Flexibility in International Institutional Design:
The Case of the OECD MLI

Jing Qian
Princeton University

April 5, 2024
ISA 2024

Summary

Summary

- I examine the flexibility measures in the OECD Multilateral Instrument

Summary

- I examine the flexibility measures in the OECD Multilateral Instrument
- Contrary to the literature, flexibility could be *cooperation-inhibiting*

Summary

- I examine the flexibility measures in the OECD Multilateral Instrument
- Contrary to the literature, flexibility could be *cooperation-inhibiting*
- Despite broad participation, the MLI is limited in scope and depth

Summary

- I examine the flexibility measures in the OECD Multilateral Instrument
- Contrary to the literature, flexibility could be *cooperation-inhibiting*
- Despite broad participation, the MLI is limited in scope and depth
- This can be attributed to states' usage of flexibility measures

Summary

- I examine the flexibility measures in the OECD Multilateral Instrument
- Contrary to the literature, flexibility could be *cooperation-inhibiting*
- Despite broad participation, the MLI is limited in scope and depth
- This can be attributed to states' usage of flexibility measures
  - Article opt-outs and treaty inclusions driven by self-interest calculations

Background

Background

- The modern international tax regime is built upon thousands of bilateral tax treaties (BTTs)

Background

- The modern international tax regime is built upon thousands of bilateral tax treaties (BTTs)

- Treaty Shopping: Multinational corporations exploit loopholes in BTTs for tax avoidance (Arel-Bundock 2017; Thrall 2021; Qian 2023)

Background

- The modern international tax regime is built upon thousands of bilateral tax treaties (BTTs)

- Treaty Shopping: Multinational corporations exploit loopholes in BTTs for tax avoidance (Arel-Bundock 2017; Thrall 2021; Qian 2023)

- OECD solution: the Multilateral Instrument (MLI)

Background

- The modern international tax regime is built upon thousands of bilateral tax treaties (BTTs)

- Treaty Shopping: Multinational corporations exploit loopholes in BTTs for tax avoidance (Arel-Bundock 2017; Thrall 2021; Qian 2023)

- OECD solution: the Multilateral Instrument (MLI)
    - Modify bilateral treaties through multilateral conventions

Background

- The modern international tax regime is built upon thousands of bilateral tax treaties (BTTs)

- Treaty Shopping: Multinational corporations exploit loopholes in BTTs for tax avoidance (Arel-Bundock 2017; Thrall 2021; Qian 2023)

- OECD solution: the Multilateral Instrument (MLI)
    - Modify bilateral treaties through multilateral conventions
    - Launched in 2017. By end of 2022, 100 signatories, 79 have ratified.

Background

- The modern international tax regime is built upon thousands of bilateral tax treaties (BTTs)

- Treaty Shopping: Multinational corporations exploit loopholes in BTTs for tax avoidance (Arel-Bundock 2017; Thrall 2021; Qian 2023)

- OECD solution: the Multilateral Instrument (MLI)
    - Modify bilateral treaties through multilateral conventions
    - Launched in 2017. By end of 2022, 100 signatories, 79 have ratified.

- However, states have great flexibility to affect MLI applicability

Research Question

Research Question

What are the consequences of flexibility measures in the OECD MLI?

Research Question

What are the consequences of flexibility measures in the OECD MLI?

- Existing literature: Flexibility $\Rightarrow \uparrow$ Cooperation

Research Question

What are the consequences of flexibility measures in the OECD MLI?

- Existing literature: Flexibility $\Rightarrow$ ↑ Cooperation
- Escape clauses $\Rightarrow$ Deeper commitments (Rosendorff & Milner 2001)

Research Question

What are the consequences of flexibility measures in the OECD MLI?

- Existing literature: Flexibility $\Rightarrow$ $\uparrow$ Cooperation

- Escape clauses $\Rightarrow$ Deeper commitments (Rosendorff & Milner 2001)

- Flexibility solves the deeper-broader trade-off (Gilligan 2004)

Research Question

What are the consequences of flexibility measures in the OECD MLI?

