Hochschule für
Wirtschaft und Recht Berlin
Berlin School of Economics and Law

Institute for International Political Economy at the
Berlin School of Economics and Law (IPE)

Multinational corporations and commercialised states: New beggar-thy-neighbour growth models in the era of neoliberal globalisation

Ryan Woodgate (BSEL, IPE, USPN)

26th March 2021

Presentation for IPE Online Workshop on Macroeconomic Regimes: Post-Keynesian and Critical Political Economy Perspectives

A work in progress…

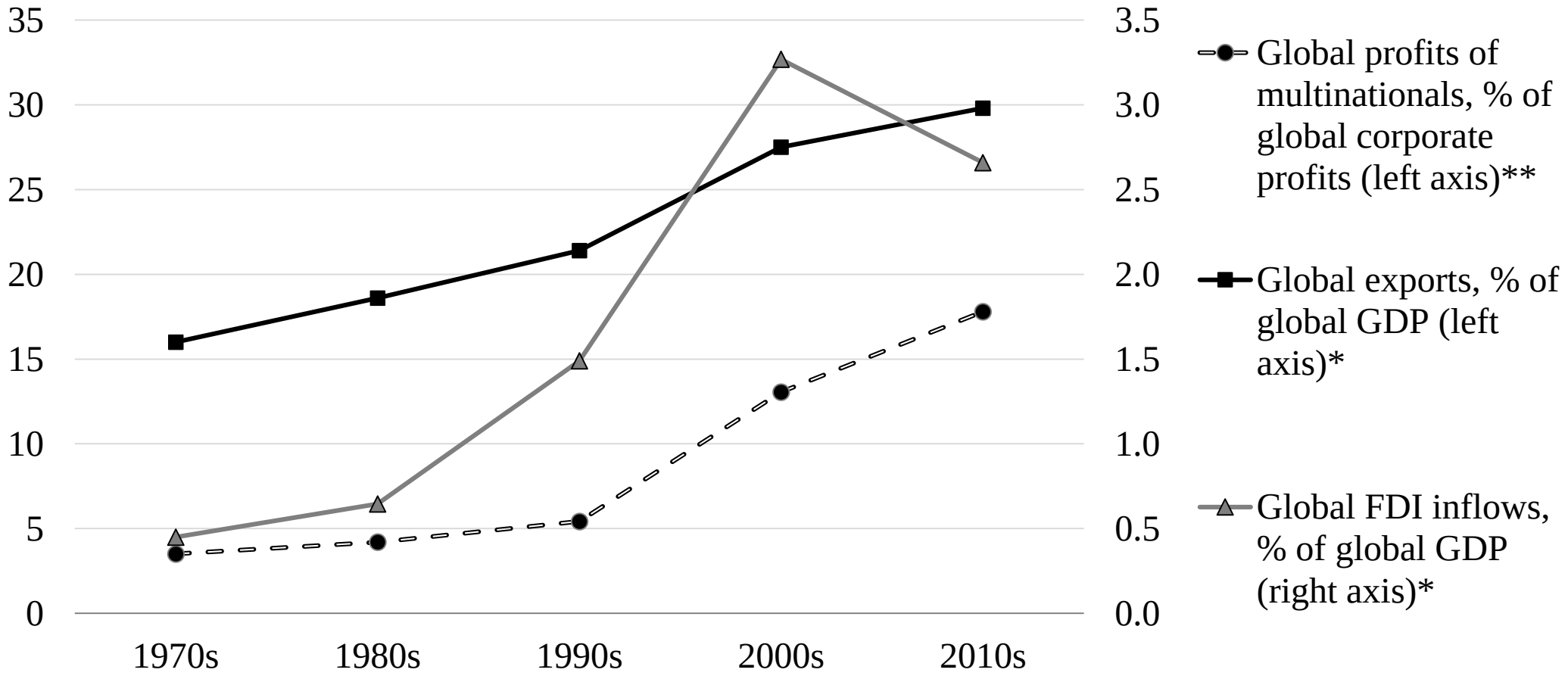
I: Neoliberal Globalisation and the Commercialisation of State Sovereignty

Neoliberal Globalisation

The current wave of neoliberal globalisation began around the 1990s, and is differentiated from previous waves by the emergence of “barge economics” (Palley 2015, p.53):

Globalised production networks are *“configured on the principle of global cost arbitrage”* where it *“as if factories are placed on barges that float between countries to take advantage of lowest costs – which can be due to under-valued exchange rates, low taxes, subsidies, absence of regulation, or abundant cheap exploitable labor”*

Neoliberal Globalisation: Global trade continues its steady rise, whereas as FDI flows and the profits of multinationals shoot up



Decade averages

Sources: *World Bank (2020) **Saez & Zucman (2019)

“The Commercialisation of State Sovereignty” (Palan, 2002)

Though Palan (2002) only uses the term for ***tax havens***, Palan (1998) describes how Oppenheimer (1985) noted that ***special economic zones*** and ***flags of convenience*** are the “same sort of thing”.

