

Power and sovereignty. How economic-ideological forces constrain sovereignty to tax

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How do nation states relate to each other in terms of power? How do they relate to private parties in terms of power? Nation states are often thought of as sovereign to tax. In a legal sense that may be true. However, to be legally sovereign is not the same thing as being able to effectively exercise sovereignty. The mobility of capital and businesses, or at least the perception of their mobility, is increasingly pressuring sovereignty to tax. To shed light on the economic constraints on nation states and the beliefs about such constraints, this article introduces the concept of economic-ideological forces and contends that sovereignty should be understood in a way that encompasses these forces. Otherwise, it does not provide an adequate account of power and thus becomes a tool for maintaining established power relations.

Keywords: Power, sovereignty, sovereignty to tax, international tax order, economic-ideological forces, ideology critique.

The dividing force of the nation state

In *Sapiens - A brief history of humankind*, Yuval Noah Harari argues that humans came to dominate other animals due to a greater capacity to cooperate in very large groups. The key to this ability was that humans did not require close relationships in order to do so. Human cooperation merely required imagination. According to Harari, a large number of people (who do not know each other) can successfully cooperate thanks to common beliefs in myths. A myth is not to be understood as a lie or an untruth but as a story within a particular epistemology, i.e. a particular way of

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understanding the world or organizing thought. One such myth is that of the nation state. Harari refers to it as imagined community.²

A similar concept is imagined geographies that was introduced by Edward Said as a part of his postcolonial critique (Said 1978). Imagined geographies refers to the framing and creation of a place and people by an observer that does not think of him- or herself as belonging to it. It is a portrayal of *the other* and it carries with it the prejudices of the observer. By portraying the other as inferior it became possible to justify colonial practices. In response to Harari I therefore think it's important to stress that the nation state is not only a unifying force; it is just as much a dividing force. Through the concept of "nation" people are categorized into an us and a them (people on the inside and people on the outside - people belonging and not belonging to the nation). The nation state may therefore be used as a tool for humans to not only dominate other animals, but also dominate other humans.

The dividing force of the nation state expresses itself both culturally and institutionally. On a cultural level, symbols such as flags, anthems and football teams reinforce the myth of the nation state. The symbols can be said to naturalize the nation state, i.e. turn it into something that is taken for granted; something that is assumed to have deep roots in history. The cultural expression of the nation state supports, and is also being supported by, an institutional expression of the nation state (parliaments, courts, the police, schools and so on). One part of the institutional expression is the sovereignty to tax.

The idea of the sovereign nation state is strongly rooted, not the least in tax law scholarship. Indeed, attempting to solve societal challenges without breaking against current societal structures requires the researcher to accept this premise. However, in this essay I intend to critically analyze it. The purpose of the essay is to demonstrate how the idea of sovereignty to tax serves to maintain established power relations. However, the way in which sovereignty to tax serves to maintain power relations is different than the technique of portraying the other as inferior. Quite the contrary, sovereignty to tax seems to equalize nation states and to protect legal independence. The problem is however that when the concept of sovereignty to tax is thought of in a mere legal sense it becomes insensitive

² Harari 2015. The concept of imagined community originates from Anderson 1983.

to other forms of power, especially the power of economic conditions and the power of belief about economic conditions.

Critical theory and economic-ideological forces

This essay draws upon critical theory as developed by the Frankfurt School. Within this school of thought, critical theory is contrasted to traditional theory. While the latter merely seeks to understand and explain society, critical theory endeavors to challenge and change society (Berendzen 2017; Horkheimer 1972, 188-243). An important component of it is to reveal how seemingly neutral depictions of society serve to sustain power relations. This approach is known as ideology critique.

In this context, “ideology” is to be understood as a system of ideas that bind people together and determine their actions (Ferretter 2006, 75-80; Buchanan 2018). Within critical theory, ideology is often described as a false consciousness; a distortion of reality. This statement follows from a philosophical turn from idealism to materialism. Whereas idealism asserts that reality is assumed to be more or less inseparable from ideas and human perception, materialism asserts that the world (including human perception) is determined by material conditions. According to a materialist, it is not enough to substitute one system of ideas with another to improve the lives of human beings; it is the material conditions that need to change. By overlooking the material conditions of life, ideology creates a false consciousness (Marx and Engels 1976; Ferretter 2006, 12-20). However, not all critical theorists think of ideology as a false consciousness. According to Louis Althusser, it is not a matter of consciousness at all but rather an unconscious phenomenon; a structure into which we’re born. This structure consists of the myths, ideas and concepts through which we have been taught to approach the world. Althusser further stresses that ideology is not instrumental, i.e. not consciously utilized by the ruling class to oppress other classes. On the contrary, the ruling class believes in its ideology just as much as the exploited classes do. Furthermore, there is not just one ideology in a society but several of them (Ferretter 2006, 75-80).

