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AN ANALYSIS OF DR. MAHATHIR MOHAMAD'S PROPOSAL TO TAX THE RICH COUNTRIES TO FINANCE INFRASTRUCTURE PROJECTS IN POOR COUNTRIES

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In a speech on February 27, 2001 in China during the official launching of the BOAO Forum for Asia, Dr. Mahathir Mohamad, the Prime Minister of Malaysia, proposed that the rich countries be taxed to finance infrastructure projects in the poor countries. The purpose of this paper is to analyse the proposal.

2. Despite the technological advances, **mankind has failed so far in its collective effort to end poverty.** The sub-Saharan Africa is a good example. Half of sub-Saharan Africa's 600 million people live on less than US$0.65 cents a day, and recently they have been getting even poorer. The rules of the game in international trade continue to be biased against the poor countries. According to The Economist (February 24th 2001), if North America, Europe and Japan were to eliminate all barriers to imports from sub-Saharan Africa, the region's exports would rise by 14%, an annual increase worth about US$2.5 billion. The developed countries' farm subsidies, which

hinder the agricultural exports of developing countries, amount to over US$360 billion a year, some US$30 billion more than Africa's entire GDP. To make things worse, while the prices of the exports of the rich countries have been rising, those of the developing countries' primary products have been generally falling. In the context of the worsening conditions in many poor countries, there is a need to consider Dr. Mahathir Mohamad's tax proposal with seriousness and a sense of urgency.

3. The proposal is, of course, international in nature. However, it has a particular relevance to the Muslims, as **69% of the Muslim population live in low income countries.** On the other hand, out of the 49 countries in the world defined as high income countries, only 4 are OIC countries. Less than half of one percent of the Muslim Ummah live in these 4 rich countries. (Details in Appendix 1).

Basic parameters

4. The **basic parameters** of the proposal should be easy to define, viz:-

(i) Tax the rich countries on a sliding scale.

(ii) Use the tax proceeds to build infrastructure projects in the poor countries.

(iii) Use an existing international institution to perform the task of collecting the tax and to carry out the projects identified by the recipient countries together with the managers of the Infrastructure Fund. Both must agree before the project is implemented.

Grant versus loans

5. How is this tax proposal superior to increasing the loans to poor countries from, say, the World Bank for infrastructure projects? **There are many problems associated with loans, even long term loans at low interest rates.** In the first place, poor countries are living from hand to mouth and are barely able to pay for their operating and maintenance costs. They would not have the cashflow to repay the infrastructure loan. In any case, whatever free cashflow the poor nations have will need to be spent on other expenses with direct and immediate economic benefits, such as trade and agricultural production, through purchases of fertilizers and seeds. If the infrastructure is funded by way of a loan, the repayment will

require tolls or taxes, which will burden the poor. This would defeat the purpose of the infrastructure in the first place. Indeed, in the case of many infrastructure projects funded through World Bank loans, the projects have turned out to be a national burden, since the resources of the nation are used to repay the loans, instead of reinvesting in revenue generating assets. Moreover, in the case of loans, there is the foreign exchange risk problem, which almost always works against the poor countries.

Why should the rich pay?

6. It is considered logical and right for those who make a good living in a country, through business for example, to pay tax on their income. The conditions in the country have enabled them to earn an income and they should return a part of it to the people through taxes levied by the Government. Such taxes on incomes are based on a sliding scale with allowances made for normal needs, while the highest portion of the income is taxed at the highest rate. This way the poor would be able to enjoy amenities which they would not be able to afford otherwise. But the rich too would enjoy the infrastructure built by the Government.

7. In the globalised world there will be rich nations and poor nations, and very poor nations. The rich would be able to enrich themselves further as the opening up of countries would provide more opportunities for them to invest their capital, technology and world-wide network. They would become even richer.

