Joint Economic Committee
Republicans Senator Sam Brownback *Ranking Member*
Representative Kevin Brady *Senior House Republican*

Republican Staff Commentary

- *U.S. economic competitiveness is slipping in various areas as documented by multiple studies and surveys. Not the least reason is U.S. tax and regulatory policies.*
- *"Creative destruction" used to characterize the U.S. economy like no other; it underpinned our scientific, technical, and economic leadership.*
- *Government meddling thwarts regenerative market forces and slows economic growth—it happened in the 1970s when Japan and Germany surged ahead, and it is happening again now.*
- *This time, many more countries small and large, including ones with huge potential such as China, India, Russia, and Brazil, are pressing for international primacy using technology-oriented economic strategies.*
- *The U.S. must cease to hamstring itself with the highest corporate income tax rate among major economies and by neglecting incentives for innovation such as allowing the R&D tax credit to expire in 2009.*

The State of U.S. Economic Competitiveness

December 7, 2010

The strength of the U.S. economy. The United States has the largest economy and one of the highest ratios of GDP per capita in the world. This is no historical accident. The reason for this success is that our economy is dynamic, generating and adopting advanced technologies and adapting its goods and services to match consumer demand. At the heart of our economy is a free market system that allows suppliers to compete on price and quality as well as through product innovations and allows consumers the choice to buy what they want, when, where, and from whom they want.

Critics of a competitive market place with free entry and exit often dismiss it as unrealistic. According to these critics, the U.S. economy is dominated by big businesses that can do as they please and must be constrained and regulated by government. But what were some of the dominant companies of the last generation and where are they now: GM, GE, U.S. Steel, AT&T, IBM, RCA, Xerox, Sears Roebuck & Co., Pan Am Airlines? Some of them no longer exist or exist only in name; of those that remain, some are hanging on, and some are profitable but none is a business icon any longer. In fact, since these companies' glory days, another crop of "dominant" companies has seen their star rise and fade, such as Microsoft (there is now talk of breaking it up and selling off pieces) and Intel, and who still remembers Wang?

The United States has the world's preeminent economy because it has stayed at the forefront of creative destruction, meaning that better ideas and methods displace lesser ones. During the 1970s, the U.S. economy had become stuck with "rust belt" industries while other countries surged ahead, notably Japan and Germany. But, the U.S. economy emerged in the 1980s and 1990s with renewed vigor. Economic growth in other countries tended to decelerate when their pursuits had run their course. As long as the United States set the direction and these other countries could marshal their resources in pursuit of a clear competitive objective, these countries could be (and can be) extraordinarily efficient. However, allocation decisions under uncertainty had proven difficult for them as had moving beyond familiar ways of operating and especially allowing upstarts to displace dominant companies.

The world is not standing still. There now are many more countries that are industrializing and eager for advancement. Technology is a defining element of competitiveness. If the United States loses its technological edge, it will lose the contest with countries such as China, India, Russia, and Brazil that are much larger than Japan and Germany and that hold more resources by far, among them oil, natural gas, coal, and rare-earth metals. China, in particular, is known for its aggressive pursuit of new technologies.[1] This is not to say that small countries do not also pose a competitive challenge. The Nordic countries, Switzerland, Singapore, to mention a few, are determined and successful innovators. In the face of intensifying international competition, the United States must preserve the dynamism of its economic system in order to maintain its leadership in the global economy.

The United States is slipping. Unfortunately, U.S. governmental priorities seem confused in the face of challenges presented by a world where many countries of all sizes have come to focus on their technological advancement and on honing their international competitiveness. As a result, there are troubling signs that U.S. competitiveness is slipping:

- The latest World Economic Forum's Global Competitiveness Report shows the U.S. dropping from second place to fourth place. The most problematic factors for doing business identified in that report are access to financing, government bureaucracy, and tax rates. With respect to balancing government budgets, the U.S. ranked 118th of 139 nations in the survey.[2]

- The Information Technology and Innovation Foundation (ITIF) ranked the U.S. sixth out of 40 countries and regions, such as the European Union (EU), in innovation last year. As recently as 2000, ITIF had found the U.S. ranked first. By some forward-looking criteria, ITIF ranks the U.S. last among the 37 countries and 3 regions it examined.[3]

- A study by the Boston Consulting Group released in March of 2009 ranked the U.S. eighth in innovation out of 110 countries.[4]

- The U.S. ranks 4th in the 2010 Global Manufacturing Competitiveness Index published by the Council on Competitiveness. The U.S. places behind China, India, and South Korea. Unfortunately, the expected change in five years is for the U.S. to slip further to 5th place behind Brazil.[5]

- Sadly, Transparency International ranked the U.S. 22nd down from 19th place last year in its Corruption Perceptions Index 2010, while our neighbor Canada ranked 6th with an improved score from last year.[6]

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[1] For recent examples, see "Train Makers Rail Against China's High-Speed Designs," and "China's New Drones Raise Eyebrows, *The Wall Street Journal*, 11/18/2010." Also significant in this connection is, "China Cites Pollution in Tightening Rare-Earth Exports," *The Wall Street Journal*, 11/15/2010.

