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Imaginary capital migration and the competitive politics of corporate taxation

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ABSTRACT

International competitiveness has solidified itself as a key policy goal for nation states. The consequent competitive re-design of tax systems has reduced corporate tax rates across borders. To understand the policy-shaping nature of tax competition, we examine how the changing imagery of competitiveness has rationalised lowering the corporate tax rate in three Finnish tax reforms since the 1990s. In attracting mobile capital by inventing tax system disparities, governments increasingly rely on imaginary capital migration. Examining imaginary capital migration demonstrates that governments' competitive policies of fiscal nationalism greatly overlap with corporate taxpayers' tax avoidance arrangements, as both practices are largely disembedded from the material dynamics of economy.

KEYWORDS

Competitiveness; tax competition; corporate tax; imaginary capital migration

1. Introduction

International tax competition has a major effect on national tax policies. Yet, the ways in which governments seek competitive advantage have remained understudied. We argue that these practices often depend on imaginary capital migration. We introduce this concept to address cross-border capital flows that shift the jurisdiction of wealth irrespective of and without changing the business logic. These capital flows bifurcate the economics of legal treatment from the business rationale, being triggered merely by the former. We demonstrate how governments' competitive strategies that rely on imaginary capital migration reap benefits from the same global economic structures that corporate taxpayers harness to avoid taxes. While digital business models have boosted imaginary capital migration (Wigan 2021), we show that imaginary capital flows have fostered tax competition at least since the 1990s. Imaginary capital migration framework provides a refined insight into the dynamics conceptualised as 'virtual tax competition' (Rixen 2011, Dietsch 2016). The framework also contributes to understanding the political uses of the asymmetries between economic value creation and its legal conceptualisation in global wealth chains (Seabrooke and Wigan 2017, Christensen *et al.* 2020). To achieve these goals, we provide a case study on the politics of corporate tax competition.

The need for case studies on tax competition is illustrated by the existing literature, in which we identify three important strands. First, scholars have examined global tax governance and its relationship with tax competition, either from the perspective of substantive tax rules (Rixen 2008, Genschel *et al.* 2011, Jaakkola and Knuutinen 2020) or information exchange (Ahrens and Bothner 2020; Hakelberg and Rixen 2020). Second, researchers have demonstrated how tax competition yields policy convergence between tax systems (see Genschel and Schwarz 2015, Genschel and

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Schwarz 2011) or contested the convergence-creating dynamics of competition (Swank 1998, Kiser and Laing 2001, Swank and Steinmo 2002). Third, scholars have emphasised the critically formative role of national institutions (Steinmo 1993, Basinger and Hallerberg 2004, Campbell 2004, Swank 2006, Campbell and Pedersen 2014, Swank 2016, Hearson 2018, Binder 2019, Ajdacic *et al.* 2021). The third strand has criticised the macro-level view for associating cross-national similarities with uniform discourses, effectively downplaying the role of national differences. Governments 'internalize the discourse of competitiveness' in varying ways (Latulippe 2016, 77), which generates differing perceptions of competitiveness. This underlines 'the need to consider the complex institutional and ideational mediations by which external economic imperatives are translated' into domestic dynamics (Hay and Rosamond 2002, 164). Even under competitive pressures, nationally diverse ways to embrace competition remain (Palan and Abbott 1996). Rather than dwelling on macro-level observations, we need to open the national 'black boxes' of competitiveness (Radaelli 2004, Ganghof 2006, Reurink and Garcia-Bernardo 2020).

We advance the latter approach by focusing on the national translation of international tax competitiveness. Discourses on tax competition are nationally embedded and competitiveness is a dynamic policy goal that evolves over time. We analyse how tax competitiveness has been used as an argument to rationalise corporate tax rate cuts and how these cuts have increasingly relied on the mobilisation of imaginary capital migration. Our findings highlight how political economic structures urge policymakers to fabricate quasi-economic incentives for corporate taxpayers, thus prompting imaginary capital migration and arbitrage between taxation and value creation. We demonstrate how imaginary capital migration, routinely associated with corporations' tax avoidance strategies, also permeates governments' policies. Since enhancing tax systems' competitiveness 'displays familiar characteristics of neoliberalism more broadly, in its effort to reinvent sovereign state authority in economically rational terms' (Davies 2017, 116, see also Supiot 2020), our findings illuminate the practices of subjecting an increasing number of aspects of social and political order to the economic rationale of competition. Our case study covers three Finnish tax reforms adopted in 1993, 2005 and 2014. We rely on legislative materials, preparatory reports drafted by influential government-commissioned expert groups, and 20 interviews with economists, legal researchers, civil servants, private sector representatives and a journalist. The interviews convey the reforms' background aspirations and policymakers' perceptions of the prevailing circumstances. The more recent a reform, the more in-depth insights the interviewees have supplied.

The article proceeds as follows. Section 2 construes the framework of imaginary capital migration. Section 3 examines how the competitiveness imperative has shaped Finnish corporate tax policies, reconstructing how competitive practices have increasingly been premised on imaginary capital migration. It recounts how the aspiration of competitive policies has evolved from financial assets to the formal incorporation of group entities and then to artificial shifting of corporate profits. Section 4 spells out the implications of our findings for future research on tax competition and the commodification of legal orders.

