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A RECOVERY SQUANDERED

The State of U.S. Competitiveness 2019

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Prior Harvard Business School reports on the state of U.S. competitiveness

2011: Prosperity at Risk

2012: Competitiveness at a Crossroads

2013–14: An Economy Doing Half Its Job

2015: The Challenge of Shared Prosperity

2016: Problems Unsolved and a Nation Divided

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EXECUTIVE SUMMARY

Harvard Business School (HBS) launched the U.S. Competitiveness Project in 2011 as a research-led effort to understand and improve the competitiveness of the United States. The Project focuses especially on the roles that business leaders do and can play in advancing America's economy.

In 2019, faculty members of the Project conducted our sixth survey on U.S. competitiveness. This report—built on the survey findings and eight years of prior research on the competitiveness of the United States—highlights a disturbing pattern: despite a decade of steady economic growth since the Great Recession, America has done remarkably little to address underlying structural weaknesses in the country's economy and society. The nation has squandered the recovery.

We discuss this pattern in chapters on the disappointing trajectory of U.S. competitiveness, the dysfunction in America's political system that has contributed to the trajectory, the role of business in political dysfunction, the unfinished business of U.S. tax reform, and America's faltering system for attracting global talent.

Chapter 1 points out that past generations of American leaders have used periods of strong economic growth in at least three ways: to upgrade the nation's business environment; to make America more equitable and humane; and to build fiscal strength to buffer future recessions. Our current leaders have accomplished none of these during the past decade's expansion.

Reflecting the lack of progress, the 5,713 HBS alumni surveyed during April and May of 2019 were pessimistic overall about the future of U.S. competitiveness: 48% expected U.S. competitiveness to decline in the next three years, while only 31% expected it to improve. Comparing the 2019 results to past surveys' findings, we find very little progress on key weaknesses in America's political system, K–12 education, health care, and infrastructure. Perhaps most disturbing, we observe that Americans lack a shared reality when it comes to sizing up the country's strengths, weaknesses, and progress. Democratic and Republican alumni disagree sharply on whether our key weaknesses, and U.S. competitiveness as a whole, are getting better or worse.

Chapter 2 zeroes in on a central reason America has made so little progress: our political system has been optimized by the two major political parties to advance their partisan interests rather than the public interest. Electoral and legislative rules serve the parties well but cause gridlock and disable our democracy. Our surveys of HBS alumni, HBS students, and the general public shed light on two aspects of this problem:

- Americans do not fully grasp the structural nature of our political system problem. Many believe that we have simply elected the wrong people, even though partisanship and gridlock have persisted across multiple administrations and many new legislators.
- Survey respondents support reforms of the political system, but there is currently stronger support for widely publicized changes, such as campaign finance reform and efforts to counter gerrymandering, than for reforms that we believe are more powerful, such as nonpartisan primaries and ranked-choice voting.

Given the system's complexity, effective political reform will require a major effort to educate Americans.

Chapter 3 highlights that business leaders are partly to blame for today's hyper-partisan, gridlocked politics. Business has funded, perpetuated, and profited from political dysfunction. We describe the major ways in which businesses engage in politics today—by lobbying, spending on elections and ballot initiatives, influencing employees' votes and donations, and hiring former government officials. We examine the prevalence and consequences of each of these.

Our survey findings reveal that:

- A high portion of business leaders seem not to be fully aware of how their companies are interacting with the political system.
- While most business leaders deny that *their own companies* engage with politics in ways that undermine the public interest, most also believe that *business as a whole* engages in politics in ways that are bad for public trust in business and bad for America.
- The majority of business leaders support reforms that would change how business interacts with the political system.

We put forward a set of voluntary standards for how businesses should engage in politics. We also suggest that business could be a leader in the political reform effort described in Chapter 2, which would benefit business in the long run.

Chapter 4 examines an area where the federal government has taken significant action affecting the business environment in recent years: the tax code. Our detailed analysis of the 2017 Tax Cuts and Jobs Act concludes that the law is a mix of good, bad, and deeply ambiguous aspects. We identify important unfinished business in tax reform, including a need to address a widening fiscal gap and, among our surveyed alumni, a considerable appetite for greater redistribution.

Chapter 5 examines an area where partisanship and political gridlock are arguably doing the greatest, longest-lasting damage to America: the system for immigration of highly skilled individuals. Our alumni survey shows that, among business leaders, foreign skilled immigrants are seen as a critical source of advantage for the United States and for individual companies. America's current immigration system, however, is seen as putting this source of advantage at severe risk. Among business leaders and the general public, there is broad agreement for shifting the overall composition of U.S. immigration towards employment-based entry. Reforming the rules that govern high-skilled immigration is a prime example of how we can make America more competitive, if only we can get our political act together.

Though America has squandered the recovery, we need not squander the future. America retains great strengths, and many of the basic policy directions required to enhance U.S. competitiveness and boost shared prosperity are well understood and widely supported. The question is whether we as a nation can muster the farsighted and consensus-oriented leadership, in both the private and the public sectors, to do what we know must be done.

CHAPTER 1

GROWTH BUT WEAK FOUNDATIONS

Jan W. Rivkin and Michael E. Porter

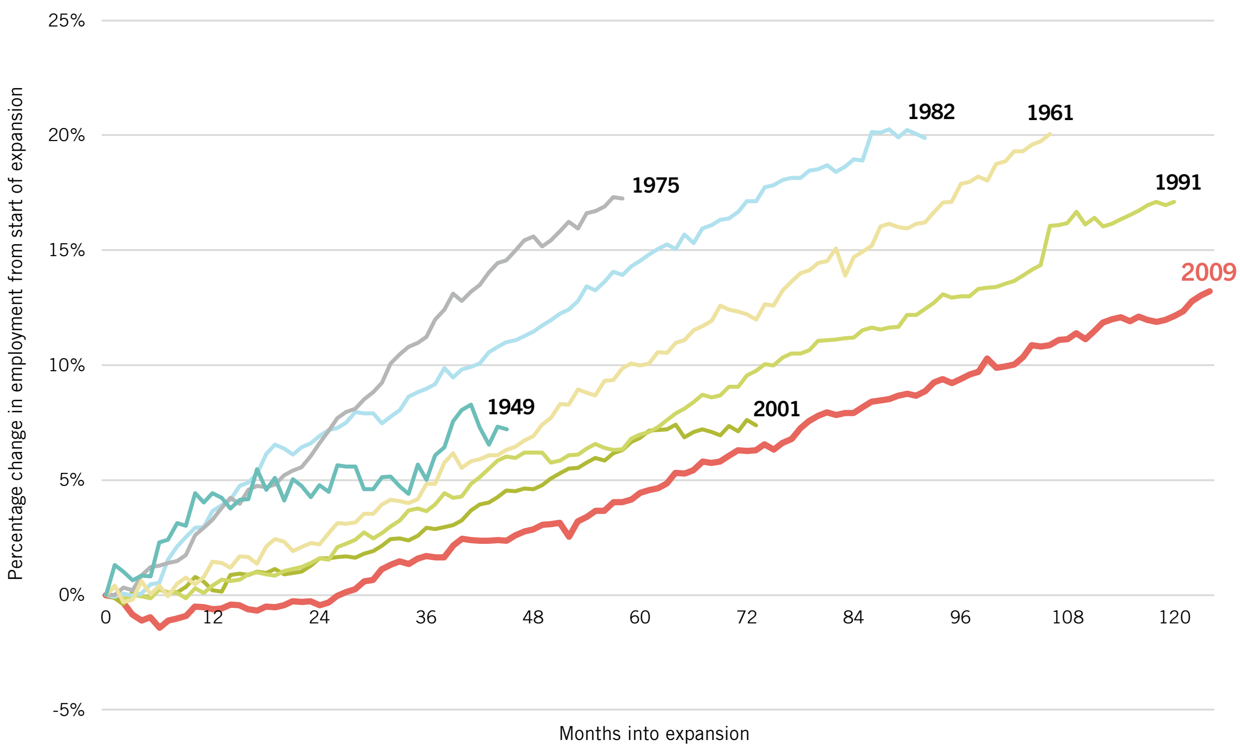
In July 2019, the recovery from the Great Recession became the longest nonstop economic expansion in America's history. It is now 126 months long and counting. Yet it is hard to feel entirely positive about this expansion. As many other observers have noted, the expansion has chalked up weaker gains in jobs and GDP than have other growth periods (Figures 1 and 2), and the period's gains have not been spread broadly among Americans (Figure 3). We share those concerns. But we have another, more serious source of apprehension: *despite a decade of steady economic growth, the United States has done remarkably little to address underlying structural weaknesses in our economy and our society.* The nation has squandered the recovery.

Past generations of American leaders have taken advantage of periods of economic expansion in at least three ways. First, they have worked to upgrade the nation's business environment, especially by investing heavily in public goods and setting other policies to make individuals, companies, and communities more productive. The strong expansions of the 1940s and 1950s, for instance, saw investments in the interstate highway system, middle-class higher education, and basic research and development. Second, past leaders have worked during good times to advance social progress, making America more equitable and humane. Witness, for example, the efforts during the 1960s' expansion to extend civil rights and voting rights to black citizens and health care to the poor and elderly. Third, American leaders have used earlier periods of economic growth to reduce public debt and build fiscal strength that could buffer future recessions. During the boom years of the late 1990s, for instance, the federal government ran a budget surplus.

As we discuss below, America's current leaders have accomplished none of these three during the past decade's expansion. To put this in perspective, consider the advice that President John F. Kennedy gave when speaking of the work he hoped America would do during

FIGURE 1: JOB GROWTH DURING ECONOMIC EXPANSIONS

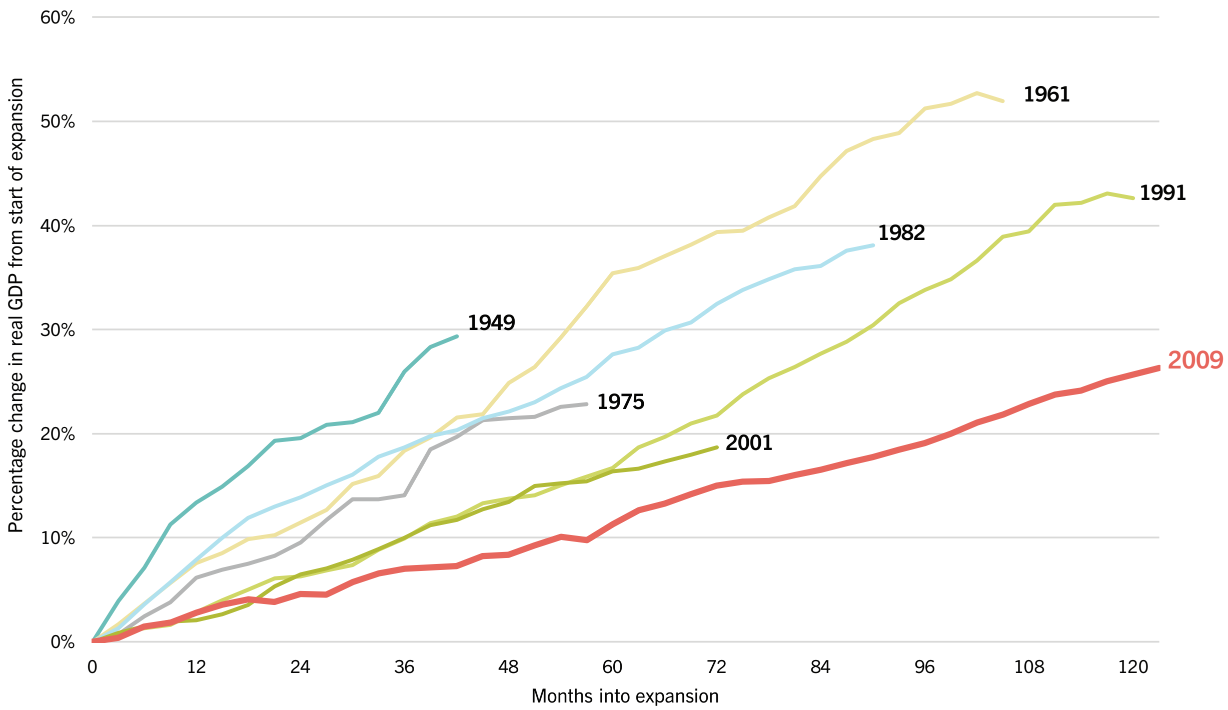
The year on each line indicates the time at which the expansion began



Source: St. Louis Federal Reserve, CNBC

FIGURE 2: GDP GROWTH DURING ECONOMIC EXPANSIONS

The year on each line indicates the time at which the expansion began



Source: St. Louis Federal Reserve, CNBC

FIGURE 3: PORTION OF TOTAL GAINS IN NET WORTH ACCRUING TO DIFFERENT WEALTH BRACKETS SINCE THE END OF THE GREAT RECESSION

Note: Includes gains from second quarter of 2009 through second quarter of 2019. Figures do not add up to 100% due to rounding.
Source: Federal Reserve Distributional Financial Accounts

an economic recovery of the early 1960s: "The best time to repair the roof is while the sun is shining." In recent years, the sun has shined brightly on America's economy. But the roof remains leaky.

Weak and Declining U.S. Competitiveness

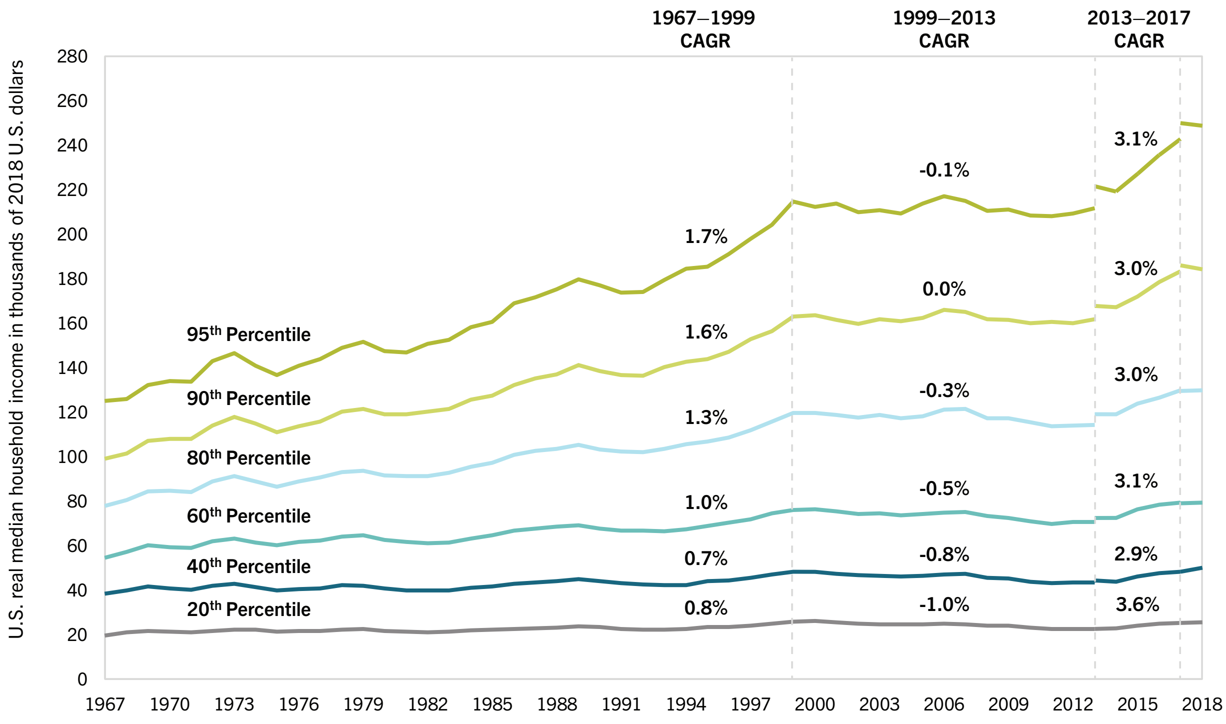
To clarify our assessment, we must first explain what it means for the United States, or any other nation, to be competitive. A nation is competitive if it creates the conditions for two things to occur simultaneously: businesses operating in the nation (1) compete successfully in global markets while (2) lifting the wages and living standards of the average citizen. When these occur together, a nation prospers. This definition of competitiveness has guided the HBS Project on U.S. Competitiveness since it was launched in 2011.

The definition makes clear that a hallmark of any truly competitive country is *shared prosperity*. A nation in which businesses thrive but most citizens struggle is not competitive. Nor is a country that pays its citizens well while its businesses fail in the marketplace.

How competitive is the United States today by these standards? Our report on the 2016 HBS alumni survey on U.S. competitiveness, *Problems Unsolved and a Nation Divided*, examined extensive evidence that the U.S. economy is fulfilling only one-half of the definition of competitiveness. Large and midsize companies in the United States are thriving and creating prosperity for those who found, run, and invest in them. But middle- and working-class Americans are struggling, as are many small businesses.

What has gone wrong? In our 2016 report, we documented a set of long-term trends that highlight how the U.S. economy has failed to lift the living standards of the average American as it had in previous periods: GDP and job growth have slowed; productivity has stagnated (crucial since productivity underpins living standards); participation of working-age Americans in the labor force has declined; and real incomes have stagnated or declined among all but the richest households in America.

FIGURE 4: REAL HOUSEHOLD INCOME ACROSS THE INCOME DISTRIBUTION



Note: Household income includes wages, self-employment, retirement, interest, dividends, other investment, unemployment, disability, alimony or child support, and other periodic income. Series breaks in 2013 and 2017 reflect new methodologies put in place by the U.S. Census Bureau.

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

Recently those trends have moderated slightly (Figure 4), as labor markets have tightened at last and workers in middle and lower incomes have finally seen some wage growth. The gains, however, are modest, do not make up for more than a decade of stagnation, and appear to reflect the business cycle's peak rather than any structural improvement. Official unemployment rates are now low, but they mask significant underemployment and low wages; many Americans work multiple part-time jobs but struggle to get by.

Trends like the one shown in Figure 4 are based on historical data. To understand the likely *future* trajectory of U.S. competitiveness, we turned to Harvard Business School alumni, who often hold business leadership roles on the front lines of global capitalism.* In March and April 2019, we surveyed 5,713 alumni on a wide range of topics related to U.S. competitiveness. (See the box on page 9 for a description of the survey and the respondents.) To examine the trajectory of overall U.S. competitiveness, we asked alumni two broad questions that correspond to our definition of competitiveness:

- Three years from now, do you expect companies operating in the United States to be *more or less able to compete successfully in the global marketplace?*
- Three years from now, do you expect companies operating in the United States to be *more or less able to support high wage rates and benefits?*

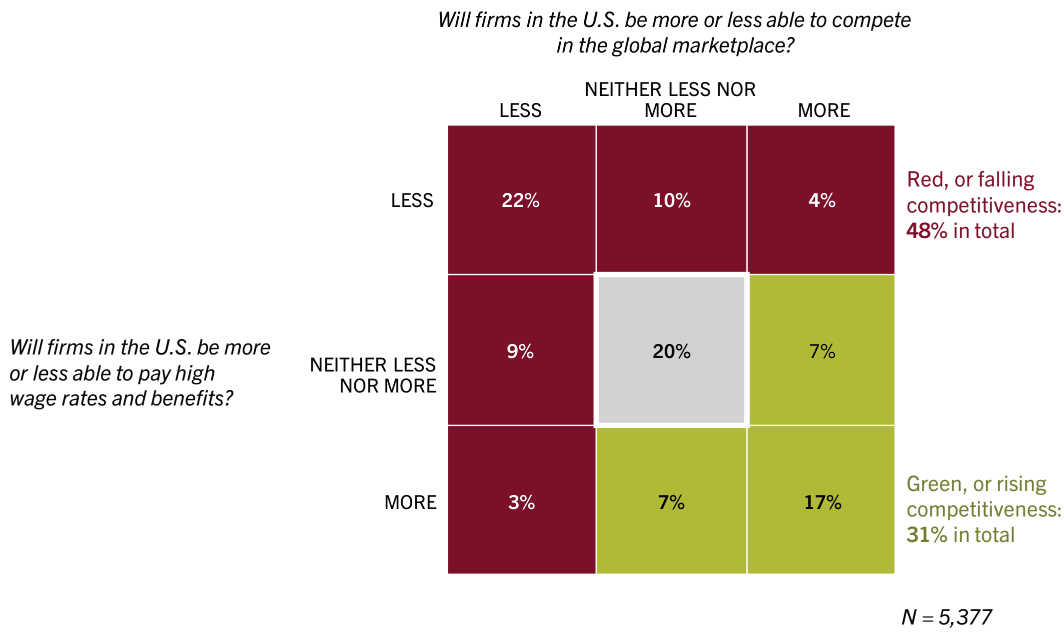
Figure 5 shows the responses: 48% of survey respondents expected U.S. competitiveness to decline, with companies less able to compete, less able to pay well, or both (red boxes). Only 31% were optimistic, expecting one or both dimensions of competitiveness to improve and neither to decline (green boxes). The remaining 20% expected little or no change on either dimension (grey box). (Figures do not sum to 100% due to rounding.)

We have asked similar questions each time we have surveyed our alumni about U.S. competitiveness. Figure 6 on page 8 summarizes the results since 2011. From deep net pessimism about the trajectory of U.S. competitiveness in 2011, when America was just beginning to recover from the Great Recession, alumni became about neutral on average by 2015. But pessimism overtook optimism again in 2016 and remained the net assessment this year.

In our 2019 survey, we also asked respondents whether they believed that, three years from now, the typical U.S. company would employ more people, the same number

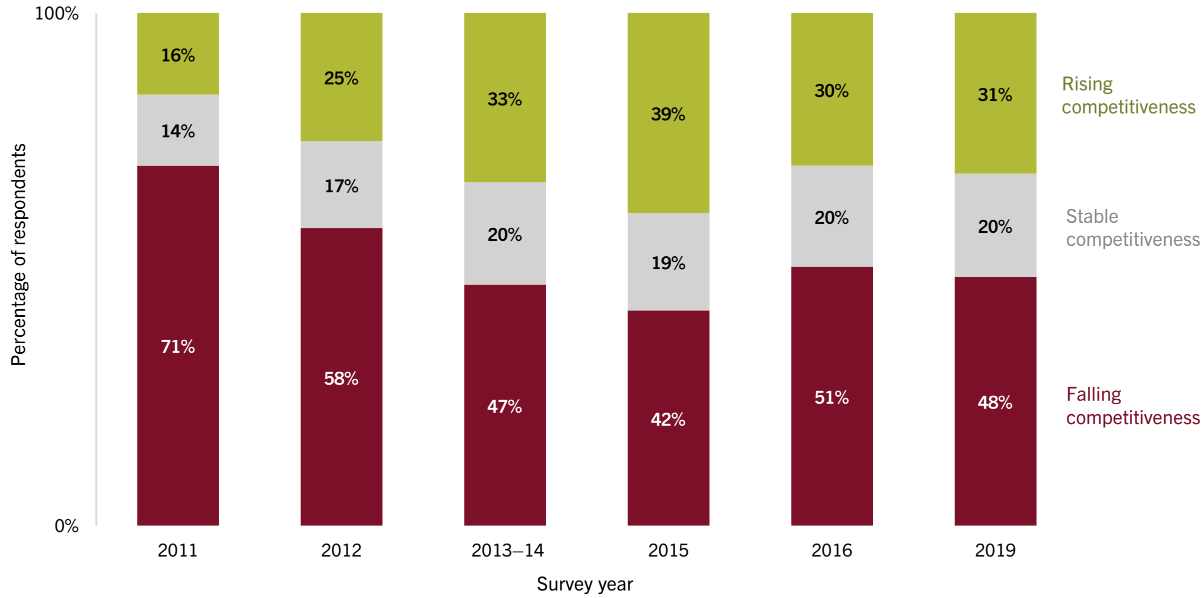
*We use the word "alumni" to refer to both male and female graduates of Harvard Business School.

FIGURE 5: U.S. COMPETITIVENESS IN THREE YEARS (ALUMNI IN 2019)



Note: Percentages in boxes may not add up to total because of rounding. Percentages exclude respondents who answered "Don't know."

FIGURE 6: ASSESSMENT OF THE TRAJECTORY OF U.S. COMPETITIVENESS (ALUMNI OVER TIME)



Note: Percentages exclude respondents who answered "Don't know."

of people, or fewer people. Fully 52% predicted *fewer* employees, while only 15% foresaw more. Coupled with the findings in Figure 5 on page 7—in which 36% of alumni predict that firms will be less able to support high wages and benefits and only 27% expect firms to be more able—the HBS alumni on the front lines of our economy foresee a challenging future for American workers.

Crumbling Foundations of Competitiveness

To understand why our alumni are collectively worried about U.S. competitiveness and especially about workers' futures, we must understand, and assess, the drivers of competitiveness.

Our definition of competitiveness points directly to a special role for a nation's productivity. To succeed in the global marketplace (the first half of our definition), a nation's firms must deliver superior value to customers and still be profitable. The only way that firms can do so while also paying employees well (the second half of the definition) is to be better than global competitors at turning inputs into valuable outputs. Efficiency and the cost of doing business in a country, then, loom large in its competitiveness.

The productivity of a nation's companies depends on the quality of the country's business environment. The box on page 9 shows 19 important elements of the local business environment that prior research has shown to be key drivers of productivity and competitiveness. These include both macroeconomic factors, such as sound fiscal and monetary policy and the ability of the political system to pass effective laws, and microeconomic factors, such as the quality of company management and the vibrancy of local capital markets.

We asked our alumni to assess the current position and trajectory of each of these elements for the United States. Our position today is summarized by the portion of respondents who assess each element in the U.S. to be better than in other advanced economies, minus the portion who assess it to be worse. The trajectory is captured by the proportion of respondents judging each element to be improving, minus the portion saying it is deteriorating. Figure 7 on page 10, plotting position and trajectory, shows America's economic strengths and weaknesses in a single picture.

The good news is that, in the eyes of alumni, the American business environment retains some powerful strengths that are getting better and are hard for other countries to match. For instance, we have high-quality

Alumni respondents were solicited with the help of Abt SRBI, a leading survey research firm, via a message to all alumni of Harvard Business School's MBA, doctoral, and longer executive education programs with known email addresses—61,255 individuals in total. Of these, 5,713 (9.3%) completed the survey.

All alumni worldwide were asked to complete the section of the survey on the U.S. business environment. The remaining four sections of the 2019 survey—on the U.S. political system, the business community's current engagement in politics, the Tax Cuts and Jobs Act, and immigration—required deep familiarity with the U.S. economy. Thus, these were administered only to HBS alumni located in the U.S., including both citizens and non-citizens. Respondents weighed in from 50 U.S. states (67.4% of respondents with known locations) and 112 other countries (32.6%). They ranged in age from 26 to 97, and the 70.0% who currently work came from every sector of the economy, with heavy representation in finance and insurance, manufacturing, and professional, scientific, and technical services.

In 2019, we also invited the 1,871 students registered in Harvard Business School's MBA program to complete the survey. A total of 199 MBA students (10.6%) responded.

Finally, in addition to HBS alumni and students, we surveyed members of the general public in the U.S. who are 18 years and older. Survey firm Dynata recruited a representative sample of 1,006 respondents.

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

Lack of corruption

Efficiency of legal framework: modest legal costs; swift adjudication

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

universities and other research institutions that drive innovations, a vibrant entrepreneurial environment that brings innovations and new companies to market, capital markets that fund good ideas, and a depth of sophisticated firm management.

Unfortunately, we also have historical strengths that are deteriorating: the skills of America's workforce are not keeping up with global standards, for example, and our fiscal deficits are growing beyond prudent levels. Worse yet, we have weaknesses that are getting worse: a paralyzed political system, high-cost health care with limited availability, crumbling infrastructure, and a weak K–12 education system.

Figure 7 clarifies why America suffers from a lack of shared prosperity, with large companies thriving even as middle- and working-class Americans are struggling. Large companies draw heavily on the nation's strengths: they tap the deep pools of innovation, capital, and management talent that America provides. Large companies are also well equipped to cope with the nation's weaknesses: they can train and source educated and skilled workers from around the world, afford to deal with complex regulations, relocate operations to countries with functioning political systems and strong infrastructure, and even influence our political system to advance their special interests.

