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INTERNATIONAL FINANCE AND STATE SOVEREIGNTY: GLOBAL GOVERNANCE IN THE INTERNATIONAL TAX REGIME

INSOP PAK*

I. INTRODUCTION

Over the past decades, we have seen the global economic integration in the world of international finance. In particular, financial markets have witnessed a remarkable increase in the cross-border capital flows around the globe. However, the impact of financial globalization has raised a number of concerns in the wake of international financial turbulence.

In recent years, effects of financial globalization on state sovereignty have been subject to critical scrutiny. Some people argue the process of financial globalization propelled by the information revolution and technological innovations has posed potential dangers to a countries' ability to pursue national tax regimes generating revenue losses and fiscal threats due to taxpayers' shifts in financial activities seeking cross-border tax arbitrage and lower tax jurisdictions.

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It may be argued that international cooperation to neutralize different tax systems is necessary to enhance national and worldwide welfare. However, others claim the process of financial globalization has fostered the tax autonomy of a nation-state in providing a tax inducement to attract business activities from another country to its jurisdiction. Arguably, the increased mobility of capital has strengthened the state sovereignty over national tax policy leading to international tax competition.

At the center of the debate, this paper takes the position that the relationship between financial globalization and national fiscal sovereignty lies somewhere between the globalism that stresses international tax harmonization and cooperation among national tax authorities, and the realism that emphasizes the primacy of a nation-state as a key driver behind international tax competition.

Given the close relationship between financial globalization and national fiscal sovereignty, there is a strong need to examine the current international tax regime. This paper begins with a description of globalization and analyzes its nature and effects on the financial environment. Implications of globalization for state sovereignty are also addressed. In particular, global challenges to national fiscal sovereignty are discussed. In this context, this writing clarifies the concept of tax jurisdiction and reviews problems with the national tax systems such as double taxation, and taxpayers' cross-border arbitrage which results from the increased mobility of capital associated with financial globalization. Furthermore, an emphasis has been given to discuss the pros and cons of tax competition and harmonization.

More importantly, this article attempts to search for the measures to enhance global governance in the international tax regime. In this regard, an analysis of the network of tax treaties is provided. I then move on to review the role of the Organization for Economic Cooperation and Development (OECD) as a global tax network in international taxation. In this context, an emphasis is placed on the evaluation of global network governance conducted by independent decentralized government agencies in the international economy under international law. In addition, an argument about the creation of the International Tax Organization (ITO) is discussed. Finally, this paper concludes by seeking alternatives to enhance global tax governance through the coordination of a bilateral tax treaty network and a global tax network in international finance.

II. GLOBALIZATION AND THE FINANCIAL ENVIRONMENT

A. FINANCIAL INNOVATION

Globalization¹ is underway in various dimensions today more than ever. Among the enormous challenges driven by the process, it is worth noting that globalization propelled by the information revolution² and technology innovations has brought about the increasing needs of cross-border relationships between countries. Remarkably, transborder flows of financial information motivated by new computer based technologies have grown up more rapidly than any other sector thus resulting in the increasing interdependence among financial markets and market participants both within and across national boundaries.

The global financial system has been evolving at ever-fast rates in the past decades. Undeniably, the impact of globalization and the internet has created the profound changes in the international financial services industry. New technology has radically reduced the cost of borrowing and lending across national borders facilitating the development of new instruments and drawing in new players.³

Indeed, computer and telecommunication technology has made it possible to use the integrated system and programmes for conducting highly complex financial transactions and for an immediate and systemic exploitation of the flood of available information that may be of relevance for financial operations.⁴ The massive use of the Internet has created not only a huge jump in transaction volumes but also the utilization of highly complex financial innovations. The whole range of ever more sophisticated derivative instruments⁵ which are used to refine

1. Globalization commonly refers to the erosion of geographical borders among nations in the form of cross-border exchange of goods, services and information technology along with cultural transfers. See Roman Terrill, *What does 'Globalization' mean?* 9 TRANSNAT'L L. & CONTEMP. PROBS. 217, 218 (1999). One observer describes globalization as "the interaction of national economic systems." See Alan Greenspan, *Opening Remarks* for the Federal Reserve Bank of Kansas City symposium on Global Economic Integration: Global Opportunities and Challenges (August 24-26, 2000) at 1.

2. The information revolution has raised the significance of the "back office operations" supporting other business activities, which were formerly considered as mere "plumbing," but now main operational process of business organizations seeking more profits. See Jane K. Winn, *Catalytic Impact of Information Technology on the New International Financial Architecture*, 34 INT'L L. 137, 146 (2000).

3. Alan Greenspan, Testimony before the Committee on Banking and Financial Services, US House of Representatives (January 30, 1998) at 1.

4. Mario Giovanoli, *Virtual Money and the Global Financial Market: Challenges for Lawyers*, 1 Y.B. OF INT'L FIN. & ECON. L. 3, 16 (1996).

5. A derivative is a financial instrument whose value is based on (derived from) other assets or variable. Derivatives include options, swaps, and warrants. See generally Hal S. Scott & Philip A.

further the allocation of instrument risk mostly traded in over the counter⁶ markets.⁷ As a result, electronic exchanges have been used around the globe for traditional stock-exchange business and for futures⁸ thanks in part to the specific programmes along with modern data-processing techniques.

However, the growth of global networked information systems poses serious threats to the soundness of financial markets thus destabilizing markets around the world because financial information can be transmitted so quickly across borders.⁹ It is argued that "excessive computerization has also tended to deform the financial services industry into a game driven by sheer lust for financial gain, without a broader sense of self-discipline or concern for the overall welfare of the economy or society."¹⁰ As a result, a good number of gullible investors in a scam investment scheme can destabilize the safety of financial markets by rushing in and out of the market based on misperceptions.¹¹

Undoubtedly, the global integration of information technology has become a challenge to the participants of the financial markets. On the one hand, financial services providers need to survive increasing competition with competitors through the prudent management of risks entailed by acting on the opportunities offered by new technologies. On the other hand, regulatory and supervisory authorities should keep pace with rapid financial innovation and make endeavors by striking an appropriate balance in the midst of a rapidly changing market environment since the evolution of the financial services industry driven by technological advances is not likely to stop.

B. FINANCIAL INTEGRATION

Over the past decades, financial markets have tended to become more tightly linked across national boundaries. A notable example of capital market linkages among the countries is the introduction of Euro along

Wellons, *INTERNATIONAL FINANCE: TRANSACTIONS, POLICY, AND REGULATION* 921-998 (5th ed. 1998).

6. Securities transactions are conducted through a telephone and computer network connecting dealers in stocks and bonds rather than through an exchange. *See id.* at 800-801.

7. Giovanoli, *supra* note 4.

8. Futures are an agreement to buy or sell a fixed quantity of a particular commodity, currency, or security for delivery at a fixed rate. Unlike an option, a future contract involves a definite purchase or sale and not an unlimited loss. *See generally* Scott & Wellons, *supra* note 5.

9. Winn, *supra* note 2, at 137.

10. Toyoo Gyoten, *Global Financial Markets: The Past, The Future, and Public Policy*, in *REGULATING INTERNATIONAL FINANCIAL MARKETS: ISSUES AND POLICIES* 18 (Franklin R. Edwards et al., eds., 1991).

11. Winn, *supra* note 2, at 143.

with the advent of EMU (European Monetary Union) which represents a significant change since the breakdown of the Bretton Woods system in 1971 and the movement to floating exchange rates in 1973.¹²

The EMU has eliminated exchange rate fluctuations among the eleven participating countries and dramatically reducing interest spreads and the volatility of the spreads.¹³ The emergence of a unified money market for liquidity with the rapid start of EMU has created a two-tiered structure. The first tier includes the large banks in each domestic market which compete for the European Central Bank (ECB) funds at auction and trade liquidity among them effectively distributing liquidity throughout the Euro area. These large banks operate as hubs for distributing liquidity to a second-tier of smaller institutions in national markets.¹⁴

As for emerging market economies, dramatic evidence of their linkage to global financial markets was drawn during the Asian financial crisis which was preceded by a massive surge in gross private capital flows to emerging market countries and a deep compression of spreads for emerging market borrowers.¹⁵

For example, the five Asian crisis countries (Thailand, Malaysia, South Korea, Indonesia, and the Philippines) received \$47.8 billion in foreign bank loans in 1996. This capital inflow turned into a \$29.9 billion outflow in 1997, a turnaround of almost \$80 billion.¹⁶ Some argues that these changes represent "a shift in tastes of global investors either toward lower assessment of the risks of investing in [Asian] emerging markets

12. Horst Koeler, *The Euro-An Emblem Success and Challenges of European Integration*, Remarks on the Occasion of the Informal Meeting of the ECOFIN Council (December 14, 2001) <http://www.imf.org/external/np/speeches/2001/121401.htm>; see also Bertold Wahlig, *European Monetary Law: The Transition to the Euro and the scope of Lex Monetae*, in INTERNATIONAL MONETARY LAW: ISSUES FOR THE NEW MILLENNIUM Ch. 6 (Mario Giovanoli ed., 2000).

13. The participating countries are Austria, Belgium, Finland, France, Germany, Greece, Iceland, Italy, Luxembourg, Portugal, and Spain. All the European countries are expected to join the EMU by 2010 under the condition that all goes well and the monetary union is prosperous. See Robert Mundell, *The Euro: How Important?* 18 CATO J. 441, 444 (Winter 1999).

14. International Monetary Fund, *International Capital Markets: Developments, Prospects, and Key Policy Issues* 13 (September 2000).

15. Michael Mussa, *Factors Driving Global Economic Integration*, the Federal Reserve Bank of Kansas City symposium paper for Global Economic Integration: Global Opportunities and Challenges 16-17 (August 25, 2000), at <http://www.imf.org/external/np/speeches/2000/082500.htm>. The Chart 5 in Mussa's paper illustrates the financing conditions for emerging markets between 1990 and 2000. According to Mussa's paper, factors driving global economic integration fall into three categories: technological developments, social and individual for the benefits of globalization, and public policy. He stresses that these factors have acted individually and interactively in driving integration.

16. Martin N. Baily et al., *The Color of Hot Money*, 79 FOREIGN AFFAIRS, No. 2 (March/April 2000) at 101.

or toward greater acceptance of such risks.”¹⁷ Encouragingly, a recent annual data on net private capital flows to emerging markets show that net inflows stabilized in 1999 after large falls during 1997-1998.¹⁸

With financial globalization, the international capital flows have increased markedly in the 1990s. Some emphasize the need to determine if there has been a genuine increase in financial market integration because cross-border financial market linkages do not necessarily imply a high degree of financial integration.¹⁹ It is worth noting that according to the causes of the increase in financial market integration the evaluation of degree of financial integration may be variably different. In short, this is because the welfare and policy implications of the apparent higher linkages depend on whether they are the outcome of greater market integration, fewer barriers to free financial trade in the context of financial services liberalization or the globalization of information which still entails barriers.²⁰

Here, there is still a need to investigate the persuasive evidence of growing international financial integration over the last decade. One adopts two indicators to support the evidence.²¹ The first indicator is the sharp expansion in the scale of both gross and net capital flows between industrial countries and between developed and emerging markets.²² According to a balance-of-payments statistics, net inflows into emerging economies rose from virtually zero in 1989 to reach \$307 billion in 1996 before falling to half that level during 1997-1998.²³

17. Mussa, *supra* note 15, at 17.

18. IMF, *supra* note 14, at 44-45 (“The stabilization of net private capital flows reflects continuing growth in foreign direct investment and a recovery in portfolio investment, which more than offset a continuing cutback in bank lending.”). According to the report, net capital inflows to five Asian crisis countries have been broadly unchanged from 1998.

19. Juan Ayuso & Roberto Blanco, *Has financial market integration increased during the 1990s?*, BIS Conference Papers No. 8 (March 2000), International Financial Markets and the Implications for Monetary and Financial Stability, at 175-195. Ayuso and Blanco focus on stock markets and compute direct measures of the changes in market integration in 1990s. They argue that the main driving factor behind the increase in financial market linkages is the information globalization that affects financial prices rather than a higher degree of market integration.

20. *See id.* at 192.

21. William R. White, *Evolving International Financial Markets: Some Implications for Central Banks*, BIS Working Papers No. 66 (April 1999) at 2.

22. For the features of net and gross flows of capital, *see* International Monetary Fund, International Capital Markets: Developments, Prospects, and Key Policy Issues (August 2001) at 6-7 (“Although net capital flows provide useful insights about balance-of-payments financing and net funding requirements, they can considerably understate the volume and volatility of international portfolio rebalancing. Gross flows more closely reflect international transactions and are more relevant in terms of their impact on market prices and volatility.”).

23. The Institute of International Finance, Inc., *Near-Term Prospects for Emerging Market Economies* (October 1998).

Although the financial crisis has subdued the economic growth in emerging economies and private capital flows to these markets net capital inflows are expected to be about \$160 billion in 2002 which is a significant increase from the \$80.5 billion in 1999 and the \$130 billion seen last year but well below the levels of the mid-1990s.²⁴ Nevertheless, gross capital inflows have risen sharply to about six times the level of net flows on a global basis since the mid-1980s.²⁵ As such, the growing global financial integration has been seen despite financial crisis over the decades.

