

## **BEPS, tax sovereignty and global justice**

Laurens van Apeldoorn\*

*University College and the Institute of Philosophy, Leiden University, Leiden, The Netherlands*

The base erosion and profit shifting (BEPS) initiative of the Organisation for Economic Co-operation and Development (OECD) and G20 countries marks an important development in the reform of the international taxation regime. In this paper I argue that the initiative nevertheless fails to provide a coherent account of what global justice requires in the realm of fiscal policy. While the OECD's ostensible aim to increase and protect the tax sovereignty of states is commendable, there is insufficient attention for the distribution of relative tax sovereignty. I show that current global income inequality is correlated with significant inequality of tax sovereignty, that this inequality is unjust on a plausible conception of what global justice requires, and that the BEPS initiative is unlikely to meaningfully address this injustice. I close by suggesting that an internationalist conception of justice concerned with securing the tax sovereignty of independent polities may need to prescribe the creation of globally redistributive institutions.

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The base erosion and profit shifting (BEPS) initiative of the Organisation for Economic Co-operation and Development (OECD) and G20 countries marks an important development in the reform of the international taxation regime (see OECD 2013a, 2015 for overviews.). The plan, which has been adopted in the last months of 2015 and now awaits implementation, is designed to close tax avoidance loopholes in the patchwork of domestic fiscal laws and bilateral tax treaties, and to correct the corrosive impact of tax competition. Aggressive tax avoidance by wealthy individuals and multinational corporations (MNCs) facilitated by states competing for foreign direct investment (FDI) and mobile capital, the OECD warned in the 1998 report 'Harmful Tax Competition: An Emerging Global Issue' that first put the issue prominently on the political agenda, may affect states' fiscal sovereignty. It may 'erode national tax bases', 'alter the structure of taxation' and 'hamper the application of progressive tax rates and the achievement of redistributive goals' (OECD 1998, p. 14). The OECD estimates conservatively that 4–10% of global corporate income tax revenue (100–240

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\*Email: [l.c.j.van.apeldoorn@phil.leidenuniv.nl](mailto:l.c.j.van.apeldoorn@phil.leidenuniv.nl)

billion USD annually) is lost to BEPS (OECD 2015, p. 4). An important aim of the BEPS project is accordingly ‘to provide governments with more efficient tools to ensure the effectiveness of their sovereign tax policies’ (OECD 2015, p. 4, cf. OECD 2013b, p. 47) with other apparent aims being the correction of ‘distortions’ in trade and investment patterns, and securing a level playing field between MNCs and domestic companies (OECD 1998, p. 14). The proposed measures are broadly informed by the principle of economic allegiance that requires that individuals and corporations pay taxes where they conduct their economic activities (OECD 2013b, p. 8, 2015, p. 4). Actions to that effect include the harmonisation of domestic legislation to prevent so-called hybrid mismatches (asymmetries in the treatment of financial instruments that may lead to the double non-taxation), additional safeguards in tax treaties to prevent profit shifting by means of transfer mispricing (manipulating the prices in transactions between subsidiaries of a MNC), and more robust transparency requirements in the form of automatic information exchange.

The dominant ‘internationalist’ position in the philosophical literature on international taxation (perhaps surprisingly) follows the assessment of the OECD in a number of important respects (e.g. Rixen 2011, Dietsch and Rixen 2014a, 2014b, Ronzoni 2014). In *Catching Capital: The Ethics of Tax Competition* (2015), the most detailed and carefully developed version of this position, Peter Dietsch condemns the current situation as unjust because it limits states’ fiscal self-determination, that is, their effective sovereignty in fiscal affairs.<sup>1</sup> Effective (or *de facto*) sovereignty is here conceived as the ability to achieve policy goals by means of legislation and is distinguished from formal (or *de jure*) sovereignty consisting in the *right* to write and enforce law (Dietsch 2011b, p. 2109). Dietsch outlines how global justice can be thought to require that the international taxation regime is reformed to improve and protect the effective fiscal sovereignty of states. He terms this a requirement of ‘international background justice’, building on an internationalist conception of justice that demands that states are provided the capacity to effectively ensure domestic distributive justice. (Rawls 1999, Ronzoni 2009) Although, as will become clear below, Dietsch is critical of various aspects of the BEPS project, he agrees with the OECD that the primary goal of institutional reform should be the protection of fiscal self-determination. He also agrees with the OECD that this aim may be secured in part by means of the implementation of the principle of economic allegiance (which he terms the ‘membership principle’): we can restore fiscal self-determination by (among other things) ensuring that individuals and corporations pay taxes there where they employ economic activities (Dietsch 2015, pp. 82, 83).

In this paper I take Dietsch’s analysis as my point of departure in order to highlight a fundamental tension in the OECD’s BEPS initiative. I argue that the principle of economic allegiance is not, as the OECD has it, a reliable means to protecting effective fiscal sovereignty, at least insofar as this can be reasonably understood to be a requirement of justice (that demands *equal* fiscal

self-determination or the universal satisfaction of a *baseline* of sufficient fiscal self-determination). The distribution of fiscal self-determination between states is an important facet of international background justice, but the principle of economic allegiance is insensitive to the distribution of fiscal self-determination (Section 5). This means that implementing the principle of economic allegiance does not reliably increase, let alone guarantee, a just distribution of fiscal self-determination. This is especially worrying given current global income inequality, which is correlated with significant inequality in fiscal self-determination (Section 4).

This observation leads me to a second broader point about the nascent literature on global tax justice (Section 6). I argue that the dominant internationalist position, that demands targeted regulation of the actions of states but generally stops short of proposing explicitly redistributive institutions at an international level, must take the possible need for continuous international redistribution more seriously. This suggests that there is room for fostering a greater consensus between internationalists and cosmopolitans, traditionally more committed to international redistribution, on appropriate institutional reform in this area.