In this essay, I do not think of ideology as a distortion of reality. I rather think of reality as formed by material conditions alongside ideas. Ideas are able to make some aspects of the material reality visible while at the same time making other aspects of the material reality invisible. Through the process of making some aspects visible and other aspects invisible, ideas

may serve to maintain power relations. If that is the case, the idea is part of an ideology. Thus, a central feature of the concept of ideology is its function of maintaining power relations.

The focus of this essay is the idea of the sovereignty to tax. As I'll demonstrate below, the idea of sovereignty to tax has been problematized in previous tax law research. The novelty of this essay is the introduction of the concept of economic-ideological forces. This concept is intended to frame *that* which is constraining effective sovereignty. The term "economic forces" is supposed to capture the fact that states are not just governing the market economy but are simultaneously *governed by* the market economy. A state may be legally entitled to enact any type of taxes that it wishes while, at the same time, being constrained by the economic conditions of the globalized world economy. For instance, a state may be reluctant to enact a wealth tax if a significant amount of capital will flee the country. It is however not easy to determine to what degree a nation state is actually constrained by economic conditions and to what degree the nation state is inhibited by beliefs about economic conditions. That is why I use the term *economic-ideological forces*. In this sense, the concept of economic-ideological forces seeks to reconcile the material with the ideological. The concept of economic-ideological forces will be further developed below.

When sovereignty to tax is understood in a formal sense it accounts for legal power, but not economic power. Consequently, the sovereignty concept becomes a tool for maintaining established power relations. In this essay, I use ideology critique to show how this is done. The core part of ideology critique is contextualization. This means that an idea is to be put in its historical and material context. This essay will describe how ideas about sovereignty in tax matters has evolved, from the peace of Westphalia to modern times of inter-state tax competition. When doing this I try to show how sovereignty to tax is increasingly being constrained by the mobility of private resources, or at least by convictions about their mobility. This development has incited tax competition in-between states and deprived developing states (primarily) of much needed revenue. There is, of course, a vast amount of literature that deals with issues of sovereignty from different disciplines and perspectives (see, for instance, Walker 2003). This essay has its focus on sovereignty in a tax law context. However, the concept of sovereignty to tax is connected to the concept of sovereignty in

International law and in political philosophy. In the following section I therefore begin by briefly situating sovereignty to tax in a broader sovereignty context.

Sovereignty to tax in the early stages of the international tax order

In the Charter of the United Nations Article 2 (1), it is expressed that the organization is built upon the principle that all of its members are sovereign equals. To think that all states *de facto* are equal, however, is a mistake. As Karl Loewenstein writes:

Actually the assumptions of both equality and the independence of states are fictions. States never have been, nor are they now, equal. They differ widely in their power potential and, consequently, also in the degree of their independence [...] In reality the notion of sovereignty and its corollaries of equality and independence are largely semantic and escapist formulae ignoring the fact that the dynamism of inter-state power relations is no longer - if it ever was - controllable by the rules of international law. The independence and equality of states have disappeared because, in this technological age with its vastly increased density of economic inter-penetration and political interdependence, an individual state can exist in isolated sovereignty no more than an isolated individual can in society (Loewenstein 1954, 223).

The idea of the sovereignty of nation states stems from the Peace of Westphalia in 1648 as a way of incorporating ideals of equality, parity and uniformity among nation states (Minkinen 2009, 62; Tomazela Santos and Rocha 2017, 30; Brauner 2017, 76). As the concept of sovereignty was elaborated it was closely connected to territory; each state was given the right to autonomously regulate the legal system within its territory (Besson 2009, 372). Sovereignty has thus been described as a supreme power; a power to govern a particular territory without interference, especially without interference from other countries and governments (Brauner 2017,

76). Regarding the field of taxation, sovereignty implies full and exclusive taxing rights within the borders of the state (Tomazela Santos and Rocha 2017, 30; Schoueri and Galendi Júnior 2017, 63-4). In the legal literature, it has been claimed that sovereignty to tax encompasses a technical autonomy and an exclusive territorial application. The technical autonomy refers to the ability to define all aspects of a tax system such as tax bases and tax rates. The exclusive territorial application refers to the ability to tax all of the elements of income connected to the territory of a state, while at the same time prohibiting the state to impose its taxes abroad (Traversa and Pirlot 2014, 128-9 with further references).

