

## **ABSTRACT**

### *Can Tax Policy Stop Human Trafficking?*

The total number of victims who are held in captivity to perform forced labor at any one time is estimated to be as high as twenty-seven million. That would be equivalent to every man, woman, and child in the states of New Hampshire, Vermont, Massachusetts, and New York being held in captivity and forced twelve to fourteen hours each day to labor in sweatshops, or toil as agricultural workers, or service sexually many customers every day with no hope that it will ever end except by death. They would live in crowded, dirty hovels, receive little food and no medical care, and live under the constant threat of beatings, rape, and other violence. Every year, new victims will be added to their numbers. This is human trafficking.

The twenty-seven million victims include those who are trafficked within their own country and those who are trafficked across international borders. Each year, as many as one to four million new victims are trafficked across international borders. Despite strong denunciation by the U.N., the United States, and the European Union, this modern day slavery flourishes.

Of all the factors that lead to human trafficking, government corruption is the most significant. This article recommends an economic incentive that would recruit as allies in this war the wealthy residents of countries where the abuse is most rampant, and where the governments themselves, or government officials are complicit in trafficking. The economic incentive that would be used is taxation.

This Article proposes that the governments of the world's major economies, where the wealthy invest the bulk of their money, re-impose the withholding tax on interest income from investments. The governments of these major economies can then agree to reduce the withholding tax rates on residents of complicit countries if trafficking is reduced. In addition, the governments of these major economies can promise to refund to the complicit governments a certain amount of the interest income withheld after the complicit governments achieve certain benchmarks. Unlike foreign aid, the refund would depend on the complicit governments' prior demonstration that they have satisfied certain criteria, rather than relying on their commitments to comply in the future. This economic solution applies pressure on those who are in positions of power to achieve change, and at the same time does not hurt those who are the most vulnerable to trafficking – the poor.

## Can Tax Policy Stop Human Trafficking?<sup>1</sup>

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<sup>1</sup> “We have always known that heedless self-interest was bad morals; we know now that it is bad economics.”  
Franklin Delano Roosevelt

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## I. INTRODUCTION

The total number of victims who are held in captivity to perform forced labor at any one time is estimated to be as high as twenty-seven million.<sup>2</sup> That would be equivalent to every man, woman, and child in the states of New Hampshire, Vermont, Massachusetts, and New York<sup>3</sup> being held in captivity and forced twelve to fourteen hours each day to labor in sweatshops, or toil as agricultural workers, or service sexually ten customers every day with no hope that it will ever end except by death. They would live in crowded, dirty hovels, receive little food and no medical care, and live under the constant threat of beatings, rape, and other violence. Every year, new victims will be added to their numbers. This is human trafficking.

The twenty-seven million victims include those who are trafficked within their own country and those who are trafficked across international borders.<sup>4</sup> Each year, as many as one to four million new victims are trafficked across international borders.<sup>5</sup>

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<sup>2</sup> Kevin Bales, *International Labor Standards: Quality of Information and Measures of Progress in Combating Forced Labor*, 24 COMP. LAB. L. & POL'Y J. 321, 343 (2003):

Being highly appreciative of the old computer programmer's rule of GIGO [garbage in; garbage out], I was very nervous about going on record with my estimate of twenty-seven million slaves. So why do so? In part because the existing estimates for the number of slaves in the world ranged from the low millions up to 100-200 million. These numbers were wildly divergent and very often apparently groundless. I was operating from the supposition that a number that is a rough estimate based on aggregation is better than a wild guess. I traced one oft-repeated estimate of 100 million slaves back to the person in India who had originally offered it. He explained that this really was a "top of the head" guess and not based on any aggregation or formal estimation. It had taken hold in the literature because he had voiced it in the context of a meeting within the United Nations. When the report of the meeting included this figure, it was taken as an estimate somehow supported by the U.N., thus giving it credence.

The United Nations International Labor Organization ("ILO") estimates that at least 12.3 million people are held in slavery at any given time. Patrick Belser, Cornell University, ILO, *International Labor Standards, Forced Labor, Forced Labor and Human Trafficking: Estimating the Profits*, at p. 4 (2005).

<sup>3</sup> U.S. Census Bureau statistics as of July 1, 2007 at [http://factfinder.census.gov/servlet/GCTTable?\\_bm=X&-geo\\_id=01000US&-box\\_head\\_nbr=GCT\\_T1&-ds\\_name=PEP](http://factfinder.census.gov/servlet/GCTTable?_bm=X&-geo_id=01000US&-box_head_nbr=GCT_T1&-ds_name=PEP).

<sup>4</sup> Although the plight of victims who are trafficked across borders has received attention and is the focus of this article, many victims are trafficked within their own country.

For example, in Brazil, internal trafficking occurs from poor agricultural areas, where drought and seasonal unemployment act as push factors, to areas where cheap labour is required for mining, seasonal work in forest clearance, charcoal production and agriculture. In Southeast Asian countries like Indonesia, Cambodia, Myanmar, Vietnam, and Philippines, internal trafficking of children occurs for sex work as well as for labour in industries such as garment manufacture, electronics, glass, and food production. In some Chinese counties and villages, up to ninety percent of the marriages are said to be the result of trafficking. Chinese boys, on the other hand, particularly those under seven years of age, are usually trafficked domestically for illegal adoption.

Nilanjana Ray, *Looking at Trafficking Through a New Lens*, 12 CARDOZO J. L. & GENDER 909, 916 (2006). See also Bales, *supra* note 2, at 323-24.

Both domestic and international efforts to prevent cross-border trafficking have been ineffective and the number of victims increases each year. Victims who are trafficked across international borders come from countries of origin that are primarily war-torn, developing, or poor countries. They are trafficked through transit countries which have weak immigration laws or in which immigration or law enforcement personnel can be easily bribed, or whose topography makes it easy to get across the border without being detected. The victims end up in destination countries that are rich and economically developed.<sup>6</sup>

Human trafficking is the third largest international criminal enterprise, behind drugs and arms smuggling, and it is starting to surpass drugs.<sup>7</sup> It generates approximately \$9 billion a year<sup>8</sup> Why is human trafficking so appealing to criminals? It is a relatively low-risk, inexpensive way to make a lot of money very quickly.<sup>9</sup>

The international community recognizes that human trafficking is a human rights violation and the United Nations repeatedly has denounced the practice. Yet, it not only continues, but it flourishes, in part, because the United Nations pronouncements themselves do not contain sanctions. Both the United States and the European Union have enacted domestic legislation; however, that legislation for the most part does not cross borders and reach into countries where the trafficking originates.<sup>10</sup>

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<sup>5</sup> Dina Francesca Haynes, *(Not) Found Chained to a Bed in a Brothel: Conceptual, Legal, and Procedural Failures to Fulfill the Promise of the Trafficking Victims Protection Act*, 21 GEO. IMMIGR. L.J. 337,342 (2007); Hanh Diep, *We Pay – The Economic Manipulation of International and Domestic Laws to Sustain Sex Trafficking*, 2 LOY. U. CHI. INT’L L. REV. 309, 317 (2005); Susan W. Tiefenbrun, *Sex Sells but Drugs Won’t Talk: Trafficking of Women Sex Workers and an Economic Solution*, 24 T. JEFFERSON L. REV. 161, 170 (2002).

*See* Martti Lehti, and Kauko Aromaa, *Trafficking for Sexual Exploitation*, 34 CRIME & JUST. 133 (2006) for a detailed discussion of victim profiles and attributes broken down by geographic source.

<sup>6</sup> *See e.g.*, Tiefenbrun, *supra* note 5, at 164.

<sup>7</sup> Susan Tiefenbrun, *The Cultural, Political, and Legal Climate Behind the Fight to Stop Trafficking in Women: William J. Clinton’s Legacy to Women’s Rights*, 12 CARDOZO J. L. & GENDER 855, 876 (2006); Diep, *supra* note 5, at 313.

<sup>8</sup> Haynes, *supra* note 5, at 342 (“[T]rafficking in human beings is an *extremely* lucrative business: earning traffickers 5 to 10 billion dollars per year.”); Ray, *supra* note 4, at 909 (“This trade in human misery generates a profit of nine billion dollars annually.”); Tiefenbrun, *supra* note 5, at 171 estimates traffickers earn between \$7billion and \$12 billion per year; Harvard Law Review, *Developments in the Law – Jobs and Borders, II. The Trafficking Victims Protection Act*, 118 HARV. L. REV. 2180, 2186 (2005) (“This industry ... generates a global economy of \$7 to 10 billion each year.”).

<sup>9</sup> *See e.g.*, Tiefenbrun, *supra* note 5, at 175 (“Traffickers make anywhere from one to eight million dollars in a period ranging from one to six years.”); Donna M. Hughes, *The “Natasha” Trade: Transnational Sex Trafficking*, NATIONAL INSTITUTE OF JUSTICE JOURNAL, No. 26, at 13, January 2001 (“According to Michael Platter, of the United Nations Center for International Crime Prevention, trafficking in women has one of the highest profit margins and lowest risks for criminal groups in Eastern Europe.”)

<sup>10</sup> *See infra* Part II.C.2, II.C.3.

Of all the factors that lead to human trafficking, government corruption is the most significant.<sup>11</sup> This article recommends an economic incentive that would recruit as allies in this war the wealthy residents of countries where the abuse is most rampant, and where the governments themselves, or government officials are complicit in trafficking. The economic incentive that would be used is taxation.

Foreign persons used to be subject to U.S. tax on nonbusiness-related interest (“portfolio interest”) they earn from U.S. government bonds, bonds issued by domestic businesses, and interest earned on domestic bank deposits. After 1984, the United States exempted portfolio interest from U.S. tax.<sup>12</sup> Other governments, in order to remain competitive with the United States, followed suit.<sup>13</sup> This Article proposes that the governments of the world’s major economies, where the wealthy invest the bulk of their money, re-impose the withholding tax on the interest income from investments. The governments of these major economies can then agree to reduce the withholding tax rates on residents of complicit countries if trafficking is reduced. In addition, the governments of these major economies can promise to refund to the complicit governments a certain amount of the interest income withheld after the complicit governments achieve certain benchmarks. Unlike foreign aid, the refund would depend on the complicit governments’ prior demonstration that they have satisfied certain criteria, rather than relying on their commitments to comply in the future. This economic solution applies pressure on those who are in positions of power to achieve change, and at the same time does not hurt those who are the most vulnerable to trafficking – the poor.

Although the primary purpose of taxation is to raise revenue to fund government, taxation is also used for social policy purposes – to encourage or discourage behavior.<sup>14</sup> My proposal expands the role of taxation with regard to social planning to the international sphere. The question can be asked: Why should human trafficking be singled out for this special tax treatment? After all, there are many social policies that governments might wish to address through taxation -- why should taxation be used to address this particular social ill? The distinction here is that, unlike many social policies, there is no dispute that human trafficking is a violation of human rights. Even countries that traffick at least pay lip service to the principle that human trafficking is wrong.

Further, the pernicious effect of human trafficking crosses borders, creating crime and government corruption as it wends its way through the countries involved. With regard to

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<sup>11</sup> See discussion *infra* Part II. B.

<sup>12</sup> See discussion *infra* Part IV.A.3.

<sup>13</sup> See discussion *infra* Part IV.A.3.

<sup>14</sup> For example, in the domestic arena, I.R.C. §163(h)(2) allows homeowners to deduct on their tax returns the interest payments from their home mortgages. The purported justification for the deduction is that it encourages home ownership. However, reasonable minds can differ as to the desirability of a particular social policy. With regard to home ownership, one can argue that it is not a good policy because it discriminates between renters and home owners. With regard to international policy, reasonable minds can disagree as to the proper role and power of the judiciary, the importance of political rights vis-à-vis economic rights.

wrongful or undesirable behavior that crosses borders, the international community is beginning to turn to taxation, in addition to regulation, as a tool to control such behavior. For example, the European Union is considering levying a carbon tax on countries which refuse to sign the Kyoto treaty in order to force compliance.<sup>15</sup>

Part II reviews the causes that make victims vulnerable to human trafficking and the factors that have encouraged its dramatic increase. The most significant factor that predicts whether trafficking will occur is government corruption. Further, trafficking has flourished in part because it has been difficult for the international community to develop sanctions and incentives that cross international borders. Part III demonstrates that this lack of incentives and sanctions has encouraged governments to commit to treaties and agreements that support human rights but enabled governments to avoid complying with their obligations without suffering adverse consequences. Part IV then examines the fiscal strains that await the developed countries and that the developing countries face now from insufficient tax revenues. Further, Part IV examines how the repeal of withholding on investment income has contributed to the fiscal strain and to tax evasion.

Finally, Part V then proposes that the developed countries with the major world economies re-impose the withholding tax on investment income. Not only would the re-imposition of the tax reduce some tax evasion and generate much needed tax revenues, but the tax could be used to provide an economic sanction or incentive towards countries that are complicit in human trafficking. In order to avoid the sanction or obtain the incentive, the complicit government must satisfy certain criteria or benchmarks. The wealthy residents of complicit countries then would be eligible for a reduced withholding rate after their governments satisfied certain benchmarks and reduced human trafficking. The complicit governments also would have the incentive to reduce human trafficking as a means of acquiring revenue from the developed countries through a refund of a portion of the withheld tax.

## **II. The Causes of Human Trafficking.**

### *A. Human Trafficking Defined.*

The United Nations Protocol to Prevent, Suppress and Punish Trafficking in Persons, Especially Women and Children defines human trafficking as follows in Article 3:

(a) ... the recruitment, transportation, transfer, harbouring or receipt of persons, by means of the threat or use of force or other forms of coercion, of abduction, of fraud, of deception, of the abuse of power or of a position of vulnerability or of the giving or receiving of payments or benefits to achieve the consent of a person having control over another person, for the purpose of exploitation. Exploitation shall include, at a minimum, the exploitation of the prostitution of others, or other forms of sexual exploitation, forced

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<sup>15</sup> See e.g., Andrew Green & Tracey Epps, *The WTO, Science, and the Environment: Moving Towards Consistency*, 10 J. INT'L ECON. L. 285, 292 (2007).

labour or services, slavery or practices similar to slavery, servitude or the removal of organs ....<sup>16</sup>

The United States Department of State estimates that between approximately 600,000 and 800,000 new victims are trafficked across international borders each year, although that is a concededly low estimate.<sup>17</sup> Other estimates are as high as four million new victims each year.<sup>18</sup> Eighty percent of the victims are women and girls and fifty percent are children.<sup>19</sup> Most of the victims who are trafficked for sexual exploitation originate from Russian and the other former Soviet Republics, Asia, and Central and South America.<sup>20</sup> However, not all victims are forced into sexual slavery and not all victims are women: men and boys are trafficked also, which is sometimes overlooked.<sup>21</sup> In addition to sexual slavery, victims also are forced to work in sweatshops, as agricultural workers, domestic servants, or even to beg.<sup>22</sup>

Traffickers do not consider victims to be “human capital” in which an investment has been made and, therefore, the investment should be preserved. Rather, victims are considered to be disposable assets and easily replaced.<sup>23</sup> As a result, victims are given the minimum of food,

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<sup>16</sup> G.A. Res. 55/25, Annex II, at 31, U.N. GAOR, 55<sup>th</sup> Sess., U.N. Doc. A/RES/55/25 (Jan. 8, 2001), reprinted in 40 I.L.M. 335, 384-85. Sections (b) and (c) address the issues of consent and the trafficking of children.

(b) The consent of a victim of trafficking in persons to the intended exploitation ... shall be irrelevant where any of the means set forth [above] have been used.

(c) The recruitment, transportation, transfer ... of a child for the purpose of exploitation shall be considered “trafficking in persons” even if it does not involve any of the means set forth [above].

<sup>17</sup> U.S. Department of State, *Trafficking in Persons Report 2007*, available at <http://www.state.gov/documents/organization/82902.pdf>. See also Jennifer M. Chacon, *Misery and Myopia: Understanding the Failures of U.S. Efforts to Stop Human Trafficking*, 74 *FORDHAM L. REV.* 2977, 2982 (2006).

<sup>18</sup> See *supra* note 5 and accompanying text.

<sup>19</sup> See Haynes, *supra* note 5, at 342; *supra* note 17, at 2982.

<sup>20</sup> R. Victoria Lindo, *The Trafficking of Persons into the European Union for Sexual Exploitation: Why it Persists and Suggestions to Compel Implementation and Enforcement of Legal Remedies in Non-Complying Member States*, 29 *B.C. INT’L & COMP. L. REV.* 135, 137 (2006); Harvard Law Review, *supra* note 8, at 2187.

<sup>21</sup> Ray, *supra* note 4, at 911-12.

<sup>22</sup> For example, in 1995 in El Monte, California, police found seventy-two Thai nationals who had been forced to work in a garment shop for as many as eighteen hours a day, seven days a week. They had been threatened and physically abused. Chacon, *supra* note 17, at 2987.

In 1997 in Queens, New York, police found sixty-two deaf mute Mexicans living in two apartments. They had been lured to the United States with promises of jobs, but were forced to peddle and beg for eighteen hours a day, seven days a week. If they did not meet their \$600 per week quotas, they were beaten, electrocuted, and sexually molested. Chacon, *supra* note 17, at 2987-88; Harvard Law Review, *supra* note 8, at 2181.

<sup>23</sup> See e.g., Bales, *supra* note 2, at 322.

In parallel with the population explosion of the [20<sup>th</sup> century], slaves became more numerous and less costly. The modernization process has pushed significant numbers of people in the developing world into

medical care, shelter, and other necessities (for example, children receive no education) and are forced to work grueling schedules with little rest.<sup>24</sup> As soon as a slave is worn out, another will be acquired from the bottomless well of impoverished, desperate human beings who inhabit this earth.