Before I outline these arguments in greater detail, I start by explaining the overlap (Sections 1 and 2) and differences (Section 3) between the OECD's BEPS initiative and Dietsch's alternative proposal to curb tax competition and to catch mobile capital in the net of domestic tax authorities.

## **1. Tax sovereignty and global justice**

According to the OECD one important reason to worry about tax competition is that it 'poses a threat in terms of tax sovereignty and of tax revenue' (OECD 2013b, p. 47). More specifically, it may hamper the ability to raise sufficient revenue and secure the redistributive goals desired by the countries' population (OECD 1998, p. 14). This is in large part attributable to aggressive tax planning by MNCs facilitated by states attempting to increase their taxable base by attracting the accounting profits of MNCs and FDI (OECD 2015, p. 4, cf. Dietsch 2015, pp. 46–54 for an overview). States engage in the former kind of tax competition (sometimes called 'virtual' tax competition) when they use fiscal policies to attract the profits from economic activities that MNCs have generated elsewhere, whereas they engage in the latter ('real' tax competition) when they use fiscal policies to attract actual investment for production or other economic activities (Dietsch 2015, pp. 87, 88, 2016, pp. 232–236). In the face of such competition, which has become endemic with the liberalisation of trade and abolition of capital controls in the last decades of the previous century, states have where possible tended to reduce corporation and capital gains taxes. While high-income states have by and large been able to protect their revenue flows by shifting the tax burden to relatively immobile economic factors such as labour, income and consumption (with predominantly regressive effects), low-income states have, for reasons that will be elaborated on below,

generally been unable to offset the decrease in corporate income tax revenue (Avi-Yonah 2000, Dietsch 2011a). This revenue loss is estimated by some to be greater than the combined foreign aid budgets of high-income states (Christian Aid 2008).

Accordingly, one important aim of the BEPS project is to support ‘the effective fiscal sovereignty of countries over the design of their tax systems’ (OECD 2014, p. 14). This aim is shared by the dominant approach in the philosophical literature on justice in the realm of international taxation. Peter Dietsch shows that the importance of protecting fiscal self-determination can be understood as a requirement of international background justice, an internationalist account of global justice first proposed by Ronzoni (2009). Problems of background justice may arise in contexts where engaging in a practice has a tendency to undermine that practice if it remains unregulated by appropriate background institutions (Ronzoni 2009, p. 251). For instance, initially voluntary exchanges between individuals may give rise to distributions that severely restrict the range of options available to some of the individuals, thus rendering their subsequent exchanges involuntary. In the international context background justice can be thought to require background institutions that ensure that states are and remain substantively or ‘effectively’ sovereign. On this account, we are, in the words of Ronzoni, ‘not interested in *outcomes*; we do not require states to be equally affluent ... We are instead interested in effective sovereignty as a set of conditions under which independent sovereign states can interact justly’ (Ronzoni 2009, p. 248, cf. Ronzoni 2012, p. 585). Global justice, then, does not require the global distribution of individual advantages to conform to some principle of distributive justice, but rather that all states have the capacity to secure a just distribution of advantages between their citizens. States must, therefore, have the capacity to design their legal and economic institutions in such a way that they reflect the conception of domestic distributive justice of their citizens. In the realm of fiscal policy Dietsch takes this to require the ability to determine the size of the government budget and the level of redistribution (Dietsch 2015, p. 35).<sup>2</sup>

Dietsch says little about how we should operationalise these aspects of fiscal self-determination and I therefore suggest to further specify the concept as follows. Since both these abilities plausibly come in degrees it is useful to conceive this capacity in terms of opportunity sets: the amount of fiscal self-determination a state possesses is dependent on the cardinality of the set of effectively available options with regard to the size of the budget and the extent of redistribution: the greater the set, the greater a states’ fiscal self-determination.<sup>3</sup> This allows for a further specification of the two components of fiscal self-determination.

First, since the ‘size of the budget’ is a function of the fiscal institutions of a state one may operationalise it in terms of the tax revenue or ‘tax take’<sup>4</sup> as share of the total economy (GDP). This means that the first component of fiscal self-determination is expressed in terms of the opportunity set of levels of

tax revenue as percentage of GDP. States have greater fiscal self-determination if they have a larger range of tax-revenue-to-GDP ratios to select from. Secondly, the 'extent of redistribution' may be operationalised in terms of the extent of the difference between wealth inequality before and after taxation and spending (where inequality is measured in terms of the Gini coefficient). This is admittedly only a rough approximation of what matters in redistributive policies, since inequality as such masks potentially relevant differences between individuals that may or may not be the appropriate object of redistributive measures. It is, however, difficult to provide a more precise operationalisation that allows for international comparisons. On this account the second component of fiscal self-determination is expressed in the opportunity set of percentage points of decrease (and, theoretically, increase) in Gini coefficient before and after taxation and government spending.

Fiscal self-determination, so understood, is necessary for a state to be able to be responsive to the beliefs of its citizens about what justice requires. Since tax competition erodes fiscal self-determination and thereby the state's capacity to shape its institutions in accordance with the conception of justice preferred by its citizens, it forms a case of international background injustice.

## **2. The principle of economic allegiance**

How do we secure fiscal self-determination? The OECD suggests by means of the implementation of the principle of economic allegiance. First proposed in 1923 in a report on the then emerging problem of double taxation submitted to the Financial Committee of the League of Nations, the principle prescribes that the jurisdiction to tax should be distributed in accordance with where 'the true economic interests of the individual are found' (League of Nations 1923, p. 20). Individuals have economic interests where they acquire, locate, or consume wealth, or in short, where they conduct economic activities. The principle is reflected in the BEPS project, which aims to 'better align rights to tax with economic activity' (OECD 2013b, p. 11, cf. OECD 2013a, p. 18) by ensuring that corporations do not shift accounting profits to low tax jurisdictions and so artificially separate the profit from the economic activities that generated it.

