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Chapter One

Global Tax Governance: What It is and Why It Matters

Peter Dietsch and Thomas Rixen

Until quite recently, a book with the title *Global Tax Governance* would have been unthinkable. Most social scientists interested in the then already widely used concept of global governance would have thought either that there is no such thing as global governance in the area of taxation or that it is too rudimentary to warrant any attention. This has changed.

Today, global tax governance is very high on the international and various national political agendas. There are two main reasons for this. First, in the wake of the 2008 financial crisis, many states have seen their public debt rise to high levels and, hence, can no longer afford to forgo tax revenues currently lost to international tax evasion and avoidance. Second, political initiatives are fuelled by recent tax scandals (such as Starbucks, Apple, Offshore Leaks and LuxLeaks) that have raised public awareness and guaranteed media attention.

While these events have triggered a rare public debate on international tax issues, the academic discussion, though still relatively young, goes back a little further. Apart from isolated contributions (Picciotto 1992; Palan 1998), issues of international taxation had hardly been dealt with in political science and international political economy until around ten years ago, when a small number of scholars began to address the issue (Sharman 2006; Rixen 2008; Webb 2004). Since then, a sizeable literature has developed. A similar situation pertains for normative political philosophy. While fiscal policy is regarded as an important tool by contemporary theories of justice (for example, Rawls 1999; Dworkin 2002), and while some work on the normative foundations of taxation has emerged in recent years (Murphy and Nagel 2002; Halliday 2013), normative work focused on the international dimensions of fiscal policy has been almost completely absent (but see Cappelen 2001). In recent years, however, a few contributions have emerged (Brock 2008; Dietsch and Rixen 2014; Dietsch 2015; Gaisbauer, *et al.* 2015). This book aims to take stock of the academic debate on global tax governance.

We are convinced that the recent interest in global tax governance is well justified. Since taxation is the most direct interface between the market and the state, it is the perfect policy area in which to observe the relation between, and relative power of, the two spheres. Moreover, taxation represents one of the core functions of the modern nation-state. Therefore, it should be key to an understanding of how economic globalisation affects state sovereignty and the choice and development of international institutions, as well as the effectiveness

and legitimacy of both national and international institutions; these are, of course, the major themes of the literature on global governance.

Politically, the governments and international institutions involved in designing global tax governance claim that they are on track to tackle the problems created by tax competition. Soon after the financial crisis hit, the G20 and OECD revived their 'black' and 'grey' lists of uncooperative tax havens and forced them to sign bilateral tax information-exchange agreements (TIEAs). Recently, the OECD has even forged an agreement that foresees multilateral automatic information-exchange (AEI) as the new global norm. In addition, the G20 and the OECD are taking steps to control the practices of base-erosion and profit-shifting (BEPS) of multinational corporations.[1] All that being said, most experts, while admitting that these initiatives represent real progress, are less optimistic about their effectiveness.

The contributions to this volume are directly relevant to this political debate. They explain why current attempts to strengthen global tax governance are insufficient; and they propose alternatives. More specifically, this involves (1) identifying the problems that globalisation creates in the area of taxation, through tax competition in particular; (2) explaining the institutions, structures, and processes of global tax governance as well as analysing their shortcomings; (3) developing the normative foundations for an appropriate regulatory response and building on these foundations; (4) deriving proposals for the reform of institutions and policies.

This is an ambitious agenda that could not be addressed appropriately within any single discipline. It requires a thorough understanding of the economics of tax competition at the interface between markets and states; a grasp of the complex and technical legal issues involved; awareness of the geopolitical and social forces at work that might either foster or obstruct reform; and, finally, a normative framework that allows one to weigh such competing values as fiscal autonomy, distributive justice, and economic efficiency. This is why this volume brings together political scientists, lawyers, economists, and political philosophers. Each contribution has a well-defined role in producing a comprehensive assessment of the challenges facing global tax governance today. Unique in this interdisciplinary focus, the book combines theoretical and conceptual work with empirical analysis. One of the key motivations in putting together this collection is the conviction that any approach to global tax governance that is grounded in a single discipline is bound to omit important considerations, and thus will most likely fail to provide sound analysis and

1. Under the current rules of international taxation, multinational enterprises have various possibilities for shifting their profits (the tax base) to subsidiaries in low-tax countries and making sure that actuarial losses are attributed to high-tax countries. This way, the enterprise arbitrages across different tax systems in order to save taxes. The different techniques of achieving this and what could be done to avoid this, will be explained in subsequent chapters (*see* e.g. Clausing 2016, Chapter Two; Eccleston and Smith 2016, Chapter Eight; Dietsch 2016, Chapter Eleven; Avi-Yonah 2016, Chapter Thirteen; and Rixen 2016, Chapter Fifteen).

policy advice. At the same time, the volume aims to provide a comprehensible and accessible overview that may serve as an entry point to the field for non-specialists.

In this introduction we will first define global tax governance, briefly situate it in the two relevant but often separated bodies of literature on global governance and taxation, and provide a sketch of its historical development as well as of how current events fit into this trajectory (Section 1). We then detail some of the challenges that tax competition poses (for national and global governance), notably concerning state sovereignty (Section 2) and in terms of rising inequalities of income and wealth (Section 3). Section 4 contains an outline of the individual contributions to the volume and of how they fit together. We conclude with a look at some of the lessons for global tax governance that we can draw from this volume (Section 5).