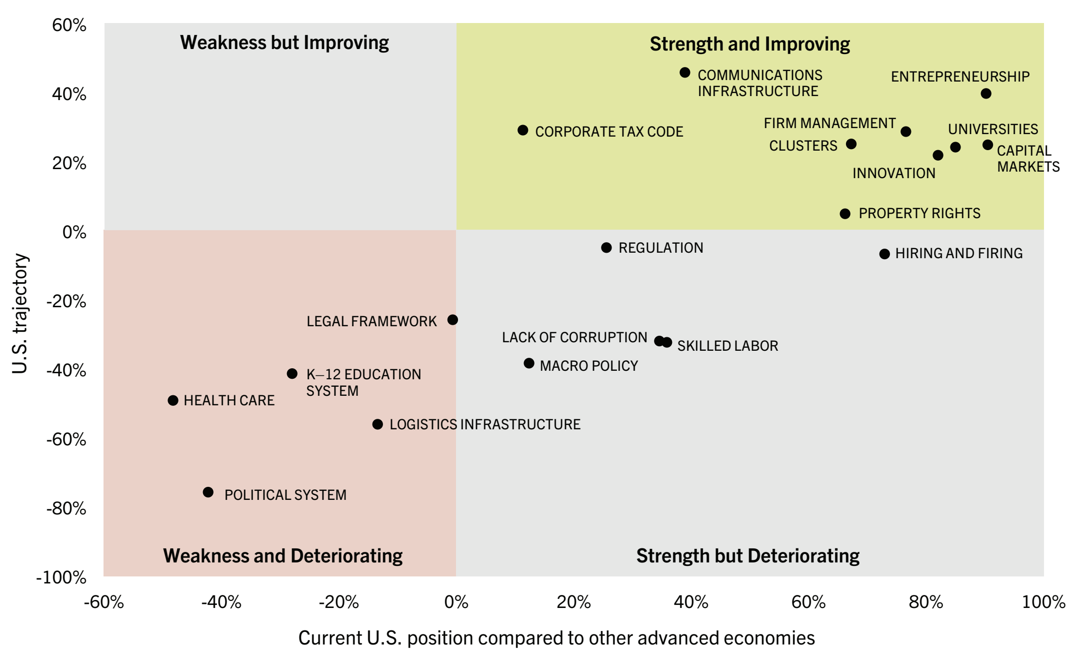
Middle- and working-class Americans, in contrast, cannot escape the ramifications of a weak educational system, political paralysis, crumbling roads and bridges, and costly, inaccessible health care. And they rarely benefit directly from strengths like vibrant capital markets and innovative research universities. Small businesses are similarly challenged.

In short, large companies can tap the strengths of America's business environment and sidestep the weaknesses, while workers and small businesses are captives of the weaknesses and rarely beneficiaries of the strengths.

Failing to Address Weaknesses in the Business Environment

A long-running economic expansion should be an ideal time for a nation to address the weaknesses in its

FIGURE 7: ASSESSMENTS OF ELEMENTS OF THE U.S. BUSINESS ENVIRONMENT (ALUMNI IN 2019)



Note: Scored as percentage with positive views minus percentage with negative views. Calculations exclude respondents who answered "Don't know."

business environment. Public and private resources are plentiful, short-term pressures are reduced, and a country can afford to make investments in physical and human capital that might not pay off for years.

Unfortunately, there is little evidence that America has upgraded its business environment during the long, current expansion. In every HBS alumni survey since the first in 2011, we have generated pictures like Figure 7, so we can track how alumni have perceived various elements over time. Figure 8 shows the shifts in assessments from 2011 to 2019.

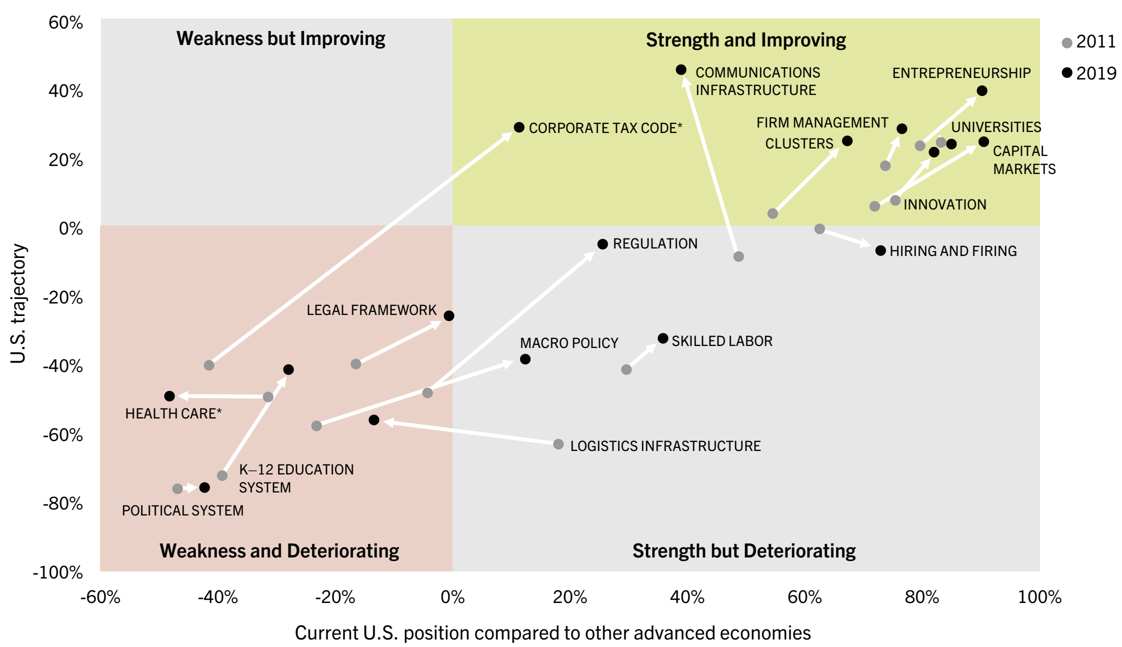
America has made little progress in addressing the country's weaknesses. The nation's political system remains a persistent and severe weakness in alumni's eyes. Assessments of the country's logistics infrastructure and health care system have deteriorated. The K–12 education system has improved in alumni's opinion, but it remains a weakness that is getting worse (and the most recent international test scores reveal little improvement relative to other countries[1]). Likewise, the nation's legal framework, while judged more positively than in 2011, is still seen as a deteriorating weakness.

The most marked upward progress has been in the country's tax code, presumably reflecting the major tax reform enacted in December 2017. Chapter 4 of this report, however, argues that the tax change may represent less progress than meets the eye. Alumni also report meaningful progress in America's regulatory regime. Arguably, however, the changes in regulation since 2011, which have occurred primarily under President Trump's administration, have mostly benefited large companies and, therefore, have not addressed directly the aspect of competitiveness most at risk: the living standards of the average American.

Why has this generation of American leaders, unlike its predecessors, failed to upgrade the country's business environment during the long expansion? Federal political paralysis—reflected, for instance, in the well-documented decline in the number of laws passed—surely plays a role. Given the critical importance of federal gridlock, Chapter 2 examines the causes of dysfunction in a political system that was once the envy of the world.

Pointing to political paralysis could sound like an attempt to blame the nation's problems solely on its politicians

FIGURE 8: CHANGES IN ASSESSMENTS OF ELEMENTS OF THE U.S. BUSINESS ENVIRONMENT (ALUMNI IN 2011 AND 2019)



Note: Scored as percentage with positive views minus percentage with negative views. Calculations exclude respondents who answered "Don't know." The initial position of "health care" is from the 2015 survey because surveys before 2015 did not ask about health care. The initial position of "corporate tax code" is from 2016 because surveys before 2016 did not ask about the corporate tax code. Two elements examined in the 2019 survey—"property rights" and "lack of corruption"—are omitted here because prior surveys did not ask about them separately.

and to declare its business leaders innocent. Chapter 3 makes it clear, however, that business leaders have been amply complicit in supporting, funding, and indeed benefiting from a gridlocked system that is highly partisan and focused on special interests.

Our survey results suggest another reason that America has failed to improve its business environment: *Americans lack a shared reality when it comes to sizing up the nation's strengths and weaknesses.* Figure 9, for instance, shows the assessments of the trajectory of U.S. competitiveness among alumni who identified themselves as Democrats, Independents, and Republicans. Republicans are strikingly more likely than Democrats to expect America's competitiveness to improve in the next three years (51% versus 24%).

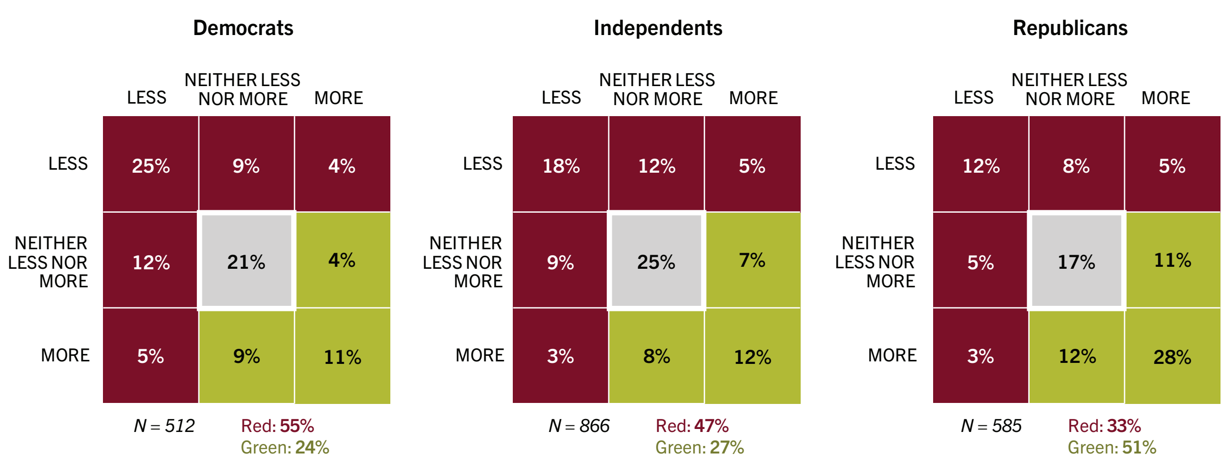
Figure 10 compares the assessments of the elements of the business environment for Republicans and Democrats. Republicans see almost every weak or declining element in a more positive light than do Democrats. This is especially true for the weakest elements. An exception is that Democrats have a more favorable view of America's regulatory environment, probably because they are more supportive of regulation. Still, there are marked differences in perceptions: Republicans see regulations as improving (presumably deregulating) while Democrats see regulations as deteriorating (presumably also due to deregulation).

HBS alumni views of America's weaknesses have also diverged sharply along party lines in recent years. Figure 11 shows how Democrat and Republican alumni assessed four important areas of weakness—America's political system, health care system, K–12 education, and logistics infrastructure—in 2016 and 2019. (Our 2016 survey was conducted in May and June of that year, before the Presidential election.) Democrats see all four elements as worse in 2019 than in 2016, while Republicans see all four as better. Republicans see better trajectories for all four in 2019 compared to 2016, while Democrats see worse trajectories for all but one in 2019.

Some of the divergence in Figure 11 probably reflects differences in policy preferences. For instance, Republicans likely see the weakening of Obamacare as an improvement in health care, while Democrats perceive the same change as a setback. We also suspect that there is simply a halo effect that comes with having one's party in the White House and the reverse from being out of power. For example, there is little evidence that the state of America's K–12 education system has changed much in objective terms since 2016, yet Republicans view it as much better in 2019 than in 2016, while Democrats see it as somewhat worse.

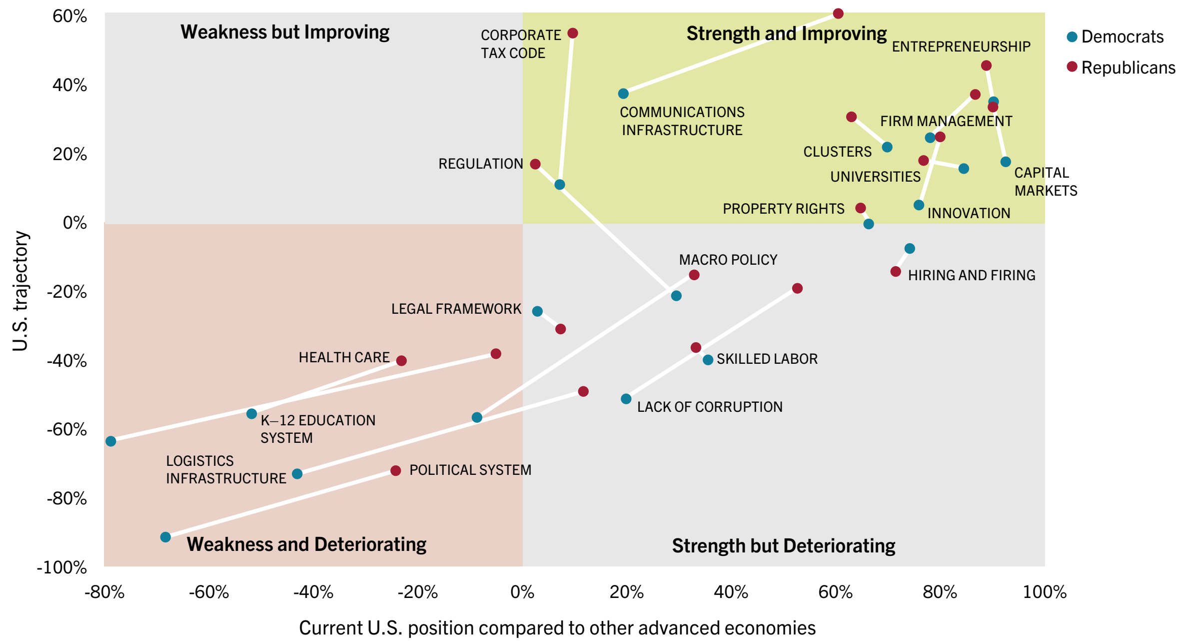
Differences in perception arise not just along party lines. We administered our survey to 1,006 members of the general public and discovered sharp differences between the public's views and those of business leaders (represented by HBS alumni). As Figure 12 on page 14 shows, members of the general public are far more likely than alumni to foresee improving U.S. competitiveness (47% versus 31%). This contrasts with 2016, when the two groups saw similar probabilities of rising U.S. competitiveness (34% for the general public and 30% for alumni).

FIGURE 9: U.S. COMPETITIVENESS IN THREE YEARS BY PARTY AFFILIATION (ALUMNI IN 2019)



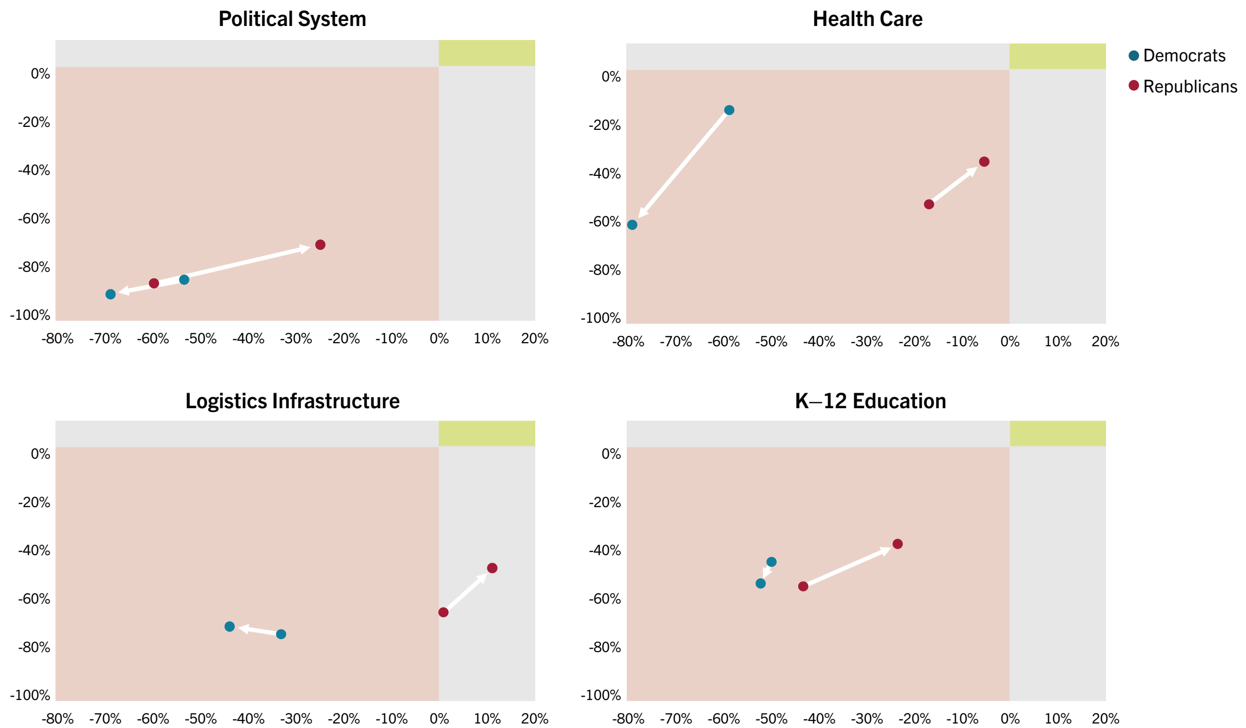
Note: Percentages in boxes may not add up to total because of rounding. Percentages exclude respondents who answered "Don't know."

FIGURE 10: ASSESSMENTS OF ELEMENTS OF THE U.S. BUSINESS ENVIRONMENT BY PARTY AFFILIATION (ALUMNI IN 2019)



Note: Scored as percentage with positive views minus percentage with negative views. Calculations exclude respondents who answered "Don't know."

FIGURE 11: CHANGE IN ASSESSMENTS FROM 2016 TO 2019 AMONG DEMOCRAT AND REPUBLICAN ALUMNI



Note: Scored as percentage with positive views minus percentage with negative views. Calculations exclude respondents who answered "Don't know."

The general public's optimism has jumped far more than HBS alumni's over the last few years. We suspect that the public's sentiment has likely been swayed more than alumni's by the continuation of the economy's expansion and constant talk about low unemployment and the boom. Put differently, a longer run of cyclical economic success may convince members of the general public, but not business leaders, that structural conditions in the economy are favorable.

Figure 13 compares the general public's and alumni's assessments of the elements of the U.S. business environment. By and large, the general public sees similar relative strengths and weaknesses as alumni, but their assessments are more compressed than alumni's and—reflecting their greater optimism—shifted upward. A key difference, however, is that members of the general public see corruption as a much more serious problem in America than do business leaders, perhaps because members of the general public see business as part of the corruption.

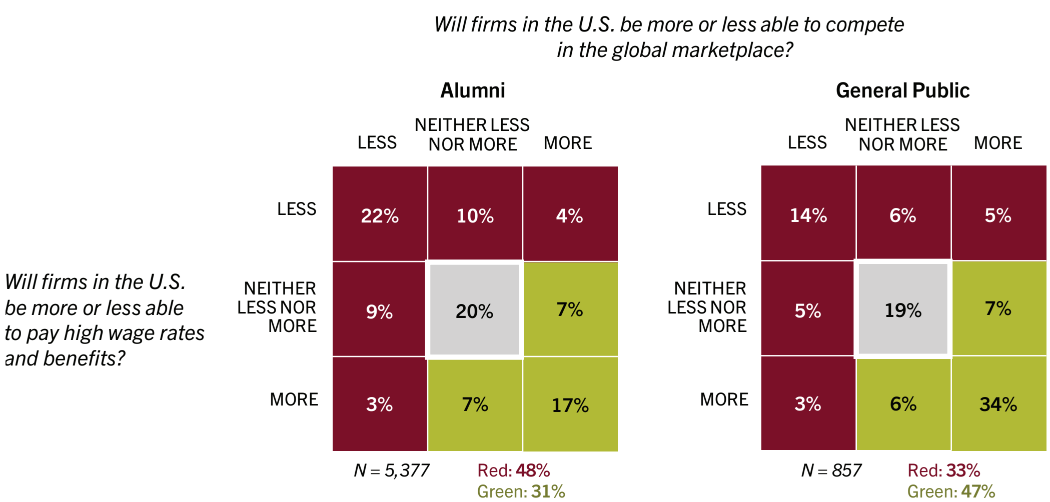
Differences of views like those we document here—between business and the general public and across party lines—stand squarely in the way of finding common ground. They thereby reinforce gridlock and hold back progress on the business environment.

Failing to Make Social Progress

Our analysis so far has focused on America's failure to improve the structural underpinnings of its economic competitiveness during the long recovery and expansion. Of course, the economy is not the only driver of living standards. Nor is it the only thing a society can choose to invest in when it has ample resources. Repeatedly in the past, America's leaders have opted to invest in social progress during good economic times.

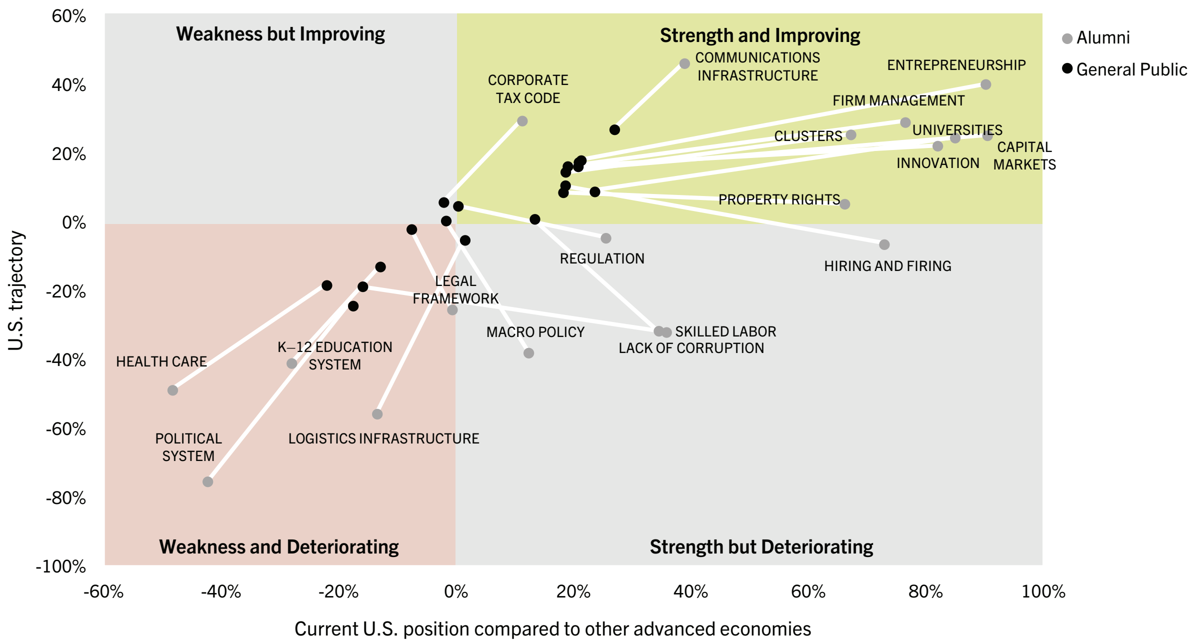
Social progress has rarely been defined systematically, much less measured. Definition and measurement have been advanced, however, by the work of the Social Progress Imperative, a nonprofit founded in 2012 by a group of social sector leaders who believed that measuring social progress was crucial to understanding the health of societies as well as competitiveness and economic development. Under the conceptual and technical guidance of Harvard's Michael Porter (a coauthor of this report) and MIT's Scott Stern, the Social Progress Imperative developed the Social Progress Index in 2014 to benchmark countries on multiple dimensions of social performance using the best data available globally. Drawing on a comprehensive review of the literature on social performance, the Index assesses each country along three broad dimensions shown in Figure 14 on page 16: basic human

FIGURE 12: U.S. COMPETITIVENESS IN THREE YEARS, ALUMNI VERSUS THE GENERAL PUBLIC (2019)



Note: Percentages in boxes may not sum to total because of rounding. Percentages exclude respondents who answered "Don't know."

FIGURE 13: ASSESSMENTS OF ELEMENTS OF THE U.S. BUSINESS ENVIRONMENT, ALUMNI VERSUS GENERAL PUBLIC (2019)



Note: Scored as percentage with positive views minus percentage with negative views. Calculations exclude respondents who answered "Don't know."

needs, foundations of well-being, and opportunity. Each dimension is captured in four components, each of which is measured using three to five specific social or environmental outcome metrics. Altogether, the Index combines 50 metrics, ranging from child mortality rates and gender parity in education to air quality and religious freedom. Economic performance is deliberately omitted from the Index to allow examination of the relationship between economic and social outcomes.

As Figure 15 on page 17 shows, the United States is hardly a leader in social progress today, despite its history of leadership on many of its dimensions. America ranks 26th among the 149 countries assessed in 2019, keeping company with the likes of the Czech Republic, Estonia, and Cyprus. U.S. weaknesses are especially pronounced in areas such as environmental quality, personal safety, access to basic knowledge, and inclusion.

Using the Social Progress Index to assess advances in social progress over time is difficult because the Index has been reported only from 2014 to 2019. But certainly there is no sign that the United States has made great social strides during that period. Indeed, the country's rank has fallen from 20th of 146 in 2014 to 26th of 149 in 2019. Among the areas contributing to America's falling rank were declines in access to quality health care and education, increasing discrimination and violence against minorities, falling freedom of expression and religion, and declining equality of political power by gender and socioeconomic position. Offsetting such changes were an increasing portion of tertiary students enrolled in globally ranked universities, increased acceptance of LGBTQ individuals, and declining premature deaths from non-communicable diseases. The United States was one of only four countries whose Social Progress Index declined in absolute terms between 2014 and 2019. The others were Brazil, Nicaragua, and South Sudan.

It is clear that the United States has not taken advantage of the recent economic expansion to strengthen its ability to meet the human, social, and environmental needs of its citizens. The lack of social progress, in turn, constrains economic progress, especially among the less advantaged.

