

Chapter Ten

International Taxation and the Erosion of Sovereignty

*Laurens van Apeldoorn**

The current international taxation regime may, by and large, seem designed to protect the fiscal sovereignty of states. It is true that states are subject to many bilateral taxation treaties; but these treaties have the aim of establishing the jurisdictional boundaries of the respective sovereign states. The basic problem with the international movement of capital is that both the source and the destination country may lay a claim to tax. This opens up the possibility of double taxation, which the treaties aim to prevent by means of the ‘territorial disentanglement’ of the tax systems. Once jurisdiction is established, countries are free to devise fiscal policies as they see fit, including rules determining the tax base and tax rates. (Rixen 2008: 64; Rixen 2010: 10) There is no co-ordination of tax policies and nor is there, strictly speaking, any superseding international law of taxation; and it has therefore been said that the current system is ‘sovereignty-preserving’ (Rixen 2008: 64).

Nevertheless, there are significant concerns about the possible erosion of state sovereignty as a result of the current regime. One such concern is much discussed. A central feature of the resulting arrangement is competition between the various sovereign jurisdictions. This is possible because of two further aspects of the system. Global economic integration – as well as a number of regulatory changes such as the reduction of capital controls – have enormously increased the cross-border mobility of capital. Furthermore, states are fiscally interdependent, which is to say that the policy choices of individual governments influence the allocation of the overall tax base. By lowering tax rates, or by otherwise developing an attractive investment climate, states can attract taxable mobile capital, in the form of private wealth, the profits of multinationals and foreign direct investment. The resulting competition limits the effective freedom of states to pursue their desired fiscal policies. After all, they may lose their tax base if they price themselves out of the market.

* Versions of this paper have been presented at the conference Political Legitimacy and the Paradox of Regulation, University of Leiden, 2013; the ECPR Joint Sessions, University of Mainz, 2013; Leuven University (2013), and Utrecht University (2014). I should like to thank the participants of these events for their very helpful comments on drafts of this paper as well as Johan Olsthoorn, Gabriel Wollner, an anonymous reviewer for the ECPR press. A special thanks is due to the editors of this book for their support and encouragement. I completed this paper while visiting the Centre de recherche en éthique, Université de Montréal, whose financial assistance I gratefully acknowledge.

Commentators conceive this reduction of policy discretion or effectiveness as an erosion of sovereignty. This is sometimes described in terms of a conflict between ‘Westphalian’ and ‘domestic’ forms of sovereignty. By signing up to tax treaties that accomplish territorial disentanglement while preserving states’ right to determine their own tax base and tax rates, states assert their right to non-interference in internal affairs and, specifically, in their fiscal policy (Dietsch 2011b: 2110; Rixen 2011a). But as a result, their domestic sovereignty, understood as policy discretion or effectiveness, is undermined. It is ‘because countries struggle to preserve their Westphalian sovereignty that arbitrage becomes possible and the erosion of domestic sovereignty results’ (Dietsch 2011b: 2110).

Other commentators have described this as a conflict between *de jure* and *de facto* sovereignty (Dietsch and Rixen 2014: 153; Rixen 2008: 27). States protect their *de jure* sovereignty, their right to rule, but the resulting tax competition limits their discretionary space to pursue the fiscal policies they want. ‘Mobile factors of production have the opportunity to “shop around” to minimize their tax burden. This interdependence of national tax regimes generates external effects that undermine the *de facto* sovereignty of states.’ (Dietsch and Rixen 2014: 151). States lose ‘the ability to effectively achieve the desired goals of tax policy’ (Rixen 2008: 27). Ronzoni (2012) makes this claim in terms of a contrast between ‘negative’ and ‘positive’ sovereignty.

In this paper, I aim to provide an alternative account of the erosion of sovereignty in the context of international taxation. While I agree that tax competition undermines sovereignty, I disagree with the arguments that are presented in the literature to arrive at this conclusion. I provide in Sections 1 and 2 an analysis of the concepts of Westphalian and domestic sovereignty as they have been used in the literature. In Section 3, I show that these conceptions of sovereignty cannot be used to support the claim that tax competition undermines sovereignty. In Section 4 I give an account of ‘sovereignty as responsibility’ (building on Dietsch 2011) and show how this concept can be used to show that the decreasing effective fiscal-policy discretion of states in the face of tax competition can be considered an erosion of sovereignty. Finally, in Section 5, I develop an alternative interpretation of the claim that states ought to have effective or positive sovereignty. In the literature, the focus in this context has been exclusively on guaranteeing the *external* conditions that allow states to effectively secure their desired tax-policy goals. I maintain that in the context of international taxation, it is also important to look at the *internal* conditions of effective or positive sovereignty. I do so by emphasising that the authority, and thereby sovereignty, of a state depends on enabling conditions, including democratic decision-making. This enabling condition is not always satisfied in the case of international tax legislation. The predicament of many contemporary states with regard to their fiscal sovereignty is therefore more complex and precarious than has generally been thought. This conclusion leads me to suggest that institutional reforms to increase effective or positive sovereignty in the context of international taxation should focus not only on reshaping the external environment within which states develop their fiscal policies but also on strengthening the democratic character of collective will-formation.