- Existing literature: Flexibility $\Rightarrow \uparrow$ Cooperation

- Escape clauses $\Rightarrow$ Deeper commitments (Rosendorff & Milner 2001)

- Flexibility solves the deeper-broader trade-off (Gilligan 2004)

The MLI represents a scope condition of the "flexibility-cooperation" thesis

Research Question

What are the consequences of flexibility measures in the OECD MLI?

- Existing literature: Flexibility $\Rightarrow$ ↑ Cooperation

- Escape clauses $\Rightarrow$ Deeper commitments (Rosendorff & Milner 2001)

- Flexibility solves the deeper-broader trade-off (Gilligan 2004)

The MLI represents a scope condition of the "flexibility-cooperation" thesis

- Multilateral conventions to reform regime based on bilateral agreements

Research Question

What are the consequences of flexibility measures in the OECD MLI?

- Existing literature: Flexibility ⇒ ↑ Cooperation

- Escape clauses ⇒ Deeper commitments (Rosendorff & Milner 2001)

- Flexibility solves the deeper-broader trade-off (Gilligan 2004)

The MLI represents a scope condition of the "flexibility-cooperation" thesis

- Multilateral conventions to reform regime based on bilateral agreements

    - Distributive concerns among treaty partners

Research Question

What are the consequences of flexibility measures in the OECD MLI?

- Existing literature: Flexibility ⇒ ↑ Cooperation

- Escape clauses ⇒ Deeper commitments (Rosendorff & Milner 2001)

- Flexibility solves the deeper-broader trade-off (Gilligan 2004)

The MLI represents a scope condition of the "flexibility-cooperation" thesis

- Multilateral conventions to reform regime based on bilateral agreements

  – Distributive concerns among treaty partners

- Flexibility limits the breadth and depth of the multilateral institution

Research Question

What are the consequences of flexibility measures in the OECD MLI?

- Existing literature: Flexibility $\Rightarrow$ $\uparrow$ Cooperation

- Escape clauses $\Rightarrow$ Deeper commitments (Rosendorff & Milner 2001)

- Flexibility solves the deeper-broader trade-off (Gilligan 2004)

The MLI represents a scope condition of the "flexibility-cooperation" thesis

- Multilateral conventions to reform regime based on bilateral agreements

  - Distributive concerns among treaty partners

- Flexibility limits the breadth and depth of the multilateral institution

- Because members can **unilaterally veto** the applicability

Research Question

What are the consequences of flexibility measures in the OECD MLI?

- Existing literature: Flexibility $\Rightarrow$ ↑ Cooperation

- Escape clauses $\Rightarrow$ Deeper commitments (Rosendorff & Milner 2001)

- Flexibility solves the deeper-broader trade-off (Gilligan 2004)

The MLI represents a scope condition of the "flexibility-cooperation" thesis

- Multilateral conventions to reform regime based on bilateral agreements

  - Distributive concerns among treaty partners

- Flexibility limits the breadth and depth of the multilateral institution

- Because members can **unilaterally veto** the applicability

  - Often based on self-interest calculations

When Would the MLI Modify a Certain BTT Article?

Both parties **signed** the MLI?

When Would the MLI Modify a Certain BTT Article?

MLI does **not** apply ←— No —— Both parties **signed** the MLI?

When Would the MLI Modify a Certain BTT Article?

```
MLI does not apply  ◄── No ── Both parties signed the MLI?
                                        │
                                       Yes
                                        │
                                        ▼
                               Both parties included the BTT?
```
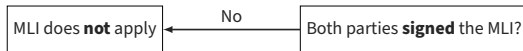
When Would the MLI Modify a Certain BTT Article?

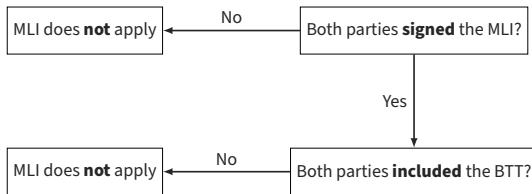# When Would the MLI Modify a Certain BTT Article?

MLI does **not** apply ← No — Both parties **signed** the MLI?

Yes

MLI does **not** apply ← No — Both parties **included** the BTT?

Yes

Either party **opt out** the article?

