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International trade and investment are the twin pillars of the modern economic world. One of the great economic developments of the past half century is the increasing interdependence of the world economy through the movement of goods and services, business enterprise, capital, and technology.[1] Approximately "20 percent of the gross world product is internationally traded," and the growth rate for international trade is twice as large as that of the world economy as a whole.[2] With the close of World War II, there was a clear recognition that the "beggar-thy-neighbor" trade policies of the 1930s significantly contributed to the start of the war.[3] That recognition led to the beginnings of the General Agreement on Tariffs and Trade (GATT) in 1947. The GATT agreements reduced both tariffs and a number of nontariff trade barriers.[4] The GATT system has succeeded in lowering tariff barriers on imported goods from an average of approximately 40 percent to 3 percent in participating nations.[5]

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1. ROBERT J. CARBAUGH, INTERNATIONAL ECONOMICS 1 (3d ed. 1989).

2. INTERNATIONAL BUSINESS HANDBOOK 4 (V.H. (Manek) Kippalani ed., 1990).

3. JOHN H. JACKSON ET AL., LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS 38 (3d ed. 1995) (citing to JEREMY ATACK & PETER PASSELL, A NEW ECONOMIC VIEW OF AMERICAN HISTORY 600-01 (1994) and RICHARD N. COOPER, U.S. TRADE POLICIES IN A CHANGING WORLD ECONOMY 291-92 (1987)).

4. ROBERT E. HUDEC, ENFORCING INTERNATIONAL TRADE LAW: THE EVOLUTION OF THE MODERN GATT LEGAL SYSTEM 4 (1993).

5. For example, in the United States, as a result of eight series of international trade negotiations, the ratio of duties collected to dutiable imports declined as follows:

1941	(after Trade Agreements Act of 1934)	36.8%
1951	(after formation of GATT)	12.3%
1961		12.1%
1971	(after Kennedy Round)	9.0%
1981	(after Tokyo Round)	4.9%
1991		5.1%

In addition, worldwide direct investment in foreign countries has reached immense proportions. Data published by the United Nations Conference on Trade and Development reveal that total investment inflows in 1997 increased for the seventh consecutive year,[6] reaching a new record level of $400 billion (a 19 percent increase), while outflows reached $424 billion.[7] Foreign direct investment (FDI) is one of the major forces shaping the increasing globalization of business. The total value of FDI that approximately 53,000 parent firms worldwide had invested in their 450,000 foreign affiliates and subsidiaries reached $3.5 trillion dollars as of December 31, 1997.[8] The Multilateral Agreement on Investment (MAI), negotiated under the auspices of the Organization for Economic Cooperation and Development (OECD), was an attempt to create a structure for the protection of international investment. Although the MAI failed in late 1998 after several years of negotiations, countries are continuing their efforts to create favorable conditions for FDI. During 1997, 151 changes in FDI regulations were made by seventy-six countries, of which 89 percent would tend to create more favorable investment environments, and by the end of that year, the number of bilateral investment treaties reached 1,513.[9] Notwithstanding the *ad hoc* nature and inelegance of the present international legal environment, the importance of international investment and trade continues to grow as the nature of business evolves at the advent of the twenty-first century.

With these developments in mind, Ramon J. Jeffery has written a remarkable book dealing with an area of extraordinary complexity.[10] In his book, Jeffery examines how the powers of governments over traditional areas of the economy through the power to tax will be transformed by the new logic of the cybereconomy. Jeffery recognizes that the manner in which business will be done in the future is as different from the post-World War II era as the Industrial Revolution was from the Feudal Age in Europe. Jeffery begins his book by examining the meaning of international direct tax distortion and the interaction of neutrality and equity considerations. He considers the nature of global economic change, which he views as an evolutionary process from a

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JACKSON, *supra* note 3, at 5 & Tbl. 1.1.

6. *World Investment Report 1998 Trends and Determinants Overview*, U.N. Conference on Trade and Development, at 1, U.N. Doc. UNCTAD/WIR/1998 (1998) [hereinafter *World Investment Report Overview 1998*].

7. *Id.* at 1 & Tbl. 1.

8. *Id.* at 1.

