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Policy Implications: Making the United States More Accessible to Foreign Investors

The preceding analysis shows that foreign multinational firms that invest in the United States are, alongside US-headquartered American multinationals, the most productive and highest-paying segment of the US economy. They conduct more research and development (R&D), provide more value added to US domestic inputs, and export more goods and services than other firms in the US economy. The superior technology and management techniques they employ spill over horizontally and vertically to improve the performances of local firms and workers. Their corporate social responsibility activities provide tangible benefits to the communities where they locate their plants and research facilities. As the United States wants not only to expand employment but also create well-paying jobs that reverse the falling earnings that many US workers and middle class families have suffered in recent decades, it is more important than ever to enhance the United States as a destination for multinational investors.

Multinational corporations (MNCs) target the United States for investment overwhelmingly because the US economy gives them access to skilled and energetic workers. The US workforce today is willing to work more hours at (often) multiple jobs than ever before. But after more than a century of spectacular progress, in recent years the rate of US educational advance has sharply decelerated. From 1940 to 1980 the mean educational attainment of all US workers climbed by 0.86 years per decade, from 9.01 to 12.46 years, but from 1980 to 2005 the total increase was no more than one year—only 0.43 years per decade (Kirkegaard 2007, Goldin and Katz 2008, Baily and Slaughter 2008). This slowdown in education has taken place while improvements in secondary education have accelerated around the world. Other countries have not merely been catching up to the US workforce; they have been moving ahead.

Among 26 member states of the Organization for Economic Cooperation and Development (OECD) in 2006, 18 had high school graduation rates higher than that of the United States. At the same time there have been concerns about the quality of US education, with US students scoring below the median in comparative tests of educational achievement in science and mathematics. Maintaining the competitive quality of the US labor force is a dynamic process. As Jacob Kirkegaard points out, the retirement of the baby-boom generation in the United States represents the largest brain drain, or skill drain, that has ever taken place from any economy in history, and replacement indicators are not promising (Kirkegaard 2007). Measures to improve the education and skill level of the US workforce are therefore vital to making the United States an ongoing attractive site for international investment.

A particularly important component of improving the human capital resources within the US labor market is policy toward high-skilled immigration. Immigrants with college or higher degrees bring skills directly into the US labor pool, as well as innovative ideas for new goods and services and connections to business networks in their home countries. Approximately one-quarter of all US high-technology startups since the early 1990s have had at least one foreign-born cofounder, up from less than 10 percent in the 1970s (Kirkegaard 2007). But the US H-1B visa program places stringent caps on the inflow of engineers, scientists, architects, doctors, and managers from abroad. As a result, the most competitive companies in the United States—including US affiliates of foreign multinationals—cannot get visas for the non-US high-skilled workers they want to hire. A snapshot from 2008 shows that about half of 163,000 companies in the United States wishing to hire a foreign high-skilled worker on H-1B visas were denied this opportunity by the annual quota of 85,000 available permits.[1] For a more recent illustration, any US firm that wanted to hire a foreign-born high-skilled person in December 2011 had to wait until April 1, 2012, as that fiscal year's quota had already been filled.[2] Reforming US policy toward high-skilled immigration would make the US economy more competitive as a site for US and non-US investors alike. Strengthening the quality and size of the skilled labor force in the United States through both education and immigration policies will increase the appeal of the United States as a location for high-value production, attracting investment that will utilize this larger pool of indigenous and foreign-born workers while benefiting the overall US economy.

State-of-the-art infrastructure—ports, airports, railroads, roads, bridges, tunnels, information technology, and electrical grids—is likewise crucial for MNCs to manage worldwide production and coordinate international supply chains. While alternative host-country sites around the world are upgrading

1. Jacob Funk Kirkegaard, "US High-Skilled Immigration Policy: A Self-Inflicted Wound," *YaleGlobal Online,* July 1, 2008.

