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Article

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Redistribution, Globalisation, and Multi-level Governance

Abstract: Global income inequalities are met with increasing calls for direct supranational redistribution. This article argues that from the perspective of political feasibility, this approach should not be prioritised. We use the example of tax competition to show that supranational regulation that stops short of direct redistribution has better chances of being implemented. Moreover, as the case of tax competition illustrates, such regulation can help to shore up the capacity of nation states to redistribute internally, which indirectly tends to reduce global inequalities, too. Against this background, we formulate the conditional subsidiarity principle of redistribution. It states that when the case for direct supranational redistribution is built on the alleged incapacity of the state to redistribute due to the pressures of globalisation, our first instinct should be regulatory reform in order to restore this capacity. Finally, the article asks whether two prominent proposals for global taxation – the global resource dividend and the financial transaction tax – pass the test of the conditional subsidiarity principle.

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Notwithstanding the mitigating effect of the emergence of a Chinese middle class in recent years,[1] indicators of global income inequalities still offer a bleak picture.[2] At the national level, the determination to fight inequalities

1 See e.g. Pogge, Thomas, “Growth Is Good! – But What Growth?” in *Social Justice, Global Dynamics: Theoretical and Empirical Perspectives*, ed. Ayelet Banai, Miriam Ronzoni and Christian Schimmel (London: Routledge, 2011), 77–94.
2 Milanovic, Branko, *The Haves and the Have-Nots: A Brief and Idiosyncratic History of Global Inequality* (New York: Basic Books, 2011), chapter 2.

seems even to have weakened. Paradoxically, while national income inequalities have been on the rise again for the last 40-odd years in many countries after having declined between the Great Depression and the 1960s, the tax systems of these countries have become more regressive.[3] That is, rather than counteracting rising inequalities, a reduced tax burden on the rich has compounded them in many places. If one thinks that political preferences and conceptions of social justice have not changed accordingly to legitimate these changes, this development presents us with a puzzle.

The common answer to the puzzle is that the growing economic interdependence of countries, referred to as globalisation, not only creates more inequality in the primary distribution but also undermines the capacity of the state to redistribute and bring about a more equal post-tax distribution.[4] A number of policy proposals to rectify this situation argue that supranational tax and transfer mechanisms need to be created to fill the void. This article presents a critical analysis of this position and suggests an alternative approach to the puzzle. Put differently, we inquire whether any general statements can be made about the level of governance – national or supranational – at which redistributive policies should be pursued.

Our central arguments can be summarised as follows. First, we contest the empirical claim that globalisation *necessarily* undermines the redistributive capacity of the state. While it *contingently* does so under certain regulatory frameworks, including the present one, globalisation is not incompatible with national redistributive policies as such. Second, while national redistribution only represents a partial step towards global justice, we argue that it is important to indeed take this partial step through national rather than supranational tax and transfer mechanisms. The justification for this argument lies in feasibility considerations. In sum, we defend what we will call a *conditional subsidiarity principle for redistribution under multi-level governance*: When the case for supranational redistribution arises from the alleged failure of states to redistribute, our first instinct should be to restore the redistributive capacity of the state by changing the regulatory framework under which globalization operates before turning to direct redistribution at the supranational level.

The article connects work on global justice in political philosophy with international tax theory in public economics. To ensure that the premises of our argument from both of these disciplines are clear, we start with two

3 OECD, *Divided We Stand: Why Inequality Keeps Rising* (Paris: OECD, 2011).
4 Due to lack of space, we cannot discuss the reasons why globalization creates inequalities and undermines states' redistributive capacities. For an entry point to the relevant literature, see e.g. ibid., chapter 2.

preliminary sections. The first of these presents a primer on taxation that serves to delineate redistribution from other objectives of fiscal policy. The second section sets out the relation between one's theory of (global) justice and the role of fiscal policy in realising the ideal of justice in question. We then, in the third section, analyse the impact that globalisation has on this relation between justice and fiscal policy. In this central part of the article, we introduce and defend the conditional subsidiarity principle for redistribution under multi-level governance. Finally, in Section 4, we ascertain the implications of this principle for two global taxation proposals that have been put forward in recent years.

1 A primer on taxation

Before thinking about redistributive taxation in a global setting, it is useful to rehearse a few preliminary points that apply to taxation in general, that is, independently of the level of governance. Three questions are addressed: Why do we tax? What do we tax? And who taxes?

Why do we tax? Three central goals of taxation have been identified.[5] First, taxes raise revenue to finance government spending. Taxing and spending serve an *allocative* function focused on those areas where market allocation does not lead to efficient results, including the provision of public goods, addressing externalities, competition policy, etc.[6] Of course, it will often be controversial in how far government intervention actually serves those purposes. The decision ought to be made democratically. Second, taxes represent an instrument to *redistribute* income and wealth to promote the conception of social justice that has been chosen through the democratic process. Note that the revenue and the spending side contribute to redistribution. The progressivity or regressivity of a fiscal regime can only be evaluated by taking into account both. Third, fiscal policy is traditionally used to *stabilize* and smooth the business cycle by tightening policy during boom years and pursuing expansionary policies during economic busts. This third goal of fiscal policy will only play a secondary role in the argument of this article.

5 Musgrave, Richard A., and Peggy B. Musgrave, *Public Finance in Theory and Practice* (New York: McGraw-Hill, 1989).

6 Note that this allocative function includes the provision of the necessary legal infrastructure of markets (property rights, judicial review etc.), which can itself be understood as a public good. See North, Douglass C., *Structure and Change in Economic History* (New York: Norton, 1981).

