Justice and International Tax Competition

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Abstract

In a globalized economy states compete for mobile tax bases. This tax competition undermines the fiscal self-determination of states and exacerbates inequalities of income and wealth both within countries and across borders. The paper provides a normative evaluation of the rules governing international tax competition. It is premised on the idea that a degree of self-determination is the most effective way to promote the interests of individuals worldwide. We put forward two principles of international taxation designed to both protect and circumscribe the fiscal self-determination of states. First, a membership principle which holds that deriving the benefits of membership in any given country grounds an obligation to pay one's taxes there. Second, an intentionality principle which states that any tax policy change is legitimate only if it would still be pursued in the counterfactual situation where the benefits of this move in terms of inflowing capital were absent. These are not principles of justice as such, but necessary conditions for domestic and, to some extent, global justice to be possible. We then consider how the two principles can be implemented and propose to establish an International Tax Organization (ITO). This organization would have to be assigned institutional capacities very similar to those of the WTO in governing international trade. Finally, we show that our principles, despite being anchored in the fiscal self-determination of states, are compatible with a cosmopolitan position on global justice.

Keywords: International Tax Competition, Justice, Self-determination, International Institutional Design, Multi-level Governance.

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A globalized economy raises intricate questions of distributive justice. Some of these have come under scrutiny in the literature. Under what conditions can international trade be regarded as respecting norms of fairness? Are wages at the subsistence level a necessary step on the path to growth or a form of exploitation? Who does and who should benefit from the profits generated by the exploitation of natural resources?[1] Yet, one important determinant of global justice, namely questions of international taxation, has received little attention in this debate. While the importance of taxation as a means to implement domestic public policy and conceptions of justice is widely acknowledged – and indeed often taken for granted – the external effects that the interdependence of national tax regimes generates are mostly neglected. Tax competition between states puts pressure on domestic fiscal regimes. Mobile factors of production have the opportunity to "shop around" to minimize their tax burden, thereby undermining the *de facto* sovereignty of states. As a consequence, tax competition tends to exacerbate inequalities of income and wealth both within countries and across borders.

One way to address these issues is to condemn the distributive outcomes and to propose redistributive policies to correct what are perceived to be unjust inequalities. This approach is largely remedial. A second possibility is to examine the rules of the game of international taxation themselves, and make sure they do not contain any unjust bias. This approach, which is geared towards the prevention of distributive injustice in the first place, is the approach favored here. To what extent does the fiscal interdependence between countries call for a normative interdependence in the form of obligations towards other countries that governments have to respect in their fiscal policy? How can we delineate legitimate fiscal interdependence from illegitimate tax competition? These are the questions that motivate this paper.

The core of the paper consists of two principles of international taxation designed to both protect and circumscribe the fiscal prerogatives of the state. First, a membership principle which holds that deriving the benefits of membership in any given country grounds an obligation to pay one's taxes there. Second, an intentionality principle which states that any lowering of national tax rates is legitimate only if it would still be pursued in the counterfactual situation where the external benefits of this move in terms of inflowing capital were absent. These are not principles of justice as such, but necessary conditions for domestic and, to some extent, global justice to be possible. As shall become clear later, our understanding and delineation of domestic and global justice is premised on the idea of a multi-level governance structure, where a certain amount of self-determination of states is not necessarily trumped by considerations of global justice.

The paper is structured as follows. In a first step, we sketch the impact of tax competition on the *de facto* sovereignty of states as well as on social inequalities in order to explain why tax competition should be on the radar of theories of justice (section 1). The central part of the paper then lays out the membership and intentionality principles (section 2). In section 3 we address the question of how these principles could be implemented. We propose the establishment of an International Tax Organization (ITO) after the model of the World Trade Organization (WTO). We also endorse unitary taxation with formulary apportionment (UT+FA) as a reform of corporate taxation. Finally, we consider and reject an objection that a cosmopolitan might raise, namely that our principles of international taxation severely restrict the accounts of global justice one may defend in conjunction with them (section 4). Section 5 concludes.

1. How Tax Competition Undermines Fiscal Self-Determination

In this section we show that tax competition leads to policy changes that have not been legitimately chosen by the states involved, but were forced upon them by external competitive pressures. In other words, tax competition undermines the self-determination of states. We first explain what fiscal self-determination entails and then how tax competition undermines it.

Fiscal Self-Determination and its Rationale

In order to establish the fiscal prerogatives of the state, it is useful to step back and consider what the purpose of taxation is. It is needed in order to finance public goods. The most important public good paid for by taxes is the institutional infrastructure of the state. Its provision can be viewed as a complex exchange between individuals in order to supply themselves with the public goods necessary to pursue their individual life plans.

But why should countries be granted autonomy in making these decisions? Why not organize fiscal affairs centrally at the level of a world government? The short answer is that granting states a degree of autonomy arguably represents the best way to promote individual interests. In other words, the normative grounding of the account of self-determination of states we defend in this paper lies in the promotion of individual interests *across* states. We presume that self-determination can only serve this instrumental role effectively if it is exercised through a form of democracy. Only if those subject to the coercively enforced rules of the state are also the authors of these rules can we expect state autonomy to protect the interests of all its members. This mere sketch of a normative grounding of self-determination will be substantiated further in section 4.

In the fiscal context, a stylized definition of self-determination entails two basic choices concerning the size of the public budget (level of revenues and expenditures) and the question of relative benefits and burdens (extent of redistribution). While there are certainly many different views on how these two evidently interdependent choices ought to be made, there is widespread agreement that they constitute the fiscal prerogatives of the state.[2] This is the substantive content of fiscal self-determination or tax sovereignty.

Three points are worth mentioning. First, we make the simplifying assumption that governments perfectly track their citizens' preferences.[3] Second, a distinction needs to be made between *de jure* and *de facto* tax sovereignty. As will become clear in the next subsection, effective self-determination in fiscal matters requires the latter. Third, self-determination is not to be understood in absolute terms. Instead, effective protection from illegitimate interference by other states requires limits on self-determination. Spelling out these limits lies at the heart of this paper.

The Consequences of Tax Competition

Tax competition is defined as interactive tax setting by independent governments in a non-cooperative, strategic way. For tax competition to exist there must be *fiscal interdependence*. This condition is met if tax bases are sensitive with respect to tax law differences, so that there is an effect of governmental actions on the allocation of mobile tax bases among jurisdictions. Tax base mobility must be legally possible and it must actually occur.[4] Favorable tax conditions to attract foreign capital can be brought about in various ways, such as a reduction in tax burdens (be it by reducing tax rates or defining tax bases in favorable ways), fashioning preferential tax regimes for foreigners, or creating (or not closing) tax loopholes, e.g. through implementing bank secrecy rules or a lax enforcement of existing rules.

