Policy Analysis

No. 735 August 22, 2013

Reversing Worrisome Trends

How to Attract and Retain Investment in a Competitive Global Economy

by Daniel Ikenson

Executive Summary

No country has been a stronger magnet for foreign direct investment than the United States. Valued at $3.5 trillion, the U.S. stock of inward foreign direct investment accounted for 17 percent of the world total in 2011, more than triple the share of the next largest destination.

Foreign direct investment is ultimately a judgment by the world's value creators about a country's institutions, policies, human capital, and prospects. As the world's largest economy, the United States has been able to attract the investment needed to produce the innovative ideas, revolutionary technologies, and new products and industries that have continued to undergird its position atop the global economic value chain.

But the past is not necessarily prologue. Indeed, while the U.S. claim to 17 percent of the world's stock of foreign direct investment is impressive, the share stood at 39 percent as recently as 1999. It has been 12 years since the annual value of U.S. inward FDI set a record high of $314 billion, and since then, annual flows have failed to establish an upward trend. The most recent figures show a decline of 35 percent, from $227 billion in 2011 to $147 billion in 2012.

To a large extent, these trends reflect the emergence of new, viable destinations for investment resulting from inevitable demographic, economic, and political changes. However, some of the decline is attributable to a deteriorating U.S. investment climate, as reflected on a variety of renowned business surveys and investment indices measuring policy and perceptions of policy.

The current U.S. business environment conspires to deter inward investment and to encourage companies to offshore operations that could otherwise be performed competitively in the United States. A proper accounting of these policies, followed by implementation of reforms to remedy shortcomings, will be necessary if the United States is going to compete effectively for the investment required to fuel economic growth and higher living standards.

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While the United States can claim the largest stock of foreign direct investment by a factor of three, its share of global foreign direct investment stock declined from 39 percent in 1999 to 17 percent in 2011.

Introduction

Investment is the lifeblood of economic growth. The value of tomorrow's output is a function of today's investments in factories, research centers, machines, technology, software, and training. Whether investment comes from domestic or foreign sources, its purpose is to create value and wealth, a process that begets higher living standards. In all but the rarest of circumstances, such as where a transaction poses obvious threats to national security, investment should be welcomed from sources both domestic and foreign.

Investment comes in many different forms. Equity investment entails purchases of shares in specific companies, industries, or funds. Purchases of debt issued by governments or corporations also constitute investment. The focus of this paper is direct investment, which includes purchases and control of real assets, such as buildings, factories, equipment, and software.[1]

No country has been a stronger magnet for foreign direct investment (FDI) than the United States. Valued at $3.5 trillion, the U.S. stock of inward FDI accounted for 17 percent of the world total in 2011, which was more than triple the share of the next largest destination.[2] For the period 2006–2011, U.S. inflows of FDI have averaged $221.3 billion per year—well more than double the next single-country destination.[3] That inward investment has punched above its weight, contributing disproportionately to increases in U.S. output, value-added, compensation, exports, and research and development spending.

It should not be surprising that global demand for U.S. factories, research and development facilities, office buildings, and industrial machinery has been strong. Foreign companies seeking greater sales in the world's largest market often require some physical presence in that market. But size is not all that matters.

Foreign direct investment (or its absence) is ultimately a judgment by the world's value creators about a country's institutions, policies, human capital, and prospects. As an economy featuring a highly productive work force, world-class research universities, a stable political climate, strong legal institutions, accessible capital markets, and countless other advantages (including size), the United States has been able to attract the investment needed to produce the innovative ideas, revolutionary technologies, and new products and industries that have continued to undergird the U.S. position atop the global economic value chain.

But the past is not necessarily prologue. Indeed, while the United States can claim the largest stock of foreign direct investment by a factor of three, the U.S. share of global FDI stock declined from 39 percent in 1999 to 17 percent in 2011.[4] It has been 12 years since the annual value of U.S. inward FDI set a record high of $314 billion. Since 2000, annual flows have failed to establish an upward trend. The most recent investment figures indicate that U.S. FDI inflows declined from $227 billion in 2011 to $147 billion in 2012, a drop of over 35 percent.[5]

To a large extent, these trends reflect inevitable demographic changes. Strong economic growth in developing countries has followed periods of political stability and economic liberalization, creating new opportunities and inspiring confidence that these formerly higher-risk bets are viable—indeed desirable—places to invest in productive activities.

However, some of the decline in U.S. share is attributable, not to increasing absolute advantages of investing in other countries, but to decreasing absolute advantages of investing in the United States. A deteriorating U.S. investment climate is making other countries relatively more attractive. Just as U.S. businesses have been reluctant to invest and hire since the Great Recession, foreign companies also have been reticent about investing in the United States, and for many of the same reasons: uncertainty and an increasingly inhospitable environment for business.

Another contributing factor is U.S. outflows of FDI. Just as the United States is the destination for more FDI than any other country, U.S. investors hold more FDI abroad than the investors of any other country. Valued at $4.5 trillion in 2011, most U.S.-owned FDI stock is located in Europe, Canada, Japan, and other wealthy countries, but a growing share is going to developing countries.[6]

Unlike ever before, the world's producers have a wealth of options when it comes to where and how they organize product development, production, assembly, distribution, and other functions on the continuum from product conception to consumption. As businesses look to the most productive combinations of labor and capital, to the most efficient production processes, and to the best ways of getting products and services to market, perceptions about the business environment can be determinative. In a global economy, "offshoring" is an inevitable consequence of competition.[7] And policy improvement should be the broad, beneficial result.

The capacity of the United States to continue to be a magnet for both foreign and domestic investment is largely a function of its advantages, many of which are shaped by public policy. Considerations of taxes, regulations, trade openness, access to skilled workers, infrastructure, energy policy, and dozens of other policy matters factor into decisions about whether, where, and how much to invest. It should be of major concern that inward FDI has been erratic and relatively downward trending in recent years, but why that is the case should not be a mystery. U.S. scores on a variety of renowned business surveys and investment indices measuring policy and perceptions of policy suggest that the U.S. business environment is becoming increasingly less hospitable.

Although some policymakers recognize the need for reform, others seem to be impervious to the investment-repelling effects of some of the laws and regulations they create. Some see the shale gas and oil booms as more than sufficient for overcoming policy shortcomings and attracting the necessary investment. The most naive consider "American" companies to be tethered to the U.S. economy and obligated to invest and hire in the United States, regardless of the quality of the business and policy environments. They fail to appreciate that increasingly transnational U.S.-based businesses are not obligated to invest, produce, or hire in the United States.

It is the responsibility of policymakers, however, to create an environment that is more attractive to prospective investors. Current laws, regulations, and other conditions affecting the U.S. business environment are conspiring to deter inward investment and to encourage companies to offshore operations that could otherwise be performed competitively in the United States.

A proper accounting of these policies, followed by implementation of reforms to remedy shortcomings, will be necessary if the United States is going to compete effectively for the investment required to fuel economic growth and higher living standards.

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Foreign Investment in Perspective

Americans are transacting with foreigners more intensively than ever before. Over the past 20 years, the value of U.S. trade as a share of gross domestic product more than doubled from 16 percent to 33 percent.[8] In 2012, the total value of imports and exports of goods and services reached an all-time high of $5 trillion.[9] If those trade statistics give a hint of the fact of increasing global integration, the international investment figures tell a compelling story about it.

The combined value of U.S.-owned assets abroad and foreign-owned assets in the United States had already surpassed the $5 trillion mark 20 years ago. In 2012 that cross-border engagement exceeded $46 trillion, a figure triple the size of the U.S. economy and more than nine times the value of U.S. trade.[10]

About 70 percent of that transnational investment—$32.5 trillion—is privately held in securities, government-issued debt, other

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financial instruments, and real assets such as land, factories, office buildings, other facilities, and equipment. The market value of these cross-border investments in real assets amounted to about $9.1 trillion in 2012, with Americans owning $5.2 trillion worth of direct assets abroad and foreigners owning $3.9 trillion worth of direct assets in the United States.[11]

It is primarily through these cross-border direct investments that Americans transact—as workers, consumers, producers, and collaborators in the production of goods and services—with people around the world. With 95 percent of the world's population living outside U.S. borders, where economic growth has been and is expected to remain stronger for many years, it is imperative that Americans develop, deepen, and broaden their channels of commercial engagement with the rest of the world. Increasingly, the success of U.S. companies will depend on their ability to sell in foreign markets, incorporate foreign intermediate goods and raw materials into their own output, and collaborate effectively with foreign firms and workers in production and supply-chain operations. Increasingly, a company's success abroad will be a determinant of its success at home, and vice versa.

An all-too-common portrayal of globalization presents the external 95 percent as a threat more than an opportunity. The 95 percent are competitors, but not customers or production partners. They will take our jobs and dominate U.S. markets, but not purchase our output or help U.S. companies succeed abroad. In this view, there is great peril, but little opportunity. The facts surrounding foreign direct investment tell a very different story.

Inward FDI

With a stock valued at $3.9 trillion, the United States is the top single-country destination for the world's FDI outflows.[12] There are plenty of reasons for that being the case, including the facts that the United States is the world's largest market and has a sound legal system and a relatively transparent business environment. More than $4 out of every $5 of that stock (84.2%) is owned by Europeans, Canadians, and Japanese, with the U.S. manufacturing sector accounting for a full third of its value, making it the primary destination for inward FDI.[13]

Foreign direct investment enters the United States through different channels, but the most common channels are through acquisitions of U.S. companies or divisions by foreign companies, mergers between foreign and U.S. companies, foreigners creating new businesses in the United States ("greenfield" investment), and expansion of existing foreign-owned companies through capital expenditures and acquisitions.

With some important exceptions, inward investment generally has been welcomed in the United States since the founding of the republic. For example, foreign ownership in some industries, such as shipping, aviation, communications, energy, mining, and banking is restricted, and a statutory process exists to examine and ultimately block prospective foreign acquisitions that are deemed a threat to national security.[14]

Although the investment climate is relatively open, not everyone sees inward FDI as beneficial. Among the common concerns registered about inward investment are that it can lead to layoffs and closures; it reduces competition in the U.S. market; it replaces domestic-based supply chains with foreign supply chains, leading to further layoffs and closures; it reduces exports and increases imports; it has only a fleeting commitment to the United States; it results in higher value-added activities being stripped from the United States; it causes loss of proprietary technology; it shrinks the U.S. tax base; and it can undermine national security through loss of control over crucial industries.

