Examining the extended reach of tax laws

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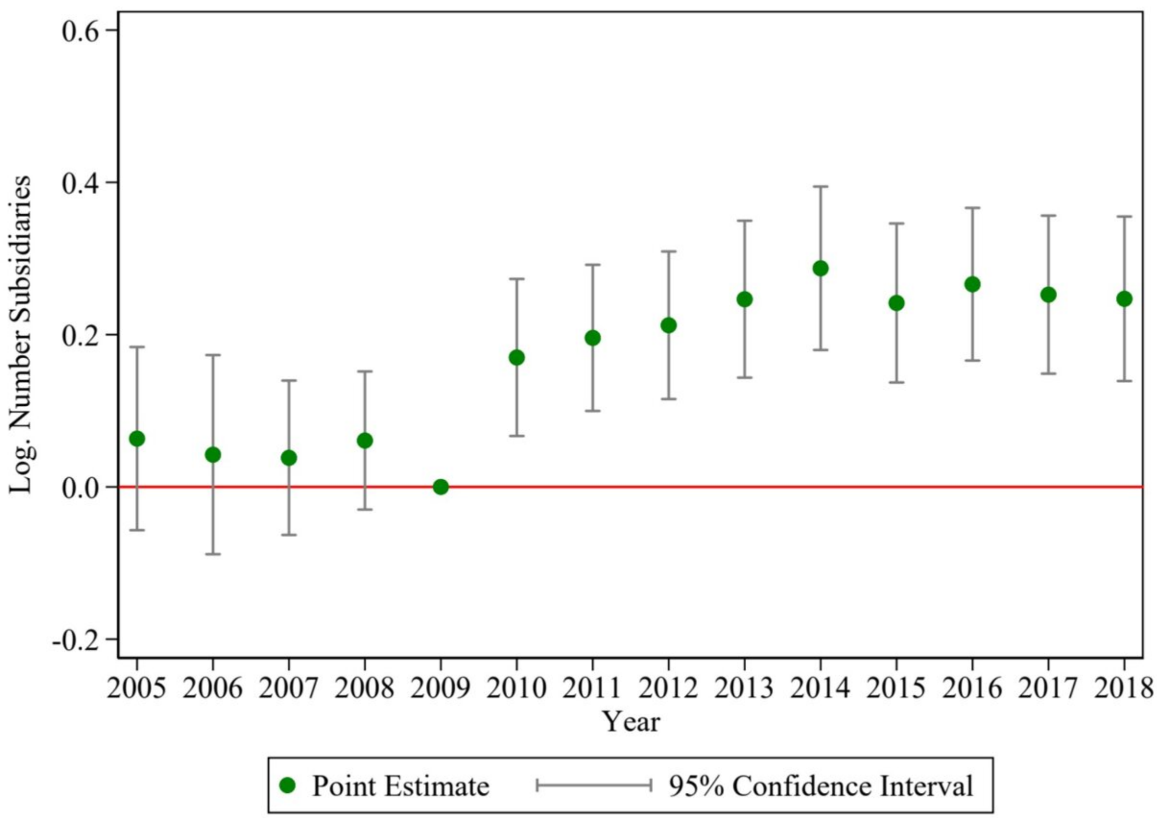

Effect of U.K. Tax Reform on U.K. Presence in Sub-Saharan Africa. Notes: This figure displays the coefficient estimates and 95% confidence intervals for event study regressions estimating the difference in the natural logarithm of the number of U.K. multinational subsidiaries as com- pared to non-U.K. multinational firms over time relative to the year 2009. The specifications are based on the model presented in Panel (A) Column (1) of Table 2 and include country-by-year and firm fixed effects. Standard errors are clustered at the firm level. Credit: *Corporate Tax Policy in Developed Countries and Economic Activity In Africa* (2023)

For big multinationals that love tax havens, the start of 2024 was not a cause for celebration. On Jan. 1, the European Union, Japan, Canada, and Australia joined other jurisdictions in requiring their largest companies to pay a tax rate of at least 15% on their worldwide profits.

The moves are part of an unprecedented push led by the Organization for Economic Development and Cooperation to create a more uniform international tax system that would reduce tax dodging by giant multinationals. The effort is rooted in a 2021 agreement by 140 countries, including the United States, to enact laws at home that would, among other things, establish a global minimum tax for the world's largest companies.

