

# An Evaluation of the Implications of the Bhagwati Tax on South-North Migration: A Dual Perspective

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*Abstract- This research critically evaluated the implications surrounding the proposed Bhagwati tax in the context of increasing South-North migration. This migration trend has gained momentum in recent years, as individuals from Southern countries seek better economic opportunities and higher returns on education in Northern regions. The Bhagwati tax, named after renowned economist Jagdish Bhagwati, is designed to impose a tax on skilled emigrants, with the intent of curbing brain drain and fostering development in their home countries. Proponents argue that the tax could serve as a financial mechanism to retain valuable human capital in the South. Conversely, critics of the Bhagwati tax raised several concerns. They argued that imposing such a tax could deter skilled individuals from pursuing opportunities abroad, infringing on personal freedoms and reducing the overall attractiveness of migration. The research methodology adopted is doctrinal.*

**Key Words:** *Bhagwati Tax, Global North, Global South, Migration*

## I. INTRODUCTION

The Bhagwati tax, named after economist Jagdish Bhagwati, is a proposed tax reform aimed at simplifying complex tax systems in developing countries.<sup>1</sup> Bhagwati advocates for policies that promote economic growth while ensuring equity in wealth distribution. This tax concept focuses on broadening the tax base while lowering rates, which is believed to enhance compliance and reduce tax evasion.<sup>2</sup> One central tenet of the Bhagwati tax is that it is believed that a simplified tax system is more efficient and less burdensome for taxpayers. Complex tax codes lead to high compliance costs and can impede investment. By reducing exemptions and loopholes, the Bhagwati tax seeks to increase government revenue.<sup>3</sup>

Practical implementations of the Bhagwati tax principles have been discussed in various reports, including one by the World Bank, which highlights

successful tax reforms in several countries that adopted similar strategies. This underscores the importance of transparency and accountability in tax administration. Academic discussions in the Journal of Economic Perspectives further explored the implications of simplified tax systems on economic performance and social welfare.<sup>4</sup> In summary, the Bhagwati tax is a proposal that represents a significant shift in tax policy designed for emigrants, aimed to foster economic growth while addressing social inequalities created by and through emigration.

## II. ARGUMENTS FOR THE BHAGWATI TAX PROPOSAL

The Bhagwati tax proposal had a meritorious acceptance by a large group of pro-remittance individuals and development and infrastructure believers. They agreed on some benefits that adopting and implementing the tax proposal in the global south would accomplish to wit:

- i. The tax will address Fiscal Losses from Emigration: The Bhagwati tax is proposed as a mechanism to compensate developing countries for the fiscal losses they experience due to the emigration of skilled workers from their countries.<sup>5</sup> The logic here is that, by taxing the income of emigrants, the source country can recoup some of the revenue it would have received had those individuals remained and contributed to the tax base.<sup>6</sup>
- ii. It will Enhance Government Revenue: Even a small tax on nationals working abroad could substantially increase government revenues for countries like India and the many countries of the global South, bearing in mind the countries with high indebtedness due to poverty and governance challenges.<sup>7</sup> These funds could then be used for public services, infrastructure development, or

other initiatives to boost the economic growth in these countries of the South.

- iii. It will promote Equity: The Bhagwati tax proposal, if adopted, will address the equity concerns emanating from the 'brain drain' because skilled migrants often benefit from higher incomes in developed countries, partly due to immigration restrictions that create economic rents<sup>8</sup> and taxing a portion of their income can be seen as a means to redistribute some of the gains back to their country of origin.
- iv. It will incentivize competition for citizens: Adopting and implementing the Bhagwati tax as part of a global tax system will incentivize countries to compete for citizens rather than just residents,<sup>9</sup> and to avoid losing citizens to emigration, governments might be encouraged to adopt policies that make living and thriving in the home country more attractive.<sup>10</sup>
- v. Potential for Universal Welfare Improvement: When considering the social intricacies of human capital, a brain drain tax system can foster investment in human capital and increase the income and welfare of residents left behind. If the tax is adequately paid in addition to ordinary income taxation, the larger fiscal burden on migrants might be offset by their higher human capital and gross income.<sup>11</sup>
- vi. Global Tax Coordination Benefits: The Bhagwati tax could pave the way for enhanced global tax coordination. By establishing a framework for taxing emigrants, countries may be encouraged to collaborate on international tax treaties, which can help minimize tax evasion and address issues related to double taxation.<sup>12</sup> This collaboration could lead to a more stable and predictable tax environment, enhancing investment opportunities across borders. A unified approach may ultimately mitigate tax competition between nations, fostering equitable taxation based on shared global principles.<sup>13</sup>