Skepticism about FDI is nothing new. In his *Report on Manufactures* in 1791, Alexander Hamilton wrote:

> It is not impossible that there may be persons disposed to look with a jeal-

> ous eye on the introduction of foreign capital, as if it were an instrument to deprive our own citizens of the profits or our own industry; but, perhaps, there never could be a more unreasonable jealousy. Instead of being viewed as a rival, it ought to be considered as a most valuable auxiliary, conducing to put in motion a greater quantity of productive labor, and a greater portion of useful enterprise, than could exist without it.[15]

The data support Hamilton's perspective. According to recent congressional testimony from Dartmouth economist Matthew Slaughter:

> U.S. subsidiaries of global companies—despite accounting for far less than 1% of U.S. businesses—perform large shares of America's productivity-enhancing activities that lead to higher average compensation for American workers.[16]

Slaughter notes that, in 2010, these subsidiaries produced $649.3 billion in output, which was 5.8 percent of all private-sector output; purchased $149 billion in new property, plant, and equipment, which was 14.4 percent of all non-residential, private-sector capital investment; exported $229.3 billion of goods, which was 18 percent of the U.S. total; performed $41.3 billion of research and development, accounting for 14.3 percent of the total performed by all U.S. companies; and purchased 80 percent of their intermediate goods—nearly $2 trillion worth—from U.S. suppliers.[17]

Digging deeper into the data, the increasing contribution of these subsidiaries, affiliates, or "insourcing" companies to U.S. economic performance is unmistakable. Between 2001 and 2010, U.S. private sector value-added (output measured in terms of GDP) increased by 39 percent; for affiliates, the increase was 56 percent, which lifted the overall average. In the manufacturing sector, the relative contribution of affiliates to GDP is even more profound: overall U.S. manufacturing sector value-added increased by 21 percent over the decade, while it rose by 53 percent for manufacturing-sector affiliates.

As average private-sector compensation per worker increased by 33 percent over the decade, it increased by 40 percent at U.S. affiliates to $77,409—a 24 percent premium over the private-sector average. Per worker compensation in the overall U.S. manufacturing sector averaged $76,484 in 2010, as compared to an average of $85,211 at manufacturing affiliates. The smaller and shrinking differential—11 percent in 2010, down from 15 percent in 2001—speaks to the positive impact of affiliates on U.S. workers' incomes.[18]

Affiliates have demonstrated a strong commitment to the U.S. economy, increasing their stock of U.S. property, plant, and equipment by 46 percent over the decade—double the overall private-sector increase. U.S.-based companies also benefit from exposure to the best practices employed by affiliates, many of which are world-class companies that know how to operate efficiently. While sales per worker in the U.S. private sector amounted to $431,758 in 2010, it averaged $632,777 among affiliates—a 47 percent premium. Just as they generate more revenue per worker, affiliates get more revenue from their physical assets. In 2010, affiliates' fixed asset turnover ratio (a measure of return on assets) was 53 percent higher than it was for the U.S. private sector on average.

U.S. affiliates have raised average economic performance by boosting output, sales revenue, exports, employment, and compensation. They have also demonstrated a strong commitment to the United States with increasing levels of capital investment, reinvested profits, research and development spending, and cultivation of relationships with U.S. suppliers. And they have introduced industry best practices, as evidenced by the achievement of higher levels of value-added per worker, sales per worker, and returns on assets.

Between 2001 and 2010, U.S. private sector value-added, measured in terms of GDP, increased by 39 percent, and for affiliates, the increase was 56 percent.

These data suggest that the alleged ill effects of inward FDI are more bark than bite, and they make a compelling case for the extension of maximum investment liberalization to currently restricted industries, such as shipping, commercial aviation, and mining. While being mindful of the national security implications of foreign acquisitions is always prudent, the potential for an overencompassing definition of national security to give cover to protectionist or otherwise political motives is also an ever-present danger.

Until the past few years, Chinese direct investment in the United States has been immaterial.[19] Some proposed high-profile Chinese acquisitions of U.S. companies have come under close scrutiny from the Committee on Foreign Investment in the United States (CFIUS), resulting in aborted transactions and post-acquisition divestment. As the volume and value of Chinese investments in the U.S. economy increases in the coming years, it is highly likely that acquisitions without any pertinent national security ramifications will be portrayed as threats and thwarted by politicians acting through an opaque CFIUS process. The recently proposed acquisition of Smithfield Foods for $4.7 billion by Shuanghui International, and the close scrutiny the deal is receiving from CFIUS at the urging of numerous politicians with constituents in the same industry, should raise concerns among those who recognize the importance of foreign investment to U.S. economic growth and job creation. Expansive definitions of national security can undermine U.S. economic security.

Any trade deficit is matched by an investment surplus, as the dollars that purchase foreign goods and services and foreign assets are matched nearly identically by dollars coming back to the United States.

Inward FDI and the Trade Deficit

Many of those who express reservations about inward investment are the same people who issue warnings about the deleterious effects of the U.S. trade deficit. They assert that the deficit is a drain on U.S. economic activity and employment. By purchasing more goods and services from foreigners than foreigners purchase from Americans, the argument goes, U.S. factories, farmers, and service providers are deprived of sales, which reduces domestic output, value-added, employment, and all of the secondary and tertiary commercial activities that would have taken place. But their argument relies on the assumption that the dollars sent to foreigners to purchase imports do not make their way back into the U.S. economy—an assumption that is incorrect.

The dollars that go abroad to purchase foreign goods and services (imports) and foreign assets (outward investment) are matched nearly identically by dollars coming back to the United States to purchase U.S. goods and services (exports) and U.S. assets (inward investment). Any trade deficit (net outflow of dollars) is matched by an investment surplus (net inflow of dollars).[20]

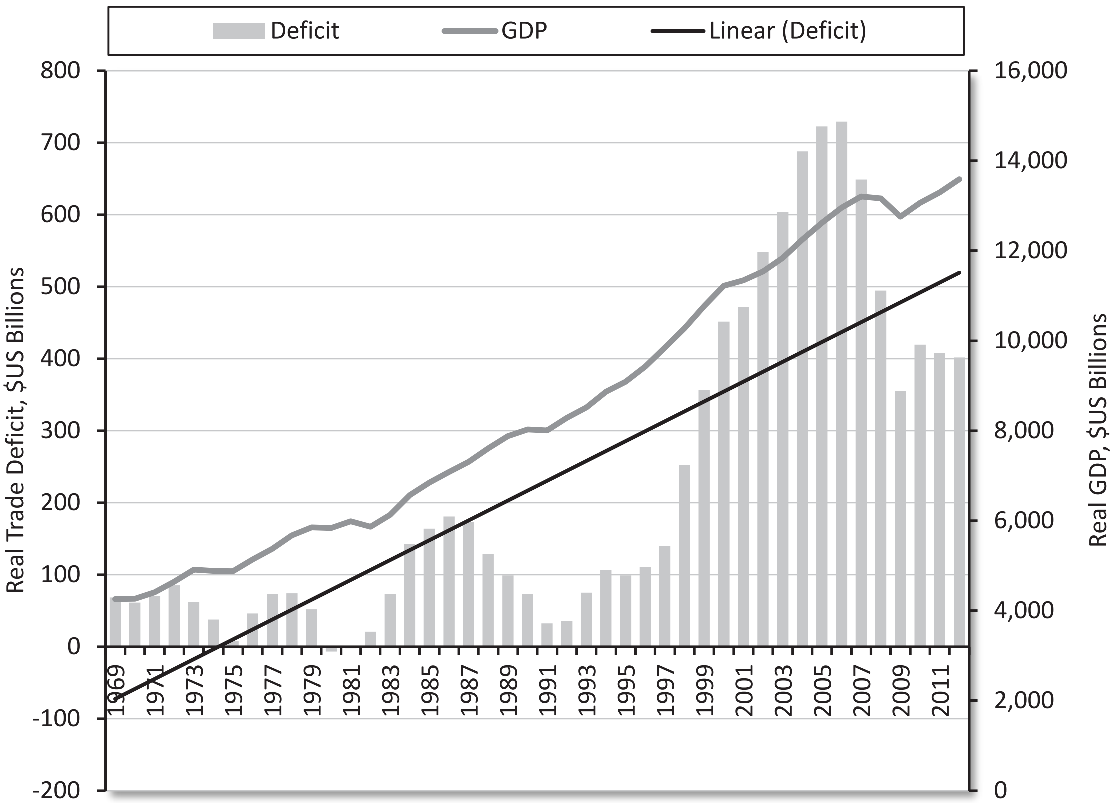
This process helps explain the absence of any inverse relationship between trade deficits and jobs and between trade deficits and domestic output, and severely weakens the claims of trade and investment skeptics.

As Figure 1 demonstrates, if anything, there is a positive relationship between the trade deficit and GDP. In years when the deficit is rising, GDP is increasing; when the deficit is falling, GDP tends to level off and stagnate.

The trade deficit equals the excess of imports over exports. Homing in on the relationship between imports and GDP and between imports and jobs, a very clear, strong, positive relationship is evident for nearly the entirety of the period. Only in the three most recent years has a growing economy (anemic as it has been) been contemporaneous with a declining trade deficit. It is worth noting, however, that the annual growth in imports in each of those years far exceeded the rate of economic growth.[21]

As Figures 2 and 3 reveal, in years when imports increase over the previous year, U.S. output (as measured by GDP) and employment tend to increase from the previous year. In years when imports show a decline, output and employment also tend to decline. The high incidence of observations in the upper-right and lower-left quadrants in both graphs suggests positive relationships

Figure 1
Real GDP and the Real Trade Deficit, 1969–2012



Source: Bureau of Economic Analysis.

between imports and output and between imports and jobs. In fact, as shown in Figure 2, in only one of the 44 years observed did imports and output move in different directions. In Figure 3, the relationship between imports and jobs is also demonstrated to be positive. In 39 of the 44 years observed, the measurements moved in the same direction.

If the trade deficit reduces economic activity and destroys jobs, why is there a positive relationship between these variables?[22] One important reason is that investment inflow provides the capital that supports economic activity and job creation.

