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Tax Havens and the Commercialization of State Sovereignty

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Over the past three decades there has been a spectacular rise in the number of microstates serving as tax havens and bogus locations for actual or phantom corporations. Most, but not all, of these havens—these *paradis fiscaux* as the French, with some irony, call them—are small tourist resorts. Of the seventy or so tax havens identified in recent counts,[1] most serve as mere "booking centers" for the larger financial centers of London, Tokyo, and New York. Yet the combined effect of tax havens on the world economy is staggering: According to some estimates, as much as half of the world's stock of money either resides in tax havens or passes through them.[2]

In contrast to other states, tax havens have distinguished themselves by enacting legislation that provides corporations and individuals with anonymity and shelter from their home governments. Lacking adequate mechanisms of "internal profit

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1. The exact number of tax havens is in dispute. The recently published task force "name and shame" report lists thirty-seven jurisdictions with *significant* offshore activities. However, specialists claim the figure is much higher. An International Monetary Fund (IMF) study lists nearly seventy tax havens, while the latest authoritative study by Diamond and Diamond lists no fewer than sixty-two tax havens. See Financial Stability Forum 2000; Musalem and Luca 1999; and Diamond and Diamond 1998. Diamond and Diamond identify at least ten additional tax havens that have not made a great impact on the international financial markets. Already in 1984, Richard Blum had arrived at a figure of over one hundred tax havens. Blum 1984, 27. Many financial experts believe, however, that practically every country can serve as a tax haven. For a good discussion of the method by which different analysts arrive at the aggregate number of tax havens, see Doggart 1997; and Ginsburg 1991, 6.
2. See Cassard 1994; and Kochen 1991. This estimated figure is often mentioned but rarely explained. The original estimate may have been derived from Blum and Kaplan 1979, who estimated that in 1979 about two-fifths of Swiss banking transactions were with, or via, tax havens. If London were added, they concluded, more than half of all Swiss transactions would be conducted in the offshore market. The figure of half of the stock of money may have been derived from their findings. Switzerland is a special case, however, and its experience cannot be extrapolated to the world economy. The fact is, no one really knows how much money goes through offshore financial centers.

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generation,"[3] these so-called paper financial centers have learned to take advantage of what *The Economist* scornfully describes as their main asset: the right to write the laws. But in so doing, tax havens are like the sovereign equivalent of parking lot proprietors: they could not care less about the business of their customers, only that they pay for parking their vehicles there. Likewise, tax havens are unconcerned with the true nature of the companies residing within their borders.[4] Those using tax havens rarely relocate to them;[5] instead they pay for the privilege of "renting" a residence there. That is, they take advantage of the juridical facilities offered to them for what is euphemistically called "effective international tax strategy," which is another way of saying avoiding or evading taxes. But with increasing numbers of tax havens and those who use them, the principles of supply and demand appear to regulate the cost of license fees and the character of the legal protection that tax havens offer. In other words, tax havens are introducing choice and marginal utility into issues of residency and sovereignty.

In this article I seek to explain the causes for the apparent commercialization of state sovereignty, and in particular the reasons why such commercialization is associated with tax havens. Thus far the subject has not attracted the attention it deserves. On the contrary, tax havens generally are viewed as a perfectly legal strategy for development particularly suited to microstates.[6] The literature acknowledges, however, that the motive of these states is to draw rent surpluses from the income that otherwise would accrue to larger states.[7] Some view the commercialization of sovereignty as it is practiced by these states to be an abuse of the rules and codes of sovereignty.[8] Others maintain that it is a perfectly legitimate strategy, but that it can lead to abuses in that it encourages tax evasion and money laundering.[9] The latter believe that such abuses can be corrected if stricter international standards are agreed to and acted upon. The consensus seems to be that tax havens flourish because of the rising regulation and taxation practiced by advanced industrial countries.

I challenge the conventional view. I argue that the conditions that gave rise to the commercial use of sovereignty as perfected by tax havens cannot be dismissed either as legitimate responses to an unreasonable surge in taxation and regulation in the

3. Johns 1983.

4. Whenever the issue is raised it generates a chorus of indignant voices from the tax havens. Many scholars have demonstrated, however, that tax havens have very limited capacity or will to regulate corporations that supposedly are residing in their territories. For instance, Blum reports that in Antigua, "government authorities have no adequate records of the number of registered companies that exist, although a regulation requires annual reporting by companies . . . we are told companies number in the hundreds or thousands." Blum 1984, 129. See also Naylor 1987; OECD 1987; Gilmore 1992; and Financial Stability Forum 2000.

5. See Doggart 1997, chap. 3; and Barber 1993.

6. Fabri and Baldacchino 1999, 141.

7. See Hampton 1996; and Johns 1983.

8. See, among others, Picciotto 1992; Gordon 1981; Hudson 1998; Marshall 1996; Palan 1998; and Palan and Abbott 1996.

9. See Hines and Rice 1994; and Johns and Le Marchant 1993.

postwar era or as mere abuse of sovereignty. On the contrary, they go to the heart of the continuing process of state formation in a period of intensified capital mobility. I trace the incipient commercial use of sovereignty not to deliberate or instrumental state behavior, but to the contradictions between two elements: (1) the continuing process of insulating the state in law, a process that began in the sixteenth century, culminated in the nineteenth century, and has only recently begun to reverse itself;[10] and (2) the growing integration of the world market, a process that began in earnest with the emergence of multinational corporations at the end of the nineteenth century. Thus, paradoxically, improvements in communication and transportation technologies and accelerating capital mobility have been accompanied not by any loosening of the juridical unity of the state but by, if anything, the strengthening of it. The ensuing conflict between the increasing insulation of the state in law and the internationalization of capital forced a series of pragmatic solutions, one of which proved conducive to the development of the tax haven and the commercialization of sovereignty.

In making this argument I rely on two sets of observations, the first having to do with timing; the second, with the nature of the tax havens strategy. We need to distinguish, as I will show, between the period that saw a tremendous proliferation in the number of tax havens in the world, namely, the final quarter of the twentieth century, and the period that saw the emergence of the first modern tax havens, the last years of the nineteenth century. Conventional theories may explain the reasons for the tremendous *proliferation* of tax havens in the later years of the twentieth century but not why they emerged in the nineteenth century, not least because taxation and state regulation in the nineteenth century remained relatively low. Nonetheless, while the argument about timing casts serious doubts on conventional theories, it does not preclude in principle a variant of conventional theories. I therefore place greater emphasis on a second argument, which addresses the nature of the tax havens strategy. In many ways, the tax havens strategy can be considered "fictional" or purely juridical;[11] it is founded on the ability of companies and individuals to shift some of their "legal" residence without physically moving. The origins and causes of such facility have to be understood therefore in the context of establishing the legal facility for juridical relocation, a point that is entirely absent in conventional theories.

