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Politicization and Institutional (Non-) Change in International Taxation[1]

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Abstract

This paper explores the institutional changes of international tax governance in response to growing politicization and contestation of international direct tax issues. I show that politicization – which is a very recent phenomenon in international taxation – results from a governance gap. The traditional setup of international tax cooperation has an unintended consequence in the form of harmful tax competition. In reaction to this problem, civil society groups have begun to question the effectiveness and fairness of the minimal international tax order, lobbying national governments and international organizations for more effective international regulation of tax issues. Thus, in contrast to existing hypotheses, societal politicization does not result from the increasing scope and authority of international institutions, but rather from the lack thereof. However, civil society demands have so far not led to institutional changes in international taxation. Instead, we can only observe indirect and incremental change, which falls short of what would ultimately be needed to address harmful tax competition effectively.

Zusammenfassung

Politisierung und institutioneller (Nicht-)Wandel des internationalen Steuerregimes

Dieses Papier untersucht den institutionellen Wandel des internationalen Steuerregimes in Reaktion auf eine zunehmende Politisierung internationaler Steuerangelegenheiten. Gesellschaftliche Politisierung, die im Bereich der internationalen Besteuerung ein sehr junges Phänomen ist, hat ihre Ursache in einer Governancelücke. Das traditionelle institutionelle Arrangement zur Vermeidung von internationaler Doppelbesteuerung hat nicht-intendierte Nebenfolgen in der Form von schädlichem und unfairem Steuerwettbewerb. Als Reaktion auf dieses Problem haben zivilgesellschaftliche Akteure den Mangel an Effektivität und Fairness skandalisiert. Sie versuchen nationale Regierungen und internationale Organisationen zu mehr internationaler Regulierung des Steuerwettbewerbs anzutreiben. Anders als in Teilen der Literatur angenommen wird, ist die gesellschaftliche Politisierung nicht das Resultat eines Zuwachses an politischem Einfluss von nicht ausreichend legitimierten internationalen Institutionen, sondern sie thematisiert im Gegenteil den Mangel an effektiven internationalen Institutionen. Die zivilgesellschaftlichen Forderungen haben bisher nicht zu institutionellen Reformen geführt. Stattdessen lässt sich lediglich indirekter und inkrementeller Wandel beobachten, der nicht ausreichend ist, um das Problem schädlichen Steuerwettbewerbs zu lösen.

Contents

Introduction

One can hardly imagine a politically more salient and contested subject than the issue of taxation. The common demand for "no taxation without representation" and the never-ending political debates over what constitutes just or fair tax policy are obvious examples for the importance of the public finances in politics, just as is the central role assigned to the adoption of national budgets in parliamentary democracies.[1]

However, tax policy has only been highly politicized within nation-states. The flipside of politicization in the national arena is the traditionally very strong de-politicization of international tax policy. Because taxes are so strongly linked to national political communities, governments have an interest in finding institutional solutions for international taxation, which preserve national sovereignty. The primary – and for many decades the sole – aim of cooperation in international taxation has been to avoid double taxation resulting from international investment and trade. National ministerial tax experts were engaged in coordinating potentially overlapping or competing tax claims. This task was considered a technically complex but nonpolitical undertaking. The resulting institutions of double tax avoidance territorially disentangle the jurisdiction to tax in a way that leaves governments free to decide over all relevant aspects of their national tax systems. Thus, tax could remain a national political affair. In the course of the last two decades, however, as a result of intensified globalization and tax competition, this system has become deficient. As a consequence international taxation has become noticeably politicized.

This politicization and the extent to which it may, or may not, have led to changes in the institutional arrangement is the subject of this paper. Its message is that even in tax policy, which can be considered a "hard case" for *international* politicization because of taxation's strong association with the nation-state, civil society actors have recently begun to voice demands of global distributive justice. However, so far they have not been able to achieve change.

In particular, I will address the following two points that are related to the hypotheses developed by Zürn et al. (2007). First, in line with the general description of

[1] Consider, for example, the following quotations: "Ideologically loaded battles over tax policy ... are the bread and butter of politics" (Murphy and Nagel 2002). "In the most integral sense the budget lies at the heart of the political process" (Wildavsky 1979, 5).

the institutional development of the post-World-War-II international order by Zürn et al. (2007, 137-8, 141-8), the sovereignty-preserving institutional construction of the international tax regime produced unintended consequences in the form of tax avoidance, evasion and tax competition. To effectively address these problems would require institutional solutions that go beyond the traditional sovereignty-preserving approach and constrain national policy choices by harmonizing at least certain aspects of national tax systems. Likewise any international agreement to such an effect must be monitored and enforced. Since this would run counter to the interests of some nation states, it could not be achieved in the traditional consensual mode of intergovernmental agreements, i.e. it would ultimately involve a supranational component.[2] However, the need for such institutional reform is not met. Rather, actors respond with incremental and indirect changes of the existing institutional arrangement. These changes involve the intensification of transgovernmental administrative cooperation and layering new institutions on top of the existing setup in order to support its viability. However, governments take great care to re-construe the rule changes in a way that is, while *de facto* violating it, at least *formally* compatible with the traditional principle of sovereignty-preserving cooperation.

Second, the lack of effective regulation of tax competition is the main reason for the politicization of international taxation. Contrary to what Zürn et al. (2007, 139-40, 149-157) hypothesize, the politicization of international taxation is *not* the result of growing influence and power of the relevant International Organizations in the field. They hypothesize that the increased influence that comes with the suspension of consensus in supranational or transnational organizations provokes a counter-reaction of civil society actors, because the organizations lack (democratic) legitimacy. In taxation, however, the story is different. It is the lack of an institution outfitted with sufficient authority to effectively regulate tax competition between countries, which leads to dissatisfaction with the status quo and, ultimately, to politicization. Rather than scandalizing a legitimacy gap of international institutions that are too influential, civil society actors criticize the *governance gap* resulting from the lack of an effective international institution.

[2] On this definition of supranationalism, see Zürn et al. (2007, 137).

It follows from this that the development of international tax policy does not correspond to the hypothesized sequence, namely, that institutional transformation towards transnationalization or supranationalization *precedes* politicization (Zürn et al. 2007, 139). In international taxation, the observed incremental change occurs *simultaneously* with politicization.

The rest of the paper is structured as follows. I first provide an overview of the development of international taxation and describe the nature of the governance gap (part 1). In part 2, I turn to the politicization of international tax issues by civil society actors and their demands for closing the governance gap. Part 3 addresses the institutional response to civil society criticism. I argue that societal concerns have so far not had an impact on intergovernmental policy-making, pre-occupied with merely incremental, path-dependent attempts at institutional reform. The governance gap is not closed. Likewise, the international organizations active in the area of tax policy only grant limited access to civil society actors.