2. Imaginary capital migration and tax competition

Over the past decades, states have waived control over their economic borders. This has contributed to a situation in which finance, production, trade and corporate structures are increasingly organised as multinational wealth chains, through which 'the capacity of actors to shift assets, costs, profits, and liabilities across borders has increased exponentially.' (Seabrooke and Wigan 2017, 2.) States have nevertheless formally retained key sovereign powers, including the power to tax, which facilitates disparities between legal orders. The decentred political structure allows the economy to 'operate within an arena larger than that which any political entity can totally control' (Wallerstein 2011, 481) and empowers capital to exploit institutional disparities. The parting of political and

economic geographies makes politically insulated legal orders act as incentives for footloose capital (Palan 2006).

Multinational enterprises play a key role in structuring cross-border capital migration. Functional and territorial corporate dispersion has been urged by the prospects of reaping from differences in national tax laws (Picciotto 2011, 64–71). In seeking regulatory benefits, corporations can detach their tax residence from the territory of business activities (sites of economic value creation). Originally, the international tax regime pursued to prevent this by introducing the concept of the permanent establishment, which served as a normative articulation for the jurisdictional coincidence of income formation and tax obligations. The concept enforced the ‘economic allegiance’ between value creation and the authority to tax (League of Nations 1923)—i.e. a ‘membership principle’ (Dietsch and Rixen 2014) indicating the economic belonging of a firm to a given jurisdiction. Yet, the structural integrity of the international corporate tax regime has been undermined by imaginary capital migration, which has distorted the jurisdictional connection between economy and taxation. Imaginary capital movements, in turn, have occupied a central role in global economy, as they can be mobilised easily for tax competition by governments and tax avoidance by corporate taxpayers.

While a demarcation between imaginary and other capital movements escapes unequivocal criteria, we highlight four overlapping properties characterising imaginary cross-border capital migration (see Table 1). First, imaginary capital flows involve hardly any meaningful economic substance and are thus unrelated to firms’ actual business logic. They are separate from the productive capacity of capital and turn the international division of labour into an increasingly deficient framework for understanding capital circulation. Rather than pursuing comparative economic advantages, imaginary cross-border capital flows seek institutional disparities, relying on the bifurcation between the economics of the business and the economics of the legal treatment (Fleischer 2010, Palan *et al.* 2021, Grasten *et al.* 2021). The sovereign state system is thus pivotal for sustaining imaginary capital migration, as it ‘permits the existence of legal and regulatory differences between jurisdictions, and opens up the space in which a person may ‘arbitrage’ and benefit from the difference’ (Vlcek 2017, 26). Imaginary capital flows are not mere sham operations taking place only on paper and as a result of false reporting. They are actual operations and recognised as such by tax statutes, but they operate beyond the business logic.

Second, since imaginary capital flows are physically and socially unembedded, they require no material transactions, such as moving a taxpayer’s physical residence abroad (Dietsch 2016). The dematerialising tendencies in the economy, such as financialisation, digitalisation and the increasing role of intellectual property, exacerbate this phenomenon. For instance, since the business prospects of financial companies are often relatively indifferent to their location, they can effortlessly shift legal domicile between territories. Hence, imaginary capital flows easily respond to institutional differences between legal environments. Their territorial presence is less fixed than that of more material activities, traditionally targeted by the notion of permanent establishment (see European Commission 2017). Often, these capital movements occur by strategic relocations of headquarters, holding companies and intra-firm functions. Such migration also follows imaginary logic (see Sections 3.1. and 3.2.), although these operations are not usually subsumed under the concept of virtual tax competition.

Table 1. Stylised characteristics of imaginary capital migration.

Feature	Aspiration	Capacity	Framework	Arbitrage
Imaginary	Exploiting institutional disparities	Unembedded in physical and social environments	Economically associated corporate entities	Ruptures between law and economy
Non-imaginary	Profiting from real investment opportunities	Dependent on material territorial presence	Market relations between non-associated actors	Differences in productivity, supply and demand

Third, imaginary capital flows often occur between economically associated entities, controlled by a unitary body of shareholders. These group companies are legally separate but constitute a single enterprise entity (Biondi 2013). The territorially and functionally dispersed corporation is a decentred firm: rather than duplicating material business activities in multiple countries, companies segregate intra-firm corporate functions to lucrative jurisdictions (Desai 2009, Palan *et al.* 2021). Furthermore, decentred corporate structures enable funnelling wealth and profits across borders to low-tax countries. Within a decentred entity, wealth can be shifted through intra-firm payments, such as interests (Organization for Economic Co-operation and Development 2015), royalties (Bryan *et al.* 2017) and service fees (Picciotto 2011, 229). Given that these transactions do not occur between independent entities, they depart from the market logic, such as non-coordinated price formation, and are routinely conducted with false transfer prices (Eden 2016, Ylönen and Teivainen 2018). The decentred but integrated corporate structures and intra-firm 'organisational circuits' (Morgan 2016) are therefore the essential means of organising imaginary capital flows across borders.

Fourth, imaginary capital flows exploit the rupture between economic reality and its legal construction. While legal concepts, such as taxable income, are always 'legal fictions' (Picciotto 1999), economic globalisation has increasingly dissociated legal representations from the economy. This prompts artificial diversion of income and disconnects the territory of economic value creation from the country taxing that value. The Organization for Economic Co-operation and Development (2013a, 10) has emphasised the disconnection between law and economy, asserting that low taxation is problematic only when 'associated with practices that artificially segregate taxable income from the activities that generate it.' In extreme instances, intra-firm arrangements capitalise on mismatches within the tax treaty network or between domestic tax laws, helping profits escape the reach of any jurisdiction, amounting to 'stateless income' (Kleinbard 2011). As the incongruence between economic reality and legal construction of income escalates, the concept of permanent establishment loses its original significance as a function of material economic activity. These deficiencies have prompted international organisations to call for '[r]e-establishing the link between taxation and where economic activity takes place' (European Commission 2015a, 6) and syncing the legal concepts of international tax regime with the geography of the market.