Failing to Build Fiscal Strength

Along with upgrading the business environment and advancing social progress, a third way that nations often take advantage of boom times is to put their fiscal houses in order. This involves taking steps to make spending

FIGURE 14: SOCIAL PROGRESS INDEX FOR THE UNITED STATES, 2019

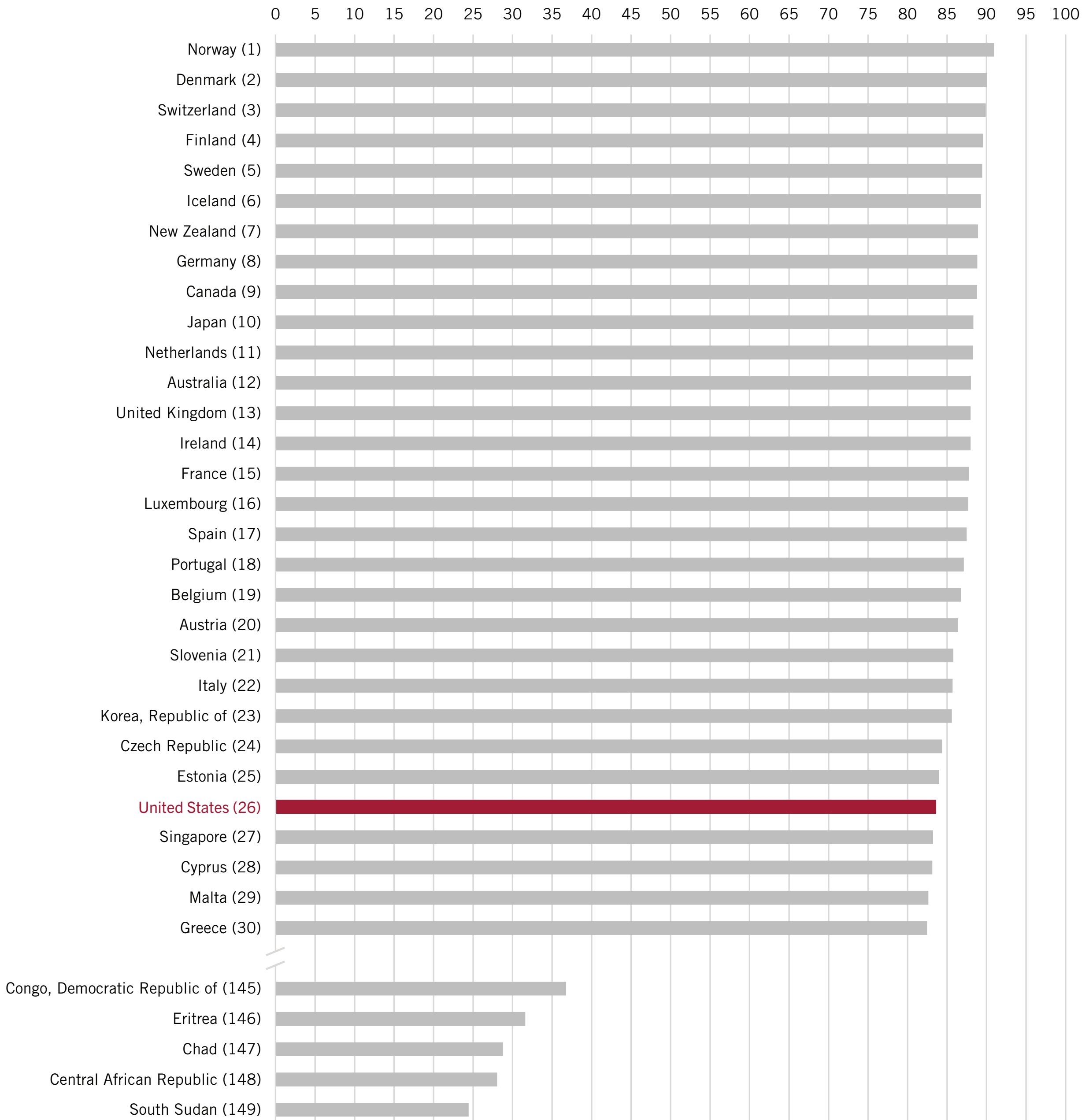
	Score/Value	Rank
BASIC HUMAN NEEDS	**91.64**	**35**
Nutrition and basic medical care	**97.33**	**30**
Undernourishment (% of pop.)	2.50	1
Maternal mortality rate (deaths/100,000 live births)	20.10	64
Child mortality rate (deaths/1,000 live births)	6.60	41
Child stunting (% of children)	2.37	3
Deaths from infectious diseases (deaths/100,000)	21.54	38
Water and Sanitation	**99.40**	**26**
Access to at least basic drinking water (% of pop.)	99.27	44
Access to piped water (% of pop.)	98.74	37
Access to at least basic sanitation facilties	99.97	11
Rural open defecation (% of pop.)	0.00	1
Shelter	**96.94**	**23**
Access to electricity (% of pop.)	100.00	1
Quality of electricity supply (1=low; 7=high)	6.24	25
Household air pollution attributable deaths (deaths/100,000 people)	0.09	11
Access to clean fuels and technology for cooking (% of pop.)	100.00	1
Personal Safety	**72.91**	**57**
Homicide rate (deaths/100,000)	5.35	93
Perceived criminality (1=low; 5=high)	3.00	33
Political killings and torture (0=low freedom; 1=high freedom)	0.91	43
Traffic deaths (deaths/100,000)	12.92	62

	Score/Value	Rank
FOUNDATIONS OF WELLBEING	**82.05**	**32**
Access to Basic Knowledge	**92.35**	**45**
Adult literacy rate (% of pop. aged 15+)	99.00	1
Primary school enrollment (% of children)	99.64	20
Secondary school enrollment (% of children)	92.18	30
Gender parity in secondary enrollment (girls/boys)	0.99	1
Access to quality education (0=unequal;4=equal)	2.36	75
Access to Information and Communications	**90.10**	**19**
Mobile telephone subscriptions (subscriptions/100 people)	120.69	1
Internet users (% of pop.)	75.23	46
Access to online governance (0=low; 1=high)	0.98	5
Media censorship (0=frequent; 4=rare)	3.27	39
Health and Wellness	**75.27**	**34**
Life expectancy at 60 (years)	23.27	36
Premature deaths from non-communicable diseases (deaths/100,000)	287.85	46
Access to essential health services (0=none; 100=full coverage)	87.77	30
Access to quality health care (0=unequal; 4=equal)	2.35	70
Environmental Quality	**70.48**	**59**
Outdoor air pollution attributable deaths (deaths/100,000)	15.04	25
Greenhouse gas emissions (CO2 equivalents per GDP)	379.18	65
Biome protection (% of biomes)	10.07	98

	Score/Value	Rank
OPPORTUNITY	**77.17**	**19**
Personal Rights	**91.58**	**32**
Political rights (0=no rights; 40=full rights)	33.00	49
Freedom of expression (0=no freedom; 1=full freedom)	0.93	25
Freedom of religion (0=no freedom; 4=full freedom)	3.72	48
Access to justice (0=non-existant; 1=observed)	0.92	34
Property rights for women (0=no right; 5=full rights)	4.74	47
Personal Freedom and Choice	**85.67**	**20**
Vulnerable employment (% of employees)	3.73	6
Early marriage (% of women)	2.00	31
Satisfied demand for contraception (% of women)	82.60	32
Corruption (0=high; 100=low)	71.00	21
Inclusiveness	**58.78**	**40**
Acceptance of gays and lesbians (0=low; 100=high)	74.77	18
Discrimination and violence against minorities (0=low; 10=high)	6.10	74
Equality of political power by socioeconomic position (0=unequal power; 4=equal power)	2.07	81
Equality of political power by social group (0=unequal power; 4=equal power)	2.61	62
Access to Advanced Education	**72.65**	**3**
Years of tertiary schooling	4.03	12
Women's average years in school	13.40	3
Globally ranked universities (points)	379.00	1
Percent of tertiary students enrolled in globally ranked universities	25.00	46

Source: Social Progress Imperative

FIGURE 15: SOCIAL PROGRESS INDEX ACROSS COUNTRIES, 2019



Source: Social Progress Imperative

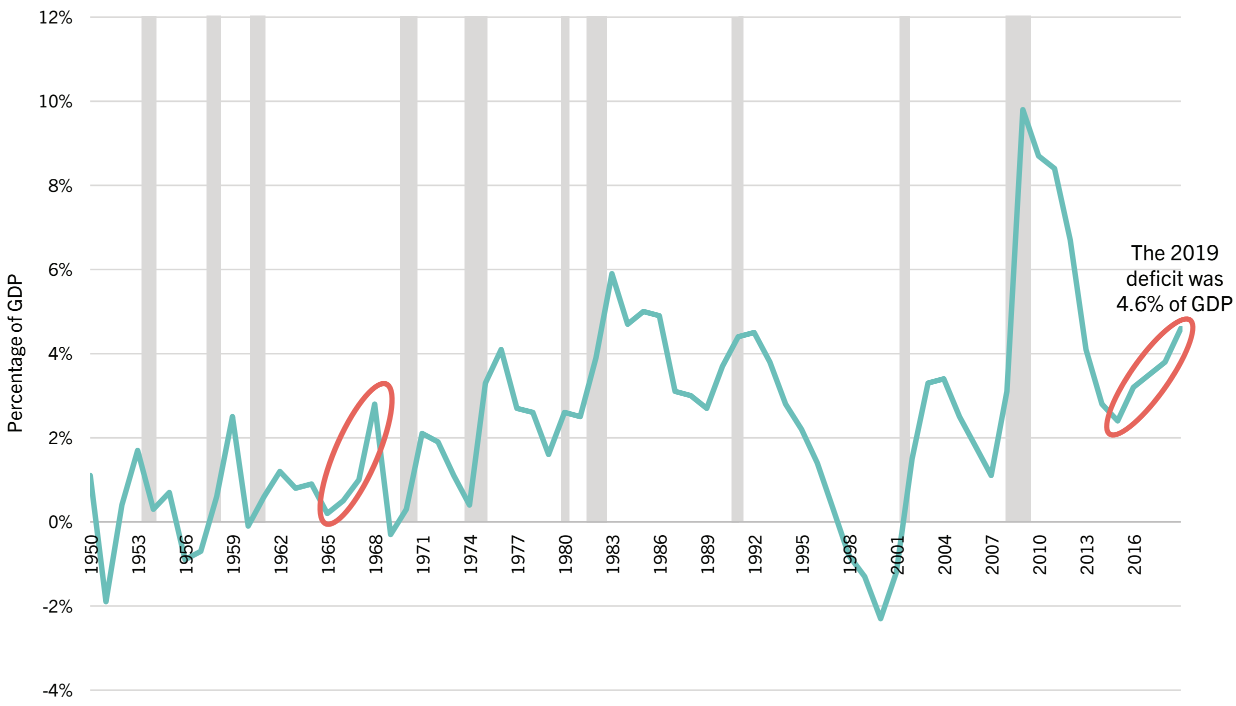
more sustainable and reducing public debt so that the government has the capacity to invest and stimulate the economy during future downturns.

That is emphatically *not* what is happening in America today. Figure 16 shows the federal deficit as a portion of GDP since 1950, with the shaded periods marking recessions. Historically, deficits have climbed during or right after recessions, reflecting fiscal efforts to stimulate the economy as well as the tax revenue declines that accompany a shrinking economy. During expansions, deficits have shrunk with just two exceptions (circled in the figure): the late 1960s, when the Vietnam War drove up expenditures, and today.

Today's deficit level is extremely high this far into an economic expansion. A significant contributor is recent tax reform, which sharply reduced revenue. (See Chapter 4.) Low interest rates currently make our resulting debt relatively inexpensive to finance, but there is no guarantee that rates will remain low. When the expansion ends and the next recession arrives, our federal government will have limited capacity to invest and stimulate the economy.

The rest of this report examines the causes and consequences of America's squandered recovery. We begin by examining what is arguably the most important reason the United States has made so little progress during the long expansion: deep dysfunction in our political system.

FIGURE 16: FEDERAL DEFICITS IN RECESSIONS AND EXPANSIONS



Note: Shaded areas denote periods of recession as defined by the National Bureau of Economic Research.
Source: CRFB, OMB, NBER, U.S. Department of the Treasury

CHAPTER 2

POLITICS AND COMPETITIVENESS

Katherine M. Gehl and Michael E. Porter

Chapter 1 paints a disturbing picture: America has squandered the nation's economic recovery. Despite a long-running economic expansion, the U.S. has failed to address the policy and implementation weaknesses that are holding back our economy and our society. As we, Katherine Gehl and Michael Porter, uncovered in our 2017 HBS report,[2] unhealthy competition in the political system, stemming from rampant optimization of self-serving rules and structures, is the root cause of the decades-long inability of our government to make progress on America's most pressing economic and social problems. (See Appendix A.)

In November 2012, soon after the publication of the first U.S. Competitiveness survey report, Jan Rivkin and Michael Porter introduced an Eight-Point Plan that laid out the most important federal policy priorities for restoring growth and competitiveness (Figure 1).[3] The Eight-Point Plan received strong bipartisan support from business leaders and the general public. Yet the U.S. has made very little progress on these policies in decades. In fact, since the 2016 election, most of these priority areas have actually eroded. (See Appendix B.)

The root causes of this erosion are evident in our research into what we call "the politics industry," which looks at our political system through the lens of industry competition to understand the political dysfunction also identified by alumni as America's greatest economic weakness.

But as we identified, the problem is *not* politicians. We believe that most individuals who seek and hold public office are genuinely seeking to make a positive contribution but are trapped in a system they cannot singlehandedly avoid or work around. The problem is also not *parties*, per se. Parties in a democracy can play a valuable role in organizing citizens around common needs and ambitions, and communicating ideas and platforms can help voters make informed decisions.

Finally, the problem with politics is not a *policy problem*, as many believe. We observe that there is no shortage of awareness, good ideas, or consensus around the state of our economic and social competitiveness and how to address it.

We conclude that the real problem is the *nature of competition* between our entrenched political duopoly, the Democratic and Republican parties, and all the surrounding actors, interests, and organizations (which we describe as the "political industrial complex").

America is stuck because we have a structural *political system problem*. Our political system has been optimized by the entrenched duopoly to advance partisan interests rather than the public interest. Electoral and legislative rules serve the parties well but cause the gridlock and dysfunction that disable our democracy.

FIGURE 1: THE EIGHT-POINT PLAN FOR WASHINGTON, 2012

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 E. Porter and Jan W. Rivkin, "An Eight-Point Plan to Restore American Competitiveness," *The Economist: The World in 2013*, November 2012

The politics industry is perfectly designed to serve the private interests of the actors in this industrial complex: to grow their power and revenues and to protect against threats to their hegemony. It's *not* designed to serve citizens—those who should be the most important customers of the industry. Instead, over decades, the duopoly has designed and optimized rules, practices and structures in two key competitive arenas: elections and legislation.

As currently engineered, elections are heavily distorted to nominate and elect highly partisan candidates—on both sides. Few moderates, and almost no Independents, can get elected, even though 41% of citizens in 2019 self-identify as Independents rather than Democrats or Republicans. And, even if a problem-solving candidate is somehow elected, the duopoly has put in place self-serving structures to control the legislative process, stifling proactive and compromise legislation in the public interest. Moderates open to compromise are increasingly threatened with a party-supported challenger in the next primary election if they stray from the party line.

In this chapter, we first describe how dissatisfied Americans have become with our nation's political system. We then use our survey results from HBS alumni, HBS students, and a representative sample of the general public to identify support for various reforms as well as the key impediments to reform. We find that Americans too often perceive our political system as having a people problem rather than a structural problem. And, among potential reforms, Americans tend to support the proposals that have been more widely put forward, even if they will have little or no structural impact. Support and awareness is much lower for the potential reforms we have identified as powerful and achievable. Only when we understand the root causes of our politics problem, and educate citizens, will we be able to make progress toward changing the system so that it works for the people rather than the political industrial complex.

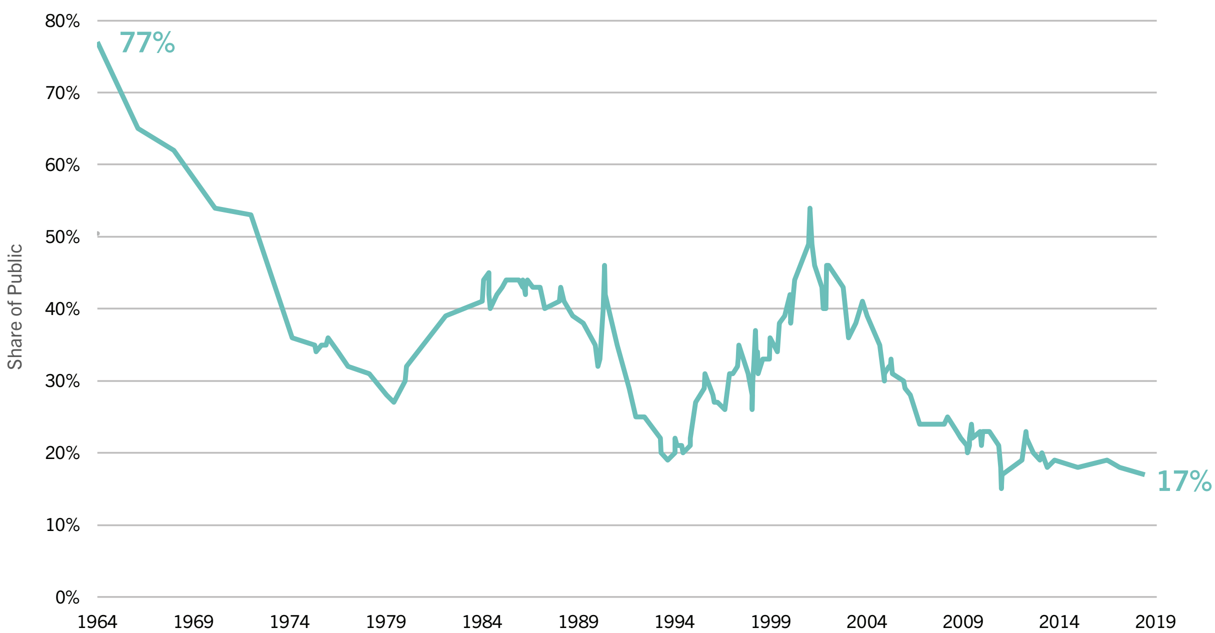
Growing Frustration with Politics

Americans are increasingly frustrated with our political system, anxious about our democracy, and distrustful of Washington. In 1964, according to Pew Center research, three out of four Americans trusted the federal government. Today, this figure has fallen to 17% (Figure 2).

At the same time, politics has become more polarized. Surveys by the Pew Center on the political values of members of the two major parties, as well as Republican-

FIGURE 2: DECLINING PUBLIC TRUST IN THE FEDERAL GOVERNMENT

Percentage of the U.S. public who trust the federal government always or most of the time, 1964–2019

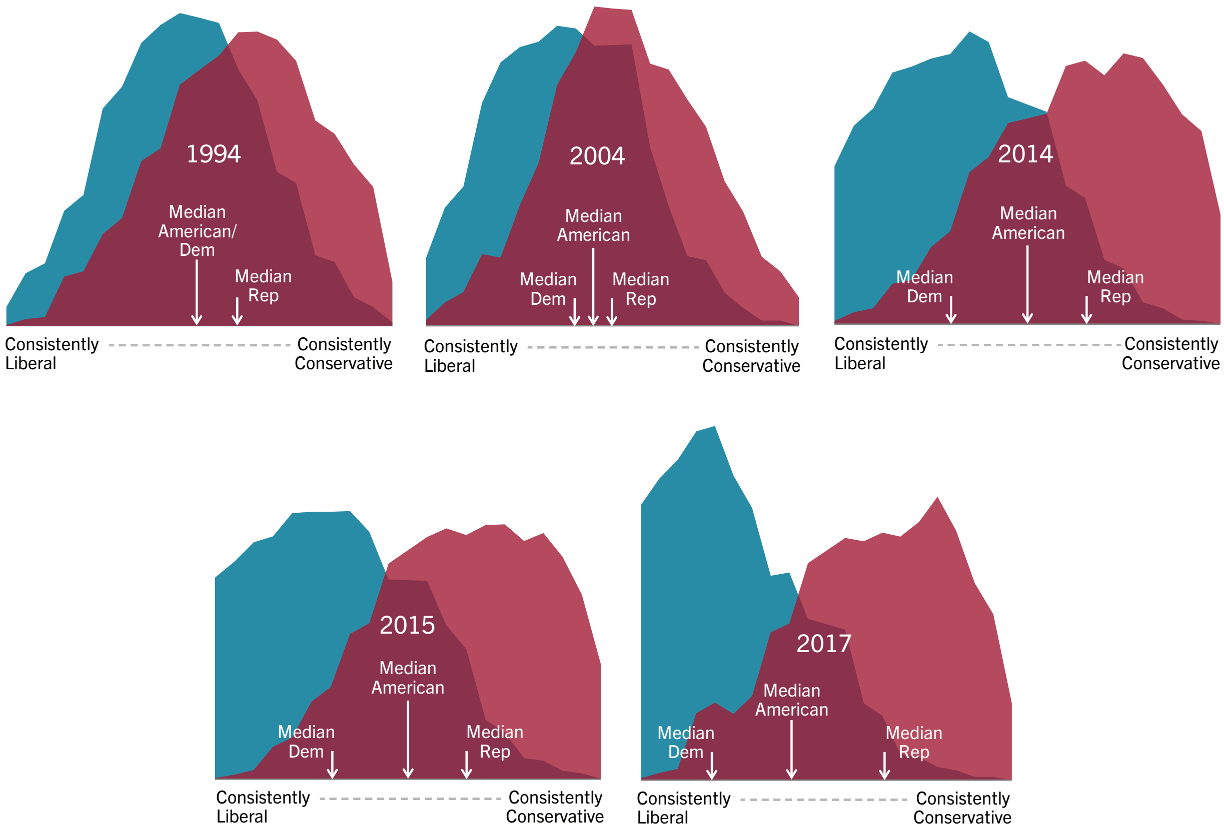


Note: Data are a moving average of individual polls.

Source: "Public Trust in Government: 1958-2019," Pew Research Center, April 11, 2019, https://www.people-press.org/2019/04/11/public-trust-in-government-1958-2019/

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 value questions. The blue area indicates the ideological distribution of Democrats and Democratic-leaning Independents; the red area is that of Republicans and Republican-leaning Independents.

Source: "Political Polarization, 1994–2017," Pew Research Center, https://www.people-press.org/interactives/political-polarization-1994-2017, accessed September 12, 2019

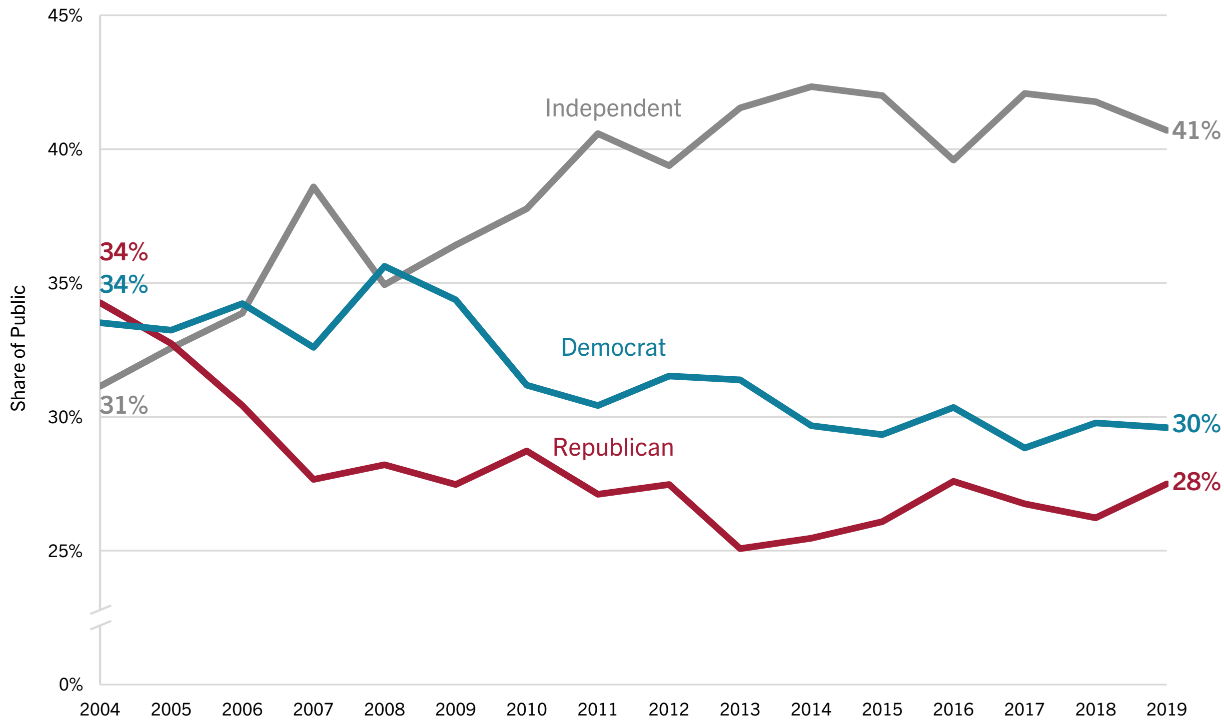
leaning and Democratic-leaning Independents, show that differences in party ideology have widened over the last 25 years (Figure 3), though areas of overlap remain.

Not only have views diverged, but *animosity between the parties* has also grown significantly. In 2017, 44% of Democrats and 45% of Republicans viewed the opposing party "very unfavorably," compared with less than 20% in 1994.[4] Party-based animosity has fueled divisiveness, turning Americans against one another as the parties position fellow citizens who disagree with their views as adversaries. Work by Thomas Patterson of the Harvard Kennedy School finds that "the widening party divide" has made us vulnerable to believing in alternate realities—such as that climate change is a hoax—as long as it demonizes the other side.[5] Harvard Law School professor Cass Sunstein terms party-based animosity as "party-ism," where by "merely identifying with a political party, a person becomes hostile to the opposing party," willing to believe its members are simply bad people.[6]

Given the deep dissatisfaction with the political system, and with the major parties, it is perhaps no surprise that the number of Americans who identify as Independent (not affiliated with any political party) has risen rapidly (Figure 4 on page 22). In Gallup's 2019 party affiliation polls, Independents account for by far the largest percentage of Americans (41%), versus Democrats (30%) or Republicans (28%).[7] The rise in Independents reflects declining confidence in the duopoly, whose favorability ratings have fallen 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.[8]

Alongside the dissatisfaction with the major parties is a belief that our democracy itself is in danger. In our

FIGURE 4: SHIFTING POLITICAL AFFILIATION OF AMERICANS, 2004–2019



Note: Figures are annual averages calculated from Gallup Poll survey on party affiliation. 2019 figures average all polls through November 14. Response to question "In politics, as of today, do you consider yourself a Republican, a Democrat, or an Independent?" Figures may not add up to 100% due to respondents who refused to answer this question.

Source: Gallup, "Party Affiliation," https://news.gallup.com/poll/15370/party-affiliation.aspx, accessed December 2019

survey, 68% of HBS alumni agreed with the statement that "democracy in America is at risk," with 31% agreeing strongly. Among MBA students, 59% agreed, as did 55% of the general public.

Causes of Political Dysfunction

To restore trust and protect our democratic process, there is a pressing need for Americans to have an accurate and shared understanding of what ails our political system.

As we have discussed, our political problems are systemic[9] and have persisted over multiple administrations and many new legislators.

Viewing politics through the lens of industry competition, we have identified the structural problems introduced by critical rules and practices in politics that are often misunderstood. The duopoly has, over time, set and optimized these "rules of the game" in elections and governing. This has generated unhealthy competition and a lack of essential compromise in legislation, and it has created high barriers to entry for new competitors. (See Appendix A for a more complete overview of our Politics Industry Theory).

These structural problems, chiefly plurality voting and partisan primaries, ensure that moderates need not apply; that those who seek compromise are punished; and that Independents and third parties are locked out. The duopoly did not create these structures originally, as we know them today, but they have optimized around them.

Do Americans grasp the structural nature of our political problems? To answer this question, we asked HBS alumni, HBS students, and the general public about their perceptions of root causes. As Figure 5 shows, respondents had diverse and sometimes conflicting views.

- Among HBS alumni, the majority (67%) attributed the problem primarily to *not electing the right people*. Importantly, however, even more alumni (74%) also attributed the problem to the "*rules of the game*," or structural problems (these were defined as "election rules, campaign finance rules, governing rules, etc.").

FIGURE 5: CAUSES OF POLITICAL PROBLEMS

Support for the following statements

OUR POLITICAL PROBLEMS...	HBS Alumni	HBS Students	General Public
Are primarily the result of *not electing the right people*	67%	56%	56%
Are structural and require reform to the political *"rules of the game"*	74%	80%	48%
Will be *self-correcting*	21%	19%	23%

- Among the general public, the most common view (56%) was that political dysfunction was primarily due to not electing the right people. Fewer (48%) blamed the rules of the game as well.
- A very high share of MBA students—80%—attributed the problem to "the rules of the game." But 56% still cited electing the wrong people.

Where we found consensus among alumni, students, and members of the general public was that the political system will not correct itself without change in practices. Just 19–23% disagree.

While it is encouraging that many respondents saw the need for structural reform, many still attribute our political problems primarily to electing the wrong people. Why? Because most citizen involvement in politics is through voting, and many who go to the polls do not like the choices they have. But the choices depend on the rules. The danger is that the American public will continue to focus mostly on the next "change candidate" who fails to deliver, rather than reforming the system that prevents the election of the right people, and their effectiveness in office. This is the first of several indications in our survey that a significant public education campaign will be needed to better focus Americans on the real problems and the right solutions.

Remedies for Political Dysfunction

To explore solutions, we proceeded at two levels. First, we surveyed respondents about underlying principles that should guide how our democracy functions. Second, we asked about specific reforms they would support. Overall, we investigated seven principles and seven corresponding reforms. For instance, the principle that "money should not be a deciding factor in elections" corresponded to "campaign finance reform" (Figure 6 on page 24).

Of these seven reforms, four have been widely discussed in the public discourse and by political commentators: (1) eliminating gerrymandering; (2) campaign finance reform; (3) congressional term limits; and (4) lobbying bans for former elected officials. These reforms can be beneficial, especially (1) and (2). The others are likely to have little impact because they do not address the structural problems.

The most powerful reforms are in three other areas not known to most individuals, but far more powerful because they will change the nature of political competition, reduce partisanship, and raise the ability of our legislators to pass and implement real solutions to our pressing economic and social challenges.

- **Nonpartisan Top-Five[10] primaries:** Many elections, especially in districts dominated by a single party, are, in effect, decided in the primary. However, only a small percentage of the electorate votes in primaries. In many states, independent voters are excluded from primaries entirely.[11] Primary voters tend to be more ideological than the party as a whole, often motivated by a single issue they care deeply about, such as immigration. In order to win the primary election, politicians are forced further to the ideological extremes than their constituents on the whole actually want. Partisan primaries are a major reason why there are few moderates remaining in Congress.

  In addition, the ability of politicians to compromise and engage in bipartisan legislating while in office is limited significantly by the threat of "getting primaried."

