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Hobbling Exports and Destroying Jobs

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The US House of Representatives has just passed the American Jobs and Closing Tax Loopholes Act (HR 4213). This bill will hurt American workers, reduce American exports, and make American companies less competitive in the international marketplace. Since the US Senate has already passed companion legislation, the American Workers, State, and Business Relief Act (S 3336), these ill-considered bills could soon be reconciled in conference and become the law of the land. If so, American firms and workers will pay the price.

The two bills contain a veritable shopping list of benefits and taxes, with a price tag of $110 billion over 10 years. We concentrate on just one aspect: tax measures costing $14 billion over 10 years that affect foreign operations of US-based multinational corporations (MNCs). As the numbers suggest, this is not the biggest aspect of the legislation. However, the foreign tax measures at issue illustrate an unfortunate direction of US tax policy under the Obama administration and its congressional allies: the eagerness to tax the foreign income of US-based MNCs as if they competed only with firms that are subject to US tax rules. That conceptual foundation completely ignores the real world of intense competition between MNCs based in diverse countries.[1]

While the technical details of the foreign tax measures in HR 4213 are mind-numbing, over a period of 10 years, what are being called "loophole closers" would, as mentioned, supposedly raise about $14 billion from US firms doing business abroad. The $14 billion figure is the score assigned by the Joint Committee on Taxation and counts in budgetary "pay for" arithmetic. But the revenue gains will prove elusive because of collateral damage to US exports and jobs, as we discuss in a moment.

Whatever the revenue, the philosophy underlying these and other foreign tax proposals floated by President Obama is that, no matter where in the world they do business, US-based MNCs should pay the US corporate tax rate. This approach is intended to prompt MNCs to export goods and services from the United States rather than expand overseas and "ship jobs abroad." While the political rhetoric may resonate on the campaign trail and in the halls of Congress, the economics falls flat.

Under current law, US-based MNCs are allowed many avenues to conduct business abroad and pay the foreign tax rate on their foreign earnings, with only a small additional payment to Uncle Sam. Some of the avenues require extensive tax planning. But the end result gives US-based MNCs approximate tax parity with their MNC competitors based in Europe, Asia, and Latin America. Like the tax laws of nearly all countries, current US tax law amounts to a *de facto* territorial

1. See Gary Clyde Hufbauer and Theodore H. Moran, *Higher Taxes on US-Based Multinationals Would Hurt US Workers and Exports,* Policy Brief PB 10-10 (Washington: Peterson Institute for International Economics, May 2010).

system: Income earned outside the United States essentially pays the foreign tax rate in the host country and only pays a small "top-up" tax when repatriated to the United States, usually under 5 percent. In the view of President Obama and his congressional allies, this system amounts to a vast network of "loopholes." Unless and until US-based MNCs pay the US corporate tax rate on their *entire* worldwide income, they are, in this populist view, evading their "fair share" of the tax burden and, at the same time, "shipping jobs abroad."

But President Obama's tax philosophy and the legislation now coming out of Congress ignore two important facts: first, that the US corporate tax rate, when federal and state taxes are combined, is one of the highest in the world (around 39 percent); and second that competing MNCs based in Europe, China, India, or Brazil pay far less than the US tax rate when they compete head-to-head with US firms in world markets. If the purpose of US tax policy is to weaken US-based firms in the global economy, to move headquarters jobs to friendly locales like Toronto, Hong Kong, and London, to undermine President Obama's goal of doubling US exports, and to shift manufacturing jobs to China and service jobs to India, then HR 4213 and S 3336 make good sense. Otherwise they make no sense.

Careful studies compare US firms that engage in outward investment with similar firms that stay at home. The studies show that outward-bound firms consistently *export more* from the United States than the homebodies.[2] If US tax policy is changed so as to hinder outward investment by US firms, the result will be fewer US exports, and fewer exports will spell fewer US jobs. Since export-related jobs pay wages around 10 percent higher than the average for homebody jobs requiring similar skills, "good jobs" will be lost to the American economy.

Revamping US tax policy to retard outward investment by US multinationals will not lead to more investment at home either. Mihir Desai, Fritz Foley, and James Hines show that the years in which American MNCs make greater capital expenditures abroad coincide with years of greater capital spending at home by the same firms.[3] They find that 10 percent greater foreign investment by the multinational triggers 2.2 percent *additional* domestic investment.

The plants of US multinationals are the most productive in the United States, in terms of both total factor productivity and labor productivity; they are the most technology-intensive and pay the highest wages. MNCs show labor productivity 16.6 percent higher than large homebody firms and 44.6 percent higher than small US firms and pay wages that are 7 to 15 percent more than wages at comparable domestic plants. The US parents of MNC groups accounted for 29 percent of all US private-sector investment in 2007 and 74 percent of all US private-sector R&D. A handful of US multinationals account for more than half of US exports. It defies common sense to embark on a course of taxation that would undermine these crown jewels of the American economy.

Do US multinationals deserve tax punishment because they "ship jobs overseas"? The evidence indicates that US export performance would be weaker, not stronger, as a consequence. Somewhat surprisingly, the positive relationship between outward investment and exports holds for US low-tech (low R&D) industries just as for US high-tech industries and heavily unionized US industries just as for non-unionized US industries. Outward investment creates more export-related jobs in the US economy for low-tech workers and unionized workers, just as it does for US workers overall.

We recognize that, under "pay for" rules, the authors of HR 4213 and S 3336 had to find revenue—even if illusory—to finance the multiple benefits and tax breaks that are the main object of their legislation. But it makes no sense to take the first step down a long path of tax policy that would weaken US firms in the global economy, destroy American jobs, and hamper US exports along the way.

The best bottom line for American workers—and the American economy as a whole—is to make the United States a *more favorable* location for American multinationals to do business. Instead of raising taxes on the foreign income of US-based MNCs, Congress should be lowering the US corporate rate to 20 percent. Other countries understand the competitive realities well enough, but Congress seems determined to turn the United States into a loser.

2. The evidence is summarized in Theodore H. Moran, *American Multinationals and American Economic Interests: New Dimensions to an Old Debate,* Working Paper 09-3 (Washington: Peterson Institute for International Economics).

3. Mihir A. Desai, C. Fritz Foley, and James R. Hines, Jr., "Foreign Direct Investment and the Domestic Capital Stock," *American Economic Review* 95, no. 2 (May 2005): 33–38.