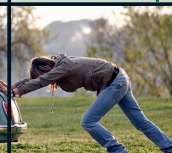
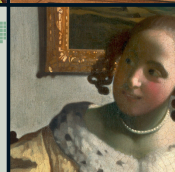
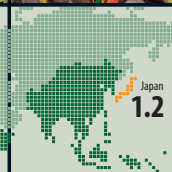
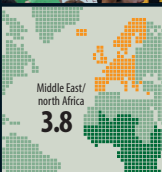
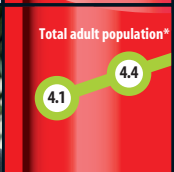
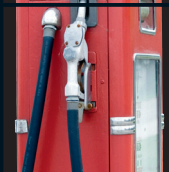
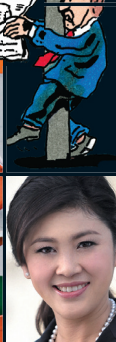
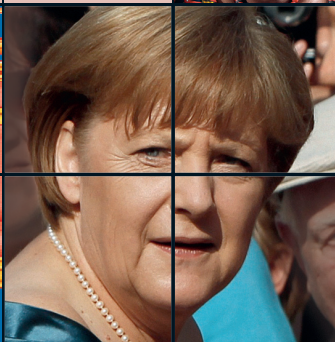
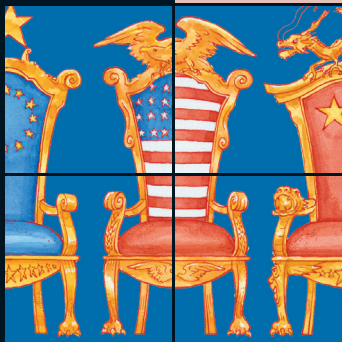
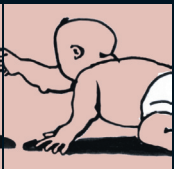


The Economist

# The World in 2013



# What Washington must do now

## An eight-point plan to restore American competitiveness

Nov 21st 2012 | The World In 2013

**T**he competitiveness of the United States began eroding seriously in the 1990s, the root cause of the disappointing economic and job growth and declining living standards that we see today. America's success in restoring competitiveness will define the opportunities and economic mobility of American citizens as well as America's influence in the world for decades to come. Neither presidential campaign fully acknowledged the problem or offered an overall strategy for action. Rather, the political dialogue has focused heavily on how to boost jobs in the short run, with different visions of how to stimulate growth through tax policy and government spending. Neither party's approach will solve the real problem.

What can the president and Congress elected on November 6th do to restore American competitiveness? First we must clear up the confusion about what competitiveness is. The United States is competitive to the degree that companies operating here can compete successfully in the global economy while simultaneously raising living standards for the average American. Companies must be able to compete, but employees have to prosper as well. One without the other is not true competitiveness, and is unsustainable.

Therefore, competitiveness requires a business environment that enables businesses and workers to be highly productive over the long run. Both American firms and workers thrived historically because the United States was the most productive place to do business. America retains core strengths, but unneeded costs of doing business have crept in, skills have eroded, critical assets have deteriorated, perverse incentives for businesses have taken hold and the nation's fiscal stability has weakened severely.

The chart shows the view of some 10,000 Harvard Business School alumni, surveyed for our United States Competitiveness Project. The big challenges, in the bottom two quadrants, require immediate action.

Our research, the research of colleagues, and conversations with a wide array of business leaders and policymakers point to eight policy steps that the president and Congress must take now. Each is highly achievable and can be implemented within two or three years. Importantly, most business leaders and policymakers—both Democrat and Republican—agree on the essence of these policies (at least behind closed doors). Progress on these eight strategic priorities, or even some of them, would be transformational to America's economic prospects.

**1. Ease the immigration of highly skilled individuals, starting with international graduates of American universities.** America faces pressing skill shortages in knowledge work. Our universities educate the world's best and brightest, and many international graduates want to work here. Yet current immigration policies force many to return home or settle elsewhere. We should staple a green card to every new graduate degree in maths, science, engineering and management.

