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TAXING THE DIGITAL ECONOMY: THE IMPACT OF DIGITAL SERVICES TAXES AND THE OECD TWO-PILLAR FRAMEWORK ON REVENUE MOBILIZATION IN EMERGING ECONOMIES

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Abstract. The rapid expansion of the digital economy has exposed a structural weakness in international tax architecture: multinational platform firms can generate substantial revenue within a country's borders while maintaining minimal physical presence, allowing much of that value to escape domestic taxation under traditional permanent-establishment rules. In response, more than forty countries introduced unilateral digital services taxes (DSTs) between 2019 and 2024, while the OECD-led Two-Pillar framework sought to establish a coordinated multilateral alternative reallocating taxing rights and imposing a global minimum corporate tax. This article evaluates the fiscal and economic effects of these competing approaches using a comparative panel analysis of eighteen emerging economies over the period 2019–2026, of which eleven adopted unilateral DSTs and seven relied primarily on Two-Pillar implementation. Employing a difference-in-differences estimation strategy alongside a decomposition of digital-sector tax revenue as a share of total corporate tax collection, the study finds that unilateral DST adopters achieved faster short-run revenue gains but faced a significantly higher incidence of retaliatory trade measures and price pass-through to domestic consumers, while Two-Pillar-aligned economies experienced slower but more stable revenue growth alongside improved investment certainty. The findings indicate that digital taxation design involves a genuine short-run trade-off between fiscal sovereignty and economic stability, and the article concludes with policy recommendations for sequencing multilateral alignment while preserving near-term revenue mobilization capacity.

Keywords: digital economy, digital services tax, international taxation, revenue mobilization, OECD Two-Pillar Solution, emerging economies.

1. Introduction The digital economy has fundamentally altered where economic value is created and where it is taxed. Multinational platform firms operating in search, social media, e-commerce, and streaming services can generate significant revenue from users and advertisers within a given jurisdiction while maintaining little or no physical presence there, allowing profits to be booked in low-tax jurisdictions largely disconnected from where value is actually generated. This mismatch has proven especially costly for emerging economies, which combine large and rapidly growing digital consumer bases with comparatively limited administrative capacity to enforce traditional transfer-pricing and permanent-establishment rules against sophisticated multinational structures.

Two competing policy responses have emerged. Unilateral digital services taxes (DSTs), first introduced by several European economies and subsequently adopted by more than forty countries worldwide, impose a turnover-based levy on qualifying digital revenues regardless of physical presence. In parallel, the OECD/G20 Inclusive Framework's Two-Pillar Solution seeks a coordinated multilateral alternative: Pillar One reallocates a share of taxing rights to market jurisdictions, while Pillar Two establishes a global minimum corporate tax rate to curb profit shifting. By 2026, implementation of both approaches remains uneven, creating a live natural experiment in comparative digital tax policy.

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This study addresses three research questions: (1) How do unilateral DST adoption and Two-Pillar alignment compare in their effect on digital-sector tax revenue mobilization? (2) What economic costs, particularly in terms of investment flows and trade friction, are associated with each approach? (3) What sequencing strategy allows emerging economies to preserve near-term fiscal sovereignty while transitioning toward multilateral alignment? The objective is to generate evidence-based guidance for finance ministries in emerging economies currently designing or revising their digital taxation strategy.

2. Methods The study employs a comparative panel dataset covering eighteen emerging economies over the period 2019–2026, of which eleven introduced unilateral digital services taxes and seven relied primarily on OECD Two-Pillar implementation without a standalone DST. Data were compiled from national tax authority annual reports, OECD Inclusive Framework statistics, and UNCTAD's World Investment Report monitor.

The empirical strategy applies a difference-in-differences estimation comparing digital-sector tax revenue as a share of total corporate tax collection before and after each country's policy adoption date, benchmarked against the alternative policy group. This design isolates the effect attributable to the specific policy choice from broader trends in global digital-sector growth common to both groups, as summarized in Table 1.

In addition, a foreign digital-investment inflow index (base year = 100) and the incidence of retaliatory trade measures—such as tariff threats or actions explicitly linked to a country's digital tax policy—were tracked for both groups to assess the broader economic costs associated with each approach, beyond the direct revenue effect.

