Progress has been 'significant' in euro zone, E.C.B. chief says

BERLIN

BY MELISSA EDDY AND JACK EWING

The president of the European Central Bank gave a guardedly upbeat assessment of the state of the euro zone on Thursday, saying that troubled countries had made "significant progress" remaking their economies and that the banking system was healthier.

"So, not bad," the president, Mario Draghi, said with an air of apparent satisfaction, at a news conference in Bled, near the Slovenian capital of Ljubljana, after a meeting of the bank's Governing Council.

But, perhaps wary of seeming too optimistic and encouraging complacency, Mr. Draghi added that matters remained tenuous. Early this year, Mr. Draghi had also called a turning point in the crisis only to see tension return with a vengeance later on.

"We also have to express a note of caution," he said. "Volatility is still relatively high. And governments will have to persevere on their reform action."

After a period of intense activity, the E.C.B. had not been expected to announce major new policy actions Thursday. And, as expected, the bank left its benchmark interest rate at a record low of 0.75 percent.

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WORLD NEWS

Church-state ties in Germany

Recent court rulings highlight the awkwardness of the close bond as the country becomes more secular. *PAGE 3*

A crackdown in Tehran

Merchants in Tehran reopened after a crackdown on currency speculators and unrest over the rial's decline. *PAGE 4*

KUNI TAKAHASHI FOR THE NEW YORK TIMES

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The future of Myanmar As the military relaxes its grip, citizens are starting to debate issues of national identity, including the name of the country itself.

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No. 40,301

A global cash shuffle to avoid U.S. taxes

Window on Wall Street

VICTOR FLEISCHER

More than a trillion dollars in cash and short-term investments sits in offshore holding companies, awaiting a repatriation tax holiday in the United States. In the meantime, tax professionals spin out ways to manipulate the system.

The U.S. tax code provides multinational corporations based in the United States with many incentives to shift income to foreign low-tax jurisdictions. In theory, American corporations are taxed at 35 percent on their worldwide income. But income earned by an actively controlled foreign corporation is not usually taxed until the cash is repatriated to the parent company in the United States as a dividend.

From a policy perspective, the problem is not so much that taxes on foreign income are deferred, but rather that U.S. income is being disguised as foreign income.

Many multinational corporations use transfer pricing (the pricing of goods and services sold between affiliates of a parent company) to minimize their global tax rates. After transferring intellectual property to low-tax jurisdictions like Ireland, Puerto Rico or Singapore, companies manipulate licensing and cost-sharing arrangements to avoid or reduce their U.S. taxes. Cash from global operations is then parked outside the United States until the tax professionals can figure out how to get it home tax-free.

Microsoft, for example, holds about $50 billion in cash, cash equivalents and short-term investments outside the United States. Apple holds about $100 billion in foreign cash and investments — an amount about equivalent to the gross domestic product of Vietnam.

Accounting rules make the situation worse. Based on a presumption that the earnings of a foreign subsidiary will eventually be distributed to the American parent company, the promise of a future 35 percent tax on repatriated income often creates a deferred tax liability on the consolidated balance sheet. There is an exception, however, for "permanently reinvested earnings" — that is, earnings the parent company does not need and is indefinitely or permanently reinvesting overseas. If a company can convince its accountants that the cash will be reinvested overseas and is not needed at home, the company can avoid recognizing a tax liability on its balance sheet.

Congress is largely to blame. In 2004, the United States temporarily reduced the tax rate on repatriations to about 5 percent. The problem was not just the lost revenue or the false promise of a flood of new domestic investment. The tax holiday also raised expectations for future tax holidays, and companies have changed their behavior accordingly by hoarding cash offshore.

Many companies now find themselves holding a particularly awkward pose — simultaneously drawing on cash for stock buybacks, acquisitions and working capital needs while maintaining the false financial-reporting premise that the cash is indefinitely reinvested overseas.

A recent hearing by the Senate Permanent Subcommittee on Investigations highlighted one technique. According to the subcommittee report, Hewlett-Packard used a loan program employing overseas cash to effectively repatriate billions of dollars each year to finance most of its American operations without paying the repatriation tax.