What do we tax? The elements of the modern tax base can be described in different ways.[7] For the purposes of this article, we will classify taxes according to the direct taxes on three factors of production – land, labour, and capital. A tax can be levied both on the flow of income generated – a capital gains tax, for example – and on the stock of the factor of production in question – a wealth tax, for example. Once again, this article posits that the particular choices of what should be taxed are to be deferred to the democratic process. One obvious desideratum for any tax system is that it should have effective control over the various elements of its tax base. This aspect will play a central role in our argument.

Who should tax? The objectives of taxation can be pursued at different levels of governance. Based on public economics alone, we can only give a partial response to the question of which level it should be. The part that public economics can speak to concerns the first goal of taxation, its allocative function. The power to tax in order to provide public goods should ideally be situated at the level of government that best reflects the reach of the benefits provided and burdens imposed. This "principle of fiscal equivalence"[8] requires that all beneficiaries of certain government activities can be made to share the costs. It is a condition for an efficient provision of public goods. Normatively speaking, the principle ensures that those subject to the rules are also their authors. The question of which group of people needs to be subjected to the rules depends on the phenomenon at hand. While it makes sense to finance garbage collection through municipal taxes, for instance, in other cases either the mobility of a factor of production – capital, for example – or the externalities of an activity – emitting pollutants, for example – call for the public policy response to be shifted to a higher level of governance. Fiscal equivalence is achieved if the power to tax is subject to the *principle of subsidiarity* that requires a government function to be located at the lowest possible level that includes both the beneficiaries and cost bearers. This principle is attractive because it combines democratic accountability (inclusion of all affected interests and closeness of decision-makers and citizens) and efficiency (coincidence of benefits and costs).[9]

By contrast, public economics on its own cannot give us a satisfactory answer to the question of who should tax when it comes to the second goal of taxation, that is, redistribution. Here, the principle of subsidiarity needs to be

7 For an overview, see Musgrave and Musgrave, *Public Finance in Theory and Practice* (Part V).
8 Olson, Mancur, "The Principle of 'Fiscal Equivalence': The Division of Responsibilities among Different Levels of Government", *American Economic Review*, 59, 2 (1969): 479–87.
9 Oates, Wallace E., *Fiscal Federalism* (New York: Harcourt Brace Jovanovich, 1972).

complemented with a normative foundation that justifies why redistribution should take place at a certain level of governance rather than another. Whereas in the allocative context, the principle of subsidiarity can appeal to functionalist considerations and hence seems to act as a stand-alone principle,[10] this move is not available in the redistributive context. As we shall see in the next section, the normative foundation subsidiarity requires in the redistributive context is a theory of (global) justice.[11]

A closer look at the present section reveals a hierarchical order between the three questions discussed. The question of why we tax is more fundamental in nature than the other two. The above considerations on the issue of who should tax, in particular, clearly show that responding to this question inevitably sends us back to the first question of why we tax. A satisfactory answer to the question of why we tax requires a theory of justice, particularly in the context of redistribution. It is to this normative part of the puzzle that we now turn.

2 Justice, redistribution, and feasibility

Viewed through the lens of theories of justice, the questions of the level of governance at which redistribution should occur, and why, appear straightforward. After all, it is precisely the point of a theory of justice to determine the relative benefits and burdens of different individuals and groups in society. Therefore, the normative case for redistribution at any given level of governance flows directly from the theory of justice one holds.

To illustrate, consider the following non-comprehensive list of theories of global justice and their implications for fiscal transfers at different levels of governance. First, take a cosmopolitan theory of justice that proposes a number of egalitarian principles of justice among all people in virtue of their common humanity[12]; second, take a left-libertarian theory that requires equal distribution

10 This is not always true. For example, decisions about the level of governance at which health or education policies – and hence their funding through the tax system – should be situated are also dependent on normative premises. Against this background, the difference between the allocative and the redistributive context turns out to be one of degree. In the redistributive context, subsidiarity requires "thicker" normative premises, whereas in the allocative context it can rely on relatively "thin" ones.

11 For the idea that "subsidiarity is secondary to general principles of justice", see also Gosepath, Stefan, "The Principle of Subsidiarity", in *Real World Justice*, ed. Andreas Follesdal and Thomas Pogge (New York: Springer, 2005), 157–70, p. 170.

12 See e.g. Caney, Simon, *Justice Beyond Borders: A Global Political Theory* (Oxford: Oxford University Press, 2006).

of natural resources, or the benefits thereof, among all human beings.[13] Both of these normative positions have in common that they require not just supranational coordination, but a global fiscal apparatus of substantial cross-border taxes and transfers to realise their ideal of justice. Third, take a statist theory of justice that holds that the coercive framework of the state is a necessary condition for the existence of egalitarian principles of justice[14]; fourth, take another flavour of the statist position that sees reciprocal provision of certain basic public goods as a necessary condition for the existence of egalitarian principles of justice.[15] For both of the latter views, there may be humanitarian duties of assistance across borders, but there are no sufficiently thick principles of global justice to warrant the creation of a global fiscal apparatus. While even these views might call for some level of supranational coordination, they will stop short of substantial direct redistribution at the supranational level. On the spectrum of theories of global justice we have just set out, a number of intermediate positions are possible, too.

This characterisation obviously does not do justice to the various positions invoked, but the important point in the present context is to establish that the answer to the question of who should redistribute flows directly from one's theory of global justice.