1. Westphalian sovereignty

The concept of what has variously been called ‘external’, ‘negative’, or ‘Westphalian sovereignty’ has at its core the value of non-interference. It is codified in international law and associated with the formally equal status that is bestowed on recognised states in international relations. As a normative concept, it can best be conceptualised as an effective claim-right to non-interference by external actors. I will call such a claim-right to non-interference an ‘immunity’ (not to be confused with Hohfeldian immunities) or a ‘negative right’.¹ This means that for every such right, external actors have a corresponding duty of non-interference. The right to non-interference can be further specified as follows. First, Westphalian sovereignty entails what is called ‘territorial integrity’, a right to the absence of the occupation or conquest of one’s territory. Secondly, it entails a ‘right to non-interference in internal affairs’ (Buchanan 2007: 263), including the organisation of one’s political, social and economic affairs.² To say that sovereignty requires the claim-right to non-interference in order to be ‘effective’ is to say that it is a necessary condition for sovereignty that the corresponding obligations are observed.

In sum, a state has Westphalian sovereignty if and only if it has a claim-right to non-interference by external actors and those external actors observe the corresponding obligations. This is consistent with, for example, Krasner (1999: 20), who defines Westphalian sovereignty as ‘territoriality and the exclusion of external actors from domestic authority structures’. ‘Rulers’, he writes, ‘may be constrained, sometimes severely, by the external environment, but they are still free to choose the institutions and policies they regard as optimal. Westphalian sovereignty is violated when external actors influence or determine domestic authority structures.’ Similarly, Dietsch (2011b: 2109) maintains that the ‘basic rule of Westphalian sovereignty is non-intervention in the internal affairs of other states’, which guarantees ‘the autonomy of the domestic political authorities over a state’s territory’.

In order to emphasise the resulting autonomy of domestic political structures, one might further argue that Westphalian sovereignty includes the right, in Buchanan’s terms, ‘to promulgate, adjudicate, and enforce legal rules within its territory’ (Buchanan 2007: 263). If one does so, however, one should make clear that this right is an immunity. It is a right to the *absence of interference* in promulgating, adjudicating and enforcing legal rules. External actors have an obligation not to interfere in domestic authority structures and, in particular, in the promulgation, adjudication and enforcement of legal rules. By contrast, external

-
1. Here I follow Ronzoni (2012: 577). A Hohfeldian immunity is an immunity against having one’s rights, privileges, claims or powers altered by another. In my terminology, an immunity is a claim-right to non-interference.
 2. The UN Charter, Article 2(4) captures both conditions: ‘All Members shall refrain in their international relations from the threat or use of force against the territorial integrity or political independence of any state.’

actors do not have an obligation to refrain from altering the environment within which states exercise their authority, short of violating their territorial integrity.

This shows why this form of sovereignty may also be appropriately called ‘external’ (as in, for example, Philpott 1995: 357). Westphalian sovereignty is only concerned with the distribution of rights and obligations with regard to actors external to the state. It is implausible that sovereign states can only claim immunities with regard to citizens and other internal actors. Rather, it seems more likely that citizens have duties to actively support these activities, including a duty to obey the law. Westphalian sovereignty thus captures only *some* of the rights that the state might be said to enjoy.

Because these rights are immunities, or negative rights, it is also appropriate to call Westphalian sovereignty ‘negative sovereignty’ (Ronzoni 2012: 577). Ronzoni argues on this basis that this form of sovereignty is ‘purely formal’ and usually ‘impossible to take advantage of’ (582). This is so, she maintains, because negative sovereignty has no ‘substantive and empirical dimension’ (577). States with merely negative sovereignty ‘have a formal equal status with other states, but are often forced to accept deals and agreements that they are not, objectively, in a position to refuse’ (581). Since these claims are supposed to apply to Westphalian sovereignty, Ronzoni seems to conflate two distinct issues.³ On the one hand, one may distinguish, as I have done, between negative and positive rights. Westphalian sovereignty can indeed be termed negative because it is based on the attribution of rights to non-interference. On the other hand, one may also distinguish between the formal, negative dimension of having a right and the substantive, positive dimension of having a right respected. With regard to this second distinction, Westphalian sovereignty has a positive dimension, since it requires both that a state has a right to non-interference *and* that the corresponding obligations are, in fact, observed. It therefore provides a real and substantive constraint on the behaviour of states in their international relations, even if this constraint applies to a narrow set of actions. Westphalian sovereignty might not be undermined if a weaker state is forced to accept a deal it would not have accepted had it been more powerful. But Westphalian sovereignty *is* undermined when outsiders arm a militia, overthrow the government and install an autocrat who is more favourable to their interests.⁴

It is worth emphasising that the concept of Westphalian sovereignty does not entail an anarchic system of states operating in a moral vacuum. Dietsch (2011: 2109) maintains that Westphalian sovereignty ‘provides the foundation’ for that

3. See, for example, Ronzoni 2012: 578 for the definition of Westphalian sovereignty in terms of an ‘immunity of non-intervention’ and the equation of Westphalian sovereignty with negative sovereignty.