A Brief History of International Tax Policy

Initially, the only goal of international tax policy was the avoidance of double taxation. The problem of double taxation consists in an overlap of jurisdiction to tax of a *residence state*, the country in which the recipient of international income resides, and the *source state*, where the investment was made and the income was generated. If both states were to fully tax the income, the total tax burden for the international investment would be significantly higher than for comparable national investments (see e.g. Musgrave 2006). Therefore, as early as the 1920s and 1930s, under the umbrella of the League of Nations, governmental representatives and tax experts from academia and business came together to draw up principles for a solution to the problem of overlapping tax claims.

Finding a satisfactory solution to allocating the right to tax between residence and source state proved to be difficult. There are good arguments, based on different normative assumptions, in support of both the residence and the source principle. If one adheres to the idea of taxation based on *ability to pay*, then one is likely to favor taxation by the residence state. Conversely, considering that a business enterprise depends on the availability and use of infrastructure at the location where goods are produced, then taxing at the source, in accordance with the principle of *benefit taxation*, is justified. Both of these arguments are simple and intuitive. None of the scholars that have discussed the issue of a desirable allocation of taxing rights have come out in favor of only the one or the other, but for some solution that accords different weights to these considerations (for a brief overview of the continuing debate, see e.g. Li 2003, 49-57).

In the political debates these theoretical issues of a legitimate link between a taxpayer and the country that wishes to exert its power to tax were mixed with material distributive conflicts. For countries that are net capital exporters – that is, importers of the income earned from this capital – taxation on a residence basis is advantageous. Conversely, net capital importers prefer taxation at source (see e.g. Dagan 2000; Rixen 2008, chapter 7). To make a long story short, the solution that ultimately emerged was based on a compromise between the residence and source principle. The tax treatment depends on the type of income (schedular taxation); in essence, active capital income is to be taxed predominantly at the source, whereas passive income is taxed in the state of residence (see e.g. Avi-Yonah, 2006).[3]

In order to institutionalize the compromise solution, a series of legal constructs were created that establish a nexus between the transnational tax base and a country (Bird and Wilkie, 2000: 91-5). For example, the permanent establishment (PE) concept codified what is taxable as a separate entity in the source state. The allocation of taxable profits to the different entities of an MNE is governed under the arm’s length standard (ALS). The distribution should correspond to that which would result if the different parts of an enterprise were to act independently from one another on the market – that is, for purposes of taxation, the parts of an enterprise are treated as if they were separate businesses (see e.g. Li 2003, chapter 3).

The important point about these and other legal constructs – which are in use until today – is that the rules defined internationally are kept at a minimum. The international rules for the avoidance of double taxation achieve nothing more (and nothing less) than territorially disentangling the transnational tax base and assigning it to different jurisdictions. They do not prescribe whether and how a state ought to exer-

[3] There are important exceptions to this general pattern: for example, the source state has the right to levy withholding taxes on dividends, interest, androyalties (see e.g. Avi-Yonah 1996).

cise this right; the internal qualities of national tax systems are not subject to the regime rules. Once jurisdiction to tax is established, the country is basically free to use its own national tax law on the respective income. The approach is not aimed at harmonizing national tax laws (Li 2003, 33) but merely at coordinating the *interfaces* of autonomous national tax systems.[4] Governments retain almost unlimited sovereignty over their share of the transnational tax base; they are free to design all elements of their tax systems – tax base, rate and system – as they wish (Rixen 2008, chapter 4).[5]

Originally, the goal was to codify the rules in a multilateral double taxation agreement (DTA); but governments were loath to submit to this kind of multilateral contract. A non-binding agreement was reached – a model convention (MC) – on which basis states could negotiate binding bilateral treaties. The MC was regularly updated and further developed. This occurred initially under the aegis of the League of Nations, thereafter for a brief period under the United Nations, and since the 1950s, it is sponsored by the OECD. Today, the MC is the international *de facto* standard for double taxation avoidance.

From the 1920s to the early part of the 1930s, only a few bilateral DTAs were actually negotiated. The economic crisis of the 1930s and the Second World War in the 1940s caused political interest in cross-border business relationships and worldwide economic integration to decline. By the end of the 1950s, there were only about 270 bilateral DTAs in force. During the 1960s, but above all in the 1980s, interest began to

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[4] This is perhaps best illustrated through a comparison with other potential solutions to the problem of double taxation. In a system of "international corporate taxation," the power to levy taxes would rest with a supranational organization which would define the tax base, fix the tax rates, and determine the method of collection. Under "unitary taxation with formula apportionment," the tax base would be jointly determined. States could still decide on their own desired tax rate and apply it to their apportioned part of this tax base, which would be determined by a fixed formula which could be based, for instance, on factors such as a company's wage bill, its assets, or its turnover (see e.g. McIntyre 2004). With each of these potential alternatives to the actually chosen method of international taxation, some elements of the national tax systems would be internationally determined: in the case of "international corporate taxation," this would be all three essential elements – tax base, rates, and system; in the case of "unitary taxation with formula apportionment," this would be just one element – namely, the tax base. The sovereignty to determine one's own national tax system would be shared with other states.

[5] Nevertheless, the chosen form of coordination requires intensive international cooperation at the administrative level, whenever in concrete cases it becomes necessary to properly restrict a country's right to tax. Especially in the determination of transfer prices, the participating states often have to engage in complex agreement procedures. In other words, the solution opted for permits the states broad legislative sovereignty but, at the same time, it limits their *de facto* administrative sovereignty in the implementation of tax law (cf. Picciotto 1992, 35). See also the discussion in part 3 below.

grow in liberalization of capital flows and, with this, the avoidance of double taxation. From then on the true value of the model convention as a blueprint for transaction-cost-effective negotiations of bilateral double taxation agreements really showed. The number of DTAs increased rapidly to more than 2000 as of today; and almost all of the agreements follow the OECD MC in form and content. The original solution – manifest in the non-binding multilateral MC, binding bilateral DTAs and national rules of international taxation – became firmly entrenched. Whereas details of the OECD MC have been continuously developed, its fundamental building blocks have remained unaltered (see e.g. Graetz 2001).

