

Debt and international taxation in the post-COVID cooperation agenda

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The winds of change do not seem to be blowing in the direction of international development aid. After more than 60 years, there is an increasing debate surrounding the international aid system and scrutiny regarding its ability to transform the lives of people in developing countries. This debate is joined by a growing number of voices from the Global South that speak of the need to “decolonise” it. Regardless of these debates, there seems to be a strong consensus on the need to move forward and define policies that go beyond international aid to support developing countries. Among all such policies—international trade rules, migration and security policies, etc.—, two of them deserve special attention: international taxation and the treatment and management of public debt. Following the devastating economic onslaught of COVID-19, an appropriate approach in both areas would allow developing countries to have more resources at their disposal and face a faster and, above all, more inclusive recovery with stronger safeguards.

A debt that already haunted developing countries before the pandemic

Before the outbreak of COVID-19, the situation was already worrying: public debt levels in developing countries had been worsening for years, their financing costs were becoming increasingly expensive and the percentage of countries vulnerable to a debt crisis was already high and rising. By the end of 2019, just three months before the global pandemic was declared, half of all low-income countries were reaching a point where they could no longer meet their debt payments [1].

Another notable factor is that the origin of these debts had been shifting, with debts owed to private creditors becoming increasingly important, as opposed to traditional countries and international financial institutions. In addition to private financial institutions of all kinds—from investment funds to well-known global banks—other non-traditional lending states, such as China, had also been providing access to large sums of money to developing countries for years. This new reality was jeopardising—and undermining the effectiveness and legitimacy of—the (imperfect) mechanisms and spaces for concerted action to resolve possible problems that might arise on this issue, such as the Paris Club. While in 2008, 15 per cent of African countries' external debt was contracted with the member countries of this Club, in 2017 it accounted for barely 7 per cent [2].

Before COVID-19, the situation was already worrying in terms of public debt, financing and vulnerability to a debt crisis

Between 2010 and 2019, debt service (the payment to be made by a country that has acquired one or more debts for a particular period) as a percentage of the least developed countries' own income rose from 7.4% to 20.7% on average. In other words, in 2019, these countries were spending one out of every five euros of their public revenue (apart from official development aid) on debt repayments, limiting the financing of other public policies such as health or education [3].

And COVID-19 came along

Although the relative health impact has so far been minor, developing countries have been particularly hard hit by the economic crisis resulting from the COVID-19 pandemic [4]. According to recent World Bank estimates, the number of people living in poverty (living on less than \$1.90 a day) soared in 2020, increasing by 77 million to 732 million people worldwide. For the first time, after 20 years of a sustained reduction in extreme poverty, this trend is reversing. To get an idea of the magnitude of this impact, it is as if the populations of two entire countries such as Thailand and Paraguay are now living in a situation of extreme poverty and vulnerability [5]. Global hunger also increased dramatically. The UN estimates that approximately 10% of the world's population, up to

811 million people, were malnourished by the end of 2020, an increase of 161 million individuals [6]

. As of today, hunger caused by the combination of COVID-19, conflict situations and the climate crisis could be killing more people in the world than the virus itself [7].

In stark contrast to what is happening in more advanced countries, where economic recovery appears to be well underway, the least developed countries will need, on average, at least three more years to recover the GDP per capita levels they had seen in 2019 [8]. The hoarding of vaccines and the greater room for manoeuvre for monetary and fiscal policies to cushion the impact and stimulate the economy are crucial elements in explaining the different recovery speeds from this crisis, in which developing countries are lagging.

Beyond the devastating impact on poverty and hunger, COVID-19 has precipitated a fiscal crisis in many of these countries. The fall in GDP (slowdown in trade, capital outflows and loss of investment), and the necessary increase in public spending to deal with the health, social and economic emergency, have further escalated public debt levels that in many cases were already at worrying levels. Put simply, it's just one thing on top of another. According to EURODAD, between 2010 and 2020 public debt in developing countries rose from 40.2% to 62.3% of GDP. Of this increase, more than a third (8.3 percentage points or about \$1.9 trillion) occurred in 2020 [9]. Public debt increased in 108 developing countries, with the most significant increases observed in those countries with the highest levels of debt prior to the pandemic [10].