4. One may further note that, morally speaking, the threat-advantage of powerful states is also strictly limited by their obligations to non-interference. A state cannot credibly threaten, say, to start a ground war, since it is not permitted to start a ground war. This is also reflected in UN Charter, Article 2(4), which prohibits the ‘threat or use of force’.

latter view,⁵ while Krasner (1997: 658) writes that Westphalian sovereignty ‘is a basic ontological assumption’ of the view that ‘states are free of external authority’. But the association of a right to non-intervention with an untrammelled right to self-help is incoherent. If we define Westphalian sovereignty as an effective claim-right to non-interference, as both these authors seemingly do, then the sovereignty of others is at least limited by the duty to respect that right. Henry Shue (2004: 15) eloquently puts it as follows: ‘if sovereignty is a right, sovereignty is limited. Sovereignty is limited because the duties that are constitutive of the right, and without which there can be no right, constrain the activity of every sovereign belonging to international society.’ What Dietsch and Krasner might have better said is that the two views *share* an ontological assumption, namely, the view that there exist territorially bound, independent states with internally complex political organisations that allow them to operate as agents in an international arena. Or they could have maintained, alternatively, that the rights associated with sovereignty are limited to internal actors while external actors are left free from moral constraints. (This is a possibility that Shue seems to disregard.) But in that latter case we are no longer speaking of Westphalian sovereignty, based on a principle of non-interference, but of what I term domestic sovereignty.

2. Domestic sovereignty

Domestic sovereignty is concerned with the internal composition and, specifically, the political institutions, of the state. Since this conception of sovereignty is contrasted with Westphalian sovereignty (which concerns the obligations of outsiders) domestic sovereignty is sometimes called ‘internal’ sovereignty, clarifying that this conception of sovereignty (only) concerns the obligations of internal actors.⁶ Some authors associate this form of sovereignty exclusively with (absolute and final) political authority.⁷ They maintain that sovereignty requires the right to rule, which can be further specified in terms of the right to promulgate, adjudicate and enforce legal rules. Others equate domestic sovereignty with *effective* authority. These authors maintain that sovereignty requires not only the right to rule but also the effective capacity to do so. For example, in one influential

5. He furthermore contrasts ‘Westphalian sovereignty that is centred on the notion of non-intervention’ with a view of ‘sovereignty that assigns duties as well as rights to states’ (2011: 2108). My point is that Westphalian sovereignty also assigns rights and duties to states, albeit minimal ones.

6. As Philpott (1995: 357) maintains, ‘internal’ sovereignty consists of ‘supremacy over the land’s inhabitants’, whereas ‘external’ sovereignty is concerned with the obligations of outsiders, namely, ‘independence from unwanted intervention by an outside authority’. See also Dietsch 2011: 2109: ‘Whereas the focus of domestic sovereignty lies on the internal affairs of the state, *Westphalian sovereignty* is a principle meant to govern relations between states.’

7. For instance, F. H. Hinsley (1986: 25–6): ‘At the beginning, the idea of sovereignty was the idea that there is a final and absolute political authority in the political community ... and no final and absolute authority exists elsewhere.’

account, Krasner (1999: 4) defines domestic sovereignty as involving ‘both authority and control, both the specification of legitimate authority within a polity and the extent to which the authority can be effectively exercised’. I follow Krasner and assume that authority and control are both necessary, and jointly sufficient, conditions for domestic sovereignty (and below give an argument for why this assumption is plausible).⁸ Authority is the right to rule, the right to promulgate, adjudicate and enforce legal rules within a territory.⁹ Citizens (and others present within the territory) have obligations to facilitate and support the exercise of these competences by the state. If one assumes that all government functions are mediated by an effective legal system then it suffices to demand that they obey the law. If the legal system is not functioning properly, or if political institutions are otherwise defective, citizens may have additional obligations to improve these institutions. Since authority is developed in terms of various obligations of citizens to facilitate and support the state in its activities, one may also call this a ‘positive’ account of sovereignty (in contra-distinction to the ‘negative’ account of Westphalian sovereignty that requires only non-intervention).¹⁰ Control is to have these rights effectuated, that is to say, to have citizens act on their obligations, in particular on the obligation to obey the law. A state has control if and only if citizens act in accordance with their obligations that are correlated with the right to rule.