### III. ARGUMENTS AGAINST THE BHAGWATI TAX

- i. Implementation Challenges: Taxing emigrants requires international cooperation and complex administrative mechanisms will make implementation difficult.<sup>14</sup> Taxing emigrants poses significant hurdles related to international

cooperation and administrative complexity. Many countries lack the infrastructure to track the incomes of their citizens living abroad, leading to difficulties in enforcement. Additionally, individual countries must negotiate terms that allow for the collection of taxes without infringing on each other's sovereignty. The variations in tax laws and compliance standards can further complicate the implementation process, making it cumbersome and potentially inefficient. Also, the political will to establish such a system may also be lacking, as governments may prioritize other pressing issues. Overall, the challenges of creating a cohesive and enforceable tax framework for emigrants could limit the effectiveness of the Bhagwati tax proposal. Bhagwati himself recognized the political and administrative problems involved in extending a country's tax system to include emigrant incomes.<sup>15</sup>

- ii. Discourages Emigration and Remittances: The tax may deter skilled workers from emigrating or sending remittances which will in turn reduce financial inflows to the home country.<sup>16</sup> The World Bank notes that taxes may discourage migrants from returning to their home country and reduce diaspora remittances and investments.<sup>17</sup>
- iii. Equity Concerns: It could be seen as unfair to tax emigrants who may already be contributing to their new country's economy.<sup>18</sup> Some argue that immigrants deserve compensation for hardships endured rather than paying a tax on two fronts.<sup>19</sup>
- iv. Administrative Costs: The costs of administering and enforcing the tax may outweigh the revenue generated, especially for smaller countries.<sup>20</sup> Relatively small countries with high emigration rates may lose, while larger developing countries may gain.<sup>21</sup>
- v. Brain Drain Exacerbation: High taxes on emigrants could incentivize more skilled workers to leave permanently, worsening the brain drain.<sup>22</sup> To prevent this, the tax rate should be low enough not to affect the decision to emigrate.<sup>23</sup>
- vi. Compliance Issues: Enforcing compliance among emigrants living abroad can be challenging, leading to potential tax evasion and revenue loss.<sup>24</sup> The Internal Revenue Service using advanced technology to identify discrepancies, and consequences for non-compliance can be severe.<sup>25</sup>

#### IV. COUNTRIES WITH AND WITHOUT ROBUST TAX SYSTEMS

In no particular order, preference and without exhaustion to the list of countries that have demonstrated having a robust tax system, below are a few examples:

- i. Estonia: Estonia consistently ranks high on the International Tax Competitiveness Index due to its efficient tax system. A key feature is that corporations don't pay income tax on retained earnings, which encourages reinvestment.<sup>26</sup>
- ii. Latvia: Similar to Estonia, Latvia also allows companies to reinvest profits without immediate taxation and offers deductions for property tax. This has contributed to a competitive business environment.<sup>27</sup>
- iii. New Zealand: New Zealand has a relatively flat, low-rate individual income tax system. The government allows companies to carry forward losses to the next year, reducing the tax burden.<sup>28</sup>
- iv. Singapore: Singapore's territorial tax system, which exempts most foreign income, makes it a leading global low-tax hub. It only taxes earnings sourced locally or remitted into the country, attracting foreign investment and skilled workers.<sup>29</sup>
- v. Switzerland: Switzerland boasts a large number of tax agreements and a relatively low standard VAT rate. Its stable economy and favorable tax policies attract international businesses and high-net-worth individuals.<sup>30</sup>

Regions with Poor Development Due to Ineffective Tax Reforms:

- i. Sub-Saharan Africa: Many countries in this region struggle with low tax-to-GDP ratios, often below the 15% threshold needed to provide basic services. They face challenges like tax evasion, illicit financial flows, and weak tax administration.<sup>31</sup>
- ii. Latin America: Several Latin American nations grapple with complex tax systems, corruption, and tax avoidance, leading to insufficient public investment and social inequality. The region also faces challenges in taxing multinational enterprises effectively.<sup>32</sup>
- iii. Asia-Pacific: Tax revenues in relation to GDP remain low in the Asia-Pacific region compared to