When Would the MLI Modify a Certain BTT Article?

```
┌─────────────────────┐   No   ┌─────────────────────────┐
│ MLI does not apply  │◄───────│ Both parties signed the MLI? │
└─────────────────────┘        └─────────────────────────┘
                                          │
                                          │ Yes
                                          ▼
┌─────────────────────┐   No   ┌─────────────────────────┐
│ MLI does not apply  │◄───────│ Both parties included the BTT? │
└─────────────────────┘        └─────────────────────────┘
                                          │
                                          │ Yes
                                          ▼
┌──────────────────────────┐  Yes  ┌─────────────────────────┐
│ The article does not apply │◄──────│ Either party opt out the article? │
└──────────────────────────┘        └─────────────────────────┘
```

When Would the MLI Modify a Certain BTT Article?

```
┌─────────────────────┐   No    ┌──────────────────────────┐
│  MLI does not apply  │◄────────│  Both parties signed the MLI? │
└─────────────────────┘         └──────────────────────────┘
                                             │ Yes
                                             ▼
┌─────────────────────┐   No    ┌──────────────────────────┐
│  MLI does not apply  │◄────────│  Both parties included the BTT? │
└─────────────────────┘         └──────────────────────────┘
                                             │ Yes
                                             ▼
┌──────────────────────────┐   Yes   ┌──────────────────────────┐
│  The article does not apply │◄────────│  Either party opt out the article? │
└──────────────────────────┘         └──────────────────────────┘
                                             │ No
                                             ▼
                                   ┌──────────────────────────┐
                                   │    The article applies    │
                                   └──────────────────────────┘
```

Notes: This figure shows the conditions for a generic article in the OECD MLI to be applicable to a specific bilateral tax treaty. Applicability may vary depending on factors such as whether the article is mandatory for meeting the BEPS minimum standard, whether either party has opted out of the provision, and the existence of similar clauses in the treaty. The final outcome of this flowchart determines whether the article applies to the BTT.

Research Design

Research Design

Focus on three steps of countries' participation in the OECD MLI

Research Design

Focus on three steps of countries' participation in the OECD MLI

1. MLI signature
   - Which countries signed the MLI?

Research Design

Focus on three steps of countries' participation in the OECD MLI

1. MLI signature

    – Which countries signed the MLI?

2. Article opt-outs through reservations

    – How often do countries opt-out MLI provisions?

Research Design

Focus on three steps of countries' participation in the OECD MLI

1. MLI signature

   – Which countries signed the MLI?

2. Article opt-outs through reservations

   – How often do countries opt-out MLI provisions?

3. BTT inclusion for MLI coverage

   – Which BTTs do countries include for MLI coverage & modification?

Research Design

Focus on three steps of countries' participation in the OECD MLI

1. MLI signature

   – Which countries signed the MLI?

2. Article opt-outs through reservations

   – How often do countries opt-out MLI provisions?

3. BTT inclusion for MLI coverage

   – Which BTTs do countries include for MLI coverage & modification?

Key explanatory variable: Tax Treaty Shopping Concerns

Research Design

Focus on three steps of countries' participation in the OECD MLI

1. MLI signature

    – Which countries signed the MLI?

2. Article opt-outs through reservations

    – How often do countries opt-out MLI provisions?

3. BTT inclusion for MLI coverage

    – Which BTTs do countries include for MLI coverage & modification?

Key explanatory variable: Tax Treaty Shopping Concerns

• CTR: Top corporate income tax rate (Tax Foundation)

