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Expansion of the Totalization Program Using Simplified Agreements to Eliminate Dual Taxation

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The United States has signed 30 bilateral social security agreements. Some of its partner countries, such as the United Kingdome or Germany, have signed international agreements to eliminate double taxation for nationals working temporarily abroad with more than 50 other countries. This project analyzes the potential macroeconomic impact of expanding the set of countries with international social security treaties by enacting new agreements that are simpler than the standard totalization agreements enacted so far.

We assess the potential effects on American firms' activities abroad, international flows of capital (as foreign direct investment, or FDI), and Social Security Administration (SSA) revenues, of expanding the set of countries with totalization agreements with the U.S. For this, we consider a potential expansion of the totalization agreements program that allows for more flexible or limited agreements. In general, totalization agreements require a significant amount of coordination between the partner countries' social security systems. But there are different types of social security systems. For example, countries with provident funds use a compulsory savings program in which workers' and employers' contributions are set aside and invested for each employee in a single, publicly managed fund for later repayment to the worker at retirement. In countries with social insurance schemes, the amount of retirement pension benefits relates to the worker's history and level of labor earnings. Therefore, regular totalization agreements between provident-fund countries and social-insurance countries can be challenging to coordinate or impossible to implement. Social security agreements that do not include such provisions could be simpler to conclude.

A typical totalization agreement states that a host country refrains from social security taxation of temporary foreign workers and that the sender country recognizes the foreign deployment in determining eligibility for and amount of social security benefits. The potential expansion studied here is one that relaxes two requirements of the current program. The first change would allow the inclusion of partner countries that do not have social security systems similar to the U.S'. The second would permit limited agreements that require less coordination between countries than full treaties. These would be agreements to eliminate dual social security taxation and would not affect eligibility requirements for social security benefits.

We study the potential effects of concluding this kind

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of international social security agreement with a variety of countries not currently partners of the U.S. to characterize the potential effects of such an expansion to the totalization program. The set of hypothetical partners includes countries from regions or sociopolitical environments different from the current set of partner countries:

1. Some of the remaining countries in the European Union without international agreements with the U.S.: Croatia, Estonia, Romania, Serbia.
2. Other countries that are not currently U.S. partners but have totalization treaties with some of the U.S.' partner countries (as with the U.K. and Germany): Israel, Morocco, Tunisia, Turkey.
3. Three of the largest Southeast Asian economies: Thailand, the Philippines, and Singapore.

These countries' varied characteristics with respect to social security systems and economy allow us to generate a range of outcomes. On average, these countries are smaller than most of the U.S.' current totalization partners.

We study the potential effect to SSA's revenues if the U.S. were to eliminate dual taxation with all these countries. We estimate the maximum lost revenues at $114.3 million a year. This is a nonbinding upper bound for two reasons: First, this estimate assumes that all (recent) temporary workers from those countries currently in the U.S. would qualify for Certificates of Coverage under a new agreement. Second, we do not have enough information about American expats to estimate the potential gain to SSA from the likely small set of Americans permanently abroad who would qualify to stop contributing to SSA and would not be eligible to receive benefits from SSA in the future. Therefore, the likely loss of SSA revenues would be significantly lower.

We extend a theoretical model of FDI to incorporate social security international agreements with several countries. We model limited totalization agreements that only eliminate double taxation, therefore reducing the cost of international relocation of managerial power and multinational production. We use the model to forecast the effects of a more flexible hypothetical totalization program.

For relocation of multinational production, we see, as expected, mixed effects from this kind of agreement, depending on the characteristics of the partner country. In several cases, we do not find that this kind of agreement would affect the flows of FDI between the U.S. and the partner countries. This is mostly in cases where the partner country is receiving very little FDI in the status quo, or in cases where such an agreement would not affect the relocation costs by much due to them being already low. In a few cases, we find that there would be a small effect of some relocation of American subsidiaries to partner countries. Only in one case, Israel, the characteristics of the economy combined with the change in relocation costs derived from the agreement, would imply that U.S. FDI flows increase to that destination.

Note that the type of limited agreement studied in this report does not address the issue of portability of social security benefits, which may be important for some migrant workers. ❖

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