[2] "The Global Competitiveness Report, 2010-2011," Klaus Schwab editor, World Economic Forum, Geneva, Switzerland, 2010.

[3] "The Atlantic Century, Benchmarking EU and U.S. Innovation and Competitiveness," European-American Business Council, ITIF, February 2009.

[4] "The Innovation Imperative in Manufacturing, How the United States Can Restore its Edge," The Boston Consulting Group, March 2009.

[5] "2010 Global Manufacturing Competitiveness Index," Deloitte Touch Tohmatsu and The U.S. Council on Competitiveness, June 2010.

Some policies to help reverse the downward trend

R&D tax credit. Many countries have adopted an innovation-led economic development strategy. Europe's Lisbon Agenda has set the goal of making the EU "the most competitive and dynamic knowledge-based economy in the world." European and Asian countries especially have been increasing their investment in R&D as a share of GDP and are working to commercialize new technologies more effectively. Meanwhile R&D tax benefits in the United States have fallen relative to other OECD nations, placing the U.S. 17th among them in 2004.[7] The R&D tax credit expired altogether at the end of 2009.

Corporate taxes. In recognition of the fact that capital has become increasingly mobile and that investment opportunities have multiplied the world over, other countries have been aggressively lowering their corporate tax rates to attract investment. Of the 30 nations in the OECD, 27 have cut their corporate income tax rates since 2000 by an average of more than 7 percentage points. Among an additional 50 nations examined by CATO,[8] 28 reduced their corporate tax rates also by an average of about 7 percentage points. The U.S. on the other hand enacted some targeted preferences that either amount to a much smaller reduction (2 percentage points for domestic production activities), or miss important forms of investment (intellectual property and human capital), or have limited benefit because they are temporary. CATO finds that the United States, with an effective tax rate of 35 percent, ranks 6th highest among the 80 nations for which it estimated effective corporate tax rates. The countries with higher rates: Argentina, Chad, Brazil, India, and Uzbekistan.

The United States has the most unfavorable corporate tax system among the world's major economic competitors. Not only is the combined corporate federal and state tax rate (35 percent plus an average of 4.3 percent) the second highest on average of any major economy, the high U.S. rates also apply to the repatriated profits of U.S. corporations earned anywhere in the world. Japan has a higher rate (39.5 percent) than the U.S. average (39.3 percent), but in 2009, Japan moved to a territorial tax system, meaning that profits are taxed only where they are earned.[9] Foreign subsidiaries of Japanese firms pay the same tax rates as their in-country competitors (on 95% of dividends) and face no tax adjustment (on that 95%) when they bring those profits home. The Tax Foundation in 2008 listed the combined state and federal corporate tax rates for each state in the union individually, showing that for companies in many states the combined corporate tax rates substantially exceed even the high rates in Japan and Germany (see Table 1).[10]

Conclusion. The United States faces critical challenges at home and abroad. At home, it faces the tasks of reconstituting the financial system, overcoming a severe economic recession, and working off an enormous debt burden. Abroad it faces rapid technological advancement in countries small and large, developed and developing. The United States does not have the luxury, as some seem to think based on a legacy of technical leadership and the economy's size, of handicapping itself with antigrowth policies. The United

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[6] "Corruption Perceptions Index 2010," Transparency International, October 2010.
[7] "Expanding the R&D tax credit to drive innovation, competitiveness and prosperity," Robert D. Atkinson, ITIF, July 24, 2007.
[8] "U.S. Effective Corporate Tax Rate on New Investments: Highest in the OECD," Duanjie Chen and Jack Mintz, Tax & Budget Bulletin, No. 62, May 2010.
[9] In the case of Japanese firms, 95% of dividends paid by a foreign company of which at least 25% was owned for at least 6 months prior to declaration of the dividend are exempted from domestic taxes.
[10] "U.S. States Lead the World in High Corporate Taxes," Fiscal fact No. 119, Tax Foundation, March 18, 2008.

