Integrating Tax and Development Policy

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Mitchell A. Kane, *Bootstraps and Poverty Traps: Tax Treaties as Novel Tools for Development Finance*, 29 **Yale J. Reg.** 255 (2012).

A quiet, but powerful, movement seems to be emerging in the field of international tax – the explicit recognition that development policy is integral to any analysis of international tax policy.[1] Put differently, if the initial *distribution* of resources affects the *return* on resources, which itself affects the *taxation* of resources and thus the provision of public goods (which themselves feed back into the return on resources), distribution must be incorporated into the efficiency analysis of international taxation rather than thought of as a second, unrelated "fairness" step.[2]

Mitchell Kane contributes to this evolution in his thoughtful new article, *Bootstraps and Poverty Traps: Tax Treaties as Novel Tools for Development Finance*, 29 Yale J. Reg. 255 (2012). In this article, Kane attempts to integrate development economics into the tax treaty calculation itself – the exact opposite of traditional tax treaty policy. Originally, the policy behind tax treaties was to lower tax barriers to cross-border trade – as barriers dropped, trade increased, making everyone better off. What this theory did not take into account, however, was that this only worked for countries between which trade would flow. That is, countries with roughly similar economies. But what about small, capital poor countries? What would they get in return for signing a tax treaty with a wealthy country? The emerging consensus is: nothing. So why would they ever sign a treaty with a wealthy country such as the United States?

Kane attempts to overcome this problem by directly compensating such countries for entering into a tax treaty. The idea, stated quite generally, is that a wealthy country can use some of the surplus from the treaty to make a side-payment to the poorer country to compensate it for sacrificing some of its taxing rights. This makes intuitive sense. If the deal was that gains from trade between treaty member countries would roughly be split between the signatories, using side payments to make that happen when it otherwise would not merely fulfills this policy. Of course, Kane's analysis is much more sophisticated, but the general idea holds.

Kane does not stop there, however. Relying on recent theories of development finance, his ultimate goal is for such countries to use the upfront revenue to pay for public goods, making the country more attractive to private capital and thereby escaping the so-called "poverty trap." This would not only compensate the poorer country for relinquishing some of its taxing power but could also create a sort-of "virtuous cycle" in which shared worldwide growth, and thereby development, could actually occur.

There is much to like in Kane's approach. Explicitly incorporating distributional considerations and development economics into the efficiency analysis of tax treaties (as opposed to tax competition more generally) marks the next logical step in the evolution of international tax scholarship. There are two potential criticisms, however, that I wish Kane would have addressed more directly.

First, the proposal looks similar at a quick glance (and only at a quick glance) to a previous failed experiment called "tax sparing" in which wealthier countries would effectively subsidize poorer ones using their tax laws to attract private capital. Unfortunately, tax sparing did not work as initially hoped, and was ultimately rejected by virtually all developed countries as a tool for increasing development. Consequently, misplaced accusations of "tax sparing" – or the related "buying off the bad guys" – are always a concern when engaging in this type of analysis.[3] That some may refuse to engage Kane's argument on its own terms is not a criticism of the argument itself and Kane addresses the

development benefits of his proposal as compared to tax sparing in some detail. But anticipating these rhetorical criticisms might have made the Article a little stronger.

Second, and more substantively, what if everyone doesn't sign on? Could the resulting system be worse from a worldwide welfare standpoint than if nothing had been done?[4] Presumably the United States would have sufficient surplus to make side payments to multiple countries, but would it have enough to do so for every country in the world? Kane attempts to address this by contending that the returns from increased public goods would make signatory countries more attractive to capital than non-signatory countries. But that is rarely seen in the world today. Absent that assumption, Kane concedes that universal implementation would require some sort of cooperation among the countries of the world. But if such cooperation was possible, presumably the problem would not exist in the first place. This is not a problem unique to Kane's article, but it underlies my ultimate skepticism of the proposal.[5]

Regardless, expressly incorporating distribution of resources, capital flows, and public goods into the tax competition analysis, and specifically into the tax treaty analysis, in the sophisticated manner Kane does, represents another valuable step in this important evolution of international tax law scholarship.

1. *See, e.g.,* David Hasen, *Tax Neutrality and Tax Amenities*, 12 **Fla. Tax Rev.** 57 (2012); Steven Dean, *More Cooperation, Less Uniformity: Tax Deharmonization and the Future of the International Tax Regime*, 84 **Tul. L. Rev.** 125 (2009); Diane Ring, *Democracy, Sovereignty and Tax Competition: The Role of Tax Sovereignty in Shaping Tax Cooperation*, 9 **Fla. Tax Rev.** 555 (2009); Allison D. Christians, *Tax Treaties for Investment and Aid to Sub-Saharan Africa – A Case Study*, 71 **Brook. L. Rev.** 639 (2005). Allocation of resources has recently been incorporated into a law and economics analysis more generally as well. *See* Lee Anne Fennell, *Resource Access Costs*, __ **Harv. L. Rev.** __ (forthcoming), available at SSRN. [?]
2. *See* Adam H. Rosenzweig, *Why Are There Tax Havens?*, 29 **Wm. & Mary L. Rev.** 239 (2010). [?]
3. *Cf.* Calvin H. Johnson, *Taxing GE and Other Masters of the Universe*, 132 **Tax Notes** 175, n.47 (2011). [?]
4. *See, e.g.,* May Elsayyad & Kai A. Konrad, *Fighting Multiple Tax Havens*, 86 **J. Int'l Econ.** 295 (2012). [?]
5. That is precisely why it could make more sense to build side payments into the regime rather than attempt to do so through treaties. *See* Adam H. Rosenzweig, *Thinking Outside the (Tax) Treaty*, 2012 **Wis. L. Rev.** 717. [?]

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