**2. Simplify the corporate tax code with lower statutory rates and no loopholes.** Our corporate tax code is, as our colleague Mihir Desai puts it, the worst of all worlds, with the highest tax rate among OECD countries, but actual revenue collection is low due to loopholes and deductions. Companies respond by aggressive tax planning, seeking offshore tax havens, and locating jobs abroad. We need a system with a much lower rate but without the loopholes. Properly designed, this approach would generate as much or more tax revenue as we collect today.

**3. Create an international taxation system for American multinationals that taxes overseas profits only where they are**



**Michael Porter and Jan Rivkin,** co-leaders of Harvard Business School's United States Competitiveness Project

**earned, consistent with practices in other leading countries.** The United States is unique in its taxation of our multinational companies. American-based companies pay corporate taxes on their profits abroad at local rates, but are taxed again when these profits return home so that the total tax rate equals the American rate. In theory, this is to discourage firms from moving activities abroad in search of lower tax rates. In practice, our high corporate-tax rate already encourages offshore investment, and these rules compound the problem by discouraging American companies from bringing their profits home. Today, an estimated \$1.4 trillion in international profits of American companies is stranded abroad and not available for investment here. Going forward, we need a "territorial" tax system, the international norm, in which profits are taxed only where they are generated. In addition, Congress should pass legislation allowing stranded profits to be brought back at a reasonable cost.

**4. Aggressively use bilateral agreements and established international institutions to address distortions and abuses in the international trading and investment system.** The United States has led the opening of the global economy, accepting some distortions that favour other



countries in exchange for the gradual opening of foreign markets and the participation of other countries in multilateral organisations such as the WTO. Global growth supported American prosperity.

Today, emerging economies are far more competitive, and the remaining distortions and subsidies especially disadvantage an economy like America's that depends heavily on service exports, innovation and intellectual property. The United States must be far more forceful in levelling the global playing field. While the United States files many unfair trade complaints, we lack a coherent strategy to work with like-minded nations to open access to consumer markets in emerging economies such as China's; to protect intellectual property rights; and to reduce restrictions on trade and investment in services. We have also dropped the ball, because of politics, by being slow to pursue bilateral and regional free-trade agreements, which clearly benefit America because its economy is already open.

**5. Simplify and streamline regulation affecting business to focus on outcomes rather than costly reporting and compliance, delays and frequent litigation.** America needs high regulatory standards, but the way we go about regulating often makes no sense. While most countries are simplifying and streamlining regulation, America adds on ever more layers of regulatory costs as if we believe American companies are still so dominant that they can absorb any compliance burden. Asked to identify the greatest impediment to investing and creating jobs in America, our survey respondents cited regulation more often than any other problem. The priority for federal policy is not to lower regulatory standards, but to regulate more intelligently. Regulation must set high standards but focus on desired outcomes rather than on dictating compliance methods. The burden of reporting and inspection should fall primarily on companies with track records of problems. Regulation should undergo rigorous cost-benefit analysis and