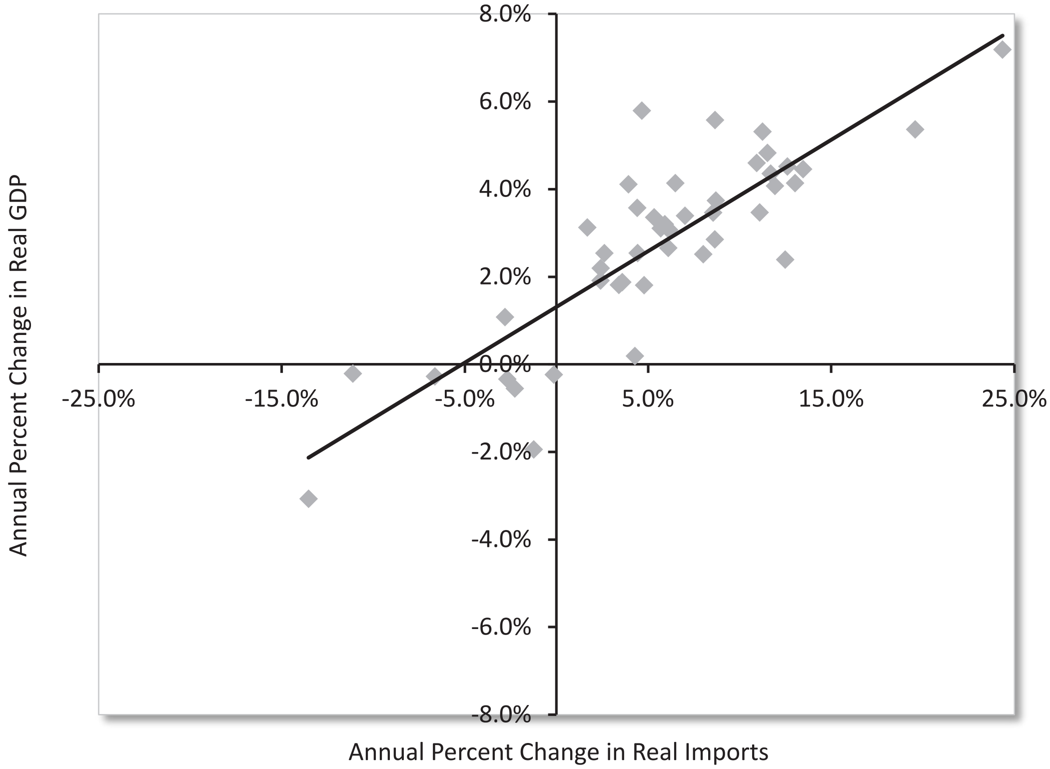
Moreover, contrary to the admonitions of deficit hawks, the trade deficit is not a running tab that we or our children will have to pay back to foreigners. Inward investment used to finance the trade deficit comes primarily in the form of foreign purchases of U.S. equities and direct investment. These are investments that produce real wealth and other benefits for American businesses, workers, and consumers. The portion of the trade deficit that the American public will have to pay back is that which finances the U.S. government's debt, which accounts for about one-third of the value of all foreign investment and is not a failing of trade or investment policy, but a consequence of excessive government spending.[23]

Outward FDI

Considering how the U.S. economy reaps all of these benefits from inward investment, it is tempting to conclude that outward investment is economically deleterious. After all, if activity-spurring, value-creating investment flows from U.S. investors to locations abroad, there will be less production, less

Investment inflow provides the capital that supports economic activity and job creation.

Figure 2
Annual Changes in Real Imports and Real GDP, 1969–2012



Source: Bureau of Economic Analysis.

Outward investment and domestic economic activity are usually complementary, as investment abroad tends to spur domestic activity.

value creation, fewer jobs, a smaller tax base, and less research and development spending in the United States.

But that is not necessarily the case. Outward investment and domestic economic activity are usually complementary; investment abroad tends to spur domestic activity because local and foreign operations are often sequential functions in the same supply chain or because there is more demand placed on domestic administrative, accounting, human resources, and other management functions to support expanding activities abroad.

The cliché about foreign outsourcing describes factories shutting down in the industrial Midwest only to be resurrected bolt-by-bolt, rafter-by-rafter in developing countries to produce the same products for export back to the United States. Yet in reality, most outward investment has been to serve purposes that cannot be fulfilled practicably or cost-effectively in the United States. Reaching potential foreign customers without having any physical presence in their countries, for example, would be a difficult task. Marketing to foreign customers, getting better acquainted with foreign product preferences, having retail locations to serve demand abroad, performing post-sale and other customer-service activities, tapping into local expertise, or diversifying market-specific risks are among several reasons to invest abroad that are highly unlikely to be successfully replicated from within the United States. Outward investment of this nature and for these purposes might be considered "non-discretionary" offshoring; they are the steps that must be taken in order for U.S. companies to compete more effectively in the global economy.

U.S. companies invest abroad for a variety of important reasons, but serving U.S.

demand from those foreign locations is not prominent among them. Referring to the recent growth of U.S. investments in China, Brazil, India, and Eastern Europe, Bureau of Economic Analysis economists Kevin Barefoot and Raymond Mataloni noted: "Judging by the destination of sales by affiliates in those countries, the goal of the U.S. multinational corporations' expanded production was to primarily sell to local customers rather than to reduce their labor costs for goods and services destined for sale in the U.S., Western Europe and other high-income countries." According to the data, over 90 percent of the value of output from foreign affiliates of U.S.-based companies is sold in foreign markets.[24]

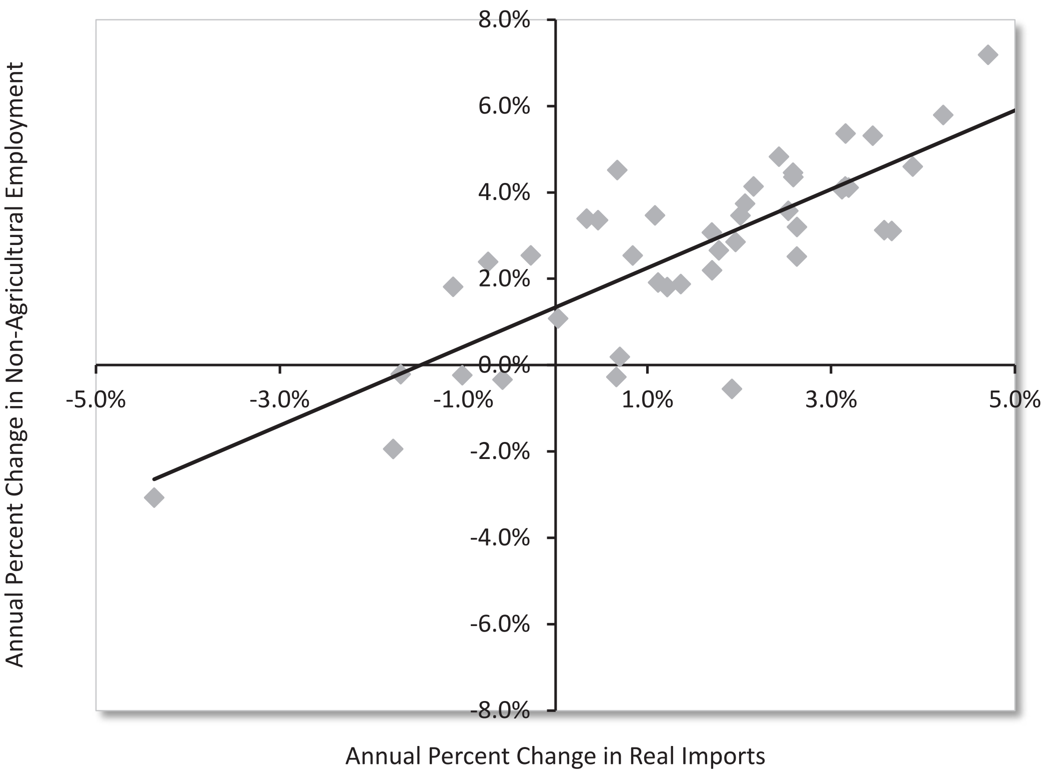
For the unconvinced, it is worth noting these findings of Harvard Business School professors Michael E. Porter and Jan W. Rivkin:

> [L]arge-scale relocations make up a tiny fraction of all American job losses. From 2008 to 2010, mass layoffs (50 or more jobs) involving relocations outside the U.S. resulted in the loss of only 27,145 U.S. jobs, government statistics show. In contrast, mass layoffs not involving foreign relocations resulted in nearly 5 million jobs lost.[25]

Outward investment benefits the U.S. economy through numerous direct and indirect channels. The pattern for outward FDI is similar to that for inward FDI in the sense that the overwhelming majority is located in rich countries. Nearly three-quarters of the $5.2 trillion stock of U.S.-owned direct investment abroad is concentrated in Europe, Canada, Japan, Australia, and Singapore.[26] Contrary to persistent rumors, only

Over 90 percent of the value of output from foreign affiliates of U.S.-based companies is sold in foreign markets.

Figure 3
Annual Changes in Real Imports and Non-Agricultural Employment, 1969–2012



Source: Bureau of Economic Analysis.

1.3 percent of the value of U.S. outward FDI was in China at the end of 2011.[27]

Even after factoring out U.S. investment in foreign financial institutions, banks, and holding companies (which account for nearly two-thirds of the total outward stock), the bulk of outward U.S. FDI remains concentrated in developed countries, with Europe, Canada, Japan, Australia, and Singapore accounting for 70 percent of all outward U.S. manufacturing FDI and China's share rising to a still modest 4.5 percent.[28] U.S. investors are also important participants in foreign professional services and information industries, as well as their hospitality and wholesaling sectors—industries that would all seem to require intensive physical presence.

U.S. companies must be engaged in foreign markets, because 95 percent of the world's population is overseas.

With 95 percent of the world's population overseas, where the rate of economic growth over the past decade well exceeded the U.S. rate, U.S. companies must be engaged in foreign markets. Nine of the 10 largest U.S. multinational companies had greater revenues in foreign markets than in the United States.[29]

In 2010, the total value of U.S. exports to the world was $1.8 trillion, but majority-owned foreign affiliates of U.S. companies had sold $5.2 trillion of goods and services in foreign markets. In other words, for every dollar of U.S. exports, foreign affiliates of U.S. companies made $3 in sales to foreign customers. That ratio is even more pronounced for multinational corporations.

Matthew J. Slaughter found that in 2010, U.S.-based multinational companies exported $573.3 billion in goods to foreign markets, while their foreign affiliates sold $3.7 trillion worth of goods in those markets, for a greater than 6-to-1 premium.[30] This would seem to confirm the importance of direct investment abroad to the success of U.S. multinational companies. And success abroad begets success at home.