Given that small and marginal social formations often exhibit eccentric development trajectories, how significant are tax havens? Even more broadly, how significant is this burgeoning market in sovereignty to the world economy? There is a danger of misjudging the significance of the tax haven phenomenon by treating it as a mere perversion or mutation of the principle of sovereign equality, or by marginalizing it because of the small size of tax havens. An examination of the conditions in the late nineteenth century that gave rise to the system of tax havens

10. Born 1992.
11. Roberts 1994.

demonstrates that far from being the exception, the relationship between tax havens and sovereignty is likely to prove the norm. My conclusion, therefore, is that the commercialization of sovereignty is endemic to a system characterized by increasing economic integration within the context of political fragmentation.

Conventional Accounts of the Rise of Tax Havens

The complexity of modern national taxation systems, combined with greater capital mobility, has rendered practically every country in the world a potential haven from some type of taxation and regulation for residents of other countries. This has resulted in some confusion as to the true identity of tax havens.[12] Considering these conceptual difficulties, a number of analysts have proposed restricting the definition of *tax havens* to those countries that explicitly promote themselves as such.[13] Others, however, take a broader view, defining *tax havens* as "countries that have enacted tax legislation especially designed to attract the formation of branches and subsidiaries of parent companies based in heavily taxed industrial nations."[14] The consensus seems to be that tax havens are deliberate development policies that aim "to attract thereto international trade-oriented activities by minimization of taxes and the reduction or elimination of other restrictions on business operations."[15] The broader definition yields a list of approximately seventy jurisdictions (see Table 1).[16]

Within this broad list, it is commonplace to distinguish among four classes of tax havens:[17]

1. Countries with no income tax and where foreign corporations pay only license fees (examples are Anguilla, the Bahamas, Bahrain, Bermuda, the Cayman Islands, Cook Islands, Djibouti, Turks and Caicos, and Vanuatu).
2. Countries with low taxation (examples are Liechtenstein, Oman, Switzerland, Jersey, Guernsey, and the British Virgin Islands).
3. Countries that levy taxes only on internal taxable events. Profits from foreign sources are either not taxed or taxed at very low rates (examples are Liberia, Panama, Philippines, Venezuela, and Hong Kong).
4. Countries that grant special tax privileges to certain types of companies or operations (examples are the Channel Islands, Liechtenstein, Luxembourg,

12. OECD 1987, 21.
13. Ginsburg 1991, 1.
14. See Starchild 1993; Johns 1983; and Banoff and Kanter 1994.
15. Johns 1983, 20. See also Palan and Abbott 1996, chap. 8.
16. Musalem and Luca 1999. Diamond and Diamond list sixty-two jurisdictions as tax havens, and Chavagneux and Palan list over seventy jurisdictions. See Diamond and Diamond 1998; and Chavagneux and Palan 1999.
17. Park 1982.

TABLE 1. *Countries and territories with offshore financial centers*

Africa	*Asia and Pacific*	*Europe*	*Middle East*	*Western Hemisphere*
Djibouti	Australia	Austria	Bahrain	Antigua
Liberia	Cook Islands	Andorra	Dubai	Anguilla
Mauritius	Guam	Campione	Israel	Aruba
Seychelles	Hong Kong	Cyprus	Kuwait	Bahamas
Tangier	Japan[a]	Gibraltar	Lebanon	Barbados
	Macau	Guernsey	Oman	Belize
	Malaysia[b]	Hungary		Bermuda
	Marianas	Ireland[d]		British Virgin Islands
	Marshall Islands	Sark and Isle of Man		Cayman Islands
	Micronesia	Jersey		Costa Rica
	Nauru	Liechtenstein		Dominica
	Niue	Luxembourg		Grenada
	Philippines	Malta		Montserrat
	Singapore[c]	Madeira		Netherlands
	Thailand[d]	Monaco		Antilles
	Vanuatu	Netherlands		St. Kitts and Nevis
	Western Samoa	Russia		St. Lucia
		Switzerland		Panama
		United Kingdom[f]		Puerto Rico
				St. Vincent
				Turks and Caicos
				United States[g]
				Uruguay

Source: Musalem and Errico 1999.
[a]Japanese offshore market (JOM).
[b]Labuan.
[c]Asian currency units (ACUs).
[d]Bangkok international banking facility (IBF).
[e]Dublin.
[f]London.
[g]U.S. international banking facilities are located in New York, Miami, Chicago, and Los Angeles–San Francisco.

the Isle of Man, Monaco, the Netherlands, the Netherlands Antilles, Austria, and Singapore).

There are also tax havens with specific legislation for regional offices of foreign companies (the Philippines, Jordan, Greece, and Tunisia).

Notwithstanding the great variation among tax havens, they share the following attributes: minimal or no personal or corporate taxation; effective bank secrecy laws (quite often, bank or state officials are barred by law from disclosing the origins, character, and names of fund holders); few, preferably no, restrictions or regulations concerning financial transactions; and protection of the secrecy of transactions. The more successful tax havens also have the following attributes:

1. They possess political and economic stability; hence some of the better-known tax havens are dependencies of large, prosperous, and stable states.
2. They are supported by a large international financial market or are equipped with sophisticated information-exchange facilities and are within easy reach of a major financial center; Gibraltar, for instance, has invested heavily in communication infrastructure.
3. They are not tainted by scandals, money laundering, or drug money; hence the concern shown by Liechtenstein and the Caymans Islands regarding the recent report from the Financial Stability Forum.
4. They have agreements with major countries in order to avoid double taxation and regulation.

Estimates of the economic impact of tax havens vary as well. Some analysts maintain that more than half of the world's stock of money passes through these tax havens.[18] In addition, it is estimated that about 20 percent of total private wealth and about 22 percent of banks' external assets are invested offshore.[19] Walter Diamond and Dorothy Diamond, however, estimate the current total assets located in tax havens at $5.1 trillion.[20] James R. Hines and Eric M. Rice estimate that by 1994 the gross amount of U.S. investment in tax havens was $359 billion of $1.39 trillion, or over one-quarter of corporate activity conducted worldwide.[21] By any standard, therefore, the tax haven phenomenon is of great and growing importance to today's economy.

