Tax Sovereignty: Rethinking The New Currency of International Investment Competitions

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Abstract

This article proposes a new way to optimize domestic tax policy that acknowledges the reality of the limits placed by the new currency—international corporate tax laws. Governments are constantly changing their statutory corporate income tax to attract multinational firms. In the United States, the 2017 Tax Cuts and Jobs Act brought the country's statutory corporate income tax rate to 25% from 49.7% in 1980. In 2023, the corporation income tax rates in several countries such as Turkmenistan (8%), Barbados (5.5%), Hungary (9%), and Paraguay (10%) were approximately 82% lower than those in 2004 (30%), Barbados (33%), Hungary (16%), and Paraguay (30%). International agencies, e.g., the OECD, implemented laws such as the global anti-base erosion (GloBE) minimum tax rule to curb international investment competition via tax policy. The GLoBE mandates that an MNC with its headquarters in any of the participating countries must pay a minimum of 15% tax on its profit. The GLoBE makes it difficult for a country to maintain its attractiveness and limits a government's ability to effectively implement desired tax policies for its taxpayers; that is, to maintain tax sovereignty.

This article rejects Thomas Nagel's (2005) understanding of tax sovereignty—the state's coercive power. Instead, this study proposes a conception of effective tax sovereignty that focuses on what states can do in the era of international competitive laws and examines how corporate income tax competition impacts fiscal sovereignty. The two dominant components of tax sovereignty are the ability to generate revenue and have full control over fiscal policy. The key components of a state's expression of sovereignty are the right to determine tax rates, structures, and the use of tax revenues. Therefore, this study investigates three key questions: how can international tax laws lead to an erosion of tax sovereignty; how can international tax policy hinder the fiscal authority from discharging their obligations, and what effective corporate tax rates would allow countries to generate sufficient revenue?

This paper provides a comprehensive overview of the most relevant literature on tax sovereignty, fiscal policy, and fiscal rules, illustrating how fiscal rules can minimise the loss of tax sovereignty. The theory of the Laffer curve is used to suggest the ideal or optimal rate of taxation for an economy, which assists countries in reducing pressures on their fiscal solvency. The paper shows how corporation tax policy can impact tax revenue and, by extension, tax sovereignty. The empirical analysis uses data taken from the OECD database and the IMF database for the years 1980 to 2023 on corporation tax rate, tax revenue, tax base, fiscal balance, gross domestic product, and foreign direct investment from the year 1980 to 2023 for selected Caribbean, European, and South American States. The findings suggest that fiscal regulations can help preserve tax sovereignty.

Keywords: tax sovereignty, fiscal rules, multinational firms, Laffer curve, tax elasticities, international corporation tax laws

1.0 Introduction

The conventional view holds that the invention of money served as a medium of exchange, thereby increasing efficiency. Today, people often refer to money as 'fiat money' instead of a commodity. Simply put, the creation of money gave governments control over resources. In the same way, governments have been using tax competition—lower corporate tax rates and less control over corporate tax policy—to empower them to attract foreign investments to their countries. Effective tax competition—cutting corporate tax rates and deregulating corporate tax policy—enables governments to attract steady capital inflows from multinational enterprises.