*B. Factors that Lead to and Encourage Human Trafficking.*

Human trafficking is rapidly becoming the preferred method of international crime because the benefit/risk analysis makes it worthwhile. In many countries, the penalties for human trafficking have been relatively mild<sup>25</sup> whereas the penalty for drug trafficking can be a life sentence. For example, in Croatia, the penalties for trafficking range from one to ten years in prison.<sup>26</sup> Greece provides for sentences from one to three years and a fine.<sup>27</sup> Prior to the enactment of the Victims of Trafficking and Violence Protection Act of 2000 (TVPA),<sup>28</sup> human traffickers in the U.S. rarely were prosecuted or given significant sentences for trafficking.<sup>29</sup> However, in the U.S. the

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social, economic, and political vulnerability. In that context, when government corruption allows the criminal to use violence with impunity, slaves can be harvested. The high levels of vulnerability produced a glut of potential slaves, and obeying the rule of supply and demand, the price of slaves fell precipitously. Slaves are now less expensive than at any point in recorded history. This cheapness is a boon to criminals, and has also altered the way that slaves are treated and used.

Bales, *supra* note 2, at 322.

<sup>24</sup> As discussed in The Harvard Law Review:

While in service, victims are routinely physically and/or emotionally abused; types of maltreatment include “beating[s], rape, starvation, forced drug use, confinement, and seclusion.” Illness and mental breakdown are common as a result.... [T]he inhumane living conditions that victims are forced to endure often result in illnesses and diseases that may spread to fellow workers, customers, and neighbors. The risk of contracting HIV/AIDS is particularly high among trafficked sex workers who are often forced to have unprotected sex yet denied health care.

Harvard Law Review, *supra* note 8, at 2185-86, quoting Francis T. Miko, Trafficking in Women and Children: The U.S. and International Response 4 (Cong. Research Serv., CRS Report for Congress Order Code RL 30545, Mar. 26, 2004, available at <http://fpc.state.gov/documents/organization/31990.pdf>).

*See also* Diep, *supra* note 5, at 318 (women forced into sex trade and required to work ten to eighteen hours a day, for at least twenty-five days each month, and to service ten customers per day).

<sup>25</sup> The United States and the European Union have taken steps to change this. They have enacted domestic legislation that contains more stringent penalties for traffickers than have been handed down in the past. *See* discussion *infra* Parts II.C.2, II.C.3.

<sup>26</sup> Susan Tiefenbrun, *The Saga of Susannah A U.S. Remedy for Sex Trafficking in Women: The Victims of Trafficking and Violence Protection Act of 2000*, 2002 UTAH L. REV. 107, 154 (2002).

<sup>27</sup> *Id.* at 155

<sup>28</sup> *See* discussion *infra* at II.C.2.

<sup>29</sup> Findings – The Congress finds that:

(14) Existing legislation and law enforcement in the United States and other countries are inadequate to deter trafficking and bring traffickers to justice, failing to reflect the gravity of the offenses involved. No comprehensive law exists in the United States that penalizes the range of offenses involved in the

statutory maximum for dealing in ten grams of LSD or distribution of a kilo of heroin is life.<sup>30</sup> It is rare for an individual convicted of human trafficking to receive anything more than a suspended sentence and a fine. For example, in Australia, an illegal brothel<sup>31</sup> owner purchased Thai women for \$18,000 to \$20,000 each and forced them to work off their debt to him by working in the brothel.<sup>32</sup> A jury found him guilty of all seven counts under the Prostitution Control Act of 1994 and the offences carried maximum sentences of four and five years; however, he was sentenced by the jury to only eighteen months and fined \$31,000.<sup>33</sup> The court then suspended his sentence and only ordered him to pay the \$31,000 fine – approximately the purchasing price of two women.<sup>34</sup> The owner generated approximately \$1.2 million in profit from the women.<sup>35</sup>

Not only are the penalties usually mild, but it is possible for traffickers to make a lot of money within a short period of time for relatively little “investment.” For example, Thai traffickers who enslaved Thai women in a New York brothel made \$1.5 million over roughly a year and three months, while the women earned nothing because they were made to pay debts ranging from \$30,000 to \$50,000.<sup>36</sup>

Kevin Bales has identified three factors that he believes have led to the resurgence of slavery:

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trafficking scheme. Instead, even the most brutal instances of trafficking in the sex industry are often punished under laws that also apply to lesser offenses, so that traffickers typically escape severe punishment.

(15) In the United States, the seriousness of this crime and its components is not reflected in current sentencing guidelines, resulting in weak penalties for convicted traffickers.

H.R. Conf. Rep. 106-939, §102(b), 106<sup>th</sup> Cong., 2<sup>nd</sup> Sess. 2000.

<sup>30</sup> Diep, *supra* note 5, at 313.

<sup>31</sup> Brothels are legal in Australia. Human trafficking and illegal brothels increase when prostitution is legalized. One reason why is that it is cheaper to operate a brothel with trafficked women. The legal operations create the “legal façade” for the illegal activity. For example, in 1983, there were 149 known brothels in Victoria, Australia. After they were legalized, there were 94 legal brothels and an estimated 400 illegal brothels. *Id.* at 329.

In 2000, the Netherlands legalized brothels. However, it is estimated that eighty percent of the women who work in them have been trafficked from other countries. *Id.* at 325.

<sup>32</sup> *Id.* at 313.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

<sup>36</sup> Tiefenbrun, *supra* note 26, at 142. *See also* ILO, *supra* note 2, at 16 (traffickers in the United Kingdom earned approximately \$276,000 over a two-year period by forcing a 16-year old girl into prostitution); Haynes, *supra* note 5, at 342 (“[A] study commissioned in the mid-1990s estimated that traffickers earn about \$250,000 for each woman trafficked for sex slavery.”)

The first is the population explosion that flooded the world's labor markets with millions of poor and vulnerable people. The second is the revolution of economic globalization and modernized agriculture which has dispossessed poor farmers and made them vulnerable to enslavement. In the new world economy capital flies wherever labor is cheapest, and the financial links of slavery can stretch around the world. The third factor is the chaos of greed, violence, and corruption created by this economic change in many developing countries, change that is destroying the social rules and traditional bonds of responsibility that might have protected potential slaves.<sup>37</sup>

The second factor (modernized agriculture) has been exacerbated by the move from food crops to cash crops; and the vagaries of international prices on rubber, tobacco, coffee, coconut, and cotton also affected the farmers. Overfishing has also put economic pressure on those who make their living this way.<sup>38</sup>

The third factor – social chaos – has led to or increased the feminization of unemployment, migration, and poverty, making women in particular increasingly vulnerable to trafficking. For example, two-thirds of the 500,000 victims of the sex trade in the EU are from the Eastern European countries.<sup>39</sup> When the formerly communist countries of Eastern Europe and Russia moved to a market economy, women in particular were vulnerable to the economic changes. Although unemployment affected the entire population, women suffered the most. Women's employment fell by as much as 40% and the quality of the employment also deteriorated dramatically. Therefore, when the state-subsidized farms and industries collapsed, women looked for other work and became easy prey for traffickers.<sup>40</sup>

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<sup>37</sup> KEVIN BALES, *DISPOSABLE PEOPLE: NEW SLAVERY IN THE GLOBAL ECONOMY* 6, 232 (1999) quoted in Nidhi Kumar, *Reinforcing Thirteenth and Fourteenth Amendment Principles in the Twenty-first Century: How to Punish Today's Masters and Compensate Their Immigrant Slaves*, 58 Rutgers L. Rev. 303, 306-07.

<sup>38</sup> Chacon, *supra* note 17, at 924-25.

<sup>39</sup> Ray, *supra* note 4, at 925-26; Lindo, *supra* note 20, at 136.

<sup>40</sup> Ray, *supra* note 4, at 925-26.

The economic transition witnessed by the former communist countries of Eastern Europe and states of the former Soviet Union has made the population extremely vulnerable to trafficking as well. ... Throughout the region, towns were built around a single industry, and when the industry collapsed, the entire town lost its livelihood. In Russia, the crisis was compounded by the collapse of the Ruble in 1998, which wiped out the meager savings of many people. Although unemployment affected the entire population, women suffered the most. This is because the industries in which they predominated – social services, medicine, textile, and the government sector – underwent maximum downsizing. In the rural areas, the closure of State and collective farms was not substituted by development of private farming. Women previously employed in State-run agricultural units migrated to cities in search of employment. A UNIFEM report highlights the fact that women's unemployment in Eastern Europe during the transition to market economy fell by as much as forty percent, and that the quality of the employment also deteriorated dramatically.

Feminization of poverty is a growing trend. A study in Uzbekistan found that the majority of the unemployed in the capital city of Tashkent were women. Most were educated up through secondary level or less, suggesting an impact on working-class women. An official report from Azerbaijan states that two-thirds of the unemployed were women. In Armenia, women make up over sixty-four percent of the unemployed. In addition, the duration of employment of women is longer for women than for men. In the

Women also increasingly have become a component of the migrant work force, which increases their vulnerability to trafficking.<sup>41</sup> For example, after the disintegration of the Soviet Union, ethnic minorities in successor states suffered from discrimination and persecution. Further, the violence in Georgia, Armenia, and Chechnya forced people to flee. Many of these migrants left behind what few assets they had and lost their traditional support systems, and, as a result, were more willing to risk accepting an offer to migrate to a developing country in hopes of a better life, but ended up being trafficked instead.<sup>42</sup>

A majority of the world's poor are women. Further, when faced with the choice of educating a girl or a boy, most poor families will educate the boy. As a result, girls have higher illiteracy rates and fewer skills, thereby perpetuating the cycle of poverty. Women who attempt to break the cycle and earn more money are at risk for ending up trafficked.

For many women in developing countries, substantial barriers exist to opportunities for equal advancement begin at birth and continue for life. First, women are disproportionately represented among the world's poorest people. In its 1995 Human Development Report, the United Nations Development Programme reported that seventy percent of the 1.3 billion people in poverty (including many living on less than one dollar per day) are women. In 2003, those statistics remain unchanged. According to the World Bank's gender statistics database, women have a higher unemployment rate than men in virtually every country and women hold a majority of the lower-paid, unorganized informal sector jobs of most world economies. "Women work two-thirds of the world's working hours, produce half of the world's food, yet earn only ten percent of the world's income and own less than one percent of the world's property."<sup>43</sup>

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Kyrgyz Republic as well, sixty percent of the unemployed were women, and women's wages were twenty-five percent lower than that of men. The post-communism economic vacuum hit women the hardest due to exclusion of women from the formal and regulated job market.

Ray, *supra* note 4, at 925-26.

See also Diep, *supra* note 5, at 317; Tiefenbrun, *supra* note 26, at 132-33.

<sup>41</sup> Women and girls now constitute approximately one-half of all migrants. See U.N. Econ. & Soc. Council, Comm'n on Human Rights, Rights of the Child: Report of the Special Rapporteur on the Sale of Children, Child Prostitution and Child Pornography, P. 54, U.N. Doc. E/CN.4/2006/67 (Jan. 12, 2006) (prepared by Juan Miguel Petit), cited in Christa Foster Crawford, *Cultural, Economic and Legal Factors Underlying Trafficking in Thailand and their Impact on Women and Girls from Burma*, 12 CARDOZ J.L. & GENDER, 821, 840, n.93 (2006).

<sup>42</sup> See Ray, *supra* note 4, at 927; Lindo, *supra* note 20, at 136 (within the European Union, there are between 200,000 and half a million illegal sex workers, mostly migrating from Eastern and Central Europe); Crawford, *supra* note 39, at 821-22 ("People from Burma and other neighboring countries are becoming more vulnerable to trafficking and prostitution in Thailand. For decades, neighboring Burma has been the source of a flood of migrants to Thailand in search of better economic opportunities as well as escape from human rights abuses"); Tiefenbrun, *supra* note 5, at 174 ("Albanian criminals also take advantage of war-torn Eastern Europe, the migration of women and children, broken-up families and confusion in the refugee camps in neighboring countries to target and traffic Kosovo women into the sex industry. These girls end up in prostitution and child exploitation rings in northern Italy, especially Turin and Milan.").

<sup>43</sup> WOMANKIND WORLDWIDE, WORLD DEVELOPMENT INDICATORS (1997), at <http://www.worldrevolution.org/Projects/GlobalIssuesOverview/development.htm> (last visited Apr. 12, 2005.)

....

The roles of rural women tend to match traditional stereotypes; women are obligated to perform the majority of agricultural labor and are discouraged from formal schooling. As a consequence, the great majority of the world's one billion illiterate adults are women. .... As a result of poverty and cultural discrimination, two-thirds of the 125 million children unable to attend primary school are girls.<sup>44</sup>

Some governments have refused to fight trafficking or have even encouraged it because the trafficker is not the only person who profits from trafficking. Traffickers can spend money in the community from which they ensnare victims, thereby ingratiating themselves with the local residents.<sup>45</sup> In addition, local businesses located near where the trafficked victims work also receive income indirectly from the trafficking. For example, restaurants, bars, hotels, and taxi services in the immediate area benefit from the trafficking.

Traffickers do not operate in a vacuum. They require not only a supply of victims, but also enabling social conditions, and a network of facilitators to help traffic the victims. Certain social conditions in a country are predictors for when trafficking is likely to occur.

What predicts human trafficking from a country to other countries? ... Most of those working in the field, and the evidence we have, points to poverty, social unrest, government corruption, population pressure, the perception of opportunity (or lack thereof), the lack of means for legal migration, the lack of knowledge of conditions in the destination country and hence a need to depend upon third parties, and the presence of friends, relatives, or other trusted individuals who are in fact criminals as determinants of trafficking from a country.<sup>46</sup>

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<sup>44</sup> Lisa Avery, *Microcredit Extension in the Wake of Conflict: Rebuilding the Lives and Livelihoods of Women and Children Affected by War*, 12 GEO. J. ON POVERTY L. & POL'Y 205, 212-14.

<sup>45</sup> Kevin Bales also acknowledges this economic effect.

Slavery is a social action that generates measurable phenomena at all three levels of social measurement – the individual (micro), the group or community level (meso), and the societal or aggregate level (macro). That said, slavery is primarily a phenomenon of the meso-level. The power differential between slave and slaveholder reflects what is allowed in the community, and the economic activity that is the aim of enslavement feeds into the local economic base.

Bales, *supra* note 2, at 330.

*See also* Lindo, *supra* note 20, at 138 (“The substantial profits from trafficking frequently allow the trafficker to become entrenched in a community and continuously exploit it as a ready source of victims.”)

<sup>46</sup> Bales, *supra* note 2, at 346.

Dina Francesca Haynes and Victoria Lindo reach similar conclusions:

What is known is that trafficked persons originate where the conditions are ripe for exploitation: where there is structural economic and social pressure on the victims to migrate; where there are few educational

However, of all these factors or conditions, Bales' research indicates that the most significant determinant of when trafficking will occur is government corruption.

But a key finding is the importance of government corruption in predicting trafficking. This analysis suggests that reducing corruption should be the first and most effective way to reduce trafficking. In other words, potential traffickers need to understand that their government perceives trafficking as a crime and that they cannot bribe their way out of prosecution or through the border if they commit the crime. This finding also implies that government actions to reduce corruption should lead to improved information about trafficking and enslavement, as well as actual reductions in slavery.<sup>47</sup>

Corrupt government officials will turn a blind eye to trafficking or even assist with obtaining visas and passports in return for bribes.<sup>48</sup> Sometimes, the government officials themselves own or patronize the brothels.<sup>49</sup>

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or employment opportunities; where there is an unstable family structure (perhaps also due in part to economic, political, or social structure); and where gender, racial, or caste stigma or marginalization exists. Traffickers are getting smarter and know how to target both the most vulnerable and least visible people. They understand how to exploit the desire that these people, their future victims, have to improve their lives, and they know how to make their own fingerprints in the process virtually undetectable.

Haynes, *supra* note 5, at 342-43.

Not surprisingly, these states tend to possess certain socioeconomic and cultural characteristics that facilitate trafficking for sexual exploitation: widespread poverty, weak social and economic structures, lack of employment opportunities, organized crime, violence against women and children; discrimination against and devaluation of women, government corruption, and political instability.

Lindo, *supra* note 20, at 137.

<sup>47</sup> Bales, *supra* note 2, at 350.

<sup>48</sup> See Tiefenbrun, *supra* note 26, at 143 ("The corruption commonly associated with the trafficking industry in many countries undermines law enforcement and the rule of law globally. Trafficking could not exist without the complicity of corrupt officials who take bribes and complacently look away as illegal aliens or victims of sex trafficking slip into countries that fail to protect them."); Int'l Helsinki Fed'n for Human Rights, A FORM OF SLAVERY: TRAFFICKING IN WOMEN IN OSCE MEMBER STATES (2000) at 36 (citing Kyrgyz media publication that appears to suggest the involvement of criminal money in bribes for arranging exit visas and passports, as well as coordination of such "processes" by "cool guys with contacts in all the state bodies.") cited in Mohamed, Y. Mattar, *State Responsibilities in Combating Trafficking in Persons in Central Asia*, 27 Loy. L. A. Int'l & Comp. L. Rev. 145, n.76 (2005).

Professors Hughes and Diep also note the role that government corruption plays in enabling trafficking:

The corruption of officials through bribes and the collaboration of criminal networks with government officials enable traffickers to operate. In Russia, the Global Survival Network found evidence of government collaboration in the Interior Ministry, the Federal Security Service, and the Ministry of Foreign Affairs. As the influence of criminal networks deepens, the corruption goes beyond occasionally ignoring illegal activity to providing protection by blocking legislation that would hinder the groups' activities. As law enforcement personnel and government officials become more corrupt and criminals gain more influence, the line between the state and the criminal networks starts to blur, making it difficult to intervene in the succession of corruption, collaboration, crime, and profit.