In the literature, another account of control is often proposed. Instead of maintaining that control consists of citizens discharging their obligations, as I have done, authors take control to consist simply in the ability of the state to get its way. Krasner (1999: 12), for instance, suggests that control depends on whether a state is able to ‘maintain order, collect taxes, regulate pornography, repress drug use, prevent abortion, minimize corruption, or control crime’. The better a state is able to accomplish these goals (provided that it aims to accomplish these goals), the more it is in control and, therefore, the more sovereign it is. This account of the control component of sovereignty as consisting of policy-effectiveness is, ostensibly, shared by Dietsch and Ronzoni. Dietsch, for instance, maintains that domestic sovereignty in the fiscal context depends on the state’s ability to effectively determine the ‘size of the state as well as the level of the redistribution of income and wealth’ (Dietsch 2011b: 2109). Similarly, Ronzoni maintains that a state has ‘positive’ sovereignty when

8. But I conceive of control differently from Krasner, for reasons I explain in Section 3.

9. Some authors deny that modern nation-states have such authority. For instance, Simmons (1979) and Morris (2002: 213) maintain that authority (and the corresponding obligation to obey) requires explicit consent. Associating sovereignty with authority accordingly has the consequence of denying that modern nation-states are generally sovereign. This is a bullet that Morris is willing to bite. He writes that ‘[o]ur world in fact turns out to be one of states without sovereignty. In this world, social order is maintained, sometimes only precariously, by power, interest, justice, convention, compromise, benevolence, religious sentiments, ties of kin and nation, and the like.’ (Morris 2002: 217).

10. See Ronzoni 2012.

it ‘possesses the internal resources to decide which *kind of polity* it wants to become and acts on it successfully’ (Ronzoni 2012: 577).

This account of control does not sit well with a rights-based conception of sovereignty. It is far from obvious that a sovereign state has a *right* to be successful in maintaining order, collecting taxes, determining the level of redistribution and so forth. A state may have the right to try to accomplish all those things, in so far as it has the right to rule, and citizens may have corresponding obligations to facilitate and support the state in aiming to accomplish these goals. However, once citizens have discharged these obligations, there is nothing else a sovereign-state can demand as a matter of sovereign-right. This is generally recognised in areas where the lack of control is not due to the failure of actors to discharge their obligations associated with the state’s right to rule. Thus we would not generally say that state’s sovereignty is undermined as the result of floods or earthquakes, or the limitations of the laws of physics.¹¹

Perhaps I should emphasise that this should not lead us to conclude that sovereignty has no control component at all. Shue notes, as I have done, that limited policy effectiveness by itself is no reason to deny a state’s sovereignty:

that the actual control over their economic fortunes that can be successfully exercised by modern states is, in fact, limited is, of course, not at all the same thing as their sovereignty over economic matters being limited, since sovereignty is a matter of the proper authority to try to exert power even where the exertions may turn out to be futile. Domestic criminal law is regularly broken, but until the violations approach the point of general disorder, only the power, not the authority, of the state is put in question by the lawbreaking (1997: 348).

Shue thus seems to think sovereignty is best accounted for in terms of authority alone. Only when authority is undermined, for instance because of the state’s inability to guarantee individual safety and public order, can we say that sovereignty is eroded. But this view is unable to account for situations in which large-scale law-breaking undermines the effectiveness of policies without, however, causing general disorder. An example is the attempt of the United States government in the 1920s to prohibit the manufacture and sale of alcoholic beverages. The policy was largely ineffective. Although alcohol consumption declined, large-scale home-brewing and bootlegging could not be prevented. This did not undermine the (presumed) authority of the state. However, individuals did not act on their (presumed) obligations to support the state in its endeavour to rule, as the result of which the policy-effectiveness of the state was undermined. The policy of prohibition would have been effective had citizens obeyed the law and

11. This claim should be qualified, since the authority of the state may be dependent on guaranteeing certain minimal conditions, such as relative stability and public order, which could be upset by natural disasters. However, in such a case it is the authority component of domestic sovereignty, not the control component, that is undermined.

thereby discharged their obligations associated with the authority of the state. It thus seems appropriate to say that, in such cases, in which the state is unable to effectuate its policy goals due to a failure of citizens to discharge their obligations, the domestic sovereignty of the state is eroded.

3. International taxation: Westphalian and domestic sovereignty

It seems that the current international-taxation regime is both sovereignty-preserving – since it disentangles the territoriality of tax systems and thereby protects the authority of states to determine fiscal policy – and sovereignty-undermining – since the resulting tax competition decreases states’ fiscal policy discretion. As noted, this paradox is sometimes expressed in terms of a conflict between Westphalian and domestic sovereignty (for example, Dietsch 2011: 2110).

Although the claim that tax competition is sovereignty-undermining is a version of a common view about the effect of processes of globalisation on state sovereignty,¹² it cannot be defended on the basis of the account of Westphalian and domestic sovereignty just outlined. In accordance with the definition provided above, domestically sovereign states have a right to promulgate, adjudicate and enforce legal rules, which translates into associated obligations of citizens to support the policies of the state. Domestic sovereignty is eroded when the state is unable to effectuate its policy goals due to a failure of citizens to discharge their obligations. However, the decreased ability of states to effectively pursue desired fiscal policies is not due to internal actors neglecting to discharge their obligations, such as, for instance, their obligation to pay tax. One may, of course, maintain that the decline in effective fiscal policy control, as the result of tax competition, is regrettable, since it exacerbates inequalities within and between states (Dietsch and Rixen 2014: 151; Dietsch 2011a). However, there are many things that states cannot do that might lead to a more just and equitable world. In order to show that the states’ inability to pursue them is an erosion of sovereignty, it must be shown that these effects are the result of non-compliance with the obligations correlated with the authority of the state. The same may be said with regard to the concepts of *de facto* sovereignty employed by Dietsch and Rixen (2014) and positive sovereignty employed by Ronzoni (2012). It cannot be enough simply to point out that either the effectiveness of policies or the range of realistic policy options has decreased. In order to show that the control component of sovereignty is eroded, one must show that the state is unable to reach its desired policy goals *because relevant parties do not discharge their obligations to support the state in its effort to rule*. For this reason, I maintain that the authors discussed in this section fail to show that tax competition leads to an erosion of sovereignty.

