A materialist political economy of international corporate tax reform – Clair Quentin – PhD thesis

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The published versions listed below in all cases represent a major improvement upon the content of this thesis and readers are strongly urged to read those publications instead.

Thesis chapter		Published version
Preface	→	'The political economy of the ecocide machine', *New Socialist* , October 2021 [link]
Chapter 2: The emergent production boundary in the jurisprudence of trading profits	→	'Juridical ontologies of production and the Ricardian machine', *Accounting, Economics and Law: a Convivium*, 2022 [link]
Chapter 3: The ontology of value	→	'Inviting the vampire in: value and thermodynamic depth', *Science & Society*, 87(2), 234-260, 2023 (co-author with Ben Butler-Cole) [link]
Chapter 4: Inside and outside the production boundary	→	'Unproductive labour and the smile curve', *Review of Radical Political Economics* (forthcoming)
Chapter 5: Corporations, comity and the revenue rule: a jurisprudence of offshore	→	'Corporations, comity and the 'revenue rule': a jurisprudence of offshore', *London Review of International Law*, 8(3) 399-424, 2020 [link]
Chapter 6: The international fiscal sociology of value absorption	→	'Global production and the crisis of the tax state', *Environment and Planning A: Economy and Space*, 2022 [link]
Chapter 1: Introduction; Chapter 7: 'Value creation' and transfer pricing reform	→	'Gently down the stream: BEPS, value theory, and the allocation of profitability along global value chains', *World Tax Journal* 13(2), 2021 [link]
Chapter 8: 'Value creation' and the taxation of the 'digital economy'; Chapter 9: Conclusions	→	'Paris is burning: a cautionary tale about the politics of value' in Isabel Feichtner and Geoff Gordon, eds., *Constitutions of Value*, Routledge, 2023, pp. 86-106 [link]

A materialist political economy of international corporate tax reform

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Submitted in fulfillment of the requirements of the degree of Doctor of Philosophy

STATEMENT OF ORIGINALITY

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ABSTRACT

This thesis considers the current multilateral corporate tax reform process – which has been characterised by the OECD as being in pursuit of a normative goal of aligning the allocation of the tax base with 'value creation' – through a value-theoretical lens. It is a 'materialist' analysis because the value-theoretical standpoint it develops and adopts is the classical one which places a production boundary around material production and treats movements of value outside that boundary as transfers. The thesis is divided into three parts, posing distinct but interrelated research questions, and each developing an interdisciplinary argument in both tax law and political economy.

Part I demonstrates the utility of a materialist distinction between surplus and transfer by means of an analysis of case law regarding whether income falls to be treated as taxable trading profits. It proceeds to develop an original interpretation of the underlying value theory.

Part II combines that value theoretical perspective with an original jurisprudence of offshore, and thereby develops a structural analysis of global contestation over revenues between capital and the state. Particular attention is drawn to the role of global value chains.

Part III analyses OECD consultation documents and corporate sector responses published pursuant to the recent international corporate tax reform process. It is shown that 'value creation' here means either (i) labour outside the production boundary and associated with value capture, or (ii) value absorption in the sphere of consumption. It is argued that these meanings arise from the need to attribute profitability to something, given that prevailing norms prevent it from being allocated upstream in global value chains to activity within the production boundary. The reform process therefore appears to be a project to retain the global tax base in wealthy states to the extent it is not conceded to offshore.

A materialist political economy of international corporate tax reform

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Preface

I was finalising the first draft of this thesis as the covid-19 crisis took hold in the UK. Supermarket shelves across the UK were empty of basic commodities such as pasta and toilet paper, and at the same time Cambridge University Press was making its catalogue of (ordinarily paywalled) electronic textbooks freely available to all for the purposes of remote teaching. A stark difference had seemingly emerged between the kind of commodity which *no-one* can get during a pandemic, such as pasta, and the kind of commodity which *anyone* can get (assuming of course that they already benefit from the necessary hardware and infrastructure) such as an electronic textbook.

Among other things, the phenomenon serves to illustrate that within the broader system that we refer to as 'the economy', with its fiat currency and intangible assets and electronic ledgers and financial instruments held in, and by, legal entities, there continues to exist the system of *material* production and consumption that is the central object of analysis for political economists in the classical tradition from the French physiocrats through to Pierro Sraffa. While the processes in that system are mediated by exchange, and so it forms part of 'the economy', it is also a determinate metabolic process in and of itself, taking place in the material world, and subject to the laws of thermodynamics: a system where quantities of material stuff are worked on in some way, and then consumed, either

(a) within a *circuit* of such activity i.e.

(i) as means of further such material production or

(ii) as wage goods for the workers engaged in that production, or

(b) by way of an *exit* from such circuits, for example as wage goods for the authors of electronic textbooks.

That there is such a distinction to be drawn between pasta, production of which takes place within the circuits of that metabolic system, and electronic textbooks, production of which does not, is a core element of the argument in this thesis. This thesis characterises the distinction as being fundamentally to do with quantitative relations in the irreversible forward march of time between production and exchange. In one category are those commodities

where the quantity available at the point of exchange is a function of the quantity of resources allocated, prior to exchange, to such material processes as manufacturing and transportation. If more pasta is needed at the point of exchange, it is simply not possible to go back in time and allocate more material resources to manufacturing and transportation. The same constraint does not apply to items in the other category such as electronic textbooks. The quantity of them available at the point of exchange is a consequence of an arbitrary constraint imposed at the point of exchange which can be lifted by the purported 'producer' on a whim. No time-travel is necessary. Physical laws, while of course having a role in the delivery systems for electronic textbooks, do *not* (as they do in the case of pasta) constrain the quantity of units available for sale by fixing behind the vendor, in the vendor's ineluctably forward passage through time, the quantity of resources allocated to their production.

The elapse of time between production and exchange is something which different theories of value handle differently, but something we therefore learn from the covid-19 crisis is that, however we fit that elapse of time into our analysis, it is a material reality which makes a substantive difference to how things play out in practice. As economist James Meadway wrote regarding the absence of pasta on the UK's supermarket shelves in March 2020, '[t]here is no amount of money that can simply conjure products into existence. If food is scarce, the price might rise; but that does not make more food appear.'[1] I therefore feel vindicated in my insistence in this thesis that, in order to theorise value, we need to at least *have* an analysis of that elapse of time, and that a necessary upshot of that analysis is that contained within 'the economy' is the aforementioned circuitous metabolic material subsystem the existence of which requires to be taken seriously.

The ostensible research topics in this thesis – the tax state, offshore as a juridical space, the transfer pricing of transactions over intangibles &c – all partake of the elements of the world *outside* that circuitous metabolic material subsystem. Indeed, the question which currently most exercises the technocrats who develop international corporate tax policy – how the so-called 'digital economy' should be taxed – is by definition a question to do with reallocations outside that subsystem. One conclusion to be drawn from this might be that materiality doesn't matter for the purposes of these topics, but this thesis inclines in the opposite direction: that it matters all the more; that in fact for analytical purposes the system of material production lies at the gravitational centre of the economic universe and all these

1 J. Meadway, 'The Anti-Wartime Economy', *Tribune*, 19 March 2020, https://web.archive.org/web/20200403010618/https://tribunemag.co.uk/2020/03/the-anti-wartime-economy (accessed 27 August 2020).

other questions are in orbit around it. If we fail to see that then (since we view them from another point in orbit) the questions may appear to move in Ptolemaic epicycles, which may be why the problem of taxing the digital economy seems so intractable. Place material production at the centre, by contrast, and (so this thesis hopes to demonstrate) it becomes possible to make sense of it.

There is another reason why the circuits of material production should be treated as central to any macro-scale question, and that is because the context of such questions is this present era of ecocide in which they are being asked. We have this thing we call 'the economy', and within it we have this system which metabolises matter on a huge scale and in a (tendentially at least) accumulative manner. If we are to find our way to a future other than the *de facto* genocide of ecological collapse, and still more if that way is to be found within the apparently unshakeoffable parameters of capitalism, we need to start (or, more accurately, resume) paying attention to how the system as a whole treats the circuits of material production contained within it.

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Chapter 1: Introduction

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1.1 The questions of political economy addressed in this thesis

In 2013, after a period of growing public uproar over the apparent scale of corporate tax abuse, seemingly amounting to a crisis of legitimacy for the entire international corporate tax system,[1] a new international corporate tax norm emerged as if from nowhere. The global corporate tax base, at least insofar as it takes the form of profits arising to multinational enterprises (MNEs) was to be allocated between jurisdictions in accordance with where 'value' is 'created'.[2] This new norm was not merely promulgated by the OECD, which is the closest thing to a global norm-setting body insofar as concerns the international corporate tax system; it was expressly promulgated in terms in a G20 announcement.[3] A substantial multilateral project was constituted, the Base Erosion and Profit Shifting ('BEPS') project, with the goal of aligning international corporate tax norms with it.

As we shall see in this introductory chapter, a consensus emerged in due course to the effect that, in and of itself, 'value creation' did not mean anything very specific. The reforms proposed by the OECD under the 'value creation' rubric are, however, reforms with substantive content, so that one might nonetheless *infer* a meaning for 'value creation' by interpreting those reforms. Indeed, on a more granular level one might infer a complex

1 V. Barford and G. Holt, 'Google, Amazon, Starbucks: The rise of "tax shaming"', BBC, 21 May 2013, https://web.archive.org/web/20200706062638/https://www.bbc.com/news/magazine-20560359 (accessed 27 August 2020).

2 OECD, *Action Plan on Base Erosion and Profit Shifting*, July 2013a, available at https://www.oecd.org/ctp/BEPSActionPlan.pdf (accessed 27 August 2020).

3 G20 Leaders' Declaration, September 2013, available at https://web.archive.org/web/20190127145718/http://www.g20.utoronto.ca/2013/Saint_Petersburg_Declaration_ENG.pdf (accessed 27 August 2020).

terrain of meaning by looking at the claims and proposals made under that rubric at different junctures and for different purposes within the reform process. And it is an exercise in that nature which forms the concluding part of this thesis (*i.e.* Part III); not mapping that terrain in its entirety, but performing a detailed survey at a couple of significant locations on that terrain (specifically, (i) the early stages of transfer pricing reform and (ii) the taxation of the digital economy as the debate over that issue was constituted following 2015's publication of the BEPS outcomes).

An exercise along those lines could be conducted without saying anything at all about what it means to 'create value' in any objective sense; the 'value creation' rubric could constitute nothing more than a framing within which to present interpretations of evolving international corporate tax norms. To illustrate: if we interpret the reform as allocating the tax base towards where a certain identifiable category of operations are conducted, then 'value creation' can be treated as nothing other than a phrase which refers to that category of operations. But this thesis takes a different approach. It takes seriously the implication that 'value' is something which can be objectively said to be 'created' by some processes, which processes may accordingly be distinguished from other, non-value-creating processes.

Indeed Part I of this thesis presents a theory of value having that capability, by bringing into conversation with each other (i) tax jurisprudence insofar as it may be interpreted as operating an objective theory of value, (ii) classical value theory in the tradition of Adam Smith, David Ricardo and Karl Marx, and (iii) (briefly) statistical mechanics. This theory of value provides the (broadly speaking, materialist) framework by reference to which the concluding part of this thesis articulates its findings. This thesis is therefore (and this is a crucial component of the contribution it seeks to make) as much an exercise in applied value theory as it is a critique of corporate tax reform. It addresses a potential readership of value theorists as much as a potential readership interested in the future of corporate tax.

Part II of this thesis, forming a bridge between the value-theoretical essay(s) with which the thesis begins and the tax reform critique with which it concludes, is about the political economy of international tax norms in the twenty-first century. There exists a tradition of talking about tax from the starting point of classical value theory, as this thesis does, and that tradition falls under the loose umbrella of 'fiscal sociology'.[4] But fiscal sociology is an

[4] See R. A. Musgrave, 'Theories of Fiscal Crises: an essay in fiscal sociology', in H. J. Aaron and M. J. Boskin, eds., *The Economics of Taxation*, Washington, Brookings Institution, 1980, pp. 361-390 for an overview foregrounding the Marxian strand within fiscal sociology; see also the extended discussion in chapter 6.

inadequate theoretical framing for this thesis. Primarily, this is because, as a theoretical toolkit, fiscal sociology (which is to do with the 'tax state' as an institution) is inadequately equipped to grapple with contestation over revenues between capital and the state as it takes place on a specifically *international* level today. Part II of this thesis seeks to remedy that inadequacy (and certain other shortcomings) by supplementing the fiscal sociology outlook with (i) some legal doctrinal research findings relating to the jurisprudence of relations between states, and (ii) borrowings from social reproduction theory and critical global value chain analysis. There exists therefore a third readership for this thesis: fiscal sociologists, and those who concern themselves with the political economy of tax systems more generally.

Overall, then, this thesis comprises three interconnected parts. In proceeding through these parts it adumbrates a theory of value, develops from that theory a lens through which to view the political economy of the international corporate tax system, and deploys that lens so as to offer a critique of the international corporate tax reform process currently in train. If this thesis were to be expressly structured around a series of formal research questions, those questions would be:

> Part I: how can we distinguish between surplus and transfer, so as to be better equipped to approach the central issue of 'value creation' which corporate tax reform raises?
>
> Part II: how can we engage with international corporate tax reform as a terrain of contestation between capital and the state? In other words, how do we address it as fiscal sociologists?
>
> Part III: how do the approaches developed in response to questions (1) & (2) assist in understanding the international corporate tax reform problems of (a) transfer pricing, and (b) taxation of the digital economy?

It is hoped, however, that the thesis is more than the sum of its parts, and that an overall argument emerges which is more coherent and powerful than this distillation into discrete research questions might suggest.

1.2 The role of legal scholarship in this thesis

In addition, this thesis is an interdisciplinary exercise as between law and political economy. Each of the three parts of this thesis has a structure whereby (a) exposition of technical or

doctrinal issues in law (or in international ‘soft-law’ norms) is put in dialogue with (b) an argument or series of arguments in political economy.

In the case of Part I, the legal question is to do with the ways in which UK tax law seeks to determine whether taxable profit has arisen. Upon examination, it turns out that, when applying tax law in these contexts, judges combine objective and subjective value-theoretical approaches, so that what appears to be a single doctrinal category (albeit with blurred boundaries) is in fact two distinct categories, only one of which is subjective and therefore indeterminate. From the perspective of outcomes for taxpayers this is of negligible consequence in almost all circumstances (which is probably why the distinction to which attention is drawn here is not treated in tax law commentary as a core structural element of the doctrine in question) but from a value-theoretical perspective it is eye-opening. In effect judges are required by the practical realities of market exchange, in all its infinite ‘real world’ variety, to adopt an objective/materialist ‘surplus-and-transfer’ approach to value (as to which, see section 1.6 below) in order to give effect to the law in difficult cases. Not only does this serve to legitimise the objective/materialist surplus-and-transfer value-theoretical approach which the remainder of Part I advocates; it offers a more substantive illustration of the utility of that approach than the ‘parlour game’ hypotheticals that value-theorists more typically use to delineate value-theoretical boundaries.

In the case of Part II, the legal question is to do with the differing extents to which company law and tax law ‘travel’ internationally. In broad summary, if a jurisdiction passes (a) some tax legislation giving rise to a tax charge and (b) some companies legislation giving rise to fictional legal persons, the courts in another jurisdiction will recognise the legal persons but not give effect to the tax charge. The judicial account for the difference – comity – is universally and unquestioningly accepted as sufficient, and yet it may be demonstrated to be specious with eyebrow-raising ease. The true reason appears to be that corporate capital is always already constituted as the kernel of a transnational property regime before the ontological question reaches a court. This anomaly is shown to be an instance of ‘self-camouflaging imperialist violence’; a key architectural element of the global legal order that perpetuates inequality between states. In addition the property regime underpinning this architecture is argued to constitute the juridical substrate from which ‘offshore’ is formed, yielding a framework within which to view international corporate tax policy questions as a terrain of contestation over revenues between capital and the state. It is this widening of the

scope of the fiscal sociology project to encompass international tax phenomena which forms the basis of Part II's elaboration upon the political economy of international corporate tax in the 21st century.

In the case of Part III the discussion follows the more conventional pattern for tax law scholarship where an aspect of tax law, *i.e.* international corporate tax reform discourse, is considered from a lawerly perspective. The analysis is then contextualised by reference to the political economy developed in Parts I and II to yield the conclusions to the thesis as a whole.

As a matter of form, then, if read from the perspective of legal scholarship as opposed to political economy, this thesis is a markedly different offering from the one seemingly set out in the foregoing section. It comprises three separate essays on three distinct and superficially unconnected topics in law: (i) objectivity and materiality in the ontology of taxable profits, (ii) the jurisprudence of offshore as derived from a comparison between the extraterritoriality of tax law and the extraterritoriality of company law, and (iii) the meaning of 'value creation' as it is deployed in the reform of international corporate tax norms (in this instance a two-part essay covering transfer pricing and the digital economy). Those essays are connected by their role in an over-arching argument in political economy, but each of them is also offered as an original contribution to scholarship in its discrete legal doctrinal space.

More generally, however, as regards the relation between the law and the political economy in this thesis, there is an extent to which the thesis strikes out in a direction which Marxist legal scholars might find interesting. Marx's critique of capitalism is simultaneously a qualitative sociological one to do with the aspects of modernity which unfold from a specific set of relations between people and commodities, and an economistic one concerned with the behaviour of a quantifiable property called 'value'. The tradition within Marxist legal scholarship is generally to cleave towards the former aspect: Marxist legal scholarship is concerned with such questions as the dialectical relation of the legal form to the commodity form,[5] and more generally with the role of the state in capitalist society. The specifically quantitative dimension to Marxist critique tends to be a background element in these debates. This thesis, too, is unavoidably concerned with the relation between commodities and the law, and between the state and capital, but – since it takes as its focus a question in tax law – it is also unavoidably concerned with the specifically quantifiable. It is hoped that the thesis

5 See, paradigmatically, E. B. Pashukanis, *Law and Marxism: a general theory*, London, Ink Links, 1978; for a recent illustration of this tradition see G. Baars, *The Corporation, Law and Capitalism*, Boston, Brill, 2019.

therefore offers to a potential readership of Marxist legal scholars an interesting departure from (as well as an oblique contribution to) the core debates in our field.

1.3 The meaning of 'value creation' in the literature on corporate tax reform

1.3.1 The meaninglessness of 'value creation'

So as to strike a mildly satirical note when presenting on the subject of 'value creation' at the London School of Economics on 7 December 2018, eminent tax scholar Allison Christians displayed a slide showing a spectrum of people and entities that had asserted that the corporate tax base should be allocated where value is created. At one end of the spectrum was the Tax Justice Network, scourge of corporate tax avoiders. At the other was Tim Cook, CEO of notorious corporate tax avoider Apple Inc. Christians's point was that if the Tax Justice Network and Tim Cook could both endorse the claim that the corporate tax base should be allocated where value is created, the claim is unlikely to contain much by way of determinate propositional content.

In fact in her presentation Christians went on to (unusually) take the idea of 'value creation' seriously as a norm potentially having a quantifiable effect in (at the very least) a practical tax controversy context,[6] but the conventional position is the one vividly illustrated by her introductory slide – that 'value creation' in this context does not really mean anything very much at all. As Itai Grinberg puts it '[e]veryone agrees on the principle – but no one agrees what it means'.[7] Agreeing on the principle is not, therefore, agreement on anything in particular, and so the idea of taxing income where value is created is, says Wolfgang Schön, a mere 'mantra'.[8] Indeed it is hard to see how it could amount to anything more than a mere mantra if 'value creation' is, as Mindy Herzfeld says, 'an incoherent and ill-defined notion',[9] or, as Susan Morse puts it, a 'messy, political idea',[10] or, as Schön has it, a 'fuzzy notion',[11] or as Christians writes in an earlier paper, 'not even conceptually coherent as a theory'.[12]

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6 A. Christians and L. van Apeldoorn, 'Taxing Income Where Value Is Created', *Florida Tax Review*, vol. 22, no. 1, 2019, pp. 1-39.

7 I. Grinberg, 'International Taxation in an Era of Digital Disruption: Analyzing the Current Debate', *Taxes*, March 2019, p. 89.

8 W. Schön, 'Ten Questions about Why and How to Tax the Digitalized Economy', Max Planck Institute for Tax Law and Public Finance, working paper, November 2017, p. 5.

9 M. Herzfeld, 'The Case against BEPS: lessons for tax coordination', *Florida Tax Review*, vol. 21, no. 1, 2017, p. 32.

10 S. C. Morse, 'Value Creation: a standard in search of a process', *Bulletin for International Taxation,* vol. 72, no. 4-5, 2018, p. 197; see also F. Muniesa, 'On the political vernaculars of value creation', *Science as Culture*, vol. 24, no. 4, 2017, pp. 445–454.

11 Schön p. 22.

12 A. Christians, 'Taxing According to Value Creation', *Tax Notes International*, vol. 90, June 18, 2018, pp.1379-1383

The 'consensus academic view' is accordingly that 'any exercise to define specific sources of value creation is entirely subjective'.[13] It is possible, however, to discern in the literature some growing differentiation in this said-to-be-indeterminate terrain of 'value creation', as the aftermath of the publication of the BEPS outcomes in 2015 unfolded into the present debate about the taxation of the so-called 'digital economy'. So, for example, Marcel Olbert and Christoph Spengel write as regards the BEPS process that outcomes from the deployment of the concept 'are limited', whereas for the purposes of the digital economy context they say that 'there is no common understanding of the term "value creation"' at all.[14] This suggests that at least in the former case (in contrast to the latter circumstances) there was something there from which outcomes might, even to a limited extent, be said to derive. Some of the scholarly commentary brings out a sharper distinction, however, which is elaborated on in the subsection which follows.

1.3.2 'Value creation': from reform to revolution

It is quite clear that during the BEPS process and in the aftermath of its outputs being published it was uncontroversial simply to infer (in the absence of any express statement from the OECD as to the meaning of the term[15]) that 'value creation' was nothing other than a synonym of 'economic substance' or 'economic activity'.[16] Indeed a 2017 paper by Michael Devereux and John Vella goes so far as to suggest that the terms 'economic activity', 'relevant substance', 'substantial activity' and 'value creation' were being used 'interchangeably' by the OECD.[17]

'Economic substance' could be understood as having a negative or a positive meaning in this context. A negative interpretation might suggest that its purpose is to exclude from the allocation of the tax base artificial tax-haven-based structuring,[18] or formal ownership of intangibles.[19] A positive interpretation would focus on the implication that it is possible to

[13] Grinberg p. 95

[14] M. Olbert and C. Spengel, 'International Taxation in the Digital Economy: Challenge Accepted?', *World Tax Journal*, vol. 9, no. 1, 2017 p. 12.

[15] See J. Hey, '"Taxation Where Value is Created" and the OECD/G20 Base Erosion and Profit Shifting Initiative', *Bulletin for International Taxation*, 2018, vol. 72, no. 4-5.

[16] See M. P. Devereux, and J. Vella, 'Are We Heading towards a Corporate Tax System Fit for the 21st Century?', *Fiscal Studies*, 2014, vol. 35 for an early instance of this perspective.

[17] M. P. Devereux and J. Vella, 'Implications of digitalization for international corporate tax reform', *Oxford University Centre for Business* Taxation Working Paper, 2017, p. 8, fn. 14.

[18] See for example F. Vanistendael, 'An Octogenarian on Value Creation', *Tax Notes International*, vol. 90, June 18, 2018, pp. 1386-1388 p. 1386.

[19] See for example M. Lennard, 'Act of creation: the OECD/G20 test of "Value Creation" as a basis for taxing rights and its relevance to developing countries', *Transnational Corporations*, vol. 25, no. 3, 2018, pp. 55-84 at p. 58.

individuate and locate or quantify the substantive inputs to profitability, as in this critique from Devereux and Vella:

> [F]rom a conceptual perspective, a system that seeks to align taxing rights over income with the 'economic activity' that created it is questionable because it is not at all clear where such economic activity actually takes place. Numerous factors contribute to the creation of income, including finance, research and development, head-office functions, manufacturing, marketing and sales. All of these factors are necessary components of the generation of profit in [a multinational enterprise]. But they might be spread over a number of countries, making it impossible – even conceptually – to pinpoint the contribution of each specific location to the overall profit earned.[20]

It is because this positive concept cannot be operationalised in practice that it is said not to have had any real content at all: the novel guiding principle of 'value creation' places mere spin on some modifications to the system which are arguably consistent with its existing guiding principles,[21] but which are in any event there to constrain abuses associated with artificial structuring rather than truly to embody a new principle.[22] As the IMF acknowledged recently, '[t]here are circumstances of tax planning in which it may be widely agreed that no value is being created'.[23] 'Value creation' from this perspective means no particular thing; just anything other than the artificial elements of tax planning structures.

There is, as noted above, a contrasting flavour to the indeterminacy attributed to the concept of 'value creation' in the context of the so-called 'digital economy'. The key point here is that the concept of 'value creation' has been considered as a rubric under which to seek to have the profits of web-based giants such as Facebook, Amazon, and Google allocated to jurisdictions in proportions more commensurate with (say) volumes of sales or numbers of users in those jurisdictions, notwithstanding that there may be only a modest taxable presence in the jurisdiction under the existing rules, or no taxable presence at all.[24] As Devereux and

[20] Devereux & Vella, 2017, ibid., p. 9.

[21] See S. I. Langbein and M. R. Fuss, 'The OECD/G20-BEPS- Project and the Value Creation Paradigm: Economic Reality Disemboguing into the Interpretation of the "Arm's Length" Standard', *The International Lawyer*, vol. 51, no. 2, 2018.

[22] See M. Devereux and J. Vella, 'Value Creation as the Fundamental Principle of the International Corporate Tax System', *European Tax Policy Forum* policy paper, 31 July 2018, at pp. 3-4.

[23] International Monetary Fund, 'Corporate Taxation in the Global Economy', IMF Policy Paper, March 2019, p.18, available at https://web.archive.org/web/20190314160442/https://www.imf.org/~/media/Files/Publications/PP/2019/PPEA2019007.ashx

[24] See chapter 8 for details of this development.

Vella point out, this has blown the question of what 'value creation' means wide open. Formerly, the question was limited to what they refer to as 'supply side' considerations, which meant (as explained above) carving up the multinational enterprise's operations into distinct functions as is already the practice and maybe tweaking the outcomes. Now, 'value creation' can take place anywhere, whether or not one of the enterprise's functions is located there. Hence, as noted above, while 'value creation' formerly did not really mean very much, there is now no clear limit to what it might mean. From having been a rubric under which incremental changes to the system were being made in order to counter abuses, it is has recently been a rubric under which revolutionary changes, such as allocation of the tax base to market jurisdictions, have been considered.[25]

The response to this latter development from academic commentators and other experts has on occasion been to look to formal value theory for triangulation points by means of which to navigate the newly enlarged territory. And it is on such occasions that the literature begins to intersect with not only the tax concerns but also the analytical approach and theoretical preoccupations of this thesis.

1.4 Formal value theory in the literature on corporate tax reform

It is probably not to the particular discredit of scholars working in this area that formal value theory was not brought to bear until some five years after the 'value creation' principle was first announced. The fact is that modern mainstream value theory is wholly incapable of assisting in the development of a determinate conception of 'value creation', as 'value creation' was initially understood (*i.e.* broadly as a synonym for 'economic substance' as discussed above). It is worth pausing to set out exactly why this should be the case.

Modern mainstream value theory is that of a school of economic thought known as 'marginalism'. Marginalism has been the dominant school in economics for over a century, having begun its eclipse of the classical school in the late nineteenth century. As we shall see in the section which follows, a theory of value is never *just* a theory of value: it is also a theory of what it is we are theorising when we theorise value – and marginalism treats 'value' as effectively synonymous with 'price'. More specifically it offers a theory of how prices are formed between buyers and sellers. It is called 'marginalism' because it assumes that market actors have preferences based on marginal costs, marginal utility *&c*, which preferences are

[25] OECD, 'Addressing the Tax Challenges of the Digital Economy, Consultation Document', February 2019a, available at https://web.archive.org/web/20190314154014/https://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf

capable of being expressed along a price curve. When market actors with different objectives meet (e.g. to buy a commodity on the part of one and, on the other, to sell that same commodity) their respective curves can be plotted together, and where the curves cross, that is where the 'equilibrium' price is to be found. In other words, mainstream marginalist value theory is a theory of how prices come into being in idealised markets. It is described as a 'subjective' theory of value because the curves are attributable to the preferences of the market actors, and so where they cross – *i.e.* at a price – is not in any sense an objective property of the goods or services exchanging for that price in a market.

Returning now to tax, the core principle which serves to allocate between jurisdictions the corporate tax base insofar as it arises to multinational enterprises is the 'arm's length principle'. The arm's length principle (which has been at the heart of the international tax system for nearly a century) provides that the pricing of an intra-group transaction ('transfer pricing') should correspond to the pricing at which the transaction would take place between independent enterprises.[26] In other words the outcome of the mechanism is already meant to be the same as the outcome that marginalist value theory would yield: essentially, a market price. To look to modern mainstream value theory as a guiding principle in a context where the arm's length principle is already being applied would therefore appear, *prima facie* at least, to be a black hole of question-begging.

Conversely, if what we are looking for is (in accordance with how 'value creation' was initially understood in the BEPS context) guidance as to the distribution of 'economic substance' between a multinational enterprise's various operations, modern marginalist value theory is not even on another planet – it is in a different set of dimensions altogether. It offers only journeys into an abstract numerical space around an idealised market price. It offers nothing by way of a route back into the universe of 'economic substance' which is joined to that abstract numerical space, along an impassable wormhole of assumptions, through the singularity of a quantity of money given for goods or services.

With the advent of the recent discourse on the taxation of the digital economy, however (which shall be considered in detail in chapter 8), the specificity of the discussion around 'value creation' has fallen away and, as already noted, scholars and other expert commentators are beginning to make reference to value-theoretical concepts in order to articulate their analyses. Johannes Becker and Joachim Englisch, for example, set out the

[26] This is explored in much greater detail in chapter 7.

basics of marginalism and then explain why it cannot help, albeit perhaps not engaging as directly as might be hoped with the sheer theoretical immiscibility of marginalism and substance, saying that tax systems do not make use of it due to 'difficulties in measurement, a lack of corresponding monetary flows, and possibly also for other reasons'.[27]

Interestingly Becker and Englisch make reference to the classical concept of 'exchange-value', which means price as distinct from value (a distinction which, as we have seen, marginalism does not draw). They are aware of the classical tradition of value theory and could have chosen to make use of it (which is the approach of this thesis), but they do not. The conclusion that they draw from the inaptness of modern marginalist value theory is the somewhat unadventurous one that, even now, 'value creation' still doesn't really mean very much at all. '[T]he "value creation" paradigm', they tell us, therefore 'lends itself more to evolutionary reform in dealing with the challenges posed by the digitalised economy, rather than to an international tax revolution with which it is sometimes associated.'[28]

A more radical approach to the use of value theory in this context, while remaining wholly within the marginalist paradigm, is adopted by Devereux and Vella, but in seeking to deploy it in defence of the idea of allocation of profits to market jurisdictions they illustrate very starkly indeed its limitations:

> From a standard economic perspective, it is simply incorrect to state that no value arises in the market. The profits being allocated among countries owe as much to the market as they owe to the various parts of a supply chain. Profit depends on the price charged at the point where supply and demand meet; it simply would have not arisen in the absence of a market. It is not entirely clear why the international corporate tax system should depart from a simple and uncontroversial economic understanding of value creation.[29]

The implication here is that, rather than treating 'economic substance' and marginalism as theoretically immiscible, they can each found a claim to share in the allocation of the tax base. But this cannot have been intended to be taken seriously. What is meant by the idea that the profits owe 'as much' to one analysis of their origin as to another? – is this intended to suggest that 50% of the tax base should be allocated to where 'economic substance' is

[27] J. Becker and J. Englisch, 'Taxing Where Value Is Created: What's "User Involvement" Got to Do with It?' *Intertax*, vol. 27, no. 2, 2019 pp. 161–171.

[28] Ibid.

[29] Devereux and Vella, 2018, p. 7.

located (wherever that may be), and 50% to the jurisdictions where the multinational enterprise's supply curve meets customers' demand curves? Is this 50/50 split based on a determination of the relative weight to be given to marginalism among value theories generally? And why is the location of the customer (*i.e.* the 'market' jurisdiction) necessarily the place where the preference curves meet – the curves meet, after all, (as noted above) in an abstract and idealised numerical space, not on any piece of physical territory. All that can really be concluded here is that the idea of 'economic substance' and the value theory of mainstream economics are in a state of mutual antagonism.

Veteran tax commentator Frans Vanistendael takes a contrasting approach. In his piece on the topic it is modern marginalist value theory, rather than classical value theory, that is absent. He contrasts '[t]his new value creation idea' in which 'number of users, the volume of sales, and the number of times databases have been accessed' with classical economic theory. 'In classical economic theory' he observes, 'these elements were not considered to be production factors contributing to business profits and therefore were never taken into consideration for defining either the location of an economic establishment or the amount of profit to be allocated to that establishment'.[30] There is a covert move here which is to elide classical value theory with the concept of 'source' to be found among international tax norms,[31] but for present purposes (and to avoid a digression) the key point is that modern marginalist value theory is leapfrogged altogether.

In general, then, the journey appears to be from the 'economic substance' conception, unanchored by reference to formal value theory of any kind, to the wild expanse of the 'digital economy' debate, where commentators look intermittently to the formal value theory on the horizon but see little there of navigational assistance.

One notable (perhaps unique) exception is a paper already cited, 'International Taxation in an Era of Digital Disruption: Analyzing the Current Debate', by Itai Grinberg. Grinberg uses classical value theory to look back and anatomise 'value creation' of the 'economic substance' variety, characterising the approach to transfer pricing which emerged from the BEPS process as the Bourgeois Labour Theory of Value ('BLTV'). Since his elaboration of the concept of the BLTV (which is clearly in part a satirical concept) is the sole instance of any scholar using classical value theory to analyse the content of the current international

[30] Vanistendael, 2018, p. 1387.

[31] As regards the relation between source and economic substance (albeit not classical value theory) see J. Schwarz, 'Value Creation: Old wine in new bottles or new wine in old bottles?', *Kluwer International Tax Blog*, 21 May 2018, https://archive.fo/gjzBa (accessed 10 May 2019).

corporate tax reform debate back to and including BEPS, I believe it to be worth quoting more-or-less in full:

> [I]f there was one central theme to the BEPS transfer pricing guidance taken as a whole, it was to put great weight for purposes of allocating intangible income and income associated with the contractual allocation of risk on 'people functions'. The people functions of interest were activities by people who are of sufficiently high skill to engage in the development, enhancement, maintenance, protection, and exploitation of intangibles [...] as well as to be able to control financial risks, including those associated with the employment of intangibles. It is these people functions that the post-BEPS [transfer pricing guidelines] treat as "meriting" the allocation of excess returns from intangibles. In contrast, contractual or legal ownership of an intangible is not particularly significant, nor is 'routine' labor. I call this approach to transfer pricing the BLTV.
>
> The labor theory of value asserts that the value of a good or service is fully dependent upon the labor used in its production. [...] The BLTV attributes profits quite heavily to the labor of certain highly educated workers who occupy upper middle management roles – roles and backgrounds broadly similar to those who negotiate transfer pricing rules for governments. The theoretical basis in economics for this BEPS transfer pricing settlement is unclear. It turns the Marxian labor theory of value on its head while being inconsistent with the conventional economic view, too.

Here in microcosm are a number of themes which are prominent in this thesis. Of course, Grinberg's one-sentence statement of the labour theory of value has its inevitable shortcomings, and Part I of this thesis will go into Marxian value theory in significantly greater detail. Further, the phenomenon alluded to in the very idea of the BLTV – the inversion of Marxian value theory to be discerned in actual and proposed outcomes from the corporate tax reform process – is a symptom of a structural phenomenon which we will come to better understand in Part II of this thesis when we explore the political economy of what we shall come to label 'absorptive labour'. And lastly the analysis of the post-BEPS position as regards transfer pricing has much in common with conclusions which will be drawn in a more focused and theoretically-grounded form in Part III of this thesis.

Needless to say, this thesis proposes to address these matters with significantly greater

analytical precision than Grinberg deploys because it will have the space to do so, and (no doubt regrettably) it will take the approach entirely seriously rather than with a degree of tongue-in-cheek. But, as a proof of concept, the existence of these two short paragraphs should perhaps be reassuring for readers sceptical of the utility of Marx in this context. Even in the hands of someone not taking it entirely seriously, classical value theory does indeed offer a toolkit with which to say meaningful things about corporate tax reform in the twenty-first century. It should be immediately obvious, for example, that the concept of the BLTV says something more precise about the BEPS outputs as regards transfer pricing than could be said using marginalist value theory.

This thesis is, however, a more ambitious project, seeking to say something broader and deeper about the evolving structural role of the international corporate tax system within actually existing capitalism today. And for that purpose it requires more from its value-theoretical toolkit than that the toolkit offers a source of ready-made analytical positions to compare with and contrast against BEPS outputs and the debate around the taxation of the 'digital economy'. One of the goals of the thesis is to persuade its reader not merely of the utility of Marxian value theory but the *necessity* of it, if certain phenomena are to be understood. And to that end it is important to begin with a broad survey of the value-theoretical options available to us, so as to understand the nature of the first step to be taken towards that goal in the chapter which follows.

1.5 Theories of value

To speak of value theory at the most general possible level one might say that it is a diverse body of theory whereby

> (a) the specifically quantitative relation between
>
> > (i) money and
> >
> > (ii) the things for which it may be exchanged in markets
>
> is said to bear a further relation to some other phenomenon or phenomena (which could be subjective marginal utility, some set or subset of factors of production, a certain set of social relations &c), and
>
> (b) that further relation is said to be explanatory either of prices or of some other

property or phenomenon distinct from price and known as 'value'.

Thus far in this introductory chapter we have identified two schools of value theory; 'classical' (associated with the labour theory of value), and 'marginalist'. This delineation is essentially a historical one: classical value theory dominated until the end of the nineteenth century, and then marginalism became the dominant value theory in mainstream economics.[32] But a historical distinction is not a particularly helpful one to draw if we are going to take classical value theory seriously. Value theory in the broad tradition of Ricardo and Marx continues to develop to this day; the implication that it stopped and marginalism took over, such that to deploy it would constitute a regressive step, is misleading.

The continuously evolving strands of classical value theory include the following (and this exposition deliberately avoids anatomising the actual value-theoretical content of each which, where relevant, will be considered in chapters 3 and 4):

(i) There is the mainstream Marxism still found (albeit rarely) in some economics faculties to this day. This strand is characterised by its amenability to deployment for the purposes of detailed modelling of capitalist economies, but that generally comes at the expense of fidelity to Marx's originating work. This is because of an apparent flaw in Marx's own modelling in volume III of *Capital*, which most Marxists in this tradition treat as requiring to be corrected. Different approaches to this issue developed over the course of the twentieth century, however, leading to a number of variants within this strand. Distinctions may be found, for example, between those who treat value and price as two separate systems and those who do not, and between those who model all the events in an economic circuit as taking place simultaneously, and those who do not.[33]

(ii) There is the increasingly dominant 'value-form' school, which takes a more philosophical approach, essentially treating the problems with which mainstream Marxism concerns itself as originating in a mistaken reading of Marx as a classical political economist rather than as a critic of classical political economy. This approach is characterised by a foregrounding of Marx's more abstract discussions of value such as those to be found in volume I of *Capital*. It began to develop in the

[32] See M. Dobb, *Theories of Value and Distribution Since Adam Smith*, London, Cambridge University Press, 1973; P. Mirowski, *More Heat than Light*, London, Cambridge University Press, 1989.

[33] For illustrative work in this strand see A. Kliman, *Reclaiming Marx's Capital*, Plymouth, Lexington Books, 2007; A. Shaikh, *Capitalism: Competition, Conflict, Crises*, New York, Oxford University Press, 2016; F. Moseley, *Money and Totality*, Boston, Brill, 2017.

1960s, evolving from a renewed focus on Marx's own writings (including manuscript sources) as opposed to the received texts that come to us via, in particular, Engels.[34]

(iii) There is 'postoperaismo', which is a more recent development. It originated in Italian activist circles in the latter part of the twentieth century and it continues to be largely peripheral to academic value theory, but it is highly influential outside the academy, underpinning much popular critique of capitalism from the turn of the twenty-first century onwards. It foregrounds Marx's earlier writings (particularly *Grundrisse*) and its focus is on features of actually existing capitalism which are said to anticipate a post-capitalist future in which value is abolished.[35]

(iv) There is the 'monopoly capitalism' school where the role value plays in the analysis is subsumed within an analysis of power relations which are more institutional than the theoretically-derived class relation foregrounded in mainstream Marxism – paradigmatically the market power exercised by large corporations, but also the power exercised by wealthy states. This strand might therefore be said to include (or stand alongside) the value-theoretical positions of Marxists whose critique of capitalism foregrounds colonial and post-colonial domination of the Global South.[36]

(v) There is Marxist feminism insofar as it departs from mainstream Marxist value theory in order to accommodate the role of reproductive labour. Over the course of the 1970s there was a debate as to the role played (or not played) in the Marxist value-theoretical schema by unpaid domestic labour, and the conclusion is generally understood to be that it is not necessary to intervene in the value-theoretical core of the Marxist critique of capitalism in order to foreground social reproduction.[37] There continues, however, to be a heterodox Marxist feminist school which holds such

[34] For an overview of the core insights of this strand of value theory see F. H. Pitts, *Critiquing Capitalism Today*, London, Palgrave Macmillan, 2018.

[35] See M. Lazzarato, 'Immaterial Labour', in Paolo Verno and Michael Hardt (eds.), *Radical Thought in Italy: A Potential Politics*, Minnesota, University of Minnesota Press, 1996, pp. 132-146; M. Hardt and A. Negri, *Empire*, Boston, Harvard University Press, 2000; P. Mason, *PostCapitalism: A guide to our future*, London, Penguin, 2015.

[36] See P. Baran and P. Sweezy, *Monopoly Capitalism*, New York: Monthly Review Press, 1966; J. B. Foster, *The theory of Monopoly Capitalism*, New York: Monthly Review Press, 2014; S. Amin, *The Law of Worldwide Value*, New York: Monthly Review Press, 2010; J. Smith, *Imperialism in the Twenty-First Century*, New York: Monthly Review Press, 2016. Relatedly see M. Kidron, *Capitalism and Theory*, London, Pluto Press, 1974.

[37] L. Vogel, *Marxism and the oppression of Women: towards a Unitary Theory*, New Brunswick, Rutgers University Press, 1983.

theoretical intervention to be necessary.[38]

(vi) There is also a neo-Ricardian classical tradition adopted by the followers of twentieth century economist Pierro Sraffa. Sraffians are very much in the classical tradition but from their perspective Marx's value theory appears as something in the nature of a wrong turn. From an economistic standpoint Sraffian models are not bedevilled by the mathematical wrinkles that arise when trying to apply Marx, and the Sraffian approach therefore caused a crisis in Marxian value theory in the 1970s when its full implications started to be felt.[39] In a sense that crisis still exists, frozen in time, because neoliberal hegemony in academia since the 1980s has rendered the debate between Marxists and Sraffians institutionally irrelevant from an economics perspective. The rise of the less economistic strands of classical value theory that we have noted is no doubt to be associated with the persistence of Marxism outside economics faculties, in places to which Sraffa does not have the inter-disciplinary reach to travel.

Given this pluralism and continuity, it is not surprising that when we try to convert the misleading historical distinction between classical and marginalist value theory into a useful *analytical* one, we find that it becomes impossible to pin down. For example, it was noted above that the classical tradition is an objective one – it views value as an objectively quantifiable property of commodities – whereas marginalist value theory is by contrast subjective. But the value-form reading of Marxist value theory does not posit value as an objectively quantifiable property of commodities either (except insofar as, like marginal utility, it is realised as a price).

Similarly, it is generally thought that the classical tradition (in contrast to marginalism) is a materialist one, in the sense that only material production and material commodities (as distinct from what one might loosely class as services) are what count. But it is only really the Ricardian/Sraffian strand which can appear truly 'physicalist' in this sense. Even in mainstream Marxism certain 'services' count as commodities, and Marxists treat value as a socially-determined rather than material property of material commodities. Further, a core

[38] A key text in this tradition, albeit not a recent one (the Italian original having been published in 1981), is L. Fortunati, *The Arcane of Reproduction: Housework, Prostitution, Labor and Capital*, Brooklyn, Autonomedia, 1995; this topic is addressed in greater depth in chapter 4.

[39] P. Sraffa, *Production of Commodities by Means of Commodities*, Cambridge, Cambridge University Press, 1960. See also I. Steedman, *Marx After Sraffa*, London, NLB, 1977; I. Steedman and P. Sweezy (eds.), *The Value Controversy*, London, Verso, 1981; R. Hahnel, *Radical Political Economy: Sraffa versus Marx*, London, Routledge, 2017.

proposition of postoperaismo is that materiality is obsolete, and the value-form school holds that any form of materialism in value theory is plain wrong.

Another such possible analytical distinction between classical and marginalist value theory which does not upon closer analysis appear to be aligned with the historical one is to do with the relation between value and price. Marginalism treats value and price as completely synonymous, but the relation between value and price in the classical tradition is a complex terrain. In terms of economistic modelling, Sraffians simply model prices and (as with marginalism) there is no separate concept of value. In mainstream Marxism, value is quantitatively different from price, but it is nonetheless a quantity, expressible in cash terms, which bears a (variously elaborated) mathematically modelable relation to it. In the monopoly capitalism analysis, by contrast, prices have become unanchored from value altogether, insofar as they are either so inflated or so suppressed by power relations of various kinds that the quantitative relation becomes qualitative for analytical purposes. And in the value-form reading, these kinds of analyses are a category error: the very idea of 'value' expresses a social relation that is qualitative in its essence, and at the same time it manifests itself quantitatively as price.

If we view the distinction between classical and marginalist value theory as being to do with whether wage labour is understood as being the sole constituent of value then, again, the distinction is not so clear-cut. As with marginalism, the Sraffian approach does not treat wage labour as a unique input having a special constitutive relation to value, and both heterodox Marxist feminism and postoperaismo decry the exclusive focus in other branches of Marxist theory with wage labour in particular, seeking to bring to the fore the relation between value and *unwaged* activity of various kinds.

As it happens any of these points of contrast with marginalism – objectivity, materiality, the idea of value as something independent of price, the centrality of wage labour – could nonetheless serve as a starting point for an exploration of classical value theory. The distinction with which this thesis begins its exploration of value theory is not going to be any of them, however. It is a distinction drawn by Helen Boss in *Theories of Surplus and Transfer*[40], which serves to circumscribe the topic (and underpin the title) of her book (one of the surprisingly small number of book-length treatments of value theories generally). The classical political economists hold what Boss describes as 'theories of surplus and transfer',

[40] Boston, Unwin Hyman, 1990.

in contrast to 'theories of interdependence'. The distinguishing feature of a 'theory of surplus and transfer' is that it delineates a 'production boundary' around activities which produce value, and activities outside that boundary do not produce value according to such a theory, *even if money is given in exchange for them*. Surplus is generated within the boundary and payments of money representing such surplus to persons whose activities fall outside the boundary are *transfers*.

The reason that this particular analytical incision into the field of value theory is the starting point for this thesis is because of the existence of companies in artificial group tax structuring that do not do anything of substance at all – they are simply elements in a formal legal exercise and exist solely to attach the intended tax advantages of the jurisdiction they are incorporated in to whatever assets or money flows are held in them or pass through them. It was noted above that if there is any kernel of widely-recognised determinate meaning to the concept of 'value creation' as trumpeted at the outset of the BEPS exercise it is the negatively-defined narrow conception of value creation as economic substance which excludes only what is wholly artificial. It is that consensus exclusion which has the consequence that we are going to need a production boundary. We know we need a production boundary because we want to be able to place whatever it is those companies are doing on paper (the pricing of which could no doubt be expressed by the meeting of hypothetical marginal preference curves) *outside of it*.

1.6 Theories of surplus and transfer

To be clear, Boss's taxonomical binary is adopted here notwithstanding that she herself is hostile to theories of surplus and transfer. As well as her book being liberally sprinkled with dry humour at the expense of classical political economists, it contains a serious critique of theories of surplus and transfer, within which what she characterises as 'input-output error' looms large.

To understand what input-output error is it is necessary first to understand that, for some, the ultimate purpose of value theory is to provide the basis for arriving at a total figure for gross national output (as opposed to, for example, explaining the existence of business profits, or underpinning an exploitation-based analysis of wage labour, or articulating a scientific understanding of the core dynamic of the capitalist mode of production). The problem Boss perceives with theories of surplus and transfer, when deployed for the purposes of computing gross national output, is that they can trip over when confronted by the activities of the state.

This is because the activities of the state tend to fall outside the production boundary as delineated in most theories of surplus and transfer – and the state is accordingly conceived of as a consumer – and yet certain services and infrastructure provided by the state are obviously production inputs.

It appears to be primarily Adam Smith that Boss has in mind when she characterises theories of surplus and transfer as evincing input-output error, and indeed the error can easily be avoided by being scrupulously consistent about what does and does not lie within the production boundary. Boss acknowledges this in her discussion of Ricardo, who avoids input-output error by simple dint of rigorously confining his conception of value to material production.[41] Marx, by contrast, stands accused by Boss of questionably sidestepping input-output error by means of the apparent double-think of treating certain inputs as unproductive of value notwithstanding that they are necessary to the production of value.[42] In fact, as we shall see in chapters 3 and 4, recognising how and why inputs can indeed be both unproductive and necessary is absolutely central to an understanding of Marxian value theory: the distinction is between inputs which are necessarily implicated as a matter of causation merely, and inputs which are *quantitatively* implicated, in the sense that to increase the amount of the commodity available at the point of exchange would require (impossibly) going back in time and increasing the quantity of the input obtained.

For the purposes of this introduction however, the key point is that the activities of the state – *i.e.* whatever it is that is done with tax revenues[43] – become a matter of concern as soon as one starts to think about classical value theory in any kind of an applied way. Among the activities of people whose days and nights are spent outside the production boundary in most theories of surplus and transfer – 'artisans and advocates, singing teachers and singers, dictators and domestics, teens and babushkas, speculators and surrogates'[44] – the wage labour of servants of the state has been a major element under actually existing capitalism for generations. And whether or not Boss's technical complaint about theories of surplus and transfer would have been better targeted at Adam Smith in particular rather than the entire classical tradition, her broad point that Smith, Ricardo and Marx all paid insufficient attention to the economic role of the state seems hard to resist. Needless to say, that role will be

41 Boss, 1990, p. 77.

42 Boss, 1990, p. 99.

43 The precise nature of the relationship between public expenditure and taxation is of course a hotly debated topic right now. That debate, however, is conducted between macroeconomists and falls outside the disciplinary scope of this thesis.

44 Boss, 1990, p. 4.

addressed in this thesis.

It may be noted that, in seeking to adopt a production boundary, we are already ruling out some of the strands of classical value theory described above (just as we would have if the starting point had been objectivity, materiality, the idea of value as something independent of price, or the centrality of wage labour). In the case of the distinction being drawn here, *i.e.* the adoption of a theory of surplus and transfer, it is really only mainstream Marxism, the monopoly capitalism school, and Sraffa who remain in play. Postoperaismo and heterodox Marxist feminism both reject the production boundary on the basis that they see activities other than wage labour as being productive of value, and (crucially, from the point of view of the direction taken by this thesis) value-form Marxism does not draw a production boundary that is distinct from whatever boundary may be drawn around the actually existing market for goods and services under capitalism.

Having said that, this thesis emphatically does not simply adopt mainstream Marxist value theory and return to the topic of international corporate tax reform. This is because the account of the production boundary given in mainstream Marxism is deeply unsatisfactory. As we shall see it comprises theoretical epicycles derived by later commentators from mutually inconsistent elements of writings which Marx never revised for publication. The reading of Marx presented here by contrast is an original one which derives the production boundary from first principles.

The argument to that effect is presented in value-theoretical terms in chapter 3 and elaborated on in chapter 4, but the chapter which immediately follows this one plays a crucial role in the argument from an empirical perspective. It takes as the object of its investigation a body of real-world practice where (as is the case with the value-form approach) no production boundary is formally posited that is distinct from whatever boundary may be drawn around the actually existing market for goods and services under capitalism. Its finding is that a production boundary having to do with objectivity and materiality, such as is to be found in mainstream classical value theory, necessarily arises even in those circumstances. The fact that that body of real-world practice is tax jurisprudence is almost a coincidence – certainly no argument is advanced to the effect that domestic tax jurisprudence offers a *direct* insight into the meaning of 'value creation' in international corporate tax reform (as with the deployment of marginalist value theory, that would be to beg the question). What is does offer an insight into, however, is the behaviour of value theory (and the emergent quality of

the production boundary) when held up against the real world of business activity.

It should be acknowledged that the use of production boundaries is open to the immediately and intuitively attractive criticism that it positions those outside it as ‘parasites’ living off the labour of the ‘productive’ members of society,[45] which may seem unobjectionable in the case of bureaucrats and bankers, but feels less appropriate in the case of, say, schoolteachers and unwaged domestic carers. That being the case it is important to point out (and experience indicates that this will need to be periodically reiterated throughout the thesis) that the boundary is a dryly analytic one deriving from technical answers to technical questions about how surplus arises in capitalism. People inside the boundary are not the ‘productive’ members of society, and those outside it are not ‘parasites’. Value is (despite its name) not in any sense something *good*, and being directly implicated in the production of it does not make a person better or more important (or more exploited) than someone who is not so implicated.

Indeed, value is what keeps us under a mode of production tending very rapidly towards ecocide. It urgently needs to be abolished, which means that the greater the proportion of people outside the production boundary the better. To some it seems politically expedient to squeeze as many people as possible *within* the boundary, so as to encourage them to view themselves as exploited by capital. This is an error. We need to take a clear-eyed analytical view of where the production boundary is in order to seek to contract it to a vanishing point. Given the major role of the state in the world of labour outside the production boundary, the interaction between tax systems and capitalist surplus is clearly going to have practical importance in any such dynamic. This is why the introduction of ‘value creation’ into discourse around corporate tax reform is such an important opportunity to talk about things that matter, even though the concept is considered (at least by those who believe themselves to understand it best) to be largely meaningless.

[45] The subtitle of Helen Boss’s book is ‘Parasites and producers in economic thought’.

PART I: VALUE

Chapter 2: The emergent production boundary in the jurisprudence of trading profits

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2.1 Introduction

In the previous chapter a distinction was drawn between 'theories of surplus and transfer', and theories such as marginalism and the value-form Marxian approach in which, by contrast, no production boundary is formally posited that is distinct from whatever boundary may be drawn around the actually existing market for goods and services under capitalism. This is not to say that there is no surplus or transfer in the latter category of theory; those theories simply hold that surplus arises throughout the market sphere, and so while no payment for goods or services is a transfer, transfers can take place into (or in) other spheres; for example a cash gift between family members.

That is why a 'theory of surplus and transfer' is here characterised not simply as a theory that has a production boundary, but as a theory with a production boundary which is distinct from whatever boundary may be drawn around the actually existing market for goods and services under capitalism. There is in effect a production boundary in other theories; it is just that it is the same boundary as bounds the entire market sphere. The difference with a theory of surplus and transfer is generally that the production boundary has to do with the objectivity and materiality of the value being produced, independently of its realisation in market transactions.

This chapter investigates how production boundaries can be drawn in practice by drawing an analogy with the jurisprudence around the UK charge to tax on trading profits. In doing so, this chapter demonstrates that, even if it is no part of a value theory to posit a production boundary that is distinct from whatever boundary may be drawn around the actually existing market for goods and services under capitalism, a phantom classical production boundary seems nonetheless to emerge whereby, if one is to be objective about whether or not value is being created, one must rely analytically on the materiality of production outputs. It follows that it is necessary to grapple with the materiality of value, which is what the rest of Part I of this thesis proceeds to do.

2.2 The basis for the analogy between tax jurisprudence and value theory

If you were to tell a UK tax lawyer that you intend to engage in 'economic activity' with a view to 'creating value', and then ask which UK tax is specifically charged on the value that you create with your economic activity, the answer would be that (broadly speaking) the value you create would be charged to tax as trading profits. This charge would arise either as a component of your income tax liability or (if the value is created through a corporate vehicle) as a component of your company's corporation tax liability. And to that extent the charge to tax on trading profits is a tax on 'value creation'. Which means that, to some general extent at least, UK legal doctrine regarding what sums of money constitute taxable trading profits is analogous to a theory of value.

This should not be a novel or controversial view provided that we continue to speak in broad terms. As John Richard Edwards wrote in the *British Tax Review* in 1976, '[i]t is generally agreed that profit is representative of some kind of increase in value'.[1] But as soon as we consider the precise scope of the charge to tax on trading profits we find that there are difficult questions. What about (it might be queried) value that is realised in the form of one-off gains rather than ongoing trading income? What about value that arises from placing funds directly at risk (rather than through investment in production) such as gambling winnings? What about value that is received as a gift, in circumstances where soliciting gifts is undertaken in the manner of an economic activity?

These are questions which judges deciding tax cases have answered over the years in relation to specific sets of facts, not because there necessarily exist theoretically consistent answers to be arrived at in principle, but because the parties before the court (the tax authority and the

[1] J. R. Edwards, 'Tax treatment of capital expenditure and the measurement of accounting profit', *British Tax Review*, vol, 5, 1976.

taxpayer) need to know whether, on those particular facts, the tax in question is payable or not. And so what has evolved is the *sui generis* concept of taxable trading profits in UK tax law. That *sui generis* concept of taxable trading profits in UK tax law is notoriously indeterminate. Writing in the *Law Quarterly Review* about a tricky Privy Council case,[2] Roger Kerridge expressed the problem as follows:

> The underlying problem in this sort of case is that there *is* no absolute dividing line between what amounts to trading and what does not amount to trading [...] It is much like the allied problem as to what is capital and what is income; Sir Wilfrid Greene MR said in *IRC v British Salmson Aero Engines* (1938) 22 TC 29 at p. 43 of the capital/income distinction that 'in many cases it is almost true to say that the spin of a coin would decide the matter almost as satisfactorily as an attempt to find reasons'.[3]

One thing we can say with certainty about the boundary around the concept of taxable trading profits, however, is that no production boundary is formally posited that is distinct from the scope of the charge. In other words, to the extent that the doctrine of taxable trading profits in UK tax law is analogous to a theory of value, it is *not* a theory of surplus and transfer.

To make as clear as possible what is being said here it may be helpful to explain what the charge to tax on trading profits might look like if it *did* operate a production boundary. Such a tax might have an 'economic rent' relief, allowing deductions from taxable profits to the extent that the taxpayer could demonstrate that the surplus represented by its profits was not produced by its own production processes, but transferred in from surplus-producing activities elsewhere in the economy (for instance by means of the exercise of market power). On the face of it, this feature would be absurd, and of course it is not being advocated here – the point is simply to show what a production boundary might look like if implemented as an element of a tax on profits.

