Spring 4-1-2012

The Connection Between Competitiveness and International Taxation

Michael S. Knoll
University of Pennsylvania Carey Law School

The Connection Between Competitiveness and International Taxation

MICHAEL S. KNOLL*

I. Introduction

Competitiveness is an often used, but rarely defined term.[1] It has been called a dangerous obsession[2] and the hot-button issue in debates over international tax policy,[3] yet it lacks a clear and specific meaning.[4]

Although it has been difficult to provide a precise definition of competitiveness, that difficulty has not prevented the rhetoric of competitiveness from informing debates about government policy and ultimately the policies themselves.[5] Governments find it hard to reject claims from their constituents that local interests (for example, businesses, workers, investors) are at a competitive disadvantage relative to their foreign counterparts, especially when the alleged disadvantage is seen as a result of government policies (either foreign or domestic). For example, the Foreign Investment in Real Property Tax Act (FIRPTA)[6] was aimed at eliminating a perceived tax advantage enjoyed by foreign investors who purchased U.S. real estate at "fire

* Theodore K. Warner Professor, University of Pennsylvania Law School, Professor of Real Estate, the Wharton School, Co-Director, Center for Tax Law and Policy, University of Pennsylvania. I thank Al Dong and Daniel Janovitz for assistance with the research. The first draft of this Essay was written while the author was the 2011 John Raneri Atax Fellow at the Australian School of Business, University of New South Wales.

[1] See Paul De Grauwe, Introduction, in Dimensions of Competitiveness i, ix-xv (Paul De Grauwe ed., 2010); Eckhard Siggel, Concepts and Measurements of Competitiveness: Toward an Integrated Approach, in Dimensions of Competitiveness, supra, at 95, 96.

[2] Paul Krugman, Competitiveness: A Dangerous Obsession, Foreign Aff., Mar.-Apr. 1994, at 28, 41-44.

[3] Daniel N. Shaviro, Decoding the U.S. Corporate Tax 133 (2008).

[4] See Staff of the Joint Comm. on Tax'n, 102d Cong., Factors Affecting the International Competitiveness of the United States 7-8 (Comm. Print 1991) [hereinafter 1991 Competitiveness Report].

[5] See generally id. (providing background information for a congressional hearing on international competitiveness).

[6] Omnibus Reconciliation Act of 1980, Pub. L. No. 96-499, § 1122, 94 Stat. 2599, 2682 (codified as amended at IRC § 897).

sale" prices in the late 1970's.[7] Similar concerns motivated the 1986 branch profit tax provisions[8] and the 1989 earnings stripping limitations.[9] More recently, Congress has taken to giving names to tax legislation, such as the American Jobs Creation Act of 2004,[10] that shows it is trying (or at least wants be perceived as trying) to improve the competitiveness of the United States.

The failure to provide a precise definition for competitiveness has hampered attempts to provide a rigorous account of how international tax policy affects competitiveness.[11] Although policy advocates of all stripes have evoked the concept of competitiveness in order to support one or another cause, there are two conceptions of international competitiveness that are invoked over and over again in discussions of international tax policy. Moreover, as illustrated below, both of those conceptions can be given solid economic foundation. In addition those two conceptions closely track well-known positions that are part of a fifty-year-old debate on international taxation and a twenty-year-old debate on foreign investment. Before describing how the term "competitiveness" is used in the context of discussions of international tax policy, in the next Part I briefly describe and discuss the broader economic literature on competitiveness.

II. Economists Use of the Term "Competitiveness"

Economists often speak of efficiency, or comparative advantage, or more narrowly of (an advantage in) marginal production costs or the cost of capital, but rarely do they speak of competitiveness.[12] Nonetheless, in recent years, a small group of economists have begun writing about competitiveness.[13] And one conclusion that is clear from their work is that there is no single definition of competitiveness that applies in all situations. Instead, different definitions of competitiveness fit better in different circumstances.[14]

Frequently, the term "competitiveness" is applied at the national level in order to make comparisons across nations. For example, the World Economic Forum and Institute of Management Development

[7] Richard L. Kaplan, Creeping Xenophobia and the Taxation of Foreign-Owned Real Estate, 71 Geo. L.J. 1091, 1092-95 (1983).

[8] Tax Reform Act of 1986, Pub. L. No. 99-514, § 1241, 100 Stat. 2085, 2576 (codified as amended at IRC § 884).

[9] Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, § 6202, 103 Stat. 2106, 2330 (codified as amended at IRC § 163(j)).

[10] American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418.

[11] See Siggel, note 1, at 95-96.

[12] De Grauwe, note 1, at ix.

[13] For a survey of their work, see Siggel, note 1, at 96-105.

[14] Id. at 96.

(WEF/IMD) annually publish their World Competitiveness Index.[15] Like all such indexes, the World Competitiveness Index summarizes a range of indicators into a single number.[16] That number is a weighted average of all the factors that go into the index.[17] Of course, as with almost any index, the choice of weights is suspect. Another and more fundamental problem is the absence of a theoretical basis for the factors chosen.[18] Nonetheless, the WEF/IMD World Competitiveness Index is highly regarded, widely cited, and regularly used.[19] The principal users of broad nationwide competitiveness indexes, such as the WEF/IMD, are investors and lenders. They use those indexes to help set hurdle rates for investments and interest rates on loans, to decide where to allocate their investment capital, and to assess the risk of their portfolios.[20]

In contrast with broad nationwide conceptions of competitiveness, narrower market-oriented conceptions focus on businesses and workers operating in markets in competition with one another.[21] Such measures are generally created with an eye towards evaluating or aiding government policy. There is a wide variety of such indicators of competitiveness. That diversity is in part a response to the widespread and divergent demand for such information. Examples of market-oriented measures of competitiveness include delivered market price, total cost in domestic prices, marginal and average cost of production, unit labor cost, market share, revealed comparative advantage, domestic resource cost, unit labor cost, full unit cost, relative unit labor cost, and total unit labor cost at domestic prices.[22]

For the purpose of understanding how government policy affects competitiveness, market-oriented definitions have several advantages over nation-wide definitions. First, because they apply to industries or firms, rather than to whole economies, market-oriented measures are more closely aligned with our intuitions about competitiveness.[23] Second, market-oriented measures are capable of being given a more

[15] World Econ. Forum, The Global Competitiveness Report 2010-2011 (2010), available at http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2010-11.pdf. For a detailed discussion of the WEF/IMD competitiveness index, see Xavier Salami-Martin, The Economics Behind the World Economic Forum's Global Competitiveness Index, in Dimensions of Competitiveness, note 1, at 1.

[16] See Salami-Martin, note 15, at 13.

[17] Id.

[18] See Siggel, note 1, at 101 (noting the lack of transparency for the factors chosen).

[19] Id. at 100-01.

[20] See generally The Vietnam Provincial Competitiveness Index 2008, at 36 (noting how private firms use the index to improve their investment decisions).