9. *Id.*

10. RAMON J. JEFFERY, THE IMPACT OF STATE SOVEREIGNTY ON GLOBAL TRADE AND INTERNATIONAL TAXATION (1999).

situation of economic nationalism to one of international economic integration. As economies around the world become increasingly open, tax competition among nations becomes more keen. A recent survey on globalization and taxation in *The Economist* stated:

> [T]here is plenty of evidence that lower tax rates have pulling power, and as economies become more open, the pulling power is getting stronger. A 1998 OECD report on harmful tax competition noted that total direct investment by G7 countries in tax havens in the Caribbean and South Pacific grew more than fivefold between 1985 and 1994, to over $200 billion. So-called tax havens accounted for 1.2% of world population and 3% of world GDP, but 26% of the assets and 31% of the net profits of American multinationals (though only 4.3% of their workers). . . . James Hines of the University of Michigan[] found that 'taxation significantly influences the location of foreign direct investment, corporate borrowing, transfer pricing, dividend and royalty payments.' . . . Another recent study asked, 'Has [U.S.] investment abroad become more sensitive to tax rates?' It analysed corporate tax-return data for 1984-92 (the latest then available), and found that by the end of this period the typical American multinational had become twice as likely to locate its operations where taxation was lowest as it had been at the beginning. Falling corporate tax rates around the world also provide strong circumstantial evidence that governments are trying harder to cater for international firms' and investors' appetite for lower taxes. . . . Are governments wise to engage in tax competition? Ireland's example suggests they may be. The country's recent economic boom owed much to low taxes on foreign firms moving there. Its GDP per head, which as recently as 1990 was 70% of the EU average, now exceed Britain's, and is expected to exceed the EU average by around 2005.[11]

11. *A Survey of Globalisation and Tax*, ECONOMIST 17 (2000).

Profitability during the Industrial Revolution was based upon the mass production of industrial and consumer products at the lowest possible cost.[12] In our new economic era, improvements in the speed of travel and communications, and the ubiquity, power, and new applications of computer technology have changed the basis of wealth creation. Although the Internet of today performs seemingly elementary tasks, its potential impact on the world economy cannot be underestimated. A second stage might consist of Internet commerce that functions within the current institutional framework and employs both national currencies and jurisdiction. A third, more advanced stage, would mark the transition to true cybercommerce.[13] Some commentators have envisioned a cybereconomy where business transactions exist completely outside of the jurisdiction of States. One commentator has opined:

> Not only will transactions occur over the [Internet], but they will migrate outside the jurisdiction of nation-states. Payment will be

12. 6 THE CAMBRIDGE ECONOMIC HISTORY OF EUROPE: THE INDUSTRIAL REVOLUTIONS AND AFTER: INCOMES, POPULATION AND TECHNOLOGICAL CHANGE 451-54 (H.J. Habakkuk & M. Postan eds., 1965).

13. JAMES DALE DAVIDSON & LORD WILLIAM REES-MOGG, THE SOVEREIGN INDIVIDUAL 184 (1997). See UNITED STATES DEPARTMENT OF THE TREASURY, *Selected Tax Policy Implications of Global Electronic Commerce* (1996) (visited Feb. 22, 2000) <http://www.ustreas.gov/tax policy/internet.html>, for a paper that considers federal income tax policy and administration issues presented by developments in communications technology and electronic commerce. Although the paper does not present the Treasury Department's legal or policy views, it was designed to solicit comments on those tax issues that relate to electronic transactions. The paper, recognizing that the Internet has effectively eliminated national borders on the information superhighway, stated that "cross-border transactions may run the risk that countries will claim inconsistent taxing jurisdictions, and that taxpayers will be subject to quixotic taxation. If these technologies are to achieve their maximum potential, rules that provide certainty and prevent double taxation are required." *Id.* According to the paper, developments in technology and electronic commerce dictate that certain parts of the Internal Revenue Code and generally accepted principles of international tax policy be reexamined. Some issues of concern identified in the paper include, first, identifying the country or countries having jurisdiction to impose tax on the electronic transaction's income. The growth of transactions in cyberspace will likely move policy away from traditional concepts of source-based taxation toward residence-based taxation. The second is classifying income arising from digitized information (e.g., computer programs, images, books, music). Due to the ease of transmitting and reproducing digitized information, the distinction between royalty income, service income, and a sale of goods should be refined. The third is dealing with the possibility for anonymous or untraceable transactions. Issues related to identifying parties to transactions and verifying records when commerce is conducted electronically are discussed. According to the paper, "electronic commerce may create new variations on old issues as well as new categories of issues. The major compliance issue . . . is the extent to which *electronic money is analogous to cash and thus creates the potential for anonymous and untraceable transactions.*" *Id.* (emphasis added).