1. What is global tax governance?

In the broadest sense, governance can be defined as the activity of 'organizing collective action' (Prakash and Hart 1999: 2). It covers the creation or development of institutions – defined as formal and informal principles, norms, rules, and procedures – that structure individual and collective behaviour. Such governance may be exercised by state and non-state, public and private actors. Governance is global governance if the reach of the principles, norms, rules, and procedures is global or at least international.[2] Global tax governance thus consists of the set of institutions governing issues of taxation that involve cross-border transactions or have other international implications.[3]

This definition implies that global tax governance need not, but could, involve a full or partial shift of the power to tax, that is, the right to impose taxes on citizens, to the international level. Currently, the right to tax is firmly tied to the nation-state. While global tax governance circumscribes and shapes a nation's power to tax in various ways, it exclusively consists of institutions governing the interaction among national tax systems. Whether or not a shift of some or all dimensions of a nation's power to tax to the international level would be desirable is one of the themes addressed by various contributions in this volume (*see* Ronzoni 2016, Chapter Nine; Dietsch 2016, Chapter Eleven; Wollner 2016, Chapter Fourteen; and Rixen 2016, Chapter Fifteen in this volume).

2. The reference to principles, norms, rules, and procedures relates to Keohane's well known definition of an international regime, an important concept in the literature on global governance (Krasner 1982: 186). While the term 'global' suggests the full inclusion of all countries in the world, in practice it is often used for any kind of international policy-making.

3. Global tax governance concerns direct and indirect taxation. Currently, most discussions of global tax governance are limited to direct taxation. This is due to the fact that under current institutional arrangements, international aspects of indirect taxes are addressed in the international trade regime. This empirical fact does not imply that the tax-related aspects of international trade should not be considered a part of global tax governance analytically. In this volume, Gabriel Wollner's proposal for a financial transaction tax (2016, Chapter Fourteen) relates to indirect taxes.

Global governance aims at the cooperative regulation of globalisation. The basic assumption/insight is that in an age of globalisation, an ever-increasing number of issues cannot be adequately governed within the nation-state. If societal interactions cross borders and create interdependencies and externalities among national societies and polities, there is a need for global governance (Dingwerth and Pattberg 2006; Zürn 2013). This has been argued convincingly for policy areas ranging from environmental protection, world trade, and financial stability to issues of health, human rights, and security (*cf.*, for example, Kaul *et al.* 2003). Until quite recently, this line of argument has been conspicuously absent in taxation.

While globalisation and its effects have been a major research field in the fiscal context since at least the 1990s, the focus has been almost exclusively on *national* political reactions. In taxation, globalisation has entered the debate as tax competition, that is, national governments competing for mobile tax bases. Political scientists and economists have asked: does tax competition lead to a race to the bottom in terms of tax rates and, consequently, in terms of revenues and public-goods provision? Does it constrain the political capacity to maintain the welfare state? A set of influential papers in political science has shown that tax revenues in industrialised countries have remained constant and concluded that, therefore, the autonomy of national tax and welfare state policy was still intact (*cf.*, for example, Swank and Steinmo 2002; Garrett and Mitchell 2001; Basinger and Hallerberg 2004). Others, building on empirical findings in economics (Devereux and Griffith 2002; de Mooij and Ederveen 2008; *see* Clausing's overview 2016, Chapter Two in this volume), disagreed. They have argued that the focus on tax revenues alone was misguided and masked important changes in the structure of tax systems. In particular, they have made the case that tax competition has undesirable distributive implications in developed countries and leads to significant revenue losses in the developing world (Genschel 2002; Ganghof 2006; Rixen 2011b; *see also* Genschel and Seelkopf 2016, Chapter Three in this volume). According to this view, tax competition seriously constrains the autonomy of national policy.

Rather than reopening this important debate, which will be taken up in detail by the three contributions in Part One of this volume, the relevant point for the purpose of this introduction is that *international* political actions were not considered by political scientists and economists. This overlooks two important aspects. First, globalisation itself, including tax-base mobility, is a political phenomenon, that is, it is the result of deliberate international cooperative efforts to liberalise international trade and investment and reduce cross-border tax distortions. It is a product of global governance. Second, national adaptation to the pressures of tax competition is not the only possible reaction. Governments could, in principle, react by establishing global governance mechanisms, or by adapting existing ones, to rein in harmful tax competition. For a long time, both aspects of global tax governance – the removal of tax obstacles and regulating tax competition – were the almost exclusive territory of international lawyers, who focused on explicating and interpreting the

relevant legal rules (*cf.*, for example, Graetz 2003).[4] Meanwhile, the political and economic determinants of global tax governance have received little or no attention. It is only recently that political scientists, economists, and political philosophers have taken up the issue. It is one major purpose of this volume to present original contributions of scholars engaged in that enterprise.

The long-time neglect of global tax governance is all the more surprising as the history of global tax governance goes back to the beginning of the twentieth century and to the first wave of globalisation that was comparable in magnitude to the current one (Bordo *et al.* 1999). The original and initially sole purpose of global tax governance was to mitigate international double taxation in order to liberalise international trade and investment.[5] In response to demands by the International Chamber of Commerce (ICC), the League of Nations commissioned several reports and convened meetings that ultimately resulted in a model convention for bilateral double tax avoidance (DTA) treaties shortly before the Second World War. In parallel to these developments, several countries began to develop unilateral (domestic) laws on the taxation of cross-border activities and also drafted bilateral tax treaties. After the war, this work on DTA was briefly taken up by the United Nations before it then migrated to the Organisation for Economic Co-operation and Development (OECD), which continuously revised and modernised the model convention. Over time, due to these multilateral efforts, a remarkable homogeneity among national laws and bilateral treaties has been achieved. Today, there are about 2500 DTAs (Rixen 2008; Genschel and Rixen 2015).