Hughes *supra* note 9, at 13.

Admittedly, there is no one single, simple solution that will eliminate the social conditions that make people vulnerable to being enslaved. Programs such as the micro-credit programs that lend money to poor women to start small businesses so that they can become economically self-sufficient are important, but these are long-term solutions.<sup>50</sup> With as many as one to four million new victims each year, we must also take some more immediate measures. Other countries and governments cannot force complicit countries to curb government corruption; however, their own residents can, in particular, the wealthy residents, who have the most power and influence over their governments. If the wealthy residents have an incentive to exert their influence and demand the end of government corruption, traffickers would not be able to operate.

### *C. International Community's Responses to Human Trafficking.*

#### **1. United Nations Pronouncements.**

The international community recognizes that human trafficking is a crime and not merely a cultural norm. The international community has condemned slavery, involuntary servitude and violence against women and other elements of trafficking in the form of declarations, treaties,

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A network of people, including corrupt government officials and international crime organizations, are involved in facilitating sex trafficking. Law enforcement officials often turn a blind eye. Government officials issue "legitimate" visas or even block legislation that would hinder the profitability of this industry.

Diep, *supra* note 5, at 317.

<sup>49</sup> The government officials involved range from local police to cabinet level officials.

The transition in each state from communism to a quasi-democratic form of government and the accompanying weakness of the new political institutions have created a favorable environment for organized crime and corruption to thrive. ... Such extreme levels of corruption are certainly instrumental in helping the traffickers with their illegal activities, especially given the fact that trafficking in Central Asia commonly "involves highly organized and well-connected criminal syndicates." As a result, corrupt law enforcement officials in Central Asian nations "have become an integral link in the trafficking chain."... But perhaps the most startling recent development involved reports alleging the involvement of Gulnara Karmova, the eldest daughter of Uzbekistan's president, in sophisticated trafficking schemes between Uzbekistan and the United Arab Emirates. ... The President of Uzbekistan is reportedly aware of this "business."

Mattar, *supra* note 48, at 160-62:

The commercial sex sector not only provides substantial income and employment for those directly involved but a wide array of other individuals and institutions. ...[T]he huge amount of easy money draws in international crime syndicates as well as corrupt government officials who hope to augment their often paltry salaries. National and international press and human rights reports all emphasize that the sex sector is supported by politicians, police, armed forces, and civil servants, who receive bribes, demand sexual favors, and are themselves customers and often partial owners of the establishments. For example, Burmese children often speak of how policemen or border guards were involved in their trafficking into Thailand and how they had to entertain policemen.

Abigail Schwartz, *Sex Trafficking in Cambodia*, 17 Colum. J. of Asian Law 371, 389-90 (2004).

<sup>50</sup> See e.g., Avery, *supra* note 44; and Jonathan Todres, *The Importance of Realizing "Other Rights" To Prevent Sex Trafficking*, 12 CARDOZO J.L. & GENDER 885,897-98 (2006) urging, *inter alia*, that governments require that all births be registered. Birth registration establishes the child's existence and age, and provides the basis for other rights.

and United Nations resolutions and reports, which date as far back as the beginning of the last century.

There are 14 international conventions prohibiting trafficking and related crimes. These conventions date back to 1904 and include the most recent U.N. Convention against Transnational Organized Crime: Protocol to Prevent Smuggling of Migrants by Land, Sea, and Air.... There are six Declarations, Treaties, and U.N. Resolutions and Reports condemning slavery, and these were passed as early as 1948. There have been many laws prohibiting slavery and trafficking, but there has been very little effective enforcement of these laws.<sup>51</sup>

However, protocols, conventions, and resolutions don't enforce themselves. These various statements do not contain any teeth; there is no penalty for failing to abide by them, and there is no central authority to enforce them.

Although the United Nations has drafted covenants, conventions, treaties, and protocols seeking to eradicate trafficking, the trade continues to grow and victims have no realistic recourse through the various tribunals currently set up by the UN. This is problematic, given that the UN Human Rights Committee (UNHRC) was formed for the purpose of investigating and fashioning remedies to human rights violations. Given the limited number of countries that have ratified the human rights treaties and protocols, it is questionable whether UNHRC can be successful or effective. It has no binding authority, limited investigative powers to look into alleged abuses, may only address violations in states that are parties to the treaties, and may only act in situations where the violation is committed by a "state actor," meaning a government official or person acting under government authority. A majority of the human rights abuses connected with trafficking are unreachable by UNHRC's mandate.<sup>52</sup>

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<sup>51</sup> Susan Tiefenbrun, *The Domestic and International Impact of the U.S. Victims of Trafficking Protection Act of 2000: Does Law Deter Crime?* 2 LOY. U. CHI. INT'L L. REV. 193, n.24 (2005).

The U.N. declarations, conventions, and resolutions include the following:

The Universal Declaration of Human Rights of 1948; the 1956 Supplementary Convention on the Abolition of Slavery, the Slave Trade, and Institutions and Practices Similar to Slavery; the 1948 American Declaration on the Rights and Duties of Man; the 1957 Abolition of Forced Labor Convention; the International Covenant on Civil and Political Rights; the Convention Against Torture and Other Cruel, Inhuman, or Degrading Treatment or Punishment; United Nations General Assembly Resolutions 50/67, 51/66 and 52/98; the Final Report of the World Congress Against Sexual Exploitation of Children (Stockholm, 1996); the Fourth World Conference on Women (Beijing, 1995); the 1991 Moscow Document of the Organization for Security and Cooperation in Europe; the U.N. Convention Against Transnational Organized Crime: Protocol to Prevent, Suppress and Punish Trafficking in Persons, Especially Women and Children and the Protocol Against Smuggling of Migrants by Land, Sea and Air (November 15, 2000).

Tiefenbrun, *supra* note 26, at 144. See also Diep, *supra* note 5, at 319-21; and Lehti, & Aromaa, *supra* note 5, at 163-73 for a history of the U.N. actions.

<sup>52</sup> Sara Elizabeth Dill, *Old Crimes in New Times*, 21-SPG Crim. Just. 12, 14 (2006).

## 2. United States Law

In 2000, Bill Clinton signed the Victims of Trafficking and Violence Protection Act of 2000 (the VTPA), which was the first U.S. statute aimed specifically at human trafficking.<sup>53</sup> Prior to the enactment of the VTPA, traffickers were prosecuted under a variety of criminal and immigration statutes, with relatively mild penalties. The VTPA provided for significant penalties on level with penalties for rape or murder, and recognizes that trafficking is a violent crime.<sup>54</sup> The VTPA has three prongs: prevention, protection, and prosecution. Under its prevention prong, the VTPA establishes programs to enhance economic opportunities for potential victims and to educate potential victims about recruitment methods.<sup>55</sup> The protection prong allows the Justice Department to arrange for victims of “severe forms of trafficking within the United States”<sup>56</sup> to receive medical, financial and legal assistance.<sup>57</sup> Further, victims of severe forms of trafficking

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<sup>53</sup> Victims of Trafficking and Violence Protection Act of 2000, Pub. L. No. 106-386, 114 Stat. 1464 (codified as amended in various sections of 8 and 22 U.S.C. (2000) ). The Act was amended and reauthorized by the Trafficking Victims Protection Reauthorization Act of 2003, Pub. L. No. 108-193, 117 Stat. 2875 (to be codified in various sections of 8, 18, and 22 U.S.C.). It was amended and reauthorized again by the Trafficking Victims Protection Reauthorization Act of 2005, Pub. L. No. 109-164, 119 Stat. 3558 (to be codified as amended in various sections of 18 and 22 U.S.C.), which was signed into law on January 10, 2006.

<sup>54</sup> 18 U.S.C. §§1589 and 1590 provide that traffickers may receive prison sentences of up to twenty years, and if the trafficker causes the death of a victim, a life sentence. 18 U.S.C. §1591 provides that If the victim is a child under the age of eighteen, the trafficker may receive a life sentence. Further, 18 U.S.C. §1592 provides that any person who “destroys, conceals, removes, confiscates, or possesses any identification, passport, or other immigration documents” as a part of a trafficking scheme, may receive a prison sentence of up to five years.

<sup>55</sup> 22 U.S.C. §7104. PREVENTION OF TRAFFICKING. (a) Economic Alternatives to Prevent and Deter Trafficking. –The President, acting through the Administrator of the United States Agency for International Development and the heads of other appropriate agencies, shall establish and carry out initiatives to enhance economic opportunity for potential victims of trafficking as a method to deter trafficking. Such initiatives may include –

- (1) microcredit lending programs, training in business development, skills training, and job counseling;
- (2) programs to promote women’s participation in economic decision making;
- (3) programs to keep children, especially girls, in elementary and secondary schools;
- (4) development of educational curricula regarding the dangers of trafficking; and
- (5) grants to nongovernmental organizations to accelerate and advance the political, economic, social, and educational roles and capacities of women in their countries.

<sup>56</sup> 22 U.S.C. §7102 defines “severe forms of trafficking” as follows:

(2) “Severe forms of trafficking in persons” means – (A) sex trafficking in which either a commercial sex act or any act or event contributing to such act is effected or induced by force, coercion, fraud, or deception, or in which the person induced to perform such act has not attained the age of 18 years; and (B) the purchase, sale recruitment, harboring, transportation, transfer, or receipt of a person for the purpose of subjection to involuntary servitude, peonage, or slavery or slavery-like practices which is effected by force, coercion, fraud, or deception.

<sup>57</sup> 22 U.S.C. §7105 provides in pertinent part as follows:

(c)(1) Victims of severe forms of trafficking, while in the custody or control of the Federal Government and to the extent practicable, shall be housed in appropriate shelter as quickly as possible, receive prompt medical care, food, and other assistance, and be provided protection if a victim’s safety is at risk or if there is danger of additional harm by recapture of the victim by a trafficker. (2) Victims of severe forms of trafficking shall not be jailed, fined, or otherwise penalized due to having been trafficked. (3) Victims of

may be given temporary T-visas to stay in this country if they are willing to be prosecution witnesses.<sup>58</sup> The VTPA's third prong is its primary one: prosecution.<sup>59</sup>

Although lauded as an important first step, the VTPA has enjoyed limited success. Commentators have found that the emphasis on prosecution has limited the Act's effectiveness.<sup>60</sup> For example, despite the fact that there are approximately 14,500 to 50,000 trafficking victims in this country,<sup>61</sup> in the first four years of the VTPA's existence fewer than 1,000 victims received

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severe forms of trafficking shall have access to legal assistance, information about their rights, and translation services.

<sup>58</sup> 22 U.S.C. §7105 provides as follows:

(4) Federal law enforcement officials shall act to ensure an alien individual's continued presence in the United States, if after an assessment, it is determined that such individual is a victim of trafficking or a material witness, in order to effectuate prosecution of those responsible and to further the humanitarian interests of the United States, and such officials investigating and prosecuting traffickers shall take into consideration the safety and integrity of trafficking victims.

<sup>59</sup> As noted above, the VTPA increased the penalties for trafficking; the VTPA also authorizes the United States Attorney General to gather and publish certain information regarding traffickers.

<sup>60</sup> Chacon, *supra* note 17, at 2978 ("The most recent diagnoses of the domestic failure are tending to converge: Commentators note that the Act – particularly as it has been implemented – emphasizes the law enforcement components of anti-trafficking initiatives in a way that undercuts the Act's humanitarian goals of assisting trafficking victims."); *See also* Haynes, *supra* note 5 for a thorough analysis of how the federal agencies' emphasis on the Act's prosecution prong has distorted and undermined the Act's primary mission of assisting trafficking victims. Further, personnel in the field who actually encounter trafficking victims have not received proper training, and, as a result, often fail to recognize a victim. As a result, few victims have received assistance.

<sup>61</sup> Professor Haynes questions the validity of the State Department's and Department of Justice's revised numbers as to the number of victims trafficked into the United States each year.

In its 2002 Report, the DOS estimated that as many as 50,000 new victims are trafficked into the United States each year. By the following year, the estimate had been lowered to 18,000 to 20,000 annually. In 2005, the DOJ lowered those estimates yet again, down to a maximum of 17,500 per year. None of the government reports specifies who has made the estimates, let alone divulged the methodology behind the statistics they offer.

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...[T]he DOJ Report attempts no explanation for the first rather dramatic reduction in the total estimated number of victims entering the United States, nor for the more gradual annual reductions since, to arrive at the current DOJ estimate of 17,500. Nor did the DOJ explain its methodology, whether new or more reliable statistics were gathered or whether, on the contrary, the government might have simply lowered the estimated number of victims entering each year to discount the fact that it only assisted 1,000 victims.

...

Instead, the DOJ offers four preferred explanations for the disparity in numbers, none of which acknowledges that there might really be up to 50,000 new victims each year who we do not find or assist, nor that there might be systemic problems which seriously limit the ability or willingness of U.S. government officials to label a victim a "victim" and offer her benefits, accordingly.

Haynes, *supra* note 5, at 343-44.

either certification that they were eligible for services or T-visa protection provided to victims of severe forms of trafficking.<sup>62</sup> In 2004, the Department of Justice initiated prosecutions against fifty-nine traffickers but only thirty-two of the defendants were actually charged under the VTPA.<sup>63</sup>

The VTPA also requires the Secretary of State to issue an annual report, commonly referred to as a TIP report (trafficking in persons), which places trafficking countries -- *i.e.*, countries of origination, transit, or destination -- into three tiers.<sup>64</sup> Tier 1 countries, which include the United States, are countries that are making significant efforts to prevent or stop human trafficking. Tier 1 countries fully comply with the Act's minimum standards.<sup>65</sup> Tier 2 countries are not in total compliance with the minimum standards but are making "significant efforts to bring themselves into compliance."<sup>66</sup> Tier 3 countries do not fully comply with the minimum standards nor are they making efforts to do so.<sup>67</sup> The 2003 amendments to the VTPA added a tier 2 "watch list" which are countries that fell to a lower tier than the prior year's report or otherwise are not making satisfactory progress, but are sufficiently compliant to escape the stigma of being placed in Tier 3.<sup>68</sup> Countries that are in Tier 3 are at risk for losing "nonhumanitarian, nontrade-related foreign assistance" from the United States.<sup>69</sup>

The effectiveness of the TIP reports is subject to dispute.<sup>70</sup> Many countries enacted anti-trafficking legislation in response to the TVPA and the TIP reports; however, it is unclear whether those countries intend to act on the legislation or whether it is merely window-dressing.<sup>71</sup> There also is concern that the reports are being politicized by the United States by rating countries based on whether or not they are allies, at least to some extent. For example, the 2004 TIP report promoted Indonesia, which is an ally in the war on terrorism, from Tier 3 to Tier 2, and demoted Venezuela, which whom we have strained relations, from Tier 2 to Tier 3, despite any discernible change in either countries' practices.<sup>72</sup>

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<sup>62</sup> Chacon, *supra* note 17, at 3018-19.

<sup>63</sup> *Id.* at 3019.

<sup>64</sup> 22 U.S.C. §§7107(b)(1) and 7106.

<sup>65</sup> 22 U.S.C. §7107(b)(1)(A).

<sup>66</sup> 22 U.S.C. §7107(b)(1)(B).

<sup>67</sup> 22 U.S.C. §7107(b)(1)(C).

<sup>68</sup> The Trafficking Victims Protection Reauthorization Act of 2003, *supra* note 53, §6(e).

<sup>69</sup> 22 U.S.C. §7107(a).

<sup>70</sup> See *e.g.*, Bales, *supra* note 2, at 335; Haynes, *supra* note 5, at 362.

<sup>71</sup> Janie Chuang, *The United States as Global Sheriff: Using Unilateral Sanctions to Combat Human Trafficking*, 27 MICH. J. INT'L L. 437, 464-65 (2006).

<sup>72</sup> *Id.* at 482-83.

### 3. European Union Legislation

Human trafficking has increased in the member states of the European Union, especially since the establishment of the Schengen Area.<sup>73</sup> In 2002, the European Council passed the 2002 Decision which obligated member states to specifically criminalize human trafficking and to adopt minimum prison sentences for individuals convicted of certain trafficking offenses.<sup>74</sup> In 2004, the European Council passed the 2004 Directive which obligates member states to provide victims with medical treatment, translation services, and a reflection period during which time they cannot be deported.<sup>75</sup>

All Member States except Estonia have passed legislation that specifically criminalizes trafficking for sexual exploitation; however, the conviction rates have not been particularly high and the penalties have been light.<sup>76</sup> For example, eight states reported sentences that consisted of suspended sentences, fines, or prison terms of less than six years. The United Kingdom and Portugal imposed more severe sentences, with average sentences for the United Kingdom of eighteen years and average sentences for Portugal of eleven to fifteen years.<sup>77</sup> These are important steps to fight human trafficking; however, these efforts are hampered by the fact that they are limited to the EU Member states.

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Concerns about using the TIPS reports for political purposes continue:

The credibility of trafficking sanctions thus turns on whether the decision to issue sanctions is based on clearly defined and consistently applied principles, rather than political calculation. Of the 15 countries ranked Tier 3 in the 2003 TIP Report, the United States ultimately sanctioned only Burma, Cuba, and North Korea. Of the ten countries ranked Tier 3 in 2004, these three countries were again subject to sanctions, along with Equatorial Guinea, Sudan, and Venezuela. In 2005, the United States ultimately sanctioned five of the fifteen Tier 3 countries – Cuba, Burma, North Korea, Venezuela, and Cambodia. That the countries sanctioned include those already under sanctions from the United States or those with which the United States has little economically and strategically at stake invites the familiar criticism of U.S. sanctions policy for “picking and choosing among human rights violators.”