Conventional accounts explain the rise of tax havens by referring to the tremendous increase in state regulation and taxation during the postwar period. The heavier the regulations and taxation, so the argument goes, the keener some people are to avoid them. "It is no coincidence," notes Paul Figleton, "that banking, insurance, and ship registration are three of the main pillars of offshore business; they are among the most heavily regulated industries in developed countries."[22] The Financial Stability Forum's recently published report from the Working Group on Offshore Financial Centers reiterates the commonly held view: "The main contributing factor identified for the historical growth of offshore banking and Offshore Financial Centers was the imposition of increased regulation . . . in the financial sectors of industrialized countries during the 1960s and the 1970s."[23] According to this account, faced by a growing demand for permissive regulations, a number of microstates began to offer zero or near-zero regulations in order to attract businesses to their territories. As Robert A. Johns observes, "Given that some countries adopt a permissive regulatory environment and others a stringent one, gaps and differen-

18. See n. 2 above.
19. See Cassard 1994; and Diamond and Diamond 1998, 1.
20. Diamond and Diamond 1998.
21. Hines and Rice 1994, 151.
22. Figleton 1989, 6.
23. Financial Stability Forum 2000, 11.

tials arise in national systems of regulation. These differences can lead to perverse competition in regulatory laxity and a gravitation by some institutions to the least regulated financial centers."[24]

Other analysts, however, have questioned such accounts, believing that tax havens evolve as deliberate state strategies aimed at attracting "hot" money. A study commissioned by the French Parliament demonstrates convincingly that both Liechtenstein and Monaco have persistently and knowingly sought to attract hot if not criminal money.[25] Similarly, Tom Naylor shows that lawyers and financiers associated with the infamous Mafia boss Meir Lansky played a key role in drafting the financial legislation of some of the best-known Caribbean tax havens.[26] According to these theories, tax havens are quite simply abusing the system of sovereignty to advance parochial interests.

In fact, tax havens have often been associated with arguments like those above that implicitly recognize the vast potential for the commercialization of state sovereignty. The vigorous campaign of the International Transport Workers' Federation against flags of convenience, for instance, has generated a large number of publications deriding the inappropriate use of sovereignty. Indeed, Rodney Carlisle gave his excellent study of the Panamanian and Liberian flags of convenience the title "Sovereignty for Sale."[27] A recent Inland Revenue document refers to "designer rate regimes" that "enable companies to pay just the right amount of tax needed in any given situation to sidestep Controlled Foreign Companies rules."[28] Among international tax experts the expression "treaty shopping" has now come into wide usage.[29]

In 1933, in a dissenting opinion in *Liggett Co. v. Lee*, Justice Louis Brandeis recalled that "companies were early formed to provide charters for corporations in states where the cost was lowest and the laws least restrictive. The states joined in advertising their wares. The race was one not of diligence but of laxity."[30] Alfred Conard notes that "there is nothing very unusual about a race between states, . . .[but] what is unusual about the race of laxity in corporation codes is that its effect will be felt among those almost entirely outside the state." He calls this the "strictly-for-export aspect of corporation code."[31]

Similarly, in the 1970s Robert Aliber noted a curious arrangement between the Swiss government and Elizabeth Taylor: "Miss Taylor and the Swiss have struck a

24. Johns 1983, 6. See also Charny 1991.
25. Montebourg 2000.
26. See Naylor 1987; and Robinson 1995, 133.
27. Carlisle 1981.
28. Inland Revenue 1999.
29. "Treaty shopping means that taxpayer 'shops' into the benefits of a treaty which normally are not available to him. To this end he generally interposes a corporation in a country that has an advantageous tax treaty." Becker and Wurm 1988, 1.
30. Cited in Conard 1973, 631.
31. Ibid., 633. Conard insists on the difference between the tax haven game and the "exportation of liberality within the United States [which] depends on a principle of conflict of laws, according to which the law governing the internal affairs of a corporation is the law of the state of incorporation." Ibid., 634.

bargain. The Swiss sell Miss Taylor tax-avoidance services. The right to live in a low-tax jurisdiction. Miss Taylor buys this service because she likes the higher after-tax income; better to live where taxes are low than where they are high. The Swiss profit from the transaction, for Miss Taylor's tax payments greatly exceed her demand on local public services."[32] Both the Swiss government and Elizabeth Taylor pursue rational strategies in the sense that both are getting something out of the bargain. Aliber depicts tax havens as states that have learned to use their legislative capacities as "baits" to attract business into their jurisdictions. Such apparently rational arrangements between states and private operators are perfectly legal. Yet they are deeply disturbing, not least because the two parties to the exchange—one of them a sovereign government—handle highly charged normative issues, such as citizenship and nationality, in purely utilitarian terms. The willful misuse of ideas and practices that go to the heart of the legitimacy of the modern state as a "national" state is the most disturbing aspect of the tax haven phenomenon.

Explanations for these sorts of "arrangements" are normally viewed in terms of variants of the so-called Tiebout-type efficiency paradigm. Writing about the competitive incorporation of American cities, Charles Tiebout postulated that different jurisdictions provide individuals and firms with a bundle of public services and tax regulations.[33] He argued that individuals and firms are likely to choose jurisdictions that offer desirable bundles of regulations by moving to them, and are likely to move away from jurisdictions that offer less desirable bundles of regulations. Since municipal jurisdictions want the business of these individuals and companies, the jurisdictions are compelled to compete with each other by offering the kind of regulations that the market wants. In contrast to the "laxity races" noted by Judge Brandeis, Tiebout maintained that such a "market" in bundles of regulations is likely to bring about optimal public service as taxpayers adapt to the economic system.

Drawing on Tiebout's theory, Gary Hufbauer argues that competition between states does not necessarily lead to a "race to the bottom" but serves as the best safeguard against what Tiebout believed was states' natural predisposition to abuse their monopoly positions.[34] These ideas resonate well with the theory of the new political economy, which views states (or public authority) as being engaged in an exchange relationship with society, providing security in return for taxes.[35] According to the theory, states are monopolistic service providers whose powers must be curbed. While only the most extreme positions in the rent-seeking literature would wish the state away, they are on the whole sympathetic to the Tiebout efficiency argument, and they implicitly *welcome* the commercialization of sovereignty as a means of curbing the state's excesses.

32. Aliber 1976, 182.
33. Tiebout 1956. For an excellent discussion of the context and failure of the Tiebout paradigm, see Miller 1981.
34. See Hufbauer 1992; and Hines and Rice 1994.
35. Auster and Silver 1979.

Tiebout-type efficiency has been debated in many circles and has been found wanting on a number of fronts. However, the debate underscores two points that are relevant here. First, there is a shared perception that a sovereign right to write the law—whether at the municipal, state, or national level—combined with a competitive system can be used as a competitive asset. In other words, a link between a competitive system of jurisdictions and the potential for the commercialized use of the right to write the law is well recognized. Second, another Tiebout argument maintains that the raising or lowering of taxation or regulation is not *in and of itself* the cause for the commercialized use of sovereignty. On the contrary, Tiebout does not assume, as conventional theories of tax havens do, that corporations will necessarily migrate to the least regulated or least taxed realm. The causes for the commercialization of sovereignty lie elsewhere.