[21] See Siggel, note 1, at 96.

[22] For a discussion of these and other microeconomic measures of competitiveness, see id. at 96-100.

[23] N. Gregory Mankiw & Mark P. Taylor, Microeconomics 27 (2006).

solid theoretical foundation because they can be integrated into standard economic models.[24] It is, thus, not surprising that the two conceptions of competitiveness that appear regularly in discussions of how international taxation affects competitiveness are both market-oriented definitions of competitiveness. These two conceptions are discussed in the next Part, but first I describe a famous, twenty-year old critique of the rhetoric of competitiveness.

III. The Two Conceptions of International Competitiveness

President Clinton frequently would say that each nation is "like a big corporation competing in the global marketplace."[25] President Clinton used that language because it resonated with the public. In Paul Krugman's opinion, however, President Clinton's simile was not merely wrong; it was dangerous.[26] In a famous article, Krugman argued that the rhetoric of competitiveness is frequently used by politicians, not just President Clinton, to avoid addressing serious domestic problems and to justify get-tough international policies that are likely to do little if anything to address a nation's real economic problems.[27] According to Krugman, the analogy between nations and corporations as competitors is fundamentally misplaced:

> The idea that a country's economic fortunes are largely determined by its success on world markets is a hypothesis, not a necessary truth; and as a practical, empirical matter, that hypothesis is flatly wrong. That is, it is simply not the case that the world's leading nations are to any important degree in economic competition with each other, or that any of their major economic problems can be attributed to failures to compete on world markets. The growing obsession in most advanced nations with international competitiveness should be seen, not as a well-founded concern, but as a view held in the face of overwhelming contrary evidence.[28]

Krugman continued his assault on the analogy as follows:

> [T]rying to define the competitiveness of a nation is much more problematic than defining that of a corporation. The

---

[24] See Siggel, note 1, at 96-105 (describing a range of methods for measuring competitiveness and noting the usefulness of market-oriented measures for evaluating and designing economic policies).

[25] Krugman, note 2, at 29 (quoting President Bill Clinton).

[26] Id. at 41-48.

[27] Id. at 29-30.

[28] Id. at 30.

> bottom line for a corporation is literally its bottom line: if a corporation cannot afford to pay its workers, suppliers, and bondholders, it will go out of business. So when we say that a corporation is uncompetitive, we mean that its market position is unsustainable—that unless it improves its performance, it will cease to exist. Countries, on the other hand, do not go out of business. They may be happy or unhappy with their economic performance, but they have no well-defined bottom line. As a result, the concept of national competitiveness is elusive.[29]

Yet, in spite of the criticism leveled by Krugman and repeated often by economists,[30] the fact remains that non-economists, including policymakers, business people, journalists and informed citizens, talk about competitiveness regularly and take it very seriously. It is, I believe, better for formally-trained economists to take the concept of competitiveness seriously, to give it content, and to subject claims about competitiveness to rigorous analysis than to abandon the notion altogether so as to leave the discussion entirely to those without formal economic training.[31] For many years, the latter is what happened. Economists following Krugman derided the notion of competitiveness,[32] but noneconomists continued to discuss how government policies affected competitiveness. Because economists were reluctant to speak of competitiveness, they did not fully participate in those discussions. Accordingly, for years economists have ignored the connections between taxation and competitiveness. These connections are described next.

In the context of debates over international tax policy, the term "competitiveness" is often used not as a characteristic of an entire nation (as Krugman criticizes), but as a characteristic of an industry,

---

29 Id. at 31.

30 See, e.g., Roberto Cellini & Anna Soci, Pop Competitiveness, 55 BNL Quarterly Rev. 71, 97 (2002) ("the idea of any generalized applicability of 'competitiveness' [is] simply meaningless"); Andrea Boltho, The Assessment: International Competitiveness, 12 Oxford Rev. Econ. Pol'y 1, 15 (1996) (concluding that competitiveness in the long run is a vague concept); Gillian Bristow, Everyone's a "Winner": Problemastising the Discourse of Regional Competitiveness, 5 J. Econ. Geography 285, 300-01 (2005) (describing discourse on competitiveness as ill defined); see also Robin D. Schatz, A New Rating of Economies Holds Some Surprises, N.Y. Times, June 6, 1998, at D2 ("[Krugman] was not the only mainstream economist to reject the competition metaphor"); The "C" Word, The Economist, Sept. 9, 1995, at 104 (quoting Paul Krugman's claim that "real economists don't talk about competitiveness").

31 See De Grauwe, note 1, at ix-x.

32 Kevin A. Hassett, R. Glenn Hubbard & Matthew H. Jensen, Rethinking Competitiveness 2 (Am. Enter. Inst. for Pub. Pol'y, Draft, Sept. 29, 2011), available at http://www.aei.org/files/2011/09/29/HHJ%20Competitiveness%20-2.pdf.

which is made up of firms, such as in the phrase "the competitiveness of the U.S. aerospace industry." Competitiveness, then, is a characteristic of nations only as it applies to an aggregate of firms from different industries that are subject to the same regulatory system. The tax system then can affect competitiveness by affecting the ability of domestic firms to compete with foreign firms.

In order to understand the connection between taxation and competitiveness, consider, for example, the U.S. aerospace industry. U.S.-based and incorporated aerospace companies include very large companies, such as Boeing, United Technologies, and Lockheed Martin, and many smaller and mid-size companies. The operations of many of the major U.S. aerospace companies are not confined to the United States. The largest such companies are multinational corporations (MNCs) with operations in many countries, and they sell their products in the United States and around the world.[33] Those firms compete for sales at home and abroad with competitors based in the European Union,[34] Canada,[35] China,[36] Russia,[37] Brazil[38] and elsewhere.

As in other industries, U.S.-based aerospace firms combine capital, labor, and technology to produce their product. They hire workers, which they combine with capital, to produce a product that they can sell at a competitive price. Those firms compete in the way that Krugman says firms compete (with perhaps a little leniency granted for government involvement in the aerospace industry).

Taxation, in general, and the corporate tax, in particular, affects the ability of such a firm to compete. Taxation creates a wedge between what a firm earns and what that same firm can return to its investors. That difference is the taxes governments collect.

---

33 See, e.g., Philip M. Condit, Expanding Horizons: Boeing's Global Business Operations, Geo. J. Int'l Aff., Winter-Spring 2003, at 44.

34 European aerospace companies include EADS, BAE Systems, Thales, and Dassault. European Aerospace Aircraft Manufacturers and Europe Aircraft, ezilonEurope, http://ezilon.com/business/aerospace_and_defense/manufacturing/index.shtml (last visited Jan. 26, 2012).

35 Bombardier is a Canadian aerospace company. See Bombardier, Canada's Bombardier (2011), available at http://www.bombardier.com/en/coporate/about-us/worldwide-presence?docID=0901260d8000ede1 (last visited Jan. 26, 2012).

