

Governance in a Globalised World: Is it the End of the Nation State?

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Introduction

Every era is characterised by vogue words that suddenly become ubiquitous. For the 1990s, this word is undoubtedly 'globalisation'. Like other vogue words, globalisation has wandered in and out of journalism and has almost become an instant cliché. Perhaps as the result of it being used by many writers on every possible occasion, globalisation has come to mean different things to different people. At the same time, it has caused apprehension, excitement, expectation and widespread confusion among citizens and governments alike.

Different theories are advanced to explain the meaning of globalisation: some of them appear simple and logical, while others seem merely to add to the confusion. At the extreme optimistic end of the spectrum are those who see globalisation as the technologically inevitable product of the internet.² These 'techno-globalists'³ argue that the shift from a manufacturing-dominated industrial economy to a service economy represents a 'Third Wave' comparable to the earlier replacement of agricultural civilisation (the First Wave) by industrial civilisation (the Second Wave).⁴

At the other end are those who argue that globalisation is an unmitigated disaster, replacing the social-democratic prosperity of post-war Europe with a plutocratic nightmare.⁵ According to this argument, globalisation will produce a '20/80 society', in which the benefits of change will be experienced by transnational corporations and the highly skilled 20 per cent of the workforce they need.⁶ The other 80 per cent face a bleak outlook, bouncing between unemployment and insecure jobs.

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2 John Quiggin, 'Globalisation: Brave New World or Techno Trap?', *The Australian Financial Review*, Sydney, 1 October 1999, Review Section 5.

3 An excellent guide to the theory of techno-globalism is provided by Alvin Toffler and Heidi Toffler in their book, *Creating a New Civilisation: The Politics of the Third Wave* (1994).

4 Quiggin, above, n 2, Review Section 5.

5 Ibid. Also see generally Hans-Peter Martin and Harald Schumann, *The Global Trap: Globalisation and the Assault on Democracy* (1997).

6 Ibid.

Between these two extreme views is to be the moderate explanation that globalisation has resulted from a combination of factors. One important factor has been the deregulation of the international financial system that has produced a more integrated world economy. In addition, revolutions in technology have seen costs of transport and communication fall dramatically. According to this view, it is the combination of these factors, together with market forces, that has led to the increasingly globalised world in which we live today. Whatever one's view of globalisation, debate about it has raised some serious questions about the viability of fiscal sovereignty and, therefore, the nation state. Proponents of the view that globalisation will see the decline of the nation state would have us believe that globalisation will be the most significant economic factor to shape our future, and the 'death of distance'⁷ that results from it will see nations drift off into the twilight of sovereignty, thereby diminishing the role and significance of the state.

Others have taken the contrary view that globalisation has changed nothing and that the world economy was just as integrated in the nineteenth century as it is today. For instance, it can be argued that technologies like the telephone and telegraph unleashed the greatest revolutions in communications since the development of the printing press, annihilating distances between people and shrinking the world further and faster than ever before. While this is certainly true, it can also be argued that the globalisation of today is very different to that of the nineteenth century.⁸ Thus, while the transatlantic telegraph allowed rapid communications between major financiers, governments and the like, cheap telecommunications now offer everyone (or at least, everyone with a telephone and a computer) instant access to the world.⁹ Indeed, people today use technologies such as the internet to play card games with people on the other side of the world, something which would have been inconceivable in the nineteenth century.

Given these polarised views, it is timely to question whether globalisation will see the decline of fiscal sovereignty and the nation state. The first part of this article will examine the meaning of globalisation, including the rise of the internet and related technologies. The concepts of 'sovereignty' and 'jurisdiction' are central to any study of globalisation and nation states, and the meanings and bounds of these terms in the context of a traditional and integrated (globalised) economy will be explored in

7 The phrase used in the book by Frances Cairncross, *The Death of Distance*, 1997.

8 See generally Thomas Friedman, *The Lexus and the Olive Tree*, 1998.

9 Quiggin, above n 2, Review Section 5.

the second part of this paper. The challenges that globalisation presents to sovereignty and jurisdiction will be discussed in relation to various areas of law in the next section of the paper. Particular emphasis will be placed on the challenges presented to taxation laws. Possible policy responses to deal with identified challenges will also be discussed. The final part of the paper examines the central question that this paper seeks to answer – whether globalisation will spell the end to the nation state.

The Meaning of Globalisation and the Rise of the Internet

Globalisation

The process of globalisation can be described as the evolution from a situation of ‘economic nationalism’ to one of ‘international economic integration’.¹⁰ The essential characteristic of such a change is that economic activity occurs on an international, rather than national, level.

In the period of economic nationalism, international trade took place between various economic units that were organised within the boundaries of states:

*For some three hundred years, from its emergence in the mid-seventeenth century, the nation state was regarded, rightly, as the dominant actor in international economic relationships. Historically, the state was the primary regulator of its national economic system. The world economy, quite legitimately, could be conceptualised as a set of interlocking national economies. Trade and investment in the world economy were literally ‘inter-national’.*¹¹

Moreover, it has been asserted that the idea of ‘borders’ or ‘boundaries’ corresponds with a State’s jurisdiction, that is, its right of regulation, which does not necessarily correlate with its actual physical boundaries, although it is often the case because, *inter alia*, of the territorial basis on which jurisdiction can be asserted.¹²

With international economic integration, various economic units have transcended national boundaries and trade occurs in, and is defined by, an international sphere. Rapid advances in telecommunications and associated technologies (especially the internet) have accelerated this trend and

10 See generally Ramon J Jeffery, *The Impact of State Sovereignty on Global Trade and International Taxation*, 1999, p. 15.

11 Peter Dicken, *Global Shift: The Internationalisation of Economic Activity*, 1992, p. 148.

12 Jeffery, *op. cit.*, n 10, 16 (footnote 60).

have increasingly rendered insignificant the national boundaries that defined the period of economic nationalism.

The notion of a 'global web', of which the internet is a prime example, is a good analogue of international economic integration. A global web entails the idea of the various actors in the economic process, whether individuals, groups or conglomerations such as transnational corporations, entering into a myriad of different relationships with other actors around the world.¹³ These relationships can be broadly characterised either as 'formal' (such as a parent/subsidiary relationship) or 'informal' (such as loose collaborations between people and entities in different parts of the world for a common outcome).

