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COMMENTARY

POLITICAL AND SOCIAL ASPECTS OF INTERNATIONAL TAX POLICY IN THE NEW MILLENNIUM

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I. INTRODUCTION

The papers by Vito Tanzi[1] and Jack Mintz[2] come to a remarkably similar conclusion. Namely, that deepening globalization and associated technological and institutional developments are creating conditions which may reduce the ability of governments in industrialized countries to sustain high levels of taxation. Tanzi goes on to identify specific elements which may generate revenue falls and measures that might neutralize or reduce the impact of these trends. Mintz goes on to argue that this challenge may create incentives for governments to spend and tax smarter over time with a more efficient use of public resources as a possible outcome. He seems to favor smaller government and sees globalization as a possible force leading to that end. Tanzi, in contrast, seems to be neutral as to the issue of the level of government, but suggests that government may have reached a high water mark on the revenue side.

My comments will focus on two aspects of the issues that

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1. Vito Tanzi, *Globalization, Technological Developments and the Work of the Fiscal Termites*, 26 BROOK. J. INT'L L. 1261 (2001).

2. Jack M. Mintz, *National Tax Policy and Global Competition*, 26 BROOK. J. INT'L L. 1285 (2001).

are raised by these papers. First, I will make an argument that globalization and related technological and institutional developments are not likely to be the key determinants of tax policy. I will suggest that political will, in the context of specific political cultures in various countries, will be the determinative factor in the responses to these challenges. Second, I observe that if one looks at the composition of the revenues being raised today and, even more importantly, which will need to be raised in the future, the key issue relates to employment taxes that sustain social programs. From this, I will argue that the social aspects of international tax policy are likely to be one of the most important developments in the new millenium and that far greater attention needs to be paid to the issues that are raised for tax policy by established patterns of social expenditures.

II. GLOBALIZATION AND RELATED TECHNOLOGICAL AND INSTITUTIONAL DEVELOPMENTS

Globalization and related technological developments appear to be creating significant economic growth and considerably more information on the activities of businesses and individuals. Thus, the challenge for governments is to understand what is going on and to use the new technology to develop better tax policies and to administer them better. In principle, it is as plausible to argue that governments, by relying on the greater information available and improved computer systems, should be able to devise better systems for imposing and collecting taxes and should do even better than in the past. To use a metaphor, there is a fatter sheep with longer hair to be shorn with sharper shears. Whether this will happen depends, of course, on the political will of governments to create modern tax laws and administrations that are efficient and up to date in their revenue collection techniques.

An example of how globalization and the new technology can be used relates to the taxation of foreign income, and is a subject that will be addressed extensively in this symposium. Accounting conventions are becoming increasingly harmonized worldwide for multi-national corporations. Taxation often follows accounting and it would be relatively straightforward for a country like the United States to require a reporting of all foreign income with foreign taxes allowed as a deduction. Financial accounting statements—where there are countervailing forces, such as the professional and ethical requirements on the major accounting firms and the preparers of returns and the need to give shareholders, creditors, and others accurate information—would ensure the integrity of this starting point for this approach. Some adjustments might be made for tax purposes and then a simple flat tax could be imposed on this foreign income. A tax at a level of five percent of net foreign income, for example, would not seem to be excessive and would be difficult for a taxpayer to avoid. Such an approach based on tracking current financial accounting developments, rather than trying to track the results of historic transactions such as presently exists in the U.S. taxation regime for foreign income, would make possible great improvements in collection and unburden tax administrations and taxpayers from the extraordinary complexity of the current approach.[3]

I must admit that governments thus far generally have not demonstrated a great deal of skill in using the new technologies and in working smarter and more efficiently. In particular, the new information and possibilities created by new technology have not led to either better tax policies or better administration in most places. The United States is an example of a country that has seen repeated failures in its attempt to use technology to modernize its tax system. Further, because of the increasing complexity and policy difficulties of its system, its revenue administration has manifested enough problems that an unprecedented reorganization took place to place it under a private board. Whether, out of this storm on the administrative side, there eventually will be a rainbow of better administrative machinery and policy is not at all clear at this point. I dare say we could find examples of the same kinds of difficulties being experienced in many other countries.