As intended, the abolition of capital controls enabled increased capital mobility and the effective removal of tax obstacles through DTAs has increased the potential fiscal advantages of moving capital across borders. In this sense, globalisation in general is a political phenomenon and tax-base mobility, in particular, is the result of global tax governance. However, the specific principles and rules chosen to avoid double taxation had an unintended, albeit foreseeable, consequence. They caused the related phenomena of tax evasion and avoidance as well as of tax competition. DTA treaties aim at disentangling the transnational tax base and assigning it to different jurisdictions. Once the jurisdiction to tax has been established, a country is then free to apply its own national tax law to its share of the income. DTA rests on the mere interface-regulation of autonomous national tax systems, and governments retain almost unlimited sovereignty over their share of the transnational tax

4. A few studies from lawyers took a broader perspective and presented more political and historical analyses of the development of international taxation (e.g. Picciotto 1992; Avi-Yonah 2000) or presented analyses of the dysfunctionalities of the system (e.g. Bird 1988; Dagan 2000).

5. Double taxation stems from an overlap of jurisdiction to tax between the country in which a taxpayer lives (residence state) and the country where the taxpayer's income is generated (source state). If both countries exert to the full their power to tax, then the tax burden for international investments is higher than for national investments, causing an inefficient allocation of capital. In order to prevent this, governments engage in efforts to avoid double taxation.

base (Bird and Wilkie 2000: 91–5; Vann 1991: 102). Governments are free to underbid each other in tax rates and other relevant legislation in order to attract a larger part of the transnational tax base. This is the supply side of tax competition. On the demand side, taxpayers exploit the resulting differences in national tax systems and engage in profit-shifting and tax arbitrage, which are to a large extent, made possible by the particular legal constructs on which DTA treaties rely. In other words, the rules of DTA endogenously create tax avoidance and tax competition. Most prominently, the principle of 'separate entity accounting' and the 'arm's length standard' (ALS) facilitate various kinds of thin capitalisation and transfer-pricing manipulations, two of the techniques used to shift profits to low-tax countries and erode tax bases in high-tax countries (*see* Clausing 2016, Chapter Two and Avi-Yonah 2016, Chapter Thirteen in this volume). The sovereignty-preserving approach to the global governance of DTA provided the institutional foundation of tax competition (Rixen 2011a).

In the 1960s, many countries reacted to the problem of tax arbitrage. Following the example of the US, they began to incorporate anti-avoidance legislation in their unilateral (domestic) tax laws. The OECD participated in those efforts by trying to promote the diffusion of such legislation across its member countries. From the late 1990s it became increasingly clear that such unilateral approaches were insufficient to solve the problem. In 1998, the OECD launched its project on harmful tax competition (OECD 1998). Likewise, the EU started initiatives such as the code of conduct on business taxation (Radaelli 2003) and the Savings Tax Directive (Rixen and Schwarz 2012; Hakelberg 2014) to formulate an international answer to the problem of tax competition. While the avoidance of double taxation continues to be a topic of global tax governance, the focus has clearly shifted to tax competition. The present volume focuses mostly on this issue and on developments since the late 1990s. Since, as explained above, DTA and tax competition are intimately connected, the institutions of DTA are nonetheless part of the analysis (*see*, for example, the contributions by Dietsch 2016, Chapter Eleven; Avi-Yonah 2016, Chapter Thirteen; and Rixen 2016, Chapter Fifteen).

Without anticipating too much, the trajectory of global tax governance can broadly be understood as an incomplete adaptation of the governance structure to the fundamentally altered international tax game. In the first period of global tax governance, when governments were mostly interested in liberalisation, a bilateral approach – supported by the OECD through its dissemination of information and shared practices that all states have an interest in following – was appropriate to accommodate countries' preferences. In a nutshell: since DTA is a coordination game with a distributive conflict, the institutions needed to deal with this problem do not have to be equipped with enforcement capabilities. The soft governance mechanisms used by the OECD – non-binding recommendations, providing technical expertise, diffusion by collecting best-practice examples and so on – were adequate. In contrast, the issue of tax competition exhibits the institutionally more demanding structure of an

asymmetric prisoner's dilemma.[6] This strategic structure would require a shift to hard and multilateral governance with independent international enforcement. While current events may be interpreted as struggles to react to the functional demands of this strategic structure, the required shift is not forthcoming. In part, this is due to the fact that global tax governance exhibits significant path-dependence (Rixen 2011a; Eccleston 2012).

Three key observations can be made about the current institutional trajectory. First, while it is true that there is a move towards multilateralism in the fight against tax evasion, it is not fully global and inclusive of all states. For example, the recent agreement on automatic exchange of tax information (OECD 2014), which is an important step forward, was signed by a mere fifty-one countries. The fact that the membership of the OECD consists only of developed countries may be part of the problem here, if the signatory OECD countries do not succeed in getting developing countries on board. Second, while major economic powers are increasingly willing to exert pressure on tax havens, they still rely on informal instruments such as naming and shaming (*see* Woodward 2016, Chapter Five in this volume) or, less often – but the US Foreign Account Tax Compliance Act (FATCA), under which foreign banks are required to disclose their US clients to the US tax administration, is an example – on blunt power politics (*see* the contributions by Hakelberg 2016, Chapter Six in this volume; and Grinberg 2016, Chapter Seven in this volume). So far, there has not been any attempt to institutionalise formal enforcement mechanisms. Third, it is true that states are increasingly willing to engage in administrative co-operation and information-exchange with other governments. However, they are hardly willing to delegate or pool their legislative sovereignty, that is, the authority to make national tax policy. While this would not be a problem as long as the particular issue could be effectively addressed by administrative co-operation, there are strong indications that the effective regulation of BEPS requires a sharing of legislative sovereignty, that is, the partial harmonisation of national tax laws (*see* Eccleston and Smith 2016, Chapter Eight in this volume).

In summary, global tax governance historically played an important role in creating the problem of tax competition but also holds the promise of providing a solution, albeit one it has not yet delivered. Thus, it is a significant phenomenon that warrants more attention than it has traditionally received in the social sciences.