In times of international economic integration, entrepreneurs are building what Negroponte terms 'global cottage industries'.¹⁴ This phrase sounds like an oxymoron, but according to Negroponte, it is not:

*To be a multinational company in the past, you had to be huge, with offices around the world capable not only of handling your corporate atoms but dealing with local laws, customs (in both senses of the word) and the physical distribution of products. Today, three people in three different cities can form a company and access a global marketplace.*¹⁵

With appropriate use of technologies (such as intranets¹⁶), collaborations can lead to the development of software, the designing of a car and the provision of consulting services taking place between different people in several countries. Therefore, an engineer who works in one country can e-mail a colleague in another country (and time zone) and can receive a reply to his request when he comes to work the next day. Virtual corporations and informal joint venture arrangements, which will be able to bring together experience and expertise for particular tasks and outcomes, will become more common as we move to a '24 x 7' environment, where entities are open for business 24 hours per day, 7 days a week.

In sum, the evolution of the transnational corporation and associated developments in transportation and communications technologies are integral threads of this vast global web.¹⁷

¹³ Ibid, p. 17.

¹⁴ Negroponte, p. 237.

¹⁵ Ibid.

¹⁶ An 'intranet' may be defined as a private network inside a company or organisation that uses the same kinds of software that you would find on the public internet, but that is only for internal use.

¹⁷ Robert B Reich, *The Work of Nations: A Blueprint for the Future* (1991) pp. 110–11.

The Rise of the Internet

In many ways, the internet is the epitome of globalisation, with its decentralised and interconnected series of networks that span the globe and render distance and geographical boundaries irrelevant. It is, therefore, instructive to examine some of the salient features of the internet as it relates to globalisation and sovereignty. The transition from an industrial age to a post-industrial or information age has been discussed so much and for so long that we may not have noticed that we are passing into a post-information age.¹⁸ The rise of the internet has been described as the revolutionary transformation in world trade from 'atoms' to 'bits',¹⁹ that is, a move from an industrial world to an information world – a world in which intangibles will increasingly dominate over tangibles.²⁰

The industrial age, very much an age of atoms, gave us the concept of mass production, with the economies that come from manufacturing with uniform and repetitious methods in any one given space and time.²¹ The information age, commonly associated with the era of computers, displayed the same economies of scale, but with less regard for space and time. The manufacturing of bits could happen anywhere, at any time, and, for example, move among the stock markets on New York, London, and Tokyo as if they were three adjacent machine tools.²² The information superhighway that we hear so much about is really concerned with the global movement of these weightless bits at the speed of light.²³ It has also given rise to the now often heard phrase 'anything, anytime, anywhere'.

At the same time, and perhaps somewhat paradoxically, the information age is characterised by mass media that is bigger and smaller at the same time, as are governments. For example, Europe finds itself dividing itself into smaller ethnic entities while at the same time trying to unite economically under the auspices of the European Union. In the post-information age, we often have an audience the size of one.²⁴ It is the period of customisation, with everything being made to order, and information becoming extremely personalised. Many believe that this individualisa-

18 Negroponte, p. 163.

19 Ibid., p. 14: 'A bit has no colour, size or weight, and it can travel at the speed of light. It is the smallest atomic element in the DNA of information'.

20 Ibid., p. 4.

21 Ibid., p. 163.

22 Ibid., p. 164.

23 Ibid., p. 12.

24 Ibid., p. 164.

tion is an extrapolation of narrowcasting – you go from a large to a small to a smaller group, ultimately to the individual.²⁵ The post-information age will increasingly become a ‘place without space’ where the limitations of geography will be removed. This will mean that there will be less dependence on being in a specific place at a specific time to carry out particular tasks.

Already, teleworking (or telecommuting) is being undertaken by Australian workers; instead of going to work in the city, workers are logging into their computers and carrying out their work from home. As at May 1999, there were 587,000 adults in Australia (7 per cent of all employed adults) who were able to access an employer’s computer from home through a modem.²⁶ An estimated 412,000 of these (70 per cent) have an agreement with their employer to work from home.²⁷

Knowledge workers (doctors, lawyers, consultants) who are not dependent on time and place will be able to take advantage of new technologies such as the internet and decouple themselves from geography. Already remote diagnosis and telemedicine are emerging as examples of these possibilities. This is planned to extend to the provision of advice via teleconferencing facilities, to web-based communication between doctors, hospitals and pharmacies, and to the use of e-mail by GPs to keep up with developments in the profession.²⁸ In the future, writers and money managers may find it more appealing to be in the Caribbean or South Pacific while preparing their manuscripts or managing their funds.²⁹

This paradox of distance has led Negroponte to conclude that time zones will probably play a bigger role in our digital future than trade zones.³⁰ This view is supported by Cairncross, who asserts that it will not be long before people across the globe will organise their work on the basis of language and three time shifts – one for the Americas, one for Europe and one for East Asia and Australia.³¹

25 Ibid.

26 Australian Bureau of Statistics, 3 Million Internet Purchases and 1.5 Million Households Online – ABS, Media Release 106/99 (6 September 1999). Available at <<http://www.abs.gov.au>> (copy on file with author).

27 Ibid.

28 John Breusch, ‘The Bare Facts of E-Health’, *The Australian Financial Review*, Sydney, 1 October 1999.

29 Negroponte, p. 166.

30 Ibid., p. 228.

31 Cairncross, op. cit., n 7.

In summary, the internet represents the quintessential example of globalisation. Because of its unique characteristics, it presents many challenges to the sovereignty of nations. Several of these challenges arise from the fact that most laws were conceived in and for a world of atoms, not bits, and these laws tended to be local and physical. The difficulty of isolating where activities take place on the internet, combined with the intangible nature of goods and services provided over the internet and the anonymity that the internet provides, presents formidable challenges for any legal system. These challenges will be examined in more detail once the concepts of sovereignty and jurisdiction are explained in the next section.