36 Aviation Industry Corp. is the principal Chinese aerospace company. See Ray Kwong, Name You Need to Know: Aviation Industry Corporation of China, Forbes (May 16, 2011, 9:00 AM), http://www.forbes.com/sites/raykwong/2011/05/16/name-you-need-to-know-aviation-industry-corporation-of-china-avic/.

37 Russian aerospace companies include Oboronprom and United Aircraft Corporation. Oboronprom, http://oboronprom.ru/en (last visited Jan. 26, 2012); United Aircraft Corporation, http://www.uacrussia.ru/en (last visited Jan. 26, 2012).

38 Embraer is a Brazilian aerospace company. Tradition and Background, Embraer, http://www.embraer.com/en-US/ConhecaEmbraer/tradicaohistoria/Pages/Home.aspx (last visited Feb. 14, 2012).

Moreover, the total amount of taxes that a company pays can differ depending upon where that company is based. Purely domestic companies are subject to tax only in the state where they do business. Companies that conduct business in multiple states are potentially subject to taxation in multiple states. Under longstanding international tax conventions, the source state has the primary right to tax and the residence state has the obligation to mitigate double taxation. That mitigation is typically achieved by the residence state either exempting foreign source income (often called a territorial or exemption tax system) or by the residence state taxing foreign source income and providing a credit for foreign taxes paid (often called a worldwide or credit tax system). If all countries adopt territorial taxation, then all businesses regardless of where they are based will be subject to the same tax system when they make a specific investment in a specific location. However, when some (or all) states adopt worldwide taxation, then companies based in different worldwide states will face different tax situations when making specific investments. They will also face a different tax situation than companies based in territorial states. That is to say, if not all states are territorial, then taxation can affect the ability of firms (and hence of industries composed of similarly situated firms) to compete with one another. Specifically, taxation can affect the ability of companies from different states to compete for workers, capital, and investment opportunities.[39] Viewed in this way, a state's industry comprises the global output of the manufacturers based in that state.

There is a second sense in which the term "competitiveness" is used in connection with tax policy. That sense is based on the notion of regulatory competition. Regulatory competition is the idea that states compete for investments and for people through their regulatory policies. A widely recognized and ongoing example of regulatory competition is the competition between U.S. states over corporate charters.[40] In the United States, a corporation is considered to reside in the state in which it files its incorporation papers.[41] States have an incentive to encourage businesses to incorporate in their jurisdiction because of the fees they pay to the state and the legal and other work they bring

[39] Eric Toder, International Competitiveness: Who Competes Against Whom and for What?, 65 Tax L. Rev. 505, 509-10 (2012).

[40] See William L. Cary, Federalism and Corporate Law: Reflections on Delaware, 83 Yale L.J. 663, 668-69 (1974); Ralph K. Winter, Jr., State Law, Shareholder Protection, and the Theory of the Corporation, 6 J. Legal Stud. 251, 255 (1977).

[41] Some countries other than the United States use a facts-and-circumstances approach to determine where a corporation is based. See Marco Rossi, Officials Grapple with Corporate Tax Residency Issues, 49 Tax Notes Int'l 338, 338 (Jan. 28, 2008) (discussing the Italian test of corporate residency). Such an approach provides less certainty, but more closely reflects the substance of the business.

into the state.[42] In the United States, Delaware is the leader in incorporations.[43] It is the state of incorporation for more than one-half the Fortune 500 and half of all publicly traded companies incorporated in the United States.[44]

Another example of regulatory competition is tax competition. States set their own tax policies, which can differ substantially. These policies can affect immigration, investment, and tax planning activity. Generally, low taxes are seen as an inducement to invest and work in a state, and high taxes are seen as the opposite. In recent years, the Organization for Economic Cooperation and Development (OECD), has taken a dim view of tax competition, especially of the policies of very low-tax countries, which are often pejoratively described as tax havens.[45] Tax competition is the notion behind the second way in which tax policy can affect competitiveness.

The two conceptions of competitiveness described above have different implications for how taxation affects competitiveness. In addition, the two conceptions of competitiveness have different implications for how the domestic industry is defined and for the mechanism through which taxation affects competitiveness. The first conception of competitiveness focuses on how taxation affects the ability of firms to compete in different locations. Thus, the first conception of competitiveness defines a state's industry by the total output (both domestic and foreign) of the companies based in that state. In contrast, the second conception of competitiveness focuses on how taxation affects the ability of states to attract investment and labor. Thus, the second conception of competitiveness defines a state's industry by the total output of that industry in that state without regard to the nationality of the producing company. For example, the U.S. aerospace industry, then, is the total output (measured by value added) in the United States by U.S.- and foreign-based aerospace companies.

Figure 1 illustrates these two definitions of the U.S. aerospace industry. The first definition (total production by U.S.-based aerospace companies) is given by the shaded rectangle entitled *Total global production of U.S.–based aerospace companies*. The second definition (total U.S. production of aerospace products by U.S.- and non-U.S.-based aerospace companies) is represented by the rectangle entitled

---

[42] See Winter, note 40, at 255.

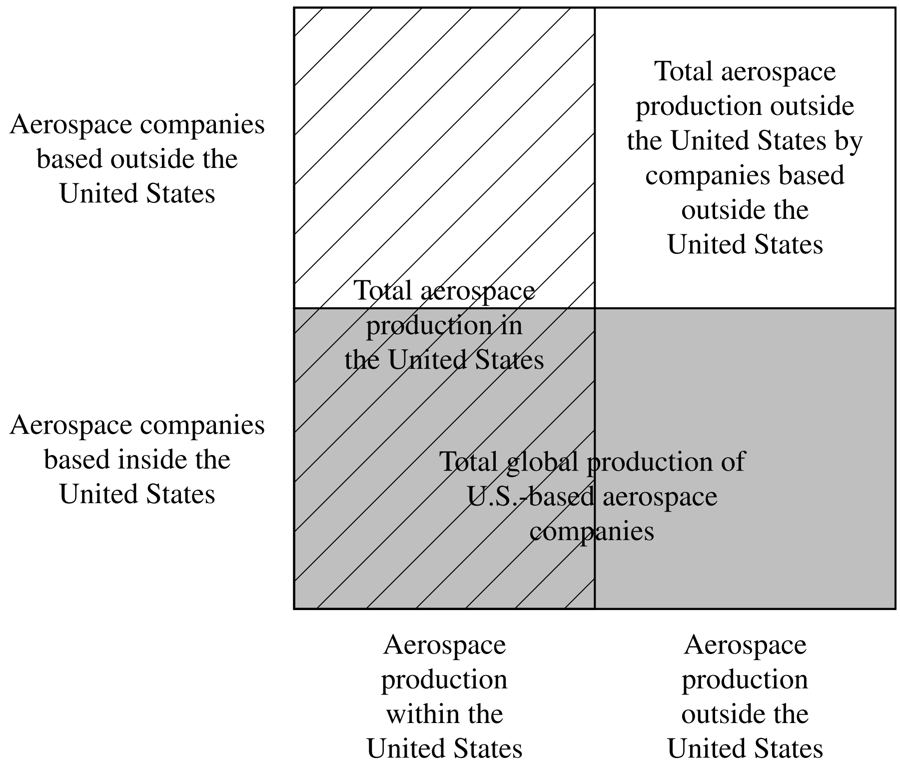
[43] See Delaware Division of Corporations, http://corp.delaware.gov (last visited Jan. 26, 2012).