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6. An asymmetric prisoner's dilemma is characterised by the following strategic structure: one party (tax haven) has deadlock preferences, i.e. it not only prefers defection over co-operation in individual strategies but also prefers the outcome of collective defection over the outcome of collective co-operation. The other party (big, developed country) has prisoner's dilemma preferences, i.e. while it prefers defection over co-operation in individual strategies it prefers the outcome of collective co-operation over that of collective defection. The game is thus different from the regular (symmetric) prisoner's dilemma, in which the cooperative outcome is preferred by both parties over the uncooperative outcome. Nevertheless, in the asymmetric game, the cooperative and Pareto-optimal outcome could be achieved if, in game-theoretical parlance, big countries offered side-payments to tax havens. For a detailed derivation of the strategic structure, see Rixen (2008: 43–8). *See also* the contributions by Genschel and Seelkopf 2016, Chapter Three; and Hakelberg 2016, Chapter Six in this volume.

Before we turn to the empirical and normative analysis of global tax governance that is the central task of this book, we first need to explain why tax competition is indeed a problem. We turn to this in the following two sections.

2. Tax competition, democracy and state sovereignty

Who decides what and how to tax, and for whose benefit? Tax competition introduces an important bias into the way national fiscal systems respond to these questions. First, tax competition undermines the capacity of polities to choose the size of their public budget as well as the level of redistribution, because it compromises their ability to tax capital. Under conditions of capital mobility, attempts to tax capital will usually trigger capital flight and thus prove futile. Second, this inability to tax capital effectively means that the 'haves' are likely to enjoy a lighter tax burden compared to the 'have-nots', for the simple reason that capital-ownership tends to be concentrated among the former. This section looks at the effect of tax competition on democratic decision-making; the next section focuses on the link to inequality.

The idea that the dynamics of economic globalisation constrain the room for manoeuvre of national economic policies is neither new nor limited to fiscal policy. One poignant way to capture this phenomenon has been formulated by Dani Rodrik in what he calls the 'political trilemma of the world economy' (Rodrik 2011: 372). The basic idea is that we cannot simultaneously have democratic politics, the nation-state as the primary *locus* of political control, and hyper-globalisation, which includes the unrestricted movement of capital. Rodrik uses corporate tax competition as one of the case studies to illustrate his trilemma (Rodrik 2011: 357–60).

In response to the trilemma, so Rodrik claims, we have three options. We can compromise democracy; we can curtail the power of the nation-state by enhancing global institutions; or we might reverse some of the deregulation that has led to hyper-globalisation. Compromising democracy is clearly undesirable but note that, under the *status quo*, this is precisely what is happening. As highlighted by Streeck (2014), the frequent political appeal to TINA ('there is no alternative') policies illustrates the diminishing leverage that democratic preferences have over global economic pressures. As a consequence, national politics is increasingly emptied of its democratic substance (Crouch 2004; Mair 2013). By comparison, the two other routes out of the trilemma are more attractive. In the fiscal context, to put it simply, this confronts us with a choice between limiting the mobility of capital on the one hand and, through global tax governance, boosting the capacity of states to tax mobile capital on the other.[7] This choice is by no means a binary one: combinations of the two are possible.

7. While several commentators, including Rodrik (2011), Streeck (2014) and Mair (2013), appear to favour regulating the forces at work in globalisation over developing institutions of global governance, the contributions to this volume are open to both approaches.

Which combination should we choose? What are the relative advantages and potential drawbacks of either approach? By answering these questions, this volume wants to make a contribution to plotting our way out of the political trilemma of the world economy.

Such projects of re-embedding the market are not utopian but already inform policy-making today. The OECD and the European Union issued the European Savings Tax Directive and started their respective initiatives on eliminating harmful tax competition as well as on working towards a consolidated corporate tax-base well before the financial crisis. The events of 2008 and the years since have added to the urgency of these projects. While the financial crisis was not caused by tax competition, one can argue that the latter had an exacerbating effect: it meant that a number of financial risks were hidden offshore (Rixen 2013); moreover, it largely blocks the option of taxing accumulated corporate profits in order to reduce public deficits. One of the dangers today, which has been borne out by the response to the crisis thus far, is that governments take the inability to tax mobile capital as a parameter rather than as a policy variable they can influence. This is not the place to assess the merits of austerity as a response to the crisis[8] but, at the very least, complementing austerity with measures to ensure the effective taxation of capital seems like a promising idea. The financial crisis has opened a window of opportunity in this regard. This volume aims to contribute to the debate on how we should go about seizing this opportunity.

3. Tax competition and rising inequalities

One of the democratic decisions undermined by tax competition concerns the level of redistribution among the members of a polity. When it is hard to tax capital effectively, redistribution becomes more difficult. As Piketty and his collaborators have shown, there is a strong and significant positive correlation between the decrease in tax rates and the increase in inequality of income and wealth. Those countries with the biggest fall in the top rates of their income-tax schedule experienced the strongest increase in the share of income going to the richest 10 per cent. Likewise, the increase in capital concentration is largely driven by reductions of the capital (income) tax. As Piketty points out, the reforms to lower tax rates occurred in all developed countries over the last two to three decades and were to a significant extent driven by the pressures of tax competition (Piketty 2014; Piketty *et al.* 2011).[9]

8. For a critical assessment, see Blyth 2013.

9. It is worth noting that before Piketty, economic analyses of tax competition tended to neglect its distributive implications. The standard economic models focus on the criterion of economic efficiency to assess the effects of tax competition (for overviews, see Wilson and Wildasin 2004; Genschel and Schwarz 2011; and Clausing 2016, Chapter Two in this volume). One notable exception in this context is Sinn's selection principle, which not only states that competition between states will be inefficient but also underscores the link between tax competition and inequality (Sinn 2003: 60).

