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The OECD Will Drive the United States into Socialism

By Peter Hongler

1. Introduction

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The use of the title of this short blog post has two reasons: First, it attracts more readers compared to my original title idea: "Value Imperialism through International Tax Policy".[1] Secondly, GOP Representative Carol D. Miller, who made this claim in last week's hearing of the Tax Subcommittee of the Ways and Means Committee, raises the justified question of whether the OECD can indeed 'drive' states in a certain political direction.[2] The statement was made to describe the impact of the suggested global minimum tax by the OECD on the US. Of course, the statement is polemic, of course it was stated in highly polarized environment and of course Congresswomen Miller is known for frequently using the term socialism. Nevertheless, I must admit that parts of the underlying base of the Congresswomen's position finds my support. The goal of the present blog post is to outline such common concerns.

2. The Danger of Value Imperialism

Imperialism is in general linked to the territorial expansion of States through military forces, but we use it here to describe situations in which states de facto force the people of other states

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to follow their values (without military means). Is it indeed true that states can be forced by other states, for instance, through the global minimum tax to be more socialistic or more capitalistic?

Of course, cultural values expand regularly beyond their traditional territory. This is why it is nowadays indeed possible to find a decent espresso in the US. However, in the following we are interested in the coerced transfer of institutional values from one country to another. We understand institutional values as values that have a direct relation to the design of the basic structure of our governmental institutions (e.g. the level of equalities, the existing basic liberties in a society but also constitutional rights as values ex lege). Let me provide three very important examples of fiscal values:

- **The size of the state:** It is well-known that tax-to-GDP ratios differ significantly among various states.[3] The tax-to-GDP ratio depends in liberal democracies, inter alia, on the political will to have a larger or smaller state. As an example, a state may decide to introduce a paid maternity leave of two years or a paid maternity leave of only two months. Of course, it would be too easy to argue that states can freely decide upon the size of the state. In particular in developing states this is simply not true and a low tax-to-GDP ratio

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might not be due to political will but due to fiscal limitations. Nevertheless, in the developed world the size of government follows to a large extent the political will within a society.

- **The level of distribution:** Each state has a different level of distribution. Therefore, it is not just the amount of fiscal revenue in relation to GDP that differs but also the relation between the market income and the after-tax and after-distribution income (i.e. the level of distribution). Such decisions should again be up to each society.
- **The culture of punishment:** Another important value relevant from a tax perspective is the culture of punishment. There are significant differences in how countries punish their citizens in case of criminal behavior (incl. criminal tax behavior). For instance, tax evasion might be punished in some states with jail and in other states only with a fine.

It is a common claim by liberal democrats that these values should be defined by each society in a deliberate discourse. So, for instance, if a society does decide to not implement a progressive income tax, it should not be forced to do so by other states through imperialistic policies. The same should be true for the

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question of whether a state wants to introduce a wealth tax or not.

In practice, cross-border transfers of values happen due to the threat of economic consequences. For instance, trade agreements can contain labor law standards or human rights obligations, or from a fiscal perspective, for instance, the EU Standard of Good Governance contains several value-based standards to be fulfilled by third countries in order to receive EU Funding (e.g. administrative assistance, certain BEPS measures, etc.).[4]

We are not per se against these transfers. However, the more essential the values are for a specific society, the more problematic is a forced transfer of values. For instance, forcing another state to comply with administrative standards such as exchange of information might be less interfering than forcing a state to change its income tax rates. Therefore, the question is whether the global minimum tax leads to such a transfer of values and how severe the sovereignty concerns are.

3. Global Minimum Tax and the Big Government Bias

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It is well-known that the Pillar 2 Model Rules (changed already through administrative guidance and other documents) favor certain tax incentives (subsidies or refundable tax credits) compared to other tax incentives (non-refundable tax credits or other tax expenditures such as traditional super deductions for R&D).[5] Except for the very recent introduction of the so called Marketable Transferable Tax Credit, the beneficial incentives are the ones that involve state spending.

From an economic perspective, a subsidy is similar to a partial tax exemption or a non-refundable tax credit, however, the main difference is that latter two do not involve a transfer of money from the government to an enterprise and do not involve an additional governmental action (apart from the tax assessment decision). Both factors lead to the suspicion that there is a big government bias[6] involved in the Pillar 2 project as the role of the state will grow after the introduction of the global minimum tax.

Big government bias means that there is a disproportionate incentive in the structure of the global minimum tax design according to which states increase their spending side and do not reduce the revenue side. The working mode of the global minimum tax (i.e. the combination of

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IIR, QDMTT and UTPR together along with the definition of the "good" and "bad" tax credits) will lead to a situation in which many states will be forced to change their incentive systems towards more spending and here the "socialist" tendency becomes obvious. Of course, we won't see the introductions of kolkhozes and sovkhozes in the US after the introduction of Pillar 2. Nevertheless, we will likely see a significant number of countries (incl. the US) introducing subsidies or refundable or transferable tax credits. As a consequence, we will likely witness an increase in tax-to-GDP ratios, and governmental bodies will gain additional competences. Unfortunately, this will occur without democratic approval.

