Journal of International Trade, Logistics and Law, Vol. 12, Num. 1, 2026, 101-106

FROM FISCAL TO LEGAL FRAGMENTATION: COHERENCE CHALLENGES IN GLOBAL TRADE GOVERNANCE

Alireza Mahdavi SHIRKHARKOLAEI
Cyprus International University, Cyprus

Received: Nov 10, 2025 Accepted: May 29, 2026 Published: June 01, 2026

Abstract:
Tax havens exemplify the structural vulnerabilities of the international commercial order. They reveal how the non-application of coherent regulatory mechanisms between tax, trade and regulatory regimes has led to the existing state of affairs of fiscal sovereignty and global interdependence as they currently exist. This article argues that the existence of tax havens is not a mere fiscal anomaly, but rather the symptom of a deeper crisis of law and institutions in the fragmentation of international trade governance. By linking fiscal fragmentation with the legal fragmentation of law, the paper shows how the same forces which have brought about offshore financial regimes regulatory competition, insecure enforcement, and asymmetrical institutional power now return in the governance of digital and sustainable trade. Through a doctrinal and comparative analysis of regimes of tax, trade and environmental law, the paper identifies a parallel between the collapse of coherence of global tax law and the growing divergence between the WTO and the EU. It is concluded that in viewing tax havens as an early warning of systemic incoherence, the potential to inform the design of a new Legal Alignment Model for the reconciliation of multilateral and regional norms of trade law. The paper thus offers a new view of coherence as a preventive principle in international economic law.

Keywords:
Tax Havens; Fiscal Fragmentation; Legal Fragmentation; International Trade Governance; WTO–EU Relations
JEL Classification:
F13, K33, H26

1. Introduction
For decades, the international economic order has been defined by a tension between the demands of global integration and the need for national sovereignty (Cottier and Elsig, 2011). The rise and continuation of tax havens demonstrate how this tension has been broken, revealing the limits of fiscal sovereignty in a globalized economy (Palan, 2002). Such jurisdictions, where minimal taxation and financial secrecy prevail, highlight the structural disconnection between national tax laws and international trade flows (Rixen, 2011). Their persistence indicates the failure of multilateral bodies such as the GATT/WTO and the OECD to ensure coherent regulation between fiscal and commercial regimes (OECD, 2022; WTO, 2023). purely fiscal or ethical standpoint, this article situates them within the broader transformations of international trade governance. The mechanisms that sustain offshore finance—regulatory competition, unilateral state policy, and weak institutional enforcement—are now reshaping governance in other domains, particularly in e-commerce and sustainable trade (Cutler, 2003; OECD, 2022). With such fragmentation of legal orders comes the erosion of predictability and equity within global market adjudication (Koskenniemi, 2006).
may be understood as an early manifestation of legal fragmentation, exposing incoherence between global and regional regimes and thereby undermining the legitimacy of international trade law (Shaffer and Trachtman, 2012; Palan, 2002). By drawing conceptual parallels between fiscal and legal fragmentation, this article underscores the urgent need for a new model of regulatory coherence capable of aligning multilateral trade policy with emerging regional frameworks such as the European Union's (EU) regulatory instruments.

2. Conceptual Framework: From Fiscal Fragmentation to Legal Fragmentation

Fragmentation in international law is a term for the overlapping and often conflicting existence of multiple legal regimes that seek different objectives and operate under different normative systems. It undermines the coherence and unity of international law by increasing the sources of authority and interpretation. As Koskenniemi (2006) noted in the International Law Commission's report, the interpretation of multilateral law must take into account the existence of fragmentation. In international economic governance, fragmentation manifests itself not only in trade, investment and competition, but also in new areas like e-commerce and the regulation of sustainability. Fiscal fragmentation describes the gap between the globally integrated capital markets and the national systems of taxation. On the one hand, liberalized cross-border finance and on the other hand, non-enforceable international tax coordination, have provided multinational enterprises the possibility to exploit jurisdictional differences when it comes to profit-shifting and base erosion. As Palan (2002) and Rixen (2011) have argued, the existing tax havens are an institutional design problem in which economic interdependence developed more rapidly than public law's capacity to govern it.

In that sense fiscal fragmentation is more than a question of differences in tax policy but a symptom of deeper systemic incoherence between law, economy and governance. Both enactments of fragmentation have the same genetic structure. They develop in those situations when multilateral structures rest upon the principle of voluntary compliance, while regional or national legal regimes want to pursue their own, independent agenda.