Now, consider the following observation. If the principal level of political decision making is situated at a lower level of governance compared to the scope of redistribution that one's theory of justice calls for, this asymmetry creates a considerable *political* obstacle to the realisation of the theory of justice. For example, when the state represents the locus of central political control, this poses a problem for the implementation of, say, a cosmopolitan theory of justice that calls for substantial redistribution beyond the state. This is precisely the predicament encountered by the strategy described in the introduction in response to global inequalities. Attempting to meet global inequalities with global tax and transfer mechanisms is an effective proposal in the context of ideal theory, that is, when agents are motivated to respect the demands of justice placed upon them. In non-ideal circumstances, however, this strategy faces a serious feasibility constraint. A situation where the theoretical demands

13 See e.g. Vallentyne, Peter, "Left-Libertarianism: A Primer", in *Left-Libertarianism and Its Critics: The Contemporary Debate*, ed. Peter Vallentyne and Hillel Steiner (Basingstoke: Palgrave, 2000), 1–20.

14 See e.g. Blake, Michael, "Distributive Justice, State Coercion, and Autonomy", *Philosophy and Public Affairs*, 30, 3 (2001): 257–96.

15 See e.g. Sangiovanni, Andrea, "Global Justice, Reciprocity, and the State", *Philosophy & Public Affairs*, 35, 1 (2007): 1–39.

of justice are global but the politics remain steadfastly national is a prime example for such a non-ideal context. Unless the citizens of the transferring state have internalized the theory of justice that calls for the transfer, the fact that the decision to pay the transfer lies with them while the potential recipients do not have a say means that the transfer is very unlikely to happen.

Three comments need to be added here. First, the existence of this feasibility constraint does not weaken the normative case for redistribution as such. While this would be the case if the feasibility constraint in question were of a "hard" kind, for example if it were physically impossible to meet the demand of justice, a "soft" feasibility constraint does not undermine the duty in question.[16] The political feasibility constraint in the present context is "soft" in the sense of socially contingent. Arguably, a cultural change could bring about a world in which the asymmetry between national politics and global redistribution is overcome. In this world, individuals have internalised the theory of global justice in question and vote for redistribution beyond their borders.

Second, if such a world seems remote from our standpoint today, this does not weaken the normative case for redistribution as we just pointed out, but it might modify the content of the duty it engenders. As Gilabert has pointed out in his innovative work on *dynamic duties*, if a feasibility constraint prevents us from discharging duty X at time t_1, we may still have a duty Y to do something that will increase our likelihood of being able to discharge duty X at time t_2.[17] For instance, if the realisation of cosmopolitan duties of justice that call for cross-border redistribution is beyond our reach today, we may still have a duty to change the political environment such that their realisation will become possible in future.

Third, theories of justice that aspire to changing the world for the better should take feasibility constraints seriously. If they do not, they open themselves up to the criticism of being utopian. Accepting the significance of feasibility constraints has practical consequences. Notably, if a duty of justice to redistribute can be discharged in different ways, we should favour the actions and policies that face the weakest feasibility constraints.

We now have all the building blocks from both political philosophy and public economics in place to put them together. The next, core section of the article will ask whether there are any general statements that can be made about the level of governance at which redistributive policies should be implemented under conditions of globalisation. In pursuing this inquiry, we do not

16 For this distinction between different kinds of feasibility constraints, see section 4.2 of Gilabert, Pablo, *From Global Poverty to Global Equality* (Oxford: Oxford University Press, 2012).
17 Ibid., section 4.6.

presuppose any particular theory of global justice. On the contrary, we explicitly aim to arrive at conclusions that hold independently of the theory of global justice one might endorse.

3 The effect of globalisation on inequality

How does the phenomenon of globalisation complicate the accounts from tax theory and from theories of global justice we have presented in the two previous sections? What should be our normative and political response to the distributive and institutional effects of globalisation? To answer these questions, we will first briefly illustrate a set of problems globalisation causes in the fiscal context. In particular, we will show that certain aspects of globalisation do indeed undermine the redistributive capacity of the state under the *status quo* (Section 3.1). Second, we will show that this effect of globalisation is contingent on the regulatory framework. There are alternative regulatory frameworks available, under which globalisation *does not* undermine the redistributive capacity of the state (Section 3.2). While the necessary reforms to put in place these regulations do require supranational *cooperation*, they do not imply *direct redistribution* at the supranational level. On this basis, we will derive the conditional subsidiarity principle for redistribution under multi-level governance (Section 3.3).

There are two motivations for why one may want to advocate shifting redistributive policies to a higher level of governance. The first of these has already been discussed in Section 2. If you hold a theory of justice that calls for redistribution beyond the boundaries of the principal level of political decision-making – e.g. if you are a cosmopolitan living in a statist world – then you will advocate rectifying this asymmetry by shifting fiscal competences up the ladder of governance. Call this the normative motivation.

The second reason to advocate shifting redistributive policies to a higher level of governance is invoked by the common approach to globalisation mentioned in the introduction. Increasing economic interconnectedness, so the argument runs, tends to both increase inequalities and undermine the redistributive capacity of the state. Because the state can no longer effectively fulfil its redistributive role, this task has to be handed to a supranational body. Call this the functionalist motivation. This argument presents us with a version of the subsidiarity argument in the redistributive context. Note that this response to globalisation is subject to the political feasibility constraint discussed in Section 2. Shifting redistributive competences up the ladder of governance while the state remains the prime locus of political decision-making is a long shot.

