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INTRODUCTION

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If citizens can work or reside abroad, i.e. if there is international mobility of people, how should the income tax jurisdiction of a country be exercised over the subset that is so mobile? That is, should the income tax be extended to citizens abroad, on a citizenship nexus, or should it be levied on the basis of residence, thereby effectively exempting from its scope those citizens who are abroad? The Symposium in this issue addresses this novel and interesting question in public finance theory for open economies.[1]

This question has come to theoretical scrutiny by the rather indirect route of a proposal to 'tax the brain drain', i.e. to extend income taxation to skilled migrants from the developing to the developed countries. This proposal had several different moral–philosophical and economic rationales: among these being the raising of revenue from successful, internationally mobile citizens to assist development in the countries of their origin or citizenship.[2] It seemed therefore that if the developing countries could exercise their income tax jurisdiction over their citizens abroad, contrary to the current practice, they would have an added source of revenue and would also bring into the tax net a generally high-income set of citizens who were hitherto exempt simply on grounds of their locale. In short, to put the matter quite generally, one should reject 'representation without taxation', i.e. citizenship without the obligation to pay the income tax.[3]

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[1]The papers in this Symposium, among others, were presented at a Conference on The Exercise of Income Tax Jurisdiction Over Citizens Abroad, held in New Delhi during January 1981, with financial support from the Ford Foundation and the National Institute of Public Finance and Policy, New Delhi.

[2]Cf. Bhagwati (1977, 1979, 1980), Bhagwati and Partington (1976), and Oldman and Pomp (1975, 1977, 1979), among several discussions of the proposal from economic, legal, human-rights, administrative, sociological and moral–philosophical viewpoints.

[3]This phraseology, while colorful and apt, may be a trifle misleading if 'representation' is taken to mean not citizenship generally but the specific right to vote. The voting right is occasionally abridged for citizens abroad owing to administrative and procedural restrictions and considerable diversity obtains in regard to this situation.

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The problem that emerges then for public finance theory is evident: we need an extension of the usual income tax theory to an open economy (where openness implies international mobility). Many problems then immediately spring to attention. For example, what is the optimal income tax rate for citizens abroad relative to the optimal tax rate for citizens at home [Bhagwati and Hamada (1982), Mirrlees (1982), Wilson (1982a)], and what is the nature of the distortions that follow and what are the second-best solutions and policy instruments if the tax rate on citizens abroad is arbitrarily set at zero, as in many countries today [Bhagwati and Hamada (1982), Wilson (1982b)]? The papers in this Symposium address many of these issues.

But many more issues need further modelling. For example, the possibility of tax evasion, a critical one insofar as taxing non-residents is a serious problem[4] (though, taxing even residents is for many developing countries possibly an equally, if not more, difficult administrative problem), needs to be incorporated into the theoretical analysis.

Yet another significant issue arises because of the harmonization question implied by the co-existence of different income tax systems. In the United States (and the Philippines)[5] the 'global' income tax system that extends the income tax to citizens abroad is practised; other countries are on the 'schedular' income tax system that does not.[6] For the United States, this has meant a twofold problem, with consequent opposition to its global system from political lobbies preferring the schedular system.

(1) Private US citizens abroad, who are taxed on the basis of the global system, allege that they are unfairly taxed because nationals of other countries abroad (e.g. Frenchmen in Bangkok, alongside Americans) are not so taxed by their own governments and because nationals of the countries where they reside (e.g. the Thais in Bangkok) are subject only to domestic taxes (e.g. the Thai income tax) which are equally borne by the US citizens on top of such US income tax as becomes applicable. Hence, the *intra-*

[4]This problem is addressed in an informed analysis of the administrative and legal aspects of the experience of the Philippines with taxing citizens abroad, by Pomp (1982) in his paper at the New Delhi Conference.

[5]It is interesting that the US practice has spread to its former colony, whereas the European practice has spread to their former colonies. Since the Americans have not been colonizers on the scale and gusto of the Europeans during Europe's outward expansion, it is inevitable therefore that the global system is currently being practised in near isolation by the Philippines and the United States. Incidentally, Mexico also theoretically taxes citizens everywhere; in practice, in a sad commentary on the state of tax administration in many developing countries, the income tax is not enforced in the case of residents abroad.

[6]These contrasts are not wholly pure. Thus, for example, the United States does extend several exemptions (other than double-tax avoidance) to citizens abroad; and there are certainly restrictions in European systems on the definition of foreign residence which justifies exclusion from tax liability. The central thrust, and principles, of the two tax systems are very clear and different, however, in both cases.

national (*horizontal*) *equity* of the global system runs afoul of the *international* (*horizontal*) *equity* claims.

(2) Also, once trade in goods is considered, the harmonization issue becomes one of efficiency, rather than only equity. If US firms have to pay US income tax on US citizens they employ abroad, whereas French firms employing Frenchmen abroad do not have to pay the French income tax, distortion of comparative advantage could easily follow. That is to say, French firms, having to pay certain net-of-tax salaries for, say, Saudi construction contracts, would then have a smaller real cost, ceteris paribus, than US firms competing for the same contracts. Of course, this assumes that the incidence of the global tax system, unlike in the models of personal income taxation in this Symposium in the tradition of the classic papers of Mirrlees (1971) and Atkinson (1973), does not fall on the taxed individuals. It also assumes, in the stark version outlined above, that the French firms must hire Frenchmen and the US firms must hire Americans: if the two were total substitutes, as they almost certainly are not for different reasons, the harmonization issue would disappear. This problem needs formal analysis but has certainly played a major role in the political economy of American income taxation. People such as Senator Proxmire, who accept the equity underlying the global system and argue that the café-crawling Americans in Paris ought to pay their share of American taxes instead of leaving the burden to be borne by the workers in Detroit, have been traditionally pitted against pressure groups such as the corporations handling construction works abroad.[7]

Quite remarkably, the countries that are on the schedular system have hardly ever debated the merits of the alternative, global tax system. Thus, to cite just a single instance, the Meade Commission on direct taxation failed even to raise the matter in its otherwise comprehensive report, implicitly taking for granted the existing schedular system in consequence. Indeed, an interesting question in the historical evolution of the two rival systems of taxation, the global in the United States and the schedular in the European countries, is why these contrasts exist.

The United States, from the very beginning, appears to have defined tax equity on a citizenship basis, the judicial determination of the issue going so far as even to maintain that payment of the income tax was a privilege, if not a duty, of citizenship. By contrast, in the British case, the levy of the income tax has always been on a residence principle, from the time of its imposition by Pitt to pay for the Napoleonic War. The failure however to extend the tax, no matter what its original design, to citizens resident abroad may have been due to any or all of the following factors. (i) A colonial power such as Great Britain, unlike a newly-established immigrants' country such as the

[7]For a historical review of this tussle, see Bhagwati (1981).

United States, had several citizens abroad during the period of European outward expansion. It was likely that the many such British abroad had powerful connections with the Parliament, and were unlikely to be taxed by their friends. (ii) A more agreeable reason might simply be that, if many abroad were civil servants running the Empire, then the incidence of the global tax might fall on the Treasury itself: if so, only transaction costs would be incurred by taxing these citizens overseas. (iii) Again, the idea that all citizens should bear an appropriate burden of taxation is an egalitarian notion that is more consistent with the early American notions of democracy and political ideals than those of the more stratified, hierarchical European societies of the nineteenth and early twentieth centuries.[8]

[8]These questions are raised, and addressed with a skeletal historical analysis for the United States and for Great Britain, in Bhagwati and Wooton (1982). They await more sustained and penetrating historical research.

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