On the Origins of Tax Havens

Although divergent in their views, conventional theories are careful to avoid the question of the exact origins of tax havens. They imply, however, that tax havens are a rational advantage-maximizing strategy adopted by states and firms. These theories advance implicit histories that, unfortunately, can lead to a misunderstanding. It is true that the origins of the modern strategy of tax havens cannot be pinpointed with accuracy, and in many ways tax havens are not particularly new: Evidence of wealthy individuals using other polities deemed safe as asset havens goes all the way back to Roman times.[36] Of course, modern tax havens are qualitatively different from these asset havens in that they have become important nodes in a globe-spanning flow of capital.[37] One thing is clear: Modern tax havens did not originate as part of a conscious state or firm strategy. Rather, they evolved slowly and haphazardly; states appear to have stumbled upon the various attributes of tax havens, such as bank secrecy laws, low taxation, and "liberal" corporation laws. Furthermore, each of these attributes appears to have originated in different places and at different times. Only by the 1930s had a select number of tax havens—including Switzerland, Liechtenstein, the Bahamas, and Bermuda—begun to integrate the diverse elements into a core component of their development strategies.

An early case for the abolition of personal taxation, for example, can be traced back to 1868, when Charles III of Monaco abolished "with one stroke of the pen all direct taxation."[38] He did so, according to sympathetic historians, because he was fearful of the tax revolts he had seen in his youth and was anxious to show that he was not profiting from the newly established Monte Carlo casino.[39] Nevertheless,

36. Doggart 1997.
37. Diamond and Diamond 1998, 2.
38. Smith 1912, 125.
39. Ibid.

since revenue from the casino paid for all the public affairs of Monaco, low taxation and the Mediterranean climate attracted many wealthy visitors and residents, and Monaco became the epitome of the cheerful, fabulously rich tax haven. It took about half a century for Monaco to integrate these laws into a veritable tax haven strategy.

In contrast, the practice of competitive reduction in corporate taxation can be traced back to the incorporation laws of New Jersey and Delaware. In fact, a behavioral characteristic of modern tax havens had already been witnessed in the late nineteenth century within the federal structure of the United States. Some of the smaller states in the Union, including New Jersey and Delaware—in competition with West Virginia, Rhode Island, and Maine—became known for enacting what Alfred Conard calls "strictly for export" laws.[40] During the 1880s, New Jersey was in dire need of funds. A corporate lawyer from New York persuaded Governor Abbet to back his scheme of raising revenue by imposing a franchise tax on all corporations headquartered in New Jersey. The scheme provided that New Jersey should "liberalize her laws regarding corporate regulation to an extent that would make it advantageous for all corporations to be organized under her protection."[41] When the Delaware legislature debated the drafting of a new general incorporation act in 1898, it sought to emulate the success of New Jersey. Here, again, a group of lawyers from New York played a prominent role in drafting the proposed act.[42] It was obvious at the time that Delaware was enacting "liberal" laws to attract corporate business.[43]

Although the smaller American states competed by offering "liberal" laws, the principle of purely "fictional" incorporation for tax purposes originated elsewhere. Sol Picciotto traces the origins of the practice to a series of rulings by the British law courts. In the last quarter of the nineteenth century, problems related to the tax liability of British companies whose activities took place abroad began to surface.[44] The British government handled the issue with the aid of the courts. In 1876 the issue of extra-jurisdictional corporate taxation was brought before the Exchequer courts. In *Cesena Sulphur Co., Ltd. v. Nicholson* and *Calcutta Jute Mills v. Nicholson,* the courts held that although their activities took place abroad, these companies were under the control of persons belonging to a governing body located in England. They were therefore "resident" in Britain and liable to the national tax regime. Aware that many shareholders were foreign, the court contended that if they invested in a British company they were liable to pay British tax.[45]

The courts established the main principles of British taxation. British-registered companies could not escape potential liability for income tax on their trading profits unless the whole of their activities and all the management and control took place

40. Conard 1973.
41. Lindholm 1944, 57.
42. Larcom 1937, 9.
43. Ibid., 17.
44. The following draws on Picciotto 1992.
45. Picciotto 1992. See also Schmitthoff 1954, 382–86.

abroad. The precedent for this was the 1929 case of the *Egyptian Delta Land and Investment Co. Ltd. v. Todd.* It was demonstrated that although the company was registered in London, "The business of the company was entirely engaged and controlled from Cairo where the directors and secretary permanently resided; the seal, minutes, and books of accounts and transfer were kept; transfers were approved (before being registered in London; and dividend was declared and paid. . . . [Consequently, the] House of Lords held that the company was ordinarily resident in Egypt, and not in the United Kingdom."[46] This case created, argues Picciotto, "a loophole which, in a sense, made Britain a tax haven."[47] Companies could now incorporate in Britain but avoid paying British tax. The ruling of the British courts proved significant because it laid down the rule not only for the United Kingdom but also for the entire British Empire, a point later exploited by jurisdictions such as Bermuda and the Bahamas and perfected in the 1970s by the Cayman Islands.

Modern bank secrecy laws, in contrast, evolved in Switzerland. Bank secrecy is an old and well-established principle. Swiss bankers began offering secrecy to aristocrats for a fee during the French Revolution.[48] In fact, *les comptes anonymes,* numbered bank accounts, were invented at the end of the nineteenth century.[49] The Swiss developed these laws further, so that as early as the 1920s Switzerland became the preferred location for asset protection.[50] During that period, Switzerland was the only country in Europe not imposing restrictions on foreign exchange. In addition, the Swiss Supreme Court had ruled much earlier that, unless the customer specifically authorized them to do otherwise, banks were under a binding obligation to preserve secrecy. Not surprisingly, many wealthy families moved their assets to Swiss banks. Around that time the Swiss began experimenting with the idea of the "offshore corporation," drawing on the experience of the United States.[51] A number of Swiss cantons, emulating Delaware and New Jersey, competed with one another by deliberately writing their company codes to allow incorporation of as many firms as possible under their statutes. Swiss lawyers created corporations, directed by "dummy" Swiss directors, whose shares were held by second personal holding companies, with the identity of their owners kept secret under the Swiss banking secrecy laws. In this way, the Swiss created companies that under international law were deemed to be completely Swiss and therefore protected by Swiss and international law, but whose assets were located in foreign countries.

Threatened by the depression of 1929 and in particular by the series of bankruptcies in Austria and Germany in the early 1930s, the Swiss financial industry managed to persuade Swiss authorities to adopt the stricter principles of bank secrecy. In an amendment to the Swiss Banking Law of 1934, for "the first time in

46. Schmitthoff 1954, 384.
47. Picciotto 1992, 8.
48. Robinson 1995, 133.
49. Ibid., 133.
50. Fehrenbach 1966, 49.
51. See ibid., chap. 3; and Faith 1982.

history the principle of bank secrecy was put under the official protection of the penal law."[52] It became a criminal offense for bank officials to divulge any information regarding a customer's identity, even to the Swiss, and the protection was extended to foreign nationals as well.