Policy competition fought along dimensions of…

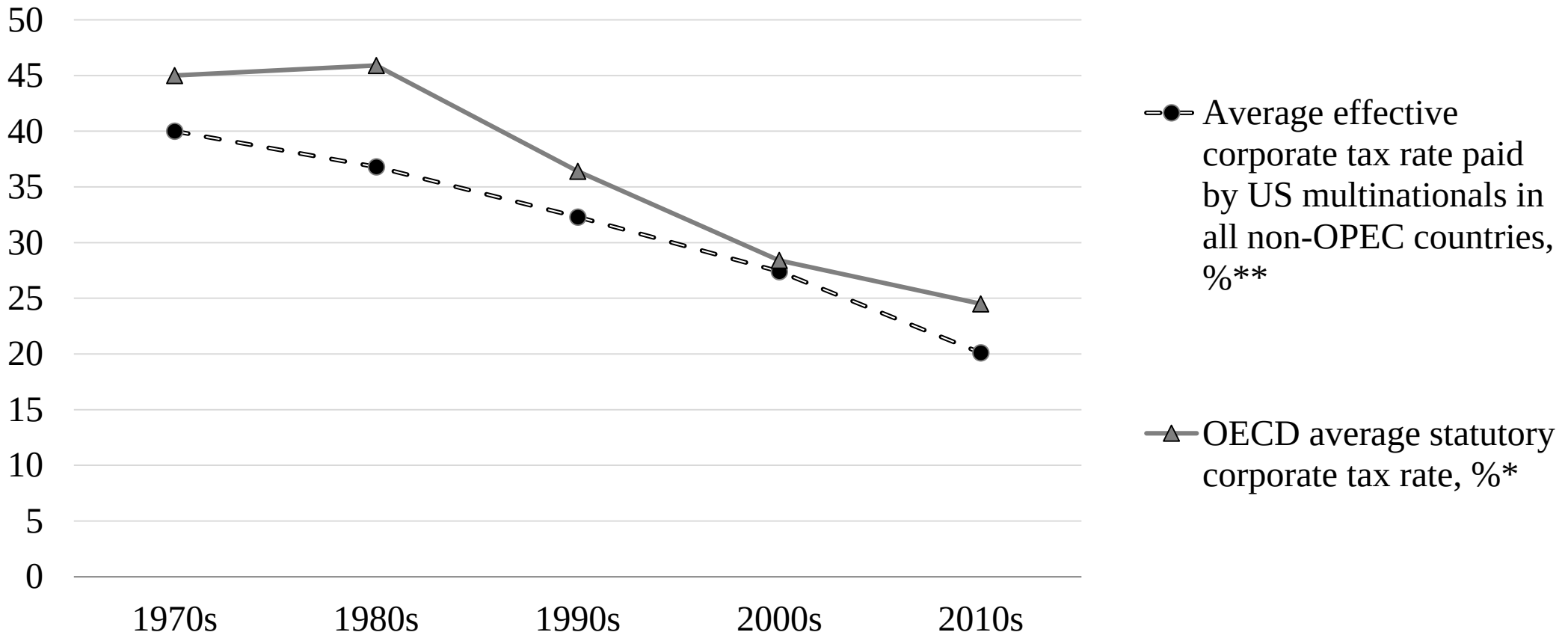
- Tax (statutory rates, holidays, deductions, exemptions) on capital income
- Tariffs and duties
- Subsidies
- Rent on public land
- Labour costs
- Regulation (worker rights, environmental protection, etc.)
- Provision of infrastructure and direct government assistance

…in order to attract/retain foreign capital and/or production processes.

Palan’s CSS is deeply related to Palley’s “barge economics”:
Technological & regulatory change → barge economics → policymakers cooperate with multinationals and compete with other countries to make itself *the* destination for foreign capital (whether financial or tangible)

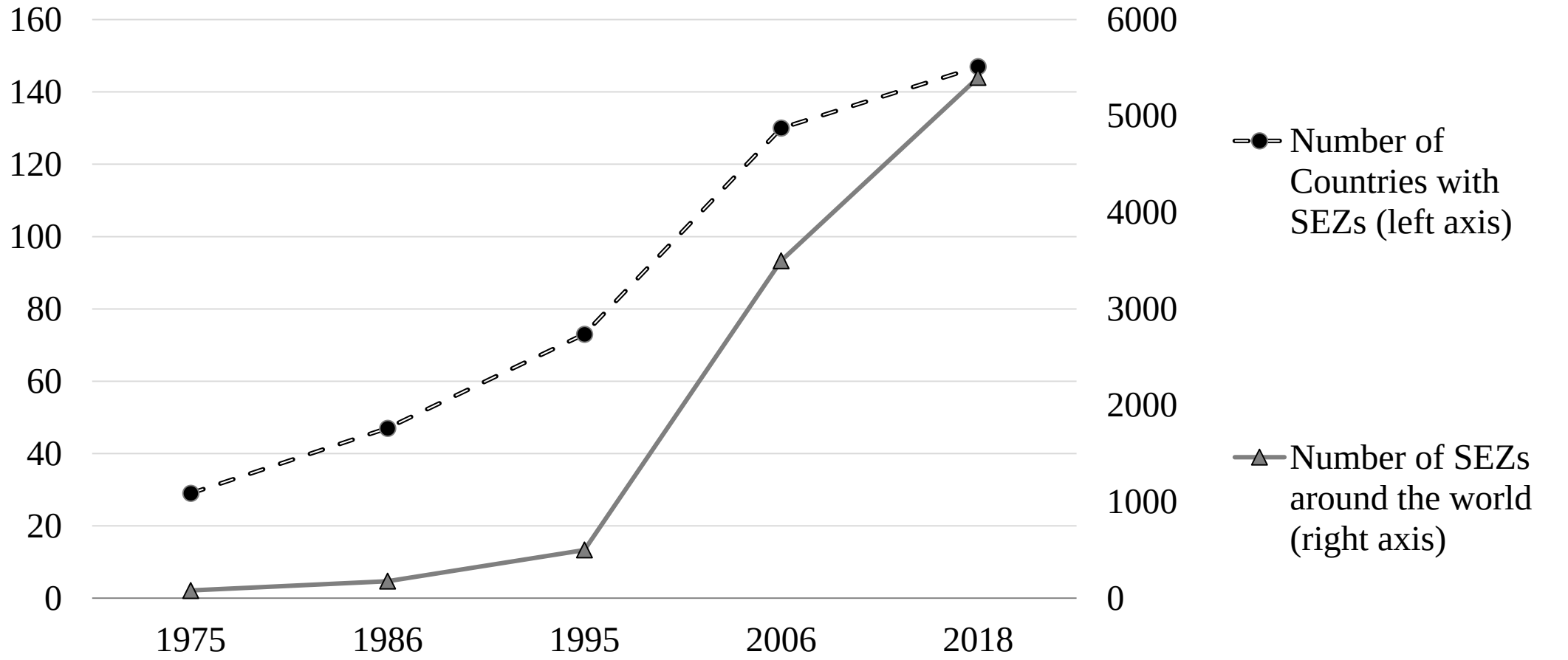
CSS: Falling corporate tax rates around the world

(decade averages)



Sources: *OECD (2020), Khan et al. (2017) **Wright & Zucman (2018), BEA (2020)