Slaughter adds:

> Expansion abroad by U.S. companies tends to complement their U.S operations, with more hiring and investment abroad often boosting hiring, investment, and R&D in their U.S operations. And they create jobs in America in other companies, not just in themselves. In particular, they create jobs in small and medium-sized American enterprises that become part of their global supply networks.[31]

U.S. multinational corporations' investment in affiliates abroad is crucial to the success of their U.S. operations, and impediments to outflows would likely adversely impact their U.S. employment, compensation, and investment. According to Slaughter, U.S. parent companies account for large shares of U.S. economic activity: they produce 23 percent of all private-sector value-added; they hold 42 percent of all private-sector capital investment; they account for 45 percent of U.S. exports; and they conduct 69 percent of all research and development expenditures undertaken by the private sector.[32]

U.S. parent operations are very much complementary to the operations of their foreign affiliates. In a recent Peterson Institute for International Economics (PIIE) paper recommending corporate tax reforms to spur more investment at home and abroad, Gary Hufbauer and Martin Vieiro argue that "MNCs which engage in FDI are in the best position to create jobs and promote prosperity at home."[33] They reinforce the point that outward FDI is not a substitute for, but a complement to, investment and economic activity at home:

> Better jobs, higher investment, larger exports, and more research and development (R&D) at home go hand in hand with greater outward FDI. Unfortunately, and contrary to these research findings, much of the recent debate over corporate tax policy reflects a zero-sum view of MNC activity.[34]

The performance of foreign affiliates and their U.S. parents points to complementarity. Across a range of relevant metrics (depicted in Figures 4–9), the performance of foreign affiliates and their U.S. parents seems to be positively correlated, improving or declining contemporaneously. Annual changes in affiliates' and parents' capital expenditures, output (value-added), total compensation, and compensation per worker moved in the same direction in 8 of the 11 years measured. Such was the case for research and development spending in 6 of the 9 years measured. For employment, the complementarity was not as evident, with changes moving in the same direction in 6 of 11 years. However, in 3 of the 5 years when employment moved in opposite directions (affiliate employment increased and parent employment decreased), there was no perceptible increase in employment at affiliates to suggest substitutability. Also notable is the fact that in all 11 years, compensation per worker at U.S. parents increased over the previous year.

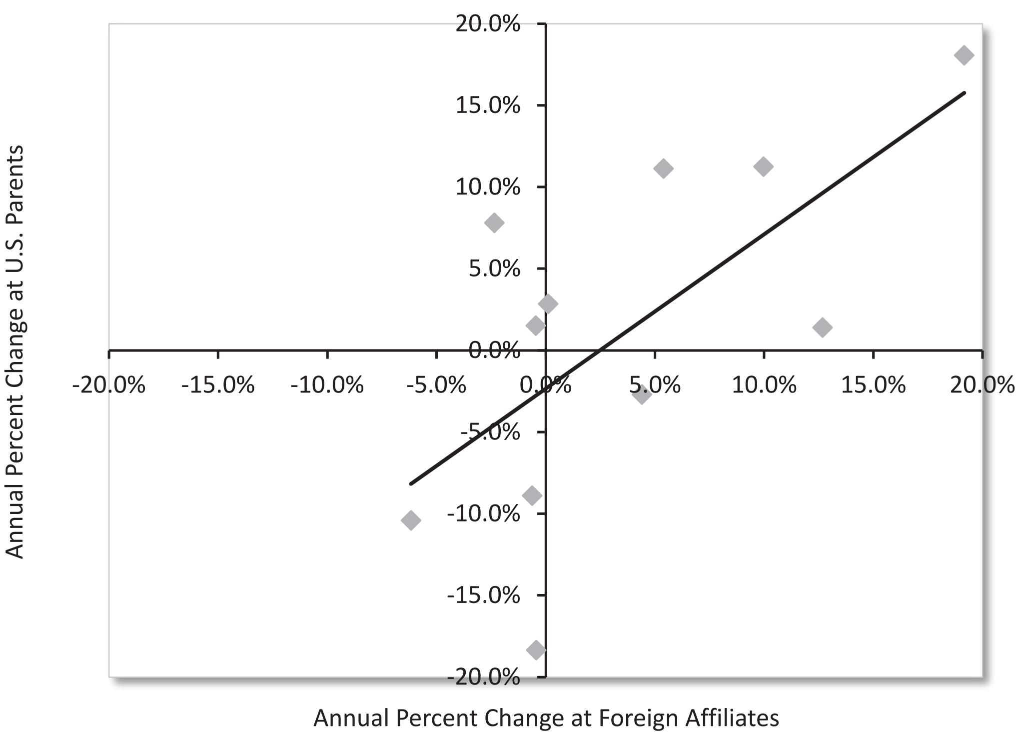
For those still skeptical, Matthew Slaughter offers these additional reassurances:

> The worldwide operations of U.S.-headquartered multinational companies are highly concentrated in America in their U.S. parents, not abroad in their foreign affiliates: In 2010, U.S. parents accounted for 67.3 percent of their companies' worldwide employment, 72.5 percent of capital investment, and 84.3 percent of R&D.[35]

The decline of both direct and indirect impediments to trade and investment—aided by other important trends—has opened new channels for connecting U.S. consumers to foreign producers and U.S. producers

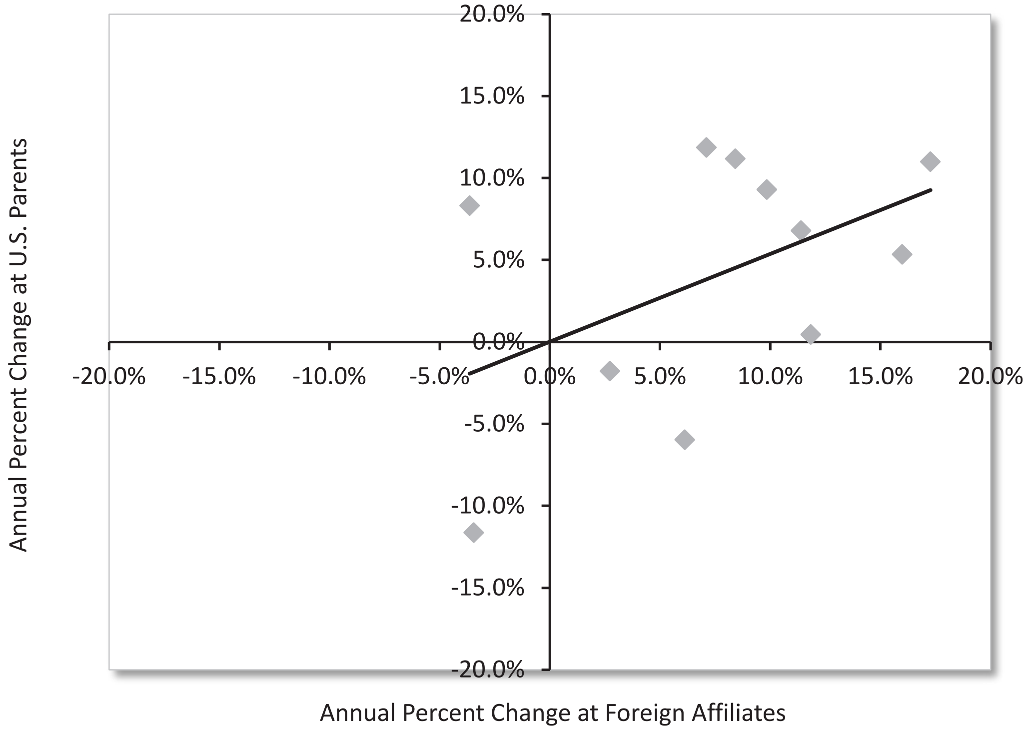
The performance of foreign affiliates and their U.S. parents seems to be positively correlated across a range of relevant metrics, improving or declining contemporaneously.

Figure 4
Annual Percent Changes at Foreign Affiliates and U.S. Parents Capital Expenditures (2000–2010)



Source: Bureau of Economic Analysis.

Figure 5
Annual Percent Changes at Foreign Affiliates and U.S. Parents Value Added (2000–2010)



Source: Bureau of Economic Analysis.

American companies investing abroad are accused of pursuing low wages and lax labor, environmental, and product-safety standards so they can cut production costs and pad the bottom line.

to foreign consumers, has improved opportunities for cross-border collaboration in production and design, has increased the likelihood that worthy ideas get funded and appropriately marketed, and, ultimately, has expanded the global pie.

The "Race to the Bottom" Canard

Like all businesses, multinational corporations are committed to maximizing profits for their shareholders. Globalization's loudest critics detect malevolence in their motives. Foreign companies seeking to purchase U.S. businesses or make new investments in production facilities in the United States are often portrayed as pursuing an opaque agenda that offends their conceptions of the "national interest." Whether it is gaining access to proprietary U.S.-owned technology, or knocking off U.S. competitors, or disrupting domestic supply chains, something sinister or economically threatening is intimated about the transaction.

Meanwhile, U.S. companies that invest abroad are accused of engaging in a race to the bottom, fueled by an endless pursuit of lower wages and increasingly lax labor, environmental, and product-safety standards so as to shave a few cents off the cost of production and pad the bottom line. Throughout the election campaigns last year, President Obama and Governor Romney traded accusations over who was most guilty of perpetuating this sin. Referring to Mr. Romney, an Obama campaign news release said "As a corporate buyout specialist, he made massive profits by shuttering plants, firing workers and investing in companies that pioneered shipping of good American jobs overseas."[36] In response, and referring to allegations that "stimulus" money was benefitting foreign companies, Romney said: "If there's an outsourcer-in-chief, it's the president of the United States, not the guy who's running to replace him."[37] Unfortunately, with the candidates droning on about the ravages of "shipping jobs overseas," the predictable debate about offshoring that transpired generated more heat than light, and was a lost opportunity to educate Americans about the real determinants and benefits of foreign direct investment.

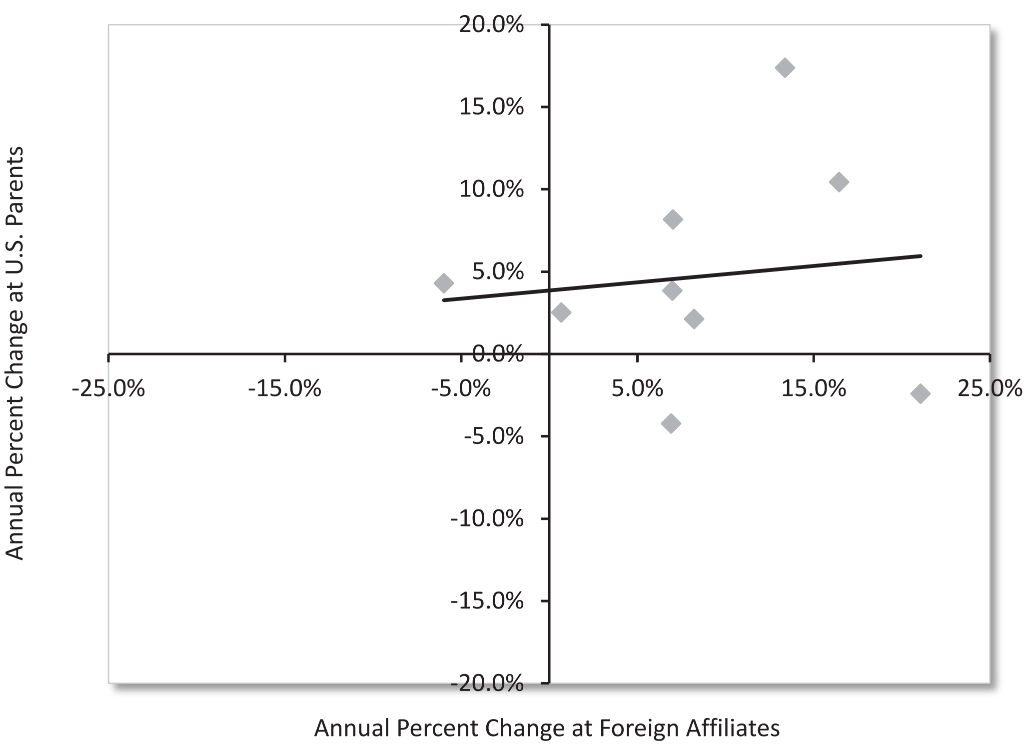
Contrary to the misconceptions so often reinforced in the media, offshoring is rarely the product of U.S. businesses chasing low wages or lax standards abroad. Businesses are concerned about the entire cost of production, from product conception to consumption. Foreign wages and standards are but a few of the numerous considerations that factor into the ultimate investment and production decision.