What then would be the impetus for governments to get smarter about using the new technology and information it produces to improve tax policy and administration? Obviously, if politicians need to raise revenue to satisfy public demands, the resources and required changes probably will be provided

3. *See* Stanford G. Ross, *U.S. International Tax Policy: Where Are We? Where Should We Be Going?*, 47 TAX NOTES 331 (1990). *See also* Stanford G. Ross, *International Taxation: A 20-Year View*, 57 TAX NOTES 945 (1992).

to improve tax policy and collection. In this regard, I would point out that most of the Organization of Economic Cooperation and Development (OECD) countries have large social benefit programs which are solidly entrenched and which have wide popular support. In order to sustain these programs governments inevitably will be required to improve their tax systems, particularly their collection machinery. Moreover, much of the developing world appears to be emulating the OECD in this respect. Thus, I will identify some new issues relating to the social aspects of international tax policy that present some of the most important new developments that need to be addressed.

III. EMPLOYMENT TAXES THAT SUSTAIN SOCIAL PROGRAMS

By far, the major change in national tax systems in OECD countries since World War II is the increased amounts of payroll or employment taxes, often denominated as social security taxes. For example, in the United States, social security taxes as a percentage of GDP in 1999 were 7.4% as compared with 12% for personal income taxes; the only category of taxation larger. As late as 1965, social security taxes were only about 3% of GDP and following World War II they were in the 1% range.

It is important to understand that the United States is not unique in having its tax system become increasingly reliant on employment taxes. It is true throughout the OECD and, indeed, the United States, with 24% of total revenues for employment taxes is on the lower end. Thus, over 40% of total tax revenues in France and Germany are from employment taxes, 33% and 37% in Italy and Japan, respectively. Canada at 15% and the U.K. at 17% are somewhat below the United States, but in both of these cases they have social benefit regimes which draw heavily on general revenues produced by income or excise taxation.

Moreover, this rapid historic growth in employment taxes only tells a part of the story. In almost every country in the OECD promised benefits are such that the implied revenue yields to finance these social benefit schemes will be multiples of the present ones. In the United States, for example, forecasts show they roughly will double from 6.5% of GDP presently, to about 12% of GDP fifty to seventy-five years from now.[4] If the needed revenues were in fact to be raised solely from increased employment taxes, which seems unlikely because of the effects on labor supply and competitiveness, they likely would far overshadow income and excise tax collections. The more likely solution is that the programs would be financed only partially by an increase in employment taxes and the remainder financed from general revenues. But whatever way the problem of financing social benefits is solved, these issues will have a huge impact on tax policy in the new millenium, both nationally and internationally.

It widely has been observed that the chief fiscal problem for the OECD countries in the coming years will be coming to grips with pension obligations under public social security schemes. There also are huge obligations under health care schemes. To ignore the impact of these trends and projections is to miss a great deal of what must be addressed by tax policy in the coming years. Tax policy analysts and tax experts are generally lagging in their analysis of these new employment tax trends. For example, one still sees literature talking about the regressive nature of payroll taxes and the burden on competitiveness of payroll taxes that raise the cost of labor. These analyses neglect the expenditure side of the situation. For example, in the United States, if one looks at the expenditures from the Social Security and Medicare systems, it is likely that the employment taxes are mildly progressive in that there is some redistribution from higher income earners to lower income earners on the benefit side. Thus, while it is not well understood because the payroll tax is a flat tax and the benefit formulas are complex and not transparent, the Social Security system provides for larger returns for the same contribution to lower earners, particularly on an after-tax basis.[5]

In terms of the financing shortfall in the United States, a recent analysis shows that increasing payroll taxes at this time, to pre-fund some or all of the projected Social Security shortfall, would have a progressive effect.[6] Also, there are

4. *See* A Summary of the 2000 Annual Reports of the Social Security and Medicare Boards of Trustees (Mar. 2001, Washington, D.C.), *at* http://www.ssa.gov/OACT/TRSUM/trsummary.html.

5. *See generally* SOCIAL SECURITY IN THE 21ST CENTURY (Eric R. Kingson & James H. Schulz eds., 1997).

