



Japanese Investment in the United States: Superior Performance, Increasing Integration

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Japan is reemerging as the most important source of foreign direct investment (FDI) in the United States. In 2013 Japanese firms were the largest source of new inflows of FDI into the United States for the first time since 1992, injecting almost \$45 billion of fresh investment into the US economy in that year alone. US investments by Japanese firms are expected to maintain a similar level when final figures are in for 2014 as major acquisitions and greenfield investments continue to take place. Japanese firms were among the most important investors in the United States from the 1980s through the mid-1990s but were then surpassed by firms from the United Kingdom, Germany, France, Canada, Switzerland, and the Netherlands for most of the past two decades. The most recent data, however, suggest that direct investments by Japanese firms in the United States are once again on the rise, both in absolute terms and relative to investments from other countries.

This Policy Brief investigates the impact of FDI by Japanese multinationals on the US economy. We present the latest evidence about wages and benefits, sales, value added, research

and development (R&D), exports, and imports on the part of US affiliates of Japanese companies, in absolute terms and compared with counterpart US companies as well as US and other multinational firms. The data show Japanese investors to be a particularly dynamic component of the US economy, with steadily increasing integration, both through networks of Japanese suppliers attracted to coinvest alongside Japanese primes and through backward linkages to indigenous US companies. The R&D intensity of Japanese firms also exceeds that of other foreign firms in the United States. This Policy Brief offers a special look at Japanese auto investors in the United States.

Japanese multinationals join other non-US multinationals in putting competitive pressure on US firms to upgrade their technologies, management practices, and quality-control procedures, often by learning from the foreigners in their midst. Our previous research has found that 12 percent of all productivity gains by firms in the US economy can be traced to spillovers from foreign investors (Moran and Oldenski 2013). Japanese firms in the United States are important contributors to that overall effect, given the research intensity and new technologies they bring to the US economy.

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Japanese investors share a common interest with US and non-US multinationals in policy reforms that could make the United States a more attractive location for international companies to conduct their worldwide operations. This includes policy initiatives directed at improving the skills of US workers, changing immigration and visa regulations, upgrading US infrastructure, and restructuring US corporate taxation. Japanese firms are attracted to the United States because it is such a desirable environment for locating innovative activities. Strengthening US advantages in this area will benefit the Japanese firms that invest here as well as the overall US economy.

JAPANESE INVESTMENT IN THE UNITED STATES: LATEST EVIDENCE

The data presented in this section show Japanese multinationals to be superior performers in the US host economy across a number of key variables. The data also document ever-deeper integration between Japanese investors and local suppliers of both US and non-US origin. There is irony in recalling that the early build-up of Japanese FDI in the United States in the 1980s was accompanied by fears that Japanese multinationals would exhibit what was called a “headquarters effect,” in which they kept all high-value activities, including R&D, at home, while offshoring lower-skilled and less-sophisticated operations. Peterson Institute research investigating the possible presence of such an effect—led by analysis from Monty Graham and Paul Krugman—dispelled this apprehension. At the same time, there

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were concerns that Japanese multinationals would not develop strong backward linkages into the US host economy. Graham and Krugman (1995) found that over time Japanese investors did source ever-larger amounts of inputs from the US domestic market. Today, our investigation of the performance of Japanese investors in the United States from earlier periods through the contemporary era shows Japanese multinationals to be making significant contributions to the US domestic economy in terms of wages and benefits, sales, value added, R&D, exports and imports.

As noted above, 2013 was the first year since 1992 that new US investments by Japanese firms exceeded those of firms from any other country in the world. In 2013 FDI from Japan surpassed that of the United Kingdom, Germany, Switzerland, Canada, and the Netherlands. These numbers are based on financial inflow transactions data collected by the US Bureau of Economic Analysis (BEA). In addition to the financial flows, these investments make important contributions to the US economy.

Figure 1 shows the total value added by Japanese-owned firms in the United States. After a slight dip during the global recession, value added by these firms has been on the rise. In 2012 the affiliates of Japanese firms in the United States

contributed \$93 billion in value added to the US economy. As in previous periods of high Japanese investment in the United States, this investment has included activities such as R&D spending—which, as figure 2 shows, has been growing rapidly and accelerating among Japanese firms in the United States, even during recession years. This R&D spending creates high-paying, high-skill jobs for US workers and increases innovation in the US economy.

Figure 3 shows that Japanese firms’ total employment in the United States is about the same as it was in 1997. However, as figure 4 shows, the wages and benefits these firms have paid to US employees have been increasing. In 2012 the average US worker at a Japanese firm received almost \$80,000 in wages and benefits, well above the US average.

