GLOBAL CORPORATE TAX CHANGE AND THE IMPACT ON SOUTHERN AFRICA: ADVANCING PLURALIST THINKING IN ECONOMICS

Summary

Corporate tax systems of developing countries can potentially be contributors or impediments to their economic development. This is especially relevant for Southern Africa and, as such, the Southern African Development Community (SADC) has a set agenda regarding regional integration goals, and where the guiding principle is tax harmonisation that benefits all members through tax reform efforts. An understanding of the main determinants of corporate tax (CT) rates, whether internal public needs or external competitive pressure, becomes pertinent. A recent announcement of a global minimum corporate tax rate of 15 per cent holds promise in reducing harmful tax competition and profit shifting and therefore sustainable revenue for all governments concerned.

1 Personal research focus

My research career has mainly focused on macroeconomics with econometric application in public and mineral economics in Africa. In an article, my post-doctoral research focused on the determinants of CT rates in Southern Africa[1]. Recent focus has shifted to the empirical impact of reduced or lowered tax rates on foreign direct investment (FDI) and ultimately economic growth. It is fortunate that my research supervision has mainly focused on the macroeconomic impact of government expenditure, taxation and debt in South Africa and other African countries. This has culminated in work on the SADC, and from this, also work on one of my old favourites, namely behavioural economics of taxation. Whilst at Unisa, I have had the opportunity to also finish a Master of Education (MEd) in Open Distance Learning with a certificate as part of the MEd from the University of Maryland, USA. This has led to interdisciplinary research in open distance e-learning, investigating the cross-sectional success, satisfaction and belonging of economics students. My past has combined with the present gift of tuition. In this tuition journey, pluralism relates to students' ability

[1] Southern Africa is mainly represented by the 16 member countries of the SADC or the Southern African Development Community, namely: Angola; Botswana; Comoros, Democratic Republic of the Congo (DRC), Lesotho, Malawi, Madagascar, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Eswatini, Tanzania, Zambia and Zimbabwe.

to "think for themselves" and "reflective judgement" should be a crucial learning outcome (Garnett, 2009). "A critical thinking view should be followed in which the aim is to cultivate students' ability to reach reasoned conclusions in the face of analytical, empirical or normative uncertainties" (Freeman, 2009; Dow, 2009; Peterson & McGoldrick, 2009 for various arguments regarding pluralism in Economics education). Within this pluralist milieu, I will try to find answers to specific questions, and explain the changing tax landscape globally and the economic implications for Southern Africa. This will include my past, present but also future research work. The first section of this lecture will investigate the background and reasons for lower corporate tax rates, the second will focus on whether theoretical models explain tax burdens, the third will analyse the data, and the fourth will focus on empirical research on reduced CT rates, and lastly, future research.

2 Background and reasons for lower corporate tax rates

During the 1980s, tax competition was triggered by several industrialised countries' tax policies and reform efforts. Major changes were first introduced in June 1981 in the early years of the Reagan administration under the Economic Recovery Tax Act. Besides significant tax reductions, more importantly, a new accelerated depreciation system (the accelerated cost recovery system or ACRS) and an investment tax credit (ITC) were introduced. This combination provided tax benefits which, in real present value terms, were roughly equivalent to expensing (immediate write-off of investment) at the inflation rates prevailing in 1981. This was more than generous to compensate for the erosion of depreciation allowances caused by inflation. Economic activity and tax collections did not rise sufficiently to offset tax cuts and large budget deficits developed. Investment increased as expected and the US immediately became a capital importer, although public and private savings simultaneously decreased. This gap could only be filled by the inflow of foreign capital. A combination of tight monetary policy and loose fiscal policy created high-interest rates which, together with investment incentives, attracted capital. The dollar also appreciated. In this sense, the US followed a beggar-thy-neighbour policy by providing huge investment incentives to their industry through the ACRS. The 1981 tax policies worsened the short-run competitive position of the US instead of improving it and the fiscal expansion significantly overvalued the dollar.