8. The poor may benefit a little from the inflow of investments but their earnings would be minimal. In relative terms they would actually become poorer. Besides, should the rich decide to pull out their capital, the economy of the poor countries can collapse completely. The result would certainly be to widen the gap between the rich countries and the poor. **A globalised world divided into rich countries and poor countries would be quite meaningless, as meaningless as a rich country having segments of the population in a state of permanent poverty.**

9. Today globalisation seems to be focused on those countries which had developed sufficiently for the rich to move in and exploit. **Little attention is given to the very poor countries which are so poorly developed that they will not provide opportunities and a**

good market for the rich. Thus the countries of Africa, Central Asia and the islands of the South Seas are ignored by the international bankers and the giant trading and manufacturing corporations.

10. If this trend continues, then the globalised world would be unevenly developed. Despite efforts at poverty eradication within countries there will be glaring poverty in the community of nations. Is this the new world order that we are aiming for with globalisation? If we believe in poverty eradication within a country, then we must eradicate the poverty of countries, too. The sight of rich countries and their wasteful consumption in the midst of abject poverty in major parts of the world is shameful. Surely the rich must be prepared to part with a little of the wealth they earned from the globalised world, so that the poor countries can also enjoy some of the amenities the rich take for granted.

Direct benefits to rich countries

11. **The building of infrastructure projects in the poor countries will also provide a direct benefit to many of the rich**

countries, since only they are capable of providing the technology, the sophisticated machinery and the engineering skills required for big infrastructure project. In some of the rich countries the boom in infrastructure building is already over. The infrastructure development phase has matured. However, on the basis of this proposal, these countries can facilitate the longevity of their engineering and infrastructure companies by sending them abroad. Even the rich countries, where construction continues to be an important domestic activity, will benefit. This is because, given that the construction sector is cyclical in nature with painful downturns, the existence of opportunities for infrastructure development in poor countries would help to smoothen the cycle, since excess capacity can be sent abroad while the domestic construction industry awaits the next upcycle in the domestic market.

12. A very poor country would surely be a poor market for the products of the rich countries. By contributing to the building of infrastructure in the poor nations, the rich nations will be securing potential new markets for their products. Infrastructure by itself builds up new demand for new goods. Better electricity, for example,

creates demand for more television sets, washing machines and fridges. New roads creates demand for more cars. A cellular phone network will create an immediate demand for cellular phones. These goods will be supplied by the rich countries. After having built the infrastructure, the contractors in the rich countries can continue to earn additional income from ancillary contracts from the poor countries, such as operations and maintenance upgrades. At the same time, the infrastructure project will improve the standard of living in the poor countries, thereby resulting in a win-win situation.

13. The rich countries, by agreeing to the proposal, will be contributing directly to the efforts to eliminate poverty in the world and thereby remove a substantial burden on the world community. Nature abhors a vacuum. The widening of the wealth gap between countries is bound to create friction and tension. By distributing some of its wealth, the rich world would assist in releasing some steam from the pressure of the wealth imbalance.

14. Poverty breeds illness and plagues. These may rapidly spread to the rich countries themselves. **Improving the standards of living**

of the poor nations improves the health level of rich nations, too, since it reduces the chances of epidemics that can spread worldwide. The problem of economic refugees is the result of poverty, either directly or indirectly due to wars that have erupted due to poverty. The rich countries, in the end, will have to receive some of the poor as refugees and bear the financial burden of looking after them. The amount spent looking after the refugees can be given by way of a tax for infrastructure projects to the poor countries to prevent the refugee problem in the first place.

Benefits of infrastructure

15. Why Infrastructure? Infrastructure is a basic requirement for any economy and it provides the fastest gains. No trade or manufacturing activities can be carried out without first addressing the infrastructure issue. Once infrastructure is in place, all sorts of economic activities can be spurred on. Wherever a road or a rail track is built, towns spring up. Local producers will not only find a market in the new towns but will be able to market their produce in far away places, including in foreign countries. **Infrastructure by its very nature as a "social good" benefits a very broad range of the**

population of any country. Many poor nations cannot afford infrastructure costs which are high and lumpy, although they may be able to support the normal maintenance budget. Given that the poor nations need the infrastructure to get out of poverty, but at the same time cannot afford the infrastructure projects, **there is an inherent vicious cycle operating in these nations. The Prime Minister's proposal is intended to help break this vicious cycle.**

