SEPTEMBER 2016

PROBLEMS UNSOLVED AND A NATION DIVIDED

The State of U.S. Competitiveness 2016
Including findings from Harvard Business School's 2016 surveys on U.S. competitiveness

Michael E. Porter
Jan W. Rivkin
Mihir A. Desai
With Manjari Raman

HARVARD | BUSINESS | SCHOOL

EXECUTIVE SUMMARY

Harvard Business School (HBS) launched the U.S. Competitiveness Project in 2011 as a multi-year, fact-based effort to understand the disappointing performance of the American economy, its causes, and the steps needed by business and government to restore economic growth and prosperity shared across all Americans. We draw on surveys of HBS alumni and the general public to solicit views about the state of U.S. competitiveness as well as the steps needed to restore it.

This report provides an overview of our findings on the evolution of the U.S. economy, the state of U.S. competitiveness in 2016, and priorities for the next President and Congress, drawing on our research and the May–June 2016 surveys of alumni and the general public.

While a slow recovery is underway, fundamentally weak U.S. economic performance continues and is leaving many Americans behind. The federal government has made no meaningful progress on the critical policy steps to restore U.S. competitiveness in the last decade or more.

Chapter 1 provides the definition of competitiveness by which we assess the state of the U.S. economy. Chapter 2 analyzes U.S. economic performance up through 2016. It traces the origins of the decline of many economic indicators to well before the Great Recession. Chapter 3 diagnoses the causes of the long-term, structural decline in U.S. competitiveness, identifies U.S. strengths and weaknesses in 2016, and assesses the future trajectory of U.S. competitiveness. Chapter 4 highlights the pressing need for a national economic strategy to change our economic trajectory and outlines the strategic agenda for business as well as state and local governments to improve competitiveness.

Chapter 5 turns to the role of federal government in improving competitiveness and outlines an Eight-Point Plan of critical federal policy priorities for restoring competitiveness that enjoy widespread support. The chapter also describes the absence of meaningful progress in Washington in addressing any of those priorities and the lack of a strategic dialog about the important U.S. weaknesses in the current presidential election campaign. Chapter 6 takes a deep look at tax reform, the area with the single greatest near-term impact on U.S. competitiveness and economic growth. It prioritizes consensus tax policy steps that could provide the foundation for broader reform. Finally, Chapter 7 identifies the U.S. political system as now the single biggest barrier to competitiveness, blocking progress on the steps needed to restore shared prosperity. (We define the political system as the institutions and processes by which our political leaders are elected and by which they govern.) Surveys of business leaders and the general public reveal serious concerns about the political system, and about the need for reform, but uncertainty about what to do about it.

Key Findings

The U.S. economy in an era of political paralysis

- Addressing America's economic challenges requires a common understanding of competitiveness and the true underpinnings of prosperity. We define competitiveness as follows: *A nation is competitive to the extent that firms operating there can compete successfully in domestic and international markets while also lifting the living standards of the average citizen.* Competitiveness must lead to shared prosperity, in which all Americans have the opportunity to advance economically.
- U.S. competitiveness has been eroding since well before the Great Recession. America's economic challenges are structural, not cyclical. The weak recovery reflects the erosion of competitiveness, as well as the inability to take the steps necessary to address growing U.S. weaknesses.
- Our failure to make progress reflects an unrealistic and ineffective national discourse on the reality of the challenges facing the U.S. economy and the steps needed to restore shared prosperity. Business has too often failed to play its part in recent decades, and a flawed U.S. political system has led to an absence of progress in government, especially in Washington.

Faltering U.S. economic performance

- America's economic performance peaked in the late 1990s, and erosion in crucial economic indicators such as the rate of economic growth, productivity growth, job growth, and investment began well before the Great Recession.
- Workforce participation, the proportion of Americans in the productive workforce, peaked in 1997. With fewer working-age men and women in the workforce, per-capita income for the U.S. is reduced.

- Median real household income has declined since 1999, with incomes stagnating across virtually all income levels. Despite a welcome jump in 2015, median household income remains below the peak attained in 1999, 17 years ago. Moreover, stagnating income and limited job prospects have disproportionately affected lower-income and lower-skilled Americans, leading inequality to rise.
- A similar divergence of performance has also occurred between large companies and small businesses. While large firms have been able to prosper, small companies are struggling, startups are lagging, and small business is no longer the leading job generator.
- Overall prosperity is growing slowly, but the benefits are increasingly not flowing to middle- and lower-income Americans. This puts the American Dream, or the ability of any American to advance and prosper, at risk.

An eroding U.S. business environment

- The U.S. economy retains critical strengths. Business leaders (including HBS students) perceive strengths in areas such as higher education, entrepreneurship, communications infrastructure, innovation, capital markets, strong industry clusters, and sophisticated firm management. However, these strengths are being offset by weaknesses such as the corporate tax code, the K–12 education system, transportation infrastructure, the healthcare system, and the U.S. political system. Skills have also been eroding and becoming a weakness. Many of the greatest weaknesses are in areas driven by federal policy.
- Alumni working in smaller firms have more negative views of the U.S. business environment than alumni working in larger firms. Members of the general public see the same U.S. competitive weaknesses as HBS alumni but, unlike alumni, perceive far fewer strengths.
- This pattern of strengths and weaknesses helps explain why the U.S. economy is no longer delivering shared prosperity. Large companies, the skilled individuals who run them, and those who invest in them benefit from America's greatest strengths and are prospering. However, workers and small businesses are captives of the nation's major weaknesses.
- Pessimism about the trajectory of U.S. competitiveness deepened in 2016, for the first time since we started surveying alumni in 2011. Fifty percent of the business leaders surveyed expect U.S. competitiveness to decline in the coming three years, while 30% foresee improvement and 20% no change.
- Business leaders and the general public are particularly concerned about the future of American workers: respondents who expect lower pay and fewer employment opportunities for the average American in the future far outnumber those who expect improving worker outcomes.
- Inadequate investment in those parts of the business environment on which middle-class Americans depend (areas like K–12 education and skills), together with lack of policy improvement in areas on which small businesses depend (tax policy, regulations, infrastructure), has undermined overall productivity and shared prosperity.

The pressing need for a national economic strategy

- Given the significant challenges facing the American economy, the U.S. needs a national economic strategy more than at any other time in recent history. A strategy is an integrated set of priorities that builds on strengths while acknowledging and tackling weaknesses. It identifies the sequence of steps needed to achieve the priorities.
- The U.S. lacks an economic strategy, especially at the federal level. The implicit strategy has been to trust the Federal Reserve to solve our problems through monetary policy.
- A national economic strategy for the U.S. will require action by business, state and local governments, and the federal government. All three levels have a crucial role to play in restoring competitiveness.
- Taking leadership in improving U.S. competitiveness is a pressing imperative for business leaders. Many companies have failed to invest enough in improving the business environments in the regions in which they operate. Companies can have a major impact on restoring U.S. competitiveness through internal steps such as training and improving opportunities and compensation for lower-income employees. Companies must also step up their role to enhance the business environment in their communities by investing in workforce skills, supporting public education, restoring a local supplier base, and participating in collaborative economic development programs in their regions. We find growing evidence that company attitudes toward investing in competitiveness are improving and this is a welcome development. There are more and more innovative programs underway by business in skills, education, and other areas critical to competitiveness.

- State and local governments must also play a crucial role in improving the business environment, because many of the crucial drivers of competitiveness are local. States and cities need a clear strategy for competitiveness rather than isolated initiatives, and government leaders should foster cross-sector collaborations among local business leaders and other community stakeholders.
- At the state and local level, the Project has found many examples of innovative steps to enhance competitiveness. Mayors, governors, nonprofit leaders, educators, and businesses are working together in new ways to build workforce skills, invigorate the local education system, upgrade infrastructure, improve the entrepreneurial ecosystem, and develop regional economic strategies. Cities and states across America are moving forward toward competitiveness, but more can be done and best practices need to be shared.

An economic strategy for Washington

- Efforts by business and state and local government to restore competitiveness cannot deliver their full promise if the federal government does not act. Many of the major weaknesses facing the U.S. are in areas controlled by the federal government.
- In 2012, we put forward an Eight-Point Plan of federal policy priorities that would unlock U.S. economic growth and competitiveness. The Eight-Point Plan consists of the following policy recommendations: simplify the corporate tax code with lower statutory rates and no loopholes; move to a territorial tax system like all other leading nations'; ease the immigration of highly-skilled individuals; aggressively address distortions and abuses in the international trading system; improve logistics, communications, and energy infrastructure; simplify and streamline regulation; create a sustainable federal budget, including reform to entitlements; and responsibly develop America's unconventional energy advantage.
- Each of these areas represents compelling U.S. weaknesses, primarily controlled by the federal government, that can have the most significant and near-term impact on the U.S. economy. There is also wide consensus on the policy change needed to make progress in each area. There are two other crucial U.S. weaknesses, public education and health care, but these are in fields controlled heavily at the state and local levels with no clear consensus yet on solutions.
- Progress on even some of these eight priorities would transform the trajectory of the U.S. economy and the economic prospects of all Americans.
- A strong majority of HBS alumni and HBS students support all eight priorities, with consensus across all political affiliations. When asked in open-ended questions about which priorities alumni felt were most important for federal economic policy, the responses identify virtually the same priorities as those in the Eight-Point Plan. Alumni also mention education, health care, and the political system.
- In the general public survey, there was net positive support for seven of the eight priorities, with a tie on territorial taxes. Public support tended to be somewhat weaker, reflecting the fact that many in the public could neither agree nor disagree, or did not know, whether the eight priorities were good or bad for the economy. Divisive political rhetoric and an uninformed national debate have confused the average American about what the country needs to do to restore the economy. This confusion is a serious obstacle to America's ability to make progress.
- Despite strong bipartisan support in business and net public support for the Eight-Point Plan, Washington has made very little or no progress on any of these federal economic priorities for well over a decade. The current presidential election is showing no signs of advancing a coherent plan to address these areas.

Achieving tax reform

- We believe tax reform is the single area with the greatest potential for immediate impact on the economy and is long overdue given changes in the global economy. Corporate tax policy has become a key obstacle to U.S. competitiveness and economic growth, and reforming both corporate and personal taxation is essential to achieving a sustainable federal budget.
- Good tax policy should be guided by the goals of increasing economic efficiency, achieving greater equity, and reducing complexity. The forces of globalization have amplified the inefficiencies and complexities of the current tax system and demand that reform make the U.S. less of an outlier in key tax policy areas – particularly corporate tax policy. Efforts to reduce the negative effects of globalization should be focused on improving competitiveness, for instance, by upgrading the skills of workers threatened by offshoring, rather than on ill-targeted tax policies.
- The top corporate tax problems, according to the surveyed business leaders, are the high corporate tax rate and the taxation of international income. Business leaders report overwhelming and bipar-

tisan support (over 95%) for corporate tax reform. Consensus corporate tax reforms include reducing the statutory rate by at least 10 percentage points, moving to a territorial tax regime, and limiting the tax-free treatment of pass-through entities for business income. The transition to a territorial regime should be complete, not half-hearted via the inclusion of an alternative minimum tax on foreign income. The feasibility of corporate tax reform is promising given the broad consensus on the nature of the problem and the required direction for reform.

- Comprehensive reform of personal taxes will be more challenging. There is less support for many types of personal tax reform. However, there is broad support for instituting a minimum tax on incomes above $1,000,000. Increasing the tax rate on savings; eliminating the deductibility of charitable giving, state and local taxes, and mortgage interest; and taxing employer-provided health insurance did not receive majority support. Respondents support limitations on deductions and exemptions in general but react strongly against them when specific examples were provided.
- Carbon, not consumption, taxes are the best step forward. Carbon taxes are remarkably popular both as a separate revenue raiser and as part of a structural, revenue-neutral reform. In contrast, consumption taxes are quite unpopular and solicit the most spirited commentary, positive and negative, from our alumni. Several recently-proposed new ideas also receive support, including taxing non-C corporation business income, raising the cap on income subject to the payroll tax, and allowing for the deductibility of dividends at the corporate level.
- HBS alumni also strongly support spending reductions as a means to fiscal stability. Nearly one-third chose not only reduced spending, but also reduced taxation. MBA students are much more accepting of tax increases and less supportive of spending cuts.
- To achieve the right kinds of tax reform, leaders must begin to speak more realistically about the fiscal realities America faces. In addition, simplistic, polarizing and protectionist rhetoric must be avoided. The time for tax reform is long overdue.
- Tax reform can also contribute directly to shared prosperity. The earned income tax credit (EITC) is probably the single most important innovation on the personal tax side over the last two decades. Simplification and expansion of the EITC is a promising direction for reform.

A failing political system

- The U.S. political system was once the envy of many nations. Over the last two decades, however, it has become our greatest liability. Americans no longer trust their political leaders, and political polarization has increased dramatically. Americans are increasingly frustrated with the U.S. political system. Independents now account for 42% of Americans, a greater percentage than that of either major party.
- The political system is no longer delivering good results for the average American. Numerous indicators point to failure to compromise and deliver practical solutions to the nation's problems. Political polarization has especially made it harder to build consensus on sensible economic policies that address key U.S. weaknesses. It is at the root of our inability to progress on the consensus Eight-Point Plan.
- A large majority of HBS alumni believe the political system is obstructing U.S. economic growth and competitiveness. Many alumni who self-identified as Democrat or Republican blame the other party, but a sizable proportion also hold their own party responsible.
- Among the general public, many believe that the political system is obstructing economic progress. However, many Americans are unsure, which we attribute to the divisive and partisan dialog on the economy which has confused the public on many issues.
- There is strong support for political reform among surveyed alumni. On six common proposals for political system reform, a strong majority of HBS alumni support five of them. The most supported reforms are gerrymandering reform and campaign finance reform.
- Among the general public, the top two political reforms supported are term limits for the House and Senate and campaign finance reform. However, a large percentage of the general public are unsure about which reforms they favor.
- Overall, we believe that dysfunction in America's political system is now the single most important challenge to U.S. economic progress. Many Americans are keenly aware that the system is broken, but are unsure why it is broken or how to fix it. While there is rising frustration with politics, there is, as yet, no framework for understanding the reasons for today's poor performance and proposing effective solutions. Identifying such a framework, and the set of reforms that can change the trajectory of our political system, has become a crucial priority.

CHAPTER 1

THE U.S. ECONOMY IN AN ERA OF POLITICAL PARALYSIS

In 2011, Harvard Business School launched the U.S. Competitiveness Project to examine the disturbing trajectory of the U.S. economy and its consequences in terms of slow growth, weak job creation, and stagnating incomes, especially for the middle class. The Project has been a long-term commitment, involving multiple faculty and staff, to monitor and understand the root causes of poor U.S. economic performance and advance a strategic agenda for business and government to restore prosperity that is widely shared among all Americans.

Five years later, U.S. economic performance remains lackluster and uneven. Moreover, the public discourse on America's economy has gone from bad to worse. Early in the Project's work, many pundits and politicians focused on the Great Recession. Most believed a sharp downturn and a weak recovery were to blame for our poor economic performance. On the contrary, America's problems actually began well before the Great Recession. This wrong diagnosis, coupled with political paralysis in Washington, has meant that we have made no meaningful progress on any of the critical policy measures needed to tackle the nation's underlying competitive weaknesses, restore robust economic growth, and improve the prospects of the average citizen. In essence, America's economic strategy defaulted to trusting that the Federal Reserve could solve our problems through monetary stimulus.

IT IS IMPERATIVE THAT AMERICANS UNDERSTAND WHY U.S. ECONOMIC PERFORMANCE IS WEAKER THAN IN RECENT GENERATIONS AND HOW SOLVING OUR REAL PROBLEMS WILL REQUIRE US TO MAKE COMPROMISES.

Today, a defining feature of America's situation is the lack of shared prosperity: working- and middle-class citizens are struggling, while those with advanced skills are thriving. We highlighted this issue in prior reports, and raised concerns that this divergence was unsustainable and would create deep divisions in our society, leading Americans to turn against each other rather than implement the compromise solutions we need. These fears have now become a reality. We are experiencing the most divisive and polarized presidential election campaign in a century.

The lack of shared prosperity has rightly been a central issue in the 2016 campaign, but the diagnoses and proposed solutions are way off the mark. The political parties and candidates demonize each other. To explain our economic woes, they blame others with little more than dubious assertions. The culprits, they say, are immigrants, Wall Street, well-off Americans, other countries, big business, international trade—everyone and everything except the parties themselves. The "solutions" offered are emotionally appealing, but simplistic and deeply misguided. There is no talk of any real strategy to improve America's economic performance and, at best, candidates offer only piecemeal proposals to address the problems we all know we must address. Instead, the focus is on whom to blame and whom to punish.

To us, the confused national discussion about our economy and future prosperity in this election year is our worst nightmare. There is almost a complete disconnect between the national discourse and the reality of what is causing our problems and what to do about them. This misunderstanding of facts and reality is dangerous, and the resulting divisions make an already challenging agenda for America even more daunting.

The Project's most important goal, and the objective of this Report, is to help bridge the gap between Americans from different walks of life in how they think about our nation's economic challenges. It is imperative that Americans understand why U.S. economic performance is weaker than in recent generations and how solving our real problems will require us to make compromises and move away from simplistic, ideological positions.

In this Chapter, we start by defining U.S. competitiveness. Only with a clear definition of what competitiveness actually means and what success looks like can we begin to assess U.S. economic performance.

In Chapter 2, we dissect U.S. economic performance, to understand the multifaceted ways in which our performance has eroded and prosperity has diverged among Americans. In Chapter 2 and throughout this report, we rely partly on insights from two related surveys conducted in May and June of 2016: one of HBS graduates together with current MBA students and the other of the general public. (See sidebar on page 7.)

In Chapter 3, we examine the underlying causes of America's disappointing economic performance. We focus on existing and emerging weaknesses in the U.S. business environment, especially those with the greatest impact on workers and small businesses.

Chapter 4 turns to the strategy necessary to restore U.S. competitiveness. Such a strategy requires action by business, state and local government, and the federal government. Chapter 4 lays out the agendas for business and for state and local governments.

In Chapter 5, we turn to economic strategy for the federal government. We review the Eight-Point Plan for Washington, a set of federal policy priorities that will restore economic growth in the near term, that we first put forward in 2012. We report on the support for the Plan by business leaders and the general public across the political spectrum and we assess the progress (or lack of progress) in Washington, for more than a decade, on these critical agenda items.

In Chapter 6, we take a deeper look at one key policy area, tax reform. Our previous work suggests that tax reform may be the single most powerful step to improve America's economic trajectory almost immediately. Here, we offer a framework for thinking about tax reform and solicit the views of business leaders and the general public on the kinds of tax reform they would support.

Chapter 7 concludes by turning to our political system. None of these policy reforms are possible if the federal government remains gridlocked. In fact, we believe that the nation's political system has now become America's gravest competitive weakness and that the situation continues to deteriorate.

Any effort to address U.S. competitiveness, then, must confront and solve the problems in our political system. In Chapter 7, we survey alumni and the general public on their views about the impact the political system has on economic growth and competitiveness, across party affiliations. We also solicit their views on the steps needed for political reform.

For readers of the U.S. Competitiveness Project's prior reports, Chapters 2, 3, and 4 update findings from earlier reports. They are essential reading for those who are new to our work. Chapters 5, 6, and 7 extend the Project's findings into new areas that are crucial to making progress.*

*Michael E. Porter was the principal author of chapters 1, 2, 5 and 7. Jan W. Rivkin was the principal author of chapters 3 and 4. Mihir A. Desai was the principal author of chapter 7. All authors, including Manjari Raman, provided invaluable input on the entire manuscript.

To solicit responses from Harvard Business School alumni worldwide, we partnered with Abt SRBI, a leading survey research firm. HBS contacted, via email, 61,874 eligible alumni of the School's MBA, doctoral, and longer executive education programs. Of these, 4,807 (7.8%) completed the survey. Respondents weighed in from 50 U.S. states (74.4% of respondents with known locations) and 96 other countries (25.6%). They ranged in age from 26 to 101, and the 70.5% who currently work came from every sector of the economy, with heavy representation in the finance and insurance, manufacturing, and professional, scientific, and technical services sectors.

We also surveyed all MBA students attending HBS. This included members of the Class of 2016 who graduated a week before the survey was administered, but were not yet part of the alumni database. Of the 1,872 students surveyed, 361 (19.3%) responded.

HBS conducted the general population survey with the help of GfK KnowledgePanel. GfK recruits general-population respondents through an online panel recruitment process. Eligible adults (residents of the United States who are 18 years and older) were first recruited onto the online panel based on a sampling methodology. Then to ensure that the respondents were representative of the general public, GfK used a probability-based process to create a sample from the active members of the online panel. The measures used included gender, age, race, education, census region, household income, home ownership status, and whether the respondent hails from a metropolitan area or not. Finally, special care was taken to provide a computer and Internet connectivity to those respondents who do not have Internet access so that they could participate in the survey. In the 2016 survey, 1,048 members of the general population responded, hailing from 49 states across America.

Defining Competitiveness

The first step toward understanding U.S. performance, and in many ways the most important step, is to reach a shared understanding of competitiveness and its role in economic performance. The concept of competitiveness remains poorly understood, which is partly to blame for the unsatisfactory public dialog in the U.S. This same problem also arises in other countries, with similar consequences.

A nation is competitive if it creates the conditions where two things occur simultaneously: businesses operating in the nation can (1) compete successfully in domestic and international markets, while (2) maintaining and improving the wages and living standards of the average citizen. When these occur together, a nation prospers. When one occurs without the other, a nation is not truly competitive and prosperity is not sustainable. If business succeeds but the average worker is losing ground, or when worker incomes rise but businesses can no longer compete, the nation is not competitive. A hallmark of a competitive economy, then, is prosperity that is widely shared. And without successful businesses, there can be no jobs and no long-run income growth.

The fundamental manifestation of competitiveness is productivity: a competitive economy achieves high value of output per worker and per dollar of capital invested. Productivity rises when a nation creates an efficient and supportive business environment *while also* equipping its citizens to improve their skills and capabilities. Only through productive citizens and a highly productive environment for business can a nation's firms pay high and rising wages while still being able to compete successfully in the national and global economy.

For decades after World War II, the U.S. was one of the most competitive nations, if not *the* most competitive, precisely because we ensured that both these conditions were in place. Historically, the U.S. set a bold agenda in economic policy and competitiveness: we invested heavily in infrastructure and education, made a commitment to strict antitrust policy to ensure open competition, created institutions for innovation, and took many other steps. Bold policy initiatives like these strengthened the business environment and built crucial assets that enabled America to be competitive.

America thus enjoyed a uniquely efficient and productive business environment across numerous dimensions such as technology, logistics, capital markets, open competition, environment for innovation, and low cost of doing business. American workers were among the best trained and the most productive workers in the world. The result was the American Dream of economic opportunity, with decade after decade of robust job growth and rising middle-class incomes.

Where We Stand

Based on this definition of competitiveness, we now turn to assessing America's economic performance in recent decades, in the context of the nation's longer-term performance since World War II. This sets the stage for an analysis of the underlying causes of the weak outcomes we are seeing today and the type of remedies that will address the real problems.

THE FUNDAMENTAL MANIFESTATION OF COMPETITIVENESS IS PRODUCTIVITY. ONLY THROUGH PRODUCTIVE CITIZENS AND A HIGHLY PRODUCTIVE ENVIRONMENT FOR BUSINESS CAN A NATION'S FIRMS PAY HIGH AND RISING WAGES WHILE STILL BEING ABLE TO COMPETE SUCCESSFULLY IN THE NATIONAL AND GLOBAL ECONOMY.

CHAPTER 2

FALTERING U.S. ECONOMIC PERFORMANCE

Around the late 1990s, well before the Great Recession, America's decades of strong economic growth and shared prosperity came to an end. U.S. economic performance has been weak ever since. Today, the U.S. is struggling not only to grow the economic pie but also to share the pie in a way that benefits all citizens.

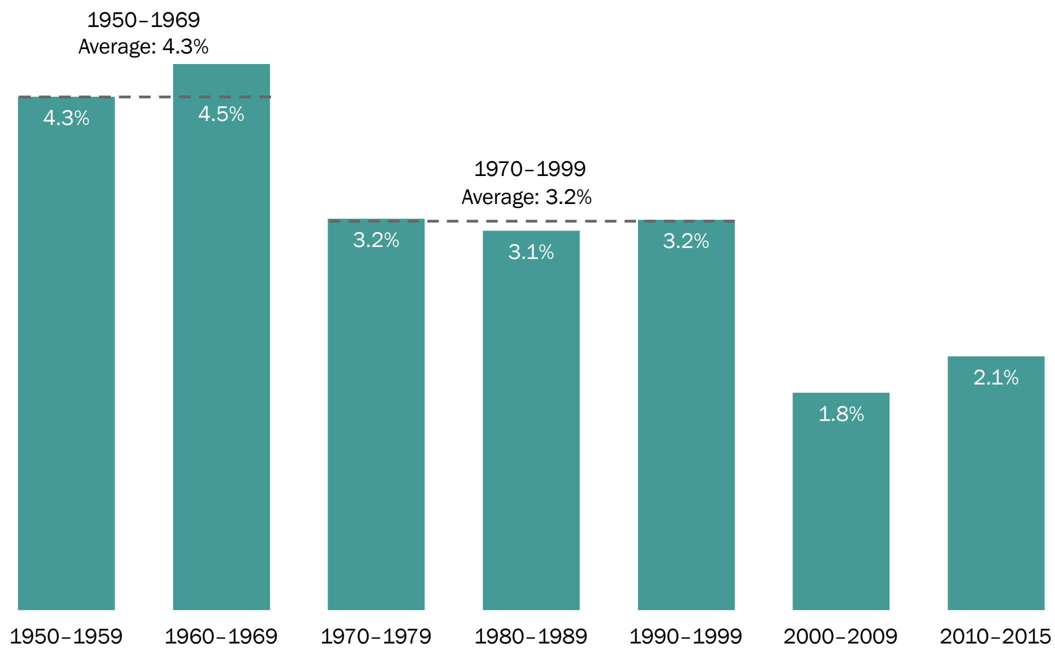
The U.S. is currently registering faster overall economic growth than some other advanced countries, partly because of higher population growth, but we should take little solace in this. Compared to our own long-term historical outcomes, performance is lagging in terms of overall economic growth, job creation, and growth in income. And slower average growth rates are accompanied by a deeper and more troubling problem we introduced in Chapter 1: the divergence in economic prospects among citizens is greater than at any time in recent history. A similar divergence has arisen among companies, with larger corporations thriving in America while many small businesses struggle.

Overall, these results raise serious concerns about U.S. competitiveness. If a competitive nation is one where firms can thrive in competition while lifting living standards among the broad base of citizens, then the United States is no longer truly competitive.

In this chapter, we describe the most recent data on America's economic performance and the long-term circumstances that have led us to this situation. Despite the hope of finding reasons for optimism, the "recovery" remains slow and uneven, largely because America's competitiveness problems took root long before the downturn. Since those problems remain unsolved, it should not be surprising that the average annual economic growth (1.6%) during the current recovery is slower than during any recovery since the late 1940s. (The previous 2000–2007 recovery was the second slowest.)[1]

FIGURE 1: SLOWDOWN IN ECONOMIC GROWTH RATE BY DECADE

Compound annual growth rate of U.S. real GDP by decade, 1950–2015



Source: Bureau of Economic Analysis; author's calculations.

Slowing Growth in GDP and Productivity

The rate of overall U.S. economic growth has been on a long downward trajectory since the 1960s (See Figure 1 on page 9). The GDP growth rate took a significant step down beginning around 2000, well before the Great Recession, and growth has been slow ever since. The U.S. registered 2.4% growth in 2014 and 2015, and growth in the first half of 2016 is only around1%, in part due to weak global conditions.

Productivity growth, a critical indicator of competitiveness and major driver of both economic growth and wage growth, is also well below long-term levels (Figure 2). Annualized labor productivity growth was actually negative over the last three quarters, including the most recent quarter available.

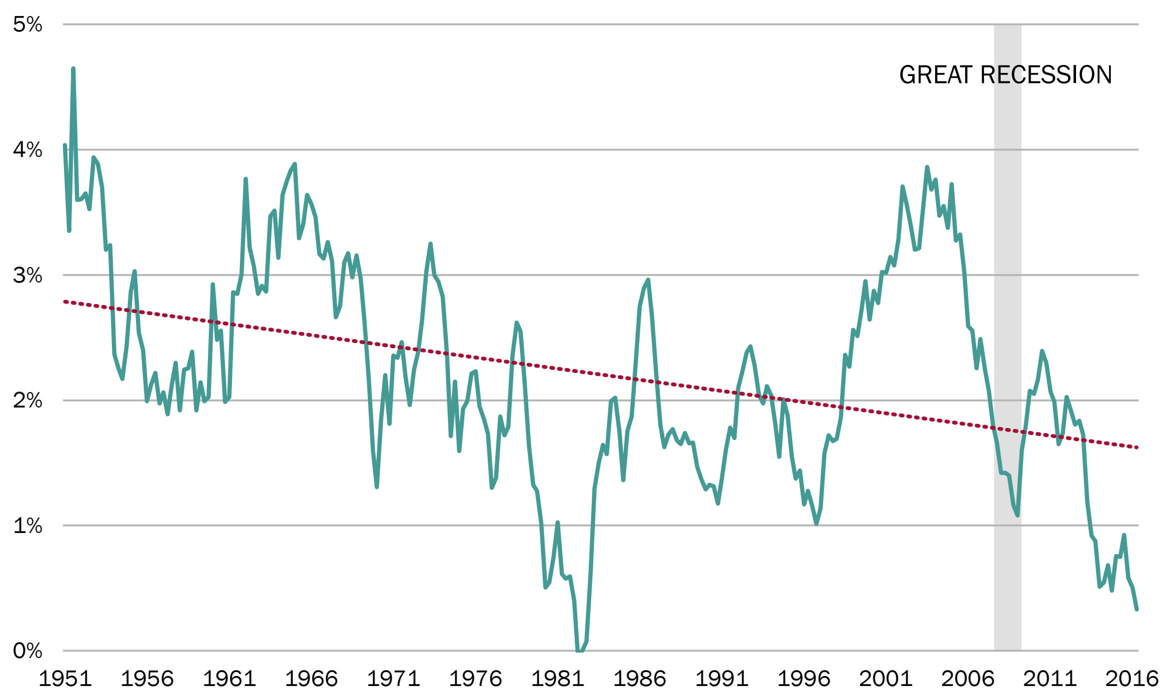
Business investment is also lagging, reflecting uncertain prospects. The annual growth rate of quarterly private investment in intellectual property, structures, and equipment remains weak, falling below historic rates, beginning in the late 1990s for structures and the early 2000s for investment in intellectual property. For 2010–2016, the average quarterly investment by business as a percent of GDP was lower than it has been since the 1980s.[2] Low rates of investment retard both overall economic growth and productivity growth.

Slower Job Growth and Declining Workforce Participation

Job growth in the U.S. also continues to be slow by historical standards. Between the 1970s and the 1990s, the U.S. economy created private-sector jobs at a long-run rate of roughly 2% per year decade after decade (Figure 3). But the job growth rate began to decline around 2001, before the Great Recession, and remains well below historical standards.

FIGURE 2: DECLINE IN PRODUCTIVITY GROWTH

U.S. non-farm business labor productivity, 4-year rolling average of annualized quarterly growth, 1951–Q2 2016



Note: Shaded area indicates the recession of December 2007 to June 2009 as defined by the National Bureau of Economic Research.

