



## Are High Corporate Taxes Shipping Jobs Overseas?

*Gary Clyde Hufbauer, assessing the Obama administration's latest corporate tax proposals, warns that they might actually cause more businesses to relocate jobs overseas.*

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Steve Weisman: This is Steve Weisman at the Peterson Institute for International Economics. Our guest, Gary Hufbauer, the Reginald Jones Senior Fellow at the Institute, has written so many books and papers recently on trade negotiations, climate change, and other issues that it's hard to keep count. This week, Gary, the headlines centered on a new proposal from the Obama administration aimed at changing the tax code to discourage companies from shipping jobs overseas. The problem, which surfaced in the campaign, is that American tax policy encourages American multinationals to relocate some of their operations overseas. Is that a problem that needs to be addressed?

Gary Clyde Hufbauer: In broad terms, the characterization is wrong. When American multinationals go overseas, on balance, they create more jobs here in the United States than they would have if they'd not gone overseas.

Steve Weisman: Why is that so?

Gary Clyde Hufbauer: I know it's counterintuitive and I know what you said about shipping jobs overseas is pretty widely believed. However, the evidence seems to indicate quite strongly that when US firms go abroad, they pull in exports from the United States to those countries by virtue of their operations. These are exports of intermediate inputs. Their exports are intangibles, such as technology, patent rights, copyrights, trademarks. They are exports of finished goods because you got an operation there and you're producing one type of item, let's say one type of turbine and you can tell another of turbine made here in the United States. So the export pull from foreign investment is quite strong. That's not to say you don't sometimes get jobs shipped overseas, but on balance, it's probably jobs shipped to the United States.

Steve Weisman: The profits made overseas by branches of American companies overseas aren't taxed unless they're repatriated back to the United States. That's apparently what this new measure seeks to address. Can you explain that?

Gary Clyde Hufbauer: Exactly, and that has been a feature of US law for a long time going back to the 1920s when we first had an income tax. And the basic proposition is that, when a US company operates overseas and keeps its money there, it will be taxed by that overseas country and it won't be taxed by the United States until the money is brought home, repatriated. Now, why is that? Well, that puts the US company when it's operating, let's say, in France or Brazil or China or wherever, on the same footing as a local company operating in that country or on the

same tax footing as another multinational company, let's say one based in Britain operating in that country. So it levels the tax playing field for the operating subsidiary. And then when the money comes home, well, it's no longer being used by that subsidiary, so there's no longer any need for that leveling, and it gets taxed by the United States but with a credit, the so-called foreign tax credit, for the foreign tax which is already been paid. That's been our system for, as I say, not quite a hundred years but going on 90 years anyway.

Steve Weisman: How would the Obama proposal changed that?

Gary Clyde Hufbauer: Basically what it would do is, say, if you have expenses here in the United States, you can't deduct them to the extent that the internal revenue code says they should be charged against some foreign operation in France or Brazil or wherever. So you can't deduct them until you bring home the income from that foreign operation. So it's kind of a backdoor way of repealing this concept of deferral or eroding this concept of deferral, and naturally the companies don't like it.

Steve Weisman: Deferral means that you defer the repatriation of the income to the United States.

Gary Clyde Hufbauer: Right. You defer both the repatriation and the US taxation of that income.

Steve Weisman: Right. So they would curb that ability under this new measure. But I think you also have found that the Obama administration wanted to tighten the restrictions on the kinds of tax deductions you can take, but they backed off because, as you put it, it was throwing out the baby with the bath water.

Gary Clyde Hufbauer: Well, yes. When they first considered it they thought, "Well, we'll disallow some of these research and development, R&D, deductions, because they should be attributed to an overseas operation." And they said, "Gee, if we do that, the obvious result is that US firms will relocate their R&D facilities and the skilled personnel elsewhere, Belgium, Singapore, wherever in the world where the country's quite happy to have these people and will give a full deduction." And so they backed off the R&D. But they're still keeping this ant deduction or no deduction for headquarters expenses, accountants, managers, people who organize logistics and so forth operating in the headquarters. A part of that will be attributed to this overseas income and the deduction won't be allowed. Now, of course, many countries would just love to have these people there. These are high skilled people, high wages, and very valuable to have corporate headquarters at least most countries look at it, and they'll say, "Whoopee!"

Steve Weisman: In other words, your analysis shows that this measure will itself "ship jobs overseas"?

Gary Clyde Hufbauer: Yes. It will tend to ship the jobs of the headquarters' operations overseas. That will be the result, and also we cut the ability of firms to compete with other multinationals in the world economy today on a level tax playing field, so they'll be somewhat disadvantaged and that will cut into our exports over time. I want to emphasize none of this is going to happen immediately even if the legislation's passed. But if you give it five or ten years, it's going on the downside.

