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Implications for US Policy

The evidence presented in this study shows that US-headquartered multinational corporations are the most productive and highest-paying segment of the US economy. They conduct more R&D, provide more value added to US domestic inputs, and export more goods and services than other firms in the American economy. The superior technology and management techniques they employ spill over in both horizontal and vertical directions to improve the performance of local firms and workers. Their corporate social responsibility activities provide tangible benefits to the communities where they locate their plants and research facilities. Perhaps most important in the context of the contemporary backlash against globalization is our finding that outward foreign direct investment (FDI) is not a substitute but rather a complement to the positive features of the American economy in the form of better jobs, larger investment, greater exports, and more R&D. US policymakers can expect that measures taken to impede or retard US MNC expansion abroad will weaken job creation, investment, R&D, and exports at home, rather than strengthening or enhancing domestic economic activity.

In an era when the United States wants not just to expand employment but also to create well-paying jobs that will reverse the declining earnings of many American workers and middle-class families, it is more important than ever to enhance the United States as an attractive business location for US and foreign multinationals. We should want these firms to locate their most dynamic and productive operations in the United States.

Tax Reform First

Our recommendation is clear: For its own prosperity, the United States badly needs to reform its corporate tax system, especially with respect to earnings at home. As the Simpson-Bowles Commission and others have urged, the federal corporate rate should be cut to 25 percent or lower (Hufbauer and Wong 2011). Within this range, the rate cut will be approximately self-financing, as firms will have less resort to pass-through entities, undertake more investment, and engage in less profit-shifting.

For earnings abroad, dividends paid by foreign corporate subsidiaries to their US parent firm should be taxed at a reduced rate. We do not delve into details here, but the Joint Committee on Taxation (2011) has summarized the territorial tax systems of major countries, while Harry G. Grubert and Rosanne Altshuler (2012), among others, have offered a proposal for US reform. Above all, Congress should refuse to enact faux "reforms" that would impose the current high US statutory tax rate on the worldwide income of US MNCs. Instead, Congress should enact genuine reforms that reduce the US corporate tax rate and embrace a permanent territorial system for taxing overseas earnings. This combination will reduce the incentive for tax arbitrage as the US tax system more closely conforms to world norms.

A simpler and better corporate tax law could deliver substantial benefits to the US economy. The good news is that corporate tax reform need not mean a loss of tax revenue (Hufbauer and Vieiro 2012b). Lower rates will automatically enlarge the corporate tax base, as firms will be less frantic in their search for tax shelters and as US production rises. (This is the positive side of the income-shifting phenomenon.) With a territorial system, the US competitive position in world markets would be enhanced. Moreover US-based MNCs could then repatriate a significant part of the $1.7 trillion stock of earnings held abroad for distribution to shareholders or productive investment in the United States without incurring a substantial US tax burden.[1] Over the long haul, US-based MNCs could compete with foreign-based MNCs on equivalent tax terms in third-country markets. Faster expansion by US MNCs abroad, abetted by a territorial tax system, would bring many benefits to the US economy. Americans should welcome, not fear, outward investment by US MNCs. This is the essence of complementarity analysis.

At the same time, the United States should undertake policy initiatives to enhance its own attraction as a place to do business. US prosperity will not be advanced by restricting investment abroad, but it can be advanced by reforms at home, as described below.

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1. As mentioned earlier, JPMorgan (2012) estimates the stock of earnings held abroad at $1.7 trillion, up from $1.4 trillion in 2010. The arguments that a territorial system would lead to substantial repatriation of foreign earnings (up to $1 trillion) are set forth by Laura Tyson, Kenneth Serwin, and Eric Drabkin (2011). Based on the experience of the 2004 Homeland Investment Act, it is an open question what portion might be distributed to shareholders as dividends or share buybacks and what portion might be invested in R&D or plant and equipment. Following the 2004 act, the bulk of repatriated earnings (60 to 90 percent) were used to finance shareholder payouts, in a period—much like today—when MNCs were not financially constrained. However, a complementary sharp cut in the US corporate tax rate would shift business decisions toward higher investments rather than a surge in shareholder payouts.

Much Better Education

US-based and foreign multinationals target the United States for investment overwhelmingly because the American economy gives them access to skilled and energetic workers. The US workforce today is more willing to work long hours, often at multiple jobs, than workers in other advanced countries. However, after more than a century of spectacular progress, the rate of US educational advancement has sharply decelerated in recent years. From 1940 to 1980, the mean educational attainment of all US workers climbed by 0.86 years per decade (from 9.01 years to 12.46 years), but from 1980 to 2005 the total increase was no more than one year—only 0.43 years per decade.[2]

This slowdown in US educational progress has taken place while improvements in secondary education have been accelerating around the world. Other countries have not merely been catching up to the US workforce, they have been moving ahead. Among 26 OECD member countries in 2006, 18 had high school graduation rates higher than the United States.

At the same time, the quality of US education is a matter of severe concern, 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 (2007) points out, the retirement of the "baby boomer" generation in the United States represents the largest brain drain (or skill drain) that has ever taken place in any economy in history, and replacement indicators are not promising. Measures to improve the education and skill level of the American workforce are therefore vital to make the United States an attractive site for international investment.

