Economic and Financial Committee

Topic 2: Establishing a Multilateral Trade Agreement to Promote Economic Development and Cooperation with Special Regard to Taxation

-Committee Guide-

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1. Introduction into a trade agreement

A trade agreement is a contract between two or more countries. It enables easier exchange of goods and services. Additionally, it regulates the trade between countries and facilitates it, often simplified by a fixed contract. Such a contract often involves consideration of taxation. Various factors are involved, such as ensuring the supply of a product that is grown or produced only in another country. Another point is that supporting a producer from another country can result in reduced custom duties. In such cases, it may make sense to seal a trade agreement that lowers taxation. However, if the goal is to support domestic producers and promote their products, it may be more effective to increase tariffs within an agreement. This is just a small example of the multiple factors that explain why a trade agreement, particularly in terms of taxation, can offer economic advantages.

2. What is the issue and why is it problematic?

Such agreements are primarily intended to reduce trade barriers such as tariffs or import quotas and facilitate cross-border trade. However, tax policy aspects are often neglected or inadequately considered, which can lead to several challenges. A central problem lies in so-called tax evasion and profit shifting by multinational corporations. When several countries promote the free movement of capital and goods in a multilateral agreement, companies often gain new opportunities to shift their profits to countries with lower tax rates,for example, through internal transfer pricing, licensing fees, or intra-group lending. Without a coordinated international tax policy, this can lead to a "race to the bottom": countries continually lower their corporate taxes to remain competitive and attract investment, which can weaken their public budgets in the long term.

Another problem arises from the unequal economic performance of the countries involved. While highly developed industrialized countries have functioning tax administrations and expertise in international tax avoidance, many developing countries are structurally disadvantaged. They can neither effectively combat tax avoidance nor do they have sufficient resources to negotiate international agreements in their favor. As a result, a multilateral agreement can widen the economic gap between rich and poor countries.

In addition, many trade agreements contain so-called investor-state dispute settlement (ISDS) mechanisms, through which foreign investors can sue states if they feel disadvantaged by national laws,including tax regulations. This can effectively prevent states from adapting their tax policies flexibly to societal needs for fear of high compensation payments.

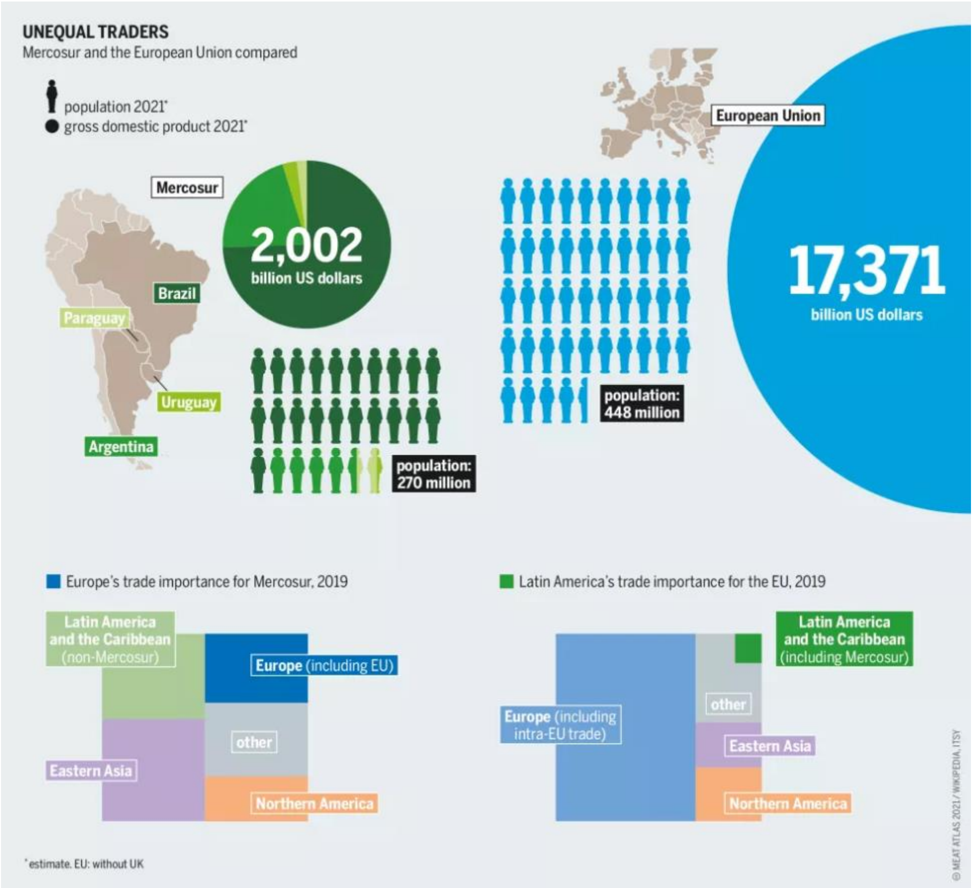
Finally, many multilateral agreements lack transparency and democratic legitimacy. Negotiations often take place behind closed doors, with the strong influence of large corporations. Tax issues, which are central political and social topics, are not openly discussed, even though they directly affect the distribution of wealth and the financing of public goods.