Over time, the OECD has established itself not only as a generally recognized forum, but in fact the most important one for discussion, diffusion of information, and further development of international taxation. Tax experts from national ministries serve as representatives on the OECD Committee on Fiscal Affairs (CFA). Here they work continuously on refinements to the model convention and the development of non-binding rules or recommendations concerning various technical matters – for instance, the determination of transfer prices. In general, the CFA can be considered a transgovernmental expertocracy. Even though no binding decisions are taken within this committee this multilateral forum nevertheless has a significant influence on international tax policy, because it developed and continuously refines the basic principles and legal constructs on which international tax law, in the form of bilateral treaties and national rules of international taxation, is based. This setup can be described as bilateralism on the basis of multilateralism.[6]

The only societal actors that participated in this process of constructing the international double tax regime were business representatives. In fact the issue of international double taxation was put on the agenda of the League of Nations by the International Chamber of Commerce (ICC), which also participated in all the meetings. Likewise the Business and Industry Advisory Committee (BIAC) represents business interests within the OECD's CFA. Although business representatives have only advisory capacity, they nevertheless have a strong influence on the development of

[6] For an explanation of why "bilateralism based on multilaterialism" was chosen, see Rixen and Rohlfing (2007).

international taxation (Webb 2006). Other civil society actors, not even to mention the broad public, have not been involved in designing the rules of double tax avoidance.

All in all, the DTA regime, even though its historical origins lie in a time prior to World War II, fits nicely into the picture of "executive multilateralism" (Zürn et al. 2007, 133). The regulatory structure described here is that of a "traditional international institution" for three reasons (on these criteria, see Zürn 2004, 269): (1) its addressees are states, (2) it deals with an interface problem, and (3) the effects of the regulation were predictable with relative certainty (at least as long as the liberalization of capital flows was not quite as advanced).

The Endogenous Creation of Tax Competition: The Origin of the Governance Gap

The construction of the DTA regime leads to unintended consequences. Explicitly, the rules of double tax avoidance address only governments and tell them how to structure their international tax relations. Implicitly, however, these same rules also tell enterprises how they can arrange their cross-border transactions to minimize their tax payments. The DTA regime pre-structures taxpayers' avoidance techniques. For example, the schedular structure of DTAs allows taxpayers to apply specific practices – for instance, substituting equity with debt – in order to reclassify their financial flows in a tax optimal way. Another method of avoidance that builds on an important aspect of the DTA regime is the manipulation of arm's length transfer prices.[7]

Such transactions often use the services of base or conduit companies – better known as "letter box companies" – located in low-tax countries or tax havens. With the aid of base companies, an enterprise can intentionally manipulate its legal state of residence in order to accumulate profits tax-free or at least at a very low rate. A company can also channel financial flows through a conduit company, which can be advantageous if, in the course of such transactions, the company gains access to

[7] Because of its susceptibility to manipulation, the arm's length standard has always been highly controversial in the literature. The irony and particular difficulty with the ALS is that, according to current economic theory, multinational enterprises have come into existence in the first place because of the absence or imperfection of markets for certain transactions; but exactly the comparison with a market is what is needed for purposes of determining transfer prices. Thus the determination of ALS transfer prices is seen by many to constitute a "fiscal myth" (Bird 1988, 299).

advantageous DTAs, which would otherwise not be applicable ("treaty shopping").[8] With these and other similar techniques taxpayers make sure that profits are taxable in low-tax countries, while losses occur in high-tax states. What these methods have in common is that none of them rely on the relocation of real business activities – such as making direct investments in a low-tax jurisdiction – but on the mere shifting of "paper" profits and losses. There is empirical evidence that this is a quantitatively important phenomenon and that tax competition is to a significant extent structured around methods of profit shifting (see the overview in Rixen 2007, 64-8).

This form of tax arbitrage is possible because the DTA regime gives states the freedom to design their own national tax laws. The sovereignty-preserving approach to double tax cooperation creates an opportunity structure for taxpayers and governments: taxpayers demand tax optimization and seek to avoid taxes; governments can satisfy this demand with corresponding offers, because the international rules give them the power to structure their national tax legislation to meet this demand. Thus, the system itself pre-determines the kinds of tax law adaptations that states will use in the attempt to attract tax base – it determines how individual states will try to win tax competition. The result is tax competition among all countries. The DTA regime not only creates the institutional framework for the avoidance of double taxation, it also unintentionally provides the institutional foundation for tax arbitrage and competition (Rixen 2008, chapters 4 and 8).

Even though they are not competing first and foremost for direct investments, the possibilities for enterprises to shift paper profits, and the resulting tax competition among countries, have negative consequences. Although on average hardly any revenue losses related to business taxation are detectable, the real consequences of tax competition reveal themselves in the structure of tax systems (see e.g. Ganghof 2006, Ganghof and Genschel 2008, Rixen 2007): large, highly profitable MNEs enjoy favorable tax treatment over small and medium-sized enterprises. Taxes are shifted away from capital onto labor and consumption. The decrease in nominal business tax rates undermines the progressivity of individual income taxes. In short, tax competi-

[8] For an overview of these and other strategies of international tax optimization, see e.g. Arnold and McIntyre (1995, 8-17 and 69-88).

tion restricts the autonomy of governments in the design of their own tax policies; in particular, the leeway for redistribution via taxation is limited.[9]

Whereas economic liberalization in the form of double taxation avoidance has progressed a great deal through successful international cooperation, a governance gap in the form of lacking regulation of the economic and social side effects of liberalization has developed. There are neither international rules to regulate tax competition – which would have to aim at some degree of standardization among national tax systems – nor is there an international organization with sufficient competence to enforce such rules. In many cases, there is not even information exchange between national tax administrations.

Countermeasures: Incremental Instead of Fundamental Reform

Nevertheless, governments are not willing just to surrender to this situation and have tried to at least limit the damage. The most important of these measures shall briefly be discussed here (for more detail, see Rixen 2008, chapter 6).

Some governments have developed unilateral measures against tax avoidance. These have, in the meantime, through diffusion via the OECD, been adopted by basically all major capital exporting nations (see e.g. Arnold 2000). In the 1960s, the United States was the first country to introduce unilateral anti-avoidance legislation. The so-called controlled foreign companies (CFC) legislation is directly aimed at the use of foreign subsidiaries as base or conduit companies in tax haven countries, which serve no substantive economic purpose but the tax privileged holding of assets for the group. Resident shareholders, e.g. the parents of an MNE, controlling a subsidiary in a tax haven are taxable on the income of the subsidiary in the current period, whether or not the income is actually distributed to them. Thus, CFC rules pierce the "corporate veil" of the tax haven entity and violate the principle of treating all parts of an MNE as separate national entities.

