A FairTax^{SM} White Paper

International competitiveness of U.S. agricultural products and the FairTax

by Ross Korves

On May 17, 2006 President Bush signed the Tax Increase Prevention and Reconciliation Act of 2005 that extended lower tax rates for capital gains and dividends and increased personal exemptions for the Alternative Minimum Tax (AMT). The 79-page bill also contained over a hundred other changes to current tax law. One of those was the repeal of the FSC/ETI Binding Contract Relief that is the latest action in a 45-year dispute over the impact of U.S. tax policy on international trade.

This process started in 1960 with a General Agreement on Tariffs and Trade (the predecessor to the World Trade Organization) ruling that indirect taxes are adjustable at a nation's international borders, while direct taxes are not border adjustable. The value-added taxes used by countries in the EU are rebated on exports and imports are taxed, while U.S. income taxes are direct taxes and are not border adjustable. By one estimate EU companies now save as much as $100 billion a year in taxes on exported products.

In 1971 Congress provided help for U.S. businesses by allowing the creation of Domestic International Sales Corporations (DISCs) that could defer taxes on export earnings. The EU (then called the EC for European Community) challenged the DISC in 1974. A decision was deferred because tax disputes were part of the discussions in the Tokyo round of GATT negotiations of the late 1970s. Based on that agreement, in 1984 the U.S. repealed the DISC and replaced it with the Foreign Sales Corporation (FSC) that allowed U.S. companies to establish subsidiaries offshore to avoid U.S. taxes.

Life was good until 1999 when the EU challenged the FSC under the Uruguay Round Code on Subsidies & Countervailing Duties. In October of 1999 a WTO panel ruled that the FSC was a prohibited export subsidy. In December of 2000 Congress passed and President Clinton signed the Extraterritorial Income Exclusion Act (ETI) that excluded certain foreign source incomes from the definition of income.

The EU took another case to the WTO, arguing that the ETI also was not consistent with the WTO agreement. In August 2001 a dispute panel ruled that the ETI income exclusions were impermissible. In August of 2002 the WTO ruled that the EU could impose $4 billion of sanctions against U.S. products unless the law was changed. The American Jobs Creation Act of 2004 repealed the ETI and provided some transition rules for certain binding contracts. The EU went back to the WTO, and it ruled in early 2006 that the new rules were also prohibited export subsidies. This latest tax bill repealed the binding contract relief.

All these actions and counter actions would be humorous if the issues were not so serious. For many U.S. farmers and ranchers exports and imports of agricultural products are simply part of doing business. Over 95 percent of the consumers of food in the world live outside our borders. Most U.S. consumers have enough income to demand food from around the world based on individual preferences. For the current marketing year exports are expected to account for 74 percent of the total use of U.S. cotton, 48 percent for rice, 46 percent for wheat, 41 percent for soybeans and products, and 18 percent for corn.

For some agricultural products the U.S. is both a major exporter and importer. Pork exports for 2006 are projected to account for 12.7 percent of use, while imports account for 4.5 percent of supply on a weight basis. Beef exports are 3.1 percent (they were much higher before the BSE issues) of use and imports are 11.5 percent of supply on a weight basis. Fruit imports were $7.8 billion in 2005, and exports were $6.8 billion. For vegetables the numbers are $6.3 billion for imports and $3.9 billion for exports for 2005.

This agricultural trade has developed over the last 40 years with taxes impacting trade flows. All of the federal income, payroll, and estate taxes represent a gap (a large gap) between what farmers and ranchers receive on an after-tax basis for their capital, labor, and management and what purchasers in other countries must pay for the products produced by U.S. farmers and ranchers.

The FairTax

There is a tax policy that can relieve the tax burden on U.S. agricultural products moving into international trade, while meeting the WTO requirements for border adjustability of taxes and treating imported products the same as U.S. production. It is the FairTax, a progressive national retail sales tax. The FairTax is designed to replace current individual and corporate incomes taxes (including the alternative minimum tax), payroll taxes for Social Security and Medicare, and estate and gift taxes.

The FairTax sets itself apart from other tax reform proposals by its impact on international trade and investment. The existing tax code has made the U.S. a less attractive place to produce goods for export to the rest of the world and as a base of worldwide operations. The FairTax would make the U.S. one of the best places in the world for business investment and to serve as a home for multinational corporations. In a world of increasing competition, the FairTax would put the U.S. ahead of the pack.

Under the FairTax the production of goods and services is not taxed. The tax is paid only on consumption. Goods produced in the U.S. and exported to other countries are not taxed. Imported products are taxed at final consumption in the U.S.

About Ross Korves
Ross Korves is an independent economic policy analyst.

He is a Trade Policy Analyst with Truth About Trade and Technology, a group begun and run by farmers and ranchers who believe in increased international trade and the use of biotechnology, and an Economic Policy Analyst with the ProExporter Network, a transportation and grain processing analysis firm. He also provides analysis and advice on federal tax policy for farmers and ranchers and health care policy.

Ross spent 25 years as an economist for the American Farm Bureau Federation. He is a native of southern Illinois and a graduate of Southern Illinois University.

What is the FairTax Plan?
The FairTax Plan is a comprehensive proposal that replaces all federal income and payroll based taxes with an integrated approach including a progressive national retail sales tax, a prebate to ensure no American pays federal taxes on spending up to the poverty level, dollar-for-dollar federal revenue replacement, and, through companion legislation, the repeal of the 16th Amendment. This nonpartisan legislation (HR 25/S 1025) abolishes all federal personal and corporate income taxes, gift, estate, capital gains, alternative minimum, Social Security, Medicare, and self-employment taxes and replaces them with one simple, visible, federal retail sales tax – administered primarily by existing state sales tax authorities. The IRS is disbanded and defunded. The FairTax taxes us only on what we choose to spend on new goods or services, not on what we earn. The FairTax is a fair, efficient, transparent, and intelligent solution to the frustration and inequity of our current tax system.

What is Americans For Fair Taxation (FairTax.org)?
FairTax.org is a nonprofit, nonpartisan, grassroots organization solely dedicated to replacing the current tax system. The organization has hundreds of thousands of members and volunteers nationwide. Its plan supports sound economic research, education of citizens and community leaders, and grassroots mobilization efforts. For more information visit the Web page: www.FairTax.org or call 1-800-FAIRTAX.

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(AFFT Documents\Papers on a specific subject\International competitiveness of US agricultural products)