In the meantime it should be recognized that before strengthening the domestic financial system the increase in the volume and volatility of international capital flows driven by the capital account liberalization in light of financial liberalization has been a factor behind the recent costly financial crises.²⁶ However, some argue that financial globalization along with international financial integration will eventually reduce the possibility of a financial crisis since it is associated with increasing direct investment, which is not so risky as portfolio investment.²⁷

By contrast, one argues the recent financial crises have been caused mainly by financial market liberalization and deregulation rather than the global financial integration.²⁸ It is worth noting that the period between 1945 and 1973 was seemingly calm and prosperous since financial markets were operated by a stable system of pegged exchange rates under the Bretton Woods system, widespread controls over capital flows, and strict restrictions on banking activities.²⁹ Arguably, the relaxing of

24. IMF, *supra* note 14, at 46; see also IIF, *Integrated Approach Proposed for a New Phase of Crisis Prevention and Crisis Management to Revive Emerging Market Capital Flows*, IIF Press Release (April 9, 2002).

25. IMF, *supra* note 22, at 7 ("The high level of gross flows relative to net flows suggests that countries and regions that have small net capital flows can nevertheless experience substantial gross inflows and outflows of capital.").

26. Barry Eichengreen et al., *Liberalizing Capital Movements: Some Analytical Issues*, IMF Economic Issues No.17 (Feb. 1999) ("It is not financial liberalization that is at the root of the problem but rather weak management in the financial sector and inadequate supervision and regulation, whose consequences are magnified by liberalization.").

27. Paul Krugman, *Crises: The Price of Globalization*, the Federal Reserve Bank of Kansas City symposium paper for Global Economic Integration: Global Opportunities and Challenges (Aug. 24-26, 2000) at 104. He stresses although the process of globalization increased the risk of financial crisis, the increase in trade as tradeoffs of the policies reducing the risk of financial crisis via costly restrictions on capital flows may lead to a reduced likelihood of financial crisis in the long run because a depreciation of the currency is likely to have net explanatory effects with increased trade.

28. Charles Goodhart, *Commentary: Crisis: The Price of Globalization*, the Federal Reserve Bank of Kansas City symposium paper for Global Economic Integration: Global Opportunities and Challenges (Aug. 24-26, 2000) at 108.

29. *Id.* at 107.

these financial regulations after 1974 brought about not only economic benefits but also potential risks of financial crisis.³⁰

Another indicator of the increase in financial integration is the creation of new financial markets and instruments to facilitate diverse transactions around the world.³¹ In particular, the offshore markets have seen the rise of financial transactions in domestic currencies to be conducted abroad although it is argued that the markets generated by the providers inducement on the users, due to the financial regulatory discrepancies and the differences in the investors perceptions of markets³² rather than the fair share of financial innovation.³³

Furthermore, new financial instruments and financing techniques have rapidly developed and grown in response to the desire of market participants over the last decades. The advent of asset securitization which links banking markets with capital markets has spread to meet the needs of financial market participants. This new method of financing helps the financial institution or corporations (originators) transform their illiquid financial assets into highly liquid securities to improve their financial situation and liquidity.³⁴

This new technique has been used to remodel all the assets such as home mortgages, credit card debt, student loans, car loans and equipment leases into asset-backed securities. As a result, credit has been expanded to consumers and the liquidity or flexibility for lenders with the

30. Goodhart stresses that there is a need to restructure the framework for regulating banking and financial sector s to restrict volatile short-term capital flows rather than as direct control. *Id.* at 110.

31. White, *supra* note 21.

32. Movements of money from the national markets to offshore banking centers have been motivated by four factors: the profit incentive, financial privacy and secrecy, tax benefits (tax savings/avoidance), and protection of assets from lawsuits and other liabilities. See B. Chad Bungard, *Offshore Banking in the British Dependencies*, 9 *TOURO INT'L L. REV.* 141, 143-145 (2001).

33. Gunter Dufey & T. Chung, *International Financial Markets: A Survey*, in *INT'L FINANCE AND INVESTING* 3-29 (R. Kuhn ed. 1990) cited in Scott & Wellons, *supra* note 4, at 7.

34. Securitization refers to the process by means of which primary creditors (originators) transfer a diversified, segregated illiquid income producing pool of assets (underlying assets) to a third party (special purpose vehicle) to transform and restructure these underlying assts and sell them into tradable equity or debt instruments. The means by which these transformation and restructuring are accomplished include pooling, unbundling, repackaging and refinancing of existing financial assets into securities or instruments that can be sold to and traded by investors in capital markets. See Tamara Frankel, *SECURITIZATION, STRUCTURED FINANCING, FINANCIAL ASSETS POOLS, AND ASSET-BACKED SECURITIES*, Vol. I, 3 (1999). For example, a special purpose vehicle (entity) purchases a pool of car loans from the creditor, using money it got by the sale of securities that are collateralized by the loans. As a result, interest and principal payments on the car loans are used to pay interest and principal on the asset-backed notes.

modulation for investors has been getting greater.³⁵ Likewise, derivative instruments have developed to meet the market participants' needs to repackage credit risk into discrete bundles thus increasing the debt market liquidity together with the improvement of the participants' balance sheets.

According to the recent data, at end of 2000 over-the-counter derivatives markets comprise \$95 trillion in notional principal and daily aggregate global turnover rose to about \$1.4 trillion.³⁶ As recognized, financial derivatives have created considerable benefits by allowing investors to unbundle and redistribute diverse risks such as foreign exchange, interest rate, market and default risks thereby contributed to the improvement of market liquidity and increase in the capacity of the financial system to bear risk and intermediate capital.³⁷

However, there is a concern that heavy reliance on new and innovative financial techniques and instruments can cause a serious turbulence resulting in financial panics and banking crisis.³⁸ Although securitization can create several benefits in the financial market it also raises some potential risks particularly to the banking system. Most importantly, a financial institution may be in big trouble when the originator could not achieve a true sale of the assets and recognize the incurred losses when the assets cease to reform subsequently.³⁹ Also, potential risks arise when banks in pursuit of a favorable market reception for the securitized assets may tend to sell off the highest quality assets despite their retention of lower quality assets and thereby increase the average risk in the remaining portfolio.⁴⁰

Securitization may also raise systemic risks leading to the increase in the fragility of the financial system in both national and international contexts as long as it reduces the proportion of financial assets and liabilities held by banks in countries where the variable minimum reserve requirement system control the central banks operation.⁴¹ Furthermore, various securitization plans have been introduced to reduce the third

35. Diana B. Henriques, *The Brick Stood Up Before. But Now?*, The New York Times (Mar. 10, 2002) at § 3, Page 1, Column 1.

36. IMF, *supra* note 22, at 30.

37. IMF, *supra* note 14, at 79.

38. *Id.* at 83.

39. Basel Committee Report on Asset Transfers and Securitization (Sept. 1992) at 5.

40. *Id.* at 6.

41. Under the system, a country's central bank can control the domestic money supply by raising or lowering the level of minimum reserves, which banks should maintain. The effectiveness is reduced with the decrease in the overall level of assets and liabilities held by financial institutions. *Id.* at 7.

world debt⁴² which arose by the loaning of unprecedented sums of money from commercial banks in industrial countries to developing nations of the third world in the 1970s due to the increase in the reserves resulting from an influx of oil-generated deposits by the Organization of Petroleum Exporting Countries (OPEC).⁴³

As highlighted in the third world debt crisis of the 1980s, arguably securitization plans may be inadequate measures of alleviating the debt problem so far as the plans cannot address the debt nation's major problem of simply having too much external debt to service in the near or medium-term future.⁴⁴

Similarly, derivatives activities can cause the build up of financial system fragilities and adverse market dynamics in some cases as demonstrated in the recent events of near collapse of the U.S. hedge fund, Long-Term Capital Management (LTCM),⁴⁵ and the Enron debacle⁴⁶ in mature financial markets. The turbulence of the near-failure

42. Mostly, these plans entail repackaging of debts into a negotiable instrument, such as bond, which creditor banks may thereafter sell on the secondary markets to private investors. See Robert Plehn, *Securitization of Third World Debt*, 23 INT'L LAW, 161, 162 (1989).

43. Alfred J. Puchala, Jr., *Securitizing the Third World Debt*, 1989 COLUM. BUS. L. REV. 137 (1989).

44. It is argued what the debtor nations really need is for creditors to forgive and write down a portion of the debt until the situation stabilizes and only thereafter, should securitization of the debt be considered. See David W. Leebron, *First Things First: A comment on Securitizing Third World Debt*, 1989 COLUM. BUS. L. REV. 173 (1989).

45. Between January and September 1998, LTCM, one of the largest U.S. hedge funds and most important market-makers and providers of liquidation in securities markets, lost almost 90 percent of its capital. By August 1998, with less than \$5 billion of equity capital, LTCM had earned a very highly valued counterparty status and highly leveraged trading positions through assembling of a trading book that involved about 60,000 trades, including on-balance-sheet positions totaling \$125 billion and off-balance-sheet positions including about \$1 trillion of notional OTC derivative positions. In September 1998, the Federal Reserve determined that rapid liquidation of LTCM's trading positions and related positions of other market participants might raise a serious threat to already unsettled international financial markets. As a consequence, the Federal Reserve facilitated a private sector recapitalization to prevent the collapse of LTCM. See United States General Accounting Office (GAO), *Long-Term Capital Management: Regulators Need to Focus Greater Attention on Systemic Risk*, Doc. No. GAO/GGD-00-03 (Oct. 29, 1998) at 1, <http://www.gao.gov>; see also IMF; *supra* note 14, at 85.

46. Enron was the main dealer, market-maker, and liquidity provider in major segments of the OTC energy derivatives markets, and at end-September 2001, its overall derivatives trading liabilities stood at nearly \$19 billion. However, its non-recurring charges amounted to \$1.01 billion for the third quarter of 2001, and net income was reduced back to 1997 by \$586 million, or 20%. The collapse resulting from the aggressive use of accounting techniques to mask the Enron's excessive leverage and weak earning caused important volatility in financial markets, and considerable losses for market participants, which may lead to the risk of systemic consequences for financial markets. The plummeting of Enron's shares and credit rating in October 2001 resulted in its filing for bankruptcy in two months. Arguably, the Enron case raised three capital market issues: inadequate oversight of financial activities of nonfinancial institutions, ineffective private market discipline, disclosure, corporate governance and auditing, and misallocation of retirement savings. See IMF, *Global Financial Stability Report* (March 2002) at 41-42. See also, John R. Emshwiller, Rebecca Smith & Jonathan Weil, *Enron Slashes Profits Since 1997 by 20%*, WALL ST. J., Nov. 9,

of LTCM in late 1998 was preceded by the accumulation of a complex network of derivatives counterparty exposures, encompassing a high degree of leverage in the major markets through late summer 1998 and the adverse shift in market sentiment following the Russian crisis in mid-August 1998.⁴⁷ In short, the near-collapse raised concerns that heavy reliance on innovative financial techniques and undue reliance on historical information got the market participants into serious trouble.⁴⁸ As such the virulence of the LTCM turbulence posed the risk of systemic impact on global financial system and real economic activities.

Meanwhile, in late 2001 the collapse of Enron; a non-financial institution, energy trading and distribution corporation highlighted the uncertainties about the effective functioning of credit-risk transfer vehicles⁴⁹ used to hedge or take on credit exposures across markets and sectors.⁵⁰ Even though these financial instruments and markets, which are usually driven by regulatory arbitrage offer some benefits to the market participants including non-traditional players, the complexity of financial transactions and markets have posed new challenges to the market.⁵¹ As demonstrated in the Enron case, the vast use of derivatives by way of

2001, at A3; Enron Corporation, Press Release, *Enron Reports Recurring Third Quarter Earnings of \$0.43 per Diluted Share; Reports Non-Recurring Charges of \$1.01 Billion After-Tax; Reaffirms Recurring Earnings Estimates of \$1.80 for 2001 and \$2.15 for 2002 and Expands Financial Reporting* (Oct. 16, 2001)

www.enron.com/corp/pressroom/release/2001/ene/68-3QEarningsLtr.html.

47. The Russian turmoil due to Russia's devaluation and unilateral debt restructuring sparked a broad-based reassessment and repricing of risk and large scale deleveraging and portfolio rebalancing that cut across a range of global financial markets. See IMF, *supra* note 14, at 85.

48. The Russian crisis deprived the LTCM of its engaging in highly leveraged bets on the historical interest rate spread between riskier debt instruments and US Treasury bonds, and thereby drove investors' worldwide flight of high risk investments to safety. See Steve Lipin, Matt Murray & Jacob M. Schleginger, *Bailout Blues: How a Big Hedge Fund Marketed its Expertise And Shrouded Its Risks*, WALL ST. J., Sep. 25, 1998, at A1.

49. Notably, credit risk transfers can foster the efficiency and stability of credit markets overall the allocation of capital with the growth of the markets by the separation of credit institution from credit risk bearing. Also, they can reduce the concentration of credit risk in financial systems by helping nonfinancial corporations take on the credit risks held by banks. Additionally, credit risk transfers create the diversification of financial institutions' credit exposures across markets and sectors, and facilitate the trading of credit risk, and thus, financial and nonfinancial institutions can flexibly manage their credit exposures. Moreover, liquid credit risk transfer markets can enhance price discovery and provide price information. See Global Financial Stability Report *supra* note 46, at 38-39.