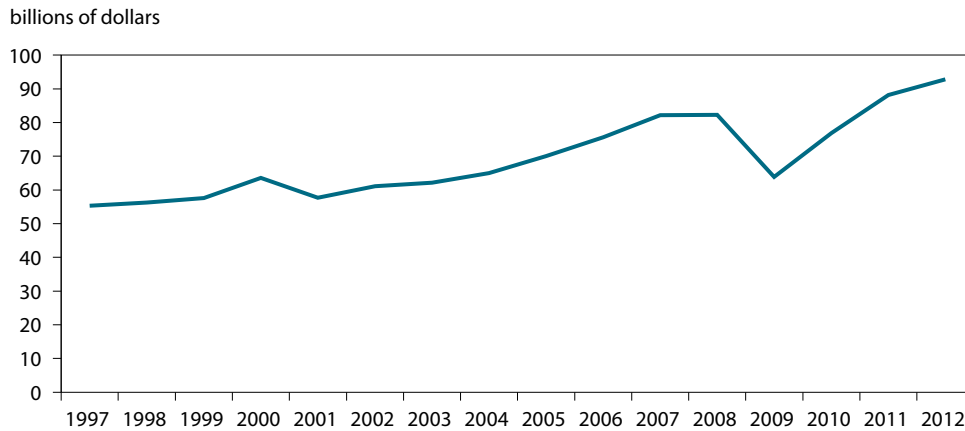
It has been well documented that multinational firms, regardless of their country of origin, outperform purely domestic firms on a number of key dimensions. Multinational corporations (MNCs) have been shown to be more productive, pay higher wages, and have greater sales than purely domestic firms do.¹ But how do Japanese-owned firms rank among MNCs? Figure 5 shows the average annual wages and benefits that domestic US firms, US MNCs, all foreign-owned MNCs, and Japanese-owned MNCs pay per US employee. Consistent with previous evidence, figure 5 reveals that MNCs of all types pay higher wages than purely domestic firms do. However, the US-based employees of foreign-owned multinationals earned more than even US MNC employees did. Studies of multinational activities pay a great deal of attention to the superior performance of US-owned multinationals relative to purely domestic firms. But they rarely look at the wages that foreign-owned firms operating in the United States pay, which are much higher than even the most productive of US-owned firms. Among foreign MNCs operating in the United States, Japanese firms pay higher than average wages, making them exceptional contributors to creating highly paying jobs in the US economy.

The high wages and tremendous wage growth that Japanese firms exhibit in the United States reflect their increasing R&D intensity. As figure 6 shows, the R&D intensity of Japanese-owned firms in the United States, as measured by annual R&D expenditure per employee, grew much more rapidly than that of other foreign firms in the United States. In 2011 Japanese firms had R&D spending of more than \$10,260 per worker, compared with about \$8,270 for the average foreign firm.

Automobile manufacturers are perhaps the most well-known among Japanese firms investing in the United States.

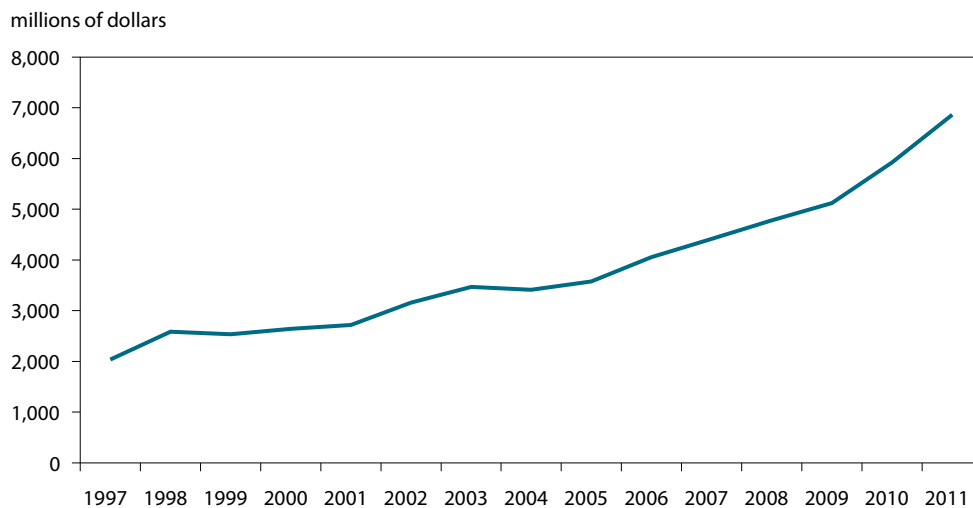
1. See, e.g., Bernard and Jensen (1999), Melitz (2003), and Moran and Oldenski (2013).