Locales with low wages and lax standards tend to be expensive places to produce all but the most rudimentary goods because, typically, those environments are associated with low labor productivity and other economic, political, and structural impediments to smooth operation of cost-effective supply chains. Most of those crucial considerations favor investment in rich countries over poor.

Indeed, if low wages and lax standards were the real draw, then U.S. investment outflows would not be so heavily concentrated in rich countries with higher wages and more stringent labor, environmental, and product safety standards than our own.[38] Likewise, the United States would not be the world's largest single country destination for direct investment. In 2011, the value of the stock

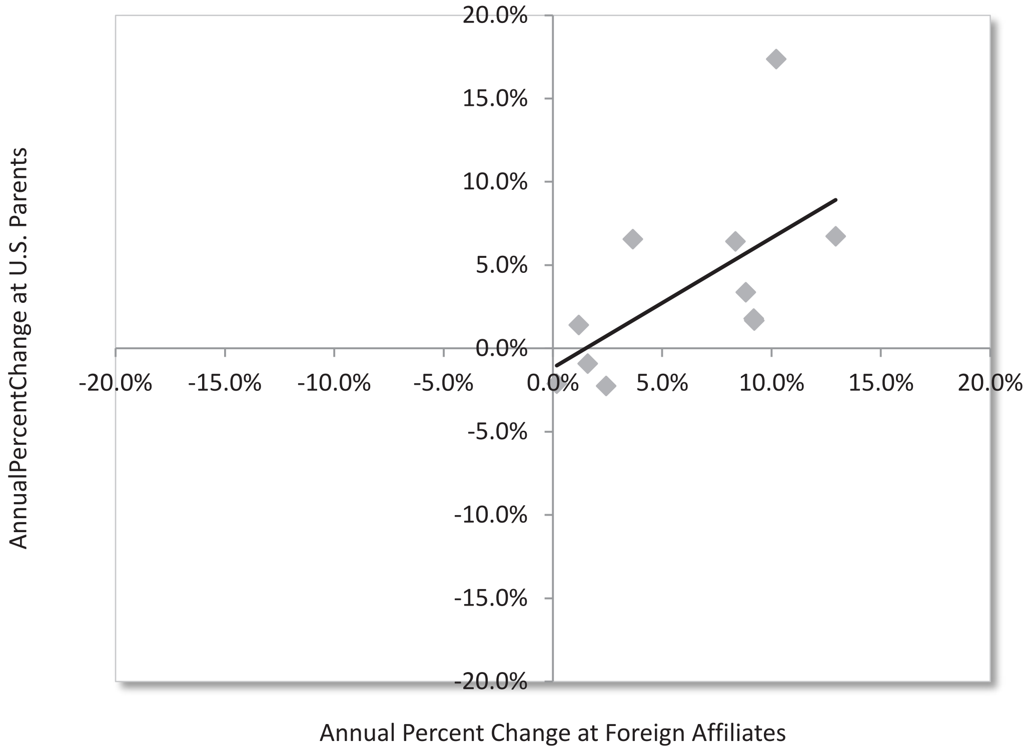
If low wages and lax standards were the real draw, U.S. investment outflows would not be so heavily concentrated in countries with higher wages and more stringent standards than our own.

Figure 6
Annual Percent Changes at Foreign Affiliates and U.S. Parents R&D Expenditures (2002–2010)



Source: Bureau of Economic Analysis.

Figure 7
Annual Percent Changes at Foreign Affiliates and U.S. Parents Compensation (2000–2010)



Source: Bureau of Economic Analysis.

Foreign investments, jobs, and related activities in America, which employ more than five million U.S. workers, are the products of foreign companies engaging in offshoring.

of foreign direct investment in the U.S. manufacturing sector alone amounted to $838 billion, while the value of the stock of U.S. direct investment in foreign manufacturing sectors amounted to $589 billion.[39] Those figures amount to a $250 billion manufacturing "insourcing" surplus.

In the midst of last summer's outsourcing brouhaha, the candidates were remiss in failing to note that Europe's Airbus had announced plans for a $600 million facility in Mobile, Alabama, just down the road from the $5 billion, 1,800-worker steel production facility belonging to German-based ThyssenKrupp, which was built there for its proximity to the dozens of mostly foreign-nameplate auto producers, who employ tens of thousands of U.S. workers and generate economic activity supporting thousands more, all while providing U.S. consumers with greater value from their automobiles than they would be getting absent those foreign investments. Those investments, jobs, and related activities are the products of foreign companies engaging in offshoring. Why do they come to American shores to produce instead of producing elsewhere? Because from an aggregate cost perspective, locating here makes the most sense. They are not here because of low wages or lax enforcement of labor and environmental standards, but because all of the factors affecting costs that each company uniquely considers weigh—in the aggregate—in favor of locating their respective activities here.

That such a large proportion of the world's investment is located in rich countries should be strongly persuasive evidence—even to globalization's biggest skeptics—that other factors are of greater significance to the investment decision than wages and environmental standards.

What Really Drives the Investment Decision?

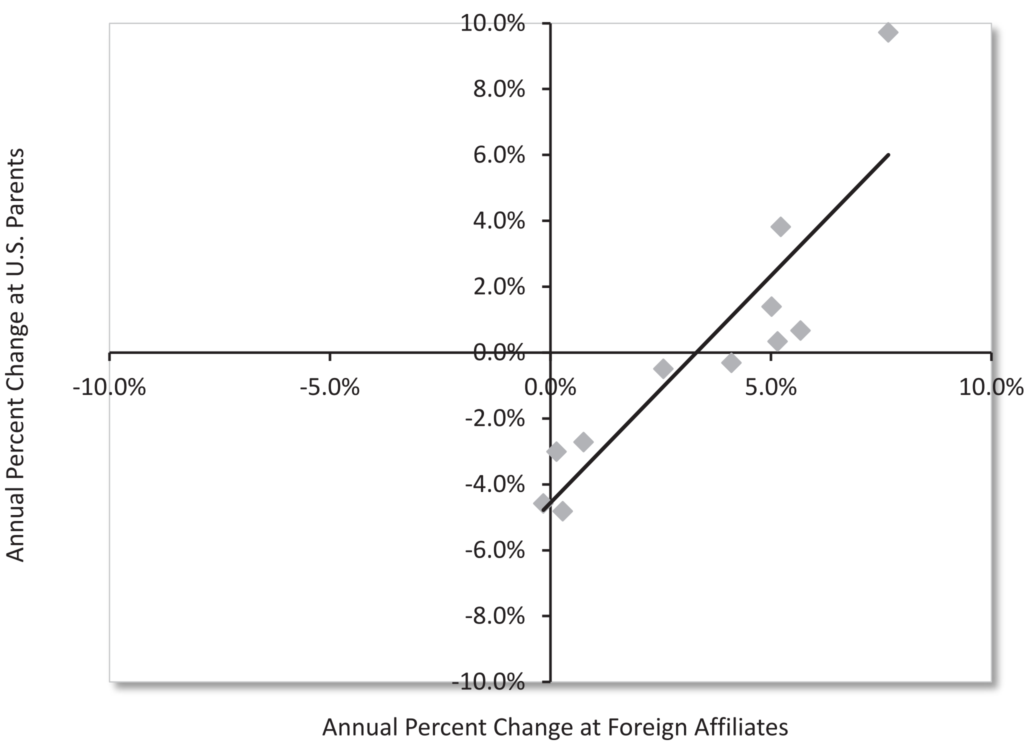
Investment is a judgment about the virtues of a jurisdiction's business and political climates. Policies that breed stability and predictability are good. The importance of these determinants of investment varies by company, by situation, and by prospective function to be performed. But, by and large, they include considerations such as the quality and skills of the work force; access to ports, rail, and other transportation infrastructure; customs-clearance procedures; import duties; proximity of the prospective production location to the next or previous link in the supply chain or to the final market; the size of nearby markets; the overall economic environment in the host country or region; the political climate; the risk of asset expropriation; the regulatory environment; taxes; and the dependability of the rule of law, to name some.

Although the United States has fared well with respect to these investment determinants over the years, it is now faltering in many respects, while facing greater competition from once-slumbering economies that have liberalized their markets, stabilized their political systems, upgraded their labor skills, and strengthened their business and legal institutions.

The Organization for Economic Co-operation and Development (OECD) publishes annually an index of foreign direct investment restrictiveness for OECD member countries and other countries. The index is a compilation of scores assigned to four types

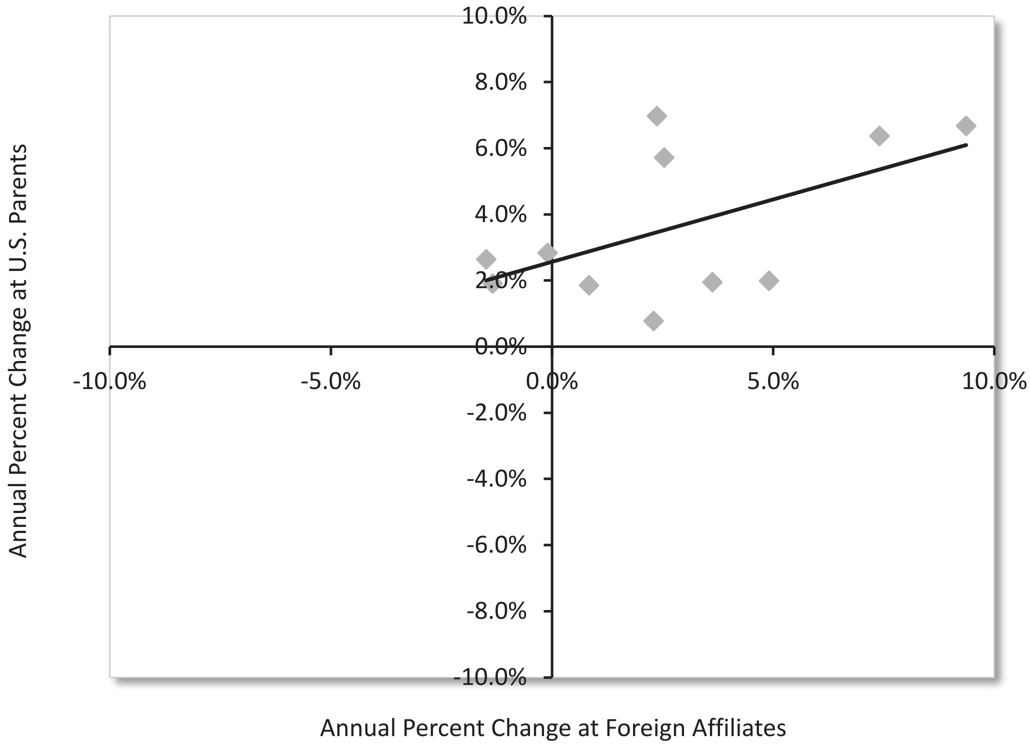
Investment is a judgment about the virtues of a jurisdiction's business and political climates.