Source: Bureau of Labor Statistics; author's calculations.

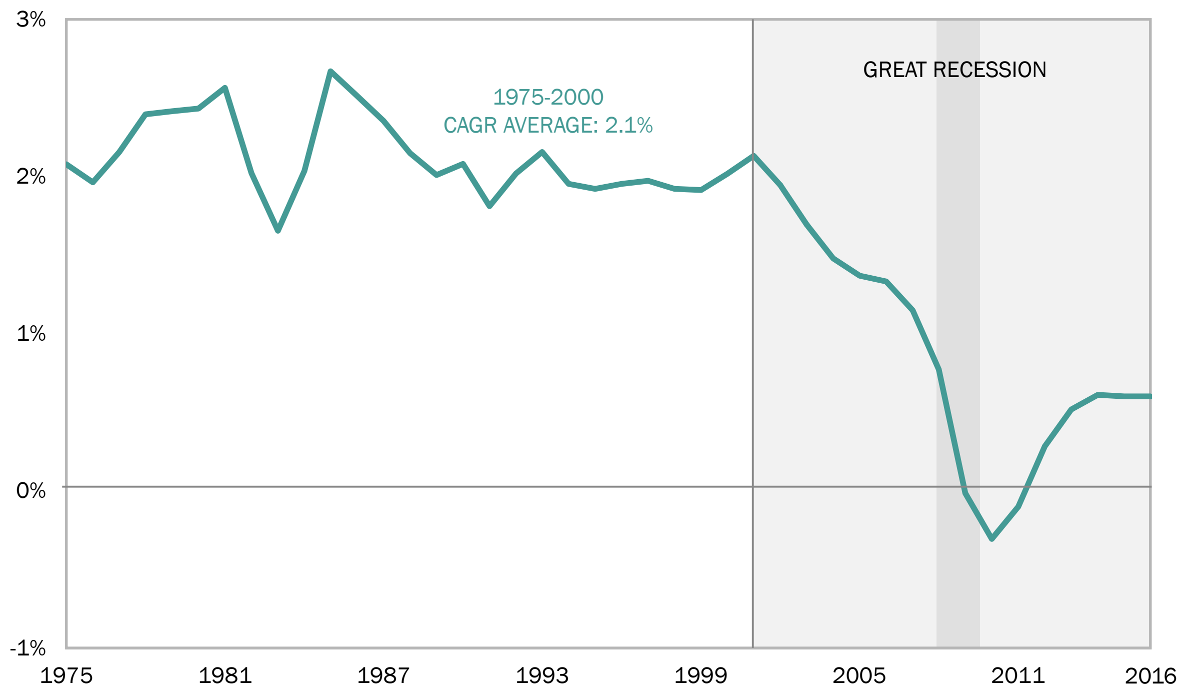
Not only has job growth slowed, but most of the jobs created since 2000 have been in "local" industries such as health care, hospitality, and business services. Local jobs pay average wages that are barely half the wages of jobs in "traded" industries exposed to international competition, such as machinery and IT equipment (See Figure 4 on page 12). The preponderance of jobs restored since the Great Recession are also local jobs. Net job creation in traded industries, where the U.S. has to compete with global peers, has been very small.

One effect of slow job creation is low workforce participation, which is the proportion of working-age Americans in the active workforce. Workforce participation for the prime-age population (16–64) peaked in 1997, again well before the Great Recession. Since then, it has fallen to levels not seen since 1982 (See Figure 5 on page 12). Low workforce participation pushes down per capita income because fewer citizens are working and earning an income. While workforce participation has stopped declining during the most recent six months, the gains have been slight, and time will tell whether they are sustained.

Recent studies have shed light on the causes of low workforce participation.[3] By far the biggest driver is weak demand for low-skilled labor, followed by high incarceration rates of low-skilled men. The net effect is a decline in participation of prime-age men 25-54 years old, which is down 3.4 percentage points since 2000. Black men have been heavily affected. Participation of prime-age women (24-58 years old) is also down, after a long period when women's participation rose. Finally, the participation of younger workers aged 18-24 years has fallen sharply since the early 1990s, with some portion due to a greater number of young people continuing their education.

FIGURE 3: SLOWER PACE OF JOB CREATION

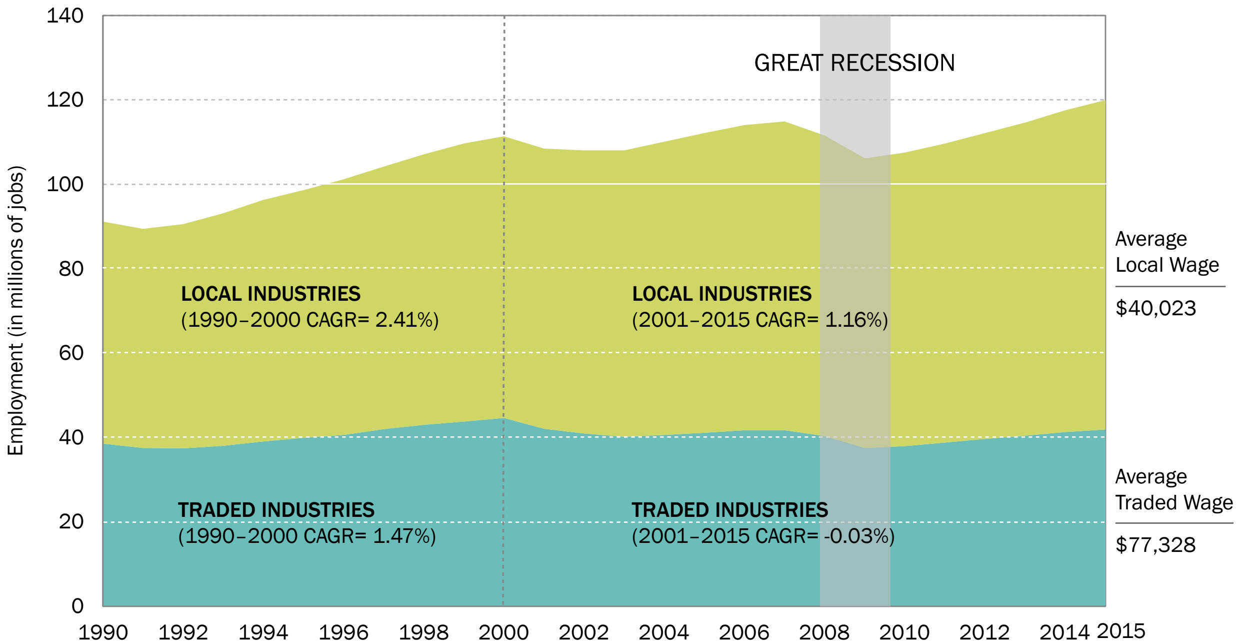
Rolling 10-year compound annual growth rate in total number of U.S. private non-farm employees, 1975–2016



Notes: Data for 2016 are as of July. All other data are year-end values.
Shaded area indicates the recession of December 2007 to June 2009 as defined by the National Bureau of Economic Research.
Source: Bureau of Labor Statistics, Current Employment Statistics survey; author's calculations.

FIGURE 4: NEGLIGIBLE GROWTH IN JOBS EXPOSED TO INTERNATIONAL COMPETITION

U.S. non-farm employment growth by type of industry, 1990–2015

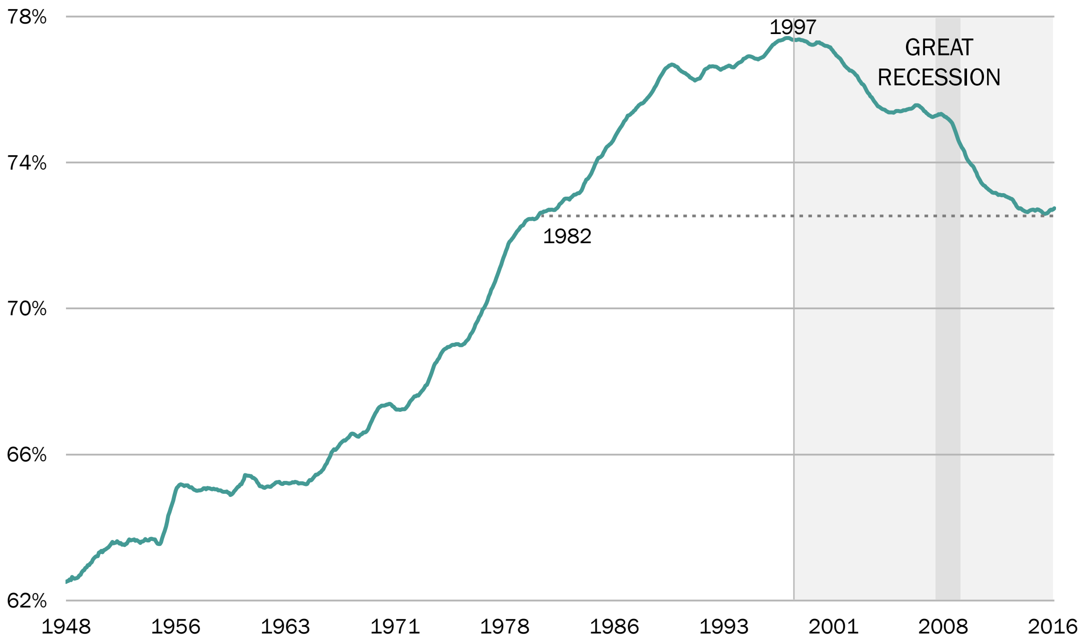


Note: Wage data is an annual average of 2015 quarterly data.

Source: Data from BLS QCEW; U.S. Benchmark Cluster Definitions (Delgado-Porter-Stern 2013); Prof. Michael E. Porter and Richard Bryden, Harvard Business School.

FIGURE 5: DECLINING LABOR FORCE PARTICIPATION

Population aged 16–64 involved in the workforce (rolling 12-month average), 1948–2016



Notes: Civilian labor force over civilian noninstitutional population (not seasonally adjusted). Shaded area indicates the recession of December 2007 to June 2009 as defined by the National Bureau of Economic Research.

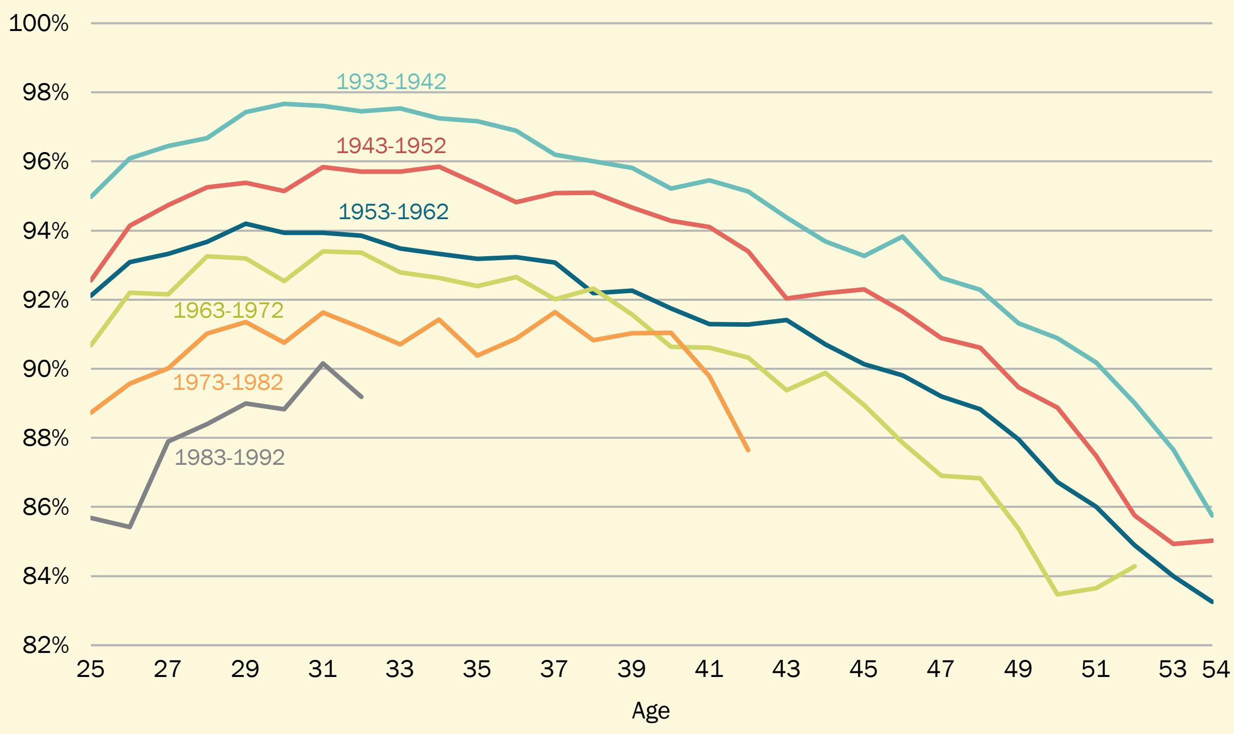
Source: Bureau of Labor Statistics; author's calculations.

Some observers have minimized declining U.S. workforce participation as an anomaly due to retiring baby boomers. However, baby boomers (age 52 and above) are actually working *longer* than historical norms. The reality is that male labor force participation has been falling for each successive birth cohort since the 1940s (Figure 6), a truly unsettling finding. This may be due to the fact that the educational attainment and skills level of the average American have not kept up with rising global standards. (See Chapter 3.)

The United States has also been lagging behind other advanced nations in participation, especially among prime-age men (See Figure 7 on page 14). America has now fallen to third lowest among the 34 OECD countries.

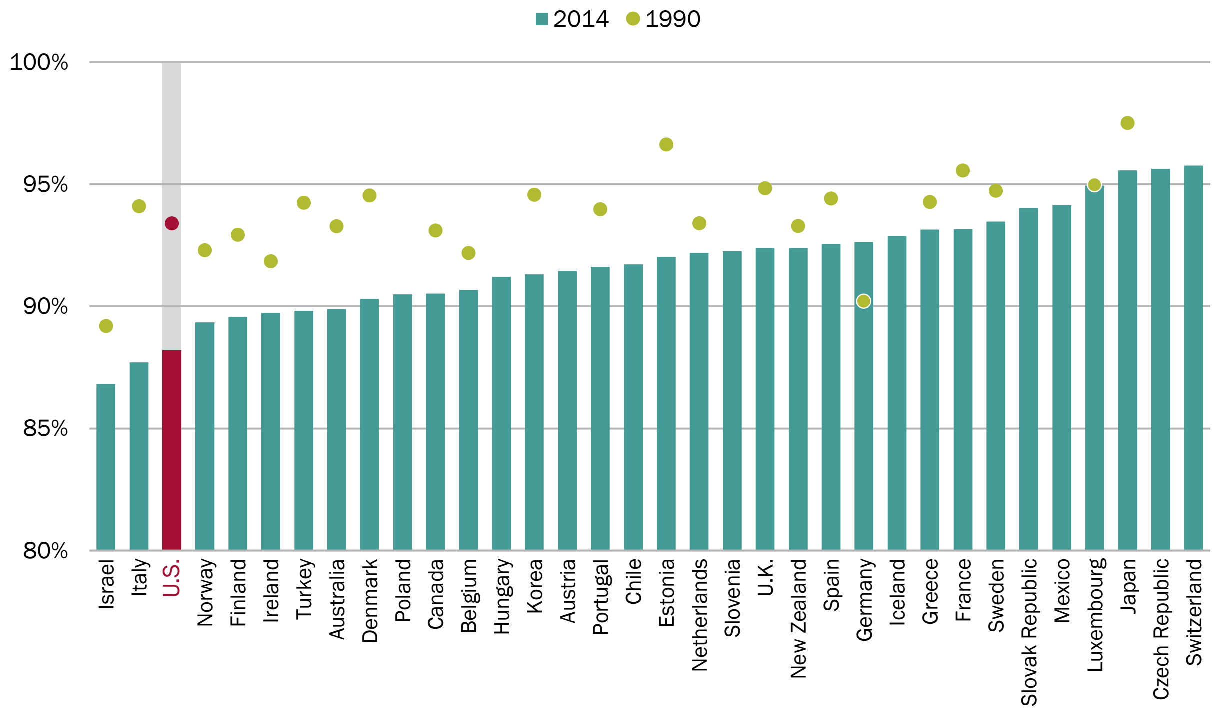
Trends in workforce participation also shed important light on how to interpret the U.S. unemployment rate. The official unemployment rate has improved since the Great Recession and, at 4.9% for the entire population (ages 16 and older) and 5.1% for the working-age population (ages 16-64, seasonally unadjusted figure), is now approaching full employment by historical standards. Many observers have celebrated this falling unemployment rate. Yet the unemployment rate is calculated as a percentage of those in the active workforce and must therefore be seen in the context of lower workforce participation in the U.S. than at any time since the early 1980s. While unemployment seems low, the proportion of Americans in the workforce is also low. Had workforce participation stayed at the level seen in 1997, current levels of employment in America would imply an unemployment rate of 11.1% for the working-age population (ages 16-64).[4] Given the number of potential workers sitting on the sidelines, not in the official workforce but eligible to work, talk of a tightening labor market seems premature, especially for lower-skill and lower-income workers.

FIGURE 6: FALLING U.S. PRIME-AGE MALE LABOR FORCE PARTICIPATION (BY BIRTH COHORT)



Source: Chart from “The Long-Term Decline in Prime-Age Male Labor Force Participation,” White House Council of Economic Advisers, June 2016.

FIGURE 7: LAGGING U.S. PRIME-AGE MALE LABOR FORCE PARTICIPATION VERSUS OTHER OECD COUNTRIES



Source: Chart from "The Long-Term Decline in Prime-Age Male Labor Force Participation," White House Council of Economic Advisers, June 2016. (Note: 1990 data was not available for some countries.)

Stagnant or Declining Real Income

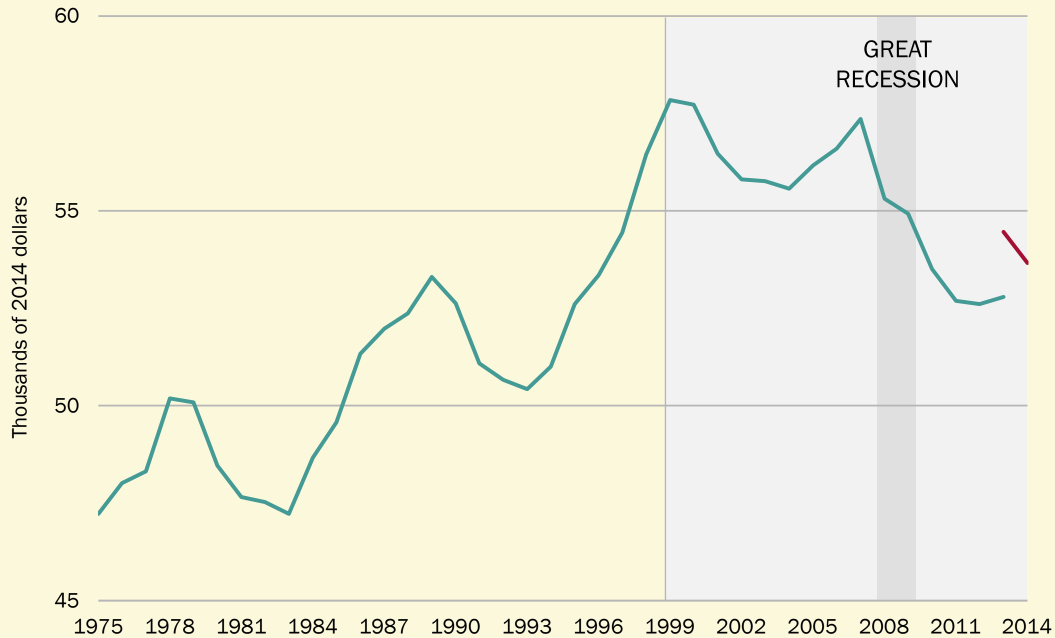
Given the developments described above, it is no surprise that wages and income levels for Americans have been under pressure. The median real household income in the U.S. peaked in 1999, again well before the Great Recession. Since then, it has fallen by about 7% (Figure 8). Note that the methodology for calculating this measure was modified in 2014, resulting in a somewhat higher figure (the red line) that cannot be compared directly with historical data (the blue line). Even after a welcome jump in 2015, real median household income is still well below the peak attained in 1999. The basic trend remains the same: real income levels for Americans have been declining.

Income growth has been under pressure at virtually all income levels (Figure 9). From 2000 to 2014, a household with income at the 80th income percentile saw zero growth in real household income. Typical households in lower-income groups experienced real-income declines, with deeper declines in each successively lower income percentile. Higher-income Americans, those at the 90th and 95th percentile, saw real household compound annual income growth of just 0.2%-0.3%, and even those in the top 1% saw volatile compound annual income growth of just 0.3% between 2000 and 2014.[4]

The decline in real median household incomes since 1999 has been pervasive across most regions of the country (See Figure 10 on page 16), affecting 2,225 out of 3,135 U.S. counties for which data are available. Rising incomes are mostly in knowledge and technology centers such as San Francisco, New York, and Boston, and especially in regions rich in unconventional oil and gas resources such as the Dakotas, Wyoming, West Texas, and Kansas. Tellingly, the area around Washington, DC, the center of government and politics, has also done well.

FIGURE 8: DECLINING U.S. MEDIAN HOUSEHOLD INCOME (ADJUSTED FOR INFLATION)

U.S. real median household income, 1975–2014

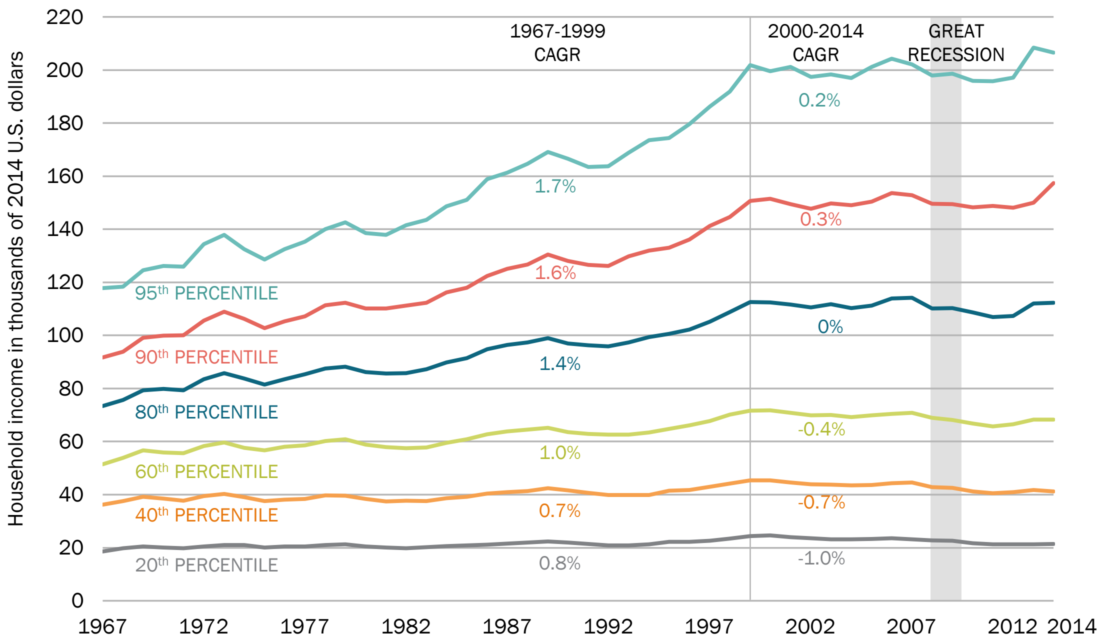


Notes: Shaded area indicates the recession of December 2007 to June 2009 as defined by the National Bureau of Economic Research. Blue line represents estimations from survey methodology in use until 2013. Red line represents methodology established in 2014 and applied to 2013 survey sample for continuity (U.S. Census Bureau's calculations).

Source: U.S. Census Bureau, Current Population Survey, Annual Social and Economic Supplements.

FIGURE 9: STAGNANT INCOME ACROSS THE INCOME DISTRIBUTION SINCE 2000

U.S. real median household income, 1967–2014

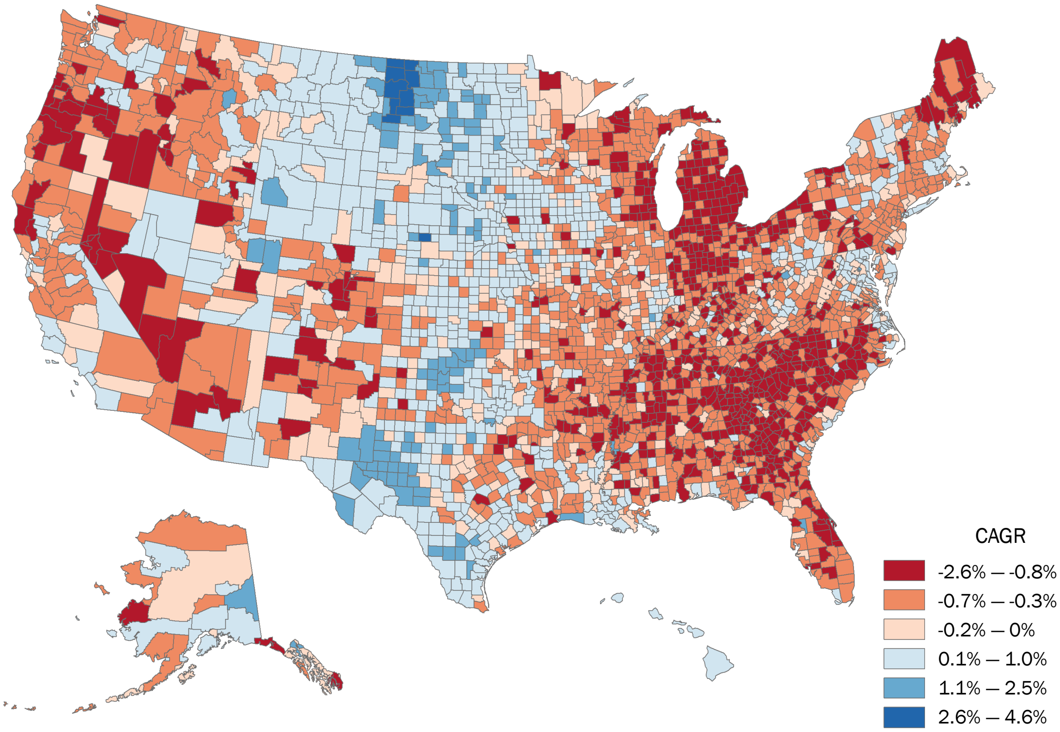


Notes: Household income includes wages, self-employment, retirement, interest, dividends, other investments, unemployment, disability, alimony or child support, and other periodic income. Household income does not include non-cash benefits such as food stamps, health benefits, and subsidized housing. Shaded area indicates the recession of December 2007 to June 2009 as defined by the National Bureau of Economic Research.

Source: U.S. Census Bureau, Current Population Survey, Annual Social and Economic Supplements.

FIGURE 10: WIDESPREAD INCOME DECLINE ACROSS THE U.S.

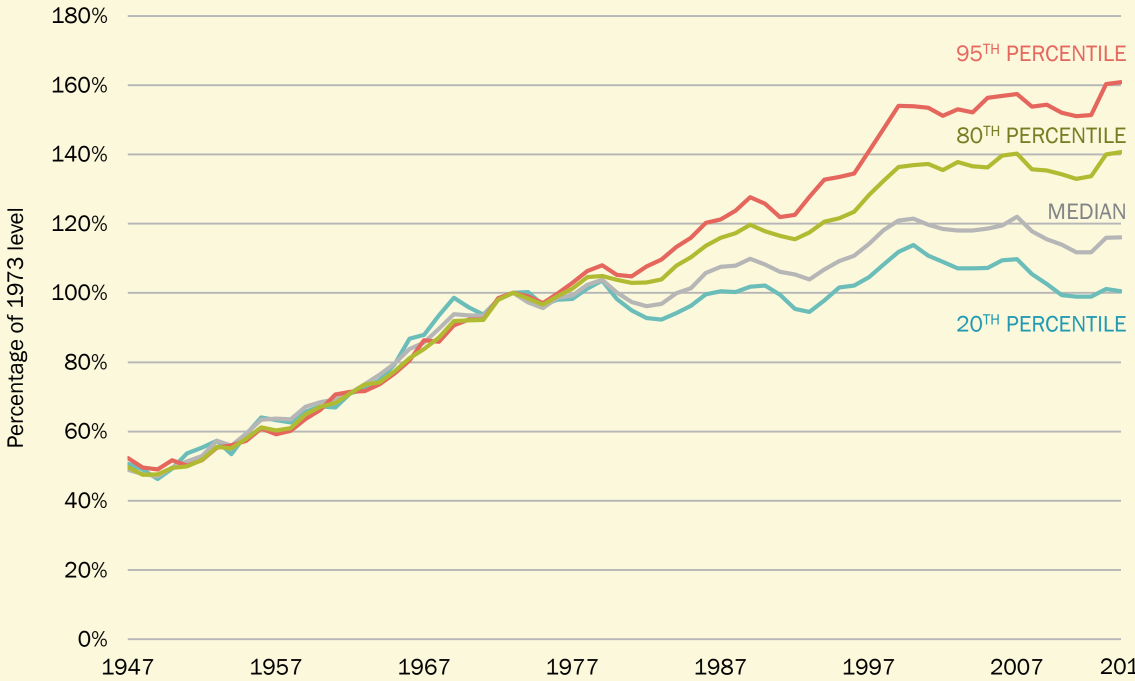
Change in real median household income by county, 1999–2014



Source: U.S. Census Bureau, author's calculations.

FIGURE 11: DIVERGING INCOME TRAJECTORIES

Real family income indexed to 1973, across the distribution 1947–2014



Source: U.S. Census Bureau, author's calculations. Chart adapted from Chad Stone and co-authors, "A Guide to Statistics on Historical Trends in Income Inequality," Center on Budget and Policy Priorities, July 2016.

The End of Shared Prosperity

Stagnating income and job prospects have disproportionately affected lower-income and lower-skilled Americans. Figure 11 gives one picture of the consequence. Real family income at the bottom, middle, and top of the income distribution tracked each other from the end of World War II until 1980 but have since diverged. Datasets on income from the Census Bureau, the Internal Revenue Service, the Congressional Budget Office, and leading academic researchers differ in terms of precisely how they define and tabulate income. But they agree on some basic trends:[6]

- Since about 1980, income inequality has risen sharply, with the largest gains concentrated in the top portion of the top 1% of the income distribution.
- A progressive tax system and government transfers have ameliorated the increase in inequality but have certainly not eliminated it.
- Wealth is even more concentrated at the top than is income.