Lacking a feature along the lines of an economic rent relief, the charge to tax on trading profits has no need of a production boundary, in principle. And as both marginalism and value-form Marxism illustrate, if one deals in principle there appears to be no need for one in value theory either. The question considered in this chapter is whether, when confronted by the practical reality of a taxpayer and a tax authority in dispute before them over the binary question of whether some tax is payable or not, judges can actually get by without one. And

2 *Rangatira Ltd v Inland Revenue Commissioner* [1997] STC 47 [PC (NZ)].
3 R. Kerridge, 'Capital and Income', *Law Quarterly Review*, 1997, vol. 113.

the answer that it offers is that they cannot – with the implication that value theory cannot get by without one either, if it is going to speak to the realities of value creation in practice.

In order for a charge to tax on trading profits to arise in UK law, there must exist some act or activity which amounts to a trade (or a 'venture in the nature of trade').[4] As already noted, that ontological question is notoriously vague. Typically, commentators and the courts will follow the approach of a 1955 Royal Commission,[5] and identify a number of 'badges of trade', derived from the relevant case law, which when present assist in determining whether on the facts the activity in question amounts to a trade or venture in the nature of trade.[6] Typically, too, they will bemoan the fact that no amount of analysis of the case law can make the concept more determinate or grounded in principle.[7] This chapter does not seek to challenge that perception that trading is a nebulous concept. What it seeks to do, however, is argue that the nebulously bounded concept of trading is in fact delineated by two distinct boundaries, bounding two overlapping but distinct categories of case, and only *one* of them is nebulous. The other – a principled boundary – is the production boundary of classical political economy.

As explained above the core purpose of this chapter is to illustrate the practical necessity of a production boundary even where no such boundary appears necessary as a matter of principle, but it also aims to make a contribution to the doctrinal analysis of some much-traversed case law. In essence that contribution is to claim that certain cases which are generally considered to be arbitrarily (or even wrongly) decided because the underlying concept is vague and nebulous, are actually *correctly decided in accordance with an identifiable principle*.

2.3 Background concepts

In the well-known case of *Ransom v Higgs*[8] Lord Reid explains that the word 'trade' is 'commonly used to denote operations of a commercial character by which the trader provides to customers for reward some kind of goods or services'. This formulation yields three elements to consider in an analysis of trading. First, there is the element that in political economy would be labelled 'production': the 'goods or services' to which Lord Reid refers.

4 s. 989 Income Tax Act 2007; s. 1119 Corporation Tax Act 2010.
5 *Royal Commission on the taxation of profits and income* (1955) Cmd 9474.
6 See for example N. Lee (ed.), *Revenue Law: Principles and Practice*, 33rd edn, Hayward's Heath: Bloomsbury, 2015, pp. 312-317; G. Loutzenhiser, *Tiley's Revenue Law*, 8th edn, Oxford, Hart Publishing, 2016 pp. 372-383.
7 See for example Marson v Morton [1986] STC 463 at 470.
8 [1974] STC 539.

Second, there is the element that in political economy would be labelled 'exchange': the fact that those goods or services yield what Lord Reid refers to as 'reward' *i.e.* the sums of money paid for the goods and services. And there is a third element which does not obviously correspond to an analytical category in political economy – the extent to which the activity is 'commercial' in 'character'. These three elements of production, exchange and commerciality are not here presented as formal juridical elements, such that each must be independently identified in order for taxable trading income to arise at law; they are presented as a way to identify some of the ideas at play in this chapter.

The hypothesis in this chapter is to do with the first of those elements: production. The hypothesis is that, while activities inside and outside the classical production boundary are both taxable, that boundary is nonetheless analytically necessary, and therefore discernible in the case law. That being the case, it is necessary to divide production in general into two distinct forms of production, which will here be referred to as 'material' and 'immaterial' production, being respectively inside and outside the production boundary. What we are looking for is differences in treatment between these two categories of production.

It should be clarified that these categories of production do *not* correspond to the categories of 'goods' and 'services', since that distinction is a vague and somewhat unsatisfactory one. As we shall see in the two chapters which follow, material and immaterial production may, in contrast to 'goods' and 'services', be distinguished with some degree of clarity. For the time being, however, as a heuristic, the distinction between material and immaterial production may be characterised as being between, on the one hand, goods and capital-intensive services (i.e. 'commodities'), and non-capital-intensive services on the other. It would be an error, however, to infer from this heuristic that the distinction is really to do with categories of output. As discussed in the two chapters which follow, material production is to do with the production and circulation of commodities *as vectors of value* within a system-wide dynamic propelled by labour processes which produce more value than they consume. And as we shall see, the underlying role of labour processes and the context of circulation will be shown to be important in the cases under consideration in this chapter.

Another distinction to be flagged up is the distinction between what is objective and what is subjective. As already noted in Chapter 1, theories of value may be objective or subjective and, broadly speaking, that signals a distinction between (on the one hand) the idea that value is an objective property of what is produced, and (on the other) the idea that value is referable

to the subjective preferences of market actors. A production boundary implies an objective theory, since market exchange takes place on both sides of the boundary and therefore cannot be determinative of whether value has arisen. In this chapter, therefore, we shall be sensitive to where reliance is placed by the courts on subjective matters in the minds of the participants (and to where reliance is placed on other matters which, it is argued, may be treated as proxies for subjectivity in this context). To illustrate, a core argument here to the effect that there exists a production boundary in UK tax law is that, while production on both sides of the boundary is taxable, it is only in the case of immaterial production that reliance is placed on subjectivity. In the case of material production, the test is an objective one. It is to that proposition that we now turn.

2.4 Material production and the ontology of trading transactions

Many discussions of this area of law raise very early on the case of *Graham v Green*,[9] and this chapter is no exception. The case is authority for the proposition that gambling is not a trade, and it contains certain helpful and much cited observations from renowned UK tax judge Rowlatt J. In *Graham v Green* Rowlatt J refers to a case decided by him a couple of years previously, *Ryall v Hoare*,[10] in which he distinguished the proceeds of trade from transfers, as follows:

> A person may have an emolument by reason of a gift *inter vivos* or testamentary, or he may acquire an emolument by finding an article of value or money, or he may acquire it by winning a bet. It seems to me that all that class of cases must be ruled out, because they are not profits or gains at all.

Referring back, in *Graham v Green*, to this observation in *Ryall v Hoare*, he said:

> In the course of my judgment I said that a mere receipt by finding an object of value, or a mere gift, was not a profit or gain, and I hardly feel much doubt about that. I further said that the winning of a bet did not result in a profit or gain. Until I am corrected, I think I was right in that. Whether it is a gift or whether it is a finding, there is nothing of which there is a profit [...] When you come to the question of a bet it seems to me the position is substantially the same. What is a bet? A bet is merely an irrational agreement that one person should pay another person something on the happening of an event. A agrees to pay B something if C's horse runs quicker than

[9] (1925) 9 TC 309 at 312.

[10] (1923) 8 TC 521.

> D's or if a coin comes one side up rather than the other side up. There is no relevance at all between the event and the acquisition of property. The event does not really produce it at all.

Here, then, is a distinction between surplus and transfer. Both the gambler and the trader receive 'property' (i.e., in this context, money), but in the case of the gambler there is no production: the event of the horse winning the race does not 'produce' the gambling winnings, and so the receipt is the same as a gift for these purposes: a mere transfer. *Prima facie* this suggests an objective boundary around what constitutes production. And so, the question arises: where is that boundary located, and is it located there on an objective basis? We can begin to approach an answer to that question, at least insofar as concerns material production, by focusing specifically on the idea of a 'venture in the nature of trade'; *i.e.* an isolated transaction which is nonetheless treated as a trading transaction rather than being a disposal of a capital asset.

Much judicial energy has been expended on the question of when a capital transaction becomes a venture in the nature of trade but seemingly without great clarity having emerged. As one senior judge once said: 'as far as I can see there is only one point which as a matter of law is clear, namely that a single one-off transaction can be an adventure in the nature of a trade. Beyond that I have found it impossible to find any single statement of law which is applicable to all the cases and circumstances'.[11]

Again and again, what saves the court from embarrassment in these circumstances is the doctrine to the effect that the question is a question of fact rather than a question of law.[12] Procedurally, what this doctrine means is that the finding cannot be appealed beyond the first instance tribunal of fact unless it could not reasonably be made on the evidence, or there was no evidence upon which it could reasonably be made. Substantively what the doctrine means is that *precisely the same facts* could be determined to (a) give rise to a trade or venture in the nature of trade, or (b) *not* give rise to a trade or venture in the nature of trade, and neither conclusion would be wrong in law provided it is one of those cases where, on the evidence, it could go either way. What we may be able to do notwithstanding this epistemological indeterminacy, however, is identify a category of cases which on their facts appear *always* to go one way or, where they are found to go the other way, they are overturned because an

[11] *Marson v Morton* [1986] STC 463 *per* Sir Nicolas Browne-Wilkinson V-C at 470.

[12] The usual authority given for this proposition is *Edwards (H M Inspector of Taxes) v Bairstow & Harrison* (1955) 36 TC 207 because it served to clarify the position UK-wide following some unhelpfully-worded Scottish decisions of the early twentieth century, but the principle appears to be as old as the tax.

appellate court holds that the finding could not reasonably be made on the evidence, or there was no evidence upon which it could reasonably be made. One such category (and this is a crucial step in the argument in this chapter) is cases where isolated transactions fall within the category of material production. These are *always* determined to be ventures 'in the nature of trade'.

Indeed, several of the most famous cases on whether or not the UK charge to tax on trading profits applies, which are resorted to again and again as authorities in this area generally, are cases within that precise category. In *Martin v Lowry*,[13] for example, a person with no connection to the linen trade bought some 44 million yards of surplus aeroplane linen from the UK government as a one-off isolated transaction, and then proceeded to sell it piecemeal into the wholesale linen market. It was found as a fact to be a trade and the taxpayer's appeal failed with unanimity among the judges who heard it all the way up to the House of Lords. It was one of the cases where Rowlatt J in the High Court did not need to hear from counsel for the tax authority in order to find in its favour.

Rutledge v The Commissioners of Inland Revenue[14] was a similar case involving a giant consignment of toilet paper. In that case the consignment was disposed of in one go rather than piecemeal and was nonetheless found to be a venture in the nature of trade, that finding being unanimously supported on appeal. In *Cape Brandy Syndicate*[15] the isolated transaction was over a large quantity of South African brandy which was blended with French brandy, recasked, and sold on. One might add to these examples *T Beynon And Co, Limited v Ogg (Surveyor of Taxes)*[16], in which the transaction was over wagons which the taxpayer was in the habit of acquiring as agent for its clients but which in one isolated instance it took an order of in its own name and then sold them on for a profit, and *F A Lindsay, A E Woodward and W Hiscox v The Commissioners of Inland Revenue*,[17] in which the asset was a large quantity of whisky. In *Lindsay*, which reached the Scottish Court of Session, there were two other issues, and the Lord President of the court, Lord Clyde said of the question whether the transaction was a venture in the nature of trade '[i]f that were the only question in the present case, I should not waste a moment on it'.[18]

As explained, these cases where the output is a commodity in circulation (of the kind

[13] (1927) 11 TC 297.
[14] (1929) 14 TC 490.
[15] (1921) 12 TC 358, at 363-4.
[16] (1918) 7 TC 125.
[17] (1933) 18 TC 43.
[18] at 54.

recognised as a vector of value by Adam Smith, David Ricardo and Karl Marx alike) *always* go this way, and yet in textbooks and in tax law lectures they are bundled in with cases on transactions over non-commodity assets such as land, and together broadly framed as illustrations of what an indeterminate area this is. To be fair, one of the aforementioned ‘badges of trade’ is characterised as ‘the subject matter of the transaction’, and transactions over income-generating assets are (rightly) said to be less likely to be treated as ventures in the nature of trade,[19] but discussion of this particular badge of trade never goes so far as to consider the possibility that where commodities in circulation are concerned, the conclusion that these transactions are trading transactions is a matter of law, rather than a question of fact that could go either way.

That conclusion is certainly consistent with what happens in material production cases, on appeal, where the first instance finding is that the transaction is not a venture in the nature of trade. In *Commissioners of Inland Revenue v Fraser*,[20] for example, the isolated transaction was another quantity of whisky. The first instance tribunal ‘on consideration of the facts and arguments submitted to them, decided by a majority [...] That an adventure in the nature of a trade had not been carried on; that merely an investment had been made and subsequently realised, and that the profit was not assessable to Income Tax.’ This finding was overturned on appeal. The Lord President of the Court of Session, Lord Normand, said:[21]

> I can scarcely consider [the transaction] to be other than [...] in the nature of a trade; and I can find no single fact among those stated by the Commissioners [i.e. the first instance tribunal in this case] which in any way traverses that view. In my opinion the fact that the transaction was not in the way of the business (whatever it was) of the Respondent in no way alters the character which almost necessarily belongs to a transaction like this.

On the thread of that ‘almost’ hangs any doubt that may be entertained that turning over a commodity or commodities for profit, even as a one-off transaction, is (in contrast to the general principle) a trading transaction as a matter of law. What is particularly interesting about this when viewed as being about material production, however, is the irrelevance to the determination of the fact that the transaction is a one-off *from the individual perspective of the person making the sale*. The point here is not primarily to treat the distinction between

[19] Loutzenhiser, 2016, pp. 378-80.
[20] (1942) 24 TC 498.
[21] at 503.

questions of fact and questions of law as a proxy for the distinction between subjectivity and objectivity (although to do so points us in the direction of the conclusion). The point is more to show how, in this kind of case, the subjectivity of the individual trader falls away altogether in favour of an analysis which is referable to the objectively discernible sphere of the production and circulation of commodities. This point may be made much more precisely by reference to certain case law on the distinction between revenue and capital, to which we now turn.

2.5 Material production, circulating capital and the labour process

The UK charge to tax on trading profits distinguishes between 'revenue' (*i.e.* income, although both receipts and expenditures can be of a 'revenue' nature) and capital. Statute provides that capital expenditure and capital receipts do not form part of trading profits[22] but the exclusion is in any event implicit in the very notion of the charge to tax on trading profits as a category of 'income' tax (in the case of receipts the express exclusion of capital transactions was a mere drafting innovation of no substantive import). The distinction between revenue and capital is often characterised by reference to an analogy with an apple tree; the apple is revenue and the tree is capital. If your output is apples and you buy or sell a tree, the tree transactions do not go into the computation of your apple profits.

What this distinction means is that, in cases where it is in dispute as between the Revenue and the taxpayer whether a receipt or expense is on revenue account or capital account, the courts are accustomed to performing what is in effect an objective analysis of a taxpayer's business, in order to determine whether the receipt or expense pertains to what one judge has referred to as the 'income earning machine or structure',[23] or to the process of operating it for profit.

Readers more familiar with political economy than tax law may be surprised to learn that the UK courts expressly deploy the classical concepts of 'fixed' and 'circulating' capital in connection with this distinction; fixed capital (i.e. the income earning machine or structure) being on capital account and circulating capital (e.g. raw materials and trading stock) on revenue account. In some instances what is deployed is a degraded version, adopted into UK tax law via UK company law, which treats the two categories as distinct funds of money, and therefore treats the distinction as being a question of which fund a receipt or expenditure goes into or out of (see the discussion in *Pattison (Inspector of Taxes) v Marine Midland Ltd*[24] at

[22] ss.33 & 96 Income Tax (Trading and Other Income) Act 2005; ss.53 & 93 Corporation Tax Act 2009.
[23] *Commissioner of Taxes v Nchanga Consolidated Copper Mines Ltd* [1964] 1 All ER 208 at 212.
[24] [1981] STC 540.

553 *et seq.*); in other instances the version of the concepts deployed is expressly the one originally defined by Adam Smith as being to do with the material components of the production process:

> Adam Smith described fixed capital as what the owner turns to profit by keeping it in his own possession, circulating capital as what he makes profit of by parting with it and letting it change masters. The latter capital circulates in this sense.[25]

The discrepancy between these two conceptions is of no consequence for the purposes of the jurisprudence because, as Lord Radcliffe explained in *Commissioner of Taxes v Nchanga Consolidated Copper Mines*,[26] all the various formulations of the distinction between revenue and capital that emerge from the cases are 'essentially descriptive rather than definitive', and inevitably one will be more helpful than another in the circumstances of a particular case (see for example Lord Macmillan's lack of enthusiasm for the entire framing of the question in terms of fixed and circulating capital in *Van Den Berghs Limited v Clark [H M Inspector of Taxes]*[27]). As regards operating the distinction in practice, Romer LJ offered the following discussion in *Golden Horse Shoe (New), Ltd v Thurgood (H M Inspector of Taxes)*[28]:

> The determining factor must be the nature of the trade in which the asset is employed. The land upon which a manufacturer carries on his business is part of his fixed capital. The land with which a dealer in real estate carries on his business is part of his circulating capital. The machinery with which a manufacturer makes the articles that he sells is part of his fixed capital. The machinery that a dealer in machinery buys and sells is part of his circulating capital, as is the coal that a coal merchant buys and sells in the course of his trade. So, too, is the coal that a manufacturer of gas buys and from which he extracts his gas.

In the case at hand, however, he was required to apply the distinction with a degree of sophistication not evinced by these examples, since it involved the conundrum of how mining is to be analysed for these purposes. As Lord Radcliffe explained in the *Nchanga Consolidated Copper Mines* case, the 'special circumstances of the extraction industries' have the consequence that they 'regularly convert part of their fixed capital for which they have paid into part of their stock in trade which they sell'.[29] In other words they buy land on

[25] *John Smith and Son v Moore (HM Inspector of Taxes)* (1921) 12 TC 266 at 282 *per* Lord Haldane.
[26] See footnote 23.
[27] (1935) 19 TC 390 at 432.
[28] (1933) 18 TC 280 at 300.
[29] at 212.

capital account and sell what they extract from it on revenue account. This means that miners do not generally get a deduction for land, as they would from an input in the form of a commodity in circulation, even though they sell what they extract from it as a commodity which they put into circulation. The *Golden Horse Shoe* case concerned a fact pattern which placed this rule under some strain, but which yielded an outcome that is highly instructive for present purposes:

New Golden Horse Shoe Ltd was formed to take possession of certain retained rights over some land; rights which enabled the company to process gold mine tailings deposited on that land in order to extract additional gold missed by the primary extraction process. The UK tax authority, accustomed to denying mining companies deductions in relation to their real property acquisitions on the aforementioned basis that real property (albeit that it might include mining rights) is fixed capital for miners, denied the company its deduction, and the company appealed. The matter reached the Court of Appeal, which held that (in contrast to the naturally occurring deposits in which gold may be found) the tailings were circulating capital, and so the company won their deduction.

The court's reasoning (with reference in particular the judgment of Lord Hanworth MR at 299) was that the tailings were in the nature of 'raw material already won and gotten' (*i.e. already* circulating capital) and therefore the process was *not* akin to the special case of mining which involves '*converting* the stuff worked into a marketable commodity'. Crucially, from the perspective of the argument here, this 'winning and getting' that was performed by the previous miner was a process that took place as a matter of *objective* analysis, even though (and this is what lies at the heart of the case for us) from the subjective perspective of the previous miner the tailings were a waste product. The underlying labour process rather than the subjectivity of the person selling it was what marked stuff which would otherwise be fixed capital as a 'marketable commodity' in the hands of the person to whom it was sold: *it had been physically placed into circulation as such by workers*.

2.6 The missing ontology of immaterial production

It will be recalled that in *Graham v Green* the proceeds of winning a bet were treated as a mere transfer – equivalent to a gift – because the horse winning the race did not 'produce' the reward, and we have seen that in the case of material production the question whether that element of production is present appears to be an objective matter. The juridical ontology of immaterial production can be considered by addressing directly the question of whether a

course of conduct consisting of soliciting and receiving gifts can amount to trading.

As a general rule the mere soliciting of gifts is not trading.[30] And indeed if something is a gift it can take the payment outside the scope of the charge to tax on trading income even where it has the appearance of being a reward for services. In *British Legion, Peterhead Branch Remembrance and Welcome Home Fund v IRC* (1953) 35 TC 509 a charity organised weekly dance parties for three years, and in that case the facts took the taxpayer over the hurdle and into trading, but the case is significant for the sheer height of that hurdle. Notwithstanding over 150 ticketed dance parties, the case was treated as being on the borderline, and the Lord President of the Scottish Court of Session, Lord Cooper, said in his judgment that he himself would have found no trade had it fallen to him to make the first instance finding of fact. In his analysis the charity was 'merely using some of the trappings of trade as a means of procuring subscriptions or donations not properly related to any service [...] or to any commodity' rendered by it. And so, while the pure soliciting of gifts is said to not constitute trading activity, even the provision of dance parties for reward could also fall short of trading, provided that subjectively the participants to the transaction perceive it as a gift.

It is, however, quite possible that, while a reward for a service can be taken *out* of the scope of trading by the subjectivities of the transaction participants, the pure soliciting of gifts can be brought *within* it by the same means. This proposition can be explored by considering the example of 'findom', which is a category of sex work. In *IRC v Aken*[31] a sex worker – specifically a professional dominatrix – was found to be trading by virtue of providing a service in exchange for reward, and (all else being the same) a finding such as the one made in *Aken* would be made in respect of any category of dominatrix services, including findom. Findom, however, is objectively indistinguishable from the receiving of gifts.

Findom operates much like the professional domination of the popular imagination, except that in the case of findom the fetishised act is not corporeal chastisement of the client but the taking of the client's money. Journalist Abi Wilkinson wrote about the subject for the magazine *Huck*, noting that practitioners of findom use social media accounts to solicit clients (who are referred to as 'paypigs'). One practitioner she interviewed

> [...] periodically meets up with one guy for short amounts of time. She meets him at a

[30] *British Olympic Association v Winter (Inspector of Taxes)* [1995] STC (SCD) 85.

[31] [1990] STC 497.

> cashpoint and he withdraws between £100 and £200 to hand to her. She then walks away without saying anything. In emails, she tells him what she bought with his cash. 'Often I'm just lying,' she confides. 'I'll say I've bought shoes or lingerie or something sexy, when actually I've bought stuff for the house or paid an electricity bill.'[32]

As already noted, one must suppose on the basis of the *Aken* case that this activity is taxable as a trade. Further, the domestic expenditures which the practitioner uses the money for would not be deductible,[33] and the social media presences are free, so the 'profit' of that trade resembles a transfer insofar as it is the entire gross receipt.

So what is the element of production, distinguishing the client's payment from a transfer, once the features which might be present in any event in the case of gifts are stripped away? If someone wants to give a person a regular gift of cash, and in order to do so it is necessary for the recipient to accompany the giver to a cash-point each time, this would not ordinarily cause the sequence of gifts to assume the status of a reward for services. It might be said that the visit to the cash-point is given in *exchange* for the money, but the visit to the cash-point is also to *effect* the exchange of money and it is difficult to see how an exchange of money can be given in exchange for itself.

As for the emotional labour consequent upon the cash, which as the Wilkinson article makes clear is more substantial than one might expect, it is nonetheless perfectly normal for gifts to necessitate burdensome emotional labour on the part of the recipient, and yet no-one thinks that issuing gratitude in some form makes gifts taxable. It is very hard therefore to see why the payments are not mere transfers of already existing value in whatever arbitrary amounts the client chooses to pay, rather than reflective in their gross amounts of a creation of surplus on the part of the findom practitioner which the charge to tax (assuming on the basis of *Aken* that it applies) suggests they should be.

What this suggests is that the production element of a trading analysis can be brought into being (like value in certain value-theoretical schema) purely by the subjectivities of the transaction participants. This should not be a controversial claim. Stepping back from Rowlatt J's choice of words in that dictum in *Graham v Green*, it is no part of existing

[32] A. Wilkinson, 'My stint as a financial dominatrix taught me free money isn't all it seems', www.huckmagazine.com, 21 September 2016, https://web.archive.org/web/20160922133647/http://www.huckmagazine.com/perspectives/financial-dominatrix-might-costlier-youd-think/ (accessed 1 September 2020).

[33] *Mallalieu v Drummond (H M Inspector of Taxes)* (1983) 57 TC 330.

learning on this topic that there needs to be an objective act of production in order for trading to exist. The claim made above to the effect that the production element is an objective matter in the context of material production is the controversial one. But proceeding on the basis that *both* claims are true, the picture that emerges is that what constitutes production for the purposes of the production element of the juridical ontology of trading is either (a) objective production within the classical production boundary, or (b) literally anything else (including the receiving of transfers), provided that (as Hamlet might put it) thinking makes it so.

It is in relation to this latter possibility that the element of commerciality becomes particularly significant. The Court of Appeal in *Aken*[34] cited Lord Reid's dictum (which we have already seen) regarding the specifically *commercial* nature of the acts amounting to a trade, over and above the mere fact of constituting the provision of goods or services for reward ('operations of a *commercial* character by which the trader provides to customers for reward some kind of goods or services'). What we are referring to when we speak of 'commerciality' is a set of contextual or extraneous features of the taxpayer's course of conduct which are typical of specifically business transactions – for example advertising so as to attract customers or clients. It resonates with another of the badges of trade; the badge regarding 'the way the sale was carried out'.

The significance for present purposes of the commerciality element is this: if attention is paid to commerciality as an objectively observable characteristic of a transaction or series of transactions, then that obviates the need to consider the subjectivities of transaction participants. It raises a presumption that the reward arising in respect of the production element is not a transfer. In *British Legion, Peterhead Branch* the court made clear that if the reward is found to be a gift from the subjective perspective of the participants then commerciality does not make the activity a taxable trade, but in ordinary cases of trading the opposite finding is not necessary; commerciality is enough. This has great significance for the present argument: what it does is obviate the need to consider the production element altogether. Commerciality and exchange are sufficient. If commerciality is present then production in category (b) above – i.e. 'anything, provided that thinking makes it so' – does not need to be anything at all. Which is why (as in the case of findom) it does not matter that it is in fact, to all intents and purposes, nothing.

[34] at 503; in common with the High Court; see *IRC v Aken* [1988] STC 69, at 74.

This analysis is supported by the fact that insurers pay tax on their profits, in the context of Rowlatt J's observations in *Graham v Green* quoted above. He said that a bet on a horse is not a productive act because the bet is irrational and any winnings are not actually produced by the victory of the horse. By way of comparison, the business of an insurer may be characterised – as it was in the case of *Liverpool And London And Globe Insurance Company v Bennett (Surveyor Of Taxes)*, as follows:

> It embarks its funds in its business simply by having money ready to pay its debts with. We are not here concerned with manufactories or the maintenance of a stock which is to be sold. The business of insurance consists in making promises to pay, by way of indemnity, in futuro and contingent sums in consideration of present payments of money, and the whole business therefore, apart from the wisdom and prudence with which it is conducted, consists in being ready to meet the liabilities if they accrue, and to the extent to which they accrue, out of one class of funds or another.[35]

Just as in the case of the horse winning, there is nothing about the insured contingencies failing to eventuate which in any meaningful sense 'produces' the insurer's profits. We are not, as the case describes material production, 'concerned with manufactories or the maintenance of a stock which is to be sold'. The insurer's business differs from the gambler's activities not because there is production going on in an insurance business which does not take place when a gambler's horse wins, but because in the case of an insurance policy the bet is generally a rational one on the part of the insurer (having been commercially assessed to be so by its staff) and the insurer goes about seeking people with whom to place such bets with the requisite degree of commerciality.[36] The commerciality itself is therefore the be-all and end-all of production in the insurer's case.

As explained at the outset of this analysis, a 'theory of surplus and transfer' is not simply a theory that has a production boundary, but a theory with a production boundary which is distinct from whatever boundary may be drawn around the entire market sphere. What appears to emerge from the trading jurisprudence, as analysed in this chapter, is that anything within *either* boundary is trading, but there is a difference in the way the two boundaries operate. The objective classical production boundary is being operated in respect of material production on the one hand and, on the other, the boundary around the market sphere (and

[35] *Liverpool And London And Globe Insurance Company v Bennett (Surveyor Of Taxes)* (1913) 6 TC 327, *per* Hamilton J at 357.

[36] By the same token while the gambler's winnings are not taxable the bookmaker's profits are: *Partridge v Mallandaine* (1886) 2 TC 179.

this is where the nebulousness of the category as a whole lies), is generally determined by reference to an inquiry into commerciality, (i) as a proxy for subjectivity where it is not expressly inquired into, and (ii) without the need for any inquiry into whether any production is objectively happening at all. That being the case (and this is another major step in the argument in this chapter) the category of immaterial production does not actually exist in this jurisprudence. Material production is the only kind it recognises on an objective level.

Of course, commerciality is also treated as a relevant consideration in instances of material production, and so it could be countered that the distinct boundary around material production argued for here is illusory. One defence of the argument here might be that, while commerciality is treated as a relevant consideration in instances of material production, there exists no case of material production where an absence of commerciality took the taxpayer *out* of the charge to tax on trading profits. In order to positively prove the point however, we would need a case where a taxpayer acted in a way as to objectively constitute material production, but somehow lacked the subjective element that would place the transaction over the resulting commodities in the market sphere. If in such a case the tax charge arose nonetheless, this would bear out the argument in this chapter. And still better would be a contrasting case, similar except for the fact that the production is immaterial in nature, where the tax charge does *not* arise. As it happens these two cases actually exist, and they do indeed have those contrasting outcomes. They are considered in the section which follows.

2.7 Material and immaterial production absent exchange

In *Sharkey v Wernher* the taxpayer was a breeder of horses which made her a producer of commodities in the form of livestock. As a personal hobby she also owned racehorses. On one occasion, having raised them in her trading capacity, she transferred five horses from her stud farm to her racing stables. Not wishing to obtain an unwarranted tax advantage, she effectively disallowed her own deductions in relation to the breeding of the horses by treating her trade as having received, for accounting purposes, an amount equal to their breeding costs. The House of Lords went further: in what may perhaps be the most controversial decision in the whole corpus of UK jurisprudence on the charge to tax on trading profits, it was held that the correct amount to enter into the accounts for tax purposes was not the breeding costs but the market value. In other words the court treated her as having created the value that she would have realised had she sold the horses for what they were worth at the point she appropriated them to her hobby, in effect treating the processes of production to the

point of exchange as having imbued the commodities in question with additional value not ontologically dependent on any actual price realised in exchange. This outcome was described by Lord Radcliffe[37] as ‘better economics’.

The contrasting case of *Mason v Innes* concerned professional author Hammond Innes. It should be acknowledged at the outset that the taxpayer in *Mason v Innes* was paying tax on his profits as a ‘professional’ rather than as a trader, which is technically a separate head of charge, but one in relation to which the same principles should generally apply. The difference between the two cases could just be a difference between the two heads of charge, but that difference should not be an arbitrary one, and the contention here is that the difference lies in the fact that professional production is invariably immaterial production.

Hammond Innes, having written a book (eventually published under the title *The Doomed Oasis*) transferred the copyright to it to his father as a gift. Had this transfer been effected by way of exchange for consideration (e.g. with a publishing house) the proceeds would have entered his professional accounts as a (subject to deductions, of course) taxable receipt. The tax authority sought to apply the logic of *Sharkey v Wernher* and treat the market value of the copyright as a receipt of the taxpayer’s profession but the Court of Appeal declined to do so, holding that the taxable receipt was nil (notwithstanding that Hammond Innes had incurred not insignificant deductible travel costs researching the novel). Lord Denning, one of the most eminent English jurists of the twentieth century, made the following observations:[38]

> Suppose an artist paints a picture of his mother and gives it to her. He does not receive a penny for it. Is he to pay tax on the value of it? It is unthinkable. Suppose he paints a picture which he does not like when he has finished it and destroys it. Is he liable to pay tax on the value of it? Clearly not. These instances – and they could be extended endlessly – show that the proposition in *Sharkey v Wernher* does not apply to professional men. It is confined to the case of traders who keep stock-in-trade and whose accounts are, or should be, kept on an earnings basis, whereas a professional man comes within the general principle that when nothing is received there is nothing to be brought into account.

Thinking forward to the case of *Aken*, Lord Denning could equally have said ‘suppose a sex worker has sex with their lover or spouse; are they liable to pay tax on the value of it?’ Lord

[37] at 307.
[38] at 339.

Denning's example of the painter who destroys a painting they don't like instead of selling it is particularly telling, but (as he says) the examples could be extended endlessly. Consider, by way of further illustration, the example of a professional programmer who works through the night on some free open source software project in addition to his 'day job' working as a freelancer on some finance sector institution's payroll administration overhaul. That open source night-work creating software for anyone to use free of charge could not realistically be treated as an act of taxable production as Lady Wernher's production of racehorses was.

In an article in the *British Tax Journal* in 2005 Roger Kerridge considered the possible reasons for the difference between the two cases and rejected the possibility that it reflects a difference of treatment between 'goods' and 'services'.[39] His grounds for doing so were that the distinction between the two is a vague one. He gives the example of a painter painting a painting to order, which would be (in Kerridge's view) a service, and a painter painting a painting and then selling it, which would make it (in Kerridge's view) 'goods'. And it is indeed hard to see why a difference so flimsy should be treated as determinative of anything. But, as we shall see in the chapters which follow, the production boundary of classical political economy is much more determinate than that, and (notwithstanding the materiality of the painting) in neither case should the painter be treated as engaged in material production.[40]

Until *Sharkey v Wernher* was placed on a statutory footing in 2008, it was widely thought amongst UK tax industry professionals that the decision was simply wrong and that all it would take to get the position for traders aligned with the position for professionals was a brave enough taxpayer with the resources to appeal the point all the way to the House of Lords (now the Supreme Court). This chapter agrees with Lord Radcliffe that in fact *Sharkey and Wernher*, even in hindsight with the contrasting subsequent case of *Mason v Innes* in view, was actually good economics, provided your economics is of the classical kind. Indeed, the same is true of the 'venture in the nature of trade' cases addressed above; to view them through the lens of classical political economy is to see the distinctions that they draw (so often derided as arbitrary) come into focus, and start to make sense.

2.8 Conclusion

To conclude: viewed through the lens of classical value theory, the charge to tax on trading profits may be understood as a tax on two distinct things. Those two things are (1) value

[39] R. Kerridge, 'The rule in Sharkey v Wernher – time for a reappraisal', *British Tax Review*, vol, 3, 2005.

[40] This specific issue is addressed in section 4.5 below.

created through material production, and (2) value created elsewhere in the economy but transferred into the hands of the taxpayer pursuant to means which fall to be treated, by reference to their commerciality, as within the market sphere (in both cases the tax arising in respect of the net rather than the gross because of deductible expenses). It is the boundary around the second category that suffers from the defect of irredeemable indeterminacy that bedevils this area of law; the first category is an objective one which is well known to the science of political economy.

There is, it is suggested, nothing particularly outlandish about viewing the tax in this way provided it is possible to persuade oneself that Hammond Innes created no 'value' in writing his books, however much joy they brought his readers, and however much revenue they generated for him and his publishers. What then is this stuff 'value', that it can be said to behave in this way? What is this fungible money-equivalent stuff which is created in material production and moves through the economy, but which (with today's digitalised economy in view, counter-intuitively) is not necessarily generated even where there is both utility and profitability in what a business is doing? It is to that question that we turn in the chapter which follows.

Chapter 3: The ontology of value

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3.1 Introduction

The theory of value set out in this chapter is a Marxian one. In order to set out the theory uninterrupted by a series of complex digressions, the theory is set out in this chapter in terms of how it applies to physical commodities – ‘goods’ – notwithstanding that there are other forms of output that are within the production boundary of Marxian value theory as elaborated here. The application of that theory to the real world, including such disparate phenomena as unpaid domestic labour, passenger transport, social media monopolists, sex work, and state bureaucracy, is addressed in the chapter which follows. In other words, in this chapter we will *presuppose* a simplifying production boundary in order to elaborate upon a theoretical system, and in the chapter which follows we will explore how a real-world production boundary is in fact *determined* by that system.

There is of course extensive and ongoing debate regarding value within the Marxian tradition, both in terms of tracing Marx’s developing and sometimes seemingly inconsistent position at various junctures in his writings, and in terms of how his theories may need to be adapted to reflect the evolution of capitalism after his time. In order to navigate a clear path through the debates arising in the chapter which follows, this chapter addresses an apparent contradiction in Marx’s theory of value, which has unfolded into a schism in how that theory is understood by Marxists scholars, and to that extent this chapter seeks to constitute an original contribution to Marxist scholarship. Its approach is to foreground the concept of ‘**reorderedness**’, which is adverted to by Marx in a footnote in *Capital*,[1] but which can be usefully expanded to (a) show how the material component of the twofold social and material Marxian ontology of value functions, and (b) assist in bridging the gap between seemingly

[1] See footnote 46 below.

conflicting interpretations of his theory of value.

3.2 The conundrum of surplus

A simple theory of value[2] might equate quantities of value with sums of money, in the sense that things are 'worth' what we pay for them. This theory when applied to business profits creates a paradox, however. A business creates its outputs by means of its inputs, and it pays for its inputs. If things are worth what we pay for them, then the price of its outputs should be the sum total of the price of its inputs. And yet, somehow, its outputs are (in general, supposing businesses to be generally profitable) worth more. It might be thought that the additional value comes from the work done to the inputs by the business in order to turn them into outputs, but that work is paid for in the form of wages just like any other input, and so is already accounted for. So where is the additional value coming from? Value theory in the classical tradition of political economy is best understood as an evolving approach to answering this conundrum.

The approach in the classical tradition is based on the labour theory of value. The theory is today most often associated with Karl Marx, but it was in broad terms shared by the political economists of the classical era whatever their politics and it informs the thinking of many heterodox economists to this day. Expressed in broad terms, the labour theory of value is a truism as regards commodities: there exists either (a) the natural world as we encounter it, and (b) commodities, which are the output of accumulations of past and present human labour. The natural world as we encounter it costs (subject to the rights of rentiers to restrict use of it) nothing, and so the value in the economy must come from the labour element. The idea that labour in general creates value may be traced, in the English-speaking world at least, as far back as Hobbes,[3] and its development may be charted through the writings of William Petty, Adam Smith (at which point the theory was still unformalised[4]) and David Ricardo.

In and of itself the labour theory of value does not solve the conundrum of surplus, but it provides a framework within which it may be addressed. The deployment of that framework to this end may be traced back to eighteenth century French political economists of the physiocratic school who held that a surplus of agricultural produce is produced by agricultural workers (insofar as more food is produced than they consume), and that surplus

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2 In essence a mercantilist one: see L. G. Magnusson, 'Mercantilism', in W. J. Samuels, J.E. Biddle and J. B. Davis (eds.), *A Companion to the History of Economic Thought*, Oxford, Blackwell, 2003, p. 46.

3 P. C. Dooley, *The Labour Theory of Value*, London, Routledge, 2005, p. 112.

4 Dobb, 1973, p. 66.

circulates around the rest of the economy, which is unproductive.[5] They therefore conceived of value in terms of actual physical goods. To do so is called 'physicalism' and it is a value-theoretical tradition which continues to this day. At the core of a physicalist account of surplus is the idea that workers produce more goods than they consume, and while this is most obviously the case with agricultural goods, since everybody eats what only agricultural workers produce, it applies to all sectors engaged in the production of goods; the workers in those sectors *produce* all the goods, but do not *consume* all the goods. Surplus in physicalism may be conceived of as the shortfall between what workers in those sectors consume as compared to what they produce.

Formalising a physicalist system is difficult because different goods require different ratios of capital and labour, and this makes the mathematics of modelling how much labour there is in any given good very far from trivial. David Ricardo's work in this area, to which Marx's is in large part is a response, sought nonetheless to formalise a physicalist account of surplus, and his approach was to posit a material external standard – some 'object in nature'[6] – having an absolute value, against which movements of relative value could be measured.[7] His oeuvre begins (echoing the physiocrats' conflation of value with agricultural produce) with corn as a measure of value, and he later posited a kind of imaginary gold produced with a ratio of labour to capital inputs always equal to the average such ratio across the economy.[8]

This approach did not yield the answer, however, and it was not until the twentieth century that the maths was solved by Piero Sraffa and his followers. They demonstrate (subject to some vastly simplifying assumptions, of course) that capitalist profits can only be positive in circumstances where there is a physical surplus of goods after wages have been paid.[9] The theory of value found in Marx is *not* a physicalist one, however. Conversely, physicalism is no longer strictly speaking a *labour* theory of value: the mathematics of the Sraffian approach does not treat any specific input as the source of surplus value. And indeed physicalism is arguably no longer even a theory of *value*: like mainstream marginalism today it treats value as synonymous with price, whereas the labour theory of value – at least in the form elaborated by Marx – theorises value under capitalism as something with its own independent

[5] Mirowski, 1989, pp. 154-163.
[6] D. Ricardo, 'Absolute Value and Exchangeable Value', in P. Sraffa (ed.), *The Works and Correspondence of David Ricardo*, Vol. IV, Cambridge, Cambridge University Press, 1962, p. 399, cited by Mirowski at pp. 173-4.
[7] Mirowski, 1989, p.174.
[8] Dobb, 1973, p.83.
[9] Hahnel, 2017, p. 29.

ontology: value is the *substance* which is created when value is created. It is that ontology which will be explored in this chapter.

One of Marx's key innovations was to identify that substance not with some external 'object in nature', real or imaginary, deployed as an invariable yardstick by which to measure output from labour, but with labour itself. Or, rather, (as adumbrated below) with an abstraction from labour as mediated by the mechanism of exchange under the particular historical mode of production that is capitalism. But, in the broadest possible terms, the Marxian solution to the surplus conundrum is along the lines of the physicalist one: the reason that a business's outputs exceed the sum of its inputs is because the value of a worker's wage (in the form of labour embodied in the commodities a worker consumes) is less than the value of the work performed by the worker (in the form of labour embodied in the commodities the worker produces). It is to the meaning of 'value' in that formulation that we now turn.

3.3 Abstract labour

In his book *More Heat than Light* historian of economics Philip Mirowski characterises the story of classical value theory up to and including Marx as a search for a labour-derived value 'substance', existing independently of money and conserved in exchange. It has to be conserved in exchange because it is only on the premise that value is conserved in exchange that the conundrum of surplus arises. In this understanding of value, value is labour *physically embodied in commodities*, as if it were a substance generated by labour, imparted to commodities, and quantitatively conserved as it circulates around the economy. This model is sometimes mocked as the 'phlogiston' theory of value.[10] Less mockingly, but in the same vein, Mirowski compares it to certain analogous understandings of energic phenomena that prevailed in the physics of the early nineteenth century; *i.e.* as a putative substance whose creation, conservation, or consumption is treated as explanatory of various material phenomena.

This substance model of value is contrasted by Mirowski with the subsequent marginalist theory. It will be recalled that in marginalism value is synonymous price and prices are understood as coming into being at the intersection of market participants' marginal preference curves. Mirowski argues that the shift from the former to the latter is akin to the developing theoretical models used by physicists, where ideas about energy enter the

[10] H. Cleaver, *Reading Capital Politically*, Leeds, Anti/Theses, 2000, p. 118. Phlogiston was a substance incorrectly inferred by eighteenth-century chemists as existing in all combustible matter, and which was released in combustion.

nineteenth century framed as a kind of fluid that passes from object to object as exchanges of energy occur, and leave the nineteenth century framed by reference to the metaphor of the 'field', where there is no such fluid, just a formal solution to an equation at every point in time and space. An understanding of value along these lines may be thought of as a 'social' as opposed to a 'substance' model of value. According to Mirowski, Marx's version of the labour theory of value is a self-contradictory conflation of these two conflicting models.[11]

Mirowski is correct insofar as both models are indeed present in Marx's value-theoretical scheme, and he is also correct insofar as the coexistence of the two models exposes a contradiction in that scheme. That contradiction has led to two distinct (and, to their devotees, mutually inconsistent) strands in the way in which Marx's theory is understood, and (so it is here argued) it is not possible to fully grasp the theory without reconciling them. It is with that need to reconcile the substance model and the social model in mind that we commence our exploration of Marx's theory of value, the core concept in which is 'abstract labour'.

Superficially, the concept of abstract labour responds to a basic 'gotcha' which may be advanced against the labour theory of value. That gotcha is to do with the vast variety of *concrete* labour i.e. all the specific instances of labour that actually take place. Concrete labour is capable of infinite variation, in terms of the acts which each individual labour process requires to be performed, and in terms of the levels of skill, experience and effort deployed by each worker at each moment in time. It would be a nonsense to suggest (as a simple labour theory of value might) that an hour of labour creates some determinate amount of value, because then something that took longer to make because the worker was incompetent or lazy would have *more* value than precisely the same commodity made with skill and application.

Abstract labour responds to this 'gotcha' by positing a kind of average labour, an hour of which is equal to a unit of value. But it goes further than that; it is a hugely powerful concept, the force of which is not immediately apparent. The point about abstract labour is not that, when concrete labour is being performed, a *notional* amount of average labour may be *posited* to stand alongside it. The point about abstract labour is that it is a kind of labour that actually exists, as a *social* substance, and it is brought into being by the mechanism of exchange.

[11] Mirowski, 1989, p. 180.

The point is perhaps best understood by reference to fungibility. In a sense, at the maximum level of abstraction, all commodities are fungible since they exchange for money, and with money one can buy other commodities. To effect this fungibility it is necessary to have the correct quantities of each, such as would attract the same amount of money,[12] but in principle and assuming the correct quantities any commodity can (via the medium of money) exchange for any other commodity. Fungibility at this level of abstraction reflects back on the labour that went into making the commodities. The specific prior *concrete* labour embodied in each commodity (which is relevant to that specific commodity's utility or desirability, making it a 'use-value' in Marx's schema[13]) is irrelevant to its *quantifiable* equivalence with other commodities. For the purposes of exchange the labour it embodies is not that specific prior concrete labour but the fraction the commodity represents of the totality of prior social labour. This totality, insofar as it must be treated as divisible into fungible fractions[14] (which treatment reflects the forcible equivalence imposed on commodities by the mechanism of exchange) is what is referred to by Marx as 'abstract' labour.[15] Abstract labour is the 'substance' of value as Marx conceives of it,[16] meaning that the value of a commodity is the quantity of abstract labour embodied in it.

As the foregoing paragraph no doubt illustrates, the concept of abstract labour is awkward to explain in writing, but it is extremely easy to explain in a diagram. In the diagram below the red and green boxes represent two different commodities. A, B and C represent the concrete labour that goes into making green boxes, and X and Y represent the (completely different) concrete labour that goes into making red boxes. If two red boxes can be purchased for the price of a single green box, then it is necessarily the case that, from the perspective of exchange, $A + B + C = 2X + 2Y$. Since A, B, C, X and Y are all qualitatively different as concrete labour, and $A + B + C = 2X + 2Y$ is both a quantitative proposition and a true proposition, there must (so proceeds Marx's reasoning) be a quantifiable and fungible counterpart to concrete labour in respect of which the proposition is capable of being *quantitatively* true. That fungible and quantifiable counterpart to concrete labour is abstract labour.

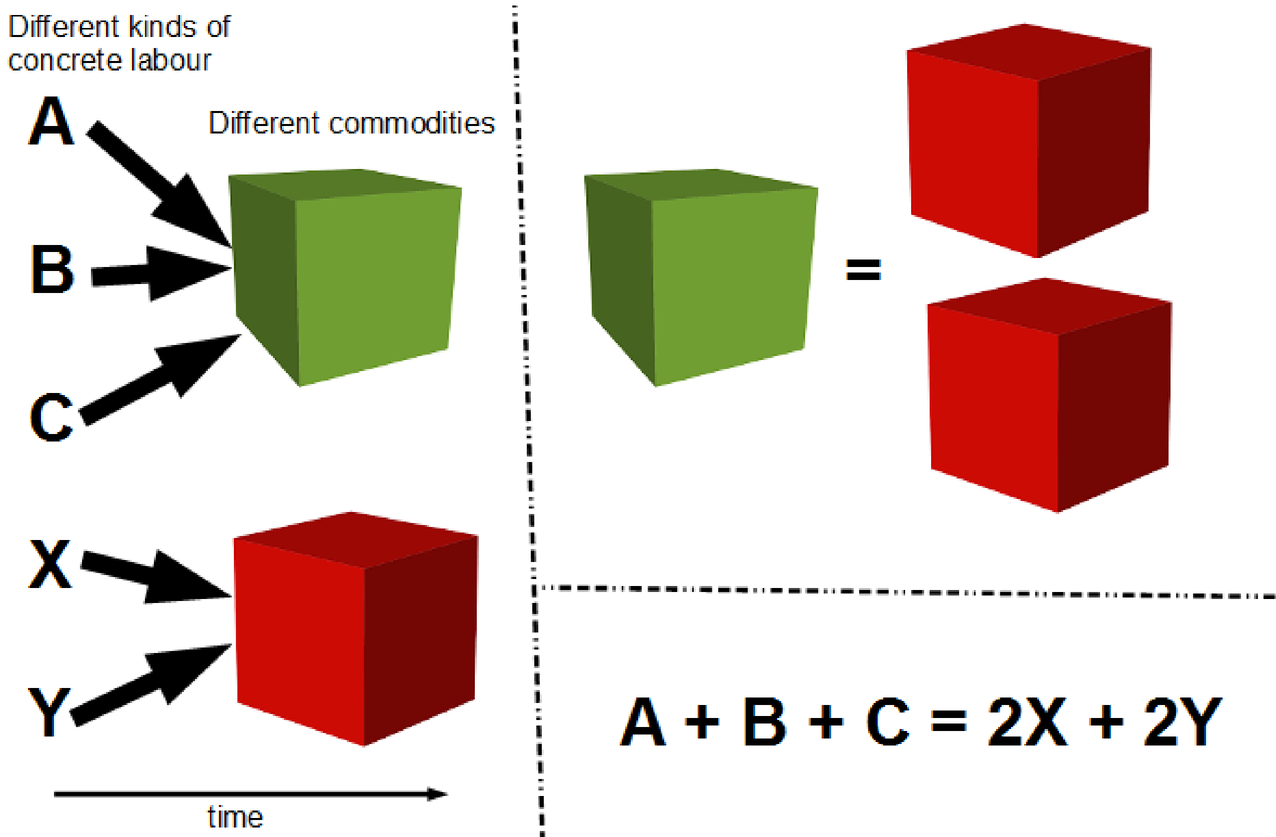
[12] It is axiomatic in Marx's exposition that commodities participate in exchange in determinate quantities: 'Within the exchange relation, one use-value is worth just as much as another, provided only that it is present in the appropriate quantity'; K. Marx, *Capital: a critique of political economy, volume I*, London, Penguin, 1976, p. 127.

[13] Marx, 1976, p. 126.

[14] Marx typically refers to a fungible fraction of a thing as an 'aliquot part'; see for example 1976, p. 202.

[15] Marx, 1976, p. 128.

[16] Marx, 1976, p. 131.



Marx proposes that abstract labour as it is embodied in commodities is to be measured in units of 'socially necessary labour time', which is 'the labour required to produce any use-value under the conditions of production normal for a given society and with the average degree of skill and intensity of labour prevalent in that society'.[17] A key feature of this metric, which reflects the logic of abstract labour, is that it quantifies value by reference to a notional totality of social labour as at exchange. Whatever the prior *concrete* labour, the act of exchange is what brings into being a notional totality of fungible prior labour, a fraction of which being the labour that would have been necessary to bring the commodity to the point of exchange in the quantity in question. 'The value of a commodity is determined not by the quantity of labour actually objectified in it,' Marx explains, 'but by the quantity of living labour necessary to produce it.'[18] Abstract labour is therefore a social substance;[19]

[17] Marx, 1976, p. 129; it may be noted that, for the purposes of modelling, the unit adopted by Marx for socially necessary labour time is not a unit of time but a unit of currency; it should be recalled that a quantity of socially necessary labour time is, after all, a quantity of value and not a quantity of concrete labour time but the logic of abstract labour places money and labour time in equivalence, and so the choice as between the two kinds of unit is to a degree arbitrary.

[18] Marx, 1976, pp. 676-7.

[19] Marx, 1976, p. 149.

quantifiable, yes, and dependent for its existence on the prior concrete labour that went into the commodity, but brought into being by the exchange relations that exist under capitalism.

Marx viewed the existence of abstract labour as a mere truism. This is perhaps best illustrated in his famous letter to Dr Kugelman of 11 July 1868, in which he writes of the critical response to the recently published first volume of *Capital*:

> The chatter about the need to prove the concept of value arises only from complete ignorance both of the subject under discussion and of the method of science. Every child knows that any nation that stopped working, not for a year, but let us say, just for a few weeks, would perish. And every child knows, too, that the amounts of products corresponding to the differing amounts of needs demand differing and quantitatively determined amounts of society's aggregate labour. It is SELF-EVIDENT that this *necessity* of the *distribution* of social labour in specific proportions is certainly not abolished by the *specific form* of social production; it can only change *its form of manifestation*. Natural laws cannot be abolished at all.[20]

The 'natural law' to which Marx refers here is the natural law which prevents us from going back in time to allocate additional resources to some specific branch of production in order to increase the quantity of the resulting commodity which is available as at social distribution. The point he is making in the passage above is that, while value is a social phenomenon under capitalism, all systems of social labour, and social distributions of the product of labour, are constrained by the indelible fact of past resource allocation as at the point of social distribution. His theory of value, he explains to Dr Kugelman, is not some novel hypothesis that requires to be tested empirically; it is a restatement of a self-evident constraint arising from natural laws, albeit a context-specific statement of it which is applicable to the historical circumstance where the allocation of resources to branches of production and the distribution of their respective outputs is effected by the mechanism of exchange under the capitalist mode of production.

It is therefore central to the Marxian value theoretical schema that, at the point of exchange, the allocation of resources to production is *in the past*, and this prompts us to return to the complaint made by Mirowski; that Marx's theory of value conflates a substance and a social model. Labour produces a value substance, which goes on to be conserved in exchange, but

[20] K. Marx and F. Engels, *Marx and Engels Collected Works* vol. 43, Lawrence & Wishart, 2010, pp. 68-9; the emphasis is reproduced from the source.

the amount that it produces is determined socially at the point of exchange. Marx is absolutely clear that the quantity of value represented by a commodity at the point of exchange is the average amount of labour required to produce it *at that point in time*. This creates the contradiction whereby, with the varying of input values over time, value can appear to be created out of nothing, rather than deriving exclusively from labour. By way of illustration, consider the following scenario, which does not derive from Mirowski but illustrates in concrete terms his abstract complaint:

In the land of Foobar there exist two regions producing commodities in accordance with the capitalist mode, Fooshire and Barshire. They are in close proximity to each other but geologically dissimilar and separated by a deep and dangerous gorge. Because of the difference in their geologies they are suitable for different food crops, foograin and barpulses. A bridge across the gorge enables easy trade between the territories, and so workers in both territories are accustomed to eating a balanced diet of foograin and barpulses. One day the bridge is destroyed by an earthquake and so the labour required to get foograin to Barshire, and barpulses to Fooshire, increases dramatically: an arduous journey down one side of the vertiginous gorge and back up the other is now required. Any Barshire baker with foograin acquired *prior* to the bridge collapse can now make foobread whose value would *include* that additional toil even though, upon acquisition, the value of the foograin only included the work of carrying it across the bridge. In a manner wholly self-contradictory for an analysis where value is said only to be created by human labour, the collapse of a bridge in an earthquake has *created* value.

What is the point of positing a phlogiston-like value substance that is created by labour, and purportedly conserved as it circulates around the economy, if the quantity of the substance in circulation can change by reference to arbitrary and materially unconnected events subsequent to its creation? It is to that question which we now turn.

3.4 Accounts of the relation between production and exchange

This problem (referred to in this chapter as 'the Fooshire-Barshire bridge problem') is not treated in the Marxist literature as a significant one when expressed in those terms, but it crystallises a major difficulty in interpreting and applying Marx's theory of value, which is the relation between production and exchange. Broadly there are two traditions; one which foregrounds production, and one which foregrounds exchange. In the former tradition –

which might be referred to as 'traditional' or 'mainstream' Marxism – the answer is bound up with solutions to the so-called 'transformation problem', and so it is necessary to digress briefly so as to explain what the transformation problem is.

It will be recalled that Ricardo got stuck on the problem of dealing with capital ratios, hence positing a kind of imaginary gold produced with a ratio of labour to capital inputs always equal to the average such ratio across the economy. Capital ratios are a problem for a labour theory of value: if surplus value comes from freshly-deployed labour then profit rates will be higher in less capital-intensive sectors, because more of the expenditure is on the element that creates the value, but this theoretical outcome does not conform to the observable facts. In the Marxian scheme the solution to this problem is that prices adjust in the market so that low-capital-intensity commodities sell at an undervalue and high-capital-intensity commodities sell at an overvalue. The problem comes when modelling an economy where the model includes this transformation from labour values to what is known as 'prices of production'; getting that modelling right is known as the transformation problem.

There are a number of proposed solutions to the transformation problem but the dominant solutions in mainstream Marxism are what is known as 'simultaneous' solutions.[21] In such a solution (and in contrast to the rough workings in Marx's manuscript of Volume III of Capital) inputs and outputs are valued simultaneously. Simultaneity as a solution to the transformation problem was first developed by Russian economist Ladislaus Bortkiewicz and popularised in the English-speaking world by Paul Sweezy.[22] A number of variants exists. The details of how these systems work need not detain us because the transformation problem is not of any concern for the purposes of drawing the production boundary, but the key point for present purposes is that in simultaneous models there is no elapse of time during which an event such as the collapse of the Fooshire-Barshire bridge is allowed to occur. The Fooshire-Barshire bridge problem is simply assumed away. The elapse of time between production and exchange is treated as a value-theoretical irrelevance, and the substance of value can be treated as simultaneously produced in production and realised in exchange. It has been argued that simultaneity is not actually necessary to solve the transformation problem;[23] but once it is adopted as part of the solution, as it has been by the majority of mainstream Marxists, the Fooshire-Barshire bridge problem also disappears, and so the problem

[21] See Hahnel, 2017, chapter 2, Kliman, 2007, and N. Potts and A. Kliman (eds.), *Is Marx's Theory of Profit Right? The simultaneist-temporalist debate*, Lanham, Lexington Books, 2015.
[22] P. M. Sweezy, *The Theory of Capitalist Development*, New York, Monthly Review Press, 1942.
[23] Kliman, 2007.

Mirowski identifies is just assumed not to exist.

It may be noted that simultaneity is also one of the simplifying assumptions in the Sraffian approach,[24] and the Sraffian approach does not suffer from a transformation problem because, as noted above, in that approach no particular input is singled out as the source of value. It is therefore unsurprising that, once the full implications of the Sraffian approach were recognised in mainstream Marxism, there was a crisis of confidence in the entire value-theoretical element of Marxian political economy.[25] As Diane Elson wrote in 1979, 'exploitation in capitalism can perfectly well be understood in terms of the appropriation of surplus product, with no need to bring in value at all'.[26] The simultaneity solution to the Fooshire-Barshire bridge problem is therefore self-defeating – it reduces the substance of value to an idealised matrix of numbers ill-reflecting the messy realities of capitalism, and (if that suffices for your theory of value) there are other idealised matrices of numbers out there that are more suitable for the purpose.