If this analysis of the impact of globalisation on redistribution were correct, then we would indeed have to take that long shot. Yet, we submit that this analysis is inadequate. Its error lies in the empirical premises. Is it really the case that the state can no longer effectively play its redistributive role? What if it could? In the next two sections, we will show that, in the realm of taxation, the impact of globalisation on redistribution is in fact contingent on the regulatory framework that the forces of globalisation are subject to.

3.1 Globalisation and national tax policies under the regulatory status quo

In fiscal policy, globalisation manifests itself in the form of tax base mobility. Once national economic borders are open, tax bases are in principle free to leave. One reason for economic agents to shift tax bases elsewhere is to reduce their tax bill. This in turn provides incentives for governments to offer tax savings to such mobile factors. The result will be tax competition, that is, the interactive tax setting by independent governments in a non-cooperative, strategic way.[18] Among the three tax bases introduced in Section 1 – land, labour, and capital – tax competition occurs primarily with respect to the most mobile of the three, that is, capital. In what follows we will very briefly describe how capital tax competition works, and what its distributive consequences are.[19]

We can distinguish between "virtual" and "real" tax competition. Under virtual competition taxpayers do not actually have to move to the country with the lower or zero tax rates, it is only their capital that changes jurisdiction. They may enjoy the public goods provided in high-tax countries but pay the taxes of low- or zero-tax countries – they behave as free riders. The corresponding behaviour of governments trying to attract foreign tax base has been labelled "poaching" by the OECD.[20] Two kinds of poaching are relevant. First, in the area of portfolio capital, so-called tax havens have low or zero tax rates. More importantly, they offer strict bank secrecy rules as well as certain legal

18 Wilson, John D., and David E. Wildasin, "Capital Tax Competition: Bane or Boon", *Journal of Public Economics*, 88, 6 (2004): 1065–91.

19 For a more detailed discussion of these issues, see e.g. Dietsch, Peter, and Thomas Rixen, "Tax Competition and Global Background Justice", *Journal of Political Philosophy*, Article first published online: 23 April 2012, DOI: 10.1111/j.1467-9760.2012.00419.x, section I and Rixen, Thomas, *The Political Economy of International Tax Governance* (Basingstoke: Palgrave/ Macmillan, 2008), chapters 4, 6 and 8.

20 OECD, *Harmful Tax Competition: An Emerging Global Issue* (Paris: OECD, 1998).

constructs such as trusts that enable individuals to hide their ownership vis-à-vis the tax administrations in their state of residence, where they are liable to tax. Estimates of the wealth hidden in tax havens are as high as 21–32 trillion USD.[21] Taxpayers' behaviour in these cases constitutes illegal tax evasion. However, since under the current international tax rules there is no obligation on governments to report foreign wealth held in their country to the investor's home country, unless the home country explicitly requests information and presents specific initial evidence of tax evasion, this kind of competition to attract tax evaders' money is possible.[22]

Second, governments compete for so-called paper profits. Through various techniques, such as manipulating transfer prices (especially of intangible assets) and thin capitalization, multinational enterprises (MNEs) can assign profits made in high-tax countries to their subsidiaries in low-tax countries without relocating real business activity. Such "tax planning" of MNEs generally constitutes legal tax avoidance and is possible because the current system of taxing multinational enterprises is based on the principle that national subsidiaries of MNEs prepare their own tax accounts as if they were independent firms (separate entity accounting). All empirical investigations into this issue come to the same conclusion: the transfer of taxable profits is very sensitive to taxation, companies make ample use of these possibilities, and governments compete for the assignment of paper profits by lowering their nominal corporation tax rates.[23]

By contrast, under "real" tax competition, taxpayers actually have to relocate to enjoy lower taxes. Countries compete for foreign direct investment (FDI) in the form of real business activity, that is, they try to influence the location decisions of MNEs. This practice may be called luring. Business decisions depend on various factors such as the level of education, the costs of labour, and the quality of infrastructure. But the effective tax burden also plays a role. Empirical studies come to the conclusion that lowering effective tax rates

21 Tax Justice Network (TJN), "The Price of Offshore Revisited. New Estimates for Missing Global Private Wealth, Income, Inequality and Lost Taxes", http://www.taxjustice.net/cms/upload/pdf/Price_of_Offshore_Revisited_120722.pdf (accessed 14 August 2012).

22 In fact, until recently tax havens were not even obliged to respond to requests for information. Following the financial crisis, the G 20 and OECD pressured tax havens to accept a new standard of information exchange where the requested state has to provide information, as long as the request is specific enough. See OECD, "Tax Transparency 2011. A Report on Progress", 2011. http://www.oecd.org/tax/transparency/48981620.pdf (accessed 18 February 2014).

23 De Mooij, Ruud A., and Sjef Ederveen, "Corporate Tax Elasticities: A Reader's Guide to Empirical Findings", *Oxford Review of Economic Policy*, 24, 4 (2008): 680–97.

increases the inflow of FDI.[24] Such real competition for FDI is possible because under the current system of international taxation the corporation tax on the profit earned is often the only tax due on that profit.[25]

Both virtual and real tax competition have consequences for public finances. In OECD countries, nominal corporate tax rates have fallen from an average of 50% in 1975 to 25.7% in 2010. Over the same period, nominal top personal income tax rates have fallen from 70% to 41.4%.[26] These rate cuts were refinanced by broadening the bases on which taxes are applied ("tax cut cum base broadening"). As a result, tax revenue as a percentage of GDP remained stable, and the capacity of OECD governments to provide public goods has not been compromised.