Tax competition primarily targets capital, which is mobile internationally.[5] Governments use different strategies and tax instruments depending on the kind of capital targeted. Three kinds of capital can be distinguished. First, in the area of portfolio capital of individuals and firms, so-called tax havens often have low or zero tax rates. More importantly, they offer strict bank secrecy rules as well as certain legal constructs such as trusts that enable individuals to hide their ownership vis-à-vis tax administrations in their state of residence. While it is hard to come up with reliable figures since tax evasion is illegal, the available evidence suggests that there is a real effect of these policies. Estimates of the worldwide yearly revenue losses to government coffers range from 155 to 255 Billion USD.[6]

Second, governments compete for foreign direct investment (FDI) in the form of real business activity, e.g. location decisions of multinational enterprises (MNEs). These business decisions depend on various factors such as the level of education, the costs of labor, and the quality of the infrastructure. But the effective tax burden also plays a role. Empirical studies come to the conclusion that raising taxes decreases the inflow of foreign direct investment. However, the direction and strength of the correlation is strongly affected by the method of measurement and the kinds of tax rates investigated.[7] In their quest to attract foreign direct investment, governments may either lower the general business tax rate or they can engage in designing so-called preferential tax regimes, which grant tax advantages to foreigners only (ring fencing).

Third, there is competition for so-called paper profits. Through various techniques, such as transfer pricing (especially of intangible assets) and thin capitalization, MNEs can assign profits made in high-tax countries to their subsidiaries in low-tax countries without relocating real business activity.[8] Despite different approaches, all empirical investigations into this issue come to the same conclusion: the transfer of taxable profits is very sensitive to taxation, and companies make ample use of these possibilities. The decisive factor to attract mobile profits is the nominal tax rate, because companies shift only those profits that cannot be offset against depreciation and other tax benefits.[9] Again, governments may also decide to compete via specially designed regimes to attract paper profits. An example are the Special Financial Institutions (SFI) in the Netherlands, which allow foreign companies to channel capital through them in order to realize tax benefits.

Standard theory predicts a "race to the bottom" in capital taxation and the under-provision of public goods in all jurisdictions.[10] While this extreme outcome cannot be observed empirically, it can be shown that tax competition undermines the fiscal self-determination of states, i.e. their ability to effectively set the size of the budget and the extent of redistribution. In OECD countries, nominal corporate tax rates have fallen from an average of around 50% in 1975 to an average below 30% in 2005. Over the same period, nominal top personal income tax rates have fallen from around 70% to well below 50%. These rate cuts were refinanced by broadening the bases on which taxes are applied ('tax cut cum base broadening'). In this way, corporate tax revenue remained stable at an average of about 2.5% of GDP, whereas income tax revenue as a percentage of GDP rose from 11.2% to 12.8% of GDP.[11] The trend towards low nominal tax rates and broad tax bases is an attempt to defend against the outflow of mobile profits and at the same time prevent an adverse revenue effect.[12]

While revenue losses did not occur, the 'tax cut cum base broadening' policy affects the distribution of the tax burden among different kinds of taxpayers. For one, there is an effect within the business sector: highly profitable MNEs benefit, while nationally organized small and medium-sized enterprises are more heavily burdened. Second, the tax burden is shifted from capital to labor. This is also visible in the general trend to increase indirect taxes, such as consumption taxes.[13] Last but not least, competitive downward pressure on corporate tax rates affects the distributional characteristics of the personal income tax. If the nominal corporation tax rate is lowered, then it is worthwhile for private individuals to re-label their income by incorporating. In order to prevent such arbitrage, policy makers often align the corporate tax rate and the top rate on personal income, thus flattening the personal income tax schedule.[14]

As to developing countries, the dynamics of a race-to-the-bottom have a more visible impact. The pressure from tax competition on public finances is comparable to OECD countries, but developing countries usually do not have the administrative resources to stabilize their revenues by broadening their tax base. On the contrary, in many countries the base has been narrowed.[15] A significant part of the revenue loss is directly due to the shifting of paper profits. One study estimates the annual revenue loss of developing countries from transfer pricing to be US $ 160 billion.[16]

Overall, the empirical evidence shows that tax competition undermines fiscal self-determination.[17] While states still possess the formal right to set tax policies (*de jure* sovereignty), they cannot effectively pursue their desired policy goals (*de facto* sovereignty). Developed countries are able to maintain the size of the budget (first component of self-determination), but this can only be achieved by compromising the desired extent of redistribution and making the tax system more regressive (second component of self-determination). By contrast, developing countries are not able to prevent revenue losses and thus lose both components of fiscal self-determination. In this respect, tax competition increases existing inequalities between countries of the global North and South.

2. Two Conditions of Tax Justice: The Membership and Intentionality Principles

The last section has specified the content of fiscal self-determination and demonstrated how it is endangered by tax competition. Just like in the case of individual liberty, to be effective, the liberty to make these collective choices is restricted by the same liberty for the citizens of other countries. The two principles we will advance in this section spell out these restrictions and are meant to ensure that countries have an effective right to tax that reflects their polities' choices about the size of the state budget and the desired extent of redistribution. The membership principle is based on the intuition that capital mobility renders this liberty fragile and that it therefore needs to be protected. The intentionality principle argues that this liberty can be abused and therefore calls for it to be circumscribed.

The Membership Principle

Imagine you live on a street with two fitness clubs. One high-end club with expensive equipment and all kinds of free-bees like club towels and shaving equipment, and one less fancy club that lacks the rowing machines, has only three Stepmasters instead of ten and no free-bees. Unsurprisingly, the membership fee of the high-end club is almost three times that of its no-frills competitor. You are a member of the no-frills club. One day, you discover that your membership card actually lets you pass the turnstile at the high-end club, too. You keep quiet and start working out there. As it turns out, quite a few members of the no-frills club frequent the fancy club. A month later, you bump into a friend in the washrooms of the high-end club. "What are you doing here?" he asks. With a sheepish look on your face, you tell him about your discovery. He is enraged: "You guys are free-riding on our membership fees." He informs the manager and, the next day, the high-end club starts issuing new membership cards. This reaction appears justified and serves to stop what was an unacceptable form of free-riding.

For the purposes of our argument, the analogy between countries and clubs is a useful one. There are places, e.g. the Scandinavian countries that provide more services like state-financed daycare, more generous unemployment insurance, and so on, but in turn also "charge" more in terms of taxes. There are others, like England, where citizens prefer to have a leaner set of services and hence pay less. Certain forms of tax planning that involve shifting one's tax base to a low-tax jurisdiction without moving the underlying activity itself are parallel to using the high-end fitness club on your no-frills card. When a company uses the services of a country – that is its infrastructure, the human capital, and so on – to produce a certain commodity, but then shifts the paper profit made with this economic activity to low-tax jurisdictions through practices like transfer pricing or thin capitalization, the citizens who finance these services have a legitimate complaint. Tax evasion by individuals, as suggested by its illegality, represents an even blunter form of abuse. This is like jumping the turnstile at the high-end fitness club when no one is watching.