12. Krasner, for instance, maintains that in a globalised world, states still have authority, that is, the right to legislate and adjudicate and implement law, but that they are increasingly limited in their capacity to reach their policy goals (Krasner 1999: 12).

4. Sovereignty as responsibility

Westphalian and domestic sovereignty, as outlined above, can consistently be attributed simultaneously to one state. It is conceptually coherent to maintain that states have positive rights to be supported in their activities by internal actors, while they only have negative rights to non-interference with regard to external actors. It is, however, an open question whether this best captures the rights that states have. In particular, the principle of non-interference may not best capture the obligations that states have with regard to other states. May it rather be the case that outsiders, too, have positive obligations to support a state in its endeavour to rule?

It is this kind of question that has led commentators to develop the concept of ‘sovereignty as responsibility’.¹³ To be a sovereign state, the argument goes, does not only entail having certain rights but also entails a number of responsibilities. A state loses its authority, its right to rule, and thereby its sovereignty, if it fails to discharge these responsibilities. This, by itself, is compatible with the concept of domestic sovereignty. Even Thomas Hobbes, who gave us one of the classic accounts of domestic sovereignty, maintains that the capacity to ensure the safety of individuals and the presence of order is a necessary condition for authority.¹⁴ One can further argue that the authority of a sovereign state is dependent on discharging the responsibility to protect the human rights of its citizens, to promote their well-being, or to secure a reasonably just society, without going beyond the concept of domestic sovereignty. Those who defend the concept of ‘sovereignty as responsibility’, however, argue that these responsibilities of states are not limited to their citizens but that states also have obligations to take into account the effects of their policies on outsiders, in ways that go over and above the Westphalian obligation of non-intervention (see Dietsch 2011b: 2115; Shue 2004).

Dietsch (2011b) utilises this argument to show that tax co-operation does not necessarily conflict with sovereignty. Tax co-operation seems to erode sovereignty since it requires surrendering certain juridical prerogatives with regard to determining fiscal policy. However, Dietsch observes that

under the paradigm of sovereignty as responsibility, it seems that sovereignty so understood is much less likely to conflict with tax cooperation in the first place. After all, the goal of tax cooperation is precisely to create an institutional framework under which the efforts of states to promote the fundamental interests of their citizens are not undermined by other states (2011b: 2115).

The sovereign state is limited by a set of obligations but ‘these constraints are not to be viewed as constraints *on* sovereignty, but as constraints *of* sovereignty.’ (2011b: 2116).

13. For an early argument, see, for example, Deng *et al.* 1996.

14. Some would even make the case that it is a sufficient condition, since he claims that there exists a ‘mutuall Relation between Protection and Obedience’ (Hobbes 1991: 491).

In what follows I want to suggest that the concept of sovereignty as responsibility also allows us to argue for the converse claim, namely, that sovereignty *is* eroded as the result of tax competition. The argument starts by following Dietsch (2011b) in maintaining that states have, by virtue of their sovereignty (as responsibility), obligations to promote the fundamental interests of individuals external to the state, over and above non-interference. These obligations can be characterised as obligations that correlate to the right of other states to rule. This claim rests on the view that states have authority – the right to promulgate, adjudicate and enforce laws – because this is more likely to promote the fundamental interests of individuals than other arrangements.¹⁵ The authority of the state is thus grounded in the instrumental relationship it has to promoting the fundamental interests of individuals (which could be expected if one takes the pursuit of those fundamental interests to be an enabling condition of authority). This means that state A can best discharge its obligations to citizens of state B by supporting state B's ability to rule. Conversely, the correlating obligations to the right of state B to rule are shared by the citizens of state B and by (the citizens of) state A. In other words, for the same reason that state A has the right to rule because it is the best way to promote the fundamental interests of citizens of state A, state A has the obligation to support state B in ruling because that is the best way to promote the fundamental interests of citizens of state B.

This has implications for the conceptualisation of the control component of sovereignty. Above, I maintained that (domestic) sovereignty consists of both authority and control, and that the control component of sovereignty should be understood in terms of having *effective* authority, which is to require that all those who have obligations correlating to the right to rule discharge their obligations. The conclusion now follows that the control of states, and thereby their sovereignty, may be eroded if other states fail to act on their obligations to support the state to rule. The effective authority of a state may be undermined if citizens fail to discharge their obligations to obey the law; but it may also be undermined if other states fail to act on their obligations to support the state in pursuing its policy objectives.