A political consensus has been forming that inequality needs to be reined in, but how? Piketty plausibly argues that any reversal of the trend of rising inequality will have to involve the return to a more progressive income-tax schedule. He states that 'the optimal top tax rate in developed countries is probably above 80 per cent', but emphasises at the same time that, in the US for example, 'taxes would also have to be raised on incomes lower in the distribution (for example, by imposing rates of 50 or 60 per cent on incomes above $200,000)' (Piketty 2014: 512–13) in order to have a significant impact on revenue. As he admits, only if tax competition is effectively curbed or at least dampened will nation-states actually have the required policy autonomy (sovereignty) to pass and implement such legislation effectively.

With regard to wealth inequalities, while he discusses the introduction of a global wealth tax, he is silent on other measures of tax co-operation. In particular, the return to higher income-tax rates and higher tax rates on capital will depend on an effective solution to the problems of tax evasion or tax avoidance through capital flight. Among other things, such as multilateral automatic information-exchange (which he briefly mentions in his proposal for a global register of wealth) and a general push for more transparency, any solution will have to be sensitive to the fact that corporate taxation acts as a backstop for income taxation (Ganghof 2006; *see also* Clausing 2016, Chapter Two in this volume). In this book, we provide a comprehensive treatment of the kind of tax co-operation required to make reforms *à la* Piketty possible.

In sum, tax competition tends to exacerbate inequalities in income and wealth. Conversely, global tax governance is a crucial element in the fight against increasing inequalities, which many policy-makers and experts have identified as a serious threat not only to economic stability and growth (for example, Ostry *et al.* 2014) but also to democracy (for example, Schäfer 2013; Stiglitz 2008). This last point establishes a link to the previous section. Tax competition, in addition to directly undermining the fiscal sovereignty of states in terms of their ability to tax capital, risks having a second, indirect negative impact on democracy once inequalities attain levels that bias the democratic process in favour of the rich.

4. Structure and content of the volume

The logic behind the structure of the volume is the following: Part One presents a diagnosis of the problematic aspects of international tax competition. The contributions to Part Two put forward an assessment of where current attempts to address these problems fall short. Part Three discusses the normative principles that a coherent and feasible political response to tax competition should be based on. Finally, the contributions to Part Four detail several of the institutional arrangements that are necessary to regulate tax competition in practice.

The three chapters that make up the first part of the book explain how tax competition works and what its consequences are. First, Kimberly Clausing presents an overview of the major empirical findings on the economics of tax competition (Chapter Two). She focuses on mobile multinational enterprises

(MNEs) and shows that these are tax-sensitive in their business decisions. In particular, referring to data on the micro- and macro-level, she shows that 'virtual' tax competition is much fiercer than 'real' tax competition. While MNEs tend to seek low-tax environments for their real economic activities, they are far more tax-sensitive when it comes to (paper) profits, the location of which can be manipulated through their financial arrangements. This implies that tax competition is unlikely to be a drag on growth in capital-rich countries (as aggregate capital stocks are hardly affected), yet it does adversely affect tax revenues and leads to a lighter tax burden on corporate income. This has regressive distributive implications in itself but Clausing explains that these are further amplified by the fact that an erosion of the corporate tax endangers the integrity of the larger income-tax system. Overall, the empirical evidence supports the notion that curbing tax competition would entail substantial welfare gains.

In Chapter Three, Philipp Genschel and Laura Seelkopf take up this finding and inquire why, given these potential welfare gains, tax competition persists. They take a political-economy perspective and ask who are the winners and losers from tax competition. They refine the conventional view, according to which workers lose and capital wins everywhere. Using the insights of a model of asymmetric tax competition (Bucovetsky 1991) and differentiating countries with respect to regime type (democracy *versus* autocracy), they show that in addition to capital (in all countries), the winners from tax competition include the governments and workers of small, well governed democracies. The losers are governments and workers of large countries, of less developed ones in particular, which are more likely to be autocratic and poorly governed. In contrast, large democratic countries can at least maintain large welfare states. However, since the latter are increasingly financed via debt and taxes on labour and consumption, workers in these countries also lose. Irrespective of these distributive implications, tax competition remains a negative-sum game: big countries lose more than small countries gain.

One implication of this is that the collective-action problem inherent in overcoming tax competition is worse than the conventional view suggests. If workers were the losers everywhere, and assuming that the median voter typically receives the large majority of her income from work, then all governments, at least in well functioning democracies, should be in favour of international tax co-operation. But since governments and workers in small countries profit, there is typically a political conflict of interest between big-country governments and small, tax-haven governments, which has become very obvious in recent campaigns for tax co-operation.

Nevertheless, if all the losers from tax competition identified by Genschel and Seelkopf are aware of being short-changed, does it not seem puzzling that they do not manage to overcome the collective-action problem of regulating tax competition, even in the face of resistance from tax havens? In Chapter Four, Lyne Latulippe offers a solution to this puzzle. She argues that countries internalise the logic of tax competition in their domestic policy-making, by adopting a competitiveness discourse that reinforces tax competition. To support her argument, Latulippe

looks at consultation processes on international tax policy in Australia in 2002 and in Canada in 2008. Both episodes illustrate how, by blurring the line between corporate and national interests, the notion of competitiveness has emerged as a policy goal. While the Australian and Canadian consultation processes were formally open in terms of both the experts who headed the process and those who participated by submitting opinions, corporate interests were dominant, thus introducing a bias into the recommended policy options. This account implies that to the extent that developed democracies are susceptible to interest-group biases – and thus less responsive to the demands of the median voter than Genschel and Seelkopf assume – tax competition is even more likely to be a stable political equilibrium. Latulippe's analysis allows us to gain a better understanding of the way, and the extent to which, domestic interest-group influence undermines multilateral efforts towards fiscal co-operation; and to appreciate just how resilient a phenomenon tax competition is.