Imaginary cross-border capital migration is routinely associated with tax avoidance, as reflected in the recent tax policy efforts of the EU and the OECD. Yet, the past three decades have seen also governments exploiting imaginary capital migration through policy competition. To attract capital, states commercialise their sovereignty (Palan 2006) and turn legal orders into false commodities (Menéndez 2019), as permitted by the political geography of sovereign states. Taxes are central for these practices, and the marketisation of tax systems urges governments to capitalise on imaginary capital flows. Imaginary flows are not merely unintended by-products of the international tax regime's flaws; rather, they result from governments' calculated political choices, spurred by assumed fiscal gains. They constitute a lucrative target for policymakers, and governments' competitive policies and corporations' tax avoidance practices align with each other in utilising tax disparities. Both states and firms endorse the rent-seeking opportunities supplied by imaginary capital migration, which generates fiscal degradation and undermines the political authority over public finances.

Tax competition scholars have distinguished between 'real' and 'virtual' tax competition (Rixen 2011, Dietsch 2015, Dietsch 2016). The former category roughly focuses on tax bases with real economic presence and entails the relocation of genuine economic activities across territories, whereas the latter category resembles what we call imaginary capital migration. Virtual tax competition influences tax revenues and taxpayers' fiscal burden without changing the character of business activity. In virtual competition, governments exploit the rupture between tax domicile and economic value creation. Ring-fencing policies that exclude local inhabitants from their scope but provide benefits for taxpayers with only nominal presence in a given territory are perhaps the most infamous instances of virtual tax competition (Palan *et al.* 2010, 31). The concept of virtual tax competition is particularly useful in understanding the recent variants of competition. Yet, as an analytical tool, it does not fully

cover the role that relocation of corporate entities and intra-firm functions play in tax competition. Our case study demonstrates that such activities have followed the logic of imaginary capital migration and have emerged as the key targets of tax competition since the 1990s.

The category of imaginary capital migration serves an analytical function for us. We are not demarcating between acceptable and unacceptable forms of tax competition, as has been done in the efforts against 'harmful' tax competition (European Commission 1997, Organization for Economic Co-operation and Development 1998). As an analytical category, imaginary capital migration is instrumental in grasping how countries harness corporate tax systems for institutional competitiveness and fiscal nationalism. It helps pinpoint the properties of contemporary capitalism that governments operationalise as adapting their tax systems to global economy. To illustrate these dynamics, we examine three Finnish corporate tax reforms that relied on various types of imaginary capital migration. Our case study recounts a trajectory where a Nordic country with Keynesian economic policies and capital controls reoriented its corporate tax system to embrace international capital.

3. International competitiveness and mobilisation of imaginary capital migration

3.1. Economic integration and the enhanced mobility of financial capital

The 1993 Finnish tax reform was guided by ideas that profoundly transformed corporate and capital taxation. It mirrored the 1986 US tax reform (see Slemrod and Bakija 2000, 29–30, Steinmo 2003), which influenced Nordic countries. Swedish and Norwegian reforms served as the immediate models and provided 'moral-political support'¹ (Viherkenttä 2019). The centre-right government asserted that 'taxation of capital income will be streamlined' and the corporate tax rate 'lowered and the corporate tax base broadened' (Prime Minister's Office 1991). The reform engaged in the internal and external economic rationalisation of the tax system: internal rationalisation (tax system neutrality) aimed at mobilising capital within borders and external rationalisation (competitiveness) targeted internationally mobile capital.

Broadening of the tax base and streamlining of manifold tax rates addressed deficiencies associated with the post-war system of corporate and capital taxation. The tax base was fragmented with various deductions, reserves, depreciations and reliefs, and it was deemed non-transparent and complex (Andersson 1993, Ministry of Finance 1992). The porous system was seen to hamper the effective and productive allocation of capital and to distort the incidence of the tax burden among firms and investors. The similar Swedish tax system was tellingly perceived as so distortionary that '[m]inimizing tax became more important than maximizing profit' (Lodin 2011, 74). The fragmented tax base pushed the effective tax burden well below the statutory rate, which was seen to incentivise quasi-economic behaviour (Niskakangas 2019). Taxpayers' tax-minimising strategies prompted artificial capital circulation, and capital was mobilised without genuine economic substance. The expert group (see Ylönen *et al.* 2021) that established the framework for the reform contended, '[t]he current system can be criticised for giving rise to tax-driven investments as well as non-neutral tax treatment, generating inefficiency' (Ministry of Finance 1991, 10). The tax system was internally incoherent, which arguably hampered the productive functioning of the economy, creating efficiency losses and perverting capital circulation.

The formative rationale of the tax policy discourse was to reform the distortionary system and enforce the principle of tax neutrality, i.e. an approximately uniform treatment of taxable activities so that taxes influence market actors' choices as little as possible. Broadening the tax base and eliminating divergent tax rates for different types of capital income would account for uniform tax treatment and efficiency. The government aimed at 'making both capital and corporate taxation more uniform and neutral' (Government of Finland 1992a, 4). This mirrored the expert group's view: '[d]ue to the more uniform taxation, national economic efficiency of investments would obviously increase' (Ministry of Finance 1991, 102). A new approach to taxation emerged, and this 'new mindset favour[ed] efficiency and demand[ed] neutrality' (Ministry of Finance 1991, 10). The old,

disparaged tax system was an outcome of interventionist policies that emphasised the role of the state in organising markets. The *dirigiste* and Keynesian ideas had advocated using the tax system to steer macroeconomic conjunctures, promote private investments and redistribute income. A seemingly neutral tax system, in contrast, required withdrawing from governmental interventions in favour of a supposedly self-allocating market mechanism. Hence, the expert report declared, 'in well-functioning capital markets, return on investments determines the allocation of capital', which 'increases the need for uniform capital taxation' (Ministry of Finance 1991, 5). Tax neutrality was expected to mobilise finance within national borders, and market-based capital allocation was assumed to result in the effective functioning of the economy and create 'intensive growth'.