Dietsch (2011a) has shown that, arguably, tax competition leads to greater inequality within and between countries and therefore may be thought to exacerbate domestic and global distributive injustice. Take the former. I argued above that this phenomenon is not plausibly the result of citizens failing to discharge their obligations with regard to the authority of the state and therefore that it could not be conceived as an erosion of sovereignty. But now it could be argued that the

15. Following Dietsch and Rixen (2014: 173–4), one can provide at least two arguments for this position. First, with Caney (2006), one may argue that a cosmopolitan concern for each individual as ultimate unit of moral concern requires a certain amount of state autonomy if there exists pluralism about conceptions of justice. If people disagree about what justice requires, then state authority could ensure that we do not impose a conception of justice on individuals who might not share it. Secondly, with Goodin (1988), one may maintain that state authority might be the best way to promote the interests of individuals worldwide, since states are better able to identify and cater to the interests of individuals than, for example, a world government.

reduced fiscal policy effectiveness is due to other states failing to discharge their obligations correlated to the authority of the state. Dietsch (2011b) has shown that tax co-operation may be required to satisfy the enabling conditions of authority – since it may be a way to ameliorate the harmful effects of tax competition and so would increase domestic distributive justice – or at least for states adequately to ‘take into account the effects of their policies on the citizens of other states’ (2115). If this is true, then we can also conclude that tax competition leads to an erosion of sovereignty. Tax competition results from states refraining from discharging obligations (which they have by virtue of their sovereignty-as-responsibility) that are correlated with the right other states have to rule. The reduced fiscal-policy effectiveness that is due to continuing tax competition therefore constitutes an erosion of control and thereby an erosion of sovereignty.¹⁶

5. Sovereignty and collective will-formation

This emphasis on the enabling conditions of authority also points towards a second relevant form of sovereignty-erosion. In the previous section, I argued that sovereignty may be eroded if the state lacks *control*, understood as effective authority. I will now argue that sovereignty can also be eroded if the enabling conditions of the *authority* of the state are not satisfied. Plausibly, one such enabling condition is a process of what one might call collective will-formation. This was recognised by Hobbes. The Hobbesian sovereign speaks for all subjects because they have all submitted their will to his will. It is from this unity of the will of all individuals, Hobbes claims, that sovereignty is born (Hobbes 1991: 120). Other accounts of collective will-formation are, of course, possible. I assume that democratic decision-making is an enabling condition for authority. That is to say, that the state can act with authority if its legislation and enforcement is democratically legitimated. I further assume that the justification for requiring democratic decision-making in this way is partly instrumental and partly intrinsic. There is an intrinsic value to democracy because of the importance of political participation and conferring equal political rights. There is an instrumental value to democracy because democratic decision-making is apt to increase the justness of the decisions, since the interests of all affected are taken into account.

The importance of democratic decision-making for sovereignty in the context of fiscal policy is not always fully recognised. Ronzoni (2012), who conceives of ‘positive sovereignty’ as analogous to positive freedom, a form

16. Note that this argument renders claims about (the erosion of) sovereignty dependent on a prior account of what justice requires. This means that it is not possible, as Ronzoni (2012) apparently does, to argue that an arrangement is unjust *because* it leads to erosions of sovereignty. Ronzoni argues that ‘the global order might be politically unjust in that it creates unjustifiable systemic obstacles to positive sovereignty’ (583). I have argued that her account of positive sovereignty as policy effectiveness fails to make explicit what rights-claims support that demand for policy effectiveness. The conclusion I draw here is that these rights-claims must be based on a theory of justice.

of ‘self-mastery’ (577), nevertheless only focuses on the external conditions that allow states to do what they will. However, self-mastery presumably also includes an appropriate process of collective will-formation and thus a specific form of internal organisation.¹⁷ Dietsch and Rixen (2014) and Dietsch (2011b) do not mention democratic legitimation as an enabling condition for the authority of the state. Indeed, Dietsch and Rixen make ‘the simplifying assumption that governments perfectly track their citizens’ preferences’ (2014: 153), thereby presupposing the existence of a democratic process of collective will-formation. By relaxing this assumption, it becomes possible to conceptualise a second form of sovereignty-erosion, namely, erosion due to a lack of *authority* as opposed to a lack of *control*. That may happen if a state lacks effective political institutions that guarantee democratic collective will-formation. I provide two examples. These examples come from a literature that is critical of the way in which legislation is written and enacted in states that most aggressively pursue policies of tax competition, namely, so-called tax havens. Tax havens are countries that aim to attract ‘international trade-oriented activities by minimization of taxes and the reduction or elimination of other restrictions on business operations’ (Johns 1983: 20). They are the ‘crowbars’ of tax competition.

