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Testimony of Matthew J. Slaughter
Discussion of "The Global Investment in American Jobs Act of 2013"

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Subcommittee Chairman Terry, Committee Chairman Upton, Ranking Member Waxman, and fellow Members, thank you very much for inviting me to testify on these important and timely issues of how global investment can contribute to American jobs and overall economic strength.

My name is Matt Slaughter, and I am currently Associate Dean and Signal Companies' Professor of Management at the Tuck School of Business at Dartmouth, Research Associate at the National Bureau of Economic Research, and adjunct Senior Fellow at the Council on Foreign Relations. From 2005 to 2007 I also served as a Senate-confirmed Member on the Council of Economic Advisers, where my international portfolio spanned topics on the competitiveness of the American economy.[1] More recently I was a founding member of the Squam Lake Group, a non-partisan group of 15 academics who initially came together in the fall of 2008 to offer guidance on the reform of financial regulation amidst the World Financial Crisis.[2]

The topic of today's hearing is extremely important. The news for American workers has improved somewhat in recent months: the rate of net job creation has accelerated, and the unemployment rate has fallen. But in many ways the U.S. labor market remains quite fragile, a fact stressed by Federal Reserve Chairman Ben Bernanke in a recent speech in which he said, "We cannot yet be sure that the recent pace of improvement in the labor market will be sustained." Today America has 113.3 million private-sector payroll jobs. That is only about 1.3% above the number of private-sector payroll jobs America had 13 years ago, in 2000. America has created almost no new private-sector jobs in well over a decade, during which time its civilian labor force has expanded by about 15 million people. The result is that today over 22 million Americans, about one in seven in the entire labor force, are unemployed or under-employed.

[1] In the past two years, I have not received any Federal research grants. Currently, in addition to the affiliations listed above I serve as a member of the academic advisory board of the International Tax Policy Forum; a member of the Congressional Budget Office's Panel of Economic Advisers; and a member of the U.S. State Department's Advisory Committee on International Economic Policy. For many years I have consulted both to individual firms and also to industry organizations that support dialogue on issues of international trade, investment, and taxation. For a listing of such activities, please consult my curriculum vitae posted on my web page maintained by the Tuck School of Business at Dartmouth.

[2] The book our Group co-authored that discusses the challenges in understanding and aiming to prevent financial crises is *The Squam Lake Report: Fixing the Financial System*, with Kenneth R. French, Martin N. Baily, John Y. Campbell, John H. Cochrane, Douglas W. Diamond, Darrell Duffie, Anil K Kashyap, Frederic S. Mishkin, Raghuram G. Rajan, David S. Scharfstein, Robert J. Shiller, Hyun Song Shin, Matthew J. Slaughter, Jeremy C. Stein, and Rene M. Stulz; Princeton University Press, June 2010.

In my remarks, I will stress that although the U.S. subsidiaries of global companies have long made large contributions to U.S. jobs and overall economic strength, past need not be prologue. There are recent worrisome trends that America's attractiveness to these companies may be waning. To support the U.S. economy amidst a still-fragile labor market and overall recovery, policymakers should strive to sustain an environment in which global firms can thrive here.

The Positives of the Past: Rising U.S. Contributions of Insourcing Companies

Research for the United States and many other countries has documented that globally engaged companies—both the U.S. parents of U.S.-based multinationals and also the U.S. subsidiaries of foreign-based multinationals —tend to perform better than purely domestic companies. Globally engaged companies enhance the American economy by their capital investment, their exports, their research and development, and by supporting good-paying American jobs.[3]

The 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 high average compensation for American workers.* For the most recent year of data available, 2010, contributions of these companies included the following.[4]

- Output: U.S. subsidiaries of global companies produced $649.3 billion in output (measured in terms of gross domestic product), which was approximately 5.8% of all private-sector output.
- *Capital Investment:* U.S. subsidiaries of global companies purchased $149.0 billion in new property, plant, and equipment—14.4% of all non-residential private-sector capital investment.
- *Exports:* U.S. subsidiaries of global companies exported $229.3 billion of goods to the rest of the world, 17.9% of the U.S. total.
- *Research and Development:* To discover new products and processes, U.S. subsidiaries of global companies performed $41.3 billion of research and development. This was about 14.3% of the total R&D performed by all U.S. companies.
- *Intermediate Inputs:* To produce their goods and services, U.S. subsidiaries of global companies purchased over $1.9 trillion in intermediate inputs from other U.S. companies, which was about 78.7% of their total input purchases.