*Id.* at 484-85

<sup>73</sup> The Schengen Area, which includes all of the European Union Member states, permits travelers and citizens who are legally present in the area to move freely without the need to show passports when crossing borders. The practical effect is that anyone who is able to enter the area, legally or not, may move about freely without restriction. Lindo, *supra* note 20, at 139.

The highest estimates of prostitution-related trafficking in Europe come from Human Rights Watch, the Swedish NGO “Kvinna till kvinna,” and from Maltzahn in the Australian Women Conference (2001) (it is probable that they are all based on a common unmentioned source), which gives 500,000 women and children as the annual volume of trafficking *to the E.U. old member countries* (E.U. 15) (or, alternatively, to “western Europe”).

Lehti, & Aromaa, *supra* note 5, at 189.

<sup>74</sup> Lindo, *supra* note 20, at 142.

<sup>75</sup> *Id.* at 142.

<sup>76</sup> *Id.* at 143.

<sup>77</sup> *Id.* at 143.

### III. Legal Enforcement and Collateral Consequences.

#### A. Symbolic, Expressive, and Instrumental Sanctions

Despite fierce condemnation, human trafficking has flourished -- in part because any sanctions imposed have had expressive or symbolic effect, but not instrumental effect. Professor Michael Kirsch has examined the imposition of sanctions from an instrumental, expressive, and symbolic perspective in the context of tax-motivated expatriation, but which has broader implications.<sup>78</sup> In 1996, Congress enacted I.R.C. §6039G(e), which requires that U.S. citizens who renounce their citizenship in order to avoid paying U.S. tax have their names published in the Federal Register.<sup>79</sup> A month later, Congress enacted the Immigration Reform and Immigrant Responsibility Act of 1996,<sup>80</sup> which contained a provision, commonly referred to as the Reed Amendment,<sup>81</sup> which prohibits these former citizens from re-entering the United States.<sup>82</sup> Congress chose to impose these shaming (name publication) and banishment (no re-entry) sanctions as an alternative to imposing a traditional tax sanction.<sup>83</sup> Professor Kirsch's article "analyses the alternative sanctions from three perspectives: their instrumental effect, their expressive function in altering social norms, and their role as symbolic legislation."<sup>84</sup>

Symbolic legislation does not seek to change or stop the target's undesirable behavior; instead, symbolic legislation's purpose is to reassure the public that "something" is being done about the problem.<sup>85</sup> If the target's behavior actually does change, that is merely a fortuitous, beneficial side-effect. For example, Professor Kirsch observes that legislation banishing expatriates sends the signal that Congress is cracking down on tax cheats.<sup>86</sup> Expatriates are a small, but visible

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<sup>78</sup> Michael S. Kirsch, *Alternative Sanctions and the Federal Tax Law: Symbols, Shaming, and Social Norm Management as a Substitute for Effective Tax Policy*, 89 IOWA L. REV. 863 (2004).

<sup>79</sup> Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, §512(a), 110 Stat. 1936, 2100. (The relevant section was originally numbered §6039F, but to avoid duplicate numbering the section was renumbered §6039G. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, §1602(h)(1), 111 Stat. 788, 1096. See Kirsch, *supra* note 78, at 888, n.118. Although §6039G is contained in the Internal Revenue Code, Kirsch considers the section to be an alternative sanction rather than a traditional civil or criminal tax penalty. See Kirsch, *supra* note 78, at 888, n.119.

<sup>80</sup> Pub. L. No. 104-208, 110 Stat. 3009-546 (1996).

<sup>81</sup> Representative Jack Reed (now Senator) introduced the provision in November of 1995 during a mark-up of a predecessor immigration bill. See Kirsch, *supra* note 78, at 891, n.130.

<sup>82</sup> *Id.* at 890-91.

<sup>83</sup> *Id.* at 888, n.119.

<sup>84</sup> *Id.* at 863. (Professor Kirsch studies the use of the nontax code sanctions to punish tax code violations. My proposal is the inverse of this: using the tax code to punish (or reward) nontax behavior – human trafficking.)

<sup>85</sup> *Id.* at 921.

<sup>86</sup> *Id.* at 923-25.

and controversial group;<sup>87</sup> enacting legislation designed to punish them provides the public with a sense of satisfaction that something has been accomplished about tax evasion, despite the fact that expatriation is a technique rarely used to avoid tax and I.R.C. §6039(G)(e) and the Reed amendment do virtually nothing to address the serious problem of tax evasion.<sup>88</sup>

Unlike symbolic sanctions, expressive sanctions do seek to change the target's behavior. They do so by changing or altering norms.<sup>89</sup> The goal of the expressive form of sanctions is to encourage the target to internalize a new norm, thereby causing the target to change its behavior. Robert McAdams's esteem-based theory of norm development theorizes that the enactment of expressive legislation publicizes to the relevant community that a consensus on certain behavior exists. After individuals become aware of this consensus, they are more likely to experience a gain in esteem by complying with the norm (or lose esteem by failing to comply.)<sup>90</sup> Simply put, if a sufficient number of people in a social group or community adopt a norm, those who comply gain esteem and those who violate the norm garner disapproval. For example, Professor Kirsh considers whether the alternative sanctions contained in the Reed amendment alter social norms so that U.S. citizens considering expatriation in order to avoid tax will be deterred from doing so.

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<sup>87</sup> One of the more notorious cases concerned Kenneth Dart, the owner of Dart Container Corporation which manufactures most of the Styrofoam cups sold in the United States. Mr. Dart surrendered his U.S. citizenship and became a citizen of Belize. He then persuaded the Belize government to appoint him as a diplomatic representative to the U.S., with the intent of opening a consulate office in Florida, where his family lived. After the Department of State indicated to the Belize government that the U.S. would not be responding to the Belize's government's appointment request any time soon, Belize withdrew its request to appoint Mr. Dart. *Id.* at 891, n.133.

<sup>88</sup> *Id.* at 876 ("More than 255,000,000 million individuals hold United States citizenship, yet, on average, fewer than 600, or 0.000023%, renounce or otherwise lose citizenship annually.") Between 1991 and 2001, 636 individuals received certificates of loss of nationality; however, not all of these individuals renounced for tax-motivated reasons. *Id.* at 875-76, n.50. Further, as of 2003, no person has been barred from re-entering the United States because of the Reed Amendment, *Id.* at 900, n.172 and n.173. See also Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 OH. ST. L. J. 1453 (2003) (demonstrating that enforcement sanctions such as auditing and penalties can buttress norms-based appeals for compliance.)

<sup>89</sup> Kirsch, *supra* note 78, at 913 For purposes of expressive sanctions, "the term 'social norms' means informal social regularities that individuals feel obligated to follow because of an internalized sense of duty, because of a fear of external non-legal sanctions, or both." Richard H. McAdams, *The Origin, Development, and Regulation of Norms*, 96 Mich. L. Rev. 338, 340 (1997) relied on by Kirsch, *supra* note 78, at 913, n.219. See also Robert Cooter, *Expressive Law and Economics*, 27 J. Legal Stud. 585, 587 (1998) (stating that a social norm is "a consensus in a community concerning what people ought to do ... [that] affects what people actually do"), cited in Kirsch, *supra* note 78, at 913, n.219.

<sup>90</sup> Kirsch, *supra* note 78, at 915, citing McAdams, *supra* note, at 400-07. Similarly, Professor Cass Sunstein argues that politicians can serve as

potential norm entrepreneurs ... alerting the public to the existence of a shared complaint and suggesting a collective solution. Under certain circumstances, the enactment of legislation may lower the cost to individuals of expressing the new norms, resulting in a norm bandwagon that encourages an ever-increasing number of people to reject a previously popular norm. Eventually, a tipping point is reached, where the new norm becomes generally accepted and adherence to the old norm produces social disapproval.

Kirsch, *supra* note 78, at 916, citing Cass R. Sunstein, *Social Norms and Social Roles*, 96 Colum. L. Rev. 903, 912 (1996).

[S]everal existing social norms might have had relevance for a person considering expatriation. For example, norms obligating individuals to behave in a patriotic manner and to refrain from engaging in “unpatriotic” behavior might have caused an individual to refrain from expatriating to save taxes. In contrast, norms favoring personal autonomy or freedom from migration might have encouraged, or at least not discouraged, an individual’s expatriation.

The potential effect of the oft-studied norm regarding tax compliance is less clear. In a technical sense, an individual who surrenders citizenship to avoid taxes would not be violating this norm as long as he complies with the alternative income tax regime . . . . Nonetheless, some individuals might perceive tax-motivated expatriation as cheating in violation of this norm. . . .

The use of alternative sanctions might be viewed as a tool for norm management to clarify which of these inconsistent norms applies in the case of tax-motivated expatriation.<sup>91</sup>

If enough people associate tax-motivated expatriation with unpatriotic behavior and tax cheating, potential expatriates should internalize those norms and will not renounce U.S. citizenship.<sup>92</sup>

The United Nations has passed numerous resolutions, conventions, etc. condemning human trafficking and involuntary servitude.<sup>93</sup> Although a cynic might argue that these various statements are merely symbolic, they are of sufficient duration, repetition, and magnitude as to have an effect on norms and, therefore, should be categorized as expressive legislation. The international community unequivocally has adopted the norm that human trafficking is slavery and barbaric, and also has adopted the norms that human beings are entitled to dignity and self-actualization. Although not all nations have signed these various documents, a sufficient number have done so to create pressure on everyone to comply with these norms. Consensus in the international community exists as to these norms. However, other than shaming, few sanctions exist, and, as shall be discussed below, most nations can avoid shaming by the simple expedient of committing to human rights treaties without complying with them.<sup>94</sup>

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<sup>91</sup> Kirsch, *supra* note 78, at 917-18.

<sup>92</sup> Professor Kirsh determined that even if expatriation is viewed as unpatriotic and a form of tax cheating, those norms will not deter tax-motivated expatriation primarily because those individuals will no longer be a part of the U. S. community which endorses those norms. In other words, even if the norms regarding expatriation are clarified so that it is viewed as unpatriotic and cheating, the target’s behavior need not change to avoid the expressive sanction (loss of esteem) contained in the norms because the target will avoid the sanction by exiting the community which endorses these norms. *Id.*, at 918-20.

<sup>93</sup> See *supra* Part II.C.1.

<sup>94</sup> There is a difference between a nation that is complicit in trafficking and a nation that condemns human trafficking but simply lacks the means to prevent it within its borders. Many war-torn or developing nations must make painful decisions as to where resources are to be allocated, and given the long-standing second-class status of women, oftentimes their protection does not take priority. In contrast are nations where the government condemns the practice, but, in fact, many public officials engage in trafficking.

The international community's failure to prevent human trafficking can be attributed, in great part, to the fact that the numerous United Nations position papers are not instrumental legislation. Instrumental sanctions attempt to change behavior by changing the cost/benefit analysis (in contrast to expressive sanctions which attempt to change behavior by changing the norms.)<sup>95</sup> For example, a U.S. citizen who contemplates expatriating to avoid taxation must weigh the benefit of not paying tax against the cost associated with losing the protection of U.S. citizenship.<sup>96</sup> The Reed amendment is instrumental legislation in that its intent is to increase the cost of tax-motivated expatriation by means of banishment and name publication.

The pronouncements condemning human trafficking do not contain any enforcement mechanisms that would change the cost/benefit analysis for human traffickers or for governments that are complicit in human trafficking. Violators can and do act with impunity. Further, there is no central enforcement authority to impose any significant sanctions to increase the cost of violations, other than perhaps the United Nations which has limited options at its disposal.<sup>97</sup> The World Trade Organization and the International Monetary Fund, which could impose economic penalties on complicit nations, have begun to scrutinize human rights practices of countries seeking funds.<sup>98</sup> However, it remains to be seen how effective these measures will be. The only meaningful sanction these U.N. agreements impose on violators is shaming.<sup>99</sup> States and their citizens might be susceptible and sensitive to shaming, but the traffickers are not.

In addition to the United Nations, the United States and the European Union have attempted to influence other nations to stop human trafficking through legislation. This legislation is not merely symbolic legislation – the VTPA, for example, contains several important provisions that are intended to assist victims, coordinate prosecution of traffickers, and encourage other countries to take measures to stop trafficking.<sup>100</sup> It is both expressive and instrumental; however, although it attempts to operate in both the domestic and international arenas, its reach is limited because it is domestic legislation. It is expressive legislation in that it attempts to change norms. One of the VTPA's key provisions is the requirement that the U.S. State Department issue annual reports placing countries in tiers. One of the goals of publishing the list is to encourage countries to take steps to prevent or eliminate human trafficking in their countries.

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<sup>95</sup> See Kirsch, *supra* note 78, at 894 and 913.

<sup>96</sup> *Id.* at 893.

<sup>97</sup> See discussion *infra* II.C.1.

<sup>98</sup> Oona A. Hathaway, *Between Power and Principle: An Integrated Theory of International Law*, 72 U. CHI. L. REV. 469, 504-05 (2005).

<sup>99</sup> Shaming is both an expressive sanction and an instrumental sanction. In the expressive context, shaming can be used to change norms. In the instrumental context, shaming might impose an increased cost on the target. For example, a nation that is shamed in the human rights area, might find it more difficult to attract investment. See Kirsch, *supra* note 78, at 914, n.223.

<sup>100</sup> See *supra* Part II.C.2.

The VTPA also attempts to be instrumental legislation in that it endeavors to shift the cost/benefit analysis against human trafficking. The VTPA provides that tier 3 countries risk losing “non-trade” and “non-humanitarian” funding.<sup>101</sup> This is not a particularly severe sanction. Although the VTPA was intended to have a three prong approach to trafficking -- prevent trafficking, protect victims, and prosecute offenders -- its reach has been confined mostly to the prosecution prong. Prosecution is important but it is after-the-fact – the victim has already been harmed.

Human trafficking crosses borders, but the United Nations, the United States, and the European Union cannot directly reach in to other countries and force them to take appropriate measures against trafficking. However, it is possible for these entities to create effective instrumental incentives and sanctions that will change the cost/benefit analysis of human trafficking in a way that will lead to compliance. Professor Hathaway’s integrated theory both explains why states do not comply with certain treaties and the factors that can be used or manipulated to create instrumental incentives and sanctions that will change that behavior.

*B. Integrated Theory: Why Commit but not Comply.*

It seems counterintuitive that states would commit to a treaty with which they do not intend to comply. However, Professor Hathaway’s empirical research of the behavior of 160 nations over a period of 40 years<sup>102</sup> reveals such to be the case, and that the failure to comply occurs more often with regard to human rights and environmental treaties and less often with regard to trade agreements.<sup>103</sup> Professor Hathaway has found that it is possible to predict whether or not a state will comply with a treaty based on four factors: (1) transnational legal enforcement; (2) domestic legal enforcement; (3) transnational collateral consequences; and (4) domestic collateral consequences.<sup>104</sup>

Transnational legal enforcement occurs when international bodies or other states that are parties to the treaty respond to violations in ways provided for in the treaty itself. Domestic legal enforcement occurs when domestic actors use a country’s own legal system to enforce the terms of an international legal agreement. Collateral consequences arise when domestic and transnational actors base their actions towards a state on whether the state complies with the international legal agreement.<sup>105</sup>

Hathaway’s integrated theory makes three main points with regard to (1) transnational legal enforcement, (2) domestic legal enforcement, and (3) collateral consequences:

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<sup>101</sup> 22 U.S.C. §(d)(1)(A)

<sup>102</sup> Hathaway, *supra* note 98, at 513.

<sup>103</sup> *Id.* at 515.

<sup>104</sup> *Id.* at 492.

<sup>105</sup> *Id.* at 473.

Where transnational enforcement of an international treaty is strong, states that are not already in compliance are less likely to commit to it. Conversely, where transnational legal enforcement is weak, states that are not already in compliance with the terms of a treaty are often as likely to commit to a treaty as those that are already in compliance. Domestic enforcement is essential to compliance with much of international law. Once they have committed to a treaty, the governments of nations with strong rule of law are likely to comply with their commitments as a result of enforcement of their agreement by domestic actors working through domestic institutions. The same is not true for nations with weak domestic rule of law. The collateral consequences of treaty membership can sometimes lead states with poor practices to commit but not comply with a treaty. Membership in a treaty can bring valuable collateral benefits, such as increased foreign aid or cross-border trade. Where compliance is not well-monitored and treaty requirements are not enforced, those collateral benefits of membership can lead states to join treaties with which they will not or cannot comply.<sup>106</sup>

Hathaway found strong evidence to support her position regarding the role of transnational legal enforcement. Human rights and environmental treaties generally do not have penalty or enforcement mechanisms, unlike trade treaties, where, if a party is not in compliance, the other parties may withdraw trade benefits. She discovered that treaties containing strong transnational enforcement provisions, such as trade agreements, gain fewer adherents than treaties with minimal transnational enforcement provisions, such as human rights and environmental agreements.<sup>107</sup> For example, the Convention Against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment had 134 parties by the end of 2003.<sup>108</sup> The treaty's only compliance requirement is that states submit reports to the Commission Against Torture, a requirement countries can ignore with impunity.<sup>109</sup> However, the General Agreement on Tariffs and Trade obtained only 60 members within a comparable period.<sup>110</sup>

Further, because compliance is not enforced, countries will commit to human rights treaties regardless of their actual practices. Hathaway's research disclosed that countries with poor human rights records and countries with the best human rights records ratified human rights

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<sup>106</sup> *Id.* at 514.