Figure 1 FDI by Japanese firms in the United States, value added, 1997–2012



Source: US Bureau of Economic Analysis.

Figure 2 Research and development spending by Japanese firms in the United States, 1997–2011



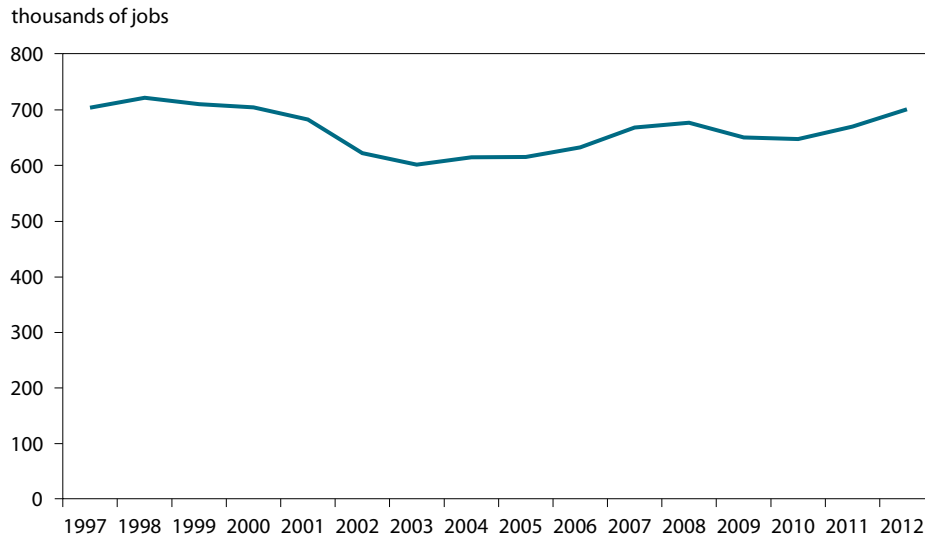
Source: US Bureau of Economic Analysis.

While motor vehicles are the single largest industry for Japanese FDI, they make up a small minority of the total. Table 1 breaks down the value added, employment, and sales of Japanese-owned firms in the United States in 2012, the most recent year for which data are available. Motor vehicle manufacturing firms are responsible for about 15 percent of the total value added and sales of Japanese MNCs in the United States. Motor vehicle wholesalers contribute another 19 percent of sales, 10 percent of value added, and 8 percent of employment. Other important industries include plastics and rubber products, machinery, metals, computers and electronics, finance and insurance, and wholesale industries.

VERTICAL INTEGRATION AND GLOBAL SUPPLY CHAINS

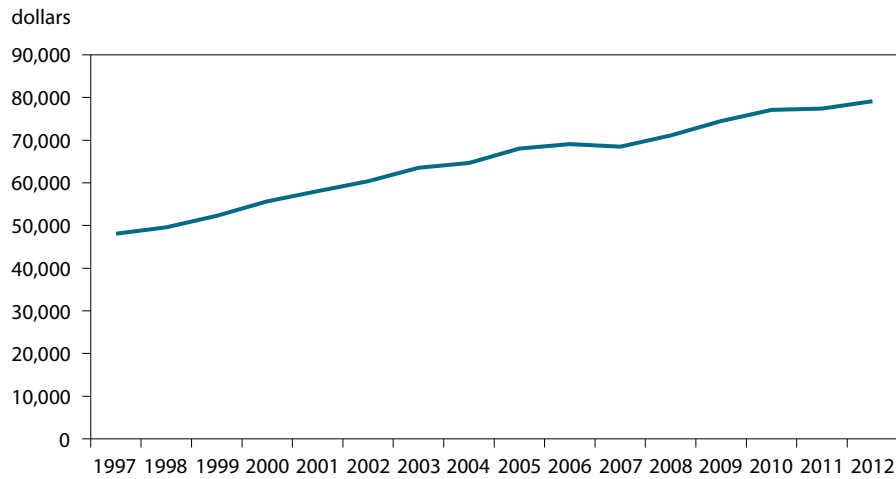
Japanese firms rely heavily on international value chains. According to data from the US Census Bureau’s Related Party Trade database, in 2013, 78 percent of all US imports from Japan took place within multinational firms. The data do not distinguish between imports by US MNCs from their affiliates in Japan and imports by affiliates of Japanese firms in the US from their parent firms. But the number is still very striking. For all other countries in the world, the share of US imports that occur within firms was only 48 percent in 2013. US exports to Japan are also slightly more likely than exports to other coun-

Figure 3 Total employment by Japanese firms in the United States, 1997–2012



Source: US Bureau of Economic Analysis.