[44] Id. (noting that 63% of Fortune 500 companies and 50% publicly traded companies are incorporated in Delaware).

[45] OECD, Harmful Tax Competition: An Emerging Global Issue 8 (1998).

Total aerospace production in the United States and marked by hash marks.

FIGURE 1
TWO DEFINITIONS OF THE U.S. AEROSPACE INDUSTRY



As is clear from Figure 1, there are two major differences between the two definitions of the U.S. aerospace industry. The first definition (total global production of U.S.-based aerospace manufacturers) includes the foreign production of U.S.-based aerospace manufacturers, which the second definition (total aerospace production in the United States by all aerospace companies) excludes (the shaded rectangle and without hash marks). The second definition includes the U.S. production of foreign-based aerospace manufacturers within the scope of the U.S. aerospace industry, which the first definition excludes (the unshaded rectangle marked with hash marks).

Neither conception of competitiveness or definition of the U.S. industry is right or wrong. Both conceptions of competitiveness are plausible as are both definitions of the U.S. industry. In addition, both conceptions and both definitions are in regular use. Moreover, as discussed next, each conception of competitiveness and its associated definition of the domestic industry implies a different mechanism whereby taxation affects competitiveness.

Under the first definition, the U.S. aerospace industry is defined as the global operations of the U.S.-based aerospace companies. Under that definition, the U.S. aerospace industry comprises all of the productive assets owned by U.S.-based aerospace companies whether in the United States or elsewhere.

Because the first definition of the U.S. aerospace industry keys off the state where the producing company is based,[46] the competition between U.S. and non-U.S. aerospace companies can be visualized as a competition to acquire control over productive assets located in different locations. Aerospace companies compete to sell aircraft, not to purchase assets. Their ability to sell aircraft, however, depends on their ability to acquire productive assets (and to hire workers) used in the production, sale, and servicing of aircraft. Under this view, the various national aerospace industries compete, for example, to own a plant in India. Viewed from such a perspective, a national industry is more competitive than its rivals if it acquires the Indian plant. Taxation, then, affects competitiveness through its impact on the ownership of productive assets. Thus, the U.S. corporate income tax will adversely affect the competitiveness of the U.S. aerospace industry if it reduces the incentive for U.S.-based aerospace manufacturers—relative to their foreign competitors—to own productive assets. If the corporate income tax discourages U.S. firms from owning productive assets, then the corporate income tax directly reduces the competitiveness of the U.S. aerospace industry; otherwise, it does not.

The U.S. worldwide tax system will affect the ability of U.S. firms to compete with firms from other countries for foreign assets—assets located outside the United States. Taxation will generally provide firms from countries with a worldwide tax system with a tax-induced disadvantage relative to firms from countries with lower tax rates and with a tax-induced advantage relative to firms from countries with higher tax rates when competing for assets located in those states. Relative to firms from countries with a territorial tax system, firms from states with a worldwide tax system enjoy a tax-induced advantage when their home state tax rate is less than the host state tax rate.[47]

Under the second definition, the U.S. aerospace industry is defined as the total aerospace production within the United States without regard to the nations where the producing firms are based. The U.S. aerospace industry, then, includes the domestic production of U.S.-

[46] Under U.S. law, a corporation is based in the state in which it is incorporated.

[47] The situation is more complicated when the foreign tax credit is limited and foreign income is deferred.

based aerospace producers as well as the U.S. production of non-U.S.-based aerospace manufacturers. Viewed from such a perspective, the U.S. aerospace industry competes with other national aerospace industries where each nation's industry is constituted by the aerospace manufacturers based in that country. Thus, the European aerospace industry is the total production of aerospace goods and services in Europe by European-based and non-European-based companies.

Viewed from such a perspective, the competition that takes place between the U.S. and European aerospace industries takes the form of competition to produce more aerospace goods and services in each location. The corporate income tax, then, affects competition through its impact on investment in aerospace production in different locations. Thus, the U.S. corporate income tax reduces the competitiveness of the U.S. aerospace industry if it discourages investment in aerospace production in the United States relative to investment in such production abroad.[48] If the U.S. corporate income tax discourages production in the United States, then it directly reduces the competitiveness of the U.S. aerospace industry; otherwise, it does not. In general, tax rates in a host state that are higher than rates in other potential host states will tend to discourage production in the former and encourage production in the latter.[49]

IV. Tracking Other Debates

In Part III, I argued that for the purpose of understanding how taxation impacts competitiveness there are two conceptions of competitiveness that are regularly used in public discourse and that both conceptions can be given rigorous economic foundations. Moreover I showed that each conception of competitiveness is associated with a specific way of defining the domestic industry and a different mechanism through which taxation affects the competitiveness of that industry.

In this Part, I argue that these two ways of describing what it means for taxation to affect competitiveness track the common intuition of people who work in the field of international taxation. I also argue that these two views readily map into well-recognized positions in longstanding policy debates. That they track the intuition of leaders

[48] If, however, all states have worldwide taxation with an unlimited foreign tax credit and without deferral, then source state tax rates will not impact local production.

[49] The analysis, implementation (especially the calculation of the foreign tax credit), and policy implications are more complicated if a portion of the host state's tax revenues is used in a fashion that generates benefits for a taxpayer resident in another state that taxes worldwide income.

in the field can be seen by examining two U.S. government reports on competitiveness that discuss tax policy at length.

A. Treasury's 2007 Report on Competitiveness

In 2007, Treasury's Office of Tax Policy released a 100-plus page report that included the words "tax" and "competitiveness" in its title.[50] The report, entitled "Approaches to Improve the Competitiveness of the U.S. Business Tax System for the 21st Century," was a follow-up to a conference hosted by Treasury earlier that year. Surprisingly, although the Treasury report's title suggests that the report will examine the connection between taxation and competitiveness, nowhere does the report provide a definition of competiveness. Nevertheless, the discussion in the report regularly and frequently tracks the two definitions provided above.

The executive summary, for example, mentions both conceptions of competitiveness in describing how tax systems can affect U.S. competitiveness.

