Will tax holiday generate jobs? It didn't a decade ago

By Eduardo Porter
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It was the summer of 2004, and to the glee of multinational corporations across the United States, a bipartisan majority in Congress offered them a gift they had long sought: an opportunity to repatriate billions of dollars stashed overseas and pay just 5.25 percent in taxes, instead of the statutory corporate rate of 35 percent.

They had lobbied hard for this — dangling before members of Congress the promise that the repatriated money would add more than 500,000 jobs in the United States over the next two years, as companies paid down debt and engaged in more capital spending, acquisitions, and research and development.

The jobs, however, didn't come. In an analysis a few years later, Kristin J. Forbes, an economist at the Massachusetts Institute of Technology who had been on President George W. Bush's Council of Economic Advisers when the tax holiday came into effect, and two colleagues from Harvard and the University of Illinois at Urbana-Champaign found that though $299 billion in corporate earnings flowed back into the country during the holiday year of 2005 — almost five times the average of the preceding five years — companies found a better way to use the money. "Repatriations did not lead to an increase in domestic investment, domestic employment or R.&D.," the authors wrote.

The smell of a tax holiday is back in the air. From Apple to Facebook to Starbucks, big business is waiting with bated breath for details on President Trump's promise to slash the tax rate on profits held abroad to encourage companies to bring the money home.

Apple alone is sitting on an overseas stash of almost $260 billion, according to Bloomberg, while Microsoft has more than $120 billion parked abroad. The pharmaceutical giant Pfizer does not regularly disclose how much of its offshore profits are stored in foreign tax havens, but the Institute on Taxation and Economic Policy estimates that at the end of 2016, it held almost $200 billion abroad.

Of course, the standard claims are being made about the vast stimulative effects of the repatriated cash. They are being met this time with vigorous counterclaims based on the results of the Bush administration's shot over a decade ago.

Back then, companies found their way around regulations forbidding this use of the money to simply benefit shareholders and corporate chiefs. A Senate commission reported that the top 15 repatriating corporations reduced their overall United States work force by 20,931 jobs, even as share buybacks increased and the annual compensation for their top five executives jumped 27 percent from 2004 to 2005 and another 30 percent the next year.

Pfizer, for instance, brought back $35.5 billion, the largest amount repatriated by a single company during the tax holiday, according to the Senate report. Then it turned around and spent over $20 billion in stock repurchases from 2005 to 2007. By 2007, the aggregate compensation of its top five executives was nearly $13 million higher than in 2004. Its United States payroll was 12,000 smaller.

The pattern was similar across most repatriating companies. Hewlett-Packard, which brought home $14.5 billion, bought back $22 billion worth of stock over the three years and cut its payroll by more than 8,500. The tobacco company Altria, which brought over $6 billion home during the holiday, spent $2.5 billion on share buybacks and bumped pay in

the executive ranks by more than $50 million, but cut 6,000 jobs.

A few years back, Ms. Forbes explained to my colleague Floyd Norris how the computer manufacturer Dell had lobbied hard for the holiday — claiming that part of the money would be used to build a plant in Winston-Salem, N.C. "They did bring back $4 billion, and spent $100 million on the plant, which they admitted would have been built anyway," she said. "About two months after that, they used $2 billion for a share buyback."

With a new move afoot to put such holdings back on American books, there is a critical question that is too quickly glossed over: Why do businesses act this way? Why didn't corporate executives invest more in their businesses and their work forces? Why did they go to the trouble of dribbling around a rule forbidding the use of repatriated profits to pay themselves a bonus? (Note to Congress: Money is fungible.)

Call me naïve. Professor Forbes and her colleagues — indeed, many economists — might swat the question away by arguing that businesses didn't use the extra cash to invest and employ because they were well-run businesses, well invested and sufficiently staffed to maximize their profitability.

There is truth to this argument. In fact, most corporate investment today comes not from retained earnings but from borrowing. Bringing a foreign profit stash home has little effect on investment incentives.

Still, the question should resonate in an administration that came to power on a promise to address the plight of the working class. Because the working class stands on the other end of a deal with the corporate class. I don't think it is possible to fully address workers' demands without understanding, and changing, corporate motivations.

Many forces have shaped this deal, including technology, which replaced workers performing routine tasks, and globalization, which squeezed the margins of many businesses and exposed their workers to competition from cheap labor markets. And yet it would be a mistake to ignore the impact of a corporate ethos that has come to focus on rewarding shareholders and executives at the expense of any other consideration — be it workers' welfare or even the company's long-term sustainability. Indeed, workers today amount to little more than a line on the cost side of businesses' balance sheets, with little claim to its prosperity.

Corporate profits have risen over the last quarter-century, as a share of the nation's income, even as the workers' share has shrunk. While executive pay has soared — padded with stock options and shares — the earnings of ordinary workers are below where they were in the 1970s. What's more, the pensions that ensured workers a retirement perch in the middle class have been replaced by 401(k) savings accounts — which are cheaper for companies but put workers' retirement prospects at the mercy of the stock market.

"How you divide the pie is a choice," said Rick Wartzman, who heads the KH Moon Center for a Functioning Society at the Drucker Institute of Claremont Graduate University. "It is being carved differently."

The change has happened across the board. In his book "The End of Loyalty," published in May by Public Affairs, Mr. Wartzman lays out a shift in corporate culture both in success stories like Coca-Cola and General Electric and in less successful ones, like Eastman Kodak and General Motors. "For workers, the story was the same, whether they were working at a winner or a losing firm," he said.

The good news is that it is not impossible to modify the behavior of the corporate leaders who have so drastically altered the contract with their work force over the last few decades. While it may be tempting to cast the new breed of executives as selfish villains who somehow

lost their sense of right and wrong, the shift in their behavior responded to a shift in the incentives they faced. It was fed by a belief that snaked its way three or four decades ago from the halls of the University of Chicago through investment-bank trading floors and into the corner offices of corporate America: that the interests of corporate managers must be brought into tight alignment with those of shareholders. It was accompanied by one of the most destabilizing propositions in the modern history of corporate governance: This alignment was best achieved by paying corporate managers almost exclusively with stock.

Mihir A. Desai of Harvard Business School argues that this strategy amounted to outsourcing corporate compensation decisions to the capital markets — which have no way of telling whether the rise or fall in shares is caused by executives' strategies or simply luck. This produced an enormous bubble in chief executive pay — which rose in tandem with the stock. It also made chief executives' jobs more uncertain, vulnerable to market downturns. And it vastly distorted their behavior, putting every decision at the service of the share price at the close of the quarter.

Professor Desai points out that in the end, this structure does not really serve shareholders, at least not those with an interest in a company's prosperity more than a few quarters down the road. "Capitalism seems to be serving managers and investment managers at the expense of shareholders," he wrote.

Changing this behavior is not beyond the reach of policy. Just as changes in the tax treatment of executive pay in the 1990s encouraged stock-based remuneration, tax reforms might motivate corporate executives to invest for the long term rather than for an immediate stock bump — maybe even encourage stable employment and worker training. Until then, offering tax breaks to American corporations seems more likely to line the pockets of executives and shareholders than to improve their long-term prospects or the prosperity of their workers.