In the literature there is broad agreement that the normative justification underlying the principle of economic allegiance is that persons having economic interests in a country are rightfully liable to taxation because of the benefits they derive from the state's provision of public goods and services. As one commentator puts it succinctly, '[t]he principle of economic allegiance requires anyone that obtains significant benefits from an economic community to pay tax to that community'. (Pinto 2003, p. 196). In the public finance literature an appeal to the benefit of taxpayers is typical in a domestic context in order to quantify their tax liability, the argument being that taxes should be proportionate to the benefit individuals receive from government spending.<sup>5</sup> In the present context the benefit principle is rather used to justify and allocate

tax jurisdiction in the first place (something that can be taken for granted in the domestic context) (Hinneken 1998, p. 196, Kaufman 1998, p. 198). How the state, given its jurisdictional authority, subsequently quantifies the appropriate size of the tax is a separate and further question.<sup>6</sup>

Dietsch also embraces the principle of economic allegiance, although he terms it the ‘membership principle’ (because it determines in which country or countries an individual or corporation is liable to taxation and thus a ‘member’). The membership principle states that ‘individuals and companies should be viewed as members [and pay tax] in those countries where they benefit from the public services and infrastructure’ (Dietsch 2015, pp. 82, 83). Since corporations benefit from public goods and services where they conduct economic activity, he equally reaches the conclusion that tax jurisdiction should depend on the location of economic activity.<sup>7</sup> Dietsch thus agrees with the OECD both that institutional reform should be aimed at the protection of fiscal self-determination and that the principle of economic allegiance is a useful means to that end. The question is whether this is true.

### 3. Tax competition for FDI and the fiscal policy restraint

The principle of economic allegiance rules out *virtual* tax competition, the competition for accounting profits that may lead to profit shifting. When effectively implemented, MNCs are prevented from conducting economic activities, such as production or research and development, in a high tax country while shifting the profits to low or zero-tax jurisdictions or ‘tax havens’. The principle of economic allegiance proscribes such behaviour. In accordance with the principle, the tax base (say, corporate profits) must be allocated to the countries where the economic activities generating the profits take place. This should make it possible for states, in principle, to tax the corporate profits that were previously relocated abroad.

It does, however, not prevent *real* tax competition in order to attract FDI. Recall that the principle of economic allegiance only allocates the tax base, and leaves the appropriate level of tax rates up to the determination of sovereign legislatures. The tax burden is one of many factors that determine the attractiveness of the investment climate and this competition could for this reason be thought to be less severe than that for accounting profits (Rixen 2011, p. 460). However, insofar as states want to attract FDI, for instance in order to increase the taxable base, promote economic growth, or attract the technical know-how that often accompanies investments by MNCs, they continue to have an interest in reducing tax rates on the mobile tax base that is allocated to them by the principle of economic allegiance, and to shift the tax burden to immobile economic factors such as labour and consumption (Keen and Marchand, 1997, Oats 1999, pp. 1125, 1126). Indeed, the OECD suggests that this kind of competition should not be considered harmful, noting that ‘no or low taxation is not per se a cause of concern, but it becomes so when it is

associated with practices that artificially segregate taxable income from the activities that generate it' (OECD 2013a, p. 10). In other words, the BEPS initiative is not designed to protect states from the threat to fiscal self-determination that may result from tax competition for FDI. (Devereux and Vella 2014, p. 469 note this as a structural weakness of the OECD's BEPS initiative.) Real tax competition can accordingly be expected to continue to limit states' ability to determine the size of the budget and to engage in redistribution, and we must conclude that the BEPS initiative inadequately protects the fiscal self-determination of states that is ostensibly one of its chief aims. That aim requires also at least the regulation of the tax rates that states set for the tax base allocated to them by the principle of economic allegiance.

Dietsch's introduction of a second principle – the *fiscal policy constraint* – may be understood as an attempt to address this problem, though Dietsch fails to call attention to this. His explicit objections to the OECD's BEPS initiative are limited to two practical concerns. First, the BEPS measures are primarily intended to correct loopholes in the current system of separate accounting in which the subsidiaries of MNCs are treated as separate companies, and companies belonging to the same unit must trade with one another as if they were unrelated parties (the 'arm's length principle'). However, since for many such transfers no comparable market transactions exist that would allow for an accurate price determination, MNCs will likely continue to be able to manipulate the system for tax purposes (Avi-Yonah 1995). Moreover, many profit shifting strategies are possible because of the complexity and artificial character of separate entity accounting. This suggests in the 'cat-and-mouse game' between government regulators and the tax advisors of MNCs, in which the former try to close the loopholes that the latter exploit, the former will ultimately lose (Dietsch 2015, p. 115). Dietsch therefore joins a number of commentators in calling to replace separate accounting with a system based on unitary taxation with formula apportionment (UT + FA) (Dietsch 2015, pp. 114, 115).<sup>8</sup> MNCs and their subsidiaries are then treated as a single entity, the total worldwide profit of which is apportioned as tax base to the countries in which the MNCs operate in accordance with a formula that reflects the economic activity of each country where the entity is active (such as property, sales or payroll) (Dietsch 2015, p. 107). Second, since the implementation by states of the OECD's recommendations is ultimately voluntary, Dietsch worries that the BEPS initiative will do little to resolve the competitive dynamic of the current system, which may reveal itself in the form of lax implementation and 'mock compliance' (Dietsch 2015, p. 115). He therefore suggests that in order to ensure that no countries will defect from such mutually beneficial cooperation more robust monitoring, dispute settlement and enforcement mechanisms are necessary, for instance in the form of an International Tax Organisation, modelled on the World Trade Organisation (WTO) that has similar functions in the domain of international trade (Dietsch 2015, p. 104, cf. Rixen 2016).