To Rebecca Lester, an associate professor of accounting at Stanford Graduate School of Business and a senior fellow at the Stanford Institute for Economic Policy Research (SIEPR), the initiative brings to light some important questions around the far-reaching—and unintended—effects of tax policies. The desire to establish a global minimum tax, while aimed at tax havens and large multinationals, will likely impact countries that are not its direct targets, she says.

If multinationals, for example, alter their international investment strategies as their tax bills rise or fall, inevitably, those changes will impact some economies more than others. Lester's recent research shows, in fact, how a set of tax cuts in the United Kingdom had ripple effects on developing nations in Africa.

"The study points to the importance for policymakers and researchers alike to understand better how changes in tax rates and other provisions can have unintended consequences—good or bad—for other economies," Lester says.

Her co-authored study, [released as a working paper](), looks at a series of large corporate tax cuts that the United Kingdom made between 2010 and 2015.

While the goal of the tax reforms was to boost business investment across the island nation, Lester's research shows that the policies also inadvertently drove U.K. investment into sub-Saharan Africa—leading to both higher job creation and overall economic growth.

Large U.K. businesses increased their subsidiary presence in sub-Saharan Africa by 22% to 28% as a result, the researchers say, of the tax cuts. Local economic activity, measured with satellite-based data, rose by 3 to 7%. And 5% more jobs on average were created.

What's also remarkable about the study's findings, Lester says, is that it shows how tax policies whose primary purpose is to achieve some result at home can have broader effects.

"We have shown not only that domestic tax policies have cross-border effects but also that those effects can be sizable," Lester says. "That's exciting because there have long been questions about whether domestic tax policies of one country can have spillover effects on others. We just didn't have clear evidence if that's actually the case and to what extent."

Following the money

When Lester and her co-authors—Jeffrey Hoopes of the University of North Carolina at Chapel Hill, Daniel Klein of the University of Mannheim, and Marcel Olbert of London Business School—set out to measure the cross-border impacts of domestic tax policies, they found an ideal case study in the U.K. tax cuts.

The cumulative tax cuts of nearly 30% over five years were focused on addressing domestic economic activity, but given the U.K.'s deep historical ties to Africa, it seemed possible that foreign investment as a result of the tax savings could wind up there.

Lester and her co-authors faced a massive challenge: A lack of readily available data. Multinationals don't typically disclose many details about the location of their foreign investments, including their subsidiaries. And economic data for many African communities is hard to find.

The researchers overcame these limits in several ways. First, they built a dataset of more than 64,000 subsidiaries that operated across 46 African countries between 2005 and 2018. They narrowed the pool to subsidiaries that were majority-owned by companies in the U.K. and used French-owned subsidiaries as a benchmark for comparing results.

The authors also tracked how the growth in U.K.-owned subsidiaries impacted surrounding economies, using three data sources: satellite imagery from the U.S. Air Force showing how nighttime lighting expanded in areas around the U.K. businesses, which strongly indicates economic progress; employment statistics from African Demographic and Health Surveys; and a tool for measuring living standards in developing countries that was built by Atlas AI, a company co-founded by SIEPR senior fellows Marshall Burke and David Lobell.

In analyzing the data, Lester and her collaborators identify a strong link between the tax changes and their foreign impacts. They rule out other possible explanations for the expansion of U.K. multinationals in sub-Saharan Africa and the subsequent benefits to local economies. They also conclude that the investment in new subsidiaries did not come at the expense of policymakers' original goal of stimulating spending by businesses across the U.K.

"It wasn't that investment in the U.K. went down and investment in

Africa went up," Lester says. Multinationals in the U.K. had more money overall, which allowed them to expand both at home and abroad. "We see a complementary effect," she says.

Calling for a broader perspective

All told, Lester says the study sheds new light on the global ramifications of tax laws.

The policy implication is especially urgent as more countries follow through on their pledge to levy a minimum tax rate of 15% on the profits of large multinationals. While the aim is to align tax rates—and some countries will raise their rates to comply—Lester says policymakers and researchers should also pay attention to ripple effects that might play out.

"Multinationals do not optimize on just one country," Lester says. "They're always thinking about investments around the world. And what we've done in our paper is document that corporate tax policies, including those meant to achieve a domestic goal, can have substantial cross-border effects."

More information: Working paper: drive.google.com/file/d/1lgsKE … wAc7P5sPsU7ljJM/view

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