Sovereignty and Jurisdiction

The concepts of 'sovereignty' and 'jurisdiction' are central to any study of globalisation and nation states, and the implications of these concepts in the context of a traditional and integrated (globalised) economy will be explored in this part of the paper.

Sovereignty

Sovereignty refers to the bundle of rights and competencies which go to make up the nation state.³² It is therefore analogous to statehood. Consistent with rights normally attributable to statehood, a nation state should possess the following qualifications: (a) a permanent population; (b) a defined territory; (c) government; and (d) the capacity to enter into relations with other states.

Sovereignty is determined by two factors as observed by Franck: 'The power of the sovereign state can be bound by its own constitution ... and by international law'.³³ This reflects the dual dimension of sovereignty – that is, the power of a sovereign state is bound by its own constitution (the internal dimension of sovereignty) and by international law (the external dimension of sovereignty).

Jurisdiction

Jurisdiction refers to a state's right of regulation manifested in its judicial, administrative and, perhaps most importantly, legislative competence.³⁴

³² Jeffery, *op. cit.*, n 10, p. 26.

³³ Thomas M Franck, *Fairness in International Law and Institutions*, 1995, p. 446.

³⁴ Jeffery, *op. cit.*, note 10, p. 26. Also, as noted by Beale, 'The power of a sovereign to affect the rights of persons, whether by legislation, by executive decree, or by the judgment of a court, is called jurisdiction': J. H. Beale, 'The Jurisdiction of a Sovereign State' (1922–23) 36 *Harvard Law Review* 241.

In other words, jurisdiction refers to particular rights of the total bundle of rights that comprise statehood.³⁵ As it is a subset of sovereignty, it follows that jurisdiction cannot extend further than sovereignty. Traditionally, jurisdiction is established by reference to either the territorial or personal bases of jurisdiction.³⁶ The personal base of jurisdiction is founded on the nationality or domicile of a person as a connecting factor.

The territorial basis of jurisdiction is the most commonly referred to approach in establishing jurisdictional connections under the traditional approach. Territorial jurisdiction refers to regulation over persons and things within the geographical boundaries of a state. For example, in relation to taxation laws (fiscal jurisdiction), income that has its source or is derived by a person within a territory, is subject to taxation in that territory, as the requisite territorial (geographical) nexus is satisfied.

The territorial theory of jurisdiction has been summarised by Mann in the following terms:

(1) As every nation possesses an exclusive sovereignty and jurisdiction within its own territory, the laws of every State affect and bind directly all property, whether real or personal, within its territory; and all persons who are resident within it, whether natural-born subjects or aliens; and also all contracts made and acts done within it.

*(2) No State can, by its laws, directly affect or bind property out of its own territory or bind its own subjects by its own laws in every other place.*³⁷

Used in this context, the concept of territory is defined in the sense of a geographical area – that is, as a physical concept. Brownlie notes that the word territory in ‘a legal context denotes a particular sphere of legal competence and not a geographical concept’.³⁸ Despite this, territory has very much been interpreted in a physical, geographical, bricks and mortar sense.

Evaluation of the Territorial Basis of Jurisdiction in a Traditional and Integrated (Globalised) Economy

Having explained the meaning of sovereignty and jurisdiction, it is instructive to compare how these concepts apply to the period of econ-

³⁵ Ibid.

³⁶ There are three other bases of establishing jurisdiction under the traditional approach: (a) the Protective Principle, (b) the Passive Personality Principle; and (c) Universal Jurisdiction. A detailed consideration of these principles is beyond the scope of this article, but a discussion of these principles may be found in R. Higgins, ‘The Legal Bases of Jurisdiction’ in Cecil J. Olmstead (ed.), *The Extraterritorial Application of Laws and Responses Thereto*, 1984, p. 3.

³⁷ Fritz A. Mann, *Studies in International Law*, 1973, p. 20.

³⁸ Ian Brownlie, *Principles of Public International Law*, 1990, p. 116.

omic nationalism (traditional economy) and the period of international economic integration (globalised economy).

When one considers the period of economic nationalism, economic activity mainly took place within the physical (territorial) boundaries of a state. It therefore was sensible, and reflected reality, that jurisdiction during this period was established by looking at matters that took place within the territory. However, when one moves forward to a globalised world and the period of international economic integration, frontier-based regulatory regimes that rely on physical concepts and geographical boundaries to determine jurisdiction are called into question. There is also the problem of how the territorial basis of jurisdiction can cope with the fleeting presence of individuals within a territory.³⁹

In short, in the period of international economic integration, greater mobility of capital, people and trade is experienced, with a consequent rise in cross-border activities. This will mean that states will be left trying to assert jurisdiction over transactions and events that have links with the asserting state that are much more tenuous and difficult to establish than was the case before these developments, in the period of economic nationalism. It will be the purpose of the next section of this paper to articulate more particularly these challenges, looking at various areas of law, particularly the challenges presented to taxation laws. The paper will then seek to answer the central question addressed – whether the nation state can survive the challenges presented by a globalised world.

Challenges Presented by Globalisation

With the advent of globalisation and the rise of new technologies, we increasingly find ourselves as participants in global markets, and also in cybermarkets. Laws have been traditionally designed through democratic political processes that have given rise to laws that are essentially national. These laws are normally enforced within national frameworks. In other words, we have developed a system of frontier-based legal and regulatory systems.

In a globalised economy, and indeed in the cybermarket, frontiers or national boundaries mean very little, and the validity of nation-based laws are therefore called into question. This sentiment is echoed in Negroponte's words: 'Laws were conceived in and for a world of atoms, not bits'.⁴⁰ This section of the paper examines the challenges presented to

³⁹ Jeffery, *op. cit.*, n 10, p. 48.

⁴⁰ Negroponte, p. 8.

traditional laws by new technologies and the globalisation of the economy. If it is shown that traditional laws are of no practical use in a globalised world, people may indeed question the utility of nation states. In other words, if a nation state cannot protect the interests of the groups that comprise its political community, then its purpose is in doubt.⁴¹ This issue will be addressed in the last part of this paper.