Struggling Small Businesses

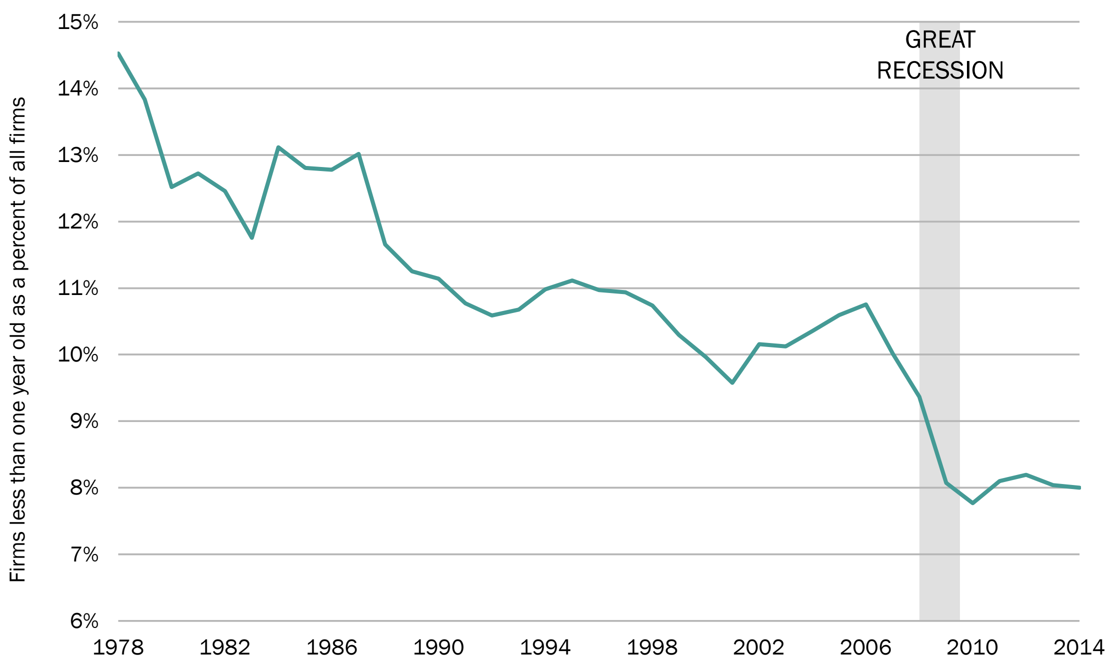
The divergence we see between higher- and lower-income Americans is echoed in a similar divergence between large and small businesses. Corporate profits in America remain near all-time highs, though revenue and profit growth has slowed. But many small businesses are struggling.

One of the defining strengths of the U.S. economy has been entrepreneurship, the most visible manifestation of which is starting a business. However, new business formation in America has declined markedly since the early 1980s (Figure 12). During the same period, the number of firms going out of business began rising. For the first time since figures began to be tallied, the number of firms created in the U.S. was actually lower in 2010 than the number dissolved.[7] Since the onset of the Great Recession, the total number of businesses with fewer than 500 employees has declined by more than 5 percent, unprecedented since data became available in 1977.[8] Even as the economy has expanded in the recovery, then, net new business formation is at low levels.

We also find a sharp divergence in new business creation between the continued success of technology-based start-ups, in places like Silicon Valley, New York, and Boston, and the weaker prospects for the average new business across America, and across local and traded industries. According to the Economic Innovation Group, half of the country's new business establishments between 2010 and 2014 were clustered in just 20 counties.[9]

FIGURE 12: SLOWDOWN IN NEW BUSINESS FORMATION

Start-ups as a portion of all U.S. firms, 1978–2014



Note: Shaded area indicates the recession of December 2007 to June 2009 as defined by the National Bureau of Economic Research.

Source: U.S. Census Bureau Business Dynamics Statistics. Chart adapted from Ian Hathaway and Robert E. Litan, "Declining Business Dynamism in the United States: A Look at States and Metros," Economic Studies at Brookings, May 2014.

Small businesses have traditionally been seen as the job creation engine for America. Since 2000, however, large businesses, with more than 1,000 employees, have grown jobs much faster than businesses with fewer than 100 employees (Figure 13).

This is reflected in the growth of employment since the Great Recession. The workforces of large- and medium-sized firms have bounced back to nearly pre-recession levels. Small businesses in contrast, have registered a tepid come-back. The smallest firms have struggled the most, with businesses with fewer than 10 employees creating jobs at the slowest pace. The number of self-employed workers has also declined since the Great Recession, versus expanding after previous recessions.[10] Other measures confirm the weak state of small businesses, including optimism and the willingness to borrow and invest.

A Failure of Competitiveness

A competitive nation is one in which firms succeed in domestic and global competition while lifting the living standards of the average citizen. In America today, larger companies and the most skilled and higher-income citizens are doing well. But working- and middle-class Americans are struggling, as are many small businesses. Prosperity is growing, but at a slower rate and for a smaller portion of the population, than in the past. America today, then, is failing the test of competitiveness.

What is the prognosis for the U.S. in terms of competitiveness? To gauge the sentiment of business leaders on this question, we surveyed HBS alumni in May and June of 2016 on expected future trends in competitiveness and the consequences for job growth. On competitiveness, reflecting our definition, we asked the following two questions:

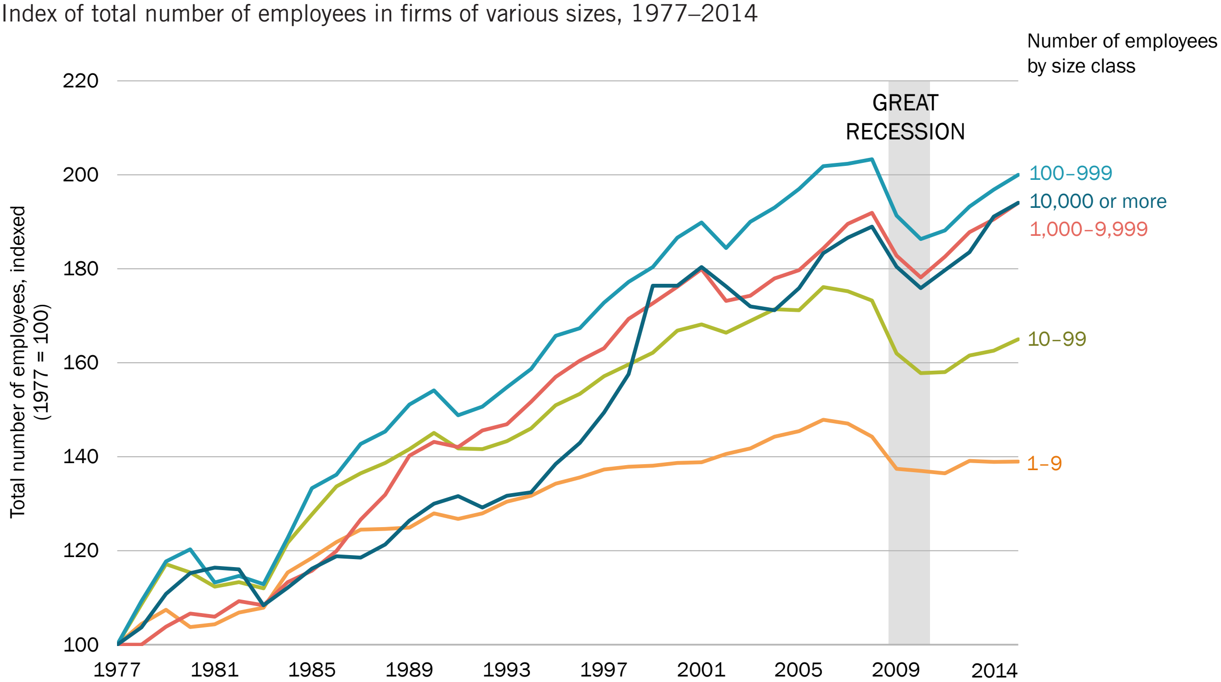
- In three years, will firms in the U.S. be *more or less able to compete* in the global economy?
- In three years, will firms be *more or less able to pay high wages and benefits?*

Figure 14 summarizes the responses: 50% of survey respondents expected U.S. competitiveness to decline, with firms less able to compete, less able to pay well, or both (red boxes). Just 30% of alumni were optimistic, expecting one or both dimensions of competitiveness to improve and neither to decline (green boxes). The remaining 20% expected no change from current conditions (yellow box).

Respondents were especially pessimistic about the prospects of workers: 41% expected firms to be less able

FIGURE 13: SMALLER BUSINESSES STRUGGLE TO CREATE JOBS

Index of total number of employees in firms of various sizes, 1977–2014



Note: Shaded area indicates the recession of December 2007 to June 2009 as defined by the National Bureau of Economic Research.
Source: U.S. Census Bureau Business Dynamics Statistics.

to pay well in the future (top row of Figure 14), while only 25% expected them to be more able to support high wages and benefits (bottom row).

We also asked our alumni business leaders about future employment levels: almost half, or 47%, expected the typical U.S. firm to employ fewer people in three years, while only 16% anticipated more employees. The findings are consistent with an American economy in which growth is slow and competitive pressure, outsourcing, and automation lead U.S. companies to do more with fewer workers.

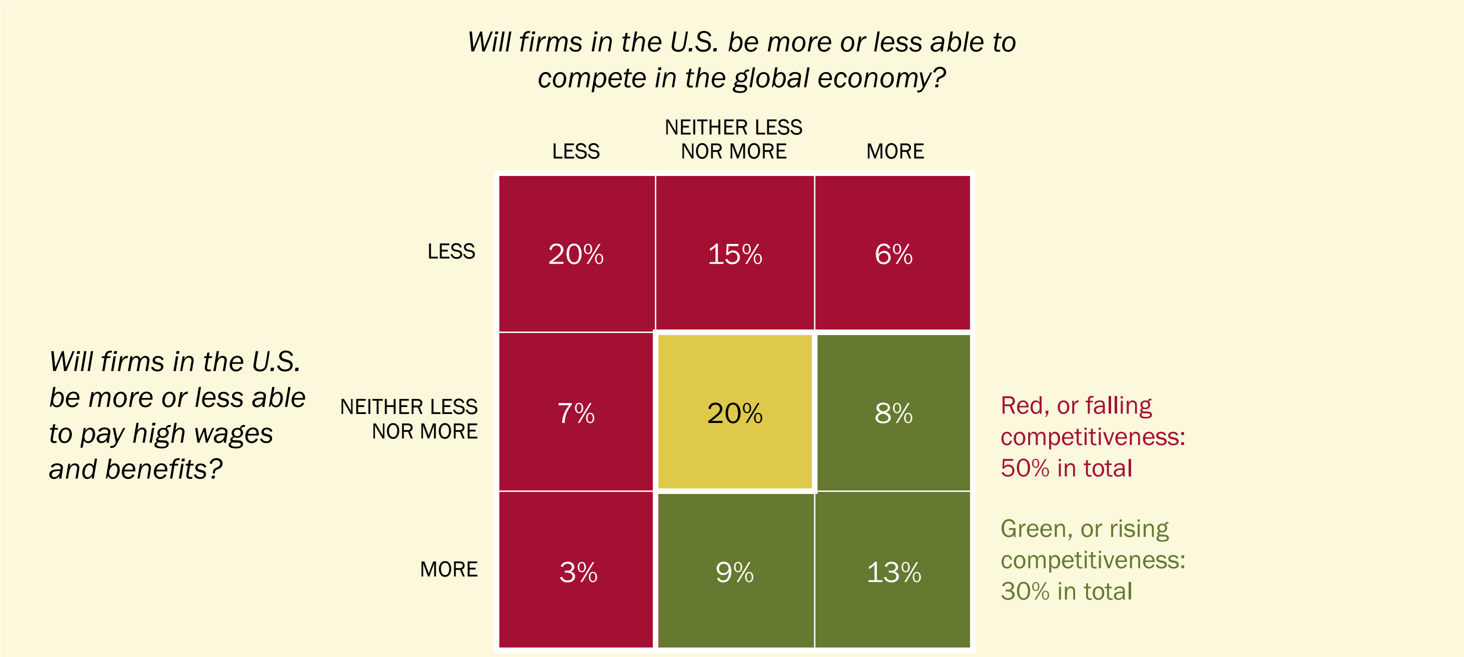
Our 2016 survey represents a disturbing break from the pattern of prior surveys starting in 2011. In previous years, pessimists about the trajectory of U.S. competitiveness outnumbered optimists, but the degree of pessimism declined somewhat each year from 2011 to 2015, reflecting more hopefulness about the American economy. 2016 is the first year in which pessimism deepened, and we will examine the reasons for this rise in subsequent chapters.

Understanding the Causes

Numerous signs point to U.S. economic performance that is weak and has been in decline since around 2000 or even earlier. The most recent data and our surveys provide few grounds for optimism. To understand the root causes of this performance and to craft a strategy to reverse the nation's economic trajectory, we need an objective diagnosis of the changes in the U.S. business environment that have undermined our competitiveness. We turn from the symptoms to the underlying causes in the next chapter.

OUR 2016 SURVEY REPRESENTS A DISTURBING BREAK FROM THE PATTERN OF PRIOR SURVEYS STARTING IN 2011. 2016 IS THE FIRST YEAR IN WHICH PESSIMISM DEEPENED.

FIGURE 14: PROGNOSIS FOR U.S. COMPETITIVENESS BY HBS ALUMNI



Percentages in boxes may not sum to total because of rounding.

CHAPTER 3

AN ERODING U.S. BUSINESS ENVIRONMENT

Slowing growth and rising inequality in the United States, seen also in other advanced economies, have captured the attention of the world's economists. Multiple research efforts are underway to understand the root causes.[11] No consensus explanation has emerged. Many of the most prominent research efforts involve macroeconomists and focus on high-level causes that are largely beyond the influence of business or even government – for instance, a purported decline in the frequency of major inventions or a mismatch between the rate of return on capital and the rate of economic growth.

Our focus is less on such broad forces and more on the microeconomic factors that shape competition, business effectiveness, and wages. This perspective highlights the evolving nature of America's business environment and points toward constructive steps that leaders in business and government can take. We start with a close look at the status of key elements of the nation's business environment. This identifies the underlying strengths and weaknesses of America's economy, and it leads us to an explanation of what has happened in the U.S. economy in recent decades, the dynamics of the eroding U.S. economic performance we saw in Chapter 2.

Assessing America's Business Environment

Essential to understanding what ails the U.S. economy is a frank evaluation of the drivers of U.S. competitiveness. To gain a foundation deeply informed by actual circumstances in domestic and international markets, we surveyed HBS alumni on 19 elements of the environment that prior research has shown to determine national competitiveness.[12] As business leaders on the front lines of global competition, HBS alumni are well positioned to provide this assessment.

The box on page 21 describes the elements we examined, which range from macroeconomic drivers of competitiveness, such as the soundness of fiscal and monetary policy and the nature of the political system, to microeconomic factors, such as the quality of company management and the vibrancy of regional economic clusters. We can compare this year's results to those of similar surveys in previous years.

Figure 1 summarizes the findings in 2016. The horizontal axis of Figure 1 reports the current position of each competitiveness driver: the portion of respondents assessing each element in the U.S. to be better than in other advanced economies, minus the portion assessing it to be worse. The vertical axis captures trajectory: the proportion of respondents judging each element to be improving, minus the portion saying it is deteriorating. Figure 1 provides a single overall picture of America's economic strengths and weaknesses.

The good news in Figure 1 is that the U.S. economy is perceived to have compelling and growing strengths—for instance, strong contexts for entrepreneurship and innovation, world-class research universities, high-quality management, and vibrant capital markets. These strengths are corroborated by a wide array of indicators. However, such strengths are offset by historical advantages that are perceived to be declining, including America's workforce skills, labor-market flexibility, and macroeconomic policy, as well as weaknesses that are worsening, such as America's tax code, K–12 education system, logistics infrastructure, healthcare system, and political system.

Three major patterns emerge from these findings.

Important strengths. The American economy retains formidable strengths. These strengths are present in areas that are challenging and time-consuming to create: building a skilled cadre of management in a nation, improving the entrepreneurial context, or creating efficient capital markets can take generations. Moreover, the strengths appear in areas that are crucial to future prosperity. America has the research universities and innovation infrastructure to pioneer tomorrow's technologies and the entrepreneurial context and capital markets to bring those technologies to the market. These strengths are why we are deeply optimistic about the potential of the U.S. economy, if only we can "get out of our own way" in other areas.

Weaknesses in federal policy. Looking at the bottom left quadrant of Figure 1, which contains America's greatest and eroding weaknesses, we see areas determined or heavily influenced by the federal government: the tax code, the political system, healthcare, regulation, and logistics infrastructure. It is for this reason that we devote Chapters 5, 6, and 7 of this report to federal matters. The silver lining behind these dark clouds is that some of the weaknesses involve *choices* that, at least in principle, can be changed relatively quickly. For example, America

ELEMENTS OF THE NATIONAL BUSINESS ENVIRONMENT

MACRO ELEMENTS

Macroeconomic policy: soundness of government budgetary, interest rate, and monetary policies

Effectiveness of the political system: ability of the government to pass effective laws

Protection of physical and intellectual property rights and lack of corruption

Efficiency of legal framework: modest legal costs; swift adjudication

Complexity of the national tax code

Corporate tax code: tax code that attracts and retains investment

Education system through high school: universal access to high-quality education; curricula that prepare students for productive work

MICRO ELEMENTS

Logistics infrastructure: high-quality highways, railroads, ports, and air transport

Communications infrastructure: high-quality and widely available telephony, Internet, and data access

High-quality universities with strong linkages to the private sector

Context for entrepreneurship: availability of capital for high-quality ideas; ease of setting up new businesses; lack of stigma for failure

Availability of skilled labor

Flexibility in hiring and firing of workers

Innovation infrastructure: high-quality scientific research institutions; availability of scientists and engineers

Regulation: effective and predictable regulations without unnecessary burden on firms

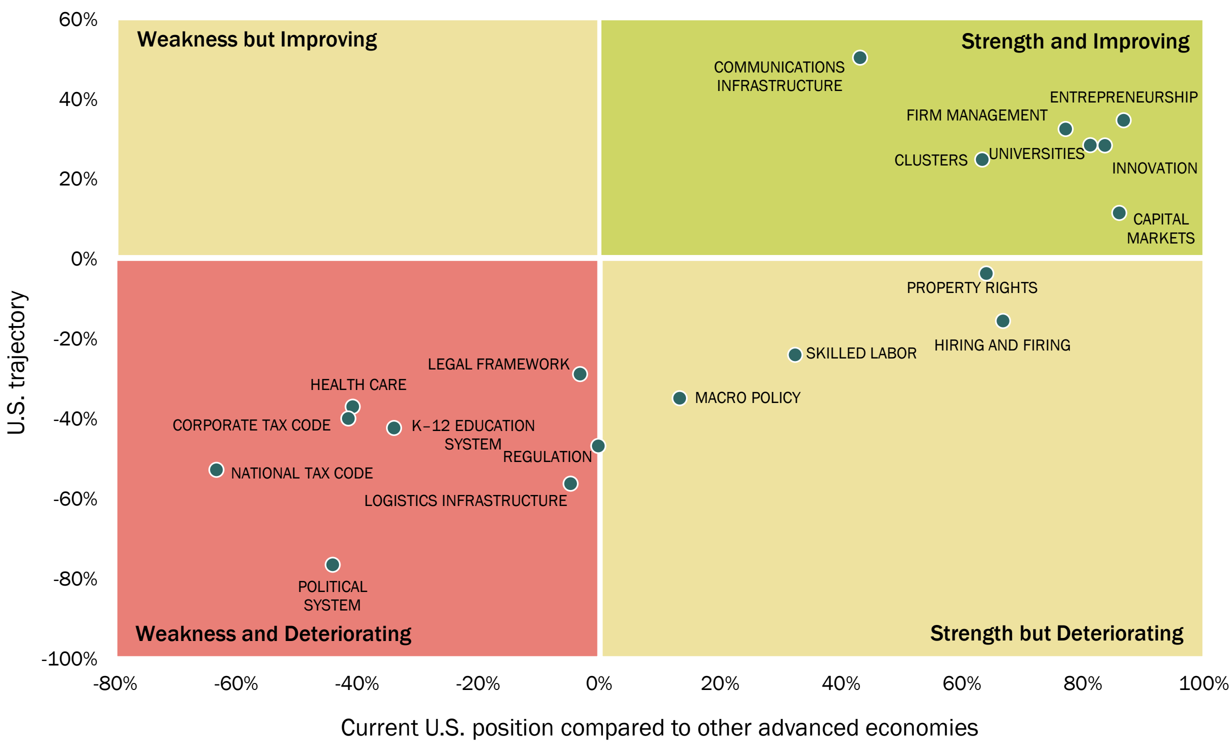
Strength of clusters: regional concentrations of related firms, suppliers, service providers, and supporting institutions with effective collaboration

Quality of capital markets: ease of firm access to appropriate capital; capital allocated to most profitable investments

Sophistication of firm management and operations: use of sophisticated strategies, operating practices, management structures, and analytical techniques

Quality of health care relative to cost

FIGURE 1: ASSESSMENTS OF ELEMENTS OF THE U.S. BUSINESS ENVIRONMENT IN 2016 (ALUMNI)



Note: Half of respondents were asked to assess the national tax code and the other half were asked to assess the corporate tax code.

can reform its tax code faster than other countries can develop a rich context for entrepreneurship.

Roots of the lack of shared prosperity. The pattern of strengths and weaknesses in Figure 1 sheds important light on the diverging economic trajectories we described in Chapter 2. Why are large companies and their owners and managers thriving even as working- and middle-class workers and small businesses struggle? For their success, many large companies rely on access to innovation, capital, and high-quality management – all among America's greatest strengths. At the same time, large companies can better cope with and often avoid America's weaknesses. A tax inversion allows them to escape the convoluted U.S. corporate tax code, for example; offshore investments allow access to the world's most skilled workforces and best transportation infrastructure; and large companies have the scale to navigate complex regulations.

Workers, in contrast, rely heavily on the human capital they bring to the workplace – human capital they draw from weak systems of K–12 education and workforce training. Lacking global mobility, workers and small businesses cannot escape the negative impacts of America's political system, tax code, healthcare system, costly regulation, and crumbling infrastructure. In short, *large companies benefit from America's greatest strengths, while workers and small businesses are captives of the nation's major weaknesses.*

This interpretation is so central to understanding the erosion of shared prosperity within the American economy that we sought to corroborate it in two ways: (1) determining how Figure 1 changes when seen from the perspective of small business, and (2) looking at the figure from the perspective of the average American.

Challenges for small business. Alumni working in smaller firms reported starkly more negative views of the U.S. business environment that did their counterparts in larger companies. In Figure 2, we show how respondents in each firm-size class assessed the current position of

FIGURE 2: RELATIVE ASSESSMENTS OF ELEMENTS OF THE U.S. BUSINESS ENVIRONMENT, BY RESPONDENT'S FIRM SIZE (ALUMNI)

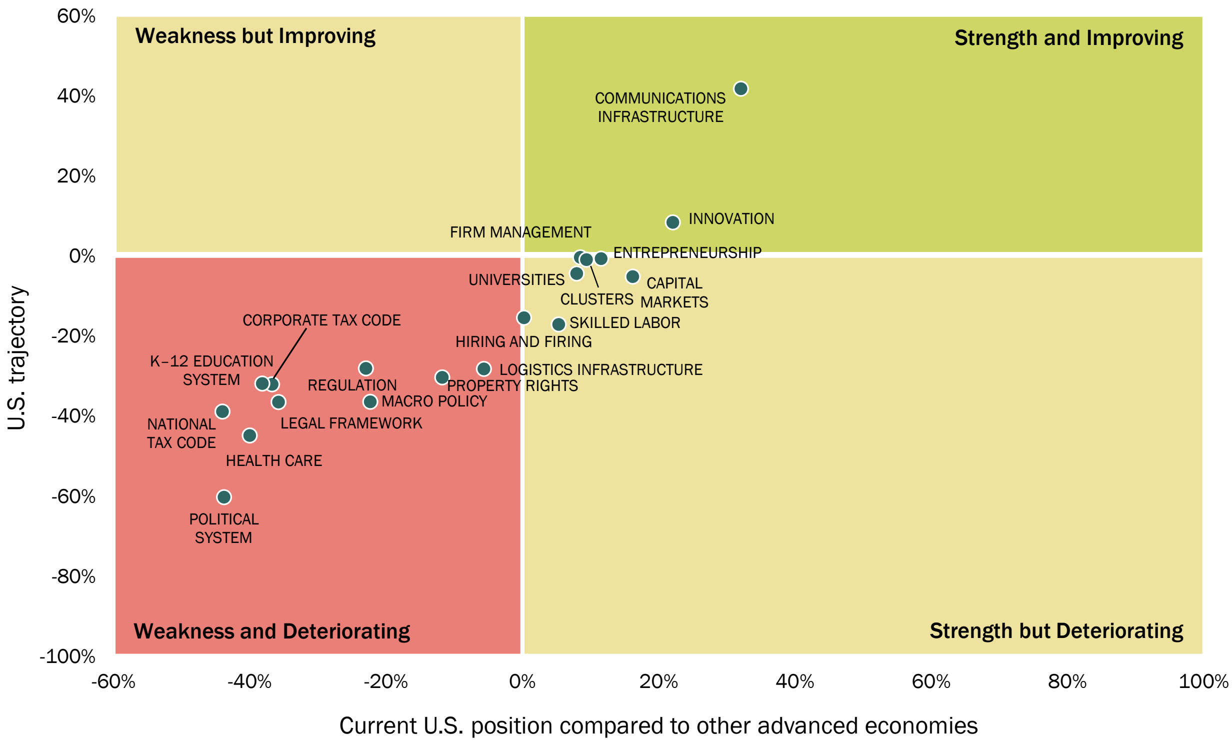
	Firm size (number of employees)				
	1–9	10–99	100–999	1,000–9,999	10,000+
Communications infrastructure	- -	-	++	+	-
Capital markets	- -	+	+	-	++
Property rights	- -	-	-	+	++
National tax code	- -	- -	++	+	+
Corporate tax code	- -	+	-	-	++
Macroeconomic policy	- - -	-	+	+	+++
Regulation	- - -	+	+	+	++
Health care	- -	-	+	-	+ +
Logistics infrastructure	- - -	-	+++	-	+
Universities	-	-	-	+	+
Innovation infrastructure	-	+	-	-	+
Political system	- - -	+	++	+	+
Skilled labor	- -	+	- -	+	++
Hiring and firing	-	+	- -	+	+
Firm management	-	+	+	-	++
Entrepreneurship	- -	+	-	+	+
Clusters	-	+	-	-	++
K–12 education	- - -	-	++	+	+
Legal framework	- -	+	++	- -	++

Compared to the average respondent as shown in Figure 4, respondents in this firm-size class placed this element:

- - -	- -	-	+	++	+++
10 or more points to the left	5 to 10 points to the left	0 to 5 points to the left	0 to 5 points to the right	5 to 10 points to the right	10 or more points to the right

Note: Data are for respondents who indicated that they work, compared to all respondents.

FIGURE 3: ASSESSMENTS OF ELEMENTS OF THE U.S. BUSINESS ENVIRONMENT, 2016 (PUBLIC)



Note: Half of respondents were asked to assess the national tax code and the other half were asked to assess the corporate tax code.

each element of the business environment, compared to all survey respondents. A dark red box signifies that the respondents in a particular firm-size class saw an aspect of the business environment as much weaker (by 10 or more points) than did the average respondents in Figure 1. At the other extreme, dark green boxes indicate that respondents in a firm-size class were much more positive or far less negative on an element.

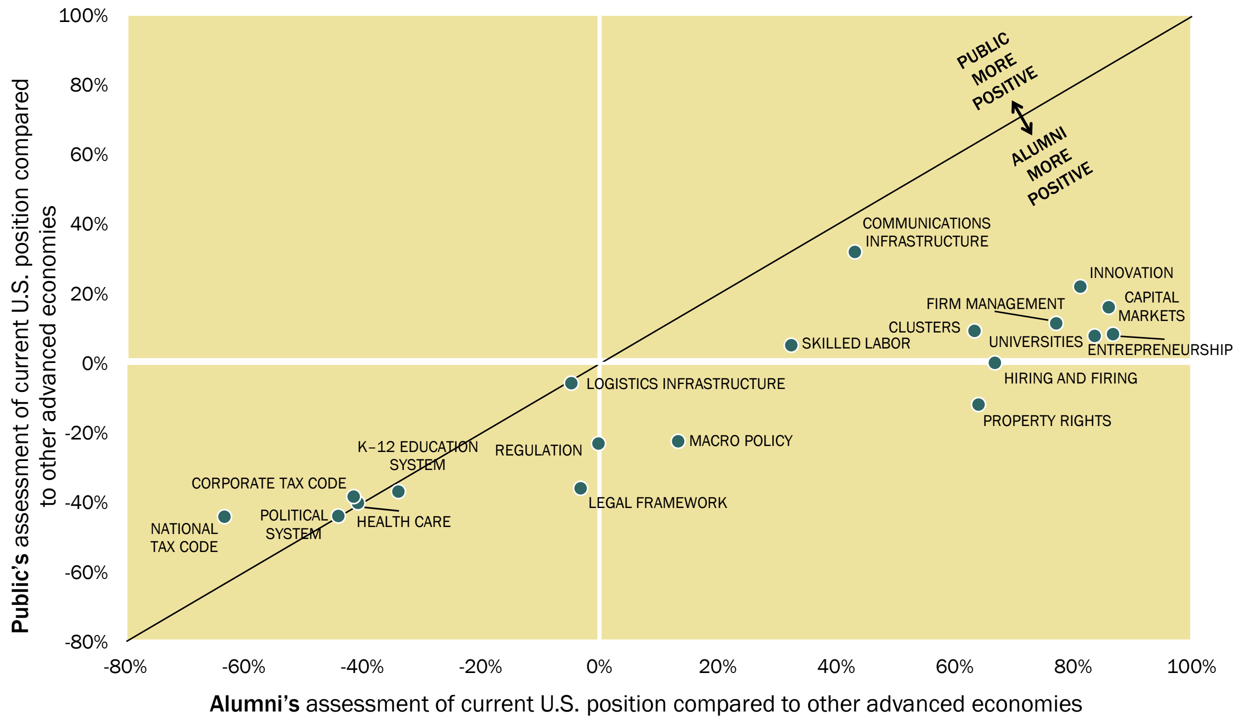
The differences are striking: Respondents in the smallest firms, with 1-9 employees, were more negative on every element of the U.S. business environment. Respondents in the largest companies, with 10,000 or more employees, were more positive on 18 of the 19 elements. The differences shed light on the dimming prospects of small business reported in Chapter 2. Across the board, the U.S. business environment looks worse from the vantage point of small business.

Perspective of the average American. To see the U.S. business environment from the perspective of working- and middle-class Americans, we drew on a survey of the general public. (Our best, rough estimate is that the typical alum has annual income that places him or her in the top 2% of U.S. households.) Figure 3 shows the equivalent of Figure 1 but for members of the general public. The contrast between the two figures is stark: members of the public agreed with business leaders on America's weaknesses, but they perceived the U.S. business environment as having very few strengths. Figure 4 on page 24 makes the contrast vivid by plotting business leaders' current assessments of each element against the public's assessments.

The lack of shared prosperity in America, then, is echoed by a lack of shared reality. Business leaders have regular access to, and benefit from, America's capital markets, research universities, entrepreneurial context, innovation infrastructure, and high-quality management, for instance. As they prosper, partly on the basis of those elements, business leaders see them as unique U.S. strengths. The average worker, in contrast, rarely benefits from those elements and is struggling economically. Without shared prosperity, it is hard for many Americans to recognize the country's core economic strengths.