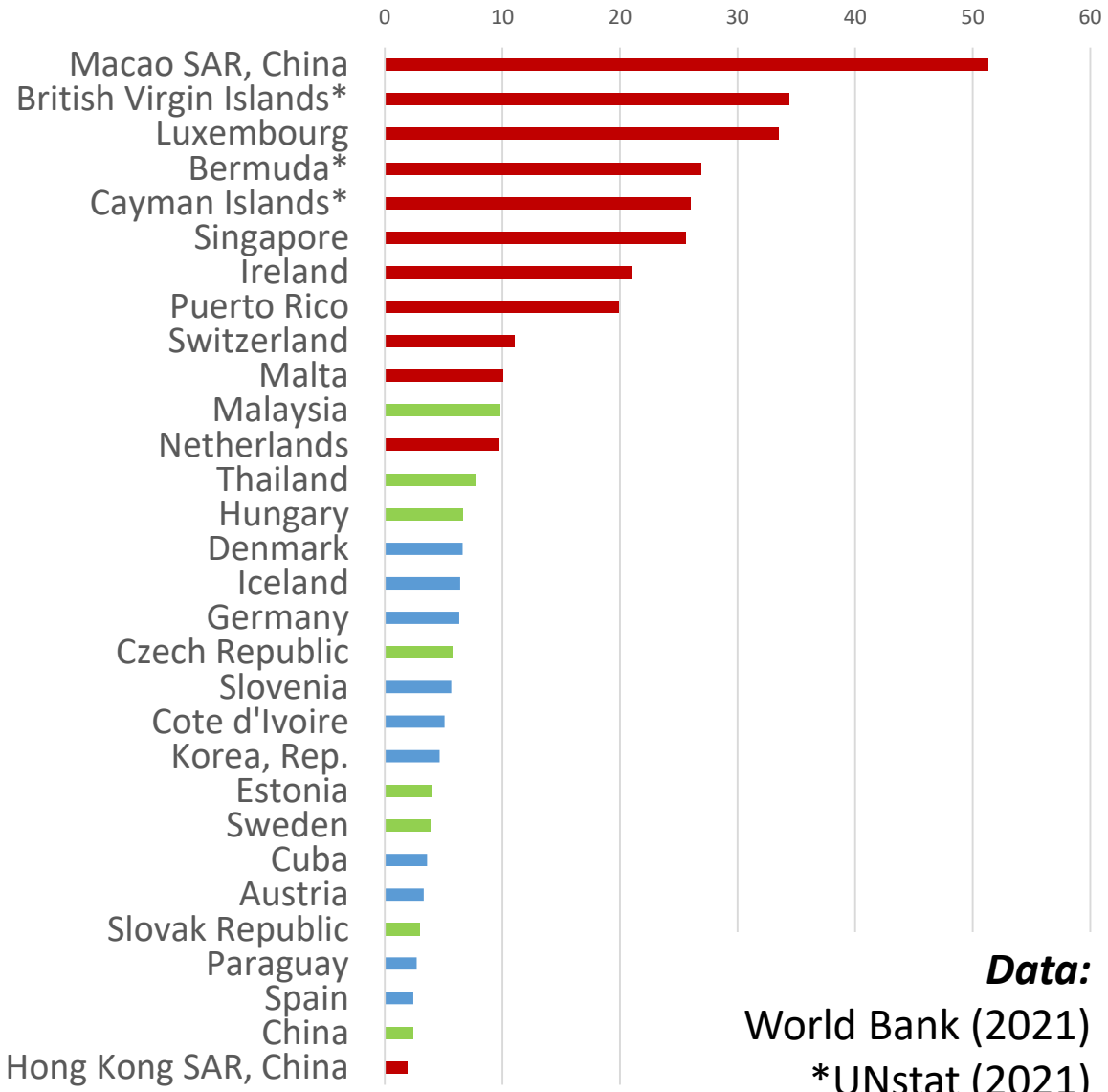
CSS: Proliferation of special economic zones around the world



Source: UNCTAD (2019)

II:
Common Features of Commercialised States

Economies whose average net exports since 2010 ≥ 2% of GDP



Data:

World Bank (2021)

*UNstat (2021)

How might CSS fuel demand and income growth?

Red: Tax havens

(Hines, 2010; Garcia-Bernardo et al., 2017; Torslov et al., 2018)

Green: Export-platforms

Non-haven economies where ≥ 40% NX due to foreign-owned firms (OECD analytical AMNE database)

- SEZ-dependent: Malaysia, China, Thailand (ADB 2015; UNCTAD 2019)
- CEE: (Bohle 2009, 2018; Drahokoupil 2009; Bohle & Regan, 2021)
- And Sweden (?)

The “net exports” of tax havens

2 of the 3 commonly identified means of profit shifting inflate net exports in havens (and deflate elsewhere):

- **Transfer mispricing**: e.g. affiliate imports finished product at cost price, exports at market price with little to no value-added
- **Intra-group royalty payments**: Locate IP in havens so affiliates elsewhere pay for the service

- Torslov et al. 2018 estimate ~40% of 2015 global MNE profits were shifted
- ~ 85% of shifted profits moved via these 2 trade-distorting channels (ibid. p.31)

Domestic demand-led? Debt-led? Export-led?

- How do the growth regimes of commercialised states relate to the basic trichotomy of macroeconomic regimes seen in the literature? (Hein 2012, 2014; Lavoie & Stockhammer 2013; Stockhammer 2015)
- Bohle & Regan (2021, pp. 82-83) describe Ireland and Hungary as "FDI-led":

"FDI-led growth models are particular cases of export-oriented growth, [where] the major exporting firms are foreign-owned… [O]nce these firms have sunk their investments in a host country, MNCs depend on government policies to support their competitive edge. In this sense, host states and MNCs become strategically interdependent… The bargains MNCs reach with host countries typically revolve around capital investment incentives, taxation, labor market flexibility, access to certain types of skills, data protection, and intellectual property."

- This can be extended to SEZ-dependent countries and other non-haven commercialised states such as the central and eastern European nations described by Bohle (2009, 2018) and Drahokoupil (2009)
- How can this kind of FDI-led growth be understood from a PK perspective?
- And can tax havens really be considered "*particular cases of export-oriented growth*"?