50. *Id.* at 41.

51. Arguably, there are some concerns about these instruments and markets. First, they reduce transparency regarding the institutional distribution of credit risk and its concentration. Second, they may create or magnify channels, which help credit events-associated distress spread across institutions and markets. Third, these instruments are not seemingly regulated as well as banks, and not necessarily have the experience required to price properly and manage these risks. Finally, the mechanism of credit risk transfer augments the potential for mispricing and misallocation of capital by adding the leveraged instruments to the total amount of credit. *Id.* at 39.

credit risk transfers raised concerns over potential systemic risks.⁵² Moreover, the Enron case called for “much greater transparency and the increased completeness in the accounting treatment of derivatives”⁵³ since it seemingly engaged in manipulative accounting transactions to minimize financial statement losses and volatility, augmented profits and avoided adding debt to the balance sheet.⁵⁴ At the time, there were no requirements to disclose information about its risks to counterparties, nor the market price conditions thus the derivatives activities have not been regulated in spite of the size of the derivatives market, its complexities and pivotal role in the energy markets under the 2000 Commodity Futures Act.⁵⁵

Under the circumstances, the same financial techniques used for the asset securitization were arguably applied to “construct the elaborately camouflaged and booby trapped partnerships” resulting in the Enron’s collapse.⁵⁶ That is, the non-consolidated special purpose entities (vehicles) were used to hedge certain Enron investments in its manipulations. However, it should be recognized that the problem in the Enron case is not the securitization, a process of creating asset-backed securities but the more Enron-like uses of structured finance.⁵⁷ Arguably, Enron’s abuse of special purpose vehicles posed fundamental questions whether its SPV transactions transferred risks of the hedged assets owned by Enron to others⁵⁸ because of the SPVs’ inability to perform their hedges resulting from the simultaneous fall in Enron’s asset and stock values.⁵⁹ In this sense, the Enron collapse has not been caused directly by

52. Allan Greenspan stresses that despite providing of greater flexibility to the financial system, due to the complexity, the counterparties could get vulnerable to serious risk that “they do not currently recognize, and hence these instruments potentially expose the overall system if mistakes are large.” See Allan Greenspan, Testimony before the Committee on Financial Services, U.S. House of Representatives (Feb. 27, 2002) at 8.

53. See *id.*

54. As a consequence, the Enron’s credit rating was damaged, and thus its credibility in energy trading business was hurt. See Report of Investigation by the Special Investigation Committee of the Board of Directors of Enron Corporation (Feb. 1, 2002) at 4, 36, 68, 78, 97.

55. Global Financial Stability Report, *supra* note 46, at 41. However, the U.S. Congressional Hearings have affirmed that certain energy derivatives activities do not fall into the categories that are exempted from key regulatory provisions under the act.

56. Henriques, *supra* note 35.

57. *Id.* (quoting law professor Ronald Gilson that “Enron gives a very useful tool a bad name for no reason. Structured finance is used for a zillion different and worthwhile purposes. The problem is Enron used it to create a structure that was genuinely not transparent, to hide things.”).

58. Steven L. Schwarcz, *Enron, and the Use and Abuse of Special Purpose Entities in Corporate Structures*, 7 (July 2002), available at http://ssm.com/abstract_id=306820; see also Henriques, *supra* note 35 (quoting law firm partner David Eisenberg that “securitization is about transferring risk to others – and Enron only appeared to be doing that, when in reality they were retaining the risk themselves”).

59. Steven L. Schwarcz, *STRUCTURED FINANCE, A GUIDE TO THE PRINCIPLES OF ASSET SECURITIZATION* § 1:1, at n. 41 (3rd ed. 2002).

the new financial techniques and instruments but rather by a partly ineffective private market discipline, disclosure, corporate governance, and inadequate accounting rules should be blamed for the Enron case.⁶⁰

Consequently, any regulatory re-evaluation needs to keep in mind a long-term perspective so that market participants can take advantage of the everlasting financial innovation in the age of the information economy. Additionally, financial institutions need to strengthen credit risk management practices to foster their review of new financial instruments. Needless to say, the market participants' attention to the lessons from the recent episodes and adoption of the adequate policies and controls will substantially prevent or minimize the risks of repeating similar excess in the near future.⁶¹

C. FINANCIAL DEREGULATION

As noted, financial regulators have responded to the evolution of financial markets which are propelled by the competition among financial service providers. However, the regulatory authorities are continuously getting behind the structural changes in the financial services industry and thereby react to immense pressures by relaxing the financial regulations or implementing new regulations

Despite the regulators efforts, the increasing complexity of financial services transactions involving the cross-institutional and cross-border activities has reduced the effectiveness of financial regulation thus eroding statutory and physical barriers between financial sectors and jurisdictions which lead to regulatory changes and convergence of financial regulatory standards in response to the regulatory arbitrage. These structural trends have blurred traditional distinctions between banking and other types of financial activities resulting in "one-stop" shopping for the customers of the financial services industry and a concentration of financial services in larger institutions through merges and acquisitions. As such, there has been remarkable convergence of banking and financial sectors.

The recent repealing of the Glass-Steagall Act (Section 20), which prohibited banks from engaging in securities underwriting, under the Financial Modernization Act of 1999 (the Gramme-Leach-Bliley Act) in

60. Global Financial Stability Report, *supra* note 46, at 41.

61. Richard Spillenkothen, Testimony before the Permanent Subcommittee on Investigations of the Committee on Government Affairs, U.S. Senate 6 (Dec. 11, 2002).

the U.S.,⁶² and the dismantling of Japan's statutory separation of banks, securities firms, and trust banks⁶³ are examples of the new regulatory approach to the structural trends.⁶⁴

Moreover, international competition between national regulatory authorities based on regulatory discrepancies⁶⁵ has intensified the pressure for deregulation of financial markets in the domestic arena. As a result, the international pressures along with globalization of financial markets spurred the domestic financial liberalization.⁶⁶ This competitive deregulation and liberalization process have removed the anti-competitive regulatory restrictions, and brought the increased competition for the financial market industry resulting in efficiency and lowered costs in the financial services sector.⁶⁷ The financial market participants enjoy net benefits from both lower prices for the financial services and the improvements in quality and access to new financial instruments through deregulation and liberalization.⁶⁸

In the meantime, there are some concerns about the potential risks and other shortcomings raised by financial deregulation.⁶⁹ In short, the issues fall into broad categories including financial market volatility, resulting from the large swings in financial market prices, debt build-ups and asset

62. Glass-Steagall Act, 12 U.S.C. § 377 (repealed 1999); and Gramm-Leach-Bliley Act § 101(a).

63. In light of the financial "Big Bang," the Law Amending related laws for Financial System Reform amended over 21 laws including the Securities and Exchange Law, Banking Law, and Insurance Law (Law No. 107 of 1997). See Mamiko Yokoi-Arai, *The Japanese Banking Crisis: Some Historical and Regulatory Aspects*, Y.B. OF INT'L FIN. & ECON. L., 205, 217 (1999).

64. At the extreme, the regulatory trends are toward the German-style "universal banking," in which banks are allowed directly to underwrite securities and invest in equities of nonblank institutions. See Richard J. Herring & Robert E. Litan, FINANCIAL REGULATION IN THE GLOBAL REGULATION 10-11(1995).

65. Differences in regulatory constraints between national financial systems have driven the shift of financial activities from one location to another than to accomplish their intended goals in some cases. See *id.* at 20. Such cases demonstrate that the regulators need to anticipate to the providers' circumvention of the regulation through the financial innovation, and thereby react by new regulation or deregulation. In particular, deregulation has played an important role in stimulating financial innovation while innovation has spurred financial deregulation. In short, financial innovation and regulation are mutually reinforcing.

66. For example, Japan's financial liberalization in the early 1980s resulted from the United States' pressures for Japan to make its financial services industry effective. See K. Osugi, *Japan's Experience of Financial Deregulation since 1984 in an International Perspective* (Basle: Bank for International Settlements, Jan. 1990) cited in OECD, *Regulatory Reform in the Financial Services Industry: Where Have We Been? Where Are We Going?*, FIN. MKT. TRENDS, No. 67 (June 1997) at 36.

67. OECD, *supra* note 57, at 53. While financial deregulation has created gains from efficient resource allocation such as the improved capacity of consumers and private businesses to allocate their spending over time thanks to increased capital mobility, it has also raised extensive changes in the financial and macro-economic environment. *Id.* at 59-63.

68. *Id.* at 56.

69. *Id.* at 63-75.

price bubbles preceded by flexibility of available financial instruments and the increased access to credit, banking sector problems, and recent international debt problems due to international capital flows.

However, it is argued that the costs and risks of deregulation can be outweighed by its benefits if only deregulation is appropriately implemented and entailed by necessary policy reforms affecting financial incentives.⁷⁰ More importantly, the financial deregulation process should be accompanied by proper reform efforts such as prudential supervision and regulation of financial markets to ensure financial stability. In this regard, the regulatory competition can focus on the quality of regulation such as its ability to deliver results in terms of financial efficiency and stability rather than the regulatory laxity.⁷¹

D. CONVERGENCE OF GLOBAL STANDARDS

There have been some debates over whether the cross-national convergence of regulatory policy is desirable by the pressure of globalization. Arguably, globalization pushing the elimination of all barriers and differences⁷² among nations and cultures has brought sharing same values accompanied by the convergence⁷³ of economic and political systems despite differences between countries with market economies.⁷⁴

In particular, the financial globalization has caused policy convergence,⁷⁵ a general convergence of policy goals, policy instruments, and policy

70. *Id.* at 75.

71. Wendy Dobson & Pierre Jacquet, FINANCIAL SERVICES LIBERALIZATION IN THE WTO 112 (1998).

72. However, some argue that globalization is misunderstood as "the promotion of homogeneity across the face of the earth as a bulldozer. [G]lobalization is a technological and telecommunications revolution, a phenomenon of the information age, which will not necessarily erase all differences and barriers between nations and cultures." See Douglas M. Branson, *The Very Uncertain Prospect of "Global Convergence" in Corporate Governance*, 34 CORNELL INT'L L.J. 321, 326-327 (2001).

73. As for the meaning of convergence, one defines it as "the process of applying increasingly similar rules to a given situation in different jurisdictions, and is closely related to the harmonization and approximation of laws." See Andrew M. Whittaker, *Tackling Systemic Risk on Markets: Barings and Beyond*, in THE FUTURE FOR THE GLOBAL SECURITIES MARKET 259, 261 (F. Oditah ed. 1996). Similarly, convergence is described as "the process by which the rules, regulations, or political institutions governing economic activity in different countries become more similar." See Henry Laurence, *Spawning the SEC*, 6 IND. J. GLOBAL LEGAL STUD. 647, 649 (1999).

74. Alex Y. Seita, *Globalization and the Convergence of Values*, CORNELL INT'L L.J. 429, 465-469 (1997) (arguing that sharing the same values promotes "similar expectations and a common ground for understanding" and thereby creating the closer relationship in human society).

75. Policy convergence is composed of different dimensions including policy goals, "a coming together of intent to deal with common policy problems," policy instruments, "the institutional tools available to administer policy, whether regulatory, administrative or judicial," and policy style, "a more diffuse notion signifying the process by which policy responses are formulated." See C.J. Bennett, *What is Policy Convergence and What Causes It?*, 21 BRIT. J. POL. SCI. 215, 219 (1991).

style. Namely, in response to the financial globalization, the international cooperation has produced the widespread adoption of similar regulatory technique and harmonized global standards by way of negotiated and multinational agreements among different national regulatory authorities.⁷⁶

While the convergence advocates note that the global convergence does not necessarily imply the convergence of identical regulatory standards and structures among different nations, they emphasize the convergence of basic values and fundamental systems to promote the reliance on market forces thus attracting international businesses and increasing economic benefits.⁷⁷

In this regard, one of the most controversial debates in the field of international economic law concerns the desirability of international cooperation. Explaining the relationship between internationalization and public choice, one of the proponents for international cooperation advocates that "international cooperation is likely to be welfare-improving in the majority of contexts, though the exact nature of that cooperation must vary from one subject to another."⁷⁸ This advocate identifies several reasons why international cooperative efforts should be encouraged.⁷⁹ First, the increasing inability of national authorities to regulate transnational activities and the unsuccessful non-cooperative strategies need international cooperation. Second, international cooperation is desirable and successful because of the increase in welfare associated with cooperation in trade liberalization under the WTO despite its value-subtracting cooperation. Third, even if international cooperation can be welfare-reducing, the argument for cooperation may be strengthened since the cooperation allowed nations to consider a broader range of interests thus producing a remarkable growth in trade and welfare.

76. One describes this convergence process as "negotiated convergence" because it is the byproduct of extensive negotiation among different regulatory authorities and the usual compromises and trade-offs inherent in bargaining. See Heidi Mandanis Schooner & Michael Taylor, *Convergence and Competition: The Case of Bank Regulation in Britain and the United States*, 20 MICH. J. INT'L. L. 595, 597-598 (1999).