Many countries viewed the Swiss interpretation of the law as a direct act of aggression. In fact, in some countries—such as Spain—owners of Swiss corporations could be jailed.[53] The United States, in particular, sought to resist the Swiss. This meant that the United States had to contemplate either going to war or engaging in a trade war with the Swiss government over divergent interpretations of the principle of sovereignty. The problem was exacerbated by other countries' following Switzerland's example. Such time-honored tax havens as the Bahamas, Liechtenstein, and Montevideo soon devised their own bank secrecy laws. (In most of these instances, a new center emerged, feeding off the collapse of a previous one—for example, Beirut's taking business from Haifa and the Bahamas' from Cuba. A steady supply of bank deposits found its way to these havens from people—including criminals, money launderers, and tax evaders—who for one reason or another sought to evade inspection in their own country. Swiss laws became the benchmark, and any newcomer had to up the ante. While the Swiss invented the numbered account, insisting that at least two bank officials should know the identity of an account holder, Luxembourg took the idea a step further by insisting that only one bank official should know the identity of an account holder. Austria then took the principle to its logical conclusion: According to Austrian banking law, no one needed to know the identity of an account holder. Consequently, as other countries followed suit, the struggle to restrict it became far too difficult to pursue. Even if Switzerland had relented and changed its basic laws, there would still have been sixty-eight other tax havens to deal with. In the end, the United States abandoned the struggle and joined the ranks of offshore jurisdictions by creating its own international banking facilities.

The inauspicious, eclectic beginning of the modern system of tax havens is not only a historical curiosity; it also alerts us to an important distinction between the origins of the modern tax havens strategy and the later diffusion and growth of the phenomenon. Although its development is naturally of great interest to financial regulators, its origins are what international relations scholars find interesting, not least because of the importance attached to a system of states, particularly a system of *sovereign* states that appears to have encouraged the experimentation and innovation in state laws that produced the tax havens strategy.

52. Fehrenbach 1966, 73.
53. Ibid.

The Fictional Character of Tax Havens

The manner in which the modern system of tax havens emerged and the timing of its emergence suggest that conventional explanations of tax havens' origins are mistaken; in addition, the nature of commercialized sovereignty is also often misunderstood. Indeed, there are good reasons for not treating the tax havens phenomenon as merely a subset of a type of Tiebout efficiency argument. For if tax havens offer superior bundles of regulation, then according to a Tiebout argument they should have become true hubs of financial, manufacturing, and commercial activities. But even the most successful havens play at best a supportive role to the major financial centers of London, Tokyo, and New York. Whatever the aspirations of these tax havens might be, their "core" business consists of charging "rent" or license fees in return for granting firms a right to incorporate in their jurisdictions. If companies and individuals were required to completely relocate from one jurisdiction to another in order to take advantage of tax havens, then interest in tax havens would have remained relatively insignificant. As opposed to other forms of competitive deregulations, whether at the municipal, national or international level, in the case of tax havens often *only a purely juridical residence* is sought. The strategy of tax havens is based, in other words, on what Susan Roberts describes as a fiction.[54] In this sense Aliber's description of the "deal" between Elizabeth Taylor and the Swiss government is misleading, for it gives a false impression that Taylor has shifted her location to Switzerland, whereas in reality she stayed in California. *The principal attraction of tax havens* and the main cause for their spectacular success lie in their ability to provide protection from national regulation and taxation *without* the need to physically relocate to the host country. They tempt foreign capital by providing "fictional" residencies, or to use Robert H. Jackson and Carl G. Rosberg's famous distinction, they offer *juridical* rather than *de facto* abodes.[55] Quite often money is not "really" deposited in tax havens, and companies do not "really" change location.[56] Thus, although a significant number of Hong Kong companies shifted their registration to Bermuda in anticipation of Hong Kong's return to Chinese rule, very few actually relocated to Bermuda. Most firms stayed put and opted to "relocate" into a different juridical domain, because their owners believed they would obtain a measure of security vis-à-vis the Chinese state if they shifted their legal residence to Bermuda and effectively "purchased" a foothold in a different regulatory domain.

54. Roberts 1994.

55. Jackson and Rosberg 1986.

56. Sometimes these fictions backfire badly. The *Toronto Globe and Mail* reports that the U.S. Securities and Exchange Commission charged a New York lawyer and his firm for defrauding investors in the United States and Dominica of $1.2 million in a scheme based on a fictitious bank in a fictitious country. The lawyer and firm are alleged to have organized a scheme promoted by Credit Bank International Co., which is purportedly chartered in Melchizedek. However, the Securities Regulator said that Credit Bank is not a bank and Melchizedek is not a country (reported in *Offshore Week*, January 2000). Melchizedek is one of a dozen rather unique jurisdictions whose legality is in question. For discussion of Melchizedek and a few other "jurisdictions" like it, see Diamond and Diamond 1998.

Here we come to the crux of the matter: "International tax planning" exploits "loopholes" that allow individuals and companies to shift residence without actually moving. Fictional or mere juridical relocation is the common denominator that turns diverse practices—such as the incorporation laws of New Jersey and Delaware, the bank secrecy laws of Switzerland, and the tax haven laws of Britain—into a viable development strategy.

In the rest of this article I uncover the roots of fictional relocation, the "mystery tool" that has facilitated the conversion of sovereign rights into a marketable product. I show that this phenomenon was emerging toward the end of the nineteenth century at the same time that embryonic forms of offshore locations were emerging, and that the two developments are connected.[57]

Nationalizing Sovereignty and the Emergence of the Three-Dimensional "National Cage"

That the original variants of tax havens emerged in the late nineteenth and early twentieth centuries is not accidental. On the contrary, they stem, as Stephen Neff observes (though in a different context), from a "basic incompatibility in the economic sphere, between the traditional prerogatives of sovereigns and the smooth functioning of the liberal economic system."[58] Neff attributes this incompatibility to the failure of international lawyers to bridge the gulf between national sovereignty, on the one hand, and the goals of liberalism and the internationalization of capital, on the other. Neff fails to recognize, however, that the reasons for the incompatibility were structural in nature and that the "solutions" to it generated the conditions under which sovereignty became commercialized. To make this argument, however, it first needs to be shown that increasing the insulation of the state in law was not as much a product of the seventeenth century, as IR scholarship generally maintains, as it was of the nineteenth century.

