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The *Paterson Review of International Affairs* (PRIA) is a scholarly journal exclusively showcasing the work of graduate students in the field of international affairs. Managed by students of the Norman Paterson School of International Affairs (NPSIA), the Paterson Review is dedicated to publishing articles on a wide range of emerging issues in the theory and practice of international affairs. Copy requests and inquiries about the submission process may be sent electronically to [patersonreview@gmail.com](mailto:patersonreview@gmail.com).

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## **Letter from the Editor**

Dear Readers,

After a three-year hiatus, the Editorial Board is proud to release the 20th Volume of the Paterson Review of International Affairs. This year's edition represents a moment of celebration, despite the global disruption from the pandemic, where we can celebrate graduate scholarship in the field of international affairs. We received a wide range of submissions covering several topics from students attending Canadian universities. Ultimately, after a rigorous double-blind peer review process, four authors and their respective research papers distinguished themselves from the pack. Our Editorial Board and Expert Reviewers have often said over the course of the review process that the future of international affairs looks incredibly bright.

The four articles showcased in this volume represent important research questions, and specific areas of global affairs, that should draw the attention of readers that are passionate about international affairs and global leaders. In 'Legality of Japan's Resumption of Commercial Whaling in 2019', Marcel Timmermans provides a thorough legal analysis of Japan's commercial whaling practices. Shawn O'Connor in 'Emerging Private Authority in Financial Governance' examines the environmental, social, and governance reforms under private corporate governance and ultimately, what prevents forceful stewardship. Additionally, we received an insightful submission on behalf of Ruth Decady Guijarro titled 'Be Our Guest' which provides a cross-comparative case study on historical, cultural, and religious ties and their relation to positive host-refugee relations. Last but not least, Chris Knoch's "How does International Migration Affect Tax Compliance?" analyzes international migration through a German case study. We hope that readers find this year's publication insightful.

I would like to extend my thanks to the authors for submitting their research papers which, assembled together, create a diverse range of perspectives on international issues in this year's publication. As well, the expert reviewers played an instrumental role in providing guidance and feedback to guarantee that the publication reflects high-quality academic work. Finally, the publication would not be possible without the hard work and dedication of our team, the Editorial Board. Despite having to carry out this process in a remote environment, teamwork and comradery kept us banded together. I will forever remember my time at the Paterson Review thanks to my team members' friendship and dedication. We would also like to thank the Norman Paterson School of International Affairs for their support and guidance over the course of the publication review process.

I eagerly look forward to the emerging perspectives in international affairs that will be explored in future editions of the Publication. It has been an honour to work with such outstanding classmates and to bring these notable areas of international affairs to print.

Regards,

**Courtney N. Aucoin**  
**Editor-in-Chief**

# **Legality of Japan's Resumption of Commercial Whaling in 2019**

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**Keywords:** Whaling, Japan, Regulation, Persistent Objector.

## **Abstract**

Despite a shifting international consensus concerning the legality of commercial whaling, Japan has fastidiously clung to its pro-whaling tendencies. For this, it has attracted much criticism. Setting aside the questionable morality of maintaining whaling operations, a dispassionate analysis of the legal regime that underlies the global management of whale stocks is essential to determine the propriety of Japan's actions. This paper briefly chronicles the evolution of the international legal regime that governs whaling, then examines the divergent interpretations that pro- and anti-whalers have with regard to the legality of commercial whaling under that regime. Following that, this paper summarizes Japan's interpretation of why it feels its conduct—both during its tenure as a member of the International Whaling Commission (IWC) and afterwards—was legal and expressly permitted under the various legal instruments that bound, and continue to bind, it. The paper then provides an unbiased analysis of the legality of Japan's conduct. In closing, the article predicts how the state of international whaling law will be changed in the wake of Japan's departure from the regime's flagship organization, the IWC.



## I. Decimated Whale Populations, a Changing International Political Climate, and the ICJ

### Japan's Enduring Relationship with the Whale

Humans have hunted whales for centuries for their substantial meat and blubber.<sup>1</sup> Though whaling was near ubiquitous in centuries past, the practice of whaling has become increasingly uncommon and small-scale.<sup>2</sup> Despite many states having extensive whaling traditions (e.g., US, Norway, and Australia) the Japanese tradition of whaling stands out as one of the most enduring.<sup>3</sup> In Japan, whaling has played an important role in the local economies of coastal communities for centuries,<sup>4</sup> and whales have even been considered “blessings from the gods of the sea.”<sup>5</sup> Historical uses for whales in Japan were vast and included use as food, fertilizer, bowstring, insecticide,<sup>6</sup> and as part of the componentry of *bunraku* puppets.<sup>7</sup> Currently, Japan is one of only a handful of states that continue to whale openly, though the number of states that support the practice is more numerous than extant whaling operations would otherwise suggest.<sup>8</sup>

One reason for Japan's reluctance to abandon whaling is its reliance on whaling as an Indigenous food source. Whaling reduces Japan's dependence on imports.<sup>9</sup> This is an important geostrategic objective for a country that regularly falls short of its food self-sufficiency rate.<sup>10</sup>

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<sup>1</sup> Gordon Jackson, “Whaling: Human Predation,” *Britannica*, April 21, 2022, <https://www.britannica.com/topic/whaling>.

<sup>2</sup> International Whaling Commission, “Total Catches,” *International Whaling Commission*, <https://iwc.int/management-and-conservation/whaling/total-catches> (accessed November 3, 2022).

<sup>3</sup> Fynn Holm, “Japan's Whaling Policy: The Reasons for Leaving the International Whaling Commission,” (2019) doi: 10.13140/RG.2.2.27540.45441.

<sup>4</sup> Nikolas Sellheim, *International Marine Mammal Law* (Switzerland: Springer, 2020), 46.

<sup>5</sup> Mayumi Itoh, “The Japanese Culture of Mourning Whales,” (Singapore: Springer, 2018), 14.

<sup>6</sup> Jakobina K. Arch, *Bringing Whales Ashore* (United States of America: University of Washington Press, 2018), 101-103.

<sup>7</sup> Sekiguchi Yuya, “Why Japan Withdrew from the IWC,” *NHK World – Japan*, February 10, 2019, <https://www3.nhk.or.jp/nhkworld/en/news/backstories/367/>.

<sup>8</sup> See e.g., *St. Kitts and Nevis Declaration* (June 2006).

<sup>9</sup> John R. Schidhauser and George O. Totten, *The Whaling Issue in US-Japan Relations*, (New York, NY: Routledge, 1978), 4.

<sup>10</sup> Yusaku Yoshikawa, “Japan's Food Self-Sufficiency Debate Overlooks the Core Problem,” *The Diplomat*, May 13, 2022, <https://thediplomat.com/2022/05/japans-food-self-sufficiency-debate-overlooks-the-core-problem/>.

Another reason is nostalgia. Severe food shortages in Japan during the 1940's and 50's were offset by substituting whale as a staple protein source.<sup>11</sup> This was perhaps the genesis of the fondness that many elderly Japanese have for the food, as whale meat continues to be consumed by some as a reminder of their childhood.<sup>12</sup> A third reason is retaining the cultural practices and cultural distinctiveness of Japanese society. Some Japanese politicians have noted that catching and disassembling whales takes skill, and thus certain forms of cultural expression (like authentic *bunraku* puppets) will be lost if whale butchery expertise is not passed on to the next generation.<sup>13</sup> Paradoxically, despite Japan's enduring pro-whaling policies, the popularity of whale meat within Japan is falling.<sup>14</sup> The resuscitation of the apparently moribund practice has thus drawn damning comparisons to US President Trump's defence of coal mining by Japan's detractors.<sup>15</sup>

### *The Plight of the Whale*

The primary reason for the steep reduction in whaling worldwide is overfishing. According to one group of researchers, in the early 2000s, the combined biomass of whales in the North Pacific Ocean accounted for just 14% of pre-exploitation biomass levels.<sup>16</sup> Though other researchers have disputed this finding—notably, one pair of researchers argued that, by 2006, the combined biomass of great whales may have recovered to as much as 46% of pre-exploitation

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<sup>11</sup> “Press Release Issued by the Headquarters of General of the Army Douglas MacArthur,” June 22, 1947, <https://history.state.gov/historicaldocuments/frus1947v06/d226>.

<sup>12</sup> Rupert Wingfield-Hayes, “Japan and the Whale,” *BBC News*. February 8, 2016, <https://www.bbc.com/news/world-asia-35397749>.

<sup>13</sup> Sekiguchi Yuya, “Why Japan Withdrew from the IWC,” *NHK World-Japan*. February 10, 2019, <https://www3.nhk.or.jp/nhkworld/en/news/backstories/367/>.

<sup>14</sup> Elaine Lies, “Outlook Uncertain for Japan's Whaling Industry Despite Commercial Restart,” *Reuters*. June 23, 2019, <https://www.reuters.com/article/us-japan-whaling-commercial-idUSKCN1TP011>.

<sup>15</sup> The Editorial Board, “Japan: Stop Slaughtering Whales,” *The New York Times*. December 31, 2018, <https://www.nytimes.com/2018/12/31/opinion/editorials/japan-whale-hunt-whaling.html#:~:text=After%20global%20populations%20of%20whales,most%20notably%20Norway%20and%20Iceland>.

<sup>16</sup> A. M. Springer, J. A. Estes, G. B. van Vliet, T. M. Williams, D. F. Doak, E. M. Danner, K. A. Forney, and B. Pfister, “Sequential Megafaunal Collapse in the North Pacific Ocean: An Ongoing Legacy of Industrial Whaling?,” *Proceedings of the National Academy of Sciences* 100, no. 21 (2003): 12225.

levels<sup>17</sup>—it is universally acknowledged that insufficient limits on whaling caused the precipitous drop in whale populations. In particular, for 30 years following World War II (WWII), the International Whaling Commission (IWC) permitted the use of the Blue Whale Unit (BWU) as a means of determining catch limits among its members. Under the BWU system, whale hunting was based on a quota system that allocated the right to hunt whales on a ratio-basis: one blue whale was equivalent to two fin whales; two and a half humpback whales; or six sei whales.<sup>18</sup> The rational basis for the BWU system was the fact that, under the system, the whale oil yield per unit was roughly the same. Moreover, all IWC members that had not objected to the incorporation of the BWU into the Schedule of the IWC's founding treaty, the International Convention for the Regulation of Whaling (ICRW), were obligated to observe the BWU system because, being part of the Schedule, it had the same legal power as the ICRW.<sup>19</sup> Perhaps expectedly, the consequences of the BWU system were disastrous. The BWU system incentivised the hunting of larger whales because these whales presented a more expedient way for states to maximize their allocated BWU quotas. This ill-conceived system led to a “free-for-all race to kill as many whales as possible[,] known as the ‘Whaling Olympics.’”<sup>20</sup> In 1972, the BWU system was finally replaced with a strict quota system,<sup>21</sup> albeit the amendment to the Schedule faced “procedural difficulties.”<sup>22</sup> This opposition portended what would become a perennial sticking point within the IWC: should the role of the international community strive to protect the *whales* or the *whaling industry*?<sup>23</sup>

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<sup>17</sup> Sally A. Mizroch and Dale W. Rice, “Have North Pacific Killer Whales Switched Prey Species in Response to Depletion of the Great Whale Populations?,” *Marine Ecology Progress Series* 310 (2006): 242-43.

<sup>18</sup> Sellheim, “The Japanese Culture of Mourning Whales,” 92.

<sup>19</sup> See: International Commission on Whaling, “Twenty-Third Report on the Commission,” 1973, para 10 for tacit proof that the BWU system was formerly part of the ICRW Schedule.

<sup>20</sup> Chris Burgess, “Killing the Practice of Whale Hunting is the same as Killing the Japanese People: The Importance of the Role of Identity, National Pride, and Nationalism in Understanding Japan's Resistance to International Pressure on the Issue of Whaling,” *The Asia-Pacific Journal* 14, no. 8 (2016): 7.

<sup>21</sup> Sellheim, “The Japanese Culture of Mourning Whales,” 92.

<sup>22</sup> International Commission on Whaling, “Twenty-Third Report on the Commission,” par. 10.

<sup>23</sup> Sellheim, “The Japanese Culture of Mourning Whales,” 96.

### Early Attempts at Whaling Governance

For most of history, the international community favoured the latter option: whales were protected insofar as protecting them was in the interest of the whaling industry. Governance of the whaling industry began with the 1931 Convention for the Regulation of Whaling,<sup>24</sup> which was followed by the 1937 International Agreement for the Regulation of Whaling.<sup>25</sup> Japan unequivocally refused to join both treaties. First, in 1931, Japan skirted the Convention in order to develop its then infant whaling industry; second, in 1937, Japan openly dismissed a British invitation to join the Agreement, expanding its pelagic whaling programme that same year.<sup>26</sup>

Ultimately these early governance attempts were short-lived; they were replaced by the ICRW in 1946,<sup>27</sup> which Japan joined in 1951.<sup>28</sup> One key motivation for Japan was to rebrand itself as a “good, law-abiding state” in the wake of WWII.<sup>29</sup> That war had left Japan an international pariah at odds with all five permanent members of the newly minted United Nations Security Council.<sup>30</sup> Like all states, Japan acceded to the ICRW with the understanding that the purpose of the treaty was the “conservation of whale species and the *orderly development of the whaling industry*.”<sup>31</sup> In the fullness of time, the purpose of ICRW would be stretched and contorted to accommodate a new vision, held by other states party, that believe that whales should be protected *ipso facto* under the ICRW. These states currently form the dominant faction within the ICRW.

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<sup>24</sup> Sellheim, “The Japanese Culture of Mourning Whales,” 83.

<sup>25</sup> Sellheim, “The Japanese Culture of Mourning Whales,” 83, 85-6.

<sup>26</sup> Sellheim, “The Japanese Culture of Mourning Whales,” 83, 85.

<sup>27</sup> International Whaling Convention, *International Convention for the Regulation of Whaling*, (Washington, DC, 1946).

<sup>28</sup> Government of Japan, Ministry of Foreign Affairs, *Japan and the Management of Whales*, November 1, 2022, <https://www.mofa.go.jp/policy/economy/fishery/whales/japan.html#:~:text=In%201951%2C%20Japan%20acceded%20to,development%20of%20the%20whaling%20industry>.

<sup>29</sup> Charlotte Epstein, “The Power of Words in International Relations,” (Cambridge, MA: The MIT Press, 2008), 82-83.

<sup>30</sup> In addition to being one of the losing Axis powers, Japan had wars with China, the US and the Soviet Union, and invaded French and British colonies, such as French Indochina and British Malaya.

<sup>31</sup> Government of Japan, Ministry of Foreign Affairs, “Japan and the Management of Whales,” [emphasis added]; *International Convention for the Regulation of Whaling*, preamble.

### *Mechanisms and Machinations: How Does the ICRW Tick?*

As mentioned earlier, the ICRW is the founding document of the IWC—it is the foundation upon which the entire IWC edifice rests. Article III of the ICRW provides for the creation of the IWC, but many other provisions also serve key functions. For example, by providing that the Schedule to the ICRW forms “an integral part” of the ICRW itself, article I expands the scope pertaining to which portions of the ICRW/IWC regime are legally binding. Many important modern components of the ICRW/IWC regime are found in the Schedule, including the legal basis for the contentious moratorium on commercial whaling (paragraph 10(e)) and the whaling sanctuaries (paragraph 7). Article V provides that the IWC may make amendments to the Schedule; but, pursuant to article III(2), such amendments require a three-fourths majority. Article VI similarly provides that the IWC may make recommendations (also called resolutions<sup>32</sup>) to IWC members, but the International Court of Justice (ICJ) has held that these recommendations are not legally binding.<sup>33</sup> Perhaps most controversially, article VIII provides an exemption from all parts of the ICRW/IWC regime (including bans on whaling) if the IWC member in question is whaling for the purposes of scientific research. Although article VIII does require that the IWC member in question grant scientific permits to its nationals before such whaling can be sanctioned, the discretion to determine where and when the provision of these permits is appropriate is left to the researching state. Finally, article XI provides IWC members with the right to withdraw from the ICRW/IWC regime, so long as they do so in accordance with the prescribed formula.

From the text of the preamble to the ICRW, it is clear that the ICRW/IWC regime serves two objectives: to ensure both “the proper *conservation* of whale stocks” and “the orderly

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<sup>32</sup> International Court of Justice, “Whaling in the Antarctic,” March 31, 2014, par. 46.

<sup>33</sup> International Court of Justice, “Whaling in the Antarctic,” March 31, 2014, par. 46.

*development of the whaling industry.*”<sup>34</sup> This point was confirmed by the ICJ in their 2014 *Whaling in the Antarctic* decision.<sup>35</sup> In fact, in that decision, the ICJ went so far as to hold that “amendments to the Schedule and recommendations by the IWC may put an emphasis on one or the other objective...but [they] cannot alter its object and purpose.”<sup>36</sup> Despite this, the IWC currently describes itself as the “global body charged with the *conservation* of whales and the management of whaling.”<sup>37</sup> In fact, in recent decades, the work of the IWC has focused exclusively on conservation and all but ignored the management of whaling. For example, in a 2018 resolution called the Florianopolis Declaration, the IWC reiterates at length the importance of conservation but neglects any mention of “whale stocks” or the “whaling industry.”<sup>38</sup> This stance has caused some experts to opine that the IWC has turned into an “anti-whaling club,”<sup>39</sup> and others have described it as an organization mired in dysfunction and deadlock.<sup>40</sup> Though Japan was the IWC’s most vocal pro-whaling member, it was far from being the IWC’s only pro-whaling member: for instance, a sizeable pro-whaling contingent (consisting of mostly Caribbean and African countries<sup>41</sup>) exists within the IWC and remains active as of autumn 2022. The end-result of this internal division has been an ongoing power struggle within the IWC, with the anti-whaling contingent usually having the upper hand.

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<sup>34</sup> *International Convention for the Regulation of Whaling*, preamble (emphasis added).

<sup>35</sup> International Court of Justice, “Whaling in the Antarctic,” par. 56.

<sup>36</sup> International Court of Justice, “Whaling in the Antarctic,” par. 56.

<sup>37</sup> International Whaling Commission, “International Whaling Commission,” <https://iwc.int/home> (emphasis added) (accessed August 20, 2022).

<sup>38</sup> Resolution: The Florianopolis Declaration on the Role of the International Whaling Commission in the Conservation and Management of Whales in the 21<sup>st</sup> Century.

<sup>39</sup> Epstein, “The Power of Words in International Relations,” 82.

<sup>40</sup> Sellheim, “The Japanese Culture of Mourning Whales,” 94.