Due to capital's high mobility, multinational enterprises can relocate to countries with the lowest tax "price" and highest benefits (Weeghel, 2019). Global lawmakers are worried that changes to corporate taxes could lead multinational companies to avoid paying taxes in other countries by moving their operations to places with lower taxes. Consequently, the global tax framework has experienced multiple modifications, making it harder for governments to adopt their preferred tax policy. Namely, the OECD 15% global minimum effective tax rule. The OECD assumes it can reduce multinational corporations' (MNCs) ability to avoid taxes by imposing a 15% global minimum effective tax rate on the income of MNCs based in countries that signed the agreement. Because of the GLOBE agreement, countries can't choose their own company tax base and rate. This diminishes tax sovereignty, defined as the state's sole power over commerce, and constrains the influx of capital, gross domestic product, and revenues.
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Limiting a government's ability to enact its desired tax policies lowers tax sovereignty, thereby denying the state the power to manage its own affairs. From a narrow point of view, an officially recognized sovereign state must have de facto control over its land and people, which comprise the internal components. Having complete power over economic policy and collecting taxes are the two most important parts of tax sovereignty. Weakness in a country's tax authority also affects its public spending and income policy. With tax freedom, a government can decide how much it spends and earns. For the supply and demand of goods and services to stay steady, which affects the gross domestic product (GDP), the government must have full control over spending policies. To achieve these sovereign goals, the government must fulfil the desires of its citizens through tax collection. Protecting the source of income (taxes) and the state's collecting power is therefore very important.

This paper argues that it is unethical for the international community to restrict a country's corporate income tax policy. Countries should be free to operate as low-tax jurisdictions to incentivize direct foreign investment. Tax influences the attractiveness of a location for international investors; tax credits and other fiscal incentives are essential policy tools to attract investors. Multinational enterprises invest in developing countries due to three key determinants: ownership-specific advantages, the desire to internalise these advantages, and the potential profits from combining these assets with location-specific resources (Dunning, 1988). Tax policies influence location attractiveness, as seen by foreign direct investments (FDIs), since higher tax rates reduce after-tax returns, i.e., profits (Gordon and Hines, 2002). FDI brings in capital and attracts new capital.

The current paper contributes to the existing literature by proposing that countries can achieve international and domestic tax law coordination without compromising their tax sovereignty. Information-sharing provisions, which require countries to disclose information regarding their obligations, can enhance tax policy coordination.

This study examines three principal enquiries: how international tax laws may erode tax sovereignty, how international tax policy can impede fiscal authorities in fulfilling their responsibilities, and what effective corporate tax rates would enable countries to generate adequate revenue. Influence from dominant international political entities necessitates that nations consider the worldwide ramifications of their tax regulations. This paper proceeds as follows. Part I presents the relevant background on corporate tax in the Caribbean. Part II discusses the literature on corporate taxation, tax competition, tax sovereignty, tax buoyancy, and the Laffer curve. Part III describes the data and the construction of our key measures. discusses. Part IV presents the regression approach, Part V results are presented, and Part VI concludes the discussion.

2.0 Background

The Caribbean region has undergone a shift in international company interests from bauxite to agriculture, petroleum, and banking industries. Between the 1970s and 1990s, diverse incentives were provided, encompassing direct or indirect subsidies, tax exemptions, and other financial inducements; regulations aimed at strengthening a market economy through a comprehensive legal framework; labour and environmental standards; intellectual property protections; and regional integration agreements, as well as infrastructure improvements. These offerings produced varying net advantages. Numerous corporations withdraw from the Caribbean following the expiration of the 5–15 tax holiday terms.