Despite these parallels between the membership in a fitness club and a country, the reaction of free-riders when they are found out is rather different. Whereas it seems reasonable to expect most people to feel sheepish about free-riding at the high-end fitness club, the parallel practice at the level of countries is often pursued without shame and, in the case of corporate tax avoidance, even under the approving stamp of legality. This reaction can be explained, but not excused, by the pervasive perception of taxation as something that the state takes away from us rather than as part of a social compact between citizens.[18]

We are now in a position to formulate our first principle of international taxation, the membership principle:

> *Natural and legal persons should be liable to pay tax in the state of which they are a member.*

In order to apply the principle, it is necessary to define membership. Our definition is the following: Individuals and companies should be viewed as members in those countries where they benefit from the public services and infrastructure. This conception of membership is related to, but distinct from, what is called the "benefit principle" or the principle of "fiscal equivalence" in the public finance literature.[19] Whereas the benefit principle in its classic formulation aims to make taxes strictly proportional to the economic benefits taxpayers receive, our conception of membership is not committed to this position.[20] As implicit in our notion of fiscal self-determination, the citizens of a state may well decide that it is appropriate to tax people with higher incomes at higher rates. True to its objective to re-establish the *de facto* sovereignty of states, the membership principle is silent on the actual tax system chosen by polities. It merely stipulates that polities should have an *effective* right to tax individuals and companies benefiting from public services and infrastructure as they see fit.

Our definition of membership is broad enough to encompass the major intuitions of diverse theories of international taxation.[21] In the international tax literature, there is agreement that a nexus between the taxpayer and the country is required for tax membership. Yet, there is disagreement about the proper nature of the nexus – should it be economic, social, political, territorial, or a combination of these? Unsurprisingly, this disagreement has never been fully resolved at the level of principles. Nevertheless, in practice a working compromise has been found that is in line with our membership principle. The so-called international tax principles specify what makes a natural or legal person a member of a country for tax purposes. Individuals are plausibly assessed on a residence basis, because residence determines where they benefit from public services and where they should therefore be counted as a member. Companies benefit from public services and infrastructure in the country where their substantive activities take place. Beyond a certain threshold of economic activity, they are therefore liable to tax in source countries, i.e. those countries in which the income was generated. For MNEs whose activities spread across borders, membership comes in degrees and should correspond to the distribution of its economic activities among countries. Some version of this justification for the residence and source principle of international taxation is commonly accepted.[22]

However, in practice there are two related problems. For one, the actual rules – domestic tax laws, bilateral double tax agreements (DTAs) and non-binding model conventions of international organizations – are not fully coherent in their definition of membership. For example, a few countries, most importantly the US, tax not only their residents but also their non-resident citizens; some countries apply different rules if an individual has multiple residences;[23] they at times disagree over what counts as a sufficient economic activity to warrant taxation at source. In effect this leads to overlaps in countries' taxing rights (so-called double taxation), but also to gaps (double non-taxation).[24] Some of these inconsistencies are indeed the consequence of disagreement over what should be the appropriate basis for tax membership. While this serves as a reminder that the detailed definition and assignment of membership is a thorny and controversial issue, we set this task aside in the current paper.[25] Second, and partly as a consequence of the lack of common rules, the membership principle is not adequately enforced under the status quo. The various practices of minimizing one's tax bill described in section 1 allow both individuals and companies to reduce their tax burdens in ways that violate the membership principle.

How would respecting the membership principle change the international tax landscape? While the answer depends on the way it is institutionalized (see section 3), some comments can already be made. Generally speaking, it prohibits the hiding or shifting of part of the tax base from one's residence in the case of individuals and from the source of the economic activity in the case of multinationals. The crucial question in assessing the potential impact of the membership principle is how individuals and companies would react if these possibilities were no longer available. To what extent would individuals and companies make use of their exit option, and move or relocate their residence or real economic activity from high-tax to low-tax jurisdictions? For a tentative assessment of this issue, it is useful to consider individuals and MNEs separately.

Individuals form a certain attachment to the place they live in. This attachment often includes the internalization of the solidarity that is reflected in their polity's choices about the size of the state and the extent of redistribution. Having said that, it is evident that in people who evade taxes in their home country, this internalization has not necessarily happened. If their affective ties to the country are not strong enough to compensate the losses that respecting the membership principle imposes on them relative to the *status quo*, then some individuals may indeed choose to leave. Note, however, that this decision will also incur a cost. Whereas under the *status quo* they are able to free-ride by evading taxes, under the membership principle leaving a high-tax country for a low-tax one implies receiving fewer government services. The result is a mechanism under which individuals self-select into different countries according to the extent to which these match their fiscal preferences. The membership principle ensures that tax competition is actually in line with Tiebout's notion of "voting with your feet."[26]

A company, by contrast, cannot form affective ties to a particular location. Its managers make the decision of where to locate its different economic activities according to what maximizes profit rather than according to the affective ties of employees. This means we can expect the reaction of companies to enforcing the membership principle to be more significant than that of individuals. Under the *status quo*, the pressure on an MNE to leave a high-tax jurisdiction is low, since the loopholes in the current system enable it to shift some of its profit instead and thereby lower its effective tax burden. A shift from the *status quo* to a world where the membership principle is respected would be a shift from a world of (merely) *virtual* tax competition for paper profits to a world of *real* tax competition for FDI: companies would have to relocate real investment in order to realize tax savings. It has been argued that such real tax competition may be more harmful to high-tax states than virtual tax competition. Instead of loosing only tax revenue, high-tax states stand to lose real capital and jobs as well.[27]

Apparently, some politicians in high-tax countries have resigned to the fact that, in the absence of fundamental international tax reform, tolerating profit shifting is their best strategy. Unsurprisingly, this acceptance is not reflected in the official political discourse since it would mean admitting to voters that one is letting some people free-ride. What we observe today in the practice of corporate taxation, in other words, is a system of nominal tax competition with price differentiation. It is as if a high-end fitness club nominally charges a high membership fee to cover its costs, but then secretly gives rebates to certain customers it does not want to lose. Since it is an empirical question how the world of real tax competition would play out, it remains unclear whether above stance of policymakers is warranted. It may well be that companies requiring state-of-the-art infrastructure or access to high-skilled labor will choose high-tax countries, whereas companies in labor-intensive, low-skill sectors will move to low-tax jurisdictions. In any case, from the perspective of the membership principle any relocation of real investment would be unproblematic, as long as taxes are paid where the benefits from public services and infrastructure are obtained. With respect to the other two forms of capital introduced in section 1, the membership principle would rule out tax competition for paper profits and severely dampen the competition for portfolio capital, because taxpayers would have to change residence in order to realize tax savings.

The Intentionality Principle

Independently of how distribution plays out in a world that respects the membership principle, the question arises whether this principle suffices as a condition of justice in international taxation. To demonstrate why we think that the membership principle on its own would be insufficient to adequately protect fiscal self-determination, let us return to a more sophisticated version of our story about fitness clubs.

Suppose the fitness clubs, though on the same street, fall on two sides of a municipal boundary. Suppose also that you can only become a member of a fitness club if you are resident in the respective municipality – this assumption guarantees that the membership principle is respected. About 20% of the population is a member in a fitness club. Since they are in better shape, fitness club members find it much easier to move house from one municipality to another. The financing structure of both clubs is 80% through membership fees and 20% through subsidies from the municipality, i.e. through municipal taxes. One day, the manager of the low-end fitness club has an idea. He lobbies the mayor to increase the municipality's subsidy to cover 40% of the costs of running the club. This allows the club to lower membership fees and the municipality to attract new residents. Since the services offered by the club remain the same, the lower price will convince some of the members of the high-end club that the difference in price is now too big to justify the service premium their club offers. They move to the municipality of the no-frills club (MN-F) and become members there.[28] Subsequently, in order to compensate the decline in revenues from membership fees, the high-end club will have to either also obtain a larger share of its financing from its municipality (MH-E) or reduce the quality of its service.