It may then be worth emphasising that Dietsch's introduction of the fiscal policy constraint indicates a significant normative departure from the approach taken by the OECD. The fiscal policy constraint proscribes a tax policy if it produces a collectively suboptimal outcome in the sense that 'it is *both* strategically motivated *and* has a negative impact on the aggregate fiscal self-determination of other states' (Dietsch 2015, p. 80). When followed this principle rules out that countries lower their corporate income tax rate in order to attract FDI from abroad (unless it does not reduce the aggregate fiscal self-determination, for instance because the resulting factor movements disproportionately increase the fiscal self-determination of the receiving countries).<sup>9</sup> In other words, the principle does not rule out fiscal policies that lead to economic factor movements, and resultant tax competition that may reduce aggregate fiscal self-determination, as long as they are pursued for non-strategic reasons. Dietsch proposes to test this by considering the following counterfactual: Would the fiscal policy under consideration still be pursued if the benefits of attracting capital from abroad did not exist? In this way he aims to strike a balance between on the one hand protecting self-determination in a context where any differences in public expenditure will likely lead to competition, and on the other hand allowing countries tax policy discretion in order to implement their preferred conception of justice, the aim for which fiscal self-determination is protected in the first place. The fiscal policy constraint then removes some of the pressure of *real* tax competition: it complements the principle of economic allegiance to ensure that countries not only are allocated the tax base (by the principle of economic allegiance) but also have the opportunity to tax it.

While this amendment to the normative structure of the BEPS initiative is a welcome one, in what follows I will argue that it does not go far enough. Even when complemented with the fiscal policy constraint, the principle of economic allegiance does not secure fiscal self-determination in a way that can be considered just according to two plausible interpretations of what international background justice requires. The problem is that both principles are insensitive to the distribution of fiscal self-determination between states and, therefore do not reliably increase the fiscal self-determination of the states that most need it. Let me first illustrate the significance of the distribution of fiscal self-determination by showing that fiscal self-determination and national income (GDP) are strongly correlated.

#### **4. Fiscal self-determination and inequality**

Recall that fiscal self-determination consists in the ability to determine the size of the government budget and the extent of fiscal redistribution within a state. In this section I show that both aspects of fiscal self-determination are highly correlated with national income, starting with the former. Low-income countries have great difficulties raising taxes due to obstacles that are widespread



and well documented (Bird and Zolt 2005, Moore 2013). They usually have largely non-urbanised, agricultural economies and extensive informal sectors, including labour markets, that are impossible to tax, or for which tax collection costs are high (Schneider and Enste 2000). Further, their ability to raise taxes is hampered by social and political factors, such as weak political institutions, lack of transparency, and poor tax morale and consequent norm compliance (Besley and Person 2014). This is reflected in their tax take as a percentage of GDP. For low-income countries this is currently on average 13% of GDP, whereas in high-income OECD countries the tax take is on average 35% of GDP (Moore, 2013, p. 7, Besley and Person 2014, p. 102 show a correlation between GDP per capita and share of taxes to GDP). This suggests a strong positive correlation between national income and the ability to determine the size of the government budget, the first component of fiscal self-determination. From the opportunity set of low-income countries are excluded the higher tax-revenue-to-GDP ratios that are available to high-income countries. Thus, whereas rich countries are able to choose within broad limits the size of their government, poor countries have no choice but to rely on a small government, relative to the size of their economy, that can offer only a limited set of services.<sup>10</sup>

It is unsurprising then that the difficulties facing low-income countries in raising revenue also affect their ability to pursue redistributive programmes, the second component of fiscal self-determination. Governments can redistribute either through the allocation of the tax burden or the allocation of government spending. Take the former first. The same kind of reasons that hamper the ability of low-income countries to tax effectively, prevent them from progressively allocating the tax burden. Progressive property and other wealth taxes are difficult to implement for political reasons (Ahmad and Stern 1989, p. 1017, Moore 2013, p. 30); whereas progressive income and capital gains taxes are relatively easy to avoid or evade (Bird and Zolt 2005, p. 933). Instead, low-income countries must predominantly rely on indirect taxes such as value-added or sales taxes, which generally have a regressive effect on income equality (Ahmad and Stern 1989, p. 1021). In general, the literature suggests that redistribution of income through progressively allocating the tax burden in low-income countries has been mostly ineffective (see for a literature review Chu *et al.* 2000, pp. 31, 34–38). For this reason commentators advise that low-income countries turn to the spending side of the government budget in order to achieve the desired redistribution (Tanzi 1998, p. 15, Bird and Zolt 2005, pp. 941–943).

Government spending may have distributional effects because it can provide direct or indirect benefits that accrue disproportionately to the poor. Unfortunately, low-income countries also have a poor track record effectively targeting poverty and inequality through expenditure programmes. This is in part due to corruption and ‘clientistic’ political institutions (Bird and Zolt 2005, p. 932) but more importantly because of the limited size of their tax

base. Since low-income countries have, as noted, tax-revenue-per-GDP ratios that are on average about one-third of that of high-income OECD countries, it follows that they can engage in much less robust redistributive spending. Accordingly, a positive correlation can be established between tax-revenue-per-GDP and the decrease in inequality after direct taxes and transfers (Kohler 2015, p. 8). For instance, whereas countries in Western Africa in 2006 achieved on average a decrease in Gini coefficient of about 2 points given a tax-revenue-per-GDP of about 23%, countries in Western Europe achieved a decrease in Gini coefficient of about 14 points with a tax-revenue-per-GDP of about 45% (Kohler 2015, p. 8). This, in turn, suggests a positive correlation between national income and the ability to determine the extent of redistribution, the second component of fiscal self-determination: the higher decreases in Gini coefficient achievable by high-income countries by means of taxation and government spending are unavailable in the opportunity set of low-income countries. Since low-income countries have difficulties implementing progressive tax systems and raising sufficient tax revenue they are unable (even if willing) to affect distributional inequality to the same degree as high-income countries.