Steve Weisman: The administration has estimated that this tax proposal would yield \$200 billion over 10 years, which given the trillions of dollars of deficits that are projected over that period, is very small. Is it worth it?

Gary Clyde Hufbauer: No. That's a very good question and it really perplexes me. Of course, nobody likes to pay taxes. You don't, I don't, nobody else does. But where taxes are really bad is when it puts you as a firm at a competitive disadvantage with your immediate competitors and that's what we're talking about here. We're talking about a tax that substantially disadvantages US firms compared to French-based multinationals, Brazilian-based, Chinese-based, you name it. So naturally they are very agitated about that and see that it's a big hit and they will fight like the devil against it.

Now, look at the revenue, as you just said: It's \$200 billion over 10 years, let's say about \$20 billion a year. I mean this is a drop in the bucket compared to the deficits we face going forward and it does perplex me. Why is the Obama administration going to use so much political energy to fight over this drop when really they need the whole bucket? So it's curious.

Steve Weisman: Well, it may be that they feel obliged to do something to follow through on what was a constant campaign theme, especially at a time when globalization is distrusted for a lot of reasons.

Gary Clyde Hufbauer: Yes, that probably is the explanation. However, I have to observe that the Obama administration has not carried through on some of its antitrade themes, against NAFTA, against the Columbian and Panamanian free trade agreements. So it has shifted its performance compared to the campaign rhetoric on these other kinds of antiglobalization themes. So I was surprised to see they carried through this one as strongly as they did, especially when there had been any number of studies—and I have done them and others have done them—that show that the way you go about raising revenue is not this path. There are other paths where you would tax business more evenly in this country and raise considerably more revenue over a period of time.

It seems like a misdirected effort, and the best you can say is what you said. It appears to carry through on a campaign theme. But if I can put in a final word there, we've had this battle, a very similar battle, three times in my career since the 1960s and every time the Congress has substantially modified the administration's initial proposals to, let's say, crack down on multinational corporations. I expect the same thing will happen this time.

Steve Weisman: But Gary, aren't there genuine tax havens like the Cayman Islands that shelter income from taxes that legitimately should be looked at? After all, the G-20 in London spoke out against tax havens without defining them. How would you define them, and are they a real thing to be concerned about?

Gary Clyde Hufbauer: There is real concern in my books and other people have written about this. There are plenty of shenanigans going on. But another curious feature of this bill, maybe politically not so curious but economically curious, is that it mixes in all the shenanigans, and those were referenced by the president: the 18,000

companies in a small office building in the Cayman Islands, that kind of thing. It mixes that in with these other practices that are, I would say, just normal business. It's a big pot going, and since we're going to attack it all, yes, there are tax haven countries and there are plenty of tax abuse practices by wealthy individuals and by some companies, not typically name-brand multinational companies, but a lot of medium-sized, smaller companies engage in this.

I would define a tax haven as a country that has a very low tax rate and is trying to attract essentially financial operations, intellectual-property holding companies, but there's no active presence there in the country. The president named Cayman Islands and Bermuda. Perhaps both of those qualify as tax havens. And then he threw in the Netherlands. And that was curious because no one before President Obama has really characterized the Netherlands as a tax haven. So, I think there's probably quite a bit of uproar in Amsterdam over that.

Steve Weisman: The Wall Street Journal also pointed out that the Netherlands is a major investor in the United States.

Gary Clyde Hufbauer: Oh, indeed. We bring a lot of investment in this country. There are many, many attractive features in the United States: skilled labor force, nice cities to live in, and so on and so forth. But one of our disadvantages, which is again the flipside of what's going on in this tax proposal, is that we are a pretty highly taxed country in terms of the marginal rate, the statutory rate, that is applied to large corporations; it's roughly 40 percent, federal and state. And the only other country of, I would say, large economic consequence in that bracket is Japan. And then all the others, including all the other European countries, which we think of typically as high-tax countries, when they tax big business, they're going down to rates like 25 percent.

Steve Weisman: Do you think that the United States then should be aiming to lower that tax rate and also to simplify the code so that it isn't such a hodgepodge of deductions and loopholes?

Gary Clyde Hufbauer: Oh, absolutely, absolutely. That's the way to go and that's why I guess nearly every economist who comes at it, every study commission, we wrestle with it and we come down to the same recommendation: broaden the base, ideally go for something like a value added tax but a very broad-based tax, very few exemptions, very few exclusions, but get that rate down. Get it down to, let's say, the mid 20 percent rate and then you've got a tax system that is, one, competitive globally, and two, doesn't invite all this gamesmanship that goes on in our tax system.

Steve Weisman: Well, of course, economists and study commissions don't write the laws. But without economists and study commissions and policy institutes, where would you and I be?

Gary Clyde Hufbauer: Exactly.

Steve Weisman: Gary Hufbauer, thank you very much for joining us today on Peterson Perspectives.

Gary Clyde Hufbauer: Thank you.