77. Laurence, *supra* note 73, at 649-650; see also Seita, *supra* note 73, at 466-469.

78. Andrew T. Guzman, *Public Choice and International Regulatory Competition*, 90 GEO. L.J. 971, 972-974 (2002). By contrast, Stephan and O'Hara's skepticism identifies about the potential hazards of international cooperation resulting from the probability and the costs of welfare-reducing international agreements through facilitating transfer payments and logrolling. See Paul B. Stephan, *The Political Economy of Choice of Law*, 90 GEO. L.J. 957, 960-961 (2002); Erin A. O'Hara, *Economics, Public Choice, and the Perennial Conflict of Law*, 90 GEO. L.J. 941, 948-956 (2002).

79. Guzman, *supra* note 78, at 978-979.

To support the argument, the international cooperation advocate asserts the determination of the appropriate level of cooperation when it should be used.⁸⁰ In particular, it is worth noting that when the other levels of cooperation fail, supranational standards and regulations should be alternatively taken into account because of their potential to reduce the cost of transfers among nations which makes it easier to reach an agreement.⁸¹

In contrast to the international cooperation advocate, some argue that international cooperative efforts have faced a great degree of skepticism at the national level because the efforts lack the political accountability of elected and appointed officials at national and local levels.⁸² Thus, the domestic decision-makers or bureaucrats face severe constraints on their behavior as opposed to international lawmakers thereby bearing some political accountability for their choices.⁸³ Also, international cooperative efforts have brought about skepticism because they lack the transparency of local lawmaking.⁸⁴ Due to the lack of transparency, a great rate of economic rents and returns in excess of what is necessary to keep a given resource from transferring to other occupation, have been sought all over the world. As such, bureaucrats may foil the cooperative efforts unless they have chances to engage in rent seeking thereby decreasing transparency and engaging in turf protection.⁸⁵ Furthermore, the pessimistic perspective on cooperative efforts classifies into two categories the reasons why international cooperation may produce undesirable outcomes.

80. See *id.* at 980-983 (providing several levels of cooperation that are available: first, a laissez-faire system as the lowest level of cooperation, second, a nation's setting of the terms of its interactions with other nations through a unilateral selection of choice-of-law rules, third, an agreement on choice-of-law rules without any comments on substantive rules, fourth, harmonization of substantive laws as a higher level of cooperation, alternatively, supranational standards and regulations as the highest level of cooperation).

81. See *id.* at 983 (taking as the best examples of this strategy, international trade and international intellectual property under the WTO, and international banking regulation through the Basel Accord).

82. Paul B. Stephan, *The Futility of Unification and Harmonization in International Commercial Law*, 39 VA. J. INT'L L. 743, 752 (1999) (arguing that this is because "[n]o mechanism exists for voters to pass judgment on the international lawmakers. At best, they can vote for the domestic governments that in turn chose the drafters of international agreements.").

83. Paul B. Stephan, *Accountability and International Lawmaking: Rules, Rents and Legitimacy*, 17 NW. J. INT'L L. & BUS. 681, 682, 732 (1996-97).

84. See *id.* at 699 (positing that "interest groups tend to have somewhat lower costs of expressing their preferences to executives engaged in international lawmaking than in conveying their wishes to domestic legislators, and that the general public has higher monitoring costs with respect to international lawmaking").

85. Stephan, *supra* note 83, at 706.

First, negotiators may give excessive weight to the preferences of private groups with unrepresentative preferences but especially low organizational costs. Second, persons with an interest in the institutions established or promoted by international cooperation may seek the adoption of agreements that expand the competence, discretion, and authority of those institutions at the expense of desirable regulatory outcomes.⁸⁶

More importantly, this pessimistic point of view on the cooperative efforts points out the costs of cooperation and welfare-reducing agreements.⁸⁷ The grounds for welfare-reducing international cooperation fall into three categories.

First, the negotiators have powerful incentives to achieve some kind of agreement regardless of substantive outcome.⁸⁸ Association with a concluded agreement brings prestige opportunities to offer interpretation, and invitation to participate in subsequent negotiations. Second, the legislatures face take-it-or-leave-it choices that limit their power to shape what gets adopted. Thus, they are [unlikely] to reject agreements that may reduce overall welfare.⁸⁹ Third, the difficulty of reaching the sustained level of agreement necessary to permit frequent updates of existing agreements pushes negotiators toward delegations of lawmaking authority to international institutions.⁹⁰

Even if international cooperative efforts have been remarkably increasing over the last decades, there is still concern that international cooperation has pitfalls and should be approached cautiously.⁹¹ As noted, the lack of

86. Stephan, *supra* note 78, at 960-961.

87. In general, the costs incurred by a potentially undesirable agreement, discounted by the likelihood of the structure producing such an agreement is greater than the benefits of a potentially desirable agreement, discounted by the likelihood of a particular institutional structure achieving it. *See id.* at 960.

88. In response to this argument, Guzman advocates that this does not show an important ground to resist international cooperation for three reasons. First, as long as a pro-agreement bias exists among the negotiators as agents for the nations, the principals have an incentive to correct for this through a change in the negotiators. Second, there are many ways to "reach a deal" without imposing important commitments on a nation under international law. Third, despite a bias toward some kind of agreement, the bias may be helpful rather than harmful in light of the overall negotiating structure of international law, under which the consent of every participating nation is required for international agreements in accordance with the unanimity rule. *See id.* at 974-975.

89. As for this argument, Guzman casts doubts for two reasons. First, the negotiators are controlled by the executive, and thus the nation has a chance to shape the content of the agreement. Second, the legislature's decision to accept a take-it-or-leave-it offer does not imply that it is not likely to approve a welfare-reducing agreement. *See id.* at 975-976.

90. *Id.* at 961. In contrast to this concern of entrenchment by international bureaucrats, Guzman claims that the concern is a concern about the form of cooperation rather than its merit since many forms of cooperation can proceed without formal institutions. *See id.* at 975.

91. Paul B. Stephan, *supra* note 83.

transparency, the lack of political accountability and the rent-seeking may impede convergence.⁹² Here, it should be noted that there is no trend to homogeneity in world economies as opposed to the globalization thesis. Moreover, modernization and Westernization are not converging trends in contrast to the underlying premise of global convergence scholarship implies.⁹³

With respect to the convergence thesis, some argue that nations still pursue diverse policy choices. In this regard, one examines the hypothesis that the Keynesian welfare policies of West European nations will be eroded by the international financial integration and concludes that notwithstanding the increased exertion of capital integration over the past two decades, "powerful pressures for convergence in economic policies,"⁹⁴ such convergence has not happened, and that "the evidence on fiscal policy conflicts sharply with the convergence thesis."⁹⁵ Another argues that "the international outcome [of financial integration] is solidly rooted in domestic policy dilemmas and distributional debates, "and that "[financial] markets remained distinctively national."⁹⁶

Nevertheless, the global convergence fueled by the process of globalization has grown significantly in international economic affairs. As a matter of fact, international cooperative efforts have brought up the less complete global convergence of harmonization in regulatory standards. Therefore, international convergence of regulatory standards and legal rules has increasingly become a noticeable trend in the global finance. Thus, for capital market concerns, several international forums have been created to cooperate in setting minimum standards among various international bodies as a process of the global convergence.⁹⁷

92. In addition, one indicates as one of the grounds the pretentious "we know better" tone of much of the convergence advocacy. See Branson, *supra* note 72, at 339.

93. John Gray, FALSE DAWN: THE DELUSIONS OF GLOBAL CAPITALISM 169-170 (1998) cited in Branson, *supra* note 72, at 349. It is argued that for much of the world, modernization and Westernization have become diverging trends or, indeed, anathema to one another.

94. Geoffrey Garrett, *Capital Mobility, Trade, and the Domestic Politics of Economic Policy*, 49 INT'L ORG. 657, 657 (1995).

95. See *id.* at 659.

96. Andrew C. Sobel, *Domestic Choices*, INTERNATIONAL MARKETS 19, 143 (1994), cited in Laurence, *supra* note 73, at 652-653.

97. The international cooperation and coordination in global finance have been underway through the Basel Committee, the International Organization of Securities Commissions (IOSCO), the International Association of Insurance Supervisors (IAIS), the International Accounting Standards Committee (IASC), the Joint Forum, and the Financial Stability Forum. Moreover, the International Monetary Fund (IMF) and the Organization for Economic Cooperation and Development (OECD) have played a major role in helping assess the fragilities of global markets and enhancing institutional coordination and exchange of information. See Joseph J. Norton, A "New

III. IMPLICATIONS OF GLOBALIZATION FOR STATE SOVEREIGNTY

A. THE BACKDROP

The process of globalization has transformed the traditional view of international law for the nation-state sovereignty, which is associated with exclusive territorial jurisdiction since the Treaty of Westphalia in 1648.⁹⁸ The traditional notion of the state sovereignty has been subject to critical scrutiny due to the rapid financial integration, the growth of regionalism around the globe, and the advent of international regulatory regimes.⁹⁹

In recent years, the impact of globalization on the dominance and autonomy of nation-state has been increasingly the subject of heated debate cutting across various disciplines. Some observers stress a need for "relocation of authority," both to the international level for problems for which the share is too small to operate effectively, and to the sub-state level, for tasks for which it are too large.¹⁰⁰ Others claim that states have lost sovereign authority in the face of independent regulatory activities by business association.¹⁰¹ This results from "the alleged loss of functions to international institutions, to pressure to develop power to regional movements demanding autonomy or secession, and to the

International Financial Architecture?"- Reflections on the Possible Law-Based Dimension, 33 INT'L LAW 891, 899-904 (1999).

98. Since the 17th century, the modern state has been the dominant entity in domestic and international affairs both in terms of power and regulatory authority. See John Ruggie, *Territoriality and Beyond: Problematizing Modernity in International Relations*, 47 INT'L ORG. 139, 174 (1993).

99. Kanishka Jayasuriya, *Globalization, Law, and the Transformation of Sovereignty: The Emergence of Global Regulatory Governance*, 6 GLOBAL LEGAL STUD. J. 425, 426 (1999) (arguing that "[t]he notion of a single unified system of internal sovereignty [the development of the internal coherence within the nation-state] has become increasingly problematic in a global political economy surrounded by islands of sovereignty, rather than by a single, central decisionmaking authority"). Jayasuriya claims that the development of this "complex sovereignty" reflects the transformation and reconstitution of the notion of nation-state and sovereignty in the light of financial globalization. *Id*

100. P. Kennedy, PREPARING THE TWENTY-FIRST CENTURY 131 (1993).

101. L. A. Kahn, *The Extinction of Nation-State*, 7 AM. U. J. INT'L L. & POL'Y 197 (1992) (noting the gradual ending of the primacy of the traditional state); see also Jan A. Scholte, *Global Capitalism and the State*, 73 INT'L AFFAIRS 427, 444-445 (1997) (arguing that "the end of state sovereignty does not mean the end of state"). Scholte recognizes that the more powerful states have retained important influence in contemporary global finance. *Id*

difficulty of effectively controlling large multinational enterprises, the flows of international finance and of information and ideas."¹⁰²

The new medievalists proclaiming the end of the nation-state emphasize the role of non-state actors with multiple allegiances and global network¹⁰³ while liberal internationalists¹⁰⁴ recognize a need for international rules and institutions, constituted by a legally binding treaty, with expanding powers of governance to solve states' problems. The adherents of new medievalism also conceive the development of a complex and varied international order with multiple layers and actors that is more akin to the order of medieval times.¹⁰⁵

In this sense, this view is construed as "a back-to-the-future model of the twenty-first century."¹⁰⁶

Another view of the "chaos paradigm" specifically addresses the decline of nation-state as an institution.¹⁰⁷ This view highlights the sharp rise in tribal, ethnic and religious conflict, the rapid increase in the activities of international criminal mafia organizations, the proliferation of biological, chemical and nuclear weapons, the increase of international terrorism, the problem of massive refugee flows and the appearance of acts of genocide and "ethnic cleansing."¹⁰⁸

102. Peter Malanczuk, *Globalization and the Future Role of Sovereign State*, in INTERNATIONAL ECONOMIC LAW WITH A HUMAN FACE 46-47 (Friedl Weiss et al., eds. 1998).

103. Jessica T. Mathews, *Power Shift*, 76 FOREIGN AFFAIRS, No. 1 (Jan./Feb. 1997) at 64 (describing a shift away from the state—up, down, and sideways—to supra-state, sub-state, and above all, non-state actors").

104. Michael Zuern, *From Independence to Globalization*, in THE HANDBOOK OF INTERNATIONAL RELATIONS 235 (Walter Carlsnaes et al., eds. 2000). The liberal internationalism requires a centralized rule-making authority, a hierarchy of organizations, and universal membership: the United Nations is one of the standard or classical models of international institutions.

105. See generally Samuel Huntington, THE CLASH OF CIVILIZATION AND THE REMAKING OF WORLD ORDER (1996).

106. Anne-Marie Slaughter, *The Real New World Order*, 76 FOREIGN AFFAIRS, No. 5 (Sep. / Oct. 1997) at 183. Slaughter pointed out two central weak points of the new medievalism: first, private power does not take the place of state power; second, "the power shift is not a zero-sum game [because] [a] gain in power by non-state actors does not necessarily translate into a loss of power for the state." See *id.* at 184.