> rendered in cyber-currency. Profits will be booked in cyberbanks. Investments will be made in cyberbrokerages. Many transactions will not be subject to taxation. As this stage, cybercommerce will begin to have significant megapolitical consequences . . . The powers of governments over traditional areas of the economy will be transformed by the new logic of the [Internet]. Extraterritorial regulatory power will collapse. Jurisdictions will devolve. The structure of firms will change, and so will the nature of work and employment.[14]

One need not agree with those prognostications. However, what is indisputable is that advances in technology have enormous economic, political, and social implications. It is inevitable that the consequences of new technology and new applications of computers and communications will continue to have an immense impact on business, with firms forming new operating structures to secure an increasingly short, competitive advantage in an ever expanding and highly competitive global marketplace.

The heightened level of global competition, Jeffery suggests, has resulted in the creation of international direct tax distortions.[15] Jeffery, following Dicken, states: "National boundaries create significant differential on the global economic surface. Political boundaries create *discontinuities* of varying magnitudes in the flows of economic activities."[16] Moreover, the remaining international direct tax distortions are increasingly transparent to international investors. Given that the creation of wealth today is less tied to fixed assets, Jeffery asks whether a State's sovereignty and jurisdiction over fiscal matters can continue to be absolute. Jeffery continues his analysis by considering the meaning of sovereignty and jurisdiction and how a State's sovereign rights are determined both by its internal constitutional arrangements and by international law. Jeffery persuasively argues that States stand at the crossroads and have a choice to make between "blind independent action on the one hand and coordinated action for the establishment of norms to benefit their citizens on the other."[17] He indicates that the nature of a State's role requires States increasingly to become aware that it is appropriate for certain international taxation matters to be dealt with not at the national, but at the international

14. DAVIDSON & REES-MOGG, *supra* note 13, at 184-85.
15. JEFFERY, *supra* note 10, at 19.
16. *Id.*
17. *Id.* at 20.

level, through the international law-making process.[18] He further contends that, even for those matters appropriately dealt with at the national level, a reassessment of approaches is necessary so that State action can be consistent with the new economic era.[19]

Jeffery considers the fundamental question of whether States possess unlimited fiscal jurisdiction and whether such unlimited fiscal jurisdiction is even tenable in the new economic era. It is in this context that Jeffery foresees that the nation-State system, primarily financed through taxes, will increasingly create significant tax distortions. Today, wealth creation is being realized through the application of intellectual capital to solving problems and creating value.[20] Knowledge is supplanting large-scale, concentrated investment in property, plant, and equipment as the principal strategic resource. As Peter Drucker has observed: "The productivity of knowledge has already become the key to productivity, competitive strength, and economic achievement. The fact that knowledge had already become the primary industry, the industry that supplies the economy the essential and central resources of production, has been well established."[21] Unlike traditional hard

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18. *Id.*

19. *Id.*

20. Thomas Stewart identifies how the transition from bricks and mortar to intellectual capital is changing both the nature and governance of corporations. He observes:

> Intellectual capitalism is different. In knowledge-intensive companies, it's not clear who owns the company, its tools, or its products. Moneybag's modern-day descendant starts with seed money from a Silicon Valley venture capitalist. He leases office space in some Edge City corporate village and doesn't own a factory; a company in Taiwan manufactures his products. The only plant and equipment the company owns are computers, desks, and a 1950s Coke machine someone picked up at auction. Whereas Moneybags bought the assets of his company, it is unclear who makes the investments on which intellectual capitalism depends, the investments in people. The manager–the Man in the Ralph Lauren Polo Shirt–paid his own way through business school. The worker is shelling out for an electronics course she takes at night, though the company will reimburse her for half the cost when she completes it. Every manager and worker receives stock options–as a group they may own as much stock as the capitalists. . . . [I]n the age of intellectual capital, the most valuable parts of [many] jobs are the human tasks: sensing, judging, creating, building relationships. Far from [a Marxian view where the industrial worker is] alienated from the tools of his trade and the fruit of his labor, the knowledge worker carries them between his ears. . . . Employees, companies, and customers share joint and several ownership of the assets and output of knowledge work.

