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Protectionism Compromises America's Homeland Security

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It was bound to happen. Opponents of outsourcing and corporate inversion have dragged the issue of homeland security into their protectionist arguments. Immediately after the Department of Homeland Security (DHS) awarded a contract to Accenture LLP (the U.S. subsidiary of the Bermuda-chartered company, Accenture) to implement DHS's new U.S. Visitor and Immigrant Status Indicator Technology (US-VISIT), CNN's *Exporting America* ran a segment about outsourcing America's security.¹ In recent months, *Exporting America* has tried to tap into the public's fear of job losses by highlighting anecdotal stories while ignoring official statistics that show that fears about job loss are wildly overblown. Apparently, *Exporting America* has now incorporated homeland security concerns into its argument, claiming that outsourcing homeland security contracts poses a threat to America. The facts simply do not bear out these concerns.

Applying protectionist policies to homeland security would only work to compromise America's security. DHS's goal when awarding contracts should be to obtain the best security for the dollars invested. To ensure that America gets both good value and good security, Congress and the Bush Administration should:

- Remove all language from the Homeland Security Act and appropriations bills that restricts DHS's ability to award contracts to the company that is best equipped for the job.
- Insist that DHS establish and require companies

Talking Points

- Applying protectionist policies to homeland security would stifle innovation and increase costs.
- Policies that encourage free trade, free labor, and free capital are not only necessary for economic growth, but crucial to America's national security because they ensure that the U.S. has the best technologies and systems available for homeland security.
- Congress should fix America's anti-competitive corporate tax system rather than discriminate against companies based in jurisdictions with better tax laws.
- Congress should grant DHS the power to award contracts to the company that is best equipped for the job.
- It is essential that DHS perform "due diligence," ensuring that services are being provided under conditions consistent with the rule of law and good management and security practices.

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to follow strict security practices in order to receive contracts.

- Direct DHS to establish a program comparable to the National Industrial Security Program (NISP), through which inspectors would examine contractor facilities to verify that all security requirements are met.
- Refrain from implementing protectionist policies that would limit DHS access to superior service and technology (and that might invite protectionist reprisals against the United States).

An Overstated Argument

Some critics do not even understand their own arguments. The Accenture controversy, for instance, has nothing to do with outsourcing—which occurs when a U.S. company subcontracts some element of its operations to a foreign entity. Instead, it is a fight about whether a company with a foreign “parent” should bid for U.S. government contracts, especially if the parent company re-chartered in a jurisdiction with better tax laws. However, even by this criterion, opponents of the Accenture contract are inaccurate because Accenture was never a U.S. company. Rather, it is a related set of partnerships in various nations that chose Bermuda as a home base for purposes of incorporation.

In any event, complaints about outsourcing the US-VISIT contract are completely misdirected. They demonstrate how eager some are to link homeland security to the debate against outsourcing. Under the DHS contract, Accenture LLP will implement US-VISIT—a program that uses biometric identifiers, such as fingerprints and photographs, to make security determinations about individuals entering or exiting the United States. Accenture, the parent company, is a global management consulting and technology services company

that is chartered in Bermuda. However, Accenture LLP—based in the U.S.—will do all of the contract work, and the dollars and tax revenue generated by the project will remain in the United States. Moreover, Accenture LLP met all of DHS’s legal requirements for the US-VISIT bid and was awarded the contract based on its ability to do the job.

The Benefits of Outsourcing

Even though the Accenture debate is not really about outsourcing, it is important to realize that the ability to contract outside national borders benefits the American economy and national security. Outsourcing opponents routinely focus on only one side of the issue, while ignoring the gains in lower prices, higher efficiency, and insourced jobs.

More Americans are employed today than ever before—a record high of 139 million workers, as reported by the Bureau of Labor Statistics. The unemployment rate has been dropping for one year and is steady at a low 5.6 percent—all the more impressive because the American workforce has grown by 2.84 million people since late 2001.² This robust performance—particularly when compared to the economic stagnation and high unemployment rate in Europe—can be attributed to U.S. reliance on the free market to allocate resources.

This market flexibility and dynamism does mean that some jobs are lost, but those job losses tend to be small compared to the number of jobs that are created. The only official study on the impact of off-shoring jobs, released by the Department of Labor on June 10, found that only 4,633 job losses were associated with overseas relocations in the first quarter of 2004.³ That represents only 2 percent of total layoffs in America.