Research Design

Focus on three steps of countries' participation in the OECD MLI

1. MLI signature
   - Which countries signed the MLI?

2. Article opt-outs through reservations
   - How often do countries opt-out MLI provisions?

3. BTT inclusion for MLI coverage
   - Which BTTs do countries include for MLI coverage & modification?

Key explanatory variable: Tax Treaty Shopping Concerns

- CTR: Top corporate income tax rate (Tax Foundation)
- Phantom FDI: Share of FDI into empty corporate shells (Damgaard et al. 2019)
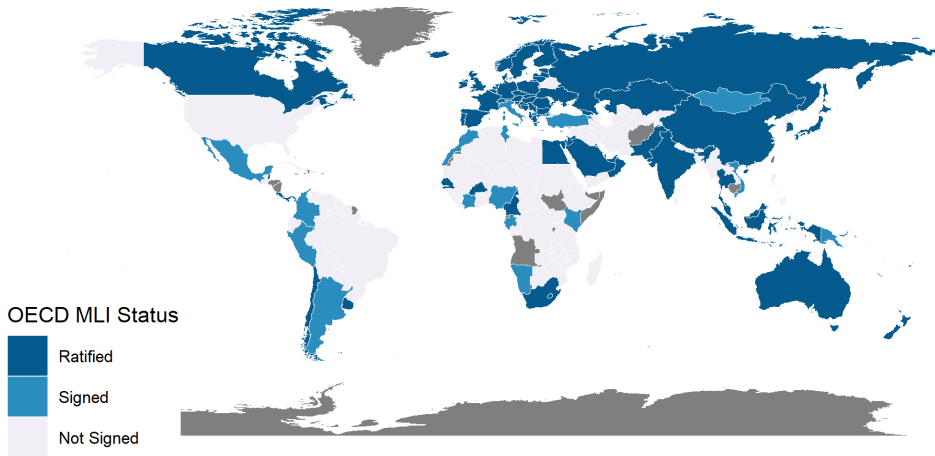
Research Design

Focus on three steps of countries' participation in the OECD MLI

1. MLI signature

    – Which countries signed the MLI?

2. Article opt-outs through reservations

    – How often do countries opt-out MLI provisions?

3. BTT inclusion for MLI coverage

    – Which BTTs do countries include for MLI coverage & modification?

Key explanatory variable: Tax Treaty Shopping Concerns

- CTR: Top corporate income tax rate (Tax Foundation)

- Phantom FDI: Share of FDI into empty corporate shells (Damgaard et al. 2019)

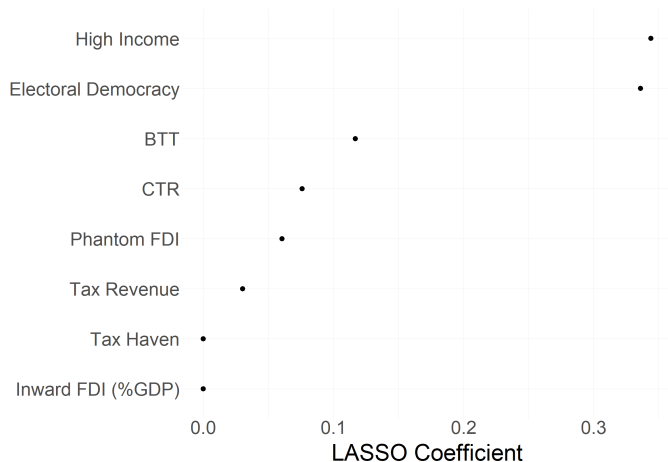- Treaty-Shopping Risk: Use BTT for indirect payment (Qian 2023)

Broad Participation in the OECD MLI

OECD MLI Status
- Ratified
- Signed
- Not Signed

	MLI Signature				
	(1)	(2)	(3)	(4)	(5)
Existing BTTs	1.033***	1.177***	1.167***	1.203***	1.219***
	(0.179)	(0.236)	(0.245)	(0.285)	(0.288)
High Income	1.753***	1.799**	1.801**	3.265**	3.060**
	(0.494)	(0.880)	(0.881)	(1.560)	(1.517)
CTR	0.009	0.092	0.086	0.437	0.554
	(0.302)	(0.494)	(0.497)	(0.557)	(0.565)
Inward FDI (% GDP)		0.197	0.195	0.056	−0.121
		(0.293)	(0.294)	(0.325)	(0.342)
Electoral Democracy		3.406***	3.383***	3.155**	2.646*
		(1.109)	(1.119)	(1.410)	(1.440)
Phantom FDI			0.002	0.004	0.008
			(0.017)	(0.019)	(0.020)
Tax Revenue				0.071*	0.083*
				(0.041)	(0.043)
Tax Haven					1.910
					(1.178)
Observations	180	160	159	147	147

Notes: Results from logistic regression. The dependent variable equal to 1 if the jurisdiction has signed the OECD MLI by the end of 2022.

