U.S. MULTINATIONAL BUSINESS AND THE AMERICAN ECONOMY

Discussion by
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Competitive Problems of U.S. Multinational Corporations
Resulting from U.S. Tax Laws

The foreign tax provisions in the federal income tax present severe challenges to the tax technician in attempting to decipher some of the most opaque language in the Internal Revenue Code. Insofar as one can make sense of the rules, one is moved to ask what objectives the various Congresses and administrations that are responsible for these provisions had in mind. The obvious answer is the Willy Sutton reply to why he robbed banks: "That's where the money is."

Perhaps that's the full explanation, but the rationales that are offered go well beyond Sutton's straightforward answer. Policy makers seem to believe they are protecting American jobs by imposing much steeper tax burdens on U.S. multinational companies' foreign operations than those imposed by other nations on their nationals' foreign business, indeed, steeper tax burdens than those levied on domestic operations. In fact, quite the contrary is the case. By disproportionately increasing the cost of capital committed to foreign operations, the foreign tax provisions of the federal income tax impair the competitive position of American businesses in the world market, to the detriment, rather than the benefit, of the domestic U.S. economy. The foreign investment and business operations of U.S. multinationals benefit the domestic economy in the same way as does international trade. Both increase our productivity and economic efficiency. Indeed, there is no meaningful distinction to be drawn, in terms of economic effects, between the movement of goods and services across national borders and the movement of capital resources and business enterprises among national jurisdictions. No fundamentally new and less punitive U.S. tax treatment of American companies' foreign subsidiaries' operations will be forthcoming until policy makers begin to understand the constructive role of those operations in promoting American economic progress.

The notion that foreign investment and operations by U.S. multinationals are at the expense of domestic U.S. jobs is predicated on the unfounded belief that the investment and operations would otherwise be undertaken by the company here at home. According to this belief, the company is bound to undertake the investment and operations somewhere, without regard to the rate of return on the investment or the profitability of the operations. This clearly is not the case. Every business continually confronts a threshhold rate of return in its decisions about whether to commit resources to any venture; if the business ignores that constraint, it soon finds that it can no longer acquire resources for ventures that fail to meet the profitability test. Indeed, it is likely to find itself under new ownership and management.

Underlying this "if not there, here" notion is the erroneous assumption that during any given period of time there is a fixed amount of saving in the economy, so that any of this saving that is directed into investment abroad necessarily reduces investment at home, dollar for dollar. The corollary proposition, equally erroneous, is that domestic saving is completely unresponsive to the rewards for saving, so that if our saving is prevented from being invested abroad, it will be invested here at home, irrespective of how low the rate of return on that investment may be.

The policy makers' reaction to the so-called runaway plant case typifies this basic misapprehension about the economic consequences of U.S. multinationals' decisions to locate production and other operations abroad. The policy maker perceives the choice by an American company of a foreign location for producing products that will be exported to the United States for sale in the domestic market as depriving the U.S. economy of the jobs, the production, the incomes, and the tax revenues that would otherwise be realized here. It should be obvious that this perception is the crudest sort of mercantilism; it is equivalent to holding that international trade is economically harmful rather than beneficial to the trading partners.

Clearly the decision to locate the "runaway" plant abroad is made because one or more production costs, including taxes, in the foreign location is sufficiently less than in the United States to afford a higher profit margin and a greater return on investment than could be obtained here. The products produced in the foreign location, therefore, come into the United States at a lower unit price than that at which they could be profitably sold if made here or in greater quantity at the price that would have to be paid if produced domestically.

This is, of course, precisely the same result that would be obtained if a foreign business were to produce the products in the same foreign location for export to the U.S. market. As users or consumers of the product, we are equally well served by the American company or a foreign firm producing the product in the advantageous foreign location. As a producer of the product, the U.S. company and its owners clearly are better off in choosing the foreign location. Are the company's employees, actual or potential, who are not employed because the production is taken abroad injured by this location choice?

To answer yes, one would have to show that (1) these employees are completely specialized to the production of the products that are produced offshore instead of here at home so that if they aren't employed producing this product they can't be employed at all; and/or (2) the U.S. company that chooses to produce abroad has a complete monopoly on the product so that no foreign producer could take advantage of the economies available in the foreign location, produce the same product or one that is a close substitute, and sell it in the U.S. market at a lower price than that at which the domestically-produced output would have to be sold. Neither of these conditions prevails for any product in the real world, or even in the abstract imaginings of economic theorists. The employment consequences of foreign production, whether by a subsidiary of a U.S. multinational or a foreign firm, are not losses of jobs but changes in jobs.

Trade often involves dislocations; employees who lose jobs because of trade must incur the costs of relocation, occupational or geographical, and these private costs should not shrugged off. Neither, however, should efforts to avert these costs be allowed to impose the very much larger social costs that would attend curbing trade, thereby losing the benefits it affords. By the same token, public policy makers should recognize the social gains from cost-dictated location choices and should not permit them to be sacrificed for the sake of protecting the employment status quo.

This tension between the interests of the specific groups that sustain losses because of trade developments and the vast majority of the population who realize substantial gains from trade is commonplace. It is, of course, the substance of the seemingly endless conflict between protectionists and free traders in the policy making community. One might think, therefore, that those policy makers who espouse the cause of free trade -- the unimpeded movement of goods and services across national boundaries -- would also strongly favor minimizing the tax barriers to the movement of capital and business enterprise among national jurisdictions. Unhappily, most free traders fail to see that no relevant distinction is to be drawn in this respect between international trade and international investment. It is this failure, one must suppose, that accounts for the fact that pro-trade policy makers vigorously and for the most part successfully oppose protectionist trade legislation but do not resist tax legislation that restricts foreign investment by U.S. multinationals.

It would be useful, indeed, if policy makers were to focus on the consequences of their decision making for the costs of operations of U.S. subsidiaries vis a vis their foreign competitors, at least to weigh those consequences against other policy considerations they may deem to be relevant. Obviously, these cost effects were given no consideration in the legislative basket-weaving exercises in 1986. This disregard is all the more distressing because many of the same policy makers who participated in designing the 1986 tax penalties on foreign operations and income profess to be deeply disturbed about the apparently poor competitive position of U.S. businesses in the world market.

Policy makers should recognize that the "fortress America" approach they take to U.S. foreign tax policy punishes the entire American economy, not merely U.S. multinationals. The contemporary global economy in which most American business must operate is characterized by the across-border movement of products as they move from one production stage to the next. The notion of national products is as antique as the fortress America way of formulating public policy. By raising taxes on foreign-produced income of U.S. companies and their affilitates, we raise the costs of the capital that goes into their production activities everywhere. In doing so, therefore, we hobble U.S. companies in the competitive race with companies of other nations. Moreover, we raise the costs of inputs and final products for businesses and households throughout the domestic economy.

The body of statutory provisions that determine the U.S. tax liabilities generated by American multinationals' foreign operations have moved, over the last three decades, in a direction that is more and more inconsistent with what has been happening in the real world. Culminating in the Tax Reform Act of 1986, we now have a body of law that would have been far less onerous when the American economy was insulated from the economic activites in other nations to a far greater extent than now. It is to be hoped that our policy makers are sincere in their professed desire to allow American businesses to be more effectively competitive in the world market. If they are, they must recognize that free trade and the free flow of saving and investment and business operations across national borders are inseparable policy goals. With that recognition, one must hope, will come awareness that our tax laws need to be revised to reduce, if not totally eliminate, the penalties they now impose on investing and operating abroad.