> As other nations modernize their business tax systems to recognize the realities of the global economy, U.S. companies increasingly suffer a competitive disadvantage. The U.S. business tax system imposes a burden on U.S. companies and U.S. workers by raising the cost of investment in the United States and burdening U.S. firms as they compete with other firms in foreign markets.[51]

The two conceptions of competitiveness are also reiterated throughout the text, often without clearly delineating between the two. The following passage is one such example from the report:

> It is important to consider the effects of leaving the system for taxing U.S. businesses unchanged while other nations reform their systems. In general, inaction would make the United States a less attractive place in which to invest, innovate, and grow. The impact of allowing the U.S. tax system to stagnate and fall behind relative to other countries would be modest at first. The United States would see less benefit from inflows of foreign capital and investment, and U.S. firms would face a higher cost of capital than foreign firms, making it more difficult to compete in foreign markets. In

[50] Treasury Dep't, Office of Tax Pol'y, Approaches to Improve the Competitiveness of the U.S. Business Tax System for the 21st Century (2007).

[51] Id. at i.

> the short run, this would translate into slower growth, less productivity, and less employment.
>
> Over the long run, however, the impact of the United States falling further behind its major trading partners is likely to become more dramatic. Industries that are relatively large producers or users of capital goods would be most affected. American manufacturers, for example, would find themselves especially disadvantaged by a tax code that causes them to face a higher cost of capital than their competitors in other countries. In a world of greater economic integration and increased trade and capital flows, a firm's decision about where to locate and expand its operations would be increasingly influenced by factors such as a country's corporate tax code and overall investment climate.[52]

Thus, the 2007 Treasury Report invokes both the locational and ownership notions of competitiveness described above.[53] Because the report does not define competitiveness, however, it does not explore the connections between taxation and competitiveness as rigorously as it could have.

B. JCT's 1991 Report on Competitiveness

Treasury's 2007 report was not the first government report to discuss how taxation affects competitiveness. In 1991, the Joint Committee on Taxation released a report that begins by noting that there is no single commonly accepted and everywhere useful definition of competitiveness.[54] The report then goes on to offer three definitions "commonly given to the term 'competitiveness' in recent writings on U.S. economic policy."[55]

The first definition, which is described in the report as trade competitiveness, "is the ability of firms located in the United States to sell their output in foreign markets and to compete in domestic markets

---

[52] Id. at 5.

[53] See Part III. There is a third conception of how taxation can impact competeviness that is sometimes mentioned. It is the idea that a broad-based tax system that imposes the same or nearly the same effective tax rate on activities across the board is more efficient than a tax system that imposes very different effective tax rates on different activities. Edgar K. Browning & Jacquelene M. Browning, Why Not a True Flat Rate Tax?, 5 Cato J. 629, 637-38 (1985) (stating that with a flat tax, resources are not shifted to lowered value, but tax preferred, uses). This is standard economic advice on designing an efficient tax system. That advice applies as well in closed economies as in open economies and so does not focus on the connection between international taxation and international competitiveness.

[54] 1991 Competitiveness Report, note 4, at 3.

[55] Id. at 7.

with output produced in foreign countries."[56] The second definition, called standard of living competitiveness, compares the current U.S. living standard with those of other countries.[57] This measure focuses on the productivity growth of U.S. labor and the saving rate of the United States, because both of these factors affect future living standards."[58] The third definition, called multinational competitiveness, "is the ability of U.S. multinationals . . . that locate production facilities overseas to compete in foreign markets."[59]

The second definition is the broadest of the three definitions of competitiveness. Although that definition contains an international gloss by comparing standards of living across states, that language is window dressing for what is otherwise a domestic concept. Even in a closed market, one with no economic connection to states outside, government policy (including tax policy) can still affect living standards and growth rates. In such circumstances, government policy can improve living standards and growth rates by correcting for negative externalities and by providing valuable public goods. Government policy can also reduce living standards and hamper growth by distorting investments and other decisions. This broad notion of an efficient tax system, however, is unrelated to international transactions or cross-border taxation because the same issue arises in a purely domestic context.

Although the first and third definition of competitiveness do not precisely match those offered above, there is a close correspondence. The third definition is closely related to the ownership definition of competitiveness. Nevertheless, the ability of multinationals to compete in overseas markets is not discussed in that report. The first definition includes the concept of attracting capital investment,[60] which is the heart of the locational definition of competitiveness. The location of investment is a topic that the 1991 report covers in detail. Indeed, Part Two of the Report, contains an extensive discussion and analysis of the effect of various tax systems on the location of investment.[61] It is, thus, worth noting that while both the 1991 and 2007 reports discuss the impact of taxation on the location of investment at some length, the 2007 report discusses the effect of taxation on ownership at some length, whereas the 1991 report largely ignores that issue. That oversight is consistent with the then–prevailing view of economists that distorting capital ownership patterns would not have substantial ad-

[56] Id.
[57] Id.
[58] Id.
[59] Id. at 8.
[60] See id. at 9-10.
[61] Id. at 232-68.

verse welfare consequences. The 1991 report was, however, a missed opportunity for commentators to have started earlier to begin thinking rigorously about the connections between taxation and ownership.

C. The Debate over International Tax Neutrality Benchmarks

Since the Kennedy Administration, two neutrality principles have dominated U.S. international tax policy and the debate over what that policy should be: capital export neutrality (CEN) and capital import neutrality (CIN).[62] Over the intervening half century, the United States' commitment to one or the other benchmark has swung back and forth.[63] The two ways that taxation can hamper the competitiveness of a domestic industry track closely those two neutrality benchmarks.

1. The Normative Meaning of CEN

A tax system satisfies CEN if an investor pays tax at the same rate on the income from an investment regardless of where the investment is located.[64] If all investors are taxed at the same rate, regardless of where they invest, the location where investment occurs will not be affected by taxes. Accordingly the allocation of capital across states will maximize output. As Peggy Musgrave pointed out many years ago, universal adoption of a worldwide tax system with an unlimited foreign tax credit will achieve CEN.[65]

In the absence of an international tax system where all countries tax their residents' worldwide income and grant unlimited foreign tax credits (the latter is widely recognized as politically infeasible and economically cost prohibitive), the only other way to achieve CEN is for states to harmonize their tax rates and bases.[66] In the absence of such

---

[62] For a short history of U.S. international tax policy, see Reuven S. Avi-Yonah, All of a Piece Throughout: The Four Ages of U.S. International Taxation, 25 Va. Tax Rev. 313 (2005).

[63] See id. at 315-16, 324-25, 330-32.

[64] The contribution that any asset makes to global welfare is a function of the before-tax rate of return generated by the asset. Thus, if the before-tax rates of return on the marginal asset in each jurisdiction are equal, then global welfare cannot be increased by shifting assets across borders. In such circumstances, the tax system is said to satisfy CEN.

[65] See Peggy Brewer Richman, Taxation of Foreign Investment Income: An Economic Analysis 5-6 (1963); Peggy B. Musgrave, United States Taxation of Foreign Investment Income: Issues and Arguments 74-75, 109 (1969).