<sup>41</sup> See: *St. Kitts and Nevis Declaration* (June 2006), par. 1; see also: “IWC: Pro-Whaling Nations Take Whaling Commission Hostage to Prevent Conservation Decisions,” IFAW, October 21, 2022, [https://www.ifaw.org/international/press-releases/pro-whaling-nations-take-whaling-commission-hostage-prevent-conservation-decisions#:~:text=\(Portoroz%2C%20Slovenia%20%E2%80%93%2021%20October,a%20South%20Atlantic%20Whale%20Sanctuary](https://www.ifaw.org/international/press-releases/pro-whaling-nations-take-whaling-commission-hostage-prevent-conservation-decisions#:~:text=(Portoroz%2C%20Slovenia%20%E2%80%93%2021%20October,a%20South%20Atlantic%20Whale%20Sanctuary).

### Introduction of the 1982 Moratorium on Commercial Whaling

In 1982, the IWC voted in favour of declaring a moratorium on the commercial whaling of great whales.<sup>42</sup> It gave this decision legal effect by amending the Schedule of the ICRW pursuant to article V of the ICRW. Then in 1994, the IWC voted in favour of creating its second whale sanctuary, a 50 million km<sup>2</sup> zone known as the South Ocean Whale Sanctuary (SOWS), which surrounded the Antarctic and banned all commercial whaling (for IWC members) within its boundaries.<sup>43</sup> Japan objected to both proposals pursuant to its treaty right to do so under article V(3) of the ICRW, but subsequently withdrew its objection to the 1982 moratorium due to the threat of economic sanctions by the US.<sup>44</sup> Japan's objection to the creation of SOWS was never withdrawn, though its objection only applied to the hunting of minke whales.<sup>45</sup> Prior to the withdrawal of its objection to the 1982 moratorium, Japan continued to whale in its coastal waters.<sup>46</sup> After Japan withdrew its objection in 1987, it promptly initiated JARPA, its first scientific whaling program, under the auspices of article VIII of the ICRW.<sup>47</sup> Japan's second scientific whaling program, JARPA II, was inaugurated in a similar fashion in 2005.<sup>48</sup>

### Japan's Persistent (and Contentious) Whaling Practice

Although Japan was not the first country to kill whales under article VIII, it is one of only four countries to do so and the number of whales it has killed under this provision far exceeds that

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<sup>42</sup> See: Holm, 8-9; *International Convention for the Regulation of Whaling*, art. 3, sec. 2.

<sup>43</sup> *International Convention for the Regulation of Whaling*, Schedule, par. 7(b).

<sup>44</sup> *International Convention for the Regulation of Whaling*, Schedule, par. 10(e), footnotes; see: Philip Shabecoff, "U.S. PRESSES JAPAN TO HALT ITS WHALE HUNTING," *The New York Times*, January 2, 1984, <https://www.nytimes.com/1984/01/02/us/us-presSES-japan-to-halt-its-whale-hunting.html>.

<sup>45</sup> *International Convention for the Regulation of Whaling*, Schedule, par. 7(b), footnotes.

<sup>46</sup> "Japan Deplores Whaling Accord," *UPI*, November 14, 1984. <https://www.upi.com/Archives/1984/11/14/Japan-deplores-whaling-accord/9543469256400/>.

<sup>47</sup> Institute of Cetacean Research, "Japan's Research Whaling in the Antarctic," accessed November 3, 2022. <http://www.icrwhale.org/eng/FAQResearch.pdf> (accessed November 3, 2022).

<sup>48</sup> Institute of Cetacean Research, "Japan's Research Whaling in the Antarctic".

of the other three scientific whaling states (South Korea, Iceland, and Norway) combined.<sup>49</sup> Japan's scientific whaling policy has garnered international criticism,<sup>50</sup> but, as noted, article VIII expressly permits the killing, taking and treating of whales for the purpose of scientific research if special permits are issued.<sup>51</sup> Moreover, recall that the discretion to issue such permits also rests solely with the researching state. That said, despite the apparent legality of Japan's article VIII programs, meat taken from whales killed under those programs frequently made its way into the hands of Japanese merchants.<sup>52</sup> Undoubtedly, this seemed contrary to the spirit of the law for many other IWC members.

In 2014, one such member, Australia, initiated proceedings against Japan at the ICJ, alleging that JARPA II was "contrary to Japan's obligations under international law" and that it was "whaling pure and simple."<sup>53</sup> Japan disagreed, but lost.<sup>54</sup> The ICJ rendered its decisions *infra petita*, limiting the scope of the ruling only to Japan and Australia's competing article VIII claims.<sup>55</sup> The Court determined that JARPA II failed the second part of the two-part legal test needed to satisfy article VIII: namely, that the special permits issued under article VIII be designed and implemented reasonably in light of the stated objectives.<sup>56</sup> Despite losing the case at the ICJ,

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<sup>49</sup> International Whaling Commission, "Catches Taken: Special Permit," [https://iwc.int/table\\_permit](https://iwc.int/table_permit). (Accessed August 21, 2022).

<sup>50</sup> "Japan Whaling: Why Commercial Hunts have Resumed Despite Outcry," *BBC* online, July 2, 2019, <https://www.bbc.com/news/world-asia-48592682>.

<sup>51</sup> *International Convention for the Regulation of Whaling*, art. 8.

<sup>52</sup> Sellheim, "The Japanese Culture of Mourning Whales," 48, Figure 3.3.

<sup>53</sup> International Court of Justice, *Whaling in the Antarctic (Australia v Japan)*, Memorial of Australia, Volume I, May 9, 2011, par. 1.8.

<sup>54</sup> International Court of Justice, "Press Release: Whaling in the Antarctic (Australia v. Japan: New Zealand intervening)," March 31, 2014, <https://www.icj-cij.org/public/files/case-related/148/18162.pdf>.

<sup>55</sup> Jeffrey J. Smith, "Evolving to Conservation?: The International Court's Decision in the *Australia/Japan Whaling Case*," *Ocean Development and International Law* 45, no. 4 (2014): 309.

<sup>56</sup> Jeffrey J. Smith, "Evolving to Conservation?" 307.



Japan reportedly downsized their scientific whaling program and resumed operations the following year.<sup>57</sup>

This ruling was a loss of face for Japan and likely prompted its withdrawal from the IWC.<sup>58</sup> In 2019, Japan stirred controversy by announcing its decision to leave the ICRW/IWC regime and resume commercial whaling within its exclusive economic zone (EEZ).<sup>59</sup> Pursuant to the formula prescribed by article XI of the ICRW, Japan's departure took effect on 30 June 2019.<sup>60</sup> Since then, and in accordance with articles 56 and 57 of the United Nations Convention on the Law of the Sea (UNCLOS,) Japan has harvested whales within the 200 nautical miles of its territorial sea.<sup>61</sup>

## **II. Legal Positions of the Main Stakeholders: The Anti-Whalers vs. Japan**

Debate over how to rightfully apply the ICRW/IWC regime to Japan's decision to resume commercial whaling has split along predictable lines, with Japan and its pro-whaling allies within the IWC (e.g., Norway, Iceland) on one side of the debate and anti-whalers (e.g., the EU and its member states, and conservation activist groups such as Greenpeace) on the other. Anti-whalers contend that, notwithstanding its lawful departure from the ICRW/IWC regime, Japan cannot resume commercial whaling because the other sources of international law that remain applicable to Japan (i.e., UNCLOS and customary international law (CIL)) forbid it.<sup>62</sup> In contrast, Japan asserts that those laws do not preclude Japan from whaling within its EEZ<sup>63</sup> and that the

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<sup>57</sup> "Japan to Resume Whaling in Antarctic Despite Court Ruling," *BBC*, November 28, 2015, <https://www.bbc.com/news/world-asia-34952538>.

<sup>58</sup> Holm, "Japan's Whaling Policy," 18.

<sup>59</sup> Government of Japan, Ministry of Foreign Affairs, "Statement by Chief Cabinet Secretary," December 26, 2018, [https://www.mofa.go.jp/ecm/fsh/page4e\\_000969.html](https://www.mofa.go.jp/ecm/fsh/page4e_000969.html).

<sup>60</sup> Japan's Opening Statement to the 68th Meeting of the International Whaling Commission, October 13, 2022.

<sup>61</sup> *United Nations Convention on the Law of the Sea*, art. 56 and 57.

<sup>62</sup> Chris Wold, "Japan's Resumption of Commercial Whaling and Its Duty to Cooperate with the International Whaling Commission," *Journal of Environmental Law & Litigation*, Forthcoming 35, no. 87 (2019): 96.

<sup>63</sup> See: *United Nations Convention on the Law of the Sea*, PART 5.

ICRW/IWC regime does not apply because Japan is no longer a ICRW state party. What follows are abridged versions of the legal arguments made by each side.

#### Legal Position of the Anti-Whalers: UNCLOS and CIL Forbid Commercial Whaling

Japan is a party to UNCLOS,<sup>64</sup> under which articles 63, 64, and 65 obligate states to cooperate with international organizations. Article 63, which addresses “stocks occurring within the exclusive economic zones of two or more coastal States,” obligates states to “agree upon measures necessary to coordinate and ensure the conservation and development of such stocks.”<sup>65</sup> Article 64 concerns “highly migratory species” and obligates states to “cooperate directly or through *appropriate international organizations*” for migratory species listed under Annex I (which includes all cetaceans (i.e., whales)).<sup>66</sup> Article 65 requires states to “cooperate with a view to the conservation of marine mammals” holding that “in the case of cetaceans [states] shall in particular work through *the appropriate international organizations* for their conservation, management and study.”<sup>68</sup>

Given their migratory patterns and taxonomic status, whales fall within the ambit of each of these articles: (1) whale stocks occur within the EEZs of two or more states; (2) whales are highly migratory; and (3) whales are marine mammals. Accordingly, under UNCLOS, Japan is bound by a “cooperation regime” for the conservation, management, and optimum utilization of its shared fisheries resources, which include whales.<sup>69</sup> This duty to cooperate is a “bedrock

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<sup>64</sup> Division for Ocean Affairs and the Law of the Sea, Office of Legal Affairs, United Nations, “Chronological list of ratifications, accessions and successions to the Convention and the related Agreements,” United Nations, [https://www.un.org/Depts/los/reference\\_files/chronological\\_lists\\_of\\_ratifications.htm](https://www.un.org/Depts/los/reference_files/chronological_lists_of_ratifications.htm) (last updated May 15, 2022).

<sup>65</sup> *United Nations Convention on the Law of the Sea*, art. 63.

<sup>66</sup> Sellheim, “The Japanese Culture of Mourning Whales,” 66.

<sup>67</sup> *United Nations Convention on the Law of the Sea*, art. 64 (emphasis added).

<sup>68</sup> *United Nations Convention on the Law of the Sea*, art. 65 (emphasis added).

<sup>69</sup> Wold, “Japan’s Resumption of Commercial Whaling and Its Duty to Cooperate with the International Whaling Commission,” 108, citing *SRFC Advisory Opinion* (2015) ITLOS, 213.

international law principle” and is affirmed in the UN Declaration of Principles on International Law (“Friendly Relations Declaration,”) which provides that “states have the duty to co-operate with one another, irrespective of the differences in their political, economic and social systems.”<sup>70</sup> In light of Japan’s geographic location, the IWC is the only “appropriate international organization” that Japan can cooperate with to fulfill its UNCLOS obligations because both of the other possible organizations, the North Atlantic Marine Mammal Commission (NAMMCO) and the Antarctic Treaty System (ATS), operate outside of Japan’s EEZ.<sup>71</sup> Finally, cooperation with the IWC necessarily entails implementing the IWC’s Revised Management Procedure (RMP) and prohibiting commercial whaling until “adequate data exists to actually use the RMP to ensure the sustainability of catches.”<sup>72</sup> Therefore, Japan’s obligation to cooperate, which is found under both UNCLOS and CIL, indefinitely precludes it from whaling commercially within its EEZ.

#### Legal Position of Japan: The IWC Breached Its Own Legal Obligations, and No Longer Applies

When the IWC announced its 1982 moratorium, it also pledged to “undertake a comprehensive assessment of the effects of [the moratorium] on whale stocks and consider modification...and the establishment of other catch limits” by “1990 at the latest.”<sup>73</sup> Despite being legally obligated to do so (as this pledge was encoded into the Schedule of the ICRW and thus holds as much legal weight as the moratorium itself) the IWC has yet to assess the effects of the moratorium.<sup>74</sup> The IWC also failed to do so despite its own Scientific Committee agreeing that

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<sup>70</sup> Wold, “Japan’s Resumption of Commercial Whaling and Its Duty to Cooperate with the International Whaling Commission,” citing G.A. Res. 2625 (XXV), Declaration on Principles of International Law concerning Friendly Relations and Co-operation among States in accordance with the Charter of the United Nations, (Oct. 24, 1970).

<sup>71</sup> Wold, “Japan’s Resumption of Commercial Whaling and Its Duty to Cooperate with the International Whaling Commission,” 121-25.

<sup>72</sup> Wold, “Japan’s Resumption of Commercial Whaling and Its Duty to Cooperate with the International Whaling Commission,” 127.

<sup>73</sup> *International Convention for the Regulation of Whaling*, schedule at par. 10 (e).

<sup>74</sup> Ministry of Foreign Affairs of Japan, “Statement by Chief Cabinet Secretary”, para 1, 3.

“many species and stocks of whales are abundant and that sustainable whaling is possible.”<sup>75</sup> In Japan’s view, the IWC has parted from its original functions and has ignored the fact that, under the ICRW, one of the IWC’s purposes is the “optimum utilization of the whale resource.”<sup>76</sup> Japan therefore withdrew from the ICRW/IWC regime to resume its basic policy of “promoting sustainable use of aquatic living resources based on scientific evidence.”<sup>77</sup>

Japan acknowledges that it is a party to UNCLOS and that articles 63, 64, and 65 create an obligation to coordinate with stakeholders to protect whale stocks. However, Japan does not accept that being a party to UNCLOS and thus subject to the aforementioned articles result in a link to the ICRW/IWC regime in any way. Those articles require Japan to “agree upon measures...to ensure the conservation and development of [straddling stocks]” and to “cooperate...through appropriate international organizations for [highly migratory species and marine mammals].”<sup>78</sup> They do not require Japan to continue to observe the IWC’s 1982 moratorium. Japan lawfully exercised its right to leave the IWC using article XI of the ICRW and satisfies its duty to cooperate under UNCLOS by engaging with the IWC as an observer and by whaling according to catch limits calculated using the IWC’s method.<sup>79</sup>

### **III. Legal Assessment: Can Japan Resume Commercial Whaling Because It Left the IWC?**

#### **A Legal Exit: Japan Can Leave the ICRW/IWC Regime**

Article XI of the ICRW expressly permits contracting governments to withdraw from the ICRW/IWC regime and thus no longer be bound by the convention, including its Schedule and

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<sup>75</sup> *St. Kitts and Nevis Declaration* (June 2006), par. 1.

<sup>76</sup> Ministry of Foreign Affairs of Japan, par. 6; Sellheim, 96, citing *International Convention for the Regulation of Whaling*, art. 5(2)(a).

<sup>77</sup> Ministry of Foreign Affairs of Japan, “Statement by Chief Cabinet Secretary”, para 1.

<sup>78</sup> *United Nations Convention on the Law of the Sea*, art. 63-65.

<sup>79</sup> Ministry of Foreign Affairs of Japan, “Statement by Chief Cabinet Secretary”, para 5, 7.

any amendments made thereto (e.g., the 1982 moratorium).<sup>80</sup> Pursuant to article XI, Japan notified the IWC in 2019 of its decision to withdraw,<sup>81</sup> and legally withdrew from the IWC on 30 June 2019.<sup>82</sup> The legality of Japan's departure from the ICRW/IWC regime is underscored *a fortiori* by several provisions of the Vienna Convention on the Law of Treaties (VCLT)<sup>83</sup> that are widely regarded as constituting CIL.<sup>84</sup> Therefore, Japan is no longer bound to observe the 1982 moratorium, the 1994 SOWS, or any creature of the ICRW/IWC Regime.

### Obligations Under UNCLOS: Japan is Tethered but Not Shackled to the IWC

Notwithstanding Japan's withdrawal, anti-whalers continue to argue that Japan is a party to UNCLOS and thus owes a duty under articles 63, 64, and 65 to coordinate and cooperate with the "appropriate international organization" regarding highly migratory species and marine mammals. Anti-whalers further claim that given Japan's location in the Pacific Ocean, the IWC is the only organization capable of meeting Japan's obligations as "no other international organization covers the geographic area covered by Japan's whaling,"<sup>85</sup> and that "cooperation" can only be interpreted as ceasing all commercial whaling until the IWC deems it appropriate to resume doing so.<sup>86</sup> This view is unsupportable for several reasons. First, articles 63 and 64 only apply to states that are *actually harvesting or fishing fish* species (i.e., whales) within Japan's EEZ.

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<sup>80</sup> Article XI; Article I: "This Convention includes the Schedule attached thereto which forms an integral part thereof."

<sup>81</sup> International Whaling Commission, "Statement on Government of Japan withdrawal from the IWC," January 14, 2019, <https://iwc.int/resources/media-resources/news/statement-on-government-of-japan-withdrawal>.

<sup>82</sup> Japan's Opening Statement to the 68th Meeting of the International Whaling Commission.

<sup>83</sup> Namely, VCLT art. 54(a) states that parties to a treaty may withdraw from said treaty "in conformity with the provisions of the treaty," and VCLT article 70(1)(a) states that the termination of a treaty under its provisions "releases the part[y] from any obligation further to perform the treaty."

<sup>84</sup> See: Karl Zemanek, "Vienna Convention on the Law of Treaties," <https://legal.un.org/avl/ha/vclt/vclt.html>; CIL is a unique species of international law because, once established, CIL rules universally bind on all states (except persistent objectors) (accessed November 2, 2022).

<sup>85</sup> Wold, "Japan's Resumption of Commercial Whaling and Its Duty to Cooperate with the International Whaling Commission," 117.

<sup>86</sup> Wold, "Japan's Resumption of Commercial Whaling and Its Duty to Cooperate with the International Whaling Commission," 127-28.

This excludes the moratorium supporting members of the IWC, and possibly the entire IWC because, due to the ongoing moratorium, they do not harvest whales. Both articles 63 and 64 contemplate harvesting living aquatic resources: article 63 requires the *development of fishing stocks*,<sup>87</sup> and article 64 requires *optimum utilization* of migratory species.<sup>88</sup> States that eschew harvesting such aquatic resources altogether accordingly fall outside the ambit of those entities that UNCLOS obligates Japan to cooperate with. Second, compelling Japan to continue to observe the IWC's 1982 moratorium and 1994 SOWS amounts to *de facto*, if not *de jure*, membership in the IWC, and is contrary to the general rule of *pacta tertiis*, whereby treaties only bind states that have ratified them.<sup>89</sup> Third, UNCLOS does not define the term "cooperation."<sup>90</sup> In the absence of a clear definition of "cooperation," and which "international organizations" an UNCLOS party must work through, it is difficult to argue that Japan is not fulfilling its UNCLOS obligations. As one legal scholar wrote, "it would be unreasonable, absent clear language, for acceptance of one treaty to entail automatic membership in another treaty regime."<sup>91</sup>

Japan continues to satisfy its legal obligations under UNCLOS by maintaining observer status with both the IWC and NAMMCO, regularly participating in NAMMCO meetings, and continuing to work on scientific issues with the IWC's Scientific Committee.<sup>92</sup> For example, since exiting the ICRW/IWC regime in 2019, Japan has led the IWC-POWER (Pacific Ocean Whale

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<sup>87</sup> *United Nations Convention on the Law of the Sea*, art. 63(1).