  In place of traditional closed-party primaries, Top Five is a single nonpartisan primary open to all

FIGURE 6: DEMOCRATIC PRINCIPLES AND CORRESPONDING POLITICAL SYSTEMS REFORMS

	Democratic Principles	Political System Reforms
1	Politicians should not have the power to draw congressional districts to favor their party	Gerrymandering reform
2	Money should not be a deciding factor in elections	Campaign finance reform
3	Politicians should not be able to become lobbyists after retiring	Institute a lifetime ban on lobbying for members and former members of the House and Senate
4	Members of Congress should not be career politicians	Implement term limits for the House and Senate
5	Party primaries, in which only a small fraction of the population votes who are party activists, should not play a central role in the election system	Reform the primary system to create a single non-partisan primary in which all candidates run and the top 4 reach the general election
6	To win an election, a candidate should be required to receive support from a majority of voters (more than 50%), rather than the current plurality system where candidates can win with less than 50% of the vote	Implement ranked-choice voting in the general election
7	The legislative process in the House and Senate should be fair and open to all legislators, not controlled by the majority party	Eliminate political party control of the legislative process in Congress

Note: The survey for this report was developed in late 2018 and incorporated top-four in the reform strategy. Based on continuing research, Gehl and Porter concluded that top-five primaries, rather than top-four primaries, are the optimal configuration when adopted in conjunction with ranked-choice voting (RCV).

voters. The five top finishers advance to the general election. Opening the primary, and expanding the number of candidates who qualify for the general election, will increase electoral competition. During elections, nonpartisan top-five primaries transfer more influence to a broad array of voters, while today's system gives major influence to highly partisan primary voters who often determine electoral outcomes. With Top Five primaries, legislators will consider a broader base of constituency when in office and will be able to vote for solutions-oriented bills citizens in their district really want.

- **Ranked-choice voting (RCV):** Under our current plurality voting system, the candidate with the most votes wins. But candidates need not secure a *majority* of votes. In a three-way race, for example, a candidate can win with only 34% of the votes, meaning 66% of voters in the voting election preferred another candidate. Plurality voting motivates candidates to appeal to their base, but not necessarily to appeal to a majority of voters. RCV, instead, ensures that the candidate with the *broadest appeal* to the *greatest number of voters* always wins.

  In RCV, voters go to the polls and rank their candidates in order of preference, selecting their top choice, their second choice, and so on. If a candidate receives a majority of first-place votes, he or she wins. If none garners an initial majority, the candidate with the fewest first-place votes is eliminated, and the second-choice of voters who preferred that candidate are then counted. This process continues until there is a majority winner. In addition to incenting candidates to appeal to a broader cross-section of the electorate and not a just-large-enough partisan base, RCV also allows independent and third-party candidates to run without fear of "spoiling" an election. When voters' second-place choices matter, they are free to select a non-major-party candidate first, who is less well known, without fear of "wasting" their vote. This feature of RCV injects healthy competition into elections by lowering barriers to new competition.

- **Legislative rules reform:** In order to enable our elected officials to better negotiate, find compromise, and pursue bipartisan legislation, current legislative rules and practices must be freed from self-interested duopoly design and optimization. Most of the rules and practices that govern legislative processes in the House and Senate are not dictated in the Constitution. Instead, they have been engineered by the duopoly over time. Our research finds that many of these rules work against negotiation and compromise while rewarding gamesmanship and gridlock.

> The Hastert Rule is one particularly striking example—an informal duopoly-defined rule that empowers the House Speaker to block a floor vote on a bill unless a majority of the Speaker's party supports it. In practice, bills with a majority of support in Congress *overall* are regularly prevented from floor votes—or even from debate. Other rules and practices, ranging from the nature of the congressional calendar to the appointment of committee chairs, have significant implications for the incentives shaping legislative behavior. Given this structure, major legislation today is only possible when a partisan majority passes bills. Absent substantial legislative reform and election changes, partisanship and gridlock will likely persist, regardless of whom we elect to Congress.

Among survey respondents, we found support for virtually all of the principles and reforms. But importantly, we also found a pattern of less support for reforms that were less widely known but which our research has shown to be the most powerful.

Democratic Principles

Figure 7 shows the democratic principles we tested with our respondents and the degree of agreement. By and large, we found strong agreement across the board. HBS alumni and MBA students were the most supportive, with the general public somewhat less certain. This may reflect the public's greater lack of knowledge about many aspects of how our complex political system works. Yet even a majority of the public supported all but the two principles, both in areas not known to many (RCV and primary reforms).

Of the seven democratic principles, two that have been widely discussed in public resonated most strongly across all groups: first, eliminating gerrymandering (the ability of the party in power to draw distorted congressional districts for partisan gain); and second, reducing money in politics. Both are clear distortions of an equitable democratic process. Yet there were differences on partisan lines. Of Democrat alumni, 89% supported the idea that money should not be a deciding factor in elections, while only 59% of Republican alumni supported this idea. Nearly all Democrat alumni (96%) supported the idea that politicians should not have the power to gerrymander, versus 72% of Republicans. These party-based differences may reflect the fact that Republicans have taken more advantage of partisan redistricting than Democrats in recent decades.

Interestingly, two-thirds of alumni *opposed* the idea of politicians becoming lobbyists after retiring, even though it is the business community that often hires them. This foreshadows our findings on the role of business in politics, discussed in Chapter 3.

FIGURE 7: SUPPORT FOR DEMOCRATIC PRINCIPLES THAT SHOULD GUIDE POLITICS

Support for Democratic Principles	HBS Alumni	HBS Students	General Public
DEMOCRATIC PRINCIPLES ASSOCIATED WITH WELL-KNOWN REFORMS			
Politicians should not have the power to draw congressional districts to favor their party	86%	86%	56%
Money should not be a deciding factor in elections	76%	80%	63%
Politicians should not be able to become lobbyists after retiring	67%	53%	53%
Members of Congress should not be career politicians	57%	35%	52%
DEMOCRATIC PRINCIPLES ASSOCIATED WITH GEHL-PORTER POWERFUL REFORMS			
Party primaries, in which only a small fraction of the population votes who are party activists, should not play a central role in the election system	53%	59%	36%
To win an election, a candidate should be required to receive support from a majority of voters (more than 50%), rather than the current plurality system where candidates can win with less than 50% of the vote	50%	52%	48%
The legislative process in the House and Senate should be fair and open to all legislators, not controlled by the majority party	58%	63%	52%

FIGURE 8: SUPPORT FOR POLITICAL SYSTEM REFORMS

WELL-KNOWN REFORMS		2019	2016	2016–2019 Change
Gerrymandering reform	HBS Alumni	84%	76%	+8%
	General Public	47%	47%	-
Campaign finance reform	HBS Alumni	76%	71%	+5%
	General Public	53%	54%	-1%
Institute a lifetime ban on lobbying for members and former members of the House and Senate	HBS Alumni	66%	65%	+1%
	General Public	52%	51%	+1%
Implement term limits for the House and Senate	HBS Alumni	64%	66%	-2%
	General Public	60%	58%	+2%

GEHL-PORTER REFORMS		2019	2016	2016–2019 Change
Reform the primary system to create non-partisan primaries in which all candidates run and the top 4* reach the general election	HBS Alumni	47%	41%	+6%
	General Public	38%	39%	-1%
Implement ranked-choice voting in the general election to require the winner to be supported by a majority of citizens	HBS Alumni	43%	-	-
	General Public	34%	-	-
Eliminate political party control of the legislative process in Congress	HBS Alumni	58%	62%	-4%
	General Public	42%	47%	-5%

*The survey for this report was developed in late 2018 and incorporated top-four in the reform strategy. Based on continuing research, Gehl and Porter concluded that top-five primaries, rather than top-four primaries, are the optimal configuration when adopted in conjunction with ranked-choice voting (RCV).

Note: The questions posed to respondents varied slightly between 2016 and 2019. We are comparing the responses to get a sense of the change in support. In 2016, respondents were asked, "Do you agree or disagree that each of the following possible changes would make the U.S. political system more effective?" The available answers were as follows: "Strongly disagree," "Somewhat disagree," "Neither agree nor disagree," "Somewhat agree," "Strongly agree," and "Don't know." Figures above for 2016 support include those who answered "Somewhat agree" and those who answered "Strongly agree." In 2019, respondents were asked, "Do you support or oppose the following reforms to the U.S. political system?" The available answers were as follows: "Oppose," "Neither support nor oppose," "Support," and "Don't know." One reform, "Implement ranked choice voting in the general election," was not asked about in 2016.

The least support among HBS alumni and the general public was for shifting to nonpartisan primaries and to majority voting instead of plurality voting. Ranked-choice voting is a voting system that shifts to majority voting. It is already in use in some parts of the U.S. but still not recognized by many. While we believe these election rules are arguably the two most powerful drivers of today's unhealthy and highly partisan political competition, it is clear that greatly expanded understanding of these rules and their consequences for outcomes is needed among business leaders and the public. This is a priority today.[12]

Support for Particular Reforms

Figure 8 reports alumni and public support, in both the 2019 survey and our previous 2016 survey, for the widely discussed reforms as well as the powerful and achievable reforms we have highlighted. Among HBS alumni, there was widespread support for many of these reforms.

Overall, the general public support for reform was lower than among HBS alumni. We believe a key reason is, again, a lack of awareness and uncertainty about how our political system actually works, and how little of this is specified in the Constitution. Large cross-sections of the general public responded "Don't know" on many reform questions.

Among alumni and citizens, we see a pattern that reforms most widely covered in the media, like gerrymandering reform and campaign finance reform, have the most awareness and support. Less well-known reforms, like primary system reform, ranked-choice voting, and eliminating partisan control of the legislative processes in Congress, receive less support, even though they are arguably more powerful levers for changing elections and governing. Eliminating party control of legislating and partisan primaries registered the highest percentage of "Don't know" responses by the public (23% and 22%, respectively). Many Americans don't yet understand how these insidious, largely unknown insider rules and practices have created strong, perverse incentives for outcomes in both elections and governing that benefit the parties and their partisans, not the public.

We also asked respondents to suggest other reforms not included in our survey. The result was a long list shown in Appendix C.[13] While the suggested reforms include some that could be helpful, several would require a Constitutional amendment, making implementation difficult. Some suggested reforms would have little or no impact because they would not influence the nature of competition in the system. Term limits, for example, have no effect on the nature of competition; a new candidate for a seat opened up by term limits would still have to navigate the same dysfunctional elections and legislative system.

While voter education is clearly an important priority for political reform, our survey results suggest that momentum for political reform is building, albeit slowly. Among HBS alumni, support for nearly all reforms rose from 2016 to 2019, with the exception of legislative reform. The need for legislative reform remains hidden except for those few citizens and business leaders who have any real understanding of how the legislative processes in both the House and Senate has been captured by the duopoly, especially the party in the majority at any given time.

Alumni results foreshadow clear progress on reform in America today. Both primary reform and RCV are being considered or going on ballots in a growing number of states.

Toward a Political System that Works for America and U.S. Competitiveness

Americans are frustrated with a political system that serves the entrenched interests of the political industrial complex, not the public interest, and blocks solutions to the critical economic and social challenge our nation faces. Our survey results highlight one of the most powerful weapons available to preserve the duopoly at the expense of good outcomes: that most Americans *do not yet understand the underlying drivers* of dysfunctional competition in politics, nor have they been exposed to the levers for change that are most powerful. Lack of knowledge is lack of power for citizens.

Our analysis makes it clear why our political challenges have not been solved by substituting one party in power for the other, or by replacing one elected official with another, or developing new policy ideas, or even by pursuing any number of well-meaning political reform efforts. Only by understanding how the system works can we more objectively determine how our energy pursuing political system innovation is best spent.

Currently, most efforts to change the politics industry revolve around a laundry list of reforms. While we endorse parts of the popular reform agenda, we find that many of its propositions and campaigns will either not address root causes of system failure, or they aren't viable—or both. Instead, we focus on what is doable *and* worth doing. The answer? Political innovations found at the intersection of what's *powerful* and what's *achievable.*

We have put forward such a strategy for political innovations, starting with the pair of electoral innovations we noted earlier: nonpartisan top-five primaries and ranked-choice voting in general elections. These will make our elected officials more accountable to all citizens and restore the connection between doing the right thing in office and getting re-elected. We also prescribe an independent, nonpartisan Commission, for which there is precedent in America, to put forth a reimagined set of legislative rules and practices that advance compromise and problem solving.

To make these political innovations a reality, a public education campaign will be essential to help citizens understand the nature of the problem and to realize that change is possible. Our job as citizens extends far beyond just showing up at the polls to vote. We must participate in the *design of our democracy* by supporting political innovation—and such efforts are already underway in states all across the country.

HBS alumni can play a pivotal role in supporting and evangelizing this movement. Find the political innovation efforts in your state and support them with your time and your resources. In addition, change the way in which your company engages in politics, including by supporting political innovation, as we discuss in Chapter 3. These will reduce partisanship and limit the power of parties to distort outcomes. And, importantly, leverage your network to spread the word. Our democracy depends on it.

CHAPTER 3

THE ROLE OF BUSINESS IN POLITICS TODAY AND TOMORROW

Michael E. Porter

Observing the political dysfunction we described in the last chapter, business leaders might be tempted to look down smugly on the political system and blame politicians for its problems. They should realize, however, that business itself is partly responsible for today's hyper-partisan, gridlocked politics. In ways we describe below, business has funded, perpetuated, and profited from political dysfunction.

In this chapter, we build on joint research by Katherine Gehl and Michael Porter on the political system as well as survey results to examine how businesses engage in politics, how business leaders and the general public feel about that engagement, and whether business leaders are willing to adopt a new engagement model.*

Three findings stand out. First, a remarkably high portion of business leaders seem not to be fully aware of how their companies interact with the political system. Second, while most business leaders deny that their own companies engage with politics in a way that has adverse societal impact, most also believe that business as a whole engages in a way that is bad for public trust in business and bad for America. And third, many business leaders support reforms that would change how businesses interact with the political system. Enacting these reforms would be powerful, but not easy.

Today's Playbook

Today, companies' involvement in politics takes five major forms:

- Companies lobby government officials and regulators.
- They spend on elections via corporate PACs and other vehicles.
- They make recommendations to employees about how the employees should vote and donate in elections.
- They spend heavily to prevail in direct democracy votes, ballot initiatives, and referenda.
- They hire former government officials to take advantage of their influence—the so-called "revolving door."

There is little systematic data on the overall prevalence of these practices, or their impact, because companies have rarely disclosed their political activities voluntarily. There are disclosure rules in areas such as lobbying spending, but loopholes allow much of it to go unreported.

To shed new light on these practices, we divided HBS alumni survey respondents into two groups. We asked the first half whether *their companies* participated in each of these practices and, if so, what the business effects and broader societal impacts were. The other half of alumni respondents were asked about *business in general*: whether companies *should* engage in each practice and what overall impact each business practice had. In addition, we surveyed HBS MBA students and members of the general public on the same set of questions about whether companies should engage in politics and the consequences.

Let's examine each of the five business practices in turn.

Lobbying. Companies and industry associations spend heavily on lobbying to influence legislation, regulatory rules, and other government actions in their favor. Lobbying has been growing. Registered and unregistered lobbying is estimated at $6 billion per election cycle.[14] From 2000 to 2018, annual reported federal lobbying expenditures more than doubled, from $1.6 billion to $3.5 billion.[15] Lobbying by big tech companies to counter regulation is rapidly growing. In 2018 alone, Alphabet, Facebook, Amazon, Microsoft, and Apple spent $65 million on lobbying the federal government,[16] more than any other lobbying group except the U.S. Chamber of Commerce and the National Association of Realtors.[17]

*This chapter draws heavily on research by Katherine Gehl and Michael Porter in the report, "Why Competition in the Politics Industry is Failing America," published by Harvard Business School in September 2017. Gehl and Porter also contributed to developing the survey questions. A comprehensive book by these authors on politics, entitled *The Politics Industry: How Political Innovation Can Break Partisan Gridlock and Save Our Democracy*, will be published in June 2020.

Of the top 20 overall lobbying spenders last year, 19 represented business interests.[18] Companies also spend an estimated $1 billion per year on state lobbying, where companies often have significant influence.[19]

The influence of lobbying is illustrated by the opioid crisis, in which more than 200,000 Americans have died from opioid overdoses, with deaths increasing rapidly from the late 1990s to 2017.[20] During this period, citizen groups and others advocating tighter restrictions on the sale of painkillers spent a total of $4 million on lobbying. Pharmaceutical companies producing and marketing opioids organized the "Pain Care Forum." This group spent more than $740 million on lobbying, primarily to block federal and state efforts to introduce sensible regulations on the sale of addictive pain medications. Unfortunately, they succeeded in doing so.[21] Of the companies involved, some channeled their funding through other industry groups or third parties, which reduced the transparency of their efforts.

In our survey, we asked the first half of alumni whether *their companies* participated in lobbying government on their behalf, either directly by company staff or through a lobbying firm. Just 25% of HBS alumni overall believed that their companies engaged in lobbying. Of this 25%, 81% believed that their companies' lobbying practices provided useful information to inform public policy, and 52% responded that they did not believe that their companies' lobbying had an adverse effect on the public interest.

When we asked the other half of alumni about the *overall impact of business lobbying practices* (not just their own companies'), 86% responded that business community lobbying primarily advanced *company interests*, sometimes *at the expense of the public interest.* MBA students had similar views on the impact of business lobbying. We were struck that lobbying by one's own company is perceived as more socially beneficial than corporate lobbying in general.

Our survey of the general public also revealed just how little awareness citizens have of the role that business is playing in influencing public policy. Compared to alumni or MBA students, numerous general public respondents answered "Don't know" to both questions asked about corporate lobbying. Of the general public, just 26% (versus 47% of alumni) believed that corporate lobbying advanced public policy, and 56% (versus 86% of alumni) answered that corporate lobbying primarily advances company interests at the *expense of public interest.*

Corporate Spending on Elections. Many companies go beyond lobbying and get directly involved in elections. Corporate election spending is channeled primarily through corporate political action committees (PACs) and, to a lesser extent, other types of entities, including super PACs, politically active trade associations, and so-called "social welfare organizations" such as Americans for Prosperity and Organizing for Action—groups that lobby as well as organize to promote civic engagement and legislation.[22] In the 2018 midterm election cycle, corporate PACs alone spent more than $400 million in federal elections, about 5% more than in the 2016 election.[23] Total 2018 federal election spending by business is estimated at $2.8 billion.[24] At the state level, business election spending was about $37 million in the 27 states where data are available for 2016.[25] From 2009 to 2018, public companies were the largest source of funding supporting partisan groups in state-level races, such as the Republican Governors Association and its Democratic counterpart.[26]

WE ARE STRUCK THAT LOBBYING BY ONE'S OWN COMPANY IS PERCEIVED AS MORE SOCIALLY BENEFICIAL THAN CORPORATE LOBBYING IN GENERAL.

Research reveals that direct election spending by companies often supports both parties and is designed to raise company influence through building relationships with multiple legislators on both sides.[27]

Despite major business spending on elections, few alumni reported that their companies sought to influence elections. Only 12% responded that their companies contributed to elections through a corporate PAC. And 37% of alumni answered that the question about election influence was *not applicable* to their companies. This suggests either that many business leaders have little knowledge of their companies' political involvement (perhaps because only a small number of alumni are directly involved in the company's political engagement, which is often managed at the CEO/Board level) or that alumni are unwilling or uncomfortable disclosing their companies' involvement in elections.

When asked whether their own companies' election spending distorted the democratic process, just 4% said yes, while 30% disagreed (27% strongly disagreed). A remarkable 61% responded to this question with "Not applicable" or "Don't know."

Yet, among HBS alumni who were asked not about their own company but about business as a whole, 60% responded that companies *should not have corporate PACs* as a vehicle for employees to contribute to candidates the company supports. And 71% of these same alumni believed that the overall business community's election spending distorted the democratic process. Among MBA students, the corresponding figures were 56% and 78%; and among the general public, 30% and 60%. Like lobbying, election spending is seen as harmless to our democracy "when I do it," but harmful in aggregate.

COMPANIES HAVE BECOME HEAVILY INVOLVED NOT JUST IN ELECTIONS OVERALL BUT IN DIRECT DEMOCRACY.

Political Recommendations to Employees. Research suggests that companies are increasingly providing information to their employees to encourage them to vote and make donations in ways that are consistent with the company's favored candidates.[28] There are numerous examples of such practices that reflect rising pressure on employees, such as companies holding mandatory meetings to express the company's political views, distributing political flyers in employees' paycheck envelopes, and offering incentives such as preferred parking spots for those donating to the corporate PAC.[29]

Just 10% of alumni, however, reported that their companies provided information to employees about how different candidates or ballot measures would impact the company. Just 4% of alumni reported that their companies do more than provide information and actually encourage employees to vote for company-preferred candidates, and just 3% reported that their companies encouraged employees to make donations to these candidates, versus a national survey of employees and managers, which found that about *one-quarter* of workers reported that their employers contacted them on political matters.[30]

When asked whether companies *should* provide political information to employees, 54% of HBS alumni and the same proportion of MBA students answered yes, as did 39% of the general public.

Among the first half of HBS alumni surveyed about their own company, just 2% reported that they personally felt pressure from their companies to vote for company-preferred candidates, and 3% felt pressure to make a contribution to these candidates. Among the alumni commenting on business overall, however, many acknowledged that influencing employees was a common practice for business in general. A substantial number of these alumni also believed that many employees felt this kind of pressure to vote for (30%), or contribute to (33%), company-preferred candidates. These responses again highlight the tendency of business leaders to see their own company's engagement in politics more favorably than overall business practice.

Among the general public, 49% of respondents reported that many employees felt pressure from their companies to vote in ways that benefited the companies, and 47% reported employee pressure to make donations to favored candidates. This is further evidence that business leaders and the general public hold different understandings of how business engages in politics. Alumni responses tend to put business practice in a more favorable light, especially when questions are framed in terms of their own companies.

When asked about whether companies *should* encourage employees to vote for or contribute to preferred candidates, however, doubts emerged. There was very little support among HBS alumni (8–9%) and MBA students (4%) for these practices. The general public saw these practices as somewhat less problematic than business leaders, with 21% supporting them. Overall, our alumni see the adverse impact of overall business practice on the political system, while defending their own practices. Our impression from many interactions with business leaders across the country is that the attitudes and norms in the business community about its appropriate engagement in politics may be shifting.

Spending to Influence Direct Democracy Votes. Companies have become heavily involved not just in elections overall but in direct democracy. This is legislation proposed by citizens via ballot initiatives and referenda and placed on the ballot, which are then voted on by all voters. A study of eight high-profile ballot initiatives in 2016 found that company spending on advertising and other marketing exceeded non-corporate spending by 10-to-1, with unbalanced spending often having a major influence on the probability of success.[31] For example, drug companies spent $86 million to defeat California's 2016 "Drug Price Relief Act," aimed at reducing high U.S. prescription drug prices relative to prices in other countries. Citizen groups supporting the Act, by contrast, raised only $10 million, and the measure was defeated 53% to 47%. A study of the 2018 election cycle found that, among ballot measures attracting more than $5 million in spending, nearly nine out of 10 were decided in favor of the side with more money, which significantly favors business.[32]

Relatively few alumni reported that their companies sought to influence ballot measures, either through spending (5%) or by influencing employees to vote the company's way (12%). A large proportion of alumni (45–46%) responded that the questions about direct democracy were "not applicable to me/my company." When asked whether their company's attempts to influence ballot measures undermined the purpose of direct democracy, just 4% conceded that they did.

Of the other half of alumni surveyed on the impact of business overall, a large majority (59%) agreed that efforts to influence ballot measures undermined the purpose of direct democracy. An even higher proportion (64%) of HBS students held this view, as did 60% of the general public. A practice that was seen as harmless "when my company does it," then was widely criticized when respondents assessed its impact for business overall.

Hiring Former Government Officials. Many companies hire former legislators and other government officials, including the staff of key regulatory agencies, to tap into their connections in government. Companies do this both directly and indirectly (via lobbying firms). The practice, sometimes called the "revolving door," is difficult to track, but research suggests that it is quite prevalent. According to the Center for Responsive Politics, since 2011, "176 former members of Congress have taken a spin through the revolving door."[33] This equals 38% of all departing members of Congress during the period.[34] Only half registered as lobbyists, whereas the rest found workarounds but nonetheless engaged in lobbying activities. Overall, almost half of all registered lobbyists prove to be some type of former government official, with the most prevalent being former regulators or congressional staffers.[35]

Despite the overall prevalence, just 8% of HBS alumni believed that their companies actively sought to hire former government officials. This could reflect a lack of personal knowledge or discomfort disclosing this practice. Of those HBS alumni whose companies *did* employ former government officials, 56% conceded that this practice allowed their companies to influence government policies. Of all alumni, 87% believed that hiring former government officials enabled the business community to shape government policy, as did 60% of the general public. However, when asked whether companies should stop supporting the "revolving door," 74% of alumni agreed.

Lack of Transparency. Much research supports the conclusion that companies are far from transparent about their overall involvement in politics. The amount of corporate political spending, the legislation targeted, the amendments sought, the desired regulatory modifications, and other efforts are kept under wraps. In some cases, companies channel funds through industry groups, lobbying firms, or other third parties in part to obscure their objectives.

An overwhelming proportion of HBS alumni (88%), and a strong majority of the general public (65%), believe that companies *should be more transparent* about their lobbying practices. Many political reform efforts over the years have attempted to increase disclosure and transparency. However, rules enacted by the parties have almost always involved significant loopholes that have allowed companies and lobbyists to avoid full disclosure. The Securities and Exchange Commission (SEC) has broad rulemaking authority to decide what information public companies must disclose to investors and could ensure the transparency of companies' political spending. However, in 2015, Congress took the unusual step to block the SEC's ability to do so—ever so convenient for the parties, and leaving investors in the dark about how executives use their capital to influence politics.[36]

JUST 8% OF HBS ALUMNI BELIEVED THAT THEIR COMPANIES ACTIVELY SOUGHT TO HIRE FORMER GOVERNMENT OFFICIALS.

The Overall Impact of Business's Engagement in Politics

We asked the first half of alumni respondents about the overall impact of *their companies' engagement in politics* on the political system, on company performance, on the quality of the business environment, and on public trust in business. We asked the other half about the impact of *business's overall engagement* in politics in the same areas (Figure 1 on page 32).

Among those asked about the impact of their own companies, the large majority responded that the questions were "Not applicable to my company" (56–57%),

FIGURE 1: OVERALL IMPACT OF COMPANY'S VERSUS OVERALL BUSINESS COMMUNITY'S ENGAGEMENT IN POLITICS, HBS ALUMNI

	My Company's Impact			Impact of Business Overall		
Impact of Political Engagement...	**Agree**	**Disagree**	**Neither Agree Nor Disagree**	**Agree**	**Disagree**	**Neither Agree Nor Disagree**
Improves the political system	32%	23%	45%	24%	53%	22%
Worsens the political system by increasing partisanship	15%	54%	31%	50%	28%	22%
Worsens the political system by advancing policies benefiting special interests	21%	50%	29%	62%	24%	14%
Improves my company's performance	45%	16%	39%	46%	23%	32%
Improves the overall U.S. business environment	51%	16%	33%	46%	31%	23%
Improves public trust in business	28%	29%	43%	11%	69%	20%

Note: Half of HBS alumni responded to questions about "My company," while the other half responded to questions about the business community overall. Findings on "My company's impact" have removed responses of "Not applicable to me/my company" and "Don't know." Data for "Impact of business overall" have removed "Don't know" responses (the option of "Not applicable" was not offered). Rows may not add up to 100% due to rounding.

"Neither agree nor disagree" (11–18%), or "Don't know" (3–4%). This reflects either a lack of awareness of company practices or discomfort about company political involvement.

Overall, we found a big difference between how business leaders responded about their own companies' engagement (more sympathetic) and how they responded on overall business community engagement (much more critical). For example, 62% of respondents agreed that business's overall engagement *worsened* the political system by advancing policies that benefited special interests. Yet only 21% conceded that their own companies' engagement in politics had the same negative effect. Half agreed that business's overall engagement worsened partisanship, but only 15% saw their own companies' engagement as having that effect. (These figures, and indeed all of the figures in Figure 1, exclude respondents who answered "Not applicable" and "Don't know.")

A plurality among alumni felt that business engagement in politics improved company performance. This was true among those assessing their own companies' engagement (45%) and those assessing business's overall engagement (46%). Yet there is also a growing awareness that business engagement in politics has become problematic by worsening the political system and public trust in business. Both MBA students and the general public also agreed that the business community's engagement in politics "worsens the political system by increasing partisanship" (62% and 57%, respectively) and "worsens the political system by advancing policies benefiting special interests" (72% and 60%, respectively).

Long-Run Consequences of Today's Playbook in Practice

Current rules give business every right to participate in politics in the ways we have described. As reflected in Figure 1, many executives, though not a majority, see these practices as working in the sense that they improve company performance. Also, much research finds that lobbying yields a positive ROI,[37] not surprising given today's highly partisan special-interest-driven system. And heavy spending on ballot initiatives often prevails.[38]

So the playbook works. Or does it? What has been the broader, long-run impact of the business playbook? We believe that the current playbook may work for businesses but fails business. That is, it can boost company performance but undermine business overall and as an institution.