Both components of fiscal self-determination, then, are significantly correlated with national income. Given the current inequality of national income we live in a world where fiscal self-determination, too, is unequally distributed among states.<sup>11</sup>

## 5. Fiscal self-determination and background justice

Dietsch maintains that implementing the two principles would restore fiscal self-determination: it ‘guarantees international background justice in one important way: national polities would regain the capacity to make collective fiscal choices about the size of the budget and the level of *domestic* redistribution’ (Dietsch and Rixen 2014b, p. 177, cf. Dietsch 2015, p. 122). While there may be other unjust constraints on the effective sovereignty of some states (e.g. in the realm of trade or environmental policy) the implementation of the two principles removes the harmful effects of tax competition and so guarantees effective sovereignty in the design of fiscal policies. I argue in this section that Dietsch is not entitled to draw this conclusion because he ignores the inequality of fiscal self-determination that exists between high and low-income countries.

Since fiscal self-determination plausibly comes in degrees, it is necessary first to clarify the nature of international background justice by specifying *how much* fiscal self-determination is sufficient for the international order to be (in this respect) just. Dietsch remains silent on this issue. I see two reasonable interpretations of his position. First, Dietsch could specify that international background justice requires *equal* fiscal self-determination, for instance the greatest amount of fiscal self-determination consistent with equal fiscal

self-determination for others. Call this the *equality* interpretation. On this interpretation international background justice requires that the world consists of independent states, not all equally affluent, but recognised as equal members of a society of states, and therefore with the right to equal fiscal self-determination to shape their institutions in accordance with the conception of justice of their citizens. Secondly, Dietsch could allow for inequality but maintain that international background justice requires a baseline of minimally effective fiscal self-determination. Call this the *baseline* interpretation. On this interpretation it is necessary to establish a baseline and maintain that sufficient fiscal self-determination requires satisfying the baseline. This probably most closely fits Ronzoni's account of background justice on which Dietsch relies.<sup>12</sup>

I argue that on both these interpretations the argument is invalid, since on both interpretations it fails to show that the two principles, if implemented, guarantee international background justice. To be sure, reversing the corrosive effects of tax competition by means of the implementation of the two principles would allow countries to increase corporate income taxes and taxes on capital, which could reverse some of the regressive effects of decades of tax competition. Further, if the implementation includes country-by-country reporting, automatic information exchange and a ban on bank secrecy rules (as Dietsch proposes) it is likely that (illegal) capital flight from low-income countries would be significantly curtailed. This would lead to a large increase in absolute tax revenue for low-income countries (since their tax take is a relatively small percentage of GDP to begin with). However, these effects would be insufficient to guarantee international background justice on either of the two interpretations. The data on which Dietsch relies to claim that tax competition has affected the tax revenue of low-income countries shows a reduction of average corporate tax revenues of low-income countries of 0.6% of GDP, from 2.6% of GDP in the early 1990s to 2.0% of GDP in the early 2000s (Keen and Simone 2004; for a less pessimistic assessment see Keen and Mansour 2009). This effect is very modest compared to the aforementioned difference between the total tax take of high-income OECD countries and low-income countries (on average 35% of GDP vs. 13% of GDP). It can therefore not be expected that curbing tax competition will bring the fiscal self-determination of low-income countries even close to that of high-income countries. On the *equality* interpretation, these inequalities in relative fiscal self-determination are straightforwardly unjust. On the *baseline* interpretation these inequalities are just only if all countries are above the baseline. A potential weakness of such an account of background justice is that it may be impossible to establish a non-arbitrary baseline,<sup>13</sup> and I will for that reason not venture to construct one.<sup>14</sup> But I submit that on any plausible account of such a baseline many of the poorest countries would still be left with too little fiscal self-determination to meet the baseline when the pressures of tax competition have been removed.<sup>15</sup>

This leads me to a second, more fundamental objection. Not only will the implementation of the two principles fail to *secure* international background justice, it will fail to even *improve* on it in a reliable way. On the *equality* interpretation, increasing international background justice requires increasing the equality of fiscal self-determination. This means giving priority to increasing the fiscal self-determination of low-income countries in order to bring them to the level of high-income countries (possibly even at the expense of lowering the fiscal self-determination of high-income countries).<sup>16</sup> On the *baseline* interpretation, increasing international background justice requires increasing the number of countries that satisfy the baseline. Again this means giving priority to increasing the fiscal self-determination of low-income countries, which on any plausible account of such a baseline, fall below it.<sup>17</sup>

Neither of the two principles is appropriately sensitive to the distribution of fiscal self-determination. The *fiscal policy constraint* limits the decisions of states in designing their fiscal systems only to the extent that the aggregate fiscal self-determination is protected. It does not protect, let alone increase, the fiscal self-determination of low-income countries. To see this, take the following example: A is a high-income country, with high fiscal self-determination (a high tax-take-to-GDP ratio and high level of redistribution), in accordance with the fiscal policy constraint A decides to significantly lower its corporate income tax rate without the intention to attract investment from abroad (e.g. country A wishes to stimulate internal capital investment and research). This induces a large MNC to relocate its economic activities to country A away from low-income country B, which already has relatively low fiscal self-determination and is highly dependent on corporate income tax revenue. The consequent loss in revenue further reduces country B's fiscal self-determination. In this example, the fiscal policy constraint thus protects the fiscal self-determination of a high-income country at the expense of the fiscal self-determination of a low-income country, contrary to what international background justice requires on either of the two suggested interpretations (assuming that country B is below the baseline).