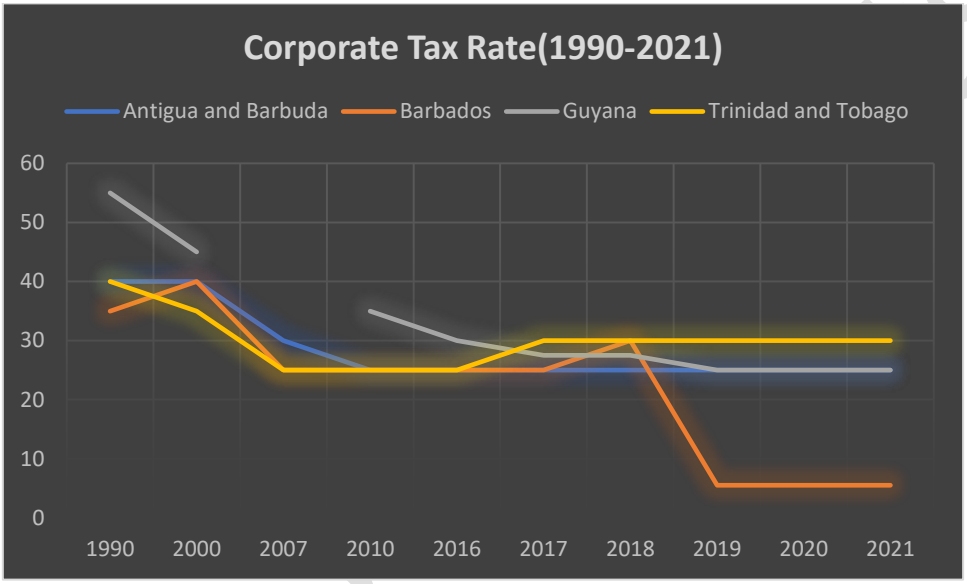
Barbados, Jamaica, Trinidad and Tobago, Guyana, and Jamaica levy taxes on companies for all income streams, irrespective of origin, allowing for the deduction of expenses associated with generating assessable income during a fiscal term not exceeding 53 weeks. Barbados typically imposes taxes on non-resident corporations solely on income originating from local sources and activities.

Since the mid-1980s, average statutory corporate income tax rates have decreased by almost 30 percent (see table 1). In 2018, Antigua and Barbuda, Dominica, and Barbados presented some of the most minimal corporate income tax rates. In 2019, the corporate tax liability decreased to 5.5 percent. The corporate tax rate in Jamaica is 25%. Between 2005 and 2024, Jamaica's corporate tax rates averaged 28.33 per cent, reaching a maximum of 33.33 per cent in 2006 and a minimum of 25.00 per cent in 2013 (See Figure 1). The corporate tax rate in Trinidad and Tobago is 30 percent. The mean corporate tax rate in Trinidad and Tobago from 2012 to 2024 was 26.92 percent, reaching a maximum of 30.00 percent in 2020 and decreasing to a minimum of 25.00 percent in 2013.

Table 1

country	1980	1990	2000	2010	2017	2018	2022	2023
Antigua and Barbuda	NA	40	40	25	25	25	25	25
Barbados	45	35	40	25	25	30	5.5	5.5
Guyana	NA	55	45	35	27.5	27.5	25	25
Jamaica	45	33.3	33.33	33.33	25	25	25	25
Trinidad and Tobago	45	40	35	25	30	30	30	30

Figure 1



Tax concessions are a prevalent characteristic of tax systems throughout the Caribbean. The 2017 Tax Cuts and Jobs Act reduced the statutory corporate income tax rate in the United States from 49.7% in 1980 to 25%. In 2023, corporate income tax rates in certain nations, such as Turkmenistan (8%), Barbados (5.5%), Hungary (9%), and Paraguay (10%), were nearly 82% lower than in 2004, when the rates were Turkmenistan (30%), Barbados (33%), Hungary (16%), and Paraguay (30%). International organizations, such as the OECD, enacted regulations like the global anti-base erosion (GloBE) minimum tax rule to mitigate international investment rivalries through tax policy. The GLoBE mandates that a multinational corporation based in any signatory nation must remit a minimum tax of 15% on its profits. The GLoBE complicates a nation's ability to preserve its appeal and constrains a government's capacity to execute preferred tax policies for its citizens efficiently, thus undermining tax sovereignty.

The international economy perceives tax competitiveness as detrimental. This image arises primarily from a survey analyzing Fortune 500 companies from 2009 to 2012, which indicated that 288 of them achieved profitability during this timeframe. One hundred eleven (111) of these enterprises remitted taxes that were either below 3% or none. The OECD has modified the international tax framework to mitigate tax competitiveness and eliminate disparities. The Organization for Economic Cooperation and Development (OECD) instituted the global anti-

base erosion (GloBE) minimum tax regulation to mitigate international investment competitiveness through tax policy. The GLoBE requires that a multinational corporation (MNC) headquartered in countries that have ratified the agreement must remit a minimum tax of 15% on its profits. The GLoBE complicates a nation's ability to sustain its appeal via tax competition.