We asked different groups for their overall views of the strength of the U.S. business environment relative to

FIGURE 4: ASSESSMENTS OF ELEMENTS OF THE U.S. BUSINESS ENVIRONMENT, 2016 (ALUMNI VERSUS PUBLIC)



Note: Half of respondents were asked to assess the national tax code and the other half were asked to assess the corporate tax code.

other advanced and emerging economies (Figures 5a and 5b). Members of the general public were markedly more likely to evaluate the U.S. business environment as worse, reflecting their economic struggles, while MBA students were strikingly positive on America. Members of the general public were also far less likely than HBS alums or MBAs to see American companies as highly successful (Figure 5c). Since the economy is not delivering prosperity for them, average Americans see it as less competitive.

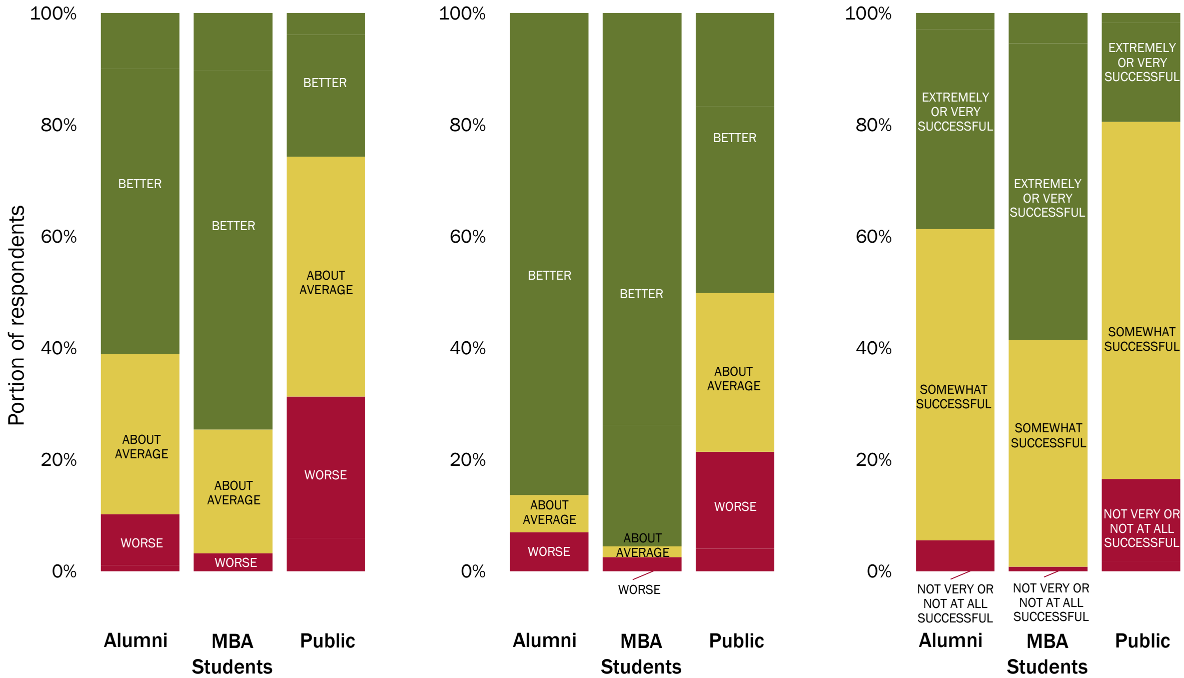
However, business leaders, MBA students, and members of the public share concerns about the future ability of U.S. firms to pay high wages and benefits and employ more people (Figure 6 on page 26). On average, all three groups saw American companies as holding their own: the portion of respondents expecting firms to be more able to compete was roughly equal to the portion expecting erosion. In contrast, there was a disturbing consensus when it came to the future of workers. In all three groups, those expecting lower pay and declining employment opportunities outweigh those expecting better outcomes for workers. No one sees shared prosperity around the corner.

Not Keeping Pace with the World's Best

The assessments of America's business environment in Figures 1 and 3 are based on impressions, but they are, by and large, well supported by the best available hard data on each element. The data shed additional light on what is really going on beneath the hood of America's economic engine: to a large extent, the problem is not that the engine is falling apart. Rather, what is clear is that we have not invested enough, or wisely enough, to keep upgrading the engine as the pace of global competition has quickened. Other countries have progressed faster.

The evidence on workforce skills and K–12 education is typical of what we see for many of America's weaknesses and declining strengths. Workforce skills and K–12 education are crucial to the economic prospects of working- and middle-class Americans, and nothing is more important to wages and job security than valuable and scarce skills. The best evidence is that American human capital has improved over time, but not at the pace set by global competition.

FIGURE 5: ASSESSMENTS OF THE OVERALL U.S. BUSINESS ENVIRONMENT AND THE SUCCESS OF U.S. FIRMS TODAY (ALUMNI, MBA, AND PUBLIC)



a. Current position of U.S. business environment vs. other **advanced** economies

b. Current position of U.S. business environment vs. **emerging** economies

c. How successful firms in the U.S. are in competing vs. firms in other **advanced** economies today

In 2013, for example, the OECD tested the skills of workers around the world and reported the results by country and age cohort. Figure 7 on page 26 shows the results for literacy skills. Younger cohorts of U.S. workers have higher literacy scores than older cohorts in absolute terms, reflecting U.S. skills improvement over time (the rising blue bars). But workers elsewhere have improved even faster (the rising red bars). American workers from earlier generations are more literate than their international peers of the same age, but younger U.S. workers are less literate than their peers. An historical U.S. skills advantage has become a disadvantage. Similarly, in educational attainment, Americans of age 55-64 are more likely to have completed high school than their age peers in 33 of 34 OECD countries. But among 25-34 year olds, Americans are tied for ninth place, with four other countries.[13] The proportion of Americans of age 55-64 with a tertiary education is the third highest among OECD countries, but among 25-34 year-olds, Americans rank eleventh out of 34.[14] The bar on education is rising, and American higher education levels are no longer greater than many other nations'.

At the same time, changes in the economy have raised the education levels required to thrive economically in America. Figure 8 on page 27 shows the real annual growth rate in hourly wages for Americans with different levels of education for two periods, 1979-2000 and 2000-2012. In the earlier period, individuals with some college saw their wages roughly keep pace with inflation, while college graduates enjoyed rising real wages. In the latter period, in contrast, college graduates saw wages barely keeping pace with inflation, and only holders of graduate degrees enjoyed real pay increases.

Finally, transportation infrastructure provides another important illustration of growing weakness due to the failure to keep up. America's public investment in transportation infrastructure is down from 2.2% of GDP during the 1960s to about 1.6% today, less than in Europe and far less than in emerging economy China.[15] Anyone who flies from modern Pudong International Airport in Shanghai to aging John F. Kennedy Airport in New York experiences the difference. The greatest impact of lower investments in infrastructure is on everyday Americans, who rely on public transport, have limited transportation options, and suffer from long commutes and resulting high costs of living. For less affluent citizens, as our colleague Rosabeth Moss Kanter puts it, "mobility is opportunity."[16] Right now, the nation is not providing enough of such opportunity for the average citizen.

FIGURE 6: ASSESSMENTS OF FIRM AND WORKER OUTCOMES IN THREE YEARS (ALUMNI, MBA, AND PUBLIC)

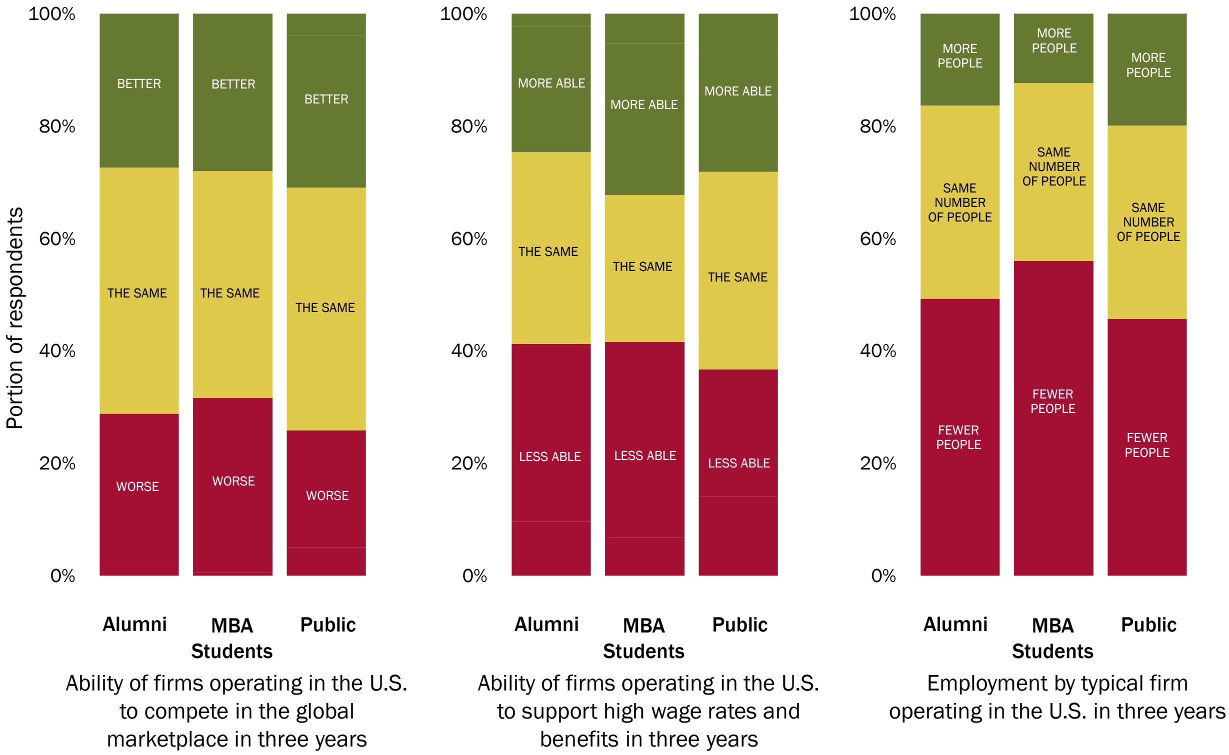
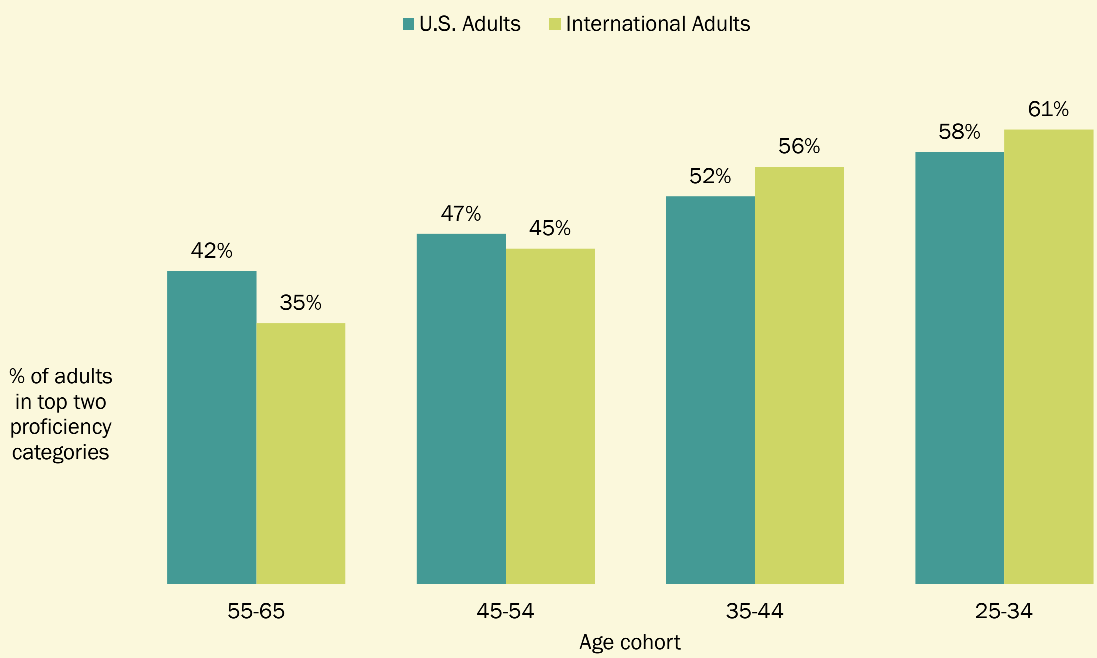


FIGURE 7: ADULT COMPETENCIES IN LITERACY – U.S. VERSUS INTERNATIONAL PEERS, BY AGE COHORT



Source: Goodman, M., Finnegan, R., Mohadjer, L., Krenzke, T., and Hogan, J. (2013). Literacy, Numeracy, and Problem Solving in Technology-Rich Environments Among U.S. Adults. Results from the U.S. Department of Education, National Center for Education Statistics, Organization for Economic Cooperation and Development (OECD), Program for the International Assessment of Adult Competencies (PIAAC), 2012 and 2014.

The overarching pattern we see, then, is inadequate investment and policy improvement in the elements of the business environment on which working- and middle-class Americans depend the most.

Evolution of America's Business Environment

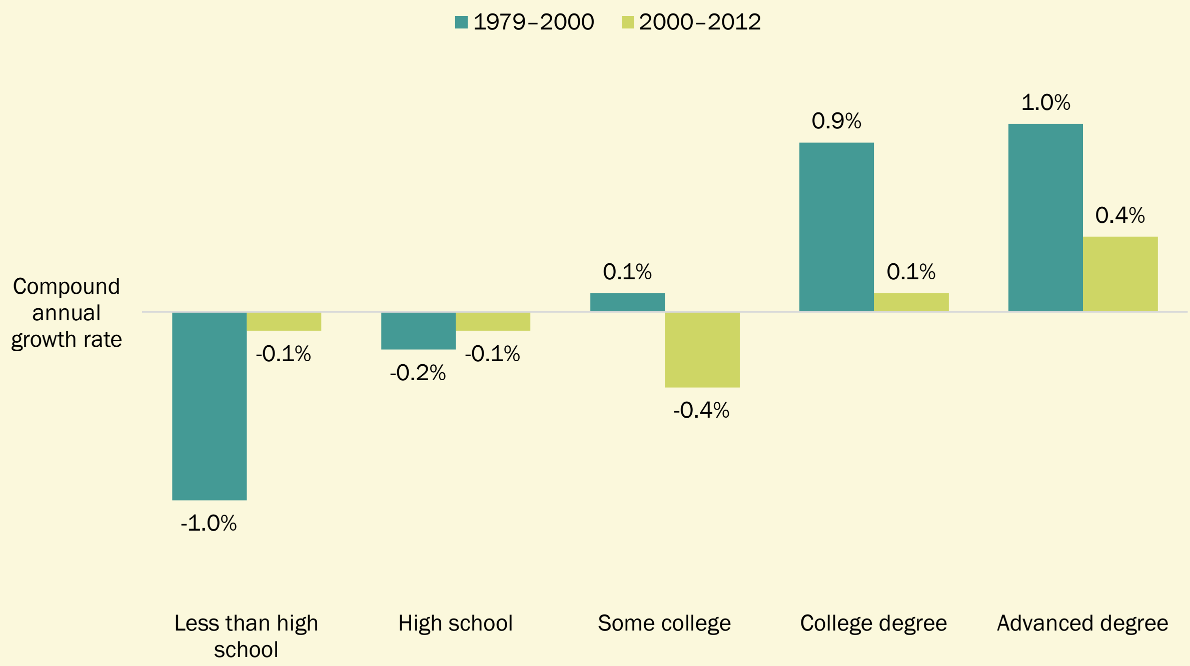
Why has the nation's business environment evolved in this way? Only by understanding the dynamics can we begin to change them. Here, we provide a basic narrative that captures the essence of what has happened (and what must change).

Our narrative begins with a concept: "the commons."[17] The commons is a set of communal assets and institutions that every economy and every company rely on to be productive, and therefore competitive. Every company needs an educated workforce, pools of skilled labor in areas important to its business, vibrant networks of suppliers, efficient physical infrastructure, a core of basic research expertise that can be commercialized, and so on.

Historically, America pioneered new ways to strengthen the commons: universal public education, land-grant universities, the interstate highway system, federal and philanthropic funding of university research, and many others. Government and business collaborated in this work, especially in the period after World War II. At the same time, policy choices kept the cost of doing business low; for instance, regulation was pragmatic and labor markets flexible. America's business environment was the envy of the world, and Americans across the economic spectrum thrived.

Over the last several decades, however, the rate of investment in those parts of the commons on which the average American depends slowed down markedly.[18] Starting around 1980, shifts in technology, geopolitics, and governance made it possible to do business from anywhere to anywhere, and large firms became globally mobile. With new forms of automation, companies could do more with fewer, more-skilled workers. The ensuing globalization and technological progress greatly benefited American firms and consumers. But longer term, they had three other consequences.

FIGURE 8: REAL HOURLY WAGE GROWTH BY EDUCATIONAL ATTAINMENT, 1979-2000 VERSUS 2000-2012



Source: Economic Policy Institute, "A Decade of Flat Wages," August 2013. Based on Current Population Survey.

- First, the connections between companies and their communities weakened and, with this, business support for the commons. Less dependent on the local workforce and with growing foreign operations, for instance, companies felt less compelled to invest in nearby schools and skills.
- Second, workers in the middle of the skills spectrum found themselves competing for jobs against workers around the world as well as fast-improving technology. Unless their skills increased, U.S. workers lost bargaining power. Private-sector unions went into secular decline as the ranks of middle-skilled union members thinned.
- Third, individuals with unique skills—including engineers, entrepreneurs, chief executives, and sophisticated investors—had growing opportunities on a global scale. Inequality soared.

At the same time, America's historical economic lead obscured increases in costs of doing business, in areas like health care, compliance with regulation, and compliance with a complex tax code. Meanwhile, other countries, especially emerging economies, improved their business environments to the point where the U.S. lead narrowed or disappeared.

THE SYSTEMATIC UNDERINVESTMENT IN KEY ELEMENTS OF THE COMMONS, ALONG WITH AN INABILITY TO MOUNT REAL SOLUTIONS, HAS UNDERMINED BOTH OVERALL PRODUCTIVITY AND SHARED PROSPERITY.

As the middle class began to stagnate, the U.S. collectively made a series of bad choices. Rather than redouble our investment in the commons and equip our middle class to compete, we made unsustainable promises to maintain the illusion of shared prosperity: extending credit that many could not repay, expanding entitlements, increasing public-sector employment and benefits, and cutting taxes across the board.

Such promises left the federal government and many state governments overextended. Public spending shifted from investing for the future toward paying for the past, with infrastructure, basic research, and education suffering as a result (Figure 9).

Limited public resources, rising inequality, and structural changes in politics, including an influx of private money, contributed to increasing political polarization and paralysis. This blocked progress on seemingly "no-brainer" policy changes that would improve the U.S. business environment—tax reform, immigration reform, and infrastructure investment, for example. In a vicious cycle, party politics and a lack of shared prosperity pushed voters to political extremes. The end result has been a sustained pattern of inadequate investment and improvement in key elements of the U.S. business environment.

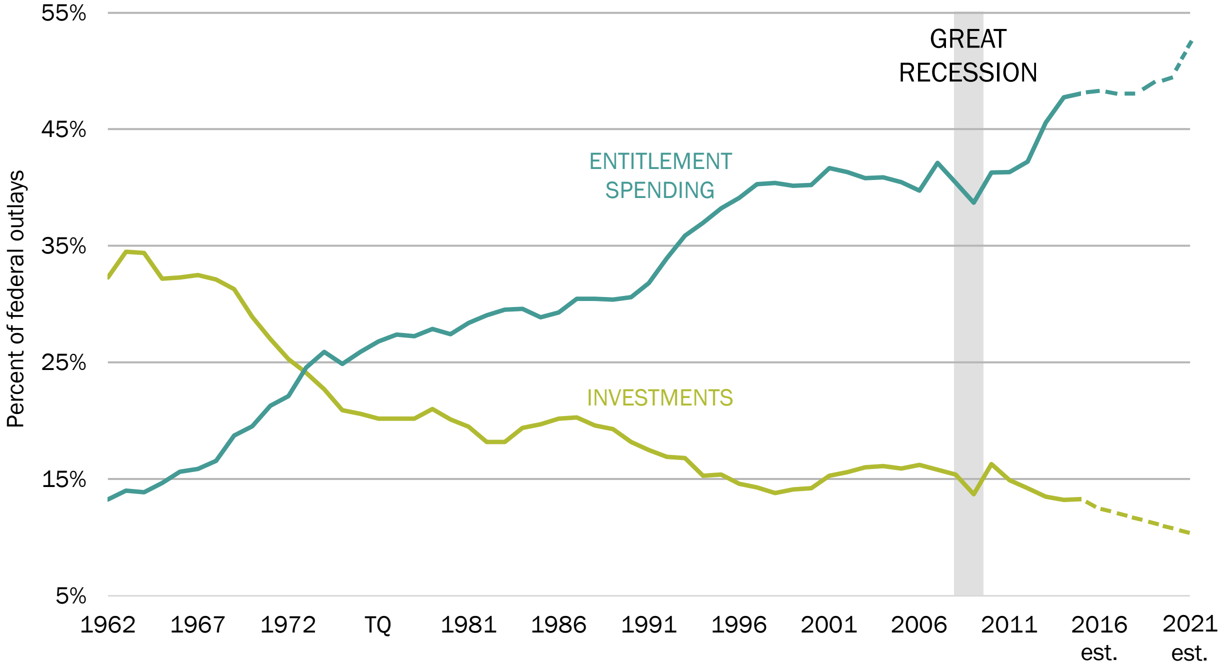
This evolution highlights three quite different underlying causes of America's economic woes, with three very different responses. First, globalization and technological change have put pressure on the U.S. economy and especially on working- and middle-class Americans. It is hard to imagine an effective way to hold back the tide of global competition and technological change. The only response is to rise to it. Unfortunately, America has failed to rise as many other countries have.

Second, institutional changes such as the decline of labor unions and shifts in the tax code, accompanied by market changes, have favored capital owners and managers rather than workers. Concerted efforts – for instance, to modify the tax code – might mitigate such changes, but such efforts would produce winners and losers and would be polarizing and politically challenging.

Third, the systematic underinvestment in key elements of the commons, along with an inability to mount real solutions, has undermined both overall productivity and shared prosperity. We see this result as an unnecessary self-inflicted wound and one that can be healed.

America's challenge, then, is to restore policies that support rising productivity and rebuild the commons—for instance, by restoring world-class opportunities for education and skills development in America that are aligned with the needs of the workplace; by surrounding workers with advanced infrastructure that provides mobility and opportunity; and by strengthening other elements of the business environment on which companies and especially workers depend. Meeting this challenge will depend on broad-based support from many parts of the American community, and it will require strategy.

FIGURE 9: SHIFTING COMPOSITION OF FEDERAL SPENDING



Note: Entitlement spending includes outlays for Social Security, Medicare, Medicaid, CHIP, and Affordable Care Act Subsidies. Investments includes outlays for infrastructure, R&D (both defense and non-defense), and education. 2016-2021 figures are Office of Management and Budget estimates. TQ refers to the Transition Quarter from July 1, 1976 to September 30, 1976, after which the federal government changed its fiscal year. Dotted line is a forecast based on previous Office of Management and Budget estimates. Shaded area indicates the recession of December 2007 to June 2009 as defined by the National Bureau of Economic Research.

Source: Office of Management and Budget; author's calculations.

CHAPTER 4

THE PRESSING NEED FOR A NATIONAL ECONOMIC STRATEGY

The Need for an Economic Strategy

Given our economic performance and the array of competitive weaknesses that have emerged, America needs an economic strategy. The current economic problems are structural, not just cyclical, and will not solve themselves.

The need for an economic strategy for the U.S. is an unfamiliar challenge. America enjoyed a huge lead in competitiveness after World War II, and its compelling economic strengths endured over decades as other countries played catchup. From the 1950s until the late 1990s, except for brief periods, economic performance was strong. The one major exception was the emergence of Japan as a powerful economic competitor in the 1980s, but America came back strongly after a period of restructuring and quality improvement.

AN EFFECTIVE STRATEGY BEGINS WITH THE RIGHT GOAL. AMERICA MUST RESTORE OVERALL ECONOMIC GROWTH AND GENERATE PRODUCTIVITY GAINS. HOWEVER, TRUE SUCCESS WILL REQUIRE GOING ONE STEP FURTHER AND ENSURING SHARED PROSPERITY, IN WHICH ALL CITIZENS BENEFIT FROM THE NATION'S GAINS.

In many ways, Americans do not know how to talk about competitiveness or economic strategy—success has been assumed. Thinking strategically about the economy has been the exception, not the rule. Economic policy tends to be addressed issue by issue as problems arise. Historically, the U.S. has been a leader in tackling big agendas such as ensuring universal public education, establishing land-grant universities to broaden access to higher education, building an interstate highway system across the length and breadth of America, and investing in world-class science and technology. But today, the number of challenges are growing while the capacity of the U.S. to make real progress has diminished.

What do we mean by an economic strategy? A strategy is an integrated set of priorities to advance overall competitiveness and economic growth in order to improve prosperity that is widely shared among citizens. A strategy builds on current strengths, while recognizing and tackling the most important weaknesses. A strategy is based on facts, not wishful thinking. It defines priorities and the sequence of steps needed to achieve them, rather than attempting to do everything at once. Finally, a strategy provides a common understanding of what is needed to create a better future and becomes a focal point for alignment and compromises across stakeholders. Having a strategy is one of the key ways Americans should judge their leaders in government and business.

Shared Prosperity

An effective strategy begins with the right goal. America must restore overall economic growth and generate productivity gains. However, true success will require going one step further and ensuring **shared prosperity,** in which all citizens benefit from the nation's gains.[19] Any comprehensive strategy to make the U.S. more competitive must address the divergence of economic outcomes among Americans that we documented in Chapter 2.

The lack of shared prosperity in America has become a major economic, social, and political challenge. More importantly, it endangers our nation's unity and security, and it compromises a longstanding bedrock promise of America.

Much of the rhetoric in the current presidential campaign focuses on *reducing inequality*, but we suggest that c*reating shared prosperity* is a more appropriate goal. Creating shared prosperity and reducing inequality are related but importantly different. Shared prosperity arises when the prospects of all Americans improve in absolute terms. Inequality, in contrast, is inherently a relative term, comparing the incomes of well-off and hard-pressed Americans. One can reduce inequality without creating shared prosperity – for instance, by taking money from the richest citizens and burning it or, more realistically, by making all Americans worse off and the richest Americans especially worse off. We doubt that many Americans would embrace that outcome. Alternatively, one can generate shared prosperity without reducing inequality—for instance, by making all citizens equally better off. Our sense is that most Americans would welcome an economy in which all Americans—poor, working-class, middle-class, and upper-class—have the opportunity to prosper. Historically, this has been key to the American Dream.

Shared prosperity is also a crucial agenda for business. More and more business leaders are understanding that they have a profound stake in the prosperity of the average American. Thriving citizens become more productive employees, better consumers, and stronger supporters of pro-business policies. Struggling citizens are disgruntled at work, frugal at the cash register, and anti-business at the ballot box.[20] Our 2015 survey revealed that most business leaders now see America's lack of shared prosperity as not only a societal issue but also a business problem.[21]

The Strategic Agenda for Business

A strategy to restore shared prosperity requires action by business, state & local government, and the federal government. In the rest of this chapter, we describe agendas first for business leaders and then for state & local government officials. The next chapter tackles the steep challenge of federal policy.

As corporations and competition became more global, many companies pulled back on investments in their U.S. communities. Many executives are now coming to understand that this lack of investment had unforeseen negative consequences, for communities and for companies themselves, and they are taking steps to reengage. Companies can contribute locally in ways that governments alone cannot, especially because they understand what the economy needs and can act independently of politics. In previous publications, we have put forward a three-pronged agenda for business.[22]

First, business leaders should vigorously pursue productivity and profitability in their own businesses. The largest contribution that most business leaders can make to U.S. prosperity is to run their companies well. Productive companies lead to a productive economy. Many companies have rediscovered opportunities to move work back to the U.S. and improve profitability. This happens, for example, when companies can avoid the hidden costs of offshore operations (such as intellectual property risk), reduce transportation costs, and respond faster to shifting market trends.

To address shared prosperity while improving productivity, leading companies are focusing new attention on prospects for their lower-income workers. For example, companies like Gap, Ikea, JP Morgan Chase, McDonalds, Starbucks, TJ Maxx, and Wal-Mart have discovered that by raising wages for low-income employees, they can often boost productivity, improve customer service, and reduce employee turnover.[23]

A STRATEGY TO RESTORE SHARED PROSPERITY REQUIRES ACTION BY BUSINESS, STATE AND LOCAL GOVERNMENT, AND THE FEDERAL GOVERNMENT

Second, businesses can pursue a range of steps to enhance the business environments—the commons—in the communities where they operate, in ways that also benefit their company. We discuss the most important priorities below.

Third, in pursuing the interests of their companies, business leaders should be certain not to undermine the commons in America. The arena in which business leaders most often violate this precept is in government relations: to advance their narrow self-interest, executives promote exceptions, exemptions, and special treatments that ultimately raise the cost of doing business in the United States. Take, for instance, the nation's corporate tax code. The code is fraught with loopholes because individual business leaders and industry associations have lobbied very effectively for special provisions that benefit particular companies and industries. (We return to the tax code in detail in Chapter 6.)

Building the commons. In a few domains, executives have especially important opportunities to build their businesses and the commons simultaneously.

- **Skills.** Business has a central role to play in addressing gaps in workforce skills. No one is better equipped than local business leaders, or more motivated, to ensure that education and training efforts develop individuals who can thrive in the workforce. Many companies, from Siemens in North Carolina to Mercedes-Benz in Alabama, are partnering with local community colleges to train trainers, shape curricula, and create pipelines of local talent for their workforces.[24] Recognizing the impact of automation on routine tasks, JP Morgan Chase is proactively retraining tellers for other careers within consumer banking.[25]

Leading companies are also moving to provide skills training that is portable across companies and industries and that focuses on not just jobs but careers. Wal-Mart is training and credentialing entry-level employees so that they can get on career ladders in fields like retail, manufacturing, transportation, and distribution after leaving Wal-Mart.[26] At the industry level, the National Network of Business and Industry Associations is developing new cross-industry, national credentials that will provide longer careers and greater job security for welders, restaurant and hotel industry workers, metal workers, construction workers, and automotive workers.[27]

- **Public Education**. Skills must build on the foundation of public education. American companies have long been involved in public education, but many support efforts are fragmented and incremental. Fortunately, more companies are moving toward truly strategic partnerships with public educators. In Georgia, for example, Southwire, a maker of cable and wire, is working with the Carroll County school system to place at-risk students in jobs, so that they can earn wages even as they complete their high school degrees. Thanks to the program, graduation rates have risen sharply. Moreover, the high productivity of well-managed high school students ensures that the program makes a profit, which is then reinvested in the program.[28]

More widely, progressive business leaders are taking advantage of recent changes in K–12 education to support schools in new ways. They are joining with educators and civic leaders to advocate for local policies that enable education innovation. They are helping to spot local programs that boost student outcomes and grow them to regional and national scale. And they are partnering with school district leaders, local nonprofits, parent groups, and labor associations to reinvigorate the entire education ecosystem in certain cities and towns. These new forms of engagement shift business from "checkbook philanthropy"—giving money to alleviate the symptoms of a weak educational system—toward working with educators to strengthen the system for the long run.[29]

- **Supplier Development.** In many industries, the local supplier base diminished as U.S. companies moved operations overseas.[30] Efforts to rebuild the local supplier base are growing. Caterpillar and John Deere, for instance, have worked with suppliers close to their U.S. facilities to upgrade manufacturing and logistics capabilities, turning the suppliers into efficient and responsive companies from which the larger companies can profitably buy.