Definition of rich countries

16. If we want to tax the rich, we must know who they are. The countries in the world are normally divided into 5 categories, as follows:-

Category	Number	GDP per capita (nominal)	Population (thousand)
High Income OECD	23	US$9,266 or higher	841,847
High income non-OECD	26	US$9,266 or higher	49,033
Upper middle income	38	US$2,996 – 9,225	573,060
Lower middle income	55	US$756 – 2,995	2,093,737
Low income	64	US$755 or less	2,416,987
Total	206		5,974,664

17. There are a number of ways to define the term “rich countries”. One way would be to equate the rich countries with high income countries, both OECD and non-OECD. Another method would be to use the nominal per capita income above a certain level. A third method would be to use the per capita income on a purchasing power parity (PPP) basis. We have used the third method, and have selected US$10,000 as the minimum level for taxation. On this basis, **45 nations would be eligible to pay the tax,** including Malaysia, as shown in Appendix 2.

Definition of poor countries

18. With regard to the definition of poor countries, we should include **all the 64 countries in the low income category,** i.e. with nominal GDP per capita of US$755 or less. The list of the 64 countries is in Appendix 3. The people living in the 64 low income countries total 2.4 billion accounting for 40% of the world’s population. The population of the the high income countries total 890 million, accounting for 15% of the world’s population.

The Tax rate

19. On a sliding scale, the infrastructure tax should be as follows:-

Countries with Per Capita GDP (PPP)	Tax Rate (% of GDP)
US$30,000 and above	0.50
US$25,000 to below 30,000	0.45
US$20,000 to below 25,000	0.35
US$15,000 to below 20,000	0.20
US$10,000 to below 15,000	0.10

20. In calculating the amount to be taxed, **the base should be the nominal GDP of the rich countries,** although for purposes of defining the rich countries we have used the per capita GDP on a purchasing power parity basis. It is easier to calculate the tax on the basis of the nominal GDP since the nominal GDP, compared to GDP on a PPP basis, is a more easily available figure and it is more official. **The amount of tax collected per year would be about US$9.4 billion.** Details of the tax to be collected from the 45 countries are shown in Appendix 3.

Administration of the tax proceeds

21. It is suggested that the **tax be collected yearly for 20 years.** It may be easier to persuade the rich countries with a proposal for a limited time rather than in perpetuity.

22. With regard to the collection and administration of the tax, it would be better not to create a new organisational structure to avoid unnecessary expenditure on overhead costs. **An institution associated with the United Nations, possibly UNDP, can be used for the purpose of collecting the tax and administering it.** If additional staff are required, this can be arranged by way of secondment from some of the upper middle income countries. This will be their contribution to the scheme since most of them would not be subject to the tax.

23. The administrators of the tax will study the request for an infrastructure project together with the recipient country and it will determine the best way to implement it. Some suggested guidelines are as follows:-

(i) Projects must be chosen such that the **multiplier and linkage effects in the recipient country are maximised.**

(ii) The infrastructure projects would be largely ***hard* infrastructure,** such as roads, railways, bridges, dams, pipelines and power plants.

(iii) The disbursement of the funds should be on a **progress-payment basis.**

(iv) The criteria should be poverty eradication and economic enhancement. **The criteria should be free of ideological and other considerations.**

(v) The projects must be **built and administered by the international agency,** with the recipient country providing all the support necessary. But the locals must be given as many job opportunities as possible and to be trained in the operation of the facilities.

Conclusion

24. The sum expected to be collected will be at about US$9.4 billion per year or **US$188 billion for 20 years.** This amount, if wisely invested in infrastructure projects in the poor countries, can quickly raise the living standards in the poor countries to decent levels. In a world where more than half of the population go to bed hungry every night, a significant gesture on the part of the rich countries to help the poor countries by way of the proposed tax mechanism will go a long way in making the world a better place to live in for all mankind. As Dr. Mahathir Mohamad said, there is very little justification for people to remain poor in a world which is so extremely rich.

25. **The proposal made by Dr. Mahathir Mohamed is certainly viable. It can be structured and implemented easily. All that is required is the will on the part of the rich countries to support a**

proposal which is likely to create a win-win situation for everyone.

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