Is there anything wrong with this from the perspective of justice? The short answer is: It depends. We will argue that the legitimacy of this move depends on the motives behind the change of policy in MN-F. Against the background of section 1, the parallel between the fitness club case and tax competition between countries is straightforward to see. In the above story, for fitness club users, read mobile factors; for non-club members, read immobile factors; for mayor, read government. The altering of the financing structure at the no-frills club corresponds to a broadening of the tax base and a shift of the tax burden to relatively immobile factors.

To see why it will be necessary to appeal to the *intention* of the mayor of MN-F to decide whether the new policy poses a problem, consider the following two scenarios. In scenario A, the mayor has an explicit mandate from the residents of his municipality to push for the policy change. A majority of residents sees the new financing structure as the just way to fund the club. Given the right of a polity to choose the size of their state and the extent of redistribution established in section 1, it is only consistent to consider the policy as legitimate in this case. In scenario B, the mayor does not have an explicit mandate, but convinces the residents that adopting the new policy is in their interest, *because* it will allow the municipality to attract new residents and the corresponding tax base. The two scenarios are observationally equivalent. Hence, if one wanted to make a case that scenario B poses a normative problem, one would have to appeal to a non-consequentialist criterion that tracks the different motives.

So why should we think anything wrong with scenario B in the first place? Reconsider the last sentence of the fitness club story: "Subsequently, in order to compensate the decline in revenues from membership fees, the high-end club will have to either also obtain a larger share of its financing from its municipality or reduce the quality of its service." The external effect of the policy change in MN-F represents a violation of the liberty of the residents in MH-E to choose *their* preferred size of the budget and extent of redistribution. Under scenario A, we have to choose between restricting the right of residents in MN-F to exercise their liberty *versus* restricting the right of residents in MH-E to exercise theirs. By contrast, under scenario B, the right of residents in MH-E to exercise their liberty trumps the purely strategic considerations of MN-F. This is the basis for condemning the policy change under scenario B. To summarize in the language of countries rather than fitness clubs, if a country changes its tax system merely in order to attract tax base from abroad, this conflicts with the rights to fiscal self-determination of other countries and is therefore problematic from a normative viewpoint.

These considerations motivate our second principle of justice for international taxation, the intentionality principle:

> *Suppose the benefits of a tax policy change in terms of attracted tax base from abroad did not exist, would the country still pursue the policy under this hypothetical scenario? If yes, the policy is evidently not motivated by strategic considerations and therefore legitimate. If not, then the policy is illegitimate.*

"Strategic" here implies that a policy is justified by the prospect of attracting mobile capital from abroad rather than by appeal to the fiscal prerogatives of the state defined in section 1. The counterfactual nature of the criterion allows us, on a conceptual level, to elicit the motivation of a country in pursuing any given fiscal policy.[29] It effectively delineates (legitimate) fiscal interdependence from illegitimate tax competition.[30] Note that it also captures cases of mixed motives. Suppose a country lowers a certain tax rate *in part* because this reflects the conception of justice of its citizens, *but also* because of the strategic value of doing so for attracting foreign tax base.[31] Perhaps the country would, in the absence of the inflowing tax base from abroad, still lower the rate in question, but by a lesser amount. In this case, that lesser reduction is motivated by legitimate motivations, whereas the part of the reduction that would be dropped is illegitimate.

Someone might object that such an attempt to discern different motives suffers, even in the abstract, from important ambiguities. Suppose the citizens of a developing country are motivated by social justice reasons to build more hospitals and, in order to do so, decide to lower their country's taxes to attract the necessary capital from abroad. Is this part of their fiscal self-determination or should it count as a strategic consideration? In the latter case, would we not deprive poor countries of an important source of redistribution? We believe that our principle can answer these questions. First, we submit that this policy should indeed count as motivated by strategic considerations. Capital that is attracted to the developing country to build a hospital is not available to build a hospital elsewhere. Second, this does not mean that building the hospital in the developing country is not important and does not exclude the possibility that richer countries have an obligation of assistance towards this project. But this obligation should not be discharged in the form of a bias in the way the jurisdictional structure of international taxation is set up. It should rather be dealt with on the level of the allocation of collective revenues or via explicit redistribution. Otherwise, the risk that the bias in the system ends up being exploited by poor and rich countries alike is too high.

Given that a large part of the literature considers tax harmonization to be the relevant alternative to tax competition, two observations should be made in this regard. First, in a world where both the membership and the intentionality principle are respected there would not be full harmonization of fiscal policies across countries. Suppose the English really do have a preference for a smaller state and less redistribution than the Swedish. Neither of our principles will stop them from designing a tax structure that reflects these preferences. In turn, nothing we have said will prevent the Swedes from making a democratic choice that the best way to finance a relatively generous welfare state is to shift a considerable portion of the tax burden onto labor and consumption and to tax capital lightly. There may indeed be good internal reasons for such a policy.[32] However, the intentionality principle prohibits the very same policies if they are based on strategic considerations.

Second, even in a world where different polities have divergent preferences about the size of the state and the extent of redistribution, our two principles will create *some* pressure towards convergence. This is so because countries with preferences for a relatively large state and/or high extent of redistribution will now have to bear the real costs of these preferences in terms of part of their tax base voting with its feet. At the other end of the spectrum, however, the danger of a race to the bottom would be eliminated by our two principles for the very same reason. Countries with smaller states and less redistribution would now be forced to bear the full costs of their tax structure, rather than being able to finance part of their public services by strategically attracting foreign tax base. The fiscal externalities generated in both directions under the intentionality principle are those minimally present under conditions of fiscal interdependence between states. They ensure a maximum – though less than perfect – correspondence between the convictions of the respective polities and their fiscal structure. The intentionality principle entails that different fiscal communities have to justify their policy choices to one another. Whether a given change in tax structure is just or not depends on how the country in question justifies this change to others. The intentionality principle complements the membership principle and fills the normative void where the membership principle on its own would fall short in adequately protecting fiscal self-determination.

Despite these attractions of the intentionality principle, it also faces two related objections. First, why try to elicit the intentions of polities and their governments in fiscal policy when the market mechanism arguably offers a shortcut to the same outcome? After all, one of the main attractions of the mechanism of competitive markets is the fact that it serves to promote the common good irrespective of the individual intentions of market participants. Should this invisible hand mechanism not also be at work in the case of tax competition? The answer to this question is no. In contrast to a competitive market where private goods are traded, tax competition is about public goods. As Hans-Werner Sinn has shown, tax competition amounts to trying to provide public goods via the market mechanism.[33] As every first-year economics student knows, this is inefficient and therefore detrimental to the common good. If, at the same time, we do not want to centralize the decision for the provision of public goods at the highest level (world government), but want to allow for some diversity among decentralized units (states), then it is necessary to eliminate the strategic element of interactions between these units. This is what our intentionality principle does.