Figure 8
Annual Percent Changes at Foreign Affiliates and U.S. Parents Employment (2000–2010)



Source: Bureau of Economic Analysis.

Figure 9
Annual Percent Changes at Foreign Affiliates and U.S. Parents Compensation per Worker (2000–2010)



Source: Bureau of Economic Analysis.

From 1997 to 2012, U.S. foreign direct investment restrictiveness has remained unchanged, but policy consistency means relative decline when the rest of the world is reforming.

of investment restrictions, including limits on foreign equity; screening or prior approval requirements of foreign investors; restrictions on the activities of foreign personnel who are key to the investment operations; and other restrictions on operations, including those with respect to domestic content, the establishment of branches, and restrictions on profit or capital repatriation.[40]

The index is designed to reflect FDI restrictiveness, as intended by the explicit rules governing foreign direct investment in each economy. The scores are not adjusted in any way to account for intensity (or lack thereof) of enforcement, nor do they reflect other laws, regulations, rules, practices, or customs that may influence or deter foreign investment.

Scores are assigned for each of the four categories based on the policies in effect on a scale of 0 to 1, where 0 means completely unrestricted and 1 means completely restricted. Major sectors within each economy are assigned scores for each of the four categories, as the rules tend to be more restrictive in some sectors than in others. Ultimately, those sector-specific scores are compiled into an economywide index.[41]

Looking at the index from 1997 to 2012, the U.S. score of 0.089 has remained the same every year.[42] Official U.S. laws and regulations with respect to these four categories of investment policy have not changed over the span of these years, which explains the consistent index score. High scores for overt ownership restrictions in U.S. fisheries, utilities, maritime and air transportation, and radio and television industries are muted by the absence of ownership restrictions in most other industries. But policy consistency means relative decline when the rest of the world is reforming.

In 1997, the average score for all OECD countries was 0.138, which was 55 percent more restrictive than the United States. In 2012, the OECD average was .081, which was 9 percent less restrictive than the United States. As the United States stood still, OECD countries, on average, became 41 percent less restrictive of foreign direct investment.

Between 1997 and 2012, all of the BRICS countries (Brazil, Russia, India, China, and South Africa) experienced significant investment reform. Brazil improved from .113 to .086, which was a 24 percent reduction in restrictiveness. Russia improved by 47 percent, from .338 to .178. Improving from .484 to .273, India became 44 percent less restrictive. China's score improved from .633 to .407, which is 36 percent less restrictive. And South Africa improved from .102 to .054, a 47 percent improvement.

In 1997, the U.S. score was better than 16 of 34 OECD economies; in 2012, the U.S. score was better than only 9 of the 34 OECD economies. In 1997, the United States was less restrictive than all nine developing countries measured, but in 2012 it was better than only five of those nine developing countries. Overall, in 1997 the United States ranked 18th out of 43 countries measured, but it fell to 29th out of those original 43 in 2012.

The relative decline of U.S. investment openness, as measured by the explicit rules, should be a major concern to U.S. policymakers, as the number of viable destinations for direct investment has been increasing. But the investment environment—the attractiveness of an economy to investment—is not exclusively, or even primarily, a function of the rules explicitly governing investment. Openness is a necessary but insufficient condition. Whether the investment comes depends on numerous other competitive factors.

The annual *Economic Freedom of the World Report* includes an index that "measures the degree to which the policies and institutions of countries are supportive of economic freedom."[43] The index score reflects performance on 42 different variables that feed into five broad measurement components of economic freedom: the size of government, the legal system and property rights, sound money, the freedom to trade internationally, and regulation. To varying degrees, each component contributes to the domestic investment environment.

Overall, the United States ranked 18th out of 144 countries in the most recent ratings, which the authors note is the latest score in "a substantial decline in economic freedom during the past decade . . . The chain-linked ranking of the United States has fallen precipitously from second in 2000 to eighth in 2005 and 19th in 2010 (unadjusted ranking of 18th)."[44]

The "Freedom to Trade Internationally" component, which is based largely on data published by the World Bank, the International Monetary Fund, the World Trade Organization, and the World Economic Forum, provides a measure of some of the laws and regulations that directly affect foreign investment, such as restrictions on foreign ownership of assets and controls on the flow of capital. As the OECD index score confirmed, U.S. performance with respect to those conditions has been declining relative to other countries. Although the United States ranked 18th overall, it ranked 57th on the "Freedom to Trade Internationally" component.

But it is not just restrictions placed on foreign investment that are taken into account by prospective investors. Foremost are answers to questions about whether foreign investors want to be in a particular country in the first place. The four other broad components measured by the *Economic Freedom of the World Report* are probably more illuminating in that regard.

Relative to its overall score, the United States performs poorly on many of the index components, which all contain subcomponents that reflect on the investment climate. On "Legal System and Property Rights," which includes consideration of the integrity of the legal system, protection of property rights, and regulatory restrictions on

The relative decline of U.S. investment openness should be a major concern to U.S. policymakers, as the number of viable destinations for direct investment has been increasing.

The United States performs poorly on many of the Economic Freedom of the World index components, including "regulation" and "size of government."

the sale of real property, the United States ranked 28th.

The authors note a whopping 2 point decline in the U.S. score on this index component since 2000, and offer the following possible explanation:

> While it is difficult to pinpoint the precise reason for this decline, the increased use of eminent domain to transfer property to powerful political interests, the ramifications of the wars on terrorism and drugs, and the violation of the property rights of bondholders in the bailout of automobile companies have all weakened the United States' tradition of the rule of law and, we believe, contributed to the sharp decline of the Area 2 rating.[45]

On "Regulation," which includes credit market, labor market, and business regulations, the United States ranked 31st. For "Size of Government," which includes consideration of income and payroll taxes, the United States ranked 73rd. Taxes, regulations, security of property, and the integrity of the legal system are all important determinants of investment flows, so policymakers should not be cavalier about these declines.

As the authors note:

> The approximate one-point decline in the summary rating between 2000 and 2010 on the 10-point scale of the index may not sound like much, but scholarly work on this topic indicates that a one-point decline is associated with a reduction in the long-term growth of GDP of between 1.0 and 1.5 percentage points annually. This implies that, unless policies undermining economic freedom are reversed, the future annual growth of the US economy will be half its historic average of 3%.[46]

Even more revealing of the qualities and conditions that may help to attract or repel investment is the *Global Competitiveness Index*, which is the basis for the analysis in the World Economic Forum's annual *Global Competitiveness Report*. The purpose of the report is to study and benchmark the many factors underpinning national competitiveness, which is defined by the World Economic Forum as "the set of institutions, policies, and factors that determine the level of productivity of a country . . . [which] also determines the rates of return obtained by investments in an economy."[47] In other words, the factors considered are those that would directly influence investment location decisions.

The United States is ranked 5th on the overall global competitiveness index for 2011–2012, which is a weighted value reflecting scores assigned for 12 broad criteria presumed to affect "competitiveness," including: institutions, infrastructure, macroeconomic environment, health and primary education, higher education and training, goods market efficiency, labor market efficiency, financial market development, technological readiness, market size, business sophistication, and innovation.

The scores assigned to each of these 12 criteria are derived by weight-averaging the scores from individual survey questions. For example, there are 21 questions related to the first criteria, "institutions," including conditions such as property rights, public trust of politicians, judicial independence, transparency of government policymaking, and more. There are nine questions that feed into the infrastructure score, six that feed into the macroeconomic environment score, 16 that comprise the goods market efficiency score, and so on.

The relatively high weighted average U.S. rank of 5th reflects a few obvious U.S. advantages, including "market size" (ranked 1st), "university-industry collaboration in R&D" (which feeds into the innovation criterion; ranked 3rd), "strength of investor protection" (institutions; ranked 5th), "availability of airline seats" (infrastructure; ranked 1st), "inflation" (macroeconomic environment; ranked 1st), "extent of marketing" (business sophistication; ranked 3rd), and a few others.

On taxes and regulations, the U.S. ranks poorly. On the "Burden of Government Regulation," the United States ranked 58th out of 142 countries with a score of 3.4 on a scale from 0-to-7, slightly above the global average of 3.3. On the "Extent and Effect of Taxation," the United States ranked 63rd; on "Total Tax Rate, % Profits," the United States came in 96th.

The United States ranked 24th on quality of total infrastructure, better than on taxes and regulations. The same goes for "technological readiness" and "innovation." "Higher education" generates bad scores for the United States, but clearly not for lack of spending.

Combine those impediments to investment and hiring with the growing perception that crony capitalism is on the rise (U.S. rank: 50th), that customs procedures present obstacles to global supply chains (58th), that U.S. public debt weighs heavily on the economy (132 of 142), and that government spending is on a treacherous path (139th), and it becomes more apparent why an increasingly mobile business community often seeks the refuge and relatively warm embrace of foreign shores.

In a recent paper with colleague Jan Rivkin, renowned and prolific expert on business strategy and competitiveness Michael E. Porter wrote:

> The question 'Where should we locate?' is more prominent in the minds of executives than it has ever been. Over the past three decades, business activities have become increasingly mobile, and more and more countries have become viable contenders for them. As a result, the number and significance of location decisions have exploded. Considerable evidence . . . suggests that the U.S. is not winning enough of the location decisions that support healthy job growth and rising wages.[48]

Although high-end activities such as advanced manufacturing and research and development have been U.S. strengths over the years, Porter and Rivkin worry that the United States has been struggling to attract and retain those activities. They attribute the loss of location decisions to bad public policies: "The U.S. government is failing to tackle weaknesses in the business environment that are making the country a less attractive place to invest and are nullifying some of America's most important strengths."[49] Their focus on policy failings is consistent with their view that "a location decision is, in many respects, a referendum on a nation's competitiveness."[50]

The authors surveyed nearly 10,000 Harvard Business School alumni about their experiences with location decisions. Citing a complex tax code, an ineffective political system, a weak public education system, poor macroeconomic policies, convoluted regulations, deteriorating infrastructure, and a lack of skilled labor, survey respondents expressed great concern that business conditions in the United States were eroding relative to other countries.

