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# US Must Woo Multinationals for Healthier Trade Balance


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In recent months, several major multinational companies announced plans to boost investment in the US. We think these moves may mark the start of a shift in global investment, production and trade patterns. But more incentives are needed to attract multinational manufacturing to the US, which could go a long way toward reducing the trade deficit.


The dynamics of global trade are changing rapidly. Domestic demand growth in the US is being outpaced by overseas markets. US manufacturing is benefiting from improved productivity and lower unit labor costs relative to its key trading partners. And a more competitive dollar makes US exports even more attractive. Global conditions are aligned for a steady and sustained reduction in the US trade deficit in the coming years.

But these trends will only translate into a healthier trade balance if multinational companies—both US and foreign—fully exploit the advantages of turning the US into a production base for exports or import substitution. Indeed, US multinational companies alone ran a $172 billion trade deficit in 2008 **(Display 1)**.

We think these companies, along with their non-US peers, have the capital and operational scale to trigger changes in global investment, production and trade patterns. The good news is that important changes already appear to be unfolding.

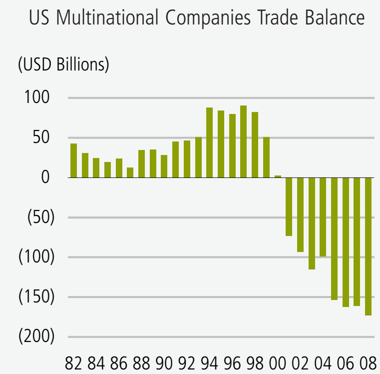
## New Investment Initiatives in US

In recent months, several major US and foreign multinational companies have announced plans to increase investment in the US, including some brand new "greenfield" facilities. The list of US-based companies includes Intel, Global Foundries, Caterpillar and GM, along with international household names such as Samsung of Korea as well as BMW and Volkswagen of Germany.

Some US-based firms are also beginning to export more from their US plants. But surprisingly, the key driver of US export growth in recent years has been US companies that are not multinational groups.

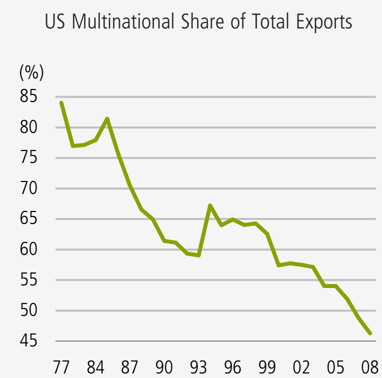
According to a recent report from the Bureau of Economic Analysis, exports by US multinational companies accounted for

Display 1
Large US Firms Run Big Trade Deficit




As of December 2008
Source: Haver Analytics and AllianceBernstein

Display 2
Export Share of Top Companies Plunges




As of December 2008
Source: Haver Analytics and AllianceBernstein

46.3% of all products shipped abroad in 2008, down 2.5 percentage points from 2007 **(Display 2)**. This represented the lowest share since statistics on multinational trade were first collected in 1977. To put this shift in context, 10 years earlier, US multinational companies accounted for two-thirds of US exports, and in the early 1980s the share reached as high as 80%.

Importantly, one reason for the declining export share decline of US multinationals is because smaller and mid-sized firms are exporting more products to an increasing number of countries. That's a positive development for the US trade balance, and one that we expect to continue. But export growth of US multinationals has trailed other US firms by a wide margin. According to our analysis, exports of US multinationals have gained 3% each year on average over the past decade compared with 12% growth of other companies.

Why has export growth been so much slower for US multinationals? Perhaps multinational groups have large operations overseas which they use to meet foreign demand instead of shipping from the US? This is a plausible explanation, although most overseas units of US multinationals are in high-cost countries and most of the incremental demand has come from emerging markets.

## Efficiency Should Be a Magnet

Whatever the reason, we think US multinationals will increasingly find good strategic incentives to produce more for export from the US. For example, US manufacturing is extremely competitive and efficient, with average annual productivity gains over the past decade of about 5%. That's well above the average of other major industrialized economies and only topped by two countries, Korea and Taiwan.[1] In addition, over the same period, US unit labor costs in manufacturing have fallen, when compared with the global average of industrialized economies, as wage growth stagnated **(Display 3)**. The decline is even larger when the correction in the US currency is included.

These efficiency improvements, along with the sheer size of the US market, should be a magnet for non-US multinationals as well. We think international companies with significant sales in the US of products manufactured overseas will find increasingly compelling reasons to boost production and investment in the US.

Even now, affiliates of foreign companies account for nearly 30% of all US imports, according to BEA. Of those imports, 80% represent intra-firm sales between the parent company and the US subsidiary. Companies no longer operate within the confines of national boundaries, and many international firms have much to gain by shifting more production to the US. It would help mitigate the impact of currency fluctuations and eliminate transportation costs. There are significant nonlabor costs savings to be captured as well because US manufacturing tends to rely more on relatively cheap natural gas for its key energy source, while European and Asian producers depend more on oil.

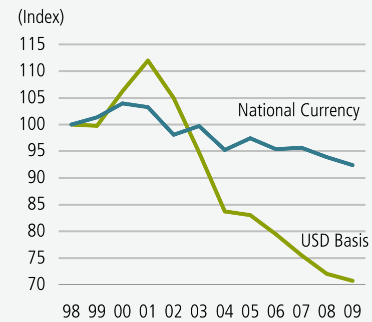
## US Tax Regime Remains a Problem

Many international companies are probably deterred from investing in the US because of an unfavorable tax regime. The US corporate tax rate is among the highest of OECD countries, although it tends to have more generous allowances for depreciation of equipment and structures that helps to reduce effective marginal tax rates. Still, we think the US could do better by offering more permanent investment incentives to attract more capital, or at least, to signal to multinational companies that the tax rate is not going to rise further in the near future.

Display 3

**US Manufacturing Has a Cost Advantage**

US Manufacturing Unit Labor Costs Relative to 14 Competitors




As of December 2009
Source: Census Bureau and Haver Analytics

In our view, recent moves by multinationals in the US mark the very early stages of a shift in investment, production and trade patterns. For the US to benefit from these changes, it will at least need to provide a stable set of tax rules—possibly along with a sweetener—to attract new capital, investment and technology.

Of course, multinational companies don't look at trade balances to run their businesses. But for policymakers, trade deficits reflect important investment and production patterns that could have a huge and enduring impact on employment if not reversed.

Eliminating the deficit of US-based multinational operations would cut the US trade deficit by a third, and we hope lawmakers understand just how important it is to make it easier for these companies to operate in the US. Discussions on tax policy in the coming months would be a good place to start drawing up better incentives that will position the US to benefit from the transition in global trade flows and promote a healthier balance of imports and exports. ■

1. The international comparison of manufacturing productivity published by the US Department of Labor does not include China in its calculation.