III:
Towards post-Keynesian growth models of commercialised states

Overview of modelling approach

- Highly simplified, 2-period demand-led model variants expreseed in levels
- Period 1: Baseline/benchmark – No foreign affiliates
- Period 2: After the establishment of foreign affiliates

Period 1: Benchmark model economy

- $C = C_A + c(Y - T)$
- $I = I_A + \gamma Y$
- $G = bT$
- $T = \tau Y$
- $NX = NX_A - \eta Y$

- $Y_1^* = E_A + Y_1^*[c(1 - \tau_1) + \gamma + b\tau_1 - \eta]$
- $$Y_1^* = \frac{E_A}{m - \tau_1(b - c)}$$

Keynesian stability assumed

$E_A := C_A + I_A + NX_A$
$m := 1 + \eta - c - \gamma$

To be held constant throughout

Period 2: General setup

$$Y_2^* + NY = E_A + Y_2^*[c(1-\tau_2) + \gamma + b\tau_2 - \eta] + I_F + NX_F$$

Income statement of FAs:
$\Pi_F = X_F + R_F^D - M_F - Mat_F^D - W_F$

Without great loss of generality, assume
$R_F^D = Mat_F^D \ (= 0)$

Therefore: $NX_F = \Pi_F + W_F$

Also, assume…

- NY comprised purely of the net profits of FAs that are repatriated out:
$$NY = -(1-\tau_2)\Pi_F$$
- Investment of foreign firms is completely financed by foreign parent (functional form given later)

Note that the tax collected on FAs will be immediated re-injected into the economy with a value of $b\tau_2\Pi_F$

$$Y_2^* = E_A + Y_2^*[c(1-\tau_2) + \gamma + b\tau_2 - \eta] + W_F + b\tau_2\Pi_F + I_F$$

$$Y_2^* = \frac{E_A + W_F + b\tau_2\Pi_F + I_F}{m - \tau_2(b-c)}$$

Briefly revisiting the "FDI-led" hypothesis

Before we consider CSS as an attractor for FAs (i.e. for now $\tau_1 = \tau_2$), what can we say generally about the possibility of "FDI-led" growth in this framework?

$$Y_2^* = Y_1^* + \frac{W_F + b\tau_F\Pi_F + I_F}{m - \tau_2(b - c)}$$

Singer (1950, p.484)

"the main requirement [for FDI-led growth] of underdeveloped countries would seem to be to provide for some method of income absorption". Singer gives 3 methods of income absorption:

1. "the reinvestment of profits in the underdeveloped countries themselves": $\boldsymbol{I_F}$
2. "the absorption of profits by fiscal measures and their utilization for the finance of economic development": $\boldsymbol{b\tau_F\Pi_F}$
3. "the absorption of rising productivity in primary production in rising real wages and other real incomes": $\boldsymbol{W_F}$

Period 2, Variant A: Traditional tax haven

- Suppose the CSS strategy is to become a traditional tax haven, marked by low effective rates of tax on all income: $\tau_2 < \tau_1$.
- τ_2 is low enough to induce multinationals to set up shell companies (SPEs) in the newly established haven to facilitate pure profit shifting: $\tau_2 < \tau_{TH}$
- No value-added takes place in the haven ($W_F = I_F = 0$). Legal and accounting costs are neglible (for now) relative to profits shifted inward:

$$NX_F = \Pi_F \quad \rightarrow \quad Y_2^* = [E_A + b\tau_2\Pi_F]/[m - \tau_2(b-c)]$$

Growth condition: $Y_2^* - Y_1^* > 0$ if

$$\Pi_F > Y_1^*(1 - \frac{c}{b})(\frac{\tau_1}{\tau_2} - 1)$$

E.g. $if \tau_2 = 0.4, \tau_1 = 0.05, c = 0.7, b = 1$
Then, $\Pi_F > 2.1 * Y_1^*$

→ If any, then only the smallest economies may succesfully employ this CSS strategy

Period 2, Variant B: Corporate tax haven

- Given our setup, the previous model variant is a blunderbuss approach
- Haven policymakers can (and do) differentiate. They can change…
  - The effective *corporate* tax rate alone, rather than overall/all income tax rates
  - Or, more effectively yet, the effective tax rate on *foreign* corporations alone. How?
    - Fill SEZs with foreign firms
    - "Industrialisation by invitation" (associated with Arthur Lewis (1950)) - Use state agencies to target foreign investment: IDA Ireland, CzechInvest, SARIO (Slovakia), HIPA (Hungary)

- Suppose that $\tau_2 = \tau_1$, but FAs pay $\tau_F < \tau_{TH}$.
- Unambiguous growth outcome: $Y_2^* = Y_1^* + b\tau_F \Pi_F / [m - \tau_2(b - c)]$

Period 2, Variant C: Export-Platform

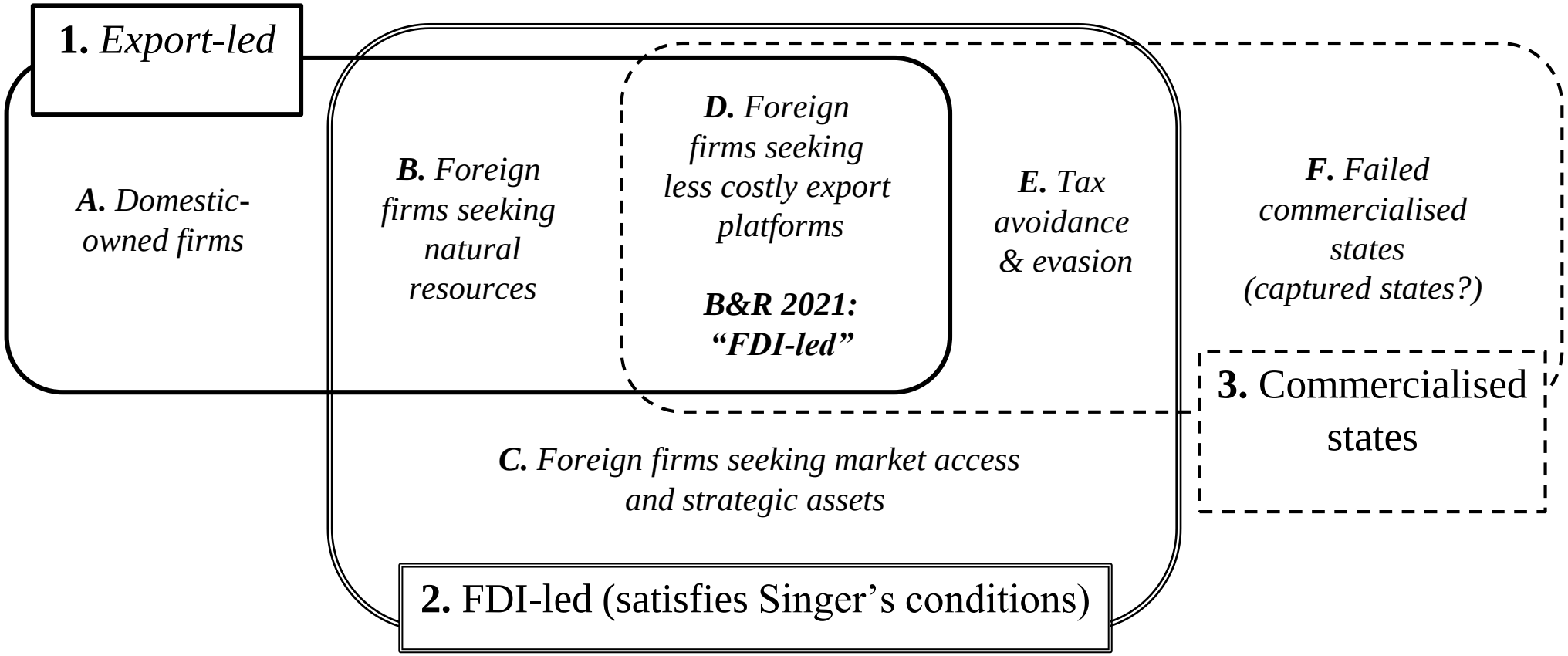
- We maintain the targeted effective foreign CTR, τ_F, and that $\tau_2 = \tau_1$
- Different from variants A and B, output subsidies, S_F, and benefits in kind, B_F, (reduced rents, provision of infrastructure, reduced bureaucracy costs, etc.) from gov't to FAs are on offer. Supposing we can give these benefits in kind a monetary value
$$\tau_F = (T_F - S_F - B_F)/\Pi_F$$
- Merely for analytical purposes, suppose $\tau_F \leq 0$. For clarity, let $\sigma_F := -\tau_F$
- Now, FA net exports represent genuine value added, not shifted profits: $NX_F = \Pi_F + \mathrm{W_F}$
- GF FDI takes place. Assuming I_F is a function of output of FAs: $I_F = \mu(NX_F) = \mu(\Pi_F + \mathrm{W_F})$
- $Y_2^* = Y_1^* + \frac{W_F + I_F - b\sigma_F \Pi_F}{m - \tau_2(b-c)}$