Lasso Results for Variable Selection

Notes: This figure shows the coefficients from LASSO regression. The dependent variable equal to 1 if the jurisdiction has signed the OECD MLI by the end of 2022. Non-binary variables are standardized. λ is determined using cross-validation.

Treaty-Shopping Factors Do Not Affect MLI Signature

Logit Regression Results

	(1)	(2)	(3)	(4)	(5)
			MLI Signature		
Existing BTTs	1.033***	1.177***	1.167***	1.203***	1.219***
	(0.179)	(0.236)	(0.245)	(0.285)	(0.288)
High Income	1.753***	1.799**	1.801**	3.265**	3.060**
	(0.494)	(0.880)	(0.881)	(1.560)	(1.517)
CTR	0.009	0.092	0.086	0.437	0.554
	(0.302)	(0.494)	(0.497)	(0.557)	(0.565)
Inward FDI (% GDP)		0.197	0.195	0.056	−0.121
		(0.293)	(0.294)	(0.325)	(0.342)
Electoral Democracy		3.406***	3.383***	3.155**	2.646*
		(1.109)	(1.119)	(1.410)	(1.440)
Phantom FDI			0.002	0.004	0.008
			(0.017)	(0.019)	(0.020)
Tax Revenue				0.071*	0.083*
				(0.041)	(0.043)
Tax Haven					1.910
					(1.178)
Observations	180	160	159	147	147

Notes: Results from logistic regression. The dependent variable equal to 1 if the jurisdiction has signed the OECD MLI by the end of 2022.
∗ ∗ ∗ $p < 0.01$, ∗ ∗ $p < 0.05$, ∗ $p < 0.1$.

Lasso Results for Variable Selection
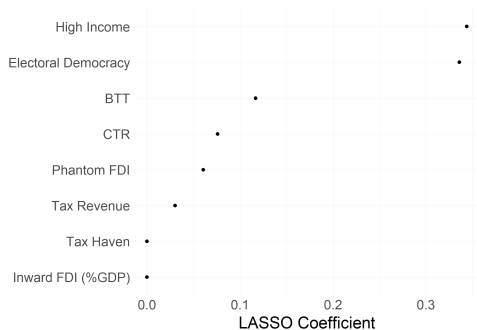
Notes: This figure shows the coefficients from LASSO regression. The dependent variable equal to 1 if the jurisdiction has signed the OECD MLI by the end of 2022. Non-binary variables are standardized. λ is determined using cross-validation.
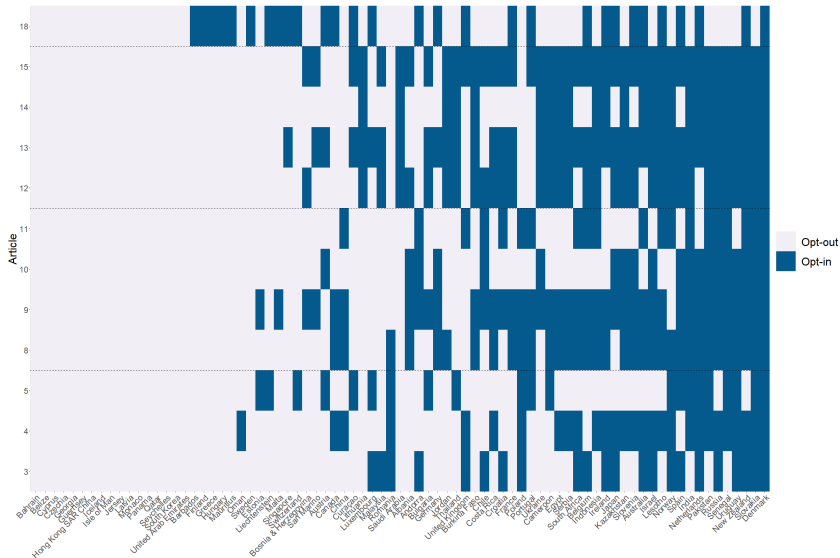
Article Opt-Outs Prevalent Among MLI Ratifiers

Proportion of Article Opt-Outs, Jurisdiction-Level

Notes: The left panel displays the percentage of jurisdictions that opted for the least demanding option for each of the four mandatory articles. The right panel shows the percentage of jurisdictions that chose to opt-out of the entire article for each of the optional articles. The data is based on a sample of 79 jurisdictions that deposited the ratification instrument by the end of 2022.