- **Regional Economic Collaboration.** Companies across the country are contributing substantial resources

FIGURE 1: BUSINESS LEADERS' COMPETITIVENESS AGENDA

1	PURSUE PRODUCTIVITY	Run their U.S. operations well, vigorously pursuing productivity and profitability within the rules set by society
2	BUILD THE COMMONS AND THE BUSINESS	Improve skills and schools by partnering with educational institutions and offering curricular guidance, mentoring, instructors, equipment, and facilities
		Upgrade supporting industries by offering in-person courses, online resources, dedicated staff, and joint projects that can improve supplier productivity
		Bolster regional strength by upgrading capabilities in areas such as skill development, environmental responsibility, and export promotion
3	REIN IN SELF-INTEREST	Advocate policies that improve the U.S. business environment rather than pursue narrow self-interest, such as seeking special permits, tax breaks, or regulatory exceptions

Source: "What Business Should Do to Restore U.S. Competitiveness," Michael E. Porter and Jan W. Rivkin, *Fortune*, October 29, 2012 to fostering regional economic development strategies.[31] In Columbus and Minneapolis-Saint Paul, for example, civic alliances led by chief executives have tackled topics such as cluster development, transportation infrastructure, and the promotion of entrepreneurship. These alliances increasingly focus on creating economic opportunities for disadvantaged citizens, to ensure that prosperity is shared widely.[32]

Figure 1 on page 32 summarizes the steps companies can take to enhance U.S. competitiveness. It is important to highlight that most such efforts are *not* corporate-sponsored charity projects. To the contrary, they serve the long-term interests of the involved companies. And most are motivated by a powerful conviction that a company cannot thrive in the long run if the community in which it operates is struggling. One of the most optimistic findings in our prior surveys was that many businesses are already engaged in such steps and more are seeking to expand their efforts.[33]

The Strategic Agenda for State and Local Government

State and local governments are crucial to competitiveness because many of the most important factors affecting competitiveness reside at the regional and local level. There are major differences across regions in terms of the types of industries and clusters present, the quality of the business environment, and economic performance.

Most state and local governments have been actively involved in economic development, and many have made progress—improving their business environments and attacking local weaknesses. Governors and mayors are overhauling their education systems, upgrading training institutions, founding business accelerators and innovation districts, tackling high local costs of doing business, improving local infrastructure, and taking other steps. Innovative new programs are targeting lower-income communities and thereby boosting shared prosperity.

In some cases, bipartisan collaboration, which is virtually absent in the federal government, has accelerated change, such as in Oregon to improve educational attainment and in New Hampshire to strengthen transportation infrastructure. State and city government leaders feel competitive pressure from other regions more acutely, and they are in closer touch with business than are leaders in Washington.

Progress at the state and city level remains uneven. We see localities on a spectrum of sophistication and effectiveness. The least effective states and cities have no deliberate approach to local competitiveness. They often focus on "elephant hunting" – offering incentives to companies to land large facilities that bring lots of new jobs to an area. The problem with this approach is that in bidding against other localities to attract companies, officials give away any gains but do not improve the business environment in a way that sustains competitiveness. In contrast, the state and local governments that have achieved the most success are those with a clear strategy, not isolated initiatives.

The most effective local leaders realize that the commons is best built by cross-sector collaborations among leaders in government, business, nonprofits, educational institutions, labor organizations, and other partners. In many respects, it is misleading to think of separate agendas for local governments and for business. Many of the most effective business efforts we described involve businesses partnering with government actors and others. Such partnerships are so promising that we have developed at Harvard Business School a leadership program, the Young American Leaders Program, which brings together cross-sector teams from cities across the country. While on campus and afterwards, they learn about strategies for enhancing shared prosperity, work towards developing local strategies, and build relationships to mobilize change. State and local government leaders can play a similar role, inspiring cross-sector collaborations that can accomplish goals which government alone cannot. In the final analysis, generating shared prosperity is a team sport.

CHAPTER 5

AN ECONOMIC STRATEGY FOR WASHINGTON

If generating shared prosperity in America is a team sport, one player has been prominently on the sidelines in recent years—the federal government. Without effective federal action, the state and local efforts we just described will not deliver their full promise. Unfortunately, Washington has been virtually paralyzed, with the current Congress on track to enact fewer laws than any session of Congress in the post-war period. Yet, this is a time when America *needs* the federal government to act: federal officials determine or deeply influence many of the weakest elements of the U.S. business environment (the elements in the lower left quadrant of Figure 1 in Chapter 3).

An economic strategy, then, is especially needed at the federal level. With the demands on the national government outstripping its resources, America will have to make difficult choices. A key role of a strategy is to guide tradeoffs and set the right priorities.

In 2012, we put forward such a strategy—an Eight-Point Plan for Washington—to identify the most important federal policy priorities that would have the greatest positive impact on U.S. competitiveness. In this presidential election year, this chapter reviews the Eight-Point Plan and its rationale. We report on the findings from our 2016 survey on support of the Plan, both among HBS alumni and the general public, compared to our previous surveys conducted in 2012. Finally, we review legislative and policy progress on implementing the Eight-Point Plan. The unfortunate conclusion is that very little has been accomplished.

The Eight-Point Plan

Figure 1 shows our Eight-Point Plan for Washington.[34] Four principles guided the construction of the plan. First, we focused on policies that would address the greatest weaknesses of the U.S. business environment in areas controlled primarily by the federal government. Policy areas that are largely the responsibility of state and local governments, such as public education, were not part of the plan even though they are critically important. Second, though seven of the eight points address crucial weaknesses, the plan included an eighth priority centered on capturing an opportunity rather than a weakness: how can the U.S. take advantage of its most important emerging strength, the energy cost advantage unlocked in the early 2000s by new technology, for developing unconventional energy resources? Third, all eight priorities were selected because they could have a significant impact quickly, in a two- to three-year period. Finally, given increasing political gridlock, we focused only on policy areas where our work suggested a wide consensus on both importance and the key steps needed to make progress. For instance, we did not include healthcare

FIGURE 1: THE EIGHT-POINT PLAN FOR WASHINGTON

1	Simplify the **corporate tax code** with lower statutory rates and no loopholes
2	Move to a **territorial tax system** like all other leading nations
3	Ease the **immigration of highly skilled individuals**
4	Aggressively address distortions and abuses in the **international trading system**
5	Improve **logistics, communications,** and **energy infrastructure**
6	Simplify and streamline **regulation**
7	Create a **sustainable federal budget**, including reform of entitlements
8	Responsibly develop America's **unconventional energy advantage**

Source: Michael Porter and Jan Rivkin. "An eight-point plan to restore American competitiveness." The Economist: The World in 2013. (Nov 2012).

reform because there was no consensus on what needed to be done. As in any sound strategy, the Eight-Point Plan does not attempt to address every problem or pursue every opportunity. Rather, it focuses on those areas with the most significant impact on growth. There are many opportunities for improvement in America, but these are the most salient ones today at the federal level.

One thing is clear to us based on our research and engagement with all stakeholders. If America can make progress on these eight strategic priorities, or even some of them, it would transform the trajectory of the U.S. economy and the economic prospects of all Americans.

Business Support for the Eight-Point Plan

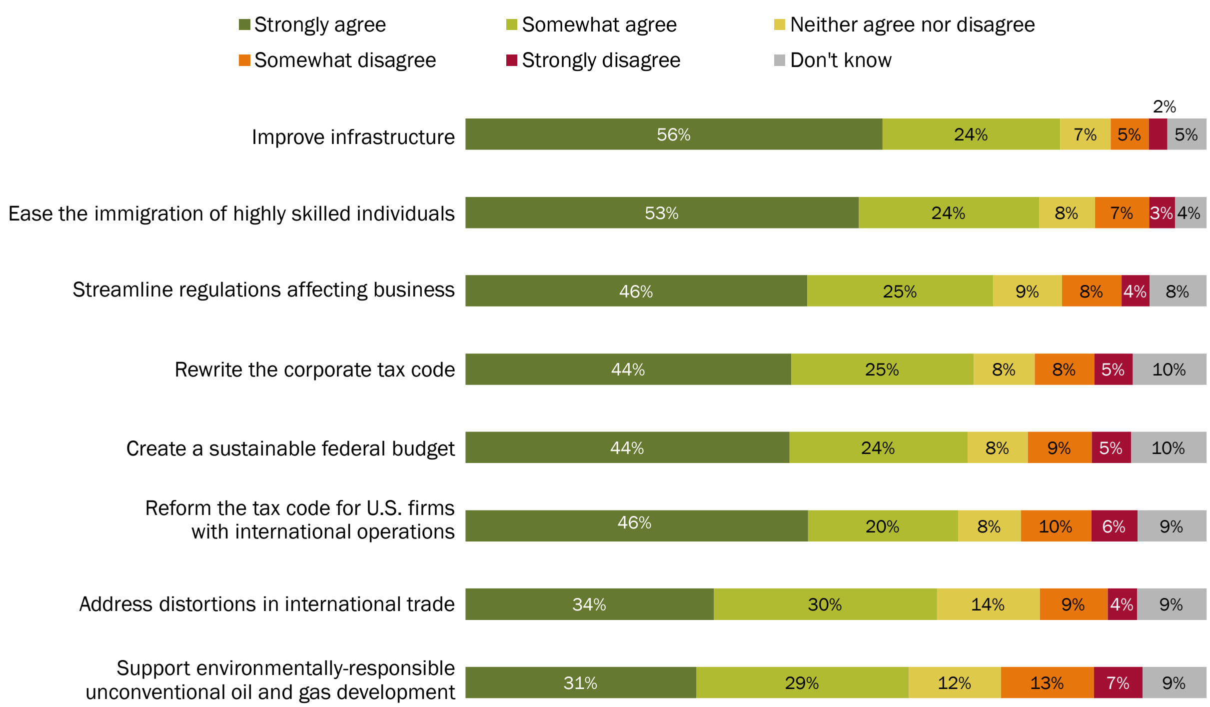
To test the support or lack of support for the Eight-Point Plan, we surveyed business leaders (via HBS alumni) and a representative sample of the general public in May and June 2016. We also compared the 2016 findings with similar surveys we conducted during the 2012 presidential election.

HBS alumni either strongly support or somewhat support all eight priorities in the Eight-Point Plan, with a clear majority strongly or somewhat agreeing with each point (Figure 2). The greatest consensus was on improving infrastructure (endorsed by 80% of respondents), high-skill immigration reform (77%), and streamlining regulation (71%). Responsible unconventional energy development, the subject of a polarizing debate pitting environmental groups opposed to any fossil fuel development against the oil and gas industry, still received 60% support. This may reflect recognition of the major energy cost savings to virtually every American household and business, restored U.S. competitiveness in major industries such as plastics and chemicals, and positive progress on reducing local environmental impacts.[35]

Another way to gauge support for the Eight-Point Plan is to examine the net approval, or the percentage of business leaders strongly and somewhat supporting each area minus those strongly or somewhat not supporting it. All eight priorities had overwhelming net approval. Even for the most controversial area, responsible unconventional energy development, supporters outnumber opponents by 40%. In an election, these levels of support would be nothing short of a landslide. The 2016 results are consistent with our 2012 alumni survey, in which all eight areas had majority support. Support in 2012 was even stronger in seven of the eight areas, perhaps in part because of a less polarizing presidential election.

We also polled current Harvard MBA students in 2016 on the Eight-Point plan, to get the perspectives of young business leaders about economic priorities. MBA students

FIGURE 2: SUPPORT FOR THE EIGHT-POINT PLAN (ALUMNI)



strongly supported all eight areas of the Plan, at similar levels as alumni. The biggest difference was in high-skill immigration: there, MBA students registered even stronger support than alumni, perhaps because the issue directly affects them and their international classmates.

Alumni Support by Political Affiliation

In this year's survey, for the first time we asked HBS alumni to self-declare their political affiliation in order to gauge how this affected their views on economic priorities. The data reveal that 38% of HBS alumni respondents self-identify in 2016 as Independents, 32% as Republicans, 21% as Democrats, and the balance (9%) some other affiliation or preferring not to answer. The proportion of respondents identifying themselves as Independents mirrors trends in the population. This is discussed further in Chapter 7.

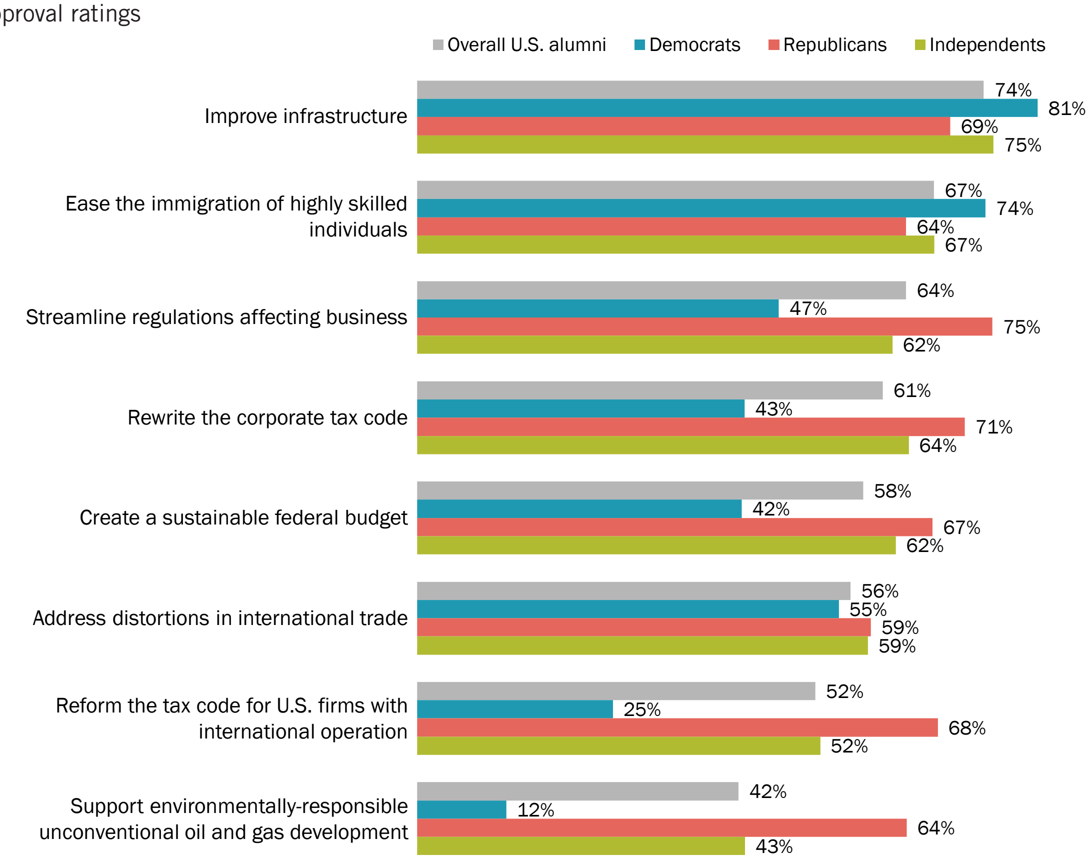
For all eight policy priorities, there was net positive support across all political affiliations (Figure 3). The lowest consensus was in two areas—moving to a territorial tax system and responsible development of unconventional energy resources. In both these areas, Independents and Republicans registered strong support while Democrats had net positive support but were more divided. In 2012, using our indirect measure of political affiliation, support for the Plan was also strongly bipartisan, with the exception of the territorial tax code.

Alumni Economic Policy Recommendations

This year, we also invited unscripted responses from alumni on the most important federal economic policy priorities (Figure 4). Based on over 1,400 responses, the priority areas were virtually the same as the Eight-Point Plan. Alumni also mentioned education, health care, and the U.S. political system as areas in need of improvement, all areas confirmed in our competitiveness assessment. As pointed out earlier, we did not include the first

FIGURE 3: SUPPORT FOR THE EIGHT-POINT PLAN, BY POLITICAL AFFILIATION (U.S. ALUMNI)

Net approval ratings



Note: Net approval rating equals percentage of respondents supporting proposal minus portion not supporting. Figures by political affiliation are for U.S.-based respondents only.

FIGURE 4: PROPOSALS FOR ECONOMIC POLICY REFORM (ALUMNI)

AREA	PROPOSAL	NUMBER OF COMMENTS	PERCENT OF TOTAL
Eight Point Plan		**1,277**	
Reducing the Regulatory Burden		402	14%
	Reduce government regulation	220	
	Reduce size and intrusiveness of the federal government	100	
	Reform judicial / legal system	82	
Taxes		387	14%
	Reform tax code	177	
	Reduce corporate tax rates	82	
	Simplify tax code	76	
	Lower personal income tax rates	33	
	Make tax code more progressive	19	
Immigration		139	5%
	Reform immigration	139	
Budget		120	4%
	Balance the budget	33	
	Reduce defense spending	30	
	Reduce government debt	13	
	Reduce entitlements or welfare	28	
	Expand access to entitlements or welfare	16	
Energy		86	3%
	Address climate change	42	
	Promote alternative or renewable energy	41	
	Promote energy independence	3	
Infrastructure		52	2%
	Invest in infrastructure	52	
Trade		91	3%
	Level the playing field for international competition	46	
	Decrease barriers to free trade	45	
Other Policy Areas Mentioned		**1,053**	
Education		430	15%
	Reform education system	154	
	Increase investment in vocational training, apprenticeships, and other forms of workforce skills training	88	
	Increase investments in K–12 education	58	
	Increase investments in post-secondary education	49	
	Expand access to education	33	
	Increase investments in STEM fields	30	
	Increase investments in early childhood education	18	
Health Care		240	9%
	Reform health care	136	
	Expand access to health care	46	
	Reduce health care costs	38	
	Reduce government involvement in health care	20	
Political System		130	5%
	Reform law-making process, including addressing lobbying	42	
	Reform political system (other)	40	
	Reform campaign finance	38	
	Change political leaders	10	
Enhance Overall Growth and Competitiveness		138	5%
	Encourage small business formation	30	
	Promote domestic manufacturing	28	
	Reduce labor market restrictions	25	
	Improve equality of opportunity in employment	22	
	Stimulate economic or job growth	21	
	Improve wages for the average worker	12	
Innovation		96	3%
	Increase investment in R&D and / or encourage innovation and productivity gains	96	
Monetary Policy		19	1%
	Reform monetary policy	15	
	Increase interest rates	4	
Miscellaneous		**473**	**17%**
Grand Total		**2,803**	**100%**

two issues in the Eight-Point Plan because education is primarily a local- and state-level issue, and health care is a critical problem but without consensus yet on the solutions. The political system by itself is not a matter of economic policy, but it has become the bottleneck on economic policy progress. Our analysis of the U.S. political system is discussed in Chapter 7.

Public Support for the Eight-Point Plan

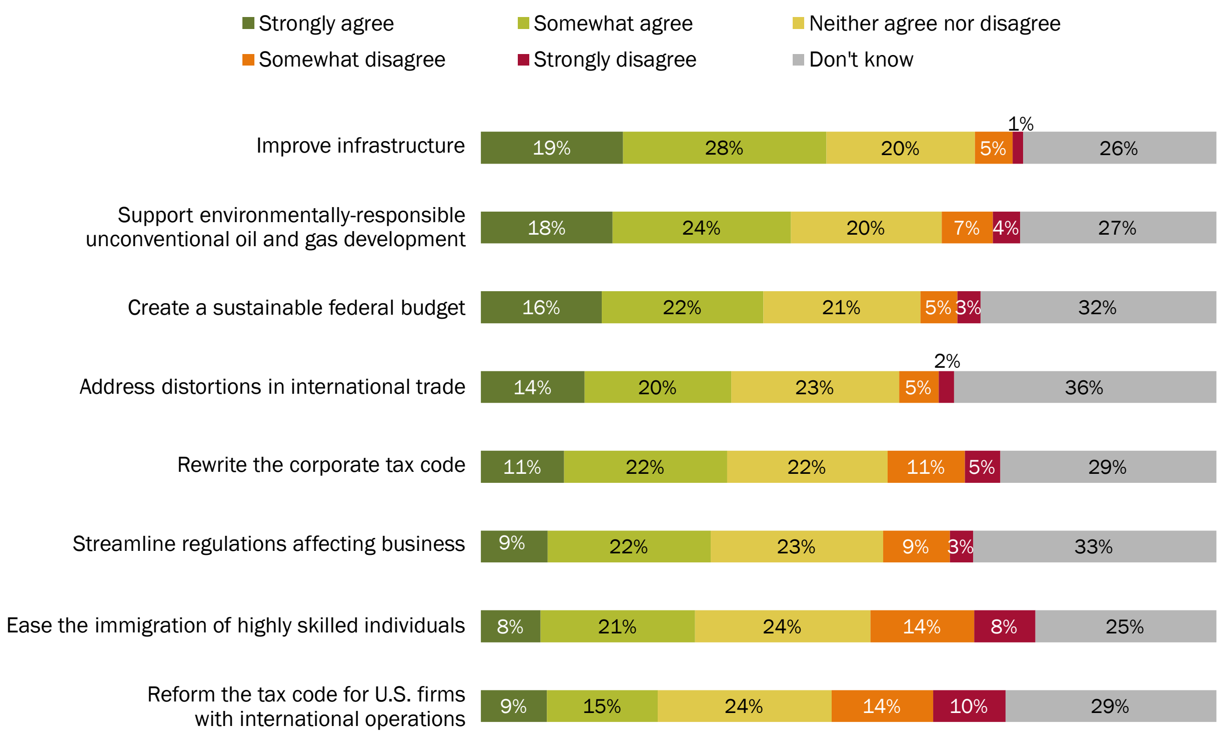
In both 2016 and 2012, we also surveyed the general public to understand their views and alignment with business leaders on these eight issues. In 2012, we compared approval rates between business leaders and the general public, excluding respondents who reported "don't know." The issues where business leaders and members of the public had the least divergence were in responsibly developing our unconventional energy resources, making infrastructure investments, and reforming corporate taxes. Approval percentages differed the most on high-skilled immigration, streamlining regulation, and fixing the territorial tax code.

In 2016, we compared business leader and public support, including respondents who said they did not know whether a policy was good or bad for U.S. competitiveness. While a majority of business leaders either strongly agreed or agreed with all eight policies, not even one policy won majority support from the general public (Figure 5). Infrastructure improvement ranked the highest in terms of support, with 80% of business leaders and 47% of the general public supporting the policy area. While high-skill immigration was supported by 77% of business leaders, only 29% of the public registered support, perhaps due to concerns about immigration leading to loss of jobs.

In 2016, in terms of net approval, there is net positive support in the pubic for seven of the eight priorities. On territorial taxes there was a tie: the percentage of supporters equaled the percentage of non-supporters. The strongest net public support in 2016 is for infrastructure improvement, unconventional oil and gas development, a sustainable federal budget, and eliminating distortions to trade. There is much lower absolute net public support than among business leaders for corporate tax reform, streamlining regulation, reforming the territorial tax, and high skilled immigration.

However, the most striking finding about public views on economic policy are the proportions of the public who *neither agreed nor disagreed* or responded that they *didn't know*. In 2016, the total of these two groups

FIGURE 5: SUPPORT FOR THE EIGHT-POINT PLAN (PUBLIC)



ranges from a low of 46% of general public respondents on infrastructure to a stunning 59% of respondents on reducing distortions in international trade and 56% on regulatory streamlining, with those not able to provide an opinion rising since our 2012 survey. *It seems clear that the average American is confused about what the country should do to restore our economy.* The lack of public knowledge and understanding of the fundamentals of U.S. economic competitiveness, and what to do about it, has been growing with more and more partisan rhetoric and a muddled and uninformative national debate. This inability of many Americans to feel equipped to distinguish good policy from bad policy is a serious threat to America's ability to make progress. We will return to this topic in Chapter 7.

Progress in Washington on the Eight-Point Plan

Given the bipartisan consensus in the business community about what needs to be done, and the net support even from an anxious and confused general public bombarded with noisy, partisan politics, what has Washington actually accomplished? How much progress have we made on the most important federal economic policy priorities we face? The answer to this question is, sadly, little or none.

Let's take corporate tax reform, arguably the most important and actionable policy step which would almost immediately spur growth and increase corporate investment in the United States. The consensus reflected in the Eight-Point Plan is to lower the statutory rate for U.S. companies to one similar to other leading countries', while making the change revenue-neutral by eliminating exclusions and loopholes. Despite broad agreement with this approach among policy experts, business leaders, and the media, there has been no progress. U.S. companies still face the highest combined tax rate of any advanced country (39%), and worldwide, the U.S. is second only to Chad (40%) and United Arab Emirates (55%). In comparison, Sweden's corporate tax rate is a more typical 22%. Democrats and Republicans say they agree that the rate needs to come down, but have wasted more than four years quibbling over a compromise number. Meanwhile, American companies continue to seek complicated corporate tax structures to mitigate the tax burden. The result is that in an era of high corporate profits, our tax policy has driven more investments (and corporate taxes) to other countries and the U.S. has suffered.

In creating a sustainable federal budget, there has also been no progress. The consensus approach is a combination of higher revenues and less spending. Instead of compromising, the longer-term budget picture has worsened.[36] Both sides are dug in and the budget process itself has become an embarrassment.

Neither have we addressed barriers and distortions that work against America and American companies in the international trading system. Instead of continuing to open up markets to greater U.S. exports, which expands high-wage jobs, the U.S. has been disadvantaged. The U.S. economy is already more open to trade than most nations in the world, so trade agreements that open currently protected markets are essential to the U.S. Yet, special interests argue against any trade agreements, at a time when virtually all other leading nations are expanding trade agreements.

THE LACK OF PROGRESS ON FEDERAL ECONOMIC POLICY HAS SPANNED THE LAST TWO PRESIDENTIAL ADMINISTRATIONS. MEANWHILE, THE U.S. BUSINESS ENVIRONMENT HAS ERODED.

The same lack of progress applies, in large part, to the rest of the Eight-Point Plan. There has also been no meaningful progress on infrastructure improvement beyond an inadequate Highway Bill, no progress on making regulation more efficient (which hurts smaller companies the most), no progress in welcoming high skilled immigrants in areas where talent is badly need to support growth, no progress on creating an international tax structure so American companies will no longer need to move their headquarters abroad and can instead bring foreign profits home. And finally, there has been little progress on further solidifying our energy advantage, with win-win steps for the economy and the environment stalled by misinformation on both sides and bitter partisanship.[37]

This lack of progress on federal economic policy has spanned the last two presidential administrations, each in office for eight years. Meanwhile, the U.S. business environment has eroded, our costs of doing business have gone up, and the skills of the average American have slipped further behind.

Today's political debate is not about how to restore competitiveness but about how to divide the pie—who deserves more and who's getting too much. We are blaming each other for poor economic performance when the real problem is that the pie is shrinking for many Americans because of declining competitiveness. We rightly debate today's social challenges, such as racial divides, but have largely ignored the critical economic policy steps that could help grow opportunity for all Americans.

The 2016 presidential race has done little to improve the discourse and shed light on the future steps we need to embrace. Instead, too often, the candidates create greater confusion. The net result is that many citizens respond that they "don't know" when asked about U.S. priorities.

Candidate "plans" put forth aspirations but fail to offer real solutions. Instead, they propose small, partial steps on some policy areas, or espouse simple, almost-cartoonish slogans without a real plan of action. Overall, no candidate has put forward anything close to a coherent strategy for the economy.

As anxious Americans ponder on the choice of who will lead us for the next four years, the Eight-Point Plan is a lens through which citizens can view and assess presidential candidates. Whoever gets elected, both as President and in Congress, will face these pressing issues. Come 2017, the new Administration and Congress must do something on these eight priorities if anything is to change. Our most pressing national goal today must be to restore economic vitality and bring prosperity to all Americans.

Summary

Leadership, and economic strategy, are as important today in the U.S. as at any time in many decades. While the recovery proceeds fitfully, America's performance remains weak. To change the trajectory, we need to tackle a number of essential areas where most Americans agree on the need for compromise solutions.

The fact that there is little or no compromise, and that little or nothing has been accomplished in well over a decade, has become the central problem in America's economy.

How can we identify concrete policy steps to break the cycle? To explore this, we selected tax reform as the single policy area which could arguably make the biggest positive impact on the economy in the near term. Given our research and numerous interactions with the business community, corporate tax policy is clearly a crucial obstacle to restoring U.S. economic growth, while personal taxes are a crucial element of creating a truly sustainable budget and making headway on rising inequality.

Can we find a consensus way forward on taxes? This is the subject of Chapter 6.

CHAPTER 6

ACHIEVING TAX REFORM

In the three decades since the last major tax reform in the U.S., the global economy has been transformed by globalization, increasing digitization, and the opening of previously-closed economies. Other countries have responded to these dramatic changes with significant changes to their tax systems, yet the U.S. tax system has remained relatively ossified. The U.S. tax system has become a significant competitiveness problem given dramatic changes abroad and inaction at home, as verified by our previous HBS surveys on U.S. competitiveness.

On the business taxation side, three developments since the last major tax reform necessitate change in the U.S. First, the U.S. statutory tax rate, previously similar to that of peer countries, is now a clear outlier, ten percentage points higher than the average OECD rate. Second, virtually all peer countries have switched to a territorial system of taxation (taxation of income within one's borders) and away from the worldwide system currently used by the U.S. (taxation of income no matter where earned). Third, more than half of all U.S. business income now goes through pass-through entities such as LLCs, Subchapter S corporations, and partnerships, meaning that the corporate tax is now fundamentally a tax on larger, public multinational companies.

The symptoms of the current mismatch between global realities and the U.S. corporate tax are numerous and substantial:

- U.S. multinational companies hold large sums of cash abroad, reflecting the disincentive to bring it home where it could be invested.
- Tax inversions and cross-border M&A that favor foreign acquirers have become common, with the largest announced mergers over the last three years reflecting tax-induced incentives.
- Corporations actively shift income around the world, partly to avoid high U.S. tax rates and, in doing so, lose public trust because they are seen as avoiding their tax obligations.

On the personal taxation side, the last three decades have also brought changes that make reform desirable. For income from capital, the U.S. system is now characterized by a byzantine patchwork of savings incentives (e.g., education and health accounts) but also by recent stealth tax increases for high-earners through complex phase-outs. The swelling pensions of aging baby-boomers and the growth of tax-advantaged accounts means that more than half of all equity income is now going to tax-exempt vehicles. For labor income, the top rate has increased and, because of the faster growth of high incomes relative to inflation, the top bracket now captures 1.0% of taxpayers, while it used to capture 0.1% of taxpayers. Rising health care costs and property values have increased the importance of the largest income exclusions and deductions (often derided as "loopholes"): employer-provided health insurance, mortgage interest deductions, and state and local taxes. The earned income tax credit (EITC) is probably the single most important innovation on the personal tax side over the last two decades, but one in four eligible individuals do not receive it, reflecting its complexity. Finally, the U.S. has chosen to rely ever more on income taxes, while many other countries have shifted to employing carbon taxes and consumption taxes with one-third of tax revenue for OECD countries coming from taxes on goods and services.