The first example is the introduction of the Financial Center Development Act of 1981 in Delaware, a small state in the north-east of the USA. Among other things, the law eliminated caps on consumer interest rates, also called ‘usury’ restrictions, and applied a regressive corporate tax structure to the income generated by the banks within Delaware. At the time, the *New York Times* noted that the legislation was drafted ‘in private’, by ‘lawyers for two large New York banks, the Chase Manhattan Bank and J. P. Morgan & Company, without any written analysis by any Delaware official involved’. Other parties, including the press and the public were ‘intentionally kept in the dark’. When the bill was passed, many of the legislators claimed they ‘did not understand the complicated measure before voting on it’ (Gerth 1981). Several further bills were developed and passed in the years that followed, including legislation that would allow foreign banks to benefit from the regressive tax structures; laws that, according to some, turned Delaware into a full-blown tax haven. They were largely written by lawyers representing ‘Morgan, Chase, Citicorp, Bank of New York, and Bankers Trust’ (Shaxson 2011: 174).

A similar pattern can be observed in the second example, the introduction of the 1996 Special Limited Liability Partnership Law in Jersey, a British Crown Dependency. The law allows companies, in particular, the big accountancy firms, to operate under limited liability while also benefiting from the perks that

17. This is noted by Isaiah Berlin, on whom Ronzoni draws to develop her analogy of sovereignty with freedom, when he writes in ‘Two concepts of liberty’ that ascribing to someone positive freedom requires identifying the individual with the ‘real’ or ‘autonomous’ self, ‘which calculates and aims at what will satisfy it in the long run’, as opposed to the ‘heteronomous’ self, driven by ‘irrational impulse, uncontrolled desires’ (Berlin 2002: 179).

come with being a partnership, such as less disclosure, lower taxes and weaker regulation. The bill was proposed and drafted by Ernst & Young and Price Waterhouse, ‘fast-tracked’, and implemented with no meaningful opposition from the legislature. Several commentators see the episode as indicative of the condition of political institutions in Jersey: ‘As exemplified by the LLP legislation episode, major firms can draft their own laws and the Jersey government promises to simply nod them through with minimal scrutiny.’ (Mitchell *et al.* 2002: 53). This was possible because, first, political power in Jersey is highly concentrated in the hands of a small group of people. One member of Jersey’s parliament comments that ‘[f]or over a century Jersey’s ruling elite has had an unchallenged monopoly of power ... With no clear division between the legislature, judiciary and executive there is an absence of checks and balances.’ (Mitchell *et al.* 2002: 35). A second reason was that many of the members of the parliament had hardly any experience or knowledge of the complexities of international finance: ‘They can argue at enormous length about the budget for the local pony club ... but a new limited liability law or a new trust law will go unchallenged. It’s the captured state.’ (Shaxson 2011: 181).

Much of the recent literature, discussed above, maintains that tax competition is the result of the structural features of the current international financial system. Assuming that states perfectly track their citizens’ preferences and interests, they respond to competitive pressures by lowering their tax rates and otherwise aiming to provide an attractive investment climate. States have limited fiscal policy discretion but they do what is best for their citizens given the circumstances. These examples, however, tell a different story. In these cases, the legislation is not simply the result of limited fiscal policy discretion. Rather, it is the result of a political process that fails to pass the test of democratic legitimacy. This is how we can understand the worry of several commentators that these tax havens have their ‘legislature for hire’ and their ‘sovereignty for sale’ (*see*, for example, Palan 2002b; Christensen and Hampton 1999. *See also* Palan *et al.* 2010: 187). In these cases, the authority-component of sovereignty is eroded. This raises the question whether these laws do, in fact, further the interests of the citizens of the state in question. An answer to this question is difficult to give, because it would involve providing an account of the counter-factual, in which the democratic process did function properly. It is clear enough, though, that in so far we value democratic government for intrinsic reasons, it is not in the interest of the citizens of Jersey or Delaware to have laws passed without proper consultation and oversight. And since very specific interest-groups shaped the content of these laws, it would be coincidental, at best, if they did, in fact, further the interests of citizens.

6. Conclusion

In the preceding sections, I have pursued two objectives. First, I have discussed recent literature on the concept of sovereignty in the context of international taxation. I have attempted to show that these recent accounts are unsuccessful in their attempts to show that tax competition undermines or erodes the sovereignty

of states. This is because it is assumed that it is enough to show that fiscal policy discretion or effectiveness has decreased as the result of such competition. I have argued that this conclusion requires instead showing that the decreasing policy effectiveness is due to actors failing to discharge their obligations correlated with the authority of the state. I have provided such an argument. Secondly, I have shown that the recent literature has insufficiently emphasised the importance of the authority component of sovereignty. It is the authority component that comes under pressure when states allow the financial sector to determine legislation in ways that evade democratic control. The sovereignty of states may thus be eroded in two distinct ways. A state may lack *control* because it is unable to effectively implement and enforce policies it legislates (or wants to legislate), due to the failure of individuals or other states to discharge their obligations to support the state in its efforts to rule. But it may also lack *authority* because the process of collective will-formation is defective.