Huge Variation in Opt-Outs Across Jurisdictions

Opt-out
Opt-in

Article

Jing Qian (Princeton)   OECD MLI   ISA 2024, April 5

		Number of Opt-outs			
	(1)	(2)	(3)	(4)	(5)
BTT	−0.029	0.010	−0.016	−0.012	0.005
	(0.041)	(0.059)	(0.062)	(0.062)	(0.064)
High Income	0.136	0.140	0.148	0.080	0.069
	(0.083)	(0.101)	(0.101)	(0.108)	(0.108)
CTR	−0.132***	−0.140**	−0.158**	−0.162**	−0.159**
	(0.040)	(0.067)	(0.069)	(0.075)	(0.075)
Inward FDI (% GDP)		0.069*	0.063	0.068	0.030
		(0.042)	(0.042)	(0.043)	(0.056)
Electoral Democracy		−0.142	−0.150	0.137	0.128
		(0.183)	(0.183)	(0.234)	(0.234)
Phantom FDI			0.004	0.004	0.004
			(0.003)	(0.003)	(0.003)
Tax Revenue				−0.002	−0.0005
				(0.007)	(0.008)
Tax Haven					0.142
					(0.131)
Observations	79	70	70	64	64

Lasso Results for Variable Selection
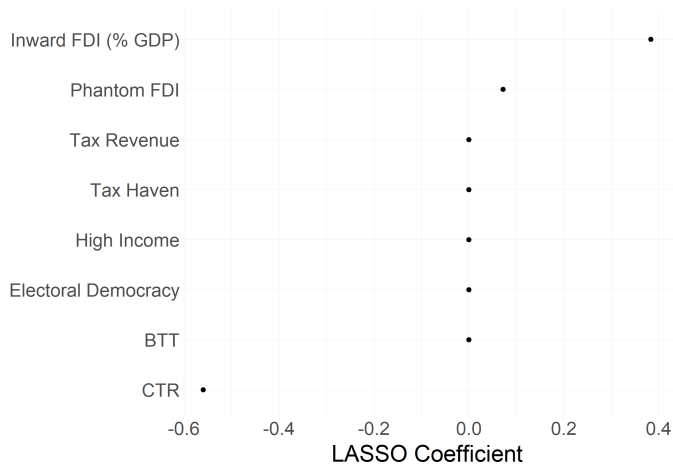
Notes: This figure shows the coefficients from LASSO regression. The dependent variable is the total number of articles that the jurisdiction has completely opted-out (optional articles) or opted for the least demanding provision (mandatory articles). Non-binary variables are standardized. λ is determined using cross-validation.

Low-Tax Countries Opt-Out More Articles through Reservations

OLS Regression Results

|	(1)	(2)	(3)	(4)	(5)
			Number of Opt-outs		
BTT	−0.029	0.010	−0.016	−0.012	0.005
	(0.041)	(0.059)	(0.062)	(0.062)	(0.064)
High Income	0.136	0.140	0.148	0.080	0.069
	(0.083)	(0.101)	(0.101)	(0.108)	(0.108)
CTR	−0.132***	−0.140**	−0.158**	−0.162**	−0.159**
	(0.040)	(0.067)	(0.069)	(0.075)	(0.075)
Inward FDI (% GDP)		0.069*	0.063	0.068	0.030
		(0.042)	(0.042)	(0.043)	(0.056)
Electoral Democracy		−0.142	−0.150	0.137	0.128
		(0.183)	(0.183)	(0.234)	(0.234)
Phantom FDI			0.004	0.004	0.004
			(0.003)	(0.003)	(0.003)
Tax Revenue				−0.002	−0.0005
				(0.007)	(0.008)
Tax Haven					0.142
					(0.131)
Observations	79	70	70	64	64

Notes: Results from ordinary least squares regression. The dependent variable is the total number of articles that the jurisdiction has completely opted-out (optional articles) or opted for the least demanding provision (mandatory articles). The data is based on a sample of 79 jurisdictions that deposited the ratification instrument by the end of 2022.