THOMAS A. STEWART, INTELLECTUAL CAPITAL (1997), *excerpted in* Thomas A. Stewart, *Brain Power*, FORTUNE, Mar. 17, 1997, at 105, 105.

21. JOHN NAISBITT, MEGATRENDS: TEN NEW DIRECTIONS TRANSFORMING OUR LIVES 16-17 (1982) (quoting Peter Drucker).

assets, knowledge is not subject to the law of conservation. It can be created, it can be destroyed, and, most importantly, it is synergetic; that is, the whole is usually greater than the sum of the parts. In the information society, for the first time the key economic resource is not only renewable but self-generating. Knowledge is an asset that can strengthen with experience, rather than depreciate.

Moreover, with information as the strategic resource, the economic system becomes much more accessible. One no longer needs the capital to build a factory to tap opportunities for wealth creation. And tapping into those opportunities is itself easier. The combined technologies of the telephone, television, and computer are increasingly merged into an information and communication system that transmits data and permits almost instantaneous interaction between persons and computers. In a world where the hard assets of a business were fixed and largely immobile, a State's ability to tax business was relatively simple. However, the present system of wealth creation, increasingly based upon the development of information processing networks, will make taxation by nation-States less attractive to international investors. Through the use of cybercommerce, transactions will increasingly occur outside the jurisdiction of States.

Jeffery states his view that a State's fiscal legislative jurisdiction is constrained only by the minimum standard in favor of foreigners.[22] Yet he recognizes that there are "very real and severe limitations on the ability of a State to exercise its enforcement jurisdiction extra-territorially,"[23] finding such limitations to be the prime regulator of a State's potentially unlimited fiscal jurisdiction. Jeffery then considers: (1) whether the personal and territorial bases of jurisdiction are adequate to deal with some of the international tax issues raised by international economic integration; and (2) whether there are any viable alternatives. He considers whether it would be possible to establish jurisdiction on the basis of a reasonable or close connection between the State and the facts in question. After all, it has been observed that "the power to tax involves the power to destroy."[24] It is axiomatic that the power of taxation is considered a fundamental State or sovereign prerogative, and that States have a legitimate interest in the preservation of their existing taxation rights. In the

22. *Id.* at 43.

23. *Id.*

24. McCulloch v. Maryland, 17 U.S. 316, 431 (1819). Although *McCulloch* involved interstate commerce questions, Chief Justice Marshall's observation is certainly no less true in global business matters.

European Union, "[d]irect taxation is left to the sovereignty of the Member States. The power to tax is the power to govern."[25] Changes in technology and telecommunications and the growing value of intellectual capital(which is increasingly portable and readily available) have created an international business environment in which far-sighted States preserve their present sovereign power to tax in the light of tremendous changes in the economic landscape. One of the principle means used by States is double taxation treaties. There were 1,794 double taxation treaties in force at the end of 1997.[26] In fact, 108 were concluded in 1997 alone.[27] Nonetheless, major tax distortions continue to exist.

How can States exercise their fiscal sovereignty in an era of international economic integration? Consider, for example, how States will exercise their fiscal jurisdiction when a team of computer software designers and engineers from India, the United States, Italy, and Brazil, each working in his or her own country, together develops a successful software product that is sold worldwide.[28] As former U.S. Secretary of Labor, Robert Reich, has observed:

> [I]n the emerging high-value economy, [products can] . . . be combined in all sorts of ways to serve customer needs in many places. Intellectual and financial capital can come from anywhere, and be added instantly. Consider some examples: Precision ice hockey equipment is designed in Sweden, financed in Canada, and assembled in Cleveland and Denmark for distribution in North America and Europe, respectively, out of alloys whose molecular structure was researched and patented in Delaware and fabricated in Japan. An advertising campaign is conceived in Britain; film footage for it is shot in Canada, dubbed in Britain, and edited in New York. . . . A jet airplane is designed in the state of Washington and in Japan, and assembled in Seattle, with tail

25. JEFFREY, *supra* note 10, at 87 (quoting B. Knobbe-Keuk, *Restrictions on the Fundamental Freedoms Enshrined in the EC Treaty by Discriminatory Tax Provisions–Ban and Justification*, EC Tax Rev. 74, 76 (1994)).