This mainstream view does not necessarily advance itself in terms of a phlogiston-like physical substance of value, produced by labour and conserved in exchange, but it is the behaviour of such a substance that (ignoring the elapse of time between cycles of production and exchange) it seeks to model. An alternative solution to the Fooshire/Barshire bridge problem is to be found in what is often referred to as the 'value-form' tradition, which has already been mentioned in the foregoing chapters. In this tradition what is ignored is not the elapse of time between cycles of production and exchange – on the contrary it fully recognises that elapse of time – but the entirety of what might be termed the 'substantialist' element to the labour theory of value as elaborated by Marx.

Admittedly, there is good reason to ignore that element: on a material level there does not appear to be a phlogiston-like substance imparted to commodities by labour, and indeed Marx himself was more than a little sarcastic about the suggestion that there might be. 'No scientist to date has yet discovered what natural qualities make definite proportions of snuff, tobacco and paintings "equivalents" for one another', he wrote in Part Three of *Theories of Surplus Value*, warning of the error of seeing value as 'something absolute, "a property of things", instead of seeing in it only something relative, the relation of things to social labour,

[24] Kliman, 2007, p.36.
[25] See for example I. Steedman, 1977.
[26] D. Elson, 'The Value Theory of Labour', in D. Elson (ed.), *Value: The Representation of Labour in Capitalism*, London, Verso, 1979, p. 116.

social labour based on private exchange, in which things are defined not as independent entities, but as mere expressions of social production'.[27]

So the substance that Marx describes value as being a quantity of – abstract labour – is expressly characterised by him as a social rather than a material substance, and it is brought into being by the social system of exchange relations under capitalism rather than by production *per se*. And this understanding of value as a social substance constituted in exchange – the perspective prioritised in the value-form school – is crucial if we are to recognise value as something peculiar to capitalism rather than an ahistorical property of human output in general.

Recognition of this aspect of the theory is generally traced back to the reading advanced by Soviet economist Isaak Illich Rubin, whose 1924 work *Essays on Marx's Theories of Value* was republished in 1972,[28] and it came to the fore in the period following, partly because of the aforementioned pressure on the more economistic tradition of mainstream Marxism coming from the Sraffian approach, and partly because of renewed close textual attention being paid to what Marx actually wrote in preference to the accreted norms of mainstream Marxism (hence the label 'Neue Marx-Lektüre' which is attached to certain of the original scholars developing this strand of thinking[29]). It involves foregrounding the fact that Marx analysed the capitalist mode of production as unfolding dialectically from the starting point of the 'value-form' of the commodity (*i.e.* its social manifestation as a bearer of value which may be realised in exchange[30]) hence the label 'value-form theory'.

This approach, if adopted to the exclusion of any other, means relinquishing altogether the idea of value as a *quantifiable* economic substance produced by labour and conserved in exchange; instead this school of thought would have us situate value at the core of our *qualitative* analysis of the capitalist mode of production as a system of oppression centred on the exchange of things for money. Units of abstract labour cease to be a neutral metric of value under the capitalist mode of production and become a measure which capitalism itself imposes on everything it comes into contact with,[31] reversing the conventional relation

27 K. Marx, *Theories of Surplus Value Part III*, Moscow, Progress Publishers, 1971, p. 130.

28 I. I. Rubin, *Essays on Marx's Theories of Value,* Detroit, Black and Red, 1972.

29 R. Bellofiore and T. R. Riva, 'The Neue Marx-Lektüre: Putting the Critique of Political Economy Back into the Critique of Society', *Radical Philosophy*, vol. 189, 2015, 24–36.

30 K. Marx, 'The Value-Form', in S. Mohun (ed.), *Debates in Value Theory*, London, Macmillan, 1994, pp. 9-34.

31 '[T]he system turns on a weird coding of what is valuable, installing human work within the commodity system as the decisive metric of wealth.' J. W. Moore, *Capitalism in the Web of Life*, London, Verso, 2015,

between production and exchange. Rather than value arising from production and being realised in exchange as a conventional reading would suggest, the bringing into being of value at the point of exchange determines the prior conditions of production (and indeed the totality of conditions under capitalism). Research proceeding from this theoretical standpoint might therefore relate to such topics as capitalist management of labour time[32] – a topic to which Marx himself, of course, devoted extensive attention in Volume I of *Capital*.[33]

There is much to be learned from this alternative body of readings, and in particular it would be a gross error not to recognise the absolute centrality in Marxian value theory of abstract labour as a specifically *social* substance, specifically constituted *in exchange*; likewise it would be an error not to recognise the totalising and historically specific nature of value under the capitalist mode of production. On the other hand, accepting this reading to the exclusion of the more conventional approach whereby value arises from production would render Marxian value theory as useless for the purposes of the present project as marginalist value theory. 'Value creation' would simply take place where sales take place. The value-form school knows no production boundary. As Frederick Pitts puts it:

> The labour that exists in the realm of production produces the goods that are later sold as commodities – the future bearers of value, posited as such by the monetary beginnings of the production process. But it is non-productive in the sense that it does not really matter whether or how much of it takes place. All that matters is that something attracts a price at the end of it all.[34]

More generally, the value-form approach in its strictest manifestations simply constitutes too great a departure from Marx's project. It is obvious from a reading of Marx that production is every bit as important as exchange in his value-theoretical schema, and that value arises from the labour performed in production so as to be embodied in commodities, as at exchange, as a *quantifiable* property that they possess. Marx writes of commodities prior to exchange: 'social labour-time exists in these commodities *in a latent state*, so to speak, [emphasis added] and becomes evident only in the course of their exchange'.[35]

To be clear, most scholars working in the field of Marxian value theory eschew extreme

p. 16.

32 Pitts, 2018, pp. 40-49.

33 See in particular chapter 10 of Marx, 1976.

34 Pitts, 2018, p. 233.

35 K. Marx, *A Contribution to the Critique of Political Economy*, New York, International Publishers, 1970, p . 45.

positions as between the substantialist view and the value-form approach; typically some language will be adopted (as here, so far, in this chapter) to indicate that value arises in production but is realised in exchange, or some such formulation, acknowledging that the dynamic in question is a circuit, and that no individual element of the dynamic properly reflects the core of Marx's value theory (or even makes sense) considered in isolation.[36] Debates within this compromise space might be about the degree of emphasis to be placed on certain aspects of production or exchange and the implications of various points of emphasis for the application of the theory.[37] What these kinds of formulations do not assist with, however – and this is the question fundamentally raised by the Fooshire-Barshire bridge problem – is *the persistence of value through time*.

Turning then to that issue of the persistence of value through time, for those who take the value-form approach it is an article of foundational theoretical importance that value (insofar as it consists of quantities of abstract labour) does not come into being until exchange. Accordingly, as we have seen, the substantive content of production is essentially irrelevant provided that sales arise.[38] Taken to its logical extreme this position, when required to recognise the pre-existence of value prior to exchange, locates it in the mind of the capitalist. As Pitts puts it, writing from this perspective, '[t]he expectation of monetary return which guides business activity already gives a tentative, latent form to abstract labour, and lays the foundation for its social validation'.[39] Somewhat in the same vein Ricardo Bellofiore argues that the social (and, more specifically, monetary) nature of abstract labour constituted in exchange is prefigured in prior concrete labour in production by specific reference to the role of finance capital.[40]

By contrast some have argued, from a traditional Marxist perspective, that abstract labour has a material pre-existence referable to the generalised physiological content of concrete labour – the expenditure of human energy.[41] This deeply controversial stance[42] takes its cue from

[36] See for example W. Bonefeld, 'Abstract Labour and Labouring', *Consecutio Rerum*, III, Vol. 5, 30 November 2018.

[37] see for example J. Kincaid, 'Production vs. Realisation: A Critique of Fine and Saad-Filho on Value Theory', *Historical Materialism* vol. 15, 2007; A. Saad-Filho and B. Fine, 'Production vs. Realisation in Marx's Theory of Value: A Reply to Kincaid', *Historical Materialism*, vol.16, 2008.

[38] See footnote 34.

[39] Pitts, 2018, p. 74.

[40] R. Bellofiore, 'A Ghost Turning into a Vampire: The Concept of Capital and Living Labour', in R. Bellofiore and R. Fineschi (eds.), *Re-reading Marx*, Bastingstoke, Palgrave Macmillan, 2008.

[41] See for example G. Carchedi, *Behind the Crisis*, Leiden, Brill, 2011, p. 60.

[42] See A. Kicillof and G. Starosta, 'On Materiality and Social Form', *Historical Materialism,* vol. 15, 2007, pp. 9–43; W. Bonefeld, 'Abstract labour: against its nature and on its time', *Capital & Class*, vol. 34, no. 2, 2010, pp. 257–276; A. Kicillof and G. Starosta, 'On Value and Abstract Labour: a reply to Werner Bonefeld',

such observations on Marx's part as 'all labour is an expenditure of human labour power, in the physiological sense, and it is in this quality of being equal, or abstract, human labour that it forms the value of commodities'.[43]

These kinds of attempts to bridge the temporal gap are unpersuasive, however, for the simple reason that value is a *quantity*. The human energy expended in production is not in any quantifiable sense imparted to commodities so as to be carried with it to the point of exchange. It is dissipated in the form of heat at the point at which it is expended by the worker. By the same token the quantifiable expectations of a capitalist, even expressed in monetary form through the mechanism of finance, are not impressed upon a commodity and carried by it to the point of exchange. In other words, these narratives do not solve the Fooshire-Barshire bridge problem. In one notable case an attempt to reconcile the substance and the social model of value in Marx is expressed as a response to Mirowski's specific complaint,[44] but none of these reconciliations confront the specific contradiction that Mirowski identifies – what is the point of a value quantity conserved *in* exchange if it is not conserved *between* production and exchange? This chapter seeks to answer that question, and in order to do so we must consider the material element in the Marxian ontology of value.

3.5 The materiality of value: 'reorderedness'

In order to approach the issue of materiality in Marx's theory of value it is necessary to return to the core concept of abstract labour. It will be recalled that what forces different concrete labour into fungibility is the quantitative equivalence imposed on that labour at exchange. The illustration above posited labour of kinds A, B, C, X, and Y. Actual deployments of those concrete kinds of labour are forced into the quantitative equivalence A + B + C = 2X + 2Y by virtue of one commodity (made by labour A, B & C) exchanging for twice the price of another commodity (made by labour X and Y). It is this quantitative relation that is carried from production to exchange by commodities, in the sense that, if additional quantities of the commodity are required at the point of exchange, it would be necessary to go back in time and devote additional resources to manufacturing them and getting them there.

This, then, is the material element in the ontology of value. The constraints that cause commodities to carry with them a quantitative imprint of the resources allocated to their

Capital & Class, vol. 35, no. 2, 2011, pp. 295–305; W. Bonefeld, 'Debating abstract labour', *Capital & Class*, vol. 35, no. 3, 2011, pp. 475–479.

43 Marx, 1976, p. 137.

44 A. Saad-Filho, 'Concrete and abstract labour in Marx's theory of value', *Review of Political Economy,* Vol. 4, October, 1997, pp. 457-477.

production are material ones. In a universe in which it was possible to click one's fingers and bring commodities into being at will, there would be no possibility of abstract labour because no past resources would be needed in order for the commodities to manifest in specific quantities at the point of exchange. But in our universe, the presence of a quantity of commodities at exchange predicates matter undergoing some past process of rearrangement, and the amount of that past rearrangement cannot be increased in retrospect.

To be clear, this has nothing to do with the *causes* of commodities being where they are in specific quantities at the point of exchange. Any number of things are causally related to the quantity of sales that a commodity might attract, but the law of value is not concerned with them, because they are not ineluctably and quantitatively predicated in the way in which the rearrangement of matter that they represent is. The law of value is, as pointed out by Marx in his letter to Dr Kugelman cited above, an emanation under the specific historical conditions of capitalism of a *law of nature*. As Marx put it in *Capital*, 'in the midst of the accidental and ever fluctuating exchange relations between the products, the labour time socially necessary to produce them asserts itself as a regulative law of nature. In the same way, the law of gravity asserts itself when a person's house collapses on top of him.'[45] This ineluctable law is the law that it is not possible to go back in time to allocate more resources to production; the concrete quantitative relation between a number of instances of a commodity *now* and the past allocation of resources that went into producing them is fixed for all time.

The concrete processes that bring about the materiality of the commodity at the point at which exchange takes place (*i.e.* at the point at which it embodies value, in accordance with the Marxian scheme adumbrated above) include all forms of resource extraction, agriculture, processing, manufacture, assembly, packaging, transportation and delivery: any process which is materially implicated in the 'reordering of physical matter'[46] required to bring the commodity, in the form in which it is subject to exchange, to the point of exchange. The 'reordering' of physical matter in material production can take place on any level from the subatomic level of nuclear reactions to the world-spanning level of heavy logistics. And it is that reorderedness which, this chapter argues, commodities carry with them to the point of

[45] Marx, 1976, p. 168.

[46] Marx, 1976, p. 133; the phrasing comes from a quotation from Pietro Verri, *Meditazioni sulla economia politica*, Livorno, 1771: 'Tutti i fenomeni dell'universo sieno essi prodotti dalla mano dell'uomo, ovvero dalle universali leggi della Fisica non ci danno idea di attuale creazione, ma unicamente di una modificazione della materia.' (See https://web.archive.org/web/20190921081930/https://it.wikisource.org/wiki/Meditazioni_sulla_economia_politica/III [accessed 29 August 2020).

exchange.

The reordering of physical matter which results from concrete production processes involves labour, and it involves other products deriving from prior production processes – previously reordered physical matter – in the form of raw materials, machinery, infrastructure &c. This previously reordered physical matter is referred to as 'means of production',[47] and it forms part of a *circuit* of what might be thought of as material 'reorderedness'. Matter is reordered by production into means of production, which further reorders matter in subsequent production processes, some of which go towards producing further means of production, and so on. Given the origins of means of production in *prior* reorderings of physical matter (*i.e.* given the fact that means of production are themselves produced by labour and means of production), any reorderedness of commodities which is attributable to means of production is in fact attributable to labour – albeit indirectly through prior embodiment in those means of production. Accordingly, *all* the prior labour embodied in a commodity may be characterised as its 'reorderedness'.

Of course human labour is just a part of the materiality of the commodity at the point in time and space at which it passes into the hands of its purchaser; any amount of additional matter or externally sourced energy can enter the production process at any stage.[48] We, however, are considering the commodity's *re*-orderedness as contrasted with how the matter would otherwise be ordered – the extent to which (as at the point of exchange) the matter in the commodity is ordered in a way in which it would not be ordered if it were not for the aggregate direct and indirect (i.e. via means of production) impact of human labour.

This concern specifically with *re*-orderedness echoes another of the truisms underlying Marx's theory of value – the core truism of the labour theory of value to the effect that the ordering of matter constituted by a commodity as at exchange can *only* consist of (a) what is effected by nature without human intervention, and (b) the physical consequences of human intervention. This is why Marx makes the *prima facie* somewhat odd claim that '[i]f we disregard the use-value of commodities, only one property remains, that of being products of labour'.[49] He is not making the (self-evidently false) claim that the only property that commodities share aside from those properties that make them useful or desirable is the

47 Marx, 1976, p. 125.

48 Marx, 1976, pp. 133-4, pp. 508-10; the relative cheapness of certain inputs and the systemic consequences of that cheapness is of particular interest in recent debates on Marx and ecology; see Moore, 2015.

49 Marx, 1976, p. 128.

property of being products of labour; he is claiming (in a precise reflection of the concept of abstract labour) that, if you take away all of the features that concrete labour imbues commodities with, you are left with the general property of the matter not being ordered as it would have been absent human labour. Their 'reorderedness', in other words.

The claim here is not that 'reorderedness' is quantitatively equal to value – the quantitative relation between reorderedness and value will be explored in the section which follows. The claim here is that reorderedness is the material component of the ontology of value, which is a social quantity with a material substrate. Reorderedness is, in a way, the physical phlogiston-like substance of value, except that (a) it is a path-dependent property of real physical things rather than some kind of imaginary fluid, and (b) it does not exist as a quantity of the *social* substance of value until exchange.

To offer a simple illustration, an object X formerly in location A and now moved to location B (which would constitute a reordering of matter) possesses the path-dependent physical property of being in location B, having formerly been in location A.[50] The quantity of value that is embodied in commodities is not determined until exchange, however. And so if object X is worthless in location A but people are prepared to pay money for it in location B, it is only by dint of that mechanism of exchange at location B that the material property of having been moved there – the reorderedness imparted to it by the concrete labour of moving it – becomes a quantity of socially necessary labour time. Value, in other words.

Similarly (to illustrate with a simplified analogy of manufacture) suppose that substance Y is created by combining substance C and substance D (which would constitute a reordering of matter). The C and D matter in substance Y therefore possesses the path-dependent property of being combined, having previously been separate. Again, if substances C and D are worthless but people are prepared to pay money for substance Y, it is only by dint of that mechanism of exchange that substance C and D's property of having been combined with each other – the reorderedness imparted to them by the concrete labour of combining them – becomes a quantity of socially necessary labour time.

These events taking place under the capitalist mode of production, it will be by reference to the capitalist's expectation of revenue that (in the first example) X is reordered from A to B, or (in the second) C and D are reordered to make Y. And by the same token it will be the

[50] Marx, 1969, p. 412.

expenditure of human energy on the part of a worker that performs these reorderings. But the property of the matter in question that is brought into being by these activities and *persists through time*, so as to be quantified in exchange as an amount of abstract labour, is neither the capitalist's expectation of revenue or the worker's expenditure of energy – it is the reorderedness itself.

3.6 Reorderedness as thermodynamic depth

A crucial feature of this property of reorderedness for these purposes is that, as well as being susceptible to precipitation as a quantity of socially necessary labour time by reference to exchange under the capitalist mode of production, it is also a quantifiable property of physical objects. In other words (in the first example in the foregoing section) object X also possesses a quantity of reorderedness at location B in excess of its prior reorderedness at location A, and (in the second example) object Y also possesses a quantity of reorderedness in respect of C and D that exceeds their prior reorderedness when they were unmixed. I have argued elsewhere[51] that the physical property of things that this reorderedness corresponds to is the quantity in statistical mechanics known as thermodynamic depth.[52]

Thermodynamic depth is fundamentally a measure of complexity. Complexity is to be contrasted with measures of both high and low entropy states, neither of which is adequate to capture the combination of informational richness and non-randomness to be found in such systems as biological life and the production of commodities. There are several measures of complexity but the crucial aspect of thermodynamic depth which makes it suitable as a measure of reorderedness in the value-theoretical scheme set out in this chapter is the fact that it is additive as regards process *i.e.* the thermodynamic depth of state C as compared to state A, having passed through intermediate state B, is equal to the thermodynamic depth of state C as compared to state B plus the thermodynamic depth of state B as compared to state A. This precisely reflects the accumulative nature of circuits of value in the Marxian schema.

A helpful way to understand what thermodynamic depth is might be to consider the difference between a blueprint and a recipe. They both give you comprehensive information about a thing, but in different ways that take different shortcuts: a blueprint does not tell you how to make a thing and a recipe does not provide you with a description of a thing.

[51] C. Quentin and B. Butler-Cole, 'Value as Thermodynamic Depth', working paper presented at the 2017 IIPPE Conference, Berlin, 14 Sept 2017.

[52] See S. Lloyd and H. Pagels, 'Complexity as Thermodynamic Depth', *Annals of Physics*, vol. 188, 1988, pp. 186-213; see also J. Crutchfield and C. Shalizi, 'Thermodynamic Depth of Causal States', *Physical Review E*, vol. 59 no. 1, pp. 275-283, 1999.

Generally speaking you would expect a complex thing to have both an intricate blueprint and a long recipe, and a simple thing to have both a straightforward blueprint and a short recipe, and so a measure of the amount of space taken up by a thing's blueprint or its recipe might be a measure of its complexity. But because blueprints and recipes take different shortcuts to describe a thing, those would be two different measures of complexity. It is possible to imagine a thing which is relatively intricate even though it can be made in a few steps. By the same token it is possible to imagine a thing which is relatively straightforward even though it requires a greater number of steps. Scrambled egg, for example, is a homogeneous substance, but it takes a greater number of steps to prepare than a fried egg, even though a fried egg (with its differentiation between white and yolk) is a more complex structure. Thermodynamic depth is a measure of the complexity of a state of matter which is analogous to a measure of the length of its recipe, as opposed to the intricacy of its blueprint.[53] For technical reasons to do with how it is defined (essentially, as the difference between two different quantities of entropy), the unit of its measurement is joules per kelvin.

It is readily apparent that a measure of the length of a thing's recipe is roughly analogous to the amount of labour that has gone into that thing: a longer recipe has more steps and each step in a recipe generally requires labour. The analogy between thermodynamic depth and labour in circuits of production runs deeper, however. Thermodynamic depth is a concept from a branch of physics which views the state of matter as akin to information, and thermodynamic depth is a measure of a quantity of information. By way of background, a chaotic state of matter may be understood to contain a lot of information (i.e. information represented by the location and state of each particle) but this information is not useful; it is just (as it were) white noise. That being the case, it is possible to distinguish *useful* information as being antithetical to this abundant but meaningless information. The thermodynamic depth of a given state of matter is a quantity of this contrasting useful, non-chaotic kind of information; specifically, it is the quantity of that information that is required in order to bring that state of matter about. It is no great leap to characterise the operation of means of production by workers (whether it be button-pushing on highly sophisticated machinery, or the pushing of a wheelbarrow) as imparting to the commodity thereby produced salient information about its consequent state or location; information that is not already provided by the means of production in an inert state.

[53] An authoritative but accessible account of thermodynamic depth may be found in *Programming the Universe* by co-author of the original paper Seth Lloyd, (London, Vintage, 2006).

But the claim here is not merely that there exists an analogy between a concept in statistical mechanics (thermodynamic depth) and a concept in classical political economy (value); the claim (as will be elaborated upon in the section which follows) is that that relation is a quantitative one. Any object possesses a determinate amount of thermodynamic depth, and any actually existing commodity at the point of exchange possesses a determinate amount of thermodynamic depth which is referable to the production processes that it has undergone in order for it to be in that state, at that location, at that point in time. Seth Lloyd, who with his co-author Heinz Pagels originated the concept of thermodynamic depth, estimates that the thermodynamic depth of the entire universe is 10^{69} joules per kelvin.[54] A certain amount of that depth is referable to the aggregate alteration of the state of matter represented by the commodities in circulation at any given moment, and a certain amount of that depth is possessed by any specific unit of a commodity as it arrives at the point of exchange. The reorderedness that is the material substrate of value in the Marxian scheme, to be *socially* quantified as the value embodied by a commodity at the point of exchange (as to which see the foregoing section), also exists as a *physical* quantity in its own right.

3.7 The quantitative relation between reorderedness and value

The reorderedness of a commodity at the point of exchange under the capitalist mode of production therefore exists, then, in two measures. It is possessed by commodities at the point of exchange (1) as a socially determined quantity (its value) functional upon the exchange of commodities as a totality, and (2) as a physical quantity (its thermodynamic depth), functional upon the path-dependent physical state of matter they represent. In principle it should follow that, at any given point in the evolution of conditions of production under capitalism, there should be a conversion factor between the physical reorderedness of matter generated under the capitalist mode of production, and exchange-quantified reorderedness measured in socially necessary labour time. This conversion factor – which would be measured in joules per kelvin per second of socially necessary labour time[55] – would constitute a kind of global average productivity ratio for a given state of capitalist development.

To be clear, there is no suggestion here that value, or abstract labour, are in any sense ahistorical or physical. They are not – value is a socially determined quantity of abstract

[54] Lloyd, 2006, p. 193; Lloyd gives his estimate measured in bits, but it is here converted to joules per kelvin (entropy is a variable in information theory as well as in thermodynamics).

[55] As regards the second being the unit of socially necessary labour time here, see by way of background footnote 17 above; seconds are chosen here to keep the derived unit within the *Système international.*

labour (which is a social substance), arising exclusively under the capitalist mode of production. The claim is that the *material* component of the twofold ontology of value, *i.e.* reorderedness in and of itself, which lacks quantity *as value* because it is lacking the social component of value's ontology, nonetheless has quantity in its own right – and that quantity *is* ahistorical and physical. And that there must therefore be, in principle, under any given conditions of capitalist production, a conversion factor between the two.

The reason that this convertability between social and physical quantities of reorderedness is analytically useful is because it helps us solve the Fooshire-Barshire bridge problem. In abstract terms the problem illustrated by reference to the Fooshire/Barshire thought experiment is the problem that external events (like the collapse of the Fooshire/Barshire bridge or, to use the example that Marx himself entertained, the failure of a harvest[56]) can increase the amount of socially necessary labour time necessary to produce a commodity *after a capitalist has acquired the inputs necessary to produce that commodity.* The reason this is a problem is because it runs directly counter to the entire premise of Marx's theory of value, insofar as that theory is concerned (by definition, as to which see above) with value as something which only human labour can contribute. It is something which only human labour can contribute, and yet here it is, in the thought experiment set out above, being increased in a loaf of bread by the collapse of a nearby bridge.

Marx blithely says of this outcome 'the change in value originates outside the process … of production', and so (seemingly) does not interfere with his theory. But he does not explain why there should be a distinction in value arising at exchange which is referable to whether it originated (a) in production or (b) outside of it. As Mirowski pointed out,[57] either all value comes from human labour, or it is something determined at the point of exchange by reference to the conditions of production generally at that point in time. Some sort of further explanation is required if it is going to be both of these things. What, in other words, is so special about production?

The answer, it is here suggested, (and this is the core point on offer in this chapter as an original contribution to the discussion of Marxian value theory) lies in the fact that reorderedness – the material component of the ontology of value – has a physical (ahistorical) quantity as well as a socially determined one under the capitalist mode of production. And

[56] Marx, 1976, p. 318.
[57] See footnote 11.

that physical (ahistorical) quantity cannot be increased except in production. And so, **while the quantity of value is socially determined at exchange, there is an ontological distinctness to an increase in value at the point of exchange which is specifically referable to production of more reorderedness in physical terms**. An increase in value which arises *without* the production of more reorderedness in physical terms is an increase in the quantity of value, certainly, but underlying it is something ontologically completely different: a change in the conversion factor (brought about, say, by the collapse of a bridge) between physical reorderedness and socially necessary labour time.

The thing that is special about production, then, is that it gives rise to an increase of the physical 'substance' (not actually a substance, of course, but a path-dependent physical quantity which is a property of commodities) that is the material substrate of value. What, then is the role of value in all of this? Should we abandon the concept of value and analyse capitalism, in line with a 'physicalist' way of thinking, by reference to circuits of thermodynamic depth? The answer is that we should not. Capitalism is a social system and it is driven forward by the fact that it is mediated by money, and money is a form taken by value, not by reorderedness. Thermodynamic depth on the part of commodities is, in and of itself, simply an inert physical quantity like length or mass, and no-one is motivated to generate a surplus of it. Capitalism is driven forward by the systemic need on the part of *value* to create more of itself. It does not care whether it does so by dint of an increase in the quantity of the material substrate of value, or by dint of a change in the conversion factor.

To put this point in concrete terms, using the Fooshire/Barshire scenario, if a Barshire baker buys up all the Foograin they can while the bridge is in place and then destroys the bridge by sabotage in the dead of night, that course of action would be just as congruent with value's need to create more of itself as exploiting labour to bake Foobread in the ordinary course of a Barshire baker's business. It is value that shapes the world we live in today, in all its ugliness and violence, not the physical reorderedness represented by commodities.

And this is why a 'physicalist' approach can never provide an adequate account of capitalism as a mode of production, albeit that it is quite clear that the physical production of commodities by those who produce them exceeds the quantities that they consume. We can, nonetheless, make a distinction between the two forms of value creation that the Fooshire/Barshire bridge problem highlights. When we speak of 'value creation' we are concerned with the substantive creation of value exemplified by the production of

commodities, and therefore with increases in physical reorderedness (as constitituted into value by exchange), and not with adjustments to the conversion factor between physical reorderedness and socially necessary labour time exemplified by the destruction of infrastructure.

3.8 Conclusion

At the end of the foregoing chapter it was asked what 'value' is. What, it was asked, is this fungible money-equivalent stuff which is created in material production and moves through the economy, but which (with today's digitalised economy in view, counter-intuitively) is not necessarily generated even where there is both utility and profitability in what a business is doing? The answer that this chapter offers is that 'value' is quantities of abstract labour, which is a socially constructed fraction of prior labour, forced into fungibility by the mechanism of exchange. It is therefore, however, necessarily a substance with a material element to its ontology, which this chapter characterises as 'reorderedness'. Value is reorderedness of matter, which has a quantity in and of itself, but which is socially re-quantified as value at the point of exchange. Recalling the idea of the production boundary, this key aspect remains to be addressed: the material element of the ontology of value has the consequence that (a) it is only labour of certain kinds which are embodied in exchange as abstract labour and (b) it is only output of certain kinds which are capable of embodying it. It is to those distinctions which we turn in the chapter which follows, in order to reassure ourselves that we have a theory of value which is capable of addressing the real world of capitalism in the twenty-first century.

Chapter 4: Inside and outside the production boundary

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4.1 Introduction

As explained early in the foregoing chapter, Marx’s solution to the conundrum of surplus – his explanation of why a business’s outputs exceed the sum of its inputs – is that the value of a worker’s wage (in the form of labour embodied in the commodities a worker consumes) is less than the value of the work performed by the worker (in the form of labour embodied in the commodities the worker produces). A distinction was drawn in the conclusions to the chapter between creating value in this way – which involves bringing about a net increase in the reorderedness of matter – and changing the conversion rate between reorderedness, as a physical quantity, and value, by (for example) destroying infrastructure.

In other words, while accepting the social construction of value as at the point of exchange in the form of abstract labour, we can for the purposes of this thesis treat the net material production of value in its ‘latent’ form (i.e. during production, in the form of the reorderedness of matter) as ‘value creation’ in the Marxian scheme – subject of course to the caveats that, (i) to be realised as such, exchange must subsequently take place, and (ii) the conversion rate between reorderedness and value may have changed between production and exchange. This is not a back-door reintroduction of ahistoricism or physicalism – where reorderedness is referred to in this chapter it is always on the assumption the reorderedness, as a physical quantity, is subsequently re-quantified as *value*, i.e. a socially constructed quantity, by the mechanism of exchange under the capitalist mode of production.

Again, as noted at the end of the foregoing chapter, not all labour and not all output participates in this material dynamic of value creation. The purpose of this chapter is to

consider how these distinctions between categories of labour and categories of output are to be drawn. In other words its purpose is to delineate a production boundary. Its further purpose is to develop a basis for a theory of business profits falling outside of that boundary, which is a topic to be revisited in chapter 6 when the global political economy of corporate tax is addressed. Where consumption (even consumption by profitable businesses) takes place outside the production boundary, value is *absorbed* which would otherwise cycle back into production in the form of wage goods or means of production. And so what is carried forward from this chapter to chapter 6 is fundamentally a theory of the *absorption* of value.

This chapter begins by considering what kinds of outputs arise inside and outside the production boundary, addressing immaterial commodities and services. It proceeds to consider categories of wage labour inside and outside the production boundary, including a review of the (somewhat unhelpful) concept of 'unproductive' labour to be found in the literature (which is rejected in favour of an analogous concept derived from fundamental principles). The chapter goes on to advert to some important perspectives which engage with Marxian value theory but treat of wider spheres of production i.e. (i) unwaged social and cultural activities, and (ii) social reproduction, albeit that those perspectives (it is shown) do not impact upon the conclusions here. Finally, it addresses the core point for the purposes of the chapters which follow *i.e.* value capture outside the production boundary.

4.2 Commodities, material and immaterial

Abstract labour, it was shown in the foregoing chapter, is not a hypothesis or a metaphor or an imaginary substance; it is the *fact* of prior allocation of resources giving rise to the commodities being exchanged under capitalism, reframed as a quantifiable and fungible social 'substance'. That reframing is achieved by reference to the necessarily quantitative relationship between that prior allocation of resources and the quantities of commodities undergoing exchange. It is at this juncture that it becomes possible to say what a 'commodity' is for the purposes of Marx's truism: a commodity is anything that exchanges for money under capitalism, if (a) it exchanges in determinate quantities, and (b) those determinate quantities are necessarily constrained by the prior allocation of resources to its production. It is only in the case of things meeting these conditions that (to refer back to the illustration in the foregoing chapter) it is possible to say that A + B + C = 2X + 2Y is true on a *quantitative* level, and it is the *quantitative* equivalence of A + B + C and 2X + 2Y that turn the different forms of concrete labour, A, B, C, X and Y, into a fungible abstraction.

The existence of abstract labour being a truism, the definitional difficulty around value is therefore shifted onto the question of what falls into the definition of ‘commodity’. Of what, the definition requires us to consider, may it be said that (a) it exchanges in determinate quantities, and that (b) those determinate quantities are necessarily constrained by the prior allocation of resources to its production? Certainly this is true of material commodities of the classic kind – ‘goods’ – and indeed commodities in Marx’s exposition are generally conceived as material objects: a commodity is an ‘external object’, a ‘thing’[1] with ‘physical properties’ which, when considered as features which cause the commodity to satisfy some want or need, constitute the ‘material’ content of wealth.[2] It is, after all, physical ‘things’ that embody reorderedness.

It is of course not the case that a thing needs to be a physical object in order to *function* as if it were a commodity under capitalism, but this does not mean that such things *are* commodities. More or less anything can have scarcity imposed on it by some exercise of power or another such that it (or access to it) can be sold in determinate quantities. If capital kept us all underground and controlled access to the surface it could commodify the beauty of the night sky. But it is by no means true of all the things that can *function* as commodities that the determinate quantities in which they exchange are constrained by the prior allocation of resources to their production. Take, for example some unit of knowledge, data, design, or other form of immaterial product. In the case of such things, even where they are sold in determinate numbers of instances, the relation between the amount of labour and material resources taken to produce it and the number of instances of it which may be distributed is wholly arbitrary.

It is true that there is a materiality to the data of which each instance of the immaterial commodity is composed, and at first blush that may seem to constitute a reordering of matter which is capable of crystallising into value at the point of exchange, but the quantitative constraint imposed by the prior allocation of resources that is reflected in that materiality is referable to the material storage and transmission mechanisms by means of which such putative ‘commodities’ are distributed; not to the putative ‘commodities’ themselves. These things, therefore, cannot be commodities.

To illustrate, a hard-drive containing the complete works of J. S. Bach represents a prior

[1] Marx, 1976, p. 125.
[2] Marx, 1976, p. 126.

allocation of *quantitatively determined* labour and material resources that is no greater than in the case of a blank hard drive. To emphasise, this is not to say that the production of a recording of a piece of music requires no labour or material resources. The claim (which should not be controversial) is that, once a recording is produced in digital form, its scarcity is a function solely of the legal constraints upon distribution which enable it to be sold by the unit as if it were commodity. On a *material* level it may be reproduced any number of times without any additional labour or material resources going into its *production*; the relevant material constraints are the prior labour and material resources that went into the production of storage and transmission mechanisms (which are of course material commodities embodying abstract labour in the usual way).

This is a key point and so it is worth dwelling on it for a moment. Marx wrote that '[t]he product of mental labour – science – always stands far below its value, because the labour-time needed to reproduce it has no relation at all to the labour-time required for its original production. For example, a schoolboy can learn the binomial theorem in an hour.'[3] He was, however, understating the matter: at the touch of a screen a toddler can make a tablet computer deploy mathematics of professorial complexity, instantly, and the number of toddlers in a position to do so is constrained only by the number of physical tablet computers they can collectively get their tiny hands on. From a strict Marxian value-theoretical perspective the value of the product of mental labour is zero.

This is counter-intuitive because knowledge, design &c is so useful, and it can also be highly profitable if deployed for commercial purposes. This usefulness is irrelevant to its value in a Marxian sense, however, which is concerned only with the strictly quantitative relation between the prior allocation of resources and the present number of units of any given commodity.[4] To take academic production as an example, this proposition may be illustrated by reference to the complete disconnect between the labour that goes into a peer-reviewed article, and the number of copies of the article that are available for distribution. To be clear, this is not a matter of the relation between the labour that went into the piece and the number

[3] Marx, 1969, p. 353.

[4] There exists some debate over whether information commodities might be of a value that *tends towards* zero (as opposed to being zero), on the basis that some quantity of labour is required to produce the information, and that quantity is smaller and smaller per unit as units are replicated; see in particular B. J. Parkhurst, 'Digital Information and Value: A Response to Jakob Rigi', *tripleC*, vol. 17, no. 1, 2019, pp. 72-85. This debate, however, misses the point elaborated upon in the foregoing chapter that value is about determinate quantitative relations between labour as at production and units as at exchange. If the labour is not quantitatively predicated as at exchange in this way it simply falls out of account, rather than being (as it were) diluted.

of copies that are in fact purchased or downloaded or cited – there may be a degree of correlation there, but that would be about mere causation, which is irrelevant to value – value is about the extent to which the number of copies which are *available* for distribution is constrained by the amount of labour that went into the piece. There is, of course, no such constraint. A piece produced by a monkey playing idly at a keyboard would be as infinitely replicable as some brilliant piece of painstaking research.

In any event the idea of knowledge or design being freshly created *ex nihilo* is somewhat misconceived. This is because all knowledge, design &c (let us call it 'data') is contained within the definition of any possibility space which is capable of containing that data. This is well known to philosophers through thought experiments such as Jorge Luis Borges's 'Library of Babel',[5] but the point may be illustrated by reference to the aforementioned monkey playing idly at a keyboard. As is often observed, it is only the brutally probabilistic unlikelihood of it, rather than the monkey's intellectual or academic failings, that prevents it from actually typing out that brilliant piece of original research. To put the point more concretely by reference to the instance of hard drives and mp3s, a blank hard drive *already* contains the complete works of J. S. Bach in the form of a *possible* configuration of its bits.

To emphasise, the foregoing arguments are not to say that there is no 'value' (in a general sense) inherent in the output of human creativity (whether in digital form or otherwise); the point here is the narrow and technical one that, even in circumstances where such output is sold in units which behave commercially as if they were instances of a commodity, those units do not embody abstract labour in the way that commodities do.

4.3 Services as commodities

Between the clear categories of material commodities (which are commodities for the purposes of Marxian value theory) and immaterial products (which, as discussed above, are not) there is the somewhat unhelpful category of 'services'. Is the output of a 'service' a 'commodity' for the purposes of Marxian value theory? This is an area where recourse to Marx himself (who to be fair wrote at a time when the 'services sector' did not exist as a concept in political economy) yields inconclusive results – as Fiona Tregenna puts it with a fair degree of understatement, '[t]here seems to be some inconsistency in Marx's treatment of commodity producing capitalist services'.[6] Fortunately, however, it is for the most part a

[5] See the extended meditation on the Library of Babel in D. Dennett, *Darwin's Dangerous Idea*, London, Penguin, 1996, pp. 107-113.

[6] F. Tregenna, 'What Does the "Services Sector" Mean in Marxian Terms?', *Review of Political Economy*, vol.

trivial matter to extract a theory of services from the core concept of abstract labour.

Very often 'services' are in fact nothing other than material production, in the sense of bringing material commodities to the point of exchange; examples of this would include such 'services' as the bulk transportation of goods,[7] and catering.[8] The category of 'services' as opposed to 'goods' is therefore a misleading one; 'goods and services' is a handy label for the totality of goods and services, but it needs to be recognised that, at least to the extent adverted to in this paragraph, the two bourgeois categories of 'goods' and 'services' overlap from the perspective of Marxian value-theoretical analysis.

Other 'services' such as broadcast media, software production and advertising fall into the category of *immaterial* production, insofar as the output of these production processes does *not* consist of commodities for the purposes of Marxian value theory for the reasons explained above *i.e.* there is no quantitative relation between the allocation of resources and the quantity of units produced. By the same token the output of the sectors more conventionally associated with the *extraction* of value – loans, the rights of lessees in respect of land – are not commodities.

Many 'services' falling into this latter category where the output is not a commodity were an in-house matter in Marx's time[9] and so he framed this question – notably insofar as concerns capitalists' marketing efforts – by reference to whether or not the labour in question was productive of value (it is not[10]). Accordingly it is on those terms that subsequent Marxists who deprecate the distinction between productive and unproductive labour (as to which see section 4.6 below) have generally engaged with him in respect of this issue.[11] The fact that there is now a 'services sector', however, makes it possible to treat this question in the way it is treated here *i.e.* framed in terms of whether or not the output constitutes a commodity for

23, no. 2, 2011, pp. 281–298.

7 Marx, 1969, p. 412.

8 It may be noted that this is not to erase the affective labour performed by, for example, waiting staff in restaurants; on the contrary, it is expressly to include that labour by simple dint of the fact that it is quantitatively implicated in bringing the commodities in question to the point of exchange. It may therefore be asked whether or not a waiter's affective labour is 'value creating' or whether it is just their manual labour in bringing the food but this is to misunderstand the concept of abstract labour. Abstract labour takes as a given that (i) the entirety of the concrete labour was performed, and (ii) the exchange took place. Based on those givens it homogenises multiple units of different forms of concrete labour as explained above. Teasing apart individual instances of concrete labour into fractional elements that may or may not be causal of the exchange because of their affective content, and fractional elements that involve physically moving matter around, is no part of the analysis, although of course that may well be a useful analysis to perform for other purposes.

9 Tregenna, 2011, p. 288.

10 Marx, 1978, pp. 207-8.

11 See for example Pitts, 2018, p. 227-233.

the purposes of the logic of the concept of abstract labour.

And so, this ‘services’ question largely reduces to the question whether we are talking about material commodities or non-value-bearing outputs of immaterial production. There is, however, a residual category of ‘services’ which do not reduce to either of these categories. These services constitute a narrow and materially exceptional category of output, being distinguished by the physical participation of the consumer’s body in the realisation of the output; the paradigmatic example being the transportation of humans.[12] Hairdressing is another example that comes up a lot; less often encountered but analytically more useful is the example of sex work. As is clear from the contrasting figures of the train driver and the sex worker, labour processes in this category can run the full gamut from being quite extraordinarily capital-intensive to not necessarily requiring any capital at all.

In the case of this subcategory of ‘services’ (perhaps they may be labelled ‘true services’ or ‘bodily commodities’) it *is* the case that the number of units available for exchange is quantitatively a function of the prior allocation of resources to their production, just as is the case with a conventional material commodity. Indeed to that extent a train ride or a haircut or some time spent with a sex worker *is* a material commodity, the only difference being that the matter of the human body being transported or trimmed or pleasured, rather than matter external to the human body consuming the commodity, is the vector for the commodity’s materiality.[13] (Given the stigma that attaches to sex work, I want to make clear that I am *not* claiming that it is the body of the sex worker that is the vector for the materiality of the commodity. Just as is the case with a train ride and the body of the passenger, or a haircut and the body of the person with the hair being cut, it is the body of the sex worker’s *client* that is the vector for the materiality of the commodity.)

To reiterate the core point, this is analytically quite different from the human body putatively constituting the vector for the materiality of an ‘immaterial commodity’ – electrical impulses in the nervous system triggered by some Bach mp3s via the vibration of the eardrums, say – because in this latter case, as already explained, the labour of producing that putative commodity is not quantitatively implicated in the number of units of it available for exchange. Whereas in the case of these ‘bodily commodities’ it is. (The pedantic point might be ventured that no additional train drivers need to be employed in order for extra additional

[12] Marx, 1978, pp. 134-5.

[13] It is consistent with Marx’s overall analysis to treat the human body as a potential vector for the materiality of commodities since human labour power is itself a commodity under capitalism: Marx, 1976, pp. 283-306.

passengers to get onto a train – particularly at off-peak times; the fact remains, however, that – for any given state of rail travel production – the labour of train drivers is quantitatively implicated in the overall capacity of a rail network.)

4.4 Labour and the production of reorderedness

In the two foregoing sections we considered what does and does not constitute a commodity for the purposes of the value-theoretical scheme adumbrated in this thesis. This section and the section which follows are concerned with the role of labour in producing value. It is convenient to label workers who produce value in the sense adumbrated here as 'productive'. But it is crucial to emphasise that the category of 'productive' labour is a purely analytical one and no moral judgement or hierarchy or class distinction is to be inferred from it insofar as it may be contrasted with other categories of work. 'Productive' does *not* mean that other categories of work do not yield utility or profitability – servants of the state can be extremely socially useful in what they do, and banking can be extremely profitable, and yet few workers in these sectors doing socially useful or profitable work would fall into the 'productive' category. The *sole* thing of which productive concrete labour is definitively productive is abstract labour, and that is because (as discussed in chapter 3) productive concrete labour is preserved in specific quantities across the gap of time between production and exchange in the form of reorderedness.

This point must be emphasised because objections may be raised against Marx's theory of value on the mistaken assumption that to exclude labour from the 'productive' category must either be a denial of the utility of its output, a claim to the effect that it cannot yield profitability, a moral judgment against the labour in question, or a claim about who is or is not included in the category of 'working class'. It is (and this cannot be emphasised too strongly) *none* of these things.

It is also important to emphasise that this is not by any means a gendered distinction – the concept of 'productive' labour in Marxian political economy is sometimes assumed to reflect an outdated attachment to supposedly manly work in heavy industry, or a 'male breadwinner' domestic model, but in fact much of the world's exploitation of 'productive' labour takes place in respect of highly feminised workforces in (for example) light industry, agriculture, and the households of the Global South. It is, as I say, just an analytical category which relates to value as a technical concept under the capitalist mode of production, and which (as

I hope will be illustrated by this project) can be deployed as a tool to positively *assist* in the analysis of precisely the phenomena which it is sometimes accused of failing to recognise.

There are, in any event, three steps to determining whether a worker is 'productive' in this sense. First, it is necessary to determine whether or not capital *pays* for the labour, in wages or some kind of wage equivalent e.g. a piece rate. This is an absolutely fundamental condition, since the entire discussion is predicated on the presupposition that the purpose of the concept of 'value' is to be explanatory of capitalist surplus. The underlying conundrum arises because capital's outputs can (and generally do) exceed its inputs, and one of those inputs is labour. (This fundamental precondition has implications for the categorisation of unwaged activity in spheres such as cultural participation and social reproduction; these implications are addressed in section 4.7. In addition, the precondition requires to be formulated in a more nuanced fashion in order to apply correctly to coerced labour taking place within the production boundary, but that complication is not addressed here because it is not relevant to the boundary between production and absorption which is the topic of this chapter).

Secondly, we determine whether the work is of a productive kind in the circumstances – i.e. that it is productive of gross reorderedness, and that is the question addressed by this section. Thirdly we determine that the worker does not absorb more reorderedness than they produce; in other words, we determine that they are a *net* producer of value, and that is the question addressed by the section which follows. Strictly speaking only the first and third question are absolutely necessary; the second question, addressed in this section, simply eliminates large swathes of workers from the reckoning required by the third question. It does so on the basis that, if they are not gross producers then they cannot be net producers.

As regards that second question, then, the starting point is that the output of the productive process that the work participates in has to be a commodity. However profitable a business may be, if it is not producing commodities then its workers are not 'productive' (we will begin to address where those other profits come from in section 4.8 below). This means that, on a sectoral level, it is possible to draw some broad-brush distinctions. It is extremely difficult to think of any role in banking, for example, where its incumbent is a 'productive' worker; likewise, digital media, advertising &c.

If the output is commodities then in order to address the question of whether a given worker

is a ‘productive’ member of the relevant workforce it is necessary to return to the core Marxian value-theoretical concept of abstract labour: the social substance that material reorderedness is quantified as, at the point of exchange. Crucial to the concept of abstract labour, it will be recalled, is that there is a determinate quantitative relation between the resources necessarily allocated to production and the number of instances of the commodity in existence at exchange. It follows that labour can only form part of the fungible totality of social labour that is abstract labour if it is *quantitatively* implicated in the materiality of the commodity at exchange. In other words, the test requires us to consider the work that the worker does in quantitative terms – the number of hours the worker does, or the number of people there are doing that work – and to ask if (assuming no change in the conditions of production) that quantity would necessarily have to increase in order for the number of units of the commodity in existence at the point of exchange to increase.

Within the world of commodity production, therefore, the distinction cuts across some more familiar ones. We have already observed that some ‘services’ in fact constitute commodity production, so that some ‘service’ workers can be ‘productive’. Another familiar distinction that is *not* in play here is the (in any event, highly questionable) distinction between intellectual and manual labour.[14] Clearly the overwhelming majority of ‘manual’ work in sectors such as mining, agriculture, manufacturing and logistics is necessarily quantitatively implicated in the materiality of the commodity in question at exchange, but so is the labour of technicians, supervisors &c,[15] provided that (and this is the key test) more of the commodity at the point of exchange would have required a greater quantity of the work that they perform. By the same token there is work to be done at a bank – counting banknotes, cleaning staff toilets – which is ‘manual’ in nature but is nonetheless not ‘productive’, because the output of the business is not a commodity.

A large number of roles within commodity-producing sectors can be determined *not* to be productive on the foregoing basis: designers, marketers, accountants, and all managerial levels above those who are so close to the process they manage that the amount of work they need to do fluctuates with output volumes.[16] It might be suggested that in practice a

14 See A. Sohn-Rethel, *Intellectual and Manual Labour*, London, Macmillan, 1978, for the classic critique.

15 ‘In order to work productively, it is no longer necessary for the individual himself to put his hand to the object; it is sufficient for him to be an organ of the collective labourer, and to perform any one of its subordinate functions.’ Marx, 1976, pp. 643-4.

16 It is of course possible to do some productive and some non-productive work; an IT support worker, for example, who assists both productive and absorptive colleagues, spends only part of their time doing productive work.

commodity which sells in greater volume requires more marketers, or a higher-value transaction over commodities requires more lawyers and bankers, and it may be the case that more marketers or lawyers or bankers[17] are indeed allocated in these circumstances for the purposes of increasing sales volumes or more carefully managing greater capitalist risk. But the question is to do with the *past* allocation of resources that is *quantitatively* necessary under the prevailing conditions of production, given the quantity of the commodity at the point of exchange. Better marketing or design might *cause* more sales, but the prior allocation of resources to marketing and design does not constitute a hard constraint on the number of units in existence at present in the same way that the past allocation of resources to production does.

It seems counter-intuitive to hold that people whose 'skilled' work has a clear causal connection with the form, content and desirability of a commodity – designers, marketers &c – are not productive of the value embodied in it, while the 'unskilled' repetitive labour of factory workers is, but the logic of abstract labour requires us to take that view nonetheless. The intuition to which this runs counter appears to be an intuitive subjective value theory; a sense that the value of a thing must be related to the features that make us desire it. It should be recalled that, in the premises of this project, we are seeking an objective theory of value. The features that make an object desirable generally bear a *causal* relation to the fact that it undergoes exchange, but the concept of value requires something more: it is absolutely of the essence of value that it exists in a *quantity.* Marx used a vivid analogy to illustrate this distinction – that of a match lighting a fire. The fire's heat is *caused* by the match but the amount of heat generated by the fire comes from the amount of fuel thereby caused to burn.[18]

Before leaving behind the question of who is a gross producer of reorderedness and moving onto the question of who among the gross producers is a net producer, it should be recalled that value is always contingent upon subsequent exchange in order to give it quantity. Indeed value is constantly in motion and only exists as such because it is in motion, and to that extent it is not just dependent on the next exchange; it is also dependent on the exchange after that, and the one after that, and so on indefinitely into the future into which it is propelling itself and us.

We look to the next exchange in the circuit because it is on the basis of the next exchange in

[17] It may be noted that moving money capital around is productive labour only in circumstances where transactions are physically settled with actual commodity money such as solid gold.

[18] Marx, 1978, pp. 207-8.

the circuit that we can be confident that the value has made it at least that far, but there is no reason to be certain that the value will stay within the circuit after that exchange. If the commodity is neither consumed by productive workers or nor deployed as means of production of commodities, but is consumed nonetheless, the value will to that extent escape the circuit at that subsequent stage. It is for this reason that some definitions of 'productive' labour exclude, for example, the manufacture of military equipment: we can see right at the point of exchange that the value embodied in heavy arms is never going back into the circuit either as means of production or as means of subsistence.

If theoretical consistency is paramount then, in view of the fact that in many cases (*i.e.* in contrast to the case of heavy arms) it will *not* be clear at the point of exchange whether the value is destined to escape the circuit, the onward journey of the value should probably be treated as analytically opaque in every case. Having said that, it would seem to be quite perverse on a macro level to treat the banking sector as structurally absorptive of value but not the sector of industry supplying military equipment to governments. The way in which value absorption manifests itself on a macro/structural level will be considered in chapter 6, and touched upon again in the concluding chapter of this thesis. We turn now, however, to the role of value absorption on a micro level in the consumption of productive workers.

4.5 Labour and net surplus

As already discussed, we are concerned here with increases in reorderedness, as opposed to the wider category of value creation which includes changes in the conversion factor between reorderedness and socially necessary labour time. In order to determine if an amount of reorderedness has been introduced into the system, then, it is a question of netting off the gross reorderedness of outputs as against the reorderedness of inputs. Reorderedness is posited as an input by capital in the form of means of production and (indirectly, via the wage relation or equivalent) in the form of means of subsistence.

While reorderedness is in principle measurable it is not something we can actually measure in practice except in models incomparably simpler than actual production processes.[19] But it is possible to say with some confidence that the sum totality of means of production in existence multiplies by a vast factor the yield of reorderedness that humans are capable of producing in a single unit of labour time. This is for a number of reasons but, to name a couple, (i) tools and machines and vehicles and fuel are capable of bringing about material

[19] Quentin and Butler-Cole, 2017.

effects on a vastly bigger and more complex scale scale and/or vastly quicker than humans can manage unaided, and (ii) they enable production processes to be broken up into a sequence of simple repetitive tasks that do not require anything resembling the careful and sequential deployment of different skills that making things by hand requires.

We are, however, talking here about *re*-orderedness. The multiplying effect of means of production does not occur because means of production themselves *create* reorderedness – they can only transfer to the commodities that they are involved in producing as much reorderedness as they themselves possess.[20] A useful way to grasp why this is the case is to recall from section 3.6 of chapter 3 that reorderedness is akin to information, and it is human labour that creates that additional information imparted by a production process that is not already possessed by the means of production. And so the vast yield of gross reorderedness that a unit of human labour time is capable of producing is referable primarily to the reorderedness already inherent in the means of production deployed. The *surplus* reorderedness introduced by any production process is by contrast solely referable to a shortfall between the additional reorderedness introduced by the productive labour deployed in that process and the reorderedness consumed by those productive workers in the form of means of subsistence.

The consumption habits of workers involved in material production, in contrast to the vast yield the system as a whole is capable of producing, are constrained by their wages (and access to debt), which can in many cases be very low. Thus it is that, purely on a physical level, those involved in material production are able to extract, manufacture and deliver as commodities a surplus of stuff that they themselves do not consume. And that surplus can in principle be expressed as a quantity of surplus reorderedness. (It is Marx's draft modelling of this surplus using actual figures for the prices of goods that evinces the transformation problem that was mentioned in section 3.4 of chapter 3, but we are not going to be detained by modelling difficulties in this thesis since there is no modelling.)

We saw in the foregoing section that only some workers are implicated in the production of gross reorderedness, and other workers must therefore necessarily be absorptive of reorderedness. In view of the huge surplus of stuff produced by the system as a whole as

[20] Marx, 1976, p. 318; Marx was here ostensibly talking about 'value' but this is the precise part of his argument where the concept of reorderedness may usefully be introduced as a substitute for value to clarify the specific value-creating properties of material production in contrast to movements in the conversion factor between reorderedness and socially necessary labour time.

contrasted with the consumption of those workers who are ‘productive’ in this sense, it is safe to assume that, in general, any such a worker is likely to be productive of a *net surplus* of reorderedness as they introduce additional *gross* reorderedness. Strictly speaking, however, there is a possibility that a person may be implicated in the production of such a small amount of gross rorderedness that they consume more than they produce and are therefore net absorbers rather than producers. This is the true threshold question distinguishing productive from absorptive workers but, as already explained, the question regarding whether gross reorderedness is being produced means that the question of net reorderedness only need be asked in a small (and for macro purposes structurally irrelevant) minority of cases. It is to that threshold question that, for the sake of completeness, we now turn.

Because we cannot measure reorderedness we cannot locate the threshold precisely, but it will determine workers to be absorptive where they are necessarily quantitatively implicated in the production of a commodity (and therefore *prima facie* productive), but the production process is at the far end of the spectrum in terms of how little reordering of matter is involved. In those circumstances the amount of reorderedness consumed by the worker in the form of the means of subsistence they purchase out of their remuneration might exceed the reorderedness they produce. This is only likely to be the case in certain narrow categories of labour where (a) the output is a commodity in the material sense explored in sections 4.2 & 4.3 above but (b) the nature of the labour is not of a kind where the volume of output is reliant on the efficient use of reorderedness already in existence in the form of means of production.

The contrasting figures of the train driver and the sex worker, adverted to above, may be recalled. A train driver may well be productive because the reordering of human bodies effected by a train journey is probably on the whole going to be non-negligble. The sex worker, by contrast, is more likely (and since we cannot measure reorderedness we can only speak in terms of relative probabilities) to be ‘absorptive’. To elaborate, the reordering of client’s bodies that a sex worker performs in a day is unlikely to exceed the reorderedness of the commodities which the sex worker consumes in a day. Indeed, because of phenomena such as ‘findom’ discussed in chapter 2, sex work may in truth involve no reordering of matter at all except for the reordering of matter involved in effecting payment.

Another example from chapter 2 is the one of the hypothetical painter where tax scholar Roger Kerridge addressed the question whether a painting was ‘goods’ or ‘services’ (see

section 2.7). Kerridge argued that the same commodity could be a 'good' or a 'service' depending on whether or not it was commissioned, and thereby demonstrated that the dichotomy is not an objective one. The distinction drawn here is by contrast an objective one, at least in principle (i.e. with the caveat that reorderedness cannot actually be measured in practice), and it works like this: a worker adding paint to a succession of commodities with repetitive production-line efficiency is probably creating more reorderedness than they consume, and a painter carefully producing a one-off artwork is probably consuming more reorderedness than they create.

4.6 'Unproductive' labour

In the foregoing two sections we distinguished productive labour from absorptive labour. In this section and the section which follows we will consider specifically labour of the absorptive kind. The mainstream Marxian tradition uses the term 'unproductive' labour for what we are here calling 'absorptive' labour. Unfortunately (as we shall see in this section) Marx's own writings on the distinction between 'productive' and 'unproductive' labour are not coherent, and the distinction as subsequently developed in Marxian literature suffers from incoherence in consequence, having the appearance of a theoretical 'add-on' rather than being grounded as it should be in the core analysis of how value is created. 'Absorptive' labour is therefore primarily differentiated from 'unproductive' labour by dint of the different theoretical genealogy of the concept.

The label 'unproductive' is, in any event, misleadingly pejorative, since (as already noted) value is a mere technical concept and labour which is not productive of it can nonetheless be very important and socially useful. Further, on a descriptive level, the label 'unproductive' is somewhat reductive, erasing the crucial role played by labour which is not *productive* of value in *absorbing* value. It is for these reasons (in addition to distinguishing the concept developed here from the received one in the literature) that, in this thesis, labour which is not productive of value is labelled 'absorptive labour'. Given the overlap – or perhaps identity – between unproductive and absorptive labour, however, it is necessary to delve a little into existing discourse around unproductive labour. That is the purpose of this section.