Lasso Results for Variable Selection
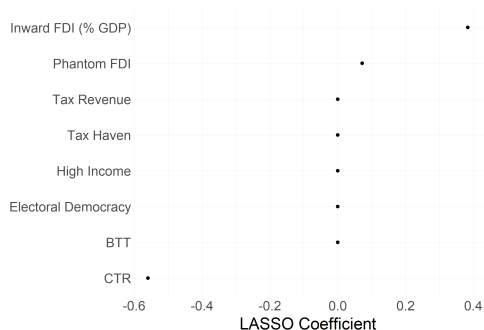
Notes: This figure shows the coefficients from LASSO regression. The dependent variable is the total number of articles that the jurisdiction has completely opted-out (optional articles) or opted for the least demanding provision (mandatory articles). Non-binary variables are standardized. λ is determined using cross-validation.

Exclusion of BTTs for MLI Coverage Is Prevalent
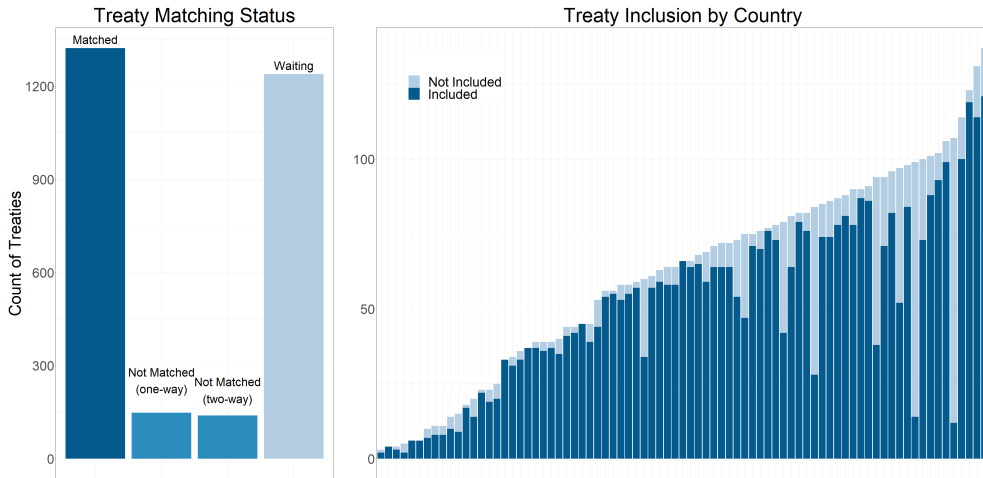
Notes: The figure displays the bilateral tax treaty matching status and MLI coverage across jurisdictions. The left panel shows whether treaties are matched (both parties have notified the treaty), not matched (one party has not notified the treaty, either one-way or two-way), or waiting (the other party has not yet signed the MLI or deposited the ratification instrument). The right panel displays the number of treaties included (or not included) for MLI coverage by each jurisdiction. The data is based on a sample of 79 jurisdictions that deposited the ratification instrument by the end of 2022.

BTT Exclusion/Inclusion Driven by Treaty-Shopping Concerns

	Tax Treaty Notified			
	(1)	(2)	(3)	(4)
Inward FDI	-0.009	0.002	0.017	0.012
	(0.014)	(0.016)	(0.023)	(0.016)
Inward Phantom FDI (%)	1.602***	0.681***	1.298**	-2.059***
	(0.568)	(0.216)	(0.520)	(0.591)
BTT Year	0.802***	0.470***	0.756***	0.505***
	(0.091)	(0.084)	(0.120)	(0.085)
Legacy BTT	-1.129***	-0.674***	-1.215***	-0.744***
	(0.278)	(0.257)	(0.398)	(0.256)
Host CTR				-0.044***
				(0.008)
Host CTR * Inward Phantom FDI (%)				0.119***
				(0.026)
Host FE	✓		✓	
Partner FE		✓	✓	✓
Observations	3507	3527	3328	3527