The OECD's global anti-base erosion (GloBE) minimum tax regulations mandate that a multinational corporation (MNC) based in any signatory country pays a minimum tax of 15% on its profits. This is applicable even if they relocate their profits to a tax haven or a jurisdiction with a tax rate below 15%. The company must send the required amount to reach the 15% level in its home nation. The GloBE constrains the Barbadian government's capacity to implement tax policy according to its preferences. It must consequently reconcile the nation's sovereignty with its policy objectives. Due to its foreign direct investment strategy and the inherent connection between international investment and tax policies, the country may experience income losses since it can no longer use low tax rates to attract foreign investment. Nonetheless, tax credits can influence the effective tax rate by diminishing the tax liability under the GloBE Rules. Taxation affects the appeal of a site for overseas investors; tax credits and other fiscal incentives are essential policy instruments to entice investors. Once established, investors contribute to economic activity and expand the tax base.

Two international model treaties can be used as a base in the negotiations and drafting of double tax treaties (Richard Vann, J, 1998). Firstly, the Organization for Economic Cooperation and Development ("OECD") model, used mainly by developed countries, promotes residence taxation and is arguably more beneficial for developed country investors. The second is the United Nations ("UN") model, mainly used as a base for tax treaties signed between a developed country and a developing country, which provides more room for "source-based" taxation – beneficial for developing countries as they are capital importers. the OECD implemented laws such as the global anti-base erosion (GloBE) minimum tax rule to curb international investment competition via tax policy. The GLoBE ensures that an MNC headquartered in countries that signed the agreement pays at least a 15% tax on its profit. The GLoBE makes it difficult for a country to maintain its attractiveness.

Capital flight would transpire due to reduced competitiveness relative to other foreign jurisdictions. Expanding the tax base to maintain a low tax rate would enable countries to reduce capital flight. A source-based corporate tax functions as a charge for public commodities provided by the government and utilized by the firm. Given that the government provides infrastructure and other public investments, corporation income tax could partially substitute for the inadequate user fees. Corporate taxation is analogous to money. The nation's export competitiveness improves when a currency depreciates relative to other currencies. A decrease in corporate tax will boost exports due to the resultant currency devaluation, consequently attracting significant new capital. Foreign investors consider countries credible when they comply with international rules, principles, directions, and treaties.

3.0 Literature Review

Tax sovereignty has been the subject of numerous publications. These authors advocate for granting governments the autonomy to manage their tax affairs. A component of tax sovereignty is the ability to establish and enforce tax policies. The contention is that fiscal policy instruments should enable sovereigns to regulate the economy as they deem appropriate to influence budgetary policy instruments, thereby impacting the gross domestic product—the aggregate quantity of output produced. (A. Sergio, A. Rocha & A. Christians, eds., Kluwer 2017).

Tax sovereignty is the capacity of a state to establish and enforce its own tax laws within its borders. It is a fundamental component of state sovereignty (Ring, 2022). Tax sovereignty enables states to establish their own tax policies and collect taxes from individuals and enterprises within their borders. The capacity to regulate tax policy allows a state to fulfil its functional obligations (Dagan, 2022).

Tax laws are comparable to penal law in that they can limit ownership rights or impose restrictions on proprietors (Filipczyk, 2013: 41). Different forms of tax sovereignty impose essential limitations, such as tax competitiveness, which can attract multinational firms. To assist a sovereign in achieving its welfare-maximizing objectives, it is necessary to grant it exclusive tax-legislative powers (Dagan T., Klaus Vogel, 2021). The state can implement effective tax policies because of its exclusive authority to establish its tax rates and base. Advocating for tax sovereignty is an inherent best practice. The expansion of tax bases, changes to the tax structure, and administrative adjustments safeguard the state's capacity to fulfil its functions and increase revenue (Gilbert M. E. and Fullerton D., 2002).