4. Global Tax Governance and the Role of National Parliaments

The missing democratic approval was highlighted (but also questioned) at several instances in last week's Tax Subcommittee hearing. It seems that through the threat of the UTPR the OECD has found a way to circumvent parliamentary approval by forcing states to follow their model or otherwise face severe economic disadvantages.

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During the hearing of the Tax Subcommittee there was a dispute about whether the executive branch in the United States breached its competences by signing on to the two Pillar agreement without involving Congress. In simplified terms, Democrats argue that at the end it will be a decision of the national parliaments whether they want to introduce the global minimum tax so the executive branch did not exceed its competences; Republicans, however, claim that due to the systemic structure of the Pillar 2 deal, the US negotiators have undermined the democratic processes.

I agree with the Republican position at least from my own perspective. We have had a public vote in Switzerland on the creation of the constitutional framework for the introduction of Pillar 2 and it was approved by a large majority. However, there was no genuine debate about whether the global minimum tax as such finds support among a majority of the people. The debate was limited to the question of how to allocate the additional revenues (if any). It was clear from the beginning that there is no room not to introduce the global minimum tax due to the severe negative economic consequences.

To conclude, we will indeed see the formal approval of Pillar 2 by national Parliaments, however, with a bitter aftertaste that there has

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been no space for a genuine discourse, and there has been limited local political leeway in general. This shows why the demonstrated transfer of values is occurring without the genuine support of democratic majorities.

5. The Future

It is still unclear whether Pillar 2 will become a reality in its current form. There is still the possibility that GILTI will be accepted as a Qualified IIR, and/or that other tax credits will also be qualified as GloBE income and not as a reduction to the Covered Taxes. The US will likely increase its pressure in the next weeks and months.

Moreover, in many states both the UTPR and IIR are currently unenforceable as they infringe various international law obligations such as tax treaties but also customary international law. These infringements need to be resolved before the introduction to avoid complete chaos. The most obvious case is the application of the UPTR on permanent establishments. This goes against a key claim of the OECD itself, which asserts that under tax treaties, the PE state has a limited taxing right. Why suddenly the PE state should have a taxing right to tax the income of the entire

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group is not at all plausible. The end seems to justify the means.

Of course, even if the global minimum tax becomes reality, the OECD will not drive the US into socialism. Nevertheless, the project will have an impact on the role and size of governments and it contains a what we call big government bias. This requires legitimacy. However, as it was recently outlined by my very esteemed colleague Cees Peters, lacking legitimacy is exactly the key concern of the global minimum tax.[7] Due to such lack of legitimacy, for instance, during the negotiation process, there are strong arguments to change the current international governance structure to make it more inclusive and make it more democratic.

I personally doubt that there will be major changes in the near future on the decision-making front. Therefore, as we are unlikely to see any improvements in how international tax policy is made, we should focus on the outcome. We need to have a debate about what the goals are of the tax work of both the OECD and the UN. Personally, I believe the goals of international tax policy should be to coordinate taxing rights, combat tax evasion and aggressive tax planning, and ensure that states can tax activities occurring within their territory.[8] A global minimum tax with excessive complexity and

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severe loopholes and planning opportunities, at the same time enforced with the full brutality of the extraterritorial effects of the UTPR is not proportionate (and not necessary) to achieve these goals.

[1] On the term value imperialism see for further details Peter Hongler, Justice in International Tax Law, IBFD 2019. Open access: Justice in International Tax Law, A Normative Review of the International Tax Regime (unisg.ch), section 8.3.1.

[2] See Tax Subcommittee Hearing: Biden's Global Tax Surrender Harms American Workers and Our Economy – YouTube, at 1:59:26. The exact statement goes as follows: "*The OECD tax project is a thinly veiled attempt to neuter the U.S. economy and drive America into the arms of global socialism*".

[3] See oecd.org/coronavirus/en/data-insights/tax-to-gdp-ratios.

[4] For details see Irma Johanna Mosquera Valderrama, The EU Standard of Good Governance in Tax Matters for Third (Non-EU) Countries, Intertax 2019, 454 et seq.

[5] According to the latest Administrative Guidance from 18 July 2023 so called marketable

transferable tax credits are treated as beneficial as refundable tax credits.

[6] The term “big government” stems for the interesting report of the Economists in November 2021 on the Triumph of Big Government, see The triumph of big government | Nov 18th 2021 | The Economist.

[7] See Cees Peters, The Legitimacy of the OECD’s Work on Pillar Two: An Analysis of the Overconfidence in a ‘Devilish Logic’, Intertax 2023, 554 et seq.

[8] This is why I am still in support of a solution under Pillar 1.

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