Of the respondents, 1,767 had been directly involved with a location decision in the previous year, and 57 percent said the decision was about moving activities out of the United States (which happened in 86 percent of those cases); 34 percent said the decision concerned whether to locate new activities in the United States or elsewhere (half of the time the U.S. was chosen); and only 9 percent said the decision was about whether to move activities into the United States from abroad (which happened three-quarters of the time).

The results of these several surveys help explain the declining U.S share of global investment: the United States is losing ground to other countries partly because of perceptions that its business and investment climate have become less hospitable.

The U.S. government is failing to tackle weaknesses in the business environment that are making the country a less attractive place to invest.

The solution will require a full accounting of the range of policies and practices in place that are subverting investment and working at cross-purposes.

The Proper Role of Investment Policy

In June 2011, the Council of Economic Advisers published a paper titled "U.S. Inward Foreign Direct Investment," which was essentially a statement about the openness of the United States to FDI and the benefits of FDI to the U.S. economy. While it made valid and important points, there were no references to the declining U.S. share of global inward FDI, no mentions of the growing perceptions that the U.S. policy environment was becoming less hospitable to investment, and, thus, no discussion about U.S. policies that might be causing these worsening perceptions.

Since then there have been expressions of greater understanding from the administration and Congress that the United States is in a global competition to attract and retain investment. Administrative initiatives have been undertaken. Legislation has been introduced. Recognition of the problem is a good start, but the solution will require a full accounting of the range of policies and practices in place that are not only subverting investment, but working at cross-purposes.

The American public is entitled to a degree of policy coherence. For example, if attracting and retaining investment in the United States is vital to economic growth, why does the U.S. government promote bilateral investment treaties and investment provisions in trade negotiations that have the primary effect of subsidizing offshoring? Official U.S. investment policy objectives—as reflected in the language of the State Department's negotiating template known as the Model Bilateral Investment Treaty (BIT)—are to make other economies as open to investment as the United States, to establish rules for treating foreign investment and investors no less favorably than domestic investment and investors, and to ensure that the rights of U.S. investors abroad are sufficiently secured. U.S. negotiators even insist on an investor-state dispute mechanism under which companies and individual investors can circumvent local courts and sue foreign governments in third party, extra-legal tribunals for their being deprived of "fair and equitable treatment," which could range from policies that have some small tertiary effect on the investor up to expropriation of property.

This policy approach may look reasonably enlightened from a rule of law perspective, but one perverse effect of requiring foreign governments to agree to conditions intended to homogenize the investment climates around U.S. standards is that it mitigates what are, in some cases, huge U.S. advantages in the race to attract investment. When companies weigh their location decisions, considerations about the commitment of the host government to transparency and the rule of law and the risk of asset expropriation are important variables in the equation. Policies designed to equalize attributes that are otherwise usually heavily in America's favor, for the purpose of providing extra guarantees and protections to U.S. companies that invest abroad, are nothing less than subsidizing outward investment. Investment is risky. Foreign investment is even more so. But surely U.S. multinational companies contemplating foreign investments are savvy and sophisticated enough to measure and manage risk. By mitigating their risks for them, U.S. policymakers are effectively subsidizing and thus lowering the cost of offshoring, which means we should expect to see more of it.

Instead, U.S. policymakers should work to create the conditions that put the United States in a stronger position to win more of the location decisions of both foreign-headquartered and U.S.-based companies. Policies that increase the benefits and lower the costs of conducting economic activities in the United States would simultaneously encourage inward investment and discourage "discretionary" outward investment.[51]

This will require an understanding of the determinants of investment location decisions and how public policy affects those determinants. (Reconsideration of the Model

BIT would be a good start.) It will also require a commitment to fixing the problems that detract from the overall appeal of the United States as an investment destination.

Some policymakers make it to this point of the analysis only to come to the wrong conclusion: that inducing investment in the United States by raising the absolute cost of investing abroad is equivalent to inducing investment here by reducing the absolute cost of investing in the United States. That is false. Both approaches may reduce the relative cost of investing in the United States, but only the latter approach reduces the absolute cost of producing anywhere.

President Obama has made mention on many occasions of his desire to "end tax giveaways to companies that ship our jobs overseas." The brouhaha over Apple's and other companies' tax minimization schemes—perfectly rational and legal strategies to contend with the byzantine U.S corporate tax—has prompted some policymakers to consider ways to make it more expensive for companies to operate abroad and to keep their profits there. Policies that would penalize companies for offshoring, such as assessing them higher tax rates, stripping them of their eligibility for tax credits or tax deductions, or subsidizing domestic competitors who vow to keep operations stateside, also reduce the relative cost of conducting activities in the United States. But they do so by raising the absolute cost of investing abroad. Policies designed to discourage offshoring by raising its absolute cost reduce economic welfare because U.S.-based multinational companies, who account for a significant share of domestic economic activity, will become less competitive and less capable of providing the jobs, compensation, capital investment, and research and development required by the U.S. economy.

If policymakers want to retain and attract more investment, compulsion is the wrong approach. The recently introduced Global Investment in American Jobs Act of 2013 takes a more reasonable tack.[52] Despite its populist-sounding title, the legislation would:

> direct the Secretary of Commerce, in coordination with the heads of other relevant Federal departments and agencies, to conduct an interagency review of and report on ways to increase the competitiveness of the United States in attracting foreign direct investment.[53]

The "Findings" section of the bipartisan Senate bill acknowledges the importance of foreign direct investment to the U.S. economy and national security, acknowledges that the United States is facing growing competition for investment from the rest of the world, acknowledges that the U.S. share has been declining, advises legislators to consider the likely impact of their bills on America's capacity to attract investment, references some of the Obama administration's efforts to promote the United States as an investment destination, and sets the table for a comprehensive assessment of the policies that both repel and attract foreign investment.

Senator Bob Corker (R-TN), one of the bill's cosponsors, remarked: "If we want the U.S. to be the very best place in the world to do business, we need to take a close look at what we're doing right, what we're doing wrong and how we can eliminate barriers that diminish investment in the U.S."[54]

What is so refreshing about the bill is that its premise is not that the practices of foreign governments or the greed of U.S. corporations that allegedly "ship jobs overseas" are to blame, but that U.S. policy and its accumulated residue have contributed to a business climate that might be deterring foreign investment in the United States, and that changes to those policies could serve to attract new investment. This kind of thinking is long overdue.

Comprehensive tax reform should be on the table, given that the United States has a tax code with the highest corporate tax rate among OECD countries and an extraterritorial system that subjects corporate earnings abroad to punishingly high rates of taxation upon repatriation. PIIE's Hufbauer and Vie-

If we want the United States to be the best place to do business, we need to look at what we're doing right, what we're doing wrong and how we can eliminate barriers to investment in the United States.

iro argue convincingly in a recent paper that "[r]educing the U.S. corporate tax rate is certainly the most efficient way to encourage domestic investment and associated gains in production and jobs."[55]

In January 2011, President Obama issued Executive Order 13563 under the heading "Improving Regulation and Regulatory Review." Section 1 states:

> Our regulatory system must protect public health, welfare, safety, and our environment while promoting economic growth, innovation, competitiveness and job creation. It must be based on the best available science. It must allow for public participation and an open exchange of ideas. It must promote predictability and reduce uncertainly. It must identify and use the best, most innovative, and least burdensome tools for achieving regulatory ends. It must take into account benefits and costs, both quantitative and qualitative. It must ensure that regulations are accessible, consistent, written in plain language, and easy to understand. It must measure, and seek to improve, the actual results of regulatory requirements.[56]

If the burgeoning, increasingly unchecked regulatory state is identified as an important impediment to investing in the United States, President Obama should reissue his Executive Order, but with a much greater sense of urgency and seriousness, including external reviews with goals and firm deadlines included.

If a badly incoherent U.S. energy policy—one that leaves investors guessing about whether and to what extent the administration will restrict gas and oil exports next year and the year after, and about whether solar energy will be subsidized or taxed in 2014—is found to be deterring capital-intensive, job-creating investments, the public should be made aware of the decisionmaking process that has produced the impasse.

Investment deterrents can be found in the millions of pages of the U.S. Code and the *Federal Register*.

If the fact that U.S.-based producers, whose intermediate goods and capital equipment purchases accounted for over 60 percent of imports in 2012, are competitively disadvantaged by higher production costs than their foreign competitors on account of the customs duties they must pay for those inputs, permanently eliminating all duties on production inputs should be an option on the table.

If U.S. producers' access to crucial raw materials is frustrated by the hundreds of antidumping and countervailing duty measures imposed at the behest of one or two domestic suppliers, reforming the trade remedy laws to include a public-interest provision and to permit full and formal consideration of the downstream consequences of such restrictions would be wise.[57]

If a dearth of skilled workers is cited as an investment deterrent, the spotlight should be shone on U.S. education and immigration policy failures with the goal of finding the right solutions.

If liability costs on account of wayward class-action suits and other legal system abuses are keeping investors at bay, major tort reform should be seriously considered.

Investment deterrents can be found in the millions of pages of the U.S. Code and the *Federal Register*. In almost every instance, these deterrents were not designed to impede foreign investment. It is just that foreign investment is a verdict about the efficacy of a country's institutions, policies, and potential.

In the conclusion to his recent book about the adverse accumulated impacts of public policy on U.S. manufacturing, author Andrew Smith provides a summary that aptly applies to the investment situation:

> [N]o one person or group set out with the intention of crippling the manufacturing sector by making a series of hostile policy choices. Each new policy, each new program, each new rule had at heart a good intention to make our system better. For an entire generation we stood at the

top of the world and saw over the horizon a seemingly endless bounty of progress. Under the gilded light, the small costs of a little stricter rule here, a little excess compensation there, a few more restrictions elsewhere simply looked like pebbles on the smooth pavement running endlessly ahead. A nation as phenomenally wealthy as the United States could afford to have a highly litigious society with jackpot judgments, could afford the most expensive health care system in the world funded by its employers, could afford to give labor unions destructive power over the workplace, could afford to let government run wild with excessive regulation, could afford a complex and dysfunctional tax system, and could afford a featherbedded disability system for its workers. It has turned out, however, that these are luxuries we can no longer afford. Only the wealthiest nations can get away with programs like these, for a time, and as the rest of the world catches up to the West, and to the United States in particular, our ability to devote so much of our national wealth to these inefficiencies is no longer sustainable. We are simply not rich enough to do this any longer.[58]

Conclusion

Empowered by greater mobility and more viable investment location alternatives, companies have greater flexibility than ever before when it comes to deciding where to conduct functions including research and development, design, manufacture, sales, customer service, and other activities.

