

# **Taxing Multinational Firms: Securing Jobs or the New Protectionism?**

Comments by Alan Auerbach  
February 20, 2009

# 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

- Does the US tax system look like what would be called for by CEN, by NN for a small country, or NN for a large country?

# The Origins of US Tax Policy

- Does the US tax system look like what would be called for by CEN, by NN for a small country, or NN for a large country?

**NON!**

# The Origins of US Tax Policy

- Does the US tax system look like what would be called for by CEN, by NN for a small country, or NN for a large country?

**NON!**

- 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