3. Results Digital-sector tax revenue as a share of total corporate tax collection rose in both policy groups between 2019 and 2026, reflecting the underlying growth of the digital economy itself. However, the trajectories diverged substantially in both magnitude and cost (Table 1). DST-adopting economies achieved a faster initial revenue gain, rising from 3.8% to 6.4% of total corporate tax collection, compared with a rise from 2.1% to 5.1% among Two-Pillar-aligned economies.

Table 1. Digital taxation outcomes by policy approach across eighteen emerging economies (2019–2026)

Policy group / period	Digital-sector tax revenue (% of total corporate tax)	Foreign digital-investment inflows (index, base=100)	Countries facing retaliatory trade measures (%)
DST adopters, 2019–2021	3.8	97.4	18
DST adopters, 2022–2026	6.4	91.8	46
Two-Pillar aligned, 2019–2021	2.1	100.0	0

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Policy group / period	Digital-sector tax revenue (% of total corporate tax)	Foreign digital-investment inflows (index, base=100)	Countries facing retaliatory trade measures (%)
Two-Pillar aligned, 2022–2026	5.1	108.6	0

Source: compiled by the author based on national tax authority reports, OECD Inclusive Framework statistics, and UNCTAD investment monitor data.

This faster revenue gain among DST adopters came at a measurable economic cost. The foreign digital-investment inflow index for DST adopters declined from 97.4 to 91.8 over the same period, while the equivalent index for Two-Pillar-aligned economies rose from 100.0 to 108.6, suggesting that unilateral taxation introduced meaningful investment-climate uncertainty relative to the coordinated multilateral approach.

The incidence of retaliatory trade measures diverged even more sharply: 46% of DST-adopting economies in the sample faced explicit retaliatory trade actions or credible threats thereof by 2026, up from 18% shortly after initial adoption, compared with zero recorded incidents among Two-Pillar-aligned economies. The difference-in-differences estimate confirms that unilateral DST adoption is associated with a statistically significant increase in retaliatory trade exposure (coefficient = 0.31, $p < 0.01$) relative to multilateral alignment, even after controlling for country size and existing trade relationships.

Notably, among DST-adopting economies, a substantial share of the tax incidence appears to have been passed through to domestic consumers via higher platform service fees, with estimated average pass-through rates of approximately 55–65% based on documented fee adjustments announced by major platform operators following DST implementation.

4. Discussion And Conclusion The findings reveal a genuine short-run trade-off between fiscal sovereignty and economic stability in digital taxation policy. Unilateral DSTs deliver faster revenue gains and immediate policy autonomy, an attractive proposition for emerging economies facing urgent domestic revenue needs. However, this approach carries a materially higher risk of retaliatory trade friction, softer digital investment inflows, and consumer-borne cost pass-through, all of which can erode the net fiscal and welfare benefit over a multi-year horizon. Two-Pillar alignment delivers slower but more stable revenue growth alongside a more favorable investment climate, but requires sustained multilateral cooperation and technical capacity that many emerging economies are still building.

These results support a sequenced policy strategy rather than a binary choice between the two approaches. First, emerging economies with urgent near-term revenue needs and limited exposure to retaliatory trade risk from major trading partners may reasonably adopt a time-limited unilateral DST, explicitly designed with a sunset clause tied to Two-Pillar ratification, rather than as a permanent parallel regime. Second, tax authorities should invest concurrently in the administrative capacity required for Pillar One and Pillar Two compliance—including transfer-pricing expertise and country-by-country reporting infrastructure—so that transition to the multilateral framework does not lag behind political commitment. Third, regional coordination among emerging economies with similar

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digital market characteristics can strengthen negotiating leverage within the Inclusive Framework and reduce the risk of any single country facing isolated retaliatory action.

In conclusion, taxing the digital economy is no longer a peripheral fiscal question but a central determinant of revenue mobilization capacity for emerging economies in the coming decade. The evidence presented here suggests that the path most likely to sustain both fiscal sovereignty and macroeconomic stability lies in careful, time-bound sequencing rather than in permanent unilateralism or premature full reliance on multilateral consensus. Future research should examine firm-level pass-through behavior in greater detail and assess how Pillar One's final implementation, once broadly ratified, reshapes this trade-off going forward.

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