The development of the international tax order has been connected, to a large extent, to the emergence of income taxation as the main source of revenue for many states. When different states adopted systems of income taxation in the beginning of the 20th century, they often made competing tax claims for the same income. That was seen as a threat to national economic interests. In response, the Financial Committee of the League of Nations appointed four economists in 1921 to create a framework for how this tax base could be shared between different jurisdictions (Bruins et al. 1923). The financial committee formulated the task as a technical matter, i.e.: as something to be solved by experts, rather than as a matter of politics. However, as pointed out by Allison Christians: “Far from being a technical or scientific matter, the questions asked implicate not just economics but also politics, culture, society, institutions, diplomacy, and above all, power” (2017, 7). The appointed economists themselves admitted that the economic origin of an item of an income could not be answered scientifically (Bruins et al. 1923, 36, 38-9; Christians 2017, 7-8, 17).

The concept of sovereignty underwent a transformation with the emerging international tax order of the 20th century. According to Ramon Tomazela Santos and Sergio André Rocha, “[t]he traditional territorial confinement that until then had limited the exercise of taxing rights was replaced using connecting factors as a criterion to legitimize international taxation” (2017, 30). The right to tax was to be determined by residence (the country where the taxpayer is resident) and source (the country where the income arises). The financial committee dismissed two alternative factors: the physical location of the object to be taxed and the enforceability of rights (Christians 2017, 9).

Competing claims to tax the same income are usually settled through tax treaties. Previous research has shown that tax treaties generally favor residence taxation. For some types of income, the treaties stipulate a reduction of the tax rate of the source state and, in some cases, even grant the jurisdiction to tax solely to the residence state (Dagan 2000, 939-96). This is fine if the contracting states are on an equal level of economic development. It can then be assumed that both of the states appear as the residence state just as much as the source state in relation to each other. However, this is not the case for a treaty between a developed and a developing state since it is more common for investments to be made from the developed state to the developing state than the other way around (Dagan 2000, 982-3; Daurer 2014, 22-3). According to Tsilly Dagan, tax treaties distribute tax revenue to the residence state to a larger extent and, therefore, benefit developed states at the expense of developing states (2000, 982-3; 2017b; see also Easson 2000, 619-25; Chisik and Davies 2004, 113-39; Davies 2004, 775-802).

In addition, double taxation is often relieved through granting taxpayers a credit for foreign taxes. This method seeks to achieve capital export neutrality which means that an investor should pay the same amount of taxes regardless of whether his or her income is received from foreign or from domestic sources. This contrasts with capital import neutrality which means that an investment made by a foreign investor should not be taxed higher than an investment made by a domestic investor. It has been argued that capital export neutrality is most compatible with the goal of economic efficiency although it has also been criticized for discriminating against low-income states, particularly developing states. It has therefore been described as “fiscal imperialism” (Vogel 2002, 5).

If states are considered as sovereign equals, it is easy to assume that the outcome of tax treaty negotiations is fair. However, as explicated above, the structure of many tax treaties appears to pose a bias towards capital-exporting states. These structures are part of the OECD model tax treaty (Articles of the Model Convention with respect to Taxes on Income and Capital). Although not binding, the model treaty often forms the basis for the negotiations of tax treaties. The contracting parties will only focus on the provisions from which they want to deviate. The UN has adopted a model convention of its own that is thought to better suit the needs of

developing states, primarily through allocating more taxing rights to the source state. However, Veronika Daurer conducts a close analysis of the UN Model Convention in her thesis. To begin with, she points out that “developing states” is a very heterogeneous group. There is a significant difference between the BRICS countries and the least developed countries. According to her, there is a general tendency to focus on the BRICS countries as representatives of the developing world (2014, 2-3). The importance of this distinction is also emphasized by Mosquera Valderrama (2015, 344-66). Daurer further points out that the UN Model may favor source taxation to a greater extent than the OECD Model, although the primacy of residence taxation also prevails in the UN Model. This is the case because the UN Model builds upon the OECD model (2014, 53-104). In addition, when a treaty is negotiated between a developed and a developing country, the different negotiators will often depart from the model that best suits their respective countries. While the developing country will probably depart from the UN Model, the developed country is likely to depart from the OECD Model. This is likely to result in a treaty somewhere in-between, favoring the developing state even less than what is prescribed in the UN Model (Daurer 2014, 303).