Yet, condemning the market alternative is not sufficient to endorse our proposed alternative. According to the second objection, the fact that intentions are unobservable stands in the way of making the principle operational. Our response to this challenge is twofold. First, we acknowledge that this is a serious problem. Second, however, we think that it is a necessary problem in the sense that any approach that aims to delineate illegitimate tax competition from mere fiscal interdependence will encounter it. Whether we are right about this or not hinges on the previously discussed question of whether the legitimacy of a given tax policy depends on the motivation that drives the policy. Recall our suggestion that it is possible to have two observationally equivalent scenarios. Under scenario A, the policy change flows from the preferences of citizens about the size of the state and the extent of redistribution. Under scenario B, the change is strategically motivated. If you agree that these should be evaluated differently from a normative perspective, then you should also agree that appealing to motivation is a *necessary* component of a normative account of international taxation. In this case, the challenge of the second objection is pushed back to the institutionalization of our principles that we will turn to now.

3. How to Institutionalize the Two Principles?

It is notoriously difficult to derive concrete institutions from abstract principles. This is so even in the absence of ambiguity about what the correct interpretation of the principle is, because there will generally be more than one way to institutionalize a principle. In the face of this institutional indeterminacy, we limit ourselves here to demonstrating that there is an institutional solution that satisfies the conditions embodied in our principles. As a further caveat, we stress that the following brief sketch will, due to space constraints, remain incomplete and cannot do full justice to the complex issues of international taxation. But it should suffice to make a case for the practical relevance of our proposal.

Any institutional solution must provide (1) a forum for governments to negotiate an agreement on the rules of international taxation and (2) make sure that the rules are enforced. In the following we propose the establishment of an International Tax Organization (ITO) and discuss some of the institutional design features required for the two tasks.[34]

(1) We have already stated that it is necessary for governments to come to a multilateral agreement on what it means to be member of a state and that the details of such a rule will be controversial. The ITO should become a forum for negotiating and defining the rules in line with the membership and intentionality principles. To ensure a level-playing field, all states should be members and adequately represented in the ITO's decision-making procedures. The OECD as the most important international tax forum today is often criticized for falling short in these respects.[35]

Furthermore, on the basis of our two principles several substantive reforms become imperative. First, the membership principle requires governments to abolish all rules that make it impossible for other countries to enforce the membership principle. Thus, strict bank secrecy regulations, the supply of other deliberately nontransparent legal constructs, and the refusal to exchange information with other tax administrations will be ruled out. This could for example be achieved through a system of multilateral automatic exchange of information.[36]

Second, as we have already acknowledged, defining rules that respect the intentionality principle will be difficult because intentions are unobservable. The most promising route lies in identifying observable implications of the unobserved intentions. One obvious candidate for a rule in this context is that all forms of preferential tax regimes for foreigners (ring fencing) must be abolished. Such discriminatory arrangements show that a government implements a policy for strategic reasons only.

Third, an ITO with inclusive membership would provide an ideal forum to reconsider the membership rule in the case of MNEs. How should the rights to tax shares of the profit of an MNE be allocated among jurisdictions? This issue is a very thorny one in international tax practice that has so far been resolved through so-called arm's length standard (ALS) transfer pricing.[37] However, as set out in section 1, both the indeterminacy of applying this standard and the difficulties in its enforcement can be exploited by MNEs to lower their tax bills. One possible solution would be to switch to a system of unitary taxation with formula apportionment (UT+FA). This would require governments to agree on a common and consolidated corporate tax base. MNEs would have to determine their worldwide profit in one single report, and they would be allowed to consolidate profits and losses of entities in different countries. The worldwide profit would then be apportioned to the respective countries in which the MNE operates on the basis of a predetermined formula. The formula should reflect the real economic activity in each country by referring to factors such as property, sales, and payroll. This would make it impossible for companies to engage in the shifting of paper profits and thus be a major step forward in the implementation of the membership principle.[38]

(2) What would it take to effectively enforce our two principles? First, we argue that monitoring the adherence to the rules should be relatively straightforward since governments can be expected to launch a complaint if other governments violate either or both of the two principles.[39] Yet, what is needed is an independent authority that will process the complaint and eventually enforce the rules. Independent third party enforcement is needed to ensure compliance with the two principles, because the structure of tax competition is such that every individual country has an incentive to deviate from the collectively desirable rules. The ITO should install a dispute settlement procedure after the WTO model to satisfy this requirement. In case a member state complains that the tax practices of another member violate the rules, they can, as a first step, try to resolve the conflict in consultations. If they are unsuccessful, the case will be transferred to the dispute settlement body (DSB), which effectively functions like an independent third party.[40] Since parties know that there will be an effective enforcement in the DSB, it can be expected that they will resolve many cases in consultation. In particular, this should be the case for obvious abuses like ring fencing.

Note that the restrictions on fiscal sovereignty under our ITO model are limited. No supranational power to tax is established. Instead, the idea is that the international community can impose certain limits on the fiscal choices of nation states. What our two principles do require is an international framework that is much stronger than the current international tax institutions, which consist of a patchwork structure of unilateral, bilateral, and multilateral rules and lacks international levers of enforcement. Against the background of the historical development of the international tax regime, it may seem unlikely that an ITO will come into being any time soon.[41] On the other hand, the existence of the WTO is testament to the fact that it is achievable.

4. Toward what Kind of Global Justice?

The membership and intentionality principles do not in themselves represent principles *of* justice. Instead, they are preconditions *for* justice in the sense that they guarantee the *de facto* sovereignty of states and their capacity to fiscally implement the conceptions of justice of their citizens domestically. Yet, what about global justice? Arguably, the most disturbing inequalities in today's world are ones between individuals across borders rather than between citizens of the same state.

This section addresses the question of whether the membership and intentionality principles impose any constraints on the account of global justice one may defend on their basis. In particular, we argue that our normative commitment to self-determination with respect to the size of the state and the extent of redistribution is compatible with the basic tenets of cosmopolitan justice.

Consider what Simon Caney calls the "*principal cosmopolitan claim*: given the reasons we give to defend the distribution of resources and our convictions about the irrelevance of people's cultural identity to their entitlements, it follows that the scope of distributive justice should be global."[42] To specify what they mean by this global scope, some cosmopolitans draw a distinction between radical *vs.* mild forms of their position. Whereas the former not only affirm that there are global principles of justice but also deny that there exist any state-wide principles of justice, mild cosmopolitanism limits itself to the former, positive claim.[43] Can one take seriously the idea of self-determination – as outlined in section 1 and implicit in the membership and intentionality principles – and, at the same time, claim to be a mild cosmopolitan? We put forward two ways in which one may answer this question affirmatively.