THE U.S. TAX SYSTEM HAS BECOME A SIGNIFICANT COMPETITIVENESS PROBLEM GIVEN DRAMATIC CHANGES ABROAD AND INACTION AT HOME.

The impact of these developments is magnified by the pressing challenge of fiscal sustainability. The current federal budget deficit, at 2.9% of GDP, is expected to balloon to 8.8% of GDP by 2046, according to the nonpartisan Congressional Budget Office. The national debt is forecasted to rise to 141% of GDP, forty percentage points higher than its historic peak after the huge financing required for World War II.

Finally, pressure to use the tax system to redress widening income inequality (not to mention a host of special interests) means that we are asking the tax system to do more than ever before. As a result, the tax system is now inextricably involved across a wide spectrum of economic activity, from health care reform to low-income housing development to education financing to campaign financing. The spreading influence of the tax system has increased the administrative burden borne by the IRS, the complexity of the tax system for taxpayers, and the resistance to reform.

What is Good Tax Policy?

Given the pressing need for reform, what should be the guiding lights for policymakers and business leaders as they evaluate what to do next? There are at least three considerations that should guide tax policy—efficiency, equity, and complexity. These three considerations are intensified by globalization.

Efficiency. Taxes influence behavior by changing the returns to effort or investment, and the relative prices of goods. The degree of these changes dictates the desirability of different tax instruments—taxes that significantly change behavior are worse because for every dollar of revenue they raise, there are greater distortions to preferred behaviors. Given these distortions, it is preferable to tax final goods rather than inputs (including capital) because taxes then only change consumer behavior as opposed to altering both production and consumption decisions. This logic is a primary reason for consumption taxation around the world.

Taxes on corporate income are an example of a tax that can alter both production decisions (making non-corporate forms preferable and reducing demand for capital) while also changing consumption decisions (those goods produced by corporations become relatively more expensive). This example also makes it clear that the entities that directly "pay" taxes (in this example, corporations) aren't the ones who really pay the tax (in this example, it is consumers, workers, and capital providers).

Tax-induced changes to behavior can actually be beneficial. In particular, taxes that help us internalize the costs of activities that are not otherwise reflected in prices are particularly valuable instruments. They can raise revenue while also making us behave more as we should, given the full set of costs or benefits of activities. Carbon taxes are a key example and are currently spreading around the world.

Equity. In a world where limiting distortions to behavior is the only goal, life would be simple. We would simply impose a "poll tax" or use land taxes as there are limited behavioral changes with such instruments. But, taxes also can have a second goal of redistributing economic rewards. Redistribution can have various rationales—social cohesion, empathy, or the idea that by transferring income across citizens, we can improve overall national welfare due to the greater value of an extra dollar to poorer individuals. Such redistribution can raise philosophical objections, but this has become a legitimate goal for the tax system in modern societies. For example, the Earned Income Tax Credit (EITC) is one of the largest anti-poverty programs in the U.S. The tension between the objectives of redistribution and greater efficiency is the central problem of taxation.

Complexity. Today, the complexity of the tax system has become an important third dimension of tax policy design. Greater tax complexity creates additional costs (e.g., advisors are required to work on corporate taxes) or siphons off benefits (e.g., lower-income Americans often require advisors to help them get the EITC). This complexity results in the reallocation of very talented people to activities that are not value-creating and is inherently regressive as larger corporations and higher-income individuals can handle, and capitalize on, this complexity more easily. An example is the byzantine system of taxing international income that impacts all citizens living abroad and firms with non-U.S. income. Larger multinational firms are better equipped to deal with it than are smaller firms and individuals.

Globalization intensifies all three of these taxation principles. Globalization has increased the returns to ability, heightening the calls for redistribution through the tax system. Globalization creates new ways for behavior to be distorted as now capital, plants, and workers are all more mobile and will move more quickly in response to taxes. Finally, globalization makes the costs of complexity even greater as there are ever more sophisticated and less observable means of responding to taxes in a world with multiple governments competing for economic activity.

The most important consequence of globalization for tax policy is that countries with tax policies that differ from global norms will bear greater and greater costs. The costs to the U.S. of inefficient and distinctive tax policies are limited in a world where the U.S. is relatively closed or where the U.S. clearly dominates other economies. The opening up and growth of other economies has meant that more and more opportunities exist around the world, giving firms and individuals a larger menu of choices of where to locate. Indeed, the recent spate of tax-motivated mergers that facilitate headquarters relocation are an example of firms responding to a highly distinctive regime by leaving the U.S.

The key temptation to avoid in this setting is the siren call to attempt to build walls around the U.S. economy that limit the flow of goods, capital, income, and people through tariffs or through tax penalties on investment abroad. Such approaches deny the reality of today's global economy by invoking primitive fears. These policies will hurt precisely those—the people with stagnating wages—whom they purport to help, given their relative immobility. Efforts to redress the negative effects of globalization should be focused on improving competitiveness, for instance, by upgrading the skills of workers threatened by offshoring, rather than blunderbuss tax policies.

Reimagining Tax Reform

Tax reform has been a central element of the U.S. Competitiveness Project since its inception, and both business taxation and budget reform are essential elements of the Project's Eight-Point Plan for federal policy reform (see Chapter 5). Indeed, the initial Competitiveness Project research in 2011-12 included a detailed corporate tax reform plan.[38] We believe that progress on tax reform is the single most powerful step to restore economic growth in America. However, tax reform has been mired in the same political gridlock we see in other areas. As a result, we undertook a renewed effort to move the agenda forward, adopting a more specific focus on what is possible.

To do so, we surveyed alumni on how to restore sustainability to fiscal policy, how to change specific parts of the tax code to enhance competitiveness, how to raise tax revenue, and how to enact revenue-neutral reform.

Survey Findings

Overall, our survey revealed several key findings for policy-makers and business leaders:

Business leaders understand that taxation is broken, and the appetite for reform is widespread. There was considerable consensus on the particular policies that are problematic, and on reforms that would enhance U.S. competitiveness. The corporate tax rate, the taxation of international income, and the spreading scope of deductions through the tax system were widely recognized as highly problematic. Tax rates on saving and labor income was deemed considerably less pivotal. Only a small fraction of respondents (less than 5%) saw no need for tax reform.

Business tax reform offers enormous promise. Every single corporate tax reform we asked respondents to assess received a positive net approval rating among all respondents and across political affiliations. Reducing the statutory rate and reforming taxation of international income were the most popular.

Comprehensive reform of personal taxes may have to wait, but a minimum tax rate on very high-earners offers political promise. Personal tax reform was considerably thornier with respondents displaying less appetite for specific changes and little consensus on what those changes should be. Interestingly, one reform to the personal tax system— a minimum tax on incomes above $1,000,000—received broad support. Explicitly coupling such a reform with a tax cut for lower-income individuals reduced, rather than increased, support for the proposal.

Carbon, not consumption, taxes are the future. Carbon taxes were remarkably popular both as a revenue raiser and as part of a structural, revenue-neutral reform. In contrast, consumption taxes were quite unpopular and solicited the most spirited commentary, positive and negative, from our alumni.

Several new tax reform ideas beyond simple rate changes are promising. Several recently proposed new ideas have received support, including taxing non-C corporation business income, raising the cap on income subject to the payroll tax, and moving the deductibility of dividends to the corporate level. However, other novel ideas were highly unpopular, including introducing a tax for the not-for-profit sector, eliminating the deductibility of corporate interest payments, and eliminating "step-up" basis at death for taxation of capital gains.

We need to educate citizens more about our fiscal future. Knowledge of the tough choices that await us has not been spread widely enough. Experts on fiscal policy agree that we will likely have to undertake both increased taxation and reduced spending to make the federal budget sustainable. But only 4% of survey respondents embraced such a combination. A quarter of respondents did not choose a set of policies that would move the U.S. toward fiscal sustainability, and more than half chose only spending reductions as a means of fiscal correction. Similarly, respondents broadly supported the removal of deductions and exemptions when framed generally but responded very negatively when specific deductions or exemptions were mentioned.

Competitiveness and Tax Policy

There was considerable consensus on what parts of tax policy are problematic for U.S. competitiveness[39] (See Figure 1 on page 44). A majority of respondents viewed taxation of international income (70%), the extent of corporate and personal deductions (59%), and the corporate tax rate (55%) as problematic for U.S. competitiveness. The taxation of international income was viewed as very problematic by 40% of respondents, and problematic by more than half of respondents of each political affiliation. Similarly, a majority of respondents of each political affiliation viewed the extent of deductions and the corporate tax rate as problematic.

Support for Tax Reform: Corporate and Personal

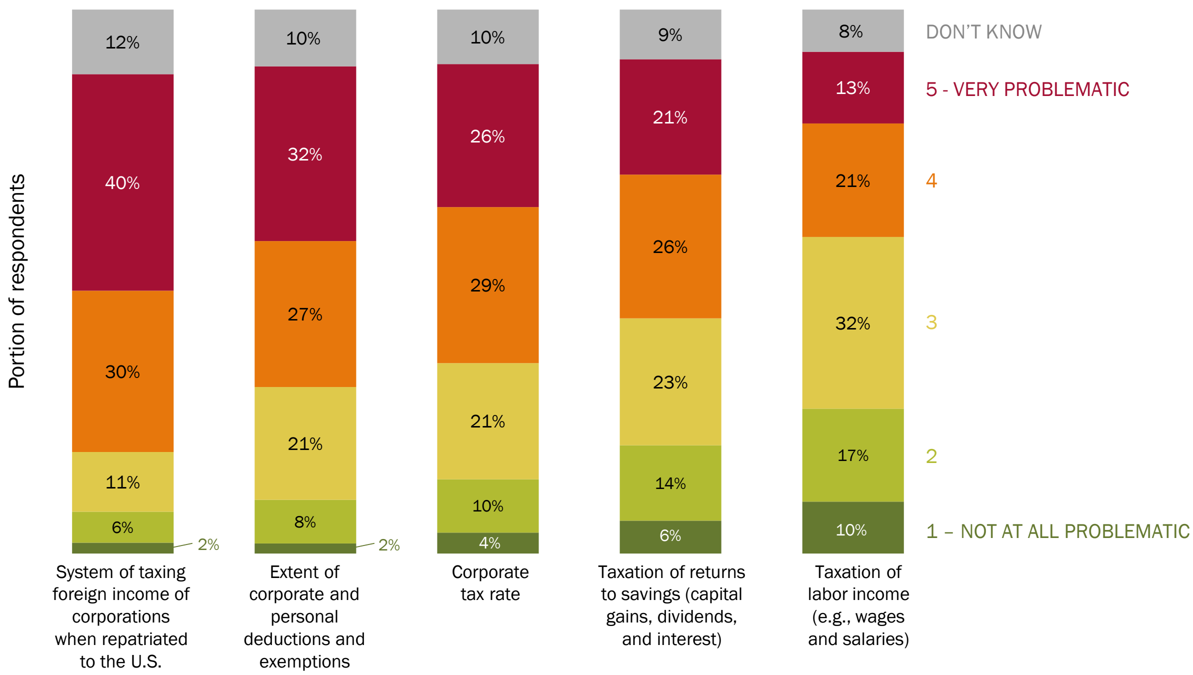
Appetite for corporate tax reform was deep and widely shared (Figure 2). Every single corporate tax reform we asked respondents to assess received a positive net approval rating, both overall and when broken down by political affiliation, age, gender, and citizenship. Cutting the corporate tax rate, shifting to a territorial system, and making dividends deductible at the corporate level were the most popular changes.

While overall discontent with the personal tax system was similarly high (less than 3% of respondents wanted the status quo for either the corporate or the personal tax system), specific changes were more polarizing (Figure 3). Only a minimum tax on households making more than a million dollars a year received a positive net approval rating, overall and across political affiliations. Other reforms to the personal tax system received sharply partisan reactions, with Democrats eager for a 5% tax rate increase and a reduction in deductions for households with income over $300,000 and Republicans opting for a reduction in individual rates in exchange for abolishing deductions. Despite the popularity of a consumption tax around the world, shifting to a consumption tax from an income tax had a negative net approval rating overall and only a 4% net approval rating amongst Republicans.

How to Raise Revenue

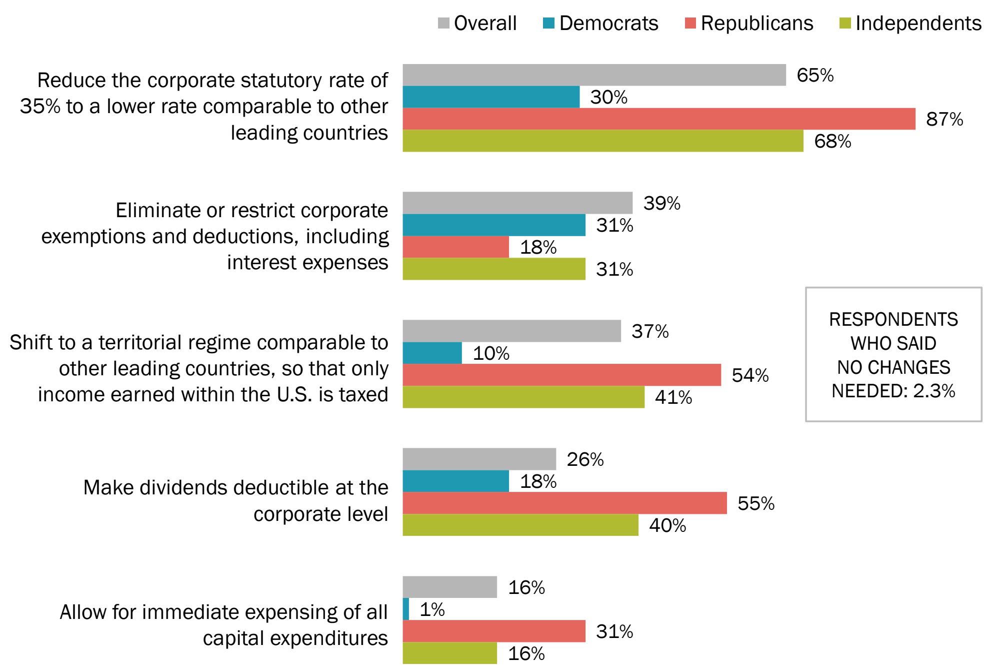
Of those who responded to the question of how the new U.S. President should raise revenue (14% of respondents disagreed with the premise of the question), several reforms had positive net approval ratings (See Figure 4 on page 46). The introduction of a carbon tax and a 30% minimum tax on households with at least $1,000,000 in income both received a positive net approval rating of approximately 30%. Alumni also provided positive net approval ratings to taxing non-C-corporation business income and raising the cap on income subject to the payroll tax. The least popular revenue raisers were increasing the tax rate on savings; eliminating the deductibility of charitable giving, state and local taxes and mortgage interest; and taxing employer-provided health insurance. While willing to eliminate deductions and exemptions in general, survey respondents resisted particular eliminations vigorously. Such preferences are one reason that tax reform is so very difficult: individuals often agree to changes in principle but then reject changes in practice.

FIGURE 1: TAX POLICY AND U.S. COMPETITIVENESS (ALUMNI)



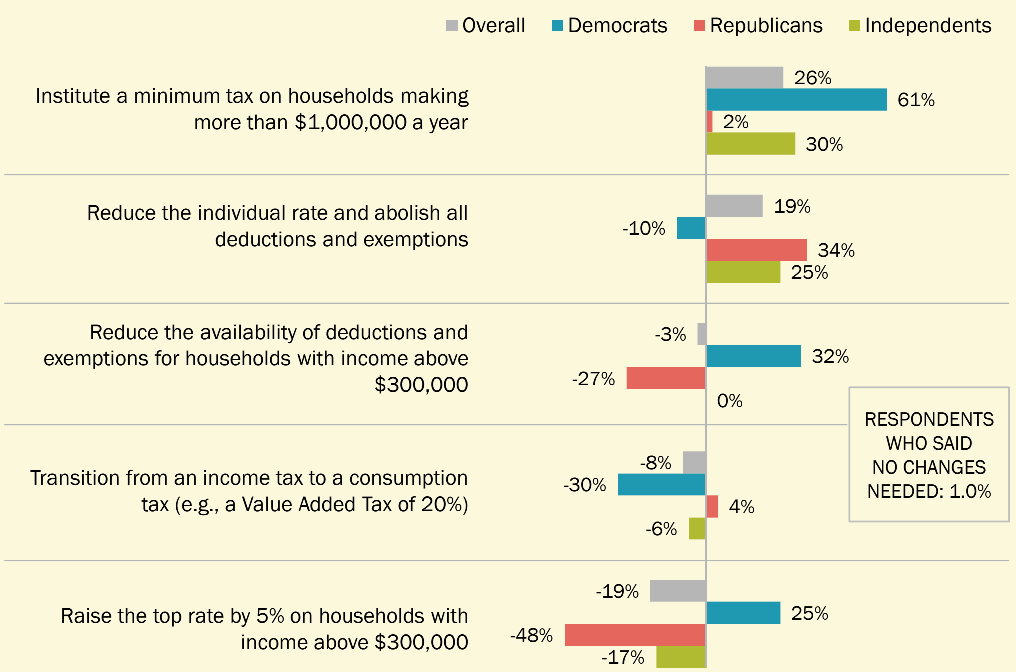
Note: Percentages in this and subsequent figures may not sum to due to rounding.

FIGURE 2: NET APPROVAL FOR CHANGES TO CORPORATE TAX SYSTEM, BY POLITICAL AFFILIATION (U.S. ALUMNI)



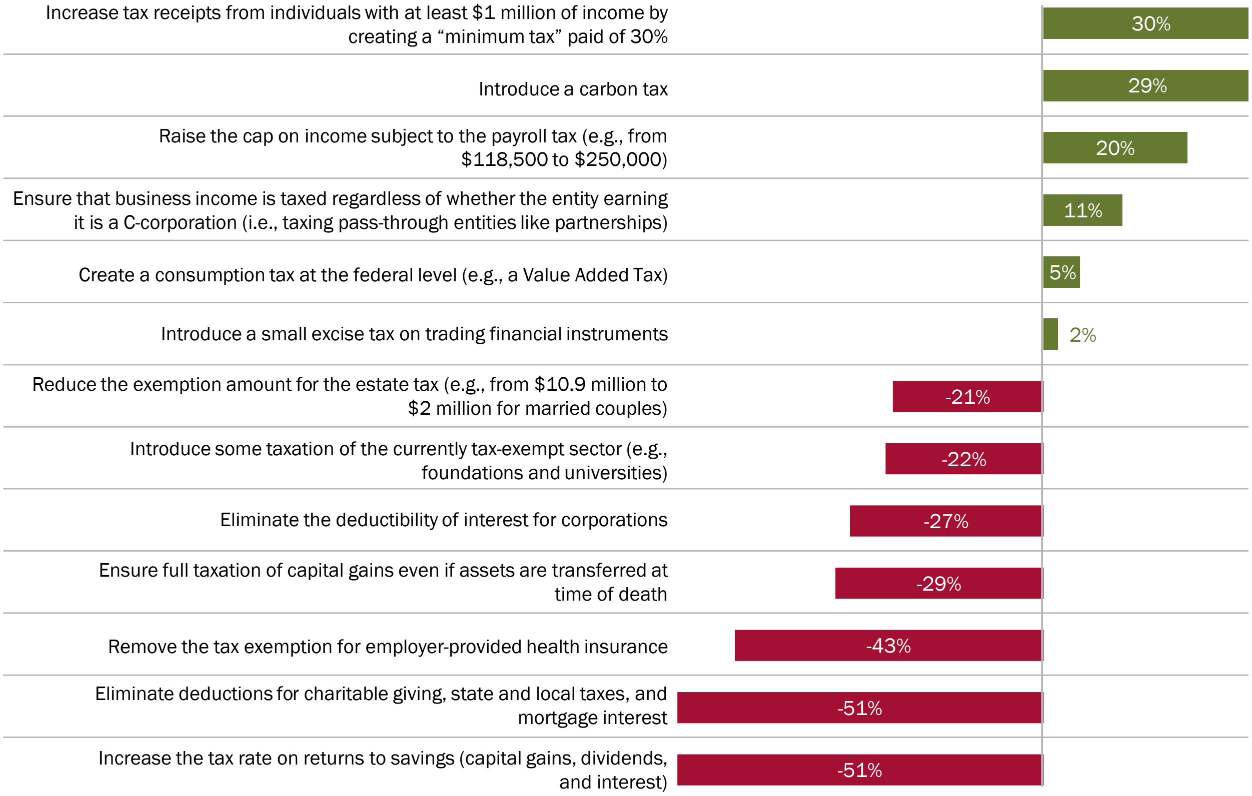
Note: Net approval rating equals percentage of respondents supporting proposal minus portion not supporting.

FIGURE 3: NET APPROVAL RATINGS FOR CHANGES TO PERSONAL TAX SYSTEM, BY POLITICAL AFFILIATION (U.S. ALUMNI)



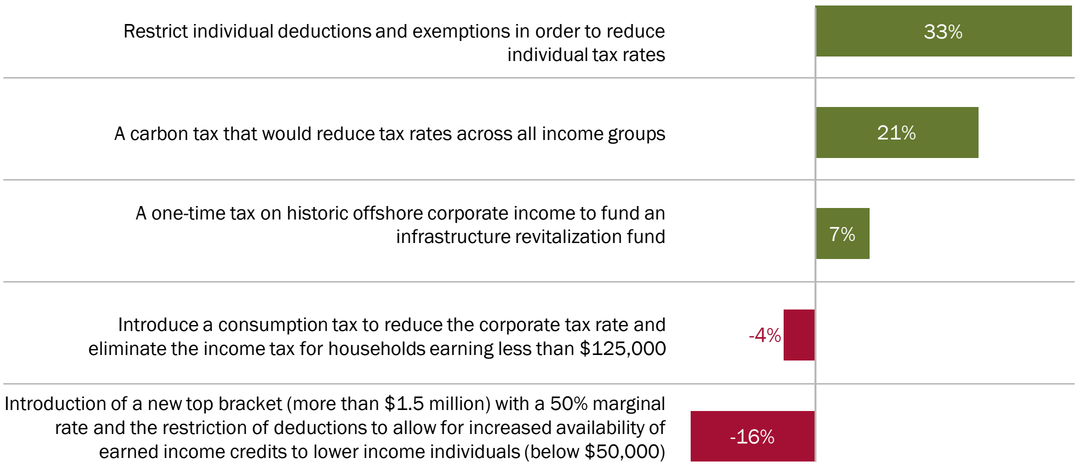
Note: Net approval rating equals percentage of respondents supporting proposal minus portion not supporting.

FIGURE 4: NET APPROVAL FOR WAYS TO RAISE REVENUE (ALUMNI)



Note: Net approval rating equals percentage of respondents supporting proposal minus portion not supporting.

FIGURE 5: NET APPROVAL FOR REVENUE-NEUTRAL TAX POLICIES (ALUMNI)



Note: Net approval rating equals percentage of respondents supporting proposal minus portion not supporting.

Revenue-Neutral Approaches to Reform

One approach to move forward given the political and fiscal constraints is to focus on revenue-neutral reforms which require both political parties to make sacrifices. In our survey, however, there was limited consensus about how to achieve such reforms (Figure 5). Only removing deductions and exemptions in exchange for a rate reduction received support overall and across political affiliations (respondents tended to resist the elimination of specific deductions and exemptions). The only other revenue neutral reform with a significant positive net approval rating was introducing a carbon tax in exchange for broad rate reductions. Highly redistributive reforms received low marks as did the introduction of a consumption tax to help eliminate income taxes for households earning less than $125,000. Respondents appeared to have little taste for explicitly tying tax increases to redistribution.

HBS Alumni Compared to the General Population and Current MBA Students

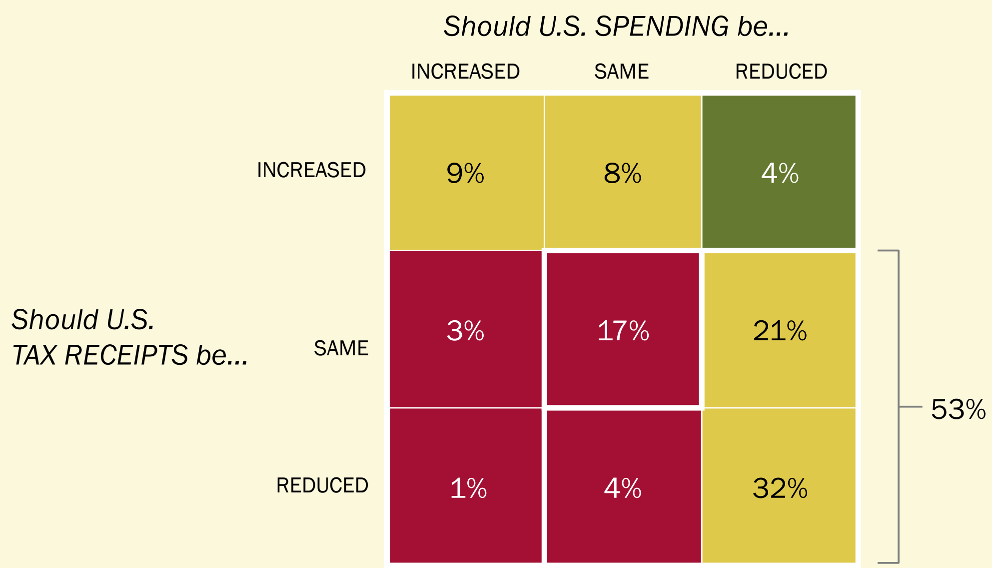
The general public population advocated even more strongly than HBS alumni for spending reductions and against tax increases. Current MBA students, in contrast, were much more accepting of tax increases and less desirous of spending cuts. Compared to alumni, current MBA students were significantly more likely to support a carbon tax, the elimination of the "step-up" basis at death for taxation of capital gains, a lowering of the exclusion limit of the estate tax, and redistributive plans generally.

Achieving Fiscal Sustainability

Reduced spending was the preferred method for addressing fiscal instability amongst our alumni, with 53% of alumni advocating reduced spending *and* either lower taxes or no change in taxes (Figure 6). In fact, nearly one-third of respondents chose reduced spending and reduced taxation. Twenty one percent (top row) of respondents supported increased taxation with 9% choosing to increase both taxation and spending. Twenty five percent of respondents (red boxes) chose combinations that failed to move toward fiscal sustainability, with 17% choosing the status quo for spending and taxation. Only 4% of respondents (green box) chose increased taxation and reduced spending. Males, Republicans and older alumni were considerably more likely to prefer reductions in both taxation and spending, compared to females, Democrats and younger cohorts.

While the size of government is a polarizing issue, it is important to acknowledge that any solution that relies *exclusively* on tax increases or spending reductions to address fiscal sustainability is impractical given the gaps that need to be closed. Moreover, calls for tax cuts

FIGURE 6: TAX RECEIPTS AND SPENDING (ALUMNI)



Percentages in boxes may not sum to total because of rounding.

and spending increases also move us further away from sustainability. Yet, 70% of respondents (yellow boxes) called for such a one-sided course of action. Decades of inaction without a crisis may well have allowed many respondents to adopt policy preferences that are divorced from reality.

Conclusion

Given the disconnect between the U.S. tax system, global realities, and competitiveness, the costs of policymaker inaction are rising with every year. Fortunately, several feasible ideas surfaced in our survey: significant business tax reform, a carbon tax, tax simplification, and a higher rate on very high earners through a new bracket. These generate broader support among our alumni than the relative inaction in Washington, D.C., would suggest. These ideas and reforms appear clear and await sufficient political conviction to move them forward.

Given the crucial importance of tax reform to restore U.S. competitiveness, what should the new administration focus on during its first year? There is sufficient consensus on the damage done by the U.S. corporate tax that it is the natural place to begin. The outlines of a meaningful reform would include (1) a rate reduction of at least ten percentage points, (2) a switch to a territorial regime without the complexity of a minimum tax on foreign income, and (3) raising revenue by limiting the use of pass-through entities for business income and shifting to reported financial income, rather than income reported to tax authorities, as the measure of taxable income. A shift to an integrated corporate tax where dividends are deductible and taxed at ordinary income rates at the individual level should also be considered. Carbon taxes, a new upper income tax bracket, and a limitation on personal income exclusions and deductions are all ideas that could raise revenue or fund significant rate reductions needed for competitiveness. Finally, if tax reforms aren't coupled with commitments to contain spending or restructure entitlements, they will likely not succeed. Coupling efforts to raise revenue with efforts to contain spending is critical if we are to restore credibility to our budget process.

What can other political and business leaders do to advance this agenda? First, speak realistically about fiscal realities and avoid polarizing talking points. As indicated by these survey results, feasible, relatively popular proposals are available. For example, Senators Orrin Hatch and Ron Wyden have been particularly effective in using their leadership of the Senate Finance Committee to create a bipartisan and exhaustive set of reform alternatives that are ready for deeper consideration.

Second, avoid protectionist impulses that frame business tax reform as "providing incentives to ship jobs overseas" or as sops to the rich. Other countries have come to understand that the global activities of their multinational firms advance, rather than retard, national interests given how these activities benefit the domestic economy. And, no matter what goal you advocate, including redistribution, corporate taxation is not the best or even an effective way to achieve it.

Third, embrace simplicity as the opportunities for reform are few and far between given today's political system. Complexity, as embodied by recent Treasury regulations on inversions or a proposal for minimum tax on foreign income, typically serves the interests of tax planners and is seldom associated with the desired outcome.

Finally, prepare to make sacrifices. We all will have to.

CHAPTER 7

A FAILING POLITICAL SYSTEM

Chapter 3 identified the U.S. political system as one of America's greatest competitive weaknesses, deteriorating faster than any other area. Chapter 4 described the lack of significant progress on the Eight-Point Plan consisting of the most important federal policy priorities for restoring growth and competitiveness. Yet in spite of strong, bipartisan support for almost all of these steps among business leaders and the general public, Washington has made no real headway.

The U.S. political system was once the envy of many nations, and helped put in place many of America's greatest strengths. Over the last two decades, however, politics has increasingly become a liability. Today, we believe that our political system is now the major obstacle to progress on the economy, especially at the federal level.

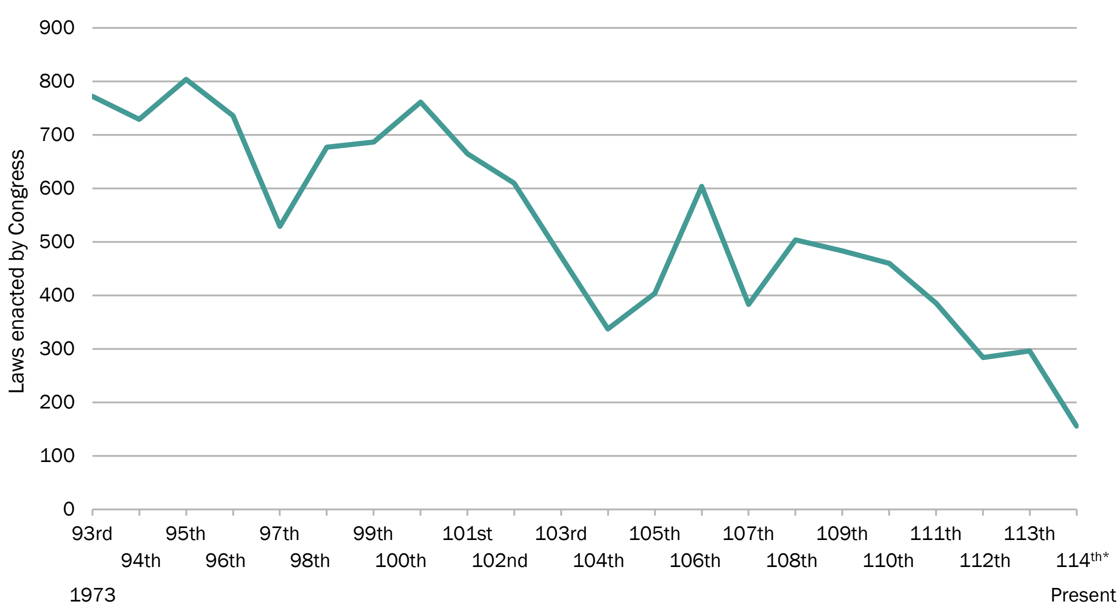
In this chapter, we examine the evolving performance of the U.S. political system, and its level of support by the public. The system is clearly not delivering good results for the average American, and many citizens have lost confidence in the nation's governance.

