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Kerry's solution to offshoring
Democrat seeks to curb tax breaks for firms that set up abroad

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Democratic presidential candidate John Kerry has come up with what he bills as a logical approach to curbing the movement of American jobs overseas -- roll back tax breaks for companies that locate abroad.

The proposal, unveiled Friday during a major economic policy address in Detroit, is the centerpiece of Kerry's response to the volatile issue of global outsourcing, in which U.S companies are setting up an ever-wider range of operations in such countries as China and India.

Experts say the Massachusetts senator is right in pointing out that the U. S. tax code encourages companies to locate overseas. While companies must pay taxes immediately on their U.S. earnings, income they get from foreign operations is tax exempt until they bring the money back home.

The problem, though, is that a move to make companies pay taxes on their foreign earnings, however advisable it may be, will do little to stem the loss of American jobs.

Simply put, American companies aren't building facilities in the developing world to save taxes. They're doing it to get lower wages. Indian computer programmers, for example, earn just 20 to 25 percent of what their American counterparts take in. Higher taxes wouldn't come close to offsetting the huge draw of cheap labor.

"We should fix the tax code, but it's not going to solve all the problems, " said Ron Hira, professor of public policy at Rochester Institute of Technology. "What's really driving this is the cost differential."

In his Detroit speech, in which he vowed to create 10 million jobs in four years, Kerry spelled out a series of steps to change the corporate tax system.

U.S. companies that produce goods or services overseas for sale in the U. S. market would have to pay the same income taxes as companies that operate inside the United States. But companies that operate international facilities to serve foreign markets would still be allowed to defer taxes until they brought profits back here.

To offset the loss of tax deferrals on foreign operations, Kerry would trim the tax rate on corporate profit from 35 percent to 33.25 percent. He would also allow a one-year tax holiday in which companies could pay a 10 percent tax rate if they reinvested their foreign profit in the United States.

Reaction to the plan divides along familiar partisan and ideological lines. Liberals point out that the taxes corporations actually pay have been dropping for decades, thanks to increased use of sophisticated, and sometimes abusive, tax shelters. They also say the plan would eliminate distortions in the tax code that reward firms for creating jobs overseas.

"He's trying to put on a more even footing the income earned abroad and income earned domestically," said Alan Auerbach, director of UC Berkeley's Burch Center for Tax Policy and Public Finance.

Conservatives and globalization boosters say Kerry is setting up barriers that will retard economic growth and raise prices for American consumers.

"The Kerry plan is a step toward isolationism and protectionism that will lead inevitably to a lower standard of living in the United States," said Margo Thorning, chief economist at the American Council for Capital Formation, a business-backed public policy group.

Conservative critics also warn that U.S. companies will be put at a disadvantage to foreign competitors if they can no longer defer U.S. taxes. Many developed countries use what's called a territorial tax system, in which they assess only profit that is earned within their borders.

For their part, business groups would welcome the reduction in the overall corporate tax rate, but criticize plans to end the deferral of taxes on foreign profit.

"What he gives on the one hand with corporate rate reductions, he may more than take away with the end of foreign deferral," said National Association of Manufacturers executive vice president Michael Baroody.

The fact is, though, that most companies will feel very little effect. Baroody notes that 90 percent of overseas manufacturing output by U.S. firms is sold in foreign markets and would still be exempt from U.S. taxes under the Kerry plan.

Meanwhile, many corporations aren't fretting.

Intel does most of its manufacturing in the United States, but 70 percent of its sales are made in other countries. "Our preliminary analysis is that it's hard to see a negative impact," spokesman Chuck Mulloy said.

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