Hewlett-Packard used alternating loans from two offshore entities, one in Belgium and another in the Cayman Islands, during 45-day windows to meet, technically, an exception for "short-term" loans. The subcommittee report explains that a pattern of "continuous lending appeared to be occurring for most of the period between 2008 through 2011."

The legality of such a loan program is questionable.

No one will be surprised when, after a new tax holiday, companies bring back "permanently" reinvested cash to conduct stock buybacks.

Hoarding cash in tax havens is evidence of the implicit cost of international tax deferral, as companies engage in wasteful tax planning techniques and fail to allocate economic resources in an efficient manner.

The tax system that creates these incentives is in need of attention. A territorial tax system with better policing of transfer pricing is one option. A worldwide consolidation system without tax deferral is a better one. And a lower corporate tax rate would help.

Until then, we can expect further scrutiny of tax professionals struggling to navigate a system that begs for gamesmanship.

Victor Fleischer is a professor at the University of Colorado Law School, where he teaches partnership tax, tax policy and deals.

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E.C.B. chief cites progress in euro zone

RATES, FROM PAGE 1

Instead, the focus has shifted to Europe's elected leaders, and particularly whether Spain will meet conditions under the terms of an agreement for aid that the E.C.B. has stipulated are necessary for it to start buying its bonds as a way of restarting bank lending in the country.

Finance ministers of the 17 euro zone countries will meet next week, creating an opportunity for Spain to apply for assistance, though many analysts expressed reservations that Madrid would move that quickly, as it is balking at conditions it would have to agree to in exchange for drawing from one of the euro zone's rescue funds. That is one of the steps required by the E.C.B. before it will buy bonds.

Spain's European partners are also conflicted over whether Madrid should apply for assistance. The Germans have been the most reluctant, with Finance Minister Wolfgang Schäuble insisting that Spain was taking the right steps and did not need a bailout. Media reports have also cited bailout fatigue among members of the German Parliament, which has to approve each application for aid.

Elsa Bartsch, the chief European economist with Morgan Stanley, said the E.C.B. seemed to be making clear that it had gone as far as it was prepared to go in restoring market confidence and that it was now up to the governments of Europe to push through restructuring efforts that are seen as necessary to restore the euro's stability in the long term. "The ball is now clearly in the courts of the governments," Ms. Bartsch said.

