WebMemo

Published by The Heritage Foundation

No. 3464
January 18, 2012

Obama's "Insourcing" Agenda: Punishing Job Creators for Competing Overseas

Curtis S. Dubay

Last week, President Obama said he would soon propose a set of policies that would eliminate tax breaks for businesses that move jobs overseas and reward businesses that bring jobs to the U.S. as part of his new "insourcing" agenda.

If the President proposes more of the same anti-growth policies he has had in past budgets, Congress should also do what it has done in the past: ignore them and then focus on true growth-promoting policies under the simple, common-sense rubric of "do less harm," starting with a fundamental reform of the tax code—especially the corporate income tax system.

Drives More Jobs Overseas. President Obama was vague regarding his actual policy proposals. For instance, he said that "in the next few weeks, I will put forward new tax proposals that reward companies that choose to do the right thing by bringing jobs home and investing in America—and eliminate tax breaks for companies that move jobs overseas." But despite this vagueness, it is possible to anticipate the thrust of intentions given his past proposals regarding the tax treatment of U.S. businesses operating internationally.

In his budget submitted to Congress last year, the President suggested a series of ill-advised policies, including limiting interest deductions, reducing the foreign tax credit, and other tax increases on businesses that operate internationally. These policies are designed to keep jobs in the U.S., but they would have the opposite effect in reality.

U.S. corporations operating internationally are at a sizeable disadvantage compared to their foreign competition, because the U.S. corporate tax rate is the second highest in the industrialized world and will be the highest when Japan reduces its rate on April 1 this year.

Further, the U.S. is one of only a handful of countries that taxes its businesses on the income they earn on their sales in foreign markets—a so-called worldwide system. In an attempt to mitigate the damage of this worldwide system, the tax code levies tax only when foreign subsidiaries bring their foreign income back to the U.S.

Rather than fix these well-known problems with the corporate tax system, President Obama's announced policies would force U.S. businesses to pay tax on their foreign income when they earn it rather than when they return the money to the U.S. That way, these businesses are subject to the high-

This paper, in its entirety, can be found at:
http://report.heritage.org/wm3464

Produced by the Thomas A. Roe Institute for Economic Policy Studies

Published by The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002–4999
(202) 546-4400 • heritage.org

Nothing written here is to be construed as necessarily reflecting the views of The Heritage Foundation or as an attempt to aid or hinder the passage of any bill before Congress.

The Heritage Foundation
LEADERSHIP FOR AMERICA

est-in-the-world U.S. corporate tax rate before they would be under the current deferral system.

The wrongheaded thinking that led to this proposal holds that as long as businesses pay the U.S. tax rate on all their income, foreign and domestic, they have less reason to locate jobs overseas. However, this is just another form of protectionism, because it purports to protect U.S. jobs from the foreign competition. And it would, in fact, imperil U.S. jobs, because U.S. companies operate synergistically between their domestic and foreign operations as they compete in international markets. Weakening their ability to operate abroad weakens these companies at home, too. It also means that to remain competitive, many U.S. companies would have to either move their headquarters overseas or be bought by foreign companies.

Misunderstanding of Global Economy. A U.S. business investing abroad is good for the U.S. economy, because it makes the company more competitive at home and abroad in selling products into foreign markets. When a U.S. company moves into a foreign market to meet this demand, it creates jobs not only in the new market but in the United States, as well.

The U.S. parent company must provide a host of services for the business in the new market—such as finance, accounting, legal, sales, customer service, marketing, human resources, information technology, management, employee training, public relations, government affairs, logistics, and procurement—which requires the U.S. parent to employ American workers. The American parent has the experience, expertise, and resources to provide these services, while foreign subsidiaries usually do not. It is in the interest of the American parent to provide these services to maintain its brand name, business process, and reputation with customers.

President Obama assumes that businesses expanding overseas are doing so at the cost of domestic jobs, when in fact expansion in foreign markets also means growth here at home.

Picking Winners and Losers. By punishing companies that seek opportunity abroad and rewarding those that happen to bring jobs back, President Obama assumes that those businesses doing the latter are better for the economy and are creating more jobs. But he cannot possibly know which businesses are better or which create more jobs.

The government can never know which businesses are better at creating jobs, because it does not have access to the broad range of information available to the diffuse network of individuals and businesses that comprise the free market. At *best*, when the government creates one job with its actions, whether through investment of taxpayer money or rigging the tax code, it destroys one job elsewhere in the economy by redirecting resources away from where the private market would have more efficiently allocated them.

In most cases, the government ends up destroying more than one job for every position it creates, because the policies it implements to create that one job are harmful to the economy. The President's policies regarding the tax treatment of U.S. businesses operating abroad are sure to fall into this more harmful category.

True Tax Reform Is the Answer. The President's call to tax more heavily U.S. businesses operating abroad conflicts with his stated position favoring corporate tax reform, and it would move in exactly the wrong direction. The U.S. needs to embrace competition and provide its champions with a tax code suitable to a global economy. While the President pursues this unwise policy, the U.S. continues to lose out on new investment—and the jobs that would follow—as expanding businesses, both U.S. and foreign, look to other developed countries, because the highest-in-the-world U.S. corporate tax rate makes those locales more appealing.

Congress should ignore the President's misguided protectionist policies and focus on reforming the entire tax code to make the U.S. as competitive as possible in the global marketplace. The goal of comprehensive tax reform should be to renew economic growth through lower marginal tax rates on individual and corporate income, eliminating taxes on saving and investment, and getting the tax code out of the business of picking winners and losers in the

market. Tax reform should pay particular attention to reducing the corporate tax rate significantly and switching to a system that taxes businesses only on the income they earn in the U.S.

*—**Curtis S. Dubay** is a Senior Analyst in Tax Policy in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.*