The sovereign state's obligation to ensure the provision of specific public commodities and services is significantly influenced by its level of tax solvency. Tightening budgets, limiting tax bases, and increasing government expenditures are significant concerns (Tanzi V. and Schuknecht A., 2006; EPC Note 2007). The direct tax base is being diminished because of the restriction on government solvency. In most developing countries, direct taxes, including income taxes, comprise a greater proportion of government tax revenue. In the Caribbean, there is a pervasive phenomenon of "tax exhaustion" of individual income taxes. In this scenario, individual income taxpayer is unable to claim tax deductions or credits on their taxable income. A tax system with the lowest excess burden achieves the utmost level of consumer welfare (Kay, 1980). Governments should preserve the flexibility of their tax systems to guarantee the effective delivery of government services (Oates, W. E. 1999).

Typically, an increase in corporation taxes has the most significant impact on growth. Compared with personal income tax, an increase in corporate income tax has the most detrimental impact on growth. Arnold et al. (2011), Lee and Gordon (2005), Mertens and Ravn (2013), and the OECD (2010) have all reported substantial and robust positive growth effects as a consequence of corporate tax reduction. A rise in corporation taxes has a more substantial effect on GDP than an increase in indirect taxes, such as VAT. An increase in corporation taxes functions as a deterrent. In the long term, corporations will encounter a decline in productivity, increased inflationary pressures, and deteriorating economic conditions because of their decreasing business investments. In essence, taxes reduce your motivation to engage in an activity, thereby increasing its cost. This is a representation of the potential direct, negative impact on growth.

High tax rates result in less investment (Goolsbee, 1998a; Auerbach and Hassett, 1992; Goolsbee and Desai, 2004; House and Shapiro, 2004; Cummins, Hassett, and Hubbard, 1994, 1996; Caballero, Engel, and Haltiwanger, 1995; House and Shapiro, 2004). Firms reduce their tax burden by transitioning to tax-favorable financing methods in response to elevated tax rates (Gruber J., Rauh J., 2007). A corporation tax buoyancy estimate can be used to determine the impact of changes in corporate tax law. Tax buoyancy is a metric that can quantify the impact of policy changes on a country's tax revenue. That can be determined by comparing the percentage change in tax revenue to the percentage change in GDP. Tax buoyance also denotes the degree to which tax revenues and collections increase or decrease in response to fluctuations in national income (Ashraf & Sarwar, 2016).

Tax autonomy enables governments to provide a variety of tax combinations that can reduce the tax burden on specific business activities (Vermeend, van der Ploeg, & Timmer, 2009). Tiebout (1956) posits that tax competition is advantageous, enabling governments to provide tax expenditure combinations or alternatives. Aumann and Kurz (1977) were the first to employ game theory to investigate the value of political taxation. Another influential paper that constructs and examines the value of an income distribution game is O'Neill (1982). Bucovetsky (1986), de Crombrugghe and Tulkens (1987), and Mintz and Tulkens (1986) have examined the issue in the context of limited numbers, where strategic interactions are essential. In 1986, Zodrow and Mieszkowski introduced the fundamental tax competition model, which examines the impact of capital mobility on capital income taxation within a simplified and restrictive framework. This model derived the literature's fundamental conclusion: As a consequence of capital mobility, public commodities need to be more adequately supplied, and capital taxes are suboptimally low. For example, Zodrow and Mieszkowski (1986) propose a model of governments that operate in small open economies and treat the return on capital.

The Laffer elasticity, also known as the tax-rate elasticity of government tax revenue, is a measure that integrates the impact of the tax rate during income distribution and its fluctuation during income variations (Canto, Joines, and Laffer, 1982). The curve demonstrates the correlation between tax rates and government revenue. The curve suggests that an optimal tax rate between 0 and 100 per cent is necessary to optimise revenue Rawls (1971).