Consumer Protection Laws

A good starting point for examining the challenges presented by globalisation and new technologies is to examine the operation of consumer protection laws in an integrated economy. Consumer protection laws represent a prototypical example of laws that have been predicated on the existence and operation of nation states. In the context of a globalised economy, there is uncertainty about the existence of reliable mechanisms to redress a number of situations, including:

- ⌘ What would occur if a product ordered through the internet never arrives?
- ⌘ What would happen if goods ordered over the internet turn out to be defective?
- ⌘ How would unfair market practices apply (such as misleading and deceptive conduct)?⁴²
- ⌘ How would infringements on privacy be controlled? For example, using appropriate technologies, including 'electronic footprints'⁴³ and 'cookies',⁴⁴ it is now possible for merchants to collate and 'mine' data on the internet, revealing people's browsing and consumption patterns.
- ⌘ How would the unauthorised use of data be controlled?

A final illustration of the uncertainties and the challenges in this area is

41 John Goldring, 'Consumer Protection, the Nation-State, Law, Globalization and Democracy', 1996, 2(2) *Journal of Computer-Mediated Communication* <<http://www.ascj.org/jcmc/vol2/issue2/goldring.html>> (Copy on file with author).

42 In Australia, the Australian Competition and Consumer Commission (ACCC) has teamed up with the US Federal Trade Commission (FTC) to crack down on a global internet scam which takes unsuspecting users to pornographic web sites then takes control of the user's browser, repeatedly bringing up more pornographic pages. Commonly referred to as 'mousetrapping' or 'pagejacking', the ACCC believes the conduct breaches the Trade Practices Act 1974 (Cth) as it is misleading or deceptive conduct: The Online Australia Update, 27 September 1999 <<http://www.onlineaustralia.net.au>> (Copy on file with author).

43 These are essentially the traces someone leaves behind when moving (surfing) from one web site to another.

44 Information stored in the consumer's hard drive which can show which sites have been visited.

the story of how in 1995 Virgin Atlantic Airways was fined \$14,000 by the US Department of Transportation for placing misleading advertising on the Internet.⁴⁵ A statement was made on its Web page that a certain fare for a designated sector was available when, in reality, the lowest fare for that sector was much higher. While the outcome of this case seems encouraging to consumers, it leaves other questions unanswered, such as problems in identifying where misleading advertising occurs in an internet environment. Determining who is the proper defendant(s) could also prove difficult. In this case, Virgin Atlantic was the defendant, but what about the host of the web site, the Internet Service Provider and others? In other words, where should the line of liability be drawn? In all the above cases, it is easy to appreciate that the application of existing laws is at best tenuous and consumers might find themselves left without a suitable legal remedy in cross-border electronic transactions. Globalised economies and new technologies afford new opportunities for transnational marketing practices that may simply ignore the restrictions created by national consumer protection laws.

US Anti-trust Laws

US anti-trust laws challenge concepts of sovereignty and jurisdiction by trying to proscribe activities occurring outside its geographical boundaries by persons who are neither residents nor citizens of the USA.⁴⁶ In so doing, US policy-makers do not wish to concede that their laws can be thwarted simply because the forbidden acts occur outside the USA and the actors are not US citizens.⁴⁷

This 'long-arm' approach is in contrast to the traditional 'waters-edge' stance taken by most countries, which confine the operation of such laws to the territory of the legislating state and to individuals over whom the state exerts effective control. Attempts by countries to apply such laws either to non-citizens or to activities outside its territorial borders is seen as an encroachment of national sovereignty. The validity of the purported exercise of jurisdiction in this situation would also have to be questioned in the light of public international law. Despite this, the USA continues to assert its sovereignty in these situations so long as the activities in question impact on businesses in the USA – a very weak basis upon

45 Jim Carroll, 'Lawsuit Sends a Wake Up Call to Senior Management', 1995, 21(26) *Computing Canada* 28. Also Paul Taylor, 'Virgin Air Fined for False Ad on the Internet', *National Post*, Canada, 24 November 1996, p. 7.

46 Goldring, *op. cit.*, n 41, p. 4.

47 *Ibid*, p. 5.

which to justify the exercise of legislative jurisdiction. This scepticism is shared by a leading international lawyer.⁴⁸

Copyright Law

It is widely accepted that many challenges are presented to traditional copyright laws by new technologies such as the internet. Some have already branded the laws relating to copyright as being totally out-of-date, a 'Gutenberg artefact'.⁴⁹ Concerns about copyright infringement normally relate to the ease of making copies. In a digital world, there are issues beyond the easy ways in which copies can be made. In a digital world, a bigger concern is that copies can be exact, and with appropriate computing technologies (such as error correction technology) can in fact be better than the original. In addition, the marginal cost of producing an extra copy is minimal or close to zero. For example, once a piece of software is created and uploaded onto an internet site, the cost of delivering to one person or 100 people is the same – a point and a click and it is simply downloaded. Reading a newspaper article and sending it to either one person or 100 people takes only a few keystrokes and costs nothing.

Recent and protracted legal proceedings in relation to downloading music over the internet illustrate the escalating problems in this area. This has led some commentators to observe that in a digital world, the medium is no longer the message, but merely represents the embodiment of it.⁵⁰

Defamation, Obscenity and Censorship Laws

Existing laws governing defamation and obscenity should apply equally in a globalised world, though determining where an offence has been committed, and so under whose jurisdiction it comes, is problematical given the nebulous nature of the internet. Censorship laws are easily circumvented by technologies such as the internet.

Retail Trade Regulation and Other Licensing Laws

In the face of a globalised world, one has to also question the applicability of retail trade regulations designed, like other laws, for a bricks and

⁴⁸ Higgins, *op. cit.*, n 36, pp. 7–13.

⁴⁹ Negroponte, p. 58.

⁵⁰ *Ibid.*, pp. 61, 71.

mortar world. These laws include regulation restrictions on matters such as the size of stores and opening hours, limitations on pricing and promotion, granting of monopolies for the sale of certain products (such as liquor) and permit and other licensing requirements.