The situation is different in developing countries, largely because they lack the administrative capacity to pursue revenue-stabilising policies.[27] A significant part of the revenue loss is directly due to the shifting of paper profits. One study estimates the annual revenue loss of developing countries from transfer pricing to be US $ 160 billion.[28] In other words, globalization and tax competition make it harder for developing countries to promote allocative efficiency through the provision of public goods. Their experience is closer to the race-to-the-bottom predicted by economic theory.

While the evidence on the impact of tax competition on the allocative function of taxation varies with the stage of development of countries, the verdict with respect to the *distributive function* is much clearer. The "tax cut cum base broadening" policy affects the distribution of the tax burden among different kinds of taxpayers. For one, there is an effect within the business sector: highly profitable MNEs benefit, while nationally organized small- and medium-sized enterprises are more heavily burdened. Second, the tax burden is shifted from capital to labour. This is also visible in the general trend to increase

24 De Mooij and Ederveen, "Corporate Tax Elasticities: A Reader's Guide to Empirical Findings".

25 If all countries operated a credit system without deferral, then tax competition among source countries would be dampened, see e.g. Zodrow, George R., "Capital Mobility and Source-Based Taxation of Capital Income in Small Open Economies", *International Tax and Public Finance*, 13 (2006): 269–94.

26 See OECD Tax Database at http://www.oecd.org/tax/tax-policy/tax-database.htm (accessed 18 February 2014).

27 Keen, Michael, and Alejandro Simone, "Is Tax Competition Harming Developing Countries More Than Developed?" *Tax Notes International*, 34, 28 June (2004): 1317–25.

28 Christian Aid, *Death and Taxes: The True Toll of Tax Dodging* (London, 2008), http://www.christianaid.org.uk/images/deathandtaxes.pdf (accessed 18 February 2014).

indirect taxes, such as consumption taxes. Last but not least, due to the backstop function of the corporate for the personal income tax a lower corporate tax rate often spills over into a flatter personal income tax structure.[29] In sum, governments feel compelled to pursue less redistributive polices than they would otherwise have pursued. These trends hold for both developed and developing countries and show that, indeed, globalisation undermines the redistributive capacity of the nation state under the current regulatory framework.

While less clear cut, a case can also be made that tax competition undermines the capacity of national governments to effectively exercise the stabilization function. The various opportunities for tax arbitrage contribute to the waves of hot money rolling around the globe in search of the best return on investment.[30] The mobility of this hot money exacerbates investment cycles. As a result, we see more volatile business cycles with – at least in the case of developing countries – fewer means available to smooth them.

To conclude, the lack of effective tax authority over capital that is induced by globalisation can be shown to undermine all three traditional functions of taxation at the national level. In addition, as developing countries are hit harder by the forces of tax competition, it also increases inequality across countries.

3.2 An alternative regulatory framework for international taxation

Elsewhere, we have put forward a regulatory framework designed to regulate tax competition and to address both cases of poaching and of luring.[31] Here, we will not set out this framework in detail, but limit ourselves to a brief summary to show that the consequences described in the previous section are indeed contingent on the existing rules of international taxation. The proposed regulatory change could restore the redistributive capacity of nation states and also address the inequalities between countries to some extent.

29 Loretz, Simon, "Corporate Taxation in the OECD in a Wider Context", *Oxford Review of Economic Policy*, 24, 4 (2008): 639–60, Schwarz, Peter, "Does Capital Mobility Reduce the Corporate-Labor Tax Ratio?" *Public Choice*, 130, 3–4 (2007): 363–80, Ganghof, Steffen, and Philipp Genschel, "Taxation and Democracy in the EU", *Journal of European Public Policy*, 15, 1 (2008): 58–77.

30 For an analysis of capital mobility in this light, see Eichengreen, Barry, "The Global Gamble on Financial Liberalization: Reflections on Capital Mobility, National Autonomy, and Social Justice", *Ethics & International Affairs*, 13, 1 (1999): 205–26.

31 See Dietsch and Rixen, "Tax Competition and Global Background Justice".

We call for two principles to regulate tax competition. First, we argue that *all natural and legal persons should be liable to pay tax in the state of which they are a member*. Bracketing various technical questions surrounding the definition of membership, this *membership principle* is compatible with the internationally accepted, but laxly enforced, principles of residence taxation for individuals and taxation at source for multinational enterprises (MNEs). In effect, the membership principle rules out all forms of poaching.

For individuals, this means that they cannot be resident in one country, and shift part of their tax base to another country without paying tax on it at home. A regulatory reform that would achieve this, which is in fact being implemented by the European Union's saving tax directive, is automatic exchange of information about capital holdings between countries.

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. A system that would achieve this is unitary taxation with formula apportionment.[32] Under this policy, corporate accounts are consolidated internationally, before each country gets assigned a share of the profits to tax on the basis of a previously agreed formula. Typically, the formula in question will include assets, payroll, and sales. The European Union is currently debating the introduction of such a scheme.

Second, and more controversially, we argue that some cases of tax competition for FDI are problematic from a normative perspective, too. Our second principle, the *fiscal policy constraint*, states that tax competition for FDI is illegitimate when it *both is strategically motivated and leads to a reduction in the aggregate level of fiscal self-determination of other states*.[33] In other words, some cases of luring should be prohibited. To implement this principle, we propose to install a judicial review of tax policies, which could be organised analogously to the dispute settlement procedure of the World Trade Organization. Any state that thinks that the tax policies of another state violate the principle could bring the case before a dispute settlement body that would have the competence to make a final decision.