107. See Huntington, *supra* note 105.

108. See Zbigniew Brzezinski, OUT OF CONTROL (1993); see also Daniel Moynihan, PANDAEMONIUM: ETHNICITY IN INTERNATIONAL POLITICS, cited in Huntington, *supra* note 11, at 35. This is a world in anarchic and chaotic world characterized by the breakdown of governmental authority, the dismemberment and fragmentation of states and the appearance of "failed states": Somalia, Liberia, Rwanda, Burundi, Afghanistan, and Yugoslavia. See G.B. Helman et al., *Saving Failed States*, 89 FOREIGN POLICY 21 (1992); see also Oscar Schachter, *The Erosion of State Authority and its Implications for equitable Development*, in International Economic Law with a Human Face 40-42 (F. Weiss et al., ed., 1998).

At the other extreme, adherents of the realist tradition of “international regime” continue to stress the primacy of the nation-state as the central actor.¹⁰⁹ This view has pointed out, in some instances; globalization has led to the expansion of government authority and government spending instead of diminishing the authority of the nation-state.¹¹⁰

By contrast, the adherents of “transgovernmentalism” recognizes that “[t]he state is not disappearing, it is disaggregating into its separate, functionally distinct parts.”¹¹¹ That is to say, that trans-governmentalism notes the frequent interaction among decentralized government agencies (global networks) all over the world rather than formal negotiation. This point of view argues that “[r]egular interaction with foreign colleagues offers new channels for spreading democratic accountability, governmental integrity, and the rule of law.”¹¹² The proponent claims that transgovernmental networks represent “a blueprint for the international architecture of the 21st century.”¹¹³

However, some critiques acknowledge the significance of networks, but hold them as accountable for the reduced transparency and impediment to political accountability.¹¹⁴ Others fear that networks may reinforce the dominance of the major economic powers, particularly inequalities between advanced industrial countries and less developed economy because networks are club-like.¹¹⁵

109. Robert Gilpin, *THE POLITICAL ECONOMY OF DIRECT FOREIGN INVESTMENT* (1975).

110. Geoffrey Garnett, *Capital Mobility, Trade and the Domestic Politics of Economic Policy*, 14 INT'L ORG. 683 (1995).

111. Slaughter, *supra* note 106, at 184. Slaughter argues that “[d]isaggregating the state permits the disaggregation of sovereignty as well, ensuring that specific state institutions derive strength and status from participation in transgovernmental order.” *Id.* at 196. Trans-governmentalism is based on international relations theory. In particular, Keohane and Nye initiated the exploration of “trans-governmental relations” to demonstrate how trans-governmentalism promoted international organizations in the early 1970s. See Robert Keohane & Joseph Nye, *Trans-governmental Relations and International Organizations*, 27 WORLD POLITICS 39 (1974).

112. See *id.* at 186. According to Slaughter, transgovernmentalism is arguably more effective and potentially more accountable than any other alternatives since it leaves the control of government agencies in the hands of “national citizens” rather than “supranational bureaucracies” answerable to no one in the liberal internationalism. She asserts that although new medievalism attracts “states’ rights enthusiasts” and “supernationalists,” it could easily reflect the worst of both worlds. *Id.*

113. See *id.* at 197.

114. See generally Robert Howse, *Regulatory Cooperation and the Problem of Democracy*, in TRANSATLANTIC REGULATORY COOPERATION 469 (George A. Bermann et al., ed. 2000).

115. David Kennedy, *When Renewal Repeats: Thinking Against the Box*, 32 N.Y.U. J. Int'l L. & Pol. 335, 412 (2000) (questioning whether exploring the “disaggregation of the state and the empowerment of diverse actors in an international civil society without asking who will win and who will lose by such an arrangement” is prudent).

B. GLOBAL CHALLENGES TO NATIONAL FISCAL SOVEREIGNTY

1. Taxation: Sovereign Authority

Historically, a state's fiscal legislation was construed as a national issue in character.¹¹⁶ In the most antique forms, taxation regimes have evolved from two competing concepts that "every man payeth equally for what he useth,"¹¹⁷ and that "the subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities."¹¹⁸ These two divergent notions have been respectively considered as the benefit, and the ability-to-pay theories.¹¹⁹

Under the backdrop, fiscal authority is an essential constituent to any government since it provides revenue for national cost and expenditure that enables a nation to maintain the existence and operation of the government benefit its citizens and compete with foreign countries.¹²⁰ Because taxes are one feature of national cost and expenditure, taxation has been traditionally viewed as the nation-states' sovereignty to levy and collect taxes from all entities within their jurisdictions.¹²¹

In the meantime, the financial globalization has brought up the hot academic debate as to whether a nation-state's absolute authority and jurisdiction over fiscal matters can continue irrespective of the impact of internationalization. Because economic integration and activities across borders, and technology advances have made taxation significantly more

116. Stephen G. Utz, *Tax Harmonization and Coordination in Europe and America*, 9 Conn. J. Int'l L. 767, 767-768 (1994) (indicating that traditional tax policy was based on national economic systems that seldom affected each other).

117. Thomas Hobbes, *THE LEVIATHAN* 239 (Richard Tuck ed. 1991) (1651).

118. Adam Smith, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* 310 (Edwin Cannan ed. 1925) (1776).

119. According to the benefit theory, a just tax distributes the tax burden in accordance with the distribution of governmental goods and services. See James Buchanan, *The Pure Theory of Government Finance: A Selected Approach*, in *FISCAL THEORY AND POLITICAL ECONOMY: SELECTED ESSAYS* 12 & n. 5 (1960) (1940). By contrast, under the pure ability-to-pay theory, those with greater capacity pay more tax. See Smith, *supra* note 118, at 310.

120. Frederick Bassinger & Michel Glautier, *A REFERENCE GUIDE TO INTERNATIONAL TAXATION* xi (1987) (conceding that any government emphasized historically the significance of revenue to raise and maintain armies, and obtain allegiances of its subjects, and that declined sovereigns lost the control when the ability to collect taxes ceased); see also Reuven Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 Harv. L. Rev. 1573, 1626 (2000) (arguing that tax policies approved by nation's citizens reflect society and quality of life that citizens prefer).

121. Utz, *supra* note 116, at 772 (describing that nations tax on the basis of traditional legal norms regarding sovereigns and their authority over individuals and entities within their borders); see also Bassinger & Glautier, *supra* note 120, at x, xi (noting that jurisdiction extended to "geographical boundaries," which defined nation's territory under international norms, and that historically, taxation authority is national in character).

challenging,¹²² the traditional concept of state's fiscal sovereignty and taxing jurisdiction has been subject to scrutiny.¹²³ Some observes conceded the interdependence between national tax systems and international economic relations.¹²⁴ Moreover, others have acknowledged the impact of international economic integration on domestic tax policies.¹²⁵ Nevertheless, some argue that no international law limits the state's authority to prescribe its fiscal legislations, and thus the nation-state can maintain its autonomy in fiscal legislation.¹²⁶ However, the realism is that states need to interact with their sovereign global neighbors to compete in world trade under the international regulatory regime.

Understandably, the time has come to take account of how the nation-state can exercise its fiscal sovereignty over individuals and entities in the era of the international economic integration. In that context, it deserves noting international cooperative efforts in the global economic affairs in the wake of the recent worldwide financial turbulence. Needless to say, a special attention should be paid to adapt national fiscal authority and their taxing jurisdictions to the new financial environment.

122. Vito Tanzi, *Globalization, Technological Developments, and the Work of Fiscal Termites*, 26 BROOK. J. INT'L L. 1261 (2001) (arguing that collecting taxes is becoming harder due to a long list of "fiscal termites" gnawing at the foundations of taxation regimes: more cross-border shopping, the increased mobility of skilled labor, the growth of electronic commerce, the expansion of tax heavens, the development of new financial instruments and intermediaries, growing trade within multinational companies, and the possible replacement of bank accounts with electronic money embedded in "smart cards").

123. Timo Virenkenta, *Tax Incentives in Developing Countries and International Taxation: A Study on the Relationship between Income Tax Incentives for Inward Foreign Investment*, in DEVELOPING COUNTRIES AND TAXATION OF FOREIGN INCOME IN CAPITAL-EXPORTING COUNTRIES 43 (1991) (stating that extent of national fiscal sovereignty became subject of controversy).

124. Utz, *supra* note 116, at 770 (noting common belief that national taxes affect international business, and are not independent of competitive conditions in global neighbors, thus national tax systems should accordingly transnational).

125. Rutsel Silvestre J. Martha, *THE JURISDICTION TO TAX IN INTERNATIONAL LAW: THEORY AND PRACTICE OF LEGISLATIVE FISCAL JURISDICTION* 11 (1989) (acknowledging that internationalization of trade and increasing mobility of people and capital resulted in the assessment of impact of international law in fiscal law); *see also* Arnold Knechtel, *BASIC PROBLEMS IN INTERNATIONAL FISCAL LAW* 10 (asserting that increased cross-border movements established a need for modifying tax systems to address new fiscal issues); *see also* Ramon J. Jefferey, *THE IMPACT OF STATE SOVEREIGNTY ON GLOBAL TRADE AND INTERNATIONAL TAXATION* (1999) (indicating that the nature of a state's role requires nation-states increasingly become aware that it is appropriate for certain international taxation matters to be dealt with not at the national, but at the international level, through the international law-making process).

126. *THE PUBLIC INTERNATIONAL LAW OF TAXATION: TEXT, CASES AND MATERIALS* 24 (Asif H. Qureshi ed. 1994) (asserting that acceptance of state's right to tax pursuant to its respective jurisdiction is not limited by international law); *see also* Bassinger & Glautier, *supra* note 120, at xi (arguing that "... nations jealously protect their right to tax people and objects within their jurisdictions").

2. The Problem with Double Taxation

Historically, with the establishment of territorial jurisdiction, the nation-state has adopted its formal tax system while the type and method can vary in accordance with its need.¹²⁷ The capacity of any government to levy and collect taxes from the subjects within its national territory is based on one or all of the three rationales: “citizenship”¹²⁸ based taxation; “residence”¹²⁹ based taxation; “source”¹³⁰ based taxation.

However, the expansion of economic activities across border has posed challenges to the absolute fiscal authority of states. That is, the conventional taxing structure did not face any impediments to the exercise of the domestic tax policy when the mobility of labor and resources was not easy, but the taxing mechanism has failed to address fiscal issues due to the increasing movement of economic activities across national borders.

When entities extend their activities into other jurisdictions, they expose themselves to the potential of taxation in an increasingly number of jurisdictions.¹³¹ The entity is subject to “double taxation” due to the extension of its activities into foreign jurisdictions.¹³² The problem of double taxation is that multiple nations’ taxing authorities attempt to claim jurisdiction over the same activity or entity results in conflicts of law.¹³³ The conflicting rules resulting from the intersection of the states

127. *See id.*

128. *See id.* at 37. In a citizenship based fiscal jurisdiction, as long as the entity is a citizen of that state, he incurs tax liability. An individual’s citizenship is commonly established by the birth place while corporations are deemed citizens of the jurisdiction where they are incorporated. *Id.* at 37-40.

129. *See id.* at 37. In a residence based fiscal jurisdiction, regardless of whether the taxpayer is a citizen, simply being a resident of that jurisdiction is single rationale sufficient to incur a tax. An individual’s residence is based on where he normally lives while the residence of a corporation is presumed to be where it was incorporated. However, this is not always the case. *Id.* at 44.

130. *See id.* at 37. In a source based fiscal jurisdiction, where neither citizenship nor residency is relevant, if an entity derives income from a source within that jurisdiction, it has incurred tax liability therein. Source, as applied to both individuals and corporations, most commonly describes the geographic location from where income is derived. *Id.* at 38, 47-48.

131. Bassinger & Glautier, *supra* note 120, at 151 (indicating that taxpayers may face triple taxation: taxes from country of citizenship, residence country, and country where income is generated).

132. OECD, 1992 MODEL DOUBLE TAX CONVENTION, available at http://www.oecd.org/daf/fa/treaties_treaty.htm (describing international double taxation as imposition of taxes by two or more nations against same income generated by single taxpayer in foreign country).

133. The problem of double taxation is raised when each jurisdiction levies and collects taxes from activities and entities within its border as it deems appropriate. *See* Bassinger & Glautier, *supra* note 120, at 165.

attribute to the multitude factors behind tax law, social policy, administrative constraints, and political compromise.¹³⁴

Under the dominant approach, the taxation of active business income is allocated to the source country, and the passive invest income is allocated to the residence jurisdiction. Arguably, in spite of the lack of a firm economic and analytic basis, this basic division has prevailed to the present, but it has misrepresented its practicality.¹³⁵ Notably, the efforts to solve the problem of double taxation have been made by both the adoption of bilateral treaties and domestic legislation.¹³⁶ In particular, redressing double taxation at the international level requires the cooperation of multiple states to establish agreements in terms of treaties.¹³⁷ Under the circumstances, many observers concede the effectiveness of treaties in preventing double taxation.¹³⁸

The initial efforts to prevent double taxation have been asserted to create the international tax regime.¹³⁹ That is, the regime was arguably developed in the 1920s following the League of Nations' study on ways to avoid international double taxation.¹⁴⁰ Despite the critics over the non-existence of supreme body or law in the international tax regime, this system has brought a special attention in the age of internationalization and international economic integration. Regardless of the advent of

134. Diane M. Ring, *One Nation among Many: Policy Implications of Cross-Border Tax Arbitrage*, 44 B.C.L. REV. 79, 80-81 (stating that conflicting rules render one of two results: taxation or nontaxation).