<sup>107</sup> *Id.* at 515.

<sup>108</sup> *Id.* at 514 (The U.N. adopted The Convention Against Torture in 1984. Nations that ratify the convention consent not to intentionally inflict "severe pain or suffering, whether physical or mental" on any person to obtain information or a confession, to punish that person, or to intimidate or coerce him or a third person. *Id.* at 516-17.)

The Vienna Convention on the Protection of the Ozone Layer of 1985 had 187 parties by the beginning of its twentieth year. *Id.* at 515.

<sup>109</sup> *Id.* at 517. (The treaty contains an optional enforcement procedure in which countries can agree to allow states and individuals to file complaints against them with the Committee Against Torture.)

<sup>110</sup> *Id.* at 515.

treaties at approximately the same rate.<sup>111</sup> In contrast, Hathaway found that in the area of economic policy noncomplying states that will be better able to comply are more likely to commit. For example, she noted that a study by Beth Simmons of “certain rules governing financial policies of national governments in the IMF’s [International Monetary Fund’s] Articles of Agreement shows that countries with economic indicators that suggest they will find it difficult to comply with the obligations are somewhat less likely to commit to them.”<sup>112</sup>

When transnational legal enforcement is nonexistent or weak, strong domestic legal enforcement mechanisms may step into the breach and ensure a state’s compliance with treaty commitments. Strong domestic enforcement is more likely to exist in democratic states with independent judiciaries or which have other institutions or means of protecting civil liberties. For example, domestic rule of law and, hence, domestic legal enforcement is strong when the judiciary, media, and political parties are free to operate independently of the executive.<sup>113</sup> She posits that “[i]n less democratic nations, where domestic enforcement can be less effective, states are less likely to abide by international law that is not enforced by transnational bodies.”<sup>114</sup> Simply put, nondemocratic states do not have institutions to which human rights advocates can turn to demand enforcement of the treaties. Therefore, nondemocratic states are free to commit without worrying about the need to comply.<sup>115</sup>

As noted above, the Convention Against Torture, which provides for weak transnational legal enforcement, provides a helpful illustration. Nondemocratic nations with poor records were more likely to commit to the Convention than nondemocratic nations with better records. In other words, nondemocratic nations with worse reported torture practices are more likely to commit to the Convention than those with better reported practices.<sup>116</sup> Her findings were

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<sup>111</sup> Further, Hathaway found that nondemocratic countries with the worst practices were more likely to ratify the Convention:

For example, roughly half of countries that have reportedly committed no genocide have ratified the Convention on the Prevention and Punishment of the Crime of Genocide; the same is true of countries with the very worst genocide ratings. Among nondemocratic nations (which tend to have weak domestic rule of law institutions) those with worse reported human rights practices appear more likely to have ratified human rights treaties than those with better reported practices.

*Id.* at 518.

<sup>112</sup> *Id.* at 519.

<sup>113</sup> *Id.* at 520.

<sup>114</sup> *Id.*

<sup>115</sup> Democracies on the whole are more likely to join international human rights treaties than nondemocracies, although they are less likely to join human rights treaties if they have worse practices than if they have better practices. By contrast, nondemocracies are more likely to join if they have worse practices than if they have better practices. *Id.* at 525.

<sup>116</sup> Hathaway’s research found that democratic nations are more likely to join the Convention. For example, fifty-six percent of democratic nations that have engaged in no torture ratified the Convention whereas only six percent of nondemocratic nations with similar records did so. She also found that democratic nations with poorer records are somewhat less likely to ratify the treaty than those democratic nations with strong records. *Id.* at 520-21.

duplicated with regard to environmental conventions which, as noted above, have weak transnational enforcement.<sup>117</sup>

Therefore, where transnational legal enforcement is weak, how states will respond to international law depends in large part on the domestic legal enforcement mechanisms that are in place. The evidence shows that democratic nations that engage in actions that are prohibited by the treaty are less likely to ratify the treaty than democratic nations with better practices. However, nondemocracies with worse practices are more likely to join treaties than nondemocracies with excellent records. She further states that “some evidence suggests that some countries that join human rights treaties may have worse practices than would be expected had they not joined.”<sup>118</sup> Only the most democratic states appear to improve their practices after ratifying human rights treaties.<sup>119</sup>

Collateral consequences arise when domestic and transnational actors premise their actions towards a state on the state’s decision to accept or reject international legal rules. At first blush, one would think that domestic and transnational actors would punish noncompliant states by imposing sanctions or penalties. However, many times the opposite occurs, and noncompliant states often reap sufficient rewards simply by committing to a treaty so that it is worth doing so even if the state cannot or will not comply with the treaty’s terms. This is particularly true with regard to environmental and human rights treaties, as opposed to trade treaties. Again, Hathaway’s findings are counterintuitive. It is one thing for transnational and domestic actors not to have any means of enforcing a treaty, which commonly occurs with regard to human rights treaties. But that does not explain why those same actors would reward or provide benefits to noncompliant states. There are several reasons why those actors do so, however.

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<sup>117</sup> *Id.* at 522-23. Hathaway reviewed the data with regard to the Vienna Convention, Montreal Protocol, and Copenhagen Amendment regarding the phase out of ozone-depleting chemicals – CFC’s. She posited that democratic states, which tend to have stronger domestic legal enforcement of international law, will be less likely to commit to these commitments if their practices are inconsistent with the agreements’ requirements than if their practices are already consistent, but if they do commit, they are more likely to comply with the agreements’ requirements. Her data found that democratic nations are more likely to commit to the agreements. For example, seventy seven percent of democracies with the lowest shares of CFC consumption ratified the Vienna Convention, but only twenty-six percent of nondemocracies with the lowest share of CFC consumption did so. However, a much greater number of nondemocratic nations with higher world shares of CFC consumption committed to the Vienna Convention than those with small world shares of CFC consumption. For example, twenty-six percent of nondemocratic nations with the lowest share of CFC consumption ratified the Vienna Convention compared to seventy-nine percent of nondemocratic nations with the highest share of CFC consumption. In other words, polluters were more likely to ratify the agreements than nonpolluters. Worse yet, nondemocracies that ratified the convention and protocol by 1989 expanded their consumption of CFC’s more in the three prior years than those that did not, despite the fact that the protocol and its amendments required percentage reductions in CFC’s from a base year of 1986. *Id.* at 523.

<sup>118</sup> *Id.* at 527. The evidence with regard to environmental treaties parallels that with regard to human rights treaties. For example, she discovered that countries which had not ratified either the Vienna Convention or the Montreal Convention reduced their CFC production much more so than those which had ratified. Specifically, she found that for countries which had not ratified the Vienna Convention by 1993, their CFC production fell 20.1 percent from the prior year, compared to a reduction of less than one percent among those that had ratified. The results were similar for countries which had and had not ratified the Montreal Protocol. *Id.* at 526.

<sup>119</sup> *Id.* at 525.

No one may discover, or not discover for some time, that the state is not in compliance. Oftentimes, commitment is used as evidence that the state intends to comply.<sup>120</sup> The state itself, which has enhanced its reputation by committing, is not going to be eager to publicize any shortcomings. Even if the state was aware that compliance would be difficult, the state's reputation was enhanced by the mere act of committing to a human rights treaty. After all, what is less shameful – refusing to commit to the treaty in the first place, or failing to comply later on down the road? Compliance can be difficult to verify. Other countries might find it difficult to monitor what takes place within a state. Nongovernmental Organizations (NGOs), such as Human Rights Watch, and other organizations specific to human trafficking, are willing to investigate and monitor, but they have limited resources.<sup>121</sup> Sometimes corporations that are eager to invest or conduct operations in the country will report back to their shareholders that the country is committed to human rights. In reality, the corporation does not care if the practices actually improve, but the shareholders have been appeased.<sup>122</sup>

In addition, there can be a lag in time between ratification and enforcement. Many of these states are in turmoil as a result of war or poverty or recently gained independence. No one expects them to become human rights bastions overnight, and, therefore, it might be several years before the state must satisfy expectations as to compliance. The state will have received “credit” for any initial efforts, even if faint. Meanwhile, the state has received the benefits – increased foreign aid or foreign direct investment. It can be difficult to unwind these benefits once they have been given to the state. The cost/benefit analysis has been tipped in favor of committing (because of the benefits) but not in favor of complying (because there is no cost.)

This is not to say that we should not encourage states to commit to human trafficking treaties. Even if the treaty does not contain some sort of enforcement mechanism, and, therefore, is not instrumental law, the treaty could change norms. By acknowledging the norms contained therein (*e.g.*, human trafficking is bad, people should be treated with dignity, women should not be given second class status, children should be protected) the state eventually might feel compelled to act in harmony with the norms, at least to some extent. More significantly, an empowered domestic organization might arise that will be able to use the treaty terms to demand domestic legal enforcement (if there are domestic institutions capable of responding to pressure. However, as Professors Kirsch and Hathaway point out, there is the danger that the treaty is merely symbolic legislation entered into to convey the impression that leaders are “doing something,” and, as noted above, it might be worth doing this if the rewards are big enough and if the risk of discovery of the noncompliance or the ability of anyone (domestic or transnational) to do something about it is minimal.

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<sup>120</sup> *Id.* at 525-26.

<sup>121</sup> *Id.* at 533, n.155.

<sup>122</sup> *Id.* at 508.

### C. Application of Integrated Theory to Human Trafficking

Human trafficking victims can be divided into two categories: (1) victims who are forced into the sex trade industry, and (2) those who are used for other purposes such as sweatshop or agricultural labor. Except where prostitution is legal, the trafficked sex trade workers are working in the illegal “shadow” economy, whereas the sweatshop and agricultural workers are being used to produce goods for the “legitimate” economy (unless the agricultural products are illegal narcotics.) The measures that can be taken to prevent the exploitation of victims in the legitimate economy differ from those in the shadow economy. It is possible to some extent to harness market forces or use domestic and international judicial bodies to pressure participants in the legitimate economy to behave in socially responsible ways and not use trafficked labor. Market forces have been exploited by “[t]he corporate social responsibility movement [which] seeks to influence directly or indirectly or control corporate behavior through a combination of (1) marketplace activism (influence over or via capital structure and sales of the corporation), (2) internal self-regulation (codes of conduct), and (3) shareholder activism.”<sup>123</sup>

Marketplace activism is an attempt to apply external pressure against the corporation; such pressure can include boycotts by consumers<sup>124</sup> and shaming those consumers who do not honor the boycott. For example, a threatened boycott of diamonds forced the DeBeers cartel to endorse the Kimberley Process’s certification requirements of which were designed to eliminate “blood diamonds” from the marketplace.<sup>125</sup> “A prominent diamond dealer reputedly suffered nightmares of the standard television commercial for diamonds ending with the tag line, “amputation is forever”<sup>126</sup> because such a grisly image, if it became strongly associated with diamonds, would taint the glamour and allure of diamonds for a long time. The reverse side of boycotts is urging consumers to purchase products that are labeled to indicate that human rights abuses did not occur in the manufacture of the product. For example, the “Rugmark” label on luxurious rugs from India and the FIFA mark on soccer balls indicates that child labor was not used in the manufacture of those products.<sup>127</sup> Another prominent example is the increased popularity of “fair trade” coffee the label of which assures consumers that the farmer was paid a

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<sup>123</sup> Eric Engle, *Corporate Social Responsibility (CSR): Market-Based Remedies for International Human Rights Violations?* 40 Willamette L. Rev. 103, 106 (Winter 2004).

<sup>124</sup> *Id.* at 110.

<sup>125</sup> See Daniel L. Feldman, *Conflict Diamonds, International Trade Regulation, and the Nature of Law*, 24 U. PA. J. INT’L ECON. L. 835 (2003). Guerilla forces in Sierra Leone, Angola, and the Congo controlled and terrorized large portions of those countries. These countries were sources of raw diamonds, and guerilla fighters forced villagers to mine the diamonds, which were easily transported out of the countries and traded for weapons. The guerillas used the weapons against government forces and terrorized villagers by committing atrocities such as hacking off children’s hands. The Kimberley process’s certification program was designed to ensure that diamonds being traded in the world markets were not these “blood diamonds.”

<sup>126</sup> *Id.* at 841.

<sup>127</sup> Engle, *supra* note 123, at 111.

fair price for the coffee beans. Activism can also be used to reward ethical corporations by encouraging investors to invest in socially responsible mutual funds.<sup>128</sup>

Activists also can apply internal pressure by using the corporation's own governance structure to force change. Shareholders can urge corporations to adopt codes of conduct, which, unfortunately, oftentimes are only symbolic in that the codes are voluntary and aspirational.<sup>129</sup> Nevertheless, corporations that violate their codes of conduct, if the violations are discovered, can be subject to shaming (and perhaps boycotts) by consumers and investors. Additionally, shareholders can attempt to elect directors committed to human rights, or try to force the adoption of shareholder resolutions.<sup>130</sup> These resolutions could prohibit the corporation from violating human rights.<sup>131</sup>

Multinational corporations in particular are increasingly viewed as beyond the reach of domestic laws, and can violate human rights with impunity. One avenue of redress is private lawsuits filed by victims under the Aliens Tort Claims Act (ATCA).<sup>132</sup> Although adopted by the First Judicial Act of 1789, the ATCA was little used until it was rediscovered by human rights activists in 1980, "when the family of Joelito Filartiga, a Paraguayan who died under torture, successfully used the ATCA to sue Joelito's torturer, Norbert Pena-Irala, for violation of the law of nations."<sup>133</sup> (Pena-Irala was the Inspector General of Police in Asuncion, Paraguay when Filartiga died, and was living in New York at the time of the lawsuit.)<sup>134</sup> Subsequently, the Second Circuit in *Kadic v. Karadzic*<sup>135</sup> held that international norms subject to the ATCA apply to both government actors and private individuals, which would include corporations.<sup>136</sup> Since the Second Circuit's decision in *Kadic v. Karadzic*, a number of suits have been filed against corporations for human rights violations.<sup>137</sup> Despite efforts by the Bush administration to eviscerate the ACTA as a means of redress against human rights violators,<sup>138</sup> the ACTA remains

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<sup>128</sup> *Id.* at 111.

<sup>129</sup> *Id.* at 112.

<sup>130</sup> *Id.* at 113.

<sup>131</sup> *Id.* at 114.

<sup>132</sup> Rebecca M. Bratspies, "Organs of Society": A Plea for Human Rights Accountability for Transnational Enterprises and Other Business Entities, 13 Mich. St. J. Int'l L 9, 28 (2005.)

<sup>133</sup> *Id.* at 29.

<sup>134</sup> *Id.* at 29, n.80.

<sup>135</sup> 70 F.3d 232 (2d Cir. 1996). Kadic made claims of genocide, torture, and war crimes against Radovan Karadzic, leader of the unrecognized Bosnian Serb "Republic of Srpska."

<sup>136</sup> Bratspies, *supra* note 132, at 29.

<sup>137</sup> *Id.* at 29.

<sup>138</sup> In *Sosa v. Alvarez-Machain*, 124 S. Ct. 2739 (2004), the Department of Justice and numerous corporate amici strenuously urged the Supreme Court to interpret the ATCA as only providing federal court jurisdiction but not an independent cause of action. This interpretation had been espoused by Judge Bork in his concurring opinion in *Tel-*

in the arsenal as a weapon in the fight against human rights' abuses. It is true that judgments rendered are virtually impossible to collect from the violators but the suits bring attention to the shameful corporate behavior.

What these activists for victims of human rights violations are employing is a private sector version of Hathaway's integrated theory. Hathaway's model predicts whether a state will comply with a treaty based on the existence of four factors: transnational and domestic legal enforcement, and transnational and domestic collateral consequences.<sup>139</sup> The corporations are the private sector equivalent of the state.<sup>140</sup> Just as states are supposed to comply with treaties, corporations are supposed to respect and comply with international and domestic law, and not employ trafficked victims as sweatshop or agricultural laborers. The ATCA can be viewed as transnational legal enforcement; those corporations that abuse human rights will be subject to legal redress. Shareholder activism and corporate codes of conduct are akin to domestic legal enforcement in that corporate codes of conduct and shareholder resolutions govern corporate actions. Shareholders who submit resolutions or demand corporate compliance with codes of conduct are acting like law enforcement agents, using the corporations' own internal "legal" structure or systems to enforce compliance with human rights norms. Collateral consequences arise when domestic and transnational actors base their actions towards a state (here the corporation) on whether the state (the corporation) complies with the international legal agreement (human rights norms and laws.) Boycotts, disinvestment, and shaming are akin to domestic and transnational collateral consequences in that these are the actions consumers and investors choose to take in response to the corporation's behavior.<sup>141</sup>

When corporations are made accountable to someone with power -- plaintiffs in ATCA lawsuits, the corporations' own investors (shareholders) or consumers -- corporate behavior can change. The most notable example is the DeBeers cartel's support for the Kimberley Process for fear that a threatened boycott would harm the diamond industry. In the face of actual and threatened boycotts and consumer activism, Nike improved its labor practices and Pepsi withdrew from Burma (the Burmese military junta is a repressive regime.)<sup>142</sup>

In the legitimate economy, the private regulatory regimes described above can make corporations comply either by direct legal and quasi-legal enforcement (the ATCA, codes of

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Oren v. Libyan Arab Republic, 726 F.2d 774, 810-16 (Bork, J., concurring.) See Bratspies, *supra* note 141, at 30-31, ns. 86-90 and accompanying text.

<sup>139</sup> See *supra* Part III.B.