In the fiscal sector, the OECD's (2022) non-binding instruments such as the BEPS system have no binding effect for the harmonisation of tax laws, just as WTO (2023) instruments have no binding effect for the harmonisation of rules on novel questions such as data governance or carbon pricing. The result is a mixture of incomplete regimes, but each of them claiming legitimacy, but to the global economy predictability and fairness. The change from fiscal to legal fragmentation is a shift in governance failure. In neither regard do states act contrary to their interests, offering tax favours or regulatory favours, but leading to a race to the bottom in regard to the setting global norms. Tax havens are a perfect illustration of how the non-binding factor for achieving co-ordination leads from economic interdependence to legal fragmentation. By analogy, in the current state of world trade, the disparity of digital and environmental regulation leads to the institutionalisation of a multi-polar order, with WTO rules co-existing uneasily alongside self-standing regional laws of the EU variety such as the Digital Services Act (European Parliament and Council, 2022) and the Carbon Border Adjustment Mechanism (European Parliament and Council, 2023). Theoretically, this trajectory can be articulated in terms of legal pluralism (Berman, 2012) and institutional asymmetries (Shaffer and Trachtman, 2012), highlighting how differences in enforcement strength and jurisdictional autonomy condition the coherence of the international trade system. The intersection of these two features results in coherence being conditional, selective, and ultimately tenuous. Hence fiscal fragmentation is the conceptual antecedent of legal fragmentation: both disclose the velocity of globalization in advance of the mechanism of collective governance. In tracing this parallel, the article seeks to explain the crisis of tax havens not as part of a dissociated fiscal exceptionalism, but as a precursory herald of the wider institutional vulnerabilities that now beset international trade law. Recognising this factor is essential to a re-conceptualization of coherence, not as uniformity, but as a functional compatibility between the multilateral and regional regimes that is necessary for the continuance of its legitimacy in a complex world order.

3. Tax Havens as a Symptom of Governance Gaps in International Trade

Tax havens are not a fiscal anomaly but the institutional consequence of international economic integration unaccompanied by similar legal integration. In the mid-twentieth century, as capital mobility increased, states retained sovereign control over taxation while liberalising trade and investment regimes (Palan, 2002). This asymmetry fostered regulatory arbitrage, allowing multinational enterprises to apportion profits to jurisdictions with the most favourable tax regimes and financial disclosure standards. The legal permissibility of such practices demonstrates the limits of international economic law (Rixen, 2011). While the World Trade Organization (WTO) established a system for the liberalisation of goods and services, it imposed no corresponding obligations regarding fiscal transparency (WTO, 2023). The enduring sanctity of fiscal sovereignty enabled states to adopt beggar-thy-neighbour tax policies without violating binding international law. Consequently, tax havens have thrived within the grey area between legitimate competition and systemic exploitation.

This governance gap has serious effects upon the international law of trade. By allowing firms to separate profit location from real economic activity, tax havens distort patterns of trade and undermine the principle of comparative advantage central to WTO law, replacing it with what Palan (2002) termed jurisdictional advantage. WTO disciplines constrain tariffs and quotas but remain silent on fiscal measures indirectly affecting competitiveness (WTO, 2023). Thus, a two-tiered system operates: highly legalistic in trade, yet loosely governed in taxation, replicating the broader problem of legal fragmentation. While WTO disciplines allow the imposition of tariffs and quotas, they are silent as to fiscal measures which indirectly affect competitiveness. Hence there is in operation a two-tiered system of legalities, highly legalistic as to trade, under the cover of an inadequately regulated fiscal regime. This imbalance replicates the wider problem of legal fragmentation with which the world of global governance is currently afflicted.

The Organisation for Economic Co-operation and Development (OECD, 2022) has sought to address this imbalance through soft-law frameworks such as the Base Erosion and Profit Shifting (BEPS) initiative and the Global Minimum Tax (Pillar Two). However, as Rixen (2011) observes, without institutional enforcement, coordination devolves into moral persuasion a fragile basis for global economic order. The parallels with broad current challenges regarding digital and environmental governance are striking. Just as the absence of binding tax co-ordination has led to fiscal arbitrage, the absence of global standards for data governance or carbon pricing has led to new forms of regulatory fragmentation. Both cases evince a systemic inability to translate interdependence into coherent legal frameworks. In each case, states seek short-term regulatory autonomy at the price of long-term institutional coherence.