Similar concerns arise in other occupations and professions that have licensing rules, as they tend to be nation-based. For example, if a doctor who is registered in Brazil provides telemedicine services over the internet to someone in Australia, the question arises as to whether the doctor would need to be registered in Australia and other countries to which he provides his services over the internet. If so, questions as to how this would be facilitated, co-ordinated and controlled would arise.

Taxation Laws

The power to tax has traditionally been regarded as an exercise of sovereign power. Sovereignty in this context has been interpreted to mean that in the absence of an agreement or treaty arrangements, the courts of another country will not recognise or enforce revenue judgments or orders made by courts of other countries.⁵¹

The best explanation of the theoretical basis of the rule is that given by Lord Keith of Avonholm in *Government of India v Taylor*.⁵² His view was that the enforcement of the taxation laws of one country by another country would be an extension of the sovereign power that imposes the taxes, and to assert sovereign authority by one state within the territory of another would be contrary to all concepts of independent sovereignties.

The exercise of this sovereign power to tax has been questioned in the light of an increasingly globalised economy and also new technologies, such as the internet. So what has changed so radically that calls into question the operation of existing laws? The challenges presented by globalised economies and new technologies to taxation laws will first be examined, followed by possible policy responses to address these challenges.

The Challenges

While many would argue that globalisation is not new, the pace of integration of national economies has quickened. As seen above, this trend

51 In the UK, Australia, Canada and most Commonwealth countries the decisions by the Privy Council in *Sirdar Gurdial Singh v Rajah of Faridkote* [1894] AC 679 and *Attorney-General (New Zealand) v Ortiz* [1984] AC 1 and the House of Lords in *Government of India v Taylor* [1955] AC 491 still represent the law.

52 [1955] AC 491, 511.

has been accentuated by the removal of restrictions on investment flows and improved communications technologies, as well as the development of regional trading blocs. This has led to greater mobility of capital and also savings. The benefits to the world economy of these changes are clear enough – liberalisation of financial markets improves the international allocation of savings and capital, thereby reducing the cost of capital to firms. The concern is that tax systems, particularly international tax systems, have not always kept pace with these developments.

It is widely feared that the gradual liberalisation of financial markets and globalisation will make international capital flows more sensitive to differences in the tax regimes as between countries and will therefore lead to tax competition. The concern here is that intensified tax competition will lead to an erosion of the worldwide tax base and a ‘race to the bottom’ as countries adjust their tax rates to align with other competitors.

The recent Review of Business Taxation in Australia (the Ralph Review) recognised these concerns and had as one of its prime objectives to improve the competitiveness and efficiency of Australian business while providing a secure source of revenue for government.⁵³ In the words of John Ralph, the Chairman of the review:

*We are living in a time of unparalleled change. Australia must have a taxation system which equips it for the coming decades, not for those that have passed.*⁵⁴

Responding to intensified tax competition, Ralph observed:

*Increasing globalisation will translate into an increasingly competitive environment for Australian business. The impact of the telecommunications revolution and associated technologies, in diminishing the significance of national boundaries, will make more businesses feel the chill wind of much stiffer competition. We may remain an island geographically [isolated] but we will not be able to hide from the forces generated by globalisation.*⁵⁵

Apart from an announced proposal to reduce the company tax rate to 30 per cent to bring Australia’s rate more into line with the rates of other countries in the Asia-Pacific region, Ralph announced proposed changes to the capital gains tax regime, again with tax competition considerations in mind:

53 John Ralph, ‘A Tax System by Design Rather Than Accident’, *Business Review Weekly*, Melbourne, 24 September 1999, 34.

54 John Ralph, Chairman’s Introduction to *Review of Business Taxation: A Tax System Redesigned* (1999) <<http://www.rbt.treasury.gov.au>> (Copy on file with author).

55 Ibid.

*A more competitive capital gains regime to encourage investment, particularly to attract highly mobile international capital for which there is strong and increasing competition, to encourage entrepreneurs to start new businesses in Australia, and to achieve a better functioning capital market.*⁵⁶

In summary, the Ralph Review announced its proposed changes to the company tax rate and capital gains tax in response to the considerations of intensified competition for highly mobile capital and the need it perceived for a better functioning capital market in an increasingly globalised world.

Leaving considerations of intensified tax competition aside, the sheer speed and borderless mobility of transactions in the globalised economy has called into question the ability to apply traditional transactional analysis inherent in transfer pricing laws. Transfer pricing laws allow revenue authorities to adjust the income of parties to international transactions (for example, multinational enterprises) to prevent the diversion of income from high-tax jurisdictions to low-tax jurisdictions (for example, tax havens). With no national borders, work on the same project can be undertaken in several countries, with intranets allowing the sharing of information. These new collaborative opportunities produce many challenges in applying traditional methods underlying transfer pricing rules. While globalisation and electronic commerce may not necessarily present any unique problems for transfer pricing, the growth of electronic commerce will be likely to make some of the transfer pricing problems more common.

Tax treaty concepts (such as permanent establishment) are also challenged by globalisation and new technologies. The combination of the internet and globalisation has allowed taxpayers to operate internationally for low cost, 24 hours a day, 7 days a week. Global communication systems will see an increase in cross-border activities and may dispense with the need for businesses to maintain a physical presence (for example, a sales force or distribution network) to do business in a country. In a business sense, this means that simple and cheap access to global markets will be available and that barriers of distance and location have disappeared. In a legal sense, it puts pressure on concepts such as 'permanent establishment' contained in most double tax agreements, as it relies on the existence of a physical presence (for example, an office or factory).

In relation to the jurisdiction to tax, jurisdiction has traditionally been based on geographical territorial connections. Generally, therefore, entities or individuals need to be geographically located (resident) or the

⁵⁶ Ibid 2.

source of income needs to be located in a country for jurisdiction to be asserted. Practical jurisdiction depends on an identified taxpayer (and also assets) being located in a jurisdiction. While it may be argued that jurisdictional rules have always been a problem for revenue authorities, they have been relatively contained, but now even smaller organisations can trade and bank globally, and location and identity become more difficult to determine.