<sup>88</sup> *United Nations Convention on the Law of the Sea*, art. 64(1).

<sup>89</sup> Sellheim, "The Japanese Culture of Mourning Whales," 81.

<sup>90</sup> Sellheim, "The Japanese Culture of Mourning Whales," 67.

<sup>91</sup> McDorman, Ted L. "Canada and Whaling: An Analysis of Article 65 of the Law of the Sea Convention." *Ocean Development & International Law* 29, no. 2(1998), 188.

<sup>92</sup> Sellheim, "The Japanese Culture of Mourning Whales," 67.

and Ecosystem Research) Programme, thereby cooperating with respect to researching large whale populations in long under-studied areas of the North Pacific Ocean.<sup>93</sup>

#### Customary International Law: A Prohibition on Whaling is Unlikely; Japan is a Persistent Objector

Despite the support for the IWC's 1982 moratorium among the majority of the IWC's membership, it is unlikely that a prohibition on commercial whaling has crystallized into a rule of CIL binding on all states. As the ICJ has stated in its jurisprudence, it is possible for a conventional rule to "pass into the general *corpus* of international law," but such a result is not "lightly to be regarded as having been obtained."<sup>94</sup> The relevant legal test to assess whether a conventional rule has crystallized as CIL requires satisfying two elements: (1) there must be "extensive and virtually uniform" state practice; and (2) this state practice should show "general recognition that a...legal obligation is involved" (so-called "*opinion juris*").<sup>95</sup>

A general prohibition on commercial whaling fails this test and therefore fails to qualify as CIL. First, the continued whaling operations of several states, including Japan, undermine any claim that observance of a general prohibition on whaling is virtually uniform. Notably, Norway has continued its practice of whaling, and so have Iceland, Korea, and Indonesia on a smaller scale.<sup>96</sup> Moreover, even if one posits that the whaling operations of these states do not meet the threshold of state practice needed to refute "virtually uniform" observance of a prohibition on commercial whaling, such a prohibition would still fail to crystallize as CIL due to the lack of any

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<sup>93</sup> Japan's Opening Statement to the 68th Meeting of the International Whaling Commission; International Whaling Commission, "IWC – Pacific Ocean Whale and Ecosystem Research Programme," <https://iwc.int/scientific-research/sower/power> (accessed November 2, 2022).

<sup>94</sup> *North Sea Continental Shelf* (Federal Republic of Germany/Netherlands), International Court of Justice (1969), par. 71.

<sup>95</sup> *North Sea Continental Shelf* (Federal Republic of Germany/Netherlands), 74, 77.

<sup>96</sup> International Whaling Commission, "Total Catches," <https://iwc.int/management-and-conservation/whaling/total-catches> (accessed November 3, 2022); Rachael Bale, "Norway's Whaling Program Just Got Even More Controversial," *National Geographic*, 2016, <https://www.nationalgeographic.com/animals/article/160331-norway-minke-whaling-fur-farms>.

indicia that most states have ceased whaling operations because they believe a general rule prohibits it. States that abstain from commercial whaling do so because they are disinterested, land-locked, or (for IWC members) because they rightfully regard compliance with the ICRW and its Schedule as a requirement of membership within the IWC—not because a prohibition on whaling has entered the corpus of CIL. Finally, even if the prohibition on commercial whaling were CIL, it would not apply to Japan because Japan is “[a] textbook example of a persistent objector.”<sup>97</sup>

Persistent objectors are states that escape the binding effect of certain rules of CIL by dint of their active and consistent disavowal of the norm in question. The ICJ has obliquely acknowledged the existence of the doctrine of persistent objection twice.<sup>98</sup> In order for a state to obtain the status of a persistent objector, the state must do two things: (1) it must persistently object to the rule while the rule was in its nascent stage, and continue to object afterwards; and (2) its objection must be consistent.<sup>99</sup> Having unequivocally demonstrated a refusal to cease whaling operations for nearly a century, Japan would clearly meet these criteria. Recall the following: (1) Japan repudiated both the 1931 Convention for the Regulation of Whaling and the 1937 International Agreement for the Regulation of Whaling; (2) Japan continued lawful whaling operations from 1982-87, despite the moratorium, due to the amendment objection it lodged; (3) Japan immediately began scientific whaling operations after it withdrew its objection to the moratorium in 1987; (4) these scientific whaling operations persisted, albeit under different names,

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<sup>97</sup> Solène Guggisberg, “Legal Considerations Around Japan’s Announcement That It Will Leave the International Whaling Commission (IWC),” Nereus Program, *The Nippon Foundation*, February 5, 2019, <https://nereusprogram.org/works/legal-considerations-around-japans-announcement-that-it-will-leave-the-international-whaling-commission-iwc/>.

<sup>98</sup> See: International Court of Justice, “Fisheries Case,” 1951, par. 131; International Court of Justice, “Asylum Case,” 1950, par. 277-78.

<sup>99</sup> Lynn Loschin, “The Persistent Objector and Customary Human Rights Law: A Proposed Analytical Framework,” 1996 *University of California Davis Journal International Law and Policy* 147: 150–51.



until the announcement that Japan would withdraw from the IWC and resume commercial whaling within its EEZ; (5) it has maintained commercial whaling ever since; and (6) Japan has consistently lobbied—through an astounding array of means including what we might call carrot-and-stick fiscal diplomacy,<sup>100</sup> in addition to multiple IWC reform proposals<sup>101</sup>—for the IWC to course correct and re-embrace working towards the orderly development of the whaling industry.<sup>102</sup>

#### **IV. Precedent: Prospect of a Ban on Whaling Becoming CIL Weakens, as Does the IWC**

While at first blush, the anti-whaling members of the IWC might rejoice at the news of Japan's departure, this change is likely less auspicious than it seems. In fact, it may well be the case that Japan's exit has signalled the beginning of a long, slow death spiral for the IWC. At the IWC's 68th (IWC68) meeting in autumn 2022, one insider noted that, in light of budgetary difficulties, "the IWC's way forward is facing heavy winds."<sup>103</sup> In fact, it has been reported that a quarter of the IWC's members have not paid annual dues that the IWC says are "critical" to its continued mandate.<sup>104</sup> Meanwhile, before leaving the organization, Japan was the largest donor to the IWC's core budget,<sup>105</sup> and this funding stopped in 2019.<sup>106</sup> Although the COVID-19 pandemic

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<sup>100</sup> See: Paul Brown, "Japan Admits to Using Aid to Build Pro-Whaling Vote," *The Guardian*. November 11, 1999, <https://www.theguardian.com/environment/1999/nov/11/whaling.internationalnews>; "Japan May Halt Funds to Whaling Commission," *The Japan Times*, June 18, 2003,

<https://www.japantimes.co.jp/news/2003/06/18/national/japan-may-halt-funds-to-whaling-commission/>.

<sup>101</sup> See e.g., Government of Japan, "The Way Forward of the IWC," 2018, <https://www.jfa.maff.go.jp/e/whale/attach/pdf/index-4.pdf>.

<sup>102</sup> For partial summary of Japan's efforts, see: Ministry of Foreign Affairs Japan, "A History of Efforts to Fulfill the International Whaling Commission's Dual Responsibility," <https://www.mofa.go.jp/files/000433146.pdf> (accessed November 4, 2022).

<sup>103</sup> Nikolas Sellheim, "No Vote on the South Atlantic Whale Sanctuary at the International Whaling Commission," <https://sellheimenvironmental.org/2022/10/21/no-vote-on-the-south-atlantic-whale-sanctuary-at-the-international-whaling-commission/> (accessed November 2, 2022).

<sup>104</sup> Karen McVeigh, "Countries Push to Undermine Ban on Commercial Whaling," *The Guardian*. October 18, 2022, <https://www.theguardian.com/environment/2022/oct/18/international-whaling-commission-iwc-ban-resolutions-meeting-slovenia#:~:text=Antigua%20and%20Barbuda%20has%20submitted,food%20security%20and%20address%20pove> rty.

<sup>105</sup> "Save the Whales, Again," *Nature*. January 8, 2019, <https://www.nature.com/articles/d41586-019-00076-2>.

<sup>106</sup> Dennis Normile, "Why Japan's Exit from the International Whaling Treaty May Actually Benefit Whales," January 19, 2019, <https://www.science.org/content/article/why-japan-s-exit-international-whaling-treaty-may>

is being touted as the reason why so many members are in arrears, historic news articles suggest that Japan was paying the other countries membership fees.<sup>107</sup> Other matters also roiled the waters at IWC68. For example, Saint Lucia argued against the proposed establishment of another whale sanctuary (this time in the South Atlantic) on the basis that it would “make poorer people poorer and less healthy,”<sup>108</sup> and 16 other IWC members staged a walk-out of pro-whaling nations on the penultimate day of Plenary session in order scupper the vote on the establishment of a South Atlantic Whale Sanctuary.<sup>109</sup>

It is clear that, with or without Japan, the thorn in the IWC’s side is that the resilient pro-whaling sentiment is not going away any time soon. Furthermore, if impecunious IWC members begin to contemplate with their own exits by using the same legal levers that Japan did, an ever-longer shadow will be cast over the prospect of a prohibition on commercial whaling one day becoming CIL.

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<sup>107</sup> Paul Brown, “Japan Admits to Using Aid to Build Pro-Whaling Vote,” *The Guardian*. November 11, 1999, <https://www.theguardian.com/environment/1999/nov/11/whaling.internationalnews>.

<sup>108</sup> Nikolas Sellheim, “No Vote on the South Atlantic Whale Sanctuary at the International Whaling Commission,” <https://sellheimenvironmental.org/2022/10/21/no-vote-on-the-south-atlantic-whale-sanctuary-at-the-international-whaling-commission/> (accessed November 2, 2022).

<sup>109</sup> Sarah Dolman, “IWC68: The Good, the Bad and the Pro-Whaling Walk-Out to Scupper a Sanctuary for Whales,” Environmental Investigation Agency, October 24, 2022, <https://eia-international.org/blog/iwc68-the-good-the-bad-and-the-pro-whaling-walk-out-to-scupper-a-sanctuary-for-whales/>.

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**Emerging Private Authority in Financial Governance: An Analysis of Asset Managers in Advancing Environmental, Social and Governance Reforms**

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## **Abstract**

The rise of asset managers, highlighted by the size of BlackRock, Vanguard, and State Street Global Advisors, is challenging how political scientists and policymakers have historically viewed private agency in international affairs. Thanks to macroeconomic trends that have concentrated corporate shareholdings in the hands of the top funds, the largest asset managers wield influence over entire markets and have become integral players in global initiatives requiring involvement from the financial sector. This paper probes the agency of asset management in decarbonization efforts in order to delineate the scope of their authority in financial governance. Although asset managers attest to advance social responsibility, this paper finds they only practice feeble stewardship. This is partly due to a host of agency, collective-action, and regulatory issues but the inconsistency between action and rhetoric reflects an agential effort, which this paper calls rational hypocrisy, to protect its market domain from regulatory oversight by attaining the minimum social license to operate. The agency of asset managers in the formation of social agendas, therefore, only feeds their burgeoning authority by expanding their infrastructural power vis-à-vis the public sector.

## Introduction

At the 26<sup>th</sup> UN Conference of Parties, the UN Special Envoy for Climate Action and Finance, Mark Carney, announced the launch of the Glasgow Financial Alliance for Net Zero (GFANZ). The GFANZ brings together over 450 global financial firms, with a collective capitalization of exceeding US\$130 trillion, to help combat climate change. After Carney's announcement, media attention focused on three specific actors: BlackRock, Vanguard, and State Street Global Advisors (SSGA) who collectively represent the "Big Three" of asset management. These three firms respectively have \$10 trillion, \$7 trillion, and \$4 trillion assets under management (AuM) – which roughly equates to 20% of all private equity.<sup>1</sup> As such, the attention given to them at the 2021 United Nations Climate Change Conference (COP26) was unsurprising as the Big Three are the titans of an increasingly concentrated financial system.

The Big Three, however, are just the pinnacle of an asset management industry with over \$100 trillion AuM, with the top ten managers accounting for 40% of those assets.<sup>2</sup> The looming presence of those managers over their portfolios has downstream implications for the firms they own, their clients, and for financial markets broadly. Fisch, Hamadani, and Solomon interpret this structural influence to mean asset managers are the "new power brokers" of the financial system.<sup>3</sup> With greater authority also comes more agency in ongoing plurilateral financial efforts to address social issues like climate change, as exemplified by their roles in the Institutional Investors Group on Climate Change, the UN Principles of Responsible Investing, and now the GFANZ.

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<sup>1</sup> Johannes Petry, Jan Fichtner, and Eelke Heemskerk, "The New Gatekeepers of Financial Claims: States, Passive markets, and the Growing Power of Index Providers," in *Capital Claims: Following Finance Across Borders*, edited by Kai Koddenbrock and Benjamin Braun. London: Routledge 2021; Bloomberg. "Passive Likely Overtakes Active by 2026, Earlier If Bear Market Insights | Bloomberg Professional Services." *Bloomberg*, March 12, 2021.

<sup>2</sup> Robert G. Eccles and Svetlana Klimenko, "The Investor Revolution," in *Harvard Business Review* 97, no. 3 (2019): 106-108.

<sup>3</sup> Jill Fisch, Assaf Hamdani, and Steven Davidoff Solomon, "Passive Investors," in *Harvard Law School Forum on Corporate Governance*, (2018): 2.

For their part, asset managers have embraced the assigned corporate social responsibility (CSR). In 2020, BlackRock CEO, Larry Fink declared that “We [at BlackRock] believe that sustainability should be our new standard for investing”.<sup>4</sup> More broadly, asset managers have labeled themselves as “champions of environmental, social and governance (ESG)” given their reliance on passive asset management tools like index funds and exchange-traded funds (ETFs).<sup>5</sup> Index funds and ETFs, hitherto referred to as ‘passive asset management’ track indices set by index providers like the S&P Dow Jones Industrial or the Russell FTSE. Asset managers are legally bound to hold the assets in the indices their index funds and ETFs track, which means their capital is ‘patient’ or long-term orientated. Asset managers, therefore, seek to generate long-term returns which enables them to overcome financial short-termism that has inhibited financial sustainability efforts in the past. This logic for boosting their claim of ‘championing’ ESG has been sold both to investors who want to feel socially responsible in their investments and to governments that entrust asset managers with spearheading plurilateral financial reforms to *green* global finance.

The literature, however, finds asset managers to be poor stewards of CSR. Scholars have identified the poor proxy voting record of asset managers, increased carbon-intensive investments, and the fact that less than 20% of their total holdings are ESG compliant.<sup>6</sup> These discrepancies between the rhetoric and action on stewardship are puzzling considering the immense authority that asset managers wield in financial markets. This paper argues that the failure of asset managers to forcefully follow through on their ESG commitments is the result of rational hypocrisy and

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<sup>4</sup> BlackRock, “BlackRock’s 2020 Letter to Clients. Sustainability as BlackRock’s New Standard for Investing,” *BlackRock*, last modified January 2020.

<sup>5</sup> Eric C. Chaffee, “Index Funds and ESG Hypocrisy,” *Case West Law Review* 71, no. 4 (2020): 1295; Alexander T. Kraik, “Environmental, Social, and Governance Issues: An Altered Shareholder Activist Paradigm,” *Vermont Law Review* 44, (2019): 493.

<sup>6</sup> The Economist, “The Saviour Complex,” *The Economist Group*, July 21, 2022.

feeble stewardship. By rational hypocrisy, this article refers to the purposeful choice made by actors to be openly hypocritical based on a contextualized rationale. Asset managers are constrained by various agency, collective action, and regulatory problems that discourage forceful stewardship. These constraints are inherently structural, so asset managers are encouraged to purport stewardship only insofar to attain a social licence to operate while refraining to actively steward change elsewhere in an effort to retain dominium over their market share.

Theorizing the role ascribed to private actors in international relations has always been an important debate but it has recently taken on new urgency in the context of the climate crisis. In addition to the normative claims on whether private actors *should* supplement public climate efforts, there is also a need for private actors to fill in the financing gap left by public treasuries – especially in a capitalist system predicated upon private equity and asset management. This public-private relationship aptly named the “Wall Street Consensus,” has proven true for both climate targets and broader social programming like achieving the UN’s 2030 Sustainable Development Goals.<sup>7</sup> As such, delineating the agency that asset managers have in climate finance will advance broader theoretical debates about private agency in the modern political economy of finance.

Therefore, this makes two contributions to the current literature: First, it attempts to denote the agency, collective action, and regulatory issues as the effective socio-political limits of an asset manager's authority. These observed limits facilitate a framework to test theoretical claims against the empirical instrumentality of asset managers in global financial and climate governance. Secondly, the paper demonstrates that social objectives remained financialized, not internalized, by asset managers. As such, this paper will first provide a broad overview of asset management and its authority before examining the socialization of ESG by asset managers vis-à-vis feeble

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<sup>7</sup> Gabor, Daniela. "The Wall Street Consensus." *Development and Change* 52, no. 3 (2021): 435-437.

stewardship. The third section will explore the various issues that prevent forceful stewardship. Lastly, the paper integrates its findings into the political economy of private corporate governance.

### **Asset Managers – The New Power Brokers**

The current popularity of asset management is largely thanks to the advent of passive asset management vis-à-vis index funds and ETFs. Whereas actively managed funds buy and sell assets based on future expectations, passive asset management “follows the market” by investing according to the weights of the market indices that they track.<sup>8</sup> The benefit of this methodology is twofold: first, by removing the need for a stockbroker to actively manage capital, it enables asset managers to lower management fees without suffering in portfolio performance as long as tracking errors are minimized. For example, the fee for investing with BlackRock’s iShare ETF in 2022 is just 0.18% compared to the 1-2% for active funds.<sup>9</sup> Secondly, these funds are fully diversified across entire markets, so they are also risk averse. Since being timely introduced in the 1980s, when capital markets were flooded by household savings and privatized pension funds, these two factors have continuously attracted new capital and at an accelerating rate. Between 2008 and 2018, \$3.1 trillion has flown out of actively managed funds into passively managed funds.<sup>10</sup> Put another way, for every dollar that entered equity markets between 2008 and 2018, 88 cents were channeled through passive asset management. Today, passive asset management accounts for over 40% of all assets.<sup>11</sup> The pace and scale of the index revolution have already fundamentally transformed the financial ecosystem.

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<sup>8</sup> Robin Wigglesworth, *Trillions: How a Band of Wall Street Renegades Invented the Index Fund* (New York: Penguin Publishing, 2021): 25-26.

<sup>9</sup> Wigglesworth, *Trillions*, 180.