The states of Europe emerged through a process that combined the internal subjugation of dissent and the forging of an alliance between the bourgeoisie and the European monarchs with external "liberation" from the Holy Roman Emperor and the Catholic Church.[59] But at this stage, claims to sovereign exclusivity evolved not as a rebuff to Christian ethics but as an extension of principles already enshrined in medieval thought. Under the new doctrine, the prince was understood to be the "servant of God," and consequently sovereign laws were still embedded in a universal ethical theory. Thus a particularistic political order was embedded in a universal order founded on natural law; the universal ethical order was upheld by the prince and not, as previously asserted, by the Church. As Kenneth C. Cole observes, "What each sovereign could reasonably claim as a prerequisite for effective local

57. Palan 1998.
58. Neff 1990, 49.
59. Ranke 1840.

government was a finality of decision on all issues arising within his realm," but, he continues, "*insulation of the nation-state in the matter of law enforcement is a very different thing from insulation as respects law itself.*"[60]

The difference is subtle but important. Sovereigns certainly claimed a right to finality of decision on issues arising within their territorial realms, but formal adherence to the principles of natural law can be construed as limiting the purview of sovereignty. Only with the decline of natural law were the last vestiges of transnational ethical morality removed and the states fully insulated from each other in law. Historians agree, therefore, that the insulation of the state with respect to the law was accomplished only during the nineteenth century. Only then did sovereignty begin to express "the exclusive, unique institutionalized and strictly public dominance over a territorial national ensemble and the effective exercise of central power without the extra-political restrictions of juridical or moral order which characterized the feudal state."[61] In fact, writes Frederik M. Van Asbeck, "since the nineteenth century we have been confronted with a new historical situation, viz., the existence side by side of isolated States, between which there is no moral or spiritual bond."[62] Only during this period did the sovereign people come to be viewed as the ultimate source of rights and duties and hence of the law, as the state effectively "nationalized" the rule of contracts.[63] Increasing insulation of the state in law found expression in legal theory through the rise of positive international law,[64] a doctrine that maintained that the practice of government, rather than theories about it, is the source of international law. Originally the function of positive law was to attach penalties to violations of natural law, and by doing this, to remove arbitrariness from authority.[65] But positive law in the nineteenth century gave the state ultimate authority.

Institutions do not exist in isolation: They interact with other institutions. The rising fortunes of positive international law parallel the increasing acceptance of the doctrine of popular sovereignty first promulgated by the Fronde movement in France in the eighteenth century.[66] The theory of popular sovereignty changed the degree to which sovereignty was seen to imply exclusiveness, suggesting that "once a nation-state is formed . . . a 'natural' organic whole has come into existence, which seems to function as a closed actor."[67] The analytical consistency between the idea

60. Cole 1948, 17 (emphasis added). The prince became the beholder of the moral fabric of his subjects, and as a result states' laws broached areas such as blasphemy, homosexuality, witchcraft, and just price. Sovereignty therefore had ideological–legal implications to the extent that it legitimized a certain order in terms that were explicable in ancient doctrines of justice and morality.

61. Poulantzas 1973, 162.

62. Van Asbeck 1976, 190.

63. Medwig 1992.

64. Positive international law can be traced back to Wolff and Vattel in the middle of the eighteenth century, but the principles became accepted only in the nineteenth century. For discussion, see Neff 1990.

65. Sabine and Shephard 1922, xxiii.

66. The idea of the nation was already found in the parliament of the Fronde, which Louis XVI rejected so vehemently in the parliament of Paris, 3 March 1766.

67. De Wilde 1991, 33.

of the nation (*idea* in the Kantian sense) and the institutions of positive international law and popular sovereignty is well established and needs no discussion here.[68] It suggests, however, that the conflict between the ideals of liberalism and positive international law cannot be reduced to a failure on the part of international lawyers—as Neff believes—but must be seen in historical or "structural" terms.

Ideas about the functional necessity of insulating states from each other for the purpose of self-governance, still implicit in the late eighteenth century, became explicit in the early years of the nineteenth century as the concept of exclusivity vis-à-vis the Church, the nobility, and the Holy Roman Empire was replaced by the concept of exclusivity in the affairs of states in relation to each other. These principles, carved out in the midst of what was, in effect, a trans-societal space of economy and society,[69] were then expressed materially in the formation of stricter forms of state borders—as replacements for the more amorphous types of frontiers that had constituted the boundaries between states. In other words, theories of national exclusiveness did not remain of purely abstract or academic interest but informed the practice of states. Consequently, parallel to states' monopolizing the means of violence and representation, by the early nineteenth century some were beginning to adopt the principles of totality and exclusivity by physically demarcating their borders.[70]

On this historians agree. During the early nineteenth century European states began in earnest to define and guard their territories and to control and regulate their populations.[71] "Over much of Europe," writes Sidney Pollard, "frontiers gelled into economically meaningful barriers."[72] Remnants of extra-territorial jurisdiction principles that had survived into the early nineteenth century were swept aside.[73] Not only were boundaries established between one state and another, but also a clear distinction was created between national and international spaces in international law.[74] Similarly, by the early nineteenth century nations were recognizing the principle that other nations could grant nationality and flags to ships.[75] The origins of domicile laws can be traced to the late nineteenth century.[76]

68. Schnapper 1998.
69. Bienkowski 1981.
70. Robé 1997.
71. Murty comments that "very few boundaries of state prior to the nineteenth century were either formalized or determined." He concedes that many European frontiers can trace their origins to the medieval period. Murty 1978, 33.
72. Pollard 1981, 253.
73. Liu describes five different methods of the transfer of jurisdiction, or what Robé calls the nationalization of law. See Liu 1925; and Robé 1997. Similarly, Medwig notes, however, that "starting in the sixteenth century, national governments began to regard the autonomous law merchant as an emptying target for nationalization. The law merchant was incorporated into the national court systems, [and] the processes continued during the eighteenth, nineteenth, and twentieth centuries." Medwig 1992, 593.
74. Kish 1973.
75. Carlisle 1981, 154.
76. Graveson 1977, 160.

The shift to clearly demarcated boundaries required an increasingly rigid interpretation of the relationship between sovereignty and territoriality as well as a new conception of the sovereign space.[77] But as states demarcate their territories with greater rigor, they encountered a series of "technical" obstacles. For reasons partly to do with technology and later with the deterioration of the colonial empires, and in parallel with the extension of the law of the seas into space, the historical context by which boundaries were established had to evolve *pragmatically* as countries sought to demarcate their boundaries more strictly. The principles enshrined in the law of the seas served as the model for demarcating boundaries of sovereignty: "The power of the land ends where the power of arms ends" was the motto.[78] However, technology in particular posed new challenges to the discrete concept of the "national" space. As states claimed new territories, the danger of conflagrations due to the lack of clear boundaries was rising. From foreign invasion to satellite communications, the defense of national space raised a practical question: What is the precise boundary of the national space? As technology has increasingly become detached from physical constraints, the conception of the "national" space has been extended to define intangible boundaries or "shores."[79]

Stricter boundaries founded on the principles of positivist international law engendered tensions that began to manifest in earnest in the late nineteenth century in four key jurisdictional areas: (1) the treatment of aliens—more specifically, guarantees that contracts signed in one country would be binding in another; (2) conflicts between the principles of "absolute" sovereignty and taxation; (3) the difficulty of identifying the fiscal location of intangible commodities (witnessed today in software and services); and (4) the possibility of one state's rules and regulation eroding another's sovereignty.[80]

