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Christopher Newfield
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Apple's Attack on the Knowledge Economy

The *New York Times* has just published the latest in Charles Duhigg's important series of pieces on Apple and the iEconomy (see also "How the U.S. Lost Out on iPhone Work" and "The iEconomy," written with various coauthors).
This third article is about Apple's global effort at maximum tax avoidance. The story is mainly about what is, in effect, one rich company's effort to contribute as little as possible to public coffers, but it shows how Apple's way of looking at society is creating a Bizarro world that steadily undermines its own ability to innovate.

The most important relationship in the story is between Apple and its neighboring community college, De Anza College.

> A mile and a half from Apple's Cupertino headquarters is De Anza College, a community college that Steve Wozniak, one of Apple's founders, attended from 1969 to 1974. Because of California's state budget crisis, De Anza has cut more than a thousand courses and 8 percent of its faculty since 2008.
> Now, De Anza faces a budget gap so large that it is confronting a "death spiral," the school's president, Brian Murphy, wrote to the faculty in January. Apple, of course, is not responsible for the state's financial shortfall, which has numerous causes. But the company's tax policies are seen by officials like Mr. Murphy as symptomatic of why the crisis exists.
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> "I just don't understand it," he said in an interview. "I'll bet every person at Apple has a connection to De Anza. Their kids swim in our pool. Their cousins take classes here. They drive past it every day, for Pete's sake.
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> "But then they do everything they can to pay as few taxes as possible."

Community colleges are finally being recognized as so central to the knowledge economy that Barack Obama wants to send them an additional $8 billion for strategic training, while some analysts call for 20 times that amount. This is because the U.S. higher ed system is great for the upper 5 percent and either nonexistent or crumbling for the bottom half to two-thirds of the population. Cuts to places like De Anza destroy mass access to a knowledge economy that is led by Apple. Corporate tax avoidance has for decades been a major mechanism of crumbling the social bridging performed by higher ed. Although corporations complain endlessly about the bad business climate of states such as California, state corporate taxes as a share of Gross State Product are half of what they were 25 years ago -- a miserable 0.28 percent of nationwide GSP. Apple has become one of the most profitable companies in history, and has the largest market capitalization in the world. Today it is worth not much less than General Electric (another champion tax avoider), Walmart, and Google combined (ranked Nos. 9 to 11). While Walmart paid about 24 percent of profits in taxes, Apple paid less than 10 percent, in large part by moving profits from where they were earned to low- or no-tax jurisdictions, whether that be from France to Luxembourg in Europe or from California to Nevada in the United States.

Apple pays a higher rate than some companies (see appendices). Yet Apple and other iEconomy leaders have trapped us on a Bizarro world where De Anza College fires around 60 instructors (guesstimating the equivalent of 8 percent from here) while Apple's CEO Tim Cook earns $376 million in stock grants, or enough to pay around 7,000 De Anza math instructors (who average $54,000 per year). Put another way, CEO Tim Cook's stock grants would take a De Anza instructor 7,000 years to earn, yet we can't afford 60/7,000 of the Apple CEO's stock grants to prepare people to work at companies like Apple. This system underwrites a Bizarro capitalism whose leaders decline to maintain the conditions required for the reproduction of their own labor force.

Why is this happening? Most literally it is happening because state corporate taxes are caught in a race to the bottom in which developed states are being carved up by underdeveloped states elsewhere in the country. Thus federal policy forces a state like California, where generations of citizens paid taxes to build a high-quality public support structure for creating its "human capital," to compete with a state like Nevada, which has no knowledge economy and no corporate income tax.

The federal government is in effect running an anti-innovation policy: the least innovative states, those that have historically made the lowest investments in their people and physical plant, get more in the way of new business than their long history of non-investment deserves. The race to the bottom in tax policy has favored low-wage states with weaker or non-existent rights to collective bargaining, low overall incomes (poorest 10 here), and more growth in manufacturing through relocation (see this Cato Institute analysis for the standard argument).

The race to the bottom of tax rates doesn't signal an innovation economy, but a predator economy, where low-rent states run by enemies of public sector development steal jobs from places that have invested in their citizens taxes for decades -- California, New York, and others being classic examples. Red states that vote against government receive more in federal government dollars than they send in taxes. Not only do more industrialized blue states subsidize their underdeveloped red neighbors with taxes: they also send their jobs to red states with tax giveaways and other free public stuff that blue states gave to them via the aforementioned tax transfers.

This means that here in America we have a tax system in which innovation states subsidize anti-innovation states, helping to deprive themselves of the tax base that made them innovation states in the first place.

So why do we put up with this? Part of the answer is that red state conservatives control federal policy even when they are in the minority in Congress. But the inability of modern American conservatism to acknowledge any connection between public investment and wealth creation is enabled by the intellectual weakness of American liberalism.

An example of the latter is Jared Bernstein's post on the Apple tax avoidance article. Bernstein was Vice-President Joseph Biden's chief economist, and here makes the Democrats' standard argument in favor of tilling the public infrastructure soil in which we will be growing our future Apple trees. He makes sensible suggestions about passing a minimum tax on foreign profits of U.S. companies and in general ending "the loopholes that make it cheaper to invest" abroad than in the U.S.
At the same time, Bernstein goes out of his way to say Apple is doing nothing wrong: "They need to compete and to avoid providing their competitors with any advantages," so they minimize their tax burden just like the other guy.

Bernstein's error is to separate Apple's exploitation of the tax system from Apple's creation of that tax system. Apple in fact helped create this begger-thy-neighbor tax system through lobbying and other interventions in the political process at every level. Apple and its competitors created this low-tax system for themselves, it works for them, and they have no economic reason to give it up. They won't voluntarily support Bernstein's tax reforms, meaning that these reforms will never happen without concerned anti-Apple pressure to get Apple to do what Apple would not do on its own.

Bernstein admits as much by calling on Apple to "be a better corporate citizen" and shower "schools in its backyard" with what in effect would be some charity money. Unfortunately, this won't work either: the knowledge economy was created by mass access to high-quality education, not by rehiring a few fired professors with a little trickle-down largesse.

The larger problem is that Silicon Valley businesses have more ideological and cultural influence than any sector on earth. Yet they won't actively support even minor rebuilding of public higher ed, much less the mass access that created the post-war middle class. As De Anza College's president put it,

> "When it comes time for all these companies -- Google and Apple and Facebook and the rest -- to pay their fair share, there's a knee-jerk resistance. They're philosophically antitax, and it's decimating the state."

The U.S. economy will go nowhere if we can't get past Silicon Valley ideology. We are used to equating Apple with the knowledge economy. We also need to see Apple as the knowledge economy's enemy. Until we do, we won't be able to reverse the erosion of that economy or of its middle class that, thanks to Silicon Valley's backward economic thinking, is already well underway.