Tax havens provide dramatic examples of how private actors exploit disjointed governance regimes. The MNE uses the contradictions between jurisdictions not only to reduce its tax liabilities but also to shape the development of international standards. It attempts to shape the interpretations given to the principle of "legitimate fiscal competition" in turn producing an immutable cycle whereby economic power creates legal nonconformity. Conceptually, tax havens exemplify what Picciotto (1992) called the "privatisation of international law," whereby private actors fill regulatory voids created by ineffective intergovernmental coordination. This reality underscores the structural inability of the international system to ensure coherence across regimes of global economic governance. The same forces that once enabled tax havens regulatory competition, sovereignty conflicts, and institutional inertia are reappearing in digital trade and environmental governance, threatening the legitimacy of international trade law itself. If fairness, transparency, and predictability are the hallmarks of the multilateral trading system, any regime that countenances the systemic evasion of these standards undermines the architecture from within. The lesson is simple enough: without any structural mechanisms to procure coherence, dualism will be continuously reproduced in new fashion. In this regard the fiscal incoherences of the late twentieth century illustrate well the legal incoherence that is the hallmark of global trade governance today.

4. Parallels Between Fiscal and Legal Fragmentation: From Tax Governance to Digital and Sustainable Trade Governance

The forces that constituted fiscal fragmentation in the twentieth century are now reappearing in the legal fragmentation of digital and sustainable trade governance. Just as tax havens exploited the absence of binding coordination in tax matters (Palan, 2002; Rixen, 2011), the weakness of international trade governance in addressing overlapping digital and environmental regulations has produced a comparable disjunction.

4.1. Competition in Regulation and Multiplication of Regimes

In tax matters, competition between jurisdictions for mobile capital gave rise to the fiscal vacuum in which offshore centres flourished (OECD, 2022). A similar structure now characterises digital trade, shaped by normative competition between the European Union, the United States, and China. The EU promotes accountability and user protection through the Digital Services Act and Data Act, the United States favours self-regulation, and China emphasises data sovereignty and security (European Parliament and Council, 2022; European Parliament and Council, 2024). The coexistence of these regimes creates structural tensions comparable to tax competition: diverging rules, forum shopping, and legal uncertainty.

4.2. Weak Multilateral Enforcement

One remarkable similarity is the absence of any enforceable multilateral oversight. The World Trade Organization (WTO), with its rulebook designed for goods trade, lacks a comprehensive code on digital services, cross-border data, or environmental measures (WTO, 2023). Its dispute-settlement mechanism has been paralysed by political stalemate. Meanwhile, tax cooperation through the OECD's BEPS and Global Minimum Tax initiatives remains voluntary and inconsistent (OECD, 2022), reinforcing a fragmented pattern of governance across regimes.

4.3. Institutional Asymmetry and Regional Autonomy

Institutional asymmetry persists across domains. In taxation, strong states and blocs such as the EU and the U.S. impose extraterritorial measures like the Anti-Tax Avoidance Directive (European Council, 2016) and FATCA (U.S. Congress, 2010), forcing weaker jurisdictions into de facto compliance. Similarly, the EU's Carbon Border Adjustment Mechanism (European Parliament and Council, 2023) extends domestic environmental standards globally, fragmenting multilateralism into concentric circles of influence.

4.4. Private Power and Norm Shaping

Corporate actors that once orchestrated profit-shifting through tax havens now exploit asymmetries in data and environmental law to avoid compliance costs. Tech giants such as Amazon and Meta operate across jurisdictions with competing data regimes, while energy-intensive industries reorganise supply chains to bypass carbon-border measures. This reflects what Cutler (2003) calls the privatization of global rule-making, where private power fills the regulatory void left by weak intergovernmental coordination.

4.5. The Replication of Fragmentation

These parallels show that fragmentation is a recurring pattern of governance failure. Fiscal fragmentation has evolved, not disappeared, re-emerging in digital and sustainable trade. Without mechanisms to align regional authority with multilateral legitimacy, the international legal order risks reproducing the same incoherence across the fiscal, digital, and environmental domains. Hence we see the advent of a new generation of "regulatory havens," whereby states and firms take advantage of the interstices between normative systems in much the same way as they once took advantage of loopholes in tax systems.

The lesson to be learned is this: fiscal fragmentation is not eliminated; it is evolved. The same structural dynamics competitive sovereignty, lax enforcement, asymmetric power of institutions will govern the future of global trade governance. This continuity must be understood to develop mechanisms of alignment which reconcile the legitimacy of the regional regime with the universal norms of multilateralism. The international legal order will run the risk of reproducing the same substantively incoherent position in various forms if no such mechanisms are developed, perpetuating the instability of the fiscal, digital, and environmental agenda.