The idea of nation states as sovereign equals is thus an inadequate legitimization of the outcome of tax treaty negotiations. According to Luís Eduardo Schoueri and Richardo André Galendi, sovereignty is certainly not the same as equality of rights. Sovereignty is merely a formal concept that should not be confused with actual independence in political, military, economic, or technological matters. The legal concept of sovereignty has nothing to do with actual equality among nations. It does not imply fairness. They also emphasize that inter-nations’ equity has never played a significant role in the international allocation of taxing rights. In order to stop the redistribution of tax revenue from poorer to richer countries, it is required to opt for the exemption method instead of the credit method or to use tax sparing clauses. However, tax sparing clauses have been discouraged by the OECD (2017, 64-66; OECD 1998). According to Schoueri and Galendi Júnior, sovereignty does not provide any state with enforceable measures to combat economic and political pressure (2017, 67).

Similarly, Yariv Brauner expresses that “the idea behind sovereignty is not to maximize the welfare of a society, but to maintain order in society

that is a precondition to any set of policies taken for the maximization of welfare or any other goal in society”. According to him, the international tax regime is rarely about ethical claims, but about dividing tax bases among nations. This division is based on negotiations and thus very much on the power that states can lord over one another (2017, 77). Brauner is however less critical of the effects of tax treaties in relation to developing countries. He argues that no one has forced any developing country to enter into a tax treaty and that developing countries have benefited from them immensely, as is proven by the enthusiasm of developing countries to conclude as many treaties as possible with developed states (2003, 259-358).

More critically, Sergio André Rocha argues that the international tax regime may be said to display “international tax imperialism” (2017, 183). To explain this concept, he begins by defining “imperialism” as the control exercised by countries that are more economically and militarily developed over less developed countries. The term refers primarily to the colonization of African as well as Asian and Latin American countries by European countries. By “international tax imperialism”, he refers to “the transformation of certain tax criteria that favor the interest of developed economies into international tax standards that become considered as basic principles of international taxation”. The attempt to export an international tax regime to developing countries can be considered a form of international tax imperialism (2017, 188). It is, however, rarely described in this way. It is more common to expound the principles of the dominating regime as “fundamental rules of international taxation” which, according to Rocha, is primarily an attempt to eliminate other possible criteria for organizing it (2014, 84-85).

According to Eric Zolt however, tax treaties are not likely to result in redistribution of tax revenue from developing to developed states. Tax treaties rather work as a way for developed states to ease the foreign tax liability of their multinational entities. Tax treaties can thus be viewed as a form of tax incentive (2018, 111-49). Some studies also indicate that developing countries that sign a larger number of tax treaties actually do receive more foreign direct investment (FDI). However, this is only the case for the group of middle- and not low-income developing countries (Neumayer 2007, 1501-19; Barthel et al. 2010, 366-377). Additionally, it's not

certain that increased FDI compensates for the losses in tax revenue, which can be quite substantial for developing countries (Jansky 2018).

The international tax order in the neoliberal era

The 1980s saw a rupture in world politics; the breakthrough of neoliberalism. This era has been characterized by globalization and economic liberalization; removal of trade barriers; and deregulations (Steger and Roy 2010). The relaxed restrictions on international flows of goods, services, workers and capital may have stimulated economic growth. However, they have also encouraged tax competition (Alepin 2018, 41-43; Houlder 2018, 77). The 1986 U.S Tax reform meant that the top marginal tax rate on income that had amounted to over 90 % during earlier decades was decreased to 28 %. Many other industrialized countries were soon to follow (Tanzi 1987, 339-55). In 28 OECD countries tax rates fell from almost 50 % to below 30 % in the timespan between 1983 and 2015 (Houlder 2018, 76).