2. US Citizenship and Immigration Services, "USCIS Reaches Fiscal Year 2012 H-1B Cap," press release, November 23, 2011, www.uscis.gov (accessed on December 11, 2012).

their infrastructure in clearly visible ways, the United States is falling behind in both relative and absolute terms (Deshpande and Elmendorf 2008). US spending on public infrastructure has declined on a gross and net basis. The American Society of Civil Engineers awarded a grade of D to the quality of US infrastructure in its *2009 Report Card for America's Infrastructure*.[3] It graded 15 segments of US infrastructure, from aviation to transit and wastewater, and found delayed maintenance and chronic underfunding as contributors to poor outcomes.

The US tax system is particularly business-unfriendly for foreign companies considering the United States as a site for business (Hufbauer and Wong 2011). The US statutory corporate tax rate (federal and state combined) is the second highest, behind Japan, among OECD countries. At 39 percent, the combined US tax rate is 11 percentage points higher than the unweighted average of competing countries. However, it is not only statutory rates that make the United States unfriendly to businesses. The US average effective tax rate, again combining federal and state, is also second highest. The US marginal effective corporate tax rate may take the prize for highest. Gary Hufbauer concludes that the United States has just about the "worst corporate tax system from the standpoint of encouraging investment in plant and equipment (P&E) or research and development (R&D), or promoting production for home or export markets."[4]

The payoff from lowering the US tax rate and simplifying the US tax code would be substantial (Hufbauer and Wong 2011). Econometric estimates suggest that cutting the corporate tax rate by 1 percentage point would, over time, increase the output produced by foreign firms operating in the United States by at least 2 percent. Cutting the US corporate tax rate by 10 percentage points could potentially increase their employment by 1 million more Americans, above the 56 million Americans foreigners currently employ.

On June 20, 2011, President Obama issued a major statement reiterating the US commitment to welcome investment from abroad. But to many observers, the United States is becoming less open and even protectionist toward inward investment. Most foreign MNCs establish a presence in the US economy through mergers and acquisitions: Of approximately $2 trillion in inward investment between 1987 and 2006, 88.8 percent took place by foreign companies acquiring existing US businesses, rather than by greenfield investment to establish a completely new business (CFR 2011, footnote 95). The tendency of some foreign acquisition cases—in particular, Dubai Ports World and the China National Offshore Oil Corporation (CNOOC)—to become highly politicized, however, may give external investors pause in considering this route. Adherence to the framework for the Committee on Foreign

3. American Society of Civil Engineers, *2009 Report Card for America's Infrastructure*, www.infrastructurereportcard.org (accessed on December 11, 2012).

4. Gary Clyde Hufbauer, US Corporate Tax Reform, Testimony before the Hearing on Tax Reform and Foreign Investment in the United States, US House of Representatives Committee on Ways and Means Subcommittee on Select Revenue Measures, June 23, 2011.

Investment in the United States (CFIUS) decision making that separates genuine national security threats from spurious allegations (see chapter 4) would adequately protect the United States while tamping down political interference in the acquisition process.

Finally, the United States might want to undertake new initiatives to attract inward investment at the national level instead of leaving investment promotion activities almost entirely to the states. SelectUSA, the federal government initiative that has replaced Invest in America, is the closest program the United States has to a national investment promotion agency, but it is underfunded and understaffed. Lacking sufficient funding for large-scale outreach, SelectUSA currently functions primarily as a clearinghouse for information. Its website offers a searchable guide to federal programs and services available to businesses operating in the United States and a catalogue explaining the advantages of operating in the country. However, the information is sparse given the lack of federal initiatives on inward foreign direct investment (FDI). The site also includes links to individual states' economic development agencies, though as a federal agency, SelectUSA must remain neutral with respect to the states and cannot advise or consult with companies on which locations they should choose within the United States.