The *principle of economic allegiance* is vulnerable to a similar charge. It allocates the tax liability of individuals and companies in accordance with where they conduct economic activities and benefit from public services and infrastructure. This ensures, as shown above, that tax competition for accounting profits is impossible (and when implemented together with the fiscal policy constraint, that any loss of fiscal self-determination is not due to other countries strategically attracting FDI). However, in the face of the abovementioned inequality of fiscal self-determination this allocation of tax rights is indefensible. Studies show that while FDI in low-income countries has steadily increased over the last decade, many low-income countries still struggle to attract FDI.<sup>18</sup> This means that there cannot be a meaningful correlation between providing access to public services and infrastructure to MNCs and low fiscal self-determination. Assuming that being allocated a greater share of

the tax base increases one's fiscal self-determination, the principle of economic allegiance does not reliably give priority to increasing the fiscal self-determination of low-income countries.<sup>19</sup> For example, a MNC conducts 80% of its economic activities in high-income country A and 20% of its activities in low-income country B. The principle of economic allegiance then allocates the taxable base (say, corporate income) in the same 80/20 ratio to countries A and B, respectively. This allocation is likely to increase the inequality of fiscal self-determination of the two countries, contrary to what international background justice requires on either of the two suggested interpretations (assuming that country B remains below the baseline).

To this line of reasoning Dietsch could respond that the objective of reform of the international taxation regime should not be to secure international background justice *tout court*. Rather it should be aimed at removing the corrosive impact of tax competition on fiscal self-determination alone, and so remove one of the many causes of international background injustice. Indeed, Dietsch suggests that the two principles are justifiable only 'provided just background global governance institutions' (Dietsch 2015, p. 80). He has in mind institutions relating to such diverse issues as 'trade agreements on intellectual property, the decision procedures in many international organisations, or the negative effects of volatile capital flows in response to monetary policies in the United States and Europe' (Dietsch 2015, pp. 204, 205). These other institutions may also have a negative impact on the opportunity set of fiscal policies available to a state. This means that curbing tax competition by means of the implementation of the two principles at most removes one of the many potential obstacles to fiscal self-determination. However, the proposed reforms would at least eliminate the reduction of fiscal self-determination *due to tax competition*.

This response is not open to Dietsch. The point of the preceding argument is not just that other factors besides tax competition lead to decreased fiscal self-determination and we must therefore also correct those further causes of international background injustice. Rather, the point is that given the conception of justice that requires either equality or the satisfaction of a baseline of fiscal self-determination, the two principles do not form a reliable means to securing justice.<sup>20</sup> The same argument applies to the BEPS initiative. The OECD's aim of securing tax sovereignty – if developed into a plausible conception of global justice that requires equality of tax sovereignty or the universal satisfaction of a baseline of sufficient tax sovereignty – conflicts with the principle of economic allegiance. The allocation of fiscal jurisdiction should be sensitive to national income in a way that the principle of economic allegiance is not. This significantly diminishes the defensibility of the OECD's BEPS initiative, as well as Dietsch more developed and refined presentation of the same approach.

## 6. Regulation and redistribution

With Ronzoni, Dietsch seems to have supposed that international background justice is an account of pure procedural justice that, unlike its domestic counter-part, does not require redistributive institutions. Ronzoni, who first suggested that tax competition might be a form of international background injustice, writes that:

[p]lausibly ... the supranational institutions that are needed to tackle tax competition will need to engage in *regulatory*, rather than *distributive*, tasks, such as penalizing dramatic forms of tax cuts that are blatantly aimed at stealing capital and skilled labor, or protecting weaker states from harmful tax competition through both financial aid and capacity-building. (Ronzoni 2009, p. 251, cf. Ronzoni 2012, p. 585)

Dietsch echoes this when he asserts that what is needed in the face of tax competition is not redistribution but ‘fair rules of the game’ (Dietsch 2015, p. 103). He argues that if low-income countries are unable to guarantee domestic distributive justice, for instance by building enough hospitals then (individuals in) rich countries may have a duty of assistance towards (the individuals in) those low-income countries. However, as he puts it, such obligations ‘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 via explicit redistribution’ (Dietsch 2015, p. 102). Analogously, he might conclude that my focus on the distribution of tax jurisdiction and concomitant tax revenue also risks introducing an institutional bias.

I respond that Dietsch may need to take the analogy between domestic and international background justice even more seriously.<sup>21</sup> In the domestic context, as Ronzoni points out, background justice requires that individuals can interact as free and equal, which is guaranteed among other things by redistributive institutions that ensure that market interactions do not give rise to excessive inequalities of advantages (Rawls 2001, p. 56). My argument shows that it is plausible that background justice in the international context, too, requires the creation of redistributive institutions. The reason is that fiscal self-determination, on the interpretation here developed, in part *consists in* having access to sufficient tax revenue (as percentage of GDP). Since it matters, for international background justice, what is the distribution of fiscal self-determination, it consequently also matters how any (potential) tax revenue is distributed. The principle of economic allegiance distributes it in accordance with where MNCs decide to locate their economic activities but this distribution is, as noted above, not meaningfully related to the distribution of fiscal self-determination. The principle of economic allegiance and the aim of securing effective tax sovereignty conflict, certainly in contexts where the capacity of states to shape their fiscal affairs is very unequal. The point in this case is not that low-income countries are sometimes unable to build

sufficient hospitals because they are poor, but that they are sometimes unable to do so because they lack sufficient fiscal self-determination. That is why designing principles of tax justice favouring the worst-off countries does not introduce an unjust bias (on Dietsch's understanding of that term). On the contrary, it would give priority to increasing the fiscal self-determination of low-income countries as required by both the *equality* and the *baseline* interpretation of international background justice.

Without attempting to develop a full-fledged alternative to the principle of economic allegiance, let me only suggest that given the aim of international background justice, tax revenue gains that arise from curbing tax competition should predominantly accrue to low-income countries (since, as established above, GDP is correlated with fiscal self-determination). For instance, one could propose a global tax authority that taxes mobile economic factors, such as MNCs, and distributes the revenues among states in proportion to their GDP or per capita income. The redistributive effect of such an institution would be intended to increase the fiscal self-determination of the poorest countries and so increase international background justice. This would mean that states must relinquish formal sovereignty in one domain of fiscal policy, which may, or may not be compensated by increased effective sovereignty in the form of an increased ability to determine the size of the budget and extent of redistribution. Given that states traditionally view their fiscal prerogative as a core aspect of their sovereignty, they will no doubt be very reluctant to do so (Ring 2008, Rixen 2011, p. 457). Nevertheless, if global justice requires equal or sufficient fiscal self-determination, then states may have an obligation to establish such a supranational authority whether they like it or not.