The Normative Grounds of Self-Determination

First, cosmopolitans are likely to probe the status of self-determination to begin with. Why should we believe that self-determination has any normative weight and, in particular, how could self-determination legitimize inequalities that are immune to the redistributive demands of global justice? In short, our reply is the following: Granting self-determination to states has instrumental value in promoting the interests of individuals worldwide. In particular, it offers a more effective way of serving these interests than concentrating collective decision-making at the highest level, i.e. in the hands of a world government. As Robert Goodin puts it, the special duties that states have towards their citizens are the best way of discharging "the general duties that everyone has towards everyone else worldwide."[44] Besides, granting autonomy to states offers protection from domination as well as immunity from the larger unit that allows it to be more responsive to local interests and to reduce the burdens of decision-making.[45]

Two comments are in order. First, having spelt out the positive, instrumental value of self-determination, it should also be emphasized what our appeal to this self-determination is not. We do not think that self-determination has any value that derives from the status of the community itself that is granted this form of autonomy. In other words, there is nothing special about states, nations, or peoples that implies they should have a right to self-determination. The normative grounding of self-determination is the individual interest of human beings, not the interest of any particular groups. Second, we see democracy as a necessary condition for self-determination to effectively serve its role in promoting individuals' interests worldwide. It is hard to see how one of the main advantages of self-determination, to wit, the responsiveness to local circumstances and interests, could manifest itself in the absence of the kind of representativity ensured by democratic forms of government.

How does this position fit with the normative commitments of mild cosmopolitanism? In fact, some global egalitarians themselves appeal to self-determination to defend transfers between countries that compensate for contingencies.[46] This is exactly the kind of reasoning that underlies our principles of membership and intentionality. For substantive self-determination to be possible, it needs to be both protected and constrained.

While we thus defend the view that mild cosmopolitanism and self-determination are compatible, we would also like to point out that mild cosmopolitans are at times too quick to assert this compatibility, thereby glossing over some of the most interesting normative questions of multi-level governance. To illustrate, consider Caney's discussion of what he calls the 'national duties' thesis, i.e. the idea that "individuals bear special obligations of distributive justice to other members of their nation."[47] While Caney wants to emphasize that the national duties thesis and mild cosmopolitanism are compatible in principle, he acknowledges that the two positions "might disagree on the *ranking* of the national duties in relation to cosmopolitan duties."[48] This line of reasoning neglects that, unless cosmopolitan duties were for some reason to trump national duties, then this tension between the two kinds of duties will in some cases call for compromising cosmopolitan duties. In other words, trade-offs exist between global and domestic justice.[49] Cosmopolitans cannot have their cake and eat it, too. They cannot acknowledge the compatibility of mild cosmopolitanism with the national duties thesis while neglecting the compromises this position requires from mild cosmopolitanism.

Nevertheless, it would be misguided to conclude from this that the self-determination implicit in the principles of membership and intentionality imposes an undue constraint on the account of global justice one may defend in conjunction with them. It rather serves as a reminder that a mild cosmopolitan position on global justice has to take a stance on the trade-offs and challenges that a multi-level governance structure entails.[50] For guidance on how to resolve those trade-offs in the fiscal context, which preoccupies us in this paper, one may consult the fiscal federalism literature. This literature specifically aims to balance out the benefits and costs of autonomous fiscal decision-making at lower governmental levels with the benefits and costs of providing them at higher (or the highest) level.[51]

An Argument from Non-Ideal Theory

Even for those cosmopolitans who remain unconvinced by our normative grounding of self-determination, there is another reason to grant states some autonomy nonetheless. A theory of justice with practical ambitions is well advised to take some features of the world as given, rather than attempting to reform everything at once. Arguably, the division of world politics into states is a good candidate for such a feature, given that a world without states has to be viewed as utopian from today's perspective.

Note that defending such a non-ideal theory argument does not imply accepting the *current* state system as just. One might argue that those states benefiting from the international structure in unjust ways incur a series of redistributive obligations towards those who get short-changed under the *status quo*.[52] We agree that such redistributive duties exist today. However, this paper relegates them to the background. From a non-ideal perspective, our concern is to design fair rules of the game to govern the fiscal interdependencies between states without probing the normative standing of states as such.

Independently of whether self-determination is granted on normative or pragmatic grounds, our project in itself can be expected to go *some* way towards eliminating global injustices. Whatever injustices remain when respecting the membership and intentionality principles should trigger redistributive obligations. Yet, formulating these redistributive obligations before defining fair rules of the game would amount to putting the cart before the horse. While we have focused on the definition of fair rules, we would like to point out that our policy recommendations provide good access points for a discussion of the issue of redistribution. For example, the model of UT+FA discussed in section 3 could be specified such that the portion of the tax base assigned to each country for tax purposes is an inverse function of its gross domestic product (GDP).[53] More generally, it can be expected that an International Tax Organization charged with implementing the membership and intentionality principles would also provide a good forum for disadvantaged states to raise the issue of inter-state transfers.

This short section cannot claim to present a comprehensive treatment of the rich literature on global justice. Our limited objective here has been to show that endorsement of the membership and intentionality principles imposes no significant constraints on the position of global justice one might want to defend.

5. Conclusion

Portraying the tax and transfer branch of government as the major instrument of redistribution can obscure the fact that competition between different tax systems will in fact exacerbate income inequalities both domestically and globally. This paper was motivated by the intuition that the inequality-enhancing effects of tax competition can be qualified as unjust. The membership and intentionality principles defended above serve as a normative toolkit to identify what that portion is. They specify to what extent the interdependence of states in fiscal matters calls for normative interdependence. To put these principles into practice, we propose the creation of an International Tax Organization (ITO), whose job description would include the settling of disputes between states about which tax policies violate the membership and intentionality principles.

To be sure, a world in which the membership and intentionality principles are respected is not yet a just world. It is merely a world that contains the preconditions for justice in two important ways. First, national polities would regain the capacity to make collective fiscal choices about the size of the state and the level of *domestic* redistribution. In other words, the membership and intentionality principles ensure that the costs of fiscal choices fall on those who make them, at least to the extent that this can be achieved under conditions of fiscal interdependence. Second, the two principles will have to be complemented by substantive principles of *global* tax justice. While these necessarily build on the work done in this paper, they also ask the question whether states have normative obligations to make transfer payments to other states and, if so, what they are. We hope to address this issue in future work.

Endnotes

[1] See e.g. Mathias Risse, "Fairness in Trade I: Obligations from Trading and the Pauper Labor Argument," *Politics, Philosophy & Economics* 6, no. 3 (2007); Malgorzata Kurjanska and Mathias Risse, "Fairness in Trade II: Export Subsidies and the Fair Trade Movement," *Politics, Philosophy & Economics* 7, no. 1 (2008); Leif Wenar, "Property Rights and the Resource Curse," *Philosophy and Public Affairs* 36, no. 1 (2008); Thomas Pogge, "Severe Poverty as a Violation of Negative Duties," *Ethics and International Affairs* 19, no. 1 (2005).

[2] Cf. e.g. Reuven S. Avi-Yonah, "Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State," *Harvard Law Review* 113, no. 7 (2000); Peter Dietsch and François Claveau, "Concurrence Fiscale Et Responsabilité Étatique," *Éthique Publique* 10, no. 1 (2008).