A simple example illustrates the problems of attempting to apply traditional jurisdictional rules is trying to determine a company's central management and control, and thereby its residence, in a globalised world. This determination may become problematical where a board of directors can meet electronically from a number of different locations via video-conferencing facilities. It is not inconceivable that in this situation it may be difficult to isolate the location of central management and control to one specific location. Also, virtual corporations can be created to carry out a particular task or venture, thereby putting further pressure on rules created for an established physical presences, rather than transient presences.

Similarly, new technologies can weaken the relationship between services provided and their location. For example, physicians can now remotely diagnose patients via the internet, and an ever-increasing number of workers can now telecommute with their employers, thereby reducing the need for a physical presence at their workplace.

In sum, the absence of borders and the lack of border controls undermines the jurisdictional rules of source and residency as they are currently formulated and applied. This is because transactions on the internet occur everywhere, but nowhere in particular, or as one writer has put it 'the trouble with cyberspace ... is that there's no "there" there'.⁵⁷ A related problem posed by globalisation and the internet is the anonymity it offers and the difficulty of isolating where a transaction occurs.

More pressure is brought to bear on tax laws by the intangible nature of many goods and services that can be delivered via the internet. This challenges traditional rules relating to the characterisation of income as it blurs distinctions between the sale of goods, provision of services and royalties. This in turn impacts on source rules underlying various taxation regimes. For example, if one looks at the simple example of the sale of an encyclopaedia, in a traditional sale (such as books), the income would be classified as sales income. Likewise, if the encyclopaedia is provided on a

57 R. Resnick, 'Cybertort: The New Era', 1994, *National Law Journal*, A1.

CD-ROM, a similar result would probably ensue. But if the encyclopaedia is provided via online access, the classification becomes more difficult – is it sales income or services income?

Up to now, the ability to move capital across national borders and access offshore financial centres has been limited to an elite of high-wealth individuals. In many ways, the problem was contained because it required a great deal of international mobility and expensive advice to exploit it and so at most it led to a fraying at the edges of the tax base. Now, the pace of globalisation, combined with new technologies, has made capital more mobile and therefore increased the accessibility of offshore centres, which have become easier to locate and cheaper to access. And while it may be argued that no major changes to laws were needed in the past (as any activity was marginal), when this activity becomes mainstream, more attention needs to be given to it and tax rules need to take account of it.

Already the effect of a more mobile capital base has exerted pressure on other taxes (such as gambling and funds transfers), where the impacts of globalisation have already been felt. Apart from differences between tax rates and tax bases that may produce distortions in the patterns of production and trade, the integration of the world economy gives rise to other problems. One is that it becomes more difficult to determine which country is entitled to tax a particular transaction and a related difficulty is that practical enforcement can also be problematic, especially if an entity has no physical presence or assets in a jurisdiction in which it transacts its business. These problems are exacerbated by the fact that investigative and enforcement powers typically stop at the border of a country and rely on co-operation with other nations to have any force.

In conclusion, it may be stated that the current tax systems of many countries reflect a period (before, during and immediately after the Second World War) when economies were closed and capital movements were much more limited. Today, the assumption of a closed economy has become increasingly anachronistic. The internet's capacity to transform the world into global communities may see the displacement of some national law, as technology reduces the significance of sovereignty. Electronic commerce is difficult to contain within geographically defined trade areas and frontier-based regulatory regimes. In a period of economic nationalism, laws were *prima facie* territorial and this reflected the general correspondence between physical space and law space. That is, geographical borders make sense in a physical world. In an integrated economy, however, territorial-based laws come under pressure, as geographical borders have little significance.

Responses to the Challenges

In trying to develop solutions for the challenges presented to taxation laws by an integrated economy, one can consider the applicability of four basic competing models for the governance of the internet as put forward by Johnson and Post.⁵⁸

First, Johnson and Post suggest that existing sovereigns can simply seek to extend their jurisdiction and amend their laws as necessary in an attempt to govern all actions on the internet that have substantial impacts on their own citizens. In other words, under this approach, countries could simply seek to unilaterally modify their rules to try to preserve their revenue bases. This policy stance is, however, fraught with danger – as John Donne once cautioned, ‘No man is an island, entire of itself; every man is a piece of the Continent, a part of the main’. Donne’s aphorism, suitably adapted, may be that no national tax system is separate from the main and therefore unilateral measures which do not have regard for other countries’ systems will cause more problems than they solve, including the possibility of double taxation.

Under the second model, sovereigns could seek out bilateral or multilateral agreements to establish new and uniform rules specifically applicable to conduct on the internet. Again, this model has specific problems, including the considerable competition between countries, how to deal with countries that remain outside the treaty system, the unequal international playing field that exists in treaty negotiations, not to mention the expense and time involved in trying to negotiate such treaties.

The third model seeks to create a new international organisation to establish new rules for governance and also a new means of enforcing those rules and of holding those who make the rules accountable to its stakeholders. This may be described as a centralised model and seeks to overcome the chief problem with regulating a medium like the internet – the lack of a central locus of control or leverage point that one can seek to regulate.

And it is true that at present there is no World Tax Organisation – a GATT for Taxes – charged with the responsibility of establishing desirable rules for taxation and with enough power to induce countries to obey them. Some would suggest that it is time to establish such an institution. However, one should not be too sanguine about the possibility of such an

58 David R. Johnson and David G. Post, ‘And How Shall the Net be Governed?’, 1996, Cyberspace Law Institute <<http://www.cli.org/emdraft.html>> (Copy on file with author) [1]. The ensuing discussion on this point is adapted from this source.

institution emerging easily or quickly. Political difficulties aside, there would be problems in obtaining agreement on the set of rules; it would also be difficult to reach consensus on the constitution and powers of such an institution.