Marx defines unproductive labour negatively by reference to productive labour, and (as already explained) there are a number of elements to the production of value: (i) in order for labour to be productive, it has to be predicated on a wage relation (or equivalent) since

otherwise it plays no part in solving the surplus conundrum and therefore falls outside what the concept of value exists to theorise, (ii) it has to produce value (in the sense of a quantity of socially necessary labour time quantified by means of a subsequent exchange) and therefore cannot simply consist of concrete labour giving rise to a use-value, and (iii) it has to produce value on a net basis and not just a gross basis.[21] Unproductive labour is therefore labour that lacks any one of these properties. And at the same time unproductive labour is also provided by Marx with a positive definition in its own right *i.e.* it is labour which is paid for out of revenue and not capital.[22] (This would of course follow from not being productive; productive labour replaces the value outlaid upon it and yields a surplus, thereby paying for itself as part of the process of capital reproducing itself, whereas unproductive labour by definition has to be paid for out of the surplus that arises.)

Considered abstractly the distinction between productive and unproductive labour that emerges from these elements makes sense, but the way in which Marx deploys it is inconsistent. There are two principal problems, which are exacerbated by the fact that Marx's detailed discussion of the distinction between productive and unproductive labour comes to us in the form of manuscript notes of varying and broadly unsatisfactory levels of preparedness (*Theories of Surplus Value*[23] and *Results of the Immediate Process of Production*[24]) rather than texts edited for publication in his lifetime.

First, Marx is primarily concerned to debunk the more 'superficial'[25] of the two distinctions which Adam Smith operates *i.e.* (broadly) a distinction that rests on the materiality of the output, since it is not the content of the labour that matters but, rather, the position of the labour within the system of social relations which produce value.[26] This has the consequence that Marx is extremely keen to include the production of immaterial outputs within the scope of productive labour, but it is clear that his counter-examples are not fully thought through.

So for example he (correctly) treats Milton's production of *Paradise Lost* as unproductive, even though Milton was paid and the poem was published commercially, but Marx is frustratingly vague about the putatively contrasting figure of the jobbing 'literary proletarian of Leipzig' who is 'pretty nearly a productive worker since his production is taken over by

21 Marx, 1969, p. 152-3, 156.
22 Marx, 1969, p. 157.
23 Marx, 1969.
24 Marx, 1976, pp. 941-1084.
25 Marx, 1969, p. 295.
26 Marx, 1969, pp. 152-174.

capital and only occurs in order to increase it'.[27] Marx acknowledges that 'with many "immaterial products" […] [t]he quantity of labour required to achieve a particular result is as conjectural as the result itself',[28] but does not expressly make the connection between that quantitative indeterminacy and the quantitative indeterminacy between the labour of the jobbing hack from Leipzig and the number of copies of the resulting book sold, save for the qualification that the jobbing hack is only 'pretty nearly' productive (whatever 'pretty nearly' may mean in the context of a binary distinction).

Marx treats a singer who performs live to an audience for the purposes of capitalist profit as *potentially* being productive from the point of view of the social relations governing the production of value, which seems correct, although it seems unlikely that such a worker would be a *net* producer of value – the vibration of even a large audience's worth of eardrums is unlikely to exceed in reorderedness the commodities consumed by the average singer in the space of time between performances. Understandably, Marx does not expressly consider the case where such a singer can sing once in a small room with no-one listening except a sound engineer and nonetheless be at the same time singing in perpetuity over and over again to anyone with a smartphone. He does, however, somewhat presciently acknowledge that in his time live performances were 'transitional' forms of capitalist output where labour was not fully subsumed into the capitalist mode of production. He (correctly!) treats difficulties like these (which seem to arise from his value-theoretical instincts coming into conflict with his wish to come up with a meaningful counter-example to Smith) as in any event not requiring to be resolved because they are 'of microscopic significance when compared with the mass of capitalist production'.[29]

Secondly, (and more confusingly) in drawing his own distinction in contrast to Smith's, Marx is focused on the production of value for the individual capitalist employing the labour, in the form of specifically monetary profits, rather than on the production of value in the form of quantities of socially necessary labour time. This would seem to be consistent with the value-form approach whereby 'any labour can be productive depending on whether its product is expressed as an exchange-value'.[30] What it leaves unexplained, however, is the categories of labour which Marx himself (correctly) treats as unproductive notwithstanding that the labour

[27] Marx, 1976, pp. 1044.
[28] Marx, 1969, p. 268.
[29] Marx, 1976, p. 1044.
[30] A. B Moraitis and J. Copley, 'Productive and unproductive labour and social form: Putting class struggle in its place', *Capital & Class*, vol. 41, no. 1, 1993, pp. 91-114.

in question is (a) posited as an input by capital, and (b) implicated in capitalist profitability. The paradigmatic instance of this is the labour required to bring sales about. Marx says that this labour

> […] no more creates value than the labour that takes place in legal proceedings increases the value of the object in dispute. This labour – which is a necessary moment of the capitalist production process in its totality, and also includes circulation, or is included by it – behaves somewhat like the 'work of combustion' involved in setting light to a material that is used to produce heat. This work does not itself produce any heat, although it is a necessary moment of the combustion process.[31]

In view of the foregoing confusions, it seems bold to claim that Marx provides us with a 'theoretically rigorous and empirically useful definition' as one scholar has recently claimed,[32] but there is nonetheless something like a consensus (among those Marxian scholars who still recognise the distinction between productive and unproductive labour notwithstanding the growing popularity of the 'value-form' approach) as to what can be derived from Marx on this point. A good summary of that consensus is to be found in Simon Mohun's 2003 essay 'Does All Labour Create Value':

> First, the nature of the output (for example, whether a physical good or an intangible service) is irrelevant. Only the social relations under which it is produced count. Hence a necessary condition for labour to be productive is that it is *wage* labour. Secondly, since wage labour must produce surplus value, or profit, to be productive, and profit only derives from the sale of output, a further necessary condition for labour to be productive is that the output it produces is *marketed*. Thirdly, the activity in which productive labour is engaged is a transformative activity of *production*. The activity cannot be one which distributes or redistributes an output which has already been produced elsewhere, and nor can it be one whose function is to collect together inputs so that they are then ready for production. These types of activity earn profit that is a redistribution (through the market via the price mechanism) of profits earned through the consumption of inputs in a production process, and so do not contribute in the aggregate to total profits produced. Hence a further necessary condition for labour

[31] Marx, 1978, p. 208.

[32] E. K. Olsen, 'Productive and Unproductive Labour', in David M. Brennan (ed.), *The Routledge Handbook of Marxian Economics*, London, Routledge, 2017, p. 123.

> to be productive is that *additional* surplus value is produced. In sum, in capitalist society, productive labour *first*, is wage labour, *second*, is employed in a capitalist production process, and *third*, produces surplus value from a social point of view. All other wage labour is unproductive.[33]

This is clear and confident, but (in addition to such minor quibbles as one may have with the detail) there is a fatal defect in it: the third condition begs the entire question – how do we distinguish labour which yields an output in its own right? What, in other words (and this is a question that we have already considered at length) is so special about production?

The underlying problem with this analysis is that it proceeds on a basis which is too reliant on the fragmentary structure of Marxian discourse on the distinction between productive and unproductive labour, as opposed to being simply a negative answer to the question whether the labour is implicated in the creation of value. The received starting point that all labour is productive if it produces profit for an individual capitalist whatever the nature of the output is clearly too wide, since it fails to account for the fact that the outputs of some forms of profitability under the capitalist mode of production (banking, for example, or robbery) cannot embody value in the Marxian sense. And after that too-wide start, the received approach has us engage in a subtractive process, albeit that there is no coherent theory underlying the subtraction.

The subtraction of marketing labour specifically by reference to the fact that it inhabits the sphere of circulation is, for example, a grave ontological misstep. The general theory of value does not rely on a distinction between a production sphere and a circulation sphere – labour either is or is not embodied as value in the commodity at the point of exchange – and so to define a sphere of circulation in order to show which categories of labour are not capable of being embodied as value in the commodity at the point of exchange is to beg the question. Ultimately if this approach is taken then the error of distinguishing between forms of labour on the basis of the different use-values produced, rather than on the basis of whether *value* is produced, is inevitable.[34] It is somewhat unsurprising therefore that many scholars throw their hands up in horror and adopt the value-form approach of, instead, treating exchange-value as indicative of production (even if it means some degree of contortion in dealing with Marx's unambiguous categorisation of, for example, marketing

[33] In A. Saad-Filho (ed.), *Anti-Capitalism*, London, Pluto, 2003, pp. 42-58.

[34] See S. Cámara Izquierdo, 'A value-oriented distinction between productive and unproductive labour', *Capital & Class*, vol. 30, no. 3, 2006, pp.37-63.

labour as unproductive[35].

The wide overly-inclusive starting point, and the inadequately theorised fragmentary subtractions for marketing, finance &c, can however both be replaced by a single test that is derived from the very core of Marx's theory of value as elaborated over the first seven chapters of *Capital i.e.* that in order to be productive of value labour must be 'socially necessary' not merely from a causal perspective but on a *quantitative* level in respect of the quantities of the commodities at the point of exchange. Indeed it is the proposition that labour must be more than merely *causative* of value coming into being that Marx uses in the extract above regarding marketing efforts, and Marx uses the precise same logic for a category of unproductive labour that is nowhere near the sphere of circulation: the labour of troops protecting crops.[36] It might be objected that a greater quantity of crops would require a greater quantity of troops, but this would be a false objection; clearly the number of troops required is a function of the level of threat to the crops and not a function of the volume of output.

This test is, in essence, the test that gives rise to the distinction between 'absorptive' and 'productive' labour set out above. Given that the test for absorptive labour is intended to be a theoretically more coherent test for the same underlying concept (*i.e.* labour which does not produce value), rather than being a fundamentally different concept, its analyses of different sectors of activity under actually existing capitalism are broadly similar to the analyses that arise when applying the concept of 'unproductive labour'. There is a substantial body of literature performing this analysis on a sectoral level.[37] There are, however, a number of differences. One such difference (offered by way of illustration) is that retail workers are productive in my analysis to the extent that their labour is quantitatively implicated in the handling of commodities, whereas in the conventional sectoral analyses the entire retail sector tends to be treated as unproductive by virtue of falling into the so-called sphere of circulation.

4.7 The wider productive and reproductive sphere

There are two important perspectives on these matters which fall to be considered by way of context: postoperaismo and social reproduction theory. Both of them locate the creation of

35 See for example Pitts, 2017, p. 230.

36 Marx, 1969, p. 289.

37 For a much cited and relatively recent example see S. Savran and E. A. Tonak, 'Productive and Unproductive Labour: An Attempt at Clarification and Classification', *Capital & Class*, vol. 22, no. 68, 1999, pp. 113–152.

value within wider reproductive spheres. Turning to the first of them, postoperaismo developed from a left movement in Italy but it gained huge traction in the English-speaking world at the turn of the twenty-first century with the publication of *Empire* by Michael Hardt and Antonio Negri[38] and has recently again been popularised in the UK by authors such as Paul Mason.[39] For our purposes the core insight of this school is the severing it identifies between the quantitative concerns of conventional materialist Marxist value theory and the role played by what it labels 'immaterial labour' in the modern global economy.

Of course all labour has material content even if it is just electrical impulses of the brain and the basic metabolic processes that support them. Immaterial labour is defined not by its content, however, but by its effect: it is labour 'that produces the informational and cultural content of the commodity'[40] (as distinct, that is, from the commodity's material properties: its substance, form, location &c). It is a key contention of postoperaismo that immaterial labour takes place throughout culture rather than exclusively pursuant to the wage relation, but specifically regarding immaterial wage labour, it is observed in the postoperaist literature, as it is observed here in this thesis, that the quantity of such labour performed in production is *not* quantitatively related to the quantity of commodities produced.[41]

For authors of the postoperaismo school, who proceed on the (*prima facie*, quite reasonable) assumption that value theory is necessarily quantitative in its purpose,[42] this 'crisis of measurability'[43] means that value theory has to be left behind altogether. Value in Hardt and Negri's analysis evaporates into an indeterminate cloud of utility and desire that permeates our cultural and informational lives and loses its distinctiveness as something measurable that emerges from the relationship between labour and capital.[44] This perspective has been vigorously contested both from a mainstream Marxist standpoint[45] and from a value-form

38 Hardt and Negri, 2000.
39 Mason, 2015.
40 Lazzarato, 1996, p. 134.
41 'When you want to establish the average time that is needed to produce a material object, you just have to do a simple calculation: how much physical labor time is needed to turn matter into that good. It's easy to state this, to decide how much time is needed to produce a material object. But try to decide how much time it takes to produce an idea. Try to decide how much time is necessary to produce a project, a style, an innovation. Well, you see that when the process of production becomes semiotic, the relationship between labor time and value suddenly evaporates, dissolves into thin air.' F. Berardi, *The Uprising: on Poetry and Finance*, Los Angeles, Semiotext(e), 2012, p. 87.
42 Pitts, 2018, p. 163.
43 C. Marazzo, *Capital and Language*, Los Angeles, Semiotext(e), 2008, p. 43.
44 Hardt and Negri, 2009, pp. 132-3.
45 See for example G. Caffentzis, *In Letters of Blood and Fire*, Oakland, PM Press, 2013, pp. 95-123; Caffentzis is identified with 'autonomist' Marxism which would generally be understood as aligning him with postoperaismo, but his critique of the Hardt/Negri school appears to be firmly rooted in a traditional materialist analysis of value.

standpoint[46] but postoperaismo's core contention in this context – that there are categories of wage labour or categories of commodity where the quantitative relation between labour and value is broken – is (as we have seen) correct.

Postoperaismo is wrong to conclude, however, that Marxian value theory is somehow rendered obsolete by this severing. As Pitts observes, in ascribing more or less productiveness to certain kinds of worker, postoperaismo is squarely contained within the continuities of traditional Marxist determinations of who or what is productive.[47] What postoperaismo identifies is therefore not, as its proponents contend, the *obsolescence* of conventional Marxian value theory, but the movement of a distinction within it (*i.e.* the distinction between productive and absorptive labour) from the periphery of political economy to a position of far greater importance.

There exists a growing Marxian literature on labour in the information economy, and there can be no doubt that it is a hugely important topic, particularly from the political point of view of including information economy workers in a class analysis of labour exploitation.[48] But from a strictly value-theoretical perspective the debate in the literature has little to add to the present discussion; such departures as may be found in that literature from the mainstream tradition of Marxian value theory are essentially a redeployment of the Marxian concept of 'value' in a novel way whereby it ceases to be a theory of value in the classical sense.

Thinking along these lines is particularly well illustrated by the claim (which we shall come to revisit in a very different context in chapter 8) that social media use during leisure time creates value.[49] The reason this position is, at best, orthogonal to value theory in the classical sense is because, as already noted, in order to form part of a determination of *surplus* value, the thing has to have been posited by capital as an input. In other words, as is the case with wage labour or means of production, capital has to have *paid* for it. This requirement has been denounced as 'wage labour fetishism'[50] but it simply marks the difference between a non-value-theoretical sociology of how certain firms make money and a value-theoretical

46 See for example Pitts, 2018, pp. 191-219.
47 Ibid, p. 221.
48 See in particular N. Dyer-Witherford, *Cyber-Marx*, Champaign, University of Illinois, 1999 and U. Huws, *Labour in the Digital Economy*, New York, Monthly Review Press, 2014a.
49 A prominent author in this strand is Christian Fuchs, who has written extensively on this subject; see in particular C. Fuchs, *Digital Labour and Karl Marx*, London, Routledge, 2014.
50 See C. Fuchs, 'The Digital Labour Theory of Value and Karl Marx in the Age of Facebook, YouTube, Twitter, and Weibo', in E. Fisher and C. Fuchs (eds.), *Reconsidering Value and Labour in the Digital Age*, London, Palgrave Macmillan, 2015, pp. 26-41.

ontology of capitalist surplus, *i.e.* a theory which is actually explanatory of the difference between the aggregate value of capitalist inputs and the aggregate value of capitalist outputs. Recalling Helen Boss's taxonomy from chapter 1, postoperaismo is a 'theory of interdependence' rather than a theory of surplus and transfer – it recognises the *causal* role of wider spheres than the productive in the bringing into being of value (in this context the sphere of social media), at the expense of the ontology of value as a thing *quantifiably* brought into being.

In any event, Marx's claims about where value comes from expressly accommodate the fact that revenues accrue in other ways than by reference to material production (*e.g.* as rents, interest &c.), having been extracted from the productive economy by means of non-productive legal rights over assets. There is nothing in Marx to preclude the addition to his analysis of new categories of method by which asset-owners can deploy the labour of others to extract value from the system *without* the assets in question being means of material production. By the same token, as Marxist feminists make clear, there is nothing in the Marxian schema which precludes the possibility of unpaid labour being implicated in capitalist profitability; indeed unpaid labour has *always* been implicated in capitalist profitability.[51] It is to Marxist feminism, and social reproduction theory, that we now briefly turn.

As we do so, it is important to be precise about what is meant by consumption in the context of the aforementioned circuit whereby some of the reorderedness in the system is consumed by the workers producing it. Of course, workers and their dependants need to eat, but the role played by means of subsistence for the purposes of this analysis is that means of subsistence form part of a material circuit whereby the reorderedness of commodities contributes to the reorderedness of further commodities. Reorderedness passes through that circuit solely by dint of being posited by capital as an input, indirectly, by means of the worker's wage (or equivalent). It could therefore be embodied by any kind of commodity performing any subsequent function provided that it is acquired out of the worker's wage; it does not need – of course! – to physically pass through the worker's body. The point is simply that it forms part of what is deducted from the gross reorderedness produced in order to arrive at a net surplus. This means that an entire household's consumption can come into the equation. The fact that some of the wage goods may be consumed by other members of a worker's

[51] This is expertly explained in U. Huws, 'The Underpinnings of Class in the Digital Age', *Socialist Register*, vol. 50, 2014b, pp. 80-107.

household, whose labour may reproduce the worker, does not impact upon the *quantities* in play.

There was nonetheless formerly fierce debate within Marxist feminism as to whether socially reproductive labour[52] (and more specifically unpaid domestic labour) is 'productive' labour in the technical sense. At the time (i.e., broadly, over the course of the 1970s) the debate was of central importance within Marxist feminism, not merely for its theoretical conclusions, but for its wider agenda-setting role, linking the 'wages for housework' movement to revolutionary Marxist thinking.[53] 'As it turned out', however (this is Lise Vogel writing in 1983), 'it was relatively easy to demonstrate theoretically that domestic labor in capitalist societies does not take the form of value-producing labor'.[54] As Susan Himmelweit put it in 1977 (referring to unwaged domestic labour simply as 'domestic labour' in this extract):

> Since productive labour is labour that has a direct relation to capital and produces surplus value, domestic labour is not productive labour. But neither is it unproductive labour, for unproductive labour exchanges not with capital but with revenue, again in a direct exchange; and domestic labour is not performed for direct payment. The categories of productive and unproductive labour relate to wage-labour alone; in the analysis of domestic labour they are irrelevant.[55]

Today the debate is no longer particularly visible within Marxist feminism although its conclusions remain theoretically valid: unpaid reproductive labour is not productive labour for the simple reason that it is not predicated on the wage relation (or remunerative equivalent). As has already been explained, this is not to attribute some kind of magic significance to the wage relation, or to ignore the causal context of accumulation (which includes unwaged socially reproductive labour, notably in the home); it simply emanates from the specific role of value theory in explaining capitalist surplus on a quantitative level. What social reproduction theory tells us, from a value-theoretical perspective, is that the entirety of capital's reproduction of itself – with an attendant surplus – takes place within a wider sphere of reproduction. That sphere can have any number of causal interdependencies with capitalist surplus but they are not the quantitative ones vis-à-vis the production of value posited by Marxian value theory as an account of capitalist surplus.

[52] As to which see T. Bhattacharya, 'How not to skip class: social reproduction of labour and the global working class', in T., Bhattacharya (ed.), *Social Reproduction Theory*, London, Pluto, 2017, pp. 68-93.
[53] S. Himmelweit, 'Domestic Labour and Capital', *Cambridge Journal of Economics*, vol. 1, no. 1, 1977, p.18.
[54] Vogel, 1983, p. 23.
[55] Himmelweit, 1977, p. 18.

The point was beautifully summed up at a recent conference on social reproduction in London by Marxist feminist legend Silvia Federici, reflecting, in the discussion following formal presentations, on her involvement in the 'wages for housework' movement decades previously. She explained that she and her comrades took from Marxian value theory the proposition that capital extracts surplus by means of that portion of the worker's labour power that it does not pay for – she was referring to the core value-theoretical point that the value of a worker's wage is less than the value of the work performed by the worker. She and her comrades wanted to make the point, as feminists and activists, that in fact capital sucks unpaid labour from the entire community.[56] And, for the reasons set out above, her claim to that effect is not inconsistent with the claims made here.

It is worth noting that in informal discussions around this topic, albeit not in the literature, one often encounters a simplified variant of the feminist critique of Marxian value theory, which is to argue that unpaid domestic labour creates value in the Marxian sense because it saves the capitalist on costs (i.e. specifically the costs of reproducing the labour which is reproduced for free by unpaid domestic labour). This constitutes a confusion between value in gross form on the one hand and, on the other, the surplus value that can be said to have arisen on a net basis once costs are taken into account. As set out in chapter 3, value is produced by labour, and *surplus* value arises from the fact that labour costs less in value than the value that it produces. While it is true that anything which reduces capital's costs means a greater quantity of surplus must necessarily arise in respect of any given quantity of gross value, such reduction in capital's costs should not be confused with an *increase* in gross value. But in any event – and this is the argument set out above – the costs of that unpaid domestic labour are *already* taken into account because the costs of labour include wage goods which are consumed by household members rather than the wage earner themselves.

Of course household members can be sustained through, for example, payments from the *state* rather than provision by a household wage-earner, which is why – as shall be elaborated upon in chapter 6 – these arguments against Marxian value theory may usefully be reconfigured as arguments in favour of *better, more feminist* fiscal sociology.

4.8 Value capture outside the production boundary

Marx was very clear that the theory of value he was developing was a theory of the underlying source of capitalist surplus, 'regardless of its particular forms as profit, interest,

[56] Social Reproduction Theory Conference, Queen Mary University of London, 25 June 2019.

ground rent, etc'.[57] Accordingly the question of whose hands the money ends up in is a separate one from the question of where the value is created. To adopt a simple illustration using the categories Marx mentions in the quotation above, an individual asset-owner can make an accounting profit even though it employs only absorptive workers – a bank for example – while tremendous amounts of value can be created by the workers employed at a factory which nonetheless makes an accounting loss because payments of interest and rent exceed what would otherwise be its profits.

To take a more schematic illustration, to put beyond doubt that there can be both exploitation of labour and profitability without value creation, let us revisit the Fooshire-Barshire bridge scenario prior to the bridge collapse, but let us suppose a mountain pass instead of a bridge. Suppose then that a notorious bandit operates at the pass and, instead of robbing people arbitrarily, charges a percentage of the value of commodities passing over it, employing a number of people to inspect consignments of commodities, collect the charge &c. In these circumstances there will be both wage labour and (potentially) profit, and yet it is impossible to imagine how it could be claimed that the bandit's business creates value. It is nothing other than a mechanism to distribute to the bandit (and onwards in part to the bandit's employees) value, which is created elsewhere in the system, by reference to the bandit's opportunity to control access to markets.

Very often the power to extract value in this way is supported by legal regimes. One paradigmatic example is the legal regime giving rise to private property over land. If the Fooshire-Barshire mountain pass was privately owned such that the owner could lawfully prevent passage over it, then the owner would be able to operate the same business as is described above, *i.e.* charging a fee to cross the pass, without being called a bandit. Other legal regimes operate in a similar way; most notably intellectual property. We have already noted that the creation of intellectual property does not create value, however commercially useful the intellectual property may be. This conclusion is reinforced by that fact that it is the legal regime (underpinned by the threat of state violence) rather than the content of the intellectual property that ensures that specifically its owner, rather than just anyone, is best positioned to benefit commercially from the use of it. Profits attributable to the use of intellectual property are therefore ultimately no less reliant on the threat of violence than the bandit's business at the mountain pass.

[57] *Marx and Engels Collected Works* vol 42, London, Lawrence & Wishart, 2010a, p. 407.

The business models and systemic dynamics associated with these kinds of phenomena will be considered in chapter 6. For present purposes it is only necessary to reinforce on a level of theoretical abstraction that profitability does not necessarily mean that value creation has taken place. This is in order to forestall the 'common sense' objection to the theory of value adumbrated in this thesis that it cannot possibly be correct because of the dazzling profitability of firms like Google, Apple, Facebook, Amazon, Microsoft and Nike, with their brands and their software and their algorithms and their big data and their industrial design innovations. A company can be as profitable as those companies and be staffed entirely by absorptive workers. The value creation would be taking place elsewhere in the system and the profitability would represent mere value *capture*. The question that value theory exists to answer (i.e. where does the surplus come from?) is externalised to the rest of the economy.

4.9 Conclusion

When we consider on a theoretical level, then, where capitalist surplus comes from, we find that (as the tax judges in chapter 2 seem to have intuited for the practical purposes of the cases before them) objectively it comes from material production, irrespective of where it may end up as profitability, by dint of what are effectively transfers, referable to our subjective desires. It is for this reason that the court in the *Aken* case only found there to be taxable profit by reference to the commerciality of the operation, rather than by reference to any objective value creation, and the court in *Mason v Innes* found that, absent the exchange required to show subjective value in the case of immaterial production, no value creation had happened at all. By the same token in the *Golden Horse Shoe* case value had been created by dint of the mine tailings having been physically and objectively 'won and gotten' from the ground even though subjectively from the perspective of the person winning and getting them they were waste materials. The production boundary elaborated in these two chapters which have followed provides a comprehensive framework in which to make sense of the decisions taken in those cases, and the related cases also discussed in chapter 2.

In the case of the charge to tax on trading profits, of course, the charge arises whether or not the taxpayer is inside or outside the production boundary – we only see the production boundary as an emergent phenomenon in tricky cases like *Mason v Innes*. But in the case of today's international corporate tax reform discourse, it is positively intended that profitability should be allocated to where value is created, and so in that context the question whether or not profitability falls inside or outside whatever production boundary is in play is a pertinent

one. And there can be no doubt that an offshore entity accumulating the untaxed profits of a multinational enterprise, even if it employs some workers falling into the absorptive category, is outside the production boundary developed here.

And so the desired outcome from the normative allocation of profitability to where 'value is created' – i.e. that it is allocated away from such entities – is something that the theory of value adumbrated here brings with it without modification. This, as anticipated in chapter 1, takes us further at least than modern mainstream marginalist value theory, which as we saw would only beg the question by using putative subjective value to correct a system based on putative subjective value. That is just the start, however. The concepts explored here will be of further assistance when we come to consider (i) the fiscal sociology of global production in Part II of this thesis, (ii) the way the concept of 'value creation' is deployed on a detailed level in the BEPS discourse in Part III of this thesis, and (iii) in the conclusions to the thesis as a whole.

That concludes Part I of this thesis – the value-theoretical section. We now turn to directly considering those aforementioned offshore profits of multinational enterprises, in the context of production globally, and we begin, in the chapter which follows, by addressing specifically the concept of 'offshore'. This concept is a juridical one, and accordingly (as warned in the introduction), this thesis makes a methodological switch back to a legal doctrinal approach to its subject matter.

PART II: GLOBAL CORPORATE CAPITAL AND THE STATE

Chapter 5: Corporations, comity and the revenue rule: a jurisprudence of offshore

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5.1 Introduction

'Offshore' is one of the defining concepts of our times. As states struggle to fund basic provision of public services,[1] inequality is growing rapidly,[2] and vast wealth is known to be accumulating outside the scope of the power of states to tax it,[3] in a space widely referred to as 'offshore'. Some significant part of that offshore accumulation (it is impossible to determine even approximately how much) is referable to the kinds of MNE tax planning activities which the BEPS process was instituted to address. And so, broadly speaking, it is where those taxable profits the reallocation of which this thesis is about are to be reallocated *from*. In the introduction to this thesis a consensus as to a negative meaning of 'value

1 I. Ortiz, et al, 'The Decade of Adjustment: A Review of Austerity Trends 2010-2020 in 187 Countries', ILO, 2015, https://web.archive.org/web/20181109104353/https://www.social-protection.org/gimi/RessourcePDF.action?ressource.ressourceId=53192, (accessed 29 August 2020); I. Ortiz & M. Cummins, 'Austerity: The New Normal: A Renewed Washington Consensus 2010-24', Initiative for Policy Dialogue *et al.*, October 2019, available at https://web.archive.org/web/20200726232710/http://policydialogue.org/files/publications/papers/Austerity-the-New-Normal-Ortiz-Cummins-6-Oct-2019.pdf

2 F. Alvaredo, et al, 'World Inequality Report 2018', https://web.archive.org/web/20180821121737/https://wir2018.wid.world/files/download/wir2018-full-report-english.pdf, (accessed 29 August 2020).

3 A. Alstadsætera, N. Johannesen, and G. Zucman, 'Who owns the wealth in tax havens? Macro evidence and implications for global inequality', *Journal of Public Economics*, vol. 162, 2018, pp. 89-100; Tørsløv, Thomas R. , Ludvig S. Wier, & Gabriel Zucman, 'The Missing Profits of Nations', NBER Working Paper 24701 (June 2018, Revised April 2020), available at https://web.archive.org/web/20200820022713/https://www.nber.org/papers/w24701.pdf

creation' was noted: whatever 'value creation' may be, it is *not* whatever MNE subsidiaries in tax havens are doing. Offshore is the name given to the juridical realm where this non-value-creating non-production takes place.

But what *is* offshore? Or, more specifically, what is offshore from a legal perspective? If it is a juridical realm in which accumulation can take place outside the power of states to tax it, it should be amenable to description by reference to legal doctrine or legal principles – there should exist something resembling a *jurisprudence* of offshore. And, indeed, there is. The prevailing conception of offshore derives from the oft-cited work of Ronen Palan, who is a scholar of international political economy, but whose definition of offshore is decidedly juridical in flavour. Offshore in his conception is what happens when the sovereign power of the state to regulate (or, as the case may be, to tax) is bifurcated into, on the one hand, a regime that applies domestically, and on the other hand a lighter regime that is 'commercialised' for the purposes of a global market for such regimes.[4] The thing we call 'offshore' is the totality of these 'juridical realms marked by more or less withdrawal of regulation and taxation'.[5] (Paradigmatically, we are talking about the tax regimes of 'tax haven' jurisdictions as conventionally understood, although activist and academic discourse around the concept of offshore is generally keen to emphasise that offshore includes preferential tax regimes offered to global capital by core jurisdictions such as the UK and the US.)[6]

The dominant conception of offshore therefore treats it as an autonomous exercise of state power. While it is widely recognised that the impulse to commercialise sovereignty in this way arises from a world order which is conducive to tax and regulatory competition between states[7] and the 'transnationalisation' of the tax base,[8] offshore is nonetheless seemingly ontologically predicated on the agency of the state: the state brings offshore into being by its own sovereign and unilateral act of withdrawal. Offshore, then, is generally analysed not as

4 R. Palan, 'Tax Havens and the Commercialization of State Sovereignty', *International Organization*, vol. 56, no.1, 2002, pp. 151-176.
5 R. Palan, *The Offshore World*, London, Cornell University Press, 2003, p. 19.
6 See for example R. Palan, R. Murphy and C. Chavagneux, *Tax Havens: how globalization really works*, London, Cornell University Press, 2010, p. 22.
7 P. Dietsch, *Catching Capital: The Ethics of Tax Competition*, Oxford, Oxford University Press, 2015; P. Genschel and L. Seelkopf, 'The Competition State: The Modern State in a Global Economy', in S. Leibfried, et al (eds.), *The Oxford Handbook of Transformations of the State*, Oxford, Oxford University Press, 2015, pp. 237-252; M. Leroy, *Taxation, the State and Society*, Oxford, PIE Peter Lang, 2011, p. 336. This topic is revisited in chapter 6.
8 P. Genschel, 'Globalization and the transformation of the tax state' *European Review*, vol. 13, no. 1, 2005, pp. 53–71.

an erosion of state sovereignty but as an *emanation* of it;[9] a deliberate and commercial 'bifurcation' of a state's sovereignty with a view to accommodating specifically *transnational* capital in a lightly-regulated or under-taxed regime.

More precisely, it is in juridical terms the aggregate of a multiplicity of specific emanations from specific states: 'offshore', writes Palan, 'refers not to the geographical location of economic activities, but to the juridical status of a vast and expanding array of specialized realms'.[10] But this purely juridical conception as an aggregation of discrete realms is seemingly not adequate to capture the quality of offshore as something distinct from the sum of its parts; not a fragmented landscape of individuated regimes but an unbounded world in and of itself – a space in which internationalized capital can move relatively freely. Any given jurisdiction might have its own specialised regimes earning it a particular place in the market for offshore services, but all such regimes participate in this 'bifurcated' sovereignty as a generalized phenomenon which (irrespective of the jurisdiction from which any specific regime emanates) seems to pervade the universe of property relations in a manner comparable to the way in which, say, gravity pervades the universe of physical relations. 'The offshore world', writes Palan, 'is not a peripheral development but is structurally related to, and indeed enables, the globalizing tendencies of the modern economy'.[11] Offshore is, as recent mainstream commentary on the topic often asserts, *everywhere*.[12]

Juridically, however, this all-pervading parallel universe continues to be understood as nothing more than an aggregation of discrete sovereign subtractions from an already fragmentary landscape of territorial property and tax regimes. The purpose of this chapter is to recharacterise it in juridical terms so as to produce a more coherent picture as between the jurisprudence of offshore and the role offshore plays as an all-pervading space in the analysis of global capitalism in the twenty-first century. As we shall see, upon investigation, the juridical substance of which the offshore realm is made turns out to be more like an already existing juridical *substrate* which is *exposed* by the subtractions effected by individual offshore regimes. That substrate is a centuries-old property regime (readily discernible from

[9] R. Palan, 'Trying to Have Your Cake and Eating It: How and Why the State System Has Created Offshore', *International Studies Quarterly*, vol. 42, no. 4, 1998, pp. 625-643.

[10] Palan, 2003, p. 2.

[11] Ibid p. 12.

[12] See for example the observations of N. Shaxson, 'Follow The Money: Inside The World's Tax Havens', The Guardian, 19 June 2015, https://www.theguardian.com/business/2015/jun/19/tax-havens-money-cayman-islands-jersey-offshore-accounts (accessed 1 September 2020), or of R. Bramall on the OpenDemocracy blog, 20 April 2016, https://web.archive.org/web/20160424215912/https://www.opendemocracy.net/uk/natasha-adams-rebecca-bramall/tax-justice-and-creative-activism-interview-with-natasha-adams, (accessed 15 November 2018).

the early modern era of chartered imperial trading monopolies, but arguably dating back a millennium or more) which is always already outside the scope of individual sovereigns' tax regimes. Accordingly, offshore is a subtraction of bifurcated elements from national legal regimes only as a matter of superficial appearance; there is (so this chapter argues) a pre-existing regime which is ordinarily obscured by territorial state sovereignty and which is revealed by the withdrawal of sovereignty effected by those bifurcations. It is that pre-existing regime which forms the globally pervading juridical substance that offshore is made of.

Palan's conception is robust and has proved useful to a generation of scholars, and this chapter does not seek to undermine it. It does, however, seek to underpin it, with a deeper layer of analysis as to the nature of offshore from a legal perspective. That analysis proceeds by contrasting two common law principles of significance in international economic law: (i) the so called 'revenue rule', whereby states do not enforce each other's tax laws, and (ii) the principle of comity as it applies to bring about mutual recognition of companies between states. As we shall see, the relation between those two principles is contradictory. The exercise of the state power to tax is territorially constrained for reasons of basic principle which should also apply to the exercise of the state power to create companies. Anomalously, however, that latter power is not so constrained. The existence of that anomaly suggests that there is some atavistic feature of corporate legal personality which can somehow cross borders of its own accord, and this chapter finds that feature rooted in a kind of rival sovereignty which is antithetical to the sovereignty of the state. When the sovereignty of the state is bifurcated, and part of it peeled away, that rival form of sovereignty is what is revealed.

To be clear, this chapter (while it looks quite deeply into the past in order to build its argument) does not seek to offer a history of offshore. This is, rather, a *jurisprudence* of offshore; alternatively put, it is an account of the ontology of offshore from a specifically legal perspective. The reason that this jurisprudence needs to delve into the past is because offshore, as this chapter characterises it, is an emanation of the relation between state sovereignty and corporate sovereignty, and the nature of that relation is easier to grasp when some of its deeper history in view. It is also important to recognise something else that the history brings to the surface *i.e.* (as the conclusion of this chapter seeks to demonstrate) the inherent violence in this seemingly technical phenomenon in the world of financial relations.

5.2 Territoriality and the 'revenue rule'

The courts of a given state do not generally give effect to the laws of other states, and in particular they do not do so where such laws are in the nature of (to use the phrasing of the leading UK textbook on conflict of laws) 'penal, revenue or other public law'.[13] The existence of this unwillingness to give effect to foreign penal, revenue or other public law is sometimes encountered as a defence in private law proceedings, in which context it is manifest as a 'rule'. A claim might be said to fall foul of the 'rule' because it amounts to an *indirect* enforcement of another state's law.[14] But to think of it as a 'rule' – to the extent such designation suggests that it derives from some authority and requires to be enforced – disguises its true nature. It is better thought of as a manifestation of the basic principle of territoriality: the principle whereby a sovereign's authority terminates at the boundary between that sovereign's territory and another's. 'Whenever a State wants to exercise sovereign powers to further its own economic interests or other political choices', explains the author of a leading textbook on international economic law, 'this State's powers are confined to its own territory.'[15]

Classically, international law scholars identify types of extraterritorial jurisdiction, drawing a distinction for example between a 'jurisdiction to prescribe' and a 'jurisdiction to enforce', which reflect (respectively) a state's power to legislate extraterritorially, and a state's power to exercise executive power extraterritorially. And so, from an international law perspective the principle being adverted to here is the default position whereby (a) no extraterritorial jurisdiction of any such type arises in the ordinary course of states legislating domestically,[16] and (b) *a fortiori* no such jurisdiction arises in respect of penal, revenue or public matters. The principle is perhaps more straightforwardly understood, however, as a principle of municipal constitutional law regarding the role of municipal courts in giving effect to legislation. Ordinarily, the legislation to which municipal courts give effect is the legislation of the state from which they derive their jurisdiction, since legislature and judiciary partake of the same territorially-bounded sovereign legal order. This is not to say that municipal courts will not give effect to foreign legislation should municipal law require it for one reason or another (for example pursuant to relations arising under a treaty). It is just that, at least in the case of foreign 'penal, revenue or other public law', the basic principle generally applies

[13] A. Dicey, J. Morris and L. Collins, *Conflict of Laws*, 14th edn., London, Sweet and Maxwell, 2006, 5R-19.
[14] See for example *JSC BTA Bank v Ablyazov and others* [2011] EWHC 202 (Comm).
[15] M. Herdegen, *Principles of International Economic Law*, 2nd edn., Oxford, Oxford University Press, 2016, p. 109.
[16] G. Boas, *Public International Law*, Cheltenham, Edward Elgar, 2012, p. 250.

so that they do not give effect to it.

The so-called 'revenue rule' is simply a somewhat narrower and more focused articulation of this same basic principle. The content of the rule ('if it be a rule', said Viscount Simonds)[17] is that states do not enforce each other's tax laws. In the UK the leading authority on the rule is *Government of India v Taylor*.[18] It concerned a UK company which owed capital gains tax in India, and the government of India was not permitted by the court to prove its debt in the company's liquidation. This was not a novel result; the House of Lords simply applied the long-established rule whereby foreign tax law is not enforced in the UK courts:

> It is perfectly elementary that a foreign government cannot come here – nor will the courts of other countries allow our government to go there – and sue a person found in that jurisdiction for taxes levied and which he is declared to be liable to by the country to which he belongs.[19]

Lord Keith offered two explanations for the principle, either of which he thought sufficient for applying it, and which are ultimately different articulations of the same principle. First, he said that 'enforcement of a claim for taxes is but an extension of the sovereign power which imposed the taxes and […] an assertion of sovereign authority by one state within the territory of another […] is, treaty or convention apart, contrary to all concepts of independent sovereignties.'[20] Second, citing Judge Learned Hand in an American case, *Moore v Mitchell*,[21] he provided the explanation that 'to pass upon the provisions for the public order of another state is, or at any rate should be, beyond the powers of a court; it involves the relations between the states themselves, with which courts are incompetent to deal, and which are entrusted to other authorities'.[22]

A key point to draw from the discussion in *Government of India v Taylor* is that, while the court cited numerous authorities in support of the rule, all those authorities concurred that they were simply doing what courts have always done: 'this point is too plain for argument', said one previous judge.[23] By contrast the idea that the court might do otherwise was a novelty, and counsel for the government of India more-or-less conceded that he was arguing

[17] *Government of India v Taylor* [1955] AC 491.
[18] [1955] AC 491.
[19] *King of the Hellenes v Brostrom* [1923], 16 Lloyd's Rep 190, per Rowlatt J., cited approvingly in *Government of India v Taylor*.
[20] *Government of India v Taylor* [1955] AC 491 at 511.
[21] 30 F 2d 600 (1929).
[22] *Government of India v Taylor* [1955] AC 491 at 511.
[23] *Government of India v Taylor* [1955] AC 491 at 505.

for a change in the law. Having admitted that there was no known instance of an English court having given effect to foreign tax law, he urged that there 'ought to be, and is a trend towards, a mitigation of the rule, particularly as between states which are united by the bonds of federal union or by such looser ties as bind the British Commonwealth of nations'.[24] The court declined, however, to adopt a model based either on balancing the needs of a federal union and its individual member states, or on the idea that a former colonial possession, India, might be allowed some extension of its recently won sovereignty into the territory of what was previously its imperial possessor.

Emanating as it does from the elementary principle of territoriality, it might be thought that there should not be much controversy around the revenue rule, but in fact it attracts a great deal of controversy. In part this is because, while the rule is very easy to apply in a simple case like *Government of India v Taylor* where one state appears in the courts of another seeking to assert its own statutory tax charge, it is much harder to apply in more indirect cases where the *outcome* of proceedings is open to being characterised as the enforcement of foreign tax law even though that is not what is directly in contention between the parties before the court. Those difficult cases give the impression that there is huge uncertainty as to the scope of the rule, and indeed there is uncertainty as to where the boundaries of the rule lie for these indirect purposes.

An example might be the relatively recent US Supreme Court case of *Pasquantino v United States*.[25] This was a wire fraud prosecution in respect of some smuggling into Canada. The elements of the offence were made out, but a defence was mounted to the effect that to convict would be to enforce Canadian import duties in contravention of the revenue rule. The defence failed, and it is not hard to see why; it relies on the misconception that the revenue rule is a free-standing rule that constrains the behaviour of courts, whereas in fact it simply reflects the territorial limits of Canada's sovereignty. The prosecution for wire fraud in *Pasquantino* did not serve to enforce Canada's import duty statutes beyond those limits; it simply prosecuted some defendants in the US for a crime defined in US criminal law and committed in the US. Intuitively, however, the expectation that the revenue rule should serve as a defence in such a context is understandable: in substance the crime being prosecuted was indeed in the nature of Canadian import duty evasion rather than US wire fraud.

Cases like this attract attention because of the apparent contribution made by the revenue rule

[24] *Government of India v Taylor* [1955] AC 491 at 506.
[25] (03-725) 544 US 349 (2005).

to the judicial arsenal of constraints upon the state power to tax. Commentators, and particularly those working professionally within the tax industry, have a tendency to perceive any instance of the rule not succeeding as a defence in court (as happened in *Pasquantino*) as a serious threat to liberty – see for example the somewhat apocalyptic piece by white shoe law firm tax partner Brian Wallach, 'All hands on deck: rescuing the revenue rule from the Supreme Court's decision in *Pasquantino*'.[26]

Another reason the revenue rule incites controversy is because it is sometimes (misleadingly) characterised as a more deeply-rooted and broadly effective *norm* which, in addition to merely reflecting the fact that the courts of one jurisdiction do not generally enforce the laws of another, also constrains the legislative and executive branches of government in the policies they implement.[27] From this perspective, when governments implement policy which either enforces foreign taxes domestically or (like the United States' notorious FATCA regime[28]) has the indirect effect of providing for domestic taxes to be enforced abroad, commentators offer dramatic framings calling into question whether the revenue rule even exists any more. For an illustration of this tendency see Toby Graham's piece 'Is *Government of India v Taylor* really dead?'[29]

These framings are misconceived. While application of and discussion around the so-called 'revenue rule' labels it as a 'rule' for discursive convenience, there is in fact no rule against the enforcement of tax law internationally *per se*; as already noted the 'rule' simply means that courts will not enforce another state's tax law unless there is a legal basis in domestic law for doing so. No constitutional principle is offended, or rule abrogated, by domestic governments providing such a basis through the ordinary mechanism of enacting legislative authority.

Speaking more broadly of the discussion surrounding the revenue rule, there are explanations for and defences of its existence that are more sophisticated than the basic territorial one, which may be cited by courts and developed by commentators to suit all tastes and theoretical biases, or to fit a specific analytical juncture,[30] but the rule itself does not call for explanation

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[26] *Tax Law*, vol. 59, 2005-6, p. 621.

[27] See for example P. Baker, 'Changing the Norm on Cross-border Enforcement of Debts', vol. 30, no. 6-7, *Intertax*, 2002, p. 216.

[28] In broad summary, FATCA requires non-US banks to disclose to the US government information about the assets of US clients.

[29] *Journal of Money Laundering Control*, vol. 3, no. 4, 2000, pp.377-382.

[30] For a detailed discussion see B. Mallinak, 'The Revenue Rule: A Common Law Doctrine for the Twenty-First Century', vol. 16, no. 1, *Duke Journal of Comparative & International Law*, 2006, pp. 79-124.

as a distinct norm. It simply flows from the general constraint on a sovereign's absolute power throughout all of space that is referable to the existence of other sovereigns located elsewhere with (on a formal level at least) equal power. In common law jurisdictions it is labelled as a rule and its scope as such debated, but civil law jurisdictions are equally unwilling to exercise another state's sovereign power on its behalf within their own territories.[31]

The territorial principle underlying the revenue rule as elaborated upon in this section is contrasted in the remainder of this chapter with the transnational recognition of corporations. Put simply, the difference is that, unlike tax law, company law (as it were) travels across borders. But the transnational recognition of corporations is said by judges and commentators alike to derive not from any specific identifiable species of prescriptive extraterritorial jurisdiction on the part of the state under whose legislation a given company comes into being, but from the general international law principle of 'comity'. And as we shall see the application of comity for these purposes is anomalous, and this anomaly has deep structural implications; implications which (going largely unnoticed) are an *unacknowledged* core feature of how capital functions on a systemic scale.

5.3 Transnational corporate personhood

Corporations are fictional persons able to act as if they were real persons for legal purposes. The core feature of legal personality which distinguishes it from some other kind of artificial personality – a drag persona, for example, or a fictional cartoon personage deployed as a brand, or an android – is recognition as a person *by the courts*: the right to sue and the capacity to be sued. All other functions of legal personality, and in particular the right to own property and the capacity to enter into contracts, flow from the right to sue and be sued. We tend to overlook the role played by recognition by the courts in the activities of corporations because, on a practical level, litigation is generally peripheral to their reasons for existence. But it is nonetheless at the heart of what they are, underpinning even the most seemingly fundamental principles of corporate law: the concepts of limited liability and the 'corporate veil', as they are generally understood,[32] are only meaningful on the basis that the entity in question is one that is capable of being a party to litigation.

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[31] International Law Association, 'International Committee on Transnational Recognition and Enforcement of Foreign Public Laws', Report of the 63rd Conference, 1988, p. 719-763.

[32] L. Gower and P. Davies, *Principles of Modern Company Law*, 7th edn., London, Sweet & Maxwell, 2003, pp.27-34.

Legal personality is conferred on corporations by the state, by means of legislative fiat. We tend to think of the phenomenon of separate legal personality as deriving from (a) legislation such as the UK's Companies Act 2006, which brings UK companies into being pursuant to the completion of some statutory formalities, and (b) some associated foundational case law (in English law it is *Salomon v A Salomon & Co Ltd*)[33] affirming that entities created in accordance with some nineteenth century statutory forbear of the legislation under which the entity in question was incorporated do indeed have separate legal personality. This does not tell the whole story, however. Separate legal personality was not a Victorian invention; it has been the prerogative of the sovereign in English law to create corporations with separate legal personality for a very long time indeed. The East India Company was created by royal charter in 1600. Chartered municipalities have been treated as having separate legal personality since medieval times.[34] The entity now known as the City of London Corporation (to this day inextricably enmeshed in the long-standing nexus of finance capital and maritime trade) does not have a surviving founding charter – it is treated as chartered by prescription – but it is addressed in a royal charter of 1067 confirming its *ongoing* 'law-worthy' status notwithstanding the Norman conquest.[35]

The novelty in corporate law as it developed in the nineteenth century was that, rather than requiring a specific royal charter or act of Parliament for every corporation brought into being, any private individual could come along and form a company pursuant to the relevant legislation by dint of some administrative and instrumental formalities. Cases such as *Salomon v A Salomon & Co Ltd* simply confirm that, yes, this ancient sovereign prerogative of creating separate legal persons has indeed been delegated by statute to anyone who wants to exercise it, whatever their purposes and however artificial the separation between corporation and corporator.

And so (drawing together the foregoing observations), corporate personhood is fictional personhood treated as real personhood by the courts, by virtue of sovereign fiat. That is all well and good in a case where the Abbot of St Benet's at Hulme sues the Mayor and

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33 [1897] AC 22, HL.

34 See *Abbot of St. Benet's (Hulme) v. Mayor and Commonalty of Norwich* (1481) Y B 21 Edw. IV f 7, 12, 27, 67.

35 Medieval English municipalities having separate legal personality are defined by reference to a head and a body of men (see F. Pollock and F. W. Maitland, *The History of English Law before the Time of Edward I* [reprint of 2nd edn., 1898], 2010, p. 517; 'Godfrey the portreeve and all the citizenry in London', in the case of the London Liberty Charter of 1067, London, London Metropolitan Archives, COL/CH/01/001/A, available at https://www.cityoflondon.gov.uk/things-to-do/history-and-heritage/london-metropolitan-archives/collections/william-i-charter-to-the-city-of-london (accessed 5 September 2020).

Commonality of Norwich fifteen miles away during the reign of Edward IV, but what of a case where a company created by sovereign fiat in one jurisdiction seeks recognition in the courts of another? If a sovereign's power ends at the boundary of another sovereign's power, as the revenue rule would have us understand, how is it that a sovereign can confer a juridical status upon a fictional being that crosses that boundary such that the fictional being can sue and be sued outside the territory of the sovereign?

This is a deeper question than questions to do with how foreign corporations are regulated, if differently from domestic corporations. It is to do with the corporation's very existence outside the jurisdiction where sovereign fiat has brought it into being – that capacity to be heard by courts which actualises the personality conferred on it by sovereign fiat. Recognition of a foreign company means allowing a fictional person, purported to be real only by a foreign sovereign act but *prima facie* no more real outside that sovereign's territory than a cartoon character, to bring to bear (as claimant in proceedings) the full power of the local sovereign on any matter in which (subject to the person's existence) it has a valid claim in the local jurisdiction.

It cannot be emphasised too strongly how fundamental this question is to the structure of global capitalism today: if a corporation incorporated in one jurisdiction does not exist in another, it cannot own shares in a corporation incorporated in that jurisdiction. If corporations incorporated in one jurisdiction could not own shares in another there could be no multinational corporate groups. (Indeed, if a corporation incorporated in one jurisdiction does not exist in another then strictly speaking it cannot even buy or sell there although in practice having a natural person as an agent would get around this problem.) That being the case, it might be expected that the question would be fully addressed in the relevant literature. In fact, however, this question generally attracts little attention, at least in literature relating to the recognition of foreign corporations in the UK.

The scale of this lacuna is well illustrated by the section in a leading textbook which addresses the fact that UK courts recognise foreign corporations. In *National Corporate Law in a Globalised Market: The UK Experience in Perspective*, David Milman,[36] explains as follows:

> Why is this welcoming attitude adopted? Undoubtedly, it is a manifestation of comity between courts of friendly jurisdictions. More

[36] 2009.

> pragmatically, the consequence of such recognition is that litigation will be allowed to be undertaken in the English law forum. English lawyers will have to be engaged to represent parties and ancillary services used to facilitate such litigation. The invisible earnings of 'UK plc' will thus be increased. This is part of a general strategic approach taken by English law towards 'capturing' foreign-party litigation.[37]

That mere mention of the concept of 'comity' is here treated as a satisfactory account from a legal doctrinal perspective is surprising – what is this 'comity'? – and more surprising still is the idea that the primary economic impact of transnational recognition of companies is to do with the UK's export industry in litigation-related services. This seems to miss the more fundamental point that without such recognition foreign companies would not be able to own subsidiaries in the UK or indeed do any business in their own names in the UK at all.

Almost unbelievably, this international law *sine qua non* of the multinational corporate group is quite literally not even mentioned in a standard textbook on the subject, Peter Muchlinski's *Multinational Enterprises and the Law*.[38] A leading textbook on UK company law generally, Paul L Davies's *Gower and Davies' Principles of Modern Company Law*,[39] footnotes case law authority for the proposition that UK courts recognise foreign companies and then more-or-less immediately moves on to the question of how the foreign company is regulated in the UK. The fundamental ontological question seems to be of no interest. Where the question is considered at somewhat greater length, for example in Francis Tansinda, 'Regulation of Overseas Companies',[40] the discussion again nonetheless follows the pattern of adverting to the relevant case law, explaining that the principle at play is 'comity', and moving on to the more practically significant matter of regulation.

One text on the topic of international business structures where the concept of comity is interrogated (if only over the course of two paragraphs) is *International Business and National Jurisdiction* by A. D. Neale and M. L. Stephens; there the authors conclude that comity is simply 'all things to all men'.[41] In summary, aside from this brief treatment, comity (if it is mentioned at all) is invariably said *without further elaboration* to be a sufficient

[37] Cheltenham, Edward Elgar, 2009, p. 94.

[38] 2nd edn., Oxford, Oxford University Press, 2007.

[39] 7th edn., London, Sweet & Maxwell, 2003.

[40] F. Tansinda, 'Regulation of Overseas Companies' in D Milman (ed.), *Regulating Enterprise Law and Business Organisations in the UK*, Oxford, Oxford University Press, 1999, pp. 265-290.

[41] Oxford, Clarendon Press, 1988, p. 14. It is this sadly somewhat superficial perspective on comity which makes it into Palan's jurisprudence of offshore: see Palan, 2003, p. 99.

juridical basis for a structural element of the global economic order as central and crucial as the multinational company. As such it calls for further investigation, and that call is what the next section of this chapter serves to respond to. Before we move on to that investigation, however, there are four features of the law to do with the transnational recognition of entities which are tangential to the argument developed in this chapter, but which can usefully be addressed here, briefly, so as to forestall any concern which may be aroused by their omission:

First, there are major jurisdictions – notably Germany – whose domestic law has historically required that, in order for a corporation to be validly incorporated there needs to be some substantive link between the operations of the corporation and its jurisdiction of incorporation (e.g. that its central management and control is there – the so-called 'real seat' theory).[42] This can have a number of awkward consequences; for example a corporation incorporated in one jurisdiction could effect its own involuntary disincorporation by moving its headquarters to another. This principle has come into conflict with the EU treaty principle of freedom of establishment and it has therefore been a matter of extensive discussion in the literature on European corporate law[43] and the subject of a line of case law in the Court of Justice of the European Union,[44] but it is not relevant to the present discussion. This is because we are concerned here with the basic legal capacity to enjoy rights and enter into obligations, in one jurisdiction, of an entity validly incorporated in another. The generality of that capacity is neither impaired by the 'real seat' theory nor bolstered by such inroads as may have been made into it.

A second tangential point is in relation to treaties between states of an international economic nature which include provision for mutual recognition of each other's corporations – this appears to have been something of a standard provision in treaties of 'friendship, commerce and navigation' which are the precursors to modern international trade treaties.[45] The presence of such treaty provisions should not be taken to imply that they are actually necessary. The UK and the US are signatories to a number of such treaties, but in common law jurisdictions foreign corporations have their juridical status recognised as of right, in any event, by reference to the principle of comity (as to which see below).

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[42] See for example the 2008 *Trabrennbahn* case (BGHZ 178, 192).

[43] See for example S. Rammeloo, *Corporations in Private International Law: A European Perspective*, Oxford, Oxford University Press, 2001.

[44] See in particular Case C- 208/ 00 Überseering [2002] ECR I- 9919 para 22.

[45] See A. L. Paulus, 'Treaties of Friendship, Commerce and Navigation' in R. Wolfrum (ed.), *The Max Planck Encyclopedia of Public International Law vol IX*, Oxford, Oxford University Press, 2012, p. 1140.

Thirdly, it should be noted that there is the question of the extent to which international bodies (i.e. entities formed pursuant to treaties) are recognised as having legal personality. That this is a well-traversed topic within what is known as international institutional law[46] makes it all the more strange that there seems to be so little interest in the seemingly much harder question of why entities formed pursuant a sovereign's autonomous power to create legal persons under municipal law should be treated as having legal personality internationally.

Lastly, it may be noted that, even with the capacity for companies to own each other across borders, the multinational corporate group as a juridical phenomenon is nonetheless a fragmentary beast as contrasted with the unitary firm or enterprise it is recognised as in accounting and economics.[47] There exist discussions of the extent to which groups are increasingly nonetheless recognised as unitary from a legal perspective, and the focus of these discussions (as befits discussions of a putative legal subject) is generally to do with the rights and obligations of the enterprise as distinct from those of its constituent entities (a foundational illustration would be the work of Phillip Blumberg on US corporate law although of course the topic of the liability of parent entities for abuses perpetrated by foreign subsidiaries is now a vast one). Those discussions all *presuppose*, however, that the entities of which the firm is composed are (if it is an MNE) held together by the juridical glue of cross-border intra-group shareholdings. It is to a closer look at that blithely-relied-upon juridical glue, *i.e.* comity, that we now turn.

5.4 The case law on comity

As already noted, when called upon to account for the cross-border recognition of companies, expert commentators simply advert to the concept of 'comity' and move on, more-or-less as if just naming it is sufficient. This section explores what judges have to say about the role of comity in this context, and (broadly speaking) the findings of the section are that (i) on the level of principle comity *cannot* account for the cross-border recognition of companies, and (ii) the true explanation is that foreign companies are always already recognised by virtue of the fact that their commercial relations are embedded before their juridical ontology is called into forensic question.

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[46] See J. Klabbers, *An Introduction to International Organizations Law*, 3rd edn., Cambridge, Cambridge University Press, 2015, pp. 41-69.

[47] J. Robé 'The Legal Structure of the Firm', *Accounting, Economics, and Law: A Convivium*, vol. 1, no. 1, 2011, pp. 1-88.

