

G7 CORPORATE TAX DEAL: WHO IS WINNING, WHO IS LOSING?

11 June 2021

ALEXIS GARATTI

Head of Economic Research
alexis.garatti@eulerhermes.com

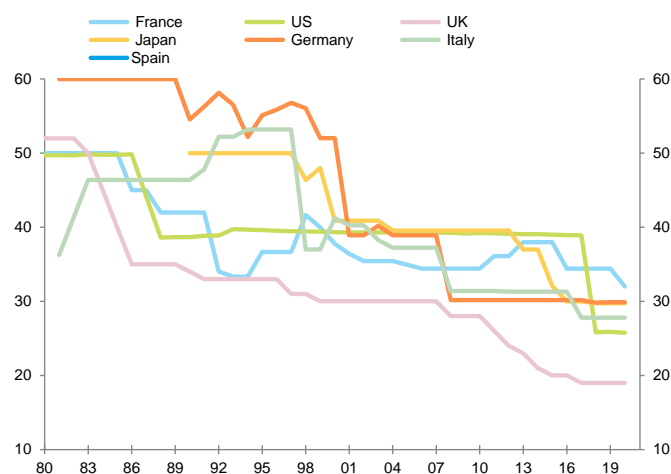
FLORENTIN LAVAUD

Research Assistant
florentin.lavaud@eulerhermes.com

Ahead of the G7 summit this weekend, we looked into who will win and who will lose from the recently proposed global minimum tax rate of at least 15% for companies. Among large Base Erosion and Profit Shifting (BEPS) countries for which data was available, we find that Poland, Spain, China, the Netherlands are clear winners; the US, the UK, Russia and Italy are relative winners; France, Japan, and Canada are neither winning nor losing and that Ireland, Brazil and Hungary are clear losers from the deal. The G7's decision has initiated a crucial negotiation process, which will include a virtual meeting of more than 130 nations on 30 June to agree on changes proposed by the OECD in relation to global taxation under the umbrella of the BEPS initiative. Next, a G20 summit will be held in Venice on 09 July for the endorsement of these agreements and then a possible sign-off is expected in October 2021 during another G20 meeting. In the meantime, and given the US's endorsement of the OECD's proposals, tense debates and negotiations emerged in countries such as Mexico (necessity to reduce tax loopholes), Ireland (necessity to increase the 12.5% corporate tax rate), Hungary and the UK (proposal of excluding financial activities from the agreement).

The BEPS initiative aims to reverse the long-term decline of the statutory corporate tax rate (Figure 1) in the context of the Covid-19 crisis, which induced a sharp rise in global public debt and therefore created a huge need to find new fiscal resources.

Figure 1 – Statutory corporate tax rates (%)



Sources: OECD, Allianz Research.

Though the eventual implementation of this agreement will take a long time because of ratification issues, the initiative represents a unique moment of global fiscal convergence. In the long run, the global minimum tax rate for large multinational enterprises (MNEs) could impact economies' potential growth via different channels:

- **The capital repatriation or productivity growth channel:** countries with corporate tax rates below 15% will be less attractive and MNEs could be tempted to repatriate capital into their domestic economy. This repatriation is likely to produce a positive productivity shock in the economy benefiting from it, whereas the country seeing a capital outflow will register a negative productivity shock with long-term consequences.
- **The terms of trade channel:** countries benefitting from capital repatriation will also reinforce their capacities of production and therefore reduce their dependency on imports (the inverse for countries with tax rates below 15%, which could face a higher dependency on imports).
- **The public debt channel:** capital repatriation will contribute to reinforce the growth potential of economies that see capital flowing back home. This will create new fiscal resources and contribute to reduce the level of debt as a percentage of GDP, or at least reduce its pace of growth. In contrast, countries that see their tax competitiveness deteriorating because of the global minimum tax could find it harder to stabilize their public debt.
- **The public investment channel or crowding-in/crowding-out effect:** countries that gain in competitiveness thanks to this global rebalancing could have a higher incentive to increase the size of public investment as a percentage of GDP, in particular in a context where demand for public goods is expected to rise post Covid-19. This channel of transmission is ambiguous in terms of impact as both crowding-in or crowding-out effects could follow. We assume a continuation of the five-year trend preceding the creation of the tax.
- **The corporate tax revenues channel or redistribution channel:** higher corporate tax revenues as a percentage of GDP could follow a movement of capital repatriation for countries with a corporate tax rate above 15%. Countries with corporate tax rates below 15% will suffer from a lower level of competitiveness and register capital outflows, followed by lower fiscal revenues normally earned from corporate profits of foreign firms.