Also, the desirability of adopting this model has been called into question by some as:

*[t]he bottleneck characteristic of any centralized law-making machinery, and the natural frailties of law-making processes based on writing authoritative texts make centralized systems unsuitable for tackling a diverse, rapidly changing, large scale set of problems like those posed by the net.*⁵⁹

The first three models put forward may be described as 'top-down' centralised models, while the fourth model seeks to adopt a decentralised solution to attack a decentralised medium, like the internet. Essentially, this model would involve the voluntary acceptance of codes or standards on a decentralised, emergent basis. The argument here is that:

*the same decentralized decision-making that created the net at a technical level may be able to create a workable and, indeed, empowering and just form of order even at the highest level of the protocol stack – the realm of rules applicable to the collective social evaluation and governance of human behavior.*⁶⁰

This last model therefore argues for a self-regulatory structure, by means of decentralised emergent law-making. In support of this proposal are those who favour minimalist regulation and interference with a medium that should be allowed to develop without undue regulatory interference. It is also argued that this approach would save considerable resources that might otherwise have been spent on trying, perhaps without greater success, to adopt other means of regulation. Opponents of this regime would, however, argue that less formal mechanisms will not work and will ultimately lead to complete chaos and unmitigated disasters in the international tax arena.

While all these models have a theoretical attractiveness, they may be impractical utopian hopes as existing sovereigns are not about to give up their law-making powers, especially when revenue is at stake. As alternatives to adopting models in the area of taxation, perhaps countries will seek out new taxes. In recent times, a carbon tax, the Tobin tax and bit taxes have been discussed. It is worth briefly examining these proposals.

The carbon tax proposal, commonly dubbed an 'energy tax' or 'green tax',

⁵⁹ Ibid [25].

⁶⁰ Ibid [18].

has gained currency in recent times on the basis of an increased public awareness of environmental issues (including the greenhouse effect), even ignoring the benefits of such a tax from a public-finance point of view. At the same time, there are considerable political sensitivities about such a proposal. Big companies such as Alcoa, Western Mining Corporation and BHP are all very nervous about such proposals and the effects it could have on their cost structures. If the tax is introduced, these companies have threatened to close down their Australian-based operations, as they would no longer be viable in terms of rising costs.⁶¹

External pressures for the implementation of a carbon tax have arisen from an agreement reached at a conference in the Japanese city of Kyoto in 1997 (the 'Kyoto Protocol'). Under this agreement, most of the world's industrialised countries agreed to a formula aimed at limiting the production of problem gases produced by each country (mainly carbon dioxide, methane and nitrous oxide). The dilemma now is how to apply the protocol in Australia, and whether Australia should attempt to lead the world in cutting gas emissions where other industrialised countries, notably the USA, are not rushing to embrace the protocol.⁶²

So while a carbon tax may become a self-fulfilling prophecy, the real issue for Australia may be how green can it afford to be? The Tobin tax initiative⁶³ is a proposal to tax currency transactions on foreign exchange markets through multilateral co-operation. Essentially a transaction tax on currency speculation, the purpose of the tax is to discourage volatile short-term or speculative trading. On that basis, non-speculative transactions would be exempt. Notwithstanding the simple attractiveness of applying a low rate of tax on a wide base that would generate considerable revenue, there are difficulties with such a proposal. These include definitional problems (such as what a 'speculative transaction' is) and the raft of problems associated with trying to achieve multilateral agreement on any issue, especially revenue matters.

Finally, a bit tax (essentially a tax on the flow of information) has been suggested in recent times as a measure that would be suitable to reflect changes in the economy at large. That is, as the economy has changed from an industrial economy to an information economy, proponents of a bit tax would argue that consideration should be given to adjust the tax system to reflect this shift. Despite the strength of economic arguments

61 Tim Treadgold, 'Industries Threaten to Flee a Costly Carbon-Tax Regime', *Business Review Weekly*, Melbourne, 24 September 1999, 44.

62 Ibid., 45.

63 The name 'Tobin tax' derives from James Tobin, a Nobel-laureate economist at Yale University.

that would support such a tax, and also the simplicity of it, the bit tax has been almost universally rejected.

In the end, the short-term policy response in the taxation area may be for countries to take the path of least resistance, and simply shift their tax base from footloose factors, such as profits and savings, toward consumption and labour.⁶⁴ But in a world of mobile capital, it may be difficult to tax goods and services sold over the internet. A disturbing consequence, therefore, is that labour is likely to bear a growing share of the tax burden – especially unskilled workers who are least mobile.⁶⁵ If this happens, it may lead to the plutocratic society referred to above.

Another target for taxation may be property. In years gone by, property taxes, such as land taxes, were major sources of revenue. Dependence on property taxes has steadily reduced over time. It may be that in a globalised society, where mobility is greatly increased, governments may have to seek to tax more heavily immovable physical presences, such as property.

Conclusions: Is it the End of the Nation State?

The central question that this paper seeks to answer is whether globalisation will spell the end of the nation state. The process of globalisation was explained in the first part of the paper, followed by a discussion of the concepts of sovereignty and jurisdiction. In the third part of the paper, the challenges that globalisation and new technologies present to sovereignty and jurisdiction were examined, with a particular focus on the challenges presented to taxation laws. In light of those challenges, a compelling case can be made to support the argument that globalisation may spell the end of the nation state.

It was observed that laws have evolved through essentially national frameworks, and represent the outcome of democratic political processes within nation states. If it is shown that these laws have little practical use in a globalised world, this raises the question of what functions may remain for democratic politics and nation states.

It is widely accepted that the role of the nation state has changed considerably as we have moved from an era of economic nationalism into a period of international economic integration. Accepting this position, and in light of the challenges that globalisation presents to sovereignty

64 The Economist, 'The Taxpayer Vanishes', *The Australian*, Sydney, 4 June 1997.

65 Ibid.

and jurisdiction, it is easy to conclude that the nation state is becoming increasingly irrelevant as the economy continues to globalise and new technologies dominate the commercial landscape.

However, against this conclusion the author prefers to take the view that the nation state has not become an irrelevance and that it will survive the onset of globalisation and the continued (and rapid) emergence of new technologies.