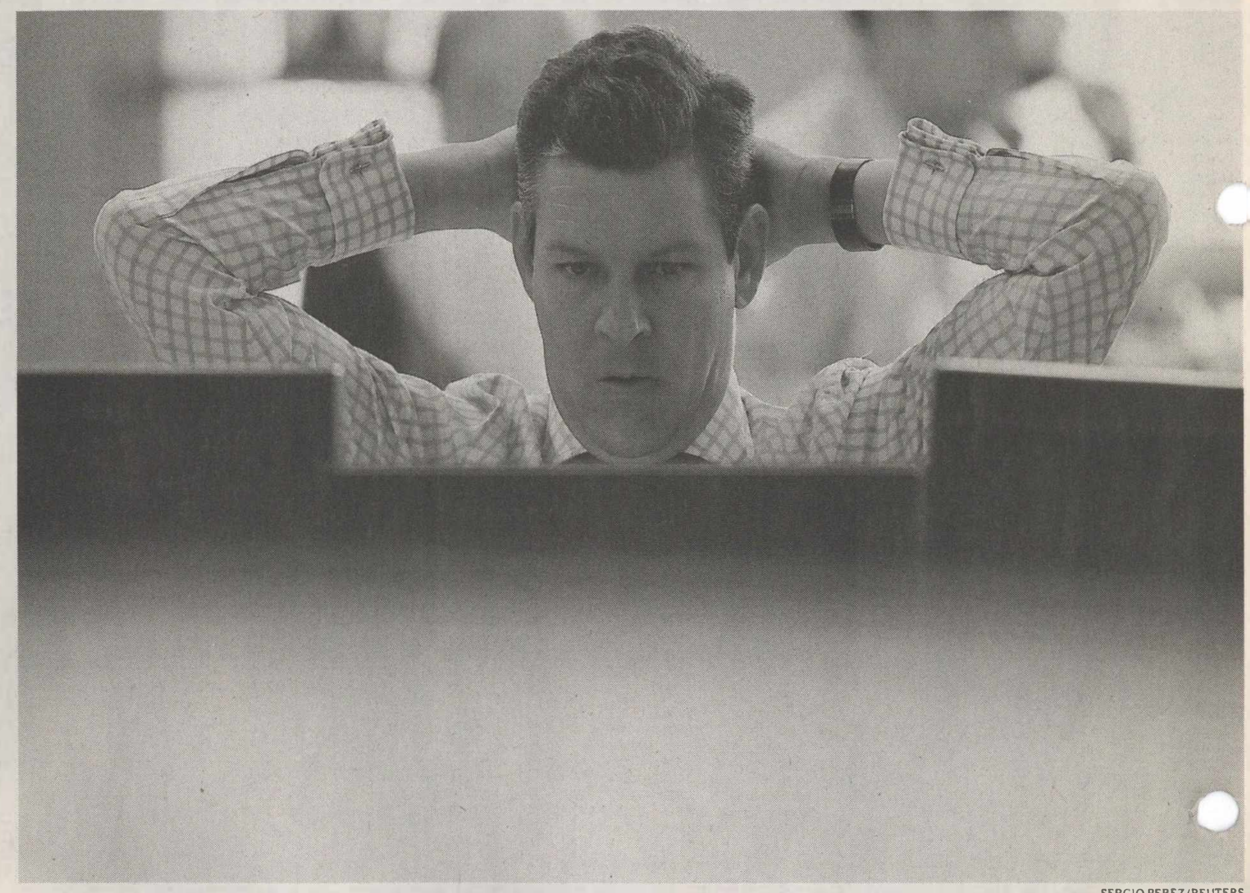
Mr. Draghi asserted that the introduction last month of the E.C.B.'s program to buy bonds had "helped to alleviate tensions" in the markets. Yields on short-term bonds have dropped considerably since the bank began taking a more activist stance. He added that the bond purchases, once they began, "will enable us to provide, under appropriate conditions, a fully effective backstop to avoid destructive scenarios with potentially severe challenges for price stability in the euro area."

Yet some experts feel that the E.C.B.'s assessment is overly optimistic and that it was too early to speak of a breakthrough: After all, until a country activates the bond-buying program, there is no proof that it will work as intended.

"We need to see whether governments can deliver on the program's conditions and whether the populations accept the change," Karen Ward, an economist with HSBC, wrote in a research note.

In his comments, Mr. Draghi repeated the need for governments to uphold their commitment to overhaul their economies and the structure of the euro zone for any improvement to be lasting.

He further warned that the E.C.B. would stop purchasing a country's bonds of a country to help lower its borrowing costs if the country failed to meet the agreed-upon conditions.



SERGIO PEREZ/REUTERS

A broker in Madrid watching a bond auction Thursday. Spain has been reluctant to ask for a bailout, possibly because of German pressure.

Last month, Mr. Draghi set out the terms for the central bank to begin buying euro zone government bonds. One of the conditions was that countries must first request help from the euro zone bailout fund, the European Stability Mechanism, which has now been ratified

Some experts say the E.C.B.'s assessment is overly optimistic and it is too early to speak of a breakthrough.

and is to take effect in the near future, or its predecessor, the European Financial Stability Facility.

That promise to intervene in bond markets, as well as Mr. Draghi's vow to do "whatever it takes" to preserve the euro, has calmed tension considerably. But interest rates for Spanish bonds have been creeping higher in recent weeks as Prime Minister Mariano Rajoy delays asking for relief, a move which would require him to accept restrictions on how he manages the economy.

On Thursday, the Spanish Treasury successfully auctioned €4 billion, or $5.2 billion, of debt, the maximum amount it had aimed to sell, paying lower interest rates than when it last sold such bonds. But analysts said it was too early to read too much into the positive result.