The incentive of nation states to attract businesses and capital has not only led to falling tax rates but also to changes in the tax bases that are being used. Over time, there has been an increasing preference for taxing labor over capital and, in recent times, for VAT over income taxation. These changes have made many tax systems far less equitable (Moreno-Dodson 2018, 5; Avi-Yonah 2001, 59-66; Avi-Yonah and Xu 2016). According to Reuven S. Avi-Yonah, the international tax competition has deprived both developed and developing countries of tax revenue and forced them to rely upon taxes that are less progressive than income taxes. Thus, tax competition has made it increasingly more difficult to maintain a redistributive welfare state (2000, 1573-676).

Research indicates that international tax competition is even more harmful for developing countries than developed countries (Grubert 2000, 113-42; Houlder 2018, 77). Not only is the decline in tax rates higher in developing countries, there is also a decline in corporate tax revenue as a percentage of gross domestic product (GDP). In many developed countries, on the other hand, an increased corporate tax base seems to offset losses due to the reductions in tax rates (Keen and Simone 2004, 1317-25; Crivelli et al. 2015). Even if a particular state is able to offset losses in tax revenue through broader tax bases it's also important to regard how this is being done. It may for instance be done through increased taxation on consumption with regressive effects (Avi-Yonah 2000, 1573-676).

It is also common among developing countries to use tax incentives, i.e. reduce the taxation, to attract foreign direct investment. However, the effect of tax incentives is uncertain (Feld and Heckemeyer 2011, 233-72; Birskyte and Giriuniene 2018, 23-39). Studies tend to show that investments depend upon many other things such as political stability and market size (UN 2011; Daurer 2014, 302; IMF 2014; Siu 2018, 16; James 2014; however, see also Klemm and Van Parys 2012, 393-423). According to ActionAid, developing countries on average lost 138 bn USD per year for the period 2005-2012 due to corporate tax incentives. This is 10 bn USD higher than the total amount of aid from the OECD countries in 2013 (ActionAid 2013). Still, a common belief in developing countries is that they have no alternative. According to a report by the IMF “developing countries sometimes believe - often correctly - that an attempt to hold the line against Multinational Enterprises negotiating for “necessary” tax breaks will simply drive the investment in question into a neighboring country” (IMF 2011, 7).

In addition, tax competition has enabled multinational corporations to shift profits from high to low-tax countries and to move tax bases out of high-tax countries. It has also facilitated concealing assets and income from tax authorities (Moreno-Dodson 2018, 10). A UN report from 2015 suggests that developing countries lose 100 bn USD per year due to tax avoidance by multinational corporations (UN 2015, 200). Some countries (primarily small countries and tax havens) are gained by tax competition. This has made it difficult to reach full global support for proposals to stop it (UN 2011, 7-8; Alepin 2018, 34; Moreno-Dodson 2018, 5).

Taxation in the BEPS era

The estimated magnitude of tax avoidance and aggressive tax planning has called for a reorientation of the international tax regime. Rather than preventing double taxation, the focus is now to prevent double *non*-taxation (Siu 2018, 17; Alepin 2018, 35-36). One of the most prominent efforts to address the issue of international tax avoidance and aggressive tax planning is the Base Erosion and Profit Shifting project (the BEPS project) by the OECD. The project has resulted in 15 action plans that are currently being implemented around the world.³

³ <http://www.oecd.org/tax/beps/beps-actions/>. Retrieved 2020-05-01.

The BEPS Project is sometimes described as a turn to cooperation instead of competition (Houlder 2018, 81-83). However, it is rather a matter of *cooperative efforts inside a competitive framework*. The project may target some abusive practices, nevertheless, it does not end tax competition altogether. A distinction is made between “virtual” and “real” tax competition. Whereas the former refers to tax policies that attract profits from economic activities that are conducted elsewhere, the latter refers to tax policies that attract actual investment or economic businesses. It is the virtual tax competition that is targeted by the BEPS Project (van Apeldoorn 2018, 480-5).