135. Reuven S. Avi-Yonah, *The Structure of International Transaction: A Proposal for Simplification*, 74 TEX L. REV. 1301, 1306-1313 (1996) (reviewing and justifying historical and current patterns of taxing active and passive income).

136. Tsilly Dagan, *The Tax Treaties Myth*, 32 N.Y.U.J. INT'L L. & POL. 939, 939-941 (2000) (asserting that treaties play a less important role in reducing double taxation, and that the problem can be solved properly by national legislation).

137. See *id.* at 941 (acknowledging that conventional account of double taxation redress emphasizes mutual cooperation among states); see also Robert Thornton Smith, *Tax Treaty Interpretation by the Judiciary*, 49 TAX LAW 845, 845-846 (1996); THE PUBLIC INTERNATIONAL LAW OF TAXATION, *supra* note 126, at 126-127 (noting that effective remedial double taxation treaties need negotiations among multiple states).

138. John F. Avery Jones, *Are Tax Treaties Necessary?*, 53 TAX L. REV. 1, 2-3 (1999) (stating that the success of tax treaties is illustrated by treaty proliferation during last 50 years). Under the tax treaty network, signatory countries signatory states agree on a maximum of tax rate and how the total tax should be allocated among each signatory state. Moreover, the country of residence grants an exemption or a credit to the taxpayer for the paid tax on income in another country (foreign-source income). See Smith, *supra* note 137, at 845-846.

139. Some denies the existence of international taxation. See David Rosenbloom, *International Tax Arbitrage and the "International Tax System"*, 53 TAX L. REV. 137, 140-141, 166 (2000) (asserting that "that system appears imaginary," because in the real world, only the different tax laws of various countries exist, and those laws vary greatly from each other).

140. Avi-Yonah, *supra* note 135, at 1303-1304 (arguing that "[t]he existence of this regime shows that despite each country's claim to sovereignty to in tax matters, it is possible to reach an internationally acceptable consensus that will be followed by the majority of the world's taxing jurisdictions").

international tax regime, the global cooperative efforts to prevent double taxation for last several decades has posed opportunities and challenges to the fiscal sovereignty of each nation-state.

3. Cross-Border Tax Arbitrage

As the mobility of capital resources becomes easier, taxpayers seek to move their resources into low or zero-tax jurisdictions. Conflicts in tax rules offer taxpayer's unique opportunities to engage in profitable tax planning where their activities are subjected to multi nations' different tax rules. As such, taxpayers' ability to take advantage of these differences to prevent their income from being taxed anywhere poses challenges to the fiscal authority of each country. This is a problem with cross-border tax arbitrage.¹⁴¹

Furthermore, international economic integration and technological advances have propelled the entities' to exploit the differences between tax rules.

Recently, the cross-border tax arbitrage issue has come into sharp focus. Some argue that international tax arbitrage is "the planning focus of the future," and the natural response of taxpayers to the normal differences that occur between any two taxes systems assuming that it does not represent egregious abuse of the tax system.¹⁴² It is asserted that the effect of tax arbitrage is similar to simply having different tax rates in different fiscal jurisdictions.¹⁴³

By contrast, other observers claim that the entities' activities to exploit the tax-law conflicts violate the single tax principle: income from cross-border transactions should be subject to tax just once as applied to double taxation and tax evasion.¹⁴⁴ More importantly, the government faces its revenue shortfalls resulting from tax avoidance through cross-border tax

141. Philip R. West, *Foreign Law in U.S. International Taxation: The Search for Standards*, 3 FLA. TAX REV. 147, 171 (1996) (defining cross-border tax arbitrage as taking advantage of inconsistencies between different countries' tax rules to achieve a more favorable result than that which would have resulted from investing in a single jurisdiction); *see also* Reuven S. Avi-Yonah, *Commentary*, 53 TAX L. REV. 167, 167 (2000) (describing international tax arbitrage as "inconsistent national treatment of the same entity or transactions that can produce multiple tax benefits or detriments").

142. Rosenbloom, *supra* note 139, at 166.

143. *Id.* at 149.

144. Avi-Yonah, *supra* note 141, at 171 (noting that the embodiment of the single tax principle in the typical title of the tax treaties "for the prevention of double taxation" <not more than once> and "fiscal evasion" <not less than once>). "International tax arbitrage is a natural primary target of attempts to enforce the single tax rule, because unlike differences in rates, it results from exploiting interactions between the laws of two countries that clearly were not intended by either." *See id.* 172-173.

arbitrage. Governments may move from relatively less efficient taxing mechanisms to more efficient mechanisms in response to revenue deficit due to tax avoidance. As a result, cross-border tax arbitrage may push up governments' marginal cost of funds by forcing increases in taxes that are more distortionary than a properly operating income tax system.¹⁴⁵

However, it is not easy to know what the proper view of cross-border tax arbitrage. As a matter of fact, too many inconsistencies and frequent changes in nations' tax rules have offered new opportunities tax arbitrage, and thus governments have difficulty in dealing with such arbitrage through minor legislation.¹⁴⁶ Additionally, the responses to the arbitrage issue vary among countries. Under the circumstances, addressing cross-border tax is critical challenges to the nations' fiscal authority.¹⁴⁷ In this regard, it deserves noting an analysis of cross-border tax arbitration by proposing a balancing test for determining the adequate treatment of specific cases.¹⁴⁸

4. Tax Competition or Harmonization

The current debate and discussion in the international dimension of taxation focus heavily on whether tax competition is undesirable. In this regard, it is argued that global cooperative efforts should be made toward international tax harmonization. Indeed, many scholars and experts have figured out the nature and effects of tax competition. Others have emphasized the desirability and feasibility of tax harmonization. Moreover, the OECD's effort to curb tax competition has ignited the debate. In order to respond to the inquiry, a special attention should be given toward adjusting international tax regime without usurping the fiscal sovereignty of the nation states.

Understandably, there is a linkage between globalization and tax competition,¹⁴⁹ which can be meant by the use of taxation by governments to induce business activities to their jurisdictions.¹⁵⁰ The

145. Julie Roin, *Taxation without Coordination*, 31 J. LEGAL STUD. 61, 75 (2002).

146. *See id.* at 76.

147. Daniel Shaviro, *Money on the Table?: Responding to Cross-Border Tax Arbitrage*, 3 CHI. J. INT'L 317, 331 (2002) (arguing that "addressing cross-border tax arbitrage has at least the potential to help everyone move in the direction of greater worldwide cooperation, while also possibly advancing purely national ends in the here and now").

148. Ring, *supra* note 134, at 136-139.

149. Jonathan Talisman, *Challenges Facing Tax Policy in the Coming Years*, Remarks to the National Conference on Federal Taxes (Nov. 7, 2000) (stating that "international tax competition occurs when one country provides a tax inducement to attract capital from another country").

150. Michael A. Livingston, Blum and Klaven at 50: Progressive Taxation, "Globalization," and the New Millennium, 4 FLA. TAX REV. 731, 742-744 (2000) (stating that globalization encourages

mobility of capital resource and business activities driven by international economic integration have pushed governments to employ new tax mechanisms such as tax incentives to attract foreign investment,¹⁵¹ and tax exemptions in response to competitive pressures from global neighbors. As such, all entities have extended their activities across borders with the reduction of barriers associated with world trade liberalization.

In the meantime, the effects of tax competition are open to hot debate. Theoretical arguments indicate the overall positive benefits of tax competition on business organizations, tax authorities, and economies.¹⁵² According to empirical studies, generally foreign direct investment reacts positively to lower tax rates, and tax competition tends to have a positive impact on attracting foreign investment.¹⁵³ More importantly, adherents of tax competition assert that tax competition improves government efficiency and social welfare, and reduces government waste.¹⁵⁴

On the other hand, other theoretical and empirical research points to the negative outcomes for economies and tax authorities.¹⁵⁵ Some observers are doubtful about the positive empirical results, and thereby referring to other studies casting questions about the risks of government inefficiency and heavier tax burdens on labor.¹⁵⁶ Tax competition contributes to the fiscal crisis of the welfare state since the lower tax rates, and other tax incentives driven by tax competition result in revenue shortfalls, and keep governments from having sufficient funds for social welfare

tax competition and discourages progressive taxation); *see also* Avi-Yonah, *supra* note 120, at 1575-1579 (arguing that

globalization creates tax competition that may cause a serious social backlash).

151. Avi-Yonah, *supra* note 120, at 1641-1646 (noting that some economists' argument that developing countries should engage in the ultimate tax competition by keeping entirely from taxing foreign investments, and others' claim that developing countries should not engage in tax competition at all by not offering incentives to foreign investment).

152. *See id.* at 1591.

153. James R. Hines, *Lessons from Behavioral Responses to International Taxation*, 52 NAT'L TAX J. 305, 308-313 (1999) (surveying and discussing the empirical studies on foreign direct investment). However, there is a concern about the manner of attracting foreign investment. *See* Avi-Yonah, *supra* note 120, at 1643-1648 (discussing problems of recent empirical studies on the benefits of tax competition and arguing that developing countries would be better off ceasing tax competition).

154. John Douglas Wilson, *Theories of Tax Competition*, 52 NAT'L TAX J. 269, 294-298 (1999) (arguing that tax competition may encourage welfare efficiency despite imperfect competition that can push tax rates to zero or "commitment problems" where companies commit to keeping operations only for as long as the initial tax subsidies remain, and claiming that tax competition encourages government efficiency either by reducing the excessive size of government or increasing public welfare through "expenditure competition").

155. *Id.* at 1592.

156. Avi-Yonah, *supra* note 120, at 1643-1648.

programs.¹⁵⁷ Also, tax competition is arguably considered to violate the “capital export neutrality” principle, which holds that companies should locate their firms where return on investment is maximized, and that tax rates should be immaterial to the profit maximizing decisions of firms.¹⁵⁸

In other words, tax competition violates this principle because it encourages companies to locate where they can avoid paying taxes rather than where they would promote “worldwide efficiency and growth.”¹⁵⁹ In short, tax competition has arguably resulted in a critical potential for tax evasion and avoidance on the income from cross-border portfolio and direct investments leading to important tax base erosion and revenue deficit.¹⁶⁰ With this background, governments have been concerned about the negative impacts of tax competition, which may reduce the states’ tax revenue.

In response to the concerns and requests of its member states,¹⁶¹ the OECD initiated a study to address the tax competition issue, and issued a report, which identifies the cause and effects of tax competition.¹⁶² This Harmful Tax Competition Report describes the effects of “harmful tax competition,” providing counteractive measures. According to the report, harmful tax competition occurs when a country’s fiscal jurisdiction collects critical income on certain income but has preferential features that subject other income to low or no taxation.¹⁶³ This regime is viewed undesirable since it redirects capital resources and financial flows, and the corresponding tax revenue from one jurisdiction to another in an aggressive bid, which is not an incidental effect of the implementation of national policy.¹⁶⁴ The concern is that such actions will interfere with other countries’ tax systems, causing changes that may distort “patterns of trade and investment and reduce global welfare.”¹⁶⁵

157. See *id.* at 1632-1639.

158. Karen B Brown, *Harmful Tax Competition: The OECD View*, 32 GEO. WASH. J. INT’L L. & ECON. 311, 311-312 (1999).

159. *Id.*

160. Avi-Yonah, *supra* note 120, at 1579-1603.

161. The OECD members are: Australia, Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States.

162. The Organization for Economic Cooperation and Development, HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUES (1998) (hereinafter Harmful Tax Competition Report).

163. See *id.* at 26.

164. *Id.* at 16.

165. *Id.* at 14.

The Harmful Tax Competition Report has received a special attention from commentators. Some argue that the regulation of tax competition infringes on the fiscal sovereignty of the nation-state.¹⁶⁶ Also, it should be noted that the Harmful Tax Competition Report ignores the national taxation features of industrial states and its effect on the economies of less-developed countries.¹⁶⁷ By contrast, others point to the revenue statistics in the member nations of the OECD, and note that the sustained reduction in tax revenue in the countries in the 1990s has pushed the OECD and EU to take policy actions against negative effects resulting from tax competition.¹⁶⁸ Moreover, the dynamic and interconnection between trade globalization and international tax regime is increasing pressures for international tax harmonization.¹⁶⁹ Despite strong arguments in favor of tax harmonization, there is still a need to take account of the impediments to reaching international tax harmonization. Even if tax harmonization is desirable, its potential danger should be considered.

As a matter of fact, cooperative efforts have been made to harmonize or coordinate national tax rates, particularly in the area of capital income taxation.¹⁷⁰ Although the implementation of this agreement remains doubtful, the possibility of harmonizing tax bases by development of a uniform definition of taxable income has been discussed.¹⁷¹

Some point out that the alleged benefits of uniformity stem from two quite disparate sources. The first being administrative advantages in

166. George M. Melo, Comment, *Taxation in the Global Arena: Preventing the Erosion of National Tax Bases or Impinging on Territorial Sovereignty?*, 12 PACE INT'L L. REV. 183, 186-189 (1998).