[66] E.g., Fadi Shaheen, International Tax Neutrality: Revisited, 64 Tax L. Rev. 131, 131 (2011).

harmonization, states with lower effective tax rates will have a tax-induced advantage in attracting investment.[67]

Of course, the tax neutrality benchmark of CEN is closely associated with the second definition of competitiveness, which focuses on a state's ability to attract foreign investment. An international tax regime that satisfies CEN (that is, universal adoption of worldwide taxation with unlimited foreign tax credits) will place all states on an equal footing in their ability to attract foreign investment. Tax considerations will not advantage or disadvantage any of them in their ability to attract investment.

2. *The Two Different Normative Meanings of CIN*

Musgrave also discusses CIN, which she describes in the context of business competition and expansion opportunities.[68] However, the economist's conception of CIN is not that of Musgrave, which I discuss below, but a different notion.

a. Savings Neutrality

The economist's view of CIN derives from an influential and important article published by Thomas Horst in 1980. In that brief article, Horst formalizes and models some of the basic ideas developed in Musgrave's early writings.[69] For example, Horst demonstrates that a worldwide tax system with unlimited foreign tax credits, will not distort the allocation of capital across locations.[70] Horst then demonstrates that territorial taxation (that is, source taxation only or equivalently the exemption of foreign source income from taxation) will not distort the consumption-savings decisions across jurisdictions.[71] Horst refers to the situation in which the tax system does not differentially distort the consumption-savings choice across investors from different states[72] as one in which CIN obtains.[73]

Horst shows that if all countries adopt territorial taxation, then the tax system will achieve CIN as savings neutrality. If some but not all countries exempt foreign source income from tax, then the only way

---

[67] To the extent that tax revenues provide benefits to investors (directly or indirectly), the tax operates more as a user fee than as a tax and so might not discourage investment.

[68] Musgrave, note 65, at 119-21.

[69] Thomas Horst, A Note on the Optimal Taxation of International Investment Income, 94 Q.J. Econ. 793 (1980).

[70] Id. at 796.

[71] See id. at 796-97.

[72] Income taxation distorts the consumption-savings choice. E.g., Lawrence Zelenak, Commentary: The Reasons for a Consumption Tax and the Tax Treatment of Gifts and Bequests, 51 Tax L. Rev. 601, 605-06 (1996).

[73] Id. at 796.

to achieve CIN as savings neutrality is for states to harmonize their tax rates and bases.

Horst's interpretation of CIN caught on in the economics literature.[74] And so that interpretation is presumably what many economists have in mind when they say that a territorial tax system satisfies CIN. That, however, is not what Musgrave meant, and more to the point it is not what many modern day legal scholars and policy analysts have in mind when they invoke CIN.

b. *Competitiveness or Ownership Neutrality*

As described in the previous Subsection, economists think of a tax system that violates CIN as differentially distorting the saving-consumption decision across taxpaying investors from different countries. In contrast with economists who write about international tax policy, legal scholars, lawyers, accountants, and other noneconomists who write in the field have generally written about CIN in terms of the ability of domestic and foreign companies and investors to compete in a specific marketplace. Thus, the second meaning of CIN is as competitiveness or ownership neutrality.

Ownership considerations were first introduced into the economic literature on foreign direct investment in the late 1950's.[75] That work, which is now recognized as the foundation of the modern literature on international trade, did not receive much attention at the time.[76] Accordingly, for many years, economists ignored the importance of ownership in influencing foreign direct investment.

It was not until the 1980's that economists again started to think seriously about how ownership considerations impact foreign direct investment.[77] Even so, the rigorous economic analysis of ownership remained outside the realm of international tax policy for some more years.

In 1990, Michael Devereux coined the phrase capital ownership neutrality (CON) to describe a tax system that is neutral with respect to the ownership of assets.[78] Devereux's original paper on CON, how-

[74] Michael S. Knoll, Reconsidering International Tax Neutrality, 64 Tax L. Rev. 99, 108 n.40 (2011).

[75] See Edward M. Graham & Paul R. Krugman, Foreign Direct Investment in the United States 191-93 (3d ed. 1995) (examining the historic development of economic literature).

[76] See id.

[77] See id. at 192-93.

[78] Michael Devereux, Capital Export Neutrality, Capital Import Neutrality, Capital Ownership Neutrality and All That 2 (Inst. for Fiscal Stud., Working Paper, 1990). The term "ownership neutrality" appears to have first been used in print in a 1994 article by Robert Green. Robert A. Green, The Troubled Rule of Nondiscrimination in Taxing For-

ever, was never published and the concept remained dormant for another decade until Mihir Desai and James Hines, in a series of articles published in 2003 and 2004, brought ownership into the forefront of the professional economists' literature on international taxation.[79] Desai and Hines argue that productivity depends on the ownership of assets so that a tax regime that distorts ownership will impose large welfare costs.[80] Their work has been very influential, although some commentators question the magnitude of tax-induced ownership distortions and the data/measurements Desai and Hines employ.[81]

Yet, the idea of competitiveness or ownership neutrality is much older. When Musgrave used the term CIN she had competitiveness in mind, not savings neutrality. Thus, in her 1963 work, Musgrave introduces the phrase "capital import neutrality" in the following sentence: "A form of capital-import neutrality under which all investors who invest in one particular country are subject to the same tax treatment, namely, that of the country of the source of investment income, would allow all foreign investors in that country equal opportunities for expansion."[82] Although Musgrave rejects CIN as the appropriate welfare benchmark because it does not promote neutrality with respect to the location of investment,[83] the passage is clearly not about savings, but is instead about competitiveness.

Similarly, in her 1969 work, Musgrave writes that business people argue that "[t]he relevant concept of neutrality is equal tax treatment of U.S. investors abroad and their foreign competitors (capital-import neutrality)."[84] And in a section entitled "*Capital-import neutrality*," Musgrave writes: "Businessmen frequently maintain that neutrality should apply between U.S. foreign investors and their competitors abroad. This view of neutrality, which may be termed 'capital-import neutrality,' suggests taxation by source or exemption of foreign invest-

eign Direct Investment, 26 Law & Pol'y Int'l Bus. 113, 138 (1994) ("Ownership neutrality prevails if the international tax system is neutral with respect to the identity of the firm that owns and controls capital in a given country.").

79 Mihir A. Desai & James R. Hines Jr., Evaluating International Tax Reform, 41 Nat'l Tax J. 487 (2003); Mihir A. Desai, New Foundations for Taxing Multinational Corporations, Taxes, Mar. 2004, at 39; Mihir A. Desai & James R. Hines Jr., Old Rules and New Realities: Corporate Tax Policy in a Global Setting, 57 Nat'l Tax J. 937 (2004) [hereinafter Old Rules].