These tensions exercised some of the best legal minds of the era, and jurists' solutions were not straightforward. Considerable evidence indicates that in some areas of the law these tensions eroded the insulation of national territory in law. This is particularly true in the case of human rights and the limited acceptance of individuals as subjects of international law.[81] Yet the process has also had the seemingly paradoxical effect of creating juridical boundaries that were "fictional" three-dimensional "national cages" of sovereignty. A state's sovereign territory extended laterally into the seas to the length of the flight of a cannon ball, or three nautical miles, and was later extended to twelve miles. This twelve-mile zone became the norm in the early nineteenth century[82] and generated internationally accepted horizontal lines separating one state from another. When hot air balloons and eventually aircraft began to fill the skies, national boundaries were extended

77. Liverani 1990.
78. Bynkershoek 1702 as quoted in Kish 1973, 6.
79. Palan 1998.
80. Neale and Stephens 1988, chap. 1.
81. See Van Asbeck 1976; and Cutler 1997.
82. Prescott 1975, 37. Not until 1930 did an international conference held at The Hague universalize this into the law of the seas.

vertically into the so-called von Kármán line of 50.55 miles. The principle also applied to the entire subsoil of national land territory, to the center of the earth.[83]

Faced with the problems of moving "intangible goods," states relied on these same principles to extend their boundaries into "imaginary" spaces, that is, to extend the national cage into the purely juridical dimension. We see this first with regard to patent laws, then with the introduction of passports and passport controls during World War I, and then with the delimitation of intangible forms of property rights.

Pragmatic Solutions to the Contradictions

Even as the sovereign national cage evolved, by the end of the nineteenth century the increasingly discrete state system was faced with companies branching beyond national frontiers.[84] In dealing with the resulting problems, two principles proved to be nonnegotiable: (1) the principle of exclusive sovereignty that evolved in response to the broader restructuring of capitalism and the state and (2) the strong support by governments of the major industrialized countries of the time—the United States and the United Kingdom—to business and to the internationalization of business.[85]

Solutions to these problems had to be of a tactical nature. By "tactical" I am not implying that they were transitory or unimportant; on the contrary, the major industrialized powers were experimenting with a number of solutions whose pragmatism clearly served the interests of capital. The patchwork of international laws evolved, first and foremost, through what was then called municipal (that is, national) legislation governing foreign affairs and the law of treaties. International law developed gradually as the core states of the emerging economy declared the manner in which they would treat foreigners and extra-jurisdictional contracts. A second layer was gradually added to this, through a host of bilateral treaties designed to harmonize the laws concerning the treatment of aliens. At this stage, the universality of international law was not yet assumed, and treaties frequently discussed the extent to which "international law" was applicable outside Western Christendom.[86] Commercial treaties became the most important species of international convention. The most significant of these was the 1860 Franco–English treaty of commerce (often called the Cobden treaty), which became the model for numerous subsequent commercial treaties and produced what Nussbaum calls an "international bill of rights."[87] Under such treaties, nationals of signatory powers were granted personal and property protection in the other country, free sojourn, admission to trade and industry including the right of permanent establishment,

83. Kish 1973.

84. This took place in the 1880s (although most companies waited until the end of World War I for expansion). Chandler 1990, 157–61.

85. See Picciotto 1992; and Neff 1990.

86. Jenks 1958, 29.

87. Nussbaum 1962, 203.

protection from discriminatory treatment in taxation and similar imposts, free access to courts, freedom of ownership, and exemption from military service.[88] Many of these treaties were supported by stock clauses, such as the "national treatment clause" that promised the nationals of another country the same rights, in certain respects, as those enjoyed by the nationals of the promising country. Some treaties were signed for mutual assistance in the enforcement of the law among governments and "among courts of civilized nations."[89] The most important one, perhaps, was the treaty establishing uniform principles in the "choice of law"—that is, that each contract must specify its location for jurisdictional purposes. In addition to the layers of municipal laws and bilateral treaties, states allowed companies to develop their own "law." Jean-Phillipe Robé notes that as "state lawyers have found great difficulty in agreeing and formulating amongst themselves rules which apply to international commerce they preferred to leave the initiative to traders themselves."[90] This allowed the growth of a hotly disputed branch of private international law: the *lex mercatoria*, or law merchant–a branch of law that traces its origins to medieval times and already was being used as the basis for the treatment of consular representatives.[91]

The Denial of the Legal Unity of the Subject

Some amendments to national laws enshrined principles whose implications apparently were not entirely understood at the time. The way the British state stumbled upon tax havens status and the way the Swiss government ended up enacting its banking secrecy laws were simply further instances of an attempt to use the courts and the legislature to handle the tension between the internationalization of capital and their sovereign rights. The solution of the British and Swiss governments, however pragmatic it may have appeared at the time, was radical and innovative. In extending the new banking secrecy laws to foreigners, which as we have seen was a principle well enshrined in international law, the Swiss government reaffirmed its claims to sovereignty over accounts "held" in its territory. In so doing, the Swiss government indicated its adherence to principles that were already accepted in British law—namely, that the location of intangible assets is determined according to the place where the transaction physically takes place. This meant that, initially, the physical act of opening an account was sufficient to offer sovereign protection for account holders, wherever they may live or whatever citizenship they may possess. Later, with the advance of technology, the physical act itself could be dispensed with, since interacting face-to-face with a bank clerk located in a tax haven is not necessary.

88. Ibid., 204.
89. Ibid., 212.
90. Robé 1997, 50.
91. Nussbaum 1962.

In extending its protective laws to foreigners, the Swiss government, in effect, followed the British example and extended the notion of territoriality into a fourth juridical dimension. At the same time, the Swiss banking laws of 1934 denied any sovereign claims over foreign accounts by their real countries of residence. The Swiss government instead claimed a sovereign privilege to write its own laws. In so doing, the Swiss in effect legislated that individuals can be separated from their money: Account holders could reside in one location and, for all intents and purposes, be under the sovereignty of that location; but "their" money, when deposited in a Swiss bank in Switzerland, was deemed to be under Swiss sovereignty. It was, of course, entirely in accordance with the principles of territorial sovereignty for the Swiss government to devise laws that (1) "extend the courtesy," as Paul Fehrenbach puts it, and provide foreigners with the same protection Swiss citizens were enjoying in Swiss courts, and (2) as a consequence, protect those foreigners from their own governments' sovereign claims.

Now, if we probe deeper into the Swiss law of 1934, we notice that the Swiss government proposed to resolve the tension between the insulation of the state in law and the internationalization of capital by questioning the legal unity of the subject in law. Individuals, as citizens or as corporate entities, could "reside" in one capacity in one jurisdiction and in another capacity in another jurisdiction. And since "real," living individuals cannot spread themselves physically over different jurisdictions, they were offered fictional or juridical location in Switzerland.

To resolve the taxation difficulties posed by the activities of the multinational enterprises, the British state proceeded similarly: A series of court rulings from 1880 onward allowed for the division of the legal unity of enterprises. These enterprises could be incorporated in the United Kingdom but reside elsewhere. The U.K. courts insisted on evidence for real residence of companies as opposed to fictional residence. Other states, which were not as concerned with material evidence of corporate activity, used the same principle as mere "bait" by which they were able to sell companies "off the shelf" to any interested party.