[3] For a discussion of the problems associated with this assumption, see Alexander Cappelen, "Responsibility and International Distributive Justice," in *Real World Justice*, ed. Andreas Follesdal and Thomas Pogge (Dordrecht: Springer, 2005), 220-22.

[4] John D. Wilson and David E. Wildasin, "Capital Tax Competition: Bane or Boon," *Journal of Public Economics* 88, no. 6 (2004), 1065-6.

[5] In general, labor is quite insensitive to tax differentials and thus the fundamental requirement of fiscal interdependence is hardly met. However, this is not true for certain high-skilled segments of the labor market. We bracket tax competition for labor here.

[6] Jeffrey Owens, "Written Testimony of Jeffrey Owens, Director, OECD Center for Tax Policy and Administration before Senate Finance Committee on Offshore Tax Evasion, 3 May 2007," http://finance.senate.gov/hearings/testimony/2007test/050307testjo.pdf, accessed 4 August 2008; Tax Justice Network, *Tax Us If You Can. The True Story of a Global Failure* (2005), http://www.taxjustice.net/cms/upload/pdf/tuiyc_-_eng_-_web_file.pdf, accessed 22 January 2010.

[7] Ruud A. de Mooij and Sjef Ederveen, "Corporate Tax Elasticities: A Reader's Guide to Empirical Findings," *Oxford Review of Economic Policy* 24, no. 4 (2008).

[8] For a description of these and other techniques of shifting paper profits, see e.g. Brian J. Arnold and Michael J. McIntyre, *International Tax Primer* (Den Haag: Kluwer Law International, 1995), 8-17. The fact that 60% of world trade is intra-firm indicates that the tax base at stake is significant.

[9] Michael P. Devereux, "The Impact of Taxation on the Location of Capital, Firms and Profit: A Survey of Empirical Evidence (with Data Appendix by Giorgia Maffini)," Working Paper, University of Warwick (2006); de Mooij and Ederveen, "Corporate Tax Elasticities." The fact that profit shifting is possible may explain the weaker effect of tax policies on FDI. As long as MNEs can realize tax savings without business relocations, the competition for FDI and mobile profit is in a substitutive relationship. We return to this issue in part 2.

[10] See e.g. Wilson and Wildasin, "Capital Tax Competition," 1069-70.

[11] OECD, *Revenue Statistics 1965-2007* (Paris: OECD, 2008).

[12] See e.g. Andreas Haufler and Guttorm Schjelderup, "Corporate Tax Systems and Cross Country Profit Shifting," *Oxford Economic Papers* 52, no. 2 (2000).

[13] Simon Loretz, "Corporate Taxation in the OECD in a Wider Context," *Oxford Review of Economic Policy* 24, no. 4 (2008); Peter Schwarz, "Does Capital Mobility Reduce the Corporate-Labor Tax Ratio?,"

Public Choice 130, no. 3-4 (2007); Philipp Genschel, "Globalization, Tax Competition and the Welfare State," *Politics & Society* 30, no. 2 (2002).

[14] Steffen Ganghof, *The Politics of Income Taxation. A Comparative Analysis of Advanced Industrial Countries* (Colchester: ECPR Press, 2006), 5-8.

[15] Michael Keen and Alejandro Simone, "Is Tax Competition Harming Developing Countries More Than Developed?" *Tax Notes International* 34, 28 June 2004.

[16] Christian Aid, *Death and Taxes: The True Toll of Tax Dodging* (London: 2008), http://www.christianaid.org.uk/getinvolved/christianaidweek/cawreport/index.aspx, accessed 19 May 2008.

[17] Some observers argue that the policy choices described above – tax cuts cum base broadening, increasing reliance on indirect taxes and low tax burdens on capital – are not caused by tax competition. They argue that these policies reflect a general shift towards market-conforming taxation that governments implemented irrespective of competitive pressures. See e.g. Sven Steinmo, "The Evolution of Policy Ideas: Tax Policy in the 20th Century," *British Journal of Politics and International Relations* 5, no. 2 (2003). While it is true that there are also domestic efficiency reasons for implementing these policies, our foregoing sketch of the mechanisms shows – in line with most of the public finance literature – that these changes are to a significant part driven by the pressures of tax competition. For more on this debate, see Ganghof, *The Politics of Income Taxation* and Thomas Rixen, "From Double Tax Avoidance to Tax Competition: Explaining the Institutional Trajectory of International Tax Governance," *Review of International Political Economy* (forthcoming). If, however, as we will discuss in section 2, such policies are indeed chosen for domestic reasons only, they would not indicate a violation of self-determination but an instance of it.

[18] Liam Murphy and Thomas Nagel, *The Myth of Ownership: Taxes and Justice* (Oxford: Oxford University Press, 2002) call this phenomenon the "myth of ownership." They argue that citizens do not have an entitlement to their pre-tax income but can only claim legitimate ownership to their post-tax income since the tax-financed state defines property rights in the first place.

[19] Mancur Olson, "The Principle Of 'Fiscal Equivalence': The Division of Responsibilities among Different Levels of Government," *American Economic Review* 59, no. 2 (1969).

[20] In public finance, the *benefit principle* is often contrasted with the *ability to pay principle*. See e.g. Joel Slemrod and Jon Bakija, *Taxing Ourselves. A Citizen's Guide to the Great Debate over Tax Reform*, 3rd ed. (Cambridge: MIT Press, 2004), 61-6. Whereas the latter justifies redistribution, the former does not. Our membership principle is more general and comprises both of these principles. It is compatible with what has been called group fiscal equivalence by Ulrich Thielemann, "Grundsätze fairen Steuerwettbewerbs - ein wirtschaftsethisches Plädoyer für einen Steuerleistungswettbewerb," in *Regulierung oder Deregulierung der Finanzmärkte*, ed. Bernd Britzelmaier, et al. (Heidelberg: Physica-Verlag, 2002).

[21] See e.g. Peggy B. Musgrave, "Fiscal Coordination and Competition in an International Setting," in *Retrospectives on Public Finance*, ed. Lorraine Eden (Durham: Duke University Press, 1991); Dieter Biehl, "Towards a General Theory of Taxing International Transactions - a Taxanomy of International Taxation Principles," *Public Finance* 37, no. 2 (1982); Alexander W. Cappelen, "The Moral Rationale for International Fiscal Law," *Ethics & International Affairs* 15, no. 1 (2001).

[22] Reuven S. Avi-Yonah, *International Tax as International Law: An Analysis of the International Tax Regime* (New York: Cambridge University Press, 2006).

[23] Typically, an individual counts as a resident for tax purposes if she spends 183 days or more in the country. However, this rule is not universally applied.

[24] For a discussion of the gaps and overlaps in the international tax regime with references to the vast legal and economic literature on the topic, see Thomas Rixen, *The Political Economy of International Tax Governance* (Basingstoke: Palgrave/Macmillan, 2008), 57-85.