Building on this understanding of the economics and politics of tax competition, the contributions to Part Two analyse the current political responses to tax competition. When you fix a problem, you want to know whether the fix works. In Chapter Five, Richard Woodward argues that the lack of this ability is one of the biggest shortcomings of recent initiatives in international taxation. Given that offshore financial centres (OFCs) have repeatedly been in the line of fire of international institutions – first in the 1990s and then again in the wake of the financial crisis of 2008 – how come they are still doing so well? Woodward claims that one explanation thus far neglected in the literature is that OFCs successfully feign compliance with new international standards while not actually changing their ways. Such behaviour, dubbed 'mock compliance' by Walter (2008) and Woodward, occurs when compliance costs would be high and when it is difficult for others to detect non-compliance. Woodward argues that mock compliance is the preferred strategy of tax-haven governments, first, because they cannot afford to remain openly non-compliant due to reputational risk and the greater power of large OECD states and, second, because full compliance would cause trouble with powerful domestic business interests. Woodward presents evidence that mock compliance poses a serious problem for both past and present OECD initiatives, especially when it comes to the implementation of recent TIEAs but also with regard to the 2014 Declaration on Automatic Exchange of Information in Tax Matters.

Lukas Hakelberg (2016, Chapter Six) takes a close look at the recent move towards multilateral automatic information-exchange. He asks why this breakthrough was possible after decades of failed attempts at international tax co-operation and argues that political-science theories conceptualising international co-operation as a Pareto-improving response to market failure cannot account for this outcome, because we should then see joint gains for all countries involved. However, as explained by Genschel and Seelkopf, some tax havens are clearly worse off under the new regime. The missing piece of the puzzle of this outcome of 'redistributive co-operation' (Oatley and Nabors 1998), according to Hakelberg, is power. In this power-play, the US as the dominant financial centre in the world

played a crucial but very ambiguous role. At first, the US used its financial power (measured as financial market share) to pass a unilateral, extra-territorial law that required all banks in the world to report the foreign income held by US citizens to the US government. As Hakelberg shows, this law unlocked the stalemate in the EU on automatic information-exchange and significantly contributed to the move towards AEI in the OECD. While this development may appear as an instance of 'benevolent hegemony' (*cf.* Kindleberger 1976; Keohane 1984), the US itself, having pressured other countries into co-operation, did not sign the OECD Declaration of AEI – thus acting as a 'malign hegemon', positioning itself as a haven for unreported capital.

Whereas Hakelberg focuses on the origins of automatic information-exchange, Itai Grinberg is interested in its implications for the future development of global tax governance. In Chapter Seven, he asks under what circumstances unilateral tax reforms can trigger wider multilateral tax co-operation. After the US adopted FATCA in 2010, the compliance issues raised by this legislation for financial institutions triggered a negotiation with five large European countries and, ultimately, paved the way for the Common Reporting Standard that forms the centrepiece of the OECD's new model of automatic information-exchange. Grinberg analyses the enabling factors behind this agreement and asks whether this sequence of events – a bold unilateral initiative leading to multilateral reform – could represent a blueprint for other areas of international taxation. He argues that one of the crucial elements facilitating the trajectory from FATCA to multilateral agreement was the alignment of interests among the large OECD members who pushed this agenda: individual tax evasion hurts them all. By contrast, when considering whether the problem of base-erosion and profit-shifting (BEPS) could be tackled in a similar way, Grinberg is pessimistic because the allocation of corporate tax base represents an essentially distributive problem, thus making consensus less likely.

Richard Eccleston and Helen Smith (2016, Chapter Eight) continue the analysis on exactly this issue: BEPS. Building on the distinction between information-exchange and tax competition, they provide an analysis of the role of the G20 in post-crisis international taxation. They argue that given the non-binding character of OECD recommendations, endorsement by the G20 is vital. It provides the OECD's policies with the necessary political clout and thus enhances compliance. G20 support has played this role in the fight for information-exchange, which is relatively uncontroversial as it is designed to counteract illegal tax evasion. But it may not suffice in the fight against the aggressive tax-planning practices of multinational corporations. To date, these practices have been legal, and measures against them require limits on a state's sovereign right to tax. As Eccleston and Smith point out, the issue also involves more serious conflicts of interest among the powerful G20 and OECD members. Consequently, the authors are pessimistic both about the scope and substance of the BEPS action plan and about the general prospects for compliance with the BEPS initiative.

The remaining contributions to the volume develop normative principles (Part Three) and make concrete reform proposals (Part Four). The chapters in Part Three address the following question: what are the normative criteria

we should appeal to in order to assess the practice of tax competition? In Chapter Nine, Miriam Ronzoni analyses tax competition through the lens of the two dominant families of contemporary theories of global justice (Barry and Valentini 2009). She argues that it is not only cosmopolitans (because they start from the premise of the equal moral status of all individuals around the globe) who have reasons to condemn tax competition; perhaps more surprisingly, internationalists, who accord substantive autonomy to national political communities, should do the same, because tax competition risks undermining this autonomy. Ronzoni thus defends the idea that we should condemn tax competition independently of which of these theories of justice we hold. Subsequently, focusing on the internationalist position, she asks what a regulation of tax competition along internationalist lines would entail. She argues that it would include three elements, namely, *some* taxation at the supranational level; the adoption of minimum tax-rates across states; and the creation of international institutions with the mandate and capacity to enforce tax standards.