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These levels of indebtedness may seem small compared to those of rich countries, which increased their debt levels dramatically to cope with the global financial crisis (for example, Spain's debt exceeds 120% of GDP). This is even the case if we compare them with the levels of the developing countries that benefited from the various international debt relief initiatives that were deployed at the beginning of the century. However, it should be remembered that sovereign debt crises do not only arise because of the relative levels of indebtedness; other elements must also be taken into account, such as the cost of financing, the capacity of countries to generate domestic resources through taxation in order to pay off the debt and even the timetable of returns. Organisations such as the International Monetary Fund and the World Bank have recently pointed out the fragility of an international financial system that could barely withstand a wave of countries defaulting on their debt repayments, thus jeopardising global economic recovery after the pandemic [11].

A rapid response, but as usual, an insufficient one

Unlike during the 2008 financial crisis, the international response to this situation has been much more responsive. However, as was the case then, the proposed measures are not sufficient, and amount to a 'kick forward', ignoring a problem that is becoming structural as it grows bigger and bigger. Indeed, despite the international response, in 2020 developing countries surrendered nearly \$194 billion in debt repayments. At least 58 countries paid back more than they received [12].

Following the initiative of the World Bank and the International Monetary Fund, the G20 countries agreed in May 2020 (just two months after the declaration of the global pandemic) to implement the Debt Service Suspension Initiative (DSSI), allowing some 73 low- and lower-middle-income countries to stop paying their bilateral debts to other governments until the end of 2021 [13]. In principle, this measure should have allowed these countries to allocate resources to the most affected sectors, but it has hardly brought any meaningful relief. This initiative has made it possible to suspend the payment of \$5.3 billion, 1.4 per cent of what they ultimately paid to their international creditors (some \$372 billion) [14]. It is also worth remembering that the Debt Service Suspension Initiative does not imply any cancellation, but rather a postponement of debt repayment.

Beyond 2021, the response of the G20 and the other countries that make up the Paris Club and the IMF has been the creation of another initiative known as the Common Framework for Debt Treatment Beyond DSSI in November 2020 [15]. This is again a step in a new direction as it includes countries such as China (and others such as India, Turkey and Saudi Arabia), hitherto outsiders to any concerted process of sovereign debt renegotiation, despite handling more and more of these countries' debt.

However, the Common Framework for debt treatment has proved insufficient for two main reasons. Firstly, middle-income states are not eligible for this mechanism, even though many of these countries are among the most affected. Secondly, private creditors have been left out of this initiative. Debtor countries that sign up to the programme must also bring their private creditors to the table and, as we know from previous experiences (such as that of Argentina), these types of creditors are hardly keen on forgiving debts. In other words, their profit and loss account is far in excess of their health needs.

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If we add to these shortcomings the lack of clarity as to whether this is indeed a mechanism for debt cancellation or a project that merely restructures debt by delaying repayment dates, we can better understand the scepticism of developing countries to embrace this

initiative. Faced with uncertain benefits and a reputational cost in the markets that is too high, these countries do not have a positive perception of the proposal.

The solution to the debt crisis that threatens the future of developing countries lies in the establishment of a permanent, UN-sponsored and more transparent multilateral framework that recognises common and binding principles for both debtor countries and creditor countries and institutions. The latter must also assume part of the risk of their operations. Furthermore, any analysis of debt sustainability, and thus of the measures to be taken, must consider its impact in terms of human rights.

An outdated international corporate tax system

To this difficult debt situation must be added another closely related issue. This is the persistent inability of developing countries' governments to increase their tax revenues. Unlike rich countries, high economic informality and weak tax collection agencies, coupled with low social acceptance, constrain the ability of developing countries to raise tax revenues. Moreover, these same weaknesses are responsible for the greater dependence of tax collection on corporate profits. Of the total revenue raised in 2018, corporate income tax accounted for 16% and 19% in Latin American and African countries, respectively, while for OECD countries it accounted for 10% [16].