3. Which regions are affected?

An example for a trade agreement is the EU-Mercosur-Agreement. The agreement is in this case between the Europe Union and South America. Mercosur is a regional economic bloc composed of five South American countries, Argentina, Brazil, Paraguay, Uruguay and Venezuela. The goal is the degradation of customs duties, as well as tax advantages for exporters and the standards for sustainable development. With a successful agreement, around 90% of custom duties between the EU and Mercosur would be abolished, boosting both exports and imports. The first ideas and plans of the agreement were introduced in July 2019 and it is expected to come into force by the end of this year.

Why does it take so long to plan and finalize an agreement? In the case of the EU-Mercosur Agreement, the countries agreed on the text at the political level in 2019. By the end of 2024, the final conclusion of negotiations on outstanding issues, particularly in the areas of labor rights and environmental protection, ended. However, there are several factors that cause delays. In Europe, especially in France, there is strong resistance from farmers who fear that the import of agricultural products from South America will undermine their livelihoods. Despite the many concerns, there are many economic but also fundamental advantages. A reason for this is that the European Union has a lot of experience, when it comes to trade agreements. They have so far concluded 40 trade agreements with more than 70 countries and regions.

This trade agreement is a suitable example with many positive and negative facets that could all be combined. Such agreements exist in many regions of the world, because they simplify trade and often lower costs, supporting economic growth.



4. <u>What has been done so far to make a difference?</u>

   There are free trade agreements (FTA) whose aim is to reduce tariffs and trade barriers.

   There are also customs unions and international markets. An example of an international market is the European one. Here, free movement of goods, services, capital and people applies. Product standardization and regulations promote cross-border cooperation. The WTO (World Trade Organization), founded in 1995, provides a platform for multilateral trade dispute resolution. It sets international rules for trade disputes and promotes transparent and fairtrade relations. With special regards to companies, for example, the Double Taxation Agreement (DTA) was established. The goal is to avoid double taxation in cross-border activities.It also encourages businesses to choose locations and invest across borders.. There is also the OECD

(Organisation for Economic Co-operation and Development) Minimum Tax, which was adopted in 2021. This sets a minimum tax rate of 15% for large, international corporations. The goal is to prevent tax avoidance through profit shifting to low tax countries. This creates a level playing field worldwide.

