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RESEARCH SUMMARY

Understanding Precautionary Cash at Home and Abroad

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United States corporations have saved the largest amount of cash, and marketable securities, in U.S. history—$3 trillion. The vast savings are attributable to two things:

1. Corporate resources for future investment needs, and
2. U.S. and international tax policies.

This research shows that U.S. corporations save money domestically to preserve the ability to fund future investment. However, lower international tax rates have encouraged U.S. corporations—especially those with intensive research and development programs—to save larger amounts of cash abroad. Faulkender, Hankins, and Petersen found that companies hold cash overseas when there is a larger difference between the domestic and foreign tax rates. Additionally, corporations developing intellectual property—trademarks, patents, and copyrights—transfer those assets to foreign subsidiaries, shifting their earnings and savings to countries with lower tax rates than the U.S.

While striving to maximize growth and profits, corporations respond to numerous incentives in the marketplace and policy world. Policymakers need to consider how firms can relocate assets abroad as they consider new proposals that are meant to discourage corporate savings.

BACKGROUND

According to recent Flow of Funds estimates, U.S. non-financial corporations are sitting on approximately $3 trillion in cash and marketable securities. The academic literature has largely focused on the precautionary motive for saving cash (i.e. future investment needs). However, given the tax consequences of bringing cash back to the U.S. (repatriating), it is not clear that cash held internationally is all held for a ‘rainy day.’

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The U.S. tax code makes it costly to repatriate. Excess cash held by the U.S. parent company can fund investments elsewhere without paying additional tax. But cash held by the foreign subsidiary can only fund investments in the U.S. at additional tax costs. In addition, foreign cash is often invested in securities that cannot be easily sold. This makes foreign held cash a poor substitute for precautionary savings held in the U.S.

So, are corporations really stockpiling $3 trillion because they anticipate needing that much for investment purposes? How much is instead being held because of taxes? Does the money held for tax purposes also provide precautionary benefits? These are the questions explored in this paper.

Publicly available data sources do not separate U.S. held and foreign held cash. And thus, past literature has struggled to differentiate between the cash held for precautionary reasons versus the cash held for tax reasons. However, the Bureau of Economic Analysis conducts a mandatory survey of U.S. multinational companies that differentiates between domestic and foreign held cash helping to tell the precautionary cash and tax stories.

FINDINGS

Previous literature on corporate cash holdings and company characteristics explains the variation in domestic savings but not in foreign savings.

The primary factors explaining the variation in foreign savings are tax rates and repatriation costs. Lower foreign tax rates are associated with greater cash savings.

- Companies respond to differences between the U.S. and foreign tax rates by keeping cash abroad to defer the cost of repatriating profits.

- Corporations with intellectual property can relocate those assets to their foreign subsidiaries to move earnings from higher tax jurisdictions to lower tax jurisdictions, contributing to their international cash holdings.