Three long-run consequences of the playbook are especially troublesome. First, as discussed in Chapter 1, many elements of the American business environment are weak or weakening (Figure 7 on page 10). Some of these elements have been directly undermined by business's engagement in politics. Take, for instance, the corporate tax code. A rat's nest of loopholes in America's corporate tax code reduces tax revenues and boosts budget deficits, distorts investment, and raises accounting and legal costs, and the cost of tax complexity makes it harder for small businesses to compete. How did America come to have such a convoluted corporate tax code? It is not because of bureaucrats at the Internal Revenue Service, but because of company and industry lobbying and election spending that was very effective in convincing politicians to enact tax breaks that serve narrow business special interests.

By contrast, companies have rarely put any weight, much less their full weight, behind policies that would enhance business overall (e.g., by pushing for deeper and smarter investments in worker skills, more sensible immigration policies, or greater infrastructure investment).

Second, the business politics playbook has only reinforced and deepened the political gridlock described in Chapter 2, slowing progress on legislation badly needed to improve the U.S. business environment. The heart of the problem we described in Chapter 2 is that the dominant parties have modified rules and garnered enough resources to win elections, especially partisan primaries, while also engineering the political system to block election success by moderates and centrists and give parties control of the legislative process.

A large portion of the funding for the current partisan party system comes from business, in the form of corporate political contributions and lobbying spending. While business sometimes benefits in the short run, this reinforces the current dysfunctional competition that has weakened our democracy and stymied progress on the many issues where real solutions require bipartisan support and compromise, such as immigration, infrastructure investment, and health care reform.

Third, and perhaps most troubling, we believe, business's involvement in politics has eroded the legitimacy of business and capitalism with the public. Many in the public have come to see business as an institution that prospers by pursuing its interests and currying political favor at the expense of citizens, while failing to contribute enough to workers, customers, or communities. Through lobbying, influencing elections, distorting referendums, and hiring former government officials to bias legislation and regulation, companies have too often rewritten the rules of the economic game to favor corporate profits and executive compensation, at the expense of workers' wages. The resulting lack of shared prosperity has undermined confidence in capitalism as an institution. Of young Americans aged 18–29, 45% have a positive view of capitalism, but 51% have a positive view of socialism. Among all Americans, positive views of capitalism have declined 4 percentage points since 2016.[39]

Our view is that the problem is not capitalism, per se, but how business and government have shaped the practice of capitalism in America today. Historically in America, as in many other countries, capitalism has increased investment, productivity, innovation, improving standards of living, major reductions in poverty, and rising economic opportunity. Historically, the American economy created opportunities for many—the American Dream. Today, however, American business has failed to implement capitalism in a way that benefits society as a whole and expands opportunity for the broad base of citizens.

MOST TROUBLING, BUSINESS'S INVOLVEMENT IN POLITICS HAS ERODED THE LEGITIMACY OF BUSINESS AND CAPITALISM WITH THE PUBLIC.

Many business leaders we have talked to see business involvement in politics as rational and legitimate, given today's highly partisan political system, and needed to protect their interests versus competitors and other adversaries. Some business leaders with whom we spoke about modifying current political practices likened this to "unilateral disarmament," disadvantaging companies relative to their competitors and interest group adversaries. Changing the business playbook by some companies, though not business overall, could disadvantage the leaders. Defenders of the playbook also argue that business should provide information to government needed for sound public policy.

Yet little of today's business involvement in politics is focused on improving overall economic policy or advocating improvements in the broader business environment. Instead, 86% of HBS alumni, and 56% of the general public, responded that "corporate lobbying primarily aims to advance company interests, at times at the expense of the public interest."

Based on our research, we believe that much of today's business involvement in politics may actually be *working against business's longer-term interests*. It is not enhancing our nation's productivity and competitiveness, failing to put business's weight behind sound public policies to enhance the U.S. business environment, advance shared prosperity among citizens, and improve the communities on which business depends. The recent "progress" in corporate tax reform is not an exception, but the rule in today's political system. The bill passed was highly divisive and partisan (zero Democratic votes), a budget buster (adding substantially to our budget deficit), and it closed no tax loopholes.

Changing the Playbook

Today, the winds of business practice are shifting. Efforts by business to play a positive and more visible role in society are growing rapidly. Companies and their CEOs, encouraged by major investors and leading business institutions, are beginning to adopt a broader corporate purpose as their central goal, going well beyond maximizing shareholder value and benefiting all stakeholders. More companies are moving beyond environmental, social, and corporate governance (ESG) reporting, which has little impact, to actually integrate social needs and challenges into core strategy.[40] Companies are also recognizing that there is no conflict between social improvement and competitive advantage, but a powerful synergy.[41]

The focus on business impact on social needs thus far has been in areas like reducing greenhouse gas emissions, improving employee health, and, more recently, paying a living wage and improving training and career development for lower-income workers. These are welcomed steps, which advance the business, but the bar is rising. The annual "Change the World" list, published by *Fortune* since 2015, recognizes 50 companies each year that have made large-scale social impact that has meaningfully enhanced their profitability. Public companies on this list in 2015, 2016, and 2017 outperformed the MSCI World Stock Index by an average of 3.9% in the year following publication.[42]

Are these winds of change in business, together with the failure of our democracy to solve many of our most important economic and social challenges, strong enough to change how business engages in politics? To test the winds, we asked our alumni a series of questions about how businesses *should* approach the political system in the future. See Figure 2 for our survey questions and the results. To a degree that surprised us, alumni strongly supported changes that would fundamentally alter the playbook. Our survey suggests what could be an emerg-

FIGURE 2: SURVEY QUESTIONS AND RESPONSES ON BUSINESS'S CURRENT INVOLVEMENT IN POLITICS

	Alumni response to the following statement	Agree	Disagree
1	Companies should engage with politics to help improve the overall business environment and advance the public interest	74%	13%
2	Trade associations should focus more on improving the overall business environment, and less on advancing the particular interests of member companies	69%	17%
3	The business community (both companies and trade associations) should spend less on lobbying	67%	12%
4	Companies should not spend corporate money on elections, regardless of whether they have a right to do so	59%	26%
5a	Companies should not encourage employees to vote for the companies' preferred candidates in elections	81%	9%
5b	Companies should not encourage employees to contribute directly to the companies' preferred candidates in elections	81%	8%
6	Companies should not try to buy favorable outcomes in ballot measures	73%	14%
7	Companies should stop supporting the revolving door of government officials joining companies for lobbying purposes	74%	11%
8	Companies should be more transparent about the nature of lobbying practices	88%	4%
9	The business community should support reforms to the political system that would reduce partisanship and align practices (election rules, governing rules, campaign finance rules, etc.) with democratic principles	79%	8%

Note: Rows do not add up to 100% due to respondents who answered "Neither agree nor disagree" or "Don't know," which were possible responses on each question.

ing consensus on a new role for business in politics, and the general public agreed.

Through analysis of the survey results and our many discussions with business leaders, we propose the following set of voluntary standards, which we believe every company should adopt when dealing with politics and government. We are confident that these more refined standards would receive even higher levels of support among the business community than did our initial survey questions. Our proposed voluntary standards for the role of business in politics are shown in Figure 3 on page 35. This is an area in which breaking from traditional practices is likely to trigger discussion, and even controversy. However, we believe that the time for this discussion has arrived.

We realize that it is far easier for business leaders to fill out a survey than it is to change traditional behavior in an area where many have seen short-term gains. Yet, if we recognize the declining trust in business, the increasing desire of younger employees and managers to work for companies that play a positive role in society, the reality of a political system that has failed us, and the ability and influence of business to change the partisan game, we think the time has come to change the business-politics playbook. We believe this will be welcomed by business's key stakeholders, rather than being seen as a risk to company success. The support by alumni for moving to a new playbook is heartening.

Among the voluntary standards in Figure 3, the first eight will reduce business's problematic role in politics. The final standard will harness the power and influence of business in driving, and even leading, the political innovations discussed in Chapter 2. These voluntary standards are meant to be a starting point to be refined through further discussion and input from the business community. We welcome this discussion, and will continue to work with alumni and all in business to take the steps needed to realign our political system with the public interest.

Not all companies will be willing to stop playing the game. We have heard some executives liken doing so to "unilateral disarmament" and that companies that move early will suffer a disadvantage relative to those that continue to pursue special interest benefits. In our survey, however, we found that the majority of business leaders approved of the direction of these changes. And we believe that more will do so as it becomes clear that multiple stakeholders, such as employees, customers, investors, and even some in government, will applaud business leadership even with its near-term cost.

We also call on business groups, such as the Business Roundtable, the U.S. Chamber of Commerce, and many others, to play a central role in encouraging adoption of the voluntary standards, as well as to support and cooperate with the establishment of a mechanism to verify their adoption by companies and to make this transparent.

Calling on business to lead political reform is likely to unleash criticism from some in the political parties, and there may be some initial skepticism by the public in light of businesses' history of contributing to, and profiting from, dysfunction in politics. Yet business leaders need to face up to this skepticism and start to rebuild public trust by taking the lead. Publicly adopting the voluntary standards for business's role in politics will go a long way toward restoring faith in capitalism.

We do not see any other major societal institution that has as much potential impact on fixing our broken political system as business. As discussed in Chapter 2, the most powerful political reforms to realign political competition and the public interest are (1) nonpartisan top-five primaries and (2) ranked-choice voting in general elections to require a majority to win. Many business leaders in our survey already agree with these reforms (47% and 43%, respectively).

Business has both the pressing need, and the capacity, to not only lead political reform but also transform business practices vis-à-vis government and politics. It is time to accept this responsibility. Business needs to become a force for improving democracy, not for perpetuating a system that is dividing citizens and blocking real solutions. Reform will also significantly reduce the need for business to play the current party game.

We call on every company to adopt the voluntary standards for business involvement in politics. The ideas behind these standards received strong majority support from HBS alumni and the public. We believe they will also be widely supported among employees, citizens, and civil servants. The only opposition will come from the party duopoly and its appointed agents in government. The time is now.

FIGURE 3: PROPOSED VOLUNTARY STANDARDS FOR BUSINESS'S FUTURE ROLE IN POLITICS

	Focus on the General Interest
1	Companies should focus their interactions and collaboration with government on supporting policies to improve the overall business environment and advance the overall public interest
2	Trade associations should focus their political involvement on improving the environment for all business and less on advancing industry special interests
	Lobbying
3	Both companies and trade associations should reduce spending on special-interest lobbying as it is practiced today, and support regulations and disclosure to moderate it
	Corporate Spending on Elections
4	Companies should reorient corporate spending on elections to support solutions-oriented candidates and organizations, rather than partisans who amplify gridlock
	Political Recommendations to Employees
5	Companies should encourage and enable employees to vote and participate in elections but no longer pressure employees to vote for, or contribute directly to, the companies' preferred candidates or corporate PACs
	Spending to Influence Direct Democracy Votes
6	Companies should no longer use heavy spending to prevail in ballot measures that favor business interests over citizen interests
	Hiring of Former Government Officials
7	Companies should stop supporting the revolving door of hiring former government officials to gain influence in legislation and regulation and support regulations to limit this practice
	Transparency
8	Companies should increase transparency on the nature of their political involvement. They should also support regulations that provide for open reporting of lobbying and elections spending to level the playing field
	Support for Political Reform
9	The business community should throw its support behind political system innovations that would reduce partisanship and align rules and practices with democratic principles (such as election rules and governing rules)

CHAPTER 4

THE PROMISE AND PITFALLS OF TAX REFORM

Mihir A. Desai

The Tax Cuts and Jobs Act (TCJA) of 2017 represents the major domestic policy achievement of the Trump administration.* As Figure 1 indicates, the recent reform shifted alumni perceptions of the tax code from a significant impediment to U.S. competitiveness to a source of strength. When asked specifically about the effects of the TCJA on U.S. competitiveness, 60% of alumni respondents indicated that the legislation made the United States more competitive. At the same time, the early evidence on the effects of the TCJA on investment suggests a more muted reaction, as the growth of business fixed investment before and after the reform has not shown a marked change. Indeed, alumni respondents were considerably more muted when asked about what specific investment decisions may have changed as a result of the TCJA: only 17% of respondents reported that the reforms caused their companies to increase investment in the U.S.

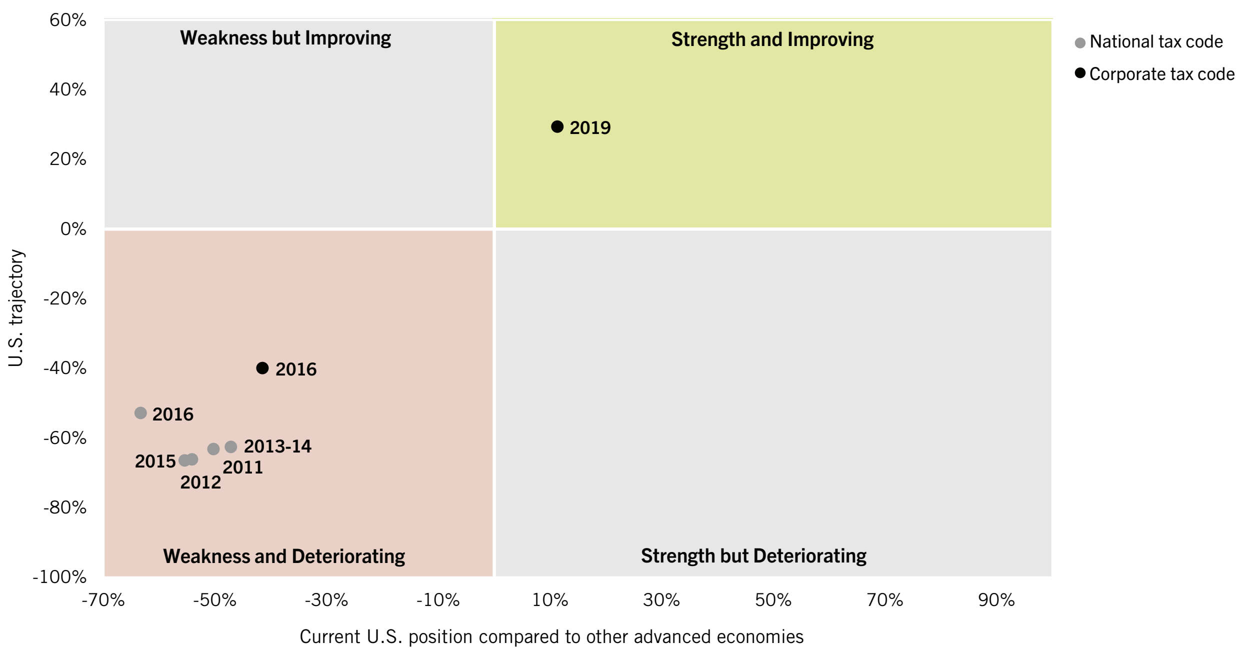
How can the promise of the TCJA's significant effects be reconciled with these more muted responses? And what should we expect going forward for the tax code's impact on U.S. competitiveness? To examine these questions, we lay out the key provisions of the Act, offer an overall assessment, and discuss the unfinished business of U.S. tax reform.

Understanding the TCJA

In the context of other legislation over the last 40 years, the tax reform was not remarkable for its magnitude. As Figure 2 on page 38 shows, the reform's revenue consequences were comparable with other reforms, when framed relative to gross domestic product.

*This chapter draws heavily on Mihir Desai's review of the TCJA originally published in *Harvard Magazine,* May–June 2018.

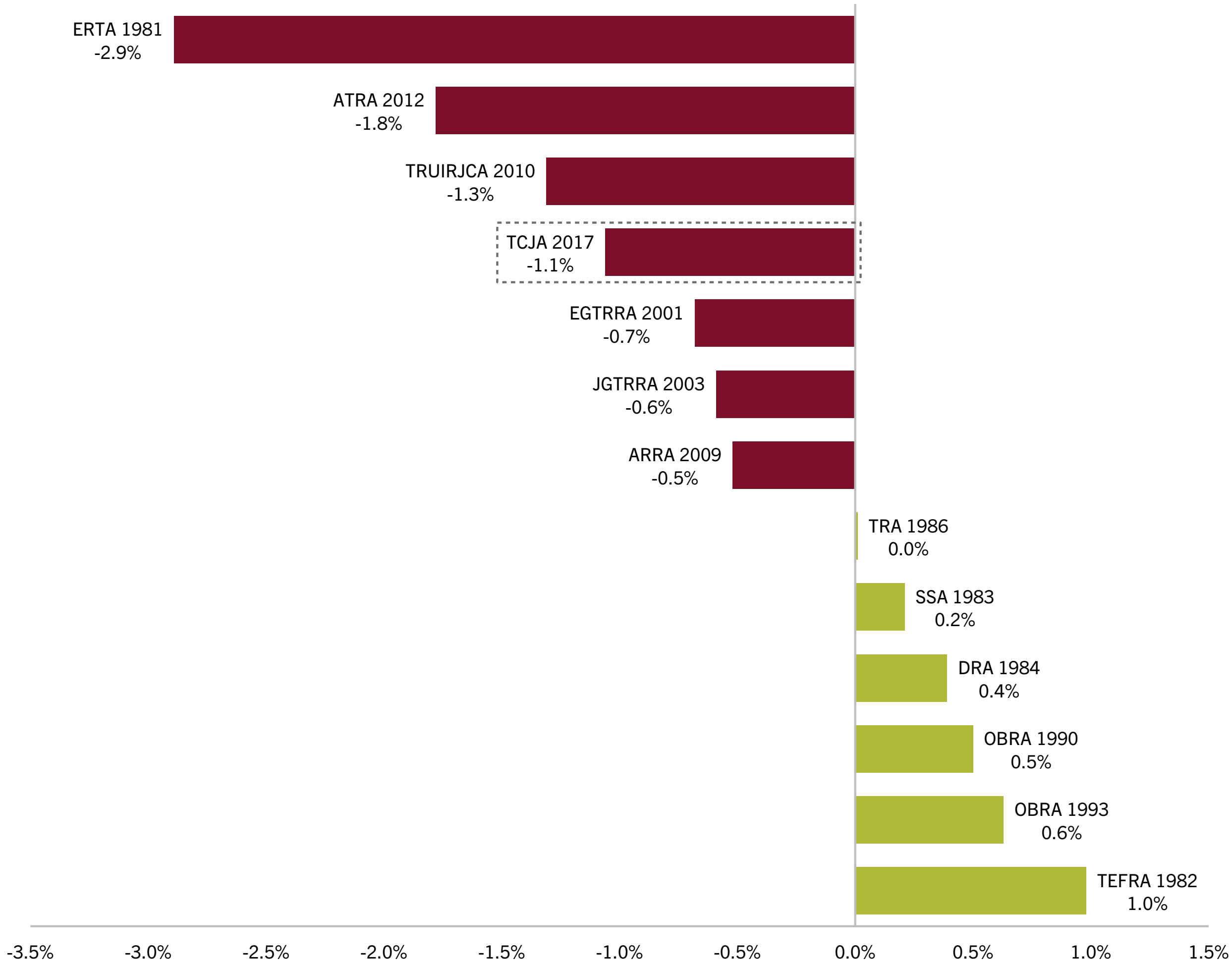
FIGURE 1: ASSESSMENTS OF THE U.S. TAX CODE BY ALUMNI SINCE 2011



Note: Prior to 2016, alumni were asked to assess the national tax code. In 2016, alumni were asked to assess both the national and corporate tax codes. In 2019, alumni were asked to assess the corporate tax code. Scored as percentage with positive views minus percentage with negative views. Calculations exclude respondents who answered "Don't know."

FIGURE 2: REVENUE EFFECTS OF MAJOR TAX LEGISLATION SINCE 1980

Revenue Gain (+) / Loss (-) as a Percentage of GDP



Note: Percentages are an average over the first four years following enactment.
Source: Jerry Tempalski, "Revenue Effects of Major Tax Bills," U.S. Dept. of Treasury; "Is President Trump's Tax Cut the Largest in History Yet?," Committee for a Responsible Federal Budget

What makes the TCJA important is the scope and depth of the changes it enacted to the overall system of taxation. No other reform over the last four decades comes close to the TCJA in terms of its far-reaching impact.

The unwieldy legislation is best understood by separately considering its impact on corporations, pass-through entities, and individuals and by framing these changes relative to the overall size of the legislation (Figures 3 and 4). The Joint Committee on Taxation estimated the TCJA's revenue cost to be $1.5 trillion over 10 years, spread between individuals (60%), pass-throughs (18%), and corporations (22%).[43] These figures are net figures that offset tax increases from tax cuts. For example, the total revenue lost through the corporate provisions is $329 billion, but that represents the net of $1.85 trillion in cuts and $1.52 trillion in increases. For individuals, there are $3.24 trillion in cuts and $2.38 trillion in increases that result in the total revenue loss of $862 billion. As such, the scope of the provisions are larger than net numbers reveal. Moreover, within each category, these provisions are highly redistributive: there are big winners and losers.

Changes to Corporate Taxation. Taken together, the five major changes to the corporate tax code constitute a revolution in the way corporations are taxed (Figure 5 on page 40). And a revolution was long overdue. Prior to the TCJA, the corporate tax code featured the worst of all worlds: a relatively high marginal rate that distorted incentives for transfer pricing and enough holes to allow for average rates to be considerably lower. The regime of taxing international income was out of step with the

FIGURE 3: MAJOR COMPONENTS OF TCJA

10-Year Revenue Change (+) / (-), Billions

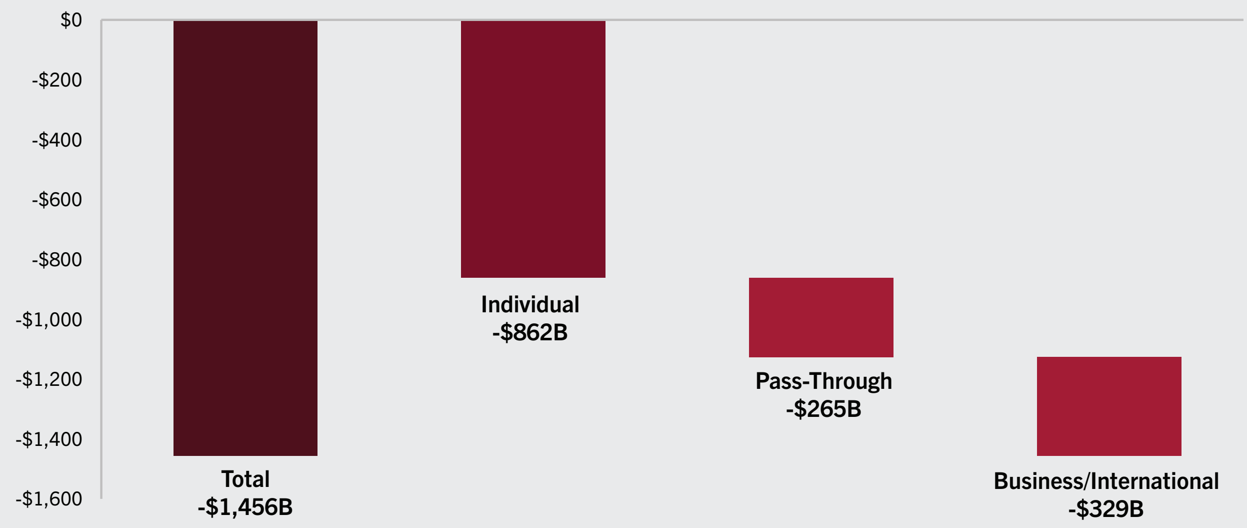
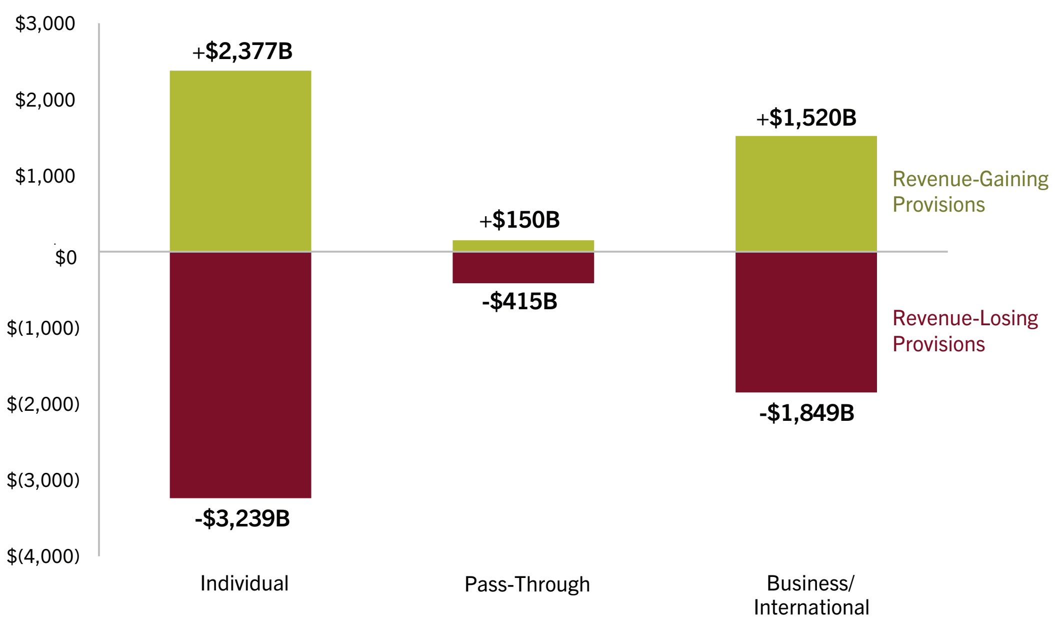


FIGURE 4: TCJA: WINNERS AND LOSERS

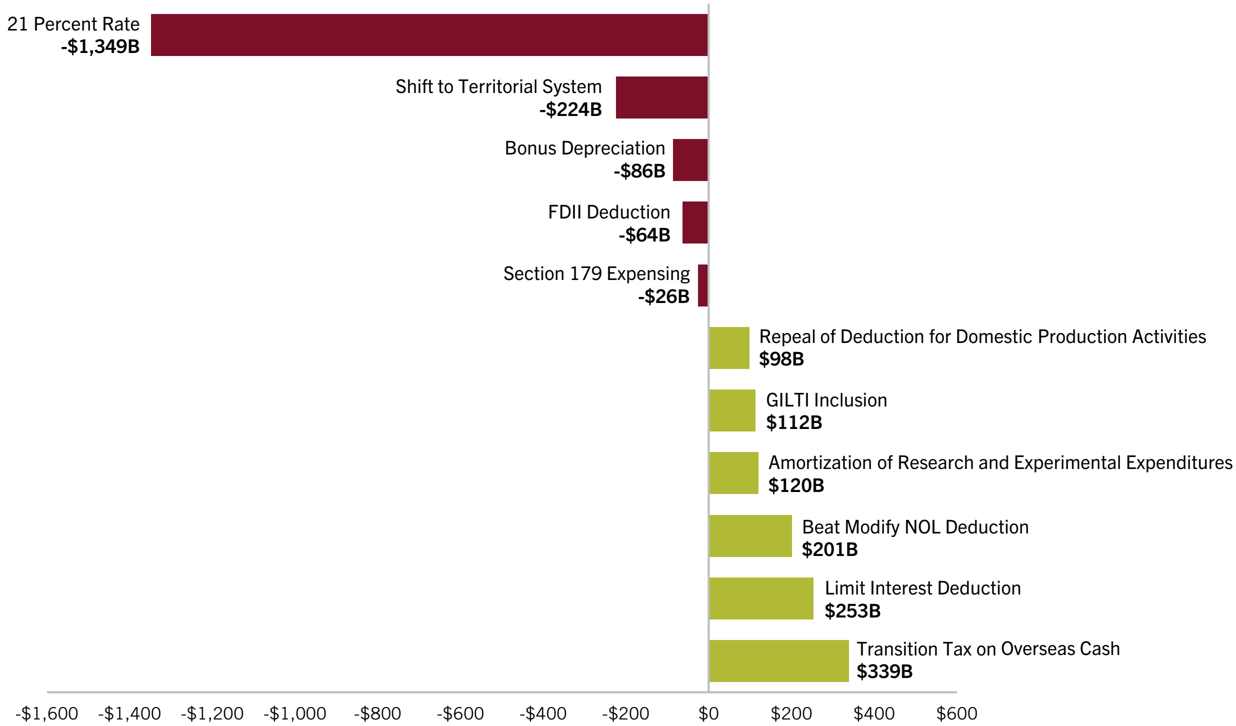
10-Year Revenue Gain (+) / (-), Billions



Source: "Estimated Budget Effects Of The Conference Agreement For H.R. 1, The 'Tax Cuts And Jobs Act,'" *Joint Committee on Taxation,* December 18, 2017

FIGURE 5: MAJOR COMPONENTS OF BUSINESS AND INTERNATIONAL TAX REFORM

10-Year Revenue Gain (+) / (-), Billions



Source: "Estimated Budget Effects Of The Conference Agreement For H.R. 1, The 'Tax Cuts And Jobs Act,'" *Joint Committee on Taxation*, December 18, 2017

practices of comparable countries around the world. The effects of these flaws were visible in the tax-motivated efforts of U.S. corporations to leave the country and in the large piles of cash held in offshore jurisdictions.