The political transition away from the interventionist economic policies was preceded by disciplinary changes within economics from the 1970s onwards (Steinmo 1993, Campbell 2004, 149–163, Interview 2019a). Tax neutrality was the core economic idea that shaped the early 1990s neoliberal reforms (Christensen 2017, 6–40). Rather than steering the market through tax policy interventions, governments advocated 'a shift from market-regulating to market-conforming policy rules' (Swank 1998, 686). The shift was also underpinned by the changing perceptions of the legitimate functions of law. The neutral legal paradigm denounced interfering with seemingly self-organising social processes and affecting the outcomes of the economy through premeditated political bargains (Teubner 1987). Finnish reformers began to view the economy as a self-ordering process and were deeply informed by exemplary policy ideas, which circulated across Western capitalist societies and fostered policy learning. The ideas were not confined to corporate taxation but they consolidated a broader mentality that taxes play a moderate role in a polity. The tax policy agenda effectively began to converge with the neoliberal prescription that the mandate of the state in reorganising socio-economic conditions and managing macroeconomic trajectories be scaled down (for discussion, see Jessop 2002, Blyth 2002, Hay and Wincott 2012). Yet, as Ban (2016, 8) has noted, Nordic countries adopted these prescriptions only in some policy areas and with some moderation. Scaling back political aspirations might nonetheless have helped harness taxes to competitive purposes, as it tempered the emergence of political alternatives to the politics of competitiveness.

The ideal of tax neutrality facilitated streamlining of both capital and corporate tax bases as well as reducing the number of rates. Yet, while neutrality may explain the coherence of a tax system (internal rationalisation), it does not account for a specific tax rate imposed on corporate and capital income. The neoliberal doctrine demanded non-interventionist tax policies but was inconclusive on the proper level of taxation (Christensen 2017, 6–8). Tax neutrality is a formal criterion that requires equal treatment of economic activities without dictating what type of treatment be adopted (Ganghof 2006, 33–34). However, the issue of tax rates is pertinent, given that the 1993 reform involved radical reductions in statutory rates. It introduced a dual income tax for personal taxation: labour income continued to be taxed at a progressive scale, while capital income was taxed at a proportional rate of 25 per cent. It reduced the statutory corporate tax rate from around 40 per cent to 25 per cent. While continuing a longer trend, the rate reduction was the largest single step downwards (Andersson 1993).

To some extent, reduced rates were intended to compensate the broadening of tax bases and factor in inflation. Concurrently, competitiveness became a key goal. The expert group (Ministry of Finance 1991) maintained,

the system must be sustainable as regards the international environment. (p. 4) It is apparent that *tax competition between countries is intensifying*, and also European economic integration accelerates tax competition. As integration proceeds, it becomes unfeasible to deviate too much from potential rival countries, especially with respect to most mobile economic activities (financial capital). (p. 6) After the liberalisation of international capital flows, it is vital to acknowledge that the level of taxation cannot essentially exceed the international standard. (p. 2) It depends primarily on the international trends in the level of capital income taxation. (p. 100) In the proposed model, the Finnish statutory corporate tax rate would be one of the lowest among West European countries. As restrictions on foreign ownership are gradually removed, the low corporate tax rate might increase foreign investments to Finland. (p. 101)

The experts perceived economic openness as a constraint on tax policy, and the government concurred (Hallituksen esitys Eduskunnalle tuloverolaiksi sekä laiksi eräiden yleishyödyllisten yhteisöjen veronhuojennuksista annetun lain 1 ja 6 §:n muuttamisesta. HE 200/1992 1992a, Government of Finland 1992a, Government of Finland 1992b). The ethos of competitiveness figured heavily, which tallied with the then-contemporary burgeoning of institutional competition among policy-makers (Pedersen 2010, Linsi 2020). Whereas neutrality was introduced to mobilise capital within borders, competitiveness aimed at keeping tax bases within national borders. The latter was considered urgent as neighbouring countries had lowered corporate and capital tax rates to 30 per cent (Sweden) and 28 per cent (Norway). Yet, the reform ‘went beyond what could be considered defensive’, as the secretary of the expert group reported (Viherkenttä 2019). In the aggressive effort to retain domestic capital and to attract foreign capital, the reform set the corporate tax rate below any other OECD country (Andersson *et al.* 1998).

Tax competition concerned principally financial capital. The mobility of portfolio investments, interest instruments, insurances, investment funds and savings were pivotal in assessing the feasible *capital income tax rate* (Ministry of Finance 1991, 6 and 100). The concern was boosted by Germany’s 1989 (shortly aborted) withholding tax on interests: Germany imposing such a tax resulted in a capital outflow from Germany to Luxembourg, which forced Germany to relinquish the tax. Similar concerns informed the choice of the Finnish *corporate tax rate*. The reform addressed primarily the location of banks, insurance companies and other financial services firms, and the experts mentioned cross-border real investments only vaguely (Ministry of Finance 1991, 100–101). In the new global economy, cross-border mobility was mainly linked to financial capital, whose migration was unrelated to physical environments. The competitive strategy was thus primarily associated with imaginary, tax-driven capital flows that have little to do with material economic factors or business logic. Importantly, while tax neutrality was advocated as countering quasi-economic capital allocation within borders, competitive tax policy was rationalised with reference to unencumbered financial capital and corporations migrating across borders solely for tax reasons. In tax competition, imaginary capital migration appeared as a promise of future fiscal prosperity, and tax-driven cross-border financial flows served as a key factor.

