Obama Tells American Businesses to Drop Dead: Kevin Hassett

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Commentary by Kevin Hassett

June 8 (Bloomberg) -- I've finally figured out the Obama economic strategy. President **Barack Obama** and his team have been having so much fun wielding dictatorial power while rescuing "failed" firms, that they have developed a scheme to gain the same power over every business. The plan is to enact policies that are so anticompetitive that every firm needs a bailout.

Once that happens, their new pay czar **Kenneth Feinberg** can set the wage for everybody and **Rahm Emanuel** can stack the boards of all of our companies with his political cronies.

I know, it sounds like an exaggeration. But look at it this way. If there were a power ranking of U.S. companies, like the ones compiled by football writers for National Football League teams, **Microsoft** would surely be first or second to **Google**. But last week, Microsoft Chief Executive Officer **Steve Ballmer** came to Washington to announce what Microsoft would do if Obama's multinational tax policy is enacted.

"It makes U.S. jobs more expensive," Ballmer said, "We're better off taking lots of people and moving them out of the U.S." If Microsoft, perhaps our most competitive company, has to abandon the U.S. in order to continue to thrive, who exactly is going to stay?

At issue is Obama's policy to end the deferral of multinational taxation.

The U.S. now has about the highest combined corporate tax rate, second only to Japan among industrialized countries. That rate is so high that U.S. firms have an enormous disadvantage versus competitors. The average corporate tax rate for the major developed countries in the **Organization for Economic Cooperation and Development** in 2008 was about 27 percent, more than 10 percentage points lower than the U.S. rate.

Tax Burden

U.S. firms have nonetheless prospered because our **tax code** allows a business to set up a subsidiary in a low-tax country. When that subsidiary earns profits, they are taxed at the rate of that country, and don't face U.S. tax until the money is mailed home.

The economically illiterate partisan Democratic view is that this practice is unpatriotic and bleeds jobs from the U.S. The economic reality is that American companies use this approach to acquire market share overseas. The alternative is losing the business to foreign competitors.

Don't just take my word for it. A recent **paper** by Harvard economists Mihir Desai and C. Fritz Foley and Berkeley economist James Hines and published in the distinguished **American Economic Review**, gathered data on American multinationals to explore the impact of foreign investments on domestic U.S. activity.

Encourage Overseas Sales

Their conclusion was striking. The authors found that "10 percent greater foreign capital investment is associated with 2.2 percent greater domestic investment, and that 10 percent greater foreign employee compensation is associated with 4 percent greater domestic employee compensation. Changes in foreign and domestic sales, assets, and numbers of employees are likewise positively associated; the evidence also indicates that greater foreign investment is associated with additional domestic exports and R&D spending."

So when firms expand their operations abroad, taking advantage of the lower foreign tax rates, it helps their workers in the U.S. Higher sales abroad (surprise, surprise) are good for domestic workers.

It is worth noting that this study, which is confirmed by a boatload of evidence elsewhere, was coauthored by the same James Hines who recently wrote a sweeping review of international tax policy with Obama's top economist, **Larry Summers**. Summers has to know what the literature says.

Inexplicable Stance

So the question is, why does Obama advocate a policy that so flies in the face of everything that economists have learned? How could Obama possibly say, as he did last month, that he wants "to see our companies remain the most competitive in the world. But the way to make sure that happens is not to reward our companies for moving jobs off our shores or transferring profits to overseas tax havens?" Further, how could Treasury Secretary **Tim Geithner** call a practice that top scholarship has shown increases wages and employment in the U.S. "indefensible?"

I have to admit I am at a loss. Maybe it is good politics to bash American corporations, and Obama isn't really serious about making this change happen. But if the change is enacted, and domestic corporate taxes aren't reduced to offset the big tax hike, the result will be a flight from the U.S. that rivals in scale the greatest avian arctic migrations.

If that occurs, the firms that stay in the U.S. will be at such a huge tax disadvantage that they will absolutely need a "rescue."

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