Figure 4 Wages and benefits per worker paid by Japanese firms in the United States, 1997–2012



Source: US Bureau of Economic Analysis.

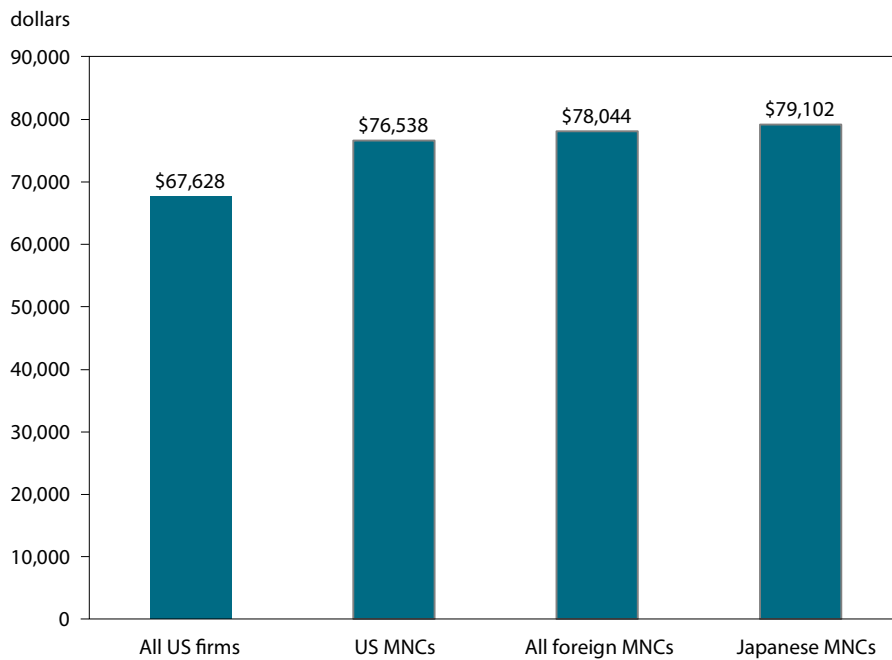
tries to occur within firms. In 2013, 30 percent of US exports to Japan were within firms, compared with 28 percent for the rest of the world.

Historically, backward linkages from Japanese multinationals into the US domestic economy have taken two paths. One path was to induce Japanese component producers to follow Japanese primes into the United States and coinvest beside them. A second path was to identify US suppliers and buy increasing amounts in inputs from them, often helping

them to meet high Japanese quality standards along the way (Graham and Krugman 1995).

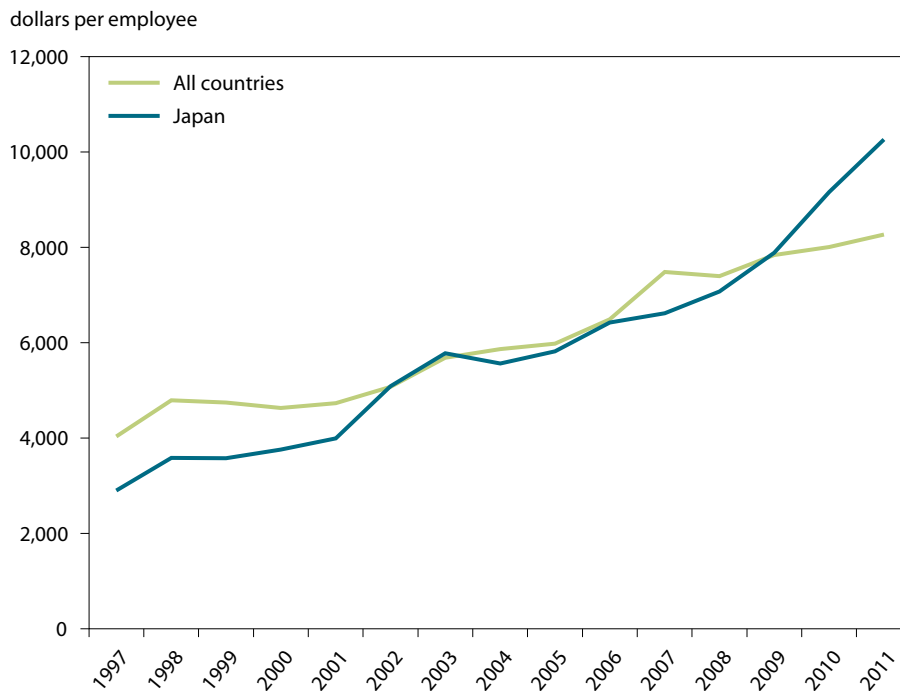
Both paths continue to be significant today. As the presence of affiliates of Japanese firms in the United States has increased rapidly in recent years, the ratio of imports by these firms to their total sales has decreased from a peak of 34 percent in 2000 to just under 30 percent in 2012. This suggests that Japanese firms are not only continuing to source domestically in the United States, but are doing so to a greater extent than