Besides the tax reform efforts in the US, 18 out of the 24 member countries of the OECD reduced their key central government corporate tax rates between 1986 and 1990. The average CT rate among OECD countries dropped after 1995 to an overall 34,8 per cent in 1999. Between 2000 and 2020, the average CT rate dropped ranging from 9 per cent in Hungary to 30 per cent in Portugal and France. In 2019, the average top personal income tax (PIT) rate dropped to 43 per cent; 2,6 per cent lower than in 2000. The Trump policies saw a reduction of the CT rate from 35 to 21 per cent. President Biden has indicated that he intends to levy a federal minimum CT rate of 15 per cent. The process of tax reductions is therefore ongoing in the new millennium to adjust to continuing global changes such as regional integration. Southern Africa has followed suit in lowering CT rates and this will further be discussed under the data analysis.

In simple terms, tax competition includes the welfare effect of one country's tax policy when goods and/or factors of production are traded internationally. It, therefore, deals with various measures or strategies that can be taken by governments on the same or horizontal level, but also on different or vertical levels to adjust their tax rates or reconsider their tax systems (especially tax bases) to attract mobile factors of production from other regions. Tax competition, therefore, does not only occur through the lowering of tax rates but also from changes or distortions in tax bases that are less visible and more difficult to assess. Mobile tax bases include income from sales and services (commodities), income and assets from labour, income from rentals and royalties, income from portfolio capital (interest income), and income from corporate profits or investment capital. Although labour has become far more mobile with technological advancements such as the internet playing a role, some major obstacles to the movement of individuals across international boundaries still exist. Obstacles such as visas, special work permits and the accreditation of degrees, diplomas and other qualifications remain problematic. Capital, and in this case portfolio capital followed by direct or fixed investment capital, is therefore still regarded as the most mobile factor of production. The conventional view has always been that, if capital is mobile, tax competition will lead to downward pressure on tax rates as well as an overestimation of the social marginal cost of public funds (SMFC) – additional revenue raised in one country as a result of tax increases in another will therefore be

disregarded. This, in turn, will result in an inadequate supply of public services. Over time, individual countries have therefore lost some of their autonomy concerning the setting of capital tax rates and, as such, have become more dependent on immobile tax bases for income, such as land and domestic labour. Ricardo (1817) goes further and reiterates that the expected future tax burden accompanying a high public debt would induce the rich and their capital to emigrate rather than save. The so-called "Ricardian equivalence" of debt and tax finance is therefore ironically rejected.

In summary, the international mobility of capital means that investment decisions have become more sensitive to tax differentials. However, this sensitivity of investment decisions also covers other cost factors such as commodity taxation within a country or regional grouping such as the European Union (EU). Commodity and capital tax differentials may therefore encourage competitive bidding between governments.

3 Do theoretical models provide explanations for tax burdens?

The growing concern about tax reform and tax policy issues alone does not necessarily explain a large amount of tax rate reductions worldwide. When considering tax competition, one must accept that governments lower tax rates or use incentives with specific reasons in mind; in this case, to attract capital or expand their national business base in other countries that export capital. In this lecture, the assumption is therefore made that taxes have a direct impact on consumption and/or investment and therefore economic growth. As mentioned earlier, a study of tax competition also includes a study of the impact of taxes on different variables, specifically consumption and/or investment patterns and economic growth.

From the earliest times, there have been different views on the impact of taxes. Smith (1776) points out that "high taxes frequently afford a smaller revenue to government than what might be drawn from more moderate taxes". Supply-side economists go further raising concerns about the disincentive effect of taxes on private savings. Tax reductions lead to an added demand and extra spending means more jobs and more income for many families; it strengthens markets and encourages greater investment to expand capacity. In contrast to the above-mentioned, some argue that increased

development is fuelled by increased taxes.