32 See Graetz, Michael J., *Foundations of International Income Taxation* (New York: Foundation Press, 2003), 400–35.

33 Both elements of the fiscal policy constraint – the strategic intention and the autonomy-reducing effect – are of equal importance. They have to be jointly satisfied for a case of luring to be considered illegitimate. Providing precise criteria to operationalise the fiscal policy constraint lies beyond the scope of this article and will require the collaboration of international tax lawyers. For more details on this issue, see Dietsch and Rixen, "Tax Competition and Global Background Justice".

To put these principles and the reforms they entail into practice, we call for the creation of an International Tax Organization (ITO), whose task it would be to enforce the respect of these principles, to act as a dispute settlement body in case of violations, and to provide a forum for discussing the harmonization of fiscal ground rules across countries. Note that none of this implies harmonization of tax *rates* on capital across countries, nor does it entail that the ITO should be given the power to levy taxes itself. On the contrary, fiscal sovereignty stays in the hands of states, while the purpose of the ITO is to ensure that states can exercise this sovereignty more effectively than under the tax competition that marks the *status quo*.

In what sense does this proposal promote effective tax authority over capital? First, ruling out poaching does not limit the mobility of capital, but it imposes the condition that the capital cannot be separated for tax purposes from the membership of its owner in a particular state. In effect, this means that the reach of the fiscal authority of the state where the taxpayer is a member does not stop at the border. Second, ruling out some instances of luring offers an additional layer of protection for the effective taxation of capital. Under certain conditions, states have a legitimate complaint against the fiscal policies of other states that have triggered "real" capital flight.

Note that even when both of our principles are respected, the tax authority of states over capital is not absolute. Under capital mobility, different democratic choices about tax structures in different states are bound to generate fiscal externalities. However, the proposed regulation of tax competition reduces these externalities to a minimum. Tax authority over capital is as effective as it can be under conditions of globalisation.

3.3 The conditional subsidiarity principle for redistribution

Someone might raise the following objection to our reasoning in the two previous sections. We object to supranational tax and transfer schemes on feasibility grounds, but then call for institutional reforms that also require supranational cooperation. Is the latter not subject to the same feasibility constraints? In this section, we will first respond to this objection and subsequently attempt to draw a general lesson about redistributive policies.

Our response to the objection relies on the distinction between supranational redistribution on the one hand and other forms of supranational cooperation that do not involve direct redistribution on the other. As we have argued in Section 2, tax and transfer arrangements that amount to direct redistribution between states face important feasibility constraints *ceteris paribus*. Whether this direct redistribution be administered by a supranational authority with an independent right to tax, or whether it be administered nationally, there is strong resistance to such proposals given the current motivational and political landscape.

Arguably, the feasibility constraints on certain kinds of supranational cooperation, as opposed to direct redistribution, are weaker. Consider the regulation of tax competition proposed in the previous section as an example. Would it not be in the interest of all states to have their effective fiscal sovereignty protected by the principles we propose? The objector might remain sceptical at this stage. After all, regulating tax competition, like any institutional reform, will produce winners and losers. Predictably, tax havens will be adamantly opposed to our reform proposals. So why should it be more feasible to pass this reform than to push through a form of direct redistribution?

Granted, regulating tax competition does not represent a mutually advantageous form of supranational cooperation. There will indeed be winners and losers. However, the following considerations lead us to believe that this regulation compares favourably with direct redistribution as far as feasibility is concerned. First and foremost, institutional reform requires a thinner normative consensus than redistribution at the supranational level. The latter presupposes that a sufficient number of individuals have internalised the theory of justice that underpins the required redistribution to make it politically feasible. By contrast, the former merely requires consensus on the idea that all states should have effective control over their tax base. Even if disagreement exists about what effective control entails, this is not as ambitious a goal as the consensus on a theory of justice.

Second, while some tax havens would clearly lose out under the proposed reform, for many states the question of whether they would win or lose in the aggregate is less clear-cut. Take the United States. While the United States figures high on lists of tax havens due to, for example, the tax treatment of corporations in the State of Delaware, tax competition also contributes to its sizable tax gap.[34] From the latter perspective, the United States clearly has an interest to support our proposed reform.

Third, once a rudimentary coalition for reform exists, it is possible to apply pressure on other states to come on board an institutional reform like regulating tax competition, in the extreme through economic sanctions. In the context of redistribution, applying such pressure seems more difficult. Even though the moral obligation of the state that poaches tax base from others covers both promoting institutional reform and redistribution, such states are more likely to appeal to their sovereignty in the latter case and argue that no one has a right to interfere with how they spend “their” tax receipts.

34 See http://www.irs.gov/uac/The-Tax-Gap (accessed 15 January 2012).

For all these reasons, we think that the feasibility constraints facing institutional reform are weaker compared to those facing redistribution at the supranational level.[35] Importantly, note that while institutional reform of the kind proposed in Section 3 does not explicitly aim at redistribution, it nonetheless has egalitarian side-effects. The regulation of tax competition would significantly curtail the inegalitarian impact this phenomenon has. It would do so both at the *national* level by restoring the redistributive capacity of the state and at the *global* level by ensuring that developing countries get a share of the global capital tax revenues, too.[36] Would such a reduction in global inequalities be incompatible with a statist theory of global justice? No, because it would be achieved by regulatory means rather than through direct redistribution. On the contrary, statists should welcome the restoration of fiscal sovereignty envisaged by our proposed institutional reform.