Immigration Reform

A particularly important component of improving human capital resources within the US labor market is the policy regarding high-skilled immigration. Immigrants with college or higher degrees bring skills directly into the US labor pool, innovative ideas for new goods and services, and connections to business networks in their home countries. Approximately a quarter of all US high-tech startups since the early 1990s have had at least one foreign-born cofounder, up from less than 10 percent in the 1970s (Kirkegaard 2007). Yet the US H1-B visa program for foreign workers now places stringent caps on the inflow of engineers, scientists, architects, doctors, and managers from abroad.

As recently as the 1990s, the quota caps on H1-B visas were rarely reached, and even in 2003 the cap was still at 195,000 skilled workers annually. But Congress has progressively reduced the cap and, as a result, the most competitive companies in the United States—including US affiliates of foreign MNCs—cannot get visas for the non-US high-skilled workers they need to hire. In 2008, about half of 163,000 US companies wishing to hire foreign high-skilled

2. See Kirkegaard (2007), Goldin and Katz (2008), and Baily and Slaughter (2008).

workers on H-1B visas were denied this opportunity because of the annual quota of 85,000 permits then available (Kirkegaard 2008). The quota cap has since been slashed to 65,000 workers annually. Any US firm that wanted to hire a foreign-born high-skilled worker in December 2011 had to wait until April 1, 2012, as the FY2012 quota had already been filled.[3] Unfortunately, Congress also takes a dim view of immigration provisions in US free trade agreements: Since the Chilean and Singapore agreements, which were ratified in 2002, no US free trade agreement has contained an immigration chapter (Stephenson and Hufbauer 2011).

There is, however, a ray of sunshine in US visa policy: L visas are available for intracorporate transfers of managers (L-1 visas) and skilled employees (L-2 visas), and about 75,000 of these were issued in 2010. Unfortunately, the eligibility requirements for L visas mean that they are not available for new hires. Liberalization of US policy (essentially H-1B visas) toward new high-skilled immigrants would make the American economy more competitive as a site for US and non-US investors alike.

World-Class Infrastructure

State-of-the-art infrastructure—ports, airports, railroads, roads, bridges, tunnels, information technology, and electrical grids—is crucial to enable MNCs to manage worldwide production and coordinate international supply chains. While alternative host-country sites around the world are upgrading their infrastructure in clearly visible ways, the United States is falling behind in both relative and absolute terms. US spending on public infrastructure has been declining on both 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*.[4] In grading 15 segments of US infrastructure ranging from aviation to roads, bridges, transmission lines, and wastewater, the report cited delayed maintenance and chronic underfunding as contributors to poor outcomes.

Countries such as Singapore have demonstrated that high-quality infrastructure delivers high social returns. Despite such evidence, however, two critical obstacles limit investment in infrastructure in the United States. First, most US infrastructure is publicly financed, and public budgets are depleted at the federal and state level by Medicare, Medicaid, Social Security, state pensions, and defense needs. Second, most rights-of-way for everything from airports to ports, roads, and transmission lines are either in the public domain

3. "USCIS Reaches Fiscal Year 2012 H-1B Cap," US Citizenship and Immigration Services press release, November 23, 2011, www.uscis.gov/portal/site/uscis/menuitem.5af9bb95919f35e66f614176543f6d1a/?vgnextoid=f0a78614e90d3310VgnVCM100000082ca60aRCRD&vgnextchannel=68439c7755cb9010VgnVCM10000045f3d6a1RCRD (accessed on March 25, 2013).

4. American Society of Civil Engineers, *2009 Report Card for America's Infrastructure*, www.infrastructurereportcard.org/2009/report-cards (accessed on March 25, 2013).

or severely regulated by public agencies. The pathway to adequate finance is the adoption of user-pay (toll) systems on a grand scale for virtually all forms of infrastructure, applying the latest technology (e.g., EZ Pass and credit cards) for collecting fees from the public. The pathway to engaging private firms is through long-term leases of public rights-of-way and speedier processes for creating rights-of-way for new infrastructure (e.g., transmission lines from wind farms to cities).

Conclusion

This study has shown that as US MNCs expand their global operations, they become more productive, expand output, provide more high-wage and high-benefit jobs, and undertake more R&D at home as well as abroad. Beyond creating a hospitable framework for outward investment, it is distinctly in the interest of the United States to create a policy environment that encourages US MNCs to use the domestic economy as the central point of their international operations. The United States could dramatically enhance its attraction as a magnet for MNCs and as a base of production for global markets. Policies to this end are readily available. To enhance investment, production, and job creation at home, corporate tax reform, better education, liberalized immigration, and world-class infrastructure are all essential. To enlarge the global footprint of US MNCs, and spur associated production, jobs, and R&D in America, territorial taxation is the answer. Political leaders in both parties frequently promise to improve life for middle-class Americans. These policies would be a good place to start. With wrong choices, the same policy areas could also be major ingredients for failure.