To identify the winners and losers from this landmark decision, we first estimate the growth potential of a sample of 16 economies (between Q1 1993 and Q4 2020) in function of the growth in productivity, growth of active population, the share of imports in total economy, the share of public investment as a percentage of GDP, public debt as a percentage of GDP and the share of corporate tax-fiscal revenues as a percentage of GDP (see **annex 1** for the precise results of our estimates). Next, we study the impact on each variable after a shock, allowing us to take into account the different transmission channels mentioned above.

We assume that the size of the shock on each channel will depend on the gap between a country's corporate tax rate in 2020 and the 15% level.

Consequently, we identify three groups of countries: Group 1 (small distance) has a distance taken in the first tercile of all the distances, Group 2 has medium distance and Group 3 a high distance compared with the 15% threshold (see Table 1, and appendix for full details on other assumptions).

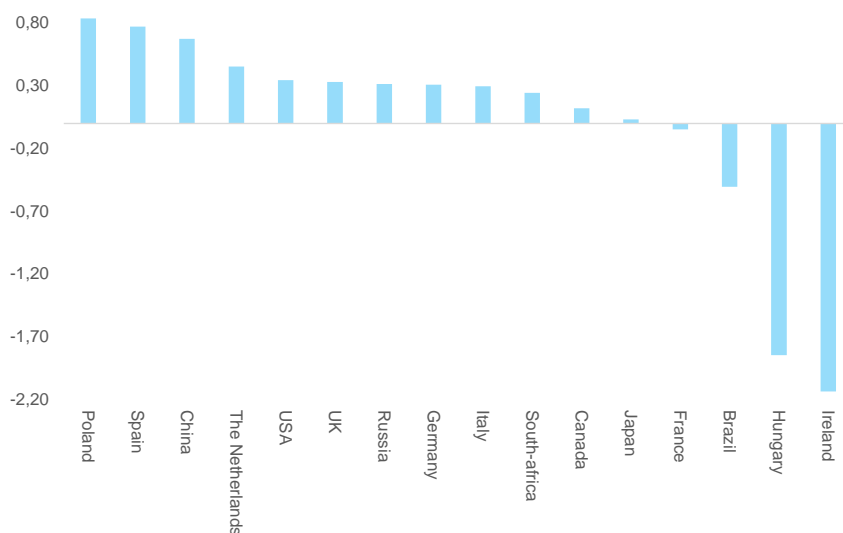
Table 1: Distance between current corporate tax rate and global minimum tax rate of 15%.

Distance by tercile	Country
Group 1: first tercile	UK, Ireland, Poland, Hungary, Russia
Group 2: second tercile	US, Spain, Netherlands, Italy, China, Canada
Group 3: third tercile	France, Germany, Japan, South Africa, Brazil

Sources: Allianz Research, Euler Hermes calculation, OECD.

For each channel of transmission, we estimate the impact on growth potential¹, taking into account different sizes of shocks determined by the distance between the domestic tax rate and the global minimum tax of 15%. In this respect we simplified at the extreme the sensitiveness analysis by saying, for example, that the country being in group 1 (closer distance to the 15% level of tax) would register a 1.5 standard deviation of productivity shock (against 1 and 0.5 standard deviation productivity shock for countries in group 2 and group 3). Our results assume “all other things being equal” and primarily aim at presenting some elements of sensitiveness (see Table 2) regarding the project for a global minimum tax rate for companies .

Table 2 - Impact on potential growth due to a global minimum corporate tax rate of 15%



Sources: Allianz Research, Euler Hermes calculation.