167. Karen B. Brown, *supra* note 158, at 315-319.

168. Tanzi, *supra* note 122, at 1261-1262 (emphasizing that globalization may influence the countries' capacity to collect taxes and the distribution of the tax burden). Tanzi notes that "in most countries in the 1990s, the tax level has stopped growing...." *Id.* at 1262. However, some argues that there is no evidence that the international economic integration and technological advances have reduced the state's capacity to raise taxes, and that the decrease in tax burden is due to "electoral resistance as to insuperable difficulty in collecting taxes." See Martin Wolf, *Will Technology and Global Capital Markets Change the Scope of Government?* 21 CATO J. 143, 144-145 (1999).

169. Robert A. Green, *Antilegalistic Approaches to Resolving Disputes Between Governments: A Comparison of the International Tax and Trade Regimes*, 23 YALE L. J. INT'L L. 79, 87-104 (1998).

170. Harmful Tax Competition Report, *supra* note 162, at 23 (stating that tax competition "may hamper the application of progressive tax rates and the achievement of redistributive goals"). The EU adopted a provisional agreement on how to tax interest income earned by foreign investors. See Roin, *supra* note 126, at 63.

171. Roin, *supra* note 147, at 63; see also Shaviro, *supra* note 149, at 330 (arguing that "harmonizing tax bases often makes sense even if tax competition with respect to rate is retained or indeed encouraged").

terms of cost reduction and the second source is eliminating cross-border tax arbitrage.¹⁷²

At the same time, it is argued that “[a]ny move toward tax base harmonization will entail substantial transition costs because a harmonized definition of taxable income undoubtedly will differ significantly from most if not all current national systems.”¹⁷³ As such, tax harmonization cannot be expected where the revenue benefits outweigh its social cost.¹⁷⁴

Moreover, the critical point to note is that people by nature are concerned with the maximization of profits and reduction of costs, and as such the competition for capital will continue.¹⁷⁵ As a consequence, the actors’ efforts to search for low tax jurisdictions will never cease, thereby driving international tax competition. In this context, it deserves noting one observer’s evaluation of the combination of capital mobility and tax competition from a global efficiency or equity perspective toward balancing the problem of tax competition against democratic countries’ right to determine the size of their government, and thus developing a distinction between harmful and acceptable form of tax competition.¹⁷⁶

IV. GOVERNANCE IN THE GLOBAL FINANCE

A. EVALUATING GLOBAL NETWORK GOVERNANCE

The global economy raises important questions concerning the structure of international governance¹⁷⁷ systems intended to safeguard markets where globalization implies the erosion of national boundaries. In this respect, one observer argues that “[r]egulators’ power to implement national regulations within those boundaries decline both because people

172. See *id.* at 63-76.

173. *Id.* at 87.

174. *Id.* at 93-94.

175. Melo, *supra* note 166, at 211.

176. Avi-Yonah, *supra* note 120, at 1604-1631.

177. As David Kennedy remarks in a particularly informative discussion, it “has emerged as a distinctive motto for international public order, consciously distinguished from ‘government’ and consciously identified with the group of phenomena that are thought to define the late twentieth-century international condition: globalization, interdependence, the demise of sovereignty, the apparent futility of further United Nations institution building, and the emergence of international civil society. These writers identify governance as a new, distinct phenomenon: either a defining characteristic of the new world order or a prescriptive for resolving its pragmatic challenge, or both. ‘Governance’ in this literature, as opposed to ‘government’ is the complex of more or less formalized bundles of rules, roles, and relationships that define the social practices of the state and non-state actors interacting in various issue areas, rather than formal interstate organizations[.]” See David Kennedy, *New Approaches to Comparative Law: Comparativism and International Governance*, 2 UTAH L.REV. 545, 548, n.4 (1997).

can easily flee their jurisdiction and because the flows of capital, pollution, pathogens, and weapons are too great and sudden for any one regulator to control.”¹⁷⁸

In contrast, the liberal internationalist response to the concern about the erosion of state regulatory power is to build a larger international apparatus, such as the United Nations system constituted by a legally binding treaty, with expanding powers of governance.¹⁷⁹

With the globalization of economic relations, and increasing interdependence among nation-states, there is a growing conflict between a conventional notion of territorial state sovereignty and the flow of economic activity, which disrupts coherence of the state. In the meantime, various agencies and institutions within the state such as independent central banks increasingly develop a high degree of autonomy and independence reflecting the fragmentation and/or desegregation of the nation-state.¹⁸⁰

As a new system of regulatory networks in the international economy, global network governance establishes rules coping with issues that each nation already regulates within its territorial boundaries: crime, securities fraud, pollution, tax evasion where traditional international law requires states to implement the international obligations they incur through their domestic law.¹⁸¹ The adherents of trans-governmentalism argue that the enforcement of national law has been more difficult due to globalization propelled by information revolution.¹⁸² This view stress regulators' potential opportunity to reap the benefits from coordinating their enforcement efforts with those of their foreign peers and from ensuring that other nations adopt similar approaches.¹⁸³

Likewise, transgovernmentalists assert that the fragmentation and desegregation of the domestic order of the nation-state is essential to the development of international regulatory governance system. That is to say, the global governance of the economy requires the internationalization of state agencies and as long as these agencies maintain a high degree of independent autonomy. This view claims that

178. Slaughter, *supra* note 106, at 192.

179. Zuern, *supra* note 104, at 241. Slaughter notes that "globalization thus leads to internationalization or the transfer of regulatory authority from the national level to an international institution." Liberals are likely to support expanding the power of international institutions to guard against the global dismantling of the regulatory state." See Slaughter, *supra* note 106, at 192-193

180. For central bank independence, see Jayasuriya; *supra* note 99, at 439-441.

181. Slaughter; *supra* note 106, at 191.

182. See *id.* at 191-192.

183. *Id.* at 192.

the operation of the global economy requires exclusive reform of regulatory system at the national level, and the transformation of state sovereignty represents the regulatory harmonization through "the nationalization of international law."¹⁸⁴ Trans-governmentalism highlights that each nation-state will be better able to enforce its domestic law by implementing the agreement if foreign counterparts do likewise in accordance with regulatory agreements between states that are pledges of good faith that are self-enforcing.¹⁸⁵ Here is arguably the rationale for regulatory harmonization, because laws are binding as coercive only at the national level.¹⁸⁶

By contrast, the new medievalist formula of global governance is "governance without government."¹⁸⁷ However, governance without government is governance without power, and government without power rarely works.¹⁸⁸ Although the new medievalists are right to point out the transformation of the globe through information revolution, they neglect the fact that persuasive power of civil society in mobilizing public opinion does not take the place of state power.¹⁸⁹

Here are notable examples of the mechanism of global governance in the international financial area such as the Basel Committee on Banking Supervision (Basel Committee), the International Organization of Securities Commission (IOSCO), and the International Association of Insurance Supervisors (IAIS).¹⁹⁰

The Basel Committee, an organization composed of 12 central bank governors, was created by a simple agreement among the governors themselves for a significant reform of international banking system.¹⁹¹ In 1988, capital adequacy requirements for all banks were adopted by the central bankers of the world's major financial powers under their supervision. Its members follow their own rules. Decisions are made by consensus and are not formally binding; however, members do implement these decisions within their own systems.

184. *Id.*

185. *See id.*

186. *Id.*

187. *See id.* at 195.

188. *Id.*

189. *See id.* Mathews argues that "[b]usiness, citizens' organizations, ethnic groups, and crime cartels have all readily adopted the network model [while] [g]overnments...are quintessential hierarchies, wedded to an organizational form from incompatible with all that the new technologies make possible." *See Mathews, supra note 103*, at 52.

190. David Zaring, *International Law by Other Means: The Twilight Existence of International Financial Regulatory Organizations*, 33 TEXAS INT'L L. J. 281 (1998).

191. George Walker, *INTERNATIONAL BANKING REGULATION: LAW, POLICY AND PRACTICE* 17-81 (2001).

The Basel Committee's authority is often cited as argument for taking domestic action. National securities commissioners and insurance regulators have followed the Basel Committee's example. The International Organization of Securities Commissioners (IOSCO) has no formal charter or founding treaty. Its primary purpose is to solve problems affecting international securities markets by creating a consensus for enactment of national legislation.¹⁹² Its members have also entered into information-sharing agreements on their own initiative.

The International Association of Insurance Supervisors follows a similar model, as does the newly created Tripartite Group, an international coalition of banking, insurance, and securities regulators the Basel Committee created to improve the supervision of financial conglomerates.¹⁹³

Three organizations have much in common in the way of their organizing themselves and the manner of their seeking to achieve their objectives.¹⁹⁴ All are sub-state actors, informally formed, with flexible internal organization and decentralized bureaucracies. They often come into operation in secrecy and informality. The institutions manage to attain influence through a kind of decentralized enforcement of their agreements and through links to international, regional, and national financial regulators.¹⁹⁵

Although the Organization for Economic Cooperation and Development (OECD) is characterized as one of the international governmental organizations in the international system, it has played a critical role in shaping the architecture of global governance despite its feature of "low-profile institution."¹⁹⁶ As the successor to the organization to the

192. Geoffrey Underhill, *Keeping Governments Out of Politics: Transnational Securities Market, Regulatory Cooperation, and Political Legitimacy*, 21 REV. INT'L STUD 251 (1995).

193. International Association of Insurance Supervisors, 1994 Annual Report 2 (1995).

194. Zaring; *supra* note 190, at 301-304. These organizations are not international organizations under international law because they lack state membership, tangible manifestations of organizational bureaucracy, and adequate legal pedigree. According to the Restatement (Third) of the Foreign Relations Law of the United States, an international organization refers to an organization "created by an international agreement [with] a membership consisting mainly or principally of states." See Restatement (Third) of the Foreign Relations Law of the United States SS 221 (1987). In this context, Zaring argues that these organizations occupy a "twilight" legal existence. See Zaring, *supra* note 190.

195. *Id.*

196. James Salzman, *Labor Rights Globalization and Institutions: The Role and Influence of the Organization for Economic Cooperation and Development*, 21 MICH. J. INT'L L. 769, 772-773 (2000); see also Slaughter, *supra* 106, at 196 (arguing that "[t]he next generation of institutions is ... likely to look more like the Basel Committee, or, more formally, the Organization for Economic Cooperation and Development, dedicated to providing a forum for transnational problem-solving and the harmonization of national law").

Organization for European Economic Cooperation, the OECD was initially established to strengthen the economies of its member states, and thereafter expanded its mission to identify common issues and coordinate national and worldwide policies.¹⁹⁷ Because the OECD offers a closed setting for its member states through the closed-door meetings, this feature of restricted membership and transparency makes difference from conventional international organizations. As a result, the OECD provides a “restricted forum on virtually unrestricted topics.”¹⁹⁸

As noted above, network governance (the external dimension of complex sovereignty) requires the functioning of independent (effective) internal self-regulatory agencies (the internal dimension of complex sovereignty).¹⁹⁹ In this sense, globalization has propelled the development of autonomous agencies, the development of “a state within a state.”²⁰⁰ It is important to note that the autonomy and independence led to the formation of a system of network governance where these agencies actively participated in the formulation and management of the regulatory institutions.²⁰¹ More importantly, the trans-governmental network governance depends on compliance, consensus, or good-faith agreements among nations.²⁰² In this regard, this regulatory system is concerned with establishing international soft law in the form of broad regulatory standards and general regulatory standards followed by compliance of state agencies rather than strict rules and direct enforcement.²⁰³

However, in response to the trans-governmentalism, some critics acknowledge that the significance of networks, but argue that they reduce transparency and impede political accountability.²⁰⁴ The club-like feature of networks may reinforce the dominance of the major economic powers, particularly inequalities among countries.²⁰⁵ Critics also claim that networks present the political right with a useful but ultimately dangerous substitute for traditional multilateralism.²⁰⁶ Here, the point to note is the anti-globalization argument that the process of establishment

197. *See id.* at 773.

198. *Id.* at 776-777.

199. Jayasuriya, *supra* note 99, at 450.

200. *Id.* at 439 (pointing out “the globalization of economic relations increasingly fractures the internal cohesiveness within the State, but this fracturing means the creation of islands of sovereignty within the State”).

201. *See id.* at 450.

202. *Id.* at 453.

203. *See id.*

204. Howse; *supra* note 114, at 12.

205. Kennedy, *supra* note 115, at 412.

206. Philip Alston, *The Myopia of the Handmaidens: International Lawyers and Globalization*, 8 EUR. J. INT'L L. 435 (1997).

and implementation of global standards are under the Western industrial states' dominance, and represents an emerging global network governance that threaten undeveloped countries' state sovereignty and takes away their freedom of action as sovereign states.²⁰⁷

In this context, one observer stresses a democratization of the legislative process by which global standards as international soft law are established, a flexibility in implementation of the standards reflecting local legal tradition and practice, a full incorporation of the majority of nation-states into the legislative process concerning the development of the standards, and a prioritization of the implementation of global standards on a country-by-country basis.²⁰⁸ In short, undeveloped countries will apparently resist in complying with global standards unless they have a realistic chance to absorb and accept the standards. In this sense, the development of new standards needs to be treated as an evolutionary and educational process.²⁰⁹

Consequently, like prior views, an "all-or-nothing" perspective for the analysis of desirable forum of global governance ignores exploring each component of it, as it is at present in the international system. In this sense, emphasis should be given to the corroboration of all the state and non-state actors in the international system in terms of liberal internationalism, trans-governmentalism, and new medievalism with full understanding of traditional international law so that governments, business, and NGOs, and international institutions can strengthen the nation-state system, by helping solve problems regulators cannot deal with.