Where does this leave us? The implications of the current dynamics of the international taxation regime may be even more far-reaching than internationalists like Dietsch and Ronzoni have thought. Ronzoni suggests that harmful tax competition shows the need to move beyond minimalist internationalist accounts of global justice. Such minimalist accounts are interactional, in the sense that they impose obligations on the actions of states such as the obligation of non-interference and a duty of assistance to burdened societies that lack the 'essentials of political autonomy' (Ronzoni 2014, p. 46, referring to Rawls 1999, p. 106). The seriousness of the threat of effective sovereignty presented by harmful tax competition, Ronzoni convincingly argues, shows that the obligations of states are more substantive and may better be thought of as institutional: states have obligations to establish ongoing supranational institutional schemes constraining and regulating the actions of states (and other relevant actors such as MNCs) so as to guarantee the effective sovereignty of states. Ronzoni's most developed proposal in this respect goes significantly beyond that of Dietsch since she recommends the establishment of a 'global fiscal authority' that, among other things, 'could tax those kinds of economic transactions that occur transnationally, and for which identifying a territorial jurisdiction might prove impossible' (Ronzoni 2014, p. 52). The purpose of such

institutional arrangements, however, is not to redistribute resources but to regulate the behaviour of states. As Ronzoni puts it, the aim is one of ‘incentivising or disincentivising certain kinds of behaviour, rather than to collect revenues in order to redistributive wealth or provide services globally’ (Ronzoni 2014, p. 52).

The argument in this paper shows that this response may still not be sufficiently robust. Not only may internationalists, concerned with securing the effective sovereignty of independent polities, be committed to the establishment of supranational institutions, they may also be committed to giving these institutions an explicitly redistributive function.<sup>22</sup> This risks blurring the distinction between internationalist and cosmopolitan conceptions of global justice. Cosmopolitan conceptions generally advocate targeting global inter-individual inequalities directly (e.g. Brock 2008). Since, as noted, global income inequality and fiscal self-determination are significantly correlated, an internationalist too has reason to be attentive to global income inequality when proposing institutional reforms in the realm of international taxation. While defenders of internationalist conceptions of justice would still disagree with cosmopolitans about the grounds for such redistribution – the former identifying the unjust distribution of states’ fiscal self-determination and the latter the unjust distribution of individual advantages – they could nevertheless agree about the need to create institutions to facilitate it. Accordingly, it may be possible to establish greater consensus among political philosophers of various stripes about the character of the reforms of the international taxation regime needed to tackle injustices in this realm. Since theoretical consensus galvanises political action, future work in this important and urgent debate could explicitly aim at fostering such agreement.<sup>23</sup>

## 7. Conclusion

The OECD’s base erosion and profit shifting initiative is an important step in furthering the cooperation between states to tackle the harms of tax competition and the aggressive tax planning of MNCs it facilitates. But while the OECD’s ostensible concern with effective tax sovereignty is laudable, I have shown in this paper that the structure of proposals insufficiently addresses the injustice of current inequality in effective tax sovereignty. First, I have pointed out that, practical concerns aside, the principle of economic allegiance on its own does not protect states in their quest for FDI from tax competition (‘real’ tax competition) that may undermine their capacity to engage in redistributive programmes. In his recent book, Peter Dietsch can be thought to address this concern by introducing a second principle, the fiscal policy constraint, that limits the freedom of states to compete by lowering tax rates on the tax base that is allocated to them by the principle of economic allegiance. Secondly, I have shown that Dietsch’s revised proposal remains vulnerable to the charge that its implementation would fail to reliably guarantee or even increase justice in the



realm of fiscal policy. If, as Dietsch maintains, justice requires that all states have equal or sufficient fiscal self-determination then the international taxation regime should be designed to promote this aim, but the principle of economic allegiance does not reliably do so. The principle of economic allegiance (which allocates tax jurisdiction in accordance with the economic activity of MNCs) is non-responsive to the distribution of fiscal self-determination between countries. The countries where MNCs conduct economic activities are not necessarily the countries that have low fiscal self-determination. Accordingly the OECD's dependence on the principle of economic allegiance is misguided. Finally, I have shown that revised principles of tax justice, based on an internationalist conception of justice that is concerned with securing the effective sovereignty of independent polities, may need to prescribe the creation of globally redistributive institutions. The paper accordingly suggests that it is possible to establish a greater consensus among internationalists and cosmopolitans about the necessary reforms of the international taxation regime.

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### **Notes**

1. Following this literature, I use the terms 'effective sovereignty' (in the realm of fiscal policy) and 'fiscal self-determination' interchangeably. See e.g. Dietsch (2015, p. 170).
2. See also Dietsch and Rixen (2014b, p. 155), Ronzoni (2014, p. 43), suggests that we may need to include a third aspect, 'flexibility – understood as the capacity to react to new challenges or circumstances with sufficient pace and discretionality', in order to ensure that states have the capacity to effectively respond to changes in their economy. I take the argument in this paper to be equally applicable to that more robust conception of fiscal self-determination.
3. Since, on the internationalist conception of global justice states ought to be able to implement the conception of justice preferred by their citizens, one may object that what matters is not so much the cardinality of the option set but rather that the option set includes the actually preferred option. A state could have a large number of options while none of them allow the creation of just institutions, in which case one could deny that this state has fiscal self-determination. I develop the cardinality interpretation because it is easier to operationalise and facilitates making comparisons between states.
4. The tax take consists of government revenue minus non-tax revenue such as foreign aid or concessions for resource extraction.