[9] This interpretation contradicts the claim by some political scientists that tax competition resulting from globalization does not represent any serious restrictions on leftist or social democratic policies (cf. e.g. Garrett and Mitchell 2001; Swank 2002; Swank and Steinmo 2002). These authors base their conclusion on the observation that revenues from business taxation have not declined. Nevertheless, what they overlook is that the expansion of the tax base coupled with a simultaneous reduction in nominal tax rates—a move which was necessary in order to retain the same level of tax revenues—led to an unjust distribution of the tax burden (cf., for more details, Ganghof 2006; Rixen 2007).

Another area in which efforts at reform have been made is that of transfer pricing. With the multinationalization of production and the rising importance of intangibles – trademarks, patents and other intellectual property – the ALS comes under pressure. Again, the US was the first country to push for changes. In the 1990s it adopted new transfer pricing guidelines and subsequently the OECD recommendations were also reformed (Webb 2001). Since then the guidelines are in a state of almost perpetual adaptation (see, most recently, OECD 2008b). Overall, the new guidelines move the actual rules closer to considering the consolidated profits of the MNE but take great care to formally reinforce the principle of separate entity accounting on a transactional basis (Bird and Wilkie, 2000: 92; Vincent 2005). With the introduction of advanced pricing agreements (APAs) in many countries and their promotion by the OECD, this trend has become even more pronounced. APAs are mechanisms under which MNEs and tax administrations can bargain over the appropriate method of arriving at reasonable transfer prices and thus basically commit to certain prices before the transactions actually take place. Some have argued that APAs are only a secret method of applying formula apportionment on a business-by-business basis (US Senator Dorgan, cited after Célestin, 2000: 130).

In addition to these unilateral approaches, there have also been international and collective efforts at reform. For example, twenty years ago a multilateral convention on information exchange was developed (Council of Europe/OECD), and this convention has since been ratified by thirteen countries (OECD 2008a).

Another attempt to combat the problem of tax competition that has received some public attention, was the OECD Project on Harmful Tax Practices (OECD 1998), begun in the mid-1990s. The original aim of the project was to force tax havens to modify their national tax laws so that it would no longer be possible for multinational enterprises to merely book profits in a low-tax country without having any bona fide business activity there. But, after resistance from the tax havens and pressure from the US following the change of government to George W. Bush, the OECD project modified its original aim, so that now the goal is just to intensify information exchange and administrative cooperation (see, most recently, OECD 2007; for more details on the OECD project, see Rixen 2007; Sharman 2006b). However, information exchange is not going to be automatic, but will still have to be requested by the authorities, who must present a suspicion to obtain information. According to many experts only automatic information exchange can be effective in preventing evasion and avoidance (see e.g. Sullivan 2007, 332-334).

The progress thus far achieved in the battle against tax avoidance, evasion, and competition is not sufficient to get the problem under control. The efforts to limit damage – which were not even devised with the aim to create an effective institution for the regulation of tax competition – cannot close the governance gap.

The Politicization of the Governance Gap in International Taxation

At least since the OECD Project on Harmful Tax Practices, it has become obvious that the normative issues at stake in international taxation can no longer be treated as purely technical issues. The question of justice between rich industrialized countries and small, sometimes poor, sometimes wealthy tax havens, the matter of fairness and equity between different groups of taxpayers, and the meaning of fiscal sovereignty in the age of globalization are issues that have finally made their way onto the agendas of governments and international organizations. In the course of this development, the propensity for conflict has also risen sharply. This holds not only for the relationships among governments: one can also observe an increasing "politicization" – in the sense of that term suggested by Zürn et al. (2007, 149), who see growing civil society demands as the defining feature of politicization. In international taxation, civil society's demands aim, above all, at closing the governance gap.[10]

The Origins of Politicization: International Taxation as a Latecomer

In the course of the development of a civil society movement against one-sided neoliberal globalization, international taxation policy has also become more politicized. Since the early and mid-1990s a growing number of NGOs and a growing number of activities and campaigns could be observed (Rucht 2005, 187-190). Taxation policy was repeatedly referred to, and tax competition was decried in general

[10] "Politicization should be understood as a process in which societal actors, be they organized at the national or transnational level, make increasing demands on governance beyond the nation state".

terms. The probably best-known NGO in the spectrum of globalization critics, Attac,[11] devoted some attention to tax policy, its main demand being the introduction of the Tobin tax to regulate financial markets. Not until 2000, however, did civil society actors start to take a closer look at the international aspects of direct taxation; the biggest campaign which dealt with this subject explicitly was that of Oxfam (2000).

In 2002 the Tax Justice Network (TJN) was formed. This organization quickly developed into the main civil society crystallization point for matters concerning international tax evasion, tax fraud, capital flight, and tax competition. TJN is a network of activists, tax experts, journalists, and development experts that grew out of the global processes of the World Social Forums (WSF) and the international Attac movement. The declared goal of the network is "[to work] for international tax co-operation and against tax evasion and tax competition" (Tax Justice Network (TJN) 2005, ii). In the few years of its existence, TJN has already succeeded in making a name for itself through its mention on the business pages of various prominent news-papers, having supplied the media with facts, figures, and stories of tax evasion strategies by private persons and enterprises (see e.g. "Places in the Sun," *The Economist*, 24 February 2007; Houlder 2006; Lawrence and Griffiths 2007).[12]

International tax policy clearly experienced its initial "politicization boost" later than other areas of economic policy. The main reason for this is probably that in the mind of most political actors, issues of taxation are so closely linked to the nation state that international taxation was for a very long time perceived to be a non-issue. The sovereignty-preserving institutional design of international tax governance may have reinforced this view. Additionally, many have argued that the relative lag in the politicization process is due to the complexity of the subject matter. National tax rules are notoriously complicated, the international rules, which were designed to disentangle these national tax systems, are accordingly even more complicated.[13] "The issues are multi-faceted, and tax havens are steeped in secrecy and complexity – which helps

[11] *Association pour une taxation des transactions financières pour l'aide aux citoyens* = Association for the Taxation of Financial Transactions for the Aid of Citizens.

[12] A search through the "Factiva" database on 28 January 2008 yielded the following statistics for number of mentions of the Tax Justice Network in all of the "major news and business publications:" TJN was cited six times in 2003, 21 times in 2004, 54 times in 2005, 45 times in 2006, and 65 times in 2007.

[13] Albert Einstein is claimed to have said that "[t]he hardest thing in the world to understand is the income tax" (quoted in Slemrod and Bakija 2004, ix).

explain why so few people have woken up to the scandal of offshore, and why civil society has been almost silent on international taxation for so long" (TJN 2007, see also Christensen/Spencer 2008). Many civil society activists simply did not have the expertise necessary to operate competently in this policy area, and thus gain the ear of policymakers.