Nicholas Spiro, managing director of Spiro Sovereign Strategy, a research firm, wrote Thursday in a note that investors were "taking an overly optimistic view" of the potential effectiveness of the E.C.B. bond-buying program.

"Spain's debt market is currently in a state of limbo," he wrote. "It is being propped up by an E.C.B.-backed bond-buying scheme that has yet to be put into practice."

In his remarks Thursday, Mr. Draghi presented a somewhat rosier picture of the situation in the euro zone, saying that significant progress had been made in countries like Spain and Portugal. He also noted that weaker banks in the euro zone had bolstered their capital cushions.

"When I said there has been significant progress, I included the repairing of the banking system," Mr. Draghi said. "The capitalization gap that was pretty wide a couple of years ago has been significantly reduced."

Mr. Draghi ticked off a number of signs that the crisis had eased, including an increase of inflows of deposits to Italian banks and a rise in bond sales by banks and companies, which should help investment and lending. He also said that Spanish banks had become less dependent on lending from the E.C.B., a possible sign they were able to raise funds on markets.

Mr. Draghi also reiterated his view, which some euro countries have questioned, that the central bank's actions to shore up the euro fell squarely within its purview.

"Let me repeat again what I have said in past months," he said. "We are strictly within our mandate to provide price stability over the medium term, we act independently in determining monetary policy, and the euro is irreversible."

The euro rose against the dollar after Mr. Draghi's comments, reaching a two-week high of $1.2990.

From the E.C.B.'s point of view, there would have been little point in cutting further the main interest rate from 0.75 percent, and Mr. Draghi said there had been no discussion of a possible cut.

The E.C.B.'s rate decision came several hours after the Bank of England kept its main interest rate at a record low of 0.5 percent and opted not to take any immediate measures to stimulate growth.

The bank said it would take another month to complete the £375 billion, or $605 billion, program, and the scale of the program would be kept "under review."

Raphael Minder contributed reporting from Madrid, and Stephen Castle from Brussels.

India pushes to allow more foreign investment

NEW DELHI

BY HEATHER TIMMONS AND VIKAS BAJAJ

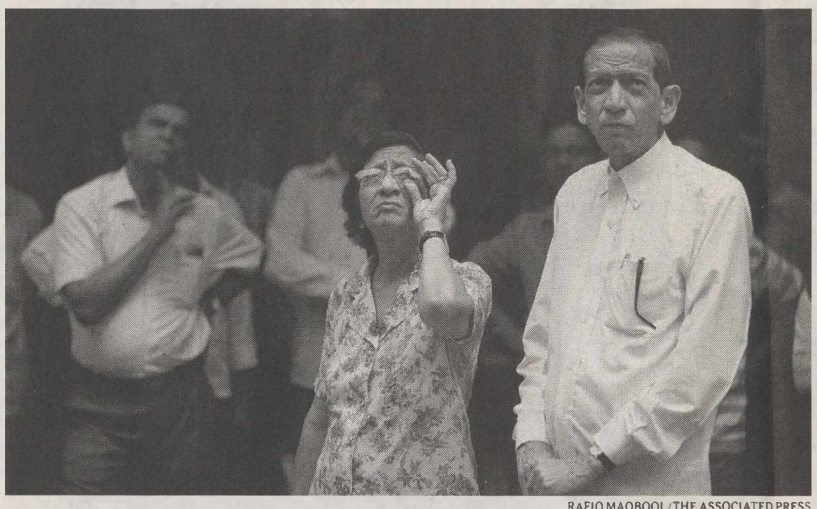
In its second major effort in two months to revive a flagging economy, Indian policy makers on Thursday proposed letting foreign investors take a bigger stake in insurance and pension companies.

The measures, which were approved by the cabinet, will now go to the Parliament, where their passage is far from certain. The national governing coalition led by the Indian National Congress party does not have a majority in the legislature, and opposition parties and even some of Congress's own allies have said they do not support greater foreign investment.

Still, anticipation of the changes sent India's benchmark stock index, the Sensex, up 1 percent to its highest close in more than a year. The index has rallied about 5 percent since the middle of September, when the government allowed greater foreign investment in retailing and aviation and reduced government energy subsidies.