For redistributive policies up to a certain threshold, we have a choice between two approaches. We can either go for direct redistribution at the supranational level or we can promote institutional reform that will have an equivalent redistributive effect partially by reversing some of the inegalitarian effects of the current way the forces of globalisation are regulated and partially by restoring the redistributive capacity of the state. On the basis of the feasibility considerations just discussed, we should go for the institutional reform option in such cases. The same may be true in other policy areas – monetary or trade policy for instance – that we have not discussed in this article.

This brings us back to the question we started out with. Can we make any general statements about the level of governance at which redistributive policies should be pursued under multi-level governance? Based on the argument developed in this section, we put forward the *conditional subsidiarity principle for redistribution*: When the case for supranational redistribution arises from the alleged incapacity of states to redistribute, our first instinct should be to try and restore this capacity through institutional reform before turning to direct supranational redistribution.

It is important to emphasise once again that this priority for institutional reform is justified exclusively on grounds of feasibility. This article has only argued for this principle in detail in the context of taxation. However, we have

35 An anonymous referee for this article stated that he was "not convinced that a regulation of international tax competition will easily win the support of many countries." We do not defend this claim. We argue that such regulation will *more easily* win the support of many countries than a scheme of direct redistribution between them.

36 See Section 3.1.

reason to think that parallel arguments apply in other policy areas. Due to space limitations, we cannot engage in this exercise here.

4 Proposals for global taxation and the subsidiarity test

In the previous section, we have argued for a conditional principle of subsidiarity under multi-level governance. Before calling for redistribution at the supranational level, we should use regulation to check the forces of globalisation that make it harder to redistribute at the national level. While doing so requires *supranational regulation*, it stops short of *direct supranational redistribution*. While in theory producing the same distributive outcome, the regulatory approach favoured here is subject to a weaker feasibility constraint than direct supranational redistribution.

In this last section, our goal is to see whether some of the existing policy proposals for global taxation pass the subsidiarity test as formulated above. Due to space constraints, we can only discuss two reform proposals here. We have selected the global resource dividend (GRD) as well as the financial transaction tax (FTT), partly because they have received widespread attention, and partly because they allow us to present some interesting distinctions when applying the subsidiarity test. We should add an important disclaimer up front. The discussion that follows cannot do justice to the nuances of the policy proposals at hand. The sole objective here is to adequately present those features that are necessary to see whether they pass the subsidiarity test or not.

4.1 A global resource dividend

The GRD "is based on the idea that the global poor own an inalienable stake in all limited natural resources."[37] According to Pogge as one of its principal advocates, the status quo is morally problematic not just because the poor do not have access to their inalienable stake, but because our economic and legal institutions deny them this access. The "uncompensated exclusion [of the poor] from the use of natural resources"[38] grounds a negative duty for those who uphold these institutions and benefit from them to remedy this situation.

37 Pogge, Thomas, *World Poverty and Human Rights* (Cambridge: Polity Press, 2008), 202.
38 Ibid., p. 205.

Pogge stops short of an egalitarian argument concerning the ownership of or benefits from natural resources, but instead makes the case for a minimal negative duty.[39] "Proceeds from the GRD are to be used toward ensuring that all human beings can meet their own basic needs with dignity."[40] Pogge explicitly presents the modesty of his proposal as a concession to political feasibility.[41] Moreover, he qualifies the GRD as a remedial measure that needs to be complemented by ideas "about how the injustice of the global order might be diminished through institutional reforms that would end the need for such remedial measures."[42] While Pogge delegates the technical details of the GRD to international lawyers and economists, the potential implementations he discusses indicate in what sense we are talking about a global tax here. As an example, he examines "the likely effects of a $3 per barrel GRD on oil extraction."[43] Such a harmonised levy, even if it were to be administered nationally, clearly requires states to surrender aspects of their fiscal sovereignty and amounts to direct redistribution at the supranational level.

We contend that the GRD is unlikely to pass the subsidiarity test. To the extent that the GRD calls for direct cross-border redistribution from the (often illegitimate) owners of resources, the extractive industries and end consumers of those resources[44] to the global poor, the GRD faces feasibility constraints that are relatively strong compared to those faced by a series of institutional and regulatory reforms. Our proposed regulation of tax competition is one example for such a regulatory reform. In the context of natural resources itself, Leif Wenar's work on restoring popular resource sovereignty over natural resources represents another.[45] Wenar calls for trade embargos against regimes that use natural resources for personal enrichment. While the indirect, inequality-reducing impact of his proposal may be equivalent or even more important than the

39 Some commentators see a tension between Pogge's earlier cosmopolitan egalitarianism and this minimalist position. See for instance Kelly, Erin I., and Lionel K. McPherson, "Non-Egalitarian Global Fairness", in *Thomas Pogge and His Critics*, ed. Alison M. Jagger (Cambridge: Polity Press, 2010), 103–22.
40 Pogge, *World Poverty and Human Rights*, p. 203.
41 Ibid., pp. 210–14.
42 Ibid., p. 30.
43 Ibid., p. 211.
44 While the tax will presumably be levied on the extractive industries, part of the burden will be passed on to end consumers, and may also depress prices for the rights of exploitation that resource owners can charge. The exact incidence of the tax will depend on the elasticities of supply and demand.
45 See Wenar, Leif, "Clean Trade in Natural Resources", *Ethics & International Affairs*, 25, 1 (2011): 27–39.

redistributive effect of a GRD, it does not require the kind of direct redistribution that we know to be subject to particularly strong feasibility constraints.