Our starting point for these purposes is a case which is often given as authority for the proposition that UK courts[48] recognise foreign companies: *Lazard Bros & Co v Midland Bank Ltd.*[49] In that case a creditor failed to recover against a Russian bank because it was no longer in existence. Lord Wright mentioned in passing the fact that the 'recognition is said to be by the comity of nations', but no further discussion is entered into. A slightly more useful case is *Arab Monetary Fund v Hashim and others (No 3)*,[50] which concerned an organisation which had been constituted by a treaty between states not including the UK (having the consequence that it would not be recognised as a legal entity by the UK), but which had also (on the evidence) been given corporate personhood by one of the signatories in its own domestic law. There is a more detailed discussion of the principle in this case although it ultimately comes down again to this concept of 'comity'.

The role of comity in this context is characterised by Hoffmann J in the decision of the High Court as the application of a rule 'based on the inconvenience of having legal entities which exist in one country but not in another'.[51] Nourse LJ, in the Court of Appeal, resorted to the *Shorter Oxford English Dictionary* which defined the comity of nations as, 'the courteous and friendly understanding by which each nation respects the laws and usages of every other, so far as may be without prejudice to its own rights and interests.'

On the face of it, convenience, courtesy and friendliness would seem to constitute an intolerably flimsy foundation for this crucial structural principle of global capitalism. Bingham LJ likewise treats comity as something to do with friendliness between states, 'but in suing as a juridical person the [Arab Monetary Fund] does not depend on a status derived from a non-justiciable treaty but on a status conferred by the law of a friendly foreign sovereign. Comity would seem to require that the United Kingdom recognise the [Arab Monetary Fund].'

And in the House of Lords Lord Templeman adds no further gloss aside from citing with approval the observations of Bingham LJ and Hoffmann J in the courts below, and similar observations in a handful of other cases. None of these eminent judges treats as worthy of serious investigation the question of how vague notions such as convenience, courtesy and friendliness translate into a hard-and-fast rule whereby any fantastical creature of whatsoever

[48] Strictly this should be the courts of England and Wales, with Scotland being a separate jurisdiction, but there is no suggestion that Scotland has a different position on this question than the rest of the UK.
[49] [1933] AC 289.
[50] [1991] 2 AC 114.
[51] at 119.

foreign legislative fiat can sue and be sued in English courts. Indeed, they seem to want to place a defensive membrane between themselves and any discussion of the underlying basis for this outcome, giving it a quasi-legislative patina of authority beyond question by repeatedly referring to it by its textbook designation of 'Rule 171'. At first blush therefore 'comity', in the English case law at least, seems to bear out the lament of John D. Haskell in his chapter 'Ways of doing extraterritoriality in scholarship' in *The Extraterritoriality of Law: History, Theory, Politics*[52] to the effect that comity and its doctrinal ilk 'remain a black box that do not offer a solution but merely restate the original problem'.

In both *Lazard Bros & Co v Midland Bank Ltd* and *Arab Monetary Fund v Hashim and others (No 3)* it is mentioned that the recognition of foreign corporations in English courts goes back at least as far as the early eighteenth century case of *Henriques v Dutch West India Co.*[53] This observation is correct but the case should not be treated as doing more for this body of jurisprudence than simply illustrating the continuity of the principle from the present back to the era of the early modern imperial trading company. While it is true that a Dutch-incorporated company was a party in that case, and the issue of its capacity to sue came up, its capacity to sue *qua* foreign corporation does not appear to have been seriously called into question. One report shows that when the case was argued in the House of Lords, counsel for the debtor did indeed take the point that a foreign company flatly cannot be recognised in English law,[54] but it appears that the principal point in that case (at least as regards recognition of a foreign company) was a technical one to do with the fact that the company was not suing under the name under which it was incorporated. The reported decision addresses the uncertainty around the company's name but the basic ontological point is left hanging. There was no discussion, or even mention, of comity.

A full judicial elaboration by a senior judge in a common law jurisdiction of the role played by comity in the transnational recognition of corporations may however be found in a decision of the US Supreme Court from 1839, *Bank of Augusta v Earle*.[55] This was a decision in some conjoined cases where a defence to a claim on certain bills of exchange was mounted on the basis that the claimant banks did not have the capacity to acquire the bills in the state under whose laws they were acquired because the banks were incorporated in another state.

[52] J. D. Haskell, 'Ways of Doing Extraterritoriality in Scholarship', in D. S. Margolies, et al (eds.), *The Extraterritoriality of Law: History, Theory, Politics*, London, Routledge, 2019, p. 16.

[53] (1728) 93 ER 733.

[54] (1728) 2 Ld. Raym. 1532.

[55] 38 U.S. (13 Pet.) 519 (1839).

The opinion of the court was given by Chief Justice Roger B Taney. The components of Taney's reasoning in *Bank of Augusta v Earle* are, broadly, as follows. He accepts the principle that, strictly speaking, corporations do not exist outside their jurisdiction of incorporation:

> It is very true that a corporation can have no legal existence out of the boundaries of the sovereignty by which it is created. It exists only in contemplation of law, and by force of the law; and where that law ceases to operate, and is no longer obligatory, the corporation can have no existence. It must dwell in the place of its creation and cannot migrate to another sovereignty.

He then adumbrates the principle of comity, which provides that states will recognise each other's laws in the context of private orderings not inimical to the policy of the state doing the recognising:

> It is needless to enumerate here the instances in which, by the general practice of civilized countries, the laws of the one will, by the comity of nations, be recognised and executed in another, where the right of individuals are concerned. The cases of contracts made in a foreign country are familiar examples; and Courts of justice have always expounded and executed them, according to the laws of the place in which they were made; provided that, law was not repugnant to the laws or policy of their own country. The comity thus extended to other nations is no impeachment of sovereignty. It is the voluntary act of the nation by which it is offered; and is inadmissible when contrary to its policy, or prejudicial to its interests. But it contributes so largely to promote justice between individuals, and to produce a friendly intercourse between the sovereignties to which they belong; that Courts of justice have continually acted upon it, as a part of the voluntary law of nations.

This principle seems to recall something we have encountered in the context of the revenue rule. The principle there was that states will not enforce another state's 'penal, revenue or other public law'. Comity for these purposes appears to be a corollary whereby law *not* falling into that category – law of a less antagonistic nature as between states than the coercive exercise of sovereignty – will (provided that it is not inimical to policy to do so) be respected.[56] And indeed the court in *Government of India v Taylor* expressly ruled out the

[56] For discussion of Comity as a principle in international law generally see J. R. Paul, 'Comity in International Law', *Harvard International Law Journal*, vol. 32, no. 1, 1991, http://repository.uchastings.edu/faculty_scholarship/625 (accessed 15 November 2018); for an overview of

application of comity in circumstances where the revenue rule applies.

Taney then notes the long-standing practice of applying that principle to the question of the transnational recognition of corporations:

> It is but the usual comity of recognising the law of another state. In England, from which we have received our general principles of jurisprudence, no doubt appears to have been entertained of the right of a foreign corporation to sue in its Courts; since the case *Henriquez vs. The Dutch West India Company*, decided in 1729, 2 L Raymond, 1532. And it is a matter of history, which this Court are bound to notice, that corporations, created in this country, have been in the open practice for many years past, of making contracts in England of various kinds, and to very large amounts; and we have never seen a doubt suggested there of the validity of these contracts, by any Court or any jurist. It is impossible to imagine that any Court in the United States would refuse to execute a contract, by which an American corporation had borrowed money in England; yet if the contracts of corporations made out of the state by which they were created, are void, even contracts of that description could not be enforced.

At this point Taney comes up against a wrinkle in his position which forms the basis of a full-blown dissenting judgment on the part of another member of the court: comity is an international law principle, and the principles of international law do not apply between members of the United States. Taney, however, speaking for the majority, despatches this difficulty with a neat reversal of the burden of proof as to the application of the principle:

> The intimate union of these states, as members of the same great political family; the deep and vital interests which bind them so closely together; should lead us, in the absence of proof to the contrary, to presume a greater degree of comity, and friendship, and kindness towards one another, than we should be authorized to presume between foreign nations.

This somewhat specious-seeming trick is then backed up with a series of very forceful observations about the hard reality of the matter:

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the principle in American law, so as to further situate the discussion of *Bank f Augusta v Earle*, see W. S. Dodge, 'International Comity in American Law' Columbia Law Review, vol. 115, no. 8. 2015, pp. 2071-2141; for a discussion from an English law perspective see M. Akehurst, 'Jurisdiction in International Law', *British Yearbook of International Law*, vol. 46, 1972, pp. 145-257.

> Money is frequently borrowed in one state, by a corporation created in another. The numerous banks established by different states are in the constant habit of contracting and dealing with one another. Agencies for corporations engaged in the business of insurance and of banking have been established in other states and suffered to make contracts without any objection on the part of the state authorities. These usages of commerce and trade have been so general and public and have been practised for so long a period of time, and so generally acquiesced in by the states, that the Court cannot overlook them when a question like the one before us is under consideration. The silence of the state authorities, while these events are passing before them, show their assent to the ordinary laws of comity which permit a corporation to make contracts in another state.

These observations echo something Taney said at the beginning of his judgment which make it clear before any of the subsequent reasoning which way he is going to go:

> A multitude of corporations for various purposes have been chartered by the several states; a large portion of certain branches of business has been transacted by incorporated companies, or through their agency; and contracts to a very great amount have undoubtedly been made by different corporations out of the jurisdiction of the particular state by which they were created. **In deciding the case before us, we in effect determine whether these numerous contracts are valid, or not**. [*Emphasis added*]

It would appear, from the implicit resignedness here to finding for the banks, that on a practical level (and irrespective of the purported effect of comity in the context of intra-state commerce within the Unites States, and indeed irrespective of judicial analysis generally) the question of whether corporate legal personhood is capable of existing beyond the territorial boundaries of the state that brings it into being has *always already* been decided. This suggests – and this is a theme to which we shall return – that the transnational ontology of corporations does *not* depend on states treating other states' corporate law as falling outside the forbidden category of 'penal, revenue or other public law' and voluntarily enforcing it on that basis; it suggests that there is some atavistic feature of corporate legal personality which can somehow cross borders of its own accord.

The idea that corporate legal personality reflects a private ordering like a contract between

two private citizens, as opposed to taking effect pursuant to a sovereign act which is public in nature, does not, in any event, bear scrutiny. Admittedly, it is possible *prima facie* to have some sympathy with the idea, since even before the era in which corporate personhood existed primarily for the purposes of capitalist accumulation, there was an extent to which it was arguably primarily a *property* relation, providing for the perpetual ownership of institutional assets.[57] As such it might seem reasonable that a sovereign should treat it as a benign private ordering and, for example, allow a given corporation to survive a complete reboot of the state, as happened to the City of London in 1066 notwithstanding the Norman Conquest (and to Dartmouth College in another landmark case of US corporate law, *Trustees of Dartmouth College v Woodward*[58]).

But the fact is that this purported jurisprudence whereby the personhood of corporations is a private rather than a public matter makes not even the slightest pretence of requiring courts who deploy it to inquire into the nature and purpose of the corporation in question. Of course, a corporation is *capable* of serving only private interests, but it could also be (like the City of London in 1067) a municipality, or it could be a charity or other public interest body, or entity pursuing state objectives. The entity in *Arab Monetary Fund v Hashim* was an international financial entity with *only states as its members*!

Perhaps most tellingly for present purposes, a corporation could also be one of the early modern 'semi-sovereign'[59] trading companies that *benefited from royal grants of monopoly over the use of violence abroad* and can therefore only be understood from an international law perspective as hybrid state/corporate entities.[60] It could, in other words, be a company such as the Dutch West India Company, whose legal personality for the purposes of litigation in an English court in 1728 was, as we have seen, treated as not subject to serious question, thereby forming the touchstone for all subsequent common law articulations of transnational corporate personhood. It would be very difficult to argue that an imperial trading company in the early modern mould is a private ordering to which exclusions relating to public matters of state, such as give rise to the revenue rule, are inapplicable.

57 P. J. Stern, 'The Corporation in History' in G. Baars and A. Spicer (eds.), *The Corporation: a critical, multi-disciplinary Handbook*, Cambridge, Cambridge University Press, 2017, pp. 21-46.

58 17 U.S. (4 Wheat.) 518 (1819); in this case the US Supreme Court upheld the charter of an institution which predated the creation of the USA.

59 Herdegen, 2016, p. 21.

60 For a detailed investigation of this hybrid status see P. J. Stern, *The Company-State: Corporate Sovereignty & The Early Modern Foundations of the British Empire in India*, Oxford, Oxford University Press, 2011; for a survey of the role of this hybridity within plural forms of polity on the international stage in the early modern era see chapter 3 of A. Phillips and J. C. Sharman, *International Order in Diversity*, Cambridge, Cambridge University Press. 2015.

It follows from the foregoing that the transnational recognition of corporations is an international law anomaly – an extraterritorial extension of sovereignty running counter to the territorial principle that constrains (as we saw in the case of the revenue rule) the spatial scope of sovereign legislative power. The idea that it arises from comity appears to be a judicial fig-leaf to disguise the fact that whenever the question comes up for potential contestation in proceedings, transnational corporate capital is always already there in terms of on-the-ground exercise of legal personhood, inextricably enmeshed in actually existing economic relations. If comity as articulated in the case law examined here genuinely were the basis for the transnational recognition of companies, it would be necessary to verify forensically, on every occasion on which a foreign company so much as entered into a contract to buy some paper-clips, that it was not doing so for an extraterritorial purpose of the state which incorporated it. Alternatively put, no court has ever taken the purported 'comity' basis for the transnational recognition of corporations seriously enough to explain why such an enquiry is not necessary.

5.5 Corporate sovereignty and offshore

It was suggested above that corporate legal personhood might be possessed of some atavistic feature which can somehow cross borders of its own accord, without the need for comity between nations. The point was that the purported operation of comity in this context may not simply be a *post hoc* rationalisation of a political and economic reality – it may entirely mistake the juridical nature of transnational corporate personhood. Rather than being an instance of extraterritoriality, predicated upon the default position of territoriality, the suggestion is that it partakes of some alternative form of sovereignty altogether. An insight into this possibility may be discerned from a truly epic seventeenth century legal battle, the litigation between the East India Company and one Thomas Sandys which took place in the early years of the 1680s.

Thomas Sandys sought to trade in such a way as would interfere with the Company's monopoly rights and so the Company brought proceedings against him. His defence was the startling one that the Company's entire, long-standing royal monopoly had been unlawfully granted. On a political and economic level this defence was highly unlikely to succeed but Sandys engaged a heavyweight legal team who threw every available argument into the matter. And so, rather than being laughed out of court at an early stage, it ended up being a catalyst for a wide-ranging debate within the court and in the public arena, about a number of

matters such as the role of monopolies and the scope of the royal prerogative.[61]

What is interesting about the case for our purposes is how the Company's arguments (which, needless to say, won the day, as inevitably as the banks' arguments in *Bank of Augusta v Earle*) were characterised by Sandy's lawyers. One of the Company's arguments was that the Company's trade was not a private monopoly because it alone had peaceable dealings at international law with the relevant foreign sovereigns on the delegated authority of the Crown; all other subjects of the Crown were effectively in a state of permanent enmity with them and therefore could not trade. Sandys's lawyers countered that, if the Crown had indeed made an exclusive grant not merely of trading rights but of elements of its exclusive sovereign prerogative, the Company was 'arguing the king by his prerogative out of his prerogative'. The constitutional ramifications of this would be to make of the Company 'a sort of republic for the management of trade'.[62]

The resonance of the word 'republic' in this context should not be understated. A republic does not simply have sovereignty; it has sovereignty in a specifically antagonistic relation to the sovereignty of a monarch. This would make of the Company not simply a bearer of the royal prerogative but something that stands in an antagonistic relation to it. Accepting this proposition formed no part of the court's express decision and it is not suggested here that it is in any way authoritative, but it is nonetheless offered here as way for us to approach an understanding of the juridical anomalies that may be gathered together under the rubric of the transnational recognition of corporations: that they can exercise imperial sovereign power but benefit from an unrebuttable presumption to the effect that they represent private orderings; that they can achieve recognition across borders by reference to an international law principle even where that principle does not apply because the matter is not between nations; and that they are fictions existing only by reference to territorial sovereign fiat and yet they penetrate all of space.

One way to conceptualise the point might be to step back from the specificities of particular legal regimes and think of property regimes in a more general sense as mechanisms by which property can protect itself from the mortality of human possessors. One method for achieving immortality, if you are a bundle of wealth and power, is to be passed down from generation to generation in accordance with the hereditary principle, and the institution of the state – which finds its origin in systems of hereditary rule over territory – is the inheritor of

[61] Stern, 2011, pp. 41-60.
[62] Stern, 2011, pp. 54-55.

this principle. Another method for achieving immortality, if you are a bundle of wealth and power, is to belong not to an individual human, but to a group of humans. Thus even as members of the group die, so other members join, and the group itself as an entity – the company – just keeps on going in defiance of mortality. On this view, it would be an error to understand corporate personhood as being predicated on legislative fiat; **legislative fiat is, rather, the mechanism by which state sovereignty accommodates the existence of this immanent alternative to itself**.

Certainly the London Liberty Charter of 1067 is an instance of this happening quite literally. By way of contrast, the English Crown subsequently sought to instrumentalise the apparent need for a statutory basis for corporate personhood in order to assert its sovereignty, but only with limited success. In the seventeenth century the Stuart kings sought to extinguish the power of rebellious corporate municipalities by bringing what were called '*quo warranto*' proceedings against them – demanding to see (on pain of judicial dissolution) the charter from which they derived their existence, knowing that in many cases they were unlikely to be able to comply.[63] This culminated in the 1680s in *quo warranto* proceedings against the Corporation of London itself, proceedings which were actually successful in that London was dissolved as a municipal corporation. But very shortly afterwards, as if to demonstrate that the state sovereignty upon which corporate personality is seemingly predicated can be more fragile than the corporate entities it purportedly brings into being, there was a revolution which replaced the Stuart kings with a different dynasty from the Netherlands more amenable to the spirit of the times. Following that revolution the dissolution of the Corporation of London was reversed by statute.[64] The point then is not merely that corporations are a sort of republic in the sense of having their own sovereignty, but that they have that sovereignty in a form which is structurally antipathic to the very sovereignty that we understand as having brought them into being.

Turning now to offshore, it will be recalled that the prevailing conception of offshore is of a world of fragmentary regimes, each one emanating from a state which has 'bifurcated' its sovereignty for the purpose, and dedicated to relieving global capital of some specific element of the tax or regulatory burden that domestic capital bears in that state. But what we have learned from our investigation into the transnational nature of corporate sovereignty is that companies *are* where state sovereignty is *not*. In *Corporate Sovereignty* Joshua Barkan

[63] T. Harris, *Restoration: Charles II and His Kingdoms*, London, Penguin, 2005.
[64] London, Quo Warranto Judgment Reversed Act 1689, 2 W & M c 8.

notes the role played by comity in extending the territorial reach of companies and says that companies have ‘carved out legal autonomy by inhabiting the negative spaces of the international state system’.[65] The argument in this chapter is that Barkan’s analysis does not go far enough: corporate sovereignty *is* that ‘negative space’; a substrate of alternative sovereignty which is exposed where state sovereignty is withdrawn. Ascribing the appearance of companies in that negative space to the agency of companies themselves, the existence of which is then in turn ascribed to the agency of states, misses the core point elaborated in this chapter that corporate sovereignty is always already there.

Manifesting as ‘offshore’ that sovereignty may be understood as the generality of global corporate personhood in a world of territorially constrained tax systems. It is important to recall at this juncture just how fundamental to offshore the phenomenon of transnational corporate personhood is.[66] It is not just a matter of multinationals having subsidiaries there – every aspect of tax havenry aside from a flesh-and-blood human physically residing in a tax haven is underpinned by the transnational reach of corporate personhood. Offshore banks are corporations; corporate trustees of family trusts are corporations, and so on. None of this architecture could exist if corporate personhood was constrained to the corporation’s territory of incorporation. And it is an architecture built out of this alternative global nexus of property relations; that nexus of property relations seemingly emanating from the institution of the state in the form of corporate personhood, but in fact standing in an antagonistic relation to it, and always available to be given over to the use of capital everywhere, as an offshore space, through the removal or alleviation of some local section of the state’s sovereign overlay of regulation or tax.

5.6 Conclusions: offshore and imperialism

There is a discipline, fiscal sociology, which exists (in part) to investigate the specifically fiscal antagonism between capital and the state, but (as we shall see in the chapter which follows) it is largely focused on that antagonism as it is manifest in a domestic fiscal sphere. There is not really any such thing as an international fiscal sociology. The chapter which follows attempts however to *construct* an international fiscal sociology, and of course armed with a theory of offshore we are better prepared for that endeavour than we might otherwise be. Before embarking on that endeavour, however, it is necessary to situate our theory of offshore in the theory of international law more generally.

[65] J. Barkan, *Corporate Sovereignty*, Minneapolis, University of Minnesota Press, 2013, p. 108.
[66] This point is ubiquitously substantiated in the literature on offshore but see for example, Palan, 2002.

Soviet jurist Evgeny Pashukanis argued that inherent in the commodity form are relations of the kind that obtain between legal subjects. Paradigmatically the relation is that of property owner, be it ownership of means of production, or of labour power to be alienated in an employee capacity. Thus the relations emanating from the commodity form are characterised by an equal set of property rights being available in principle to atomised legal subjects, but unequal power subsisting between them in practice ('between equal rights, force decides', wrote Marx[67]). Pashukanis's contribution to jurisprudence was essentially to develop from this observation a theory of law.[68]

An important elaboration of his analysis, applying it to international law, gives us China Miéville's Pashukanite perspective on the state, which posits that the institution of the state is not merely a further extension of this principle, but the manifestation of it which exposes most clearly to view the inherent violence of the legal form.[69] His core argument (in part a reflection on the impunity of the aggressors in the Iraq War) is that when unequal power is exercised between states through acts of violence for which no legal redress is available, it is not an aberration from the international legal order under capitalism but the purest expression of it. International law itself is, in his analysis, 'self-camouflaging' imperialist violence.

The international law anomaly identified in this chapter can form the basis for a similar logic, but in the context of fiscal rather than military engagements. If corporate capital based in one state can penetrate another to effect capital accumulation by means of personhood there, but the other state's tax regime cannot cross its border in the opposite direction to chase any tax that should have been paid in respect of that accumulation, that would seem to benefit capital-exporting countries and run counter to the interests of 'capital-importing' countries (poor countries, in other words; generally former colonial possessions in the Global South). The anomaly would therefore be an instance of formal equality between sovereign states where 'between equal rights, force decides'. All states have territorially constrained power to tax and the capacity to project their corporate persons through infinite space, but for disadvantaged states this is a further disadvantage, and for states in an advantageous position it is a further advantage.

In addition, the clothing of the anomaly in the guise of an international law principle, comity, whose applicability does not withstand scrutiny, appears to constitute just such a self-

[67] Marx, 1976, p. 344.
[68] Pashukanis, 1978.
[69] C. Miéville, *Between Equal Rights*, London, Pluto Press, 2006.

camouflaging as we have been primed by Miéville to look out for in our engagements with international law. Indeed it is telling that the author who originally codified it as 'Rule 171', A V Dicey, was the very originator of the idea of the 'rule of law' as a liberal apologetics for imperial violence.[70] It is also telling to recall, in this context, that the authority for the proposition that tax law does not benefit from the same unconstrained universal immanence that corporate personhood evinces, *Government of India v Taylor*, was one where the UK declined to impose upon a UK-resident company a tax levied by its newly independent former colonial possession, India.

Of course the fact that the early modern imperial trading companies are such a crucial element of the story makes it impossible to avoid the theme of imperial domination when considering the anomaly to which this chapter draws attention. And the violence of that domination is much more integral to the superficially dry jurisprudential nature of the analysis than might first appear. The case law touchstone for the proposition that the courts in one jurisdiction will recognise the legal persons created by another, *Henriques v. Dutch West India Co*, concerns a company which was deeply implicated in the Atlantic slave trade.[71] And Chief Justice Roger B Taney who elaborated upon that conclusion in *Bank of Augusta v Earle* is most famous for giving the majority opinion in *Dred Scott v Sandford*, [72] the notorious US Supreme Court decision in which (in startling contrast to the court's attitude towards companies) it was held that slaves from Africa and their descendants were not juridically capable of being US citizens and therefore had no standing to sue in a federal court.

Returning to the theoretical, the imperial dimension to the analysis has important implications in terms of how we conceptualise offshore. The starting point of this chapter was the prevailing view that offshore emanates from the institution of the state, insofar as the state bifurcates its sovereignty to create juridical spaces where transnational capital is relieved of local tax or regulatory regimes. This chapter has sought to underpin that view with an analysis whereby corporate capital and state sovereignty are rival species of property regime, existing (putatively as coevals) in a state of mutual antagonism. The analysis has been illustrated by reference to jurisprudence which shows that economic relations are always already constituted through the corporate form prior to any forensic scrutiny of their

[70] D. Lino, 'The Rule of Law and the Rule of Empire: A.V. Dicey in Imperial Context', *Modern Law Review*, vol. 81, no. 5, 2018, pp. 739-764.

[71] P. Brandon, 'Between Company and State: The Dutch East and West India Companies as Brokers between War and Profit' in Baars and Spicer, 2017, pp. 215-225.

[72] 60 U.S. (19 How.) 393 (1857).

ontology. On this view offshore is the juridical space where the company is sovereign over the state rather than vice-versa (that alternative sovereignty taking effect by virtue of the bifurcations that the conventional analysis of offshore adverts to).

But it should be borne in mind that mutual antagonism between corporate capital and the state is not a simple squaring off of individuated antagonists: as the example of *Government of India v Taylor* and the example of the imperial trading company both illustrate, in a world where force decides between formally equal states, the interests of corporate capital and the interests of wealthy states are intertwined. This is a feature of actually existing global capitalism which we must bear in mind in the chapter which follows, which seeks to (a) understand the broader terrain of contestation between capital and the state that offshore and international corporate tax reform both inhabit, and (b) analyse that terrain by reference to the value-theoretical framing set out in Part I of this thesis.

Chapter 6: The international fiscal sociology of value absorption

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6.1 Introduction

In chapter 5 we saw that global corporate capital partakes of a transnational property regime that exists in a state of mutual antagonism with state sovereignty, and the fiscal phenomenon we know of as 'offshore' comprises the juridical spaces where the company rather than the state is (at least to some relative degree or another) sovereign, such that revenues can accumulate there untaxed. As such, offshore is a manifestation of an antagonism which is not only juridical; it partakes of a systemic antagonism under capitalism i.e. **contestation between capital and the state over revenues**. Antagonism between between capital and the state as it plays out in fiscal arenas is sometimes considered under a specific disciplinary label: 'fiscal sociology' *i.e.* the study of the tax state as a locus of crisis under capitalism. This chapter, which elaborates on that terrain of structural antagonism, is therefore to that extent an exercise in fiscal sociology – as indeed is this thesis as a whole.

In Part I of this thesis we saw established a 'production boundary' around (broadly speaking) material production. Activity outside that boundary, even if it generates revenue, and even if it involves labour, are accordingly analysed as absorption rather than creation of value. It was noted in Part I that the overwhelming majority of state expenditure is in the sphere of absorption. Indeed as noted there the labour of servants of the state is a paradigmatic form of 'unproductive labour' in the classical tradition.[1]

In the popular orthodoxies of today's *neo*classical era, too, it is believed that state expenditure is 'unproductive', albeit that the pejorative connotations are pertinent in this context: state expenditure is popularly contrasted with the activities of the private sector which are believed to be inherently productive.[2] The tradition which rejects production boundaries (of which

1 Marx, 1969, p. 160.

2 See the account of this perspective in M. Mazzucato, *The Value of Everything*, London, Penguin, 2018, pp. xvi-xvii.

Helen Boss, to whom reference was made in chapter 1, is a prominent example) exists in part to counter this popular macroeconomic orthodoxy: to argue that through its causal (or 'interdependent') relation with the activities of the private sector the state, too, should be considered to be productive of value. This thesis by contrast adheres strictly to a classical-type production boundary (i.e. one which, broadly speaking, contains only material production), with the consequence that (as discussed in chapter 4) rather than *including* the state in the sphere of production, we are *excluding* vast swathes of the private sector activity from it. Value creation for our purposes only takes place in those parts of the economy where such processes as resource extraction, agriculture, manufacture and transportation take place. Other activity in the private sector is, like the labour of civil servants and the consumption of the unwaged, absorptive.

It is through the lens of their respective roles in the *absorption* of value that we are going to look at the contestation between the corporate sector and the state over revenues. Broadly, the contestation in contemplation is not between private value creation and public absorption (as neoclassicals would have it), or between public and private value creation (as theories of interdependency would hold) – it is between value absorption of different kinds. It is for that reason that this chapter is not a general exercise in fiscal sociology; it is specifically a fiscal sociology of value absorption. It is, however, more than that: it is specifically an *international* fiscal sociology of value absorption. This is because, with the classical production boundary deployed as an analytical tool, the contestation between capital and the state over revenues evinces a dynamic which can only really be understood as a global one: a dynamic to do with inequality between states as well as antagonism between capital and the state. It is that global dynamic, described in this chapter, which is carried forward into Part III of this thesis so as to inform the investigation undertaken there of the international corporate tax reform process of the 2010s.

The structure of the argument in this chapter proceeds through four stages. The first stage (in section 6.2) is to elaborate upon the concept of the 'tax state' to be found in fiscal sociology, so as to be able to deploy it as a specifically *international* phenomenon. The second stage (in section 6.3) is to update the concept of the tax state by reference to social reproduction theory. This is because the contestation over revenues between capital and the state (in the present historical moment at least) refracts a deeper contestation between capital and those who bear a disproportionate burden in the reproductive sphere. It is therefore at this juncture

that an explicitly feminist perspective (which was deferred in chapter 4 by reason of the technicalities addressed in section 4.7) becomes pertinent to the unfolding of the argument in this thesis. The third stage (in section 6.4) is to turn our attention to the other antagonist, i.e. capital, and to consider, by means of the analytical tool of the global value chain, how it organises itself globally. It is by reference to the global value chain analysis in the third stage of the argument that the international dynamic to be extracted from this discussion is arrived at, in the fourth and final stage of the argument (in section 6.5).

As the chapter proceeds through those stages, attention will also be drawn to the Marxian genealogies of the analytical tools deployed. This is for two reasons. First, this thesis is expressly using Marxian value theory for its core argument and, while it falls short of being a comprehensively 'Marxist' account of its subject matter, it is hoped that it can be shown that there is an evolving but fundamentally coherent methodological tradition underlying the argument. Second, the themes that emerge, while they may appear somewhat digressive for the purposes of the argument in this chapter, will be revisited in the conclusions to the thesis as a whole in chapter 9.

As will already be apparent, there are a number of moving parts in this chapter, and necessarily so since it forms the joint and cartilage between (a) the value-theoretical and jurisprudential topics we have hitherto been considering, and (b) the topic of Part III to follow, which is actual processes of international corporate tax reform over the last decade or so. That being the case, a series of conclusions emerge over the course of the discussion. For clarity, they are picked out in bold.

6.2 International fiscal sociology

Fiscal sociology is, as the name suggests, the sociology of fiscal matters. It is not, however, primarily concerned either with fiscal phenomena as *causes* of wider social or historical phenomena nor with fiscal phenomena as *symptoms* of wider social or historical phenomena, although these generally figure in the analysis. What is most important in fiscal sociology, according to Joseph Schumpeter in 'The Crisis of the Tax State' (the essay which is generally considered to be the founding text of fiscal sociology), is 'the insight which the events of fiscal history provide into the laws of social being and becoming and into the driving forces of the fate of nations, as well as into the manner in which *concrete* conditions, and in particular organizational forms, grow and pass away'.[3]

[3] J. Schumpeter, 'The Crisis of the Tax State', in R. Swedberg (ed.), *Joseph Schumpeter: The Economics and Sociology of Capitalism*, Princeton, Princeton University Press, 1991, p. 101.

At its inception fiscal sociology had a core set of questions, which are to do with the nature of the 'tax state' and its tendency towards crisis. Schumpeter's essay was a response to Rudolf Goldscheid's 1917 book prompted by the dire state of Austria's public finances towards the end of World War I, *Staatssozialismus oder Staatskapitalismus* ('State socialism or state capitalism').[4] Goldscheid argued that, in the modern era, as the productive forces under the prevailing mode of production shifted from being the property of princes to being the property of capitalists, and as over the same period states became increasingly democratic, what the people inherited was an impoverished state saddled with war debt, incapable of fulfilling major social tasks, and reliant for revenue on the mechanism of taxation – a mechanism to which capital is hostile, and which ultimately only channels revenue back to capital in any event. The solution, argued Goldscheid, if the tax state is to escape from a condition of permanent crisis, is a capital levy leading to public ownership of the means of production. Schumpeter's response to this was to take up and memorably rearticulate its anatomy of the contradictions of the tax state, but to prescribe instead the unleashing of private enterprise so that the abundance that it can create will free us all from both capitalism and the state.

It is noticeable in this debate that its content, framing and teleology is Marxian. The institution of the tax state is understood historically as contingent upon the mode of production underpinning its continued existence, and the inquiry is fundamentally about whether structural contradictions – in circumstances where the mode of production in question is capitalism – lead to crisis. This is an unmistakeably Marxian preoccupation. Goldscheid, certainly, was working within the Marxian tradition; his departure from the mainstream Marxism of the time was primarily in treating the tax state as an additional site of structural antagonism, rather than being merely the organising committee of the bourgeoisie. For his part, Schumpeter was careful to meet Goldscheid on this ground, even going so far as to claim in his conclusion that Marx himself would agree with it.

A recent revival of the fiscal sociology framing proclaims that it investigates tax as 'central to modernity',[5] which is no great distance from saying that it investigates tax as central to the era in which the capitalist mode of production prevails, but one crucial element of a Marxian outlook that fiscal sociology today lacks is a value-theoretical framework – something this

[4] R. Goldscheid, *Staatssozialismus oder Staatskapitalismus*, Vienna, Anzengruber-Verlag, 1917.

[5] I. W. Martin, A. K. Mehrotra, and M. Prasad, 'The Thunder of History: The Origins and Development of the New Fiscal Sociology', in Martin, Mehrotra, and Prasad (eds.), *The New Fiscal Sociology: Taxation in Comparative and Historical Perspective*, Cambridge, Cambridge University Press, 2009, p. 4.

chapter seeks to remedy. From today's perspective another feature of the debate between Goldscheid and Schumpeter that is particularly noticeable is that the tax state is viewed largely in isolation. Indeed Schumpeter even makes express reference to international tax competition only in order to flag that he was ignoring it for the purposes of the discussion: 'since we are here dealing with a problem common to *all* tax states, with a problem of the system and not of a particular state, we shall disregard also the tendency of capital and labour to migrate to countries of lower taxation'.

While the ambit of fiscal sociology is now considerably wider than the debate as framed by Goldscheid and Schumpeter, there is an extent to which it has struggled to evolve in such a way as to provide a useful framing for an investigation into the global political economy of corporate tax. In 2014, performing a survey of recent fiscal sociology in the *Annual Review of Sociology*, Isaac William Martin and Monica Prasad make no mention of the global upheavals considered in this thesis, which were already at that time well underway, and even where global inequalities are considered by Martin and Prasad the emphasis continues to be on the domestic fiscal sociology of developing countries.[6]

The focus on domestic fiscal sociology is perhaps unsurprising: to a certain extent there may be something of an unspoken premise at play that the 'tax state' – insofar as legal regimes such as property and tax emanate from it on a broadly territorial basis as discussed in section 5.2 of chapter 5 – is something of a self-contained subject of analysis. And as established in that chapter, this is not a safe premise, in view of the global nature of corporate sovereignty.

In any event, when scholars *do* address the international fiscal upheavals considered in this chapter they do not (oft-encountered Schumpeter quotes about the 'thunder of history' notwithstanding) characterise themselves as doing fiscal sociology on an international scale but, rather, international political economy.[7] In 'The new politics of global tax governance: taking stock a decade after the financial crisis'[8] international political economy scholars Rasmus Corlin Christensen & Martin Hearson offer a summary of the state of play in the international political economy of corporate tax, and to an extent they are working in the

[6] I. W. Martin and M. Prasad, 'Taxes and Fiscal Sociology', *Annual Review of Sociology*, 2014, vol. 40, pp. 331–45, updating J. L. Campbell, 'The State and Fiscal Sociology', *Annual Review of Sociology*, vol. 19, 1993, pp. 163–85.

[7] Some work on international tax issues uses terms like 'fiscal crisis', and refers to the 'tax state' as an actor in the international context, but without deep engagement with the fiscal sociology underpinning these concepts; see for example R. S. Avi-Yonah, 'Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State', *Harvard Law Review*, vol. 113, no. 7, 2000, pp. 1573-1676 and Genschel, 2005.

[8] R. C. Christensen and M. Hearson, 'The New Politics of Global Tax Governance: Taking Stock a Decade After The Financial Crisis', *Review of International Political Economy*, vol. 26, no. 5, 2019, pp. 1068-1088.

same vein as Goldscheid and Schumpeter. There can be no doubt that the upheavals Christensen and Hearson are concerned with constitute something in the nature of a fiscal crisis of the state, albeit that there is no single state in crisis. What is in crisis, rather, is *an unnamed composite formation comprising the world's tax states*.

As regards the antagonist of that unnamed composite formation, the structural antagonism they identify is initially said to exist between 'globalisation and the state', but since globalisation is unabashedly referred to as having 'structural power' it could be understood as synonymous with global capital. It is important to note, however, that the habit in the literatures they survey is to treat the 'structural power of capital' as coextensive with (and indeed nothing other than) the phenomenon of tax competition between states. What is largely absent from these literatures is a sense of capital as an ontologically distinct actor deriving ultimately from the generation of surplus value but capable of exerting structural power and also capable of exhibiting other features and behaviours which unfold from that core dynamic.[9] It is as if these literatures remedy Schumpeter's omission of the phenomenon of international tax competition from the original fiscal sociology, but at the same time drop the Marxian framing and of his debate with Goldscheid and, in doing so, proceed to *replace* one of the core antagonists of the piece (capital) with that phenomenon (international tax competition), rather than seeking to understand how the core antagonist in question, capital, acts *through* that phenomenon.

This echoes the contrast between competition as understood in modern mainstream economics and competition as understood by political economists in the Marxian tradition. Mainstream economics treats competition as a universal dynamic, whereas political economists working in the Marxian tradition view competition between actors under capitalism as a historically contingent phenomenon, coeval with (and indeed unfolding from) the commodity form. What this means is that economic actors as viewed within the Marxian tradition conduct themselves under compulsions emanating from the core dynamic that Marx identifies. These compulsions may be thought of as the 'laws' of capital, and competition, rather than going hand-in-hand with autonomous economic actors on a walk through a realm of infinite economic possibility, is the *enforcer* of those laws.[10] It is by virtue of compliance with those laws on the part of individual economic actors that one is able to treat capital as a

[9] See for example Dietsch, 2015, which defines 'capital' as nothing other than (i) portfolio investment, (ii) foreign direct investment, and (iii) the paper profits of multinational enterprises; accounting artefacts, in other words.

[10] G. Palermo, 'Competition: A Marxist View', *Cambridge Journal of Economics*, vol. 41, no. 6, 2017, pp. 1559–1585.

system-wide whole to which it is possible to ascribe behaviours and even a kind of agency, notwithstanding that the interests of the individual firms comprised within it are in conflict with each other.[11]

On this analysis it is a structural actor arising from competition between firms, rather than the phenomenon of competition between states, that is the antagonist of the unnamed composite formation comprising the world's tax states. This is of course not to say that tax competition between states does not play a role – on the contrary it is fundamental to the analysis: the dynamic between firms that has the consequence that one can regard capital as a whole as an actor also applies to states – hence the unnamed composite formation comprising the world's tax states that a specifically *international* fiscal sociology must on some level be about.

As already mentioned, 'capital' is a composite of firms whose interests are structurally opposed to each other. Indeed some become huge and powerful within it while others suffer suppressed performance or go under. The composite whole called capital accordingly contains antagonisms within it on a scale which is intermediate between the whole on the one hand and, on the other, a putative population of atom-like firms competing on equal terms. These intermediate scale antagonisms – i.e. between firms that dominate the markets they operate in and those which do not – give rise to certain sub-formations, and this is something that will be investigated in greater detail in section 6.4 below on global value chains. The same is of course true of the unnamed composite formation comprising the world's tax states, and this is something already noted in the conclusions to chapter 5: structural inequality between states exists, and is self-perpetuating in various ways of which the contrast between the revenue rule and comity vis-à-vis the ontology of companies served as an illustration. This structural inequality between states will be revisited in section 6.5 below.

These then are the core elements of a specifically *international* fiscal sociology: the contestation over revenues between capital and the state identified by Goldscheid and Schumpeter, reconceived on a global scale to encompass global capital and *all* states, and with alertness to the sub-formations and internal dynamics that may come into focus once these actors are considered on that scale. Sections 6.4 & 6.5 consider certain such sub-formations and internal dynamics (i.e. global value chains, and inequality between states), but it should be recalled before moving on that, to the extent the the state prevails in that contestation, value will in very large part (indeed almost overwhelmingly) be channelled

[11] P. Chattopadhyay, 'Competition', in B. Fine and A. Saad Filho (eds.), *The Elgar Companion to Marxist Economics*, Cheltenham, Edward Elgar, 2012, pp. 72-77.

towards absorption rather than further value creation. In principle the corporate sector, by contrast. while also containing an absorptive element, nonetheless contains a value-producing element. The structural situation of that value-producing element vis-à-vis the corporate sector will be considered in section 6.4 as a component of the discussion of global value chains.

Before turning to that topic, however, it is important to consider another core structural antagonism at play from the point of view of the state's value-absorbing function, which is to do with its role in the sphere of social reproduction. In part this is because to do so helps reconcile the outlook in fiscal sociology with the reluctance in mainstream Marxism to view the state and capital as having opposed interests. The section which follows conducts that investigation.

6.3 The state and social reproduction

Conventional Marxist state theory tends to guard its position closely against any suggestion, such as is to be found in the very premises of fiscal sociology, that the state might have a structurally antagonistic relation to capital. This is for fear of encouraging the erroneous perception that liberal democracy, and the welfare state which developed into a major feature of the relationship between labour and capital in the Global North as the twentieth century progressed, might tend towards class liberation for workers.[12]

This absolutist rejection of the liberatory mirage of the welfare state may be replaced by a significantly more nuanced approach if a feminist perspective is adopted. While it hardly needs saying that the modern state is an instrument of gendered oppression on any number of levels,[13] when considered specifically from the perspective of its revenue and expenditure, it also plays a role (or it is at least in principle, subject to resource constraints, capable of playing a role) in socialising burdens and mitigating risks that would otherwise be borne predominantly by women. While from a conventional Marxist perspective the tendency is to wish a plague on the houses of both capital and the state, the struggle between the two over revenues is by no means gender neutral.

Public services and welfare provision may be understood in the context of the wider sphere of

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[12] See for example W. Müller and C. Neusüss, 'The 'Welfare-State Illusion' and the Contradiction between Wage Labour and Capital', in J. Holloway and S. Picciotto (eds.), *State and Capital: A Marxist Debate*, London, Edwin Arnold, 1978, pp. 32-39.

[13] For a classic radical feminist critique of the liberal state see C. A. MacKinnon, *Towards a Feminist Theory of the State*, Boston, Harvard University Press, 1989.

what is often labelled 'social reproduction'. Social reproduction theory posits a totality of interconnected productive and reproductive processes, which in social reproduction theory is understood from a broadly Marxian perspective. Tithi Bhattacharya writes that 'social reproduction theorists perceive the relation between labour dispensed to produce commodities and labour dispensed to produce people as part of the systemic totality of capitalism'. As such social reproduction theory is 'primarily concerned with understanding how categories of oppression (such as gender, race and ableism) are coproduced in simultaneity with the production of surplus value'.[14] The concept of *labour* performs a central role in the social reproduction literature, in unifying discussion of production and discussion of reproduction in an integrated theory of oppression.

As we saw in chapter 4, this does not mean that unwaged labour in the sphere of social reproduction creates value as if it were posited by capital as an input in the way that waged labour is. It does mean, however, that such labour is *labour*, whereby the reproduction of society as a whole is a burden imposed disproportionately on some of its members by dint of structural oppressions, prominent among which is the oppression of women under various forms of patriarchy the world over.

In order to fully understand the gendered role of the state in the sphere of social reproduction it is necessary to have as wide a conception of this form of labour as possible. Even from a relatively narrow perspective, it is clear that provision by the state for the care of children, the elderly, the sick and the disabled will disburden women more than men, since absent such provision the burden of unwaged care work in most societies falls predominantly on women. But social reproduction under capitalist patriarchy also involves certain *risks* which the state is capable of mitigating, and which are predominantly faced by women. An extreme example might be the risk of medical complications in childbirth,[15] which are notoriously likely to become fatal without readily available healthcare. For the purposes of the analysis here, the bearing of such risks may equally be thought of as gendered labour. This logic extends into many areas of public spending and is of global relevance: within the sphere of social reproduction the world over, provision for basic public infrastructure like sanitation, clean water and public transport has (or, where it is absent, would have) a highly gendered impact in terms of the burdens it relieves and the risks it mitigates.[16]

[14] T. Bhattacharya, 'Introduction: mapping Social Reproduction theory' in T. Bhattacharya (ed.), *Social Reproduction Theory*, London, Pluto Press, 2017, p. 2, 14.

[15] To be clear, this is not to suggest that the category of risks referred to here is exclusively those risks which cis women face by reference to reproductive anatomy.

[16] There are extensive literatures on these topics which adopt a feminist perspective and consider the issues

In addition, the gendered impact of state spending should not be understood solely by reference to the services and infrastructure it provides. The way that the state spends money is also highly gendered from the point of view of the individuals to whom it makes cash transfers. This is because within states and globally women bear a disproportionate burden of poverty: a dynamic known as the feminization of poverty.[17] The state can alleviate this burden directly in the form of welfare payments of various kinds, and also indirectly in the form of (often low-paid) employment in the very same service provision sectors (care, welfare &c) that are already relevant to the gendered impact of the state because of the content of the services provided.

This is not to claim, of course, that somehow the state is in any way positively in pursuit of the emancipation of women. It would be outside the scope of this thesis to review the feminist critique of the welfare state or survey the myriad ways in which the welfare state is analysed in feminist scholarship as reproducing gender oppressions.[18] For present purposes it need only be brought into focus that the relationship between the state and those who bear a disproportionate burden in the sphere of social reproduction is, like the relationship between the state and capital, a fiscally antagonistic one. '[A] fundamental assumption of the welfare state', wrote Anne Showstack Sassoon in 1987, articulating this antagonism, 'has been that family/women will provide fundamental services. The welfare state will only provide what cannot be provided elsewhere.'[19]

from the perspective of wealthy countries and from the perspective of the Global South; for illustrative broad discussions see I. Ray, 'Women, Water, and Development', *Annual review of environment and resources*, vol. 32, no. 1, 2007, pp. 421-449 and R. Law, 'Beyond "Women and Transport": Towards New Geographies of Gender and Daily Mobility', *Progress in Human Geography*, vol. 23, no. 4, 1999, pp. 567-588. This is not simply a matter of social reproduction (and therefore those who perform unpaid reproductive labour) being assisted by public services, however, although that is of course of central importance – there also exists an additional layer of more complex interrelations between public spending and the mitigation of gendered risks; investment in sanitation infrastructure offers a particularly stark and uncomfortable illustration since an absence of basic sanitation facilities is implicated in increased risk of sexual violence towards women: J. McCarthy, 'How A Lack Of Toilets Puts India's Women At Risk Of Assault', National Public Radio, 9 June 2014, https://web.archive.org/web/20200905084417/https://www.npr.org/sections/parallels/2014/06/09/319529037/indias-rape-uproar-ignites-demand-to-end-open-defecation?t=1599295434782 (accessed 30 August 2020).

17 See H. Scott, *Working Your Way to The Bottom: The Feminization of Poverty*, King's Lynn, Pandora Press, 1984.

18 For a broad overview of welfare state regimes in a number of wealthier countries from a feminist perspective see J. O'Connor, , A. S. Orloff, and S. Shaver, *States, Markets, Families: Gender, Liberalism and Social Policy in Australia, Canada, Great Britain, and the United States*, Cambridge, Cambridge University Press, 1999; for contrasting perspectives from the Global South see S. Razavi and S. Staab (eds.), *Global Variations in the Political and Social Economy of Care: Worlds Apart*, London, Routledge, 2012 (see also R. Antonopoulos and I. Hirway (eds.), *Unpaid Work and the Economy: Gender, Time Use and Poverty in Developing Countries*, Basingstoke, Palgrave Macmillan, 2010).

19 A. S. Sassoon, 'Women's New Social Role: The Contradictions of The Welfare State', in A. S. Sassoon (ed.), *Women and The State*, London, Routledge, p. 171.

The degree of antagonism here identified, and the sheer scale of the state's intervention (or, where it is absent, the state's *potential* intervention) into the gendered world of social reproduction, is startlingly illustrated by the effects of austerity policies implemented since the Global Financial Crisis. In 2017, for example, researchers at the House of Commons Library estimated that 86% of the adverse impact of the UK's tax and benefit changes since 2010 had fallen on women.[20] The gendered impact of austerity policies and of fiscal consolidation emerges in an unsummarisable diversity of indicators ranging from public sector pay freezes and lay-offs in the world's richest countries[21] to falling girls' education participation in the world's poorest,[22] but the overall conclusion is clear (and unsurprising): when states come under fiscal pressure, the burden of the adverse impact is disproportionately borne by precisely those groupings who are already identified within social reproduction theory as bearing a disproportionate burden within the sphere of social reproduction.[23]

There was formerly (*i.e.* in the 80s and 90s) a nuanced debate between on the one hand a liberal perspective on the welfare state which tended to idealise the social democratic model,[24] and on the other hand a more critical feminist perspective which noted the retrenchment taking place under what we are now accustomed to think of as neoliberalism.[25] The more critical perspective may have appeared temporarily to diminish in relevance during

[20] R. Keen and R. Cracknell, 'Estimating The Gender Impact of Tax and Benefits Changes', House of Commons Library Briefing Paper Number SN06758, 18 December 2017 http://researchbriefings.files.parliament.uk/documents/SN06758/SN06758.pdf - also available at http://archive.is/A20kq, (accessed 31 August 2020).

[21] A. Asthana, 'Thousands of Women Fear Bleak Future as They Bear The Brunt of Public Sector Cuts', *The Observer*, 8 August 2010, https://www.theguardian.com/society/2010/aug/08/women-public-sector-cuts-pay-freeze (accessed 31 August 2020); J. Lethbridge, 'How Women Are Being Affected By The Global Economic Crisis and Austerity Measures', Public Services International Research Unit, October 2012, https://web.archive.org/web/20140803190023/https://www.world-psi.org/sites/default/files/documents/research/en_austerity_women.pdf (accessed 31 August 2020).

[22] UNAIDS, Impact of the global economic crisis on women, girls and gender equality, 2012, http://www.unaids.org/sites/default/files/media_asset/JC2368_impact-economic-crisis-women_en_0.pdf & https://archive.is/lSAq3 (accessed 31 August 2020).

[23] For useful overviews of the position both theoretically and empirically (notwithstanding a bias towards Europe/the Global North), see M. Karamessini and J. Rubery (eds.), *Women and Austerity: The Economic Crisis and the Future for Gender Equality*, London, Routledge, 2014 and H. Bargawi, G. Cozzi, S. Himmelweit (eds)., *Economics and Austerity in Europe: Gendered impacts and sustainable alternatives*, London, Routledge, 2017; for an overview from a global perspective see K. Donald and N. Lusiani, 'The Gendered Costs of Austerity: Assessing The IMF's Role in Budget Cuts Which Threaten Women's Rights', Bretton Woods Project, September 2017, https://web.archive.org/web/20200412205513/https://www.brettonwoodsproject.org/2017/09/imf-gender-equality-expenditure-policy/ (accessed 31 August 2020).

[24] A highly influential book in this regard was G. Esping-Andersen, *The Three Worlds of Welfare Capitalism*, Cambridge, Polity Press, 1990.

[25] See for example the final chapter of D. Sainsbury, *Gender, equality and welfare states*, Cambridge, Cambridge University Press, 1996.

the ascendency of 'third way' political leaders in the final years of the twentieth century and the increased room for budgetary manoeuvre which they seemed to bring with them, but the 2008 crash 'shattered all illusions'.[26] It is tolerably clear now that, at our current historical juncture at least, the contestation over revenues between capital and the state refracts a deeper contestation (deeper, at least, from the point of view of the systemic totality of production and reproduction under capitalism) between (i) capital and (ii) those who bear a disproportionate burden in the sphere of social reproduction.[27] **That contestation is over the extent of the contribution that capital is going to make in the sphere of social reproduction, via its fiscal relationship with the state, out of its own revenues**.

It was noted in chapter 4 that Marxist feminist value theory (correctly) argues that unpaid reproductive labour is implicated in capitalist surplus because it reduces capital's costs of social reproduction. When encountered in its most abstract form the implication of the argument tends to be that, absent that labour, capital's costs would show an increase in the form of higher wages. In practice, looking broadly at the rise and decline of welfare states since World War II, such increase seems more likely to manifest itself in the form of an increased tax burden. That being the case, fiscal sociology (whether applying to a single state or to states globally) is necessarily and fundamentally about gender justice. It is here suggested, accordingly, that to have fiscal sociology and social reproduction theory both in view is to better integrate the role of unpaid socially reproductive labour in the Marxian value-theoretical schema than is possible if one looks exclusively at the core value-theoretical debates within Marxist feminism (as to which see section 4.7). In addition, as already noted, recognising the antagonism between the state and those who perform labour in the sphere of social reproduction helps (at least insofar as concerns the present historical moment) reconcile the outlook in fiscal sociology with the reluctance in mainstream Marxism to view the state and capital as having opposed interests.

Finally, it may be recalled that a key feature of social reproduction funded by the state is that (as with the vast majority of other state spending) it is *absorptive* of value. (In view of the analysis in this section it may be clarified that, for the purposes of this chapter, the concept of public sector absorptive labour should be understood to include the reproduction of the self and others by the recipients of non-wage state payments in the nature of welfare payments.) It is to a contrasting category of value absorption i.e. absorptive labour in the corporate sector

[26] S. Mohandesi and E. Teitelman, 'Without Reserves', in Bhattacharya, 2017, p. 65.

[27] H. Hester, 'Care Under Capitalism: The Crisis of "Women's Work"', *IPPR Progressive Review*, vol. 24, no. 4, 2018 pp. 343-352.

that we now turn.

6.4 Monopoly power and global value chains

This chapter opposes absorptive labour paid for by the state with another category of absorptive labour; one which is extremely important in today's global economy *i.e.* the labour that goes into creating and preserving monopoly power in global value chains. This is the labour noted in chapter 4 as being implicated in the suppression of the prices of commodities relative to their value, insofar as it serves to bring about value capture elsewhere in the economy. This section elaborates upon that proposition, and draws attention to its relevance to the 'large-scale digitalisation of the economy' that Christensen and Hearson describe in their survey of the international political economy of corporate tax; a development which they further characterise as 'upending the distribution of value within global production networks and creating an unprecedented consolidation of capital'.[28]

The concept of monopoly power is a broad one, referring not only to cases where a market has a single seller, but to dominance in all cases of market imperfection: oligopoly, monopsony, oligopsony, control over market access, and indeed any exploitation of an advantageous position vis-à-vis a market insofar as it evinces some sort of asymmetry or barrier to entry. Monopoly power is an endemic feature of the real-world business environment. An oft-encountered kind of monopoly power in consumer markets is oligopoly – the dominance of a small number of players. Members of an oligopoly can extract excess profits without forming a formal cartel by each unilaterally taking a strategic decision not to compete with the others on price.[29] And even where they appear to be competing with each other on price, they might nonetheless be benefiting from oligopsonistic practices[30] vis-à-vis their suppliers; suppliers who cannot get their product to market except through the 'choke point'[31] of the oligopoly.

A key element in monopoly power since the nineteenth century has been the deployment of intellectual property, which is of course a literal monopoly in the sense that it confers on its owner a state-enforced right to exclude others from making commercial use of it, although its role is often to embed and enhance monopoly power in circumstances of competition with

[28] Christensen & Hearson, 2019, p. 1071.
[29] Baran and Sweezy, 1966.
[30] R. D. Blair and J. L. Harrison, *Monopsony in Law and Economics*, Cambridge, Cambridge University Press, 2012.
[31] F. Guy and P. Skott, 'Technology, Power and the Political Economy of Inequality' in U. Mattei and J. D. Haskell (eds.), *Research Handbook on Political Economy and Law*, Cheltenham, Edward Elgar, 2015, pp. 105-119.

other market participants. Apple's hardware, for example, is so profitable in part because of Apple's technical innovations, and in part because of its attractive product design, and these elements are held together by a carefully curated brand.[32] All of these features of its hardware business are underpinned by formal monopolies over intellectual property.

Another role that intellectual property can play is in encroachments of monopoly power from one sphere to another. Google and Facebook have monopolized our attention in various ways, primarily in (respectively) web search and social media, and they are thereby enabled to exercise immense monopoly power in the online advertising market. These kinds of deployments of intellectual property are not new – consider for example the phenomenon of the free newspaper funded through advertising – but the 'digital' or 'information' sphere creates unprecedented opportunities for enhanced or novel forms of encroachment of monopoly power from one sphere to another.

Google and Facebook represent an advance on the free advertising newspaper model, for example, because of the targeted nature of their advertising based on the data they hold on us.[33] Another example would be Microsoft's MS-DOS software product (and its 'Windows'-branded successors), which famously piggybacked on the advantageous position IBM had in a particular segment of the computer hardware market (i.e. PCs) to establish an almost total monopoly over the supply of PC operating systems, leading to dominance of the 'productivity' software market.[34] More generally, intellectual property is instrumental in exercising monopoly power through the 'network effect' *i.e.* a circumstance where something becomes more valuable to its users as a function of the number of users it has.

Public concern regarding monopoly power ebbs and flows with the evolution of national economies generally. Around the turn of the twentieth century, in the US, at the birth of the modern competition law regime, the concern was with giant 'trusts' which deployed aggressive monopolistic practices to corner markets in basic commodities such as oil and steel.[35] There was an uptick in interest in monopolies in the 1960s, again in the US, in connection with oligopolistic practices among manufacturers of high-value consumer goods such as motor cars.[36] In the UK in the 2000s awareness grew of oligopsonistic practices

[32] As regards the role of branding as a component of monopoly power in the global economy, see N. Klein, *No Logo*, London, Picador, 1999.
[33] N. Srnicek, *Platform Capitalism*, Chichester, John Wiley & Sons, 2016.
[34] M. Becraft, *Bill Gates: A Biography*, Oxford, Greenwood, 2014.
[35] M. Josephson, *The Robber Barons: The Great American Capitalists, 1861–1901*, London, Harcourt, 1934.
[36] Baran & Sweezy, 1966.

among supermarkets, and the adverse impact those practices had on farmers.[37] Currently there are concerns about the network-effect-related monopoly power exercised by 'platform economy' websites such as Uber and Airbnb.[38]

For our purposes, however, these instances represent a coming into unusually precise focus of a specific manifestation of a phenomenon which, as already noted, is simply an endemic feature of real-world markets: the accruing of enhanced profitability to some market participants at the expense of others,with the implication that at least some of the profitability of a given business (and in some instances most or all of it) may reflect capture by the firm in question of value created elsewhere. In today's global economy, the question of where it may be captured *from* is generally addressed through the analytical lens of the global value chain ('the GVC').