In the meantime, however, this has changed. Within TJN there are a number of recognized tax experts who could close the competence gap (Webb 2006, 109). Given that these individuals consider it an essential part of their work to convey the basic principles of international tax policy to the public (TJN 2007), the complexity of the issues itself should no longer pose the significant barrier to further politicization – or to counter-act the strategy of de-politicization of business interests[14] – of this policy area. Commenting on the intensified activities of NGOs in the field of international taxation Jeffrey Owens, Director of the OECD's Centre for Tax Policy and Administration (CTPA), remarked that "[t]ax is where the environment was ten years ago" (quoted in Houlder 2004).

The Demands of Civil Society

If we consider the statements by NGOs on international tax policy, it becomes clear that their main interest is to scandalize the status quo of international tax competition. The campaigns of these organizations are designed to put the current injustices in international tax policy on the public agenda, and thus to create a broader awareness for the importance of this problem among the general public (cf. e.g. TJN 2007).

One of the most important issues on their agenda is the link between international tax injustice and development. Developing countries are particularly vulnerable to the consequences of tax competition because, unlike the rich OECD countries, the former often have only weak tax administrations at their disposal and are thus unable to

[14] Webb (2006) has argued that, in the area of international income taxation, it would be especially easy for business interests to attain a powerful level of influence. Because of the complexity of the subject matter, only very few civil society organizations actually possess the necessary know-how to function competently on the same plane as their adversaries. In contrast, representatives of transnationally organized business interests have far greater resources and knowledge at their disposal, enabling them to influence the development of the international tax regime. This "epistemic community," comprised of tax bureaucrats and business association representatives has thus succeeded in excluding civil society from international tax matters by defining the issues as being "purely technical" in nature.

adequately pursue wealthy taxpayers and tax evaders (Oxfam 2000).[15] Christian Aid (2008) estimates the annual revenue loss of developing countries from transfer mispricing and false invoicing (under- or overvaluing the actual price of a commodity in official documentation to strip a company off profits) to be US $ 160 billion. An important demand is for developed countries and International Organizations to assist developing countries in building effective tax systems by curbing tax competition (see e.g. Martens 2007;TJN 2005a, 54).[16]

Although NGOs acknowledge the fact that the OECD broached the problem with its Project on Harmful Tax Practices, the project has been subject to criticism by these groups, because up to now it has failed to achieve progress to any notable or satisfactory extent (Giegold 2004; TJN 2007). In particular, disapproval has been expressed at the fact that, to the detriment of small island nations, many of which are developing countries, the OECD initiative has concentrated too one-sidedly on their unfair tax practices, while handling those of OECD countries less stringently. Tax avoidance and evasion, however, are more widespread phenomena that involve the offshore activities of small islands as well as the onshore activities in OECD countries, like those, for instance, in the big financial centers of London and New York (Oxfam 2000).

The leitmotiv of civil society engagement is their criticism of the incomplete regulation of international tax competition. They argue that the imbalance between globally operating taxpayers (enterprises and individuals), on the one side, and purely national tax systems, on the other, must be eliminated. This can ultimately only occur if the respective governments intensify international cooperation in matters of taxation (cf. e.g. TJN 2005a; Oxfam 2000). To this end, activists have drawn up a set of demands and made a number of proposals.

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[15] TJN cites a study by the Boston Consulting Group, which shows that wealthy private households in developing countries deposit a higher portion of their assets in tax havens than do wealthy individuals in North America and Europe. According to these estimates, in Latin America, for instance, more than 50% of the cash assets of its wealthiest residents are deposited in tax havens; in the Near East, this figure is as high as 70% (TJN 2005a, 5-6). Other empirical studies also show that developing countries are particularly negatively affected by the consequences of tax competition. While developed countries only experienced a change in their tax structure, developing countries additionally lost tax revenues (Keen and Simone 2004).

[16] As an interesting aside: Some development NGOs are skeptical of the tax justice agenda, because they fear that the focus on mobilizing tax revenues in developing countries may let developed countries off the hook of being responsible for helping developing countries (see e.g. Wilks 2008).

They propose to create a “World Tax Organization” to guarantee that individual countries’ tax policy decisions would also consider the interests of all people and all countries.[17] In the eyes of TJN, the most suitable organization to assume such a role would be the United Nations. While, over the years, the OECD has accumulated an impressive level of expertise in international tax policy, it is not seen to adequately represent the interests of all countries, but only those of rich nations. At the same time, activists would like to strengthen the UN’s Committee of Experts on International Cooperation in Tax Matters. Because of its inclusive membership, this body is seen as the only one on a global level with enough legitimacy to be considered a potential nucleus of a World Tax Organization (TJN 2005a, 52-4). The main task of this new agency, in addition to taking over the work now done by the OECD, would be to devote itself intensively to the matter of tax competition and capital flight (TJN 2005a, 39). However, TJN criticizes the UN Committee of Experts, which is currently too badly funded, for concerning itself too much with the technical details of DTAs instead of the more basic options for reform (Gurtner and Picciotto 2006).

With its preference for the UN to become the main forum of international tax policy, TJN has joined developing countries. Since the latter are not members of the OECD, developing countries sought to create a counterweight to that organization within the framework of the UN. Since the late 1970s, the United Nations began to become active in the area of tax policy, and drafted a model convention which was designed to be favorable to the developing countries who are traditionally capital importers and therefore prefer the source principle. Although the UN possesses greater legitimacy because of its broader membership (Horner 2001), its deficit in resources in the area of tax policy has meant that up to now it has posed no threat to the position of the OECD in international taxation matters. The OECD, however, as a reaction to the criticism, has since began to allow developing countries to attend the meetings of the CFA (Rixen 2008, chapter 5).

In any case, activists do not support a utopian demand for a world government that is equipped with its own power to tax; rather TJN is of the opinion that tax policy ought to be governed within democratically constituted nations. For this reason, they

[17] Proposals for a world taxation organization, although with a more limited scope, can also be found in the academic literature: e.g. Tanzi (1999) and Horner (2001).

do not proclaim a far-reaching harmonization of national tax policies as their main objective. Instead, they are concerned with closing the governance gap so that governments are in a better position to bring their tax systems in line with the preferences of their constituencies. In other words, the real issue is to safeguard national tax policy through international governance (TJN 2005b).