Figure 5 Average wages and benefits per worker paid by firms in the United States, 2012



MNC = multinational corporation
 Sources: US Bureau of Economic Analysis and US Census Bureau.

Figure 6 Research and development spending by foreign firms in the United States, 1997–2011



Source: US Bureau of Economic Analysis.

Table 1 Japanese foreign direct investment in the United States by industry, 2012

Industry	Value added (millions of dollars)	Employment (thousands)	Sales (millions of dollars)
All industries total	97,543	719	603,928
Manufacturing total	34,612	326	181,207
Motor vehicles, bodies and trailers, and parts	14,539	*	92,833
Plastics and rubber products	4,814	56	16,032
Machinery	3,045	26	13,558
Primary and fabricated metals	2,586	25	12,960
Computers and electronic products	2,329	19	9,528
Other chemicals	1,696	10	8,073
Navigational, measuring, and other instruments	1,415	12	5,953
Food	1,113	12	5,978
Semiconductors and other electronic components	821	6	2,954
Electrical equipment, appliances, and components	815	6	3,560
Pharmaceuticals and medicines	690	7	7,526
Basic chemicals	487	4	1,703
Transportation equipment other than motor vehicles	420	*	1,448
Paper	193	2	777
Wholesale trade total	33,576	242	317,690
Other wholesale	20,555	*	157,771
Motor vehicle wholesale	9,577	57	113,343
Electrical goods wholesale	2,500	26	26,061
Petroleum and petroleum products wholesale	945	*	20,515
Finance and insurance total	11,996	34	28,176
Finance, except depository institutions	6,067	10	14,550
Depository credit intermediation (banking)	4,709	19	8,569
Insurance carriers and related activities	1,220	5	5,057
Other industries			
Professional, scientific, and technical services	2,405	17	5,397
Mining	1,252	0	2,369
Transportation and warehousing	1,004	10	4,601
Accommodation and food services	903	12	1,761
Real estate and rental and leasing	502	2	1,656
Construction	466	4	2,946
Administration, support, and waste management	422	5	3,383
Utilities	68	0	401

* indicates values suppressed for confidentiality reasons.

Source: US Bureau of Economic Analysis.

they were in the early 2000s. The majority of sales by these firms are still to US customers, but exports from the United States by these firms are growing in importance. Exports by Japanese-owned firms in the United States have increased from 9 percent of total sales in 2000 to 11 percent in 2012. This is greater than the average export share for other foreign firms in the United States, which continue to export about 9 percent of their total sales.

PRODUCTIVITY SPILLOVER EFFECTS

Japanese investors in the United States join other international companies in generating significant productivity spillovers to US firms and workers. The FDI has economic implications beyond immediate job creation and R&D spending. The presence of foreign firms may also indirectly affect domestic firms. When foreign firms enter a market, they bring with them new production technologies, management practices, and quality-control procedures that can spill over to the local market. These FDI spillovers can take the form of horizontal technology transfers from foreign to domestic firms in the same industry. Workers may leave a foreign-owned firm and take the techniques they have learned with them to their next job in a domestic firm. Spillovers may also be vertical. If foreign-owned firms wish to source inputs locally, they may demand higher quality or even share production technology with their suppliers, resulting in greater productivity of local firms in upstream industries.

In a previous Peterson Institute study, Moran and Oldenski (2013) used detailed firm-level data on both FDI in the United States and the operations of domestic US firms from 1987 through 2007 to study the spillover effects of inward FDI on US firms. This study employed an empirical methodology that controls for firm entry and exit, for the endogeneity of input choice and productivity, and for firm, industry, and year characteristics. It found that a 1 percentage point increase in the share of total employees in an industry who work at foreign-owned firms in the United States increases the productivity of all firms in the industry by an average of 0.81 percent after one year and by 2.75 percent in the second year, or a total of more than 3.5 percent.