The reform highlights how the transfer of policy ideas promoted the tax system’s internal coherence. Yet, the perceived boundaries of the system’s viability were determined in comparison to foreign and especially other Nordic tax systems. These were not simply rational exemplars but also competitive benchmarks. Internal coherence was thus accompanied by external compatibility, in line with international trends (Slemrod 1990). Following Linsi’s (2020) categorisation, the result was both intra- and inter-border neoliberalisation. The latter was essentially concerned with mobile financial capital, and it was imperative for both the capital income tax rate and the corporate tax rate, which were of equal competitive relevance. Hence, imaginary capital migration featured prominently in the early 1990s, during a transition away from a Keynesian-influenced economic system.

3.2. Dispersed corporate entities and the primacy of corporate tax

While the 1993 reform relied on the anticipated effects of tax competition, competitiveness was even more central for the 2005 reform. Finland’s EU membership and the downward trend in statutory corporate tax rates across the OECD countries provided the context for the reform. International competitiveness contributed to a corporate tax rate reduction from 29 to 26 per cent and the narrowing of the tax base. The reform reoriented tax competition from financial assets and personal capital income towards formal incorporation of firms and jurisdictionally segregated intra-firm functions.

The reform was preceded by the reports from two expert groups, one of which involved economists, the other lawyers (Ylönen *et al.* 2021). The latter report, emblematically titled *Towards Competitive Taxation*, became influential for the subsequent policies. The group based its work on the vision

that 'international tax competition will become ever more intense' and that 'remaining passive in politics of taxation will likely turn Finland into an unattractive location for mobile tax bases, such as parent companies and headquarter operations' (Ministry of Finance 2002, 179). Competition on tax rates appeared inexorable as harmonising rates within the EU had repeatedly failed, preserving the institutional conditions for tax rate competition. Furthermore, by the early 2000s, obstacles to economic mobility in the internal market had been largely eradicated. Under these premises, interdependence between European tax systems was considered so profound that competitiveness was incorporated into the principles of an ideal tax system, which served as a normative background for redesigning the system (Ministry of Finance 2002, Prime Minister's Office 2002). For tax scholars, competitiveness became a key criterion for appraising a tax system and the issue gained prominence in the agendas of economic research institutions.

In the 2005 reform, capital income and high-skilled labour were conceived as mobile tax bases and susceptible to competition. Yet, corporate income was considered most responsive to tax differentials (Ministry of Finance 2002, Prime Minister's Office 2002). This emphasised the importance of the legal design of international double tax treaties, which allocate taxing rights between countries. Treaty rules typically dictate that capital income acquired by individuals be taxed by the country of a taxpayer's residence. The residence country's tax system determines the level of taxation, unless income is unlawfully concealed from tax authorities. Therefore, the relevance of the source country's capital tax rate remains limited for capital owned by individuals. In contrast, corporations can manipulate their residence for tax purposes. Against this backdrop, the 2005 reform considered the corporate tax rate a key variable in tax competition. The government stated, '[d]ifferentiating between capital and corporate tax rates allows more substantial reductions in corporate tax rate' (Government of Finland 2004, 21, Prime Minister's Office 2002, 154). Consequently, the 1993 reform's core invention of uniform capital and corporate tax rates was abandoned. For the sake of competitiveness, the latter was set below the former, and resulting revenue losses could be mitigated through capital taxation (Ministry of Finance 2002, Interview 2019f). Corporate tax competitiveness outweighed the interests of domestic capital owners, who were less opportune to migrate across borders and expected to tolerate a higher tax burden; the territorially encumbered were to pay.

Throughout the reform, the core target were multinational firms, which segregate company functions across borders and are therefore highly mobile even among corporations. The expert group repeatedly stressed the mobility of corporate entities and functions, 'such as management, service and holding companies. These companies have necessarily no physical connection to any country, and incorporating them or relocating their residence do not involve significant direct costs. Also the parent company's residence can be shifted with relatively minor costs.' (Ministry of Finance 2002, 60, see also Government of Finland 2004, 21–29). This applied especially in the EU, where corporate restructuring could be implemented without tax costs (resembling 'corporate inversion' in the US context). While Sweden had traditionally been a key rival regarding the location of multinationals, the practice of reacting to Swedish corporate tax reforms was accentuated in the 2000s, as many companies had segregated their operations between Finland and Sweden (Interview 2019g, Interview 2019c). Moreover, the EU enlargement was anticipated to accelerate tax competition, as 'the internal market will be accessed by countries with comparatively low-burden systems of taxation' (Ministry of Finance 2002, 61, see also Prime Minister's Office 2002, Government of Finland 2004). In this environment, tax competition focused on formal incorporations of firms, which do not presuppose sizeable material presence but still act as proxies for tax liability. Tax policy was designed to attract decentred and dematerialised corporate functions, whose jurisdiction correlates only tenuously with physically embedded value creation. In comparison to the 1993 reform, the intra-firm aspect obtained greater relevance in corporate tax policy. The competitive ethos relied on formal proxies of establishing the tax liability and increasingly disentangled legal and economic corporate presence from each other.