Some concrete demands – independent from calls for a new international regulatory institution – are the following. First, concerning personal income taxes, TJN supports the enforcement of the residence principle. Private persons should be taxable where they reside and use public goods and services. In order to implement the residence principle, the first step should be to introduce automatic information exchange between countries.[18] While the demand for an automatic information exchange between countries may sound modest, it would in fact require a much higher degree of international cooperation and greater constraints on national tax sovereignty than has heretofore been accepted by governments (see Rixen 2008, chapters 4 and 8).

Second, with regard to the taxation of enterprises, TJN proposes a common, consolidated tax base that would be apportioned to the various countries according to a formula that is better able to capture the true economic contributions than the legal constructs on which the tax regime is currently based. Further, TJN proposes to adopt a general anti-avoidance principle in all national tax laws (TJN 2005a).

In addition to demands for regulating tax competition, TJN also wants enterprises to refrain from tax planning and implement this as an important element of their "corporate social responsibility." Under TJN's proposal of "country-by-country reporting" MNEs would be obliged to disclose all their profits, the locations where these were made, and the locations where they were taxed (Murphy 2007a). These and other demands – e.g. the obligation not to make use of tax havens – are to be included in a corporate "Code of Conduct for Taxation," developed by TJN (Murphy 2007b). States, enterprises, and tax consultants are supposed to comply voluntarily with this code of conduct, which goes far beyond the recommendations on taxation contained in

[18] Currently, the tax authorities generally exchange information about taxpayers only on request. This is also the case even for the most recent information exchange agreements which developed out of the OECD Project on Harmful Tax Practices. Whereas these newer agreements foresee better, more viable information exchange than do the normal double taxation agreements, the reciprocal provision of taxpayer information still does not occur automatically. The EU's Directive on the Taxation of Savings Income does foresee automatic information exchange (Sullivan 2007, 332-333).

the "OECD Guidelines for Multinational Enterprises" (OECD 2000). Compliance should be verified on a yearly basis by an independent expert commission. These recommendations are designed to generate transparency and create an ethically responsible tax culture.[19]

With the exception of this last demand, which is a moral appeal to private enterprises backed up with a threatened loss of reputation, NGOs address states or international governmental organizations to close the governance gap in international taxation. Although the interest of the broader public for international tax matters currently remains small, these developments show that international tax policy – for a long time the exclusive domain of technical experts and tax bureaucrats – is increasingly being subjected to public criticism and scrutiny according to criteria of the global common good.

What are the Institutional Responses to the Politicization of International Taxation?

This section of the paper deals with the institutional reactions to the increasing politicization of international tax policy. I will first show that the institutional reforms that have been undertaken are insufficient to solve the issues raised by civil society actors. Second, given that governments and IGOs failed to meet the demands of civil society, it is interesting to analyze whether they have at least undertaken procedural reforms and have allowed civil society actors access to their decision-making processes. One may think that they would be interested to do this to mask their lack of success on the side of substantive policy reform.

[19] The "responsible approach" to taxation supported by TJN does not perceive tax as a "cost" for enterprises, but rather – like dividends paid to shareholders – as a dividend payout from enterprise profits to the "stakeholders," namely, society. Society deserves this share of the profits, because it provides the physical and social infrastructure for enterprises. "Tax is the return due on this investment by society from which companies benefit" (TJN 2007).

Politicization Has Not Succeeded – The Institutional Trajectory Remains Unchanged

So what has happened with material institutional development? Has the effectiveness of international tax institutions improved, and has the governance gap been closed? What role do the demands of civil society play in this scenario?

In response to the problem of tax competition, the international tax system has undergone a change, but this change takes on a peculiar form. The process can be characterized as rule stretching and layering (see e.g. Thelen 1999; Pierson 2004, 133-166): the unilateral anti-avoidance measures and the continuing adjustments of transfer pricing regulations can be interpreted as *rule stretching*. Both reforms contradict the principle of sovereignty-preserving tax cooperation. CFC legislation violates the tenet of treating parts of an enterprise operating in different countries as essentially independent units. It extends taxation into foreign territory by consolidating the accounts across borders for at least certain kinds of passive income. The new transfer pricing guidelines likewise involve an implicit consolidation of accounts across borders for those cases where the traditional methods of arm's length pricing cannot be applied, which are numerous. With the introduction of advanced pricing agreements (APAs) – mechanisms under which MNEs and tax administrations basically commit themselves to certain prices before the transactions actually occur – the trend towards implicit consolidation of accounts has become more pronounced. In both cases, however, the basic principles of the tax regime were not amended accordingly (cf. e.g. Li 2003, 105-116; Vincent 2005). Instead, actors re-construe the rules in such a way that they formally remain in line with the principle of sovereignty-preserving cooperation.

Governments also follow a strategy of *layering* – that is, they create new institutions, designed to provide a support structure for the DTA regime and thus to buttress its operability. The OECD Project on Harmful Tax Practices represents such an instance of layering. Although the project was ultimately not successful, what is remarkable about it is the fact that, for the first time in the history of global tax policy, the principle of sovereignty-preservation was openly questioned. This was possible precisely because it occurred outside the DTA regime. This is an advantage of layering: the question of consistency between the original rules and the layered rules does not have to be answered. Since the two institutions are formally separate, actors can always retreat to the position that the old as well as the new rules demand full compliance.

This institutional trajectory results from a particular constellation of interests. On the one hand, governments do not want to capitulate defenselessly to tax competition; on the other hand, they do not want to endanger the established institutional arrangement for the avoidance of double taxation. Third, there is a strong conflict of interests inherent in tax competition. Some countries, especially small ones, profit from tax competition, while others loose. The strategic structure is that of an asymmetric prisoner's dilemma respectively Rambo game.

Rule stretching and layering allow actors to preserve the coordinating function in the avoidance of double taxation, while they can at the same time limit at least some of the possibilities for tax arbitrage. Because the DTA regime is based on a non-binding consensus in the form of the model convention, countries proceed very cautiously in the battle against tax avoidance and tax competition.[20] While in fact these rule changes imply an intervention into national tax systems, actors take great care to formally realign them with the traditional principle of preserving sovereignty. Since any rule changes need the approval of the winners of tax competition, who would block more fundamental reforms, there are only indirect and incremental rule changes. In consequence, the DTA regime remains on its traditional institutional trajectory (see Rixen 2008, 117-51 and 181-96 for a detailed account of the institutional trajectory).

