

How Inevitable Is Corporate Tax Competition?

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Thomas Tørsløv, Ludvig Wier, and Gabriel Zucman, *The Missing Profits of Nations*, [NBER Working Paper 24701](#) (2018).

How much profit-shifting, from high-tax to low-tax countries, do multinational companies (MNCs) engage in? The question is hard to answer, for both theoretical and empirical reasons. The “true” geographical source of profits earned by MNCs on their global production and sales activities would often be theoretically ambiguous even if their actions and decisions were completely transparent. In addition, however, not only is there a large gulf between what they know and what we (or the tax authorities) know, but relevant economic data may either be unavailable or reflect formalistic reporting conventions.

A recent [literature review](#) by [Dhammika Dharmapala](#) reports that, in the “more recent empirical literature, which uses new and richer sources of data, the estimated magnitude of [profit-shifting] is typically much smaller than that found in earlier studies.”¹ [James R. Hines](#) goes further, [asserting](#) that profit-shifting is “notably small in magnitude,” and that any public (or even scholarly) impressions to the contrary merely reflect journalistically-driven over-excitement in response to a few “distasteful anecdotes of crass tax avoidance.”²

But what if such conclusions—which are not, however, universal³—reflect data limitations? An important new National Bureau of Research Working Paper by [Thomas Tørsløv](#), [Ludvig Wier](#), and [Gabriel Zucman](#) (“Zucman et al”) makes novel use of macroeconomic data, comparing the wages and profits of MNCs’ foreign affiliates to those of local companies, both in tax havens and high-tax countries, to reach very different conclusions. Zucman et al find that forty percent of MNC profits are shifted to low-tax countries in a typical year, and that this estimate is conservative given the likely impact of statistical gaps. (P. 26.)

I look forward to following, without fixed preconceptions, the debate between and among trained empirical economists regarding what one might loosely call the “Hines versus Zucman” question. In the interim, however, I must confess that Zucman et al’s findings strike me as more plausible given my own, admittedly anecdotal, sense of what is actually happening out there in the field. But let us just suppose (without definitely asserting) here that Zucman et al have mainly gotten it right. What are the main consequences for corporate and international tax policymaking?

[Paul Krugman](#) argued, in a recent [New York Times op-ed column](#), that the Zucman et al paper helps to show why the 2017 U.S. corporate tax rate cut, from 35 to 21 percent, is unlikely to yield the promised surge in U.S. capital investment and wages. “[T]he vision of a global market in which real capital moves a lot in response to tax rates is all wrong; most of what we see in response to tax rate differences is profit-shifting, not real investment. [So] there is no reason to believe that the kind of tax cut America just enacted will achieve much besides starving the government of revenue.”⁴

While this seems clearly right (again, conditioned on the contested empirics), a further question is what countries that object to profit-shifting can unilaterally do about it. Zucman et al argue that the relative immobility (to date) of actual capital employed in productive processes suggests that plunging corporate tax revenues (and statutory rates, in response to observed revenue trends) reflect a wholly avoidable policy failure in high-tax countries. These countries could have maintained high corporate tax revenues and statutory rates, the authors assert, simply by auditing MNCs more aggressively. This has not happened, however, due to incentive problems pertaining to the tax authorities that enforce national tax laws.

More specifically, Zucman et al argue that “tax authorities have incentives to relocate profits booked in other high-tax countries—not profits shifted to havens. Take the case of France. €1 relocated to France is worth the same to France whether it comes from Germany or from Bermuda. But it is easier for the French tax authority to relocate €1 booked in Germany, for three reasons.” (P. 22.) These are (1) feasibility, since far better public information is available to them regarding profits booked in other high-tax countries than in tax havens, (2) likelihood of success, since MNCs don’t particularly care which high-tax country succeeds in claiming a given €1 of profit, and hence will not vigorously resist an auditor’s adverse findings, and (3) speed of settlement, since high-tax countries tend to act quickly in resolving tax base disputes between themselves. (Pp. 22-23.)

This argument evidently has more application to tax auditors than to legislators. Are Zucman et al therefore arguing that tax legislators have merely been inattentive and over-trusting of the tax agency personnel whom they have charged with executing the laws that they enact? One should keep in mind that legislators as well may not especially care whether or not incremental revenue comes at the expense of peer countries. In addition, the legislators may dislike angering MNCs that have political or financial clout, even apart from the question of how taxpayer resistance affects the prospects of audit success. But then we are reaching issues of tax competition and domestic political choice that might be harder to overcome than mere “policy failure[s]” (P. 4) in the realm of administrative oversight.

A further question goes to how MNCs would respond to tougher anti-tax haven, anti-profit-shifting efforts by high-tax countries. Zucman et al’s finding that “[m]achines don’t move to low-tax places; paper profits do” (P. 1) presumably reflects the current ease of shifting just the latter. Cracking down on profit-shifting would increase MNCs’ incentives to consider increasing their real responses to high statutory tax rates.

Despite any such quibbles, Zucman et al have done extremely important work that merits all of the attention it will surely receive. We should all closely follow the ensuing empirical debate, given how dramatically it can affect both our theoretical understanding of MNC behavior and real world policy choices that might dramatically affect rising high-end inequality.

1. Dhammika Dharmapala, [What Do We Know About Base Erosion and Profit Shifting? A Review of the Empirical Literature](#), [Coase-Sandor Inst. for L. & Econ.](#) Working Paper No. 702, abstract (2014).
2. James R. Hines, [How Serious is the Problem of Base Erosion and Profit-Shifting?](#), 62 **Can. Tax J.** 443, 453 (2014).
3. See [Kimberly A. Clausing](#), [The Effect of Profit Shifting on the Corporate Tax Base in the United States and Beyond](#), 69 **Nat’l Tax J.** 905-934 (2016) (finding higher levels of profit-shifting, and citing earlier literature that is in accord).
4. Paul Krugman, [Tax Cuts and Leprechauns](#), **N.Y. Times**, (June 15, 2018).

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