Taxing for a New Social Contract

The pandemic has exposed the costs of tax injustice—now is the time to make it right

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WE CANNOT AFFORD to rethink fiscal policy only in the context of the pandemic. The climate and biodiversity crises are upon us too, and both are ultimately crises of social justice.

Immediate responses to the pandemic showed the great power of states to act for the public good. But many states appeared indifferent to the brutal inequalities observed, both within and between countries. The dramatic shift necessary to respond to these crises calls for nothing less than the renewal of the social contract. That means putting the “four Rs of tax” at the heart of our analysis and policy, to fix our broken tax rules and rebuild the accountability of governments.

Empowered by tax

Effective taxation most obviously provides revenue and redistribution, ensuring states can deliver quality public services and infrastructure while curbing inequalities. But tax also allows the repricing of public goods and public “bads” (such as the wider public health costs of individual tobacco consumption). Any climate response that requires changing the price of carbon or other emissions will depend on this.

But most important of all is the fourth R of tax: representation. Paying tax is the glue in the social contract. When people pay tax, they are empowered to hold their governments to account for how their money is spent. That’s why the share of tax revenues in government spending is one of the very few variables that are consistently associated with improvements in the quality and integrity of government, with the reduction of corruption.

Tax not only provides states with the means for the progressive achievement of human rights, it also strengthens the motivation of states to deliver on that promise, by bolstering the effectiveness of political representation. And it is direct tax—on income and profits, say, rather than on consumption—that is most important to the relationship.

Paradoxically, however, lower-income people and households are almost always the most heavily taxed, as a share of their gross income, but are also actively disempowered in the process.

This result stems from the fact that the great majority of tax paid by lower-income households is in the form of indirect taxes. Consumption necessarily accounts for a greater share of income for these households, and so consumption taxes fall more heavily—indeed, regressively—on them. But these taxes do not drive the sense of tax citizenship nearly as powerfully as direct taxes on personal incomes or wealth. Since value-added and similar taxes are typically less salient, those paying them are less aware, and so their role is also weaker in strengthening political representation and supporting accountability and the social contract.

And of course, the households with lower incomes disproportionately include people already struggling for representation. They are, for example, more likely to be headed by women and to include people living with disabilities, racialized
and marginalized ethnolinguistic groups, and LGBTIQ people. These same groups are also disproportionately likely to fall outside of formal government systems and are therefore often excluded from public services and fiscal transfers. That is, people in these groups are most likely to go uncounted. They will miss out systematically on the benefits of public spending, while at the same time contributing disproportionately through indirect taxes.

Where tax systems fail to deliver on the fourth R—representation—they compound this problem and deepen political inequalities as well as economic ones, weakening the social contract of the already marginalized.

National obstacles, international failures

At the national level, political incentives are completely misaligned. Short-term popularity is prioritized for electoral success, which encourages lower taxes and less salient, indirect taxes that will annoy voters less. But strengthening the social contract over the medium and longer term requires more salient, direct taxes that lead people to demand accountability.

A silver lining to the pandemic is that people have clearly seen the power of states to act to protect public health but also the deep inequalities in who has benefited. Public demand for truly universal public services and social security confirms the need for longer-term tax measures. And there is no doubt who should meet new tax responsibilities—extreme wealth inequalities have flourished during the pandemic.

Even with domestic political commitment, however, direct taxes are too often stymied by the weaknesses of international tax rules. These rules, and the Organisation for Economic Co-operation and Development’s (OECD’s) latest proposals, still do not require the taxation of multinational companies where their economic activity takes place. They still do not prevent the anonymous ownership of assets and income streams—central to every case of individual tax abuse and, more widely, to almost every corruption case and every illicit financial flow.

Since the Tax Justice Network was established in 2003, we have sought global delivery of the “ABC of tax transparency.” A is for the automatic exchange of financial information, to ensure that people’s home tax authorities are aware of their overseas bank accounts. B is for beneficial ownership transparency, through public registers for companies, trusts, partnerships, and other legal vehicles, so these cannot be used for hidden abuses. And C is for country-by-country reporting, a simple measure to ensure accountability for multinationals if there is a divergence between where they do business and where they declare profits and pay tax.

There has been substantial progress. All these ideas were originally written off as entirely unrealistic and utopian, but just 10 years later the Group of Eight confirmed support for automatic exchange arrangements and for country-by-country reporting to be introduced, and then the Group of Twenty adopted all three in principle. But delivery remains patchy even now, and the OECD mechanisms for international exchange both of financial information and of privately held country-by-country reporting systematically exclude lower-income countries from the benefits of cooperation.

Global inequalities

These international failures result in stark inequality in the global distribution of taxing rights. Specifically, lower-income countries are denied the right to tax effectively the proceeds of economic activity and wealth accrued in their jurisdictions—and with direct human consequences.

The State of Tax Justice 2021, published jointly by the Global Alliance for Tax Justice, Public Services International, and the Tax Justice Network, estimates that the combined global revenue losses from cross-border tax abuse by people with undeclared offshore assets and of multinational companies amount to some $483 billion a year—or enough to vaccinate everyone in the world three times over.
The greatest losses in absolute terms are suffered by the member countries of the OECD, which presides over the tax rules—many of them former imperial powers. But by far the greatest losses as a share of their tax revenues, or of their public health budgets for example, are the lower-income countries—many of them former colonies. The losses translate directly into forgone public services and in turn forgone human development—including many thousands of needless deaths.

At the same time, some of the richest countries—OECD member states and their dependent territories—are responsible for the great majority of the tax losses suffered by others. To deliver on the four Rs requires us to confront the underlying inequalities.

Imagine a Venn diagram with four circles. One contains countries made wealthy by imperial conquest. A second contains countries with greatest historical responsibility for the climate crisis. A third circle contains the countries that benefit most from the unfair distribution of global taxing rights. And a fourth contains countries that have hoarded COVID-19 vaccines and the intellectual property rights to produce them.

We don’t need to imagine that the four circles are perfectly overlapping to understand two things. First, the countries inside most of the circles seem to make the same choices, over and again—to prioritize their own immediate, perceived needs above all else. And second, we’re unlikely to make major progress without changing the fundamental dynamic that underpins the picture.

Rethinking fiscal policy
In the shadow of the pandemic, there may be political space for the first time in decades for significant tax policy changes to fight inequality.

There is remarkable, perhaps unprecedented, consensus between groups ranging from tax justice activists to the World Economic Forum’s Global Future Council on the New Agenda for Fiscal and Monetary Policy on the need for measures including wealth taxes, such as that adopted by Argentina, and excess profit taxes on companies like Amazon that collected huge unearned revenue from pandemic lockdown measures.

At the global level, the final report of the high-level UN Financial Accountability, Transparency and Integrity (FACTI) panel recommended a range of measures. These include a UN tax convention to ensure consistent transparency and to create a globally inclusive intergovernmental body to set tax rules, long supported by the Group of 77. The FACTI panel also adopted our proposal for a Centre for Monitoring Taxing Rights to provide consistent data and analysis on the tax abuse suffered by, and facilitated by, each country. For the countries most responsible for global harm simply to allow the damage they do to be seen would represent an important step toward accountability—and toward reestablishing their own social contract with the world.

Policymakers need to combine new progressive tax policies with domestic and international transparency measures. This will strengthen the four Rs of tax and—crucially—make possible a meaningful renewal of the social contract within countries at all levels of per capita income. Without such measures, we may see neither the necessary responses to the pandemic nor to the climate crisis, nor the curtailing of the unnecessary inequalities that scar our world.

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