Aside from debunking inflated fears about the export of American jobs, it is necessary to recog-

1. “Bermuda Based Accenture Wins Department of Homeland Security Contract,” CNN *Lou Dobbs Tonight*, June 1, 2004, at cnnstudentnews.cnn.com/TRANSCRIPTS/0406/01/ldt.00.html (July 2, 2004).
2. U.S. Department of Labor, Bureau of Labor Statistics, “The Employment Situation, June 2004,” USDL 04–1170, July 2, 2004, at www.bls.gov/news.release/empst.nr0.htm (July 2, 2004).
3. U.S. Department of Labor, Bureau of Labor Statistics, “Extended Mass Layoffs Associated with Domestic and Overseas Relocations, First Quarter 2004,” June 10, 2004, at bls.gov/news.release/reloc.nr0.htm (June 29, 2004).

nize the many benefits of outsourcing. Outsourcing is a two-way street. There are currently 6.4 million jobs in the U.S. in which the employer is a foreign company. These “insourced” jobs are growing at a faster rate than jobs in general are being lost. According to the Organization for International Investment, “Over the last 15 years, manufacturing ‘insourced’ jobs grew by 82%—at an annual rate of 5.5%; and manufacturing ‘outsourced’ jobs grew by 23 percent—at an annual rate of 1.5%.”⁴

Furthermore, outsourcing is a means of increasing output while reducing input costs. This leads to lower consumer prices, higher living standards, and more jobs in a growing economy. Outsourcing also lets competition run its course and encourages companies to become more efficient. In the end, having a pool of highly competitive and efficient companies bidding for homeland security contracts will only further the quality of America’s security.

Policies that punish businesses that outsource jobs are protectionist and isolationist—and such policies have a long history of failure. They also erode U.S. competitiveness. Policies that encourage free trade, free labor, and free capital are not only necessary for economic growth, but are crucial to America’s national security because they ensure that the U.S. will have access to the best technologies and systems for homeland security.

Corporate Expatriation: Blame the Tax Code, Not Companies

Much of the protectionist sentiment in the Accenture debate is not really about outsourcing, but is targeted at companies that choose to incorporate outside the United States. Many companies—including Tyco, Ingersoll–Rand, Cooper Industries, McDermott International, Nabors Industries, the Noble Corporation, and Foster–

Wheeler—have dissolved their U.S. charters and reincorporated in low-tax jurisdictions that have territorial tax regimes. (This business practice is also known as inversion or expatriation.) Other companies, such as Accenture, chose low-tax jurisdictions when they first incorporated. On a similar note, a vice president of Intel remarked that, if Intel could start over, it would organize as a foreign company.⁵

The United States’ high corporate tax rate and “worldwide taxation” policy simply make it difficult for corporations chartered in the United States to compete overseas. The federal government imposes a 35 percent tax on corporate income⁶ and states take another 5 percent (on average). This cumulative 40 percent tax rate is significantly higher than the 29.96 percent average corporate tax burden in OECD (Organization for Economic Co-operation and Development) countries.⁷ Indeed, the tax burden on U.S.-based corporations is currently the second highest in the industrialized world.⁸ Additionally, U.S.-chartered firms must pay tax to the Internal Revenue Service on income earned in other countries, in addition to the local corporate tax. This “worldwide taxation” policy puts American-based companies at a disadvantage because most U.S. trading partners rely on “territorial taxation”—the commonsense notion that governments tax only income earned inside their borders.

The combination of these misguided policies is undermining U.S. competitiveness—as, for instance, when a U.S. company competes against a Dutch company in Ireland. Because Holland has a territorial tax system, the Dutch company pays only the 12.5 percent Irish corporate income tax on its Irish income.⁹ The American company, though, must pay the 12.5 percent Irish tax and the 35 percent U.S. corporate income tax.

4. Organization for International Investment, “The Facts About Insourcing,” at www.ofii.org/insourcing (April 27, 2004).

5. Robert Perlman, “U.S. International Tax Reform,” testimony before the Committee on Finance, U.S. Senate, March 11, 1999, at finance.senate.gov/3-11perl.htm (June 6, 2004).

6. KPMG, “Corporate Tax Rates Survey,” January 2004, at www.kpmg.com/Rut2000_prod/Documents/9/2004ctrs.pdf (June 29, 2004), p. 17.

7. *Ibid.*, p. 1.

8. Japan has the highest corporate tax burden. *Ibid.*, p. 3.

Companies like Accenture still have U.S. operations, and their U.S. subsidiaries pay tax to the IRS on all U.S. income. This certainly will be the case with Accenture's Illinois-based U.S. subsidiary. However, because the parent company is based in a jurisdiction with better tax laws, it avoids paying the punitive U.S. corporate tax rate on non-U.S. income. This is simply a smart business decision, which protects the interests of both workers and shareholders. In no way does this practice of having parent companies based in low-tax jurisdictions threaten America's homeland security.