Regressive taxes must be considered when a country's direct tax base is reduced, mainly because of capital flight. Regressive taxes are those in which high- and low-income earners pay the same dollar amount for excise taxes, user fees, and tariffs, irrespective of their income. This starkly contrasts with a progressive tax, which extracts a more substantial percentage from high-income earners. Governments apply sales tax uniformly to all consumers, regardless of the items they purchase. A disproportionate burden on the impoverished characterises regressive taxation compared to the wealthy, which impacts price stability. Regressive taxation can potentially exacerbate the disparities in the distribution of income and wealth, thereby exacerbating the disparity between the wealthy and the impoverished. The international community's coercive power significantly influences taxation.

4.0 Methodology

The study assessed the impact of changes in corporate income tax policies on revenue in Barbados, Antigua and Barbuda, Jamaica, and Trinidad and Tobago between 1980 and 2022. It uses secondary data from the OECD, Barbados, Jamaica, Trinidad and Tobago, central banks, and statistical services. The Eastern Caribbean Central Bank's dashboard provided the fiscal data for Antigua. The idea is to use buoyancy as a proxy for tax sovereignty. The tax system is buoyant if the tax revenue increases more than the GDP; hence, solvency would be lost if tax rates were lowered.

Tax revenue is more stable than GDP and does not function as a measure of sovereignty if short-term buoyancy is less than one. A long-run buoyancy that exceeds one would suggest a more sensitive effect on sovereignty. A decrease in tax rate will deplete the growth of the fiscal balance and the budget's revenue side. Conversely, a long-run buoyancy that is less than one would suggest that growth will have a contrary effect. A buoyancy of one would suggest that an additional one per cent of GDP would result in a one per cent increase in tax revenue, thereby maintaining the tax-to-GDP ratio at its current level. However, a tax buoyancy that surpasses one could potentially result in a decrease in the deficit ratio and an increase in tax revenue that exceeds GDP (Belinga V. et. al., 2014).

4.1 Buoyancy

Model specification for Elasticity and Buoyancy: The Study used a log regression Model to measure the elasticity and Buoyancy of various taxes through regression analysis.

$$\boldsymbol{Y_t = \alpha + \beta_1 ln(X) + \varepsilon_t} \qquad \textbf{Equation (1)}$$

Where: $\boldsymbol{Y_t}$: is the growth rate of aggregate tax revenue

TB=Tax Base (current GDP at market prices)

$\boldsymbol{\beta_1}$***: tax buoyancy is the ratio between the percentage increase in tax revenues and the percentage increase in the tax base.***

A dummy variable has been introduced in the traditional equation to capture some changes. Singer developed the method in 1968. The study introduced the dummy variable for each year with an exogenous tax policy change (Bonga et al., 2015).

$$\boldsymbol{Y_t = \beta_0 + \beta_1 X_t + \beta_1 D_{1t} + \beta_2 D_{2t} + \beta_3 D_{3t} + \beta_4 D_{4t} + \beta_5 D_{5t} + \varepsilon_t} \qquad \textbf{Equation (2)}$$

$\boldsymbol{D_1}$*= dummy 1980*
$\boldsymbol{D_2}$*= dummy 1990*
$\boldsymbol{D_3}$*=dummy 2000*
$\boldsymbol{D_4}$*=dummy 2017*
$\boldsymbol{D_5}$*=dummy 2019*

The reform process of the 190s and 1990s included the consolidation of several business levies into a single tax.