The debate is an ongoing saga with numerous outcomes depending on which assumptions are being used in the different models. It is therefore not always clear whether effective tax rate[2] cuts lead to more investment. A shift in taxes may even occur, say, from the capital to labour, and this could have a damaging effect on economic growth. Further studies on the effects of taxation on domestic and international investment, as well as tax reforms, also exist. In this regard, it is insightful to discuss one of the best-known theories in terms of tax burdens, namely the Laffer theory.

The Laffer curve indicates that an optimal tax rate will lie somewhere between a zero and a hundred per cent tax level and that this level will yield the highest return to the government with a minimum excess burden to influence total output. A tax cut may therefore give rise to increased government revenue depending on where a country finds itself on the Laffer curve. Although some literature finds that the net impact of a tax rate reduction may be an improvement in government revenue, in the long run, the Laffer theory has debilitating assumptions that have to be taken into account. These and other studies emphasise one fact, namely how economic growth is defined and factors that influence it (e.g., aggregate demand) are of crucial importance if one wishes to proceed with studies of this nature. Tax competition is a competition in effective tax rates. Effective tax rates, which are determined by statutory tax rates, the deductibility of interest, depreciation allowances, special investment incentives and the integration of personal and corporate income taxes, should thus be considered, and this in itself may be problematic.

4 What does the data say about tax competition and tax burdens?

In the period between 1983 and 2020, earnings from FDIs increased internationally (in nominal terms) from less than US$50 billion in 1983 to almost $1.5 trillion in 2019

2 Effective tax rates on consumption or investment measure the difference between the return before and after taxation when alternative consumption or investment possibilities are available. This can also be interpreted as the average rate of taxation levied on gross income or the GDP, hence taxation as a proportion of the value added.

(UNCTAD, 2021). However, because of the uncertainty with the Covid-19 pandemic, this figure has fallen, but bounced back higher than pre-pandemic levels in 2021, growing by 88 per cent. The increase before Covid-19 was even larger for foreign portfolio investment and today the total volume of portfolio investment exceeds the volume of international FDIs. These increases are much higher than the growth of world commodity trade, of which the volume has approximately tripled since the early 1980s, again emphasising the importance of capital. Trade in the capital is also more heavily concentrated in OECD countries, with about 80 per cent of all FDIs taking place between developed countries. Governments have therefore become much more aware of and intertwined in one another's actions. Mobile resources such as capital can be moved through the "press of a button" and countries have therefore continuously attempted new strategies to get a slice of the "capital cake". Governments need to respond more quickly to changes to gain the resources already pursued in most cases. For developing countries especially, it has become a strenuous task to keep up with the pace of change. The whole process has become an international "game" of interactions and even clashes in some cases, with clear winners and losers. More than ever before, developing countries must find ways and strategies to improve their competitive position in the global marketplace.

Whether a high GDP-to-tax ratio is a good or a bad thing is dependent upon each country's view. For a nation that has a high ratio, but where taxpayers are receiving good value for money, a high tax burden might not be that detrimental. Countries such as Denmark, Sweden and Norway have high tax-to-GDP ratios, but these nations also report the highest standard of living. A very low tax-to-GDP ratio can be problematic as it may be a sign of an inefficient tax system. A government will struggle to provide services, build infrastructure, or maintain public goods if it fails to collect taxes during periods of strong economic growth. The tax-to-GDP ratio alone does not indicate good governance, the efficiency of the taxation system in the country, or how taxes are used or distributed. Within the EU, countries such as France and Denmark have the highest tax burden at 46 per cent of GDP in 2020. The South American regional grouping MERCOSUR has the lowest tax burden at 17,1 per cent and Mexico at 17,2 per cent of GDP. Usually, the South and North American data do not include social security contributions as in the case of the EU and OECD countries.