OECD countries. Several countries are in the early stages of tax reform, indicating ongoing challenges in mobilizing domestic resources.<sup>33</sup>

- iv. Countries Blocking UN Tax Reform: A report by the Tax Justice Network indicates that countries opposing UN tax reforms, including some OECD members, enable a significant portion of global tax abuse, leading to revenue losses for other nations.<sup>34</sup>
- v. Heavily Indebted Poor Countries: Many of the world's poorest countries struggle with weak tax systems, making them heavily reliant on external aid. These countries often face difficulties in mobilizing domestic resources to finance sustainable development goals.<sup>35</sup>

#### V. CHALLENGES SURROUNDING THE BHAGWATI TAX PROPOSAL

- I. Enforcement and Administration Costs: Implementing the Bhagwati tax requires significant administrative infrastructure to track and collect taxes from emigrants, potentially outweighing the revenue generated, especially for smaller countries.<sup>36</sup> Bhagwati himself acknowledged the practical difficulties in implementing such a tax.<sup>37</sup>
- II. Risk of Reduced Remittances and Emigration Deterrence: The tax may discourage skilled workers from emigrating or sending remittances, reducing crucial financial inflows to their home countries.<sup>38</sup> The World Bank also suggests that taxes may discourage migrants from returning to their home country and reduce diaspora remittances and investments.<sup>39</sup>
- III. Equity and Fairness Concerns: Taxing emigrants could be viewed as unfair, especially if they are already contributing to their new country's economy through taxes.<sup>40</sup> Some argue that immigrants deserve compensation for hardships endured rather than paying a tax.<sup>41</sup>
- IV. International Cooperation and Legal Issues: Successful implementation hinges on international cooperation and agreements to share tax information, which can be difficult to achieve.<sup>42</sup> The legal and political constraints may hinder its materialization into an operative tool.<sup>43</sup>
- V. Potential for Brain Drain Exacerbation: High taxes on emigrants could incentivize more skilled workers to leave permanently, worsening the brain

drain.<sup>44</sup> To prevent this, the tax rate should either be low enough not to affect the decision to emigrate or makes emigration worse.<sup>45</sup>

## VI. RECOMMENDATIONS

- a. Implementation of countrywide surveys in Southern countries to gather detailed information on migration trends, educational backgrounds, and motivations. This data collected will help identify key drivers of migration and inform policies to enhance local educational opportunities and retain skilled talents;
- b. Conducting a thorough cost-benefit analysis to assess the Bhagwati tax proposal, its effectiveness in reducing human capital flight (brain drain) and generating revenue for development in Southern countries and consequently promulgating policies to make proficient decisions in the adjustment of the tax;
- c. Through the lenses of comparison, assessment should be conducted in the areas of remittances, personal freedoms and economic implementation to understand potential trade-offs and arriving at competent policies that provides an equilibrium for the interest of migrants and developmental needs of their home countries.
- d. After adoption and implementation of the tax, governments should establish a policy whereby, in order to start a university education, individuals or their family must sign a contract that stipulates that if they emigrate at some point in the future, they must transfer back a specified share of their income (for a specified period of time) and to ensure enforcement, the government would have each prospective student's family sign a contract whereby it would pay the tax if the student emigrated and failed to make the agreed-upon payments, with the family's assets serving as collateral. Also, the contract would stipulate that if individuals emigrated at some point after their studies and failed to make the agreed-upon transfers, the source country's government could challenge it in court, given that most skilled migrants live in about ten advanced countries, it might be worth examining the feasibility of an agreement on this issue. Once established, the host country's government would not have to be directly involved in the execution of the policy.

## VII. CONCLUSION

Bhagwati's proposal for a brain-drain tax survives major objections that have been levied against it, including the view that it would eliminate desirable competition for residents. Note in addition that governments compete not just for residents, but also for capital investment, and the latter form of competition is not directly affected by a brain-drain tax. A major stumbling block in the implementation of such a tax continues to be the administrative problems associated with collecting it. But these problems exist whenever taxes are levied on foreign-source income. Without the cooperation of host country governments, it is most difficult for the source country to collect these taxes. A large element of such cooperation would include information-sharing among governments, a topic that is now being actively researched (e.g, Keen and Ligthart.<sup>46</sup>

The tax proposal in itself as canvassed by its proponent shall bring about instant and sustainable economic benefits, but then, amidst these challenges as highlighted, questions like who? Where? At what point such taxes are to be collected? What if? etc. arises.

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