4.2 Laffer Curve

The Laffer Curve represents a non-linear relationship between tax revenues and tax rate Wanniski (1978). Usually, a concave quadratic function represents this non-linear relationship. Traditionally, empirical estimations of the Laffer curve solely utilize the tax rate as an explanatory variable, with the tax revenues as the dependent variable, as seen in Equation 3.

$$\boldsymbol{Revenues = \alpha + \beta_2 Rate + \beta_3 Rate^2} \qquad \textbf{Equation (3)}$$

Where: $\boldsymbol{\alpha, \beta_2 \text{ and } \beta_3}$ are core coefficients, Revenues represent the Tax Revenues, and the Rate represents the tax rate, which varies between 0% and 100%. The existence of a Laffer Curve requires a negative and significative value for the coefficient. "$\boldsymbol{\beta_3}$" and a positive value for the coefficient. "$\boldsymbol{\beta_2}$". A Laffer Curve for each country.

The Laffer Curve illustrates the basic idea that changes in tax rates have two effects on tax revenues: the arithmetic effect and the economic effect. The arithmetic effect is simply that if tax rates are lowered, tax revenues (per dollar of tax base) will be reduced by the amount of the decrease in the rate. The reverse is true for an increase in tax rates.

Results & Discussion

Corporate tax buoyancy is greater in Barbados than in Antigua, Barbuda, Trinidad, and Tobago. The buoyancy coefficient was 11.15 for the period 2019, and it is statistically significant. A coefficient greater than unity indicates that the Barbadian Tax system has been more dynamic since the 1990s. This implies that whatever tax reforms have been done have not affected the tax revenue performance in Barbados. The optimal effective corporate tax rate lies between 20% and 5%.

Table 2 Corporate Tax Buoyancy 1980-2022

country		Buoyancy	R2
		Coef (t-stat)	
Antigua and Barbuda	1990	3.580 (1.206)	0.88
	2019	0.8356 2.254)	0.86
Barbados	1990	8.7450 (2.457)	0.87
	2019	11.1542 (3.352)	0.91
Trinidad and Tobago	1990	0.473 2.015	0.97
	2019	1.9297 4.134	0.96

The results highlight the need to closely monitor corporation tax reform in Barbados and the reduced tax severity, which reduces the economic growth effect. According to the estimations,

a decrease in the corporate income tax in the three countries mentioned above would shift these countries out of the prohibitive side of the Laffer Curve and possibly increase fiscal revenues for this tax.

