Greek Crisis Won't Lead to Repatriation of Earnings by U.S. Corporations

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Recent details about the Greek debt crisis suggest that Greece may soon decide to (or be forced to) leave the Euro zone and revert to a national currency regime, which some believe may precipitate a default on its international debts and various other deleterious consequences for its economy, with possible reverberations across Europe and perhaps even for the U.S. As reported by the Wall St. Journal on June 1, "multinational companies are rehearsing for any number of contingencies. . . . [ranging] from a paralysis in cross-border payments to a civil breakdown in Greece to a broader breakup of Europe's common currency. . . . [r]etrieving their cash is among the companies' gravest concerns. . . . Greece is widely expected to impose capital controls to keep the remaining cash in the country."

Some may believe that this set of circumstances might provide U.S.-based multinational corporations with a powerful incentive for the repatriation of earnings from their Greek (and possibly also other European) subsidiaries. This expectation might amplify already in-progress arguments favoring actions that could be taken by the Government to encourage such steps by major domestic manufacturers.

Over the past few years, the supposed recession-fighting effects of earnings repatriations have been widely touted – most specifically, the expectation that if only foreign subsidiaries' earnings and cash were repatriated, the parent companies would use these funds to expand domestic employment and production, with predictable salutary effects for the overall U.S. economy. To encourage such repatriations, some legislators and lobbyists have been advocating the enactment of a brief change to tax laws that would seek to replicate the provision of a 2004 law, the American Jobs Creation Act (AJCA), which granted a temporary 85% dividends-received deduction that effectively lowered the U.S. tax rate on foreign earnings to about 5.25% from 35%.

That earlier effort was said to have spurred the repatriation of as much as $360 billion of the $1 trillion of earnings that was reported to have been held abroad at that time. In today's environment, with some $1.5 trillion of earnings being reportedly held by foreign subsidiaries, some suggest that as much as $500 billion of fresh capital inflows could be stimulated. If companies with earnings not yet repatriated from Greece are sufficiently frightened by the most recent news, arguably a flood of cash could be brought home, even absent the artifice of a tax-cut, gleaning the hoped-for economic benefits without the substantial cost to the Treasury of a tax forgiveness – the best possible outcome, or so the thinking goes.

Unfortunately, there are two flaws to this view. First, academic research and other evidence has established the fact that the funds repatriated by the 2004 AJCA failed to achieve the stated objective, and that stock buy-backs and dividends paid by the parent companies absorbed more than 90 percent of the remittances, which were thus not available for plant investments or the hiring of new workers. Admittedly, however, funds returned to shareholders via dividends or stock purchases, to the extent later deployed for consumer purchases or personal or business investments, may still have had beneficial impact on the economy – a possibility that seemingly has not yet been fully researched.

Second, and more importantly, studies have suggested that American companies' disinclination to repatriate the earnings of their foreign subsidiaries has not been primarily motivated by the availability of a tax deferral, but rather by the perceived lack of profitable domestic investment opportunities. One inquiry found that domestic operations of U.S. multinationals were not financially constrained at the time of the AJCA, meaning that the paucity of job-boosting domestic outlays was not due to a lack of investable funds, but rather reflected the dearth of profitable opportunities. The ability to access capital at a lower cost (via tax-favored repatriations) would not be expected to boost domestic investment, domestic employment, or R&D under such circumstances.

If anything, this description is even more apt today, with interest rates being at all-time lows, making necessary borrowing appealing, if only confidence in the economy and a supply of attractive investments existed. Reportedly, non-financial U.S.

corporations are now sitting on a $2 trillion mountain of cash, yielding little or no return. If investments in capital assets were expected to provide greater returns, those investments could be made with existing cash holdings, which would entail a near-zero opportunity cost. If investments in expansions of plant capacity and the hiring of new workers were seen as being attractive, these would already be under way, with no need for repatriation of the earnings of foreign subsidiaries.

Although the Greek crisis may yet have some marginal impact on U.S. corporations' willingness to maintain earnings of foreign subsidiaries outside the U.S., at this point in time there is little to suggest that there will be a material inflow of earnings and cash to the U.S. – and even if that were to occur, there is even less reason to expect that this will fuel domestic economic expansion. In light of the Government's overwhelming budgetary problems, a tax holiday analogous to that contained in the 2004 AJCA is now considered highly improbable – indeed, it is no longer being seriously advocated. Given the tax costs of repatriation, many will prefer to gamble on there being solutions to the European crisis, rather than choosing to repatriate earnings for which there are no profitable investment opportunities in the near-term here.

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