First among the changes, and most visibly, the TCJA reduced the statutory corporate rate from 35% to 21%,[44,45] a reduction that easily eclipses any undertaken by a developed country over the last several decades. Second, capital expenditures on equipment that were previously expensed over time according to depreciation schedules can now be deducted entirely in the year they are undertaken ("expensing"). Third, rather than taxing corporations on their income around the world and providing credits for taxes they paid abroad, the U.S. will now transition to a regime that emphasizes only taxing income within its borders (i.e., a transition from a worldwide regime to a territorial regime). And, as part of that transition, the stock of foreign profits that had been held abroad in order to defer their tax obligations will be taxed currently. Fourth, there are three new international tax instruments that are completely novel on the global scene. And finally, the deductibility of interest at the corporate level will be limited to 20% of operating profit.

For investment incentives in the U.S., the statutory rate reduction, the implementation of full expensing, and the limits on interest deductibility are the key features. These features interact in surprising ways for different types of investments. In general, the rate reduction and the move from depreciation to expensing increase the incentive to invest, while the limitation on interest deductibility discourages investment. For equipment, the expensing is critical and limits the importance of the tax-rate reduction because expensing makes the actual tax rate irrelevant for investment incentives. Because the government provides tax relief upon investment and taxes profits later at the same rate, investors earn the same return regardless of the tax rate, as the government functions as a joint-venture partner. In fact, the lower tax rate and limits on interest deductibility decrease investment incentives because they make debt financing less attractive. Moreover, firms will now have incentives to locate debt-financed investment abroad where these limits don't bite. On net, investment incentives are improved for equipment but not enormously because of these offsetting effects.

The reduction in the tax rate is critical for structures and real property, given their long lives and the limited changes to the way these investments are depreciated. And those improved incentives are only partially offset by the limits on interest deductibility, creating large increases in the incentive to invest in structures. Finally, some intellectual property investment incentives are actually worsened because of the switch away from expensing toward amortization over time and the fact that a lower tax rate reduces the value of interest deductibility. Other changes—the limitation on the use of losses and restriction of some manufacturing incentives—are also deterrents to investment.

Taken together, these changes boost the incentives to invest in the U.S. But the boost varies by investment type and sector of the economy and is complicated by these interactions. All of this contradicts the simple view that a rate reduction helps investment greatly. The benefits of these corporate tax reductions will partially flow to workers, though the magnitude of that benefit has been considerably exaggerated. Indeed, the primary effect of the rate reduction alone is to provide a windfall to investments already in place that were undertaken with the expectation of a higher tax rate.

Changes to International Taxation. The far more significant changes on the corporate side are to the taxation of overseas activities. First, the taxation of previous profits stored abroad will raise significant revenue, and the transition to a territorial regime from a worldwide regime removes the perverse incentives to keep profits abroad. The combination of these two will result in a significant challenge to corporations to revisit central capital allocation questions. When and how should cash be distributed to shareholders or invested? If I distribute cash, are dividends or share buybacks preferred? If I invest, is organic investment or mergers better as a way of growing? The consequences of these decisions will ripple through the economy for the next decade and, given the magnitude of the stock of cash overseas, will dominate the TCJA's effects on the economy.

Going forward, the shift to territoriality makes the U.S. a more hospitable domicile for corporations, and the rate reduction will reduce the incentives to use transfer pricing to shift profits abroad through convoluted structures. That simple story is complicated by the introduction of three novel tax instruments. These instruments are motivated by the fear that a move to territoriality, despite the rate reduction, will provide incentives for firms to move profits out of the U.S. to low-tax jurisdictions, given that the U.S. now only attempts to tax profits within its borders.

First, the GILTI (global intangible low-taxed income) tax attempts to make sure that corporations pay a minimum tax (beginning at 13.125%) on their profits around the world. This minimum tax is meant to discourage the incentive to move profits to low-tax jurisdictions, as that income will face a 13.125% rate at home. Unfortunately, this tax will have several perverse effects. Governments around the world will change their rates to 13.125%, shifting all revenue from this tax to foreign governments rather than to the U.S. government. Indeed, this supposed floor on taxes paid around the world may well become a ceiling. To some degree, this minimum tax means that, rather than transitioning from a worldwide regime (with deferral of taxation until repatriation) to a territorial regime, we have, in fact, repealed deferral and have a worldwide regime at a 13.125% rate—a move that undoes many of the benefits of moving to territoriality. In addition, the actual working of the GILTI provides an incentive to move investment abroad as a base level of returns to real investment abroad is exempt from the GILTI. And the complexity and unresolved details of the GILTI have created havoc for multinational firms as they struggle to understand how it will actually work.

Second, in an effort to ensure that intellectual property is not moved abroad, the legislation provides a preferential rate (also 13.125%) on income from intellectual property domiciled domestically that is associated with exports. Given the proliferation of preferential regimes for intellectual property income around the world, this FDII (foreign-derived intangible income) provision makes the United States a more competitive location for intellectual property. Unfortunately, the emphasis on exports jeopardizes this instrument, as it may not comply with international agreements. In addition, the actual workings of the FDII makes firms want to move real investment abroad in order to maximize the benefit of the FDII.

In one final effort to address the fear of more profit-shifting out of the U.S., there is a new BEAT (base erosion and anti-abuse tax) that presumes that service transactions by multinational firms with related parties are motivated by avoidance. That presumption means that firms, especially foreign firms operating in the U.S. with transactions with related parties, will face additional taxes. This instrument is novel in its presumption of avoidance and its willingness to tax transactions rather than profits. That novelty also means that it is a significant challenge to current international norms and treaties.

In many ways, the corporate provisions are the best part of the legislation—the shift to territoriality and the rate reduction were long overdue and had enjoyed bipartisan support. Unfortunately, that core of the corporate provisions was spoiled by several decisions. The desire to get the rate to 21% was enormously expensive and created a larger windfall to older investment. To offset that revenue loss, the tax treatment of research expenditures was made less generous, interest limitations were introduced, and a host of international taxes were created that undo the benefits of the shift to territoriality. A simpler reform with a reduction of rate to 25% and a simpler move to territoriality would have been preferred.

The actual legislation has created significant winners and losers. As one example, multinational firms that employ intellectual property widely that previously were able to have global tax rates in the low teens will now face a new world of complexity and potentially higher rates. By contrast, domestic firms that invest in real estate and with moderate leverage will be significant winners.

Changes to Pass-Through Taxation. The TCJA also revolutionized the taxation of pass-through entities, so named because there is no taxation at the entity level (as with corporations) but all income is passed through to, and taxed at, the individual level. Over the last 30 years, the share of business income that is associated with pass-through entities (e.g., partnerships, LLCs and subchapter S corporations) rose from less than 20% to more than 50%.

The 2017 legislation created a new regime for pass-through entities by allowing them a 20% reduction in their tax rate so that, for example, an individual facing a 37% tax rate on labor income will now face a tax rate of 29.6% on their pass-through income instead of their usual rate. This new regime for pass-through income creates a host of planning opportunities and mind-numbing complexity. And for the first time since the early 1980s, individuals will have to confront existential tax questions: Who am I? Do I want to be a corporation, a pass-through entity, or just an individual?

The legislation creates a large gap between corporate tax rates and top personal marginal rates, a gap that the U.S. has not had for the last 40 years.[46,47] Such a gap can make a corporation a tax shelter for individuals who want to avail themselves of the lower 21% rate. As an example, an individual could corporatize and provide consulting services to clients and only pay themselves a small amount of that income. Wealth saved in the corporation could also grow and pay that lower tax rate. This opportunity is limited in two ways. First, there is an accumulated earnings tax designed to deter such opportunism, but it has not been used greatly and has significant implementation issues. The bigger limitation is that distributing the cash out of the corporation will incur additional taxation as it leaves the corporation and is delivered to the individual. Absent reaching tax nirvana (i.e., death and the step-up of basis in one's assets for one's heirs), the combination of corporate and individual tax can limit the desirability of this strategy.

The new pass-through regime will also provide an incentive for some corporations and for some individuals to become pass-through entities. Corporations that don't want to pay both the corporate tax and the taxation to equity income can avail themselves of one level of taxation by becoming pass-through entities.

Similarly, individuals who would rather pay 29.6% rather than 37% can stop being employees and contract with their employers as pass-through entities. Indeed, it may become commonplace for similarly situated employees to find that they are paying very different taxes because some are pass-through entities and others are employees. Taking advantage of these provisions is easiest for families earning less than $315,000. For higher income earners, they will need to be more savvy about this, as many engaged in "services" activities will not be allowed to take advantage of this provision easily. What is a service? The legislation ensures that some services are specifically identified but leaves much more to be articulated. At a minimum, one can imagine that firms that are service providers (e.g., a quantitative trading asset manager) might find it advisable to split into a services firm and a technology firm so that part of the firm can avail themselves of the advantageous rate.

Taken together, the pass-through regime created by the TCJA is enormously complex, creates numerous planning opportunities, and will create windfalls to those best positioned to navigate that complexity. As such, they represent some of the most problematic parts of the legislation. In part, the pass-through regime was designed to limit the incentive to corporatize by reducing the relevant gap from 16% (i.e., 37%–21%) to 8.6% (i.e., 29.6%–21%). But it would have been wiser to police the corporatization margin rather than create an entire new regime with its own difficulties.

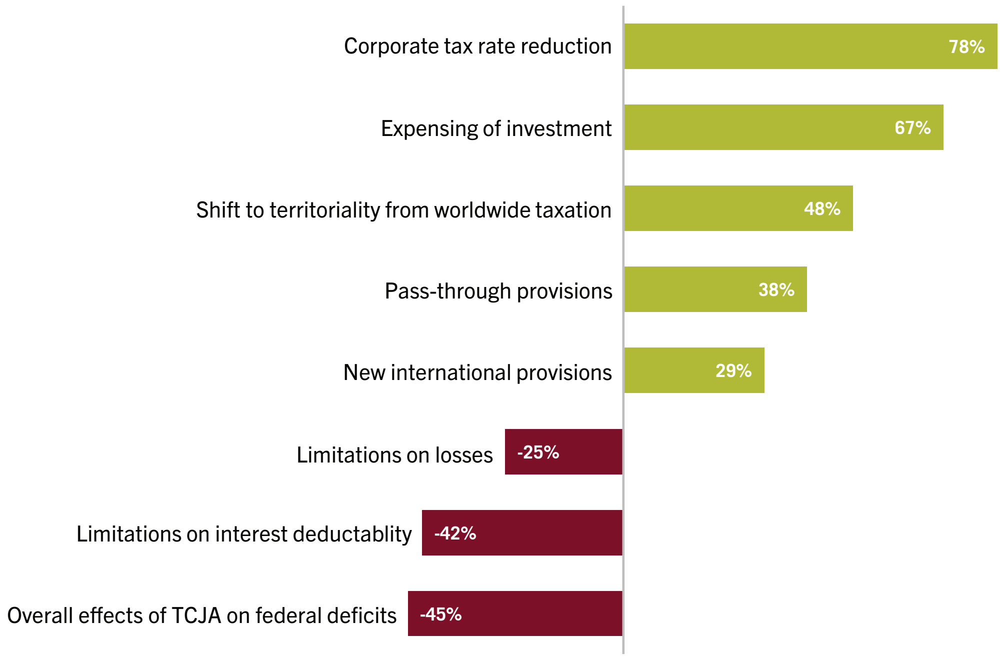
Assessment

The core of the TCJA legislation is a long overdue modernization of the corporate tax with a reduced rate and a move to territoriality. The desire to reduce the rate below 25% and the inability to pass a pure corporate tax reform required additional changes, including new international taxes, that undo some of the benefits of that core. Tax changes for pass-throughs have added remarkable complexity and scope for opportunism with little associated benefits. Finally, in pursuit of a wrapper of middle-class tax cuts, individual changes were included that dramatically increased the fiscal cost of the legislation. That stated fiscal cost is $1.5 trillion, but it is likely understated because it assumes reversals of tax cuts that, once granted, are hard to reverse. That fiscal cost, in the context of current fiscal realities and near full employment, should be associated with interest-rate increases that partially undo the improved investment incentives. Second, the complexity of the international and pass-through provisions opens the door to opportunism that we can only begin to imagine.

The ambiguity of the effects of the tax reform on actual investment behavior are captured in the survey results on the separate pieces of the TCJA. Figure 6 illustrates alumni responses to separate aspects of the TCJA. In the eyes of alumni, the treatment of losses and interest expenses, along with overall concerns about deficits is hampering the competitiveness of the U.S., just as other aspects of the TCJA are quite beneficial. A large portion of alumni answered “Don’t know” to our tax-reform questions, perhaps reflecting the uncertainty of these effects. This mixed bag on investment incentives combines with subsequent uncertainty on trade policy and ongoing ambiguity over the actual workings of the new international provisions to deter investment in the United States. As such, the headline effects of the TCJA are quite positive, but the underlying reality is more complex and messy, with deficit concerns and policy uncertainty clouding the investment picture.

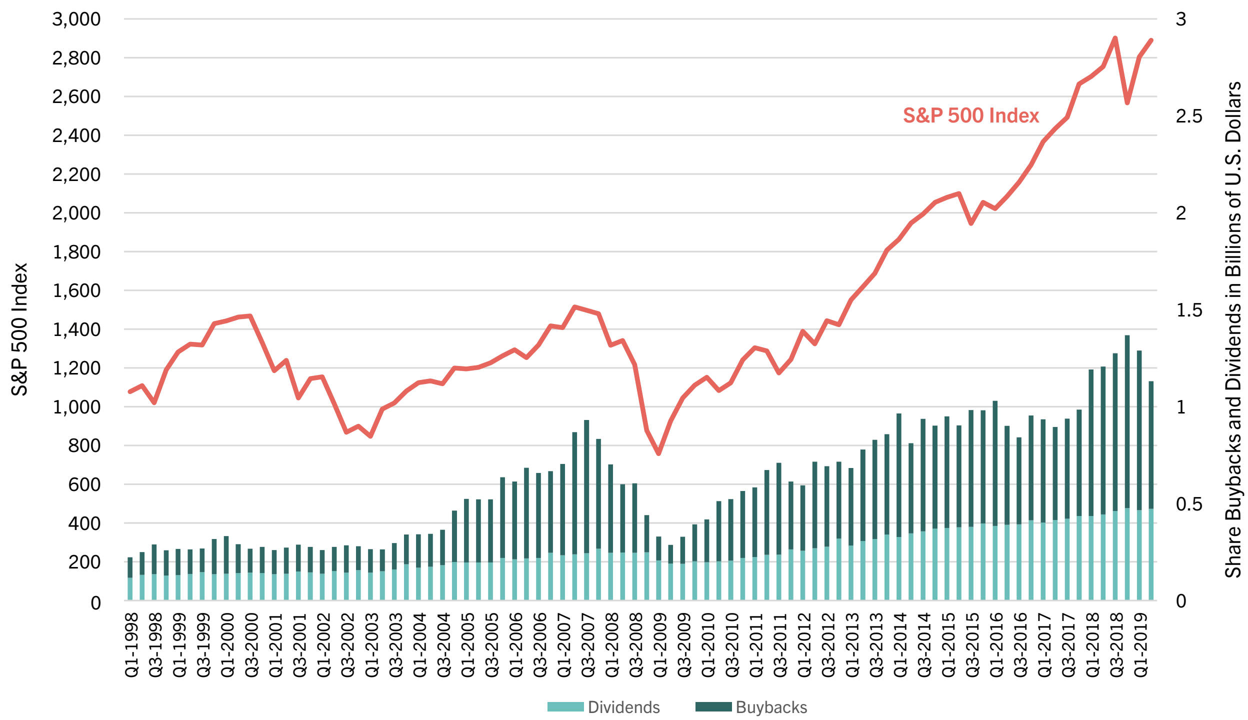
FIGURE 6: ALUMNI ATTITUDES TOWARD SPECIFIC ELEMENTS OF TCJA

Does this provision of the TCJA increase U.S. competitiveness?



Note: Rating equals the percentage of respondents who said provision somewhat or significantly increases competitiveness minus the percentage of those who said provision somewhat or significantly decreases competitiveness. Rating excludes those who answered “Don’t know.” Descriptions of each provision were provided to survey respondents.

FIGURE 7: S&P 500 DIVIDENDS AND SHARE BUYBACKS VERSUS PERFORMANCE



Note: S&P 500 Index shows quarterly averages.
Source: S&P 500

The effects of the TCJA are not ambiguous in one specific domain. Capital allocation decisions that flow from the freeing of offshore cash are already manifest in larger distributions, with a further tilt toward share buybacks as shown in Figure 7.

Tax Reform 2.0

The most significant missed opportunities in this reform relate to the inability to make the individual tax considerably more progressive to address current appetites for redistribution and for addressing the structural mismatch between revenues and expenditures.

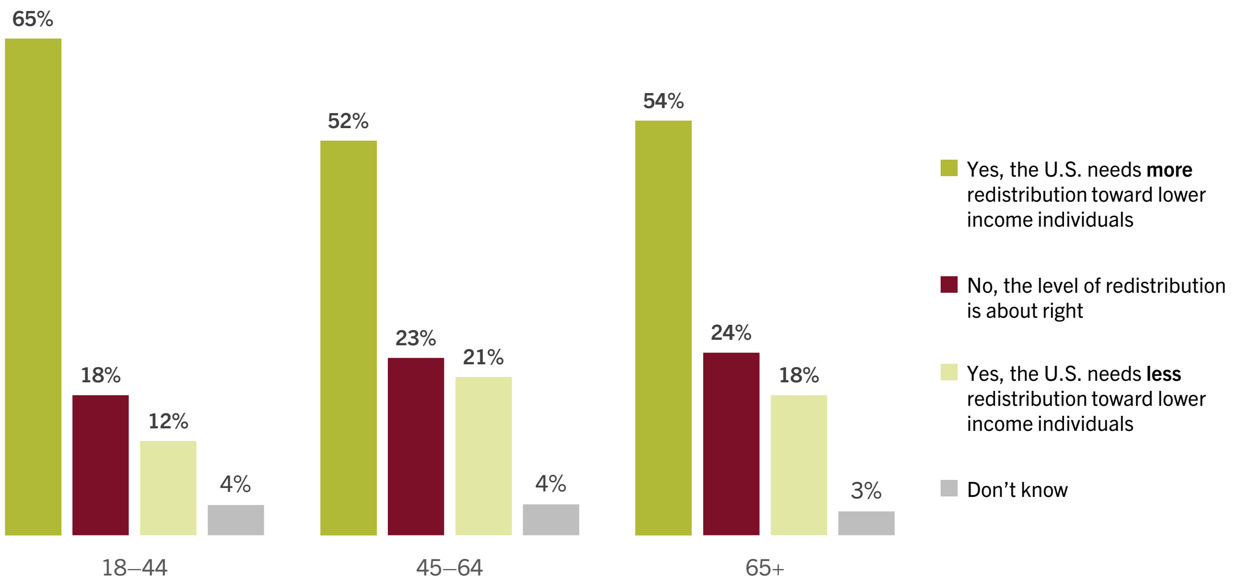
The survey results indicate, as manifest in Figure 8, a considerable appetite for increased redistribution through the tax code. Indeed, current political debate is dominated by proposals for increased redistribution. Unfortunately, current reform proposals to increase redistribution are likely to founder for several reasons.

First, these efforts often invoke increasing the corporate income tax, which has ambiguous effects on redistribution. Economic logic demonstrates that corporate taxes are borne not by corporations but by either capital, labor, or consumers. And, in a global economy with mobile capital and goods, labor is most likely to bear that burden, undoing any perceived redistributive benefits. Second, these efforts often invoke an increase in the top marginal rate. Emphasizing top marginal rates ignores that what matters for redistribution are a) average tax rates and b) the fractions of the population bearing those rates. A higher top marginal rate on a small number of individuals is both hard to enforce and will do little to address perceived changes in income inequality. Finally, these efforts often invoke a wealth tax. Such efforts are complicated by a) the questionable constitutionality of such a provision, b) the significant valuation problems associated with such a provision, and c) the avoidance possibilities that other countries have experienced.

A pragmatic approach to increasing redistribution, if so desired, would counter these misguided efforts with less flashy but more substantive efforts. First, rather than focus on the corporate income tax, reversing the pass-through provisions would do more to ensure that higher income individuals are paying an ordinary income-tax rate on their labor income. Second, rather than focusing on marginal rates on high-income individuals, efforts

FIGURE 8: ALUMNI APPETITE FOR REDISTRIBUTION BY AGE GROUP

Should the U.S. change the extent of redistribution toward lower income individuals done through the tax system?



Note: Percentages may not add up to 100% due to rounding.

should be focused on lowering the average tax rates of lower-income individuals by a large increase in the earned income tax credit. The earned income tax credit provides good work incentives but is currently undersized, and an expansion enjoys bipartisan support. Finally, a wealth tax could be replaced with more pragmatic approaches, such as a repeal of step-up-basis at death and the possibility of taxation of capital gains as they accrue on public stock. The ability to exempt historic returns from taxation by dying benefits the wealthiest and provides incentives to hold on to assets all too long.

The wealth tax is most problematic as it will divert attention from the effort that will be required to innovate on the most pressing agenda for our tax system—a carbon tax. Devising a new tax instrument is a difficult and cumbersome effort, and that effort is best spent on an instrument that has real revenue-raising possibilities and corrects for the externalities created by carbon emissions.

What comes next? We should expect a significant response from other nations in the form of legal challenges and policy moves. The FDII and BEAT have tenuous legal underpinnings under international agreements and treaties. Legal challenges should be expected and may be particularly problematic at a time when the U.S. seems eager to turn its back on international treaties and norms. And such a significant move by the U.S. with the statutory rate and the GILTI will narrow the corridor of desirable tax rates for other countries to between 13% and 21%.

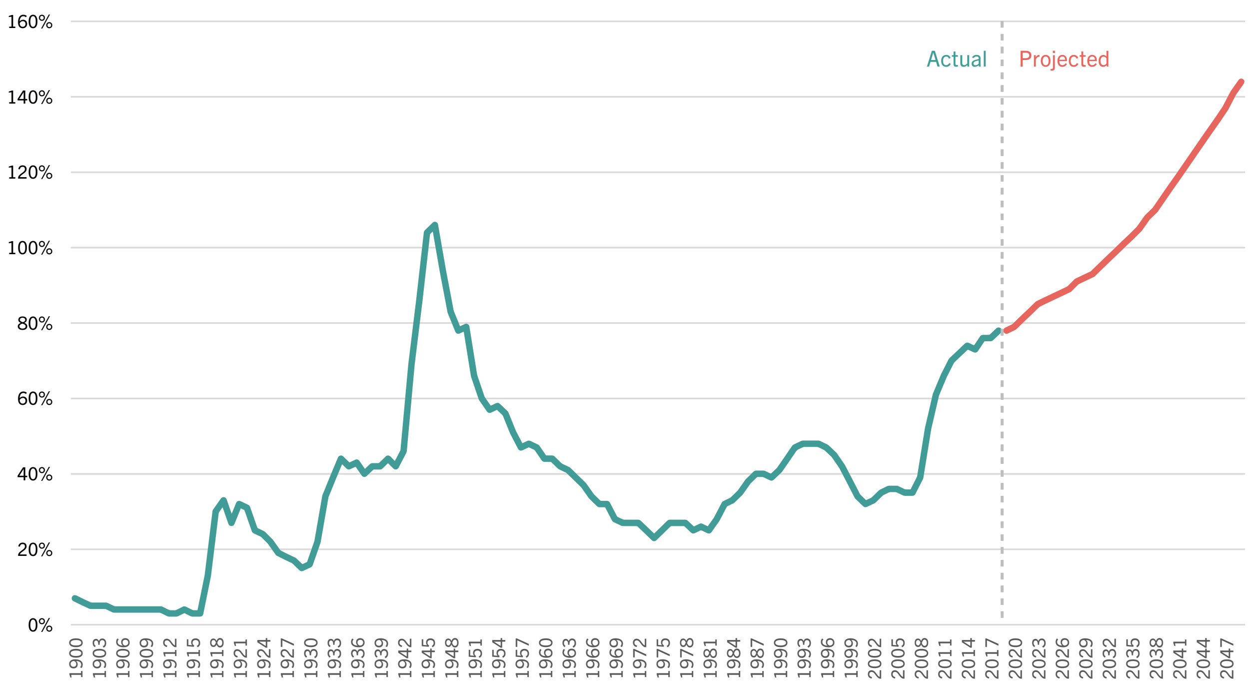
Domestically, the TCJA is most reminiscent of the 1981 tax cuts that were followed with a 1982 reform that reversed some of its effects and additional annual reforms that patched and improved the 1981 act. Ultimately, these more minor fixes led to the transformational reform of 1986. If the next five years are similar, the TCJA will have accomplished much by beginning that process. Of course, skeptics will quickly point to the differing political dynamics between and within parties today relative to the 1980s—and to the general inability to pass meaningful legislation these days. But those same skeptics, including me, would have argued that the TCJA would never have passed in the first place.

Given current fiscal realities, we should all hope that the TCJA represents a beginning to tax reform rather than an ending. Projected debt and deficit levels, as depicted in Figures 9, 10 and 11 on pages 46 and 47, remain alarming and indicate that the hard work of reconciling demands for high expenditures and low taxes has not begun. Delays will only make that effort more painful.

FIGURE 9: CORPORATE TAX INCOME AS A PERCENTAGE OF GDP

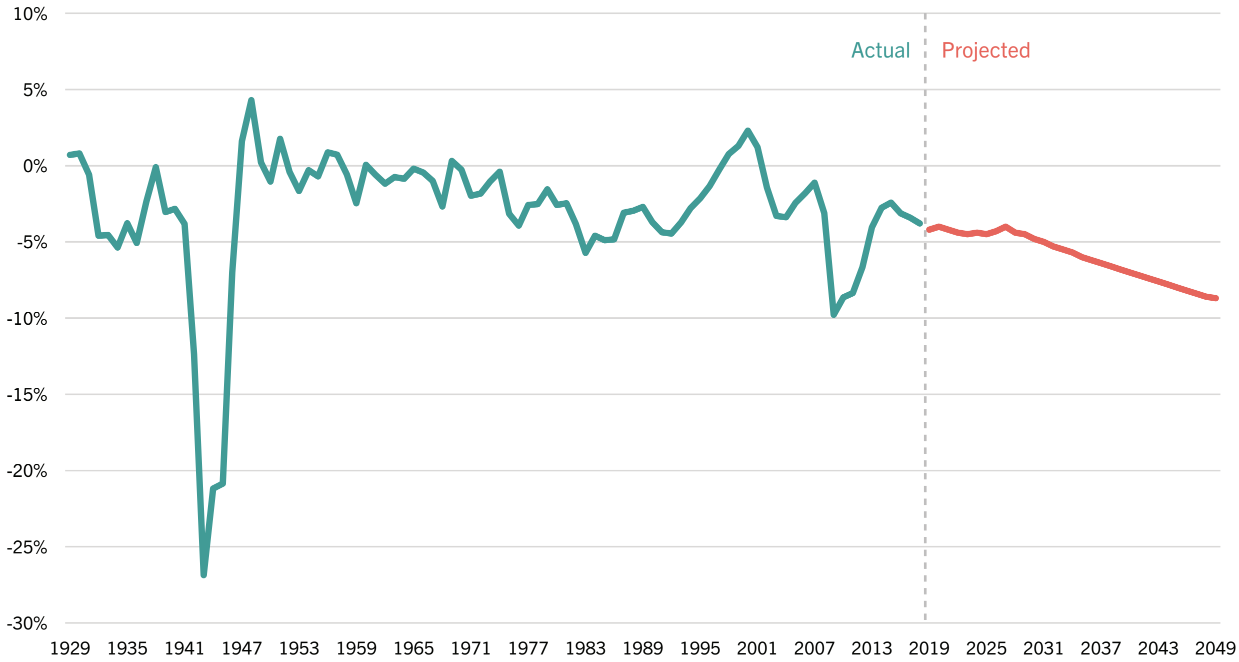
Source: U.S. Bureau of Economic Analysis, Federal Reserve Bank of St. Louis

FIGURE 10: FEDERAL DEBT HELD BY THE PUBLIC AS A PERCENTAGE OF GDP



Source: Congressional Budget Office, "The 2019 Long-Term Budget Outlook," 2019

FIGURE 11: FEDERAL SURPLUS OR DEFICIT AS A PERCENTAGE OF GDP



Source: Federal Reserve Bank of St. Louis; U.S. Office of Management and Budget, “Federal Surplus or Deficit as Percent of Gross Domestic Product”; Congressional Budget Office, “The 2019 Long-Term Budget Outlook”

CHAPTER 5

AT RISK: THE GIFT OF GLOBAL TALENT

William R. Kerr

America's immigration system is a top concern for business leaders. While the United States has long attracted the world's most-talented individuals, its overseas luster is declining due to federal policy paralysis and rising anti-immigration rhetoric. Individuals are increasingly directing their anxieties about macroeconomic concerns, such as fears of job loss or diminished economic mobility, toward immigrants and global integration.