- $Y_2^* = Y_1^* + \frac{W_F(1+\mu) + \Pi_F(\mu - b\sigma_F)}{m - \tau_2(b-c)}$

IV:
Categorising the growth model variants of commercialised states: Initial findings

Conceptualising types of export-led & FDI-led economies

(By incorporating Dunning's (1992) types of FDI)



Increasingly, SEZs fail to catalyse growth

- ADB (2015, pp. 10
  or exceeded expec
  have remained enc
  Numerous others h
  no SEZ established
  Shenzhen or of the
- Farole (2011) consi
  "SEZ programs in A
- Narula & Zhan (20
  an SEZ-driven appr
  that followed this a
- First mover advant
- Unlikely to outcom

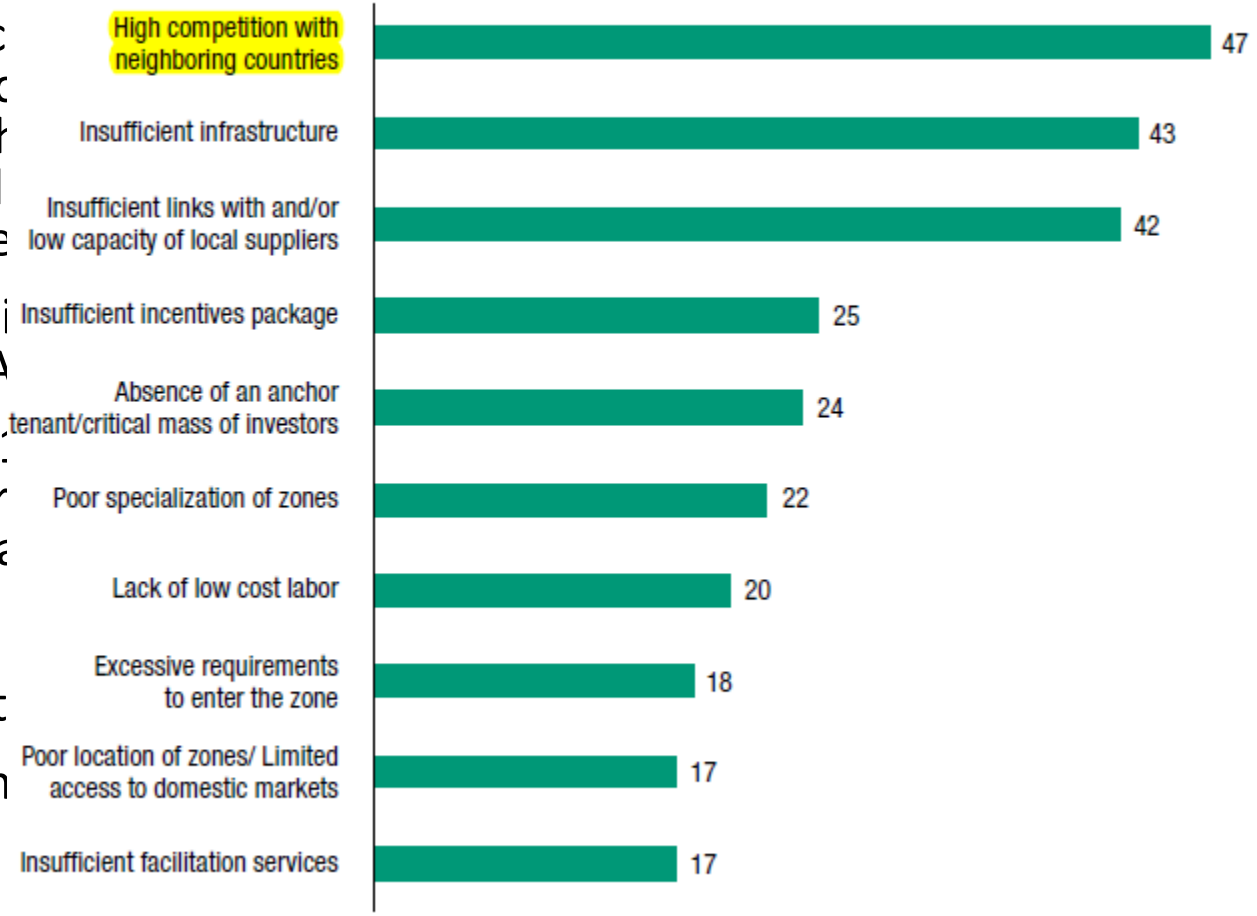
-a few have matched
elopment … Others
and GDP growth.
have become fewer;
he performance of
'

a central reason why
s" (p. 239)

nat seek to pursue
those countries

d role models

Figure IV.20. Key challenges for SEZs according to national Investment Promotion Agencies (Percentage of respondents)



Source: UNCTAD Survey of Investment Promotion Agencies.
Note: UNCTAD's World Investment Prospects Survey 2019; respondents from 120 IPAs from 110 economies.