A key concept in the BEPS Project is “value creation”. The ambition is that income shall be taxed where economic activities are performed and value is generated. However, it is important to note that the ambition to align taxing rights with value creation does not necessarily lead to the suggested policy proposals. “Value” can be understood in several different ways. The value of a good or a service can indeed be comprehended as the wants and needs of consumers, such as the marginal utility theory (see inter alia Stigler 1950, 307-27). However, it can also be understood as the labor that is required to produce a good or a service (Wolff 2017). Different conceptualizations of “value” can entail different principles for assigning taxing rights to states. Thus, there is no necessary answer to where value is generated and where taxation shall occur. The task of assigning value creation to geographical spaces becomes particularly difficult in a globalized world economy. As Allison Christians writes: “[A] dollar earned in the global economy is the product not of the effort of one person or group of persons - and not of one nation or of a handful of nations - but rather of the entirety of the global economic community” (2017, 11). Undoubtedly, globalization has adhered people together across nations and made them economically interconnected. Whether and to what degree the global economic bonds create global distributive duties has been discussed extensively within political philosophy and legal scholarship.⁴

⁴ Regarding political philosophy see inter alia Beitz 1979a, 405-24; Beitz 1979b; Pogge 1989; Pogge 1992, 48-75; Pogge 1994, 195-224; Cohen and Sabel 2006, 147-175; Sangiovanni 2007, 3-39. Regarding legal scholarship see inter alia Richman 1963; Musgrave and Musgrave 1972, 63-85; Musgrave 1975, 29-39; Musgrave 1991, 275-305; Benschalom 2010, 1-82; van Apeldoorn 2018, 478-99.

The efforts to combat aggressive tax planning by the OECD have been criticized by some nation states for infringing upon sovereignty. It is argued that all nation states must be free to design their tax systems in any way they please and that it may be essential for a state, particularly those that are smaller, to arrange for a tax system that attracts businesses and capital. However, while some states thus defend tax competition in the name of sovereignty, other states object to it in the name of sovereignty (Ring 2009, 574, 579-580). It is argued that, when some states have used their sovereignty to lower their taxation in pursuit of capital and businesses, they have forced other states to also do it. In this sense, tax competition has restricted the possibilities of these other states to freely choose their tax systems (Christians 2017, 5; Rocha 2017, 199; Dagan 2017a, 24). Nation states, therefore, must surrender some of their sovereignty in order to keep as much of it as possible (Dietsch 2015, chapter 4). This is sometimes referred to as “the sovereignty paradox”. According to the OECD, the supranational measures of the BEPS Project “support the effective fiscal sovereignty of countries over the design of their tax systems” (OECD 2000, 5; Christians 2009, 148).

However, the BEPS Project is not just a cooperative effort that empowers all nation states to an equal extent. As noted by Luís Eduardo Schoueri and Ricardo André Galendi Júnior, it is simply not possible to separate the debate on abusive behavior from the debate on the allocation of taxing rights (2017, 47). It is clear that several action plans within the BEPS Project specifically seek to address the concerns of high-income countries. For instance, it proposes changes to the arm’s length principle in order to shift taxation to capital exporting countries, i.e. typically to developed countries (Schoueri and Galendi Júnior 2017, 61). Another example is the effort of the BEPS Project to address the tax challenges of the digitalized economy by expanding the taxing rights of the user/market jurisdiction that protect countries with strong purchasing power (OECD 2019, 9). These suggestions are not surprising given the fact that almost all members of the OECD are high income countries.

According to Laurens van Apeldoorn, the capacity to determine the size of the government budget and the level of distribution is highly correlated with national income. Low income countries experience substantial difficulties in raising taxes. On average, low income countries have a ratio

of tax revenue to GDP of 13 %. For high income countries this ratio is 35 %. As a consequence, high income countries have an enormous number of opportunities to choose the size of their governments, while this is not the case for low income countries. By necessity, low income countries need to rely upon governments that are very small in relation to the size of their economy. They are, therefore, also hampered in pursuing redistributive programs. The BEPS Project does little to amend for this. According to van Apeldoorn, data shows that tax competition has led to a reduction of average corporate tax revenue in low income countries of 0,6 % of GDP (from 2,6% to 2% in ten years). Curbing tax competition, therefore, is not enough to bring low income countries even somewhat close to high income countries regarding the ratio of tax revenue to GDP (2018, 485-8). Based upon this, van Apeldoorn argues in favor of a global redistribution of tax revenue in-between states (2018, 491).