Nevertheless, it is doubtful whether the incremental reforms can solve the problem effectively. Since no one really wants to challenge the validity of the DTA regime in principle, governments intervene in the system only selectively, targeting each specific international tax avoidance technique with a corresponding legal countermeasure. The problem with this strategy is that the taxpayers adjust their tax avoidance

[20] Because the avoidance of double taxation is, in effect, a coordination game with a distributive conflict, it is difficult to exert institutional change. In this type of game, as soon as one of the possible equilibria has been chosen, no actor has an incentive to deviate from it. In particular, there are sunk costs invested into the construction of a focal point in the form of the model convention. In addition, there are specific investments of tax administrators who have learned to operate the existing rules. Further, the sovereignty preserving constitution of the tax regime can be interpreted as a source of positive feedback for the existing solution: the internationally guaranteed freedom of governments to design their national tax systems solely in accordance with their own wishes has made it possible for governments to incorporate specific regulations in their national legislation, which they can then use as a bargaining chip in treaty negotiations (Avery Jones 1999, 3-6; Vann 1991, 110). Thus, the construction of the tax system not only allows sovereignty to be preserved, it also reinforces the sovereignty-preserving character (see Rixen 2008, 184-193).

strategies accordingly; they are quick to find new tax loopholes for minimizing their tax payments. The result is a "proliferation spiral," in which the state reacts to the actions of taxpayers. An undesired side-effect of this is that tax law becomes increasingly complex. This development can be described as an *institutional drift* because, on the one hand, repairs to the existing arrangement have to be constantly undertaken but, on the other, the governance gap will never be effectively closed. To actually close this gap would require a fundamental reform of the international tax regime, abrogating the absolute validity of the principle of sovereignty preservation; but governments do not agree on the desirability of such a reform.[21]

We can conclude from this that civil society has not been able to influence the path of institutional development of the international tax regime thus far. Although, in the course of ever-increasing and more intense tax competition, the pressures to regulate tax competition have risen (and will continue to rise), governments and the OECD so far do not meet the demands of civil society. They are more concerned with further developing the present tax regime along the path predetermined by the traditional principles, and they attempt to ward off any far-reaching reform proposals. Thus the logic of institutional stability and the conflict of interests among governments in tax competition are a plausible explanation for the continuance of the governance gap in international taxation policy.

Limited Access for Civil Society to International Organizations

The OECD is an intergovernmental organization engaged in gathering and disseminating information, expertise, and non-binding policy recommendations. Insofar as the OECD actually influences policy developments, this influence is based on its authority as a source of objective expertise (Sharman 2006a). The OECD, since its inception, has granted access to civil society interests. This, however, has been limited to BIAC and the Trade Union Advisory Committee (TUAC), both of whom have been granted

[21] What is paradoxical about this situation is that governments fall into the tax competition trap precisely because they hold uncompromisingly onto formal tax sovereignty; but, by so doing, they are compelled to make specific tax policy adjustments—thus, *de facto* tax sovereignty has already been yielded. States can gain real sovereignty over tax revenues under conditions of globalization only if they accept to share *de jure* sovereignty with other states. Only collectively can states win back what they have lost individually. One potential reform would be the introduction of unitary taxation with formula apportionment (see e.g. Rixen/Uhl 2007).

official status as consultants. In the OECD's CFA, only BIAC is represented and has taken active part in negotiations. Other civil society interests, in contrast, were not officially included. The OECD, at least in the area of taxation, insists that it is an organization of and for governments, and that, therefore, civil society participation should remain limited.[22]

Despite this, the OECD has maintained informal relations and personal contact to tax activists. For example, Jeffrey Owens, Director of the CTPA (the OECD's tax affairs department), accepted an invitation to a meeting of TJN's steering committee and engaged in discussions with TJN activists on this occasion. Furthermore, Owens and other OECD employees regularly meet TJN representatives on a personal and informal basis to exchange and discuss their positions. Thus the OECD is indeed interested in the activists and even sympathetic to some of their demands (while they reject others as too extensive). In particular, within the framework of its Project on Harmful Tax Practices, the OECD explicitly advocates the regulation of tax competition; however, unlike TJN, the OECD does not categorically reject it entirely. Also, the OECD is not in favor of the creation of an international tax authority within the UN framework because, quite naturally, it sees itself as the legitimate organization in that position.[23]

In any case, the OECD seems to have realized that it is necessary to make its own work more inclusive and transparent. In 2002, the OECD together with the World Bank, the International Monetary Fund (IMF), and the UN jointly established the "International Tax Dialogue" (ITD). The ITD is designed to intensify communication between these organizations and national governments, and to contribute to a better dissemination of "best practice." The establishment of the ITD was a follow-up to recommendations made at the First International Conference on Financing for Development (organized by the UN and held in Monterrey, Mexico, in March 2002), which pushed for improvements in international tax cooperation. Whereas the ITD was "not at any stage [to] have any power to make, enforce or mediate binding tax rules" (IMF,

[22] In other policy areas – development cooperation, for instance – the OECD has opened up to civil society input over the last ten years. Whereas NGOs have not been accorded any official status by the OECD, it does claim to have established relationships to a number of civil society groups, and it is making an effort to engage in a dialogue with various stakeholders (OECD 2005).

[23] This section is based on interviews with Bruno Gurtner (on 7 February 2008) and John Christensen (on 4 July 2008), both members of TJN's International Steering Committee.

OECD and World Bank 2002), it contributes to greater public transparency. The ITD website <http://www.itdweb.org> has published a plethora of official documents on, and other contributions to, the discussion on international taxation policy; most of these, however, are directed more towards experts, rather than interested lay persons.

Unlike the OECD, the United Nations is open to let civil society actors participate in its activities in the field of international tax policy. The UN has seized upon the dissatisfaction with the OECD as an exclusive organization. In the Financing for Development (FfD) Initiative (United Nations 2001), which is directed at various policy areas, international tax policy plays a prominent role. This initiative stresses the urgent necessity for significant intensification of international cooperation on matters of taxation. It has also generated a number of proposals for the creation of new institutions or the reform of existing organizations.[24] Civil society organizations have been closely involved in the FfD process: NGOs are regularly consulted; even for high-level intergovernmental meetings, they have access to government representatives (United Nations 2007).

In the course of the FfD initiative, the UN upgraded its "*ad hoc* group of experts" and granted it the status of a special committee, viz., the "Committee of Experts on International Cooperation in Tax Matters". Civil society actors have access to this body (United Nations 2005, paragraph 5).[25] Thus, TJN began to lobby at the UN and particularly approached delegates from developing countries, making a concerted effort to raise the latter's awareness of the problems of tax flight and tax competition, and to suggest possible solutions to these problems (Sikka 2006; Christensen 2007). Further, TJN proposed that the UN's Economic and Social Council (ECOSOC) develop a "Code of Conduct on Cooperation in Combating Capital Flight and International Tax Evasion and Avoidance" (Gurtner and Picciotto 2006).