Laurens van Apeldoorn, in Chapter Ten, discusses the contours of a modern understanding of the idea of fiscal sovereignty. He critically discusses recent attempts to define this sovereignty in a way that extends, at least to some extent, to the protection of the effectiveness of fiscal policy (Dietsch and Rixen 2014; Ronzoni 2016, Chapter Nine in this volume). While these accounts maintain that the mobility of tax-bases constitutes a *variable* that polities, at least to some extent, should be able to control, van Apeldoorn defends the idea that capital outflows in reaction to tax incentives elsewhere should be viewed as a *parameter* of national tax policies. As a result, his conception of fiscal sovereignty is substantially thinner than those of the accounts he criticises – Dietsch takes up this challenge explicitly in the subsequent chapter. The robust core of fiscal sovereignty that van Apeldoorn recognises is based on the idea that sovereignty, in the sense of domestic authority and control, is potentially subject to erosion. On the one hand, a state can be said to lose control when aspects of (fiscal) regulation are not respected by the citizenry and, on the other hand and perhaps more problematically, a state can be said to lose legitimacy when its regulations do not reflect democratic preferences. The latter scenario corresponds to the corporate capture of the legislature by vested interests as, for instance, in the US states of New Jersey and Delaware (Palan *et al.* 2010: 109–11).

In the final contribution to Part Three, Peter Dietsch (2016, Chapter Eleven) distinguishes between virtual and real tax competition; he makes the case that our response from an ethical and political point of view needs to track this distinction. The first, virtual type refers to cases where tax bases are mobile even though their owners stay put – think of the German citizen who does not declare capital gains in a Swiss bank account or of multinationals like Google or Volkswagen who generate a lot of income in France but book their profits in Bermuda or Luxembourg. From a legal perspective, there is a difference between these two cases – the first is considered evasion and illegal whilst the second constitutes legal tax avoidance – but from an ethical perspective, there

is no difference between the two. Dietsch argues that the case for banning this type of activity, which has been called 'poaching' by the OECD, is strong. The second, real type of tax competition is more akin to a form of 'luring'. Here, the owner of the capital in question responds to tax incentives by actually relocating elsewhere, for instance, through foreign direct investment (FDI) in a low-tax jurisdiction. Dietsch points out that these cases are more complex from an ethical perspective. Instead of defending one specific normative response to them, he outlines a menu of positions one might defend, depending on one's conception of fiscal autonomy.

The final part of the volume turns to concrete reform proposals. In Chapter Twelve, Markus Meinzer, who is not only an academic but also a tax-justice activist, argues that political initiatives to counter tax havens at national and international levels have, typically, relied on arbitrary and doubtful criteria for what constitutes a tax haven. This arbitrariness is one important factor behind the failure of past and most current attempts to counter harmful tax competition. In contrast, Meinzer proposes to rely on the Financial Secrecy Index (FSI), which shifts the focus away from tax aspects on to secrecy, using transparent, verifiable criteria and data sources. The index assesses the degree to which a jurisdiction's legal and regulatory system contributes to global financial secrecy and thus facilitates corrupt practices, including those stemming from tax-abuse. The FSI, Meinzer claims, can help to shape reforms in three main ways. First, the high ranking of major OECD powers in the index (that is, their lack of transparency) underlines their need to lead through example, by enacting domestic policy reforms, before imposing changes on others. Second, once these reforms are implemented, a broad menu of specifically designed counter-measures can be adopted, targeting aspects of the financial secrecy of all jurisdictions. Third, by focusing on transparency as an intermediate step to achieving fair international tax rules, more sustained public support for reform efforts against the resistance of vested interests is likely to emerge.

In Chapter Thirteen, Reuven Avi-Yonah argues for the introduction of a system of unitary taxation and formula apportionment (UT+FA). He explains why the current system of arm's-length standard (ALS) transfer-pricing does not work properly. Among other problems, it is overly complex and allows corporations to engage in profit-shifting to avoid paying taxes. According to Avi-Yonah, the best alternative would be the introduction of full-scale UT+FA. Under such a system, corporations would have to issue a combined report on their global profits, which would then be attributed to the different jurisdictions in which the MNE is active according to a formula that relies on indicators of real economic activity, such as the number of jobs, sales, or assets in a country. He discusses a number of objections raised against UT+FA and comes to the conclusion that they can all be defeated. However, given fierce resistance from the OECD and many governments, he acknowledges that full-scale UT+FA is currently unfeasible (at least as long as the EU does not move forward to introduce such a system, which is referred to as the Common Consolidated Corporate Tax Base (CCCTB) by the EU). Consequently, he argues for an

intermediate step that would use formula apportionment only in those cases where the OECD guidelines currently foresee the use of profit-split methods. These are cases where it is particularly difficult to determine ALS prices in the traditional manner and which are therefore already resolved by reference to the profits realised in different countries.

Gabriel Wollner (2016, Chapter Fourteen) analyses the role that an international financial transaction tax (IFTT) could play in the institutional arrangements of global tax governance. He presents two families of arguments that have been mobilised in favour of such a tax. First, what one might call an internal argument (James 2012: 144), namely, Tobin's idea that sand needs to be thrown into the wheels of finance in order to reduce the risk of financial instability. From this perspective, an IFTT would ensure that the risk-externalities of transactions are internalised and that those who benefit from the public good of a well functioning financial system contribute to its maintenance. As to the second, external argument, an IFTT represents an important means of promoting distributive justice. Its progressive features on the revenue side, as well as the fact that it represents an important potential source of expenditure targeted at reducing poverty, make it an attractive policy option. Finally, Wollner argues that an IFTT would promote global background justice by shoring up the effective sovereignty of states over their economic fate, for instance by increasing the transaction costs of tax arbitrage and other practices that undermine this sovereignty.

Finally, in Chapter Fifteen, Thomas Rixen proposes an International Tax Organisation (ITO). This new organisation would be responsible for the international governance of direct taxation. Rixen engages in an exercise of positively informed normative institutional design that builds on two considerations: first, an analysis of the functional requirements of the institution – what kind of collective rules are required to defeat individual states' incentives to engage in harmful, competitive behaviour? And second, which rules help to safeguard national *de facto* tax sovereignty? The answers to these two questions provide the design of the institution (and its policies), which are spelled out in detail in the chapter. The design features turn out to be similar to those of the World Trade Organization (WTO). The ITO would, for one, function as a multilateral forum for governments to negotiate the concrete rules, thus replacing the mode of bilateralism and increasingly (partial) clubs so far prevalent in international taxation. Second, and even more importantly, it should entail a legalised dispute-settlement procedure very similar to that of the WTO, in which countries can be forced to abandon tax policies that constitute harmful tax competition.