26. *World Investment Report Overview 1998*, *supra* note 6, at 11.

27. *Id.*

28. *See* Michael P. Avramovich, *Intercompany Transfer Pricing Regulations Under Internal Revenue Code § 482: The Noose Tightens On Multinational Corporations*, 28 J.MARSHALL L. REV. 915, 928 n.68 (1995).

> cones from Canada, special tail sections from China and Italy, and engines from Britain.[29]

The increasing integration of the global economy, resulting from a confluence of telecommunications, computers, and available capital, has led some commentators to suggest that our notions of the State will wither away; after all, our contemporary notion of the State is less than two hundred years old.[30] Other commentators have recognized that States will need to adapt to the increasingly changing circumstances of the global economy in order to survive.[31] It is these issues that Jeffery seeks to address. His book provides

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29. ROBERT REICH, THE WORK OF NATIONS 112 (1991).

30. GORDON A. CRAIG, EUROPE 1815-1914, 2-3 (1966). Craig writes:

> The political and territorial settlement that had been effected [following the Napoleonic Wars] in 1814-15 was not, after all, universally admired. Its most inveterate opponents were those who claimed that [the Treaty of Vienna] violated what we would today call the principle of national self-determination. Believing that men who shared a common history, language, and culture should be permitted to form independent political units (or nations) under rulers of their own choice, these critics argued that the [Treaty of Vienna] denied this right to such peoples as the Belgians, the Germans, the Italians, the Poles, and the Greeks. . . . The *nationalism* that inspired their efforts had little of the narrow arrogance or the frenetic jingoism that was to characterize nationalistic movements in the second half of the [19th] century. Early nineteenth-century nationalism was animated by an ardent, if idealistic, belief that a Europe based on truly national lines–that is, composed entirely of free nations–would be a healthier and a more peaceful Europe than one in which there were still subject nationalities living under alien rule.

Id.

31. Kenichi Ohmae observed:

> The nation state has become an unnatural, even dysfunctional, unit for organizing human activity and managing economic endeavor in a borderless world. It represents no genuine, shared community of economic interests; it defines no meaningful flows of economic activity. In fact, it overlooks the true linkages and synergies that exist among often disparate populations by combining important measures of human activity at the wrong level of analysis. . . . Governments are likely to resist giving up the power to intervene in the economic realm or to relinquish their impulses for protectionism. The illusion of control is soothing. Yet hard evidence proves the contrary. . . . Textiles, semiconductors, autos, consumer electronics–the competitive situation in these industries did not develop according to the whims of policymakers, but only in response to the deeper logic of the competitive marketplace. If U.S. market share has dwindled, it is not because government policy failed but because individual consumers decided to buy elsewhere. *If U.S. capacity has migrated to Mexico or Asia, it is only because individual managers made decisions about cost and efficiency.*

Kenichi Ohmae, *The Rise of the Region State*, FOREIGN AFF., Spring 1993, at 78, 83 (emphasis added).

a theoretical structure for States to continue to be the predominant organizational and political institution in the coming centuries.