80 Desai & Hines, Old Rules, note 79, at 955-57.

81 Jane G. Gravelle, International Corporate Income Tax Reform: Issues and Proposals, 9 Fla. Tax Rev. 469, 477-83 (2009); Harry Grubert, Comment on Desai and Hines, "Old Rules and New Realities: Corporate Tax Policy in a Global Setting," 58 Nat'l Tax J. 263, 263-65 (2005); Mitchell A. Kane, Ownership Neutrality, Ownership Distortions, and International Tax Welfare Benchmarks, 26 Va. Tax Rev. 53, 54-56 (2006).

82 Richman, note 65, at 8.

83 Id.

84 Musgrave, note 65, at 118.

ment income by the United States."[85] Once again, Musgrave is skeptical of the efficiency and fairness benefits of CIN, but there is no ambiguity as to connotation. CIN is about competitiveness, not savings.[86]

Ownership neutrality, then, is a second meaning of CIN and it seems to be the meaning intended by Musgrave. It is also a more intuitive meaning for the term CIN than the alternative meaning of not distorting the consumption-savings choice across investors. The phrase "capital import neutrality" does not suggest anything about savings. Instead, the phrase suggests investment from abroad into a host country in competition with local investors and the neutrality is often expressed as occurring between a home investor and a foreign investor or among foreign investors from different states. In many instances, the investors are assumed to be firms, not individuals, which further strains the interpretation of CIN as dealing with the trade-off between consumption and savings. Also, both CEN and CIN are often described as dealing with foreign direct investment, not portfolio investment. In a world where firms make direct investments and individuals make portfolio investments, it makes little sense for CIN to be about both direct investment and the consumption-savings tradeoff. Instead, ownership neutrality—or something close to it—appears to be what many writers about tax policy who are not professionally trained economists have in mind when they use the term CIN.

Indeed, some prominent economists have referred to CIN as related to ownership. Devereux, in a footnote to his 1990 paper introducing the concept of CON, writes, "[i]n my [Institute for Fiscal Studies] report with Mark Pearson, we attempted to redefine capital import neutrality to cover this concept [CON]. This may have caused some confusion with what others have called capital import neutrality."[87] As Devereux's comment makes clear, economists have generally defined CIN in such a way that it differs from CON, even though CON is a natural interpretation for the term CIN. Also in 1990, Hugh Ault and David Bradford wrote "'[c]apital-import neutrality' refers to the nationality of ownership of firms."[88] Although they define CIN as

---

[85] Id. at 119.

[86] Although Musgrave's use of CIN focuses on competitiveness, not savings, she does not explain how businesses compete with one another to expand production. That gap in the argument might be a result of her rejection of CIN as a benchmark worth pursuing. Nevertheless, modern corporate finance provides the link Musgrave did not by explaining how firms compete. They compete with one another for assets by raising money from outside investors, which they use to acquire assets.

[87] Devereux, note 78, at 2 n.4.

[88] Hugh J. Ault & David F. Bradford, Taxing International Income: An Analysis of the U.S. System and Its Economic Premises, in Taxation in the Global Economy 11, 39 (Assaf Razin & Joel Slemrod eds., 1990).

essentially CON, they reject the idea that CON is an important welfare benchmark: "The nationality of the owners of capital is not generally associated with economically significant consequences (apart, perhaps, from portfolio diversification)."[89]

The 1991 Joint Committee report illustrates the then-accepted view of the economics profession that the welfare consequences of a tax system distorting ownership were minimal.[90] Consistent with the then-prevailing (and still existing) view among professional economists that the welfare consequences of a tax system distorting the location of investment can be large, the Joint Committee's 1991 report discusses the effect of taxation on the location of investment at length.[91] That report, however, discusses CIN briefly in the context of saving neutrality and pays little attention to ownership considerations.[92]

Of course, the tax neutrality benchmark of CON as well as the benchmark of CIN (when the latter is understood as ownership neutrality) are closely associated with the first definition of competitiveness, which focuses on the ability of companies located in different countries to acquire productive assets. A tax system that satisfies CON is one in which companies, regardless of where they are based, compete on an equal footing in seeking to acquire productive assets. Tax considerations will not advantage or disadvantage any of them in their ability to acquire productive assets.

Thus, the two common meanings of competitiveness that are expressed in discussions of international tax policy correspond closely to the two leading tax neutrality benchmarks. Those benchmarks, CEN on the one hand and CIN as ownership neutrality and CON on the other, have dominated the debate on international tax policy for fifty years. Thus, for many noneconomists, the central international tax policy debate of the last half century—should states attempt to achieve CEN or CIN—has been a debate between the two conceptions of competitiveness—locational neutrality and ownership neutrality—described in this Article.

Viewed in this way, the rhetoric of taxation and competitiveness foreshadowed the introduction of ownership considerations into the economic literature on international taxation. That issue, which is today an issue of widespread debate among economists and economically sophisticated writers about international taxation, is most often referred to by the acronym CON. For years, the economics profession

---

89 Id.

90 See 1991 Competitiveness Report, note 4, at 243-48 (comparing CEN to CIN without considering CON).

91 Id. at 232-68.

92 Id. at 247-48.

ignored or rejected the idea that taxation could reduce welfare by distorting ownership. Economists now widely recognize that taxation can reduce welfare by distorting ownership. In general, the critics of pursuing CON argue not that distorting ownership has no adverse welfare consequences. Instead, they typically argue that locational distortions are more—and perhaps much more—important. In other words, the non-economists were telling the economists something—ownership matters—but the economics profession was not listening.

D. Who Is Us?

The two ways of describing how international taxation affects competitiveness also tracks a debate from twenty years ago between two prominent academics that still resonates today. The debate took place between Robert Reich and Laura D'Andrea Tyson, both of whom would soon become members of President Clinton's cabinet. In 1990, Reich, who would later become Secretary of Labor in the Clinton Administration, published an article in the Harvard Business Review, entitled *Who Is Us?*[93] The article begins with a rhetorical question, "[a]cross the United States, you can hear calls for us to revitalize our national competitiveness. But wait—who is 'us'?"[94]

Reich's answer was as follows:

> Typically, the assumed vehicle for improving the competitive performance of the United States is the American corporation—by which most people would mean Corporation A. But today, the competitiveness of American-owned corporations is no longer the same as American competitiveness. Indeed, American ownership of the corporation is profoundly less relevant to America's economic future than the skills, training, and knowledge commanded by American workers—workers who are increasingly employed within the United States by foreign-owned corporations.
>
> So who is us? The answer is, the American work force, the American people, but not particularly the American corporation. The implications of this new answer are clear: if we hope to revitalize the competitive performance of the United States economy, we must invest in people, not in nationally defined corporations. We must open our borders to investors from around the world rather than favoring companies that may simply fly the U.S. flag. And government policies

[93] Robert B. Reich, Who Is Us?, Harv. Bus. Rev., Jan.-Feb. 1990, at 53.
[94] Id.