GVC analysis has its origins in the study of global inequality in the post-WWII world. For a time the prevailing framing was by reference to inequality between states. This is the world as anatomised by dependency theory, which draws a distinction between 'core' capitalist states and exploited states at the 'periphery', and describes how the burden borne by the periphery is systemically reproduced rather than alleviated by 'development'.[39] Out of dependency theory evolved an approach (known as 'world systems' theory in connection with the work of Immanuel Wallerstein but including the work of a number of other political economists; notably Samir Amin[40]) which developed these categories into a Marxian analysis of global capitalism taking the world as a whole rather than individual national economies as the primary unit of analysis. (It is noticeable, therefore, how we are already in a very different, and more realistic, world from the one described by Goldscheid and Schumpeter.)

A central concern of these and related literatures was with the relative cheapness of labour in the periphery, and the consequent accumulation (*i.e.* at the expense of the periphery) at the core.[41] These traditions continue to be broadly relevant today but a major analytical

[37] J. Blythman, *Shopped: The Shocking Power of British Supermarkets*, 2nd edn, London, HarperCollins, 2005.
[38] Srnicek, 2016.
[39] For an illustrative text in this tradition see A. Gunder Frank, *Dependent Accumulation and Underdevelopment*, London, Palgrave Macmillan, 1978.
[40] *The Law of Worldwide Value*, New York, Monthly Review Press, 2010.
[41] In terms of specific theory this concern evolved through a series of distinct articulations, including the Prebisch-Singer thesis (see J. Toye and R. Toye, 'The origins and interpretation of the Prebisch-Singer thesis', *History of Political Economy*, vol. 35, no. 3, 2003, pp. 437–467), the theory of unequal exchange (see A. Emmanuel, *Unequal Exchange: A Study of the Imperialism of Trade*, London, Monthly Review Press, 1972 and S. Amin, *Unequal Development: An Essay on the Social Formations of· Peripheral Capitalism*, London, Monthly Review Press, 1976) and the analysis known as the 'new international division of labour' (see F. Fröbel, J. Heinrichs, and O. Kreye, *The New International Division of Labour*, Cambridge, Cambridge University Press, 1980 and see also the editors' introductory chapter to G. Charnock and G.

shortcoming is in their tendency to homogenise the regions of the world once categorised. Often the impacts of the 'world system' in a given region are of a complex texture which requires greater granularity of analysis, recognising the role played by a particular sector or a particular resource. The broad categories of world systems theory did not obviously accommodate, for example, the rapid growth of certain east-Asian economies in the 80s and early 90s. The required greater granularity of analysis was, however, delivered by the 'global commodity chain' model where the focus shifted from states to the firms whose commercial relations underpin the 'world system': nodes in a global production network bringing commodities from raw materials extraction to finished goods at the point of retail sale.[42]

The 'global commodity chain' model came to be known as the 'global value chain' model, but this was more than a mere change of label. At its inception the model was still firmly rooted in a concern with structural inequalities, maintaining an express focus on monopoly power exercised by what came to be known as 'lead firms' at nodes in the network where the extraction of excess profits at the expense of other chain participants was possible.[43] Over time this concern with excessive returns to capital was replaced with a focus on the concept of 'value added', which means profits *plus* labour costs, *i.e.* the amount of 'value' (in price-based accounting terms at least) produced at the node, irrespective of its onward transfer into the hands of capital or labour. In other words the attention paid to the core structural antagonism between capital and labour was lost. At the same time the concern with monopoly power evolved into a focus on 'governance': sector-wide standard-setting analysed as a mechanism for reducing transaction costs, for example.[44] Either way, however, a crucial element of commodity chain or value chain analysis is recognition that the largest-scale structural entity in the analysis is not the firm but the chain itself, insofar as control is exercised by lead firms all the way from raw materials extraction to retail, whether or not they own the means of production being operated, and employ the labour engaged, at any particular node in the chain.

The relation between this feature of GVCs and the question of value in the Marxian sense is illustrated by the 'smile curve', or 'smiling curve' (which is a feature of mainstream GVC

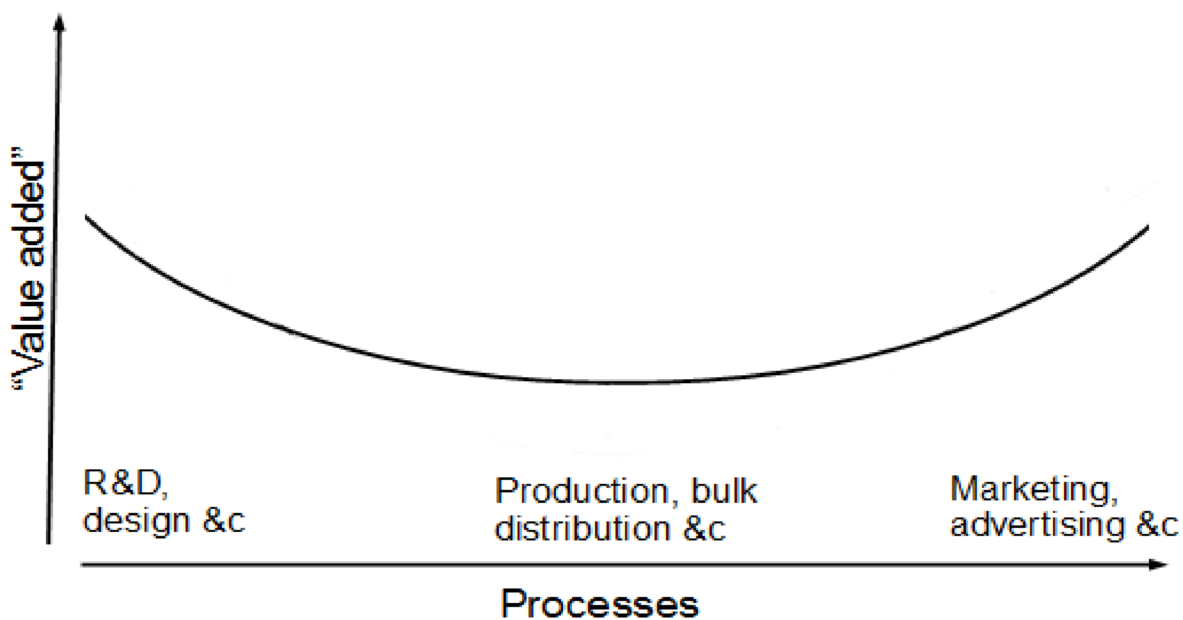
Starosta (eds.), *The New International Division of Labour*, London, Palgrave Macmillan, 2016, pp.1-22).

42 See G. Gereffi, M. Korzeniewicz, and R. P. Korzeniewicz, 'Introduction: global commodity chains' in G. Gereffi and M. Korzeniewicz (eds.), *Commodity Chains and Global Capitalism*, London, Praeger, 1994, pp. 1-14.

43 See T. K. Hopkins and I. Wallerstein, 'Commodity Chains: Construct and Research' in Gereffi and Korzeniewicz, 1994, pp. 17-20.

44 G. Gereffi, J. Humphrey and T. Sturgeon, 'The Governance of Global Value Chains', *Review of International Political Economy*, vol. 12, no. 1, 2006, pp. 78-104.

analysis). The smile curve (see the figure below) reflects the fact that generally speaking the GVC nodes which add the least value in accounting terms are the nodes where actual processes of material production take place. Greater value added is achieved by the nodes whose role is in developing and designing products, and by nodes whose role is in marketing and advertising products. These are nodes associated with precisely those kinds of intangible assets which are to be identified with the exercise of monopoly power, and the lowest 'value added' is created by precisely those processes (*i.e.* material production) which Marxian value theory would (as discussed above) identify with value creation.



The curve is schematic but has strong empirical support,[45] which should of course not be controversial since it accords with the widespread observation that intangibles are of great significance in profitability today: insofar as business processes are disaggregated along global value chains we would expect those nodes where the intangibles are deployed to 'add' the lion's share of the total 'value added' in the chain. Indeed, the smile curve is generally said to be *deepening*,[46] and this accords with the commonplace observation that intangibles are of *increasing* importance in today's global economy. But it might equally be taken to

[45] M. Ye, B. Meng and S.-J. Wei, 'Measuring Smile Curves in Global Value Chains', Institute of Developing Economies Discussion Paper. No. 530, 27 August 2015, https://web.archive.org/web/20170809192728/http://rigvc.uibe.edu.cn/docs/20160329210052329340.pdf (accessed 31 August 2020).

[46] OECD, 'Interconnected Economies: Benefiting From Global Value Chains', 2013, https://web.archive.org/web/20180717095003/http://www.oecd.org/sti/ind/interconnected-economies-GVCs-synthesis.pdf (accessed 31 August 2020).

show that value is still, to this day, being created at what is now the lowest point in the smile curve, as it has been since the days of 'dark satanic mills', and captured in an increasingly high proportion by nodes of capital exercising monopoly power from positions up the sides of the curve.

GVC analysis, then, is consistent with the proposition that it is not necessarily to the owners of means of production that surplus value accrues but to the various kinds of monopolists that dominate global value chains. It is for this reason (among others) that the prices of material commodities may be understood as suppressed in comparison with their values: it follows from the fact that profits at the GVC nodes where means of production are owned are suppressed by monopoly power. The surplus value may be understood to arise precisely as described in Marxian value theory *i.e.* from material production (as to which see chapter 3), but it accrues elsewhere in the GVC. What this means in practice, to be clear, is that **material goods and services produced otherwise than for final consumption** (raw materials, intermediate goods, wholesale goods, bulk transportation &c) **systematically take place at an undervalue, whether or not the producer is within the formal control of a multinational corporate group**, and the resulting excess surplus accrues elsewhere in the economy. We are therefore in theoretical territory falling into what is known as the 'monopoly capitalism' school of Marxian analysis, whereby prices are treated as impacted by dynamics of market power, having the consequence that they do not bear a quantitative relation the value of the commodities to which they attach.[47]

There is a major analytical difference, it should be noted, between this phenomenon of surplus value accruing somewhere other than the GVC node where it is created, and the recognition in mainstream economics of excess profits derived from monopoly power (which one might label 'monopoly rent'). In mainstream economics such excess is to be contrasted with the profits that would accrue from deploying the same factors of production competitive markets, whether those factors of production be inside or outside any classical-type production boundary (which mainstream economics does not recognise). The value capture referred to here is the capture of surplus value in the Marxian sense, arising from the sole factor of production *capable* of creating such a surplus i.e. productive labour; labour within the production boundary. This distinction therefore takes us beyond the point of being able to determine as non-value-creating the offshore entities accumulating the untaxed profits of a multinational enterprise. **We are adopting a position whereby we can distinguish between**

[47] See the discussion in chapter 1 at footnote 36.

apparent factors of production which are not value-creating and those that are. Crucially, however, in order to adopt that position, (and this point is fundamental to the argument developed in Part III of this thesis) **it is necessary to have in view the entire value chain rather than just the multinational enterprise in question**.

So, for example, it may be the case that an online vendor of some commodity is connected to a group entity which manufactures that commodity, and in those circumstances, we would say that the value is entirely created in the manufacturing entity and the vendor entity only captures value. But equally where the vendor entity outsources the production to an unconnected entity, the value is entirely created in the manufacturing entity and the vendor entity only captures value. And, likewise where, for example, the manufacturing entity makes sales itself, but can only do so by spending money on advertising through an unconnected entity, the value is entirely created in the manufacturing entity and the advertising entity only captures value. It is of course counter-intuitive to say that advertising and selling (and by the same token design and product development) create no value, since they are manifestly implicated in the desirability of products and the profitability of those who produce them, but (as discussed extensively in chapter 4) this is what emerges from a rigorous application of the value-theoretical framework adopted for the purposes of this thesis. The value relation between production and exchange is not merely a causal one, it is a *quantitative* one.

In any event, a crucial point to extract from this analysis is that it is applicable whether or not the value creation and value capture take place within the same corporate group. It was noted above that compliance with the 'laws of capital' on the part of individual firms means that one is able to treat global capital as a system-wide whole to which it is possible to ascribe behaviours and even a kind of agency. It was also said that within that system-wide whole are to be found sub-formations more complex than the atomised business entities of economic abstraction, of which sub-formations multinational enterprises are a widely noted instance. A key conclusion of this chapter, for the purposes of the analysis in Part III of this thesis, is therefore that **the salient sub-formation when considering the role of corporate capital in its global contestation over revenues with the state is not the multinational enterprise but the global value chain or chains in which it participates**. And for the purposes of the argument in this chapter it should be borne in mind that (as recalled above) developing and maintaining the monopoly power that shapes those global value chains

requires *labour*: absorptive labour, but labour, nonetheless.

As we shall see in Part III of this thesis, the instruments of monopoly power are deeply implicated in the phenomenon of tax avoidance by multinational enterprises: taking the schematic examples of value creation and value capture described above, the value capture is unlikely to be taking place in the jurisdictions where the consumers are situated but would largely be taking place instead in offshore entities. And so, the category of absorptive labour considered here is notable from the perspective of fiscal sociology for two reasons. Not only does it have in common with public sector labour that it is absorptive rather than productive of value, but it also actively partakes in the contestation over which category of absorptive labour is going to be supplied with revenues. It therefore gives rise to a vicious (or, perhaps, to someone of a neoclassical bent, virtuous) circle; to the extent resources are kept out of the hands of the state so as to be deployed for the purposes of creating and maintaining monopoly power, so the state can be further deprived of resources. This vicious circle may of course not be wholly unrelated to the deepening of the smile curve, and the apparently tendential nature of the phenomena discussed in this chapter will be returned to in the conclusions to the thesis as a whole.

Stepping back at this stage, however, it is worth taking in the picture that has emerged. We have identified different two categories of absorption: public sector absorptive labour, and corporate sector absorptive labour, both ultimately drawing the value they consume from that region at the bottom of the smile curve where production takes place. And so, given the sheer economic scale of the activities up the sides of the smile curve, **the global contestation over revenues between capital and the state is a contestation over the extent to which each category of value absorption will be funded**. As we have seen, however, this antagonism cannot be divorced from other struggles: the antagonism between the state and those who labour in the sphere of social reproduction, the antagonism between MNEs and small value chain participants, and the core fault-line within capitalism between capital and labour, exposed to our view right there at the bottom of the smile curve, where all the surplus value in the system arises, and is extracted from the labour that takes place within the production boundary. Our focus in the section which follows will be on one such intersecting antagonism: the antagonism between wealthy states and poor states.

6.5 Inequality between states

It was observed in the conclusion to chapter 5 that, in a world where force decides between

formally equal states, the interests of corporate capital and the interests of specifically *wealthy* states are intertwined, adding an additional dimension of complexity to what would otherwise be a simple opposition between two mutually antagonistic kinds of property regime (*i.e.* the corporation and the state). That additional dimension of complexity is deeply relevant to the dynamics identified in this chapter. While the GVC analytic serves to unpack the basic 'core'/'periphery' duality and provide for more granular analysis of specific sectors in specific economies, the structural story about inequality between states generally that is told by the GVC data is very much in accordance with the story formerly told in dependency theory, world systems theory &c. The vast majority of the world's population lives in states with a GDP per capita very substantially below the GDP per capita enjoyed in the rich countries of the global north. Further, those lower-income states are almost exclusively states which have a proportion of the workforce employed in raw materials extraction, agriculture and manufacture which is substantially *higher* than the kinds of proportion generally to be found in the higher income states.[48] Or, to put it more simply, from the point of view of headcount, the business functions at the low point at the centre of the smile curve are disproportionately located in poorer countries, and the activities up the sides of the smile curve are disproportionately located in wealthier countries. From the point of view of payroll, of course, that effect will be hugely magnified, because of the higher cost of labour in wealthier countries.

To the extent, therefore, that 'value added' in multinational corporate groups represents value created by market participants at the bottom of the smile curve and captured through monopoly power, the conclusion here is that GVCs are implicated in yielding value for capture predominantly from nodes in low-income countries deploying labour which is on the whole much cheaper than labour in the wealthy countries of the global north.[49] As for those wealthier states with a lower proportion of the workforce employed in raw materials extraction, agriculture and manufacture, labour deployed in developing and maintaining monopoly power in those jurisdictions is comparatively more expensive. And while this is clearly the case if one compares the incomes of global south workers in functions at the bottom of the smile curve with the incomes of, say, workers in the global north in IT or

[48] The empirical claims made here are uncontroversial and may be readily borne out with data from the International Labour Organisation, the Word Bank &c. The purpose here, however, is to describe a set of structural relations rather than to make out an empirical case.

[49] Indeed, it is much more susceptible to exploitation in any number of respects. For an illustration of this mechanism in action see M. Anner, 'Squeezing workers' rights in global supply chains: purchasing practices in the Bangladesh garment export sector in comparative perspective', *Review of International Political Economy*, vol. 27, no. 2, 2019, pp. 320-347.

creative roles, it is all the more pronounced in view of the vast incomes of certain other kinds of workers implicated in value capture such as bankers and MNE senior management.

This has profound *fiscal* implications from the perspective of inequality between states. Multinational enterprises capturing value from material production by deploying absorptive labour to dominate GVCs suppresses the corporate tax take in low-income countries, because it is disproportionately in low income states that the profitability arising from material production would otherwise accrue. Meanwhile the absorptive labour deployed to capture value, when it comes in the form of higher-waged labour in wealthy countries, gives rise to a substantial *employment* tax base in those countries, notwithstanding that the tax base represented by corporate profitability may be eroded in connection with the use of offshore regimes and other mechanisms identified by Christensen and Hearson (and indeed considered in Part III of this thesis).

And so **the channelling of surplus output into corporate sector absorptive labour also serves the purpose of externalising to low-income countries the brunt of the adverse impact of the global fiscal antagonism between capital and the state, reproducing the very inequalities that have the consequence that the labour is cheaper in those low-income countries in the first place**.[50] (To be clear, since this effect takes place whether or not the multinational enterprises actually have taxable presences in low-income jurisdictions, it should be understood as arising in addition to the structured corporate tax planning and tax competition which we are aware erodes the corporate tax bases in low-income countries as noted by Christensen and Hearson and elaborated upon in the extensive literatures underlying their article.)

Speaking more generally, once the incomes of absorptive workers in wealthy countries are considered in comparison with wages or wage-equivalents in poorer countries for workers at the bottom of the smile curve, the sheer scale of corporate sector value absorption becomes apparent. That being the case, it would not be inapposite to suggest (having reintegrated a theory of value into fiscal sociology, and having introduced the global dimension) that **the contestation between capital and the state specifically over how value absorption is to be apportioned between them is the central structural issue to which international fiscal sociology may be applied**.

[50] This illustrates the phenomenon which has elsewhere been described as the ‘global inequality chain’; see C. Quentin and L. Campling, ‘Global inequality chains: integrating mechanisms of value distribution into analyses of global production’, *Global Networks*, vol. 18 no. 1, 2018, pp. 33-56.

6.6 Conclusions

In chapter 5 two mutually antagonistic property regimes were identified; the state and the company, with offshore being the juridical space where profits accrue to the extent that the company succeeds in its contestation with the state over revenues. It was also noted that this set of relations appeared to have imperialist violence baked into it. In this chapter we saw that fiscal sociology in the twentieth century was to do with fiscal antagonism between states and domestic capital, but to address the present moment it needs to recognise the fact that the contestation over revenues between the state and capital takes place globally in the form of a contestation over revenues between states generally and corporate capital generally (i.e. the two property regimes identified in chapter 5).

Further, we saw that the salient sub-formation when considering the role of corporate capital in its global contestation over revenues with the state is not the multinational enterprise but the global value chain or chains in which the enterprise participates, since the behaviour of value in this context has a pattern (i.e. the smile curve) which is recognisable across the global production network irrespective of whether global value chain nodes are within or outside multinational enterprises. From that pattern it was concluded that the global contestation over revenues between capital and the state is a contestation over the extent to which value absorption will be funded through each sector.

The dynamic of the global value chain when considered from the perspective of fiscal sociology constitutes a nexus of inequalities, but the particular inequality to which attention is drawn here (picking up the theme of imperial domination established in the conclusions of chapter 5) is inequality between states. As explained in the foregoing section, the channelling of surplus output into corporate sector absorptive labour serves the purpose of externalising to low-income countries, where the cheap labour at the bottom of the smile curve is predominantly deployed, the brunt of the adverse impact of the global fiscal antagonism between capital and the state.

By way of a final thought with which to conclude Part II of this thesis, it might be suggested that some relief from that inequality between states would follow from placing improved fiscal resources in the hands of states disproportionately hosting the labour taking place at the bottom of the smile curve. In other words, if one adopts a Marxian conception of value, taxing rights over the profits of MNEs should be more closely aligned with *where value is created*. Which is of course, as discussed in chapter 1, (and albeit lacking the value-

theoretical foundation required to give it meaning) the normative goal of the international corporate tax reform process that the OECD has been conducting for the best part of a decade. It is to that process that we now turn, in Part III of this thesis.

PART III: INTERNATIONAL CORPORATE TAX REFORM

Chapter 7: 'Value creation' and transfer pricing reform

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7.1 Introduction

This chapter, and the chapter which follows, both consider the use made of the concept of 'value creation' in recent discussions around international corporate tax reform. As noted in the introduction to this thesis, the use made of that concept in this context constitutes a complex terrain of meaning, and these chapters do not propose to map that terrain comprehensively. Instead they perform a detailed survey at a couple of key locations: (i) this chapter will focus on the early stages of the transfer pricing reform effected in connection with the OECD BEPS process, and (ii) the chapter which follows will focus on the taxation of the digital economy as the debate over that issue was constituted in the run-up to the OECD's recent flurry of policy development in that area.

The primary research materials considered in these chapters are the consultation documents issued by the OECD in relation to corporate tax reform, formal responses to those discussion

drafts from business advisory firms and corporate lobbying entities, and (where particularly apposite) position statements and reports prepared for state actors. Methodologically, these chapters deploy close reading of those materials ('lawyerly' reading, one might say) rather than formal discourse analysis. As regards literature, there are growing literatures relating to the topics brought to the fore here but these chapters do not engage with those literatures to any great extent. This is because the purpose here is to apply to these research materials a theoretical framework (*i.e.* the one adumbrated in the foregoing chapters) which (as explained in the introduction to this thesis) is almost entirely alien to contemporary tax scholarship. To the extent relevant to that framework the literature has already been reviewed in the introduction to this thesis, in sections 1.3 and 1.4. For the purpose of setting the scene for these chapters, however, significant reliance will be placed (particularly in the early parts of this chapter) on Richard Collier and Joseph Andrus's robust textbook *Transfer Pricing and the Arm's Length Principle After BEPS.*[1]

As we saw in the introduction to this thesis the term 'value creation', which emerged as an articulation of a proposed solution to a crisis of legitimacy on the part of the international tax system, is widely considered to be of indeterminate meaning in those (and related) areas of discussion, apparently just referring broadly to activity which gives rise to profitability (and therefore begging the question it is posited to answer). As a starting point, however, we saw that transactions and assets artificially located offshore are *not* considered to constitute value creation for BEPS purposes, and so what is therefore posited by this approach is some kind of boundary separating surplus from transfer.

We saw in chapter 2 that such a boundary, if it is to be drawn *objectively*, can only be drawn around material production. We saw in chapter 3 how that objective boundary is to be drawn if it is to be drawn with precision *i.e.* by reference to labour which is quantitatively implicated in the reorderedness of matter represented by commodities at the point of exchange. And we saw in chapter 4 that this gives rise to a category of labour which does not *create* value but which may be implicated in *capturing* value in the form of corporate profitability *i.e.* absorptive labour. Those three chapters taken together, *i.e.* Part I of this thesis, deliver what was sought in the introduction *i.e.* a mechanism for (in certain circumstances at least) distinguishing surplus from transfer notwithstanding that either can be booked as corporate profit. To illustrate, a company whose workers are only performing absorptive labour is not *creating* surplus value but, rather, procuring transfers of surplus value from elsewhere in the

[1] Oxford, Oxford University Press, 2017.

system.

Part II of this thesis placed that formal distinction in its real-world context: a world where capital and the state are in conflict over revenues. As we saw in chapter 5, this is not the world that traditional fiscal sociology describes, where a property regime emanates from the state and includes provision in the form of tax law for appropriating back to the state surplus value generated through that regime, with policy debate going to the question of the extent and distribution of that appropriation. Instead, it is a world where global corporate capital operates what is in effect its own property regime – offshore – where surplus value can accumulate outside the power of the state to tax it. Chapter 5 also establishes that, in an international context, the tax state as an institution is an instance of 'self-camouflaging imperialist violence', alerting us to issues pertaining to inequality between states.

In chapter 6 we saw that the profitability of multinational enterprises ('MNEs') represents at least in part value captured from global value chains by means of intangible assets through the exercise of monopoly power, and as we shall see in this chapter, these two themes are crucial to discussion of transfer pricing reform because of the role of intangible assets in causing corporate profitability to arise offshore. Drawing the conclusions of Parts I and II together in that regard, profits arising otherwise than by reference to productive labour represent value capture rather than value creation, *notwithstanding that they are said to arise by reference to labour as a production factor*. Surplus value is being created by productive labour somewhere in the value chain and the offshore holdings of MNEs are to a great extent where it accumulates, and while this no doubt happens in connection with the efforts of certain *absorptive* workers employed within the MNE, it happens irrespective of whether the node in the value chain actually employing the *productive* workers is within the corporate group.

In broad summary as regards the conclusions of these two chapters, at the outset of the BEPS process, 'value creation' meant (as we shall see in this chapter) absorptive labour associated with value capture, and (as we shall see in the chapter which follows) it since came to mean value absorption in the sphere of consumption. In other words the tendency appears to be towards characterising 'value creation' as everything that value creation *isn't* (insofar as it is possible to arrive at an objective theory of value). This development, it is argued in these chapters, arises from the need imposed by core international corporate tax norms to attribute the surplus value captured from global value chains to *something*, given that in many cases

those norms prevent it from being allocated to where value is in fact being created in an objective analysis (i.e. outside the group). Given that objective value creation generally takes place predominantly in the parts of global value chains located in less wealthy states, this approach therefore appears to be, in essence, a project to retain the global tax base in wealthy states to the extent it is not conceded to offshore.

The argument in this chapter unfolds as follows. Section 7.2 explains the system in place prior to the reform processes of the 2010s, and identifies the problem of 'residual profit' associated with that system (i.e. profit not accounted for by treating each entity within the firm as subject to competitive market pricing even for intra-group transactions). Section 7.3 explains how, since the system requires residual profit to be allocated within the firm, that profit may be associated with intangible assets as a kind of residual production factor, and that residual production factor is easily located offshore, hence (to some substantial degree) the problem of untaxed MNE profits. Section 7.4 examines the dialogue between the OECD and the corporate sector in the period immediately preceding the BEPS process regarding the transfer pricing of intangibles. In this dialogue the concept of 'value creation' emerged as a compromise solution; not bringing residual profit entirely onshore, but allowing absorptive labour within the MNE to exert a gravitation pull on it so as to bring it onshore to an extent. Section 7.5 illustrates how this became a pervasive approach in the BEPS process, yielding one of the two conceptions of 'value creation' examined in this chapter and the next.

7.2 The arm's length principle and offshore residual profits as at July 2010

Before addressing the question of 'value creation' as a concept in transfer pricing reform, it is necessary to set the scene as regards the arm's length principle and the problems associated with it as at the commencement of the recent reform processes.

On a basic formal level corporate income taxes generally treat a company as a person and tax it as such, but this is made more complex by the existence of groups of companies under common ownership and common control, pursuing commercial objectives collectively. Some jurisdictions (the US and France, for instance) have provision to treat the corporate group as the taxable entity rather than its individual members, while others (the UK for instance) have exemptions and reliefs which make allocations of risks and assets around the group, and intra-group transactions, broadly neutral from a tax perspective. In either case the inference is therefore that corporate income tax is primarily interested in commercial enterprises that

operate through the corporate form – the corporate group as an 'economic unit'[2] – rather than discrete corporate entities *per se*. This approach needs further refinement, however, in cases where the 'economic unit' exists in multiple jurisdictions, since in such instances it may be appropriate to treat only part of the profit arising to the 'economic unit' as arising in any particular jurisdiction. The international tax norm which has this effect is the arm's length principle, which provides (to cite the OECD model tax treaty provision embodying it, *i.e.* Article 9.1) as follows:

> Where
>
> > a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State,
> >
> > b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,
>
> and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

To paraphrase, what this means is that in an international context the 'economic unit' of the corporate group should be treated as comprising separate entities after all, and dealings between those entities insofar as they take place across national borders should be adjusted for tax purposes so that the terms of those dealings are as they would be if the entities were *not* under common control. This pricing of intra-group transactions – 'transfer pricing' – is the mechanism which allocates profit around the group. If a price is high more profit will arise in the recipient entity and if the price is low more profit will arise in the entity making the expenditure, and that is the pricing to which the arm's length principle applies.

This principle is generally implemented in national tax legislation in the form of a domestic legislative regime imposing 'arm's length' prices as between corporate group members, at

[2] For an illustration of this usage see HMRC, *Company Taxation Manual*, 16 April 2016, updated 24 August 2020, https://web.archive.org/save/https://www.gov.uk/hmrc-internal-manuals/company-taxation-manual/ctm80105 (accessed 31 August 2020).

least insofar as concerns cross-border transactions. These regimes do not necessarily elaborate on what is meant by 'arm's length' provisions, but standing behind them is a vast volume of systematised practice on the part of revenue authorities and tax practitioners. The practices of different revenue authorities in this regard differ widely around the world, even among OECD member states, but the closest we have to a body of norms regarding such practice is the transfer pricing guidelines issued by the OECD. The most recent edition was published in July 2017, and the previous edition, published in July 2010, represents the state of the transfer pricing art prior to the commencement of the policy development processes under discussion in this chapter.

A major difficulty with the arm's length approach is the phenomenon of residual profit, which is succinctly pointed out by Collier and Andrus:

> [T]he MNE group of companies is not simply an amalgam of separate legal entities each of which necessarily has a stand-alone and independent counterpart operating in the market, nor are all MNE transactions and arrangements necessarily mirrored in the market. What this means is that an economic slicing of MNE transactions into 'market' components will not necessarily allocate *all* of the group profits of an MNE to individual group members. [Emphasis added][3]

The question of how to understand (and allocate for tax purposes) this residual profit is a core concern of this chapter as a whole (and the next), but it is important to understand at the outset some basic dynamics which tend to determine *where* it will arise.

First, there is a long-established tendency within transfer pricing to focus *only* on the transaction at hand rather than placing it in the context of how the group as a whole makes profits. Under the 2010 guidelines, as Collier and Andrus explain, '[i]t is assumed that if transactional pricing is arm's length, the overall allocation of income and expense between the relevant associated enterprises resulting from that pricing will be appropriate'.[4] The absence of any kind of check against the overall profits of the group has generally meant that, where a price considered in isolation can be justified according to transfer pricing principles, any amount of residual profit can accrue elsewhere in the group. Inevitably prices are suppressed (as to which see the following paragraph) in entities operating in jurisdictions which impose tax on corporate profits and so the maximum possible amount of residual profit

[3] 2017, 2.26.
[4] Ibid, 3.13.

will arise offshore.

Secondly, (and regarding the suppression of prices) there generally exists a range of prices which can be justified by reference to the arm's length principle,[5] and so there is generally an extent to which a group can choose a price which optimises its tax position without falling foul of the principle, which means that any residual profit will tend to arise where tax is lowest – *i.e.* offshore. This phenomenon arises in part simply because transfer pricing is by no means an exact science, and in part because there exists a variety of methods for determining a price, and there is no obligation (at least not pursuant to OECD norms) to deploy the method which is *most* appropriate – it is only necessary to show that the method chosen is appropriate. And so inevitably groups choose a method which yields the lowest prices in taxing jurisdictions and the highest prices offshore, and indeed allocate functions around groups so as to make methods available which optimise the possible outcomes in this regard (for example by arranging group functions so that those located in taxing jurisdictions are susceptible to being characterised as merely 'routine' or 'low-value-adding' functions).

Thirdly, this phenomenon has been further exacerbated in recent years by the evolution of transfer pricing methods based solely on a rate of return attributable to a party in the transaction. These methods have developed as a response to the problem that many intra-group transactions simply have no counterpart in the market, and they respond by allocating to a party a rate of return based on its contribution. Where such methods are adopted, in addition to there being no check against the outcome that might be yielded by an alternative method, and no check against the overall profits of the group, there is not even a check against the pricing of the transaction from the perspective of the other party (which may of course be an offshore entity). As Collier and Andrus explain, '[t]axpayers are then free to contractually allocate risks, capital, and movable [*i.e.* intangible] property away from the tested party to minimize its routine return, and into low-tax untested parties in order to seek to justify the allocation of large residual profits to those low-tax entities.[6]

Schematically, then (and recognising of course that in any real-world instance the position will be more complicated), we are looking at a system whereby group entities actually performing business functions are treated as operating as independent participants in markets for routine outputs – markets which are presumptively competitive in nature and therefore permitting only tightly constrained margins – with a substantial residual group profit arising

[5] Ibid, 2.85.

[6] 2017, 3.39-40

offshore. The question then arises where this offshore residual profit comes from, and the parameters of that question are considered in the section which follows.

7.3 Intangibles as the source of offshore residual profits

7.3.1 The problem: 'synergy'

Clearly one viable explanation for the existence of offshore residual profits is that, while the group entities actually performing business functions are treated as operating as independent participants in competitive markets for routine outputs, the group as a whole is exercising monopoly power, with the consequence that the offshore residual profits constitute monopoly rents in a distilled form. This is a possibility which has been recognised[7] since the embryonic phase of the international corporate tax regime; consider for example this observation made in the report commissioned by the Fiscal Committee of the League of Nations in the early 1930s:

> It is not possible to say that one establishment has procured a certain profit because that establishment may only serve to suppress a dangerous competition for the establishment situated in another country. In this case, the accounts of the establishment will most frequently show a deficit whereas in reality it will have contributed to increasing the turnover of the other establishments, and consequently; the general profit.[8]

Monopoly power is not the only possible explanation, however. There exists a substantial body of learning dedicated to the question of why enterprises controlled on a top-down basis even exist, given the supposed power of markets to produce optimal results. That body of learning – known as the 'theory of the firm' – can offer a variety of alternative answers to the question of where such offshore residual profit might come from. Many of these answers are a variation on the theme that market transactions give rise to costs which can be eliminated through organisational control, shared knowledge &c.[9] These answers are not a complete answer, however. In particular, the theory of the firm should not be understood as a *substitute* for the explanation that excess profits might arise from monopoly power. The best that can be said of theory-of-the-firm explanations for the existence of offshore residual profits is that transaction cost phenomena might mean that monopoly power exercised by the

[7] With the proviso that we are here talking about economic rents derived from monopoly power as understood in mainstream economics as opposed to the kind of value capture discussed in chapter 6; see section 6.4 for discussion of this distinction.

[8] Cited by Collier and Andrus, 2017, at 1.91.

[9] For a survey of mainstream theories see P. Walker, *The Theory of the Firm*, London, Routledge, 2017.

group as a whole does not account for those offshore residual profits *in their entirety*. Offshore residual profits as a generalised phenomenon may well include organisational transaction cost savings, but that does not exclude the possibility that they comprise, at least in part or even predominantly, monopoly rents.

Theory-of-the-firm approaches do play a key *rhetorical* role, however, which is to obscure that possibility that they comprise monopoly rents. There is a marked tendency to (a) bundle up explanations for the phenomenon of residual profit under the label ‘synergies’, which has a positive rhetorical force suggestive of *earned* additional profits, and (b) nonetheless to include in the ‘synergies’ bundle the possibility that the profits in question are monopoly rents (to the extent that possibility is acknowledged at all). A particularly stark example is to be found in Collier and Andrus at 4.08 & 09:

> If all interactions between the constituent entities of an MNE group were precisely priced on an arm's-length basis and determined by reference to the prices charged between comparable independent entities that do not share in the synergistic benefits of group membership, the sum of the resulting profits would not include the amount of any synergistic benefits that arise from operating as an integrated MNE group. [...]
>
> A straightforward example of this problem is presented by the operation of a centralized group purchasing function. Combined group purchasing can, in some cases, create market power that enables negotiation of more favourable prices by the combined group. [...] The difficult transfer pricing question is to which group member or members these synergy-enhanced group profits should be allocated.

As we shall see, this concept of ‘synergies’ as a euphemistic tactic for eliding economic rent into transaction cost savings is encountered often. If the theory of the firm literature is actually confronted, however, a curious outcome emerges. This exercise has been undertaken by tax scholar Romero Tavares.[10] He contends that the evolving approaches taken by the international community to the tax problems thrown up by the phenomenon of MNEs tracks the evolution of the theory of the firm, and he draws parallels between the present state of the theory of the firm and the notion of ‘value creation’ as it appears to be used in the BEPS process. He goes on to deploy that theory to show how a hypothetical MNE can be analysed into component ‘firms’ that account for where the value is being created, but he accepts that

[10] R. Tavares, ‘Multinational Firm Theory and International Tax Law: Seeking Coherence’, *World Tax Journal*, vol. 8, no. 2, 2016, pp. 243-276.

this may not be the full story:

> US shareholders who invested in the overall MNE would remain as the ultimate risk-taking entrepreneurs of the unified MNE operations, and accordingly any residual profits, synergetic gains or economic rents over and above the normal return for the operations of the 'firms' identified above*,* should accrue to such US shareholders.

The idea of allocating residual profits to shareholders derives from a body of theory-of-the-firm literature regarding the separation of ownership and management, which articulates the theoretical benefits of having shareholders in a non-operational role as residual risk-bearers.[11] Leaving aside the question of whether allocation of residual profits to shareholders has merit on this theoretical basis, it should be noted that the shareholders are not actually an element of the firm at all – and there is no reason to suppose that the allocation of profit to shareholders would necessarily allocate it to a jurisdiction in which the firm would have a tax footprint under ordinary principles (Tavares skirts this problem by means of an unstated and unrealistic assumption that shareholders are residents of the group's parent entity's jurisdiction).

What this points to (although having skirted the problem Tavares does not acknowledge the implication) is something which, if expressed in more general terms, is a core contention of this thesis: **if you are to properly theorise the residual profit of a multinational corporate group after profits have been allocated to its component entities, you have to confront the possibility that the residual profit should be allocated outside the group altogether**. Tavares implicates shareholders, but recognising the phenomenon of monopoly power exercised in global value chains would implicate supplier firms,[12] and (as we shall see in the chapter which follows) it is modish to implicate users of social media and online retail insofar as they generate data. Given allocations of this kind are impossible under the arm's length principle, however, we should not be surprised to discover that any attempt to theorise residual profit *specifically for the purposes of the arm's length principle*, whether it be under the rubric of 'value creation' or any other rubric, reproduces the very problem it sets out to solve.

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[11] See in particular E.F. Fama and M. C. Jensen, 'Separation of Ownership and Control', *Journal of Law and Economics*, vol. 26, no. 2, 1983, pp. 301-325.

[12] C. Quentin, 'Corporate Tax Reform and "Value Creation": Towards Unfettered Diagonal Re-allocation across the Global Inequality Chain', *Accounting, Economics and Law: a Convivium*, vol. 7, vol. 1, 2017, pp. 1-21.

7.3.2 *The solution: 'alchemy'*

In common with Tavares, Collier and Andrus do not go as far as to expressly articulate this problem, but their analysis teases out some underlying themes in the OECD's approach to the fact that it is an insoluble problem, and in particular they note the following:

> The question comes to the fore particularly in the services area, in determining when a group member should be compensated by another associated enterprise for benefits flowing from group membership. Paragraph 7.13 of the 2010 OECD Guidelines states that:
>
> > [A]n associated enterprise should be considered to receive an intra-group service when it obtains incidental benefits attributable solely to its being part of a larger concern, and not to any specific activity being performed. For example, no service would be received where an associated enterprise by reason of its affiliation alone has credit-rating higher than it would if it were unaffiliated, but an intra group service would usually exist where the higher credit rating were due to a guarantee.
>
> The Guidelines thus try to draw the line between when compensation for synergistic benefits is required and when it is not by asking whether some overt action was taken to create the benefit.[13]

In this idea of 'some overt action' there is more than a mere echo of the conflation of (a) mere causation and (b) quantitive implication, that causes so much confusion in the value-theoretical debates considered in Part I of this thesis. Where the preconceptions in operation have the consequence that value appears to come out of nowhere, and its existence nonetheless has to be accounted for, then the temptation will always be to look for *something* to which it may be attributed, even at the cost of no longer requiring that the thing to which it is attributed is proportionate to the value which arises.

A telling illustration from the OECD is their 1979 recommendation that tax authorities should address the legitimacy of interest payments to offshore lenders by looking at where the loan agreements were negotiated; a recommendation which, as Collier and Andrus point out, was subsequently applied by analogy to a variety of contexts.[14] The recommendation is

[13] Collier and Andrus, 2017, 4.11 and 12.
[14] Collier and Andrus, 2017, 2.52.

ultimately baseless, however. When the nature of interest income is considered, there does not appear to be any substantive link between the act of negotiating the loan and the 'value' accruing to the lender in the form of interest. The interest arises by reference to the principal advanced and not by reference to the labour of the finance workers on the deal: the question of where the value originates pre-exists their labour.

In many ways the most tempting thing to attribute residual profit to without attributing it outside the group is intangible assets. The category of intangibles does, after all, include the asset value accounting sweep-up of 'goodwill', and narratives around the profit-generating power of identifiable intangible assets – brands, patents, algorithms, data &c – are intuitively plausible and persuasive. Further, most kinds of intangible asset implicate labour (or can be made to implicate labour) in their creation and maintenance. The disadvantage of allocating profitability to intangibles (or advantage, depending on whether you view it from the perspective of the state or capital), is that intangible assets can be shifted offshore at low values,[15] and that is one of the principal mechanisms having the consequence that residual profit arises there. As Collier & Andrus explain:

> A taxpayer may arrange its contracts in such a way that a low-function, low-tax entity is assigned the entrepreneurial risk taking role in an intangible development undertaking. Even if it lacks the autonomy to make its own investment decisions, such an entity can be imbued with enough substance to withstand challenges based on transactional recharacterization and in that way assume the right to the fruits of successful intangible development projects. The interaction of contractual assignments of risk, characterization of research or marketing arrangements as a limited risk provision of services by the party performing most or all of the business functions, and the transfer of investment capital to low-tax locations can combine to generate hard to challenge claims to the fruits of research by low function associated enterprises in low-tax jurisdictions.

As is clear, structuring to achieve this outcome is a technical matter, but it accords with the magical thinking regarding the source of profitability that may be found anywhere outside formal political economy. As the author of the League of Nations report put it some 85 years ago:

> There is apparently no theoretically perfect rule for determining exactly how much of

[15] Collier and Andrus, 2017, 3.45-47.

> the income is attributable to each establishment any more than there is an accurate way for apportioning the compensation of an individual workman to his hands and his feet, and to his brain which has coordinated all his efforts. Income is sometimes classified, for tax purposes, as income from capital, income from work, and income from work and capital combined, the profits of an industrial and commercial enterprise being included in the last mentioned category. It is obvious that the proportion of work to capital varies from business to business and that, in the alchemy of a successful business, the intangible, immeasurable element of brainwork is a very important factor, if not the most vital factor.[16]

If a group can situate this imagined 'alchemy' offshore – and as we have seen to a very substantial extent it can – that is where the arm's length principle as at July 2010 would allocate the profits for tax purposes. And it was in order to address that problem that the concept of 'value creation' was introduced to the world of transfer pricing norms.

7.4 'Value creation' and the transfer pricing of intangibles before BEPS

7.4.1 Value creation as at 2010

The concept of 'value creation' was not entirely unheard of in formal transfer pricing norms as at 2010, but on the single occasion it was referred to in the 2010 guidelines, it was not adverted to as an explanatory or guiding principle as it subsequently came to be; it was, rather, mentioned in passing, in a paragraph regarding 'asset-based allocation keys'. An allocation key is a formula for splitting the combined profits of associated entities in order to determine transfer pricing between them, and an asset-based allocation key is one which relies on the relative involvement of assets belonging to the respective entities in the overall profitability (an alternative allocation key might rely on respective costs). The guidelines provided as follows:

> Asset-based or capital-based allocation keys can be used where there is a strong correlation between tangible or intangible assets or capital employed and creation of value in the context of the controlled transaction.[17]

The guidelines go on to mention that asset-based allocation keys are particularly appropriate to circumstances where 'each party to the transaction contributes valuable, unique

[16] Cited by Collier and Andrus, 2017, at 1.86.

[17] OECD, 'OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations', 2010a, p. 102, https://www.oecd-ilibrary.org/taxation/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2010_tpg-2010-en (accessed 31 August 2020).

intangibles'.[18] This sole mention of 'creation of value' comes without an explanation as to its meaning, but the context is telling:

The circumstance in question is one where (i) dealings between two group companies require to be priced, (ii) the profitability thereby apportioned is attributable to intangible assets, and (iii) the assets in question are held by both companies. This would of course be a paradigmatic instance of the 'synergy' problem noted above. A profit split is suitable because the transaction is not one which finds its equivalent in an ideal atomised market of arm's-length participants with independent businesses, and the profitability in question is attributed to intangibles as a residual explanation for its existence. Further, in this hypothetical case discussed in the guidelines the methods noted above whereby groups avoid an allocation on this basis and instead secure allocation of the profits to a 'low-function, low-tax entity' seem conspicuous in their absence. As we shall see, this 2010 nod to the concept of value creation therefore contains in microcosm some of the core themes of the BEPS approach to transfer pricing.

7.4.2 *The 2010 scoping exercise*

In any event, even as those guidelines were being published, the process that would eventually become the BEPS project was already under way, with the invitation being issued on 2 July 2010 for interested parties to comment on the scoping of a future project on the transfer pricing aspects of intangibles.[19] A dominant theme in the responses is the monopoly power problem, with some respondents – at this stage at least – expressly articulating it in terms. The Institute of Chartered Accountants of England and Wales explains that 'the nature, and aim, of many companies with world leading brands is to be the number one participant in any geographical country/area in relation to their (branded) product. The inevitable consequence of that is that there are unlikely to be comparable products in respect of which the [Comparable Uncontrolled Price] method can be easily applied.'[20] Transfer pricing consultant Ross Newman expressly characterises the non-market proceeds of this kind of positioning as 'rent', complaining about the 'lack of adequate guidance to deal with cases in which a company owns a non-routine intangible that allows the company to generate

[18] Ibid.

[19] OECD, 'OECD Invites Comments on The Scoping of its Future Project on The Transfer Pricing Aspects of Intangibles', 2010b, https://web.archive.org/web/20170417104243/http://www.oecd.org/tax/transfer-pricing/oecdinvitescommentsonthescopingofitsfutureprojectonthetransferpricingaspectsofintangibles.htm (accessed 31 August 2020).

[20] ICAEW submission to OECD consultation, August 2010, https://web.archive.org/web/20181201163014/http://www.oecd.org/tax/transfer-pricing/45895914.pdf (accessed 31 August 2020).

an economic rent *i.e.*, a source of exceptional profitability relative to other firms in the same industrial sector'.[21] Some respondents even offer taxonomies of how monopoly rents are acquired: both Ernst & Young and the OECD's own Business and Industry Advisory Committee offer lists of quasi-asset intangibles which include 'economies of scale', 'barriers to entry', 'first mover advantage' and 'group network attributes'.[22]

In addition, there is a remarkable degree of frankness in the responses about the possibility that profitability potentially attributable to 'intangibles' is simply a residual excess profitability that arises in MNEs in consequence of their structural positioning. 'These "intangibles"', writes Canadian tax lawyer J. Scott Wilkie (albeit with a subsequent nod to the theory-of-the-firm account as opposed to that of monopoly power), 'manifest the essence of the residual profitability of a multinational enterprise and in many ways define its distinctive character. In short this is the "elephant in the room" concerning the potential effectiveness of the revised Transfer Pricing Guidelines'.[23]

What is at first glance surprising is that some respondents go so far as to urge that the phenomenon of monopoly rents be formally investigated, as such, as part of the OECD's work on the transfer pricing of intangibles. PwC responded 'that it would be helpful if WP6 [*i.e.* the OECD working party tasked with this area of policy development] considered the issue of economic rent and, in particular, consider whether it would be appropriate to set out some of the principles involved.'[24] The reason this is at first glance surprising is because it appears to run counter to the revenue interests of capital. If the capacity to capture value reflected in part in the phenomenon of residual profitability is analysed as an asset, the residual profitability would become income referable to that asset, which would then (if it is to make its way into a low-function low-tax entity) have to be properly paid for in accordance with the arm's length principle. The mechanism of simply permitting it to arise offshore by default once all market-value transactions are accounted for would consequently cease to be

[21] Altus Alliance submission to OECD consultation, 14 December 2010, https://web.archive.org/web/20181201082956/http://www.oecd.org/tax/transfer-pricing/46018080.pdf (accessed 31 August 2020).

[22] Ernst and Young submission to OECD consultation, 15 December 2010, https://web.archive.org/web/20181201151734/http://www.oecd.org/tax/transfer-pricing/46020216.pdf, and BIAC submission to OECD consultation, 15 December 2010, https://web.archive.org/web/20181201124140/http://www.oecd.org/tax/transfer-pricing/46026029.pdf (accessed 31 August 2020).

[23] J. S. Wilkie submission to OECD consultation, 15 September 2010, https://web.archive.org/web/20181204101651/http://www.oecd.org/tax/transfer-pricing/46027879.pdf (accessed 31 August 2020).

[24] PwC submission to OECD consultation, 2 September 2010, https://web.archive.org/web/20181202072734/http://www.oecd.org/tax/transfer-pricing/46043673.pdf (accessed 31 August 2020).

available.

Unsurprisingly this is not the direction of travel to which the responses generally point. It is clear from the responses that the problem being adverted to here is that tax authorities were *already* seeking to make groups pay for these notional monopoly power assets, and the call for the OECD to define them is a call for them to be defined *out* of existence for transfer pricing purposes. This is an endemic feature of the responses, and the anxiety over the point among respondents deserves extensive illustration:

‘What is an intangible?’, ask AstraZeneca, ‘(and by association, what isn’t an intangible)’ they add, going on to elaborate that ‘assets should not be “created” by tax authorities through the bifurcation of tax payers’ commercial arrangements’.[25] Ernst & Young want to be sure that the OECD treat it as within their purview to define ‘what intangibles are subject, and – maybe even more – are not subject to transfer pricing’.[26] PwC ask ‘How to separate factors which, whilst not tangible, are not “intangibles”?’, since, ‘A number of countries in our network reported that tax authorities sometimes try to take a very broad view of what might be an intangible and then use that either to attempt to enforce a transfer pricing adjustment or to try to force the use of the profit split method.’.[27] ‘At a minimum,’ says the Tax Executives Institute, ‘the OECD should provide examples of intangible property that is not capable of being transferred per se and thus should not require compensation in connection with a business restructuring or other transaction’.[28] ‘It will be [...] critical to articulate what is not covered by the Project’ say Baker & Mackenzie, ‘Otherwise, the Project could easily be misunderstood as endorsing either unprincipled pricing approaches inconsistent with the arm's length principle or an indeterminate expansion of taxing jurisdiction’.[29] ‘We are concerned’, write the Institute of Chartered Accountants of England and Wales, ‘that there is sometimes a belief that anything that is not tangible must be an intangible and have a value attaching to it […] We are also concerned that some tax authorities argue for an ever increasing range of “soft” intangibles and ascribe a value to them in order to enhance their tax

[25] AstraZeneca submission to OECD consultation, 15 September 2010, https://web.archive.org/web/20181201084333/http://www.oecd.org/tax/transfer-pricing/46025487.pdf (accessed 31 August 2020).

[26] Ernst and Young, 2010.

[27] PwC, 2010.

[28] Tax Executives Institute submission to OECD consultation, 14 September 2010, https://web.archive.org/web/20181204074012/http://www.oecd.org/tax/transfer-pricing/46019971.pdf (accessed 31 August 2020).

[29] Baker and Mackenzie submission to OECD consultation, 15 September 2010, https://web.archive.org/web/20181204095547/http://www.oecd.org/tax/transfer-pricing/46025552.pdf (accessed 31 August 2020).

revenues.'[30]

What is being sought here is seemingly an international norm as regards what constitutes an intangible asset, leaving outside that boundary other intangible 'value drivers' – 'exotic value drivers', as they are referred to by one respondent.[31] This label, 'exotic value driver', may usefully be adopted here to refer to the putative intangible assets which are (a) associated in this thesis with the residual profitability attributable at least in part to monopoly power, and (b) of debatable status as assets for transfer pricing purposes. As regards precisely where and how this boundary between intangible assets and exotic value drivers should be drawn, respondents say very little, aside from to plead for clarity to the effect that the boundary should and does exist (and, therefore, by implication, that a portion of residual profitability should be reserved to offshore).

In one case there is a suggestion that juridical ontology should be adopted as a model for where the boundary should be placed, with the respondent making reference to 'legally protected intangible property'[32] as a contrasting category to exotic value drivers. But really this suggestion does not need to be expressly advanced; the category of intangibles is ineluctably characterised by its inclusion of a nebulous range of assets including formal legal monopolies at one end of a spectrum and concepts as vague as 'profit potential'[33] at the other, and the boundary between assets which do and do not exist for transfer pricing purposes is inevitably going to have all the formally negotiable legal assets on one side of it. The question seemingly posed by the responses to the scoping consultation is therefore this: how far outside the category of such formal assets may tax authorities go in order to bring residual profits back onshore?

A bold answer to this question was suggested by a consultancy which numbers among its personnel leading transfer pricing practitioner and author (and former head of Ernst & Young's European transfer pricing network), Pim Fris.[34] Fris's submission gives to these exotic value drivers the label 'intellectual capital'. He argues that '[intellectual capital] is not being seriously considered in the [2010 guidelines] despite the fact that it is in many cases at the heart of the value creation process of MNEs.'

Fris's observation is clearly somewhat at odds with the main thrust of the responses as

[30] ICAEW, 2010.
[31] Tax Executives Institute, 2010.
[32] Tax Executives Institute, 2010.
[33] Ibid.
[34] Nera 2010.

characterised above. It welcomes exotic value drivers into transfer pricing, on the basis that they 'create' (rather than merely 'drive') value. He then performs a move which will, as we shall see, will be in part (or at least superficially) replicated by the OECD. He writes:

> The proper starting point is in the relationship between the transacting parties, in the role of intangibles in the value creation, and in the roles and responsibilities allocated to the parties involved in *value creation* according to the business model defined for the enterprise. Only then do we have the ability to identify how this behavior would translate on the open market, i.e., between parties without shareholder relations per se but otherwise engaged under similar commercial and financial relations. [*Emphasis added*]

As we saw above the focus in transfer pricing has historically been on the roles and responsibilities of the entities participating in the transaction at hand, whereas here we are to understand that there exists a totality of roles and responsibilities attributable around the group, all of which taken together account for the entirety of the group's profitability, and it is on that basis that profitability may be allocated between entities. In this 'value creation' analysis, in contrast to the developments sought by the preponderance of other respondents, there continues to be no theoretical possibility of residual profitability. He refers to this approach as the 'total value chain' approach, but of course it is not the totality of the value chain; it is only the part of value chain which arises within the MNE. Simultaneously with his move of theorising the problem faced within transfer pricing without acknowledging the existence of residual profit within MNEs, he erases the remainder of the global value chain from which such residual profit is captured. (Unnamed but probably lurking behind this move, which will be considered further in section 7.5.2 below and in the chapter which follows, is the 'value chain' model promulgated by management guru Michael Porter.)

7.4.3 *The 2012 discussion draft*

A discussion draft of revised intangibles guidelines followed in June 2012,[35] and by the third paragraph it had seemingly endorsed the Fris approach, or at least adopted its language: 'in cases involving the use or transfer of intangibles', it announced, 'it is especially important to ground the analysis on an understanding of the MNE's global business and the manner in

[35] OECD, 'Revision of The Special Considerations for Intangibles in Chapter VI of the OECD Tansfer Pricing Guidelines and Related Provisions', 6 June 2012a, https://web.archive.org/web/20190116094939/http://www.oecd.org/tax/transfer-pricing/50526258.pdf (accessed 31 August 2020).

which intangibles are used by the MNE to add or *create value*' [emphasis added]. In the same vein paragraph 11 provides as follows:

> In a transfer pricing analysis of a matter involving the use or transfer of intangibles, it is important to identify the relevant intangibles with some specificity. The functional analysis should identify the economically significant intangibles at issue, the manner in which they contribute to the creation of value in the transactions under review, and the manner in which they interact with other intangibles, with tangible assets and with business operations to create value.

The phrase 'value creation' crops up again throughout the document, but the role it plays does not become clear without investigating the response the document offers (despite the apparent adoption of the so-called 'total value chain' approach) to the call for a boundary to be drawn between intangibles for transfer pricing purposes and what we have come to refer to as exotic value drivers. This is to be found in paragraphs 23 and 24.

In paragraph 23 the discussion draft articulates the boundary under the familiar label of 'group synergies', which 'can take many different forms including streamlined management, elimination of costly duplication of effort, integrated systems, purchasing power, etc'. In paragraph 24 the draft articulates the boundary under the heading 'market specific characteristics' and by way of example of these it offers that 'the high purchasing power of households in a particular market may affect the prices paid for certain luxury consumer goods. Similarly, low prevailing labor costs [...] may affect the prices paid for specific goods and services in a particular market.' The draft provides that neither synergies nor market specific characteristics are intangible assets for its purposes, and the distinction the discussion draft offers is that, unlike intangible assets proper, these exotic value drivers are (according to paragraph 23) 'not owned or controlled by a single enterprise' or (as paragraph 24 puts it) may not 'be owned, controlled and transferred by a single enterprise'.

It does not appear that much turns on the differences of drafting between the two paragraphs since the point appears to be the simple one that no individual entity in the group is capable of treating the exotic value driver as an asset held specifically by it as against other members of the group. In other words this proposed boundary between intangible assets and exotic value drivers reflects the fundamental flaw in the separate entity approach which has been there all along – the fact that the group is from the point of view of profitability more than the

sum of its parts. It constitutes a fresh articulation of it, however, and one that is proposed to be formally embedded in transfer pricing norms.

The way that these synergies and market specific characteristics should figure in the transfer pricing process, according to the draft guidelines, is not as intangible assets but as 'comparability factors'. Paragraph 23 proposes this with regard to synergies without further elaboration, but market specific characteristics are said in paragraph 24 to amount to comparability factors with a notable reference to paragraphs 9.148-153 of the 2010 guidelines.