Because of the discrete nature of insulated "national" laws, the multinational enterprises do not exist in law. As Robé argues, "*de jure*, the multinational enterprise, as differentiated from *the corporation*, does not exist in law!"[92] Yitzhak Hadari substantiates the argument, noting that "the MNE [multinational enterprise] is a business and economic creature, and the usage of that term is presently found only in those fields. Properly viewed the MNE is not a single *legal* entity, but rather a group of corporations throughout the world sharing a single underlying economic unity."[93] The patchwork of international as opposed to truly global law creates what Robert Johns calls "the potential for government-induced frictions and factor immobility."[94] But far from being a hindrance, "the separation of the enterprise into distinct legal entities enables corporations to achieve greater efficiency. It can

92. Robé 1997.
93. Hadari 1973, 754. For a similar view, see Robé 1997.
94. Johns 1983, 2.

provide a convenient vehicle through which a single group can manage much different business."[95] Thus, "the greatest challenge to state sovereignty comes from organizations which have no existence in law! . . . Although the economic or political reality of the existence of enterprises such as IBM, Toyota, Elf Aquitaine, and the like is not questioned by anyone, *the enterprises themselves do not exist as such in positive law.*"[96]

Although Robé uses language too strong for most jurists, there is broad agreement that the legal status of the multinational enterprise is ambiguous. There are certainly ways and means by which different legal systems have sought to clarify their positions with regard to the nationality of corporations, not only for the purpose of taxation but also for diplomatic protection and inclusion in bilateral and multilateral treaties.[97] More specifically, in most countries income tax statutes contain specific provisions under which tax authorities may fully or partially disregard the separate existence of a corporation in a multicorporate structure, if this is necessary, in order to prevent tax avoidance or tax evasion. Courts also try to distinguish between real corporations and sham corporations.[98] Nonetheless, the variations among different statutes and interpretations, including the marked difference between Anglo-Saxon and continental laws, muddy the waters considerably.[99] Combined with the proliferation of tax havens and the practice of "treaty shopping," the multinational enterprises have managed to obtain considerable freedom from national laws.

The dissection of sovereignties would reach absurd proportion. In 1953, in *Lauritzan v. Larsen*, the U.S. Supreme Court determined an issue of the jurisdiction of foreign-registered ships by postulating the possibility of seven jurisdictions: the place of the wrongful act, the law of the flag, the allegiance or domicile of the injured party, the allegiance of the ship owners, the place of contract, the accessibility of the foreign forum, and the law of the forum.[100] The denial of the legal unity of corporate personality makes perfect sense from the perspective of national sovereignty, sovereign equality, and national self-determination, but it has created huge problems for the regulatory capacity of the state. Under the circumstances of the growing insulation of the state in law and the internationalization of capital, it was logical to extend the same principle of demarcation into a new imaginary analytical space in which foreigners were presumed to reside in some capacity "within" the territorial boundaries of one state and in another capacity in another state. Furthermore, each state developed its own principles of demarcation.

95. Hadari 1973, 758.

96. Robé 1997, 52 (emphasis added).

97. In particular, there is international disagreement over the scope of U.S. state taxation of multinational enterprises, as a number of U.S. states—in particular, California—use the worldwide-combined reporting standard for calculating local taxable income of multinational enterprises. Devgun 1995.

98. Hadari 1973.

99. Leben 1980.

100. Carlisle 1981, 160.

There was a price to pay for dividing the legal subject in law in order to accommodate a stricter notion of territorial demarcation and thus upholding and even strengthening the fiction of the discrete juridical unity of the sovereign state. The fiscal subject was divided: In the fictional world of sovereign equality, its activities were placed under various jurisdictions, each representing a spatio-analytical (for want of a better term) territory. But while the fiscal subject was divided and was denied full legal unity, the real subject—whether corporate or individual—remained whole. With the complicity of a growing number of governments, these juridically dispersed subjects have learned to take advantage of the fiction of their fragmentation by rearranging their legal existence in ways they see fit.

Since individuals and corporations were given the opportunity to spread themselves into different localities, they understandably went "shopping" for those localities that offered them what they considered to be the best arrangements. The ambiguity of the law, and the diverging and insecure interpretations of legal and fiscal jurisdictions ensured, however, that for the sake of prudence many corporations avoided the more scandalous tax havens. But the practice of jurisdiction shopping—or commercialized sovereignty—has spread. This is the true meaning of the term "international tax planning"; it is the planning of whichever aspect of their "reality" corporations or wealthy individuals are prepared to reveal at whichever location.

Conclusion

To resolve the two conflicting aims—insulation of the state in law in times of increasing internationalization of capital—states were forced, somewhat reluctantly, to accept the principle that legal persons could reside concomitantly in a number of jurisdictions. Once these legal persons could reside in different locations, there was always the risk that they would go shopping for the best bundles of regulation they could find. The commercialization of state sovereignty perfected by tax havens (though not exclusively) is founded therefore on an absurdity—on the denial of the legal unity of the multinational enterprise.

In employing sovereign rights as commercial assets, however, tax havens perform an important if controversial act: They demonstrate clearly the manner by which the modern state system not only accommodates globalization but also produces in subtle ways the infrastructure of globalization. In prostituting their sovereign rights, tax havens provide important legal platforms for globalizing financial and, increasingly, other types of services. Thus, a virtual world of a state system can exist beside the "real" state system, feeding on its juridical and political infrastructure. The two are not adversarial; they merely present the complex face of the processes we call globalization. This finding underlies my contention that the tax havens strategy and the commercialization of state sovereignty are endemic to the modern state system.

What would happen if, say, tomorrow the group of advanced industrialized countries, the G-7, announced that companies or individuals doing business in tax havens were no

longer allowed to operate in G-7 territories? The G-7 would have to pronounce on a whole sort of "technical" matters —that is, the threshold of corporate and individual tax beneath which a state would be considered a tax haven, the kind of tax "holidays" or deferments that would be allowed and in which conditions, and so on. But for the sake of argument let us agree that the G-7 countries are willing and able to resolve these technical issues. The result of their action would be nothing less than the creation of a two-layered or even a multilayered system of sovereignties, because the G-7 countries would use their power to effect a change in the laws of tax havens or alternatively would legislate that residency of corporations in some countries is not equal to residency in others. De facto, such a system would signal the end of the principle of national self-determination and sovereign equality. This argument leads me to a controversial conclusion: Tax havens cannot simply be legislated away, because they are not perversions of the principle of sovereignty as much as they are a direct outcome of the conflicting principles of national sovereignty in the age of mobile capital. Consequently, any serious attempt to combat the tax havens phenomenon would have to be conducted at a multilateral level, and would have great implications for the modern doctrine of sovereignty. The abolition of tax havens would require a degree of cooperation among the major industrialized countries and a limit on the sovereign rights of states, which effectively would spell the end of the so-called Westphalian system.

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