Tax havens: Recipients of shifted profits

	Π_{shift}/Y	NX_F/NX		NX/Y	FDI/Y	τ_F		T_{CORP}/T	T^F_{CORP}/T_{CORP}
Cayman Is.	1988%			26%	811%	0.2%*			40%
Brit. Virgin Is.	1931%			34%	5547%	0.8%*			56%
Bermuda	497%			27%	0%	0.4%			9%
Luxembourg	251%	40%		33%	36%	6.6%		13%	45%
Malta	132%			5%	103%	8.9%		17%	
Ireland	64%	85%		17%	30%	4.3%		10%	65%
Singapore	29%	93%		25%	19%	5.7%		27%	33%
Hong Kong	14%	60%		4%	37%	12.8%		25%	
Switzerland	10%	62%		11%	6%	7.0%		11%	
Netherlands	9%	66%		9%	26%	16.4%		7%	20%
Belgium	4%	81%		1%	13%	15.7%		7%	20%
AVG HAVEN	**448%**	**70%**		**17%**	**603%**	**9%**		**15%**	**36%**
AVG NON-CAR	**64%**	**70%**		**13%**	**34%**	**10%**		**15%**	**32%**
Year(s)	*2015*	*2008-16*		*2008-16*	*2008-16*	*2008-16*		*2008-16*	*2016*
Data used	*Torslov et al (2018)*	*OECD Analytic. AMNE*		*World Bank/ UNStat*	*World Bank/ UNCTAD*	*BEA *OECD CbCR*		*OECD*	*OECD (2020)*

Export-platforms: Non-haven, high foreign exports

	NX_F/NX	*SEZs?*	NX/Y	FDI/Y	τ_F	T_{CORP}/T	T^F_{CORP}/T_{CORP}
Slovakia	84%		2%	3%	19%*	9%	10%*
Hungary	81%		6%	11%	15%	4%	13%*
Czechia	68%		5%	3%	18%	11%	7%*
China	50%	80% FDI 44% Exports	4%	3%	20%	25%	
Estonia	45%		3%	6%	13%*	5%	
Sweden	44%		4%	2%	13%	7%	6%
Poland (?)	44%		0.03%	3%	17%	6%	7%
Thailand	42%	2006: 15% FDI, 6% X	6%	2%	23%	28%	
Malaysia	41%	72% FDI 83% Exports	13%	3%	15%	51%	
AVG ExPlat	**55%**		**5%**	**4%**	**17%**	10%	**8%**
Year(s)	*2008-16*	*2018 FDI, 2012 X*	*2008-16*	*2008-16*	*2008-16*	*2008-16*	*2016*
Data used	*OECD Analytic. AMNE*	*UNCTAD (2019) ADB (2015)*	*World Bank/ UNStat*	*World Bank/ UNCTAD*	*BEA *OECD CbCR*	*OECD*	*OECD (2020), *OECD CbCR*

Comparison to other trade surplus countries

	$\Pi^{in}_{\text{shift}}/Y$	NX_F/NX		NX/Y	FDI/Y	τ_F		T_{CORP}/T	T^F_{CORP}/T_{CORP}
Non-Caribbean Tax Havens	**42%**	**70%**		**13%**	**34%**	**10%**		**15%**	**32%**
Export Platforms	**-1.4%**	**55%**		**6%**	**4%**	**17%**		10%	**8%**
Other net exporters in sample*	**-1.2%**	**22%**		**4%**	**2%**	**29%**		**11%**	**10%**

*Average of 18 countries that ran trade surpluses in same period of 2008-16 :

Argentina, Austria, Chile, Germany, Denmark, Spain, Finland, Indonesia, Israel, Italy, Japan, Korea, Norway, New Zealand, Russia, Saudi Arabia, Slovenia

V:
Final thoughts

Summary

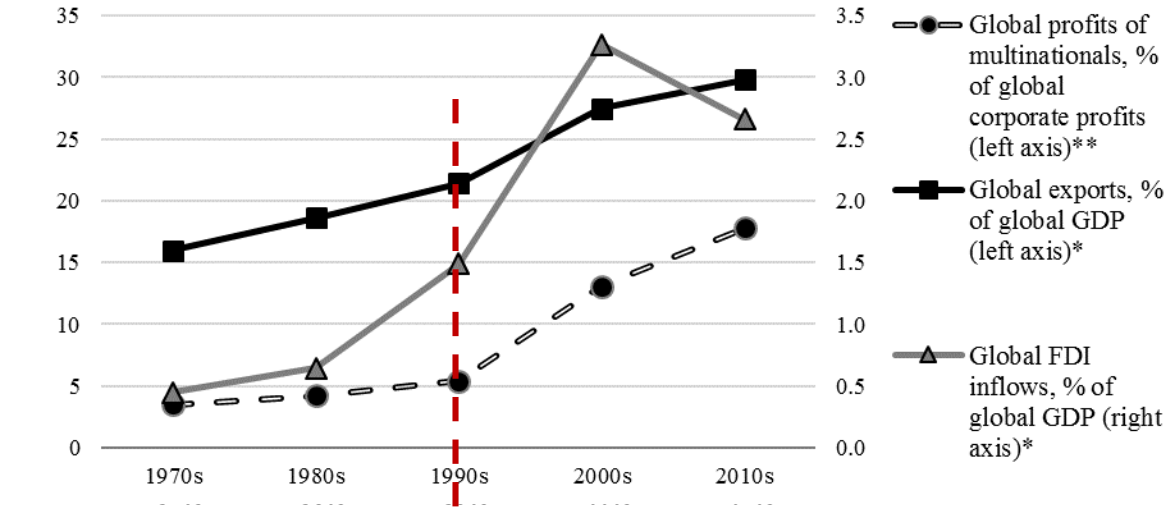
- New beggar-thy-neighbour growth models have sprung up in the period of NL globalisation
- FDI-led export platforms:
    - At the intersection of export-led and FDI-led growth
    - Primary demand channels seem to be investment and a part of net exports (=wage bill)
- FDI-led tax havens:
    - Small traditional tax havens, marked by an absence of statutory income taxes generally
    - Modern/corporate tax havens, marked by targeted corporate tax rates
    - Primary demand channel: Gov‘t expenditure, but potentially also…
        - NX_D: Domestic firms may benefit from exporting financial/professional services to MNCs
        - I_F and NX_F: When FAs need high skilled labour anyway (e.g. tech & pharma firms in Ireland)