Those paragraphs offer two contrasting examples of procuring inputs from a sibling entity in a low-labour-cost jurisdiction. In one instance, the input is a manufactured item, where the market for such production is competitive, and in another instance, the input is a specialised service where the sibling 'has developed a valuable intangible corresponding to its technical knowhow'. We therefore have an example on the productive, and an example on the absorptive, side of the production boundary elaborated in Part I of this thesis (the equivalent in this context of the contrast between the cases of *Sharkey v Wernher* and *Mason v Innes* discussed in section 2.7 of chapter 2). In neither case is an exotic value driver analysed as an asset, but the enhanced margins referable to the exotic value driver are analysed differently in each case nonetheless. In the case of the manufactured item an ordinary comparison with a (competitive and therefore low) uncontrolled price is indicated, with the consequence that the residual profitability lies where it falls (*i.e.*, potentially, offshore). In the case of the valuable service, by contrast, a certain amount of the residual profitability may be reallocated to the onshore jurisdiction where the work is done, under the profit split method, on the basis that the unique technical know-how underpinning the service means that comparability with the market is not available.

The implication of drawing particular attention to these paragraphs appears to be that, notwithstanding the generality of the role of comparability factors, exotic value drivers *when encountered in combination with certain kinds of labour* tend to impose a requirement to adopt the profit split method (the consequences of that method being that greater amounts of profitability will be allocated onshore). This inference is reinforced in paragraph 128 of the draft which provides that the profit split method is the method best suited to situations 'where both parties to the transaction make unique and valuable contributions to the transaction'.

Returning now to 'value creation', as already noted it is adverted to throughout the document, but there are two paragraphs which particularly help in clarifying the role the concept plays; paragraphs 108 and (to a lesser extent) 68. Paragraph 68 is concerned with the specific situation where an intangible asset is itself the subject of an intra-group transaction, and it discusses the residual profitability problem as manifest in those particular circumstances, explaining that individual intangible assets held by individual entities can add up to a greater value than the sum of their individual values. The example given in the paragraph is of a pharmaceutical patent, a pharmaceutical brand, and pharmaceutical regulatory approval, all applicable to the same drug, but in the hands of three different members of a pharmaceuticals group. The point the paragraph makes is the simple one that the values of these assets for the purposes of intra-group transactions must be the value they have in combination with the other group assets. So, for example, if one of the assets is being allocated to a low-tax jurisdiction, with a view to allocating residual profitability to it, it would not be in accordance with these draft guidelines to perform that transfer at a low value.

The point is made in terms of asset values throughout the paragraph, but it ends with the following sentence: 'It is important to consider the relative contribution to the *value creation* where different associated enterprises hold rights in the intangibles used' (emphasis added). It is not clear what the concept of value creation adds to the point being made in the paragraph, but it establishes a connection between value creation and residual profitability; that the valuing of assets and carving up of residual profitability has to be performed on a basis that is sensitive (and, impliedly at least, consistently so) to the realities of the role assets play in profitability. It is, in other words, an articulation of the total value chain approach. But, as already noted, the discussion draft only pays lip service to the total value chain approach, excluding exotic value drivers from the definition of intangible assets. What, then, of the situations where residual profitability is not capable of being associated with any recognised intangible asset; the more general version of the specific circumstance envisioned in paragraph 68. The answer emerges in paragraph 108:

> In matters involving the use or transfer of intangibles, caution should be exercised in adopting a transfer pricing methodology that too readily assumes that all residual profit from transactions after routine functional returns should necessarily be allocated to the party entitled to intangible related returns. The selection of the most appropriate transfer pricing method should be based on a functional analysis that

> provides a clear understanding of the MNE's global business processes and how intangibles interact with other functions, assets and risks that comprise the global business. The functional analysis should identify other factors that contribute to value creation, which may include risks borne, specific market characteristics, location, business strategies, and MNE group synergies among others. The transfer pricing method selected, and any adjustments incorporated in that method based on the comparability analysis, should appropriately reflect all of the relevant factors materially contributing to the creation of value, not merely reflect intangibles and routine functions.

In the context of paragraphs 23, 24 and 128, it is clear what is being proposed here. The profitability of the group as a whole should be analysed, and residual profitability should not necessarily be allocated to formal intangible assets (presumptively held offshore in accordance with the kinds of structures described by Collier and Andrus above). Instead, it may be attributed to exotic value drivers, potentially increasing the amount of profitability to be allocated *onshore*. This allocation would take place either by means of a comparability adjustment or (in cases where the exotic value driver is so dominant that a comparability adjustment would not be possible) through a normative preference for the profit split method. 'Value creation' seems to indicate the basis on which to determine that an onshore entity is entitled to such an allocation, and as we have seen this entitlement arises in respect of certain categories of labour.

In referencing the distinction between the categories of labour discussed in Paragraphs 9.148-153 of the 2010 guidelines, the OECD is seemingly proposing that exotic value drivers can only yield a reallocation of residual profitability in a case where the exotic value driver can be associated with intellectual content of (as opposed to the material performance of) a labour process – the 'alchemy' must be understood as lying in human brains. As elaborated at length in chapter three, the production of that intellectual content can only be absorptive labour; it *cannot* create value. This is because (to recall, by way of a summary) no further resources need be allocated to past processes giving rise to that intellectual content in order to replicate it in greater quantities. Recalling that residual profitability includes the proceeds of value capture, **a norm therefore appears to be emerging whereby absorptive labour within the MNE can exert a gravitational pull over the portion of the global corporate tax base structurally associated with value capture.** Provisionally, it would appear that that is what

‘value creation’ in this context means: absorptive labour associated with value capture. This is what (recalling chapter 1) Itai Greenberg refers to as the ‘bourgeois labour theory of value’.

It should be noted that the profit split method associated with exotic value drivers as comparability factors does not yield a full reallocation of residual profitability from one entity to another, as exotic value drivers would if they were characterised as assets in accordance with some of the more aggressive tax authority positioning complained of in response to the scoping exercise. The profit split method yields, rather, a basis for carving up the allocation *between* entities. What is being proposed in this discussion draft, therefore, is a compromise basis on which states can make a claim to a share in at least some of the proceeds of value capture, and ‘value creation’ (*i.e.* absorptive labour associated with value capture) is being offered as the euphemistically-labelled conceptual space in which that negotiation can take place. To be clear, this is not a proposal for states to share in the proceeds of value capture by taxing them; it is a proposal for states to share in *some* of the proceeds by taxing *some* of them. **The offshore space in which the residual profits of MNEs arise is being deliberately kept open by this proposal**. What is up for grabs is the size of capital’s tax-free portion.

7.4.4 *Responses to the discussion draft*

The discussion draft yielded a huge response, which is available as a single thousand-page pdf on the OECD website.[36] A key feature of the responses is that the identification of ‘synergies’ with comparability factors rather than intangibles is widely welcomed, the welcome generally qualified by a call for further clarity.[37] At the same time a note of caution is sounded by some as regards ways in which the approach might go too far. For example a corporate sector international tax working group convened by Baker & McKenzie make the following observation:

> While the Discussion Draft appropriately acknowledges that comparability factors

[36] OECD, ‘The Comments Received with Respect to The Discussion Draft Revision of The Special Considerations for Intangibles in Chapter VI of The OECD Transfer Pricing Guidelines and Related Provisions’, 29 October 2012b, https://web.archive.org/web/20141120102431/http://www.oecd.org/ctp/transfer-pricing/Intangibles_Comments.pdf (accessed 31 August 2020).

[37] See for example the responses of the Federation of German Industries at p. 126, BIAC at p. 163, BusinessEurope at p.244, the Confederation of British Industry at p. 260, CMS Bureau Francis Lefebvre at p. 313, Fédération des Experts comptables Européens at p. 436, Freshfields Bruckhaus Deringer at p. 452, Grant Thornton at p. 457, Japan Foreign Trade Council at p. 492-3, the National Foreign Trade Council at p. 589, PwC at p. 611 and pp. 622-623, RSM International at p. 645, Salans at p. 650, the Transfer Pricing Discussion Group (a multi-sector MNE association) p. 849, Unites States Council for International Business at p. 695, and VNO-NCW (a Dutch employers’ federation) at p. 987.

> may affect the valuation of transferred assets, we are concerned that it could be read to signal that such valuations may be performed not in a manner consistent with comparability analyses, but in a manner that effectively negates the distinction between comparability factors and intangibles. If the distinction between intangibles and comparability factors is to be meaningful and administrable, it must be maintained clearly for both definitional and valuation purposes.[38]

A few respondents seem more alarmed by the possibilities. Ernst & Young, for example, say this:

> The Discussion Draft (paragraph 23) indicates that group synergies contribute to the level of income of an MNE. Based on current guidance, if both parties make unique and valuable contributions, a profit split may be found to be the most appropriate method. We suggest clarifying that the comparability factors, the "soft intangibles" (e.g., group synergies, low prevailing labor costs etc.) as described in the Discussion Draft are not unique and valuable contributions that should lead to the application of a profit split.[39]

A remarkable counter-attack is mounted by Deloitte, which forensically unpicks the contradictions in the discussion draft's approach – in particular (i) the variation in the discussion draft between circumstances where exotic value drivers are said to be 'owned or controlled', 'owned, controlled or transferred', or 'owned, controlled and transferred', and (ii) the fact that 'while group synergies, such as streamlined management, integrated systems or purchasing power, cannot be owned by a particular MNE entity, they can certainly be controlled by a single designated entity (or multiple entities) within the MNE firm.'[40] They go on to explain that

> In fact, without such controlling entities, the business operations of group entities may not benefit to the same extent, or at all, from any of such group synergies. Efforts have to be made, and control has to be exerted to ensure coordination amongst the MNE group entities to ensure group synergies are realized. Often, the stronger the coordination and control over the use of group synergies by the group entities, the more valuable group synergies become.

38 Treaty Policy Working Group (another multi-sector MNE association, represented by Baker & MacKenzie) response at p. 920.
39 Ernst and Young response at p. 427.
40 Deloitte response at pp.330-332.

On the face of it this critique would appear to take the part of tax authorities seeking to identify exotic value drivers as intangibles so as to bring the proceeds onshore, but Deloitte is actually making an audacious play for the compromise offered by the OECD to be rejected in favour of ongoing accrual of residual profits offshore. They argue that

> while there is a need for some form of test for recognizing separate compensation for group synergies, which would be based on a factual analysis of the value drivers of the MNE, we submit that group synergies should be considered intangibles [...] based on the fact that they may be controlled for use in commercial activities by a designated entity (or multiple entities) in the MNE group.

In other words, the 'value creation' narrative should be brought to bear to identify the source of residual profits, but the location of that source is a matter of *designation* on the part of the group – the inference apparently being that 'designation' of an offshore entity would be a formal matter falling outside the factual exercise. Deloitte is seeking to turn the proposed new approach into a fresh instrument of tax-free value capture.

Only one respondent, Richter Consulting, sought simply to defend the status quo, with the following observation, seeking to characterise the phenomenon of residual profitability arising offshore as the 'natural result' (and therefore, inferentially, the normatively desirable result) of the operation of the system:

> Also included in the category of undefined intangibles are those that the Discussion Draft identifies as "group synergies". Although these are intangible assets, we believe these should be ignored for transfer pricing purposes because by definition, the arm's length principle asks us to price transactions as if parties are dealing at arm's length and therefore, the effect on pricing from factors such as group synergies in a controlled transaction should be ignored. Under this premise, the natural result is one where returns associated with group synergy intangible assets, if any, accrue to the non-tested party in a controlled transaction.[41]

At the other end of the spectrum, only one respondent seemed to think that the approach taken in the discussion draft did not go far enough: Pim Fris, who again submitted that all intangibles, including exotic value drivers, should be treated in the same way, in pursuance of the total value chain approach. Mindful of the sheer scale of the problem this discussion

[41] Richter consulting response at p. 637.

draft's approach only goes some way towards solving, he notes that

> It can reasonably be defended that the approach of the Discussion Draft, and the current one of Chapters I-III, can very adequately serve as effective guidance for the large majority of intercompany transactions. Point is however that a (relatively small) number of transactions is not covered, while precisely these transactions usually connect with considerable entitlements to future profits.[42]

What is noticeable among this spectrum of reactions, however, and in particular in connection with the broad welcome received by the idea of treating exotic value drivers as comparability factors, is that the core structural problem of residual profit is no longer at the forefront of the responses. A couple of respondents (namely Ernst & Young and PwC) continue to use the term 'economic rent' in passing, but the surprisingly frank and widespread engagement with the practical manifestations of monopoly power that characterised the responses to the scoping exercise is absent. The overall impression therefore, notwithstanding the concerns expressed over the detail (and the outliers who reject the proffered solution altogether), is one of crisis averted. **The core structural problem of the arm's length principle – that multinational corporations make more profit than the profit which their individual component entities would make; so much more in fact that it was threatening to delegitimse the entire system – is returned to respectable obscurity beneath a layer of transfer pricing technicality seeking to effect a fresh compromise between capital and the state.**

In tandem with this development the 'value creation' language is largely adopted unchallenged in the responses, or even (as this example from KPMG's response illustrates) expressly approved:

> KPMG also agrees with several other statements in the Discussion Draft. Another example is the following statement on the importance of understanding the MNE's global business: "Indeed, in cases involving the use or transfer of intangibles, it is especially important to ground the analysis on an understanding of the MNE's global business and the manner in which intangibles are used by the MNE to add or create value."[43]

[42] NERA Consulting response at p. 597.

[43] KPMG response at p. 515; for instances of more neutral adoption of the language, see Baker & McKenzie response at p. 56, CMS response at p. 317 and TPWG response at p. 940.

Deloitte go so far as to suggest that the discussion draft's adoption of the value creation concept is nothing more than a *reminder* of existing learning:

> Paragraph 130 reminds us of the issues to be taken into account when applying a profit split method in a case involving the use of intangibles, which includes (i) the identification of the intangibles in question, (ii) the evaluation of the contribution of these intangible to the creation of value, and (iii) the evaluation of other income-producing functions, risks, and assets.[44]

Barely any respondents treat the meaning of the phrase as anything other than self-evident. It is possible to discern in PwC's response a wry acknowledgement that the concept serves a euphemistic function,[45] but they certainly do not reject it. The only outright rejection comes from Grant Thornton, who object to the final sentence of paragraph 108 of the discussion draft which, as observed above, serves to tie the discussion of transfer pricing method selection where there are intangibles to the more general thrust of the document:

> The meaning of the word "securing" appears unclear, as is the meaning of the term "value creation". We find the last sentence confusing, and suggest it may not be needed.[46]

The sentence does indeed appear otiose in its immediate context. Grant Thornton are here refusing to read between the lines, and what is remarkable is that they were the only respondent to do so. The overwhelming majority of respondents accede to it without comment or with greater or lesser degrees of express enthusiasm. **The 'value creation' gloss on the OECD's compromise solution to the problem of value *capture* seems to have embedded itself almost imperceptibly.**

Three respondents to the discussion draft, including KPMG & PwC, characterise the overall effect of the proposed developments in a way which anticipates somewhat the role the 'value creation' element plays in the formally structured BEPS process. They note that the effect of

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[44] Deloitte response at p. 376.

[45] 'We however, wish to note that while paragraph 13 indicates that the OECD has chosen not to rely on the distinction between "routine" and "non-routine" intangibles, we assume that this does not constitute a rejection of the rationale for the distinction between "routine" and "non-routine" intangibles, since the Discussion Draft encourages the identification of "economically significant intangibles" as well as the manner in which intangibles "contribute to the creation of value" (paragraph 11). Otherwise, it would be difficult to practically assess what constitute "economically significant intangibles" or which intangibles create value. If this is not how the OECD interprets such paragraph, we would like the OECD to consider providing some guidance as to how one could objectively assess if an intangible indeed meets the definition of being "economically significant"?' PwC response at p. 611

[46] Grant Thornton response at p. 459.

the proposal is to bring the system closer to to one based on 'formulary apportionment'. As USCIB puts it:

> We believe the current draft will devolve in some cases to a de facto formulary apportionment where one country argues for a share of synergistic values based on allocation of the intangibles it has created in whole or part if a new standard is created that does not rely on legal ownership and the risks borne by the legal owner.[47]

Formulary apportionment is an alternative mechanism for allocating the corporate tax base. Under formulary apportionment entities under common control have their profits pooled for tax purposes and then allocated between the jurisdictions in which they operate by means of a formula, taking into account (for example) worker headcount, payroll, asset values and/or sales totals in each jurisdiction (rather than by reference to how profitable they would be as independent enterprises transacting with each other at arm's length).[48] It is popular among tax justice campaigners as a proposed basis for a structural reboot of the global corporate tax system, it is formally in train as an EU-wide solution for the problem of allocating the corporate tax base between member states, and it has long been the mechanism by which member states of the USA allocate the US domestic corporate tax base between them. It is not, however, popular with the OECD: notwithstanding their ostensible purpose as a set of neutral practical norms for operating the existing system, the 2010 guidelines contain a five-page section advocating against replacing that system with formulary apportionment.[49] Still less is it popular with the corporate sector and those who advocate for corporate interests, and it is not hard to understand why when the problem of residual profits arising offshore is brought into view: entities in tax havens would possess very little by way of apportionment factors and so formulary apportionment would largely eradicate offshore residual profits. The scope for capital to accrue tax-free revenues via the corporate form would therefore be substantially reduced.

When respondents to the intangibles discussion draft raised concerns about the proximity of the solution to formulary apportionment, this was therefore very much in the nature of the concerns noted above about the proposed compromise being taken too far by tax authorities. The correct resolution to the problem of residual profits accruing offshore for these

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47 USCIB response at p. 967; see also KPMG response at p. 516, PwC response at p. 623.

48 See S. Picciotto (ed.), *Taxing Multinational Enterprises as Unitary Firms*, Brighton, Institute of Development Studies, 2017 for a compendium of recent research on this subject.

49 OECD 2010a, pp. 37-41; in a nutshell the arguments against boil down to the difficulty of achieving the necessary international coordination in implementing it to avoid double taxation.

respondents was for a space to be developed where some profitability, but definitely not all, was to be brought onshore. And **it is in the context of this developing settlement over the problem of residual profits – a halfway measure between the existing regime and formulary apportionment – that the subsequent deployment of the concept of 'value creation' may be understood.**

7.5 'Value creation', transfer pricing and BEPS

7.5.1 'Value creation' introduced as an overall guiding principle in the BEPS process

In February 2013 the initial BEPS study was published[50] (it may be recalled the the material examined here up to this point predates the formal BEPS process). It did not mention 'value creation' at all, although it did advert to the issue of intangibles as a key area of concern and flag up that the existing work on intangibles was anticipated to 'provide immediate responses to some of the most critical profit shifting challenges'.[51] The language here is notable – the OECD began the BEPS process seemingly confident that (a) it already knew what one of its centrepiece solutions was going to be, and (b) that that solution was to be found in this arena of intangibles that we have been investigating in this chapter.

The BEPS Action Plan was published a few months later in July 2013, and value creation is a prominent concept in the document. It did not, at this stage, quite go so far as to place the value creation concept front and centre in respect of the entire thrust of the project – that came a few weeks later with the G20's St Petersburg declaration of September 2013: 'We welcome the establishment of the G20/OECD BEPS project and we encourage all interested countries to participate. Profits should be taxed where economic activities deriving the profits are performed and where value is created.'[52] This centrality of the value creation concept then fed into subsequent OECD materials – for example the project's explanatory statement,[53] and its FAQ.[54] None of these documents made any attempt to explain – not even obliquely –

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[50] OECD, 'OECD Urges Stronger International Co-operation on Corporate Tax', 2013c, https://web.archive.org/web/20170417150453/http://www.oecd.org/tax/oecd-urges-stronger-international-co-operation-on-corporate-tax.htm (accessed 1 September 2020).

[51] OECD 2013a, p. 49.

[52] G20 Leaders' Declaration, 2013, https://web.archive.org/web/20190127145718/http://www.g20.utoronto.ca/2013/Saint_Petersburg_Declaration_ENG.pdf (accessed 1 September 2020).

[53] OECD, 'First Recommendations for a Co-ordinated International Approach to Combat Tax Avoidance by Multinational Enterprises', 2014a, https://web.archive.org/web/20170417154825/http://www.oecd.org/ctp/beps-2014-deliverables.htm (accessed 1 September 2020).

[54] OECD, 'Top Ten FAQ About BEPS', 2015a, https://web.archive.org/web/20170417154954/http://www.oecd.org/ctp/beps-frequentlyaskedquestions.htm (accessed 1 September 2020).

what was meant by the term ‘value creation’.

The role played by the concept of value creation in the BEPS Action Plan is more intricate than the subsequent broad statements of principle that seem to derive from it. One of the ways in which it is used is to refer back to the BEPS study in such a way as to suggest an existing genealogy for the concept where no such genealogy exists. It makes the following claim:

> The BEPS report notes that there are several studies and data indicating that there is an increased disconnect between the location where value creating activities and investment take place and the location where profits are reported for tax purposes.[55]

What was noted in the preceding study was in fact this:

> There are a number of studies and data indicating that there is increased segregation between the location where actual business activities and investment take place and the location where profits are reported for tax purposes. Actual business activities are generally identified through elements such as sales, workforce, payroll, and fixed assets. [56]

Prima facie, then, ‘value creation’ means the same as ‘actual business activities’, which means the kinds of identifiable factors of apparent production and indicia of apparent realisation (‘sales, workforce, payroll, and fixed assets’) that might end up in an apportionment formula under a formulary apportionment system. That is not the whole story, however; the paragraph goes on to elaborate as follows:

> Studies that have analysed aggregated data on global investment positions between countries show that this segregation is indeed taking place, with in particular profits from mobile activities being increasingly shifted to where they benefit from a favourable tax treatment. However, because the underlying accounting data may not reflect some of the most important assets, namely mobile assets, these studies cannot be regarded as providing more than circumstantial evidence of the existence of BEPS.

Those important mobile assets are, of course, intangibles. And so value creation in this context appears to mean actual business activites such as would allocate the tax base to an onshore jurisdiction under formulary apportionment, subject to the complicating factor of

55 OECD, 2013a, p. 21.
56 OECD, *Addressing Base Erosion and Profit Shifting*, February 2013d, p. 20.

intangibles which may, *to some indeterminate extent* (albeit not wholly, since that would militate against any action at all), legitimise the continued allocation of corporate profitability offshore. This is of course completely consistent with the idea that emerges from the discussion draft of value creation as a kind of gravitational pull exerted on offshore residual profits, not bringing them onshore altogether, but bringing them onshore to a certain extent.

This positioning of the idea of value creation as a kind of compromise between allocating residual profitability to intangible assets held offshore and eradicating it altogether by means of formulary apportionment is almost set out in terms in this paragraph in the Action Plan:

> In the area of transfer pricing, the rules should be improved in order to put more emphasis on value creation in highly integrated groups, tackling the use of intangibles, risks, capital and other high-risk transactions to shift profits. At the same time, there is consensus among governments that moving to a system of formulary apportionment of profits is not a viable way forward[.][57]

The key point here is that the adoption of value creation as a guiding principle for transfer pricing reform goes hand in hand with a rejection of formulary apportionment. **The role of the 'value creation' concept is neither to protect nor eradicate the phenomenon of residual profitability arising offshore, but to open up a space in which capital and the state can bargain over it as it arises**.

7.5.2 The metastasisation of 'value creation'

As noted in the introduction to this chapter, the focus here is on extracting a meaning for the phrase 'value creation' from pre-BEPS materials relating to the transfer pricing of intangibles. Once the phrase was adopted as a guiding principle for the BEPS project more generally it rapidly assumed the vaguer meaning identified in the introduction to this thesis as a whole – its largely question-begging and wholly anodyne deployment as a broad reference to activities which could be said to give rise to profitability. As used in that sense its most readily appreciable manifestation may be in the use made by tax professionals of the 'value chain analysis' concept, already encountered in this chapter in the form of Pim Fris's submissions to the intangibles consultation set out in section 7.4.2 above.

'Value chain analysis' is to be contrasted with the concept of the global value chain, insofar as global value chains are by their very nature agnostic as to whether a node is within or outside

[57] OECD, 2013a, p. 14.

a lead firm, from the point of view of its participation in the chain. The 'value chain analysis' concept, by contrast, is about identifying the activities *within* a firm which play a role in its 'competitive advantage' over other firms.[58] It therefore embeds the assumption that all profitability in a firm is a manifestation of value creation within a firm rather than value captured from outside. Its principal role in transfer pricing today (*i.e.* following BEPS) is a defensive one on the part of firms, in the context of the vastly more exigent reporting requirements imposed pursuant to Action 13 of BEPS (Transfer Pricing Documentation and Country-by-Country Reporting).[59] The enhanced data available to tax authorities with regard to the activities and tax affairs of the firm as a whole has the consequence that transfer pricing outcomes will need to be justified in the context of that data, and it is by means of 'value chain analysis' that tax professionals propose to navigate those risks.[60]

It may be noted that the OECD did not itself deploy the 'value chain analysis' concept in the original BEPS project but it did briefly flirt with it in post-BEPS work on the profit split method,[61] much to the dismay of consultation respondents representing the interests of corporate capital.[62] Broadly speaking their objection was that, notwithstanding their use of the concept as a shield on the part of firms as described above, the concept should not be deployed as a sword by tax authorities, i.e. as a back-door route for establishing unitary taxation by formulary apportionment. It did not survive into the subsequent discussion draft.[63] We will, however, encounter it again in the context of the 'BEPS 2.0' work on taxation of the digital economy, which is considered in the chapter which follows.

In any event, notwithstanding the metastasisation of the value creation concept as thus

58 M.E., Porter, *Competitive Advantage*, New York, The Free Press,1985.

59 See OECD, 'Transfer Pricing Documentation and Country-by-Country Reporting: Action 13 Final Report', October 2015b, https://web.archive.org/web/20200226153336/https://www.oecd-ilibrary.org/docserver/9789264241480-en.pdf?expires=1582732092&id=id&accname=guest&checksum=33F25964EB3895439B36362D2BB1B09B (accessed 1 September 2020).

60 See by way of illustration P. Daly and M. Joy, 'Value Chain Analysis', *Tax Journal*, no. 1353, May 2017, pp. 18-19.

61 OECD, 'Public discussion draft: BEPS Action 8-10: revised guidance on profit splits', July 2016a, https://web.archive.org/web/20160803114714/http://www.oecd.org/tax/transfer-pricing/BEPS-discussion-draft-on-the-revised-guidance-on-profit-splits.pdf (accessed 1 September 2020).

62 See OECD, 'Comments Received on Public Discussion Draft: BEPS Action 8-10, Revised Guidance on Profit Splits' parts I and II, September 2016b, https://web.archive.org/web/20190219014138/http://www.oecd.org/ctp/transfer-pricing/Comments-on-discussion-draft-beps-action-8-10-revised-guidance-on-profit-splitsP1.pdf and https://web.archive.org/web/20200226155145/http://www.oecd.org/ctp/transfer-pricing/Comments-on-discussion-draft-beps-action-8-10-revised-guidance-on-profit-splitsP2.pdf (accessed 1 September 2020).

63 OECD, 'Public Discussion Draft: BEPS Action 10: Revised Guidance on Profit Splits', June 2017a, https://web.archive.org/web/20170722071033/http://www.oecd.org/ctp/transfer-pricing/Revised-guidance-on-profit-splits-2017.pdf (accessed 1 September 2020).

sketched out, it is nonetheless possible to trace into the BEPS project the more focused themes which have emerged in this chapter, albeit that it is in these pre-BEPS materials that they are to be observed most clearly; in the BEPS project proper the apparent strategy of using the absorptive labour implicated in MNE value capture as a way to apportion the tax base between the state and offshore is only imperfectly realised under a number of specific heads. Perhaps most notably, there is the BEPS resolution to the problem of risk. Accordingly, the remainder of this section will briefly address that topic, as an illustration of the kinds of manifestations of the 'value creation' concept (as elaborated in this chapter) to be found in the BEPS outputs.

7.5.3 Risk

Much as in the case of formal intangible ownership, risk can easily be allocated offshore, such that the rewards which accrue to the taking of risk by the group can be made to accrue untaxed. These allocations are necessarily only meaningful on a formal level; as a matter of practical reality the risks of the group's business are borne by those with a financial interest in it – its shareholders and creditors – and (as already noted) the core norms at play here do not allow for allocation of the tax base to them. The OECD's solution to this problem is, in summary, to pay close attention to where the risk is 'controlled', with control defined by reference to decision-making capacity.[64]

The simple illustration of a loan, as discussed in the introduction to this chapter, may be recalled. In that illustration the source of the interest was the capital advanced and so the question where the underlying value comes from precedes the labour of those negotiating the loan. Equally, in the case of corporate risk, profits arising by reference to capital placed at risk can only be *causally* linked to risk-management labour; this labour is absorptive and cannot 'create' value. It nonetheless exerts a gravitational pull on the international corporate tax base pursuant the BEPS outputs. It may be noted that the scheme developed in the pre-BEPS materials whereby (as elaborated above) a gravitational pull of this nature creates a space in which capital and the state can bargain over the tax base is imperfectly realised in this instance, because it is a threshold test. An entity either performs enough 'control' to be treated as the risk-bearer, or it does not.[65]

Indirectly, however, this approach to the allocation of risk provides the conceptual framework for a number of features of the BEPS transfer pricing outcomes where profitability can be

[64] Collier and Andrus 6.24-26.
[65] Collier and Andrus 6.27.

partially allocated away from the entity to which it accrues by virtue of control otherwise than through that entity. Cost contribution arrangements are one example;[66] another example is one we are already familiar with – the profitability accruing in respect of intangible assets.[67] It is illustrative of the quantitative disconnect between even well-remunerated absorptive labour and the volume of profitability it is said to 'create' that the deployment of this 'control' concept for these purposes provides a fresh opportunity for abuse. As Collier and Andrus explain:

> If sufficient risk control related functionality is moved to a low-tax environment, using risk allocations to shift profits to that low-tax jurisdiction will still be possible. The control requirement may, therefore, not present a serious obstacle to those intent on shifting income on the basis of risk allocation. Indeed, it may create incentives to move certain types of employees to tax advantaged locations to shore up the claim that income should be allocated to such locations. Home jurisdictions to MNEs may thus lose both the income tax base and employment.

7.6 Conclusion

In conclusion then, the story here is one whereby a crisis which appeared to have been developing was (at least temporarily) averted. The crisis was one whereby states were losing huge tranches of the tax base to offshore, and had been (seemingly contrary to principle) categorising residual profit as arising from intangibles in order to claw back some of their losses. The OECD's solution was the concept of 'value creation', which refers to absorptive labour exerting a kind of gravitational pull over the portion of the global corporate tax base structurally associated with value *capture*. (After all, since value capture must in the premises mean that value is captured from outside the group, *something* must be treated as giving rise to it, however quantitatively unrelated to the value in question, if the tax base is to be allocated between jurisdictions in which the group operates.)

This approach (in contrast to formulary apportionment) offered to keep open the offshore space in which the residual profits of MNEs arise, albeit that it placed the size of capital's tax-free portion up for grabs. The core structural problem of the arm's length principle – that multinational corporations make more profit than the profit which their individual component entities would make; so much more in fact that it was threatening, as noted at the outset of chapter 1, to delegitimse the entire system – was thereby to be returned to respectable

[66] Collier and Andrus 6.74.

[67] Collier and Andrus 6.64 and 7.55.

obscurity beneath a layer of transfer pricing technicality effecting a fresh compromise between capital and the state.

In the event as noted above the BEPS outcomes only imperfectly realised that objective, although a full discussion to that effect is outside the scope of this chapter – the key point for the purposes of this thesis is the use of 'value creation' to refer to absorptive labour within the group which is associated with value capture. We saw in chapter 1 that there is near universal consensus that the offshore space away from which profitability is to be allocated lies outside the production boundary of whatever value-theoretical system underpins BEPS, and we saw in the remainder of Part I of this thesis that an established value-theoretical system consistent with that consensus is a Marxian one. What we have seen in this chapter is an impulse to reallocate the profitability to be found offshore to another region (i.e. the absorption of value in waged activity devoted to the capture of value) which, from the point of view of that value-theoretical system, is *also* outside the production boundary. The post-BEPS evolution of that impulse in connection with the taxation of the digital economy will be considered in the chapter which follows.

Chapter 8: 'Value creation' and the taxation of the 'digital economy'

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8.1 Introduction

The problem of untaxed corporate profits has for almost a decade been indelibly associated with the untaxed profits of certain specific MNEs, notable amongst which have been Apple, Google and Amazon. Accordingly, more-or-less from the outset of the BEPS process there was specific focus on a sector which (despite the diversity of products, services and business models included within it) is conveniently labelled the 'digital economy'. As the initial BEPS report explains:

> current international tax standards may not have kept pace with changes in global business practices, in particular in the area of intangibles and the development of the digital economy. For example, today it is possible to be heavily involved in the economic life of another country, *e.g.* by doing business with customers located in that country via the internet, without having a taxable presence there or in another country that levies tax on profits. In an era where non-resident taxpayers can derive substantial profits from transacting with customers located in another country, questions are being raised on whether the current rules are fit for purpose.[1]

It is already clear at the stage of the BEPS Action Plan (i.e. in July 2013) that something slightly different is going on with regard to this topic as compared to the scheme that we saw developing in the context of transfer pricing in the previous chapter, where 'value creation' was a composite concept which included value capture. In this context value *capture* starts off as a named phenomenon and is being treated as distinct from value creation. The Action

[1] OECD, 2013d, p. 7.

Plan argues that the 'digital economy is characterised by an unparalleled reliance on intangible assets, the massive use of data (notably personal data), the widespread adoption of multi-sided business models *capturing value* from externalities generated by free products, and the difficulty of determining the jurisdiction in which *value creation* occurs [emphasis added].'[2]

The 'difficulty of determining the jurisdiction in which value creation occurs' is one we are familiar with from our exploration of the topic of transfer pricing. 'Value capture', at this stage at least, appears to be a fairly narrowly circumscribed *additional* phenomenon which only takes place when you give away free products. To elaborate, the Action Plan seems to posit a distinct sphere in addition to the sphere where transactions in the nature of market transactions take place – a sphere where the mechanism of exchange is indirect: free products are supplied and value accrues from some other source than the consumers of the product. This might be, for example, (so the Action Plan implies) where Google provides web search or Facebook provides social networking for free but they sell advertising to businesses wishing to advertise to the websites' users.

On the face of it, it is hard to see how this really is a distinct sphere from the sphere of 'value creation'. If we suppose 'value creation' to mean, broadly, substantive business activity of any kind, as is generally inferred (as to which see chapters 1 and 7), then sales of advertising should just be value creation of that ordinary kind, irrespective of the specific advertising medium. Of course in the Marxian schema as elaborated in this thesis, *all* advertising spend is value capture (as opposed to value creation) on the part of the business receiving the spend, whether it be in the 'digital economy' or in a printed magazine. But the OECD appears to be intimating that there is a mid-point between these two analyses, whereby advertising services create value in some circumstances but capture it in others.

A clue as to how, tentatively, the OECD may have been imagining the distinction to be drawn is to be found in a report published a few months earlier by a French-government-commissioned task force on this same topic. The report makes the following core claim (to quote from its executive summary):

> Data collection reveals the "free labour" phenomenon. Everything leaves a trail in the digital economy. Regular and systematic monitoring of their online activity means that data on application users are collected without any monetary consideration.

[2] OECD, 2013a, p. 10.

> Users become virtual volunteer workers for the companies providing the services that they use. The data from the users' "free labour" are collected, stored and processed to be integrated into the production chain in real time, blurring the dividing line between production and consumption. Users are attracted by the quality of interfaces and network effects. The data that they provide makes them production auxiliaries and they create value that gives rise to profits on different sides of the business models.[3]

The report makes extensive use of this 'free labour' concept, offering policy recommendations off the back of it to do with tax systems recognising it and capturing for tax purposes the value argued to arise from it. The distinction between profitability where 'free labour' is implicated and ordinary profitability is drawn out in a passage referencing theory-of-the-firm literature:

> Companies are no longer restricted to a choice between sub-contracting to suppliers and hiring employees. In the digital economy, they have a third choice, which is to produce an application that inspires users to engage in an activity that generates positive externalities in the form of data, which are then put back into the production chain without any monetary consideration for the users. This "free labour" explains some of the low marginal operating costs and explains the exponential returns to scale that are specific to the digital economy.[4]

The difference then, expressed in terms of the contrast between advertising on a social media platform such as Facebook and advertising in a printed magazine, is that the magazine proprietor had to pay journalists, editors, designers, photographers &c to make the magazine attractive to readers, whereas the attractions of Facebook *to* its users are generated *by* its users. By the same token, the argument in the context of Amazon would be that the costs being saved are the costs of determining which products are going to be attractive in which markets, how they should be priced &c. The enhanced profitability of the 'digital economy' sector is, on this analysis, a matter of cost reduction as opposed to being attributable to the origination of products and services to which 'free labour' contributes.

The report makes the further claim that user data is 'put back into the production chain in the digital economy, blurring the dividing line between production and consumption',[5] but no

[3] P. Collin and N. Colin, *Task Force on the Taxation of the Digital Economy Report*, January 2013a, https://web.archive.org/web/20151020171724/http://www.hldataprotection.com/files/2013/06/Taxation_Digital_Economy.pdf, p. 2, (accessed 1 September 2020).

[4] Collin and Colin, p. 49.

[5] Ibid.

account is provided in the report of this mechanism whereby activities which save the firm costs become factors of production. The analysis is reminiscent of the informal feminist critique of Marxist value theory, discussed in chapter 4 (at section 4.7), whereby the saving of costs (in that instance taking place in connection with unpaid domestic labour) is conflated with the production of value. It is not the use of data in the 'digital economy' that is blurring the dividing line between production and consumption, it seems; it is the authors of the report. They concede that there is nothing new about consumer participation playing a role in business models, but explain that 'the digital revolution expanded this approach by taking it to a much larger scale and by extending it beyond advertising, marketing and the media into all dimensions of business.'[6] Again, the distinction between the 'digital economy' and its non-digital analogues is not satisfactorily theorised.

Despite these shortcomings the report appears to have been influential upon the authors of the BEPS action plan; the language about user activity generating positive externalities which are then put back into the production chain without any monetary consideration seems to be reflected in the BEPS action plan language about business models capturing value from externalities generated by free products. And indeed the authors of the report claim that their interactions with the BEPS team were 'informal but frequent and in-depth, especially on the road to adopting the BEPS action plan'.[7] (The fact that the OECD is based in Paris may have had something to do with the frequency of these interactions.)

A particularly fascinating aspect of the report for the purposes of the argument in this thesis is the list of antecedents to their analysis that the authors provide. There are a number of management authors and tech authors, but buried at the bottom of the list are authors writing in the Marxian tradition including one that we have already met, also in chapter 4 at section 4.7; Antonio Negri.[8] Here then (nanometre-thin though it may be!) is a discernible genealogical thread linking the BEPS process to a value-theoretical tradition. The questions being asked of the dynamics to which value is subject in the digital economy seem to have a root – or at least a tendril – in the postoperaist idea (modish since the late 90s but, as elaborated upon in chapter 4, fundamentally misconceived) that unwaged immaterial labour in culture at large is implicated in the production of value.

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[6] Ibid p. 50.

[7] *International Tax Review*, 'Pierre Collin and Nicolas Colin' (interview), 11 December 2013b, https://www.internationaltaxreview.com/article/b1fbsx5c9x2vs5/pierre-collin-and-nicolas-colin and https://archive.is/rsrX8 (accessed 1 September 2020).

[8] Collin and Colin, 2013a fn. 240.

From the perspective of international corporate tax reform this is a profoundly radical position, because it potentially locates 'value creation' (in other words, within the BEPS scheme, a phenomenon attracting an allocation of profits for tax purposes) in jurisdictions where no business activity of any kind takes place on the part of the MNE aside from giving away services for free. Realistically of course for the most part one would expect sales (e.g. of advertising) to also be taking place in those jurisdictions, and so this approach may in practice not be such a departure from the idea of allocating a tranche of digital economy profitability to jurisdictions in which sales take place (also alluded to as a possible route to a solution in the initial salvo of BEPS documents[9]). Either way, however, it is being suggested that 'value creation' is taking place at the point of consumption rather than within the firm, which is wholly at odds with the axiom we encountered in the foregoing chapter whereby profitability has to be kept within the firm for tax purposes even if (as explained in chapter 6) it may have been captured from elsewhere in the global value chain.

The difference here of course is that the locus of 'value creation' is not upstream in the value chain to sites of material production (i.e. to sites within the production boundary as elaborated upon in Part I of this thesis; or, from the point of view of the scheme elaborated upon in chapter 6, to the bottom of the smile curve); it is downstream in the value chain towards the sphere of consumption. The reallocation of taxable profits being contemplated in this context would largely bolster fiscal resources in regions with high levels of consumption, rather than effecting a redistribution to less wealthy jurisdictions. And (in view of the quasi-imperialist function of the international tax system as a mechanism for reproducing inequality between states as discussed in Part II of this thesis) that is no doubt why reallocation outside the firm is in blithe and unabashed contemplation here while being unthinkable in other contexts. Broadly speaking the story of the onward progress of this possibility, is what is traced in this chapter.

From the more abstract perspective of the value-theoretical narrative unfolding in this thesis, it is a story about the extension of the self-contradictory idea that absorptive *labour* is 'value

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[9] See for example footnote 1 of this chapter; it may be noted in this context that in 2005 the OECD had already considered and rejected a series of proposals to modify norms around the definition of what constitutes a 'permanent establishment' for tax nexus purposes (in other words for establishing a jurisdiction's right to tax an MNE which operates in a jurisdiction otherwise than through a resident company) in the specific context of an enquiry into whether tax norms were up to the task of handling the digital economy – the report to this effect 'Are the current treaty rules for taxing business profits appropriate for e-commerce?', 2005, is https://web.archive.org/web/20141121195341/http://www.oecd.org/tax/treaties/35869032.pdf (accessed 1 September 2020).

creating' for the purposes of the allocation of the international corporate tax base (i.e. the idea elaborated in chapter 7), into an even more glaringly self-contradictory idea whereby value absorption more generally (i.e. *consumption*) is 'value creating' for those purposes. Either way, of course, the target of reallocation is as much outside the production boundary as the offshore spaces that profitability is to be allocated away *from*.

8.2 BEPS Action 1

The initial phase of that story played out under the BEPS Action 1, its purpose being to 'address the tax challenges of the digital economy' by 'identify[ing] the main difficulties that the digital economy poses for the application of existing international rules and develop[ing] detailed options to address these difficulties'.[10] The issues to be examined included 'the attribution of value created from the generation of marketable location-relevant data through the use of digital products and services'. This form of 'value creation' would appear to be the aforementioned 'value capture', here subsumed within the broader 'value creation' concept.

Action 1 began in earnest in October 2013 with a meeting of the topic's task force, followed in November 2013 with a 'Request for Input Regarding Work on Tax Challenges of the Digital Economy'.[11] A compilation of responses received was published in January 2014.[12] A core theme of the responses was resistance to the idea of a radical change in approach, notwithstanding the much-flagged 'challenges' presented by the digital economy. The idea of value being created by consumers was widely rejected.

Typical was the response of Baker & MacKenzie, who represent the interests of 'an informal coalition of leading U.S. and non-U.S. software, information / content, social networking, and e-commerce companies that provide goods or services through digital and nondigital means'. Their view was that '[l]abor, capital, and innovation drive value in enterprises that exploit the efficiencies of digital communications' and further that '[t]his is no different than for any other enterprise operating in a competitive market'. The key difference between this sector and other sectors being that a 'digital enterprise may have a greater part of its assets embodied in intellectual property as opposed to physical assets such as machinery or

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[10] OECD, 2013a, p. 14.

[11] OECD, 'Request for Input Regarding Work on Tax Challenges of the Digital Economy', November 2013e, https://web.archive.org/web/20140704021558/https://www.oecd.org/tax/request-for-input-regarding-work-on-tax-challenges-of-the-digital-economy.pdf (accessed 1 September 2020).

[12] OECD, 'Compilation of Comments Received in Response to Request for Input on Tax Challenges of the Digital Economy', January 2014b, https://web.archive.org/web/20140124222710/https://www.oecd.org/ctp/comments-received-tax-challenges-digital-economy.pdf (accessed 1 September 2020).

equipment. In these cases, the principal value-drivers will be those personnel who pursue those business innovations necessary to maintain a competitive advantage.'[13]

It is not hard to speculate as to the driver behind responses such as these. The focus on intellectual property and associated absorptive labour, rather than consumers and their 'free labour', keeps the enhanced profitability of the digital economy subject to the offshore/onshore tug-of-war created by transfer pricing regimes as they apply to intellectual property assets (as to which see chapter 7). This is in contrast to locating it exclusively onshore to the fiscal detriment of MNEs.

A short while later there followed a discussion draft,[14] which began with a substantial overview of the role played by information technology in the global economy. The idea of users creating value through their free labour is still there, now characterised – by reference to generalised examples corresponding to Amazon and Facebook – specifically as a network effect, arising 'from users' marginal utility to each other'. '[T]he more users there are', the draft goes on to explain, 'the higher the value created is.'[15] There is of course no doubt that a network effect increases the utility of sites like Amazon and Facebook to their users, but what is interesting here (for a reading maximally attuned to value-theoretical nuances, at least) is that that increased utility is characterised as *creating value*, on the basis that the network effect increases specifically the *marginal* utility of users to each other.

Marginal utility is a concept from mainstream marginalist value theory – indeed it is one of the foundational concepts in that theory. It is the utility of the least important use to which a unit of a commodity would be put, that use being discovered by supposing the available quantity of that commodity to be reduced by one unit.[16] So, for example, if you own two hammers and use one for banging in nails and the other as a doorstop, but would use a single hammer (i.e. if you only owned one) for banging in nails, the utility of hammers, on the margin of their availability, to you, is that of a doorstop. The role of marginal utility as a concept is theoretical – it is the marginalist explanation for diamonds being worth more than water, even though they are less useful. It stands in opposition to the classical account, which would in simple terms (and leaving aside the role played by property over land) be broadly to

[13] Ibid p. 40.

[14] OECD, 'Public Discussion Draft; Beps Action 1: Address The Tax Challenges Of The Digital Economy', March 2014c, https://web.archive.org/web/20190118200320/https://www.oecd.org/ctp/tax-challenges-digital-economy-discussion-draft-march-2014.pdf (accessed 1 September 2020).

[15] Ibid, p. 39.

[16] See chapter 5 of William Smart, *An Introduction to the Theory of Value*, London, Ludwig von Mises Institute, 1931.

do with the disproportionate amount of labour that goes into obtaining diamonds as compared to the labour that goes into obtaining water. And so the suggestion here is that the value creation that takes place as between users is not, after all, referable to the 'free labour' that they do, but is instead somehow a value creation process as theorised in mainstream economics, akin to the price-finding mechanism of the market as theorised in mainstream marginalism. Labour here is being impliedly repudiated as a source of value.

How specifically *marginal* utility is relevant here is not, however, explained. And an explanation would seem appropriate since there is no price-finding as between users on these sites. The price finding on Amazon is between itself (and other vendors of commodities) and its users, and on Facebook it is as between Facebook and buyers of advertising. It is perfectly possible to come up with narratives as to how the role of other users enhances utility in these contexts, but it is by no means immediately obvious how the specifically *marginal* utility of users *to each other* should be relevant to a broad depiction of their role in a network effect. The inference therefore is that the deployment of the concept of marginal utility is more cosmetic than analytical, seeking to give the impression that there is no departure here from mainstream conceptions of how value is created (i.e., as discussed in chapter 1 of this thesis, at the intersection of marginal utility curves on the part of market participants rather than in material production).

The more practical sections of the discussion draft do not, in any event, draw to any great extent on this theorising. An extensive section discusses how other strands of the BEPS project will address the challenges of the digital economy without the need for a specific focus on it, and (perhaps because 'value creation' is presupposed as the guiding principle for those other strands) it is not framed by reference to 'value creation' at all. The problem is referred to as 'stateless income', and the solutions are grouped into (i) measures that will restore taxation in the market jurisdiction, (ii) measures that will restore taxation in both market and ultimate parent jurisdictions, and (iii) measures that will restore taxation in the jurisdiction of the ultimate parent. A following section on the problems specific to the digital economy that will remain despite these other strands does invoke the concept of 'value creation', and again it is in the context of data: specifically 'how to attribute value created from the generation of data through digital products and services'.[17] The picture appears to be one whereby, in the case of the big digital economy players, the 'bourgeois labour theory of value' as emerged for the purposes of transfer pricing reform (as to which see chapter 7 of

[17] OECD, 2014c, p. 56.

this thesis) is not anticipated to make sufficient inroads into offshore profitability, and so a distinct additional class of 'exotic value driver' – data – is required.

In chapter 7 we encountered a variety of euphemisms for market power, and it is worth noting that in this context the phenomenon of monopoly power is again being downplayed in the discussion – it gets a single paragraph's mention in the discussion draft and is then forgotten.[18] Seemingly 'value creation' by users in respect of data is the additional narrative fig leaf required to make that erasure. Monopoly power in the discussion draft is (as it was in chapter 6 of this thesis) expressly associated with the network effect,[19] and the network effect is expressly associated with data,[20] but the link between data and monopoly power is not drawn. Recalling chapters 4 and 6 of this thesis, what we have here is a circumstance – disproportionate profitability in the digital economy, to which attention is being drawn because of its propensity to go untaxed – which cannot be explained by mainstream marginalism, but which is consistent with Marxian value theories. On the one hand there is the monopoly capitalism take on traditional Marxism, which would analyse these profits as surplus value created in material production and accruing in the digital economy by virtue of value capture mechanisms associated one way or another with monopoly power.[21] And on the other hand there is postoperaism, which would characterise this disproportionate profitability as being referable to immaterial unwaged value creation by consumers participating in society at large.[22]

Clearly, in view of its downplaying of the phenomenon of monopoly power, the OECD is not plumping for the former. It would appear, however, that the OECD was positively aligning itself the latter. This may be discerned from the proposed policy interventions suggested in the discussion draft,[23] which largely[24] relate to a concept in international tax law known as 'nexus'. In principle a state can legislate to tax whatever it likes, but in practice, and certainly in the case of corporate tax as levied in accordance with international norms, there must be a 'nexus' within the jurisdiction giving rise to the liability to tax. That nexus is either a company resident or incorporated in the jurisdiction, or a 'permanent establishment' (i.e. a branch), located in the jurisdiction, of a non-resident company. In essence the proposed

[18] Ibid p. 41.
[19] Ibid.
[20] Ibid p. 40.
[21] See section 6.4 of chapter 6.
[22] See section 4.7 of chapter 4.
[23] Ibid pp. 64-67.
[24] At least insofar as concerns what relevant here i.e. relating to direct tax; there are also proposals relating to indirect tax.

interventions either (a) extend the concept of permanent establishment so as to make a permanent establishment more likely to arise in market jurisdictions in the case of digital economy companies, or (b) develop a wholly new nexus for the purpose of taxing digital economy companies in market jurisdictions. A further suggestion involved imposing a withholding tax on payments from market jurisdictions. In summary, then, the solution to the problem of 'stateless income' in the case of the digital economy, was to allocate the tax base downstream in global value chains towards consumption (i.e. to market jurisdictions), even in circumstances where to do so involves (in direct contrast to the constraints we saw applying in chapter 7 in relation to the issue of transfer pricing) piercing the boundary of the MNE and allocating the tax base to a jurisdiction where it does not have any kind of presence as conventionally understood.

As regards responses to the discussion draft,[25] there was a general consensus that the digital economy should (as the OECD had already asserted) not be ring-fenced for tax purposes but that (in contrast to the OECD's suggested approach of targeted measures) there was nothing really new about it. Many of the responses vigorously supported the points taken by the OECD in respect of other BEPS measures being apt to tame the fiscal monster of the digital economy at least to a degree. None of the respondents engaged with the heterodox value theory in the discussion draft, except to the extent that (again) some respondents argued that, while clearly data is implicated in profitability, it is the work done to the data within the MNE that creates the value.[26] In contrast to the context of transfer pricing, where (as we saw in chapter 7) the 'bourgeois labour theory of value' was advanced by the rich states' club that is the OECD to effect a compromise with capital rather than having to adopt a more radical approach, here it is being advanced in the other direction by the representatives of capital as a bulwark *against* a more radical approach. Either way, however, whether it is capital's preference for the bourgeois labour theory of value in this context, or states' tentative interest in postoperaist excursions beyond the bounds of the firm, the target for reallocation is where the wealth is already concentrated, whether it be in the form of salaries or consumption levels. The idea of reallocation to where value is objectively created in accordance with classical theory (as adumbrated in chapters 3 and 4 of this thesis) has not been mooted. And this means (broadly, in view of the circumstances set out in chapter 6 with regard to the

[25] OECD, 'Comments Received On Public Discussion Draft; BEPS Action 1: Address The Tax Challenges Of The Digital Economy', 16 April 2014d, https://web.archive.org/web/20140513203829/http://www.oecd.org/ctp/comments-action-1-tax-challenges-digital-economy.pdf (accessed 1 September 2020).

[26] See for example the responses of BIAC and KPMG; ibid at pp. 68 & 332.

economic geography of the global value chains from which the value in the digital economy is captured) substantially constrained room for reallocation to less wealthy states.

The content of the discussion draft went through two further iterations, as an interim deliverable in September 2014[27] and as a final BEPS output in October 2015,[28] but for present purposes the material evolved no further and no substantive reforms were recommended. The final report rather weakly suggested that states could unilaterally implement one or another of the solutions discussed 'provided they respect existing treaty obligations', or implement them in bilateral treaties among each other.[29] The core problem of untaxed super-profits in the digital economy, the addressing of which was arguably the fundamental purpose of the BEPS process, remained unsolved. And the most overtly value-theoretical work stream – in a project driven by a purportedly value-theoretical guiding principle – had come to nothing.

8.3 "BEPS 2.0"

8.3.1 The request for input

Following delivery of the BEPS package there was an institutional shift whereby further policy developments were to take place under the auspices of the 'Inclusive Framework', a mechanism for states which are not OECD members to collaborate with OECD members on the implementation of the BEPS reforms on a (formally at least) equal footing. In January 2017 the Inclusive Framework approved a renewed mandate for the task force which had produced the BEPS Action 1 output, and (with the blessing of the G20 and G7 expressed in subsequent months) the work began again – under the gathering clouds of what subsequently became a storm of unilateral measures intended to fill the gap left by BEPS Action 1 – with another request for public input, in September 2017.[30] In keeping with previous work in this area, the request for input invited respondents to discuss the role of digitalisation on the

[27] OECD, 'Addressing The Tax Challenges of The Digital Economy; Action 1: 2014 Deliverable', September 2014e, https://web.archive.org/web/20200221072733/https://www.oecd-ilibrary.org/docserver/9789264218789-en.pdf?expires=1582270945&id=id&accname=guest&checksum=5A201748CC8D3D43055F318848F7CD39 (accessed 1 September 2020).

[28] OECD, 'Addressing The Tax Challenges of The Digital Economy; Action 1: 2014 Final Report', October 2015c, https://web.archive.org/web/20200221072536/https://www.oecd-ilibrary.org/docserver/9789264241046-en.pdf?expires=1582270570&id=id&accname=guest&checksum=F805B02514699310FD8803C735B6DD45 (accessed 1 September 2020).

[29] Ibid p. 13.

[30] OECD, 'Request for Input on Work Regarding The Tax Challenges of The Digitalised Economy', September 2017b, https://web.archive.org/web/20171013091927/http://www.oecd.org/tax/tax-policy/tax-challenges-digital-economy-request-for-input.pdf (accessed 1 September 2020).

‘means and location of value creation’, and flagged up the possibility that user participation and data gathering might have implications for how ‘value creation’ is analysed for the purpose of that discussion. A draft outline of the report intended to follow the consultation[31] promised ‘analysis of heavily digitalised business models and their value chains to shed light on how and where value is created.’

Responses to the request for input varied greatly in their willingness to accept that further reform was in the pipeline. On one end of the spectrum were those for whom the ‘value creation’ concept, much though they may have deprecated it as an indeterminate novelty in other contexts, had seemingly (and most implausibly) become a hallowed principle of long standing which was threatened by this new process. ‘Consensus has been achieved’, announced KPMG by way of an argument against further reform,[32] ‘and is driving changes in corporate behavior to align around historic understandings of value creation and arm’s length principles’. ‘[S]ignificant time and effort was spent during the BEPS process determining where value is created and now’, complained the OECD’s own Business and Industry Advisory Committee with a markedly petulant tone, ‘it appears that those standards are considered by some to no longer be viable before we have seen their full implementation’.[33] At the other end of the spectrum were voices like Ernst & Young’s, who balefully recited the sheer number of unilateral measures already adopted or in the process of being adopted by states, and made it very clear that multilateral action would in their view be preferable.[34] Somewhere in between was PwC, whose counsel of extreme patience seems to have been offered in the hope that the promise of multilateral reform would be sufficient to stem the tide of unilateral measures, without actually delivering anything any time soon.[35]

Most of the respondents offered resolute resistance to the idea that value is created in markets, with some going so far as to posit value as an objective property of commodities which is conserved in exchange, broadly in accordance with the premises of classical value theory (as to which see chapter 3 of this thesis). ‘We would continue to take the view that the

31 OECD, ‘Outline of The Interim Report for The G20 Finance Ministers’, September 2017c, https://web.archive.org/web/20171013095506/http://www.oecd.org/tax/beps/tax-challenges-digital-economy-draft-outline-2018-interim-report.pdf (accessed 1 September 2020).

32 OECD, ‘Tax Challenges of Digitalisation, Comments Received on The Request for Input, Part II’, 25 October 2017d, https://web.archive.org/web/20200225134834/http://www.oecd.org/tax/beps/tax-challenges-digitalisation-part-2-comments-on-request-for-input-2017.pdf, at p. 123 (accessed 1 September 2020).

33 OECD, ‘Tax Challenges of Digitalisation, Comments Received on The Request for Input, Part I’, 25 October 2017e, https://web.archive.org/web/20171031095200/http://www.oecd.org/tax/beps/tax-challenges-digitalisation-part-1-comments-on-request-for-input-2017.pdf, at p. 34 (accessed 1 September 2020).