<sup>10</sup> Jan Fichtner, Eelke M. Heemskerk, and Javier Garcia-Bernardo, "Hidden Power of the Big Three? Passive Index Funds, Re-concentration of Corporate Ownership, and New Financial Risk," *Business and Politics* 19, no. 2, (2017): 15.

<sup>11</sup> Bloomberg, “Passive Likely Overtakes Active by 2026.”

Albeit beneficial to investors enjoying lower fees, the index revolution has inadvertently concentrated the investment chain, and its associated ownership rights, into a handful of asset managers. The Big Three alone represent an effective oligopoly since they manage over 70% of all passive mutual funds and 80% of all ETFs.<sup>12</sup> Moreover, the top asset managers symbiotically respond to centripetal market forces like first-mover advantages, liquidity benefits, and economies of scale that make it challenging for competitors to break into the market. What makes this market concentration concerning is that when considered in the context of a burgeoning asset management industry, the top asset managers are bestowed with significant corporate control they can wield as a result of the market's structural asymmetries.

Discussions on asset managers typically focus on their structural 'influence over' institutional investors and corporate managers. Since 1932, the literature on corporate governance has been dominated by the epistemology of Adolf Berle and Gardiner Means who observed the "separation of ownership and control" whereby ownership was divided amongst many investors along the entire investment chain.<sup>13</sup> Investors faced collective action constraints when exercising effective control, delegating 'firm control' to management. Yet the structural prominence of asset managers over the investment chain poses a puzzle as the key matrix of corporate governance is less the separation of "ownership and control" than it is "the separation of ownership from ownership".<sup>14</sup> Although asset managers have a fiduciary duty to their clients, U.S. corporate law – section 13(d) of the Securities Exchange Act – does not distinguish ownership rights for

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<sup>12</sup> Fichtner, Heemskerk, and Garcia-Bernardo, "Hidden Power of the Big Three?" 18.

<sup>13</sup> Adolf A. Berle and Gardiner C. Means, *The Modern Corporation and Private Company* (New York: Transaction Publishers, 1932), 5.

<sup>14</sup> Leo E. Strine Jr, "Toward Common Sense and Common Ground-reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance," *Journal of Corporation Law* 33, (2007): 7.

proxies.<sup>15</sup> Hence asset managers can exploit their legal position in the investment chain to assert their claims over institutional investors from the same investment chain.

Structural prominence in the investment chain enables asset managers to overcome collective action issues at shareholder meetings by leveraging their *significant* blockholdings as swing votes. BlackRock and Vanguard hold over a 5% stake in 2011 and 1797 American firms respectively whereas the average fund manager holds an “influential” holding of 3-13% for the average S&P 500 firm.<sup>16</sup> These significant shareholdings are reinforced by the coordinated voting strategies employed across common ownership in asset managers’ portfolios. When viewed as a collective blockholding, the Big Three are the largest shareholder for 88% of the S&P 500 with an average blockholding of 22%.<sup>17</sup> By definition, the concentration of ‘ownership’ represents the structural power of asset managers as their influence emanates from a “set of fundamental (asymmetrical) interdependencies between actors” and the “occupation of a core position within interconnected structures”.<sup>18</sup> It is these conditions that also make asset managers suitable stewards of CSR as they can encourage reforms across their portfolios and therefore across entire markets.

### **Stewardship and Corporate Control**

Given their spectacular growth and structural prominence over investment chains, the Big Three have become the centre of debates on whether they can, or should, use their structural power to influence corporate governance. These debates are taking on urgency in the current climate crisis as the Big Three have the scale, diversification, and public pressure to make their portfolios more sustainable. To their credit, BlackRock, Vanguard, and SSGA vowed to become “Champions

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<sup>15</sup> Carmel Shenkar, Eelke M. Heemskerk, and Jan Fichtner, "The New Mandate Owners: Passive Asset Managers and the Decoupling of Corporate Ownership," *Antitrust Chronicle*, (2017): 22-24.

<sup>16</sup> Lucian A. Bebchuk and Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy* (Washington: National Bureau of Economic Research, 2019).

<sup>17</sup> Fichtner, Heemskerk, and Garcia-Bernardo, "Hidden Power of the Big Three?" 18.

<sup>18</sup> Fichtner, Heemskerk, and Garcia-Bernardo, "Hidden Power of the Big Three?" 319.

of long-termism,”<sup>19</sup> and have reaffirmed their ESG commitments through service provisions for international climate finance projects like the GFANZ. The existing literature, however, contends that the Big Three continually fail to meet their stewardship commitments.

Historically, shareholders would “[rely] on mechanisms of competition to ensure adequate performance” by threatening to divest – or ‘exit’ in Hirschmanian terms.<sup>20</sup> Yet in their quest to achieve economies of scale through passive asset management strategies, asset managers have forgone their ability to “exit” a portfolio firm. Recall indexing means investments are bounded by indices which asset managers follow; as long as the firm is listed in an index, the asset manager cannot divest. Cyrus Taraporevala, CEO of SSGA, once said: “We are essentially permanent capital and cannot turn the S&P 500 into the S&P 499”.<sup>21</sup> Hence, as long as unsustainable firms remain listed on an index, asset managers are compelled to hold their shares. BlackRock and Vanguard consequentially increased their coal holdings by 20% in the two years following COP21.<sup>22</sup> Asset managers have been labeled as “holders of the last resort” since they undermine the divestment efforts of active fund managers and retail investors.<sup>23</sup> Without a financial ‘exit’ option, the carbon intensity of AuM is inexorably linked to the indices that funds track.

Index providers may have full agency over the indexing methodology, but this does not absolve asset managers of all responsibility. The ten largest asset managers represent nearly 50%

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<sup>19</sup> Jahnke, Patrick, “Holders of the Last Resort: The Role of Index Funds and Index Providers in Divestment and Climate Change.” *SSRN*, 3314906, (2019), 10.

<sup>20</sup> Albert O. Hirschman, *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States*, Vol. 25, (Cambridge MA: Harvard University Press, 1970), 8.

<sup>21</sup> Cyrus Taraporevala, “Be a Global Citizen,” *Financial Times*, last updated July 18, 2018.

<sup>22</sup> Patrick Jahnke, “Asset Manager Stewardship and the Tension Between Fiduciary Duty and Social License,” in *SSRN*, 3307172 (2019).

<sup>23</sup> Emre Tarim, “Modern Finance Theory and Practice and the Anthropocene,” *New Political Economy* 27, no. 3 (2022): 5.



of the revenues for the major index providers such as S&P, MSCI, and Russell FTSE.<sup>24</sup> As significant stakeholders, fund-provider engagement has been observed in events like the 2017 de-listing of Snap Inc. given its multiple-class stock options.<sup>25</sup> Asset managers could threaten to create their own indices for their funds rather than employing those provided by index providers as a means to extract methodological concessions in index formation. There is some power relationship between index providers and asset managers, but it remains hidden behind the black box of the industry. Without access to those constitutive engagements, assessing the agency of asset managers in index exclusion decisions is impossible.

Asset managers tend to resist criticism by directing attention to new ESG financial products like thematic ETF. By offering ESG products, it provides clients with the ability to feel guilt-free in their investments. BlackRock advertises its iShares Global Green Bond ETF consisting of “green bonds” used to finance climate adaptive and resilient projects.<sup>26</sup> Asset managers argue as ESG ETFs become more popular, investors will shift from carbon-intensive products. However, evidence suggests thematic ETFs are poor tools to promote ESG. There is no consensus as to what “ESG” means for financial products with different managers advancing different taxonomies. Studies have found that less than 50% of ESG metrics across the entire are congruent.<sup>27</sup> Nor do thematic ETFs account for a significant share of an asset manager’s portfolio. The same Economist investigation also discovered that when using ESG metrics as defined by the International Finance Corporation, a unit of the World Bank, only US\$636 billion in assets, in a \$100 trillion industry,

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<sup>24</sup> Adriana Z. Robertson, “Passive in Name Only: Delegated Management and Index Investing,” *Yale Journal on Regulation* 36, (2019): 795.

<sup>25</sup> Jahnke, “Holders of the Last Resort,” 14.

<sup>26</sup> Wigglesworth, “Trillions,” 276-289.

<sup>27</sup> The Economist, “The Saviour Complex.”; Wigglesworth, “Trillions,” 283.

are ESG aligned.<sup>28</sup> The only broad agreement in the literature is that thematic ETFs shift ESG-stewardship responsibility from the asset manager to the client.

The other financial governance tool at the disposal of asset managers is their ‘voice’ through engagements with portfolio firms. BlackRock purports to use its portfolio engagements to promote compliance with sustainability accounting initiatives. Some scholars like Thistlethwaite and Paterson criticize the affluence of engagement since private actors only engage insofar as to meet the minimal standards of CSR.<sup>29</sup> Unfortunately, these claims are difficult to substantiate since most engagements are also hidden behind closed doors. What is observable are the meager stewardship teams that asset managers employ to manage these engagements. In 2019, Vanguard (16,000 staff) had 40 employees on its stewardship team to manage 170,000 vote-related matters. BlackRock (13,000 staff) had 74 employees in its corporate governance team to manage the 155,131 ballots that same year.<sup>30</sup> Given the recent emphasis on ESG objectives, the small stewardship resourcing suggests ESG commitments by asset managers might be insincere. Nonetheless, without knowledge of how manager-firm engagements occur, the opaqueness of stewardship provides enough obscurity for asset managers to dismiss criticisms.

A better indicator of the discrepancy between stewardship rhetoric and action is proxy voting records. In the past decade, activist shareholder proposals at publicly listed firms have increased dramatically and now account for 40% of all shareholder proposals.<sup>31</sup> Asset managers do occasionally vote with activist proposals as they did in 2017 when their 21% blockholdings

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<sup>28</sup> The Economist, “The Saviour Complex.”

<sup>29</sup> Jason Thistlethwaite and Matthew Paterson, "Private Governance and Accounting for Sustainability Networks," *Environment and Planning C: Government and Policy* 34, no. 7 (2016): 1204.

<sup>30</sup> Lucian A. Bebchuk, Alma Cohen, and Scott Hirst, "The Agency Problems of Institutional Investors," *Journal of Economic Perspectives* 31, no. 3 (2017): 100.

<sup>31</sup> Caleb N. Griffin, "Environmental & Social Voting at Index Funds," *Delaware Journal on Corporate Law* 44, (2020): 179.

pushed through approval for an SAI at Exxon Mobil.<sup>32</sup> However, asset managers usually defer their voting decisions to corporate management; who have subsequently voted against 93% of all ESG proposals in that same period.<sup>33</sup> The Big Three, for example, would only be consequential in approximately 24% of votes given their blockholdings but nonetheless voted with management in over 89% of such instances.<sup>34</sup> If the proxy voting records of asset managers indicated anything, it's that asset management prefers the status quo over stewardship despite their ESG promises.

### **Agency and Collective Action Problems**

Instances of successful stewardship certainly exist but a broad analysis of the stewardship activities taken by asset managers suggests they fall short of the “forceful stewardship” initiatives they purport to take. Rather, asset managers employ feeble stewardship activities whereby the actions they take are minimal but highly publicized to create an allure of forceful stewardship. Even with the scale, diversification, and patience to generate change, this greenwashing should not be unexpected. When one considers the host of agency and collective action issues afflicting asset management, asset managers conduct feeble stewardship as the result of rational hypocrisy.

Consider the agency concern that arises from the fact asset managers often own firms that are also clients. Cvojanovic *et al.* found asset managers are often guilty of client favouritism and adopting differential attitudes toward management as a result. SSGA publishes “Conflict Mitigation Guidelines” to explain how its stewardship team is walled from its business development team via corporate engagements.<sup>35</sup> As Griffin shows, asset managers adopt general

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<sup>32</sup> Jahnke, “Holders of the Last Resort,” 8.

<sup>33</sup> Joseph Baines and Brian S. Hager, “From Passive Owners to Planet Savers? Asset Managers, Carbon Majors and the Limits of Sustainable Finance,” *Competition and Change*, (2022): 77.

<sup>34</sup> Griffin, “Environmental & Social Voting at Index Funds,” 8.

<sup>35</sup> Dragana Cvijanović, Amil Dasgupta, and Konstantinos E. Zachariadis, “Ties that Bind: How Business Connections affect Mutual Fund Activism,” *The Journal of Finance* 71, no.6 (2016): 15-16.

principles, policies, and practices for stewardship to avoid instances of conflict of interest.<sup>36</sup> Intrinsic to these guidelines are self-imposed deference incentives that Griffin labels “general manager favouritism.”<sup>37</sup> Griffin’s study is consistent with that of Ashraf, Jayaraman, and Ryan, and Davis and Kim, who document industry-wide deference to management across thousands of indexed markets.<sup>38</sup> This may explain why asset managers rely on engagements rather than confronting management at shareholder meetings.

Other agency concerns arise from the business model of asset management. Asset managers can increase profits in two ways: Either by attracting capital from institutional investors or by increasing the aggregate price of AuM. In 2020, \$5 billion of profits could be attributed to new investors whereas \$29 billion came from growth in AuM prices.<sup>39</sup> This business model is not conducive to stewardship since any economic benefit can only be realized indirectly and non-exclusively. Aggregate price increases benefit all funds so there is no real economic gain whereas the ultra-low fees necessitate any gains to be significant relative to stewardship costs. If management fees were 0.4% - an average for the Big Three’s ETFs – and a potential stewardship activity could increase AuM by \$1 million, the stewardship cost would need to be no more than \$4,000. The fee structure means asset managers bare the full cost of stewardship activities but only profit from a fraction of the benefit.

In addition to absolute cost factors, asset managers risk alienating their clients. There are undoubtedly activist institutional investors like the California State Teachers’ Retirement System

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<sup>36</sup> Griffin, "Environmental & Social Voting at Index Funds," 33.

<sup>37</sup> Griffin, "Environmental & Social Voting at Index Funds," 32.

<sup>38</sup> Rasha Ashraf, Narayanan Jayaraman, and Harley E. Ryan, "Do Pension-related Business Ties Influence Mutual Fund Proxy Voting? Evidence from Shareholder Proposals on Executive Compensation," *Journal of Financial and Quantitative Analysis* 47, no. 3 (2012): 33; Gerald F. Davis, and E. Han Kim, "Business Ties and Proxy Voting by Mutual Funds," *Journal of Financial Economics* 85, no. 2 (2007): 22-25.

<sup>39</sup> Benjamin Braun, "From Exit to Control: The Structural Power of Finance under Asset Manager Capitalism," Working Paper, (2021): 7-8.

that place savings in ‘ethical’ ETFs, but they still represent a minority of capital. Most pension funds – which account for 46% of the capital base for asset management– simply want to maximize their returns for retirees.<sup>40</sup> Given the lexicon of investment needs, asset managers attempt to be a one-stop shop through thematic funds.<sup>41</sup> This explains why asset managers prefer ETF variability over working with index providers to reform the benchmark ETFs. It avoids the risk of alienating institutional investors who can easily move their money to another fund.

The zero-sum competition for existing savings has generated what Wigglesworth calls a “race to the bottom” in terms of fees.<sup>42</sup> Vanguard, for example, has experienced the most growth of the Big Three in the past 5 years due to having the lowest fees.<sup>43</sup> Asset managers are hence incentivized to minimize operational costs, including those spent on stewardship activities. Anything that prevents upward pressure on management fees is business optimal. Costs are the quintessential factor in the value most asset managers attribute to stewardship. The downward market pressure on management fees discourages greater stewardship beyond what is demanded to acquire the social license to operate.<sup>44</sup> For asset managers, ESG stewardship is less activism than a means of “defending their ‘institutional commons’ from regulatory and reputational threats”.<sup>45</sup> Hence these ESG actions are performative of market logic and reinforce the claim that private governance can effectively govern ESG issues.

Asset managers could overcome price pressures through market coordination which is not uncommon in oligopolies. Coordination is already critical to asset managers as their corporate

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<sup>40</sup> Anna Christie, “The Agency Costs of Sustainable Capitalism,” *UC Davis Law Review* 55, (2021): 41; Braun, “From Exit to Control,” 16.

<sup>41</sup> Wigglesworth, “Trillions,” 198-202.

<sup>42</sup> Wigglesworth, “Trillions”, 203.

<sup>43</sup> Wigglesworth, “Trillions”, 210-216; Baines and Hager, “From Passive Owners to Planet Savers?” 12-14.

<sup>44</sup> Jahnke, “Asset Manager Stewardship and the Tension,” 22.

<sup>45</sup> Thistlethwaite and Paterson, “Private Governance and Accounting for Sustainability Networks,” 1206.

influence wanes without coordinating proxy votes. As universal and diversified holders of patient capital, the interests of asset managers are structurally aligned which may explain why they might coordinate on issues from the Exxon Mobil SAI to U.S. airline prices in the past.<sup>46</sup> Of course, coordination requires a balancing act as any collusion creates anti-competitive suspicion amongst regulators. Asset management was already the subject of anti-competition hearings at the Federal Trade Commission in 2018 and the European Commission later that same year.<sup>47</sup> Harvard Law School professor Einer Elhauge raised eyebrows when she concluded the Big Three pose “the greatest anticompetitive threat of our time mainly because it is the one, we are not dealing with.”<sup>48</sup> This issue is game theory resumes in an environment absent of coordination and centripetal winner-take-all behaviours become the market compass at the expense of stewardship activities.

Asset managers can no longer proliferate outside the view of politicians and regulators. In 2021, Senator Elizabeth Warren advocated for classifying BlackRock and Vanguard as “too-big-to-fail” so they can be subject to greater regulatory oversight per the Dodd-Frank Act.<sup>49</sup> The Big Three often emphasize their ‘partisan neutrality’ and apolitical attitudes to avoid this type of regulatory encroachment.<sup>50</sup> Yet the desire to incorporate asset managers into the Dodd-Frank legislation is increasing on both sides of the aisle.<sup>51</sup> The political variable only places asset managers in a more precarious position. On one hand, they are conscious of how they are being perceived politically to avoid regulatory encroachment and on the other hand, asset managers are

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<sup>46</sup> José Azar, Martin C. Schmalz, and Isabel Tecu, “Anticompetitive Effects of Common Ownership,” *The Journal of Finance* 73, no. 4, (2018): 24.

<sup>47</sup> Annie Lowrey, “Could Index Funds Be 'Worse than Marxism'?” *The Atlantic Magazine*, last updated April 5, 2021.

<sup>48</sup> Einer Elhauge, “How Horizontal Shareholding Harms our Economy-and Why Antitrust Law Can Fix It,” *Harvard Business Law Review* 10, (2020): 207.

<sup>49</sup> David Goldman, “Elizabeth Warren Grills Janet Yellen: Why Isn't Blackrock 'Too Big to Fail?'” *CNN*, March 24, 2021.

<sup>50</sup> Elhauge, “How Horizontal Shareholding Harms our Economy,” 208.