Notes: Results from conditional logistic regression. Robust standard errors clustered at host jurisdiction level reported in parentheses. The dependent variable equal to 1 if the tax treaty was notified by the host jurisdiction in its ratification instrument deposited to the OECD. The data is based on a sample of 79 jurisdictions that deposited the ratification instrument by the end of 2022.
$*** p < 0.01, ** p < 0.05, * p < 0.1.$

Interaction between Article Reservation & BTT Notification

Interaction between Article Reservation & BTT Notification

- MLI Article 8: Address dividend treaty shopping

Interaction between Article Reservation & BTT Notification

- MLI Article 8: Address dividend treaty shopping
- Direct dividend treaty shopping risk (Qian 2023)

Interaction between Article Reservation & BTT Notification

Interaction between Article Reservation & BTT Notification

	Tax Treaty Notified		
	Opt-in Article 8	Opt-out Article 8	All Sample
	(1)	(2)	(3)
Inward FDI	-0.028	0.057*	0.016
	(0.028)	(0.029)	(0.019)
Inward Phantom FDI (%)	1.937***	-0.088	0.685***
	(0.605)	(0.301)	(0.244)
BTT Year	-0.845***	-0.904***	-0.856***
	(0.250)	(0.234)	(0.155)
Legacy	-0.017	-1.066**	-0.463
	(0.389)	(0.517)	(0.289)
Treaty Shopping Risk	1.026**	-0.441	-0.302
	(0.460)	(0.442)	(0.129)
Opt-in Article 8			0.210
			(0.406)
Opt-in Article 8 * Treaty Shopping Risk			1.053*
			(0.561)
Partner FE	✓	✓	✓
Observations	1348	1072	2926

Notes: Results from conditional logistic regression. Robust standard errors clustered at host jurisdiction level reported in parentheses. The dependent variable equal to 1 if the tax treaty was notified by the host jurisdiction in its ratification instrument deposited to the OECD. Column (1) includes only the jurisdictions that have opted-in Article 8 of the MLI. Column (2) includes only the jurisdictions that have opted-out of the

Conclusion

Conclusion

- Flexibility in institutional design can be cooperation-inhibiting

Conclusion

- Flexibility in institutional design can be cooperation-inhibiting
  - Distributive concerns among members

Conclusion

- Flexibility in institutional design can be cooperation-inhibiting
    - Distributive concerns among members
    - Strategic utilization of flexibility based on self-interest

Conclusion

- Flexibility in institutional design can be cooperation-inhibiting
  - Distributive concerns among members
  - Strategic utilization of flexibility based on self-interest
- Scope condition for the "flexibility-cooperation" theory

Conclusion

- Flexibility in institutional design can be cooperation-inhibiting
  - Distributive concerns among members
  - Strategic utilization of flexibility based on self-interest
- Scope condition for the "flexibility-cooperation" theory
  - OECD MLI: Multilateral convention to reform bilateral agreements

Conclusion

- Flexibility in institutional design can be cooperation-inhibiting
  - Distributive concerns among members
  - Strategic utilization of flexibility based on self-interest
- Scope condition for the "flexibility-cooperation" theory
  - OECD MLI: Multilateral convention to reform bilateral agreements
- Implications for future design of multilateral conventions

Conclusion

- Flexibility in institutional design can be cooperation-inhibiting
  - Distributive concerns among members
  - Strategic utilization of flexibility based on self-interest
- Scope condition for the "flexibility-cooperation" theory
  - OECD MLI: Multilateral convention to reform bilateral agreements
- Implications for future design of multilateral conventions
  - Multilateral Convention to address tax challenges from digital economy

Conclusion

- Flexibility in institutional design can be cooperation-inhibiting
  - Distributive concerns among members
  - Strategic utilization of flexibility based on self-interest
- Scope condition for the "flexibility-cooperation" theory
  - OECD MLI: Multilateral convention to reform bilateral agreements
- Implications for future design of multilateral conventions
  - Multilateral Convention to address tax challenges from digital economy
  - The reform of bilateral investment treaties (BITs)