The structure of many developing economies, with many small producers operating outside the formal sector or officially exempt on the grounds of their size, could lead to the high dependence of revenue authorities on a few large businesses. In terms of tax revenue to GDP ratios, DRC is less than 13 per cent, Angola, Zambia, Malawi and Tanzania is between 13 and 18 per cent, with the remainder of the SADC members above 18 per cent. For some countries, the tax revenue to GDP target is still below the minimum level of 20 per cent considered by the UN as necessary to achieve the Millennium Development Goals. South Africa (27 per cent) finds itself ahead of other countries such as the United Kingdom (25,7 per cent), Australia (22,2 per cent), Brazil (12,7 per cent), and the United States (11,9 per cent). The world average, according to the IMF, was 15,4 per cent in 2017. The consideration that social security contributions are not included, and that child, disability and old age grants or universal credits are excluded, should be borne in mind.

One determinant generally used, namely per capita income, is normally linked to the level of economic development, and leads to increased demand in public expenditure and a larger supply of taxing capacity to meet such demands. This determinant and others normally suggest that there is a positive correlation between tax levels and economic development. They also suggest that the direction of causation or influence tends to run from development to tax levels, and not the other way around. Higher tax levels, therefore, do not necessarily generate larger distortions that could harm growth in general. It is thus not only about the tax level per se, but it is more often than not about additional needs for tax revenue to finance rising public expenditure on development, and thus the ability of revenue authorities to raise the revenue and how they utilise the revenue. In a global society where all governments have to compete on an equal footing regardless of their level of economic development, size or political agendas, it can happen that some countries, especially developing countries, push taxes too low without any regard for public needs. The outcome of low taxes, that is higher levels of capital investment, is also questionable in literature (see the next section).

4.1 Narrow tax bases

Corporate tax bases have narrowed in sub-Saharan Africa, particularly by using special zones and spreading tax holidays, though tax revenues have remained similar. Some low-income economies attempt to attract foreign direct investment (FDI) with incentive schemes; though good governance, infrastructure and financial markets are needed for sustainable FDIs (Munongo & Robinson, 2017).

Torslov et al. (2018) found that between 1985 and 2018, the global average statutory corporate tax rate fell by more than half, from 49 to 24 per cent. Torslov et al. (2018) argue that profit shifting is a key driver of the decline in CT rates. No evidence of a global “race to the bottom” was found for standard tax systems. However, for special regimes, the “race to the bottom” has long taken place, with effective tax rates close to zero.

In a similar analysis, Robinson & De Beer (2021) shows that since 1985 the SADC average statutory rate fell from 44 to 23 per cent in 2017, potentially indicating the possibility of strategic action and some tax competition. However, we expected not much change during the Covid-19 pandemic pressuring governments for sustainable tax revenues.

However, macroeconomic convergence criteria in Southern Africa have ignored the pressing realities of the actions of corporate firms. Labour or trade unions have strongly advocated for the need to impose higher taxes on firms in light of seeming unwillingness to unlock capital while hoarding profits. In Zambia, concessions granted to mining companies in form of lower taxes have raised issues that Zambia has ceded much-needed revenues at a costly expense.

Renewed momentum has been gained with the global minimum CT rate of 15 per cent that will be implemented from 2023 in two pillars. It provides a governmental solution for tax challenges arising from digitalisation and globalisation of the economies signed by 137 countries in October 2021 (OECD, 2021). All MNEs that make more than 750 million euros in the SADC and pay a lower effective tax rate than 15 per cent will be affected. Extensive documentation including examples has been made available by

the OECD in 2022. However, the National Treasury of South Africa has listed their concerns that these measures might be more applicable to developed regions.