Accordingly, the BEPS Project has been criticized for not including the voices and needs of developing states to a sufficient degree (Mosquera Valderrama 2015, 344-66; Quiñones 2017, 165-177; Rocha 2017, 183; Ozai 2020, 53-78; Ring 2010, 649-722). Ricardo García even argues that the multilateral efforts by the OECD are actually consecrating “the traditional “status quo” anchored in the division between developed and non-developed countries” (2016, 147-192; see also Rocha 2017). The BEPS Project may be claimed to enable nation states to pursue their own interests as sovereign equals, but the project seems to enable some states more than others. To quote Minkkinens paraphrasing of George Orwell’s *Animal Farm*, it seems to be the case that “some states are more equal than others” (2009, 61). Therefore, the primary concern of the BEPS Project does not seem to be about sovereignty, but about western states losing to the liberalized economy. It is a matter of power. In the following section I will discuss how different understandings of sovereignty may hide or bring forth this power dimension.

Sovereignty and power

Tax law scholars often acknowledge the existence of unequal power relations among nation states and the growing economic power of private parties while, at the same time, maintaining that sovereignty has nothing to do with this. The argument is that sovereignty is a formal construct that does not require actual independence in political, military, economic or

technological matters (Schoueri and Galendi Júnior 2017, 64; Ring 2009, 557 footnote 3, 558-559, 582). It is indeed possible to understand sovereignty in such a way and it is not a distortion of reality to claim that most states are sovereign in this sense. However, it is not necessary to understand sovereignty like this.

Peter Dietsch has made a distinction between formal (*de jure*) sovereignty and effective (*de facto*) sovereignty. The former is the right to write and enforce law, while the latter is the ability to achieve policy goals through legislation (2011; 2109). Thus, even if a state is sovereign in a legal sense it may be constrained in its ability to effectively exercise its sovereignty. This ability is sensitive to tax policies elsewhere (Houlder 2018, 77). Studies indicate that for every 1 percentage point cut in the weighted average statutory rate, the home country decreases its statutory rates by 0,7 percentage points (Devereux et al. 2008, 1212-1213).

The first theory on tax competition was presented by Wallace Oates in 1972. According to him, tax competition produces a race to the bottom. It threatens the existence of corporate income taxation and compels nation states to rely on taxes on labor, land and consumption instead (1972; see also De Mooji 2005, 277-301). Based upon this theory, Zodrow and Mieszkowski (1986, 356-70) and Wilson (1986, 296-315) created models that demonstrated this effect of tax competition. Subsequent research generally confirm these results even when one or more of the assumptions of the models are altered, although some studies claim that tax competition may be beneficial in an efficiency perspective (Wildasin 1989, 193-212; Sinn 1990, 489-504; Wilson 1999, 269-30; Zodrow 2003, 651-71; Talpoş and Crâşneac 2010, 39-52; Birskyte and Giriuniene 2018, 23-39). From a public choice perspective, government officials often act in their own interests rather than in the interests of the public. Following this kind of reasoning, Brennan and Buchanan (1980) and Edwards and Keen (1996, 113-34) argue that tax competition serves the important function of constraining the overexpansion of local governments. This reasoning is not an objection to the claim that tax competition constrains nation states; it is an objection to the view that these effects are undesirable.

If tax competition is detrimental for a particular state and if tax competition is made possible through a deregulated and liberalized market, wouldn't it be possible for any particular state to re-regulate the market? In

order to answer this question, it is important to acknowledge that the effective sovereignty of many states has been limited by various forms of economic coercion by other states. For instance, in order to secure a loan from the IMF or the World Bank the receiving state is required to abide by structural adjustments concerning its economic policy. This instrument has pressured developing states to pursue a smaller public sector, lower taxation, privatization, limitations on labor standards, liberalization of inward FDI, and austerity (Macmillan 2018, 428-46). Material conditions leave states with practically no choice. As Ilan Benshalom has expressed it regarding the possibility of developing states to opt out of the rules set by the IMF, WTO and OECD: “In a global economy, in which peoples’ welfare has become so dependent on international trade, noncompliance with those rules becomes a remote and merely formal possibility for many sovereigns, no matter how controversial these rules may be” (2010, 41. See also Cohen and Sabel 2006, 147-175).⁵