¹ We took a corporate tax rate of 25.7% for the US (Source Tax Foundation). When taking 21% as the basis of our calculation, the impact on potential increases to +0.5pp instead of +0.3pp, respectively to +0.1pp when taking into account a tax rate of 28% as once envisaged by President Biden. In France's case, taking into account a corporate tax rate of 27.5% instead of 30% in our calculation, would increase the impact on potential from -0.05 to +0.2pp.

The majority of our panel with a corporate tax rate above 15% would benefit from such an agreement. However, countries with corporate tax rates below 15% would see their growth potential negatively impacted.

We find that Poland would be the major beneficiary (+0.8pp from a 5-year potential of growth of 3.4%), followed by Spain (+0.77pp from an average potential of 0.7%) and China (+ 0.67pp from an average potential of 6.6%). The US's potential output would increase by 0.34pp by going from 1.80 on average between 2015-2019 to 2.1. For countries with a corporate tax rate above 25%, such as Japan, France and Brazil, our analysis emphasizes that their potential growth variation gain is lower and almost negligible or even negative in Brazil's case. For instance, France potential growth variation to set up a 15% minimum corporate tax rate would be near zero (-0.05pp from an average potential of 1.3%). In this context, it is clear why this category of countries insists on raising the proposed global minimum tax rate. In general we consider that an average speed of convergence would be required to reach the new level of growth potential eventually mirroring a new state of competitiveness or attractiveness. In the US case for example, registering a +0.3pp positive shock on the 1.8% potential of growth would require between 2 and 3 years to be fully visible.

Countries with a corporate tax rate below 15% would largely lose from a global minimum tax rate. Ireland - whose current tax rate is 12.5% - could see its potential growth drop by -2.14pp (from a potential of growth of 5.9%). This major drop should be interpreted with cautiousness but it can give an idea of why Dublin has opposed a European tax harmonization. Likewise, Hungary – whose current tax rate is 9% - could see its growth potential reduced by -1.85pp (from an average potential of growth of 2.9%).

Annex 1. Estimated coefficients of our equations estimating growth potentials

	Productivity trend	Population of working age	Corporate tax revenues (%GDP)	Imports - goods & services	Debt (%GDP)	Government investment (%GDP)	R-squared	F-statistics
US	0.097**	0.423**	0.235**	-0.27**	-0.03**	-2.179**	0.79	71.26**
United Kingdom	0.511**	0.338	-0.037*	0.219**	-0.037**	-0.699**	0.8	78.93**
France	0.54*	-0.56**	-0.0690	0.0510	-0.034**	0.54*	0.83	95.4**
Spain	0.587**	0.947**	1.025	-0.108**	-0.069**	-7.038**	0.72	49.85**
Germany	0.294**	0.443**	0.277	0.013	-0.034**	0.78	0.45	15.41**
Ireland	0.461**	1.772**	2.147	0.046	0.073**	0.484	0.27	7.07**
The Netherlands	0.21**	0.96**	-0.818	-0.025*	-0.03**	-3.113**	0.71	31.59**
Japan	0.155**	-2.439**	3.524**	-0.146**	-0.02**	-0.825**	0.63	33.04**
Italy	0.34**	0.181**	-0.321	-0.075**	-0.026**	0.199	0.69	42.94**
Russia	0.049**	3.308**	1.006**	-0.06	0.149**	0.224	0.93	168.07**
China	0.382**	2.325**	-0.07	-0.104**	-0.187**	1.286**	0.85	261.33**
South Africa	0.145**	1.055**	1.834**	0.107**	-0.069**	-1.601	0.64	34.45**
Brazil	0.106**	7.314**	1.804**	0.034	-0.021**	-20.724**	0.85	91.02**
Poland	0.194**	0.093	-1.613	-0.003	-0.01	-1.265**	0.31	5.34**
Hungary	0.002	-0.761**	-1.9**	-0.004**	-0.085**	-0.524**	0.25	6.5**
Canada	0.225**	0.52*	-0.815**	0.206**	-0.008**	-0.456**	0.94	360.05**

Sources: Allianz Research, Euler Hermes calculations, Oxford economics.

Variables with ** are strongly significant, * are significant.