However, this source of revenue is severely constrained by an outdated and ill-adapted international tax system, which makes it easier for multinational companies to avoid (and minimise) their tax obligations. Various estimates suggest that the amount of tax revenue lost globally is as high as \$600 billion. In the case of low-income countries, this amount exceeds \$200 billion (1.3% of their GDP) [17]. Beyond the resources lost to offshore tax havens, the current rules that determine where these large corporations must pay their taxes penalise the poorest countries. Currently, multinationals are taxed in the countries where they are headquartered, which tend to be wealthy countries. The Tax Justice Network estimates that if companies paid taxes in the countries where their businesses and employees are based, lower-income countries would collect up to 5% more, while rich countries would lose just 1% [18].

Thirsty for resources, the governments of the rich G20 countries—which have also seen their tax bills increase—resumed negotiations to finalise a long-awaited and urgent reform that lays the groundwork for how to tax the international profits of large corporations in an increasingly digitalised economy. Pending ratification by the end of October this year, this agreement aims to specify how much and where large multinational companies must pay their taxes, determining for the first time a global minimum that they must contribute.

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In short, the new tax model proposed by the G20 would for the first time set a global minimum tax rate for multinationals, thus curbing the predatory practices of tax havens and harmful tax competition. However, the design of the agreement will reproduce the same inequalities between rich countries—where the headquarters of large corporations are located—and developing countries, providing very little additional resources for the least advanced economies.

Due to years of political impassivity, the bill for these tax abuses by big business has ultimately been paid by the citizens. Social indignation has been growing as it has become public knowledge that large corporations are multiplying their profits (even during the pandemic) while at the same time obscenely reducing the taxes they pay on them. Indeed, these political decisions have affected the ability of many countries to deal with the COVID-19 pandemic.

An unambitious and unfair reform proposal

Despite being trumpeted as the ultimate long-term solution to these problems in the international tax system, the G20 agreement, as it stands, is a perverse gamble for developing countries, as it places them in a false dilemma: support an agreement that is unfair to them or give free rein to the most unconscionable tax avoidance.

The agreement reached is unfair and unambitious for two reasons. The first has to do with the proposed minimum effective rate 'of 15%'. This is a far cry from the 21% that President Biden wants to apply in the United States, and below the 25% recommended by economists such as Joseph Stiglitz and Thomas Piketty [19]. In essence, it is a concession that only brings us closer to the levels of well-known tax havens such as Ireland and Singapore. It is better than nothing, no doubt, but the bar is set so low that it is unlikely to achieve the expected effect of putting an end to tax competition. It will surely put a strain on the most aggressive tax havens, but it will be to the benefit of the richest countries. It is a measure designed to be enforceable by the country of the parent company. Therefore, according to some estimates, two thirds of the additional revenue will go to G7 and EU countries, while the poorest countries will get barely 3% of the total, despite representing 36% of the world's population [20]. We are merely perpetuating decades of injustice in the international tax system, while certain European countries continue to behave as tax termites in the global system [21].

The second problem relates to the agreed way of distributing taxes on the global profits of large companies that, despite making large profits, have no presence for tax purposes. The idea is to redistribute part of these global profits to the other countries in which the company has a presence. However, the thresholds are so high that it will only affect around 100 companies, those with a turnover of more than €20 billion and a profitability of more than 10%. So few companies meet these thresholds that even digital behemoths such as Amazon could be left out. Moreover, the countries in which the multinationals are actually making their sales and profits will only share a minimal part of the global profits, which is less than 5% [22].

There are also problematic details that have yet to be finalised, for it is well known that the devil is in the details. It appears that the financial sector, for example, will be left out of the agreement, no doubt due to pressure from Britain and others. Their exclusion will mean cutting overall tax revenues by half [23].

The agreement reached is unfair and unambitious: the proposed minimum effective rate of 15% is a far cry from the 21% that Biden wants to apply in the United States, and below the 25% recommended by economists such as Joseph Stiglitz and Thomas Piketty

The agreement is not yet signed, but if we are serious about creating a truly level fiscal playing field that will curb the excesses of big business and generate substantial additional revenue for all, especially for developing countries, the current details of the agreement must be changed.

Among the most important of these, is that we must consider a higher minimum rate of 25%. This is the only way to ensure that there is no return to the crazed competition between countries to attract investment, much of which is phantom investment, at the cost of many millions of lost dollars. On the other hand, we must guarantee that the benefits are shared in a balanced way with developing countries and that large companies, which have profited from the digitalisation of the economy, cannot escape this agreement.

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