All these activities contribute to millions of well-paying jobs in America. In 2010, these U.S. affiliates employed nearly 5.3 million U.S. workers, 4.7% of total private-sector payroll employment. Their total compensation was $408.0 billion—a per-worker average of $77,409,

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[3] See, for example, "A Warning Sign from Global Companies," by Matthew J. Slaughter and Laura D'Andrea Tyson, *Harvard Business Review*, March 2012. See also *American Jobs, American Infrastructure, and American Global Competitiveness*, by Matthew J. Slaughter, Organization for International Investment research report, spring 2011. See also *American Companies and Global Supply Networks: Driving U.S. Economic Growth and Jobs by Connecting with the World*, by Matthew J. Slaughter and U.S. Council Federation, Business Roundtable research report, January 2013.

[4] A foreign-based multinational company is any foreign entity, called the "parent," that holds at least a 10% direct ownership stake in at least one U.S. business enterprise, called the "affiliate" or "subsidiary." All data cited in this passage come from the Bureau of Economic Analysis of the U.S. Department of Commerce. In 2009 there were in America 4,662 majority-owned subsidiaries of foreign-headquartered multinationals.

more than a third above the average for the rest of the private sector. Of these jobs, 37.7%—nearly 2.0 million—were in manufacturing, far higher than manufacturing's 10.6% share of all jobs in the overall U.S. private sector today. And U.S. subsidiaries of global companies have long had relatively high unionization rates, contrary to what is sometimes assumed. In 2007 12.4% of these firms' U.S. employees were covered by collective bargaining, versus just 8.2% of all private-sector workers.

In the late 20th century the U.S. presence of these "insourcing" companies expanded considerably. Between 1987 and 2002 their U.S. employment more than doubled, from 2.6 million to 5.6 million—an average annual rate of growth of 5.25%. Over this period many of their other activities, such as capital investment, at least doubled as well. The last part of the 20th century, then, was a period where the U.S. economy enjoyed a steadily rising presence of and benefits from the foreign direct investment (FDI) of U.S. subsidiaries of global companies.

The Uncertainties of the Present: Two Worrisome Trends

Over the first dozen years of the 21st century, two worrisome trends emerged regarding the presence and dynamism of U.S. subsidiaries of global companies.

First, although many of their non-employment activities continued to grow, their U.S. employment did not: it flat-lined from 2002 to 2007 and then dipped from 2007 to 2010. The result was fewer Americans working in these companies in 2010 than in 2002.

Employment in U.S. Subsidiaries of Global Companies (Millions)

Year	U.S. Affiliates
1987	2.6
1992	3.9
1997	4.4
2002	5.6
2007	5.6
2009	5.2
2010	5.3

The second worrisome trend is that the U.S. share of global FDI has fallen sharply. According to data from the United Nations, the U.S. share of the world's stock of FDI rose from 25.9% in 1990 to 41.4% in 1999, but it then fell sharply down to just 17.6% in 2009. Much of this fall reflects the surge of China, India, and other developing countries as attractive locations for multinational companies to establish and expand operations. Regardless, the clear fact is that the U.S. share of global FDI has fallen over the past decade—and has fallen at a much faster rate than has either the FDI share of other advanced countries or the U.S. share of other global economic activities such as global gross domestic product.

What forces explain these two trends? They were not simply a matter of global companies shrinking all dimensions of their U.S. subsidiaries. For example, from 2002 to 2010 their R&D expanded from $27.5 billion to $41.3 billion and capital investment expanded from $111.9 billion to $149.0 billion.

The trend of falling U.S. employment has not yet been closely examined to assess its causes. Despite this, some plausible connections can be made. One force at play seems to have been the business cycle; in particular, the historic drop in business activity triggered by the World Financial Crisis and Great Recession. A second important force may have been strong productivity gains, which even as they generate economy-wide gains can sometimes trim employment in their source industries. The mix of forces reducing the employment in U.S. subsidiaries of global companies is not yet understood—nor is the outlook for this trend.

More generally, both the share of global FDI that America attracts and the related magnitude of the American operations of investing global companies depend on three related forces: U.S. *economic performance*, *economic policies*, and *economic promotion*—all relative to the rest of the world. The phrase "relative to the rest of the world" is critical, because what matters is not just America's strengths in and of themselves but those strengths compared to what other countries offer. Policymakers can surely shape all three of these forces, but not always immediately and not always with certain effects.