5. Implications for the WTO–EU Relationship: Towards a Legal Alignment Model

The co-existence of the World Trade Organization (WTO) and the European Union (EU) exemplifies the institutional tension between multilateralism and regionalism in global trade governance (Cottier and Elsig, 2011). Both institutions pursue stability and fairness, yet their philosophies of regulation diverge: the WTO seeks universality through negotiated consensus, while the EU pursues normative leadership via unilateral and regional initiatives (WTO, 2023; European Commission, 2023).

The increasing intersections of these two systems, particularly in fields such as digital trade, environmental policy and taxation, are symptomatic of a new phase of legal fragmentation reminiscent of fiscal fragmentation in earlier decades. The co-existence of the World Trade Organization (WTO) and the European Union (EU) exemplifies the institutional tension between multilateralism and regionalism in global trade governance (Cottier and Elsig, 2011). Both institutions pursue stability and fairness, yet their philosophies of regulation diverge: the WTO seeks universality through negotiated consensus, while the EU pursues normative leadership via unilateral and regional initiatives (WTO, 2023; European Commission, 2023). The EU on the other hand has extended its legislative reach to just those fields and gone beyond its frontiers in generating regulatory spillovers. It is this asymmetry of normative capacity that has resulted in the EU becoming the de facto generator of global rules while the WTO has been left with responsibility for an increasingly outmoded legal framework. The resultant overlap of commitments made

within the WTO and by regulations made in the EU gives rise to uncertainty both for states and for enterprises alike, in some measure similar to the jurisdictional confusion that prevailed in earlier days around the world of tax havens.
From a governance standpoint, the lesson is clear: The persistence of fragmentation parallels earlier fiscal incoherence. The OECD's (2022) soft-law frameworks BEPS and the Global Minimum Tax could not overcome jurisdictional divergence without enforcement, just as the WTO cannot preserve legal coherence without structured regional input. This article thus proposes a Legal Alignment Model (LAM) to harmonize multilateral and regional regulatory objectives through dialogue, notification, and equivalence assessment. A "compatibility review" process within the WTO could evaluate regional instruments such as the DSA and CBAM in light of its principles of non-discrimination and transparency (WTO, 1994).
The broader implication is that coherence in international economic law can only be understood as a preventative principle a principle anticipating fragmentation before it has crystallized. The experience of tax havens demonstrates that once institutional incoherence becomes entrenched, it is extremely difficult to reverse (Palan, 2002). The WTO–EU interface therefore embodies both a challenge and an opportunity: fragmentation threatens legitimacy, yet intentional convergence could transform it into a framework for adaptive resilience. Ultimately, the move from fiscal to legal coherence necessitates the need for the re-conceptualisation of the very nature of governance itself, from competition between sovereign regulators to co-operation of interdependent legal systems. It is in this transformation that we may glimpse the hope of a sustainable and legitimate future for the law of global trade.

6. Conclusion

This study has shown that the tax haven phenomenon is more than a fiscal anomaly: It is a structural symptom of the deeper fragmentation of international economic governance. The transition from fiscal to legal fragmentation reveals a constant trend: that global interdependence outgrows the regulatory structures designed to cope with it. Without binding coordination, states are in competition with each other to obtain regulatory advantage, whilst global institutions are ineffectually attempting to coordinate. The analysis demonstrated that the forces that produced fiscal fragmentation regulatory competition, weak multilateral enforcement and institutional asymmetry are already repeating themselves within the governance of digital and sustainable trade. The same dynamics that previously made possible profit-shifting by tax haven route now make possible"norm-shifting" across fractured legal orders. As the European Union, the United States, and other regional actors extend their normative outreach, the World Trade Organization has the problem of remaining both relevant and legitimate in a multipolar regulatory environment.
The comprehension of tax havens as an early sign of systemic incoherence suggests a key lesson for today's trade governance: that fragmentation, after institutionalization, results in the erosion of the predictability and fairness of international law. To avoid such evils, Legal Alignment would be demanded, which is the establishment of instruments to guarantee that multilateral and regional objectives can be achieved without loss of sovereignty or diversity. So viewed, coherence should not be equated with homogeneity. It is not a state, but a procedure to guarantee the continuing alignment of diverse legal regimes. It is a continual process of supplementary evolution. The most effective perspective is to see coherence as the prophylactic principle rather than as the remedial measure through the recent crisis of legitimacy of international trade law may be solved and sophisticated towards some more necessary, transparent and fairer global order.

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