The European internal market facilitates tax competition, but the EU also acts as a potentially counterbalancing force. In the mid-1990s, the EU and the OECD began to discern the fiscal discontents of economic integration and to address what they identified as ‘harmful tax competition’ (European Commission 1997, Organization for Economic Co-operation and Development 1998). Both organisations reduced harmful tax competition to preferential tax regimes. These are selective tax base structures that benefit only certain economic actors or specific activities, therefore discriminating between taxpayers. They deviate from the general patterns of a tax system and generate subnormal effective tax burdens. However, the international consensus read that competition on general tax rates and non-discriminatory tax bases remained allowed and was deemed beneficial. The narrow scope of the new international regulatory standards limited their effect. Rather than eradicating competition, the rules reshaped competitive policies, urging countries to maintain their competitiveness by statutory tax rates (Kemmerling and Seils 2009). The European Commission (2001, 5) indeed stated that curbing competition ‘must not hinder the possibility of general tax competition’, which countries were encouraged to enter.

Because of the 1990s commitment to tax neutrality, the Finnish corporate tax system conformed with the international rules on tax competition. Lowering the tax rate figured as the proper means of achieving competitiveness, and the EU and OECD policies provided additional legitimacy for such a practice, illustrating the context-specific influence of international rules. Legal experts endorsed this choice not only because it conformed with international regulations but also because the statutory tax rate was considered a transparent item that reflects the general level of the tax burden. It has a ‘symbolic function of expressing a tax system’s rate of competitiveness’ (Ministry of Finance 2002, 64) and it adapts rapidly to competitive pressures (*ibid.*). As the doctrine of uniform tax rates for capital and corporate income was dismantled, the latter became an even more elastic variable, as it could be developed independently of the former. Experts thus saw the statutory tax rate as a core measure in competition. Unusual and non-neutral tax base structures were to be avoided, even when they would mitigate foreign tax systems’ competitive advantage and prove non-discriminatory in light of international rules.

In line with the expert view, the corporate tax rate was reduced. However, in contrast to the expert opinion, politicians favoured competitiveness also over tax base neutrality. Profits that companies generate by selling long-term business shares became a key issue. Both the experts and a subsequently elected government observed numerous countries having exempted these types of profits from taxation, which raised competitive pressures. Yet, they proposed opposite responses. The experts asserted that the profits be taxed, as exempting them would violate the tax system’s internal coherence (Ministry of Finance 2002). The government advocated exemption from taxation, which the parliament endorsed. After the early 1990s, the decision constituted the most obvious deviation from the triumphant doctrine of tax neutrality, compromising the ideal of a streamlined tax system (Viherkenttä 2019). Yet, exempting these profits was anticipated to attract headquarters and holding companies. While these companies do not generate material economic activities, they nonetheless perform taxable operations. The government (Government of Finland 2004, 28–29) thus declared that ‘responding to international tax competition is an important factual motif for exempting capital gains from taxation’, which confirmed the focus of the reform: headquarters as well as service, holding and management companies were the core target of competitive measures throughout the reform—also for tax base exemptions. In this mindset, imaginary capital migration became favoured also over tax neutrality.

The reform engaged heavily in corporate tax competition. It abandoned the uniformity between tax rates on capital income and corporations, which allowed harnessing the latter more fully for competitive purposes. Tax base neutrality was also undermined for the sake of competitiveness, which marked another departure from the 1993 reform. Most importantly, the reform targeted intra-group company restructurings, exploiting the imaginary aspects of corporate existence. Functionally decentred and territorially dispersed corporations shifted into the focus of institutional competition.

3.3. Reigniting the economy or mobilising profit shifting? Tax competition disguised

The 2014 reform was framed by an influential expert reflection drafted mainly by economists (see Ylönen *et al.* 2021). Given the declining corporate tax rates internationally, the report found that the 'Finnish corporate tax rate has completely lost its prior competitive advantage' (Ministry of Finance 2010, 59). Resembling the 2005 reform, the corporate tax rate was seen as especially vulnerable to competition, which encouraged shifting tax burden towards capital income and consumption (Ministry of Finance 2010). This conventional wisdom of maintaining fiscal capacity was endorsed by the subsequently elected government, which included political parties from the whole political spectrum (Prime Minister's Office 2011).

In comparison to the 2005 reform, the experts went beyond the advice of attracting corporate entities. They repeatedly referred to the high mobility of corporate profits, stressing that a low statutory corporate tax rate 'would incentivise domestic and foreign companies to report their profits in Finland' (Ministry of Finance 2010, 19). Because profits remain taxable once all tax base deductions have been utilised, profits were considered responsive to statutory tax rate differences. Furthermore, firms could shift profits effortlessly across jurisdictions through transfer pricing and interest deduction techniques, since the international regulatory framework was even weaker than it is today (Ganghof 2006, Dietsch 2015, European Commission 2015b). Mobility of profits effectively dissociated business income formation from jurisdictions where profits were disclosed for taxation. This underlined tax jurisdiction as an artificial legal construction, which governments can harness for competition. The experts saw an observable shift towards virtual tax competition, for which corporate profits are essential.