States cannot rely on past innovations or on its size going forward. The rest of the world has discovered the power of technology and the advantages of international economic competitiveness. The so-called BRIC countries (Brazil, Russia, India, and China) with a combined population of nearly 3 billion people are developing rapidly and hold among them substantial amounts of important natural resources. The federal government must put its tax and regulatory systems in order so as not to extend easy advantages to other economies. Our nation's future prosperity depends on it.

Table 1 Comparing U.S. State Corporate Taxes to the OECD (2008)				
OECD Overall Rank	**Country/State**	**Federal Rate Adjusted**	**Top State Corporate Tax Rate**	**Combined Federal and State Rate (Adjusted)[a]**
	Iowa	35	12	41.6
	Pennsylvania	35	9.99	41.5
	Minnesota	35	9.8	41.4
	Massachusetts	35	9.5	41.2
	Alaska	35	9.4	41.1
	New Jersey	35	9.36	41.1
	Rhode Island	35	9	40.9
	West Virginia	35	9	40.9
	Maine	35	8.93	40.8
	Vermont	35	8.9	40.8
	California	35	8.84	40.7
	Delaware	35	8.7	40.7
	Indiana	35	8.5	40.5
	New Hampshire	35	8.5	40.5
	Wisconsin	35	7.9	40.1
	Nebraska	35	7.81	40.1
	Idaho	35	7.6	39.9
	New Mexico	35	7.6	39.9
	Connecticut	35	7.5	39.9
	New York	35	7.5	39.9
	Kansas	35	7.35	39.8
	Illinois	35	7.3	39.7
	Maryland	35	7	39.6
	North Dakota	35	7	39.6
1	**Japan**	**30**	**11.56**	**39.54**
	Arizona	35	6.968	39.5
	North Carolina	35	6.9	39.5
	Montana	35	6.75	39.4
	Oregon	35	6.6	39.3
2	**United States**	**35**	**6.57**	**39.27**
	Arkansas	35	6.5	39.2
	Tennessee	35	6.5	39.2
	Washington [b]	35	6.4	39.2
	Hawaii	35	6.4	39.2
3	**Germany**	**26.38**	**17.0**	**38.9**
	Michigan [b]	35	6	38.9
	Georgia	35	6	38.9
	Kentucky	35	6	38.9
	Oklahoma	35	6	38.9
	Virginia	35	6	38.9
	Florida	35	5.5	38.6
	Louisiana	35	8	38.5

	Missouri	35	6.25	38.4
	Ohio	35	5.1	38.3
	Mississippi	35	5	38.3
	South Carolina	35	5	38.3
	Utah	35	5	38.3
	Colorado	35	4.63	38.0
	Alabama	35	6.5	37.8
4	**Canada**	**22.1**	**14**	**36.1**
	Texas [b]	35	1.6	36.0
	Nevada	35	0	35.0
	South Dakota	35	0	35.0
	Wyoming	35	0	35.0
5	**France**	**34.43**	**0**	**34.4**
6	**Belgium**	**33.99**	**0**	**33.99**
7	**Italy**	**33**	**0**	**33**
8	**New Zealand**	**33**	**0**	**33**
9	**Spain**	**32.5**	**0**	**32.5**
10	**Luxembourg**	**22.88**	**7.5**	**30.38**
11	**Australia**	**30**	**0**	**30**
12	**United Kingdom**	**30**	**0**	**30**
13	**Mexico**	**28**	**0**	**28**
14	**Norway**	**28**	**0**	**28**
15	**Sweden**	**28**	**0**	**28**
16	**Korea**	**25**	**2.5**	**27.5**
17	**Portugal**	**25**	**1.5**	**26.5**
18	**Finland**	**26**	**0**	**26**
19	**Netherlands**	**25.5**	**0**	**25.5**
20	**Austria**	**25**	**0**	**25**
21	**Denmark**	**25**	**0**	**25**
22	**Greece**	**25**	**0**	**25**
23	**Czech Republic**	**24**	**0**	**24**
24	**Switzerland**	**8.50**	**14.64**	**21.32**
25	**Hungary**	**20**	**0**	**20**
26	**Turkey**	**20**	**0**	**20**
27	**Poland**	**19**	**0**	**19**
28	**Slovak Republic**	**19**	**0**	**19**
29	**Iceland**	**18**	**0**	**18**
30	**Ireland**	**12.5**	**0**	**12.5**

[a] Combined rate is adjusted for federal deduction of state taxes paid.

[b] Michigan, Texas and Washington have gross receipts taxes rather than traditional corporate income taxes. For comparison purposes, we converted the gross receipts taxes into an effective CIT rate. See footnote 2 for methodology.