Getting Homeland Security Right

Applying protectionist policies to homeland security would stifle innovation and increase costs—working against the DHS goal of getting the best security for the dollars invested. Where the contract is fulfilled—whether in Boston, Britain, or Bermuda—does not necessarily add to or detract from the end goal of protecting America. More important are the safeguards in the contract. The Department of Homeland Security should ensure that its contracts outline stringent security and data protection requirements. It is imperative that DHS award contracts to companies that both meet those security standards *and* possess the expertise to complete the projects. In general, DHS should insist that contract work is conducted in countries that have a cooperative relationship with the United States across a broad spectrum of security initiatives, including:

- Harmonization of security requirements and acquisition processes;
- Security of supply;
- Export procedures;
- Security of information;
- Ownership and corporate governance;

- Research and development;
- Flow of technical information; and
- Security trade.¹⁰

The federal government also has the responsibility to perform “due diligence,” ensuring that services are being provided under conditions consistent with the rule of law and good management and security practices. These criteria, rather than geographic location, are the best guarantor of getting good value and good security.

Improving homeland security is a vital national priority. Better security should not be sacrificed in the name of an emotional debate about outsourcing. Congress and the Administration ought to take a firm stand on this issue. Specifically:

- **Congress should remove Section 835—“Prohibition on Contracts with Corporate Expatriates”—from the Homeland Security Act.**¹¹ As it stands, §835(a) states that “The Secretary may not enter into any contract with a foreign incorporated entity which is treated as an inverted domestic corporation.” Subsection (d) of §835 entitled “Waivers,” however, gives the Secretary of Homeland Security the right to waive Subsection (a) in the interest of homeland security, to prevent the loss of any jobs in the U.S., or to prevent the government from incurring any additional costs. This substantially limits the prohibitions set by §835. To clarify matters and to ensure maximum flexibility for the DHS Secretary, Congress should remove §835 and grant the DHS the power to award contracts to the company that is best equipped for the job.
- **Congress should remove language in the DHS budget that would restrict the Department's ability to award contracts to corporate expatriates.** The House of Representatives

9. Marc A. Miles, Edwin J. Feulner, and Mary Anastasia O'Grady, *2004 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2004), p. 231, at www.heritage.org/research/features/index/downloads.html (July 1, 2004).

10. These principles are similar to those laid out in the declaration of principles that Senator John McCain (R-AZ) included in his amendment (S. Amdt. 3461) to the National Defense Authorization Act for Fiscal Year 2005 (S. 2400).

11. *Homeland Security Act of 2002*, Public Law 107–296.

recently voted 224–205 on a procedural motion designed to remove such restrictions from the appropriations bill. The Senate should take similar action.

- **DHS should continue to require that companies meet strict standards of security practices in order to receive contracts.** It is crucial that DHS demand that companies uphold stringent security standards when dealing with sensitive and confidential information—specifically by maintaining sufficient physical security; having a data protection system in place; and being able to audit and trace access to information and systems. Without these standards, any contract award—whether to a U.S. or foreign-based company—could compromise homeland security.
- **DHS should establish a program comparable to the National Industrial Security Program.** Through the NISP and approximately 240 Industrial Security Representatives, the Defense Security Service oversees, advises, and assists over 11,000 contractor facilities that are cleared for access to classified information.¹² Similarly, the Division of Field Investigations in the U.S. Food and Drug Administration’s Office of Regulatory Affairs sends out an International Inspection Cadre to inspect foreign firms that export to the United States.¹³ DHS needs to assemble a similar team to perform due diligence tasks on all contracts and to ensure that contract provisions are strictly followed.

- **The Administration and Congress should refrain from implementing protectionist policies that would limit DHS access to superior service and technology and that might invite protectionist reprisals against the United States.** Instituting tariffs, punishing businesses that outsource, or changing tax rules could have devastating effects on efforts to secure America’s homeland. Such barriers could also provoke retaliation in the World Trade Organization and negatively affect the flow of insourced jobs.

Conclusion

The homeland security “argument” against outsourcing and corporate inversion is a red herring. Instead of implementing protectionist measures that would harm the economy and impair national security, Congress and the Administration should use the market to improve and develop DHS’s capabilities, while maintaining strict security practices in all DHS contracts.

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12. Defense Security Service, “An Overview of the National Industrial Security Program,” revised April 2001, at www.dss.mil/isec/nispbrochure.pdf (June 28, 2004).

13. U.S. Food and Drug Administration, Office of Regulatory Affairs, “ORA Field Management Directive No. 13A: Foreign Inspection Program,” revised October 2002, at www.fda.gov/ora/inspect_ref/fmd/fmd13a.htm (June 30, 2004).