34 Ibid at p. 165.

35 OECD, 2017d, at p. 194.

profit attributable to a country where we make sales but have no physical presence is zero,' explained publishing behemoth Informa in this vein, 'as the value of an item is not changed by its mere sale.'[36] 'Innovation and production create value, consumption does not', explain the Digital Economy Group: a consortium of digital economy giants including Amazon, Expedia, Google, Facebook, Netflix, Microsoft, Spotify and Twitter (represented by Baker & McKenzie). 'A commercial transaction between a supplier and a purchaser is an exchange of value for value (the good or the service is supplied in exchange for money or other consideration), but that transaction creates no new value.'[37]

The proposition that value is created in consumption was offered in order to justify allocating the profits of digital economy giants onshore to market jurisdictions for tax purposes, and this counter-conception of value as an objective property of commodities which is conserved in exchange would in theory serve to protect them from that possibility, but of course in so doing it perpetuates the core BEPS problem: how to quantitatively allocate 'value creation' to the various factors of production understood to imbue the commodity with value. It also, by way of a side-effect, constitutes a wholesale rejection of modern marginalist value theory. The 'value creation' narrative, which was grudgingly adopted as a compromise solution to the problem of monopoly profits in a transfer pricing context has blossomed into a full-blown assertion of the classical model of value. But it thereby revives the very problem which classical value theory exists to solve: if a 'commercial transaction between a supplier and a purchaser is an exchange of value for value', then that must be true of all of a company's inputs, including labour. So where does profit come from? We are placed firmly back in the position David Ricardo was in before his unfortunate early demise (see chapter 3 section 3.2). By positing that value is conserved in exchange but not addressing the paradox that premise gives rise to, these respondents are essentially taking (in response to the OECDs approach of postoperaism turned marginalism-without-money) a pre-classical, mercantilist view of value.[38]

An alternative perspective is to be found among the respondents, however, which acknowledged the role of monopoly power. '[I]t is not appropriate extrapolating the situation of a few global digital giants owning digital platforms that are in a monopolistic / duopolistic situation, to the rest of market players,' submitted a consortium of Spain-based lesser digital

[36] Ibid, at p. 33.
[37] OECD, 2017e, at p. 138.
[38] See Chapter 3 footnote 2.

economy players.[39] Grant Thornton, an accounting firm responding to the consultation from outside the 'Big Four' oligopoly within the business services market, and so no doubt reflecting the concerns of its client base also among lesser digital economy players, expressly draw the link between data, the network effect, and monopoly power:

> The global economy has been increasingly impacted by the network effect, under which a business may use its data, derived from a critical mass of users, allowing it to develop a unique competitive advantage. By having a presence in a large market/country, software companies are now able to collect large quantities of raw data, which further enhances the opportunities for that business to further consolidate its market advantage and to be in a position to create even more valuable IP.[40]

Grant Thornton even go so far as to accept in principle the logical conclusion of the existence of monopoly power that value may be created outside the firm, recognising that there could be an argument that consumers create value downstream in the value chain in the form of data. They express doubts about the possibility that raw data as an input could be valued for these purposes, however, and (needless to say) there is no recognition of the possibility that the value may in fact be being created by productive workers *upstream* in the value chain in jurisdictions hosting material production.

Aside from the odd glimpse like this of an alternative view, however, in general the respondents representing the corporate sector seemed wholly unimpressed by the idea that user interaction with digital economy businesses is in and of itself value creating. It is against that background that the UK's intervention shortly afterwards seems particularly notable, as an epilogue to the request for input phase of the rebooted BEPS process. In November 2017 the UK published a position statement[41] which initially seemed to embed the new orthodoxy to the effect that, despite the contempt that it had attracted as a novelty earlier in the decade, the 'value creation' principle had in fact been the principle underpinning international corporate tax norms all along.[42] It went on, however, to firmly adopt the analysis whereby data generated by users, at least insofar as concerns certain specific digital economy business models, should be treated as reflecting value creation, exhorting the OECD

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[39] Ibid at p. 128.

[40] Ibid at p. 178.

[41] HM Treasury, 'Corporate Tax and The Digital Economy: Position Paper', November 2017, https://web.archive.org/web/20181112092935/https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/661458/corporate_tax_and_the_digital_economy_position_paper.pdf (accessed 1 September 2020).

[42] Ibid p. 4.

to consider the option of allocating profitability to jurisdictions based on some sort of user base metric.[43]

Curiously, the UK government did not publish consultation responses, which it ordinarily would in these contexts, but it did publish a follow-up paper purporting to have taken into account views expressed to it.[44] One interesting evolution of the ideas previously expressed in the initial position paper was an answer to a question that might have arisen in respect of the claim that existing transfer pricing norms already identify where value is created, sitting alongside the novel claim that in some cases value is created by users, that question being to do with where within the firm this additional value is to be found. The answer offered by the UK is our old friend from the transfer pricing context (as to which see section 7.2 in chapter 7) the 'residual profit'.[45] In other words, if you assume that all the apparently productive activity within the firm takes place internally at competitive margins, the 'user generated' value is an element of the additional profits earned by the outside-world-facing firm overall, in addition to those internal margins: additional profits that could equally be characterised as deriving from value capture referable to monopoly power.

The problem of the digital economy seems therefore to be the persistent (and, as we saw in chapter 7, deliberately only partially resolved) problem of what to do with excess profits referable to the monopoly power of MNEs. What the digital economy framing offers, whether it be via the idea of user-created value or otherwise, and whether it be by means of ring-fencing certain business models or otherwise, is a route to attributing the value creation outside the boundary of the firm (which on a Marxian analysis is where it belongs) *without* attributing it to the low-paid workers who actually produce the stuff that, on a material level (and recalling the famous opening words of *Capital*), constitutes the wealth in our world.

8.3.2 The 2018 Interim Report and January 2019 policy note

In accordance with the renewed mandate the OECD delivered an interim report in March 2018.[46] The strategy the report adopts for navigating the theoretical indeterminacy of the

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[43] Ibid p. 11.

[44] HM Treasury, 'Corporate Tax and The Digital Economy: Position Paper Update', March 2018, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/689240/corporate_tax_and_the_digital_economy_update_web.pdf (accessed 1 September 2020).

[45] Ibid p. 15.

[46] OECD, 'Tax Challenges Arising from Digitalisation –Interim Report 2018', March 2018, https://web.archive.org/web/20200221131110/https://www.oecd-ilibrary.org/docserver/9789264293083-en.pdf?expires=1582291562&id=id&accname=guest&checksum=17CABBDA10BD42B36319446FC27A2DF0 (accessed 1 September 2020).

space in which it is seeking to intervene is to attribute different theoretical positions to different groups of countries participating in the inclusive framework. It identifies three groups. There are those who adopt the position already adopted in its unilateral work on this issue by the UK; the position to the effect that user participation creates value. And there is a contrasting group that views the data that user participation gives rise to as a raw input which is *purchased* by digital economy firms pursuant to a barter-type transaction with users (i.e. in exchange for a free service). The third group (perhaps inferentially supportive of the status quo) adopts neither of these novel positions.[47] As regards the question of monopoly power, it lists a number of features of the digital economy which would tend to suggest that that is a key mechanism at play (network effects; lock-in &c), but equivocates on drawing that conclusion, noting the 'low marginal costs and non-rivalry of many digital goods'.[48]

The key novelty in the 2018 Interim Report for present purposes is its attempt (finally!) to theorise value creation, or at least to place it in the context of some history of the concept. Disappointingly, however, that history begins not with the patriarchs of classical value theory, nor with the reformatory schismatics of the marginalist tradition, but in 1985, with the 'competitive advantage' concept of Michael Porter's, which we met in chapter 7 (see section 7.5.2). The report explains that that '[d]iscussions of value creation tend to start with the value chain. Developed by Michael Porter in the mid-1980s, the value chain is a standard tool in academia and business applied to analyse a firm's competitive advantage.'[49]

Michael Porter's conception of value is not a quantitative one; it is a managerial one: applying his thinking may help identify specific areas of a firm's activity where competitiveness may be improved, but it does not exist to determine the respective quantifiable contributions to profitability made by those specific areas of a firm's activity. So (like marginalism) it begs the BEPS value-theoretical question. Further, since it presupposes that all profitability within a firm is extracted from the market it is fundamentally agnostic as to the role of market power. For Michael Porter, a component of a firm's activities which is to do with entrenching market power is equally as value-creating as a component which is to do with, say, developing a more efficient manufacturing process. This is a mixed blessing from the point of view of the OECD's purposes: it retains value creation within the bounds of the firm, and therefore obviates any need to re-allocate profitability upstream in global value chains to production, but also therefore constitutes an obstacle to reallocating it downstream

[47] Ibid pp. 25-26.
[48] Ibid pp. 26-28.
[49] Ibid p. 35.

in global value chains to consumption. It is therefore unclear why Porter's conception of value has been adopted as the *fons et origo* for these purposes.

The Interim Report does critique the Porterian value chain concept, but not in a manner calculated to inspire confidence that its defects for these purposes have been engaged with. The claim is made that the Porterian value chain suffers from the defect that, unlike the global value chain analytic, it is only to do with domestic firms. But this critique completely misses the point about the global value chain analytic which is that the 'governance' exercised by lead firms (alternatively put, market power) is exercised on businesses in the chain that are *not part of the firm at all*.[50] Ironically, given the argument presented here, the other critiques levelled at the Porterian value chain concept in the Interim Report are to do with the fact that it is primarily adapted for use in respect of firms engaged in material production. The report proceeds to describe adaptations of the Porterian value chain concept from management literature which focuses on the business models of (broadly speaking) service providers and information economy actors, and digital economy business models are analysed in detail on the basis of those adaptations, but (being fundamentally inapposite to the task at hand) no conclusions are drawn from the discussion that actually resolve any of the indeterminacies that have plagued this workstream. On the vexed question of the role of data and user participation, Porterian models take a back seat and the report retreats into the fudge of observing that some countries think one thing and other countries think another.[51]

That approach then resurfaces when the Interim Report comes to discussing practical solutions. There is the group of countries who take the view articulated by the UK that the digital economy should be subject to a ring-fenced measure which allocates profitability based on user participation as a form of value creation, there is a group of countries which believes that the problem of taxing the digital economy is really a problem with fundamental tax norms which are made obvious by the digital economy but which are in fact endemic in the system. And there is a third group which believes nothing further need be done, or at most that the existing BEPS reforms should be allowed to bed down before anything further is done.[52] It is the second group that seems to have prevailed: the next step which the Interim Report promises is work reviewing those norms; namely nexus, and rules for allocating profits. The Interim Report makes clear that the second group does not even display a consensus within it as to its theory of value creation, and in hindsight it is easy to hear the

50 See chapter 6 section 6.4.
51 Ibid pp. 58-9.
52 Ibid pp. 171-2.

first death knell of the value creation principle in this call for fundamental norms to be revisited afresh.

In January of 2019 a short policy note was issued explaining that work had continued following the Interim Report, and that discussions within the Inclusive Framework had resulted in a way forward.[53] That way forward was presented as standing on two pillars. Pillar one was to consider 'several proposals […] that would allocate more taxing rights to market or user jurisdictions in situations where value is created by a business activity through participation in the user or market jurisdiction that is not recognised in the framework for allocating profits'. And so, without resolution to any of the theoretical difficulties encountered in the foregoing work, (and albeit only impliedly, insofar as that is the direction to which the practical proposals point) 'value creation' was to be understood as taking place downstream in global value chains. 'Some of the proposals', the note goes on to explain, 'would require reconsidering the current transfer pricing rules as they relate to non-routine returns, and other proposals would entail modifications potentially going beyond non-routine returns.'

The OECD is keen to prepare the ground for the fact that radical proposals are in train ('[i]n all cases, these proposals would lead to solutions that go beyond the arm's length principle') but in the very articulation of the problem as quoted in the foregoing paragraph, i.e. with the inclusion of the formulation 'non-routine returns', there is a radical departure. As we saw in chapter 7, commentators and consultation respondents have been happy to talk of routine and non-routine profits (since it is used all the time in transfer pricing practice) but the OECD in its BEPS output had up to this point been noticeably unenthusiastic about allowing the distinction to look like it was being formalised. This is no doubt for the reason elaborated upon in chapter 7 and revisited above i.e. it exposes the fundamental theoretical flaw in the entire concept of the arm's length principle whereby, if you assume that all the apparently productive activity within the firm takes place internally at competitive margins, additional profits earned by the outside-world-facing firm overall remain unaccounted for and can therefore be squirrelled away offshore. But as practical solutions overtake inadequately theorised characterisations of the problem, so practical characterisations of the problem appear to be taking over, and the role of the 'value creation' principle seemingly recedes. Perhaps even more tellingly, the second pillar involves policy proposal to which the 'value

[53] OECD, 'Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note', 23 January 2019b, https://web.archive.org/web/20190214124700/http://www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challenges-digitalisation.pdf (accessed 1 September 2020).

creation' principle is conceptually irrelevant. The proposal (broadly, a global minimum tax rate, modelled on a recently enacted US domestic tax measure) simply directly targets double non-taxation of profits, without engaging any of the conceptual conundrums that the 'value creation' principle has introduced to the topic of international corporate tax reform.

8.3.3 The February 2019 consultation document

Shortly afterwards, on 13 February 2019, a consultation document was published is pursuit of the agenda set out in the January policy note.[54] There was no sign in the consultation document of the Porterian value chain model, which seemed to have vanished as suddenly as it had appeared. In its place was the concept of 'residual' or 'non-routine' profits, which has been lurking in the background since the beginnings of the project in 2010 (as documented in chapter 7), but which is only now taking centre stage, being fundamental to two of the three proposals advanced in the consultation document in pursuit of pillar one. The proposals, we are told, 'have the same over-arching objective, which is to recognise, from different perspectives, value created by a business's activity or participation in user/market jurisdictions that is not recognised in the current framework for allocating profits.'[55]

Paragraph 13 of the consultation document crystallises the problem beautifully, in a manner which closely associates it with the ideas explored in chapter 7. The preceding paragraph had explained the nexus problem – i.e. MNEs making profits in a jurisdiction without any physical (and therefore taxable) presence, and the purpose of paragraph 13 is to explain why the profit allocation issue requires to be addressed as well:

> However, any solution that seeks to address nexus must also address the closely-related issue of profit allocation, or it is bound to fail – with likely increases in uncertainty and controversy without a meaningful increase in income allocation. This can easily be demonstrated by developments already taking place on the ground: in response to the BEPS package (including Action 7), some MNE groups with highly digitalised business models were able to establish local affiliates in market jurisdictions, especially in those jurisdictions constituting the businesses' larger markets. However, the local affiliates are commonly structured to have no ownership interest in intangible assets, not to perform DEMPE [development, enhancement,

[54] OECD, 'Base Erosion and Profit Shifting Project; Public Consultation Document; Addressing The Tax Challenges of The Digitalisation of The Economy', 13 February 2019c, https://web.archive.org/web/20190314154014/http://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf (accessed 1 September 2020).

[55] Ibid p. 8.

> maintenance, protection and exploitation] functions, and not to assume any risks related to such assets. Accordingly, only a modest return may be allocated to these "limited risk distributors," or LRDs. Thus, without effective changes to profit allocation rules, an MNE group may seek to sidestep the nexus issue by establishing local affiliates that are not entitled to an appropriate share of the group's profit.[56]

What appears to be going on here is actually quite simple. The 'bourgeois labour theory of value' – i.e. the compromise struck in relation to the problem of transfer pricing as described in chapter 7 whereby absorptive labour exerts a gravitational pull on profitability in excess of the aggregate of idealised competitive internal margins – does not bring *enough* of these MNEs' excess profits onshore, and the *assumption* is that the place where they should be brought onshore is market jurisdictions. (The alternatives, e.g. shareholder jurisdictions, or supplier jurisdictions, are no doubt too preposterous even to contemplate, because no reasons for excluding them are offered.)

The first of the three proposals, the 'user participation proposal',[57] is essentially the UK's proposal from March 2018. Notwithstanding the OECD's disinclination to ring-fence the digital economy, the proposal is to target specific business models where user participation leads to market power: social media, search, and online marketplaces are proffered as illustrations. The 'residual or non-routine' profits of MNEs adopting such models would be calculated – 'i.e. the profits that remain after routine activities have been allocated an arm's length return' – and a proportion of those profits would be allocated to jurisdictions based on a metric related to user participation. The rationale on which this proposal relies is that user participation gives rise to 'value creation', but the veil that the value creation rubric throws over what is essentially a bringing onshore to market jurisdictions of a tranche of the monopoly rents of Facebook, Google, Amazon &c is gossamer-thin. Indeed the proposal is nakedly to do with monopoly rents; the proposed metric for user participation is simply revenues!

The second of the three proposals, the 'marketing intangibles proposal'[58], is founded on (a) an acknowledgement that the work discussed in chapter 7 of this thesis was not enough to solve the problem it sought to address, and (b) a consequent framing whereby the solution to the digital economy taxation problem may be found in an *extension* of the principles

[56] Ibid.
[57] Ibid pp. 9-11.
[58] Ibid pp. 11-16.

deployed in that context. The idea is to carve out a tranche of non-routine profits referable to marketing intangibles and allocate them to market jurisdictions. 'The proposal', the consultation document explains, 'is intended to be consistent with the principle of allocating profit based on the value creation by firms in that [a] positive attitude in the minds of customers is created by, and the customer information and data is acquired through, the active intervention of the firm in the market.' Of course that active intervention is (as we saw in chapter 7) *already* supposed to give rise to allocation to the jurisdiction where the allegedly value-creating absorptive wage labour takes place that is associated with the intangibles in question, and so this rationale is not in fact explanatory of the proposal.

This second proposal therefore constitutes tacit admission that the 'bourgeois labour theory of value' cannot do the heavy lifting it was hoped it would do. The document goes on to explain that the problem is that profits associated with marketing intangibles can be shifted away by deploying only 'a relatively modest degree of decision-making capacity outside the market jurisdiction'. This is of course a consequence of treating labour that is merely causally implicated in profitability as quantitatively implicated in value creation: as with the loan-negotiating labour considered in chapter 7, the proportionality between the volume of labour and the profitability with which it may be associated is ultimately arbitrary, and it cannot be relied upon as a value-theortetical linkage between the two.

The third of the three proposals is the 'significant economic presence proposal'.[59] Only the vaguest gesture is made towards justifying this proposal on the basis of the 'value creation' norm. Essentially, it involves conferring nexus on a jurisdiction on the basis of a significant economic presence that doesn't require physical presence, and allocating profitability to that jurisdiction on the basis of a formulary apportionment of the MNE's global profits. The pillar two proposal,[60] likewise, is essentially unencumbered by any substantive claim to being founded in the 'value creation' principle, and will not be considered further here.

8.3.4 Responses to the consultation

The consultation responses form a truly vast body of observations on these proposals.[61] Unsurprisingly in view of the foregoing, though, very little of it framed itself in any

[59] Ibid pp. 16-17.
[60] Ibid pp. 24-29.
[61] The responses are available in a dropbox folder linked to from this page OECD 2019d, 'Public comments received on the possible solutions to the tax challenges of digitalisation', https://web.archive.org/web/20190310162103/http://www.oecd.org/tax/beps/public-comments-received-on-the-possible-solutions-to-the-tax-challenges-of-digitalisation.htm (accessed 1 September 2020).

meaningful way around the concept of value creation. The concept of course surfaces as shorthand for the BEPS compromise settled in 2015, insofar as the proposed reforms are departures from it: '[c]areful consideration should be given to major departures from existing principles', warn PwC, for example, 'and to their [...] consistency with the economic rationale (value creation) that forms the foundation of the current international tax regime'.[62] The consultation document, complained the American Petroleum Institute, 'seems to disregard the base premise for the BEPS project, which is to ensure taxation where value is created'.[63] '[T]he proposals under Pillar I', observe the Confederation of Finnish Industries, 'are not in line with aligning taxation with value creation approach adopted in the BEPS project'.[64] Other respondents, notably Ernst and Young,[65] simply make no mention of it.

Many respondents expressed concern that the reforms would be arbitrary and unevenly imposed among jurisdictions, and (as if to highlight the total vacuity of the value creation principle on a practical level in this context) pleaded for them to be founded on principle. (ICAEW, for example, 'believes that there need to be clear principles to underpin any new proposals'.[66]) A brave few persisted in articulating this plea under, rather than in spite of, the value creation rubric, for example Grant Thornton: 'we believe that the TFDE needs to provide greater detail regarding how to determine the underlying value that is created within the taxable base and how to identify who effectively creates the value'.[67] Many respondents thought it appropriate to signal their impression that the proposed reforms represented a substantive departure from the separate entity principle and arm's length principle Of course this charge had been levelled at the OECD throughout the BEPS process, since those principles were the underpinning of the pre-BEPS system, but the corporate sector seems by this stage to have persuaded itself that the compromise effected between the arm's length principle and the gravitational pull of 'value creation' in the sense elaborated in chapter 7 (i.e. Grinberg's 'bourgeois labour theory of value') did not ultimately represent a detatchment from that underpinning. In the context of these ubiquitous calls for a substitute principle, however, the charge seems to stick. 'Should the Inclusive Framework decide to move away

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62 PwC response to OECD consultation, 6 March 2019, available at the location linked to in footnote 61.

63 American Petroleum Institute response to OECD consultation, 6 March 2019, available at the location linked to in footnote 61.

64 Confederation of Finnish Industries response to OECD consultation, 6 March 2019, available at the location linked to in footnote 61.

65 Ernst and Young response to OECD consultation, 6 March 2019, available at the location linked to in footnote 61.

66 ICAEW response to OECD consultation, 6 March 2019, available at the location linked to in footnote 61.

67 Grant Thornton response to OECD consultation, 6 March 2019, available at the location linked to in footnote 61.

from the ALP and single entity approach,' submitted PwC, 'clear guidance will be required, preferably outlining a flexible and principles based approach, or a detailed and mechanical approach with the view of reducing uncertainty and complexity for all stakeholders'.[68]

As regards the specific proposals, the 'user participation' proposal and the 'significant economic presence' proposal were both deeply unpopular. In the case of the latter proposal, it was almost universally rejected out of hand as being back-door formulary apportionment, which had already been rejected by the OECD at the outset of the BEPS process. Indeed perhaps the most meaningful use of the value creation concept in the entire body of responses was the argument that, whatever the value creation principle means, formulary apportionment runs counter to it. As regards the 'user participation' proposal, only a handful of respondents were persuaded by the idea of ring-fencing the digital economy. UK-based AstraZeneca, with a vast intangibles portfolio and negligible user participation, was one,[69] but most respondents considered that the integration of digitalised business practices with more traditional sectors made the distinction – and therefore the 'user participation'-based reform trajectory – impossible. 'We do not believe that the concept of user participation is able to deliver the clear-cut boundary necessary to define the scope of this approach', wrote the Swiss Business Federation, for example.[70] In many instances the objection was also articulated in such a way as to expressly pour scorn on the idea that the value creation principle was meaningful in this context; as was the case with the submission of the Digital Economy Group:

> We are troubled that the Consultation Document seems to adopt the approach of speaking about value creation so as to deemphasize value creation by the enterprise, for example when it refers to "value generated by user participation". This form of expression obscures the hard questions: Who exactly is the relevant value creator for purposes of corporate income taxation? At what physical location does that person actually create whatever value is created through user interaction? What exactly about interacting with users is the value-creating activity? Finally, once those questions are sorted out, how do the answers justify a changed nexus rule for cross-border transactions? And why shouldn't that justification apply to all remote sales of goods and services rather than be limited to only a particular sector (and a subset of

[68] PwC response to OECD consultation, 6 March 2019, available at the location linked to in footnote 61.
[69] AstraZeneca response to OECD consultation, 1 March 2019, available at the location linked to in footnote 61.
[70] Swiss Business Federation response to OECD consultation, 6 March 2019, available at the location linked to in footnote 61.

that sector, for good measure)?[71]

Inevitably, then, the 'marketing intangibles' emerged as the least worst option by default. Seemingly respondents saw in it an opportunity to produce a fresh terrain of compromise between capital and the state, perhaps in the form of further concessions to the bourgeois labour theory of value. 'People-based functions (including those related to the control and decision-making around risks and the development of assets) carried out by employees of a business remain an important driver of business value,' explain Deloitte, for example, 'and the locations where activities are performed (including research and development and sales and marketing) must continue to receive an appropriate reward under any new proposal.'[72] The idea is encapsulated by the Digital Ecoomy Group, who suggest that the reforms should 'bend' but not 'break'[73] the arm's length principle.

Indeed there appears to have been some hope that the principle would not really have to bend very far: '[i]n most interactions,' suggest PwC, 'the [arm's length principle] produces outcomes that are acceptable to businesses and governments, but there does need to be change if countries agree that they want to recalibrate or fine tune where profit should be considered to arise for corporate tax purposes.' 'It will be important to recognize', explain KPMG, 'that residual profit is derived from a variety of activities, and that the share attributable to marketing intangibles may be a relatively modest amount of the total residual profit'.

What is particularly fascinating about this point, as taken by KPMG, is the apparent acceptance of the overall presupposition of the entire 'BEPS 2.0' process, which is that there exists a bundle of untaxed surplus profitability over and above the aggregate of competitive internal margins which is available for reallocation. Not all the respondents accepted this premise: for example the Confederation of Swedish Enterprise (alongside other Scandinavian bodies and firms) argued that the reallocation to market jurisdictions 'would essentially mean an arbitrary shift of taxable income from smaller net exporting countries with high levels of R&D-activities and associated entrepreneurial risk taking to larger net importing jurisdictions with large consumer bases', but generally among respondents there was remarkably little push-back against the idea that the residual profitability being targeted by these proposed

71 Digital Economy Group response to OECD consultation, 6 March 2019, available at the location linked to in footnote 61.

72 Deloitte response to OECD consultation, 6 March 2019, available at the location linked to in footnote 61.

73 Digital Economy Group response to OECD consultation, 6 March 2019, available at the location linked to in footnote 61.

reforms was out there. It is as if we have almost (i.e. not expressly) come full circle back to the point where we began in 2010 with PwC innocently suggesting that ‘it would be helpful if [the OECD working party] considered the issue of economic rent and, in particular, consider whether it would be appropriate to set out some of the principles involved.’[74] By a circuitous route the OECD has in effect considered that issue, and the answer seems to be that at least some of it should be allocated to the markets out of which the rent is realised.

What is absent, of course, as already observed, is the underlying principle on the basis of which to send it in the direction of the market jurisdiction, and it is in the resulting void that the BEPS process comes face to face with not just its own value-theoretical shortcomings but the shortcomings of marginalism more generally. ‘We believe that there is no principled basis for the notion that an enterprise creates value at any place other than where it deploys its personnel, invests in and manages its assets, and bears and manages its risks.’ Explain the Digital Economy Group. ‘What is it about a “market” that justifies the allocation of more profit to that jurisdiction?’[75] ‘What is the appropriate balance between the reward to innovation (R&D, entrepreneurial risk-taking, etc.)’, ask OECD’s Business and Industry Advisory Committee, ‘and the reward to the destination/market? And, in particular, what does economic theory and practice tell us about that?’[76]

These questions recall the proposition encountered in Chapter 1 where tax scholars Michael Devereux and John Vella posited (in 2018, and apparently not wholly seriously) that the doctrine of allocating profits in accordance with the location of value creation would imply, if understood in the context of modern marginalist value theory, that allocation should be split between the location of supply and the location of demand. And indeed one respondent to the consultation went there, saying that ‘the tax base for income tax or corporate tax is constituted not by value addition undertaken within the supply chain, but by profits of business enterprises. Such profits are generated by the excess of sales revenue over costs, and are accordingly contributed by both demand and supply. Thus, [we consider] it essential to take both demand and supply side factors into account in any measure aimed at allocation of profits.’ (That one respondent was the G-24, representing around 44% of the population of the world![77] The proposition seems to have been an *ad hoc* one in this context, however, and

[74] See Chapter 7 footnote 24.
[75] Digital Economy Group response to OECD consultation, 6 March 2019, available at the location linked to in footnote 61.
[76] BIAC response to OECD consultation, 6 March 2019, available at the location linked to in footnote 61.
[77] Intergovernmental Group of Twenty-Four response to OECD consultation, available at the location linked to in footnote 61.

does not form part of a consistent theoretical position adopted on behalf of major Global South economies.)

8.3.5 The May 2019 Programme of Work and the end of the value creation principle

It is interesting to recall at this point the contrast drawn in chapter 2 between the case of *Golden Horse Shoe (New), Ltd v Thurgood* and the case of *IRC v Aken*. In the former case, mine tailings were found to embody value even though subjectively they were a waste product because objectively they proceeded from production to exchange, whereas in the latter case the transactions over the sex worker's services were found to fall within the ambit of the tax because, on a subjective level, they were treated by their participants as market transactions. The conclusion to that chapter was that the charge to tax on business profits, at least according to UK tax jurisprudence, was in fact two distinct charges to tax; one on value created by the taxpayer through *material* production, and another on value captured from elsewhere in the economy, via the market.

And so UK tax judges have in effect already considered this question of how to analyse the boundary between profitability to attribute to activities within the firm and profitability to attribute to the market; they (like Marx, as we saw in chapters 3 and 4) consider that the boundary between value creation and value capture lies around material production. And this conclusion is consistent with the dominant sense among the consultation respondents that the profits of the digital economy cannot be ring-fenced; the operations of modern businesses all comprehend at least a certain amount of (as it were) immaterial 'production'. No one is merely a producer of material commodities – everyone has design, branding, marketing &c. Value capture penetrates every firm's Porterian 'chain' of value creation.

'There is no inherent economic difference in how an enterprise goes about creating value in its business by investing in its product and in its customers', offer the Digital Economy Group; '[i]n both cases, companies take risks and make investments in order to develop superior products and to build market presence.' They mean to bring investment in market position within the ambit of what is considered productive but, ironically, Marx would agree that there is no difference. Recalling the analogy of the match and the fire from chapter 4, which distinguishes *causes* of value being realised in exchange from that which actually *creates* value, both investment in product development and investment in market position are in the match category: *neither* creates value. By the same token the analysis of the vast profits in the digital economy as economic rent in excess of what the aggregate of its

functions should earn in the market (as inferred above) is ultimately inadequate. As the International Bar Association asked in its consultation response, 'What are the routine activities in digital businesses?'[78] *All* of, say, Facebook's revenues represent value capture. Ultimately, the fact that it has to have actual operations in order to effect that value capture is neither here nor there. There is no immaterial production. Only material production and value capture.

On this analysis the problem that the BEPS process had been running up against is a simple contradiction. On one limb of the contradiction, there is the fact that the taxation of corporate profits involves the taxation of both value creation and value capture, and so there is nothing in the principles of the tax that enable a distinction between the two (unless one looks very closely indeed, as to which see chapter 2). This elision between value creation and value capture is exacerbated by the fact that value capture can involve the deployment of resources within the firm – notably (as we saw in chapter 7) labour, which can generally be quite clearly located. And on the other limb of the contradiction, there is the fact that the mechanism *through* which value capture is achieved – the market – is (as the vast majority of the responses to the February 2019 consultation considered in this chapter demonstrate) quite obviously not a location of value creation in any meaningful sense.

The solution to this contradiction which was adopted by the OECD was essentially to abandon the value creation principle altogether. The process discussed in this chapter continues, but from the perspective of the story of value creation it ends with the subsequent document, published in May 2019: the OECD's 'Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy'.[79] In terms of the substantive outcome what the 'Programme of Work' does is observe that the three suggestions it ventilated in the consultation document have features in common (i.e. nexus without physical presence, and allocation of profitability to market jurisdictions), and the next steps will involve building consensus around those common features. What it does *not* do is characterise that further work as being entered into in pursuit of the principle of allocating profitability to where value is created.

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[78] International Bar Assocation response to OECD consultation, 6 March 2019, available at the location linked to in footnote 61.

[79] Available at OECD 2019e https://web.archive.org/web/20190531212946/http://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.pdf (accessed 1 September 2020).

8.4 Conclusion

In chapter 7 we saw that the arm's length principle is inherently liable to create residual profits accumulating in the kinds of spaces theorised in chapter 5 i.e. offshore spaces. Further, in chapter 7, we saw that the OECD's initial response to the crisis this phenomenon was creating for tax states globally (as to which see chapter 6) was to allocate (at least to an extent) the residual profitability to labour implicated in value capture. In this chapter we saw how this response was found to be inadequate, and the further response was to allocate profitability to the markets in which value capture takes place. This effects a rupture in the principle whereby only activities within the firm are treated as generating the profits on which corporate income tax bites, giving taxing rights to jurisdictions outside the boundary of the firm. Crucially, however, that rupture is only in respect of consumer markets; there is no rupture of the boundary between the firm and the sphere of production. While allocation downstream in the global value chain is possible, allocation upstream continues to be impossible.

This is clearly a domestic political matter for certain states. '[T]he spread of remote sales models due to digitalisation', recognised the Digital Economy Group, 'has created political tension in certain market jurisdictions over the existing international allocation of the right to tax business profits.'[80] But it is also a matter as between states, globally. In its response to the February 2019 consultation, the World Bank observed that 'while some of the jurisdictions we work with [i.e. 'developing' economies] represent significant markets in their own right, and markets that are increasingly digital, their value by comparison to developed markets is going to be smaller because their consumers have less purchasing power. Moreover, activity at the other end of the value chain, production of raw materials and manufacture, is a proportionately more significant part of their economies.'[81]

The geopolitics of the matter is for scholars of international political economy, international relations &c, but a core contribution of this thesis is to offer to place those geopolitics (i) in the context of the structural relations described in Part II of this thesis, by reference to (ii) the value-theoretical distinction adumbrated in Part I: put simply the state may be encroaching upon corporate capital's untaxed surplus by means of corporate tax reforms, but it is doing so in a way that perpetuates inequalities between states, by retaining the allocation of the tax

[80] Digital Economy Group response to OECD consultation, 6 March 2019, available at the location linked to in footnote 61.

[81] World Bank response to OECD consultation, February 2019, available at the location linked to in footnote 61.

base predominantly outside the classical production boundary. Pre-BEPS it was to be found to a great extent offshore, which is outside everyone's production boundary; BEPS brought some of it onshore by reference to absorptive labour, and BEPS 2.0 proposes to bring more of it onshore by reference to value absorption in the sphere of consumption. And the story of this trajectory may, as it is hoped Part III of this thesis demonstrates, be told through the rise and fall of the concept of 'value creation' in the relevant technocratic discourse. In chapter 7 we saw that 'value creation' came to mean absorptive labour implicated in value capture, and in this chapter we have seen the OECD swerve between postoperaism, Michael Porter's value chain, and a kind of metaphorical deployment of the language of marginalism to non-monetary transactions, while the representatives of capital have advanced a seemingly pre-classical mercantilist conception of value. No-one has entertained the possibility that Smith, Ricardo and Marx might have been right to locate 'value creation' where the production takes place of those things – material commodities – the quantity of which as at exchange is constrained by the prior allocation of resources.

Chapter 9: Conclusions

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9.1 What is happening here? Why? What is to be done?

Even in formal value-theoretical contexts there is something seemingly centrifugal about the idea of 'value creation'. If one were to begin with the basic classical notion that value is created where material production takes place, one would find that over the years political economists have displayed a tendency to seek to include a diversity of other activities within the boundary of what is 'value creating'. As we saw in chapter 6 there exists a tendency among certain progressively-minded mainstream economists to point to the 'value creating' role of the state. And as we saw in chapter 4 there exists a tendency within certain strands of Marxism – specifically postoperaism and heterodox Marxist feminism – to classify as value creating (respectively) consumer activity and unwaged domestic labour. At the same time both mainstream marginalism and the value-form school of Marxism (not to mention, recalling chapter 2, those who frame and apply tax laws) seek to bring within the scope of what is 'value creating' anything that gives rise to the subjective value implicit in a commercial sale whether or not an objective act of production as classically understood stands behind it.

So who among them is right? Are they *all* right? Can *anything* constitute value creation? It should be recalled that this centrifugal property of the idea of 'value creation' is prefigured by the very introduction of the classical model of value, which extended a prior idea of what was 'value creating' from agricultural production to all material production.[1] Indeed in her recent popular book on the evolution of value theory, prominent economist Mariana Mazzucato argues that the question of what is 'value creating' is nothing more than a choice.[2] Was it perfectly coherent therefore, for the OECD to suggest that consumer activity in markets

[1] The story of the evolution of the idea from the French 'physiocrat' school is told in Marx, 1969.
[2] Mazzucato, 2018.

constitutes value creation (as to which see chapter 8), but not the formal role played by tax haven entities in tax-advantaged corporate structures (as to which see chapter 1)? Is 'value creation' (as the tax commentators whose views we canvassed in chapter 1 conclude) simply too vague and flexible a concept to be objectively applied?

This thesis argues that all these diverse extensions of the production boundary that may be found in the value-theoretical literature are misconceived. Upon interrogation, these positions extend the idea of value creation to include things that are merely *causally* connected to profitability. Value by contrast is of its very nature something which arises in specific *quantities*, and it is to the objectively determinate sources of value as something specifically *quantifiable* (rather than its mere causes) that we must look in order to see where it is created. Further, those sources may on a structural (and indeed geographical) level be far removed from where the resulting profitability arises (as to which see chapter 6). That being the case (and provided that it is properly and fully theorised, as to which see chapters 3 and 4), the classical notion that value is created where material production takes place is sufficient after all to provide an account of value creation. And so rather than straining to include such topics as may concern us *within* the production boundary, we should accept that those topics may to a large (or, in some cases, exclusive) extent pertain to the realm of absorption that lies outside it.

If instead we succumb to the centrifugal pull of the concept of 'value creation', and include other activities within the production boundary, we risk overlooking one of the most fundamental structural features of capitalism today: the fact that the labour which goes into *creating* the value absorbed in that realm of absorption is disproportionately cheap and disproportionately concentrated in low-income countries. (This is not to say that the fact that material production tends to benefit from cheap labour in low-income countries goes overlooked; it does not. The claim here is specifically that it risks being overlooked as a *structural* feature. The labour in question is not an arbitrary category of labour which just happens to be disproportionately cheap and disproportionately concentrated in low-income countries; it is specifically *the very labour that is value creating*.)

Certain fiscal implications of this were discussed in chapter 6. There we saw how the fiscal antagonism between capital and the state may be characterised as being specifically over how value absorption is to be apportioned between them, and further we saw that the playing out of the consequent dynamic in practice externalises to low-income countries the brunt of the

adverse impact of that global fiscal antagonism. At the end of that chapter it was suggested that some relief from the consequent self-reproducing inequality between states would follow from placing improved fiscal resources in the hands of those states where value creation in the classical sense takes place. And yet at no stage in any of the discussions we have been investigating in Part III of this thesis (or in related multilateral discussions around international corporate tax policy) did any of the participants suggest adopting a theory of value (such as the classical one adopted in this thesis) which would result in the 'value creation' mantra having that effect. And this despite the inoperability of mainstream marginalism in this context and the flirtations with a diversity of (in some instances wildly heterodox) value-theoretical positions.

It might be said that it is impossible within the constraints of existing international corporate tax norms to allocate taxing rights upstream in global value chains to where the value (as classically understood) is created, because (as discussed in chapters 6 and 7) to a large extent that value is not created within the MNE group where the taxable profitability accrues. But as we saw in chapter 8, the participants of the discussions in question have shown themselves perfectly able to countenance the allocation of taxing rights *downstream* in global value chains to the market jurisdictions where it is absorbed. So why not upstream? Or, to put it another way, why may sales *into* a jurisdiction constitute an economic presence, but not purchases *from* a jurisdiction? Why may these norms bend in one direction but not the other? Why, since the state is encroaching upon global corporate capital's untaxed surplus by means of international corporate tax reforms, must it do so in a way that (a) retains the allocation of the tax base predominantly outside the classical production boundary, and thereby (b) perpetuates inequality between states?

This thesis does not serve to answer that question; the bare fact that that is what is going on (as elaborated upon in chapters 7 and 8) constitutes this thesis's conclusion as regards the research questions posed in chapter 1. But it is tempting to speculate in the context of these concluding thoughts as to the answer to that question of *why.* I would suggest that the answer is that the international norms and institutions that effect distribution of revenues between states have imperial domination baked hard into them. We saw this illustrated in chapter 5. The imperialist ideology giving rise to the structural asymmetries in the international system is so deeply embedded that the questions that expose that ideology to view – why do the courts of one state recognise the legal personality of companies constituted in another? why

may sales into a jurisdiction constitute an economic presence, but not purchases from a jurisdiction? – do not even seem to get asked. And even if the questions do get asked, any alternative norms and propositions that might offer serious resistance to the structural asymmetries at play here (whether those norms and propositions be fiscal, juridical or value-theoretical) generally strike the liberal technocratic minds of the global economic core as so obviously erroneous as to be undeserving of serious engagement.

I have considered elsewhere what that serious engagement might look like on a practical policy level if it took place in the context of international corporate tax reform, offering the suggestion of 'unitary taxation by formulary apportionment of the entire value chain'.[3] In summary, this means collecting tax from MNEs based on group profits and then allocating the tax between the jurisdictions in which they have an economic presence in accordance with a formula but (in contrast to the existing proposal, discussed in chapter 7, of unitary taxation by formulary apportionment) including for these purposes jurisdictions upstream in the MNE's value chains. Obviously even with such a system in place the apportionment factors could be stacked in favour of rich countries (e.g. by placing emphasis on sales and payroll as opposed to headcount and tangible assets). But, with an equitable formula, unitary taxation by formulary apportionment of the entire value chain should mean fiscal transfers from high-income countries to low-income countries.

9.2 The international fiscal sociology of value absorption revisited

That observation could constitute the terminus of the discussion in this thesis, but I would like to draw attention to another more general conversation that this thesis might usefully prompt, in addition to the question of policy implications. To this end I will pick up some themes to which attention has already been drawn in chapter 6, so as to develop further what an international fiscal sociology might look like more generally, now that the framing developed in that chapter has been tested against research materials in the chapters which followed. It was observed above that, absent a classical perspective on value, we risk overlooking the fundamental structural feature of capitalism today whereby the labour which goes into material production is disproportionately cheap in comparison with the economic scale of corporate sector absorption. It is that point (illustrated in chapter 6 by the smile curve) which is to be elaborated upon from the perspective of international fiscal sociology in this further concluding section.

[3] Quentin, 2017.

It was noted in chapter 6 that the smile curve is *deepening*, which means that these phenomena identified as structural are also apparently *tendential*. An underlying theme of chapter 6 was the reconnecting of fiscal sociology to its Marxian roots, and much Marxian analysis is concerned with this topic of tendencies. It is the specifically tendential nature of the structural features to which attention is drawn here that this section will address.

Structural tendencies within capitalism are often viewed as deriving from the fundamental conflict Marx identified between the relations of ownership and control under capitalism and the productive forces it unleashes. It is from the contradictions inherent in the dynamic arising from that conflict that unfolds capitalism's central structural antagonism; the antagonism that subsists between capital and labour. This antagonism further unfolds, in traditional Marxian analysis, into class conflict, and various other contradictions that Marxist scholars are inclined to identify. These contradictions proliferate because capitalism as understood by Marxists is at the same time compelled towards crisis by its own core internal contradictions, and also constantly revolutionising itself so as to seek to stave off crisis by means of countervailing tendencies. Capitalism is therefore understood as lurching from crisis to crisis, with each new lurch reflecting a reconfigured system and each new crisis different from the last – a crisis not so much of the system as a whole but of whatever countervailing tendency was driving the lurch.

A classic illustration might be imperialism of the traditional territorial variety, which reached its crisis with the First World War. Another is the financialisation of the neoliberal era, which of course reached its crisis in 2008. To be clear, these kinds of tendential phenomena are *not* to be understood as discrete temporary components of a system which, between its intermittent reconfigurations at specific junctures of crisis, behaves in a deterministic fashion. This would be to mistake their role in the analysis. They are a way for us who observe it to make some kind of sense of a system which is unceasingly chaotic in its behaviour but which nonetheless displays discernible trajectories punctuated by sharp changes of direction.[4]

Identifiable countervailing tendencies do not necessarily determine the nature of the forthcoming crisis; multiple such tendencies might be in operation and it just depends which one hits the buffers first. One tendency which was observed in the 1960s and 1970s, but which did not seem to have driven the crisis of the mid 1970s, and so has not been much

[4] Anwar Shaikh articulates this by distinguishing equilibrium 'as an achieved state' from what Marxists discern in capitalism *i.e.* 'turbulent equilibriation'; in the latter case 'exact balance is a transient phenomenon because any given variable constantly overshoots and undershoots its gravitational center.' 2016, p. 104.

commented upon since, was the tendency for capital to spend greater and greater amounts of money on 'unproductive' (*i.e.* absorptive) labour. A major strand of observation along these lines was known as the 'monopoly capitalism' school, of which the founding text is the 1966 book of that name by Paul Baran and Paul Sweezey.[5] The picture painted by Baran and Sweezey is of a world in which oligopolies emerge in markets where the largest players preserve their excessive profits by choosing not to compete on price, instead investing increasing amounts of capital on operations such as marketing, advertising, branding and product design, in order to compete with each other in other ways. Baran and Sweezy focused on the national economy of the US, and on players which generally owned means of production within the group, but there is a clear commonality with the deepening smile curve identified in chapter 6: in both instances there is a tendency for the absorptive elements of corporate sector activity to assume greater and greater economic significance.

Underlying the monopoly capitalism outlook is a perception which is sometimes framed in terms of the idea that capitalism has a tendency towards overproduction and underconsumption, and that tendency is counteracted by a tendency to fund increasing consumption on the part of absorptive labour.[6] This 'underconsumptionist' position is considered by some to be heretical, not least because Marx himself seems to have expressly rejected it,[7] but for present purposes the theoretical debates around these issues[8] are somewhat beside the point. The fact is that *empirically* there exists (so the deepening smile curve tells us) a tendency for absorptive labour to be implicated to a greater and greater extent in profitability, with the consequence that it attracts a greater and greater share of capitalist wage spend. And in principle such a tendency should suppress material production without suppressing demand.

The reason that such a tendency would help capital stave off crisis is perhaps easiest to conceptualise if one revisits Schumpeter's prediction mentioned in the introduction to chapter 6. Schumpeter suggests, it will be recalled, that the productive forces unleashed by privately-owned capital will create such abundance that capitalist relations as we know them will be

5 1966.

6 Olsen, 2017 p. 129; for greater detail see chapters 4 & 5 of Foster, 2014; for a related but contrasting approach see E. N. Wolff, *Growth, Accumulation and Unproductive Activity*, Cambridge, Cambridge University Press, 1987.

7 'It is a pure tautology to say that crises are provoked by a lack of effective demand or effective consumption': Marx, 1978, p. 486; for more extensive critique see for example D. Yaffe, 'The Marxian Theory of Crisis, Capital and the State', *Bulletin of the Conference of Socialist Economists*, Winter, 1972, pp. 5-58.

8 For an overview see M. F. Bleaney, *Underconsumption Theories*, New York, International Publishers, 1976.

rendered obsolete. On the face of it this may seem plausible enough (if somewhat optimistic) as a long-term prognostication, but it suffers from a fatal paradox, which may be approached by considering that final generation of capital, so limitlessly productive of the material things that people want and need, that it abolishes the need for people to get jobs and the need for capital to be owned. The question is, who would invest in it? The investment would be a complete waste of money – a gift to society that would end profitability altogether. And if that investment is never going to happen because no capitalist would make a self-obliterating investment, why would the previous generation of investment (made in anticipation of its demands) take place, and so on. Viewed from the perspective of this paradox, the productive forces of capitalism appear to be driving it towards an outcome that its relations of ownership and control shy away from. And one way out of the contradiction is for a greater and greater proportion of investment to be spent on absorptive labour, suppressing material production without suppressing demand.

At this point in the analysis fiscal sociology swings right back into the frame, for the simple reason that states are (given adequate fiscal resources) extremely dependable employers of absorptive labour. And so an increasing tax take can in principle serve the same crisis-averting purpose as modern capitalism's vast and seemingly ever-increasing spend on marketers, administrative assistants, advertisers, designers, consultants, call-centre workers, bankers, programmers, managers &c (not to mention the cleaners who clean their offices). But for the reasons that it is the very stuff of fiscal sociology to identify, states are hampered in their ability to perform this crisis-averting role by capital's own aversion to seeing its revenues expropriated. It is (at least in part) for this reason that, alongside the development of the 'monopoly capitalism' theory, the final years of post-war growth preceding the crisis of the mid-1970s saw a revival of the fiscal sociology framing, exploring from a number of diverse (but on the whole broadly Marxian) perspectives the fiscal contradictions of the state under the capitalism of the specific oligopoly-oriented variety that prevailed in the wealthy states of the global north at that time.[9]

It is in a similar vein that I would suggest viewing the contestation between capital and the state over the extent to which the state rather than capital gets to determine what kinds of absorption are funded out of capitalist surplus. On the one hand it would be good for

[9] J. O'Connor, *The Fiscal Crisis of the State*, New York, St Martin's Press, 1973; I. Gough., 'State Expenditure in Advanced Capitalism', *New Left Review*, vol. 92, July-August, 1975, pp. 53-92; D. Foley, 'State Expenditure from a Marxist Perspective', *Journal of Public Economics*, April, 1978 pp. 221-38; B. Fine and L. Harris, 'State Expenditure in Advanced Capitalism: a critique', *New Left Review*, vol. 98, July-August, 1976, pp. 97-112. There is a helpful survey in Musgrave, 1980. See also chapter 6 of Foster, 2014.

capitalism to have its material productivity suppressed by means of huge absorptions of revenue through the agency of the state, but on the other hand individual capitals like to hog their own revenues (the realisation of revenues being the point of their existence). From this latter predilection follows capital's preference for performing the necessary absorption through the pouring of increasing spend into the horns of the smile curve rather than through enthusiastic participation in corporate tax regimes the world over.

This implications of this are profound. What it suggests is that there is a truly vast latent capacity within the system for funding state expenditure without any diminution of corporate sector productivity, and that that capacity is tendentially *increasing*. In the 1970s, at a time when state expenditure was very conspicuously being deployed on weapons technology so excessively powerful that it was unthinkable that it might be put to use, and on repeated expeditions into the sterile vacuum of space, the idea of value absorption by the state being any less futile than value absorption by the corporate sector might have appeared questionable. Today, however, we are living in a world of deliberately and savagely suppressed public investment on almost all fronts (i.e. from public health all the way through to space exploration), and (recalling discussion of this topic in chapter 6) we have the benefit of further decades of evolution in feminist theory of the state, gender budgeting, and other frameworks for directing public spending towards socially useful and equitable purposes.

That being the case, it is here suggested that we revive the discussion about the tendentially increasing capacity (and indeed *need*) of the system to absorb value, and build a progressive international fiscal sociology around that discussion; a fiscal sociology which (in place of its foundational Schumpeterian eschatology) advocates for tendentially increasing proportion of capitalist surplus to be placed equitably in the hands of states, to be absorbed by such spending targets as relief from the intertwined burdens of risk and unwaged labour in the sphere of social reproduction.

As already noted there exists a habit of mind among some who advocate placing greater fiscal resources in the hands of states to seek to portray the state as productive, on the assumption that the *production* of value will be understood to be a good thing. The argument being advocated for here, by contrast, is one where instead we recognise the state as (alongside much corporate sector activity) primarily absorptive of value. And fiscal sociology is as good a discipline as any from which to explain why in fact it is the *absorption* of value, rather than the production of value, that is (potentially, depending on how it is done)

a good thing. This is not because it is a good thing to preserve capitalism from crisis *per se*, as if capitalism were something worth preserving, but because capitalist crisis only serves to violently reconfigure the routes by which capitalism – value creating more of itself – causes harm. Much better to steadily and progressively *tax value out of existence altogether*, if we possibly can, leaving only the thermodynamic depth of the means of producing the things we want and need. And at this juncture of ecocide, the thermodynamic depth of the means of producing the things we want and need is something that we as a species might do well to take collective control of.

9.3 Summary of conclusions

This final section summarises the key conclusions drawn over the course of the thesis, notes the areas where it makes a contribution, acknowledges omissions, and indicates further research possibilities.

The thesis began by recognising the need for a production boundary in order to approach the meaning of 'value creation' in the context of recent discourse around international corporate tax reform. This was on the basis of the general consensus that, whatever 'value creation' might mean as positively understood, it *excluded* the formal activities of artificial offshore entities.

9.3.1 Part I (Value)

Part I investigated where such a boundary is to be drawn if it is to be drawn objectively, and found that the answer is that it is to be drawn around material production, irrespective of where the value thereby created may end up as profitability.

In arriving at that conclusion, Part I offered (in chapter 2) an original analysis of the charge to tax on trading profits in UK tax law, showing that, rather than 'trading' being a single nebulous body of activities, it is two overlapping bodies of activity, one being a nebulously defined set of circumstances where the receipts in question are pursued with a sufficient degree of subjective commerciality, and the other being the circumstances where the receipts in question arise from acts which are within the aforementioned objective production boundary. In addition (in chapter 3), Part I offered an original contribution to discussion within the the much contested classical tradition of political economy as to how that boundary is to be determined, showing that while value is realised at the point of exchange, there is nonetheless an ontological distinctness to material production processes insofar as

they increase the thermodynamic depth of the system (as opposed to merely adjusting the conversion factor between thermodynamic depth and value). Chapter 4 elaborated upon these theoretical conclusions, developing the concept of 'absorptive labour', i.e. labour which is outside the production boundary and which therefore absorbs rather than creates value.

9.3.2 Part II (Global Corporate Capital and the State)

Part II served as a bridge between the value-theoretical discussion in Part I and its application in Part III to the fiscal sociology of international corporate tax reform. It began in chapter 5 with an original contribution to discussion regarding the ontology of offshore. The chapter identified two mutually antagonistic sovereign property regimes; the state and the company, with offshore shown to be the juridical space where profits accrue to the extent that the company succeeds in its contestation with the state over revenues.

That antagonism is not immediately susceptible to analysis using the existing tools of fiscal sociology, since fiscal sociology has hitherto primarily been to do with fiscal antagonism between states and specifically *domestic* capital. Chapter 6 therefore proceeded to elaborate upon fiscal sociology so as to make it applicable globally to a contestation over revenues between states generally and corporate capital generally (i.e. the two property regimes identified in chapter 5). It showed that the salient sub-formation when considering the role of corporate capital in its global contestation over revenues with the state is not the multinational enterprise but the global value chain or chains in which the enterprise participates. This is because the profitability of multinational enterprises ('MNEs') represents at least in part value captured from global value chains by means of intangible assets through the exercise of monopoly power. From the pattern of behaviour displayed by value in that context (i.e. the 'smile curve') it was concluded that the global contestation over revenues between capital and the state is a contestation over the extent to which value absorption will be funded through each sector.

The dynamic of the global value chain when considered from the perspective of fiscal sociology constitutes a nexus of inequalities, but the particular inequality to which attention was drawn in chapter 6 (picking up the theme of imperial domination established in the conclusions of chapter 5) was inequality between states. A further conclusion in chapter 6 was that the channelling of surplus output into corporate sector absorptive labour serves the purpose of externalising to low-income countries the brunt of the adverse impact of the global fiscal antagonism between capital and the state.

9.3.3 Part III (International Corporate Tax Reform)

Part III considered specific elements of international corporate tax reform discourse over the last decade in the context of the conclusions arrived at in Parts I and II. Chapter 7 showed that the arm's length principle is inherently liable to create residual profits accumulating in the kinds of spaces theorised in chapter 5 (i.e. offshore spaces). Further, chapter 7 showed that the OECD's initial response to the crisis this phenomenon was creating for tax states globally was to allocate the residual profitability (at least to an extent) to the absorptive labour implicated in value capture. In chapter 8 we saw how this response was found to be inadequate, and the further response was to allocate profitability to the markets in which value capture takes place (i.e. to absorptive processes more generally). This effected a rupture in the principle whereby only activities within the firm are treated as generating the profits on which corporate income tax bites, giving taxing rights to jurisdictions outside the boundary of the firm. Crucially, however, that rupture is only in respect of consumer markets; there is no rupture of the boundary between the firm and the sphere of activities within the production boundary. While allocation downstream in the global value chain is now possible, Chapter 8 concluded that allocation upstream continues to be politically impossible.

The broader conclusion is therefore that the state may be encroaching upon corporate capital's untaxed surplus by means of corporate tax reforms, but it is doing so in a way that perpetuates inequalities between states, by retaining the allocation of the tax base predominantly outside the production boundary. Pre-BEPS it was to be found to a great extent offshore, BEPS brought some of it onshore by reference to absorptive labour, and BEPS 2.0 proposes to bring more of it onshore by reference to value absorption in the sphere of consumption. But none of these reforms even contemplates allocating the corporate tax base to where value is actually, objectively, created i.e. predominantly outside the jurisdictions of the global economic core.

9.3.4 *Contributions, omissions, and further possibilities for related research*

The bodies of literature to which this thesis makes a substantive contribution are therefore the literatures on the following topics: (i) tax law doctrine vis-à-vis the ontology of trading profits, (ii) the role of material production, or alternatively the distinction between 'productive' and 'unproductive' labour, in classical value theory, (iii) the nature of offshore both as a juridical and as a geopolitical phenomenon, (iv) the nature and scope of fiscal

sociology as a discipline, (v) the role of intangibles in global production networks, (vi) the role of the tax state in global capitalism, (vii) the meaning of 'value creation' in international corporate tax reform discourse and (viii), relatedly, the political economy of the BEPS process.

Inevitably in an interdisciplinary project of this scope there are omissions and shortcomings, and in particular it should be conceded that Part II offered very much a skeletal rather than fully-fleshed-out linkage between the value theory in Part I and the consideration of the BEPS process in Part III. In part this is because an overtly Marxian branch of modern tax scholarship does not really exist. Chapter 6 could therefore only point to what the broader concerns of that branch of scholarship might be if it existed, so as to situate the argument in this thesis in a set of at-the-very-least-tangentially-related literatures. Each of the moving parts in that chapter could have formed an entire chapter in a much-expanded exploration of what such a body of scholarship might look like. By the same token it is unfortunate that, since Marxian value theory of the classically materialist kind is today not widely taken seriously as a tool of analysis, a disproportionate amount of this thesis was necessarily taken up leaving fiscal topics aside altogether and (a) justifying that theory from first principles while (b) resolving internal debates within related literatures which, if left unresolved, would undermine its utility.

Further regarding omissions, an element of the argument in this thesis which has been taken entirely for granted is the relationship between public expenditure and taxation, and the precise nature of that relationship is of course a hotly debated topic right now. That debate, however, is conducted between macroeconomists and falls outside the disciplinary scope of this thesis.

As regards possibilities for further research, the 'value creation' principle in corporate tax reform is now (as noted at the end of chapter 8) effectively dead, and the geopolitics of international corporate tax reform have moved on, and so the story told in Part III of this thesis is to that extent over for the foreseeable future. Some thoughts on what that story means were nonetheless offered in section 9.1 above. It has already been mentioned that the fiscal sociology developed in Part II of this thesis is incomplete, and some thoughts were offered in section 9.2 above on what further concerns might be brought into the picture in a more developed form of the argument.

As regards Part I, it is my view that the arguments developed there barely scratch the surface of what could be achieved, in terms of scientific analysis of actually existing capitalism, by restoring to pre-eminence a specifically materialist Marxian approach to value. Chapter 3 offers a physics (or more specifically a thermodynamics) of value, by grounding its argument in statistical mechanics. It seems to me that there is a strong possibility of building on that foundation something resembling a biology (or perhaps xenobiology) of capital. After all the world of commodities and the world of living organisms are strikingly similar in the sense of being self-reproducing and self-expanding forms of complexity. The step up from the physical to the xenobiological would be through analysis of the sphere of human social relations which drives the behaviour of commodities, and in that analysis a prominent role would be played by (a) absorptive labour in the specifically managerial and fiduciary spheres and (b) the corporate and fiduciary regimes that give such labour its material consequences. By the same token corporate tax regimes would constitute a key feature of the environmental conditions inhabited by the terrifying xenobiont under the macroscope.

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