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A Stimulus That Works: Tax Repatriation

by Peter Ferrara

In his inauguration speech, President Barack Obama said, "The question we ask today is not whether our government is too big or too small, but whether it works—whether it helps families find jobs at a decent wage, care they can afford, a retirement that is dignified." Or as Obama transition spokeswoman Stephanie Cutter said, the touchstone for the Obama administration is, "What will have the biggest and most immediate impact on creating private sector jobs and strengthening the middle class? We're guided by what works, not by any ideology or special interests." [1]

There is a proven idea that would work to ease the credit crunch for American businesses, provide fresh capital for investment and job creation, help to lead the recovery, and actually reduce rather than increase the overgrown deficit and federal debt.

Tax Repatriation 2004

The overseas operations of American companies are taxed under the laws of the countries in which they operate. But under American law, if the profits of those operations are returned to America, they are taxed again at the federal corporate tax rate of 35%, one of the highest in the world. Consequently, American companies generally keep those funds invested overseas. With the increasing globalization of business operations worldwide, the accumulation of such overseas earnings retained outside the U.S. by American companies is now estimated to be almost $1.5 trillion.[2]

In 2004, Congress enacted the American Jobs Creation Act, which allowed overseas profits returned to the U.S. in 2005 to be taxed at a 5.25% effective tax rate. As a result, an astounding $360 billion in profits cascaded back to the U.S. in 2005, out of $809 billion in overseas retained earnings at that time.[3] This alone produced $18.9 billion in additional federal income tax revenues (.0525 x $360 billion).

To qualify for the lower rate, repatriated profits had to satisfy qualifying conditions as to their use, such as for job creation, capital investment, research and development, and others. In fact, 24% of the repatriated funds were used for capital investment in the U.S., 23% for hiring and training of U.S. workers, and 15% for U.S. research and development.[4] These uses of the repatriated funds generated still further new federal revenue.

Tax Repatriation 2009

The highly successful experiment with tax repatriation in 2005 should be repeated today. Congress should provide a one year holiday for 2009, retroactive to January 1, providing that any overseas profits repatriated to the U.S. will be taxed at a 5.25% rate. With the current credit crunch, and U.S. companies scrambling for funds to stay in business, now is the time to tap into the $1.5 trillion in accumulated earnings retained overseas by U.S. firms.

Those funds would enable otherwise successful companies to bypass the frozen credit markets and obtain the cash to keep their U.S. operations going. U.S. business balance sheets would consequently improve, enhancing their creditworthiness in the normal credit markets, and accelerating the return to normal business conditions. The end result would be higher U.S. business investment, increased jobs for American workers, and new revenues for the federal Treasury.

A recent study by Allen Sinai, Chief Global Economist and President of Decision Economics,[5] estimates that such a tax repatriation holiday would produce the following results,

> A tidal wave of $565 billion would roll into the U.S. in 2009 from overseas retained earnings.[6]
>
> The influx of those funds would increase GDP by more than $300 billion over the next 5 years, with an almost 1% increase in economic growth in 2010 alone.[7]
>
> More than half a million new jobs would be created in 2010, and over 600,000 in 2011, reducing unemployment in each of those years by almost half a percentage point.[8]

> The stock market, as measured by the S&P 500 Index would increase by 5% in 2010, and over 10% in 2011 and 2012, from this one initiative alone.[9]

Sinai discusses a further effect of the reform, saying,

> Stronger business balance sheets reduce the credit risk of nonfinancial corporations and lenders are more willing to provide financing. The cash flow injection provides an inexpensive source of liquidity to firms and there are fewer issues of relatively expensive long term debt. Long term corporate interest rates move lower as a result and the cost of capital declines.[10]

Sinai adds further,

> The financial position of nonfinancial corporations is considerably enhanced as the increase of cash flow gets used not only for increased capital spending, jobs, and R&D, but also for improving corporate financial conditions. The parameters that define the financial risk of the nonfinancial corporate sector are also improved.[11]

In fact, Sinai estimates that the cash flow of nonfinancial corporations would improve by $670.9 billion over the next 5 years due to the reform.[12]

All of this would be accomplished without increasing federal deficits, debt, and ultimately higher future taxes on the American people. Indeed, Sinai estimates that the reform would increase federal revenues by almost $140 billion over the next 5 years, with deficits overall reduced by close to $240 billion.[13] Sinai explains,

> [F]ederal government tax receipts rise, in part because of the original allocation of funds to the federal government from an effective 5.25% tax rate applied to funds otherwise untaxed, but also because of increased corporate profits, personal income, capital gains, social security and excise tax receipts. The federal government budget deficit is reduced as a result.[14]

With federal deficits now soaring well over $1 trillion, such additional revenues are sorely needed.

The enormous stimulus package included funding for federal birth control programs, more federal babysitters, needles for drug addicts, and the National Endowment for the Arts. Yet, it did not allow American companies to bring home their profits, benefitting the economy while actually reducing rather than increasing the deficit.

If the Obama Administration really is going to be guided by what works, rather than by ideology, they will adopt this proposal, for the good of the country. But the primary objection to it is purely ideological, that American companies should somehow not participate in the worldwide trend towards globalization, and should not be investing overseas in the first place. On this view, sharply reducing punitive double taxation of overseas earnings would somehow be rewarding bad corporate actors for their overseas investment. So this proposal will be a good test of whether Obama really will side with what is good for American workers, or side with anti-corporate ideology after all.

1. Jonathon Weisman and Naftali Bendavid, "Obama Eyes $310 Billion Tax Cut," The Wall Street Journal, January 5, 2009, p. A4.
2. Allen Sinai, Macroeconomic Effects of Reducing the Effective Tax Rate on Repatriated Foreign Subsidiary Earnings in a Credit-and Liquidity-Constrained Environment, Decision Economics, Inc., Economic Studies Series No. 66, December 11, 2008, Table 2, p. 7.
3. Id., p. 6.
4. J. Graham, M. Hanlon, T. Shevlin, "Barriers to Mobility: The Lockout Effect of U.S. Taxation of Worldwide Corporate Profits," Fig. 2, p. 35, October 27, 2008
5. Sinai was the Chief Economist at Lehman Brothers until 1996, and before that Chief Financial Economist at the prestigious economic consulting firm of Data Resources, Inc. (DRI), founded by longtime Harvard Economics Professor Otto Eckstein.
6. Sinai, pp. 6-7.
7. Id., Table 3, p. 11.
8. Id.
9. Id.
10. Id., pp. 9-10.
11. Id., p. 10.
12. Id., Table 3, p. 11.
13. Id.
14. Id., pp. 10-11.

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