The U.S. Competitiveness Project has long recognized that business leaders must articulate why they believe immigrants benefit the workplace and the economy. This year, the Project took the step of soliciting data on these business perspectives. Our survey of HBS alumni identified that three beliefs are widely held among business leaders:

1. Foreign skilled immigrants are a source of competitive advantage for the United States.
2. Such immigrants are critical to firms' individual competitive advantages.
3. America's immigration system is at risk of throwing those competitive advantages away.

Moreover, the Project asked the broader American public comparable survey questions about immigration. For business leaders championing immigration reform efforts, a comparison of their views with those of the broader public reveals important barriers and opportunities. Alumni and the general public lack a shared understanding about the role of immigrants in the economy, and both groups hold a narrow view of the potential range of reforms to skilled immigration. That said, our surveys identified a source of potential common ground: alumni and the general public both support shifting the composition of immigration toward employment-based entry.

Many potential reforms to enhance U.S. competitiveness are expensive (e.g., infrastructure investments) or involve tradeoffs among citizens (e.g., taxation and welfare reform). By contrast, improvements in immigration processes and selection can provide a stronger workforce and self-sustaining benefits with low or even zero costs. There exists especially low-hanging fruit for improvements to policies governing employment-based skilled migration, and the path to achieving this reform starts with a better understanding of opinions among business leaders and the broader community.

Background

Immigrant labor has long been vital to the American economy, and it has become even more important in recent decades. In 1970, 4% of the U.S. population was foreign born. Today, that figure has more than tripled, to 14%. Foreign higher-skilled immigrants have been particularly important, and America has long enjoyed an advantage in drawing such talent.[48] From 2000 to 2010, the United States hosted more immigrant inventors than the rest of the world combined. Such foreign talent has contributed substantially to the development of new technologies and their commercialization. Immigrants founded prominent companies such as Procter & Gamble, Goldman Sachs, Kroger, Alphabet/Google, and Tesla.[49] One study calculated that 43% of current companies in the Fortune 500 were founded or cofounded by an immigrant or a child of one.[50] In terms of new business and idea creation, immigrants account for more than a quarter of new start-ups and patents in America today.[51]

The current legal framework for skilled workers to work in America dates back to the Immigration Act of 1990. This act established the H-1B visa, which allows American companies to employ higher-skilled foreigners with specific skills or specialty knowledge temporarily. H-1B candidates include both foreign workers migrating to America for a new job and the international students at American universities applying for work upon graduation. Uses of H-1B visas range from management consulting to computer programming to engineering to theology, with the substantial majority of visas today being in computer-related occupations. As firms select and sponsor the immigrants they wish to employ, the design of the H-1B program makes American business leaders an important gatekeeper for foreign talent entering the country.*

Despite rapid and extraordinary changes in the global economy over the past three decades, the H-1B program looks largely the same as it did in 1990. Early in the

*There are other visa categories besides the H-1B, including most notably the L visa for intra-company transfers. We focus on the H-1B system since it is the largest pathway, the most well known, and likely the most controversial.

program's development, there were major fluctuations in the cap on the number of new H-1B visas issued each year. (The visa is for three years and can be renewed once.) The cap initially stood at 65,000 new H-1Bs per year, but Congress expanded it to 195,000 during the late 1990s in response to the heavy demand resulting from the Internet boom and fixing the Y2K bug. Sunset clauses during the early 2000s reduced the cap back to 65,000, but Congress later increased the total to 85,000. Other than this modest net growth of 20,000 visas since 1990, most aspects of the program remain the same.

Partisanship and political discord are core reasons for the limited updating of the H-1B system. Immigration can be a political lightning rod, and legislators debate the appropriate number and types of immigrants admitted to the country. Presidential administrations and groups in Congress have worked on comprehensive reform bills, but these have never reached a consensus. Politicians also grapple over how to enforce border security and determine the legal future of millions of undocumented immigrants already living in America. While members from both sides of the aisle can see the challenges and opportunities of immigration, America continues to stagnate without Congress passing any major legislation on immigration in the 21st century. Even in settings where apparent consensus exists, such as the development of an immigrant entrepreneur visa, the struggle over comprehensive immigration reform often blocks these quicker, focused wins.

This tension has escalated during the administration of President Donald Trump. In early 2017, President Trump issued executive orders seeking to build a U.S.–Mexico border wall, increase the number of deportations, and ban immigrants from Muslim-majority countries.[52] President Trump called for the removal of the Deferred Action for Childhood Arrivals (DACA) program, established under President Obama in 2012 to provide interim standing for unlawful immigrants who arrived in America as children. The Trump administration also rescinded another Obama-era proposal, the "International Entrepreneur Rule," which would have provided temporary residency to immigrant founders of new companies.[53] Recent controversy has further focused on the separation of migrant children from their parents after illegal border crossings.[54]

While broader support exists for higher-skilled foreign workers coming to America to work, they too have been a source of political controversy. Skeptics often point to cases where firms have hired immigrants on H-1B visas to replace American workers and reduce labor costs. Other scandals included situations where employers have abused their relationship with the immigrant employee. Supporters of the program, by contrast, cite cases where firms have hired skilled H-1B immigrants to access valuable and scarce skills that boosted innovation and growth. Both skeptics and supporters make valid points, as the H-1B visa has a very crude selection process. The government usually receives more than three times the number of applicants for H-1B visas than the annual cap will allow *in the first week* that it accepts them! Unfortunately, the system then uses a lottery to select among the many applicants, a technique that does not prioritize high-quality uses.

PARTISANSHIP AND POLITICAL DISCORD ARE CORE REASONS FOR THE LIMITED UPDATING OF THE H-1B SYSTEM.

The more time that the United States spends in political gridlock on immigration, the more America risks losing its special access to foreign higher-skilled workers. Heated political rhetoric on immigration, combined with an onerous immigration application system, appears to be driving talent away. Student enrollments are one early indicator, where, for example, applications to U.S. business school programs (e.g., MBA, accounting) from international candidates declined 13.7% between 2018 and 2019, compared with a 3.6% drop from domestic candidates.[55] And while still vastly oversubscribed, H-1B visa applications fell by 15% between 2016 and 2019, suggesting latent interest is diminishing.[56]

By contrast, other countries are racing to attract higher-skilled immigrants. During the last decade, Australia, Canada, Chile, France, Germany, Ireland, Israel, Italy, Japan, New Zealand, Portugal, Singapore, Spain, and the United Kingdom each created start-up visas or similar programs to make it easier for skilled immigrants to move to their countries.[57] Many of those countries also actively recruit foreign talent, even to the point of advertising in other countries. One billboard in Silicon Valley read: "H-1B Problems? PIVOT to CANADA."[58] Reports in 2019 often noted that increasing numbers of American employers were opening satellite offices in Toronto to access talent.[59]

Business Leaders: Potential Champions of Immigrants

Given that much of higher-skilled immigration in the United States is employer driven, we posed a series of questions to HBS alumni and the general public about the economic impact of immigrants of different skill levels and policy changes they supported. We found that the perspectives of business leaders and the general public diverged widely; in most cases, the views of business leaders fell outside the range of views held by Republicans and Democrats in the general public.*

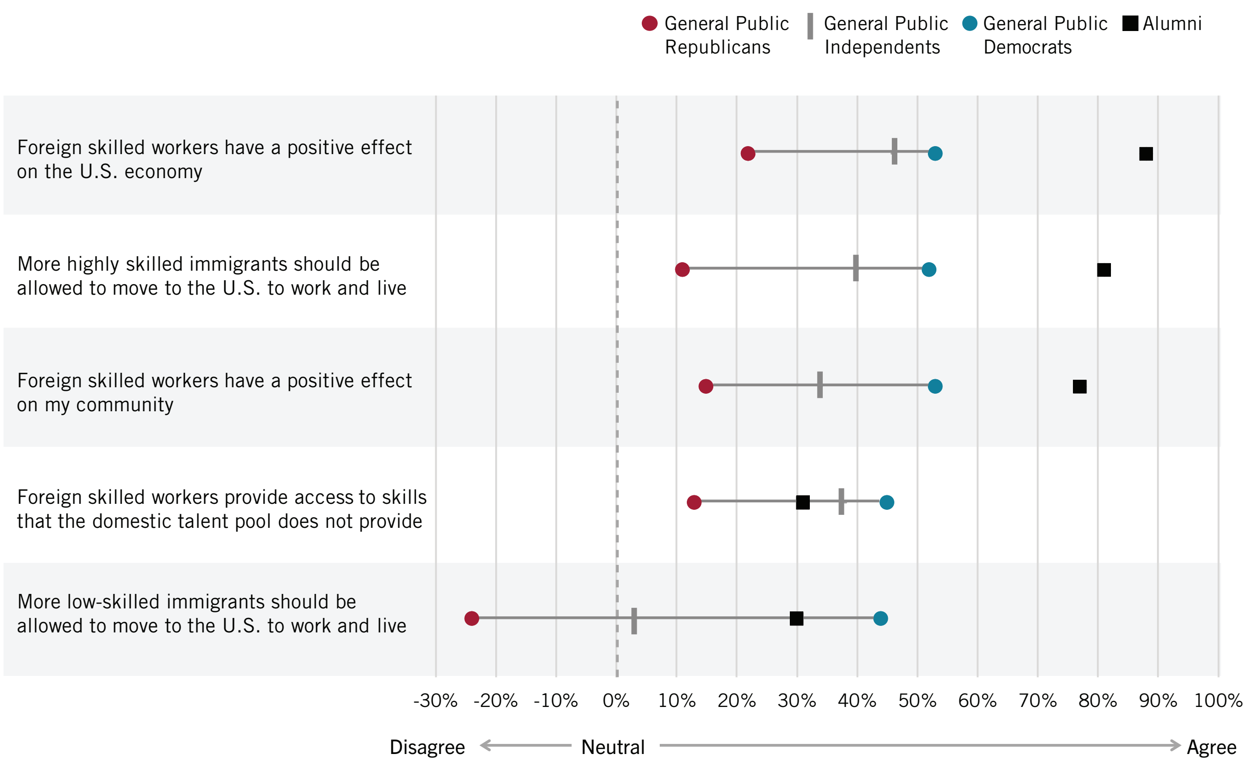
Three viewpoints emerged from the survey responses:

Foreign skilled workers make the United States more competitive. There was net-agreement among alumni and the general public that "Foreign skilled workers have a positive effect on the U.S. economy," "More highly skilled immigrants should be allowed to move to the U.S. to work and live," and "Foreign skilled workers have a positive effect on my community" (Figure 1). Such support was strong among alumni, far greater than among members of the general public—whether they were Republicans, Independents, or Democrats. By comparison, similar statements about *lower-skilled* immigrants garnered net-agreement only from alumni and Democrats. Taken together, such results confirmed our initial hypothesis that most Americans, regardless of political party, view higher-skilled immigrants as critical to the U.S. economy, and this support is especially strong among business leaders.

As many HBS alumni are immigrants themselves, the alumni survey also asked respondents if they were natural-born U.S. citizens, naturalized U.S. citizens, permanent residents, or on a temporary visa such as the H-1B. The strongest support for skilled immigration was

*A note on the political orientation of the survey sample groups: We did not survey the 40% of the alumni who answered questions on immigration about their political party. Other sections of the survey collected political affiliation among alumni and showed a very balanced distribution: about 39% generally identified as Independent, 26% as Democrat, and 25% as Republican. Since the survey randomly assigned respondents between the two sections, the political affiliations for alumni answering immigration questions are very likely to have had a similar distribution of political affiliation.

FIGURE 1: NET-AGREEMENT FOR BELIEF STATEMENTS ABOUT IMMIGRATION



Note: Net-agreement is calculated as the percentage of respondents who agree with statement minus the percentage of respondents who disagree with statement. Calculations exclude responses of "Don't know" and "Not applicable to me/my company."

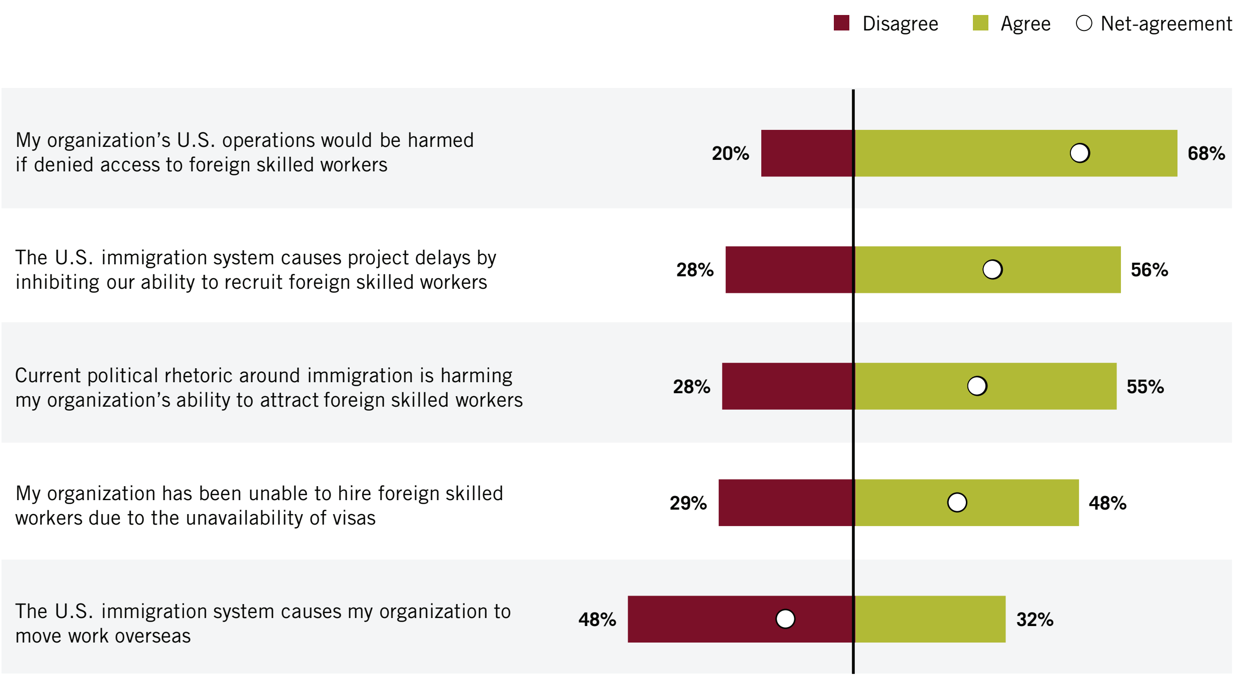
among the immigrants themselves, but American-born alumni also showed greater net-agreement with the positive benefits of skilled immigration than members of either political party among the general public.

Foreign skilled workers are essential for many firms' competitive advantages. Nearly one out of four alumni said that at least 15% of their companies' U.S.-based skilled workforce—or roughly one out of seven workers—was foreign-born. More alumni than not said the number of foreign higher-skilled employees at their firms had grown over the past five years, and a similar number of respondents expected further increases over the coming five years. Alumni expressed that immigrants were critical for developing better products and services, increasing the quality of innovation, and reaching international customers. They also viewed foreign higher-skilled workers as important for filling technology positions (e.g., scientist, engineer, or coder) in their organizations.

The United States' current immigration system erodes America's competitiveness. Alumni showed net-agreement with the statement that the U.S. immigration system "causes project delays by inhibiting our ability to recruit foreign workers" and that they "couldn't hire foreign higher-skilled workers due to an unavailability of visas." Alumni outright rejected the possibility that "the U.S. immigration system makes it easy for my organization to hire foreign higher-skilled workers into our U.S. operations." These responses indicated frustration with the impact of U.S. immigration hurdles on their business operations and competitiveness. However, contrary to some popular perceptions and lobbyists' claims, more HBS alumni disagreed than agreed that the U.S. system causes their firms to move operations overseas (Figure 2).

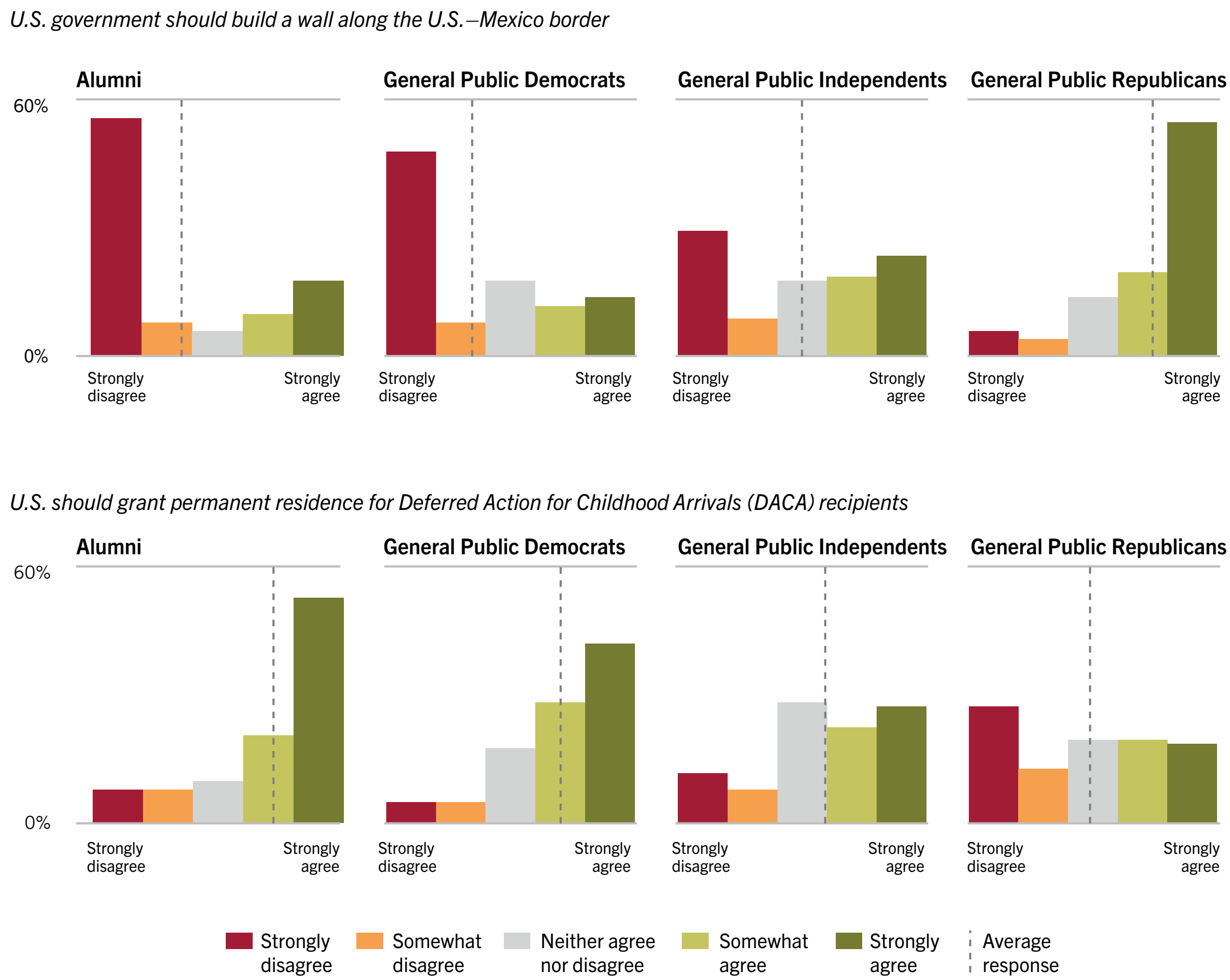
While alumni supported immigrants and overall derided the immigration system, their views on policy solutions were less clear. For advocates of reform, we highlight the cases for pessimism and optimism below.

FIGURE 2: ALUMNI VIEWS OF IMMIGRATION SYSTEM AND POLITICS



Note: Percentages for each question will not add up to 100% because responses of "neither agree nor disagree" are not shown. Calculations exclude responses of "Don't know" and "Not applicable to me/my company."

FIGURE 3: DISTRIBUTION OF ATTITUDES ON CONTROVERSIAL IMMIGRATION TOPICS



Challenges to Reform

The survey revealed two reasons to be skeptical that the United States will achieve meaningful reform on immigration soon.

First, business leaders and the average American lack a shared understanding of immigrants' role in the economy and their effect on domestic workers. The results laid out in the prior section show a meaningful gap in perspectives on immigration, the workplace, and the economy. As larger immigration debates often influence or block narrower reforms on particular aspects of immigration policy, we also asked respondents to reflect on two recent "headline" controversies: Should the United States build a wall on the Mexican border? And, should the DACA program be preserved? (Figure 3.)

The most extreme differences were about the border wall. Nearly all alumni and general public Democrats strongly disagreed with the idea. Republicans in the general public were the exact opposite, with a clear majority strongly agreeing with the idea. Independents remained neutral and had an even distribution across the two viewpoints. This polarization aligned with results on the question as to whether the United States should allow more lower-skilled immigrants into the country. Republicans rejected that idea, often citing concerns about such immigrants' impact on American workers. Democrats and HBS alumni, by contrast, believed in more expansive policies toward lower-skilled migration.

The survey asked respondents whether the United States should grant permanent residency to DACA recipients. The clear majority of alumni and Democrats in the general public agreed with this statement, and

Independents slightly leaned in favor of it. Interestingly, unlike the border wall, Republicans in the general public were far more mixed on this issue. This suggests that, for policymakers looking to find common ground, certain controversial issues may be much less incendiary than others, particularly if there's not a clear negative consequence for American workers.

Until American concerns and confusion regarding the impact of immigrants on U.S. workers are at least partly mitigated, these types of debates will likely remain a major hurdle for business leaders and policymakers looking to reform immigration policy at any skill level.

A second challenge to reform is this: despite frustrations with the U.S. skilled immigration system for work purposes, business leaders ask for "more of the same" and the general public does not know what to do. The survey asked respondents what changes they would support to the H-1B visa system (Figure 4).

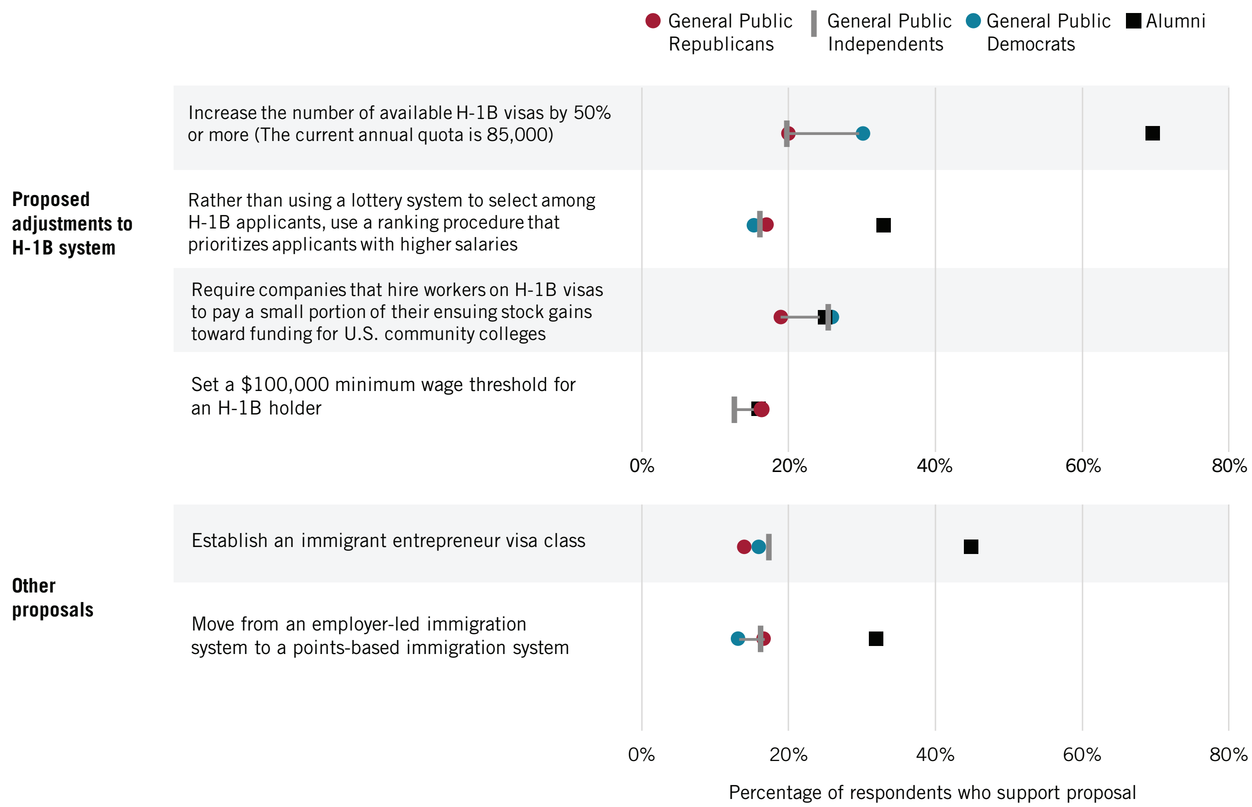
Alumni clearly supported one proposal: 70% supported increasing the number of available H-1B visas by 50% or more from its current annual quota of 85,000. The next most popular idea, with 45% support among alumni, was to establish a visa to support immigrant entrepreneurs.

Perhaps unsurprisingly, HBS alumni who themselves were immigrants showed the greatest support for these proposals.

As important, none of the other policy proposals garnered much support from alumni. Figure 4, for example, shows a modest one-third support among HBS alumni for using wage ranking to prioritize candidates for H-1B visas instead of the current lottery system.

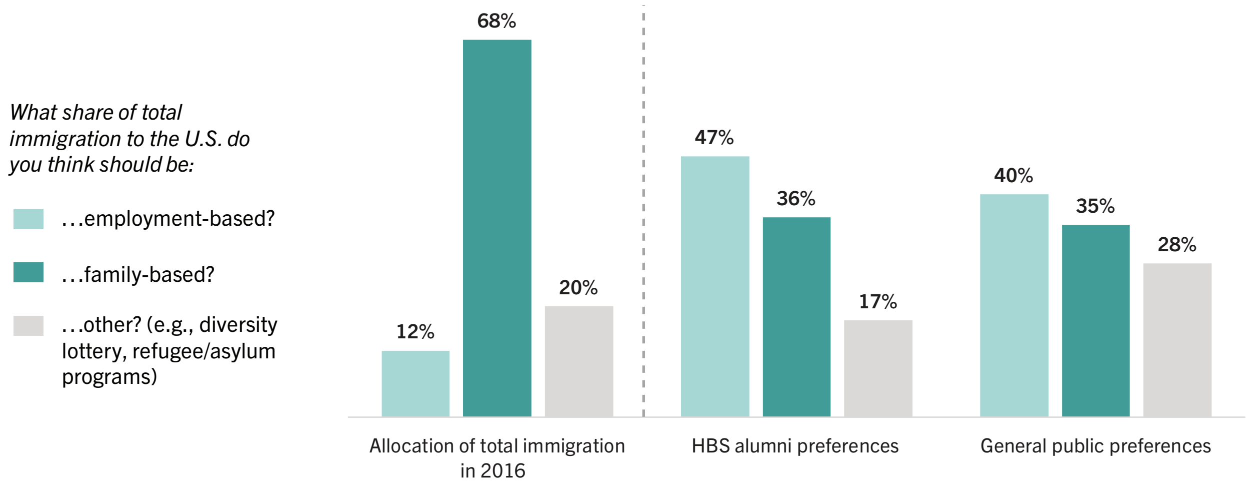
We found these responses puzzling: many HBS alumni said the immigration system hurt their businesses by limiting access to foreign talent, yet their scope for reform seemed limited to asking for "more of the same." Employers are likely underestimating the effectiveness of alternative systems that would make skilled immigration to America more selective to better serve critical needs. To the degree that consensus support for immigration rises by skill level, the general public would also be more

FIGURE 4: SUPPORT FOR IMMIGRATION REFORM PROPOSALS



Note: Roughly one-third of general public respondents and 14% of alumni gave answers of either "None of the above" or "Don't know."