<sup>51</sup> Lowrey, “Could Index Funds Be 'Worse than Marxism'?”

anxious of alienating institutional investors. Asset managers, therefore, cultivate a crafted reputation through targeted engagements and actions that highlight their agency without overstepping their social license to employ their structural power. In this context, the rational hypocrisy of feeble stewardship is justified so long as it reflects political attitudes manifesting in the investment chain while placating political divides.

### **Moving Beyond the Limits of Private Authority**

Asset managers have become the new “masters of the universe” as their scale and diversification have concentrated both shareholder and investment power into their link of the investment chain. Such adages derive from their asymmetric relations with both institutional investors and portfolio firms. Nonetheless, power is not without its limits. The previous section demonstrated asset managers are afflicted with various agency, collective action, and regulatory problems that discourage stewardship on ESG matters. Importantly, the observed deference, cost incentives, competition, and potential politicization do not remove the opportunities available to passive asset managers through their structural power – they only discourage asset managers from utilizing that power to precipitate market-wide reforms.

Such incentive structures can appear like natural market barriers, but the scale of asset management and their structural prominence have endowed asset managers with a constitutive authority that can be exploited to circumvent those boundaries. The top asset managers have become broadly viewed as the only actors capable of prudentially managing potentially toxic assets in large sums. Already, BlackRock and Vanguard have been contracted by several central banks, including the Federal Reserve and Bank of Canada, to manage distressed asset portfolios and

corporate bond programs.<sup>52</sup> In climate finance, this has translated to major international initiatives like the UNFCCC's GFANZ entrusting BlackRock to eventually manage the committed US\$50 trillion in assets that are ESG-compliant over the long run. Yet asset managers have made their participation in these programs conditional on backstops from public treasuries or, in the case of plurilateral programs, by the IMF and World Bank.<sup>53</sup> Similarly, Braun has identified instances whereby BlackRock and Vanguard have sought monetary and retirement policy reforms in exchange for their assistance with overleveraged assets on the public balance sheet.<sup>54</sup> Lockwood reminds us that basic business operations like risk assessments or asset management can become inherently political tools to claim epistemic authority.<sup>55</sup> Whether it is perceived or real, any asymmetric relationship can be weaponized. The efforts to extract concessions from states exhibit passive managers as political agents despite their efforts to seem otherwise.

The public dependency on asset managers to deliver public goods represents “infrastructural power” or the reliance on private services as a node in governance.<sup>56</sup> Frugal governments rely on private actors to achieve public policy goals that exceed the means of public coffers like climate targets. In return, private actors like asset managers enjoy delegated authority that can be leveraged to extract concessions from states similar to the above examples provided by asset managers. Scholarship on credit-rating agencies, private risk practices, and derivative clearing houses show private actors with epistemic authority not only safeguard their markets from

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<sup>52</sup> Benjamin Braun, “Asset Manager Capitalism as a Corporate Governance Regime,” in *The American Political Economy: Politics, Markets, and Power*, edited by Jacob S. Hacker, Alexander Hertel-Fernandez, Paul Pierson, and Kathleen Thelen (Cambridge: Cambridge University Press, 2021): 283.

<sup>53</sup> Camilla Hodgson and Owen Walker, “Carney-led Finance Coalition has up to \$130tn Funding Committed to Hitting Net Zero,” *The Financial Times*, November 18, 2021.

<sup>54</sup> Braun, “Asset Manager Capitalism as a Corporate Governance Regime,” 284.

<sup>55</sup> Erin Lockwood, “Predicting the Unpredictable: Value-at-Risk, Performativity, and the Politics of Financial Uncertainty,” *Review of International Political Economy* 22, no. 4 (2015): 150-152.

<sup>56</sup> Benjamin Braun and Daniela Gabor, “Central Banking, Shadow Banking, and Infrastructural Power,” *The Routledge International Handbook of Financialization* (London: Routledge Publishing, 2020), 241-244.



public contestation but can lock-in their services as best practices, regulations, and standards. Whether asset managers can effectively employ their infrastructural powers to overcome the agency issues via public regulatory aid remains a topic of future research.

## **Conclusion**

The Big Three have embraced the role of stewards of sustainable capital and champions of ESG. Yet despite having the means to engender ESG reforms into their portfolios, asset managers have adopted a feeble stewardship strategy to achieve their ESG goals. This paper explains this discrepancy with the rational hypocrisy that arises from the variety of agency, collective action, and regulatory constraints. These constraints represent the effective limits of the private authority held by asset managers since overcoming them would risk alienating investors, losing market share, and potential regulatory encroachment. By affirming the status quo that has enabled them to exploit the index revolution and consolidate their structural prominence over corporate control and institutional investors. Ultimately, the observable rational hypocrisy is performative of market logic to attain the social license to operate without jeopardizing their potential market shares.

This paper only presented a preliminary overview of these limits with several questions left unanswered. Ascertaining how asset managers interact with index providers or how states engage and regulate asset managers will all have important implications for understanding the place of asset managers in global financial (and social) governance. Indeed, addressing these questions will be a crucial task as the role of asset management only grows; both within markets and in public-private social agendas. Their leadership position in GFANZ and other UNFCC's Conference of Party financial initiatives has cemented their status as vehicles for social action. As universal owners, asset managers have also become key stakeholders in achieving the 2030 UN Sustainable Development Goals given their blockholdings in key industries. Beyond the questions

of accountability that naturally arise in debates on private authority, the understudied agency of asset managers also raises concerns about monetary and social security policies in a world dependent on universal owners. The structural and infrastructural power of asset managers will continue to grow with their portfolios but understanding that they cannot employ that power without agency cost will be a vital consideration for policymakers and academics seeking to hold asset managers accountable.

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**Be Our Guest: Exploring Host-Refugee Dynamics Through the Lens of History, Culture, and Religion**

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**Keywords:** Host-refugee relations, forced displacement, Rwanda, Myanmar, religion, solidarity.

## Abstract

Host-refugee dynamics are undeniably complex. Animosity, mistrust, and resentment are feelings often expressed by hosts as those unable or unwilling to return to their country of origin settle within their communities. The alarmist and conspiratorial narratives used to justify this lack of hospitality are quite varied, ranging from statements of national security to economic pressures. The growing belief that “refugees are a threat to everything *ours* is the root of many host community antipathies.” Given the fact that forced displacement is no longer a short-term and temporary phenomenon, a focus on host-refugee relations is critical to the well-being of the individuals and communities experiencing forced displacement. Considering the long-standing focus in the literature on exploring tense and violent host-refugee relations, this paper investigates the following questions: Can shared historical, cultural, and religious ties contribute to the formation of positive host-refugee relations? Are these commonalities enough to ensure the well-being of those experiencing forced displacement? By critically engaging with examples from Bangladesh, Turkey, Malaysia, Rwanda, Niger and Guinea, this paper provides insights into the underlying motivations behind the solidarity and resentment of host populations.

## Introduction

Increasingly, frequent humanitarian crises have contributed to the current global displacement of more than 80 million people.<sup>1</sup> Of this number, around 20 million are considered refugees which are, according to the 1951 Refugee Convention, “unable or unwilling to return to their country of origin owing to a well-founded fear of being persecuted for reasons of race, religion, nationality, membership of a particular social group, or political opinion.”<sup>2</sup> Above and beyond these reasons, a confluence of other factors such as conflict, climate change, and state fragility have pushed many to leave their homes in search of protection, safety, and peace. Often left with no other choice than to risk their lives in order to save their lives,<sup>3</sup> many of the world’s refugees “live without formal state protection and are in the process of waiting for or seeking some form of political belonging.”<sup>4</sup> Further complicating forced displacement is the fact that 86% of refugees are hosted by developing countries.<sup>5</sup> As such, local communities hosting refugees are “[not always] composed of settled and established groups of citizens.”<sup>6</sup> This can lead to paradoxical situations wherein the host state has the same (or similar) problems that the newly arrived refugees are precisely fleeing from.<sup>7</sup> Although the binary division between ‘host’ and ‘refugee’ is not fixed (as refugees often enter communities formed by established or former refugees),<sup>8</sup> for the purpose of this paper, ‘hosts’ and ‘refugees’ refer to distinct entities.

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<sup>1</sup> UNHCR, *Global Trends - Forced Displacement 2020* (Copenhagen: UNHCR, 2021), [https://www.unhcr.org/60b638e37.pdf#\\_ga=2.10986684.920476314.1659305287-1751450733.1659305287](https://www.unhcr.org/60b638e37.pdf#_ga=2.10986684.920476314.1659305287-1751450733.1659305287)

<sup>2</sup> UNHCR, *Convention and Protocol Relating to the Status of Refugees* (Geneva: UNHCR, 1951), <https://www.unhcr.org/3b66c2aa10.html>

<sup>3</sup> Hathaway, James C. “The Global Cop-Out on Refugees.” *International Journal of refugee law* 30, no. 4 (2018): 592.

<sup>4</sup> Serena Parekh, *Refugees and the Ethics of Forced Displacement* (New York: Routledge, 2017).

<sup>5</sup> UNHCR, *Global Trends 2020*

<sup>6</sup> Elena Fiddian-Qasmiyeh, “Refugees Hosting Refugees,” *Forced Migration Review*, no. 53 (2016): 25–27, <https://www.fmreview.org/sites/fmr/files/FMRdownloads/en/community-protection/fiddianqasmiyeh.pdf>

<sup>7</sup> Fiddian-Qasmiyeh, *Refugees*, 25-27.

<sup>8</sup> Fiddian-Qasmiyeh, *Refugees*, 25-27.



Many host governments struggle to “meet the additional demands that refugees place on public services and infrastructure” due to constrained government budgets and weak state capacity.<sup>9</sup> There is also growing concern around protracted refugee situations, as has been the case for the *Ain El Hilweh* camp in Lebanon (more than 73 years) and the *Nakivale* camp in Uganda (62 years).<sup>10</sup> Given the long-lasting nature of displacement situations, refugees do not simply “arrive today and [are] gone tomorrow.”<sup>11</sup> Thus, it is crucial that hosting states and humanitarian aid organizations work to foster and facilitate positive host-refugee relations. The well-being of individuals and communities experiencing forced displacement depends on it.

Research around host-refugee relations is relatively wide in scope and breadth. On the one hand, we may read accounts of refugees who face “unfamiliar edifices, inexplicable customs, unknown and undecipherable habits [and] encounter enigmatic people.”<sup>12</sup> On the other hand, we read about the experiences faced by host communities as they are “juxtaposed with foreigners [who] disrupt familiar comforts [and] the usual order of things.”<sup>13</sup> Such situations can spark varying degrees of hospitality from local municipalities and even national authorities.

For example, Rwanda’s capital city of Kigali is known as a ‘City of Light’ for its “accepting and supportive attitude toward refugees.”<sup>14</sup> This is attributable to the many inclusionary policies put forth by the Rwandan government such as the *Joint Strategy on The Economic Inclusion of*

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<sup>9</sup> Ala' Alrababa'h, Daniel Masterson, Marine Casalis, Dominik Hangartner and Jeremy Weinstein, "The Dynamics of Refugee Return: Syrian Refugees and Their Migration Intentions," last modified 2020, <https://immigrationlab.org/working-paper-series/dynamics-refugee-return/>

<sup>10</sup> *A World Not Ours*, directed by Mahdi Fleifel (London: Nakba Film Works, 2012), Online.; *Alexander Betts, Louise Bloom, Josiah Kaplan, and Naohiko Omata*, *Refugee Economies*

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<sup>11</sup> Heidrun Friese, “The Limits of Hospitality,” *Modern Critical Theory Group*, no. 1 (2009): 51–68, <https://www.jstor.org/stable/43151905>.

<sup>12</sup> Heidrun Friese, “Spaces of Hospitality,” *Journal of Theoretical Humanities*, no.2 (2004): 67–79, <https://www.jstor.org/stable/43151905>.

<sup>13</sup> Friese, *Limits of Hospitality*, 67–79.

<sup>14</sup> Sara Olk, "Refugees in Rwanda: An Inclusive Approach," *The Borgen Project*, last modified August 2019, <https://borgenproject.org/refugees-in-rwanda>.

*Refugees* which seeks to ensure that “all refugees and neighbouring communities are able to fulfill their productive potential as self-reliant members of Rwandan society.”<sup>15</sup> However, in other cases, some communities are unwilling to engage with newcomers.<sup>16</sup> For instance, Lebanon<sup>17</sup> has put into motion the ‘October Policy’ which seeks to “decrease the number of Syrian refugees in Lebanon by reducing access to territory (...) to those who can prove that their stay in Lebanon fits into one of the approved entry categories, such as tourism, business or study.”<sup>18</sup> This inevitably contributes to denying “entry to poorer Syrians while keeping the borders open to those who enjoy good financial standing.”<sup>19</sup> Such varying attitudes, perceptions, and feelings expressed by hosts, as illustrated through the aforementioned examples, encourage deep reflection on the possibility of ‘unconditional welcomes’ or if hospitality itself is an impossible demand.<sup>20</sup>

Framed with this context in mind, this research paper investigates the following question: Can shared historical, cultural, and religious ties contribute to the formation of positive host-refugee relations? Are these commonalities enough to ensure the well-being of those experiencing forced displacement? This paper demonstrates, somewhat counter-intuitively, that shared characteristics are not sufficient for meaningful host-refugee relations. With examples from Bangladesh, Turkey, Malaysia, Rwanda, Niger, and Guinea, it is clear that it takes more than just shared ties to ensure

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<sup>15</sup> UNHCR, The Ministry in Charge of Emergency Management (MINEMA) and the United Nations High Commissioner For Refugees Joint Strategy on Economic Inclusion of Refugees and Host Communities in Rwanda (Kigali: UNHCR, 2020), [https://www.minema.gov.rw/fileadmin/user\\_upload/Minema/Publications/Laws\\_and\\_Policies/MINEMA-%60\\_](https://www.minema.gov.rw/fileadmin/user_upload/Minema/Publications/Laws_and_Policies/MINEMA-%60_)

<sup>16</sup> Hilal Alkan, “The Gift of Hospitality and the (un)welcoming of Syrian Migrants in Turkey,” *American Ethnologist*, no.2 (2021): 180-191 <https://anthrosource.onlinelibrary.wiley.com/doi/full/10.1111/amet.13012>,

<sup>17</sup> Janmyr, Maja. “No Country of Asylum: ‘Legitimizing’ Lebanon’s Rejection of the 1951 Refugee Convention.” *International Journal of refugee law* 29.3 (2017): 440.

<sup>18</sup> Maja Janmyr and Lama Mourad, “Modes of Ordering: Labelling, Classification and Categorization in Lebanon’s Refugee Response.” *Journal of Refugee Studies*, no. 4 (2018): 544–565, <https://academic.oup.com/jrs/article-abstract/31/4/544/4792968?redirectedFrom=fulltext>

<sup>19</sup> Janmyr and Mourad, *Labelling, Classification and Categorization in Lebanon’s Refugee Response*, 544–565.

<sup>20</sup> Jonathan Darling, “Becoming Bare Life: Asylum, Hospitality, and the Politics of Encampment,” *Environment and Planning D: Society & Space*, 27, no. 4 (2009): 649-665, <https://journals.sagepub.com/doi/10.1068/d10307>

peaceful coexistence and sustainable refugee care.<sup>21</sup> In fact, positive host-refugee relations do not depend solely on commonalities between hosts and refugees but depend on the actions posed by other key actors such as humanitarian organizations and host governments.<sup>22</sup>

### **Shared Historical Ties**

Common historical ties between hosts and refugees have the power to shape the nature of their relationship, for better or for worse. In many cases, very specific and relevant historical factors have been a motivating force behind hosting community's friendly welcome of refugees. As "the uninvited guest"<sup>23</sup> enters a hosting community, many tensions arise "between 'being at home' and 'being a stranger', between closeness and distance, territory and boundary, private and public space, membership, and exclusion."<sup>24</sup> Yet, how can hospitality, which is "considered primarily as a human virtue," be influenced by historical ties? In what ways is it easier or more difficult to navigate a host communities' social structures when both the hosts and the refugees have a common history, shared narrations, and memories?

Positive impacts of shared historical ties between hosts and refugees can be found, for instance, when observing the arrival of Rohingya refugees from Myanmar in neighbouring Bangladesh. The forced displacement of the Rohingya people from Myanmar sparked warm hospitality and sympathetic behaviour from the Bangladeshi people. Historically, Bangladesh and Myanmar (formerly Arakan) have been in commercial contact since the 8<sup>th</sup> century, which for

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<sup>21</sup> Ismat Jerin, and Muhammad Mozumder, "Exploring Host Community Attitudes Towards Rohingya Refugees in Bangladesh," *Intervention* no. 2 (2019): 169–170, <https://www.interventionjournal.org/article.asp?issn=1571-8883;year=2019;volume=17;issue=2;spage=169;epage=173;aulast=Jerin>

<sup>22</sup> Karen Jacobsen, "Livelihoods in Conflict: The Pursuit of Livelihoods by Refugees and the Impact on the Human Security of Host Communities," *International Migration* 40, no. 5 (2002): 95-123, <https://onlinelibrary.wiley.com/doi/10.1111/1468-2435.00213>

<sup>23</sup> Friese, *Spaces of Hospitality*, 67 - 79.

<sup>24</sup> Friese, *Limits of Hospitality*, 67–79.

them, was the start of a “cross-border relationship.”<sup>25</sup> In the pre-colonial period, both countries encouraged marriage between their citizens, thus allowing the creation of family connections on both sides of the border.<sup>26</sup> To this day, the “historical relation [between both countries] is evident in the folklore, music and other cultural elements.”<sup>27</sup> Shared history encouraged local Bangladeshi communities, despite severe resource constraints, to mobilize “resources of various types and volumes to ameliorate the sufferings of the refugees, even before the Bangladesh government officially engaged in the humanitarian effort.”<sup>28</sup> Furthermore, the fact that both Bangladesh and Myanmar have a “shared memory of refugee experiences” also played a role in garnering support for the plight of Rohingya refugees.<sup>29</sup> During the 1971 liberation war of Bangladesh, millions of Bangladeshi refugees “escaped to bordering India in a military crackdown by the Pakistani armed forces.”<sup>30</sup> The arrival of Rohingya refugees in Bangladesh was, for the Bangladeshi people, a “painful reminder of [the] bloody liberation war;”<sup>31</sup> so much so that Bangladesh’s Prime Minister said: “We, too, were forced to seek refuge in India in the face of Pakistan’s attack.”<sup>32</sup> It is clear that “the war and the subsequent refugee situation [remain a] defining feature of Bangladesh’s national psyche.”<sup>33</sup> This, in turn, has shaped the relationship between the Bangladeshi people and the Rohingya refugees as the former know what it’s like to experience forced displacement and can therefore understand what the Rohingya refugees are currently experiencing.

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<sup>25</sup> Anas Ansar and Abu Faisal Khaled, “From Solidarity to Resistance: Host Communities’ Evolving Response to the Rohingya Refugees in Bangladesh,” *Journal of International Humanitarian Action*, no. 1 (2021): 1–14, <https://jhumanitarianaction.springeropen.com/articles/10.1186/s41018-021-00104-9>

<sup>26</sup> Ansar and Khaled, *Host Communities’ Evolving Response to the Rohingya Refugees in Bangladesh*, 1-14.