Looking specifically at the future of FDI from China in the United States, the outlook presented here—like that of other researchers, including Daniel Rosen and Thilo Hanemann—is that the types and amounts of Chinese FDI can be expected to grow rapidly, and that the benefits accruing to US firms, workers, and communities will likely expand rapidly as well. But this may not happen as rapidly as would be optimal for the United States. The evidence in chapter 3 shows that Chinese investors pay wages above the average for US or other foreign-owned firms, and contrary to some fears, Chinese companies in the United States are not mere vehicles for imports of Chinese goods. Rather, Chinese investors are attracted by the superior human capital they find in the United States—despite recent declines in educational standards—and they use their US plants as sources of US exports, so much so that in some years their exports of US-produced goods have been greater than their imports from other countries. Chinese firms also use the US economy as a base for conducting R&D, with expenditures as a proportion of value added higher than comparable US firms and significantly higher than other investors from developing countries. The capabilities Chinese investors bring to their US operations spill over and improve the efficiency of other firms in the US economy.

As much of Chinese FDI will take place through acquisition of existing US firms, US authorities will want to be vigilant in assessing the potential for threats to national security identified in chapter 4. But vigilant does not mean exclusionary. As with foreign investment from other sources—the Middle East, other Asian countries, Europe, Russia, and the developing world—the conditions within which foreign acquisition might pose a credible national security threat can be rigorously defined and assessed, allowing the vast majority of FDI acquisitions to pass through unimpeded.

In addition to economic benefits, there are strategic reasons to encourage Chinese FDI in the United States. The Chinese government has made the expansion of FDI by Chinese firms a top priority. From a strategic perspective, removing barriers and encouraging firms to invest gives the United States a strong bargaining chip in future interactions. Chinese ownership of US firms locates Chinese assets on US soil, under US jurisdiction, giving the United States greater leverage in its interactions with China. This principle applies to environmental and labor concerns as well as economic and security issues. Chinese firms in the United States must abide by US laws, including those relating to the environment and treatment of workers. Individuals concerned about the poor record of Chinese firms on these issues should want to encourage those firms to locate their production in the United States, as doing so will put them under tighter regulations and hold them to higher standards of conduct than if they produced the same output in China.

Chapter 3 shows that Chinese FDI in the United States is currently quite low in relation to a number of benchmarks. A standard predictive gravity model indicates that Chinese FDI is lower than what would be expected given China's GDP, population, and per capita income. Chinese FDI in the United States also has been growing more slowly than that of countries in a similar stage of development, including Brazil, Russia, and India. As outbound FDI from China continues to grow very rapidly, however, US policy should not focus on how to keep Chinese FDI out, but how to attract more Chinese direct investment into the US economy.

It is an understatement that information is far from perfect about Chinese perceptions regarding the potential for investing in the United States. The cultural and language barriers to be overcome are very high. Even factual comparisons are often far off the mark. John Ling, managing director of the South Carolina State Office in Shanghai, has found that many Chinese companies he speaks with about investing in South Carolina are shocked to learn how low the costs of doing business are in the United States.[5] Because the United States is among the most developed countries in the world, Chinese executives tend to think that everything must be more expensive than in China. When the Chinese owner of a plastics company asked what he would have to pay a manager if he opened a production facility in South Carolina, he was surprised by the answer—about $150,000 per year—as that was what the owner was currently paying his general manager in China. The Chinese plastics investor was also surprised to discover that the cost of electricity is about two to three times higher in China than it is in South Carolina, and that the supply of US electricity is much more reliable than it is in some regions in China, where his plants experienced frequent power outages. These are just a few examples of extremely widespread misperceptions among Chinese firms about the benefits of investing in the United States.

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5. Oldenski interview, Shanghai, July 21, 2011.

There is a large role that SelectUSA or a similar agency could play at the federal level alongside vigorous state level representations to demonstrate the advantages of choosing the US economy as a site for Chinese firms to invest. As Chinese FDI increases, taking along Chinese managers from Chinese US affiliates as satisfied customers might go a long way to overcome cultural and language barriers. The message, however, must be unambiguous: Except for a very few rigorously defined national security exceptions, Chinese investment is welcome in the United States.

Overall, to the extent the United States can make the domestic economy a more attractive locale for international companies from all over the world to base their operations, US workers, firms, communities, and consumers will benefit.