<sup>140</sup> Indeed, Bratspies argues that transnational corporations in the natural resource field in particular are endowed with state-like characteristics. ("As private armies and as managers of mineral concessions, TNEs [transnational enterprises] assume powers resembling those of states.") Bratspies, *supra* note 132, at 12-13.

<sup>141</sup> Collateral consequences can also be positive. For example, corporations which show a high regard for human rights can have an enhanced reputation and will attract investors who engage in socially responsible investing, and consumers who pay attention to labels such as "fair trade," "FINA," or "Rugmark."

<sup>142</sup> Peter J. Spiro, *Disaggregating U.S. Interests in International Law*, 67-Fall, Law & Contemp. Probs. 195, 208 n.41 (2004).

conduct, shareholder resolutions) or indirectly by negative consequences (boycotts, disinvestment, shaming.) With the legitimate economy, activists can target the corporations that produce or sell the goods, the corporations' investors, or the consumers to create an atmosphere of corporate social responsibility. In contrast, the shadow economy is not subject to these pressures. There is no corporation, no shareholders, no board of directors. Corporations can be subject to shaming when their bad behavior is exposed, whereas human traffickers are little affected by condemnation. In the legitimate economy, consumers can be identified more readily and shamed if they buy boycotted products because their purchase is legal and their enjoyment or use can take place openly. In the shadow economy, consumers are unknown and harder to identify unless arrested. Therefore, the ability to shame consumers is much more limited.

In short, the same legal enforcement mechanisms and collateral consequences that exist for the legitimate economy do not exist for the shadow economy. We face the problem of how to create effective legal enforcement mechanisms and collateral consequences that will prevent human trafficking from occurring.<sup>143</sup> At bottom, the international community cannot force sovereign nations to take measures to stop human trafficking. However, the international community can find ways to "salt their oats"<sup>144</sup> and give them incentive to take effective measures against trafficking. Further, the measures taken must be designed so that they do not end up hurting the poor; otherwise, we run the risk of exacerbating the problem of human trafficking instead of eliminating it.

#### **IV. Financial Incentives to Stop Trafficking.**

##### *A. The International Tax Regime*

##### **1. Overview**

The term "international tax" refers to the United States tax system and how it taxes transactions that involve foreign persons (which include artificial persons such as corporations) who earn income from economic activities in the United States, and United States citizens and resident aliens who earn income from economic activity abroad.<sup>145</sup> For example, if a non-U.S. individual owns stock in a domestic corporation and receives dividends on that stock, international tax refers to the sections of the Internal Revenue Code that would address how the United States will tax that individual. Likewise, if a United States citizen earns income from work performed overseas, the Internal Revenue Code's international tax provisions address how the United States will tax that citizen.

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<sup>143</sup> Legal enforcement exists in the sense that traffickers are subject to prosecution, but criminal prosecution only has limited preventive effect. Likewise, the limited economic duress provided for in the VTPA for states which do not take certain preventive and prosecutorial measures (loss of funds for cultural activities) is not significant enough to provide much incentive. As noted above, shaming of customers can be employed but it is not readily available and in some cultures, solicitation of prostitutes is not shameful.

<sup>144</sup> This is a response to the old adage that "you can lead a horse to water but you can't make it drink." True, but you can salt its oats.

<sup>145</sup> Subtitle A. Income Taxes, Chapter 1. Normal Taxes and Surcharges, Subchapter N. Taxes Based on Income From Sources Within or Without the United States addresses how inbound and outbound transactions are taxed. Subtitle A. Income taxes, Chapter 3. Withholding of Tax on Nonresident Aliens and Foreign Corporations details the mechanisms by which the U.S. tax on inbound transactions is collected.

The international tax system, therefore, is composed of two parts: (1) inbound transactions and (2) outbound transactions. Inbound transactions refers to how the United States taxes foreign individuals and entities who earn U.S. source income (the taxation of foreign persons); outbound refers to how the United States taxes United States citizens and resident aliens on income earned from abroad (the taxation of foreign income.)<sup>146</sup> One reason for dividing international taxation into these two parts is that U.S. citizens and resident aliens have a different tax base from nonresident aliens. U.S. citizens and resident aliens are taxed on their worldwide income, which means that U.S. citizens and resident aliens pay United States income tax on all their income, regardless of whether it was earned within the United States or overseas.<sup>147</sup> In contrast, nonresident aliens and foreign entities (inbound transactions) are taxed only on income that has an economic relationship to the United States.<sup>148</sup>

## 2. Taxation of Interest Income from Inbound Transactions.

The United States Internal Revenue Code taxes inbound transactions under one set of rules contained in I.R.C. sections 871 and 881 for passive, investment-type income such as dividends, interest, royalties, and rents,<sup>149</sup> and another set of rules contained in I.R.C. sections 871 and 882 for income “effectively connected with a United States trade or business.”<sup>150</sup> Effectively connected income is taxed in a manner similar to that by which U.S. citizens and resident aliens are taxed on their business income; the income is taxed at the regular, graduated tax rates with allowances for deductions. In contrast, passive income is taxed on the gross amount at a flat rate

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<sup>146</sup> ERNEST R. LARKINS, INTERNATIONAL APPLICATIONS OF U.S. INCOME TAX LAW, VIII, (2004). See generally BORIS I. BITTKER & LAWRENCE LOKKEN, FUNDAMENTALS OF INTERNATIONAL TAXATION (2006).

<sup>147</sup> I.R.C. §§1 and 11 impose a tax on the gross income of every U.S. citizen, resident alien, and U.S. corporation. I.R.C. §61 defines “gross income” as “income from whatever source derived.”

<sup>148</sup> I.R.C. §871 controls the taxation of foreign individuals and I.R.C. §§881 and 882 govern the taxation of foreign corporations.

<sup>149</sup> I.R.C. §871(a)(1) imposes a tax on the investment-type income of foreign individuals and states as follows:

Except as provided in subsection (h), there is hereby imposed for each taxable year a tax of 30 percent of the amount received from sources within the United States by a nonresident alien individual as –

(A) interest (other than original issue discount as defined in section 1273), dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income ....

I.R.C. §881(a) imposes the 30% tax on the investment-type income of foreign corporations and its provisions are the same as §871(a)(1). As the language of these code sections indicates, the 30% tax is imposed on the gross income earned and the gross income is not reduced by any deductions.

<sup>150</sup> I.R.C. §871(b) imposes a tax on the trade or business income of a foreign individual and I.R.C. §882(a) imposes a tax on the trade or business income of a foreign corporation (“effectively connected with U.S. business income”). Both sections impose a tax on the taxable income of the foreign person or corporation, indicating that they are permitted to deduct from the gross income the deductions incurred in earning that trade or business income. In addition, both sections provide that the taxable income shall be taxed at the rates provided in I.R.C. §§1 (individuals) or 11 (corporations) which provide for graduated rates rather than one flat rate.

of 30% (unless a different tax rate, or no tax at all, is provided for in a treaty between the United States and another country.)<sup>151</sup> In order to collect the tax due on the passive income, I.R.C. sections 1441(a) and 1442(a) require that the tax be withheld at the source by the payor.<sup>152</sup> A person obligated to withhold is called a withholding agent. The withholding agent is usually the last person in the United States who handles the item before it is remitted to the taxpayer.<sup>153</sup> Without withholding at the source, there would be no practical way to enforce the collection of the tax from the nonresident alien or foreign entity.

The withholding agent is required to take certain steps to determine whether the beneficial owner is a foreign person, or a U.S. person (a U.S. citizen or resident alien.)<sup>154</sup> A beneficial owner can prove he or she is a U.S. person by furnishing the withholding agent with a Form W-9 withholding certificate.<sup>155</sup> In this situation, the U.S. person will not be subject to the withholding tax.<sup>156</sup>

A foreign person can demonstrate to the withholding agent that the foreign person is the beneficial owner by presenting a Form 8233 or W-8 withholding certificate. If the foreign person does not present the necessary documentation or if the documentation is not satisfactory, the withholding agent must make certain presumptions to determine whether the beneficial owner is a foreign person or a U.S. person.<sup>157</sup>

However, the Internal Revenue Code eliminates the 30% tax in some situations. If the item of income in question is exempt from U.S. tax (for example, portfolio interest paid to a foreign resident), the withholding agent need not withhold the 30% tax. In addition, tax treaties often provide for either a reduced rate on certain items of income (such as dividends) or even

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<sup>151</sup> I.R.C. §894 provides that “[t]he provisions of this title shall be applied to any taxpayer with due regard to any treaty obligations of the United States which applies to such taxpayer.”

<sup>152</sup> I.R.C. §§1441 (foreign individuals) and 1442 (foreign corporations) and the accompanying regulations create a withholding system which generally provides that the last U.S. entity handling the item of income payable to a foreign person or entity shall be responsible for determining whether the item of income is subject to the 30% tax and withholding such amount (unless a tax treaty or other Internal Revenue Code section provides for a lesser amount or exempts the item of income from U.S. tax altogether.)

<sup>153</sup> I.R.C. Reg. §1.1441-7(a) provides that a withholding agent is a person having “control, receipt, custody, disposal, or payment” of an item of income of a foreign person and the payment is subject to withholding. (I.R.C. §§1441 and 1442 permit non-U.S. based withholding agents under certain circumstances.)

<sup>154</sup> The beneficial owner is not always the same person as the payee. For example the payee might a conduit entity such as a partnership which will turn over the payment to the partners for inclusion in their respective incomes. The beneficial owner is defined in Reg. §1.1441-1(c)(6)(i) as “the person who is the owner of the income for tax purposes and who beneficially owns the income.”

<sup>155</sup> Reg. §1.1441-1(d)(2), (3).

<sup>156</sup> At times, a U.S. citizen is subject to withholding at the source under I.R.C. §3406.

<sup>157</sup> I.R.C. Reg. §1.1441-1(b)(3)(i).

eliminates the tax altogether. Again, the withholding agent need not withhold the full 30% in those situations.<sup>158</sup>

### 3. Modifications to the Taxation of Investment-type Income.

Passive income earned from inbound transactions was not always taxed at a flat rate. Prior to 1966, nonresident aliens were taxed on this passive income in virtually the same way as U.S. citizens were taxed; the passive income was subject to the U.S. progressive tax rates. In 1966, Congress enacted the Foreign Investors Tax Act of 1966 (“FITA”)<sup>159</sup> the objective of which was to encourage foreign investment in the United States.<sup>160</sup> FITA did this, in part, by providing that passive, investment income would be subject to a flat tax rate of 30% rather than the regular progressive tax rates<sup>161</sup> (which at the time were considerably higher than today.)<sup>162</sup>

The next major change in the manner by which the United States taxes passive investment income earned by nonresident aliens occurred in 1984 in order to fund the huge deficit created by the Reagan administration’s fiscal policies. In 1981, Ronald Reagan was sworn in as president and set about to fulfill his campaign promise to cut taxes.<sup>163</sup> As a result, that same year, Congress enacted the largest individual and corporate tax decrease in U.S. history: the Economic Recovery Tax Act of 1981 (ERTA.)<sup>164</sup> Not only did ERTA cut tax rates, it also provided that businesses could depreciate property at greatly accelerated rates, thus further reducing their taxes.<sup>165</sup> In addition, ERTA provided businesses with an investment tax credit for investing in new equipment, which also reduced corporate taxes. As a result, by 1983, “the United States collected no net tax whatsoever on capital income.”<sup>166</sup>

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<sup>158</sup> As a result, U.S. citizens sometimes try to take advantage of the I.R.C. §§ 871(h) and 1441 rules by attempting to appear as foreign persons in order to escape U.S. taxation on their worldwide income (perhaps through the use of intermediary entities so that the true beneficial owner of the item of income is not revealed.) This occurs frequently with regard to portfolio investment income.

<sup>159</sup> Pub. L. No. 89-809, 80 Stat. 1541, 1551.

<sup>160</sup> S. Rep. No. 89-1701, at 9, reprinted in 1966 U.S.C.C.A.N. at 4554.

<sup>161</sup> *Id.* at 4447. Application of the 30% flat rate on passive investment-type income is codified at I.R.C. §871(a), and application of the graduated tax rates on effective-connected income is codified at I.R.C. §871(b).

<sup>162</sup> IRS STATISTICS OF INCOME, SELECTED HISTORICAL DATA. SOI HISTORICAL TABLE A. U.S. INDIVIDUAL INCOME TAX: PERSONAL EXEMPTIONS AND LOWEST AND HIGHEST BRACKET TAX RATES AND TAX BASE FOR REGULAR TAX, TAX YEARS 1913-2005. In 1963, the highest marginal tax rate was 91%; in 1964 it was 77% See also Kirsch, *supra* note 78, at 877 – 83 for an explanation as to how these changes encourage U.S. citizens to expatriate in order to receive the more favorable flat tax rate.

<sup>163</sup> Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1629 (May, 2000).

<sup>164</sup> Pub. L. No 97-34, 95 Stat. 172.

<sup>165</sup> ERTA §221(a)

<sup>166</sup> Avi-Yonah, *supra* note 163, at 1629.

At the same time that the United States government dramatically reduced tax revenues, it also engaged in a large defense buildup. The combination of the two created an enormous budgetary deficit that could only be financed by foreign capital.<sup>167</sup> Hans-Werner Sims argues that the consequences of the huge inflow of foreign capital into the United States benefited the United States but at the expense of the rest of the world:

The first half of the [1980s] was characterized by enormous capital imports into the United States accompanied by a strong dollar and a high world interest rate level. Most countries suffered from this situation. Europe was driven into the worst recession of the post-war period, and the developing countries were shaken by one debt crisis after another. A number of countries were unable to meet their interest obligations, and a collapse of the world banking system was avoided only by strenuous effort. The United States alone seems to have benefited: despite the high interest rate it enjoyed a significant consumption and interest boom.<sup>168</sup>

In 1984, the United States eliminated the 30% tax on most portfolio interest income from U.S. sources earned by nonresident persons.<sup>169</sup> Generally, the United States exempted from taxation portfolio interest earned on U.S. government bonds, bonds issued by U.S. businesses and U.S. bank accounts.<sup>170</sup> Further, withholding agents were no longer required to withhold any tax prior to making the interest payment to the foreign persons.<sup>171</sup>

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<sup>167</sup> *Id.* at 1580, 1630.

<sup>168</sup> HANS-WERNER SINN, CAPITAL INCOME TAXATION AND RESOURCE ALLOCATION 224-25 (1987), cited in Avi-Yonah, *supra* note 163, at 1630.

<sup>169</sup> Deficit Reduction Act of 1984, Pub. L. No. 98-369, §127(a), 98 Stat. 494, 648-50 (codified as amended at I.R.C. §§871(h) and 881(c) (2000).

<sup>170</sup> I.R.C. §§871(h)(3) and 881(c)(3) remove from the definition of “portfolio interest” and, hence, from the tax exemption, interest earned by 10% shareholders of corporations or partnerships. With regard to obligations issued by corporations, a 10% shareholder is any person who owns 10% or more of the total combined voting power of all classes of stock of such corporation entitled to vote. With regard to obligations issued by partnerships, a 10% shareholder is any person who owns 10% or more of the capital or profits interest in such partnership.

In addition, I.R.C. §§871(h)(3) and 881(c)(4) remove from the definition of “portfolio interest” and, hence, from the tax exemption, certain kinds of contingent interest payments. For example, interest payments that are contingent on the income or profits of the debtor, probably because these interest payments are more akin to dividends, which are not exempt from the 30% tax.

Further, I.R.C. §881(c)(3)(A) does not exempt from tax portfolio interest received by foreign banks (otherwise, domestic banks making loans to U.S. citizens or entities would be at a disadvantage vis-à-vis foreign banks doing so because the foreign bank would be able to charge a lower rate of interest (or otherwise benefit from the lower cost of doing business because of the eliminated tax.)

<sup>171</sup> I.R.C. §1441(c)(9) provides that “no tax shall be required to be deducted and withheld from such interest unless the person required to deduct and withhold tax from such interest knows, or has reason to know, that such interest is not portfolio interest by reason of section 871(h)(3) or (4). I.R.C. §1442 is the foreign corporation counterpart.

There were several motivations behind the elimination of the interest tax and withholding. The most important was the need to finance the burgeoning federal deficit caused by ERTA and spending on defense, and eliminating tax on portfolio interest would encourage foreign investment in United States source debt instruments. Moreover, Japan was a likely source of foreign capital; however, the United States and Japan tax treaty in existence at that time reduced the withholding on interest from 30% to 10%. Eliminating the withholding altogether would create an even greater incentive for Japanese investment in the United States. In addition, U.S. multinationals were eager to have portfolio interest exempted from tax. U.S. multinationals had been creating subsidiary corporations in the Netherlands Antilles and those subsidiaries would borrow from abroad. The Netherlands Antilles did not impose a tax on any interest payments to the lenders. By funneling the loans through a Netherlands Antilles subsidiary, U.S. multinationals had been able to attract capital from abroad by avoiding United States withholding tax on the portfolio interest payments to the lenders.<sup>172</sup> The U.S. multinationals were eager to eliminate the need for a subsidiary.

The interest exemption succeeded in attracting foreign capital into the United States. For example, Latin American countries lost \$300 billion in capital flight to the United States, with catastrophic consequences for Latin America.<sup>173</sup> Subsequently, all of the major economies followed suit and eliminated their withholding taxes on portfolio income for fear of losing capital to the United States, resulting in the classic “race to the bottom.”<sup>174</sup> Most developed countries now do not tax interest paid to nonresidents on bank deposits, government bonds, and corporate bonds.<sup>175</sup> Any attempts by a developed country to “go it alone” and impose the tax have been unsuccessful.