[25] While our definition of membership is not detailed enough to resolve all cases of ambiguous membership assignments, it does nonetheless exclude certain conceptual possibilities. It should be emphasized, for example, that our definition of membership is distinct from citizenship. Permanently non-resident citizens should not be liable to tax in their country of citizenship. Conversely, resident aliens do not necessarily have a democratic voice in state decisions. This is plausible. A company should not be given voting rights. In the case of individuals, consider a person living and working in a country for one or two years. It seems justified to tax her, but also permissible not to give her a say in democratic decisions. In fact, one could sensibly distinguish between different thresholds of permanence. Whereas a tourist should not be liable to income tax in the country he visits, a “guest worker” staying for longer than, say, 6 months should be. For a resident alien taxpayer to acquire voting rights, the level of permanence can be significantly higher – even though it seems to us that many countries are too restrictive in granting citizenship to permanently resident foreigners. We bracket these debates here.

[26] Charles M. Tiebout, "A Pure Theory of Public Expenditures," *Journal of Political Economy* 64, no. 5 (1956).

[27] Michael Keen, "Preferential Regimes Can Make Tax Competition Less Harmful," *National Tax Journal* 54, no. 4 (2001); Dhammika Dharmapala, "What Problems and Opportunities are Created by Tax Havens?" *Oxford Review of Economic Policy* 24, no. 4 (2008), 671-6.

[28] To make this plausible, let us assume that club membership fees represent a significant part of people’s budget.

[29] The counterfactual nature of the criterion is in part inspired by Calvin Normore, "Consent and the Principle of Fairness," unpublished paper (2009) on the foundations of political obligation.

[30] Remember from the definition provided in section 1 that the strategic motivation is a necessary element of tax competition. Thus, by eliminating strategic motivations, none of the remaining fiscal interdependence qualifies as tax competition.

[31] As explained in footnote 17, such mixed motives are empirically plausible.

[32] See e.g. Adam Przeworski and Micheal Wallerstein, "Structural Dependence of the State on Capital," *American Political Science Review* 82, no. 1 (1988).

[33] Hans-Werner Sinn, "The Selection Principle and Market Failure in Systems Competition," *Journal of Public Economics* 66, no. 2 (1997).

[34] Calls for an International Tax Organization can be found in the literature, see e.g. Vito Tanzi, "Is There a Need for a World Tax Organization?," in *The Economics of Globalization. Policy Perspectives from Public Economics*, ed. Assaf Razin and Efraim Sadka (Cambridge: Cambridge University Press, 1999); Frances M. Horner, "Do We Need an International Tax Organization," *Tax Notes International* 24, 8 October 2001. However, so far no attempt has been made to derive the institutional design from the functional requirements of the issue to be dealt with. On institutional design, see e.g. Barbara Koremenos, Charles Lipson, and Duncan Snidal, "The Rational Design of International Institutions," *International Organization* 55, no. 4 (2001).

[35] See e.g. Tax Justice Network, *Tax Us If You Can*.

[36] Ronen Palan, Richard Murphy, and Christian Chavagneux, *Tax Havens. How Globalization Really Works* (Ithaca: Cornell University Press, 2010), 244.

[37] According to the ALS, foreign branches or subsidiaries of an MNE are to be taxed as if they were independent market participants, exchanging goods and services at arm's length (i.e. market) prices, see e.g. Lorraine Eden, *Taxing Multinationals: Transfer Pricing and Corporate Income Taxation in North America* (Toronto: University of Toronto Press, 1998), 32-52.

[38] For a proposal to implement UT+FA, see Kimberly A. Clausing and Reuven Avi-Yonah, "Reforming Corporate Taxation in a Global Economy: A Proposal to Adopt Formulary Apportionment" (The Hamilton Project, Brookings Institution, 2007), http://www.brookings.edu/~/media/Files/rc/papers/2007/06corporatetaxes_clausing/200706clausing_aviyonah.pdf, accessed 21 April 2010.

[39] That said, it may be in the interest of governments to assign the ITO with the task to collect and provide information on tax policy changes to all member countries.

[40] All member states are on the DSB and can only block a panel report (judgment) if they agree unanimously on blocking it. See e.g. Bernhard Zangl, "Judicialization Matters! A Comparison of Dispute Settlement under GATT and the WTO," *International Studies Quarterly* 52, no. 4 (2008).

[41] Rixen, "From Double Tax Avoidance to Tax Competition."

[42] Simon Caney, "International Distributive Justice," *Political Studies* 49, no. 5 (2001), 977.

[43] Ibid., 975; Samuel Scheffler, *Boundaries and Allegiances. Problems of Justice and Responsibility in Liberal Thought* (Oxford: Oxford University Press, 2001), 115-19; Kok-Chor Tan, *Justice without Borders: Cosmopolitanism, Nationalism and Patriotism* (Cambridge: Cambridge University Press, 2004), 11-2.

[44] Robert E. Goodin, "What is So Special About Our Fellow Countrymen?," *Ethics* 98, no. 4 (1988), 681.

[45] These are some of the classic reasons given for a federal structure. In addition, the existence of several smaller units allows for different experiments of life. See e.g. Andreas Follesdal, "Federal Inequality among Equals: A Contractualist Defense," in *Global Justice*, ed. Thomas Pogge (Oxford: Blackwell, 2001), 251-53; Wallace E. Oates, "An Essay on Fiscal Federalism," *Journal of Economic Literature* 37, no. 3 (1999).

[46] Christian Barry and Laura Valentini, "Egalitarian Challenges to Global Egalitarianism: A Critique," *Review of International Studies* 35, no. 3 (2009), 503.

[47] Caney, "International Distributive Justice," 980. The 'national duties' thesis differs from the argument based on self-determination we defend here. However, the relation between demands of global justice and national duties is structurally similar to that between demands of global justice and self-determination.

[48] Ibid., 981.

[49] One promising avenue to address these trade-offs is by conceptualising national responsibility. If an inequality between countries is due to contingent factors like natural resource endowment or climate, then global justice duties seem to trump self-determination and require international transfer payments. If, on the other hand, an inequality can be traced to collective choices for which the state can be held responsible, it would be immune to the demands of global justice. Cappelen, "Responsibility and International Distributive Justice" defends a position of this kind.

[50] This is explicitly acknowledged by Follesdal, "Federal Inequality among Equals" who argues that some global equality may legitimately be sacrificed in exchange for more subunit autonomy.

[51] We cannot do justice to the arguments of the huge literature on fiscal federalism. For an overview, see e.g. Oates, "An Essay on Fiscal Federalism."

[52] For instance, countries can have redistributive duties towards the members of other states because they unduly benefit from economic interaction with them, see Philippe Van Parijs, "International Distributive Justice," in *A Companion to Contemporary Political Philosophy*, vol. 2, ed. Robert E. Goodin, Philip Pettit, and Thomas Pogge (Oxford: Blackwell, 2007); or because they have inflicted harm on them in the past, see Thomas Pogge, *World Poverty and Human Rights* (Cambridge: Polity Press, 2002); or simply because the latter find themselves unable to survive without outside assistance. This list is not meant to be complete.

[53] Richard A. Musgrave and Peggy B. Musgrave, "Inter-Nation Equity," in *Modern Fiscal Issues: Essays in Honour of Carl S. Shoup*, ed. Richard M. Bird and J. G. Head (Toronto: University of Toronto Press, 1972).