Consider economic performance. One of America's continued strengths is its market scale: today the United States remains the world's largest single-country market, with a 2012 GDP of $15.7 trillion. Serving this market remains a powerful imperative for many global companies. However, for decades the United States has grown more slowly than much of the world. The cumulative impact is that the United States accounts for a steadily falling share of total world output. The U.S. share of world GDP fell from 32.3% in 2001 to just 21.6% in 2011. Connecting with foreign customers in fast-growth markets has thus become more imperative for many global companies—even as America remains important to many of them.

Taken together, these two worrisome trends of the past decade suggest that the U.S. economy has become a less-attractive location for global companies to establish and expand their operations. And these trends have emerged while a steadily rising share of the leading global companies are headquartered outside of America. In 2010 the United States was home to 179 of the Fortune Global 500 companies; by 2011 that number had fallen 25.7%, to just 133 companies.[5]

The Possibilities of the Future: Optimistic or Pessimistic?

The options the world presents to global firms have expanded dramatically in recent years, due to policy liberalization and related accelerated economic growth in so many countries. The United States cannot rest on past success and take the U.S. engagement of these global companies for granted. Leaders of these companies are today voicing concern about a deep set of problems facing America across the three dimensions of economic performance, policies, and promotion: e.g., complex taxation, broken immigration, and crumbling infrastructure.

What is unclear is what policies the United States will pursue in response to this challenge of maintaining America's economic strength by, in part, sustaining an environment in which global firms can thrive here. Perhaps the most pressing dimension of this challenge is filling the large jobs hole that America still faces in the wake of the World Financial Crisis and Great Recession.

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[5] See *Landscape Changing for Headquarter Locations: An Update*, by Tom Neubig, Thomas Kinrade, and Tiffany Young, Ernst & Young research report, September 2011.

So, what will the future bring? A pessimistic future would entail a continued erosion of America's global competitiveness. In absolute size, the U.S. subsidiaries of global companies may or may not hold steady. But their share of the U.S. economy would erode as they made more key investments outside America. These companies' dynamic connections to the broader U.S. economy would erode as well, with smaller contributions to the U.S. economy by their U.S. subsidiaries: less R&D, less investment, fewer exports, and fewer jobs. All of this, in turn, would slow overall U.S. growth in output, productivity, and standards of living.

This pessimistic future would need not involve any dramatic crisis. But it would involve a slower-growing, less-dynamic U.S. economy without any rekindling of the growth trajectory insourcing companies followed in the last part of the 20th century. In the pessimistic future, 2020 may well arrive with business and government leaders puzzling over why the U.S. labor market had still not recovered its pre-Crisis health.

This need not be the future for the United States. A vigorous, optimistic future is very possible. But achieving an optimistic future will require crafting new U.S. policies to boost FDI inflows and the related employment and other productivity-enhancing activities of insourcing companies.

Conclusions and Policy Implications

Which future is more likely? The answer will hinge on U.S. policy choices. With poor policies, then the pessimistic future may well play out. Indeed, if the strong economic performance of the "BRIC and beyond" countries continues, then just to maintain U.S. competitiveness U.S. policies will need to improve. Realizing an optimistic FDI future will almost surely require bold policy changes in America—changes that, nevertheless, are well within the grasp of policymakers.

An important first policy step would be for the Secretary of Commerce to oversee an interagency review and report of America's global competitiveness in attracting FDI, as specified in the Global Investment in American Jobs Act of 2013. The baseline information from this report would provide an excellent guide to refining U.S. economic policies and promotion—and, ultimately, economic performance.

Let me recommend a second important policy step: higher-quality U.S.-government data. U.S. government statistics currently do not capture the full extent and evolution of the U.S. operations of global companies. This is in no way a fault of the dedicated public servants working at statistical agencies such as the U.S. Bureau of Economic Analysis. Rather, it simply reflects the fact that many of the business surveys conducted and analyzed by BEA and other agencies were created decades ago in ways that today fail to encompass the modern and ever-evolving complexity of business in America. Here in the 21st century, if we want to craft U.S. economic policies and promotion that reflect best support U.S. job creation, then then we need to find a way to update and expand many of our key economic statistics on how global companies work.

Thank you again for your time and interest in my testimony. I look forward to answering any questions you may have.