5. Theoretical and political implications

The subtitle of this volume asks a double question about global tax governance: what is wrong with it and how to fix it? In this final section, we pull together some of the main insights the contributing chapters offer to answer these questions. In doing so, we follow the logic of the four parts to the book.

A precise diagnosis is a precondition for any cure. The contributions to Part One offer a sophisticated understanding of the phenomenon of tax competition and the challenges it presents. It is worth highlighting three of them here. First, consider the relative importance of virtual *versus* real tax competition. While Clausing 2016 (Chapter Two) rightly points out that today, poaching through *virtual* tax competition is the dominant form of tax competition, a ban on this kind of activity would substantially increase the incentives of corporations to actually shift their economic activities to low-tax jurisdictions. Reform efforts will have to be alert to this substitutive relationship. Second, both the *status quo* of tax competition and potential reforms come with distributive implications. Genschel and Seelkopf (2016, Chapter Three in this volume) identify the winners and losers of tax competition and notably dispel the idea that all members of a state share the same interests in a context of tax competition. Especially in large countries, workers and governments tend to lose from tax competition. Even within the corporate sector gains and losses differ: on the one hand, multinationals benefit from being able to play different jurisdictions off against each other but, on the other hand, small and medium-size enterprises' ability to avoid paying taxes is much more limited. Third, as highlighted by Latulippe (2016, Chapter Four in this volume), one of the principal difficulties of forming a coalition among the losers of tax competition is the extent to which the competitiveness discourse has led to an internalisation of the idea that competing on taxes is in the public interest.

Building on this analysis, the contributions to Part Two point to areas in which regulation needs to do better than today. The common finding of these chapters is that international taxation, an area that only ten years ago was governed by an administrative and technocratic logic, has clearly developed into a salient issue that is on the radar of IGOs, governments, parliaments, and civil-society activists. The process of international tax policy-making has been politicised. In terms of policy outputs, the chapters also agree: the recent initiatives represent an astonishing development and significant progress when measured against the long-term historical trajectory of international taxation; they do, however, fall short when measured against what would be needed to regulate international tax competition effectively. One obstacle is the phenomenon of mock compliance in the context of initiatives on transparency and information-exchange, as discussed by Woodward in Chapter Five. Also, as argued by Hakelberg in Chapter Six, leadership by the United States in promoting automatic exchange of tax information has not been driven by benevolent motives but rather by the desire to redistribute to its own advantage. Another obstacle lies in the distinctive challenge posed by BEPS. While both tax evasion and tax avoidance through BEPS represent types of 'poaching' and are thus equally problematic from an ethical standpoint, Chapters Seven and Eight, by Grinberg and Eccleston and Smith, both underline the importance of distributive conflict in any regulation of BEPS. Whereas it has been relatively straightforward to form a coalition against individual tax evasion,

the configuration of winners and losers in the case of corporate tax avoidance makes it harder to find a consensus on reform.

One of the contributions of this volume is to underscore the importance of a sound normative justification for global tax governance. The chapters in Part Three illustrate the kinds of arguments that are necessary to arrive at such a justification. First of all, we need a more nuanced understanding of such concepts as efficiency, sovereignty or fiscal autonomy, and distributive justice, which are frequently invoked in the debate on global tax governance. For instance, Chapters Nine through Eleven agree that tax co-operation can, in fact, be sovereignty-enhancing rather than sovereignty-compromising. That said, they vary in the robustness of the concept of sovereignty they adopt and thus also in the intensity of tax co-operation they advocate. Second, normative justification requires value judgements about the relative weight we should attach to the kinds of concepts listed above. For example, the extent to which one's regulatory response to tax competition includes the levying of some global taxes – *see* Ronzoni (2016, Chapter Nine) – plausibly depends on the relative weight one attaches to distributive considerations relative to sovereignty or efficiency. Likewise, as both van Apeldoorn (2016, Chapter Ten) and Dietsch (2016, Chapter Eleven) emphasise, the normative stance we adopt towards the luring of tax-base depends both on our understanding of fiscal autonomy and on its weight relative to other values.

Finally, when it comes to concrete reforms that flow from the arguments in this volume, Part Four offers a number of valuable lessons. First, a general precondition for a paradigm shift on global tax governance, as emphasised by Markus Meinzer (2016, Chapter Twelve), is the development of new and more appropriate measures to combat tax-abuse, secrecy and other problematic features of global tax governance. Second, as underlined in Avi-Yonah's (2016, Chapter Thirteen) defence of UT+FA, one of the critical drawbacks of the current OECD's efforts to 'repair' the arms-length standard (OECD 2013) lies in the fact that this perpetuates the 'cat-and-mouse' game between regulators and the tax-avoidance industry – one in which regulators always seem to be one step behind. Effective reform such as UT+FA has the potential to overcome these dynamics. The last two chapters of the volume sketch two complementary paths to reform. Wollner's (2016, Chapter Fourteen) case for an IFTT amounts to slowing down tax competition by making tax-avoidance strategies less profitable. Rixen (2016, Chapter Fifteen) more ambitiously calls for the creation of an ITO to oversee and enforce the regulation of the various forms of tax competition. Given the arguments throughout the volume with respect to the nature of tax competition as well as concerning the blind spots of the current regulatory response, this call for an international organisation is a logical conclusion. It is hard to see how anything short of an ITO could satisfy the functional requirements of global tax governance today.

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