The transition from a period of economic nationalism to international economic integration has seen the emergence of a number of challenges to sovereignty and jurisdiction, largely and simply because economic activity is structured and occurs on the international, rather than national level. To respond to this evolution, nation states have two broad policy options open to them:

*They can try and cling to the mirage of absolute sovereignty ... or alternatively they can regard self-interest as inextricably entwined in the mutual interest in acclimatising to the changes in the global economy which are taking place, through co-ordinated action at the national and international levels.*⁶⁶

While the choices appear clear enough, the reality is that nation states are reluctant to cede sovereignty, especially in revenue matters. This attitude manifests a fundamental assumption that sovereignty is to be equated with empowerment and conversely that cession or restriction of it is to be associated with disempowerment.⁶⁷

However, absolute sovereignty is largely illusory and this is illustrated well by what has come to be known as Hobbes' paradox. According to Hobbes, if men were to hold on to all their rights and liberties and be able to do as they wish (i.e. exercise absolute sovereignty), this would necessarily imply the right to invade other men's rights, leading to a state of anarchy or war.⁶⁸ In reality, equilibrium or peace can only be achieved when there is a mutual laying down of rights for mutual benefit.⁶⁹ Hobbes paradoxically asserts, therefore, that in fact giving up sovereignty can lead to empowerment (by harnessing mutual benefits), while retaining it can actually lead to disempowerment.

One can extrapolate Hobbes' paradox to nation states in a globalised economy – that is, if nation states are to achieve mutual benefits and

66 Jeffery, op. cit., n 10, p. 23.

67 Ibid., p. 21.

68 Ibid.

69 Thomas Hobbes, *Leviathan*, 1991, p. 92.

adapt to the new global world, there can be no room for the exercise of absolute sovereignty. Rather, the mutual laying down of rights by nation states, by means of cession or restriction of sovereignty, has to be done in a manner which is tailored to the new global forces so that the harnessing of mutual benefits can be maximised.⁷⁰ Consistent with this is the assertion that nation states will give up or cede sovereign rights if they can secure mutual advantages for their citizens – that is, their decision to give up sovereignty will be guided by the benefits that accrue to the individuals making up the nation state.

While the author believes that nation states will ultimately come to the above realisation, it is accepted that this will not occur uniformly, clearly or quickly but will represent an evolutionary policy change eventually leading to the situation described above. Indeed, in the short term, it may be expected that nation states will do nothing or very little, as they cling dearly to their cherished rights of sovereignty and jurisdiction. This may be from fear or simply from a desire to retain the positive outcomes that may accrue to nation states as a result of the deregulation that is consequent upon the forces of globalisation. For example, it may be expected that countries such as the USA that currently dominate the internet environment and are net exporters of technology will do little to push for changes in regulation of the internet, as the current situation gives them substantial economic benefits.

In the medium term, one would expect fragmented approaches by countries (on either a unilateral or bilateral basis), as it becomes evident that their laws and revenues are no longer on a stable platform to deliver the economic and legal benefits expected from them. During this period, nation states will start to come to the realisation that they need to take active steps to continue to exercise their sovereign powers (especially on taxation) and their rights of jurisdiction.

Ultimately, there will be a need for co-ordinated multilateral action to overcome the inconsistencies that arise from fragmented approaches. Many see the attainment of such consensus as 'an impractical utopian hope'.⁷¹ However, while it is easy to adopt this view, perhaps there is too much scepticism about the possibility of achieving multilateral consensus.

One only has to go back to the 1920s when the League of Nations first undertook to study ways to avoid international double tax. Much of this work is now embodied in tax treaties developed by the OECD and UN.

⁷⁰ Jeffery, *op. cit.*, n 10, pp. 21–2.

⁷¹ D.A. Ward, 'Abuse of Tax Treaties', *Intertax*, 1995, 181, pp. 177.

This shows that despite sovereignty, it is possible to reach international consensus.

Another example of multilateral co-operation is The Nordic Pact Multilateral Convention on Administrative Assistance in Tax Matters⁷² which has been described as 'the most far-reaching form of co-operation between tax authorities at present in existence'.⁷³ However, this statement needs to be tempered by the fact that the success of this agreement is probably due largely to its regional nature:

*This far-reaching form of co-operation seems to have been made possible by the resemblances between the participating States in various fields, in particular mutually understood languages, similar legal systems, and the fact that most participants had already been co-operating intensively for some years under bilateral assistance agreements.*⁷⁴

Two other examples of multilateral co-operation may be noted here. The first is an EU Directive covering mutual assistance, which provides for the exchange of information based on that contained in Article 26 of the OECD Model Tax Convention, but at the same time, does not provide for the enforcement of foreign revenue laws in another state.⁷⁵

Finally, the joint Council of Europe/OECD Multilateral Convention on Mutual Administrative Assistance in Tax Matters of 1988, represents another example of a multilateral initiative. This Convention, which came into force on 1 April 1995, has not been embraced by many countries (including Australia), probably because of its perceived breadth, in that it contains provisions allowing for the exercise of enforcement by one state in the territory of another.⁷⁶ At the same time, signatory states can limit their involvement when signing such conventions, so such concerns may be overstated.

In summary, it is submitted that while globalisation and new technologies continue to exert pressure on the concepts of sovereignty and jurisdic-

72 Entered into in 1972 between Denmark, Finland, Iceland, Norway and Sweden.

73 W.B. Westerburgen, 'Ways and Means to Improve European and Wider International Co-Operation Against Tax Evasion and Avoidance, Including Those Proposed in Recommendation 833 (1978) of the Parliamentary Assembly', *European Taxation* 1980, 168, 172.

74 Ibid.

75 Council Directive of 19 December 1977 Concerning Mutual Assistance by the Competent Authorities of the Member States in the Field of Direct Taxation.

76 Article 11 provides that the requested state shall take steps to recover foreign claims as if it were its own. Article 17 provides for the sending of tax demands abroad.

tion, the nation state can work symbiotically with, rather than against, these forces. It must be remembered that the forces that benefit most from globalisation (large multinational enterprises) are predicated upon and constantly require support from the legal systems of nation states.⁷⁷ Businesses and consumers similarly depend on nation states to underpin commerce by providing 'last resort' mechanisms for enforcing contracts and bringing legal certainty (and trust) to the marketplace.⁷⁸ Therefore, despite the pressures created by globalisation and new technologies, it is submitted that the nation state will emerge as the enduring custodian of jurisdiction and sovereignty, both of which will have undergone necessary changes and evolutions along the way.

⁷⁷ Goldring, *op. cit.*, n 41, p. 12.

⁷⁸ *Ibid.*