Some policymakers believe that it is the obligation of U.S. multinational firms to ensure that they are doing their part to maximize U.S. employment—that these companies have a responsibility to hire and retain U.S. workers. They will do that if the conditions are right, but they are under no obligations except to maximize profits for their shareholders.

U.S. policymakers, however, do have an obligation to maintain smart policies. They may find it convenient to chide U.S. companies for sending jobs overseas or to say they are being un-American, but the fact is that policy and its accumulated residue weigh heavily on decisions about where to locate production and other-supply chain functions.

In a global economy, where investors have options, governments are in a competition—whether they know it or not and whether they like it or not—to attract the financial, physical, and human capital necessary to nourish high value-added, innovation-driven, 21st-century economies. Punitive policies will only chase away the companies with the capital needed to fuel growth.

In a global economy, offshoring is a natural consequence of business competition. And policy competition is the natural response to offshoring. This global competition in policy is a positive development, and a properly functioning feedback loop should serve as a check against bad policies.

U.S. policymakers are deluding themselves if they think the United States need not compete to earn its share with good policies. The decisions we make now with respect to immigration, education, energy, trade, entitlements, taxes, and the role of government in managing the economy will determine the health, competitiveness, and relative significance of the U.S. economy in the decades ahead. Offshoring is a check against bad policy. Its increase tells us that reform is in order.

Governments are in competition to attract the financial, physical, and human capital necessary to nourish high value-added, innovation-driven economies.

Notes

1. The U.S. Bureau of Economic Analysis tracks cross-border investment of all kinds, as well as the operations of U.S.-headquartered multinational companies, their foreign affiliates, and the U.S. affiliates of foreign-headquartered multinational companies. Foreign affiliates are at least 10 percent owned by a U.S. parent (10% of the vot-

ing shares are owned or controlled by the parent) and U.S. affiliates are at least 10 percent owned by a foreign parent. The BEA distinguishes and separately tracks the operations of affiliates that are 10–50 percent owned and those that are more than 50 percent owned by a U.S. or foreign parent. Data cited in this paper concerning affiliate performance are for these "majority-owned" entities. See www.bea.gov.

2. United Nations Conference on Trade and Development, "World Investment Report 2012: Towards a New Generation of Investment Policies" (2012), Annex Table I.2, p. 173. In 2012, according to the U.S. Bureau of Economic Analysis, the stock of U.S. foreign direct investment was valued a $3.9 trillion, but there is no corresponding figure for the value of the world stock in 2012.

3. Ibid., Annex Table I.1, p. 169. The next largest destinations over this period were the UK ($103.3b), China ($99.7b), and Belgium ($96.4b).

4. United Nations Conference on Trade and Development, http://unctadstat.unctad.org/TableViewer/tableView.aspx.

5. United Nations Conference on Trade and Development, "Global FDI Recovery Derails," *Global Investment Trends Monitor* 11 (January 23, 2013): 6.

6. Bureau of Economic Analysis, International Investment Position, 1976–2012, http://www.bea.gov/international/index.htm#iip. The market value of the stock of outward U.S. FDI in 2012 was $5.2 trillion.

7. The terms outward direct investment, outward foreign direct investment, outward FDI, and offshoring are used interchangeably throughout the paper. The term outsourcing, often mistakenly used to refer to what is really offshoring, will be avoided to the fullest extent possible.

8. Council of Economic Advisors, "Economic Report of the President, 2013," Table B-1.

9. U.S. Department of Commerce, Bureau of the Census, "Foreign Trade," http://www.census.gov/foreign-trade/data/index.html.

10. U.S. Department of Commerce, Bureau of Economic Analysis, "International Investment Position of the United States," Table 1, http://www.bea.gov/international/index.htm#iip.

11. BEA, "International Investment Position."

12. Ibid. This figure is the market value of the U.S. stock in 2012.

13. The BEA provides investment stock by industry and by country on a historical cost basis only. Historical cost data are available for 2011, but not 2012. Whereas the market value of the stock of inward U.S. FDI was $3.9 trillion in 2012, it was $3.5 trillion in 2011. The historical cost was $2.5 trillion in 2011, and the manufacturing sector stock, accounting for one-third of the total, was $838 billion.

14. See Michael V. Seitzinger, "Foreign Investment in the United States: Major Federal Statutory Regulations," Congressional Research Service, January 26, 2009.

15. Secretary of the Treasury Alexander Hamilton, cited in Michael V. Seitzinger, "Foreign Investment in the United States: Major Federal Statutory Regulations," Congressional Research Service, January 26, 2009.

16. Testimony of Matthew J. Slaughter before the United States House of Representatives, Committee on Energy and Commerce, Subcommittee on Commerce, Manufacturing, and Trade, "Discussion of 'The Global Investment in American Jobs Act of 2013'," April 18, 2013.

17. Ibid.

18. Bureau of Economic Analysis, "International Data, Direct Investment & Multinational Companies (MNCs)," http://www.bea.gov/iTable/index_MNC.cfm.

19. Valued at less than $1 billion in 2009, Chinese direct investment in the United States has begun to increase. There has been a spate of acquisitions and proposed acquisitions of U.S. companies by Chinese suitors since 2010. According to the BEA data, the stock of Chinese FDI in the United States as of the end 2011 was $9.5 billion. However, a more recent accounting by the Rhodium group (www.rhg.com) puts that figure at about $25 billion, which includes deals in the pipeline that might not yet have been consummated. In any event, China's share of the $2.55 trillion of U.S. FDI stock is no more than 1 percent of the total.

20. Technically, the outflow of dollars to buy imports and foreign assets, plus remittances and profits paid to foreigners, equals the inflow of dollars to buy U.S. exports and U.S assets, plus remittances and profits paid to Americans by foreigners. Rearranging terms, the identity that holds is: Current Account = -Capital Account.

21. Council of Economic Advisers, *Economic Report of the President (2013)*, Table B-2, Real Gross Domestic Product (1964–2012). Between 2009

and 2010, real import growth was 12.5% and real GDP growth was 2.4%; between 2010 and 2011, real import growth was 4.8% and real GDP growth was 1.8%; between 2011 and 2012, real import growth was 2.4% and real GDP growth was 2.2%.

22. Note that import value is being used instead of the trade deficit (import minus exports) because the occasional large annual swings in value of the deficit makes for large year-over-year percentage changes, which are difficult to plot alongside annual changes in GDP or employment.

23. BEA, U.S. International Investment Position.

24. Kevin B. Barefoot and Raymond J. Mataloni Jr., "Operations of U.S. Multinational Companies in the United States and Abroad: Preliminary Results From the 2009 Benchmark Survey," *Survey of Current Business* (November 2011): 35, http://www.bea.gov/scb/pdf/2011/11%20November/1111_mnc.pdf.

25. Michael E. Porter and Jan W. Rivkin, "Choosing the United States," *Harvard Business Review* 90, no. 3 (March 2012): 80–91.

26. BEA, "Balance of Payments and Direct Investment Position Data," (May 17, 2013). The country- and industry-specific allocations for investment are based on 2011 historical value figures, as the market value figures by country and industry are not tracked by the BEA and the most recent allocated values are for 2011, http://www.bea.gov/international/di1fdibal.htm.

27. Ibid.

28. Ibid.

29. Mergent Online (database), Mergent, Inc., American University Library, http://www.mergentonline.com, data obtained on March 19, 2013. These are the top 10 companies by revenue, excluding banking and financial industry firms.

30. Matthew J. Slaughter, "American Companies and Global Supply Networks: Driving U.S. Economic Growth and Jobs by connecting with the World" (December 2012): 28.

31. Ibid., p. 3.

32. Ibid., p. 10.

33. Gary Hufbauer and Martin Vieiro, "Corporate Taxation a US MNCs: Ensuring a Competitive Economy," Peterson Institute for International Economics Policy Brief Number PB13-9 (April 2013).

34. Ibid.

35. Slaughter, "American Companies and Global Supply Networks," p. 5.

36. Jon Greenberg, "Obama Says Tax Code Rewards Firms for Shifting Jobs Overseas," Politifact.com, http://www.politifact.com/truth-o-meter/statements/2012/oct/08/barack-obama/obama-says-tax-code-rewards-firms-shifting-jobs-ov/.

37. "Obama Stimulus Program Sent Jobs Abroad, GOP Says," *Wall Street Journal*, July 10, 2012, http://online.wsj.com/article/SB10001424052702303292204577519181071135146.html.

38. Eighty percent of U.S. outward foreign direct investment is in Europe, Canada, Bermuda, Australia, Singapore, and Japan.

39. BEA, "Balance of Payments and Direct Investment Position Data" (May 17, 2013), http://www.bea.gov/international/di1fdibal.htm.

40. OECD, "FDI Restrictiveness Index," http://www.oecd.org/investment/fdiindex.htm.

41. Ibid.

42. Ibid.

43. James Gwartney, Robert Lawson, and Joshua Hall, et al., *Economic Freedom of the World 2012 Annual Report*, Fraser Institute (2012): v.

44. Ibid., p. vi.

45. Gwartney et al., *Economic Freedom of the World, 2012 Annual Report*, p. 17.

46. Ibid.

47. Klaus Schwab, "The Global Competitiveness Report 2011–2012," World Economic Forum (2011).

48. Porter and Rivkin, "Choosing the United States."

49. Ibid.

50. Ibid.

51. The term "discretionary" refers to investment that goes abroad, but doesn't really have to. It is investment in activities that could be performed in the United States if perceptions of the U.S. policy environment were more favorable. The term is used to distinguish investment in these activities from investment in activities that require a foreign presence.

52. The Global Investment in American Jobs Act of 2013, S. 1023 and H.R. 2052.

53. Ibid.

54. Office of Senator Bob Corker, "Corker, Klobuchar Introduce Bill to Help Encourage More Global Investment in the U.S., Improve American Competitiveness," press release, May 23, 2013.

55. Hufbauer and Veiro, p. 11.

56. Exec. Order No. 13,563, 76 Fed. Reg. 3821 (Jan. 18, 2011), "Improving Regulation and Regulatory Review."

57. For a detailed discussion of this problem, see Daniel Ikenson, "Economic Self-Flagellation: How U.S. Economic Policy Subverts the National Export Initiative," Cato Institute Trade Policy Analysis no. 46, May 31, 2011.

58. Andrew O. Smith, *Sand in the Gears: How Public Policy Has Crippled American Manufacturing* (Washington: Potomac Books, 2013).

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