It is not just statutory CT rates that matter, as shown by Munongo and Robinson (2017) with extensive tax incentives in the SADC and the profit-shifting operations of MNEs in South Africa (Isaac & Robinson, 2022). In a recent working paper, Garcia-Bernardo et al. (2022) found that in terms of corporate tax avoidance and profit shifting, the costs increased by 36 per cent for developing countries, whilst it was reduced by 44 per cent for developed countries. Sub-Saharan Africa will especially be on the losing side with also a lower tax base and revenues overall. It can be difficult to estimate the corporate tax base, as issues, such as defining depreciation, measuring capital gains, costing inventories and accounting for inflation, also require consideration. Economic or pure profits are therefore not always that clear-cut. The most common measure to use is the (top marginal) statutory CT rate. Some studies on tax competition use the effective average tax rate (EATR) as a proxy for taxing the burden. The EATR is a measurement that includes the statutory rate, as well as deductions, exemptions and other credits, and the decision-making process regarding the cost of capital. With the above-mentioned as background, it is essential to note that not only is the "rent" element important for SMMEs, but natural resource companies tend to have a high "rent" (royalty) component. The SADC region has a vast natural resource base, and each country has a different way of taxing these. Some countries use differentiated CT rates on different resources, whilst others use unique formulas designed for a specific natural resource (e.g., the tax formula used for gold production in South Africa).

4.2 Empirical research on reduced CT rates

Empirical studies tend to be rather inconclusive concerning the influence of taxation, and this again emphasises the need for reconciliation between empirical and theoretical work. Taxes can thus affect growth through their impacts on labour productivity and capital costs. For recent examples, various researchers find a negative relationship between taxation and growth. Other researchers do not detect any significant negative impact of taxes on growth. In terms of tax competition, different rates on corporate income in different countries (regions) provide incentives that affect the allocation of investments unless tax rates are harmonised. Low nominal tax rates induce the shifting of the tax base, but low effective rates encourage the

shifting of real investment. The equilibrium outcome of the Cournot-Nash game is under-taxation of capital, which increases in severity the larger the elasticity of capital outflows to the changes in the tax rate. The government's ability to tax capital, especially in capital-importing countries, becomes restricted and the burden ultimately falls on immobile factors of production, which in itself provides limited tax revenue. This borders on the phenomenon of under-provision of local public services and “a race to the bottom”. According to the World Bank classification, differing levels of development are seen to exist within the SADC. Countries such as the DRC, Malawi, Mozambique, Tanzania and Zimbabwe are classified as low-income developing countries. Countries such as Lesotho, Swaziland and Zambia are classified as low-middle-income developing countries. Angola, Botswana (lower tax regime), Mauritius (lower tax regime), Namibia and South Africa are upper-middle-income countries. Seychelles is regarded as a high-income country, whilst also being a lower tax regime. To afford a wider tax base, some of these countries have placed altered tax administration high on the agenda.

Which variables or factors determine CT rates with possible tax competition in the SADC?

This work stems from updates to earlier post-doctoral work of mine (Robinson & De Beer, 2021). The first observes that the backstop scenario is applicable both in terms of the average and statutory CT rate. Here it makes perfect sense to accept that in countries with a higher personal income tax (PIT) rate, the statutory CT rate will also be higher and that these countries will raise more CT revenues when PIT rates increase, due to the direct link between the two rates (the differentiation between labour and business income with income linked to the GDP). Further, if capital gains tax increases, the CT rate tends to decrease.

It might be more appropriate to administer a fully or partially integrated system where the CT acts as a withholding tax of corporate-source income, and is, in the absence of preferential treatment of capital gains, credited in full at the shareholder’s level (providers of capital). In the SADC region, where withholding tax rates (from 5 to 25%, depending on the type of income involved) still exist and South Africa has the most extensive list of double taxation agreements, it is not surprising that a strong negative

relationship is present in terms of CT rates. This could mean that these countries need to adjust their CT rates downwards when withholding tax rates move in the opposite direction. Another variable that is also related to this context is the dummy variable that considers whether the country is on a source or residence (SR) system, which is significant and points to the sensitivity in terms of CT rates.

The government expenditure-to-GDP ratio is negatively related, it becomes negative as soon as the openness variable is added to local variables: This is to be expected, for the higher the spending, the more pressure there is on the CT rates to become more competitive in terms of capital income tax systems. Only the variables for which data was available were included in this study. The openness and/or presence of trade variables partly give an indication of trade openness in the region. This variable is negatively associated with the CT rate where all international variables are present. This result could be indicative of lower CT rates with higher trade ratios, and therefore, international pressure to lower the CT rates. It should be taken with caution, as other factors also play a definite role in terms of a country's openness. Various other variables were also sourced, such as population, which showed that an increase in the population still leads to decreased CT rates.