In his strongest chapters, Jeffery also examines the international direct tax distortions associated with international tax discrimination and considers the adequacy of solutions for their removal. That discussion is made in the context of the European Community (EC) and in the context of the non-discrimination provisions of OECD Model Double Taxation Treaty. Article 24(1) of the treaty contains a general prohibition on discriminatory treatment based upon nationality.[32] Jeffery proposes a number of changes to Article 24 to make it more relevant to the manner in which international economic activity is conducted and fiscal jurisdiction ought to be exercised. He observes:

> The most important provision of Article 24, in terms of the most generally applicable wording, is the nationality provision. However, it is still too greatly influenced by conceptions associated with sovereignty and jurisdiction which may have been appropriate to the period of economic nationalism, but which are no longer relevant. This is evident from the following points regarding the operation of Article 24(1). First, the sole focus is on nationality as the criterion which has been picked out for neutral treatment. However in practice, States do not often use such a criterion as a point of distinction in the exercise of their fiscal jurisdiction. Secondly, non-residents can never be in the same circumstances as residents.
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> Article 24 operates on the whole in a haphazard and internally inconsistent manner without any regard for what should be the underlying rationale behind the principle of non-discrimination in international taxation. Article 24 needs to be re-appraised so that it is more in tune with the demands

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32. Article 24(1) of the OECD Model Tax Treaty provides as follows:

> *Nationals* of a Contracting State shall not be subjected in the other Contacting State to any taxation or any requirement connected therewith, which is other or more burdensome than . . . [that imposed on] nationals of that other State in the same circumstances, in particular with *respect to residence* . . . . This provision shall, notwithstanding . . . Article 1, also apply to persons who are not residents of one or both of the Contracting States.

OECD COMMITTEE ON FISCAL AFFAIRS, MODEL TAX CONVENTION ON INCOME AND ON CAPITAL, art. 24 (1998).

> of international economic integration (including the need to dismantle barriers to trade) and with the other provisions of the OECD Model [Treaty]. The long-term goal should be to replace the nationality provision with a general prohibition on differential taxation which leads to distortions to trade, taking into account the concepts of neutrality and equity. The other existing provisions could then be retained as specific illustrations of the application of the general principle. Over time further illustrations could be added as additional problem areas are identified. In the meantime the nationality clause should be reworded so that it provides for the equal treatment of residents, rather than nationals, of the Contracting States who are in the same circumstances.[33]

Jeffery recommends that the European Union approach to tax non-discrimination reflects its "advanced stage of economic integration and points the way for improvements in the tax treaty non-discrimination provisions contained in Article 24 of the OECD Model [Treaty]."[34] Jeffery recommends, for example, that the nationality provision of Article 24(1) should be replaced with

> a provision which prohibits the differential taxation of residents, rather than nationals, of the Contracting States who are 'in the same circumstances'. . . . [W]hether or not taxpayers are in the same circumstances should then be determined by looking to see whether or not the differential taxation leads to distortions to trade, taking into account the concepts of neutrality and equity. This is targeted at the elimination of direct tax distortions over and above those whi[c]h are unavoidable as a result of the interaction of national tax systems.[35]

Jeffery also considers international direct tax distortions associated with tax avoidance and evasion. The topic is examined in the context of the issues of treaty shopping and the prohibition on the extra-territorial enforcement of

33. JEFFERY, *supra* note 10, at 73.
34. *Id.* at 95-96.
35. *Id.* at 96.

revenue laws. Jeffery focuses attention on the extent to which the application of domestic anti-abuse measures to combat perceived unacceptable forms of treaty shopping is supported by international law. The inclusion of an international anti-avoidance standard in the OECD Model Treaty to deal with abusive transactions relating to treaty shopping is also considered. His discussion of the prohibition on the extra-territorial enforcement of a State's revenue laws questions the underlying rationale and relevance of that rule, especially in light of the consequences of international economic integration. The discussion concludes by examining the feasibility of drafting a new OECD model article to provide for the regulated enforcement of one Contracting State's tax laws by another Contracting State. Finally, Jeffery considers the extent to which the successful elimination of direct tax distortions within the EC requires the coordination of internal EC provisions for the removal of such distortions in the tax relationships of Member States with third-party countries. He examines the implications of the European Court of Justice's development of an implied external relations power for the Community and the impact that it has had on Member State power to enter into bilateral tax treaties with third-party countries. Jeffery discusses the extent to which the Community is required to participate in the negotiations and conclusion of such treaties, and to the extent that is the case, whether it is desirable for the Community to do so.

Ramon Jeffery has written a compelling and powerful book that should be required reading for those involved in establishing international tax policy at the ministries of finance and other national governmental entities and for those practitioners who advise businesses operating in the global market.