Germany is a case in point. In 1988, its government introduced a relatively low 10% withholding tax on interest on bank deposits but had to abolish it within a few months because of the magnitude of capital flight to Luxembourg. In 1991, the German federal Constitutional Court held that withholding taxes on wages but not on interest violated the constitutional right to equality; the government was therefore obliged to reintroduce the withholding tax on interest, but it exempted nonresidents. “Nonresidents” may, however, be German residents investing through Luxembourg bank accounts and benefiting from the Luxembourg tradition of bank secrecy.

The current situation resembles a multiple-player assurance (“stag hunt”) game: all developed countries would benefit if all re-introduced the withholding tax on interest because they would gain revenue without the risk that the capital would be shifted to another developed country. However, no country is willing to attempt to spark

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<sup>172</sup> Avi-Yonah, *supra* note 163, at 1580.

<sup>173</sup> *Id.* at 1631

<sup>174</sup> *Id.* at 1579.

<sup>175</sup> *Id.* at 1582.

cooperation by imposing a withholding tax unilaterally; thus, they all “defect” (that is, refrain from imposing the tax) to the detriment of all.<sup>176</sup>

Further, exchange rules for currency have been relaxed or eliminated, and investors also are able to transfer funds electronically. As a result, capital now is extremely mobile, increasing international tax competition, with countries seeking to attract both portfolio and direct investment by lowering taxes on foreign investors.<sup>177</sup>

### B. *International Tax Competition’s Undesirable Consequences.*

This continuing race to the bottom to exempt capital from taxation has undesirable domestic consequences, two of which are of particular significance here: (1) the shift of the tax burden to consumption, labor and land<sup>178</sup> in order to compensate for the loss of revenue, and (2) the curtailment of spending on domestic programs when no more tax burden can be shifted to labor or land.

Unlike capital, labor and land are not mobile. As noted above, capital can be moved almost instantaneously and without cost now; however, labor cannot relocate at will because of immigration restrictions and the cost of relocating. Therefore, if the owner of capital is unhappy with a tax being imposed, the owner can go elsewhere where little or no tax is imposed, and that threat now hangs constantly over countries. However, if labor is taxed, it can do little about it – and countries know that also. A number of studies have revealed that, in fact, “as an economy becomes more open to capital flows, it tends increasingly to shift the tax burden from capital to labor.”<sup>179</sup> In addition, the tax burden is also being shifted from the taxation of capital to the taxation of consumption. A consumption tax tends to be regressive because the poor must spend a greater proportion of their income on consumption than the wealthy and can only reduce their consumption to certain levels. (The less affluent can reduce, but not eliminate, their spending on food, shelter, medicine and other necessities.) Since the repeal of the interest withholding tax,

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<sup>176</sup> *Id.* at 1583-84.

<sup>177</sup> *Id.* at 1575.

<sup>178</sup> *Id.* at 1624, n.233 (“For this purpose, taxes on consumption comprise general taxes on goods and services and excise taxes. Taxes on labor comprise the portion of the individual income tax that falls on wages, social security taxes – both employee and employer portions – and payroll taxes. Taxes on capital comprise the portion of the individual income tax that falls on non-wage income, corporate income taxes, property taxes, and taxes on financial transactions.”)

<sup>179</sup> *Id.* at 1624 (discussing the implications of two studies. The first study was conducted by Enrique G. Mendoza, Assaf Razin, and Linda L. Tesar, *Effective Tax Rates in Macroeconomics: Cross-Country Estimates of Tax Rates on Factor Incomes and Consumption*, 34 J. MONETARY ECON. 297, 307-08, 306, tbl. 1, 308 tbl. 3 (1994). In the first study, they calculated the tax rates for the G7 countries from 1965 to 1988. The study found that taxes on consumption and capital income tend to be stationary but the tax rate on labor has increased in all countries. The second study was conducted by Enrique G. Mendoza, Gian Maria Milesi-Ferretti, and Patrick Asea, *On the Ineffectiveness of Tax Policy in Altering Long-Run Growth: Harberger’s Superneutrality Conjecture 4* (Centre for Econ. Policy Research Discussion Paper No. 1378, 1996.) They calculated the tax rates for eighteen OECD member countries for the period from 1965 to 1991. As noted above, they found that the more open a country is to capital flows, the more the tax burden is shifted to labor.)

taxation of consumption has increased.<sup>180</sup> This shift of tax burden from capital to labor and consumption is inequitable, with the result that the tax burden is being shifted to those who can least afford it.<sup>181</sup> Further, this shift in the tax burden also widens the gap in income between the rich and the poor.

[B]ecause the rich save more than the poor, taxes on labor, such as consumption and payroll taxes, are generally more regressive than taxes on capital or on savings. Thus, a shift in the tax burden from capital to labor tends to render the tax system more regressive. Such a tax system is also less capable of redistributing resources from the rich to the poor. As a result, the overall distribution of income in a society tends to become more inequitable....

The range of before-tax incomes widened in the 1980s and 1990s in several OECD countries, including the United Kingdom and the United States. ... This pattern is not limited to the OECD member countries. The evidence from Latin America indicates that as countries have opened their borders, income inequality has tended to rise.<sup>182</sup>

At some point, countries cannot shift any more tax burden to labor, land, or consumption in order to compensate for the lost revenue from the non-taxation of capital. When that saturation point in tax burden is reached, countries must compensate for the lost tax revenue from the non-taxation of capital by reducing or eliminating government spending on domestic programs. Yet, tax competition, increased globalization and the economic uncertainty it generates have rendered the social safety net of even greater importance.<sup>183</sup> In developed countries, the economic impact

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<sup>180</sup> (“...[B]oth OECD member countries and developing countries have seen a rise in taxes on consumption, which are usually considered taxes on labor. In OECD member countries, general consumption tax, or value-added tax (VAT), revenues rose from 12% of total tax revenues in 1965 to 18% in 1995. In developing countries, general consumption taxes rose from 25.5% of total tax revenues for the period from 1975 to 1980 to 31.8% for the period from 1986 to 1992. Most of this increase can be explained by a rising tax rate.”) Av-Yonah, *supra* note 172, at 1621.

<sup>181</sup> “...[G]iven that most societies have a lopsided distribution of capital, and thus of income from capital, I consider it meaningful to distinguish between the majority of citizens who earn only labor income (many of whom cannot afford to save and therefore have no significant savings or income from savings at any point in their lives) and the small (in most countries) minority who earn significant income from capital. This distinction is particularly significant in the cross-border context because most capital investment overseas, and certainly most capital invested other than in widely held mutual funds (in which evasion is not an issue) is held by the richest segment of society. For example, a 1997 survey found that, in the United States, 68% of all stock is held by the wealthiest 5% of households. See Martha Starr-McLuer, *Stock Market Wealth and Consumer Spending* 14 tbl. 2 (Federal Reserve Bd. Fin. & ec. Discussion Series No. 1998-20).... The income of that segment derives to a large extent from (previously accumulated) capital, not current labor. See Henry J. Aaron & Alicia H. Munnell, *Reassessing the Role for Wealth Transfer Taxes*, 45 *Nat'l Tax J.* 119, 132, 130-32 (1992); ...The half of American families whose annual incomes are below \$50,000 have less than \$12,500 in total financial assets and thus must depend almost entirely on labor earnings for survival. See Michael J. Graetz & Jerry L. Mashaw, *True Security: Rethinking American Social Insurance* 69 (1999).” Cited in Av-Yonah, *supra* note 163, n.199.

<sup>182</sup> Av-Yonah, *supra* note 163, at 1624-25.

<sup>183</sup> Michael Keen & Maurice Marchand, *Fiscal Competition and the Pattern of Public Spending*, 66 *J. Pub. Econ.* 33, 34-35 (1997) (showing that tax competition leads to the underprovision of public goods, that benefit immobile

that results from job loss, health problems, and old age can be ameliorated by social insurance programs such as social security and medicare. Further, the shift in the tax burden to labor renders the less affluent less able to save money for emergencies.

Social insurance is popular precisely because in a market economy people may lose their source of income due to factors beyond their control. No one can escape being too young or too old to earn a living, nor is it possible to forestall illness, disability, or unemployment caused by such uncontrollable factors. Ex ante, everyone faces a similar likelihood of suffering from such income disruptions: “there but for the grace of God go I.” Thus, it is not surprising that social insurance programs designed to prevent such risks from threatening a reasonable standard of living are so widespread. As Michael Graetz and Jerry Mashaw state: “[S]ocial insurance thus represents one of the greatest triumphs of twentieth-century domestic public policy .... [S]ocial insurance is a crucial underpinning of a vibrant market economy.” It seems unrealistic, given the data about inequality, to expect most people to supplement even predictable declines in income purely from their own savings.<sup>184</sup>

### C. Developed Countries’ Need for Revenues

For the developed nations, the social safety net will be subject to tremendous strain from increasing demands within the next few decades as the aging post-World War II generation retires (and with increasing life spans). Moreover, because of the declining birth rate, there are fewer young people to provide the tax revenues needed to fund pensions and health care services.<sup>185</sup> If these social programs are funded under the current systems in place, “[t]he projections indicate that by 2030, all of the OECD members studied (except Ireland) will experience a budget deficit ranging from 0.5% of GDP in Belgium to 8.7% of GDP in Japan.<sup>186</sup> The tax implications for future generations to maintain these programs are grim.

Generational accounting compares the estimated lifetime net tax rates facing future generations with the rate today’s newborns must pay to finance current government programs without change. Kotlikoff estimates that for future generations in the United States, the net tax rate will be an impossibly high 84%. To equalize lifetime net tax rates of current newborns and future generations from 2006 and onward, Kotlikoff estimates, it will be necessary either to increase federal taxes by 61%, to cut transfer payments by

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consumers, such as recreational facilities, social services, or redistributive payments, and the overprovision of public goods that benefit mobile capital, such as infrastructure.) *Id.* at 1612, n.173.

<sup>184</sup> Avi-Yonah, *supra* note 163, at 1637. See also Michael J. Graetz and Jerry L. Mashaw, *True Security: Rethinking American Social Insurance* 69, at 4, 8 (1999).

<sup>185</sup> Avi-Yonah, *supra* note 163, at 1632 (“the result has been a significant increase in almost every OECD member country’s “dependency ratio” defined as the ratio of the young (those under age twenty) and the elderly (those above the retirement age for public pensions) to the working-age population. For example, in Japan the dependency ratio will rise from about 40% in 1995 to a peak of 60% in 2045.... Even in the United States, which has relatively high fertility and immigration rates, the dependency ratio will rise from about 20% in 1995 to 40% in 2035.”)

<sup>186</sup> *Id.* at 1632.

43%, or to reduce federal purchases by (an impossible) 109%. The picture is similar for other countries: the generational imbalance for males – the increase in net tax payments for future generations required to finance future benefits at current rates – ranges from 27% in Germany to 446% in Italy.<sup>187</sup>

Certainly, efforts to limit international tax competition and to prevent further erosion of the tax base are imperative. Reinstating the taxation of portfolio interest income would provide funding.

#### *D. Developing Countries' Need for Revenue.*

Governments in developing countries spend money somewhat differently than in developed countries. Generally, developing countries do not have the extensive (and increasingly costly) social insurance regimes, such as unemployment insurance, of the developed countries.<sup>188</sup> (Although some developing countries use government employment and procurement programs as a means of providing their citizens with some economic security.)<sup>189</sup> However, in order to maintain legitimacy and to improve the lives of their citizens, developing countries need reliable sources of revenue. “The United Nations estimates that basic social services (such as universal primary education) could be assured for all developing countries for a mere \$30 to \$40 billion a year.”<sup>190</sup> One of several reasons why Ireland was able to attract foreign investment to its shores during the 1990s was its highly educated workforce and stable government.<sup>191</sup>

Developing countries compete with developed countries and with each other for foreign direct investment and portfolio investment. A developing country dares not tax foreign investors on their portfolio investments if other countries do not impose a similar tax because the developing country would be at a disadvantage (unless the developing country were to offer foreign investors a higher rate of return on the investment, which would be difficult to accomplish.)

#### *E. Method of Taxing Portfolio Interest Income earned by Foreign Investors*

Subjecting portfolio interest income to taxation would help developed countries fund their social safety nets, and help developing countries satisfy basic social needs. The actual mechanics of

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<sup>187</sup> *Id.* at 1632-33. See also *The Erosion of the American Dream: Hearing Before the House Comm. on the Budget*, 104th Cong. 28-29, 30-31, 32-33 & chart 2 (1996) (statement of Laurence J. Kotlikoff, professor of economics, Boston University).

<sup>188</sup> The Eastern European countries do have significant pension obligations that will start to become due and payable in the near future, however. Avi-Yonah, *supra* note 163, at 1640.

<sup>189</sup> *Id.* at 1640.

<sup>190</sup> *Id.* at 1599.

<sup>191</sup> A tax holiday occurs when a country offers foreign corporate investors a reduced tax rate in order to encourage the corporation to relocate its production facilities there. There is no doubt that the tax holidays that Ireland offered to foreign investors was the prime attraction. However, Ireland also has a stable government and businesses do not face the threat of nationalization of industries. The stable government and English-speaking, educated workforce were important factors that led foreign investors to choose Ireland over other countries. *Id.* at 1644.

subjecting the interest income to tax are relatively simple, especially because the tax is subject to a flat rate.

If the major economies all agreed to tax foreign investors on their portfolio interest income the developing countries would be able to do so also. Further, if all of the major economies agreed to impose the tax, foreign investors would find it difficult to escape the tax by investing elsewhere.<sup>192</sup> Taxpayers might resort to tax havens to avoid taxation by their country of residence,<sup>193</sup> but the money does not simply sit in the tax haven. Taxpayers prefer to invest their money in countries with stable governments and societies. The taxpayers' goals are both to earn high returns on their investments and to avoid paying tax on those returns. Taxpayers can use tax havens to escape taxation by their countries of residence on investment income, but if the portfolio interest is taxed in the source country (where the interest is earned), the taxpayer cannot escape taxation.<sup>194</sup>

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The prospects for agreement in this area are particularly good because only a limited number of players need be involved. The world's savings may be parked in traditional tax havens, but the tax havens' cooperation is not needed. To earn decent returns without incurring excessive risk, investors must use the markets in the EU, the United States, Japan, and Switzerland. Thus, if the OECD member countries could agree to the principles adopted by the EU in its draft Directive, they could effectively tax cross-border portfolio interest flows.

Avi-Yonah, *supra* note 163, at 1668.

Yoram Margalioth, *Tax Competition, Foreign Direct Investments and Growth: Using the Tax System to Promote Developing Countries*, 23 Va. Tax Rev. 161, 198 (2003) ("developing countries are unlikely to attract portfolio investments. Portfolio investors tend to invest in the large capital markets in developed countries, primarily the United States, Western Europe, and Japan. The few rich residents of developing countries usually invest their money outside of the country and do not report that investment income to their tax authorities.")

See also Steven A. Dean, *Philosopher Kings and International Tax: A New Approach to Tax Havens, Tax Flight, and International Tax Cooperation*, 58 HASTINGS L.J. 911, 956 (2007).

<sup>193</sup> For example, A is a U.S. citizen who forms a corporation in the Cayman Islands, a tax haven. Through the corporation, A invests her money in the United States. When the U.S. corporation pays portfolio interest to A's corporation, the interest or dividends are exempt from tax under I.R.C. §881 because the portfolio interest is being paid to a foreign person and not to a U.S. citizen (who are taxed on their world-wide income, including portfolio interest income.) The tax haven is merely a device A is using to avoid tax imposed by her country of residence: the United States. However, she does not invest or otherwise leave her money in the Cayman Islands (and the Cayman Islands corporation will have few, if any, assets.) A's corporation pays the Cayman Island government fees for incorporating, but the Cayman Islands do not impose any taxes (such as an income tax) on A's corporation or on A herself. The OECD has had little success with its recent attempts to demand that tax havens furnish the taxpayer's country of residence with information so that the residence can impose a tax.

Risk still remains for the taxpayer, especially if the taxpayer does not control the Cayman Islands corporation, as recently learned by investors in certain Bear Stearns hedge funds. Bear Stearns invested the money in the United States but incorporated the hedge funds in the Cayman Islands. When the funds became worthless in the current subprime mortgage disaster, Bear Stearns decided to liquidate the Cayman Islands hedge funds and applied to the United States bankruptcy courts for protection from creditors – including the investors – while the liquidation was taking place. See e.g., Bloomberg.com, February 28, 2008, "Bear Stearns Caymans Filing May Hurt Funds' Creditors (Updated4), Jeff St. Onge & Bill Rochelle.

<sup>194</sup> Taxpayers from the disfavored, complicit countries might attempt to evade the tax on their portfolio investment interest by funneling the interest payments through corporations formed in the developed countries. Mechanisms

### *F. Withholding Tax by the Source Country*

Source countries can tax portfolio interest income by withholding the tax at the source. The United States does not need to create a new withholding system; a withholding system is already in place to collect the tax due on passive investment income such as dividends on stock or interest that is not exempt as portfolio income interest.<sup>195</sup> I.R.C. sections 1441 and 1442, and the accompanying regulations, create the mechanism by which the United States collects the tax due from foreign investors on passive, investment income earned from U.S. sources. I.R.C. sections 1441(a) and 1442(a) already impose an obligation on the withholding agent to withhold the 30% tax on various other types of income before the payment is made to the foreign investor.<sup>196</sup> Withholding at the source of the payment before the interest is paid to the foreign investor who is located outside the United States is the only practical way the United States can be certain it will be able to collect the tax.