Figure 2. Laffer Curve

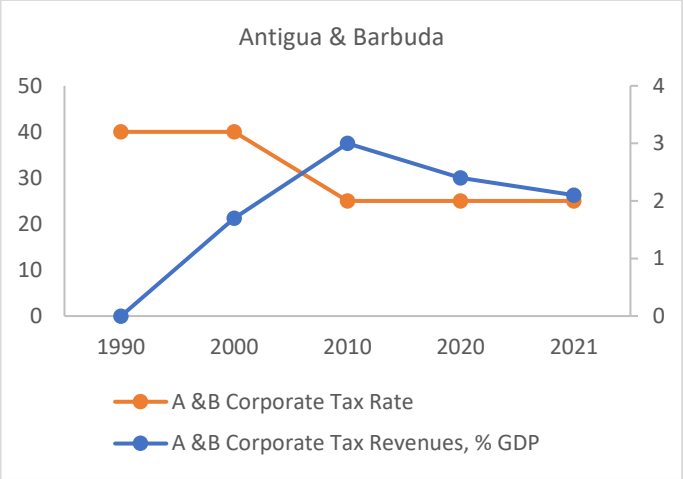


Figure 3: Laffer Curve

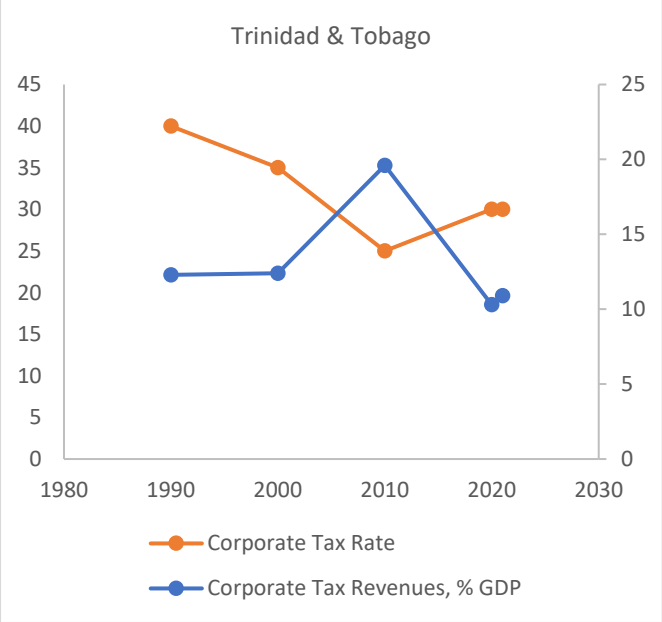
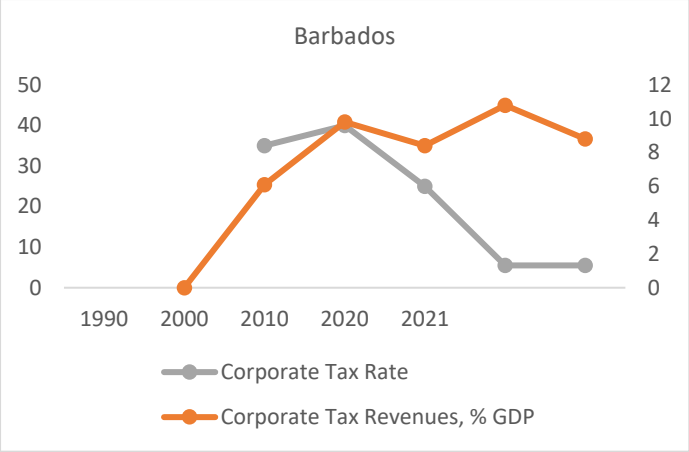


Figure 4: Laffer Curve



5. Conclusions and Policy Suggestions

The challenge is how to preserve the opportunities competitive opportunities while adhering to internation tax laws. In the absence of legal restrictions, multinational enterprises will relocate to countries with the lowest tax "price" and the highest benefits. An efficient tax system can create a positive environment for business growth, attract investment, and contribute to the extensive development of the country. However, international tax policy has hindered the fiscal authority from discharging their obligations, and the low effective tax rate of around % 5would enable countries to become more competitive and generate an adequate amount of revenue. By setting lower corporate tax rates and providing additional incentives like tax credits, each country incentivizes itself not to cooperate, irrespective of the actions of the other.

A globally conceived system would be less effective than a regional approach to tax coordination. As such, ‘tax sovereignty concerns remain one of the prime drivers of international tax policy’. A government cannot function without low tax revenues. The empirical analysis confirms that Caribbean territories will struggle to generate enough revenue if they cooperate. Improvements in tax revenues and economic diversification are crucial for the region.

Caribbean countries are price-takers or "small" players in the global economy; therefore, competition would lead to an equalization of the marginal productivity of investment across countries differently, tax harmonisation cannot yield further gains, and inter-regional coordination, not global coordination, is essential. n. With the long-term goal of maximizing profits, multinational corporations are more focused on maintaining the flexibility of their global production systems than on location-related considerations, such as labor costs and the availability of natural resources.

Automatic information sharing can also be a helpful alternative. The government can influence the ongoing processes in the economy either by stimulating or fostering all mechanisms needed to innovate and control the flow of information. The administrative burden is complex and costly, but countries can design effective domestic systems to manage data flow.

International tax policy should allow the fiscal authority in the Caribbean to discharge their obligations. Caribbean nationals should be allowed to set effective corporate tax rates to enable them to generate sufficient revenue.

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