US Tax Policy and Outsourcing: Part I

Gary Clyde Hufbauer says that despite what President Obama says, Governor Mitt Romney's proposal to lower the corporate tax rate would create jobs in the United States as well as overseas.

Transcript of interview recorded July 23, 2012.

Steve Weisman: The controversy over policies alleged to contribute to the outsourcing of American jobs overseas is sharper than ever, with a proposal from Governor Romney, the presumptive Republican nominee, to change the tax laws, and President Obama in July attacking that proposal as accelerating the trend.

Gary Hufbauer of the Peterson Institute for International Economics is here with me, Steve Weisman, to discuss the proposal. Gary, what would the Romney proposal do?

Gary Hufbauer: Let's start with the agreement between Governor Romney and President Obama.

Steve Weisman: OK.

Gary Hufbauer: They both agree that the U.S. corporate tax rate, which is basically paid by large firms, is too high. It is way out of the norm of what other industrial countries are charging and certainly way above China or some other emerging countries.

So they both proposed that the statutory rate be cut from 35 percent to a lower figure. For President Obama, the lower figure is 28 percent. For Governor Romney it's 25 percent. So there's not much difference on this pretty big agreement that we're taxing large corporations too heavily in order to be competitive in the world economy.

Where there is disagreement is how we should tax the overseas income of these multinational corporations, i.e. the earnings they have abroad.

Governor Romney has proposed that the U.S. adopt pretty much the same system that the other eight large industrial countries in the G-8 have, which is a so-called territorial system, which is that basically with safeguards, we only tax income earned by these corporations in the United States, and the income they earn through their subsidiaries operating in Brazil or France or South Africa or wherever is not going to be taxed by the United States. It will be taxed by those countries, but not the United States.

And that's the proposal that President Obama has gone after hammer and tongs. That is the source of his sound bite which really goes back four or five years. Let's not use tax breaks to ship jobs overseas.

Steve Weisman: Yes. Intuitively it makes sense. If there are lower tax rates that multinationals would pay on their operations abroad, they would then transfer those operations to abroad.

Gary Hufbauer: Yes. I understand the intuition, and it sounds terribly natural and logical. There are two kind of basic problems with the intuition. One is that our multinational firms are facing competition from firms based in other countries, again, China, Canada, Mexico, France, wherever, which are very able firms based in those countries. So if U.S. firms are not present in the markets of the world, they'll just give up those markets to firms based elsewhere.

That's one point. But the second point, which is deeper and a little harder to appreciate, is that when firms expand globally, they actually increase the amount of exports from the home country and they spread the very high cost.

Let's take the Apple case, developing the iPhone. The research on that was tremendous and of course was brilliant, but it was very heavy. And you couldn't make and sell the iPhone around the world. I don't know whether you could have done the research just on the base of the U.S. market. And you can multiply that example many, many times.

This has been reaffirmed again and again by people who have looked at the econometric evidence. U.S. firms that produce abroad actually export more, they grow faster, they do more investment, and —

Steve Weisman: Export more from the United States.

Gary Hufbauer: From the United States, yes. [They] invest more in the United States, pay higher wages in the United States, than what we'll call homebody firms, which are similar in all respects except they don't have that international footprint.

Steve Weisman: The figure that President Obama invoked in his attack on this proposal was that this [the Romney proposal] would create 800,000 jobs in other countries. He cited a study by Professor [of Economics at Reed College] Kimberly Clausing.

Gary Hufbauer: I find several flaws in the study. Some of them are pretty technical for a conversation, so I'll leave them out. But a really big flaw is this: that research done fairly recently by Harry Gruber at the Treasury Department -- and he has access to actual tax return data, so it's better data than anybody else has – found that although our tax rate is higher in the United States than it is abroad, and I think that makes us uncompetitive, surprisingly we haven't seen much production shifted abroad. That's a surprise, and why is that?

The big reason why is that multinational firms under our existing tax system have what I would call a semi-territorial approach. They don't pay much tax on their overseas income. They don't pay tax until it's repatriated to the United States, and these are run by smart people. They don't repatriate income to the United States unless they don't have to pay much tax on it, because they've got other provisions, other tax credits that shelter it from taxes.

So the result is we have about $1.4 trillion of accumulated earnings in overseas subsidiaries, some of which might be repatriated -- in other words unlocked and brought home to the United States if we didn't have a heavy tax burden. But the fact is we do have a heavy tax burden if it's brought home, so it's left abroad.

But also the fact is that because of the election by firms not to repatriate, their tax burdens are not so high as they would otherwise be. And they can earn their intellectual property and come abroad and do other things that Professor Clausing doesn't like and probably President Obama doesn't like.

But the practical result is that we have a huge difference in our statutory tax rates between ourselves and our main competitors. The effective tax rate on multinational corporations is not so great. That has been a saving grace probably for the United States, and not having happened what Professor Clausing is afraid will happen, if we go to a territorial system.

Steve Weisman: Gary, I'm going to stop there and then pick up in a part 2.