In sum, whereas Pogge in the above quote characterises the relationship between the redistribution of the GRD and regulatory reform as *complementary*, our argument claims that from the perspective of political feasibility, regulatory reform should receive *priority*. None of this questions the moral validity of the GRD as a policy proposal, but it suggests that it is not the best place to start.

4.2 A financial transaction tax

In the case of an FTT, we shall see that it is more ambiguous whether or not it passes the subsidiarity test. The idea of the FTT was first launched by the economist James Tobin in 1972. Following the collapse in 1971 of the Bretton Woods regime of fixed exchange rates that had governed the post-war period, Tobin asserted that the new regime of flexible exchange rates "does not satisfactorily solve all the problems."[46] In particular, and it is worth quoting Tobin at length here,

> [u]nder either exchange rate regime the currency exchanges transmit disturbances originating in international financial markets. National economies and national governments are not capable of adjusting to massive movements of funds across the foreign exchanges, without real hardship and without significant sacrifice of the objectives of national economic policy with respect to employment, output, and inflation. … Likewise, speculation on exchange rates, whether its consequences are vast shifts of official assets and debts or large movements of exchange rates themselves, have [sic!] serious and frequently painful real internal economic consequences.[47]

These considerations underpin Tobin's case for throwing "sand in the wheels" of international financial markets. In its original formulation, what has become known as the Tobin tax referred to "an internationally uniform tax on all spot conversions of one currency into another, proportional to the size of the transaction."[48] Tobin muted the possibility of a 1% tax. Contemporary versions of the tax usually call for a lower rate, but frequently propose the extension of the tax base to include other financial instruments "such as derivatives and other hedge products."[49] The policy objectives of the FTT thus conceived were a "modest

46 Tobin, James, "A Proposal for International Monetary Reform", *Eastern Economic Journal*, 4, 3–4 (1978): 153–59, p. 158.
47 Ibid., p. 154.
48 Ibid., p. 155.
49 Wachtel, Howard, "Tobin and Other Global Taxes", *Review of International Political Economy*, 7, 2 (2000): 335–52, p. 340.

national autonomy in monetary and macroeconomic policy"[50] and, closely related, promoting financial stability by reducing the volatility on foreign exchange markets.

When defended as serving these two objectives, the FTT *does* pass the subsidiarity test. If one accepts that a return to capital controls is not desirable,[51] then the phenomenon of hot money swirling around the globe plausibly represents a constitutive facet of globalisation. Since this phenomenon cannot be met by unilateral national regulation, supranational action is required. By taxing capital flows of various kinds, the FTT reduces the corrosive impact of hot money in the international economy. It is an instrument of *regulating* financial markets.

However, this is not the end of the story. Many contemporary advocates of an FTT defend the policy on different grounds. Commenting on the idea again in 1996, Tobin himself pointed out that the tax "has been discovered by a non-economics constituency, those looking for ways to finance the United Nations and other international agencies when the demands upon them are exploding and the member nations are stingy in supporting them."[52] There is now "a growing constituency of advocates of the tax for its revenue-raising potential, not its incentive effects."[53] When conceived in this way, the FTT is likely – depending on how its proceeds are spent – to become a tool of direct redistribution at the supranational level. Let us call this version of the idea FTT_R, where R stands for redistribution.

For the reasons set out in Section 2 of this paper, FTT_R faces stronger political feasibility constraints than its cousin that is justified along the original Tobinian lines. It also faces stronger feasibility constraints than other, institutional reforms like for instance the instauration of minimum investment periods for stocks and other securities or, again, the regulation of tax competition proposed in Section 3. Therefore, FTT_R fails the subsidiarity test. To conclude, the question of whether the FTT passes the subsidiarity test depends on the policy objective it is designed to serve.[54]

50 Eichengreen, Barry, James Tobin, and Charles Wyplosz, "Two Cases for Sand in the Wheels of International Finance", *The Economic Journal*, 105, 428 (1995): 162–72, p. 163.
51 See for instance Edwards, Sebastian, "How Effective Are Capital Controls?" *NBER Working Paper No. 7413*, November 1999 (1999).
52 Tobin, James, "A Currency Transactions Tax, Why and How", *Open Economics Review* 7 (1996): 493–99, p. 493.
53 Ibid., p. 497.
54 This opens the door for political instrumentalisation of the grounds on which the FTT is defended, but this complication is bracketed here.

5 Conclusion

We have argued that we should think twice before calling for direct redistribution at the supranational level to compensate for reduced redistribution within states. Not because these calls for justice lack normative foundation, but because they face serious feasibility constraints. Instead, the political focus should lie on regulatory reforms that restore the capacity of states for internal redistribution and, as a by-product, lead to indirect redistribution between states, too. While such reforms require supranational cooperation, they do not require direct supranational redistribution, which makes them more feasible politically. This priority for redistribution both through regulatory reform and through national fiscal policy has been expressed in the conditional subsidiarity principle for redistribution.

We have illustrated this argument with an investigation of international taxation. Here, regulating tax competition would indeed shore up the effective control states have over their tax base and, by eliminating the pressure to favour regressive fiscal policies, reduce inequalities both within states and across borders.

Finally, we should emphasise that this article does not imply that we should abandon the political struggle for direct supranational redistribution. Most likely, there is some level of global equality that could not be attained without it. However, up to a certain threshold of supranational redistribution, we have a choice between two ways of promoting it. This article argues we should favour indirect redistribution through institutional reform over direct redistribution to do so. The outcome will not be a world with a just distribution of income and wealth, but one with a *more* just distribution than we have now.

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