5. Why is there still an issue/conflict?

A central problem in concluding modern Trade Agreements lies in the different economic interests of the participating states. While industrialized countries are primarily seeking access to new markets for their technologies and services, many emerging and developing countries fear that an overly rapid market opening will endanger their domestic economy. This conflict of interest is particularly evident in the case of tax regulations: countries with low corporate taxes want to retain their location advantages, while high-tax countries want to take action against tax avoidance of international corporations. Many countries are concerned about giving up control over their tax policies, as they see taxation as an important part of their national sovereignty. International obligations, such as the introduction of a global minimum tax or mandatory tax transparency, are therefore often perceived as interference with one's own state autonomy. The enormous complexity of such negotiations adds to the difficulty. Trade agreements cover a variety of topics,from tariffs and environmental standards to investment protection and tax regulations. Especially tax aspects such as withholding taxation, profit transfer or transparency regulations are legally and technically particularly demanding, which often makes the negotiations lengthy and conflict-ridden. In addition, the drafting of many agreements face political and public opposition. In the public debate, the focus is often on fears that trade and tax agreements will place corporate interests above national laws or are negotiated in an intransparent manner. This leads to parliaments or governments blocking ratification or exerting strong pressure on civil society organizations, such as CETA (Comprehensive Economic and Trade Agreement between Canada and the European Union) or TTIP (Transatlantic Trade and Investment Partnership between the EU and the United States). Last but not least, the implementation of many international tax regulations fails due to the lack of global assertiveness. Some countries,especially tax havenssuch as Cayman Islands, Monaco, UAE, Panama or Lichtenstein, do not participate in international agreements or even deliberately undermine them. In doing so, they undermine efforts to increase tax transparency and fair taxation and jeopardize the credibility of multilateral agreements.

6. <u>What are the consequences?</u>

   If free trade agreements are not concluded within the right political framework, they can damage economic prosperity rather than increase it. A vivid example of the difficulties and conflicts in concluding modern trade agreements is the CETA between the European Union and Canada. Although it was already signed in 2016 and put into force provisionally in 2017, it has not yet been fully ratified by all EU member states, a clear sign of the political and social tensions that such agreements can trigger. Opposition to CETA feeds mainly on the concern that economic interests could be placed above democratic and social standards. The planned investment court system, which allows corporations to sue states if they feel disadvantaged by new laws, such as those related to the environment or taxation, was viewed particularly critically.. Critics fear that this could weaken national legislation and restrict government freedom of action. CETA has also revealed fundamental weaknesses in tax policy. Although the agreement itself does not regulate specific tax rules, the promotion of cross-border investment and closer economic interlocking creates increased pressure on national tax systems. Tax avoidance by multinational companies is thus more likely to be facilitated than prevented if no binding tax policy standards are integrated into the agreement. Especially at a time when international minimum taxation and measures against profit transfer are central issues, CETA has been accused of not keeping up with the current challenges of the globalized economy. Instead of taking a clear position against aggressive tax planning, the agreement left these issues to national or other multilateral regulations,an approach that is considered insufficient in today's tax policy debate. The consequences of this incomplete approach are far-reaching. On the one hand, the unclear tax structure of the treaty has significantly weakened public acceptance and delayed ratification. On the other hand, it has stimulated the discussion about how future trade agreements need to be designed not only to promote economic exchanges, but also to ensure fiscal fairness and political sovereignty. As a result, CETA became a symbol of the tensions between global economic integration and national control over key areas such as tax policy, environmental protection and social standards.

7. <u>Who needs to handle this issue/take action?</u>

The failure of a trade agreement, whether it fails to function effectively or is terminated prematurely, can have significant consequences for all parties involved. First, the government of the affected country must take care of it, especially the ministries of economy, finance and foreign policy. Parliament also plays a role when new legislation is needed. Companies that are dependent on trade will also have to adapt to the new situation. At the same time, the other countries or trade partners that were part of the failed agreement must also be involved. International organizations such as the World Bank or the World Trade Organization often often assist in identifying and implementing solutions.. In order for a new or improved agreement to emerge, it is important to first understand the reasons for the failure. Maybe the conditions were unfair, the taxes too high or there were too many tariffs. After that, the countries must renegotiate and ensure that the agreement is beneficial to both sides. It is also particularly important that tax issues are clarified,for example, so that companies do not have to pay double taxes and clearly understand which rules apply. This also makes a country more attractive to foreign investors. A good trade agreement should also promote cooperation between countries. This also includes sharing knowledge and technology or investing together in training and infrastructure. It is best if environmental and social standards are also observed, so that the agreement is not only economic, but also sustainable.