By the 2010s, the international community had awoken to the practices and outcomes of profit shifting, with varying political responses. The Finnish government that came into office in 2011 adopted a twin-track approach. First, it counteracted tax avoidance and regulated profit shifting by limiting interest deductions, which coincided with international attempts to invent rules to prevent profit shifting (see Organization for Economic Co-operation and Development 2013b, European Commission 2015b). This unilateral choice curbed the exportation of profits abroad and protected only the domestic tax base. Shielding the domestic base without limiting profit shifting from abroad aligned with competitive fiscal nationalism. Second, the government made corporate profits explicitly a target for tax competition and operationalised the corporate tax rate for this purpose. Hence, to curb the outflow of profits, the government resorted not only to regulatory constraints but tax incentives as well. The tax system conformed to profit-shifting behaviour, reflecting how the state 'is ultimately compliant based on the exercise of power by the firm' (Morgan 2021, 185). Beyond insulating domestically generated profits, the reform assumed that reducing the corporate tax rate incentivises foreign entities to disclose profits in Finland. Hence, the government reduced the statutory corporate tax rate first from 26 to 24.5 per cent and then to 20 per cent in 2014. Competition for profits was especially important in the latter decision, to which we now turn.

The government declared that it 'will monitor movements in corporate tax rates in rival countries and, where necessary, take action to safeguard Finnish competitiveness' (Prime Minister's Office 2011, 16). The action ensued in the 2013 budget framework negotiations, with a decision to reduce the corporate tax rate to 20 per cent. Static calculations estimated a €960 m fall in corporate tax revenue. The calculations did not consider the effect of the policy change on firms' economic behaviour. While static calculations had traditionally been a norm, the preparations, greatly influenced by economic experts, now involved estimating *dynamic* effects on economic behaviour. Based on the anticipated dynamic effects, the actual drop in corporate tax revenue was expected not to exceed €480 m. Since the reform was presumed to generate dynamic effects and to expand the tax base, it was considered to have a self-financing rate of approximately 50 per cent. (Ministry of Finance 2013). A fierce public debate emerged over the quantifiable dynamic effects. Proponents maintained that a lower tax rate fosters employment and real economic activity. Opponents questioned its revenue-generating prospects and stressed the uncertainty of dynamic calculations,

which had been considered as ‘economistic nonsense’ in earlier tax law-making, as one of our interviewees recalled.

These quarrels notwithstanding, the predicted dynamic effects had influential support. The budget framework negotiations identified factors that were expected to have a base-broadening effect (Ministry of Finance 2013). They were inferred from the theoretical economics literature. de Mooij and Ederveen’s (2008) meta-analysis was influential in quantifying how tax policy changes affect the size of the corporate tax base. The article served as a key epistemic source for the 2010 expert report (Ministry of Finance 2010) and in the budget framework negotiations (Interview 2019e). The article acknowledged five decision margins through which policy changes influence the volume of the tax base, the most important of which was intra-firm cross-border profit shifting (de Mooij and Ederveen 2008, 694–695). The factors were identical to those identified in the budget framework negotiations. The article also argued that the statutory corporate tax rate was a particularly important driver for shifting corporate profits, and this relevance ‘may explain why countries engage in fierce competition with their statutory tax rates in order to attract multinational profits’ (ibid., p. 695). This assumption resonated with the 2014 reform, which endorsed the intimate connection between the statutory corporate tax rate and profit shifting (Interview 2019a, Interview 2019b, Interview 2019h). The status of the article reflects a process in which certain pieces of economic research reach ‘hinge’ status in policy processes, effectively allowing for politicians to ‘see like an economist’ (Broome and Seabrooke 2012, Helgadóttir 2021).

While relying on dynamic effects was not entirely unwarranted, the effects were not what their public proponents portrayed them to be. Rather than producing genuine economic effects, a lower tax rate was seen to alter firms’ profit-shifting patterns. Profit-generating activities already existed, and the issue was merely where profits are reported for tax purposes and who gets to tax them. Indeed, most of the anticipated effects were essentially the circulation of profits, as noted by the experts. As one of our interviewees (Niskakangas 2019) explained:

In previous reforms, what was called dynamic effects were something that was seen to boost economic activity. This time, however, we were dealing with more specific issues, and transfer-pricing practices played an important role. [...] We knew that big corporations engage in international tax planning, which enables them to report profits in jurisdictions with low taxation, and this happens essentially through transfer pricing[.] It was therefore possible to estimate, not precisely but to a relevant degree, how many hundred millions of profits corporations were expatriating overseas, and tax administration as well as the ministry of finance had some idea about the proportions of the phenomenon.

Hence, besides academic analysis, relevant practical information for assessing the dynamic effects and justifying the reduction of corporate tax rate existed, but the effects amounted to imaginary migration of tax bases. Once again, the argument related to a zero-sum competition over profits from the existing activity. The dynamic effects were thus not that different from what was pursued before through competitive tax policies. This time, however, the imperative of international competitiveness resonated vigorously with profit shifting, i.e. with perhaps the most paradigmatic instance of imaginary capital migration.

Despite the dissension over dynamic effects, the government proposed reducing the corporate tax rate to 20 per cent, which the parliament endorsed. The proposal included no references to dynamic effects, and the tax cut was estimated to cause a short-term revenue loss of around €850 m. Yet, the core argument of competitiveness remained. The government observed the international decline of corporate tax rates and argued that ‘the substantial lowering of the corporate tax rate aims at fortifying Finland’s position in the international environment and creating incentives to report profits therein’ (Government of Finland 2013, 24). This was also a response to the Swedish reform of lowering the corporate tax rate to 22 per cent and the pressure coming from the Estonian tax system (Interview 2019d). The politics of competitiveness triumphed, and even in the absence of the economistic calculations and epistemic foundations initially framing the process and rationalising the lower rate for left-leaning politicians reluctant to accept it (Niskakangas 2019). In fact, a key aspect of the reform was the divergence between public contestation and expert-driven

preparations. While the former focused on the economic and employment-boosting effects, the latter was informed by competition. Competitiveness featured powerfully but acquired a disguise in the public debate. Competitiveness is sometimes conceived as a smoke-screen argument that falsely proclaims the common interest while masking the real political aspirations, such as carrying out the neoliberal agenda or capital interests (Hirsch 1995). The reform suggests an alternative: arguments relating to the real economy may be used to camouflage the competitive ethos of fiscal nationalism.