[24] The "Zedillo Report" (United Nations 2001), among others, proposed the creation of a so-called "International Tax Organization." The role of this organization, as described in that report, is essentially identical to the one proposed by TJN. The "Monterrey Consensus of the International Conference on Financing for Development" (the final text of agreements and commitments adopted at that intergovernmental meeting), which served as the preparatory basis for the subsequent Zedillo Report, no longer contained such a proposal. It did, however, call for an intensification of international tax cooperation.

[25] They had also been allowed to attend the meetings of the *ad hoc* group of experts. However, until TJN actually showed its interest in participating, no civil society representatives, except for the International Chamber of Commerce, attended the meetings. When John Christensen of TJN first approached the Committee, the UN's administrator replied to his question of whether they could attend the meetings that he had been waiting for such a request from civil society activists for decades.

The differences between the UN and the OECD in granting civil society groups access to decision-making processes can be explained by the fact that the UN is not influential in the area of economic policy-making. In order to develop any impact at all, the UN and its principals, many of whom are governments of developing countries, have a particular interest in getting civil society on their side. In this way they may hope to gain moral credibility, which may be instrumental in achieving their policy goals. Additionally, for some developing countries this may also involve considerations of functional efficiency (see Tallberg 2008, 10-4; Steffek 2008). Lacking enough resources to develop technical expertise themselves, they may wish to get access to the technical expertise of some civil society actors.

In contrast to that, the OECD, while it can certainly not take binding decisions, has developed into the most well-known and most important forum for discussion of international tax policy because of its access to sufficient resources and its disposition over a large body of expertise. A stronger inclusion of civil society actors would thus endanger the OECD’s present status. In the first place, activists and their arguments could disrupt the presumably depoliticized discussion of technical-administrative details. Most importantly, this would contradict the interests of its member countries, whose desire it is to handle tax policy matters foremost as a national concern and to achieve nothing more on the international level than a sovereignty-preserving coordination of different national tax systems. In other words, in order for the UN to have any impact at all, it is dependent on cooperation with societal groups. Conversely, for the OECD, granting access to such groups is dangerous, even if it cannot completely ignore their demands.

This suggests that civil society influence on intergovernmental tax policy making is still limited. First, while they have access to the UN, this channel of influence is not very effective. Even though the United Nations repeatedly claims to be an effective counterweight to the OECD in matters of international taxation (e.g. United Nations 2005, 3), most observers think that the UN, in view of its limited resources, will not succeed in becoming a serious competitor for the OECD any time soon (Zagaris 2005, 338). Even civil society support for the UN will, at best, only be able to change this situation in the long run. Second, civil society influence on the OECD is small. While civil society actors have informal access to the bureaucrats, their access to the organization's principals is negligible. Apparently, OECD governments do not see any functional need to grant them formal consultative status. Likewise, as long as decision making is based on intergovernmental consensus, OECD governments do not have to involve civil society actors in order to remedy any legitimacy deficit. In view of this constellation, what can be said is that the relevant institutions neither can nor want to fully ignore civil society protest but, at the same time, they do not acquiesce to its demands. Instead, they use civil society protest for their own purposes, insofar as it is useful to them; but they exclude this protest from their policy processes whenever it contradicts their, respectively their principals' interests.

Conclusion

In this paper I show that international tax cooperation – a policy area which for a long time has been highly depoliticized – is undergoing a process of politicization. Normative demands by civil society occur with greater frequency and intensity. Even in the domain of taxation, which is at the core of the nation state, there has finally emerged a reframing of issues in terms of global instead of merely national justice (on the need for reframing the political struggles for justice, see Fraser 2005).

Further, I show that this increased politicization has so far not resulted in significant institutional change. While international governmental organizations and governments have not been able to simply ignore civil society demands but in fact consider them to be relevant, only the UN, as the less significant of the two main organizations in international tax policy, has granted civil society formal access to consultation processes. The OECD is more conservative in this respect.

The institutional development of international tax policy fits well into the picture drawn by Zürn et al. (2007) of the formation of international political order beyond the nation state in their first hypothesis. The sovereignty-preserving institutional arrangement of intergovernmental cooperation focusing on the coordination of interfaces among nation states leads to unintended consequences in the form of tax competition. In response to this unintended consequence, transgovernmental administrative cooperation is intensified and new institutions are layered on top of the existing setup in order to support its viability. Likewise, in accordance with the first hypothesis, we can observe that the development of institutional change involves an intervention into national tax policy that has not been foreseen by the traditional rules – in other words, the institutional change affects "behind-the-border" issues.

Nevertheless – and this is a variation which was not addressed by Zürn et al. (2007), even though, presumably, it is not ruled out – the process of institutional development does not culminate in the genesis of an international institution of a new type. Rather, as described above, governments re-construe the *de facto* changes so that, at least *formally*, the rules remain compatible with the traditional principle of sovereignty-preservation. Thus, national governments have maneuvered the international tax system and themselves into a collective self-deception by pursuing the idea that the prevention of tax competition and tax arbitrage are compatible with unrestricted national tax sovereignty. The actual behavior of governments, however, demonstrates the contrary. In fact, national tax sovereignty is already partially constrained through the incremental reforms. Thus, the international tax regime is in a protracted process of institutional drift away from the principle of sovereignty preservation.

Whether this process may lead to the creation of a new type of international institution is difficult to predict. As long as the actors involved succeed in sweeping the continually growing internal contradictions between the two aims of preserving sovereignty and hindering tax competition and arbitrage under the rug it is plausible that the present institutional trajectory can be stabilized. Alternatively, however, it is also conceivable that the contradictions will reach a critical level so that basic institutional adjustments will have to take place (punctuated equilibrium).

Even if it is the case that development is going in the direction of stronger intervention into areas of national dominion, this tendency is not the catalyst which generates growing politicization. To the contrary, criticism is directed at the fact that tax competition is not adequately regulated. Politicization in the area of (direct) international taxation policy is not a counter-response to the exercise of too much power or too much intervention by an international institution, but rather a reaction to the lack of such an institution. politicization crystallizes around a governance gap. This means that the processes described in Zürn et al. (2007) and thought to occur *sequentially* – viz., first comes institutional transformation in the sense of the first hypothesis, followed by politicization in the sense of the second hypothesis – occur *simultaneously* in the case of international taxation.

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