Under the proposal approved by the cabinet, foreign companies would be allowed to acquire up to 49 percent in Indian insurance and pension firms, a change that both Indian and overseas companies have long lobbied for, saying that the sectors needed more capital to grow.

Currently, foreign companies are allowed to hold a 26 percent stake in insurance companies but are not allowed to invest in pension firms. India's insurance premiums total about $40 billion a year and its pension industry has assets of $300 billion.



RAFIQ MAQBOOL/THE ASSOCIATED PRESS

The Bombay Stock Exchange on Thursday, when the benchmark hit a 15-month high after the government said it wanted to further open insurance and pension firms to foreigners.

The changes are likely to meet stiff opposition in Parliament, which was paralyzed during its last session after the Bharatiya Janata Party, an opposition group, repeatedly interrupted proceedings to demand the resignation of the prime minister, Manmohan Singh, in connection with a scandal involving the allocation of coal concessions. The next session of Parliament begins in November.

Opposition officials, who were involved in drafting the proposals at an earlier stage of the lawmaking process, have said they will not support an increase in foreign investment to 49 percent. Some of the government's allies have also said they do not support the change.

"Legislation in democracy is a process of negotiation and discussion," Palaniappan Chidambaram, India's finance minister, said at a news conference. "Obviously, we need to talk. We will sit and talk to all parties, especially the principal opposition."

After eight years of relative inaction on economic policy, the Indian government moved into high gear last month, when Mr. Chidambaram became finance minister. The government introduced India's most serious economic overhauls in 20 years, including a plan to allow big foreign retailers like Wal-mart into the country. Those changes, which did not need to be passed in Parliament, prompted one prominent regional political ally of the government to pull out of the alliance in protest, leaving it without a majority in Parliament.

India's pension industry is expected to grow quickly as more people gain formal jobs, according to a report this summer from an Indian industry trade group. Analysts also see huge growth potential in the insurance industry: the ratio of premiums to gross domestic product is about 4 percent, a McKinsey study found, well below the ratios of 6 percent to 9 percent in developed economies.

The cabinet also approved changes to the rules governing corporate boards and financial reporting, and it expanded the jurisdiction of the country's new Competition Commission.

Vikas Bajaj reported from Mumbai. Hari Kumar contributed reporting from New Delhi.

World food prices rise on droughts in U.S. and Europe

WASHINGTON

BY RON NIXON

Global prices for meats, dairy products and cereals rose slightly last month, according to a report Thursday by the Food and Agriculture Agency of the United Nations, raising more concerns about possible food shortages in developing countries as major exporting countries like the United States have seen their agriculture production fall after a severe drought.

The U.N. agency said prices increased 1.4 percent in September after remaining steady in the two previous months. The increase was largely caused by scorching heat and drought in the United States, Russia and Europe, which has pushed up the price of corn and soybeans to record levels.

The largest price increases were for dairy products, which rose 7 percent, the sharpest increase since January 2011. World demand for milk products remains firm, the U.N. agency said, which, combined with increasing feed costs, is reducing the amount of available dairy products.

Meat prices were up 2.1 percent, which the food agency said was largely because of rising feed cost for the "grain-intensive" pork and poultry industries.

Cereal prices rose 1 percent since August. The organization forecast a decline in global cereal production this year.

The Food and Agriculture Organization's price index, which measures monthly price changes for a basket of cereals, oilseeds, dairy, meat and sugar, remains below the levels it reached in 2011, when high food prices led to unrest in the Middle East and North Africa, but it remains close to 2008 levels, when high food costs also set off riots in several countries.

After the release of the food agency's report, Oxfam, a nonprofit international aid group, called on governments to tackle the root causes of food price volatility.

The price index "shows that food prices remain at extremely high levels," an Oxfam spokesman, Colin Roche, said in a statement. "The fact they are relatively steady is no cause for celebration. Governments must ensure that these high prices do not tip more vulnerable people into hunger. We cannot afford to sleepwalk into the next food crisis."