Next, we present the results of our first survey of HBS alumni and the general public on the role of the political system in economic growth and competitiveness. Is politics helping or hurting? We investigate the similarities and differences between the views of business leaders and those of the public on the system, and how they differ by political affiliation.

Of those who voiced an opinion, 65% of business leaders and 50% of the general public believe that the political system is *obstructing* U.S. economic growth and competitiveness. We also polled alumni and the general public on a number of common proposals for political reform. Finally, we asked alumni to identify specific steps they believe would repair the system, and provide an analysis of the almost 2,500 suggestions they put forward.

What is clear from our work is that the underlying causes of gridlock and poor performance in our political system are complex and multifaceted. Business leaders and citizens want change, but are unsure of what to do. As gridlock in the political system has become apparent, there is also a growing body of research and commentary on the subject. In this chapter, we offer a new fact base and introduce the beginnings of a framework for thinking about political system dysfunction. A detailed framework for diagnosing its problems, and identifying workable solutions, will be the subject of ongoing research.

FIGURE 1: FEWER LAWS ENACTED BY CONGRESS



*114th Congress is still in session.

Source: GovTrack.us, https://www.govtrack.us/congress/bills/statistics.

Eroding Performance and Rising Dissatisfaction

Numerous indicators point to a U.S. political system that is failing to deliver solutions to the nation's problems and is losing the confidence of citizens. Legislation enacted by Congress has declined markedly over the decades, with the number of laws unacted by the 112th and 113th Congresses at historic lows (See Figure 1 on page 49). Many bills are passed purely for political benefit and are never signed into law.

With federal lawmakers failing to deliver solutions, it is no surprise that Americans no longer trust their political leaders. Trust in the federal government has declined steadily over the Bush and Obama eras, and hit an all-time low in 2015.[40] In 1958, three out of four Americans trusted their government. Today less than one in five trust their government to do the right thing.[41] (Figure 2.)

In addition to losing trust in their leaders, Americans increasingly do not trust each other. Based on 10 survey questions measuring the political values of Republicans and Democrats, differences in political ideology have widened markedly over the last 20 years.[42] (Figure 3.)

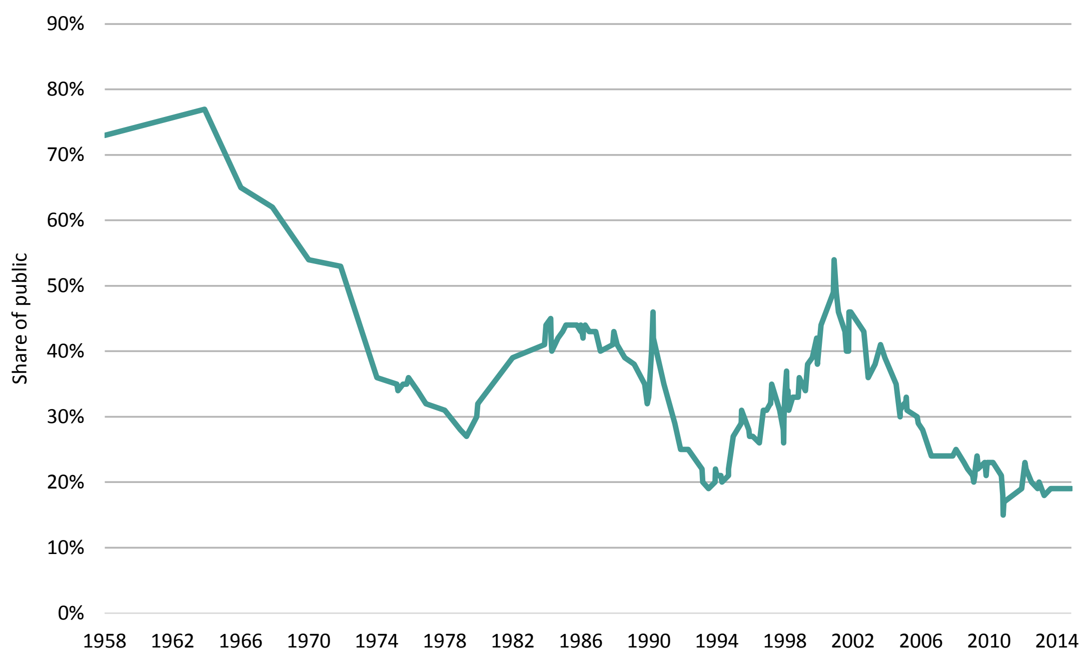
Research by the Pew Center has also revealed that political polarization has increased much faster than differences among Americans on other basic areas such as education, race, and gender.[43]

The 2016 Presidential election is leading more Americans to hold extreme views of the opposing party. For the first time since Pew began collecting such data in 1992, a majority of Americans in each party viewed members of the other party "very unfavorably." Increasingly, American party members use words like "afraid," "angry," and "frustrated" to describe each other.[44] The percent of Republicans who say the Democratic Party makes them feel afraid (49%), angry (46%), and frustrated (57%) is similar to the percent of Democrats who say the Republican Party makes them feel afraid (55%), angry (47%), and frustrated (58%).[45]

Instead of building bridges and respect for other citizens' viewpoints, the Presidential candidates have too often appealed to Americans' worst fears. A good example is trade. In May 2015, a Pew Center poll showed that the majority of Republican voters looked upon free trade agreements positively.[46] By March 2016, divisive campaign rhetoric on the evils of trade had left 53% of registered Republican voters believing free trade was bad for America.[47]

FIGURE 2: WANING TRUST IN WASHINGTON

Percent of the U.S. public who trust the federal government always or most of the time, 1958–2015

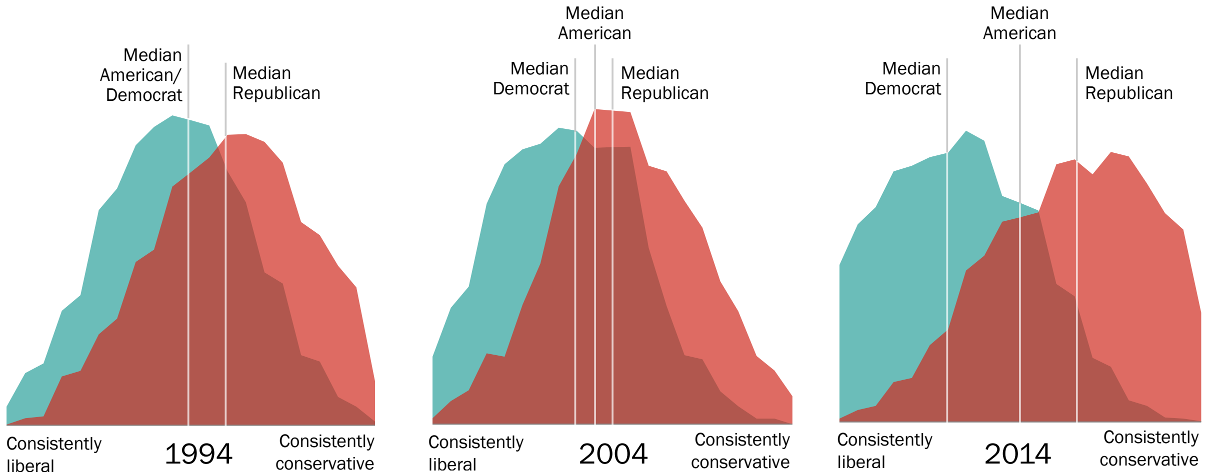


Note: Data are a moving average of individual polls.

Source: "Public Trust in Government: 1958-2015," Pew Research Center, November 23, 2015, http://www.people-press.org/2015/11/23/public-trust-in-government-1958-2015/.

FIGURE 3: GROWING IDEOLOGICAL DIVIDE ON POLITICAL VALUES

Distribution of Democrats and Republicans based on 10 political value questions



Note: Ideology is measured on a scale based on responses to 10 political values questions. The blue area indicates the ideological distribution of Democrats; the red area is that of Republicans. Republicans include Republican-leaning Independents and Democrats include Democratic-leaning Independents.

Source: "Political Polarization in the American Public," Pew Research Center, June 12, 2014, http://www.people-press.org/2014/06/12/political-polarization-in-the-american-public/.

Political rhetoric has also increased anti-business sentiment. A large majority of registered Democrat voters, whether they were Sanders supporters (82%) or Clinton supporters (69%), believe that corporations make too much profit.[48] Republicans who support Trump are less prone than the average Republican to think corporate profits are fair. Given such political attacks on businesses, the ability to build consensus on sensible policies to address key economic weaknesses in America is set back.

Given rising dissatisfaction with the major parties, Gallup's party affiliation poll finds that Americans who identify themselves as Independents have now grown to account for the largest percentage of Americans (42%), versus Democrats (28%) or Republicans (28%) (See Figure 4 on page 52.)[49] The rise in Independents is a reflection of declining confidence in the parties, whose favorability ratings have declined steadily over time. For the first time since Gallup began to collect the data in 1992, favorability dipped below 40% for both parties in March 2015.[50]

The Political System's Role in U.S. Economic Progress

In order to examine more deeply the role of politics in the crucial area of economic prosperity, we surveyed HBS graduates and members of the general public directly on the role of the political system in U.S. competitiveness.

We also gathered data on the political affiliation of HBS alumni respondents and members of the general public surveyed to see how views of the political system differed by political affiliation.

The View from the Business Community

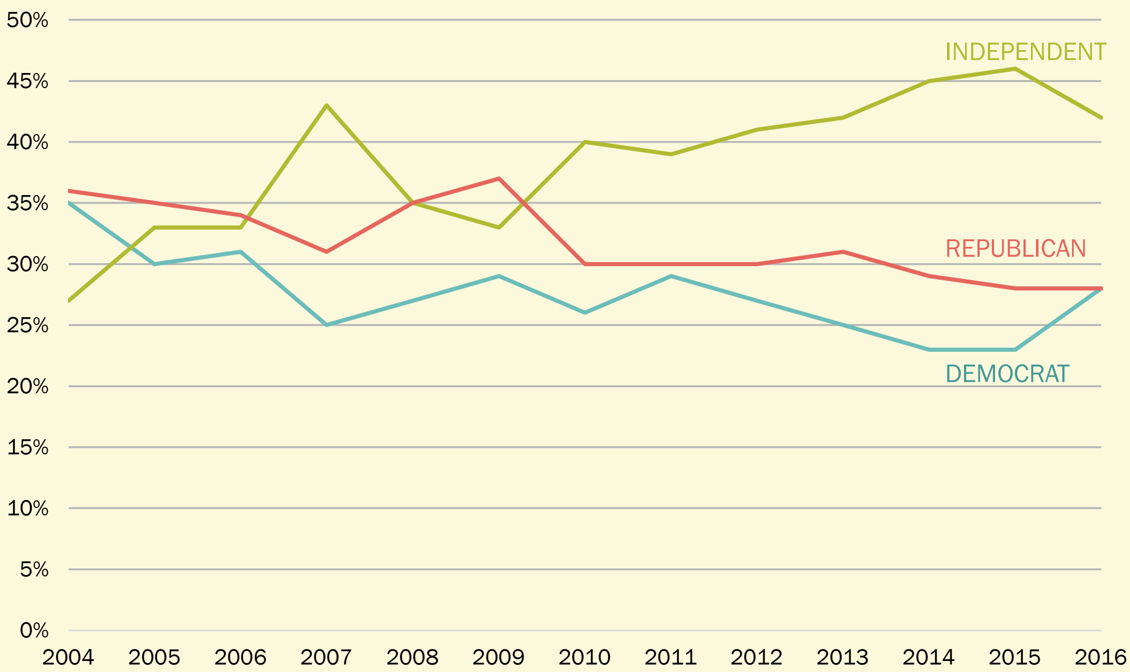
Among the U.S.-based HBS alumni responding, 38% identified themselves as Independents, 32% as Republicans, and 21% as Democrats, with the remaining 9% identifying themselves as "something else" or preferring not to answer. HBS alumni are diverse politically and reflect the shift towards Independents in the overall population.

A large majority of alumni, of every political affiliation, believed that our political system obstructs the nation's economic growth and competitiveness (See Figure 5 on page 52.) The majority of MBA students also agreed and were even more negative on the system than alumni. These findings on alumni views about the role of politics in competitiveness are consistent with our findings in Chapter 3, where the political system was identified as one of America's greatest weaknesses.

The View from the General Public

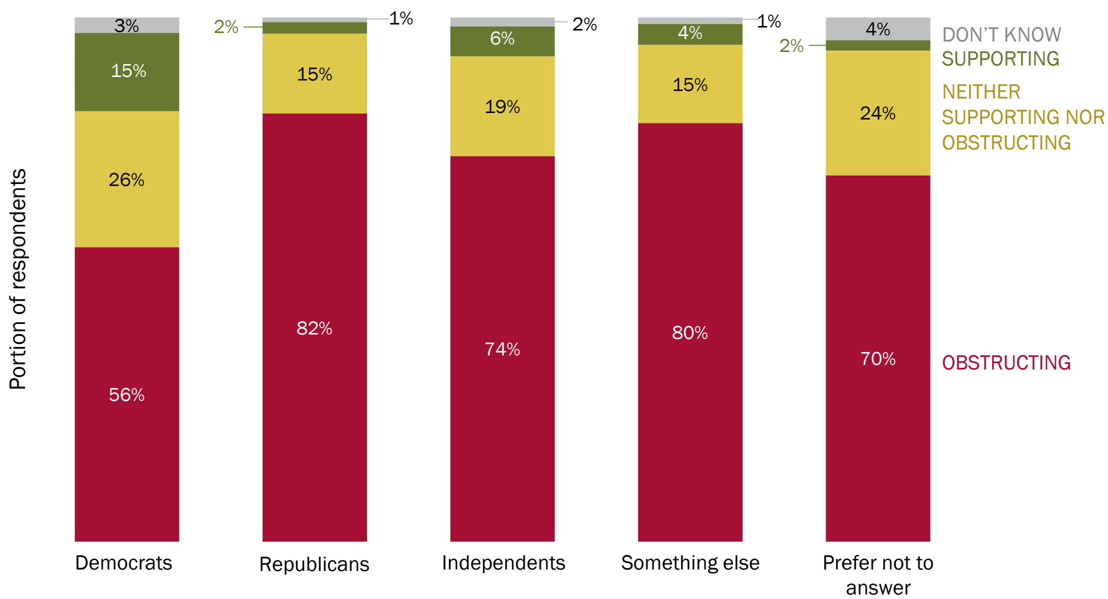
In our sample of the general public, 40.1% identified as Independents, 33.5% as Democrats, and 26.4% as Republicans.[51] In the general public sample, a smaller percentage than HBS alumni were negative on the role

FIGURE 4: SHIFTING POLITICAL AFFILIATION OF AMERICANS, 2004–2016



Source: Gallup.

FIGURE 5: ROLE OF THE POLITICAL SYSTEM IN OBSTRUCTING COMPETITIVENESS, BY POLITICAL AFFILIATION (U.S. ALUMNI)



Percentages in this and subsequent figures may not sum to 100% due to rounding.

of the political system in economic growth. However, a large percentage of the general public responded that they *did not know* whether politics was obstructing, supporting, or neutral to economic growth, especially among Independents (Figure 6). This finding may reflect greater party loyalty among the general public, but also confusion about how the political system affects the economy.

Among HBS alumni, respondents who self-identified as Republicans or Democrats tended to view their own party's role in the economy more favorably, with a large majority blaming the other party for obstructing competitiveness. Within each party, however, there was a group (somewhat greater for Republicans) that believed that their own party was obstructing growth and competitiveness as well. Among Independents, a clear majority saw both parties as obstructing growth, with a somewhat higher percentage blaming Democrats. (See Figure 7 on page 54.)

As with alumni, members of the general public were much more positive about their own party and more negative about the other party. Again, however, a meaningful proportion of members of each party believed their own party was obstructing U.S. economic growth and competitiveness. Perhaps reflecting lack of confidence in their own knowledge about the role of politics in competition, a substantial percentage of general public respondents (about 25%) responded "don't know" when asked if their own party was obstructing or supporting prosperity. (See Figure 8 on page 54.)

Overall, these findings are consistent with those in Chapter 5 that the federal government has made little or no progress on our most important economic policy priorities. The business community has clearly noticed and the general public echoes their concerns but with less certainty.

Need for Reform

What is causing this major erosion in public and business leader confidence in politics? At its core is the absence of solutions. The system is not delivering practical solutions to the problems our nation faces. Instead, there is gridlock and no progress in so many areas. So much of what happens in our government seems more focused on the parties and scoring political points, rather than taking steps that will benefit the average citizen. Yet, while results for the citizens are next to nonexistent, the parties themselves and other actors involved in the political system are thriving in terms of funding, media coverage, and attention.

This disconnect between political system success and citizen satisfaction points to a failure in how the political system is designed and operates. In order to explore those elements of the structure of politics that could be leading to the poor outcomes, we first identified six commonly proposed political reforms (see the box on page 55) and asked HBS alumni and the general public to register their support or lack of support for each of these proposals.

FIGURE 6: ROLE OF THE POLITICAL SYSTEM IN OBSTRUCTING COMPETITIVENESS, BY POLITICAL AFFILIATION (PUBLIC)

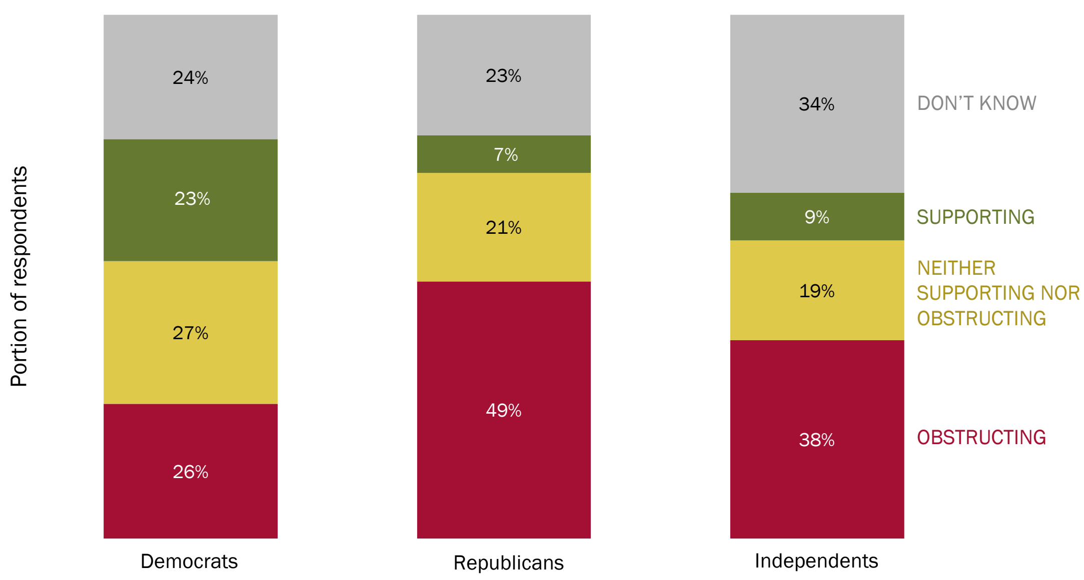


FIGURE 7: ROLE OF POLITICAL PARTY IN OBSTRUCTING COMPETITIVENESS, BY POLITICAL AFFILIATION (U.S. ALUMNI)

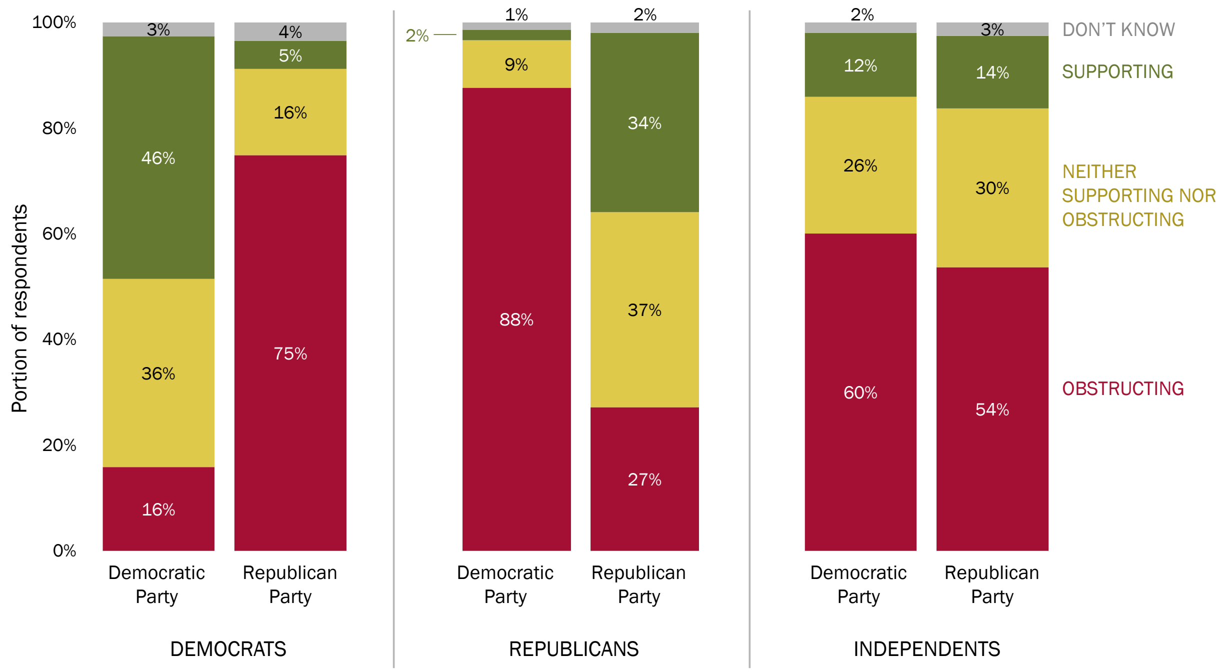
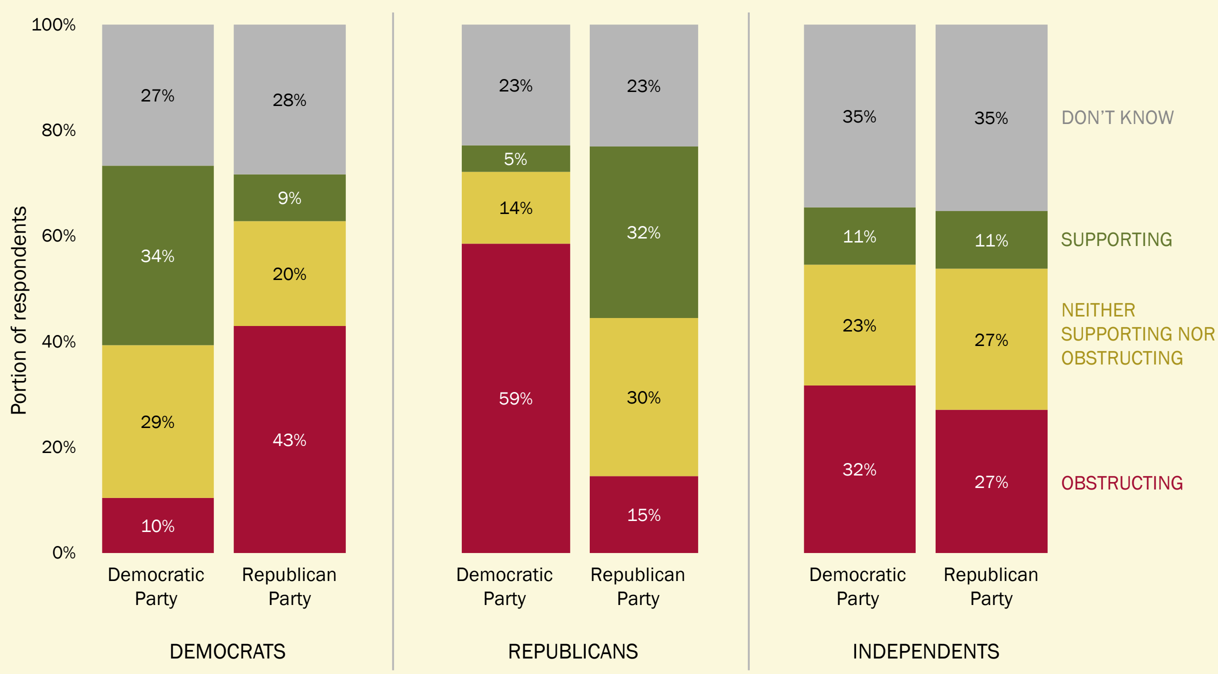


FIGURE 8: ROLE OF POLITICAL PARTY IN OBSTRUCTING COMPETITIVENESS, BY POLITICAL AFFILIATION (PUBLIC)



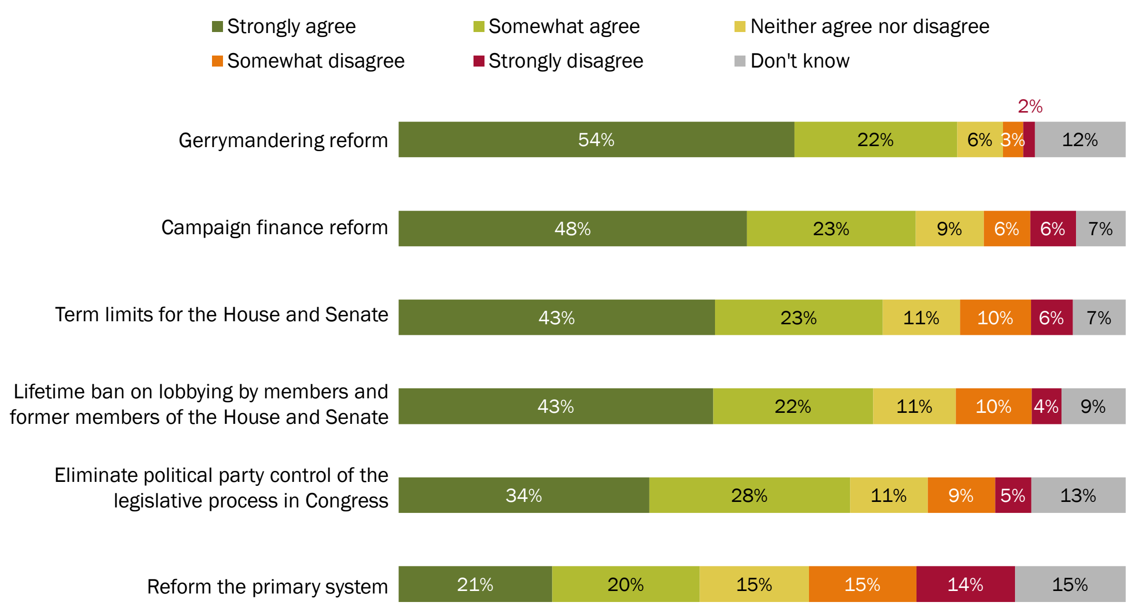
COMMON PROPOSALS FOR POLITICAL REFORM	
Campaign finance reform including stricter limits on, or taxation of, campaign contributions	Eliminate political party control of the legislative process in Congress, such as withholding committee votes, not reporting legislation to the full House or Senate, and controlling what bills are voted upon by these bodies
Gerrymandering reform: Eliminate distorted congressional districts that create “safe” seats for the parties by moving to nonpartisan redistributing commissions	Lifetime ban on lobbying by members and former members of the House and Senate
Reform of the primary system, by replacing separate party primaries with one open primary in which the top two vote getters (regardless of party) advance to the general election ballot	Term limits for the House and Senate

A significant majority of alumni supported (strongly agreed or somewhat agreed) five of the six proposals (Figure 9). Gerrymandering reform and campaign finance reform had overwhelming majority support. Term limits, a lifetime lobbying ban, and eliminating party control of the legislative process registered strong majorities. Reforming the primary system had net positive support but the lowest absolute level of support (41%) as well as the highest percent of “don't knows.” Among the six recommendations, we believe respondents were the least familiar with how a non-partisan primary system would work to reduce polarization among candidates elected.

Clearly, the great majority of alumni believe that serious reforms are needed. The majority of young business leaders (HBS MBA students) registered similar levels of support for all six proposals.[52] MBA students showed equally strong support as alumni for campaign finance reform and term limits, but somewhat lower majorities than alumni on others steps. MBA students were more receptive than alumni to primary-system reform, though this proposal had the highest percentage of “don't know” responses.

Overall, however, the percent of alumni and MBA respondents who answered “don't know” on steps for political reform was significantly higher than similar responses on economic policy priorities (Chapter 5). For example, 15% of HBS alumni said they did not know whether reforming the primary system would make the U.S. political system more effective, while 20% of HBS students said they didn't know whether political party control of the legislative process should be eliminated in Congress. Clearly, HBS respondents are uncertain about what is causing

FIGURE 9: SUPPORT FOR PROPOSALS TO REFORM POLITICS (ALUMNI)



the problems in the political system and less confident in evaluating solutions.

Among the general public, a very high percentage of "don't know" responses revealed an even greater lack of understanding than alumni of how the political system works (Figure 10). For all six options, "don't know" responses ranged between 18% and 28% of all general public responses. On an issue like reforming the primary system, more respondents (25%) chose "don't know" than any other reply. Even for gerrymandering reform, a practice that clearly distorts the voting process, a high percentage of respondents (28%) responded "don't know" when polled about whether to change it.

Well-informed, highly engaged voters are needed for strengthening our democracy and ensuring that our government works for the average American. Our survey reveals that among both business leaders and the general public, much more education is needed so that the political system is less of a black box, and so that citizens will understand the steps that will produce real reform.

Business Leaders' Proposals for Political Reform

In addition to the six proposals we identified, we asked HBS alumni to share their own, open-ended views of steps necessary to make our political system more effective. Almost half the alumni who completed the survey wrote in their suggestions. The high response rate was remarkable, and reflects the keen interest in this topic today.

Alumni suggestions were diverse, but some areas stood out (Figure 11). By far the most common category of suggestion was changing the election process, including steps such as modifying the primary system and shortening elections. A second related but separate area of reform was campaign finance reform, including reversing Citizens United and limiting campaign contributions from corporations and unions. The third major reform category was changes to Congressional rules and norms, with the most common suggestion being to reduce special privileges of members of Congress. A fourth category was government and constitutional reforms, with many respondents advocating Congressional or Presidential term limits. A fifth category was modifying the two-party system, with the largest support for encouraging new political parties and steps to foster more compromise and bipartisanship.

