“ESSAYS ON INTERNATIONAL TRADE AND CORPORATE TAX AVOIDANCE”

Baptiste Souillard PhD dissertation Two-page summary

The recent data leaks and tax scandals have raised awareness about the aggressive strategies implemented by companies to avoid corporate income taxes. They revealed that multinational companies artificially shift a substantial amount of profits from high- to low-tax countries, and especially to tax havens, where corporate income tax rates are low and where a lack of transparency provides unique opportunities for tax dodging. Many questions have emerged in the wake of these events. What pushes companies to engage in profit shifting? Tax rate differentials certainly play a role. Profits are disproportionately high in jurisdictions with near-zero tax rates. Nevertheless, tax rates are insufficient to explain why some companies engage in profit shifting and why some others do not. What are the consequences, notably in terms of income inequalities? It is often admitted that profit shifting aggravates income inequalities in the public sphere. Yet, there is still little statistical evidence on this topic.

The dissertation of Baptiste Souillard addresses these questions. It consists of four single-authored chapters, whose approach combines methods from economics and statistics with insights from accounting, international business, and management. The objective is twofold: better understand the determinants and distributional repercussions of profit shifting.

The first chapter is entitled “The Indirect Effect of Import Competition on Corporate Tax Avoidance.” The impact of competition in corporate tax avoidance is theoretically unclear in the literature. To clarify this, Baptiste conducts an empirical analysis. He uses the so-called China shock – the surge in exports from China during the 1990s and 2000s – as a competition shock and examines how the tax avoidance activities of US-listed companies evolved in response to rising Chinese import competition. The setup proves convenient because exports from China varied both across sectors and over time and because the US conferral of PNTR status on China in October 2000 provides exogenous variation in Chinese import competition. Overall, he finds that import competition fosters corporate tax avoidance. However, the effect holds only for multinational companies and more specifically for those implanted in tax havens. His results indicate that these companies invested in intangible assets after the China shock to mitigate losses in sales and market shares. The intangible assets, at the same time, facilitated the income shifting operations of multinationals already located in tax havens. The conclusions shed light on the evolution of the effective tax rate of US-listed companies and highlight a controversial side of globalization and import competition. They also reaffirm the need to articulate fiscal and trade policies at the international level.

The second chapter is entitled “Intra-Industry Spillovers of Profit Shifting and Tax Haven Foreign Direct Investments.” A stream of research establishes that similar companies adopt similar strategies. Another line of work shows that some activities spill over across firms. Perhaps surprisingly, studies along these lines for profit shifting are scant. The chapter is a first step in that direction. To complement the literature, Baptiste builds and exploits a new database on US-listed firms and observes whether the probability of entering a particular tax haven (through subsidiaries) increases once another firm operating in the same sector enters that tax haven. A key feature of the study resides in the data. Their granularity (firm-tax haven-year level) allows Baptiste to identify precise profit shifting schemes and neutralize the effect of numerous confounding factors in the econometric exercise. The analysis confirms that multinational companies tend to assimilate and replicate the profit shifting strategies of their peers. Moreover, it shows that intra-industry spillovers of profit shifting vary along three dimensions: over time, across sectors, and between tax havens. The findings partly explain the rapid development of profit shifting activities witnessed in the 1990s-2000s. They have policy implications too. They suggest that when a firm undertakes tax dodging activities in a specific tax haven, its peers are more prone to carry out operations in this tax haven all else equal. Anti-profit shifting reforms could thus be more efficient by concentrating efforts on some sectors and tax havens.

The third chapter is entitled “Executive Experience and Expansion Strategies of Multinational Firms.” It explores how foreign investment strategies disseminate across firms and, in that sense, can be seen as an extension of the second chapter. There are numerous anecdotes about the role of top managers in the performance of multinationals in international markets, but systematic evidence on this matter remains scarce. In this chapter, Baptiste fills this gap by putting forward executive mobility as one of the channels whereby investment strategies propagate across firms. Using rich data on the executives and foreign subsidiaries of US-listed companies, he observes that the probability of entering a foreign country rises after recruiting an executive who has already overseen business operations in that country. The pattern is more pronounced for C-level executives and low-income foreign countries. It suggests that executives acquire and develop country-specific knowledge while working for multinationals and then transmit it to the corporations they join. The finding is relevant in various regards. For example, from a fiscal policy perspective, it hints that inspecting the movements of executives across firms could help public authorities better anticipate the presence of multinational enterprises in offshore financial centers and then facilitate their fight against aggressive tax planning and profit shifting.

The fourth and last chapter is entitled “Profit Shifting, Employee Pay, and Inequalities: Evidence from US-Listed Companies.” Baptiste takes a different approach this time. Instead of looking at the causes of profit shifting, he studies the consequences of profit shifting. More specifically, he examines the impact of profit shifting on employee pay and within-firm pay inequalities. Although it is generally argued that profit shifting widens income inequalities in the public sphere, very few papers in the existing literature tackle this issue. The chapter attempts to close this gap. To this end, Baptiste scrutinizes the evolution of employee pay before and after firm entry into tax havens. He makes a clear distinction between top executives and non-executive employees. The results show that the compensation of chief executive officers and chief financial officers paid on an after-tax basis increases following firm entry into tax havens. On the contrary, if anything, wages of non-executive employees fall in the meantime. Hence, profit shifting indeed exacerbates within-firm pay inequalities, in line with anecdotal evidence and his theoretical predictions. Furthermore, the inequality-deepening effect of profit shifting is magnified among intangible-intensive companies. The findings show that the surge in profit shifting contributed, together with the shift toward performance pay and intangible assets, to the rise in income inequalities observed during the last decades. In addition, they indicate that anti-profit shifting measures could not only increase tax revenues in high-tax countries but also directly curb income inequalities.