To put the magnitude of the spillover effects in context, consider the total effect that inward FDI has had on US productivity growth over the past two decades. Overall, US total factor productivity (TFP) grew by about 25 percent from 1987 through 2007 (OECD 2011). Over that same time period, employment at foreign-owned firms as a share of total US employment grew from about 3.8 to 4.6 percent (a 0.8 percentage point increase). These numbers imply that productivity spillovers from FDI alone are responsible for US TFP growth of about 3 percent ($0.008 \times (0.81 + 2.75)$) from 1987 to 2007. This 3 percent is

more than one-tenth of the 25 percent US TFP growth over that period.

In other words, about 12 percent of the total productivity growth in the United States from 1987 to 2007 can be attributed to productivity spillovers from inward FDI. Japanese firms are among the largest and most technologically sophisticated sources of FDI in the country, making them important contributors to this overall effect. In an earlier study, Branstetter (2006) looked specifically at data on investment in the United States by Japanese-owned firms. Using patent citations data to infer knowledge spillovers, he found evidence that FDI increases the flow of knowledge spillovers both from and to the investing Japanese firms. The results of both studies are consistent with the findings of other studies on multinational spillover effects, including Haskel, Pereira, and Slaughter (2007) and Keller and Yeaple (2009). These papers use different datasets and take different methodological approaches, but the basic results are the same: FDI imparts important productivity benefits on domestic firms in the countries receiving the investment.

SPECIAL CASE OF JAPANESE INVESTMENT IN THE US AUTOMOTIVE SECTOR

The apprehension that Japanese multinationals would undertake no more than screwdriver assembly of automobiles in the United States, so as to jump over US trade barriers while keeping high value-added operations at home in Japan was particularly pronounced during the build-up of Japanese automotive investment in the 1980s. Research on Japanese multinationals revealed the importance of intra-*keiretsu* interactions and long established buyer-supplier relationships, which, it was feared, would prevent deep linkages into the US host economy.

In fact, in the first decade after the Honda Motor Company began making cars in Ohio in 1982, the strong buyer-supplier ties within Japanese auto multinationals expanded the vertical dimension of Japanese FDI in the United States. Yuri Kimura and Thomas Pugel (1995) find that Japanese investors exhibiting strongest *keiretsu*-like characteristics pulled their traditional supplier operations into the United States to invest alongside their final assembly operations. The “intangible relationship assets” represented by stable buyer-supplier relationships lead to vertical-linkage measurements for US operations by Japanese automotive primes that are positive and highly significant (greater than the 0.01 level). The phenomenon of pulling home-country suppliers into the US economy is present in other sectors as well, but not as strong as it is in the automotive industry. The vertical linkage variable for Japanese electronics investors in the United States is also positive, but only moderately significant.

The passage of the North American Free Trade Agreement (NAFTA) in 1994 gave a large boost to Japanese investment in North America. All five major Japanese automakers established themselves in North America: Honda, Toyota Motor Corporation, Nissan Motor Company, Subaru (a unit of Fuji Heavy Industries), Mitsubishi Motors Corporation, and Isuzu Motors. Japanese automakers cut the exposure to fluctuating currency valuations and shipping expenses by making cars in the United States, Mexico, and Canada for the US market. After 2000, the percentage of Japanese automobiles that were produced in North America reached 70 percent in 2012 and 71 percent in 2013, according to the Japanese Auto Manufacturers Association (JAMA) website.²

Turning to the contemporary period—and focusing on the United States alone—direct employment by Japanese automotive investors has grown to more than 80,000 employees.³ The intensity of R&D activities in relation to manufacturing operations is notable: 36 research facilities compared with 26 manufacturing plants, and more than 4,000 research engineers and scientists compared with almost 60,000 manufacturing workers.⁴ Distributors add more than 18,000 employees for total direct employment.⁵ Dealerships augmented this total by a further 300,000 employees, for total employment figures of 408,511 in the United States in 2012 and 402,384 in 2013.

Japanese companies produced 3.2 million cars and trucks in the United States in 2012 and 3.6 million in 2013. Of these they exported 335,680 in 2012 and 391,336 in 2013. Cumulative Japanese automotive investment totaled \$35 billion in 2012 and \$41 billion in 2013. Japanese purchases of US auto parts amounted to \$51 billion in 2012 and \$57 billion in 2013 (JAMA does not break down purchases between US affiliates of Japanese auto parts companies and independent US auto parts producers).

2. Data are from Japanese Automobile Manufacturing Association (JAMA), www.jama.org, October 14, 2014.

3. In 2012 the figure for direct employment from Japanese automotive investors was 81,034. In 2013, it was 82,816.

4. In 2012, Japanese auto firms employed 4,196 R&D workers and 57,939 manufacturing workers in the United States. In 2013, these firms employed 4,479 R&D workers and 59,494 manufacturing workers.

