

Taxing Multinational Firms: Securing Jobs or the New Protectionism?

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Paper's Main Points

- Traditional US tax policy motivated by “arbitrage” view of multinationals
- Multinationals don't behave the way envisaged by this world view, so tax design should reflect this
- Transfers of activities abroad by US multinationals is not an important source of loss of “good” US jobs

My Views

- Hard to know what traditional US tax policy is motivated by
- The “arbitrage” view is based less on a particular view of multinational behavior than on ignoring the existence of multinationals
- Multinationals may not be bad for US workers, but globalization is bad for some of them and good for others

Exploring Key Points

The Origins of US Tax Policy

- CEN/NN: want equal tax rates on US capital income, wherever earned
 - CEN: include foreign taxes in calculation
 - NN: don't include taxes in calculation
- Notes:
 - Same logic also calls for **no** source-based taxes
 - This logic assumes a small country with no impact on terms of trade

The Origins of US Tax Policy

- For **large** country, NN implies optimal tariffs on capital, just as on goods and services, to improve terms of trade
 - Even higher tax on outbound investment – less than full deduction for foreign taxes
 - Positive tax on inbound investment – a source-based tax

The Origins of US Tax Policy

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- Full taxation at source
- Tax credits, but with limits
- Deferral
- Some logic, but not much

The Origins of US Tax Policy

- So, no way to justify US tax system in terms of traditional norms

Multinational Behavior

- Would achievement of CEN or NN call for true worldwide taxation of multinationals?
 - Yes, if multinationals are simply conduits for domestic saving; for then, taxing the income of multinationals is equivalent to taxing residents directly

Multinational Behavior

- Would achievement of CEN or NN call for true worldwide taxation of multinationals?
- But, in general, multinationals violate assumptions in two important respects
 - They can move, so their own residence is not fixed
 - Even if they don't move, they can raise funds from domestic or foreign investors
- Thus, taxing multinationals differs from taxing domestic residents and requires its own theory

Multinational Behavior

- What does theory say?
- It depends on how one models behavior of multinationals
 - Paper focuses on efficiency of capital ownership
 - If this is all that is at stake, we are led to CON or NON
 - But this is an extreme assumption, so empirical analysis is needed to determine the extent to which taxing multinationals affects capital allocation and how much it affects ownership allocation

Multinational Behavior

- Evidence suggests that foreign and domestic activities of multinationals are complementary, not substitutes
 - Some decisions (horizontal) may be substitutes, but overall complementarity dominates

Multinational Behavior

- Evidence suggests that foreign and domestic activities of multinationals are complementary, not substitutes
- Note: this result is not a necessary condition to like CON or NON
 - Lower taxes on foreign income might cause US firms to shift operations abroad and foreign firms to enter the US market in their place
 - But this evidence suggests that a more direct mechanism may be at work

Multinationals and Globalization

- Paper provides other evidence regarding employment and investment patterns among multinationals suggesting that US jobs aren't being transferred abroad through the activities of multinationals
- Should this placate US workers?
 - Evidence is suggestive but not definitive
 - But, more importantly, only part of the picture

Multinationals and Globalization

- Prices (e.g., wages) matter, not just quantities
 - International location decisions can exert downward pressure on wages if there are big international differences
- Not all international activity involves U.S. multinationals
 - Foreign multinationals
 - Trade
 - Even if US multinationals are good for workers, they are part of a larger global environment in which US individuals must now compete

The Bottom Line for Taxes

- No obvious case for the US system now
 - But no obvious case ever
- Is source-based taxation the answer?
 - Not as bad as some people think, to a large extent because we're close already except for a lot of distortions
 - Has its own problems not discussed in the paper
 - Should be considered in conjunction with taxes on individual investors, not on its own; and should be weighed against other **sensible** alternatives