5. In this form the benefit principle has been broadly discredited, owing to the difficulty of measuring with any precision the benefit that individuals (or companies) derive and the arbitrariness of the pre-tax baseline. See e.g. Murphy and Nagel 2002, pp. 16–19.
6. The authors of the League of Nation report suggested the ability-to-pay principle (Kaufman 1998, p. 197).
7. ‘For MNEs, the membership principle means that the profits from an economic activity have to be declared for tax purposes in the same jurisdiction where the activity takes place’ (Dietsch and Rixen 2014a, p. 73, cf. Dietsch 2015, pp. 85, 107).
8. Besides proposing UT + FA, Dietsch also proposes a number of transparency measures such as country-by-country reporting (2015, pp. 198–200) and automatic information exchange (pp. 113, 114). Other defenders of UT + FA include Avi-Yonah and Benshalom (2011), Avi-Yonah (2016) and Picciotto (2016).
9. Note, though, that this principle does not rule out competition on the spending side of the government budget. For instance, it could still mean that governments in the face of competition for the FDI choose to spend the tax revenue on goods and services that predominantly benefit MNCs. This, too, may limit governments’ ability to redistribute and thus their fiscal self-determination (e.g. Sinn 2003, pp. 56–60).
10. Andreas Cassee points out to me that GDP may decrease with very high levels of taxation (as is suggested by the Laffer curve). A revised account may say that this component of fiscal self-determination consists in the cardinality of the option set of tax-revenue-to-GDP ratios that excludes rates of taxation that reduce GDP.
11. One of the particular obstacles that low-income countries face in this respect is recognised, albeit implicitly, by Dietsch when he compares the impact of tax competition on high and low-income countries. He points out that while high-income countries have largely been able to sustain tax revenue levels by allocating the tax burden to less mobile economic factors, low-income countries ‘usually do not have the administrative resources to stabilise their revenues by broadening tax bases’ (Dietsch 2015, p. 48). I take this to mean that some fiscal policies were not included in the opportunity set of these low-income countries, limiting their fiscal self-determination.
12. Ronzoni (2009, p. 239), explains that in the case of contracts between individuals, background justice can be taken to require ‘some effective freedom’ to negotiate an agreement, which includes the enjoyment of an ‘adequate’ range of alternative options and ‘sufficient’ bargaining power. Ronzoni (2014, p. 48) speaks of the ‘conditions for the enjoyment of (a sufficient level of) fiscal self-determination’. However, Ronzoni (2014, p. 48), also leaves open the equality interpretation when she writes that ‘it surely is a problem of inter-state fairness, from an internationalist perspective, if the self-determination of some countries is structurally and systemically more endangered than that of others.’
13. This is a difficulty that Ronzoni (2009, p. 239), escapes by claiming that her argument is ‘methodological’ rather than ‘substantive’. See also Ronzoni (2014, p. 48).
14. Except to say that a tax take below 15% of GDP is a threshold below which countries are generally considered to find it hard to finance even basic goods and services (Adam and Bevan 2001, p. 12, IMF 2005, p. 47).
15. For instance, countries like Bangladesh, Cambodia, the Democratic Republic of Congo and Sudan have recently reported tax-take-to-GDP ratios well below 15% (Le *et al.* 2012, pp. 33–37).
16. I bracket a number of difficulties including the possibility of having to ‘level down’ and the possibility of a ‘bottomless pit’ that absolute priority to raise the fiscal self-determination of low-income states might give rise to.

17. One might object that this overlooks the possibility that all countries are beneath the baseline. I bracket this issue since this would seem to be a sign that the baseline is implausibly high.
18. For instance, a group of 48 so-called ‘least developed countries’ attracted just 1.9% of global FDI flows in 2014 (UNCTD 2015, p. 78).
19. This is a plausible assumption especially for low-income countries that struggle to raise sufficient revenue even to provide basic services and infrastructure to their population.
20. The argument can be extended to apply to a further issue, having to do with low-income countries that see their fiscal self-determination decreased as the result of curbing tax competition. There is evidence to suggest that some states, mostly poor and small, stand to gain from tax competition (e.g. Genschel and Schwarz 2012). They can offset the loss of lower domestic tax revenue by the gains in revenue from attracting taxable capital from abroad. (See for a discussion Rixen 2008, pp. 44, 45, Dietsch 2015, pp. 58–61.) Dietsch maintains that we must move beyond the effective sovereignty framework in order to show that we have a ‘reason of justice’ to continue to allow these low-income countries to engage in tax competition, for instance by maintaining that ‘letting low-income countries compete on taxes would get us closer to equality in the relevant dimension’ (Dietsch 2015, p. 203). In response one may point out that the framework of effective sovereignty does give a pro-tanto reason of justice to allow small low-income countries to engage in tax competition. Not because this will make them richer but because their poverty is correlated with low fiscal self-determination and increased tax revenue will increase their fiscal self-determination. Thanks to one of the anonymous referees of this journal for pressing this issue.
21. Thanks to one of the anonymous referees for suggesting this way of putting the response.
22. With regard to the revenues generated by her proposed global tax authority, Ronzoni comments that they could be ‘distributed back to states according to some appropriate criterion’ (Ronzoni 2014, p. 52, n. 21). The ‘appropriate criterion’ would be the aim of securing a just distribution of fiscal self-determination, accomplished by distributing revenue to those countries that lack sufficient fiscal self-determination.
23. I should perhaps emphasise that Dietsch himself has shown admirable initiative in this regard by aiming to develop a theory of international tax justice that remains as far as possible neutral on contested philosophical issues with regard to global justice. (See e.g. Dietsch 2015, pp. 65, 66, for an expression of that commitment.)

### **Notes on contributor**

Laurens van Apeldoorn is assistant professor of philosophy and a member of the Centre for Political Philosophy at Leiden University, the Netherlands. His main research interests concern early modern political thought, in particular the philosophy of Thomas Hobbes, and contemporary theories of justice.

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