This proposal does not gainsay the importance of prosecution to curb the inflow of trafficked victims into a country. Further, it is important to address the economic factors that make women and children in particular, and the poor in general, susceptible to human trafficking. But we also need to find an incentive that will cause this to happen.

### **V. Legal Enforcement and Collateral Consequences by Means of Tax Incentives.**

All of the various U.N. denunciations of human trafficking have failed to abolish human trafficking because they lack legal enforcement mechanisms and fail to create collateral consequences. States can enact domestic legislation to punish trafficking within their own borders only. NGOs can create programs to educate or assist victims but only to the extent they have funds and governments cooperate with them. The marketplace cannot provide legal enforcement or collateral consequences (*e.g.*, boycotts or shareholder resolutions) in the shadow

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will need to be put in place to prevent this. The U.S. currently imposes an obligation on the withholding agent to determine the beneficial owner for similar types of payments. For example, the taxpayer wishing to evade taxation could attempt to escape the U.S. imposed withholding tax by making the beneficial owner a corporation set up in a developed jurisdiction. The corporation then remits the payment to a citizen in a disfavored country. The developed countries will need to impose an obligation on the corporation to determine the beneficial owner of the interest payment. Corporations in the developed countries should determine if any of their payees are citizens of the disfavored corporations before making any payments. If the corporation fails to do so, it should face a fine in an amount that exceeds the interest payment. (Even if a chain of corporations is used, this should prevent the beneficial owners from escaping the tax, if each corporation in the chain, especially the last one, determines the beneficial owner.)

<sup>195</sup> See text at **XXX**. See generally Bittker and Lokken, *supra* note 146.

<sup>196</sup> I.R.C. §1441(a) provides as follows:

... all persons, in whatever capacity acting (including lessees or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the United States) having the control, receipt, custody, disposal, or payment of any of the items of income specified in subsection (b) (to the extent that any of such items constitutes gross income from sources within the United States), of any nonresident alien individual or of any foreign partnership shall (except as otherwise provided in regulations prescribed by the Secretary under section 874) deduct and withhold from such items a tax equal to 30 percent thereof ...

economy where most trafficking occurs. None of these entities or institutions has the ability to reach into a complicit or noncooperative state and force change.

Economic growth does not solve all social problems and will not eliminate any time soon the poverty that drives much of human trafficking. There are great disparities of wealth between the developed and developing nations,<sup>197</sup> and the gaps are widening.<sup>198</sup> In addition, the disparities in wealth within countries are greatest in the poor, developing countries, many of which are source countries for victims.<sup>199</sup> Most developing countries' societies contain a thin crust of the very wealthy, perhaps some middle class, and the bulk of the people are poor.<sup>200</sup> Foreign aid

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<sup>197</sup> See Margalioth, *supra* note 192, at 162-64 (2003):

The world population is approximately 6 billion people. 1.2 billion or one-fifth, are rich while 4.8 billion or four-fifths, are poor. The world is more unequal today than at any time in world history. Only 240 years ago, at the beginning of the industrial revolution, most everybody was poor. Author Lant Pritchett explains that the very poor nations today are just barely above the subsistence level as measured in income per person. Since subsistence is defined as not starving to death, the poorest nations today have about the same income in real terms today as they did two centuries ago. It could not be less because that would mean they were below subsistence level, which, by definition, cannot be true. The period of economic growth is a fairly recent one, but it has been a period of extreme divergence in economic performance. A relatively small part of the world achieved what economists call modern economic growth. ... Some poor countries grew very slowly, while others, such as most African nations, did not grow at all. This created a huge gap between the countries that enjoyed sustained growth and the rest of the world. Developing countries are not only relatively poorer, they are worse off by absolute measures as well. The median per capita growth in developing nations between 1980 and 1999 was zero.

<sup>198</sup> *Id.* at 162, n.2. ("According to the World Bank study, per capita income in the richest countries was eleven times greater than in the poorest countries in 1870, thirty-eight times greater in 1960, and fifty-two times greater in 1985.")

<sup>199</sup> Richard M. Bird and Eric M. Zolt, *Redistribution Via Taxation: The Limited Role of the Personal Income Tax in Developing Countries*, 52 UCLA L. REV. 1627, 1628 (2005.) For example, Professors Bird and Zolt examined the distribution of wealth using the Gini coefficient. According to the Gini coefficient, a country with total income equality measures at zero and a country with extreme inequality measures at one.

Many developing countries have extremely unequal distributions of income and wealth. At the end of the last century, the Gini coefficient, a common measure of income inequality was 0.522 in Latin America compared to 0.412 in Asia, and only 0.342 in the developed, Organization for Economic Cooperation and Development (OECD) countries. In Latin America, measured income inequality increased steadily over the last three decades, rising from 0.484 in the 1970s to 0.508 in the 1980s and then again to 0.522 in the 1990s. Even in Asia, the least unequal developing region, income inequality rose slightly in the 1990s after holding steady in the 1980s. Other measures of inequality tell the same story. The poor are relatively much poorer and the rich are relatively richer in developing countries than in developed countries. In 1992, for example, almost half (48 percent) of income in Latin America accrued to the richest decile of households with only 1.6 percent going to the poorest decile; that is, on average, those at the top of the income heap commanded thirty times as many resources as those at the bottom. In Asia, the comparable ratio was only fourteen times, while in the developed countries it was twelve times. Given the apparently high concentration of income and wealth even within the top decile of the income distribution, the contrasts between rich and poor in much of the developing world are in all likelihood considerably starker than even the Latin American numbers suggest.

<sup>200</sup> Approximately 1.2 billion people subsist on under \$1 per day (the minimum level for subsistence), and the majority of the developing world's population lives on less than \$2 per day. Margalioth, *supra* note 192, at 162, n.1.

programs and programs administered by NGOs direct their efforts towards assisting the poor, such as by providing education or teaching skills. However, foreign aid and NGOs face overwhelming demands on their limited resources. Further, their efforts to prevent trafficking can be frustrated in countries where the government is uncooperative or even complicit in the practice. However, the Internal Revenue Code and tax treaties can be used to create internal pressure within complicit or noncooperative countries on the governments and on their wealthiest citizens who have the political power to force change. For example, they can demand that the government crack down on corrupt government officials who abet human trafficking by accepting bribes to look the other way or even engage in it themselves (such as brothel owners). They can demand that the government allocate resources to the problem, such as by providing more funding for education.

The developed countries should re-impose a withholding tax of 30% or 40% on the portfolio interest income earned by foreign investors.<sup>201</sup> Investors who are residents of countries which satisfy certain benchmarks or criteria with regard to human trafficking would be subject to a lesser withholding rate by the source country.<sup>202</sup> In addition, the source countries could return a portion of the revenues collected to governments of countries that satisfy the criteria. This revenue would provide more stability and support to these governments. Unlike foreign aid, these governments would not receive the funds until they have complied with certain criteria. One of the biggest problems with foreign aid is corruption and misuse of the funds.<sup>203</sup>

The benefits that arise from this proposal are threefold: (1) It is in the economic interests of developed countries to tax this revenue in order to fund the welfare state and of developing countries in order to fund basic services; (2) it would curtail tax evasion, at least with regard to

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<sup>201</sup> I.R.C. §§1441 and 1442 impose a withholding tax of 30% on dividends, non-exempt interest, and other forms of passive, investment-type income, and, in the past, portfolio interest income was also subject to the 30% tax rate. Subjecting portfolio interest income to the 30% rate (as opposed to 40% or some other amount) has the virtue of keeping the rate imposed by the Internal Revenue Code uniform on passive, investment-type income. On the other hand, many tax treaties impose a different rate, so uniformity might not be so crucial.

Professor Avi-Yonah suggests imposing a withholding tax of 40% on portfolio interest income, refundable upon the taxpayer providing proof that this income has been reported in the taxpayer's country of residence. Avi-Yonah, *supra* note 163, at 1669. Professor Margalioth endorses Avi-Yonah's proposal. Margalioth, *supra* note 192, at 199-200.

<sup>202</sup> The United States would re-impose the withholding tax on portfolio interest income by means of the internal revenue code. The governments of the other major economies would amend their respective tax codes also. These countries could then enter into tax treaties with developing countries, which treaties would specify the terms and conditions that must be satisfied in order for the residents of the developing countries to receive the more favorable withholding tax rates on the portfolio interest income.

<sup>203</sup> See e.g., Margalioth, *supra* note 192, at 166:

The World Bank and IMF pursued an ambitious plan to make developing countries improve their institutions and policies by conditioning loans on implementing reforms. These "adjustment loans" were not successful because most countries did not comply. They used the money to finance current consumption instead of promoting growth, and were later unable to service the debts. Where did the money go? Some of it addressed immediate needs, like famine relief. Most of it financed corruption or unnecessary construction projects, such as new capital cities and dams.

portfolio investment income. If the portfolio interest is taxed at the source, foreign investors cannot avoid tax on this income by the simple expedient of funneling it through a tax haven; (3) it creates economic pressure on the wealthy in developing countries who are the most powerful constituency and in a position to demand change, and provides economic rewards to governments that take meaningful steps to stop trafficking.

If the withholding tax rate is sufficiently high, and if the developed countries refuse to break ranks, the wealthy foreign investors face limited choices: (1) either submit to the tax; (2) invest in riskier, less desirable countries; or (3) demand that their governments take action so that the investors can receive the benefit of the lower withholding rates. This transnational legal enforcement provided by the Internal Revenue Code and tax treaties changes the cost/benefit analysis for countries in which human trafficking is tolerated or even encouraged. There now would be real economic penalties and benefits associated with human trafficking.<sup>204</sup> Further, this instrumental sanction does not harm the poor – the economic penalty is imposed only on the wealthy. If the government complies with certain benchmarks and receives a refund of revenues, those revenues are additional sources of income to the government and the refund would only occur if the government had taken certain actions that would benefit victims of trafficking (the poor.)

Two issues remain problematic. First, the source countries need to reach an agreement as to what the minimum standard will be in order for the foreign investors to receive a lower tax rate and for the complicit government to receive a refund. If a source country on an individual basis were able to determine what the standards should be, the source country could gain an unfair advantage by setting lower standards than the other source countries, thereby unfairly attracting foreign investors and triggering again the race to the bottom.

Finding and agreeing on an entity that would set the standards presents a challenge. Because human trafficking is illegal (in fact, if not always in practice), governments, NGOs, and other interested entities have found it difficult to collect accurate data as to the extent of human trafficking, the degree to which certain governments are complicit, and the good faith of a

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<sup>204</sup> Professor Dean found that the lack of either domestic or transnational collateral consequences was the reason why the Organization for Economic Cooperation and Development (OECD) failed to obtain cooperation from tax havens in providing tax information to tax flight jurisdictions. The OECD's proposals contained no means for forcing tax havens to comply and provide information, nor did the proposals contain any incentives or benefits to encourage compliance. Therefore, the OECD's proposals for the most part lacked legal enforcement mechanisms other than the threat of being placed on the list of tax havens, which some tax havens avoided by committing to comply in the future. The proposals also lacked domestic collateral consequences – there would be no outcry from the local populace about the lack of cooperation because they would not suffer the imposition of penalties or the loss of benefits.

The absence of mechanisms for legal enforcement against tax havens and significant domestic collateral consequences for tax havens suggests that cooperation commitments simply will not work. The reason tax havens can fail to live up to their commitments without concern for the consequences (either in terms of legal enforcement or domestic collateral consequences) of doing so is that cooperation commitments provide tax havens with no entitlements. As a result, the residents of tax havens have little reason to encourage their leaders to vigorously pursue their cooperation commitment obligations.

Dean, *supra* note 192, at 961-62.

government's purported efforts to fight human trafficking. Further, the desire to obtain and disseminate accurate data at times is subverted by political or other agendas. The United States State Department's Office to Monitor and Combat Human Trafficking obtains information from staff around the world, and the State Department also obtains data from countries for purposes of the TIP reports. However, the information from the Office to Monitor and Combat Human Trafficking is not available to the public, and the Bush Administration appears to be using the TIP reports for political agendas.<sup>205</sup>

Another source of information is the U.N. Global Program against Trafficking in Human Beings which maintains an extensive global database of information from 161 countries and special administrative territories, includes data on trafficking flows between 1996 and 2003, and is based on 473 reports and statistics from 190 international and national institutions. Unfortunately, the database has several important limitations. "The quality of the data is no better than that of the original sources, which is highly variable, and North America and western European organizations are vastly overrepresented among the source institutions, which distorts regional comparability."<sup>206</sup> The ILO also collects data, but at times will dilute the information disseminated.<sup>207</sup> However, the U.N. has issued reports by experts who are not invested in the political process which reports have been considered reliable.<sup>208</sup> In addition, some NGOs, such as Human Rights Watch and Anti-Slavery International, have also issued reports that are credible.<sup>209</sup>

Second, some sort of monitoring system would need to be in place in order to determine whether a complicit country is complying with the standards. Self-reporting clearly would be unacceptable and would turn the system into a charade or farce. Finding an entity or body that would be acceptable to the complicit countries presents a challenge. Many of these countries are former colonies and will resent any perceived infringement of their sovereignty no matter how well-intentioned, especially by former colonizers. This issue of monitoring arose with regard to Kimberley Process, designed to stop the trade in blood diamonds financing the wars in Sierra

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<sup>205</sup> See *infra* II.C.3. See also Lehti & Aromaa, *supra* note 5, at 145 ("[TIP] is put together using local contacts and sources in each country, and data are thus of uneven quality.")

<sup>206</sup> Lehti & Aromaa, *supra* note 5, at 143.

<sup>207</sup> Bales, *supra*, note 2, at 325-26.

<sup>208</sup> *Id.* at 337.

<sup>209</sup> *Id.* at 337-38. He notes that many NGOs are not equipped to collect and analyze data, and some NGOs at times cannot resist the temptation to overstate abuses; however, Human Rights Watch and Anti-Slavery International "have a long history of careful and precise reporting."

Lehti & Aromaa share his concerns:

Systematized databases kept by NGOs are rare. In many countries, (e.g., Finland, Italy, the Netherlands, Spain), NGOs possess significant information, but the challenge is to make the information available for research and to coordinate it with data from other sources. If this could be done, the result would be more and better information on numbers, characteristics, and needs of victims.

Lehti & Aromaa, *supra* note 5, at 144.

Leone, the Congo, and Angola.<sup>210</sup> Diamond traders were persuaded to put in place the Kimberley Process -- a certification procedure that would squeeze these blood diamonds out of the diamond trade.<sup>211</sup> However, during the negotiations, the issue arose as to who would monitor the Kimberley Process to ensure that cheating did not take place.<sup>212</sup> The war-ravaged countries fiercely objected to the creation of a Secretariat that would monitor them, nor were they open to the possibility of NGOs performing inspections because the countries believed these measures impinged on national sovereignty.<sup>213</sup>

The problem also arose with regard to the OECD's proposal that tax havens cooperate and assist the wealthier tax flight jurisdictions in tracking down tax evaders. As noted by Steven Dean, the tax havens responded with open hostility to the OECD's proposals, in part because the tax flight jurisdictions did not distinguish between tax cheating and money laundering (from the narcotics trade) in which tax havens in the past had engaged. Apparently, tax havens believed that the two activities are not morally equivalent.<sup>214</sup> More importantly, however, the OECD and the tax flight jurisdictions fail to appreciate tax havens' sensitivity to intrusions on their sovereignty. The tax haven countries were developing countries and former colonies who objected to expending their limited funds in assisting wealthy, developed countries track down tax evaders.<sup>215</sup>

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<sup>210</sup> See, *supra* note 125, at 835.

<sup>211</sup> *Id.*

<sup>212</sup> *Id.* at 854.

<sup>213</sup> *Id.* at 865-66.

The African nations represented in the Kimberley Process negotiations stood up strongly for their prerequisites of national sovereignty in resisting the efforts of the NGOs to impose monitoring, to mandate the collection of statistical data, and to establish a secretariat independent of control by those nations. In terms of American regime values, one might read into their stance a commitment to representation: a duly constituted government should be responsible only to its national constituency and should not turn over the power delegated to it by its people to some other, independent authority. However, in the American case, representation comes out of some amalgam of liberty and equality, through the democratic process of elections. Not all of the African countries utilize this process in a way that could be said to advance liberty and equality. South Africa, in the post-apartheid period, does employ what seems to be a fully democratic electoral process. However, DeBeers so powerfully influences South African policy that the DeBeers property interest most likely overwhelmed any other factor motivating that nation's initiatives.

<sup>214</sup> Dean, *supra* note 192, at 931-34.

<sup>215</sup> *Id.* at 934-35.

Looking at those jurisdictions as a group reveals important differences between them and the OECD members. In comparison to OECD member nations, the tax havens that were the focus of the OECD's criticism are small countries. In addition, many are either newly or only partly independent. As a result, they tend to be extremely, and perhaps excessively, sensitive to perceived affronts to their sovereignty. That supporters of the initiative included former (and in some cases current) colonial rulers of the nations targeted by the initiative reinforced a perception that the OECD effort represented an attempt by powerful nations to exert control over weaker nations. One official called the OECD initiative "the worst form of bullying by big, strong and powerful nations that the world has witnessed since the 19<sup>th</sup> Century."

## **VI. CONCLUSION**

The most significant factor that determines whether human trafficking will occur is government corruption. Traffickers flourish in countries where government officials participate in the trafficking. Other countries can prohibit or even actively combat the problem, but law enforcement ends at the border. Other countries and the U.N. cannot reach into complicit countries and force them to stop; the pressure on the government officials must come from within and from those who have the power to apply pressure – the wealthy who invest in the stable economies of the developed countries. If those investors suffer adverse economic collateral consequences as a result of their government's corruption, they are in a position to demand change.