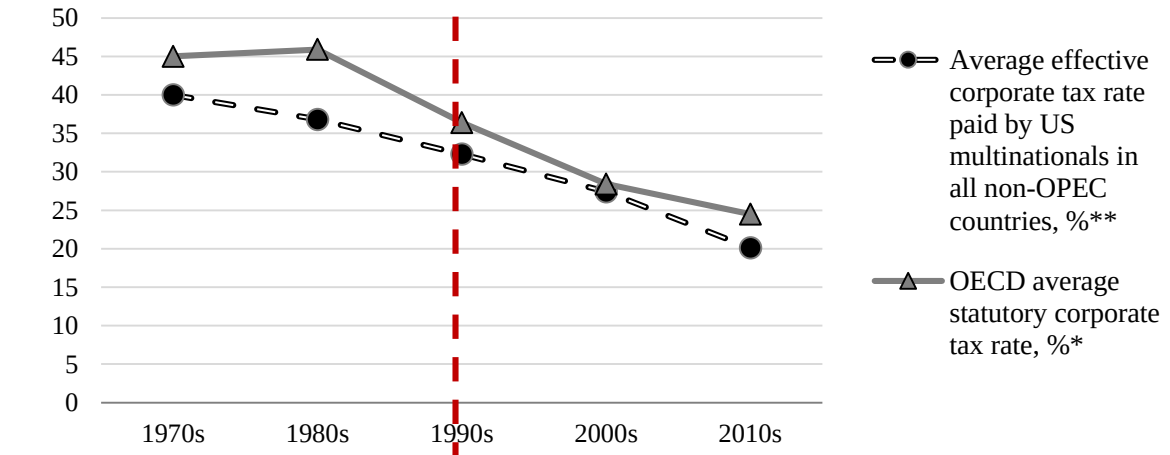
Problems of CSS-based growth

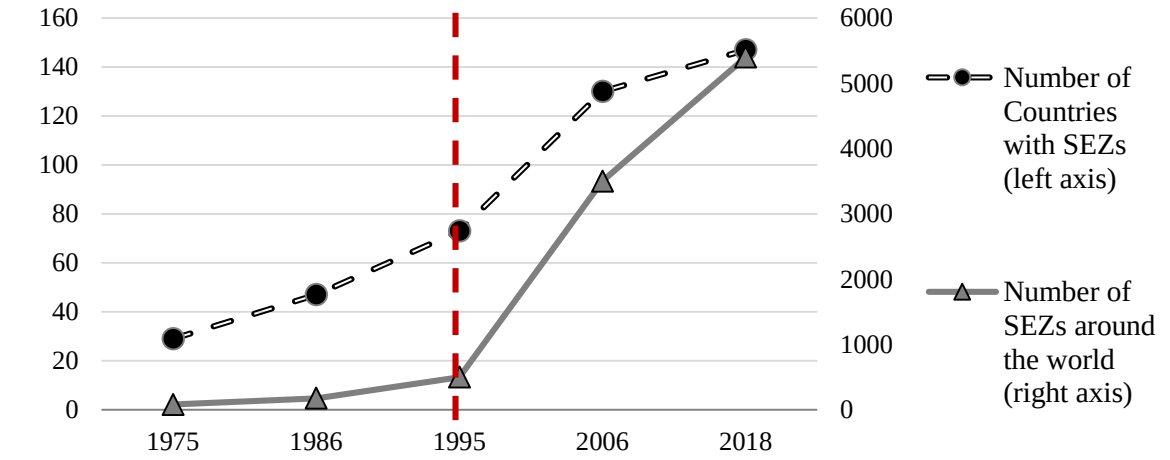
- Simultaneous, widespread policy competition means the surest winners are the multinationals and their shareholders, who mostly reside in richer nations:
  - Uneven development
  - Growing inequality
  - Stagnation in wage-led economies
- May grow unstable due to politcal factors – Likely considered unfair by…
  - Domestic capitalists, who do not receive equally favourable treatment from gov‘t
  - Foreign governments, who have every incentive to clamp down (particularly on BEPS)
- Other important concerns: Ensuing races to the bottom lead to…
  - Decoupling of social and economic upgrading in GVCs (Dünhaupt et al. 2020)
  - Less regulation around pollution, etc.

In sum, governments should enforce competition between firms, not the other way around.

EXTRA SLIDES







First instances of barge economics and CSS can be traced back decades and centuries…

←… but appear to have truly intensified since the 1990s (consistent with Palley's start date for neoliberal globalisation)

CSS is a defining feature of neoliberal globalisation, in addition to barge economics

Table 1. *Investment attraction tools and their prevalence in SEZs around the world*

Incentives	Measures include…	
Fiscal incentives 72%* - 92%†	• Complete tax exemptions • Performance-based tax deductions • Reduced tax rates	68%† 18%† 7%†

Special customs
74%* - 95%†
	• Import duty exemption on…
	  ○ Capital equipment & material inputs
	  ○ Capital equipment only
		
		55%†
		40%†

Investment facilitation 32.3%*	• Legal and technical advice • Relaxed recruitment and employment regulation	
Investment protection 26.0%*	• Assurances SEZ firms cannot be expropriated or affected by newer domestic laws	
Preferential land use 25.2%*	• Exemptions from lease payment • Reduced rent	
Trade facilitation 17.3%*	• Simplification of tax filing obligations	
Infrastructure 16.5%*	• Provision of electricity, gas, water, communication utilities	
Social amenities 3.1%*	• Provision of educational, health, or recreation facilities	

** Of a sample of 127 SEZs (UNCTAD 2019, pp. 166-167)*

† Of a sample of 553 SEZs (CIIP 2017, p. 19)

Might CSS form the basis of a growth model?