<sup>27</sup> Ansar and Khaled, *Host Communities’ Evolving Response to the Rohingya Refugees in Bangladesh*, 1-14.

<sup>28</sup> Chowdhury R Abrar, “Lost in conversation: voice of the host community,” *The Daily Star*, 2017.

<https://www.thedailystar.net/starweekend/the-shadow-violence/voice-the-host-community-1475143>

<sup>29</sup> Ansar and Khaled, *Host Communities’ Evolving Response to the Rohingya Refugees in Bangladesh*, 1-14.

<sup>30</sup> Sydney Schanberg, “Bengal refugees stirring strife in India,” *New York Times*, 1971.

<https://www.nytimes.com/2000/04/10/us/the-well-marked-roads-to-homicidal-rage.html>

<sup>31</sup> Ansar and Khaled, *Host Communities’ Evolving Response to the Rohingya Refugees in Bangladesh*, 1-14.

<sup>32</sup> Gary Bass, “We, too, were forced to seek refuge,” *The Atlantic*, 2017,

<https://www.theatlantic.com/international/archive/2017/1%200/rohingya-bangladesh-refugees-pakistan/543969/>

<sup>33</sup> Ansar and Khaled, *Host Communities’ Evolving Response to the Rohingya Refugees in Bangladesh*, 1-14.

However, even despite a common history, host-refugee dynamics are also heavily charged with tension. When looking at the case of Syrian refugees in Turkey, it has been observed that historical ties between the two groups have been a source of “dispute and contestations.”<sup>34</sup> A major issue between the two countries has been over the region’s Kurdish population. While Turkey maintained a neutral stance toward the Kurdish people, Syria allied itself with the rebel Kurdistan Workers Party (also known as PKK) and sheltered its leader inside its borders and was even accused of providing logistical aid to the PKK.<sup>35</sup> This caused extreme tension between the two countries that it almost caused a war in 1998.<sup>36</sup> Later, relationships improved based on certain foreign policy decisions<sup>37</sup>, particularly during the Arab-Israeli wars,<sup>38</sup> when the conflict in Syria escalated rapidly in 2012, “Turkey granted temporary protection status that included three main principles: an open-door policy to Syrian refugees, no forced return to Syria, and unlimited length of stay in Turkey.”<sup>39</sup> Despite such policies and the historical ties between both countries, many Syrians were “treated with open or covert hostility.”<sup>40</sup> Syrian refugees have also “recently been framed in security terms”, meaning that they have been increasingly associated with “crime, socio-economic problems, cultural deprivation, and internal security.”<sup>41</sup> This has resulted in, at times, “racist and violent attacks” against Syrians.<sup>42</sup> Despite these realities, the Turkish government “has

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<sup>34</sup> Alkan, *The Gift of Hospitality and the (un)welcoming of Syrian Migrants in Turkey*, 180-191.

<sup>35</sup> Mark Dohrmann and Robert Hatem, "The Impact of Hydro-Politics on the Relations of Turkey, Iraq, and Syria," *The Middle East Journal*, no. 4 (2014), 567 - 583.

<sup>36</sup> Dohrmann and Hatem, *Hydro-Politics on the Relations of Turkey, Iraq, and Syria*, 567–583.

<sup>37</sup> Examples of such foreign policy decisions include Turkey’s refusal to recognize the annexation of East Jerusalem after 1967 and its denying the US use of its territory to refuel while shipping arms to Israel in 1973.

<sup>38</sup> Dohrmann and Hatem, *Hydro-Politics on the Relations of Turkey, Iraq, and Syria*, 567–583.

<sup>39</sup> Ayhan Kaya, "Syrian Refugees and Cultural Intimacy in Istanbul: I Feel Safe Here, " Robert Schuman Centre for Advanced Studies Research, last modified 2016, <https://ssrn.com/abstract=2870516> or <http://dx.doi.org/10.2139/ssrn.2870516>.

<sup>40</sup> Alkan, *The Gift of Hospitality and the (un)welcoming of Syrian Migrants in Turkey*, 180-191.

<sup>41</sup> Burcu Togral Koca, " Syrian Refugees in Turkey: From 'guests' to 'enemies'?" *New Perspectives on Turkey*, no 54 (2016): 55-75,

[https://www.researchgate.net/publication/305820094\\_Syrian\\_refugees\\_in\\_Turkey\\_from\\_guests\\_to\\_enemies](https://www.researchgate.net/publication/305820094_Syrian_refugees_in_Turkey_from_guests_to_enemies)

<sup>42</sup> UNHCR. Syria Regional Refugee Response, Operational Data Portal (2022). Retrieved from: <https://data.unhcr.org/en/situations/syria>.

continued its humanitarian stance and sought to support its ‘open door’ policy by reference to narratives of historical necessities.”<sup>43</sup> As seen in this case, the common historical ties shared by hosts and refugees do not override social divisions.

### **Shared Cultural Ties**

Host-refugee dynamics can also be facilitated by shared ethnic and cultural attributes, which brings familiarity between both groups. The co-ethnicity or shared culture argument “posits that people possess particular warmth for members of their ethnic group.”<sup>44</sup> A shared culture can also “take away some of the reasons for which groups sometimes fight each other by ensuring that they share similar values and tastes.”<sup>45</sup> There are also many potential psychological effects for refugees to “operate in a familiar culture.”<sup>46</sup> For groups with shared or similar languages, quite a positive impact can be seen on host-refugee relations. As a matter of fact, “when refugees and locals share the same language, it makes it easier for them to avoid conflicts that arise from common misunderstandings.”<sup>47</sup> For example, the existence of linguistic and cultural ties between the Bangladeshi people and the Rohingya refugees greatly facilitated host-refugee dynamics. As a result, Rohingya refugees found it easier “to navigate their host communities’ social structure.”<sup>48</sup> For Rohingya refugees hosted in Malaysia, the fact that they dressed very similarly to their Malay hosts, allowed them to “blend into the rural *kampung* (village) life as they go about their business,

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<sup>43</sup> Koca, *Gift of Hospitality*, 55-75.

<sup>44</sup> Ato Kwamena Onoma, *Anti-Refugee Violence and African Politics* (New York: Cambridge University Press, 2013).

<sup>45</sup> Onoma, *Anti-Refugee Violence and African Politics*.

<sup>46</sup> Onoma, *Anti-Refugee Violence and African Politics*.

<sup>47</sup> Onoma, *Anti-Refugee Violence and African Politics*.

<sup>48</sup> Ansar and Khaled, *Host Communities’ Evolving Response to the Rohingya Refugees in Bangladesh*, 1-14.

often working alongside Malays and Indians in shops, restaurants, and in construction.”<sup>49</sup> This cultural familiarity helped them integrate into their host community with more ease.

Another example of refugee groups sharing cultural proximities with their hosts are the Congolese refugees in Rwanda. In fact, “many Congolese refugees are associated with some Rwandan ancestry and more often than not speak the same language as the host population.”<sup>50</sup> Due to a “pre-existing cultural closeness,” it is generally accepted (by Rwandan locals) that their shared cultural similarities with the refugees “may have facilitated [their] process of acceptance.”<sup>51</sup> Many Rwandans living close to refugee camps have expressed the following inclusive statements: “Those refugees have already become Rwandans. The only difference arises from the fact that they are located in the camp. Otherwise, we consider them as Rwandans.”<sup>52</sup> The importance of sharing cultural or ethnic similarities is also evident when looking at the factors that are taken into consideration for the resettlement process of refugees. Amongst factors such as “housing availability, cost of living, job opportunities, and the community’s willingness and ability to offer needed language, health, and educational services”, there is the desire, for some countries, to resettle refugees where there is the “presence of a network of co-nationals who share the same language and cultural background.”<sup>53</sup>

Claire L. Adida challenges this “well-accepted view that cultural and ethnic similarities between [refugees] and [hosts] contribute significantly to the smooth accommodation of [refugees]

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<sup>49</sup> Gerhard Hoffstaedter, “Refugees, Islam, and the State: The Role of Religion in Providing Sanctuary in Malaysia,” *Journal of Immigrant & Refugee Studies*, no. 3 (2017): 287–304, <https://www.tandfonline.com/doi/abs/10.1080/15562948.2017.1302033>

<sup>50</sup> Veronika Fajth, Özge Bilgili, Craig Loschmann, and Melissa Siegel, “How Do Refugees Affect Social Life in Host Communities? The Case of Congolese Refugees in Rwanda,” *Comparative Migration Studies*, no. 1 (2019): 1–2, <https://comparativemigrationstudies.springeropen.com/articles/10.1186/s40878-019-0139-1>.

<sup>51</sup> Fajth et al., *How Do Refugees Affect Social Life in Host Communities?* 1–21.

<sup>52</sup> Fajth et al., *How Do Refugees Affect Social Life in Host Communities?* 1–21.

<sup>53</sup> Catalina Amuedo-Dorantes, Cynthia Bansak, and Susan Pozo, “Refugee Admissions and Public Aafety: Are Refugee Settlement Areas More Prone to Crime?” *International Migration Review* 55, no. 1 (2021): 135–165, <https://journals.sagepub.com/doi/full/10.1177/0197918320920192>

in receiving societies.”<sup>54</sup> The essence of Adida’s argument is that when immigrants or refugees are culturally similar to their hosts, they can easily maneuver the host’s cultural networks. However, given this reality, hosts are threatened by the “economic disadvantages it presents to them, which sharpens their hostility toward such immigrants [or refugees].”<sup>55</sup> This creates a situation where “both locals and refugees [are competing in the same (...) daily labour market.”<sup>56</sup> By the same token, “if [refugee] groups share few or no cultural traits with their host society, [there is a] lower threat of group identity loss.”<sup>57</sup> In other words, refugees can be perceived as less of a threat by hosts given that they “can [be] easily marked as foreigners and are therefore less likely to [be] rejected.”<sup>58</sup> Gradstein and Schiff (2006) have also argued that “the social cost of minority integration into a majority depends, among other factors, on the cultural distance between the two groups.”<sup>59</sup> In the example of Hausa immigrants from Nigeria in Niamey, Niger, both groups share an ethnic identity.<sup>60</sup> Yet, regardless of this strong ethnic connection, Niamey residents excluded Hausas to the point that when asked if they would vote for a Hausa presidential candidate, only 6% of them responded in the affirmative. In fact, 13% of them<sup>61</sup> would prefer to have a Yoruba president with not much cultural overlap with Niamey residents.<sup>62</sup> This exemplifies how “cultural

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<sup>54</sup> Claire L Adida, *Immigrant Exclusion and Insecurity in Africa: Coethnic Strangers* (New York: Cambridge University Press, (2014): 69.

<sup>55</sup> Claire L Adida, *Immigrant Exclusion and Insecurity in Africa: Coethnic Strangers* (New York: Cambridge University Press, (2014): 69.

<sup>56</sup> Ansar, Anas, and Abu Faisal Md. Khaled. “From Solidarity to Resistance: Host Communities’ Evolving Response to the Rohingya Refugees in Bangladesh.” *Journal of International Humanitarian Action* 6, no. 1 (2021): 6.

<sup>57</sup> Adida, Claire L. “Too Close for Comfort? Immigrant Exclusion in Africa.” *Comparative political studies* 44, no. 10 (2011): 1371.

<sup>58</sup> Adida, Claire L. “Too Close for Comfort? Immigrant Exclusion in Africa.” *Comparative political studies* 44, no. 10 (2011): 1371.

<sup>59</sup> Mark Gradstein and Maurice Schiff, “The Political Economy of Social Exclusion, with Implications for Immigration Policy.” *Journal of Population Economics* 19, no. 2 (2006): <https://www.jstor.org/stable/20008014>

<sup>60</sup> Adida, *Too Close for Comfort*, 1370 - 1396.

<sup>61</sup> Adida, Claire L. “Too Close for Comfort? Immigrant Exclusion in Africa.” *Comparative political studies* 44, no. 10 (2011): 1383.

<sup>62</sup> Adida, Claire L. “Too Close for Comfort? Immigrant Exclusion in Africa.” *Comparative political studies* 44, no. 10 (2011): 1383.



similarities may exacerbate, not ameliorate, immigrant-host relations.”<sup>63</sup> In the case of Liberian refugees in Guinea, despite being co-ethnic with their hosts, they were treated badly.<sup>64</sup> Much research has demonstrated that “when it came to intimate relations with people involved in their daily lives, (...) hosts seemed to put character above ethnicity.”<sup>65</sup> Indeed, inter-communal knowledge and other individual demonstrations of trustworthiness seemed to be more important than ethnic ties.

As such, co-ethnicities aren't always the strongest determinant when it comes to grievances in host-refugee relations. In some cases, as seen previously, shared cultural linkages act as a bridge between the two groups. However, in other cases, as Adida so strongly argues, common cultural ties are not enough to override feelings of competition. The benefits of co-ethnicity are there, yet they might not always manifest themselves within certain host societies or with certain refugee groups.

### **Shared Religious Beliefs**

It is widely argued that “religion can, has, and does play a key role in motivating and framing diverse forms of support for refugees and asylum-seekers around the world.”<sup>66</sup> It has also become increasingly recognized that “locally based actors are key responders in situations of displacement.”<sup>67</sup> As such, it is no wonder that many local religious communities, religious leaders,

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<sup>63</sup> Adida, Claire L. “Too Close for Comfort? Immigrant Exclusion in Africa.” *Comparative political studies* 44, no. 10 (2011): 1390.

<sup>64</sup> Onoma, *Anti-Refugee Violence and African Politics*.

<sup>65</sup> Onoma, *Anti-Refugee Violence and African Politics*.

<sup>66</sup> Elena Fiddian-Qasmiyeh, Unni Karunakara, Aydan Greatrick, Alastair Ager, Louisa Lombard, Catherine Panter-Brick, Lyndsey Stonebridge, and Anna Rowlands, “Religion and Social Justice for Refugees: Insights from Cameroon, Greece, Malaysia, Mexico, Jordan and Lebanon”. *Bridging Voices Report to the British Council*, (2020). <https://refugeehosts.files.wordpress.com/2020/07/bc-hl-religion-and-social-justice-for-refugees-report-rev.pdf>

<sup>67</sup> Shatha El Nakib and Alastair Ager, *Local faith community and civil society engagement in humanitarian response with Syrian refugees in Irbid, Jordan* (New York: Columbia University, 2015), <https://rpl.hds.harvard.edu/files/rpl/files/el-nakib-ager-local-faith-communities-and-humanitarian-response-in-irbid.pdf?m=1602765060>

and Faith-Based Organisations (FBOs) have stepped in and played a direct role in offering humanitarian assistance to refugees.

Historically, hospitality has been considered a religious duty by many religious groups.<sup>68</sup> Many important religious texts, such as the Bible and the Qur'an, have the commandment to protect and shelter strangers.<sup>69</sup> Even when religious beliefs are not shared between both groups, many hosts are compelled by their own religious beliefs to help refugees. However, are host-refugee dynamics different if the same religious beliefs are shared between both groups? As the following examples will demonstrate, shared religious ties influence relationships between hosts and refugees do not guarantee that both groups will bond over deeply shared beliefs.

For instance, when Cham refugees arrived in Malaysia after fleeing “both the Vietnam War and the ethnic cleansing operations of the Khmer Rouge in Cambodia in the late 1970s,”<sup>70</sup> the Malaysian government granted refuge to the Cham because of “humanitarian reasons and also the common Muslim brotherhood factor.”<sup>71</sup> It is important to note here that supporters of the Islamic faith make up the largest demographic in Malaysia. The country also previously assisted, in 1992, 300 Bosnian Muslims who “faced ethnic-cleansing campaigns by Serb nationalists.”<sup>72</sup> This intervention was later explained by the Malaysian government as them simply acting on behalf of Muslim refugees, appealing to the Ummah (Muslim brotherhood), and because they had the general plight of the Muslim community at heart<sup>73</sup>. The goal here was also to “situate Malaysia within a wider Islamic community and thus in opposition to a ‘Western’ one.”<sup>74</sup> Thus, Malaysia’s

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<sup>68</sup> Friese, *Limits of Hospitality*, 51–68.

<sup>69</sup> Friese, *Limits of Hospitality*, 51–68.

<sup>70</sup> Hoffstaedter, *Refugees, Islam, and the State: The Role of Religion in Providing Sanctuary in Malaysia*, 287–304.

<sup>71</sup> Danny Wong Tze-Ken, “The Cham Arrivals in Malaysia: Distant Memories and Rekindled Links,” *Archipel* 85, no.1, 151–165, [https://www.persee.fr/doc/arch\\_0044-8613\\_2013\\_num\\_85\\_1\\_4389](https://www.persee.fr/doc/arch_0044-8613_2013_num_85_1_4389)

<sup>72</sup> Hoffstaedter, *Refugees, Islam, and the State: The Role of Religion in Providing Sanctuary in Malaysia*, 287–304.

<sup>73</sup> Shanti Nair, *Islam in Malaysian Foreign Policy* (London: Routledge, 1997).

<sup>74</sup> Nair, *Islam in Malaysian Foreign Policy*.

treatment of refugees can also be presented as a “case for Muslim solidarity.”<sup>75</sup> It is also interesting to note that the UNHCR has used religion and faith as a way “to elicit sympathy, charity, and recognition for refugees.”<sup>76</sup> This is especially true in “Muslim majority countries that are not signatories to the refugee convention in the hope of carving out a complementary protection space based on Islamic law and practice.”<sup>77</sup>

In the context of Bangladesh, the country has received more than half a million Rohingya refugees since 2017, with many residing in Cox’s Bazar district.<sup>78</sup> The host population of Cox’s Bazar was “mostly sympathetic to the plight of the refugees” because of their religious similarities, both practicing Sunni Islam.<sup>79</sup> Given that almost all the refugees in Cox’s Bazar are Sunni Muslims, local hosts provided greatly for them by offering up their homes, providing food and clothes as well as “donated money to community charities who were the first to provide the initial living arrangement before the NGOs and international relief operations flooded into the region.”<sup>80</sup> Many locals have voiced their opinions by saying the following: “Rohingyas are our Muslim brothers and sisters in need. Our Prophet Muhammad and his followers fled from Mecca to nearby Medina to escape persecution. Rohingyas are killed for being Muslims, and we should support them because it is also our religious obligation”<sup>81</sup> and “Rohingyas are *Iatim* (Orphan) in this world. No one helps them. If we Muslims do not stand by, then how they will [sic] even survive?”<sup>82</sup> Thus, shared religious identity and beliefs can not only encourage hosts to welcome refugees but also

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<sup>75</sup> Nair, *Islam in Malaysian Foreign Policy*.

<sup>76</sup> Nair, *Islam in Malaysian Foreign Policy*.

<sup>77</sup> Nair, *Islam in Malaysian Foreign Policy*.

<sup>78</sup> Nair, *Islam in Malaysian Foreign Policy*.

<sup>79</sup> Ansar and Abu Faisal, *Host Communities*, 1-14.