Oxfam also released a report on Thursday stating that rising food prices had helped drive a global land rush that it said was undermining the rights and livelihoods of some of the poorest and most vulnerable people.

The report said that more than 60 percent of investments in agricultural land by foreign investors from 2000 to 2010 were in developing countries with serious hunger problems. However, two-thirds of those investors plan to export everything they produce on the land, the report said.

Silicon Valley bias dispute takes an unusual turn

SAN FRANCISCO

BY NICOLE PERLROTH

In a sexual discrimination lawsuit involving one of Silicon Valley's top venture capital firms and one of its investment partners, the two sides cannot agree on anything — including whether the partner has been fired.

Ellen Pao, a junior investment partner at Kleiner Perkins Caufield & Byers who is suing the firm for discrimination and retaliation, said late Tuesday that the firm had fired her. Kleiner Perkins rejected that claim and said Ms. Pao remained an employee.

It is the latest twist in a lawsuit that has gripped Silicon Valley since Ms. Pao filed her suit in May, claiming that she had been sexually harassed by another investment partner at the firm. When she complained to senior partners, her suit claims, they retaliated against her, cutting her out of investment decisions and profits and limiting her career advancement. Her suit claims that gender discrimination at Kleiner Perkins is rampant, with female partners routinely being passed over for promotions and a greater share of the firm's profits.

Kleiner Perkins has rejected all of Ms. Pao's claims. It has said that it chose not to promote her to senior partner because she was a poor performer, and that she did not complain about her treatment at the firm until shortly before filing suit. The firm has also said that nearly a quarter of its investment partners are women. That gender ratio is notable relative to other Silicon Valley venture firms, where full-time female investment partners are few.

As her discrimination suit winds its way through the courts, Ms. Pao has continued to work at Kleiner Perkins, which legal experts say is uncommon. Typically in work-related discrimination suits — especially cases with underlying sexual harassment claims — plaintiffs file suit after they have been fired or claim they were forced to quit because of a hostile work environment.

Ms. Pao wrote on Quora, a question-and-answer Web site, that previously she had no plans to leave the firm.

"I have been terminated from my job at KPCB," she wrote on the site. "On Monday afternoon, senior management told me to clean out my office, leave, and not come back."

Ms. Pao's lawyer, Alan B. Exelrod of Rudy, Exelrod, Zieff & Lowe, said that Ms. Pao had been "cut off from access to company documents and told to transition off her corporate boards within 30 days." Mr. Exelrod said, however, that the firm did not cut off her pay.

"Our view is that this is retaliatory for making the claims and filing the lawsuit," Mr. Exelrod said. "Also, that it is because she is of her gender. We intend to add this claim to the lawsuit."

Kleiner Perkins characterized Ms. Pao's post as "misleading" and said she remained an employee. The firm said it had approached her about a 6- to 12-month "transition" plan to ease her departure from Kleiner Perkins, not because of the lawsuit, but because of longstanding performance issues. The plan involved keeping her on the firm's payroll and helping her find a new job.

Ms. Pao says she was fired; the firm says that's not true.

"Ellen and her lawyer are painting a false picture of what happened," said Lynne C. Hermle, outside counsel for Kleiner Perkins. "No one ever told Ellen to clean up her office, or any words in that regard."

Legal experts said the question of whether Ms. Pao had been fired would factor prominently into her case. "If she can persuade a judge or jury that she was fired in retaliation for filing a claim, or the underlying sexual harassment claim, then this will help her case," said Alison D. Morantz, a professor at Stanford Law School in California. "But if the firm can prove she was dismissed for totally unrelated reasons, such as poor performance, it may not factor in — well, assuming she was discharged."

Ms. Pao has not granted interviews since filing her suit, opting instead to address the public via Quora.

Ms. Pao sits on the board of three Kleiner Perkins portfolio companies: Flipboard, Lehigh Technologies and Datameer. Those board seats are reserved for the firm, and Kleiner Perkins said that, as of Tuesday, it had still been working with Ms. Pao to find the appropriate people to replace her.

Representatives for all three companies said they could not comment on Ms. Pao's status on their respective boards.