How then could it be conceptualized what *it* is that constrains effective sovereignty? For these purposes I’m of the opinion that the concept of *economic-ideological forces* could be beneficial. The term “forces” is supposed to draw a parallel to its meaning in physics; the energy that is causing something to move. With “economic forces”, I refer to the fact that states are not just governing the market economy, but are simultaneously *governed by* the market economy. Nation states have become market actors themselves. As Tsilly Dagan expresses it: “In the international tax market, where state compete for residents, investments, and tax revenues, their sovereignty becomes fragmented” (2017a, 4; see also 2017b). According to her, international tax competition “has put states in an unfamiliar position: they no longer strictly impose compulsory tax and regulatory requirements on their subjects. Instead, the tax policymaking process has gradually transformed under competition, and states increasingly operate as recruiters of mobile investments and residents from other states, while at the same time striving to retain their own residents and investments” (2017a, 15; see also Peters 2013). A new kind of market has emerged; a

⁵ For a discussion on the relationship between global institutions and global injustice, see Pogge 2002; Pogge 2010, 417-436; Patten 2005, 19-27; Risse 2005, 349-76).

market where governments offer packages of services in return for a price: the taxes. Thus, sovereignty has been commercialized (Morgan 2017, 541).

Sovereignty to tax is not only constrained by material conditions, but also by convictions about material conditions. This is why I employ the term *economic-ideological forces*. For instance, it is not absolutely certain to what extent taxes influence the location of investments and businesses. The research cited above doesn't provide a clear answer to the relationship between tax policies and the probability of attracting foreign direct investment. Many other factors are important and it may be the case that a large portion of investments are made regardless of what the tax policy looks like. However, if the *belief* is strong enough that investments and businesses will relocate unless a favorable tax policy is enacted, it does not really matter that the investments would have been made anyway. The concept of economic-ideological forces thus encompasses material as well as ideological constraints on sovereignty to tax.

It shall be mentioned that the awareness of economic-ideological forces is unlikely to generate change at a national policy level. This is due to Institutional preconditions; rulers in democratic societies need to get elected by a delimited group of people. Consequently, rulers are incentivized to look after the interests of this particular group (or most often subgroups within this group). As Luís Eduardo Schoueri and Ricardo André Galendi Júnior stated: "States are incentivized to prioritize the interest of their citizens, instead of seeking global justice, and there are generally no deviations from this expected behavior. The centrality of the Nation State is still an undeniable fact and has led to rather skeptic statements on the impossibility of determining what would be a fair outcome under the perspective of inter-nations equity" (2017, 65; see also Christians 2017, 3). This means that research on global justice cannot just be delivering policy proposals to policymakers. Change must come from underneath, by dismantling dominant ideas, myths and discourses that justify the current state of affairs. One such idea is sovereignty to tax. If sovereignty is understood in a manner that does not encompass economic-ideological forces it does not inform us about power that is exercised through economic means. Sovereignty then becomes a tool for protecting established power relations.

Conclusions

When sovereignty is thought of in a formal sense (*de jure*) it does not take political, military or economic power into account. Understood in this way, the concept of sovereignty is not informative on the power relations that are vested in the international tax order. When analyzing the development of the international tax order from a power perspective, however, it does become clear that this order is neither neutral nor equal. The international efforts to prevent double taxation in the early 20th century manifested themselves in a policy framework that favored economically stronger states. The efforts to prevent double non-taxation in the 21st century is not a correction of these inequalities, but rather a restoration of them.

To a large degree, the ability of a state to exercise its sovereignty to tax depends upon economic conditions and beliefs about economic conditions. Sovereignty to tax is constrained by what I refer to as economic-ideological forces. I contend that sovereignty should be understood in a way that encompasses these economic-ideological forces in order to not implicitly justify established power relations.

Yariv Brauner writes that the “sovereignty harm rhetoric” has been used to reject global harmonization and to maintain an order based on an unquestioned belief in the invisible forces behind markets and their capacity to maximize the welfare pie (2017, 79-80). Through the concept of economic-ideological forces, I hope to contribute to explaining how this is being accomplished. As I would like to state it, formal sovereignty blinds us from seeing the economic-ideological forces. Consequently, biases towards high income countries in the international tax regime go unnoticed, and an unbalanced regime is implicitly justified. Maintaining sovereignty thus becomes a tool for maintaining established power relations. Critically analyzing it is important in order to notice that the international tax order is, as Allison Christians has indicated, a matter of power rather than principle (2017, 3-27).

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