<sup>80</sup> Nusrat Jahan Mim "Religion at the Margins: Resistance to Secular Humanitarianism at the Rohingya Refugee Camps in Bangladesh" *Religions* 11, no. 8 (2020): 423. <https://doi.org/10.3390/rel11080423>; V Palmer, "Analyzing cultural proximity: Islamic Relief Worldwide and Rohingya refugees in Bangladesh" *Development in Practice* 21, no. 1 (2011): 96–108. <https://doi.org/10.1080/09614524.2011.530226>.

<sup>81</sup> Ansar and Khaled, *Host Communities' Evolving Response to the Rohingya Refugees in Bangladesh*, 1-14.

<sup>82</sup> Ansar and Khaled, *Host Communities' Evolving Response to the Rohingya Refugees in Bangladesh*, 1-14.

create a foundation to build meaningful relationships. Many Rohingyas have even voiced their opinion of wanting to stay in Bangladesh because of the relationships they were able to form but also, given the shared religious beliefs, they knew they “would get a dignified Muslim burial.”<sup>83</sup>

Despite the aforementioned examples, common religious ties do not necessarily shape host-refugee relationships positively. In fact, many Syrian refugees have referred to the “ethnoreligious identity of the people who refused to engage with them or treated them with open or covert hostility.”<sup>84</sup> One Turkish man, despite being “very well trained in religious scripture regarding hospitality,”<sup>85</sup> did not open the door to his new Syrian neighbours, even though both parties shared the same faith: Islam.<sup>86</sup> This man had no desire to “share whatever he had—rights, property, salary, status, land, citizenship, and entitlements”.<sup>87</sup> He rejected any possible relationship that might eventually cost him sovereignty over his territory, his neighbourhood, and his country.<sup>88</sup> Moreover, many Turkish landlords were even recalled as not renting their apartments to refugees as they were perceived as terrorists.<sup>89</sup> With religious and nationalist undertones in the actions of certain Turkish people toward Syrian refugees, it is clear that religious ties heavily shape host-refugee dynamics, sometimes as a source of unity, and other times, as a source of harsh discrimination.

## Conclusion

This paper aimed to share the complexities brought on by common historical, cultural, and religious ties in host-refugee dynamics. As it has been described, such shared elements can act as a double-edged sword - they can be the catalyst for unity *or* division. One need not look far to find

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<sup>83</sup> Holloway, Kerrie, and Lilianne Fan. *Dignity and the Displaced Rohingya in Bangladesh*. (London: Overseas Development Institute, 2018), <https://cdn.odi.org/media/documents/12362.pdf>

<sup>84</sup> Alkan, *The Gift of Hospitality and the (un)welcoming of Syrian Migrants in Turkey*, 180-191.

<sup>85</sup> Alkan, *The Gift of Hospitality and the (un)welcoming of Syrian Migrants in Turkey*, 180-191.

<sup>86</sup> Alkan, *The Gift of Hospitality and the (un)welcoming of Syrian Migrants in Turkey*, 180-191.

<sup>87</sup> Alkan, *The Gift of Hospitality and the (un)welcoming of Syrian Migrants in Turkey*, 180-191.

<sup>88</sup> Alkan, *The Gift of Hospitality and the (un)welcoming of Syrian Migrants in Turkey*, 180-191.

<sup>89</sup> Alkan, *The Gift of Hospitality and the (un)welcoming of Syrian Migrants in Turkey*, 180-191.

various examples of either outcome. For instance, when Russia began its war with Ukraine, various Ukrainians fled to neighbouring countries to find food, shelter, and peace. However, it wasn't long before various reports emerged of "racist and xenophobic treatment of people fleeing Ukraine who were visible minorities."<sup>90</sup> In other words, hosts tended to be more sympathetic toward those who looked like them. Shared culture, or in this case, shared physical attributes became an important factor in deciding who to help, thus creating double standards in refugee protection. While the nature of host-refugee relationships will "vary by host country and [refugee] group,"<sup>91</sup> the question remains if the well-intentioned sentiments expressed by hosts can stand the test of time. In many cases, initial hospitality turns into hostility because the adverse impacts of the refugees' presence become more notable, especially when the local host population is impoverished.<sup>92</sup> In other words, how refugees are treated depends on the real (or perceived) impact they have on local economies and the well-being of their hosts.<sup>93</sup> In cases such as these, the role of humanitarian organizations is extremely crucial as they need to be aware of the many tensions that the provision of aid can spark between refugees and hosts.

Strategies surrounding the delivery of aid must keep in mind the social fabric of the host society. For instance, organizations can provide both humanitarian and long-term development assistance in key areas such as health and education to both refugee and host communities. This can reduce tensions and improve host-refugee dynamics as both groups benefit from integrated

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<sup>90</sup> Ayelet Shachar, "<https://www.ethicsandinternationalaffairs.org/2022/expanding-protection-global-lessons-from-the-ukrainian-refugee-crisis/>," Ethics and International Affairs, last modified March 2022, <https://www.ethicsandinternationalaffairs.org/2022/expanding-protection-global-lessons-from-the-ukrainian-refugee-crisis/>

<sup>91</sup> Adida, *Too Close for Comfort*, 1370 - 1396.

<sup>92</sup> Ansar and Khaled, *Host Communities' Evolving Response to the Rohingya Refugees in Bangladesh*, 1-14.

<sup>93</sup> Jerin and Mozumder, *Exploring Host Community Attitudes Towards Rohingya Refugees in Bangladesh*, 169–170.

and balanced levels of services.<sup>94</sup> Furthermore, humanitarian organizations can engage in advocacy with host governments to allow refugees fuller access to economic and social opportunities. This may include reducing the restrictions on the movement of refugees or allowing them access to the labour market.<sup>95</sup> This is not to say that humanitarian organizations fail to “support newly displaced refugee groups while remaining sensitive to the socio-economic conditions of (...) host communities,”<sup>96</sup> but “it is widely noted that this problem [remains] ineffectively addressed and under-researched.”<sup>97</sup> Thus, the international community must take the necessary steps to implement strategies that work to minimize host-refugee tensions, especially during the delivery of aid and humanitarian resources. On their own, host governments can provide (resources permitting) integration services quickly, allow refugees to find employment, and validate foreign work experience and credentials.<sup>98</sup> The reality is that “whether we want it or not, people will keep moving, and the sustainability of everyone’s welfare cannot be but a common affair.”<sup>99</sup> Lastly, one need not over-emphasize the increased burden placed on host countries and communities when refugees arrive, especially in situations when the host country’s citizens already face economic, political, or social hardships. However, the opposite of this sentiment must be understood equally: refugees bring with them a fount of untapped potential which can serve as a

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<sup>94</sup> Jeremy Konyndyk, "Towards a new model for post-emergency refugee assistance," Humanitarian Practice Network, last modified October 2005, <https://odihpn.org/publication/towards-a-new-model-for-post-emergency-refugee-assistance/>.

<sup>95</sup> Leah Berry, "The Impacts of Environment Degradation on Refugee-Host Relationships," *African Security Review* 17, no. 5 (2002):95-123, <https://journals.co.za/doi/abs/10.10520/EJC47448>; Karen Jacobsen, *Livelihoods in Conflict*, 95-123.

<sup>96</sup> Fiddian-Qasmiyeh, *Refugees*, 25-27.

<sup>97</sup> Oliver Walton, *Examples of good practice/programmes in preventing/addressing conflict between refugees and host communities* (Birmingham: Governance and Social Development Resource Centre, 2012), <http://gsdrc.org/docs/open/hdq845.pdf>

<sup>98</sup> Victoria Crawford, "10 ways countries can help refugees integrate," last modified May 2016, <https://www.weforum.org/agenda/2016/05/10-ways-countries-can-help-refugees-integrate>.

<sup>99</sup> Estella Carpi, Sara Al Helali and Amal Shaiah Istambouli, "Educating the host: It's not just refugees who need 'integration' programmes," *Open Democracy*, last modified October 2021, <https://www.opendemocracy.net/en/north-africa-west-asia/educating-the-host-its-not-just-refugees-who-need-integration-programmes/>

great benefit to the hosting nation. After all, “it is not only a bundle of belongings that a refugee brings to his new country,”<sup>100</sup> but a lifetime of experiences, passions, and drive.

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<sup>100</sup> Ekuru Aukot. “It Is Better to Be a Refugee Than a Turkana in Kakuma: Revisiting the Relationship Between Hosts and Refugees in Kenya.” *Refuge* 21, no.3 (2003): 73-83, <https://refuge.journals.yorku.ca/index.php/refuge/article/view/21224?articlesBySimilarityPage=7>.

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# **How does International Migration Affect Tax Compliance? Investigating German Tax Morale in the Aftermath of the 2015-2016 European Refugee Crisis**

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**Keywords:** Tax morale, tax evasion, tax compliance, taxation, migration.

## **Abstract**

The current taxation literature is dominated by research into ‘tax morale,’ or an individual’s intrinsic willingness to pay taxes. However, much of this literature is methodologically problematic and relies on public opinion data that does not fully separate variables at the demographic, ideational, and institutional levels. To account for this, the following paper employs a novel approach to the study of tax compliance, using large-scale, international migration to vary conditions. To do so, macroeconomic data is used to investigate German taxpaying efficiency in the aftermath of the 2015-2016 European refugee crisis, given the short-run influx of over one million North African and Middle Eastern asylum seekers. The results suggest that while certain demographic and ideational characteristics may affect tax compliance, this effect is significantly lower in the presence of strong institutions and enforcement in the target country. This indicates that the current approach to studying tax compliance does not fully account for institutional effects and enforcement-based policies likely regulate taxpaying to a greater extent than previously thought.

## Introduction

Understanding the willingness of individuals to pay tax is an underdeveloped area in the social science literature. Taxes underwrite government budgets and provide the resources necessary to fund public goods (e.g., infrastructure, national defence, etc.). Refusing to pay one's tax obligations, otherwise termed 'tax evasion,' therefore directly impacts the welfare of the collective. Tax evasion may increase the tax rate for compliant citizens, reduce public services, create misallocations in resources, and undermine trust in government and legal institutions.<sup>1</sup> In the developing world, widespread tax evasion and the existence of large, informal economies also serve to stifle economic growth and perpetuate cycles of underdevelopment.<sup>2</sup> Understanding the determinants of tax compliance is thus of great interest to political economy researchers.

Tax compliance is, however, difficult to measure. Attempts to evade tax are, by their very nature, illegal, and individuals have little incentive to reveal these activities on official documentation.<sup>3</sup> To account for this, many researchers ask instead why people choose not to evade taxes, allowing for an empirical proxy that is both quantifiable and measurable.<sup>4</sup> Researchers term this variable 'tax morale' and define it as an individual's intrinsic willingness or moral obligation to pay taxes, providing a number of important findings on how institutions, demography, and ideational factors affect tax compliance.<sup>5</sup>

There are, however, a number of empirical problems with this research. Notably, most studies do not separate variables at the individual (i.e., demographic and ideational) and

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<sup>1</sup> James Alm and Benno Torgler, "Culture Differences and Tax Morale in the United States and in Europe," *Journal of Economic Psychology* 27 (2006): 230-234.

<sup>2</sup> Benno Torgler, "Tax Morale in Latin America," *Public Choice* 122, no. 1-2 (2005): 133-134.

<sup>3</sup> Cummings et al., "Tax Morale Affects Tax Compliance: Evidence from Survey and an Artefactual Field Experiment," *Journal of Economic Behaviour & Organization* 70, no. 3 (2009): 449-452.

<sup>4</sup> Benno Torgler and Jan Werner, "Tax Morale and Fiscal Autonomy: Evidence from Germany," *Public Finance and Management* 5, no. 4 (2005): 466-467.

<sup>5</sup> Benno Torgler, "Tax Morale and Direct Democracy," *European Journal of Political Economy* 21, no. 2 (2005): 525-526.

institutional levels, which is important as these often have complementary effects on tax morale. For example, countries with a culture or demographic make-up that lends to greater tax evasion are generally also those with weak institutions and enforcement.<sup>6</sup> Thus, since most research on tax morale relies on the same by-country datasets, there may be persistent error in the results.

To account for such a challenge, this paper will focus on the role of international migration. This is because it allows one to understand how populations act under different institutions, and in doing so, provide an empirical counterfactual. Intuitively, it is reasonable to suggest that large-scale migration between countries with differing tax morale should affect government revenue, though this has not yet been investigated. Therefore, by assessing taxation efficiency as individuals move between countries, the opportunity exists to contribute to the literature by considering the role of individual-level variables under different institutional contexts. In doing so, this paper asks the following question: *How does international migration affect tax compliance?* To answer, it is argued that while migration flows may affect tax compliance by changing a state's ideational characteristics, this effect is significantly lower in the presence of strong institutions and enforcement in the target country.

This paper begins by reviewing the literature on tax morale and discussing the variables found to be significant in affecting tax compliance. Next, it goes on to describe the theory, focusing on how populations with certain ideational characteristics react under different institutional contexts, and the implications this has for government revenue collection. It, then, continues by investigating this relationship in the context of the German economy, as large migration flows from North Africa and the Middle East beginning in 2015-2016 offer a unique opportunity to test

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<sup>6</sup> Cummings et al., "Tax Morale Affects Tax Compliance," 449-450.



ideational effects. Finally, the paper concludes by assessing the significance of its findings and enumerating a number of limitations and policy implications to consider.

## Literature Review

The majority of research on the determinants of taxpaying comes from the field of public opinion. Here, large cross-country surveys such as the World Values Survey (WVS) and European Values Survey (EVS) are used to compare attitudes in different countries and across time. These surveys often measure tax morale through questions on the justification of tax evasion, e.g.,: “Please tell me for each of the following statements whether you think it can always be justified, never be justified, or something in between ... Cheating on taxes if you have a chance[.]”<sup>7</sup> Questions such as this have the advantage of measuring tax morale as an ordered categorical variable, thus, better mirroring the changing nature of real-world compliance. However, this has not rendered it free from criticism, as many papers suggest that such questions either neglect the context of respondents’ answers (e.g., autocratic repression) or produce significant error given inconsistencies in survey delivery across countries and regions.<sup>8</sup>

Despite these limitations, the literature offers several insights on the behaviour of individuals *vis-à-vis* their tax obligations, much of which is important to understand when considering the role of migration. In addition, and as will become evident, despite an emphasis on enforcement in many tax systems and the threat of punishment for non-compliance, numerous institutional and ideational variables appear to affect one’s willingness to pay tax. The puzzle here, however, is whether each of these variables are truly causal in affecting individuals’ tax morale, or if the effect is conditioned by one or more variables.

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<sup>7</sup> Alm and Torgler, “Culture Differences and Tax Morale in the United States and in Europe,” 229.

<sup>8</sup> James Alm, Jorge Martinez-Vazquez, and Benno Torgler, “Russian Attitudes Toward Paying Taxes – Before, During, and After the Transition,” *International Journal of Social Economics* 33, no. 12 (2006): 850.

## Institutional Variables

Perhaps the most established relationship in the tax morale literature is that of institutional trust, found to be significantly and positively associated with taxpaying.<sup>9</sup> Up until now, however, the reasons for this relationship have received little attention in the literature. Torgler uses data on Eastern European and former Soviet countries and finds that the public is more likely to comply when it is believed that rules allow for the efficient delivery of government services.<sup>10</sup> This suggests that trust depends on government performance and taxpayers will be more likely to comply when the exchange between taxes and public services is more equitable.<sup>11</sup>

Alm et al. provide perhaps the most evident example of this relationship, using WVS and EVS data to investigate attitudes in post-transition (i.e., post-Soviet) Russia.<sup>12</sup> Here, it is found that a breakdown in institutions and the economy led to few government services or those of much lesser quality, resulting in a higher justification of tax evasion as the exchange between the price of public goods (i.e., taxes) and the services received worsened.<sup>13</sup> In a similar paper, Alm and Gomez use Spanish data from the Centre for Sociological Research (CIS) and find that the transition away from dictatorship and resulting improvements in public goods delivery helped foster perceptions of institutional efficiency (increasing citizens' tax morale).<sup>14</sup> This effect has also

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<sup>9</sup> Alm et al., "Russian Attitudes Toward Paying Taxes" 847-848; Alm and Torgler, "Culture Differences in Tax Morale in the United States and in Europe," 233-234; Luca Andriani, Randolph Bruno, Elodie Douarin, and Paulina Stepien-Baig, "Is Tax Morale Culturally Driven?" *Journal of Institutional Economics* (2021): 76.

<sup>10</sup> Benno Torgler, "Tax Morale, Rule-Governed Behaviour and Trust," *Constitutional Political Economy* 14, no. 2 (2003): 120-123.

<sup>11</sup> Torgler, "Tax Morale in Latin America," 135-140; Alm et al., "Russian Attitudes Towards Paying Taxes," 847-848.

<sup>12</sup> Alm et al., "Russian Attitudes Towards Paying Taxes," 832-834.

<sup>13</sup> Alm et al., "Russian Attitudes Towards Paying Taxes," 849-852.

<sup>14</sup> James Alm and Juan Luis Gomez, "Social Capital and Tax Morale in Spain," *Economic Analysis & Policy* 38, no. 1 (2008): 75.

been found in non-transition states, with evidence from Italy suggesting a positive relationship between public spending efficiency and tax morale.<sup>15</sup>

In the opposite sense, the literature also reports a consistent and negative association between perceived corruption and tax morale.<sup>16</sup> According to Torgler, this owes not solely to the underprovision of public goods but the impact corruption has on perceptions of fairness in the tax system.<sup>17</sup> Indeed, Jahnke uses micro-level data from Afrobarometer and finds that petty corruption throughout sub-Saharan Africa yielded additional and negative effects on trust in countries' tax administration.<sup>18</sup> Concerns over corruption are also of particular worry in many developing states as the institutions meant to constrain overreach do not function properly and are often emboldened by large, neo-patrimonial systems.<sup>19</sup> Furthermore, corruption may undermine attempts to increase a state's fiscal capacity, thus, perpetuating the circumstances that allow for rampant corruption to take place (e.g., underinstitutionalization, infrastructural deficiencies, etc.).<sup>20</sup>

Several papers also find that those who perceive democracy as the best system of government or express satisfaction with democracy are less likely to justify tax evasion, presumably as greater participation in the process of public goods delivery leads to more equitable outcomes.<sup>21</sup> Indeed, acts of direct democracy are also found important to representing the interests

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<sup>15</sup> Guglielmo Barone and Sauro Mocetti, "Tax Morale and Public Spending Inefficiency," *International Tax and Public Finance* 18, no. 6 (2011): 746.