5. Adding distribution to the total employment figures yielded 81,034 workers in 2012 and 82,816 workers in 2013.

WHAT CAN THE EVOLUTION OF JAPANESE INVESTMENT TELL US ABOUT THE FUTURE PATH OF CHINESE INVESTMENT IN THE UNITED STATES?

Thirty years ago Japanese FDI in the United States was viewed with suspicion and apprehension; today this FDI is widely welcomed as beneficial and valuable. Chinese investment in the United States is met with the same suspicion that Japanese investment experienced three decades ago. Might the same evolution emerge regarding Chinese FDI in the United States as occurred for Japanese investment?

Chinese FDI in the United States is currently very small. Total levels are much lower than might be expected based on the characteristics of the Chinese and US economies (Moran and Oldenski 2013). The gap between actual and potential investment, along with larger trends in China's economy and economic reforms, leads to an expectation that Chinese investment will continue to rise rapidly, and even accelerate in the coming years.

Regardless, some key differences between Japan and China may affect the reception of Chinese investors in the United States. From a political point of view, the last 30 years have seen the United States and Japan solidify themselves as close strategic allies in the Pacific and beyond. Over the next 30 years, the US-China relationship is likely to include ongoing elements of tension as well as cooperation.

From an economic point of view, however, the growth in Chinese FDI is likely to prove increasingly beneficial to the United States. Like Japanese firms, Chinese investors pay wages and benefits at the high end of all companies in the United States. Chinese R&D is thus far a much smaller fraction of value-added than Japanese R&D, but it is much higher than R&D spending of other emerging-market firms, including those from India, Brazil, Russia, and Mexico. Productivity spillovers from developed-country investors, including Japanese investors, to US companies are substantial. Productivity spillovers from emerging-market investors, including Chinese investors, to US companies are smaller but nonetheless measurably positive. Overall, Chinese companies, like Japanese companies, will continue to locate in the United States to hire US workers, engineers, and executives to do what these Americans do best: perform high-skilled activities, such as management and research. These lead to the creation of high-skill, high-wage jobs and operations in the United States.

Chinese FDI through acquisition of US firms is almost certain to continue to be beset with concerns about threats to national security. In previous work, we have shown that the types of national security threats from foreign acquisitions,

including Chinese acquisitions of US firms, can be rigorously defined: denial of output (Threat I); leakage of sensitive technology (Threat II); and surveillance or sabotage (Threat III). Whether these constitute plausible threats in a given case can be carefully tested for. Within this framework, the vast majority of Chinese operations, like other foreign investor operations, can be shown to pose no genuine national security threat whatsoever (Moran and Oldenski 2013). Because of the complex US-China geostrategic relationship, Chinese FDI in the United States is unlikely to experience exactly the same growing acceptance that Japanese FDI has received. But with few exceptions, Chinese FDI is nonetheless likely to undergo steadily greater appreciation for the benefits it brings to the US economy. Other important patterns in the evolution of FDI, such as increasing reliance on domestic US suppliers and increasing R&D intensity, are likely to materialize within Chinese firms over time, though perhaps to not quite the same extent as with Japanese firms.

CONCLUSION

Understanding what characterizes the recent growth in Japanese FDI in the United States is crucial for predicting future trends and generating informed policy recommendations. Perhaps most striking is how the amount of R&D spending from Japanese investors in the United States has grown in recent years—more than doubling between 2000 and 2011—and how the R&D intensity of Japanese operations has increased. From 2000 to 2011, R&D expenditures by Japanese firms in the United States grew 160 percent, while total R&D expenditures by all foreign firms in the United States grew a more modest 73 percent over the same time frame. In 2000 the R&D intensity of Japanese firms, measured by total R&D spending per employee, was slightly lower than that of the average foreign firm. However, by 2011 Japanese firms in the United States were much more R&D intensive than the average foreign firm, with R&D spending of more than \$10,260 per worker in that year, compared with about \$8,270 for the average foreign firm. This R&D intensity underpins the finding that Japanese wages and benefits are higher than the wages and benefits in other foreign multinationals in the United States.