**Defining competitiveness:**

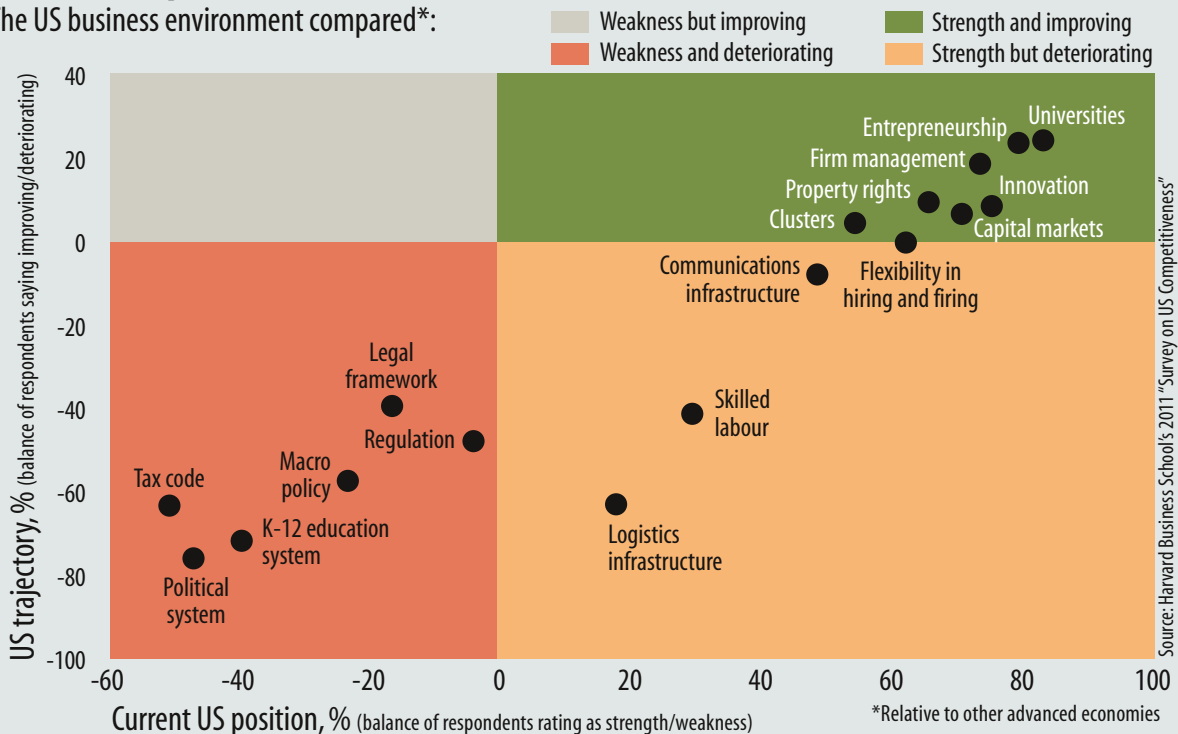
The United States is competitive to the degree that companies there can compete successfully in the global economy while raising living standards for the average American. Companies must be able to compete, but employees have to prosper as well. One without the other is not true competitiveness, and is unsustainable.

look-backs to ensure it is achieving the desired outcomes efficiently.

**6. Enact a multi-year programme to improve logistical, communications and energy infrastructure, prioritising those projects most important for reducing the costs of doing business and promoting innovation.** America's roads, bridges and ports are crumbling, and our communications and energy infrastructure fails to match the world's best. Much of the money we do devote to infrastructure is poorly spent, with priorities set by pork-barrel politics and

**Drawn and quartered**

The US business environment compared\*:



Source: Harvard Business School's 2011 "Survey on US Competitiveness"

short-term stimulus objectives. A new federal infrastructure policy should allocate funds based on hard-nosed judgments about which investments will boost economic growth, and it should establish new financing mechanisms such as dedicated funds and public-private partnerships to raise the rate of investment.

**7. Agree on a balanced regulatory and reporting framework to guide the responsible development of American shale-gas and oil reserves.** Technology has opened up huge low-cost reserves of natural gas and oil, a game-changer for the American economy. Newly abundant natural gas can also serve as a far cleaner bridge than oil and coal to our eventual goal of renewable energy. Low-cost domestic energy will not only spur new investment but will also dramatically lower the trade deficit and reduce America's vulnerability to crises in unstable oil-exporting nations. Instead of seizing this opportunity, however, we are caught up in ideological debates about subsidies for renewables, the

environmental impact of new extraction technologies and whether to allow natural-gas exports. We need a clear federal regulatory framework to develop this crucial asset while protecting our environment and safety.

**8. Create a sustainable federal budget through a combination of greater revenue (including reducing deductions) and less spending (through efficiencies in entitlement programmes and revised spending priorities), embodying a compromise such as Simpson-Bowles or Rivlin-Domenici.** Most critically, the federal government must get on a sustainable fiscal path with a budget compromise that includes both revenue increases and spending reductions. The longer the federal government shirks its responsibility the less the private sector's faith in government will be, with disastrous consequences for private investment.

These eight strategic priorities are not all that America must do to restore its competitiveness. We have not included crucial reforms

in K-12 education and workforce development, for example, because major progress will take longer than two to three years and the key levers are often local. We have not included health-care and campaign-finance reform because there is not yet consensus, even behind closed doors, about what needs to be done.

There is, however, wide consensus on these eight priorities, and making progress on them will profoundly change the trajectory of our economy. It will also restore—to all Americans—a sense of optimism, opportunity and fairness. Let us put the new president and Congress on notice: we can't wait any longer. ■

