net wealth taxes is that they had major exemptions. In practice, a large fraction of the wealth of taxable individuals was legally exempt or taxed at only a

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[11] See Saez and Zucman (2019b) for a discussion of these proposals.

[12] Saez and Zucman (2022).

[13] OECD, 2018.

[14] Garbinti et al., 2023.

fraction of its market value. This was the case for equity in private businesses (a key source of wealth at the top of the wealth distribution) and for equity in primary homes (typically the main source of wealth just above the exemption threshold). Moreover, most countries had ceiling mechanisms whereby the amount of wealth tax owed could not exceed a fraction of taxable income.[15] These issues could be addressed by taxing all net wealth at its market value, in excess of a high exemption threshold above which it is very likely that the affected taxpayers have a high ability to pay and do not need any relief.

The last issue is that policymakers did not attempt to address tax competition. There is a widespread view that property taxes are vastly superior to wealth taxes because real estate is immobile (you cannot move houses to other countries), while financial assets are highly elastic: their owners can move abroad. However, elasticities are not immutable parameters: they are affected by tax design. With proper tax design, elasticities can be reduced, possibly to very low levels – just like they can be increased, possibly to very high levels, when policymakers introduce loopholes, reduce enforcement, destroy information or let tax competition fester.

The countries that used to have wealth taxes did not tax their expatriates. In that context, it was child's play to avoid the tax, simply by moving to a low-tax territory. But other choices can be made. For example, countries could keep taxing rich people who have been long-term resident for some years after they move. If you spent, say, 50 years in France and built a huge fortune there, France could keep taxing you for 10 or 15 years after you left, with tax credits to offset any taxes paid in your new country. The logic is straightforward: if someone became extremely wealthy in France, that is in part because they benefited from the public goods provided by France, from access to its markets, from its workers, doctors, teachers and infrastructure. The forces of tax competition can be tamed by unilateral action.

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[15] See Jakobsen et al. (2020) for a description of these rules in the Danish context.

International agreements, eventually, are preferable to unilateral action. Just like countries agreed on a 15 per cent minimum tax for multinational profits, so too could they agree on a minimum wealth tax for global billionaires or centi-millionaires. Multinational companies, like very wealthy individuals, are the economic actors who have most benefited from globalisation, and yet have seen their taxes also fall the most over the last decades.[16] Globalisation is unlikely to be sustainable if it means ever-lower taxes for its main winners, and ever-higher taxes for the 'immobile' factors who have benefited relatively little from it.

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