What are the determinants of this R&D intensity, and will its trajectory persist into the future? Our Peterson Institute colleagues Marcus Noland and Lee Branstetter, and coresearchers Ashish Arora and Matej Drev, have uncovered evidence that may help provide an answer. As software patents have become an increasingly prominent segment of patenting overall, Japanese software patenting behavior at home has shown itself to be much weaker than in other countries, especially in the

United States. Perhaps to compensate, Arora, Branstetter, and Drev (2013) show that 24 percent of Japanese patents issued in the United States are filed by Japanese companies that have moved operations to the United States—even higher than the 17 percent share prevailing among US firms, and much higher than the 6 percent of overall Japanese patents. This trend will surely continue as software remains a key component of the increasingly technology-intensive trajectory of the US economy.

Japanese investment is unique because of its R&D intensity, manifested across a number of industries in which Japanese multinationals invest other than automobiles.

Another key to forecasting the future pattern of Japanese FDI in the United States is understanding what accounts for the significant differences in Japanese firm behavior at home and abroad. One answer, as Tsukada and Nagaoka (2015) suggest, is the relative lack of home-country facility in English. A second answer, as Marcus Noland (2015) notes, is that Japan permits the entry of far fewer immigrant information technology workers into the Japanese homeland than the United States does. The flow of labor into the software sector from domestic and immigrant sources was three times as large in the United States as in Japan, notwithstanding the relatively restrictive H-1B visa program. Finally, as Noland (2015) points out, home-based US firms are more active than their home-based Japanese counterparts in offshoring software and other operations. So companies based in the United States are much more actively engaged as senders and receivers of software and other activities than companies based in Japan, and the latter may come to the United States precisely to take part in this global engagement. Domestic factors within Japan also point to increasing FDI by Japanese firms in the United States. Given that domestic demand in Japan is falling, mainly due to a decline in population, total Japanese FDI to all destinations is expected to follow an uptrend in the period ahead. Meanwhile the rate of return on FDI for Japanese firms is much higher than that on domestic investment within Japan, creating an additional incentive for Japanese firms to proceed with foreign investment (Bank of Japan 2013).⁶

Finally, because Japan's corporate tax rates are almost as high as US rates, the corporate tax environment is less of a deter-

6. We thank Tomohiro Sugo for raising this point.

rent to investing in the United States for Japanese firms than for other foreign firms, relative to the tax burden of staying in their home countries. However, because Japanese MNCs have other options for FDI in addition to the United States, the high US corporate tax rate is still a concern.

Our analysis shows how Japanese investment in the United States differs from that of other countries along several dimensions. These differences not only make FDI by Japanese firms especially valuable, but point to some important policy goals for attracting it. Although the automotive sector is the largest single industry for Japanese investment in the United States, this does not mean that the focus should be on competing to attract the auto industry in particular, nor should any active industrial policy of “picking winners” be pursued. Japanese investment is unique because of its R&D intensity, manifested across a number of industries in which Japanese multinationals invest other than automobiles, which just happen to comprise a sector of traditional Japanese comparative advantage.

Instead, US policy should focus on reinforcing and expanding the factors that attract high-performing firms and high-value production stages to the United States, regardless of industry.

First is a requirement to turn around the trajectory of educational accomplishments and worker skills in the United States. After more than a century of notable progress, the US record in secondary education has begun to fall behind the attainment levels of previous generations in the United States and behind the attainment levels of competitor countries. Measures to improve the education and skill level of the US workforce are vital to make the United States an ongoing attractive site for international investment, especially in R&D-intensive activities.

Second is the need to enhance the human resource base of the United States through reforming policy toward 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. Allowing wider access to the United States through H-1B visas would make the US economy a more competitive site for US and non-US investors alike. This is especially crucial for investment from Japan, as US high-skilled immigration policy is seen as a source of comparative advantage by Japanese firms.

Third, state-of-the-art infrastructure—ports, airports, railroads, roads, bridges, tunnels, information technology, and electrical grids—is crucial for MNCs to manage worldwide production and coordinate international supply chains. Increasingly sophisticated FDI requires increasingly sophisticated infrastructure.

Finally, the United States needs to fundamentally reform the way it taxes international business operations. US corporate taxes—federal and state—are today among the highest in the world, and the thrust of US policy is to penalize firms that undertake foreign operations. The corporate tax rate should be reduced to 25 percent (or lower) and move toward a territorial tax system, as most other countries have adopted, in which the active business income of foreign affiliates is subject to a sharply reduced or zero rate of taxation to the home country. The gap between US and Japanese corporate tax rates is not large, but the United States is not in competition with Japan alone as a destination for foreign investment.

Japanese multinationals with operations in the United States, like other foreign investors and US-headquartered American multinationals, make up 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 US economy. Their superior production techniques and quality-control processes spill over horizontally and vertically to improve the performance of US firms and workers. US interests are best served by making the domestic economy a more favorable destination for these international corporations from around the world.

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