Competitiveness figured forcefully in the reform. The tax burden was to be shifted towards domestic capital owners and less mobile tax bases. Illustratively, the government raised the capital income tax rate from 28 to 30/32 per cent and rendered it progressive. This presented a stark contrast to the proportional 20 per cent corporate tax rate and was further accentuated by the subsequent increase in the capital income tax rate. It highlighted corporate activities' salient role among mobile tax bases. The reform was driven by competition over corporate profits and presented a climax in the development of virtual tax competition and the political operationalisation of imaginary capital migration. Profit shifting being at the core of firms' tax avoidance arrangements, the reform accommodated tax policies to the facticity of tax avoidance. Competition responded to avoidance with tax-reducing concessions, which made both states and firms affirm the arbitrage between economic value creation and tax jurisdiction.

4. Conclusion

The IPE scholarship has greatly expanded after the global financial crisis, including the burgeoning of studies on global tax governance. Research has also witnessed progress in regulating global finance. Despite these developments, socio-economic inequalities have exacerbated. In this context, IPE researchers have been urged to map empirical and conceptual blind spots that hinder their understanding of the processes that sustain deficiencies in global governance (LeBaron 2021). As the editors of the NPE Special Issue on such blind spots note, researchers need to consider how theoretical assumptions filter and steer their views of political economic reality (Best 2021). With the benefit of hindsight, nationalism has been recognised as one of the blind spots (ibid., p. 221). This article has analysed tax competition as an instance of fiscal nationalism. While the cross-border market regime was a product of abandoning the protectionist variant of economic nationalism (now in resurgence), it has enabled fiscal nationalism to emerge. The article has highlighted the national embeddedness and virtual aspects of tax competition, resonating with the appeal that the tax literature should 'tell us something new about the evolving relationship between the state and globalization.' (Christensen and Hearson 2019, 1084.) We have pointed to the practices of commodifying legal orders and informed how 'the overall exercise of political power can be modelled on the principles of a market economy' (Foucault 2008, 131). Our case study on imaginary capital migration and corporate tax policy incites three key observations.

First, tax competition exploits the immaterial and virtual aspects of the economy, as governments seek to benefit from imaginary capital migration. Over time, imaginary capital flows have taken various forms. First, they involve the relocation of actual business activities that are immaterial and therefore independent from particular socio-economic environments. These entail the formal reincorporation of a business entity. This was especially relevant for the 1993 tax reform, which targeted financial services companies and financial capital. Second, imaginary capital flows involve the formal reincorporation of parent and holding companies as well as immaterial intra-firm functions, such as management and services operations. The dispersed intra-firm functions were in the focus of the 2005 tax reform. Third, imaginary capital flows artificially sever the connection between value creation and taxation. These flows are usually regarded as instances of virtual tax competition (Dietsch 2016). They are routinely enforced in the form of intra-firm profit shifting, on which the 2014 reform heavily relied. Therefore, to understand tax competition, one should pay attention to

the historical and national diversity of financial flows and corporate operations countries wish to attract (Reurink and Garcia-Bernardo 2020).

Second, in seeking benefits from imaginary capital migration, policymakers harness the same dynamics of capitalism as corporations in avoiding taxes. Policymakers' and taxpayers' rent-seeking practices intersect not only in efforts to exploit tax system disparities but also in the means of execution. In mobilising imaginary capital migration, governments' routines increasingly overlap with tax avoidance arrangements. Furthermore, since introducing tax system disparities creates incentives for tax avoidance, tax competition may accelerate cross-border tax avoidance (Faulhaber 2018). The Finnish 2014 reform was a striking example. The government acknowledged tax avoidance as an established reality, and by responding to profit shifting with tax incentives, it conceded to firms' power to shift and avoid. Notwithstanding the rhetoric of making firms pay their 'fair share', the political ethos of fiscal nationalism has routinely undermined that share. This entails that policymakers are not only architects of the structures that enable imaginary capital migration and tax avoidance but also actors whom fiscal nationalism pushes to exploit these structures. The recent international ambition of introducing a minimum corporate tax rate of around 15 per cent may counteract these practices. On the other hand, it may merely reorient tax competition towards tax base structures. The reorienting effect was something that the mid-1990s regulatory attempts by the EU and the OECD accentuated (see Section 3.2.).

Third, the law not only allows legal disparities to emerge but involves another aspect that exacerbates the significance of disparities. The law, as a semi-autonomous institution, creates conceptual realities that may prove foreign to the material sphere of the economy. As our case study demonstrates, the rupture between value creation and its legal construction catalyses imaginary capital migration. Legal constructions do not merely replicate the structures of the economic sphere but also shape capital circulation and produce new logics of profit seeking (Grasten *et al.* 2021). Their role does not depend on their variation between systems, as these constructions are consolidated also through international arrangements, such as tax treaties. In fact, the more firmly entrenched by international regulations, the more resistant to change these constructions may be, even in the event of proving dysfunctional. We assume that recent digital business models have diversified these asymmetries between law and economy. Our study urges further research on how the legal representations of economic reality are constructed, how they frame tax competition, and how they shape imaginary capital migration.

Note

1. Quotations from Finnish sources have been translated by the authors.

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