We also polled the general public on their suggestions. The suggested areas were remarkably similar (Figure 11).

FIGURE 10: PROPOSALS TO REFORM POLITICS (PUBLIC)

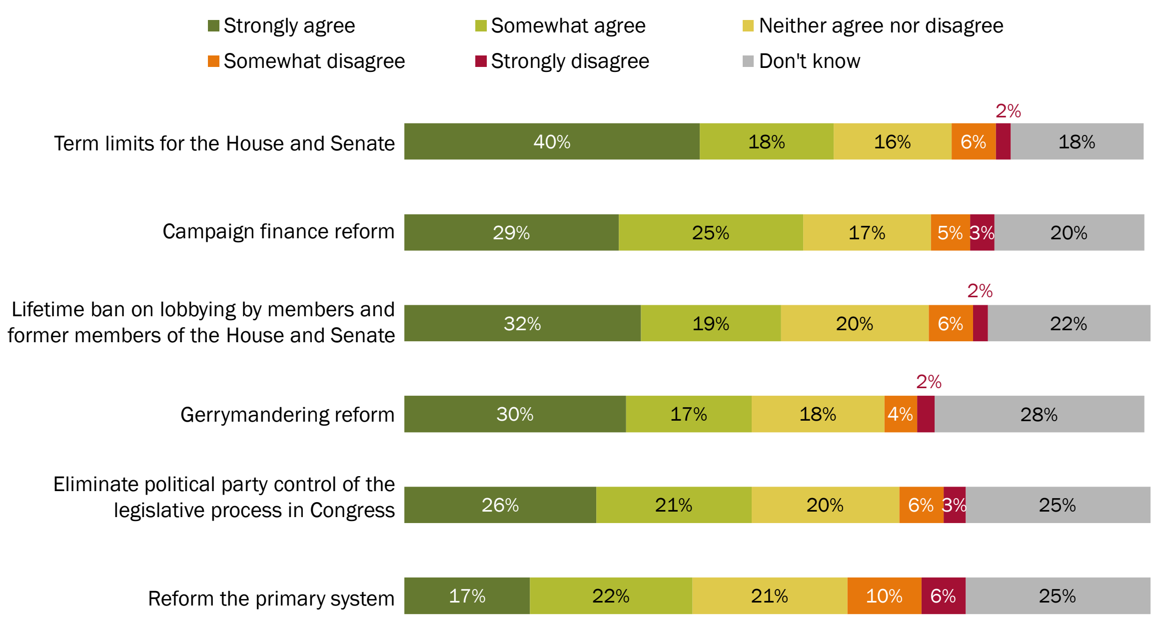


FIGURE 11: PROPOSALS FOR POLITICAL REFORM (ALUMNI AND PUBLIC)

AREA	PROPOSAL	NUMBER OF ALUMNI COMMENTS	PERCENT OF TOTAL (ALUMNI)	NUMBER OF PUBLIC COMMENTS	PERCENT OF TOTAL (PUBLIC)
Elections Process		458	18%	70	20%
	Shorten the Presidential election process	104			
	Reform the primary system	95			
	Eliminate the Electoral College	65			
	Direct elections / popular vote	57			
	Increase voter access	55			
	Restrict voter access (e.g. literacy test)	30			
	Reform districting process / eliminate gerrymandering	28			
	Eliminate superdelegates	15			
	Reform voter access laws (not specified)	9			
Campaign Finance Reform		368	15%	28	8%
	Reverse Citizens United and limit campaign contributions from corporations, unions	99			
	Limit campaign spending and contributions	75			
	Eliminate PACs or forbid corporate donations to PACs	64			
	Public funding of elections	36			
	Campaign finance reform (not specified)	34			
	Make campaign donations public	33			
	Reduce time candidates spend fundraising	27			
Congressional Rules and Norms		325	13%	54	16%
	Reduce protections, privileges, and benefits for lawmakers	125			
	Reform lobbying laws and / or reduce power of lobbies	67			
	Improve efficiency or output of Congressional legislative process	40			
	Reform filibuster rules	37			
	Greater transparency of legislation records and / or process	21			
	Eliminate or curtail riders on bills	20			
	Encourage Congress to spend more time legislating	15			
Government and Constitutional Reforms		309	12%	39	11%
	Congressional and / or Presidential term limits	109			
	Increase terms of the President and / or Congress	43			
	Reduce the power of the executive branch	42			
	Decentralize federal power in favor of states	24			
	Eliminate appointment of public officials for life (e.g. Supreme Court)	21			
	Proportional representation in Congress based on vote shares	16			
	Enforce separation of powers	15			
	Reform political appointments	14			
	Line-item veto	14			
	Limit Constitutional rights to individuals, not corporations or unions	11			
Party System		281	11%	49	14%
	Encourage the formation of new political parties	108			
	Foster more compromise and bipartisanship between the parties / reduce polarization	101			
	Reform the two parties / two party system	57			
	Change structure of government (e.g., move to Parliamentary system)	15			
Media		50	2%	5	1%
	Reform media practices	50			
Judiciary and Legal System		41	2%	4	1%
	Reform the legal system	25			
	Reform the Supreme Court	16			
Other		648	26%	94	27%
	Reduce government spending and enforce balanced budget	69			
	Encourage civility and civic duties	54			
	Regulatory reform	27			
	Incentivize quality candidates	18			
	Reform union practices	16			
	Control 'revolving door' lobbying by former government officials	13			
	System is fine	9			
	Mandatory national service	2			
	Miscellaneous	440			
Grand Total		**2,480**	**100%**	**343**	**100%**

Conclusion

Taken together, these findings strengthen our conviction that dysfunction in America's political system is now the most important single problem facing America. Citizens are keenly aware that our political system is broken. Citizens are abandoning the two historically dominant parties, and many remaining members have doubts about whether their parties are helping or hurting. The 2016 Presidential election has only brought this issue even more to the forefront.

The political system is not only a crucial priority for citizens, but has also become the greatest priority for business. Many in business have been wary of politics, or made our political dysfunction worse through self-interested efforts to influence government. When business becomes a special interest, it undermines competitiveness and the environment for all business, not to mention public support for business. Corporate leaders must rethink how they engage with government, and play a positive role in restoring shared prosperity.

The impact of politics on our economy and our society can no longer be ignored. Changing the trajectory of the political system has become a major national priority in this phase of our democracy, if not the major priority. The system will not fix itself. Nor is hoping for better candidates a solution. Whatever candidates we elect will be trapped in a system that stands in the way of constructive progress.

The reasons why the political system is failing to deliver good results, and what to do about it, are far from clear. We lack a framework for understanding the causes of the poor outcomes and lack of solutions the system is delivering, and which reforms will change this. Such a framework, and its implications for reforms that can work, will be described in a paper to be published after the 2016 presidential election.[53] We have drawn on this paper in preparing this chapter.

APPENDIX: METHODOLOGY AND RESPONDENT PROFILES

In 2016, the Harvard Business School survey on U.S. competitiveness was administered to individuals in three populations: HBS alumni, HBS MBA students, and the general public. The survey was designed and conducted by HBS faculty and researchers in conjunction with Abt SRBI, a leading survey research firm. Abt SRBI programmed and hosted the HBS alumni and the HBS MBA student survey, while GfK Custom Research North America programmed and hosted the general public survey. A copy of the HBS alumni survey instrument and a full report on methodology are available at http://www.hbs.edu/competitiveness/survey.

HBS alumni survey: In 2016, all eligible HBS alumni worldwide with email addresses were invited to participate in the survey. These included all former students of the MBA and doctoral degree programs as well as participants who completed comprehensive executive education programs that confer alumni status, such as the Advanced Management Program. This year's survey was wholly administered on the web and no paper copies were used. The invitation email was sent to 61,874 alumni. A total of 7,782 alumni emails were suppressed by HBS's Silverpop email distribution software because they had previously been undeliverable or because the alumni had previously opted out of receiving HBS email, and these have been listed as "no invitation sent."

A total of 4,807 alumni responded indicating a response rate of 7.8%.* In 2015, the response rate was 9%. The two rates are quite comparable for two reasons. First, given that more than 7,000 alumni did not receive the invitation, the 4,807 alumni who responded came out of a pool of 54,092 alumni who received the invitation to participate; that is, 8.9% of the alumni who were sent the invitation responded. Second, cognitive testing before the launch of the survey showed that the 2016 survey was one of the longest survey instruments in the series of alumni surveys on U.S. competitiveness since 2011. The median time to complete the survey was 23 minutes in 2016, compared to 19 minutes for the 2015 survey and just 13 minutes in 2013-14. We are very grateful to alumni who took time out of their busy schedules to respond.

HBS alumni were invited to participate in the survey from May 3, 2016, to June 6, 2016.

HBS student survey: For the first time, HBS faculty members chose also to survey current HBS students on their views on the state and trajectory of U.S. competitiveness. These young leaders represent the future and in turn, their future rests on a stronger U.S. economy. HBS invited all 1,872 students registered in the MBA program to participate in the survey. These included 921 students in the class of 2016 and 951 in 2017 and later classes. Even though the students in the class of 2016 graduated at the end of May 2016, they were not yet in the HBS alumni database, and there was no overlap between the HBS alumni and HBS student samples. Students registered a 19.3% response rate.

The HBS student survey was open from June 1, 2016 to June 27, 2016.

General public survey: HBS's general public survey on U.S. competitiveness was administered by GfK to adult (age 18 and over) residents of the United States. GfK recruits eligible adults in two stages. First, GfK uses an Address Based Sampling (ABS) methodology to select households for the sample; this ensures that the sample covers households without telephone access or with cell phones only. All eligible adults from these households are then invited to join the GfK panel. In the second stage GfK creates a sample for specific surveys. In the case of the U.S. competitiveness survey, a nationally representative sample of U.S. adults was selected using benchmarks from the Current Population Survey. A target of a minimum of 1,000 responses was set for the general population, and the final tally of responses came from 1,048 members of the general public.

The general public survey launched on June 10, 2016, and closed on June 26, 2016.

Instrument. Every year, HBS faculty members collaborate with survey methodologists to develop and design the U.S. competitiveness survey. In 2016, recognizing that five years have passed since the initial design, HBS faculty members took the opportunity to refresh and refine the survey instrument. This resulted in a number of changes in the survey instrument. In the initial respondent profile section, for example, job titles and company names

*Response rates are the American Association for Public Opinion Research Response Rate 1.

were dropped. A question on citizenship was introduced to identify which alumni should be asked questions on political party affiliation.

As always, the first half of the survey repeated questions that remain the same in every U.S. competitiveness survey. These questions pertain to collecting longitudinal data on the respondents' assessments of the elements of the U.S. business environment as well as understanding respondents' views on the current state and future trajectory of the U.S. economy. This year, respondents were also asked about their approval or disapproval of possible federal policies, their views of the U.S. political system and possible changes to it, and their views on the U.S. taxation system and possible changes to it. The general public was provided an abridged set of questions on the U.S. taxation system, as some of the questions were deemed to require a formal business education.

Respondents based in the U.S. were asked to provide details of their political affiliation. Alumni and MBA students were asked to identify their political affiliation from the following six choices: "A Democrat," "A Republican," "An Independent," "Something else (specify)," "Prefer not to answer," and "Don't know." The political affiliation of the public was determined based on GfK's standard item on political affiliation, which is available for all panelists. That item asked respondents from the public to identify their political affiliation on the following scale: "Strong Republican," "Not Strong Republican," "Leans Republican," "Undecided/Independent/Other," "Leans Democrat," "Not Strong Democrat," and "Strong Democrat." For the purposes of analyzing the public's response data by political affiliation, "Republican" refers to those who identified as strong or not strong Republican, "Democrat" refers to those who identified as strong or not strong Democrat, and "Independents" refer to those who identified as leaning Democrat or Republican or those who said they were undecided/Independent/other.

Weighting. Weighting for alumni took place in two steps: nonresponse weights that adjusted for nonresponse from the selected sample were calculated and post-stratification weights were calculated based on age, gender, alumni type (degree and Executive Education), and location (U.S. and overseas) of all HBS alumni. In the MBA student survey, post-stratification weights adjusted completed responses to the class (2016 or later) of the student. (The demographic information available for students was very limited due to FERPA restrictions.) In the public survey, the completed responses were raked to benchmark distributions of general population adults from the March 2016 Annual Demographic Supplement of the Current Population Survey.

Precision of estimates. The alumni and MBA student surveys were censuses in that all eligible persons were selected to participate. As such, sampling error does not apply because no sample was drawn. For the public survey, sampling error does apply, and the design effect was estimated at 1.17. Given that 1,048 people completed surveys, the effective sample size was n=896. Based on this effective sample size, the 95% confidence intervals for proportion of 50% would be ± 3.3%. Analyses based on a subset of cases will have wider confidence intervals, while percentages above or below 50% will have narrower confidence intervals. The specific confidence intervals for any item may, however, deviate from these estimates.

Respondent Profiles

ALUMNI RESPONDENTS

ALUMNI LOCATION

IN THE UNITED STATES	
California	523
Massachusetts	429
New York	382
Florida	255
Texas	243
Connecticut	160
New Jersey	115
Illinois	110
Virginia	109
Pennsylvania	90
40 other states, plus D.C., territories, and U.S. armed forces overseas	1,049
Subtotal	**3,465**

OUTSIDE THE UNITED STATES	
United Kingdom	124
Canada	97
Japan	94
Switzerland	72
Germany	56
Brazil	52
Mexico	50
Australia	46
France	40
Hong Kong SAR	38
85 other countries and territories	521
Subtotal	**1,190**

UNKNOWN LOCATION	152
TOTAL	**4,807**

ALUMNI AGE

	NUMBER	PERCENT
Under 30	73	1.5%
30-39	497	10.3%
40-49	613	12.8%
50-59	948	19.7%
60-69	1,050	21.8%
70 and older	1,175	24.4%
Unknown	451	9.4%
TOTAL	**4,807**	**100%***

*Percentages do not sum to 100% because of rounding.

ALUMNI SECTOR OF EMPLOYMENT**

	NUMBER	PERCENT
Finance and Insurance	1,060	22.1%
Manufacturing	1,030	21.4%
Computer, Electrical, and Appliance	*217*	*4.5%*
Metal and Machinery	*177*	*3.7%*
Petroleum, Chemicals, and Plastics	*142*	*3.0%*
Food and Beverage	*116*	*2.4%*
Wood, Paper, and Printing	*49*	*1.0%*
Textile and Apparel	*40*	*0.8%*
Other Manufacturing	*289*	*6.0%*
Professional, Scientific, and Technical	792	16.5%
Information: Media, Telecom, and Data Processing	301	6.3%
Educational Services	255	5.3%
Construction and Real Estate	252	5.2%
Health Care and Social Assistance	229	4.8%
Wholesale and Retail Trade	221	4.6%
Other Services	204	4.2%
Transportation and Logistics	113	2.4%
Mining and Oil & Gas Extraction	93	1.9%
Utilities	71	1.5%
Public Administration	58	1.2%
Agriculture, Forestry, and Fishing	44	0.9%
Accommodation and Food Services	39	0.8%
Arts, Entertainment, and Recreation	39	0.8%
Subtotal	**4,801**	**99.9%***
Gave no response	**6**	**0.1%**
TOTAL	**4,807**	**100%****

*Percentages do not sum to 100% because of rounding.

**Includes working and nonworking respondents. Working respondents were asked, "In what sector do you work?" Nonworking respondents were asked, "In what sector did you work?"

MBA STUDENT RESPONDENTS

STUDENT RESIDENCE BEFORE HBS*

IN THE UNITED STATES	
New York	54
Massachusetts	45
California	36
District of Columbia	16
Texas	10
Virginia	10
Illinois	9
Pennsylvania	8
Florida	7
Colorado	5
Minnesota	5
20 other states	38
Subtotal	**243**
OUTSIDE THE UNITED STATES	
United Kingdom	14
Canada	13
Australia	8
Mexico	7
India	6
Japan	6
China	5
Germany	5
France	4
United Arab Emirates	4
31 other countries and territories	46
Subtotal	**118**
TOTAL	**361**

STUDENT CLASS

	NUMBER	PERCENT
2016	159	44.0%
2017 and later	202	56.0%
TOTAL	**361**	**100%**

STUDENT INTENDED SECTOR**

	NUMBER	PERCENT
Financial Services	85	23.5%
Professional Services	84	23.3%
Manufacturing	27	7.5%
Other Manufacturing	*8*	*2.2%*
Computer, Electrical, and Appliance	*6*	*1.7%*
Food and Beverage	*5*	*1.4%*
Metal and Machinery	*5*	*1.4%*
Textile and Apparel	*2*	*0.6%*
Petroleum, Chemicals, and Plastics	*1*	*0.3%*
Health Care and Social Assistance	27	7.5%
Technical Services	21	5.8%
Wholesale and Retail Trade	12	3.3%
Other Services	11	3.0%
Transportation and Logistics	9	2.5%
Real Estate	8	2.2%
Public Administration	8	2.2%
Telecommunications	7	1.9%
Mining and Oil & Gas Extraction	6	1.7%
Arts, Entertainment, and Recreation	5	1.4%
Utilities	4	1.1%
Educational Services	4	1.1%
Scientific Services	2	0.6%
Media: Broadcast, Film, and Multimedia	2	0.6%
Data Processing	1	0.3%
Construction	1	0.3%
Accommodation and Food Services	1	0.3%
Agriculture, Forestry, and Fishing	1	0.3%
Subtotal	**326**	**90.3%**
Don't know	**35**	**9.7%**
TOTAL	**361**	**100%****

*Students were asked for their primary place of residence before joining HBS.

**Students were asked in which sector they plan to work after graduating from HBS.

GENERAL PUBLIC RESPONDENTS

GENERAL PUBLIC LOCATION

IN THE UNITED STATES	
California	117
Texas	73
New York	66
Florida	57
Pennsylvania	55
Ohio	51
North Carolina	45
Illinois	36
Michigan	35
Virginia	35
39 other states and the District of Columbia	478
TOTAL	**1,048**

GENERAL PUBLIC AGE

	NUMBER	PERCENT
Under 30	186	17.7%
30-39	144	13.7%
40-49	155	14.8%
50-59	239	22.8%
60-69	170	16.2%
70 and older	154	14.7%
TOTAL	**1,048**	**100%***

*Percentages do not sum to 100% because of rounding.

ENDNOTES

[1] Bureau of Economic Analysis. Also, Eric Morath, "Seven Years Later, Recovery Remains the Weakest of the Post-World War II Era," *The Wall Street Journal*, July 29, 2016, http://blogs.wsj.com/economics/2016/07/29/seven-years-later-recovery-remains-the-weakest-of-the-post-world-war-ii-era/.

[2] Federal Reserve Bank of St. Louis. Calculations based on data sourced from the FRED economic database on August 24, 2016. For intellectual property: https://fred.stlouisfed.org/series/Y001RL1Q225SBEA; For non-residential equipment: https://fred.stlouisfed.org/series/Y033RL1Q225SBEA; For non-residential structures: https://fred.stlouisfed.org/series/A009RO1Q156NBEA; For total investment as a percent of GDP: https://fred.stlouisfed.org/series/PNFI and https://fred.stlouisfed.org/series/GDP.

[3] Council of Economic Advisers. Chart from "The Long-Term Decline in Prime-Age Male Labor Force Participation," White House Council of Economic Advisers, June 2016.

[4] The hypothetical number of workers required to increase the current labor force participation rate for the prime working-age population ages 16-64 to its peak in 1997 is 10,244,000. This figure was then added to the current population of unemployed persons and the current labor force to estimate the hypothetical unemployment rate. Figures are seasonally unadjusted.

[5] U.S. Census Bureau, Current Population Survey, Annual Social and Economic Supplements; University of Minnesota, Integrated Public Use Microdata Series, Current Population Survey.

[6] For an excellent overview of these trends and the underlying data, see Chad Stone, Danilo Trisi, Arloc Sherman, and Emily Horton, "A Guide to Statistics on Historical Trends in Income Inequality," Center on Budget and Policy Priorities, updated July 29, 2016.

[7] U.S. Census Bureau, Business Dynamics Statistics.

[8] "The two-speed economy," Goldman Sachs Global Market Institute, Exhibit 5, April 2015.

[9] "The new map of economic recovery and growth," Economic Innovation Group, May 2016, http://eig.org/recoverymap#mapReport.

[10] "The two-speed economy," Goldman Sachs Global Market Institute, Exhibits 8 & 9, April 2015.

[11] The most prominent research efforts include Robert J. Gordon, *The Rise and Fall of American Growth: The U.S. Standard of Living since the Civil War*, January 2016; Lawrence H. Summers, "The Age of Secular Stagnation," *Foreign Affairs*, February 2016; and Thomas Piketty, *Capital in the Twenty-First Century*, February 2015.

[12] In past years, corporate tax was considered part of the complexity of the national tax code in the assessment of the U.S. business environment. In 2016, given the significance of corporate tax reform and its impact on U.S. competitiveness (see Chapter 6), corporate tax was added as a new, 19th element to assess the U.S. business environment.

[13] "Education at a Glance 2015," OECD, Indicator A1 To What Level Have Adults Studied, Table A1.2a – Percentage of adults who have attained at least upper secondary education, by age group, 2014.

[14] "Education at a Glance 2015," OECD, Indicator A1 To What Level Have Adults Studied, Table A1.3a – Percentage of adults who have attained tertiary education, by type of programme and age group, 2014.

[15] Business Roundtable, "Road to Growth: The Case for Investing in America's Infrastructure," September 2015, p. 10; Congressional Budget Office, "Public Spending on Transportation and Water Infrastructure: 1956 to 2014."

[16] Rosabeth Moss Kanter, "Transportation Infrastructure" in Michael E. Porter and Jan W. Rivkin, "An Economy Doing Half Its Job: Findings of Harvard Business School's 2013-14 Survey on U.S. Competitiveness," pp. 27-31; Rosabeth Moss Kanter, *Move: Putting America's Infrastructure Back in the Lead*, May 2015.

[17] Our focus on the commons is inspired by the work of Gary Pisano and Willy Shih: "Restoring American Competitiveness," *Harvard Business Review*, July-August 2009 and *Producing Prosperity*: *Why America Needs a Manufacturing Renaissance*, Boston: Harvard Business Review Press, 2012. The following section is based on Jan W. Rivkin, Karen G. Mills, and Michael E. Porter, "The Challenge of Shared Prosperity: Findings of Harvard Business School's 2015 Survey on U.S. Competitiveness," pp. 22-23.

[18] Michael E. Porter and Jan W. Rivkin, "The Looming Challenge to U.S. Competitiveness," *Harvard Business Review*, March 2012.

[19] The World Bank has added shared prosperity as one of its twin goals. The Bank uses the incomes of the bottom 40% of the population in a country as a measure of shared prosperity.

[20] Michael E. Porter and Jan W. Rivkin, "An Economy Doing Half Its Job: Findings of Harvard Business School's 2013-14 Survey on U.S. Competitiveness," September 2014, p. 4. The report is available on the HBS U.S. Competitiveness Project website at http://www.hbs.edu/competitiveness.

[21] Michael E. Porter and Jan W. Rivkin, "The Challenge of Shared Prosperity: Findings of Harvard Business School's 2015 Survey on U.S. Competitiveness," September 2015. The report is available on the HBS U.S. Competitiveness Project website at http://www.hbs.edu/competitiveness.

[22] Michael E. Porter and Jan W. Rivkin, "What Business Should Do to Restore U.S. Competitiveness," *Fortune*, October 29, 2012.

[23] Zeynep Ton, "Why 'Good Jobs' Are Good for Retailers," *Harvard Business Review*, January-February 2012; Zeynep Ton, *The Good Jobs Strategy: How the Smartest Companies Invest in Employees to Lower Costs and Boost Profits*, New York: Houghton Mifflin Harcourt, 2014.

[24] Mike Panigel, "Siemens: An ApprenticeshipUSA LEADER in STEM Fields," U.S. Department of Labor Blog, May 19, 2015, https://blog.dol.gov/2015/05/19/siemens-an-apprenticeshipusa-leader-in-stem-fields/, accessed September 2015; Mercedes Partnership, Shelton State Community College, http://www.sheltonstate.edu/future_students/mercedes_partnership.aspx, accessed September 2015.

[25] Jamie Dimon, "Jamie Dimon: Why We're Giving Our Employees a Raise," *The New York Times*, July 12, 2016.

[26] Charlene Sarmiento, "Goodwill® Creates New Retail Industry Credentialing Initiative with Funding from the Walmart Foundation," Goodwill Industries International, Inc., February 26, 2015, http://www.goodwill.org/press-releases/goodwill-creates-new-retail-industry-credentialing-initiative-with-funding-from-the-walmart-foundation/.

[27] For more on how business can work effectively with partners in other sectors to build workforce skills, see "Bridge the Gap: Rebuilding America's Middle Skills," Accenture, Burning Glass, Harvard Business School.

[28] Jan W. Rivkin and Ryan Lee, "Southwire and 12 For Life: Scaling Up (A)," *Harvard Business Publishing*, October 21, 2013, case number 714-434.

[29] For more on how business leaders can partner well with educators to support students and improve schools, see Sara Allan, Allen Grossman, Jan W. Rivkin, and Nithya Vaduganathan, "Lasting Impact: A Business Leader's Playbook For Supporting America's Schools," Bill and Melinda Gates Foundation, The Boston Consulting Group, and Harvard Business School.

[30] Gary Pisano and Willy Shih, "Restoring American Competitiveness," *Harvard Business Review*, July-August 2009. Gary Pisano and Willy Shih, *Producing Prosperity: Why America Needs a Manufacturing Renaissance*, Boston: Harvard Business Review Press, 2012.

[31] Rosebeth Moss Kanter, "Enriching the Ecosystem: Forging the Missing Links Between Innovation, Enterprises, and Jobs," *Harvard Business Review*, March 2012.

[32] Jan W. Rivkin, "The Columbus Partnership," *Harvard Business Publishing*, May 1, 2015, case number 715-462; William W. George, "Greater Minneapolis-St. Paul: Building on a Diversified Base (Abridged)," *Harvard Business Publishing*, November 17, 2011, case number 412-074.

[33] Michael E. Porter, Jan W. Rivkin, and Rosabeth Moss Kanter, "Competitiveness at a Crossroads: Findings of Harvard Business School's Survey on U.S. Competitiveness," February 2013.

[34] For a fuller discussion of each element of the plan, see Michael E. Porter and Jan W. Rivkin, "What Washington Must Do Now: An Eight-Point Plan to Restore American Competitiveness," in The World in 2013, *The Economist,* November 21, 2012.

[35] Michael E. Porter, David S. Gee, and Gregory J. Pope, America's Unconventional Energy Opportunity: A win-win plan for the economy, the environment, and a lower-carbon, cleaner-energy future," Harvard Business School and The Boston Consulting Group, June 2015.

[36] Congressional Budget Office, Long –Term Budget Projects, July 2016.https://www.cbo.gov/sites/default/files/51119-2016-07-LTBO-4.xlsx.

[37] Michael E. Porter, David S. Gee, and Gregory J. Pope, "America's Unconventional Energy Opportunity: A win-win plan for the economy, the environment, and a lower-carbon, cleaner-energy future," Harvard Business School and The Boston Consulting Group, June 2015.

[38] Mihir A. Desai, "A Better Way to Tax Business," *Harvard Business Review*, July-August 2012.

[39] Respondents were asked to evaluate these policies on a scale of one to five with one being "Not at all problematic" and five being "Very problematic." In this discussion, responses of 4 or 5 are termed as "problematic."

[40] Pew Research Center: Public Trust in Government 1958-2015.

[41] Pew Research Center: Public Trust in Government 1958-2015. Chart accessed from: http://www.people-press.org/2015/11/23/public-trust-in-government-1958-2015/.

[42] Pew Research Center, June 2014, "Political Polarization in the American Public," http://www.people-press.org/2014/06/12/political-polarization-in-the-american-public/.

[43] Pew Research Center, June 4, 2012, "Partisan Polarization Surges in Bush, Obama Years: Trends in American Values: 1987-2012," http://www.people-press.org/2012/06/04/partisan-polarization-surges-in-bush-obama-years/.

[44] Pew Research Center, June 2016, "Partisanship and Political Animosity in 2016," http://www.people-press.org/2016/06/22partisanship-and-political-animosity-in-2016/.

[45] Pew Research Center, "Frustration, Fear and Anger Among Partisans," http://www.people-press.org/2016/06/22/partisanship-and-political-animosity-in-2016/.

[46] Pew Research Center, March 31, 2016, "Campaign Exposes Fissures Over Issues, Values and How Life Has Changed in the U.S.," http://www.people-press.org/2016/03/31/3-views-on-economy-government-services-trade/.

[47] Pew Research Center, March 31, 2016, "Campaign Exposes Fissures Over Issues, Values and How Life Has Changed in the U.S.," http://www.people-press.org/2016/03/31/3-views-on-economy-government-services-trade/.

[48] Pew Research Center, March 31, 2016, "Campaign Exposes Fissures Over Issues, Values and How Life Has Changed in the U.S.," http://www.people-press.org/2016/03/31/3-views-on-economy-government-services-trade/.

[49] Gallup Poll Party Affiliation, July 13-17, 2016, http://www.gallup.com/poll/15370/party-affiliation.aspx.

[50] Lydia Saad, Gallup, March 16, 2015, "Neither Major Party Cracks 40% Favorability in Latest Poll," http://www.gallup.com/poll/181985/neither-major-party-cracks-favorability-latest-poll.aspx.

[51] Among general public respondents, Democrats include people who identified themselves as "strong" and "not strong" Democrats; Republicans include "strong" and "not strong" Republicans; and Independents include those who identified as "leaning" Democrat or Republican, as well as people who said they were Independent, undecided, or of another political affiliation. Given the different survey methodology, this approach aimed to make the political affiliation data the most comparable.

[52] HBS MBA Students Survey on U.S. Competitiveness, 2016.

[53] Katherine M. Gehl and Michael E. Porter, "Why Competition in the Politics Industry is Failing America," (forthcoming).

Michael E. Porter is the Bishop William Lawrence University Professor, based at Harvard Business School. **Jan W. Rivkin** is the Bruce V. Rauner Professor at Harvard Business School and the Senior Associate Dean for Research. **Mihir A. Desai** is the Mizuho Financial Group Professor of Finance at Harvard Business School and a Professor of Law at Harvard Law School.

Manjari Raman, Program Director and Senior Researcher of the U.S. Competitiveness Project at Harvard Business School, was instrumental in designing this survey, executing it, and reporting the findings.

Ilyes Kamoun, Research Associate, provided valuable support in survey dissemination, coding survey responses, and analyzing survey and U.S. economy data. Staff assistant **Stuart Gardner** and research associate **Alexandra Houghtalin** provided significant support in managing drafts. Research associates **Gabriel Ellsworth** and **James Palano** helped extensively in proof-reading and fact-checking.

The authors would like to acknowledge the crucial contributions of Abt SRBI vice president **Benjamin Phillips**.

The authors extend a special thanks to the HBS alumni, HBS students, and members of the general public who completed the U.S. competitiveness survey.

Please direct inquiries to Manjari Raman (mraman@hbs.edu).

For more information on Harvard Business School's U.S. Competitiveness Project, please visit http://www.hbs.edu/competitiveness/

Report design: Terberg Design, LLC.