<sup>16</sup> Andriani et al., "Is Tax Morale Culturally Driven?" 76; Marko Crnogorac and Santiago Lago-Peñas, "Determinants of Tax Morale in Former Yugoslavian Countries," *Eastern European Economics* 58, no. 2 (2020): 187-190; Mariana Gerstenblüth, Natalia Melgar, Juan Pablo Pagano, and Máximo Rossi, "How does Inequality Affect Tax Morale in Latin America and the Caribbean?" *Revista de Economía del Rosario* 15, no. 2 (2012) 130-131; Björn Jahnke, "How Does Petty Corruption Affect Tax Morale in Sub-Saharan Africa? An Empirical Analysis," *European Journal of Political Economy* 60, (2017): 18; Colin C. Williams and Besnik Krasniqi, "Evaluating the Individual- and Country-Level Variation in Tax Morale: Evidence from 35 Eurasian Countries," *Journal of Economic Studies* 44, no. 5 (2017): 825-826; Torgler, "Tax Morale in Latin America," 153.

<sup>17</sup> Torgler, "Tax Morale in Latin America," 137-138.

<sup>18</sup> Jahnke, "How Does Petty Corruption Affect Tax Morale," 18.

<sup>19</sup> Torgler, "Tax Morale in Latin America," 138.

<sup>20</sup> Jahnke, "How Does Petty Corruption Affect Tax Morale," 18.

<sup>21</sup> Christian Daude, Hamlet Gutiérrez, and Ángel Melguizo, "What Drives Tax Morale? A Focus on Emerging Economies," *Review of Public Economics* 207, no. 4 (2013) 29-30; Ignacio Lago-Peñas and Santiago Lago-Peñas,

of the public in government policy. Using data from the International Social Survey Programme (ISSP), Torgler finds that referendums have a significant and positive effect on tax morale, independent of the influence from trust variables.<sup>22</sup> While Hug and Spörri use WVS and EVS data to propose instead that referendums affect how citizens link their trust in institutions with tax morale, suggesting that opportunities for direct democracy condition the trust variable.<sup>23</sup> In systems with sufficiently high levels of trust, referendums may increase tax morale.<sup>24</sup> However, in systems with low levels of trust, instituting referendums and other direct democracy initiatives may decrease tax morale as individuals are likely to question the fairness of the process.<sup>25</sup>

### Ideational Variables

Turning now to ideational-level variables, perceptions of tax compliance are also found to be significant in affecting tax morale. Apparent or normalized tax evasion may induce members of the public to free-ride on the contributions of others, thus, further constraining revenues. Torgler and Schneider confirm this using WVS and EVS data, suggesting that perceptions of tax evasion as a common phenomenon lowered Austrians' motivation to pay taxes, an effect termed "conditional cooperation."<sup>26</sup> Likewise, Alm et al. found using similar data that an increase in perceived tax evasion in post-transition Russia lowered the share of people considering tax evasion

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"The Determinants of Tax Morale in Comparative Perspective: Evidence from European Countries," *European Journal of Political Economy* 26, no. 4 (2010): 449; Benno Torgler and Friedrich Schneider, "What Shapes Attitudes Toward Paying Taxes? Evidence for Multicultural European Countries," *Social Science Quarterly* 88, no. 2 (2007): 448; Benno Torgler, "Tax Morale in Asian Countries," *Journal of Asian Economics* 15, no. 2 (2004): 258.

<sup>22</sup> Torgler, "Tax Morale and Direct Democracy," 528.

<sup>23</sup> Simon Hug and Franziska Spörri, "Referendums, Trust, and Tax Evasion," *European Journal of Political Economy* 27, no. 1 (2011): 128-129.

<sup>24</sup> Hug and Spörri, "Referendums, Trust, and Tax Evasion," 128-129.

<sup>25</sup> Hug and Spörri, "Referendums, Trust, and Tax Evasion," 128-129.

<sup>26</sup> Benno Torgler and Friedrich Schneider, "Attitudes Towards Paying Taxes in Austria: An Empirical Analysis," *Empirica* 32, no. 2 (2005): 244.

“never justifiable.”<sup>27</sup> This is also consistent with Frey and Torgler who confirm that individuals pay their taxes conditionally based on the behaviour of others.<sup>28</sup>

Likewise, culture is important in affecting social norms and how individuals relate to each other as members of a community.<sup>29</sup> Kountouris and Remoundou, for example, find using EVS data that immigrants originating from countries with higher tax morale report a greater willingness to pay taxes, suggesting that cultural subtleties are related to the effectiveness of tax systems.<sup>30</sup> Likewise, Andriani et al. use similar data to determine that cultural values such as femininity and individualism are positively associated with tax morale while aspects such as power distance and uncertainty avoidance are negatively associated.<sup>31</sup> In another sense, diversity may also play a role in affecting taxpaying, as Xin Li finds using WVS and EVS data that ethnic heterogeneity is negatively associated with tax morale given a lacking sense of community and common objectives among the population.<sup>32</sup>

## Theory

This paper’s theory is primarily one of empirical and methodological critique. It is known, for example, from the current literature that variables at the individual and institutional levels have statistically significant effects on tax morale. Indeed, a number of demographic and ideational characteristics are deemed causal, and this affects the policy response from government in dealing

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<sup>27</sup> Alm et al., “Russian Attitudes Toward Paying Taxes,” 849-850.

<sup>28</sup> Bruno S. Frey and Benno Torgler, “Tax Morale and Conditional Cooperation,” *Journal of Comparative Economics* 35, no. 1 (2007): 153-156.

<sup>29</sup> Luca Andriani, “Tax Morale and Prosocial Behaviour: Evidence from a Palestinian Survey,” *Cambridge Journal of Economics* 40, no. 3 (2015): 837; Benno Torgler, “Cross-Culture Comparison of Tax Morale and Tax Compliance: Evidence from Costa Rica and Switzerland,” *International Journal of Comparative Sociology* 45, no. 1-2 (2004): 36-37.

<sup>30</sup> Yiannis Kountouris and Kyriaki Remoundou, “Is There a Cultural Component to Tax Morale? Evidence from Immigrants in Europe,” *Journal of Economic Behaviour & Organization* 96 (2013): 117-118.

<sup>31</sup> Andriani et al., “Is Tax Morale Culturally Driven?” 78-80; “Power distance” describes a society with an unequal distribution of power and/or hierarchy that is accepted without clear justification.

<sup>32</sup> Sherry Xin Li, “Social Identities, Ethnic Diversity, and Tax Morale,” *Public Finance Review* 38, no. 2 (2010): 171-173.

with tax evasion. However, much of the previous literature is also reliant on the same (or similar) data and employ near identical methods for measuring variables' effect. In essence, this means that researchers cannot vary the characteristics of the population under study and must often collect and analyze data on a by-country basis. Given this constraint, if institutions are the truly causal force, the possibility exists for variables at the individual-level to report strong statistical significance despite having little (or no) effect.

Theoretically speaking, this line of argumentation aligns most with findings in the neo-institutionalist literature, emphasizing the role of structures in effecting political and economic outcomes. According to this approach, individual actions are not purely self-determined, but channeled through a set of rules (i.e., laws) that affect behaviour.<sup>33</sup> In an economic sense, this means that all individuals, regardless of origin, will make the same rational calculations when attending to their finances, including the practice of taxpaying. All of this meaning that institutions, as described before, may be more significant than previously thought in determining tax morale and the extent of true tax evasion.

This paper's contribution, then, uses international migration to further specify variables at the individual-level while holding the institutional context as constant. Theoretically, if these individual-level variables are causal, a corresponding change in the tax compliance of a state amid a large influx of migration should be evident. Stated alternatively, large-scale movements of people in the short-term should change the population characteristics of a country but not its institutions, thus isolating the relative impact of each. However, the standard method for measuring tax morale in the literature cannot properly capture changes, as individuals are surveyed on a by-country basis and population characteristics are, therefore, not variable. As a result, this paper also considers

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<sup>33</sup> Klaus Nielsen, "Institutionalist Approaches in the Social Sciences: Typology, Dialogue, and Future Challenges," *Journal of Economic Issues* 35, no. 2 (2001): 505-509.

macroeconomic data within and between countries, which aids in the analysis of specific tax collection outcomes.

To isolate the effect of migration between countries with differing tax morale, a case study is also employed, assessing the long-run impacts of migration from the Middle East and North Africa into Germany, beginning in 2015-2016. Germany is an ideal case when compared to most European countries given the government's 'open-borders' policy in response to the refugee crisis, leading to more than one million asylum seekers entering the country over two years.<sup>34</sup> This case is also preferred given the similarity of migrants from the Middle East and North Africa (e.g., culturally, economically) as well as the fact that they have been found to possess significantly lower tax morale than Germany (in terms of institutional and individual-level variables), offering a unique opportunity to determine the relative importance of non-institutional factors in affecting tax compliance.<sup>35</sup> The logic being that greater reductions in per capita government revenue suggest ideational factors to be relatively more important in affecting tax compliance than institutions, since the case study assumes the latter as constant. In addition, including long-run data helps prevent confusion between changes in government revenue as a result of short-run relocation costs (i.e., finding employment, housing) and incidental changes from the business cycle with the effects of differences in tax compliance.

In this case, it is expected that the assumptions of the neo-institutionalist literature will hold, yielding no discernable change in German tax compliance. This is suggested as while most social scientists accept some degree of social construction, many formal institutions experience

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<sup>34</sup> Rahim Alkousaa, "Refugee Crisis Influx No Boon for German Integration: Study," *Reuters*, last modified November 16, 2017.

<sup>35</sup> Alm and Torgler, "Culture Differences and Tax Morale," 238-240; Andriani, "Tax Morale and Prosocial Behaviour," 829; Wilfred A.K. Kouamé, "Trust to Pay? Tax Morale and Trust in Africa," *The Journal of Development Studies* 57, no. 7 (2021): 1092-1093; Kountouris and Remoundou, "Is There a Cultural Component to Tax Morale?" 108-113.

very gradual change and are limited by path dependence. Germany, for example, contains a very robust bureaucracy and the *Bundesministerium der Finanzen* (Federal Ministry of Finance) has existed in various forms since its founding in 1879. As a result, it is expected that the institutional structure will compel migrants towards a level of tax compliance that is consistent with native Germans, despite individual-level differences in tax morale.

## **Empirical Evidence**

### *How do Institutions Affect German Taxpaying?*

The first question to consider when assessing previous research methods is whether German taxpaying is affected by government performance or enforcement. According to the most common indicator for tax morale in the WVS and EVS, Germans have among the highest willingness to pay tax of any country.<sup>36</sup> Consistently, over three-quarters of respondents answer that cheating on taxes is “never justifiable,” and most others select relatively close alternatives.<sup>37</sup> Such data are also consistent with estimations on the extent of tax evasion and tax avoidance in Germany, which is relatively small when compared with similarly sized economies.<sup>38</sup> Given the history and power of Germany’s tax authorities, this is, perhaps, unsurprising, though such opinion-based data also presents a number of empirical puzzles to solve. In particular, as confidence measures for Parliament, or the *Bundestag* in this case, and government are also relatively low.<sup>39</sup>

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<sup>36</sup> World Values Survey Association, “World Values Survey Data,” accessed March 26, 2022.

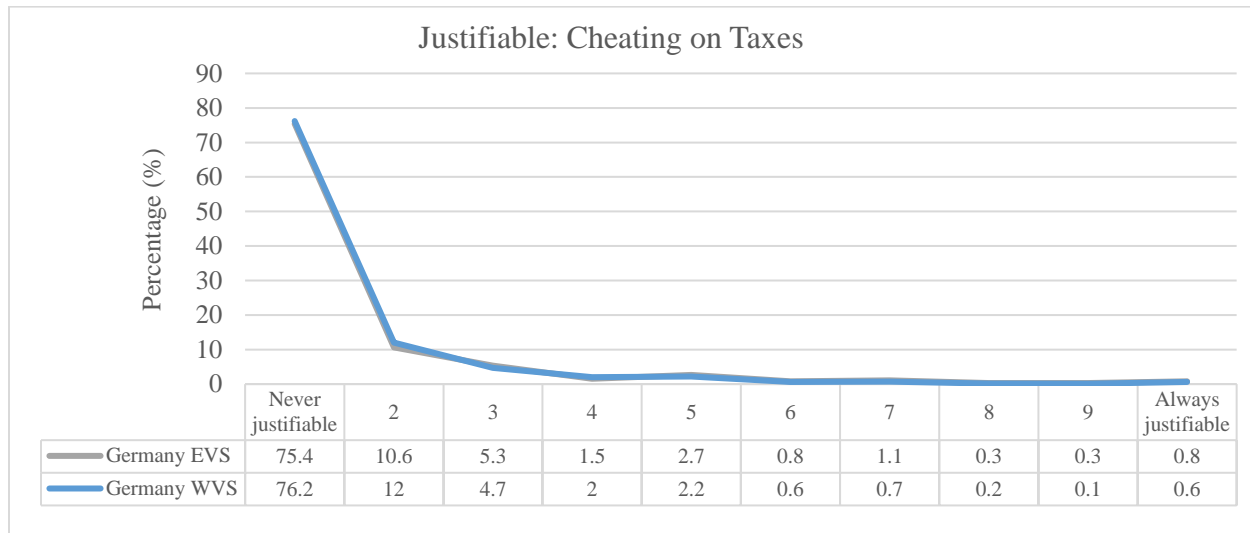
<sup>37</sup> World Values Survey Association, “World Values Survey Data.”

<sup>38</sup> Richard Murphy, “The European Tax Gap: A Report for the Socialists and Democrats Group in the European Parliament,” *Tax Research UK*, 2019: 10-11; Note the difference between tax evasion and tax avoidance.

<sup>39</sup> World Values Survey Association, “World Values Survey Data.”



## Justification of Tax Evasion: Germany<sup>40</sup>



Theoretically speaking, low confidence in the public service and its representatives should lead to lower tax morale. Indeed, this is the common finding in the literature, with the general explanation being that institutional confidence is fostered through perceived efficiency, and often in the form of greater public goods delivery.<sup>41</sup> Yet, the above chart observes the opposite in the case of Germany, suggesting, perhaps, that enforcement remains significant in tax compliance. Indeed, this may indicate a more robust role for institutions or, at the very least, motivate further research on the topic.

The reasons for this low confidence are also not particularly clear. Germany's macroeconomic indicators suggest overwhelming state efficiency, with an average growth rate from 2015-2020 of approximately 3% per year.<sup>42</sup> Among advanced, industrialized economies, this is relatively high and occurred amid rapid migration inflows and the aftermath of the Eurozone Crisis. In addition, Germany's economy is the largest in Europe and often perceived as responsibly

<sup>40</sup> World Values Survey Association, "World Values Survey Data."

<sup>41</sup> Alm and Gomez, "Social Capital and Tax Morale in Spain," 84.

<sup>42</sup> World Bank, "Indicators," accessed March 26, 2022.

run by international observers.<sup>43</sup> All of this suggesting that Germany's economic indicators are not the primary motivator for confidence in government.

### *Has Migration Affected German Revenue Collection?*

International migration is often studied in terms of wages, less so in how it affects government revenue. Traditionally, large migration flows in the short-run depress wages, often as the added labour supply does not generate the same level of corresponding demand and workers cannot quickly and easily move between industries.<sup>44</sup> However, in the long-run, most models predict a return to equilibrium as labour shifts to its most efficient point of production and immigrants become fully integrated into the economy.<sup>45</sup> In this sense, one should expect government revenue to respond in a similar fashion. Large migration inflows in the short-run should accompany a drop in per capita government revenue, given a variety of relocation costs (e.g., housing, employment) and wage rate effects. Whereas in the long-run, one should expect to see per capita government revenue return to its equilibrium, while accounting for inflation and general economic growth rates.

The data, however, tell a different story, with German per capital government revenue rising by 18.83% between 2015-2020.<sup>46</sup> In fact, this is greater than the aggregate increase in German GDP over the same period at 14.6%, suggesting an increase in taxpaying efficiency after migrants began arriving, short-run and long-run.<sup>47</sup> In other words, since government revenues increased faster than growth rates, and no large taxation measures were brought in, it can be asserted that authorities are collecting a higher proportion of tax relative to the size of the economy

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<sup>43</sup> Deutsche Welle, "The Secrets of Germany's Economic Success," October 19, 2013, <https://www.dw.com/en/the-secrets-of-germanys-economic-success/a-17169035>.

<sup>44</sup> Paul R. Krugman, Maurice Obstfeld, and Marc Melitz, *International Economics: Theory and Policy* (New York: Pearson, 2022), ch. 4.

<sup>45</sup> Krugman et al., *International Economics*, ch. 4.

<sup>46</sup> Organisation for Economic Co-operation and Development, "Economy – OECD Data," accessed March 26, 2022.

<sup>47</sup> World Bank, "Indicators."

than before the influx of migration. What does this suggest, then, about the relationship between taxpaying and institutions? One answer is that institutional robustness negates or lessens the impact of differences in tax morale. The German government, for example, has implemented a number of enforcement-based laws and regulations since 2010 meant to further curb tax evasion, with stiffer financial and legal penalties on tax dodgers. If this is, indeed, the case, then much of the findings in the previous tax morale literature are conditional on weak institutions, though confidence and trust in government are often poor in these countries as well.<sup>48</sup> Another possible answer is that a variety of individual-level characteristics in German society better facilitate taxpaying when compared to other countries, though the sources of these effects are not immediately obvious based on the previous literature.

## **Conclusion**

Tax morale was developed as an empirical proxy for the measurement of tax evasion, given the often-unobservable nature of the phenomenon. However, it also sought to address a crucial gap in the tax compliance literature; that is, why tax compliance often appeared higher than traditional economic models would suggest, most of which treating the taxpayer as a rational, utility-maximizing actor.<sup>49</sup> Indeed, since most taxpayers' declarations are not subject to a thorough review and the penalties that accompany fraud rarely, if ever, exceed the taxable deductions, a purely rational actor should seek to underreport income and overclaim deductions whenever possible.<sup>50</sup> If this is the case, then institutions are the primary, if not the sole, determinant of taxpaying behaviour, meaning that the extent of rules and severity of punishment are directly related to the efficiency of the tax system. Yet, the apparent willingness to pay tax, even when formal

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<sup>48</sup> Cummings et al., "Tax Morale Affects Tax Compliance," 447.

<sup>49</sup> Michael G. Allingham and Agnar Sandmo, "Income Tax Evasion: A Theoretical Analysis," *Journal of Public Economics* 1, no. 3-4 (1972): 324-327.

<sup>50</sup> Alm and Gomez, "Social Capital and Tax Morale in Spain," 74.

mechanisms are unable to observe non-compliance, motivated research into the attitudes of taxpayers.

Through this short paper, however, evidence suggests that the current approach to studying tax compliance does not fully account for institutional effects. In particular, it indicates that enforcement-based policies likely regulate taxpaying to a greater extent than previously thought, though the conditions of this effect are not fully certain. In terms of policymaking, this may affect how governments seek to ensure tax compliance moving forward, with enforcement-type policies likely to be more efficient in countries with robust bureaucracies. Whereas in countries with more underdeveloped institutional structures, governments may collect taxes more efficiently by addressing a lack of trust as well as gaps between the perception and reality of public goods delivery. However, further research on the impact of enforcement and inducement-based policies is necessary, and ideally looking beyond the public opinion data that has so far dominated the literature.

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