6. *See* Lawrence H. Thompson, *Sharing the Pain of Social Security and*

many proposals in the United States to use general revenue from the anticipated surpluses in the non-Social Security budget to offset the Social Security shortfall. Analysis of the expenditure side of the Social Security system would need to be done to see what sort of distributional effects this would have. If the shortfall is financed with general revenues, it likely would be even more progressive than with payroll taxes. My point here is simply to indicate that a greater understanding of how social benefit schemes work is vital to tax policy analysis in the new millenium.

Many analysts who write about the effects of globalization are predicting "a race to the bottom" on social benefits—in the sense that they think that the power of globalization will require states to lower costs on labor so that countries like Germany, for example, can better compete with countries such as China. This, however, greatly oversimplifies a highly contested set of complex issues. Many of the countries which do have heavy employment taxes and large social benefit schemes, while doing some retrenching—and undoubtedly there will be pressure to do more in the future—will not at some point be able to do that to any significant degree and will have to find other ways to deal with the pressures of globalization than cutting social infrastructure.[7] France and Germany, with relatively modest proposed retrenchments, already have had governments toppled. The recent upheavals in Western Europe from increased prices for fuel would be nothing like the massive upheavals that would come from any attempt to seriously change the high levels of social support from benefit schemes to which people have contributed for ten, twenty, thirty or more years. Thus, a major issue that needs to be addressed by tax policy is what level and what types of taxation will be consistent with the social expenditures that particular countries must necessarily maintain from a cultural and political standpoint.

Not only is tax policy going to be affected in major ways by the financing of social benefit schemes, but tax administration

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Medicare Reform (Urban Institute Retirement Project Brief series, No. 11, 2000), *available at* http://www.urban.org/retirement/briefs/11/brief11.pdf (last visited Feb. 18, 2001).

7. *See* Stanford G. Ross, *Doctrine and Practice in Social Security Pension Reform*, 53 INT'L SOC. SECURITY REV. 3 (2000).

will also. Some countries collect payroll taxes and income taxes with the same unified mechanism, such as the United States, the U.K., and Canada. Many countries in the OECD, such as Germany, France and Italy, have dual or separate collection systems in which social contributions are collected by social insurance agencies and income taxes by a tax administration. At first it may seem that there are two major ways to handle tax administration: either unified or dual collection systems. But, in fact, this is only a surface observation. In places where a high level of compliance is obtained, such as Germany, there is close coordination between the collection of the contributions and taxes, with a sharing of identification numbers, cross-matching of data, and common techniques for enforcement. The same underlying factors that are inherent in a unified collection system are present under a dual collection system. Sweden is interesting because it ran a very efficient dual collection system, but converted to a unified collection system to get the inherent cost savings of having one agency and a single process for collecting social contributions and income taxes.[8]

This issue of how to collect social contributions and income taxes is a major issue of tax administration in almost every country outside the OECD, and even within some of the countries within the OECD that are less proficient at collection. In Central and Eastern Europe, Russia and the other countries in the former Soviet Union, there generally are dual collection systems. In some places, emphasis has been placed on modernization of the tax collection system. In other places, on modernization of the social insurance collection system. What is often lacking is an overall view of the collection problem. This would indicate that for any collection system to work in the modern world, there must be a government-wide approach with all agencies involved sharing identification numbers, computer processes, common enforcement tools, and using a great deal of cross-matching data.[9] Technology is rapidly mak-

8. International Social Security Association, *See Interactions of Social Security and Tax Systems* (1997), *at* http://www.issa.net.

9. *See* Stanford G. Ross, *Building Pension Institutions: Administrative Issues*, *in* THE THIRD APEC REGIONAL FORUM ON PENSION FUND REFORM 120 (2000). *See also* Warren R. McGillivray, *Contribution Evasion: Implications for Social Security Pension Schemes*, *in* THE THIRD APEC REGIONAL FORUM ON PENSION FUND REFORM 37 (2000).

ing it possible to increase the efficiency of tax collection provided that collection schemes are well designed. In this regard, the United States, the U.K., Canada, and Sweden, which have unified systems, may well be the model that develops more universally in the future as governments are forced to act smarter to satisfy public demands.