Dietsch and Rixen (2014) have proposed an institutional scheme that could limit the strategic behaviour that states are allowed to engage in in order to attract foreign capital, and so would curb tax competition. Although this proposal would require sovereign states to accept certain limitations on their authority to write fiscal legislation, these limitations would restore the control component of sovereignty. It would provide countries greater freedom to determine the size of the public budget and the extent of redistribution, and so allow them to better pursue the fundamental interests of their citizens. However, since, as I have argued, sovereignty also requires democratic decision-making, such institutional reforms to curb tax competition as proposed by Dietsch and Rixen must be pursued in tandem with reforms to increase democratic control over fiscal policy legislation, where such control is shown to be defective. Policies to improve the quality of democratic decision-making, which could include institutional capacity-building, more robust consultation procedures or transparency initiatives, may not be easy, given the highly technical nature of much international tax legislation. However, only if legislation tracks the preferences of citizens can we be assured that states utilise the greater control they are afforded to the benefit of their citizens.

Bibliography

- Berlin, I. (2002) *Liberty: incorporating Four Essays on Liberty*, edited by Hardy, H. and with an essay by Harris, I., Oxford: Oxford University Press.
- Buchanan, A. (2007) *Justice, Legitimacy and Self-Determination*, Oxford: Oxford University Press.
- Caney, S. (2006) 'Cosmopolitan justice and institutional design: an egalitarian liberal conception of global governance', *Social Theory & Practice* 34(4): 725–56.
- Christensen, J. and Hampton, M. P. (1999) 'A legislature for hire: the capture of the state in Jersey's Offshore Finance Centre', in Hampton, M. P. and Abbott, J. (eds) *Offshore Finance Centers and Tax Havens: The rise of global capital*, West Lafayette, Indiana: Purdue University Press.
- Deng, F. *et al.*, *Sovereignty as Responsibility: Conflict management in Africa*, Washington, DC: Brookings Institution Press, 1996.
- Dietsch, P. (2011a) 'Tax competition and its effects on domestic and global justice', in Banai, A., Ronzoni, M. and Schemmel, C. (eds.) *Social Justice, Global Dynamics: Theoretical and empirical perspectives*, London: Routledge.
- (2011b) 'Rethinking sovereignty in international fiscal policy', *Review of International Studies* 37(5): 2107–20.
- Dietsch, P. and Rixen, T. (2014) 'Tax competition and global background justice', *Journal of Political Philosophy* 22(2): 150–77.
- Gerth, J. (1981) 'New York banks urged Delaware to lure bankers', *New York Times*, 17 March.
- Goodin, R. (1988) 'What is so special about our fellow countrymen?', *Ethics* 98(4): 663–86.
- Hinsley, F. H. (1986) *Sovereignty*, Cambridge: Cambridge University Press.
- Hobbes, T. (1991) *Leviathan* [Revised Student's Edition], Cambridge: Cambridge University Press.
- Johns, R. A. (1983) *Tax Havens and Offshore Finance*, New York: St Martin's Press.
- Krasner, S. (1997) 'Pervasive not perverse: semi-sovereigns as the global norm', *Cornell International Law Review*, 30(3): 651–80.
- (1999) *Sovereignty: Organized Hypocrisy*, Princeton, New Jersey: Princeton University Press.
- Mitchell, A. *et al.* (2002) *No Accounting for Tax Havens*, Basildon, Essex: Association for Accountancy & Business Affairs.
- Morris, C. (2002) *An Essay on the Modern State*, Cambridge: Cambridge University Press.
- Palan, R. (2002a) 'Trying to have your cake and eating it: how and why the state system has created offshore', *International Studies Quarterly* 42(4): 625–43.
- (2002b) 'Tax havens and the commercialization of state sovereignty', *International Organization* 56(1): 151–76.

- Palan, R. *et al.* (2010) *Tax Havens: How globalization really works*, Ithaca, New York: Cornell University Press.
- Philpott, D. (1995) 'Sovereignty: an introduction and brief history', *Journal of International Affairs* 48(2): 353–68.
- Rixen, T. (2008) *The Political Economy of International Tax Governance*, Basingstoke: Palgrave Macmillan.
- (2010) 'From double tax avoidance to tax competition: explaining the institutional trajectory of international tax governance', *Review of International Political Economy* 18(2): 197–227.
- (2011) 'Tax competition and inequality – the case for global tax governance', *Global Governance: A Review of Multilateralism and International Institutions* 17(4): 447–67.
- Ronzoni, M. (2012) 'Two conceptions of state sovereignty and their implications for global institutional design', *Critical Review of International Social and Political Philosophy* 15(5): 573–91.
- Shaxson, N. (2011) *Treasure Islands*, London: Bodley Head.
- Shue, H. (1997) 'Eroding sovereignty: the advance of principle', in McKim, R. and McMahan, J. (eds) *The Morality of Nationalism*, Oxford: Oxford University Press.
- (2004) 'Limiting sovereignty', in Welsh, J. M. (ed.) *Humanitarian Intervention in International Relations*, Oxford and New York: Oxford University Press.
- Simmons, A. J. (1979) *Moral Principles and Political Obligations*, Princeton, New Jersey: Princeton University Press.
- Wilson, J. D. and Wildasin, D. E. (2004) 'Capital tax competition: bane or boon?', *Journal of Public Economics* 88(6): 1065–91.