FIGURE 5: PREFERRED COMPOSITION OF IMMIGRATION



Note: Statistics on the allocation of total immigration in 2016 were provided to survey respondents in the body of the survey question. Totals may not add up to 100% due to rounding. The percentages for "HBS Alumni preferences" and "General public preferences" represent the statistical means of the answers given by respondents.

likely to support an expansion in the visa cap if they felt the uses were especially beneficial to the U.S. economy. Other alumni may fear losing the special power their businesses have over the existing system if it is reformed. Either way, business leaders who want to enact significant reforms must play a more active role in advocating for those policies to their peers in the private sector if they wish to make headway.

The possibility of widespread reforms was even more muted among the general public, which didn't offer more than 30% support for any individual policy. Much of this is due to uncertainty: nearly one-third of respondents from the general public said that they did not even know which policies to support. This suggests many Americans do not know what action to take on reforming immigration in the United States at the level of pathways such as the H-1B visa. We cannot tell if this is due to a lack of sufficient information about policy options or uneasiness about how to proceed even with a good understanding of the issues. If it is about information access, then politicians who support such reforms must invest much more into educating the broader public about the ramifications of new skilled immigration policies.

Foothold for Agreement

Yet the survey data also suggested that meaningful immigration reform—particularly for employment-based workers—might still be feasible in the United States: There is broad agreement that the overall composition of U.S. immigration should adjust towards employment-based entry.

Both alumni and the general public agreed the United States should allocate more immigration slots based on employment (Figure 5). The survey asked respondents how they would choose to allocate permanent residency slots over potential uses, noting that "In the 2016 fiscal year, 12% of foreigners granted permanent residency in the U.S. arrived through employment-based visa programs, 68% arrived through family-based visa programs, and 20% arrived through other visas like the diversity lottery and refugee/asylum programs. These percentages have not significantly changed over the past 10 years."

Given that baseline, the general public preferred a system that tripled the percentage of slots allocated on the basis of employment, and HBS alumni wanted to quadruple this allotment.[60] That result held across political affiliations. Democrats in the general public preferred that 36% of total immigration slots be granted on the basis of employment, while Republicans and Independents preferred 43% and 41%, respectively (Figure 5).

The startlingly high degree of alignment between HBS alumni and the general public on this issue indicates that there may be more common sentiment to pass laws that influence this macro-structure than to focus on specific tweaks to the employer-driven part of the immigration system. Such sweeping reform faces the challenge of whether the compositional shift is achieved through boosting employment-based allocations while holding other categories fixed or reallocating existing slots. Reform will also require overcoming the political gridlock that has stymied prior efforts for comprehensive immigration legislation.

Saving the Gift of Global Talent

A lot has changed since 1990, when the legal framework for higher-skilled immigration was put in place, and America's antiquated system is starting to squander its gift of global talent. While the system lumbers along, its structure and processes no longer serve the country's best interests or maximize U.S. competitiveness. Given that businesses are a primary gatekeeper—and a major beneficiary—of the U.S. immigration system, they will likely want to shape the future of the U.S. debate on immigration and its potential reforms.

To make progress toward that goal, business leaders should first explore and refine a wider range of potential immigration reforms to the employer-led programs like the H-1B visa system. This recommendation reflects the reality that comprehensive immigration reform will likely remain a political lightning rod for the near future. Moreover, while the public supports skilled immigration, its response is quite tepid to simply expanding the programs that exist today. Business leaders should consider more closely how the existing systems can become more selective (e.g., replacing lotteries with preference rankings) so that they get better access to the critical talent they need while also ensuring that the public feels more comfortable that the reforms are good for America.

Better tools and resources for capturing and publicizing data on the inflows and economic impact of immigrants would aid this process, a task that policymakers and academics should share with business leaders. Given the role of talent in the knowledge economy, it is untenable that we know far more about the trinkets on cargo ships that come into ports than the skilled workers flying in airplanes. Without good data on talent, we cannot have productive, evidence-based debates on immigration policy. Only by shining a bright spotlight on the issue and being candid about the opportunities and challenges will we build the foundation for a more adaptable system of immigration that benefits the country. This will be particularly helpful as we consider the tensions faced by comprehensive reform. The results of this survey show a common appetite for how that reform might look, but much work remains.

CHAPTER 6

CLOSING

Jan W. Rivkin and Michael E. Porter

America's leaders have squandered the nation's long economic expansion. But the nation need not squander the future. The United States retains great strengths. Perhaps most importantly, it is blessed with a strong context for, and heritage of, innovation and entrepreneurship. Our hope is that Americans and America's leaders will begin to unleash the nation's innovative capacity and entrepreneurial energy toward two related ends: shared prosperity and political reform.

Shared prosperity lies at the heart of our definition of competitiveness, and it is lacking in today's American economy. Many of the basic policy directions required for shared prosperity are well known and, in our experience, acknowledged by leaders of both political parties when they are behind closed doors. For instance, deeper investments in infrastructure would provide public goods that lift all Americans; wider doors for high-skill immigration would spur private-sector growth and broad job creation; and regressive tax changes must be avoided if we are aiming for shared prosperity. It is galling that the country has made so little progress in the past decade in arenas like these, where consensus exists. To be sure, other policy areas pose tougher challenges. K–12 education and health care, for example, remain stubborn weaknesses that face resistance to change despite decades of effort, and they lack policy directions that attract broad agreement. Even in areas now contested, however, self-inflicted national stagnation is surely unwise.

This brings us to the need for political reform. For America to make progress in getting done what we know what must be done, and to have the capacity to experiment and learn where we don't have agreed-upon solutions, we need a federal political system run for the people, not for the parties. We need a system in which elected officials are rewarded for crafting solutions that benefit most Americans, not for scoring points that appeal to fringe partisans. Political reforms like ranked-choice voting and nonpartisan primaries are powerful steps toward such a system.

Adopting such reforms is an urgent need and requires the commitment of all hands—perhaps most importantly, the business community. If business takes a business-as-usual approach to the political system, we will see ongoing stagnation in the U.S. business environment, continued backsliding in social progress, and continuing decline in the public's confidence in capitalism. These trends, in turn, will lead to policies that undermine the economy and make things worse.

A prerequisite for change is that America's leaders, and fellow citizens, have a clear-eyed and shared view of where we are and why we are here. A striking pattern in our survey findings is that no such shared understanding exists today: we have uncovered a lack of shared reality across party lines about the trajectory of U.S. competitiveness, a poor understanding of the structural nature of our political problems, little grasp of the political reforms that are most powerful, a spotty knowledge of how one's own firm participates in politics and the consequences, meaningful gaps between business leaders and the general public in their beliefs about the impact of immigrants, and other gaps in understanding.

Our hope is that this report—with its findings on the views of business leaders and the public and with the new perspectives it introduces—can be a step toward greater and shared understanding. Our nation desperately needs such an understanding, as well as the narrowed divisions and the progress that would follow from it.

APPENDIX A

GEHL PORTER POLITICS INDUSTRY THEORY

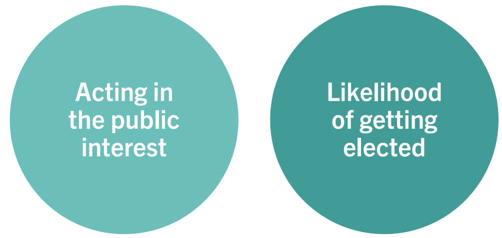
In 2017, Katherine Gehl and Michael Porter published a report analyzing the true nature of the American political system through the lens of industry competition.[61] Their report also identified root causes of the system's failure to deliver outcomes in the public interest and prescribed a strategy to restore healthy competition.

True Nature: An Industry, Not an Institution

Most people think of our American political system as a public institution derived from the Constitution. Not so. There are only six tiny paragraphs in the Constitution detailing how Congress should work and only a few sentences on how Congress is to be elected. As Gehl and Porter show, our political system has become a self-serving, self-perpetuating industry comprising gain-seeking actors who write their own rules. By applying the same tools used to understand competition and outcomes in for-profit industries, namely Porter's Five Forces framework, Gehl and Porter were able to map the politics industry's players, power structure, and its operating incentives.

At the center of the politics industry are two private rivals who can only be described as a textbook duopoly: the Democratic Party and the Republican Party. Around this duopoly has arisen a large array of actors and organizations, including special interest groups, lobbyists, big-money donors, Super PACs, think tanks, consultants, and the media that bridges Washington, D.C., to the rest of the country. Together they comprise what Gehl and Porter call the "political industrial complex."

By nearly every measure, the political industrial complex is thriving, while citizens are more dissatisfied than ever. However, Gehl and Porter are clear that the problem is not politicians or parties *per se* but rather the *nature of competition* that governs how they—as well as the other actors in the politics industry—compete. These actors compete to grow and accumulate resources for themselves—not necessarily in the public interest—and have created artificial barriers to prevent new competition from threatening their dominance. A critical outcome of this unhealthy competition is that there is virtually no intersection between an elected official acting in the public interest and the likelihood of getting re-elected.



What should be a problem-solving, outcomes-based process in elections and governing has become an industrial-strength perversion of democracy. It fosters unhealthy competition and gridlock, and it blocks the innovation and progress for which America is known. Politics has become the preeminent barrier to addressing the very problems it exists to solve.

Root Causes: Rules of the Game

The engines of unhealthy competition in the politics industry are the overlooked but all-powerful rules, structures, norms, and practices of politics (what Gehl and Porter call the "machinery" of politics) that behind the scenes determine everything—from how a candidate gets on a ballot to how a bill becomes law. Waves of engineering of this machinery over the past five decades—orchestrated jointly by the parties—have optimized the industry to protect and perpetuate its interests, not produce results. The ability of new competition to rein in this optimization has been systematically neutralized, creating a state of play that rewards dysfunction, inaction, and failure to address our most pressing social and economic challenges.

Interestingly, the greatest barriers to entry in politics are created by rules and structures that *seem* perfectly normal. These are party primaries and plurality voting (elections machinery) and the partisan-controlled legislative process in Congress (legislative machinery).

Today's elections machinery, the most pressing concern for Gehl and Porter, virtually ensures those who seek compromise are punished and Independents and new third parties are locked out. The duopoly did not originally create partisan primaries and plurality voting, but they have optimized around them to pervert democracy.

Party primaries are a fundamental reason why Congress doesn't solve problems in the public interest. Most elections are decided in the primary (especially in gerrymandered districts), and the relatively small proportion of voters who turn out for party primaries tend to be more ideological and partisan than the electorate. Therefore, to make it through the primary, candidates often must go further to the right or left than voters as a whole really want. The influence of party primaries extends beyond the election to affect the legislative process—actual governing. The threat of being challenged by a party-backed primary opponent makes it difficult for legislators on both sides to support bipartisan legislation (which requires compromise). Instead, party primaries force our elected officials toward extreme positions and exacerbates gridlock.

Under plurality voting (which is the method in almost all U.S. elections), any election with more than two candidates can be won without a true majority. For example, a candidate can win with 34% in a three-way race, meaning that 66% of the voters preferred someone else. Plurality voting creates what is known as the "spoiler effect." For example, in a three-way general election race for a U.S. Senate seat (a Republican, a Democrat, and a moderate Independent), voters who prefer the new challenger—the Independent—will not vote for that candidate out of fear they are "wasting their vote" or "spoiling" the election by accidentally helping to elect the candidate they like the least. As a result, plurality voting is the single greatest barrier to entry for new competition in politics. Most potential competitors to the duopoly simply do not run.

Nonpartisan Solutions: Political Innovation

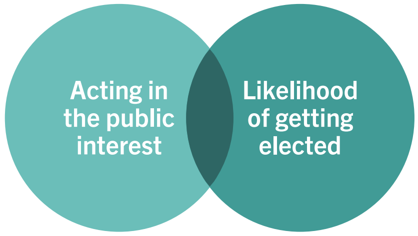
To inject healthy competition into the politics industry—starting first with elections—Gehl and Porter prescribe a nonpartisan and interdependent set of political innovations: the Final Five Voting System, and the Legislative Innovation Commission.

The Final Five Voting System is comprised of two constituent parts involving primaries and the general election: (1) Top Five open, single-ballot, nonpartisan primaries (Top Five), and (2) ranked-choice voting (RCV) in general elections. Addressed in tandem, these will eliminate the negative impacts of both partisan primaries and plurality voting.

Top Five puts every candidate from any party, as well as Independents, on a single ballot. All voters are eligible to vote in the primary (unlike party primaries, which are often limited to party members and often exclude Independents and third-party supporters). The five top finishers then advance to the general election, again regardless of their party affiliation. This sets up a far more competitive field of five candidates for the general election.

The second change, RCV, replaces plurality voting with a ranked-ballot system in the general election that ensures the winner passes the 50% threshold and will always have support from the broadest possible portion of the electorate. RCV eliminates the powerful "spoiler effect" barrier to entry that plurality voting erect, and rewards candidates who actually reflect the will of most voters.

The Final Five Voting System will go a long way toward creating healthy competition in the politics industry. It will fundamentally alter what politicians are incented to do and voters' ability to hold them accountable for results. Under current rules, there is virtually no intersection between acting in the public interest and the likelihood of getting re-elected, which is dominated by partisanship. Final Five Voting solves this fundamental design problem by creating the incentives for actors in the politics industry to solve problems in a way that addresses the public interest.



Final Five Voting also opens the door for additional innovations. Gehl and Porter's second stage of political innovation involves reengineering the partisan legislative machinery in Congress that has been carefully constructed over time for the benefit of the political industrial complex. Today's partisan control of legislating produces ideological, unbalanced, and unsustainable legislation often passed along strict party lines—which is only exacerbated by the effects of partisan primaries and plurality voting. Fixing Congress's dysfunctional legislative machinery will require an independent and nonpartisan effort to design a modern, model legislative structure designed to produce real results by adopting state-of-the-art negotiation, communication, and problem-solving practices.

APPENDIX B

PROGRESS ON THE EIGHT-POINT PLAN, JANUARY 2017–DECEMBER 2019

	Policy Direction	Progress Score*	Policy Actions
Point 1	Ease the immigration of highly skilled individuals, starting with international graduates of American universities.	-2	– H-1B applications and renewals are seeing increased scrutiny, delays, and denials. – Immigration legislation has failed to advance at all. – The Trump administration has called for drastic cuts to legal immigration. – Both parties have made sensible reform of high-skilled immigration a hostage in intractable battles over comprehensive immigration reform.
Point 2	Simplify the corporate tax code in a revenue-neutral manner, with lower statutory rates and no loopholes.	0	+ The 2017 tax reform created a much-needed territorial system of taxation. + It also lowered statutory rates. – But the reform was far from revenue neutral. Instead, it reduced taxes more than necessary to achieve the intended purpose. As a result, it increased federal deficits dramatically. – The reform also failed to close loopholes. – The reductions in tax rates were across-the-board and, on balance, regressive.
Point 3	Create an international taxation system for American multinationals that taxes overseas profits only where they are earned, consistent with practices in all other leading countries.		
Point 4	Aggressively use bilateral agreements and established international institutions to address distortions and abuses in the international trading and investment system.	-1	+ The Trump administration has recognized, and acted on, the fact that the U.S. is disadvantaged by certain current trade deals and rules. + The U.S. has struck a new trade deal with South Korea and may soon gain Congressional approval of a renegotiated NAFTA. – Yet the administration has attacked valuable multilateral agreements like the TPP and international institutions like the WTO, rather than working to improve or acting through them. – The introduction of tariffs has led to sustained trade wars and economic disruption, with no clear logic in terms of trade distortions and with net negative effects so far on U.S. manufacturing.
Point 5	Simplify and streamline regulation affecting business to focus on outcomes rather than costly reporting and compliance requirements, delays, and frequent litigation.	-1	+ The Trump administration has recognized that some regulations increase the costs of doing business without protecting the public interest. – But the focus has been on wholesale regulatory rollback rather than selective reform based on expert assessment and a focus on improving important outcomes. – Useful environmental rules, addressing harmful externalities and encouraging lower-cost renewable energy, have been targeted for rollback. – Both parties continue to use regulation for political aims, increasing special interest lobbying and inducing frequent litigation.
Point 6	Enact a multiyear program to improve logistical, communications, and energy infrastructure, prioritizing those projects most important for reducing the costs of doing business and promoting innovation.	-1	+ President Trump and Democratic leaders have met repeatedly to talk about infrastructure plans. – Yet each so-called bipartisan plan has broken down amid preconditions and disagreements over funding mechanisms. – As a result, Congress and the President have made no progress on a federal infrastructure bill, despite broad political and public support. – Meanwhile, America's infrastructure continues to deteriorate relative to other advanced nations, inflicting rising costs on users.
Point 7	Agree on a balanced regulatory and reporting framework to guide the responsible and environmentally sensitive development of American shale-gas and oil reserves.	-1	– Deregulation by the Trump administration has weakened standards for responsible energy development. – Important rules that limited emissions of methane, an especially potent greenhouse gas, have been relaxed. – The Clean Power Plan, which would have required states to reduce carbon emissions and likely shutter coal plants, was rescinded and replaced with optional guidelines that protect coal, and forego a cost-effective method of promoting clean energy. – No bipartisan agreement concerning responsible development of America's shale-gas and oil reserves has emerged. Gridlock continues.
Point 8	Create a sustainable federal budget through a combination of greater revenue (including reducing deductions) and less spending (through efficiencies in entitlement programs and revised spending priorities), embodying a compromise such as Simpson-Bowles or Rivlin-Domenici.	-2	– Government spending increases have continued unabated regardless of which party had a majority in the House of Representatives. – The 2017 tax reform substantially reduced revenues. – As a result, the growing U.S. federal deficit is projected to reach $1 trillion in 2020.

*A progress score of -2 indicates significant deterioration; 0 indicates neither deterioration nor improvement; and +2 indicates significant improvement.

APPENDIX C

ALUMNI PROPOSALS FOR POLITICAL REFORM

We asked alumni, "What other reforms, if any, would you support to make the U.S. political system more effective?" We received responses from 599 alumni, totaling 778 proposals. The table below includes the 40 most commonly proposed reforms.

Area	Proposal
Election Process Reforms	Reform or eliminate the Electoral College
	Increase voter access
	Restrict voter access (e.g., require IDs)
	Reform the primary system
	Shorten political campaigns
	Require federal candidates to release their tax returns or provide full financial disclosure
	Reform districting process to eliminate gerrymandering
	Mandatory voting
	Required testing or stricter criteria for candidates (e.g. intelligence, ethics, etc.)
	Improve election integrity (e.g., paper ballots) or defend against foreign election interference
	Incentivize or elect higher quality candidates
Campaign Finance Reforms	Reverse Citizens United
	Eliminate PACs or forbid corporate donations to PACs
	Limit campaign contributions and spending
	Make all political donations public
	Public funding of elections
	Other campaign finance reforms
Government and Constitutional Reforms	Congressional term limits
	Reduce government spending or enforce a balanced budget
	Cut pay or benefits for elected officials
	Reform the Supreme Court and federal court system, or how judges and justices are chosen
	Single longer terms for the President and/or Congress (e.g., a single 6-year term)
	Reform Senate representation to reflect state population
	Reform lobbying laws and/or reduce power of lobbies
	Term limits for Supreme Court justices or all federal judges
	Reform filibuster rules
	Reduce the power of the executive branch
	Congress must abide by the laws like everyone else
	Better checks and balances against corruption and nepotism
	Repeal the 17th amendment
	Reform budget process
Party System Reforms	Reform the two-party system or encourage the formation of new political parties
	Foster more compromise and bipartisanship between the parties or reduce polarization
	Reduce power of political parties in Congress or elections
Other	Reform the educational system or require more education in civics
	Reform media practices
	Tax reform
	System is fine
	Immigration reform
	Impeach Trump or permit charging a sitting President with a crime

APPENDIX D

METHODOLOGY AND RESPONDENT PROFILE

In 2019, 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. We are very grateful to all respondents.

The survey was designed by HBS faculty members and researchers of the U.S. Competitiveness Project. Abt SRBI, a leading survey research firm, programmed and administered the HBS alumni and the HBS MBA student surveys, while Dynata programmed and administered 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 2019, all eligible HBS alumni worldwide with email addresses known to HBS were invited to participate in the survey. These included 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. The invitation email was sent to 61,255 alumni. The survey was wholly administered on the web.

A total of 5,713 alumni responded, yielding a response rate of 9.3%.* For our prior survey on U.S. competitiveness, conducted in 2016, the response rate was 7.8%.** The median survey length for non-U.S. respondents was 15 minutes. For U.S. respondents, who were asked more questions, the median length was 19 minutes. HBS alumni were invited to participate in the survey from March 15, 2019 to April 24, 2019.

HBS student survey: HBS invited all 1,871 students registered in the MBA program to participate in the survey. The list of MBA students was provided by the registrar's office.

A total of 199 MBA students responded, indicating a response rate of 10.6%. In 2016, the response rate was 19.3%. The median survey length was 18 minutes. The HBS student survey was open from April 4, 2019 to April 30, 2019.

General public survey: HBS's general public survey on U.S. competitiveness was administered by Dynata to U.S. residents age 18 and older. The sample was built from Dynata's online sample stream. Participants were recruited via a variety of contact methods, including emails and online banners, to ensure that the sample was representative of the U.S. population.

A target of a minimum of 1,000 responses was set for the general population, and the final tally of responses came from 1,006 members of the general public. The general public survey launched on April 19, 2019 and closed on April 22, 2019.

Instrument: Since the first HBS survey on U.S. competitiveness was conducted in 2011, the instrument has included a stable battery of questions asking respondents to assess different elements of the U.S. business environment as well as the trajectory of the U.S. economy. Asking the same or similar questions in each version of the survey allows HBS faculty to collect longitudinal data.

In 2019, recognizing that three years had passed since the prior survey was administered, HBS faculty reviewed and refined the elements of the U.S. business environment. This resulted in two revisions in the 2019 instrument. First, two separate elements in previous surveys—"complexity of the national tax code" and "corporate tax code"—were combined into a single element: "corporate tax code." Second, "protection of physical and intellectual property rights and lack of corruption" was split into two different elements in the 2019 survey: "protection of intellectual property rights" and "lack of corruption." The first section of the 2019 survey was administered to HBS alumni worldwide, HBS students, and members of the U.S. general public.

In addition to the longitudinal questions, every U.S. Competitiveness survey contains sections designed by individual faculty members related to their current areas of research. In 2019, the U.S. competitiveness survey included the following sections: assessment of the U.S. political system; the business community's current engagement in politics; the Tax Cuts and Jobs Act (TCJA); and general immigration. Many of the questions in the 2019 survey on the U.S. political system as well as on corporate taxes were adapted from questions posed in

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

**When excluding alumni who did not receive the survey invitation due to suppression by email distribution software, the response rate was 8.9%. This was not an issue for the 2019 survey.

the 2016 survey. Answering the questions in these four sections required deep familiarity with the U.S. economy, so the sections were offered only to HBS alumni located in the United States (both citizens and non-citizens) and to HBS students. A subset of these questions were asked of the general public in the U.S. To reduce the time required of any single respondent and thereby make it more likely that he or she would complete the survey, the instrument was programmed so that 60% of the respondents received the U.S. political system and TCJA questions while 40% received the general immigration questions.

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 (2019 or later) of the student. (The demographic information available for students was very limited due to FERPA restrictions.) In the general public survey, the data were strategically sampled to be representative of the U.S. and were, therefore, not weighted.

Precision of estimates: The alumni and MBA student surveys were censuses in that all eligible persons were selected to participate. Therefore, sampling error does not apply because no sample was drawn. Other sources of error, such as nonresponse error, may contribute additional non-sampling error. For the general public survey, sampling error does apply. With a sample size of 1,000, the 95% confidence interval for proportion of 50% was estimated to be ± 3 percentage points. 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	637
New York	469
Massachusetts	468
Florida	274
Texas	254
Connecticut	134
New Jersey	131
Illinois	127
Virginia	118
Washington	99
40 other states, plus D.C., territories, and U.S. armed forces overseas	1,137
Subtotal	**3,848**

Outside the United States	
United Kingdom	155
Canada	141
Japan	135
Switzerland	102
Germany	83
Australia	80
Mexico	73
Brazil	66
India	62
Hong Kong	61
102 other countries and territories	900
Subtotal	**1,858**

Unknown Location	**7**
Total	**5,713**

ALUMNI AGE

	Number	Percentage
Under 30	70	1.2%
30–39	587	10.3%
40–49	852	14.9%
50–59	1,116	19.5%
60–69	1,259	22.0%
70 and older	1,389	24.3%
Unknown	440	7.7%
Total	**5,713**	**100%***

*Percentages do not add up to 100% due to rounding.

ALUMNI SECTOR OF EMPLOYMENT*

	Number	Percentage
Finance and Insurance	1,312	23.0%
Manufacturing	1,115	19.5%
Metal and Machinery	*220*	*3.9%*
Computer, Electrical, and Appliance	*215*	*3.8%*
Petroleum, Chemicals, and Plastics	*152*	*2.7%*
Food and Beverage	*146*	*2.6%*
Wood, Paper, and Printing	*42*	*0.7%*
Textile and Apparel	*39*	*0.7%*
Other Manufacturing	*301*	*5.3%*
Professional, Scientific, and Technical	910	15.9%
Health Care and Retail Trade	540	9.5%
Information: Media, Telecom, and Data Processing	345	6.0%
Construction and Real Estate	308	5.4%
Educational Services	280	4.9%
Public Administration and Non-profit	210	3.7%
Other Services	208	3.6%
Transportation and Logistics	128	2.2%
Mining and Oil & Gas Extraction	107	1.9%
Utilities	73	1.3%
Agriculture, Forestry, and Fishing	70	1.2%
Accommodation and Food Services	43	0.8%
Arts, Entertainment, and Recreation	43	0.8%
Subtotal	**5,692**	**99.6%**
Gave no response	21	0.4%
Total	**5,713**	**100%**

*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	40
California	26
Massachusetts	16
Texas	9
Illinois	9
Georgia	7
District of Columbia	5
Virginia	5
New Jersey	4
Washington	4
40 other states, plus D.C., territories, and U.S. armed forces overseas	26
Subtotal	**151**

Outside the United States	
United Kingdom	6
India	4
Canada	3
Israel	3
22 other countries and territories	32
Subtotal	**48**
Total	**199**

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

STUDENT CLASS

	Number	Percentage
2019	103	51.8%
2020 and later	96	48.2%
Total	**199**	**100.0%**

General Public Respondents

GENERAL PUBLIC LOCATION

In the United States	
California	125
Florida	89
New York	83
Texas	65
Pennsylvania	56
Illinois	49
Ohio	44
North Carolina	32
Georgia	32
Michigan	28
40 other states, plus D.C., territories, and U.S. armed forces overseas	403
Total	**1,006**

GENERAL PUBLIC AGE

	Number	Percentage
Under 30	215	21.4%
30–39	198	19.7%
40–49	163	16.2%
50–59	170	16.9%
60–69	160	15.9%
70 and older	100	9.9%
Total	**1,006**	**100%**

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Top-five RCV is preferred because fewer than five candidates fails to maximize the benefits of increased competition, while more than five risks what political scientists term "ballot exhaustion," or the inability for voters to meaningfully distinguish between and develop opinions on a laundry list of candidates. In addition to exhaustion, more than five candidates may distract from focused policy conversations with a limited set of candidates drawing important distinctions between positions for voters to evaluate. In other words, it may "dilute" the important public conversations that elections are supposed to induce.

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[59] Riia O'Donnell, "Is Canada the Next Talent Hub?," August 15, 2019, https://www.hrdive.com/news/is-canada-the-next-talent-hub/559736/.

[60] The survey's design could have some influence for how respondents answered this question. By asking respondents to allocate immigration spots into three distinct groups (e.g., employment-based, family-based, and other), respondents may have allocated a greater percentage to employment-based immigration than they would have if presented with four or more buckets (e.g., breaking out diversity vs. refugee uses). As previous research has also found broad support for employment-based immigration policies, the effects of the question design are likely minimal.

[61] Gehl, Katherine M. and Michael E. Porter, "Why Competition in the Politics Industry is Failing America," Harvard Business School, September 2017. Their book, *The Politics Industry: How Political Innovation Can Break Partisan Gridlock and Save Our Democracy*, will be published in 2020.

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