These problems of tax policy and administration are not confined to Europe. Thus, in Asia, for example, countries such as Thailand and Korea have adopted social security systems that are similar to those in the United States and Europe. Japan, which runs a dual collection system, is experiencing problems and acknowledges its need to change. China is moving in this area, as well as India, Indonesia, and others.

In Latin America, Brazil, the largest country, is an example of a dual collection system, neither part of which works adequately to produce necessary revenues. The Brazilian pension system runs great deficits, at least in part because of the inability to collect sufficient payroll contributions, and the Brazilian income tax collection system also is lacking in efficiency. Argentina, Chile, Venezuela, as well as less developed economies in Latin America, all must face up to these issues of modernizing tax policy and collection administration based on paying for the social expenditures that are expected in those countries.[10]

Another dimension of the social aspect of tax policy in the new millenium concerns international accommodations. Many workers will work in more than one country. Within the European Community (EC), there are rules so that a worker working in any one country will be able to receive a pension based on his or her work in other countries. Outside a regional grouping like the EC, the accommodations essentially are made through internal rules or so-called bilateral totalization agreements. Thus, totalization agreements generally provide an exemption for short-term workers and a totalized social benefit for long-term workers. Totalization agreements, however, are not adequate to deal with the massive migration of people that is manifest in today's world and likely only will increase as globalization deepens. A great deal of work needs to

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10. *See generally* ASIAN DEVELOPMENT BANK, PRIVATIZING PENSION REFORM: A CRITICAL ASSESSMENT OF THE POLICY AGENDA (1998).

be done to address the international aspects of employment taxes in the context of related social benefit programs.[11]

The United States has moved reasonably and has totalization agreements with most of its major trading partners. In contrast, Japan at this point only has one agreement. However, Japan generally provides unilateral relief by not taxing workers from foreign countries, so as to avoid at least building up benefit claims. However, workers who are not covered under their home country's schemes while they are abroad are not protected adequately. This is an area that deserves increasing attention and hopefully, in the years ahead, governments will do more to mesh social benefit schemes and the employment taxes that support them.

IV. CONCLUSION

In conclusion, my aim here is to try to put on the agenda for tax policy in the next millenium a need to look at the expenditure side of taxes that are earmarked for social programs or which generally are used to support social programs. Social programs are as inherently difficult to change as tax systems and are highly dependent on tax systems to raise the revenues that are expended. Thus, they present many of the most difficult issues of public policy. Tax policy analysis that looks only to the revenue side and neglects the expenditure side of taxes is far too narrow to address the major issues that will need attention in the new millenium. Sound fiscal policy requires a comprehensive view of revenues and expenditures. Indeed, the liveliest issues may be those of employment taxes; how far they can be pushed and to what extent other sources of revenue such as income or excise taxes will be earmarked or otherwise dedicated to supporting social benefit schemes because of the weaknesses or difficulties of relying entirely on employment taxes.

Finally, let me suggest at least part of the reason for the historic neglect of the social aspects of tax policy. In most countries, the administering agencies for social programs are largely separated from treasury departments and tax administrations. Even the collection personnel in social insurance institu-

11. *See* David Williams, *Chapter 11 Social Security Taxation, in* TAX LAW DESIGN AND DRAFTING 340 (Victor Thuronyi ed., 1996).

tions may have little contact with tax administration personnel. Thus, issues that need attention often are not raised because there is no one to raise them. Some international organizations, such as the Fiscal Affairs Division of the International Monetary Fund, often do a good job of addressing these issues. However, their technical advice is largely provided only upon request and many countries do not know enough even to request that help.

In contrast, the World Bank largely has concentrated on the social expenditure side and has done relatively little on the taxation side. A clearer recognition of the importance of the revenue side of social expenditure schemes, and the need for tax modernization and improvements in tax policy in the World Bank programs, could be very helpful to the developing world.

In short, there essentially are separate institutional spheres involved in taxation and social programs—two cultures, if you will—that must be united if tax policy in the new millenium is to be efficacious from the standpoint of supporting social expenditures.