Annex 2: Corporate tax rates and impact of a 15% global minimum tax rate

	5 years average potential rate of growth before 2020	Potential growth variation due to minimum global tax rate	Current corporate tax rate
Poland	3,4	0,84	19,00
Spain	0,7	0,77	25,00
China	6,6	0,67	25,00
The Netherlands	1,5	0,45	25,00
USA	1,8	0,34	25,77
UK	1,7	0,33	19,00
Russia	0,7	0,31	20,00
Germany	1,6	0,31	29,90
Italy	0,0	0,30	27,81
South-africa	0,9	0,24	28,00
Canada	1,8	0,12	26,47
Japan	0,8	0,03	29,74
France	1,3	-0,05	30,02
Brazil	0,4	-0,50	34,00
Hungary	2,9	-1,85	9,00
Ireland	5,9	-2,14	12,50

Sources: Allianz Research, Euler Hermes calculations, Tax Foundation Data (2020) to ensure a homogeneous database.

Annexe 3: Further assumptions of our model

- Assumptions on the productivity shock.** France is in group 3: the positive shock of competitiveness on productivity related to repatriation will be three times smaller compared with the UK (the incentive to repatriate capital into France will be much smaller for a French company benefitting from lower tax in a certain foreign country, compared with a British company benefitting of the same advantages in the same foreign country. Indeed, the interest to come back is smaller, given a pretty elevated level of tax in France, while it is worth evaluating the case of capital repatriation in the UK if there is not much difference between 15% and the current level of taxes in the UK.
- Assumptions on tax revenue shock.** Tax revenues as a percentage of GDP increase for countries above 15% in terms of the corporate tax rate. Group 1 observes a 1.5 standard deviation (last five years before 2020) increase in this ratio (respectively 1 standard deviation for group 2, 0.5 standard deviation for group 3). Tax revenues decline for countries in which the corporate tax rates are below 15%.
- Assumptions on the public debt shock.** Debt as a percentage of GDP declines by 1.5 standard deviation of country's level across the last five years preceding 2020 if the country is in group 1 (respectively 1 standard deviation for group 2 and 0.5 standard deviation for group 3) and above 15% in terms of corporate tax rate, (respectively increases by 1.5 (resp. 1 and 0.5) standard deviations if the country is below 15% in terms of the corporate tax rate.
- Assumptions on the terms of trade shock.** Imports as a percentage of GDP are expected to decline by 1.5 standard deviation of the country's level across the last five years preceding 2020 if the country is in group 1 (respectively 1 standard deviation for group 2 and 0.5 standard deviation for group 3) and above 15% in terms of the corporate tax rate, (respectively increases by 1.5 (resp. 1 and 0.5) standard deviations if the country is below 15% in terms of the corporate tax rate.
- Assumptions on active population growth and weight of public investment.** Growth of active population, and public investment as a percentage of GDP. Growth of active population will not be affected by the global minimum tax rate. Thus, we use the trend from the last five years in our calculation. With respect to public investment as a percentage of GDP, we supposed that its trend in the five years preceding 2020 will continue.

These assessments are, as always, subject to the disclaimer provided below.

FORWARD-LOOKING STATEMENTS

The statements contained herein may include prospects, statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties. Actual results, performance or events may differ materially from those expressed or implied in such forward-looking statements.

Such deviations may arise due to, without limitation, (i) changes of the general economic conditions and competitive situation, particularly in the Allianz Group's core business and core markets, (ii) performance of financial markets (particularly market volatility, liquidity and credit events), (iii) frequency and severity of insured loss events, including from natural catastrophes, and the development of loss expenses, (iv) mortality and morbidity levels and trends, (v) persistency levels, (vi) particularly in the banking business, the extent of credit defaults, (vii) interest rate levels, (viii) currency exchange rates including the EUR/USD exchange rate, (ix) changes in laws and regulations, including tax regulations, (x) the impact of acquisitions, including related integration issues, and reorganization measures, and (xi) general competitive factors, in each case on a local, regional, national and/or global basis. Many of these factors may be more likely to occur, or more pronounced, as a result of terrorist activities and their consequences.

NO DUTY TO UPDATE

The company assumes no obligation to update any information or forward-looking statement contained herein, save for any information required to be disclosed by law.