> should promote human capital in this country rather than assuming that American corporations will invest on "our" behalf. The American corporation is simply no longer "us."[95]

Looked at through the lens of investment policy, Reich is arguing that U.S. policy should not seek to promote U.S. corporate champions, but should instead encourage investment into the United States in order to raise U.S. wages. It is, thus, not surprising that Reich is critical of tax policies that discourage foreign investment into the United States as the following passage illustrates:

> In July 1989, for instance, the House Ways and Means Committee voted to apply a withholding capital gains tax to foreigners who own more than 10% of a company's shares. Another provision of the committee would scrap tax deductibility for interest on loans made by foreign parents to their American subsidiaries. A third measure would limit R&D tax credits for foreign subsidiaries. More recently, Congress is becoming increasingly concerned about foreign takeovers of American airlines. A subcommittee of the House Commerce Committee has voted to give the Transportation Department authority to block foreign acquisitions.
>
> These policies make little sense—in fact, they are counterproductive. Our primary concern should be for training and development of the American work force, not the protection of the American-owned corporation. Thus, we should encourage, not discourage, foreign direct investment.[96]

Viewed in terms of the two definitions of competitiveness discussed earlier, Reich is arguing that we should reject the first definition, which defines competitiveness in terms of the performance of U.S.-based companies, and adopt the second definition, which defines competitiveness in terms of domestic wages, which are closely related to the ability to attract foreign investment. Viewed in terms of the debate over what tax policy benchmark the United States should pursue, Reich is explicitly rejecting the notion of equating U.S. competitiveness with CON or CIN as ownership neutrality and advocating instead associating it with CEN.[97]

---

[95] Id. at 54.

[96] Id. at 63.

[97] Although Reich is a strong proponent of defining competitiveness in terms of domestic workers and not in terms of domestic-owned companies, it is worth mentioning that he recognizes at least implicitly that government policies can distort ownership and that such policies can be detrimental to the welfare of the host state. Reich continues the discussion above as follows:

Tyson, Reich's opponent in the debate, would later chair President Clinton's Council of Economic Advisors. In 1991, Tyson published a response, entitled *They Are Not Us: Why American Ownership Still Matters*.[98] Although she raises several caveats and does not discuss tax policy, Tyson, as the subtitle of her article states, advances an ownership view of competitiveness. She writes: "Despite several decades of substantial foreign direct investment by U.S. multinationals, the competitiveness of the U.S. economy remains tightly linked to the competitiveness of U.S. companies."[99] And after a review of the evidence on globalization as of about twenty years ago, Tyson concludes:

> Unlike Reich, I read the evidence as proving a strong, continuing link between American companies and the vitality of the U.S. economy. Who is us? American companies still are. And while foreign firms represent bigger shares of the domestic economy, especially in a few major industries, they are still not as important as American firms. "They are not yet us, although they are beginning to bear a strong family resemblance. And for national defense purposes, they will never be just like us."[100]

Tyson goes on to discuss policy, but nowhere does she discuss tax policy. She generally agrees with Reich on broad policy agendas, such as education and job creation, and puts a heavy reliance on reciprocity as a tool to open foreign markets.[101] She also concedes that Reich might be right for the future, but Tyson is clearly arguing that ownership matters and that U.S. government policy should to some extent support U.S.-owned firms. Thus, she concludes:

> Engine Charlie Wilson [the president of GM who famously said "what is good for GM is good for America"] may have been right for the 1950s, and Robert Reich might well be

---

> Experience shows that foreign-owned companies usually displace American-owned companies in just those industries where the foreign businesses are simply more productive. No wonder America's governors spend a lot of time and energy promoting their states to foreign investors and offer big subsidies to foreign companies to locate in their states, even if they compete head-on with existing American-owned businesses.

Id. at 63.

[98] Laura D'Andrea Tyson, They Are Not Us: Why American Ownership Still Matters, Am. Prospect 37, Winter 1991, at 37.

[99] Id. at 38.

[100] Id. at 47.

[101] Id. at 48-49.

> right for the next century. But, for now, we need to improvise in a world that fits no ideal model.[102]

Thus, Tyson's position is closely associated with the first definition of competitiveness, which focuses on ownership of assets by U.S.-based businesses. Although she is not choosing between benchmarks, her argument clearly implies that it would be a mistake to reject CON outright.

V. Conclusion

Although the term "competitiveness" has been invoked for decades in debates about economic policy and has been applied to a wide range of issues, it continues to attract the ire of economists. Twenty years ago, Krugman called competitiveness a dangerous obsession.[103] He argued that policymakers and politicians were flat wrong when they said or implied that nations were in direct economic competition with one another so that one nation's gain would come only at another's loss.[104] That obsession is dangerous, he contended, because it tends to redirect policymakers and politicians away from the largely domestic policies that have the potential to improve living standards and towards punitive international policies that would benefit no one and likely harm many.[105] In the context of international taxation, however, competitiveness is not generally used as a justification for punitive tax policies.

In debates over international taxation, the term "competitiveness" is generally used in two distinct ways. The first is in terms of the ability of companies from different nations to compete against one another to acquire assets in a specific location. The second is in terms of the ability of a nation to attract capital. Moreover, although economists have long appreciated the value to a state of attracting investment and the role of regulatory arbitrage, until recently the economics profession did not appreciate the welfare consequences of ownership. For years, after Horst redirected the economics profession from viewing CIN as dealing with competitiveness to viewing it as dealing with savings, noneconomists raised the issue of how taxes affect ownership using the rhetoric of competitiveness.

Both ways of thinking about the connection between taxation and competitiveness are intuitive and both are based on conceptions of competitiveness that have deep roots in the economics literature going

102 Id. at 49.
103 Krugman, note 2, at 28-30.
104 Id. at 30.
105 Id.

back for many years. Moreover, the two conceptions of competitiveness closely match prominent positions in longstanding debates about economic policy, including international taxation. The first approach is consistent with advocacy of CON (alternatively with advocacy of CIN as ownership neutrality), whereas the second approach is consistent with advocacy of CEN. Accordingly, the first approach is often invoked to lower the domestic tax rate on foreign source income, whereas the second approach is often employed to justify lowering tax rates on domestic source income. The second approach is also used to argue for worldwide taxation. The two conceptions also match up with the positions taken by Reich and Tyson in the *Who Is Us?* debate. The first approach, with its emphasis on ownership of investment, tracks the position taken by Tyson, whereas the second, with its emphasis on the location of investment, tracks the position taken by Reich.

Competitiveness may be a dangerous obsession and the hot button issue in debates about international tax policy, but it need not be an incoherent concept. There is no need to choose between engaging in economic analysis and talking about competitiveness. By carefully defining what is meant by competitiveness and by thoroughly examining how international taxation affects a well-defined conception of competitiveness, the connection between taxation and competitiveness can be rigorously studied. International tax policies could then be formulated after giving proper consideration to the impact of alternative policies on competitiveness.