Surely, in developing countries, public needs should take precedence over inefficient tax policies that generate uncertain revenues. However, from the above explanation, it could mean that countries are pressurised into following competitive regimes when determining the statutory CT rate as part of a globalised tax environment. Note should be taken of the fact that multinational companies tend to shift profits to tax havens no matter the levels of CT rates. More pressure is then put on the personal income tax base that needs to cover public expenditure needs. With South Africa, the so-called Stackelberg leader, the importance of sustainable economic growth needs to be emphasised. Economic growth in South Africa results in economic wealth and well-being for Southern Africa and viable taxation bases for the future.

4.3 The possibility of tax coordination as a solution

Ade et al. (2018) summarise it as follows: "For the countries that have large economies, good infrastructure, natural resources and attractive non-tax related FDI

determinants, the case for tax harmonisation does not appear to be overwhelming. However, for countries that have small economies, poor infrastructure, relatively low levels of natural resources and less attractive non-tax related FDI determinants, the merits for tax policy harmonisation may be more appealing." This can be observed from the Southern African Customs Union (SACU) agreement, with smaller economies and the leader, South Africa.

It appears that tax policies take precedence over public needs, and as such, external competitive pressure determines CT rates. This can also be seen in a country such as South Africa, where most of the tax revenue collected is derived from personal income taxation and not corporate taxation. Emerging and/or developing regions thus tend to under-tax capital, specifically the more elastic capital outflows. Even in the eighteenth century, Adam Smith (1776) acknowledged that capital has never been the "citizen of any country". Tax havens or low tax regions have become a familiar sight to avoid current and future taxes. Tanzi (1995) suggested the establishment of a World Tax Organisation to deal with global tax harmonisation issues. It needs to be seen how far the recent announcement of a minimum CT rate of 15 per cent will go. Countries do not appear to give much attention to their macroeconomic environment when determining their statutory CT rates. Indeed, corporate tax rates do not appear to be geared towards the spending behaviour of governments.

5 Future research

In forthcoming research work, the relationship between CT rates and economic growth in the SADC will be investigated. Initial findings show that reduced CT rates do not necessarily lead to higher economic growth. This is in contradiction to the usual result expected. The personal tax rate delivers insignificant results, which were expected from the literature. As also expected, the government expenditure to GDP ratio is positively related. The withholding tax delivers an expected negative result, meaning an increase in this tax leads to a decline in economic growth. The presence-of-trade variable (OP) is positively associated with economic growth. The significance of the openness variable is not an isolated issue and should also be seen in the light of capital mobility and the degree of doing business in Southern Africa. The Davis Tax Committee (2018) concludes that a reliable supply of electricity, labour relations and

policy uncertainty are common obstacles to investment and that efficiency will rather be determined by the simplicity of the corporate tax system as a whole and broader tax bases. The latter was also the recent goal of a lower CT rate for South Africa to 27 per cent. A global minimum tax of 15 per cent will have a significant impact, especially in those countries where the effective tax rate is lower. However, other measures such as the regulatory and labour environment also play a significant role.

Interesting future collaborations in a personal capacity include the macroeconomic impact of taxes, government expenditure and debt in terms of African challenges such as income inequality, poverty, economic growth and ultimately economic development. Going beyond the UN sustainable development goals, international collaboration in terms of our professional qualification mix is also made possible to ultimately empower our students in the spirit of giving. The World Economic Forum (2017) highlighted one of the hurdles that prevent a smooth transition into the Fourth Industrial Revolution being adult learning together with continuous re-skilling, both seen as key to success, especially so in Africa, where historical legacies still impact education and development. A need for foundational skills such as critical thinking, creative listening, and innovative problem solving exists and thus pluralist thinking in Economics.

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