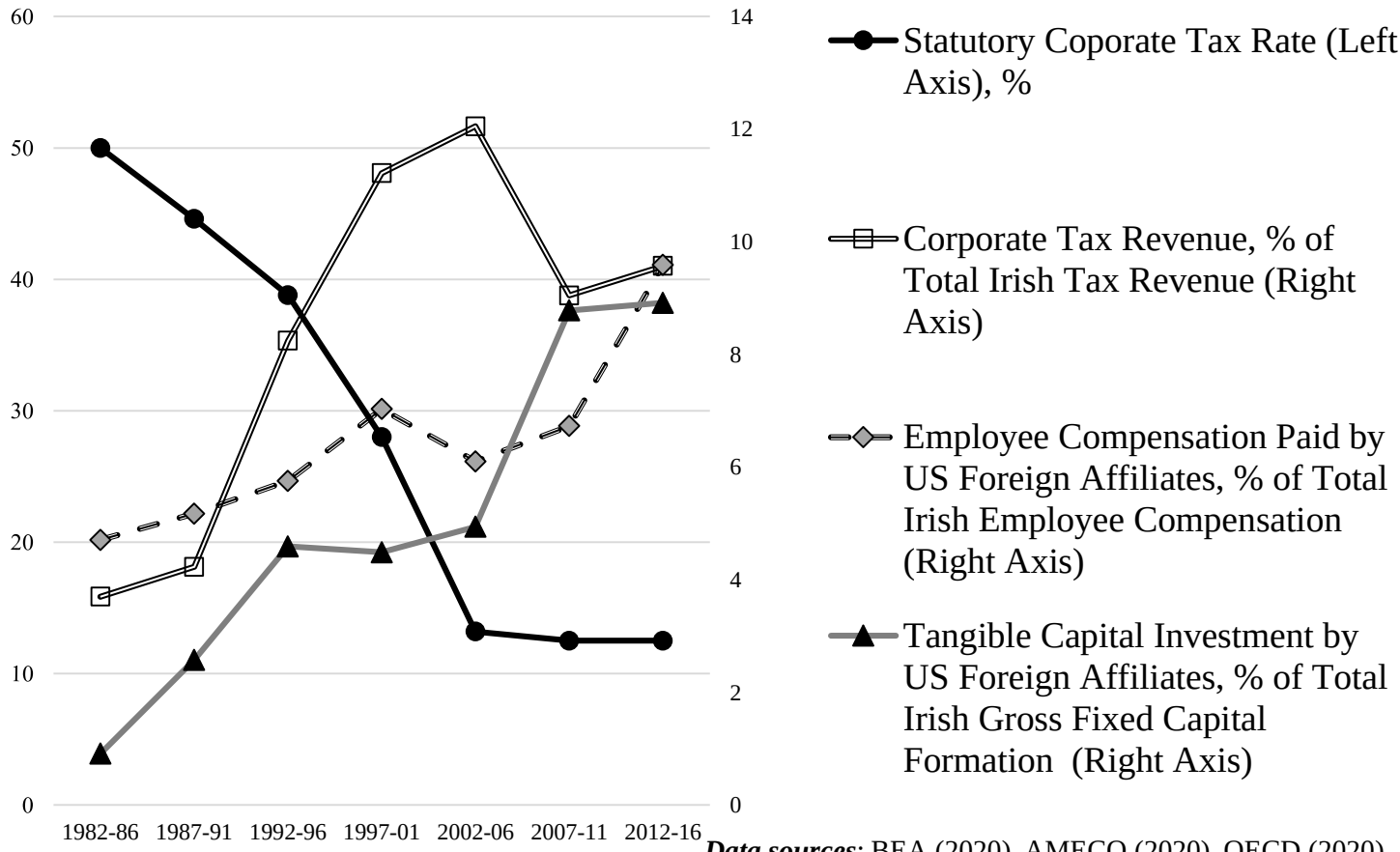
Since 1990, when the real GNI in G7 grew 2% annually…

Ireland – avg. (modified) rGNI: 4%

- CSS begins 1956: Export profits tax relief
- 1958: First „modern“ SEZ at Shannon
- 1984: AECTR on US affiliates: <2% (BEA 2020) and hovered around 5% since

China – avg. Real GNI: 10%

- First SEZs in 1980 (influenced by Shannon)
- 2018: 2543 SEZs, ~50% of world (UNCTAD 2019)
- SEZs account for 80% cum.FDI (2018) and 44% of exports in 2012 (ADB 2015, UNCTAD 2019)



Data sources: BEA (2020), AMECO (2020), OECD (2020)

CSS: An exhausted paradigm

Copycat policy arising from early successes

- 1940s: Puerto Rico & Panama → 1950s: Ireland & Caribbean (Lewis 1950; Barry & Ó Fathartaigh 2015; Barry & O'Mahony, 2017)
- Ireland → 1960s SE Asia and (end of 1970s) China (Kennard & Provost, 2016)

Since then,

- Countries with SEZs grew from around 30 to 150 in number
- Average corporate tax rates have halved

In the beggar-thy-neighbour zero-sum-game of state commercialisation, simultaneous and widespread competition means the surest winners are the multinationals and their shareholders, who mostly reside in richer nations. This has important ramifications for inequality and uneven development the world over, as well as stagnant demand and output growth in wage-led economies. ALSO: fuel feelings of disenfranchisement among voters, who increasingly see the power of multinationals and their shareholders go unchecked. Moreover, the ensuing races to the bottom in regulation are likely to be a driver of the decoupling of economic and social upgrading in global value chains, as is documented by Dünhaupt et al. (2020).

Governments should enforce competition between firms, not the other way around

Saez & Zucman (2019) proposal to address tax competition and BEPS:

- Exemplarity, coordination, defensive measures, and sanctions

Palley (2015): Globalisation ≠ free trade

- Anti-protectionist conclusions of trade theories that do not account for the mobility of factors of production are deeply problematic
- Dunning (2008, p.71): Historically speaking, “the majority of first-time manufacturing and service investments” of foreign firms was motivated by the desire to circumvent trade barriers

	Primary demand channel(s)	Possible catalysts	
Domestic demand-led	Government expenditure	Demand management policy	
	Consumption	Pro-labour distributional changes in wage-led regime	
	Investment	Pro-capital distributional changes in profit-led regime	
Debt-led	Consumption, non-capacity creating investment	Private debt growth (fuelled by inequality), asset price inflation	
Export-led	Net exports	Price factors	Wage moderation
			Competitive currency devaluation
		Non-price factors	Natural resource endowment
			Industrial policy

Why might CSS fail to fuel growth?

Theory shows:

- τ_F must be low enough to arouse interest of multinationals…
- … but not too low: Subsidies may leak out of circular flow to no effect

Furthermore, in reality:

- Policy competition is shrouded in fundamental uncertainty: how much lower should τ_F go if other countries are also lowering τ_F? (*cf.* Woodgate 2020)
- Path dependency: Can you outcompete those who reached the bottom first?
- Political challenges: unhappy domestic capitalists and foreign gov‘ts