B. ENHANCING GLOBAL TAX GOVERNANCE

With the increasing role of the OECD in the international tax regime, the network of international tax conventions has come into sharp focus in recent years. Some argue that the bilateral tax treaty network is "a triumph of international law," and a framework for the international tax regime based on principles underlying these treaties.²¹⁰ That is, over 1500 bilateral tax treaties with similarity in policy and language constitute an international tax regime.²¹¹ Indeed, the treaties are similar because they

207. Herbert Morais, *The Quest for International Standards: Global Governance vs. Sovereignty*, 50 U. KAN L. REV. 779, 779-780 (2002).

208. *See id.* at 806-820.

209. *Id.* at 820.

210. Rosenbloom, *supra* note 139, at 164.

211. Avi-Yonah, *supra* note 141, at 169.

have been based on the same OECD and UN models.²¹² In most countries, the treaties have priority over domestic ordinary statutes, thereby constraining domestic tax jurisdiction. As a result, nation-states are bound by treaty to behave in certain ways, and cannot enact legislation to the contrary.²¹³

Others argue that a network of bilateral tax treaties seems increasingly inconsistent with multinational business structure.²¹⁴ It does not look more likely to work for the international tax system.²¹⁵ As such, multinational enterprises may take advantage of the "current situation by planning their affairs to exploit inconsistencies in the network of national tax laws and treaties."²¹⁶ Moreover, the current treaty regime poses challenges to developing countries. That is, many less-developed countries find it difficult to participate in treaty network because they do not have substantial resources to negotiate numerous treaties while a considerable amount of time is needed to negotiate and ratify each treaty.²¹⁷

Accordingly, one could argue that globalization has posed pressures to the current tax rules, and critical limitations on taxing powers.²¹⁸ As a result, some claim that a multilateral agreement would provide more flexibility than the bilateral treaty, and "replace the existing treaty with a single, uniform text."²¹⁹

212. See *id.*; see also OECD, Model Income Tax Convention on Income and Capital, July 23, 1992, 1 Tax Treaties (CCH) P 191 [hereinafter OECD Model Treaty]; U.N. Model Double Taxation Convention Between Developed and Developing Countries, 1980, 1 Tax Treaties (CCH) P 206 [hereinafter UN Model Treaty]. The U.S.A. has issued a model treaty (1996), which follows the OECD model.

213. Avi-Yonah, *supra* note 139, 169. However, arguably, in some ways, the OECD Model Treaty is a victim of its own success: Due to unattractive compromises, and the vagueness of major provisions, and getting behind current tax developments, the effectiveness of bilateral tax treaties is limited in removing tax impediments to cross-border investment, and in preventing international tax avoidance. See BRIAN J. ARNOLD & MICHAEL J. MCINTYRE, INT'L TAX PRIMER 100 (1995).

214. Victor Thuronyi, *International Tax Cooperation and a Multilateral Treaty*, 26 BROOK. J. INT'L L. 1641, 1651 (arguing that "[t]he current network of bilateral tax treaties would work well if each multinational corporate group were located in no more than two countries. Each bilateral tax treaty could then appropriately provide for the taxation of the group. There is, of course no such constraint on multinational enterprises.").

215. See *id.* at 1653 (asserting that the nature of bilateral treaties limits the negotiations to the concerns of the two countries involved, and that because global concerns are subordinate, negotiators focus on benefits "for business headquartered in their country instead of how the treaty fits in with the global tax system").

216. *Id.* at 1647.

217. See *id.* at 1651.

218. Charles E. McClure, Jr., *Globalization, Tax Rules, and Sovereignty*, 55 Bulletin for Int'l Fiscal Documentation 328 (2001).

219. Thuronyi, *supra* note 214, at 1641-1642. Arguably, all countries are affected by the amendments and interpretation of the agreement at the same time. *Id.* at 1644. Ironically, the success

Now is the time to examine the OECD's role in international tax regime in terms of global governance. Here, the question is whether the OECD's efforts at "global tax governance" as a "global tax network" are right on target.²²⁰ The successful functioning of the OECD in international taxation as a global tax network depends on its intent to fill the global governance gap in taxation. As stated above, the OECD has been criticized for its restricted membership, the feature of rich man's club, and the lack of transparency. In particular, the inability of developing countries to participate in the OECD has resulted in the failure of the OECD's initiative to counteract tax havens.²²¹ Furthermore, the OECD's initiative has been attacked in that it violated international law due to the intervention in other states' domestic affairs, and the OECD's lack of legal ability to form a treaty.²²²

In this regard, it is argued that "[d]eveloping countries should have a meaningful voice in any world tax body or tax convention arrangement."²²³ One way for developing countries to be granted a meaningful voice is to consider special arrangements to ensure the reflection of their interests on the agenda, and to minimize the dominance by largest contributors like the United States.²²⁴

Under the circumstances, there is a strong argument to establish an "International Tax Organization" (ITO) to enhance global tax governance because the inability of other international organizations to handle tax issues leads to the creation of the ITO for both developed and

of the OECD bilateral Model Treaty implies the plausibility of a multilateral treaty. *Id.* at 1662-1663. Some point to the drawbacks of a bilateral treaty: As for the tax arbitrage, "the [partial and] retrospective nature of [treaty] remedies] maximizes political opposition to changes that benefit the government, it is always harder to take away tax benefits taxpayers believe are "theirs" than to prevent their acquisition ab initio ... treaties are even less subject to updating and amendment than legislation." See Roin, *supra* note 145, at 76-77.

220. This OECD's efforts have been postulated in August 2001. The reported function of this "network" would be discussions of tax matters of common interest, sharing experiences, identifying best practices, and maintaining a widely accessible database on technical assistance activities in tax policy and administration. See Frances M. Horner, *Do we need an International Tax Organization?*, 21 Tax Notes Int'l 179, 182-183 (2001); see also Technical Note, *Existing Proposals for Enhanced International Cooperation on Tax Matters*, United Nations A/AC. 257/xx (Aug. 2001).

221. Horner, *supra* note 220, at 181. In this regard, the designers of the OECD did not anticipate an international governance role. The problem is that the OECD in tax function was not set up for the kind of policy coordination it now enjoys. *Id.*

222. Gilbert Morris, *The Loss of Sovereignty, The United Nations, and Offshore Financial Centers*, *Worldwide Tax Daily*, Aug. 27, 2001, available at LEXIS 2001 WTD 171-13.

223. Horner, *supra* note 220, at 186.

224. *Id.* (noting one possibility to reserve a few items on the agenda for developing countries, and super-majority voting to weight developing country votes more heavily in some cases on the other hand).

developing countries.²²⁵ With this understanding, a proposal, known as the Zedillo report, for the creation of the ITO was issued as a part of the United Nations' Financing for Development initiative in 2001.²²⁶ The proponents of the ITO point out that an ITO would be in a better position to "recognize the reality of territorial and worldwide systems of taxation, and then set forth rules such as a safe harbor for excluding extraterritorial income."²²⁷

In response to the argument about the creation the ITO, critics assert that an ITO would be redundant in the context of tax expertise and agenda of the OECD.²²⁸ Even among tax experts, there is no global consensus as to such issues regarding "what sort of tax to levy at the corporate level and how to relate that tax to the taxation of shareholders."²²⁹ Nor is the ITO is likely to be created in the near future.²³⁰

As noted, the critical agenda is how to fill the governance gap in taxation. Despite the criticism about the OECD's role in international taxation, its on-going efforts at global tax governance as a global tax network have brought a considerable attention. Here, it deserves pointing to an empirical study on the examination of three regulatory policy arenas, such as securities regulation, competition policy, and environmental policy, in which transgovernmental networks have arisen.²³¹ This study illustrates that networks play different roles in accordance with the spectrum of regulatory power. In short, the concentration of regulatory powers in securities regulation encourages harmonization, and thus networks can be alternatives.

In contrast, the diffusion of regulatory powers in environmental regulation leads to harmonization but less likely, and thus treaties fill the gaps while networks may strengthen the compliance with treaties.

225. See generally, *id.*; see also, VITO TANZI, *TAXATION IN AN INTEGRATING WORLD* (1995) (arguing that globalization is pushing tax systems under substantial pressure and that the coordinating role of the OECD "falls far short of what it needs to be on a worldwide scale.... There is no world institution with the responsibility to establish desirable rules for taxation and with enough clout to include countries to follow those rules. Perhaps the time has come to establish one.").

226. Report of the High Level Panel on Financing for Development, *available at* <http://www.un.org/reports/financing> [hereinafter the Zedillo Report].

227. William M. Funk, *The Thirty-Years Tax War*, *Tax Notes Today*, Oct. 9, 2001, *available at* LEXIS, Tax Analyst File.

228. Horner, *supra* note 205, at 179; see also Outgoing Staffer Discusses Treaty Policy, 76 *Tax Notes* 1536 (1997) (arguing that "[i]t has not proven practical to have a multilateral tax treaty").

229. Shaviro, *supra* note 147, at 330.

230. Avi-Yonah, *supra* note 120, at 1649.

231. Kal Raustiala, *The Architecture of International Cooperation: Trans-governmental Networks and the Future of International Law*, 43 *VA. J. INT'L L.* 1, at 26-51, 72, 76 (2002).

Meanwhile, the moderate concentration of the powers in competition policy supports the liberal internationalism by promoting convergence in regulatory approach.²³² It is worth noting that as gap-fillers, global networks have fostered international cooperation and facilitated global convergence, thus enhancing the effectiveness and compliance of treaties.²³³

Likewise, an emphasis should be placed on the coordination of bilateral tax treaty network and global tax network toward enhancing global tax governance. In this context, a special attention should be given to fill the governance gaps through the evolution of the OECD as a global tax network, and participation of developing countries in the agenda rather than the creation of an ITO as a multilateral tax treaty.

V. CONCLUSION

Globalization has certainly influenced the power and authority of nation-states. The process of globalization transformed the Westphalia notions of sovereignty associated with exclusive territorial jurisdiction. Nevertheless, nation-states are, and will remain the main actors in international economic affairs under international law.

In the meantime, global economy with new information technologies has raised questions regarding how to characterize the function of nation-states as actors in international financial markets. Moreover, the debate as to the framework of regulatory governance in the global economy has been still subject to critical scrutiny.

The new system of global regulatory governance reflecting the fragmentation and desegregation of state sovereignty stresses the active participation of independent decentralized government agencies rather than supranational international regimes along with regulators' compliance with broad regulatory standards constituting international soft law instead of direct enforcement. In this context, trans-governmentalism highlights nationalization of international law toward the regulatory harmonization.

However, these claims are still controversial, and the subject of hot debate even though global network governance has emerged in the

232. See *id.* Raustiala argues that "the distribution of regulatory power helps account for the presence of treaties and therefore helps explain when, and how, networks may interact with treaties." See *id.* at 72.

233. *Id.* at 90-92 (stating that "transgovernmental cooperation is a significant development in international law, one more likely to supplement liberal internationalism than supplant it").

international economy. In order for all the undeveloped and industrialized countries to benefit from the regime of global regulatory governance in the age of globalization, various types of realistic measures should be taken to reduce inequalities between North and South. Otherwise, global standards as *international soft law* will not be apparently welcome to developing and transitional countries.

Under the perspective, this paper has set out some considerations regarding the measures needed for enhancing global tax governance. At the center of the debate over the interplay between bilateral tax treaty network and global tax network, this paper has taken the position that the interplay lies somewhere between liberal internationalism that emphasizes tax treaties under international law, and trans-governmentalism stressing the primacy of global tax network as the central actor in the international tax regime.

More importantly, the task of enhancing global tax governance requires filling the governance gap in the international tax regime. The success of this agenda depends largely on whether any international tax policy forum has transparency, legitimacy and accountability. In this context, the evolution of the OECD as a global tax network is inevitable. That is, if the OECD still attempts to serve a useful role in global tax governance, developing countries should be given an effective voice in the forum. Otherwise, developing countries may find that a global tax arrangement holds little interest, and poses some dangers.²³⁴

Meanwhile, the time has not come to establish the International Tax Organization since the proposal for the creation still needs global consensus from tax experts, academics, and authorities around the world. Under the circumstances, a special attention should be paid on the coordination of bilateral tax treaty network and global tax network.

Finally, this paper concludes in pointing to one observer's argument that "[g]lobal governance will come not at the expense of the state but rather as an expression of the interests that the state embodies. As the source of order and basis of governance, the state will remain in the future as effective, and will be essential, as it has ever been."²³⁵

234. Horner, *supra* note 220, at 187.

235. Martin Wolf, *Will the Nation-State survive Globalization?* 80 FOREIGN AFFAIRS No. 1 at 190 (Jan. /Feb. 2001).